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SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

UNION PACIFIC RAILROAD COMPANY'S COMMENTS AND REQUEST FOR CONDITIONS

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UNION PACIFIC RAILROAD COMPANY'S COMMENTS AND REQUEST FOR CONDITIONS

UP submits these comments on CP's proposed combination with KCS.[1] In support of these comments, UP is submitting the joint verified statement of Kenny Rocker, UP's Executive Vice President, Marketing and Sales, and John Turner, UP's Vice President, Network Planning & Operations, as well as verified statements from Steven C. Salop, Professor of Economics and Law at the Georgetown University Law Center, Thomas C. Haley, an independent railroad consultant, and Dr. Luis de la Calle, managing director and founding partner of De la Calle, Madrazo, Mancera, S.C.

An unconditioned combination of CP and KCS would likely cause a significant loss of competition, especially for traffic moving via the Laredo Gateway. CP would gain control of KCSM, and thus the ability to increase the costs or reduce the quality of rail service in Mexico for railroads providing shippers competitive options to CPKC north of Laredo. CPKC would have a strong incentive to engage in this type of anticompetitive conduct: to meet Applicants' aggressive promises to investors, CPKC must divert substantial volumes of business from shippers currently using UP or BNSF to provide service north of Laredo without sacrificing profits. The limited (if not illusory) efficiencies arising from the proposed transaction will not achieve those aggressive promises. UP's comments propose narrowly tailored conditions the Board should impose to prevent the reduction of competitive options at gateways, particularly the Laredo Gateway.

UP's comments also address a fundamental issue Applicants failed to discuss in their Application: the need for investment in jointly-used rail infrastructure critical to implementing

[1] UP is using the abbreviations the Board used in Decision No. 11 in this proceeding, served November 23, 2021.

their proposed transaction, including investment necessary to maintain fluid operations in the Houston terminal. Applicants should not expect others to subsidize their transaction. The Board should not allow Applicants to increase their operations over lines they share with other railroads until they reach agreements with those railroads regarding investments in new capacity necessary to accommodate the traffic levels projected in their Application.

I. Introduction And Summary Of Position

A. An Unconditioned Combination of CP and KCS Would Likely Cause a Significant Loss of Competition to the Detriment of Shippers.

An unconditioned combination of CP and KCS would likely cause a significant loss of competition among railroads in the United States, especially for traffic moving via the Laredo Gateway, to the ultimate detriment of shippers. CPKC would control KCSM, the only railroad serving the Mexican side of the critically important Laredo Gateway. The Board recognized long ago that rail competition via the Laredo Gateway must be protected because other gateways and other modes do not provide effective alternatives. KCS's right to operate from Kansas City to Laredo exists only because the Board concluded in 1996 that the Laredo Gateway "occupied a position of separate and surpassing economic significance" to U.S.-Mexico rail transportation.[2]

Since 1996, the Laredo Gateway has become even more important to cross-border trade. In 2019, the Port of Laredo was the leading U.S.-international freight gateway, moving $226.8 billion in cargo, which included 264,406 loaded rail containers crossing from Mexico to the

[2] *Union Pac. Corp.—Control & Merger—S. Pac. Rail Corp.* ("*UP/SP*"), 1 S.T.B. 233, 422 (1996). In that proceeding, one of the Applicants here, Tex Mex, argued that U.S. policy regarding the North American Free Trade Agreement required the Board to "give heightened scrutiny to transactions within its jurisdiction that present a danger of diminishing competition for transportation of U.S.-Mexican traffic." *UP/SP*, FD 32760, Brief of the Texas Mexican Ry. (TM-39) at 17 (June 3, 1996).

United States, an increase of 282% from 69,204 loaded rail containers in 1996.[3] The Board should prioritize protecting the Laredo Gateway in evaluating the proposed combination.

The Biden Administration has emphasized the need for vigilance against vertical (*e.g.*, end-to-end) mergers that harm competition, as well as the need to protect shippers, and has called on the Board to work with the antitrust enforcement and other agencies to meet these goals.[4] Consistent with that approach, the DOJ and FTC have rejected the notion that vertical mergers are presumptively procompetitive, and instead are challenging proposed vertical transactions where the agencies identify potential harm to consumers.[5]

Applicants' own evidence shows why a CP/KCS combination would harm shippers. Applicants' expert economist, Dr. Majure, concedes that end-to-end mergers can cause competitive harm where the merged carrier would have the ability and incentive to force inferior terms on shippers.[6] The evidence shows CPKC would have both such ability and such incentive.

CPKC Would Have the Ability to Force Inferior Terms on Shippers. Applicants do not address the *ability* of a combined CPKC to force inferior rate and service terms on a

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[3] U.S. Department of Transportation, Bureau of Transportation Statistics, *Freight Facts and Figures* (2019), https://data.bts.gov/stories/s/International-Freight-Gateways/4s7k-yxvu/

[4] *Executive Order on Promoting Competition in the American Economy* (July 9, 2021) ("*Biden Competition Order*"), Sec. 2(d) (Board charged with "resisting consolidation and promoting competition within industries through the independent oversight of mergers"), https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/

[5] *Prepared Remarks on Modernizing Merger Guidelines* (Jan. 18, 2022), https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-remarks-modernizing-merger-guidelines

[6] *See* APP Vol. 2 at 18, Majure VS ¶ 22.

References to "APP Vol." are to the consecutively numbered pages in the Application. References to verified statements accompanying the application are identified by the last name of the witness submitting the statement and "VS."

significant number of shippers who depend on rail service via the Laredo Gateway. Dr. Majure asserts that CPKC could not force inferior terms on hypothetical customers with "ready alternatives,"[7] but neither Dr. Majure nor any other witness for Applicants asserts (nor could they) that CPKC could not force inferior terms on customers that lack such ready alternatives.[8] Applicants' witnesses do not dispute that such customers exist; in fact, as Mr. Rocker explains, *many* shippers lack viable alternatives to rail service via Laredo.[9] And although Dr. Majure hypothesizes that FXE might be a viable competitive alternative to KCSM for some shippers,[10] he does not analyze the issue or show that FXE actually offers a viable option for shippers using KCSM.[11]

Mr. Rocker and Professor Salop also describe CPKC's ability to make UP-KCSM transportation less attractive to shippers in practical terms: CPKC could raise KCSM rate factors for shippers who prefer to use UP service north of Laredo, or reduce KCSM cooperation with UP on operational and service matters in Mexico and at the Laredo Gateway.[12] In sum, CPKC would have the ability to engage in anticompetitive conduct.

CPKC Would Have the Incentive to Force Inferior Terms on Shippers. Dr. Majure tries to dismiss concerns about CPKC's *incentives* to foreclose competition by pointing to the

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[7] *See* APP Vol. 2 at 19–20, Majure VS ¶ 25.

[8] Professor Salop also shows that end-to-end transactions can produce anticompetitive effects even for shippers who have the option of using Ferromex ("FXE") service via an alternative Mexican gateway. *See* Salop VS ¶ 15, ¶¶ 62–72.

[9] *See* Rocker/Turner VS at 16–17.

[10] *See* APP Vol. 2 at 19–20, Majure VS ¶ 25.

[11] *See* Ex. 1 (Majure Tr. 84:18–24 ("Q: Have you done any analysis as to whether FXE is a ready alternative for shippers using KCSM today? A: No, I have not tried to isolate the -- or test whether this hypothetical applied to any particular shipper or the degree to which it was.")).

[12] *See* Rocker/Turner VS at 11–16; Salop VS ¶¶ 75, 81.

"one-lump theory." Under that theory, he asserts, CPKC would have no incentive to force inferior terms on customers who depend on KCSM service in Mexico and ship traffic from Laredo to points served by both CP and UP (or CP and BNSF), because KCS already collects the full measure of returns associated with KCSM's existing market power.[13] While that theory may apply in some circumstances, it does not apply in this particular case.

As Professor Salop explains, when an upstream monopolist (KCSM) and downstream rivals (UP and CP) lack full information about each other's costs and prices, or when the rivals provide differentiated services—*i.e.*, services that shippers view as qualitatively different—the monopolist generally cannot extract the full "one lump," so the shipper retains a surplus.[14] In those circumstances, which exist here, the merged carrier *does* have an incentive to engage in anticompetitive conduct: to eliminate the shipper's surplus and extract the full "one lump."[15]

In addition, and as Professor Salop also explains, CPKC will have *increased* incentives to foreclose rivals using the Laredo Gateway. That is because CPKC would capture a greater portion of the proceeds from a foreclosure strategy than KCS standing alone. That increased incentive undermines Applicants' unsupported assertions that the proposed merger will not change the status quo at Laredo Gateway.

To be clear, UP is not claiming that all end-to-end transactions harm shippers or that the Board needs to abandon long-standing precedent. As Professor Salop explains, economic modeling shows that outcomes depend on a variety of factors affecting the incentives of market participants. The Board should merely adopt modern antitrust enforcement's more tailored

[13] *See* APP Vol. 2 at 19, Majure VS ¶ 24.

[14] *See* Salop VS ¶¶ 36–39 (imperfect information); *id.*, ¶¶ 40–59 (differentiated products).

[15] *See id.*, ¶¶ 39, 43.

approach to evaluating vertical mergers—and the suitability of a presumption—on the particular facts of the transaction.

Data Regarding KCS's Acquisition of KCSM Do Not Support Applicants' Arguments. Dr. Majure also tries to dismiss concerns about competition at gateways by reviewing KCS, UP, and BNSF shares of traffic that KCSM moved north to the Laredo Gateway from Mexico in 2019.[16] According to Dr. Majure, the share data show that no gateway-related harm resulted from KCS's acquisition of Tex Mex and KCSM's predecessor, TFM, S.A. de C.V.[17] But, as Professor Salop explains, Dr. Majure's analysis is uninformative because it fails to address the central question in any such antitrust analysis: what the traffic shares would have been but for the KCS-TM-TFM transaction.[18] In fact, KCS's share of Laredo Gateway traffic increased significantly after the transaction—a result that is at least as consistent with anticompetitive foreclosure as with any procompetitive explanation.[19] Moreover, had Dr. Majure reviewed KCS, UP, and BNSF shares of traffic that KCS moved *south* to the Laredo Gateway from the United States, he would have observed that the vast majority of traffic he classifies as "competitive" moved on KCS.[20]

Notably, in the KCS-TM-TFM transaction, KCS projected minimal diversions of cross-border traffic from UP.[21] By contrast, Applicants here project substantial diversions of cross-

[16] *See* APP Vol. 2 at 22–24, Majure VS ¶¶ 30–31.

[17] *See Kansas City S.—Control—The Kansas City S. Ry., et al.* ("*KCS/Tex Mex*"), FD 34342 (STB served Nov. 29, 2004).

[18] *See, e.g.*, Salop VS ¶ 89.

[19] *See id.*, ¶ 90.

[20] *See id.*, ¶¶ 94–96.

[21] *See KCS/Tex Mex*, FD 34342, Railroad Control Application (KCS-3/TM-3) at 122 (May 14, 2003); *see also KCS/Tex Mex*, FD 34342, slip op. at 11.

border traffic for which UP and CP compete within the United States. That is further indication that CPKC would have much stronger incentives to foreclose competition at the Laredo Gateway than the applicants in KCS-TM-TFM.

The CP/KCS Application Raises a Series of Red Flags. Applicants project that their transaction will produce $1 billion annually in quantifiable benefits through a combination of revenue gains and cost savings by 2025.[22] The projected costs savings are modest, amounting to approximately 3.1% of CP's and KCS's combined pre-merger operating costs.[23] Most of the savings are not even merger-related: they reflect plans to apply CP's version of "precision scheduled railroading" to KCS and KCSM.[24]

Applicants' benefits projection relies primarily on aggressive assumptions that CPKC will (i) divert existing U.S.-Mexico traffic interchanged by KCSM and UP, or KCS and BNSF, to CPKC single-line routes, and (ii) grow U.S.-Mexico traffic that would move on the former-KCS north of Laredo using hundreds of miles of trackage rights over UP-owned lines that are already at capacity. Their plans to grow traffic are highly speculative. This leaves diversion of existing U.S.-Mexico traffic as a critical source of their projected revenue growth. However, Applicants provide no plan to compete for this traffic on the merits. They do not claim their transaction will create faster, more efficient routes than UP and BNSF provide today. In fact, CPKC's route between Laredo and Chicago will be far less efficient than UP's and BNSF's

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[22] *See* APP Vol. 1 at 351, Vargas VS ¶ 41 & Table 2.

[23] *See* Haley VS ¶ 14.

[24] *See id.*, ¶¶ 18–31.

route.[25] Applicants do not promise to reduce rates to attract this traffic. To the contrary, their own revenue projections require them to capture interline traffic at existing revenue levels.[26]

In short, Applicants would be under tremendous pressure to divert this traffic without competing harder to attract the business. How would they do it? Their only path would be to restrain competition and divert traffic without competing on the merits.

Applicants acknowledge the validity of concerns about the CP/KCS transaction's effects on shippers' competitive options at gateways. {

}[27]

To address these significant concerns, Applicants offer only a vague commitment to keep the Laredo Gateway "and other affected gateways open both physically and commercially."[28] They promise to provide shippers rates to gateways that are "commercially reasonable."[29] However, they do not present any concrete, enforceable proposal for defining "commercially reasonable." Instead, they say rates would be commercially reasonable "in the sense that they would be established by CPKC in good faith."[30]

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[25] *See id.*, ¶¶ 53–59.

[26] *See id.*, ¶ 54; *see also* APP Vol. 2 at 133, Brown/Zebrowski VS ¶ 32 (assuming rate reductions averaging five percent only when diverting traffic from existing single-line service).

[27] Ex. 2 (CP Letter to National Industrial Transportation League (CP-C-00000851–854 at 852)).

Material within single braces ("{ }") has been designated "Confidential" under the Protective Order in this proceeding. Material within double braces ("{{ }}") has been designated "Highly Confidential." Confidential and Highly Confidential materials have been redacted from the public version of this filing.

[28] APP Vol. 1 at 20–21, Application at 11–12.

[29] APP Vol. 1 at 233, Brooks VS ¶ 46.

[30] Ex. 3 (KCS and CP's Joint Responses and Objections to UP's First Set of Discovery Requests, Response to Request No. 40).

If the Board does authorize the transaction, shippers should not have to rely on CPKC's "good faith." The Board should impose conditions to prevent the reduction of competitive options at gateways, particularly the Laredo Gateway.

First, the Board should impose a concrete, enforceable standard requiring CPKC to establish gateway rates that are "commercially reasonable." UP has identified an appropriately concrete and enforceable approach: When a customer asks CPKC to provide rates for (i) CPKC service for only former-CP, former-KCS, and/or former-KCSM portions of an origin-to-destination route, and (ii) CPKC single-line service on a competitive route, CPKC must provide the customer with a Rule 11 rate for the former-CP, former-KCS, or former-KCSM portions that reflects a mileage-based prorate of the CPKC single-line rate.[31]

As discussed in Part VII, UP's proposed condition is a narrowly tailored remedy designed to ameliorate harmful effects of the transaction by protecting competition, not competitors. It places control in the hands of the shippers that the condition is intended to protect.

