Freight Rail Customer Alliance

NATIONAL COAL TRANSPORTATION ASSOCIATION
NCTA

PRFBA

June 7, 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: Reply to Joint Motion for Approval of Voting Trust Agreement in FD 36514, Canadian National Railway Company, *et al.* – Control – Kansas City Southern, *et al.* ("CN-KCS")

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

The Freight Rail Customer Alliance, National Coal Transportation Association, and Private Railcar Food and Beverage Association, Inc. (collectively, "Shipper Associations"), submit this letter stating their opposition to the "Joint Motion for Approval of Voting Trust Agreement" that CN and KCS filed May 26, 2021 (CN-18 KCS-1, referred to herein as CN-18).

As in SHAS-1, Shipper Associations have taken no position at this time on the merits of the CN-KCS merger, particularly as no application has been filed. Nonetheless, as Shipper Associations have previously explained, the CN-KCS proposal involves more overlap, and the acquisition of KCS by a larger entity, relative to the CP-KCS proposal. The CN-KCS merger is thus more problematic, as the Surface Transportation Board ("Board" or "STB") agreed in ruling that the new merger rules govern the CN-KCS merger.

Shipper Associations have specific concerns about the CN-KCS proposed voting trust.

First, much of what CN-KCS offer in support of the proposed voting trust relates to the CN-KCS claimed benefits of the merger itself. As no application has been filed, such claims appear premature and should be given little, if any, weight in ruling on the CN-KCS Motion.

Second, Shipper Associations are particularly concerned about the interaction of the voting trust, the purchase price, and the potential asset write-up that may result from the acquisition premium associated with the purchase price. In that regard, CN-KCS claim that the voting trust is needed to put their railroad merger on a level playing field with a private equity acquisition. However, a private equity transaction does not present the risks to competition that support application of the new merger rules in the first place. Furthermore, CN proposes to pay far more to KCS than private equity was reportedly willing to pay. *E.g.,* https://www.wsj.com/articles/kansas-city-southern-rejects-20-billion-takeover-offer-from-investor-group-11599681465 (identifying a purchase price of $20 billion at $208 per share). The proffered solution exceeds the scope of the alleged problem.

Furthermore, the voting trust itself facilitates a higher purchase price. CN-KCS explain that Board approval of the voting trust would provide "regulatory certainty" that is "essential" to the transaction. CN-18 at 2. The certainty is achieved by allowing KCS stockholders to be paid off early so they bear no further risk, and CN avoids the risk that KCS or its stockholders might seek to renegotiate or pursue other options as the Board's review proceeds. *Id.* at 10-12, 39, 41-42. The voting trust thus reduces the commercial risk of the transaction, and a less risky transaction is a more valuable transaction. CN is logically willing to pay more for a less risky transaction, and KCS's stockholders are surely happy to be paid more. The result is a win-win as far as CN and KCS are concerned.

<u>But those are private interests, and the Board's review is concerned with the public interest</u>. Under the old merger rules, there may have been a presumption that mergers were in the public interest, but that is not the case under the new merger rules.

The higher purchase price that results from using a voting trust is problematic in terms of the public interest because it translates into an increased acquisition premium. The burden of that premium falls on captive shippers in the form of increased URCS costs, increased asset investment base for determining revenue adequacy, increased R/VC ratios under the three-benchmark ratios, etc. Such burdens are not consistent with the public interest or enhancing competition. Significantly, the various merger mitigation measures that CN has mentioned so far do not include anything about the acquisition premium.

The Board's order served May 17, 2021, makes clear, and CN-KCS purport to accept, that approval of voting trusts is discretionary and available only when supported by the public interest. Shipper Associations respectfully submit that no regulatory acceptance of acquisition premiums is in the public interest in the first place and that removal of any acquisition premium is an appropriate condition for approval of the voting trust. It bears noting in that regard that all of these dollars are being spent for ownership of KCS shares, and none of the dollars represent additional investment in actual railroad operating assets.

However, assuming that some acquisition premium is to be allowed for regulatory purposes, then a minimum condition for approval of the voting trust to establish a level playing field with private equity is that the acquisition premium for regulatory purposes not exceed the premium that would have applied for the private equity transaction. Captive shippers should not be made worse off, or forced to support other shippers that might benefit from competition, because KCS is being acquired by CN instead of private equity, especially if a level playing field is part of the justification for the voting trust.

Third, a related concern with the higher price facilitated by the voting trust is the risk that CN will be adversely affected by the increased debt if KCS can be sold only at a depressed price. CN points to its robust health, but it is not evident that its analysis reflects any stress testing. In particular, much of the current M&A and other activity appears to be fueled by very low interest rates that may not persist. Prevailing interest rates could be considerably higher when the application is decided and CN seeks to divest KCS. Those higher interest rates would plausibly suppress what potential buyers would want and be able to pay for KCS. The higher interest rates could also slow the pace of the economy, which could in return reduce CN's revenues, profits, and cashflows. The financial cushion that CN posits may prove illusory, and an analysis that does not attempt to address such factors explicitly is inadequate.

Fourth and finally, there should be some recognition that a KCS overseen by a trustee while the merger remains pending is not the same thing as a KCS that is accountable to shareholders and the board of directors that they have elected. That disparity is exacerbated in an era of Precision Scheduled Railroading. Furthermore, trustee-led management is spared from facing analysts and the investment public on a quarterly or more frequent basis to explain and defend choices, performance, and strategy. There is a loss of accountability stemming from the proposed CN-KCS voting trust at an important time, especially as our nation and our economy seek to recover from the pandemic.

For the reasons stated, Shipper Associates urge the Board not to approve the CN-KCS voting trust in its current form.

Respectfully submitted,

Ann Warner

Ann Warner, Spokesperson
Freight Rail Customer Alliance

John N. Ward

John Ward, Executive Director
National Coal Transportation Association

Herman Haksteen, President
Private Railcar Food and Beverage Association

cc: Parties of Record in FD 36514

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.