

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB Finance Docket No. 36500**

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February 28, 2022  
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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**

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**CN'S COMMENTS ON APPLICATION AND REQUEST FOR CONDITIONS**

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Dated: February 28, 2022

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## EXECUTIVE SUMMARY

Applicants claim that a combined CP-KCS will deliver massive pro-competitive benefits, while causing no competitive harm, and they assert that joining their networks would generate substantial operating efficiencies, without any risk of harm to service.<sup>1</sup> Based on this rosy picture, Applicants choose not to offer meaningful protective conditions.

Applicants' position is flatly inconsistent with their own prior advocacy. For example, after CP spent much of 2021 raising alarms about the competitive risks of mergers involving parallel lines (and claiming that even a proposed divestiture of a parallel line would be insufficient to mitigate competitive harm), Applicants simply ignore the fact that KCS's Springfield Line is parallel to CP's north-south mainline. Applicants not only fail to propose conditions to remedy this loss of horizontal competition, they entirely abandon KCS's prior plans to invest in the line to improve track speeds to better compete with trucks and propose no merger-related capital investment in it.

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<sup>1</sup> Railroad Control Application, *Canadian Pacific Railway, et. al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500 (filed Oct. 29, 2021) (“Application”), Vol. 1, at 1 § 1180.6 (“The CP/KCS combination presents a once-in-a-lifetime opportunity to inject new and invigorated competition into North-South transportation corridors connecting the United States, Mexico, and Canada, supporting U.S. and North American economic growth. The Transaction is unambiguously and uniformly beneficial for competition and the public interest.”); *id.* at 11 § 1180.6(a)(2)(i) (“The Transaction will generate competitive benefits and cause no competitive harm.”); *id.*, Verified Statement of Keith Creel ¶ 28 (“CP/KCS will enhance competition against the larger Class I railroads in the central United States and do so without harming competition anywhere.”).

Applicants concede they must offer gateway protections to address the well-recognized risk of vertical foreclosure from Applicants' obvious incentive to favor single-line CP-KCS movements over participation in joint-line movements with other railroads. The Application, however, proposed only an ill-defined gateway commitment, without specifying the locations at which it would apply, an enforcement mechanism, or any limitation on what "commercially reasonable" rates the proposed condition would permit Applicants to charge (short of a maximum reasonable rate as determined in a rate reasonableness case).

Moreover, Applicants present no evidence that they have adequately considered – much less planned for – the types of implementation-related service disruptions that have plagued multiple recent rail mergers. They appear to have forgotten their pledge to provide "all the information [the Board] needs to satisfy itself that Applicants have carefully planned for the integration of these railroads and will implement measures to monitor and adjust service levels during the integration process so that shippers' service levels are safeguarded . . ." <sup>2</sup> Indeed, they do not propose any future Board oversight of their merger, despite the fact that such oversight has been a standard condition in prior major mergers and that CP

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<sup>2</sup> Applicants' Reply to Objections to KCS Waiver from 2001 Major Merger Rules, *Canadian Pacific Railway, et. al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500, at 19 (filed Apr. 12, 2021) ("Applicants' Reply to Objections to KCS Waiver").

itself has advocated for oversight in connection with a recent *significant* transaction.<sup>3</sup>

Applicants’ request for a virtually unconditioned merger would be inappropriate even if their Application had made a compelling, well-supported case demonstrating that their merger was clearly in the public interest. But they have not come close to doing so. The Application is riddled with errors, omissions, inconsistencies, and plainly unreasonable assumptions.

For example, Applicants’ Base Year Operating Plan is not based on their traffic or operations during the “Base Year” that they selected (and the Board accepted).<sup>4</sup> Instead, it is based on a single month of unrepresentative traffic data from disparate (and inconsistent) time periods, with arbitrary alterations, and the CP and KCS train service plans that were in effect during the 1st Quarter of 2021. Further, neither Applicants’ operating expense estimates nor their financial *pro formas* are based on their Operating Plan. Rather, those exhibits are based on a spreadsheet of operating statistics untethered to Applicants’ Operating Plan and unsupported by any other record evidence. Applicants’ traffic diversion estimates are similarly full of errors and invalid assumptions. For example, the single largest “revenue synergy” they identify—accounting for { <sup>Redacted</sup> Redacted } of their alleged

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<sup>3</sup> Canadian Pacific’s Comments to Application, *CSX Corporation and CSX Transportation, Inc., et al.—Control and Merger—Pan Am Systems, Inc., et al.*, STB Docket No. FD 36472, at 27–28 (filed Aug. 27, 2021) (requesting indefinite oversight).

<sup>4</sup> See Decision No. 11, *Canadian Pacific Railway Ltd.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500 (STB served Nov. 23, 2021).

merger-related synergies—is for a movement from a crude oil facility *that Applicants had already contracted with the shipper to move in joint CP-KCS service before the merger was contemplated.* **Redacted**

} He **Redacted**

} Finally, Applicants publicly disavowed their own density charts in January 2022, claiming that it would be a “misrepresentation” to use them to identify projected density changes on CPKC lines.<sup>8</sup> Based on these and other errors, the Board cannot rely on the Application in evaluating this proposed transaction.

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<sup>5</sup> Exhibit 8, Excerpts from Transcript of February 22, 2022 Deposition of Patrick J. Ottensmeyer (“Ottensmeyer Dep.”), at 88:11–90:13.

<sup>6</sup> *Id.* at 89:9–16.

<sup>7</sup> *Id.* at 88:11–90:13.

<sup>8</sup> See Applicants’ Reply to Canadian National’s Description of Anticipated Responsive Application, *Canadian Pacific Railway Ltd., et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500, at 9, n.7 (filed Jan. 28, 2022) (claiming three times that density figures from Exhibit 14 were “figures presented by CN”).

Canadian National Railway Company and its U.S. subsidiaries (referred to collectively herein as “CN”) understand that rail mergers that deliver more efficient service and create more effective competition can deliver public benefits to customers—if such mergers are appropriately conditioned to guard against harms to the public interest. That was why CN voluntarily requested that its proposed merger with KCS be reviewed under the Board’s current, more stringent merger rules, and publicly committed to conditions to assuage concerns about competitive harm—including a divestiture of a parallel line and a robust gateway commitment with an arbitration remedy, and additional conditions to enhance competition.<sup>9</sup> That was why CN volunteered to comply with the new rules requirement to provide a full Service Assurance Plan and would have complied with the Board’s performance of a full Environmental Impact Statement for the proposed CN-KCS merger.<sup>10</sup> Railroads proposing major mergers must commit to real protective

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<sup>9</sup> See CN Letter, *Canadian Pacific Railway, Ltd., et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500, at 2 (filed Apr. 26, 2021) (“CN will submit an application that fully complies with the current major merger rules.”); CN Letter, *Canadian Pacific Railway, Ltd., et al.—Control—Kansas City Southern, et al.*, STB Finance Docket 36500, at 3 (filed Apr. 23, 2021) (“CN would commit to keep all existing gateways between KCS and other rail carriers open on commercially reasonable terms, including the Kansas City gateway between KCS and CP.”); Applicants’ Reply to Comments on Proposed Voting Trust Agreement, *Canadian National Railway Company et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36514, at 60 (filed July 6, 2021) (noting CN’s commitment to “divest the KCS line between Baton Rouge and New Orleans”); See *id.*, Reply Verified Statement of James Cairns at 4 (noting arbitration commitment).

<sup>10</sup> See CN Letter, *Canadian National Railway Company et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36514, at 1 (filed May 3, 2021) (“CN ... is committed to filing an application that includes all elements required by the current merger rules.”).

conditions that guard against harms to service, competition, or other aspects of the public interest.

As CN shows herein, the CP-KCS merger will provide far fewer and smaller public benefits than Applicants have represented and will cause competitive harms and operational and service problems that Applicants have ignored. As explained above, the Application itself is replete with material inconsistencies and obvious errors. The Board should require Applicants to make concrete commitments to mitigate the competitive harms and operational and service problems the merger will create, including by imposing conditions on merger approval. Indeed, the numerous errors in Applicants' data and Operating Plan undermine any confidence in the Application's basic assertions.

As the Board is aware, even under the old merger rules, the Board can approve a combination only if it is in the public interest.<sup>11</sup> Congress expressly set a higher bar for major mergers, based on its recognition that a merger of Class I railroads requires a thorough assessment of all relevant factors.<sup>12</sup> Thus, Applicants are required to prove that their proposed combination would benefit the public interest and that these benefits would outweigh any potential harms. That is why

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<sup>11</sup> See generally *Railroad Consolidation Procedures*, 47 Fed. Reg. 9844, 9845 (Mar. 8, 1982); *id.* § 1111.1 (c); Decision No. 44, *Union Pacific Corp., et al. – Control and Merger – S. Pac. Rail Corp., et al.*, STB Docket No. FD 32760, 1 S.T.B. 233, 367 (1999) (“*UP-SP*”); *S. Pac. Transp. Co. v. ICC*, 736 F.2d 708, 712 (D.C. Cir. 1984) (“In deciding whether and what conditions to impose, the Commission’s guide is the public interest.”).

<sup>12</sup> 49 U.S.C. § 11324(b)–(c).

applicants in successful merger applications, including applications under the old rules, have proven and quantified specific, concrete benefits to the *public*—not simply increases in the railroads’ profitability.<sup>13</sup>

Relatedly, the Board has statutory authority to condition its approval of mergers to address competitive and other public-interest concerns.<sup>14</sup> The Board has

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<sup>13</sup> See, e.g., Decision No. 10, *Canadian National Railway Co., et al.—Control—Wisconsin Central Transportation Corp.*, STB Docket No. FD 34000 (STB served Sept. 7, 2001), slip op. at 11–12 (in approving the acquisition, recognizing public benefits such as, “expanded single-line service and other large network advantages,” the “availability of a larger supply of well-maintained locomotives and railcars, “cost-saving[s] ... without large labor force reductions,” “shortened car transit times, increased reliability, and other service improvements and operating efficiencies,” and “that CN will remain financially strong after consummation of the transaction[] and ... have the financial resources to maintain the integrated CN/WC system in top condition”); Decision No. 89, *CSX Corp. and CSX Transp., Inc. and Norfolk Southern Corp. and Norfolk Southern Ry. Co., et al.—Control and Operating Leases/Agreements—Conrail Inc. and Consolidated Rail Corp.*, STB Docket No. FD 33388, 3 S.T.B. 196, 248–49 (1998) (“*CSX/NS-Conrail*”) (recognizing public benefits of more effective competition with trucks, “new and efficient single-line service,” “improved service and reduced transit times,” over a million truck diversions annually, and “substantial new investments in improving rail infrastructure” of over \$1.1 billion “in new rail property and equipment,” “reduce[d] ... cost[s] of providing transportation by about \$1 billion per year,” “lower rates,” and “improved financial ratios”); *Norfolk Southern Corp.—Control—Norfolk & Western Railway Co. and Southern Railway Co.*, ICC Docket No. FD 29430 (Sub-No. 1), 366 I.C.C. 173, 193–96 (1982) (“carefully distinguish[ing] between public and private benefits” and recognizing “cost reductions,” “service improvements,” “rate reductions or deferral of rate increases,” “faster or more reliable service,” and “the railroad industry ... becom[ing] stronger, more competitive, and more responsive to the shipping public” as examples of public benefits, in contrast to mere “benefits for the applicants,” such as “profits,” “raising rates,” “reduc[ing] competition,” or mere “transfer[s] [of] revenues ... without significantly affecting efficiency”).

<sup>14</sup> See 49 U.S.C. §§ 11324(c), 11344(c); *UP-SP*, 1 S.T.B. at 367 (discussing the breadth of the Board’s “broad conditioning power and [] continuing oversight” of mergers) (quoting *McLean Trucking Co. v. United States*, 321 U.S. 67, 87–88 (1944)); *Grainbelt Corp. v. STB*, 109 F.3d 794, 796 (D.C. Cir. 1997) (“The Commission . . . has broad authority to impose protective conditions to govern

explained that it has “broad power under 49 U.S.C. § 11344(c) to impose appropriate conditions on our approval of railroad consolidations, including those that might be useful in ameliorating potential anticompetitive effects,” and that its “overriding concern in the imposition of conditions is the public interest.”<sup>15</sup> The Board has not hesitated to deny applications and impose significant conditions where it was concerned about whether public benefits outweighed potential harms, including under its old rules.<sup>16</sup> Further, the Board has cited the importance of lessons learned from mergers under the old rules, which sometimes resulted in substantial harms to service and significant transitional disruptions, indicating it would carefully evaluate the need to address concerns about service, including by requiring concrete commitments from merging railroads.<sup>17</sup>

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mergers.”); *CSX/NS-Conrail*, 3 S.T.B. at 250 (“we have used our broad conditioning authority to *preserve or enhance* service and competitive opportunities” (emphasis added)).

<sup>15</sup> *Norfolk Southern Corp.—Control—Norfolk & Western Railway Co. & Southern Railway Co.*, ICC Finance Docket No. 29430 (Sub-No. 1), 366 I.C.C. 173, 235 (1982).

<sup>16</sup> *See, e.g.*, Decision No. 44, *Union Pacific Corp., et al.—Control and Merger—Southern Pacific Rail Corp., et al.*, STB Docket No. FD 32760 (STB served Aug. 12, 1996) (granting extensive BNSF trackage rights to remedy competitive harm); *Santa Fe Southern Pacific Corp.—Control—Southern Pacific Transportation Co.*, ICC Docket No. FD 30400, 3 I.C.C.2d 926, 935–36 (1987) (“Having had the opportunity to examine the complete package that applicants have presented, we think it continues to pose considerable problems.”).

<sup>17</sup> *See, e.g.*, Final Rules, *Major Rail Consolidation Procedures*, STB Docket No. EP 582 (Sub-No. 1) (STB served June 11, 2001), slip op, at 20–21 (“Despite the railroads’ very strong financial incentives to avoid post-merger service disruptions, despite substantial planning by applicants in conjunction with this agency and the Federal Railroad Administration (FRA), and despite carefully phased and delayed implementation, the *CSX/NS/CR* transaction resulted in severe service problems that plagued applicants and their customers for a full year or more. Moreover, ...

Applicants here bear the burden of demonstrating that their combination is in the public interest,<sup>18</sup> but they have not carried it. CN shows in Part I that the Application contains a host of shortcuts, inconsistencies, and material gaps. Based on the content of the Application (and related workpapers), it is not possible to determine whether the merger is in the public interest.

CN shows in Part II that Applicants have failed to quantify, and have significantly overstated, the benefits of the proposed transaction while omitting its significant risks. Applicants simply assume that the mere existence of a CPKC single-line route via Kansas City will automatically result in public benefits—even without adequate, specified capital investments to support anticipated traffic growth and even if the CPKC single-line route is longer or more circuitous than other (cheaper and faster) competitive options. The only quantified benefit in the Application is the merged railroad’s anticipated private profits—which are not a public benefit at all. Neither do Applicants’ post-merger traffic diversion and revenue estimates constitute public benefits; and, in any event, Applicants’

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The [UP/SP,] UP/CNW[,] and BN/SF transactions were also accompanied by service disruptions .... Thus, it is natural for the Board to be concerned about future mergers in this connection ....”); *id.* at 41 (requiring a concrete Service Assurance Plan for major merger proposals to plan for and swiftly address “any potential adverse service effects during implementation”).

<sup>18</sup> 49 CFR § 1180.4(c)(8) (“The application must present a *prima facie* case. Applicants can fail to meet their burden of proof and thus not present a *prima facie* case either by (i) disclosing facts that, even if construed in their most favorable light, are insufficient to support a finding that the proposal is consistent with the public interest, or by (ii) disclosing facts that affirmatively demonstrate that the proposal is not in the public interest. *See Railroad Consolidation Procedures*, 363 I.C.C. 767 (1980).”).

predictions are wildly overstated and entirely unreliable. Applicants have also failed to demonstrate that the merger will give rise to any substantial unquantifiable public benefits (such as more efficient routings, increased capacity, capital investment, or improved service). Even if proven, any such modest benefits would be overshadowed by the significant risks and uncertainty created by Applicants' "essentially meaningless"<sup>19</sup> Operating Plan.

The limited capital investments identified in the Application are demonstrably inadequate to support the predicted traffic growth, which would more than double the number of trains on key line segments and at major terminal areas on the CPKC network (including at locations where CPKC must share capacity with other freight carriers and Amtrak). Shockingly, { Redacted

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In Part III.A, CN shows the Application also fails to address the merger's severe risks of competitive and other harms to the public interest. The CP-KCS merger presents a significant horizontal competition issue. KCS currently operates a line ("the Springfield Line") that is parallel to CP's line running between Kansas

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<sup>19</sup> Exhibit 2, Verified Statement of Carl Van Dyke ("Van Dyke V.S.") at 5.

<sup>20</sup> Exhibit 7, Excerpts from Transcript of February 18, 2022 Deposition of Raymond A. Elphick and John F. Orr ("Elphick/Orr Dep."), at 71–74, 93–97, 152–155.

City and Chicago. The Board recognized in *CN-IC* that the Springfield Line’s connection to CN was a viable competitive route, but it has been less used in recent years. Despite KCS’s recent pre-merger statements that this line could be a “Kansas City Speedway” competing for north-south traffic with routes like the CP line,<sup>21</sup> the Application abandons this plan, and instead anticipates no increased investment in the Springfield Line.

An unconditioned merger would permanently eliminate the Springfield Line as a competitive alternative, instead favoring the parallel CP line. The Board should condition approval of the merger on divestiture of the Springfield Line so that CN can preserve and upgrade the route and turn it into a high speed, efficient route—competing for traffic not only between Kansas City and Chicago, but beyond to Detroit and Eastern Canada. This condition can be imposed without impeding a combined CPKC in any way. CN proposes to grant back to KCS haulage rights that will enable KCS to access customers on the Springfield Line. Thus, every customer on the Springfield Line would retain access to KCS, while gaining access to CN, and would benefit from CN’s investments in the line. To protect the public interest, merger approval should be conditioned on this targeted divestiture.<sup>22</sup>

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<sup>21</sup> *See, e.g.*, Exhibit 14, June 3, 2021 CN-KCS Presentation Slides, Bernstein’s 37th Annual Strategic Decisions Conference (“Bernstein Slides”), at 5 (touting the “Kansas City Speedway – connecting CN’s Midwest foothold and the KC region”).

<sup>22</sup> Today, CN is separately filing a responsive application seeking divestiture in STB Docket No. FD 36500 (Sub-Nos. 1–4).

Moreover, the merger will reduce routing choices through gateways, by diminishing KCS's existing incentives to interchange traffic with other railroads on commercially reasonable terms. Pre-merger, KCS served as an important neutral interchange partner, providing limited single-line service, and thus had a strong incentive to cooperate neutrally with all connecting railroads to jointly serve shippers that neither could serve individually. Post-merger, KCS will have an incentive to maximize traffic that is exchanged with CP. Applicants' vague promises to keep gateways open provide an insufficient safeguard against this potential loss of competition. Instead, as explained in Parts III.B and IV, merger approval should be conditioned on their concrete commitment to prompt, neutral arbitration of commercially reasonable rates and the provision of service on non-discriminatory terms.

In Part III.B, CN shows that the merger also presents significant risks to the rail network as a whole. Despite Applicants' earlier assurances, the Application does not provide "all the information [the Board] needs to satisfy itself that Applicants have carefully planned for the integration of these railroads and will implement measures to monitor and adjust service levels during the integration process so that shippers' service levels are safeguarded . . ." <sup>23</sup> In fact, the opposite is true. Applicants' witness admitted that the "Service Assurance Group" that he vaguely referenced in his verified statement does not exist, and that Applicants have no plans for public reporting of metrics, Board monitoring, or any of the other

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<sup>23</sup> Applicants' Reply to Objections to KCS Waiver, at 19.

key elements of a Service Assurance Plan. The Board should insist on fulfillment of this promise, through provision of a Service Assurance Plan or its equivalent, as a condition of approving the merger, as well as imposing at least five years of post-merger monitoring.

Moreover, as detailed in Part III.C, the Application substantially overstates the financial benefits the merged company will achieve.<sup>24</sup> When the predicted revenue growth fails to materialize, the merged company will have a strong incentive to cut costs, raise prices for shippers, discriminate against interline partners, degrade service, defer investment and maintenance, and spin off assets—exacerbating the risks of harm described above. Respectfully, the Board needs to put safeguards in place through robust conditions that will guard against these harms to the public interest.

For all these reasons, Applicants have not carried their burden of demonstrating that the merger is in the public interest, and it is essential that the Board, at the very least, impose conditions sufficient to mitigate the harms the merger would cause. Specifically, as set forth in Part IV, CN requests that the Board require divestiture of the Springfield Line to CN, require a concrete gateway commitment including neutral arbitration of disputed rates, require Applicants to fulfill their promise to provide the equivalent of a Service Assurance Plan, and impose a monitoring period for a minimum of five years. Both divestiture and access

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<sup>24</sup> See generally, Exhibit 4, Verified Statement of Mark E. Zmijewski (“Zmijewski V.S.”), at Section III.

to gateways on fair terms are independently important to prevent the merger from causing competitive harm—the former mitigates a specific competitive concern regarding parallel routes between Kansas City and Chicago and routes beyond to Detroit and Eastern Canada, while the latter does so for all situations where a formerly neutral KCS would be motivated to force customers to use CP-KCS single-line routes by refusing to participate in competitive joint-line routes on commercially reasonable terms. If the merger goes forward, these conditions are essential to addressing the competitive concerns it raises. The Service Assurance Plan (or its equivalent) and post-merger monitoring are necessary to prevent one of the most troubling consequences of mergers under the old rules, where disruption and degradation of service followed the less demanding examination of a merger's benefits and harms. As demonstrated below, such concerns are plainly present here.

Accompanying these comments are several verified statements in support.<sup>25</sup> First, Exhibit 1 is the Verified Statement of David Hunt. Mr. Hunt is a Vice-President of the global consulting firm of Oliver Wyman and has been a consultant in the transportation sector for more than 35 years. His statement analyzes the Application's post-merger traffic diversion projections and demonstrates that they are based on flawed methodologies, unsupported assumptions, and error-ridden calculations, and thus are wholly unreliable.

Exhibit 2 is the Verified Statement of Carl Van Dyke. Mr. Van Dyke is a senior advisor and partner emeritus at Oliver Wyman and has been a consultant in

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<sup>25</sup> The workpapers will be made available to parties upon request.

the transportation sector for more than 40 years. As the developer of the MultiRail modeling software for analyzing rail operations, operating expenses, and associated investment requirements, he shows that Applicants' Operating Plan is based on invalid inputs, significant omissions, and numerous errors such that it is wholly unreliable and fails to comply with the Board's requirements.

Exhibit 3 is the Verified Statement of Hugh Randall. Mr. Randall is a senior advisor and partner emeritus at Oliver Wyman and has been a consultant in the transportation sector for over 30 years. His statement shows that Applicants' capital investment plan is inadequate and their operating expense estimates are clearly erroneous and unreliable.

Exhibit 4 is the Verified Statement of Mark E. Zmijewski. Professor Zmijewski is a professor emeritus at The University of Chicago Booth School of Business and Senior Consultant to Charles River Associates, specializing in accounting, valuation, and securities analysis. His statement analyzes the financial effects of CP's acquisition of KCS using the same analyses CP used to criticize CN's proposed acquisition of KCS and concludes that CP's financial risks—including high debt leverage, historically low ROIC, and likely incentives to behave anti-competitively when Applicants' over-optimistic financial projections fail to materialize—are the very same risks CP asserted made the proposed CN-KCS merger contrary to the public interest. Professor Zmijewski also reviews Applicants' claimed merger benefits in light of FTC guidelines and concludes that most of them would not be considered as cognizable or verifiable benefits.

**I. THE APPLICATION IS RIDDLED WITH ERRORS, INCONSISTENCIES, AND FLAWED ASSUMPTIONS THAT CANNOT PROVIDE A BASIS FOR THE BOARD TO FIND THAT THE MERGER IS CONSISTENT WITH THE PUBLIC INTEREST.**

Before the Board can even consider the “public interest” question in this proceeding, it must first understand the transaction Applicants are proposing and how the proposed merger will be implemented. But Applicants have submitted an Application that is so riddled with errors, omissions, inconsistencies, and unrealistic assumptions that the Board simply cannot rely on it in performing the public interest assessment required by 49 U.S.C. § 11323 *et seq.* and the Board’s merger regulations.

As explained by CN witness Carl Van Dyke—the developer of the MultiRail modeling software for analyzing rail traffic and operations, operating expenses, and associated investment requirements—the first prerequisite for a sound operating plan for a proposed merger is a *traffic study* that, among other things, accurately predicts the volume of traffic that will be carried by the merger railroad.<sup>26</sup> These traffic diversion figures drive the development of the *operating plan*.<sup>27</sup> The projected traffic diversions also determine the merger’s predicted revenues, which, along with the operating statistics derived from the operating plan, provide the necessary inputs to the *financial plan* (*i.e.*, revenues, capital spending, and operating expenses).<sup>28</sup>

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<sup>26</sup> Van Dyke V.S. at 10

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 7.

“Any failure to use reasonable inputs and/or generate accurate outputs at any step [of this process] cascades through the process and renders the subsequent calculations invalid.”<sup>29</sup> This is precisely what is offered in the Application—a error-ridden foundation that generates meaningless projections.

**A. Applicants’ Projected Traffic Diversions and Revenue Projections Are Grossly Exaggerated and Invalid.**

Fundamental to an analysis of whether the proposed merger is in the public interest are diversion studies and related revenue projections. These are critical building blocks to assessing, for example, the extent to which the merger will generate procompetitive benefits, take trucks off the road, and allow the merging parties to handle their increased debt load. As Mr. Hunt explains, Applicants’ diversion studies and related revenue projections are based on flawed methodologies, unsupported assumptions, and erroneous calculations that render the results of the study invalid.<sup>30</sup> These errors are not minor—Applicants’ traffic-related revenue projections appear to be overstated by more than 100 percent.<sup>31</sup> As Mr. Hunt demonstrates, rather than the more than \$1 billion of traffic-related revenue Applicants project, the likely figure is on the order of \$500 million.<sup>32</sup>

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<sup>29</sup> *Id.*

<sup>30</sup> Exhibit 1, Verified Statement of David T. Hunt (“Hunt V.S.”) at 3.

<sup>31</sup> *Id.* at 3–4.

<sup>32</sup> *Id.* at 6, Exhibit 3-2.

This overstatement is the result of several fundamental methodological errors committed by Applicants. First, Applicants grossly overstate expected rail-to-rail diversions and, as a result, the revenues they will earn post-merger.

Applicants' rail-to-rail diversions are based on the simplistic and highly implausible assumption that the length of a route is unrelated to that route's ability to gain a share of the available traffic.<sup>33</sup> But the relationship between route length and market share is a well-established concept in transportation modeling (as well as intuitive—the shortest route between an origin and destination can be expected to capture the greatest market share where cost is a function of distance).<sup>34</sup> Instead of applying this accepted principle, Applicants' experts mechanically assigned diversion percentages to traffic movements regardless of the relative distance of the incumbent rail route and the proposed CPKC route.<sup>35</sup> This is particularly problematic because the majority of the CPKC single-line routes that will be created by the merger are substantially longer than the already-existing route options available to shippers.<sup>36</sup> In fact, new CPKC single-line routes will be, on average, 217 miles longer than the routes over which the diverted traffic actually moves today.<sup>37</sup> Given that the routes to which Applicants predict traffic would be diverted are significantly longer than the routes over which that traffic moves today, Applicants'

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<sup>33</sup> *Id.* at 8.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 8–13.

<sup>36</sup> *Id.* at 13–14.

<sup>37</sup> *Id.* at 14.

claim that 216,675 carloads and containers will be diverted to CPKC is simply not credible.<sup>38</sup>

To compound this clearly invalid assumption, Applicants' traffic experts applied overstated revenue amounts for many diverted carloads that are much higher than the average per carload revenue for those movements shown in the STB Public Waybill sample, in some cases by over 60 percent.<sup>39</sup> This overstatement of revenue per diverted carload is neither explained nor justified.<sup>40</sup> In other words, Applicants implausibly project that CPKC will collect more revenue from shippers on diverted traffic than those shippers pay today, and will do so by diverting the shipments to new CPKC routes that are substantially more circuitous than the existing joint-line route! As a result of these, and other, errors, Applicants have overstated the rail-to-rail diversions by at least \$133 million.<sup>41</sup>

But this massive overstatement is just the tip of the iceberg. Applicants also proffer "supplemental" diversion estimates from company witnesses, which add an additional \$411 million of projected revenues gains (approximately 40 percent of the total incremental revenue gains) over and above the diversions found by their expert traffic witnesses (Richard Brown, Nathaniel S. Zebrowski,

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<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 7 & n.9.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 7.

and Bengt Muten).<sup>42</sup> These “additional opportunities” include traffic that Applicants’ experts did not include in their analysis of the same commodities, movements that clearly are not merger-related (because CP or KCS already participate in those movements today), and even traffic that does not currently exist.<sup>43</sup> CN witness Mr. Hunt estimates that these phantom opportunities account for as much as \$388 million of the \$411 million in projected “supplemental” revenues posited by Applicants’ company witnesses.<sup>44</sup> For example, the claim by CP witnesses Jonathan Wahba and Mike Naatz that the merger would allow new shipments of “DRUbit” from a facility at Hardisty, AB, ignores that CP and KCS had already signed a contract to serve such shipments in 2019—long before merger discussions began.<sup>45</sup> **Redacted**

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<sup>42</sup> See generally, Application, Vol. 2, Verified Statement of Richard W. Brown and Nathaniel S. Zebrowski (“Brown & Zebrowski V.S.”) and Verified Statement of Bengt Mutén.

<sup>43</sup> Hunt V.S. at 24–35.

<sup>44</sup> *Id.* This does not include a currency conversion error that further overstates revenues on shipments with a currency conversion by 78%. *Id.* at 23–24.

<sup>45</sup> See Exhibit 11, December 3, 2019 Gibson Energy Press Release (“Gibson Energy Press Release”), at 1 (announcing “an agreement to construct and operate a diluent recovery unit (DRU) near Hardisty, Alberta, Canada ... to process 50,000 barrels per day of inlet bitumen blend through the DRU to be shipped by Canadian Pacific ... and Kansas City Southern Railway Company ... to the U.S. Gulf Coast”); *id.* at 3 (KCS stating the agreement was “a great opportunity to grow our business in the Gulf Coast area and develop our Port Arthur asset”).

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}} Applicants have disclosed in their SEC filings that they had reached remarkably different views of the potential synergies of the merger before entering the transaction. Specifically, at the KCS special Board meeting held on September 15, 2021, the KCS Board of Directors considered two separate synergies analyses: a CP synergies analysis showing annualized EBITDA synergies for the combined company of approximately \$990 million (\$810 million from revenue synergies and \$180 million from operating and expense synergies); and a KCS management synergies analysis showing EBITDA synergies of approximately \$377 million (\$222 million from revenue synergies and \$155 million from operating and expense synergies).<sup>47</sup> The enormous gap between the CP analysis and the KCS analysis casts considerable doubt on the

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<sup>46</sup> See Ottensmeyer Dep. at 88:11–90:13 (stating that the Dec. 3, 2019, Gibson Energy Press Release described “a new service, moving DRUbit from western Canada to the U.S. Gulf Coast, specifically Port Arthur, Texas” with “a Canadian Pacific origin, interchanged at Kansas City, and ... from Kansas City to Port Arthur,” and responding, “Correct,” when asked if the new service was “well before any merger talks”); *id.* at 90:3–13 (responding, “Correct” to the statement that “CP and KCS didn’t need a merger to develop this particular piece of interline business”).

<sup>47</sup> Exhibit 15, Excerpts from Canadian Pacific Railway Limited Form F-4 Registration Statement, filed with the Securities and Exchange Commission on October 1, 2021, at pp. 64–65, 97.

accuracy of Applicants' merger synergies analysis—particularly when the Application appears to have adopted the CP analysis and discarded the KCS one.

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<sup>48</sup> {{Redacted

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<sup>50</sup> Exhibit 13, Excerpts from February 4, 2021 KCS Board of Directors Meeting Materials, at KCSR-HC-00014589 through KCSR-HC-00014591.

<sup>51</sup> *Id.* at KCSR-HC-00014591

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**B. Applicants’ Operating Plan Is “Essentially Meaningless.”**

As Mr. Van Dyke attests from his experience, “a rigorous operations plan is a key element of a reliable merger application.”<sup>53</sup> In particular, the operating plan must be based on a “series of logical, interrelated steps,” each of which must be sound to ensure that later steps are not skewed.<sup>54</sup> Applicants’ operating planning process, however, “fails at nearly every level ... [and] [t]he result is a set of modeling outputs that were so unreliable that *Applicants themselves disregarded their own operating plan outputs, including train-miles and GTMs – both of which are critical drivers of operating costs.*”<sup>55</sup> The outputs of Applicants’ Operating Plan do not align with their financial and environmental evidence and cannot be reconciled with one another. The result is incoherence.

Applicants’ approach to developing their Operating Plan is both conceptually flawed and patently unreasonable. Applicants proposed to use 2019 as the “Base Year” for the Application. In its Decision accepting the Application, the Board

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<sup>52</sup> *Id.* at KCSR-HC-0014593 through KCSR-HC-0014601.

<sup>53</sup> Van Dyke V.S. at 7.

<sup>54</sup> *Id.* at 7.

<sup>55</sup> *Id.* at 12–13 (internal footnote omitted) (emphasis in original).

adopted 2019 as the Base Year for this proceeding.<sup>56</sup> However, Applicants did not develop a Base Year Operating Plan that accurately reflected the 2019 traffic or operations of CP or KCS. Instead, Applicants developed a MultiRail operating model based on a series of disparate data sources from different years.

For example, rather than using carload data for the year 2019,<sup>57</sup> Applicants input to MultiRail a traffic file containing carload traffic that moved on CP and/or KCS during a single month in a different year, October 2020.<sup>58</sup> For unit train traffic, Applicants used a single month (October 2019) for CP and a different 30-day period (which is not identified in the workpapers) for KCS. Neither the Application nor the underlying workpapers offer any evidence to support the notion that these disparate traffic sources accurately portray the traffic volumes and commodity mix that moved on CP and KCS, respectively, during the (supposed) 2019 Base Year.

Even more strangely, Applicants elected not to use the blocking and train service plans that were in effect on CP and KCS during the actual Base Year (2019)

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<sup>56</sup> Amended Notice of Intent to File Application for Approval of Transaction Subject to 49 U.S.C. §§ 11323-25, *Canadian Pacific Railway Ltd.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500, at 3 (filed Sept. 15, 2021) (“Applicants will use the year 2019 as the base year for purposes of the impact analyses to be included with the Application (which remains the last full year unaffected by the COVID pandemic for which data are available”); Decision No. 11, *Canadian Pacific Railway Ltd., et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500 (STB served Nov. 23, 2021).

<sup>57</sup> Full year CP and KCS traffic data for 2019 was available to Applicants. See CPKC WP-HC-Traffic File – Methodology, at 3 (“FTI supplied CPRS with multiple years of data, *but CPRS chose to use October 2020 for a base month*”) (emphasis added).

<sup>58</sup> Elphick/Orr Dep. at 157:13 – 157:21.

in building an initial set of trains in the MultiRail model. Instead, Applicants constructed a Base Year (2019) blocking and train service plan that reflected the carriers' operations *as of the 1st Quarter of 2021*. Applicants' explanation for doing so—that Q1 2021 data were used to avoid attributing to the merger efficiencies already achieved by Applicants between 2019 and Q1 2021<sup>59</sup>—is beside the point. A series of inputs involving traffic, blocking plans and trains from three different time periods, by definition, cannot produce an accurate estimate of Applicants' actual Base Year (2019) operating plan.

Applicants further undermined the validity of their Operating Plan outputs for both the pre- and post-merger cases by removing trains that had traffic assigned to them by MultiRail from the counts of trains per day by subdivision and the subdivision traffic densities (tonnages). Specifically, Applicants applied a “rule” that removed from the train counts and line densities any train that did not traverse at least 25 percent of the stations on a subdivision. This rendered the trains per day and tonnages by subdivision incomplete and had a cascading effect on the calculation of key operating statistics, including train-miles (which in theory should be used to estimate operating expenses).<sup>60</sup>

While it is customary to use a full year of traffic data, *Applicants took a similar, mere one-month sample approach to rail yard activity and carloads,*

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<sup>59</sup> See Application, Vol. 2, Exhibit 13 (Operating Plan), at 27.

<sup>60</sup> See Van Dyke V.S. at 24–25.

including the number of hazardous cars on their lines in the Base Year.<sup>61</sup> Applicants submitted this flawed information as the foundation of their Application, as well as in response to the requests from the Board’s Office of Environmental Analysis.<sup>62</sup>

These and other significant errors when processing traffic data used to develop the Operating Plan resulted in “invalid traffic” that “distorted the Applicants’ development of the Base Year blocking and routing plan, train plan, and the operating metrics, rendering the operating plan invalid and unusable.”<sup>63</sup> The Operating Plan does not produce reliable estimates of traffic density, train counts, or yards where growth is expected such that “Applicants have provided essentially meaningless responses” to the Board’s requirements.<sup>64</sup> Ultimately, Applicants’

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<sup>61</sup> See, e.g., Application, Vol. 2 Operating Plan, Appendix B, Changes in Yard Volumes (“Base Traffic: October 2020FTIBase, 28 days” and “Alternate Traffic: October 2020FTIBase.”). The Board requires density charts be submitted for the “latest available full calendar year” for precisely this purpose. See 49 C.F.R. § 1180.8(b)(5).

<sup>62</sup> Applicants’ response to the Board’s Office of Environmental Analysis did not reveal the use of a one-month snapshot from October 2020 for carload and intermodal traffic in the gross tons, rail yard activity, and [trains per day and carloads.] Letter from Applicants to Danielle Gosselin, FD 36500, at 2 (October 28, 2021) (In Response to Request A, Applicants indicated their transaction-related growth analyses “set 2019—the last pre-pandemic year—as a starting point” and indicating that they provided the “2019 baseline traffic” in tables); *id.* at 6 (In Response to Request F, “Like the other tables CP and KCS are providing, these tables show 2019 traffic...”). Applicants’ December 20 response to the Board’s Office of Environmental Affairs again reiterated their erroneous claim that their first response included actual historic numbers form 2019: “As it did in response to Information Request No. 1, CP is providing three data sets: actual numbers from 2019 (the last pre-pandemic year)...” Letter from Applicants to Danielle Gosselin, FD 36500, at 2 (Dec. 20, 2021).

<sup>63</sup> Van Dyke V.S. at 3.

<sup>64</sup> *Id.* at 5.

Operating Plan “fails to meet basic Board requirements” and is a “deeply flawed proposal that cannot be relied upon in evaluating the impact of the proposed merger on CP-KCS operations, the operations of other railroads, or other stakeholder, such as shippers and communities.”<sup>65</sup>

The numerous flaws in Applicants’ Operating Plan generated additional errors throughout the Application. For example, *Applicants did not use their Operating Plan to calculate their purported operating metrics or expenses*. In particular, the post-merger table of operating plan metrics in Applicants’ Exhibit 13<sup>66</sup> is not based on the MultiRail Operating Plan but, rather, on a “System Model” that does not align with the Operating Plan.<sup>67</sup> And while the Operating Plan accounted for organic growth, the System Model does not (thereby significantly understating Year 3 operating metrics). Nor do the Operating Plan metrics align with Applicants’ financial projections, which are based strictly on new business growth. Likewise, Applicants’ environmental filing relies on values that are inconsistent with those in the Operating Plan. In other words, Applicants’ System Model, operating plan, financial projections, and environmental filings—which all should be in harmony and reflect consistent inputs—paint multiple contradictory pictures, and there is no way of knowing which is correct.

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<sup>65</sup> Van Dyke V.S. at 2.

<sup>66</sup> See Application, Vol. 2 at 287, Table 2.

<sup>67</sup> See Elphick/Orr Dep. at 180:17–183:3.

These disconnects are not minor. For example, the Operating Plan produces an annual increase in train-miles of approximately {{Redacted }} whereas Applicants' costing process appears to be based on an increase of approximately {<sup>Red</sup> }} train-miles. Likewise, while the Operating Plan contemplates an { Redacted }} , the costing process uses an { Redacted

}}. Applicants' decision not to develop operating metrics based on Applicants' Operating Plan (as has been done in prior merger cases) means that Applicants' operating and capital expense calculations (which should be based on accurate operating metrics) are understated and wholly "unreliable."<sup>68</sup>

**C. Applicants' Financial Plan Is Inadequate and Understates Operating Costs by More Than \$2.0 Billion.**

A robust and accurate capital investment plan is necessary for the Board to determine the financial impact of the merger and the ability of the merging parties to handle their projected traffic. As Mr. Randall explains, Applicants identify specific projects for only 8 percent of the \$5.7 billion they plan to spend in Years 1–3 and otherwise fail to identify the nature or location of other capital projects—much less their estimated cost and timing—which makes “it impossible for interested parties (or the Board) to assess the adequacy of Applicants' capital spending plans.”<sup>69</sup>

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<sup>68</sup> Van Dyke V.S. at 6.

<sup>69</sup> Exhibit 3, Verified Statement of Hugh Randall (“Randall V.S.”), at 7.

In any event, Applicants’ projected capital spending appears to be woefully inadequate. Pre-merger, CP and KCS collectively averaged capital expenditures of \$1.9 billion annually, which equaled 24.2 percent of revenue between 2014 and 2019, and in no year were their (combined) capital expenditures less than 21.0 percent of (combined) revenues. Post-merger, Applicants plan to continue spending the same \$1.9 billion per year, or 20.6 percent of revenue, in Year 1, 20 percent in Year 2, and 19.6 percent in Year 3 on capital projects.<sup>70</sup> At the same time, Applicants are projecting that CPKC will transport 40 percent more traffic (in GTMs) by the end of Year 3 (19.8 percent resulting from merger-related growth and 21 percent from organic growth). As Mr. Randall notes, “[i]t is simply not credible that Applicants can adequately address the merged railroad’s capital needs by spending no more per year than they spend before the merger, while accommodating significantly higher traffic growth.”<sup>71</sup>

Importantly, Applicants have failed to provide for capital projects that clearly would be required to accommodate post-merger traffic volumes. Mr. Randall and his team at Oliver Wyman assessed the CPKC network in light of projected traffic increases and found that “significant train delays and service disruptions are likely without additional capital spending” to ensure line-of-road, yard capacity, key bridges, and locomotive fleets can handle the traffic.<sup>72</sup>

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<sup>70</sup> *Id.* at 8–9.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 10.

This is not surprising given the lack of attention Applicants paid to this critical issue. Applicants' operating witness, Mr. Elphick, {{Redacted

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With regard to operating expenses, Applicants "have failed to prove that they have adequately estimated operating expenses and have used a deeply flawed and inaccurate approach to cost analysis and financial projections."<sup>75</sup> In particular, Applicants' operating expense estimate is based entirely on a table of incremental

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<sup>73</sup> See, e.g., Elphick/Orr Dep. at 55:10-56:24, 79:21-81:4, 124:5-20, 250:14-251:23  
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<sup>74</sup> See *id.* at 124-28.

<sup>75</sup> Randall V.S. at 23.

operating expenses that has no relation to the Operating Plan and is not supported by work papers or other evidence.<sup>76</sup> Mr. Randall estimates that Applicants have understated their projected operating expenses for the first three years by no less than \$2.0 billion and (based on CP's and KCS's U.S. actual experience) by as much as \$2.47 billion.<sup>77</sup> This represents a "an understatement of the merged railroad's operating expenses of approximately 10.7 to 12.9 percent of total operating expenses for those years."<sup>78</sup>

Finally, Applicants overstate productivity savings. Doing so has the effect of allowing Applicants to claim they will have greater cash flow available to fund capital improvements and pay off the massive debt CP is incurring to acquire KCS. Reality is far less rosy and casts significant doubt on whether Applicants will be able to provide adequate levels of service.

Applicants make the obviously incorrect assumption that the vast majority of the projected productivity savings will be realized during the first year of merged operations. *Applicants assume that \$93.5 million, or 80.8 percent, of the total projected \$115.7 million savings in operating expenses will be achieved in Year 1.* For transportation, fuel-related, and locomotive leasing/depreciation cost savings, Applicants assume that fully 96.5 percent will be realized in Year 1.<sup>79</sup> It is highly

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<sup>76</sup> *Id.* at 23–24.

<sup>77</sup> *Id.* at 23.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.* at 24–25; see Oliver Wyman Opex worksheet for calculation.

unlikely that Applicants would be able to implement all of the operating changes required to generate virtually all of the achievable operating expense savings in the first post-merger year, especially when considering that CP and KCS cannot begin the merging of their networks until Day 1 of the approved merger.

Based on their seriously flawed operating expense estimation process, Applicants posit they will incur only \$306.3 million in increased operating expenses to transport 510,315 incremental carloads, while those carloads will generate \$1,021.9 million in additional revenues.<sup>80</sup> This equates to a 70 percent flow-through of revenue to operating income, or a 30 percent operating ratio—*something no Class I railroad in North America has ever achieved on either baseload or incremental traffic*.<sup>81</sup> As Mr. Randall explains, “while Applicants submitted the veneer of an operating expense development process (including a purported MultiRail analysis of post-merger operations), the operating expenses reflected in the Application are nothing more than assumptions that are unsupported by documentation or analysis.”<sup>82</sup>

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<sup>80</sup> Randall V.S. at 24.

<sup>81</sup> *Id.* at 31.

<sup>82</sup> *Id.* at 24.

## II. APPLICANTS' ASSERTED BENEFITS ARE VASTLY OVERSTATED & UNSUPPORTED.

The core question entrusted to the Board in a Class I merger proceeding is whether the proposed merger is “consistent with the public interest.”<sup>83</sup> This standard requires more than a mere showing that the proposed merger will result in private profits, traffic diversions, or even new single-line service. Rather, the application must demonstrate that verifiable and quantifiable benefits would flow *to the public* from the proposed merger, and that those *public* benefits would outweigh “any harm to competition, essential service(s), labor, and the environment that cannot be mitigated by conditions.”<sup>84</sup> Applicants have failed to meet this standard.

### A. Traffic Diversions and Private Profits Are Not Public Benefits.

Applicants have failed to prove the proposed merger will be in the public interest by quantifying its claimed public benefits.<sup>85</sup> The Application’s alleged “quantified public benefits” is merely a balance sheet of hoped-for private earnings.<sup>86</sup> Providing an estimate of increased CP-KCS profits does not satisfy Applicants’ burden of proof: The agency has long made clear that private earnings are not public benefits: “financial benefits for the consolidating carriers that are

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<sup>83</sup> Decision No. 37, *Canadian National Ry. Co., et al.—Control—Illinois Central Corp., et al.*, STB Docket No. FD 33556 (STB served May 25, 1999) (“*CN-IC*”), slip op. at 19 (“[t]he Act’s single and essential standard of approval is that the [Board] find the [transaction] to be “consistent with the public interest.””).

<sup>84</sup> *Id.*

<sup>85</sup> *See id.*

<sup>86</sup> Application, Vol. 1 at 10; *id.*, Vol. 1 at 74 (“Summary of Benefits” exhibit).

purely transfers from competing carriers” are “private benefits [that] have not been considered in our analysis of the public benefits of the consolidation.”<sup>87</sup>

In this proceeding, the demonstrated and quantifiable benefits to the shipping public supported by the Application are exactly *zero*. Providing financial gains to CP-KCS shareholders does not further the public interest. Applicants, who have the burden of proof to establish quantifiable public benefits in their Application, have thus failed to meet their burden.<sup>88</sup> The Board should not approve a major merger application that fails to prove any quantifiable public benefits, particularly in light of the current Administration’s competition policy goals and positions.<sup>89</sup>

Likewise, Applicants’ projected traffic diversions do not constitute public benefits. Shippers do not benefit from shifting traffic to different routes or different carriers absent some showing that those diversions will produce lower rates, better service, shorter routes, or the like—none of which Applicants have proven. In any event, as discussed above, Applicants’ projected traffic diversions are grossly exaggerated and cannot be relied upon by the Board.

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<sup>87</sup> *Union Pac. Corp., et al.—Control—Missouri-Kansas-Texas R.R. Co., et al.*, ICC Finance Docket No. 30800, 1988 WL 226818, at \*5 (decided May 13, 1988); *see also* Decision No. 37, *Canadian National Ry. Co., et al.—Control—Illinois Central Corp., et al.*, STB Finance Docket No. 33556 (STB served May 25, 1999), slip op. at 18, n. 62 (noting that the “total annual net revenue gain of \$90.3 million[] must be viewed as a private benefit (not a public benefit) of the CN/IC control transaction”).

<sup>88</sup> 49 CFR § 1180.4(c)(8).

<sup>89</sup> *See, e.g., Promoting Competition in the American Economy*, E.O. 14036, 86 Fed. Reg. 36987 (Jul. 9, 2021), available at <https://www.govinfo.gov/content/pkg/FR-2021-07-14/pdf/2021-15069.pdf>.

**B. Applicants' Assumed Public Benefits Are Unsupported and Overshadowed by the Significant Risks of the Proposed Merger.**

If the errors, exaggerations, and unsubstantiated claims in the Application are set aside, the potential *public* benefits that remain from the proposed transaction do not amount to much. While CP and KCS may be able to capture some modest traffic diversions (if there are no serious service problems), the Application offers few substantial and identifiable capital improvements to enhance the national rail network or benefit shippers, limited environmental benefits, no planned innovations to improve the customer experience, and no evidence that rates would fall or service would improve.

Importantly, the majority of CPKC single-line routes to which Applicants propose to divert traffic are substantially longer than the incumbent routing options. Specifically, as CP-KCS witnesses Brown and Zebrowski acknowledge, *the new CPKC single-line route would be, on average, 217 miles longer than the routes over which the diverted traffic actually moves today.*<sup>90</sup> Replacing a more efficient, less costly interline route with a longer, more circuitous single-line route does not benefit shippers. Moreover, Applicants have not committed to any rate reductions for shippers who agree to utilize CPKC's less efficient routes. Indeed, Applicants assume a 333 R/VC ratio on traffic they convert from other railroads.<sup>91</sup>

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<sup>90</sup> Brown & Zebrowski V.S. at 132, Table 6.

<sup>91</sup> Application, Vol. 1 at 74. CP-KCS assert that the merger will result in a \$1.02 billion "Revenue Increase from Traffic Gains" (primarily from alleged diversions from other railroads), but that their "Cost of Handling Added Traffic" would be only

Neither would a combined CP-KCS improve service, particularly in light of the more circuitous CPKC routes. In addition, as discussed above, Applicants' inadequate capital investment plan—far from improving service—actually poses a serious risk even to maintaining current service levels. With the longer routes and minimal levels of investment Applicants have planned, shippers cannot expect increased capacity, faster transit times, lower rates, or innovative service offerings.

Applicants have shown little interest in developing truck-to-rail diversion opportunities. They estimate that the merger would take only 64,000 trucks per year off the road. By contract, CN's Responsive Application will divert more than 80,000 annual truck shipments to the Springfield Line alone. Applicants' seeming indifference to removing trucks from America's highways is a loss to shippers, local communities, and the Administration's environmental goals. In addition, Applicants have failed to protect—and will be incentivized to discourage—interline opportunities, which would increase competition and offer more routing options to the benefit of shippers.

In short, Applicants have merely asserted—but have not proven—that significant public benefits would flow from the proposed transaction. Repeating the mantra of “single-line service” is not evidence. And even assuming some portion of the projected traffic diversions will materialize, any potential benefits to shippers

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\$306 million. *Id.* Applicants are thus assuming that they would realize an average revenue-to-variable-cost ratio metric (“R/VC”) of 333% on diversion traffic.

would be, at best, modest and would be far outweighed by the significant risks to the public interest that this proposed transaction poses, discussed next.

**III. THE APPLICATION DOWNPLAYS THE SERIOUS PUBLIC INTEREST RISKS OF THE PROPOSED MERGER.**

**A. The Net Competition Benefits of the Proposed Transaction Are Negative Unless Remedial Conditions are Proposed.**

Applicants repeatedly assert that their merger threatens no competitive harm whatsoever. That is untrue for multiple reasons. First, Applicants simply ignore the competition harm caused by their proposed consolidation of parallel lines and their plan to forego investment in KCS's Springfield Line. Second, the vague gateway commitment in the Application is plainly insufficient to protect against vertical foreclosure concerns. If the Board approves the proposed transaction, it should at a minimum, impose robust conditions to protect competition, including divestiture of the Springfield Line to CN and a clear and enforceable gateway commitment. The need to impose such conditions here is supported by CP's historical conduct. KCS used to offer a competitive alternative to Iowa and Minnesota based on agreements with CP—agreements that CP refused to renew, thus eliminating that competitive option only three years before proposing to acquire KCS. The Board should view CP's alleged "commitment" to preserving robust competition in light of its actual past actions.

**1. A combined CP-KCS is not a "pure" end-to-end merger and raises significant horizontal competition concerns.**

In opposing the proposed CN-KCS merger, CP proffered the verified statement of Dr. W. Robert Majure, who broadly asserted that a merger between

railroads with parallel routes creates a horizontal threat to competition.<sup>92</sup> In his expert opinion, railroads that terminate or originate traffic within the same BEA are competitors.<sup>93</sup> For example, Dr. Majure treated CN's and KCS's lines in Mississippi as competitive even though they were many miles apart.<sup>94</sup> Indeed, Dr. Majure's analysis treated CN's and KCS's main north-south lines as competing even though they were separated by the Mississippi River.<sup>95</sup> Dr. Majure's analysis did not consider truck or barge competition to be of any relevance, focusing exclusively on loss of "rail choice."<sup>96</sup> Apparently convinced by CP's advocacy, the Board

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<sup>92</sup> Canadian Pacific's Reply to CN and KCS Joint Motion for Approval of Voting Trust, *Canadian National Railway Company, et al.—Control—Kansas City Southern, et al.*, STB Docket No. 36514 ("Canadian Pacific Reply") (filed June 28, 2021), Verified Statement of W. Robert Majure ("Majure V.S."), ¶¶ 49–50; *see also id.* ¶¶ 46–48; *id.* at 38–41.

<sup>93</sup> Majure V.S. ¶¶ 42–53.

<sup>94</sup> Applicants' Reply to Comments on Proposed Voting Trust Agreement, *Canadian National Railway Company, et al.—Control—Kansas City Southern, et al.*, STB Docket No. 36514 (filed July 6, 2021), Reply Verified Statement of William J. Rennie ("Rennie Reply V.S."), at 40–41 (discussing Dr. Majure's competition analysis). The DOJ also raised concerns about mergers involving parallel lines, even when they do not serve the same origin-destination pairs. Comment of the U.S. Dep't of Justice, *Canadian National Railway Company et al.—Control—Kansas City Southern Railway Company, et al.*, STB Docket No. 36514, at 2 (filed May 14, 2021); *see also* Comment of the U.S. Dep't of Justice, *CSX Corporation and CSX Transportation, Inc., et al.—Control and Merger—Pam Am Systems, Inc, et al.* STB Docket No. FD 36472, at 3 (filed Aug. 26, 2021).

<sup>95</sup> *Compare* Majure V.S. ¶ 48 & Ex. 4, *with* Rennie Reply V.S. at 16, 32–33, 37–42.

<sup>96</sup> *Compare* Majure V.S. ¶¶ 5, 46, *with* Rennie Reply V.S. at 22–23.

concluded that CN and KCS “operate parallel lines through the central portion of the United States....”<sup>97</sup>

Applicants now try to sweep CP’s prior positions under the rug. They appear to hope that if they repeatedly assert their merger is a “pure” “end-to-end” combination, that will make it so.<sup>98</sup> Rhetoric, however, is not a substitute for facts. The CP-KCS merger raises a significant horizontal competitive concern that must be addressed by the Board.

As CN had demonstrated, the Springfield Line is part of a direct competitive alternative to CP’s route between Kansas City and Chicago, and beyond to Detroit and Eastern Canada.<sup>99</sup>

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<sup>97</sup> *Canadian National Railway Co., et al.—Control—Kanas City Southern, et al.*, STB Docket No. FD 36514, at 28 (STB served Aug. 31, 2021).

<sup>98</sup> Application, Vol. I, at 20; *id.*, Creel V.S. ¶ 28. This hide-the-ball tactic stands in direct contrast to CN’s treatment of horizontal competition issues in its proposed merger with KCS. There, CN expressly acknowledged the parallel KCS line between Baton Rouge and New Orleans, Louisiana and committed to divest the line on terms that would ensure no reduction in competition for shippers in that corridor. Joint Motion for Approval of Voting Trust Agreement, *Canadian National Railway Company—Control—Kansas City Southern*, STB Docket No. FD 36514 (filed May 26, 2021), Verified Statement of Jean-Jacques Ruest, at 3–5; *id.*, Verified Statement of William J. Rennie, at 4, 7, 10.

<sup>99</sup> Description of Anticipated Responsive Application, *Canadian Pacific Railway Limited, et al.—Control—Kansas City Southern, et al.*, STB Docket No. 36500 (“Notice of Responsive Application”) (filed Jan. 12, 2022).

### The Parallel CP and KCS Routes



This route can be used to move freight in competition with CP’s parallel line, and shippers have in the past moved freight between Kansas City and Chicago using this line.<sup>100</sup> More recently, KCS expressed interest in, and touted the benefits of, investing to increase track speeds on this line to create a “Kansas City Speedway.”<sup>101</sup>

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<sup>100</sup> See, e.g., Decision No. 37, *Canadian National Railway Company, et al.—Control—Illinois Central Corporation, et al.*, STB Finance Docket No. 33556, 4 S.T.B. 122, 175 (1999) (“CN-IC”) (recognizing that KCS and Illinois Central (now CN) were interchanging “three trains per week” via the Springfield interchange point at Cockrell).

<sup>101</sup> See, e.g., *Kansas City Southern, Combination of CN & Kansas City Southern: Creating the Premier Railway of the 21st Century*, at 8–9 (July 2021), available at <https://www.sec.gov/Archives/edgar/data/0000054480/000005448021000202/kcsinve storpresentation .htm> (stating that “Kansas City Speedway” would be a “new competitive route between KC, Detroit & Chicago”).

Yet Applicants propose *no* incremental investment in the Springfield Line.<sup>102</sup> A combined CP-KCS will have little incentive to invest in the Springfield Line or to partner with CN to create the Kansas City Speedway or to invest in improvements on the line, because such pro-competitive actions would be inconsistent with their plan to concentrate traffic on CP's parallel route to Chicago.

As DOJ has explained in this proceeding<sup>103</sup> and elsewhere,<sup>104</sup> a combined CP-KCS will have an incentive to resist efficient interchanges with rival railroads that could divert traffic from CP's network. The Application confirms that concern, as the parties apparently plan to allow the KCS Springfield Line effectively to wither on the vine in favor of CP's parallel route. This not only prevents its use as a competitive option for through traffic, but also harms local customers on the line who will see no incremental investment and likely deteriorating rail service.

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<sup>102</sup> Notice of Responsive Application at 3–4 (citing Application, Vol. 1 at 41) (showing no planned capital investment on Springfield Line).

<sup>103</sup> See Comment of the U.S. Dep't of Justice, *Canadian Pacific Railway Limited et al.—Control—Kansas City Southern Railway Company, et al.*, STB Docket No. FD 36500, at 4 (filed Apr. 12, 2021) (observing that the pending merger would cause “KCS [to] make decisions regarding new track construction and old track closure with an eye toward interchanging KCS traffic with CP in the future. Such decisions may be at the expense of interchanges with other railroads, even though these other interchanges may be better for KCS's customers and KCS itself”).

<sup>104</sup> See Comment of the U.S. Dep't of Justice, *CSX Corporation and CSX Transportation, Inc., et al.—Control and Merger—Pan Am Systems, Inc., et al.*, STB Docket No. 36472, at 3 (filed Aug. 26, 2021) (noting that if CSX were to acquire a stake in a line parallel to its own it could “undermine [its rivals] notwithstanding the joint venture by sabotaging this service and expecting to recapture traffic on its independent line”).

Applicants appear to suggest that there is no competitive issue because CN's lines do not physically connect with KCS's at Springfield.<sup>105</sup> Applicants are wrong. In fact, CN's subsidiary, Illinois Central, has unrestricted trackage rights over UP to connect with KCS at Springfield, as recognized by the STB in its decision in the *CN-IC* merger.<sup>106</sup>

Further, and dispositively, Dr. Majure, Applicants' economist, acknowledges that { **Redacted**

}<sup>107</sup> The fact that this traffic today is moved jointly by KCS in cooperation with a railroad other than CP contradicts Applicants' assertion that the Springfield Line is not "parallel" to CP's line.<sup>108</sup> Indeed, it directly raises the concern that the merger will eliminate KCS's existing incentives to facilitate the

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<sup>105</sup> Applicants' Reply to Canadian National's Description of Anticipated Responsive Application, *Canadian Pacific Railway Limited, et al.,—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500, at 6 (filed Jan. 28, 2022).

<sup>106</sup> *CN-IC*, 4 S.T.B. at 190–99 (describing various trackage rights agreements relevant to KCS/IC Springfield interchange).

<sup>107</sup> Buried towards the end of his statement, Dr. Majure { **Redacted**

} *Id.*

<sup>108</sup> Applicants' Reply to Canadian National's Description of Anticipated Responsive Application, *Canadian Pacific Railway Limited, et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500, at 6 (filed Jan. 28, 2022).

interchange of traffic with other railroads because it risks diverting traffic from CP after the merger.<sup>109</sup>

To be sure, the traffic volumes that currently move between Kansas City and Chicago over the Springfield Line are below the levels that are currently moved by CP over its parallel line.<sup>110</sup> But that does not mean that shippers today are not able to leverage the Springfield Line as a competitive threat when negotiating with CP, as Dr. Majure previously acknowledged.<sup>111</sup>

Moreover, even if there were *no* traffic being moved between Kansas City and Chicago today over the Springfield Line, there would still be a significant competitive concern. As noted, KCS has touted the potential for this line to be upgraded to create a Kansas City Speedway.<sup>112</sup> As described in CN’s Notice of

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<sup>109</sup> In making this suggestion, Applicants are again quarreling with their own economist. Dr. Majure { **Redacted**

} Majure V.S. ¶ 54. And yet, KCS does not serve the Upper Midwest or Canada, which makes clear that corridor competition under Dr. Majure’s argument includes interline routes.

<sup>110</sup> *Cf.* Majure V.S. ¶ 70.

<sup>111</sup> Majure V.S. ¶¶ 18–19, 38 (describing { **Redacted** }).

<sup>112</sup> *See, e.g.*, Bernstein Slides, at 5 (touting the “Kansas City Speedway – connecting CN’s Midwest foothold and the KC region”); Kansas City Southern, *Combination of CN & Kansas City Southern: Creating the Premier Railway of the 21st Century*, at 8–9 (July 2021), available at [https://www.sec.gov/Archives/edgar/data/0000054480/000005448021000202/kcsinvestorpresentation .htm](https://www.sec.gov/Archives/edgar/data/0000054480/000005448021000202/kcsinvestorpresentation.htm) (stating the “Kansas City Speedway” would be a “new competitive route between KC, Detroit & Chicago”).

Responsive Application, such a Speedway would provide enormous public interest benefits—preserving and renewing the route and doing more to benefit customers, including creating a more attractive option for moving freight between Kansas City and Chicago and then beyond to Michigan and Eastern Canada.<sup>113</sup> It would provide a far superior alternative to CP’s more circuitous route and, CN projects, remove more than 80,000 trucks off the road annually.<sup>114</sup> The antitrust agencies have repeatedly recognized that significant competitive concerns arise where, as here, an acquiring company will have reduced incentive to deploy the acquired assets efficiently because of the concern that doing so will cannibalize the acquiring company’s existing sales.<sup>115</sup>

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<sup>113</sup> See generally, Notice of Responsive Application.

<sup>114</sup> Application and Exhibits, *Canadian Pacific Railway, et. al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500 (Sub-Nos. 1, 2, 3, 4) (filed Feb. 28, 2022) (“CN Responsive Application”), Verified Statement of David T. Hunt, at 8.

<sup>115</sup> See U.S. DEP’T OF JUST., ANTITRUST DIV., MERGER REMEDIES MANUAL 6–9 (Sept. 2020); Press Release, U.S. Dep’t of Just, Antitrust Div., Just. Department Sues to Block Visa’s Proposed Acquisition of Plaid (Nov. 5, 2020), <https://www.justice.gov/opa/pr/justice-department-sues-block-visas-proposed-acquisition-plaid> (asserting, *inter alia*, that Visa’s acquisition of Plaid was likely to prevent Plaid from competing with it in the future); *United States v. Bazaarvoice, Inc.*, No. 13-cv-0013-WHO, 2014 WL 203966 (N.D. Cal. Jan. 8, 2014), <https://www.justice.gov/atr/case-document/file/488846/download> (similar); *cf.* Press Release, Fed. Trade Comm’n, FTC Challenges Illumina’s Proposed Acquisition of Cancer Detection Test Maker Grail (Mar. 30, 2021) (similar), <https://www.ftc.gov/news-events/press-releases/2021/03/ftc-challenges-illumina-proposed-acquisition-cancer-detection>.

**2. CP's acquisition of KCS will fundamentally undermine KCS's existing incentives to interchange traffic with other railroads on commercially reasonable terms**

The proposed merger will also reduce KCS's existing incentives to interchange traffic with other railroads on commercially reasonable terms, creating a significant threat to future rail competition. Today, KCS provides very little "single-line" service. According to STB data, approximately 87 percent of the traffic KCS carries is handled in partnership with another railroad.<sup>116</sup> Pre-merger KCS is, in essence, a neutral connecting carrier with strong incentives to work cooperatively with other railroads to exchange traffic on reasonable terms so that KCS and its partners can jointly serve shippers that individually neither could serve.

The proposed transaction will fundamentally change those existing incentives. Post-merger, Applicants will have a strong incentive to favor CP-KCS routings, to the detriment of other efficient routes in which other railroads participate with either KCS or CP today. KCS will seek to concentrate that traffic on the combined firm's routes, which serves many of the same geographic areas in the Midwest and Canada as CN. Working with CN, in contrast, would threaten to divert traffic from CP, reducing the revenues the combined company earns.<sup>117</sup> CP-

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<sup>116</sup> See STB 2019 Commodity Statistics Report for KCS, *available at* <https://www.stb.gov/wp-content/uploads/files/econdata/QCS/KCS/2019/QCS-KCS-2019.xlsx> (showing 13 percent of KCS traffic are local moves where KCS serves both the origin and destination—164,967 cars of local KCS movements out of 1,263,808 total movements).

<sup>117</sup> When CP-KCS serve a customer entirely over their own facilities, they keep all of the revenues earned. When KCS jointly serves a customer with another railroad such as CN, then those revenues are divided between KCS and the partner railroad.

KCS, for example, may not have an incentive to maintain service levels at efficient interchanges with other railroads or to quote competitive rates for movements that require participation of other railroads.

This agency has repeatedly recognized that an “end-to-end” rail combination, while generally efficient, can nevertheless raise significant vertical competition concerns: “[In an end-to-end merger], the consolidated system may profit by limiting the ‘downstream’ competition [from connecting carriers] and routing traffic over its own lines from origin to destination.... This vertical foreclosure effect will occur, if at all, at the gateways served commonly by the consolidating carriers.”<sup>118</sup> DOJ has likewise recognized the potential for vertical competitive harm from end-to-end

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<sup>118</sup> *Lamoille Valley R.R. Co. v. ICC*, 711 F.2d 295, 319 (D.C. Cir. 1983) (quoting *Union Pac. Corp.—Control—Mo. Pac. Corp.*, 366 I.C.C. 462, 529 (1982)); see also Decision No. 44, *Union Pac. Corp., et al.—Control & Merger—Southern Pac. R.R. Co., et al.*, 1 S.T.B. 233, 365 (1996) (recognizing that “[v]ertical effects [may] occur where the merging parties connect end-to-end”); *Union Pac. Corp., et al.—Control—Missouri Pacific Corp. and Missouri Pacific Railroad Co.*, 366 I.C.C. 462, 514 (1982) (“A vertical effect can occur if one of the consolidating carriers formerly interchanged traffic with both its consolidation partner and other carriers in providing joint line services over a particular gateway. The transaction then may result in the foreclosure of the nonincluded carrier from competing in the markets it formerly served.”); *Norfolk S. Corp.—Control—Norfolk & W. Ry. Co., et al.*, 366 I.C.C. 173, 216 (1982) (“An end-to-end consolidation ... may allow the system to divert traffic from remaining competitors and hence foreclose their opportunity to compete in the marketplace. ... Such diversions can have anticompetitive effects.”); *Guilford Transp. Indus., Inc.—Control—Bost. & Me. Corp.*, 366 I.C.C. 294, 341 (1982) (“We have previously found that end-to-end rail consolidations can directly reduce competitive alternatives ... for shippers located at common points on the consolidating systems”).

transactions—indeed, it has raised this concern with respect to the CP-KCS merger itself.<sup>119</sup>

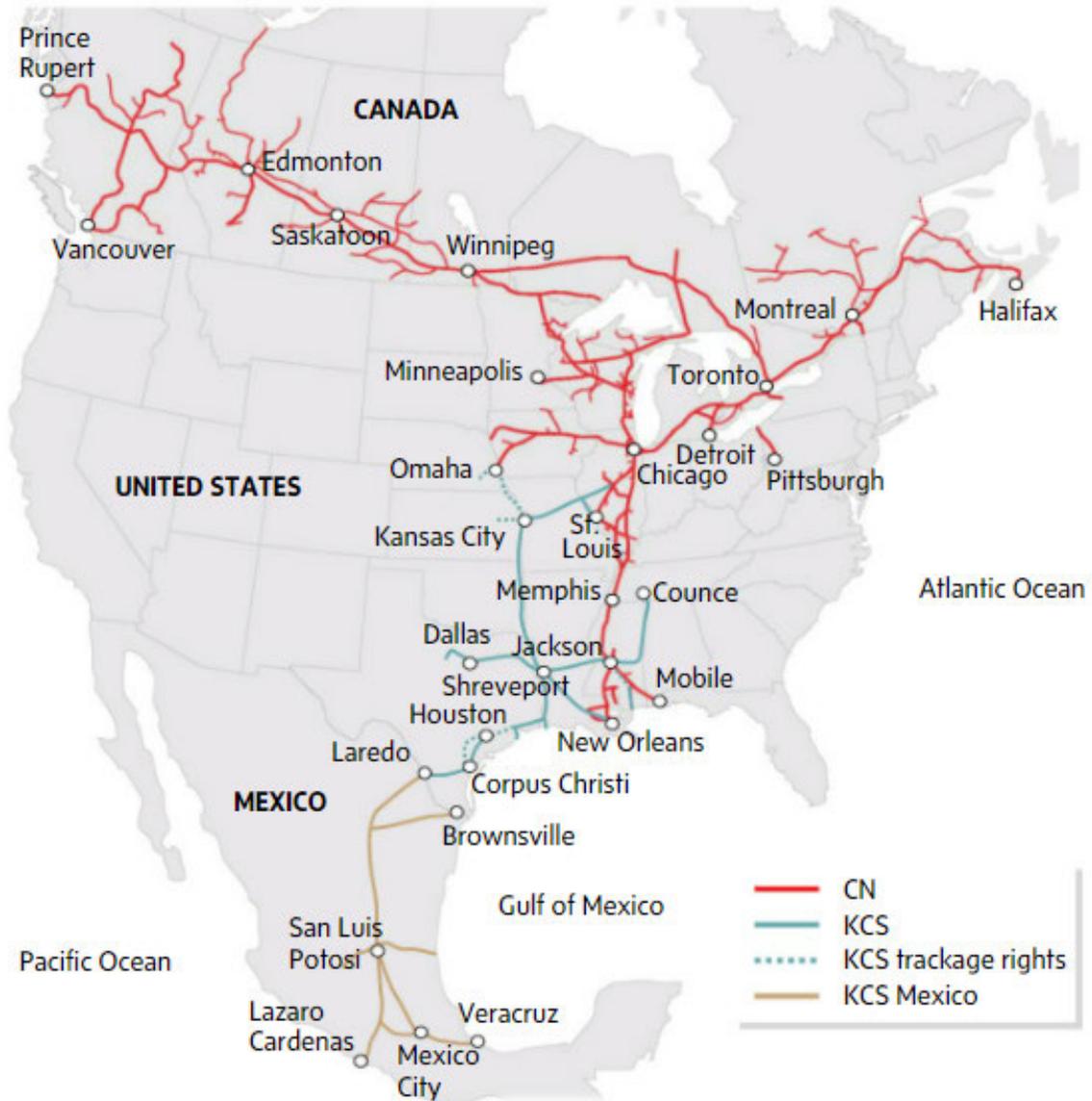
Of particular concern is that post-merger KCS will have reduced incentive to interchange traffic with CN at Jackson, Mississippi—an exchange that illustrates the points made above. As KCS has previously recognized, there is a significant commercial opportunity to connect origins and destinations in Mexico and Texas on its network with destinations in the upper Midwest and Canada on CN’s network.<sup>120</sup> The interchange at Jackson is a critical link for CN and its customers to reach origins and destinations in Mexico and Texas. After the merger, however, a combined CP-KCS will be concerned that interchanging at Jackson with CN and other railroads will divert traffic away from the legacy CP network, which connects with KCS at Kansas City, and through that route, services large parts of Canada and the Midwest. The following maps illustrate this point.

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<sup>119</sup> Comment of the U.S. Dep’t of Justice, *Canadian Pacific Railway Limited et al.-Control-Kansas City Southern Railway Company, et al.*, STB Docket No. 36500, at 4 (filed Apr. 12, 2021) (after the merger, KCS will make operational and investment decisions with an “eye toward interchanging KCS traffic with CP”).

<sup>120</sup> *See, e.g.*, Joint Motion for Approval of Voting Trust Agreement, *Canadian National Railway Company, et al.-Control-Kansas City Southern, et al.*, STB Docket No. FD 36514 (filed May 26, 2021), Verified Statement of Patrick J. Ottensmeyer at 8–9.

**CN and KCS Networks Efficiently Connect at Jackson to Serve Traffic Flows between Texas/Mexico and the Upper Midwest/Canada**



**CP and KCS Will Have an Incentive to Favor CP-KCS Routes between Texas/Mexico and the Upper Midwest/Canada**



The Application underscores this concern. In connection with the CN-KCS merger proposal, KCS recognized that the merger would allow shippers to move industrial goods between Texas and Mexico, on the one hand, and Detroit and Ontario, on the other, via Jackson. However, the Application projects a material *decrease* in KCS’s interchange traffic with CN and other railroads at Jackson, while traffic on the competing CP-KCS route via Kansas City is expected to increase substantially.<sup>121</sup> Indeed, the core assumption of CP-KCS’s claims of volume growth from the merger is that a substantial volume of traffic that CP and KCS currently

<sup>121</sup> See Application, Vol. 2 at 305 (showing decrease in cars moving through Jackson yard even under CP-KCS “growth plan”).

move in joint-line service with other railroads will instead move on single-line CP-KCS service.<sup>122</sup> Applicant's post-merger strategy is further revealed by the fact that *the Application identifies \$276 million in planned capital investment in the proposed CPKC north-south mainline between Sabula Jct., IA, and Beaumont, TX, while no capital investment dollars are earmarked for KCS's Springfield Line.*<sup>123</sup>

This vividly illustrates the danger that a combined CP-KCS will set prices and degrade service to push shippers to their own long-haul routes unless significant enforceable protections are imposed as merger conditions. Applicants' operating plan thus confirms the need for the Board to impose meaningful, enforceable conditions to ensure that gateways remain open on commercially reasonable terms.

Ultimately, and as conceded by Applicants,<sup>124</sup> the issue is what conditions the Board should impose to address these concerns, not whether any conditions should be imposed. Given the foregoing facts, no other position would be tenable. However,

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<sup>122</sup> See Applicants' Reply to "Comments" Seeking Rejection of Application Filed October 29, 2021, *Canadian Pacific Railway Limited, et al.-Control-Kansas City Southern, et al.*, STB Docket No. 36500, at 3 (filed Nov. 16, 2021) (asserting that CP-KCS single-line service would replace 80,356 UP interline moves, 38,342 BNSF interline moves, 15,439 CSXT interline moves, and 9,540 CN interline movements). To be sure, single-line service can potentially offer shippers substantial benefits and some amount of diversion can be expected from the new CP-KCS single-line service will be able to offer. However, as explained above, Applicants' diversion estimates are overstated because their single-line offerings are frequently inferior to existing, substantially shorter routes and they appear to envision charging commercially unreasonable rates.

<sup>123</sup> See Application, Vol. 2, Operating Plan (Exhibit 13) at 85, Table 8.

<sup>124</sup> See Application, Vol. 1 at 233.

the vague commitments that Applicants have proffered to date are facially inadequate and would not address the fundamental concern that the merger will eliminate KCS's existing incentive to act as a neutral connecting carrier and work cooperatively with other railroads to serve shippers that KCS cannot today service by itself. CN explains some of the key contours required for an effective gateway commitment in Section IV below.

**3. CP's pre-merger actions to foreclose competition from KCS raise serious concerns.**

KCS formerly had hundreds of miles of haulage rights over CP lines, which enabled KCS to compete for grain traffic moving from Iowa and Minnesota to destinations on the KCS network, and for chemicals, forest products, and other carload traffic moving between Kansas City and Chicago, based on other agreements with the Dakota, Minnesota and Eastern ("DM&E") and Iowa, Chicago, and Eastern Railway ("IC&E") (collectively, "DME"), entered in 1997.<sup>125</sup> After CP acquired control of DM&E and IC&E, it refused to renew those agreements. As a result, "no customer is jointly served by CP and KCS" today only because CP

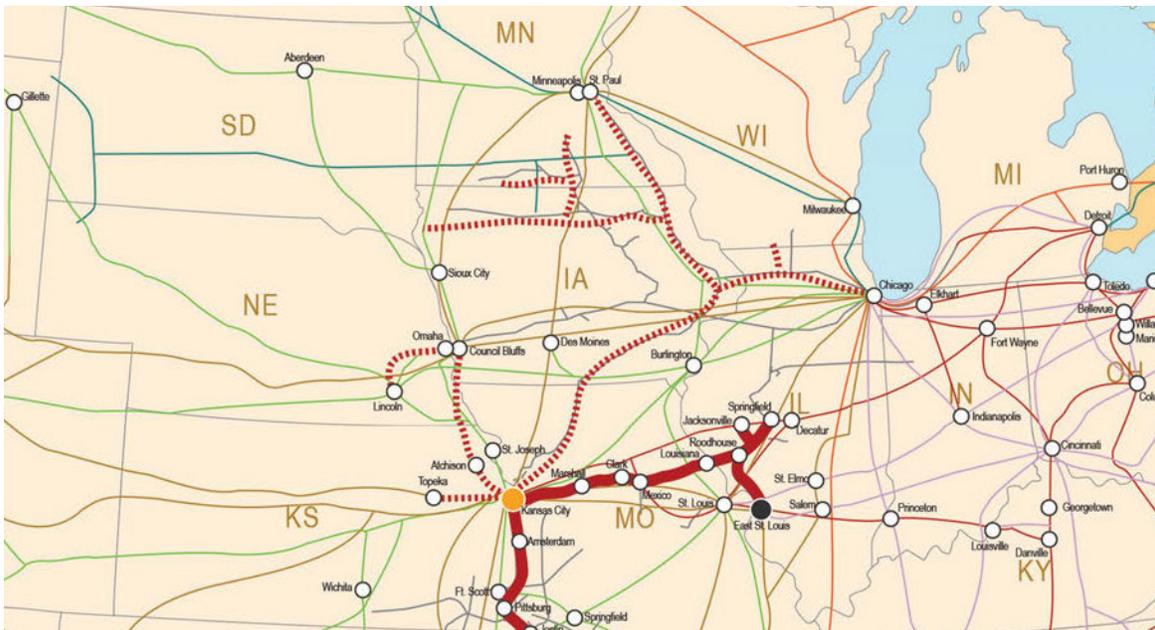
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<sup>125</sup> Specifically, a "Grain Agreement" that provided KCS with ratemaking authority for the transportation of grain from IC&E-served origins in Iowa and Minnesota to KCS-served destinations in the south-central United States and a "Chicago Agreement" that gave KCS ratemaking authority for rail service over the IC&E route between Kansas City and Chicago for chemicals, forest products, and other carload commodities. See Decision No. 11, *Canadian Pacific Railway Company, et al.—Control—Dakota, Minnesota & Eastern Railroad Corp., et al.*, STB Docket No. FD 35081, at 11 (STB served Sept. 30, 2008) ("*CP-DME*"); see also Comments of the Kansas City Southern Railway Company and Request for Conditions, *Canadian Pacific Railway Company, et al.—Control—Dakota, Minnesota & Eastern Railway Corp., et al.*, STB Docket No. 35081, at 8–11 filed Mar. 4, 2008).

unilaterally extinguished KCS's access to those customers four years ago, converting customers with access to both KCS and CP into customers solely served by CP.

The impact of CP's unilateral action is illustrated by looking at the difference between KCS's system maps in 2017 and 2018. KCS's market reach over CP's lines was markedly reduced after the Grain Agreement expired:

**KCS System Map in 2017 (northern portion)<sup>126</sup>**



<sup>126</sup> See Exhibit 9, Excerpts from 2016 KCS Annual Report. This excerpt shows the northern portion of the KCS system; the entire map is in Exhibit 9.

**KCS System Map in 2018 (northern portion)<sup>127</sup>**



CP should not be allowed to claim no competitive harm where the absence of competition results from its own anti-competitive behavior. This history is all the more reason for the Board to ensure strong conditions are in place to prevent CP from using its position to decrease competition on the network.

**B. The Application’s Inadequate and Unreliable Operating Plan Poses A Serious Risk to the Post-Merger Service of CPKC and Other Rail Carriers.**

One of the Board’s primary concerns in connection with its review of railroad mergers is their potential for post-consummation service disruptions. When commenters raised objections to CP’s and KCS’s request that the Board assess their merger under the old rules, they noted that one of the main catalysts for the updated 2001 merger rules was the experience of severe service disruptions that

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<sup>127</sup> See Exhibit 10, Excerpts from 2017 KCS Annual Report. This excerpts the northern portion of the KCS system; the entire map is enclosed at Exhibit 10.

occurred following several 1990s mergers.<sup>128</sup> For that reason, interested stakeholders asked the Board to apply the new rules so that, among other things, CP and KCS would be required to submit a Service Assurance Plan.

In response, Applicants made a promise to the STB. They pledged that if they were permitted to proceed under the old rules, they would provide an effective equivalent by giving the Board “all the information [the Board] needs to satisfy itself that Applicants have carefully planned for the integration of these railroads and will implement measures to monitor and adjust service levels during the integration process so that shippers’ service levels are safeguarded . . .”<sup>129</sup>

Applicants have broken that promise. They did not submit a Service Assurance Plan with the Application, or anything like it. The Application includes only a vague reference to a “Service Assurance Team.”<sup>130</sup> However, when asked for documents related to that group in discovery, Applicants responded that there were none. When asked to explain the group in his deposition, CP witness Mr. Brooks admitted that the group had not even been formed yet, and that Applicants had no plans to publicly report on its work, publish any metrics or benchmarks, or develop

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<sup>128</sup> CSX Transportation, Inc. Comments with Respect to Rules Applicable to this Proceeding, *Canadian Pacific Railway Limited, et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500, at 2 (filed Apr. 1, 2021); Comments of the United States Department of Justice, *Canadian Pacific Railway Limited et al.—Control—Kansas City Southern Railway Company, et al.*, STB Docket No. FD 36500, at 8 (filed Apr. 12, 2021).

<sup>129</sup> Applicants’ Reply to Objections to KCS Waiver, at 19.

<sup>130</sup> See Application, Vol. 1, Verified Statement of John Brooks ¶ 51.

contingency plans for merger-related disruptions.<sup>131</sup> A mere reference to a “Service Assurance Team” that does not currently exist and that apparently would carry out its work in secret plainly does not provide “all the information [the Board] needs to satisfy itself that Applicants have carefully planned for the integration of these railroads . . .”

Indeed, the Operating Plan itself makes clear that Applicants have not carefully planned for post-merger service—or at least that they have not undertaken detailed capacity analyses or developed a detailed capital investment plan that will limit the potential for service disruption. On the contrary, the Application and Operating Plan contain a myriad of inconsistencies and methodological errors that should raise alarms about service disruptions.<sup>132</sup>

First, as discussed above, Applicants’ Operating Plan is based on traffic data, a blocking plan, and a train service plan that have not been shown to be truly representative of CP and KCS Base Year (2019) traffic and operations. In addition, Applicants arbitrarily altered the outputs of their MultiRail model (*e.g.*, by removing from their train counts and tonnages any train that did not traverse 25 percent or more of the nodes in a subdivision). These methodological flaws render

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<sup>131</sup> Exhibit 5, Excerpts from Transcript of February 4, 2022 Deposition of John Brooks (“Brooks Dep.”), at 210:22–212:18.

<sup>132</sup> See *CSX Corp. and CSX Transp., Inc., Norfolk S. Corp. and Norfolk S. Ry. Co.—Control and Operating Leases/Agreements—Conrail Inc. and Consolidated Rail Corp.*, STB Docket No. FD 33388, 3 S.T.B. 196, 249 (1998) (“We are mindful of the fact that the recent *UP/SP* merger was followed by serious service problems resulting from a variety of factors, a significant one being a rail infrastructure that is inadequate to meet the rapidly increasing demand for rail service ....”).

the Operating Plan fatally deficient. This, in turn, means that the Operating Plan cannot reliably support the development of accurate operating statistics (including trains, train miles and GTMs), operating expenses, capital requirements or equipment needs for the merged railroad. These critical components of the Operating Plan must be accurate to assure the Board that service will not be disrupted.

Second, accurate estimates of line density, train counts, and yard activity<sup>133</sup> “are critical to demonstrating that a merged railroad will be able to move projected post-merger traffic over the network without degrading service.”<sup>134</sup> Significantly, in their reply to CN’s Notice of Responsive Application, *Applicants disavowed their own density data provided in Application Exhibit 14*.<sup>135</sup> Accurate estimates of train counts and line density are essential to identifying line segments where capital investment may be required to maintain fluid train service. Likewise, accurate estimates of yard activity are necessary to identify yards with insufficient capacity to handle the projected post-merger increase in switching work. As demonstrated

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<sup>133</sup> See 49 C.F.R. § 1180.8(b)(1) (requiring applicants to provide three specific items in the operating plan for first year in which it will be implemented: (i) traffic density (tonnage) maps or tables for all main and secondary network line segments, (ii) train counts for all main and secondary network line segments, and (iii) a list of all yards anticipated to experience activity growth of 20 percent or more).

<sup>134</sup> Van Dyke Verified Statement at 19.

<sup>135</sup> See Applicants’ Reply to Canadian National’s Description of Anticipated Responsive Application, *Canadian Pacific Railway Ltd., et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36500, at 9 n.7 (filed Jan. 28, 2022) (claiming three times that density figures from Exhibit 14 were “figures presented by CN”).

above, none of these critical elements of Applicants' Operating Plan is reliable or valid. The traffic density tables and maps contain numerous material errors, for example, omitting unit trains and using unsupported "calibration factors." The projected changes in yard activity portrayed in the Operating Plan are inconsistent with the data in Applicants' environmental filing and significantly underestimate intermodal yard traffic. Contravening Board rules, the Application fails to accurately identify all yards with a projected 20 percent change in activity level (e.g., Port Arthur, Texas).<sup>136</sup> These are not merely "theoretical" failures—inaccurate train counts, density projections, and yard activity estimates can lead to service failures that spread throughout a network.

Third, even assuming that the Operating Plan were valid, the Application is deeply flawed because Applicants chose not to use its outputs to estimate the merged railroad's operating expenses. The GTMs, train-miles, and car-miles generated by an operating plan are customarily used to calculate the merged railroad's operating expenses, equipment needs and capital expenditure requirements. Here, Applicants instead developed a "System Model" that was divorced from the Operating Plan, and they based their operating expense estimates on a spreadsheet of values that was likewise unrelated to the Operating Plan. Like the Operating Plan itself, Applicants' operating expense calculations are unreliable and do not provide a credible basis for the Board to assess the potential for service disruptions.

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<sup>136</sup> Van Dyke V.S. at 24.

Fourth, Applicants' operating expense estimates are based only on "synergy growth" (i.e., the amount of additional traffic that CPKC would gain by diverting shipments from other railroads and trucks) and do not account for the Application's projected "organic growth" (i.e., the amount of additional traffic occurring as a result of general economic and business conditions during Years 1-3). The omission of "organic growth" resulted in massive errors. For example, while the Operating Plan projected an annual increase in train-miles of roughly { Redacted } by Year 3, Applicants' operating expense estimates reflect an increase of only { Redacted } train-miles per year. Likewise, the Operating Plan projects an increase in GTMs of { Redacted }, while operating costs assume an increase of only { Redacted } GTMs. The Board can have no assurance that the merged railroad has accurately forecast its operating expenses.

In short, the Application offers no assurance that this major merger will not be disruptive. To the contrary, Applicants' defective and deficient evidence creates ample cause for concern about the potential for serious post-merger services disruption. Moreover, even where the proponents of a merger have submitted realistic and reliable evidence, the Board has, in recent years, imposed a condition providing for post-merger oversight for five years to monitor the actual effects of the merger on rail service. Indeed, the Board has made such oversight a standard condition in major merger proceedings governed by the new merger rules. Under the circumstances present here, and in light of Applicants' unfulfilled promise to

address service assurance in their Application, the Board should impose a five-year oversight period here.

**C. Applicants' Unsubstantiated Growth Synergies, Combined with CP's Plan to Not Reduce Earnings, Poses Significant Public Interest Risks.**

The proposed CP-KCS merger raises serious financial concerns. Indeed, it flunks the very test that CP has proposed to evaluate the potential financial consequences of a merger of Class I railroads. The combination of the massive debt being assumed by CP with patently unrealistic growth projections will likely leave CP starved for cash. This in turn will inevitably lead to post-merger CP cutting service or leveraging its increased market power to enhance the revenues it needs to service its debt. The merger is thus likely to disserve the public interest, with potentially severe consequences for shippers, interconnecting railroads, and the national economy.

In opposing CN's proposed merger with KCS, CP conducted a financial analysis of the transaction and concluded that:

- (1) "CN Will Take on a Very High Level of Debt," "[t]he proposed transaction will CN's leverage to levels that CN has not incurred in the recent past," and CN's debt leverage would be "materially higher than that of any other Class 1 railroad over the last decade;"<sup>137</sup>
- (2) After the transaction, CN's rate of return on investment ("ROIC") would fall below its historic and target levels;<sup>138</sup> and

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<sup>137</sup> Exhibit 4, Verified Statement of Mark E. Zmijewski ("Zmijewski V.S.") ¶ 20 (quoting Velani V.S. at 6, 8).

<sup>138</sup> *Id.* ¶ 40.

- (3) CN had failed to conduct stress testing of its projections using conservative assumptions, demonstrating that CN is “leaving no margin for error,” calling into question its ability to repay its debt and retain investor confidence.<sup>139</sup>

Based on this analysis, CP reached the following conclusion:

CN’s targeted rate of return will not be achieved based on the synergies CN forecasts, which will place pressure on CN to boost returns in other ways, such as through cost-cutting, or — more plausibly — reaping the benefits of reduced competition ....<sup>140</sup>

In his attached verified statement, Professor Mark Zmijewski, a Professor at the University of Chicago Booth School of Business, has applied CP’s own analysis of the proposed CN-KCS merger to CP’s proposed acquisition of KCS.<sup>141</sup>

Straightforward application of CP’s financial test shows that:

- “CP is taking on a high level of debt that will substantially increase CP’s leverage, and thus, its financial risk;”<sup>142</sup>
- CP’s leverage ratios are as high as the CN leverage ratios CP criticized, and higher than its target ratio;<sup>143</sup>
- a credit rating analysis of CP post-acquisition “further corroborate[s] the conclusion of substantially increased financial risk”;<sup>144</sup>
- CP’s post-transaction ROIC will fall far below its historic and target levels;<sup>145</sup> and

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<sup>139</sup> *Id.* ¶¶ 17, 29.

<sup>140</sup> *Id.* ¶ 5 (quoting Velani V.S. at 11).

<sup>141</sup> To be sure, CN does not agree with all aspects of CP’s prior analysis, which CN showed was exaggerated and flawed. But CP cannot now complain about application of its own financial “stress-test” to its proposed acquisition of KCS.

<sup>142</sup> Zmijewski V.S. ¶ 20.

<sup>143</sup> *Id.* ¶ 28.

<sup>144</sup> *Id.* ¶ 20.