Second, the Board should require Applicants to abide by the commitments KCS made when it acquired Tex Mex to protect operations involving the Laredo Gateway and Laredo Bridge. These commitments (as applied to CPKC) include:

- CPKC will not change the basic structure and operations of KCSM except through negotiations. CPKC's carriers (including KCSM) will continue to cooperate closely and fairly with UP, BNSF and other rail carriers on interline services such as pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, providing excellent service, and promptly quoting rates.

[31] "Rule 11" rates apply to interline shipments where railroads do not establish "through pricing" or "through rates." The rule means each carrier in the route bills the customer separately for its portion of the movement. Rule 11 rates are often used to protect confidential prices.

- CPKC will honor the terms of all existing Tex Mex and KCSM agreements and will allow such agreements to continue to their full term and not seek to cancel them early, even if it has the legal right to do so.
- CPKC will treat all carriers fairly at the Laredo Bridge. CPKC will abide by the existing dispatching and operating practices over the Bridge, will not make any unilateral changes in the way the Bridge is dispatched and operated, and KCS, Tex Mex, and KCSM will continue to be bound by the contracts and agreements that now govern operations over the Bridge.
- CPKC will ensure safety remains a top priority with regard to CPKC operations at the Laredo Gateway.[32]

The Board also should make one aspect of these commitments more concrete: UP's right to access any new railroad bridge constructed by CPKC in Laredo on the same terms as its right to access the existing International Bridge. These narrowly tailored operational conditions are discussed in more detail in Part VII.

B. The Public Interest Requires CPKC to Bear the Costs of New Capacity Necessary to Implement the Proposed Transaction.

The conditions described above would help mitigate competitive harms that would arise from the proposed transaction, but they would not be enough to ensure the transaction is in the public interest. As part of their overall effort to show their transaction would be in the public interest, Applicants identified "the additional infrastructure needs required to support anticipated traffic growth" on CPKC lines "to ensure that the trains on these lines would operate fluidly."[33] They outlined specific plans for investing in new capacity and described the investments as "among the highest priorities on the combined CPKC system."[34] However, Applicants failed entirely to address the impact of their transaction on infrastructure that they use but that is owned by other railroads. The Application contains no analysis, no plans, and no promises to add

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[32] *See KCS/Tex Mex*, FD 34342, slip op. at 13–14; *id.* at 18–19.

[33] APP Vol. 2 at 340, OP Plan ¶ 238.

[34] *Id.* at 344, OP Plan ¶ 244.

capacity to ensure operations on the lines owned by other carriers would remain fluid while supporting Applicants' planned traffic growth.

Most significantly, Applicants failed to address the need for additional infrastructure and investment to accommodate the additional eight to twelve trains per day they plan to operate on UP-owned tracks between Robstown and Beaumont, Texas, including lines through the crowded Houston terminal. BNSF also operates its own trains on many of these lines. Amtrak also operates on UP's lines between Beaumont and Houston. Applicants also failed to address other railroads' operations in analyzing the investment needs on lines they own but share with other railroads. They did not account for UP, BNSF, and Amtrak operations over the Neches River Bridge, a chokepoint for traffic moving between Houston and New Orleans. They also failed to address whether the 42-mile joint facility that UP and CP use to access Kansas City could accommodate their planned traffic growth of 14 trains per day. They also failed to address the impacts of their plan to route additional traffic through St. Paul, Minnesota, where their operations overlap with the operations of UP, BNSF, and Amtrak.

Applicants might dispute how much new capacity would be necessary to accommodate their planned operations on shared facilities, but no one should dispute the basic principle that Applicants should not make others subsidize investments needed to implement their transaction. If the Board allows the proposed transaction to proceed despite Applicants' failure to identify all the investments necessary to accommodate their plans, it should not allow Applicants to increase their operations above pre-merger levels until they enter into agreements with other affected railroads that identify and provide for funding of investments in new capacity necessary to accommodate their planned traffic growth.

II. A Combination Of CP And KCS Would Likely Cause A Substantial Lessening Of Competition For Traffic Moving Via The Laredo Gateway And Other Gateways.

CP proposes to acquire the KCS rail network, which extends in a north-south corridor from Kansas City south to the Pacific Ocean at the Port of Lázaro Cárdenas. In Mexico, KCS conducts operations through KCSM. KCS and KCSM connect at the Laredo Gateway, where KCSM also connects to UP.

The Board's charge in this proceeding is to determine whether the proposed combination of CP and KCS is "'consistent with the public interest.'"[35] "In determining the public interest," the Board "balance[s] the benefits of the merger against any harm to competition, essential service(s), labor, and the environment that cannot be mitigated by conditions."[36]

Since the early 2000s, the Board has recognized that one crucial harm to competition that must be addressed is the commercial or physical closure of major existing gateways. The Board's current rules for major rail consolidations require applicants to "explain how they would preserve the use of major existing gateways."[37] When the Board adopted the rules in 2001, it said that applicants must "present an effective plan to keep open major existing gateways," and that it would "impose conditions on any transaction that [it] approve[s] to ensure that result."[38] While CP and KCS obtained a waiver from the current rules, Applicants acknowledged that the Board's policy of keeping gateways open predates the current rules, and that the Board has "ample

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[35] *Canadian Nat'l Ry.—Control—Ill. Cent. Corp.*, 4 S.T.B. 122, 139 (1999) (quoting *Missouri-Kansas-Texas R. Co. v. United States*, 632 F.2d 392, 395 (5th Cir. 1980)).

[36] *Id.*

[37] 49 C.F.R. § 1180.6(b)(10)(i); *see also Major Rail Consolidation Procedures*, 5 S.T.B. 539, 546–47 (2001) ("Applicants also will be expected to include . . . effective plans to keep open major existing gateways.").

[38] *Major Rail Consolidation Procedures*, 5 S.T.B. at 563.

conditioning power under the pre-2001 rules" to impose conditions requiring them to keep gateways open physically and commercially.[39]

CP has previously recognized the need in railroad merger cases to protect competition at gateways, particularly the Laredo Gateway. When KCS proposed to acquire Tex Mex and TFM to create a "NAFTA Rail" system, CP actively urged the Board to protect against the commercial closure of the Laredo Gateway. It told the Board that "the Laredo gateway plays an indispensable role in the movement of rail freight to and from Mexico."[40] It echoed the Board's statements that Laredo "'occupie[s] *a position of separate and surpassing economic significance*' among the rail gateways serving the U.S.-Mexico border."[41] And CP criticized KCS's and Tex Mex's "vague[] assert[ions] that they would 'keep the Laredo gateway open on commercially reasonable terms'" as insufficient because the applicants had "*not* committed on the record to any *specific measures* to assure that result."[42]

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[39] *Canadian Pac. Ry.—Control—Kan. City S.*, FD 36500, Applicants' Reply to Objections to KCS Waiver from 2001 Major Merger Rules (CP-8/KCS-8) at 22 (Apr. 12, 2021).

[40] Ex. 4 (CP Additional Comments in *KCS/Tex Mex* (CPR-5) at 2 (Sept. 30, 2004)).

[41] *Id.* (quoting *UP/SP*, 1 S.T.B. at 422) (emphasis in CP's original filing).

[42] *Id.* (first emphasis in original). CP also recognized that KCS's settlement agreement with the National Industrial Transportation League (NITL)—which Applicants rely upon here, *see* APP Vol. 1 at 238–42, Brooks VS, Ex. 1—"does not mitigate the potential for competitive harm," because it does "'not require NAFTA Rail to establish and maintain commercially reasonable contract or common carrier rates and charges with respect to traffic interchanged between UP and TFM at the Laredo Gateway.'" Ex. 4 (CP Additional Comments at 6 (quoting NITL-4/KCS-17, Letter to David Meyer dated Aug. 18, 2003) (emphasis omitted)).

As CP explained: "The KCS-NITL settlement applies *only* to U.S.-Mexico cross-border movements in which KCS and/or TexMex are the participating carriers, and preserves interline competition only at interchange points *other than Laredo*. The KCS-NITL Agreement does *not* address the ability of non-Applicant railroads to access the Laredo gateway on commercially reasonable terms following the creation of a 'NAFTA Rail' system . . . ." *Id.*

Here, Applicants fail their own test: they have "*not* committed on the record to any specific measures to assure" rivals' access to the Laredo Gateway.[43] Indeed, they acknowledge the insufficiency of their own vague assertions about keeping gateways open "on commercially reasonable terms."[44] Relying on Applicants' vague promises is far riskier than in the KCS/Tex Mex transaction. As explained below, the potential for anticompetitive harm is great, particularly at the Laredo Gateway. Applicants will have the ability and incentive to divert traffic from interline routes to CPKC routes not on the merits, but by raising rates and degrading service for shippers seeking competitive alternatives to CPKC.

A. The Laredo Gateway Is Vitally Important to U.S.-Mexico Rail Transportation and the Proposed Combination of CP and KCS.

The Board should be concerned about the proposed transaction's impact on competition via all gateways potentially affected by a combination of CP and KCS, but no gateway is more important to competition in the United States, or more likely to be affected by the proposed transaction, than the Laredo Gateway.

1. The Laredo Gateway Is Critical to Applicants' Plans.

Applicants talk grandly about "the potential for a CP/KCS combination to transform North American railroading."[45] But their plans depend entirely on their ability to capture existing and new traffic that KCSM and UP could otherwise interchange at the Laredo Gateway (or that KCS and BNSF could interchange at Robstown, just north of the Laredo Gateway). Applicants'

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[43] Ex. 4 (CP Additional Comments at 2).

[44] *See* APP Vol. 1 at 233, Brooks VS ¶ 47 (committing to "work with shippers to find ways to make these commitments more concrete and readily enforceable").

[45] APP Vol. 1 at 159, Creel VS ¶ 11.

projection of a $1.15 billion annual revenue increase from traffic gains by 2025[46] assumes that CPKC will capture {{ }} carloads and containers of existing and new rail business, of which approximately {{ }} or {{ }} would move between the United States and Mexico via the Laredo Gateway.[47] Handling all this new traffic would require CPKC to increase the average number of trains currently moving over KCS's Laredo Subdivision from 10 per day to 20 per day.[48] CPKC would have a strong incentive to meet its aggressive projections by using commercial and operational control of KCSM to foreclose competition from UP.

2. The Board Has Recognized the Need to Protect Rail Competition Via the Laredo Gateway.

In the 1996 *UP/SP* merger proceeding, the Board concluded that the Laredo Gateway was "the most important U.S.-Mexican rail gateway,"[49] occupying a position of "separate and surpassing economic significance" in U.S.-Mexico commerce.[50] To ensure there would be no reduction in competition for traffic moving via the Laredo Gateway, the Board granted Tex Mex trackage rights over UP's lines between Robstown and Corpus Christi, Texas, on the one hand, and a connection with KCS in Beaumont, Texas, on the other hand.[51] Applicants would rely on

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[46] *See* APP Vol. 1 at 351, Vargas VS ¶ 41, Table 2.

[47] *See* Haley VS ¶ 42 (citing Operating Plan workpaper "HC - 1.Proposed Final FTI Rail to Rail Diversions for Merger Application_matching Finance with Truck to Rail.xlsx").

[48] *Compare* APP Vol. 2 at 452, OP Plan, App. N at 1, *with id.* at 454, OP Plan, App. O at 1.

[49] *UP/SP*, 1 S.T.B. at 422.

[50] *Id*. The Board said Laredo's status as "the principal rail gateway between the United States and Mexico" is "due to its superior infrastructure, especially customs inspection facilities, and its location on the shortest route between many U.S. and Mexican origins and destinations." *Id.* at 410.

[51] *See id.* at 424 (justifying grant of trackage rights "to ensure the continuation of an effective competitive alternative to UP's routing into the border crossing at Laredo"); *see also UP/SP*, *Houston Gulf/Coast Oversight*, Decision No. 10, slip op. at 9 (STB served Dec. 21, 1998) (noting that Tex Mex's trackage rights over UP "were designed to address the potential loss of competition at Laredo").

those rights to implement their proposed transaction: without the rights, CPKC could not move traffic between the Laredo Gateway and KCS's connection with CP in Kansas City.[52]

In 2004, the Board considered whether conditions were needed to protect competition via the Laredo Gateway in the context of KCS's merger with Tex Mex. The Board did not believe a merged KCS and Tex Mex could raise rates or foreclose competition by UP or BNSF via Laredo. Nonetheless, the Board found the "Laredo Bridge and gateway are so significant to rail traffic between the U.S. and Mexico" that it imposed a condition requiring KCS to adhere to a series of pledges to "guarantee that traffic will continue to flow fairly and efficiently at the Laredo Bridge and through the Laredo gateway."[53] The pledges included KCS's commitment to "establish and maintain commercially reasonable rates over any existing interchange with any railroad."[54]

CP's combination with KCS presents different and greater risks to competition via the Laredo Gateway than KCS's merger with Tex Mex. And the Laredo Gateway continues to play an irreplaceable role for traffic moving between the United States and Mexico.

3. The Laredo Gateway Remains Critical to U.S.-Mexico Rail Transportation.

The Laredo Gateway remains by far the most important rail gateway between the United States and Mexico. Approximately 54% of all U.S.-Mexico rail traffic (by dollar value) crosses the border at Laredo.[55] The Laredo Gateway's share of total U.S.-Mexico rail traffic understates

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[52] KCS relies on trackage rights over UP between Corpus Christi/Robstown and Victoria, Texas, and between Rosenberg, Texas, and Beaumont. Between Victoria and Rosenberg, KCS operates on a line that UP sold Tex Mex in 2000. *See Texas Mexican Ry.—Purchase Exemption—Union Pac. R.R.*, FD 33914 (STB served Dec. 11, 2000).

[53] *KCS/Tex Mex*, FD 34342, slip op. at 19 (emphasis added).

[54] *Id.*

[55] *See* Rocker/Turner VS at 4–5.

its importance. Basic geography makes the three rail gateways in western Mexico—Calexico, El Paso, and Nogales—non-viable alternatives to Laredo for most rail traffic flowing between the central and eastern United States (and Canada) and the most populous and industrialized regions of Mexico. Those gateways generally handle traffic moving between the western United States and points in western Mexico.[56]

Of the three rail gateways in Eastern Mexico—Laredo, Eagle Pass/Piedras Negras, and Brownsville/Matamoros—the Laredo Gateway's share is the largest. In 2019, Laredo handled over 66% of total rail traffic (by dollar value).[57] The principal alternative to Laredo is Eagle Pass/Piedras Negras, where UP and BNSF connect with Ferromex ("FXE").[58]

The Laredo Gateway remains critical to UP and its customers. UP was never willing to rely on KCS's vague commitment to keep the Laredo Gateway open "on commercially reasonable terms." Over time, UP has worked with FXE to make the Eagle Pass Gateway a more attractive alternative for customers, in an effort to reduce reliance on KCS and the Laredo Gateway. UP has an additional incentive to encourage customers to route traffic via Eagle Pass whenever feasible: UP owns a 26% equity interest in FXE. Despite UP's strong incentives, the Laredo Gateway's share of UP traffic moving via the Laredo or Eagle Pass gateways in 2019 was 57%.[59]

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[56] *See id.* at 5.

