

BEFORE THE SURFACE TRANSPORTATION BOARD

Finance Docket No. 36514

CANADIAN NATIONAL RAILWAY COMPANY, ET AL. – CONTROL –
KANSAS CITY SOUTHERN, ET AL.

CANADIAN PACIFIC’S OBJECTION TO 49 C.F.R. § 1180 WAIVER

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TABLE OF CONTENTS

I. INTRODUCTION AND EXECUTIVE SUMMARY.....3

II. THE BOARD HAS DISCRETION TO FIND THAT THE NEW RULES SHOULD APPLY TO A CN/KCS TRANSACTION..... 5

III. THE CN/KCS TRANSACTION DOES NOT SATISFY ANY OF THE CRITERIA THE BOARD RELIED UPON IN FINDING THAT THE WAIVER SHOULD APPLY TO CP/KCS 6

 A. CN is a Much Larger Railroad than CP.....6

 B. The CN/KCS Transaction Would Combine Overlapping Routes and Have Significant Competitive Impacts 7

IV. OTHER FACTORS UNDERScore THE INAPPROPRIATENESS OF APPLYING THE KCS WAIVER TO A CN/KCS TRANSACTION 11

 A. There Are Material Service Risks from a CN/KCS Transaction..... 11

 B. There Are Material “Downstream” Risks from a CN/KCS Transaction. 12

V. THE NEW RULES ARE NEEDED TO ENSURE APPROPRIATE CONSIDERATION OF THE PUBLIC INTEREST IMPLICATIONS OF CN’S VOTING TRUST PROPOSAL..... 13

VI. CN’S CONCERNS ABOUT FAIRNESS SUPPORT APPLICATION OF THE 2001 RULES..... 13

CONCLUSION 14

EXHIBIT 1 —VERIFIED STATEMENT OF ROBERT MAJURE

EXHIBIT 2 – FINANCE DOCKET No. 36500, CP APRIL 21, 2021 LETTER

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Canadian Pacific Railway Limited and its U.S. rail carrier subsidiaries (all of which are Applicants in Finance Docket No. 36500),¹ object to the application of the waiver of the Board’s rules for major transactions with respect to CN’s proposed acquisition of control of Kansas City Southern. *See* 49 C.F.R. § 1180.0(b).

I. INTRODUCTION

On April 19, 2021, a month after Canadian Pacific announced its agreement with Kansas City Southern to bring CP and KCS together to create a more formidable competitor in North-South transportation markets, Canadian National announced that it was offering to pay a substantial price premium in an effort to compel KCS’s board of directors to accept CN’s bid to acquire control of KCS. The next day, CN filed a Notice of Intent to File an application seeking approval to acquire such control. *See* CN-1.² In that filing – and in CN’s contemporaneous public statements – CN told the world that its merger application would proceed under the current (2001) rules for major mergers and that any review of its transaction under the pre-2001

¹ Canadian Pacific Railway Limited, Canadian Pacific Railway Company, and their U.S. rail carrier subsidiaries Soo Line Railroad Company, Central Maine & Quebec Railway US Inc., Dakota, Minnesota & Eastern Railroad Corporation, and Delaware and Hudson Railway Company, Inc. (collectively “Canadian Pacific” or “CP”).

² CN was apparently uninterested in acquiring KCS when it was reported during the summer and fall 2020 that private equity investors were seeking to acquire KCS. *See* “Report: Private Equity Firms Eye Purchase of Kansas City Southern,” KANSAS CITY BUSINESS JOURNAL (Aug. 3, 2020), <https://www.bizjournals.com/kansascity/news/2020/08/03/report-blackstone-gip-eyeing-kansas-city-southern.html>.

rules would be inappropriate. CN-1 at 3-4 (“CN believes that the current major merger rules should be applied to a transaction involving KCS”).³ Even after the Board ruled that Canadian Pacific’s proposed acquisition of KCS would proceed under the pre-2001 rules, CN doubled down, reaffirming that CN “remains committed to the current merger rules.” CN Apr. 26 Ltr. (CN-5), at 2.

