

South Dakota Grain & Feed Association

BY ELECTRONIC FILING

June 11, 2021

The Honorable Cynthia T. Brown
Chief, Section of Administration, Office of Proceedings
Surface Transportation Board
395 E Street S.W.
Washington, DC 20423

Re: Finance Docket No. 36514 – *Canadian National Ry. – Control – Kansas City Southern*

Dear Ms. Brown:

On behalf of the South Dakota Grain & Feed Association, I am writing to express our members perspective on Canadian National's ("CN's") proposal to use a voting trust in connection with its proposed acquisition of Kansas City Southern. In Decision No. 3, the Board explained that it will adopt a "more cautious approach" to CN's proposed voting trust and will consider whether allowing the use of a voting trust would be consistent with the public interest in light of the "potential benefits and costs of such use." I am writing to express our view that the use of a trust in this proceeding would not be in the public interest.

We have not formed a definitive view regarding the public interest consequences of CN's proposed acquisition of control of KCS, but we welcome the fact that the Board has confirmed its intention to consider whether that transaction is in the public interest under the Board's 2001 Major Merger rules. As the Board acknowledged in Decision No. 3, those rules place "heavier burden[s] on merger applicants to show that a major rail consolidation is consistent with the public interest" and give the Board much greater discretion to disapprove proposed transactions or impose extensive conditions aimed at ensuring that they serve the public interest.

We think the fact that the Board cannot (and should not) pre-judge whether CN's proposed control transaction would ultimately be found consistent with the public interest after 18+ months of review under the new merger rules is exactly why the Board should not allow CN to use a voting trust to complete its acquisition first and have it reviewed later. CN would be spending tens of billions of dollars to buy KCS, and there is no way to be confident that it could ever recoup that investment were it required – more than a year and a half from now – to divest KCS. The unpredictable consequences of having to do so – and of leaving ownership of KCS shares in the hands of CN all that time – would inevitably encumber the Board's evaluation of the first-ever major merger to be reviewed under the 2001 rules. The Board should not have to worry about the consequences of KCS coming out of trust as it

decides whether to allow CN to take control of KCS, or how extensive the conditions need to be for it to do so.

In addition, this is the first time the Board will be applying the 2001 merger rules, both on the merits and in considering whether to allow a voting trust. It would not be consistent with the public interest to rubber stamp use of a voting trust here when doing so could create a precedent that both encourages additional rail mergers and also limits the Board's freedom to apply the 2001 merger rules the way they were intended – meaning that disapproval or extensive conditions are much more likely.

We think that the costs of allowing a voting trust far outweigh the benefits. We see no real benefits, other than allowing KCS's shareholders to collect billions of dollars without having to bear the burdens and risks of CN and KCS trying to persuade the Board that their deal is in the public interest. That does not seem to be a public benefit at all. Without prejudging how that assessment will turn out, if CN is right that its proposal is great for competition and all stakeholders, there ought not be such a great risk for KCS's shareholders either, and no need for a voting trust.

The costs of allowing a voting trust here, however, are quite significant. In addition to the concern about establishing a precedent for other mergers and constraining the Board's first-ever application of the new merger rules, we see a number of realistic concerns that arise immediately if CN were allowed to use a trust.

First, from our perspective, the most significant cost associated with allowing CN to use a voting trust to complete its acquisition of KCS is the *adverse impact that would have on existing competition between KCS and CN*.

We are familiar with the rail service offerings of CN and KCS, which are broadly parallel across much of KCS's service territory on the south central United States. Our experience in rail transportation markets confirms that competition between two railroads serving the same points, corridors and regions manifests itself not just where they serve the same specific shipper facilities. Competing railroads like CN and KCS also provide alternative solutions for shipments of the same commodities in the same geographic areas, thereby disciplining one another even where they are not head-to-head alternatives for the same shipper. For example, they serve alternative transloads, alternative grain terminals, alternative receivers or shippers of the same commodity across the regions they both serve, like much of Mississippi, much of Louisiana, Omaha/Council Bluffs, St. Louis, Springfield, and southwestern Illinois.

CN's proposed control of KCS would, of course, do away with all of this competition completely. It may be possible to remedy some of it with targeted access for other rail carriers, but without an independent KCS it would be impossible to remedy all of the harm. Under these circumstances, we would imagine that the Board would not approve CN's proposed control transaction under the new merger rules, which emphasize "enhanced" rather than reduced competition.

But some of the harm would come immediately if CN were allowed to acquire KCS's stock and hold it in a voting trust. As we understand how voting trusts work, CN would receive all of the benefits of owning KCS – including dividends from KCS's profits – even though KCS's management continued to direct the day-to-day functions of that railroad. As a market participant, we cannot imagine that competition between CN and KCS would remain robust if CN knew it would earn profits when KCS was able to win business despite charging higher rates or offering worse service. Why would either of them sharpen their pencils against one another if the profits ended up in the same place: with CN? Ultimately, we

agree with the U.S. Department of Justice's observation that "threats to competition would be present immediately after the CN voting trust is consummated."

