

BEFORE THE SURFACE TRANSPORTATION BOARD

Docket No. FD 36500

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CANADIAN PACIFIC RAILWAY LIMITED; CANADIAN PACIFIC RAILWAY
COMPANY; SOO LINE RAILROAD COMPANY; CENTRAL MAINE & QUEBEC
RAILWAY US INC.; DAKOTA, MINNESOTA & EASTERN RAILROAD
CORPORATION; AND DELAWARE & HUDSON RAILWAY COMPANY, INC.

—CONTROL—

KANSAS CITY SOUTHERN; THE KANSAS CITY SOUTHERN RAILWAY COMPANY;
GATEWAY EASTERN RAILWAY COMPANY; AND
THE TEXAS MEXICAN RAILWAY COMPANY

**Comments and Request for Conditions of
The American Chemistry Council, The Fertilizer Institute, and
The National Industrial Transportation League**

The American Chemistry Council (“ACC”), The Fertilizer Institute (“TFI”), and The National Industrial Transportation League (“NITL”) (collectively “Joint Associations”) hereby submit these “Comments and Request for Conditions” on the application of Canadian Pacific Railway Company (“CP”) to acquire Kansas City Southern Railway Company (“KCS”) (collectively “Applicants”).¹ The Joint Associations offer conditional support for the proposed merger provided that their competitive concerns are satisfactorily addressed through appropriate conditions.

Throughout this proceeding, the Applicants have taken the position that, because their proposed merger is end-to-end, it does not have serious anti-competitive consequences.

¹ All references to “CP” also include Canadian Pacific Railway Limited; Soo Line Railroad Company; Central Maine & Quebec Railway US Inc.; Dakota Minnesota & Eastern Railroad Corp; and Delaware & Hudson Railway Company, Inc. All references to “KCS” also include Kansas City Southern Corporation; Gateway Eastern Railway Company; and The Texas Mexican Railway Company.

Although this merger does not threaten to reduce any shipper from two rail carriers to just one or have extensive overlapping or parallel lines, it does threaten existing competition through its extension of origin and destination bottlenecks. This is the primary concern of the Joint Associations in these comments, and they request conditions to mitigate this competitive threat. In addition, the Joint Associations are concerned with potential adverse service impacts that could result from this merger and they request conditions to protect shippers in the event serious service disruptions arise. Lastly, the Joint Associations request conditions that would preclude application of CP's tariff indemnity requirements for transportation of toxic-by-inhalation ("TIH") materials to movements that originate, terminate, or traverse the pre-merger KCS network.

I. THE BOARD MUST IDENTIFY AND REMEDY POTENTIALLY HARMFUL COMPETITIVE EFFECTS OF A PROPOSED MERGER WHENEVER POSSIBLE.

Pursuant to 49 U.S.C. § 11323(a), a consolidation or merger of two rail carriers may occur only with the approval and authorization of the Surface Transportation Board ("STB" or "Board"). Both the legislative history of the statute and the agency's decisions implementing the law demonstrate that the Board must carefully and broadly consider the potential adverse effects on competition and, where harmful competitive effects may result, the Board must impose conditions on the merger to eliminate those effects, if the conditions are operationally feasible and will produce public benefits outweighing any harm to the merger.

A. The Statute Requires The Board To Consider A Merger's Adverse Effects On Competition.

The statute, at 49 U.S.C. § 11324(b), requires the Board to consider at least the following factors in its evaluation of a merger of two Class I railroads:

- (1) the effect of the proposed transaction on the adequacy of transportation to the public;

- (2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction;
- (3) the total fixed charges that result from the proposed transaction;
- (4) the interest of rail carrier employees affected by the proposed transaction; and
- (5) whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system.

The Board “shall approve and authorize a transaction...when it finds the transaction consistent with the public interest.” 49 U.S.C. § 11324(c). This same section of the statute also states that the Board “may impose conditions governing the transaction.” *Id.*

Subpart (5) is central to the Joint Associations’ concerns. This subpart, which previously was codified at 49 U.S.C. § 11344(b)(1)(E), was added to the Interstate Commerce Act by the Staggers Rail Act of 1980. Pub. L. 96-448, 94 Stat. 1931 (Oct. 14, 1980). The legislative history of this amendment indicates that the Staggers Act was intended to place increased reliance on the forces of competition. 126 Cong. Rec. H8604 (daily ed. Sept. 9, 1980) (remarks of Rep. Panetta). Citing to this legislative history, the Interstate Commerce Commission (“ICC”) observed that the addition of subpart (5) not only “codified the need to consider competitive effects of consolidations, it has actually increased the need to identify carefully any anticompetitive effects and to balance those effects against the benefits of a transaction.” *Union Pac. Corp. et al. – Control – Missouri Pac. Corp. et al.*, 366 I.C.C. 462, 502 & n. 22 (1982) (“*UP/MP Control*”). The reason for this increased emphasis on anticompetitive effects, according to the ICC, was the addition of the rail transportation policy “to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail” because, by otherwise freeing the railroads of regulatory restraints, the Staggers Act also made it “easier to exert or abuse market power gained as a result of consolidation.” *Id. citing* 49 U.S.C. § 10101a(1) (currently codified at § 10101(1)). Thus, the

ICC concluded that it “must take even greater care to identify harmful competitive effects and to mitigate those effects where possible.” *Id.*