Despite these seemingly unequivocal statements, CN has also implied that its embrace of the 2001 rules was a “voluntar[y]” matter (CN Apr. 29, 2021 Ltr. (CN-8) at 1), perhaps suggesting that the Board would lack authority to bind CN to compliance with those rules. And CN has also signaled that it might challenge the application of the 2001 rules to its proposed transaction in light of the Board’s decision to apply the pre-2001 rules to the CP/KCS transaction.⁴

In light of these seemingly contradictory positions and the confusion they create, out of an abundance of caution, Canadian Pacific is formally objecting to application of the KCS waiver to CN’s proposed acquisition of KCS. The Board’s decision to apply the KCS waiver to the CP/KCS transaction does not mandate applying the waiver here. To the contrary, the reasoning of that decision shows why the very different CN proposal *should be* subject to the 2001 rules. Unlike the “end-to-end” CP/KCS transaction – after which the combined company would still be the smallest Class I railroad – the CN/KCS proposal raises all of the concerns that the 2001 rules were adopted to address (as CN’s own arguments confirm).

³ That position was unsurprising given that CN had previously objected to the waiver in Finance Docket No. 36500, contending that the “most significant U.S. rail merger that has been proposed in the 21st century should be evaluated under the current rules.” *See* Finance Docket No. 36500, CN-1 at 12.

⁴ A footnote buried in CN’s Notice of Intent contended that “[i]t would be fundamentally unfair to use one set of rules to evaluate a proposed CP-KCS transaction and a different set of rules to evaluate a proposed CN-KCS transaction.” CN-1 at 4 n.5.

II. THE BOARD HAS DISCRETION TO FIND THAT THE NEW RULES SHOULD APPLY TO A CN/KCS TRANSACTION

The Board's plenary authority over rail mergers is well established. 49 U.S.C. § 11341. The breadth of the Board's authority to oversee rail consolidations to ensure that the public interest is safeguarded was confirmed when the court of appeals affirmed the Board's 2000 merger moratorium, and again in 2001 when the Board adopted its new merger rules to "substantially increase the burden on applicants to demonstrate that a proposed transaction would be in the public interest, by requiring them, among other things, to demonstrate that the transaction would enhance competition where necessary to offset negative effects of the merger, such as competitive harm or service disruptions." *Major Rail Consolidation Procedures*, Ex Parte No. 582 (Sub-No. 1) (STB served June 11, 2001) at 1.

When the Board waived its new rules for transactions involving KCS, it underscored two things. First, not all potential transactions involving KCS would qualify for the waiver. The Board observed that, "as a general matter, ... a potential transaction involving KCS and another Class I carrier would *not necessarily* raise the same concerns and risks as other potential mergers between Class I railroads." *Id.* at 15. The Board was not prepared to "assess in the abstract the effect of every potential merger proposal involving KCS." *Id.* at 16.

Second, the Board retained complete discretion to find that, as to a specific transaction being proposed, those "same concerns and risks" would apply, and that the transaction therefore should be reviewed under the 2001 rules. The Board simply had to be "persuaded otherwise." *Id.*

CN itself has emphasized the Board's discretion to reject the KCS waiver in this case. In the CP/KCS docket, CN pointed out that "the 'KCS exception' to ordinary major merger rules *is*

not automatic, and it will not be applied if the Board finds that it ‘should not be allowed.’”

Finance Docket No. 36500, CN Objection (CN-1) at 1 (emphasis added).

III. THE CN/KCS TRANSACTION DOES NOT SATISFY ANY OF THE CRITERIA THE BOARD RELIED UPON IN FINDING THAT THE WAIVER SHOULD APPLY TO CP/KCS

The Board’s April 23 decision in Finance Docket No. 36500 explained that it was applying the pre-2001 rules to the proposed CP/KCS transaction because that transaction “fall[s] neatly into the Board’s rationale for adopting the waiver in the first instance.” CP/KCS Decision No. 4 at 2. The Board reached this conclusion “for several reasons”:

“If approved, the combination of CP and KCS, the sixth largest and seventh largest Class I railroads, respectively, would still result in the smallest Class I railroad, based on U.S. operating revenues. (*See* Applicants’ Reply 4, 9-14, Apr. 12, 2021.) In addition, a merger of the CP and KCS networks would appear to result in the fewest overlapping routes when compared to a merger between KCS and any other Class I carrier. (*Id.* at 8, 14-15 (explaining that there will be ‘no overlaps whatsoever’).) The interrelationship between the CP and KCS networks in fact appears to be end-to-end in nature, (*id.* at 14-15), which likely raises fewer competitive concerns than a transaction that is not end-to-end. (*See* Freight Rail Customer Alliance, National Coal Transportation Alliance, Private Railcar Food & Beverage Association, Inc. Opp’n 2, Apr. 1, 2021 (acknowledging that the Transaction ‘appears to be “end-to-end,”’ which ‘carries potential to increase both efficiency and competition for the benefit of shippers’).)”

