customers, and that BBRR would also provide additional service as needed by its customers.

Under the lease, CSXT would retain limited overhead trackage rights to return westbound empty hopper cars, including empty coal unit-trains, to their origins. CSXT would also retain local trackage rights to move unit-trains of rock from Martin Marietta's quarry at Verdon (about 29.5 miles west of the eastern end of the C&O Line) to points on CSXT's lines in the vicinity of Newport News, VA, and to move empty unit-trains in the reverse direction. Applicants also state that BBRR will permit CSXT to detour loaded eastbound coal trains over the C&O Line in case of an emergency or maintenance on CSXT's James River Line.

BBRR projects that it would handle about 11,700 carloads annually, consisting of 6,200 carloads of local traffic, 1,000 carloads for interchange with NSR and the Eastern Shore Railroad, Inc., and 4,500 CSXT non-revenue carloads (the latter are apparently carloads of rock intended to be used by CSXT on its own lines). CSXT projects that it would annually move about 156,000 westbound empty cars (using its overhead trackage rights) and about 7,900 revenue carloads of rock from the Martin Marietta quarry (using its local trackage rights).

Financial Arrangements. CSXT does not plan any new financial arrangements in connection with the transaction. BBRR does not plan to issue any new securities in connection with the transaction, but it does expect to obtain some unsecured short-term financing to meet operating-capital needs in the early stages.

Passenger Service Impacts. An Amtrak train (the Cardinal) operates over part of the C&O Line (between Clifton Forge and Gordonsville) and all of the Orange Line. Amtrak operates two Cardinal trains per day on Sunday, Wednesday, and Friday of each week, one eastbound and one westbound. Both trains stop at Charlottesville, Staunton, and Clifton Forge. To minimize Amtrak delays, BBRR plans to schedule its operations around the scheduled times for Amtrak's trains.

BBRR also plans to seek approval from FRA (and Amtrak, if necessary) to discontinue use of the Train Control System (TCS, a signal system that facilitates maintaining a safe separation between trains) currently in place between Clifton Forge and Orange. Applicants state that CSXT would maintain the TCS and manage train dispatching for the C&O and Orange Lines for up to 2 years while BBRR seeks FRA's approval. Upon approval of removal of the TCS, or 2 years after consummation of the transaction, whichever occurs first, BBRR intends to dispatch the lines.

Truck Competition. The C&O Line is paralleled by Interstate Highway 64 and is crossed by Interstate Highway 81, both of which provide major highway access for truck transportation from/to customers on the line. According to BBRR, trucking provides significant competition to the Lines' railroad traffic, especially intermodal traffic. BBRR plans to compete vigorously with trucks for traffic moving from/to points on the C&O Line and the Orange Line by providing more frequent rail service and local sales, marketing, and operating personnel.

Applicants contend that under their proposal BBRR would provide more frequent and responsive service to the local customers without changing routes and rates. According to applicants, the additional traffic that BBRR expects to generate would improve BBRR's financial viability, and the rationalization of the CSXT system would improve CSXT's financial viability, by enabling CSXT to reduce its operating expenses and to save on some capital expenditures. Applicants further claim that the improved rail service on the C&O and Orange Lines would have no adverse competitive impacts, but rather would increase intermodal and intramodal competition.

Labor Impacts. CSXT projects that 35 CSXT employees would be affected by the proposed transaction: 7 trainmen, 4 engineers, 14 MOW employees, and 7 signal and communications employees would be displaced, and an additional 3 signal and communications employees would be relocated. CSXT explains that the trainmen, engineers, and MOW employees would be displaced because local work now performed by CSXT employees would be performed by BBRR employees. As respects the signal and communications employees, CSXT has agreed to continue to maintain the signal system and to provide dispatching, and to defer displacing employees, for up to 2 years after consummation of the transaction. CSXT does not expect any dispatchers to be impacted by the proposed transaction.

No existing employees of BBRR would be adversely affected by the proposed transaction. BBRR expects to hire, on consummation, 5 trainmen, 5 engineers, 12 MOW employees, 2 mechanical employees, and 1 clerical employee. BBRR intends to cross-train many of these employees to perform other functions. If removal of the signal system has not been approved within 2 years, BBRR expects to hire approximately 6 signal and communications employees to operate the signal system. BBRR plans to consider for employment qualified local CSXT employees whose positions would be abolished as a result of the transaction and who make proper application for employment.

To provide the level of labor protection mandated by 49 U.S.C. 11326, CSXT and BBRR suggest that we should impose the "*Mendocino Coast*" labor protective conditions set forth in *Mendocino Coast Ry., Inc.—Lease and Operate*, 354 I.C.C. 732 (1978), as modified in *Mendocino Coast Ry., Inc.—Lease and Operate*, 360 I.C.C. 653(1980), *aff'd sub nom. RLEA v. United States*, 675 F.2d 1248 (D.C. Cir. 1982), as clarified in *Wilmington Term. R.R., Inc. — Pur. & Lease — CSX Transp., Inc.*, 6 I.C.C.2d 799, 814-826 (1990), *aff'd sub nom. RLEA v. ICC*, 930 F.2d 511 (6th Cir. 1991). They cite *Portland & Western Railroad, Inc.—Lease and Operation Exemption—Burlington Northern Railroad Company*, Finance Docket No. 32766 (ICC served January 5, 1996), a similar type of transaction that involved both the lease by a Class III railroad of lines of a Class I railroad and also the retention by the Class I railroad of the right to conduct certain operations over the leased lines.

BBRR MOTION TO STRIKE

On September 23, 2004, BBRR filed a motion to strike "all statements and references concerning the condition of its current rail line and of its equipment predicated upon unauthorized intrusions on its property by Mr. Roy Griffith, as included in comments filed on behalf of BMWE." BBRR-9 at 1. BBRR states that Mr. Griffith entered upon BBRR property without the knowledge or consent of BBRR, and that, when he was discovered, he was promptly escorted off the property by proper authority.

Without condoning any trespass on private rail property, we deny the motion to strike and will give Mr. Griffith's observations the weight they are due.

DISCUSSION AND CONCLUSIONS

Statutory Criteria

Under 49 U.S.C. 11323(a)(2), "[a] purchase, lease, or contract to operate property of another rail carrier by any number of rail carriers" requires prior Board approval. The criteria for approval are set forth in 49 U.S.C. 11324. Because the proposed transaction does not involve the merger or control of two or more Class I railroads, this transaction is governed by 49 U.S.C. 11324(d), under which the Board must approve the application unless the Board finds that (1) as a result of the transaction, there is likely to be substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States, and (2) the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs.

Here, there is no claim that competition would be reduced or a monopoly created. BBRR would simply replace CSXT as the carrier for all traffic originating or terminating on these Lines other than the Martin Marietta traffic mentioned above.

At oral argument, an issue was raised as to whether a provision of the lease, which establishes a higher rental payment to CSXT under limited circumstances which involve BBRR interchanges of traffic with a railroad other than CSXT, would constitute a restraint of trade by economically foreclosing shippers the option of interchanging with carriers other than CSXT. However, BBRR clearly does not expect that to be the case, as it intends to interchange 1,000 cars annually with NSR and the Eastern Shore Railroad.[3] At oral argument, BBRR's president, Robert E. Bryant, stated that he negotiated at length concerning the additional rent provision and he is satisfied that the agreed amount will not preclude BBRR from interchanging

[3] Application at 15.

with other railroads. Our assessment of the relevant provision of the lease is consistent with Mr. Bryant's view that BBRR will be able to offer shippers similar interchange options to those available under CSXT's operation of the Lines. Accordingly, we find no restraint of trade or other anticompetitive effects likely to result from the proposed transaction.

BMWE contends that, in addition to meeting the standards of section 11324(d), a proposed lease transaction must also comport with the rail transportation policy (RTP) set forth at 49 U.S.C. 10101. According to BMWE, we may not approve a proposed transaction that is contrary to the RTP even if the transaction would not have any anticompetitive effects and would otherwise be approved under section 11324(d). CSXT agreed that the RTP should "inform" our decision under section 11324(d), but argued that the proposed transaction comports with the RTP.

We need not determine here whether the Board could find that a proposal satisfies the narrow standard set out in section 11324(d) but nevertheless disapprove the proposal based on RTP concerns. As discussed below, BMWE has failed to demonstrate that approval of the transaction proposed here would be contrary to the RTP.

Propriety of the Proposed Transaction

BMWE argues that the way that the applicants have chosen to structure this transaction is improper and deceptive. It claims that the proposal before us is not a true lease, but is more properly characterized as a trackage rights arrangement for BBRR to serve most (but not all) of the local shippers. However, even if that were so, both the need for Board approval and the applicable standard for approval would be the same as for a lease. *See* 49 U.S.C. 11323(a)(6), 11324(d).

BMWE suggests that it is improper for CSXT, which would continue to handle most of the cars that would move over the C&O Line pursuant to the retained overhead trackage rights, to transfer the responsibility for maintenance of the C&O Line to BBRR. There is, however, no requirement that the railroad that handles the majority of traffic on a line be the party that bears responsibility for maintenance of the line.

We are not dealing here with a situation in which the railroad that seeks to be relieved of the maintenance responsibility has an incentive to allow maintenance to deteriorate to such a degree that, sooner or later, operations would have to be suspended. As BMWE acknowledges, CSXT plans to retain the C&O Line for directional running in connection with the James River Line and as a substitute for the James River Line at those times when that line cannot be used. CSXT therefore has an incentive to see that maintenance of the C&O Line does not deteriorate.

BMWE also charges that the lease is not really a 20-year lease, but in effect only a 10-year lease because the lease allows negotiation of new terms or termination at will by either party after 10 years. It is not unusual or unlawful for the parties to revisit remuneration after a decade of operations under a lease, and to allow termination of the lease if either party is dissatisfied. But we have no reason to doubt the sincerity of the applicants' intent to enter into a long-term arrangement.

In short, BMWE has not persuaded us that the applicants are misusing the Board's processes here to achieve a result other than that for which they seek approval. Thus, the Board decisions that BMWE cites that were designed to protect the integrity of the Board's processes — from applicants who claimed to be independent actors when they were not,[4] or who purportedly sought to buy a line for continued rail purposes when their real intent was to discontinue service and scrap the materials in the lines[5] — are not implicated here.

BMWE's RTP Arguments

Pointing to the RTP goal of promoting a safe transportation system, 49 U.S.C. 10101(3), (8), BMWE claims that BBRR lacks the personnel, experience, and financial resources to provide adequate maintenance on the C&O and Orange Lines, portions of which BMWE claims have current maintenance problems. Applicants deny that there are significant maintenance problems on these Lines and claim that ample funds have been earmarked by BBRR for maintenance of the Lines. They point out that BBRR will generate the funds for the Lines' maintenance via CSXT's payments for its overhead operations on the C&O Line. These payments are expected to be in excess of $2 million per year for the first 10 years, for a net of $1.86 million (or more) after BBRR pays $140,000 in annual rent to CSXT. They also point out that BBRR's management has extensive prior experience in Class I railroad operations.

Applicants state that BBRR has planned a comprehensive maintenance program for the two lines that would divide the Lines into three subdivisions, assign personnel to each subdivision, and develop an inspection schedule, a routine maintenance program, and an ambitious tie replacement program. In addition to dedicating employees to full-time MOW work, BBRR intends to provide cross-training so that employees who do other work can be assigned to MOW duties as needed. BBRR also has established a good working relationship with capable contractors and plans to call upon them for manpower and equipment to supplement its own employees and resources as needed to handle unexpected maintenance issues. BBRR has allocated between $1.8 and $2 million per year for maintenance and replacement of equipment. At oral argument, BBRR reiterated its commitment to keeping the track in good condition so as to be able to compete effectively for local traffic that has the option of moving by truck.

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[4] *See, e.g., County of Marin v. United States*, 356 U.S. 412, 418-19 (1958); *Gilbertville Trucking Co. v. United States*, 371 U.S. 115, 125 (1962); *Burlington Northern R. Co. v. United Transp. Union*, 862 F.2d 1266 (7th Cir. 1988).

[5] *See, e.g., Redmond-Issaquah R.R. Preserv. v. STB*, 223 F.3d 1057 (9th Cir. 2000); *SP&L Ry.–Acquire & Operate–Toledo, Peoria & Western Ry.*, 6 S.T.B. 426-27 (1992); *SF&L Railway, Inc.–Acquisition and Operation Exemption–Toledo, Peoria, and Western Railway Corporation Between La Harpe and Peoria, IL*, STB Finance Docket No. 33995, slip op. at 3 (STB served January 31, 2003).

Under the circumstances, BMWE has not convinced us either that the revenues to be generated by the overhead trackage rights would be insufficient to fund necessary maintenance or that the maintenance program itself would otherwise be inadequate. Rather, BBRR has convincingly demonstrated that it has seriously examined the Lines' maintenance needs and is prepared to fulfill its safety responsibilities.

Other Safety Issues

(1) *Track Conditions for Passenger Operations*. Amtrak and the Commonwealth have also expressed concern that the Clifton Forge-to-Orange track conditions, which allegedly have deteriorated in recent years, would deteriorate further if maintenance responsibility is shifted. Amtrak seeks a condition obligating BBRR to maintain track conditions to at least the existing track-class standards and directing CSXT to ensure that the lines leased to BBRR are maintained to the levels required for continued passenger and freight operations. The Commonwealth of Virginia seeks similar conditions ensuring that the safety and efficiency of operations of Amtrak's Cardinal are protected and that all "deficiencies" on the C&O and Orange Lines are corrected prior to approving the consummation of the proposed transaction.

We are confident that FRA will continue to require adequate maintenance of the entire 200 miles of track. BBRR plans to devote 12 MOW employees to the C&O and Orange Lines. BBRR is committed to maintaining the track so that it can be operated safely for both passenger and freight trains. Because BBRR's intention to divert traffic now moving by truck, which is the cornerstone of its business plan, will succeed only if the track is maintained sufficiently, BBRR has ample incentive to keep the track well maintained so that its freight operations are not impeded by difficulties encountered by passenger trains.

Thus, we are satisfied that both Amtrak's and the Commonwealth's interests will be amply protected without the conditions they seek.

(2) *Removal of the TCS Signal System*. BRS points to BBRR's plan to remove the TCS, used to facilitate the safe movement of trains, from the C&O and Orange Lines as a reason to disapprove the application.[6] Amtrak expresses similar concerns, but does not take a position on whether to grant the application.

As noted above, the removal of the TCS is subject to the approval of FRA (and possibly also Amtrak), and we defer to FRA on that matter. FRA, which is responsible for maintaining the safety of both passenger and freight railroad

[6] On September 30, 2004 (one week after the record in this proceeding had closed, and 5 weeks after the due date for the submission of comments), BRS submitted its comments for consideration by the Board. The BRS submission does not appear to have been served on applicants. Despite the unexplained lateness of the filing and the apparent failure to serve applicants, we will treat the BRS submission as correspondence and address the safety matters raised, and we will deny applicants' BBRR-11 motion (filed October 29, 2004) to strike the BRS pleading.

operations, will ensure the safety of the traveling public when considering any request to remove the signal system.

(3) *Grade-Crossing Signals.* BRS also expresses concern that BBRR would not have sufficient resources to maintain the 56 grade-crossing signals along the C&O and Orange Lines that facilitate the safe movement of vehicular and pedestrian traffic at rail/highway grade crossings. However, BRS has offered no evidence that BBRR would not likely comply with applicable safety regulations respecting the maintenance, inspection, testing, and repair of the grade-crossing signal systems. BBRR has expressed its commitment to proper maintenance of the C&O and Orange Lines, and that commitment necessarily includes proper maintenance of the various grade-crossing signal systems. Indeed, the BBRR/CSXT lease provides that BBRR "shall comply with all applicable Federal, State and local laws, ordinances and regulations" in its use and operation of the C&O and Orange Lines.[7]

Concentration of Traffic

Amtrak also expresses a broader concern that the efforts of Class I railroads to rationalize their systems by reducing the size of their networks means that more trains are now consolidated on fewer, often congested core lines. Amtrak would have us examine the impact of leases such as this on the capacity of the national rail network. We do not believe, however, that the proposed transaction before us here raises such concerns. To the contrary, the continued availability of the Clifton Forge-to-Gordonsville segment of the C&O Line for Amtrak may well turn on the proposal before us. Much of the overhead traffic that once might have moved via the C&O Line is now routed via the James River Line. It may well be that only the revival of local traffic on this segment will ensure its continued existence. The same appears to be true of the Orange Line. The apparent lack of *any* current overhead freight traffic on the Orange Line makes it likely that the Orange Line's continued existence rests upon BBRR's ability to revive the local traffic.

NSR Concerns

NSR sought clarifications from Applicants of two aspects of the proposal regarding the Orange Line: (1) whether the proposal constitutes an assumption/assignment or a sublease; and (2) whether CSXT intends to operate over the Orange Line. Applicants have responded that (1) the proposal would be a sublease of the Orange Line, and (2) BBRR would be the only freight railroad operating over the Orange Line.

NSR contends that the proposed transaction cannot be carried out until NSR consents to the exercise, by BBRR, of certain rights now exercised by CSXT pursuant to contracts with NSR. Most of these rights involve the Orange Line, although some involve NSR facilities at Charlottesville, a point

[7] BBRR-1 at 49.

on the C&O Line. We will leave it to the parties to interpret the various contracts at issue, and, if they do not agree, to resort to arbitration or the courts to resolve those contractual disputes. Our approval of this application conveys only permissive authority for BBRR and CSXT to enter into the proposed lease and sublease agreements, and does not mandate those arrangements or interpret CSXT's contractual rights and obligations as to NSR.

NSR also asks us to clarify, to the extent appropriate, the status and terms of the obligations to Amtrak by any of the parties to this proceeding. Because these obligations are also rooted in contractual arrangements, it would not be appropriate for us to attempt to do so.

Labor Protection

Under 49 U.S.C. 11326(a), we must impose labor protection conditions on our approval of this transaction. The appropriate conditions for a lease transaction are the *Mendocino Coast* conditions, and no party has claimed that some other conditions should be imposed in this case.

Environmental Issues

As noted in Decision No. 2 (STB served June 22, 2004), the Board's Section of Environmental Analysis (SEA) has concluded, based on the information presented in the application, that this proceeding is "categorically excluded" from environmental review required by the National Environmental Policy Act of 1969, *see* 49 CFR 1105.6(c)(2)(i), and that formal environmental review is not warranted in this case. SEA also agrees with applicants that the proposed action does not require historic review under the National Historic Preservation Act of 1966, because further approval would be required to abandon any service and there are no plans to dispose of or alter properties subject to our jurisdiction that are 50 years old or older. *See* 49 CFR 1105.8(b)(1). Moreover, we have not received any comments disputing SEA's conclusions or expressing environmental concerns. Accordingly, we adopt SEA's conclusions.

VICE CHAIRMAN MULVEY, dissenting:

I dissent from the Board's decision in this case. I find that the lease agreement between Buckingham Branch Railroad and CSXT includes a fundamentally anti-competitive provision—the erection of what is essentially a "paper barrier"—that would operate as a restraint of trade in rail transportation in the region.

Paper barriers are clauses in contracts for the sale or lease of rail lines to shortline carriers by which Class I carrier sellers seek to ensure that the traffic originated or terminated by shortline carriers on the segments (sold or leased) continues to flow over the lines of the seller to the maximum extent possible.

As such, these restrictions effectively tie the shortline to a single Class I carrier, thereby restricting the flow of interstate commerce and reducing the potential public benefits of the lease transaction.

In the lease agreement at issue, BBRR must pay to CSXT, in addition to its regular lease payments, additional payments on a per car basis for interchanging current CSXT traffic with other carriers. In effect, this raises the cost to BBRR of entering the market if it chooses to interline with a carrier other than CSXT. At oral argument, CSXT admitted that this surcharge is based at least in part on competitive concerns, and the BBRR witness admitted that this had been the most contentious issue in the parties' negotiations.

I concede that paper barriers result from voluntary negotiations between private parties. However, that these provisions conflict with the notion of avoiding restraints of trade is beyond doubt. I do not believe that the Board should continue to condone this practice. While I would prefer not to interfere with contracts between private individuals, I believe the Board should do so when contractual provisions run counter to public policy and the public interest as a whole. Thus, while restrictions on interchange may be in the private interests of two railroads, they nevertheless operate as a restraint of trade and run counter to the public interest.

We find:

1. The lease by BBRR of the CSXT line that runs between Clifton Forge, VA, and AM Junction, VA, and the sublease by BBRR of the NSR line that runs between Gordonsville, VA, and Orange, VA, will not substantially lessen competition, create a monopoly, or restrain trade in freight surface transportation in any region of the United States.

2. This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. The motion to strike filed September 23, 2004, by BBRR is denied. The motion to strike filed October 29, 2004, by BBRR and CSXT is denied.

2. The proposed lease by BBRR of the CSXT line that runs between Clifton Forge, VA, and AM Junction, VA, and the proposed sublease by BBRR of the NSR line that runs between Gordonsville, VA, and Orange, VA, is approved, subject to the conditions for the protection of railroad employees set out in *Mendocino Coast Ry., Inc. — Lease and Operate*, 354 I.C.C. 732 (1978), as modified in *Mendocino Coast Ry., Inc.—Lease and Operate*, 360 I.C.C. 653 (1980), as clarified in *Wilmington Term. R.R., Inc.—Pur. & Lease—CSX Transp., Inc.*, 6 I.C.C.2d 799, 814-826 (1990).

3. This decision shall be effective on December 5, 2004.

By the Board, Chairman Nober, Vice Chairman Mulvey, and Commissioner Buttrey. Vice Chairman Mulvey dissented with a separate expression.

APPENDIX : CORRESPONDENCE

Those who did not participate formally in this proceeding but have expressed their views through correspondence are listed below.

Those Expressing Support.

- Honorable Virgil Goode, Jr. (Member, U.S. House of Representatives)
- Honorable Watkins M. Abbitt, Jr. (Member, Virginia House of Delegates)
- Augusta Cooperative Farm Bureau, Inc.
- Bakery Feeds (a division of Griffin Industries)
- Bear Island Paper Company, LLC
- Brett Aggregates, Inc.
- ChipCo of Virginia, Inc.
- Klöckner Pentaplast of America, Inc.
- Koppers Inc.
- Luck Stone Corporation
- Martin Marietta Aggregates
- MeadWestvaco Corporation
- Richmond Times-Dispatch
- Ruffin & Payne Inc.
- The Burke-Parsons-Bowlby Corporation
- The County of Hanover, Virginia
- The County of Louisa, Virginia
- The Town of Gordonsville, Virginia
- U.S. Silica (Montpelier Mine & Mill)
- Virginia Vermiculite

Those Expressing Opposition.

- Brotherhood of Railroad Signalmen

STB FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN
— CONTROL —
THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN RAILWAY COMPANY, AND THE TEXAS MEXICAN RAILWAY COMPANY

Decision No. 12

Decided November 23, 2004

The Board approves the control by Kansas City Southern of The Texas Mexican Railway Company subject to various conditions for the benefit of shippers and protection of rail employees, and subject to Board monitoring of operations at the Laredo Bridge.

