BEFORE THE

SURFACE TRANSPORTATION BOARD

STB FINANCE DOCKET 34342

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

REMARKS DURING OPEN HEARING

BY THE

UNDER SECRETARY OF AGRICULTURE

FOR MARKETING AND REGULATORY PROGRAMS

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Date: July 31, 2003

Thank you for the opportunity to speak before the Board today regarding Kansas City Southern Railway's application to control Texas Mexican Railway. I am presenting my remarks on behalf of the Secretary of Agriculture. The Department of Agriculture (USDA) supports this control application and concludes that Board imposition of competitive conditions will not be necessary.

USDA represents the agricultural shippers and U.S. farmers, and the vitality of their livelihood is our primary interest. Toward that end, we expect that all parties (UP, BNSF, and KCS, as well as our Mexican colleagues) will uphold their commitments to fair market behavior, providing adequate service to shippers and, ultimately, agricultural producers. Our interest is in preserving an efficient and competitive transportation sector that serves U.S. agriculture effectively. To the extent that the parties can identify their expectations for fair competition, we anticipate they will do so in a public manner that their customers can also review and understand.

Despite historical skepticism regarding rail mergers and wariness of increased railroad industry concentration, USDA contends that this 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. Increased rail-to-rail competition reduces the need for regulatory interference because it promotes efficiency, improves the levels of service provided shippers, and keeps transportation rates competitive.

USDA contends this merger would benefit our Nation's agricultural producers by improving the efficiency of rail access to Mexican markets and shortening transit times. Subsequent to NAFTA, Mexico has become one of our Nation's most important trade partners. U.S. agricultural exports to

Mexico amounted to $7.1 billion during fiscal 2002 and are expected to reach $7.6 billion during fiscal 2003.[1] During 2001, the United States exported over 18 million tons of corn, sorghum, soybeans, and wheat to Mexico (table 1). Railroads transported 41 percent of all U.S.-grown grain exported to Mexico during 2001, and 31 percent of that passed through the Laredo, TX, gateway.

U.S. farmers produce more than our country can consume. Therefore, the ability to export surplus production is extremely important because the ability to export supports domestic grain and agricultural product prices, enhancing the vitality of rural economies.

One of the key decisions the Board must make in this proceeding is whether to impose competitive conditions and, if so, to what extent. Historically, the Board has been conservative in its application of competitive conditions, applying only those necessary to preserve rail-to-rail competition, and usually tailoring those conditions to protect shippers rather than competing railroads. Although it has often requested competitive conditions in prior mergers, USDA is not convinced competitive conditions on this merger are necessary to protect shippers.

USDA concludes that competitive conditions need not be placed upon this transaction because the use of railroad market power requires one party to have significantly more market power than the other parties and for other parties to lack competitive transportation options. USDA contends Kansas City Southern is unlikely to have the ability to exercise any significant market power because:

- Rail movements to Mexico must compete against cost-effective ocean transportation;
- Kansas City Southern is much smaller than either of its competitors in the U.S.-Mexico trade

[1] USDA, Economic Research Service, Outlook for U.S. Agricultural Trade, May 27, 2003.

lane;

- Both Union Pacific and Burlington Northern Santa Fe control competing gateways into Mexico that provide competitive transportation options, and
- Union Pacific has considerable leverage over Kansas City Southern because Tex Mex must operate over Union Pacific lines in order to connect to Kansas City Southern.

First, ocean transportation to Mexican markets is extremely competitive with rail movements. Ocean shipments comprise 53 percent of all U.S.-grown grain exported to Mexico, whereas rail transports only 41 percent. The availability of cost-effective ocean transportation to Mexican markets constrains the ability of Kansas City Southern to impose commercially unreasonable terms at the Laredo gateway.

