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

CANADIAN NATIONAL RAILWAY COMPANY'S OBJECTION TO 49 C.F.R. § 1180.0(b) WAIVER

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On March 22, 2021, Canadian Pacific Railway Limited, Canadian Pacific Railway Company, and their U.S. rail carrier subsidiaries (collectively, "CP"), and Kansas City Southern, Kansas City Southern Railway Company, and its other U.S. rail carrier subsidiaries (collectively, "KCS")[1] filed a Notice of Intent to File an application for approval of a major transaction in which CP would acquire control of KCS.[2] In that notice, Applicants announced their intent to proceed under "the regulations set forth at 49 CFR Part 1180 (2000)," and thus to have their proposed transaction reviewed under rules that the agency has found to be "outdated and inadequate to address future major rail merger proposals."[3] Applicants cite the "KCS exception" of 49 C.F.R. § 1180.0(b), but provide no arguments explaining why the Board should apply it here. The absence of arguments from the Applicants is troubling.

As § 1180.0(b) makes clear, 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."[4] Canadian National Railway Company on behalf of itself and its U.S. rail operating subsidiaries[5] (hereafter "CN") respectfully submit that a waiver

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[1] CP and KCS are together referred to as "Applicants."

[2] Notice of Intent to File Application for Approval of Transaction Subject to 49 U.S.C. §§ 11323-25 (Mar. 22, 2021), Filing ID No. 301790.

[3] *Id.* at 4. *See Major Rail Consolidation Procedures*, 5 S.T.B. 539, 545 (2001).

[4] 49 C.F.R. § 1180.0(b).

[5] The U.S. rail operating subsidiaries include Illinois Central Railroad Company, Wisconsin Central Ltd., Grand Trunk Western Railroad Company, and Bessemer & Lake Erie Railroad Company, and they report to the Board on a consolidated, Class I basis under the name of Grand Trunk Corporation, CNR's U.S. holding company.

of the Board's rules for major transactions is not justified. The potential "KCS exception" was adopted twenty years ago by a divided Board, in response to arguments from KCS that the Board should only apply new major merger rules to railroads with revenues over $1 billion. In a 2-1 decision, the Board adopted the current § 1180.0(b), which recognized even then that a waiver might not be appropriate and could be challenged by other parties. In the ensuing two decades, any justification for the potential KCS exception has evaporated. KCS's expansion of its Mexican operations post-2000 make it a transnational carrier and a very different railroad from the one it was in 2000. Indeed, KCS's revenues now exceed the $1 billion threshold that it claimed in 2000 would be an appropriate trigger for full review under the new rules. As then-Chairman Linda Morgan observed in 2001, KCS has critical "strategic importance," and there is no cause to give it "special treatment."[6]

Moreover, waiving the Board's current regulations would have a negative impact on the Board's ability to adequately review the effects of the proposed transaction and to impose appropriate conditions, should conditions be required. If a waiver is granted, Applicants will not be required to prepare a Service Assurance Plan under current § 1180.10, a requirement specifically designed to guard against service disruptions encountered with past mergers. They will not be required to demonstrate enhanced competition, which is a requirement for Class I mergers.

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[6] *Major Rail Consolidation Procedures*, 5 S.T.B. at 605 (Morgan, L., commenting and dissenting in part) ("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.").

They will not be required to submit whole-system analyses that take into account their Canadian and Mexican operations, or to meet § 1180.11's requirement to address transnational issues.

The Board's major merger rules were specifically designed to ensure that applicants have plans in place to ensure that promises of smooth implementation are met and competitive benefits are realized. The Board should not set those rules aside here, when presented with a significant restructuring of the rail industry.

I. *MAJOR RAIL CONSOLIDATION PROCEDURES* WAS DESIGNED TO REPLACE THE "OUTDATED" PRIOR RULES.

The *Major Rail Consolidation* Procedures rulemaking grew out of the Board's concern that its merger rules had grown stale and "were outdated and inadequate to address future major rail merger proposals."[7] The Board concluded that the merger rules that it inherited from the ICC did not reflect "the significant changes that have taken place in the rail industry" or the "merger-related service problems that have been experienced."[8] It was particularly concerned about "severe service problems" that occurred with then-recent mergers.[9] And it identified a need to require major merger applicants to explain how enhanced competition outcomes from proposed mergers could outweigh potential harms. Under the new rules, the Board resolved "to take a more skeptical, 'show me' attitude toward claims of

[7] *Major Rail Consolidation Procedures*, 5 S.T.B. at 545.