In addition to these explicit statutory considerations, the Board is required by *McLean Trucking Co. v. U.S.*, 321 U.S. 67 (1944) and the *Northern Lines Merger Cases*, 396 U.S. 491, 510-13 (1970), to weigh the policy of the antitrust laws, which disfavor diminution in competition resulting from a proposed rail merger, against the national rail transportation policies favoring efficiency enhancements. Although the Board does not sit as an antitrust court, the antitrust laws give “understandable content to the broad statutory concept of the public interest.” *UP/MP Control*, 366 I.C.C. at 485, *quoting FMC v. Aktiebolaget Svenska Amerika Linien*, 390 U.S. 338, 244 (1968). Moreover, even if a particular transaction would *not* violate the antitrust laws, the Board has the discretion to disapprove it. *Burlington N. Inc. et al. – Control and Merger – Santa Fe Pac. Corp. et al.*, 10 I.C.C. 2d 661, 726 (1995) (“*BN/SF Control*”).

B. The Board’s Policy Statement On Rail Mergers Requires It To Consider Any Significant Lessening Or Reduction In Competition Caused By A Merger.

In its April 23, 2021, decision in this docket, the Board held that its review of this transaction will be governed by the regulations contained in 49 C.F.R. Part 1180, subpart A, in effect before July 1, 2001, pursuant to a waiver from the current rules for a major merger transaction involving KCS under 49 C.F.R. § 1180.0(b). Those regulations include a policy statement codified at 49 C.F.R. § 1180.1 (2000) (“pre-2001 rules”). That prior policy statement originated with the ICC’s reevaluation of an even earlier policy statement in view of changes wrought by the Staggers Act. *See, Railroad Consolidation Procedures, General Policy Statement (49 CFR Part 1111)*, 363 I.C.C. 784, 785 (1981) (“*EP 282*”). The Staggers Act contained two provisions that had bearing on the policy statement: (1) the consolidation criteria

at 49 U.S.C. § 11344(b) (currently 11323(b)) should apply only to mergers of two or more Class I railroads, and (2) the added criteria at subpart (b)(1)(E), currently subpart (b)(5), requiring consideration of “whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system.” This latter addition is the predicate underlying these Joint Associations’ comments.

In applying the Staggers Act changes to the pre-2001 policy statement, the ICC emphasized that, in addition to being concerned with the elimination of competition, “we are necessarily also concerned about any significant ‘lessening’ or ‘reduction’ in competition caused by a consolidation.” *EP* 282 at 786-87. The ICC also noted “that a consolidation can in certain circumstances lead to a reduction in potential competition in markets which the applicants do not both serve.” *Id.* at 787. This could be the case, for example, for end-to-end mergers where there is no overlap of the markets that each applicant serves individually but there is potential for the merged entity to foreclose competition on downstream route segments. *See, e.g., UP/MP Control*, 366 I.C.C. at 528 (“End-to-end transactions also may allow the system to divert traffic from remaining competitors and hence foreclose their ability to compete in the marketplace.”). Ultimately, “[t]he Board’s competitive analysis depends on the relevant market(s)” and “[i]n some markets the Board’s focus will be on the preservation of effective intermodal competition, while in other markets (*such as long-haul movements of bulk commodities*) effective intramodal competition may also be important.” 49 C.F.R. § 1180.1(c)(2)(i) (2000) [emphasis added]. All the foregoing concerns were codified in the pre-2001 policy statement.

In determining whether a proposed merger is in the public interest, the Board “performs a balancing test” that “weighs the potential benefits to applicants and the public against the potential harm to the public” and “whether the benefits...could be realized by means other than

the proposed consolidation that would result in less potential harm to the public.” 49 C.F.R. § 1180.1(c) (2000). Because the Joint Associations’ members primarily rely upon rail transportation for long-haul movements of bulk commodities, they have specific concerns over the lessening of intramodal competition due to the ability of the merged entity to foreclose competition from other railroads. Absent mitigating conditions, those concerns outweigh the claimed benefits of the merger.

C. The Board Possesses Broad Authority To Impose Conditions Upon A Merger To Ameliorate Anticompetitive Effects.

The Board’s power to attach conditions to its approval of a major rail merger is unqualified by the statute. 49 U.S.C. § 11324(c). The pre-2001 policy statement declares that the Board has “broad authority to impose conditions on consolidations, including those that might be useful in ameliorating potential anticompetitive effects of a consolidation.” 49 C.F.R. § 1180.1(d) (2000). Indeed, the Board may impose conditions that otherwise would exceed its authority in other contexts. *Cf., CSX Corp. and Norfolk S. Corp. et al. – Control and Operating Leases/Agreements – Conrail Inc. et al.*, FD No. 33388 [Decision No. 89], slip op. at 73-74 (served July 23, 2998) (overriding anti-assignment clauses in contracts); *UP/SP Control*, 1 S.T.B. at 420 (opening contracts at 2-to-1 points).