<sup>145</sup> *Id.* ¶ 40.

- stress-testing CP’s transaction with conservative projections about post-transaction growth and revenues reveals that CP would be subject to the same anti-competitive incentives it predicted for CP.<sup>146</sup>

More specifically, in criticizing CN’s leverage in connection with its proposed transaction, CP noted that it would be “materially higher than that of any other Class I railroad over the last decade,” highlighting that as of 2020 “the highest leverage amongst other Class I railroads is 3.0 times Adj. Debt/EBITDA, materially lower than the contemplated 4.8 times adjusted debt/EBITDA for CN.”<sup>147</sup> That standard is fatal to CP. Applying that very standard, Professor Zmijewski shows CP’s “[u]nconsolidated leverage ratios are as high as CN’s leverage ratios, and based on both sets of forecasts, CP’s leverage ratios are higher than the Target Leverage Ratio of 2.5x.”<sup>148</sup> Indeed, Professor Zmijewski demonstrates that CP’s \$8.2 billion acquisition debt “pushes the leverage ratio above the thresholds associated with investment grade credit rating.”<sup>149</sup>

Likewise, again using the same analysis CP did of CN’s transaction, Professor Zmijewski has shown that CP’s post acquisition ROIC would be substantially lower than CP’s historical ROIC and target ROIC of roughly 15%.<sup>150</sup> In its 2021 SEC Form 8K filing, however, CP shows that while it had a ROIC of 16.7 percent in 2020—consistent with its historical ROIC—that number fell dramatically

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<sup>146</sup> *Id.* ¶¶ 36, 38.

<sup>147</sup> *Id.* ¶ 28 (quoting Velani V.S. at 8–9).

<sup>148</sup> *Id.* ¶ 28.

<sup>149</sup> *Id.* ¶ 37.

<sup>150</sup> *Id.* ¶ 40.

to 8.2 percent in 2021 after the KCS acquisition.<sup>151</sup> Even using CP’s optimistic forecasts of synergies submitted to the STB, “the expected ROIC in the post-acquisition period ranges between 7.0% and 9.1% and is well below CP’s 15% target ROIC even with a full credit of [CP’s] Claimed Efficiencies.”<sup>152</sup> In this scenario, CP would have to “more than double its unleveraged earnings” to achieve an ROIC close to its 15% target.<sup>153</sup> Critically, moreover, using a more conservative forecast of synergies arising from the merger, “the expected ROIC in the post-acquisition period ... falls even lower into the 5.7 to 6.3% range.”<sup>154</sup>

Finally, in connection with CN’s proposed merger, CP highlighted the importance of stress testing a transaction to determine whether a company can manage its debt if optimistic projections are not realized. Indeed, CP criticized CN for allegedly failing to do so and accused CN of adopting a strategy that “leaves no margin for error.”<sup>155</sup> Despite CP’s (incorrect) criticism of CN on this point,<sup>156</sup> CP failed to stress test its own proposed acquisition.

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<sup>151</sup> *Id.* ¶ 52.

<sup>152</sup> *Id.* ¶ 56.

<sup>153</sup> *Id.* ¶ 56.

<sup>154</sup> *Id.* ¶ 58.

<sup>155</sup> *Id.* ¶ 29.

<sup>156</sup> See Applicants’ Reply to Comments on Proposed Voting Trust Agreement, *Canadian National Railway Co., et al.—Control—Kansas City Southern, et al.*, STB Docket No. FD 36514 (filed July 6, 2021), Exhibit 4, Reply Verified Statement of Mark Zmijewski at 15–25 (showing multiple stress tests in extreme financial distress scenarios).

All of the financial risks described above become worse if, as is likely, CP's rosy synergy and growth projections do not come to pass. As described in other sections of these Comments, CP's projections are built on data riddled with errors and illogical assumptions. If CP's claimed revenue gains and operating efficiencies are not realized, then "CP would be \$2.2 billion short of the free cash flow that is necessary to de-lever the company by Year 4 to a level consistent with CP's historical leverage."<sup>157</sup> Yet CP's ability to successfully manage the financial risk associated with its transaction depends on CP's ability to de-leverage the company by aggressively repaying its debt.

The post-merger combination of CP's high leverage and low ROIC—and CP's likely inability materially to improve its financial position in the way it forecasts—raise significant public interest concerns under 49 U.S.C. § 11324(b)(5). After asserting that CN could not meet its stated ROIC targets based on the synergies CN projected in connection with its acquisition of KCS, CP asserted that CN "must have based its investment decision on some unstated set of strategic benefits CN expects to realize. The most plausible explanation is that CN's investment is justified by CN's anticipated increase in market power — giving it greater pricing power."<sup>158</sup> That was nonsense—and CN proved its confidence in the projected growth benefits of its then-proposed transaction by committing to a review under the new merger rules with enhanced competitive conditions. But if one accepts that a railroad that

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<sup>157</sup> Zmijewski V.S. ¶ 34.

<sup>158</sup> *Id.* ¶ 59.

fails to realize projected merger synergies would be motivated to make up the difference by behaving anti-competitively—these same conclusions “equally apply to, and are equally valid for, CP’s acquisition of KCS.”<sup>159</sup>

At a minimum, these financial considerations raise serious concerns about the “effect of the proposed transaction on the adequacy of transportation to the public.”<sup>160</sup> As CP itself has stated, in the circumstances presented here, CPKC will likely face a cash crunch and seek to boost profits by cutting costs and reducing capital investment, with inevitable, negative consequences for service quality.

#### **IV. CONDITIONS ARE NECESSARY TO ENSURE THE PUBLIC INTEREST IS PROTECTED.**

Given the serious deficiencies and inaccuracies of the Application, the Board must impose conditions if it approves the proposed merger to protect the public interest.

##### **A. If the Board Approves the Merger, It Should Order Divestiture of the Springfield Line to CN as a Condition of the Merger**

In light of the competitive concerns and threat to the adequacy of post-merger transportation discussed above, the Board should require divestiture to CN’s U.S. subsidiary, Illinois Central, of the Springfield Line.<sup>161</sup> Divestiture would (i) ensure that this important asset will be efficiently utilized to preserve the Kansas City to Chicago corridor and to provide an efficient competitive option in the Kansas City to

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<sup>159</sup> *Id.*

<sup>160</sup> 49 U.S.C. § 11324(b)(1).

<sup>161</sup> Notice of Responsive Application at 1.

Chicago corridor, (ii) restore and upgrade the Springfield Line, (iii) improve transportation options and increase rail-to-rail competition, and (iv) take more than 80,000 long-haul trucks off of the nation's highways annually. CN proposes to develop the "Kansas City Speedway" that KCS envisioned prior to its agreement to merge with CP. To this end, CN has committed to invest approximately \$250 million to create a high speed, direct route between Kansas City and Chicago.<sup>162</sup> These investments would be used to increase the speed of the entire route to at least 40 mph and to add intermodal and automotive terminal capacity, among other improvements.

This would preserve and foster competition and give rail shippers a far more efficient way of shipping between Kansas City and Chicago, and beyond to Michigan and Eastern Canada. CP's service to these areas is limited by restrictions on its trackage rights and other operational constraints. In contrast to CP, CN would be able to serve intermodal and automotive shippers in Michigan and Ontario over its own tracks, providing shippers with a far more efficient way of reaching Kansas City.

CN projects that this route could annually take more than 80,000 long-haul trucks off the road—more than CP-KCS project for their entire post-merger

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<sup>162</sup> *Id.* at 5, 7.

network.<sup>163</sup> This would generate significant environmental benefits in the form of reduced greenhouse gas emissions.

Applicants do not dispute that the Board has authority to order divestiture. The Board has express statutory authority from Congress to order the “divestiture of parallel tracks” as a condition of approving a merger and in furtherance of its authority to ensure a merger serves the public interest.<sup>164</sup>

To be sure, the Board will not “lightly” order divestiture, and any divestiture remedy should be “tailored” to the concerns that have been identified.<sup>165</sup> But CN’s proposal satisfies these criteria. CN is seeking only targeted divestiture of the Springfield Line (including ancillary rights to access yard facilities in the Kansas City terminal area). Divestiture here is necessary to ensure that this key asset connecting Kansas City with CN’s line to Chicago will remain available to provide efficient and competitive rail service, whereas, absent the requested condition, CP will have little (if any) incentive to deploy the assets efficiently.

Indeed, the antitrust authorities routinely seek divestiture in these circumstances.<sup>166</sup> “Structural remedies are strongly preferred in merger cases

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<sup>163</sup> See CN Responsive Application, Verified Statement of David T. Hunt, at 8; Application, Vol. 1 at 23, 310 (asserting that CP-KCS will divert 64,000 trucks to rail annually).

<sup>164</sup> 49 U.S.C. § 11324(c).

<sup>165</sup> Applicants Reply to Responsive Application at 7–8.

<sup>166</sup> See U.S. DEP’T OF JUST., ANTITRUST DIV., MERGER REMEDIES MANUAL 6–9 (Sept. 2020); Press Release, U.S. Dep’t of Just, Antitrust Div., Just. Department Sues to Block Visa’s Proposed Acquisition of Plaid (Nov. 5, 2020), <https://www.justice.gov/opa/pr/justice-department-sues-block-visas-proposed->

because they are clean and effective, and they avoid ongoing government entanglement in the market.”<sup>167</sup> Divestiture is also needed for CN to make the “Kansas City Speedway” a reality, which will benefit shippers of intermodal and automotive traffic moving between Kansas City, on the one hand, and Detroit and points in Eastern Canada, on the other hand.

Finally, Applicants would not be harmed by this divestiture, except to the extent it would be used to provide meaningful competition to CP’s parallel line between Kansas City and Chicago and Detroit.<sup>168</sup> As explained in the Responsive Application in FD 36500 (Sub-No.1), CN would grant KCS haulage rights to serve all customers on the Springfield Line and to interchange with other carriers at interchange points along the Line. No local customer on the Springfield Line would lose a rail option—to the contrary, most of those shippers would gain access to an additional rail alternative.

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[acquisition-plaid](#) (asserting, *inter alia*, that Visa’s acquisition of Plaid was likely to prevent Plaid from competing with it in the future); *United States v. Bazaarvoice, Inc.*, No. 13-cv-0013-WHO, 2014 WL 203966 (N.D. Cal. Jan. 8, 2014), <https://www.justice.gov/atr/case-document/file/488846/download> (similar); Press Release, Fed. Trade Comm’n, FTC Challenges Illumina’s Proposed Acquisition of Cancer Detection Test Maker Grail (Mar. 30, 2021) (similar), <https://www.ftc.gov/news-events/press-releases/2021/03/ftc-challenges-illumina-proposed-acquisition-cancer-detection>.

<sup>167</sup> Comments of the U.S. Dep’t of Justice, *CSX Corporation and CSX Transportation, Inc., et al.—Control—Pan Am Systems, Inc., et al.*, STB Docket No. FD 36472, at 6 (filed Aug. 26, 2021) (“*CSX-Pan Am*”) (citing U.S. DEP’T OF JUST., ANTITRUST DIV., MERGER REMEDIES MANUAL 13 (Sept. 2020)).

<sup>168</sup> *Cf.* Applicants Reply to Responsive Application at 8.

As discussed previously, Applicants apparently do not plan on making the investments necessary to maintain their existing customer base or serve new customers, whereas CN's planned improvements would *increase* the speed at which trains could be operated on the Springfield Line, benefiting all shippers who rely on the line, including those that would choose to ship their freight via CPKC pursuant to the haulage arrangement.<sup>169</sup> CN's planned investment would also increase line capacity, again benefiting all shippers on the line, including those that would choose CPKC haulage service.

**B. The Board Should Impose Conditions Needed to Prevent a Combined CP-KCS from Engaging in Foreclosure.**

In CN's proposed acquisition of KCS, CN addressed possible "vertical" concerns forthrightly and committed to significant conditions to address them financially. Specifically, CN committed to keep existing gateways open on commercially reasonable terms, not on the basis of maximum regulatory rate-setting methodologies, and to promptly arbitrate disputes before a neutral.<sup>170</sup>

Applicants have conceded that they must provide a remedy to address the vertical concerns raised by the merger, but offered only vague promises: They stated that the combined company will "maintain efficient operations" and "offer commercially reasonable rates and terms."<sup>171</sup> Notably, Applicants did not identify

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<sup>169</sup> See CN Responsive Application, Exhibit 13 (Operating Plan).

<sup>170</sup> See CN-26/KCS-9, Applicants' Reply to Comments on Proposed Voting Trust Agreement, *CN-KCS* (July 6, 2021), Reply Verified Statement of James Cairns, at 11–12.

<sup>171</sup> See Application, Vol. 1 at 233.

what “gateways” are covered by their commitment.<sup>172</sup> Nor did they provide any detail as to how this commitment would be enforced, other than potential Board enforcement on an individual, post-hoc basis, which would be highly inefficient and fail to offer meaningful assurances of competitive joint-line service.<sup>173</sup> Indeed, ultimately revealing the lack of substance to the merging parties’ commitment, the Application stated that CPKC will work “to find ways to make these commitments more concrete and readily enforceable.”<sup>174</sup>

As explained below, the Board should tighten and strengthen the vague gateway commitments offered by Applicants. In this regard, in their depositions, Applicants’ own witnesses effectively conceded the gateway conditions as proposed were not sufficient and that additional protections were appropriate. At the same time, as revealed by the deposition testimony, Applicants appear to intend to enforce an “affected traffic” restriction on the availability of the gateway condition that was not disclosed in the Application. The Board should make clear that Applicants cannot adopt this new restriction. Finally, consistent with gateway conditions that CN offered in connection with its proposed acquisition of CP, the

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<sup>172</sup> Subsequent developments increase the need for skepticism of CP-KCS’s “trust us” approach. In discovery responses, CP and KCS named only seven locations that would be covered by their gateway commitment: Chicago, St Paul, Jackson, Shreveport, Laredo, Robstown, and Kansas City). *See Applicants’ Responses to CN’s First Discovery Requests* at 70. That list omits numerous gateways where CN exchanges traffic with CN or KCS, including gateways at the Canadian border for cross-border traffic (Vancouver; Superior, Wisconsin; Noyes, MN); East Dubuque, Illinois; Superior, WI; Baton Rouge, Louisiana; and Hattiesburg, Mississippi.

<sup>173</sup> *See Application*, Vol. 1 at 233.

<sup>174</sup> *Id.*

Board should adopt binding arbitration as the means to resolve disputes over whether Applicants are offering commercially reasonable terms.

1. Although CN believes the gateway conditions proposed by Applicants remain a second-best remedy with respect to the vertical concerns it has identified,<sup>175</sup> at a minimum, the Board must clarify and strengthen the vague commitments proposed by Applicants. Indeed, CP itself has in the past argued that vague assurances that merging parties will agree to keep gateways open on “commercially reasonable” terms are insufficient to protect competition and that clear and enforceable terms are necessary.<sup>176</sup>

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<sup>175</sup> As discussed above, CN’s principal concern is how the merger will change KCS’s incentives with respect to working with CN to serve customers in Mexico. Requiring CPKC to grant CN haulage rights between Jackson and Laredo, Texas would be a superior solution to the gateway conditions Applicants have proposed here. A haulage condition would largely eliminate CPKC’s ability to block CN from competing because CN would be able to independently price traffic to Laredo, paying a fixed fee to CPKC to haul traffic on CN’s account. However, CN understands a key portion of the line between Jackson and New Orleans (the so-called “Meridian Speedway”) is jointly owned and operated by NS and KCS. CN further understands the contractual arrangement between NS and KCS may restrict KCS’s ability to grant haulage rights, and thus NS would likely contend that the Board cannot order KCS to grant haulage rights to CN. Because of this contractual restriction, CN is not now seeking a haulage condition. Of course, if the Board concludes haulage is the only condition that can fully ameliorate the competitive concerns raised by the CP-KCS merger, it could condition the merger on CPKC securing the necessary rights to provide haulage to CN. At a minimum, however, if the Board approves the merger subject to gateway conditions, the Board should make clear that it will permit parties to seek haulage in the future if the Applicants do not in fact provide commercially reasonable rates and services as they have committed to do.

<sup>176</sup> Brooks Dep., Ex. 5 at 2 (CP comments).

Notably, in his deposition testimony, CP's Chief Marketing Officer, John Brooks, "clarified" the gateway commitments in important respect. The Board should hold Applicants to these representations.

- On behalf of Applicants, Mr. Brooks clarified that a "gateway" means "the interchange point that would link two carriers." He agreed that "any location where two railroads interchange or link together" is a "gateway."<sup>177</sup>
- Mr. Brooks effectively abandoned the Applicant's position that a rate would be "commercially reasonable" merely because it was below the maximum lawful rate that would be permitted by the Board.<sup>178</sup> Instead, Mr. Brooks agreed that to be "commercially reasonable" the rate must be one that would give the customer a "choice" and that a "high gateway rate" that would "force traffic to [Applicants] single-line routes" "would not be acceptable."<sup>179</sup> Mr. Brooks also acknowledged that this "commercially reasonable" rate commitment applies both to a shipper's request for "interline rates" as well as a competing carrier's request for a "commercially reasonable divisions."<sup>180</sup>
- Mr. Brooks acknowledged Applicants' commitment also extended to non-rate terms. Just as Applicants could foreclose competition by charging high joint rates to shippers that want to reach CP-KCS's rivals, they could also do so by degrading the quality of the interchange with those

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<sup>177</sup> Brooks Dep. at 21:23–22:2.

<sup>178</sup> Brooks Dep. at 82:11–14, 103:23–104:2. While Applicants acknowledged that "interline options via these gateways must be commercially viable" to provide meaningful competition to its own service, the Application itself merely stated that they were committing to offering a "Rule 11" rate—that is, a rate between the gateway and a shipper location that could theoretically be challenged before the Board. *See* Application, Vol. 1 at 233.

<sup>179</sup> Brooks Dep. at 210:12–21.

<sup>180</sup> *Id.* at 94:22–95:5, 96:21–97:7.

rivals.<sup>181</sup> Thus, Mr. Brooks acknowledged that Applicants needed “to provide the best quality service we can provide to the interchange.”<sup>182</sup>

The need to hold Applicants to Mr. Brooks’ clarifications is reinforced by the testimony of Dr. Majure. CP’s expert economist, Dr. Majure, admitted that his conclusion that the transaction would not result in anticompetitive foreclosure at locations like Laredo was entirely predicated on the general applicability and the efficacy of the types of conditions imposed by the STB in the *KCS/Tex-Mex/TFM* decision—that is, Dr. Majure did not offer any opinion that the transaction was unlikely to result in harm to competition absent these conditions being universally applied to the combined CP-KCS.<sup>183</sup> And, as the Board knows, these conditions include the right of connecting carriers to challenge a rate, and service commitments to mitigate the possibility of non-price foreclosure.<sup>184</sup>

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<sup>181</sup> See, e.g., *CSX Corp.—Control—Am. Com. Lines, Inc.*, 2 I.C.C.2d 490, 515 (1984) (“In our competitive analysis, we will consider whether the proposed transaction would create or enhance the ability of CSX and ACBL to maintain rates above competitive levels, or to reduce or eliminate nonprice competition, in the relevant transportation markets.”); see also U.S. Dep’t of Justice & Fed. Trade Comm’n, Vertical Merger Guidelines 4 (June 30, 2020) (noting that foreclosure can occur, *inter alia*, by lowering product quality) (withdrawn by FTC on other grounds).

<sup>182</sup> Brooks Dep. at 209:16–210:3; see also *id.* at 209:6–11 (agreeing that with respect to “the quality of interchange service at a gateway” that Applicants’ “intent would be to preserve the service there”).

<sup>183</sup> Exhibit 6, Excerpts from Transcript of February 7, 2022 Deposition of W. Robert Majure, Ph.D., at 92:7–94:13.

<sup>184</sup> See NITL-3, Comments and Statement of Support on behalf of the National Industrial Transportation League, *Kansas City Southern—Control—Kansas City Southern Ry. Co. et al.*, STB Finance Docket No. 34342 (filed Aug. 4 2003) (attached as Exhibit 1 to the Verified Statement of John Brooks). These conditions include an arbitration requirement, as discussed further below.

2. On the other hand, discovery revealed that CP-KCS intend to engraft a limitation on their gateway commitment that was nowhere mentioned in their Application. In his deposition testimony, Mr. Brooks stated for the first time that Applicants' gateway condition only applied to "affected" movements. The thrust of this limitation appears to be that Applicants will only agree to provide commercially reasonable interline rates or division for movements where a combined CPKC would, *for the first time*, be able to provide competing single-line service (or at least a longer portion of the movement that it previously could).<sup>185</sup>

As a matter of economics, foreclosure concerns are not raised solely where a competitor seeks to move traffic between the same origin and destination as a new CP-KCS single-line movement. As the Board has recognized, geographic competition means that movements between different origins and destinations can still compete with each other. Geographic competition exists when a shipper can "obtain[] the same product from a different source, or by shipping the same product to a different destination . . ." <sup>186</sup> DOJ raised this very concern with regard to the CP-KCS merger. <sup>187</sup> Thus, Applicants would still potentially have incentive to

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<sup>185</sup> See Brooks Dep. at 89:13–19. Mr. Brooks, however, was unable to articulate a clear standard for what constitutes "affected traffic" that would be entitled to the gateway protection commitment See *id.* at 94:3–7, 123:15–126:9, 126:15–129:25.

<sup>186</sup> See Decision, *Market Dominance Determinations—Product and Geographic Competition*, STB Docket No. EP 627, at 1 (STB served Dec. 21, 1998); see also Decision, *Major Rail Consolidation Procedures*, STB Docket No. EP 582 (Sub-NO. 1), 2001 WL 648944, at \*11 (STB served June 11, 2001).

<sup>187</sup> Comment of the U.S. Dep't of Justice, *Canadian Pac. Ry. Ltd., et al. – Control – Kansas City S. Ry Co., et al.*, STB Finance Docket No. FD 36500 (filed April 12,

refuse to interchange traffic with rivals even via routes where they do not themselves provide single line service, but where that route may be attractive as an alternative to a shipper that they do serve.

In addition, it is not clear whether Applicants' limitation would apply only where the exact same origin-destination is served by a combined CP-KCS. So, for example, it is unclear whether Applicants would provide commercially reasonable access at Kansas City where a rival is seeking to provide interline service from New Orleans to Minneapolis—a route that CP-KCS could provide as single-line service—but where the rival's customer in Minneapolis is not currently a CP customer or able to access CP's facilities in Chicago.

For these reasons, the Board should reject Applicants' attempted after-the-fact limitation on its gateway commitment. It would eliminate competitive protections in instances where Applicants may still have incentive to foreclose competition and invite countless disputes as to whether a particular route qualified.

3. Notwithstanding the foregoing, key aspects of how Applicants' gateway commitments would actually be implemented remain unclear. Applicants acknowledge that “CP isn't promising to agree with shippers on a more concrete standard for what it means for a rate to be commercially reasonable.”<sup>188</sup> Rather, as

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2021), at 9 (“[R]ailroads can also compete through ‘source competition’—that is, the ability of shippers to choose between railroads that can carry their goods to (or receive goods from) different endpoints.”).

<sup>188</sup> Brooks Dep. at 100:2–5.

Mr. Brooks conceded, Applicants are “just saying [they will] talk [with shippers] and try to develop some sort of standard.”<sup>189</sup>

CN agrees with Applicants in so far as they are saying it would be difficult—if not impossible—to prescribe *ex ante* a rate formula that would ensure a particular rate in connection with a particular movement for a particular route is commercially reasonable. Whether a particular rate or division provides a commercially viable alternative to CP-KCS will depend on a host of factors, such as the length of the move, the nature of the freight, the extent of intermodal, geographic and source competition, and the point of interchange. As Applicants acknowledge, given these factors, there will undoubtedly be “good faith” disagreement as to whether a particular interline rate or division offered by CP-KCS is, in fact, “commercially reasonable.”<sup>190</sup>

It is essential that such disputes be resolved promptly and efficiently. Otherwise, CP-KCS could potentially preclude competition simply by threatening to force resolution of any dispute by litigation before the Board. The potential costs involved in such litigation would deter shippers and carriers alike from invoking their rights and the inherent delay would likely render even favorable decisions of little value because the commercial opportunity will have vanished. At a minimum, Applicants should be required to commit to prompt arbitration of all disputes over

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<sup>189</sup> *Id.* at 100:6–19.

<sup>190</sup> *Id.* at 102:7–103:2.

commercially reasonable rates, similar to the commitment in the NITL settlement agreement that was incorporated into the *Tex Mex* conditions.<sup>191</sup>

**C. Applicants Should Be Required to Provide A Service Assurance Plan or Its Equivalent.**

In light of the errors, inconsistencies, and illogic embedded in Applicants' Operating Plan, which cascade into the Application's projected operating expenses and investment planning, service disruptions are a serious concern. Applicants received approval to proceed under the old rules after expressly committing to provide the Board with adequate information to ensure that the merger would not result in service disruptions. Yet the Application provides no such assurance and gives rise to serious concerns. In this setting, the Board should require Applicants to provide a Service Assurance Plan or its equivalent. Merger applicants under the old rules have provided such plans,<sup>192</sup> and it is clearly appropriate to require such a plan here.

The Board should also impose an oversight period of at least five years. The Board has done so in past mergers, and Applicants would be required to do so

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<sup>191</sup> National Industrial Transportation League (NITL) Letter Filing, STB Docket No. FD 34342 (filed Aug. 5, 2003), Attached Agreement, at 3 § 6.

<sup>192</sup> See, e.g., Decision No. 10, *Canadian National Railway Company, et al.—Control—Wisconsin Central Transportation Corporation, et al.*, STB Docket No. FD 34000, at 20 (STB served Sept. 7, 2001) (“[E]ven with a *minor* transaction, there is a need to assure the Board that service is not compromised, particularly during the implementation of the transaction. With this in mind, applicants have provided a Service Assurance Plan ... to assure the Board and affected shippers that all aspects of the implementation planning process have been fully considered.” (emphasis added)).

under the new rules.<sup>193</sup> The oversight period should include required reporting on whether merger benefits have been achieved, compliance with conditions, and any merger-related harms. The Board should retain jurisdiction to impose additional conditions as needed and to entertain additional conditions requests from parties. The deficiencies in this Application and operating plan require no less.

### **CONCLUSION**

For the reasons stated in these Comments, Applicants have failed to carry their burden to show that this merger is in the public interest. At the very least, the conditions requested, including the divestiture of the Springfield Line to CN, should be imposed to prevent the harms to public interest that the merger threatens.

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<sup>193</sup> See Final Rules, *Major Rail Consolidation Procedures*, STB Docket No. EP 582 (Sub-No. 1), at 10 (STB served June 11, 2001); *CSX/NS-Conrail*, 3 S.T.B. at 217 (“we are establishing oversight for 5 years so that we may assess the progress of implementation of the CSX/NS/CR transaction and the workings of the various conditions we have imposed”).

Respectfully submitted,

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*Counsel for Canadian National Railway Company, Grand Trunk Corporation, and  
CN's Rail Operating Subsidiaries*

Dated: February 28, 2022

**CERTIFICATE OF SERVICE**

I hereby certify that on this 28th day of February 2022, a copy of the foregoing Comments on Application and Request for Conditions was served by first class mail or email on the service list for Finance Docket No. 36500.

/s/ Matthew J. Warren  
Matthew J. Warren

# **Exhibit 1**

## **Verified Statement of David Hunt**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB FINANCE DOCKET NO. 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**

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**CN'S COMMENTS ON APPLICATION AND REQUEST FOR CONDITIONS**

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**Verified Statement of David T. Hunt**

**February 28, 2022**

**PUBLIC VERSION**

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# 1. Qualifications

My name is David T. Hunt. I am a Vice President with Oliver Wyman, a global general management consulting firm with more than 60 offices in 31 countries. My office address is 1 University Square, Suite 100, Princeton, NJ 08540.

Oliver Wyman is a leading general management consulting firm. We maintain one of the largest practices in the world dedicated to the transportation and logistics sectors. Oliver Wyman's transportation clients include national and regional governments on six continents, as well as many of the world's largest users of rail services, railroads, motor carriers, leasing companies, and industrial and consumer manufacturing firms.

I have been a consultant in the transportation sector for more than 35 years. I joined Oliver Wyman in 2008, specializing in strategic planning, regulatory issues, and operations for freight railroads and other freight transportation providers. Prior to joining Oliver Wyman, I was a consultant at Cambridge Systematics, Wilbur Smith Associates, and ALK Associates. While at ALK from 1983 through 2000, I provided services to clients in connection with all of the Class I railroad mergers that occurred during that time period. I also was responsible for the annual calibration of and updates to ALK's Advanced Traffic Diversion Model that was used in ICC and STB merger proceedings. I hold a bachelor's degree in civil engineering from West Virginia University and a master's degree in civil engineering and operations research from Princeton University. My resume is included in Appendix A.

## 2. Assignment and Summary of Findings

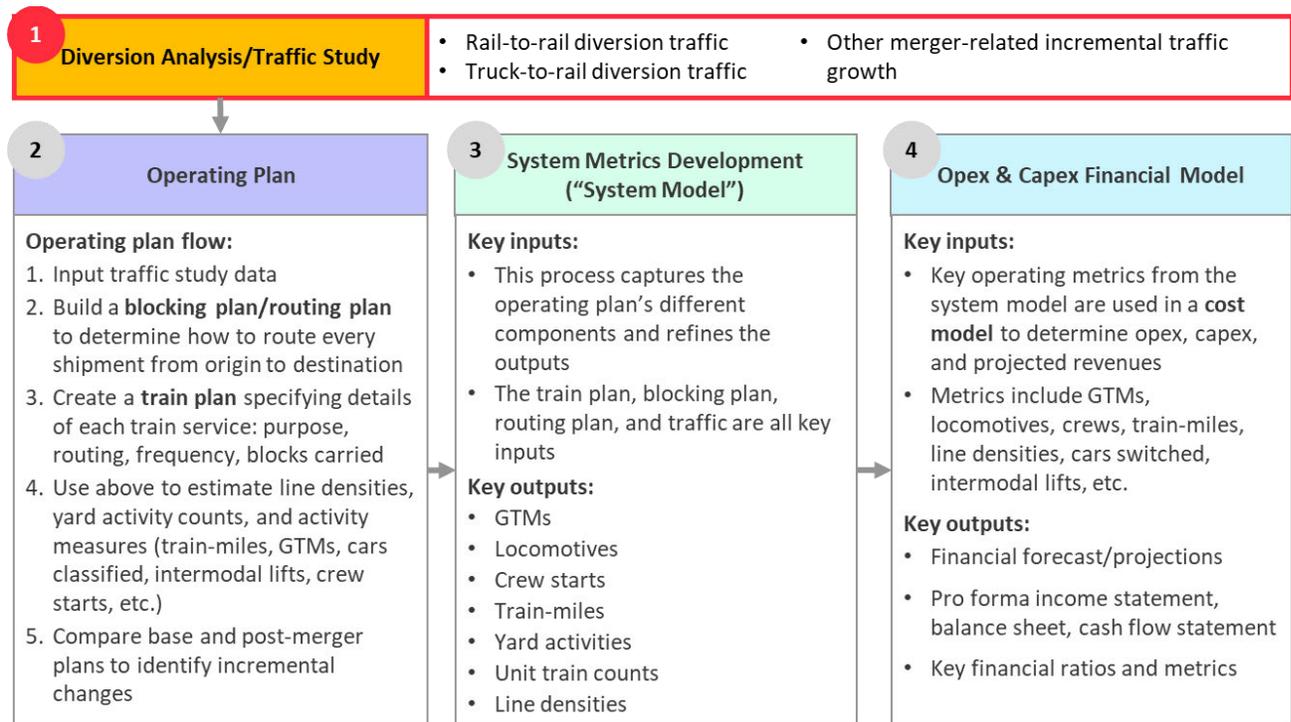
I have been asked to review and comment on Applicants' testimony regarding the traffic diversions and associated revenues that are likely to be achieved by the merged CPKC as a result of the proposed transaction. Specifically, my testimony focuses on the traffic and revenue synergies from rail-to-rail diversions projected by witnesses Richard W. Brown and Nathan S. Zebrowski, the truck diversions posited by witness Mutén, and the additional traffic and revenue sources identified by witnesses Jonathan Wahba and Michael J. Naatz (in their corresponding Verified Statements and work papers to the Application).

As shown in Exhibit 2-1, complete and accurate traffic and revenue data is the fundamental building block of the major merger application required by Board regulations.<sup>1</sup> Accurate operating plans, operating statistics, and financial exhibits must be predicated on reliable traffic projections. As shown below, Applicants' traffic diversion estimates (and associated revenues) are vastly overstated. Exhibit 2-1 illustrates the relationship between traffic projections and other elements of a merger application.

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<sup>1</sup> The required content applicable to the CP/KCS major merger application is set forth at 49 CFR 1180.7 through 49 CFR 1180.11 (2000).

**Exhibit 2-1: Elements of a reliable merger plan: the operating plan and financial model are dependent on the accuracy of Applicants’ traffic projections<sup>2</sup>**



The Application claims that the proposed merger will generate \$1,021.9 million in incremental revenue<sup>3</sup> from rail-to-rail diversions, truck-to rail diversions, and (what Applicants characterize as) “growth initiatives.”<sup>4</sup> The Applicants’ traffic diversion studies, however, are based on flawed methodologies, unsupported assumptions, and erroneous calculations that render their traffic and revenue estimates invalid. Indeed, *Applicants’ merger-related revenue projections appear to be overstated by more than \$520.2 million. When corrected, Applicants’ adjusted merger-related revenue projection is \$501.8 million. The overstatement is more than*

<sup>2</sup> Exhibit 2-1 depicts the logical connection between traffic, operating, and financial elements of the application explicitly cited in the Canadian National-Illinois Central and Norfolk Southern-Conrail merger proceedings. See Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998 (CN-IC merger) and Finance Docket No. 33388, Railroad Control Application, Surface Transportation Board, June 1997 (Conrail merger). Oliver Wyman has been unable to find a clear connection between Applicants’ traffic studies, operating plan, and financial model in the Canadian Pacific-Kansas City Southern Application or work papers.

<sup>3</sup> Application Vol. 1, p. 141. All revenue figures in this report are in 2019 US dollars.

<sup>4</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

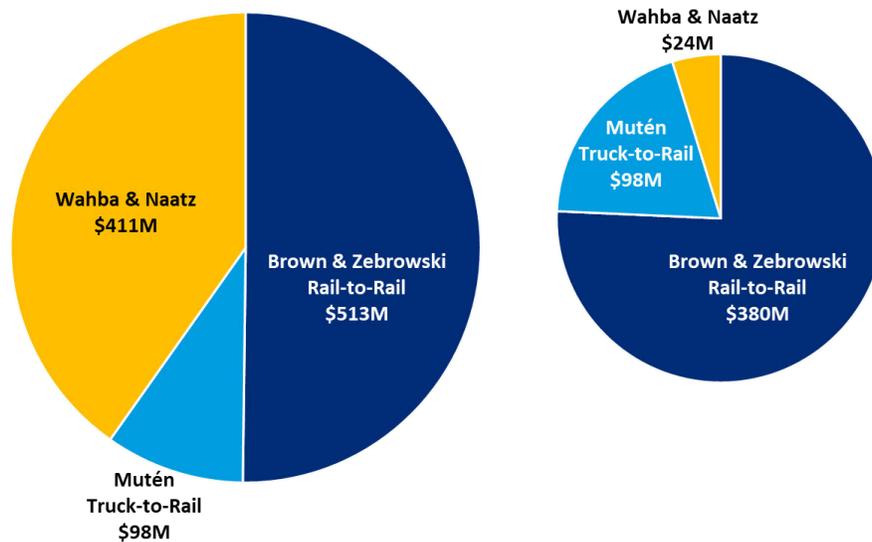
100 percent; i.e., the revenue gains claimed by Applicants are more than double the plausible incremental revenues that could be supported based on the traffic data provided in the Application and supporting work papers.

### 3. Applicants’ Incremental Traffic and Revenues of \$1.02 Billion Are Overstated by \$520 Million and Are Inaccurate

Exhibit 3-1 identifies the amount of incremental revenue that Applicants’ traffic witnesses claim the CPKC system will gain by Year 3 by diverting traffic from other railroads and motor carriers and from certain new business opportunities, and the amount of such incremental revenue that is realistic based on my testimony.

**Exhibit 3-1: Applicants’ projected incremental revenue gains from the proposed merger (left chart) and corrected totals (right chart)<sup>5</sup>**

In 2019 US dollars



<sup>5</sup> Verified Statement of Richard W. Brown and Nathan S. Zebrowski, Application Vol. 2, p. 166, Table 28; Verified Statement of Bengt Mutén, Application Vol. 2, pp. 223-224; FD 36500 - Work Paper - HC - Growth Initiative Calculations.xlsx.

Reliable traffic volume and revenue estimates are critical to virtually every other element of the Application. A feasible operating plan must be based on an accurate count of cars and trains moving along the network. The incremental increase in traffic volume likewise informs decisions regarding the capital investment required to handle that traffic safely and efficiently. Accurate train data is essential to measuring the environmental impacts of the proposed transaction. From a financial perspective, the reliability of incremental traffic and revenue estimates determines the accuracy of Applicants' expense projections and pro forma financial exhibits.

The incremental traffic and revenue estimates presented by Applicants' traffic witnesses are inaccurate and vastly overstated, for a variety of reasons. In particular, I find that:

- The rail-to-rail traffic diversions projected by witnesses Brown and Zebrowski are based on critical conceptual flaws and significant calculation errors that result in a substantial overstatement of the incremental revenue likely to be achieved as a result of the merger. Witnesses Brown and Zebrowski apply fixed diversion percentages of 25, 50, or even 75 percent that are unsupported by any credible rationale. The Brown and Zebrowski traffic study also contains substantial calculation and conceptual errors. Finally, witnesses Brown and Zebrowski inflated their diversions of grain and forest products traffic with a random, unsupported five percent "market share increase."<sup>6</sup> The result of these flaws in the Brown and Zebrowski analysis is an overstatement of rail-to-rail traffic diversion revenues attributable to the proposed merger of at least \$133 million.
- Applicants took the unusual step of "supplementing" the diversion estimates sponsored by their expert traffic witnesses (Brown, Zebrowski, and Mutén) with a verified statement by CP witness Wahba and KCS witness Naatz, who purport to identify "additional revenue opportunities" for the merged CPKC system. These additional traffic volumes and revenues – *which account for \$411 million or 40 percent of the total incremental revenue gains set forth in the Application* – are based on unrealistic

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<sup>6</sup> Brown and Zebrowski V.S., Application Vol. 2, ¶42 and ¶81.

assumptions and unsupported claims, including attributing to the merger *traffic movements in which CP and/or KCS already participate today* and other traffic gains that were excluded by Applicants' expert traffic witnesses. Those assumptions, inconsistencies, and conceptual errors invalidate as much as \$387 million (out of the total of \$411 million) in additional revenue opportunities posited by witnesses Wahba and Naatz.

In all, I estimate the \$1,021.9 million in new revenue estimated by the Applicants' diversion witnesses should be reduced to at most \$501.8 million in legitimate, plausible merger-related revenue gains. Corrections required to produce more realistic post-merger incremental revenue gains are shown in Exhibit 3-2.

**Exhibit 3-2: Applicants' diversion estimates adjusted for incorrect assumptions, inconsistencies, and conceptual errors<sup>7</sup>**

\$ millions

| Category   |            | Adjusted Total  |
|--|------------|-----------------|
| Applicants' Estimated New Revenue - Total                                  | \$ 1,021.9 |                 |
| Brown & Zebrowski Overstatement of Revenue Due to Error                    | \$ (47.4)  | \$ 974.5        |
| Brown & Zebrowski Grain and Lumber Arbitrary 5% Gain                       | \$ (86.0)  | \$ 888.5        |
| Wahba & Naatz Crude Oil Movement Announced in 2019, Prior to Merger        | \$ (158.1) | \$ 730.4        |
| Wahba & Naatz Lazaro Cardenas Intermodal Unlikely Due to High Circuitry    | \$ (107.0) | \$ 623.4        |
| Wahba & Naatz "Missed" by Other Experts - Grain                            | \$ (36.7)  | \$ 586.7        |
| Wahba & Naatz "Missed" by Other Experts - LPG                              | \$ (30.5)  | \$ 556.2        |
| Wahba & Naatz "Missed" by Other Experts – Perishables                      | \$ (54.4)  | \$ 501.8        |
| <b>CPKC Revenue Adjusted for Mistakes, Overreach, and Poor Assumptions</b> |            | <b>\$ 501.8</b> |
| <b>Revenue Overstatement</b>   |            | <b>\$ 520.2</b> |
| <b>Percent Revenue Overstated</b>  |            | <b>104%</b>     |

For the Applicants' diversion estimates to be achievable, shippers would have to agree to use longer rail routes and pay higher rates. The Applicants acknowledge that *the average route for rail-to-rail diversions on CPKC is 217 miles longer than the average route on current rail*

<sup>7</sup> Oliver Wyman work paper Corrected Revenue Summary.xlsx.

*carriers*.<sup>8</sup> Increased route length leads to increased shipment times, which impacts rail customers through the need for larger fleets to move the same traffic. Furthermore, as I demonstrate in Section 4.2, there are numerous cases where the incremental revenue assigned to CPKC greatly exceeds the revenue received by the existing carrier, in some cases by over 60 percent.<sup>9</sup>

#### **4. Applicants' Rail-to-Rail Diversion Estimates Are Not Based on a Credible Methodology and Are Overstated by More Than \$133 Million**

Applicants' estimated rail-to-rail traffic diversion revenues are conceptually and arithmetically wrong. Revenues are significantly overstated for the following reasons:

- Witnesses Brown and Zebrowski use a simplistic rule-based modeling methodology that ignores the impact of route circuitry on how divertible traffic is likely to be. This conceptual error undermines the validity of Applicants' operating plan, capital investment evidence, and assessment of environmental impacts.
- The methodology used by witnesses Brown and Zebrowski to allocate revenue to diverted traffic leads to an implausible result: According to their calculations, CPKC's post-merger revenues from diverted traffic shipments will, in many instances, substantially exceed the revenue currently earned by the railroads hauling that traffic today. This leads to at least a \$47.4 million overstatement of revenue.
- Brown and Zebrowski's traffic diversion model applies simplistic rules that are not supported by data or other credible evidence. Moreover, their projected diversions include unjustified additions of traffic outside the model. Despite modeling specific origin-destination based grain and forest product shipments that could divert to CPKC, Brown and Zebrowski add to their totals an additional 5 percent market share increase

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<sup>8</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 132, Table 6.

<sup>9</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Row ID=6422. CN received {{ }} for a shipment from Jackson, MS to Chicago, IL. CPKC was given {{ }} in incremental revenue for this projected diversion, in constant 2019 dollars. This is an increase of 62 percent.

for these products, which they distribute equally across multiple locations.<sup>10</sup> These flaws result in an \$86 million overstatement of revenue.

- An error in converting Canadian dollars to US dollars further inflates some of the revenues associated with diverted traffic.

I estimate that, collectively, these fundamental flaws in witnesses Brown and Zebrowski's analysis generate an overstatement of achievable revenue for the merged railroad from rail-to-rail diversions of more than *\$133 million or 26 percent of the total of \$513 million in rail-to-rail diversions projected by those witnesses.*

#### **4.1 The simplistic modeling methodology employed by witnesses Brown and Zebrowski ignores the effect of route circuitry and diverts traffic from customers over longer CPKC routes**

The relationship between route length and route choice is a well-established concept in transportation modeling.<sup>11</sup> This idea is both simple and intuitive: the least-cost route between an origin and a destination is likely to capture the greatest share of traffic, where cost is a function of distance.<sup>12</sup> The traffic diversion models used in prior Class I railroad merger cases have consistently recognized this principle. Indeed, Applicants' own witness, Bengt Mutén, testifies that "distance between end points" was found by his former colleagues at Reebie Associates to be one of "the primary drivers of intermodal market share."<sup>13</sup> CP witness Mutén's truck-to-rail diversion model includes two parameters based on route distance: overall truck distance and the difference between truck and rail distances.<sup>14</sup>

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<sup>10</sup> Brown and Zebrowski V.S., Application Vol. 2, ¶42 and ¶81.

<sup>11</sup> Route choice models use cost or travel time, both of which are a function of distance. *See, e.g.*, Chapter 7.2 "Route Choice," in *Transportation Demand Analysis*, Adib Kanafani, McGraw-Hill Book Company, New York, NY, 1983.

<sup>12</sup> The Board's Uniform Rail Costing System (URCS) lists distance as one of the mandatory parameters used in the railroad costing process. "Railroad Cost Program," Surface Transportation Board, User's Manual, December 2011, p. 1.

<sup>13</sup> Mutén V.S., pp. 17-18, ¶46.

<sup>14</sup> Mutén V.S., pp. 17-18, ¶46.

From a rail customer perspective, switching traffic from a shorter to a longer route can lead to increased transit times and higher transportation costs. If customers use private railcars, increased transit times require the purchase or lease of additional cars to move the same quantity of traffic, since the cycle time (origin to destination and back to origin) for each car will increase. Longer transit times also lead to increased inventory costs, since a shipment in transit is not available for productive use. Finally, switching to longer-distance routes increases the variable costs of a shipment, and these increased costs must be absorbed either by the railroad or the customer.

It appears that witnesses Brown and Zebrowski initially recognized the importance of distance in rail market share. They conducted a statistical analysis comparing the relationship between rail carriers' length-of-haul and their historical market share. But the results of their analysis – which purported to find “a weak correlation between the relative shares of traffic among the available routing options and the movement mileage for those options”<sup>15</sup> – are utterly inconsistent with both prior traffic diversion modeling and witness Mutén's truck-to-rail diversion analysis.

Using their flawed analysis as justification, witnesses Brown and Zebrowski set aside customary traffic diversion modeling principles and instead applied a set of fixed percentage-based diversion rules that are not supported by data. In an attempt to dismiss the competitive advantage enjoyed by a carrier whose route is shorter than that of a potential new entrant, witnesses Brown and Zebrowski arbitrarily assumed that any time CPKC will compete head-to-head with another railroad for single-line service, CPKC will divert a 25 percent share of traffic

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<sup>15</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 131; Mutén V.S., pp. 17-18, ¶46; FD 32549, Mark Hornung, V.S., ALK Associates.

regardless of the competing carriers' respective lengths of haul.<sup>16</sup> They assigned this same arbitrary diversion percentage rule to each traffic lane involving a single-line competitor they studied, regardless of distance, asserting (without explanation or analysis of particular movements) that their percentages are "reasonable and conservative."<sup>17</sup>

To demonstrate the fallacy of their assumption, consider the example in Exhibit 4-1. It shows that witnesses Brown and Zebrowski assigned the same 25 percent traffic diversion share regardless of whether the new CPKC single-line service route would be shorter than the existing route – such as New Orleans, LA to Superior, WI – or drastically longer, such as New Orleans to Elkhart, IN. It is simply not credible to believe that CPKC could divert the same percentage of traffic in these two lanes; nor do witnesses Brown and Zebrowski support their conclusion with any logical or established traffic analysis. The fact that Brown and Zebrowski mechanically attribute the same diversion percentage to these vastly different scenarios highlights the degree to which their approach is flawed.

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<sup>16</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 132, Table 6 and p. 183, ¶16.

<sup>17</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 183, ¶16.

**Exhibit 4-1: Witnesses Brown and Zebrowski use the same diversion percentage, regardless of whether CPKC has a shorter route or much longer route<sup>18</sup>**

| Origin          | Destination    | Current RR | Current RR Miles   | CPKC Miles | Difference in Miles | Assigned Diversion Percentage |
|-----------------|----------------|------------|--------------------|------------|---------------------|-------------------------------|
| New Orleans, LA | Superior, WI   | BNSF       | 2023               | 1675       | -348                | 25%                           |
| New Orleans, LA | Elkhart, IN    | NS         | 1075 <sup>19</sup> | 1476       | +401                | 25%                           |
| Chicago, IL     | San Angelo, TX | BNSF       | 1274 <sup>20</sup> | 1499       | +225                | 25%                           |

In total, witnesses Brown and Zebrowski diverted a total of 66,845 cars and containers that now move in single-line service at a constant rate of 25 percent, regardless of the difference in length of haul between the incumbent carrier’s single-line route and the proposed CPKC route.<sup>21</sup> It is important to note that, for these movements, the creation of a new CPKC single-line route would not, in itself, confer any advantage on the merged carrier, since an incumbent railroad already offers single-line service.

Even if Applicants’ assumed diversion of 25 percent for lanes with existing single-line service were correct on average (which is impossible to determine, since it is not based on any data), this rule still generates serious downstream problems. For example, in Exhibit 4-1, if 25 percent were a realistic average, then CPKC would, in all likelihood, gain more than 25 percent of the traffic moving from New Orleans to Superior and less than 25 percent of the shipments from New Orleans to Elkhart. But witnesses Brown and Zebrowski mechanically diverted *exactly* 25 percent of both movements. The third example in Exhibit 4-1, from Chicago, IL to

<sup>18</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Row ID (column A) 14638, 14709, and 13350. Current RR Miles from column AB and CP/KCS miles from column BI. Diversion percentage from column BZ.

<sup>19</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Row ID (column A) 14709 states the distance is 581 miles; however, this appears to be an error, so the PC\*Miler|Rail ver. 27 distance of 1,075 miles was used.

<sup>20</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Row ID (column A) 13350 states the distance is 1,104 miles; however, this appears to be an error, so the PC\*Miler|Rail ver. 27 distance of 1,274 miles was used.

<sup>21</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx. The 66,845 value was calculated by filtering Status to “Final” (column BJ) and New Percent to “25%” (column BZ) and then summing the Diversion Units (column CA).

San Angelo, TX, also receives the same 25 percent diversion, despite the CPKC route being 225 miles longer than the existing BNSF route.

This discrepancy impacts the operating plan, assessment of environmental impacts, capital investment evidence, and assumptions about impacts of the proposed merger on other railroads. Applying such a broad and unsupported diversion assumption has consequences for multiple components of the Application, including:

- **Operating plan:** Witnesses Brown and Zebrowski's indiscriminate diversion of 25 percent of the traffic in each diverted lane, rather than accounting for the real-world differences between scenarios like those in Exhibit 4-1, results in an overstatement of post-merger traffic volume in some lanes and an understatement of post-merger traffic volume in other lanes. This, in turn, means that the operating plan fails to assign the correct number of railcars and trains to the correct rail lines and yards. For the example in Exhibit 4-1, a realistic operating plan would need to provide for handling less traffic heading northeast to Elkhart and more traffic heading northwest to Superior from New Orleans.
- **Assessment of environmental impacts:** Spreading diverted traffic equally across rail lines dilutes the impact on routes where CPKC truly has an advantage in length-of-haul that might lead to diversion percentages above the arbitrary 25 percent value used by witnesses Brown and Zebrowski. Conversely, the use of a constant diversion percentage will lead to overstatement of volume increases on lines where CPKC has a distance disadvantage. Applicants' approach of applying a constant diversion percentage generates unreliable information on traffic volume increases by route, which is a primary input to the environmental assessment.
- **Capital investment evidence:** By potentially understating railcar and train counts on routes where CPKC could realistically achieve above-average diversion percentages due to length-of-haul advantages, the capital investment evidence may not properly reflect the infrastructure necessary to support the number of trains on those lines and in those yards.

- **Impact of merger on other railroads:** In the example in Exhibit 4-1, BNSF might experience more diversions than estimated by witnesses Brown and Zebrowski and NS less diversions. The true impact of the merger on other railroads, including on railroads’ line capacity, operating plans, and capital plans, cannot be determined without an assessment of traffic diversions that includes length-of-haul impacts as part of diversion modeling.

The flaws in witnesses Brown and Zebrowski’s mechanical approach likewise impacts their other estimated diversions. Witnesses Brown and Zebrowski estimate rail-to-rail diversions based on flat percentages of 25, 50, or 75, based on five “rules” that are summarized in Exhibit 4-2. But witnesses Brown and Zebrowski do not consider length-of-haul differences when applying these rules and percentages, and they offer no data, analysis, or other evidence to support such inflexible percentage-based diversion assumptions.<sup>22</sup>

**Exhibit 4-2: Witnesses Brown and Zebrowski diversion percentages<sup>23</sup>**

| Traffic Type   | Diversion Percentage/<br>Market Share |
|--|---------------------------------------|
| 1. New CPKC Single-Line Moves Replacing Other Railroads' Interline Moves       | 50%                                   |
| 2. New CPKC Single-Line Moves Replacing Other Railroads' Single-Line Moves     | 25%                                   |
| 3. CP or KCS Interline Moves Converted to CPKC Single-Line Move Closed by CPKC | 75%                                   |
| 4. Other CP or KCS Interline Moves Converted to CPKC Single-Line Move          | 50%                                   |
| 5. Remove Bridge Carrier on CPKC Route   | 75%                                   |

While differences in length-of-haul are important in any analysis of potential traffic diversions, they are of particular relevance in this case, because many of the CPKC single-line routes that will be created by the merger will be substantially longer than incumbent routing options. For example, in the New Orleans, LA to Elkhart, IN example contained in Exhibit 4-1, witnesses *Brown and Zebrowski divert railcars to a CPKC route that is 400 miles longer than*

<sup>22</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 183, ¶16.

<sup>23</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 134, Table 7.

*the existing NS route.* The CPKC route must move a shipment northwest on KCS from New Orleans to Kansas City and then head east from Kansas City to Elkhart on CP, whereas the NS route can move a shipment directly northeast from New Orleans to Elkhart. Witnesses Brown and Zebrowski were clearly aware of this fact – their testimony includes a table showing the average incremental circuitry of the merged CPKC routes, summarized below in Exhibit 4-3.<sup>24</sup> As Exhibit 4-3 shows, *new CPKC single-line routes will be, on average, 217 miles longer than the routes over which potentially divertible traffic actually moves today.* Yet, Brown and Zebrowski apparently concluded that such substantial route-distance disadvantages would not affect CPKC’s ability to divert traffic from carriers with more efficient routes.

**Exhibit 4-3: Overall average mileage characteristics for traffic eligible to be diverted<sup>25</sup>**

| Length-of-Haul | Current Railroad | CPKC  | Difference |
|----------------|------------------|-------|------------|
| Average miles  | 1,853            | 2,070 | +217       |

Given that many of the CPKC routes to which witnesses Brown and Zebrowski diverted traffic are substantially longer than the routes over which that traffic moves today,<sup>26</sup> Brown and Zebrowski’s estimate that 216,675 carloads and containers will be diverted to the CPKC network, regardless of circuitry differences, is simply not credible.

**4.2 Revenue for post-merger diverted traffic is overstated by \$47.4 million due to errors assuming CPKC revenues after the merger exceed the rates currently charged to customers**

The revenue gain for CPKC from diverted traffic should logically reflect the approximate revenue that would be lost by the railroads that currently haul that traffic. Indeed, witnesses Brown and Zebrowski “considered it appropriate to assume that CP/KCS would be *required to*

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<sup>24</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 132.  
<sup>25</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 132, Table 6.  
<sup>26</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 159.

*offer rate reductions averaging five percent in order to attract traffic away from existing single-line service.*<sup>27</sup> Yet the incremental revenue per diverted carload claimed by witnesses Brown and Zebrowski in many cases exceeds the rates currently charged by the incumbent carrier (in constant 2019 dollars). If Brown and Zebrowski's revenue estimates are accurate, it is hard to see how Applicants can claim that diverting this traffic will be beneficial to shippers, who (according to Brown and Zebrowski's revenue assumptions) would be charged significantly more than the current "going rate" to move those shipments over longer, more circuitous routes.<sup>28</sup>

Witnesses Brown and Zebrowski use the Board's Carload Waybill Sample to calculate the average revenue for a rail shipment for comparable available traffic.<sup>29</sup> The revenues were calculated for:

- **End-to-end movements** from the ultimate shipment origin to the ultimate shipment destination.
- **Segment movements** from the new CP or KCS on-point to the new CP or KCS off-point.

It is logical to expect that the revenue for a segment of a rail shipment would be *less* than the revenue for the entire rail shipment. Yet, in cases where the segment revenue exceeds the end-to-end revenue, *witnesses Brown and Zebrowski establish the illogical rule that "if the estimated end-to-end revenue amount was lower than the estimated segment revenue amount, we used the segment estimate."*<sup>30</sup> In other words, witnesses Brown and Zebrowski always selected the higher revenue.

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<sup>27</sup> Brown and Zebrowski V.S., p. 21, ¶32 (emphasis added).

<sup>28</sup> Witnesses Brown and Zebrowski show that, on average, CPKC routes are 217 miles longer than the existing route and 323 miles longer than the shortest route in the market. Brown and Zebrowski V.S., Application Vol. 2, p. 132, Table 6.

<sup>29</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 185, Appendix C, ¶2, Comparable traffic included origin and destination region, AAR car type, commodity, and car ownership.

<sup>30</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 186, Appendix C, ¶5.

To illustrate the error, Exhibit 4-4 shows the movement of a carload of { } from Bayou Pierre, LA to Chicago, IL that witnesses Brown and Zebrowski diverted from a KCS-CN interline route to CPKC. The pre-merger route for this shipment involves the KCS line from Bayou Pierre, LA to Jackson, MS, which generates {{ }} in revenue per carload for KCS. The shipment then interchanges to CN at Jackson, MS, generating {{ }} in revenue per carload for CN for the move between Jackson, MS and Chicago, IL. Cumulatively, the current revenue per carload on this movement is {{ }}.

Witnesses Brown and Zebrowski predict that after the merger, this traffic will be diverted to a CPKC single-line route, traveling from Bayou Pierre to Kansas City, MO on KCS lines, and then from Kansas City to Chicago on CP lines. The claimed incremental revenue on this movement is {{ }} per carload, which is {{ }} higher than the current rate for the entire KCS-CN route via Jackson. Witnesses Brown and Zebrowski further compound this higher rate by failing to subtract the {{ }} that KCS already receives for the movement from Bayou Pierre to Jackson. The error is that {{ }} is not incremental revenue, since the {{ }} already received by KCS is not removed.<sup>31</sup>

**Exhibit 4-4: Example of the revenue error by witnesses Brown and Zebrowski<sup>32</sup>**

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<sup>31</sup> Witnesses Brown and Zebrowski average the revenue for each individual diversion with revenues for similar diversions and apply the averages in FD 36500 – Work Paper – HC – 8 – Diversion Identification, Results tab. Overstating the revenue for individual diversions leads to an overstatement of the averages, and therefore an overstatement of the total revenue.

<sup>32</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Row ID=6422. Map from PC\*Miler|Rail, ver. 27.

}}

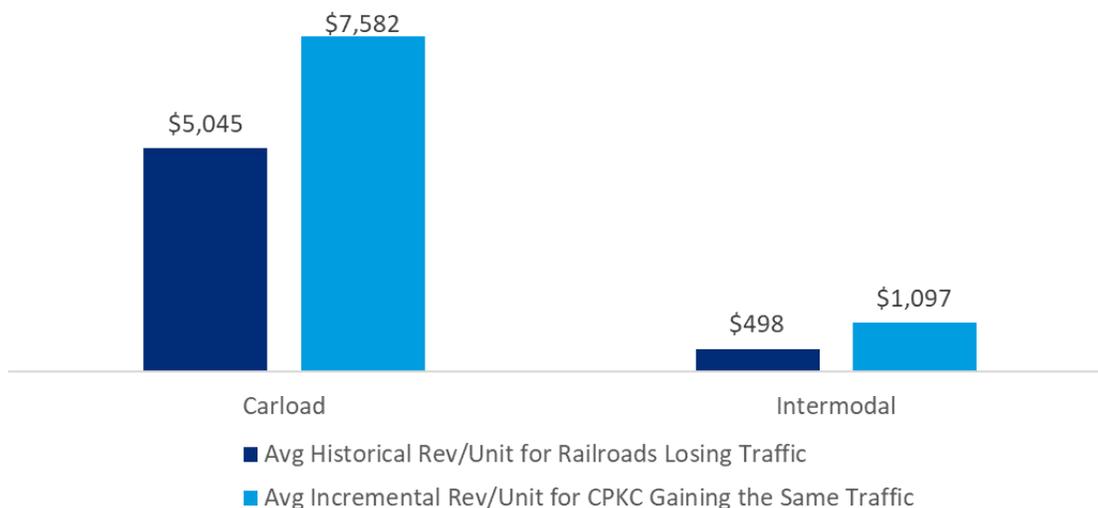
The source of the overstatement of revenue can be traced back to the illogical rule to use the segment revenue if it exceeds the end-to-end revenue. The {{ }} in incremental revenue used by witnesses Brown and Zebrowski in the Bayou Pierre – Chicago example is actually the segment revenue from Jackson, MS to Chicago, IL, as calculated from the Board’s Carload Waybill Sample. This segment revenue exceeded the end-to-end revenue from Bayou Pierre to Chicago, therefore witnesses Brown and Zebrowski selected the higher value, based on their rule. Because they considered it a segment rather than an end-to-end move, the existing KCS segment revenue from Bayou Pierre to Jackson was not subtracted.

To correct this example, I used the end-to-end revenue for Bayou Pierre to Chicago calculated by witnesses Brown and Zebrowski from the Board’s Carload Waybill Sample and then subtracted the existing KCS revenue from Bayou Pierre to Jackson. So, instead of the {{ }} incremental revenue claimed by witnesses Brown and Zebrowski, my calculation using their values shows an end-to-end revenue of {{ }} minus the existing KCS revenue of {{ }}, to yield an incremental revenue to CPKC of {{ }}, which is {{ }} percent less than the current CN revenue of {{ }}.

Bayou Pierre to Chicago is not an isolated case. Witnesses Brown and Zebrowski select the higher segment revenue when it exceeds the end-to-end revenue for 52,927 of the 201,707 diverted railcars and containers (26.2 percent).<sup>33</sup> This results in incremental revenue added to CPKC that greatly exceeds the revenue lost by the current railroad, as shown in Exhibit 4-5.

**Exhibit 4-5: Witnesses Brown and Zebrowski assign significantly more revenue to CPKC than was lost by the current carrier<sup>34</sup>**

Revenue per carload or container



For carload traffic, the average revenue per car for the non-CP/KCS portion of the move lost by the current carrier is \$5,045, while the incremental revenue added by witnesses Brown and Zebrowski as a benefit of the merger is \$7,582. For intermodal traffic, the average revenue per container for the non-CP/KCS portion of the move lost by the current carrier is \$498, while the incremental revenue added by witnesses Brown and Zebrowski as a benefit of the merger is \$1,097.

<sup>33</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab. “CWS Segment > End to End Flag” (column CF) is 1. The 201,707 is the number of diverted cars and containers, excluding the 14,968 additional grain and forest products diversions (see Brown and Zebrowski V.S., Application Vol. 2, p. 159, Table 26).

<sup>34</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Filters were Non-CP/KCS Revenue/Car > 0 (col AD), Route Filter Flag = 0 (col BY), Diversion Units > 0 (col CA), and CWS Segment > End to End Flag = 1 (col CF). For Non-CP/KCS Revenue/Car, all records with a zero or negative value were excluded from the exhibit.

Applicants' experts appear to assume that customers after the merger will choose CPKC as a rail carrier even if distances are longer and rates are higher than those of the current rail movement. Absent competitive foreclosure by CPKC, this is not a logical assumption. Furthermore, witnesses Brown and Zebrowski's flawed use of the higher revenues (when the segment revenue exceeds the total revenue for the movement) falls disproportionately on shippers in Illinois and Michigan. Illinois originates or terminates 29 percent of the carloads and containers where witnesses Brown and Zebrowski selected the higher revenue, while Michigan originates or terminates 14 percent of the diverted carloads and containers.<sup>35</sup>

By applying the simple correction used in the Bayou Pierre – Chicago example to the diverted traffic in witnesses Brown and Zebrowski's Diversion Identification spreadsheet, I estimate that witnesses Brown and Zebrowski have overstated revenues by at least \$47.4 million due to this error. My correction was to use the end-to-end revenue minus the existing CP-KCS revenue, rather than repeating the error made by witnesses Brown and Zebrowski of taking the higher segment revenue and not subtracting existing CP-KCS revenue to eliminate double counting.

However, this simple correction does not fully capture the magnitude of the error. For example, in an intermodal move from Chicago, IL to Laredo, TX, BNSF originates the traffic and interchanges with KCS for furtherance to Mexico. The historical data in witnesses Brown and Zebrowski's work papers show a revenue of {{ }} for KCS and {{ }} for BNSF, for a total revenue/container of {{ }}. The incremental CPKC revenue assigned by witnesses Brown and Zebrowski for this move is {{ }}, and when added to the existing KCS revenue, brings the total to {{ }}, which is { } percent above the historical 2019 revenue. I applied the

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<sup>35</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab.

correction of subtracting the historical KCS revenue from the estimate by witnesses Brown and Zebrowski for end-to-end revenue, yielding an incremental revenue of {{ }} and a total revenue of {{ }}, which is still { } percent above the existing historical revenue.<sup>36</sup>

The challenge to determining the full magnitude of the error by witnesses Brown and Zebrowski is the poor data quality in their work papers for the historical revenue received by the non-CP/KCS carrier. In many cases, their work paper assigns revenue of zero, or even negative revenue, to the third-party railroad. For example, on a movement from Toluca, EM to Cottage Grove, MN, the revenue shown for the BNSF portion of the move is {{ }}.<sup>37</sup> This move was diverted to a CPKC route and assigned an incremental revenue of {{ }} for the CPKC diversion of the BNSF segment.<sup>38</sup>

#### **4.3 Diversion estimates include arbitrary and unsubstantiated additions for grain and lumber traffic that overstate revenue by \$86 million**

After applying an across-the-board percentage-based diversion approach to movement-specific rail-to-rail traffic diversion judgments, witnesses Brown and Zebrowski arbitrarily increased their post-merger diversion estimate by adding another \$86 million in incremental revenue from grain and lumber traffic.

Specifically, they assumed that merger synergies would enable the merged CPKC system to capture a five percent increase in market share for cereal grain exports to Mexico (Exhibit 4-6).<sup>39</sup>

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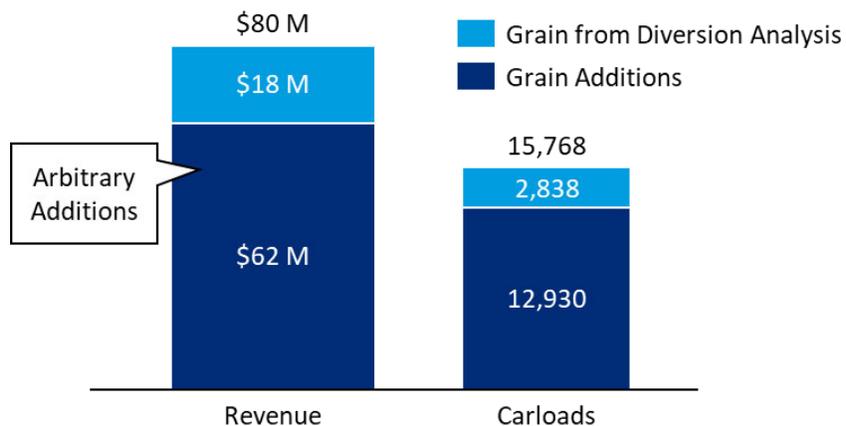
<sup>36</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Row ID = 2693.

<sup>37</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Row ID = 11979, column AD.

<sup>38</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Calculations tab, Row ID 11979, column CL.

<sup>39</sup> Brown and Zebrowski, V.S., Application Vol. 2, ¶42.

Exhibit 4-6: Witnesses Brown and Zebrowski grain diversion breakdown<sup>40</sup>



This (unexplained) assumption, which increases total revenues from diverted grain shipments in the Brown and Zebrowski diversion model by more than 340 percent, does not appear to be based on any movement-specific analysis. Indeed, witnesses Brown and Zebrowski do not even identify the specific origins and destinations between which these shipments would move. Rather, they simply assume that “For purposes of developing operating outputs for use in the Operating Plan, we estimate that these carloads would be distributed proportionally across the CP-served grain-supply regions that would be newly accessible via single-line routes.”<sup>41</sup> There is no justification or evidentiary support for either this arbitrary increase in CPKC’s post-merger grain traffic – which accounts for nearly 17 percent of all projected rail-to-rail traffic diversion revenues – or for the random distribution of this traffic across the grain producing regions that CP serves.

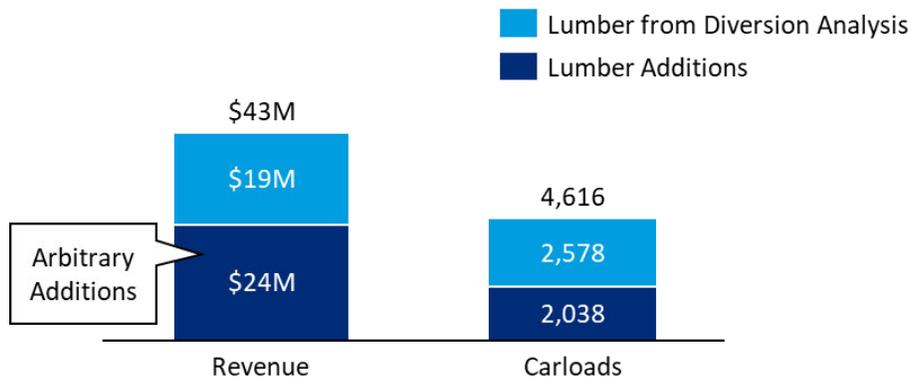
Witnesses Brown and Zebrowski likewise assume an arbitrary five percent market share increase on Canadian lumber exports to Dallas. They then apply a 15 percent growth rate to this market share gain to account for growth between 2019 and 2021 (Exhibit 4-7), despite all other

<sup>40</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Results tab.

<sup>41</sup> Brown and Zebrowski V.S., p. 26, ¶42.

traffic in their study being based on Base Year 2019 volumes.<sup>42</sup> Witnesses Brown and Zebrowski provide no analysis or calculations to support these market share and growth assumptions. In total, these adjustments account for 2,038 additional carloads, or *56 percent of all incremental revenue from lumber diversions*.<sup>43</sup>

**Exhibit 4-7: Witnesses Brown and Zebrowski lumber diversion overstatement<sup>44</sup>**



Given the complete lack of analytical support for these “additional opportunities” (not to mention the methodological inconsistency of arbitrarily adding traffic and revenue that was not identified by Applicants’ traffic diversion model in the first place), these incremental traffic and revenue gains should be excluded from any realistic evaluation of the rail-to-rail traffic likely to be captured by the merged CPKC system.

#### **4.4 Applicants made a currency conversion error of Canadian dollars to US dollars that further inflated the revenues likely to be achieved from diverted traffic**

In addition to the methodological errors and inconsistencies discussed above, witnesses Brown and Zebrowski made a significant calculation error that further inflated their revenue projections. A portion of the Canada traffic in the rail-to-rail diversion model contains a currency

<sup>42</sup> Brown and Zebrowski V.S., Application Vol. 2, p. 156, Table 23.

<sup>43</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Results tab, Forest Products (Line 16) and Grain (Line 18).

<sup>44</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification.xlsx, Results tab.

conversion error that resulted in an overstatement of revenue. The average exchange rate in 2019 was 0.754 US dollars for one Canadian dollar.<sup>45</sup> Witnesses Brown and Zebrowski rounded this to 0.75. Their SQL code, shown below, states that if Currency = 'C' for Canadian, then divide the Tot\_Rev by 0.75 and reassign the value to Tot\_Rev.<sup>46</sup>

*Set [Tot\_Rev] = case when Currency = 'C' then [Tot\_Rev]/.75*

The problem is that *witnesses Brown and Zebrowski should have multiplied rather than divided*. One Canadian dollar *divided* by 0.75 incorrectly converts to 1.33 US dollars, not the correct value of 0.75 US dollars. This miscalculation inflated the revenues on shipments with a currency conversion by 78 percent. This error is illustrated in Exhibit 4-8, where witnesses Brown and Zebrowski calculate the incremental revenue for a movement as **{{ }}**, when the correct revenue in US dollars should be **{{ }}**.

**Exhibit 4-8: Example of Brown and Zebrowski overstated revenue due to CAD to USD currency error<sup>47</sup>**

| Origin        | Orig. RR | Destination  | Dest. RR | Commodity    | Incremental Revenue/Car | Corrected Revenue/Car |
|---------------|----------|--------------|----------|--------------|-------------------------|-----------------------|
| Saskatoon, SK | CP       | Longview, TX | UP       | <b>{{ }}</b> | <b>{{ }}</b>            | <b>{{ }}</b>          |

The precise impact of this error on Applicants' overall incremental traffic revenue estimate is difficult to determine, because the error occurs at the data extraction step, prior to the estimation of diversions. To calculate the impact of the error would require a full rerunning of Brown and Zebrowski's SQL code and recreating their diversions.<sup>48</sup>

<sup>45</sup> The US Internal Revenue Service lists the average exchange rate in 2019 as 1.327 Canadian dollars for 1 US dollar, or 0.754 US dollars per Canadian dollar.

<sup>46</sup> Line shown is from FD 36500 – Work Paper – HC – 1 - Traffic Consolidation.sql, Line 584, shown in Oliver Wyman work paper HC- Currency Conversion Error.txt.

<sup>47</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification, tab Calculations, Row ID 922. Incremental revenue per car is from cell CL 927. Corrected Revenue/Car = (\$11,012\*0.75)\*0.75 = \$6,194.

<sup>48</sup> The error is contained in FD 36500 – Work Paper – HC – 1 - Traffic Consolidation.sql, lines 582 through 587.

## **5. Certain Additional Claimed Incremental Revenues of \$386.7 Million Are Unsubstantiated or Unrelated to the Merger**

Applicants took the unusual step of “supplementing” the traffic diversion studies conducted by their expert traffic witnesses with a verified statement sponsored by company witnesses Wahba and Naatz, who purport to identify a number of “additional revenue opportunities” for the merged CPKC system. Witnesses Wahba and Naatz claim that those opportunities will generate an additional \$411 million in annual revenue for the merged CPKC. *This represents fully 40 percent of the total incremental revenue from traffic diversions identified in the Application.*

This incremental traffic and revenue is questionable in terms of why it was not identified in the diversion analyses presented by Applicants’ experts. In addition, the supplemental traffic and revenue gains sponsored by witnesses Wahba and Naatz suffer from several conceptual and methodological errors that render their conclusions invalid. The vast majority of this claimed additional incremental revenue should be excluded from any realistic assessment of the traffic and revenue impact of the proposed CPKC merger for the following reasons, which are discussed in detail below:

- Nearly 40 percent of the revenue from additional traffic opportunities posited by witnesses Wahba and Naatz is attributable to traffic gains that are unrelated to the merger.
- Several supposed revenue opportunities involve impractical, circuitous, and complicated routes.
- Applicants’ expert traffic witnesses did not divert the traffic identified by witnesses Wahba and Naatz.

I estimate that in total, these assumptions, inconsistencies, and conceptual errors result in an overstatement of as much as \$387 million (out of a total of \$411 million) of the additional revenue opportunities posited by witnesses Wahba and Naatz.

**5.1 Nearly \$158.1 million (40 percent) of the revenue from additional traffic opportunities posited by witnesses Wahba and Naatz is attributable to traffic gains that are unrelated to the merger**

The single largest “opportunity” cited by witnesses Wahba and Naatz (accounting for \$158.1 million in incremental revenue) is a crude oil movement from Hardisty, AB to Port Arthur, TX.<sup>49</sup> However, as the press release reproduced as Exhibit 5-1 clearly indicates, that traffic opportunity pre-dates the merger. The plan for the new movement was made public by the shipper, Gibson Energy, *in December 2019*. According to witnesses Wahba and Naatz, “CP’s evaluation of specific traffic growth opportunities thus *began* at the very outset of our pursuit of KCS *in late 2020*” – *nearly a year after the Gibson Energy press release*.<sup>50</sup> Witnesses Wahba and Naatz also state that discussions with customers regarding the additional traffic opportunities in their testimony did not occur until CP and KCS announced their plans in March 2021.<sup>51</sup> If that statement is true, merger-related discussions could not have occurred with Gibson Energy at the time of the 2019 press release.<sup>52</sup>

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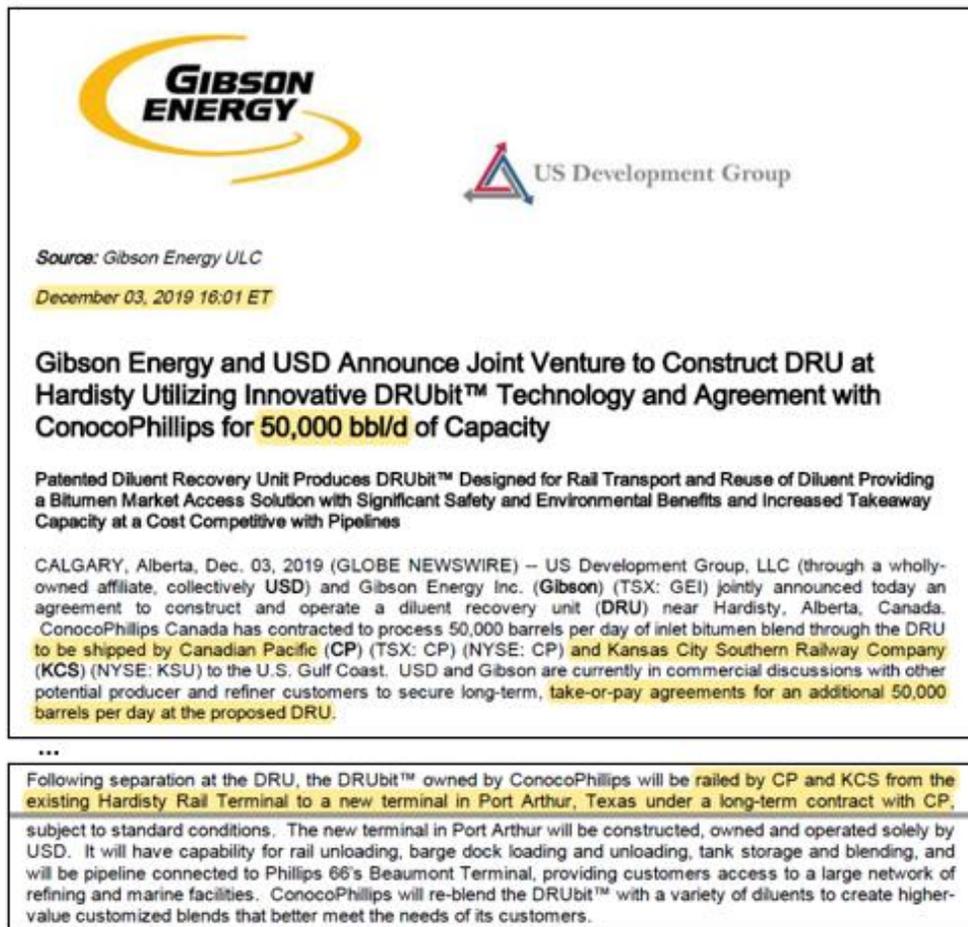
<sup>49</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

<sup>50</sup> Verified Statement of Jonathan Wahba and Michael J. Naatz, ¶6.

<sup>51</sup> Wahba and Naatz V.S., ¶11.

<sup>52</sup> Wahba and Naatz V.S., ¶11.

Exhibit 5-1: Announced joint CP and KCS crude oil move from Hardisty, AB to Port Arthur, TX: December 2019 press release<sup>53</sup>



In addition, Gibson Energy announced in December 2021 “the DRU Fully Operational, including shipment of DRUbit™ By Rail™” from the facility in Hardisty, AB to Port Arthur, TX.<sup>54</sup> Canadian Pacific shared that announcement on social media the same day, including a photograph of a CP train departing the Hardisty facility.<sup>55</sup> In short, this rail movement clearly predates the merger.

<sup>53</sup> Press release, Global Energy ULC, December 3, 2019.

<sup>54</sup> “Gibson Energy and US Development Group declare the DRU Fully Operational, including shipment of DRUbit™ By Rail™,” PR Newswire, December 14, 2021.

<sup>55</sup> Canadian Pacific, Twitter @CanadianPacific, December 14, 2021.

The Gibson Energy announcement involved an agreement to ship 50,000 barrels per day with a take-or-pay for an additional 50,000 barrels per day, which is equivalent to approximately 50,000 annual tank cars.<sup>56</sup> Witnesses Wahba and Naatz claim that the fully phased in number of units is 51,840 annual tank cars – almost identical to the volume mentioned in the Gibson Energy press release of 2019.<sup>57</sup>

Because this incremental revenue opportunity was announced publicly more than a year before the CP-KCS merger was announced and is operational now, it clearly did not come to pass because of the proposed merger, and therefore cannot properly be considered a result of, or synergy generated by, the merger.

## **5.2 Additional diversion revenue opportunities of \$107 million involve impractical, circuitous, and complicated routes**

Certain other revenue opportunities claimed by witnesses Wahba and Naatz are implausible because they fail to account for the reality of global supply chains or the circuitry of the longer rail and maritime routes that would make it difficult for CPKC to capture that traffic.

For example, the Application assumes that CPKC will capture incremental traffic and revenue by shifting international container traffic that currently moves via the Port of Los Angeles/Long Beach to destinations such as Chicago, New York, and Toronto to more complex and circuitous water and rail routes via the Port of Lazaro Cardenas (on the Mexican Pacific coast) and KCSM/KCS/CP. Witnesses Wahba and Naatz use a distorted map (reproduced in Exhibit 5-2) in an attempt to show that such a routing would be a viable competitive alternative

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<sup>56</sup> A tank car can hold about 560 barrels of heavy crude oil. Wahba and Naatz claim tank cars can haul 20-30 percent more DRUbit, so  $(365 \text{ days} \times 100\text{kbd}/(560 \text{ bbl}/0.75)) = 48,900$  annual tank cars. The API gravity for Canadian heavy crude oil is 9° to 11° (see [API Gravity](#), Oil Sands Glossary). A 10° API gravity weights 8.328 lbs./gallon, or 350 lbs./barrel at 42 gallons/barrel (see [API Gravity \(engineeringtoolbox.com\)](#)). A 195,900 lbs. net weight limit for a tank car would allow for 560 barrels of heavy crude oil.

<sup>57</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

to the shorter routes over which the traffic already moves. This map misrepresents the operational challenge of routing international container traffic bound to US destinations via the Port of Lazaro Cardenas.

To test the Wahba and Naatz hypothesis, I used the industry standard software program PC\*Miler|Rail to calculate the distance between the Port of Los Angeles/Long Beach and Chicago via BNSF and the distance between the Port of Lazaro Cardenas and Chicago on a hypothetical CPKC network. As shown in a more accurate map in Exhibit 5-3, the rail route from LA/Long Beach to Chicago is 2,195 miles long, while the rail route via KCSM/KCS/CP from Lazaro Cardenas would be 2,650 miles. The difference is 455 miles, or nearly a 21 percent increase in rail distance, making the route from Lazaro Cardenas slower, less economical, and less environmentally friendly.

Exhibit 5-2: CPKC map of proposed route from Port of Lazaro Cardenas, which distorts differences in distance versus the Port of Los Angeles<sup>58</sup>

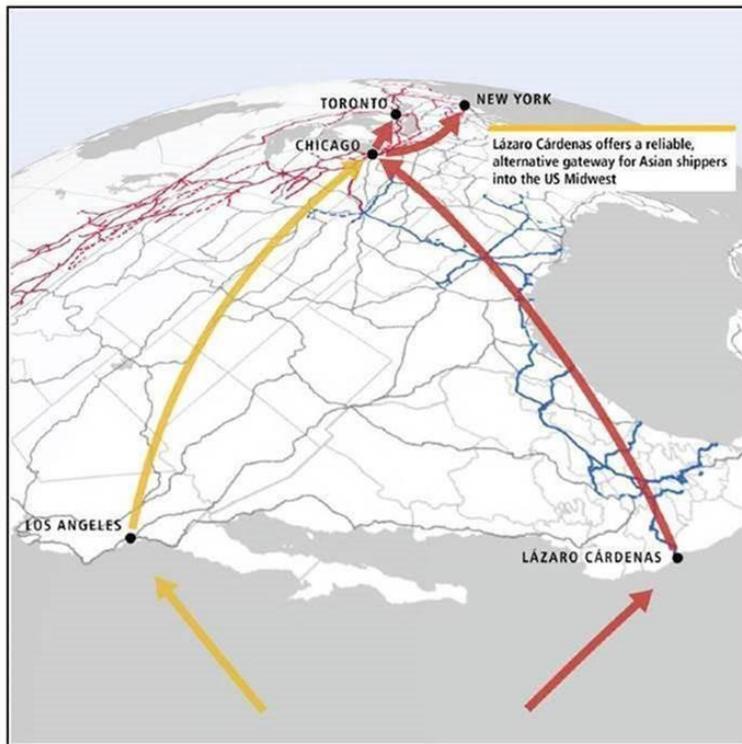
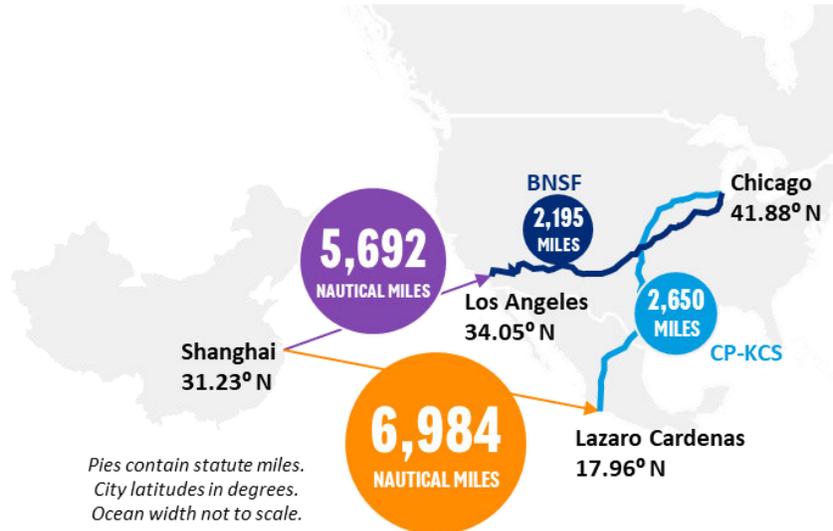


Exhibit 5-3: Oliver Wyman map of proposed route from Lazaro Cardenas, which better shows the 1,300 nautical-mile and 455 rail-mile differences when compared to the Port of Los Angeles<sup>59</sup>



<sup>58</sup> Wahba and Naatz V.S., p. 28, Figure 6. Two trains per day based on Wahba and Naatz claim of 130,000 containers per year.

<sup>59</sup> Shanghai to Los Angeles is 5,692 nautical miles and Shanghai to Lazaro Cardenas is 6,984 nautical miles, based on [Portworld.com Distance Calculator](http://Portworld.com) from S&P Global Platts. Nautical miles converted to statute miles using 6,080 ft/5,280 ft. A “standard” nautical mile is 6,080 feet versus a statute mile of 5,820 feet, though this is an approximation, since distances vary by latitude (see [Royal Museums Greenwich](http://Royal Museums Greenwich)).

Witnesses Wahba and Naatz not only obscure the substantial *rail* routing circuitry implied by their proposed diversion, they also fail to consider the additional length of the *maritime* route that would be required to divert intermodal traffic originating in East Asia to the Port of Lazaro Cardenas. Using Shanghai (the largest container port in the world<sup>60</sup>) as an example, a ship traveling to Los Angeles/Long Beach would travel approximately 5,692 nautical miles. By comparison, the journey from Shanghai to Lazaro Cardenas would cover 6,984 nautical miles. Thus, a container ship would need to travel an additional 1,292 nautical miles, an increase of 23 percent, to get from Shanghai to Lazaro Cardenas as compared to Los Angeles. This added distance over the ocean further undermines the economics, operational efficiency, and environmental merits of diverting intermodal traffic to Lazaro Cardenas, as posited by Applicants.

The noncompetitive nature of a proposed route involving an additional 1,292 nautical miles plus an additional 455 rail miles is underscored by the fact that *Lazaro Cardenas currently handles almost no traffic destined to any point in the United States.*<sup>61</sup> In any event, CP already has a better option to reach Chicago via the Port of Vancouver, which involves both a shorter rail route and a shorter maritime distance from East Asia than a route via Lazaro Cardenas.

The claimed diversion to Lazaro Cardenas of containers destined for Toronto and New York City posited by the Applicants is even less feasible. To reach Toronto from Lazaro Cardenas, traffic would:

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<sup>60</sup> See “[Shanghai port retains crown as the world’s busiest container port](#),” Seatrade Maritime News, January 6, 2021.

<sup>61</sup> CP-KCS waybill data provided by FTI, summarized in Oliver Wyman work paper HC- Lazaro Cardenas – USCanada Traffic.xlsx. Waybill records show { } loaded containers from the Port of Lazaro Cardenas to Kendleton, TX and { } empty cars between the Port of Lazaro Cardenas to/from the US and Canada in 2019.

- Incur 436 miles of additional rail distance compared to the shorter route from Los Angeles/Long Beach;<sup>62</sup>
- Then travel through some of the most congested rail segments in the nation (including the use of terminal railroads in the Chicago area, as well as several congested crossings);
- Then move via trackage rights on Norfolk Southern to reach the Detroit-Windsor tunnel (which has clearance restrictions for double stack containers), *or*
- Be transferred to CSX for movement (via haulage rights) to Buffalo, NY, where it would be interchanged back to CP for movement to Toronto.<sup>63</sup>

Needless to say, these options are vastly inferior to the available direct routings on either CP or CN from Vancouver, or via UP or BNSF from Los Angeles/Long Beach with an interchange to CN at Chicago.

Routing traffic from Lazaro Cardenas to New York City via CPKC also would be noncompetitive: Intermodal traffic originating on KCSM already has a more direct routing option over the Meridian Speedway to Norfolk Southern, instead of using any portion of the CP network. The route from Lazaro Cardenas to New York via the existing KCS-NS interchange at Meridian, MS is 489 miles shorter than a route from Lazaro Cardenas to New York involving a KCS-CP interchange at Kansas City.<sup>64</sup>

Finally, witnesses Wahba and Naatz quote Mr. Jonathan Sinton, Regional Head of Procurement of A.P. Moller-Maersk, as stating the KCS combination with CP promises to “open

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<sup>62</sup> PC\*Miler|Rail ver. 27. Distance for Long Beach-BNSF-Chicago-CP-Toronto is 2,722.4 miles, provided the traffic can use NS trackage rights in Michigan and has clearance to use the Detroit Tunnel. Distance for Lazaro Cardenas-KCSM-Laredo-KCS-Kansas City-CP-Toronto is 3,157.9 miles, with same assumptions about trackage rights and tunnel clearance.

<sup>63</sup> One of the two Detroit tunnel tubes in 1993 was enlarged to handle auto racks and international doublestack containers. But the tunnel cannot handle doublestacked domestic containers. So CP’s current Montreal-Chicago intermodal trains, which include both international and domestic boxes, run via CSX between Buffalo, NY and Chicago. See: “[CP sought to control its own destiny with Detroit tunnel purchase](#),” *Trains*, October 20, 2020.

<sup>64</sup> PC\*Miler|Rail ver. 27. Distance for Lazaro Cardenas-KCSM-Laredo-KCS-Meridian-NS-Oak Island is 3,073.9 miles versus Lazaro Cardenas-KCSM-Laredo-KCS-Kansas City-CP-Chicago-NS-Oak Island which is 3,562.6 miles.

up new options for efficient intermodal rail transportation all the way into America’s Heartland.”<sup>65</sup> However, witnesses Wahba and Naatz fail to mention Mr. Sinton’s very next sentence, where he states, “*We don’t expect these options to supplant the current options from ports on the U.S. West Coast.*”<sup>66</sup> (Emphasis added.)

Witnesses Wahba and Naatz claim that traffic diverted from the Ports of Los Angeles/Long Beach to the Port of Lazaro Cardenas will generate 130,000 containers, totaling \$107 million in annual merger-related revenue for CPKC.<sup>67</sup> They even attribute \$21.1 million of the \$107 million in merger-related benefits to Lazaro Cardenas – Kansas City diversions and another \$22.9 million to Lazaro Cardenas-Dallas diversions, *routes where KCS could provide single-line service on a stand-alone basis today.*<sup>68</sup> The Port of Lazaro Cardenas is simply not a realistic alternative to Los Angeles/Long Beach, given the increased distances and the presence of more competitive alternatives, such as the Port of Vancouver.

