

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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PUBLIC SERVICE COMMISSION

COMMON CARRIER OBLIGATION OF RAILROADS

WRITTEN TESTIMONY OF

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Written Testimony of David C. Reeves**

Kansas City Southern Railway Company

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INTRODUCTION AND BACKGROUND

My name is David Reeves. I am an Associate General Counsel for The Kansas City Southern Railway Company (“KCSR”). I am pleased to submit these comments on behalf of KCSR in response to the Surface Transportation Board’s (“STB” or “Board”) announced hearing to examine issues related to the common carrier obligation of railroads.

KCSR appreciates the opportunity to participate in this hearing and to share KCSR’s perspectives on this important issue. KCSR has always striven to meet its obligation to provide service to shippers upon reasonable request. However, what requests are reasonable must be viewed not only in light of a particular shipper’s desires, but also in light of the capabilities and needs of the entire rail network, of which KCSR is just a part, and of course, the needs of other shippers. Such an analysis is complicated by capacity constraint issues and the impossibility of obtaining sufficient capital to meet every potential request for service. It is further complicated by the various issues surrounding the transportation of hazardous materials. KCSR therefore applauds the Board’s effort to discharge its oversight responsibility through this hearing to clarify the nature of the obligation. However, KCSR strongly believes that the Board should avoid any pronouncement of a one-size-fits-all standard in this proceeding, and should instead continue the Board’s policy of considering these matters on a case-by-case basis.

COMMENTS

The Board has requested that the hearing focus on various topics related to the extent of the common carrier obligation, including, but not limited to: (1) service limitation resulting from a capacity constrained environment; (2) cost and safety issues

related to the transportation of hazardous materials, especially toxic inhalation hazards; (3) carrier-imposed requirements for infrastructure investments by shippers; (4) the impact of volume requirements or incentives; (5) economically motivated service reductions and metering of the demand for service; (6) the proper use of rail embargoes; (7) when it becomes necessary to obtain abandonment authorization; and (8) to whom does the common carrier obligation apply. KCSR does not intend to address all of these topics, but notes that these issues, and others, are being addressed in the comments filed by the Association of American Railroads (“AAR”), in which KCSR has joined.

I. CAPITAL INVESTMENT CONCERNS ARE INEXTRICABLY INTERTWINED WITH RATES AND SERVICE

One of the issues raised by the Board’s notice of this hearing is what service limitations, if any, a railroad can adopt in the context of a capacity constrained environment. Another way to look at this issue is to ask whether a carrier can tailor its network and operations to maximize the efficiency of its rail network for the vast majority of the shippers’ that it serves, or instead must be subject to deploying its assets and changing its network solely to accommodate random requests for service, regardless of the impacts of those requests on other the overall shipper community that it serves.

Recent studies, and there have been several, show that the demand for freight rail service will continue to grow, requiring more and more capacity. One study issued by a prominent economic and transportation consulting firm found that the system will become so congested that there could be significant service disruptions unless steps are taken to ensure adequate funding for expanded rail capacity.¹ Given that there is also a

¹ NATIONAL RAIL FREIGHT INFRASTRUCTURE CAPACITY AND INFRASTRUCTURE STUDY, Cambridge Systematics (September 2007).

growing demand for rail on the passenger/transit side, of which many of these transit systems require shared track capacity with the freight railroads, the problem of constrained capacity will only be further exacerbated. It is clear, therefore, that capacity must be expanded, and it must be funded from somewhere.

KCSR is already doing its part to use its revenues and profits to build infrastructure for the future. For 2008, Kansas City Southern (“KCS”), the parent company of KCSR, plans capital expenditures of approximately \$529 million for new infrastructure and equipment, plus another \$111 million in new locomotive and equipment lease programs. KCS is also committed to implementing new technologies to improve service and fluidity over the entire network and has already done so through adoption of the MCS information systems on both its U.S. and Mexican operations. KCS’s commitment to building capacity to improve service and fluidity is demonstrated in that the KCS 2008 capital expenditure program outlined above represents approximately 28% of KCS’s expected revenues. It is projected that over the next five years, KCS’s capital spending will average approximately 20% of its revenues. This stands in stark contrast to the 3% spent by an average U.S. manufacturer on capital on an annual basis.²

Infrastructure and capacity drive the ability to provide service. KCSR is committed to doing its best to meet the demands for service placed upon it by its shippers through an aggressive, multi-year capital spending program targeted to meet anticipated areas of growth in service demand. Yet, even the substantial capital spending levels that we have projected may not be enough to meet the increasing demands for freight service.

² Source: U.S. Bureau of the Census, AAR, and Edison Electric Institute.

KCS will obviously do its part to provide the private capital for expanded capacity, but reliance on purely private capital will not necessarily be enough to meet the demand, especially when one factors in the need to add infrastructure to accommodate growing rail freight traffic and vehicular mobility in conjunction with the public goals of reducing the number of at-grade crossings, improving safety, and relocating rail lines away from congested areas.

Despite extensive capital investment, a railroad is sometimes faced with a shipper who demands a certain level or type of service that it believes to be reasonable yet cannot be met due to capacity constraints or the overall needs of other shippers at large. That shipper may then complain that the railroad has failed to meet its common carrier obligation. Meeting that shipper's particular need, however, could mean that several other shippers' needs would not be met, and could lead to complaints from those shippers that the railroad was violating its common carrier obligation to them. Thus railroads must plan their capital spending and service plan designs to meet the needs of those shippers who are most using the system, even if this means an individual shipper may not always be able to obtain the level or type of service that it desires. Designing such a system is not a violation of – indeed it is the essence of – meeting the common carrier obligation.

