CP-33/KCS-21

BEFORE THE
SURFACE TRANSPORTATION BOARD

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

APPLICANTS' REPLY TO UNION PACIFIC'S "PETITION TO REJECT APPLICATION AS INCOMPLETE"

Applicants[1] submit this reply to Union Pacific's "Petition to Reject Application as Incomplete" (UP-4), filed late in the afternoon on Friday, November 19.

Apparently conscious of the fact that its previous effort to delay the Transaction will be unsuccessful, UP now seeks to derail it in an effort to delay the injection of new competition that UP will face if the Transaction is approved. With its untimely and meritless filing, UP is playing games with the Board's processes by filing just before the Board must accept or reject the Application pursuant to 49 U.S.C. § 11325(a) and in the hope that Applicants will not have time to respond.[2] The Board should not reward such gamesmanship – particularly in a proceeding

[1] Canadian Railway Limited, Canadian Pacific Railway Company, and their U.S. rail carrier subsidiaries Soo Line Railroad Company, Central Maine & Quebec Railway US Inc., Dakota, Minnesota & Eastern Railroad Corporation, and Delaware & Hudson Railway Company, Inc. (collectively "CP" or "Canadian Pacific") and Kansas City Southern and its U.S. rail carrier subsidiaries The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company (collectively "KCS").

[2] Applicants have responded as quickly as possible given the shortness of time occasioned by UP's timing. Nevertheless, if the Board desires a more thorough response on any of the issues raised by UP, Applicants stand ready to provide one on whatever schedule the Board deems appropriate.

such as this that presents an unambiguously procompetitive Transaction that will advance the public interest.

The Board should reject the Petition because it is both procedurally improper and fundamentally incorrect on the merits.

I. UP'S PETITION IS UNTIMELY

UP's Petition was filed 21 days after the Application, and a full week after UP submitted its "comments" on the Board's procedural schedule (UP-3). Comments on the Board's proposed procedural schedule were due on November 12, and UP had every opportunity in its submission to make assertions about the supposed shortcomings of the Application. Its fellow Delay-Seeking Railroads in fact made similar (and equally invalid) assertions in their "comments" filed on November 11 (BNSF-4 at 3-10) and 12 (CSXT-2 at 3-6). That UP instead waited to file its Petition until the 21st day – beyond the 20-day deadline for responsive pleadings, *see* 49 C.F.R. § 1104.13(a), and only three business days before the statutory date for a decision accepting or rejecting the Application – appears plainly designed to put the Board and Applicants in a bind that only serves UP's interest in delaying the new competition that this Transaction will yield.[3] The Board should reject UP's gambit as untimely.

II. THE APPLICATION IS NOT INCOMPLETE

A. The Application Presents a Compelling Prima Facie Case for Approval

UP's contention that the Application is "incomplete" should be swiftly rejected.

First, the job of an Application is to present a *prima facie* case for approval, and the Application here far exceeds that standard. As set forth in 49 C.F.R. § 1180.4(c)(8), "Applicants

[3] UP filed its Petition *after* commenting on the Board's procedural schedule without raising any of these issues, and also after serving Applicants (on November 8) with *123 separate discovery requests*, a response to which was requested by November 23.

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." The Application amply demonstrates that the Transaction advances the public interest. There is no reduction in competition whatsoever. And there are many procompetitive and other benefits of the Transaction, starting with its fundamentals: the creation of new single-line routes serving north-south traffic flows.

Those fundamentals necessarily shape the nature of the case before the Board in this proceeding, which is to determine whether the transaction is in the public interest. 49 U.S.C. § 11324. It is certain that the Transaction would – if approved by the Board – strengthen the capacity and capability of the core CPKC north-south routes and in the process create new single-line competitive alternatives that have not previously existed. It is also certain that railroads like UP will face stiffer competition for some portion of the traffic they handle today, both via their own single-line routes and via interline routes with CP or KCS. Those aspects of the Transaction *alone* are sufficient public benefits to make out a *prima facie* case given that there are no competitive overlaps and no other harms to the public interest. Indeed, UP's quibbles are about how substantial the public interests will be – not whether there will be any.