Although Section 1180.1(d) of the pre-2001 policy statement explicitly defines the criteria the Board will consider for imposing conditions to protect a particular carrier, the policy statement does not set forth in similar comprehensive fashion the Board’s criteria for imposing conditions to protect the public. *UP/MP Control*, 366 I.C.C. at 562. The ICC, however, established such criteria in *UP/MP Control* at 562-65. In *BN/SF Control*, 10 I.C.C. 2d at 729, the ICC summarized those criteria:

There [in *UP/MP Control* at 562-65], we stated that we will not impose conditions unless we find that the consolidation may

produce effects harmful to the public interest (such as a significant reduction of competition in an affected market), and that the conditions will ameliorate or eliminate the harmful effects, will be operationally feasible, and will produce public benefits (through reduction or elimination of the possible harm) outweighing any reduction to the public benefits produced by the merger. We are also disinclined to impose conditions that would broadly restructure the competitive balance among railroads with unpredictable effects. *See, e.g., Santa Fe Southern Pacific Corp. – Control – SPT Co.*, 2 I.C.C. 2d 709, 827 (1986), 3 I.C.C. 2d 926, 928 (1987) (*SF/SP*); and *UP/MKT*, 4 I.C.C. 2d at 437. To be granted, a condition must first address an effect of the transaction. We will not impose conditions ‘to ameliorate longstanding problems which were not created by the merger,’ nor will we impose conditions that ‘are in no way related either directly or indirectly to the involved merger.’ *BN/Frisco*, 360 I.C.C. at 952 (footnote omitted); *see also UP/CNW*, slip op. at 97.

Thus, the Board should impose conditions to protect the public interest if such conditions are operationally feasible, ameliorate or eliminate the threatened harm, and are more beneficial to the public than that are detrimental to the transaction. *UP/MP Control* at 564.

With the foregoing principles in mind, the evidence presented herein shows that there will be a substantial lessening of competition by the merged CP/KCS.

II. THE PROPOSED MERGER WILL HARM COMPETITION.

A. Description of Competitive Harm.

The CP/KCS combination will harm vertical competition. CP and KCS connect at a single location today, Kansas City, MO. KCS, however, has multiple connections with other Class I railroads that serve the same territories as CP. Conversely, CP has connections with other Class I railroads that serve the same territories as KCS. Pre-merger, both railroads are neutral as to whether they connect with each other or another Class I railroad to provide through route transportation services. The proposed merger will destroy that neutrality, as the combined KCS and CP will have strong incentives to favor their long-haul route. *See, e.g., UP/MP Control*, 366 I.C.C. at 529-31 (Finding that the merger of UP and MP would create incentives for

UP to favor the MP route over the MKT route on moves south of Kansas City). Post-merger, KCS and CP could close those interchanges for traffic that today has the option to use an alternative Class I carrier. *Id.* at 529 (“If one of the end-to-end consolidation partners formerly interchanged traffic with both its consolidation partners and other carriers in providing joint line services..., the transaction may result in the foreclosure of the nonincluded carrier from competing in the markets it formerly served.”). Absent conditions to protect these pre-merger competitive options, those consequences could go unaddressed in the instant transaction.

Although this competitive harm will affect interchanges with most Class I railroads, its greatest impact will be upon Canadian National (“CN”) routings for two reasons. First, the CP/KCS network would overlap substantially with the CN rail network in both the United States and Canada. Second, CP and CN compete directly for substantial traffic volumes in Canada because “interswitching,” which functions like reciprocal switching in the U.S. but is much more widely available in Canada, means that CP and CN effectively can serve most traffic at Canadian locations. As a result of these two factors, CN and CP compete for most traffic between the United States and Canada.² Post-merger, most KCS locations will become captive to CP, which will enable CP to foreclose the competition that currently exists with CN via multiple interchange locations between KCS and CN.³ The merged CP/KCS could foreclose these existing KCS/CN routing options.

² U.S. locations that currently are captive to either CP or CN are exceptions due to the long-haul rights of origin carriers under U.S. law. *See* 49 U.S.C. § 10705(a). By adding KCS captive locations to the CP network, the number of exceptions will be greatly expanded.

³ The precise number of interchange locations between KCS and CN is unclear. Applicants’ witness, John Brooks, identifies interchanges at New Orleans, LA, and Jackson, MS, and the workpapers underlying Appendix K of the Application also shows cars interchanging over Baton Rouge, LA. *See* Verified Statement of John Brooks, at ¶ 41. The Official Railway Guide further identifies both carriers as interchanging at East St. Louis, IL, and Springfield, IL.

A proper condition is needed to protect existing routing options by preserving all pre-merger interchanges both physically and commercially. The Applicants have committed to the first part of this by agreeing to keep their interchanges with other Class I carriers physically open and to quote Rule 11 rates to those interchanges. But the Applicants have not offered any proposal to protect those interchanges commercially. That is problematic because the Applicants could quote a Rule 11 rate for their portion of a through route that effectively forces the traffic over their preferred long-haul route because the resulting through rate is uneconomic.