[8] Notice of Proposed Rulemaking, *Major Rail Consolidation Procedures*, 5 S.T.B. 1, 9 (2000).

[9] *Major Rail Consolidation Procedures*, 5 S.T.B. at 558.

merger benefits and toward claims that no transitional service problems would occur."[10]

KCS advocated for an exception that would apply the major merger rules only to railroads with annual revenues under one billion dollars.[11] This proposed "KCS exception" met with some opposition, most notably from CP, which argued that "it would be illogical to treat certain railroads as 'Class I' railroads 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."[12]

Rather than opt for KCS's proposed $1 billion cutoff, a divided Board decided to recognize the possibility of a waiver for KCS.[13] The Board made clear that, in the future, its decision to grant a waiver would be subject to future challenge in any proposed KCS transaction, and that its appropriateness would be evaluated under the circumstances.[14]

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[10] *Id.* at 549.

[11] *See id.* at 674; *The Surface Transportation Board's New Merger Rules*, Hearing Before the Subcomm. on Surface Transp. & Merch. Marine of the S. Comm. on Commerce, Sci., & Transp., 107th Cong. 89-90 (2001) [hereinafter STB New Merger Rules Hearing] (responses to written questions by Michael Haverty, Q. 3).

[12] Rebuttal Comments of Canadian Pacific Railway Co. at 8-9, *Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Sub-No. 1) (filed January 11, 2001).

[13] *See* STB New Merger Rules Hearing, *supra*, note 11, at 74, 76-77 (responses to written questions by William Clyburn, Jr., Q. 8).

[14] *See Major Rail Consolidation Procedures*, 5 S.T.B. at 553.

Then-chairman Linda Morgan dissented from the Board's decision to single out KCS for "special treatment." As she explained in her separate statement and dissent, "[t]his historical Class I railroad situated in the Nation's heartland serves a number of important markets and provides significant competitive routes and connections not only for North-South traffic but for East-West traffic as well."[15] She concluded, "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."[16]

II. THE WAIVER SHOULD NOT BE GRANTED HERE.

The Board should not waive application of its major transaction rules for two reasons. First, KCS is simply not the same railroad that it was in 2001. With its acquisition of the Texas Mexican Railway Company ("Tex Mex"), expansion into Mexico, and growth in revenue and carloads, KCS is an even more critical part of the rail network than it was in 2001. Second, a waiver will mean that the Board will not obtain much of the information that it has determined would be critical to evaluating a major merger—from service assurance plans to evidence about cross-border impacts. And a waiver would mean that the Board's efforts to provide that

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[15] *Id.* at 605 (Morgan, L., commenting and dissenting in part).

[16] *Id.*; *see also* STB New Merger Rules Hearing, *supra*, note 11, at 8-9 (prepared statement of Linda Morgan) ("I do not believe that KCS adequately demonstrated why it should have been given special treatment. Also, I am concerned that, given KCS' strategic position, any merger involving KCS and another large railroad will likely trigger the final round of consolidations . . . .); *id.* at 5-6 (statement of Linda Morgan) ("Exempting a strategically important carrier in a transaction that could be expected to begin the final round and putting KCS customers under a different set of rules from other customers seems inconsistent and inappropriate to me.").

future major mergers would feature competition enhancements to offset negative impacts would be for naught. A proposed $29 billion transcontinental rail merger should not be evaluated under 40-year-old rules that this agency set aside two decades ago.

A. KCS's Size and Importance to the Rail Network Have Grown Since 2001.

Chairman Morgan's concerns about the KCS exception were prescient. Since the current rules took force, KCS's importance has only grown. In particular, KCS has undertaken acquisitions that extended its reach southward and its presence in Mexico.