Second, contrary to UP's Petition, an Application is not "incomplete" just because it does not expressly predict and refute in advance every contention a party like UP might make in response. If UP wishes to quarrel with the facts laid out in the Application, or adduce other facts that it says call into question the public benefits of the Transaction, it is free to try. That is why

the Board's process allows for discovery and many months for UP to prepare opposition evidence.

Third, the nature of UP's grumblings about the Transaction highlight, rather than cast doubt on, the compelling public benefits on the Transaction. In the face of the Application's compelling public interest thesis, which is backed up by extensive evidence and analysis, the response of railroads like UP has been to seek delay (which is still further evidence of the competitive benefits of the Transaction) and to try to raise various purported issues associated with the new competition unlocked by the Transaction. For its part, UP asks how CPKC will adjust its rates to compete against UP for traffic (UP-4 at 9); how CPKC will overcome route mileage disadvantages in some lanes (*id.*); whether FXE (a Mexican railroad in which UP has a large minority ownership interest) might be able to compete with KCSM for certain traffic (*id.* at 10); and whether CPKC yards will have sufficient capacity to handle all of the traffic that may shift to CPKC routes (*id.* at 12).[4] As discussed below, Applicants *have* addressed such issues in their Application, and they are prepared to address them further during the course of this proceeding. But the cascade of quibbles from UP and the other Delay-Seeking Railroads misses a more fundamental point: all of the potential traffic "diversions" from other railroads that flow from the Transaction will be the result of shippers choosing to use the new competitive single-line routing options that the combination will unlock. That improvement in the competitive landscape – not every detail about the precise *results* of the newly invigorated competition – is one of the core public benefits of the Transaction.

[4] Tellingly, despite lobbing 123 detailed discovery requests at Applicants on November 8, UP did not seek information about most of the issues raised in its Petition.

The exact number of carloads shifted to CPKC is not the point of the proceeding because that outcome will arise from the competitive process rather than Applicants' fiat. If CPKC does not use its new competitive tools to offer customers an attractive value proposition compared to their other transportation options (in terms of rates, service, and the other attributes shippers care about), CPKC will attract (*i.e.*, "divert") less traffic because fewer customers will choose CPKC options. If UP is able to offer customers FXE-UP routes that meet their needs better than new CPKC single-line routes, CPKC will attract less of that traffic. And if CPKC is even more successful than it expects and runs out of capacity to handle still more "diverted" traffic, it will either add still more capacity or end up unable to attract as much additional traffic. This proceeding is about whether creating a new, more-competitive railroad environment is in the public interest, and the Application provides compelling evidence that it is and that the Transaction would achieve that result.[5]

UP will have ample opportunity to attempt to pursue its arguments, and Applicants will in due course reply to any evidence UP puts forward. But none of the issues raised in UP's Petition provides a basis for rejecting the Application as "incomplete" because the Application far exceeds the requirement to present a *prima facie* case for approval. In addition, as discussed below, UP's arguments lack merit even on their own terms.

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[5] UP appears to be confusing this end-to-end *CP/KCS* transaction with its own *UP/SP* transaction, or perhaps the *CSX/NS/Conrail* transaction. In both of those prior transactions, many of the traffic shifts were the inevitable product of structural realignments in the railroad network: in *UP/SP*, the combination of parallel routes in numerous corridors, and in *CSX/NS/Conrail*, the splitting of Conrail in two and reintegration of both halves into two systems that already blanketed much of the same territory. Those transactions *forced traffic shifts on customers. CP/KCS* is completely different. *CP/KCS* is purely end-to-end, it will not consolidating parallel routes or split lines between two carriers, and there will be no forced diversions. For the Transaction to be successful, CPKC's new single-line option will need to provide rate and service options better than those available by the larger carriers. Thus, unlike in *UP/SP* and *CSX/NS/Conrail*, the precise impacts of the Transaction are not pre-engineered – they will be won in the competitive marketplace using the new tools made possible by the CP/KCS combination.

B. UP's Arguments Lack Merit

1. No Traffic Was Excluded from the Rail-to-Rail Diversion Analysis.

The "principal" issue UP identifies is the claim that Applicants' rail-to-rail "diversion analysis" "excluded" approximately 360,000 carloads or "one-third of all potentially divertible traffic," allegedly as a "shortcut." UP-4 at 2, 4-6. UP's accusation is false.