TABLE OF CONTENTS

ABBREVIATIONS AND ACRONYMS

ACC	American Chemistry Council
ACL	American Commercial Lines, Inc.
AK Steel	AK Steel Corporation
BCR	British Columbia Rail
BCT	Barbours Cut Container Terminal
BMWE	Brotherhood of Maintenance of Way Employes
BN	Burlington Northern Inc. and Burlington Northern Railroad
BNSF	The Burlington Northern and Santa Fe Railway Company
Board	Surface Transportation Board
CCB	Canadian Competition Bureau
CN	Canadian National Railway Company
CNW	Chicago and North Western Transportation Company and Chicago and North Western Railway Company
CP	Canadian Pacific Railway Company
CSX	CSX Corporation and CSXT
CSXI	CSX Intermodal, Inc.
CSXT	CSX Transportation, Inc.
DM&E	Dakota, Minnesota & Eastern Railroad Corporation
DOJ	U.S. Department of Justice
DOT	U.S. Department of Transportation
DT&I	Detroit, Toledo & Ironton Railroad Company
DuPont	E. I. du Pont de Nemours and Company
D&H	Delaware and Hudson Railway Company
Ferromex	Ferrocarril Mexicano, S.A. de C.V.
FRA	Federal Railroad Administration
GLT	Great Lakes Transportation LLC (Duluth, Missabe and Iron Range Railway Company, Bessemer and Lake Erie Railroad Company, and The Pittsburgh & Conneaut Dock Company)
Grupo TFM	Grupo Transportación Ferroviaria Mexicana, S.A. de C.V.
Grupo TMM	Grupo TMM, S.A.
GWER	Gateway Eastern Railway Company
GWWR	Gateway Western Railway Company
IC	Illinois Central Railroad Company
ICC	Interstate Commerce Commission
IC&E .... Corporation	Iowa, Chicago & Eastern Railroad

KCS	Kansas City Southern (formerly known as Kansas City Southern Industries, Inc.)
KCSR	The Kansas City Southern Railway Company
MCS	Management Control System
Mexrail	Mexrail, Inc.
MFCC	Mexican Federal Competition Commission
MFIC	Mexican Foreign Investment Commission
NAFTA	North American Free Trade Agreement
NAVL	North American Van Lines, Inc.
NEPA	National Environmental Policy Act
NITL	The National Industrial Transportation League
NS	Norfolk Southern Corporation and Norfolk Southern Railway Co.
Pacer	Pacer International, Inc.
PHA	Port of Houston Authority
PTRA	The Port Terminal Railway Association
RCAF	Rail Cost Adjustment Factor
RCAF-U	Rail Cost Adjustment Factor unadjusted for productivity
RRIF	Railroad Rehabilitation and Improvement Financing
SF	Santa Fe Pacific Corporation and The Atchison, Topeka and Santa Fe Railway Company
SIP	Safety Integration Plan
Soo	Soo Line Railroad Company
SP	Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and The Denver and Rio Grande Western Railroad Company
STB	Surface Transportation Board
TCU	Transportation•Communications International Union
Tex Mex	The Texas Mexican Railway Company
TFM	TFM, S.A. de C.V. (formerly known as Transportación Ferroviaria Mexicana, S.A. de C.V., *see CN/IC*, 4 S.T.B. 122 at 135 n.52) (1999)
TM	The Texas Mexican Railway Company
TMM Multimodal	TMM Multimodal, S.A. de C.V.
UP	Union Pacific Railroad Company
USDA	U.S. Department of Agriculture

Watco	Watco Companies, Inc.
WC	Wisconsin Central Transportation Corporation, Wisconsin Central Ltd., Fox Valley & Western Ltd., Sault Ste. Marie Bridge Company, and Wisconsin Chicago Link Ltd.

BY THE BOARD:

INTRODUCTION

The Application. By application filed May 14, 2003, Kansas City Southern (KCS), The Kansas City Southern Railway Company (KCSR), Gateway Eastern Railway Company (GWER), Mexrail, Inc. (Mexrail), and The Texas Mexican Railway Company (Tex Mex or TM) seek approval under 49 U.S.C. 11323-25 for KCS, which already controls KCSR and GWER, to acquire control of Tex Mex (the "KCS/TM Transaction"). In the earlier-issued *Decision No. 2* (STB served June 9, 2003), the Board found that the KCS/TM transaction is a "minor" transaction governed by 49 U.S.C. 11325(a)(3) and 49 CFR 1180.2(c).

The procedural schedule governing this proceeding was set in *Decision No. 2*, suspended in *Decision No. 10* (STB served October 8, 2003), and resumed in *Decision No. 11* (STB served August 31, 2004). Also, the Board conducted a public hearing on July 31, 2003.

Submissions. In 2003, the following railroads submitted comments respecting the KCS/TM application, which are summarized in Appendix A:

- •Union Pacific Railroad Company (UP);
- •The Burlington Northern and Santa Fe Railway Company (BNSF);
- •CSX Corporation and CSX Transportation, Inc. (referred to collectively as CSX) filed jointly;
- •Norfolk Southern Corporation and Norfolk Southern Railway Company (referred to collectively as NS) filed jointly;
- •Canadian Pacific Railway Company (CP, which filed on behalf of itself and its Soo Line Railroad Company (Soo) and Delaware and Hudson Railway Company (D&H) subsidiaries);
- •Canadian National Railway Company (CN); and
- •Dakota, Minnesota & Eastern Railroad Corporation (DM&E, which filed on behalf of itself and its subsidiaries, Cedar American Rail Holdings, and Iowa, Chicago & Eastern Railroad Corporation (IC&E)).

The following other parties submitted comments, which are summarized in Appendix B (together with railroad comments regarding the settlement agreement entered into by The National Industrial Transportation League (NITL) and KCS):

•NITL;
•American Chemistry Council (ACC);
•Port of Houston Authority (PHA);
•Pacer International, Inc. (Pacer);
•E.I. du Pont de Nemours and Company (DuPont);
•AK Steel Corporation (AK Steel);
•Transportation•Communications International Union (TCU);[1]
•Brotherhood of Maintenance of Way Employes (BMWE);
•United States Department of Agriculture (USDA); and
•United States Department of Transportation (DOT).

Applicants submitted two rebuttal pleadings (KCS-18, filed September 2, 2003, and KCS-19, filed September 22, 2003), summarized in Appendix C.

When the procedural schedule was resumed in 2004, additional comments were submitted by UP, CP, NITL, DOT, and Watco Companies, Inc. (Watco), and KCS submitted a reply. These submissions are summarized in Appendix D. The Board also received correspondence from others, listed in Appendix E.

Summary Of Decision. In this decision, we approve the acquisition by KCS of control of Tex Mex, subject to conditions (1) requiring KCS to comply with the terms of a Safety Integration Plan (SIP) developed with the Federal Railroad Administration (FRA); (2) providing affected employees the *New York Dock*[2] labor protective conditions, augmented for this transaction so that employees who choose not to follow their work to Mexico will not be deemed to have forfeited their *New York Dock* protections; and (3) providing for monitoring of operations at the Laredo Bridge by the Board's Office of Compliance and Enforcement (OCE). In addition, we are requiring KCS to comply with its commitment to keep the Laredo gateway open on commercially reasonable terms. Finally, in the event KCS acquires control of TFM, S.A. de C.V. (TFM), a Mexican railroad, we reserve the right to conduct oversight to examine the effects on transportation within the United States.

THE KCS/TM APPLICATION

The corporate structures of the applicants and other entities discussed in this decision are set forth in a chart in Appendix F and described more fully in

[1] TCU's request for leave to late-file its comments (on August 6, 2003) will be granted.
[2] *See New York Dock Ry.–Control–Brooklyn Eastern Dist.*, 360 I.C.C. 60, 84-90 (1979).

Decision No. 2. Because of the complex corporate structures, a brief description is also provided here.

Kansas City Southern. KCS, a noncarrier holding company, currently controls two U.S. rail carriers: KCSR and GWER. KCSR, a Class I railroad[3] and a wholly owned direct subsidiary of KCS, owns and operates approximately 3,100 miles of main and branch lines in 10 midwestern and southern states. KCSR's principal routes extend from Kansas City, MO, to Beaumont-Port Arthur, TX, Lake Charles, LA, and New Orleans, LA. KCSR also has a route extending from Dallas, TX, via Shreveport, LA, to Meridian, MS, and a branch line route extending north out of Alexandria, LA, to Hope, AR. KCSR also provides service, via haulage rights, over 1,200 miles of lines of other railroads and owns a non-controlling interest in two terminal railways in Kansas City, MO. GWER, a Class III railroad that is a wholly owned direct subsidiary of KCSR, owns and operates approximately 17 miles of rail lines in Illinois and also operates via trackage rights over 16 miles of other railroads.

Mexrail. Mexrail, a noncarrier holding company, was a wholly owned direct subsidiary of TFM, a Mexican railroad. Mexrail owns two assets: (1) all of the shares of Tex Mex; and (2) the U.S. portion of the bridge structure (but not the track) of the International Rail Bridge (referred to as the Laredo Bridge) that spans the Rio Grande River between Laredo, TX, and Nuevo Laredo, Mexico.

The Texas Mexican Railway Company. Tex Mex, a Class II railroad and a wholly owned direct subsidiary of Mexrail, owns and operates 157 miles of rail line between Laredo and Corpus Christi, TX. Tex Mex also operates via trackage rights over approximately 379 miles of UP lines between Robstown and Beaumont, TX, via Houston. *See UP/SP*,[4] 1 S.T.B. at 421-26. Tex Mex interchanges with KCSR at Beaumont, TX; with BNSF at Corpus Christi, Houston, and Robstown, TX; with UP at Corpus Christi, Houston, Laredo, Robstown, and Victoria, TX; with TFM on the Laredo Bridge; and with two terminal railways at Houston.

TFM. TFM, which held a 100% ownership interest in Mexrail, is a railroad located entirely in Mexico. TFM operates from Nuevo Laredo south to Monterrey, San Luis Potosi, Querataro, and Mexico City, and, from the Querataro-Mexico City area, west to Lazero Cardenas and east to Veracruz. TFM, which owns no U.S. property and which does not operate in the U.S.,

[3] Our regulations divide railroads into three classes based on annual carrier operating revenues. Class I railroads are those with annual carrier operating revenues of $250 million or more (in 1991 dollars); Class II railroads are those with annual carrier operating revenues of more than $20 million but less than $250 million (in 1991 dollars); and Class III railroads are those with annual carrier operating revenues of $20 million or less (in 1991 dollars). *See* 49 CFR Part 1201, General Instruction 1-1(a).

[4] *Union Pacific/Southern Pacific Merger,* 1 S.T.B. 233 (1996).

connects on the Laredo Bridge with two U.S. railroads: Tex Mex and UP. Traffic is interchanged at the middle of the Bridge between TFM on the Mexican side, and Tex Mex and UP, on the U.S. side. *See* KCS-3 at 221.

Ownership Interests In TFM. (1) TFM is owned by Grupo Transportación Ferroviaria Mexicana, S.A. de C.V. (Grupo TFM) and the Mexican Federal Government (which, as of 2003, owned a 20% interest in TFM).

(2) Grupo TFM is owned by NAFTA Rail, S.A. de C.V., TMM Multimodal, S.A. de C.V. (TMM Multimodal), and TFM (which itself holds an interest, with limited voting rights, in Grupo TFM, its 80% parent).

(3) NAFTA Rail, S.A. de C.V., is a wholly owned indirect subsidiary of KCS. Through KCS's ownership of NAFTA Rail, S.A. de C.V., KCS has "an economic interest" in Grupo TFM of approximately 46.5%, *see* KCS-3 at 73. *See also* KCS-8, Attachment No. 1.

(4) TMM Multimodal is a 96.3%-owned direct subsidiary of TMM Holdings, S.A. de C.V., which is itself a wholly owned direct subsidiary of Grupo TMM, S.A. (Grupo TMM, a noncarrier).

Although applicants often refer to Grupo TMM, S.A., as "TMM," *see, e.g.,* KCS-3 at 8, this decision refers to Grupo TMM, S.A., as "Grupo TMM," to avoid confusion (by using a consistent naming practice that reflects the fact that each "Grupo" entity sits at the top of its respective corporate chain, *see* KCS-3 at 13 and Appendix F).

Two Transactions: KCS/TM and KCS/TFM. On April 21, 2003, KCS and Grupo TMM announced a series of agreements that contemplated not only the KCS/TM transaction (the acquisition, by KCS, of control of Tex Mex) but also a KCS/TFM transaction (the acquisition, by KCS, of control of TFM). Neither of these transactions was contingent upon the other. The KCS/TM transaction is subject to our jurisdiction under 49 U.S.C. 11323(a)(5). The KCS/TFM transaction is not subject to our jurisdiction, *see Decision No. 2*, slip op. at 7 n.15, and therefore, KCS has not sought our approval of the KCS/TFM transaction.

If both transactions are consummated, KCS — which, as part of the KCS/TFM transaction, will be renamed "NAFTA Rail" — would control, directly or through one or more corporate intermediaries, three U.S. railroads (KCSR, GWER, and Tex Mex) and one Mexican railroad (TFM), all of which would be operated as separate subsidiaries under common control. We note that the new "NAFTA Rail" would be a different corporate entity than the intermediate holding company now known as "NAFTA Rail, S.A. de C.V."

The KCS Acquisition of Mexrail. Under the first Mexrail Stock Purchase Agreement, KCS, on May 9, 2003, acquired from TFM 51% of the shares of Mexrail for $32,680,000. This gave KCS an indirect 51% interest in Tex Mex.

To avoid any violation of § 11323 *et seq.*, KCS immediately placed its Mexrail shares into an independent voting trust (the First Mexrail Voting Trust). KCS stated that, if and when we approved the acquisition by KCS of control of Tex Mex, the voting trust would be dissolved.

The KCS/TFM Transaction. Under the agreements announced on April 21, 2003, KCS would acquire control of TFM by acquiring a controlling interest in Grupo TFM. *See* KCS-8 at 2. TMM Multimodal would receive 18 million shares of the new NAFTA Rail plus $200 million in cash and a potential incentive payment of between $100 million and $180 million, based on the resolution of certain contingencies primarily involving a value-added-tax dispute in Mexico, *see* KCS-3 at 54. The KCS/TFM transaction, including the change of name from KCS to NAFTA Rail, was contingent upon obtaining adequate financing, the outcome of the U.S. Department of Justice (DOJ) review (under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (Hart-Scott-Rodino)), the approval of the Mexican Federal Competition Commission (MFCC), the approval of the Mexican Foreign Investment Commission (MFIC), and the approval of the shareholders of KCS and those of Grupo TMM.

On August 1, 2003, KCS announced that the Hart-Scott-Rodino waiting period had expired without a formal request from DOJ for additional information or documentary material. (This "approval" lapsed in 2004, as explained below.) The KCS/TFM transaction has been approved by the MFCC. *See* KCS-16 at 11. Although the shareholders of KCS approved the transaction, Grupo TMM's shareholders disapproved the sale in August 2003. The same month, because of Grupo TMM's disapproval of the KCS/TFM transaction, the MFIC deferred a decision, then closed its proceedings, on KCS's proposal to acquire control of Grupo TFM.

Transfer Back To TFM Of The 51% Interest In Mexrail. The first Mexrail Stock Purchase Agreement gave TFM the right to repurchase shares of Mexrail from KCS, which right TFM exercised on September 30, 2003.

Procedural Schedule Suspended. In *Decision No. 10* (STB served October 8, 2003), the Board suspended the procedural schedule in this proceeding, pending a resolution of the uncertainties that surrounded KCS's efforts to acquire control of Tex Mex. The Board stated that it would reinstate the procedural schedule if and when KCS demonstrated that there was a reasonable likelihood that it would be able to acquire control of Tex Mex.

Revised KCS/TM Agreement. On August 16, 2004, KCS, TFM, and Grupo TMM announced the execution of a revised Stock Purchase Agreement pursuant to which KCS on that date again acquired from TFM a 51% interest in Mexrail. KCS immediately placed its Mexrail shares into an independent voting trust (the Second Mexrail Voting Trust) substantially identical to the previous voting trust. KCS has advised that the revised Stock Purchase Agreement is substantially the same as the first Mexrail Stock Purchase Agreement, with these exceptions: (1) KCS is now obligated to purchase the remaining 49% of Mexrail's shares no later than October 31, 2005; (2) TFM has no right to repurchase the Mexrail shares; (3) KCS has agreed to repay certain debt owed by Mexrail and Tex Mex to TFM; and (4) in addition to its and Mexrail's 5-year obligation not to sell or lease their interest in the northern half of the Laredo Bridge, KCS will abide by known existing written contracts and protocols for operation of the Bridge.

KCS has not yet reached agreement with Grupo TMM on the proposed KCS/TFM transaction. However, the revised agreement to acquire control of Mexrail, and thereby Tex Mex, is separate from KCS's efforts to acquire control of TFM itself and is not contingent on KCS acquiring control of TFM. And the elimination of TFM's repurchase right means that the revised KCS/TM transaction is not dependent on the outcome of any litigation or negotiation with respect to KCS's efforts to acquire control of TFM.

Resumption Of The Procedural Schedule. In *Decision No. 11* (STB served August 31, 2004), we resumed the procedural schedule.

Public Interest Considerations. According to applicants, bringing the KCSR/GWER and Tex Mex systems under common control represents another step in KCS's efforts to develop a "NAFTA Railroad" that will connect Canada, the U.S., and Mexico and provide seamless, efficient, and competitive rail service in all of North America. They claim that common control of KCSR/GWER and Tex Mex would provide more efficient routing and service options to shippers; enable better coordination of marketing, improved customer service, and improved single-line service; allow KCSR/GWER and Tex Mex to reduce expenses and rationalize operations; enable full integration of KCS's Management Control System (MCS, a computerized shipment and billing management system), resulting in improved freight car utilization, improved performance of the locomotive fleet, reduced time-keeping and payroll-processing costs, and consolidation of general and administrative functions; provide financial stability to Tex Mex; provide an effective competitive alternative at Laredo and intermodal competition in a market in which motor carriers are the dominant mode of transportation; and finally, help position KCSR to remain a competitive, independent, and viable carrier. Applicants assert that a combined KCSR/GWER-Tex Mex system would be stronger, financially and operationally, than either could be separately.

Applicants anticipate that, as a result of common control, within 3 years, approximately 6,313 carloads of traffic would be diverted to the combined KCSR/GWER-Tex Mex system annually, generating additional annual revenues of approximately $14.3 million; that much of the diverted traffic would be interchanged with CSX and NS; and that common control would result in net operating-expense savings of approximately $3.3 million annually.

Applicants further contend that common control of KCSR/GWER and Tex Mex would not result in any loss of competitive rail options for any shipper or any receiver because common control would not reduce the number of independent railroads serving them. KCSR/GWER and Tex Mex share only one common connection (at Beaumont, TX). Thus the KCS/TM transaction involves an end-to-end connection whereby two carriers that already share common ownership and operating practices would be combined under a unified management team.

Applicants maintain that common control would not adversely impact the essential services provided by any rail carrier. They estimate that they would attract only 4,123 cars a year away from UP (representing 1.7% of all cars delivered or picked up by UP at Laredo) and only 1,692 cars a year away from BNSF (representing 17% of all cars delivered or picked up by BNSF at Brownsville). *See* KCS-3 at 122.

Applicants also contend that the KCS/TM transaction would not be anticompetitive because it does not call for cancellation of any cooperative agreements with other carriers. These agreements include a 1997 NS-KCSR-Tex Mex marketing agreement (renewed in 2000) for traffic moving into Texas and Mexico, a 1998 CN-IC-KCSR Alliance Agreement (*see CN/IC*,[5] at 134-136), and a 2002 BNSF-KCSR marketing agreement. KCS states that it would improve Tex Mex's financial stability by working with all of its connecting carriers to increase the amount of traffic flowing over Tex Mex. Applicants state that they would honor all Tex Mex agreements pursuant to the terms of such agreements, but that any agreement that does not provide adequate revenues would be reviewed, and, upon expiration, renegotiated or not renewed.

In sum, applicants contend that common control of KCSR/GWER and Tex Mex would not result in a substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States.

The KCS/TFM Transaction: Implications For U.S. Competition; KCS's Pledges. In *Decision No. 2,* the Board noted that, although the KCS/TM and KCS/TFM transactions had been cast as separate and independent transactions, they were actually two components of a single, larger transaction with broader potential implications in the United States. Accordingly, the Board required applicants to supplement the KCS/TM application with the information specified in 49 CFR 1180.1(k)(1) and 1180.11 (concerning transnational operations). *Decision No. 2,* slip op. at 11.

In their KCS-10 supplement, applicants maintain that, even if the two transactions were considered together, the KCS/TM transaction would enhance competition by making the new NAFTA Rail a stronger and more economically viable competitor with an enhanced ability to invest in

[5] *Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated — Control — Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central and Pacific Railroad Company, and Cedar River Railroad Company,* 4 S.T.B. 122 (1999).

infrastructure, equipment, and technology at the Laredo Bridge and along the entire KCSR-Tex Mex-TFM line. They assert that considering the two transactions in tandem would still yield a purely end-to-end transaction with no adverse competitive effects on shippers, customers, or receivers in the United States. Applicants argue that there is pervasive intermodal (truck and barge) as well as intramodal competition for traffic from/to Mexico and within Mexico, which means that NAFTA Rail would have to lower prices or improve service if it were to gain market share. They further argue that, even if effects on competitors (as opposed to effects on competition) were relevant to our determination, we could be satisfied that UP and BNSF have sufficient bargaining power and leverage to protect themselves.

Applicants point out that, although Laredo is today the key gateway for U.S.-Mexico rail traffic, rail traffic now routed via Laredo is subject to competitive routings, both intramodal and intermodal. There are six major U.S.-Mexico rail gateways (at Calexico, CA; at Nogales, AZ; and at El Paso, Eagle Pass, Laredo, and Brownsville, TX). On the U.S. side of the border, UP has direct access to all six of these gateways; BNSF has direct access to three (El Paso, Eagle Pass, and Brownsville) and indirect access to a fourth (Laredo, via a connection with Tex Mex at Robstown); Tex Mex has direct access to only one (Laredo); and KCSR has indirect access to only one (Laredo, via a connection with Tex Mex at Beaumont). On the Mexican side of the border, Ferrocarril Mexicano, S.A. de C.V. (Ferromex or FXE), has direct access to four of the gateways (Calexico, Nogales, El Paso, and Eagle Pass) and TFM has direct access to two (Laredo and Brownsville). Applicants contend that, if multi-carrier access to TFM were not preserved, traffic now routed over TFM via Laredo will be diverted either to Ferromex (which is owned 26% by UP) at gateways not accessible by KCSR/Tex Mex (Calexico, Nogales, El Paso, and Eagle Pass) or to alternative barge and truck routings.

Thus, according to applicants, NAFTA Rail would have every incentive to maintain a positive business relationship with UP and BNSF, because NAFTA Rail's financial success would depend on the continued flow of traffic from UP and BNSF at the Laredo gateway. They state that UP and BNSF control 90% of the rail traffic in the entire western United States and have much more extensive coverage than KCSR. Whereas UP carries 90% of the northbound traffic and 79% of the southbound traffic between Mexico and the U.S. via all U.S./Mexico gateways, the KCSR/Tex Mex routing carries just 3% of the northbound traffic and 9% of the southbound traffic. BNSF also has a significantly higher market share than KCSR/Tex Mex for transportation to Mexico, carrying 12% of all southbound traffic. And Tex Mex must operate via trackage rights over UP to connect TFM with KCSR, which means that NAFTA Rail's ability to compete against UP at Laredo would depend largely upon the dispatching, maintenance, and investment practices of UP. Indeed, NAFTA Rail could remain competitive only if UP provides neutral treatment to Tex Mex trains, invests in its infrastructure, and maintains service levels on the tracks used by Tex Mex (and BNSF) to provide a competitive alternative to UP.

Nonetheless, to ensure the shipping community that it has no intention of using the KCS/TM and KCS/TFM transactions to restrain trade or take any other adverse competitive action, KCS makes the following five pledges. *See* KCS at 10, Davies V.S. at 13-18:

(1) KCS will not change the basic structure and operations of TFM except through negotiations. KCS's carriers (including TFM) will continue to cooperate closely and fairly with UP, BNSF, and other rail carriers on interline services such as pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, providing excellent service, and promptly quoting rates. For traffic moving via TFM, the new NAFTA Rail will have every economic incentive to continue to provide reasonable interchange conditions with both UP and BNSF.

(2) KCS will honor the terms of all existing Tex Mex and TFM agreements (marketing and pricing agreements in particular) and will allow such agreements to continue to their full term and not seek to cancel them early, even if it has the legal right to do so. When an existing agreement reaches its full maturation, KCS will not simply renew the agreement under the old terms without undertaking a good faith negotiation.

(3) KCS will keep the Laredo gateway open on commercially reasonable terms. This is the same commitment that was made in the CN/WC and CSX/NS/Conrail merger cases with regard to certain gateways, *see CN/WC*,[6] at 897, 902-904; *Conrail*,[7] 3 S.T.B. at 255, 450. In conjunction with this commitment, KCS will provide the same level of service to UP and BNSF that they have experienced in the past, and Tex Mex will also work with BNSF to route traffic via Laredo.

(4) All carriers will be treated fairly at the Laredo Bridge. KCS will abide by the existing dispatching and operating practices over the Bridge, will not make any unilateral changes in the way the Bridge is dispatched and operated, and Tex Mex and TFM will continue to be bound by the contracts and agreements that now govern operations over the Bridge. If UP is unhappy with existing operations or practices over the Bridge, UP should invoke the rights and remedies it has in the numerous contracts governing those operations. If UP prefers, KCS would be willing to discuss alternative arrangements to further improve the efficiency of operations of the Bridge.