[57] *See id.*

[58] *See id.* Brownsville/Matamoros is used principally for traffic moving between the United States and Mexican points just across the border from Brownsville, and for routing of empties to relieve congestion at Laredo. *See id.*

[59] *See id.* at 6.

In addition, focusing on aggregate cross-border traffic flows understates the importance of the Laredo Gateway. For example, for the business CPKC is most focused on diverting—*i.e.*, finished vehicles, auto parts, and intermodal—the Laredo Gateway's share of UP traffic moving via the Laredo and Eagle Pass gateways is approximately 62%.[60] For traffic moving between the Upper Midwest and Mexican states in the industrialized heartland of northeastern and central Mexico, Laredo's share of UP cross-border traffic in many cases exceeds 95%.[61]

The Laredo Gateway's critical role in cross-border rail transportation stems in large part from the fact that it provides the only efficient connection with KCSM. Many shippers of cross-border traffic have no choice but to continue routing substantial volumes of traffic via Laredo because there are significant flows for which FXE service via Eagle Pass cannot provide an efficient alternative to KCSM service via Laredo. KCSM has two main advantages over FXE:

First, KCSM serves many important points in Mexico exclusively, including Toluca, San Luis Potosí, and many locations in Nuevo Leon. Of the more than 300,000 cars and containers UP interchanged with KCSM in 2019, UP estimates that more than half moved between Laredo and locations served exclusively by KCSM.[62] The overwhelming majority of the exclusively-served traffic is the finished vehicle, auto parts, and intermodal business that CPKC is most focused on targeting for diversion.[63]

Second, KCSM often has significant routing advantages for cross-border traffic, even when shippers have access to both KCSM and FXE. For example, KCSM and FXE both can

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[60] *See id.*

[61] *See id.*

[62] *See id.* at 7.

[63] *See id.*

access shippers in the Valle de Mexico region surrounding Mexico City through a jointly owned railroad, Ferrocarril y Terminal del Valle de México. But FXE's route from the Mexico City area to Eagle Pass is 55% (392 miles) longer than KCSM's route to Laredo.[64] Nearly 80% of UP's traffic between the U.S. and the Mexico City area moves via the Laredo Gateway.[65]

B. CP Control of KCS Would Undermine Competition Via the Laredo Gateway.

In *UP/SP* and *KCS/Tex Mex*, the Board acted to preserve effective competition for cross-border traffic moving via the Laredo Gateway. CP's proposal to acquire control of KCS requires the Board to act once again to protect the interests of shippers who depend on rail service via the Laredo Gateway. Applicants have acknowledged the validity of concerns that their transaction will harm shippers' competitive options at gateways. Those concerns are particularly justified with regard to harms to competitive options at the Laredo Gateway.

1. Shippers Benefit from Competition at the Laredo Gateway.

Today, most shippers that depend on rail service via the Laredo Gateway have at least two competitive options for moving cross-border traffic within the United States. UP and BNSF compete to provide service between the border area and common points throughout the western two-thirds of the United States, and they have efficient connections to carriers serving shippers in the Eastern United States and Canada.[66] In some cases, shippers have the option to use KCS's

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[64] *See id*. FXE's concession from the Mexican government includes trackage rights over KCSM's line between Ramos Arizpe and Querétaro, which would provide FXE a more efficient route to Eagle Pass. However, FXE cannot use the rights for cross-border traffic. *See* OECD, International Transport Forum, Freight Railway Development in Mexico at 25 (April 2014), https://www.itf-oecd.org/sites/default/files/docs/14mexicorail.pdf

[65] *See* Rocker/Turner VS at 7.

[66] *See id.* at 9.

network in the United States. Often, KCS's only participation in a cross-border movement in the United States will be to move traffic between Laredo and an interchange with BNSF.

When UP and BNSF compete, each relies on KCSM to handle the traffic between the border and points in Mexico. With regard to operational matters, KCSM and UP have a good working relationship. Between KCSM's Sanchez Yard, located just south of the border, and points in Mexico, traffic KCSM interchanges with UP typically moves in the same trains as traffic KCSM interchanges to KCS for BNSF. The use of the same trains for both railroads' traffic helps ensure UP traffic is handled in an equitable, even-handed manner by KCSM.[67] More generally, KCSM has strong incentives to cooperate with UP on operational matters because a substantial portion of its cross-border business depends on its ability to provide efficient service in Mexico for traffic UP originates or terminates in the United States.[68]

With regard to commercial matters, shippers benefit from competition created by the confidential nature of most pricing for cross-border traffic. Most of UP's cross-border traffic moves under "Rule 11" rates.[69] When a shipper requests a Rule 11 rate, each carrier participating in an interline route separately and confidentially provides the shipper a rate for its portion of the route. In other words, a shipper asks KCSM for a rate to move traffic between a point in Mexico and the border, and it asks UP and BNSF to provide competing rates to move the traffic between the border and a point in the United States. UP and BNSF compete to provide transportation in the United States with regard to the rates they offer the shipper and on non-price dimensions as

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[67] *See id.*

[68] *See id.*; *see also* Ex. 5 (Ottensmeyer Tr. 140:8–141:4 {

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[69] *See* Rocker/Turner VS at 9.

well (*e.g.*, transit time, equipment supply, reliability).[70] KCSM's rates are constrained by its concerns that the combined price might exceed what the customer is willing to pay.[71]

UP believes that not all shippers experience the same benefit from competition at the Laredo Gateway that they experienced before KCS acquired Tex Mex and KCSM. In particular, UP is concerned that KCSM sets Rule 11 rates to discourage shippers from using UP, and to extract extra revenue from shippers who use UP, when KCS has a single-line alternative. That is one reason UP has worked to improve the Eagle Pass Gateway. But UP's ability to offer alternative routes is limited by FXE's route structure and KCSM's exclusive access in Mexico.[72]

However, for most cross-border traffic that Applicants plan to divert from UP and BNSF, KCS cannot currently offer a viable alternative north of the border. KCS's network extends only as far north as Kansas City—it does not reach Chicago and other origins and destinations in the Upper Midwest. CP's Chief Marketing Officer explains that CP and KCS had tried but failed to develop lasting interline relationships that would allow KCS to extend its cross-border hauls further into the United States.[73] As a result, KCS's incentive has been to create a competitive environment for most traffic moving via the Laredo Gateway to grow revenue on KCSM.

2. CPKC Would Have the Incentive and Ability to Use Its Control of KCSM to Deprive Shippers of the Price and Service Benefits of UP-KCSM Routings.

CPKC's incentives to skew the competitive playing field at the Laredo Gateway would be vastly different from KCS's incentives today. By combining KCS's routes between Mexico

[70] *See id.* at 10.

[71] *See id.*

[72] *See id.* at 6–7, 16.

[73] *See* APP Vol. 1 at 226–28, Brooks VS ¶¶ 28–34. KCS's Chief Executive Officer also describes KCS's unsuccessful efforts to extend its reach through alliances with other railroads. *See* APP Vol. 1 at 198, Ottensmeyer VS at 12.

and Kansas City with CP's routes between Kansas City and the Upper Midwest, CPKC would have the opportunity to generate hundreds of millions of dollars of additional revenue by carrying north of the border the several hundred thousand carloads and containers of traffic that KCSM currently interchanges with UP and BNSF via the Laredo Gateway. Applicants are specifically targeting more than {{ }} containers of intermodal freight, more than {{ }} carloads of automotive business, and thousands of carloads of metals, minerals, consumer products, chemicals, energy, and grain products that moved between the U.S. and Mexico via the Laredo Gateway in 2019.[74]

CPKC would have a significant incentive to manipulate competitive outcomes for cross-border traffic to favor routes in which it participates in the United States. When KCS acquired Tex Mex and TFM, KCS faced no pressure to divert UP-KCSM traffic moving over the Laredo Gateway: it projected essentially no diversions of cross-border traffic from UP to KCS.[75] By contrast, Applicants here have promised investors a $1.15 billion annual revenue increase from traffic gains by 2025.[76] To meet these aggressive projections, Applicants' plans require CPKC to capture more than {{ }} carloads and containers of existing and new business, of which more than {{ }} or approximately{{ }} would be traffic moving between the United States and Mexico via the Laredo Gateway.[77] KCS's public disclosures emphasize the truly aggressive nature of the projections. KCS's proxy statement urging shareholders to approve the

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[74] *See* Salop VS ¶ 76, Fig. 3.

[75] *See KCS/Tex Mex*, FD 34342, Railroad Control Application (KCS-3/TM-3) at 122; *see also KCS/Tex Mex*, FD 34342, slip op. at 11.

[76] *See* APP Vol. 1 at 351, Vargas VS ¶ 41, Table 2.

[77] *See* Haley VS ¶ 42 (citing Operating Plan workpaper "HC - 1.Proposed Final FTI Rail to Rail Diversions for Merger Application_matching Finance with Truck to Rail.xlsx").

proposed transaction, which was filed November 3, 2021—that is, *after* the Application had been submitted to the Board—shows CP projected annualized synergies for the combined companies of approximately $990 million would be realized within the first three years after the transaction, while KCS management projected just $377 million in annualized synergies.[78]

If the proposed transaction enabled the merged CPKC to attract Laredo Gateway traffic to its lines north of Laredo solely by reducing rates or improving service, the effect would be procompetitive, not anticompetitive. UP might lose traffic, but shippers would not be harmed.

However, CP control of KCS poses a serious threat to the competitive process because it would likely undermine the transportation options available to shippers for traffic moving via the Laredo Gateway. Applicants have placed themselves in a difficult position. They promised the proposed transaction would generate significant merger-related benefits, but they are unlikely to achieve their objectives by competing for business on the merits.

CPKC would not generate significant merger benefits through cost savings. Applicants say the proposed transaction creates "tremendous opportunities for efficiency gains."[79] However, Applicants' actual projected operating cost savings are minimal, amounting to just 3.1% of CP's and KCS's current combined operating costs—a level of productivity improvement that railroads regularly achieve as part of their normal course of business.[80] Applicants have few opportunities to generate cost savings because the CP and KCS systems connect at just one location—Kansas City—where they already share a yard.[81] CPKC would not be able to offer shorter, more efficient

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[78] *See* Ex. 6 (KCS Schedule 14A at 65 (Nov. 3, 2021)). KCS's Chief Executive Officer, Mr. Ottensmeyer, described the difference as { } Ex. 5 (Ottensmeyer Tr. 96:6–97:3).

[79] APP Vol. 2 at 283, OP Plan ¶ 76.

[80] *See* Haley VS ¶ 14.

[81] *See id.*, ¶¶ 15–16.

routes or reduce costs by combining terminals and facilities, other than headquarters facilities.[82] Applicants say CPKC would generate cost savings by optimizing train operations. But aside from eliminating interchange of a few cars in Kansas City, the "optimization" merely reflects CP's application of precision scheduled railroading ("PSR") principles to KCS and KCSM—a change that does not require a merger.[83]

Making Applicants' task even more daunting, CP apparently knows very little about railroad business in Mexico. CP's Chief Marketing Officer has never worked in Mexico, has never done sales in Mexico, and does not even know how much KCSM traffic is handled to or from locations exclusively served by KCSM. Before agreeing to merge, CP apparently never analyzed pricing opportunities in Mexico or performed any competitive analysis regarding traffic that could move between CP or KCS-served points and KCSM-served points in Mexico.[84]

Applicants describe aspirations to draw substantial quantities of new traffic to their combined system, anchored by vague plans to attract international intermodal traffic to the Port of Lázaro Cárdenas and expand shipments of DRUbit—a more concentrated form of crude oil. Of the {{ }} containers and carloads of traffic that Applicants identify in their "growth initiative," {{ }} is Lazaro intermodal traffic and {{ }} is DRUbit.[85] But the Lázaro Cárdenas project is entirely speculative. Applicants' documents produced in discovery show {{

[82] *See id.*, ¶¶ 15–16.

[83] *See id.*, ¶ 31.

[84] *See* Ex. 7 (Brooks Tr. 188:19–190:8).

[85] *See* Wahba/Naatz workpaper "Growth Initiative Calculations.xlsx."

}}[86] As for DRUbit, Applicants acknowledge CP and KCS were already cooperating to connect CP-served origins and KCS-served destinations to promote DRUbit.[87] They also appear to suggest DRUbit will merely displace crude oil already being moved by CP and interchanged with KCS or BNSF.[88] Either way, prospects for additional, merger-related growth are speculative.

Ultimately, Applicants' most credible prospect for merger-related traffic growth comes from traffic they plan to divert at the Laredo Gateway. However, Applicants offer no reason customers would willingly choose longer CPKC routes over existing interline routes. Applicants make clear they would not offer lower rates to attract traffic from interline routes—their revenue projections require them to divert interline traffic at existing rates.[89] If they reduced rates to attract traffic, they would break their $1 billion promise to investors. Applicants also do not have a realistic prospect of attracting traffic by offering better service than existing alternatives. On

[86] *See* Ex. 8 (Lazaro Cardenas Presentation (KCSR-C-00016306–16312, at 16312)); Ex. 9 (Lazaro Cross-Border Pricing Business Review (KCSR-HC-00017701–17707, at 11704)).

[87] *See* APP Vol. 1 at 284–86, Wahba/Naatz VS ¶¶ 90–92; *see also* Marybeth Luczak, USD, Gibson Launch "DRUBit by Rail," Railway Age (Dec. 15, 2021), https://www.railwayage.com/freight/class-i/usd-gibson-launch-drubit-by-rail/

[88] *See* APP Vol. 1 at 283, Wahba/Naatz VS ¶¶ 85–87. Applicants appear to take a contradictory position, first saying "[t]he volume of crude oil shipments from source to refinery is determined by macroeconomic forces that will not be affected by the Transaction," *id.* at 280, Wahba/Naatz VS ¶ 80, and suggesting DRUbit will merely substitute for existing moves already handled by CP and interchanged with KCS or BNSF, *id.* at 283, Wahba/Naatz VS ¶ 85, but then claiming significant additional volumes and revenues as part of their planned "growth initiative," *see* Wahba/Naatz workpaper "Growth Initiative Calculations.xlsx"; *see also* OP Plan workpaper "HC – 1.Proposed Final FTI Rail to Rail Diversion Results for Merger Application_matching Finance with Truck to Rail.xlsx."

[89] *See* Haley VS ¶ 54.

average, their routes would be 217 miles longer than existing options.[90] A very substantial portion of Applicants' planned diversions involve traffic moving between Laredo and Chicago, but their route in that important corridor is approximately {{ }} more circuitous, and thus less efficient, than the average existing route, according to their own calculation.[91]

In short, Applicants would face enormous post-merger pressure to divert traffic from existing KCSM interline service to CPKC single-line service using strategies that reduce shippers' existing competitive options. As explained below, CPKC would have the ability to implement such anticompetitive strategies by raising rates shippers must pay for interline service or degrading the quality of service shippers receive when using interline service.

a) CPKC Would Have the Ability to Raise Interline Rates on Cross-Border Traffic to Foreclose Competition.