In 2005, just four years after the current rules were enacted, KCS acquired the Tex Mex and a controlling stake in Transportación Ferroviaria Mexicana (TFM), Mexico's largest railroad.[17] KCS's acquisition of TFM, a deal valued at $672 million, doubled KCS's total trackage and transformed KCS into a force in the crucial "NAFTA corridor."[18]

In addition to growing through acquisition, KCS has simply grown its business—realizing higher revenues and higher carloads. In 2001, KCS earned

[17] *See Kan. City S.—Control—Kan. City S. Ry., Gateway E. Ry., & the Tex. Mexican Ry.*, FD No. 34342 (STB served Nov. 29, 2004); Rob Roberts, *KC Southern Completes Deal for Mexican Railroad*, Kan. City Bus. J. (updated Jan. 3, 2005), https://www.bizjournals.com/kansascity/stories/2004/12/13/daily15.html.

[18] Roberts, *supra*, note 17.

about $600 million in annual revenues and handled less than a million carloads.[19] Twenty years later, its revenues have grown by nearly 400%, to more than $2.8 billion. While this total includes Mexican operations, KCSR's U.S. operating revenues as reported in its R-1 are nearly $1.5 billion—far exceeding the $1 billion threshold that it proposed in 2001 for the application of major merger rules.[20] And its annual carloads have increased by more than 220% since 2001.

	KCS in 2001[21]	**KCS in 2019**[22]
North American Route Miles	3103	6700
Revenue	$572.3 million	$2.866 billion
Carloads	957,800	2,291,000

In short, KCS is even more significant to the North American rail network in 2021 than it was in 2001. If there ever was a justification to consider treating KCS differently than other Class I railroads, it no longer exists.

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[19] *See* KCS, *2002 Annual Report* 31, https://investors.kcsouthern.com/~/media/Files/K/KC-Southern-IR-V2/annual-reports/annualreport2002.pdf.

[20] KCS, *R-1 Report to the U.S. Surface Transportation Board for the Year Ended December 31, 2019*, at sched. 210, l. 13, https://investors.kcsouthern.com/~/media/Files/K/KC-Southern-IR-V2/2019-r-1-kcs-v2.pdf.

[21] KCS, *2002 Annual Report*, *supra*, note 19, at 14, 31.

[22] KCS, *2019 Annual Report* 3, 17, 27, https://investors.kcsouthern.com/~/media/Files/K/KC-Southern-IR-V2/annual-reports/kcs-2019-annual-report.pdf.

B. A Waiver Would Prevent the Board from Reviewing the Key Issues Presented by a Transaction of this Magnitude.

More importantly, waiving application of the major merger rules would deprive the Board of information it needs to review key issues in this transaction that bear on the public interest. Granting a waiver would mean:

- No Service Assurance Plan, and thus no requirement to demonstrate that the service problems that resulted from past mergers would not recur;
- No full-system analysis or consideration of transnational issues—even for a transaction marketed as "the first US-Mexico-Canada railroad";
- No requirement to explain the enhanced competition that would be required for any other Class I merger application; and
- No consideration of downstream effects for what would be the first Class I merger in over 20 years.

To be sure, Applicants have asserted publicly that they will achieve widespread benefits for rail customers and stakeholders with virtually no downside effects. But the Board should apply the approach that it adopted in *Major Rail Consolidation Procedures*, and should require Applicants to submit the detailed information that the Board decided it would need to evaluate major transactions.

First, granting the Applicants a waiver would excuse them from providing the necessary information for the Board to determine whether the transaction will result in adverse service consequences. One of the main motivations of *Major Rail Consolidation Procedures* was the Board's experience with "serious transitional service problems that have accompanied recent major rail consolidations."[23] To

[23] *Major Rail Consolidation Procedures*, 5 S.T.B. at 546.

address this problem, the current merger rules provide that transitional service problems constitute a distinct harm to the public interest that the Board will evaluate.[24] Moreover, as a safeguard, the rules were further amended to also require applicants to submit an extensive Service Assurance Plan to minimize and mitigate merger disruptions.[25] This plan must explain applicants' "plans to deal with any potential adverse service effects during implementation and to accommodate such less-than-optimum operations," and it must detail plans for dealing with a wide swath of potential integration problems, from operations to IT to customer service.[26]

The Board has focused in recent years on monitoring service and increasing transparency about service given the interconnected rail network.[27] That commitment to promoting transparency concerning rail service cannot be reconciled with a decision to waive application of *Major Rail Consolidation Procedures* to Applicants, which would bypass § 1180.10's crucial requirement for a Service Assurance Plan and deprive the Board of the information it needs to assess how projected service levels would be attained and how any service problems would be mitigated.