KCSR is committed to its capital program and to developing a service plan designed to meet as much service demand as possible, but it can't always design a service plan that accommodates every type and level of service that is requested of it. KCSR works with its shippers to achieve the type of balance that is necessary to ensure that adequate capacity, and corresponding service levels, are available now and will be in the

future. Yet, this does not mean that KCS expects to be able to spend enough capital to satisfy every service request. Particularly in the context of constrained capacity, even a plan to expend capital at almost six times the average rate for U.S. manufacturers, as KCS plans to do, does not guarantee the ability to meet every request for service. Like others, KCS will need to rationalize, the use of some of its capacity to some degree, and will likely look to its shippers to share in shipper specific infrastructure investments and/or provide certain guarantees of traffic.

Given the capacity constrained environment faced by the rail industry and the fact that demand for rail service may outstrip the ability of the railroads to fund infrastructure projects to meet that demand, there are going to be some shippers that do not receive the level and type of service that such a shipper believes it is entitled to and those shippers may seek redress from the Board. When such a situation arises, the Board needs to carefully evaluate each and every claim on the specific merits of that case, and to do so in the context of the overall needs of the entire rail network. Any attempt to formulize the meaning of the common carrier obligation without such a case-by-case approach would be flawed and could do long lasting harm to future capacity and service to other shippers.

II. RATE CONCERNS ARE A SEPARATE ISSUE FROM THE COMMON CARRIER OBLIGATION

The common carrier obligation stems from 49 U.S.C. § 11101. The obligations of KCSR under this section are to provide its rate and service terms on request, to give at least 20 days notice of certain changes in rate or service terms, and to provide transportation or service in accordance with its rates and service terms. This section imposes no substantive standards or requirements regarding the level of the rate quoted or the frequency in which the railroad must provide the service. Those issues are covered

by other provisions of ICCTA, particularly 49 U.S.C. Sections 10701-10709. In the context of this proceeding, therefore, the Board needs to carefully ensure that it not adopt any policy or pronouncement that would allow complaints, which are really about the level of rates, to be confused with being issues of the common carrier obligation.

III. WITHOUT LIABILITY LIMITS, RAILROADS SHOULD NOT BE REQUIRED TO TRANSPORT HAZARDOUS MATERIALS

Another area of concern to KCSR and the industry, and where the Board has sought comments, involves issues surrounding the railroads' common carrier obligation to transport highly-hazardous materials, especially so-called "toxic inhalation hazards" ("TIH"), which are certain gases or liquids, such as chlorine and anhydrous ammonia. Despite the rail industry's outstanding safety record in moving TIH materials, the risk of even one accident related to TIH materials is potentially devastating, especially for smaller carriers. Yet, despite this risk, carriers generally view their service obligations as requiring them to carry such TIH materials, whether they want to or not.

Then, if a carrier attempts to account for this risk through the rates quoted to such a TIH shipper, it is subject to a rate complaint due to the high level of rates needed to fully account for the shipment's costs. This is a problem because the Board's rules for simplified stand-alone costs cases and three benchmark cases do not provide a carrier with an adequate opportunity to recover the fully-allocated costs of transporting such TIH materials. A rail carrier thus can be stuck carrying TIH materials at rates that are not fully compensatory, particularly in light of the extreme risk of a release of such chemicals. The simple fact of the matter is that the revenue generated by transporting TIH materials does not come close to covering the potential liability to railroads associated with this traffic. This situation must be corrected.

Improving the safety of transporting such materials is one step. In that light, KCSR supports the industry's efforts to establish new standards for tank cars carrying TIH, to cooperate with communities that are developing and evaluating emergency response plans; to train emergency responders, to improve information flow, and to develop special operating rules governing TIH. KCSR also supports efforts to replace TIH materials with safer product substitutes wherever possible. Unless these movements can be completely eliminated, however, the risk of a catastrophic accident remains. Such an accident could be through no fault of the railroad, such as a road vehicle running into the side of a train or a tank car owner's failure to adequately maintain the cars in which it ships hazardous chemicals, yet the railroad is nevertheless exposed to tremendous liability.

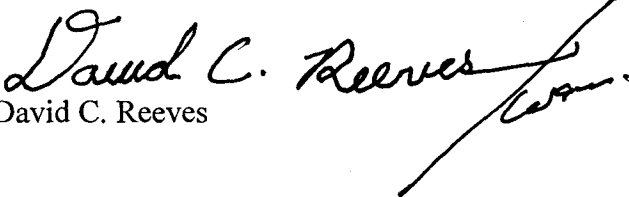
There are numerous options to remedy the fundamental problems inherent in forcing railroads to carry TIH while at the same time denying them adequate opportunity to recover the fully-allocated costs of transporting such TIH materials by effectively capping the rates through rate regulation. Some of these options include, but are not limited, to eliminating the common carrier obligation for TIH shipments altogether, adopting special rate reasonableness procedures to account for the increased costs associated with moving TIH, allowing rates to be set without subjecting them to a rate reasonableness proceeding, or requiring TIH shippers to enter into special arrangements, such as indemnification agreements, before a railroad would be required to transport such commodities. KCSR does not endorse any specific approach at this time, but believes the Board needs to carefully examine these issues and develop either a regulatory solution, or

if need be, propose and support legislative changes as necessary to fix the dilemma faced by the industry.

CONCLUSION

KCSR supports the Board's efforts through this hearing to clarify the meaning of the common carrier obligation in today's environment. KCSR has always understood that the common carrier obligation required KCSR to provide a rate and service upon reasonable request, and has always abided by that requirement to the best of its understanding and ability. Of course the issue is always what is a reasonable request? KCSR believe the answer to that question should continue to be a matter of case-by-case analysis through the STB and the courts. The Board should avoid any temptation in this proceeding to produce a "one size fits all" formula pronouncement about what is a reasonable request.

Respectfully submitted,


David C. Reeves

April 17, 2008