CPKC could readily disable competition for cross-border rail traffic by raising the rates KCSM charges shippers for UP-KCSM movements. UP could have the most efficient routes and best service north of the border, but CPKC could make UP-KCSM interline service too expensive to overcome those advantages.[92]

As Mr. Rocker and Professor Salop explain, CPKC could foreclose competition from UP without refusing to offer shippers rates for UP-KCSM interline movements, and even without discriminating between UP and CPKC in the KCSM rates it offers. CPKC could accomplish its objective by raising KCSM's rate factor in relation to CPKC's rates north of the border, which Mexican law would allow.[93]

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[90] *See* APP Vol. 2 at 132, Brown/Zebrowski VS ¶ 30, Table 6.

[91] *See* Haley VS ¶ 57.

[92] *See* Rocker/Turner VS at 12–14.

[93] *See id*. at 13; Salop VS ¶¶ 81–82; de la Calle VS at 4–5.

CPKC's anticompetitive strategy can be illustrated using a simple example: Assume that before CP gains control of KCS, KCSM quotes a shipper a rate of $100 from a Mexican origin to the Laredo Gateway. UP and CP serve the destination. UP has an efficient route and quotes a rate of $100. KCS and CP could move the traffic using a less efficient route through Kansas City, but the customer prefers the UP route, even if KCS and CP would jointly charge the same $100. In today's competitive market, the shipper would choose the KCSM-UP route and pay $200.

After the transaction, CPKC could raise KCSM's rate factor to $110—or even higher—while still offering the customer a single-line rate of $200. In other words, CPKC could easily disadvantage UP's efforts to compete for the traffic without lowering rates or improving service. The customer would have to choose between accepting CPKC service to avoid a rate increase or paying KCSM an additional $10 (or more) to continue using UP. Either way, CPKC would generate more revenue and more profit (assuming the CP/KCS joint rate of $100 included some return), and the shipper would lose the benefits of real competition—by paying more, by losing its preferred route north of the border, or by having to accept poorer service.[94]

CPKC could easily implement this strategy. Even today KCS and KCSM do not have separate rate-setting functions. "KCS has a core pricing team for all rates, US and Mexico. KCS and KCSM do not have separate pricing groups . . . ."[95] As Applicants explained in discovery, when KCS offers single-line service between Mexico and the United States, KCSM's revenue division is established *after* the overall rate has been determined. KCS and KCSM first set an overall price based "on a variety of factors and considerations." Then, "[o]nce the overall rate is

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[94] *See* Rocker/Turner VS at 12–14.

[95] Ex. 10 (UP's Motion to Compel, Ex. C at 9).

determined, revenue divisions are assigned between KCSR and KCSM."[96] In other words, the strategy would not require any additional coordination. CPKC could maintain the veneer of charging non-discriminatory KCSM rates in Mexico, while structuring KCSM-UP and CPKC single-line rates it offers to foreclose competition from UP.

In addition, CPKC would have a great deal of latitude to manipulate KCSM's rates to foreclose competition from UP. There are no effective regulatory limits on the level of KCSM's rates for transportation within Mexico, as Dr. de la Calle explains.[97] CPKC could cause KCSM to increase its rates as much as necessary to assure that UP is effectively disabled from competing, while offsetting any increase in the single-line rates it offers shippers.

As Mr. Rocker and Professor Salop explain, CPKC's implementation of such a strategy would hurt shippers and competition, not just UP. In the example above, CPKC would not be shifting $10 from UP's pockets to CPKC's pockets. The shipper would be forced to choose between (i) receiving inferior service, and (ii) paying more to KCSM while paying the same amount to UP. Applicants claim KCSM already extracts every last dollar of revenue that might be available for cross-border moves.[98] However, they offer no proof.[99] They cannot offer any

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[96] Ex. 11 (KCS and CP's Joint Responses and Objections to UP's Second Set of Discovery Requests, Response to Request No. 148).

[97] *See* de la Calle VS at 6.

[98] *See* APP Vol. 1 at 208, Ottensmeyer VS at 22 ("With respect to existing rail dependent movements, prices are already pushed to market levels.").

[99] Applicants acknowledged in discovery that their expert economist's claim that "KCS would already be collecting the full measure of returns associated with its existing market power" from shippers with "no ready alternative to KCS," APP Vol. 2 at 19, Majure VS ¶ 24, "was not based on any specific documentary evidence in the possession of Applicants." Ex. 12 (KCS and CP's Supplemental Joint Responses and Objections to CSXT's Second Set of Discovery Requests, Response to Interrog. No. 12). When asked for documents discussing whether KCS or KCSM was collecting the full measure of returns associated with its existing market power, Applicants responded: "KCS does not have any responsive documents." Ex. 3 (KCS and CP's Joint

proof because their claim is incorrect. As Professor Salop explains, KCS/KCSM's lack of full information about CP's and UP's costs and pricing and its incomplete knowledge about the particular circumstances and demand factors facing CP's and UP's customers in the United States reduces KCS/KCSM's ability to effectively discriminate among customers on their cross-border movements. The CP/KCS transaction would give CPKC full control of costs and pricing of its single-line route and additional insight into customer circumstances that would allow the combined entity to increase its profits at the expense of shippers—if CPKC is given the opportunity to foreclose competition.[100]

A CPKC pricing strategy that expressly treats KCSM-UP movements differently from CPKC single-line movements would be even easier to implement. As Dr. de la Calle observes, it is unclear whether Mexican anti-discrimination law would even regard a difference between the portion of a CPKC single-line rate allocated to KCSM and the KCSM factor in a KCSM-UP interline rate as a prohibited "discrimination."[101] Even today, KCS's interpretation of Mexican antidiscrimination rules {{

}}[102] CPKC would have incentives to take an even more aggressive legal position to meet its revenue projections.

Responses and Objections to UP's First Set of Discovery Requests, Response to Request No. 99).

[100] *See e.g.*, Salop VS ¶¶ 60–61.

[101] *See* de la Calle VS at 5–9.

[102] *See* Ex. 13 (KCS Policy on Rate Offers for KCSM Routes (KCSR-HC-00020720–20726)).

b) CPKC Would Have the Ability to Reduce KCSM Cooperation with UP on Operational and Service Matters in Mexico and at the Laredo Gateway.

CP control of KCS would also provide opportunities to divert cross-border traffic by making UP-KCSM transportation offerings more costly or less attractive in other ways. Today's competitive UP-KCSM service is built on and continues to depend on cooperation between the carriers on a wide variety of operational matters.[103] However, CPKC's incentive to cooperate with UP would be different from KCSM's incentives. Although Applicants claim "cooperating with UP at Laredo . . . will be in the self-interest of the CP/KCS system,"[104] their Application makes clear their interests would lie in diverting traffic from UP-KCSM service to CPKC service.

Applicants' incentives to reduce operational cooperation with UP would grow along with any growth of their business in Mexico. KCSM currently has strong incentives to provide excellent service to UP to expand its overall business, and the incentives are reinforced by the fact that UP traffic often moves on the same trains as other KCSM traffic.[105] If Applicants' plans come to fruition, CPKC would have more trains carrying only CPKC traffic, more customers receiving service from only CPKC, and thus reduced incentives to provide equal treatment for customers choosing UP service north of the Laredo Gateway. The result would be a downward spiral in which the reduction in the quality of service provided to UP-served shippers in Mexico would force shippers to move their business to CPKC, which in turn would lead to further reductions in the quality of service provided to UP-served shippers.

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[103] *See* Rocker/Turner VS at 9, 14.

[104] APP Vol. 1 at 232, Brooks VS ¶ 43.

[105] *See* Rocker/Turner VS at 9–10, 15.

CPKC could also reduce competition by giving preferential treatment to its own traffic moving over the International Bridge at Laredo. KCS controls the bridge through its ownership of Tex Mex and KCSM. Operations over the bridge are governed by a 1951 agreement between Tex Mex and a UP predecessor, but the agreement speaks only in general terms about Tex Mex's obligations to perform service "impartially" with "no preference . . . to movements of cars by one of the parties."[106] UP and KCS have given meaning to the agreement by setting aside alternating "windows" for northbound and southbound traffic.[107] However, Applicants have indicated they may want to change the current process.[108] Any change to operations that would permit a more subjective interpretation of Tex Mex's contractual obligation would give CPKC opportunities to restrict UP's use of the bridge in ways that would harm customers of UP.

In addition, UP and KCSM have worked together over the years to increase the effective capacity of the existing bridge. Recently, KCS obtained a Presidential Permit to construct a new rail bridge at Laredo.[109] KCS currently has strong incentives to cooperate to ensure the existing bridge has sufficient capacity to accommodate both parties' future needs. If CPKC could shift operations to a new bridge, while excluding UP and maintaining control of the existing bridge, CPKC could act on its incentive to confine UP's future ability to compete for cross-border transportation at Laredo.

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[106] Rocker/Turner workpaper "C - International Bridge Agreement.pdf."

[107] *See* Rocker/Turner VS at 15.

[108] *See* APP Vol. 2 at 317, OP Plan ¶ 162 (discussing goal to "[e]volve the operational model at the border").

[109] *See* Rocker/Turner workpaper "P - Presidential Permit.pdf."

III. The Board Should Not Simply Presume That The Proposed Transaction Would Not Have Anticompetitive Effects.

Applicants dismiss concerns regarding CPKC's enhanced ability and incentive to foreclose competition. In lieu of any probative analysis to support their claim that their transaction will not harm competition, they rely heavily on the "one-lump" theory to presume that CPKC will have no incentive to force inferior terms on customers who depend on KCSM service in Mexico and ship traffic from Laredo to points served by both CP and UP (or CP and BNSF). That theory, which the Board has utilized at times in reviews of other mergers, in turn rests on the assumption that KCS must already be collecting the full measure of returns associated with KCSM's existing market power[110] and that merging with CP therefore cannot increase the post-merger firm's ability or incentive to foreclose.

While the one-lump theory may apply in some circumstances, it does not apply in this particular case. As Professor Salop explains, modern economic analysis has shown that when an upstream monopolist (KCSM) and downstream rivals (UP and CP) lack full information about each other's costs and prices, or when the rivals provide differentiated services—*i.e.*, services that shippers view as qualitatively different—the monopolist generally cannot extract the full "one lump," so the shipper retains a surplus.[111] In those circumstances, which exist here, the merged carrier *does* have an incentive to engage in anticompetitive conduct: to eliminate the shipper's surplus and extract the full "one lump."[112]

Applicants' expert Dr. Majure leans so heavily on the "one lump" presumption that, in Applicants' own words, his conclusion that "[a] combined CP/KCS would not be expected to

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[110] *See* APP Vol. 2 at 19, Majure VS ¶ 24.

[111] *See* Salop VS ¶¶ 36–39 (imperfect information); *id.*, ¶¶ 40–59 (differentiated products).

[112] *See id.*

have any incentive to affect the competitive terms available to [a solely-served] shipper, because KCS would already be collecting the full measure of returns associated with its existing market power"[113] "was not based on any specific documentary evidence in the possession of Applicants."[114] In other words, Dr. Majure reviewed no documents or information from KCSM regarding how that railroad operates. He conducted no assessment of whether KCSM is obtaining its single monopoly profit today, which means that Applicants are asking the Board to rely on a presumption—that the post-merger firm will not have an increased incentive to use its control of Laredo to foreclose competition—that is based purely on an untested assumption.

To support the assertion that KCSM is not presently acting on its incentive to foreclose competition by exploiting its control of the Laredo bottleneck, Dr. Majure presents an analysis of a single-year, incomplete snapshot of data—the results of which are as consistent with the existence of some foreclosure as with none and are thus of no probative value whatsoever. And while Dr. Majure questions whether the post-merger firm will have the ability to foreclose by suggesting that shippers can turn to FXE as an alternative to KCSM in Mexico, he conducted no analysis to determine whether that hypothesis is correct.

Applicants' proposed merger also comes at a time of increasing concern regarding the potential competitive effects of vertical transactions. At the suggestion of the White House,[115]

[113] APP Vol. 2 at 19, Majure VS ¶ 24.

[114] Ex. 12 (KCS and CP's Supplemental Joint Responses and Objections to CSXT's Second Set of Discovery Requests, Response to Interrog. No. 12); *see also* APP Vol. 2 at 19, Majure VS ¶ 24.

[115] *See Biden Competition Order*, Sec. 5(c) ("To address the consolidation of industry in many markets across the economy, as described in section 1 of this order, the Attorney General and the Chair of the FTC are encouraged to review the horizontal and vertical merger guidelines and consider whether to revisit those guidelines.").

the antitrust enforcement agencies are currently revisiting their enforcement guidelines.[116] They have also recently challenged several vertical transactions on the theory that one party had market power and could use control of the other party to foreclose competition—enforcement actions that make no presumption the party with market power was already extracting its full "lump."[117] And the current version of their Vertical Merger Guidelines contains no presumption that certain vertical mergers are procompetitive or competitively neutral.

Applicants themselves acknowledge that concerns about foreclosure are valid.[118] Applicants have promised to address those concerns by providing shippers "commercially reasonable" rates to and from gateways.[119] However, while they also apparently recognize that their current commitments are neither sufficiently concrete nor readily enforceable,[120] their promises do not include any more concrete or enforceable provisions.

Applicants would thus have the Board rely on a flawed and unsupported presumption that their vertical merger cannot harm competition, at a time of increasing concern regarding the possible competitive effects of vertical mergers, with only Applicants' vague assurances as a backstop. UP proposes that if the Board is inclined to approve the transaction, it impose remedies—including an administrable, readily enforceable formula for developing competitively

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[116] *See* Press Release, U.S. Dep't of Just., *Justice Department Issues Statement on the Vertical Merger Guidelines* (Sept. 15, 2021); Press Release, F.T.C., *Federal Trade Commission Withdraws Vertical Merger Guidelines and Commentary* (Sept. 15, 2021).

[117] *See, e.g.*, Complaint, *Illumina, Inc.*, Docket No. 9401 (F.T.C. Mar. 30, 2021); Complaint, *Lockheed Martin Corp.*, Docket No. 9405 (Jan. 25, 2022); Complaint, *Nvidia Corp.*, Docket No. 9404 (F.T.C. Dec. 6, 2021).

[118] *See* Ex. 2 (CP Letter to National Industrial Transportation League) ({ }).

[119] APP Vol. 1 at 16, Application at 7; *see also* APP Vol. 1 at 214, 233, Brooks VS ¶¶ 4, 46.

[120] *See* APP Vol. 1 at 233, Brooks VS ¶ 47 ("Finally, we will work with shippers to find ways to make these commitments more concrete and readily enforceable, including via appropriate alternative dispute resolution mechanisms.").

reasonable interline rates—to prevent the anticompetitive foreclosure that might otherwise result from the proposed merger.