B. Description of Requested Conditions.

Joint Associations request the following conditions to protect existing interchanges both physically and commercially and thereby preserve the pre-merger competition that alternative routes via those interchanges provide to CP/KCS routes:

1. Gateway/Interchange Protections: Applicants shall preserve all interchanges with Class I and II railroads that were active at any time from January 1, 2018, through the consummation date of the merger.
2. Rule 11 Rates: Applicants shall quote Rule 11 rates for all traffic to/from the interchanges referenced in Condition #1 in the shipper's choice of a contract or tariff. Where there are multiple routing options via different interchanges with the same Class I or II railroad, a Shipper may request rates to any or all such interchanges. To implement this commitment, Applicants waive any rights that they may have now or in the future to refuse to quote Rule 11 rates to any of these interchanges.
3. Bottleneck Rate Protections:
 - a. Application: This condition applies to any bottleneck movement that originates or terminates (including via reciprocal switch or inter-switching) on Applicants or a connecting Class II or III railroad for which the merger of Applicants creates the opportunity for a longer haul on their combined network than either Applicant would have by itself.
 - b. Rate Level: A Rule 11 rate provided in accordance with Condition #2 on qualifying movements under Condition #3.a. may not exceed a rate determined by the following method:
 - i. Applicants shall first quote a rate for their long-haul route. Applicants may quote any rate for such service subject only to the rate

reasonableness requirements codified at 49 U.S.C. § 10701. If the Board prescribes a maximum reasonable rate for the Applicants' long-haul route, that rate shall be used in this methodology.

- ii. Calculate the rate per mile of the Applicants' long-haul rate quote (using PC*Miler).
 - iii. Multiply the rate per mile by the distance of the bottleneck segment (calculated using PC*Miler) to calculate a Rule 11 rate for the bottleneck segment. If the Applicants' long-haul rate is predicated upon a minimum volume commitment, Applicants may require the same commitment for the Rule 11 rate.
- c. Duration: A Rule 11 rate determined pursuant to Condition #3.b. may not be modified by either railroad or shipper for a minimum of one year unless they mutually agree otherwise. Nothing herein shall preclude the parties from entering a multi-year contract that contains a mutually agreeable method to adjust the initial base rates established pursuant to this condition after Year 1.
4. Rate reasonableness. Nothing in these conditions shall preclude a shipper from challenging the reasonableness of a Rule 11 rate determined pursuant to Condition #3.b.
5. Dispute Resolution: If a dispute arises over calculation of a Rule 11 rate pursuant to Condition #3, the shipper may elect to resolve such dispute pursuant to the Board's arbitration rules at 49 C.F.R. Part 1108. If the shipper makes such election, Applicants are deemed to have opted into the Board's arbitration program as a requirement of this condition. Any dispute that is arbitrated shall be subject to the limitations upon arbitrations contained in the Board's rules.

Applicants already have committed in concept to Condition #1, which physically preserves existing interchanges, and to Condition #2, which ensures that a shipper can challenge the reasonableness of the bottleneck rate without having to challenge the total through rate. It is unclear, however, whether these two commitments extend to all existing interchanges with the same carrier when more than one such interchange currently exists. Also, Applicants have not specified how far back they will look to determine existing interchanges. Joint Associations propose January 1, 2018, as a reasonable two-year period prior to the Covid-19 pandemic. Applicants have not committed to any condition that would protect the competitiveness of their bottleneck rate vis-à-vis their long-haul rate, such as Condition #3 would do.

The Joint Associations have proposed Condition #3 to ensure that the Applicants' post-merger Rule 11 rates to interchanges are true market rates by linking them to the market rates that the Applicants establish for their long-haul rates. The objective is not to prescribe a maximum bottleneck rate, but rather, the objective is to protect the competitiveness of the Applicants' bottleneck rate relative to the Applicants' long-haul rate. The latter rate, over which the Applicants retain complete control, will determine the former rate. By pegging the bottleneck rate to the long-haul rate on a distance pro-rated basis, Condition #3 prevents the Applicants from setting a disproportionately higher rate for the bottleneck segment that renders the choice of a competing railroad over the non-bottleneck segment commercially impractical. Post-merger, this permits shippers to retain the benefits of two railroads competing over non-bottleneck segments to the same extent as pre-merger. If the CP/KCS long-haul route is the most economically efficient, it will be the favored route.

Condition #3.a. applies this condition only to bottleneck movements where the merger creates a longer haul for the Applicants than either possesses independently pre-merger. This precludes application to movements where the CP/KCS route does not change because of the merger, which ensures that the condition is narrowly tailored to a merger-related harm.

Condition #3.b. establishes the method for determining the Rule 11 bottleneck segment rate to interchanges with connecting carriers. Proration of the Applicants' long-haul rate by distance is necessary to create an apples-to-apples relationship between the bottleneck rate and the long-haul rate. Pre-merger, KCS and CP interchange at just one location, Kansas City, whereas they interchange with other Class I carriers at multiple different locations. For example, KCS interchanges with CN at four locations, none of which are at Kansas City. Condition #3.b. therefore prorates the long-haul rate on a per-mile basis to obtain the Rule 11 bottleneck rate.

A simple illustration explains how Condition #3.b. would work. Assume the following facts:

- Applicants' post-merger long-haul route is 1000 miles.
- Applicants' long-haul rate is \$1000.
- Applicant's bottleneck segment to the interchange with a connecting carrier is 500 miles.

Applying these assumptions, Applicants' long-haul rate per mile is \$1 ($\$1000 / 1000$ miles).

Applicants' bottleneck rate, therefore, is \$500 ($\1×500 miles).

Condition #3.c. fixes the Rule 11 bottleneck rate for one year absent a different agreement by the parties. For subsequent years, the parties have the option to perform a new calculation based upon a new long-haul rate or they can agree to a multi-year contract with a rate adjustment mechanism. This condition neither requires nor dictates such a mechanism.