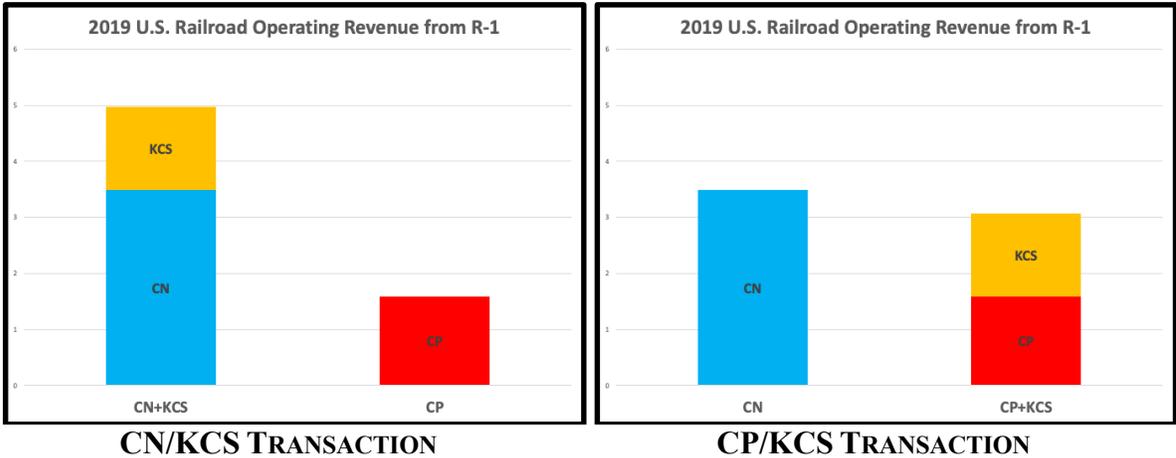
CP/KCS Decision No. 4 at 2. None of these factors supports applying the pre-2001 rules to CN’s proposed transaction.

A. CN is a Much Larger Railroad than CP

CP/KCS Decision No. 4 focused on the impact of the proposed transaction on the relative size of the remaining Class 1 railroads. Specifically, a CP/KCS transaction would combine “the sixth largest and seventh largest Class I railroads, respectively, [and] would still result in the smallest Class I railroad, based on U.S. operating revenues.” *Id.* at 2

The proposed CN/KCS transaction would have a very different impact. A combined CN/KCS would expand the size of the fifth largest U.S. Class I railroad, vastly increasing the gap between CN/KCS and CP, which would become the new smallest Class I. As shown in Figure I below, a combined CN/KCS would be more than three-times the size of CP (as shown in the left panel), whereas the proposed CP/KCS would still be 13 percent smaller than CN (as shown in the right panel) (as measured by U.S. operating revenue).

FIGURE 1



B. The CN/KCS Transaction Would Combine Overlapping Routes and Have Significant Competitive Impacts

CP/KCS Decision No. 3 (at 2) emphasized that the “CP and KCS networks would appear to result in the fewest overlapping routes when compared to a merger between KCS and any other Class I carrier” and that the “interrelationship between the CP and KCS networks in fact appears to be end-to-end in nature, ... which likely raises fewer competitive concerns than a transaction that is not end-to-end.” The Board specifically emphasized that the “end-to-end nature” of the CP/KCS transaction was the most important factor in “determining the application of the waiver.” *Id.* at 3 n.4. This conclusion was appropriate given how important potential impacts on competition were in the Board’s adoption of the 2001 rules in the first place.

