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CANADIAN PACIFIC RAILWAY LIMITED, ET AL. – CONTROL –
KANSAS CITY SOUTHERN, ET AL.

UNION PACIFIC RAILROAD COMPANY'S OPPOSITION TO WAIVER OF THE REGULATIONS CONTAINED IN CURRENT SUBPART A OF 49 CFR PART 1180

CRAIG V. RICHARDSON
JAMES B. BOLES
ELISA B. DAVIES
JEREMY M. BERMAN
Union Pacific Railroad Company
1400 Douglas Street
Omaha, Nebraska 68179
(402) 544-7004

MICHAEL L. ROSENTHAL
Covington & Burling LLP
One CityCenter
850 Tenth Street, NW
Washington, D.C. 20001
(202) 662-6000

Attorneys for Union Pacific Railroad Company

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In their prefiling notification, Applicants CP and KCS invoked the special waiver of the Board's current rules for major mergers involving KCSR. *See* CP-1/KCS-1 at 3.[1] Union Pacific Railroad Company ("Union Pacific") objects to application of the special KCSR waiver in this proceeding. *See* 49 C.F.R. § 1180.0(b) ("Interested parties must file any objections to this waiver within 10 days after the applicants' prefiling notification (see 49 CFR § 1180.4(b)(1))."). The special KCSR waiver was never appropriate, and even if it had been appropriate when it was devised roughly twenty years ago, it is certainly not appropriate for today's KCSR and the proposed $29 billion transaction with CP. Applicants invoke the waiver in order to provide less information about the proposed transaction than would otherwise be required and to avoid rules specifically designed to ensure delivery of promised merger benefits and to remedy merger-related service harms. The Board should abandon the special treatment it afforded KCSR at the turn of the century and evaluate the proposed transaction in the present, vastly different KCSR context.

[1] Union Pacific adopts the abbreviations Applicants used in their Notice of Intent, CP-1/KCS-1.

A. The Board never should have adopted a special waiver for KCSR.

In 2001, when the Board last revised its rules for major rail mergers, KCSR urged the Board to adopt a special waiver so the new rules would not apply to transactions involving KCSR. At the time, CPRC urged the Board to reject KCSR's waiver proposal and apply its new rules "equally to all Class I carriers":

> This proposal should be rejected. . . . Indeed it would be illogical to treat certain railroads as "Class I" carriers for most regulatory purposes, but to accord them different treatment in connection with transactions in which they proposed to combine with another major railroad. The STB's revised merger regulations should apply equally to all Class I carriers.

Major Rail Consolidation Procedures, EP 582 (Sub-No. 1), Rebuttal Comments of Canadian Pacific Railway Company Regarding Proposed Rail Consolidation Regulations at 8–9 (Jan. 11, 2001). CPRC was correct. It has only now reversed its position because it sees the opportunity to invoke the waiver and thereby avoid full regulatory scrutiny of the proposed CP-KCS transaction.

As CPRC recognized back in 2001, the justification for a special KCSR waiver was "illogical." The Board said a potential transaction involving KCSR "would not necessarily raise the same concerns and risks as other potential mergers between Class I railroads." *Major Rail Consolidation Procedures*, 5 S.T.B. 539, 552 (2001). But the Board adopted new rules in large part because it wanted applicants to submit more information about their proposed transactions so the Board could better determine whether the transactions actually raised "concerns and risks." The new rules, with their more demanding requirements, were essential to the Board's "plan to take a more skeptical, 'show me' attitude toward claims of merger benefits and toward claims that no transitional service problems would occur." *Id*. at 549. The Board also wanted more and better information so that it could "look down the road and determine whether

approving not just the immediate proposal that may be before [the agency], but others like it, would ultimately result in a rail industry structure that continues to provide at least the existing level of competitive option for shippers." *Id*. The Board said it was "acutely aware that, as we approach the 'end-game'" – meaning a situation in which only two or three transcontinental railroads remain in North American – "the price for any failure would be high." *Id.* at 560. But by adopting a special KCSR waiver, the Board potentially denied itself the opportunity to obtain information it otherwise considered necessary to protect the public interest.