Condition #4 clarifies that a bottleneck rate determined pursuant to Condition #3 can be challenged as unreasonable. This is important for two reasons. First, because the base long-haul rate may be unreasonable, the bottleneck rate determined by Condition #3.b. also could be unreasonable. Second, because a condition is what the Board imposes upon the Applicants as a condition of approving their merger, this condition should not bind shippers who are not parties to this transaction. Therefore, any shipper who can prove market dominance should retain the right to challenge the bottleneck rate using any of the Board's accepted processes.

Condition #5 is intended to prevent any dispute over the calculation of the bottleneck rate from becoming bogged down in litigation before the Board. Joint Associations do not foresee much potential for disputes given the clearly defined functions. But if a dispute should arise, it would be amenable to resolution pursuant to the Board's arbitration rules. Therefore, as a

condition to approval of this transaction, the Board should require the Applicants to opt-in to arbitrating disputes over calculation of the bottleneck rate.

C. Board Precedent Should Not Foreclose the Requested Conditions.

Over the course of multiple post-Staggers Act consolidations, there has been much debate over the vertical effects of end-to-end mergers on rail competition. Out of those decisions, the so-called “one-lump” theory has emerged as a rebuttable presumption against any anti-competitive effects. More recently, however, the Board has recognized that competitive harm does occur in certain situations. Lastly, there are insurmountable complications to applying the one-lump theory to carload traffic.

1. The Board’s application of the one-lump *theory* has converted it into an unassailable *rule*.

The Board’s most recent comprehensive discussion of the one-lump theory can be found in *BN/SF Control*, 10 I.C.C. 2d at 747-57. The premise of the one-lump theory is that there is only one monopoly profit to be gained from the sale of an end-product or service. The theory holds that, because a monopolist at the end stage of production (*e.g.*, a bottleneck carrier) is in a position to capture the entire monopoly profit, integration with a connecting carrier on a competitive route segment normally does not enable it to raise the profit-maximizing price. Thus, for movements from A to C, where one carrier has a bottleneck segment from A to B, but two carriers compete from B to C, the Board has held that a merger of the sole AB carrier with one of the BC carriers does not result in competitive harm because the AB, or “bottleneck,” carrier already reaps the monopoly profit for the entire AC movement even prior to the merger. In every major merger decision, the agency has invoked this theory to conclude that there would be no loss of competition when a bottleneck destination railroad merged with one of two

competing origin railroads.⁴ The theory itself is highly controversial and its accuracy has long been disputed by the shipping community.

The Board has never declared the one-lump theory to be a truism. Rather, it has held that the theory creates a rebuttable presumption that, when a neutral bottleneck carrier merges with one of two competing carriers over a connecting route segment, the shipper did not benefit from that competition pre-merger and thus will not suffer any competitive harm post-merger.⁵ To rebut this presumption, the Board has required shippers to show that the benefits of competition over the connecting segment flowed through to the shipper despite its captivity over another segment and any such flow-through will be significantly curtailed by the merger.

Shippers have challenged the presumption created by the one-lump theory and simultaneously made good faith efforts to rebut its presumption. They have done so on grounds that the theory requires, at a minimum, the following factors to be present, which they then have proceeded to demonstrate is not the case with respect to their movements:

(1) the bottleneck carrier must have perfect information regarding all aspects of pricing; (2) it must control all aspects of pricing of the movement; (3) it must have exercised maximum market power before the merger; (4) prior to the merger, it must have carried out a perfect price squeeze on connecting carriers, by holding their revenue share to incremental costs; and, most crucially, (5) it must not have passed through to the shipper any rate reductions of connecting carriers.

BN/SF Control at 751. The Board has rejected the evidence and argument submitted in prior cases, citing to its “experience” that, when there are no transportation alternatives to a bottleneck

⁴ *E.g., Burlington Northern Inc. et al. – Control and Merger – Santa Fe Pacific Corp. et al.*, 10 I.C.C.2d 661, 747-57 (1995), *aff’d sub nom, Western Resources, Inc. v. STB*, 109 F.3d 782 (D.C. Cir. 1997); *Union Pacific– Control – Missouri Pacific*, 366 I.C.C. 462, 538 (1982).

⁵ *BN/SF Control* at 748, *citing Chi., Milw, St. Paul and Pac. R.R. Co. – Reorganization – Acquisition by Grand Trunk Corp.*, 2 I.C.C. 2d 427, 455 (1985), and *Union Pac. Corp. et al. – Control – Missouri-Kansas-Tex. R.R. Co. et al.*, 4 I.C.C. 2d 409, 476 (1988).

carrier, that carrier is able to capture the preponderance of economic profits, or when there are factors that limit a carrier's ability to take full advantage of a bottleneck, those factors will continue to exist post-merger. *Id.* It is unclear, however, what "experience" the Board has in such matters.

The Board also has rejected arguments that vertical integration would foreclose efficient through routes, summarily concluding that, "there is no reason for a carrier to foreclose an efficient connecting carrier just to achieve a long-haul." *Id.* at 751-52. Yet, there are examples of this occurring today. For example, recent comments submitted in EP 711 (Sub. No. 1) by ACC member, The Dow Chemical Company, shows that railroads can and do favor their long-haul over routes with significantly shorter total distances.⁶ One explanation for this likely is the fact that railroads have shifted more of their costs to shippers, such as rail car ownership, so that the shipper rather than the railroad bears the inefficiencies of a longer route in the form of higher rail car ownership costs. Hence, the railroad no longer considers that cost when determining the most profitable route for it. But, even if achieving its long-haul is more efficient for the bottleneck carrier, the same is not necessarily true for the connecting carrier or the shipper.