A CN/KCS transaction plainly flunks the “end-to-end” test, notwithstanding CN’s occasional and misleading assertions that such a transaction would be end-to-end. *E.g.*, CN Motion for Approval of Voting Trust Agreement (CN-6) at 12 (asserting that CN/KCS is an “end-to-end rail merger”); CN Apr. 29 Ltr. (CN-8) at 4. CP has addressed some of the obvious competitive issues raised by a CN/KCS transaction in its prior submissions (which we incorporate herein), and so will not belabor them here. We summarize the key points below:

1. The broadly overlapping North-South route structures of CN and KCS between Kansas City and the Gulf Coast make clear that CN and KCS are today independent competitive alternatives for many rail shipments in these corridors. *See* CP Apr. 27 Ltr. (CP-2) at 3-6.
2. Reciprocal switching tariffs available to CP reveal that more than 340 shippers at numerous locations have access to both CN and KCS, and a quick glance at a map shows that CN and KCS offer competing routes to and from these points (*e.g.*, between Omaha/Council Bluffs and the Gulf, between Baton Rouge/New Orleans and St. Louis, and on many more routes). *See id.* We reproduce below as Figure 2 the map set forth in our prior letter.

FIGURE 2



3. Major shippers have previously expressed grave concern about any transaction that would dampen competition between CN's former Illinois Central lines and KCS.⁵

4. CN itself acknowledges the need to remedy at least some competitive overlaps, though it seeks to minimize them by misleadingly referencing the number of route miles where the two railroads run side-by-side between Baton Rouge and New Orleans, and CN proposes to provide some form of remedy only for the specific shipper facilities that are dually served by CN and KCS and no other railroad. CN Apr. 23 Ltr. (CN-5) at 3; CN Apr. 29 Ltr. (CN-8) at 5-6.

5. In addition, examination of the overlapping territories of CN and KCS in regions like Louisiana and Mississippi make clear that the CN/KCS transaction likely would have complex impacts on geographic competition (*e.g.*, for grain to Mississippi feed lots served by either KCS or CN) as well as potential build-in/build-out opportunities, such as has occurred before in the New Orleans-Baton Rouge corridor. *See* CP Apr. 27 Ltr. (CP-2) at 3-4.⁶

6. A significant number of shippers have already submitted letters expressing competitive concerns with the CN/KCS transaction (while at the same time confirming the

⁵ CP Apr. 27 Ltr. (CP-2) at 4-5 (quoting from the Petition of Bordon, Fina and Shell in *Illinois Central Corp. – Common Control – Illinois Central R.R. & The Kansas City Southern Ry.*, Finance Docket No. 32556 (filed Sept. 27, 1994), at 2); *Canadian National Ry., Grand Trunk Corp., & Grand Trunk Western R.R. – Control – Illinois Central Corp., Illinois Central R.R., Chicago, Central & Pacific R.R., & Cedar River R.R.*, Finance Docket No. 33556 (STB Decision No. 37 served May 25, 1999) (“*CN/IC*”) at 103 (“Exxon contends that, as a practical matter, these facilities, for the most part: (a) are rail-served both by IC and KCS, but by no other railroad; or (b) are rail-served solely by IC, but have a KCS build-in/build-out option; or (c) are rail-served solely by KCS, but have an IC build-in/build-out option ... Exxon therefore argues: that, in the context of the Alliance, all of these facilities should be regarded as 2-to-1 facilities; and that the Alliance, *by uniting the two carriers (IC and KCS) that together originate 94% of the rail cars moving outbound from these facilities will have anticompetitive impacts at all of these facilities.*”) (emphasis added).