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[24] 49 C.F.R. § 1180.1(c)(2)(iii).

[25] *Id.* § 1180.10.

[26] *Major Rail Consolidation Procedures*, 5 S.T.B. at 579.

[27] *See, e.g.*, Ex Parte No. 724, *U.S. Rail Serv. Issues* (STB).

Second, Applicants should be required to explain how their transaction will enhance competition. *Major Rail Consolidation Procedures* requires major merger applicants "to present proposals that enhance, not merely preserve, competition, in order to secure our approval."[28] If the waiver is allowed, the Board would not have the benefit of this information in its evaluation.

Like any other major merger applicants, Applicants here should explain how their proposal will yield "[e]nhanced competition" which can offset the likely anticompetitive harm.[29] Indeed, KCS and CP have asserted publicly that that their combination will enhance competition. [30] As such, they should have no objection to providing such information to the Board, and the Board should not excuse them from doing so.

Third, declining to apply the current merger rules to the instant transaction would enable the Applicants to constrain the Board's review of the operational and transnational issues that it would otherwise consider in this cross-border transaction. The Board concluded in *Major Rail Consolidation Procedures* that "future major transnational mergers are likely to raise novel jurisdictional, national interest, and public interest issues. We need to be able to gather information about relevant facts, laws and policies that are important to an accurate and

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[28] *See Major Rail Consolidation Procedures*, 5 S.T.B. at 547.

[29] 49 C.F.R. § 1180.1(c)(2)(iv).

[30] *See* Press Release, *Canadian Pacific and Kansas City Southern Agree to Combine to Create the First U.S.-Mexico-Canada Rail Network*, CP (Mar. 21, 2021).

comprehensive understanding of a major transnational merger application."[31] Being faced with such a merger proposal from Applicants, the Board should not waive its requirements that applicants to transnational mergers provide that information. Nor should it grant a waiver that would allow Applicants to avoid the requirement to submit "full-system operating plans that document how the application would affect all operations, including those in Canada and Mexico."[32] Indeed, Applicants have advocated that their proposal would create a "USMCA railroad," a primary benefit of which would be the facilitation of cross-border traffic flows.[33] To evaluate these issues, the Board needs full information about transnational impacts.

Fourth, the Board should not grant a waiver that will enable the Applicants to sidestep the need to address "the likely strategic responses of other Class I carriers" and how the downstream effects of their proposal "would affect the structure of the industry and the public interest."[34] There is no cause for the Board to do so.

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These four instances are just a few examples of the valuable information that the Board would not receive if it were to allow Applicants to proceed under the pre-

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[31] *Major Rail Consolidation Procedures*, 5 S.T.B. at 584.

[32] *Id.* at 599.

[33] *See* Press Release, *supra*, note 30.

[34] *Major Rail Consolidation Procedures*, 5 S.T.B. at 597; *see also* 49 C.F.R. § 1180.6(12).

2001 framework. The list could also include the substantially more detailed impact analyses required under § 1180.7.[35] Applicants have not given the Board any cause to conclude that the information set forth in current Part 1180 is not required for the Board to evaluate the impacts of the proposed transaction and to consider whether and what conditions might be necessary to mitigate any harms from the transaction. The most significant U.S. rail merger that has been proposed in the 21st century should be evaluated under the current rules.

III. CONCLUSION

For the above reasons, the Board should not allow a waiver under § 1180.0(b) and should require Applicants to comply with the current Part 1180 rules.

Respectfully submitted,

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[35] *See Major Rail Consolidation Procedures*, 5 S.T.B. at 597-99.

CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of April, 2021, a copy of Canadian National Railway Company's Objection to 49 C.F.R. § 1180.0(b) Waiver was served by email on the service list for Finance Docket No. 36500.

/s/ Matthew J. Warren
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