### **5.3 Witnesses Wahba and Naatz claim approximately \$122 million in diversions that were apparently “missed” by Applicants’ diversion experts in LPG, grain, and perishable commodities**

After engaging expert witnesses Brown and Zebrowski to estimate potential rail-to-rail traffic diversions and expert witness Mutén to analyze potential truck-to-rail diversions, Applicants took the unusual step of adding to their estimates of incremental traffic revenues the “additional revenue opportunities” discussed above. But Applicants offer no explanation as to why their outside traffic experts either “missed” such consequential traffic opportunities or failed to include them in their estimates of post-merger CPKC traffic.

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<sup>65</sup> Wahba and Naatz V.S., Application Vol. 1, p. 273, ¶64.

<sup>66</sup> Letter from Mr. Jonathan Sinton, Application Vol. 3, p. 153.

<sup>67</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

<sup>68</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

An estimated \$121.7 million in revenue for liquified petroleum gas (LPG), grain, and perishables was added by witnesses Wahba and Naatz, even though Applicants' witnesses Brown, Zebrowski, and Mutén analyzed the potential for diverting shipments of those commodities in their testimony.

**LPG (\$30.5 million):** Witnesses Wahba and Naatz identified existing rail shipments of LPG as likely diversion candidates. This claimed “additional opportunity” accounts for 4,300 carloads of LPG – a volume that is nearly triple the 1,545 carloads that Brown and Zebrowski deemed divertible – and generates an additional \$30.5 million in post-merger revenues for the CPKC system.<sup>69</sup> Applicants offer no explanation for, or reconciliation with, Brown and Zebrowski's findings regarding the sources and volumes of divertible LPG traffic. Witnesses Wahba and Naatz vaguely mention a possible CPKC investment in a new LPG origin facility, but that investment is not reflected in Applicants' capital expense evidence.<sup>70</sup> Moreover, 2,600 carloads of the LPG traffic that Wahba and Naatz identified move between Saskatchewan and Mexico. However, Applicants' own work papers indicate that there were only {{ }} total carloads of LPG traffic between Saskatchewan and Mexico in the Base Year<sup>71</sup> – which means that witnesses *Wahba and Naatz are claiming traffic that does not currently exist*. By comparison, *Applicants' outside traffic experts found only seven carloads of LPG between these locations to be divertible*.<sup>72</sup>

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<sup>69</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx; Brown and Zebrowski V.S., Application Vol. 2, p. 154, Table 21.

<sup>70</sup> Verified Statement of Elphick and Orr, Application Vol. 2, pp. 81-91, provides capital expenditures for track, yards, and terminals. There is no mention of any LPG facility investment for Canada.

<sup>71</sup> FD 36500 – Work Paper – HC – 4 - Traffic Screening.xlsx. On the CPKCS Combined Traffic Tapes tab, filtered column E as “SK,” and column N to “MX,” and column AD as “L.P.G.” Summed column V to obtain {{ }}.

<sup>72</sup> FD 36500 – Work Paper – HC – 8 - Diversion Identification, tab Calculations, Row ID 877 and 878.

**Grain (\$36.7 million):** Witnesses Wahba and Naatz projected an additional \$36.7 million in incremental revenue from rail-to-rail grain diversions, consisting of 3,630 carloads of soybeans and 3,000 carloads of DDGs and sweeteners.<sup>73</sup> These diversions are in addition to the volumes of those commodities that Applicants’ expert traffic witnesses identified as divertible (3,684 carloads of soybeans and 2,650 carloads of DDGs and sweeteners), effectively doubling the diversion total for each commodity.<sup>74</sup> Applicants offer no explanation for or reconciliation with witnesses Brown and Zebrowski’s findings with respect to these grain shipments.

**Perishables (\$54.4 million):** Witnesses Wahba and Naatz also project that CPKC will earn an additional \$54.4 million in incremental revenues from perishables truck-to-rail diversions.<sup>75</sup> Specifically, they divert to the CPKC network 24,748 units of perishables in 53-foot refrigerated containers that move by truck from Michoacán/Veracruz, Mexico to Chicago, the Twin Cities, and Kansas City.<sup>76</sup> Applicants’ own truck-to-rail diversion expert Mutén concluded that only a much smaller volume of this perishable traffic would be divertible: 374 units, with associated revenues of just \$0.6 million.<sup>77</sup> Witness Mutén explained why he did not include the 24,748 units diverted by witnesses Wahba and Naatz: “Most of these volumes flow out of Mexico to intermediate destinations [sic] in border states and later move to the Midwest.”<sup>78</sup> Witnesses Wahba’s and Naatz’s “analysis” of this “additional opportunity” appears to consist of (i) estimating that five million tons of produce moved from Mexico to wholesaler markets in border states, (ii) assuming that CPKC could capture ten percent of such traffic, and (iii) diverting that ten percent from truck to CPKC. Applicants do not explain why these shipments are divertible,

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<sup>73</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

<sup>74</sup> Brown and Zebrowski V.S., p. 26, Table 11 and p. 28, Table 12.

<sup>75</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

<sup>76</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

<sup>77</sup> Mutén V.S., p. 22.

<sup>78</sup> Mutén V.S., p. 22.

or why witness Mutén (who clearly was aware of the movements) did not judge them to be divertible.

In sum, witnesses Wahba and Naatz “found” an additional \$121.7 million in diversion revenue that was not identified by Applicants’ diversion experts, with no explanation or facts to support why these additional revenues are credible and should be included in the Application.

**VERIFICATION**

I, David Hunt, declare under penalty of perjury that the foregoing information is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on this 28th day of February, 2022.

A handwritten signature in black ink, appearing to read "David Hunt", is written over a horizontal line. The signature is stylized and cursive.

David Hunt

## Appendix A. Resume of David Hunt

Mr. Hunt, a Vice President in Oliver Wyman's Transportation & Service practice, has over 30 years of experience in the areas of transportation operations and strategic planning, national and regional transportation policy, and network modeling and operations research. Mr. Hunt focuses on projects involving regulatory and policy analysis, strategic planning, and operational improvements. His projects include:

- Developed a market share model that predicted truck/rail shares and volumes under various scenarios, including autonomous truck technologies and the potential responses by the rail industry.
- Worked with a Class I railroad to explore opportunities and the value of adopting predictive maintenance practices for their railcar fleet.
- Prepared several policy white papers filed with the US Department of Transportation, addressing issues such as positive train control and the use of electronically controlled pneumatic brakes.
- Called as an expert witness in rail capacity modeling as part of an international arbitration case in South America.
- Participated in discussions with the Mexican government that led to a favorable ruling for the rail industry regarding proposed regulatory action to promote competition through expanded interconnection of rail services.
- Managed the design and development of BlueNet, a facility location model used in network design.
- Developed a simulation model that showed the benefits of operating a nationwide railcar pool, the results of which were used in a Surface Transportation Board proceeding to reauthorize the operation of the pool.
- Worked with a rail industry supplier to restructure their support services, incorporating predictive maintenance tools for safer and more reliable operations.

Prior to joining Oliver Wyman, Mr. Hunt was a Senior Associate at Cambridge Systematics. Mr. Hunt also was a Vice President at ALK Associates. Mr. Hunt is active in the Institute for Operations Research and the Management Sciences (INFORMS), where he was the recipient of the 2017 INFORMS President's Award. He currently serves on the INFORMS Board of Directors as Treasurer and is a member of the Transportation Research Board's Railroad Operating Technologies Committee.

Mr. Hunt earned a BS in civil engineering from West Virginia University and a MSE from the Civil Engineering and Operations Research Department at Princeton University.

# **Exhibit 2**

## **Verified Statement of Carl Van Dyke**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB FINANCE DOCKET NO. 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**

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**CN'S COMMENTS ON APPLICATION AND REQUEST FOR CONDITIONS**

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**Verified Statement of Carl Van Dyke**

**February 28, 2022**

**PUBLIC VERSION**

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# 1. Qualifications

My name is Carl Van Dyke. I am a Senior Advisor to and a Partner Emeritus of Oliver Wyman, a global general management consulting firm with more than 60 offices in 31 countries. My office address is One University Square Drive, Suite 100, Princeton, NJ 08540.

I have been engaged in the design, development, and application of software tools to model, evaluate, and improve the operations of railroads for more than 40 years. I was a Vice President at ALK Associates, where I led the development of rail planning tools and the initial design and proof-of-concept of the algorithmic blocking system currently used by Norfolk Southern (NS) and Canadian Pacific (CP).

In 1992, I founded and became President of MultiModal Applied Systems. MultiModal developed the MultiRail family of software tools, which have been used in the modern redesign of virtually all major North American railroad operating plans, as well as those of many railroads in Europe, Africa, and Asia. While at MultiModal, I led teams in applying MultiRail to evaluate or develop operating plan designs for the Union Pacific-Southern Pacific, Illinois Central-Canadian National, Norfolk Southern-Conrail, and the proposed Canadian National-BNSF mergers. Both CP and Kansas City Southern (KCS) use MultiRail and are familiar with the software's functionality.

Oliver Wyman acquired MultiModal in 2006 and I became a Partner with the firm until my retirement in 2013. At Oliver Wyman, I continued to advance the use of MultiRail at numerous railroads and led engagements focused on improving railroad operations and the design of new software tools for railroad management.

Currently, I continue to be active in consulting to the industry. Most recently, I assisted two Class I railroads in the design of their next generation operations control systems and helped a

new technology start-up design and build the next generation of software tools for the management of freight rail operations.

I earned a BSE in mechanical engineering from the University of Pennsylvania, and an MS in civil engineering from the Massachusetts Institute of Technology. My full resume is provided in Appendix A.

## 2. Assignment and Summary of Findings

I have been asked to review the process by which Applicants developed the operating plan for the combined CP, KCS, and Kansas City Southern de Mexico (KCSM) system; the metrics generated through that process; and the process by which those metrics flowed through to the operations costing and capital planning processes.

Based on my review, I conclude that the operating plan presented in the Application fails to meet the Board's basic evidentiary requirements. The result is an incomplete and deeply flawed operating plan that cannot be relied upon in evaluating the impact of the proposed merger on CP-KCS operations, the operations of other railroads, or other stakeholders, such as shippers and communities. This is so for three basic reasons:

- **The operating plan was developed using one-month “samples” from different years, not on the Base Year.** Despite selecting 2019 as the “Base Year” for the Application (including the operating plan), Applicants actually based their operating plan on a mismatched set of data from multiple years. {{XXX}}<sup>1, 2</sup> Applicants provide no evidence that either of the selected one-month traffic samples is representative of any

<sup>1</sup> dwnld\_Traffic\_KCS.csv, provided as part of the accompanying attachments to Traffic File - Methodology.pdf, indicate the traffic data used is from October 2020; FD 36500 - Work Paper - HC - CP Bulk Cars Per Day By Sub.xlsx, and FD 36500 - Work Paper - HC - KCS KCSM Bulk Train Cars Per Day by Subdivision.xlsx, provided as part of the accompanying attachments to Trains Per Day - Methodology.pdf.

<sup>2</sup> HC - Remote Videotaped Deposition of Raymond A. Elphick and John F. Orr, STB Docket No. FD 36500, Elphick Deposition, pp. 187:17, Feb 18, 2022

full year (much less the Base Year of 2019), nor do they explain why they could not have utilized samples of manifest and intermodal traffic from the same month and year, or for full year 2019. Likewise, Applicants fail to demonstrate that the Q1 2021 train plans on which they relied are representative of Base Year (2019) operations.

Moreover, Applicants made other significant errors when processing the traffic data used to develop the operating plan. Based on my review of the data and the process used by the Applicants, and my experience in developing railroad operating plans, I conclude that using mismatched traffic data and a mismatched train plan distorted the Applicants' development of the Base Year blocking and routing plan, train plan, and the operating metrics, rendering the operating plan invalid and unusable.

- **The flawed operating plan does not produce reliable estimates of traffic density, train counts, or yards expected to experience growth:** It is my understanding that the Application was filed under the Board's "old" merger rules that were in effect in 1982, so the provisions of 49 CFR Part 1111.8(a)(2000) apply with respect to the operating plan. 49 CFR Part 1111.8(a)(1)(2000) requires applicants to provide three specific outputs for the operating plan for the year in which it will be fully implemented: 1) traffic density (tonnage) maps or tables for all main and secondary network line segments,<sup>3</sup> 2) train counts for main and secondary network line segments, and 3) the identity of all yards that are anticipated to experience growth in activity of 20 percent or more.

Based on my review of the Application, I conclude:

- The **traffic density** tables and maps contain material errors that render them meaningless and unusable. The exact causes of these errors are unknown, but likely are due to flawed traffic data and a convoluted and error-prone process used for their preparation.
- The **train counts** are inaccurate because:

<sup>3</sup> 49 CFR Part 1111.8(a)(5)(2000) requires that historic traffic density data for all lines carrying one million gross ton-miles per mile per year or more be presented on a density map.

- The carload and intermodal operating plan is based on flawed traffic data drawn from inconsistent and unrepresentative samples.
  - Unit trains are based on a non-representative sample of trains and were incorrectly input in some cases.
  - Applicants deliberately chose to exclude any train that did not traverse at least 25 percent of the stations on a subdivision, thereby failing to account for an (unknown) number of local trains that were assigned traffic in Applicants' MultiRail modeling.<sup>4</sup>
  - There are inconsistencies between the work papers and the actual values in the Application that leave one uncertain as to the accuracy of the Application.
- The analysis of which **yards** will experience an increase of activity greater than 20 percent is invalid because:
- The operating plan is based on a flawed analysis of traffic data drawn from inconsistent and unrepresentative samples.
  - Applicants omitted originating/terminating unit train traffic from the MultiRail modeling process, thereby failing to include yard activity values for such traffic.
  - Applicants used the wrong operating plan for the base period in the comparison.
  - Applicants did not include in their calculation of yard activity "block swaps," an integral feature of precision scheduled railroading (PSR), upon which Applicants rely for a significant portion of their cost savings.
  - Not all yards that had significant changes in cars handled were disclosed in the operating plan.
  - Applicants miscounted intermodal cars.
  - In this area, too, there are multiple discrepancies between values in Applicants' work papers and the values in the Application.

Based on my knowledge of the operations planning process, the proper use of the MultiRail software supporting that process, and the material flaws I have described in

<sup>4</sup> Applicants note in FD 36500 – Work Paper – HC – Trains Per Day - Methodology.pdf that "The train must pass by at least 25% of the subdivision's segment stations in order to be counted on it."

the data, I conclude that Applicants have failed to meet the requirements of 49 CFR Part 1111.8(a)(1) and (5)(2000). Applicants have provided essentially meaningless responses to those provisions.

- **Applicants did not use their operating plan to calculate the merged railroad’s operating metrics or expenses:** As described in this Verified Statement and in the Verified Statement of Hugh Randall,<sup>5</sup> in a customary operations planning process, metrics such as gross ton-miles (GTMs), train-miles, and cars switched are generated based on the operating plan, and are then used to drive the calculation of the merged railroad’s operating expenses, equipment needs (required by 49 CFR Part 1111.8(a)(3)(2000)), and capital expenditures (required by 49 CFR Part 1111.8(a)(4)(2000)). Applicants failed to follow that customary procedure in this case. Instead, it appears that in calculating operating expenses, Applicants ignored the outputs of their MultiRail operations modeling, and instead used outputs generated by a simplistic spreadsheet model (which they call the “System Model” or “Cost Metrics Model”<sup>6</sup>).<sup>7</sup> This System Model is driven largely by estimated changes in GTMs that were not generated by the MultiRail operating plan.

In fact, Applicants appear to have intentionally decided to develop their operating plan and operating expenses separately. Applicants’ post-merger operating plan includes both “synergy growth” traffic from their traffic diversion studies and “organic growth” (growth resulting from general economic conditions unrelated to the proposed merger). On a systemwide basis, Applicants’ post organic growth in traffic volumes of {{XXX percent}} increase from the Base Year to post-merger Year 3.<sup>8</sup> However, in calculating the merged CPKC’s operating expenses, Applicants considered only “synergy growth traffic of 19.8” and excluded “organic growth” traffic.<sup>9</sup> It is not clear why Applicants

<sup>5</sup> See Verified Statement of Hugh Randall.

<sup>6</sup> FD 36500 – Work Paper – HC – System Model - Methodology.pdf, FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019.xlsx.

<sup>7</sup> I state that Applicants “appear” to have calculated the costs based on outputs not generated by the operating model because I could not find anything in the work papers that demonstrated how the incremental operating costs in the financial statements were prepared, or even any linkage to the Applicants’ “System Model/Cost Metrics Model.”

<sup>8</sup> FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019.xlsx (Reference tab).

<sup>9</sup> Application Vol. 1, p. 442 states that financials do not include any organic growth; Application Vol. 2, p. 286, ¶85 states that the operating plan includes organic growth.

took this inherently contradictory approach. What is clear is that the resulting operating expenses do not account for the cost of handling the {{XXX}} increase in “organic growth” traffic. As a result, their claimed operating expenses bear no relation to their operating plan.

- This disconnect is not insubstantial. For example, the operating plan produces an annual increase in train-miles of approximately {{XXX}}, while the costing process appears to be based on an assumed increase of only approximately {{XXX}} train-miles.<sup>10</sup>
- Similarly, the increase in GTMs based on Applicants’ operating plan is {{XXX}}, while the costing process assumed an increase of only 76.3 billion GTMs, *less than half of the GTMs generated by Applicants’ traffic studies inclusive of organic growth and by the operating plan.*<sup>11</sup>
- Other operating metrics customarily developed in the course of preparing an operating plan, such as train-miles, train-hours, and crew-starts, were also estimated without reference to the operating plan for purposes of estimating CPKC’s post-merger operating expenses.<sup>12</sup>

Applicants’ failure to generate a reliable set of operating statistics based on a unified and rigorous operations planning process, and to base their operating and capital expense calculations on such outputs from the operating plan, resulted in fatally flawed operating plan and operating expense evidence. Any conclusions reached by Applicants based on them are plainly unreliable. While Applicants attempt to leave the impression that they conducted a rigorous planning process, at the end of the day they essentially abandoned the outputs of this planning process in favor of a series of ad hoc calculations taken from a simplistic spreadsheet model.<sup>13</sup> The metrics generated by those ad hoc calculations are

<sup>10</sup> See HC – Oliver Wyman - Change in Train Miles and GTM from Base Year to Year 3.pdf for analysis and associated data sources.

<sup>11</sup> See HC – Oliver Wyman - Change in Train Miles and GTM from Base Year to Year 3.pdf for analysis and associated data sources.

<sup>12</sup> See HC – Oliver Wyman - Review of Operating Plan Statistics and Their Sources.pdf.

<sup>13</sup> FD 36500 – Work Paper – HC – System Model - Methodology.pdf, FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019.xlsx, FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx – Inputs – Revenues + Costs tab.

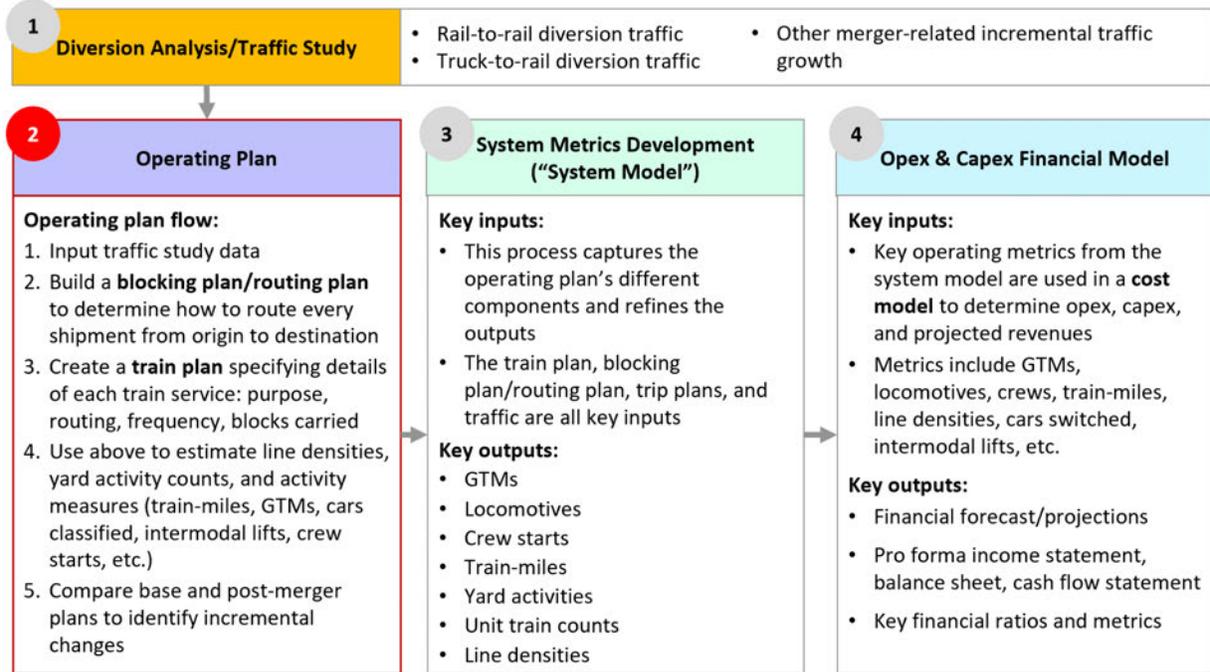
unreliable at best and distort Applicants' operating plan and both operating and capital expense calculations.

### **3. A Rigorous Operations Planning Process is a Key Element of a Reliable Merger Application**

#### **3.1 The operating plan plays a critical role in the application**

Based on my direct experience in developing operating plans for prior merger applications, and the applications submitted in connection with those mergers, the Applicants in most recent Class I mergers generally have employed the process depicted in Exhibit 3-1. It is important to understand that this process for developing a merger application consists of a series of logical, interrelated steps: The **diversion analysis/traffic study** provides both revenue input to the financial plan and data concerning the anticipated volumes of carload, intermodal, and bulk commodity traffic that drive the development of an operating plan that is capable of accommodating that traffic. The **operating plan** is then used to generate key operating metrics that are used to calculate the merged carrier's operating and capital expenses. Those outputs, combined with the revenue estimate, drive the **financial plan**. Any failure to use reasonable inputs and/or generate accurate outputs at any step cascades through the process and renders the subsequent calculations invalid.

**Exhibit 3-1: Elements of an adequate merger plan: The operating plan and system model provide outputs that drive calculation of operating and capital expenses and the financial plan<sup>14</sup>**



The MultiRail software has been used in most recent Class I merger cases to develop the operating plan, including the car blocking and routing plan and train plan for the merged railroad. Based on that operating plan, Multirail generated operating metrics such as GTMs, train-miles, crew starts, and car handlings. Traffic was then carefully developed and tested to ensure that MultiRail would directly produce operating metrics for the base period that were consistent with historical values. For example, both the merger of Canadian National with the Illinois Central Gulf (CN-IC) and the merger of Norfolk Southern with Conrail (NS-CR) followed this process, and this approach is directly cited in their merger applications:

CN-IC: “The pre-merger traffic flows were first determined, then the commercial and transportation plan teams worked with ALK and Reebie to determine the likely post-merger flows. MultiModal created a computer simulation of the combined rail system on its MultiRail model and the pre- and post-merger traffic was run through that

<sup>14</sup> This is the logic flow explicitly cited in the Canadian National-Illinois Central and Norfolk Southern-Conrail STB merger applications. Oliver Wyman was unable to find a statement indicating an explicit connection between operating plan and financial model in the Canadian Pacific-Kansas City Southern Application.

simulation to assess train schedules, blocking patterns, and line and yard capacity. When the service design was complete, and the various related integration decisions were made, the MultiModal model produced a variety of operating statistics that were used...to assist the railroads in performing costing, benefits, and financial projections for the combined system. These and other operating statistics were also produced for the environmental and safety teams for their use in putting together environmental data and the Safety Integration Plan.”<sup>15</sup>

NS-Conrail: “To prepare the Operating Plan, I received traffic data, including new and diverted business, provided by NS’s traffic consultants, and then applied that data to an operational modeling structure created by MultiModal, Inc. Our team then formulated the Plan, assisted by experienced NS operating and service management personnel. Outputs from the Plan were [used]...to estimate cost impacts of the Plan, and...for purposes of preparing the Environmental Report.”<sup>16</sup>

In addition to generating the outputs needed for subsequent steps in the planning process, a normal operating plan modeling process supports development of a forward-looking operating plan, which is a specific requirement for the Application,<sup>17</sup> for the following reasons:

- To demonstrate the nature of the service to be provided and any service improvements or other benefits achieved during the first three years after the merger;
- To document the anticipated changes in activity levels for yards and lines, to show that sufficient capacity exists to handle the anticipated increase in traffic volumes (or to inform the capital planning process where investments in the physical plant are needed);
- To document the effects on labor due to changes in operations;
- To document that the merged railroad’s locomotive and railcar fleets will be sufficient in light of changes in traffic volumes and operating strategy, and any associated capital requirement needs;
- To understand the changes in various operating metrics such as train-miles, crew-starts, and cars handled, which drive the process of estimating the incremental costs associated with the merger and any associated changes in volumes; and

<sup>15</sup> Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998, Volume 2, pp. 5-6 (CN-IC merger).

<sup>16</sup> Finance Docket No. 33388, Railroad Control Application, Surface Transportation Board, June 1997, Volume 3B, p. 7 (Conrail merger).

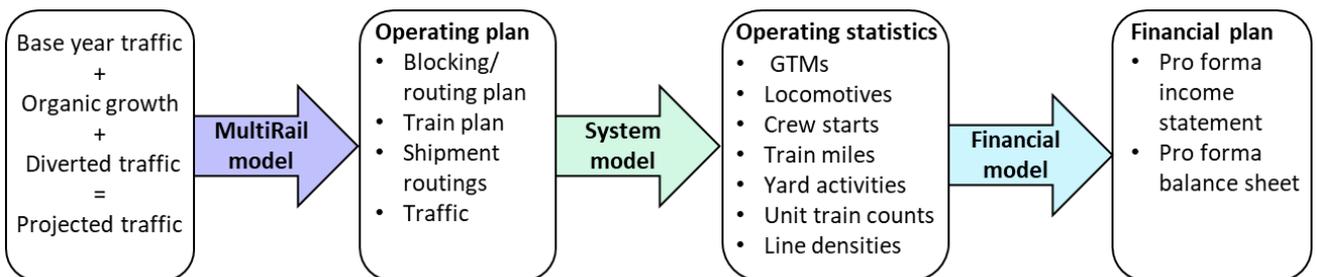
<sup>17</sup> 49 CFR Part 1111 (2000).

- To provide information at a sufficiently granular level of detail on the changes to activity levels for lines and yards to support the assessment of environmental impacts.

### 3.2 Customary method for preparing an operating plan

The heart of the merger planning process is the development of the operating plan. As shown in Exhibit 3-2, in a customary and logical operating planning process for a merger, applicants utilize operations planning software, such as MultiRail, to flow projected traffic over a model of the merged railroad’s network to develop the building blocks of the operating plan. Operating plan results are then processed to generate the operating statistics that are the key drivers of the merged railroad’s operating and capital expense projections (i.e., the “System Model”).

**Exhibit 3-2: Logical operating plan development process**



As the creator of the MultiRail software, I am keenly aware that the software relies on accurate traffic projections to produce reliable results. Traffic projections typically are based on a single, representative “base year” and include carload, intermodal, and unit train traffic for that year. Projections of organic growth and diverted traffic are then typically developed on a consistent basis and added to the base year traffic to develop a complete picture of the merged railroad’s future traffic.

Typically, in prior recent mergers, applicants would build the network of the merged railroads into MultiRail and first flow **base year traffic** over that network using the applicants’ pre-merger blocking and train service plans to verify that the model results are consistent with

actual operating results for the base year. Only then would applicants flow **projected traffic** for the merged railroads over the network, review the impact of this traffic on the operating plan, and adjust the operating plan both to accommodate changes in volumes and to leverage opportunities the merged network might provide. Based on this process, merger applicants can create consistent pre- and post-merger operating plans that include:

- A blocking and traffic routing plan that determines the route that each shipment will follow from its origin to its destination; and
- A train plan that specifies for each train its purpose, routing, service frequency, and the blocks it will carry.

The MultiRail model uses the traffic, blocking and traffic routing plan, and train plan to calculate line densities and yard activity counts. Merger applicants would then typically compare the base year and projected year densities and yard activity counts to identify line segments and yards that require additional investment to handle projected traffic. (Changes in line density also can be used as inputs to the environmental assessment of the merged system.) Once the operating plan is complete, a “system model” is then used to develop the key metrics for the plan, such as GTMs, train-miles, locomotives required, crew starts, and cars switched.

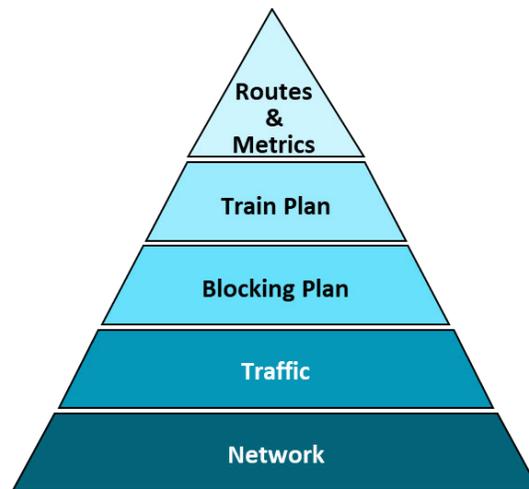
This process is clearly articulated, for example, in the Canadian National-Illinois Central merger application, including the development of the base case, creation of the post-merger case, development and refinement of the blocking plan, and generation of the changes in line volumes and yard activities.<sup>18</sup> That merger application provides explicit enumeration of details such as

<sup>18</sup> Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998, Volume 2, Exhibit 13, pp. 126-129.

block swap car volumes versus general switching activities,<sup>19</sup> and the explicit listing of passenger trains versus freight trains.<sup>20</sup>

Railroad operating plan modeling is essentially a “bottom up” process, in which each element of the plan is layered on the prior element, as depicted in Exhibit 3-3. The process begins with the network, followed by the traffic, blocking and routing plan, and train plan. If any foundational layer is flawed or incomplete, then each of the dependent layers are also flawed -- the adage “garbage in, garbage out” quickly comes to mind to describe the operating plan and key metrics based on inaccurate or unreliable inputs.

**Exhibit 3-3: The operating plan modeling hierarchy**



## 4. Applicants’ Operations Planning Process

Applicants’ operations planning process fails at nearly every level of the modeling hierarchy described above. The result is a set of modeling outputs that were so unreliable<sup>21</sup> that

<sup>19</sup> Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998, Appendix E to Exhibit 13, starting p. 255.

<sup>20</sup> Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998, Appendix F, starting p. 258.

<sup>21</sup> See Verified Statement of Hugh Randall for additional detail on operating and capital expense modeling outputs.

*Applicants themselves disregarded their own operating plan outputs, including train-miles and GTMs – both of which are critical drivers of operating costs.*

Instead, Applicants developed their incremental GTMs using manual calculations, based on the diversion analysis and (unsupported) estimates of car weights and distances traveled.<sup>22</sup> These externally estimated incremental GTMs did not include GTMs generated by Applicants’ projected “organic growth” traffic – indeed, they were less than half of the incremental GTMs calculated in the operating plan.<sup>23</sup> Metrics such as incremental train-miles were computed in the Applicants’ system model without reference to the operating plan by simply dividing the GTMs by an assumed average train weight value. As a result, the train miles in the Applicant’s system model are roughly {{ }} of the incremental train-miles that resulted from the MultiRail operations modeling.<sup>24</sup> Similarly, the line densities from the MultiRail operating plan were significantly modified or “calibrated” to make it appear that the operating plan outputs were consistent with the system model at an aggregate level.<sup>25</sup>

#### **4.1 Applicants have failed to produce reliable base year traffic or operating plan.**

Based on my experience, a critical initial step in the operations modeling process for a merger is to create a “pre-merger plan,” which involves flowing the merged railroads’ base year traffic over the network, and a base period operating plan (once this has been coded into the

<sup>22</sup> FD 36500 - Work Paper - HC - 1.Proposed Final FTI Rail to Rail Diversion Results for Merger Application 10\_21\_20 Updat\_Truck\_Rev.

<sup>23</sup> See HC – Oliver Wyman - Change in Train Miles and GTM from Base Year to Year 3 Used in Cost Metrics/System Model and HC – Oliver Wyman - MultiRail Estimates – Methodology.pdf for analysis and associated work papers: FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx, FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019.xlsx.

<sup>24</sup> See HC – Oliver Wyman - Change in Train Miles and GTM from Base Year to Year 3 Used in Cost Metrics/System Model and HC – Oliver Wyman - MultiRail Estimates – Methodology.pdf.

<sup>25</sup> FD 36500 – Work Paper – HC – Gross Ton Miles, Train Miles, Train Weights and MGT – Methodology; FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019; FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - Working Copy with Haz Breakdown.xlsx.

operations planning software, such as MultiRail), to verify that the model produces realistic operating statistics. Once it is verified that the model is correctly coded, and that the traffic inputs are accurate, the process should produce modeled operating statistics within plus or minus 5 percent of the railroads' actual base year operating statistics. Typical statistics used in this process include car-miles by load/empty and major car type (intermodal, boxcar, covered hopper, etc.), train-miles by major train type (local, intermodal, unit, manifest), and GTMs. Volumes at key locations should also be spot checked. The MultiRail software's diagnostics capabilities also identify issues like highly circuitous moves that reveal areas where the base year plan may have errors. Where the statistics do not match, merger applicants should use the results of the validations to identify and correct problems with the coded network, traffic data, and base operating plan until a satisfactory outcome is achieved.

Based on my review of the Application and associated work papers, there is no evidence that Applicants tested their MultiRail operations planning model to ensure consistency with CP and KCS historic performance/metrics. Further, because unit train traffic was excluded entirely from the Applicants' MultiRail model,<sup>26</sup> any comparisons would have to be done using multiple sources for the statistics such as October 2020 for carload and intermodal traffic, and October 2019 for unit train traffic, and a train plan based on operations during Q1, 2021. The lack of validation is clearly demonstrated by the failure of the Applicants to recognize that their actual October 2020 traffic had almost no intermodal traffic out of Lazaro Cardenas due to labor actions near the port (see Section 5.2 for further details), which would have resulted in a depressed number of intermodal car-miles that should have been obvious in any validation

<sup>26</sup> See FD 36500 – Work Paper – HC – Trains Per Day – Methodology.pdf, sections 3.3-3.5. See also FD 36500 – Work Paper – HC – Traffic File - Methodology.pdf, Section 1: “Note that Bulk Train Design is completed outside of the MultiRail application...”

process. This is critical, because an accurate, representative base year traffic file – which incorporates all traffic types, including unit trains – is the foundational layer upon which all the other layers in the operations modeling process are dependent. Applicants have not provided parties either the operating plan model or the input files underlying their Application, so the accuracy of the base traffic or operating plan cannot be independently verified. But the fact that Applicants found it necessary to abandon the outputs of their MultiRail modeling and to introduce manual adjustments and “calibrations” suggests that the network, traffic, and base operating plan are incorrect.

#### **4.2 Applicants’ pre- and post-merger traffic file is flawed**

Once the base period traffic and operating plan have been verified, applicants in the most recent Class I mergers would typically flow projected traffic for the merged railroad over the network to produce the post-merger operating plan.<sup>27</sup> The post-merger plan is typically a variation of the pre-merger plan, taking into account both the changes in traffic volumes that must be accommodated and the opportunities that are likely to arise from the merger. Based on the post-merger operating plan, the Year 3 line density and yard activity data required by 49 CFR Part 1111.8(a)(1) and 1111.8(a)(5)(2000) can be developed. Operating statistics that are critical to developing operating and capital expenses for the merged railroad (such as GTMs, train-miles, train starts, crew starts, and locomotives required) are also generated at this stage. It is critical that the projected traffic data that is the foundation for these calculations is as complete and accurate as possible.

<sup>27</sup> Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998; Finance Docket No. 33388, Railroad Control Application, Surface Transportation Board, June 1997.

The traffic data employed by Applicants in conducting their MultiRail modeling is anything but complete and accurate. This is true for many reasons, the most significant issues being as follows:

- **Applicants falsely claim that they were forced to use a representative month because MultiRail can accommodate only 28 days of traffic data.**<sup>28</sup> As the creator of MultiRail, I am uniquely qualified to state that this claim is false. The “days in period” functionality in the MultiRail software allows Applicants to accommodate up to 365 days of data. Furthermore, even if the 28-day limitation were true, it is a relatively easy task to take a full year of traffic and convert it to a set of representative (or “average”) values for either a 7- or 28-day period. Applicants do not explain why they chose to rely entirely on a single month of data – with all the issues that creates – when they could have used a full year of data.<sup>29</sup>
- **Applicants chose to use traffic data from October 2020 to represent base year carload and intermodal traffic but used a month from a different year to represent base year unit trains.**<sup>30</sup> For unit trains, Applicants chose to use the actual trains operated during the month of October 2019 as a proxy for unit train operations during the base year (without examining or using the underlying traffic). October 2019 is a full year removed from the month of October 2020 that was used by the Applicants to support all other analytics. Applicants provide no explanation for why they chose a month from a different year than the base year to model their base carload and intermodal traffic volumes, and then and a completely different month/year for unit trains.<sup>31</sup> As noted above, there is nothing in the MultiRail software that would have prevented Applicants

<sup>28</sup> FD 36500 – Work Paper – HC – Traffic File - Methodology.pdf , Section 3. Process Detail notes that “CPRS chose to use October 2020 for a base month as MultiRail only can process 1 month at a time,”

<sup>29</sup> In Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al. STB Docket No. FD 36500, Elphick and Orr Dep. 160:15–160:17, Feb. 18, 2022: {

}  
<sup>30</sup> dwnld\_Traffic\_KCS.csv provided as part of the accompanying attachments to Traffic File - Methodology.pdf indicate the traffic data used was from October 2020; FD 36500 - Work Paper - HC - CP Bulk Cars Per Day By Sub.xlsx, and FD 36500 - Work Paper - HC - KCS KCSM Bulk Train Cars Per Day by Subdivision.xlsx provided as part of the accompanying attachments to Trains Per Day - Methodology.pdf.

<sup>31</sup> It is interesting to note that footnote 4 on p. 283 of Application Vol. 2 indicates that the “2019” base year operating plan CPKC chose to create in MultiRail actually reflects the Q1 2021 operating plan (with October 2019 unit trains, and October 2020 intermodal and carload traffic).

from modeling the full base year traffic using the correct year. The choice to use October 2020 for Applicants' base carload and intermodal traffic leads to significant flaws in traffic volumes in aggregate and by lane.<sup>32</sup> This has particularly large impacts for intermodal traffic originating at the Port of Lazaro Cardenas, which was largely closed in October 2020 due to labor issues.<sup>33</sup>

- **Applicants offer no evidence that their modeling of base year unit train traffic is accurate or reliable.**<sup>34</sup> Nothing in the Application explains Applicants' methodology for determining which bulk commodity traffic was unit train traffic, or why it was necessary to exclude unit trains from their MultiRail modeling. Based on my actual experience undertaking numerous efforts to identify unit train traffic in waybill data sets, it can be a challenging task to identify specific carloads that moved in a unit train, because loaded movements are not clearly delineated as "unit train traffic" in waybills, and empty moves do not always return to the origin of the loaded move and sometimes go on to diverse next destinations. For this reason, it is more accurate to undertake unit train modeling within MultiRail, so that the traffic that does not conform to unit train standards will drop through to the carload network and not get lost in a "gap" between the two modeling approaches.
- **Applicants correctly included organic growth in the post-merger traffic used to develop the operating plan in MultiRail but excluded that organic growth from the costing process.**<sup>35</sup> The contradiction in Applicants' use of "organic growth" projections indicates that Applicants did not use the results of the operating plan to drive the costing process. Consequently, train-miles, car-miles, and GTMs arising from the operating plan

<sup>32</sup> See work paper: FD 36500 – Work Paper – HC – Traffic File - Methodology.pdf , Section 3 (B). Section header indicates "desired month" was October, 2019, while details indicate that "XXX" In Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al. STB Docket No. FD 36500, Elphick and Orr Dep. 160:15–160:17, Feb. 18, 2022: Deponent Elphick states: {"XXX"}

<sup>33</sup> "Rail blockade ends in Mexico," Freight Waves, December 2, 2020.

<sup>34</sup> FD 36500 – Work Paper – HC – Gross Ton Miles, Train Miles, Train Weights and MGT – Methodology.pdf, FD 36500 - Work Paper - HC - New Bulk Input w Year Splits 2021.10.20.xlsx, FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - Working Copy with Haz Breakdown.xlsx, FD 36500 - Work Paper - HC - CP Bulk Cars Per Day By Sub.xlsx, FD 36500 - Work Paper - HC - KCS KCSM Bulk Train Cars Per Day by Subdivision.xlsx, FD 36500 – Work Paper – HC – Synergy Bulk Train Run Details - Year 1, 2, 3 with summary – Copy.

<sup>35</sup> Application Vol. 1, p. 442 states that financials do not include any organic growth; Application Vol. 2, p. 286, ¶85 states that the operating plan includes organic growth.

are more than twice the values Applicants ultimately used to develop their operating and capital expenses. As noted earlier, the operating plan produced an increase of {{XXX}} gross-ton-miles including organic growth, while Applicants' operating expense calculations are based on a value of 76.3 billion gross-ton-miles excluding organic growth.<sup>36</sup> Since organic growth is certain to occur (and was estimated by Applicants to be more than {{XXX}} by Year 3),<sup>37</sup> Applicants' financial projections clearly understate the costs and capital requirements associated with Year 3 operations.

Applicants' approach to projecting traffic introduced a multitude of opportunities for fundamental errors. Carload and intermodal traffic that moved in October 2020 is not representative of carload and intermodal traffic moved during October 2019 (much less the full Base Year). Likewise, Applicants introduced no evidence to support the assumption that bulk commodity traffic moved during October 2019 is representative of full Base Year bulk traffic. The nine hypothetical unit train pairs<sup>38</sup> created by Applicants may not accurately represent the merged railroads' new unit train grain traffic. Applicants' decision to include organic growth in the operations modeling process but then exclude it from the spreadsheet/costing model introduces major inconsistencies in Applicants' projections. Based on my review of the Application and work papers, Applicants provide no proof that their traffic estimates or the base operating plan are accurate or representative.

Applicants did not need to adopt such a complex and disjointed modeling approach. As part of developing the analysis of the proposed merger of Canadian National and KCS, I led a team

<sup>36</sup> The Summary Table tab of the work paper FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019.xlsx presents an incremental GTM value of {{}} when organic growth is included, and an incremental GTM value of 76.3 billion when organic growth is excluded (when annualized). See HC – Oliver Wyman - Change in Train Miles and GTM from Base Year to Year 3 Used in Cost Metrics/System Model and MultiRail Estimates – Methodology for analysis and associated data sources.

<sup>37</sup> The {{XXX}} percent organic growth is based on values provided in FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019.xlsx, Reference tab.

<sup>38</sup> FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx, Bulk Reference tab, shows nine new train pairs for loaded and empty traffic in the Train Symbol column.

that developed an operating plan using MultiRail software and full-year traffic data, including bulk commodity unit train traffic. The model was built on actual base year inputs and provided outputs in a consistent and rigorous fashion. There is no reason that Applicants could not have provided an operating plan based on the same rigorous process.<sup>39</sup> I also can state that based on personal experience with the CN-IC and Norfolk Southern-Conrail merger operating plans, both plans used full-year data that was from the same year as the base period.<sup>40</sup>

### **4.3 Applicants failed to correctly estimate line density, train counts, and yard activity**

49 CFR Part 1111.8(a)(1) and 1111.8(a)(5)(2000) specifically require merger applicants to provide an estimate of post-merger traffic density and train counts on all main and secondary rail lines and to identify all yards that are projected to experience an increase in activity greater than 20 percent.<sup>41</sup> The operations planning process followed by Applicants does not provide sufficiently robust or accurate information to meet these requirements.

Accurate estimates of line density, train counts, and yard activities are critical to demonstrating that a merged railroad will be able to move the projected post-merger traffic over the network without degrading service. Research by the Association of American Railroads (AAR) has proven that as traffic on a railroad line approaches the line’s practical capacity (which the AAR defines as 70 percent of its theoretical capacity<sup>42</sup>), the level of service on the line

<sup>39</sup> In workpaper FD 36500 – Work Paper – HC – Traffic File - Methodology.pdf Section 3 (B) Applicants state “FTI supplied CPRS with multiple years of data, but CPRS chose to use October 2020” from which one can infer that Applicants could instead have “chosen” to use the full year 2019 data to be consistent with the Applicant’s selection of 2019 as their base year.

<sup>40</sup> Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998, Vol. 2, p. 127 (2.1 Base Period); Finance Docket No. 33388, Railroad Control Application, Surface Transportation Board, June 1997, Vol. 3B, p. 90 (2.1 Base Period).

<sup>41</sup> 49 CFR Part 1111.8(a)(1)(2000).

<sup>42</sup> {{XXX}} See: Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al. STB Docket No. FD 36500, Elphick and Orr Dep. 60:25 – 61:16, Feb. 18, 2022

degrades.<sup>43</sup> Accurate line density data are essential in identifying line segments where degraded service will occur, therefore requiring the provision of capital investment to increase capacity.

Similarly, accurate estimates of yard activity are essential for identifying yards with insufficient capacity to handle post-merger switching activity. Failure to estimate post-merger yard activity correctly and to provide for the capital investment needed to keep yards fluid can lead to catastrophic network failures. For example, following the merger of the Union Pacific and Southern Pacific, Englewood Yard in Houston did not have enough capacity to handle the increase in traffic from the merger. The yard became overwhelmed, resulting in gridlock on Union Pacific routes in the Houston area, which then cascaded out into service disruptions across the railroad's network.<sup>44</sup>

Likewise, train counts and yard activity levels are central to the environmental review process. Clearly, developing accurate estimates of line and yard capacity is too important to be left to ad hoc and untested processes, particularly where, as here, Applicants had tools at hand, such as MultiRail, to develop estimates in a rigorous manner.

#### **4.3.1 Line density**

As previously discussed, in a customary operations planning process, all carload, intermodal, and bulk unit train traffic is flowed over the network and is coded into the operations planning software (i.e., MultiRail). The software develops estimates of traffic density and train counts by line segment and car handlings by yard. Applicants did not follow such a procedure. Instead, they employed an overly complex process to compute line density values that used a

<sup>43</sup> National Rail Freight Infrastructure Capacity and Investment Study, Association of American Railroads, September 2007, p. A-10, where it notes "Practical capacity is about 70 percent of the theoretical capacity and provides reliable service."

<sup>44</sup> "Problems in Wake of Merger Continue for Union Pacific," Wall Street Journal, October 2, 1997.

combination of (1) historic tonnage, (2) train counts (without weight values<sup>45</sup>) extracted from MultiRail for selected traffic and trains, and (3) a separate manual process for estimating tons for existing and new unit trains.<sup>46</sup> In addition to being based on inaccurate traffic data, including a purely statistical representation of organic growth-related changes in unit trains,<sup>47</sup> the Applicants' estimates do not include trains that operated over an arbitrarily determined subset of a line segment.<sup>48</sup>

As the designer of MultiRail, I know that this tool is fully capable of estimating the weights of trains. Once traffic has been loaded, and routed, the size of each train is estimated, including its weights. These weights are responsive to changes in the operating plan, such as train frequency and shipment routings. Thus, if you are trying to estimate train weights, and the effects of changing the operating plan design, it is far more effective to do this using MultiRail than by applying a set of fixed, historic train weights that are insensitive to the operating plan design.

In developing their line density analysis, Applicants chose to ignore tonnage values by line segment from MultiRail. Instead, they computed tonnage values using an aggregate tonnage spreadsheet model (which also was divorced from the tonnages in the system model).<sup>49</sup> Any differences between the aggregate tonnage spreadsheet model and the tonnages by line segment

<sup>45</sup> {XXX}. See Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al. STB Docket No. FD 36500, Elphick and Orr Dep. 188:8 – 192:20, Feb. 18, 2022.

<sup>46</sup> FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx.

<sup>47</sup> See Section 5.3.1 of this Verified Statement for details on the handling of unit trains.

<sup>48</sup> Applicants note in FD 36500 – Work Paper – HC – Trains Per Day - Methodology.pdf that "The train must pass by at least 25% of the subdivision's segment stations in order to be counted on it."

<sup>49</sup> FD 35600 - Work Paper - HC - 1.Proposed Final FTI Rail to Rail Diversion Results for Merger Application 10\_21\_20 Updat\_Trunk\_Rev.xlsx.

were obfuscated by applying numerous “calibration factors” to the process.<sup>50</sup> These calibration factors had the effect of significantly distorting growth values in many cases, leading to further errors in density values. For example, while Applicants use an organic growth factor through Year 3 for KCS of approximately {{ in the system model, they instead applied the higher merged system average growth rate of {{ }} for the KCS subdivisions.<sup>51</sup> They then compounded this error through the use of “calibration factors” to cause the effective organic growth rate to exceed {{ }} on the Kansas City-Springfield line, more than double the correct value of {{ }}.<sup>52</sup> Applicants do not explain why they chose to use an untested (and unprecedented) process requiring a series of unorthodox adjustments, when the MultiRail software offered a much more transparent and integrated way to conduct the analysis thoroughly and accurately.

The Applicants’ process produced line density (tonnage) results that are demonstrably incorrect on essentially every subdivision. In short, these values are wrong and cannot be used for any purpose.<sup>53</sup>

#### **4.3.2 Yard activity**

The Applicants’ process for estimating changes in yard activity is similarly flawed. To begin with, any errors in traffic volumes and mix (e.g., due to it being for a non-representative time period<sup>54</sup> or due to processing errors in creating the MultiRail traffic data) carried through to the

<sup>50</sup> FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx.

<sup>51</sup> See HC – Oliver Wyman - Review of Growth Factors in CPKC Application.pdf.

<sup>52</sup> See Sections 5.1 and 6.1 of this Verified Statement for specific examples; also see Section 5.3.1 for example of errors in unit train counts. See HC- Oliver Wyman - Review of Growth Factors in CPKC Application.pdf and HC - Oliver Wyman – Springfield Line 30 Percent Growth.pdf.

<sup>53</sup> See Sections 5.1 and 6.1 of this Verified Statement for specific examples of invalid line density values.

<sup>54</sup> See prior discussion of use of October 2020 for intermodal and carload traffic, and October 2019 for unit trains.

yard statistics in the Application. As shown in Exhibit 3-1 and previously discussed, in a customary operations planning process, activity per yard is a direct output of the MultiRail software. Applicants, however, produced values from MultiRail that excluded unit traffic, with no footnote on or explanation for the missing traffic.<sup>55</sup> Applicants then relied on a pieced-together combination of MultiRail outputs and manually calculated unit train traffic originating/terminating volumes by location to estimate yard activities for the purposes of the environmental filing.<sup>56</sup> The result is that *the yard activity values submitted by applicants to the Board in the environmental filing and the operating plan are not the same*. In addition, Applicants' estimate of yard activities intentionally excluded block swaps (a key element of the PSR efficiencies touted in the Application)<sup>57</sup> and underestimates intermodal yard counts by a factor of 2.5, using a non-standardized approach to counting intermodal platforms.<sup>58</sup>

Next, instead of providing the required comparison between the Base Year and Year 3 yard activity, Applicants provided a comparison between a so-called "optimized plan" and the post-merger plan in the main body of the Application, and an uninterpretable and mislabeled comparison of the optimized plan with the growth plan in an appendix.<sup>59</sup> Doing so does not comply with the Board's regulations.

<sup>55</sup> See Section 5.3.1 of this Verified Statement for discussion of Applicants' handling of unit trains and traffic.

<sup>56</sup> Based on file submitted to the Board by Venable LLP and CP under Comment ID "31353" (31353.pdf), which contains master segment and yard tables with information on environmental trains per day.

<sup>57</sup> Of the 21 new trains listed by Applicants in Application Vol 2., Appendix I, pp. 438-442, at least 20 appear to engage in block swaps, particularly at Shreveport, Sanchez, and Chicago.

<sup>58</sup> See HC – Oliver Wyman - Intermodal to RailCar Conversion Factor Source Compilation.pdf.

<sup>59</sup> Application Vol, 2, p. 292, ¶100 states that Appendix B "displays all yard volume changes under the Optimized Plan and Growth Plans" – as discussed in Section 6.3 of this Verified Statement, the reports in Appendix B are mislabeled, making it impossible to determine their exact content. The only tables in the main body of the Application are Table 3, on p. 297 of Vol. 2, which is strictly between the base plan and the optimized plan, and Table 5, on p. 305 of Vol. 2, which is between the optimized plan and the growth plan. A reliable, direct comparison between the base plan and the growth plan is not present in the Application.

Applicants also ignored the requirement to identify all yards that have a projected 20 percent or greater change in car handlings, leaving out the details of several highly impacted locations (Port Arthur, TX for example).

### 4.3.3 Train counts by subdivision

Applicants' train counts by subdivision also are unreliable due to a variety of factors, including the use of invalid base traffic (see Section 4.1), errors in estimating post-merger traffic volumes (particularly for intermodal – see Section 4.2), the exclusion of any train that did not traverse at least 25 percent of the stations on a line segment,<sup>60</sup> the use of a one-month sample period for unit trains,<sup>61</sup> errors in the entry of unit train counts,<sup>62</sup> and the failure to break out any passenger trains operating over a subdivision.<sup>63</sup> In addition, the source for the train counts used in the filing provided by Applicants in response to CN discovery request #115 does not match the values presented in the Application.<sup>64</sup>

One of the key “rules” applied by Applicants in developing the system model train counts was a decision to exclude all trains that traversed fewer than 25 percent of the “MultiRail nodes” in a subdivision.<sup>65</sup> MultiRail nodes are placed by the modeler based on topographic and operational characteristics of the network and bear no relationship to distance.<sup>66</sup> Thus, one pair

<sup>60</sup> Applicants note in FD 36500 – Work Paper – HC – Trains Per Day - Methodology.pdf that “The train must pass by at least 25% of the subdivision’s segment stations in order to be counted on it.”

<sup>61</sup> See FD 36500 – Work Paper – HC – Trains Per Day - Methodology.pdf.

<sup>62</sup> See Section 5.3.1 of this Verified Statement.

<sup>63</sup> No passenger trains are listed in Applicants’ train counts by line segment tables (Application Vol. 2, Appendix A, pp. 363-368. In contrast, *see* Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, Vol. 2, July 1998, pp. 258-264, Appendix F (Train Densities) (CN-IC merger).

<sup>64</sup> *See* response #115, “Kansas City Southern and Canadian Pacific’s Joint Responses and Objections to Canadian National Railway Company’s First Set of Discovery Requests,” p. 91.

<sup>65</sup> Applicants note in FD 36500 – Work Paper – HC – Trains Per Day - Methodology.pdf that “The train must pass by at least 25% of the subdivision’s segment stations in order to be counted on it.”

<sup>66</sup> In the MultiRail software, the physical rail network is represented as a series of node and links. Each node represents a station on the railroad or a location that plays a role in properly describing the railroad network, such as a junction point. Links are the tracks that connect nodes (stations).

of nodes could be one mile apart, and another pair could be 25 miles apart. To use node count as a screening criterion is improper and unreliable, as it is not truly a distance-based criterion.

Furthermore, Applicants provide no rationale as to why trains should be excluded simply because they operate over only part of a subdivision. Indeed, Applicants' approach {{XXX}}.<sup>67</sup> The peak train count on a subdivision, even if it does not traverse the full subdivision, might be of more value than the average count of trains traversing the full subdivision, as the peak train count could be more important from a capacity and environmental perspective.

In *Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al.* STB Docket No. FD 36500, Elphick and Orr Dep. 176:7 – 180:3, Feb. 18, 2022 deponent Elphick states that { } By witness Elphick's own admission, {XXX}.

#### **4.4 Applicants largely abandoned their MultiRail operating plan in developing the merged carrier's operating expenses.**

Compared to Class I merger filings since the mid-1990s,<sup>69</sup> Applicants' planning process is disjointed, resulting in misaligned, misleading, and erroneous outputs of such frequency and magnitude that Applicants apparently were unable to use their activity-based MultiRail operating statistics as the basis for projecting operating and capital costs to move Year 3 projected traffic.<sup>70</sup>

As noted previously,<sup>71</sup> in a customary merger planning process, current and projected traffic flows for the merging railroads are loaded into an operations model (such as MultiRail). Using the functionality included within the model, an operating plan is developed. This process

<sup>67</sup> HC - Remote Videotaped Deposition of Raymond A. Elphick and John F. Orr, STB Docket No. FD 36500, Elphick Deposition, pp. 178:22, Feb 18, 2022.

<sup>68</sup> HC - Remote Videotaped Deposition of Raymond A. Elphick and John F. Orr, STB Docket No. FD 36500, Elphick Deposition, pp. 178:9 – 178:10, Feb 18, 2022

<sup>69</sup> See discussion in Section 3 above.

<sup>70</sup> See discussion below and Verified Statement of Hugh Randall for additional detail on operating and capital expense modeling outputs.

<sup>71</sup> See Section 3.1 (Exhibit 3-1).

results in a blocking plan, train plan, a routing plan for each traffic movement, as well as resulting operating statistics. The operating statistics are then input into a financial model to develop operating costs. In this model, based on the historic relationships between operating statistics and each category of operating expense for the merging railroads, operating statistics are converted into estimated operating expenses for the combined railroad and become inputs to the post-merger financial projections for the merged railroad.<sup>72</sup>

While Applicants employed MultiRail as a first step in preparing their operating plan, Applicants did not follow the process used in past mergers that utilized the outputs of the MultiRail model to support the costing process.<sup>73</sup> For example, while Applicants included organic growth in the MultiRail traffic, they (inexplicably) chose to exclude it in developing post-merger operating expenses. As a result, it became impossible to use operating statistics such as train-miles from MultiRail in the costing process. This decision had a major (negative) impact on the reliability of Applicants' operating cost estimates. While MultiRail produced an estimated increase in train-miles of approximately {{ }} per year, the costing process was based on a "no organic growth" increase in train miles of only about {{

}} per year.<sup>74</sup> This lower value was generated by Applicants' system model, which incorporated various assumptions about efficiency gains, so as to produce a very low incremental increase in train-miles. None of those efficiency gains have been proven using MultiRail or any

<sup>72</sup> The verified statement by Kent and Klick in the CN-IC merger application provides an excellent example of the use of operating metrics to drive the costing process (see Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998, Verified Statement of Kent and Klick, starting on p. 289)

<sup>73</sup> Finance Docket No. 33556, Railroad Control Application, Surface Transportation Board, July 1998, Vol. 2, pp. 127-129, and Verified Statement of Kent and Klick, starting on p. 289; See also Finance Docket No. 33388, Railroad Control Application, Surface Transportation Board, June 1997, Volume 3B, pp. 90-92.

<sup>74</sup> See HC – Oliver Wyman - Change in Train Miles and GTM from Base Year to Year 3.pdf for associated analysis and workpapers.

other detailed operating analysis – to the contrary, they are based entirely on a set of externally provided assumptions.

Applicants obfuscate this fact by portraying metrics in their Application as if they were derived from the operating plan – for example, in Table 2 on page 28 of Volume 2 of the Application.<sup>75</sup> In fact, the metrics in Table 2 have little to do with the operating plan and were sourced instead from the previously cited system model.

In *Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al.* STB Docket No. FD 36500, Elphick and Orr Dep. 180:8 – 184:22, Feb. 18, 2022, deponent Elphick is asked about Table 2, and the role of the system model. In response to a series of questions on whether MultiRail produced the statistics in Table 2 the following exchange took place:

{

}

In later questioning Elphick stated:

{ }

Exhibit 4-1 depicts my understanding of the process actually used by Applicants to generate the operating plan and metrics used for costing.

<sup>75</sup> See HC – Oliver Wyman - Review of Operating Plan Statistics and Their Sources.pdf.

**Exhibit 4-1: Application operating plan flaws: no connection between the operating plan, system model, and financial projections**

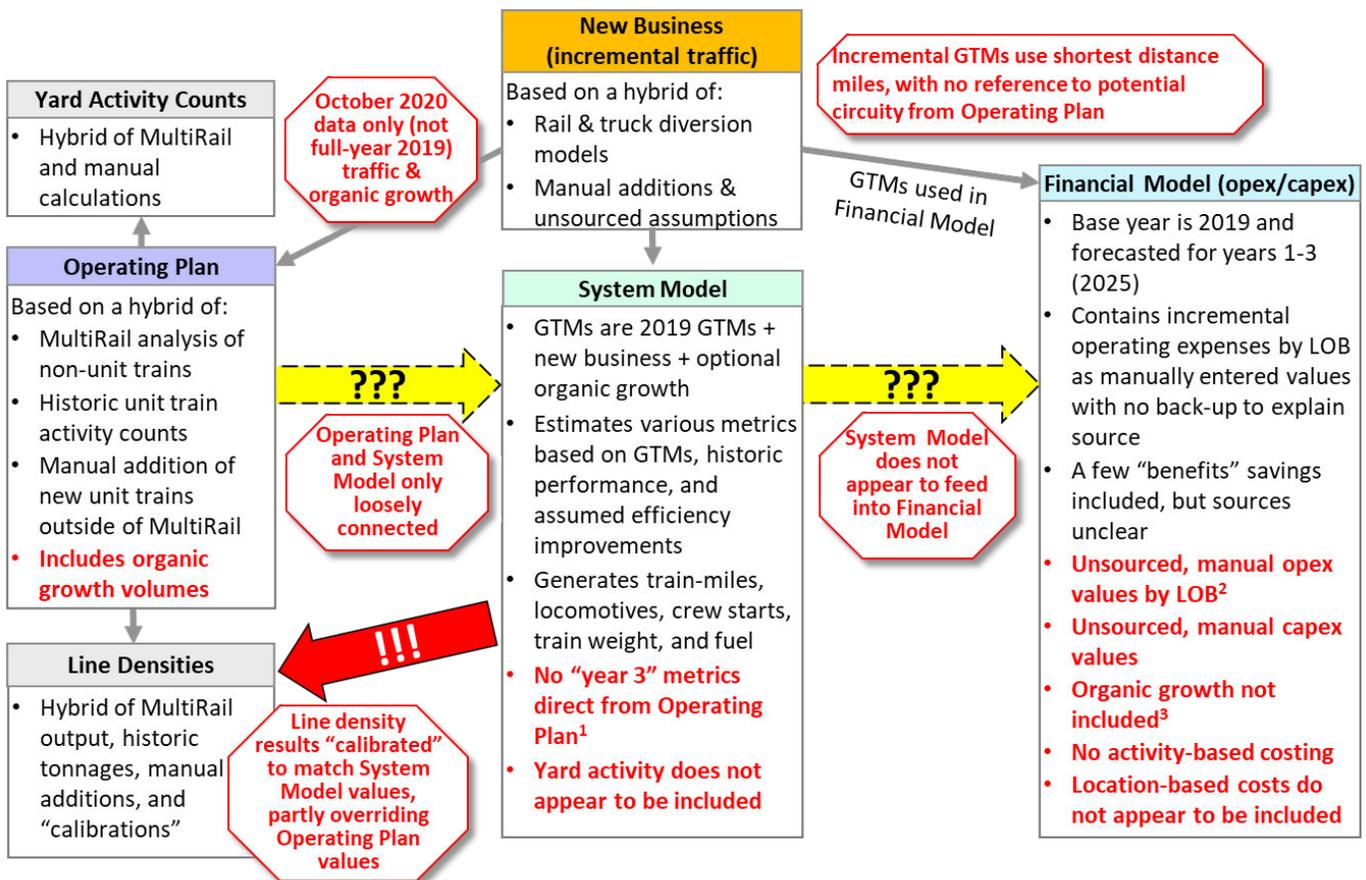


Exhibit 4-1 illustrates that the metrics used by the Applicants in the costing process are *not* based on the operating plan, but instead are based on a set of standalone assumptions about how various metrics will change in response to changes in volumes. In the system model, ton-miles are the key metric that drives the generation of almost all other metrics, such as changes in train-miles and crew starts. But the projected change in ton-miles in the system model was not based on the operating plan, but rather resulted from a process that does not utilize key considerations,

such as actual empty/loaded ratios and the effects of the operating plan on circuitry – all of which are normally considered in the operating plan modeling process.<sup>76</sup>

Applicants have not explained why the metrics developed from their operating plan were not flowed through to the financial model, as they would in a typical merger application. As stated above, a review of the Application and associated work papers did not identify any links between the methodologies or Excel-based “models” that tied the operating plan to incremental operating expense costing. Applicants’ projected operating costs are presented by line of business; a review of the Application and workpapers did not yield any statistics either in the operating plan or the system model that were organized in this manner.<sup>77</sup>

A central element of PSR and of the “optimized plan” presented by Applicants is a reduction in intermediate car classifications through the creation of more direct blocks closer to the origin of shipments and the increased use of block swaps. In point of fact, of the 21 new trains Applicants describe, my review indicates at least 20 of those trains are involved with block swaps, primarily at Shreveport, Sanchez, and Chicago.<sup>78</sup>

<sup>76</sup> FD 36500 - Work Paper - HC - 1.Proposed Final FTI Rail to Rail Diversion Results for Merger Application 10\_21\_20 Updat\_Truck\_Rev.xlsx.

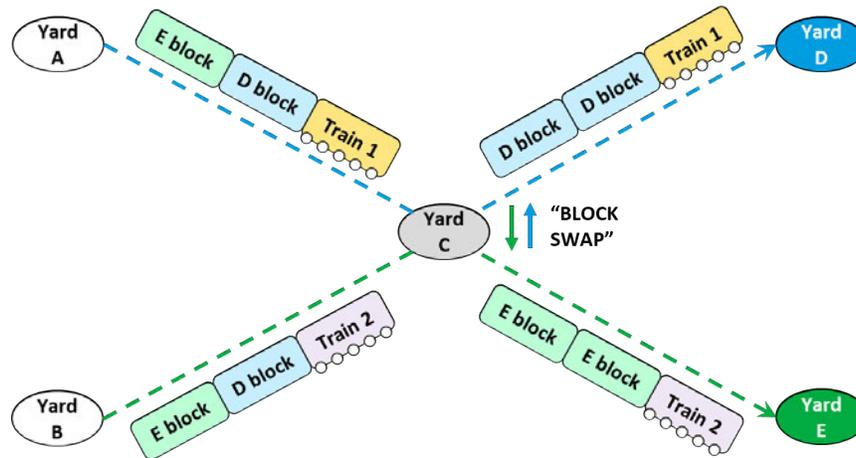
<sup>77</sup> See Verified Statement of Hugh Randall.

<sup>78</sup> Application Vol. 2, Appendix I, pp. 437-442.

A “block swap” refers to the movement of an intact group of cars from one train to another.

For example, consider the following diagram (Exhibit 4-2):

**Exhibit 4-2: Block swap example**



In this example, Yard A and Yard B each make blocks for D and E. When Train 1 leaves Yard A it carries both D and E blocks, and when Train 2 leaves Yard B it carries both D and E blocks. But Train 1 only goes to D (blue line) and Train 2 only goes to E (green line). However, since both trains travel via Yard C, they can “swap” blocks at that yard for the end points they do not serve: Train 1 can give its E block to Train 2, and Train 2 can give its D block to Train 1.

Such block swaps reduce the need to classify cars at Yard C into new blocks, while maximizing service quality to D and E. Note that while this does eliminate the need to do detailed switching of cars at Yard C for the cars traveling in these blocks, it does not eliminate the need to break apart both trains and set-off/pick-up cars at Yard C, which does impact the use of Yard C’s capacity and environmental footprint.

Despite Applicants’ reliance on block swaps to achieve efficiencies through implementation of PSR operating concepts, no mention is made of any activity measures related to yard switching activity, including intermediate switching, block swaps, or intermodal lifts in Applicants’ system model, and nothing indicates that such measures were taken into account in

developing post-merger operating expenses. There is one small entry in the benefits section of the financial model that cites a reduction in “I&I Switching” of a few hundred thousand dollars per year.<sup>79</sup> This unexplained benefit is the only reference I could find to location-based car handling costs.

In sum, while the Application presents a veneer that somewhat resembles the type of operations planning process characteristic of the most recent Class I rail mergers, the processes they describe are, with apologies to Macbeth, “full of sound and fury, signifying nothing.” In actuality, Applicants set aside the proven tools and models such as MultiRail in the costing process. Instead, Applicants embarked on a convoluted (and unprecedented) operating plan process that they never fully explain. Then, essentially abandoning their own operating plan, Applicants substituted operating costs derived from a simple, undocumented spreadsheet that accounted for less than half of the GTMs identified in the operating plan process – and used this as the critical driver of their operating and capital cost calculations.<sup>80</sup>

## 5. Specific Errors in Applicants’ Analysis

Applicants’ choices concerning traffic data and modeling raise serious issues concerning the credibility of their operating plan and operating metrics. In this section, I describe some of the more serious errors in Applicants’ planning process, which are summarized in Exhibit 5-1. Beyond these more serious examples, there are a host of other issues with the operating plan, which are summarized in Section 6.

<sup>79</sup> FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx, Inputs- Operating Benefits tab.

<sup>80</sup> Application Vol. 1, p. 442, ¶13 states organic growth was excluded from financials, Application Vol 2, p. 286, ¶85 states organic growth was included in the operating plan. *See also* FD 36500 - Work Paper - HC - System Model-Methodology.pdf; FD 36500 - Work Paper - HC - Cost Metrics Growth Model\_Base year 2019.xlsx; and FD 36500 – Work Paper – STB Rail Road Application Model – Final.xlsx, Inputs - Revenues + Costs tab.

**Exhibit 5-1: Summary of serious errors in Applicants’ operating planning process<sup>81</sup>**

| Section | Description  | Discussion   |
|---------|--|--|
| 5.1     | Traffic density on the main line between Sabula, IA and Airline Junction (Kansas City) is understated by up to 25 percent.   | <ul style="list-style-type: none"> <li>• The Sabula – Airline Junction line is the primary artery in the CP-KCS system and the only line linking the CP and KCS systems.</li> <li>• If Applicants use invalid or understated traffic volume estimates for this line, this in turn invalidates capital expense decisions and environmental assessments for this line.</li> <li>• Given the central role of the line, service issues arising from insufficient investment in capacity based on inaccurate traffic estimates might well spread to other portions of the system, as has occurred in past mergers.</li> </ul>   |
| 5.2     | Northbound intermodal traffic at Lazaro Cardenas is significantly understated in the Base Year, and the understatement carries forward into the Year 3 estimate.   | <ul style="list-style-type: none"> <li>• While the Base Year for the operating plan is 2019, Applicants chose to model carload and intermodal traffic based on traffic in October 2020. The Port of Lazaro Cardenas, however, was effectively closed during October 2020 by a blockade established by striking teachers.</li> <li>• The annualized October 2020 intermodal traffic at Lazaro Cardenas used by the Applicants is less than 10 percent of the actual 2019 traffic it is supposed to represent. This error in Base Year traffic carries forward into Year 3 and materially affects train design to and from the Port.</li> </ul>  |
| 5.3     | The train counts by subdivision are invalid and cannot be relied upon  | <ul style="list-style-type: none"> <li>• Merger regulations require Applicants to report the changes in trains per day on each line segment or subdivision between the pre- and post-merger operating plans – due to a variety of causes the train counts produced by the applicants are invalid and cannot be relied upon</li> <li>• Applicants’ train counts are inherently unreliable in light of the numerous errors in the traffic on which Applicants’ operating plan is based.</li> <li>• An unknown number of trains were arbitrarily excluded from train counts because they traversed fewer than 25 percent of the nodes on a line segment/subdivision. In all likelihood, this results in Base Year and Year 3 train counts that are understated.</li> <li>• Base Year unit trains were developed using one only month of data (October 2019). Applicants provided no analysis or other evidence to demonstrate that this period is representative of full-year 2019 unit train operations.</li> <li>• There is real potential that some traffic operated in unit trains was excluded from MultiRail and its train counts, but also not accounted for in the one-month snapshot of unit trains used by Applicants.</li> <li>• The trains per day values published in the Application do not match the work papers Applicants identified as being the source of those values.</li> </ul> |
| 5.4     | The Application provides invalid data on car handling changes at yards and does not report numerous yards with projected growth in activity of more than 20 percent (as required by the Board’s merger application | <ul style="list-style-type: none"> <li>• Merger regulations require Applicants to report any yard at which they project activity will increase by more than 20 percent. This percentage is supposed to be measured between pre-merger operations and the steady-state post-merger case.</li> <li>• Applicants incorrectly use their so-called “Optimized Plan” as the starting point for measuring changes in yard activity, but that is a plan or scenario that can only be implemented beginning after the merger is consummated.</li> </ul>   |

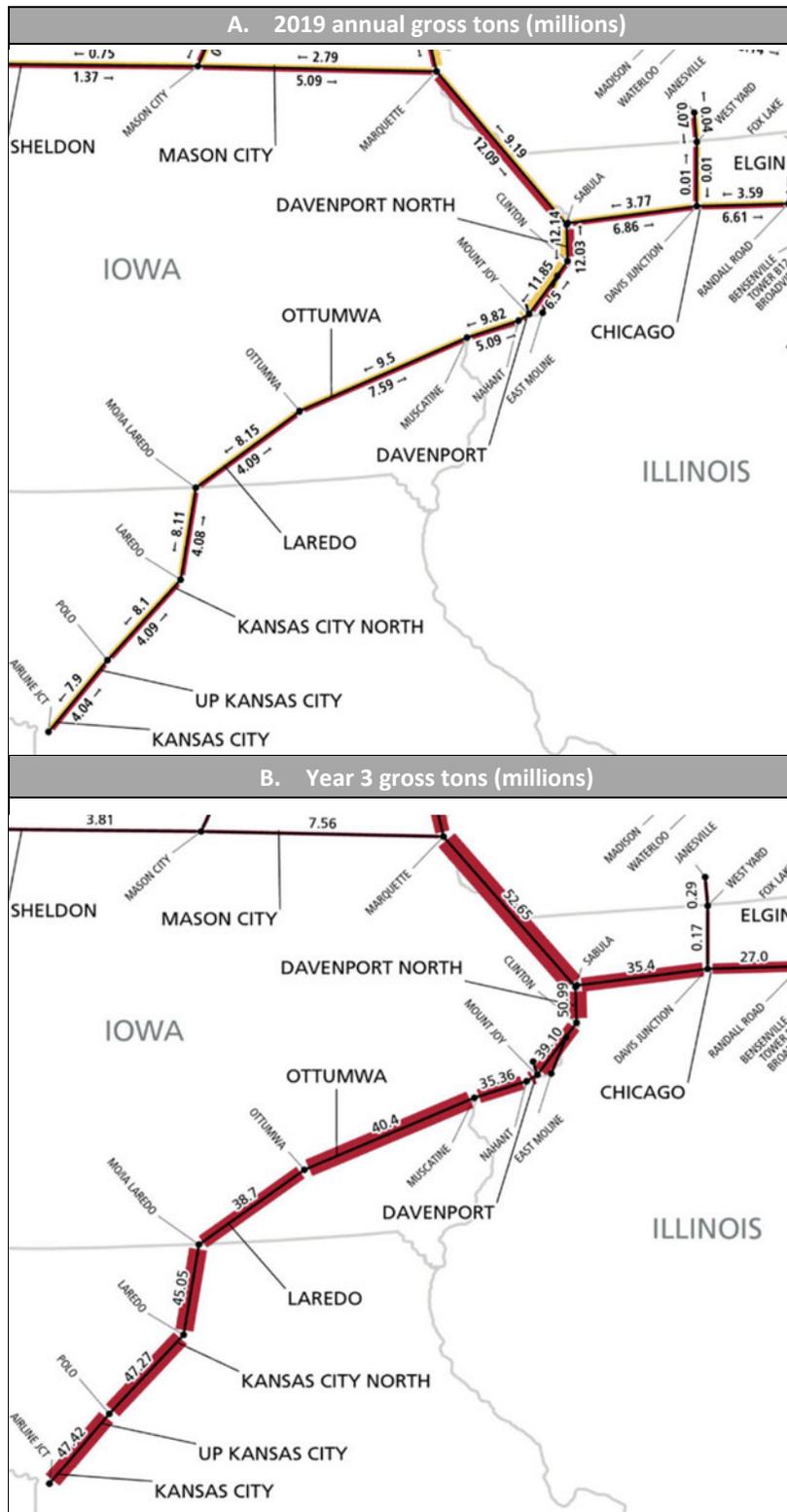
<sup>81</sup> Summary table only: All citations for error descriptions and discussion are provided in subsequent detail sections.

| Section | Description   | Discussion   |
|---------|---|--|
|         | and environmental regulations).   | <ul style="list-style-type: none"> <li>• Applicants fail to include all yards that will experience an increase in activity of more than 20 percent, in part because they failed to include bulk traffic in their statistics.</li> <li>• Given experience in past mergers in which traffic exceeded a yard's capacity and triggered service disruptions, this requirement is an important cross-check of the Applicants' operating and capital plans.</li> </ul>  |
| 5.5     | Originating and terminating traffic estimated in the Application is out of balance at numerous locations. | <ul style="list-style-type: none"> <li>• One of the primary methods to check the accuracy of a traffic base is to compare originations and terminations at each location, as originations and terminations by location should balance generally.</li> <li>• Numerous locations reported in the Application are out of balance, indicating that there likely are problems with the traffic data.</li> <li>• This in turn has a direct impact on the activity levels reported for yards, and likely has caused distortions in the blocking and train plans.</li> </ul> |

## 5.1 Traffic density between Sabula, IA, and Airline Junction, Kansas City

The line between Sabula, IA and Airline Junction near Kansas City is the sole artery that connects the CP and KCS systems and will be the CPKC network's critical north-south route. It is, therefore, essential that the tonnages projected for this line are accurate. Otherwise, Applicants are likely to fail to allocate sufficient capital to maintain capacity and keep this artery fluid. (Accurate tonnage also supports the environmental assessment process.) Exhibit 5-2 shows the tonnages reported in the Application for the Sabula-Airline Junction line, as well as the feeder lines into Sabula from the north. Exhibit 5-3 shows the underlying tonnage figures by line segment.

Exhibit 5-2: Base Year and Year 3 projected traffic for Sabula, IA-Airline Junction, Kansas City<sup>82</sup>



<sup>82</sup> Refer to Exhibit 14 traffic density maps in Volume 2 of Application, pp.508, 510.

**Exhibit 5-3: Tonnage by line segment<sup>83</sup>**

| Line Segment                        | 2019 Tonnage | Year 3 Tonnage | Difference |
|-------------------------------------|--------------|----------------|------------|
| Nahant – Muscatine                  | 14.91        | 35.36          | 20.45      |
| Muscatine – Ottumwa                 | 17.09        | 40.4           | 23.31      |
| Ottumwa – MO/IA Laredo (state line) | 12.24        | 38.7           | 26.46      |
| MO/IA Laredo – Laredo               | 12.19        | 45.05          | 32.86      |
| Laredo – Polo                       | 12.19        | 47.27          | 35.08      |
| Polo – Airline Junction             | 11.94        | 47.42          | 35.48      |

The 2019 tonnage demonstrates that traffic over the line, especially between Ottumwa and Airline Junction, varies very little, indicating that little traffic originates or terminates along this line. Yet, the Applicants project that in Year 3, tonnage on the line will vary widely between segments, from a low of 38.7 million tons to a high of 47.42 million tons (see Exhibit 5-3 above). To understand this anomaly, and to demonstrate that there are no significant new sources of traffic along this line in the Year 3 scenario, I conducted two location-specific analyses.

First, I conducted a manual review of all the diversion traffic identified in Applicants' Diversion Traffic Excel Workbook<sup>84</sup> and classified it either as traversing the line or not traversing the line. Because of the location of this line between the merging railroads, it is generally not affected by reroutes associated with extended hauls – and thus the analysis did not need to broadly consider potential volume adjustments where an extended haul move was already in the base (2019) traffic. “Extended haul” traffic was considered and counted only if it was new to CP and would (for the first time) move over the Sabula – Airline Jct. line segment.<sup>85</sup> My analysis focused on the Muscatine-Ottumwa segment, with results as shown in Exhibit 5-4.

<sup>83</sup> Based on values from Exhibit 14: Density Charts in Volume 2 of Application, pp.461-504.

<sup>84</sup> See FD 35600 - Work Paper - HC - 1.Proposed Final FTI Rail to Rail Diversion Results for Merger Application 10\_21\_20 Updat\_Truk\_Rev.xlsx.

<sup>85</sup> See HC – Oliver Wyman - Evaluation of Ottumwa Line Segment (Muscatine - Ottumwa) Tonnage – Methodology.pdf for methodology and associated work papers.

**Exhibit 5-4: Results of analysis of diverted traffic<sup>86</sup>**

| Line Segment                  | Applicants<br>2019<br>Tonnage | Applicants<br>Year 3<br>Tonnage | Estimated<br>Tonnage from<br>Diversion | Organic<br>Growth<br>@{{XXX}} | Revised<br>Estimated<br>Tonnage | Percentage<br>Under -<br>Estimate |
|-------------------------------|-------------------------------|---------------------------------|--|-------------------------------|---------------------------------|-----------------------------------|
| <b>Muscatine-<br/>Ottumwa</b> | 17.09                         | 40.40                           | {{XXX}}                                | {{XXX}}                       | {{XXX}}                         | {{    }}                          |

The tonnage values for each shipment were directly based on the values Applicants presented in their system model.<sup>87</sup> The stated approach taken by Applicants was to compute tonnages by starting with base 2019 tonnages and then adding new business that is expected to result from the merger, plus an allowance for organic growth (here, Applicants used a {{XXX}} growth factor).<sup>88</sup> *The analysis revealed that the tonnages shown on the maps in the Application are {{XXX}} below the correctly calculated tonnages for this line segment.*<sup>89</sup>

Second, to test the fluctuation in traffic densities on the line segments between Ottumwa and Airline Junction shown in the Application, I loaded the diversion traffic into a version of MultiRail controlled by Oliver Wyman and flowed it across the network to develop the gross tonnage values for each line segment. This exercise both provided a cross-check to my analysis of the traffic on the Muscatine-Ottumwa segment and tested whether any traffic originates/terminates along the line. The result of my analysis, shown in Exhibit 5-5, is largely consistent with my earlier analysis. It demonstrates that, contrary to the data presented in the Application, there are no significant variations in tonnages between the segments.

<sup>86</sup> Applicant's 2019 and Year 3 tonnages are based on values provided in Exhibit 14: Density Charts in Volume 2 of Application, pp. 461-504. See HC – Oliver Wyman - Evaluation of Ottumwa Line Segment (Muscatine – Ottumwa) Tonnage - Methodology.pdf for analysis and associated sources to calculate the “Tonnage from Diversion.”

<sup>87</sup> See FD 36500 – Work Paper – HC – System Model - Methodology.pdf.

<sup>88</sup> See FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019.xlsx. (Organic growth is derived from the change in Year 3 and the Base year “Reference tab”).

<sup>89</sup> See HC – Oliver Wyman - Evaluation of Ottumwa Line Segment (Muscatine - Ottumwa) Tonnage – Methodology.pdf for approach to analysis and how the 25 percent difference is calculated.

**Exhibit 5-5: Results of MultiRail analysis of the line between Nahant and Airline Junction<sup>90</sup>**

| Line Segment            | Applicants<br>2019<br>Tonnage | Applicants<br>Year 3<br>Tonnage | Diversion<br>Tonnage from<br>OW MultiRail | Organic<br>Growth<br>@21% | Revised<br>Estimated<br>Tonnage | Estimated<br>Percentage<br>Error |
|-------------------------|-------------------------------|---------------------------------|---|---------------------------|---------------------------------|----------------------------------|
| Nahant - Muscatine      | 14.91                         | 35.36                           | {{XXX}}                                   | {{XXX}}                   | {{XXX}}                         | {{ %}}                           |
| Muscatine - Ottumwa     | 17.09                         | 40.4                            | {{XXX}}                                   | {{XXX}}                   | {{XXX}}                         | {{ }}                            |
| Ottumwa – MO/IA Laredo  | 12.24                         | 38.7                            | {{XXX}}                                   | {{XXX}}                   | {{XXX}}                         | {{ }}                            |
| MO/IA Laredo – Laredo   | 12.19                         | 45.05                           | {{XXX}}                                   | {{XXX}}                   | {{XXX}}                         | {{ }}                            |
| Laredo – Polo           | 12.19                         | 47.27                           | {{XXX}}                                   | {{XXX}}                   | {{XXX}}                         | {{ }}                            |
| Polo – Airline Junction | 11.94                         | 47.42                           | {{XXX }}                                  | {{XXX}}                   | {{XXX}}                         | {{ }}                            |

**5.2 Base Year intermodal traffic at Lazaro Cardenas is understated**

Exhibit 5-6 compares actual intermodal traffic during the full year 2019 with the 2019 Base Year intermodal traffic for Lazaro Cardenas that Applicants projected by annualizing traffic from the single month of October 2020.

**Exhibit 5-6: Comparison of annualized intermodal units<sup>91</sup>**

| Annualized from         | From Lazaro Cardenas |         | To Lazaro Cardenas |         |
|-------------------------|----------------------|---------|--------------------|---------|
|                         | Loads                | Empties | Loads              | Empties |
| 2019 Full Year Waybills | {{XXX}}              | {{XXX}} | {{XXX}}            | {{XXX}} |
| October 2020 Waybills   | {{XXX}}              | {{XXX}} | {{XXX}}            | {{XXX}} |

Exhibit 5-6 clearly illustrates the impact of Applicants’ decision to rely entirely on October 2020 traffic data to create the Base Year operating plan for carload and intermodal traffic. The number of originating loaded containers in the annualized October 2020 data is less than 10 percent of the number of loaded containers in the actual 2019 full year data. This discrepancy is attributable largely to the fact that the Port experienced a blockade by striking teachers during

<sup>90</sup> Applicant’s 2019 Tonnage and Year 3 Tonnage are based on values from Exhibit 14: Density Charts in Volume 2 of Application, pp. 461-504. Organic growth tonnage is calculated from multiplying the 2019 tonnage by 21 percent. See HC – Oliver Wyman - MultiRail Corridor Volume, Tonnage and Length Estimates for Diversion Traffic Methodology.pdf for how the “Diversion Tonnage” is obtained from MultiRail and associated outputs.

<sup>91</sup> See HC – Oliver Wyman - Comparison of Intermodal Traffic at Lazaro Cardenas between Oct 2020 and FTI 2019 Data – Methodology.pdf for associated analysis and sources.

October 2020.<sup>92</sup> (It is not clear whether Applicants were aware of that fact in selecting October 2020 as the sole source of carload and intermodal traffic for their Base Year MultiRail model.)

While most of the originating container traffic in the base period is local to Mexico, these missing container volumes must have had a material effect on the train design out of Lazaro Cardenas. The 2019 full year waybills equate to more than 10,000 feet of intermodal cars northbound per day, while the annualized October 2020 waybills generate less than 500 feet of intermodal cars northbound per day.<sup>93</sup> As a cross-check, I reviewed the number of cars originating/terminating in the base period at Lazaro Cardenas in the report contained in Volume 2, Appendix B of the Application,<sup>94</sup> and found the stated values to be consistent with the above finding. Moreover, the Applicants carried the erroneous estimate of Base Year traffic at Lazaro Cardenas forward into Year 3, likely distorting the Year 3 operating plan as well.

### **5.3 Application train counts are not reliable**

The train counts by line (a specific filing requirement),<sup>95</sup> as published in the Application, are inaccurate due to the use of non-representative unit train data for the base period, intentional exclusion of other trains,<sup>96</sup> errors in how the operating plan was developed, and inconsistencies between the work papers and the values published in the Application.

Nothing in the regulations permits Applicants exclude from their operating plan (and environmental submission) selected trains that “only” touch a subset of the locations in a

<sup>92</sup> “Rail blockade ends in Mexico after 60 days of protests.” Freight Waves, December 2, 2020.

<sup>93</sup> Uses CP standards for intermodal cars so formula is  $[\text{Annual Containers}]/[\text{365 Days}]/[\text{4.7 Containers/Car}]*[\text{165 Feet/Car}]$ . See HC – Oliver Wyman - Intermodal to Railcar Conversion Factor Source Compilation.pdf for sources.

<sup>94</sup> Application, Vol. 2, Appendix B: Change in Yard Volumes, p. 389 for Lazaro Cardenas has 8.4 originating cars per day; multiplying the figure by  $4.7 * 365$  yields 14,410 originating containers. See HC-Oliver Wyman - Intermodal to Railcar Conversion Factor Source Compilation.pdf for sources.

<sup>95</sup> CFR 49 Part 1111.8 (a)(1).

<sup>96</sup> FD 36500 – Work Paper – HC Trains Per Day - Methodology.pdf, p. 2.

division.<sup>97</sup> Yet, as discussed above, CP arbitrarily decided to remove from the train list generated by MultiRail any train that did not traverse at least 25% of the stations on any subdivision on which it operated. Combined with the known errors in the traffic included in Applicants' MultiRail modeling, it is virtually certain that the train counts in the Application are wrong.

In addition, *the train counts in the Application are inconsistent with the work papers cited by Applicants as being the source of those train counts.* In response to CN discovery request #115, Applicants stated that the FD 36500 – Work Paper – HC - Trains Per Day - Methodology.pdf is the file that explains how the trains per day shown in the Application were calculated and produced.<sup>98</sup> However, none of the corresponding Excel files cited in that methodology have figures that match the trains per day in the Application.

The only file where the identified level of trains per day even comes close is “FD 36500 – Work Paper – HC- Trains per Day and Gross Ton Miles – Working Copy with Haz Breakdown.xlsx,” which provides a summary view of the trains per day by subdivision/segment (hereafter, the “Trains-per-Day Model”).

The Trains-per-Day Model shows how trains were calculated/derived by providing data on Base Year non-unit and unit trains, growth year non-unit trains, unit train organic growth, and unit train synergy growth. (It is implied that the growth year non-unit train count includes both organic and synergy growth.) The materials indicate that:

- Non-unit train counts in the Trains-Per-Day Model were sourced from MultiRail, from which trains that traversed less than 25 percent of the MultiRail nodes in a subdivision were arbitrarily removed.<sup>99</sup>

<sup>97</sup> Applicants note in FD 36500 – Work Paper – HC – Trains Per Day - Methodology.pdf that “The train must pass by at least 25% of the subdivision’s segment stations in order to be counted on it.”

<sup>98</sup> FD 36500 – Work Paper – HC- Trains per Day.pdf; Application Volume 2, Appendix A. Trains per Day by Subdivision Review.

<sup>99</sup> See FD 36500 – Work Paper – HC – Trains Per Day - Methodology

- The Base Year unit trains were sourced from a set of operational snapshots that appear to be a one-month sample of unit trains operated during October 2019. Nothing in the Application or workpapers shows that these trains are representative of full year 2019 operations.<sup>100</sup>
- The organic growth in unit trains is a simple multiplier applied to the Base Year unit trains without regard to specific commodities.<sup>101</sup>
- The synergy growth in unit trains is based on a manual spreadsheet analysis of new unit trains to be operated based on the traffic diversion analysis (including traffic provided by witnesses Wahba and Naatz).<sup>102</sup>

Exhibit 5-7 demonstrates the discrepancies between the trains per day listed in the Application and the Trains-per-Day Model.

**Exhibit 5-7: Trains per day from Application and Trains-per-Day Model<sup>103</sup>**

| Subdivision              | Application <sup>104</sup> |                          | Trains-Per-Day Model Values <sup>105</sup> |                          | Difference  |         |
|--------------------------|----------------------------|--------------------------|--|--------------------------|-------------|---------|
|                          | Current Trains/Day Base    | Future Trains/Day Year 3 | Current Trains/Day Base                    | Future Trains/Day Year 3 | Base Period | Year 3  |
| Ottumwa                  | 4.2                        | 18.4                     | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |
| Laredo CP                | 3.0                        | 17.0                     | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |
| Kansas City              | 2.9                        | 16.9                     | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |
| Shreveport               | 9.4                        | 23.6                     | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |
| Greenville               | 5.5                        | 7.0                      | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |
| Rosenberg <sup>106</sup> | 8.5                        | 17.7                     | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |
| Laredo KCS               | 10.5                       | 19.4                     | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |

<sup>100</sup> Based on FD 36500 – Work Paper – HC – 2019\_Consolidated\_Data\_Master.txt.

<sup>101</sup> An organic growth rate of {{XXX}}% and {{XXX}}% is used for Year 3 and Year 5 for bulk traffic respectively. See HC – Oliver Wyman - Review of Growth Factors in CPKC Application.pdf.

<sup>102</sup> FD 36500 - Work Paper - HC - New Bulk Input w Year Splits 2021.10.20.xlsx, FD 36500 - Work Paper - HC - Summary of Volume Growth (Units) through Year 5 v4.xlsx.