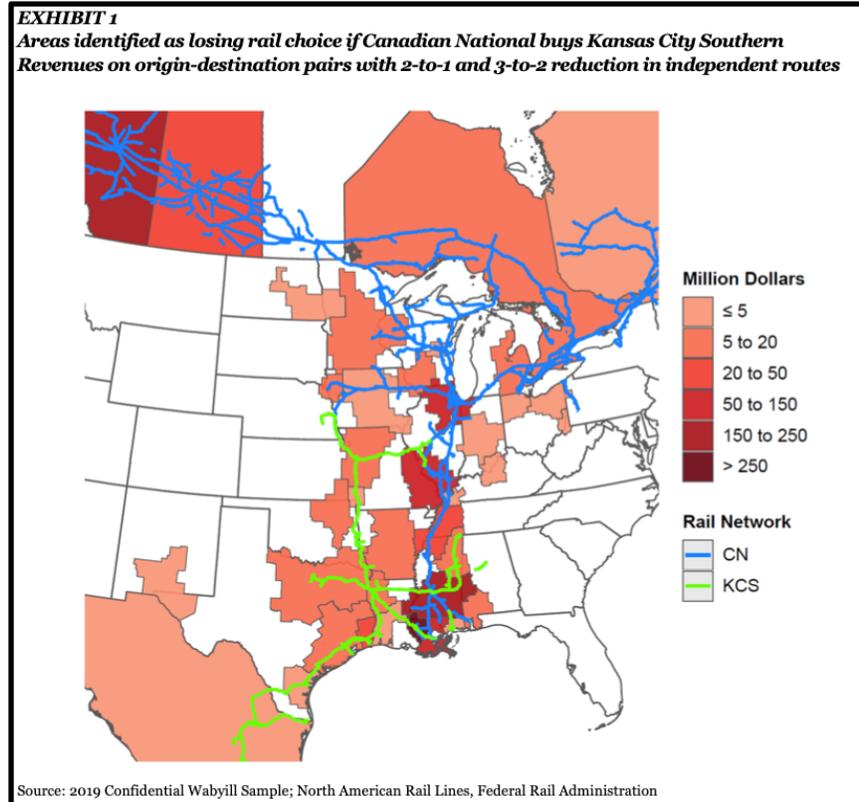
⁶ *See CN/IC*, Decision 36 at 17 n.56 (describing KCS proposal to construct a build-in line to obtain access to the three IC-served shippers at Geismar, Louisiana); *id.* at 105 (Exxon's KCS and IC build-in/build-out options).

absence of such concerns with CP/KCS). *See, e.g.*, the 62 statements compiled in CP-1, plus dozens more submitted to the Board more recently.⁷

7. CN has asserted that these obvious competitive issues are “unsubstantiated and unsupported.” CN Apr. 29 Ltr. (CN-8) at 4. To be sure, there will need to be extensive further analysis of these issues, which application of the 2001 rules will greatly facilitate. But there can be no doubt that these issues are real. As explained in CP’s April 27 letter (CP-2), economic analysis of Waybill Sample data identifies a significant number of origin-destination corridors where the number of independent rail competitors will be reduced from 2-to-1 or 3-to-2 by the CN/KCS transaction. That conclusion is not CP’s imagination. As explained in the Verified Statement of W. Robert Majure, who has extensive experience analyzing railroad competitive issues, application of standard screening analysis to available Waybill Sample data confirms both that CN/KCS raises many significant “horizontal competition concerns” and that CP/KCS raises none. Majure V.S. (Exhibit 1 hereto) at 5, ¶¶ 13-14. We reproduce as Figure 3 below Dr. Majure’s Exhibit 1.

⁷ To quote just a handful of examples: “We believe that the CN's proposal for the KCS will create a high degree of market dominance that will negatively impact service for shippers In contrast, Canadian Pacific's proposal will help enhance competition.” (CP-1, Canada Drayage Inc., Apr. 21, 2021 Ltr. at 1); “[I]t will be the consumers that suffer as a result of CN’s market dominance. . . . In comparison, CP’s proposal to acquire the KCS will create a more balanced and competitive marketplace.” (CP-1, Consolidated Fastfrate, Apr. 21, 2021 Ltr. at 1); “A CP-KCS combination would place us on a more even playing field and greatly expand access to growing markets The bid by CN jeopardizes this access and once-in-a-lifetime opportunity.” (CP-1, Farmers of Co-Operative of Hanska, Apr. 21, 2021 Ltr. at 1); “[B]etween the Upper Midwest and Gulf Coast, a CN/KCS combination would reduce the number of independent routing options from four to three.” (CP-1, USD Group Apr. 22, 2021 Ltr at 1).

FIGURE 3



The Board should apply the 2001 rules to ensure it the broadest possible scope and tools to examine and address (and perhaps remedy, if the transaction is not disapproved outright) these many horizontal competitive issues.

IV. OTHER FACTORS UNDERScore THE INAPPROPRIATENESS OF APPLYING THE KCS WAIVER TO A CN/KCS TRANSACTION

In addition to the factors the Board rested on in applying the KCS waiver to the CP/KCS transaction, other considerations distinguish CN's proposed transaction and support application of the 2001 rules in this case.