Second, allowing CN to use a voting trust to complete its acquisition of KCS would eliminate the opportunity for *KCS to be acquired by Canadian Pacific and the strong competitive benefits such a transaction would yield.*

A CP/KCS transaction promises to create new, better single-line routes from America's Heartland and Canada to the Gulf of Mexico. CN (via its 1998 acquisition of Illinois Central) already reaches the Gulf of Mexico. CN has a high capacity mainline route straight from Chicago to New Orleans. CP, by contrast, has an underutilized route line that only goes as far as Kansas City. CP's only friendly connection at Kansas City is with KCS. Were CP and KCS allowed to combine, CP would have incentives to invest in this route via Kansas City, opening up new competition against CN, BNSF and Union Pacific.

Allowing CN to acquire all of KCS's stock as part of a voting trust transaction would kill this opportunity for enhanced competition. Not only that, it will leave CP and its U.S. network a shadow of a CN/KCS network. CN in the U.S. would be three times the size of CP in the U.S. This kind of competitive imbalance is bad for America's rail network, and we worry in particular about its implications for potential further consolidation.

Making matters worse, CN would get stronger by absorbing KCS's system, much of which is broadly parallel to CN's existing U.S. network. This implies rationalization of assets, not investment in new competitive routes. And it implies a loss of competitive options – both concrete multi-railroad access to individual shippers and more subtle benefits of having multiple railroads near one another to serve as "geographically competitive" options for transload shipments, grain moving to alternate elevators/terminals, build-ins and build-outs, and other means.

We are aware that the Board would consider a proposed CN/KCS under the new merger rules, and therefore could condition it to try to protect competition or disallow the transaction entirely. But that is a reason *not to let CN use a voting trust*, so that there is no pre-judgment of the outcome of that first-ever new rules assessment, and no foreclosure of a potential CP/KCS transaction and all the competitive benefits it promises.

Third, in its Decision No. 3, the Board pointed to the fact that one aspect of the public interest it needed to consider was the potential *financial impact of a transaction on the "total fixed charges" and the "financial integrity" of the rail carriers involved.* The Board specifically noted cause for concern relating to CN's proposal to issue over \$19 billion of new debt to finance its purchase of KCS, and the 45% price premium it was proposing to pay.

We share the concerns the Board noted, and believe these factors are compelling reasons why CN should not be able to use a voting trust to complete its purchase – spending all of this money and issuing all of this debt – unless and until the Board has completed its full assessment whether a CN/KCS transaction that would burden the railroad and its customers in this would be in the public interest.

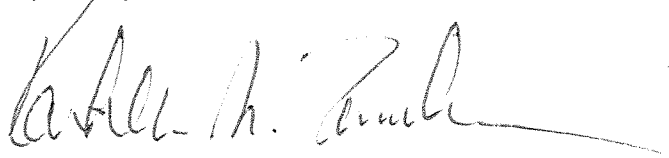
We understand that CN has said it plans to try to demonstrate how its strong balance sheet and financial forecasts will allow it to earn a return on its investment in KCS, and to avoid financial hardship if it has to divest KCS. No matter what showing CN is able to make in this regard, in our view it cannot support a finding that it would be in the public interest to allow CN to buy KCS first and defend its acquisition later.

No matter how strong CN's balance sheet might be, the huge price premium it is paying and massive debt burden will create immediate incentives for CN to extract more revenues from its existing customers. It won't be able to do that with any of the merger "synergies" it plans for several years, so it will have incentives to do it through higher prices for CN's current customers or less investment on CN's network. These incentives arise whether or not CN ends up having to divest KCS.

In addition, if CN is allowed to use a voting trust and the Board ultimately denies CN's application to control KCS, CN would have to divest KCS sometime in 2023. It is hard to imagine CN would be able to get a price for KCS anywhere close to what it agreed to pay. Its high premium seems designed to deny KCS to CP, and no other railroads would be willing (or able) to pay such a high price for KCS. In that scenario, CN would be saddled with massive amounts of debt and no merger synergies with which to recoup them. Even if CN could put forward an optimistic business plan that showed it could bear these burdens without financial disaster, what if the economic picture in 2023 were not so rosy? CN might have to sacrifice investment, downgrade service levels, or jack up rates even more in order to overcome the burdens it took on.

Accordingly, we urge the STB to reject CN's motion to approve its proposed voting trust. The fact is that the Board does not need to play Russian Roulette with the U.S. rail network. It can deny CN's proposed voting trust and let CN proceed to convince the Board that its proposal offers compelling public benefits that cannot be achieved any other way, and that the super-premium CN is paying to KCS's shareholders is not contrary to the public interest. Only then should CN be allowed to spend so many billions to acquire KCS.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kathleen M. Zander", with a long horizontal line extending to the right.

Kathleen M. Zander
Executive Director

Cc: All Parties of Record