<sup>103</sup> FD 36500 – Work Paper – HC- Trains per Day, Gross Ton Miles – Working Copy with Haz Breakdown; Application Vol. 2, Appendix A. Trains Per Day, pp. 364-368; and HC - Oliver Wyman - Train Counts Methodology.pdf

<sup>104</sup> Application Vol. 2, Appendix A. Trains Per Day by Subdivision, pp. 364-368.

<sup>105</sup> The highest number of trains per day by subdivision/segment are presented in the above table, data based on FD 36500 – Work Paper – HC- Trains per Day, Gross Ton Miles – Working Copy with Haz Breakdown.

<sup>106</sup> The trains per day listed in the filing for the Rosenberg subdivision match the trains per day summarized in the Excel file that is utilized for this analysis. It is the only subdivision from the list in the table above where both sources have trains per day that match.

| Subdivision | Application <sup>104</sup> |                          | Trains-Per-Day Model Values <sup>105</sup> |                          | Difference  |         |
|-------------|----------------------------|--------------------------|--|--------------------------|-------------|---------|
|             | Current Trains/Day Base    | Future Trains/Day Year 3 | Current Trains/Day Base                    | Future Trains/Day Year 3 | Base Period | Year 3  |
| Saltillo    | 24.1                       | 29.8                     | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |
| Caltzontzin | 3.6                        | 7.3                      | {{XXX}}                                    | {{XXX}}                  | {{XXX}}     | {{XXX}} |

### 5.3.1 Non-Representative Unit Trains

The use of a non-representative set of unit trains for the Base Year plan, the application of global scaling factors for unit trains to estimate organic growth, and the potential that some traffic was not represented in either the bulk plan or carload plan raises further questions about the reliability of Applicants' train counts.

As an initial matter, *there is no bulk train operating plan provided at all in the Application.* Historic or “base” bulk trains are not identified at all – they are simply a statistical representation of line activities derived from a “snapshot,” which appears to be from October 2019 for CP and from a 30-day sample for KCS with no specified time period.<sup>107</sup> Nothing demonstrates that these one-month snapshots are representative of full-year 2019 traffic patterns. The projected organic growth in these “bulk” trains is based on system average growth factors<sup>108</sup> that do not in any way tie back to Applicants' traffic studies.

The specific methodology Applicants used to calculate unit trains appears to be as follows:

- An operations monitoring type system was used to identify all unit trains that were operated by CP and KCS/KCSM during a one-month period. The route and consist (weight, length) of each was obtained, along with the train type.<sup>109</sup>

<sup>107</sup> FD 36500 - Work Paper - HC - CP Bulk Cars Per Day By Sub.xlsx; FD 36500 - Work Paper - HC - KCS KCSM Bulk Train Cars Per Day by Subdivision.xlsx.

<sup>108</sup> See HC – Oliver Wyman - Review of Growth Factors in CPKC Application.pdf for organic growth percentages used by CPKC.

<sup>109</sup> See FD 36500 – Work Paper – HC – Trains Per Day - Methodology.pdf and associated work papers: FD 36500 - Work Paper - HC - CP Bulk Cars Per Day By Sub.xlsx and FD 36500 - Work Paper - HC - KCS KCSM Bulk Train Cars Per Day by Subdivision.xlsx.

- Based on the routing of each observed unit train, the subdivisions each train traversed were identified, and the total train count and tons were tallied by subdivision. If a train had a hazardous materials designation (primarily crude oil and ethanol trains), then the traffic also was added to a hazardous materials car count.
- The resulting values by subdivision were divided by days in the time period covered by the sample (one month) and treated as the Base Year values for the operating plan.
- A global growth factor was applied to the unit train counts by subdivision to obtain organic growth in these trains. The same organic growth values of {{XXX}} percent for Year 3 and {{XXX}} percent for Year 5 were applied across all subdivisions, without consideration of the railroad, the commodity involved or the origin/destination of the traffic.<sup>110</sup>
- All of the “synergy” traffic was combined into nine (supposedly) representative train pairs.<sup>111</sup> The frequency of each train pair was set based on a target train size and forecasted diversion volume. The routings of these trains were then used to compute the additional train counts and tonnage associated with “synergy” traffic.
- Some final adjustments were made to “calibrate” these values. While no explanation of the reason for such “calibration” is set forth in the Application, it appears that this step was undertaken to make the overall values appear consistent with a simplistic spreadsheet model which the Applicants called the “System Model.”<sup>112</sup>

If the train pairs used by Applicants are truly representative of the origins and destinations of new post-merger grain unit train movements, then I accept that the non-organic growth bulk trains for the post-merger scenario are likely accurate. But I question the accuracy of the Base Year unit train counts and organic growth unit train counts.

<sup>110</sup> See HC – Oliver Wyman - Review of Growth Factors in CPKC Application.pdf for organic growth percentages used by CPKC.

<sup>111</sup> FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx, Bulk Reference tab, shows nine new train pairs for loaded and empty traffic in the “Train Symbol” column.

<sup>112</sup>FD 36500 – Work Paper – HC- Cost Metrics Growth Model Base year 2019.xlsx.

To determine whether the snapshot of unit trains is indeed representative, I examined the differences between the number of loads handled by KCS/KCSM for full-year 2019 versus October 2019 for selected commodities that move in unit trains.<sup>113</sup> Since I could not directly identify which moves were unit train moves from the data provided, I instead looked at volumes for grain, crude oil, and coal, assuming that differences in the volumes of these commodities between the full year and October 2019 would be consistent with differences in the number of unit trains operated. Among the findings from this analysis are the following:

Almost no crude oil traffic moved from Alberta to Texas or Louisiana during the month of October 2019. While {{XXX}} loaded cars were moved during all of 2019 (equivalent to {{XXX}} cars per month, or about {{XXX}} trains per month accounting for returning empty trains), I only found {{XXX}} such loaded car moves in October 2019.<sup>114</sup> To confirm this finding, I examined the number of crude oil trains Applicants identified in their October 2019 snapshot as transiting the Ottumwa to Laredo, MO segment of the line from Sabula to Airline Junction. All the crude oil traffic from Alberta would necessarily have to transit this line segment. What I found is a total of two trains, one southbound and one northbound – consistent with the low volumes that I identified.<sup>115</sup> Essentially, the Application is understating this very important element of the base CPKC operating plan by 85 percent in terms of train count ({{XXX}} versus {{XXX}} oil trains), and 92% in terms of cars ({{XXX}} versus {{XXX}} cars).

<sup>113</sup> See HC – Oliver Wyman - Evaluation of Bulk Traffic – Coal, Crude, and Grain Methodology.pdf for associated data and analysis.

<sup>114</sup> See HC – Oliver Wyman - Evaluation of Bulk Traffic – Coal, Crude, and Grain Methodology.pdf for associated data and analysis. A standard 115 cars per train conversion is used for crude oil, based on FD 36500 - Work Paper - HC - New Bulk Input w Year Splits 2021.10.20.

<sup>115</sup> FD 36500 - Work Paper - HC - CP Bulk Cars Per Day By Sub.xlsx.

To compound these errors, it appears that Applicants failed to capture this information properly in their analysis of line densities. In the same analysis in which I identified two crude oil trains transiting the Ottumwa-Laredo segment,<sup>116</sup> I found a total of {{XXX}} other unit trains also on the line in October 2019,<sup>117</sup> which translates to {{XXX}} unit trains per day on average.

Exhibit 5-8 shows the bulk train counts that Applicants used for part of the Sabula to Airline Junction line density analysis. Not only is the number of bulk trains understated on the Ottumwa to Laredo segment (it should be {{XXX}}, not {{XXX}}), all unit trains completely disappear on the segment between Clinton and Water Works. These findings indicate that the October 2019 “snapshot” of unit trains is not representative of full-year operations, and that errors in the recording of unit train counts mean that these counts cannot be relied upon.

**Exhibit 5-8: Sabula, IA-Laredo, MO line segments: Application unit-train counts<sup>118</sup>**

| Line Segment                 | Base (2019)<br>Unit Trains/Day |
|------------------------------|--------------------------------|
| SABULA,IA - CLINTON,IA       | {{XXX}}                        |
| CLINTON,IA - WATER WORKS,IA  | {{XXX}}                        |
| WATER WORKS,IA - NAHANT,IA   | {{XXX}}                        |
| NAHANT,IA - MUSCATINE,IA     | {{XXX}}                        |
| MUSCATINE,IA - OTTUMWA,IA    | {{XXX}}                        |
| OTTUMWA,IA - MO/IA LAREDO,MO | {{XXX}}                        |
| MO/IA LAREDO,MO - LAREDO,MO  | {{XXX}}                        |

Turning to organic growth of unit trains, a single, systemwide organic growth factor was applied to the base period unit train counts by line segment.<sup>119</sup> We know from history that different lines of business, such as coal and grain traffic, can have very different organic growth

<sup>116</sup> FD 36500 - Work Paper - HC - CP Bulk Cars Per Day By Sub, Crude tab, filtered for "Ottumwa" as Location.

<sup>117</sup> Based on review of FD 36500 - Work Paper - HC - CP Bulk Cars Per Day By Sub for all train types on Ottumwa division.

<sup>118</sup> FD 36500 – Work Paper – HC – Trains Per Day, Gross Ton Miles - Working Copy with Haz Breakdown .xlsx.

<sup>119</sup> See HC – Oliver Wyman - Review of Growth Factors in CPKC Application.pdf for organic growth percentages used by CPKC.

rates (for example, for coal in the current “anti-fossil fuel” regulatory environment).<sup>120</sup> Lane and geographic-based differences may also factor into growth rates. The use of undifferentiated global adjustment factors by the Applicants for organic growth completely ignores this issue.

Applicants developed an operating plan in MultiRail only for non-unit train operations. But, neither the Application or the workpapers explain how Applicants determined which Base Year traffic was “unit train” traffic and excluded from MultiRail. It is quite likely that there are gaps where some traffic excluded from MultiRail also was not captured in unit train counts.

It is also possible that some unit trains were not included in the “snapshot” of one month of data, as only specific train types were counted. Other unit trains would have been operated during the time period, such as military trains, trackage rights/haulage trains, rock/aggregate trains, etc. It is not clear if the traffic moving in these trains was included in the MultiRail Base Year operating plan, unit plan, or neither.

While nine train pairs were developed to account for new unit train traffic,<sup>121</sup> these trains are not documented in the formal Application, despite their significant volumes – particularly between Alberta and Texas for crude oil (approaching two trains/day in each direction), and between various points in Canada, the United States, and Mexico for grain. Given the significant percentage of CPKC trains that are “unscheduled” unit trains, Applicants’ failure to describe these trains leaves a significant gap in their description of expected operations.

<sup>120</sup> Growth rates differed across commodities from 2015 to 2020, e.g., the amount of coal originated in the US by Class I railroads dropped by 45 percent, while grain loadings increased by 6 percent over the same period. *See* Growth Commodity Growth Rates 2015 - 2020 from AAR Class I Railroads Analysis.xlsx.

<sup>121</sup> FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx, Bulk Reference tab, shows nine new train pairs for loaded and empty traffic in the “Train Symbol” column.

### 5.3.2 Conclusions

The train counts in the Application and in the Environmental Train Count Table<sup>122</sup> should not be relied upon for the following reasons:

- Applicants' train counts are inherently unreliable in light of the numerous errors in the traffic on which Applicants' operating plan is based. An unknown number of trains were arbitrarily excluded from train counts because they traversed fewer than 25 percent of the nodes on a line segment/subdivision. This results in Base Year and Year 3 train counts that are understated.
- Base Year unit trains were developed using one only month of data (October 2019). Applicants provided no analysis or other evidence to demonstrate that this period is representative of full-year 2019 unit train operations. Based on the clear distortions in the traffic data used for the operating plan, there is every reason to believe that similar distortions exist in the unit train counts.
- There is real potential that some traffic operated in unit trains was excluded from MultiRail and its train counts, but also not accounted for in the one-month snapshot of unit trains used by Applicants. The result would be that some of the traffic was not counted in Applicants' disconnected unit train planning process, causing distortions in unit train counts.
- To the extent that the number of unit trains is understated, investments required to increase line-of-road and yard capacity may be understated, jeopardizing Applicants' ability to provide the efficient single-line service levels needed to attract projected Year 3 traffic growth.
- The trains per day values published in the Application do not match the work papers Applicants identified as being the source of those values.

<sup>122</sup> Based on file submitted to the Board by Venable LLP and CP under Comment ID "31353" (31353.pdf), which contains master segment and yard tables, with information on environmental trains per day.

## 5.4 The Application fails to meet the requirement to identify all yards projected to experience more than a 20 percent increase in activity

The merger regulations require Applicants to identify any yard that will experience an increase in activity of 20 percent or more.<sup>123</sup> This information is important because, among other factors, it serves as a check to ensure that the capital expenditure plan considers situations in which added traffic will push yards to (or beyond) their practical capacity. In past mergers, an increase in traffic beyond a yard's practical capacity resulted in service failures that spread across the network.

My review of the Application and workpapers found that dozens of yards should have been reported were omitted from the Application. Some of these yards were small, so that even a small increase in traffic might generate a 20 percent increase in activity. Exhibit 5-9 focuses on the six largest yards with a projected increase in activity of greater than 20 percent that were not addressed in the Application. As Exhibit 5-9 indicates, the increase at several of the yards is quite substantial and may well exceed their current practical capacity. Some of these yards, such as Port Arthur, Hardisty, and Bruderheim, were not listed because Applicants failed to include unit traffic in their activity counts in the filing.

**Exhibit 5-9: Six yards with a change of activity > 20 percent omitted from the Application**<sup>124</sup>

| Yard         | Processed Cars<br>Base | Processed Cars<br>Year 3 | Change  | % Change |
|--------------|------------------------|--------------------------|---------|----------|
| Port Arthur  | {{XXX}}                | {{XXX}}                  | {{XXX}} | 85%      |
| Hardisty     | {{XXX}}                | {{XXX}}                  | {{XXX}} | 286%     |
| Bruderheim   | {{XXX}}                | {{XXX}}                  | {{XXX}} | 557%     |
| Agincourt    | {{XXX}}                | {{XXX}}                  | {{XXX}} | 41%      |
| Jesus Maria  | {{XXX}}                | {{XXX}}                  | {{XXX}} | 28%      |
| Det Con Term | {{XXX}}                | {{XXX}}                  | {{XXX}} | 88%      |

<sup>123</sup> 49 CFR Part 1111.8(a)(1)(2000).

<sup>124</sup> See HC - Oliver Wyman - Yard Projections Methodology.pdf.

The Board's regulations require that Applicants compare pre-merger yard activity with post-merger yard volumes once the merged system has reached a steady state.<sup>125</sup> Applicants failed to satisfy this requirement, because they used the "Optimized Base Year" scenario (rather than the true Base Year) for pre-merger values. The Optimized Base scenario reflects the efficiencies CPKC hopes to achieve using precision scheduled railroading principles *after* the merger is consummated. As a result, the "Optimized Base Year" figures presented by Applicants do not actually reflect the pre-merger situation but instead represent a hypothetical intermediate stage between "Day 1" and Year 3 post-merger.

### **5.5 Originating and terminating railcar volumes are out of balance at many of the locations shown in the Application**

One indicator of potentially inaccurate traffic data is the balance between originating and terminating cars by location. With few exceptions, the long-term trend should be for locations to be balanced in terms of originating versus terminating car counts. There may be some differences at interchanges due to directional agreements between a set of locations, but even these often trend toward statistical balance over longer periods of time. As a result, a clear lack of balance is often indicative of either the use of non-representative traffic or errors in deciphering (and correcting as necessary) the locations found in waybills. Such errors in the traffic data flow directly through to the activity counts for yards.

I examined the Base Year originating and terminating cars by location in Applicants' MultiRail yard volume comparison report.<sup>126</sup> While this report does not include unit train traffic, it provides a reasonable comparison of the originating and terminating volumes used by

<sup>125</sup> CFR Part 1111.8(a).

<sup>126</sup> Application Vol. 2, Appendix B Change in Yard Volumes Overall, pp. 369-403.

Applicants in creating their carload and intermodal operating plans. The results of my review are shown in Exhibit 5-10.

**Exhibit 5-10: Originating and terminating cars/day for CPKC base period<sup>127</sup>**

| Location             | Originating  | Terminating  | Balance       | % Imbalance |
|----------------------|--------------|--------------|---------------|-------------|
| Baton Rouge          | 47           | 93.6         | 46.6          | 33%         |
| Detroit              | 71.2         | 138.5        | 67.3          | 32%         |
| Heavener             | 11.5         | 32.3         | 20.8          | 47%         |
| Lecheria             | 16.2         | 107.6        | 91.4          | 74%         |
| Salinas Vic          | 96.3         | 74.9         | -21.4         | -13%        |
| Shreveport           | 70.8         | 45.9         | -24.9         | -21%        |
| St Paul              | 197.5        | 138.1        | -59.4         | -18%        |
| Corpus Christi       | 95.6         | 166.5        | 70.9          | 27%         |
| Robstown             | 159.3        | 49.7         | -109.6        | -52%        |
| <b>Total</b>         | <b>254.9</b> | <b>216.2</b> | <b>-38.7</b>  | <b>-8%</b>  |
| Intl Freight Gateway | 31           | 16.1         | -14.9         | -32%        |
| Kansas City          | 274.2        | 179.7        | -94.5         | -21%        |
| <b>Total</b>         | <b>305.2</b> | <b>195.8</b> | <b>-109.4</b> | <b>-22%</b> |
| Laredo               | 585.4        | 476.9        | -108.5        | -10%        |
| Nuevo Laredo         | 4.5          | 101.2        | 96.7          | 91%         |
| <b>Total</b>         | <b>589.9</b> | <b>578.1</b> | <b>-11.8</b>  | <b>-1%</b>  |
| Bensenville          | 380.3        | 10.7         | -369.6        | -95%        |
| Calumet              | 6            | 175          | 169           | 93%         |
| Chicago Clearing     | 407.8        | 283.5        | -124.3        | -18%        |
| Gibson               | 70.6         | 105.5        | 34.9          | 20%         |
| <b>Total</b>         | <b>864.7</b> | <b>574.7</b> | <b>-290</b>   | <b>-20%</b> |

- The first set of yards, Baton Rouge through St. Paul, reflect various levels of imbalance, which may well be indicative of issues with the underlying source data used by Applicants in MultiRail.
- Corpus Christie and Robstown are both interchanges with BNSF; while still out of balance when paired, at least the balance improves.
- International Freight Gateway and Kansas City show significant imbalances that, like the first set of yards, likely point to issues with the underlying data/limited time period used to develop the MultiRail traffic data.

<sup>127</sup> Application Vol. 2, Appendix B Change in Yard Volumes Overall, pp. 369-403. See Oliver Wyman - Rail Car Volumes methodology.pdf.

- Laredo and Nuevo Laredo point to (i) a likely failure in processing the traffic data to correct for how cross-border traffic is reported by KCS and KCSM, and (ii) some rebilling of traffic at the border. It is my understanding that very little traffic actually originates or terminates at Nuevo Laredo, so this is likely an error and most of the Nuevo Laredo traffic should have been remapped to Laredo. How this affected the representation of cross-border blocking and train operations is unclear – but it certainly caused an understatement of the switching activity at Laredo Yard (and a corresponding overstatement at Nuevo Laredo).
- Chicago also exhibits a significant amount of imbalance in its volumes, even when combining the most obvious locations that could have imbalanced interchanges. These differences raise significant doubts about the yard activity counts for Chicago and how representative Applicants’ operating plan is for both the pre- and post-merger scenarios.

Once these imbalance issues are corrected using more representative traffic data or correction of waybill location mapping issues, the volumes at the locations as reported by the Applicants are likely to change, potentially changing the assessment of how the merger will affect yard operations.

## 6. Other Issues That Undermine the Validity of the Application

Other issues were found within the Application and associated work papers that call into question the validity of the operating plan, as shown in Exhibit 6-1. I conducted additional analysis of several of these issues. This section provides a summary of these additional issues, with further analysis added where appropriate.

### Exhibit 6-1: Summary of additional issues related to the Application

| Section | Description                               | Summary   |
|---------|---|---|
| 6.1     | Additional examples of bad line densities | Additional bad line densities were determined through the analysis of line density values (see subsection for details). |

| Section    | Description  | Summary  |
|------------|--|--|
| <b>6.2</b> | Critique of NS/CSX haulage/trackage rights volumes | No clear assessment of the volumes using the NS and CSX agreements for the movement of traffic from Chicago to Michigan and Buffalo was provided by Applicants. An assessment of these volumes was undertaken, which found that insufficient capacity exists to serve the Detroit intermodal market, and there will likely be periodic delays for cars waiting for space on CPKC capacity-controlled trains on NS. Depending on train length limits on CSX, there may also be issues to/from Eastern Canada during peak periods. |
| <b>6.3</b> | Review of carload volumes                          | There are several issues with carload volumes that undermine the validity of the operating plan (see subsection for details)   |

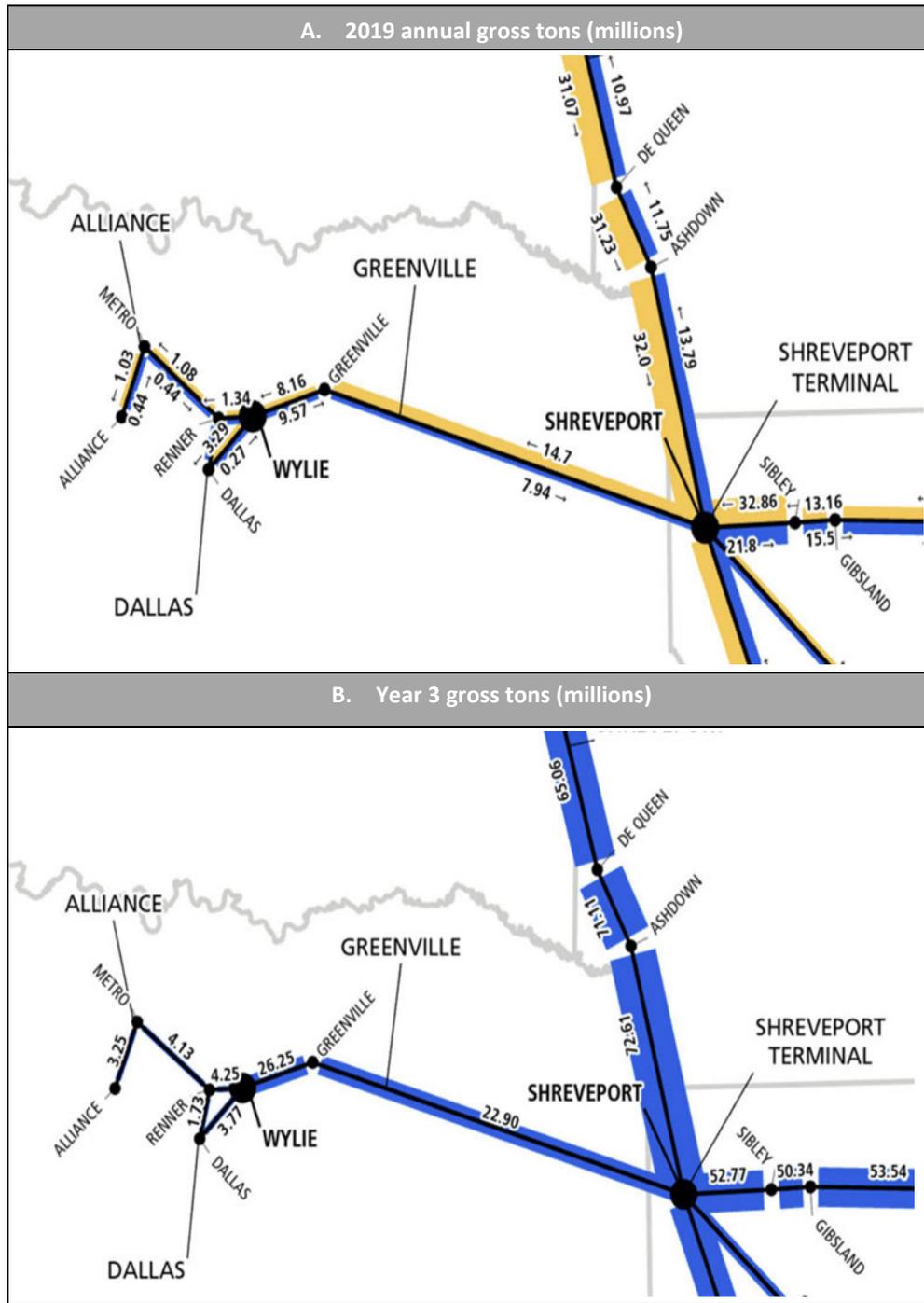
## **6.1 Detailed review of tonnages for additional line segments**

Analyses are presented for the tonnages shown for the Shreveport-Wylie line and the main lines on KCSM. Both provide additional evidence that the tonnages on the line segments in the Application are incorrect.

### **6.1.1 Shreveport-Wylie**

Density maps for Shreveport-Wylie are shown in Exhibit 6-2. I also performed a MultiRail analysis of tonnage on this line segment; the results are shown in Exhibit 6-3.

Exhibit 6-2: Shreveport-Wylie density maps<sup>128</sup>



<sup>128</sup> See Application Vol. 2, Exhibit 14 traffic density maps, pp. 512-513.

**Exhibit 6-3: Shreveport-Wylie tonnage analysis<sup>129</sup>**

| Line Segment               | Applicants<br>2019<br>Tonnage | Applicants<br>Year 3<br>Tonnage | Estimated<br>MultiRail Year 3<br>Tonnage From<br>Diversion | Organic<br>Growth<br>@{{XXX}}% | Revised MultiRail<br>Year 3 Estimated<br>Tonnage | Percent<br>Error |
|----------------------------|-------------------------------|---------------------------------|--|--------------------------------|--|------------------|
| Shreveport –<br>Greenville | 22.64                         | 22.9                            | {{XXX}}  | {{XXX}}                        | {{XXX}}  | {{XXX%}}         |
| Greenville – Wylie         | 17.73                         | 26.25                           | {{XXX}}  | {{XXX}}                        | {{XXX}}  | {{XXX%}}         |

The change of density at Greenville, from the location being a net terminator of traffic to a net originator of traffic, is significant. In 2019, for movement from Shreveport to Wylie, the tonnage drops at Greenville by 4.9 million gross tons (“MGT”) in the westbound direction, but in Year 3 there is an increase of 3.4 MGT in the westbound direction. There is no evidence explaining why Greenville becomes a major generator of traffic in Year 3, particularly in the westbound direction. While Applicants’ operating plan describes “large increases in IM volumes at Wylie,”<sup>130</sup> there is essentially no change in the tonnage over the entire Shreveport-Greenville segment between 2019 and Year 3. This inconsistency strongly suggests that the tonnage numbers developed by the Applicants are unreliable.

**6.1.2 The post-merger traffic density of the KCSM main line is understated**

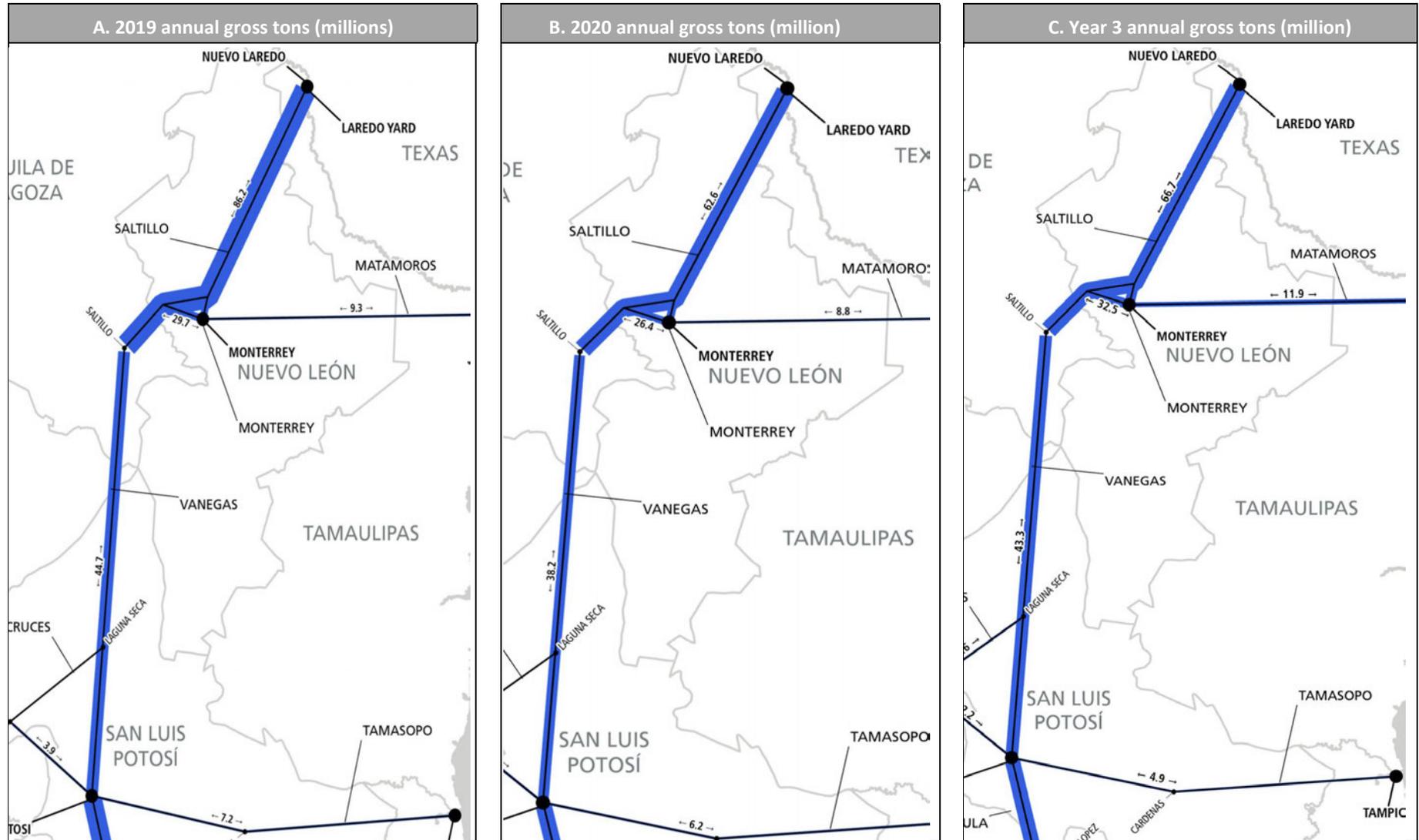
Exhibit 6-4 shows the density charts in the Application for the Saltillo and Venegas divisions of KCSM. These are the northernmost divisions on the critical KCSM main line between Mexico City and the international crossing at Laredo. The Board’s merger regulations specifically require that accurate density charts for main lines and secondary rail lines be

<sup>129</sup> Based on values from Application Vol. 2, Exhibit 14: Density Charts, pp. 461-504, and diversion traffic estimates from MultiRail (see HC – Oliver Wyman - MultiRail Corridor Volume, Tonnage and Length Estimates for Diversion Traffic Methodology for associated data and outputs).

<sup>130</sup> Based on Application Vol. 2, Table 10, “Intermodal Terminals have Adequate Capacity for Increased Handlings,” p. 345.

included in the Application. Exhibit 6-5 lists the tonnages for these two divisions as reported by Applicants.

Exhibit 6-4: Density charts for the Saltillo and Venegas Divisions<sup>131</sup>



<sup>131</sup> Refer to Exhibit 14 traffic density maps in Volume 2 of Application, pp. 514-516.

**Exhibit 6-5: Tonnage on the Saltillo and Vanegas Divisions<sup>132</sup>**

| Subdivision     | 2019<br>Tonnage | 2020<br>Tonnage | Year 3<br>Tonnage | Difference<br>2019 – Year 3 | Difference<br>2020 – Year 3 |
|-----------------|-----------------|-----------------|-------------------|-----------------------------|-----------------------------|
| <b>Saltillo</b> | 86.2            | 62.6            | 66.6              | -19.6                       | 4.0                         |
| <b>Vanegas</b>  | 44.7            | 38.2            | 43.3              | -1.4                        | 5.1                         |

As Exhibit 6-5 shows, Applicants’ operating plan assumes that traffic on the KCSM main line declined between 2019 and 2020, and that the tonnage will not recover by Year 3. This cannot be correct. It is my understanding that 2019 tonnage reflects official KCSM historic volumes, whereas 2020 tonnage and Year 3 tonnage reflect values computed by Applicants using a complex and error-prone estimation process.<sup>133</sup> These values would have been directly affected by the incorrect intermodal volumes at Lazaro Cardenas that resulted from Applicants’ reliance on the single month of October 2020 traffic to estimate full-year values.<sup>134</sup>

The traffic density data detailed in Exhibit 6-5 demonstrates how incorrect inputs and erroneous methodologies at one stage of the operations planning process (e.g., traffic inputs and tonnage estimation) will invalidate the output of later stages (e.g., line segment traffic density calculations). This is not a trivial matter. As with the underestimate of density on the Sabula to Airline Junction segment, underestimated traffic continues through the planning process and becomes an incorrect input to the operating plan and capital expense plan. This can result in a distorted train and blocking plan, as well as an inadequate capital budget to make the investments in capacity required to keep this critical link in the KCSM network fluid.

<sup>132</sup> Based on values from Exhibit 14: Density Charts in Volume 2 of Application, pp. 502-504.

<sup>133</sup> FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx.

<sup>134</sup> dwnld\_Traffic\_KCS.csv provided as part of the accompanying attachments to Traffic File - Methodology.pdf indicate the traffic data used was from October 2020.

Applicants' workpapers show that some of the original KCSM values for 2019 were in metric tons, which according to the methodology were incorrectly converted to imperial tons (also known as long tons), instead of being converted to short tons.<sup>135</sup> Correcting that error would make 2019 tonnage figures even higher. And it is insufficient to explain the scale of the differences between the various values for the given years in Exhibit 6-5.

## **6.2 The Applicants' operating plan may violate the constraints of the Michigan and Eastern Canada CSX and NS trackage/haulage rights**

CP's existing agreements with NS and CSX impose limitations on the amount of traffic that CP can move beyond Chicago to Detroit and Eastern Canada. Applicants' operating plan does not appear to acknowledge the significant limitations on CP's current rights under those agreements. In the case of NS, CPKC is limited to two trains in each direction per day, with a maximum length of 12,000 feet, and a prohibition against the movement of automotive traffic (finished vehicles and parts) and of intermodal traffic not from legacy CP terminals.<sup>136</sup> In the case of CSX, which CPKC uses to get intermodal traffic to the Detroit area and Eastern Canada, CPKC is (and will continue to be) limited to a maximum of 2,500 feet to/from Detroit, and one train pair per day between Chicago and Buffalo/Toronto.<sup>137</sup> Furthermore, Applicant has indicated that {XXX}.<sup>138</sup>

Applicants are aware of this limitation, and cited the CSX limitation as affecting their diversion studies:

“As a result of the service design analysis, certain capacity restraints were identified for intermodal shipments into and out of CP's Detroit intermodal terminal accessed via

<sup>135</sup> FD 36500 – Work Paper – HC – Methodology for Creating KCSM 2019 Density Chart and Map.pdf; FD 36500 - Work Paper - HC - KCSM 2019 density.xlsx.

<sup>136</sup> Application, Vol. 2, p. 272. See also Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al. STB Docket No. FD 36500, Elphick and Orr Dep. 18:8 – 18:25, Feb. 18, 2022

<sup>137</sup> Application, Vol 2, pp. 268 and 272; see details of trains 142 & 143 in Application, Vol. 2, p. 438.

<sup>138</sup> See Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al. STB Docket No. FD 36500, Elphick and Orr Dep. 19:14 – 18:21, Feb. 18, 2022

CSXT trackage rights that include daily haul-length limits, and as a result we adjusted downwards our Detroit intermodal diversions by 55 percent.”<sup>139</sup>

To provide an estimate of 2019 Base Year volumes, I examined the 2019 full year waybill data and identified all movements that originated in Mexico or from points in or west/south of Illinois on CP or KCS/KCSM and that terminated on CP in Michigan, Eastern Canada, and New York. Also included is intermodal traffic terminating in Michigan from CP intermodal terminals in British Columbia.

Domestic double-stacked traffic from eastern Canada, especially Montreal must also use the CSX routing to reach Detroit, while most international container moves will fit through the Detroit River Tunnel. Because we could not readily determine which of this traffic needed to use the CSX routing, to be conservative we assumed all of it would fit through the tunnel.

I divided this data between intermodal, multilevel, ethanol, and other carload traffic. I also identified the volumes of intermodal traffic moving to/from Michigan versus Eastern Canada and well as the traffic to/from British Columbia.<sup>140</sup>

Next, I examined the data from Applicants’ traffic diversion studies and identified all traffic that would necessarily use the NS or CSX routes, using the same screening criteria as the 2019 base traffic. For the diverted carload traffic, I added allowances for empty moves, using the same empty/loaded ratios that Applicants use in their system model, and added empties that would balance the intermodal volumes in the backhaul direction.

I added Applicants’ projected organic growth rate of {{ }} to the Base Year volumes and added in the diversions that CP projected to arrive at the total projected Year 3 volumes for both the NS and CSX lines.

<sup>139</sup> Application, Vol. 2, p. 145.

<sup>140</sup> See HC – Oliver Wyman – NS CSX Traffic Analysis – Methodology.pdf for associated data and analysis workpapers.

All of this traffic was loaded into an Oliver Wyman version of MultiRail and “flowed” across the network to generate the cars/containers, tons, and train-feet that would use each route.<sup>141</sup>

**CSX-Chicago-Fostoria (North Baltimore)-Buffalo and CSX Fostoria (North Baltimore)-Detroit**

I defined the base and growth CSX traffic as purely intermodal. Initially, I assigned the British Columbia to Michigan intermodal traffic to the CSX line as well. As will be shown below, capacity constraints preclude this traffic from using this route once the full CPKC intermodal diversion volumes are realized.

My analysis of current traffic volumes and Applicants’ projection of future organic growth and traffic diversion volumes indicates that the average daily volume to Detroit will be about {{XXX}} feet, thus exceeding the current contractual limit of 2,500 feet.<sup>142</sup> The peak volume on the train going to Buffalo, prior to setting off/picking up the Detroit traffic, should be around {{XXX}} feet on average.<sup>143</sup> Depending on the maximum allowed length of this train, there could well be capacity issues during peak periods.

Not included in my analysis is the Quebec/Montreal to Detroit base intermodal volumes of {{XXX}} containers per year, which translates to an additional {{XXX}} feet per day.<sup>144</sup> Assuming these are international containers, they will have to be routed through the Detroit River tunnel, given the capacity constraints on the CSXT routing.

<sup>141</sup> See MultiRail Corridor Volume, Tonnage and Length Estimates for Diversion Traffic Methodology.pdf for associated outputs and how growth traffic was obtained.

<sup>142</sup> Application, Vol 2, pp. 268 and 272; see details of trains 142 & 143 in Application, Vol. 2, p. 438.

<sup>143</sup> See HC – Oliver Wyman – NS CSX Traffic Analysis – Methodology.pdf for associated data and analysis workpapers.

<sup>144</sup> See HC – Oliver Wyman – NS CSX Traffic Analysis – Methodology.pdf for associated data and analysis workpapers. See also HC – Oliver Wyman - Intermodal to Railcar Conversion Factor Source Compilation.pdf.

Exhibit 6-6 details the intermodal volumes to/from Detroit, and Exhibit 6-7 provides the estimated average train lengths for the three main segments of the CSX service.

**Exhibit 6-6: Volume on the CSXT segment between Ohio and Detroit<sup>145</sup>**

| Traffic Group                         | Containers/Day (Forward) | Containers/Day (Reverse) | Feet/Day (Forward) | Feet/Day (Reverse) |
|---------------------------------------|--------------------------|--------------------------|--------------------|--------------------|
| British Columbia: Intermodal – Base   | {{XXX}}                  | {{XXX}}                  | {{XXX}}            | {{XXX}}            |
| British Columbia: Intermodal – Growth | {{XXX}}                  | {{XXX}}                  | {{XXX}}            | {{XXX}}            |
| Intermodal – Projected                | {{XXX}}                  | {{XXX}}                  | {{XXX}}            | {{XXX}}            |
| <b>Total</b>                          | {{XXX}}                  | {{XXX}}                  | {{XXX}}            | {{XXX}}            |

**Exhibit 6-7: Volume on CSXT corridor by segment, in feet<sup>146</sup>**

| Traffic Group          | Chicago-Fostoria feet |         | Fostoria-Detroit feet |         | Fostoria-Buffalo feet |         |
|------------------------|-----------------------|---------|-----------------------|---------|-----------------------|---------|
|                        | Forward               | Reverse | Forward               | Reverse | Forward               | Reverse |
| Intermodal – Base      | {{XXX}}               | {{XXX}} | {{XXX}}               | {{XXX}} | {{XXX}}               | {{XXX}} |
| Intermodal – Growth    | {{XXX}}               | {{XXX}} | {{XXX}}               | {{XXX}} | {{XXX}}               | {{XXX}} |
| Intermodal – Projected | {{XXX}}               | {{XXX}} | {{XXX}}               | {{XXX}} | {{XXX}}               | {{XXX}} |
| <b>Total</b>           | {{XXX}}               | {{XXX}} | {{XXX}}               | {{XXX}} | {{XXX}}               | {{XXX}} |

The calculations for Detroit are based on an estimate of current container volumes to Detroit of about {{XXX}} /year, almost entirely originating in British Columbia. This is equivalent to {{XXX}} of train. Projected new business yields another {{XXX}} and {{XXX}} of train for the to and from Detroit directions, and Applicants’ organic growth figure of {{XXX}} yields another {{XXX}}/{{XXX}} directionally. This totals to {{XXX}} in the peak direction.<sup>148</sup>

Since the traffic moving to Detroit exceeds the 2500-foot limit, we must then assume that the BC Intermodal to Michigan traffic would travel via the NS line. This lowers the project

<sup>145</sup> See HC – Oliver Wyman – NS CSX Traffic Analysis – Methodology.pdf for associated data and analysis workpapers.

<sup>146</sup> See HC – Oliver Wyman – NS CSX Traffic Analysis – Methodology.pdf for associated data and analysis workpapers.

<sup>147</sup> See HC – Oliver Wyman – Review of Growth Factors in CPKC Application.pdf.

<sup>148</sup> See HC – Oliver Wyman – NS CSX Traffic Analysis – Methodology.pdf for associated data and analysis workpapers.

traffic to Detroit to {{XXX }}, below the 2,500 feet limit. However, this is alarming considering:

- Most likely, part of the Quebec/Montreal intermodal traffic of {{XXX }} will be domestic containers and must travel on the same line.
- There is little room for daily traffic variations. Intermodal service will be affected if, say, 10% of the traffic from Montreal is domestic and must ride through Buffalo and onto the Fostoria-Detroit section, and on a given day there is volume of eastbound traffic 15% higher than average. This will create situations that routinely exceed the 2500-foot limit. In practice, the peaks and valleys of intermodal traffic are at least 20%, so reaching the length limit and causing service issues due to delaying shipments of intermodal traffic is highly likely.

**NS-Chicago-Detroit**

Next we examined the NS-Chicago-Detroit line. Due to the above analysis, I include the British Columbia to Michigan Intermodal traffic on the NS routing.

We initially calculated the number of daily trains using the 12,000 maximum feet allowed by agreement with NS for manifest trains<sup>149</sup>. For the bulk hazardous trains (Ethanol), we derived that the filing used {{XXX}} cars per train. This is based on their {{XXX}} trains per day and our calculation of {{XXX}} cars per day (including growth).

**Exhibit 6-8: CPKC - NS-Chicago-Detroit carload traffic volumes<sup>150</sup>**

| Traffic Group           | Cars/Day (Forward) | Cars/Day (Reverse) | Feet/Day (Forward) | Feet/Day (Reverse) | Trains/Day (Forward) | Trains/Day (Reverse) | Basis   |
|-------------------------|--------------------|--------------------|--------------------|--------------------|----------------------|----------------------|---|
| Ethanol – Base          | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}              | {{XXX}}              | Applied<br>{{XXX}} <sup>151</sup><br>cars/train |
| Ethanol – Growth        | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}              | {{XXX}}              |   |
| Ethanol Total           | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}              | {{XXX}}              |   |
| Other Carloads - Base   | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}              | {{XXX}}              | Applied 12000<br>feet/train                     |
| Other Carloads - Growth | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}            | {{XXX}}              | {{XXX}}              |   |

<sup>149</sup> Application, Vol. 2, p. 272. See also Canadian Pacific Railway Limited, Et Al. – Control – Kansas City Southern, Et. Al. STB Docket No. FD 36500, Elphick and Orr Dep. 18:8 – 18:25, Feb. 18, 2022

<sup>150</sup> See HC – Oliver Wyman – NS CSX Traffic Analysis– Methodology.pdf for associated data and analysis workpapers

<sup>151</sup> In FD 3500 Work Paper HC Trains Per Day and Gross Ton Miles – Working Copy with Haz Breakdown.xlsx, the applicants cite 0.67 trains per day including growth. Based on the waybill data, that resolves to approx. 95 cars per train.

|                            |         |         |         |         |                |                |  |
|----------------------------|---------|---------|---------|---------|----------------|----------------|--|
| Other Carloads - Projected | {{XXX}} | {{XXX}} | {{XXX}} | {{XXX}} | {{XXX}}        | {{XXX}}        |  |
| Other Carloads – Total     | {{XXX}} | {{XXX}} | {{XXX}} | {{XXX}} | {{XXX}}        | {{XXX}}        |  |
| BC Intermodal              |         |         | {{XXX}} | {{XXX}} | {{XXX}}        | {{XXX}}        |  |
| <b>Total Trains</b>        |         |         |         |         | <b>{{XXX}}</b> | <b>{{XXX}}</b> |  |

We note that the statistics that we derived using the 2019 waybills and the Applicants' diversion traffic appear to be consistent with the train counts in the CPKC filing. The Application's workpapers shows {{XXX}} trains/day<sup>152</sup>, and we derived {{XXX}} trains per day. While we agree overall with the Application, it apparently averaged the two directions resulting in misleading conclusions.

Our analysis demonstrates there is a need to operate more than {{XXX}} trains per day towards Detroit and {{XXX}} trains per day from Detroit, including both ethanol and manifest trains. However, {{XXX}} trains/day towards Detroit is precariously close to the maximum allowed of 2 trains per day. We can also infer that in practice {{XXX}} trains per day – of smaller size – will be traveling in the reverse direction to keep crews and locomotives in balance.

It is doubtful that there is enough capacity under the current NS agreement to service the projected carload traffic volumes for three reasons: (1) not every manifest train will be filled out to exactly its maximum length, (2) there will be peaks in traffic volumes and (3) there is the need to try to coordinate unscheduled ethanol trains and scheduled manifest trains sharing the available capacity. This becomes a particular concern because CPKC will need more than one manifest train on some days to service the volumes it needs to handle. When the need arises to operate both manifest trains and an ethanol train, one of these trains will need to be delayed. We must also consider that some amount of manifest traffic (or intermodal) will have to be delayed

<sup>152</sup> See FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx

when the primary manifest train is full, and the overflow train is not operating on that specific day – hardly an ideal approach under the principles of Precision Scheduled Railroading.

Operating a second, “overflow” manifest train is also challenging if one is basing one’s plans on having every train be at its maximum length of 12,000 feet. While running in an over-subscribed manner can help ensure that the primary train will be full, the secondary train will more likely than not, be only partially filled. Thus, a more likely scenario might be to assume an average of 11,000 feet per manifest train, which would put the daily average train count over {{XXX}} trains in the head haul direction.

**Exhibit 6-9: CPKC - NS-Chicago-Detroit train counts assuming 11,000 foot manifest trains**

| Traffic Group               | Trains/Day (Forward) | Trains/Day (Reverse) | Basis                      |
|-----------------------------|----------------------|----------------------|----------------------------|
| Ethanol – Base              | {{XXX}}              | {{XXX}}              | Applied {{XXX}} cars/train |
| Ethanol – Growth            | {{XXX}}              | {{XXX}}              |                            |
| <b>Ethanol Total</b>        | <b>{{XXX}}</b>       | <b>{{XXX}}</b>       |                            |
| Other Carloads - Base       | {{XXX}}              | {{XXX}}              | Applied 11000 feet/train   |
| Other Carloads - Growth     | {{XXX}}              | {{XXX}}              |                            |
| Other Carloads - Projected  | {{XXX}}              | {{XXX}}              |                            |
| <b>Other Carloads Total</b> | <b>{{XXX}}</b>       | <b>{{XXX}}</b>       |                            |
| BC Intermodal               | {{XXX}}              | {{XXX}}              |                            |
| <b>Total Trains</b>         | <b>{{XXX}}</b>       | <b>{{XXX}}</b>       |                            |

Add in natural peaks and valleys in volumes of approximately 20 percent, and the clear result will be ongoing capacity issues. Further, this arrangement will prove even less sufficient beyond 2025, if CPKC actually achieves all the organic growth that Applicants are projecting. In part this reflects the dangers of creating a solution based on averages that have no slack to take natural volume variations into account.

### 6.3 Assessment of carload traffic issues

The Lazaro Cardenas intermodal traffic is but one example of the significant errors that are present in the traffic data (see Section 5.2 for discussion of Lazaro Cardenas issues). I also show in Section 4.1 that Applicants’ use of non-representative data from October 2020 and in Section

5.5 the location mapping errors resulted in unbalanced yard volumes and associated errors in the yard statistics.

In Section 5.3.1, I showed that the use of October 2019 for unit trains resulted in a failure to account for all the crude oil trains operating on the key Sabula to Airline Junction line. Several additional issues are presented in this section, including:

- Other effects of using non-representative traffic data;
- Inconsistent use of organic growth; and
- The need for empty modeling to be consistent and complete.

### **6.3.1 Impact of using non-representative traffic data to drive the plan**

I conducted a focused investigation of two sets of car types that were not treated as unit train traffic: Multilevels (car type V), and boxcars (car types A, B, R). This was done by comparing the full year, 2019 CPKC waybills to the October 2020 CPKC waybills. Based on this analysis, I found that the annualized, loaded multilevels on KCS and KCSM for October 2020 were approximately {{XXX }} below 2019 volumes, and the annualized loaded boxcars on KCS and KCSM for October 2020 were approximately {{XXX }} below 2019 volumes.<sup>153</sup> These findings are not surprising, given the lingering effects of the COVID-19 pandemic throughout 2020. Both undercounts directly affect Applicants' pre- and post-merger yard activity estimates and projected line densities. It is also possible that applying the higher 2019 traffic volumes would necessitate material changes to the train plan, including (potentially) the need to operate additional trains.

Another error that arises from using non-representative traffic is that there can be changes in traffic patterns, which will cause a shift in train requirements between various routings. I

<sup>153</sup> See HC – Oliver Wyman - Multi-level and Boxcar Traffic Volume Comparison between Full Year 2019 and October 2020 – Methodology.pdf for associated analysis and data.

considered loaded multilevels going to Laredo, primarily for interchange to Union Pacific (representing well over half of all loaded multilevels on KCS-KCSM). Some of the more significant differences are shown in Exhibit 6-10 and suggest that train flow and traffic patterns are not likely to be properly estimated by Applicants’ methodology, due to differences in traffic volumes between October 2020 and full year 2019 traffic patterns.

**Exhibit 6-10: Differences in annualized volumes destined for Laredo<sup>154</sup>**

| Origin-Destination | 2019 Full Year Waybill | October 2020 (Annualized) | Difference |
|--------------------|------------------------|---------------------------|------------|
| Lecheria-Laredo    | {{XXX}}                | {{XXX}}                   | -7,894     |
| Jesus Maria-Laredo | {{XXX}}                | {{XXX}}                   | -2,703     |
| Pesqueria-Laredo   | {{XXX}}                | {{XXX}}                   | -581       |
| Derramadero-Laredo | {{XXX}}                | {{XXX}}                   | 577        |
| Rojas-Laredo       | {{XXX}}                | {{XXX}}                   | 2,186      |
| Silao-Laredo       | {{XXX}}                | {{XXX}}                   | 3,936      |
| Panzacola-Laredo   | {{XXX}}                | {{XXX}}                   | 7,818      |

The correction of the differences between the October 2020 traffic and the full-year 2019 traffic would lead directly to a shift in thousands of railcars between lanes, which clearly would affect line densities, yard volumes, and train sizes. Applicants stated that 2019 was their chosen Base Year. But, as Exhibit 6-14 graphically demonstrates, attempting to build a 2019 operating plan based on traffic data for a single month in a different year (2020) is likely to produce inaccurate results.

### **6.3.2 Inconsistent use of organic growth raises questions as to the accuracy of the post-merger plan**

Applicants state that organic growth was included in the post-merger operating plan:

“In order to confirm – and demonstrate to the Board – that the operation of the combined network will be fully resourced and capable of an efficient operation without congestion or service degradation. The traffic growth considered thus includes both

<sup>154</sup> See HC – Oliver Wyman - Multi-level and Boxcar Traffic Volume Comparison between Full Year 2019 and October 2020 – Methodology.pdf for associated analysis and data.

anticipated volume growth for traffic currently handled by CP or KCS as well as volume growth that will be attracted by the combined network.”<sup>155</sup>

Despite this assertion, there is no meaningful discussion in either the Application or the work papers explaining how organic growth traffic volumes were developed, or how they were input to the operating plan in MultiRail. Organic growth is a major element of post-merger traffic and revenue. As such, a credible operating plan must include a full explanation of the key assumptions made in developing organic traffic growth, and basis supporting any projected “organic” traffic increase. Applicants’ “System Model”<sup>156</sup> contains unexplained and unsupported organic growth traffic values, as do a number of other work papers.<sup>157</sup> It appears that the growth values adopted by Applicants are generally “global” assumptions applied either to the entire CPKC network or applied differentially by predecessor railroad, in each case without regard to commodity or origin/destination.

A review of the work papers indicates that organic growth traffic was included in Applicants’ MultiRail modeling,<sup>158</sup> and thus was reflected in the post-merger train counts and train-miles generated by MultiRail. However, the application of unexplained “calibration factors” to the GTM and train-mile values generated by MultiRail raises questions as to whether (or how) this organic growth traffic was ultimately reflected in the System Model that served as the foundation for Applicants’ operating expense estimates. Without access to the actual pre- and post-merger MultiRail traffic files used to develop the operating plan, it is impossible to ascertain exactly how organic growth was handled. Based on the use of system averages, and the

<sup>155</sup> Application Vol. 2, pp. 286-287.

<sup>156</sup> FD 36500 - Work Paper - HC - Cost Metrics Growth Model \_ Base year 2019.xlsx.

<sup>157</sup> FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx applies organic growth parameters to the base period unit trains.

<sup>158</sup> FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - 2021.10.22 - Working Copy with Haz Breakdown.xlsx.

overstatement of organic growth in the calculation of gross tons by line segment values,<sup>159</sup> I have no confidence that this growth was appropriately handled.

### **6.3.3 Empty modeling is inconsistent and incomplete**

Because Applicants' modeling process included a mix of historic traffic and diverted traffic, empty car movements must be carefully considered in building a reliable operating plan. At a minimum, Applicants must account for sufficient empty movements for diverted traffic. However, it can be challenging to identify which empty movements should be adjusted in the case of extended haul traffic.

In some cases, particularly for grain and ad hoc unit trains, it also can be challenging to determine which empty moves correspond to loaded unit train movements when volume adjustments must be made. While in some cases one can identify unit train movements through multi-car waybills, one often needs to identify unit train moves by finding sets of cars with the same origin, destination, car type, commodity, load/empty status, and waybill date/time. This becomes a significant data analysis exercise. If the empty movements are treated similarly and are reverse routed to the loaded movement's origin after unloading, this is not too hard. But for commodities such as grain, the empty trains generally do not reverse route, but go to alternate loading sites instead. In addition, these unit trains are often broken up and the cars may then be moved to a variety of next loading sites. When this happens, figuring out which empty moves correspond to which loaded moves can become very tricky, and making volumetric adjustments to these empty moves when they are sent to multiple next loading sites can become almost impossible.

<sup>159</sup> See HC – Oliver Wyman - Review of Growth Factors in CPKC Application.pdf for details.

Therefore, to ensure consistency between loaded and empty movements for the pre- and post-merger operating plans, it is more reliable to actually model or generate empty movements, instead of using a mix of historic and generated empty movements. In particular, such an approach avoids the need to make complex adjustments to historic empty movements.

In developing empty movements, careful attention must be paid to historic directional traffic balance and empty/loaded ratios to ensure that the appropriate numbers of car-miles and ton-miles are associated with empty movements. Applicants elected to pursue the complex approach of making (supposedly) “surgical” adjustments to historic traffic for extended haul movements, while at the same time applying simplistic load/empty rules for key intermodal and automotive traffic.

As a result, I believe that the following errors were likely made by Applicants in the MultiRail modeling exercise:

- Empty multilevel volumes are understated. It appears that a {{XXX }} empty return ratio was used.<sup>160</sup> Examining the imbalance between loaded northbound and southbound moves from/to Mexico in Applicants’ traffic diversion study reveals that the flow of loads is unidirectional in the northbound direction. This indicates that a much higher southbound empty return ratio ({{XXX-XXX}} percent) would be more appropriate for this traffic.<sup>161</sup>
- Empty intermodal container volumes are understated. It appears that a {{XXX }} empty return ratio was used for intermodal shipments.<sup>162</sup> Examining the imbalance between loaded northbound and southbound moves from/to Mexico in the traffic diversion study indicates that a southbound empty return ratio of approximately {{XXX

<sup>160</sup> Table on “Tonnage Assumptions” in FD 36500 – Work Paper – HC – System Model - Methodology.pdf, p. 4.

<sup>161</sup> See HC – Oliver Wyman - Evaluation of Load and Empty Ratios – Methodology.pdf for associated data and analysis.

<sup>162</sup> Table on “Tonnage Assumptions” in FD 36500 – Work Paper – HC – System Model - Methodology.pdf, p. 4.

}} would be more appropriate.<sup>163</sup> If one examines the volume of northbound containers from Mexico into the U.S., and compare this to the volume of southbound containers from the U.S. to Mexico in the CPKC traffic study you will find that for every {{XXX}} northbound loads there are about {{XXX}} southbound loads. Thus, to balance this movement of containers one needs to introduce {{XXX}} southbound empties for every {{XXX}} northbound loads, resulting in a {{XXX}} percent southbound empty return ratio.

- Certain other car types historically have an empty/loaded car-mile ratios that are greater than 1:1. This is particularly true of tank cars, which in the case of KCS have historic empty/loaded ratios of about {{XXX }}.<sup>164</sup>

All these errors result in an understatement of gross-ton-miles and car-miles and would also lead to an understatement of train-miles in the Applicants' "System Model."

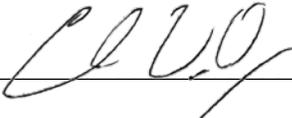
<sup>163</sup> 70% reverse route value is based on witnesses Wahba & Naatz's growth traffic data (FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx), where they used an average value of 70% under "Assumed Backhaul" for the total intermodal volume at Lazaro Cardenas. See also HC – Oliver Wyman - Evaluation of Load to Empty Ratios.pdf

<sup>164</sup> See HC – Oliver Wyman - Evaluation of Load and Empty Ratios – Methodology.pdf for associated data and analysis.

**VERIFICATION**

I, Carl Van Dyke, declare under penalty of perjury that the foregoing information is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on this 28th day of February, 2022.

  
\_\_\_\_\_

Carl Van Dyke

## Appendix A. Carl Van Dyke Resume

Mr. Van Dyke is Managing Director of TransNetOpt, a consultancy focused on the use of computers to address transportation network planning and design issues. He is a retired Partner in the Surface Transportation Practice of Oliver Wyman, with a focus on improving the operations and general performance of transportation companies, and railroads in particular. He continues to undertake engagements on behalf of Oliver Wyman in the role of Senior Advisor. Mr. Van Dyke has spent over 40 years focused on the application of computers to transportation planning and operations issues, with particular emphasis on railroad network modeling, service design, train scheduling, line capacity analysis, and equipment management. In 1992, he founded MultiModal Applied Systems, which became part of Oliver Wyman in 2006.

He is best known for leading the design, creation, and application of the MultiRail planning products, including both the MultiRail-Passenger Edition and MultiRail-Freight Edition. The Freight Edition has been used by major freight railroads around the world, and has become the tool of choice for special studies such as mergers, privatization studies, operating plan redesigns, and routing/yard investment analysis. Over the past decade, Oliver Wyman-MultiModal has had a hand in the redesign of the operating plans of every major North American railroad, and is now pursuing a similar role in Europe, Africa, and the CIS.

Mr. Van Dyke has designed and implemented over a dozen freight rail, passenger rail, trucking, and container line operations planning models, many of which significantly advanced the state-of-the-art through the use of innovative algorithms and user interfaces. He also has played a key role in the adoption of algorithm-based methods for the real-time control of car routing and classification at a major North American carrier, and has led the development of a similar system which became the MultiRail-Enterprise Edition. Over the course of his career, he has provided technical assistance to dozens of railroads for the in-house use of MultiRail and other models, including all of the major North American carriers, and a number of commuter operators. The “scheduled railroad” operating plans deployed by five of the six Class I’s were developed using MultiRail and Oliver Wyman-MultiModal’s consulting services. Work with CP resulted in winning the 2003 Franz Edelman Prize in Operations Research from the Institute for Operations Research and Management Science (INFORMS).

An integral part of the modeling work undertaken by Mr. Van Dyke has been the analysis of traffic and operating plans related to mergers and reconfigurations of railroads. He first started undertaking this work by participating in the processing of the STB Waybill Sample and full waybill databases from individual railroads while at ALK Associates in the late 1980s. This work included traffic database processing, network traffic flow modeling, and diversion analysis. He went on to fill leading roles in traffic modeling and operating plan development efforts for the UP-SP, NS-Conrail, IC-CN, and CN-BNSF merger filings, as well as developing traffic models for the break-up of the Mexican railroads. Deep experience processing full-year proprietary railroad waybill databases was also gained through numerous projects including operating plan development efforts at Class I’s in North America, and at a variety of railroads in countries such as Sweden, Switzerland, Italy, France, Kazakhstan, Germany, and South Africa.

Over the course of his career, Mr. Van Dyke has become very familiar with the computer systems that drive the operations and planning aspects of numerous railroads in both North

America and many other countries around the world. He has worked extensively with the IT departments at many of these railroads in the design and development of a wide variety of systems, and through this process has become familiar with the IT practices and organizations at these railroads. Examples include assistance to Class I's in the design of current production systems, development of roadmaps for systems improvement, and design and development of numerous planning systems.

Mr. Van Dyke's background in equipment management includes directing the design and development of a real-time, intermodal equipment management system for the rail industry, and adapting this model for use by a major steamship line. He also worked on the development of locomotive planning tools that have been applied to a number of major railways worldwide. While at ALK Associates, Mr. Van Dyke also served as President of Fleet Management, Inc., a company providing central management of railway car fleets. Mr. Van Dyke's other areas of expertise include the design and implementation of optimization and heuristic algorithms, logistics and market analysis, network rationalization, traffic analysis, and geographic information systems.

Mr. Van Dyke received an MS degree in civil engineering from MIT, with a concentration in transportation. He graduated *summa cum laude* from the University of Pennsylvania with a BSE in mechanical engineering. He has served on the National Council of the Transportation Research Forum, various Transportation Research Board committees, and was a charter member and former Chairman of the Rail Applications Special Interest Group of INFORMS. MultiRail, based on its impact on the rail industry, was named "technology of the decade" by *Trains Magazine* in November 2010. He is a co-author of a book on the use of operations research in the rail industry, which was published by Springer Verlag in 2015. He makes presentations and writes articles on a regular basis on various transportation analysis topics.

# **Exhibit 3**

## **Verified Statement of Hugh Randall**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB FINANCE DOCKET NO. 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**

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**CN'S COMMENTS ON APPLICATION AND REQUEST FOR CONDITIONS**

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**Verified Statement of Hugh Randall**

**February 28, 2022**

**PUBLIC VERSION**

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## **1. Qualifications**

My name is Hugh Randall. I am a Senior Advisor to and a Partner Emeritus of Oliver Wyman, a global general management consulting firm with more than 60 offices in 31 countries. My office address is 1717 Main Street, Suite 4400, Dallas, TX 75201.

I have been engaged as a consultant to the transportation industry for the past 30 years and was formerly head of Oliver Wyman's global transportation consulting practice. In that capacity, I have directed consulting projects for railroads, airlines, trucking companies, parcel carriers, maritime shipping companies, freight forwarders, and contract logistics users and providers. Those studies have encompassed clients in North America, Europe, Asia, Latin America, and southern Africa.

Prior to joining Oliver Wyman, I held several senior management positions in the rail and trucking industries, including Assistant Vice President – Intermodal Planning, Assistant Vice President – Operations, and General Manager – Atlantic Region at Conrail; Executive Vice President and Chief Financial Officer at Ryder/PIE; and Managing Director of CSX/Sealand Logistics. I hold a BA degree from Antioch College and an MBA from Harvard University. My full resume is provided in Appendix F.

## **2. Assignment and Summary of Findings**

I have been asked to review and comment on (1) Applicants' estimate of the capacity improvements and other capital expenditures that would be required to handle the additional traffic volumes projected by Applicants safely and efficiently, and (2) Applicants' projected

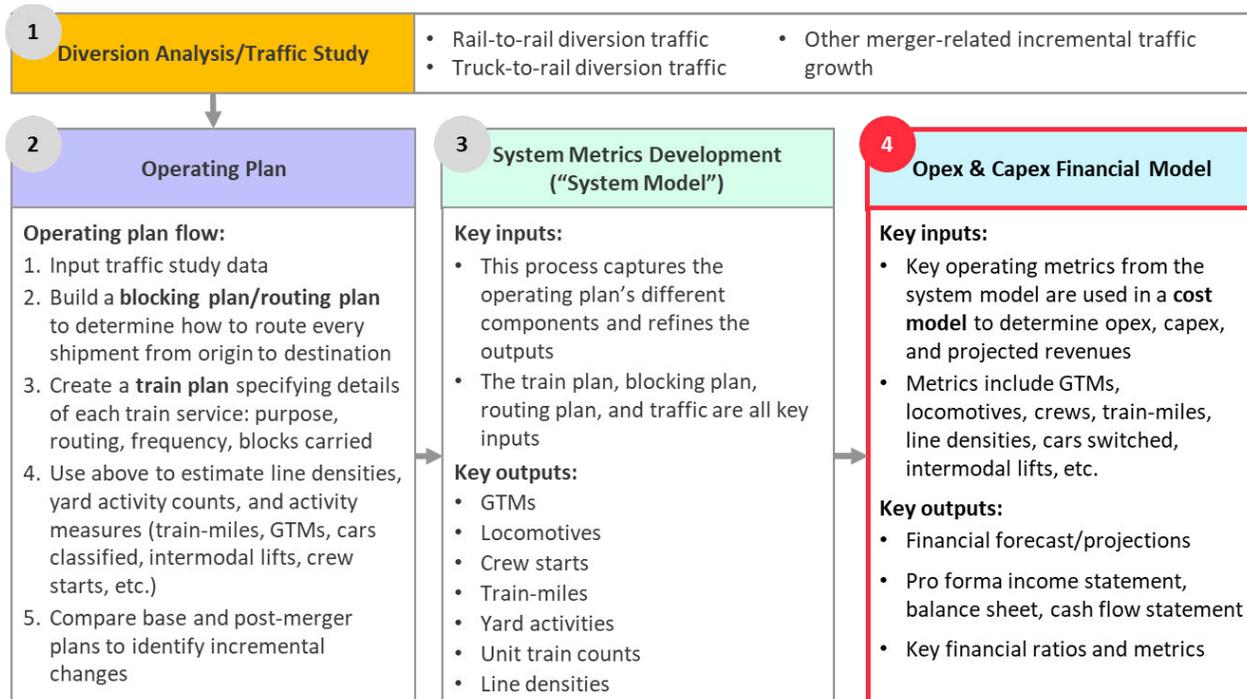
post-merger operating expenses, in each case as presented in the Application<sup>1</sup> and in the work papers of Applicants' witnesses. Solely for purposes of this Verified Statement, I have assumed that the envisioned merged railroad, CPKC, will achieve the traffic increases projected in the Application.

As shown in Exhibit 2-1, complete and accurate operating and capital expense plans are essential elements of the merger planning process. Accurate operating and capital expense plans, in turn, depend on accurate traffic projections and operating statistics (such as train-miles and gross ton-miles – "GTMs"). The capital and operating expense plans provide an essential cross-check to determine whether the Applicants have committed sufficient resources to execute their operating plan.

As CN witness Hunt demonstrates, Applicants' post-merger traffic projections are wildly inaccurate. CN witness Carl Van Dyke identifies numerous errors and omissions in Applicants' operating plan that render the resulting operating statistics invalid. As my testimony will demonstrate, these flaws in Applicants' traffic study and operating plan, and other errors described below, render the operating and capital expense estimates and post-merger financial exhibits set forth in the Application meaningless.

<sup>1</sup>The Application filed on October 29, 2021 by Canadian Pacific Railway Limited, Canadian Pacific Railway Company, and their US rail carrier affiliates (collectively, "CP") and Kansas City Southern and its US rail carrier affiliates (collectively, "KCS") seeking approval of the acquisition of control by CP of KCS. In this Verified Statement, I refer to CP and KCS collectively as "Applicants," and the proposed merged carrier as "CPKC."

**Exhibit 2-1: Elements of a reliable merger plan: The financial model (operating and capital expense) is dependent on the accuracy of Applicants’ traffic projections and post-merger operating plan<sup>2</sup>**



### 3. Applicants’ Capital Expenses Are Significantly Understated for Their Projected **{{XXX}}** Growth

Making adequate investment in infrastructure and equipment is essential to a railroad’s ability to provide efficient and reliable service. The Board understands this linkage: The Board has focused on railroad service issues and the potential for service disruption on one railroad to impact other parts of the interconnected North American rail network, and has inquired whether

<sup>2</sup> This is the logic flow explicitly cited in the Canadian National-Illinois Central and Norfolk Southern-Conrail merger applications to the Board. *See* FD33556, Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated – Control – Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central & Pacific Railroad Company, and Cedar River Railroad Company Railroad Control Application, Volume 2 of 4, Section 2.0. Oliver Wyman has been unable to find a statement indicating an explicit connection between the operating plan and financial model in the Canadian Pacific-Kansas City Southern Application.

railroads have adequate infrastructure and car supply to provide reliable service to their customers.<sup>3</sup>

The Board's pre-2001 merger regulations, which govern this proceeding, explicitly require the Applicants to address:

“The anticipated equipment requirements of the proposed system, including locomotives, rolling stock by type, and maintenance-of-way equipment; plans for acquisition and retirement of equipment; projected improvements in equipment utilization and their relation to operating changes; and how these will lead to the financial and service benefits described in the summary.”<sup>4</sup>

The Board again explicitly recognized the importance of a comprehensive capital expenditure plan when it promulgated the current service assurance plan requirement for Class I railroad mergers, which require:

“Applicants must develop a capital improvement plan (to support the operating plan) for timely funding and completion of the improvements critical to transition of operations. They should also describe improvements related to future growth and indicate the relationship of the improvements to service delivery.”<sup>5</sup>

These regulations describe the elements of an adequate capital investment plan. Exhibit 2-1 above shows the steps a railroad would typically follow to develop a capital expenditure plan using its projected traffic, operating plan, and system metrics to identify investments in track and facilities, rolling stock, and other assets required to accommodate the railroad's anticipated traffic. Capital investments logically are targeted to those projects and locations where additional capacity and/or resources are needed to ensure competitive transit times and service reliability.<sup>6</sup>

<sup>3</sup> See, for example, Ex Parte No. 724, which was initiated in response to service quality complaints concerning Canadian Pacific and led to weekly performance data reporting requirements for all Class I railroads.

<sup>4</sup> 49 CFR 1180.8(a)(3) (2000).

<sup>5</sup> 49 CFR 1180.10(d) (2001).

<sup>6</sup> Applicant railroads have likewise recognized that an accurate capital plan is essential to demonstrating that a merger will be operationally and financially viable. For example, in its application to control the Illinois Central, Canadian National provided the Board with a section

Here, Applicants have failed to present a detailed capital investment plan that makes adequate provision for additional track and yard capacity, bridge renewal and replacement, and rolling stock and resources at locations where they claim the proposed merger will generate substantial increases in traffic and train and yard activity. In particular:

- The Application does not contain the detailed, location-specific information required to assess the adequacy of Applicants’ capital investment plan. While the Application asserts that Applicants will spend \$5.7 billion in Years 1-3 for what is vaguely described as “capex,” only about {XXX } of that sum is actually allocated to specific investments that are described in the Application.<sup>7</sup>
- Applicants state that their financial projections do not include revenues and expenses related to organic growth.<sup>8</sup> However, as confirmed in witness Van Dyke’s Verified Statement, Applicants’ operating plan outputs include the impact of {{XXX }} organic growth in GTMs by 2025 (the assumed Year 3 of the merged system) and 19.8 percent growth in GTMs as a result of the merger, for a total increase of {{XX }}

concerning “Line Infrastructure, New Construction, and Other Capital Investments.” That section included subsections concerning line infrastructure, merchandise/unit train yards, intermodal/auto terminals, new and upgraded connections, locomotives, information systems, and a summary of capital investments. In each case, Canadian National identified the specific projects to be undertaken and the specific funds budgeted. (*See*, for example, FD33556, Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated – Control – Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central & Pacific Railroad Company, and Cedar River Railroad Company Railroad Control Application, Volume 2 of 4, Section 7.0.)

<sup>7</sup> Verified Statement of John A. Orr and Raymond F. Elphick at p. 84 identify \$276 million for one merger-related capital project, including new sidings and CTC on the mainline between Sabula Jct., IA and Beaumont, TX. For a second capital project, Verified Statement of James Clements at p. 9 identifies \$138.6 million for IT and communications integration of the two railroads. For a third capital project, Orr and Elphick V.S. at p. 70 identify \$45 million for locomotive rebuilds in Year 3. (Orr and Elphick V.S. at p. 70, identify \$135 million for locomotive rebuilding but defer rebuilding of 90 locomotives in Years 1 and 2, saving \$90 million. From this statement, I infer that Applicants will spend \$45 million to rebuild 45 locomotives in Year 3). The sum of these three expenditures is \$459 million, which is 8 percent of the \$5.7 billion for capital improvements (\$1.9 billion per year as identified in Appendix G of Application 1 for three years equals \$5.7 billion).

<sup>8</sup> Verified Statement of Chris De Bruyn, p. 6.

in GTMs by Year 3.<sup>9</sup> It is unclear whether Applicants' average of \$1.9 billion per year budgeted (but largely unspecified) capital investment funding, in their financial projections for each of Years 1-3, includes adequate funding for capacity improvements to handle organic and merger-related GTM growth of {{XXX }} by Year 3 of the merged system, as well as funding for the normal renewal of assets.

- Whether Applicants intend that the average \$1.9 billion per year will cover both organic and merger-related growth, this amount of funding appears to be inadequate, especially when compared with Applicants' own pre-merger capital spending. Between 2014 and 2019, CP and KCS together made capital investments equal to, on average, 24.2 percent of their annual revenue.<sup>10</sup> In no year did the railroads spend less than 21.0 percent of their combined revenue on capital investments. Yet the Application indicates that the merged CPKC would spend only 19.3 to 20.6 percent of post-merger revenue during each of Years 1-3.

In terms of dollars spent for capital expenditures during 2014-2019, CP and KCS in total spent an average of \$1.9 billion per year.<sup>11</sup> During that period, the GTMs carried by CP and KCS combined grew by 3 percent.<sup>12</sup> The \$1.9 billion per year budgeted for Years 1-3 is no more than the average annual spend for 2014-2019, even though post-merger annual GTMs are projected to increase by more than {{XXX }} from 2019 to Year 3.<sup>13</sup> Also, one would expect Applicants to dedicate a greater percentage of revenue to undertake capital projects in the early years, so as to prepare the network to handle increased volumes of post-merger traffic. Applicants' capital expenditure plan is insufficient to support just organic growth, much less the projected \$1 billion in

<sup>9</sup> Application, Vol. 2, p. 287, Exhibit 13 Table 2; Oliver Wyman Capex worksheet No. 1, GTMs tab.

<sup>10</sup> Railroad Facts, 2015 to 2020 editions (which contain statistics for 2014 to 2019), Association of American Railroads. See HC - Oliver Wyman – HC - Capex Worksheet No. 1 for calculation.

<sup>11</sup> Railroad Facts, 2015 to 2020 editions, Association of American Railroads. See HC - Oliver Wyman - Capex Worksheet No. 1 for calculation.

<sup>12</sup> Based on data reported in CP's annual reports and KCS's Consolidated Investors' Reports, the combined GTM growth from 2014 to 2019 was 3 percent (371,526 million GTMs in 2014 to 382,543 million GTMs in 2019). (CP Annual Report 2014, p. 26 and 2019 Annual Report p. 57; KCS Consolidated Investors Report Q4 2014, p. 12 and Q4 2019 p. 13.) See HC - Oliver Wyman - Capex Worksheet No. 1, GTMs tab.

<sup>13</sup> See HC - Oliver Wyman - Capex Worksheet No. 1 – GTMs tab for GTM growth calculation.

additional merger-related traffic.<sup>14</sup> Applicants offer no explanation as to how the merged CPKC could handle a {{XXX }} increase in GTMs and maintain service levels, while not increasing the level of capital spending they have incurred in the normal course of business. In the absence of such an explanation, Applicants' capital plan is simply not credible.

- Applicants failed to provide for a number of capital projects that will almost certainly be required to accommodate their projected traffic growth. As discussed below, such improvements include expanding capacity of tracks, yards, intermodal terminals, and auto ramps at locations that will experience substantial increases in train activity; and providing sufficient locomotives and railcars to handle projected traffic volumes.

### **3.1 Applicants have failed to prove the adequacy of their committed capital investment funding**

Applicants have not provided a detailed description of capital investments that will be made post-merger, nor have they shown that a merged CPKC will have adequate funding allocated to its capital plan, given projected traffic growth.

While the Application includes \$5.7 billion in Years 1-3 for what is vaguely described as "capex," Applicants have allocated only about 8 percent of that sum for specific identifiable projects.<sup>15</sup> Nowhere in the Application or work papers do Applicants identify the nature or location of other specific capital projects that they propose to undertake during Years 1-3, much less the estimated cost and timing of such work. In the absence of such evidence, it is impossible for interested parties or the Board to assess the adequacy of Applicants' capital spending plans. Applicants also have not demonstrated that the amount of capital provided in their financial exhibits will be sufficient to accommodate merger-related and organic volume growth.

<sup>14</sup> Application Vol. 1, Appendix F, Income statement (Change in Revenue Between Year 3 and Base Year), pp. 131-142.

<sup>15</sup> Orr and Elphick V.S., pp. 70 and 84; Clements V.S., p. 9.

In the absence of project-specific information, benchmarks can be used to evaluate Applicants' capital plan.

**Historical capital spending** by CP and KCS prior to the merger. As shown in Exhibit 3-2, CP and KCS collectively averaged capital expenditures equal to 24.2 percent of revenue between 2014 and 2019. *In no year were their combined capital expenditures less than 21.0 percent of their combined revenue.* Yet the Application indicates that Applicants plan to spend only 20.6 percent of revenue in Year 1, 20.0 percent of revenue in Year 2, and 19.3 percent of revenue in Year 3 on capital projects, despite a projected increase of {{XX }} in GTMs by Year 3.<sup>16</sup>

**Exhibit 3-2: CP and KCS (full system) combined capital spending, 2014-2019<sup>17</sup>**

\$ billions

|                              | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | Avg. 2014-19 |
|------------------------------|-------|-------|-------|-------|-------|-------|--------------|
| <b>Revenue</b>               | \$8.6 | \$7.7 | \$7.0 | \$7.6 | \$8.3 | \$8.7 | \$8.0        |
| <b>Capex</b>                 | \$2.3 | \$2.1 | \$1.5 | \$1.8 | \$2.0 | \$1.9 | \$1.9        |
| <b>Capex as % of revenue</b> | 27.4% | 27.4% | 21.0% | 23.3% | 23.7% | 21.9% | 24.2%        |

**Dollars spent for capital expenditures** is another relevant benchmark. During 2014-2019, CP and KCS together spent an average of \$1.9 billion per year, while GTMs grew by 3 percent during that period.<sup>18</sup> Yet Applicants propose to spend the same \$1.9 billion per year for Years 1-3 post-merger,<sup>19</sup> an amount that is woefully deficient in light of their projected increase of more than {{XXX }} in GTMs by Year 3 of the merger compared to 2019. It is simply not credible to assume that Applicants can adequately address the merged railroad's capital needs by

<sup>16</sup> Application Vol. 1, Appendix G, p. 143; Oliver Wyman Capex worksheet No. 1, Capex tab.

<sup>17</sup> Railroad Facts, 2015 to 2020 editions, Association of American Railroads; see HC - Oliver Wyman Capex Worksheet No. 1 for calculation. Includes all North American operations.

<sup>18</sup> Based on data reported in CP's annual reports and KCS's Consolidated Investors' Reports, the combined GTM growth from 2014 to 2019 was 3 percent (371,526 million GTMs in 2014 to 382,543 million GTMs in 2019). (CP Annual Report 2014, p. 26 and 2019 Annual Report, p. 57, KCS Consolidated Investors Report Q4 2014, p. 12 and Q4 2019, p. 13.) See HC - Oliver Wyman - Capex Worksheet No. 1, GTMs tab.

<sup>19</sup> Application Vol. 1, Appendix G, pp. 143-154, cash flow statement.

spending no more per year than they spent before the merger, while accommodating significantly higher traffic growth. Moreover, Applicants are asking the Board to accept this clearly inadequate capital plan with no detailed explanation as to how or where the \$5.7 billion in capital expense funding would be deployed. The Applicants' capital plan is clearly completely inadequate in terms of describing the investment needs of the merged railroads.

### **3.2 Applicants have failed to make provision for capital projects that will be required to accommodate post-merger traffic volumes**

To understand whether Applicants' proposed capital spending sufficiently accounts for the capacity that would be consumed by their projected traffic increases, I conducted the following analysis. I note that in many cases my analysis was constrained by the lack of detailed information that ordinarily would be provided in a capital planning process (for example, the Applicants did not provide a complete set of track or bridge condition reports until the week before opposing statements were due).

- I assessed the line-of-road and yard capacity increases that would be required to handle projected increases in carloadings, using CP's methodology for assessing capacity compared to expected demand.
- I compiled a list of locations (such as subdivisions, yards, at-grade crossings with other Class I railroads, and bridges) where Applicants did not identify any specific capital projects, but where the projected increase in trains per day (or, in the case of yards, car handlings per day) make it virtually certain that significant capital investment will be necessary to maintain fluid operations to serve customers. I also reviewed certain trackage rights agreements where CPKC as a tenant railroad may be required to expand capacity to accommodate an increase in its traffic, but where Applicants have not identified any specific capital allocation. Given the projected increases in trains and yard handlings in the Application, I identified a number of critical capital expenditures that were not identified in the Application, as shown in Exhibit 3-3 and described below.

**Exhibit 3-3: Critical capital expenditures missing from the Application but likely required**

| Category                                     | Potential capex issue  | Resources impacted  |
|--|--|---|
| <b>Line of road</b>                          | <ul style="list-style-type: none"> <li>• Significant train delays and service disruptions are likely without additional capital spending</li> <li>• The number and location of long sidings to handle 10,000-foot trains are likely inadequate to prevent post-merger delays</li> <li>• No capital allocation for busy at-grade crossings controlled by other railroads</li> <li>• No capital allocation for increased traffic on lines accessed via trackage rights</li> <li>• No capital allocation for Mexican lines</li> </ul> | <ul style="list-style-type: none"> <li>• Seven subdivisions</li> <li>• Three at-grade UP/BNSF rail crossings</li> <li>• Two UP line segments used by CPKC under trackage rights agreements</li> </ul> |
| <b>Yards</b>                                 | <ul style="list-style-type: none"> <li>• No capital allocated to handle increased workloads, except at Bensenville</li> <li>• Adequacy of Bensenville expansion cannot be determined from information provided</li> </ul>  | Yards located in: <ul style="list-style-type: none"> <li>• Bensenville, IL</li> <li>• Schiller Park, IL</li> <li>• Shreveport, LA</li> <li>• Wylie, TX</li> <li>• St. Paul, MN</li> </ul>             |
| <b>Automotive ramps/intermodal terminals</b> | <ul style="list-style-type: none"> <li>• No capital allocated to handle increased workloads</li> </ul>   | <ul style="list-style-type: none"> <li>• All auto ramps/intermodal terminals except Bensenville</li> </ul>  |
| <b>Bridges</b>                               | <ul style="list-style-type: none"> <li>• No capital allocated for bridge expansion/replacement to handle increased traffic</li> </ul>  | <ul style="list-style-type: none"> <li>• Neches River Bridge</li> <li>• KCS Bridge at Laredo</li> </ul>   |
| <b>Revenue cars</b>                          | <ul style="list-style-type: none"> <li>• Insufficient new cars being added to handle projected loadings, given projected retirements</li> </ul>  | <ul style="list-style-type: none"> <li>• Insufficient gondolas and centerbeam flats for steel and forest products loadings</li> </ul>   |
| <b>Locomotives</b>                           | <ul style="list-style-type: none"> <li>• Insufficient new and rebuilt locomotives to handle increased traffic</li> </ul>   | <ul style="list-style-type: none"> <li>• Less than 1 percent increase in fleet size to move {{XXX }} more GTM's in Year 3</li> <li>• 45 rebuilds per year (need 90)</li> </ul>                        |

**3.2.1 Insufficient capital investment for expanded track capacity (line of road)**

I assessed the ability of each CP and KCS/KCSM subdivision on the north-south post-merger route between CP's Marquette subdivision (south of St. Paul), on the one hand, and KCSM's Tula subdivision (north of Mexico City), on the other hand, to absorb the increase in train activity projected in the Application, *using Applicants' own approach to capacity analysis*.<sup>20</sup> As shown in Exhibit 3-4, Applicants project a large increase in trains per day for

<sup>20</sup> A description of my (and CP's) capacity assessment methodology is provided in Appendix D.

almost every one of those subdivisions, as well as an increasing number of trains that will require 10,000-foot sidings (which is CP's stated objective for non-bulk trains, to achieve its post-merger productivity assumptions).

**Exhibit 3-4: Applicants' projected increase in trains per day by subdivision<sup>21</sup>**

| Subdivision | State | Base Trains/Day | Year 3 Trains/Day | % Growth | Base (Non-Bulk Trains) | Year 3 (Non-Bulk Trains) |
|-------------|-------|-----------------|-------------------|----------|------------------------|--------------------------|
| Chicago     | IL    | 2.9             | 11.1              | 283%     | {{XXX}}                | {{XXX}}                  |
| Marquette   | IA    | 7.7             | 14.3              | 86%      | {{XXX}}                | {{XXX}}                  |
| Davenport   | IA    | 7.1             | 21.6              | 204%     | {{XXX}}                | {{XXX}}                  |
| Ottumwa     | IA    | 4.2             | 18.4              | 338%     | {{XXX}}                | {{XXX}}                  |
| Laredo      | TX    | 3.0             | 17.0              | 467%     | {{XXX}}                | {{XXX}}                  |
| Kansas City | MO    | 2.9             | 16.9              | 483%     | {{XXX}}                | {{XXX}}                  |
| Pittsburg   | KS    | 13.5            | 28.5              | 111%     | {{XXX}}                | {{XXX}}                  |
| Heavener    | OK    | 11.3            | 25.9              | 129%     | {{XXX}}                | {{XXX}}                  |
| Shreveport  | LA    | 9.4             | 23.6              | 151%     | {{XXX}}                | {{XXX}}                  |
| Beaumont    | TX    | 8.9             | 20.3              | 128%     | {{XXX}}                | {{XXX}}                  |
| Rosenberg   | TX    | 8.5             | 17.7              | 108%     | {{XXX}}                | {{XXX}}                  |
| KCS Laredo  | TX    | 10.5            | 19.4              | 85%      | {{XXX}}                | {{XXX}}                  |
| Saltillo    | MX    | 24.1            | 29.8              | 24%      | {{XXX}}                | {{XXX}}                  |
| Vanegas     | MX    | 15.1            | 20.8              | 38%      | {{XXX}}                | {{XXX}}                  |
| Tula        | MX    | 14.6            | 19.5              | 34%      | {{XXX}}                | {{XXX}}                  |

As summarized below, even after spending \$276 million in specific planned capacity-expanding line-of-road investments during Years 1-3, CPKC is likely to encounter significant train delays, due to a lack of capacity to handle the planned increase in trains on almost every subdivision. This appears to be the result of a disconnect in Applicants' operations planning processes, as described by CN witness Van Dyke in his Verified Statement. One of those

<sup>21</sup> Trains per Day, Base and Year 3: Application, Appendix A. Trains per Day by Subdivision, Vol 2, pp. 364-368; Non Bulk Base and Non Bulk Year 3: Oliver Wyman utilized the FD 36500 - Work Paper - HC - Trains Per Day and Gross Ton Miles - Working Copy with Haz Breakdown.xlsx file to get the percentage of trains that were bulk vs. non-bulk and applied it to the trains per day from Appendix A of the Application. See HC - Oliver Wyman Capex - Worksheet No. 2.

disconnects involves train counts by subdivision. The counts in Exhibit 3-4 include both organic and merger-related growth through Year 3 of the merger. However, the projected capital expenditures in Application's financial exhibits *exclude organic growth*. So, it is, at best, unclear whether Applicants' capital expenditure plan was sized to accommodate the {{XXX }} increase in GTMs resulting from organic and merger-related growth. What is clear, as described in Appendices B and C of this Verified Statement, is that Applicants' specified capital investment allocations to upgrade these lines is substantially inadequate. The result is that, by Year 3, CPKC is likely to experience significant train delays on most subdivisions.

In light of Applicants' projection that the combined CPKC system would see {{XXX }} growth in GTMs by Year 3, I could not understand why Applicants included *no capital expenditure for several lines where trains per day are scheduled to double*. From the joint deposition of CP witness Raymond Elphick and KCS witness John Orr,<sup>22</sup> the co-sponsors of Applicants' Operating Plan (Exhibit 13), I learned that {{XXX.}} Witness Elphick initially asserted that {{XXX.}}<sup>23</sup> However, upon further questioning, he {{XXX.}}

<sup>22</sup> HC - Remote Videotaped Deposition of Raymond A. Elphick and John F. Orr, STB Docket No. FD 36500, February 18, 2022. Terence M Hynes and Michael Rosenthal, representing Canadian National and Union Pacific, respectively, conducted the portions of the deposition cited in my testimony.

<sup>23</sup> HC - Remote Videotaped Deposition of Raymond A. Elphick and John F. Orr, STB Docket No. FD 36500, Elphick Deposition, pp. 71-74 and 93-97, Feb 18, 2022.

{XXX } Exhibit 3-5 sets forth a summary of the deposition testimony of witness Elphick regarding two of the subdivisions for which Applicants performed only such cursory capacity discussions. (See Appendix E for the full text of these discussions from the deposition.)

**Exhibit 3-5: Elphick/Orr deposition extracts on the capacity assessment of KCS lines<sup>25</sup>**

| Rosenberg to Victoria |       |       |
|-----------------------|-------|-------|
| {XXX}                 | {XXX} | {XXX} |

| Beaumont to Rosenberg |       |       |
|-----------------------|-------|-------|
| {XXX}                 | {XXX} | {XXX} |

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

Considering Applicants' planned investments to upgrade the St. Paul-Chicago-Beaumont line segment of their north-south line, I found that seven out of 15 subdivisions<sup>26</sup> and three at-grade crossings of busy BNSF or UP lines are likely to experience significant train delays and potential service disruptions without additional capital investment, for the following reasons:

- *More than {{XXX}} of the CPKC trains operating on {{XXX}} subdivisions will be 10,000 feet in length.<sup>27</sup> This includes four subdivisions (the Chicago Subdivision and all three subdivisions in Mexico) on which *more than {{XXX}} of trains are**

<sup>26</sup> See Appendix C, subdivisions coded red in Tables B-1, B-3, and B-4.

<sup>27</sup> HC - Oliver Wyman - Capex Worksheet No. 2., see Summary tab.

*projected to be 10,000 feet in length.*<sup>28</sup> It is highly unlikely that those subdivisions currently have enough 10,000-foot sidings to maintain fluid service, given the anticipated increase in 10,000-foot trains, yet Applicants offer no specific plans to lengthen existing sidings or install additional sidings.