A. There Are Material Service Risks from a CN/KCS Transaction.

A central thrust of the Board's 2001 rules was a focus on potential service disruption from further consolidation. Whereas the end-to-end nature of the CP/KCS transaction minimizes these risks, the overlapping nature of CN/KCS heightens them. CN will have to integrate

operations at numerous common points and terminals and decide which set of parallel routes to use and which to downgrade. And CN will have to remedy competitive issues, potentially introducing complex new operations at numerous points on its system.

It is premature to attempt to catalog all of the ways that rail service might be threatened, but it is clear that the Board's concerns about service disruption that motivated the 2001 rules apply squarely to a CN/KCS transaction. CN would appear to agree. *See* Finance Docket No. 36500, CN-1 at 9 (2001 rules needed to allow assessment of "how projected service levels would be attained and how any service problems would be mitigated").

B. There Are Material "Downstream" Risks from a CN/KCS Transaction.

Another focus of the new rules was on the potential harms associated with downstream consolidation that might be stimulated by a proposed transaction. *See* Finance Docket No. 36500, CP April 21 Letter (CP-12) (Exhibit 2 hereto). Whereas CP/KCS preserves the basic six-carrier structure of the North American rail network (two in the East, two in the West, and two in Canada with routes to the Gulf), the CN/KCS transaction would destabilize that structure. It would strand CP north of Kansas City and render it far smaller than CN, the next largest Class I (as shown in Figure 1 above). There can be no doubt that CN's completion of its acquisition of KCS – even just acquiring KCS's shares and placing them in trust – would generate meaningful strategic pressure for further consolidation, and the 2001 rules should apply to enable the Board to address that concern. To borrow CN's own words, unlike CP/KCS, the CN/KCS transaction would be a "significant restructuring of the rail industry," and the Board needs the new rules to address the "likely strategic responses." Finance Docket No. 36500, CN-1 at 3, 11.

V. THE NEW RULES ARE NEEDED TO ENSURE APPROPRIATE CONSIDERATION OF THE PUBLIC INTEREST IMPLICATIONS OF CN'S VOTING TRUST PROPOSAL

As set forth in the 2001 rules, a public interest review of CN's proposed voting trust would be the natural consequence of the Board's decision to apply the 2001 rules to this transaction. In addition, the importance of subjecting CN's voting trust proposal to such review is a further reason why the Board should reject the KCS waiver as to the CN/KCS transaction.

All of the features that distinguish the unilateral CN/KCS proposal from the agreed-upon CP/KCS transaction result in heightened risks associated with CN's proposed use of a voting trust to hold KCS's shares pending Board review, particularly the risks associated with lost competition and potential stimulation of downstream consolidation. The extraordinary premium price CN is offering to try to disrupt CP's proposed combination with KCS ought to concern the Board,⁸ as it will not only extinguish the new competition that a CP/KCS combination would bring to CN (and other carriers) but also require CN to find ways to recoup those extra costs. All of these consequences would arise immediately upon KCS being placed into trust as part of a CN acquisition, and the "public interest" standard of the Board's 2001 rules should be applied to address these concerns, none of which are present with CP's proposed acquisition.

VI. CN'S CONCERNS ABOUT FAIRNESS SUPPORT APPLICATION OF THE 2001 RULES

As noted above, CN has implied that it would regard application of the 2001 rules to its transaction as "fundamentally unfair." CN-1 at 4 n.5. If CN takes this position, it would be ignoring the many significant distinctions between its own proposal and the CP/KCS transaction. CN would unfairly be demanding the same treatment for two situations that are not at all alike. An even-handed and fair application of the relevant considerations will confirm that the CN/KCS

⁸ CN's offer was 21% percent higher than CP's when announced and is more heavily weighted towards cash. CN is proposing to spend \$10.7 billion more in cash than CP to acquire KCS.

proposal raises the concerns that motivated the 2001 rules and thus should be reviewed under those rules, and, by contrast and as the Board has already decided, the CP/KCS transaction does not and should be reviewed under the pre-2001 rules.

CONCLUSION

For the foregoing reasons CP respectfully requests that the Board determine that the 2001 merger rules shall apply to all aspects of the proposed CN/KCS transaction.

Respectfully submitted,

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April 30, 2021

CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing Canadian Pacific's Objection to Waiver to be served electronically or by first class mail, postage pre- paid, on all parties of record in this proceeding.

/s/

Freesia M. Ferrantino

April 30, 2021