UP's allegations concern the analysis of potential shifts of base year rail traffic from other railroads to new CPKC single-line routes, which was presented in the Verified Statement of Richard W. Brown and Nathaniel S. Zebrowski ("Brown/Zebrowski V.S.") (Application Vol. 2 at 2-112). UP's contention that Messrs. Brown and Zebrowski excluded certain traffic from consideration (as a "shortcut" or otherwise) is just wrong, and UP ought to know that from its review of the witnesses' workpapers (or had UP inquired about this issue in discovery, which it did not). Instead, UP misreads and mischaracterizes a straightforward process of multi-stage screening of traffic that Messrs. Brown and Zebrowski describe in their Verified Statement:

First, precisely to ensure all theoretically divertible traffic was analyzed, Messrs. Brown and Zebrowski started with the *entire carload waybill sample* combined with CP and KCS 100 percent traffic tape data – reflecting tens of millions of movements, most of which could not even conceivably be handled on a CPKC system (*e.g.*, movements within the state of California). Brown/Zebrowski V.S. ¶ 20 (Application Vol. 2 at 2-123 to -124).

Second, to identify movements for which further analysis was warranted, Messrs. Brown and Zebrowski used an initial screen that examined only whether the origin or destination "stations" (as reflected in an AAR database) were served by CP on one end and KCS on the other. Brown/Zebrowski V.S. ¶¶ 22 & n.5 (Application Vol. 2 at 2-124 to -125). That screen yielded the 1.1 million movements referenced by UP and reflected in Table 3 of the Brown/Zebrowski V.S. (Application Vol. 2 at 2-128). These movements were "potentially

divertible" in a theoretical sense, but as Messrs. Brown and Zebrowski explain, more work was needed to determine whether one could reasonably expect such traffic to be attracted to CPKC routes post-Transaction.

Third, as a first step in assessing the likelihood of diversions for this group of 1.1 million movements, Messrs. Brown and Zebrowski considered whether – despite CP serving the station at one end of a route, and KCS serving the station at the other – any obvious attributes of the movements in question made it impossible or unrealistic for the CPKC system to attract the traffic. This is the step UP misunderstands and mischaracterizes. At this stage of the analysis, Messrs. Brown and Zebrowski examined all 1.1 million movements (grouped as they were into 4,000 individual lanes, *i.e.*, origin-destination pairs for a given commodity) and concluded that 360,000 of them did not warrant further analysis. In other words, contrary to UP's characterization, all movements were analyzed *and none were "excluded" from analysis*; it is just that for some movements that Messrs. Brown and Zebrowski analyzed, the analysis did not need to proceed past the recognition that "diversion" to a theoretical CPKC route would not be possible or reasonably likely.

All of these 1.1 million movements are in the Brown/Zebrowski workpapers, along with the determinations made regarding whether they warranted further analysis in light of their basic attributes. Although UP claims to have examined those workpapers (*e.g.*, UP-4 at 5 n.17), those workpapers ought to have made it obvious why diversion of the 360,000 movements in question would be unrealistic and in many cases impossible. For example, the movements deemed unworthy of further analysis included:

- Traffic moving to/from geographic areas that the CP or KCS systems *clearly do not reach*, such as points in Kentucky and Oregon;

- Traffic between the Houston area (reached by KCS) and CP-served points that CPKC *could not handle* because of restrictions in the UP trackage rights KCS uses north of Houston;

- Traffic moving between points on KCS east of Kansas City (especially East St. Louis) and points reached by CP in the mid-Atlantic states (*e.g.,* Pennsylvania and New Jersey) for which a CPKC route would be *far too circuitous* to offer a realistic alternative for most shippers;[6] and

- Intermodal traffic moving to locations (such as Bethlehem, PA) where CP *did not have any intermodal facilities* and in addition the CPKC route would be highly circuitous.