A. Professor Salop's Analysis Explains Why Reliance on the One-Lump Presumption Would be Inappropriate in This Case.

The Board has utilized the "one-lump" theory in previous cases to presume that end-to-end mergers with a monopolist in one segment and competition in the other segment will not cause competitive harm.[121] Put simply, the theory assumes the monopolist is already earning its "one lump" and that merging with a downstream company therefore cannot increase its incentive or ability to foreclose. The theory has its roots in the "single monopoly profit" theory developed in the early industrial organization economics literature analyzing tying arrangements and then was applied to vertical mergers. As Professor Salop explains:

> [I]n this economic model applied to vertical mergers, one firm has a monopoly in producing an "input," while there is perfect competition among the competing firms, (*i.e.*, two or more firms with perfect information producing an undifferentiated (homogeneous) "output" that use the input and sell that output to consumers. According to this theory, the monopolist would not need to acquire one or both of the competitors in the output market in order to be able to extract all of its input monopoly profits from consumers. That is, the acquisition does not change anything, absent efficiencies, because there is only "one lump" of profits that can be extracted by the monopolist, and it can do so either with or without the acquisition.[122]

Modern economic analysis has shown the one-lump presumption is appropriate only when certain conditions are present, including that the parties have perfect information about each other's prices and costs, and that the downstream competitors offer homogenous (i.e., identical) products. But, as Professor Salop explains, the monopolist is *not* presumed to be

[121] *See* Salop VS ¶ 21.

[122] *Id.*, ¶ 22 (internal citations omitted).

earning its lump if the competing downstream firms earn a positive margin over costs. That can be the result if, for example, the companies are selling differentiated products or operating with imperfect information regarding each other's prices and costs, as is the case in the rail markets likely to be affected by the proposed transaction.[123]

Dr. Majure acknowledges the one lump theory may not apply where the merging parties have imperfect information about each other's costs, prices, and rates.[124] As Professor Salop explains, in such a rail market, the monopoly carrier may not be able to extract its "one lump" prior to the merger. Instead, uncertainty regarding the rates and costs of the other carriers may result in the monopoly carrier setting its pre-merger divisions below the monopoly level, out of concern that if the through rate exceeds the price the shipper is willing to pay the carrier will not win the movement.[125]

Thus, competition in the pre-merger market with imperfect information leads to the shipper obtaining through rates that are below its reservation price at least some of the time.[126] A merger with one of the downstream competing railroads, however, reduces that uncertainty, which increases the likelihood that the merged firm will be able to profitably raise rates. After (and because of) the merger, for example, CP and KCS will know each other's costs and prices, be better able to set a single-line rate equal to the shipper's reservation price—in other words, a higher price than the shipper is offered today—and thus will be better able to extract the full

[123] *See id.*, ¶ 23.

[124] *See* Ex. 1 (Majure Tr. 60:18–25 ("[T]he degree of imperfection of the information would affect the degree to which the theory is applicable.")).

[125] *See* Salop VS ¶ 37.

[126] *See id.*, ¶ 38.

monopoly revenue from the shipper than KCS can today. Contrary to the one-lump presumption, a merger in such a market increases the post-merger firm's ability and incentive to foreclose.[127]

As Professor Salop explains, even in markets where the participants have access to better information, the one-lump theory does not apply to an end-to-end merger involving a monopoly carrier and one of the competing carriers if the services offered by the competing carriers are not perfect substitutes for each other.[128] That is precisely the situation here. The transport services offered by UP and KCS differ across a spectrum of factors, such as relative distance from a shipper's business to the origin and destination stations, the speed of the shipment, etc. As a result, today UP and KCS are able to charge through rates that exceed their marginal costs, and KCSM may therefore be unable to extract its single monopoly profit. KCS already has the ability and incentive to foreclose today, and merging with CP will only exacerbate those concerns, because it will enable the combined CPKC to earn additional revenue and profits on the CP segments of movements, increasing the financial benefits of foreclosure.

Professor Salop illustrates the inapplicability of the one-lump presumption to the proposed transaction with simulation models designed to reflect some of the variations in characteristics of shippers, commodities, and origin-destination routes that could be affected by the merger.[129] Professor Salop's work recognizes that the effects of a merger may differ across origin/destination markets and commodities. And, as the results of his models demonstrate, he notes that the ultimate effects of a vertical merger on shippers depends on the interplay of numerous factors, including the extent to which the incentive to raise prices through a

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[127] *See id.*, ¶ 39.

[128] *See id.*, ¶¶ 40–43.

[129] *See id.*, ¶¶ 50–54.

foreclosure strategy may be offset by the incentive to lower prices, for example as a result of merger-specific efficiencies.

Professor Salop's models confirm that vertical mergers like the proposed transaction can produce either or both sorts of incentives, and they may benefit some shippers and harm others. The models do not attempt to predict the likelihood of any particular outcome, but rather demonstrate that vertical mergers in markets with characteristics such as those at issue in this transaction can lead to a wide variety of impacts. The results of his simulation models show that significant price changes are highly possible, and that some or all shippers can be harmed as a result of an end-to-end merger.[130] That there is no certain or even "most likely" general result is precisely the point; the models demonstrate that there is no economic basis for presuming that a merger such as the CP/KCS merger will be procompetitive, anticompetitive, or competitively neutral.

In fact, as other aspects of Professor Salop's analysis demonstrate, the proposed merger raises serious risks of anticompetitive foreclosure. Applicants' experts Brown and Zebrowski estimate the volume of traffic that moves through the Laredo gateway that the post-merger company could be able to divert. Their calculations incorporate the assumption that CPKC will not reduce rates to attract business away from competitors that currently interline with KCS and KCSM and that CPKC will rely instead on post-merger quality improvements—improvements that UP witness Thomas Haley explains are largely not merger-specific[131]—to win the significant volumes of additional traffic necessary to justify the cost of the acquisition.[132] Brown and Zebrowski also assume that CPKC will not engage in foreclosure but that, again, is just another

[130] *See id.*, ¶ 54.

[131] *See generally* Haley VS ¶¶ 18–36.

[132] *See* Salop VS ¶¶ 83–84.

assumption—Brown and Zebrowski neither provide nor cite to any evidence that CPKC will not have an incentive to foreclose rivals.

As Professor Salop notes, if CPKC will be able to divert traffic by reducing its own costs, as Brown and Zebrowski's formulation assumes, it could also divert traffic by increasing its rivals' costs through a foreclosure strategy.[133] And in fact, CPKC will have an *increased* incentive and ability to raise KCSM interline rates, compared to the situation pre-merger (where such incentives already exist), because shipments diverted from competitors like UP will enable CPKC to capture the revenue and profits associated with the KCS segments as well as the CP segments.[134] Professor Salop illustrates this conclusion by extending the Brown and Zebrowski analysis to an example of movements of finished automobiles from Mexico to Chicago via Laredo, demonstrating that even partial foreclosure would be profitable for CPKC, even if it resulted in CPKC losing some revenue and margin as a result of decreased interlining between KCSM and the foreclosed competitors.[135]

B. The Statement of Applicants' Expert Does Not Support a Presumption That the Proposed Transaction Will Not Have Anticompetitive Effects.

In his Verified Statement, Dr. Majure dismisses concerns regarding CPKC's incentives and ability to foreclose competition without actually analyzing or addressing those concerns. As discussed above, Dr. Majure relies entirely on the "one lump" presumption that vertical end-to-end mergers with a monopolist at one end and a railroad facing competition at the other end cannot have anticompetitive effects. Relying on that presumption, Dr. Majure asserts that CPKC will not have "the incentive and ability as a combined firm to foreclose rivals or otherwise lessen

[133] *See id.*, ¶ 75.
[134] *See id.*, ¶ 76.
[135] *See id.*, ¶¶ 77–80.

competition as a result of vertical integration,"[136] because "KCS would already be collecting the full measure of returns associated with its existing market power."[137]

Dr. Majure's use of the conditional progressive—"would already be collecting," not "is already collecting . . . ."—is telling. It reflects that Dr. Majure does not *know* whether KCSM is currently collecting the full measure of returns associated with its existing market power. He cannot know, because he has not examined any documents or data from KCSM and, as Applicants' responses to interrogatories admit, his analysis was "not based on any specific documentary evidence in the possession of Applicants."[138] Nor has he tested his hypothesis that the post-merger firm will not have the ability to foreclose if shippers and interlining carriers have alternatives to KCSM. He suggests that FXE may be such an alternative,[139] but does not analyze the issue or show that FXE actually offers a viable option for shippers using KCSM.[140]

Dr. Majure's only effort to address these serious gaps in his analysis is his examination of traffic shares for the northbound traffic that KCSM brought to Laredo from Mexico in 2019. He claims that this empirical analysis—specifically, his conclusion that in 2019 KCSM interchanged 68% of shipments with UP at the Laredo gateway for which KCS could have served the final destination—is "consistent" with the absence of foreclosure incentives.[141] But that percentage is

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[136] APP Vol. 2 at 12, Majure VS ¶ 12.

[137] *Id.* at 19, Majure VS ¶ 24.

[138] Ex. 12 (KCS and CP's Supplemental Joint Responses and Objections to CSXT's Second Set of Discovery Requests, Response to Interrog. No. 12); *see also* Ex. 1 (Majure Tr. 63:22–64:11).

[139] *See* APP Vol. 2 at 20, Majure VS ¶ 25.

[140] *See* Ex. 1 (Majure Tr. 84:18–24 ("Q: Have you done any analysis as to whether FXE is a ready alternative for shippers using KCSM today? A: No, I have not tried to isolate the -- or test whether this hypothetical applied to any particular shipper or the degree to which it was.")).

[141] APP Vol. 2 at 22–23, Majure VS ¶¶ 30–31 & Ex. 2; *see also* Ex. 1 (Majure Tr. 64:2–65:6).

equally consistent with the opposite of what Dr. Majure claims. It also tells us nothing about how merging with CP may increase KCS's incentives to foreclose.

Even leaving aside that Dr. Majure's use of very broad BEA areas to define the relevant geographic areas of competition almost certainly overstated the extent to which KCS could have handled the movements that were interchanged with UP at Laredo, Dr. Majure's analysis is flawed for at least two fundamental reasons.

First, Dr. Majure analyzes only a snapshot of some 2019 traffic. He does not compare his results with what the market looked like fifteen years earlier, when KCS acquired KCSM's predecessor and control of the Laredo Gateway,[142] nor does he compare his 2019 results with the counterfactual: the market "but for" the KCS/TFM/Tex-Mex transaction.[143]

Because no counterfactual is presented against which to measure his claims, one cannot reasonably conclude that the share of traffic Dr. Majure claims KCS interchanged with UP moving north of Laredo demonstrates anything at all, other than perhaps that KCS was not engaging in a strategy of *complete* foreclosure in 2019. In fact, as Professor Salop notes, UP's share of northbound shipments from Laredo was significantly *higher* prior to the merger that gave KCS control of that gateway than it was in the single year Dr. Majure chose to examine.[144] There are many possible explanations for that decline, as both Professor Salop[145] and Dr.

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[142] *See, e.g.*, Ex. 1 (Majure Tr. 101:16–19 ("I did not try to do a before-and-after comparison of the number of cars that came to Laredo before and after the merger.")).

[143] *See, e.g.*, APP Vol. 2 at 21–25, Majure VS ¶¶ 28–33; *see also* Ex. 1 (Majure Tr. 101:20–102:2 ("Q: So you did not attempt to define a but-for world in which the KCS/TFM transaction didn't occur. Correct? A: Didn't try to -- I did not try to forecast how the traffic might have evolved over the course of 15 years in a hypothetical where there was no transaction.")).

[144] *See* Salop VS ¶ 90.

[145] *See id.*, ¶ 91.

Majure[146] acknowledge. Dr. Majure's analysis sheds no light on the reasons for the change, because he did not measure his 2019 numbers against figures for earlier years, nor did he attempt to identify what would have happened to those shares had the earlier merger not occurred.

Second, Dr. Majure did not analyze traffic moving south from Laredo into Mexico.[147] That is not surprising, because the results of that analysis are at odds with his conclusions. Using the same format that Dr. Majure used for his assessment of northbound traffic, Professor Salop found that UP's share of southbound traffic interchanged from areas that KCS serves is far *smaller* than its share of such traffic moving north. If, as Dr. Majure claims, UP moving a large share of traffic in areas that KCS can serve north of Laredo is consistent with KCS having no incentive to foreclose, then applying Dr. Majure's logic, UP's much smaller share of such southbound traffic must be consistent with a significant foreclosure concern.[148]

Of course, the key question is not only whether KCS has the pre-merger incentive and ability to foreclose competition, but whether the merger with CP will increase that incentive and ability. The one-lump theory presumes that certain vertical mergers cannot have that effect, but Professor Salop explains in his Verified Statement why that presumption is not applicable to the proposed transaction. He also explains why the post-merger CPKC will have *greater* incentive to foreclose than KCS does today, because it will earn additional revenue and profits on the CP segments of movements, increasing the financial benefits of foreclosure.

Dr. Majure and Applicants ignore that reality, instead arguing that foreclosure concerns cannot be cognizable unless the Board or opponents of the transaction identify pre-merger

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[146] *See* Ex. 1 (Majure Tr. 228:10–229:24).

[147] APP Vol. 2 at 22, Majure VS ¶ 30 n.17; *see also* Ex. 1 (Majure Tr. 122:5–7 ("I have not tried to do a similar exercise to Exhibit 2 focused on southbound movements.")).

[148] *See* Salop VS ¶¶ 94–96 & Fig. 8.

constraints on the parties' ability to foreclose and explain how the merger would relax or eliminate those constraints.[149] Dr. Majure has testified that because he could identify no such constraints, CP and KCS must not "have any unexploited power . . . that might be unlocked by a merger."[150] But pre-merger constraints on the parties' ability to foreclose are not difficult to find, if one looks for them. For example, the merger would improve the cost and price information to which the merging parties will have access, making it easier for CPKC to exploit fully KCSM's monopoly power.[151] The merger would also eliminate the information asymmetries and strategic bargaining incentives that would make it difficult for the parties today to reach agreement to structure their pricing and operations in a way that forecloses competitors, as well as the legal constraints on the parties' ability to enter into such anticompetitive agreements.[152]

There is therefore no basis for Dr. Majure to move from his limited conclusion that, in 2019, KCS interchanged a large amount of northbound traffic to UP to his sweeping claim that "a combined CPKC would not have the ability and incentive to preclude its rivals' access to gateways."[153] His analysis, such as it is, says nothing about whether KCS has the incentive and ability to foreclose some competition today, nothing about whether the merger with CP will increase those incentives, and nothing about whether foreclosure may be a profitable strategy for

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[149] *See* Ex. 1 (Majure Tr. 89:24–90:25); Ex. 12 (KCS and CP's Supplemental Joint Responses and Objections to CSXT's Second Set of Discovery Requests, Response to Interrog. No. 27 (arguing that "the conditions that would raise concern about possible foreclosure" include "a pre-existing constraint that can be shown to limit the feasibility of arrangements CP and/or KCS could have, as separate entities, to align their respective incentives and abilities in a fashion that would lessen competition" and "a credible mechanism by which [the merger] makes the constraint no longer bind")).

[150] Ex. 1 (Majure Tr. at 71:12–14).

[151] *See, e.g.*, Salop VS ¶¶ 36–39.

[152] *See id.*, ¶¶ 101–105.

[153] APP Vol. 2 at 23, Majure VS ¶ 31.

the combined company. In short, his analysis says nothing about whether the proposed merger is in the public interest, and instead casts significant doubt on that conclusion.

C. A Presumption That Certain Categories of Mergers Are Procompetitive Is Inconsistent With Current Antitrust Enforcement Policy.