The question thus should be whether the *net* economic benefit of the total movement is maximized. That question is answered by determining the total cost to the shipper – *e.g.*, the rail rate, which reflects the carrier's costs, and the additional costs to the shipper of a longer haul, such as fleet and inventory expenses. But when the bottleneck carrier forecloses a competitive connecting carrier's route based solely upon the most efficient route for itself, there is no opportunity for the shipper to choose an alternative route that offers a greater net benefit.

⁶ "Comments of The Dow Chemical Company," Docket No. EP 711 (Sub No. 1), *Reciprocal Switching*, at 7 (filed Feb. 14, 2022) (By claiming its long-haul, UP added over 335,000 route miles to the ten highest volume lanes at Dow's Louisiana facilities in 2021).

Logic also dictates that, because vertical mergers increase bottleneck distances, they enhance the bottleneck carrier's ability to execute the one-lump theory. For example, the shorter the distance of the pre-merger bottleneck, the less information the bottleneck carrier possesses about the costs of operating over the entire route and the services that the shipper requires of the connecting carrier. By extending its bottleneck through a merger, the bottleneck carrier increases the amount of information it possesses. This logic indicates that consolidation removes pre-merger impediments to the exercise of a perfect price squeeze under the one-lump theory.

The one-lump theory also is limited because it evaluates monopoly power solely in the context of rates (*e.g.*, the one-lump of monopoly rent). But service also is an important competitive factor. Even if the bottleneck carrier can capture an equivalent amount of monopoly rent pre- and post-merger, a shipper can still be harmed by loss of a competitor that is willing and able to provide superior service. The one-lump presumption overlooks this factor.

The Board's precedent has created a "heads I win, tail you lose" standard that effectively converts the one-lump theory from a rebuttable presumption into an unassailable rule, much like the Board's reciprocal switching rules, which are currently under review in Docket No. EP 711 (Sub No. 1), *Reciprocal Switching*, have become a standard that no shipper can satisfy.⁷

⁷ *Reciprocal Switching*, Docket No. EP 711 (Sub-No. 1), slip op. at 8-9 (served July 27, 2016) (The sheer dearth of cases...despite continued shipper concerns about competitive options and quality of service, suggests that [the current reciprocal switching rules] have effectively operated as a bar to relief rather than as a standard under which relief could be granted.”).

2. **Rate regulation is not a practical tool for carload shippers to defeat the one-lump theory.**

Following *BN/SF Control*, in the so-called “Bottleneck” decisions,⁸ the Board has acknowledged that regulation of the bottleneck rate is a factor that prevents the bottleneck carrier from executing the one-lump theory. The Board also declared a “contract exception” to its longstanding policy that a shipper ordinarily is entitled to challenge the reasonableness of rates only on a through basis (i.e., from the origin to destination). *Bottleneck I* at *27-30. The exception declared that, where a bottleneck carrier cannot serve both the origin and destination, and where a shipper secures a separately negotiated contract rate for the non-bottleneck segment of the route, the shipper may separately challenge a common carriage bottleneck rate. *Id.* at *30-31. Regulation of the bottleneck rate thus prevents the bottleneck carrier from extracting the entire monopoly profit from both the captive and competitive route segments under the “one-lump” theory. The D.C. Circuit affirmed this “contract exception” in *Union Pacific RR Co. v. STB*, 202 F.3d 337, 342 (D.C. Cir. 2000).

End-to-end consolidations reduce the ability of captive shippers to avoid the “one-lump” theory through the foregoing “contract exception.” Because the contract exception does not apply when the bottleneck carrier serves both the origin and destination, any merger, or combination of mergers, that enable bottleneck carriers to serve both locations necessarily have anti-competitive consequences. Specifically, such mergers destroy the captive shipper’s eligibility to invoke the contract exception to bring a regulatory challenge to the bottleneck rate that would enable that shipper to realize the benefits of competition over the non-bottleneck

⁸ *Central Power & Light Co. v. Union Pacific RR Co.*, Nos. 41242 et al., 1996 STB LEXIS 358 (served Dec. 31, 1996) (“*Bottleneck I*”), clarified 1997 STB LEXIS 91 (served May 1, 1997) (“*Bottleneck II*”), *aff’d in part*, *MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999),

segments, thereby rebutting the one-lump theory. Because most major mergers occurred before the agency adopted the “contract exception,” this competitive harm was not identified and addressed in prior merger decisions. This harm, however, was recognized when the Board revised its merger policy statement in 2001. *Major Rail Consolidation Procedures*, Ex Parte No. 582 (Sub-No. 1), slip op. at 26 (served June 11, 2001).⁹

Furthermore, even for movements where the contract exception is not eliminated by a vertical merger, the length of the bottleneck segment increases. This in turn requires greater reliance upon regulation over longer distances to defeat the one-lump theory. Conversely, a vertical merger reduces the distance over which shippers can take advantage of competition. Such consequences are contrary to the rail transportation policy to allow competition to establish reasonable rates “to the maximum extent possible,” and thus would be contrary to the public interest evaluation of a merger. 49 U.S.C. § 10101(1).