Second, NAFTA Rail, as controlled by Kansas City Southern would operate approximately 6,000 miles of road and would have operating revenues of $1.3 billion. In contrast, Union Pacific is the largest Class I railroad in North America, operating 33,586 miles of road and having operating revenue exceeding $10.6 billion during 2001. The Burlington Northern Santa Fe Railway is a close second, operating 33,063 miles of road and having operating revenue exceeding $9.2 billion during 2001. Both Burlington Northern Santa Fe and Union Pacific shares of U.S. grain exports to Mexico are larger than that of Tex Mex, and are expected to remain larger.

In addition, both Union Pacific and Burlington Northern Santa Fe control alternative routes to Mexican markets. Union Pacific controls crossings at Brownsville and Eagle Pass, TX, Calexico, CA, and Nogales, AZ. Both Union Pacific and Burlington Northern Santa Fe control crossings at El Paso, TX. Burlington Northern Santa Fe has access to Union Pacific controlled crossings at Brownsville and Eagle Pass, TX. As shown by table 3, the other three Texas border crossings provide significant competition to the crossing at Laredo.

Finally, Tex Mex operates over 379 miles of Union Pacific Railroad lines between Robstown and Beaumont, TX, to connect with Kansas City Southern in Beaumont. The terms and price of these trackage rights are negotiated by the parties involved without Board interference. Therefore, Union Pacific has considerable leverage over Kansas City Southern, which should ensure commercially reasonable terms for rail interchange at Laredo.

In conclusion, USDA supports this control application and concludes that the imposition of competitive conditions will not be necessary.

Respectfully submitted,

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Commodity	Total 2001 U.S. exports (000 tons)	Total 2001 U.S. exports by railroad (000 tons)	Percent rail to total exports	Rail exports through Laredo (000 tons)	Percent Laredo rail to total rail exports
Corn	6,165	2,943	48%	715	24%
Sorghum	5,525	1,751	32%	780	45%
Soybeans	4,345	2,197	51%	235	11%
Wheat	2,346	670	29%	436	65%
Other grains	509	279	55%	229	82%
Total grains	18,889	7,792	41%	2,395	31%

Table 1–Railroad Share of Total U.S. Grain Exports to Mexico

Sources: Rail tonnages estimated from the 2001 STB Waybill Sample;
Export data from the Department of Commerce, U.S. Census Bureau.

Notes: Other grains include barley, oats, and rough rice only.
Canadian-grown grain traveling by rail to Mexico through the United States is excluded.
Some rail shipments to the U.S.-Mexico border region may have been used locally or exported by ocean vessel at Brownsville, TX, rather than exported across the U.S.-Mexico border by rail.
Quantities are rounded, thus the sum of individual grain tonnages may not equal the total grain tonnage.

Table 2–Terminating Railroad Share of 2001 U.S. Agricultural Exports to Mexico by Rail and Share of Rail Exports Through Laredo, Texas

Commodity	BNSF percent of total rail	Tex Mex percent of total rail	UP percent of total rail	Tex Mex percent of rail through Laredo	UP percent of rail through Laredo
Corn	37%	8%	56%	32%	68%
Sorghum	30%	23%	47%	51%	49%
Soybeans	20%	2%	78%	19%	81%
Wheat	13%	27%	61%	41%	59%
Other grains	3%	6%	90%	8%	92%

Source: Rail tonnages estimated from the 2001 STB Waybill Sample.

Notes: Other grains include barley, oats, and rough rice.
Canadian-grown grain traveling by rail to Mexico through the United States is excluded.

Table 3–Percentage by Port of U.S. Agricultural Exports to Mexico Shipped by Rail						
Commodity	**Brownsville, TX**	**Eagle Pass, TX**	**El Paso, TX**	**Laredo, TX**	**Calexico, CA**	**Nogales, AZ**
Corn	15%	48%	8%	24%	1%	3%
Sorghum	3%	24%	21%	45%	0%	7%
Soybeans	25%	34%	18%	11%	n/a	11%
Wheat	6%	3%	19%	65%	n/a	8%
Other grains	3%	5%	10%	82%	0%	0%

Source: Rail tonnages estimated from the 2001 STB Waybill Sample.

Notes: Other grains include barley, oats, and rough rice.
Canadian-grown grain traveling by rail to Mexico through the United States is excluded.