- The Application projects an *increase of 330 percent in trains operating on the Sabula to Kansas City mainline*, from an average of 4.3 trains per day at present to an average of 18.5 per day.<sup>29</sup> This line includes busy at-grade crossings with UP at Clinton, IA and with BNSF at Savannah, IL and Ottumwa, IA. UP and BNSF control those crossings, and each crossing is currently used by an average of 28-35 BNSF or UP trains per day.<sup>30</sup> Without capital investment to expand capacity at those locations, the massive increase in projected CPKC train movements at these busy crossings will threaten the fluidity of operations at each location.
- CPKC's planned route to/from Mexico, via the Laredo gateway, includes KCS trackage rights over two critical segments in Texas: UP's lines between Beaumont and Rosenberg, TX (a busy set of UP mainlines through Houston over which BNSF and Amtrak also operate trains) and between Victoria and Robstown, TX. *Applicants' operating plan contemplates that CPKC trains over these segments will more than double* – an increase from 7.7 trains per day to 16 trains per day between Beaumont and Rosenberg, and from 7.7 trains per day to 16.8 trains per day between Victoria and Robstown.<sup>31</sup> Applicants do not explain how CPKC will be able to add these trains on trackage they do not own (whether such increases are even permitted under the relevant trackage rights agreements and whether any additional capital investment would be required). Despite repeated requests, Applicants have not provided copies of the relevant trackage rights agreements with UP, which are necessary to determine whether CPKC will be permitted to double its daily trains over these lines without UP's concurrence, whether such concurrence has been granted, and, if so, what responsibility CPKC will have to fund capacity expansion of the lines to accommodate post-merger train activity. UP has expressed concern

<sup>28</sup> HC - Oliver Wyman - Capex Worksheet No. 2., *see* Summary tab.

<sup>29</sup> HC - Oliver Wyman - Capex Worksheet No. 1, *see* Other Calculations tab.

<sup>30</sup> Grade Crossing Inventory, FRA Office of Safety.

<sup>31</sup> Application Vol. 2, Appendix A, Trains Per Day by Subdivision, pp. 364-368.

regarding the Applicants' planned increase in traffic, stating that "their (the Applicants') Application, including their Operating Plan, should address all the consequences of the proposed transaction."<sup>32</sup>

Applicants' operating plan does not demonstrate that the increased CPKC traffic over the Beaumont-Rosenberg line will not interfere with operation of Amtrak's Sunset Limited intercity passenger service. Applicants are obligated to provide this proof.<sup>33</sup> UP echoes this concern, stating that "The Application does not support Applicants' claim that their proposed transaction will not adversely affect Amtrak."<sup>34</sup> Amtrak's Sunset Limited transits this busy corridor three times per week. With CPKC doubling its trains on this line segment and across the Neches River Bridge, there will be an increased risk of delaying this Amtrak train. CP's recent Agreement with Amtrak dated February 2022 does not address the Sunset Limited.<sup>35</sup>

- Despite the projected increase in post-merger traffic to and from Mexico, Applicants have *identified no planned capital projects to expand capacity on KCSM's lines in Mexico*. This is of particular concern because *more than {{XXX }} of CPKC trains, which will carry time-sensitive intermodal and automobile traffic, will move in 10,000-foot trains*. Additional siding capacity will be required to handle that traffic in Mexico.
- With the construction of Bensenville Yard not expected to be completed until 2025 (the presumed Year 3 of the CPKC merger), transfer movements between Bensenville and Schiller Park yards will likely increase significantly as (1) work is shifted to Schiller Park and back to Bensenville, to enable the rebuilding and expansion of Bensenville Yard; and (2) to accommodate the significant increase in Bensenville's workload due to organic and merger-related growth. Each transfer move between these two yards involves crossing the

<sup>32</sup> Union Pacific Railroad Company's Petition to Reject Application as Incomplete, STB Finance Docket 36500, p. 14.

<sup>33</sup> 49 CFR 1111.8(a)(2) (2000).

<sup>34</sup> Union Pacific Railroad Company's Petition to Reject Application as Incomplete, STB Finance Docket 36500, p. 15.

<sup>35</sup> Amtrak-Canadian Pacific Agreement, Section 6, conveyed to Cynthia T. Brown, Chief Section of Administration, Office of Proceedings, Surface Transportation Board, by letter from Sophia Ree, dated February 2, 2022.

tracks of two busy Metra commuter lines (the Milwaukee District West Service to Elgin and the North Central Service to Antioch) and a lengthy reverse move to Schiller Park. There is no evidence that any simulation studies were carried out to determine the impact of this increase in transfer movements on the quality of Metra's services, and in fact counsel for CP has said no modeling was done related to Metra. *See* Letter from David L. Meyer, Counsel for CP, to STB, Docket No. FD 36500 (filed Feb. 23, 2022). And there are no specified capital investment projects in Applicant's capital plan to mitigate or eliminate any impact on Metra's services.

- Other line segments have no planned investments. That includes line segments of the Springfield Line, for which CN is seeking a divestiture condition. When two railroads merge and have parallel lines, the concern is that the merged entity will concentrate investment on one, to the detriment of the other. That is what will happen here. CP is investing in its mainline between Kansas City and Chicago but has not identified *any* investments in KCS's parallel route between Kansas City and Springfield/East St. Louis.

### **3.2.2 Insufficient capital investment for yards, auto ramps/intermodal terminals, and bridges**

#### ***Insufficient capital investment for key yards***

The Application does not specifically allocate capital dollars during Years 1-3 to any yard in the CPKC system except CP's Bensenville Yard (and the amount of anticipated investment to expand Bensenville is not disclosed in the Application). However, *each of the following CPKC system yards is unlikely to have sufficient capacity to accommodate the increased workloads assigned to them* in Applicants' operating plan.

- Bensenville and Schiller Park (Chicago): Applicants' work papers project a completion date of 2025 for the rebuilding and expansion of Bensenville Yard and assert that the resulting capacity will be adequate to handle post-merger loading.<sup>36</sup> However, Applicants

<sup>36</sup> Kansas City Southern and Canadian Pacific's Joint Responses And Objections to Canadian National Railway Company's First Set Of Discovery Requests, Response to Request No. 100, STB Finance Docket 36500, p. 79.

provide no proof as to how they will handle a significant increase in post-merger yard work in a smaller space, following the sale of land to the Illinois Tollway to fund the rebuilding and expansion.

The merged system will be operating in Years 1-3 with Bensenville under construction and while the combined network is coping with an anticipated {{XXX }} in GTMs (including a 19.8 percent increase related to the merger). Much of this increase will consist of intermodal and automotive traffic that will flow through Bensenville and Schiller Park. There is no indication in the filing that Applicants did any capacity studies to see how Year 2 and 3 volumes would fit through the yard, how many additional transfers to Schiller Park would be required during this period, and, as mentioned above, how much delay this would cause for the two affected Metra lines.

- Shreveport: The operating plan indicates that Applicants plan to *more than double the number of trains moving through Shreveport, from 9.4 trains per day to 23.6 trains per day* (including originating, terminating, and through trains). The yard will be assigned 81 more cars to switch, 14 more blocks to make, and an unspecified increase in blocks to swap between trains. Through trains affect yard operations, because they occupy the mainline during crew changes.<sup>37</sup> It is virtually certain that the 30 yard tracks and mainlines at Shreveport in their current configuration will not be sufficient to handle the increase in workload (particularly in light of the fact that only one of the two mainlines adjacent to the yard can be used for originating/terminating and block swapping). Yet Applicants have not identified any planned capacity expansion at Shreveport yard.
- Wylie, Schiller Park, and St. Paul yards are each assigned more work in Applicants' post-merger operating plan. However, Applicants have not identified planned capacity expansion at any of those yards to accommodate the increased activity.

Further detail on the Bensenville, Wylie, Schiller Park, and St. Paul yards is provided in Appendix A.

<sup>37</sup> Orr and Elphick V.S., pp. 41, 43, 49, and 51

### ***Insufficient capital investment for auto ramps and intermodal terminals***

Applicants cite the ability to offer single-line service for northbound movements of imported containers and finished vehicles from Mexico as one of the primary benefits of the merger.<sup>38</sup> Yet the Application makes no provision for capacity expansion of any CPKC system auto ramps or intermodal facilities other than Bensenville and Schiller Park. Also, despite a projected increase in intermodal and automotive loadings from 27,272 and 4,364 pre-merger to 72,796 and 7,043 in Year 3 (168 percent and 62 percent increases, respectively), Applicants have designated no funding for expansion of their IFG intermodal and automotive terminal 24 miles south of Kansas City. Further detail on these intermodal and auto terminal expansion plans is provided in Appendix A.

### ***Insufficient capital investment in key bridges***

The Application does not identify capital spending for critical bridges that will be affected by projected traffic increases:

- KCS owns and operates a 20-mph single-track drawbridge over the Neches River in Beaumont, TX. The bridge is also used by BNSF, UP, and Amtrak trains. The Application projects that *CPKC daily train volume will more than double, from an average of 8.9 trains per day in the Base Year (2019) to 20.3 trains per day in Year 3.*<sup>39</sup> The need to replace this bridge – even at current traffic levels – has been noted by the

<sup>38</sup> Witnesses Brown & Zebrowski in their work papers show \$125 million in autos from Mexico to Chicago interchange, Canada, Chicago, Twin Cities, and Kansas City. See the “Results” tab of HC - Diversion Identification work paper for Year 3 incremental revenue attached to their V.S.. They also have new moves of autos from Ontario to Kansas City and from the Gulf to Canada. Witnesses Wahba & Naatz in their work papers show an additional \$16 million in autos from Guanajuato to Chicago interchange (35%), Chicago local (35%), Kansas City (10%), Toronto (10%), and Twin Cities (10%). See Row 10 in the HC - Growth Initiative Calculations work paper attached to their V.S.

<sup>39</sup> Application Vol. 2, Appendix A, Trains per Day by Subdivision, Beaumont Subdivision, pp. 364-368.

Texas Department of Transportation.<sup>40</sup> But the Application makes no provision for capital spending to increase the capacity of the existing bridge or to replace it.

- The KCS Bridge at Laredo, TX, which is used by both KCS and UP, is a critical link for traffic moving between Mexico and points in the United States and Canada. By Year 3, given the projected increase in trains crossing the bridge, congestion may become a problem. Construction of a second railroad bridge at Laredo has been approved by US Presidential permit, and KCSM believes the remaining three permits needed to begin construction will be obtained in time to begin construction at the start of 2023.<sup>41</sup> Yet the Application makes no provision for the cost of constructing a second bridge.

Applicants also make no mention of carrying out detailed capacity studies of the Neches Bridge to determine what capital investments will be needed to accommodate projected traffic growth.

### 3.2.3 Insufficient increase in revenue cars

The Application projects that CPKC will earn \$1.021 billion of incremental revenues from: (1) post-merger traffic moving in {{XXX}} new units (carloads and containers) diverted from trucks and other railroads, and (2) {{XXX}} existing units that will have a longer length of haul.<sup>42</sup> These traffic diversions will generate a projected increase of 19.8 percent in GTMs.<sup>43</sup> Applicants posit that they will be able to handle this increase in GTMs with 2,002 fewer revenue cars, a 3.4 percent decrease.<sup>44</sup> Moreover, they plan to retire without replacement 833 general

<sup>40</sup> 2019 Texas Rail Plan, which cites bridge replacement as a long-range project (2023-2039), Texas Department of Transportation, Table 5-3, pp. 329-330.

<sup>41</sup> Federal Register:: 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; “KCSM outlines projects for 2022,” T21com.mx and Google Translate, January 11, 2022.

<sup>42</sup> HC - Oliver Wyman - Capex Worksheet No. 1, Carloads and containers growth tab.

<sup>43</sup> HC - Oliver Wyman - Capex Worksheet No. 1, GTM tab.

<sup>44</sup> Orr and Elphick V.S., pp. 71, 73-74, Calculation  $2,002/59,405 = 3.4\%$ .

flatcars (including centerbeam flatcars) and 2,063 gondolas (including coil-steel cars), even as they experience an increase of 3,722 carloads<sup>45</sup> per year of forest products and 2,277 carloads per year of steel-related products.<sup>46</sup> In addition, no capital allocation has been made in the Application for revenue cars for projected organic growth. It seems unlikely that CPKC can accommodate a nearly {{XX }} increase in total GTMs from organic and merger-related growth simply by increasing the number of annual car turns with a smaller fleet, particularly given the significant increase in lengths of haul per load (and the need to return empties).<sup>47</sup>

### 3.2.4 Insufficient supply of new and rebuilt locomotives

The Application reflects an assumption that the merged CPKC will be able to move {{XXX }} more GTMs by Year 3 without acquiring any additional locomotives.<sup>48</sup>

The Application also appears to contemplate that *the average age of the combined CPKC locomotive fleet will increase significantly, from 16.5 years to 19.1 years.*<sup>49</sup> Applicants plan to continue with a locomotive rebuilding program. To maintain the current average fleet age of 16.5 years,<sup>50</sup> CPKC would need to rebuild approximately 90 road locomotives per year. However, Applicants' planned budget for locomotive rebuilding – one of the few specific capital projects identified in the Application – contemplates only 45 rebuilds per year. Moreover, Applicants plan to suspend their rebuilding program altogether during Years 1 and 2, and to reduce the pre-merger locomotive fleet by 135 units by temporarily storing the road locomotives that are the

<sup>45</sup> Orr and Elphick V.S., pp. 73-74. (124+73+1,397+372+97 = 2,063 gondolas) & (67+315+246+205 = 833 general flatcars).

<sup>46</sup> Brown and Zebrowski V.S., Application Vol. 2, pp. 157-158 (1,684+2,038 = 3,722 carloads of forest products, 1,444+833 = 2,277 carloads of steel-related products).

<sup>47</sup> Orr and Elphick V.S., pp. 71 and 73-74.

<sup>48</sup> Orr and Elphick V.S., p. 68; HC - Oliver Wyman - Capex Worksheet No. 1, GTMs tab.

<sup>49</sup> HC - Oliver Wyman - Capex Worksheet No. 1, Locomotives tab.

<sup>50</sup> *Id.*

most expensive to operate during Years 1 and 2 – rather than rebuilding these units in anticipation of higher Year 3 traffic volumes. Applicants apparently plan to return 90 of these units (without rebuilding) to service in Year 3.<sup>51</sup> Taken together, these decisions will leave CPKC with a locomotive fleet that is older.<sup>52</sup> The likely consequence of this decision will be reduced locomotive reliability and increased maintenance expense.

In short, Applicants propose to handle an overall {{XXX }} increase in GTMs in Year 3 with a road locomotive fleet that is the same size as pre-merger,<sup>53</sup> but three years older than the current road locomotive fleet. With an older and less reliable locomotive fleet, Applicants' operating plan is likely to be more difficult to execute. While it may be possible to increase the length of some trains, depending on the length of sidings, the number of locomotives assigned to each train is a function of the weight of the train and ruling grades on a line, not the train's length in feet. Applicants' desire to increase many trains to a 10,000-foot configuration (the standard in CP's precision scheduled railroading (PSR) guidelines) might produce some increase in locomotive utilization, but only if trains are not currently using the full capacity of the locomotives assigned to them. In the work papers, Applicants appear to assume an increase in train speeds as the means to turn locomotives faster and improve utilization. But it is unlikely, even with an increase in train speeds, that the reduced locomotive fleet will be sufficient to handle a {{XXX }} increase in GTMs.<sup>54</sup>

<sup>51</sup> Orr and Elphick V.S. at p. 70 identify \$45 million for locomotive rebuilds in Year 3. (Orr and Elphick V.S. at p. 70 identify \$135 million for locomotive rebuilding but defer rebuilding of 90 locomotives in Years 1 and 2, saving \$90 million. From this statement, I infer that the Applicants will spend \$45 million to rebuild 45 locomotives in Year 3.)

<sup>52</sup> HC - Oliver Wyman - Capex Worksheet No. 1, Locomotives tab.

<sup>53</sup> Fleet size of 1,615 from Orr and Elphick, V.S., Table 6, p. 68.

<sup>54</sup> Orr and Elphick V.S., footnote 9 on p. 68; HC - Oliver Wyman - Capex Worksheet No. 1, GTMs tab.

#### **4. Applicants Significantly Understate Operating Expenses By At Least \$2 Billion and Project an Operating Ratio of 30 Percent for Merger-Related Traffic**

Determining whether the incremental post-merger operating expenses projected by Applicants are in line with the projected increase in post-merger traffic is another important factor that the Board must assess in reviewing the viability of the proposed transaction. In past merger applications, applicants have employed a standardized modeling process to generate operating expenses based on projected changes in workload. Here, however, Applicants used a flawed and inaccurate approach to cost analysis and financial projections. As a result, Applicants have not shown that their operating expense estimates accurately reflect the cost of post-merger operations.

Indeed, Applicants' projected operating expenses for the first three post-merger years are understated by approximately \$2.47 billion when compared to the operating expenses actually incurred by CP US and KCS US during the 2015-2019 period.<sup>55</sup> When compared to the average operating expenses incurred by the four largest Class I railroads (BNSF, UP, CSX, NS) between 2015 and 2019, Applicants' post-merger operating expense estimates appear to be understated by approximately \$2.0 billion.<sup>56</sup> This represents an understatement of the merged railroad's operating expenses of approximately 10.7 to 12.9 percent of total operating expenses for those years.

The most significant flaws in Applicants' operating expense estimate include the following:

- Applicants did not base their estimate of incremental operating expenses on the analyses or outputs of their operating plan or system model. Instead, Applicants based their

<sup>55</sup> Analysis of US Class I Railroads – years 2015 to 2019, Association of American Railroads. See Oliver Wyman Opex Worksheet.

<sup>56</sup> *Id.*

estimate solely on a table of incremental operating expenses that is hard-coded into an unsourced spreadsheet in Applicants' work papers.<sup>57</sup> In other words, while Applicants submitted the veneer of an operating expense development process (including a purported MultiRail analysis of post-merger operations), the operating expenses reflected in the Application are nothing more than assumptions that are unsupported by documentation or analysis.

- Applicants' incremental post-merger operating expenses are clearly not credible, given their projected increase in post-merger traffic volumes. Comparing Base Year 2019 to Year 3 of the merged system, Applicants claim that the merged CPKC will incur only \$306.3 million<sup>58</sup> in incremental operating expenses, an increase of only 5.67 percent over the Base Year, even though they project an increase of 19.8 percent in GTMs in Year 3.<sup>59</sup>
- Applicants project that this new business will generate \$1,021.9 million in additional revenues.<sup>60</sup> Based on their projected incremental operating expenses of \$306.3 million, this equates to a 70 percent flow-through of revenue to operating income, or a *projected operating ratio of only 30 percent for the incremental traffic*.<sup>61</sup> That is far lower than any operating ratio ever achieved by any Class I railroad in North America on either baseload or incremental traffic.<sup>62</sup> This strongly suggests that Applicants' operating expenses are greatly understated.
- Applicants' claimed operating cost savings are projected to occur in an unrealistically accelerated time frame. Specifically, *Applicants assume that \$93.5 million, or 80.8 percent, of the total projected \$115.7 million savings in operating expenses will be*

<sup>57</sup> FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx, Inputs – revenues + costs tab.

<sup>58</sup> See Application Vol. 1 at 427. Elsewhere in the Application (Vol. 1 at 140), Applicants state that Year 3 operating expenses would be even lower, at \$282 million. Nowhere in the filing is this discrepancy explained.

<sup>59</sup> Application Vol. 2, Table 2, p. 287. Base Plan GTMs = 385.6 billion, Growth Plan GTMs = 461.9 billion, Growth = 19.8 percent. The 5.67% increase was calculated by dividing \$306.3M by \$5.4 billion. See Oliver Wyman Opex worksheet for calculation.

<sup>60</sup> Application Vol. 1, Appendix B. Summary of Benefits, p. 74.

<sup>61</sup> The 30 percent incremental traffic operating ratio is calculated by taking \$306.3 million divided by 1,021.9 million.

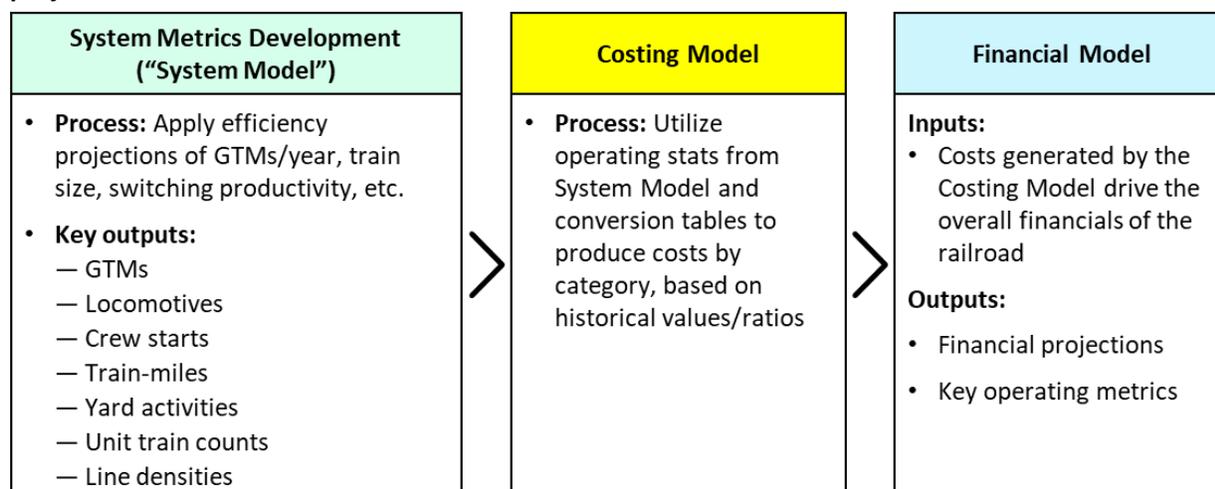
<sup>62</sup> 2020 operating ratio range for Class I railroads: 60.7 to 73.6 percent, from Railroad Facts, 2020 Edition, Association of American Railroads. See Oliver Wyman Opex Worksheet.

achieved in Year 1 post-merger. For transportation, fuel-related, and locomotive leasing/depreciation cost savings, Applicants assume that fully 96.5 percent will be realized in Year 1.<sup>63</sup> Since CP cannot begin to physically integrate its network with KCS or influence KCS operations until the merger is approved, it is unlikely that Applicants would be able to implement all of the operating changes required to generate virtually all of the achievable operating expense savings in the first post-merger year.

#### 4.1 The methodology employed by Applicants to estimate post-merger operating expenses is flawed and opaque

Exhibit 4-1 illustrates the logical and typical sequence of steps involved in preparing complete and accurate operating expense projections.

**Exhibit 4-1: Logical process for developing accurate post-merger operating statistics and financial projections**



As described in Exhibit 4-1, in past merger proceedings, applicants:

- First produced estimates of **traffic growth**, which were then added to the carriers' pre-merger traffic base to produce an estimate of traffic that would be handled by the merged railroad.
- The estimated post-merger traffic file was then input into an **operations planning model** to develop an operating plan for the merged railroad. (MultiRail, which Applicants

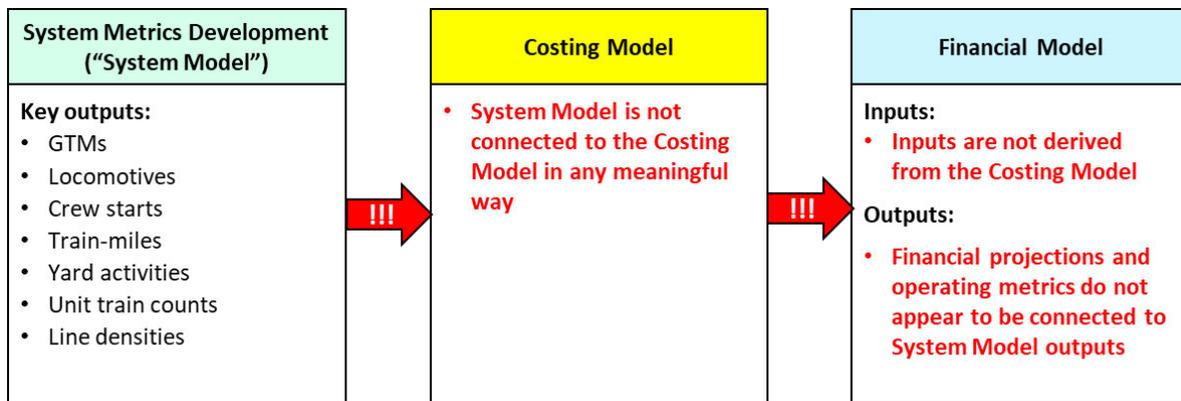
<sup>63</sup> FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx, CPKC Summary of Benefits tab; Oliver Wyman Opex worksheet.

purport to have used in planning for this merger, is one such model that has been used for that purpose in many prior merger proceedings.) The resulting operating plan identifies the number of trains and the level of yard activity required to handle post-merger traffic efficiently.

- Prior merger applicants then used a **system model** to derive operating statistics (such as GTMs, train-miles, crew starts, etc.) from the operating plan.
- The operating statistics produced by the system model were then input to a **costing model**, where they were converted into projected operating expenses based on the historic relationship of each category of operating expense with projected changes in operating activity, as represented by projected changes in GTMs.
- The projected operating expenses, in turn, were input to a **financial model** to develop pro forma financial statements for the post-merger period.

As illustrated in Exhibit 4-2, Applicants here did not apply a logical process capable of producing credible and complete operating expenses for the merged CPKC system. As a result, Applicants have failed to prove that they have adequately accounted for the incremental operating costs that they would incur in moving their projected {{XXX }} increase in GTMs by the end of Year 3.

**Exhibit 4-2: Applicants’ approach to developing projected post-merger operating statistics and financial projections**



As CN witness Van Dyke describes in greater detail, Applicants' operating plan, from which operating expenses should have been derived, is seriously flawed.<sup>64</sup> In the normal planning process, the merged carrier's projected traffic is flowed through a model of the railroad's network (for example, in MultiRail) to project post-merger train-miles, car handlings, etc., which are the fundamental building blocks used to estimate railroad operating expenses. However, Applicants did not follow that logical (and time-tested) process here. Instead, final values for each incremental operating expense category simply appear as hard-coded numbers in a table found in Applicants work papers (shown in Exhibit 4-3).<sup>65</sup>

<sup>64</sup> As witness Carl Van Dyke explains, "Applicants appear to have intentionally decided to develop their operating plan and operating expenses separately. Applicants' post-merger operating plan includes both 'synergy growth' traffic from their traffic diversion studies and 'organic growth' (growth resulting from general economic conditions unrelated to the proposed merger). On a systemwide basis, Applicants' posit organic growth in traffic volumes of {{XXX}} percent increase from the Base Year to post-merger Year 3. However, in calculating the merged CPKC's operating expenses, Applicants considered only 'synergy growth of 19.8%' traffic and excluded 'organic growth' traffic. It is not clear why Applicants took this inherently contradictory approach. What is clear is that the resulting operating expenses do not account for the cost of handling the {{XXX}} increase in 'organic growth' traffic. As a result, their claimed operating expenses bear no relation to their operating plan." Verified Statement of Van Dyke at 5.

<sup>65</sup> FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx, inputs – revenues + costs tab.

**Exhibit 4-3: Hard-coded CPKC traffic, revenue, expense, and profit projections<sup>66</sup>**

|   | Year 1 (2023)   | Year 2 (2024)   | Year 3 (2025)    |
|---|-----------------|-----------------|------------------|
| <b>Diverted Carloads/Units</b>          |                 |                 |                  |
| Automotive                              | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Energy, chemicals, and plastics         | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Forest products                         | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Grain                                   | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Domestic intermodal                     | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| International intermodal                | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Metals, minerals, and consumer products | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| <b>Total</b>                            | <b>195,093</b>  | <b>351,620</b>  | <b>509,490</b>   |
| <b>Incremental Revenues</b>             |                 |                 |                  |
| Automotive                              | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Energy, chemicals, and plastics         | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Forest products                         | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Grain                                   | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Domestic intermodal                     | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| International intermodal                | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Metals, minerals, and consumer products | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| <b>Total</b>                            | <b>\$418.0M</b> | <b>\$726.7M</b> | <b>\$1021.9M</b> |
| <b>Incremental Costs</b>                |                 |                 |                  |
| Automotive                              | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Energy, chemicals, and plastics         | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Forest products                         | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Grain                                   | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Domestic intermodal                     | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| International intermodal                | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Metals, minerals, and consumer products | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| <b>Total</b>                            | <b>\$129.2M</b> | <b>\$217.8M</b> | <b>\$306.3M</b>  |
| <b>Incremental Profits</b>              |                 |                 |                  |
| Automotive                              | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Energy, chemicals, and plastics         | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Forest products                         | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Grain                                   | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Domestic intermodal                     | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| International intermodal                | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| Metals, minerals, and consumer products | {{XXX}}         | {{XXX}}         | {{XXX}}          |
| <b>Total</b>                            | <b>\$288.9M</b> | <b>\$508.8M</b> | <b>\$715.6M</b>  |

<sup>66</sup> *Id.*

Applicants provide no explanation in the Application or supporting work papers describing how these total incremental operating expense figures were derived. All that can be discerned from Applicants' submission is that witness Baranowski's costing assumptions (see Section 4.2 below) result in an extremely low level of incremental operating costs per GTM in relation to projected incremental revenues.

#### **4.2 Applicants' operating expense estimate omits some expenses and underestimates others**

Applicants' Verified Statement of witness Baranowski describes how he estimated incremental operating expenses for the merged railroad.<sup>67</sup> According to witness Baranowski, Applicants' outside experts and internal marketing executives collectively estimated the number of incremental carloads that would be added to the merged railroad's traffic base during the first three years following the merger.<sup>68</sup> To estimate Year 1-3 incremental operating expenses, witness Baranowski then employed a costing methodology that assigned only *short- and medium-term* incremental operating expenses to the projected *long-term* increase in traffic. Specifically, witness Baranowski excluded depreciation from his operating expense calculations. This is a major flaw in Applicants' operating cost calculations, given that depreciation accounted for fully 19 percent of Class I railroad expenses in 2020.<sup>69</sup>

<sup>67</sup> Baranowski describes his costing methodology in Electronic Work Paper "Incremental URCS Unit Costs.xlsx," which describes his allocation of Transportation, Mechanical and MOW expenses to activity statistics; Electronic Work Paper "URCS Diversion Costing Metrics Adjustments.xlsx," which describes his methodology for deciding what costs to include in his definition of incremental costs to handle incremental carloads, and Electronic Work Paper "URCS Phase III Calculation for Growth Traffic.xlsx, Tab Final Summary."

<sup>68</sup> A description of these traffic growth projections, also prepared by Applicants using a deeply flawed process, is provided in the Verified Statement of David Hunt.

<sup>69</sup> Railroad Facts 2021, Association of American Railroads, p. 11.

The incremental operating expenses for Years 1-3 developed using the methodology employed by witness Baranowski<sup>70</sup> are artificially low due to his omission of depreciation and certain other recognized categories of operating expenses (summarized as “Unspecified” in Exhibit 4-4 below). As a result of those omissions, the unreasonably low level of operating expenses projected by Applicants are highly unlikely to be achieved during any year of the merger, and certainly will not be sustainable over the long term. The unrealistic nature of the amounts and allocation of incremental operating expenses for each functional category developed by witness Baranowski can be seen by comparing witness Baranowski’s calculations with the allocation of operating expenses by Class I railroads as a group, by CP (for its US operations), and by KCS (for its US operations), as shown in Exhibit 4-4. Neither Applicants (nor witness Baranowski) attempt to explain how (or why) the merged CPKC’s operating costs would be so markedly different from industry norms – *including the Applicants’ own real-world experience.*

**Exhibit 4-4: Comparison of allocation of incremental operating expense by function** <sup>71</sup>

| Category                 | CPKC Year 3     | % of Total  | 2015-2019 Average % for: |             |             |
|--------------------------|-----------------|-------------|--------------------------|-------------|-------------|
|                          |                 |             | US Class I’s             | CP (US)     | KCS (US)    |
| Maintenance of way       | \$38.8M         | 13%         | 21%                      | 30%         | 23%         |
| Maintenance of equipment | \$37.0M         | 12%         | 20%                      | 11%         | 22%         |
| Transportation           | \$230.5M        | 75%         | 46%                      | 43%         | 41%         |
| Unspecified              | \$0M            | 0%          | 13%                      | 16%         | 14%         |
| <b>Total</b>             | <b>\$306.3M</b> | <b>100%</b> | <b>100%</b>              | <b>100%</b> | <b>100%</b> |

<sup>70</sup> Application Vol. 1, p. 427.

<sup>71</sup> Verified Statement of Michael Baranowski, Application Vol. 1, p. 427; Source for CP US, KCS US, Class I’s (includes all US Class I’s): Analysis of US Class I Railroads – years 2015 to 2019, Association of American Railroads. Calculations are included in the Oliver Wyman Opex Worksheet.

As the breakdown of operating expenses in Exhibit 4-4 clearly demonstrates, *witness Baranowski's calculations ignored general and administrative expenses altogether and significantly underestimated maintenance of way and maintenance of equipment expenses*. As discussed above, he also accounted only for short- to medium-term operating expenses, thereby omitting depreciation. While witness Baranowski does not provide an explanation for his functional allocation of operating expenses, it is likely that omitting depreciation contributed to his underestimate of maintenance of way and maintenance of equipment expenses. Both of those categories account for a disproportionate share of depreciation expense relative to other railroad operating expense categories.<sup>72</sup>

In an asset-intensive business such as the railroad industry, projecting an increase in long-term revenues without also accounting for the associated long-term expenses (including depreciation) required to renew the railroad's assets will ultimately lead to the demise of the business. Applicants' flawed approach, which assumes \$306.3 million in incremental operating expenses, equal to only 30 percent of incremental revenues, results in a projected 70 percent flow-through to operating income, a level of performance that (I believe) has never been achieved by any North American Class I railroad.

### **4.3 Large operating expense savings claimed for the first year of the merger are unlikely to be realized**

Applicants' estimated operating expense savings attributable to the merger are unrealistically front-loaded, which has the effect of inflating Applicants' projection of operating income. Specifically, Applicants assume: (1) that 80.8 percent of the total three-year merger-

<sup>72</sup> 2020 Class I average: Maintenance of way: 25%, Maintenance of equipment: 20%, Transportation: 41%, Unspecified: 13%. See Oliver Wyman Opex Worksheet.

related savings of \$115.7 million (including 96.5 percent of assumed transportation/fuel/locomotive savings of \$92.5 million) will be achieved in the first year of the merger as KCS's operations are "optimized" and integrated with CP's, and (2) that subsequent productivity improvements of \$23.1 million (primarily purchasing efficiencies) will be realized in Years 2 and 3 of merged operations.<sup>73</sup>

Without identifying what specific expense reduction measures would be implemented in Year 1, witness Baranowski assumes that CPKC will realize this extremely high percentage of total projected operating expense savings during the first year of the merger, (supposedly) by implementing CP's precision scheduled railroading (PSR) on KCS.<sup>74</sup> This aggressive assumption ignores the fact that a significant portion of the implementation of PSR has *already been realized by KCS without the merger*. Beginning in January 2019, KCS commenced an aggressive initiative to implement PSR, which helped to reduce its operating ratio from 69.1 percent in 2019 to 62.2 percent in 2020.<sup>75</sup> As stated in KCS's Q4 2020 Consolidated Investor Report:

“During 2020, the KCS network experienced a rapid decline in volumes followed by an unprecedented volume rebound, forcing the Company to quickly adjust its service model to match customer demand while optimizing its cost structure. These actions resulted in significant improvements to train length and fuel efficiency, improving 12% and 5%, respectively. *PSR initiatives also contributed directly to operating expense savings of \$96 million in 2020 and are projected to deliver incremental savings of \$50 million in 2021.*”<sup>76</sup>

Given that KCS has largely implemented PSR, , and that CP already employs PSR on its own network, it is simply not realistic to assume that the merged CPKC can realize an additional

<sup>73</sup> Baranowski V.S., Table 9, p. 11. Calculations are included in Oliver Wyman Opex Worksheet.

<sup>74</sup> Orr and Elphick, V.S., p. 38, where they state that “CP's long experience with PSR...informed the approach to designing a consolidated plan for CP/KCS.”

<sup>75</sup> “Kansas City Southern Announces EVP Precision Scheduled Railroading Sameh Fahmy Will Leave the Company,” Business Wire, October 13, 2021; KCS Consolidated Investor Report Q4, Kansas City Southern, January 22, 2021, p. 6.

<sup>76</sup> Consolidated Investor Report Q4, Kansas City Southern, January 22, 2021, p. 3.

\$92.5 million in transportation, fuel, and locomotive savings from the merger, much less almost entirely during Year 1. Changes in operations (and related operating expense savings) do not happen overnight. Whatever additional incremental PSR efforts might be launched on Day 1 of the merged operations will almost certainly take months to implement – indeed, rushing the implementation of major operational changes could lead to substantial service failures, as has happened in connection with previous Class I mergers, such as the UP/SP merger.

As described in the operating plan, key claimed cost savings will require operating changes that will need to be planned and implemented, such as:

- Work will need to be transferred from Kansas City to Shreveport and St. Paul.<sup>77</sup>
- Clerical and dispatching activities will need to be moved from St. Paul to Kansas City.<sup>78</sup>
- Labor agreements and crew rosters will almost certainly need to be adjusted and/or renegotiated before changes to workloads and work activities can be implemented.<sup>79</sup>
- T&E and Mechanical personnel will need to be relocated and qualified to operate over new territories.<sup>80</sup>
- New blocking plans will need to be developed and put in place.<sup>81</sup>
- New locomotive distribution, servicing, and fueling plans will need to be implemented.<sup>82</sup>

<sup>77</sup> Orr and Elphick V.S., pp. 34-36.

<sup>78</sup> Verified Statement of Dean Vargas, p. 5.

<sup>79</sup> Verified Statement of Myron W. Becker, p. 10; Exhibit E of the Operating Plan (pp. 350-361) shows the pre- and post-merger locations of each category of employee.

<sup>80</sup> Orr and Elphick V.S., pp. 40-52 describe CPKC's changes in train and yard operations post-merger, many of which will require changes in domiciles for T&E and Mechanical personnel.

<sup>81</sup> Orr and Elphick V.S., p. 34.

<sup>82</sup> Orr and Elphick V.S., pp. 40-52 and 67 describe the many changes in train operations for CPKC operations. In preparation for implementation of merged operations, locomotive domiciles will need to be changed so they will align with new train plans, Mechanical personnel will need to be repositioned so that they are aligned with the train plan's fueling and locomotive servicing requirements. Exhibit E of the Operating Plan shows the locations of operating employees pre- and post-merger.

Given these and other measures that must be undertaken to merge the operations of CP and KCS, Applicants' claim that fully 80 percent of the total operating expense savings will be achieved during Year 1 is simply not credible. In my opinion, Applicants' assumption that the merged system can realize 80 percent of total three-year operating expense savings during the first post-merger year is unrealistic, especially given that KCS has already largely implemented PSR.

#### **4.4 Applicants' projected Year 1-3 operating expense projections are further belied by industry benchmarks**

To further assess the reasonableness of Applicants' projected operating expenses, I examined the historical relationship between operating expenses, gross-ton miles, and revenues for the four largest Class I railroads (BNSF, CSX, NS, and UP) and for CP's US operations and KCS's US operations based on the 2015-2019 period. I compared those figures to the projected revenues, GTMs, and operating expenses for the combined CPKC (as reflected in the Application and work papers).<sup>83</sup> As Exhibit 4-5 shows, when compared to the average operating expenses per GTM achieved by the four largest Class I railroads – *and by Applicants themselves in their real-world operations* – the projected operating expense per GTM for CPKC of \$0.0126 during the first three post-merger years is well below historical benchmarks.

<sup>83</sup> Analysis of US Class I Railroads – years 2015 to 2019, Association of American Railroads; FD 36500-Work Paper- HC- Cost Metrics Growth Model\_ Base year 2019; FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx.

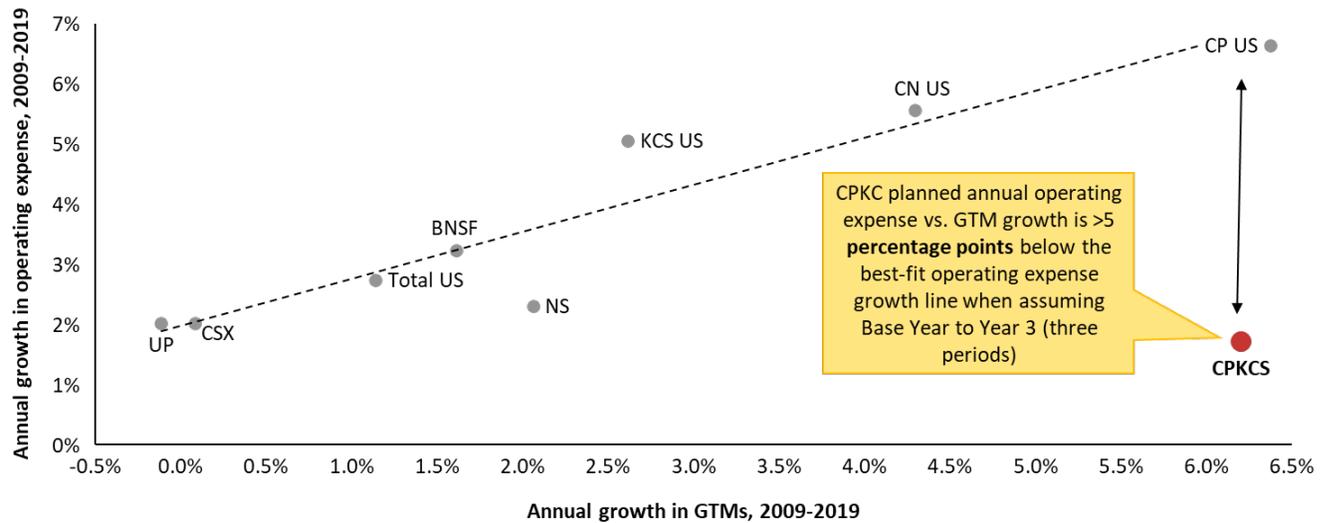
**Exhibit 4-5: Operating expense per GTM comparison<sup>84</sup>**

| Railroads  | Average Operating Expense per GTM 2015-2019 | Projected Operating Expense per GTM | Percentage Difference |
|--|---|-------------------------------------|-----------------------|
| <b>US Four Largest Class I's (BNSF, CSX, NS, UP)</b> | \$0.0141                                    | \$0.0126                            | 10.7% Less            |
| <b>CP (US) and KCS (US)</b>                          | \$0.0145                                    | \$0.0126                            | 12.9% Less            |

Another way to illustrate the unrealistically low operating expense per GTM posited by Applicants is shown in Exhibit 4-6, which shows changes in operating expense per GTM for all of the Class I railroads between 2009 and 2019. Again, this analysis strongly suggests that Applicants have significantly underestimated the operating expense per GTM that the combined CPKC system is likely to experience.

**Exhibit 4-6: Change in operating expense vs. change in GTMs, CPKC plan vs. historical data for US Class I railroads<sup>85</sup>**

CPKC: Scatterplot measures change between Year 0 (2019) and Year 3; Class I benchmark measures change between 2009 and 2019. CPKCS: 3-Year CAGR; benchmarks: 10-Year CAGR



<sup>84</sup> Analysis of US Class I Railroads – years 2015 to 2019, Association of American Railroads; FD 36500-Work Paper- HC- Cost Metrics Growth Model\_ Base year 2019; FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx. Operating expense includes amortization and depreciation. Calculations are included in the Oliver Wyman Opex Worksheet.

<sup>85</sup> FD 36500-Work Paper- HC- Cost Metrics Growth Model\_ Base year 2019; FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx Analysis of US Class I Railroads

In addition to operating expense per GTM, another common way to measure financial performance in the rail industry is the operating ratio (operating expense as a percentage of revenue). As shown in Exhibit 4-7, the implied operating ratio for CPKC’s post-merger incremental traffic (based on the incremental revenues and operating expenses set forth in the Application) is far below the historic norms for the US operations of Applicants themselves, and for the US Class I railroads as a group.

**Exhibit 4-7: Comparison of historic average operating ratios with Applicants’ projection<sup>86</sup>**

| Railroads                                  | Average Operating Ratio<br>2015-2019 | CPKC Projected<br>Operating Ratio | Percentage Difference |
|--|--------------------------------------|-----------------------------------|-----------------------|
| Four Largest Class I’s (BNSF, CSX, NS, UP) | 67%                                  | 58%                               | 13.3% Less            |
| CP (US) and KCS (US)                       | 69%                                  | 58%                               | 16.2% Less            |

#### **4.5 The shortfall in Applicants’ projected operating expenses is substantial**

As shown in Exhibit 4-5 above, the operating expense per GTM estimated by witness Baranowski and incorporated in the Application is well below “real-world” levels achieved by the Class I railroads and by CP and KCS themselves. Based on these benchmarks, Applicants’ total projected operating expenses for the first three years of operation are greatly understated.

– years 2015 to 2019, Association of American Railroads; Oliver Wyman analysis. Total for US Class I’s includes CSX, UP, BNSF, NS, KCS (US), CP (US), CN (US). Calculations are included in Oliver Wyman Opex Worksheet.

<sup>86</sup> Note: Applicants projected operating expense by year: \$5.4 billion in Year 1, \$5.56 billion in Year 2, and \$5.69 billion in Year 3. FD 36500-Work Paper- HC- Cost Metrics Growth Model\_ Base year 2019; FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx; Analysis of US Class I Railroads – years 2015 to 2019, Association of American Railroads. Calculations are included in the Oliver Wyman Opex Worksheet.

**Exhibit 4-8: Adjustments to Application operating expenses based on comparison to four largest Class I's and CP (US and KCS (US), 2015-2019<sup>87</sup>**

| Railroads  | Project Operating Expense CPKCS | Dollar Understated | Percentage Understated |
|--|---------------------------------|--------------------|------------------------|
| <b>US Four Largest Class I's (BNSF, CSX, NS, UP)</b> | \$16.70B                        | \$2.00B            | -10.7%                 |
| <b>CP (US) and KCS (US)</b>                          | \$16.70B                        | \$2.47B            | -12.9%                 |

Indeed, as Exhibit 4-8 shows, based on Applicants' own pre-merger operations, operating expenses for the CPKC system in the US during Years 1-3 are understated by \$2.47 billion. This benchmark is the best benchmark, because it reflects the particular characteristics of Applicants' networks and traffic bases in the United States.

<sup>87</sup> FD 36500-Work Paper- HC- Cost Metrics Growth Model\_ Base year 2019; FD 36500 – Work Paper - STB Rail Road Control Application Model – Final.xlsx; Analysis of US Class I Railroads – years 2015 to 2019, Association of American Railroads. Calculations are included in the Oliver Wyman Opex Worksheet.

**VERIFICATION**

I, Hugh Randall, declare under penalty of perjury that the foregoing information is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on this 28th day of February, 2022.

*Hugh Randall*

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Hugh Randall

## Appendix A. Yard Capacity Assessment

- Bensenville (Chicago): The Applicants do not provide sufficient information concerning the redesign of Bensenville Yard on less land (some having been sold to the Illinois Tollway) to prove that it will be able to handle:
  - For manifest trains, the switching of 112 additional cars/day (an 11 percent increase from the Base Case) and the preparation of four more blocks per day.<sup>88</sup>
  - For intermodal trains, construction of a high-volume terminal capable of handling 10,000-foot trains; the grounding/loading of 274 intermodal cars, a 213 percent increase; and an increase in lifts of 548 per day.<sup>89</sup>
  - For finished autos, construction of a new facility to handle 76 multilevel autoracks per day, compared to three autoracks per day in the optimized plan,<sup>90</sup> including the storing of hauled automobiles until they can be moved out of the yard by auto-carrier trucks.
- Wylie: The capital plan assumes that Wylie’s volume will increase by 52 percent (292 cars/containers per day).<sup>91</sup> The Applicants do not provide sufficient information to prove that the existing facility will be able to handle this increase in volume.
- Schiller Park East (Chicago): The capital plan includes new intermodal trains connecting Mexico with Detroit and Eastern Canada. The trains to/from Mexico will originate/terminate in Bensenville Yard; the trains to/from Detroit/Eastern Canada will originate/terminate in Schiller Yard, 4.5 miles from Bensenville. Moving blocks between these yards is very complex, involving a simultaneous crossing of two Metra lines and carrying out a reverse move for more than a mile.<sup>92</sup> The Application is silent as to the number of additional transfers that will be needed and the volumes of intermodal cars that will need to be moved. The Applicants fail to demonstrate that, given their plan for

<sup>88</sup> Orr and Elphick V.S., p .49.

<sup>89</sup> Orr and Elphick V.S., p. 49 Lifts equals 274 cars times 2 containers per car.

<sup>90</sup> Orr and Elphick V.S., p. 49.

<sup>91</sup> Orr and Elphick V.S., p. 89.

<sup>92</sup> Google Maps; CN Timetable No. 3 for Central Division, July 1, 2020.

handling intermodal traffic, Schiller Park Yard will have the capacity to handle this increased workload without capital expenditure. The Applicants also fail to demonstrate that the planned increase in intermodal units being transferred will not adversely affect Metra's commuter operations, as required by 49 CFR 1111.8(a)(2) (2000).

- St. Paul: While the yard tracks may be able to handle the proposed increase in switching of 69 cars/day,<sup>93</sup> the Applicants do not provide the information necessary to prove that the yard will have enough mainline and receiving/departure tracks to handle an increase of:
  - {{XXX }} in non-bulk trains/day to be made up and taken apart (from an average of {{XXX}} in 2019 to an average of {{XXX}} in Year 3); and
  - {{XXX }} in bulk (largely oil and grain) unit trains/day in each direction moving between Western Canada, the Gulf of Mexico, and Mexico (from an average of {{XXX}} in 2019 to an average of {{XXX}} in Year 3), whose crews will need to change adjacent to St. Paul Yard.<sup>94</sup>

<sup>93</sup> Orr and Elphick V.S., p. 49.

<sup>94</sup> HC - Oliver Wyman - Capex Worksheet No 2, Summary tab.

## Appendix B. Subdivision Capacity Assessment

### B.1 CP Line: St. Paul, MN/Elgin, IL to Kansas City, MO

This CP line, used infrequently pre-merger, ends in Kansas City, the only place where CP and KCS connect. It will become a critical link in the route that CPKC plans to use to operate new single-line services between Mexico and the Gulf Coast to the Upper Midwest and Eastern and Western Canada. To move the more than {{XXX}} new units of freight that CPKC projects will be diverted from trucks and other railroads through the merger,<sup>95</sup> *train volumes on this route are expected to increase by 330 percent, from 4.3 per day to an average of 18.5 per day.*<sup>96</sup> To handle this massive increase in trains, CP plans to invest more than \$276 million to upgrade this line,<sup>97</sup> as well as the KCS line from Kansas City to Beaumont, TX, with most of this investment being allocated to extending existing sidings and building new sidings. The planned increase in train volumes is expected to consist of approximately {{XXX}} of 10,000-foot intermodal/automotive/merchandise trains and {{XXX}} of 7,300-foot unit oil and grain trains.<sup>98</sup>

Using CP's methodology for estimating line capacity (described in Appendix C), I assessed the post-merger and post-capex operating capacity for each of the six subdivisions on the line. The results of my capacity simulations, using the same methodology applied by CP, are summarized in the exhibits below, with the relative severity of each subdivision's capacity issues, based on the projected increase in Year 3 trains per day, color-coded (**red** = most severe –

<sup>95</sup> HC - Oliver Wyman - Capex Worksheet, No. 1, Carloads and Containers Growth tab.

<sup>96</sup> HC - Oliver Wyman - Capex Worksheet No. 1, Other Calculations.

<sup>97</sup> Orr and Elphick V.S., p. 84.

<sup>98</sup> HC - Oliver Wyman - Capex Worksheet No. 1, Other Calculations.

will exceed practical capacity; **orange** – will be at practical capacity; **green** – will be less than practical capacity).

**Exhibit B-1: CP Line from Elgin, IL/St. Paul, MN to Kansas City**

| Subdivision                   | Miles <sup>99</sup>  | Speed Limits (mph) <sup>100</sup> | Base Year Trains/Day <sup>101</sup><br>% Bulk vs Non-Bulk | Year 3 Trains/Day <sup>102</sup><br>% Bulk vs Non-Bulk | Year 3 CPKC Capacity Issues  |
|-------------------------------|--|-----------------------------------|---|--|--|
| <b>Chicago</b>                | 101  | Avg: 33<br>Max: 40                | 2.9<br>{{XXX }}<br>{{XXX }}                               | 11.1<br>{{XXX }}<br>{{XXX }}                           | 11.1 trains/day = 100% of estimated practical capacity in this subdivision   |
| <b>Special Considerations</b> | CP crosses a BNSF mainline in Savanna, IL. BNSF controls this “first-come, first-served” automated crossing; speed for both RR’s at the crossing is 25 mph; 32 BNSF trains/day. <sup>103</sup> Large increase in CPKC trains likely to cause more train delays                                   |                                   |   |  |  |
| <b>Marquette</b>              | 159  | 25-35                             | 7.7<br>{{XXX }}<br>{{XXX }}                               | 14.3<br>{{XXX }}<br>{{XXX }}                           | 27 miles between Eckard & Harpers Ferry, practical capacity 13.3 trains/day<br>45 miles between Harpers Ferry & Brownsville, practical capacity 8.9 trains/day |
| <b>Special Considerations</b> | CP operates over CN for 1.6 miles in Dubuque, IA; speed limit of 25 mph; CN’s train volume was 11/day in 2016. <sup>104</sup> With CPKC’s increase in train frequency, delays likely to increase   |                                   |   |  |  |
| <b>Davenport</b>              | 55   | 40                                | 7.1<br>{{XXX }}<br>{{XXX }}                               | 21.6<br>{{XXX }}<br>{{XXX }}                           | 27 miles Camanche to Bettendorf with a practical capacity of 13.7 trains/day   |
| <b>Special Considerations</b> | 7.3 mile segment between Camanche and Deer Creek, including crossing of UP mainline in Clinton, IA; 20 mph limit across 6 of these 7 miles, UP operates 33-35 trains/day <sup>105</sup> and controls this crossing. Large increase in CPKC trains/day likely to result in increased train delays |                                   |   |  |  |
| <b>Ottumwa</b>                | 107  | 40                                | 4.2<br>{{XXX }}<br>{{XXX }}                               | 18.4<br>{{XXX }}<br>{{XXX }}                           | Estimated practical capacity for the entire subdivision is 16.7 trains/day   |
| <b>Special Considerations</b> | CP crosses BNSF at Ottumwa. BNSF dispatcher controls this crossing and BNSF operates 26 trains/day; Amtrak operates an additional 2 trains/day. <sup>106</sup> Addition of CPKC trains likely to increase train delays   |                                   |   |  |  |
| <b>Laredo</b>                 | 102  | 40                                | 3<br>{{XXX }}<br>{{XXX }}                                 | 17<br>{{XXX }}<br>{{XXX }}                             | 39.2 mile segment between Moravia & Powersville with a practical capacity of 12.2 trains/day   |

<sup>99</sup> Oliver Wyman CP Capacity Analysis Worksheet.

<sup>100</sup> *Id.*

<sup>101</sup> HC - Oliver Wyman - Capex Worksheet No. 2, Summary tab.

<sup>102</sup> *Id.*

<sup>103</sup> See FRA Office of Safety – Grade Crossing Inventory document.

<sup>104</sup> See *id.*

<sup>105</sup> See *id.*

<sup>106</sup> See *id.*

| Subdivision        | Miles <sup>99</sup> | Speed Limits (mph) <sup>100</sup> | Base Year                 | Year 3                    | Year 3 CPKC Capacity Issues   |
|--------------------|---------------------|-----------------------------------|---------------------------|---------------------------|---|
|                    |                     |                                   | Trains/Day <sup>101</sup> | Trains/Day <sup>102</sup> |   |
|                    |                     |                                   | % Bulk vs Non-Bulk        | % Bulk vs Non-Bulk        |   |
| <b>Kansas City</b> | 94                  | 40                                | 2.9<br>{ }<br>{ }         | 16.9<br>{ }<br>{ }        | 25.8 mile segment between MP 431 to Polo with a practical capacity of 18 trains/day |

### Exhibit B-2: KCS Line from Kansas City to Beaumont, TX

| Subdivision       | Miles <sup>107</sup> | Speed Limits (mph) <sup>108</sup> | Base Year                 | Year 3                    | Year 3 Capacity Issues  |
|-------------------|----------------------|-----------------------------------|---------------------------|---------------------------|---|
|                   |                      |                                   | Trains/Day <sup>109</sup> | Trains/Day <sup>110</sup> |   |
|                   |                      |                                   | % Bulk vs Non-Bulk        | % Bulk vs Non-Bulk        |   |
| <b>Pittsburg</b>  | 123                  | 55                                | 13.5<br>{ }<br>{ }        | 28.5<br>{ }<br>{ }        | Operating 29.1 trains will utilize 96% of the line's capacity in the 20.4 miles between Jaudon and Drexel and more than 80% between Amsterdam & Mulberry          |
| <b>Heavener</b>   | 209                  | 55                                | 11.3<br>{ }<br>{ }        | 25.9<br>{ }<br>{ }        | Even for 7,300-foot trains, capacity will be 96% utilized for 18 miles between Marble City & Gans and 89% utilization for 15.8 miles between Joplin and Dalby     |
| <b>Shreveport</b> | 209                  | 55                                | 9.4<br>{ }<br>{ }         | 23.6<br>{ }<br>{ }        | In the 24-mile section between Rich Mountain & Potter, capacity will be at 95% utilization; between Jury and Sandra, utilization will reach 87%                   |
| <b>Beaumont</b>   | 205                  | 55/59                             | 8.9<br>{ }<br>{ }         | 20.3<br>{ }<br>{ }        | In the 28-mile section between Hollywood & Mansfield, 20.3 trains/day will utilize 92% capacity; the 25-mile section between Neame/Singer capacity will reach 85% |

## B.2 KCS Line – Beaumont, TX to Laredo, TX

KCS's route from Beaumont to Laredo includes two line segments over which KCS operates using trackage rights over UP lines. These operations occur between Beaumont and Rosenberg, TX and between Victoria and Robstown, TX. The route also includes two line segments on KCS-owned track between Rosenberg and Victoria, TX and between Robstown and

<sup>107</sup> Oliver Wyman KCS Capacity Analysis Worksheet.

<sup>108</sup> *Id.*

<sup>109</sup> HC - Oliver Wyman - Capex Worksheet No. 2, Summary tab.

<sup>110</sup> *Id.*

Laredo, TX. In addition to the capacity constraints that CPKC will encounter on these two owned line segments (shown in the exhibit below), the process of moving between KCS owned and UP trackage rights introduces additional capacity issues, such as waiting for dispatcher approval to move between KCS and UP trackage and vice-versa. At present, there are no sidings on KCS's single-track line at either Robstown or Victoria, two of the entry points to the UP trackage rights lines. Despite train volumes projected to double by Year 3, the Application does not allocate any capital expenditure funding to increase capacity on either of the two subdivisions or on the UP trackage rights segments over which CPKC proposes to double KCS's current train operations.

**Exhibit B-3: Beaumont to Laredo – CPKC operating on its own tracks**

| Subdivision                   | Miles <sup>111</sup>  | Speed Limits <sup>112</sup> (mph) | Base Year<br>Trains/Day<br>% Bulk vs<br>Non-<br>Bulk <sup>113</sup> | Year 3<br>Trains/Day<br>% Bulk vs<br>Non-<br>Bulk <sup>114</sup> | Capacity Issues  |
|-------------------------------|---|-----------------------------------|---|--|--|
| <b>Rosenberg</b>              | 87  | 55/59                             | 8.5<br>{ }<br>{ }   | 17.7<br>{ }<br>{ }   | Even if the new 10,000-foot siding between Kendleton and Louise is built, capacity on this line will be limited to 16 – 10,000-foot trains/day   |
| <b>Special Considerations</b> | KCS operates over UP trackage between Beaumont and Rosenberg. Discussed in detail above |                                   |   |  |  |
| <b>Laredo</b>                 | 205   | 55/59                             | 10.5<br>{ }<br>{ }  | 19.4<br>{ }<br>{ }   | Even with the one additional siding that is expected to be built, capacity to move 10,000-foot trains will be limited to 14.7/day. Additional sidings may be required at three locations |
| <b>Special Considerations</b> | KCS operates over UP trackage between Rosenberg and Victoria. Discussed in detail above |                                   |   |  |  |

<sup>111</sup> Oliver Wyman KCS Capacity Analysis Worksheet.

<sup>112</sup> *Id.*

<sup>113</sup> HC - Oliver Wyman - Capex Worksheet No. 2, Summary tab.

<sup>114</sup> *Id.*

### B.3 KCSM Line – Laredo, TX to Metro Mexico City, MX

Applicants allocated no capital in their plan for capacity expansion in Mexico, even with significant projected volume increases and significant constraints on the ability to handle trains of the maximum 10,000-foot length specified in the operating plan. This is of particular concern because CPKC’s growth volumes consist primarily of time-sensitive intermodal and automotive traffic, which tends to move in longer, lighter tonnage trains. Clearly, additional sidings and (perhaps) siding length extensions will be required to keep the network fluid for the projected train volumes and to handle the larger 10,000-foot maximum train sizes proposed by CPKC. My capacity assessments of the three districts where additional (or expanded) 10,000-foot sidings will be needed are shown in the exhibit below.

**Exhibit B-4: KCSM Line from Nuevo Laredo to Mexico City**

| District        | KMs <sup>115</sup> | Speed Limits <sup>116</sup> (mph) | Base Year<br>Trains/Day<br>% Bulk vs<br>Non-Bulk <sup>117</sup> | Year 3<br>Trains/Day<br>% Bulk vs<br>Non-Bulk <sup>118</sup> | Capacity Issues   |
|-----------------|--------------------|-----------------------------------|---|--|---|
| <b>Saltillo</b> | 387                | 59                                | 24.1<br>{ }<br>{ }  | 29.8<br>{ }<br>{ }   | The current siding lengths limit the capacity for long trains to 16 per day. Several new 10,000-foot sidings will likely be needed. Capacity between Brazil & Rodriguez is projected to be slightly above 80%.                          |
| <b>Vanegas</b>  | 345                | 59                                | 15.1<br>{ }<br>{ }  | 20.8<br>{ }<br>{ }   | The current capacity for long trains on this line is less than 12 (6 each way per day) compared to a projected 20.8, so only about 56% of the trains can be long trains per day. Several new 10,000-foot sidings will likely be needed. |
| <b>Tula</b>     | 439                | 59                                | 14.6<br>{ }<br>{ }  | 19.5<br>{ }<br>{ }   | The segment from Ahorcado to Puerto Carrozas is 55KM between viable passing sidings and is projected to be operating at 96% of capacity post-merger. An additional siding may be needed.  |

<sup>115</sup> Oliver Wyman KCSM Capacity Analysis Worksheet.

<sup>116</sup> *Id.*

<sup>117</sup> HC - Oliver Wyman - Capex Worksheet No. 2, Summary tab.

<sup>118</sup> *Id.*

## Appendix C. Description of Rail Crossings Assessment

The CPKC operating plan does not address potential difficulties in moving large volumes of additional traffic over at-grade crossings with other railroads. To determine the service impact of increasing CPKC trains moving over these crossings, Applicants should have performed a detailed rail capacity simulation for the following crossings:<sup>119</sup>

- Ottumwa, IA: An average of 26 BNSF and two Amtrak daily trains move over this crossing, which BNSF controls. For CP today, this is an operationally difficult, capacity-consuming crossing. Southbound trains must ease down a 1.6 percent grade so they can stop if needed before the crossing. Northbound, CP trains also must ease up to the crossing in case they have to stop. Just beyond the crossing, northbound CP trains must immediately climb a 1.6 percent grade. *CPKC train movements through this crossing are projected to grow by more than 400 percent, from an average of 4.2 in 2019 to 18.4 in Year 3.* BNSF has a speed limit of 30 mph and CP has a speed limit of 20 mph.
- Clinton, IA: This crossing of UP's E-W mainline requires CP trains to operate on UP trackage for seven miles through the town of Clinton. Six of the seven miles are subject to a speed restriction of 20 mph (which at this speed uses up 79 percent of the capacity of the CP line). While Applicants are investing in two sidings at the approaches to the UP crossing, my capacity analysis indicates that this investment will be insufficient to overcome projected capacity problems in the Davenport Subdivision. UP controls this crossing and 33-35 UP trains move through Clinton daily. With CPKC planning an increase of trains from 7 to 21.6 per day in Year 3, congestion will increase and UP and CP trains will be delayed.
- Savanna, IL: CP crosses a BNSF mainline in Savanna, IL. This is currently an automatic, first-come first-served crossing, which has a 25-mph speed restriction for both railroads; 32 BNSF trains per day move across this crossing. With an increase in CPKC train frequency from 3 to 11 daily, an increase in delays is likely.

<sup>119</sup> The source for all train volumes moving through these three crossings is the FRA Office of Safety, Grade Crossing Data Inventory.

## Appendix D. Methodology for Estimating Capacity

Estimating the capacity of a line is a function of a variety of factors, including the number of tracks, siding length, distance between sidings, train speed, the size of trains, and the number of trains per day. The best-in-class method of capacity analysis employs a tool called the Berkeley Simulation Software Rail Traffic Controller (RTC) Model, which includes a train performance calculator to evaluate train schedules input by the user. Here, Applicants instead used a “spreadsheet model” based on train running times between sidings, plus a delay for entering and leaving the passing siding. From these data a theoretical capacity can be calculated.

*The practical capacity of a line is 70 percent of its theoretical capacity, to accommodate track maintenance activities, recovery from disruptions (which can include mechanical failures, derailments, and weather-related issues), bunching rather than smooth timing of trains (often caused by mixing unscheduled unit trains into the network along with scheduled intermodal and manifest trains), and switching activities at customer facilities along the route.*<sup>120</sup> This methodology is consistent with the spreadsheet work papers provided by Applicants for the KCS lines in the United States and the CP lines from Kansas City to Chicago and St. Paul. This is especially important in a merger filing, where everything is considered based on an “average” day. There are day-of-week variations in train numbers as well as seasonal variations which in real life operations must be handled without significant delays.

Applicants provided capacity worksheets for the KCS lines in the United States using this methodology, but their analysis included all sidings regardless of length, without considering the sizes of the specific trains to be operated. While the operating plan calls for a 10,000-foot

<sup>120</sup> National Rail Freight Infrastructure Capacity and Investment Study, Association of American Railroads, September 2007, p. A-10, where it notes “Practical capacity is about 70 percent of the theoretical capacity and provides reliable service.”

maximum train length, Applicants used many sidings that are well short of 10,000 feet in calculating line capacity. Moreover, their analysis of the KCS-owned lines between Rosenberg and Laredo assumed the existence of sidings that are not in the provided timetable and also are not identified as post-merger capital projects in the Application.

For KCSM lines in Mexico, no capacity analysis was done, and no capital plans were disclosed. However, service issues between Mexico City and Laredo will adversely impact traffic destined into the US at Laredo, TX. My analysis suggests that, unless some capital is spent to improve capacity, it is likely that CPKC will experience congestion issues on the Mexican portion of the network, especially given that most of the projected traffic growth for Applicants in Mexico is intermodal and finished automobiles, and CPKC plans to run this traffic with 10,000-foot trains, as with all non-bulk traffic.

## **Appendix E. Deposition Quotes on Capacity Analysis for KCS Lines<sup>121</sup>**

**Rosenberg to Victoria**  
**{XXX}**

<sup>121</sup> HC - Remote Videotaped Deposition of Raymond A. Elphick and John F. Orr, STB Docket No. FD 36500, Elphick Deposition, pp. 71-74 and 93-97, Feb 18, 2022.

**Beaumont to Rosenberg**  
**{XXX}**

{XXX}

{XXX}

## Appendix F. Hugh L. Randall Resume

Mr. Randall, a Partner Emeritus in Oliver Wyman's Transportation & Services practice and previously head of its global transportation consulting practice, has directed consulting projects for railroads, airlines, trucking companies, parcel carriers, maritime shipping companies, freight forwarders, and contract logistics users and providers. These studies have encompassed clients in North America, Europe, Asia, Latin America, and southern Africa.

Mr. Randall has carried out a wide range of projects in the areas of post-merger integration, due diligence/transactions, business strategy, market entry, operations improvement, and organizational realignment.

Relevant rail assignments directed by Mr. Randall in North America include the following:

- For a Class I railroad, Mr. Randall led a comprehensive and intensive examination of seven major business processes, to determine how best to change such processes to enable cost reduction and efficiency improvement. The project was carried out and implemented successfully, resulting in a savings in excess of \$150 million.
- For a Class I railroad, Mr. Randall led an intermodal strategy study and an extended reach initiative. Both these projects were implemented successfully, enabling the railroad to increase market share, revenues, and profitability.
- For a Class I railroad, Mr. Randall directed a comprehensive extended reach initiative, exploring ways to expand the revenue base through increased use of transloading, rail-truck partnerships, intermodal services, and other initiatives. This project resulted in an increase in revenue, market share, and profitability for the railroad.
- For a Class I railroad, Mr. Randall directed a confidential M&A study examining the feasibility of acquiring another Class I railroad.
- At the request of a Class I CEO, Mr. Randall presented an assessment of the international container shipping industry and intermodal services to the Board of Directors.

Before joining Oliver Wyman, Mr. Randall held a series of senior management positions in railways, trucking, and consulting. At Consolidated Rail Corporation (Conrail), for the chairman and CEO, he oversaw five-year strategic planning for the railroad's freight and passenger services. Mr. Randall also served as General Manager of Conrail's Atlantic region and Assistant Vice President – Operations, with responsibility for developing and managing Conrail's operations improvement program.

At Ryder PIE Nationwide, Mr. Randall was Executive Vice President and Chief Financial Officer. In that position, he was responsible for the financial, planning, and administrative functions of a billion-dollar LTL trucking company. And as a Vice President at Booz•Allen and Hamilton, Mr. Randall directed consulting projects involving railways, trucking companies, and logistics functions throughout the world.

Mr. Randall received a BA in accounting and administration from Antioch College and an MBA from the Harvard Graduate School of Business Administration.

# **Exhibit 4**

**Verified Statement of  
Mark E. Zmijewski**

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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**STB FINANCE DOCKET NO. 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**

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**CN'S COMMENTS ON APPLICATION AND REQUEST FOR CONDITIONS**

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**Verified Statement of Mark E. Zmijewski**

**February 28, 2022**

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- Exhibit B-I:** Canadian Pacific Railway (CP) Recreated Pro-Forma Income Statement
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- Exhibit B-III:** Canadian Pacific Railway (CP) Recreated Pro-Forma Statement of Cash Flows
- Exhibit B-IV:** Kansas City Southern (KCS) Recreated Pro-Forma Income Statement
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- Exhibit B-VI:** Kansas City Southern (KCS) Recreated Pro-Forma Statement of Cash Flows
- Exhibit B-VII:** Canadian Pacific Railway (CP) and Kansas City Southern (KCS) Recreated Pro-Forma Consolidated Income Statement
- Exhibit B-VIII:** Canadian Pacific Railway (CP) and Kansas City Southern (KCS) Recreated Pro-Forma Consolidated Balance Sheet
- Exhibit B-IX:** Canadian Pacific Railway (CP) and Kansas City Southern (KCS) Recreated Pro-Forma Consolidated Statement of Cash Flows
- Exhibit B-X:** Canadian Pacific Railway (CP) and Kansas City Southern (KCS) Recreated Summary of CP/KCS Claimed Efficiencies
- Exhibit B-XI:** Canadian Pacific Railway (CP) and Kansas City Southern (KCS) Recreated Pro-Forma Consolidated Income Statement Including the Effects of the Claimed Efficiencies
- Exhibit B-XII:** Canadian Pacific Railway (CP) and Kansas City Southern (KCS) Recreated Pro-Forma Consolidated Balance Sheet Including the Effects of the Claimed Efficiencies
- Exhibit B-XIII:** Canadian Pacific Railway (CP) and Kansas City Southern (KCS) Recreated Pro-Forma Consolidated Statement of Cash Flows Including the Effects of the Claimed Efficiencies

## I. INTRODUCTION AND CONCLUSIONS

1. My name is Mark E. Zmijewski. I specialize in the areas of accounting, economics, and finance as they relate to financial analysis, valuation, and securities analysis, or more generally, financial economics. I am Professor Emeritus at The University of Chicago Booth School of Business. I am also a Senior Consultant to Charles River Associates. In my practice, I have consulted in matters related to assessment of the valuation, financial performance, capital structure/financial leverage, and financial health of companies and in merger and acquisition transactions. I have also taught courses on these topics as part of my academic career (financial accounting, mergers and acquisition accounting, financial analysis, corporate valuation, and financial strategy). I discuss my qualifications and present my curriculum vitae in Appendix A.
2. This matter arises from the acquisition of Kansas City Southern (“KCS”) by Canadian Pacific Railway Limited (“CP”) (collectively, the “Merging Parties”) on December 14, 2021.<sup>1</sup> As of the close of the acquisition, CP owned KCS via a voting trust, “which ensures KCS will operate independently of CP, [and which] will remain in effect until the U.S. Surface Transportation Board (“STB”) issues its decision on the companies’ joint railroad control application.”<sup>2</sup> In October 2021, CP and KCS submitted an application (“CP/KCS Application”)<sup>3</sup> to the STB, which seeks permission from the STB to dissolve the voting trust structure: “The STB’s approval of CP’s control of KCS would create

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<sup>1</sup> Kansas City Southern, Form 8-K, dated December 14, 2021.

<sup>2</sup> Kansas City Southern, Form 8-K, dated December 14, 2021.

<sup>3</sup> Before the Surface Transportation Board, Finance Docket No. 36500, Railroad Control Application, October 29, 2021, vol. 1-4.

Canadian Pacific Kansas City Limited ('CPKC'), the only single-line railroad linking the United States, Mexico and Canada.”<sup>4</sup>

3. As part of the CP/KCS Application, Dean Vargas, a Managing Director of Revenue Planning for CP, submitted a verified statement (“Vargas VS”) dated October 28, 2021.<sup>5</sup> In that verified statement, Mr. Vargas stated that he prepared pro forma financial statements for CP that “show the financial impact of the Transaction on a forward-looking basis over the three-year period during which the Transaction will be implemented and in a normal post-implementation year.”<sup>6</sup> These forecasts include Base Year financial statements for the standalone CP and KCS (“Base Year CP” and “Base Year KCS”), and pro forma financial statements for CPKC on a consolidated basis (“Pro Forma Exhibits”), including the potential transaction benefits claimed by CP (“Claimed Efficiencies”).<sup>7, 8</sup> Based on the forecasts in the Vargas VS, I developed an alternative set of forecasts that exclude the effects of the Claimed Efficiencies (“Conservative Forecasts”).
4. CP also submitted a verified statement of Chris De Bruyn, Managing Director – Investor Relations and Treasury for CP (“De Bruyn VS”), which claims to “explain: (a) the

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<sup>4</sup> Kansas City Southern, Form 8-K, dated December 14, 2021.

<sup>5</sup> Verified Statement of Dean Vargas before the Surface Transportation Board, dated October 28, 2021. Finance Docket No. 36500.

<sup>6</sup> Vargas VS, ¶22.

<sup>7</sup> Vargas VS. The Pro Forma Exhibits include Income Statements, Balance Sheets, and Cash Flow Statements for each of the companies. See, CP/KCS Application, vol. 1, Appendix E (Exhibit 16), Appendix F (Exhibit 17), and Appendix G (Exhibit 18).

<sup>8</sup> The potential revenue and cost benefits in a merger and acquisition transaction are called synergies or efficiencies. I use the *Horizontal Merger Guidelines* issued by the U.S. Department of Justice & Federal Trade Commission to analyze the potential revenue and cost benefits claimed by the Merging Parties in this transaction and I refer to those potential benefits as “Claimed Efficiencies,” which is consistent with the term used in the *Horizontal Merger Guidelines*. See, U.S. Department of Justice & Federal Trade Commission’s *Horizontal Merger Guidelines*, dated Aug. 19, 2010, Section 10.

financial terms of CP's proposed acquisition of control of Kansas City Southern ('KCS'); (b) CP's ability to repay transaction-related debt while simultaneously increasing its network investment; and (c) the fairness of the consideration to be paid by CP to KCS from the financial perspective of CP's shareholders."<sup>9</sup>

5. Notably, the CP/KCS Application does not include a verified statement from Nadeem Velani, CP's Chief Financial Officer ("CFO"), even though previously, on June 28, 2021, Mr. Velani submitted a verified statement<sup>10</sup> that analyzed the proposal by Canadian National Railway Company ("CN") to acquire KCS ("Velani VS on CN's Acquisition of KCS"). The Velani VS on CN's Acquisition of KCS concluded, "CN's proposal to acquire KCS is fraught with risk to a wide range of stakeholders"<sup>11</sup> and "CN's targeted rate of return will not be achieved based on the synergies CN forecasts, which will place pressure on CN to boost returns in other ways, such as through cost-cutting, or – more plausibly – reaping the benefits of reduced competition ...."<sup>12</sup> The De Bruyn VS did not conduct the same analyses or apply the same standards to CP's acquisition of KCS that were used in the Velani VS on CN's Acquisition of KCS to evaluate CN's proposed acquisition of KCS. Yet, as I show in this verified statement, the criticisms of CN's proposed acquisition of KCS in the Velani VS on CN's Acquisition of KCS equally apply to, and are equally valid for, CP's acquisition of KCS.

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<sup>9</sup> Verified Statement of Chris De Bruyn before the Surface Transportation Board, dated October 28, 2021. Finance Docket No. 36500.

<sup>10</sup> On June 28, 2021, CP filed a Reply to CN and KCS's Motion For Approval of Voting Trust, including a Verified Statement by CP's Chief Financial Officer Nadeem Velani attached as Exhibit 2 to CP Reply. See, Canadian Pacific's Reply to CN and KCS Joint Motion For Approval of Voting Trust, STB Finance Docket No. 36514, filed June 28, 2021 by Canadian Pacific Railway.

<sup>11</sup> Velani VS on CN's Acquisition of KCS, p. 2.

<sup>12</sup> Velani VS on CN's Acquisition of KCS, p. 11.

6. I have been asked by Sidley Austin LLP to address two aspects of the acquisition of KCS by CP:
- a. Analyze the financial effects of CP's acquisition of KCS on CP, including an analysis of the De Bruyn VS, and conducting the analyses and applying the standards previously used by CP to evaluate the proposed acquisition of KCS by CN;<sup>13</sup> and
  - b. Assess the verifiability of CP's Claimed Efficiencies from the perspective of the *Horizontal Merger Guidelines* ("Merger Guidelines")<sup>14</sup> provided by the U.S. Department of Justice ("DOJ") and Federal Trade Commission ("FTC").<sup>15</sup>
7. In this verified statement I show the following regarding the De Bruyn VS:
- a. None of the analyses in the De Bruyn VS is based on the Pro Forma Exhibits, but, instead, the De Bruyn VS uses more optimistic forecasts: "CP and KCS as they are today and with ongoing economic growth moving forward."<sup>16</sup>
  - b. The estimated 3.8x 2021 pro forma leverage ratio for CP in the De Bruyn VS does not represent the leverage ratio that CP would ever report in 2021 because the De Bruyn VS calculated the pro forma leverage ratio by combining CP and KCS, when, in fact, in 2021 and for some time afterwards, KCS will be held in a trust and operate independently. That leverage ratio without combining KCS in 2021 using the data used in the De Bruyn VS is 4.5x versus the 3.8x estimated pro forma leverage ratio for 2021 in the De Bruyn VS.
  - c. The estimated 2021 pro forma leverage ratio for CP in the De Bruyn VS is substantially lower than CP's actual pro forma leverage ratio for 2021 (3.8x in the De

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<sup>13</sup> Although I do not agree with the usefulness or economic foundation of certain analyses, standards, and conclusions in the Velani VS on CN's Acquisition of KCS, I nonetheless, utilize these analyses and standards to analyze CP's acquisition of KCS; and I show that the key criticisms in the Velani VS on CN's Acquisition of KCS equally apply to, and are equally valid for, CP's acquisition of KCS.

<sup>14</sup> U.S. Department of Justice & Federal Trade Commission's *Horizontal Merger Guidelines*, dated Aug. 19, 2010.

<sup>15</sup> I understand that the *Merger Guidelines* are not legally applicable to the Transaction, but they nevertheless provide a reasonable and appropriate framework to analyze the Claimed Efficiencies from the perspective of a financial economist.

<sup>16</sup> De Bruyn VS, p. 6. Although the De Bruyn VS does not provide a source of the forecasts used, the forecasts appear to be the same forecasts that were disclosed in the CP/KCS November 3, 2021 Proxy Statement/Prospectus, p. 101, which was filed with the U.S. SEC by both companies as KCS Schedule 14A ("Proxy Statement") and CP Form 424B3 ("Prospectus"). The forecasts for CP and KCS on a standalone basis are referred to in the Proxy Statement/Prospectus as "KCS management unaudited CPRL projections" and "KCS management unaudited KCS projections," respectively. These forecasts are used in the BMO Transaction Model (CP-HC-00007073.xlsx) that also incorporates the Claimed Efficiencies into the forecasts. I refer to the forecasts underlying the BMO Transaction Model as "Proxy/Transaction Model Forecasts." De Bruyn VS appears to use the Proxy/Transaction Model Forecasts.

- Bruyn VS versus CP's actual pro forma leverage ratio, 4.0x), indicating that CP's forecast for 2021 was optimistic.
- d. Using the data in the De Bruyn VS, CP's estimated 2021 leverage ratio (without combining KCS), which is the leverage ratio CP would report based on its actual financial statements, is 4.5x. Based on its actual financial results for 2021,<sup>17</sup> CP's actual 2021 leverage ratio is 4.8x not 4.5x, again, indicating that CP's forecast for 2021 was optimistic.
  - e. The De Bruyn VS claims that CP will attain its target leverage ratio of 2.5x within four years. Had the De Bruyn VS used either CP's Pro Forma Exhibits or the Conservative Forecasts, CP would not attain its target leverage ratio within four years.
  - f. The De Bruyn VS conducted no analysis of CP's post-acquisition ROIC, which was a primary criticism that the Velani VS made about a potential CN-KCS transaction. Based on CP's actual financial results for 2021, or either CP's Pro Forma Exhibits or the Conservative Forecasts, CP's ROIC for 2021 and the following four years is substantially below – less than one-half – of its historical and target ROIC of 15% in every year. (See ¶9.a - ¶9.b.)
  - g. Based on credit rating thresholds used in the De Bruyn VS, CP's credit rating is likely to fall below investment grade if CP experiences a substantial downturn in its financial performance.
8. The Velani VS on CN's Acquisition of KCS concluded that "CN Will Take on a Very High Level of Debt,"<sup>18</sup> and "CN's proposal to acquire KCS is fraught with risk to a wide range of stakeholders."<sup>19</sup> In this verified statement, when I apply the leverage analyses and standards used in the Velani VS on CN's Acquisition of KCS to CP's acquisition of KCS, I show that:
- a. CP took on a high level of debt that will substantially increase CP's leverage and, thus, its financial risk.
  - b. Based on either CP's Pro Forma Exhibits or the Conservative Forecasts, CP would not attain its target leverage ratio within four years. Based on CP's Pro Forma

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<sup>17</sup> CP 2021 SEC Form 10-K, p. 79.

<sup>18</sup> Velani VS on CN's Acquisition of KCS, p. 6.

<sup>19</sup> Velani VS on CN's Acquisition of KCS, p. 2.

- Exhibits, CP would only attain a leverage ratio of 2.8x in four years; and based on the Conservative Forecasts, CP would only attain a leverage ratio of 3.8x in four years.
- c. Based on the analysis in the Velani VS on CN's Acquisition of KCS, CP's leverage will be "materially higher" than that of any other Class I railroad over the last decade. "As of 2020, the highest leverage amongst other Class I railroads is 3.0 times Adjusted Debt / EBITDA,"<sup>20</sup> which is substantially lower than 4.8x Adjusted Debt / EBITDA for CP in 2021.
  - d. Based on CP's Pro Forma Exhibits, CP has no margin of error in its forecasts so that it can repay its debt over the next four years, and based on the Conservative Forecasts, CP will have a cash flow deficit of over \$2 billion over the next four years.
9. Based on an analysis of CN's post-acquisition ROIC, the Velani VS on CN's Acquisition of KCS concluded that CN's post-acquisition ROIC would be substantially lower than CN's historical ROIC and target ROIC. In this verified statement, I conduct that same analysis of CP's post-acquisition ROIC and show that CP's post-acquisition ROIC will be substantially lower than CP's historical ROIC and target ROIC in the 15% range:
- a. Based on its actual financial results for 2021, CP's actual ROIC for 2021 is 8.2%,<sup>21</sup> which is substantially below its historical and target ROIC of 15%.
  - b. Based on CP's Pro Forma Exhibits, CP's ROIC for the next four years has a range of 7.0% to 7.3%; and based on CP's Conservative Forecasts, CP's ROIC for the next four years has a range of 5.7% to 6.3%, which, again, are substantially below – less than one-half – of its historical and target ROIC of 15% in every year.
10. Lastly, in this verified statement, my assessment of the verifiability of CP's Claimed Efficiencies from the perspective of the *Merger Guidelines* shows that most of the Claimed Efficiencies are not verifiable and many are not merger-specific; and thus, the majority of the Claimed Efficiencies would not meet the standards to be cognizable based on the *Merger Guidelines*.

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<sup>20</sup> Velani VS on CN's Acquisition of KCS, pp. 8 – 9.

<sup>21</sup> CP 2021 SEC Form 10-K, p. 75.

11. The remainder of this verified statement is organized as follows. In Section II, I discuss my analysis of the financial effects of CP's acquisition of KCS on CP, including an analysis of the De Bruyn VS and an analysis of the CP acquisition of KCS by applying the same analyses and standards previously used by CP to evaluate the proposed acquisition of KCS by CN. In Section III, I assess the verifiability of CP's Claimed Efficiencies from the perspective of the *Merger Guidelines*. In Appendix A, I provide my curriculum vitae; and in Appendix B, I present CP's Pro Forma Exhibits.

## **II. ANALYSIS OF THE FINANCIAL EFFECTS OF CP'S ACQUISITION OF KCS ON CP**

12. In this section, I first describe CP's Pro Forma Exhibits and the Conservative Forecasts. Then, in the remainder of this section, I analyze the financial effects of CP's acquisition of KCS on CP, including an analysis of the De Bruyn VS. I conduct the same analyses and apply the same standards previously used by CP to evaluate the proposed acquisition of KCS by CN.

### **A. CP's Forecasts Submitted to the STB and the Alternative More Conservative Forecasts**

13. As I noted in the introduction, the Pro Forma Exhibits in the CP/KCS Application included forecasts of CPKC (CP and KCS combined) and the potential efficiencies claimed by CP.<sup>22</sup> As I explain later in this section, I adjusted the Pro Forma Exhibits to develop more conservative forecasts of CP's acquisition of KCS (Conservative Forecasts). In this section, I describe these two sets of forecasts.

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<sup>22</sup> Vargas VS, ¶22. See, CP/KCS Application, vol. 1, Appendix E (Exhibit 16), Appendix F (Exhibit 17), and Appendix G (Exhibit 18).

## 1. CP's Pro Forma Exhibits

14. The Vargas VS stated that CP's Pro Forma Exhibits were prepared to "show the financial impact of the Transaction on a forward-looking basis over the three-year period during which the Transaction will be implemented and in a normal post-implementation year. All impacts are shown relative to the base year pro forma financial statements of CPKC for 2019."<sup>23</sup> In other words, each year in the Pro Forma Exhibits is based on CP's adjusted 2019 reported financial statements plus the Claimed Efficiencies, which are assumed to be realized during the three-year period (one-third realized each year). I replicated these forecasts and present them in Appendix B, Exhibits B-I through B-XIII.<sup>24</sup>
15. CP's Pro Forma Exhibits include a 2019 Base-Year forecast, forecasts for Year 1 through Year 3, and a forecast for a Normal Year beyond Year 3 (four years of forecasts). The 2019 Base-Year forecast for CP does not include CP's acquisition of KCS. I adjusted the 2019 Base-Year forecast for CP's acquisition of KCS to create a CP Unconsolidated Base-Year Forecast, which is how CP will report its acquisition of KCS in the years KCS is held in the trust and operates independently.<sup>25</sup> In the following table, I present various financial items derived from the forecasted income statement (Revenues, EBITDA,<sup>26</sup> and

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<sup>23</sup> Vargas VS, ¶22.

<sup>24</sup> See, CP/KCS Application, vol. 1, Appendix E (Exhibit 16), Appendix F (Exhibit 17), and Appendix G (Exhibit 18).

<sup>25</sup> I assume that: (1) KCS will pay CP a dividend; (2) CP will incur debt to finance the KCS acquisition and pay interest on that debt; (3) CP will not repurchase any shares but rather use that cash to repay its debt; (4) CP's common shares (and the dividend paid on those shares) include the amount of shares issued to finance the KCS acquisition; and (5) CP will record purchase accounting adjustments to its assets and liabilities following the KCS acquisition similar to those that CP recorded in December 2021. All adjustment amounts used are from the Forecasts Submitted to the STB.

<sup>26</sup> EBITDA is equal to earnings before interest, taxes, depreciation and amortization.

Interest Expense), the balance sheet (Total Debt and Invested Capital<sup>27</sup>), and the cash flow statement (Cash Flow from Operations, Capital Expenditures, and Unlevered Free Cash Flows<sup>28</sup>). The table presents five years of information, the CP Unconsolidated Base-Year (“CP Unconsol”), Year 1 through Year 3 forecasts (“Year 1,” “Year 2,” and “Year 3,” respectively), and the Normal Year (“Year 4”); the table also presents the compound average growth rate (“CAGR”) over Years 1 to 4 in the last column of the table.

**Table 1**  
**Pro Forma Exhibits**  
**Selected Financial Statement Measures**

|  | CP<br>Unconsol | Year 1    | Year 2    | Year 3    | Year 4    | Yr 1-Yr 4<br>Total | Yr 1 - Yr 4<br>CAGR |
|--|----------------|-----------|-----------|-----------|-----------|--------------------|---------------------|
| <b>Panel A: Income Statement</b>         |                |           |           |           |           |                    |                     |
| TOTAL REVENUES                           | \$5,999        | \$9,283   | \$9,592   | \$9,887   | \$9,887   | \$38,649           | 2.1%                |
| EBITDA                                   | \$3,383        | \$5,064   | \$5,311   | \$5,534   | \$5,534   | \$21,443           | 3.0%                |
| NET INTEREST EXPENSE                     | 536            | 652       | 637       | 607       | 575       | \$2,471            |                     |
| <b>Panel B: Balance Sheet</b>            |                |           |           |           |           |                    |                     |
| TOTAL DEBT                               | \$15,416       | \$18,669  | \$17,366  | \$15,843  | \$14,267  |                    |                     |
| TOTAL INVESTED CAPITAL                   | \$36,240       | \$44,601  | \$45,497  | \$46,319  | \$47,078  |                    |                     |
| <b>Panel C: Cash Flow Statement</b>      |                |           |           |           |           |                    |                     |
| CASH PROVIDED BY OPERATING<br>ACTIVITIES | \$2,303        | \$3,506   | \$3,804   | \$4,016   | \$4,059   | \$15,385           |                     |
| CASH USED IN INVESTING<br>ACTIVITIES     | (\$1,254)      | (\$1,946) | (\$1,950) | (\$1,942) | (\$1,930) | (\$7,768)          |                     |
| UNLEVERED FREE CASH FLOWS                | \$1,459        | \$2,046   | \$2,329   | \$2,526   | \$2,557   | \$9,458            | 7.7%                |

Sources: CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

16. As seen from the above table, the CAGR over Years 1 through 4 (the period when the parties expect to realize their Claimed Efficiencies) for the consolidated revenue,

<sup>27</sup> Invested Capital is equal to Total Debt plus Shareholders Equity plus Non-Controlling Interest. Total Debt equals Long-Term Debt plus Current Maturities of Long-Term Debt.

<sup>28</sup> Unlevered Free Cash Flows is equal to Cash Flow from Operating Activities plus After-Tax Interest Expense minus Capital Expenditures.

EBITDA and Unlevered Free Cash Flows are 2.1%, 3.0% and 7.7%, respectively. Over that period the consolidated CPKC is projected to generate approximately \$38.6 billion in Revenue, \$21.4 billion in EBITDA, and \$15.4 billion in Operating Cash Flows, of which \$7.8 billion are expected to be reinvested as capital expenditures. The Merged Company<sup>29</sup> also expects to generate about \$9.5 billion of Unlevered Free Cash Flows and use that cash to pay dividends and reduce its debt from roughly \$19 billion in Year 1 to \$14 billion in Year 4.