In this transaction, the Applicants have committed to preserve the contract exception by quoting Rule 11 rates over pre-merger bottleneck segments. But they have stopped there, seemingly taking the position that STB regulation of those bottleneck rates will be sufficient to prevent them from extracting monopoly rents through the one-lump theory. But reliance upon STB rate regulation is dubious.

In this transaction, the most vulnerable traffic to acts of foreclosure is carload traffic that moves between hundreds of origin-destination pairs. It is well-established that stand-alone cost

⁹ Although the pre-2001 merger policy statement applies to this transaction, the resulting competitive harm from loss of the contract exception is derived from the pre-2001 *Bottleneck Decisions*. The Board’s official recognition of this harm in the current policy statement thus cannot bar consideration of that harm under the prior policy statement. See *BN/SF Control* at 753 (In discussing the one-lump theory, the Board noted that approval of the merger was not intended to foreclose any shipper’s right to maximum rate relief in several pending cases that subsequently resulted in the *Bottleneck Decisions*).

cases are too expensive, complex, and lengthy to be used by carload shippers, and the Board's small rate case methodologies also have been unavailing. *Expanding Access to Rate Relief*, Docket No. EP 755, slip op. at 4-5, 10 (served Nov. 15, 2021). Although the Board has proposed a new rate review process for smaller cases called "Final Offer Rate Review" or "FORR," a final rule has not yet been adopted and the process has not been tested. Furthermore, the rail industry has vigorously opposed FORR as unlawful, and the Board is considering exempting railroads from FORR if they agree to arbitrate rate disputes while simultaneously proposing limits on the number of arbitrations. *Joint Pet. For Rulemaking to Establish a Voluntary Arbitration Program for Small Rate Disputes*, Docket No. EP 765, slip op. at 13-14, 17-20 (served Nov. 15, 2021). This combination of an FORR exemption and a cap on arbitrations could result in neither FORR nor arbitration being available to many affected shippers. Knowing these impediments, the threat of a rate case is unlikely to be an effective constraint upon the Applicants' Rule 11 interchange pricing.

3. **Because it is impractical for carload shippers to rebut the one-lump theory, they effectively are without protection from commercial gateway closures unless the Board grants the requested conditions.**

In addition to the foregoing concerns with the logic of the one-lump theory and the inadequacies of rate regulation, the Joint Associations have serious concerns over the practicality of applying the theory to carload shippers, such as the Joint Associations' members. Specifically, although the Board has labelled the one-lump theory a "rebuttable presumption," carload shippers will not find it practicable to attempt a rebuttal.

The one-lump theory has been discussed in prior mergers and applied solely in the context of unit train coal movements. Because electric utilities transport coal in large volumes between the same origin-destination pairs for years, typically decades, they had a very strong

interest in, and much to gain, by challenging the applicability of the one-lump theory to their movements.

It is far less practical for carload shippers to rebut the one-lump presumption because they tender much smaller volumes of traffic over hundreds of origin-destination pairs that are constantly shifting. To rebut the one-lump theory in the manner required by the Board, they would have to present evidence in this proceeding for each of these lanes. Furthermore, as shippers develop new lanes post-merger, does the Board intend to require them to rebut the one-lump theory at that time or will they forever lose that opportunity? Although a shipper may tender large volumes of traffic by rail in the aggregate, the small volumes over individual lanes, combined with the fact that lanes are constantly shifting, makes presenting such rebuttal a complex, expensive, and overall daunting task. This is comparable to the obstacles that carload shippers face when challenging the reasonableness of rail rates for such lanes. The cost and uncertainty of these challenges far exceed the benefits if they are successful.

The conditions proposed by the Joint Associations are a reasonable solution to the carload shippers' dilemma because they neither require the Board to decide the applicability of the one-lump theory nor undermine it if applicable. First, if the Board's assumption that the one-lump theory captures the full monopoly rent is flawed in any form, this condition offers protection that otherwise would not exist. But if the one-lump theory is accurate, the requested conditions will not alter the pre-merger competitive landscape because the Rule 11 bottleneck rate will be pegged to the post-merger long-haul rate. The one-lump theory holds that the consolidated CP/KCS will receive the same "lump" of monopoly rent post-merger that either railroad received pre-merger on routes where it was a bottleneck carrier. This means that the monopoly rent is embedded within the Applicants' long-haul rate, which is the basis for setting

the Rule 11 bottleneck rate under the requested conditions. Therefore, any monopoly rent that may exist in the pre-merger bottleneck rate will carry forward to the post-merger Rule 11 bottleneck rate too.

III. **CONDITIONS TO MITIGATE MERGER-RELATED SERVICE DISRUPTIONS.**

The Joint Associations' members harbor long memories of the post-merger service disruptions that followed a series of mergers that began with the BN/SF merger and grew exponentially after the UP/SP and Conrail mergers. Moreover, similar service disruptions have occurred in more recent years following the implementation of precision scheduled railroading ("PSR") by most of the Class I railroads. Therefore, the Joint Associations request appropriate conditions to mitigate the impacts of any merger-related service disruptions that do occur.

Although Applicants contend that the end-to-end nature of this merger greatly reduces the likelihood of major post-merger service disruptions, the new traffic patterns that they propose, including increased volumes through areas that already are congested, are a cause for concern. If the Applicants fail to make sufficient infrastructure investments to handle the projected traffic shifts, service disruptions are a distinct possibility. Also, work force reductions due to a combination of PSR and Covid-19 pose risks to a smooth implementation.