(5) There would not be significant changes in applicants' operations and safety will remain a top priority. The KCS/TM transaction will not adversely

[6] *Canadian National Railway Company, Grand Trunk Corporation, and WC Merger Sub, Inc. — Control — Wisconsin Central Transportation Corporation, Wisconsin Central Ltd., Fox Valley & Western Ltd., Sault Ste. Marie Bridge Company, and Wisconsin Chicago Link Ltd.*, 5 S.T.B. 890 (2001).

[7] *CSX Corp. et al. — Control — Conrail Inc. et al.*, 3 S.T.B. 196 (1998).

impact the operations of any carrier, the environment, or safety. With respect to the KCS/TFM transaction, KCS's increased ownership is not anticipated to have any operational impacts within the U.S. because KCS will not consolidate its operations with TFM. Even with the KCS/TFM transaction, the operations of TFM will remain south of the border, and TFM will not take over, in whole or any part, the operations of KCSR or Tex Mex in the U.S. KCSR and Tex Mex will continue to be dispatched within the U.S.; investment and management decisions of KCSR and Tex Mex will remain within the U.S., and control of rail operations within the U.S. will remain in the U.S. and will not be transferred to or controlled by TFM. Applicants assert that the KCS/TFM transaction will improve rail safety in the United States. *See* KCS-10, Leopold V.S. at 1-2 (TFM's Train Operations and Energy Simulator software would be used to analyze incidents on KCSR, GWER, and Tex Mex).

Labor Protection. Applicants acknowledge that the applicable level of labor protection for the KCS/TM transaction is that set forth in *New York Dock,* 360 I.C.C. at 84-90. Applicants have also agreed that employees would not be required to follow their work to Mexico as a condition of receiving *New York Dock* benefits and that an employee whose work is moved into Mexico would not be required to show that Mexican law precluded him from following his work. The existing collective bargaining agreements for KCSR and Tex Mex would remain in force. Implementation of KCSR's MCS on Tex Mex would result in the elimination of a limited number of employee positions and other anticipated operating economies will result in the elimination of a limited number of marketing management, time-keeping and payroll-processing positions, and positions involved with car and locomotive pools. Applicants further acknowledge the possibility that significant labor changes might occur as they gain experience in the course of implementing the KCS/TM transaction. *See* KCS-3 at 158.

Environmental Issues. Applicants contend that, under 49 CFR 1105.6(c)(2)(i), the proposed KCS/TM transaction is exempt from environmental reporting requirements because there would not be changes in carrier operations that would exceed the thresholds established in 49 CFR 1105.7(e)(4) or (5). They state that there would be less than a 1% increase in KCSR traffic and less than a 7% increase in Tex Mex traffic. Although there are significant rehabilitation and improvement plans for Tex Mex property if KCS obtains control, they state that those are for activities that would not be subject to environmental review by the Board. Applicants further contend that, under 49 CFR 1105.8(b)(1) and (3), the proposed KCS/TM transaction is exempt from historic preservation review requirements because rail operations would continue after consummation of common control; further Board approval would be required to abandon any service; and there are no plans to dispose of or alter properties that are 50 years old or older.

Safety Integration Plan. On July 1, 2003, applicants submitted a SIP that describes the process by which they intend to safely integrate the infrastructure, equipment, personnel, and operating practices of KCSR/GWER and Tex Mex. After the resumption of the procedural schedule, applicants submitted an updated SIP to FRA. FRA and applicants recently reached final agreement on a SIP, which they submitted to the Board.

Recent Developments. (1) *Mexican Foreign Investment Commission Approval.* In September 2004, KCS and Grupo TMM announced that MFIC had resolved to deny KCS's application for authority to acquire Grupo TMM's interest in TFM, that they would seek reconsideration of the denial, and that they had agreed to extend their mutual deadline for KCS to acquire the interest in TFM. On October 6, 2004, KCS and Grupo TMM announced that MFIC had approved a new KCS application for authority to acquire Grupo TMM's interest in TFM and that the approval would remain in effect until October 5, 2005.

(2) *Mexican Federal Competition Commission Extension.* On October 7, 2004, KCS and Grupo TMM announced that MFCC had extended, to April 2005, KCS's authority to acquire Grupo TMM's interest in TFM.

(3) *U.S. Department Of Justice: Lapse*. On October 15, 2004, KCS advised that DOJ's 2003 Hart-Scott-Rodino early-termination notice respecting the KCS/TFM transaction had lapsed. If the KCS/TFM transaction is revived, KCS and Grupo TMM will have to refile their Hart-Scott-Rodino notice, and DOJ will then have another opportunity to review the competitive effects of the KCS/TFM transaction. *See* KCS-22 at 46 n.32. However, as of October 15, 2004, KCS and Grupo TMM had not yet reached an agreement to move forward on the KCS/TFM transaction. *See* KCS-22 at 11.

DISCUSSION AND CONCLUSIONS

Statutory Criteria. Under 49 U.S.C. 11323(a)(5), the acquisition of control of a rail carrier by a noncarrier that controls another rail carrier requires prior Board approval. The criteria for approval are set forth in 49 U.S.C. 11324. Because the KCS/TM transaction does not involve the merger or control of two or more Class I railroads, this transaction is governed by 49 U.S.C. 11324(d), under which we must approve the application unless we find that: (1) as a result of the transaction, there would likely be a substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States; and (2) the anticompetitive effects of the transaction would outweigh the public interest in meeting significant transportation needs.

In assessing transactions subject to § 11324(d), our primary focus is on the anticipated competitive effects. We must grant the application unless adverse competitive impacts are both "likely" and "substantial." And, even if there would be likely and substantial anticompetitive impacts, we may not disapprove the transaction unless the anticompetitive impacts outweigh the benefits and cannot be mitigated through conditions (which we have broad authority to impose under § 11324(c)). *See CN/GLT*,[8] at 537-538; *DM&E/IC&E*,[9] at 523-524; *CN/WC*, at 899; *KCS/GWWR*,[10] slip op. at 4.

Competitive harm would result from a merger to the extent that the merging parties would gain sufficient market power to profit by raising rates and/or reducing service. Wherever feasible, we will impose conditions to ameliorate significant competitive harm that is caused by a merger. However, in evaluating claims of competitive harm, consideration must be given not just to the relevant *rail* market(s) but to the relevant *transportation* market(s), and harms caused by a merger must be distinguished from pre-existing circumstances that are not "merger-related" (i.e., would neither be caused nor exacerbated by the merger). *See Conrail,* 3 S.T.B. at 246.

Competitive Analysis. We will approve the KCS/TM application because the evidence demonstrates that, subject to the conditions imposed in this decision, there will not be, as a result of common control of KCS, KCSR, GWER, Mexrail, and TM, either a substantial lessening of competition, the creation of a monopoly, or a restraint of trade in freight surface transportation in any region of the United States. This minor transaction connects two transportation systems that do not compete, but complement each other. Together, they will create a stronger rail transportation network. The labor, environmental, and safety concerns that have been raised by the proposed transaction will be addressed by the imposition of appropriate conditions, and operations at the Laredo Bridge will be monitored by OCE. Also, in recognition of KCS's continued commitment to acquire control of TFM, which provides the most direct rail link between Mexico City and large portions of the U.S., we reserve jurisdiction to conduct oversight to examine the impacts on rail operations in the U.S. should KCS achieve control of TFM.

The KCS/TM transaction is "end-to-end" and there will not be a reduction in the number of carriers serving any shippers on the KCS/TM system. An end-to-end consolidation of carriers, by its very nature, is not likely to generate the kinds of competitive problems that often arise in connection with a "parallel" consolidation. And, although an end-to-end consolidation may generate concerns of its own, those concerns can be resolved here by holding KCS to its pledge (discussed above) to keep the Laredo gateway open. Indeed, the evidence demonstrates that the end-to-end configuration of the KCS/TM control transaction will benefit shippers by enabling KCS to offer expanded single-line service and to provide the benefits of efficient use of a

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[8] *Canadian National Railway Company and Grand Trunk Corporation — Control — Duluth, Missabe and Iron Range Railway Company, Bessemer and Lake Erie Railroad Company, and The Pittsburgh & Conneaut Dock Company,* 7 S.T.B. 526 (2004).

[9] *Dakota, Minnesota & Eastern Railroad Corporation and Cedar American Rail Holdings, Inc. — Control — Iowa, Chicago & Eastern Railroad Corporation,* 6 S.T.B. 511 (2003).

[10] *Kansas City Southern Industries, Inc., KCS Transportation Company, and The Kansas City Southern Railway Company — Control — Gateway Western Railway Company and Gateway Eastern Railway Company,* STB Finance Docket No. 33311 (STB served May 1, 1997).

NAFTA route connecting the Central United States with Mexico (and Canada, through a marketing alliance with CN). In addition, KCS/TM will be able to achieve important cost-saving benefits without a wholesale restructuring of rail facilities. The evidence also demonstrates that customers of both KCS and TM will benefit from increased reliability and other service improvements and operating efficiencies fostered by the transaction, that KCS and Tex Mex will remain financially strong after consummation of the transaction, and that KCS will have the financial resources to maintain the integrated KCS/TM system in good condition.

The issue here is whether the vertical integration of KCS and TM (and ultimately TFM) would have any anticompetitive effects for the users of rail transportation services. Under the "one lump" theory, which generally applies to vertical integration, "there is only one monopoly rent to be 'gained from the sale of an end-product.'" *Western Resources, Inc. v. STB*, 109 F.3d 782, 784 (D.C. Cir. 1997), quoting Phillip Areeda & Donald F. Turner, 3 *Antitrust Law* ¶725b, at 199 (1978). Thus, "the monopolist's upstream vertical integration (even if accompanied by monopolization of prior phases) will normally not affect the end-product consumer adversely." *Western Resources*, 109 F.3d at 784. The Board has subscribed to the one lump theory (as a rebuttable presumption) in approving several end-to-end mergers.

In an attempt to rebut the "one lump" assumption, UP alleges that this case is unusual because under regulation of the Mexican government, TFM — the monopolist south of the Laredo Bridge — has not been able to extract all of the monopoly rents on through shipments from and to the U.S. Thus, UP expresses concern that, if KCS is allowed to control TFM, KCS will be able to extract additional rents from shippers.

However, as KCS has pointed out, if KCS tried to raise rates on TFM movements that are not rail dependent, the traffic would shift to motor or water carriage. And on TFM movements that are rail dependent, if for some reason TFM is not presently extracting monopoly rents, then the connecting carrier within the United States could be doing so. Therefore, UP's argument seeks to protect the U.S. carrier's leverage regarding divisions of joint rates (that is, concerns over how the interline rail partners will divide the profit), not to protect shippers. KCS-22 (filed October 15, 2004) at 37-38. Moreover, KCS's experts credibly explained that market conditions would prevent KCS from raising rates to shippers or foreclosing UP and BNSF from the Mexican market, because the latter two carriers account for more than 90% of the rail traffic interchanged with TFM at Laredo, and it would be unprofitable for KCS to use its control of TFM to take actions that would foreclose this traffic.

If control of TFM would lead KCS to favor its own routings for those few points that are served both by KCS and UP (or KCS and BNSF), KCS might earn more revenue than in the past, and UP (or BNSF) might earn less, but that is not going to result in higher costs to shippers. This could well mean some harm to a competitor (UP, BNSF), but not harm to competition.

UP's final argument is that we should impose a condition to further the Board's earlier action to protect competition at the Laredo gateway in the context of the UP/SP merger, by granting Tex Mex trackage rights to connect with KCSR at Beaumont. But approval of the KCS/TM application would not alter those trackage rights. In the UP/SP merger, the combination of those two carriers would have foreclosed horizontal competition at Laredo, because UP and SP were at that time the only U.S. rail carriers reaching Laredo and their merger would leave only one U.S. carrier at that location. To preserve competition at Laredo, the Board ordered Tex Mex trackage rights over UP, thus allowing a KCS-Tex Mex routing to reach Laredo. Here, in contrast, approval of the KCS/TM application will not foreclose any horizontal competition, and therefore a "competition-preserving" condition is not needed for the Laredo gateway.

KCS has undertaken to make five pledges to assure the public that it will not act anticompetitively, particularly concerning the Laredo gateway and bridge. These pledges, set forth more fully above, are:

- to continue to work with UP and BNSF on operating matters such as pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars, accommodating run-through train service, providing excellent service, and promptly quoting rates;

- to honor the terms of all existing Tex Mex and TFM agreements and allow such agreements to continue to their full term (and not seek to cancel early, even if it has that legal right);

- to keep the Laredo gateway open on commercially reasonable terms;

- to treat all carriers fairly at the Laredo Bridge, preserving existing dispatching and operating practices over the Bridge, with Tex Mex and TFM continuing to be bound by agreements governing operations over the Bridge; and

- to make no significant changes in applicants' operations, with safety remaining a top priority, ensuring that the KCS/TFM transaction (if it occurs) would not have operational impacts within the United States, and not transfer management and control of rail operations within the United States to TFM.

The Laredo Bridge and gateway are so significant to rail traffic between the U.S. and Mexico that we will require KCS to adhere to these five pledges. As a condition of our approval, these pledges should guarantee that traffic will continue to flow fairly and efficiently at the Laredo Bridge and through the Laredo gateway.

The NITL/KCS Settlement Agreement. As described more fully in Appendix B, NITL and KCS have privately negotiated an agreement for the benefit of shippers and receivers of freight whose rail movements originate or terminate on KCS or TM, to apply when the KCS/TM transaction is consummated. The major provisions of the agreement are:

- KCS and/or Tex Mex will establish and maintain commercially reasonable rates over any existing interchange with any railroad.

- KCS and/or Tex Mex will forgo exercising their right to cancel any agreement on rates or rate factors between either KCS or Tex Mex and other U.S. rail carriers prior to expiration of the agreements. Upon expiration, KCS will negotiate in good faith to establish commercially reasonable rates going forward.

- KCS and/or Tex Mex will maintain, and try to improve, service levels between Beaumont and Laredo, TX (operating under trackage rights on UP's line for most of this movement). KCS will report to the Board on the service level provided for each quarter of the past 2 years, and going forward, for each quarter for the 3 years commencing on the effective date of the KCS/TM transaction. If service deteriorates, KCS will provide the Board with a plan to correct the deterioration, possibly including a request for Board assistance if it is determined that UP was responsible for the service problems.

In the event of a dispute, the parties agree to use arbitration to enforce the agreement. NITL asks us to impose the terms of that agreement as a condition of approval. KCS opposes making it a condition, arguing that its contractual obligations are sufficient.

NITL has not made a convincing case that imposition of the terms of the NITL/KCS Agreement is necessary to remedy some anticompetitive effect of this end-to-end merger. For that reason, we will not impose its terms as a condition of approval. Of course, the parties to the agreement remain contractually obligated to fulfill their obligations under it.

One remaining matter arising under the NITL/KCS Agreement merits discussion. UP argues that the Confidentiality Provision in Section 3 of the agreement is anticompetitive and asks us to direct KCS to remove that section from the agreement. UP's concern about an anticompetitive effect from this confidentiality provision arises if KCS acquires control of TFM. UP fears, and KCS acknowledges, that the terms of Section 3 of the agreement would allow TFM to share with KCS and Tex Mex confidential information about a shipper's move acquired by TFM as a result of participation in UP-TFM movements. This sort of information sharing is to be expected when one carrier acquires control of another, and UP has not shown that the information sharing would result in anticompetitive effects such as higher prices or reduced service for shippers. Consequently, we will not direct KCS to remove Section 3 from its private agreement with NITL.

Monitoring and Oversight. DOT, along with a number of parties, asks that we impose a condition providing some type of oversight for 3 to 5 years, in which parties could present evidence of merger-related harms or violations of KCS's commitments. Although we do not anticipate anticompetitive consequences from the transfer of control, we are mindful that operational difficulties can arise whenever organizational changes occur. We are approving the transfer of control of the U.S. side of Laredo Bridge from a small, independent railroad (Tex Mex) to a much larger railroad (KCS). Assuring smooth operations over the bridge is essential. Consequently, we will condition our approval upon the monitoring of operations at the Laredo Bridge, as we have jurisdiction over rail operations on the U.S. side of the bridge (from the mid-point of the Laredo Bridge north, a fact that DOT has asked us to confirm).

While we will not impose a formal operational oversight of this transaction (as the Board did in *Conrail* concerning the Shared Assets Areas), several parties have noted the continued importance of the border crossing at Laredo. Therefore, we will require OCE to establish a plan for monitoring KCS's representations to "keep the gateway open on commercially reasonable terms, treat all railroads without discrimination at the bridge," and to "keep this connection (BNSF, Robstown) open, on fair terms." As part of the monitoring plan, KCS will be required to submit to the Director of OCE a complete description of all agreements and protocols now in effect and statistical measures of pre-merger activity at the Laredo Bridge and applicable interchanges. KCS shall notify the Director of any changes in these agreements as they occur. KCS will initially report statistics on activity on a bi-weekly basis, subject to changes as circumstances warrant. The Director will, after conferring with KCS, establish the format of this reporting. If KCS should in the future gain control of TFM, KCS shall report to the Director what, if any, changes to these agreements and activities will occur as a result of the consummation of that transaction.

Various parties also argued that continuing oversight would be necessary in the event that KCS acquires control of TFM, which provides the most direct rail link between Mexico City and large portions of the U.S. While we are not the proper authority to rule on the antitrust implications of a KCS/TFM transaction, we remain committed to ensuring that cross-border operations flow smoothly if KCS achieves control of TFM. Accordingly, we reserve our right to conduct oversight to examine the operational effects of KCS's control of TFM upon transportation in the U.S., should that transaction occur.

Labor Protection. As indicated above, KCS has no objection to a request by TCU that we augment the labor protective conditions for this case so that employees will not be required to follow their work to Mexico as a condition of receiving *New York Dock* benefits, and employees whose work is moved over U.S. borders will not be required to show they were precluded by Mexican law from following their work. We will modify the *New York Dock* conditions as requested for this transaction.

Environmental Issues. The National Environmental Policy Act (NEPA), 42 U.S.C. 4321-43, generally requires federal agencies to consider "to the fullest extent possible" environmental consequences "in every recommendation or report on major federal actions significantly affecting the quality of the human environment." 42 U.S.C. 4332(2)(C). Under both the regulations of the President's Council on Environmental Quality implementing NEPA and the Board's own environmental rules, actions are separated into three classes that prescribe the level of documentation required in the NEPA process. Actions that may significantly affect the environment generally require the preparation of a full Environmental Impact Statement (EIS). 40 CFR 1501.4(a)(1); 49 CFR 1105.4(f), 1105.6(a). Actions that may or may not have a significant environmental impact ordinarily require the preparation of a more limited Environmental Assessment (EA). 40 CFR 1501.4(c); 49 CFR 1105.4(d), 1105.6(b). Finally, actions whose environmental effects are ordinarily insignificant may be "categorically excluded" from NEPA review across the board, without a case-by-case review. 40 CFR 1500.4(p), 1501.4(a)(2), 1508.4; 49 CFR 1105.6(c).

As indicated above, applicants asserted in their application that this transaction will have insignificant environmental effects and therefore does not require a formal environmental review. Applicants stated that the transaction will not result in changes in carrier operations that would exceed the thresholds triggering environmental review established in the Board's environmental rules at 49 CFR 1105.7(e)(4) or (5). Applicants explained that only minor rail traffic increases are projected (approximately 17 carloads per day) and that the transaction will not add more trains on Tex Mex. Moreover, applicants stated that this is an entirely end-to-end coupling of the existing systems with no overlapping or parallel routes, and that there will be no rail line abandonments or construction projects related to the transaction. Applicants further argued that this transaction is exempt from historic review under the National Historic Preservation Act (NHPA).

In *Decision No. 2,* the Board found the information in the application sufficient to create a presumption that formal environmental review was not required. However, to assist the Section of Environmental Analysis (SEA) in independently determining whether applicants' transaction is appropriately categorically excluded from NEPA review, the Board directed KCS and Tex Mex to prepare an Environmental Appendix providing additional details and explanation. The Board directed KCS and Tex Mex to make the Environmental Appendix available for public review and comment. In addition, applicants were directed to publish a notice in major newspapers in communities between Beaumont, TX, and Laredo, TX, with populations of more than 5,000 people, alerting the public to the availability of the Environmental Appendix and the opportunity to raise any environmental concerns. The Board also made the Environmental Appendix available on the Board's website. Further comments addressing any potential environmental issues also were specifically invited in *Decision No. 11,* following the resumption of the procedural schedule.

No comments have been received challenging the presumption made in *Decision No. 2* that this proposal is categorically excluded from the environmental review requirements of NEPA. Accordingly, SEA has recommended that the Board find that formal environmental review is not necessary here, and that this proceeding does not require historic review under the NHPA. We adopt SEA's conclusions.

DOT did raise concerns about possible congestion in the City of Laredo relating to the slightly longer trains proposed by applicants. But as KCS and Tex Mex explain in a comment on environmental issues dated September 30, 2004, applicants have worked, and intend to continue to work, with TFM and UP to improve operating efficiencies in Laredo, which, we believe, should address DOT's concerns. CN has noted that the proposed TFM acquisition, if it occurs, could result in increased traffic impacts. But CN has not shown that the possible change in ownership and control of TFM in and of itself would have adverse environmental consequences or that an EA or an EIS should be prepared.

This transaction also raises no major issues regarding safety concerns. KCS and Tex Mex have worked with FRA to develop a detailed SIP, in accordance with the joint regulations adopted by FRA and the Board at 49 CFR 244 and 1106, addressing applicants' plans for safe integration of their rail lines, equipment, personnel, and operating practices. While DOT in its initial filings noted that FRA had some concerns about applicants' draft SIP, consultations between applicants and FRA have continued. On September 30, 2004, applicants submitted an updated draft SIP to FRA, and FRA and applicants recently reached final agreement on a SIP and Implementation Plan, as noted above.

In *Decision No. 2*, the Board stated that, even if no EA or EIS is warranted, the Board intended to include in any decision approving the transaction a condition requiring applicants to comply with their SIP. We will do so by imposing SEA's recommended condition requiring KCS and Tex Mex to comply with their SIP (which may be modified and updated as necessary to respond to evolving conditions as this transaction is implemented), and to participate in and fully cooperate with the ongoing regulatory activities associated with the safety integration process until FRA advises us in writing that the integration of KCS's and Tex Mex's systems has been completed safely and satisfactorily.

UP Petition Concerning Laredo Bridge. In response to applicants' statement that KCS might seek to acquire control of Mexrail's interest in the Laredo Bridge *prior* to Board approval of the KCS/TM application, KCS-6 at 27 n.19, UP asked for a Board order declaring that KCS may not, without prior Board approval, acquire operational control of the Laredo Bridge. UP-2 at 1. UP argued that, because only a rail carrier may exercise operational control of a railroad bridge, KCS would have to receive Board approval, either under 49 U.S.C. 11323 or under 49 U.S.C. 10901, before it could legally exercise any right to control rail operations over the northern half of the Laredo Bridge. Applicants replied to the UP-2 petition. *See* KCS-11. Our approval of the KCS/TM application moots UP's request.

CN Petition to Vacate Acceptance of Application. In its CN-3 petition, CN contends that applicants neither completely addressed nor correctly analyzed the impacts of the KCS/TFM transaction on U.S. rail operations and on U.S. markets, and improperly shifted the burden to do so onto other parties. CN also argues that applicants have failed to comply with *Decision No. 2,* leaving us without a sufficient basis for determining that the KCS/TM transaction is consistent with the public interest, as required by 49 U.S.C. 11324(c). CN asks that we reopen *Decision No. 2,* vacate the Board's acceptance of the KCS/TM application, and reject the application even as supplemented. Replies to the CN-3 petition were filed by UP (UP-4) and by applicants (KCS-16).

Because we are satisfied that the KCS/TM transaction is a minor transaction, the KCS/TM application must be evaluated under the presumptive grant standard of § 11324(d), not under the broader public interest standard of § 11324(c), which applies only to "major" transactions (involving two or more Class I railroads). Moreover, we are satisfied that applicants have provided sufficient information to allow us to make an informed assessment of the transaction under the § 11324(d) standard. For these reasons, the CN-3 petition will be denied.

Status Reports. In light of our concern about the effects on operations in the U.S. if KCS acquires control of TFM, we will continue to require KCS to file status reports detailing new developments (if any) in its efforts to acquire control of TFM. Should that transaction occur, the Board would consider arguments on the effect of the TFM transaction on this order.

Effective Date. Applicants asked, in both their 2003 and 2004 submissions, that any decision approving the KCS/TM application take effect on the 5th day (and not, as is customary, the 30th day) after the date of service. They base this request on the long hiatus in the transaction and the fact that Tex Mex is currently being run under a voting trust. However, the voting trust is routine in cases of acquiring control of another carrier, and the Board did not cause the hiatus. Therefore, we will decline the request and adhere to the Board practice of making our decisions effective on the 30th day.