To be sure, CPKC's new single-line options might well prove attractive for some small volumes in these categories, particularly if (for reasons impossible to know up-front) shippers are dissatisfied with their current transportation options or view new CPKC options as superior in light of their specific circumstances. Applicants will not turn away that traffic where they have the facilities and service design plan capable of supporting it. But the potential that some of it might come to the CPKC system does not mean that a proper assessment of likely traffic on the CPKC network would have or should have assumed that more traffic would switch. Applicants would be quite surprised if UP thinks CPKC would have a meaningful chance of winning material volumes of any of this traffic. If UP does think that CPKC would compete effectively for this traffic, it is free to propose augmenting the Transaction's measurable competitive benefits.

The analysis of Messrs. Brown and Zebrowski made very clear that the traffic estimates resulting from their analysis should not be taken as a precise roadmap of the exact composition of CPKC's future traffic. It is a *reasonable estimate*. Brown/Zebrowski V.S. at ¶ 5 (Application

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[6] In later stages of their analysis, Messrs. Brown and Zebrowski applied a formal circuity screen. *See* Brown/Zebrowski V.S. ¶¶ 28 (Application Vol. 2 at 2-130). These determinations that traffic was likely not divertible involved circumstances where there was no need to perform those calculations because of the obvious circuity of CPKC routes as compared to the current route and other available routes.

Vol 2 at 2-116); *see also id.* Appendix A ¶ 17 (Application Vol 2 at 2-183 to -184). Messrs. Brown and Zebrowski reviewed their diversion estimates (within the bounds of confidentiality restrictions) with Applicants' commercial experts, and those experts confirmed their reasonableness. Wahba/Naatz V.S at ¶ 14 (Application Vol. 1 at 1-250). This process is more than sufficient. [7]

Further, contrary to UP's suggestion that the other components of the Application were dependent on the exact precision of the traffic diversion estimates (UP-4 at 7), they were not. For example, in building the Operating Plan, Applicants did "not expect[]that the CPKC merger-related traffic growth will take exactly the shape (in terms of precise mix, volume and timing) represented in the traffic file." Rather, they designed a robust plan for handling increased traffic that provides for the "assets and capabilities needed to be nimble and able to adjust as the transaction is implemented in the real world." Operating Plan (Exhibit 13) at ¶ 82 (Application Vol. 2 at 2-185).

At bottom then, UP's argument boils down to the obvious and innocuous fact that some of the specific traffic that Applicants reasonably forecast to shift to CPKC routes may not ultimately shift, while other specific traffic that Applicants do not forecast to shift to CPKC may well ultimately shift. Those decisions will be for shippers to make – with the benefit of new transportation options in a newly more vibrant competitive marketplace. But these details do not

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[7] This approach is customary in diversion analyses undertaken in railroad merger cases. For example, the approach taken by UP in *UP/SP* was no more precise. The rail-to-rail diversion study in that case "stress[ed]" that it was intended to yield "best estimates of overall diversions of the various categories of traffic that we review. They may err in diverting a particular movement and not diverting another, and they invariably fail to take account of all the pertinent factors and peculiarities of individual traffic movements. But they are intended to be as accurate as possible *on average." UP/SP*, Finance Docket No. 32760, Railroad Merger Application, Vol. 2, Verified Statement of Richard B. Peterson (filed Nov. 30, 1995) at 261; *see also id.* at 291 ("analysis clearly did not identify every new traffic movement that the merged system would handle," some of which "involve small movements that would have been much too difficult and time-consuming for us to identify and study individually").

affect the completeness of the Application or the strength of the Application's compelling public interest thesis.

2. The Application Adequately Addresses Competition for U.S.-Mexico Cross-Border Traffic.

UP's next contention is that the Application fails to "provide evidence" relating to competition for U.S.-Mexico cross-border traffic. UP's concern about the Transaction's effects on such traffic is easy to understand, since UP stands to lose the most from stronger CPKC competitive options for traffic moving via the Laredo gateway. *See, e.g.,* Brown/Zebrowski V.S., Table 27 (Application Vol. 2 at 2-161). As with its other arguments, UP's critiques of the evidence submitted in the Application are avenues UP may choose to explore in its comments in this proceeding, but they do not render the Application "incomplete."