Former Chairman Linda Morgan anticipated this very problem with the waiver. She dissented from the adoption of the special KCSR waiver, stating: "I do not believe that it is sound policy to give KCS such special treatment while applying the new rules to the other Class I railroads." *Id.* at 605 (Morgan, dissenting). She also observed: "KCS is of such strategic importance that any merger between it and another Class I railroad could well trigger the next round of major rail mergers resulting in two transcontinental railroad systems." *Id.*

CPRC and Chairman Morgan were both correct in 2001. The Board never should have adopted a special waiver of its merger rules for Class I mergers involving KCSR.

B. Changes in KCSR's circumstances since 2001 make application of the special KCSR waiver wholly inappropriate to the proposed transaction between CP and KCS.

Even if the Board's decision to create a special KCSR waiver might have made sense in 2001, allowing Applicants to use the special KCSR waiver makes no sense today. KCSR is a vastly different railroad now than it was in 2001, and the potential consequences of a transaction involving KCSR are much more significant. Perhaps the most important difference is that KCS now owns (1) The Texas Mexican Railway Company ("Tex-Mex"), which gives KCS full control of a KCSR-Tex-Mex route to the critical U.S.-Mexico border crossing at Laredo, Texas, and (2) Kansas City Southern de Mexico ("KCSM"), which provides exclusive rail access from

Mexico to Laredo. KCS also owns the northern half of the only rail bridge at Laredo and has the right to use and operate the southern half of the bridge through KCSM's 50-year concession from the Mexican government.[2] In addition, KCS recently obtained a Presidential Permit to construct a second railroad bridge at Laredo.[3]

In 2001, KCSR told the Board that it needed special treatment because it was just a small railroad – 3,718 track miles – with low operating revenues– $519.2 million.[4] But for 2019, KCS reported operating revenues of approximately $2.9 billion (an increase of more than 450% since 2001), and it described its network as comprising "approximately 6,700 route miles extending from the midwest and southeast portions of the United States south into Mexico."[5] On January 2, 2001, KCS stock closed at $9.50 per share. On March 19, 2021, the last day of trading before news of the proposed transaction leaked, KCS stock closed at $224.16 per share (an increase of over 2000% since January 2, 2001). KCS does not need a government subsidy in the form of relaxed regulatory obligations to prop up a transaction with one of its Class 1 peers.

Applicants plainly recognize KCS plays an outsized role in today's rail transportation marketplace by providing a critical link between the United States and Mexico, and access to important existing and potential customers across North America. *See, e.g.*, CP-1/KCS-1 at 4. The Board need look no further than the value the parties to the CP-KCS transaction themselves

[2] Kansas City Southern 2019 Form 10-K at 3.

[3] *See* 85 Fed. Reg. 47,009 (Aug. 3, 2020) (Presidential Permit of July 29, 2020, Authorizing the Kansas City Southern Railway Company to Construct, Connect, Operate, and Maintain Railway Bridge Facilities at the International Boundary Between the United States and Mexico).

[4] *See Major Rail Consolidation Procedures*, EP 582 (Sub-No. 1), Comments of The Kansas City Southern Railway Company at 6–7 (Nov. 17, 2000).

[5] Kansas City Southern 2019 Form 10-K at 3, 23.

placed on the KCS enterprise to confirm these points: $29 billion.[6] A deal of that magnitude merits even-handed scrutiny under the Board's current rules for major mergers.

C. Unless the Board revokes the special KCSR waiver, Applicants will be allowed to escape rules designed to test their own claims about the proposed transaction.

If Applicants' public statements about their proposed transaction are accurate, they should have no problem submitting an application that complies with the current rules. In those statements, Applicants already tout the purported benefits of the proposed transaction and the purported lack of competitive harms. However, if the Board allows Applicants to use the special KCSR waiver, they can altogether avoid rules designed to test their claims and to ensure the transaction is actually consistent with the public interest.

