

RAILROAD WEEK IN REVIEW

September 3 , 2021

*So that the Board can fully evaluate whether the impact of the Merger and Related Transactions would have any potential for environmental impacts warranting environmental review when the PAR System integration has occurred, the Board directs CSXT to update its projections by **providing traffic forecasts through 2027**—five years after the date of the anticipated year of the issuance of a final decision from the Board.” —STB in Decision No.4, FD-36472, Notice of Acceptance of Application and Related Filings, July 30, 2021*

I totally agree with the STB Decision on the Canadian National Voting Trust.. I’ve attached my annotated and highlighted copy of the Decision if you’d like to see what I felt was pertinent to the interests of this audience. Numbers following the excerpts are pages in the Decision.

** On the “new” merger rules.

Current merger regulations, which apply in this proceeding but did not apply in previous agency voting trust decisions, changed the Board’s voting trust standard; they now require applicants to affirmatively demonstrate that the use of a voting trust in the context of their impending control application would be consistent with the public interest. - 18

In March 2000, the Board concluded that its regulations governing applications for approval of railroad mergers were outdated and inadequate to address future major rail merger proposals. Accordingly, the Board instituted a rulemaking proceeding to develop new regulations reflecting its concerns about what an appropriate rail merger policy should be in light of consolidation that had occurred within the industry and problems associated with those events. -19

Because of the small number of remaining Class I railroads, the fact that rail mergers are no longer needed to address significant excess capacity in the rail industry, and the transitional service problems that have accompanied recent rail mergers, we believe that future merger applicants should bear a heavier burden to show that a major rail combination is consistent with the public interest. Our shift in policy places greater emphasis in the public interest assessment on enhancing competition while ensuring a stable and balanced rail transportation system. 19

The new regulations were specifically designed to address the potential impacts of a merged entity with some degree of overlapping routes and presently existing direct competition... requiring applicants to propose remedies to mitigate and offset competitive harms, including elimination of shippers’ build-out, transloading, plant siting, and production shifting choices when two railroads serving overlapping areas merge - 19

The Board also explained it was adopting the new regulations because “the prospect of reducing the already small number of major Class I railroads even further, perhaps to the point where only two major railroads remain in the U.S. and Canada, gives us substantial concern.” - 19

As part of the rulemaking effort, the Board also added a new regulation pertaining to voting trusts, that required applicants in major rail consolidations to demonstrate that their proposed use of a trust would not result in unlawful control and, in the context of their impending control application, would be consistent with the public interest. - 20

The Board noted the need, with only a limited number of major railroads remaining, for it to “take a much more cautious approach to future voting trusts in order to preserve [its] ability to carry out [its] statutory responsibilities,” and said that, under the new approach, “[voting trusts] should not be used routinely, but rather should be available only for those rare occasions when their use would be beneficial,” - 20

The voting trust agreement and related arrangements that had been proposed by CP and KCS were consistent with the regulations under 49 C.F.R. part 1013 designed to prevent the exercise of unauthorized control during the pendency - 4

** On Voting Trusts

The Board finds that the proposed use of a voting trust, in the context of their impending control application, would not be consistent with the public interest. Applicants have failed to establish that their use of a voting trust would have public benefits, and the Board finds that using a voting trust, in the context of the impending control application would give rise to potential public interest harms relating to both competition and divestiture. -2

CN’s voting interest in Kansas City Southern acquired in the Merger would be placed into an independent voting trust pending review and approval of the control transaction by the Board.-3

Applicants have not demonstrated that their use of a voting trust would have public benefits. The Board further finds that there are public interest risks to competition and divestiture associated with the use of a voting trust in the context of the impending control application. -17

The use of a voting trust for the CN-KCS transaction raises different and greater risks with respect to both competition and divestiture. Accordingly, Applicants’ contentions that approval is required because CN and CP are “two similarly situated potential acquirers,” or because they may be “identically situated” with respect to some factors pertinent to the Board’s consideration of a voting trust are misplaced. - 23

KCS, as the potential acquiree, is in a position to weigh (among other things) the potential benefit of shorter or less burdensome regulatory review against potential benefits that a different proposal (with more demanding regulatory requirements) might provide. - 23 [This is exactly

where CP has the edge: How much is the dollar received at some indefinite future time worth compared to a dollar received today? — rhb]

Applicants fail to demonstrate that allowing CN to acquire and place KCS into a voting trust during the pendency of this proceeding would give rise to any public benefit that could not otherwise be achieved. - 24

On competition.