First, UP appears to demand that Applicants disclose the specific rate reductions they plan, predicated on UP's notion that market impact analyses should "reflect the consolidated company's marketing plans." UP-4 at 9. But the Application does this extensively, as reflected in the Verified Statements of John Brooks (CP's Chief Marketing Officer) ("Brooks V.S.") (Application Vol. 1 at 1-211) and of Jonathan Wahba and Michael J. Naatz (CP's VP of Commercial Integration and KCS's Chief Marketing Officer, respectively) (Application Vol. 1 at 1-243) ("Wahba/Naatz V.S."). The Board's rules do not require Applicants to predict the precise competitive moves they will make when they implement their Transaction a year or more hence, much less to disclose those moves in advance to one of their principal competitors. At least UP recognizes (at 9 n.35) that it may need to lower its rates to compete against CPKC, which is among the public benefits the Application highlights. *See, e.g.,* Brown/Zebrowski V.S. at ¶ 89 (Application Vol. 2 at 2-162); Verified Statement of W. Robert Majure ("Majure V.S.") at ¶ 34 (Application Vol. 2 at 2-25 to -26).

Second, UP expresses dismay that CPKC might dare to compete against UP single-line routes for U.S.-Mexico automotive traffic despite a disadvantage in route miles. UP claims to want an explanation for how CPKC expects to win these moves. As the Application explains, however, single-line routes often garner significant shares notwithstanding route mileage disadvantages relative to other rail options. *See* Brown/Zebrowski V.S. at ¶ 29 & Appendix B (Application Vol. 2 at 2-131 to -132, 2-175 to -184). Nor is there any lack of information regarding the basis for Applicants' reasonable diversion estimates, which reflect improvements in the capabilities of new CPKC single-line routes. *See* Brown/Zebrowski V.S. at ¶¶ 59-68 (Application Vol. 2 at 2-145 to-151); Wahba/Naatz V.S. at ¶¶ 67-74 (Application Vol. 1 at 2-162). UP is free to dispute those estimates in its comments.

More fundamentally, however, it is not clear what point UP is trying to make. If it turns out that UP can out-compete CPKC and retain all of this traffic north of Laredo that competition would be no less of a public benefit than the opposite result.

Finally, UP attacks Applicants for purportedly failing to consider rail competition within Mexico for U.S.-Mexico cross-border traffic or analyze "competitive impacts" on traffic moving via the Laredo gateway. But the Application is filled with such analysis. As just one example, the Verified Statement of W. Robert Majure extensively analyzes the competitive implications of CPKC's potential "diversions" of traffic from KCSM-UP interline routes to CPKC single-line routes. The impact on competition *will be positive*; the impact *on competitors* may not be. It may require UP to offer rate reductions, improve its service levels, or otherwise work harder to retain the traffic. Majure V.S. at ¶¶ 20-38 (Application Vol. 2 at 2-17 to -28). And the same competitive analysis expressly considered the implications of FXE's presence as a viable competitive alternative within Mexico for traffic originated or terminated by KCSM in Mexico.

Id. at ¶ 25 (Application Vol. 2 at 2-19 to -20). Yet again, though, UP's point is illusive. If FXE – a carrier in which UP has two board seats and large minority ownership stake – is a stronger competitive alternative to KCSM routes than Applicants estimate, that merely means there will be *more competition*, not less, as a result of the Transaction.

3. There Is Nothing Deficient About Applicants' Operating Plan.

UP's contentions regarding Applicants Operating Plan are equally insubstantial. The Operating Plan considered all of the issues UP raises. UP is free to disagree and present evidence disputing Applicants' conclusions, but the Application is not incomplete just because it does not present the operational data in the exact form and scope advocated by UP.

First, UP observes that the Multirail tool does not "spit out efficient blocking and train plans." UP-4 at 11. UP is correct. The development of efficient blocking and train plans was performed by the railroad operating experts who prepared the Operating Plan, who used the Multirail tool along with their own experience and expertise, implementing the same approach to service design that CP uses successfully on its own system. *See* Operating Plan (Exhibit 13) at ¶¶ 65, 72 (Application Vol. 2 at 2-279 to -280, 2-282).