Based on the record, we find:

1. The acquisition by Kansas City Southern of control of The Texas Mexican Railway Company will not substantially lessen competition, create a monopoly, or restrain trade in freight surface transportation in any region of the United States.

2. This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. TCU's request for leave to late-file its comments is granted.
2. The UP-2 and CN-3 petitions are denied.

3. The proposed acquisition by Kansas City Southern of control of The Texas Mexican Railway Company is approved, subject to the conditions set forth here.

4. Applicants must adhere to their five representations, as set out in this decision.

5. Applicants must comply with the operational monitoring condition imposed in this decision by filing the reports discussed in this decision.

6. Applicants must (1) comply with the Safety Integration Plan, which may be modified and updated as necessary to respond to evolving conditions, and (2) participate in, and fully cooperate with, the ongoing regulatory activities associated with the safety integration process, until the Federal Railroad Administration advises the Board in writing that the integration of KCS's and Tex Mex's systems has been completed safely and satisfactorily.

7. Approval of the KCS/TM control application is subject to the conditions for the protection of railroad employees set out in *New York Dock*, 360 I.C.C. 60, 84-90 (1979), with the added condition that employees who choose not to follow their work to Mexico will not lose their otherwise applicable *New York Dock* protections, and that employees whose work is moved over U.S. borders will not be required to show that Mexican law precluded them from following their work.

8. Any conditions requested by any party in this proceeding not specifically imposed in this decision are denied.

9. KCS shall file a status report detailing new developments (if any) in its efforts to acquire control of TFM on the first business day of January 2005, and then as events warrant, but in no case later than the first business day of every third month thereafter.

10. This decision shall be effective on December 29, 2004.

By the Board, Chairman Nober, Vice Chairman Mulvey, and Commissioner Buttrey.

APPENDIX A: COMMENTS OF RAILROAD PARTIES (SUBMITTED IN 2003)

Union Pacific. UP warns that, because Laredo plays a uniquely important role in U.S.-Mexico rail transportation, the KCS/Tex Mex/TFM transaction, if not properly conditioned, will cause a substantial lessening of rail competition in the United States. KCS control of Tex Mex and TFM will give KCS control of all U.S.-Mexico traffic moving via Laredo; and, if the KCS/Tex Mex/TFM transaction is not properly conditioned, KCS will use its control to cause anticompetitive shifts of traffic from UP-TFM routes to KCS/Tex Mex-TFM routes, which will effectively degrade the services provided to shippers and raise the rates charged to shippers. While applicants have made several commitments to reassure the Board and the shipping community that the KCS/Tex Mex/TFM transaction will not harm competition for U.S.-Mexico rail traffic, to ensure that such competition is indeed not harmed, the Board must impose conditions that will make applicants' commitments meaningful and enforceable.

UP contends that KCS's acquisition of control of Tex Mex and TFM constitutes, and therefore should be treated as, a single "KCS-Tex Mex-TFM" transaction. Even the "one case at a time" rule would not have required the Board to ignore the TFM component of the KCS/Tex Mex/TFM transaction because the TFM acquisition is a core component of the transaction that the Board has been asked to review. The Board should consider the competitive effects in the United States of the entire KCS/Tex Mex/TFM transaction, and, to the extent the transaction threatens to produce anticompetitive effects in the United States, the Board should impose conditions that will mitigate those effects. UP argues that the voting trust, which purports to insulate TFM from Tex Mex, is nothing more than an effort to evade the jurisdiction of the Board by artificially breaking a single corporate family into separate segments. While KCS's purchase and voting-trust strategy may have technically avoided the need for KCS and TFM to seek Board approval of the acquisition of TFM, it cannot oust the Board's authority to impose conditions addressing the adverse effects on competition of the entire KCS/Tex Mex/TFM transaction.

The Board and the Interstate Commerce Commission (ICC) have consistently evaluated the full range of effects associated with transnational mergers — including, where pertinent, activities that physically occur outside the United States — so long as those effects relate to transportation in the United States. *See Canada Southern*, slip op. at 8-11; *CN/WC*, 5 S.T.B. 890, 900 n. 19; CN/IC, 4 S.T.B. at 145-146, 153-155. Precedents involving CN and CP, UP argues, cannot be distinguished on the basis that CN and CP have for many years operated in the U.S. through their various U.S. subsidiaries, whereas TFM has not. Prior to May 9, 2003, TFM operated in the U.S. through Tex Mex, its U.S. subsidiary. *See also TFM Pooling*, slip op. at 1. UP warns that, if the Board were to allow KCS to evade the jurisdiction of the Board (as to the TFM acquisition) by a creative shuffling of assets and use of a voting trust, the strategy laid out by KCS might well be adopted by others. If UP or BNSF were to seek to acquire control of CN or

CP, the acquiring railroad could attempt to evade examination of the transnational competitive implications of the transaction by carving off and acquiring the U.S. assets of its merger partner, and then placing those assets in a voting trust. The Board should look to the future, and should reject KCS's effort to limit, by means of a strategy of restructuring corporate relationships, the authority of the Board to review a transaction in which a carrier seeks to acquire both U.S. and foreign rail assets.

The Board may fashion remedies addressing the adverse effects of the KCS/Tex Mex/TFM transaction on transportation in the United States — including effects arising from the transaction's international aspects — even though those remedies will affect non-U.S. carriers and conduct outside the United States. *See CN/IC*,4 S.T.B. at 155-156; *CN/WC*, 5 S.T.B. at 902, 924. In view of the importance of protecting NAFTA traffic, UP insists that the Board clearly has authority to remedy adverse effects in the United States arising out of KCS's acquisition of control of TFM (in combination with its acquisition of control of Tex Mex) by imposing conditions requiring applicants to adhere to their commitments to treat other carriers fairly in the operation of the Laredo Bridge, to keep the Laredo gateway open on commercially reasonable terms, and to avoid discrimination against connecting carriers.

UP contends that the imposition of conditions to remedy adverse effects of the KCS/Tex Mex/TFM transaction on transportation in the United States would neither exceed the Board's jurisdiction nor violate principles of comity. The Board is not being asked to assert extraterritorial jurisdiction over TFM or any other Mexican entity but to impose conditions on KCS's movements into and out of the United States and commercial arrangements relating to those movements. UP contends that the fact that other regulatory bodies have some role in reviewing the TFM portion of the KCS/Tex Mex/TFM transaction should not deter the Board from taking appropriate action to safeguard competition in the United States because those entities have limited resources and spheres of jurisdiction.

UP focuses on the need for a condition preserving competition at Laredo. As a result of extensive investment over many years by public and private parties, Laredo is today a uniquely efficient point for interchanging large volumes of cross-border rail shipments. Laredo also has uniquely well-developed capabilities for handling the customs, agricultural, immigration, narcotics, and security-related inspections required at an international border, as well as an unmatched community of brokers, freight forwarders, and other third parties that can assist shippers with customs and other aspects of the border-crossing process. UP contends that, in view of Laredo's superior infrastructure and its location on the shortest route between major Mexican industrial and population centers and the Midwest and Eastern U.S., Laredo is vitally important to U.S.-Mexico rail transportation and, therefore, to rail competition in the United States.

UP reminds the Board that the purpose of Tex Mex's Beaumont-Robstown trackage rights that enable Tex Mex to connect with KCSR at Beaumont was to protect competition for traffic moving via Laredo that might have been threatened by the diversion to UP/SP single-line routes of traffic that had previously moved via SP-Tex Mex joint-line routes. *See UP/SP*, 1 S.T.B. at 424. UP insists that unless the Board concludes that circumstances have substantially changed since 1996 — in which event there would be no justification for a continuation of the Tex Mex trackage rights — the Board cannot now find that there are sufficient alternatives to rail transportation via Laredo (e.g., alternative gateways or alternative modes) to put aside the Board's *UP/SP* concern for protecting rail competition at Laredo. Intermodal alternatives are plainly not sufficient, because for most of the major flows of U.S.-Mexico traffic that now move by rail via Laredo, railroad transportation offers significant and growing cost advantages relative to available truck and water alternatives. As important as Laredo was in 1996, it is even more important today, as the volume of traffic moving via Laredo has more than doubled in the past 7 years. Laredo's importance relative to the other Mexican rail gateways is striking: more than 75% of all U.S.-Mexico rail traffic (by dollar value) crosses the border at Laredo. Because shippers demand the benefits that Laredo offers, UP's own cross-border traffic has shifted increasingly toward Laredo in recent years, rather than via Eagle Pass using a UP-Ferromex routing, and BNSF moves a substantial volume of its U.S.-Mexico traffic in a BNSF-Tex Mex joint-line routing via Laredo, even though BNSF has its own single-line routing via Eagle Pass.

UP warns that unconditioned KCS control of Tex Mex and TFM would threaten to undermine rail competition in the United States for U.S.-Mexico traffic moving via Laredo. UP insists that, even though up to now there has no rail competition for such traffic south of the border, there has been a three-way rail competition for such traffic north of the border, among UP single-line routings, BNSF-Tex Mex joint-line routings, and KCS-Tex Mex joint-line routings. TFM, which has sought to attract traffic to its system in Mexico without regard to which U.S. carrier handles the traffic north of the border, has interacted with its U.S. connections in an equitable and even-handed manner; has cooperated extensively with both UP and Tex Mex to develop highly efficient cross-border transportation options; and, consistent with the requirements of Mexican law, has charged the same rate factors for its portion of the movement regardless of which U.S. carrier handles the U.S. portion of the movement.

Thus, UP is concerned that the consolidated KCS/Tex Mex/TFM will have the incentive and the ability to manipulate competitive outcomes to favor routes in which its U.S. railroads participate. KCS will have an incentive to increase its profits by capturing more traffic north of the border, in part to capture the "margins" on that traffic (i.e., the excess of the price charged by KCS for moving additional traffic over the marginal cost of handling that additional traffic, *see* UP-7B, Hausman V.S. at 10) and in part to pay off the substantial debt it will be taking on when it acquires TFM. And although KCS may have an incentive to permit TFM to continue its cooperation with UP as respects the portion of traffic now moving via Laredo that is not subject to handling by KCS and/or Tex Mex, KCS's incentive with respect to the remainder of Laredo traffic will be to shift this traffic from UP-TFM routes to

KCS-Tex Mex-TFM (or BNSF-Tex Mex-TFM) routes by implementing strategies aimed at degrading the transportation services provided by TFM to UP. UP rejects the notion that it has a "chokehold" over Tex Mex's Beaumont-Robstown trackage rights that would prevent a consolidated KCS/Tex Mex/TFM from implementing such strategies, citing the protocol governing its dispatching of Tex Mex trains and the available capacity for increased traffic over UP's Beaumont-Robstown line.

UP concedes that, if the KCS/Tex Mex/TFM transaction were to enable KCS/Tex Mex to attract additional traffic to their lines north of Laredo solely by improving services or lowering rates, those effects would be pro-competitive rather than anticompetitive. UP insists, however, that, unless properly conditioned, the KCS/Tex Mex/TFM transaction will enable KCS/Tex Mex to attract additional traffic to their lines north of Laredo by giving KCS the ability to degrade UP-TFM competitive options and thereby force traffic to KCS/Tex Mex lines. Competition for U.S.-Mexico cross-border traffic depends on efficient access to the Laredo Bridge and effective cooperation from TFM. With control of both Tex Mex and TFM, KCS will have effective control of 100% of Laredo gateway traffic, and KCS control of TFM will also allow KCS to circumvent the non-discrimination requirements imposed by Mexican law, and thereby extract additional profits from those cross-border shippers that are most dependent on rail. These strategies will not merely shift traffic away from UP-TFM routes, but will do so in anticompetitive ways by forcing shippers to pay higher rates and accept poorer service.

UP insists that common control of KCS, Tex Mex, and TFM will not achieve any significant efficiencies that could not be accomplished without common control, and, therefore, common control will not strengthen the KCS-Tex Mex-TFM routing as a competitive alternative to the UP-TFM routing. The KCS/Tex Mex/TFM transaction will simply transfer control of Tex Mex and TFM from Grupo TMM to KCS whereas KCS, Tex Mex, and TFM have already aligned their operations closely, and KCS has acknowledged that it intends to keep the three railroads intact and separate. Even if some efficiencies are created through elimination of duplicative Tex Mex administrative functions, Tex Mex is so small compared to KCS and TFM that any such efficiencies will also be relatively small in the context of KCS/Tex Mex/TFM common control.

UP believes that KCS's pledges, if made concrete and specific through negotiated agreements, would prevent the competitive harms likely to arise from the NAFTA Rail transaction. However, these commitments are only a starting point for effective remedial measures that would avoid the threat to competition posed by unconditioned KCS control of Tex Mex and TFM because they lack definition in crucial respects and would be utterly unenforceable unless imposed as conditions.

UP therefore asks that the Board impose conditions generally requiring applicants to abide by their commitments, and, in furtherance of their commitments, to negotiate in good faith with UP and other interested parties to develop agreements that will implement applicants' commitments in effective and enforceable ways; and retaining jurisdiction to resolve disputes and impose appropriate implementing arrangements should the parties fail to reach agreement within a reasonable period of time, perhaps 90 days. The Board has broad authority to place conditions on approval of railroad control transactions. *See DM&E/IC&E*, 6 S.T.B. at 523 n.32. That authority is provided by 49 U.S.C. 11324(c), which grants the Board authority to impose, even in transactions governed by 49 U.S.C. 11324(d), conditions that are in the public interest. *See CN/WC*, 5 S.T.B. at 899 n.18; *KCS/GWWR*, slip op. at 4. And the Board has routinely imposed conditions requiring applicants to abide by the representations they have made during the course of a control proceeding. *See CN/WC*,5 S.T.B. at 919 (ordering paragraph 5); *CN/IC*, 4 S.T.B. 187 (ordering paragraph 6).

UP asks, in particular, that the Board impose five conditions that would neither grant UP special benefits nor interfere with applicants' efforts to obtain whatever efficiencies they can from their NAFTA Rail transaction. *See* UP-7A, Exhibit 19. The five conditions are that applicants must adhere to all of the representations they made during the course of this proceeding, whether or not such representations are specifically referenced in this decision; that the Laredo gateway will remain open on commercially reasonable terms; that UP will have the continued cooperation of TFM in providing shippers with competitively viable rates between the U.S. and Mexico; that UP will have the continued cooperation of TFM on all the aspects of service that are required to make UP-TFM offerings competitively viable; and that UP's cross-border traffic will receive fair treatment at the Laredo Bridge. UP has detailed its ideas for implementing these proposed conditions and its rationales for their imposition.

UP insists that the conditions it seeks are consistent with the Board's policy on end-to-end (vertical) transactions because: although end-to-end consolidations typically present much less risk of harm than parallel consolidations, they can nonetheless give rise to anticompetitive effects in certain circumstances; although concerns about closing gateways were unwarranted in the context of most past end-to-end transactions, concerns about closing the Laredo gateway are appropriate in the context of the KCS/Tex Mex/TFM transaction where alternative U.S.-Mexico gateways are not adequate substitutes for Laredo; and the Board's policy of holding applicants to their commitments is the same for major and minor transactions, whether they are largely parallel or end-to-end.

UP contends that, although recent developments raise questions about whether the KCS/Tex Mex/TFM transaction will occur and may affect the timing of the two components of that transaction, such developments do not affect the need to preserve competition via the Laredo gateway in the event the KCS/Tex Mex/TFM transaction does occur. Therefore, if and when it acts on the KCS/TM application, the Board should take into consideration the combined effects of KCS control of Tex Mex and TFM, and should impose the conditions proposed by UP.

Burlington Northern and Santa Fe. BNSF advises that its interest in the KCS/TM transaction is to ensure that rail shippers relying on BNSF for access to south Texas and Mexican markets are not competitively worse off as a result of the transaction. BNSF contends that the Board should ensure that traffic can continue to flow freely and competitively through Laredo and Brownsville, important gateways for NAFTA traffic. Laredo is the most important Mexican gateway (it accounts for 75% of the value of all rail traffic between the U.S. and Mexico), and, therefore, maintaining an open gateway at Laredo is critical for ensuring the free flow of goods between the U.S. and Mexico. Laredo is a key gateway for at least three reasons: first, because Laredo is located on the most direct route between the major population and industrial centers of Mexico City and Monterrey and the central and eastern U.S.; second, because the infrastructure that has been built up at Laredo to handle significant traffic volumes on a timely basis makes Laredo one of the most efficient rail gateways from/to Mexico; and third, because Laredo is the principal juncture with TFM, which has exclusive access on the Mexican side of the northeastern Mexican gateways of Laredo/Nuevo Laredo and Brownsville/Matamoros. And Brownsville, though carrying less traffic than Laredo, is also a significant gateway for traffic from/to the areas of northeastern Mexico it can efficiently serve, particularly for grain processors and other producers near the Mexican border.

BNSF acknowledges that UP, which carried 84% of the traffic at Laredo in 2001, is the dominant railroad on the U.S. side of the Laredo gateway. BNSF insists, however, that although it has only an 8% share of the traffic at Laredo, it is nonetheless a critical competitor there, providing effective competitive discipline to UP. BNSF insists that, because it is the only carrier that can provide full replacement competition against UP at Laredo, maintaining BNSF's access to Laredo at competitively reasonable rates is critical for ensuring effective competition for shippers. According to BNSF, unless it continues to receive commercially reasonable rates and service from both Tex Mex and TFM, the proposed transaction could jeopardize the progress BNSF has made in providing customers relying on it as a competitive alternative to UP.

BNSF contends that, absent an open gateway condition, KCS's control over Tex Mex and TFM would give KCS numerous opportunities to reduce competitive options at Laredo and Brownsville. KCS could raise rates at Robstown for any traffic going over Tex Mex unless it originates from the KCS system or is routed to give KCS its longest haul; KCS could raise rates at Laredo for any traffic going over TFM that does not originate from the KCS/Tex Mex system or does not give that system its longest haul; KCS could discriminate against competing carriers on TFM by charging higher bridge fees or by reducing the crossing access that it would charge itself; and KCS could cause TFM and Tex Mex to discontinue providing value-added services to KCS's competitors, thus preventing those carriers from offering fully competitive services. BNSF claims KCS has effectively acknowledged that it intends to raise rates on BNSF traffic over Tex Mex and to use discriminatory pricing and service to divert traffic away from BNSF, even if that diversion results in inefficient routings.

BNSF contends that, if the KCS/TM transaction is not properly conditioned, shippers could be injured in two ways. First, because the combined NAFTA Rail will have the ability and incentive to divert traffic to its routes in the U.S., and because of inefficiencies in many of those routes, shippers may be forced to use longer, slower, less efficient service for rail transportation through Laredo and Brownsville. Second, to the extent that NAFTA Rail succeeds in diverting traffic from BNSF and thereby reduces BNSF's long-term competitiveness through Laredo and Brownsville, the KCS/TM transaction may lessen the competitive options open to many shippers that ship goods through those gateways. Such a lessening of competitive options, BNSF warns, threatens to undo the benefits that resulted from the conditions the Board imposed on the *UP/SP* merger, because KCS simply will not be able to replace BNSF as the primary competitive alternative to UP.

Other Mexican gateways do not offer a competitive alternative to Laredo and would not be able to ensure competitive discipline on UP if the KCS/TM transaction undermined BNSF's competitiveness at Laredo. BNSF contends that: (1) El Paso, Eagle Pass, and Brownsville lack the physical infrastructure that is in place at Laredo, and, as a result, dramatically increased shipper volumes moving through these gateways would strain existing capacity, resulting in delays for existing as well as rerouted traffic; (2) El Paso and Eagle Pass are out of route for most eastern shippers that ship via Laredo, adding further inefficiency at those gateways; (3) because the El Paso and Eagle Pass gateways provide interchange with Ferromex rather than with TFM, those gateways are ineffective as alternatives to Laredo, because, in practice, Ferromex cannot serve most shippers and receivers located on TFM; and (4) even aside from the fact that BNSF's only connection into Mexico at Brownsville would be over the KCS-controlled TFM, Brownsville cannot serve as a replacement to Laredo because the infrastructure of the track between Matamoros and the TFM main line cannot accommodate the traffic that moves through Laredo, and also because, for most TFM points, the route via Brownsville is longer and slower than the route via Laredo.

BNSF also contends that truck and water competition simply cannot serve as an effective replacement for open rail gateways. Although truck and water play an important role overall in transportation of goods between the U.S. and Mexico, many shippers of many commodities are dependent upon rail competition for competitive transportation options. Indeed, if the Board had believed that truck and water competition could act as effective replacements for rail competition through Laredo and Brownsville, it would not have conditioned its approval of the *UP/SP* transaction on access for both BNSF and KCS to Laredo and for BNSF to Brownsville.

BNSF requests that, if the Board finds the KCS/TM transaction to be in the public interest, the Board condition its approval of the transaction: by requiring applicants to honor the pledges and commitments they have made; by clarifying these pledges and commitments so that they achieve their intended purposes; by requiring applicants to maintain, for a 5-year period, the existing Tex Mex and TFM rates and services presently available for service in conjunction with BNSF, subject to RCAF-U adjustments; by retaining oversight authority during the 5-year period so that the Board may address any issues that arise and ensure that there is no adverse impact on competition; and by requiring applicants to provide, after the end of the 5-year period, commercially reasonable rates and services, subject to the jurisdiction of the Board. BNSF argues that the imposition of a condition to maintain open gateways at Robstown, Laredo, and Brownsville on a commercially reasonable basis would provide shippers and connecting carriers a safety net and regulatory jurisdictional backstop if the market did not function to preserve and permit the use of efficient routings, and it would do so without unduly affecting applicants' ability to offer shippers the benefits of the KCS/TM transaction.

BNSF suggests several clarifications to the applicants' pledges, and has advanced a multi-part explanation of its claim that the Robstown-Laredo-Brownsville open gateway condition it has proposed would be an appropriate remedy for the anticompetitive consequences of the KCS/TM transaction: (1) an "open gateway" condition is consistent with the Board's promise in its *New Merger Standards* decision, 5 S.T.B. at 563, that "major merger" applicants will henceforth be required "to present an effective plan to keep open major existing gateways;" (2) an open gateway condition is consistent with conditions imposed in other control proceedings, *see CN/IC*, 4 S.T.B. at 158-159, *CN/WC*, 5 S.T.B. at 902; (3) modern gateway commitments are easily distinguished from the anticompetitive and discredited *DT&I* conditions that the ICC routinely imposed in the past, *see* BNSF-4, Reishus V.S. at 21; (4) an open gateway condition is necessary to preserve BNSF's ability to offer effective "SP Replacement" competition; (5) in imposing an open gateway condition on the KCS/TM transaction, the Board should provide a transition mechanism to ensure that there are no significant market dislocations during the implementation period; and (6) the Board has jurisdiction to impose an open gateway condition at Laredo and Brownsville for cross-border traffic.

The Board has jurisdiction over KCS and Tex Mex, and can impose conditions in the U.S. public interest on KCS's acquisition of control of Tex Mex. The jurisdiction of the Board extends not only to domestic rail traffic but also to traffic moving between the U.S. and a foreign country. KCS's planned acquisition of control of TFM is closely related to KCS's planned acquisition of control of Tex Mex, and it is at least arguable that how KCS uses its control of TFM may be even more important than how KCS uses its control of Tex Mex, because TFM is the only carrier carrying traffic from/to Mexico via both Laredo and Brownsville. KCS's ability to use its control of Tex Mex and TFM to divert to KCSR-Tex Mex-TFM routings traffic that is now routed BNSF-Tex Mex-TFM or UP-TFM via Laredo and BNSF-TFM or UP-TFM via Brownsville depends on whether the Laredo and Brownsville gateways remain open, both physically and economically.

The Board need not be concerned that it is being asked to "regulate" in a foreign country because the issue here is cross-border traffic moving between the U.S. and Mexico — traffic in which the U.S., its shippers, and its railroads have a vital interest. The Board made clear in its *New Merger Standards* decision, 5 S.T.B. at 563-564, that the public interest is served when major gateways remain open in the wake of a merger. BNSF adds that, while Mexican or Canadian law may also have a role to play in keeping international gateways open, the Board must make its own judgment about the conditions that are appropriate to protect U.S. commerce when railroads seek approval for a transaction that involves cross-border traffic. *See also New Merger Standards*, 5 S.T.B. at 583-585. Finally, because KCS's control of Tex Mex and TFM will enable KCS to interfere with BNSF's ability to continue to provide efficient cross-border service via Laredo and Brownsville, the jurisdiction the Board has to enforce its *UP/SP* conditions allows the Board to require KCS to permit its controlled affiliates to continue commercially reasonable rates and practices with BNSF.