Dr. Majure's formulaic reliance on the one-lump theory is also inconsistent with evolving economic thinking surrounding vertical mergers. To be clear, UP is not suggesting all vertical mergers are anticompetitive, all end-to-end railroad mergers are anticompetitive, or all vertical mergers are pro-competitive. UP's position is simply that it would be inappropriate to presume any of those outcomes in the merger currently before the Board. As Professor Salop notes, vertical mergers can generate efficiencies and lead to pro-competitive benefits for shippers, but the conditions that would be necessary to produce such an outcome are not present here.

And those facts matter, which is why presuming that the proposed merger has no anticompetitive effects would be inconsistent with current competition enforcement policy and the modern economic analysis that supports it. The Vertical Merger Guidelines issued by the DOJ and the FTC in 2020 ("2020 VMGs"), for example, note that a "vertical merger may diminish competition by allowing the merged firm to profitably use its control of the related product to weaken or remove the competitive constraint from one or more of its actual or potential rivals in the relevant market."[154] Of note, the 2020 VMGs make *no* mention of a presumption that vertical mergers are pro-competitive. Dr. Majure provided comments on the draft 2020 VMGs, and did not recommend that they include any such presumption.[155]

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[154] U.S. Dep't of Just. & F.T.C., *Vertical Merger Guidelines* at 4 (June 30, 2020).

[155] *See generally* Hatzitaskos et al., *Comments on the January 2020 Draft Vertical Merger Guidelines* (Feb. 19, 2020).

Dr. Majure's comments on the draft 2020 VMGs reflect an evolving view that vertical mergers should be reviewed as carefully as horizontal mergers. Before they were issued, FTC Chairman Joseph Simons commented that one of the goals of the draft 2020 VMGs was to "make clear that anticompetitive vertical mergers are not unicorns," and that "there should not be a presumption that all vertical mergers are benign."[156] Even after their issuance, there has been substantial disagreement on whether the 2020 VMGs went far enough in expressing concerns about vertical mergers.[157] In July 2021, the President issued an executive order on competition, specifically encouraging the Attorney General and the Chair of the FTC to review and consider whether to revisit the horizontal and vertical merger guidelines.[158] On September 15, 2021, the FTC voted 3-2 to rescind the 2020 VMGs. As noted by then-Commissioner Rohit Chopra, "[v]ertical integration, as we all recognize, can lead to foreclosure of rivals and increased barriers to entry."[159] And while the 2020 VMGs remain in place at DOJ, they are nonetheless under review, and the Department plans to seek public comment on issues such as the burden-shifting framework and range of circumstances considered that can lead to harm of competition.[160]

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[156] Prepared Remarks of Chairman Joseph Simons, *Fordham Speech on Hearings Output* (Sept. 13, 2019).

[157] *See, e.g.*, Dissenting Statement of Commissioner Rebecca K. Slaughter regarding FTC-DOJ Vertical Merger Guidelines (June 30, 2020) ("The Vertical Merger Guidelines are inexplicably mute on the well-known and well-supported fact that the potential anticompetitive harms from raising rivals' cost and foreclosure are also 'distinct considerations' in vertical-merger analysis.").

[158] *See Biden Competition Order*, Sec 5(c).

[159] Prepared Remarks of Commissioner Rohit Chopra regarding 2020 FTC-DOJ Vertical Merger Guidelines (Sept. 15, 2021); *see also* Statement of Chair Lina M. Khan and Commissioners Rohit Chopra and Rebecca K. Slaughter on the Withdrawal of the Vertical Merger Guidelines, (Sept. 15, 2021).

[160] *See* Press Release, U.S. Dep't of Just., *Justice Department Issues Statement on the Vertical Merger Guidelines* (Sept. 15, 2021).

Recent enforcement actions, along with the increasing scrutiny previously discussed, reflect this reality. For example, in *United States of America v. AT&T, Inc.*, the Department of Justice argued that vertical mergers can lessen competition "where the merging parties—by means of their control of an input that their competitors need—have the incentive and ability to substantially lessen competition by withholding or raising the price for that input."[161] This concern is also reflected in recent enforcement actions brought by the FTC to block vertical transactions, including its challenges to Illumina's attempted acquisition of GRAIL,[162] Nvidia's attempted acquisition of Arm,[163] and Lockheed Martin's attempted acquisition of Aerojet Rocketdyne.[164] Presuming that the proposed transaction is procompetitive—instead of requiring Applicants to demonstrate its likely net competitive effects—would put the Board squarely at odds with the other agencies participating in the Administration's efforts to scrutinize vertical mergers and promote effective competition.

IV. Other Transportation Alternatives Will Not Prevent Anticompetitive Effects.

Because Applicants essentially assume the proposed transaction does not raise any competitive issues relating to cross-border traffic, they did not meaningfully address whether other transportation options would prevent anticompetitive effects. KCS's Chief Executive Officer says CPKC could not raise rates on KCSM movements that "would shift to motor or water carriage," but he never addressed whether any KCSM traffic *could* shift if CPKC tried to

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[161] Complaint at 7, *United States of America v. AT&T, Inc.*, 310 F. Supp. 3d 161 (D.D.C. 2018) (No. 1:17-cv-02511).

[162] *See* Complaint, *Illumina, Inc.*, Docket No. 9401 (F.T.C. Mar. 30, 2021).

[163] *See* Complaint, *Nvidia Corp.*, Docket No. 9404 (F.T.C. Dec. 6, 2021).

[164] *See* Complaint, *Lockheed Martin Corp.*, Docket No. 9405 (F.T.C. Jan. 25, 2022).

raise rates.[165] Similarly, Dr. Majure opines that CPKC could not force inferior terms on a shipper "who can readily switch to another railroad or mode of transportation." [166] But Dr. Majure was addressing a "hypothetical shipper."[167] He never actually looked to see whether any such shippers are served by KCSM. In discovery, Applicants said Dr. Majure's discussion of shippers with "ready alternatives" was "not based on a contention regarding any particular shipper's actual competitive options" but rather "was presented to illuminate the range of possibilities envisioned by economic theory and analysis."[168] When asked to produce documents discussing whether KCSM rates are constrained by competitive pressures from other rail options, Applicants responded that KCS "has no responsive documents."[169] CP's Chief Marketing Officer was the only one of Applicants' witnesses to discuss actual competitive options available to shippers, and he agreed that their options are limited: "many of the commodity flows in the[] lanes [targeted for diversion]—like LPG, grain, finished autos and others—are not well suited to long-distance movement by truck."[170]

As Mr. Rocker explains, a substantial number of shippers currently using UP-KCSM service do not have viable intramodal or intermodal alternatives to KCSM service in Mexico.[171] If CPKC tried to divert their traffic by raising KCSM-UP rates or degrading KCSM-UP service,

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[165] APP Vol. 1 at 208, Ottensmeyer VS at 22.

[166] APP Vol. 2 at 19, Majure VS ¶ 25.

[167] *Id.*

[168] Ex. 12 (KCS and CP's Supplemental Joint Responses and Objections to CSXT's Second Set of Discovery Requests, Response to Interrog. No. 13).

[169] Ex. 3 (KCS and CP's Joint Responses and Objections to UP's First Set of Discovery Requests, Response to Request No. 101).

[170] APP Vol. 1 at 226, Brooks VS ¶ 26.

[171] *See* Rocker/Turner VS at 16–17.

they would have no choice but to pay more, shift their business to CPKC, or both.[172] Most UP-KCSM traffic originates or terminates at points served exclusively by KCSM. Other traffic moves to or from points served by FXE, but FXE lacks an efficient route to the border.[173] In addition, truck and water service are not viable options for the vast majority of traffic that Applicants say they will target for diversion to KCSM.[174] Some shippers would have options, but those options would not protect the large number of shippers dependent on KCSM.

V. Mexico's Regulatory Regime Will Not Prevent CPKC From Engaging In Anticompetitive Acts Affecting U.S. Shippers.

Applicants suggest Mexican law would prevent CPKC from engaging in anticompetitive conduct because Mexican law would "restrict[] the combined CP/KCS network from providing only a single-line rate on international through traffic."[175] Dr. de la Calle, former Undersecretary for International Trade Negotiations in Mexico's Ministry of the Economy and former Trade and NAFTA Minister at the Mexican Embassy in Washington, D.C., explains that Mexican law and regulations would not effectively prevent CPKC from engaging in anticompetitive behavior.

As Dr. de la Calle explains, Mexican law would not prevent CPKC from foreclosing competition using the rate tactics described by Messrs. Rocker and Salop: raising KCSM rates between Laredo and KCSM-served points on a non-discriminatory basis, while reducing the U.S. portion of CPKC rates as needed. Mexican law does not impose a practical limit on how high KCSM could raise its rates in Mexico to carry out this strategy.[176] Mexican law and the KCSM

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[172] *See id.* at 16.

[173] *See id.*

[174] *See id.* at 16–17.

[175] APP Vol. 1 at 207, Ottensmeyer VS at 21 n.18.

[176] As Dr. de la Calle observes, a procedure exists though which certain parties may challenge a carrier's registered maximum rates at ARTF, but the party would first have to demonstrate to

Concession contain various provisions that purport to require KCSM to set rates in a non-discriminatory manner. However, as Dr. de la Calle explains, Mexican authorities likely would not address the overall CPKC rate for traffic moving between Mexico and the United States if KCSM's portion of the rate was offered in a nondiscriminatory manner.[177] In other words, a strategy involving across-the-board KCSM rate increases for traffic moving between Mexican points and Laredo, combined with CPKC rate reductions in the U.S., probably would not be actionable in Mexico.

CPKC may take the position that treating CPKC traffic differently from interline traffic is not discriminatory under Mexican law. In Mexico, jurisdiction over rail rates is split between two agencies, the Federal Economic Competition Commission ("COFECE") and the Railway Transport Regulatory Agency ("ARTF"). Neither COFECE nor ARTF appears to have ever investigated a case involving railroad rate discrimination, much less in the cross-border context, so there is no guidance available regarding how regulators would view the law as applied to a rate strategy of the kind described above.[178]

Even if UP or affected U.S. shippers could in theory challenge discriminatory conduct by CPKC, the process for obtaining a favorable resolution, then enforcing it against CPKC, would likely involve years of protracted litigation before administrative agencies and courts in Mexico. Turf battles between COFECE and ARTF could add to the protracted nature of any litigation.[179]

COFECE that effective competition does not exist in the relevant market. Both proceedings would take years to resolve and the agency decisions would be subject to multiple court challenges along the way. *See* de la Calle VS at 6, 9–12.

[177] *See id.* at 6.

[178] *See id.* at 7.

[179] *See id.* at 10.

In addition, all resolutions issued by Mexican administrative agencies are subject to complicated appeal and review by Mexican courts, and can be blocked by an "amparos" claim, a type of injunction proceeding available to parties seeking to contest the agency decision.[180] COFECE's recent experiences in investigating allegations of anticompetitive conduct in various economic sectors and ARTF's limited efforts to regulate domestic rail rate tariffs confirm the challenges UP or a shipper would face in seeking effective resolution of such matters in Mexico.[181] As a result, Mexican law cannot realistically protect U.S. shippers from anticompetitive effects of CPKC's control of traffic moving between the U.S. and Mexico.

Finally, Mexican regulators would not protect against anticompetitive foreclosure at the Laredo Gateway through their review of the proposed transaction. COFECE issued a four-page decision unconditionally clearing the transaction in November 2021. The four-page decision provides no indication that COFECE considered competition for cross-border traffic or the impacts of the transaction on shippers in the United States.[182]

VI. Applicants' Failure To Address The Proposed Transaction's Impacts On Facilities Applicants Share With Other Railroads Precludes The Board From Finding That An Unconditioned Transaction Would Be Consistent With The Public Interest.

The substantial anticompetitive risks created by the proposed transaction—and the absence of meaningful offsetting benefits—are reason enough for the Board to conclude that unconditioned CP control of KCS would not be consistent with the public interest. However, the Application is also fundamentally deficient in another respect: It fails to address both CPKC's planned operations on facilities owned by other railroads and other railroads' use of facilities

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[180] *See id.* at 6 n.2.

[181] *See id*. at 9–12.

[182] *See id.* at 12–13.

owned by CPKC. As a result, Applicants fail to take into account the substantial investments in new capacity that would be required to implement their proposed transaction.[183] The Board cannot find the proposed transaction is consistent with the public interest without imposing conditions to ensure that Applicants bear responsibility for the costs of implementing their transaction.

Applicants share lines and terminal areas with other railroads all along their North-South corridor in the United States, from South Texas to Kansas City to the Twin Cities. Applicants' failure to provide for the additional capacity necessary to implement their transaction in these locations would harm the many shippers whose traffic moves over the shared lines and in the shared terminals.

Applicants' failure to address shared facilities stems from a critical flaw in their effort to identify capacity needs of a merged system. Applicants claim "[d]etailed capacity modeling was performed to identify the additional infrastructure needs required to support anticipated traffic growth while maintaining the improved level of services that will attract and retain traffic."[184] That claim is untrue. Applicants' workpapers show {{

}}

[183] *See* 49 C.F.R. § 1180.8(a) (2000) ("Submit a summary of the proposed operating plan changes, based on the impact analyses, that will result from the transaction, and their anticipated timing, allowing for any time required to complete rehabilitation, upgrading, yard construction, or other major operational changes following consummation of the proposed transaction.").

[184] APP Vol. 2 at 340, OP Plan ¶ 238.

At one point, Applicants apparently {{

}}[185] However,

Applicants apparently never followed through by developing the information for their Application.

When Applicants were asked about {

}[186]

}[187] But as discussed below, {

}[188] In trying to explain {

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[185] Ex. 14 (CP Board of Directors Meeting Materials (CP-HC-00010640–10678, at 10645)).

[186] Ex. 15 (Elphick/Orr Tr. 80:21–81:22) { } *see also id.* (Elphick/Orr Tr. 85:24–86:12) { }

[187] Ex. 15 (Elphick/Orr Tr. 125:5–24); *see also id.* (Elphick/Orr Tr. 73:16–18 { }

[188] APP Vol. 2 at 340, OP Plan ¶ 237.

}[189]

{

}

Applicants' claim that they engaged in detailed capacity modeling to identify additional infrastructure needs to accommodate their plans on lines owned and used by other railroads is not credible for another reason: Applicants identified $279 million in investments on lines they would use exclusively to accommodate their planned traffic growth, but they identified no investments needed on lines owned by others or shared with others.[190]

The sections below briefly address some of the areas ignored in the Application. UP has not performed the detailed analyses to specify additional infrastructure that should be required to support Applicants' anticipated traffic growth.

