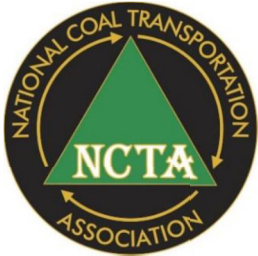




Freight Rail Customer Alliance



April 1, 2021

By E-Filing

Chairman Martin J. Oberman
Vice Chairman Robert E. Primus
Member Ann D. Begeman
Member Patrick J. Fuchs
Member Michelle A. Schultz
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423-0111

Re: Application of the “New” Merger Rules and Procedural Schedule in
FD 36500, Canadian Pacific Railway Limited, et al. –
Control – Kansas City Southern, et al. (“CP-KCS”)

Dear Chairman Oberman, Vice Chairman Primus, and Board Members Begeman, Fuchs, and Schultz:

The Freight Rail Customer Alliance, National Coal Transportation Alliance, and Private Railcar Food and Beverage Association, Inc. (collectively, “Shipper Associations”) submit this letter to urge the Surface Transportation Board (“Board” or “STB”) to review the proposed CP-KCS control application under the “new” merger rules that the Board adopted in 2001, and not the “old” rules that applied before 2000.

Shipper Associations have a related concern regarding the applicants’ Petition to Establish Procedural Schedule filed March 22, 2021 (calling for a 10-month review period), particularly as it assumes use of the old rules.

Information about each Shipper Association is presented at end of this letter. As shown, the Shipper Associations have different types of members that ship different freight products and commodities by rail. Notwithstanding those differences, the Shipper Associations and their members all share a strong common interest in a vibrant and competitive railroad industry that

serves the needs of its shippers, particularly those that are captive and otherwise rail-dependent, and not just the interests of the carriers or their investors.

The Shipper Associations appreciate that any other combination of Class I railroads would be far more problematic. Because CP-KCS involves the two smallest Class I's and appears to be "end-to-end," it carries potential to increase both efficiency and competition for the benefit of shippers. Whether that potential is realized, particularly for benefit of captive shippers, depends in large part on the level and type of STB review. For that reason, the Shipper Associations strongly urge the Board to apply its new rules.

The Board noted in *Major Rail Consolidation Procedures* (2001) that "Of course, we cannot assess in the abstract the effort of every potential merger involving KCS." The Board further noted it would not apply the old rules if "we are persuaded otherwise." Substantial changes have occurred since the Board addressed KCS's status twenty years ago, and those changes compel application of the new rules:

1. No aspect of the current KCS warrants special treatment. In obtaining its special treatment in 2001, KCS stressed that its annual rail revenues were in the range of \$500 million. By 2019, its domestic revenues reached \$1.485 billion, an increase of nearly 200%, while the Consumer Price Index rose less than 50% over that period. KCS's net income grew even more, from \$31 million to \$283 million, an increase exceeding 800%.¹ Furthermore, KCS need not be acquired by another Class I railroad in order for its investors to realize an impressive return on its assets, as reports indicate continued strong acquisition interest by private equity. KCS does not need a merger to grow, prosper, or attract investor interest.
2. The industry as a whole has grown, prospered, and experienced a major "renaissance" since 2001. Valuations have continued to soar following Berkshire Hathaway's acquisition of the remainder of BNSF and the adoption of so-called Precision Scheduled Railroading ("PSR") throughout the industry. Those gains, especially recently, have occurred at the expense of shippers, particularly captive ones, that have faced inferior and interrupted service, increased rates, and onerous demurrage and accessorial service charges, as the carriers fixate on reducing their operating ratios, which are far below those prevailing at the time the merger rules were revised. CP and KCS have both embraced PSR, increasing the need to consider whether the proposed combination will enhance competition consistent with the public interest, or just provide the applicants with enhanced leverage and market power.
3. The transaction's \$25 billion magnitude alone more than compels application of the new rules. The acquisition price is nearly five times what the Union Pacific Railroad paid to acquire Southern Pacific Railroad, very near the \$28 billion that CP initially proposed to acquire Norfolk Southern ("NS") six years ago,² and even more than the \$19.5 billion value

¹ The data is taken from the tables at <https://prod.stb.gov/reports-data/economic-data/quarterly-earnings-report/>.

² *E.g.*, <https://www.wsj.com/articles/canadian-pacific-confirms-offer-for-norfolk-southern-1447851465>.

assigned to the proposed BNSF Railway-Canadian National Railway (“CN”) combination that prompted the Board to impose its merger moratorium and adopt its new merger rules.³ By comparison, CN acquired the Illinois Central (“IC”) at a value of \$2.5 billion, about one-tenth of the proposed CP-KCS combination.⁴ The CP-KCS combination cannot be dismissed as a small or modest transaction, especially in comparison to previous mergers.

Shipper Associations emphasize that they have not formed, individually or collectively, any position on the ultimate merits of the application, which has not even been filed. Instead, Shipper Associations’ immediate concern is that the application receives a review consistent with the public interest. Within the context of the industry’s financial and operating environments, that review requires application of the new rules:

1. Shipper Associations are particularly concerned that the reduction in Class I railroads from seven to six, even if unaccompanied by further consolidation, will facilitate further rate and practice coordination in what is already a highly concentrated and coordinated industry. In addition, CP and KCS will cease to be neutral connections for each other, causing shippers to lose effective alternatives.