BNSF contends that recent developments respecting the KCS/TM and KCS/TFM transactions make it all the more important that the Board impose the conditions BNSF seeks. A temporary transition period in the range of 3 to 5 years, BNSF advises, will help to maintain stability in what is likely to be a complicated merger integration, because, although KCS has indicated that it intends to proceed with the two transactions, the difficulties that have arisen between KCS and Grupo TMM will create the potential for service disruptions upon closure and implementation. And, BNSF adds, stability pending the integration of the three NAFTA Rail railroads into a single network will be particularly important, because three rail lines in two countries will be combined, the transaction will be impacted by differing regulatory environments, the transaction will require a challenging integration of IT infrastructure, and two of the parties to the transaction may be involved in litigation until the transaction closes.

CSX. CSX's interests in the KCS/TM transaction reflect the operations of several CSX affiliates: CSXT, a Class I railroad that operates in 23 states, the District of Columbia, and two Canadian provinces; CSX Intermodal, Inc. (CSXI), a transcontinental intermodal transportation service company that provides, among other things, multimodal movement of containers and highway trailers across the United States and into key markets in Canada and Mexico; CSX de Mexico, S.A. de C.V., a company that provides personal attention and information to customers regarding available CSX services; and TRANSFLO Corporation, a company that operates terminals for the transloading of bulk materials between transportation modes, primarily truck and rail.

CSX reports that the movement of freight from/to Mexico has become a significant and growing part of the transportation business of CSXT and CSXI (in 2002 alone, the 103,515 carloads that CSX and its affiliates handled from/to Mexico generated over $100 million in revenues to CSX). CSX further reports that virtually all CSXT traffic moving from/to Mexico is handled on a joint-line basis either with UP (CSXT's predominant interline partner), BNSF, or KCS. CSX advises that CSXI has joined with UP and KCS/Tex Mex to promote the use of containers and trailers in moving intermodal freight from/to Mexico. CSX notes, by way of example, that CSXI has worked with a major customer and UP to establish regular service between

Detroit and manufacturing facilities in Mexico for the movement of automotive parts needed for the assembly of finished vehicles. CSX also notes that the "NAFTA Express" program was established by CSXI, KCS, and Tex Mex to make available North American Container System equipment in serving the general transportation needs of a broad spectrum of intermodal users desiring transportation from/to Mexico.

CSX emphasizes that Laredo is the primary and most important rail gateway between the United States and Mexico. CSX notes that 80% of CSXT-UP joint-line traffic from/to Mexico is routed via Laredo, which is also the primary crossing point for CSXT-KCS joint-line traffic from/to Mexico. CSX argues that, if KCS successfully completes its intended transactions and acquires control of both Tex Mex and TFM, the new NAFTA Rail would be able to exercise control over the Laredo gateway in a manner that could discourage and substantially reduce competition for rail transportation services from/to important commercial locations in Mexico.

While it is pleased that applicants have made commitments designed to facilitate continued competition for freight traffic from/to Mexico (particularly via Laredo), CSX believes that these commitments, and particularly KCS's pledge to keep the Laredo gateway open on commercially reasonable terms, should be given greater substance. CSX therefore asks that the Board impose a condition that would require applicants to honor the commitments they have undertaken with respect to the Laredo gateway, specifically: to keep the Laredo gateway open on commercially reasonable terms; to treat all carriers fairly at the Laredo Bridge; to continue to work with UP and BNSF to provide reasonable interchange and operating conditions for those carriers; and to honor all existing Tex Mex and TFM agreements for their full terms. CSX also asks that the Board impose oversight and monitoring of applicants' compliance for an appropriate period. These conditions are consistent with the Board's recent practice of holding control applicants to their commitments and of requiring a reasonable period of oversight and monitoring. These conditions also would help to ensure the maintenance of vigorous competition for rail freight traffic between the United States and important commercial locations in Mexico.

CSX contends that recent actions in Mexico have created some doubt as to whether applicants will succeed in acquiring control of TFM and perhaps even as to whether KCS will ultimately retain its controlling interest in Tex Mex. Nevertheless it is essential that the Board address the entire set of transactions proposed by applicants because KCS has said that it remains committed to pursuing the full NAFTA Rail transaction.

Norfolk Southern. NS operates 21,500 route miles in 22 States, the District of Columbia, and the province of Ontario, maintains an extensive intermodal network, and provides comprehensive logistics services to its customers. NS advises that its interests in this proceeding involve the potential effects of the Tex Mex and TFM transactions on the operation of KCS's "Meridian Speedway" line between Dallas, TX, and Meridian, MS; and the maintenance of Laredo as an efficient key interchange point for NS-Mexican traffic.

NS, working with KCS, provides transcontinental intermodal (as well as carload) through service between points on the West Coast and in the Southwest United States, on the one hand, and points in the Southeast United States, on the other. NS further reports that KCS is a vital link in this service, because it provides the connection between BNSF in Dallas and NS in Meridian, hauling traffic in both directions between the two railroads. NS adds that routing traffic over the Meridian Speedway provides an effective, and often more efficient, alternative to routes through the other two primary east-west gateways in the southern United States (Memphis and New Orleans, both of which can become congested). The availability of the Meridian Speedway, NS insists, enhances competition for east-west rail service, and offers an important alternative to service through the Memphis and New Orleans gateways. The traffic routed via the Meridian Speedway is substantial (210,700 carloads in 2002 alone).

It is essential to the maintenance and growth of the NS-BNSF transcontinental service now provided via the Meridian Speedway that the new NAFTA Rail continue to maintain the Dallas-Meridian line and continue to provide good, reliable, quality service over that line. NS is concerned, however, that the new NAFTA Rail's focus on north-south and cross-border traffic may unduly divert attention and resources away from its Dallas-Meridian service, which in turn could reduce the effectiveness and competitiveness of east-west rail service over the Meridian Speedway. Any erosion in the quality of service over the Meridian Speedway as a result of the proposed transactions would likely reduce east-west rail transportation competition, which would be detrimental to shippers and consumers. Shippers could suffer from reduced price and routing competition for rail transportation.

Next, NS contends that the Laredo gateway is the largest and most important rail gateway between the United States and Mexico (due to Laredo's superior infrastructure and its location on the shortest route between many U.S. points, particularly points in the Midwestern and Eastern United States, on the one hand, and many Mexican points, on the other, particularly major Mexican industrial and population centers). NS further contends that the primary routes for cross-border traffic, including the large and growing volumes of automobiles and automobile parts, are via the Laredo gateway. If KCS acquires control of both Tex Mex and TFM, the new NAFTA Rail will fully control the Laredo gateway and the best and most direct rail routes between the Mexican border and such "TFM Corridor" points as Mexico City, Monterrey, Veracruz, and Tampico. To an overwhelming extent, the prospects for growth in trade over the TFM Corridor will depend on the continued vitality of competition for cross-border traffic through the Laredo gateway.

NS asks that the Board impose a condition requiring applicants to adhere to their commitments regarding the Laredo gateway and that the Board give this condition practical effect and enforce ability by imposing, for an appropriate period, a continuing oversight and monitoring requirement. The conditions NS seeks respecting Laredo are consistent with the Board's recent practice in control proceedings and are necessary to facilitate the growth of cross-border trade and transportation on competitive terms.

NS contends that, although recent actions in Mexico have created some doubt as to whether applicants will succeed in acquiring control of TFM (and perhaps even as to whether KCS will ultimately retain its controlling interest in Tex Mex), the Board should nevertheless address the entire set of transactions proposed by applicants because KCS has repeatedly expressed its continuing commitment to completing the proposed transactions, including the acquisition of a controlling interest in TFM.

Canadian Pacific. CP contends that trade between Canada and Mexico has experienced exponential growth as a result of NAFTA. Between 1993 (the year before NAFTA went into effect) and 2002, Canada's imports from Mexico increased at an annual rate of 14.6%, and Canada's exports to Mexico increased at an annual rate of 12.6%. The continued growth of this Canada-Mexico NAFTA trade depends upon the availability of competitive transportation alternatives. TFM and the Laredo gateway occupy a critical position in the rapidly expanding North American trade network. Laredo now serves as the primary rail gateway between the United States and Mexico (due to Laredo's superior infrastructure, such as customs brokers, and its location on the shortest route between major Mexican industrial and population centers and the Midwest and Eastern U.S.). Laredo is also by far the most efficient gateway for rail traffic moving between Canada and Mexico: nearly 90% of all rail traffic handled by CP from/to Mexico currently moves via Laredo. Traffic handled from/to Mexico by CN pursuant to its alliance with KCS likewise moves via Laredo.

Although the U.S. side of the Laredo gateway is served directly by two railroads (UP and Tex Mex), the Mexican side of the Laredo gateway is served exclusively by a single railroad (TFM). CP warns that the cumulative result of KCS's plan to acquire control of both Tex Mex and TFM would be to give a single rail system (the new NAFTA Rail) control not only of one of the two U.S. carriers serving the Laredo gateway but also of the only Mexican carrier serving that gateway. By way of contrast, each of the three principal U.S./Canada rail gateways — Detroit, Chicago, and the Twin Cities — is served on both sides by multiple Class I railroads, thus allowing shippers to enjoy a choice of competitive routing options on both sides of the border.

CP acknowledges that its rail lines do not reach Laredo, or any other Mexican border crossing. Traffic moving between points served by CP in the United States and Canada, on the one hand, and points in Mexico, on the other, is interchanged with other carriers (primarily UP) for movement to the Mexican border. CP is vitally interested in TFM's continued willingness to participate in cross-border traffic with CP (via UP) on commercially reasonable terms. CP warns that if a combined KCSR/TM/TFM system were to close the Laredo gateway either physically or commercially, shippers would lose the benefit of the efficient, competitive rail services now offered by CP in conjunction with UP in the NAFTA corridor.

CP notes that applicants have indicated a general willingness to keep the Laredo gateway open on commercially reasonable terms. However, that applicants have thus far declined to identify on the record the specific measures that they would take to implement this commitment. In view of the significance of the Laredo gateway to North American trade, the future competitive viability of interline routes connecting Mexico and the rest of the North American continent via Laredo is simply too important to leave to chance. *Cf. CN/IC*, 4 S.T.B. at 156 (in view of the importance of the Detroit River Tunnel to international trade, the Board imposed a condition holding applicants to their representation that they would not frustrate necessary improvements to the tunnel).

CP asks that the Board assure the continued vitality of rail competition for NAFTA traffic by imposing a condition that will give substance to applicants' commitment to keep the Laredo gateway open on commercially reasonable terms. CP asks that the Board impose a condition requiring applicants to enter into a written agreement that will assure the future ability of all North American railroads to offer competitive interline rail service from/to Mexico via the Laredo gateway on commercially reasonable terms, and CP suggests several terms of such an agreement.

CP contends that the condition it proposes is consistent with the policy articulated in the Board's "major merger" rules. *See New Merger Standards*, slip op. 5 S.T.B. at 561-562. Although the new rules do not formally apply to this proceeding, the Board has followed a similar policy in recent "minor" cases. *See CN/WC*, 5 S.T.B at 902 (holding applicants to their pledge to keep all existing active gateways affected by the CN/WC transaction open on commercially reasonable terms). CP insists that, given the importance of the Laredo gateway to North American trade, the Board should likewise require KCS to agree to an effective plan to preserve rail competition via Laredo, which goes beyond the vague promises offered by applicants to date.

The Board has legal authority to impose a condition to remedy the potential anticompetitive effects of the creation of a combined KCSR/TM/TFM system. The fact that KCS does not need Board authorization for its acquisition of TFM is not a bar to imposing the condition requested by CP. In *CN/IC*, the Board rejected a similar claim by the CN/IC applicants that the Board lacked authority to remedy the effects of a settlement agreement entered into by the CN/IC applicants in connection with the transaction, simply because the settlement agreement itself was not subject to Board approval. *See CN/IC*, 4 S.T.B. at 154. CP insists that KCS's proposal to bring TFM under common control with KCSR and Tex Mex is even more closely related to the KCS/TM transaction than the settlement agreement at issue in *CN/IC* was to the CN/IC transaction.

CP acknowledges that Grupo TMM's shareholders voted to reject the KCS/TFM transaction. Nevertheless, the public interest requires the Board to continue to evaluate "the broader transaction," *Decision No. 2*, slip op. at 11, and not merely the KCS/TM transaction, because KCS has indicated that it intends to continue to move forward with the KCS/TFM transaction.

Canadian National. CN reiterates its argument, discussed in the body of our decision today, that applicants have not provided the Board with enough information to determine the cumulative effects on transportation in the

United States of the combined Tex Mex and TFM transactions. CN insists that actions taken by KCS and its affiliates, including TFM, are not beyond the Board's jurisdiction to the extent they involve or affect transportation in the United States, citing *Canada Southern,* slip op. at 8.

CN urges the Board to examine the record carefully to determine whether KCS has provided sufficient information to permit the Board to resolve whether, once KCS has control of TFM, KCS can be expected to seek to recover a cost-of-capital return on its investment in TFM and Tex Mex through enhancements of the efficiency of TFM or through an exercise of TFM's market power that may reduce efficiencies. This is a legitimate economic question that is relevant to the Board's examination of these transactions. It is especially pertinent in view of KCS's assertions that it has no plans to make changes in the operations of TFM or to integrate TFM's operations with those of Tex Mex and KCSR has said that it plans to "grow the business" on TFM, but has given no indication how it plans to do so and thus increase KCS earnings sufficiently to recover its investment.

CN contends that because TFM, as the only Mexican railroad that reaches Laredo, has substantial market power with respect to rail traffic moving from/to the U.S. via Laredo, KCS, by acquiring TFM, is acquiring a well-assured earnings stream. CN further contends: that, because TFM is not publicly traded, there is no ready means of determining whether the purchase price that KCS has agreed to pay for TFM includes a premium beyond the present value of that earnings stream; that, however, it would be most unusual if the purchase price did not include such a premium; that, in the overwhelming majority of acquisitions of publicly traded companies, the purchaser pays a premium over the prevailing market price for the target firm, often in excess of 25%; that there is no evident reason why Grupo TMM would not have successfully demanded a premium for control of the major Mexican railroad, which has a bottleneck position in what are probably the fastest growing rail traffic flows in North America; and that there would be little reason for Grupo TMM's debt holders to consent to a sale without a premium. CN insists that, because a control premium is a plausible and unrebutted possibility, a prudent economic analysis must take seriously the questions that a control premium would raise.

A control premium means that the acquiring railroad expects the increase in its earnings as a result of the acquisition to be greater than simply the pre-merger earnings of the acquired railroad. CN adds that there are essentially three ways that this additional increase in "contribution" (the excess of revenues over variable costs) can occur. The first way is to increase efficiency (by lowering costs, or by improving service without a corresponding price increase); the second way is to expand output (at profitable prices) over an existing infrastructure, through improved marketing, sales, or product development; and the third way is to exploit additional market power. CN insists that the questions it claims KCS has failed to answer relate to which of these alternatives is the intended and likely result of KCS's acquisition of TFM.

CN argues that because KCS has indicated that it does not anticipate increased efficiency or improved marketing, sales, or product development, KCS may be anticipating the exploitation of additional market power. Against this background, the Board cannot conclude that the effects of KCS's acquisition of TFM on U.S. rail movements, in conjunction with its acquisition of Tex Mex, will be neutral or pro-competitive.

CN argues that Board approval of the KCS/TM transaction, without more information relating to the consequences in the United States of the combined KCS/TM and KCS/TFM transactions, makes it especially important that the Board impose conditions on the KCS/TM transaction allowing for continuing Board oversight of KCS's plans with respect to TFM. CN contends that the Board should impose four conditions: (1) require applicants to meet the commitments they have made on the record, including their pledge that TFM shall deal with all carriers at Laredo on reasonable commercial terms, in an efficient and pro-competitive manner, with the Board retaining jurisdiction to investigate any step taken or not taken to meet those commitments; (2) ensure that KCS's future actions with respect to TFM are "transparent" by requiring that any KCS agreements in this regard be made available, subject to the customary confidentiality protections, to concerned parties; (3) require KCS to stipulate that it will not object on jurisdictional grounds to the Board's reopening of this proceeding to consider allegations that KCS, as a result of its control of Tex Mex or TFM, is acting to reduce competition or efficiency in U.S. markets; and (4) explicitly state that any antitrust or other legal immunity flowing from the Board's approval of the KCS/TM transaction extends only as necessary to carry out that transaction and not to carrying out any aspect of the KCS/TFM transaction.

CN contends that recent developments that appear to have delayed, if not put in jeopardy, the KCS/TM and KCS/TFM transactions require the Board to determine whether this proceeding should go forward at all with respect to the KCS/TM transaction, and, if so, what actions the Board should take with respect to the KCS/TFM transaction.

CN contends that, if the Board chooses to approve the KCS/TM transaction, the Board should impose certain precautionary conditions and other limitations to assure that, if the KCS/TFM transaction eventually occurs, the Board and the parties will be in a position to mitigate any potential anticompetitive or adverse environmental effects in this country of KCS's common control of Tex Mex and TFM. If the Board chooses to approve the KCS/TM transaction, the Board should, at a minimum: (1) condition approval of the Tex Mex transaction on a stipulation by KCS that it will not consummate any transaction to acquire control of TFM without prior Board review in this proceeding of the implications of KCS's common control of Tex Mex and TFM on transportation in the United States; and (2) expressly reserve jurisdiction and provide that, if KCS acquires control of Tex Mex and TFM, the Board will reopen this proceeding to consider imposing additional conditions and oversight.

Dakota, Minnesota & Eastern Railroad Corporation. DM&E supports the KCS/TM application because it believes that common control of KCS and

Tex Mex and single-line access into Mexico will facilitate the growth of traffic between points served by DM&E/IC&E and points in the Mexican market. DM&E adds that common control of KCS and Tex Mex could benefit the joint marketing efforts now undertaken by DM&E/IC&E and KCS, and enable DM&E/IC&E to provide expanded service to its customers.

APPENDIX B: COMMENTS OF OTHER PARTIES (SUBMITTED IN 2003)

The National Industrial Transportation League. NITL is an association of companies that conduct industrial and/or commercial enterprises throughout the United States and internationally, and are concerned with the transportation of goods in domestic and international commerce. On August 1, 2003, NITL and KCS entered into an agreement (the NITL/KCS Agreement) containing provisions that will protect NITL members and other rail shippers from anticompetitive effects, if any should arise as a result of the KCS/TM transaction. The NITL/KCS Agreement offers significant contributions to the public interest by satisfying major concerns of the rail customers that might be affected by the KCS/TM transaction by providing for protection of rates and services through existing Tex Mex interchanges with any rail carrier, and addressing some of the transnational effects of the KCS/TFM transaction. NITL contends that, in view of the commitments made by KCS in the NITL/KCS Agreement, the Board should approve the KCS/TM transaction. Further, because the terms of the NITL/KCS Agreement may address certain issues respecting the competitive effects of the KCS/TFM transaction, the Board should impose as a condition the terms of NITL/KCS Agreement.

NITL notes that in similar circumstances in *CN/WC*, the Board declined to impose the terms of a NITL/CN Agreement as a condition, because it found there was no evidence indicating that the terms of the NITL/CN Agreement must be imposed as a condition to remedy adverse consequences of the control transaction. *CN/WC*, 5 S.T.B. at 901. The circumstances differed there because neither NITL nor CN had asked the Board to impose the terms of the agreement as a condition. *Id.* But here the KCS/TM transaction and the KCS/TFM transaction are two components of a single, larger transaction with broader potential implications, and the terms of the NITL/KCS Agreement may address issues raised about the competitive effects of the KCS/TFM transaction. However, even if the terms of the NITL/KCS Agreement are not imposed as a condition, the NITL/KCS Agreement is still binding on the parties thereto and their beneficiaries, and can be enforced accordingly.

The NITL/KCS Agreement consists of seven numbered sections that record the terms on which NITL has agreed to support the KCS/TM transaction and the promises given by KCS to NITL for the benefit of the members of the shipping public. Section 1 provides that NITL will support approval of the KCS/TM transaction, and that either NITL or KCS may request to have the NITL/KCS Agreement made a condition of the KCS/TM transaction. Section 2 provides that KCS and/or Tex Mex will establish and maintain commercially reasonable rates and charges over any existing interchange, and that existing agreements will be honored to their expiration date. Section 3 provides for protection of confidential shipper information, and Section 4 provides that KCS will maintain and strive to improve the service levels between Beaumont and Laredo. Section 5 provides that, aside from each party's obligations under Section 1, the rights and obligations set forth in the Agreement are contingent upon, and will become effective only on the date of, acquisition by KCS of control of Tex Mex and TFM. Section 6 provides for arbitration of the agreement in case of U.S.-related disputes, governed by District of Columbia law. However, any disputes arising under the Agreement with respect to matters within Mexico, including disputes involving rates or rate factors in Mexico, will be resolved in accordance with the requirements established by the Government of Mexico.

NITL and KCS have explained and clarified certain aspects of their Agreement. *See* NITL-4 (filed August 18, 2003). Section 2(a) will not require NAFTA Rail to establish and maintain commercially reasonable contract or common carrier rates and charges with respect to traffic interchanged between UP and TFM at Laredo, but only such traffic as is interchanged between KCSR or Tex Mex, on the one hand, and another U.S. railroad, such as BNSF at Robstown, on the other. With respect to through movements between Mexico and the United States that are interchanged between Tex Mex or KCSR, and another U.S. railroad (e.g., traffic routed TFM-Tex Mex-BNSF, TFM-Tex Mex-UP, TFM-Tex Mex-KCSR-BNSF, or TFM-Tex Mex-KCSR-UP), NITL and KCS have clarified that Section 2(a) would require NAFTA Rail to use its control of TFM to cause TFM to establish and maintain commercially reasonable rates and charges for TFM's portion of such through movements. This clarification reflects that the "commercially reasonable contract or common carrier rates and charges" that Section 2(a) requires KCS and/or Tex Mex to establish include the rates and charges applicable to the TFM portion of Mexico-U.S. through movements that are interchanged between Tex Mex or KCSR, on the one hand, and another U.S. railroad, on the other hand. To take advantage of Section 2(a)'s "commercially reasonable rates" provision, it would be customary and appropriate for a connecting railroad to disclose to the serving railroad the minimum information necessary to obtain the appropriate rate division or rate factor and other terms of carriage necessary to offer a commercially reasonable rate or charge for a through movement. Whether rates and charges are "commercially reasonable" would be determined with reference to the rates and charges as a whole, and not with reference to individual railroad divisions or rate factors.

With regard to Section 3's confidentiality protection, Section 3 would not prevent TFM from discussing with UP shipper needs for joint moves as long as information about shipper needs does not include "confidential commercial information about a shipper's move, including transportation services and rates." NITL and KCS have acknowledged that Section 3, by its terms, would allow NAFTA Rail to share with KCS and Tex Mex confidential information about a shipper's move acquired by TFM as a result of participation in

UP-TFM movements. However, other agreements entered into by TFM and/or other provisions of law might prohibit the sharing of such information.

UP's Analysis Of The NITL/KCS Agreement; Relief Requested. UP contends that the Board should impose the NITL/KCS Agreement, except for Section 3, as a condition. Whether or not the Board imposes the NITL/KCS Agreement as a condition, UP urges the Board to find Section 3 of the Agreement to be anticompetitive and asks that we direct NITL and applicants to remove it from the Agreement. UP further contends that, because the NITL/KCS Agreement does not adequately address the competitive harms that would be caused by KCS's control of both Tex Mex and TFM, the Board should impose UP's proposed conditions in addition to the NITL/KCS Agreement.

BNSF's Analysis Of The NITL/KCS Agreement; Relief Requested. BNSF argues that the NITL/KCS Agreement has a number of deficiencies that should be addressed either through amendments to the Agreement or through conditions to the Board's approval of the proposed transaction. BNSF contends that the NITL/KCS Agreement will not require NAFTA Rail to establish and maintain commercially reasonable rates and charges with respect to traffic interchanged between TFM and U.S. carriers. BNSF next contends that the NITL/KCS Agreement does not define "commercially reasonable" rates, and leaves open the possibility that the "commercially reasonable" obligation may not apply to the division demanded by the NAFTA Rail entities but only to the through rate that shippers pay for the joint-line movement. BNSF submits that a proper definition of the term would be that "commercially reasonable" rates and charges are such as to permit BNSF and UP to continue to compete for traffic as to which they can provide rail customers equal or more efficient service than can be provided by the NAFTA Rail carriers. Third, BNSF contends that the NITL/KCS Agreement does not address rate agreements between TFM and other carriers, or marketing, operational, and service agreements between KCS, Tex Mex, and/or TFM and other carriers. BNSF notes that Section 2(b) does not mention whether existing agreements between TFM and other carriers would be honored and whether replacement agreements would be negotiated in good faith. Section 2(b) addresses only existing rate agreements, whereas similar protection is needed for existing marketing, operational, and service agreements. BNSF contends that the NITL/KCS Agreement does not require the NAFTA Rail carriers to provide neutral and non-discriminatory interline service both at Laredo and Brownsville and over their lines. Finally, BNSF contends that the NITL/KCS Agreement does not require formal Board oversight of the transaction.