1. Applicants should submit "full system" competitive analyses and operating plans.

Applicants are proposing to create "the first rail network connecting the U.S., Canada, and Mexico," connecting customers "between points on CP's system throughout Canada, the U.S. Midwest, and the U.S. Northeast and points on KCS's system throughout the South Central United States and Mexico." CP-1/KCS-1 at 4. However, if the special KCSR waiver applies, Applicants will not be subject to the requirement under the Board's current rules to "submit 'full system' competitive analyses and operating plans – incorporating any operations in Canada or Mexico" so the Board can fully evaluate "the competitive, service, employee, safety, and environmental impacts of the prospective operations within the United States." 49 C.F.R. § 1180.1(k).[7] The Board should not excuse Applicants from submitting information the Board

[6] For comparison, the Union Pacific/Southern Pacific transaction was valued at $5.4 billion.

[7] *See also id.* § 1180.7(b) ("[A]pplicants shall submit 'full system' impact analyses (incorporating any operations in Canada or Mexico) from which they must demonstrate the impacts of the transaction – both adverse and beneficial – on competition within regions of the

would require in other major mergers to "fully determine the effects of the application on competition and the provision of essential services within the United States," *Major Rail Consolidation Procedures*, 5 S.T.B. at 599, and "to determine how operational changes in foreign nations would likely affect the U.S. rail network," *id.* at 600.

2. Applicants should submit a service assurance plan and be subject to post-approval monitoring.

Applicants are promising "a smooth and efficient combination of the two railroads without service disruptions." CP-1/KCS-1 at 4. However, if the Board allows Applicants to use the special KCSR waiver, they will not be subject to the requirement under the Board's current rules to file a Service Assurance Plan – a plan "identifying the precise steps they would take to ensure adequate service and to provide for improved service" and containing "service benchmarks" and "contingency plans that would be available to mitigate any unanticipated service disruption." 49 C.F.R. § 1180.1(h)(1); *see also id.* § 1180.10 (detailed requirements for service assurance plans). They also will not be subject to the Board's "significant post-approval operational monitoring to help ensure that service levels after [the] merger are reasonable and adequate," *id.* § 1180.1(h)(2), or the requirement to "establish problem resolution teams and specific procedures for problem resolution to ensure that any unanticipated post-merger problems related to service or any other transportation matters, including claims, are promptly addressed," *id.* § 1180.1(h)(3). Applicants also will avoid complying with current rules for handling merger-related loss and damage claims and service failure claims. *Id.* § 1180.1(h)(4)

United States and this nation as a whole . . . ."); *id.* § 1180.8(a) ("Applicants . . . must include a full-system operating plan – incorporating any prospective operations in Canada and Mexico – from which they must demonstrate how the proposed transaction would affect operations within regions of the United States and on a nationwide basis.").

& (5). The Board should not excuse Applicants from complying with rules it would impose on other major mergers to prevent transitional service problems and resolve problems that arise.

3. Applicants should stand behind claims that the transaction will produce public benefits.

Applicants are promising their transaction "will generate substantial public benefits" and "support economic growth across the entire North American continent." CP-1/KCS-1 at 4. However, if the Board allows Applicants to use the special KCSR waiver, they will face no requirement to show the claimed public benefits could not be achieved by means short of merger. *See* 49 C.F.R. § 1180.1(c); *id.* § 1180.6(b)(11). They will also escape the requirement to stand behind their benefit claims by "propos[ing] additional measures that the Board might take if the anticipated public benefits fail to materialize in a timely manner." *Id.* § 1180.1(c)(1); *see also id.* § 1180.6(b)(11); *Major Rail Consolidation Procedures*, 5 S.T.B. at 560 ("We ask for this information . . . to provide applicants with the proper incentives to identify more cautiously and, if approved, to secure more certainly, the public benefits that they project for their merger proposals."). The Board should not excuse Applicants from complying with rules it would impose on other major mergers to ensure applicants deliver on promised merger benefits.

4. Applicants should explain how they will preserve the use of major gateways and address cumulative impacts and crossover effects.