Those concerns might be outweighed if savings were achieved and then passed along to shippers, especially captive ones, in the form of lower rates and improved service. But CP and KCS are, as noted, both firmly committed to PSR and lowering their operating ratios. Lower operating ratios may be desirable where they rest on improved service and volume growth obtained from lower rates. Unfortunately, Shipper Associations have not had that experience. PSR has brought about reduced and impaired service, higher rates, and increased demurrage and accessorial service charges. The lower operating ratios (operating expenses divided by revenues) have come to measure the extent to which cost reductions are retained by the carrier and its investors, and *not* passed through to shippers.

Shipper Associations are concerned that the proposed merger may bring more of the same: more PSR, less shipper choice, higher rates, impaired service, and lower operating ratios. The effect is to reduce competition, and not to preserve, much less, enhance it.

2. Application of the older merger rules under such circumstances may be aligned with the applicants’ and their investors’ private interests, but not with the public interest. As noted,

³ *E.g.*,

<https://money.cnn.com/1999/12/20/deals/rail/#:~:text=Details%20of%20the%20deal&text=Th%20CN%20shares%20going%20to,prices%2C%20not%20including%20corporate%20debt> (specifying a figure of \$19.45 billion for the combined entity). Another article, <https://www.nytimes.com/1999/12/21/business/international-business-6-billion-merger-would-create-transcontinental-railroad.html>, placed the value at \$6 billion, and noted a \$10.2 billion value for the Conrail transaction.

⁴ *E.g.*,

<https://www.wsj.com/articles/SB887151974537815500#:~:text=Canadian%20National%20Railway%20Co.,fifth%2Dlargest%20North%20American%20railroad>.

KCS shareholders have other means to realize a massive return on their shares other than an acquisition by CP, and KCS has more than demonstrated it is viable and prosperous as a stand-alone entity. Today's KCS is not the KCS of 2000 or 2001. If a merger is to be allowed in the current environment, it should only be allowed where it enhances competition for the benefit of shippers, especially captive ones. That can only be achieved by applying the new merger rules instead of the old ones.

3. Under the new merger rules, it would be especially appropriate for the applicants to address whether and how they would provide open connections and gateways, particularly in order to facilitate “bottleneck” rate cases. CP proposed just such open access measures when it pursued a combination with of NS, and it stressed how CN-NS would compete for the benefit of both itself and shippers.⁵ CP-KCS have made no similar suggestions regarding their proposed combination, and presumably will not unless the new rules apply.
4. The Board should also consider the treatment of what is likely to be a very large acquisition premium and associated write-up of asset values, the brunt of which will fall on captive shippers. A cruel irony is that the merged entity will appear less revenue adequate precisely because of CP's eagerness to pay a substantial premium for KCS, despite its perceived lack of revenue adequacy. Such perversions run counter to the public interest.
5. The Board need not necessarily determine which merger rules apply before it considers the evidence, although doing so would make for a more efficient and orderly proceeding.

However, the merger rules issue bears directly on the procedural schedule. The applicants have proposed a 10-month schedule based on the CN-IC merger. As noted, that was a much smaller combination, with a value of \$2.5 billion, about one-tenth of the proposed CP-KCS combination. Size alone demonstrates that CN-IC is not a good benchmark for the instant proceeding. Moreover, CN-IC was considered under the old merger rules. If the new rules are to apply, then a longer schedule is needed, particularly since they have not been applied previously. It should also be kept in mind that the set of Board Members that decides the schedule will not be the same set of Board Members that rules on the merits.

Finally, regardless of which merger rules apply, the proposed voting trust should receive a full review by the Board. A transaction of \$29 billion (when debt is considered) is far too consequential to rest on an informal staff review or no review at all. The Board should be assured that there is independence, no unauthorized or premature transfer of control, that the transaction can be unwound without damage to the public interest if the merger does not occur.

Accordingly, Shipper Associations strongly urge the Board to evaluate the CP-KCS application under the new merger rules and to adopt a procedural schedule consistent with the new rules.

⁵ *E.g.*, https://s21.q4cdn.com/736796105/files/doc_presentations/cp-proposal-december-8.pdf (slides 16, 18, 19).

Respectfully submitted,



Ann Warner, Spokesperson
Freight Rail Customer Alliance



John Ward, Executive Director
National Coal Transportation Association



Herman Haksteen, President
Private Railcar Food and Beverage Association

About FRCA

The Freight Rail Customer Alliance (FRCA) is an umbrella membership organization that includes large trade associations representing more than 3,500 electric utility, agriculture, chemical, and alternative fuel companies and their consumers. The mission of FRCA's growing coalition of industries and associations is to obtain changes in Federal law and policy that will provide all freight shippers with reliable rail service at competitive prices. www.railvoices.org

About NCTA

The National Coal Transportation Association is a non-profit corporation comprised of electric utilities, coal producers, shippers of coal-related commodities and entities that produce, repair, and manage all facets of railcar component parts and systems, as well as services for railcar operations. Its primary purpose is to promote the exchange of ideas, knowledge, and technology associated with the transportation and beneficial uses of coal. www.movegoal.org

About PRFBA

The Private Railcar Food and Beverage Association, Inc. is a trade association comprised of private railcar food and beverage companies. The focus of PRFBA has several objectives: sharing of best practices for the management of a private railcar fleet, exploring supply chain efficiencies within the group and with the railroad providers, and collaborating with each other to develop efficient railroad network opportunities.

cc: All Parties of Record