Second, all of UP's supposed concerns about operational issues were extensively considered and addressed by Applicants. For example,

- The capacity at CP's Bensenville yard was addressed in the Operating Plan (at ¶¶ 135-36, 154-56 (Application Vol. 2 at 2-306 to -307, 2-313-315).
- Applicants also considered capacity at St. Paul, MN (about which UP also claims concern). *See* Operating Plan at ¶¶ 219, 238 (Application Vol. 2 at 2-333 to -334, 2-340). If UP believes that the handful of additional daily trains traversing St. Paul would cause problems at its Hoffman Yard (see UP-4 at 13), it will have ample opportunity to raise that concern in its comments.
- UP's concern about Houston are particularly ironic, given that UP and BNSF are by far the dominant users of the UP trackage over which KCS operates through Houston. Had Applicants perceived capacity concerns at Houston, they would have addressed them in the Application. If UP thinks there are capacity needs at

> Houston, it should say so in its comments or address the matter commercially under the governing trackage rights agreements, which provide for capacity expansions to facilitate increases in KCS traffic. UP certainly should not be allowed to hold up the increased competition from CPKC based on its own intransigence.

Finally, UP posits concerns about passenger service. Of course, Metra and Amtrak can speak for themselves if they have concerns about impacts on the passenger services they provide, which in any event were addressed in the Application. *See* Verified Statement of Keith Creel ("Creel V.S.") at ¶¶ 41-45 (Application Vol. 1 at 1-172 to -174); Operating Plan at ¶¶ 175-76 (Sunset Limited), 184-85 (Metra) (Application Vol. 2 at 2-320, 2-322).

4. The Application Adequately Addresses Service Assurance Issues.

There is no merit in UP's insistence that Applicants submit the formal "Service Assurance Plan" required by the Board's 2001 merger rules, which UP acknowledges do not apply to this Transaction. Failure to include a formal Service Assurance Plan cannot justify rejection of the Application as incomplete where such a Plan was not required by rule, and where the Application extensively addresses service assurance issues.

The only basis offered for UP's position is language in Applicants' SEC filings (*i.e.*, communications to investors) noting the obvious: there are operational risks associated with implementing this and any combination. UP is well aware of the commonplace role this kind of "risk factor" disclosure plays in the context of communications to public shareholders. UP's own securities filings routinely identify the same sorts of operational risks on UP's system. As UP said in its most recent 10-K:

> "We may experience other operational or service difficulties related to network capacity, dramatic and unplanned fluctuations in our customers' demand for rail service with respect to one or more commodities or operating regions, *or other events that could negatively impact our operational efficiency*, which could all

> have a material adverse effect on our results of operations, financial condition, and liquidity."[8]

The fact that Applicants are aware of these risks and are working hard to ensure they do not materialize should have been obvious to anyone, especially UP. Applicants' awareness is why they have paid such close attention to implementation planning and addressed issues relating to service assurance so extensively in the Application, notwithstanding the inapplicability of the Board's "Service Assurance Plan" rule. *See, e.g.,* Creel V.S. at ¶¶ 35-40 (Application Vol. 1 at 1-170 to -172); Brooks V.S. at ¶¶ 13-23, 49-54 (Application Vol. 1 at 1-219 to -225, 1-234 to -236); and Verified Statement of James Clements ("Clements V.S.") at ¶¶ 4-56 (Application Vol. 1 at 1-319 to -336). Applicants' forthcoming Safety Implementation Plan, due December 28, will provide extensive additional detail concerning their implementation plans. And more fundamentally, Applicants are not finished with their planning for the smooth integration of the CP and KCS systems. That work will continue through the Board's review of the Transaction and beyond, as the Transaction is implemented under an internal CPKC Transaction Implementation Service Assurance Team. Integration steps will not be taken until CPKC is fully prepared to do so without disruption. Creel V.S. at ¶¶ 36-37 (Application Vol. 1 at 1-171); Brooks V.S. at ¶ 51 (Application Vol. 1 at 1-235).

CONCLUSION

For the foregoing reasons, the Board should reject Union Pacific's Petition and accept the Application.

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[8] Union Pacific Corp., Form 10-K (filed Feb. 5, 2021) (emphasis added).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing Applicants' Reply to Union Pacific's "Petition to Reject Application as Incomplete" to be served electronically or by first class mail, postage pre-paid, on all parties of record in this proceeding.

/s/ *Sonia Gupta*
Sonia Gupta

November 22, 2021