A. Applicants Failed to Address Their Operations on Lines Owned by UP

As shown in the figure below, large portions of KCS's route from Laredo to Shreveport, Louisiana, via Robstown/Corpus Christi, Victoria, Rosenberg, and Beaumont, Texas, including KCS's route through the busy Houston terminal, rely on trackage rights over UP lines that Tex Mex obtained in the *UP/SP* merger (the Tex Mex trackage rights lines).[191]

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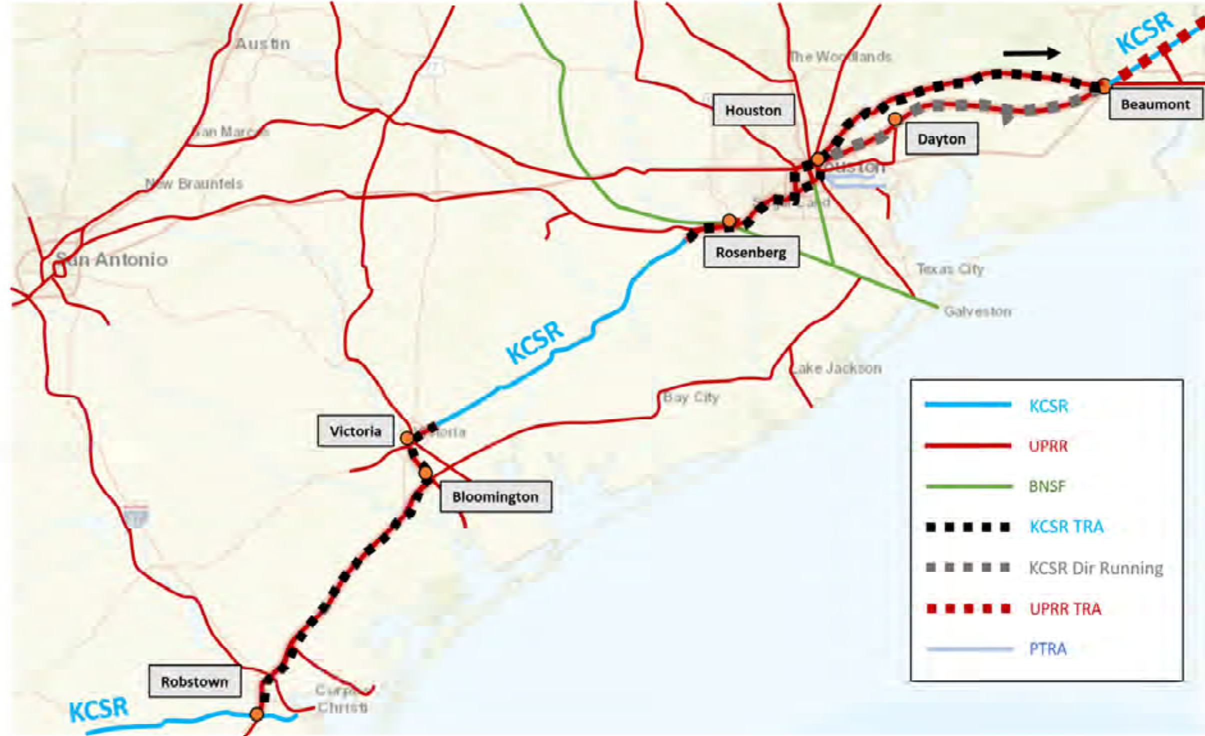
[189] Ex. 15 (Elphick/Orr Tr. 124:5–125:4).

[190] *See* APP Vol. 2 at 340–41, OP Plan ¶¶ 239–40 & Table 8.

[191] *See id.* at 276, OP Plan ¶ 52.

Figure 1: Texas Area KCS Trackage Rights



The Tex Mex trackage rights lines are critical to the merged CPKC's plans. They provide a necessary link in the North-South railroad transportation corridor connecting the United States, Canada, and Mexico that Applicants discuss throughout the Application. Applicants project they will more than double KCS's current use of the lines. At the southern end of the trackage rights, from Robstown to Victoria, CPKC traffic will increase from 7.7 trains per day to 16.8 trains per day, an increase of 9.1 trains per day, or 118%.[192] On the northern end, from Rosenberg through Houston to Beaumont, CPKC traffic will increase from 7.7 trains per day to 16.0 trains per day, an increase of 8.3 trains per day, or 108%.[193] Applicants do not identify any plan for investing in

[192] *See id.* at 364, OP Plan, App. A at 1.

[193] *See id.*

new capacity on any of the Tex Mex trackage rights lines.[194] However, accommodating their projected traffic growth will require new capacity on all these trackage rights lines.

Applicants' workpapers help explain why Applicants did not identify the need for any investments on the Tex Mex trackage rights lines: {

}

Applicants' capacity modeling for KCS lines is shown in one of Applicants' workpapers, Exhibit 2 in the deposition of Applicants' Operating Plan witnesses, Messrs. Elphick and Orr.[195] As Mr. Elphick explained, Applicants' capacity modeling process {

}}[196] The workpaper explains: {{

}}[197]

Applicant's capacity modeling workpaper shows {

}[198]

[194] APP Vol. 2 at 337, OP Plan ¶ 231, Fig. 11.

[195] Ex. 15 (Elphick/Orr Tr. 65:12–66:17).

[196] Ex. 15 (Elphick/Orr Tr. 60:21–62:12).

[197] Ex. 16 (Elphick/Orr Deposition Exhibit 2 (OP Plan workpaper "HC - Capacity - Methodology_docx.docx")).

[198] *See id.*; Ex. 15 (Elphick/Orr Tr. 72:18–73:2) {

As Mr. Turner explains, additional capacity would be required on the Tex Mex trackage rights lines to accommodate Applicants' planned traffic volumes.[199]

Robstown/Corpus Christi to West Junction. Additional capacity would be required on all UP's lines between Robstown and Beaumont to accommodate Applicants' planned traffic volumes. Currently, capacity on UP's lines between Robstown and Victoria is just sufficient to accommodate existing traffic, which includes not only KCS trains, but also UP trains moving between Houston, Corpus Christi, and Brownsville, and BNSF trains moving over the lines to interchange traffic with KCS at Robstown.[200] Any increased demand for capacity that would be created by Applicants' success in attracting traffic to the lines would not be offset by UP's loss of Mexico business. UP moves Laredo Gateway traffic using different lines—its lines via San Antonio.[201]

Accommodating CPKC's planned traffic growth would also require the addition of capacity on UP's Glidden Subdivision between Rosenberg and West Junction in Houston. The Glidden Subdivision, which runs between San Antonio and Houston, is a critical link in UP's Sunset Route and is also used by BNSF trackage rights trains and Amtrak. Again, the line has

} *id.* (Elphick/Orr Tr. 85:24-86:1) {

} *id.* (Elphick/Orr Tr. 97:2–10) {

}

[199] *See* Rocker/Turner VS at 26–32.

[200] *See id.* at 28. To better accommodate existing traffic and growth projected before the CP/KCS transaction was announced, UP has been planning to construct a new siding just south of Bloomington that will be called the Linn siding. *See id.* at 29.

[201] *See id.* at 29.

sufficient capacity to accommodate current demand. However, Applicants' plan to add more than eight new trains per day would push use of the line above the line's fluid capacity.[202]

Houston terminal area. Applicants also fail to address the impact of their planned new traffic on operations in the Houston terminal. Houston is an extremely challenging area in the best of times, requiring careful operational coordination among UP, BNSF, KCS, Amtrak, and the Port Terminal Railroad Association (PTRA). UP has learned through hard experience how congestion in one part of Houston can rapidly spread throughout the terminal and ripple across its network.[203] As shown in the figure below, KCS has extensive trackage rights in Houston, allowing it to participate in the generally directional flow of traffic through the terminal and interchange traffic with the PTRA. KCS has trackage rights over UP's Houston Subdivision between West Junction and Tower 26, then over the West Belt, which provide KCS access to UP's Beaumont Subdivision. UP, BNSF, and KCS all use the Beaumont Subdivision for traffic moving eastbound towards Beaumont. Amtrak also uses the Beaumont Subdivision for its Sunset Limited train. KCS also has rights from the Beaumont Subdivision directly past UP's Settegast Yard on the East Belt, which connect to KCS's rights on the Glidden Subdivision. UP has also given KCS rights to move traffic westbound on UP's Houston Subdivision, which run past UP's Englewood Yard toward Tower 26.[204]

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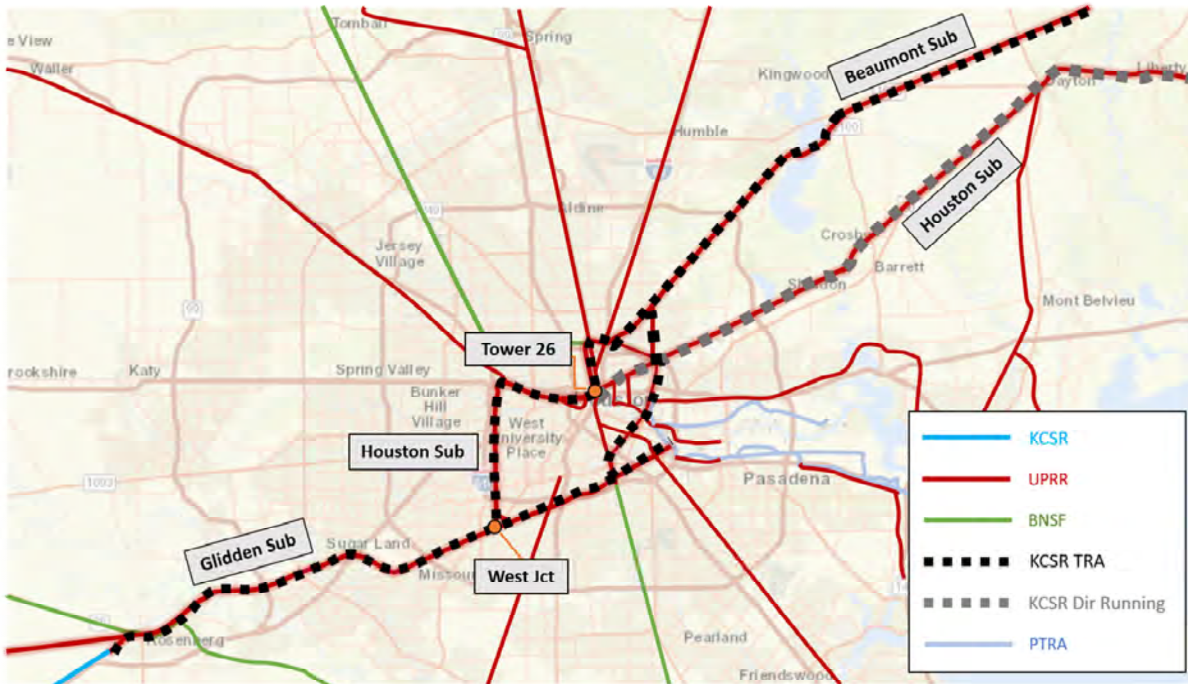
[202] *See id*.

[203] *See id.*

[204] *See id.* at 29–30.

Figure 2: Houston Area KCS Trackage Rights



Applicants plan to add more than eight trains per day to the mix of traffic in Houston, which could increase train counts on already busy lines by 25% or more.[205] However, Applicants provide no analysis of the impact their plans would have on terminal operations or the need for new capacity. As discussed above, { } When Mr. Elphick was asked whether Applicants performed any formal evaluation of how increases in rail traffic from the proposed transaction would affect operations in Houston, he replied, { }[206] CP appears to believe there are no impediments to moving more trains through Houston. CP's Executive Vice-President Operations was recently quoted as saying, "you can get through Houston pretty quick."[207] However, as Mr. Turner explains,

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[205] *See id*. at 30.

[206] Ex. 15 (Elphick/Orr Tr. 94:21–95:1).

[207] *See* Rocker/Turner VS at 30–31 & Rocker/Turner workpaper "P - Rail Group Interview.pdf."

additional capacity would be necessary at several locations in the terminal to prevent the projected jump in traffic from endangering operations in Houston.[208]

On the eastern end of the Houston terminal KCS has trackage rights on UP's Beaumont Subdivision and UP's Houston Subdivision between Houston and Beaumont. BNSF also uses those two lines to move its own traffic between Houston and New Orleans, and as noted above, Amtrak's Sunset Limited operates over the Beaumont Subdivision. These two lines are fluid at current traffic levels, but both would be at or above capacity if Applicants' traffic in the corridor grows by more than eight trains per day, as Applicants project in their Application.[209]

Applicants' complete failure to address the impacts of their planned traffic growth on the need for capacity investment on the Tex Mex trackage rights lines reflects a serious gap in their Application, especially given the essential role these rights play in their post-merger plans.

B. Applicants Failed to Fully Address Operations on Facilities They Own and Share With Others.

Applicants not only failed to evaluate the impacts of their planned traffic growth on lines CPKC would use but would not own, their analyses failed to account for the operations of other railroads with rights to use lines owned by Applicants. In some instances, {

} Three examples are discussed below.

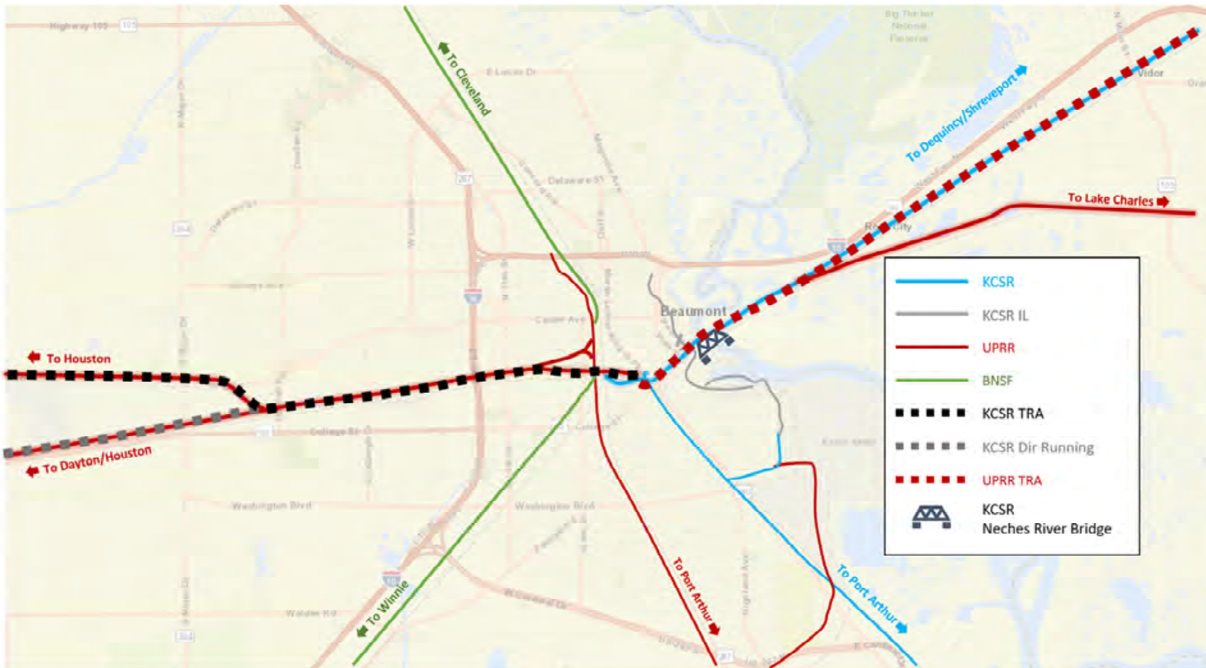
Neches River Bridge. UP is particularly concerned about the proposed transaction's impact on the Neches River Bridge. KCS owns the bridge, which spans the Neches River at

[208] *See* Rocker/Turner VS at 31.