CN managers would have diminished incentives to compete aggressively against KCS in areas served by both railroads,” which include the competing routes operated between New Orleans and Baton Rouge, La., as well as other parallel lines, such as north-south routes through Mississippi. - 9

In the event of divestiture, CN could seek to avoid sales to purchasers who would be strong competitors, or that CN could break up KCS and sell it to multiple purchasers, rendering it impossible to preserve the joint line service KCS currently provides. - 9

The proposed CP-KCS transaction in Docket No. 36500 is an end-to-end merger, whereas, here, the CN system overlaps with that of KCS... These differences, particularly the heightened regulatory standards the CN-KCS proposal must meet, necessarily place CN’s proposal to acquire KCS on a different footing from Canadian Pacific’s proposal. - 23

The Board finds that the use of a voting trust could result in a dampened incentive for the merging parties to compete vigorously during the pendency of the voting trust... If the Board were to approve the use of the voting trust, CN would become the owner of KCS prior to the Board assessing the public interest, including the competitive ramifications, of the proposed control transaction. - 29

Conclusion.

For the reasons discussed above, the Board finds that Applicants have not demonstrated that their use of a voting trust would be consistent with the public interest. Applicants have shown no benefit from the use of a voting trust to stakeholders other than KCS and CN. - 33

[end Decision summary]

I realize this is an over-long email yet I felt it better for you to see the language than to read a summary. I am encouraged that the the Board’s focus on competition and the public interest will be helpful in future cases regarding paper barriers and line sales.

CP says its offer is still good — until Sep 12 at least. CN has several options: raise the bid and risk the regulatory outcome in two years, rework the VT, or retire from the field. KCS can either stick with CN and its uncertainties or go with CP saying a dollar in hand is worth two in the bush. Interesting times.

A number of WIR readers have had extensive experience working with the STB on similar matters and what they have to say about the present proceeding is enlightening - pardon the lack of attribution, but I want to keep receiving their unvarnished opinions...

I'm afraid I have to agree that the STB doesn't want to approve the merger. Whether they would or not is another matter. The DoJ, the FTC and various political leaders don't matter so much because they routinely oppose anything, but the STB is different. And there is not much of a record to play off of.

I think those reaching a little to find arguments to support a CN bid — that its bigger size and standing better ensures the long-term status of the acquiree and therefore the public interest of the United States and Mexico — miss the point. The CP offers a bigger payoff to investors in the long-term but that is not the board's primary lookout.

Former STB practitioners are not to be ignored. I agree with your remarks about the Rail Baron game we seem to be in now. Not only are this crop of regulators skeptical, they are vocal in a way which I can't remember since the days of Reese Taylor. But are they aimed in the right direction, or at all?

Another reader adds that he believes the railroads are somewhat or even dangerously out of step with today's commercial realities. The current regulatory milieu at the STB relies on metrics by which market competition is measured and re-balanced. I was hopeful that the CN - KCS affair would expose a number of novel solutions to particular instances of market dominance like the Canadian practice of inter-switching. I doubt that happens now. We will slide on by the CP-KCS transaction with as little disruption to the regulatory milieu as possible - such as little heavy lifting.

Having missed an opportunity to innovate, and lacking any demonstrable alternative, the STB will then be free to pursue the already declared (as lately noted in this morning's WSJ) imposition of reciprocal switching across the industry. I'm not sure how that cuts for shortlines and regionals but it's something to think about now.

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