The Joint Associations' members hope for the smoothest of transitions but want to be prepared for the worst. In prior service disruptions, whether they were the result of a merger, PSR, or other causes, shippers have had few options to avoid the disruption, mitigate its impacts, or recover damages, even when the rail carrier clearly was at fault. Therefore, the Joint Associations request conditions to address their concerns.

Specifically, the Joint Associations request the following conditions which are modelled, in part, on conditions adopted in STB Finance Docket No. 43000, *Canadian National Ry. Co. et al. – Control – Wisconsin Central Transp. Corp. et al.*, Decision No. 10 (served Sept. 7, 2001):

1. Upon the request of any Shipper, CP shall make a good faith offer to enter into an agreement with that Shipper with respect to that Shipper's traffic affected by this transaction that, at a minimum:
 - a) identifies that Shipper's base service level as the average transit time during each base period (i.e., the 12 calendar months preceding the month in which the transaction is consummated, or such other time period agreed to by CP and the Shipper) for each of the commodities shipped or received by that Shipper between each pertinent origin/destination pair affected by the transaction;
 - b) assures that average transit time at the base service level will not be adversely affected by the transaction;
 - c) provides that, if the Shipper notifies CP that the Shipper's average transit time for any post-transaction calendar month has been adversely affected relative to that Shipper's average transit time for the corresponding base period calendar month, CP will have not more than 30 days to bring the average transit time for the movement(s) in question up to the base service level for the corresponding base calendar month;
 - d) notwithstanding any contrary provision in a contract between CP and the Shipper, the Shipper may divert traffic from CP routes without being in violation of any contract volume commitments during the foregoing 30-day period and continuing until the average transit time has been restored to the corresponding base period calendar month;

- e) provides remedies if the Shipper's average monthly transit time continues to be adversely affected by the transaction for more than 30 days after the date of notification to CP that shall include the following, at a minimum:
- on-the-ground management flexibility and top-level backing with whatever resources are necessary to affect a complete and timely resolution;
 - unless otherwise agreed to by CP and the Shipper, a sliding scale of charges based on CP's post-transaction performance for that Shipper relative to that Shipper's base service levels; and
 - if a Shipper's average transit time calculated over a calendar month for a particular movement exceeds that for the corresponding base period calendar month, CP shall have the burden of showing that the adverse effect was not a result of the transaction; and
- f) provides that, unless otherwise agreed to by CP and the Shipper, any agreement made pursuant to the service protection provisions of this condition will expire 5 years after the consummation of the transaction.
2. CP shall process all claims for service-related damages in accordance with 49 C.F.R. Part 1005.
3. CP shall provide Shippers with at least 30 days prior written notice of any planned service changes at Shipper facilities. If CP fails to provide such advance notice, CP shall be liable for all damages sustained by the Shipper that are caused by or arise from the service change during the first 30 days after the service change.
4. If CP denies a claim for damages resulting from any of the foregoing conditions or any service disruption caused by or arising from this transaction, it agrees to arbitrate such

claims, upon a Shipper's demand, under the Commercial Arbitration Rules administered by the American Arbitration Association and such arbitration shall be decided no more than 90 days from the date of selection of the arbitrator. This arbitration condition shall not supersede any arbitration provision in a contract unless the shipper expressly demands arbitration pursuant to this condition.

IV. CONDITIONS TO ADDRESS TIH LIABILITY CONCERNS.

CP has published one of the most onerous tariff provisions covering the transportation of TIH materials among the Class I railroads, whereas KCS has not published any tariff item specific to TIH, but instead has addressed TIH materials in a fair and reasonable manner that is applicable to hazardous materials generally. The Joint Associations are concerned that CP will extend its onerous tariff to all shipments over the combined CP/KCS network. But for this transaction, that could not occur.

CP Tariff 8, Items 51-56, contain extensive indemnification and insurance requirements for TIH shipments. The bottom line is that CP accepts liability for its own negligent or willful misconduct and assigns the shipper liability for everything else, which includes third party liability and Acts of God. CP is not even required to seek recovery from a responsible third party before seeking indemnity from shippers. TIH shippers must indemnify CP for those liabilities and procure not less than \$100 million of insurance to cover their indemnity obligations. CP imposes this cost upon TIH shippers above and beyond its exceedingly high transportation rates for TIH shipments. In contrast, KCS has much narrower indemnity requirements and no insurance requirement. *See* KCS 9011-G, Item 260 and KCS 9012, Item 260.

To protect TIH shippers against the extension of the CP tariff on TIH shipments to movements over KCS resulting from this merger, the Joint Associations request the following condition:

- CP may not extend its TIH liability, indemnification, or insurance requirements to TIH shipments that originate on, terminate on, or traverse any segment of the pre-merger KCS network. Such transportation shall continue to be governed by the pre-merger KCS tariff indemnity terms for all hazardous materials shipments.

V. CONCLUSION

For the foregoing reasons, the Joint Associations respectfully request that the Board grant the conditions requested In Parts II.B, III, and IV by making its approval of the Applicants' transaction subject to those conditions.

Respectfully submitted,

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Dated: February 28, 2022

Certificate of Service

I certify that I have this 28th day of February 2022, served copies of this document upon all parties of record in this proceeding by email, except that the parties listed below have been served by first-class mail, postage pre-paid:

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