CSX's Analysis Of The NITL/KCS Agreement. CSX believes that the NITL/KCS Agreement does not fully address the potential effect on competition for rail traffic from/to Mexico via Laredo of the entire NAFTA Rail transaction (i.e., the KCS/TM and KCS/TFM transactions combined). The NITL/KCS Agreement would not require NAFTA Rail to maintain commercially reasonable rates for traffic interchanged between TFM and UP at Laredo, and it does not address all of the commitments applicants have made in this proceeding concerning the Laredo gateway.

NS's Analysis Of The NITL/KCS Agreement. NS contends that the NITL/KCS Agreement does not fully address the potential effect of the entire NAFTA Rail transaction on competition for rail traffic from/to Mexico via Laredo, because the Agreement would not require NAFTA Rail to maintain commercially reasonable rates for traffic interchanged at Laredo between TFM and UP.

CP's Analysis Of The NITL/KCS Agreement. CP contends that the NITL/KCS Agreement falls far short of ensuring that non-applicant railroads will be able to access the Laredo gateway on commercially reasonable terms following the creation of NAFTA Rail. The Agreement will not require NAFTA Rail to establish and maintain commercially reasonable rates and charges with respect to traffic interchanged between UP and TFM at Laredo, because the Agreement applies only to U.S.-Mexico cross-border movements in which KCS and/or Tex Mex are participating carriers. Indeed the "protections" afforded by the Agreement appear to be intended primarily to preserve existing interline routes at interchange points other than Laredo.

DOT's Analysis Of The NITL/KCS Agreement. DOT believes that, although the NITL/KCS Agreement holds promise for resolution of some disputes respecting commercially reasonable rates, the Agreement appears to fall short of ensuring effective transportation alternatives for shippers using the Laredo gateway for traffic from/to Mexico. The Agreement apparently would not apply to rates provided to UP for movement over TFM. Even for routings and through rates using a TFM interchange with KCS/Tex Mex, the Agreement's dispute resolution procedures apparently would allow an arbitrator to rule on the through rate as a whole, and separately on the part of the through rate for movement in the U.S., but not on the part of the through rate for movement in Mexico. Because the implications of a possible acquisition of TFM for ratemaking and resolution of disputes with UP for joint UP-TFM movements are uncertain, consummation of the KCS/TFM transaction may result in a loss of shipper transportation alternatives at Laredo.

The American Chemistry Council. ACC commends KCS for its commitment to support Tex Mex's participation in ACC's "Responsible Care" initiative, with a target of full implementation by December 2004. ACC advises that Responsible Care, a voluntary program to achieve improvements in environmental, health, and safety performance beyond levels required by the U.S. government, has resulted in significant reductions in releases to air, land, and water; major improvements in workplace and community safety; and expanded programs to research and test chemicals for potential health and environmental impacts. ACC also commends KCS for working with Tex Mex and DuPont to offer training for emergency responders in Laredo in 2004.

The Port of Houston Authority. PHA supports the KCS/TM transaction. PHA believes that having KCSR and Tex Mex under common management with common objectives would provide an opportunity to shift existing roadway traffic to rail and to gain additional marine cargoes through the Port of Houston destined to Mexican points. PHA contends that, with effective coordinated through intermodal service with TFM, cargoes now moving between the Port of Houston and Monterrey by truck could be attracted to rail, and cargoes originating in or destined to Mexico City could be attracted to use the Port of Houston. PHA adds that the broader perspective provided by common control could make a Houston-Mexico intermodal service attractive to the combined system, though it might not have been attractive to an independent Tex Mex.

PHA, a political subdivision of the State of Texas that owns and operates the public facilities located on the Houston Ship Channel, reports that, in 2002, the Port of Houston served 81 steamship lines, with over 6,400 vessel calls and over 150,000 barge movements. Each year, the Port of Houston handles over one million 20-foot-equivalent-container units. The Port's facilities handle general cargo, containers, grain and other dry bulk materials, project and heavy-lift cargo, and virtually any other kind of cargo. The public facilities that are owned and operated by PHA include 53 general cargo wharves available for public hire and two liquid cargo wharves.

The Port of Houston is served by three line-haul railroads (UP, BNSF, and Tex Mex). Most of the facilities along the Houston Ship Channel are switched by The Port Terminal Railway Association (PTRA), an unincorporated association of PHA and the three line-haul railroads serving Houston, which provides shippers efficient and equal access to all three line-haul railroads. Whereas the shipment volumes handled from/to the Port of Houston by Tex Mex have been low to date (generally less than 1% of the carloads handled by PTRA), common control of KCSR, Tex Mex, and TFM will make the Tex Mex/TFM routing more efficient and should allow Tex Mex to attract additional traffic that currently moves from Houston by truck.

In recent years, PHA has made substantial investments in rail facilities to handle containers in intermodal rail service. In the last 6 years, PHA rebuilt and expanded the rail ramp at its Barbours Cut Container Terminal (BCT) to handle increased volumes (container volumes at BCT increased 57% from 1996 to 2002) and built 11 miles of additional main line track on UP right-of-way to facilitate rail-to-rail competition at BCT and to relieve severe congestion that had regularly delayed train movements to/from BCT. PHA plans to build another container terminal, larger than BCT, at Bayport, with more than triple the capacity of the rail facilities at BCT. Pursuant to a 1995 PHA-UP agreement, PHA will also construct an additional 7-mile rail line on UP's right-of-way to assure rail-to-rail competition and adequate main line capacity for the Bayport Terminal.

PHA advises that its recent and planned investments in rail infrastructure are related to its overall plan to build additional capacity in its container-handling facilities to handle anticipated growth in containerized shipments and thereby to strengthen its leadership position in container handling among the U.S. Gulf ports. Although some of that volume growth will be fueled by growth in the local Houston market (which requires only local truck drayage to move cargoes from the port to the receiver), effective inland rail service will be required to draw to the Port of Houston cargoes moving from/to points beyond the local truck-served market. Although the UP and BNSF rail systems provide broad inland reach throughout the western United States (including direct train service from the BCT rail ramp to the Port of Los Angeles), there is currently no rail intermodal service from BCT to Mexican destinations. PHA believes that there is a substantial market that could be served if there were effective rail service from BCT (and eventually from the Bayport Terminal) to Monterrey and Mexico City. PHA reports that containerized cargoes to/from Monterrey that now use the Port of Houston are transported between Houston and Monterrey by truck and that efficient rail intermodal service from the Port of Houston to Monterrey could shift those cargo movements from truck to rail. Whereas containerized cargoes to/from Mexico City generally do not now use the Port of Houston, an efficient and cost-effective rail intermodal service such as the new NAFTA Rail from Houston to Mexico City could draw additional containerized cargoes to the Port of Houston.

Pacer International. Pacer, an intermodal transportation and logistics services company, provides a comprehensive portfolio of freight transportation, logistics, and other related services directly to shippers and other beneficial owners, including retail intermodal transportation services, trucking services, warehousing services, and international ocean carrier, freight forwarding, logistics, and customs brokerage services. Pacer advises that, in 2002, it moved approximately 16,000 intermodal container loads of freight between the United States and Mexico utilizing the services of its underlying rail carriers, including KCSR. Pacer also provides double-stack and related intermodal rail transportation services for full intermodal container loads of freight over a 50,000-mile North American railroad network, operating out of 54 terminal locations in the United States and 11 terminal locations in Mexico. Pacer Stacktrain, which operates its own fleet of intermodal equipment (including more than 1,800 rail cars, 21,000 containers, and 23,000 chassis), moves more than 1,000,000 full container loads per year in the North American rail network. Pacer claims that Pacer Stacktrain, as a "neutral" stacktrain operator, offers high quality, reliable, cost-efficient intermodal rail transportation services to its customers, which consist primarily of intermodal marketing companies, large automotive intermediaries, and international steamship lines.

As a non-railroad supplier of intermodal logistics, Pacer Stacktrain's relationships with the railroads and its ability to deal with them on fair terms are critical to its customers and to its business, a significant portion of which is U.S.-Mexican trade. Today, Pacer Stacktrain's substantial volume of intermodal U.S.-Mexico traffic travels primarily under contracts with UP in the United States and with TFM in Mexico, with connections at the Laredo Bridge. Pacer Stacktrain runs continuous trains across the border with only the locomotive and/or crews changed at the crossing. All of these trains run over the Laredo Bridge because it provides the safest and most direct — and therefore the fastest — route for traffic between Pacer Stacktrain's customers (mostly in Chicago, Detroit, and eastern Canada) and the manufacturing, distribution, and commercial centers around Mexico City and Monterrey. Over the past 5 five years, Pacer Stacktrain has handled over 800,000 trans-border shipments with an average annual growth rate of 11% (in 2002, it moved 137,000 loaded containers over the Laredo gateway).

In view of the operational superiority of the Laredo gateway, Laredo is the primary border crossing for Pacer's NAFTA traffic that moves from/to Mexico's major markets. Pacer explains that the vast majority of its Laredo container traffic involves the movement of auto parts and vehicle assembly components to various manufacturing facilities in central Mexico; that stringent performance measures have been established with UP and TFM to ensure the accomplishment of "just-in-time" delivery of the freight for Pacer's automobile and other customers; and that Pacer's 55-hour schedule from Chicago to Laredo for these shippers cannot be matched via potential alternative gateways such as Nogales, El Paso, Eagle Pass, and Brownsville.

Pacer is concerned about the potential anticompetitive impact of the KCS/TM transaction on cross-border traffic flowing through the Laredo gateway. Pacer warns that KCS will have economic incentives to maximize single-route traffic over its own lines; that, to achieve a return on its investment in the NAFTA Rail companies and to meet the more immediate debt service and covenant maintenance requirements of its highly leveraged capital structure,[11] KCS may be required to prioritize traffic handled by NAFTA Rail over traffic handled by other railroads; and that, in seeking to maximize single-line traffic over its tracks, the new NAFTA Rail would be forced to favor its traffic over that of other U.S. carriers where bottlenecks exist, such as at the Laredo Bridge. Under the combined NAFTA Rail ownership, TFM will have the same economic pressures and incentives post-merger to favor U.S. traffic that uses KCSR and/or Tex Mex over other carriers. The negative impact of these economic pressures and incentives and KCS's resultant actions could have severe consequences on the NAFTA trade and on competing railroads' customers, such as Pacer.

Pacer warns that, for the first time in its history, the Laredo Bridge will be under common ownership with a U.S. Class I railroad that connects at the Laredo gateway, eliminating the incentive the Laredo Bridge formerly had to operate neutrally. Pacer fears that KCS, by acquiring not only Tex Mex but also the Laredo Bridge, will have the incentive and the ability to operate the Laredo Bridge so as to favor and prioritize KCSR/TM traffic over that of all other railroads. Pacer contends that KCS's interest in maximizing KCS traffic

[11] Pacer claims (in its 2003 comments) that major U.S. credit rating agencies have downgraded KCS's credit rating.

over Tex Mex and the Bridge will affect management in a manner that could wreak havoc for much of the cross-border NAFTA traffic, including Pacer Stacktrain's time-sensitive intermodal traffic. KCS will be able to set schedules and other operating conditions in a manner that favors shipments traveling on the new NAFTA Rail to the detriment of shipments traveling on competing railroads, such as UP. No assurance can be gained from KCS's vague promise that it will continue to work with UP and BNSF to keep the Laredo gateway open on commercially reasonable terms. Rather, KCS should be required to guarantee non-discriminatory treatment.

The companion KCS/TFM transaction will increase KCS's economic pressures and incentives and will further enhance its ability to undertake conduct that will have anticompetitive effects on NAFTA trade. KCS should not be permitted to increase the traffic on its rail network by discrimination in access to bottleneck facilities, which will harm both competitor railroads and the shippers that depend on them. Pacer warns that TFM's incentives will be dramatically altered by the proposed combinations. Pacer contends that the new NAFTA Rail will seek to maximize single-route traffic by shifting TFM traffic to KCSR-Tex Mex routes from competing railroads; that, to accomplish this, TFM may discriminate against railroads that compete with KCSR-Tex Mex and the shippers that do business with them; and that, by exercising bottleneck control, or setting discriminatory rates, schedules, and other operating conditions, TFM could leave shippers with no real option at Laredo other than NAFTA Rail. If the Board determines that it lacks jurisdiction over TFM, it will be even more critical to impose conditions in the United States sufficient to ensure non-discriminatory treatment at the U.S. side of the Laredo gateway as a check on any potential discriminatory conduct of TFM.

Pacer warns that implementation of KCS's MCS on Tex Mex and TFM could threaten Laredo gateway traffic. The installation of MCS on KCSR created a number of difficulties, including serious delays (especially at major interchanges), build-up of loaded cars with nowhere to go, loads damaged from sitting in yards for too long, congestion, lost cars, and "ping-pong" cars (cars that leave loaded and, though still loaded, return labeled "empty"). The installation of MCS on Tex Mex and TFM could well be accompanied by similar difficulties with repercussions for connecting railroads. Thus, the Board should impose discipline, oversight, and monitoring of the MCS-implementation process to ensure minimal service disruptions affecting the Laredo gateway. Pacer is similarly concerned about KCS's planned capital investment program for Tex Mex track upgrades, and urges similar Board oversight and monitoring.

If the Board finds that the KCS/TM transaction is in the public interest, the Board should impose conditions to alleviate the transaction's likely anticompetitive effects. Pacer insists that the conditions it has proposed are critical to ensure that KCS's ownership and control over the Laredo gateway, including the Laredo Bridge itself as well as the Tex Mex- and TFM-controlled access to the Laredo Bridge, are not used unfairly against, and to the competitive disadvantage of, other railroads and their customers that ship freight via Laredo. Its recommended conditions are also necessary to prevent KCS's ownership and control from creating major service disruptions and failures to all rail traffic that must rely on the Laredo gateway to service the freight transportation needs of the Canadian, U.S., and Mexican economies. Although the KCS/TM transaction is technically a minor transaction, it may have significant effects when viewed in the context of KCS/TFM transaction, which is effectively a major transaction. *See Decision No. 2*, slip op. at 10. Pacer requests conditions relating to non-discriminatory operation of the Laredo Bridge; planned implementation of MCS and capital improvements; and Board retention of jurisdiction over KCS's implementation of these conditions.

E.I. du Pont de Nemours and Company. DuPont, a diversified chemical and life sciences corporation that offers a wide range of products and services to markets including agriculture, nutrition, electronics, and communications, supports the KCS/TM transaction. Common control of KCSR and Tex Mex, DuPont believes, will benefit the rail industry and its customers as well as the public. DuPont, which has six major manufacturing sites in Mexico, advises that its cross-border rail traffic includes shipments to DuPont plants in Mexico and in the United States, as well as direct sales shipments to Mexican and U.S. customers. Laredo is the primary border crossing for DuPont rail shipments, which include hazardous and non-hazardous commodities moving both southbound and northbound. At Laredo, both UP and Tex Mex handle cross-border DuPont shipments from and to TFM.

DuPont contends that common control of KCSR and Tex Mex will enhance the safety, health, and environmental performance of Tex Mex. One of the ways DuPont has responded to public concerns about the safe management of chemicals is through ACC's "Responsible Care" Program, which is built around progressive principles and flexible management practices. DuPont looks to its rail suppliers to share in a similar commitment to outstanding safety, health, and environmental performance. Any failure on the part of carriers to achieve outstanding performance in these areas directly affects DuPont's "right to operate." KCS has made a commitment to integrate Tex Mex into the KCS Responsible Care Partnership Program, which will result in improvement in the safety-health-environmental performance of Tex Mex. Based on the KCS Partnership experience, DuPont believes that this integration will likely result in a number of significant Tex Mex improvements, including a reduction in FRA reportable injuries, a reduction in FRA reportable derailment expenses, a reduction in grade-crossing injuries, increased emergency response drills, additional management resources, improved processes, enhanced security plans, and a stronger and more empowered safety culture.

DuPont contends that common control of KCSR and Tex Mex will provide a pro-competitive rail improvement opportunity that will benefit both the railroad industry and its customers. The end-to-end nature of the proposed transaction and the absence of any 2-to-1 locations, stations, points, and corridors are significant, as is KCS's commitment to abide by all existing agreements governing operations over the Laredo Bridge and to keep the

Laredo gateway open on commercially reasonable terms. While the minimal cross-border market position currently enjoyed by KCS and Tex Mex at Laredo has the potential to grow, it will be subject to very keen competition from alternative carriers in both the U.S. and Mexico, alternative Texas border crossings, and alternative truck and marine options. DuPont believes that competition to/from Laredo is likely to be enhanced, not diminished, by common control of KCSR and Tex Mex. DuPont also supports facilitation of FRA approval of Tex Mex's application for a Railroad Rehabilitation and Improvement Financing (RRIF) loan, *see* KCS-3 at 63-64, which will improve the existing Tex Mex infrastructure, service frequency, and reliability. Finally, DuPont believes that the common control Tex Mex will increase the probability that service will be restored on the line between Victoria and Rosenberg, TX, which would also be pro-competitive. KCS has indicated that, once common control of KCSR and Tex Mex is accomplished and ownership disputes over the Victoria-Rosenberg line are resolved, "the parties expect to turn attention to the Victoria-Rosenberg line as the next major capital project on the Tex Mex." KCS-3 at 141. Restoration of this line, DuPont explains, would result in a KCS-Tex Mex offering that would be more competitive based on greater operating control and a significant reduction in reliance on trackage rights on competing rail lines.

AK Steel Corporation. AK Steel, which has steel manufacturing facilities in Indiana, Ohio, and Pennsylvania, relies on railroad transportation to deliver its steel products to end-users located throughout the United States and Mexico. AK Steel is concerned that, once the formation of NAFTA Rail has been completed, TFM will favor traffic that originates on its affiliated carriers as opposed to traffic received from UP or BNSF, and will be able to exercise bottleneck control to assure that AK Steel's only transportation options will be those involving NAFTA Rail. AK Steel asks that the Board condition any approval of KCS's acquisition of control of Tex Mex and TFM to protect shippers like AK Steel from potential discriminatory service and pricing practices relating to the Mexican gateway. It specifically asks the Board to impose conditions that assure that all carriers interchanging traffic at the Laredo Bridge will be treated fairly by TFM and to prevent TFM from exercising bottleneck control. AK Steel insists that any approval of the acquisition of control sought by KCS must assure that each of the three carriers that can now be used to reach Laredo will continue to provide service at commercially reasonable terms.

The Transportation•Communications International Union. TCU, the collective bargaining representative for approximately 400 employees of KCSR and Tex Mex working in the clerical, carmen, and supervisory crafts, advised that it is not yet prepared to state whether it supports or opposes the KCS/TM application. TCU argues that, although the *New York Dock* conditions are appropriate to the KCS/TM transaction, the international nature of this transaction requires the modification of these conditions to address the concerns of employees whose work may be transferred across the U.S.-Mexico border. TCU therefore asks that the Board rule that employees will not be required to follow their work to Mexico as a condition of receiving

New York Dock benefits and that employees whose work is moved over U.S. borders will not be required to show they were precluded, by Mexican law, from following their work. *See CN/IC,* 4 S.T.B. at 165 & n.102.

At the public hearing held on July 31, 2003, TCU was asked whether the protection it seeks had ever been imposed by the Board or the Commission in any cross-border merger prior to the 1999 CN/IC merger. TCU has advised that, aside from the 1999 *CN/IC* merger, the 1990 *CP/D&H* merger appears to have been the only other post-*New York Dock* merger transaction that involved the potential for movement of work over international borders. TCU suggests that CP's acquisition of the Soo and CN's acquisition of the Grand Trunk Western and the Duluth, Winnipeg and Pacific occurred before the *New York Dock* era. TCU has also advised, however, that although the Commission imposed the standard *New York Dock* conditions on the CP/D&H merger, *see CP/D&H*, 7 I.C.C.2d at 122-23, the parties to the CP/D&H merger opted to address protective issues through negotiation between the parties rather than through the Commission. *See CP/D&H*, 7 I.C.C.2d at 123 n.27. TCU advises that cross-border protection was sought in the CN/IC proceeding because of a then-recent attempt by CP to move D&H dispatching work to Canada.[12]

The Brotherhood of Maintenance of Way Employes. BMWE advises that, in view of the statements applicants have made respecting the KCS/TM transaction, BMWE believes that the *New York Dock* conditions will adequately protect the interests of the employees involved in this transaction. BMWE also notes "that KCSR is a party to the Agreement dated March 21, 2001 between Class I railroads and labor organizations concerning the use of Board imposed employee protective conditions to effect changes in collective bargaining agreements outside the collective bargaining processes provided in the Railway Labor Act, 45 U.S.C. §151, *et seq.*," BMWE-2 at 2, and expects KCSR will live up to its obligations under that agreement as they are applicable to the KCS/TM transaction. The agreement referenced by BMWE appears to be the settlement agreement respecting overrides of collective bargaining agreements signed by most of the Class I railroads and by the unions representing most rail employees. *See New Merger Standards,* 5 S.T.B. at 571-572.

United States Department of Agriculture. USDA, which seeks to preserve an efficient and competitive transportation sector that serves U.S. agriculture effectively, supports the KCS/TM application and contends that the imposition of competitive conditions will not be necessary. USDA argues that the KCS/TM transaction will increase competition by allowing a third Class I railroad to better compete in the vital corridor between the lower Plains States and gateways to Mexico. Enhanced competition in this corridor could provide gains in trade to Mexico, especially because these potential gains largely

[12] While the CP/D&H dispatching dispute was pending before the Board and the courts, FRA expressed concerns about the safety implications of extraterritorial dispatching of U.S. trains. FRA subsequently commenced a rulemaking proceeding that eventually precluded CP from transferring dispatching work to Canada, except under limited circumstances.

depend upon competitive transportation options and gateway access into Mexico. USDA also believes that the KCS/TM transaction will provide significant efficiency benefits and shorten the transit time to Mexican markets. KCS control of Tex Mex, concurrent with control of TFM, could enhance agricultural trade with Mexico.

The importance of the KCS/TM transaction is enhanced by TFM's significant role in the U.S.-Mexico NAFTA corridor. Mexico is now one of the United States' most important trade partners. During 2001, the United States exported 6.2 million tons of corn, 5.5 million tons of sorghum, 4.4 million tons of soybeans, and 2.3 million tons of wheat to Mexico, and that same year, railroads transported 41% of all U.S.-grown grain exported to Mexico, and 31% of that passed through the Laredo gateway.

Because KCS is unlikely to have the ability to exercise any significant market power vis-à-vis UP and BNSF and because shippers will have other transportation options as well, competitive conditions need not be placed upon the KCS/TM transaction. Rail movements to Mexico must compete against cost-effective ocean transportation; ocean shipments comprise 53% of all U.S.-grown grain exported to Mexico, whereas rail shipments comprise only 41%. Whereas the new NAFTA Rail would operate approximately 6,000 miles of railroad and would have operating revenues of $1.3 billion, UP operates 33,586 miles of road and has operating revenues exceeding $10.6 billion (in 2001) and BNSF operates 33,063 miles of road and has operating revenues exceeding $9.2 billion (also in 2001). UP's and BNSF's shares of U.S. grain exports to Mexico are considerably larger than Tex Mex's and are expected to remain larger. If KCS were to attempt to exercise market power at Laredo, UP could exercise the leverage it derives from its ownership of the lines over which Tex Mex's trackage rights run, and both UP and BNSF could shift traffic to other U.S.-Mexico gateways. USDA maintains that there are ample alternative gateways to Mexican markets and that KCS is not likely to gain a controlling percentage of the traffic through Laredo.