## 2. Conservative Forecasts

17. The Velani VS on CN's Acquisition of KCS criticized the analyses submitted by CN to the STB related to CN's proposed acquisition of KCS. One criticism was not "stress testing" the forecasts used: "The biggest flaw in Mr. Houle's analysis is that he performs no stress testing of financial performance."<sup>30</sup> In response, I was asked by counsel for CN to "stress test" CN's proposed acquisition of KCS. To that end, I submitted a verified statement to the STB using a set of pessimistic forecasts ("Zmijewski VS on CN's Acquisition of KCS").<sup>31</sup> Based on the framework I developed in my previous verified statement, in this verified statement, I adjust the forecasts CP submitted to the STB for CP's acquisition of KCS and create a more conservative set of forecasts ("Conservative Forecasts").
18. The Conservative Forecasts assume that the 2019 Base-Year forecasts continue for the next four years, which excludes the Claimed Efficiencies from the forecasts CP submitted

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<sup>29</sup> I use the term "Merged Company" to refer to an integrated CP and KCS, that is CPKC.

<sup>30</sup> Velani VS on CN's Acquisition of KCS, p. 18.

<sup>31</sup> Verified Statement of Mark E. Zmijewski before the Surface Transportation Board, dated July 6, 2021. Finance Docket No. 36514.

to the STB. The Conservative Forecasts are more conservative than the forecasts CP submitted to the STB and thus can “stress test” CP’s acquisition of KCS. I note that the Conservative Forecasts are more optimistic forecasts than the pessimistic forecasts I used to “stress test” CN’s proposed acquisition of KCS.<sup>32</sup> I present a summary of these forecasts in the following table (presenting the same financial measures as in the above table).

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<sup>32</sup> I described the pessimistic forecasts I used in the Zmijewski VS on CN’s Proposed Acquisition of KCS as follows (p. 15):

In my analyses I used pessimistic forecasts (stress test) for both CN and KCS (“Pessimistic Forecasts”). The Pessimistic Forecasts:

- a. are based on the actual financial performance of CN and KCS in 2020, which, as is widely known, included the effects of a substantial downturn in the economy resulting from the COVID-19 pandemic;
- b. are adjusted to include the change in operating working capital of \$0 (instead of being positive and a source of cash) and an increase in investment in capital expenditures at its pre-COVID-19 (pre-2020) levels;
- c. do not include the cash flows generated by CN or KCS while KCS is held in the Voting Trust, which could be used by CN to repay its debt and which will increase KCS’s value while it is held in the Voting Trust; and
- d. do not include the realization of any synergies expected to result from the Merger.

Thus, my analyses based on the Pessimistic Forecasts are conservative and provide a stress test of the Merger because they assume a continuation of the substantial economic downturn that occurred in 2020; they ignore the consensus forecast that the economy is expected to grow substantially over the next few years; they are adjusted for an increase in investments in capital expenditures; they do not include the cash flows generated by either company while KCS is held in the Voting Trust; and, if the Merger is ultimately approved by the STB, they ignore that CN and KCS, as well as financial analysts, expect the realization of substantial synergies to result from the Merger.

**Table 2**  
**Conservative Forecast**  
**Selected Financial Statement Measures**

|  | CP<br>Unconsol | Year 1    | Year 2    | Year 3    | Year 4    | Yr 1-Yr 4<br>Total | Yr 1 - Yr 4<br>CAGR |
|--|----------------|-----------|-----------|-----------|-----------|--------------------|---------------------|
| <b>Panel A: Income Statement</b>         |                |           |           |           |           |                    |                     |
| TOTAL REVENUES                           | \$5,999        | \$8,865   | \$8,865   | \$8,865   | \$8,865   | \$35,460           | 0.0%                |
| EBITDA                                   | \$3,383        | \$4,646   | \$4,646   | \$4,646   | \$4,646   | \$18,584           | 0.0%                |
| NET INTEREST EXPENSE                     | 536            | 652       | 643       | 626       | 610       | \$2,531            |                     |
| <b>Panel B: Balance Sheet</b>            |                |           |           |           |           |                    |                     |
| TOTAL DEBT                               | \$15,416       | \$18,949  | \$18,167  | \$17,360  | \$16,530  |                    |                     |
| TOTAL INVESTED CAPITAL                   | \$36,239       | \$44,612  | \$45,532  | \$46,401  | \$47,219  |                    |                     |
| <b>Panel C: Cash Flow Statement</b>      |                |           |           |           |           |                    |                     |
| CASH PROVIDED BY OPERATING<br>ACTIVITIES | \$2,302        | \$3,210   | \$3,263   | \$3,288   | \$3,313   | \$13,074           |                     |
| CASH USED IN INVESTING<br>ACTIVITIES     | (\$1,254)      | (\$1,930) | (\$1,930) | (\$1,930) | (\$1,930) | (\$7,720)          |                     |
| UNLEVERED FREE CASH FLOWS                | \$1,458        | \$1,766   | \$1,812   | \$1,824   | \$1,837   | \$7,240            | 1.7%                |

Sources: CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

19. As seen from the above table, in Years 1 through 4, absent the Claimed Efficiencies, the parties' consolidated Revenue, EBITDA and Unlevered Free Cash Flows are essentially flat (with minimal increase in the Unlevered Free Cash Flows due to tax advantages of increased depreciation). Over that period the consolidated CPKC will generate approximately \$35.5 billion in Revenue, \$18.6 billion in EBITDA, and \$13.1 billion in Operating Cash Flows of which \$7.7 billion will be reinvested as capital expenditures. The consolidated company will generate about \$7.2 billion of Unlevered Free Cash Flows and use that cash to pay dividends and reduce its debt from roughly \$19 billion in Year 1 to \$16.5 billion in Year 4. Thus, if none of the Claimed Efficiencies are realized,

CP will generate about \$2.2 billion less of Unlevered Free Cash Flows and pay off about \$2.2 billion less of debt.<sup>33</sup>

**B. Analysis of CP's Post Acquisition Financial Risk (Debt Burden)**

20. In this section, I analyze CP's post-acquisition financial risks based on the analyses of the company's leverage ratio and free cash flow used in the Velani VS on CN's Acquisition of KCS. Based on these analyses, the Velani VS on CN's Acquisition of KCS concluded that "CN Will Take on a Very High Level of Debt,"<sup>34</sup> "[t]he proposed transaction will increase CN's leverage to levels that CN has not incurred in the recent past,"<sup>35</sup> and "CN's leverage will be materially higher than that of any other Class 1 railroad over the last decade."<sup>36</sup> My analyses show that the criticisms by Mr. Velani about CN's proposed acquisition of KCS equally apply to, and are equally valid for, CP's acquisition of KCS. Namely, that CP is taking on a high level of debt that will substantially increase CP's leverage and, thus, its financial risk. I also conduct a credit rating analysis of CP post acquisition and find that the results of that analysis further corroborate the conclusion of substantially increased financial risk.

**1. Comparison of the De Bruyn VS 2021 Estimated CP Leverage Ratio to CP's Actual 2021 Leverage Ratio**

21. The De Bruyn VS presents a comparison of CP's historical leverage ratios (Adjusted Net Debt to Adjusted EBITDA) from 2011 through 2020 and CP's estimated leverage ratios

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<sup>33</sup> Year 4 debt of \$14.3 billion in the Pro Forma Exhibits versus Year 4 debt of \$16.5 billion in the Conservative Forecasts. See Tables 1 and 2.

<sup>34</sup> Velani VS on CN's Acquisition of KCS, p. 6.

<sup>35</sup> Velani VS on CN's Acquisition of KCS, p. 8.

<sup>36</sup> Velani VS on CN's Acquisition of KCS, p. 8.

in 2021 through 2024, assuming CP's acquisition of KCS occurred in the Q4 2021.<sup>37</sup> For 2021, the De Bruyn VS calculates CP's leverage ratio on a "pro forma" basis, which assumes CP and KCS are combined. However, if CP's acquisition of KCS occurred in Q4 2021, CP would not combine (and did not combine) KCS because KCS would be held in a trust and operate independently from CP. Thus, De Bruyn's "pro forma" leverage ratio for CP in 2021 is not what CP would report in 2021 because KCS would be held in a trust.

22. In the following figure, I reproduce CP's leverage ratios from the De Bruyn VS through 2021. The 2011-2020 ratios (blue-gray bars) are as reported by CP in the company's Form 10-K filings with the U.S. SEC. The De Bruyn VS presents CP's expected 2021 leverage ratio (orange bar, 3.8x) on a pro forma basis (CP and KCS combined). In the same figure, I also show CP's expected 2021 leverage ratio (orange bar, 4.5x) based on the financial statements CP would report (that is, KCS is not consolidated but reported as an equity investment because it is held in a trust and operates independently). The two red bars show CP's actual leverage ratios: (i) CP's actual 2021 leverage ratio (red bar, 4.8x) based on CP's 2021 actual financial statements;<sup>38</sup> and (ii) CP's actual pro forma 2021 leverage ratio (red bar, 4.0x).<sup>39</sup>

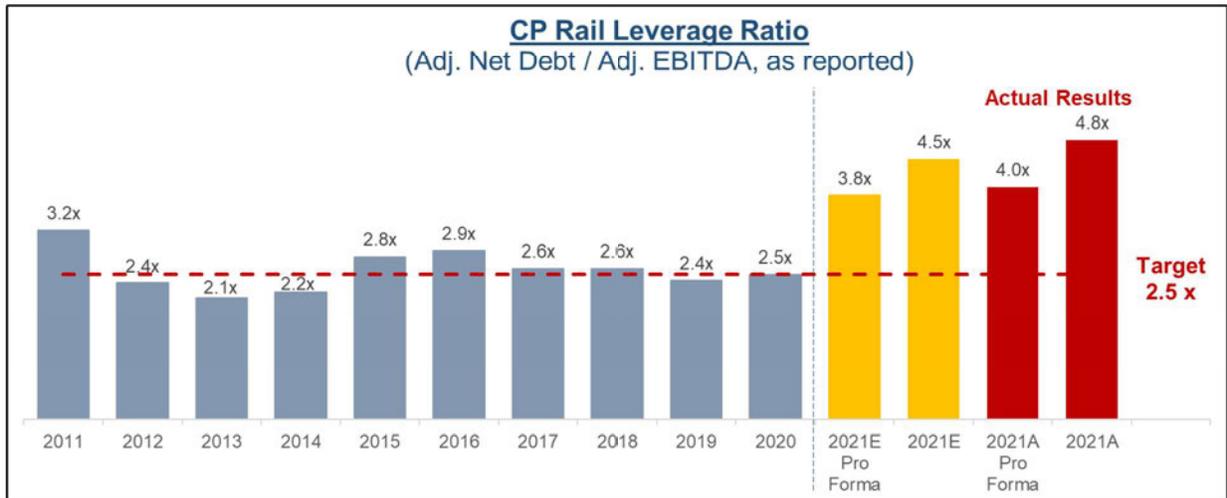
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<sup>37</sup> De Bruyn VS, Figure 1, p. 5.

<sup>38</sup> CP 2021 SEC Form 10-K, p. 79.

<sup>39</sup> CP's actual pro forma 2021 leverage ratio is calculated using debt and EBITDA figures for KCS as reported in the company's 2021 Form 10-K filed with the U.S. SEC (see KCS Form 10-K for the period ended December 31, 2021).

**Figure 1**  
**De Bruyn VS 2021 Estimated CP Leverage Ratio**  
**Compared to CP's Actual 2021 Leverage Ratio**



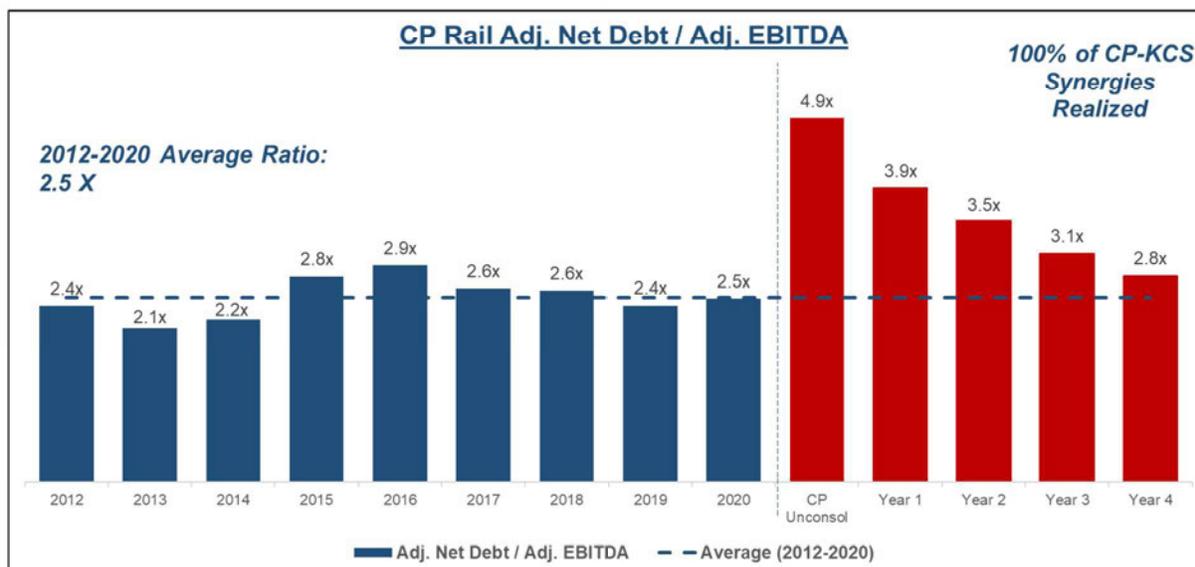
Sources: CP 2013-2021 SEC Forms 10-K; De Bruyn VS, Figure 1; CRA calculations.

23. As is seen from the above figure, the estimated 2021 CP leverage ratio in the De Bruyn VS was 3.8x on a pro-forma basis while its actual leverage ratio was 4.0x on a pro-forma basis, which is about 5% higher than the estimate in the De Bruyn VS. I also note that CP's 2021 leverage ratio on a standalone basis was 4.8x which is more than 90% higher than CP's 2020 standalone leverage ratio of 2.5x and CP's target leverage ratio of 2.5x. These results show not only that CP's leverage ratios are higher than its historical leverage ratios, but also that CP's forecasts for 2021 were optimistic.

## 2. CP's Post-Acquisition Leverage Ratios

24. In the following figure, I present CP's leverage ratios (Adjusted Net Debt to Adjusted EBITDA)<sup>40</sup> pre-acquisition from 2012 through 2020 (blue bars) and post-acquisition (red bars: CP Unconsol, Year 1, ..., Year 4) based on the Pro Forma Exhibits.

**Figure 2**  
**CP's Leverage Ratios Based on the Pro Forma Exhibits**



Sources: CP 2013-2020 SEC Forms 10-K; De Bruyn VS, Figure 1; CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

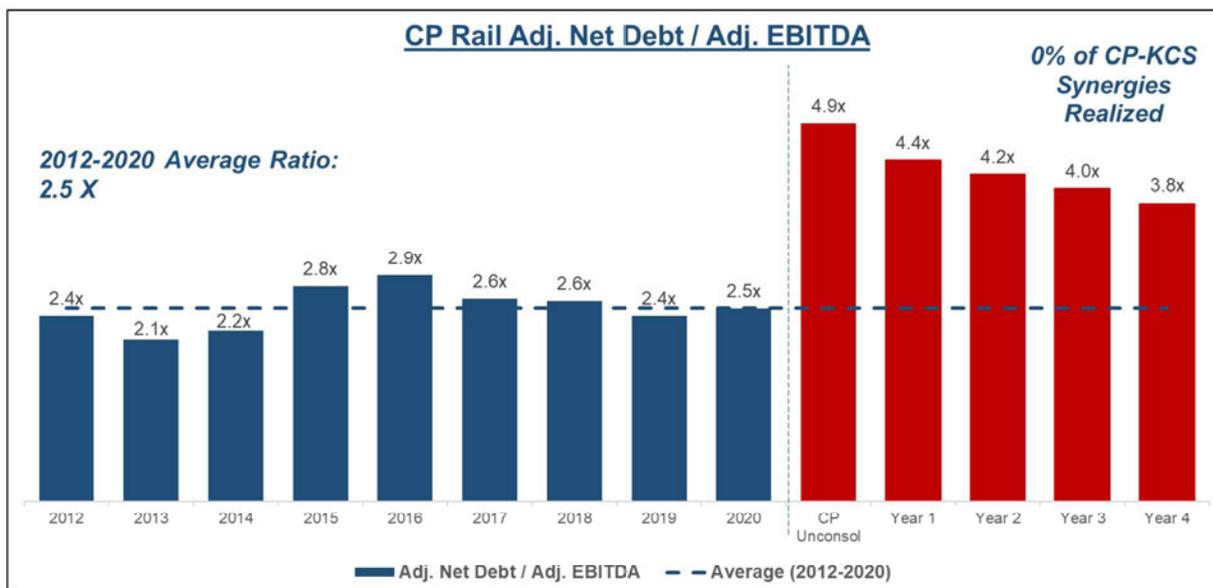
25. As is seen from the above figure, CP's leverage ratio ranged between 2.1x and 2.9x over the 2012-2020 period and averaged about 2.5x (which is also CP's Target Leverage Ratio). Following the KCS acquisition and while KCS is held in trust, CP's leverage ratio increases to 4.9x mostly due to the increased debt incurred to finance the acquisition. In Years 1 to 4 when CP expects STB to approve the KCS acquisition and

<sup>40</sup> For definitions of Adjusted Net Debt and Adjusted EBITDA, see, for example, 2020 CP Form 10-K, pp. 68-69. Adjusted Net Debt is defined as Long-term debt including long-term debt maturing within one year + Pension plan deficit + Operating lease liabilities – Cash and cash equivalents. Adjusted EBITDA is defined as Adjusted EBIT + Operating lease expense + Depreciation and amortization – Other components of net periodic benefit recovery. I assume that Pension plan deficit, Operating lease liabilities, Operating lease expense, and Other components of net periodic benefit recovery in Years 1 to 4 are as reported by CP in the Base Year (2019).

KCS will be consolidated with CP, the leverage ratio declines from 3.9x in Year 1 to 2.8x in Year 4. Thus, CP does not attain its 2.5x target leverage ratio within four years after the merger.

26. In the figure below, I also present CP’s leverage ratios (CP Rail Adjusted Net Debt to CP Adjusted EBITDA) pre-acquisition from 2012 through 2020 (blue bars) and post-acquisition (red bars: CP Unconsol, Year 1, ..., Year 4) based on the Conservative Forecasts.

**Figure 3**  
**CP’s Leverage Ratios Based on the Conservative Forecasts**



Sources: CP 2013-2020 Forms 10-K; De Bruyn VS, Figure 1; CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

27. As is seen from the above figure, in Years 1 to 4 when CP expects the STB to approve the KCS acquisition and KCS will be consolidated with CP, the leverage ratio declines from 4.4x in Year 1 to 3.8x in Year 4. Thus, CP does not attain its 2.5x target leverage ratio within four years after the merger.

28. The Velani VS on CN's Acquisition of KCS criticized CN stating, "Further, CN's leverage will be materially higher than that of any other Class I railroad over the last decade. As of 2020, the highest leverage amongst other Class I railroads is 3.0 times Adj. Debt / EBITDA, materially lower than the contemplated 4.8 times Adj. Debt / EBITDA for CN."<sup>41</sup> As seen from the above figures, the CP Unconsol leverage ratios are as high as CN's leverage ratios, and based on both sets of forecasts, CP's leverage ratios are higher than the Target Leverage Ratio of 2.5x.<sup>42</sup> Thus, my analyses show that the criticisms by Mr. Velani about CN's proposed acquisition of KCS equally apply to, and are equally valid for, CP's acquisition of KCS.

### **3. All of CP's Free Cash Flow Will be Used to De-Lever the Company Post Acquisition**

29. The Velani VS on CN's Acquisition of KCS criticized CN for the use of its excess cash flow to service the company's debt in a manner that Mr. Velani argued "leaves no margin for error."<sup>43</sup> The Velani VS on CN's Acquisition of KCS demonstrated that "the comparison between (a) projected total free cash flow (calculated as cash from operations, less capital expenditures and investing activities) generated by both CN and KCS ... inclusive of some synergies ... and (b) cash flow required to pay CN's dividend and repay the amount of CN's debt required to achieve its target Leverage Ratio ... [implies that] CN is pursuing a strategy that leaves itself very little margin of error."<sup>44</sup>

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<sup>41</sup> Velani VS on CN's Acquisition of KCS, pp. 8 – 9.

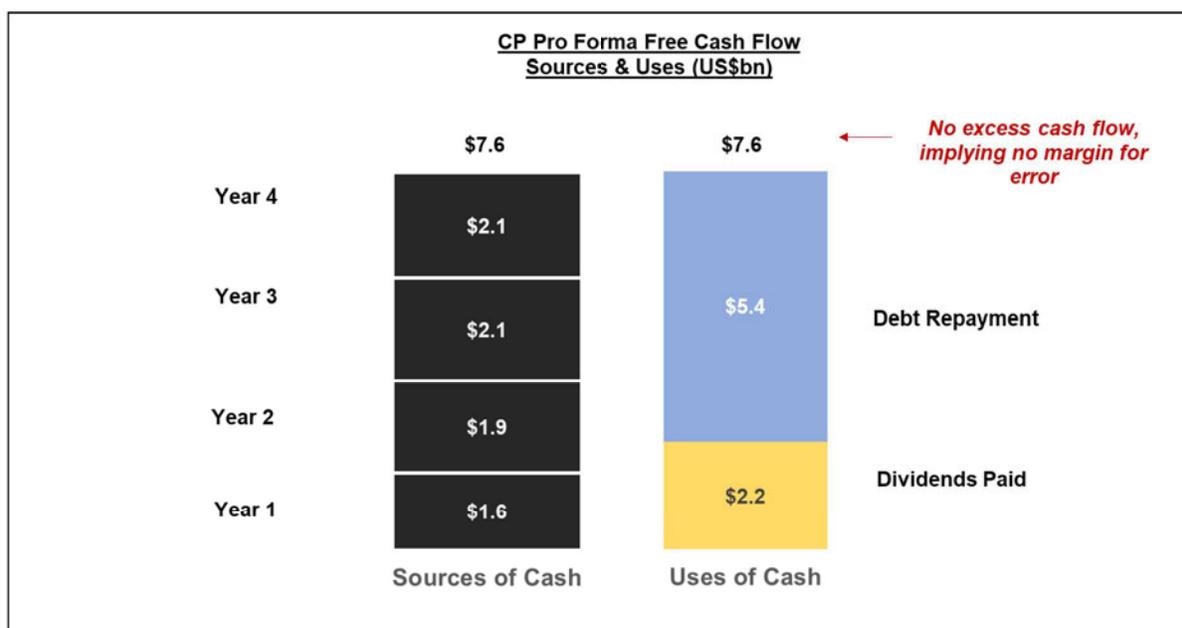
<sup>42</sup> I note that using the Proxy/Transaction Model Forecasts, CP's post-acquisition leverage ratios in 2022-2025 are {{ }}, respectively (see also De Bruyn VS, Figure 1). Using the Proxy/Transaction Model Forecasts and assuming none of the Claimed Efficiencies is realized, CP's post-acquisition leverage ratios in 2022-2025 are {{ }}, respectively.

<sup>43</sup> Velani VS on CN's Acquisition of KCS, p. 10.

<sup>44</sup> Velani VS on CN's Acquisition of KCS, pp. 10-11 and Figure 6.

30. I conduct the same analysis for the CP acquisition of KCS and compare the sources and uses of CP’s Free Cash Flows; or stated alternatively I compare “(a) projected total free cash flow (calculated as cash from operations, less capital expenditures and investing activities) ... [and] ... (b) cash flow required to pay ... dividend and repay the amount of ... debt.”<sup>45</sup>
31. In the following figure, I present CP’s sources and uses of Free Cash Flow based on the Pro Forma Exhibits.

**Figure 4**  
**CP’s Post Acquisition Sources and Uses of Free Cash Flow**  
**Based on the Pro Forma Exhibits**



Sources: Velani VS on CN’s Acquisition of KCS, Figure 6; CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

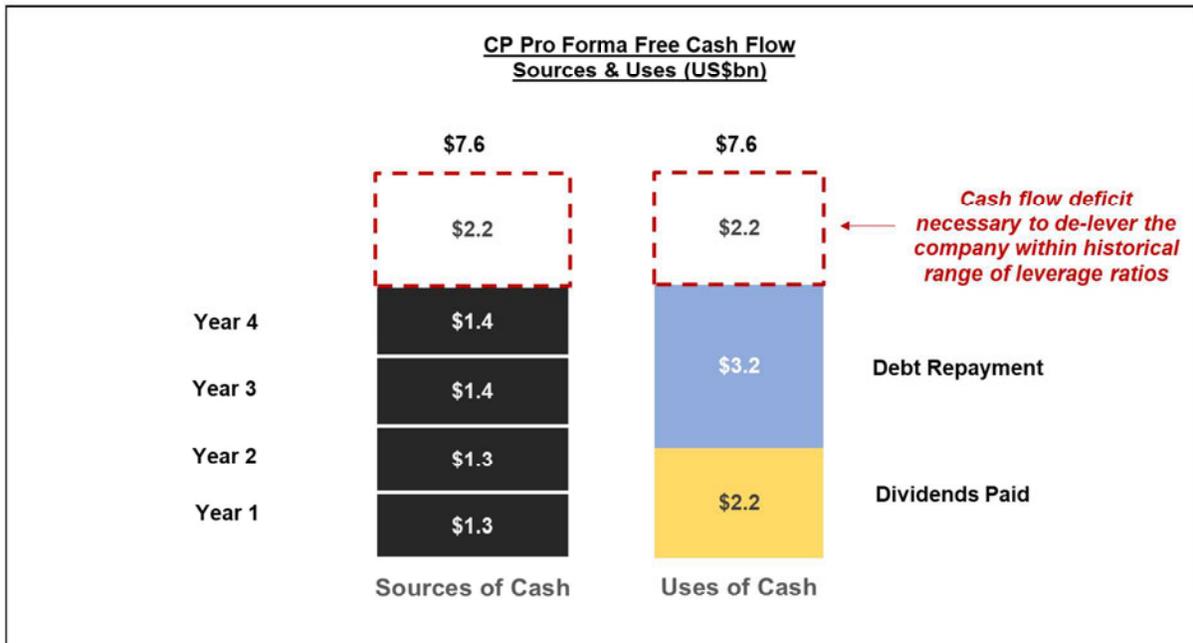
32. As is seen from the above figure, in order to de-lever the company by Year 4 and achieve leverage ratio of 2.8x, which is still above its 2.5x target leverage ratio (see Figure 2), CP uses all of the \$7.6 billion Free Cash Flows that the company is expected to generate

<sup>45</sup> Velani VS on CN’s Acquisition of KCS, pp. 10-11 and Figure 6.

from Year 1 to Year 4 to pay dividends (\$2.2 billion) and repay debt (\$5.4 billion), thus, according to the Velani VS on CN's Acquisition of KCS, CP has no margin for error.

33. In the following figure, I present CP's sources and uses of Free Cash Flow based on the Conservative Forecasts.

**Figure 5**  
**CP's Post Acquisition Sources and Uses of Free Cash Flow**  
**Based on the Conservative Forecasts**



Sources: Velani VS on CN's Acquisition of KCS, Figure 6; CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

34. As is seen from the above figure, if none of the Claimed Efficiencies is realized, CP will generate about \$5.4 billion free cash flows from Year 1 through 4, an amount sufficient to pay the \$2.2 billion dividend and repay only \$3.2 billion of debt. Thus, CP would be \$2.2 billion short of the free cash flow that is necessary to de-lever the company by Year 4 to a level consistent with CP's historical leverage.<sup>46</sup>

<sup>46</sup> I note that using the Proxy/Transaction Model Forecasts, CP is projected to generate post-closing approximately \$3.8 billion excess cash flows (\$12.3 billion free cash flows less \$8.5 billion of dividend and debt payments)

#### 4. CP's Post-Acquisition Credit Rating

35. Although the Velani VS on CN's Acquisition of KCS raised various criticisms of the amount of debt that CN would have issued in the acquisition of KCS, it failed to acknowledge that CN's post-acquisition credit rating was expected to be investment grade and close to CP's pre-acquisition credit rating.<sup>47</sup> Moreover, CP's post-acquisition credit rating Baa2/BBB+<sup>48</sup> is the same as CN's expected post-acquisition credit rating had CN acquired KCS. I illustrate the effect of CP's acquisition of KCS on its credit rating using the De Bruyn VS credit rating thresholds, which are based on CP's leverage ratio.<sup>49</sup> Typically, a credit rating below Baa3/BBB- is considered non-investment grade.<sup>50</sup>
36. In the following figure, I present CP's post-acquisition leverage ratios as measured by the Debt to EBITDA ratio (CP Unconsol, Year 1, ..., Year 4) relative to the credit rating thresholds for the various investment grade credit ratings using the Pro Forma Exhibits.

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between 2022 and 2025. Using the Proxy/Transaction Model Forecasts and assuming none of the Claimed Efficiencies is realized, CP is projected to generate post-closing approximately \$2.5 billion excess cash flows (\$11.0 billion free cash flows less \$8.5 billion of dividend and debt payments) between 2022 and 2025.

<sup>47</sup> See Zmijewski VS on CN's Acquisition of KCS, pp 11 – 13.

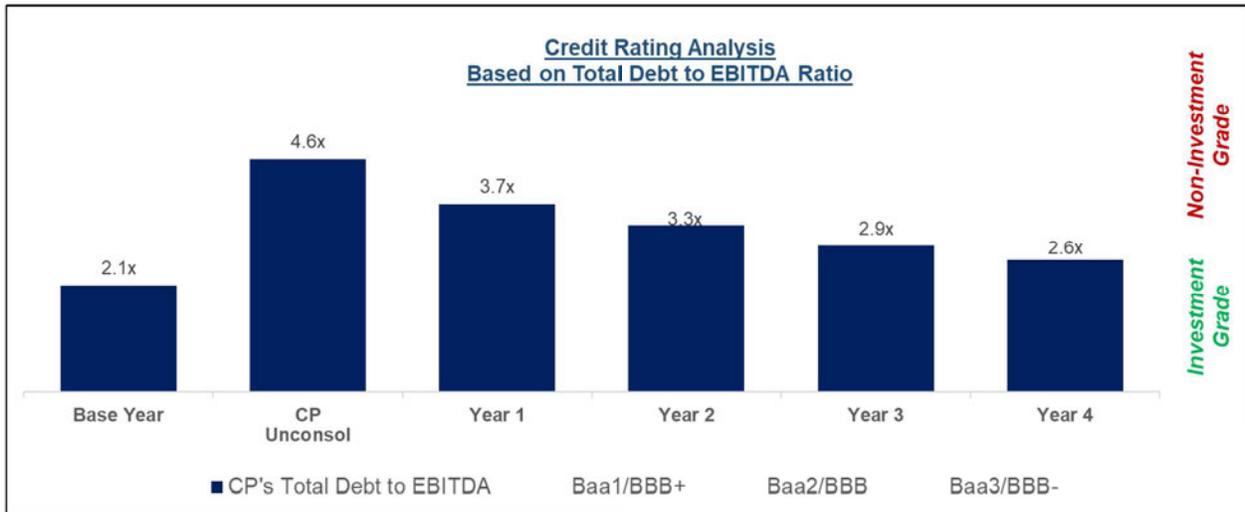
<sup>48</sup> Moody's and S&P Global.

<sup>49</sup> The De Bruyn VS support workpapers, FD 36500 – Work Paper – HC – Debruyn - Excel Back-up.xlsx, Tab "23.2" (Rating Agency - Credit Rating Summary Matrix) indicates that credit ratings Baa1/BBB+, Baa2/BBB, and Baa3/BBB- are associated with Debt/EBITDA ratios below {{ }}, respectively.

<sup>50</sup> See Zmijewski VS on CN's Acquisition of KCS, pp 11 – 13. See also Charles Schwab *Guide to Sub-Investment Grade/High Yield Bonds*, p. 2, "Sub-investment grade/high yield bonds are bonds with a credit rating below investment grade (Baa3 or BBB-), as judged by the bond ratings assigned by one of the major rating agencies: Moody's Investors Service (Moody's) and Standard & Poor's. The ratings are the opinion of the agency. They are not a guarantee of credit quality, probability of default, or recommendation to buy or sell." Available at <https://www.schwab.com/public/file/p-4635483/>.

**Figure 6**  
**Illustration of CP's Credit Ratings**  
**Based on the Pro Forma Exhibits**

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Sources: FD 36500 – Work Paper – HC – Debruyne - Excel Back-up.xlsx, Tabs "21.2" and "23.2"; CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

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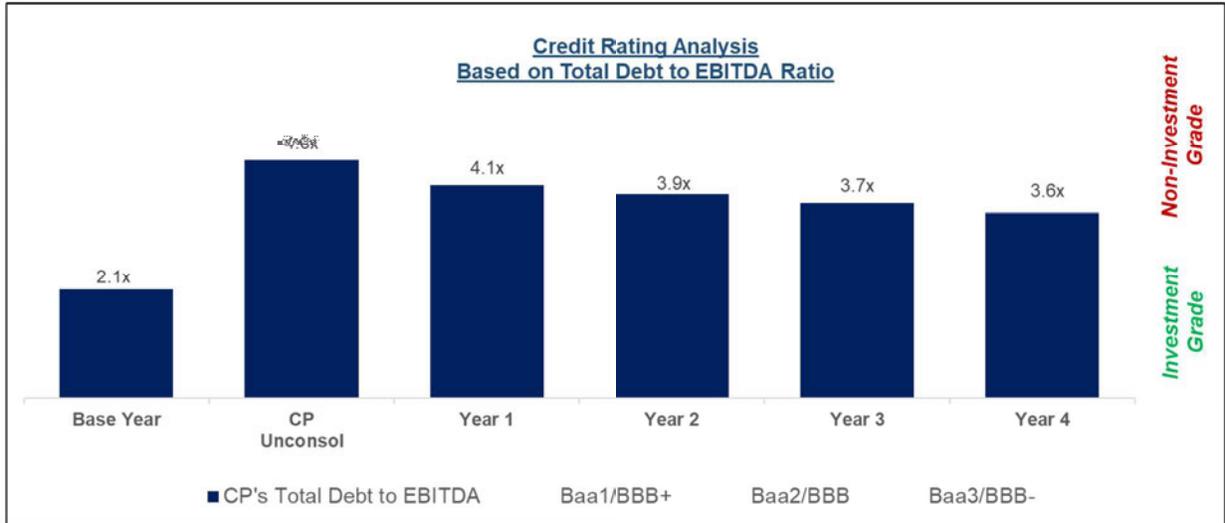
37. The above figure illustrates how the addition of \$8.2 billion acquisition debt to the company's balance sheet pushes the leverage ratio above the thresholds associated with investment grade credit rating. This evidence is consistent with an increased financial risk for CP following the KCS acquisition. The ability to successfully manage that risk depends on CP's ability to de-lever the company by Year 4 by aggressively repaying its debt. A strategy that in the CP CFO's own words "leaves no margin for error."<sup>51</sup>
38. In the following figure, I present CP's post-acquisition leverage as measured by the Debt to EBITDA ratio (CP Unconsol, Year 1, ..., Year 4) relative to the credit rating

<sup>51</sup> Velani VS on CN's Acquisition of KCS, p. 10.

thresholds for the various investment grade credit ratings based on the Conservative Forecasts.

**Figure 7  
Illustration of CP's Credit Ratings  
Based on the Conservative Forecasts**

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Sources: FD 36500 – Work Paper – HC – Debruyne - Excel Back-up.xlsx, Tabs "21.2" and "23.2"; CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

}

39. As discussed earlier, CP generates about \$2.2 billion less of free cash flows under the Conservative Forecasts and repays about \$2.2 billion less of debt, thus, the company's leverage remains higher relative to the leverage under the Conservative Forecasts. This implies higher debt burden and more pressure on the company's investment grade credit rating. The above figure illustrates that if CP experiences a substantial downturn in its

financial performance, CP's debt levels remain relatively high even by Year 4 and its credit rating is likely to fall below investment grade.<sup>52</sup>

### **C. Analysis of CP's Return on Invested Capital (ROIC)**

40. Based on an analysis of CN's post-acquisition ROIC, the Velani VS on CN's Acquisition of KCS concluded that CN's post-acquisition ROIC would be substantially lower than CN's historical ROIC and target ROIC.<sup>53</sup> In this section, I conduct that same analysis of CP's post-acquisition ROIC and show it will be substantially lower than CP's historical ROIC and target ROIC of roughly 15%.
41. In the remainder of this section, I first discuss the lack of ROIC analysis in the De Bruyn VS. I then follow the approach in the Velani VS on CN's Acquisition of KCS that identified CN's target ROIC based on CN's historical ROICs, management compensation, and statements by CN's Chief Financial Officer Ghislain Houle.<sup>54, 55</sup> Lastly, I show CP's 2021 reported ROIC and calculate CP's ROIC based on the forecasts in the Pro Forma Exhibits and the Conservative Forecasts.

#### **1. The De Bruyn VS Did Not Analyze ROIC**

42. CP states that its adjusted ROIC is also an important measure of the company's financial performance: "Adjusted ROIC is a performance measure that measures how productively the Company uses its long-term capital investments, representing critical indicators of

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<sup>52</sup> I note that using the Proxy/Transaction Model Forecasts, CP's post-acquisition Debt/EBITDA ratios in 2022-2025 are {{ }}, respectively. Assuming none of the Claimed Efficiencies are realized, CP's post-acquisition Debt/EBITDA ratios in 2022-2025 are {{ }}, respectively.

<sup>53</sup> Velani VS on CN's Acquisition of KCS, Section IV, pp. 15 – 16.

<sup>54</sup> Velani VS on CN's Acquisition of KCS, Section IV, pp. 11 – 18.

<sup>55</sup> I note that Mr. Houle responded to the allegations of Mr. Velani and explained how Mr. Velani mischaracterized his statements. See Verified Statement of Ghislain Houle before the Surface Transportation Board, dated July 6, 2021. Finance Docket No. 36514, pp. 7-9.

good operating and investment decisions made by management, and is an important performance criteria in determining certain elements of the Company's long-term incentive plan."<sup>56</sup> Tellingly, even though Adjusted ROIC is an important measure of financial performance used by CP, and even though the Velani VS on CN's Acquisition of KCS analyzed and made conclusions about CN's proposed acquisition of KCS, the De Bruyn VS conducts no analysis and provides no discussion of the effect of the KCS acquisition on CP's post-acquisition ROIC.

**2. CP's Target ROIC Has Been in the 15.3% and 15.5% Range (Roughly 15%)**

43. CP explains Adjusted ROIC as:

Adjusted ROIC is calculated as Adjusted return divided by Adjusted average invested capital. Adjusted return is defined as Net income adjusted for interest expense, tax effected at the Company's adjusted annualized effective tax rate, and significant items in the Company's Consolidated Financial Statements, tax effected at the applicable tax rate. Adjusted average invested capital is defined as the sum of total Shareholders' equity, Long-term debt, and Long-term debt maturing within one year, as presented in the Company's Consolidated Financial Statements, each averaged between the beginning and ending balance over a rolling 12-month period, adjusted for the impact of significant items, tax effected at the applicable tax rate, on closing balances as part of this average ....<sup>57</sup>

44. In the following figure, I present CP's historical ROIC from 2016 through 2020, which I extracted from CP's 2020 SEC Form 10-K filing.<sup>58</sup>

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<sup>56</sup> CP 2021 SEC Form 10-K, p. 73.

<sup>57</sup> CP 2020 SEC Form 10-K, p. 64.

<sup>58</sup> CP 2020 SEC Form 10-K, p. 66.

**Figure 8**  
**CP's Historical ROIC (2016 – 2020)**

| (in millions of Canadian dollars, except for percentages) | For the year ended December 31 |               |               |               |               |
|---|--------------------------------|---------------|---------------|---------------|---------------|
|   | 2020                           | 2019          | 2018          | 2017          | 2016          |
| Adjusted return   | \$ 2,748                       | \$ 2,626      | \$ 2,421      | \$ 2,013      | \$ 1,896      |
| Adjusted average invested capital                         | \$ 16,443                      | \$ 15,547     | \$ 14,953     | \$ 13,672     | \$ 13,541     |
| <b>Adjusted ROIC</b>                                      | <b>16.7 %</b>                  | <b>16.9 %</b> | <b>16.2 %</b> | <b>14.7 %</b> | <b>14.0 %</b> |

45. As is seen from the above figure, between 2016 and 2020, CP earned an ROIC in the range of 14.0% to 16.9%.
46. In the next figure, I present the target ROIC for Management's Performance Share Units ("PSUs").<sup>59</sup>

<sup>59</sup> In CP's annual report for the 2020 fiscal year, it stated (p. 118):

During 2020, the Company issued 97,998 PSUs with a grant date fair value of approximately \$ 34 million and 10,029 PDSUs with a grant date fair value, including value of expected future matching units, of approximately \$ 4 million. PSUs and PDSUs attract dividend equivalents in the form of additional units, based on dividends paid on the Company's Common Shares, and vest approximately three years after the grant date contingent upon CP's performance ("performance factor"). The fair value of these PSUs and PDSUs is measured periodically until settlement using closing share price on the date of measurement. The fair value of units that are probable of vesting based on forecasted performance factors over the three-year performance period is recognized as expense in the Consolidated Statements of Income. Vested PSUs are settled in cash. Vested PDSUs are settled in cash pursuant to the DSU plan and are eligible for a 25 % match if the holder has not exceeded their share ownership requirements, and are paid out only when the holder ceases their employment with CP.

The performance period for PSUs and PDSUs issued in 2020 is January 1, 2020 to December 31, 2022, and the performance factors are Return on Invested Capital ("ROIC"), Total Shareholder Return ("TSR") compared to the S&P/TSX 60 Index, and TSR compared to Class I railways.

**Figure 9**  
**CP's Target ROIC for Management Performance Share Units<sup>60</sup>**

| 2019 PSU performance measures   | Why the measure is important  | Threshold (50%) | Target (100%)   | Exceptional (200%) | Weighting |
|---|---|-----------------|-----------------|--------------------|-----------|
| <b>PSU three-year average return on invested capital (ROIC)</b><br>Net operating profit after tax divided by average invested capital   | Focuses executives on the effective use of capital as we grow<br>Ensures shareholders' capital is employed in a value-accretive manner  | 15.3%           | 16%             | 16.4%              | 70%       |
| <b>Total shareholder return</b><br>Measured over three years. The percentile ranking of CP's TSX Compound Annual Growth Rate (CAGR) relative to the companies that make up the S&P/TSX 60 | Compares our TSR on the TSX to the broader S&P/TSX60 to reflect our progress relative to the Canadian market<br>Aligns long-term incentive compensation with long-term shareholder interests                        | 25th percentile | 50th percentile | 75th percentile    | 15%       |
| <b>Total shareholder return</b><br>Measured over three years. The ordinal ranking of CP's NYSE CAGR relative to the Class 1 Railroads   | Compares our TSR on the NYSE to the publicly traded Class 1 Railroads to ensure we are competitive against our primary competitors.<br>Aligns long-term incentive compensation with long-term shareholder interests | 4th             | 3rd             | 1st                | 15%       |

2020 MANAGEMENT PROXY CIRCULAR 39

47. CP awards PSUs to its executives to “focus executives on achieving medium-term goals within a three-year performance period.”<sup>61</sup> As is seen from the above figure, ROIC is an important metric that is used to evaluate management performance because it represents about 70% weight in the overall score. The minimum threshold for ROIC is 15.3%.
48. Lastly, I show an excerpt from CP's internal management presentation to the company's Board of Directors in the following figure.

<sup>60</sup> CP 2020 Management Proxy Circular, p. 39.

<sup>61</sup> CP 2020 Management Proxy Circular, p. 39.

**Figure 10**  
**CP's ROIC in Internal Management Presentation to the Board of Directors<sup>62</sup>**

{{



}}

49. As is seen from the above figure, the CP management envisioned about {{ }}% average ROIC in the 2021-2024 period based on the company's standalone multiyear 2022-2024 Plan.

50. Based on my review of these documents, I conclude that CP's Target ROIC has been in the 15.3% and {{ }}% range (roughly 15%).

### **3. CP's Actual 2021 Post-Acquisition ROIC**

51. In the following figure, I present CP's reported 2021 ROIC disclosed in its SEC Form 10-K filing.<sup>63</sup>

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<sup>62</sup> CP Standalone Multi Year Plan 2022 – 2024, Board of Directors Presentation, September 2021, p. 2 (17.2.32 CP-HC-00007424).

<sup>63</sup> CP 2021 SEC Form 10-K, p. 75.

**Figure 11**  
**CP's Actual 2021 Post-Acquisition ROIC**

| Calculation of Adjusted ROIC                              |    | For the year ended December 31 |    |               |    |               |    |
|---|----|--------------------------------|----|---------------|----|---------------|----|
| (in millions of Canadian dollars, except for percentages) |    | 2021                           |    | 2020          |    | 2019          |    |
| Adjusted return   | \$ | 2,899                          | \$ | 2,748         | \$ | 2,626         | \$ |
| Adjusted average invested capital                         | \$ | 35,383                         | \$ | 16,443        | \$ | 15,547        | \$ |
| <b>Adjusted ROIC</b>                                      |    | <b>8.2 %</b>                   |    | <b>16.7 %</b> |    | <b>16.9 %</b> |    |

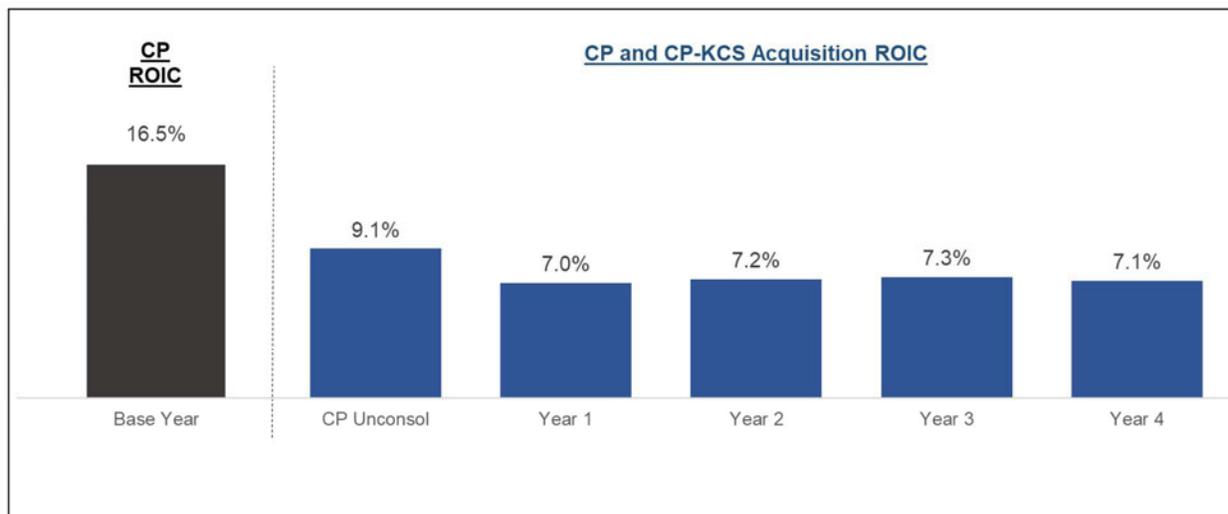
52. As is seen from the above figure, CP achieved 16.9% ROIC in 2019, 16.7% ROIC in 2020, and 8.2% in 2021 following the KCS acquisition.

#### 4. CP's Post-Acquisition ROIC Based on the Forecasts

53. The Velani VS on CN's Acquisition of KCS conducted an ROIC analysis of CN post acquisition and found that "[e]ven after factoring in the \$1 billion in annual synergies that CN forecasts for the KCS combination, it appears that CN's return on invested capital for this transaction will fall well short of ... target range."<sup>64</sup>
54. I conduct similar ROIC analysis using both the Pro Forma Exhibits (with the full amount of Claimed Efficiencies) and the Conservative Forecasts (with no Claimed Efficiencies).
55. In the following figure, I present CP's ROIC post acquisition (CP Unconsol, Year 1, ..., Year 4) based on the Pro Forma Exhibits.

<sup>64</sup> Velani VS on CN's Acquisition of KCS, Section IV, p. 15.

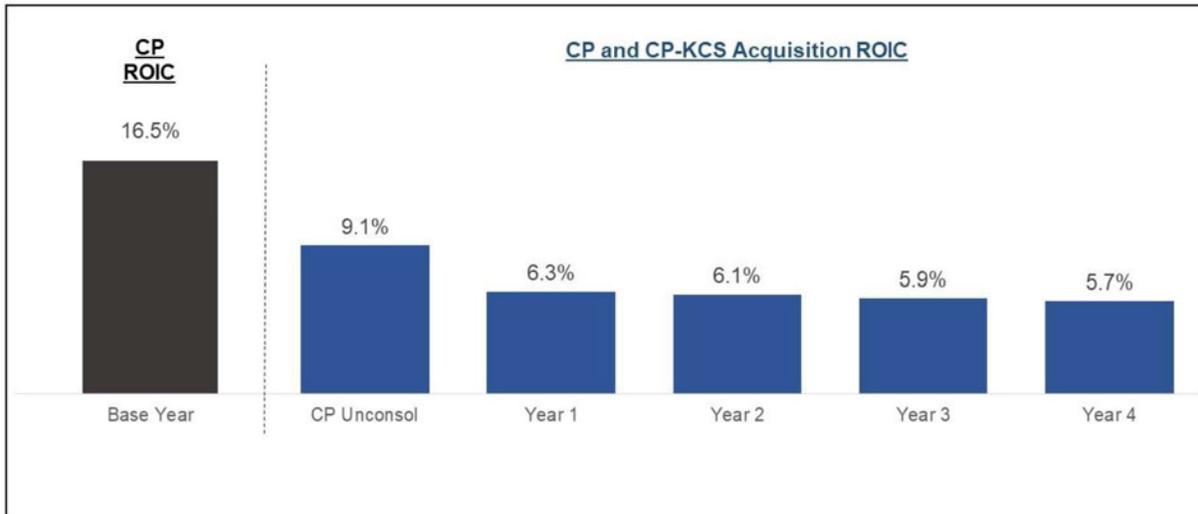
**Figure 12**  
**CP's Post-Acquisition ROIC Based on the Pro Forma Exhibits**



Sources: Velani VS on CN's Acquisition of KCS, Figure 9; CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

56. As is seen from the above figure, the expected ROIC in the post-acquisition period ranges between 7.0% and 9.1% and is well below CP's 15% target ROIC even with a full credit of the Claimed Efficiencies. The expected ROIC is about 7.0% to 7.3% in Year 1 to 4 when CP claims that it will realize the Claimed Efficiencies. Thus, in order to achieve an ROIC close to its target, holding its invested capital (ROIC denominator) constant, CP will have to more than double its unlevered earnings.
57. In the following figure, I present CP's ROIC post acquisition (CP Unconsol, Year 1, ..., Year 4) based on the Conservative Forecasts.

**Figure 13**  
**CP’s Post-Acquisition ROIC Based on the Conservative Forecasts**



Sources: Velani VS on CN’s Acquisition of KCS, Figure 9; CP 2013-2020 Forms 10-K; CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4; Appendix F (Exhibit 17), pp. 1-2; Appendix G (Exhibit 18), pp. 1-2; CRA calculations.

58. As is seen from the above figure, again, the expected ROIC in the post-acquisition period, Years 1 to 4, falls even lower, to the 5.7% to 6.3% range, in the absence of the Claimed Efficiencies.<sup>65</sup>

**5. Conclusions – CP’s Post-Acquisition ROIC**

59. The Velani VS on CN’s Acquisition of KCS concluded, for example, “[m]y analysis in Section IV demonstrates that the implicit ROIC for CN’s huge investment in KCS does not meet CN’s own stated ROIC targets based on the \$1 billion in transaction synergies CN has estimated. This means that CN must have based its investment decision on some unstated set of strategic benefits CN expects to realize. The most plausible explanation is that CN’s investment is justified by CN’s anticipated increase in market power –giving it

<sup>65</sup> I note that using the Proxy/Transaction Model Forecasts, CP’s post-acquisition ROIC in 2022-2025 are {{ }}, respectively. Using the Proxy/Transaction Model Forecasts and assuming none of the Claimed Efficiencies are realized, CP’s post-acquisition ROIC in 2022-2025 are {{ }}, respectively.

greater pricing power ....”<sup>66</sup> My analyses show that the criticisms by Mr. Velani about CN’s proposed acquisition of KCS equally apply to, and are equally valid for, CP’s acquisition of KCS.

### III. ASSESSMENT OF CP’S CLAIMED EFFICIENCIES

60. In this section, I assess the verifiability of the CP’s Claimed Efficiencies from the perspective of the DOJ/FTC *Merger Guidelines*. My analysis of CP’s Claimed Efficiencies shows that most of the Claimed Efficiencies are not verifiable, and many are not merger-specific; thus, the overwhelming majority of the Claimed Efficiencies would not meet the standards to be cognizable based on the *Merger Guidelines*.
61. While I understand that the *Merger Guidelines* are not legally applicable to CP’s acquisition of KCS, the *Merger Guidelines* nevertheless provide a reasonable and appropriate framework to analyze the Claimed Efficiencies from the perspective of a financial economist. Based on the *Merger Guidelines*, assessing whether the efficiencies claimed by the Merging Parties are cognizable requires assessing whether they are: (1) merger-specific, (2) verifiable, and (3) not the result of anticompetitive reductions in output or service.<sup>67</sup> I summarize my conclusions in the following table, which I also present as Exhibit III-1.

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<sup>66</sup> Velani VS on CN’s Proposed Acquisition of KCS, pp. 26 – 27.

<sup>67</sup> *Merger Guidelines*, § 10 at 30. I note that I have not been asked to comment on whether the Claimed Efficiencies are the result of anticompetitive reductions in output or service.

**Table 3**  
**Summary of the Assessment of CP's Claimed Efficiencies**

| <b>SUMMARY OF BENEFITS</b>                     | <b>Assessment of Verification</b> | <b>Assessment of Merger Specificity</b> |
|--|-----------------------------------|---|
| Benefit Component                              |                                   |   |
| <b><u>OPERATING REVENUE GAINS</u></b>          |                                   |   |
| Revenue Increase from Traffic Gains            |                                   |   |
| Rail-to-Rail Diversions (Brown/Zebrowski)      | Not verified                      | Merger specific                         |
| Truck-to-Rail Diversions (Mutan)               | Not verified                      | Merger specific                         |
| Attract New Rail Traffic (Wahba/Naatz)         | Not verified                      | Partially merger-specific               |
| Cost of Handling Added Traffic:                |                                   |   |
| Engineering - Maintenance of Way               | Not verified                      | Merger specific                         |
| Mechanical                                     | Not verified                      | Merger specific                         |
| Transportation                                 | Not verified                      | Partially merger-specific               |
| Equipment Requirements & Utilization           | Not verified                      | Merger specific                         |
| Intermodal Operations                          | Not verified                      | Merger specific                         |
| <b><u>OPERATING BENEFITS</u></b>               |                                   |   |
| Mechanical                                     | Not verified                      | Not merger-specific                     |
| Transportation                                 | Not verified                      | Partially merger-specific               |
| Equipment Requirements                         | Not verified                      | Partially merger-specific               |
| Purchasing (Procurement)                       | Not verified                      | Partially merger-specific               |
| <b><u>G&amp;A Savings</u></b>                  |                                   |   |
| Personnel Savings                              | Not verified                      | Merger specific                         |
| Non-Personnel Savings                          |                                   |   |
| Non-Personnel Expenditures                     | Not verified                      | Merger specific                         |
| IT (Licensing/Subscriptions/Contract Services) | Not verified                      | Merger specific                         |
| Facilities                                     | Verified                          | Merger specific                         |
| Audit & Listing Fees                           | Partially verified                | Merger specific                         |

Source: CP/KCS Application, Vol I, p. 74 (Appendix B - Summary of Benefits Exhibit)

62. Regarding the Revenue Increase from Traffic Gains component, none of the categories within this component is verifiable. Most, but not all, of these revenue increases are merger-specific. Regarding the Cost of Handling Added Traffic, none of the categories within this component is verifiable but these costs are merger-specific. CP's Claimed Operating Benefits efficiency has five components: 1) Mechanical; 2) Transportation; 3)

Equipment Requirements & Utilization; 4) Purchasing (Procurement); and 5) General and Administrative (G&A).

- a. None of the claimed Mechanical Operating Benefits is verifiable and they are not merger-specific.
  - b. None of the claimed Transportation Operating Benefits is verifiable and they are only partially merger-specific.
  - c. None of the claimed Equipment Requirements Operating Benefits are verifiable and they are only partially merger-specific.
  - d. None of the claimed Procurement Operating Benefits are verifiable and they are only partially merger-specific.
  - e. One of the five categories of General and Administrative Benefits is verifiable and one category is partially verifiable; all categories are merger-specific.
63. In sum, in this verified statement, my assessment of the verifiability of CP's Claimed Efficiencies from the perspective of the *Merger Guidelines* shows that most of the Claimed Efficiencies are not verifiable and many are not merger-specific; and thus, the majority of the Claimed Efficiencies would not meet the standards to be cognizable based on the *Merger Guidelines*.
64. In what follows, I describe the framework and methodology I use in my assessment of CP's Claimed Efficiencies based on the *Merger Guidelines*, I describe each of the categories of CP's Claimed Efficiencies, and I provide my analysis of each of the categories of CP's Claimed Efficiencies to assess whether they are cognizable.

**A. Framework and Methodology to Assess Merger Efficiencies**

65. In this section, I analyze CP's Claimed Efficiencies. More specifically, I assess whether CP's Claimed Efficiencies are cognizable from the perspective of the *Merger*

*Guidelines*<sup>68</sup> provided by the DOJ and FTC. I understand that the *Merger Guidelines* are not legally applicable to CP's acquisition of KCS, but the *Merger Guidelines* nevertheless provide a reasonable and appropriate framework to analyze the Claimed Efficiencies from the perspective of a financial economist.

66. The DOJ and the FTC ("Agencies") issued updated *Merger Guidelines* on August 19, 2010.<sup>69</sup> The *Merger Guidelines* outline how the Agencies view efficiencies that result from a merger and set forth criteria of whether Claimed Efficiencies will be deemed cognizable. The *Merger Guidelines* state, "[c]ognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies."<sup>70</sup>
67. The *Merger Guidelines* state that the Agencies assess whether cognizable efficiencies will reverse the potential anticompetitive effects of a proposed merger in the relevant market:<sup>71</sup>

The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price increases in that market ... In adhering to this approach, the Agencies are mindful that the antitrust laws give competition, not internal operational efficiency, primacy in protecting customers.

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<sup>68</sup> *Merger Guidelines*.

<sup>69</sup> *Merger Guidelines*.

<sup>70</sup> *Merger Guidelines*, § 10 at 30.

<sup>71</sup> *Merger Guidelines*, § 10 at 30-31 (footnotes omitted).

68. The analysis of the cognizable efficiencies claimed by the Merging Parties in the *Merger Guidelines* requires assessing whether they are: (1) merger-specific, (2) verifiable, and (3) not the result of anticompetitive reductions in output or service (collectively, “*Merger Guidelines Efficiencies Criteria*”).<sup>72</sup> I note, however, that I have not been asked to comment on whether the Claimed Efficiencies are the result of anticompetitive reductions in output or service and I do not discuss this consideration further.

### 1. Methodology for Verifying Efficiencies

69. The *Merger Guidelines* state, “[e]fficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means.”<sup>73</sup> The *Merger Guidelines* also state:<sup>74</sup>

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so) ...

70. While the *Merger Guidelines* do not prescribe specific standards, methods, or tests that should be used to verify efficiency claims, the 2006 *Commentary on the Horizontal Merger Guidelines*<sup>75</sup> (“*Commentary on the Horizontal Merger Guidelines*”) provides

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<sup>72</sup> *Merger Guidelines*, § 10 at 30.

<sup>73</sup> *Merger Guidelines*, § 10 at 30.

<sup>74</sup> *Merger Guidelines*, § 10 at 30.

<sup>75</sup> U.S. Department of Justice & Federal Trade Commission’s *Commentary on the Horizontal Merger Guidelines*, dated Mar. 2006.

guidance on the documentation the DOJ and FTC look for to substantiate efficiency claims, and the process they use to verify those claims.

71. The *Commentary on the Horizontal Merger Guidelines* notes that, “[t]he best way to substantiate an efficiency claim is to demonstrate that similar efficiencies were achieved in the recent past from similar actions. Documentation must be based on appropriate methods and realistic assumptions, and ideally would be grounded on actual experience.”<sup>76</sup> It naturally follows that in order for an extrapolation of the cost savings experienced from a previous merger to form the basis of cognizable efficiencies in a subsequent merger, the cost savings from the previous merger must also be cognizable (verifiable, and merger-specific, and not the result of anticompetitive reductions in output or service).<sup>77</sup>
72. The *Commentary on the Horizontal Merger Guidelines* also describes the verification process, stating:<sup>78</sup>

After the parties have presented substantiation for their claimed merger-specific efficiencies, the Agencies attempt to verify those claims. The verification process usually includes, among other things, an assessment of the parties’ analytical methods, including the accuracy of their data collection and measurement, an evaluation of the reasonableness of assumptions in the analysis, and scrutiny into how well the parties’ conclusions stand up to modifications in any assumptions (i.e., the “robustness” of the parties’ analysis).

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<sup>76</sup> U.S. Department of Justice & Federal Trade Commission’s *Commentary on the Horizontal Merger Guidelines*, dated Mar. 2006, § 4 at 53.

<sup>77</sup> See generally *Merger Guidelines*, § 10 at 30.

<sup>78</sup> U.S. Department of Justice & Federal Trade Commission’s *Commentary on the Horizontal Merger Guidelines*, dated Mar. 2006, § 4 at 52.

73. Consistent with the *Merger Guidelines*, the *Commentary on the Horizontal Merger Guidelines* summarized above, and the basic principles in accounting, economics, and finance, I assess whether the Claimed Efficiencies can be verified by analyzing whether the Merging Parties have:
- a. Provided adequate documentation to support and explain each of the Claimed Efficiencies;
  - b. Used standard, widely accepted and reliable principles, methods, and analyses to measure the Claimed Efficiencies and employed them appropriately; and
  - c. Used facts and data, the foundation of any economic analyses, to support the inputs and assumptions used in these analyses.
74. This framework and methodology are consistent with the *Merger Guidelines*, the *Commentary on the Horizontal Merger Guidelines*, and basic principles in accounting, economics, and finance.

## 2. Assessing Merger-Specificity of Efficiencies

75. The *Merger Guidelines* define “merger-specific efficiencies” as “those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects.”<sup>79</sup> As discussed in the *Commentary on the Horizontal Merger Guidelines*, an efficiency may be “merger-specific,” even if it theoretically could be achieved without a merger, if for example, the other means were not practically feasible or would impose substantial transaction costs.<sup>80</sup> The *Merger Guidelines* further explain

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<sup>79</sup> *Merger Guidelines*, § 10 at 30.

<sup>80</sup> U.S. Department of Justice & Federal Trade Commission’s *Commentary on the Horizontal Merger Guidelines*, dated Mar. 2006, § 4. Specifically, the *Commentary on the Horizontal Merger Guidelines* states, “[t]hat an efficiency theoretically could be achieved without a merger—for example, through a joint venture or contract—does not disqualify it from consideration in the analysis. Many joint venture agreements or contracts may not be practically feasible or may impose substantial transaction costs (including monitoring costs). In their assessment of

that, “[t]he Agencies will not deem efficiencies to be merger-specific if they could be attained by practical alternatives that mitigate competitive concerns, such as divestiture or licensing. If a merger affects not whether but only when an efficiency would be achieved, only the timing advantage is a merger-specific efficiency.”<sup>81</sup>

76. The *Commentary on the Horizontal Merger Guidelines* further states:<sup>82</sup>

[T]he parties may believe that they can reduce costs by adopting each other’s “best practices” or by modernizing outdated equipment. But, in many cases, these efficiencies can be achieved without the proposed merger. The presence of other firms in the industry unilaterally adopting similar “best practices” would suggest that such cost savings are not merger-specific. By contrast, if a “best practice” is protected by intellectual property rights, then it could be the basis for a merger-specific efficiency claim.

In other words, the “best practices” portion of an efficiency that could be practically achievable through other means and is not protected by intellectual property rights is generally not merger-specific.<sup>83</sup>

77. This framework and methodology are consistent with the *Merger Guidelines*, the *Commentary on the Horizontal Merger Guidelines*, and basic principles in accounting, economics, and finance.

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proffered efficiency claims, the Agencies accord appropriate weight to evidence that alternatives to the merger are likely to be impractical or relatively costly.” (U.S. Department of Justice & Federal Trade Commission’s *Commentary on the Horizontal Merger Guidelines*, dated Mar. 2006, § 4 at 50).

<sup>81</sup> *Merger Guidelines*, § 10 at 30 n.13.

<sup>82</sup> U.S. Department of Justice & Federal Trade Commission’s *Commentary on the Horizontal Merger Guidelines*, dated Mar. 2006, § 4 at 50-51.

<sup>83</sup> I note that if a merger can speed the adoption of best practices by the merging parties, then best practices may be a cognizable efficiency, but only for the limited time period until the merging parties could have developed best practices independently.

### 3. Concluding Comments on the Framework and Methodology

78. As I stated above, the analysis of the cognizable efficiencies claimed by the Merging Parties in the *Merger Guidelines* requires assessing whether the Claimed Efficiencies are: (1) merger-specific, (2) verifiable, and (3) not the result of anticompetitive reductions in output or service.<sup>84</sup> It is widely accepted that accounting, economic, financial analysis, and valuation experts analyze efficiencies claimed in mergers to assist the trier of fact in assessing whether efficiencies are cognizable based on these criteria.<sup>85</sup>
79. Lastly, I note that a finding that a claimed efficiency is not verifiable does not mean that the claimed efficiency does not exist (has a \$0 value); rather, it means that the merging parties have not provided sufficient foundation to substantiate the magnitude of the claimed efficiency or to assess the likelihood that a meaningful efficiency will be realized. Said differently, the information provided by the merging parties does not allow a third party to distinguish the magnitude of the claimed efficiency from, for example, 0% or 1% of the amount claimed and 200% or 300% of the amount claimed.

#### B. Summary of CP's Claimed Efficiencies

80. In this section, I provide a summary of the CP Claimed Efficiencies. CP presented a summary of the Claimed Efficiencies in Appendix B ("Summary of Benefits Exhibit") of Volume 1 of the CP/KCS Application (Total Merger Benefits in the CP/KCS Application). The Summary of Benefits Exhibit partitions the Claimed Efficiencies into two main components: (i) Operating Revenue Gains; and (ii) Operating Benefits. In

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<sup>84</sup> *Merger Guidelines*, § 10 at 30. I note that I have not been asked to comment on whether the Claimed Efficiencies are the result of anticompetitive reductions in output or service at this time.

<sup>85</sup> I note that the *Merger Guidelines* state, "[t]he Commentary on the Horizontal Merger Guidelines issued by the Agencies in 2006 remains a valuable supplement to these Guidelines." *Merger Guidelines*, § 1 at 1 n.1.

Exhibit III-2 and presented in the table below, I provide a summary of the Summary of Benefits Exhibit presented by the CP.

**Table 4**  
**Summary of Benefits (CP's Claimed Efficiencies)**

*USD million*

| <b>SUMMARY OF BENEFITS</b>            | <b>NORMAL<br/>YEAR</b> |
|---------------------------------------|------------------------|
| Benefit Component                     |                        |
| <b><u>OPERATING REVENUE GAINS</u></b> |                        |
| Revenue Increase from Traffic Gains   | 1,021.9                |
| Cost of Handling Added Traffic:       | (306.3)                |
| Net Revenue Gains                     | <b><u>715.6</u></b>    |
| <b><u>OPERATING BENEFITS</u></b>      |                        |
| Mechanical                            | 19.9                   |
| Transportation                        | 62.5                   |
| Equipment Requirements                | 12.8                   |
| Purchasing (Procurement)              | 20.5                   |
| Subtotal                              | <b><u>115.7</u></b>    |
| Support Functions (G&A)               | 57.1                   |
| Total Operating Benefits              | <b><u>172.8</u></b>    |
| Employee Separation/Relocation        | -                      |
| <b>Total Merger Benefits</b>          | <b><u>888.4</u></b>    |

Source: CP/KCS Application Vol I, p. 74 (Appendix B - Summary of Benefits Exhibit)

81. I discuss each of these components below.

## 1. Operating Revenue Gains

82. In this section, I summarize the Claimed Efficiencies related to the Operating Revenue Gains.

### i. Revenue Increase from Traffic Gains

83. The first component of the Operating Revenue Gains is the assumed estimated increase in revenue from traffic gains (“Revenue Increase from Traffic Gains”). CP claims it will achieve \$1.0 billion of additional revenue from traffic gains in a “Normal Year.”<sup>86</sup> The \$1.0 billion Revenue Increase from Traffic Gains is made up of three components of additional revenue: (i) \$513.1 million from rail-to-rail diversions; (ii) \$98.2 million from truck-to-rail diversions; and (iii) \$411.4 million from attracting new rail traffic.

84. The \$513.1 million of additional revenue from rail-to-rail diversions is addressed and estimated in the Verified Statement of Richard Brown, a consultant in the Network Industry Strategies practice at FTI, and Nathaniel S. Zebrowski, managing director in the Network Industry Strategies practice at FTI (“Brown and Zebrowski VS”).<sup>87</sup> The Brown and Zebrowski VS explains, “[a]s part of the assessment of the market impacts of Canadian Pacific Railway’s (‘CP’) proposed acquisition of control of Kansas City Southern (‘KCS’), we have been asked by CP to estimate the amount of railroad traffic that would shift from movement on other railroads to the combined CP/KCS system as a result of the new service offerings, more efficient single-line services, and other changes

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<sup>86</sup> STB, Volume I, p. 74 (Summary of Benefits Exhibit).

<sup>87</sup> Verified Statement of Richard W. Brown and Nathaniel S. Zebrowski before the Surface Transportation Board, dated October 28, 2021. Finance Docket No. 36500.

resulting from the Transaction. Such traffic shifts are commonly referred to as rail-to-rail diversions.”<sup>88</sup>

85. The \$98.2 million of additional revenue from truck-to-rail diversions is addressed and estimated in the Verified Statement of Bengt Muten, Consulting Principal at IHS Markit, (“Muten VS”).<sup>89</sup> The Muten VS explains that he was asked “to estimate the expected diversions of current truck traffic to intermodal services the combined Canadian Pacific (‘CP’) and KCS system will offer.”<sup>90</sup>
86. The \$411.4 million of additional revenue from attracting new rail traffic is addressed and estimated in the Verified Statement of Jonathan Wahba, Vice President of Commercial Integration at CP, and Michael J. Naatz, Executive Vice President and Chief Marketing Officer at KCS (“Wahba and Naatz VS”).<sup>91</sup> The Wahba and Naatz VS explains, “[i]n this statement, we drill down to describe in more detail – and on a commodity-by-commodity basis – some of the key opportunities CPKC intends to pursue to bring the benefits of the Transaction to customers across North America.”<sup>92</sup>

## **ii. Costs of Handling Added Traffic**

87. CP claims that there will be additional costs related to the Revenue Increase from Traffic Gains in the amount of \$306.3 million (“Costs of Handling Added Traffic”).<sup>93</sup> The Costs

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<sup>88</sup> Brown and Zebrowski VS, p. 4.

<sup>89</sup> Verified Statement of Bengt Mutén before the Surface Transportation Board, dated October 28, 2021. Finance Docket No. 36500.

<sup>90</sup> Muten VS, pp. 2-3.

<sup>91</sup> Verified Statement of Jonathan Wahba and Michael J. Naatz before the Surface Transportation Board, dated October 29, 2021. Finance Docket No. 36500.

<sup>92</sup> Wahba and Naatz VS, p. 4.

<sup>93</sup> STB, Volume I, p. 74 (Summary of Benefits Exhibit).

of Handling Added Traffic are discussed and estimated in the Verified Statement of Michael Baranowski, Sr. Managing Director at FTI, (“Baranowski VS”),<sup>94</sup> which “develop[s] the total dollar value of the operating savings resulting from the Canadian Pacific (‘CP’)/Kansas City Southern (‘KCS’) combination, as quantified in the Operating Plan (Exhibit 13 to the Application) and ... estimate[s] the additional costs, revenues, and net revenues that would be associated with the additional traffic the CP/KCS system would attract as a result of the merger through extended hauls, rail-to-rail diversions, and truck-to-rail diversions.”<sup>95</sup>

88. The Costs of Handling Added Traffic have the following components and amounts:<sup>96</sup>

- a. Engineering – Maintenance of Way: \$38.8 million
- b. Mechanical: \$23.4 million
- c. Transportation: \$204.8 million
- d. Equipment Requirements & Utilization: \$13.6 million
- e. Intermodal Operations: \$25.7 million

89. These costs are calculated by multiplying the number of diverted units by the applicable costs for those units (for example, the number of diverted automotive units times the mechanical cost per additional unit).<sup>97</sup>

## 2. Operating Benefits

90. The Operating Benefits (“Claimed Operating Benefits”) include Mechanical, Transportation, Equipment Requirement & Utilization, Purchasing Claimed Efficiencies, which total \$115.7 million, which are addressed and estimated in the Baranowski VS.

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<sup>94</sup> Verified Statement of Michael R. Baranowski before the Surface Transportation Board, dated October 28, 2021. Finance Docket No. 36500.

<sup>95</sup> Baranowski VS, p. 3 (footnotes omitted).

<sup>96</sup> Baranowski VS, p. 26.

<sup>97</sup> See FD 36500 – Work Paper – HC – URCS Phase III Calculation For Growth Traffic.

The remainder of the Claimed Operating Benefits consist of general & administrative (“G&A”) savings of \$57.1 million and are primarily addressed in the Verified Statement of Dean Vargas, the Managing Director of Revenue Planning at CP, (“Vargas VS”).<sup>98</sup> I discuss each of these components below.

**i. Mechanical**

91. The Baranowski VS calculates mechanical savings (“Claimed Mechanical Savings”) by calculating claimed operating metrics savings of \$52.6 million<sup>99</sup> and allocating a portion of those claimed savings to mechanical operations.<sup>100</sup> The Baranowski VS calculates the claimed operating metrics savings by multiplying the reduction in each operating metric which it identifies (train miles, locomotive unit miles, locomotive gross ton miles, and I&I switches) by “the dollar savings attributable to the operating metric reductions ... [based] upon relevant unit costs from the URCS [Uniform Rail Costing System].”<sup>101</sup> Of the total \$52.6 million of claimed operating metrics savings, the total Claimed Mechanical Savings are \$19.9 million.

**ii. Transportation**

92. The Baranowski VS calculates transportation savings (“Claimed Transportation Savings”) by adding together claimed fuel savings and the claimed operating metrics

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<sup>98</sup> Vargas VS.

<sup>99</sup> Baranowski VS, p. 6.

<sup>100</sup> The remaining claimed operating metrics savings are allocated to transportation operations, which I discuss in the next section.

<sup>101</sup> Baranowski VS, p. 5.

savings that were not allocated to the Claimed Mechanical Savings.<sup>102</sup> To calculate the claimed fuel savings, the Baranowski VS states, “I calculated the difference between the number of gallons that would have been consumed ... at the base year consumption rate for KCSR and KCSM, and the gallons at the revised consumption rates at each year’s projected volumes. I then multiplied the KCS difference by an average price per gallon of \$2.04 ... and the KCSM difference by an average price of \$3.08.”<sup>103</sup> The claimed fuel savings are \$29.8 million, and the total Claimed Transportation Savings are \$62.5 million.

### **iii. Equipment Requirements & Utilization**

93. The Baranowski VS estimates \$12.8 million of claimed equipment requirements & utilization costs savings (“Claimed Equipment Savings”), which is equal to the expected savings from the claimed locomotive depreciation and lease annual expense plus the claimed freight cars expense. The Baranowski VS explains the process by which the claimed locomotive depreciation and lease annual expense was calculated:<sup>104</sup>

The reduction in locomotive unit miles between the base and optimized operating plan will achieve savings for locomotive depreciation and lease costs. I calculated these savings by applying the URCS locomotive depreciation and lease costs per locomotive unit mile and per gross ton mile to the locomotive unit miles saved between the base and the optimized operating plan and the equivalent affected gross ton miles.

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<sup>102</sup> While the Baranowski VS calculates the components that make up the Claimed Transportation Savings, the Baranowski VS never specifically identifies the Claimed Transportation Savings; rather, the Claimed Transportation Savings is identified in the Summary of Benefits Exhibit (Appendix B to the CP/KCS Application).

<sup>103</sup> Baranowski VS, p. 7.

<sup>104</sup> Baranowski VS, p. 8.

94. The Baranowski VS also explains the process by which the claimed freight cars expense was calculated:<sup>105</sup>

CP personnel identified specific reductions in locomotive and freight car counts for the combined system before any extended hauls or traffic diversions ... Applicants have determined that full service lease costs for the types of freight cars identified ... average \$4,800 annually. Based on this number, I calculated the cumulative cost savings attributable to freight cars.

**iv. Purchasing (Procurement)**

95. The Baranowski VS estimates \$20.5 million of claimed procurement savings (“Claimed Procurement Savings”). The Baranowski VS explains the process by which the Claimed Procurement Savings were determined:<sup>106</sup>

CP identified the total spend by major expense category for which prices are negotiated routinely as part of the procurement process. For each category, CP reviewed the scope of the combined CP/KCS spend and identified opportunities for savings. These opportunities range from increased overall purchase volumes that allow for negotiation of lower rates to the extension of existing favorable terms or best practices to the other carrier. CP then determined the estimated percentage savings from 2019 spend levels that could be achieved in future negotiations by the combined CP/KCS.

**v. General & Administrative**

96. The Vargas VS summarized “the general and administrative (‘G&A’) cost savings that CP/KCS expects to realize from the Transaction and describe how these savings were developed.”<sup>107</sup> The Vargas VS estimates G&A savings of \$57.1 million, which is

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<sup>105</sup> Baranowski VS, pp. 9-10.

<sup>106</sup> Baranowski VS, p. 10.

<sup>107</sup> Vargas VS, p. 2.

comprised of personnel savings of \$43.7 million and non-personnel savings of \$13.4 million (“Claimed G&A Savings”).<sup>108</sup>

97. The headcount reductions upon which the personnel savings of \$43.7 million are based are addressed in the verified statement of Chad Rolstad, the Vice President of Human Resources and Chief Culture Officer of CP, (“Rolstad VS”),<sup>109</sup> which “explain[s] the steps CP anticipates taking to manage the small number of changes in the non-agreement labor force that will result from implementing the proposed combination of CP and KCS under CP control.”<sup>110</sup>
98. The non-personnel savings of \$13.4 million estimated in the Vargas VS are comprised of the following components:
- Non-personnel expenditures (\$2.0 million): “non-personnel expenditures that will decrease with a reduction in personnel levels, such as business travel and meals, training, and mobile communication.”<sup>111</sup>
  - IT (Licensing/Subscriptions/Contract Services) (\$8.1 million): “These saving [sic] will be achieved through ... rationalizing IT software licensing and subscription fees, and insourcing of outsourced IT contract services.”<sup>112</sup>
  - Facilities (\$1.4 million): “These saving will be achieved through consolidating the CP and KCS U.S. operating headquarters in Kansas City, eliminating a duplicative IT data center in Minneapolis.”<sup>113</sup>
  - Audit and listing fees (\$1.8 million): “... from eliminating duplicative fees and expenses related to reporting as a publicly traded company, given that the two

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<sup>108</sup> Vargas VS, pp. 5-6.

<sup>109</sup> Verified Statement of Chad Rolstad before the Surface Transportation Board, dated October 28, 2021. Finance Docket No. 36500.

<sup>110</sup> Rolstad VS, p. 2.

<sup>111</sup> Vargas VS, p. 6.

<sup>112</sup> Vargas VS, pp. 6-7.

<sup>113</sup> Vargas VS, pp. 6-7.

railroads will report financial results as a single consolidated company. Examples of these duplicative costs include audit and stock exchange listing fees.”<sup>114</sup>

### C. Analysis of Claimed Efficiencies

99. In this section, I provide my assessment of whether the Claimed Efficiencies are cognizable (verifiable and merger-specific). In my analysis and assessment of the Claimed Efficiencies, I rely on several of the verified statements prepared by experts from Oliver Wyman, a global management consulting firm, that was asked to review certain of the Claimed Efficiencies. Specifically, I have reviewed and rely upon the following verified statements:

- Verified Statement of David T. Hunt related to the expected revenues achievable by the Merged Company (“Hunt VS”);<sup>115</sup>
- Verified Statement of Hugh Randall related to the operating costs on the incremental revenue and the forecasted capital expenditures (“Randall VS”);<sup>116</sup> and
- Verified Statement of Carl Van Dyke related to the operating plan of CP and KCS (“Van Dyke VS”).<sup>117</sup>

#### 1. Revenue Increase from Traffic Gains

100. In this section, I assess the verifiability of claimed revenue efficiencies.

I understand that the Hunt VS has also analyzed CP’s claimed revenue efficiencies from the perspective of a railroad industry expert, and “review[ed] and comment[ed] on Applicants’ testimony regarding the traffic diversions and associated revenues that are

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<sup>114</sup> Vargas VS, pp. 6-7.

<sup>115</sup> Verified Statement of David T. Hunt before the Surface Transportation Board, dated February 28, 2022. Finance Docket No. 36500.

<sup>116</sup> Verified Statement of Hugh Randall before the Surface Transportation Board, dated February 28, 2022. Finance Docket No. 36500.

<sup>117</sup> Verified Statement of Carl Van Dyke before the Surface Transportation Board, dated February 28, 2022. Finance Docket No. 36500.

likely to be achieved by the merged CPKC as a result of the proposed transaction.”<sup>118</sup> I review the Hunt VS and provide additional analysis interpreting its findings from the perspective of a financial economist and the *Merger Guidelines*.

**i. The Baseline Forecasted Market Share that the Merged Company Will Achieve from Rail-to-Rail Diversions Is Not Verifiable**

101. The Brown and Zebrowski VS explains the methodology it used to estimate rail-to-rail diversions: “We applied the starting point diversion percentages shown in Table 7 below to project the amount of traffic that will divert to CP/KCS, but as noted below our diversion estimates considered further individualized factors that led us to apply adjustments.”<sup>119</sup> As shown in Table 7 of the Brown and Zebrowski VS, the “starting point diversion percentages” are 25% for “[t]raffic moves via single-line option via other carriers,” 50% for “[t]raffic moves via interline service via other carriers,” 50% or 75% for “CP or KCS participates in traffic via interline service with other carriers,” and 75% for “[t]raffic moves in interline service via two interchanges, with CP and KCS at origin or destination and a third bridge carrier.”<sup>120</sup>
102. I am not aware of any quantitative analysis or foundation substantiating these baseline diversion percentages. Therefore, given the lack of foundation to support the inputs and assumptions used in this analysis, while it is likely that the Merged Company may achieve some diversions, these claimed diversion percentages cannot be verified.
103. I understand that the Hunt VS has also analyzed the expected incremental revenue per unit from the perspective of a railroad industry expert. The Hunt VS states: “Witnesses

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<sup>118</sup> Hunt VS, Section 2.

<sup>119</sup> Brown and Zebrowski VS, p. 22.

<sup>120</sup> Brown and Zebrowski VS, p. 22.

Brown and Zebrowski apply fixed diversion percentages of 25, 50, or even 75 percent that are unsupported by any credible rationale.”<sup>121</sup> The Hunt VS’s conclusion that the diversion percentages are “unsupported by any credible rationale” provides additional evidence that the revenue per incremental unit of rail-to-rail diversions is not verifiable.

**ii. The Forecasted Revenue per Diverted Rail-to-Rail Carload Is Not Verifiable**

104. The Brown and Zebrowski VS explains how it estimates incremental revenue per unit: “In light of the factors noted above, and the incentives that incumbent carriers will have to seek to retain the traffic in which they currently participate, we considered it appropriate to assume that CP/KCS would be required to offer rate reductions averaging five percent in order to attract traffic away from existing single-line service to CP/KCS single-line service.”<sup>122</sup> I am not aware of any quantitative analysis or foundation that substantiates this 5% reduction in rates is sufficient to realize the forecasted diversions. Therefore, these rates cannot be verified.
105. I understand that the Hunt VS has also analyzed the expected incremental revenue per unit from the perspective of a railroad industry expert. The Hunt VS concluded that “Revenue for post-merger diverted traffic is overstated by \$47.4 million due to errors.”<sup>123</sup> Specifically, the Hunt VS explains that “the revenue gain for CPKC from diverted traffic should logically reflect the approximate revenue that would be lost by the railroads that currently haul that traffic”<sup>124</sup> and notes that the Brown and Zebrowski VS “considered it

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<sup>121</sup> Hunt VS, Section 3.

<sup>122</sup> Brown and Zebrowski VS, p. 21.

<sup>123</sup> Hunt VS, Section 4.2.

<sup>124</sup> Hunt VS, Section 4.2.

appropriate to assume that CP/KCS would be *required to offer rate reductions averaging five percent in order to attract traffic away from existing single-line service.*"<sup>125</sup>

However, the Hunt VS shows that, due to errors in the Brown and Zebrowski VS's analysis, "the incremental revenue per diverted carload claimed by witnesses Brown and Zebrowski in many cases exceeds the rates currently charged by the incumbent carrier."<sup>126</sup> The Hunt VS concludes that "[i]f Brown and Zebrowski's revenue estimates are accurate, it is hard to see how Applicants can claim that diverting this traffic will be beneficial to shippers, who (according to Brown and Zebrowski's revenue assumptions) would be charged significantly more than the current 'going rate' to move those shipments over longer, more circuitous routes."<sup>127</sup> Thus, these errors identified in the Hunt VS provide additional evidence that the revenue per incremental unit of rail-to-rail diversions is not verifiable.

### **iii. The Additional Rail-to-Rail Diversions are not Verifiable**

106. Additional rail-to-rail diversions are also not verifiable.

#### *Grains*

107. Regarding grains, the Wahba and Naatz VS states: "Given our knowledge of the market and our customers, we expect the Transaction to lead to at least a five percent increase in the CP/KCS share of all grains exported from the United States to Mexico."<sup>128</sup> The

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<sup>125</sup> Brown and Zebrowski VS, p. 21, ¶32 (emphasis added).

<sup>126</sup> Hunt VS, Section 4.2.

<sup>127</sup> Hunt VS, Section 4.2.

<sup>128</sup> Wahba and Naatz VS, p. 11.

Brown and Zebrowski VS corroborates this claim with its own professional judgement.<sup>129</sup>

I am not aware of any quantitative analysis or foundation, however, that substantiates this 5% increase in market share. Therefore, while it is likely that the Merged Company may achieve some increase in market share, this increase in market share cannot be verified.

108. I understand that the Hunt VS has also analyzed the expected increase in market share from the perspective of a railroad industry expert. The Hunt VS states: “This (unexplained) assumption, which increases total revenues from diverted grain shipments in the Brown and Zebrowski diversion model by more than 340 percent, does not appear to be based on any movement-specific analysis ... There is no justification or evidentiary support for ... this arbitrary increase in CPKC’s post-merger grain traffic.”<sup>130</sup> This provides additional evidence that the increase in market share is not verifiable.

### *Lumber*

109. Regarding lumber, the Brown and Zebrowski VS states: “In addition to CP/KCS’s increased ability to attract Canadian lumber traffic that CP currently hands off to other U.S. carriers, CP/KCS’s new single-line routes will also enable it to originate a larger share of lumber from Canadian mills served by both CP and CN (and where CN dominates). We estimate this additional traffic by identifying lumber mills CP can access in Alberta, British Columbia, Ontario, and Quebec, and assuming CP increases its share by five percentage points and moves that traffic to destinations in Dallas and other destinations to either displace existing supply or accommodate future growth.”<sup>131</sup> I am

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<sup>129</sup> Brown and Zebrowski VS, pp. 25-27.

<sup>130</sup> Hunt VS, Section 4.3.

<sup>131</sup> Brown and Zebrowski VS, p. 44.

not aware of any quantitative analysis or foundation, however, that substantiates this 5% increase in market share. Therefore, while it is likely that the Merged Company may achieve some increase in market share, this increase in market share cannot be verified.

110. I understand that the Hunt VS has also analyzed the expected increase in market share from the perspective of a railroad industry expert. The Hunt VS states: “Witnesses Brown and Zebrowski provide no analysis or calculations to support these market share and growth assumptions. In total, these adjustments account for 2,038 additional carloads, or 56 percent of all incremental revenue from lumber diversions.”<sup>132</sup> This provides additional evidence that the increase in market share is not verifiable.

**iv. Additional Incremental Revenues Forecasted by the Wahba and Naatz VS Are Not Verifiable**

111. The Wahba and Naatz VS identifies additional incremental revenues beyond those identified in the Brown and Zebrowski VS and the Mutén VS. These additional incremental revenues are calculated by identifying the average revenues per car at 2019 levels for certain routes and multiplying that revenue by an estimate of fully phased in units.<sup>133</sup> The Wahba and Naatz VS does not provide an explanation of how almost all of the additional fully phased in units are calculated. With one exception,<sup>134</sup> the values of fully phased in units are either hardcoded<sup>135</sup> or come from calculations that are based on

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<sup>132</sup> Hunt VS, Section 4.3.

<sup>133</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx.

<sup>134</sup> FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx, cell E23. The one exception is the domestic perishables from Michoacan/Veracruz to Chicago/Twin Cities/Kansas City-2. With regards to perishables, the Hunt VS states, “Applicants do not explain why these shipments are divertible, or why witness Mutén (who clearly was aware of the movements) did not judge them to be divertible.” (Hunt VS, Section 5.3).

<sup>135</sup> See, for example, FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx, cells E6, E9, and E21.

hardcoded and/or unexplained values.<sup>136</sup> Therefore, while it is possible that the Merged Company may achieve some additional incremental revenues, the total additional incremental revenues forecasted by the Wahba and Naatz VS are not verifiable.

112. I understand that the Hunt VS has also analyzed the expected additional incremental revenues forecasted by the Wahba and Naatz VS from the perspective of a railroad industry expert. The Hunt VS states, “These additional traffic volumes and revenues – which account for \$411 million or 40 percent of the total incremental revenue gains set forth in the Application – are based on unrealistic assumptions and unsupported claims.”<sup>137</sup> The Hunt VS additionally states: “witnesses Wahba and Naatz are claiming [LPG] traffic that does not currently exist.”<sup>138</sup> The Hunt VS’s conclusion that the claimed additional incremental revenues lack foundation provides additional evidence that the additional incremental revenues forecasted by the Wahba and Naatz VS are not verifiable.

**v. Additional Incremental Revenues Forecasted by the Wahba and Naatz VS Are Not Merger-specific**

113. Additional rail-to-rail diversions forecasted by the Wahba and Naatz VS are not merger-specific.

*Crude oil*

114. Regarding crude oil, the Wahba and Naatz VS states: “The new single-line service unlocked by the CP/KCS Transaction will support the investments needed to accelerate

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<sup>136</sup> See, for example, FD 36500 – Work Paper – HC – Growth Initiative Calculations.xlsx, cells E4, E5, and E12.

<sup>137</sup> Hunt VS, Section 3.

<sup>138</sup> Hunt VS, Section 5.3.

the transition away from traditional crude-by-rail and towards the movement of Alberta crude in private cars in non-hazardous DRUbit form.”<sup>139</sup> I understand from the Hunt VS, however, that “a crude oil movement from Hardisty, AB to Port Arthur, TX ... was made public by the shipper, Gibson Energy, in December 2019” and therefore “this rail movement clearly predates the merger.”<sup>140</sup> If incremental revenues can be realized without a merger, then it logically follows that a merger is unnecessary to realize these specific benefits. The incremental revenues from crude oil are not merger-specific and are not cognizable.

*Diversions that exclusively utilize the KCS network*

115. I understand from the Hunt VS that the Wahba and Naatz VS “attribute[s] \$21.1 million ... in merger-related benefits to Lazaro Cardenas – Kansas City diversions and another \$22.9 million to Lazaro Cardenas-Dallas diversions, routes where KCS could provide single-line service on a stand-alone basis today.”<sup>141</sup> I am aware of no reason that has been provided as to why KCS could not realize these diversions as an independent company, and therefore, based on the conclusions presented in the Hunt VS, these diversions are not merger-specific.