Use of the special KCSR waiver would allow Applicants to omit from their application any discussion of two critical issues raised by the proposed transaction: (i) preservation of major gateways, and (ii) cumulative impacts and crossover effects. Under the Board's current rules, "applicants must explain how they would preserve the use of major existing gateways." 49 C.F.R. § 1180.6(b)(10); *see also Major Rail Consolidation Procedures*, 5 S.T.B. at 546–47 ("Applicants also will be expected to include . . . effective plans to keep open major existing gateways."). Applicants expect their proposed transaction to have a significant impact on rail

movements between the U.S. and Mexico through the Laredo Gateway. Their public statements tout opportunities to capitalize on grain, intermodal, and automotive traffic moving through the Laredo Gateway.[8] Currently, KCS and Union Pacific both access the Laredo Gateway from the U.S. side, but KCS controls the only rail bridge in Laredo, and it owns the only railroad with access to the gateway from the Mexican side – KCSM. Such exclusivity raises the potential for foreclosure concerns, particularly in the absence of any plan for preserving the use of the major gateways. If the Board approved the proposed transaction, CP and KCS together would have an even stronger incentive than KCS has today to discriminate against traffic of other railroads moving through the Laredo Gateway. The Board should not excuse Applicants from providing plans for preserving the use of major gateways, especially the Laredo Gateway.

The Board should also require Applicants to address the cumulative impacts and crossover effects of their proposed transaction. Applicants should be required to comply with the Board's current rules, which recognize "the Board cannot evaluate the merits of a major transaction in isolation," and thus require applicants to address "the cumulative impacts and crossover effects likely to occur as rival carriers react to the proposed combination." 49 C.F.R. § 1180.1(i). As the Board recognized in adopting its current rules, additional mergers could undermine the claimed public benefits of a proposed merger or the effectiveness of conditions imposed on the merger. *See id.* The Board should not excuse Applicants from providing information it would require in other major mergers to determine whether the proposed transaction will be in the public interest in view of potential downstream consequences.

[8] *See, e.g.*, https://futureforfreight.com/economic-growth/

5. Applicants should be required to show their use of a voting trust would be consistent with the public interest.

Finally, use of the special KCSR waiver would allow Applicants to avoid complying with the Board's current rules regarding voting trusts, which require applicants to show why their use of a proposed trust "would be consistent with the public interest." 49 C.F.R. § 1180.4(b)(4)(iv). Applicants have stated they intend to use a voting trust. *See* CP-1/KCS-1 at 3. Under the former merger rules, parties could obtain informal approval to use a voting trust, but they were under no obligation to do so.[9] However, the Board's current rules make clear that "use of a voting trust is a privilege, not a right." *Major Rail Consolidation Procedures*, 5 S.T.B. at 568. The new rules reflect the Board's concern with the potential harms to applicants and rail customers from using a voting trust if the application is unsuccessful. As the Board explained, "there would likely be cases where there would be *no* remaining railroad bidders acceptable to us to buy the shares held in a voting trust if we were to deny a major control transaction or impose conditions that the applicants choose not to accept." *Id.* And "[b]idding limited to nonrailroad entities poses the risk of serious financial harm to applicants and, more importantly, poses risks to their customers as well." *Id*. Therefore, to show use of a voting trust is consistent with the public interest, applicants must "demonstrate either that any harm to the public interest associated with the divestiture process would be relatively small or that some countervailing *public* benefit would be associated with their proposed use of a voting trust that would outweigh this risk." *Id.* (emphasis added). The Board should not excuse Applicants from complying with voting trust requirements

[9] *See Union Pacific Corp., et al. – Request for Informal Opinion – Voting Trust Agreement*, FD 32619, 1994 WL 680238, at *1 (ICC served Dec. 6, 1994) ("Union Pacific's submission of its voting trust to the Commission for an informal opinion was purely voluntary. As such, Union Pacific could enter into the trust agreement with or without an informal staff opinion.").

it would impose on other major mergers to protect the public against potential harms created by the merger process itself.

Respectfully submitted,

/s/ Michael L. Rosenthal

MICHAEL L. ROSENTHAL
Covington & Burling LLP
One CityCenter
850 Tenth Street, NW
Washington, D.C. 20001
(202) 662-6000

CRAIG V. RICHARDSON
JAMES B. BOLES
ELISA B. DAVIES
JEREMY M. BERMAN
Union Pacific Railroad Company
1400 Douglas Street
Omaha, Nebraska 68179
(402) 544-7004

Attorneys for Union Pacific Railroad Company

April 1, 2021

CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of April, 2021, I caused a copy of the foregoing document to be served by email or first-class mail, postage prepaid, on all parties of record in Finance Docket No. 36500.

/s/ Michael L. Rosenthal