United States Department of Transportation. DOT believes that the KCS/TM and KCS/TFM transactions present, in the abstract, the kind of classic end-to-end combinations which, though they might result in "vertical foreclosure" harm to competitors (by closing off formerly neutral connections), will not result in harm to competition. Such transactions have traditionally been found to raise few if any competitive problems, *see BN/SF*, 10 I.C.C.2d at 747-57; *Conrail*, 3 S.T.B. at 259, 268-69; *DM&E/IC&E*, 6 S.T.B. at 527. DOT points out, however, that the *New Merger Standards* now require that major gateways at which such combinations take place continue to remain "open" to other carriers. The new standards, DOT concedes, apply only to transactions involving two or more Class I railroads, and do not apply to this case. However, DOT argues that TFM should be regarded as a Class I railroad given its size, and the Board should apply the new standards to the KCS/TFM transaction, given the importance of preserving competition through the pivotal rail gateway at Laredo, *see New Merger Standards*, 5 S.T.B. at 563-564. DOT concludes that, if certain conditions are imposed and if applicants are held to their representations, the KCS/TM transaction should be approved. If the KCS/TFM transaction occurs, the Board should require applicants to maintain an open gateway at Laredo, by holding applicants to their commitments and by establishing an oversight proceeding to enforce those commitments and to entertain evidence of merger-related harm.

DOT argues that, although the "one lump" theory (which explains why "vertical foreclosure" cannot have an anticompetitive impact) is valid with regard to the KCS/TM and KCS/TFM transactions, control of the Laredo gateway is a unique issue, and, therefore, the Board should take steps to assure that the gateway remains physically and economically open. If only the KCS/TM transaction takes place, the Board should take remedial action only with respect to the Laredo Bridge and the BNSF trackage rights issues. In recent years, Laredo has become even more significant as the primary rail gateway for burgeoning NAFTA trade with Mexico. The present growth trend is expected to continue for the foreseeable future and therefore there is a strong, established national policy argument for assuring that Laredo remains an open gateway.

Because the pending transactions amount to classic end-to-end mergers, they can be expected to provide relatively few public benefits (largely the elimination of some transaction costs and the creation of single-line service for shippers). On that basis alone, there would seem to be no adequate justification for reducing shipper transportation alternatives at Laredo. In view of the U.S. commitment under NAFTA to ensure the smooth flow of international trade across the borders with Mexico and Canada, and in further view of the lack of any efficiencies lost to the NAFTA Rail carriers from keeping the Laredo gateway open, the Board should require applicants to maintain a physically and economically open gateway at Laredo to the extent the Board's jurisdiction allows. DOT suggests that, if the Board decides not to apply the *New Merger Standards* to the pending transactions, the Board could nevertheless find that an exception to its "vertical foreclosure" precedent is merited.

Next, DOT contends that, although the "short-hauling" feared by BNSF would not be an unusual development in mergers, BNSF operates via trackage rights granted in the *UP/SP* proceeding to sustain competition at Laredo by a second major railroad, and to preserve two-railroad competition for shippers along the former SP line between Houston, Robstown-Corpus Christi, and Brownsville. *UP/SP*, 1 S.T.B. at 409-10, 423-24. The issue with regard to Laredo is whether that BNSF role becomes moot if the KCS/TM transaction is approved and KCS attempts to supplant the role of BNSF in providing that competition. Unless and until the Board determines that the rights granted to BNSF are no longer necessary to provide competition to UP for Laredo traffic, the Board must assure that the BNSF connection to Tex Mex at Robstown is not closed.

Control of the Laredo Bridge is a related aspect of the gateway closure issue, and raises concerns related to the potential physical denial of access, or degradation of service, to competitors that use the Bridge. The KCS/TM transaction alone would give KCS control of access to, and operation of, the

U.S. side of the Bridge. Resolution of the discriminatory-treatment threat feared by UP should be achievable through negotiations of the parties to the agreements governing Bridge operations, through the Board's regulatory review, and through oversight of the commitments made by applicants with respect to Bridge operations.

DOT has specific requests for relief. DOT asks the Board, to the extent it has jurisdiction, to impose a condition that will require NAFTA Rail to maintain Laredo as an open gateway. As in *CN/WC*, if any allegations of merger-related harms respecting the Laredo gateway are brought before the Board, the individual facts and applicable law would determine the extent to which mitigation would be available. Although the Board should first rely upon the signatories to the operational agreements to abide by their terms or to negotiate appropriate adjustments, the Board should also hold applicants to their commitments respecting the Bridge. DOT further contends that the Board should reaffirm its authority over the agreements/operations at the Bridge, so as to forestall any disputes should the parties fail to resolve matters among themselves. DOT also contends that the Board should assure that the BNSF connection to Tex Mex at Robstown is not closed. Finally, DOT contends that the Board should require applicants to inform the Board and the parties if and when it appears that the KCS/TFM transaction may become more likely.

In its DOT-2 comments (filed July 31, 2003), DOT advised that, with a single exception, it agreed with applicants that it was likely that the KCS/TM and KCS/TFM transactions did not warrant specific action to ameliorate adverse environmental impacts. The exception concerns the slightly longer trains anticipated by applicants, which might exacerbate existing circumstances in Laredo. Laredo has already experienced significant traffic delays and congestion as a result of growing cross-border traffic. If longer trains suffer the same kinds of delays in Laredo, they might block more at-grade crossings or they might block the same crossings for longer periods of time. DOT therefore urged applicants to work with the City of Laredo to minimize any such potential consequences of their transactions. DOT did not discuss environmental issues in its DOT-4 comments (filed September 2, 2003).

Also in its DOT-2 comments, DOT advised that applicants had cooperated with FRA in the development of their SIP, and that DOT fully anticipated this cooperation would continue through the preparation of an appropriately detailed final SIP and a successful and safe integration of the different rail systems comprising NAFTA Rail. However, the SIP was still in need of significant further development, and applicants had not yet addressed all of the safety implications of the Tex Mex and TFM transactions. Applicants had not specified the financial and other resources to be committed for such important components as "Computer Based Training" and "Remote Control Technology." Although applicants indicated that various Tex Mex capital projects would be financed by a $50 million FRA loan, they had not actually received, or even applied for, that loan. Further, while applicants indicated that they intended to extend KCS's MCS to Tex Mex and TFM, they had not specified the resources that would be devoted to assuring that extension of MCS to these carriers could be achieved without disruption. And, applicants' SIP did not yet reflect sufficiently detailed attention to issues raised by the expanded coordination with TFM generally, and in particular with those arising from common control of the International Rail Bridge at Laredo.

In its DOT-4 comments, DOT advises that applicants have continued to cooperate with FRA and that progress is evident. DOT anticipates that this cooperation will continue until all outstanding issues have been addressed. FRA will work closely with applicants to ensure a safe implementation of any approval that is granted, and will also inform the Board of appropriate developments.

APPENDIX C: REBUTTAL OF APPLICANTS (SUBMITTED IN 2003)

KCS's 9/2/03 Rebuttal Submission. KCS contends that the KCS/TM application should be approved without conditions because the KCS/TM and KCS/TFM transactions will have a pro-competitive impact, in that they will allow KCS to create a more capable competitive alternative to UP's domination of U.S./Mexico rail traffic. KCS is committed to consummating the KCS/TFM transaction and will continue to pursue all commercial and legal alternatives to complete that transaction.

The § 11324(d) Criteria. KCS contends that the KCS/TM transaction will not result in a substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States because it involves the end-to-end common control of three railroads (KCSR, GWER, and Tex Mex) that already share some common ownership and that already cooperate closely. The common control over KCSR, GWER, and Tex Mex will offer shippers more efficient and competitive single-line service, closer coordination of operations between the participating carriers, improved efficiency, greater financial stability, and increased access by Tex Mex to cars, marketing, and other resources available only to larger railroads. No party has established that anticompetitive effects are both likely and substantial so as to warrant denial of the transaction or the imposition of conditions. Even if the Board were to agree with the concerns that have been expressed, the conditions suggested by UP, BNSF, CN, and Pacer are not narrowly tailored and, therefore, should not be imposed.

KCS reiterates that its control of Tex Mex will not result in any reduction in any shipper's independent routing options. KCS claims that no shipper or receiver will see its competitive options reduced from 3-to-2 or from 2-to-1, and there will be no reduction in source or geographic competition. KCS contends that its control of the northern half of the Laredo Bridge will not result in a lessening of competition, the creation of a monopoly, or the restraint of trade because NAFTA Rail will have the same operational and cost incentives that KCS, Tex Mex, and TFM now have to ensure the efficient and fair movement of UP's trains over the Bridge. Because the privately negotiated agreement that governs operations over the Laredo Bridge has worked, there is no demonstrated need for the Board to impose a condition that would require the negotiation of a new dispatching protocol. KCS rejects UP's claim that TFM's Border Superintendent, who has long administered Laredo Bridge operations in an even-handed manner, has recently been less accessible than previously. In short, KCS contends that UP's concerns regarding future operations are nothing more than baseless conjecture, and thus the Laredo Bridge remedies proposed by UP are unnecessary. Indeed, KCS contends that the remedies proposed by UP would effectively freeze the existing allocation of slots and thereby guarantee a competitive advantage for UP by preventing Tex Mex from increasing its use of the Bridge.

KCS contends that, although BNSF has expressed concerns that KCS might use its control of Tex Mex to prevent an interchange with BNSF at Robstown, the KCS/TM transaction will not result in inefficient foreclosure of BNSF-Tex Mex routings. Mere concerns about whether or not existing interchanges will be continued after an end-to-end transaction is consummated do not prove that the end-to-end transaction will result in an anticompetitive action that would warrant imposition of a condition; mere concerns do not establish that any such anticompetitive actions is both "likely" and "substantial" as required by the statute; and to establish that an end-to-end transaction will result in increased prices to shippers or reduced service would require overcoming agency precedent, *see*, *e.g.*, *UP/CNW*, slip op. at 70.

KCS contends that concerns respecting safety are being addressed in consultation with FRA, and expects continued progress prior to the Board's decision in this proceeding. KCS notes that, although Tex Mex has not yet filed with FRA a RRIF loan application seeking $50 million in funds for track rehabilitation and improvement, Tex Mex did file a RRIF loan application with FRA in October 2000 and has had considerable discussion of that application with FRA since that time, leading to a plan to submit a revised, $50 million application.

KCS reiterates that the KCS/TM transaction is categorically exempt under NEPA, even if the effects of the KCS/TFM transaction as well as the effects of the KCS/TM transaction are considered.

KCS does not object to the adoption by the Board of the ruling requested by TCU: that employees will not be required to follow their work to Mexico as a condition of receiving *New York Dock* benefits; and that an employee whose work is moved to Mexico will not be required to show that he/she was precluded, by Mexican law, from following his/her work.

The KCS/TFM Transaction: No Anticompetitive Impacts. KCS contends that, even assuming that the Board has the legal authority to condition the KCS/TM transaction on alleged effects arising from the KCS/TFM transaction, it should not do so because the KCS/TFM transaction will not result in any adverse competitive or "horizontal" effects. KCS contends that the KCS/TM and KCS/TFM transactions will not result in vertical foreclosure at the Laredo gateway. ICC/STB precedents clearly indicate that an end-to-end transaction cannot increase market power. The "one lump" theory holds that any market power a bottleneck carrier (e.g., TFM) may have can be fully exploited without vertical integration. Therefore, there can be no vertical foreclosure incentive to engage in an end-to-end merger with a bottleneck carrier, because no additional market power will be gained through the merger. An end-to-end merger with a bottleneck carrier will not change whatever pre-merger economic incentives the bottleneck carrier has to fully exploit its monopoly power. If, for whatever reason, the pre-merger bottleneck carrier is not exploiting its monopoly power, the market forces that prevent such exploitation will survive an end-to-end merger with a connecting carrier and will continue to prevent the bottleneck carrier from taking anticompetitive actions. *See Conrail*, 3 S.T.B. at 266-269; *BN/SF*, 10 I.C.C.2d at 747-757; *UP/CNW*, slip op. at 87-89; *UP/MKT*, 4 I.C.C.2d at 476-477; *CSX/ACL*, 2 I.C.C.2d at 520-528; *Soo/Milwaukee II*, 2 I.C.C.2d at 454-456; *NS/NAVL*, 1 I.C.C.2d at 869-874; *UP/MP/WP*, 366 I.C.C. at 533-546; *CSX Control*, 363 I.C.C. at 567-573.

KCS contends that UP and BNSF are advancing arguments that have long been discredited by ICC/STB precedents. UP is arguing that TFM is "neutral" as respects KCS/Tex Mex and UP routings; that shippers benefit from the intense upstream competition between those two systems; and that, unless TFM remains neutral, the competition between the two upstream carriers will be diminished. BNSF is arguing that TFM *and* Tex Mex are neutral as respects BNSF and KCSR routings, and that it is important to maintain this neutrality. However, no shipper has presented any evidence to prove UP's or BNSF's theories and to disprove over 20 years of economic analysis and ICC/STB precedents. Neither UP nor BNSF has presented any evidence showing that TFM and Tex Mex are neutral today, and neither UP nor BNSF has presented any evidence showing that the "lump" is being passed along to shippers rather than being taken by one of the upstream carriers. UP and BNSF have thus failed to meet their burden of proof. *See BN/SF*, 10 I.C.C.2d at 748.

For the theories expressed by UP and BNSF to be valid, one must assume that existing UP or BNSF rates to many shippers could be pushed higher without loss of that traffic. But this is not the case, because existing rail rates, including UP's and BNSF's, are already as high as they can go without having that traffic switch to other modes or to other origins and destinations. In any event, even if TFM is not taking the full profit, UP is, as the only carrier with single-line access to Mexico. UP's intense opposition to the KCS/TM and KCS/TFM transactions is due to its fear that, after the transaction, TFM will be in the better position to take the lump, or at least part of it.

Market forces that prevent a lump from being taken prior to a control transaction will continue to prevent that lump from being taken even after vertical firms have come under common control. *See BN/SF*, 10 I.C.C.2d at 751. If Mexican regulatory constraints prevent the pre-transaction TFM from extracting a full lump, those same regulatory constraints will prevent the post-transaction TFM from extracting a full lump. Regardless of Mexican regulatory constraints, both UP and BNSF have, and will continue to have, enormous leverage and bargaining power in establishing rate divisions with

TFM. Given the enormous market coverage of UP and BNSF, and given the vast number of markets that are UP or BNSF sole-served, it would not be in KCS's interest to eliminate TFM access to UP and BNSF routings. If KCS did attempt to foreclose efficient UP and BNSF routings in favor of inefficient alternative KCSR routings, affected traffic would simply switch to other gateways or other modes, thus depriving TFM of needed revenues. Because most of the traffic is locked up under long-term contracts between TFM and the other carriers, KCS could not utilize its control of TFM to eliminate UP or BNSF routings, and in any event, there is simply not enough capacity on the UP line used by Tex Mex for KCS to use its control of TFM and Tex Mex to route significant amounts of traffic away from UP and BNSF.

The theories advanced by UP and BNSF rest upon the premise that the vertically integrated KCSR/TM/TFM will favor inefficient KCSR-TM-TFM routings and will foreclose efficient routings involving UP or BNSF, which is at odds with ICC/STB precedents. *See DM&E/IC&E*, 6 S.T.B. at 527; *BN/SF*, 10 I.C.C.2d at 752. For the markets where KCSR does not compete with UP or BNSF (the vast majority of markets for Laredo gateway traffic), NAFTA Rail would have no incentive to foreclose UP or BNSF routings because, without such routings, the traffic cannot move by rail. For the very few markets where KCSR-TM-TFM routings do compete against a UP-TFM routing or a BNSF-TM-TFM routing, NAFTA Rail would have no incentive to foreclose UP or BNSF routings as long as they provide more profit to NAFTA Rail than a KCSR-TM-TFM routing. As a practical matter, a UP-TFM routing or a BNSF-TM-TFM routing *could* provide more profit to NAFTA Rail than a KCSR-TM-TFM routing wherever the UP or BNSF routing is more efficient than the KCS-TM routing. In sum, NAFTA Rail would have no incentive to foreclose an efficient UP or BNSF joint-line routing, even where the UP or BNSF joint-line routing competes against a NAFTA Rail single-line routing, as long as the profit to NAFTA Rail via the joint-line routing is greater than or equal to the profit to NAFTA Rail via the single-line routing. What UP and BNSF are really concerned about, KCS argues, is the split of the profits generated by the efficient joint-line routing.

KCS acknowledges that it has predicted that some traffic not now routed KCSR-TM will be diverted to a KCSR-TM routing post-transaction, and that a large share of this to-be-diverted traffic is now routed BNSF-TM. KCS insists, however, that any such diversion will not reflect economic leverage. Rather, that any such diversion will reflect that, for some traffic, a KCSR-TM routing is either more efficient than, or just as efficient as, a BNSF-TM routing. However, there will be no diversions from a BNSF-TM routing to a KCSR-TM routing as a result of "forced" inefficient routings or anticompetitive actions taken by KCS. KCS claims that UP argues that the standard theories governing vertical foreclosure will not apply in the context of the KCS/TFM transaction. KCS responds that the assumptions on which this argument rests are implausible and have no relationship to the realities of the marketplace, and it refutes UP's argument point by point.

KCS rebuts CN's exploitation arguments, contending that its motivation for the KCS/TFM transaction stems from KCS's existing stake in TFM, and the importance to KCS of TFM's profitability. When it appeared that Grupo TMM's financial problems might adversely affect TFM, KCS acted to protect its investment in TFM against the uncertainties arising from Grupo TMM's financial difficulties. Whether TFM is controlled by Grupo TMM or by KCS, there is no need for TFM to act anticompetitively, and in any event, the KCS/TFM transaction is not before the Board for approval and was found by DOJ and MFCC not to present competitive problems. KCS claims that it has not agreed to pay a burdensome or inordinate "acquisition premium" that it can only finance through anticompetitive behavior. An acquisition premium is nothing more than recognition that a controlling interest in a company allows the owner a greater ability to protect its investment, and brings with it an increased stake in the company's financial progress. Therefore, an acquisition premium is not out of the ordinary, and there is nothing inherently wrong about an acquisition premium. The multiple of earnings that KCS is paying for TFM is not out of line with that paid in other railroad control transactions, and KCS can pay for its acquisition through the existing earnings stream of TFM and need not raise rates to do so. *See New Merger Standards*, 5 S.T.B. at 566. NAFTA Rail will gain traffic and revenues not by engaging in anticompetitive manipulations but, rather, by investing in improved service.

Requested Conditions: Neither Necessary Nor Appropriate. KCS contends that the conditions that have been requested by parties to this proceeding are not narrowly tailored to address substantial harms to competition that probative evidence shows will arise from the transaction before the Board, but rather are overly broad, inefficient, and anticompetitive, and call for the Board to reach well beyond its jurisdiction by regulating the rates and services of a railroad that is not an applicant in this proceeding and that is not controlled by an applicant in this proceeding. *See New Merger Standards*, 5 S.T.B. at 570. The Board should deny these requests for conditions, and should instead rely on existing remedies, such as the NITL/KCS Agreement and Board jurisdiction to address future problems should they arise. KCS-18A at 104.

KCS/TFM Transaction: Beyond The Board's Jurisdiction. KCS reiterates that, because the Board's jurisdiction "applies only to transportation *in* the United States," 49 U.S.C. 10501(a)(2) (emphasis added), the Board lacks jurisdiction to impose conditions that would regulate the rates and services of TFM. KCS contends that the *Canada Southern, CN/IC*, and *CN/WC* decisions stand for the proposition that the Board can consider the effects in the U.S. of a transaction that occurs in the U.S. involving multiple carriers subject to the Board's jurisdiction when that transaction has been submitted to the Board for its review. But that proposition, KCS contends, is far different from the contention that the Board can reach across an international border and control the rates and services of a railroad operating only in a foreign country.

Pacer International. KCS contends that the Board should not grant the relief sought by Pacer because Pacer has failed to show that the transaction before the Board will have any anticompetitive effect, and therefore, has not established the necessary prerequisite for the relief it seeks. KCS has repeatedly stated that it will honor the contractual commitments of Tex Mex and TFM, and that, even if it does not do so, legal remedies exist to enforce any legal contract. Pacer's concerns about operation of the Bridge are likewise misplaced because Pacer traffic handled by UP is protected by contracts with TFM that would prevent any discrimination and KCS has said that it will continue to operate the Bridge as the Bridge has been operated under longstanding agreements. Further, installation of MCS on Tex Mex is not directly connected with this proceeding, but is an independent initiative that was planned without regard to how the parties proceed on the control issue. But in any event, implementation of MCS on Tex Mex is covered by the SIP and will be overseen by FRA. The combination of FRA monitoring under the SIP and KCS's own monitoring under the NITL/KCS Agreement fully addresses any concerns that Pacer has about the implementation of MCS on Tex Mex. As respects the implementation of MCS on TFM, because the KCS/TFM transaction is not before the Board and because operational monitoring in Mexico would raise substantial jurisdictional issues, any condition related to implementation of MCS on TFM would be highly inappropriate.

KCS questions Pacer's interest in KCS's management of track improvements on Tex Mex. In any event, the track work, which is addressed in the SIP, is a matter in which FRA has an interest, particularly if the track work is funded under the RRIF program. Further, the effects of the track work would be reflected in service levels, monitoring of which will be conducted under the NITL/KCS Agreement.

KCS contends that the Board should not grant the relief sought by any shipper because no shipper has demonstrated that, on account of a KCS/TFM transaction, benefits from competition would be lost, rail rates would increase, or service would decline. Indeed many shippers expect that the KCS/TFM transaction will result in a reduction in the rates applicable to KCS-TM-TFM routings. And that pro-competitive action is why the vast majority of shippers support the KCS/TM and KCS/TFM transactions.

KCS's 9/22/03 Rebuttal Submission. KCS contends that DOT's comments confirm that vertical foreclosure and increases in shipper rates will not occur and that private agreements and commitments are preferable to the heavy-handed regulation sought by KCS's competitors. KCS further argues that the logic of DOT's comments supports the approval of the KCS/TM application without any conditions.

APPENDIX D: ADDITIONAL SUBMISSIONS (2004)

Union Pacific. UP contends that, now that this proceeding has resumed exactly where it left off in 2003, the Board should adopt the conditions that UP proposed in its 2003 comments. UP adds that nothing has changed during the 1-year hiatus in this proceeding to reduce the need for narrowly crafted conditions that would implement KCS's commitments and assuage the competitive concerns raised by UP and others.

In support of its proposed condition addressing the adverse effects of KCS's acquisition of control of TFM, UP cites a new example of government action in a similar context: the Canadian Competition Bureau (CCB) announced in July 2004 that it had entered a Consent Agreement in connection with CN's acquisition of British Columbia Rail (BC Rail). This agreement was designed to implement in a measurable manner CN's commitments to keep the Vancouver gateway open for shippers served by BC Rail that had benefitted from interline routes via Vancouver involving BNSF, CP, and UP. (BC Rail traffic that moved in interline routes involving CN was routed via Prince George.) CCB demanded this relief because the transaction "raised serious competition issues" and CN's unilateral commitment to keep the gateway open provided an insufficient remedy. UP argues that KCS's proposed NAFTA Rail transaction raises even more serious competitive issues and thus presents an even stronger case for government action to preserve existing competition.

Canadian Pacific. CP takes no position as to whether the KCS/TM transaction should be approved, but it contends that, if the transaction is approved, the Board should impose a condition requiring applicants to enter into one or more written agreements that would assure non-applicant carriers serving the NAFTA Corridor future access to the Laredo gateway on commercially reasonable terms. Given the unique importance of the Laredo gateway to the NAFTA Corridor trade, the condition CP seeks is necessary to preserve effective rail competition for traffic moving between points in Canada and the United States, on the one hand, and, on the other hand, points in Mexico, in the event that KCS's successfully acquires both Tex Mex and TFM. Nothing that has occurred since the Board suspended this proceeding in October 2003 has obviated the need for such a condition.

The National Industrial Transportation League. NITL contends that the NITL/KCS Agreement will provide significant protections and benefits for NITL members and other rail shippers, and will be an important element that will enhance the benefits of the proposed acquisition of control of Tex Mex and/or TFM by KCS. NITL advises that it has received assurances that KCS continues to consider NITL/KCS Agreement to be binding with respect to KCS's control of Mexrail and Tex Mex, and that KCS will implement that agreement for the benefit of NITL members and other shippers when it is authorized to control Tex Mex. NITL further advises that it has itself determined that the NITL/KCS Agreement continues to apply by its terms with respect to Tex Mex upon the acquisition of control of Tex Mex by KCS. NITL believes that the record developed before the Board is clearly sufficient n to support a reasoned decision to approve the acquisition of control of Tex Mex by KCS, and it also believes that the Board should move ahead expeditiously in coming to a favorable decision in this proceeding, so that the benefits of the NITL/KCS Agreement and the transaction can be realized. Thus, NITL contends that the Board should approve the KCS/TM transaction, subject to imposition of the NITL/KCS Agreement as a condition.