**2. Cost of Handling Added Traffic**

116. In this section, I assess the verifiability of the Claimed Cost of Handling Added Traffic. I understand that the Randall VS has analyzed CP’s Claimed Cost of Handling Added Traffic from the perspective of a railroad industry expert, and that it “review[ed] and

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<sup>139</sup> Wahba and Naatz VS, p. 43.

<sup>140</sup> Hunt VS, Section 5.1.

<sup>141</sup> Hunt VS, Section 5.2.

comment[ed] on ... Applicants' projected post-merger operating expenses."<sup>142</sup> The Randall VS concludes that "Applicants' projected operating expenses for the first three post-merger years are understated by approximately \$2.47 billion when compared to the operating expenses actually incurred by CP US and KCS US during the 2015-2019 period."<sup>143</sup>

117. Below, I provide an analysis of the Costs of Handling Added Traffic, which interprets the related verified statements from the perspective of a financial economist and the *Merger Guidelines*.<sup>144</sup>

**i. The Cost for Diverted Units Is Not Verifiable**

118. The Baranowski VS explains that it calculates the incremental cost per diverted unit by "develop[ing] a model that replicates certain of the relevant URCS costing procedures for the cost components that are affected directly by the traffic shifts that are not accounted for in other analyses undertaken by CP."<sup>145</sup> The Randall VS explains, however, that "Applicants did not base their estimate of incremental operating expenses on the analyses or outputs of their operating plan or system model. Instead, Applicants based their estimate solely on a table of incremental operating expenses that is hard-coded into an

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<sup>142</sup> Randall VS, Section 2. The Randall VS explains, "Solely for purposes of this Verified Statement, I have assumed that the envisioned merged railroad, CPKC, will achieve the traffic increases projected in the Application" (Randall VS, Section 2).

<sup>143</sup> Randall VS, Section 4.

<sup>144</sup> I note that the Randall VS "review[s] and comment[s] on ... Applicants' estimate of the capacity improvements and other capital expenditures that would be required to handle the additional traffic volumes projected by Applicants safely and efficiently" and concludes that "Applicants' [c]apital [e]xpenses [a]re [s]ignificantly [u]nderstated" (Randall VS, Sections 2-3). I note that to the extent that the Randall VS is correct that the Merged Company underestimates its required capital expenditures, that is further evidence that the costs of revenue efficiencies are understated and not verifiable.

<sup>145</sup> Baranowski VS, p. 15.

unsourced spreadsheet in Applicants' work papers"<sup>146</sup> and that "operating expenses reflected in the Application are nothing more than assumptions that are unsupported by documentation or analysis."<sup>147</sup> Consistent with the finding presented in the Randall VS, I am aware of no facts, calculations, or detailed methodology for the Baranowski VS's calculation of the incremental cost per diverted unit. Therefore, given the lack of sufficient documentation and foundation underlying these assumptions and consistent with the *Merger Guidelines*, I find that the cost per diverted unit is not verifiable.

119. The Baranowski VS calculates the total cost for diverted units by multiplying the incremental cost per diverted unit by the total number of diverted units of each type.<sup>148</sup> As I discussed in Section III.C.1, however, the total number of diverted units is not verifiable. Therefore, neither the cost per unit, nor the number of units, is verifiable and the total cost for diverted units is also not verifiable.

### 3. Operating Benefits

120. In this section, I assess the claimed Operating Benefits of the Transaction.<sup>149</sup> Those claimed Operating Benefits are divided into Claimed Mechanical Savings, Claimed

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<sup>146</sup> Randall VS, Section 4.

<sup>147</sup> Randall VS, Section 4. In addition, I understand that the Randall VS opines that certain categories of costs were inappropriately excluded from the calculations of the cost of handling additional traffic (Randall VS, Section 4.2).

<sup>148</sup> FD 36500 – Work Paper – HC – URCS Phase III Calculation For Growth Traffic.xlsm, tab Incremental Costs by Category.

<sup>149</sup> I note that the Randall VS has analyzed the speed at which the Claimed Operating Benefits will be realized. The Randall VS states: "Since CP cannot begin to physically integrate its network with KCS or influence KCS operations until the merger is approved, it is unlikely that Applicants would be able to implement all of the operating changes required to generate virtually all of the achievable operating expense savings in the first post-merger year" (Randall VS, Section 4). This provides additional evidence that the rate at which certain claimed cost efficiencies will be realized is not verifiable, further reducing the extent to which these efficiencies are cognizable. See also the *Merger Guidelines*, which explain that "Delayed benefits from efficiencies (due to delay in the achievement of, or the realization of customer benefits from, the efficiencies) will be given less weight because they are less proximate and more difficult to predict" (*Merger Guidelines*, § 10 at 31 n.15).

Transportation Savings, Claimed Equipment Savings, Claimed Procurement Savings, and Claimed G&A Savings.<sup>150</sup>

**i. Mechanical**

121. As I discussed in Section III.B.2.i, the Claimed Mechanical Savings are equal to a portion of the total claimed operating metrics savings calculated by the Baranowski VS. The Baranowski VS explains that its calculations of the claimed operating metrics savings “reflect[] the operations of a consolidated CP/KCS network ... It does this in two phases: first, by identifying the operational efficiencies that arise from operating a larger, fully integrated and optimized network that *adopts the best practices of both railroads*, and second, by planning for and assessing the operations (including capacity additions) that would accommodate the increased traffic the combined system will attract.”<sup>151</sup> As I explained Section III.A.2, savings from “best practices” are not merger-specific and thus would not be considered cognizable efficiencies. Therefore, to the extent that the Claimed Mechanical Savings are expected to be realized via adoptions of best practices, they are not cognizable efficiencies, or, at best, cognizable for a limited time period.<sup>152</sup>
122. In addition, I understand that some or all of the Claimed Mechanical Savings are due to implementation of precision scheduled railroading (“PSR”).<sup>153</sup> However, the Randall VS

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<sup>150</sup> I do not discuss claimed savings from Engineering – Maintenance of Way or Intermodal Operations because they do not have benefits in the Normal Year.

<sup>151</sup> Baranowski VS, pp. 4-5 (emphasis added).

<sup>152</sup> As I explained above when I discussed the framework and methodology to assess merger efficiencies, I note that if a merger can speed the adoption of best practices by the merging parties, then best practices may be a cognizable efficiency, but only for the limited time period until the merging parties could have developed best practices independently.

<sup>153</sup> Specifically, the Randall VS explains that “Without identifying what specific expense reduction measures would be implemented in Year 1, witness Baranowski assumes that CPKC will realize this extremely high percentage of total projected operating expense savings during the first year of the merger, (supposedly) by implementing CP’s precision scheduled railroading (PSR) on KCS” (Randall VS, Section 4.3).

explains that “a significant portion of the implementation of PSR has already been realized by KCS without the merger. Beginning in January 2019, KCS commenced an aggressive initiative to implement PSR, which helped to reduce its operating ratio from 69.1 percent in 2019 to 62.2 percent in 2020.”<sup>154</sup> Therefore, based on the criteria found in the *Merger Guidelines*, these claimed cost reductions are not merger-specific<sup>155</sup> and thus are not considered cognizable efficiencies.

123. Finally, I note that the expected reduction of train miles per day for KCS’s US and Mexican railroads, which is the core input that allows the Merging Parties to realize the Claimed Mechanical Savings, are hardcoded values that are calculated by “{ {

}}”<sup>156</sup> I have not seen any explanation for this calculation, and given the lack of foundation to support the inputs and assumptions used in these analyses, the Claimed Mechanical Savings are not verifiable.<sup>157</sup>

## ii. Transportation

124. As I discussed in Section III.B.2.i, the Claimed Transportation Savings are equal to a portion of the claimed operating metrics savings calculated by the Baranowski VS plus the claimed fuel savings. I already discussed the reasons that the claimed operating

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<sup>154</sup> Randall VS, Section 4.3.

<sup>155</sup> *Merger Guidelines*, § 10 at 30 (“... those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects”).

<sup>156</sup> FD 36500 – Work Paper – HC – CP Operating Plan Output Cost Metrics Model.xlsx, tab Model, cells C33 and C49.

<sup>157</sup> I note that the reduction in I&I switches is a hardcoded value that cannot be tied directly to FD 36500 – Work Paper – HC – CP Operating Plan Output Cost Metrics Model.xlsx, despite being sourced to this file (see FD 36500 – Work Paper – HC – Base to Optimized Operating Plan Savings.xlsx, tab Base to Optimized Metrics). Therefore, even if the reduction in I&I switches is not related to PSR, it is unexplained and therefore not verifiable.

metrics savings are not cognizable (not verifiable and not merger specific) in the previous section, Section III.C.3.i, and I do not repeat myself here. The Claimed Transportation Savings related to the claimed fuel savings are calculated by applying a “regression of horsepower per ton and gross ton-miles [for CP to the] forecast of Years 1 through 3 gross ton-miles and extrapolat[ing] the results to forecasts of KCSR and KCSM.”<sup>158</sup> While a regression is a reasonable process to calculate an efficiency, the forecasts of gross ton-miles are closely linked to the forecasts of incremental revenues, which as I explained in Section III.C.1 are not verifiable. Therefore, the claimed fuel savings are not verifiable.

### iii. Equipment Requirements

125. I understand that some or all of the Claimed Equipment Savings, other than the reduction in the claimed freight car expense, are due to implementation of PSR.<sup>159</sup> I already discussed the reasons that the claimed savings related to PSR are not cognizable (not verifiable and not merger specific) in Section III.C.3.i, and I do not repeat myself here. The Claimed Equipment Savings related to the claimed freight car expense is calculated with hardcoded inputs sourced from the Operating Plan.<sup>160</sup> The Van Dyke Verified Statement, however, explains that the Operating Plan is “incomplete and deeply flawed” and “cannot be relied upon in evaluating the impact of the proposed merger on CP-KCS operations, the operations of other railroads, or other stakeholders, such as shippers and

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<sup>158</sup> Baranowski VS, p 7.

<sup>159</sup> Specifically, the Randall VS explains that “Without identifying what specific expense reduction measures would be implemented in Year 1, witness Baranowski assumes that CPKC will realize this extremely high percentage of total projected operating expense savings during the first year of the merger, (supposedly) by implementing CP’s precision scheduled railroading (PSR) on KCS” (Randall VS, Section 4.3).

<sup>160</sup> FD 36500 – Work Paper – HC – Freight Car Savings.xlsx.

communities.”<sup>161</sup> Therefore, the Claimed Equipment Savings related to the reduction in total freight cars is therefore not verifiable.

#### iv. Purchasing (Procurement)

126. The Baranowski VS calculates the Claimed Procurement Savings by multiplying different categories of costs by assumed savings percentages, which range from {{ }}% to {{ }}%, and which are all hard-coded values that include no additional support or foundation and thus cannot be verified.<sup>162</sup>
127. In addition, as the Baranowski VS explains, some of the savings are expected to result “... from increased overall purchase volumes that allow for negotiation of lower rates to the extension of existing favorable terms or *best practices* to the other carrier.”<sup>163</sup> As I explained above, savings from “best practices” are not merger-specific and thus would not be considered cognizable efficiencies or, at best, cognizable for a limited time period.<sup>164</sup> In addition, while savings achieved via pooling purchasing volumes and realizing bulk purchasing discounts are merger-specific, to the extent any expected savings are due to simply realizing another party’s more favorable purchasing terms for similar orders, that expected savings is not merger-specific and is therefore not cognizable.

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<sup>161</sup> Van Dyke VS, Section 2.

<sup>162</sup> FD 36500 – Workpaper – HC – CPKCS Procurement Synergies Study.xlsx.

<sup>163</sup> Baranowski VS, p. 10 (emphasis added).

<sup>164</sup> As I explained above when I discussed the framework and methodology to assess merger efficiencies, I note that if a merger can speed the adoption of best practices by the merging parties, then best practices may be a cognizable efficiency, but only for the limited time period until the merging parties could have developed best practices independently.

## v. General & Administrative

128. In this section, I assess the Claimed G&A Savings of the Transaction. Those claimed savings are divided into personnel savings and several categories of non-personnel savings: non-personnel expenditures, information technology (“IT”) expenditures, facilities, and audit & listing fees.

### *Personnel Savings*

129. The claimed personnel savings are calculated by determining the total cost per employee at each title and division at CP and KCS (for example, the cost of an executive in corporate risk at KCS) and multiplying that total cost for each of those employees by the number of employees terminated at that level in that division from that railroad. These savings are then summed to determine total personnel savings.<sup>165</sup>

130. In Exhibit III-3, I present an example of the calculation of a portion of the claimed personnel savings. Specifically, I show the calculation of the claimed personnel savings related to the elimination of executives in corporate risk from KCS. First, I show the calculation of the total corporate risk executive salary per employee at KCS. This is equal to the KCS corporate risk executive salary plus expected incentive compensation and expected fringe rates compensation. Incentive compensation is equal to {{ }}% of base salary and fringe rates compensation is equal to {{ }}% of base salary. The sum of these three values is the total KCS corporate risk executive compensation per employee of \${{ }} per year. This salary is then multiplied by the total number of KCS corporate risk executive employees to be terminated: {{ }}.

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<sup>165</sup> FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx, tabs Summary, Comp & headcount.

Therefore, the total claimed savings per year are \${{ }}. In order to calculate the total claimed personnel savings efficiency, the Baranowski VS then conducts a similar calculation for each different class of employees (divided by title and division) at each of CP and KCS. The total savings are then summed and represent the total claimed personnel efficiency.

131. While it is likely that the Merged Company may achieve some personnel savings, the personnel savings are not verifiable because CP (and the Vargas VS and the Rolstad VS) rely on unfounded and unsupported assumptions and use business judgment for the headcount reduction assumptions underpinning this claimed efficiency. I have seen no calculations or underlying foundation that provides substantiation of the headcount reductions at each company or the total amount of reduced headcount.

#### *Non-Personnel Expenditures*

132. The Vargas VS explains that the claimed non-personnel expenditures savings will be realized because “non-personnel expenditures ... will decrease with a reduction in personnel levels.”<sup>166</sup> As examples of these expenditures, the Vargas VS lists “business travel and meals, training, and mobile communication.”<sup>167</sup> In Exhibit III-4, I show the calculation of the claimed non-personnel expenditures savings. As shown in this exhibit, the Baranowski VS calculates non-personnel expenditures savings for KCS and CP separately. For each railroad, non-personnel expenditures savings are equal to variable G&A per employee times the expected headcount reduction. The total expected savings are \${{ }} and \${{ }} for KCS and CP, respectively. The

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<sup>166</sup> Vargas VS, p. 6.

<sup>167</sup> Vargas VS, p. 6.



Therefore, there are no rigorous calculations or underlying foundation that provides substantiation of the inputs to this efficiency, and while it is likely that the Merged Company may achieve some IT expenditures savings, this efficiency is unverified.

*Facilities*

136. The claimed facilities costs savings is based on the assumption that “{{

}}”<sup>171</sup> These

costs are factual and are verified.

*Audit & Listing Fees*

137. The claimed audit & listing fees costs savings is calculated “from eliminating duplicative fees and expenses related to reporting as a publicly traded company, given that the two railroads will report financial results as a single consolidated company. Examples of these duplicative costs include audit and stock exchange listing fees.”<sup>172</sup> In Exhibit III-6, I show the calculation of this claimed efficiency. As shown in this exhibit, the claimed efficiency is equal to the sum of avoided listing fees of \${{ }} and auditor fees of \${{ }}.

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}}” (FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx, tabs Summary, Non – comp.)

<sup>171</sup> FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx, tabs Summary, Non – comp.

<sup>172</sup> Vargas VS, p. 6.

138. Professional or business judgement was used to assume that audit fees would be reduced by “{{ }}”<sup>173</sup> Therefore, because the only foundation for this assumption is business judgement, while it is likely that the Merged Company may achieve some savings related to audit fees, the savings cannot be verified.<sup>174</sup>

#### **4. The Operating Ratio of the Merged Company Provides Additional Evidence that the Claimed Efficiencies Are Not Verifiable**

139. The Randall VS provides additional evidence that the Claimed Efficiencies are not verifiable by comparing the forecasted cost for the Merged Company to benchmarks. The Randall VS states that “the projected operating expense per GTM for CPKC of \$0.0126 during the first three post-merger years is well below historical benchmarks.”<sup>175</sup> The Randall VS also states that the “changes in operating expense per GTM for all of the Class I railroads between 2009 and 2019 ... strongly suggest[] that Applicants have significantly underestimated the operating expense per GTM that the combined CPKC system is likely to experience.”<sup>176</sup> Furthermore, the Randall VS states that “the implied operating ratio for CPKC’s post-merger incremental traffic (based on the incremental revenues and operating expenses set forth in the Application) is far below the historic norms for the US operations of Applicants themselves, and for the US Class I railroads as a group.”<sup>177</sup> The *Merger Guidelines* note that Claimed Efficiencies ideally “would be

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<sup>173</sup> FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx, tabs Summary, Non – comp.

<sup>174</sup> The cost savings from the avoided listing fees, \$798 thousand, is factual and is verified.

<sup>175</sup> Randall VS, Section 4.4.

<sup>176</sup> Randall VS, Section 4.4.

<sup>177</sup> Randall VS, Section 4.4.

grounded on actual experience.”<sup>178</sup> In this instance, the “actual experience” provides evidence that the Merged Company will have greater costs than CP claims. Therefore, this is economic evidence that the expected cost for the Merged Company is not verifiable and may be understated.

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<sup>178</sup> “The best way to substantiate an efficiency claim is to demonstrate that similar efficiencies were achieved in the recent past from similar actions. Documentation must be based on appropriate methods and realistic assumptions, and ideally would be grounded on actual experience ... If the parties cannot point to similar efficiencies achieved in the recent past, they should use the best information available to substantiate their efficiency claims. For example, the parties might do an internal study and analysis of expected efficiencies using recent cost records and other pertinent objective data” (U.S. Department of Justice & Federal Trade Commission’s *Commentary on the Horizontal Merger Guidelines*, dated Mar. 2006, § 4 at 53-54).

**VERIFICATION**

I, Mark E. Zmijewski, declare under penalty of perjury under the laws of the United States that the foregoing information is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on this 28th day of February, 2022.

A handwritten signature in black ink that reads "Mark E. Zmijewski". The signature is written in a cursive style with a large, looping initial "M".

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Mark E. Zmijewski

## Exhibit III-1

### Assessment of Claimed Efficiencies

| SUMMARY OF BENEFITS                            | Assessment of<br>Verification | Assessment of<br>Merger Specificity |
|--|-------------------------------|-------------------------------------|
| Benefit Component                              |                               |                                     |
| <b><u>OPERATING REVENUE GAINS</u></b>          |                               |                                     |
| Revenue Increase from Traffic Gains            |                               |                                     |
| Rail-to-Rail Diversions (Brown/Zebrowski)      | Not verified                  | Merger specific                     |
| Truck-to-Rail Diversions (Mutan)               | Not verified                  | Merger specific                     |
| Attract New Rail Traffic (Wahba/Naatz)         | Not verified                  | Partially merger-specific           |
| Cost of Handling Added Traffic:                |                               |                                     |
| Engineering - Maintenance of Way               | Not verified                  | Merger specific                     |
| Mechanical                                     | Not verified                  | Merger specific                     |
| Transportation                                 | Not verified                  | Partially merger-specific           |
| Equipment Requirements & Utilization           | Not verified                  | Merger specific                     |
| Intermodal Operations                          | Not verified                  | Merger specific                     |
| <b><u>OPERATING BENEFITS</u></b>               |                               |                                     |
| Mechanical                                     | Not verified                  | Not merger-specific                 |
| Transportation                                 | Not verified                  | Partially merger-specific           |
| Equipment Requirements                         | Not verified                  | Partially merger-specific           |
| Purchasing (Procurement)                       | Not verified                  | Partially merger-specific           |
| <b><u>G&amp;A Savings</u></b>                  |                               |                                     |
| Personnel Savings                              | Not verified                  | Merger specific                     |
| Non-Personnel Savings                          |                               |                                     |
| Non-Personnel Expenditures                     | Not verified                  | Merger specific                     |
| IT (Licensing/Subscriptions/Contract Services) | Not verified                  | Merger specific                     |
| Facilities                                     | Verified                      | Merger specific                     |
| Audit & Listing Fees                           | Partially verified            | Merger specific                     |

Source: CP/KCS Application, Vol I, p. 74 (Appendix B - Summary of Benefits Exhibit)

## Exhibit III-2

### Summary of Benefits ("Claimed Efficiencies")

*USD million*

| SUMMARY OF BENEFITS                   | NORMAL<br>YEAR |
|---------------------------------------|----------------|
| Benefit Component                     |                |
| <b><u>OPERATING REVENUE GAINS</u></b> |                |
| Revenue Increase from Traffic Gains   | 1,021.9        |
| Cost of Handling Added Traffic:       | (306.3)        |
| Net Revenue Gains                     | <b>715.6</b>   |
| <br><b><u>OPERATING BENEFITS</u></b>  |                |
| Mechanical                            | 19.9           |
| Transportation                        | 62.5           |
| Equipment Requirements                | 12.8           |
| Purchasing (Procurement)              | 20.5           |
| Subtotal                              | 115.7          |
| Support Functions (G&A)               | 57.1           |
| Total Operating Benefits              | 172.8          |
| Employee Separation/Relocation        | -              |
| <b>Total Merger Benefits</b>          | <b>888.4</b>   |

Source: CP/KCS Application Vol I, p. 74 (Appendix B - Summary of Benefits Exhibit)

**Exhibit III-3**  
**Claimed Personnel Savings**  
**KCS Corporate Risk Executives**

*USD thousands*

| Description  | Formula               | Run Rate                            | Source  | Verifiability  |
|--|-----------------------|-------------------------------------|---|----------------|
| KCS corporate risk executive salary                          | [a]                   | {{                      }}<br>_____ | FD 36500 – Work Paper – HC – summary of benefits<br>SG&A.xlsx | Verifiable     |
| Incentive compensation multiplier                            | [b]                   | {{                      }}<br>_____ | FD 36500 – Work Paper – HC – summary of benefits<br>SG&A.xlsx | Verifiable     |
| Expected incentive compensation                              | [c] = [a] x [b]       | {{                      }}<br>_____ | Calculation   | Verifiable     |
| Fringe rates multiplier                                      | [d]                   | {{                      }}<br>_____ | FD 36500 – Work Paper – HC – summary of benefits<br>SG&A.xlsx | Verifiable     |
| Expected fringe rates compensation                           | [e] = [a] x [d]       | {{                      }}<br>_____ | Calculation   | Verifiable     |
| Total KCS corporate risk executive compensation per employee | [f] = [a] + [c] + [e] | {{                      }}<br>_____ | Calculation   | Verifiable     |
| Number of KCS corporate risk executive employees terminated  | [g]                   | {{                      }}<br>_____ | FD 36500 – Work Paper – HC – summary of benefits<br>SG&A.xlsx | Not verifiable |
| KCS corporate risk executive savings                         | [h] = [f] x [g]       | {{                      }}<br>_____ | Calculation   | Not verifiable |
| <b>Magnitude of verifiable run-rate savings</b>              | <b>n/a</b>            | <b>-</b>                            | <b>Not verifiable</b>   |                |

Notes and sources:

Source: FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx

### Exhibit III-4 Claimed Non-Personnel Expenditures Savings

*USD thousands*

| Description                                     | Formula         | Run Rate                   | Source   | Verifiability  |
|---|-----------------|----------------------------|--|----------------|
| Variable KCS G&A per employee                   | [a]             | {{                      }} | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Verifiable     |
| KCS headcount reduction                         | [b]             | {{                      }} | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| KCS non-personnel expenditures savings          | [c] = [a] x [b] | {{                      }} | Calculation  | Not verifiable |
| Variable CP G&A per employee                    | [d]             | {{                      }} | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Verifiable     |
| CP headcount reduction                          | [e]             | {{                      }} | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| CP non-personnel expenditures savings           | [f] = [d] x [e] | {{                      }} | Calculation  | Not verifiable |
| Total non-personnel expenditures savings        | [g] = [c] + [f] | {{                      }} | Calculation  | Not verifiable |
| <b>Magnitude of verifiable run-rate savings</b> | <b>n/a</b>      | <b>-</b>                   | <b>Not verifiable</b>                                      |                |

Notes and sources:

Source: FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx

### Exhibit III-5 Claimed IT Savings

*USD thousands*

| Description   | Formula   | Run Rate | Source   | Verifiability  |
|---|---|----------|--|----------------|
| Infrastructure licensing  | [a]   | {{       | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| Network   | [b]   | {{       | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| SAP Licensing/maintenance rationalization and renegotiate                               | [c]   | {{       | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| Microsoft licensing rationalization and renegotiate                                     | [d]   | {{       | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| ServiceNow licensing rationalization and renegotiate                                    | [e]   | {{       | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| License rationalization and renegotiation of remainder of licenses not identified above | [f]   | {{       | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| Transition managed services to Insource   | [g]   | {{       | FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx | Not verifiable |
| IT Savings  | [h] = [a] + [b] + [c]<br>+ [d] + [e] + [f] +<br>[g] | {{       | Calculation  | Not verifiable |
| <b>Magnitude of verifiable run-rate savings</b>   | <b>n/a</b>  | <b>-</b> | <b>Not verifiable</b>                                      |                |

Notes and sources:

Source: FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx

### Exhibit III-6 Claimed Audit and Listing Fees Savings

*USD thousands*

| Description                                     | Formula         | Run Rate                          | Source  | Verifiability  |
|---|-----------------|-----------------------------------|---|----------------|
| Listing fees                                    | [a]             | {{                      }}        | FD 36500 – Work Paper – HC – summary of benefits<br>SG&A.xlsx | Verifiable     |
| Auditor fees                                    | [b]             | {{                      }}        | FD 36500 – Work Paper – HC – summary of benefits<br>SG&A.xlsx | Not verifiable |
| Audit & Listing Fees                            | [c] = [a] + [b] | {{                      }}        | Calculation   | Not verifiable |
| <b>Magnitude of verifiable run-rate savings</b> | <b>[a]</b>      | <b>{{                      }}</b> | <b>Verifiable</b>   |                |

Notes and sources:

Source: FD 36500 – Work Paper – HC – summary of benefits SG&A.xlsx

## **APPENDIX A – QUALIFICATIONS**

1. I specialize in the areas of accounting, economics, and finance as they relate to valuation, financial analysis, and security analysis, or more generally, financial economics. I am Professor Emeritus at The University of Chicago Booth School of Business, and previously held the Charles T. Horngren Professorship and the Leon Carroll Marshall Professorship in my 30-year career at Chicago Booth. In addition to my faculty duties, I also held the positions of Deputy Dean and the PhD Program faculty director at Chicago Booth. I was also the faculty director of the University of Chicago's Center for Research in Security Prices, which is widely recognized for its expertise in building and maintaining historical, academic, research-quality stock market databases.
2. I earned my BS in 1976, MBA in 1981, and PhD (PhD with major in accounting and minors in economics and finance) in 1983, all from the State University of New York at Buffalo. In addition to The University of Chicago, I have taught at the State University of New York at Buffalo and at York University in Toronto, Canada. I have taught various courses in accounting (financial accounting, managerial accounting, and advanced accounting/mergers and acquisitions), finance (corporate finance, financial strategy and corporate transactions, financial analysis, and valuation of companies and corporate transactions), and entrepreneurship.
3. My research focuses on firm valuation, the pricing of securities, including publicly traded securities, and the ways in which various capital market participants use information to value securities. I have taught courses in financial and managerial accounting, mergers and acquisition accounting, financial analysis, corporate valuation, and financial strategy. I have published articles in academic journals in the areas of accounting and financial economics and also co-authored a textbook (with Professor Robert Holthausen of The

Wharton School of the University of Pennsylvania) on how to value companies, parts of companies, and the securities issued by companies, titled *Corporate Valuation: Theory, Evidence and Practice*. I have been an Associate Editor of *The Accounting Review* and have been on the Editorial Boards of both the *Journal of Accounting Research* and *The Accounting Review*.

4. I am a Senior Consultant to Charles River Associates, a consulting firm that provides economic, financial, and management consulting services. I am also a member of the Investment Committee at Patron Capital Partners (Funds IV and V), a private equity investment company with a focus on real estate related investments. I was a founding partner of Chicago Partners, LLC, which was acquired by Navigant Consulting. I am a former managing director of Navigant Economics (a subsidiary of Navigant Consulting) and a former member of the corporate executive committee of Navigant Consulting.
5. I have worked as a consultant or expert in litigation matters in U.S. state and federal courts, in the Supreme Court of Victoria in Australia, and in U.S. and international arbitrations. The issues on which I have worked include: business valuation and securities valuation (valuation of corporate transactions, companies, and parts of companies, intangible assets and intellectual property, and securities); securities litigation (Rule 10b-5, Section 11, Section 12, ERISA, Martin Act, effect of disclosures, analysis of how markets work, and insider trading); mergers and acquisitions (appraisals and price disputes, analyzing merger synergies, material adverse changes, corporate transactions, and the process of purchasing and selling companies); solvency and ability to pay (fraudulent conveyance, solvency assessment, and ability to pay government fines, analysis of debt covenants, renegotiation of terms of debt agreements, and debt

refinancing); antitrust litigation (analysis of merger efficiencies, failing firm defense, and financial analyses of alleged anticompetitive behavior); commercial and stockholder disputes (damages, accounting analyses, and economic assessment of transactions); accounting issues (measuring and analyzing revenue, cost structures, profitability, rates of return, interest rates, and other financial metrics and concepts); and creating and evaluating business plans. The frameworks and tools I use in my work are generally applicable to all industries, and I have applied my expertise in a broad range of sectors, including airline, auto, financial services, chemical, computer hardware and software, credit card and credit card security, energy, entertainment, for-profit education, health care, insurance, heavy and light manufacturing, pharmaceutical, retail, real estate investment funds, technology, telecommunications, transportation, investment companies/funds, investment advisory and brokerage companies, and others. My curriculum vitae, which is attached to this verified statement in Appendix A, details my qualifications, including my publications and testimonial experience within the last five years.

## Mark E. Zmijewski (Zme – yev’ -ski) Bio

Professor Zmijewski specializes in the areas of accounting, economics, and finance as they relate to valuation, financial analysis, and security analysis, or more generally, financial economics. He is Professor Emeritus at The University of Chicago Booth School of Business, and previously held the Charles T. Horngren Professorship and the Leon Carroll Marshall Professorship in his 30-year career at the Booth. In addition to his research and teaching activities, Professor Zmijewski also held the positions of Deputy Dean, Associate Dean for PhD Studies, and the Faculty Director of the Center for Research in Security Prices (CRSP), all at the Booth School of Business. Professor Zmijewski is a Senior Consultant to Charles River Associates, a consulting firm that provides economic, financial, and management consulting services. He is also a Senior Advisor to, and a member of, the Investment Committee at Patron Capital Partners (Funds IV and V), a private equity investment company with a focus on real estate related investments. Professor Zmijewski was a Founding Partner of Chicago Partners, LLC, which was acquired by Navigant Consulting. He is the former Managing Director of Navigant Economics (a subsidiary of Navigant Consulting) and a former member of the Corporate Executive Committee of Navigant Consulting.

Professor Zmijewski earned his BS in 1976, MBA in 1981, and PhD with a major in accounting and minors in economics and finance in 1983, all from the State University of New York at Buffalo. In addition to The University of Chicago, he has taught at the State University of New York at Buffalo and at York University in Toronto, Canada. He has taught various courses in accounting (financial accounting, managerial accounting, and advanced accounting/mergers and acquisitions), finance (corporate finance, financial strategy and corporate transactions, financial analysis, and valuation of companies and corporate transactions), and entrepreneurship. Professor Zmijewski’s research has focused on firm valuation and the ways in which various capital market participants use information to value securities. He has published articles in academic journals in the areas of accounting and financial economics and has co-authored a textbook (with Professor Robert Holthausen of The Wharton School of the University of Pennsylvania) on how to value companies, parts of companies, and the securities issued by companies, titled “Corporate Valuation: Theory, Evidence and Practice.” He has been an Associate Editor of *The Accounting Review*, and has been on the Editorial Boards of both the *Journal of Accounting Research* and *The Accounting Review*.

Professor Zmijewski has worked as a consultant or expert in litigation matters in US state and federal courts, in the Ontario Superior Court of Justice in Canada, in the Supreme Court of Victoria in Australia, and in US and international arbitrations. The issues on which he has consulted include: business valuation and securities valuation (valuation of corporate transactions, companies, and parts of companies, intangible assets and intellectual property, and securities); securities litigation (10b-5, section 11, section 12, ERISA, Martin Act, and insider trading); material adverse changes; mergers and acquisitions (appraisals and price disputes, analyzing merger synergies, corporate transactions, and the process of purchasing and selling companies); solvency and ability to pay (fraudulent conveyance, solvency assessment, and ability to pay government fines); antitrust litigation (analysis of merger efficiencies, failing firm defense, and financial analyses of alleged anticompetitive behavior); commercial and stockholder disputes (measurement of damages, accounting analyses, and economic assessment of transactions); accounting issues (measuring and analyzing revenue, cost structures, profitability, rates of return, interest rates, and other financial metrics and concepts); and creating and evaluating business plans.

The frameworks and tools used in his work are generally applicable to all industries, and he has applied his expertise in a broad range of sectors, including the airline, auto, chemical, computer hardware and software, credit card, energy, entertainment, financial services, for-profit education, health care, insurance, heavy and light manufacturing, pharmaceutical, retail, real estate investment fund, technology, telecommunications, and transportation industries, among others.

**Mark E. Zmijewski**  
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Senior Consultant

PhD, Accounting  
State University of New York  
at Buffalo

MBA, Accounting  
State University of New York  
at Buffalo

BA, Accounting  
State University of New York  
at Buffalo

## Academic employment

|              |  |
|--------------|--|
| 1984–Present | The University of Chicago Booth School of Business<br><i>Professor Emeritus</i> (2018–Present)<br><i>Charles T. Horngren Professor of Accounting</i> (2015–2018)<br><i>Leon Carroll Marshall Professor of Accounting</i> (1999–2015)<br><i>Deputy Dean</i> (1996–2011)<br><i>Professor of Accounting</i> (1992–1999)<br><i>Associate Dean for PhD Studies</i> (1995–1996)<br><i>Executive Director, Center for Research in Securities Prices (CRSP)</i><br>(1992–1998)<br><i>Associate Professor of Accounting</i> (1988–1992)<br><i>Assistant Professor of Accounting</i> (1984–1988) |
| 1980–1984    | <i>Assistant Professor of Accounting</i> , State University of New York at Buffalo   |
| 1979–1982    | <i>Course Director</i> , York University, Toronto Canada   |
| 1977–1980    | <i>Teaching Assistant</i> , State University of New York at Buffalo  |

## Honors and awards

Business Information Professional of the Year—Education, Beta Alpha Psi, 2007.

Hillel J. Einhorn Excellence in Teaching Award, The Executive MBA Program, The University of Chicago Graduate School of Business, 1999.

Emory Williams Award for Excellence in Teaching, The University of Chicago, 1988

Competitive Manuscript Award, American Accounting Association, 1984.

Beta Alpha Psi, Honorary Accounting Society, 1981.

Beta Gamma Sigma, Honorary Business Society, 1980.

## Grants

Research Grant, SEC and Financial Reporting Institute, 1985.

University Fellowship, State University of New York at Buffalo, 1979.

Graduate Fellowship, State University of New York at Buffalo, 1976–1978.

## Publications

*Corporate Valuation: Theory, Evidence and Practice (textbook)*. With Robert W. Holthausen, Cambridge Business Publishers, LLC, 1<sup>st</sup> Edition, 2014; 2nd edition, 2020.

“Valuation with Market Multiples: How to Avoid Pitfalls When Identifying and Using Comparable Companies.” With R. Holthausen. *Journal of Applied Corporate Finance*, Summer 2012.

“Pitfalls in Levering and Unlevering Beta and Cost of Capital Estimates in DCF Valuations.” With R. Holthausen. *Journal of Applied Corporate Finance*, Summer 2012.

“Accounting and Disclosure Issues in Structured Finance.” With Keith Bockus and W. Dana Northcut. In *Corporate Aftershock: The Public Policy Lessons from the Collapse of Enron and Other Major Corporations*, C.L. Culp and W.A. Niskanen, eds., Wiley, 2003.

“Discovery and the Financial Analyst.” With Roger Hickey. *Litigation Services Handbook*, January 1995.

“How Useful Are *Wall Street Week* Stock Recommendations?” With P. Griffin and J. Jones. *Journal of Financial Statement Analysis*, Fall 1995.

“Contemporaneous Announcements of Dividends and Earnings.” With R. Leftwich. *Journal of Accounting, Auditing, and Finance*, Autumn 1994.

“The Relative Informativeness of Accounting Disclosures in Different Countries.” With A. Alford, J. Jones, and R. Leftwich. *Journal of Accounting Research*, Supplement, 1993.

“Extensions and Violations of the Statutory SEC Form 10-K Filing Requirements.” With A. Alford and J. Jones. *Journal of Accounting and Economics*, 1993.

“SEC Form 10-K/10-Q Reports and Annual Reports to Shareholders: Reporting Lags and Squared Market Model Prediction Errors.” With P. Easton. *Journal of Accounting Research*, Winter 1993.

*The Phish Corporation: A Practice Case in Managerial Accounting*, With R. Derstine, R. Huefner, and S. Gunn. McGraw-Hill, 1991.

“Cross-Sectional Variation in the Stock Market Response to the Announcement of Accounting Earnings.” With P. Easton. *Journal of Accounting and Economics*, 1989.

“An Evaluation of Alternative Proxies for the Market’s Expectation of Earnings.” With L. Brown, P. Griffin, and R.L. Hagerman. *Journal of Accounting and Economics*, 1987.

“Predictive Value of Accounting Information.” With P. Griffin. In *Usefulness to Investors and Creditors of Information Provided by Financial Reporting*, 2<sup>nd</sup> Edition, P. Griffin, ed. Financial Accounting Standards Board, 1987.

“Security Analyst Superiority Relative to Univariate Time-Series Models in Forecasting Quarterly Earnings.” With L. Brown, P. Griffin, and R. Hagerman. *Journal of Accounting and Economics*, 1987.

“The Effect of Labor Strikes on Security Analysts’ Forecast Superiority and on the Association between Risk-Adjusted Stock Returns and Unexpected Earnings.” With L. Brown. *Contemporary Accounting Research*, 1987.

“Estimating Models with Binary Dependent Variables: Some Theoretical and Empirical Observations.” With G. Gessner, W. Kamakura, and N. Malhotra. *Journal of Business Research*, 1987.

“Methodological Issues Related to the Estimation of Financial Distress Prediction Models.” *Journal of Accounting Research*, 1984.

“The Association Between the Magnitude of Quarterly Earnings Forecast Errors and Risk-Adjusted Stock Returns.” With R.L. Hagerman and P. Shah. *Journal of Accounting Research*, 1984.

“An Income Strategy Approach to the Positive Theory of Accounting Policy Setting/Choice.” With R.L. Hagerman. *Journal of Accounting and Economics*, 1981. Reprinted in *The Economics of Accounting Policy Choice*, Ray Ball and Clifford Smith, Jr., eds. McGraw-Hill, 1992.

“A Test of Accounting Bias and Market Structure: Some Additional Evidence.” With R.L. Hagerman. *Review of Business and Economic Research*, 1981.

“Some Economic Determinants of Accounting Policy Choice.” With R.L. Hagerman. *Journal of Accounting and Economics*, 1979.

Comments on “Earnings Forecasting Research: Its Implications for Capital Markets Research.” *International Journal of Forecasting*.

## Dissertation committees

Sandip Madan, The University of Chicago, 1999, Member

Keith Bockus, The University of Chicago, 1998, Co-Chairperson

Beverly Walther, The University of Chicago, 1995, Member

Howard Bunsis, The University of Chicago, 1993, Co-Chairperson

Phillip Berger, The University of Chicago, 1992, Member

Stuart Essig, The University of Chicago, 1991, Member

Sherri Jarrell, The University of Chicago, 1991, Member

Andrew Alford, The University of Chicago, 1990, Chairperson

Mark Lang, The University of Chicago, 1990, Member

Laureen Maines, The University of Chicago, 1990, Member

Walter Teets, The University of Chicago, 1988, Member

Siew Teoh, The University of Chicago, 1988, Member

Kirsten Ely, The University of Chicago, 1988, Member

M. Daniel Beneish, The University of Chicago, 1987, Member

Pat O'Brien, The University of Chicago, 1986, Member

W. Forbes Cavanagh, State University of New York at Buffalo, 1985, Member

## University activities

Accounting Advisory Counsel, State University of New York at Buffalo, 1993–1995.

Faculty Facilitator, Leadership, Education, and Development (LEAD) Program, The University of Chicago, Graduate School of Business, 1989, 1991.

Dean's Advisory Committee on MBA Students and Curriculum, The University of Chicago, 1988.

Executive Director, Management Development Council, State University of New York at Buffalo, 1981–1984.

Advisor, Center for Management Development, State University of New York at Buffalo, 1979–1980.

## Editorial service and boards

Associate Editor, *The Accounting Review*, 1993–1997.

Editorial Board, *Journal of Accounting Research*, 1988–1993.

Editorial Board, *The Accounting Review*, 1985–1987.

## Ad hoc referee

*Journal of Accounting, Auditing, and Finance*

*The Accounting Review*

*Contemporary Accounting Research*

*The Financial Review*

*Journal of Accounting and Economics*

*Journal of Accounting Research*

*Journal of Banking and Finance*

*Journal of Business*

*Journal of Forecasting*

*International Journal of Forecasting*

*Management Science*

## Professional organizations

American Accounting Association

The American Finance Association

## Testimony, declarations, and other court filings and submissions in the past five years

*Cineplex, Inc., Plaintiff, v. Cineworld Group PLC and 1232743 B.C. Ltd., Defendants.* In the Ontario Superior Court of Justice (Commercial List), Case No. CV-20-00643387-00CL. Expert Report July 15, 2021. Reply Expert Report August 16, 2021. Trial testimony October 4, 2021.

*In the Matter of the Amalgamation Agreement Between JMH Investments Limited and JMH Bermuda Limited and Jardine Strategic Holdings Limited and In the Matter of Section 106 of the Companies Act 1981.* In the Supreme Court of Bermuda Civil Jurisdiction (Commercial Court). Affidavit filed September 21, 2021.

*Hollywood Firefighters' Pension Fund, West Palm Beach Firefighters' Pension Fund, and Sheet Metal Workers' Local Union No. 80 Pension Trust Fund, on behalf of themselves and all similarly situated v. John C. Malone, Gregory B. Maffei, Gregg L. Engles, Ronald A. Duncan, Donne F. Fischer, and Richard R. Green.* In the Court of Chancery of the State of Delaware, Case No. 2020-0880-SG. Declaration filed September 14, 2021.

*US Airways, Inc., for American Airlines, Inc., (as Successor and Real Party in Interest) v. Sabre Holdings Corporation; Sabre GBL Inc.; and Sabre Travel International Limited.* In the United States District Court Southern District of New York, Civil Action No. 1:11-cv-02725 (LGS). Deposition testimony August 24, 2021.

*Joint Petition for Rulemaking to Modernize Annual Revenue Adequacy Determinations on Behalf of Canadian National Railway, Norfolk Southern Railway and Union Pacific Railroad Company.* Before the Surface Transportation Board. Verified Statement of Professor Kevin M. Murphy and Professor Mark E. Zmijewski, September 1, 2020. Supplemental Verified Statement of Professor Kevin M. Murphy and Professor Mark E. Zmijewski, October 13, 2020. Reply Verified Statement of Professor Kevin M. Murphy and Professor Mark E. Zmijewski, August 16, 2021.

*Ahmed D. Hussein, Plaintiff, v. Sheldon Razin et al., Defendants.* In the Superior Court of the State of California For the County of Orange, Case No. 30-2013-00679600-CU-NP-CJC. Deposition testimony June 10, 2015. Deposition testimony October 28, 2020. Trial testimony July 23, 2021.

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*Fairbank Reconstruction Corp. v. Greater Omaha Packing Co. Inc.* In the United States District Court for the Western District of New York, Case No. 1:13-cv-00907. Deposition testimony December 3, 2020.

*Norman Leslie Wills and Jane Anne Danaher (as Trustees for the Minty Tin Superannuation Fund), v. Woolworths Group Ltd (formerly Woolworths Ltd), Respondent.* In the Federal Court of Australia Victoria Registry, Case No. VID 1131/2018. Expert Report February 17, 2020, Expert Rebuttal Report October 30, 2020.

*Railroad Revenue Adequacy – 2019 Determination.* Before the Surface Transportation Board. Verified Statement of Professor Kevin M. Murphy and Professor Mark E. Zmijewski, October 21, 2020.

*Federal Trade Commission v. Peabody Energy Corporation and Arch Coal, Inc.* In the United States District Court for the Eastern District of Missouri, C.A. No 4:20-cv-00317-SEP. Deposition testimony June 26, 2020. Trial testimony July 24, 2020.

*Zantran Pty Limited, Applicant vs. Crown Resorts Limited, Respondent.* In the Federal Court of Australia Victoria Registry, Case No. VID 1317/2017. Expert Report April 18, 2019, Expert Rebuttal Report March 27, 2020, Joint Expert Report June 18, 2020.

*Alison Court, et al., Applicants vs. Spotless Group Holdings Limited, Respondent.* In the Federal Court of Australia Victoria Registry, Case No. VID 561/2017. Expert Report December 22, 2019, Expert Rebuttal Report March 25, 2020.

*In Re American Realty Capital Properties, Inc. Litigation.* In the United States District Court for the Southern District of New York, C.A. No. 1:15-mc-00040-AKH. Deposition testimony July 26, 2019.

*In Re Appraisal of Jarden Corporation.* In the Court of Chancery of the State of Delaware, Consol. C.A. No. 12456-VCS. Deposition testimony May 2, 2018. Trial testimony June 26, 2018 and June 28, 2018. Affidavit July 26, 2019.

*In Re Bracket Holding Corp. Litigation.* In the Superior Court of the State of Delaware, Consol. C.A. No. N15C-02-233 WCC CCLD. Deposition testimony September 20, 2018. Affidavit July 25, 2019.

*Nathan F. Brand et al. v. William A. Linton and Promega Corporation.* State of Wisconsin Dane County Circuit Court, Case No. 2016CV001978. Deposition testimony November 14, 2018. Trial testimony July 22, 2019.

*Precision Castparts Corp. and PCC Germany Holdings GMBH v. Schulz Holding GMBH & Co. KG, et al.* International Centre For Dispute Resolution, American Arbitration Association, Case No. 01-18-0001-0115. First witness statement November 16, 2018. Second witness statement May 17, 2019. Arbitration testimony July 1, 2019.

*Reynolds American Inc. v. Third Motion Equities Master Fund Ltd, et al.* State of North Carolina Forsythe County. In the General Court of Justice, Superior Court Division, Case No. 17 CVS 7086. Deposition testimony April 17, 2019. Trial testimony June 17, 2019.

*In Re Appraisal of Stillwater Mining Company.* In the Court of Chancery of the State of Delaware. Consol. C.A. No. 2017-0385-JTL. Deposition testimony November 27, 2018. Trial testimony December 13, 2018.

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In Re *Appraisal of Columbia Pipeline Group, Inc.* In the Court of Chancery of the State of Delaware, Consol. C.A. No. 12736-VCL. Deposition testimony August 14, 2018. Trial testimony November 2, 2018.

*Federal Trade Commission v. Tronox Limited, et al.* In the United States District Court for the District of Columbia, Docket No. D09377. Deposition testimony May 15, 2018. Trial testimony May 31, 2018.

*Brian Jones, Applicant vs. Treasury Wine Estates Limited, Respondent.* In the Federal Court of Australia District of New South Wales, Case No. NSD 660 of 2014. Expert Report February 4, 2017, Expert Rebuttal Report July 10, 2017, Supplemental Expert Rebuttal Report August 17, 2017.

*Money Max Int Pty Limited (ACN 152 073 580), as a trustee for the Goldie Superannuation Fund, Applicant vs. QBE Insurance Group Limited (ACN 008 485 014), Respondent.* In the Federal Court of Australia, Case No. VID 513 of 2015. Expert Report August 10, 2017.

*United States of America v. Bumble Bee Foods, LLC.* In the United States District Court, Northern District of California, San Francisco Division, Case No. 17-CR-00249 CRB. Presentations before the U.S. Department of Justice, Antitrust Division September 20, 2016 and January 9, 2017. Declaration filed July 18, 2017.

*Authenticom, Inc. v. CDK Global, LLC and The Reynolds and Reynolds Company.* In the United States District Court for the Western District of Wisconsin, Case No. 17-CV-318. Declaration filed June 16, 2017. Trial testimony June 28, 2017.

*United States Securities and Exchange Commission v. ITT Educational Services, Inc. et al.* In the United States District Court, Southern District of Indiana, Indianapolis Division, Case No. 15-CV-00758. Deposition testimony May 10, 2017.

*In the matter of Determination of Rates and Terms for Making and Distributing Phonorecords (Phonorecords III).* Before the Copyright Royalty Board Library of Congress, Washington, D.C., Docket No. 16-CRB-0003-PR (2018-2022). Trial testimony April 12, 2017.

*PharMerica Corporation et al. v. AmerisourceBergen Drug Corporation v. BGS Pharmacy Holding Company et al.* In the Jefferson Circuit Court Division Ten (10), Case No. 14-CI-004682. Deposition testimony April 4, 2017.

In Re *Caesars Entertainment Operating Company, Inc., et al. Chapter 11 Bankruptcy Case.* In the United States Bankruptcy Court for the Northern District of Illinois Eastern Division, Case No. 15-01145 (ABG). Declaration filed December 2, 2016.

**APPENDIX B – CP’S PRO FORMA EXHIBITS**

**Exhibit B-I**  
**Canadian Pacific Railway (CP)**  
**Recreated Pro-Forma Income Statement**

| (\$ in Millions)  | CP<br>HISTORICAL<br>2019               |                    | CP               |                  |
|---|--|--------------------|------------------|------------------|
|   | AS REPORTED                            |                    | CP               | CP               |
|   | <u>US GAAP</u>                         | <u>ADJUSTMENTS</u> | <u>BASE YEAR</u> | <u>BASE YEAR</u> |
|   | \$CDN<br>(1)                           | \$CDN<br>(2)       | \$CDN<br>(3)     | \$USD<br>(4)     |
| TOTAL REVENUES  | \$ 7,792                               | \$ -               | \$ 7,792         | \$ 5,999         |
|   | <i>OPERATING EXPENSES</i>              | 3,962              | 3,962            | 3,050            |
|   | <i>DEPRECIATION &amp; AMORTIZATION</i> | 706                | 706              | 544              |
| TOTAL OPERATING EXPENSES  | 4,668                                  | -                  | 4,668            | 3,594            |
| OPERATING INCOME  | \$ 3,124                               | \$ -               | \$ 3,124         | \$ 2,405         |
| LESS: OTHER (INCOME) EXPENSES   | (470)                                  | 94                 | (376)            | (290)            |
| INCOME BEFORE INTEREST AND INCOME TAXES                                 | \$ 3,594                               | \$ (94)            | \$ 3,500         | \$ 2,695         |
| <i>EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION &amp; AMORTIZATION</i> | \$ 4,300                               | \$ (94)            | \$ 4,206         | \$ 3,239         |
| NET INTEREST EXPENSE  | 448                                    | -                  | 448              | 345              |
| INCOME BEFORE INCOME TAX EXPENSE  | 3,146                                  | (94)               | 3,052            | 2,350            |
| INCOME TAX EXPENSE  | 706                                    | 56                 | 762              | 587              |
| LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTEREST                | -                                      | -                  | -                | -                |
| NET INCOME  | \$ 2,440                               | \$ (150)           | \$ 2,290         | \$ 1,763         |

## NOTES TO PRO FORMA INCOME STATEMENT

CP  
BASE YEAR

1. CP HISTORICAL 2019 AS REPORTED: Represents CP's 2019 income statement as reported under US GAAP in its 2019 Annual Report on Form 10-K.
2. ADJUSTMENTS: Represents adjustments made to eliminate effects on CP's income statement of the following non-recurring transactions as reported in 2019:
  - (1) a deferred tax expense of \$24 million as a result of a provision for an uncertain tax item of a prior period;
  - (2) a deferred tax recovery of \$88 million due to the change in the Alberta provincial corporate income tax rate;
  - (3) a net non-cash gain of \$94 million (\$86 million after \$8 million deferred tax) due to foreign exchange translation of debt and lease liabilities.
3. CP BASE YEAR: Represents CP's 2019 income statement as reported in the 2019 Annual Report on Form 10-K revised to include the adjustments indicated in 2.
4. CP BASE YEAR \$USD: Represents the CP Base Year stated in \$CDN (3. above) converted to \$USD using a conversion factor of \$CDN 1 equals 0.7699, which was the exchange rate as of December 31, 2019 from the Bank of Canada.

Bank of Canada December 31, 2019 Exchange Rate

|                 |        |
|-----------------|--------|
| Canadian\$/US\$ | 1.2988 |
| US\$/Canadian\$ | 0.7699 |

Source: CP/KCS Application, vol. 1, Appendix F (Exhibit 17), pp. 1-2.

**Exhibit B-II**  
**Canadian Pacific Railway (CP)**  
**Recreated Pro-Forma Balance Sheet**

| (\$ in Millions)                                  | CP<br>HISTORICAL<br>2019        |               |                  |                  |
|---|---------------------------------|---------------|------------------|------------------|
|   | AS REPORTED                     |               | CP               |                  |
|   | US GAAP                         | ADJUSTMENTS   | BASE YEAR        | BASE YEAR        |
|   | \$CDN<br>(1)                    | \$CDN<br>(2)  | \$CDN<br>(3)     | \$USD<br>(4)     |
| <b>ASSETS</b>                                     |                                 |               |                  |                  |
| <b>CURRENT ASSETS</b>                             |                                 |               |                  |                  |
| CASH AND CASH EQUIVALENTS                         | \$ 133                          | \$ 909        | \$ 1,042         | \$ 802           |
| ACCOUNTS RECEIVABLE, NET                          | 805                             | -             | 805              | 620              |
| MATERIALS AND SUPPLIES                            | 182                             | -             | 182              | 140              |
| OTHER CURRENT ASSETS                              | 90                              | -             | 90               | 69               |
| <b>TOTAL CURRENT ASSETS</b>                       | <b>1,210</b>                    | <b>909</b>    | <b>2,119</b>     | <b>1,631</b>     |
|   | <i>GROSS PROPERTIES</i>         | 27,255        | -                | 27,255           |
|   | <i>ACCUMULATED DEPRECIATION</i> | (8,099)       | -                | (8,099)          |
| PROPERTIES, NET                                   | 19,156                          | -             | 19,156           | 14,749           |
| OTHER ASSETS                                      | 2,001                           | -             | 2,001            | 1,541            |
| <b>TOTAL ASSETS</b>                               | <b>\$ 22,367</b>                | <b>\$ 909</b> | <b>\$ 23,276</b> | <b>\$ 17,921</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>       |                                 |               |                  |                  |
| <b>CURRENT LIABILITIES</b>                        |                                 |               |                  |                  |
| ACCOUNTS PAYABLE AND ACCRUED LIABILITIES          | \$ 1,693                        | \$ -          | \$ 1,693         | \$ 1,304         |
| LONG-TERM DEBT MATURING WITHIN ONE YEAR           | 599                             | -             | 599              | 461              |
| <b>TOTAL CURRENT LIABILITIES</b>                  | <b>2,292</b>                    | <b>-</b>      | <b>2,292</b>     | <b>1,765</b>     |
| LONG-TERM DEBT                                    | 8,158                           | -             | 8,158            | 6,281            |
| DEFERRED INCOME TAXES                             | 3,501                           | -             | 3,501            | 2,695            |
| OTHER LONG-TERM LIABILITIES                       | 1,347                           | -             | 1,347            | 1,037            |
| <b>TOTAL LIABILITIES</b>                          | <b>15,298</b>                   | <b>-</b>      | <b>15,298</b>    | <b>11,778</b>    |
| <b>SHAREHOLDERS' EQUITY</b>                       |                                 |               |                  |                  |
| SHARE CAPITAL                                     | 1,993                           | -             | 1,993            | 1,535            |
| ADDITIONAL PAID-IN CAPITAL                        | 48                              | -             | 48               | 37               |
| ACCUMULATED OTHER COMPREHENSIVE LOSS              | (2,522)                         | -             | (2,522)          | (1,942)          |
| RETAINED EARNINGS                                 | 7,550                           | 909           | 8,459            | 6,513            |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                 | <b>7,069</b>                    | <b>909</b>    | <b>7,978</b>     | <b>6,143</b>     |
| NONCONTROLLING INTEREST                           | -                               | -             | -                | -                |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <b>\$ 22,367</b>                | <b>\$ 909</b> | <b>\$ 23,276</b> | <b>\$ 17,921</b> |

## NOTES TO PRO FORMA BALANCE SHEET

CP

BASE YEAR

1. CP HISTORICAL 2019 AS REPORTED: Represents CP's 2019 balance sheet as reported under US GAAP in its 2019 Annual Report on Form 10-K.

2. ADJUSTMENTS: Represents \$US 700 million merger termination fee paid to CP in Q2 2021.

3. CP BASE YEAR: Represents CP's 2019 balance sheet as reported in the 2019 Annual Report on Form 10-K.

4. CP BASE YEAR \$USD: Represents the CP Base Year stated in \$CDN (3. above) converted to \$USD using a conversion factor of \$CDN 1 equals 0.7699, which was the exchange rate as of December 31, 2019 from the Bank of Canada.

Bank of Canada December 31, 2019 Exchange Rate

Canadian\$/US\$ 1.2988

US\$/Canadian\$ 0.7699

Source: CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 1-2.

**Exhibit B-III**  
**Canadian Pacific Railway (CP)**  
**Recreated Pro-Forma Statement of Cash Flows**

| (\$ in Millions)   | CP<br>HISTORICAL<br>2019 |                    |                  |                  |
|--|--------------------------|--------------------|------------------|------------------|
|  | AS REPORTED              |                    | CP               |                  |
|  | <u>US GAAP</u>           | <u>ADJUSTMENTS</u> | <u>BASE YEAR</u> | <u>BASE YEAR</u> |
|  | \$CDN<br>(1)             | \$CDN<br>(2)       | \$CDN<br>(3)     | \$USD<br>(4)     |
| <b>OPERATING ACTIVITIES</b>  |                          |                    |                  |                  |
| NET INCOME   | \$ 2,440                 | \$ (150)           | \$ 2,290         | \$ 1,763         |
| RECONCILIATION OF NET INCOME TO CASH PROVIDED BY OPERATING ACTIVITIES:                   |                          |                    |                  |                  |
| DEPRECIATION AND AMORTIZATION  | 706                      |                    | 706              | 544              |
| DEFERRED INCOME TAX  | 181                      | 56                 | 237              | 182              |
| OTHER OPERATING ACTIVITIES, NET  | (311)                    | 94                 | (217)            | (167)            |
| CHANGE IN NON-CASH WORKING CAPITAL BALANCES RELATED TO OPERA                             | (26)                     | -                  | (26)             | (20)             |
| CASH PROVIDED BY OPERATING ACTIVITIES  | <u>2,990</u>             | <u>-</u>           | <u>2,990</u>     | <u>2,302</u>     |
| <b>INVESTING ACTIVITIES</b>  |                          |                    |                  |                  |
| ADDITIONS TO PROPERTIES  | (1,647)                  | -                  | (1,647)          | (1,268)          |
| OTHER INVESTING ACTIVITIES   | (156)                    | 174                | 18               | 14               |
| CASH USED IN INVESTING ACTIVITIES  | <u>(1,803)</u>           | <u>174</u>         | <u>(1,629)</u>   | <u>(1,254)</u>   |
| <b>FINANCING ACTIVITIES</b>  |                          |                    |                  |                  |
| DIVIDENDS PAID   | (412)                    | -                  | (412)            | (317)            |
| ISSUANCE OF COMMON SHARES  | 26                       | -                  | 26               | 20               |
| PURCHASE OF COMMON SHARES  | (1,134)                  | -                  | (1,134)          | (873)            |
| ISSUANCE OF LONG-TERM DEBT (EXCLUDING COMMERCIAL PAPER)                                  | 397                      | -                  | 397              | 306              |
| REPAYMENT OF LONG-TERM DEBT (EXCLUDING COMMERCIAL PAPER)                                 | (500)                    | -                  | (500)            | (385)            |
| NET ISSUANCE OF SHORT-TERM DEBT AND COMMERCIAL PAPER                                     | 524                      | -                  | 524              | 403              |
| OTHER FINANCING ACTIVITIES   | (12)                     | -                  | (12)             | (9)              |
| CASH USED IN FINANCING ACTIVITIES  | <u>(1,111)</u>           | <u>-</u>           | <u>(1,111)</u>   | <u>(855)</u>     |
| EFFECT OF FOREIGN CURRENCY FLUCTUATIONS ON FOREIGN-DENOMINATED CASH AND CASH EQUIVALENTS | (4)                      | -                  | (4)              | (4)              |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                                     | <u>\$ 72</u>             | <u>\$ 174</u>      | <u>\$ 246</u>    | <u>\$ 189</u>    |

NOTES TO PRO FORMA SOURCES AND APPLICATION OF FUNDS (STATEMENT OF CASH FLOWS)

CP  
BASE YEAR

1. CP HISTORICAL 2019 AS REPORTED: Represents CP's 2019 sources and applications of funds as reported under US GAAP in its 2019 Annual Report on Form 10-K.  
2. ADJUSTMENTS: Represents adjustments made to eliminate effects on CP's sources and applications of funds of the following non-recurring transactions as reported in 2019:

- (1) a deferred tax expense of \$24 million as a result of a provision for an uncertain tax item of a prior period;
- (2) a deferred tax recovery of \$88 million due to the change in the Alberta provincial corporate income tax rate;
- (3) a net non-cash gain of \$94 million (\$86 million after \$8 million deferred tax expense) due to foreign exchange translation of debt and lease liabilities;
- (4) on December 30, 2019 CP invested \$174 million towards the purchase of 100% of Central Maine & Quebec Railway.

3. CP BASE YEAR: Represents CP's 2019 sources and applications of funds as reported in the 2019 Annual Report on Form 10-K revised to include the adjustments indicated in 2.

4. CP BASE YEAR \$USD: Represents the CP Base Year stated in \$CDN (3. above) converted to \$USD using a conversion factor of \$CDN 1 equals 0.7699, which was the exchange rate as of December 31, 2019 from the Bank of Canada.

Bank of Canada December 31, 2019 Exchange Rate

|                 |        |
|-----------------|--------|
| Canadian\$/US\$ | 1.2988 |
| US\$/Canadian\$ | 0.7699 |

Source: CP/KCS Application, vol. 1, Appendix G (Exhibit 18), pp. 1-2.

**Exhibit B-IV**  
**Kansas City Southern (KCS)**  
**Recreated Pro-Forma Income Statement**

| (\$US in Millions)  | KCS<br>HISTORICAL<br>2019              |                    | KCS              |  |
|---|--|--------------------|------------------|--|
|   | AS REPORTED                            |                    | KCS              |  |
|   | <u>US GAAP</u>                         | <u>ADJUSTMENTS</u> | <u>BASE YEAR</u> |  |
|   | (1)                                    | (2)                | (3)              |  |
| TOTAL REVENUES  | \$ 2,866                               | \$ -               | \$ 2,866         |  |
|   | <i>OPERATING EXPENSES</i>              | <i>(169)</i>       | <i>1,460</i>     |  |
|   | <i>DEPRECIATION &amp; AMORTIZATION</i> | <i>-</i>           | <i>351</i>       |  |
| TOTAL OPERATING EXPENSES  | 1,980                                  | (169)              | 1,811            |  |
| OPERATING INCOME  | \$ 886                                 | \$ 169             | \$ 1,055         |  |
| LESS: OTHER (INCOME) EXPENSES   | (18)                                   | 17                 | (1)              |  |
| INCOME BEFORE INTEREST AND INCOME TAXES                                 | \$ 904                                 | \$ 152             | \$ 1,056         |  |
| <i>EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION &amp; AMORTIZATION</i> | <i>\$ 1,255</i>                        | <i>\$ 152</i>      | <i>\$ 1,407</i>  |  |
| NET INTEREST EXPENSE  | 116                                    | -                  | 116              |  |
| INCOME BEFORE INCOME TAX EXPENSE  | 788                                    | 152                | 940              |  |
| INCOME TAX EXPENSE  | 247                                    | 3                  | 250              |  |
| LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTEREST                | 2                                      | -                  | 2                |  |
| NET INCOME  | <u>\$ 539</u>                          | <u>\$ 149</u>      | <u>\$ 688</u>    |  |

## NOTES TO PRO FORMA INCOME STATEMENT

KCS  
BASE YEAR

1. KCS HISTORICAL 2019 AS REPORTED: Represents KCS's 2019 income statement as reported under US GAAP in its 2019 Annual Report on Form 10-K.
2. ADJUSTMENTS: Represents adjustments made to eliminate effects on KCS's income statement of the following non-recurring transactions as reported in 2019:
  - (1) restructuring charges: \$169 million (\$125 million after \$44 million tax expense);
  - (2) foreign exchange gain: \$17 million (\$12 million after \$5 million tax expense);
  - (3) foreign exchange component of income taxes: \$36 million expense.
3. KCS BASE YEAR: Represents KCS's 2019 income statement as reported in the 2019 Annual Report on Form 10-K revised to include the adjustments indicated in 2.

Source: CP/KCS Application, vol. 1, Appendix F (Exhibit 17), pp. 3-4.

**Exhibit B-V**  
**Kansas City Southern (KCS)**  
**Recreated Pro-Forma Balance Sheet**

| (\$US in Millions)                                | KCS<br>HISTORICAL<br>2019       |                    |                        |
|---|---------------------------------|--------------------|------------------------|
|   | AS REPORTED                     |                    | KCS                    |
|   | <u>US GAAP</u>                  | <u>ADJUSTMENTS</u> | <u>BASE YEAR</u>       |
|   | (1)                             | (2)                | (3)                    |
| <b>ASSETS</b>                                     |                                 |                    |                        |
| <b>CURRENT ASSETS</b>                             |                                 |                    |                        |
| CASH AND CASH EQUIVALENTS                         | \$ 149                          | \$ -               | \$ 149                 |
| ACCOUNTS RECEIVABLE, NET                          | 274                             | -                  | 274                    |
| MATERIALS AND SUPPLIES                            | 151                             | -                  | 151                    |
| OTHER CURRENT ASSETS                              | 155                             | -                  | 155                    |
| <b>TOTAL CURRENT ASSETS</b>                       | <u>729</u>                      | <u>-</u>           | <u>729</u>             |
|   | <i>GROSS PROPERTIES</i>         | <i>11,496</i>      | <i>-</i>               |
|   | <i>ACCUMULATED DEPRECIATION</i> | <i>(2,690)</i>     | <i>-</i>               |
| <b>PROPERTIES, NET</b>                            | <b>8,806</b>                    | <b>-</b>           | <b>8,806</b>           |
| <b>OTHER ASSETS</b>                               | <b>252</b>                      | <b>-</b>           | <b>252</b>             |
| <b>TOTAL ASSETS</b>                               | <u><b>\$ 9,787</b></u>          | <u><b>\$ -</b></u> | <u><b>\$ 9,787</b></u> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>       |                                 |                    |                        |
| <b>CURRENT LIABILITIES</b>                        |                                 |                    |                        |
| ACCOUNTS PAYABLE AND ACCRUED LIABILITIES          | \$ 473                          | \$ -               | \$ 473                 |
| LONG-TERM DEBT MATURING WITHIN ONE YEAR           | 18                              | -                  | 18                     |
| <b>TOTAL CURRENT LIABILITIES</b>                  | <u>491</u>                      | <u>-</u>           | <u>491</u>             |
| LONG-TERM DEBT                                    | 3,228                           | -                  | 3,228                  |
| DEFERRED INCOME TAXES                             | 1,128                           | -                  | 1,128                  |
| OTHER LONG-TERM LIABILITIES                       | 194                             | -                  | 194                    |
| <b>TOTAL LIABILITIES</b>                          | <u>5,041</u>                    | <u>-</u>           | <u>5,041</u>           |
| <b>SHAREHOLDERS' EQUITY</b>                       |                                 |                    |                        |
| SHARE CAPITAL                                     | 7                               | -                  | 7                      |
| ADDITIONAL PAID-IN CAPITAL                        | 844                             | -                  | 844                    |
| ACCUMULATED OTHER COMPREHENSIVE LOSS              | (29)                            | -                  | (29)                   |
| RETAINED EARNINGS                                 | 3,601                           | -                  | 3,601                  |
| <b>TOTAL SHAREHOLDERS' EQUITY</b>                 | <u>4,423</u>                    | <u>-</u>           | <u>4,423</u>           |
| <b>NONCONTROLLING INTEREST</b>                    | <b>323</b>                      | <b>-</b>           | <b>323</b>             |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> | <u><b>\$ 9,787</b></u>          | <u><b>\$ -</b></u> | <u><b>\$ 9,787</b></u> |

## NOTES TO PRO FORMA BALANCE SHEET

KCS  
BASE YEAR

1. KCS HISTORICAL 2019 AS REPORTED: Represents KCS's 2019 balance sheet as reported under US GAAP in its 2019 Annual Report on Form 10-K.
2. ADJUSTMENTS: No adjustments were necessary to represent KCS's base year balance sheet.
3. KCS BASE YEAR: Represents KCS's 2019 balance sheet as reported in the 2019 Annual Report on Form 10-K.

**Source: CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 3-4.**

**Exhibit B-VI**  
**Kansas City Southern (KCS)**  
**Recreated Pro-Forma Statement of Cash Flows**

| (\$US in Millions)   | KCS<br>HISTORICAL<br>2019 |                           |                         |
|--|---------------------------|---------------------------|-------------------------|
|  | AS REPORTED               |                           | KCS                     |
|  | <u>US GAAP</u><br>(1)     | <u>ADJUSTMENTS</u><br>(2) | <u>BASE YEAR</u><br>(3) |
| <b>OPERATING ACTIVITIES</b>  |                           |                           |                         |
| NET INCOME   | \$ 541                    | \$ 149                    | \$ 690                  |
| RECONCILIATION OF NET INCOME TO CASH PROVIDED BY OPERATING ACTIVITIES:                   |                           |                           |                         |
| DEPRECIATION AND AMORTIZATION  | 351                       | -                         | 351                     |
| DEFERRED INCOME TAX  | 53                        | 3                         | 56                      |
| OTHER OPERATING ACTIVITIES, NET  | 168                       | (120)                     | 48                      |
| CHANGE IN NON-CASH WORKING CAPITAL BALANCES RELATED TO OPERATIONS                        | (10)                      | -                         | (10)                    |
| CASH PROVIDED BY OPERATING ACTIVITIES  | 1,103                     | 32                        | 1,135                   |
| <b>INVESTING ACTIVITIES</b>  |                           |                           |                         |
| ADDITIONS TO PROPERTIES  | (626)                     | -                         | (626)                   |
| OTHER INVESTING ACTIVITIES   | (50)                      | -                         | (50)                    |
| CASH USED IN INVESTING ACTIVITIES  | (676)                     | -                         | (676)                   |
| <b>FINANCING ACTIVITIES</b>  |                           |                           |                         |
| DIVIDENDS PAID   | (144)                     | -                         | (144)                   |
| ISSUANCE OF COMMON SHARES  | 7                         | -                         | 7                       |
| PURCHASE OF COMMON SHARES  | (793)                     | -                         | (793)                   |
| ISSUANCE OF LONG-TERM DEBT (EXCLUDING COMMERCIAL PAPER)                                  | 848                       | -                         | 848                     |
| REPAYMENT OF LONG-TERM DEBT (EXCLUDING COMMERCIAL PAPER)                                 | (285)                     | -                         | (285)                   |
| NET ISSUANCE OF SHORT-TERM DEBT AND COMMERCIAL PAPER                                     | -                         | -                         | -                       |
| OTHER FINANCING ACTIVITIES   | (12)                      | -                         | (12)                    |
| CASH USED IN FINANCING ACTIVITIES  | (379)                     | -                         | (379)                   |
| EFFECT OF FOREIGN CURRENCY FLUCTUATIONS ON FOREIGN-DENOMINATED CASH AND CASH EQUIVALENTS | -                         | -                         | -                       |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                                     | \$ 48                     | \$ 32                     | \$ 80                   |

NOTES TO PRO FORMA SOURCES AND APPLICATION OF FUNDS (STATEMENT OF CASH FLOWS)

KCS  
BASE YEAR

1. KCS HISTORICAL 2019 AS REPORTED: Represents KCS's 2019 sources and applications of funds as reported under US GAAP in its 2019 Annual Report on Form 10-K.
2. ADJUSTMENTS: Represents adjustments made to eliminate effects on KCS's sources and applications of funds of the following non-recurring transactions as reported in 2019:
  - (1) restructuring charges: \$169 million (\$125 million after \$44 million tax expense), partially offset by \$6M cash payments for restructuring charges;
  - (2) foreign exchange gain: \$17 million (\$12 million after \$5 million tax expense);
  - (3) foreign exchange component of income taxes: \$36 million expense;
  - (4) settlement of treasury lock agreements: \$26 million.
3. KCS BASE YEAR: Represents KCS's 2019 sources and applications of funds as reported in the 2019 Annual Report on Form 10-K revised to include the adjustments indicated in 2.

Source: CP/KCS Application, vol. 1, Appendix G (Exhibit 18), pp. 3-4.

**Exhibit B-VII**  
**Canadian Pacific Railway (CP) and Kansas City Southern (KCS)**  
**Recreated Pro-Forma Consolidated Income Statement**

| (\$US in Millions)  | <u>CP</u><br><u>BASE YEAR</u><br>(1) | <u>KCS</u><br><u>BASE YEAR</u><br>(2) | <u>PURCHASE</u><br><u>ACCOUNTING</u><br><u>ADJUSTMENT</u><br>(3) | <u>CP/KCS</u><br><u>BASE YEAR</u><br>(4) |
|---|--------------------------------------|---------------------------------------|--|--|
| TOTAL REVENUES  | \$ 5,999                             | \$ 2,866                              | \$ -   | \$ 8,865                                 |
| <i>OPERATING EXPENSES</i>   | <i>3,050</i>                         | <i>1,460</i>                          | <i>-</i>   | <i>4,510</i>                             |
| <i>DEPRECIATION &amp; AMORTIZATION</i>                                      | <i>544</i>                           | <i>351</i>                            | <i>-</i>   | <i>895</i>                               |
| TOTAL OPERATING EXPENSES  | <u>3,594</u>                         | <u>1,811</u>                          | <u>-</u>   | <u>5,405</u>                             |
| OPERATING INCOME  | \$ 2,405                             | \$ 1,055                              | \$ -   | \$ 3,460                                 |
| LESS: OTHER (INCOME) EXPENSES   | <u>(290)</u>                         | <u>(1)</u>                            | <u>-</u>   | <u>(291)</u>                             |
| INCOME BEFORE INTEREST AND INCOME TAXES                                     | \$ 2,695                             | \$ 1,056                              | \$ -   | \$ 3,751                                 |
| <i>EARNINGS BEFORE INTEREST, TAXES,<br/>DEPRECIATION &amp; AMORTIZATION</i> | <i>\$ 3,239</i>                      | <i>\$ 1,407</i>                       | <i>\$ -</i>  | <i>\$ 4,646</i>                          |
| NET INTEREST EXPENSE  | <u>345</u>                           | <u>116</u>                            | <u>-</u>   | <u>461</u>                               |
| INCOME BEFORE INCOME TAX EXPENSE  | 2,350                                | 940                                   | -  | 3,290                                    |
| INCOME TAX EXPENSE  | <u>587</u>                           | <u>250</u>                            | <u>-</u>   | <u>837</u>                               |
| LESS: NET INCOME ATTRIBUTABLE TO<br>NONCONTROLLING INTEREST                 | -                                    | 2                                     | -  | 2  |
| NET INCOME  | <u>\$ 1,763</u>                      | <u>\$ 688</u>                         | <u>\$ -</u>  | <u>\$ 2,451</u>                          |

NOTES TO PRO FORMA INCOME STATEMENT

CP/KCS

BASE YEAR

1. CP BASE YEAR: Represents CP's 2019 income statement as reported under US GAAP in its 2019 Annual Report on Form 10-K, adjusted to eliminate the effects of non-recurring transactions, and converted from \$CDN to \$USD. See separate CP base year pro forma income statement included in this section of the Application.
2. KCS BASE YEAR: Represents KCS's 2019 income statement as reported under US GAAP in its 2019 Annual Report on Form 10-K, adjusted to eliminate the effects of non-recurring transactions. See separate KCS base year pro forma income statement included in this section of the Application.
3. PURCHASE ACCOUNTING ADJUSTMENTS: Represents the CP acquisition of KCS and related purchase accounting adjustments.
4. CP/KCS BASE YEAR: Represents the base year income statement for the combined CP/KCS entity.

**Source: CP/KCS Application, vol. 1, Appendix F (Exhibit 17), pp. 5-6.**

**Exhibit B-VIII**  
**Canadian Pacific Railway (CP) and Kansas City Southern (KCS)**  
**Recreated Pro-Forma Consolidated Balance Sheet**

| (\$US in Millions)                          | CP<br>BASE YEAR<br>(1)          | KCS<br>BASE YEAR<br>(2) | PURCHASE<br>ACCOUNTING<br>ADJUSTMENT<br>(3) | CP/KCS<br>BASE YEAR<br>(4) |
|---|---------------------------------|-------------------------|---|----------------------------|
| <b>ASSETS</b>                               |                                 |                         |   |                            |
| CURRENT ASSETS                              |                                 |                         |   |                            |
| CASH AND CASH EQUIVALENTS                   | \$ 802                          | \$ 149                  | \$ (851)                                    | \$ 100                     |
| ACCOUNTS RECEIVABLE, NET                    | 620                             | 274                     | -   | 894                        |
| MATERIALS AND SUPPLIES                      | 140                             | 151                     | -   | 291                        |
| OTHER CURRENT ASSETS                        | 69                              | 155                     |   | 224                        |
| TOTAL CURRENT ASSETS                        | <u>1,631</u>                    | <u>729</u>              | <u>(851)</u>                                | <u>1,509</u>               |
|   | <i>GROSS PROPERTIES</i>         | 20,985                  | 11,496                                      | -                          |
|   | <i>ACCUMULATED DEPRECIATION</i> | (6,236)                 | (2,690)                                     | -                          |
| PROPERTIES, NET                             | 14,749                          | 8,806                   | -   | 23,555                     |
| OTHER ASSETS                                | 1,541                           | 252                     | 23,580                                      | 25,373                     |
| TOTAL ASSETS                                | <u>\$ 17,921</u>                | <u>\$ 9,787</u>         | <u>\$ 22,729</u>                            | <u>\$ 50,437</u>           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b> |                                 |                         |   |                            |
| CURRENT LIABILITIES                         |                                 |                         |   |                            |
| ACCOUNTS PAYABLE AND ACCRUED LIABILITIES    | \$ 1,304                        | \$ 473                  | \$ 65                                       | \$ 1,842                   |
| LONG-TERM DEBT MATURING WITHIN ONE YEAR     | 461                             | 18                      | 549   | 1,028                      |
| TOTAL CURRENT LIABILITIES                   | <u>1,765</u>                    | <u>491</u>              | <u>614</u>                                  | <u>2,870</u>               |
| LONG-TERM DEBT                              | 6,281                           | 3,228                   | 9,142                                       | 18,651                     |
| DEFERRED INCOME TAXES                       | 2,695                           | 1,128                   | (66)  | 3,757                      |
| OTHER LONG-TERM LIABILITIES                 | 1,037                           | 194                     | -   | 1,231                      |
| TOTAL LIABILITIES                           | <u>11,778</u>                   | <u>5,041</u>            | <u>9,690</u>                                | <u>26,509</u>              |
| SHAREHOLDERS' EQUITY                        |                                 |                         |   |                            |
| SHARE CAPITAL                               | 1,535                           | 7                       | 17,881                                      | 19,423                     |
| ADDITIONAL PAID-IN CAPITAL                  | 37                              | 844                     | (844)                                       | 37                         |
| ACCUMULATED OTHER COMPREHENSIVE LOSS        | (1,942)                         | (29)                    | 29  | (1,942)                    |
| RETAINED EARNINGS                           | 6,513                           | 3,601                   | (4,027)                                     | 6,087                      |
| TOTAL SHAREHOLDERS' EQUITY                  | <u>6,143</u>                    | <u>4,423</u>            | <u>13,039</u>                               | <u>23,605</u>              |
| NONCONTROLLING INTEREST                     | -                               | 323                     | -   | 323                        |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY  | <u>\$ 17,921</u>                | <u>\$ 9,787</u>         | <u>\$ 22,729</u>                            | <u>\$ 50,437</u>           |

NOTES TO PRO FORMA BALANCE SHEET  
CP/KCS  
BASE YEAR

1. CP BASE YEAR: Represents CP's 2019 balance sheet as reported under US GAAP in its 2019 Annual Report on Form 10-K converted from \$CDN to \$USD. See separate CP base year pro forma balance sheet included in this section of the Application.
2. KCS BASE YEAR: Represents KCS's 2019 balance sheet as reported under US GAAP in its 2019 Annual Report on Form 10-K. See separate KCS base year pro forma balance sheet included in this section of the Application.
3. PURCHASE ACCOUNTING ADJUSTMENTS: Represents the CP acquisition of KCS and related purchase accounting adjustments:
  - CASH AND CASH EQUIVALENTS - Adjustments represents cash on hand used to fund the cash consideration portion of the purchase price.
  - OTHER LONG-TERM ASSETS - Adjustment represents remainder of the total purchase price consideration. Once detailed valuations and related calculations are completed, a material portion of this amount could be attributable to properties, goodwill and intangible assets, other assets, other long-term liabilities, and the related deferred income tax balances.
  - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES - Adjustment represents post transaction compensation adjustments, primarily retention payments.
  - LONG-TERM DEBT - Represents the net issuance of long-term debt required to fund the cash consideration of the purchase price, CN agreement termination payments, CP and KCS merger transaction costs, cash settlement of outstanding KCS compensation equity awards, and fair value increase of KCS long-term debt.
  - DEFERRED INCOME TAXES - Adjustment relates to the fair value adjustment of long-term debt and lease obligations.
  - TOTAL SHAREHOLDERS' EQUITY - Represents CP common shares issued as part of the purchase price, less KCS base year total shareholders' equity, CP merger transaction costs, and accounts payable and accrued liabilities purchase accounting adjustments.
4. CP/KCS BASE YEAR: Represents the base year balance sheet for the combined CP/KCS entity.

**Source: CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 5-6.**

**Exhibit B-IX**  
**Canadian Pacific Railway (CP) and Kansas City Southern (KCS)**  
**Recreated Pro-Forma Consolidated Statement of Cash Flows**

| (\$US in Millions)   | <u>CP</u><br><u>BASE YEAR</u><br>(1) | <u>KCS</u><br><u>BASE YEAR</u><br>(2) | <u>PURCHASE</u><br><u>ACCOUNTING</u><br><u>ADJUSTMENT</u><br>(3) | <u>CP/KCS</u><br><u>BASE YEAR</u><br>(4) |
|--|--------------------------------------|---------------------------------------|--|--|
| <b>OPERATING ACTIVITIES</b>  |                                      |                                       |  |  |
| NET INCOME   | \$ 1,763                             | \$ 690                                | \$ -   | \$ 2,453                                 |
| RECONCILIATION OF NET INCOME TO CASH PROVIDED BY OPERATING ACTIVITIES:                   |                                      |                                       |  |  |
| DEPRECIATION AND AMORTIZATION  | 544                                  | 351                                   | -  | 895                                      |
| DEFERRED INCOME TAX  | 182                                  | 56                                    | -  | 238                                      |
| OTHER OPERATING ACTIVITIES, NET  | (167)                                | 48                                    | -  | (119)                                    |
| CHANGE IN NON-CASH WORKING CAPITAL BALANCES RELATED TO OPERATIONS                        | (20)                                 | (10)                                  | -  | (30)                                     |
| CASH PROVIDED BY OPERATING ACTIVITIES  | <u>2,302</u>                         | <u>1,135</u>                          | <u>-</u>   | <u>3,437</u>                             |
| <b>INVESTING ACTIVITIES</b>  |                                      |                                       |  |  |
| ADDITIONS TO PROPERTIES  | (1,268)                              | (626)                                 | -  | (1,894)                                  |
| OTHER INVESTING ACTIVITIES   | 14                                   | (50)                                  | -  | (36)                                     |
| CASH USED IN INVESTING ACTIVITIES  | <u>(1,254)</u>                       | <u>(676)</u>                          | <u>-</u>   | <u>(1,930)</u>                           |
| <b>FINANCING ACTIVITIES</b>  |                                      |                                       |  |  |
| DIVIDENDS PAID   | (317)                                | (144)                                 | -  | (461)                                    |
| ISSUANCE OF COMMON SHARES  | 20                                   | 7                                     | -  | 27                                       |
| PURCHASE OF COMMON SHARES  | (873)                                | (793)                                 | -  | (1,666)                                  |
| ISSUANCE OF LONG-TERM DEBT (EXCLUDING COMMERCIAL PAPER)                                  | 306                                  | 848                                   | -  | 1,154                                    |
| REPAYMENT OF LONG-TERM DEBT (EXCLUDING COMMERCIAL PAPER)                                 | (385)                                | (285)                                 | -  | (670)                                    |
| NET ISSUANCE OF SHORT-TERM DEBT AND COMMERCIAL PAPER                                     | 403                                  | -                                     | -  | 403                                      |
| OTHER FINANCING ACTIVITIES   | (9)                                  | (12)                                  | -  | (21)                                     |
| CASH USED IN FINANCING ACTIVITIES  | <u>(855)</u>                         | <u>(379)</u>                          | <u>-</u>   | <u>(1,234)</u>                           |
| EFFECT OF FOREIGN CURRENCY FLUCTUATIONS ON FOREIGN-DENOMINATED CASH AND CASH EQUIVALENTS | (4)                                  | -                                     | -  | (4)                                      |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                                     | <u>\$ 189</u>                        | <u>\$ 80</u>                          | <u>\$ -</u>  | <u>\$ 269</u>                            |

NOTES TO PRO FORMA SOURCES AND APPLICATION OF FUNDS (STATEMENT OF CASH FLOWS)  
CP/KCS  
BASE YEAR

1. CP BASE YEAR: Represents CP's 2019 sources and applications of funds as reported under US GAAP in its 2019 Annual Report on Form 10-K, adjusted to eliminate the effects of non-recurring transactions, and converted from \$CDN to \$USD. See separate CP base year pro forma sources and applications of funds included in this section of the Application.
2. KCS BASE YEAR: Represents KCS's 2019 sources and applications of funds as reported under US GAAP in its 2019 Annual Report on Form 10-K, adjusted to eliminate the effects of non-recurring transactions. See separate KCS base year pro forma sources and applications of funds included in this section of the Application.
3. PURCHASE ACCOUNTING ADJUSTMENTS: Represents the CP acquisition of KCS and related purchase accounting adjustments.
4. CP/KCS BASE YEAR: Represents the base year sources and applications of funds for the combined CP/KCS entity.

**Source: CP/KCS Application, vol. 1, Appendix G (Exhibit 18), pp. 5-6.**

**Exhibit B-X**  
**Canadian Pacific Railway (CP) and Kansas City Southern (KCS)**  
**Recreated Summary of CP/KCS Claimed Efficiencies**

| (\$US in Millions)                   |  | <u>YEAR ONE</u> |                  | <u>YEAR TWO</u> |                  | <u>YEAR THREE</u> |                  | <u>NORMAL</u>   | <u>TO 2025</u>    |
|--------------------------------------|--|-----------------|------------------|-----------------|------------------|-------------------|------------------|-----------------|-------------------|
| <u>BENEFIT COMPONENT</u>             |  | <u>ANNUAL</u>   | <u>ONE-TIME</u>  | <u>ANNUAL</u>   | <u>ONE-TIME</u>  | <u>ANNUAL</u>     | <u>ONE-TIME</u>  | <u>YEAR</u>     | <u>NORMAL</u>     |
| (1)                                  |  | (2)             | (3)              | (4)             | (5)              | (6)               | (7)              | (8)             | (9)               |
| <b>OPERATING REVENUE GAINS</b>       |  |                 |                  |                 |                  |                   |                  |                 |                   |
| Revenue Increase from Traffic Gains  |  | \$ 418.0        |                  | \$ 726.7        |                  | \$ 1,021.9        |                  | \$ 1,021.9      | \$ 1,150.8        |
| Cost of Handling Added Traffic       |  | \$ (129.2)      |                  | \$ (217.8)      |                  | \$ (306.3)        |                  | \$ (306.3)      | \$ (345.0)        |
| Net Revenue Gains                    |  | <u>\$ 288.9</u> |                  | <u>\$ 508.8</u> |                  | <u>\$ 715.6</u>   |                  | <u>\$ 715.6</u> | <u>\$ 805.8</u>   |
| <b>OPERATING BENEFITS</b>            |  |                 |                  |                 |                  |                   |                  |                 |                   |
| Engineering - Maintenance of Way     |  | \$ -            | \$ (53.6)        | \$ -            | \$ (60.9)        | \$ -              | \$ (12.0)        | \$ -            | \$ -              |
| Mechanical                           |  | \$ 19.9         | \$ -             | \$ 19.9         | \$ -             | \$ 19.9           | \$ -             | \$ 19.9         | \$ 22.4           |
| Transportation                       |  | \$ 59.3         | \$ -             | \$ 60.9         | \$ -             | \$ 62.5           | \$ -             | \$ 62.5         | \$ 70.4           |
| Equipment Requirements & Utilization |  | \$ 10.1         | \$ 45.0          | \$ 11.9         | \$ 45.0          | \$ 12.8           | \$ -             | \$ 12.8         | \$ 14.4           |
| Intermodal Operations                |  | \$ -            | \$ -             | \$ -            | \$ -             | \$ -              | \$ -             | \$ -            | \$ -              |
| Purchasing                           |  | \$ 4.2          | \$ -             | \$ 12.1         | \$ -             | \$ 20.5           | \$ -             | \$ 20.5         | \$ 23.1           |
| Subtotal                             |  | <u>\$ 93.5</u>  | <u>\$ (8.6)</u>  | <u>\$ 104.8</u> | <u>\$ (15.9)</u> | <u>\$ 115.7</u>   | <u>\$ (12.0)</u> | <u>\$ 115.7</u> | <u>\$ 130.3</u>   |
| Support Functions (G&A)              |  | <u>\$ 36.0</u>  | <u>\$ (7.7)</u>  | <u>\$ 51.0</u>  | <u>\$ (3.8)</u>  | <u>\$ 57.1</u>    | <u>\$ -</u>      | <u>\$ 57.1</u>  | <u>\$ 64.3</u>    |
| Total Operating Benefits             |  | <u>\$ 129.5</u> | <u>\$ (16.3)</u> | <u>\$ 155.8</u> | <u>\$ (19.7)</u> | <u>\$ 172.8</u>   | <u>\$ (12.0)</u> | <u>\$ 172.8</u> | <u>\$ 194.6</u>   |
| Employee Separation/Relocation       |  | <u>\$ -</u>     | <u>\$ (42.6)</u> | <u>\$ -</u>     | <u>\$ (3.3)</u>  | <u>\$ -</u>       | <u>\$ (6.1)</u>  | <u>\$ -</u>     | <u>\$ -</u>       |
| Total Merger Benefits                |  | <u>\$ 418.4</u> | <u>\$ (58.9)</u> | <u>\$ 664.6</u> | <u>\$ (23.0)</u> | <u>\$ 888.4</u>   | <u>\$ (18.1)</u> | <u>\$ 888.4</u> | <u>\$ 1,000.4</u> |

\* Normal year converted from 2019 to 2025 \$US using an index factor of 1.1262 based on Railroad Cost Adjustment Factor All-Inclusive Less Fuel with Error Adjustment (All-LF) forecast.

Source: CP/KCS Application, vol. 1, Appendix B.

**Exhibit B-XI**  
**Canadian Pacific Railway (CP) and Kansas City Southern (KCS)**  
**Recreated Pro-Forma Consolidated Income Statement Including the Effects of the Claimed Efficiencies**

|   | CP/KCS<br>BASE YEAR | YEAR 1<br>ADJ | CP/KCS<br>PRO<br>FORMA<br>YEAR 1 | YEAR 2<br>ADJ | CP/KCS<br>PRO<br>FORMA<br>YEAR 2 | YEAR 3<br>ADJ | CP/KCS<br>PRO<br>FORMA<br>YEAR 3 | NORMAL<br>YEAR<br>ADJ | CP/KCS<br>PRO<br>FORMA<br>NORMAL YEAR |
|---|---------------------|---------------|----------------------------------|---------------|----------------------------------|---------------|----------------------------------|-----------------------|---------------------------------------|
|   | (1)                 | (2)           | (3)                              | (4)           | (5)                              | (6)           | (7)                              | (8)                   | (9)                                   |
| TOTAL REVENUES  | \$ 8,865            | \$ 418        | \$ 9,283                         | \$ 727        | \$ 9,592                         | \$ 1,022      | \$ 9,887                         | \$ 1,022              | \$ 9,887                              |
| <i>OPERATING EXPENSES</i>   | 4,510               | -             | 4,510                            | 62            | 4,572                            | 134           | 4,644                            | 134                   | 4,644                                 |
| <i>DEPRECIATION &amp; AMORTIZATION</i>                                      | 895                 | 41            | 936                              | 95            | 990                              | 148           | 1,043                            | 201                   | 1,096                                 |
| TOTAL OPERATING EXPENSES  | 5,405               | 41            | 5,446                            | 157           | 5,562                            | 282           | 5,687                            | 335                   | 5,740                                 |
| OPERATING INCOME  | \$ 3,460            | \$ 377        | \$ 3,837                         | \$ 570        | \$ 4,030                         | \$ 740        | \$ 4,200                         | \$ 687                | \$ 4,147                              |
| LESS: OTHER (INCOME) EXPENSES   | (291)               | -             | (291)                            | -             | (291)                            | -             | (291)                            | -                     | (291)                                 |
| INCOME BEFORE INTEREST AND INCOME TAXES                                     | \$ 3,751            | \$ 377        | \$ 4,128                         | \$ 570        | \$ 4,321                         | \$ 740        | \$ 4,491                         | \$ 687                | \$ 4,438                              |
| <i>EARNINGS BEFORE INTEREST, TAXES,<br/>DEPRECIATION &amp; AMORTIZATION</i> | \$ 4,646            | \$ 418        | \$ 5,064                         | \$ 665        | \$ 5,311                         | \$ 888        | \$ 5,534                         | \$ 888                | \$ 5,534                              |
| NET INTEREST EXPENSE  | 461                 | 191           | 652                              | 176           | 637                              | 146           | 607                              | 114                   | 575                                   |
| INCOME BEFORE INCOME TAX EXPENSE  | 3,290               | 186           | 3,476                            | 394           | 3,684                            | 594           | 3,884                            | 573                   | 3,863                                 |
| INCOME TAX EXPENSE  | 837                 | 49            | 886                              | 102           | 939                              | 153           | 990                              | 148                   | 985                                   |
| LESS: NET INCOME ATTRIBUTABLE TO<br>NONCONTROLLING INTEREST                 | 2                   | -             | 2                                | -             | 2                                | -             | 2                                | -                     | 2                                     |
| NET INCOME  | \$ 2,451            | \$ 137        | \$ 2,588                         | \$ 292        | \$ 2,743                         | \$ 441        | \$ 2,892                         | \$ 425                | \$ 2,876                              |

NOTES TO PRO FORMA INCOME STATEMENT

CP/KCS

YEAR 1 THROUGH NORMAL YEAR

1. CP BASE YEAR (2019): Represents pro forma combined CP/KCS base year income statement, included separately in this section of the Application.
2. YEAR 1 THROUGH NORMAL YEAR ADJUSTMENTS: Represents the effects on the combined CP/KCS pro forma base year income statement of cumulative net benefits arising from implementation of the operating plan, inclusive of one-time expenses related to combining operations, as well as interest expense on acquisition debt:

TOTAL REVENUES - Represents gross revenue gains from additional traffic.

TOTAL OPERATING EXPENSES - Represents net benefits from operating efficiencies, reduced by: (1) additional expenses incurred to handle increased traffic; and (2) increased depreciation expense arising from annual additions to properties (resulting from the base-year sources and applications of funds), and one-time capital expenditures to combine operations.

NET INTEREST EXPENSE - Represents the net increase in interest expense arising from debt incurred to finance the acquisition, net of interest expense reductions arising from debt repayment, and amortization of the fair value increase to KCS long-term debt included in the purchase accounting adjustment.

INCOME TAX EXPENSE - Represents the change in current and deferred income taxes resulting from the net adjustments to pretax earnings as outlined above.

**Source: CP/KCS Application, vol. 1, Appendix F (Exhibit 17), pp. 7-11.**

**Exhibit B-XII**  
**Canadian Pacific Railway (CP) and Kansas City Southern (KCS)**  
**Recreated Pro-Forma Consolidated Balance Sheet Including the Effects of the Claimed Efficiencies**

| (\$US in Millions)                          | CP/KCS<br>BASE YEAR | YEAR 1<br>ACTIVITY | CP/KCS<br>PRO FORMA<br>YEAR 1 | YEAR 2<br>ACTIVITY | CP/KCS<br>PRO FORMA<br>YEAR 2 | YEAR 3<br>ACTIVITY | CP/KCS<br>PRO FORMA<br>YEAR 3 | NORMAL<br>YEAR<br>ACTIVITY | CP/KCS<br>PRO FORMA<br>NORMAL YEAR |
|---|---------------------|--------------------|-------------------------------|--------------------|-------------------------------|--------------------|-------------------------------|----------------------------|------------------------------------|
|   | (1)                 | (2)                | (3)                           | (4)                | (5)                           | (6)                | (7)                           | (8)                        | (9)                                |
| <b>ASSETS</b>                               |                     |                    |                               |                    |                               |                    |                               |                            |                                    |
| <b>CURRENT ASSETS</b>                       |                     |                    |                               |                    |                               |                    |                               |                            |                                    |
| CASH AND CASH EQUIVALENTS                   | \$ 100              | \$ -               | \$ 100                        | \$ -               | \$ 100                        | \$ -               | \$ 100                        | \$ -                       | \$ 100                             |
| ACCOUNTS RECEIVABLE, NET                    | 894                 | -                  | 894                           | -                  | 894                           | -                  | 894                           | -                          | 894                                |
| MATERIALS AND SUPPLIES                      | 291                 | -                  | 291                           | -                  | 291                           | -                  | 291                           | -                          | 291                                |
| OTHER CURRENT ASSETS                        | 224                 | -                  | 224                           | -                  | 224                           | -                  | 224                           | -                          | 224                                |
| TOTAL CURRENT ASSETS                        | 1,509               | -                  | 1,509                         | -                  | 1,509                         | -                  | 1,509                         | -                          | 1,509                              |
| <i>GROSS PROPERTIES</i>                     |                     |                    |                               |                    |                               |                    |                               |                            |                                    |
|   | 32,481              | 1,910              | 34,391                        | 1,914              | 36,305                        | 1,906              | 38,211                        | 1,894                      | 40,105                             |
| <i>ACCUMULATED DEPRECIATION</i>             |                     |                    |                               |                    |                               |                    |                               |                            |                                    |
|   | (8,926)             | (936)              | (9,862)                       | (990)              | (10,852)                      | (1,043)            | (11,895)                      | (1,096)                    | (12,991)                           |
| PROPERTIES, NET                             | 23,555              | 974                | 24,529                        | 924                | 25,453                        | 863                | 26,316                        | 798                        | 27,114                             |
| OTHER ASSETS                                | 25,373              | 155                | 25,528                        | 155                | 25,683                        | 155                | 25,838                        | 155                        | 25,993                             |
| TOTAL ASSETS                                | \$ 50,437           | \$ 1,129           | \$ 51,566                     | \$ 1,079           | \$ 52,645                     | \$ 1,018           | \$ 53,663                     | \$ 953                     | \$ 54,616                          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b> |                     |                    |                               |                    |                               |                    |                               |                            |                                    |
| <b>CURRENT LIABILITIES</b>                  |                     |                    |                               |                    |                               |                    |                               |                            |                                    |
| ACCOUNTS PAYABLE AND ACCRUED LIABILITIES    | \$ 1,842            | \$ (65)            | \$ 1,777                      | \$ (30)            | \$ 1,747                      | \$ (30)            | \$ 1,717                      | \$ (30)                    | \$ 1,687                           |
| LONG-TERM DEBT MATURING WITHIN ONE YEAR     | 1,028               | (549)              | 479                           | -                  | 479                           | -                  | 479                           | -                          | 479                                |
| TOTAL CURRENT LIABILITIES                   | 2,870               | (614)              | 2,256                         | (30)               | 2,226                         | (30)               | 2,196                         | (30)                       | 2,166                              |
| LONG-TERM DEBT                              | 18,651              | (461)              | 18,190                        | (1,303)            | 16,887                        | (1,523)            | 15,364                        | (1,576)                    | 13,788                             |
| DEFERRED INCOME TAXES                       | 3,757               | 225                | 3,982                         | 238                | 4,220                         | 251                | 4,471                         | 249                        | 4,720                              |
| OTHER LONG-TERM LIABILITIES                 | 1,231               | (25)               | 1,206                         | (25)               | 1,181                         | (25)               | 1,156                         | (25)                       | 1,131                              |
| TOTAL LIABILITIES                           | 26,509              | (875)              | 25,634                        | (1,120)            | 24,514                        | (1,327)            | 23,187                        | (1,382)                    | 21,805                             |
| <b>SHAREHOLDERS' EQUITY</b>                 |                     |                    |                               |                    |                               |                    |                               |                            |                                    |
| SHARE CAPITAL                               | 19,423              | -                  | 19,423                        | -                  | 19,423                        | -                  | 19,423                        | -                          | 19,423                             |
| ADDITIONAL PAID-IN CAPITAL                  | 37                  | -                  | 37                            | -                  | 37                            | -                  | 37                            | -                          | 37                                 |
| ACCUMULATED OTHER COMPREHENSIVE LOSS        | (1,942)             | -                  | (1,942)                       | -                  | (1,942)                       | -                  | (1,942)                       | -                          | (1,942)                            |
| RETAINED EARNINGS                           | 6,087               | 2,004              | 8,091                         | 2,199              | 10,290                        | 2,345              | 12,635                        | 2,335                      | 14,970                             |
| TOTAL SHAREHOLDERS' EQUITY                  | 23,605              | 2,004              | 25,609                        | 2,199              | 27,808                        | 2,345              | 30,153                        | 2,335                      | 32,488                             |
| NONCONTROLLING INTEREST                     | 323                 | -                  | 323                           | -                  | 323                           | -                  | 323                           | -                          | 323                                |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY  | \$ 50,437           | \$ 1,129           | \$ 51,566                     | \$ 1,079           | \$ 52,645                     | \$ 1,018           | \$ 53,663                     | \$ 953                     | \$ 54,616                          |

PUBLIC VERSION

NOTES TO PRO FORMA BALANCE SHEET  
CP/KCS  
YEAR 1 THROUGH NORMAL YEAR

1. CP/KCS BASE YEAR (2019) OR PRO FORMA FOR PRECEDING YEAR: For Year 1, represents the pro forma combined CP/KCS base year balance sheet. For Year 2 through Normal Year, represents the pro forma combined CP/KCS for the preceding year. See separate combined CP/KCS Year 1, Year 2, or Year 3 pro forma balance sheets included in this section of the Application.

2. YEAR 1 THROUGH NORMAL YEAR ACTIVITY: Represents the effects on the combined CP/KCS pro forma balance sheets of the operating results (earnings and cash flows) for the respective years, inclusive of adjustments to reflect implementation of the operating plan:

CASH AND CASH EQUIVALENTS - Represents the normal change in cash (resulting from the base year) as derived from the statement of sources and application of funds (statement of cash flows).

PROPERTIES, NET - Represents capital expenditures for each of the respective years, including capital expenditures necessary to combine operations of CP and KCS, less an allowance for depreciation for each year. All years reflect an increase in the normal allowance for depreciation resulting from the capital expenditures to combine operations of CP and KCS.

OTHER LONG-TERM ASSETS - Represents normal expenditures for other investing activities and normal annual other operating activities (base year).

ACCOUNTS PAYABLE AND ACCRUED LIABILITIES - Represents net cash flows from net changes in non-cash working capital balances related to operations, principally net changes in the balance of accounts payable and accrued liabilities.

LONG-TERM DEBT - Represents the net issuance or repayment of long-term debt for the respective years, as well as the amortization of the fair value increase to KCS long-term debt included in the purchase accounting adjustment. In any year where there is a net use of cash arising from the combination of CP and KCS and the implementation of the operating plan, long-term debt is assumed to be issued. In any year where there is a net source of cash arising from the combination and the operating plan, long-term debt is assumed to be repaid.

DEFERRED INCOME TAXES - Represents the net change in the deferred income tax liability resulting principally from different book and tax treatment for depreciation expense and for the depreciation or amortization of components of the excess purchase price resulting from the transaction.

OTHER LONG-TERM LIABILITIES - Represents normal proceeds from other financing activities (resulting from the base year), and effect of foreign currency fluctuations on foreign-denominated cash and cash equivalents, as derived from the statement of sources and application of funds (statement of cash flows).

RETAINED EARNINGS - Represents net earnings for the respective years, less dividends declared and paid to shareholders, and employee separation and relocation costs as a result of combining CP and KCS operations.

**Source: CP/KCS Application, vol. 1, Appendix E (Exhibit 16), pp. 7-11.**

**Exhibit B-XIII**  
**Canadian Pacific Railway (CP) and Kansas City Southern (KCS)**  
**Recreated Pro-Forma Consolidated Statement of Cash Flows Including the Effects of the Claimed Efficiencies**

| (\$US in Millions)   | CP/KCS<br>BASE YEAR<br>(1) | YEAR 1<br>ADJ<br>(2) | CP/KCS<br>PRO FORMA<br>YEAR 1<br>(3) | YEAR 2<br>ADJ<br>(4) | CP/KCS<br>PRO FORMA<br>YEAR 2<br>(5) | YEAR 3<br>ADJ<br>(6) | CP/KCS<br>PRO FORMA<br>YEAR 3<br>(7) | NORMAL<br>YEAR<br>ADJ<br>(8) | CP/KCS<br>PRO FORMA<br>NORMAL YEAR<br>(9) |
|--|----------------------------|----------------------|--------------------------------------|----------------------|--------------------------------------|----------------------|--------------------------------------|------------------------------|---|
| <b>OPERATING ACTIVITIES</b>  |                            |                      |                                      |                      |                                      |                      |                                      |                              |   |
| NET INCOME   | \$ 2,453                   | \$ 137               | \$ 2,590                             | \$ 292               | \$ 2,745                             | \$ 441               | \$ 2,894                             | \$ 425                       | \$ 2,878                                  |
| RECONCILIATION OF NET INCOME TO CASH PROVIDED BY OPERATING ACTIVITIES:                   |                            |                      |                                      |                      |                                      |                      |                                      |                              |   |
| DEPRECIATION AND AMORTIZATION  | 895                        | 41                   | 936                                  | 95                   | 990                                  | 148                  | 1,043                                | 201                          | 1,096                                     |
| DEFERRED INCOME TAX  | 238                        | (16)                 | 222                                  | (3)                  | 235                                  | 10                   | 248                                  | 8                            | 246                                       |
| OTHER OPERATING ACTIVITIES, NET  | (119)                      | (58)                 | (177)                                | (17)                 | (136)                                | (20)                 | (139)                                | (12)                         | (131)                                     |
| CHANGE IN NON-CASH WORKING CAPITAL BALANCES RELATED TO OPERATIONS                        | (30)                       | (35)                 | (65)                                 | -                    | (30)                                 | -                    | (30)                                 | -                            | (30)                                      |
| CASH PROVIDED BY OPERATING ACTIVITIES  | 3,437                      | 69                   | 3,506                                | 367                  | 3,804                                | 579                  | 4,016                                | 622                          | 4,059                                     |
| <b>INVESTING ACTIVITIES</b>  |                            |                      |                                      |                      |                                      |                      |                                      |                              |   |
| ADDITIONS TO PROPERTIES  | (1,894)                    | (16)                 | (1,910)                              | (20)                 | (1,914)                              | (12)                 | (1,906)                              | -                            | (1,894)                                   |
| OTHER INVESTING ACTIVITIES   | (36)                       | -                    | (36)                                 | -                    | (36)                                 | -                    | (36)                                 | -                            | (36)                                      |
| CASH USED IN INVESTING ACTIVITIES  | (1,930)                    | (16)                 | (1,946)                              | (20)                 | (1,950)                              | (12)                 | (1,942)                              | -                            | (1,930)                                   |
| <b>FINANCING ACTIVITIES</b>  |                            |                      |                                      |                      |                                      |                      |                                      |                              |   |
| DIVIDENDS PAID   | (461)                      | (82)                 | (543)                                | (82)                 | (543)                                | (82)                 | (543)                                | (82)                         | (543)                                     |
| ISSUANCE OF COMMON SHARES  | 27                         | (27)                 | -                                    | (27)                 | -                                    | (27)                 | -                                    | (27)                         | -   |
| PURCHASE OF COMMON SHARES  | (1,666)                    | 1,666                | -                                    | 1,666                | -                                    | 1,666                | -                                    | 1,666                        | -   |
| ISSUANCE OF LONG-TERM DEBT (EXCLUDING COMMERCIAL PAPER)                                  | 1,154                      | -                    | 1,154                                | -                    | 1,154                                | -                    | 1,154                                | -                            | 1,154                                     |
| REPAYMENT OF LONG-TERM DEBT (EXCLUDING COMMERCIAL PAPER)                                 | (670)                      | (1,476)              | (2,146)                              | (1,770)              | (2,440)                              | (1,990)              | (2,660)                              | (2,045)                      | (2,715)                                   |
| NET ISSUANCE OF SHORT-TERM DEBT AND COMMERCIAL PAPER                                     | 403                        | (403)                | -                                    | (403)                | -                                    | (403)                | -                                    | (403)                        | -   |
| OTHER FINANCING ACTIVITIES   | (21)                       | -                    | (21)                                 | -                    | (21)                                 | -                    | (21)                                 | -                            | (21)                                      |
| CASH USED IN FINANCING ACTIVITIES  | (1,234)                    | (322)                | (1,556)                              | (616)                | (1,850)                              | (836)                | (2,070)                              | (891)                        | (2,125)                                   |
| EFFECT OF FOREIGN CURRENCY FLUCTUATIONS ON FOREIGN-DENOMINATED CASH AND CASH EQUIVALENTS | (4)                        | -                    | (4)                                  | -                    | (4)                                  | -                    | (4)                                  | -                            | (4)                                       |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                                     | \$ 269                     | \$ (269)             | \$ -                                 | \$ (269)             | \$ -                                 | \$ (269)             | \$ -                                 | \$ (269)                     | \$ -                                      |

PUBLIC VERSION

NOTES TO PRO FORMA SOURCES AND APPLICATION OF FUNDS (STATEMENT OF CASH FLOWS)

CP-KCS

YEAR 1 THROUGH NORMAL YEAR

1. CP-KCS BASE YEAR (2019): Represents pro forma combined CP-KCS base year sources and application of funds (statement of cash flows), included separately in this section of the

2. YEAR 1 THROUGH NORMAL YEAR ACTIVITY: Represents the effects on the combined CP-KCS pro forma base year sources and application of funds of: (1) cumulative benefits arising from implementation of the operating plan; (2) one-time capital expenditures related to combining operations; and (3) the issuance or repayment of debt.

NET INCOME - Represents net adjustments to net income/(loss) in the respective years, as derived from the income statement.

DEPRECIATION AND AMORTIZATION - Represents the increased depreciation or amortization expense arising from: (1) annual additions to properties (resulting from the base year); and (2) one-time capital expenditures to combine operations.

DEFERRED INCOME TAX EXPENSE - Represents the adjustment to deferred income tax expense resulting from the net adjustment to pretax earnings.

OTHER OPERATING ACTIVITIES, NET - Represents annual other operating activities (base year), one-time employee separation and relocation costs as a result of combining CP and KCS operations, and non-cash amortization of the fair value increase to KCS long-term debt included in the purchase accounting adjustment.

CHANGE IN NON-CASH WORKING CAPITAL BALANCES RELATED TO OPERATIONS - Represents annual changes to working capital accounts for each of the respective years, principally changes in accounts payable and accrued liabilities.

ADDITIONS TO PROPERTIES - Represents capital expenditures for each of the respective years, including one-time expenditures required to achieve the benefits of combining operations.

DIVIDENDS PAID - Represents dividend payments for CP's existing common shares outstanding and dividend payments for incremental CP common shares issued as part of the purchase price consideration.

LONG-TERM AND SHORT-TERM DEBT ISSUED / REPAID - Represents the issuance or repayment of long-term debt for the respective years. In any year where there is a net use of cash arising from the combination of CP and KCS and the implementation of the operating plan, long-term debt is assumed to be issued. In any year where there is a net source of cash arising from the combination and the operating plan, long-term debt is assumed to be repaid.

**Source: CP/KCS Application, vol. 1, Appendix G (Exhibit 18), pp. 7-11.**

# **Exhibit 5**

**Excerpts from  
Transcript of February  
4, 2022 Deposition of  
John Brooks**

**WITHHELD FROM  
PUBLIC VERSION**

# **Exhibit 6**

**Excerpts from  
Transcript of February  
7, 2022 Deposition of  
W. Robert Majure,  
Ph.D.**

**WITHHELD FROM  
PUBLIC VERSION**

# **Exhibit 7**

**Excerpts from  
Transcript of February  
18, 2022 Deposition of  
Raymond A. Elphick  
and John F. Orr**

**WITHHELD FROM  
PUBLIC VERSION**

# **Exhibit 8**

**Excerpts from  
Transcript of February  
22, 2022 Deposition of  
Patrick J. Ottensmeyer**

**WITHHELD FROM  
PUBLIC VERSION**

# **Exhibit 9**

**Excerpts from  
2016 KCS  
Annual Report**



# KANSAS CITY SOUTHERN





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**KANSAS CITY SOUTHERN**  
 427 West 12th Street  
 Kansas City, Missouri 64105



[www.KCSouthern.com](http://www.KCSouthern.com)

# **Exhibit 10**

**Excerpts from  
2017 KCS  
Annual Report**

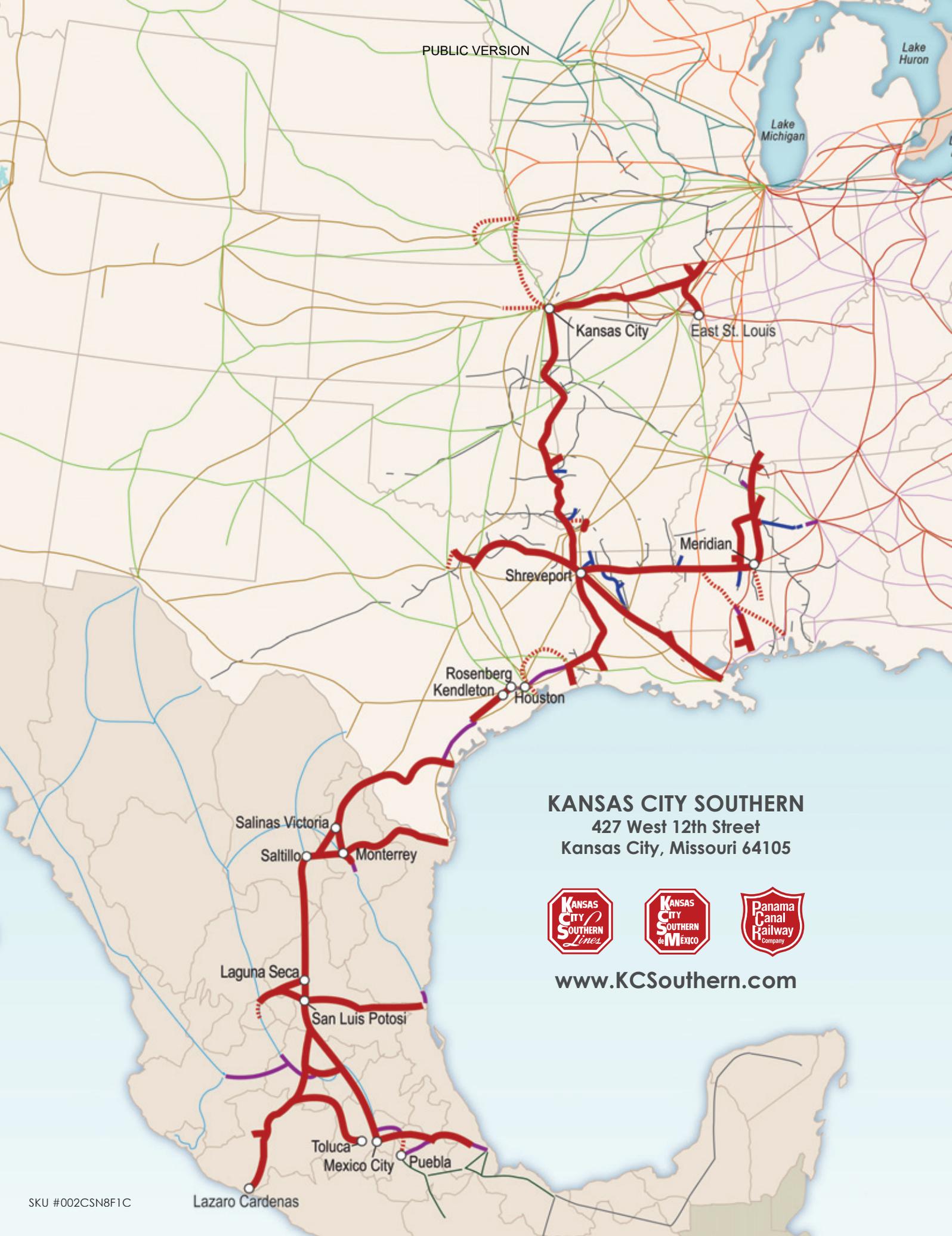


# CONNECTING NORTH AMERICA FOR PROSPERITY AND SECURITY

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Kansas City, Missouri 64105



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# **Exhibit 11**

**December 3, 2019 Gibson  
Energy Press Release**



## Gibson Energy and USD Announce Joint Venture to Construct DRU at Hardisty Utilizing Innovative DRUbit™ Technology and Agreement with ConocoPhillips for 50,000 bbl/d of Capacity

Patented Diluent Recovery Unit Produces DRUbit™  
Designed for Rail Transport and Reuse of Diluent  
Providing a Bitumen Market Access Solution with  
Significant Safety and Environmental Benefits and  
Increased Takeaway Capacity at a Cost Competitive with  
Pipelines

December 03, 2019 16:01 ET | Source: [Gibson Energy Inc.](#)



CALGARY, Alberta, Dec. 03, 2019 (GLOBE NEWSWIRE) -- US Development Group, LLC (through a wholly-owned affiliate, collectively **USD**) and Gibson Energy Inc. (**Gibson**) (TSX: GEI) jointly announced today an agreement to construct and operate a diluent recovery unit (**DRU**) near Hardisty, Alberta, Canada. ConocoPhillips Canada has contracted to process 50,000 barrels per day of inlet bitumen blend through the DRU to be shipped by Canadian Pacific (**CP**) (TSX: CP) (NYSE: CP) and Kansas City Southern Railway Company (**KCS**) (NYSE: KSU) to the U.S. Gulf Coast. USD and Gibson are currently in



USD's patented DRU technology separates the diluent that has been added to the raw bitumen in the production process which meets two important market needs – it returns the recovered diluent for reuse in the Alberta market, reducing delivered costs for diluent, and it creates **DRUbit™**, a proprietary heavy Canadian crude oil specifically designed for rail transportation. DRUbit™ is crude oil or bitumen that has been returned to a more concentrated, viscous state that creates safety and environmental benefits when transported by rail in Canada and the U.S. DRUbit™ is a market access solution that will satisfy demand for heavy Canadian crude oil on the U.S. Gulf Coast and in other markets at a cost that is economically competitive to the crude oil that is transported by pipeline today.

“Our DRU technology provides a sustainable, long-term solution for shipping Canadian crude oil to the U.S. Gulf Coast. DRUbit™ offers safety and environmental benefits in transportation, provides greater take-away capacity and improved economics for all parties,” said USD CEO, Dan Borgen. “USD is a company that provides solutions for energy infrastructure and our patented DRU technology is another valuable solution. We are thrilled to work with ConocoPhillips Canada, our JV partner Gibson, and both CP and KCS to deliver this DRU and DRUbit™ solution as part of a networked system that provides direct market access for Canadian producers.”

“The DRU process is an innovative solution that competes with pipeline economics and secures improved netbacks across the seasonality and widely varying differentials experienced in the Western Canadian spot market,” said Kirk Johnson, President, ConocoPhillips Canada. “It helps address a critical challenge to Canada’s oil producers — constrained market access — to the benefit of all Canadians.”

“We expect DRUs to be a critical part of solving the egress challenges Western Canadian producers are facing, both today and over the long-term,” said Steve Spaulding, Gibson’s President and Chief Executive Officer. “Improved netbacks for producers will drive increased oilfield and related business activity, create new jobs and help revive communities as well as positively benefit all levels of government through increased royalties and other levies.”



standard conditions. The new terminal in Port Arthur will be constructed, owned and operated solely by USD. It will have capability for rail unloading, barge dock loading and unloading, tank storage and blending, and will be pipeline connected to Phillips 66's Beaumont Terminal, providing customers access to a large network of refining and marine facilities. ConocoPhillips will re-blend the DRUbit™ with a variety of diluents to create higher-value customized blends that better meet the needs of its customers.

"From an innovation, sustainability and safety perspective, this is a game changer," said Keith Creel, CP President and CEO. "This process removes diluent from the crude-by-rail supply chain, and as a result, we end up moving a non-hazardous commodity. This will further increase the safety of crude-by-rail, to the benefit of the communities we operate in and through."

"KCS is pleased to be a strategic partner in this innovative solution to improve the economics and safety of moving crude oil," said KCS President and Chief Executive Officer Patrick J. Ottensmeyer. "It's also a great opportunity to grow our business in the Gulf Coast area and develop our Port Arthur asset."

Construction of the DRU is expected to take approximately 18 to 24 months and is subject to certain conditions, including obtaining agreements to underpin the economics of the project and receipt of required regulatory approvals, including from the Alberta Energy Regulator. The DRU could be placed into service as early as the second quarter of 2021.

#### **Media & Investor Contacts**

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##### **USD Group**

Mary Ellen Kilpatrick  
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[maryellen@goodengroup.com](mailto:maryellen@goodengroup.com)

#### **About USD Group LLC**

US Development Group, LLC ("USD") and its affiliates are engaged in designing, developing, owning, and managing large-scale multi-modal logistics centers and energy-related infrastructure across North America. USD solutions create flexible market access for customers in significant growth areas and key demand centers, including Western Canada, the U.S. Gulf Coast and Mexico. Among other projects, USD is currently pursuing the development of a premier energy logistics terminal on the Houston Ship



additional information, please visit [www.usdg.com](http://www.usdg.com). Information on websites referenced in this release are not part of this release. DRUbit™ is a trademark of DRU Assets LLC, a subsidiary of USD, and is used by permission. All rights reserved.

### **About Gibson**

Gibson is a Canadian-based oil infrastructure company with its principal businesses consisting of the storage, optimization, processing, and gathering of crude oil and refined products. Headquartered in Calgary, Alberta, the Company's operations are focused around its core terminal assets located at Hardisty and Edmonton, Alberta, and also include the Moose Jaw Facility and an infrastructure position in the U.S. Gibson shares trade under the symbol GEI and are listed on the Toronto Stock Exchange. For more information regarding Gibson as well as the DRU project visit [www.gibsonenergy.com](http://www.gibsonenergy.com) and Gibson's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

### **About ConocoPhillips**

Headquartered in Houston, Texas, ConocoPhillips had operations and activities in 17 countries, \$70 billion of total assets, and approximately 10,400 employees as of Sept. 30, 2019. Production excluding Libya averaged 1,310 MBOED for the nine months ended Sept. 30, 2019, and proved reserves were 5.3 BBOE as of Dec. 31, 2018. Our Canadian operations are focused on developing our world-class portfolio including the ConocoPhillips-operated Surrmont Joint Venture with TOTAL E&P Canada in the Athabasca region of northeast Alberta and exciting opportunities in the liquids-rich Montney play in northeast British Columbia. For more information, go to [www.conocophillips.ca](http://www.conocophillips.ca).

### **About Canadian Pacific**

Canadian Pacific (CP) is a transcontinental railway in Canada and the United States with direct links to major ports on the west and east coasts. CP provides North American customers a competitive rail service with access to key markets in every corner of the globe. CP is growing with its customers, offering a suite of freight transportation services, logistics solutions and supply chain expertise. Visit [www.cpr.ca](http://www.cpr.ca) to see the rail advantages of CP.

### **About the Kansas City Southern Railway Company**

Headquartered in Kansas City, Mo., Kansas City Southern (KCS) (NYSE: KSU) is a transportation holding company that has railroad investments in the



serving northeastern and central Mexico and the port cities of Lázaro Cárdenas, Tampico and Veracruz, and a 50 percent interest in Panama Canal Railway Company, providing ocean-to-ocean freight and passenger service along the Panama Canal. KCS' North American rail holdings and strategic alliances with other North American rail partners are primary components of a unique railway system, linking the commercial and industrial centers of the U.S., Mexico and Canada. More information about KCS can be found at [www.kcsouthern.com](http://www.kcsouthern.com).

### **Forward Looking Statements**

*Certain statements contained in this press release constitute forward-looking information and statements (collectively, **forward-looking statements**) including, but not limited to, statements concerning the proposed construction and operations of the DRU, the anticipated benefits, opportunities and sustainability of the DRU and DRUbit™ for project participants, oil field and related business activities, market participants, local communities and governments, the methods of transportation of DRUbit™ and contribution of the DRU to the improvement of market access for oil producers, construction, ownership and operation of USD's Port Arthur terminal and the plans for such terminal, improved industry economics associated with the DRU and transportation of DRUbit™, the safety features of the transportation of DRUbit™ and expectations with respect to the business and financial prospects and opportunities related to the DRU and DRUbit™ transportation.*

*These statements relate to future events or future performance. All statements other than statements of historical fact are forward-looking statements. The use of any of the words "anticipate", "plan", "aim", "target", "contemplate", "continue", "estimate", "expect", "intend", "propose", "might", "may", "will", "shall", "project", "should", "could", "would", "believe", "predict", "forecast", "pursue", "potential" and "capable" and similar expressions are intended to identify forward-looking statements. The forward looking statements reflect the project participant's beliefs and assumptions with respect to, among other things, the ability to obtain necessary commercial support and regulatory approvals in connection with the DRU and Port Arthur terminal, the timing of completion of the DRU and Port Arthur terminal, continued market demand, general economic trends, industry trends, commodity prices, capital markets, the governmental, regulatory and legal environment in the various jurisdictions in which they*



*current and future obligations, ability to obtain financing for capital programs and the DRU and Port Arthur terminal on acceptable terms, the successful and timely implementation of capital projects in a manner consistent with financial expectations and the other business activities of the participants, and other assumptions inherent in management's expectations of future operating and financial results and other forward-looking statements identified herein.*

*Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. Although the project participants believe these statements to be reasonable, no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this press release should not be unduly relied upon. Actual results could differ materially from those anticipated in these forward looking statements as a result of, among other things, risks inherent in the businesses conducted by each of the project participants, ability for Gibson and USD to secure additional long-term, take-or-pay agreements with other producer and refiner customers to fully underpin the economics of the project, the ability to satisfy the commercial conditions relating to ConocoPhillips' participation in the DRU project and other conditions associated with the DRU and its construction and operation, the ability of customers to discover and market reserves, construction costs in respect of the DRU and USD's Port Arthur terminal, regulatory decisions, competitive factors in the industries in which the project participants operate, prevailing economic conditions, world-wide demand for crude oil and petroleum products, volatility of commodity prices, currency and interest rates fluctuations, product supply and demand (including demand for DRUbit™), changes in credit ratings applicable to any of the participants, operating costs and the accuracy of cost estimates, exposure to counterparties and partners, including ability and willingness of such parties to satisfy contractual obligations in a timely manner, future capital expenditures, ability to obtain necessary regulatory approvals for the DRU and USD's Port Arthur terminal, the availability, costs, terms and timing of or execution of, and competition for, required regulatory approvals, rail capacity and terminal access, the successful and timely implementation of construction on the DRU and Port Arthur terminal and/or stages thereof, changes to any of the*



regulations, including environmental and tax laws and regulations, competition for employees and other personnel, equipment, material and services related thereto, the availability and cost of employees and other personnel, equipment, materials and services, weather, including its impact on product demand, exploration, production and transportation, inherent risks associated with the exploration, development, production and transportation of bitumen, the timing and extent of changes in foreign currency exchange rates, interest rates, inflation rates, global and domestic financial market conditions and global and domestic general economic conditions, political developments around the world, including the areas in which the project participants individually, or collectively, operate, many of which are beyond the control of any of the project participants. Readers are cautioned that the foregoing lists are not exhaustive. For a full discussion of the material risk factors please refer to those included in Gibson's Annual Information Form dated March 4, 2019 as filed on SEDAR and available on the Gibson website at [www.gibsonenergy.com](http://www.gibsonenergy.com), the more detailed information about factors that could affect future events may be found in filings by ConocoPhillips with the Securities and Exchange Commission including ConocoPhillips' Annual Report on Form 10-K for the year ended December 31, 2018 and subsequent reports, those detailed from time to time in reports filed by CP with securities regulators in Canada and the United States under "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Information" in CP's annual and interim reports on Form 10-K and 10-Q, and the more detailed information about factors that could affect future events may be found in filings by KCS with the Securities and Exchange Commission including KCS' Annual Report on Form 10-K for the year ended December 31, 2018 and subsequent reports.

#### Tags

[Gibson Energy](#)
[DRUbit](#)
[dru](#)
[usd](#)

#### Related Links

- [Gibson Energy Website](#)
- [US Development Group Website](#)

## Recommended



Source: [Gibson Energy Inc.](#)

### Gibson Energy Confirms 2020 Fourth Quarter and Year-End Earnings Release Date and Provides Conference Call & Webcast Details

CALGARY, Alberta, Jan. 25,  
2021 (GLOBE NEWSWIRE) --  
Gibson Energy Inc.  
announced today that it  
expects to release its 2020  
fourth quarter and year-end  
financial and operating  
results on Monday,...



Source: [Gibson Energy Inc.](#)

### Gibson Energy Announces Redemption of Convertible Debentures

CALGARY, Alberta, Dec. 23,  
2020 (GLOBE NEWSWIRE) --  
Gibson Energy Inc.  
announced today that it has  
completed the previously  
announced redemption of its  
outstanding 5.25%  
convertible unsecured...



## Explore



### The Hotbed of the 3D Printer Must Be Hot? The Soon...

February 20, 2022 08:00 ET

### Kessler Topaz Meltzer & Check, LLP Reminds Shareho...

February 19, 2022 21:00 ET

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# **Exhibit 12**

**Excerpts from  
October 20, 2020 KCS  
Board of Directors  
Meeting Slides**

**WITHHELD FROM  
PUBLIC VERSION**

# **Exhibit 13**

**Excerpts from  
February 4, 2021  
KCS Board of  
Directors Meeting  
Materials**

**WITHHELD  
FROM PUBLIC  
VERSION**

# **Exhibit 14**

**June 3, 2021 CN-KCS  
Presentation Slides,  
Bernstein's 37th Annual  
Strategic Decisions  
Conference**



# Bernstein's 37<sup>th</sup> Annual Strategic Decisions Conference

**JJ Ruest**

President & CEO, CN

**Patrick J. Ottensmeyer**

President & CEO, KCS

---

June 3, 2021

PUBLIC VERSION





# Forward-Looking Statements

Certain statements included in this presentation constitute “forward-looking statements” within the meaning of the United States Private Securities Litigation Reform Act of 1995 and under Canadian securities laws, including statements based on management’s assessment and assumptions and publicly available information with respect to KCS, regarding the proposed transaction between CN and KCS, the expected benefits of the proposed transaction and future opportunities for the combined company. By their nature, forward-looking statements involve risks, uncertainties and assumptions. CN cautions that its assumptions may not materialize and that current economic conditions render such assumptions, although reasonable at the time they were made, subject to greater uncertainty. Forward-looking statements may be identified by the use of terminology such as “believes,” “expects,” “anticipates,” “assumes,” “outlook,” “plans,” “targets,” or other similar words.

Forward-looking statements are not guarantees of future performance and involve risks, uncertainties and other factors which may cause actual results, performance or achievements of CN, or the combined company, to be materially different from the outlook or any future results, performance or achievements implied by such statements. Accordingly, readers are advised not to place undue reliance on forward-looking statements. Important risk factors that could affect the forward-looking statements in this presentation include, but are not limited to: the outcome of the proposed transaction between CN and KCS; the parties’ ability to consummate the proposed transaction; the conditions to the completion of the proposed transaction; that the regulatory approvals required for the proposed transaction may not be obtained on the terms expected or on the anticipated schedule or at all; CN’s indebtedness, including the substantial indebtedness CN expects to incur and assume in connection with the proposed transaction and the need to generate sufficient cash flows to service and repay such debt; CN’s ability to meet expectations regarding the timing, completion and accounting and tax treatments of the proposed transaction; the possibility that CN may be unable to achieve expected synergies and operating efficiencies within the expected time-frames or at all and to successfully integrate KCS’ operations with those of CN; that such integration may be more difficult, time-consuming or costly than expected; that operating costs, customer loss and business disruption (including, without limitation, difficulties in maintaining relationships with employees, customers or suppliers) may be greater than expected following the proposed transaction or the public announcement of the proposed transaction; the retention of certain key employees of KCS may be difficult; the duration and effects of the COVID-19 pandemic, general economic and business conditions, particularly in the context of the COVID-19 pandemic; industry competition; inflation, currency and interest rate fluctuations; changes in fuel prices; legislative and/or regulatory developments; compliance with environmental laws and regulations; actions by regulators; the adverse impact of any termination or revocation by the Mexican government of KCS de México, S.A. de C.V.’s Concession; increases in maintenance and operating costs; security threats; reliance on technology and related cybersecurity risk; trade restrictions or other changes to international trade arrangements; transportation of hazardous materials; various events which could disrupt operations, including illegal blockades of rail networks, and natural events such as severe weather, droughts, fires, floods and earthquakes; climate change; labor negotiations and disruptions; environmental claims; uncertainties of investigations, proceedings or other types of claims and litigation; risks and liabilities arising from derailments; timing and completion of capital programs; and other risks detailed from time to time in reports filed by CN with securities regulators in Canada and the United States. Reference should also be made to Management’s Discussion and Analysis in CN’s annual and interim reports, Annual Information Form and Form 40-F, filed with Canadian and U.S. securities regulators and available on CN’s website, for a description of major risk factors relating to CN. Additional risks that may affect KCS’ results of operations appear in Part I, Item 1A “Risks Related to KCS’s Operations and Business” of KCS’ Annual Report on Form 10-K for the year ended December 31, 2020, and in KCS’ other filings with the U.S. Securities and Exchange Commission (“SEC”).

Forward-looking statements reflect information as of the date on which they are made. CN assumes no obligation to update or revise forward-looking statements to reflect future events, changes in circumstances, or changes in beliefs, unless required by applicable securities laws. In the event CN does update any forward-looking statement, no inference should be made that CN will make additional updates with respect to that statement, related matters, or any other forward-looking statement.

# Additional Information



## No Offer or Solicitation

This presentation does not constitute an offer to sell or the solicitation of an offer to buy any securities or a solicitation of any vote or approval, nor shall there be any sale of securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction. No offer of securities shall be made except by means of a prospectus meeting the requirements of Section 10 of the Securities Act of 1933, as amended.

## Additional Information and Where to Find It

In connection with the proposed transaction, CN will file with the SEC a registration statement on Form F-4 to register the shares to be issued in connection with the proposed transaction. The registration statement will include a preliminary proxy statement of KCS which, when finalized, will be sent to the stockholders of KCS seeking their approval of the merger-related proposals. This presentation is not a substitute for the proxy statement or registration statement or other document CN and/or KCS may file with the SEC or applicable securities regulators in Canada in connection with the proposed transaction.

INVESTORS AND SECURITY HOLDERS ARE URGED TO READ THE PROXY STATEMENT(S), REGISTRATION STATEMENT(S), TENDER OFFER STATEMENT, PROSPECTUS AND ANY OTHER RELEVANT DOCUMENTS FILED WITH THE SEC OR APPLICABLE SECURITIES REGULATORS IN CANADA CAREFULLY IN THEIR ENTIRETY IF AND WHEN THEY BECOME AVAILABLE BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT CN, KCS AND THE PROPOSED TRANSACTIONS. Any definitive proxy statement(s), registration statement or prospectus(es) and other documents filed by CN and KCS (if and when available) will be mailed to stockholders of CN and/or KCS, as applicable. Investors and security holders will be able to obtain copies of these documents (if and when available) and other documents filed with the SEC and applicable securities regulators in Canada by CN free of charge through at [www.sec.gov](http://www.sec.gov) and [www.sedar.com](http://www.sedar.com). Copies of the documents filed by CN (if and when available) will also be made available free of charge by accessing CN's website at [www.CN.ca](http://www.CN.ca). Copies of the documents filed by KCS (if and when available) will also be made available free of charge at [www.investors.kcsouthern.com](http://www.investors.kcsouthern.com), upon written request delivered to KCS at 427 West 12th Street, Kansas City, Missouri 64105, Attention: Corporate Secretary, or by calling KCS's Corporate Secretary's Office by telephone at 1-888-800-3690 or by email at [corpsec@kcsouthern.com](mailto:corpsec@kcsouthern.com).

## Participants

This presentation is neither a solicitation of a proxy nor a substitute for any proxy statement or other filings that may be made with the SEC and applicable securities regulators in Canada. Nonetheless, CN, KCS, and certain of their directors and executive officers and other members of management and employees may be deemed to be participants in the solicitation of proxies in respect of the proposed transactions. Information about CN's executive officers and directors is available in its 2021 Management Information Circular, dated March 9, 2021, as well as its 2020 Annual Report on Form 40-F filed with the SEC on February 1, 2021, in each case available on its website at [www.CN.ca/investors/](http://www.CN.ca/investors/) and at [www.sec.gov](http://www.sec.gov) and [www.sedar.com](http://www.sedar.com). Information about KCS' directors and executive officers may be found on its website at [www.kcsouthern.com](http://www.kcsouthern.com) and in its 2020 Annual Report on Form 10-K filed with the SEC on January 29, 2021, available at [www.investors.kcsouthern.com](http://www.investors.kcsouthern.com) and [www.sec.gov](http://www.sec.gov). Additional information regarding the interests of such potential participants will be included in one or more registration statements, proxy statements, tender offer statements or other documents filed with the SEC and applicable securities regulators in Canada if and when they become available. These documents (if and when available) may be obtained free of charge from the SEC's website at [www.sec.gov](http://www.sec.gov) and from [www.sedar.com](http://www.sedar.com), as applicable.

## Non-GAAP Measures

CN reports its financial results in accordance with United States generally accepted accounting principles (GAAP). This presentation includes certain forward looking non-GAAP measures, including EBITDA, free cash flow and adjusted debt-to-adjusted EBITDA multiples. These non-GAAP measures may not be comparable to similar measures presented by other companies. It is not practicable to reconcile, without unreasonable efforts, these forward-looking measures to the most comparable GAAP measures, due to unknown variables and uncertainty related to future results. Please see note on Forward-Looking Statements above for further discussion.

**All amounts in this presentation are expressed in US dollars, unless otherwise noted. All references to the "Company" are to CN.**

# CN-KCS: An “End-to-End” Merger That Will Enhance Choice and Competition



## CUSTOMER CHOICE

- Wide variety of transportation options in the center of the U.S. including rails, highways and barges on the Mississippi River system
- The CN-KCS combination will create and add new direct rail routes that will **enhance multimodal competition** and **maximize customer choice**
- Committed to preserve connectivity by **keeping current gateways open**

## NEW OPPORTUNITIES

- Create service where no direct choices exist today, **enhancing competition** between motor carriers and railroads and among railroads
- Provide grain shippers in Illinois with **new access** to East St. Louis and new direct single-line service to Mexico and ports in Mobile / New Orleans

## NO OVERLAP

- CN has committed to a divestiture of a 70-mile section of track that would result in **zero overlap**
- **End-to-end** merger ensures that shippers enjoy the **same number of options** that they do today

## CONTINUED INVESTMENT

- **\$250 million in infrastructure investments** across CN and KCS lines
- Results in **more efficiency, more capacity and more opportunities for employees and communities**



CN-KCS is a fully end-to-end merger that will produce significant public interest benefits

# High Confidence in Our Original Estimate of \$1B in EBITDA Synergies



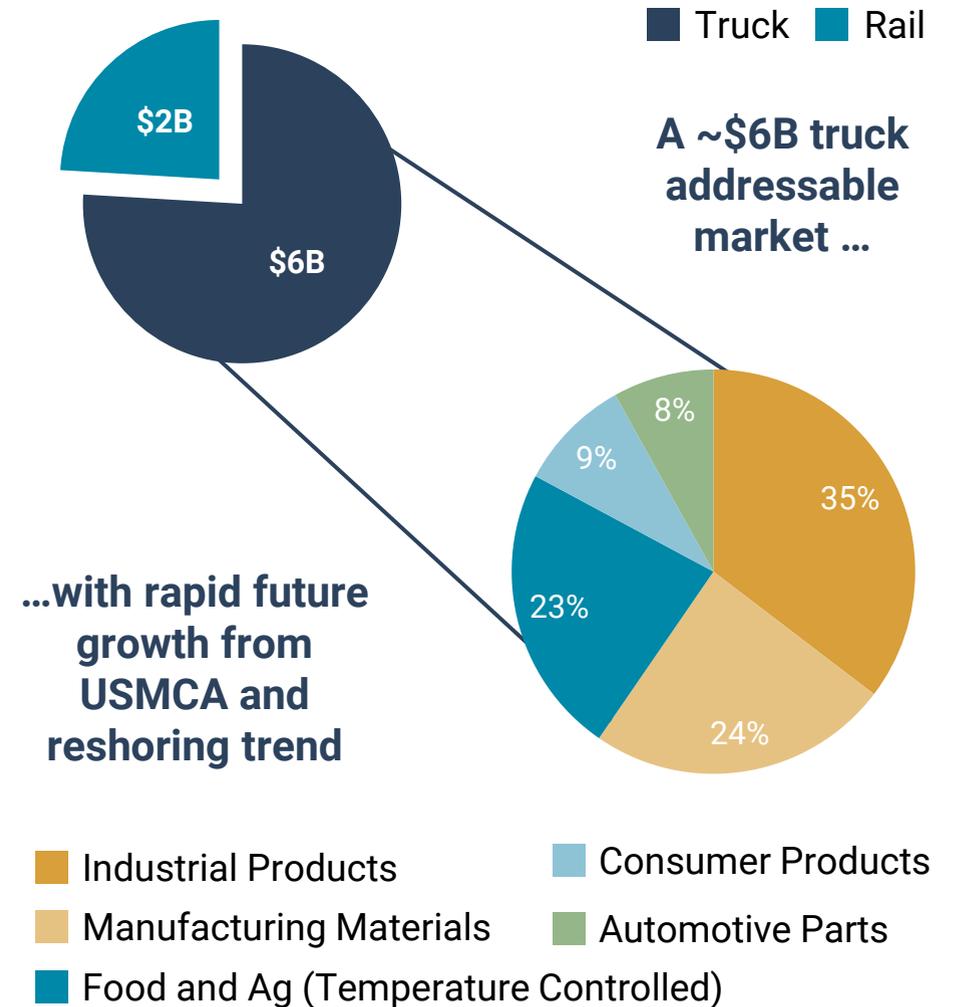
## New Revenue Opportunities

- ✓ The revenue opportunities are based on two major routes:
  - Kansas City Speedway – connecting CN’s Midwest foothold and the KC region
  - CN Greenway – connecting Mexico, East Texas and the Gulf with CN’s US Midwest and Eastern Canada foothold
- ✓ Combined business could target an incremental \$6B of truck intermodal and \$2B of rail TAM
- ✓ Diligence on KCS identified additional opportunities beyond original assessment (mostly carloads)

## Cost Efficiencies

- ✓ Improved fuel efficiency and lower costs
- ✓ Technology deployment on a larger network
- ✓ More effective purchasing of operating and capital expenditures
- ✓ Core of cost savings will not be people-driven

### Intermodal Opportunity Breakdown (1)



**Synergies are predominantly growth and revenue-driven; and will yield environmental benefits by taking trucks off the road**

(1) Conservative estimate based on CN’s original assessment of new revenue opportunities.

# CN's Advanced Technology Applied to a Larger Rail Network



## ✓ Autonomous Track Inspection Program *(for Safety and Capacity)*

- Latest sensors and AI technology for accurate preventative maintenance, enabling up to 20x more inspections
- Proven rail safety improvements (reduce incidents, reduce incident costs, better customer sentiment)



## ✓ Digitalized and Automated Train Inspection *(for Safety and Reliability)*

- More frequent and better machine vision-based inspections
- High-resolution imaging coupled with powerful machine learning algorithms



## ✓ Connecting the Supply Chain *(for Service and Business Growth)*

- Real-time “track and trace” for customer shipments
- Reducing end-to-end variability and cycle times



The combined CN-KCS customers will benefit from CN's leadership and investments in advanced technology

# Mexico Provides Unparalleled Growth Opportunities

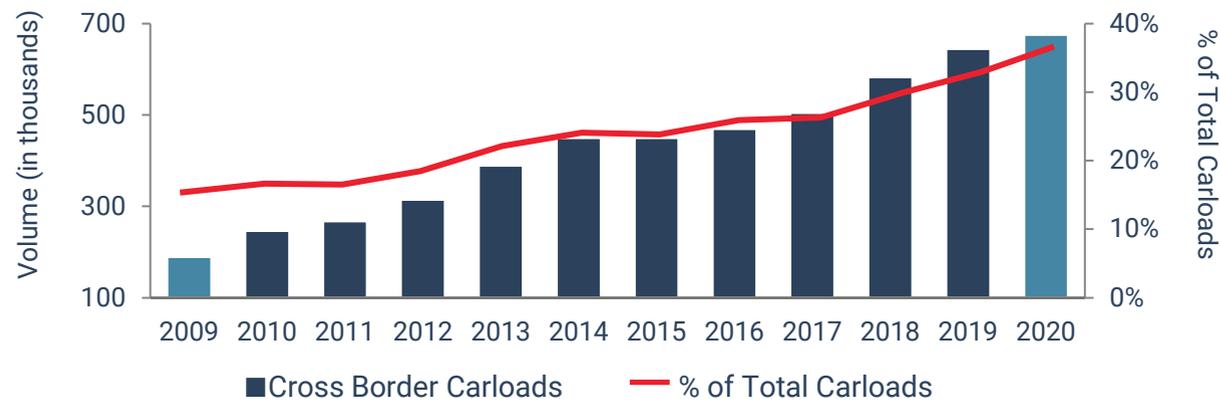


## Mexico Near-Sourcing Benefits and Positive Drivers

- ✓ Multiple factors (including the ratification of USMCA, the COVID-19 pandemic, and other macro geo-political trends) have led to an increased corporate focus on near-sourcing / near-shoring
- ✓ Mexico's manufacturing economy will reap material benefits
- ✓ Companies who near-source in Mexico have multiple advantages:
  - Trade advantages
  - Manufacturing clusters
  - Competitive labor costs with a highly trained workforce

## KCS US-Mexico Volume

13% Volume CAGR since 2009



## KCS Customer / Partner Investments and Projects



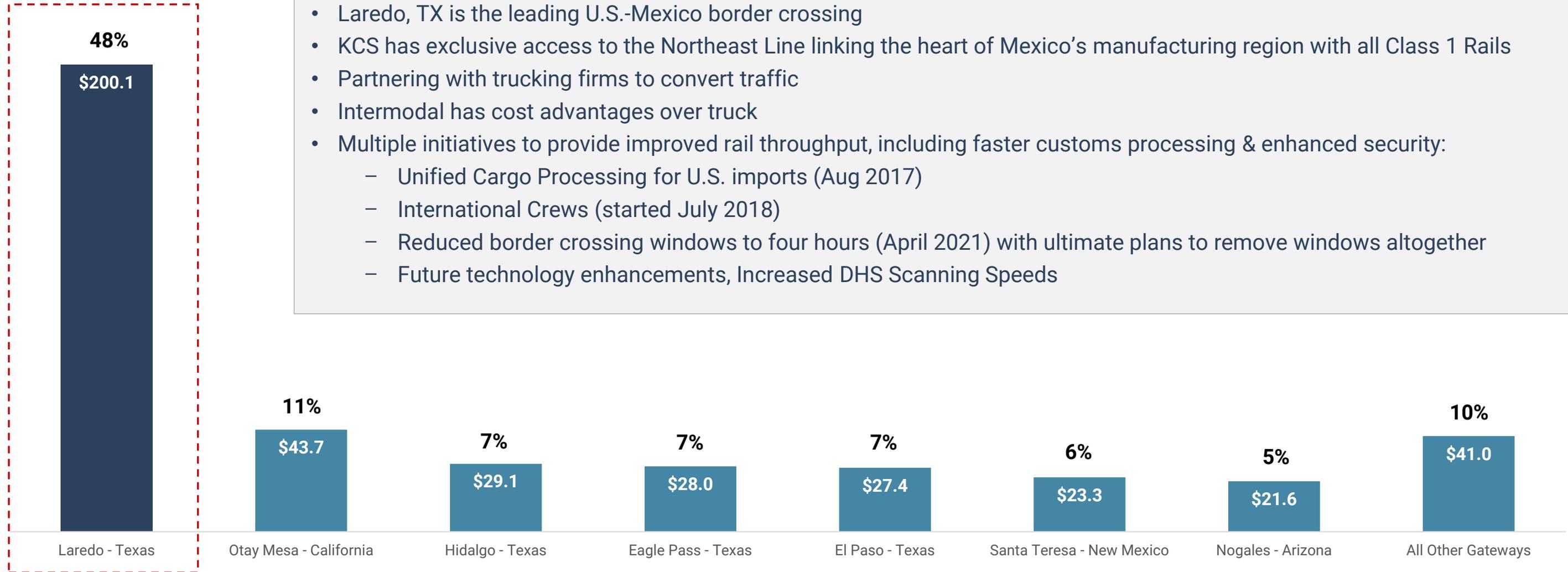
**CN-KCS will be very well positioned to participate in Mexico's growing economy and near-sourcing phenomenon**

# Creating A Seamless, Same-System U.S.–Mexico Connection via Laredo, TX



## 2020 U.S. & Mexico Surface Trade by Border Crossing Import and Export

Value (US\$ billions) & % Share



### Commentary

- Laredo, TX is the leading U.S.-Mexico border crossing
- KCS has exclusive access to the Northeast Line linking the heart of Mexico’s manufacturing region with all Class 1 Rails
- Partnering with trucking firms to convert traffic
- Intermodal has cost advantages over truck
- Multiple initiatives to provide improved rail throughput, including faster customs processing & enhanced security:
  - Unified Cargo Processing for U.S. imports (Aug 2017)
  - International Crews (started July 2018)
  - Reduced border crossing windows to four hours (April 2021) with ultimate plans to remove windows altogether
  - Future technology enhancements, Increased DHS Scanning Speeds

**The CN-KCS Premier USMCA rail network will connect the U.S. and Mexico through the #1 gateway in Laredo, TX**

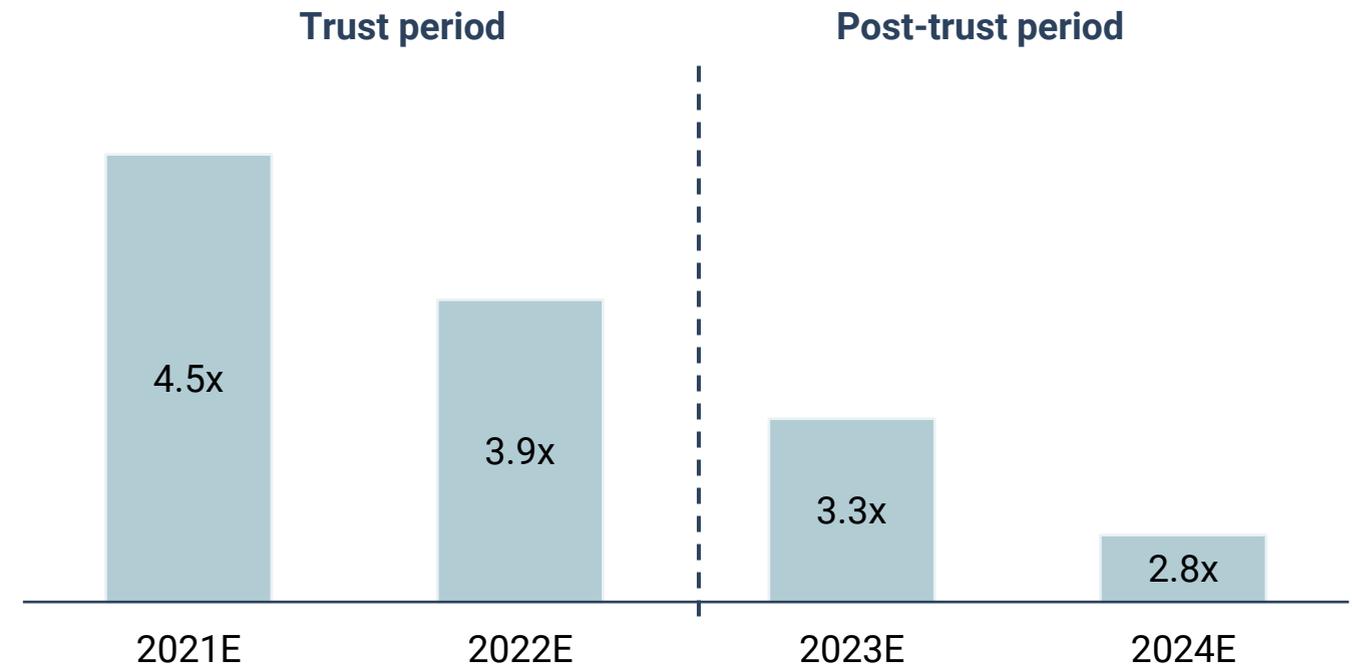


# Committed to Maintaining a Strong Balance Sheet and Investment Grade Rating – During and After the Voting Trust

## CN's Strong Financial Profile

- Strongest balance sheet among Class I rail carriers
- S&P and Moody's expect CN to remain investment grade
- Suspended share buy-backs
- Strong FCF profile
- Continued capital expenditure investments
- Rapid deleveraging profile

## Projected Rapid Deleveraging Profile <sup>(1)</sup>



**CN is committed to maintaining a strong financial position and investment grade profile**

(1) Represents adjusted debt-to-adjusted EBITDA multiple, assuming closing into trust at end of 2021. Please see the heading Non-GAAP Measures in this presentation.

# KCS Management and Governance While in Voting Trust



## 1. Continuity of KCS' existing governance and executive management

- KCS management will remain in control of KCS (CN will have no governance rights nor exercise any control over KCS)
- Pat Ottensmeyer will continue to lead KCS as CEO, reporting to the Board and the Trustee
- KCS' Board has approved retention bonuses to ensure the team stays in place and manages the company

## 2. No change in KCS' existing strategic plan and operations

- KCS management will lead and operate KCS in the same manner as it currently does
- KCS will act in the ordinary course of business and will continue to pursue its existing strategic plan

## 3. No change in capital allocation policy; KCS will continue to be well-capitalized and make investments in its business

- Investment grade rating of BBB+ / Baa2
- KCS will continue to deploy 40-50% of available cash to capital expenditures
- KCS will make marketing and capital investments with the interests of KCS and its customers in mind, not those of CN

**CN application satisfies every aspect of Voting Trust approval framework**

# **Exhibit 15**

**Excerpts from  
Canadian Pacific  
Railway Limited Form  
F-4 Registration  
Statement, filed with  
the Securities and  
Exchange Commission  
on October 1, 2021**

# SECURITIES AND EXCHANGE COMMISSION

## FORM F-4

Registration statement for securities issued by foreign private issuers in certain business combination transactions

Filing Date: **2021-10-01**  
SEC Accession No. [0001193125-21-289901](#)

([HTML Version](#) on [secdatabase.com](#))

### FILER

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**CANADIAN PACIFIC RAILWAY LTD/CN**

CIK: **16875** | IRS No.: **980355078** | Fiscal Year End: **1231**  
Type: **F-4** | Act: **33** | File No.: **333-259991** | Film No.: **211300045**  
SIC: **4011** Railroads, line-haul operating

**Mailing Address**

7550 OGDEN DALE ROAD  
S.E.  
CALGARY ALBERTA A0 T2C  
4X9

**Business Address**

7550 OGDEN DALE ROAD  
S.E.  
CALGARY ALBERTA A0 T2C  
4X9  
403-319-3591

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As filed with the Securities and Exchange Commission on October 1, 2021

Registration No. 333-[-]

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM F-4  
REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933**

**Canadian Pacific Railway Limited**  
(Exact name of registrant as specified in its charter)

**Canada**  
(State or other jurisdiction of  
incorporation or organization)

**4011**  
(Primary Standard Industrial  
Classification Code Number)

**98-0355078**  
(IRS Employer  
Identification Number)

7550 Ogden Dale Road S.E., Calgary, Alberta,  
Canada, T2C 4X9  
(403) 319-7000

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

*With copies to:*

**Jeffrey J. Ellis**  
Canadian Pacific Railway Limited  
7550 Ogden Dale Road S.E.  
Calgary, Alberta, Canada T2C 4X9  
(403) 319-7000

**Francis J. Aquila**  
C. Andrew Gerlach  
Sullivan & Cromwell LLP  
125 Broad Street  
New York, New York 10004  
(212) 558-4000

**Adam Godderz**  
Kansas City Southern  
427 West 12th Street  
Kansas City, Missouri 64105  
(816) 983-1303

**Steven A. Rosenblum**  
Elina Tetelbaum  
Wachtell, Lipton, Rosen & Katz  
51 West 52nd Street  
New York, New York 10019  
(212) 403-1000

**Approximate date of commencement of proposed sale of the securities to the public:**

**As soon as practicable after the effectiveness of this registration statement and upon completion of the transaction described in the enclosed proxy statement/prospectus.**

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, as amended, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If applicable, place an X in the box to designate the appropriate rule provision relied upon in conducting this transaction:

U.S. Exchange Act Rule 13e-4(i) (*Cross-Border Issuer Tender Offer*)

U.S. Exchange Act Rule 14d-1(d) (*Cross-Border Third Party Tender Offer*)

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933.

Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards<sup>†</sup> provided pursuant to Section 7(a)(2)(B) of the Securities Act

<sup>†</sup> The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

**The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act, or until this registration statement shall become effective on such date as the U.S. Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.**

**CALCULATION OF REGISTRATION FEE**

| Title of Each Class of Securities to Be Registered | Amount to Be Registered | Proposed Maximum Offering Price Per Share | Proposed Maximum Aggregate Offering Price | Amount of Registration Fee |
|--|-------------------------|---|---|----------------------------|
| Canadian Pacific Railway Limited common shares     | 264,723,380(1)          | N/A                                       | \$16,669,128,225.64(2)                    | \$1,545,228.19(3)          |

(1) Represents the maximum number of Canadian Pacific Railway Limited ("CPRL") common shares estimated to be issuable or subject to stock-based awards that may be assumed by the registrant upon the completion of the transaction described herein. The calculation of the number of CPRL common shares being registered is based on (a) the sum of (i) 90,789,609, an estimate of the maximum number of shares of common stock, par value \$0.01 per share, of Kansas City Southern ("KCS") issued and outstanding as of September 27, 2021, and (ii) 1,000,744.6654, the maximum number of shares of KCS common stock issuable upon the exercise or settlement of KCS options and time-based and performance-based awards (collectively, the "KCS equity awards") with respect to KCS common stock (together, the "estimated number"), multiplied by (b) the exchange ratio of 2.884 CPRL common shares for each share of KCS common stock.

PUBLIC VERSION

- (2) Calculated pursuant to Rules 457(c), 457(f)(1) and 457(f)(3) promulgated under the Securities Act of 1933, as amended (the "U.S. Securities Act"), and solely for the purpose of calculating the registration fee. The proposed maximum aggregate offering price of the securities being registered was calculated based on (a) the product of (i) \$271.60, the average of the high and low prices for shares of KCS common stock as reported on the New York Stock Exchange on September 24, 2021, multiplied by (ii) the estimated number (which represents the estimated maximum number of shares of KCS common stock that may be exchanged in the transactions contemplated by the merger agreement described herein, as described in footnote (1) above), minus (b) \$8,261,131,829.89 (which represents the estimated aggregate amount of cash that will be paid by CPRL to the holders of shares of KCS common stock in the transactions contemplated by the merger agreement described herein). In accordance with Rule 416, this registration statement also covers an indeterminate number of CPRL common shares as may be issuable as a result of stock splits, stock dividends or similar transactions.
  - (3) The registration fee for the securities registered hereby has been calculated pursuant to Section 6(b) of the U.S. Securities Act, by multiplying the proposed maximum aggregate offering price for the securities by 0.0000927.
- 
-

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“*The KCS Merger Proposal–Opinion of Morgan Stanley*” and “*The KCS Merger Proposal–Opinion of BofA Securities*” on pages 71 and 84, respectively. After further discussion and deliberation, the KCS board unanimously determined that the final CPRL proposal continued to constitute a company superior proposal and approved the proposed waiver letter agreement with CN, termination of the CN merger agreement, KCS’ s payment of the \$700.0 million CN agreement termination payment and the \$700.0 million CN refund owed to CN (or its affiliates) under the terms of the CN agreement, and KCS’ s entry into the merger agreement with CPRL. The KCS board also approved the updated retention and severance arrangements set forth in the final CPRL proposal.

Following the completion of the KCS board meeting, KCS management notified CN of the KCS board’ s determination, after which KCS and CN entered into the waiver letter agreement and KCS terminated the CN agreement and paid the \$700.0 million CN agreement termination payment. Shortly thereafter, KCS delivered an executed signature page to the merger agreement with CPRL, which had already been executed by CPRL, and KCS and CPRL issued a joint press release announcing the transaction. Following execution of the merger agreement, CPRL remitted to KCS \$700.0 million in connection with the payment of the CN agreement termination payment made by KCS to CN, KCS paid the \$700.0 million CN refund to an affiliate of CN, and CPRL remitted to KCS \$700.0 million in connection with the payment of the CN refund made by KCS to an affiliate of CN.

### **Recommendation of the KCS Board; KCS’ s Reasons for the Transaction**

At a special meeting held on September 15, 2021, the KCS board unanimously: (1) determined that it was in the best interests of KCS and its stockholders, and declared it advisable, to enter into the merger agreement with CPRL; (2) approved the execution, delivery and performance of the merger agreement and the transactions contemplated by the merger agreement (including the merger); (3) recommended that the stockholders of KCS adopt the merger agreement; and (4) directed that the merger agreement be submitted to a vote at a meeting of KCS’ s stockholders. **The KCS board unanimously recommends that KCS stockholders vote “FOR” the merger proposal.**

In evaluating the transaction and in reaching its determinations and making its recommendations with respect to the merger agreement, the KCS board consulted with KCS senior management and outside legal and financial advisors over the course of several meetings, and considered a number of factors, including the following material factors that weighed in favor of the transaction.

#### *Strategic Considerations and Synergies:*

The KCS board believes the transaction will create the first rail network connecting the U.S., Mexico and Canada, with the ability to deliver dramatically expanded market reach for KCS and CPRL customers, provide new competitive transportation options, provide infrastructure, public safety and environmental benefits through truck to rail conversion opportunities, and support North American economic growth;

The KCS board believes CPRL and KCS are the fastest growing Class I railroads, with significant success in the transformation to Precision Scheduled Railroading;

The KCS board considered a synergy analysis (based on CPRL’ s synergies analysis) showing annualized EBITDA synergies for the combined company of approximately \$990 million (plus \$20 million of capital expenditure and depreciation and amortization synergies) expected to be realized within the first three years after the transaction, primarily by executing the combined growth strategies of KCS and CPRL with new efficiencies for customers and improved on-time performance under their respective PSR programs; the KCS board also considered a more conservative synergy analysis prepared by KCS management showing EBITDA synergies of approximately \$377 million (plus

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\$23 million of capital expenditure and depreciation and amortization synergies) over three years, and assessed both synergy analyses in making its decision, as further described in the section entitled “*KCS Unaudited Prospective Financial Information*”;

The KCS board believes that the combined company will have the scale, balance sheet strength, financial flexibility, and free cash flow to fund future growth, and improved ability to access the capital markets on more favorable terms than available to KCS as an independent company, which would allow the combined company to be more competitive in capturing strategic opportunities;

The KCS board received information from and had discussions with KCS’ s management, in consultation with outside financial advisors, regarding CPRL’ s business, results of operations, financial and market position, KCS management’ s expectations concerning the combined company’ s business and financial prospects, and historical and current trading prices of CPRL common shares;

### *Attractive Value and Mix of Consideration*

The KCS board considered the aggregate value and nature of the consideration to be received in the transaction by KCS stockholders, including:

that the merger consideration had an implied value per share of KCS common stock of \$300, based on the closing price of CPRL common shares on the NYSE as of August 9, 2021 (the last full trading day prior to the date on which CPRL submitted the revised CPRL proposal), which represented a premium of approximately 34% to KCS stockholders based on the unaffected closing price of KCS common stock on March 19, 2021 (the last trading day before the KCS board’ s approval of and the announcement of the prior CP merger agreement);

that based on CPRL’ s market price on September 13, 2021, approximately 69% of the merger consideration consists of CPRL common shares, with the CPRL common shares to be issued to KCS common stockholders constituting approximately 28% of the outstanding shares of CPRL common shares following the transaction, offering KCS common stockholders the opportunity for meaningful ownership participation in the future earnings, dividends, synergies and growth of the combined company, a company which the KCS board considers to be an attractive investment for the reasons discussed above in the section entitled “*Strategic Considerations and Synergies*”;

that based on CPRL’ s market price on September 13, 2021, approximately 31% of the merger consideration consists of cash, which provides KCS stockholders with immediate liquidity for a portion of their shares; and

that the first merger and the second merger, taken together, are intended to qualify as a “reorganization” within the meaning of Section 368(a) of the Code and that Section 367(a)(1) of the Code will not apply to cause the mergers to result in gain recognition by holders of KCS common stock that exchange their shares of KCS common stock for the merger consideration (other than any Excepted Shareholder), as more fully described in the section entitled “*Material U.S. Federal Income Tax Consequences*”;

### *Attractive Strategic Alternative:*

The KCS board believes that the transaction with CPRL is attractive in comparison to the alternative of remaining independent and continuing to execute on KCS’ s long-range business strategy and is also attractive in comparison to other alternatives, including the CN agreement. In this regard, the KCS board considered:

the course and history of KCS’ s discussions and competitive negotiations with Party A and CN, including: (i) the fact that, after six rounds of bidding, Party A’ s last proposal to acquire KCS for

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have received or in the future may receive compensation for the rendering of these services, including (i) having acted as a bookrunning manager and/or co-manager on certain debt capital markets transactions for CPRL, (ii) having acted or acting as a lender under CPRL's \$1.3 billion revolving credit facility, which consists of a \$1.0 billion tranche and a \$300 million tranche, which was amended on September 24, 2021 to extend the maturity dates of such tranches to September 27, 2026 and September 27, 2023, respectively, and (iii) having provided or providing certain treasury services and products to CPRL. From September 1, 2019, through August 31, 2021, BofA Securities and its affiliates derived aggregate revenues from CPRL of approximately \$6.6 million for corporate and/or investment banking services. In addition, BofA Securities received a customary fee of less than \$100,000 in connection with its commitment to act as a lender under CPRL's amended revolving credit facility, which was received subsequent to such period.

### **KCS Unaudited Prospective Financial Information**

The prospective financial information included in this section has been prepared by, and is the responsibility of, KCS's management. This prospective financial information was not prepared with a view toward compliance with published guidelines of the SEC or the guidelines established by the American Institute of Certified Public Accountants for preparation or presentation of prospective financial information.

Neither Deloitte LLP nor PricewaterhouseCoopers LLP has audited, reviewed, examined, compiled nor applied agreed-upon procedures with respect to the accompanying prospective financial information and, accordingly, neither Deloitte LLP nor PricewaterhouseCoopers LLP expresses an opinion or any other form of assurance with respect thereto. The PricewaterhouseCoopers LLP report incorporated by reference in this document relates to KCS's previously issued financial statements. It does not extend to the prospective financial information and should not be read to do so.

### **Summary of KCS Prospective Financial Information**

#### **KCS Unaudited Prospective Financial Information**

As described under the section of this proxy statement/prospectus entitled "*The KCS Merger Proposal—Background of the Transaction*," on page 49, KCS management maintains the KCS long-range plan, which is periodically updated and reviewed with the KCS board, that reflects KCS management's financial and business outlook for KCS over a ten-year period. This KCS long-range plan was reviewed by the KCS board in connection with its consideration of a transaction with CPRL, CN and other potential strategic alternatives throughout the latter half of 2020 continuing through its meeting on September 15, 2021. The KCS long-range plan included certain unaudited prospective financial information concerning KCS on a standalone basis for the fiscal years ending December 31, 2021 through December 31, 2029. We refer to these unaudited projections as the "KCS management unaudited KCS projections". The KCS management unaudited KCS projections were provided to Morgan Stanley and BofA Securities, which were directed by KCS management to use and rely upon the KCS management unaudited KCS projections for purposes of their respective financial analyses and fairness opinions. In addition, certain of the KCS management unaudited KCS projections were provided to CPRL, the CPRL board and their respective financial advisors, BMO, Goldman Sachs and Evercore.

In connection with the transaction, KCS management also prepared certain unaudited prospective financial information concerning CPRL on a standalone basis using (i) the CPRL five-year plan (as prepared by CPRL management and provided to KCS management) and (ii) extrapolations prepared by KCS management on the basis of the CPRL five-year plan for the fiscal years ending December 31, 2026 through December 31, 2029. Such unaudited prospective financial information was translated into U.S. dollar amounts from the original Canadian dollar amounts presented in the CPRL five-year plan based on an assumed foreign exchange ratio of 1.25x. We refer to these unaudited projections as the "KCS management unaudited CPRL projections," and the KCS management unaudited KCS projections and the KCS management unaudited CPRL projections, collectively, as the "KCS management unaudited projections". The KCS management unaudited CPRL

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projections were provided to the KCS board in connection with its consideration of the transaction as well as to Morgan Stanley and BofA Securities, which were directed by KCS management to use and rely upon the KCS management unaudited CPRL projections for purposes of their respective financial analyses and fairness opinions.

The KCS management unaudited projections were prepared treating KCS and CPRL, respectively, on a standalone basis, without giving effect to the transaction, including any impact of the negotiation or execution of the transaction, the expenses that may be incurred in connection with the transaction or the consummation thereof, the potential synergies that may be achieved by the combined company as a result of the transaction, the effect of any business or strategic decision or action that has been or will be taken as a result of the merger agreement having been executed or in anticipation of the transaction, or the effect of any business or strategic decisions or actions which would likely have been taken if the merger agreement had not been executed but which were instead altered, accelerated, postponed or not taken in anticipation of the transaction.

In connection with the transaction, KCS management prepared pro forma analyses, which were presented to the KCS board, that included CPRL's estimated potential earnings before interest, taxes, depreciation and amortization (which we refer to as "EBITDA") synergies of \$990 million (consisting of \$810 million from revenue synergies and \$180 million from operating and expense synergies), together with an alternative case showing a lower estimate of potential EBITDA synergies of \$377 million (consisting of \$222 million from revenue synergies and \$155 million from operating and expense synergies). The primary difference between the two cases was a more conservative assumption on revenue synergies (specifically the combined company's share of bulk commodities) in the \$377 million EBITDA synergies case. The assumptions used in the \$990 million EBITDA synergies case were based on CPRL's assessment of market opportunities that the combined company could reasonably be expected to capture, leading to a substantially greater estimate of revenue synergies. KCS management believed, however, that for purposes of the KCS board's consideration of the transaction, the KCS board should also consider a synergies estimate reflecting the more conservative assumptions. The \$377 million EBITDA synergies case also used slightly more conservative assumptions with respect to operating and expense synergies. The pro forma analyses, in each case, assumed a phase-in of synergies over the three years following CPRL's receipt of STB final approval, beginning in fiscal year 2023. KCS management, among other things, assumed that the aggregate cost of achieving the projected synergies would be, with respect to the \$990 million synergies case, \$180 million, and with respect to the \$377 million synergies case, \$155 million, with half of the costs to be incurred in the first year of the phase-in and the remaining half to be incurred in the second year of the phase-in. KCS management also assumed, with respect to the \$990 million synergies case, no dissynergies, \$20 million of capital expenditure and depreciation and amortization synergies and a one-time capital investment of \$50 million, and, with respect to the \$377 million synergies case, \$50 million of dissynergies and \$23 million of capital expenditure and depreciation and amortization synergies. These assumed dissynergies or additional synergies were subtracted from or added to the EBITDA synergies estimates. The assumed EBITDA synergies, including the cost to achieve such synergies, included in the two cases (which we refer to collectively as the "KCS management assumed synergies") are not reflected in the KCS management unaudited projections. The KCS management assumed synergies were provided to Morgan Stanley and BofA Securities, which were directed by KCS management to use and rely upon the KCS management assumed synergies for purposes of their respective financial analyses and fairness opinions.

Other than annual financial guidance provided to investors, which is generally updated each quarter, KCS does not as a matter of course make public long-term forecasts or projections as to future performance, revenues, earnings or other results, due to, among other reasons, the inherent difficulty of accurately predicting financial performance for future periods and the uncertainty of the underlying assumptions and estimates. However, the financial projections by KCS management are being included in this proxy statement/prospectus to give shareholders access to certain non-public information provided to the KCS board and KCS's financial advisors and to CPRL and the CPRL board and their respective financial advisors. The inclusion of the financial projections by KCS should not be regarded as an indication that the KCS board, KCS, the CPRL board, CPRL, Morgan Stanley, BofA Securities, BMO, Goldman Sachs or Evercore or any other recipient of this information

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considered, or now considers, it to be an assurance of the achievement of future results or an accurate prediction of future results, and they should not be relied on as such.

This prospective financial information was not prepared with a view toward compliance with published guidelines of the SEC or the guidelines established by the American Institute of Certified Public Accountants for preparation or presentation of prospective financial information, or GAAP, but, in the view of KCS' s management were prepared on a reasonable basis, reflected the best available estimates and judgments at the time of preparation, and presented as of the time of preparation, to the best of KCS' s management' s knowledge and belief, the expected course of action and the expected future financial performance of KCS or CPRL, as applicable. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and readers of this proxy statement/prospectus are cautioned not to place undue reliance on the KCS management unaudited projections or the KCS management assumed synergies. Although KCS' s management believes there is a reasonable basis for the KCS management unaudited projections and the KCS management assumed synergies, KCS cautions stockholders that future results could be materially different from the KCS management unaudited projections and the KCS management assumed synergies. This summary of the KCS management unaudited projections and the KCS management assumed synergies is included in this proxy statement/prospectus because the KCS management unaudited projections and the KCS management assumed synergies were provided to KCS' s financial advisors and to the KCS board for purposes of considering and evaluating the transaction and the merger agreement.

Other than annual financial guidance provided to investors, CPRL does not as a matter of course share with third parties long-term forecasts or projections as to future performance, revenues, earnings or other results due to, among other reasons, the inherent difficult of accurately predicting financial performance for future periods and the uncertainty of underlying assumptions and estimates. CPRL' s management prepared and provided to KCS' s management the CPRL five-year plan solely in connection with KCS' s consideration of a transaction with CPRL. The fact that the CPRL five-year plan was provided to KCS management should not be regarded as an indication that the CPRL board, CPRL, KCS or any other recipient of the CPRL five-year plan considered, or now considers, it to be an assurance of the achievement of future results or an accurate prediction of future results of CPRL, and it should not be relied on as such.

The KCS management unaudited projections and the KCS management assumed synergies are subject to estimates and assumptions in many respects and, as a result, subject to interpretation. While presented with numerical specificity, the KCS management unaudited projections and the KCS management assumed synergies are based upon a variety of estimates and assumptions that are inherently uncertain, though considered reasonable by KCS' s management as of the date of their preparation. These estimates and assumptions may prove to be inaccurate for any number of reasons, including general economic conditions, industry trends, the regulatory environment, competition, and the risks discussed in this proxy statement/prospectus under the sections entitled "*Cautionary Statement Regarding Forward-Looking Statements*" and "*Risk Factors*" beginning on pages 36 and 21, respectively. See also "*Where You Can Find Additional Information*" beginning on page 229. The KCS management unaudited projections and the KCS management assumed synergies also reflect assumptions as to certain business decisions that are subject to change. Because the KCS management unaudited projections were developed for KCS on a standalone basis without giving effect to the transaction, they do not reflect any divestitures or other restrictions that may be imposed in connection with the receipt of any necessary governmental or regulatory approvals, any synergies that may be realized as a result of the transaction or any changes to KCS' s or CPRL' s operations or strategy that may be implemented after completion of the transaction. There can be no assurance that the KCS management unaudited projections or the KCS management assumed synergies will be realized, and actual results may differ materially from those shown. Generally, the further out the period to which the KCS management unaudited projections and the KCS management assumed synergies relate, the less predictable and more unreliable the information becomes.

The KCS management unaudited projections contain certain non-GAAP financial measures that KCS believes are helpful in understanding its past financial performance and future results. KCS management regularly uses a

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variety of financial measures that are not in accordance with GAAP for forecasting, budgeting and measuring financial performance. The non-GAAP financial measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures. While KCS believes that these non-GAAP financial measures provide meaningful information to help investors understand the operating results and to analyze KCS' s financial and business trends on a period-to-period basis, there are limitations associated with the use of these non-GAAP financial measures. These non-GAAP financial measures are not prepared in accordance with GAAP, are not reported by all of KCS' s competitors and may not be directly comparable to similarly titled measures of KCS' s competitors due to potential differences in the exact method of calculation.

Financial measures included in projections provided to a financial advisor and a board of directors in connection with a business combination transaction are excluded from the definition of "non-GAAP financial measures" under the rules of the SEC, and therefore such financial measures are not subject to SEC rules regarding disclosures of non-GAAP financial measures, which may otherwise require a reconciliation of a non-GAAP financial measure to a GAAP financial measure. Reconciliations of non-GAAP financial measures were not provided to and were not relied on by Morgan Stanley or BofA Securities for purposes of their respective financial analyses and opinions or by the KCS board in connection with its consideration of the transaction, nor were they provided to CPRL or its financial advisors. Accordingly, a reconciliation of these non-GAAP financial measures has not been provided.

None of KCS, CPRL, the combined company or their respective affiliates, advisors, officers, directors or other representatives can provide any assurance that actual results will not differ from the KCS management unaudited projections or the KCS management assumed synergies, and none of them undertakes any obligation to update, or otherwise revise or reconcile, the KCS management unaudited projections or the KCS management assumed synergies to reflect circumstances existing after the date the KCS management unaudited projections or the KCS management assumed synergies were prepared or to reflect the occurrence of future events, even in the event that any or all of the assumptions underlying the KCS management unaudited projections or the KCS management assumed synergies, as applicable, are shown to be in error. Except as required by applicable securities laws, KCS does not intend to make publicly available any update or other revision to the KCS management unaudited projections or the KCS management assumed synergies, even in the event that any or all assumptions are shown to be in error. None of KCS or its affiliates, advisors, officers, directors or other representatives has made or makes any representation to any KCS stockholder or other person regarding KCS' s ultimate performance compared to the information contained in the KCS management unaudited projections or the KCS management assumed synergies or that forecasted results will be achieved. KCS has made no representation to CPRL, in the merger agreement or otherwise, concerning the KCS management unaudited projections or the KCS management assumed synergies.

The prospective financial information included in this document has been prepared by, and is the responsibility of, KCS management. Neither PricewaterhouseCoopers LLP nor Deloitte LLP have audited, reviewed, examined, compiled nor applied agreed-upon procedures with respect to the accompanying prospective financial information and, accordingly, neither PricewaterhouseCoopers LLP nor Deloitte LLP express an opinion or any other form of assurance with respect thereto. The PricewaterhouseCoopers LLP report incorporated in this document relates to KCS' s previously issued financial statements, and the Deloitte LLP reports incorporated in this document relate to CPRL' s previously issued financial statements. These reports do not extend to the prospective financial information and should not be read to do so.

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The following table presents a summary of the KCS management unaudited KCS projections that were reviewed by the KCS board in connection with its consideration of the transaction and provided to Morgan Stanley and BofA Securities for purposes of their respective financial analyses and fairness opinions. In addition, certain of the KCS management unaudited KCS projections were provided to CPRL.

| <b>(Dollars in millions)</b> | <b>FY' 21</b> | <b>FY' 22</b> | <b>FY' 23</b> | <b>FY' 24</b> | <b>FY' 25</b> | <b>FY' 26</b> | <b>FY' 27</b> | <b>FY' 28</b> | <b>FY' 29</b> |
|------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Revenue                      | \$2,992       | \$3,292       | \$3,554       | \$3,748       | \$3,946       | \$4,143       | \$4,344       | \$4,556       | \$4,770       |
| EBITDA(1)                    | 1,551         | 1,827         | 2,033         | 2,174         | 2,318         | 2,462         | 2,610         | 2,768         | 2,928         |
| Capital Expenditures         | 500           | 541           | 586           | 618           | 651           | 684           | 717           | 752           | 787           |
| EPS(2)                       | 8.29          | 10.75         | 12.60         | 14.21         | 16.06         | 18.04         | 20.20         | 22.60         | 25.20         |
| Unlevered Free Cash Flow(3)  | 364 (4)       | 779           | 940           | 1,013         | 1,089         | 1,164         | 1,242         | 1,324         | 1,408         |

- (1) EBITDA is defined as earnings before interest, taxes, depreciation and amortization.
- (2) EPS is defined as diluted earnings per share adjusted for the depreciation component of income tax driven by the difference in the Mexican peso to U.S. dollar exchange rate that existed at the time assets in Mexico were put into service and the current Mexican peso to U.S. dollar exchange rate.
- (3) Unlevered Free Cash Flow is defined as EBITDA less depreciation and amortization, plus other income, less other expenses, tax affected, plus depreciation and amortization, adjusted for changes in net working capital, less capital expenditures and less other investing activities. The calculation of Unlevered Free Cash Flow was not expressly included in the KCS management unaudited KCS projections but was derived from the KCS management unaudited KCS projections and is included for reference.
- (4) Figure represents July - December 2021.

The following table presents a summary of the KCS management unaudited CPRL projections that were provided to the KCS board in connection with its consideration of the transaction as well as to Morgan Stanley and BofA Securities for purposes of their respective financial analyses and fairness opinions.

| <b>(Dollars in millions)</b> | <b>FY' 21</b> | <b>FY' 22</b> | <b>FY' 23</b> | <b>FY' 24</b> | <b>FY' 25</b> | <b>FY' 26</b> | <b>FY' 27</b> | <b>FY' 28</b> | <b>FY' 29</b> |
|------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Revenue                      | \$6,580       | \$7,086       | \$7,498       | \$7,875       | \$8,287       | \$8,694       | \$9,111       | \$9,551       | \$9,995       |
| EBITDA(1)                    | 3,526         | 3,862         | 4,127         | 4,376         | 4,652         | 4,943         | 5,242         | 5,558         | 5,878         |
| Capital Expenditures         | 1,260         | 1,240         | 1,200         | 1,224         | 1,249         | 1,310         | 1,373         | 1,439         | 1,506         |
| Unlevered Free Cash Flow(2)  | 852 (3)       | 1,989         | 2,267         | 2,457         | 2,666         | 2,603         | 2,775         | 2,958         | 3,143         |

- (1) EBITDA is defined as earnings before interest, taxes, depreciation and amortization.
- (2) Unlevered Free Cash Flow is defined as EBITDA less depreciation and amortization, plus other income, less other expenses, tax affected, plus depreciation and amortization, less capital expenditures, less other cash/non-cash expenses, plus land sales and others and plus increase in deferred tax liability.
- (3) Figure represents July - December 2021.

**Listing of CPRL Common Shares**

It is a condition to the completion of the transaction that the CPRL common shares issuable under the merger agreement are approved for listing on the NYSE, subject to official notice of issuance, and the TSX, subject to customary listing requirements.

CPRL must use its reasonable best efforts to cause the CPRL common shares to be issued in the first merger to be approved for listing on the NYSE, subject to official notice of issuance, and the TSX, subject to customary listing conditions, prior to the effective time. Listing will be subject to CPRL fulfilling all the listing requirements of the NYSE and TSX. There can be no assurance that the CPRL common shares will be accepted for listing on the NYSE or the TSX.