United States Department of Transportation. DOT advises that its view of the appropriate outcome in this proceeding has not changed, because no material factor in this proceeding has changed. DOT has advised that, although FRA has not yet approved a final SIP, FRA anticipates no difficulty on this matter. FRA will report directly to the Board when it has approved the SIP in this case. *See* DOT-7 (filed September 30, 2004) at 6.

DOT reiterates that the Board should consider whether KCS's unfettered control of Tex Mex would adversely affect the Board's *UP/SP* conditions respecting Laredo traffic. Issues arising out of KCS's control of the U.S. side of the Laredo Bridge should be resolved by reliance upon the terms of existing agreements and negotiations among interested parties. DOT also reiterates that KCS should be held to the commitments it has made on the record, particularly those concerning operations at the Laredo Bridge and the interchange of traffic with BNSF. Contingent upon KCS's acquisition of control of TFM, the Board should require KCS to honor its commitment to keep the Laredo gateway physically and economically open, and the Board should initiate a 3 to 5 year oversight period during which parties would be free to bring evidence to the Board of merger-related harms and/or violations of KCS's commitments.

Watco Companies. Watco advises that it continues to support the KCS/TM transaction. Watco contends that, although the agreement under which KCS recently acquired a 51% interest in Mexrail is slightly different than the earlier agreement for that acquisition, nothing about those changes alters the fundamental pro-competitive nature of the KCS proposal or Watco's previous opinion that this transaction should be approved without conditions. The transaction is end-to-end in nature, and no shipper will lose its competitive routing options. It is important to note that NITL, the nation's largest shipper trade association, supports the transaction and believes that its agreement with KCS resolves any concerns that shippers might have had regarding the KCS/TM and KCS/TFM transactions.

KCS's 2004 Rebuttal Submission. KCS responds that the evidence of record demonstrates that, under § 11324(d), the Board should approve the KCS/TM transaction without conditions. In particular, the Board should not impose conditions that would require it to micromanage operations at the Laredo Bridge; should not impose conditions respecting Tex Mex's Robstown interchange with BNSF; and should not impose conditions that would manipulate pricing or service options on TFM.

KCS notes that it has committed to keep the Robstown and Laredo gateways open on commercially reasonable terms, and it has stated that it does not have any plans to change the neutrality of the operation of the Laredo Bridge, nor any plan to alter the operations of TFM. *See* KCS-22 at 8-9.

As further support for its argument that there is no need for change to the Laredo Bridge operations, KCS also contends that the future offers the prospect of improvement in Bridge operations under the existing agreements. It is anticipated that train speed through the gamma ray scanner at the Bridge will eventually increase. If FRA grants UP's recent waiver request for the elimination of duplicative inspections, a source of potential delays in moving TFM-UP trains through Laredo will be eliminated. A recent change to FRA drug and alcohol-testing regulations may mean that trains will not have to be stopped on the Bridge to change crews, which might eliminate another source of delay in moving trains over the Bridge. And even today, the Bridge has substantial available capacity. Rather than accepting UP's invitation to formulate a global solution for problems that do not exist, the Board, if it has any concerns regarding the Bridge, should adopt DOT's suggestion that the Board monitor the situation under its oversight authority.

Next, KCS advises that two agreements have been negotiated with BNSF, one by Tex Mex and one by KCS. Tex Mex, with KCS's knowledge, entered into an agreement with BNSF that extended to December 31, 2004, the BNSF-TM joint rate agreement (respecting the divisions applicable to BNSF-TM routings) that was originally set to expire on December 31, 2003. KCS has entered into an agreement with BNSF that resolves the concerns BNSF expressed in its comments filed in this proceeding in 2003. KCS adds that, as a result of this agreement, BNSF did not file supplemental comments in this proceeding in 2004.

Responding to UP's latest comments, KCS contends that the consent decree governing the CN/BCR transaction does not represent a good model for use in connection with the KCS/TFM transaction. The CN/BCR transaction demonstrates that it is the appropriate agency of the foreign country, and not this Board, that has the authority to impose conditions on the transaction. Even if the Board had the authority to impose conditions on the KCS/TFM transaction, the Board should note a fundamental difference between the regulatory schemes applicable in Canada and in the U.S. The relevant Canadian agencies continue to play a very active role in managing the marketplace by setting rates, divisions, trackage rights fees, and switching fees, and by imposing mandatory competitive access, whereas the Board does not. In the CN/BCR context, there was no alternative railroad that could provide access to shippers in British Columbia. But in the KCS/TFM context, there is an alternative railroad — Ferromex — that can provide access to shippers in Mexico. Also, the degree of intermodal competition varies between the two transactions. Trucks and water transport played a lesser role in providing a competitive check on rail rates in the CN/BCR context than they do here.

KCS contends that the KCS/TM transaction now before the Board is in all material respects the same as the transaction that was presented to the Board in 2003. KCS acknowledges that there are a few substantive differences between the First Mexrail Stock Purchase Agreement and the Second Mexrail Stock Purchase Agreement: now, TFM has no right to repurchase the Mexrail stock; now, KCS has an obligation, not merely an option, to acquire the remaining Mexrail shares before November 2005; now, certain Tex Mex debt to TFM and Grupo TMM has been or shortly will be repaid, while most Tex Mex debt to TFM has been capitalized, rather than being assumed in the acquisition; and now, KCS has obligated itself to abide by known current written agreements governing operation of the Laredo Bridge, and has given TFM a 5-year right of first refusal to reacquire the north half of the Bridge should a KCS-controlled Mexrail attempt to sell that half of the Bridge.

However, these changes to the Mexrail Stock Purchase Agreement are immaterial to the Board's consideration of the issues in this proceeding, because TFM's lack of a repurchase option merely means that this proceeding can now move forward without further interruption; KCS's obligation to purchase the remaining Mexrail stock is immaterial, because, if one carrier holds a controlling interest in another with less than 100% stock ownership, acquisition of additional stock up to and including 100% will not result in any additional control, and, therefore, will not be subject to Board jurisdiction, *see UP/CNW*, slip op. at 59; no party has raised an issue with respect to the financial aspects of the Mexrail acquisition; and the contractual provision that requires KCS to honor the Bridge agreements, and that gives TFM a right of first refusal to reacquire the north half of the Bridge, merely reinforces the certainty that all parties should feel about Bridge operations. In addition, KCS details certain changes that have occurred over the past year with regard to Pacer, the Meridian Speedway, capacity of the Laredo Bridge, contracts with BNSF, and installation of MCS on Tex Mex in the Spring of 2004, as further support for its position.

KCS reiterates its request that the Board approve the KCS/TM application unconditionally. KCS advises that unconditioned approval would allow the marketplace to govern subject to the Board's continuing oversight to review potential problems in the future. KCS-22 at 52. KCS asks that the decision approving the KCS/TM application take effect on the 5th day (and not, as is customary, the 30th day) after the date of service of such decision. KCS argues that, given the delays that have taken place over the past year and that Tex Mex is now being run under a voting trust, an expedited effective date would be appropriate. *See* KCS-22 at 52-53.

APPENDIX E: CORRESPONDENCE

Many parties that did not participate formally in this proceeding by filing comments made their views known through correspondence. The views of these parties are as indicated in this appendix.

A few parties made two submissions, the first submission expressing unqualified support for the KCS/TM transaction and the second submission urging that conditions of one sort or another be imposed on applicants in the event of approval of the KCS/TM application. The parties that made two submissions of this nature are listed in the "Parties Urging Conditions" section rather than the "Parties Expressing Unqualified Support" section.

Parties Expressing Unqualified Support. A number of parties expressed unqualified support for the KCS/TM transaction:

- Air Sea Forwarding Specialists, Inc.
- Allied Domecq Spirits & Wine USA, Inc.
- Ameripol Synpol Corporation
- AN Railway, L.L.C.
- Arguindegui Oil Co. II, Ltd.
- Arkansas Louisiana & Mississippi Railroad
- ATK Thiokol Propulsion
- Atlantic & Western Railway, Limited Partnership
- ATOFINA Chemicals, Inc.
- ATOFINA Petrochemicals, Inc.
- Bartlett and Company
- Bay Line Railroad, L.L.C.
- Beachner Grain, Inc.*
- BPSolvay Polyethylene North America
- Buffalo Marine Service, Inc.
- Calabrian Corporation
- Clarke Logistics, Inc.
- CMA-CGM (America) Inc.
- Coastal Warehouse, Ltd.
- Commercial Metals Company
- Copper Basin Railway, Inc.
- Corus Tuscaloosa
- Degussa Corporation
- Delta Southern Railroad, Inc.
- Dunham-Price, Inc.
- East Tennessee Railway, L.P.
- EPCO Carbon Dioxide Products Incorporated
- Exel Transportation
- Farmers Grain Terminal, L.L.C.
- Fordyce, Ltd.
- Forest City Trading Group, Inc.
- Fort Worth & Western Railroad
- Galamet, Inc.
- Galveston Railroad, L.P.
- Georgia Central Railway, L.P.
- Great Lakes Carbon Corporation
- Greenwood Products, Inc.
- Hood Industries, Inc.
- Huntsman Corporation
- Inland Paperboard and Packaging, Inc.
- J.B. Hunt Transport, Inc.
- Jefferson Triangle Marine, L.P.
- Jefferson Triangle Properties, L.P.
- Kinder Morgan Materials Services LLC
- KWT Railway, Inc.
- Lanco International Inc.
- Landstar Logistics, Inc.
- Laser Networking, Inc.
- Little Rock & Western Railway, L.P.
- Lone Star Steel Company
- Longview Fibre Company
- Martin Marietta Materials, Inc.
- Martin Product Sales LLC*
- Martin Resource Management Corp.
- Mazda North American Operations
- MeadWestvaco Corporation
- Meridian Southern Railway, LLC
- Mid-Continent — I-80 Transload
- Millar Western Forest Products Ltd.
- Miller and Company LLC
- Minnesota Grain and Feed Association
- M&B Railroad, L.L.C.
- O.K. Transportation, Inc.
- Packaging Corporation of America
- PCS Sales (USA), Inc.
- Pegasus Transportation Group, Inc.
- Petronila Grain Cooperative Assoc.

- Raven Logistics, Inc.
- Ray West Warehouses, Inc.
- Re Transportation, Inc.
- Rhodia Inc.
- Sabine River and Northern Railroad
- Sandhill Group, LLC
- Savage Services Corporation
- Shrieve Chemical Company
- Stupp Corporation
- Terral FarmService, Inc.
- The Dow Chemical Company
- The Kansas & Oklahoma Railroad
- The Paper Tigers, Inc.
- The Port of Corpus Christi Authority
- The Port of Port Arthur
- The South Kansas Oklahoma Railroad
- The Stillwater Central Railroad
- The Timber Rock Railroad
- Tomahawk Railway, Limited Partnership
- Valdosta Railway, L.P.
- Warehouse Specialists, Inc.
- Watco Companies, Inc.
- Western Kentucky Railway, L.L.C.
- Westlake Polymers LP
- Wilmington Terminal Railroad, L.P.
- Wright Materials, Inc.

* Beachner Grain and Martin Product Sales expressed their unqualified support for the KCS/TM transaction at the 7/31/03 public hearing. They did not submit correspondence.

Parties Urging Conditions. A number of parties asked that conditions be imposed in the event of approval of the KCS/TM application.

- Agriliance, LLC, asks that the Board secure enforceable conditions or agreements to ensure that NAFTA Rail will not discriminate against UP traffic and that TFM will continue to support competitive UP-TFM services and rates.

- Badger Mining Corporation asks that the Board make KCS's various commitments solid and enforceable, to ensure that the NAFTA Rail transaction does not interfere with Badger's ability to use the existing, efficient UP-TFM service.

- Chicago Sweeteners Incorporated contends that any approval of the merger of KCS, Tex Mex, and TFM should be conditioned upon the binding commitment of NAFTA Rail that it will not engage in unfair practices against shippers that use UP.

- Compass Consolidators, Inc., contends that there should be no discrimination against UP traffic at the Laredo Bridge, that UP-TFM shipments via Laredo should not be discriminated against, and that KCS's commitments should be made concrete and enforceable.

- Concannon Lumber Company asks that the Board require NAFTA Rail to abide by KCS's promises to provide fair treatment and efficient operations at the Laredo Bridge, non-discrimination for service in Mexico, and equitable and competitive rate factors for UP-TFM routings via Laredo.

- CWS, Incorporated, asks that the Board require NAFTA Rail to provide fair treatment and efficient operations at the Laredo Bridge, non-discrimination for rates and service in Mexico, and equitable and competitive rate factors for UP-TFM routings via Laredo.

- DaimlerChrysler Corporation contends that the Board should give sufficient consideration to guarantee competitive, efficient UP-TFM rail service via Laredo. DaimlerChrysler recommends that UP receive bridge crossing window times based on the prorated share of volume handled, and it asks that current commercial arrangements between UP and TFM be maintained.

- Dal-Tile asks that the Board require NAFTA Rail to provide fair treatment and efficient operations at the Laredo Bridge, non-discrimination for service in Mexico, and equitable and competitive rate factors for UP-TFM routings via Laredo.

- FMC Corporation contends that the Board should ensure that UP-TFM services and rates remain competitive with NAFTA Rail.

- General Chemical Industrial Products, Inc., asks that the Board impose conditions to ensure continued competitive and efficient rail service via the Laredo gateway for customers using the current UP-TFM rail routing.

- Global Motors S.A. de C.V. asks that the Board require NAFTA Rail to abide by KCS's promises to provide fair treatment and efficient operations at the Laredo Bridge, non-discrimination for service in Mexico, and equitable and competitive rate factors for UP-TFM routings via Laredo.

- Griffin Industries, Inc., asks that the Board impose conditions that will ensure continued competitive, efficient UP-TFM service via Laredo and that will further ensure that NAFTA Rail will abide by KCS's promises.

- Hub Group, Inc., supports conditions that will guarantee continued competitive and efficient UP-TFM rail service via Laredo.

- IMC Chemicals Inc., asks that the Board propose conditions that will ensure that NAFTA Rail lives up to the commitments made by KCS.

- INCON Container USA Ltd. advises that it supports all efforts to guarantee that there will be competitive and efficient rail service via the Laredo gateway. Any restrictions on access to that gateway, INCON warns, will have a negative impact on its business.

- International Paper Company asks that applicants be required to provide enforceable commitments that will ensure: (a) fair treatment and efficient operations at the Laredo Bridge and operational cooperation with TFM regarding pre-blocking rail cars, automated customs pre-clearance procedures, car supply, run-through train service, and prompt rate quotes for UP and BNSF customers; (b) the continuation of non-discriminatory, competitive rates for UP and BNSF customers for traffic moving over KCS/TFM routes from/to Mexico; and (c) the maintenance of Laredo as a commercially open gateway. International Paper adds that these and like conditions should be applied not only to KCS but also to UP and BNSF "in any future actions before this Board as well as to include the revision of any past Board actions where the opportunity for the Board to impose such non-discriminatory conditions was overlooked or somehow rejected."

- Kimberly-Clark de México, S.A. de C.V., asks that the Board work with the Mexican Federal Competition Commission to ensure that NAFTA Rail cannot discriminate against shipments delivered to Laredo by other carriers.

- Knichel Logistics, LP, asks that there be enforceable terms established for the fair handling of service between KCS-TFM and UP-TFM.

- Lason Grain Company asks that the Board require NAFTA Rail to provide fair treatment and efficient operations at the Laredo Bridge, non-discrimination for service in Mexico, and equitable and competitive rate factors for BNSF and UP routings via Laredo.

- Pacesetter Steel Service, Inc., asks that the Board require NAFTA Rail to provide fair treatment and efficient operations at the Laredo Bridge, non-discrimination for service in Mexico, and equitable and competitive rate factors for UP-TFM routings via Laredo.

- Plum Creek Marketing, Inc., has expressed conditional support for the KCS/TM application (although it has not asked the Board to impose any particular conditions).

- Reagent Chemical & Research, Inc., believes that the Laredo gateway should be kept open on commercially reasonable terms and that the Board should require applicants to commit to concrete and enforceable terms respecting such an open gateway.

- Solvay Engineered Polymers contends that there should be firm and enforceable conditions requiring KCS to operate the Laredo Bridge and the connection with TFM fairly and without discrimination so that the current service offered by UP-TFM over this gateway can continue to be offered efficiently and without interference.

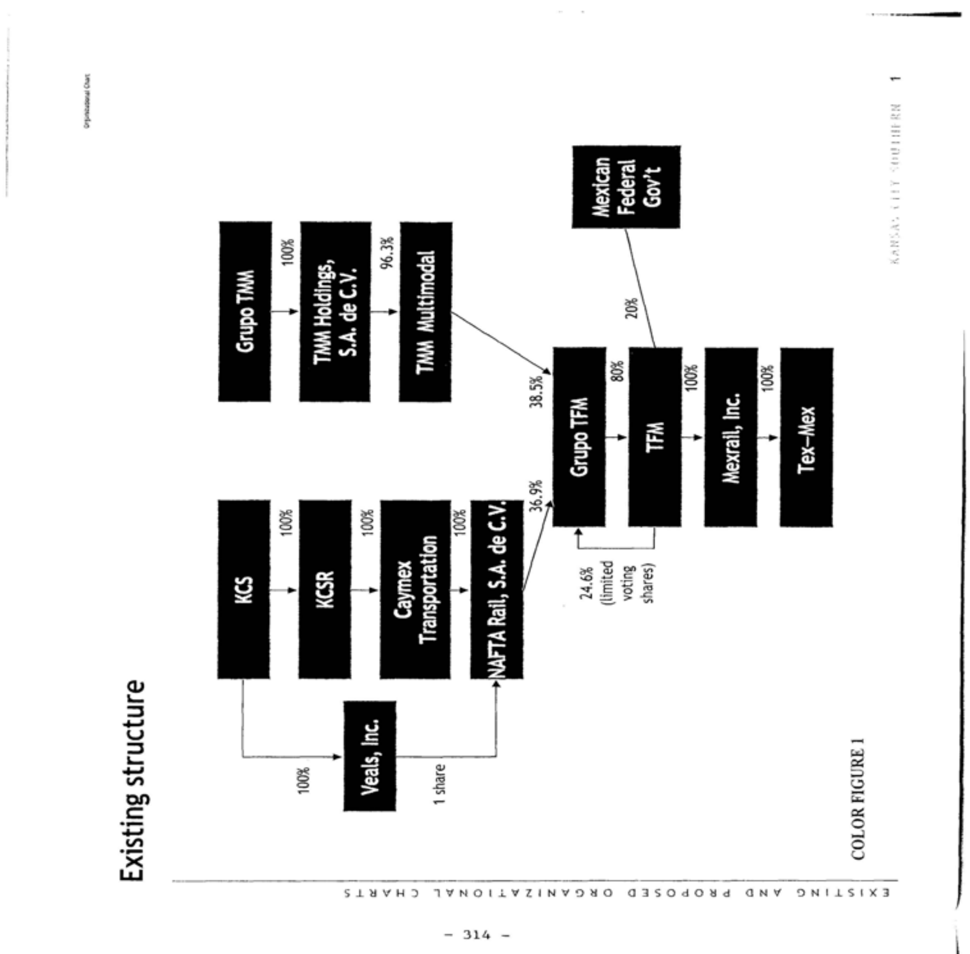
- Unimin Corporation asks that the Board impose detailed conditions of neutrality and non-discrimination to preserve competition among rail carriers and to enable Unimin to compete fairly for sales to Mexican customers. Unimin asks that the Board impose conditions that will ensure that the Laredo Bridge will not be used to discriminate against UP traffic, and that TFM will not discriminate against connecting traffic from carriers other than KCS. Unimin adds that the non-discrimination obligation, to be effective, must apply not only to price but also to all aspects of service, including transit times, switching service, and car supply.

- United Farmers Cooperative contends that it is of the utmost importance that NAFTA Rail live up to KCS's commitments.

- Westwood Forest Products, Inc., asks that NAFTA Rail be required to abide by KCS's promises to provide fair treatment and efficient operations at the Laredo Bridge, non-discrimination for service in Mexico, and equitable and competitive rate factors for UP-TFM routings via Laredo.

- Weyerhaeuser Company asks that a "firewall" be developed between KCSR/TM (in the U.S.) and TFM (in Mexico). Weyerhaeuser contends that, without a firewall, KCSR/TM would have an unfair advantage over the other U.S. railroads that handle traffic with TFM. The firewall that Weyerhaeuser envisions would "provide the Board with assurances and process, which can be monitored to insure the impartiality of [TFM] in its dealings with other railroads."

APPENDIX F: CORPORATE STRUCTURES



COLOR FIGURE 1

APPENDIX G: "SHORT FORM" CITATIONS

BN/SF .... *Burlington Northern et al. — Merger — Santa Fe Pacific et al.,* 10 I.C.C.2d 661 (1995)

Canada Southern .... *Canadian National Railway Company and Canadian Pacific Limited — Acquisition — Interests of Consolidated Rail Corporation in Canada Southern Railway Company and Detroit River Tunnel Company*, Finance Docket No. 30387 (ICC served Sept. 4, 1984)

CN/GLT .... *Canadian National Railway Company and Grand Trunk Corporation — Control — Duluth, Missabe and Iron Range Railway Company, Bessemer and Lake Erie Railroad Company, and The Pittsburgh & Conneaut Dock Company,* 7 S.T.B. 526 (2004)

CN/IC .... *Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated — Control — Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central and Pacific Railroad Company, and Cedar River Railroad Company,* 4 S.T.B. 122 (1999)

CN/WC .... *Canadian National Railway Company, Grand Trunk Corporation, and WC Merger Sub, Inc. — Control — Wisconsin Central Transportation Corporation, Wisconsin Central Ltd., Fox Valley & Western Ltd., Sault Ste. Marie Bridge Company, and Wisconsin Chicago Link Ltd.,* 5 S.T.B. 890 (2001)

Conrail .... *CSX Corp. et al. — Control — Conrail Inc. et al.*, 3 S.T.B. 196 (1998)

CP/D&H .... *Canadian Pacific Ltd. — Pur. & Trackage — D&H Ry. Co.,* 7 I.C.C.2d 95 (1990)

CSX/ACL .... *CSX Corp. — Control — American Commercial Lines, Inc.*, 2 I.C.C.2d 490 (1984)

Decision No. 2 .... *Kansas City Southern — Control — The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company*, STB Finance Docket No. 34342, Dec. No. 2 (STB served June 9, 2003), 68 FR 35474 (June 13, 2003)

DM&E/IC&E .... *Dakota, Minnesota & Eastern Railroad Corporation and Cedar American Rail Holdings, Inc. — Control — Iowa, Chicago & Eastern Railroad Corporation*, 6 S.T.B. 511 (2003)

DT&I conditions .... *Detroit, T. & I. R. Co. Control*, 275 I.C.C. 455, 492-93 (1950)

KCS/GWWR .... *Kansas City Southern Industries, Inc., KCS Transportation Company, and The Kansas City Southern Railway Company — Control — Gateway Western Railway Company and Gateway Eastern Railway Company, STB Finance Docket No. 33311* (STB served May 1, 1997)

New Merger Standards .... *Major Rail Consolidation Procedures*, 5 S.T.B. 539 (2001)

New York Dock conditions .... *New York Dock Ry. — Control — Brooklyn Eastern Dist.*, 360 I.C.C. 60, 84-90 (1979)

NS/NAVL .... *Norfolk Southern Corp. — Control NAVL*, 1 I.C.C.2d 842 (1985)

Soo/Milwaukee II .... *Milwaukee — Reorganization — Acquisition by GTC*, 2 I.C.C.2d 427 (1985)

TFM Pooling	*Transportacion Ferroviaria Mexicana — Pooling of Car Service Regarding Multilevel Cars*, STB Finance Docket No. 29653 (Sub-No. 7) (STB served Sept. 28, 1999)
UP/CNW	*Union Pacific Corporation*, *Union Pacific Railroad Company and Missouri Pacific Railroad Company — Control — Chicago and North Western Transportation Company and Chicago and North Western Railway Company*, *Finance Docket* No. 32133, Dec. No. 25 (ICC served Mar. 7, 1995)
UP/MKT	*Union Pacific Corp. et al. — Cont. — MO-KS-TX Co. et al.,* 4 I.C.C.2d 409 (1988)
UP/MP/WP	*Union Pacific — Control — Missouri Pacific; Western Pacific*, 366 I.C.C. 459 (1982)
UP/SP	*Union Pacific/Southern Pacific Merger,* 1 S.T.B. 233 (1996)