[209] *See id*.

Beaumont.[210] UP's Beaumont and Houston Subdivisions converge at the bridge's west end. KCS's Beaumont Subdivision and UP's Lafayette Subdivision (also known as the 50/50 Line, because BNSF jointly owns the line) converge at the bridge's east end.[211] The bridge is a single-track choke point for UP, BNSF, and KCS, as shown in the figure below.

Figure 3: Neches River Bridge Area



As Mr. Turner explains, UP believes the Neches River Bridge is already near or at the limits of its fluid capacity. UP and BNSF currently operate approximately 25 trains per day over the bridge. Amtrak's Sunset Limited also uses the bridge. The bridge opens several times each day to allow river traffic to pass underneath. Bridge capacity is also limited by the nature of rail activity on each end of the bridge. On the east end, KCS blocks approach to the bridge when it

[210] *See* APP Vol. 2 at 320, OP Plan ¶ 175.

[211] *See* Rocker/Turner VS at 32.

moves unit trains into and out of the large Jefferson Energy Terminal. On the west end, trains must operate at reduced speeds over a series of converging and diverging tracks.[212]

Applicants plan to increase traffic on KCS's Beaumont Subdivision from 8.9 trains per day to 20.3 trains per day, an increase of 11.4 trains per day, or 128%.[213] However, Applicants did not identify any need for additional bridge capacity.

Applicants' workpapers reveal why Applicants did not identify a bridge capacity issue: {

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}[215] {

}[216] {

}[217] {

}[218] {

[212] *See id*. at 33.

[213] *See* APP Vol. 2 at 364, OP Plan, App. A at 1.

[214] *See* Ex. 15 (Elphick/Orr Tr. 101:9–16).

[215] *See* Ex. 16 (Elphick/Orr Deposition Exhibit 2); Ex. 15 (Elphick/Orr Tr. 109:12–15) {

}

[216] *See* Ex. 16 (Elphick/Orr Deposition Exhibit 2); Ex. 15 (Elphick/Orr Tr. 108:3–11). {{

}}

[217] *See* Ex. 16 (Elphick/Orr Deposition Exhibit 2); Ex. 15 (Elphick/Orr Tr. 108:3–11).

[218] *See* Ex. 15 (Elphick/Orr Tr. 108:19–109:4).

} When asked, Mr. Elphick ultimately {

}[219] Adding capacity to the route across the Neches River would be an expensive and time-consuming undertaking, but CPKC's plan requires that capacity to operate its North-South corridor.

Kansas City and the Polo Line. Applicants also failed to account for UP traffic that moves over a CP-UP joint facility north of Kansas City called the Polo Line. CP and UP access Kansas City from the north using paired tracks between Airline Junction in Kansas City and a location on CP's Kansas City Subdivision called Polo. UP operates approximately eight trains per day between Airline Junction and Polo.[220] Applicants plan to increase traffic on CP's Kansas City Subdivision from 2.9 trains per day to 16.9 trains per day, an increase of 14 trains per day, or nearly 500%.[221] However, Applicants do not identify the need for any investment between

[219] Ex. 15 (Elphick/Orr Tr. 113:3–12) {

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{

} *See* Rocker/Turner VS at 34.

[220] *See* Rocker/Turner VS at 34.

[221] *See* APP Vol. 2 at 364, OP Plan, App. A at 1.

Airline Junction and Polo, even though UP has experienced challenges operating over the Polo Line with today's significantly lower volumes.[222]

{ } Applicants' capacity modeling for CP lines is addressed in a different workpaper than their modeling for KCS lines—Exhibit 3 in the deposition of Applicants' Operating Plan witnesses.[223] { }[224] { }[225] {{ }}[226]

In discovery, Applicants produced { } {{ }}[227] { }[228] As Mr. Turner observes, the Polo Line is not truly a double-track

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[222] *See* Rocker/Turner VS at 34–35.

[223] *See* Ex. 15 (Elphick/Orr Tr. 132:24–133:14); *see also* Ex. 17 (Elphick/Orr Deposition Exhibit 3 (OP Plan workpaper "HC – 2021 - 10-20 CP RJct-KCity and KCS KCity-Laredo.pdf")).

[224] *See* Ex. 15 (Elphick/Orr Tr. 136:11–15) { }

[225] *See* Ex. 15 (Elphick/Orr Tr. 137:10–15).

[226] *See* Ex. 17 (Elphick/Orr Deposition Exhibit 3).

[227] *See* Ex. 15 (Elphick/Orr Tr. 137:25–139:15); *see also* Ex. 18 (Elphick/Orr Deposition Exhibit 7 (CP-HC-00007947.xlsx)).

[228] Ex. 15 (Elphick/Orr Tr. 139:22–140:21).

line.[229] {{

}} Applicants did not address the need for any investment on the Polo Line in their Application.

Twin Cities. Applicants' failure to account for the impacts of their proposed transactions on other railroads' operations extends to their plan to increase traffic moving through the Twin Cities. Applicants claim a benefit of the CP/KCS combination would come from options it gives shippers to bypass Chicago.[230] Applicants' plan to route traffic around Chicago would increase the number of trains moving through St. Paul, Minnesota, on CP's River Subdivision, from 11.9 trains per day to 18.1 trains per day, an increase of 6.2 trains per day, or 52%.[231] However, Applicants did not propose any capacity improvements in the St. Paul area.[232]

As shown in the figure below, UP, BNSF, and CP have significant, overlapping operations in St. Paul.

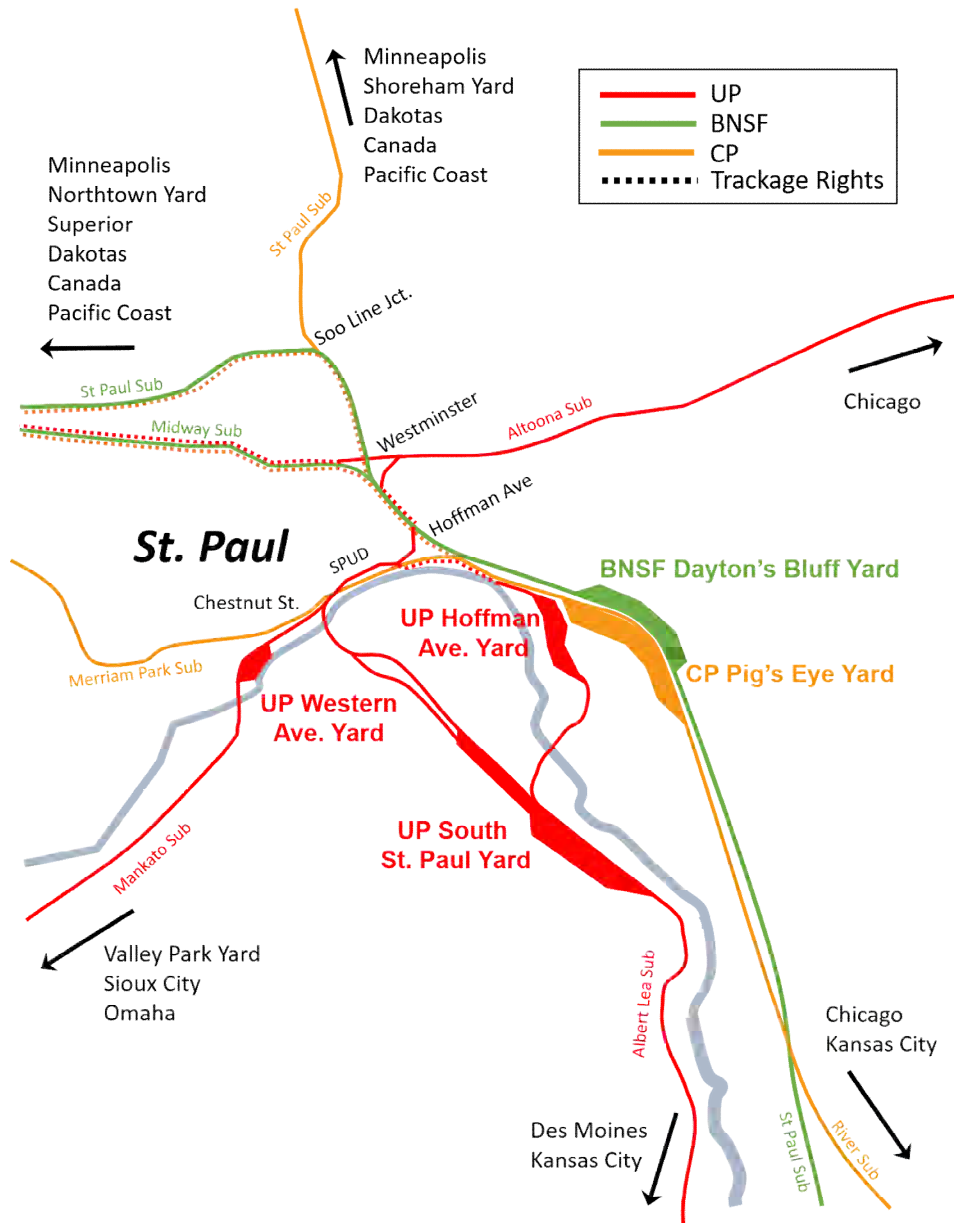
[229] *See* Rocker/Turner VS at 35.

[230] *See* APP Vol. 2 at 313, OP Plan ¶ 152.

[231] *See id.* at 364, OP Plan, App. A at 1.

[232] *See* APP Vol. 2 at 337, OP Plan ¶ 231, Fig. 11.

Figure 4: St. Paul Area



As a result, the St. Paul area can become extremely congested. CP's River Subdivision converges with BNSF's St. Paul Subdivision near CP's Pig's Eye Yard and BNSF's Dayton's Bluff Yard. North of those yards, CP and UP operate using trackage rights on BNSF to connect between their own lines through St. Paul. Specifically, CP uses the rights for its route between Canada, the Dakotas, and Chicago, while UP uses the rights for traffic moving between its Albert Lea Subdivision, Altoona Subdivision, and Mankato Subdivision and to reach several yards it

uses in St. Paul.[233] Amtrak's Empire Builder train also operates over CP's River Subdivision.[234] Applicants also say CP's yard in St. Paul "will see meaningful changes in classification demand" as a result of the proposed transaction.[235] {

}[236]

UP believes the increased traffic levels moving via CP's River Subdivision would require adding capacity to hold UP trains that would have wait longer for openings on CP and BNSF track to move through the St. Paul terminal between UP's lines.[237] Applicants apparently plan to impose these costs of accommodating their projected traffic growth on UP.

* * *

Applicants' failure to account fully in their Application for the impacts of their proposed transaction precludes them from carrying their burden of proving the transaction is in the public interest. The Board cannot find the proposed transaction would be in the public interest without evaluating a complete operating plan, and a complete operating plan must fully address changes in operations requiring new investment in capacity, the necessary investments in new capacity, and the time required to complete the projects.[238] The Application is plainly deficient because it ignores the need for new capacity at locations from north to south along the proposed CPKC network in the United States.

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[233] *See* Rocker/Turner VS at 35–36.

[234] *See* Ex. 15 (Elphick/Orr Tr. 145:14–16).

[235] APP Vol. 2 at 306; OP Plan ¶ 133.

[236] *See* Ex. 15 (Elphick/Orr Tr. 146:5–8) {

}

[237] *See* Rocker/Turner VS at 37.

[238] *See* 49 C.F.R. § 1180.8(a).

In addition, the Board cannot find the transaction to be in the public interest because it cannot accurately evaluate the transaction's net benefits without considering the cost of achieving the projected benefits. Here, Applicants seek credit for all the benefits they project, but they fail to acknowledge all the costs—or they plan to impose significant costs on others, which amounts to the same thing.

If the Board approves the transaction despite the significant deficiency in the Application, it should condition its approval to ameliorate the potential harms arising from the deficiency. As discussed in the next Part, the conditions must ensure other railroads and their customers are not forced to subsidize Applicants' implementation of their transaction.

VII. If The Board Approves The Proposed Transaction, It Should Impose Conditions To Protect Competition At The Laredo Gateway And Other Gateways And To Address Fully The Infrastructure Needed To Support Applicants' Planned Traffic Growth.

If the Board were to authorize the proposed transaction, it should impose conditions to mitigate the anticompetitive effects of the transaction and ensure it will be otherwise consistent with the public interest. An unconditioned transaction would produce effects that harm the public interest. UP's proposed conditions would ameliorate the harmful effects.[239] The conditions are designed to be concrete and enforceable, and to produce net public benefits.[240] They also are

[239] *See UP/SP*, 1 S.T.B. at 418 ("Conditions will not be imposed unless the merger produces effects harmful to the public interest (such as a significant loss of competition) that a condition will ameliorate or eliminate."); *Union Pacific Corp.—Control—Missouri-Kansas-Texas R.R.* ("*UP/MKT*"), 4 I.C.C.2d 409, 437 (1988) (conditions must "ameliorate or eliminate" a consolidation's "harmful effects").

[240] *See UP/SP*, 1 S.T.B. at 419 ("A condition must also be operationally feasible, and produce net public benefits."); *see also Union Pac. Corp.—Control—Mo. Pac. Corp.* ("*UP/MP*"), 366 I.C.C. 462, 565 (1982) ("conditions should not be imposed unless they will produce benefits outweighing their harm to the transaction").

narrowly tailored to remedy the transaction's adverse effects and nothing more.[241] They would not reduce the public benefits of the proposed transaction.[242] They would not prevent Applicants from achieving the legitimate objectives of increasing competition and reducing operating costs.[243]

Specifically, the Board should impose conditions to preserve effective competition for traffic moving over gateways, particularly the Laredo Gateway. It should also require Applicants to work with the railroads that own or use shared facilities affected by the transaction to identify investments required to accommodate Applicants' planned traffic growth, and to ensure the funding for such investments would not result in subsidization of Applicants' transaction.

UP's proposals for addressing these issues are described below.

A. The Board Should Impose Conditions to Protect Competition at Gateways.

Applicants have acknowledged the validity of concerns about the proposed transaction's effects on shippers' competitive options at gateways. They commit in a general way to keep the Laredo Gateway "and other affected gateways open both physically and commercially."[244] However, Applicants also recognize their commitments are not sufficiently "concrete" and "enforceable."[245] UP's proposed conditions are designed to convert Applicants' vague assurances into effective, concrete, enforceable remedial measures.

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[241] *See UP/SP*, 1 S.T.B. at 419 ("The condition must also be narrowly tailored to remedy [adverse] effects [of the transaction].").

[242] *Cf. UP/MKT*, 4 I.C.C.2d at 437 ("conditions [must] produce public benefits (through reduction or elimination of the possible harm) outweighing any reduction to the public benefits produced by the merger").

[243] *See UP/MKT*, 4 I.C.C.2d at 437 (conditions "must not frustrate the ability of the consolidated carrier to obtain the anticipated public benefits").

[244] APP Vol. 1 at 20–21, Application at 11–12.

[245] APP Vol. 1 at 233, Brooks VS ¶ 47.

Specifically, UP is asking the Board to:

1. Require Applicants to agree that when a customer asks CPKC to provide rates for (i) CPKC service for only former-CP, former-KCS, and/or former-KCSM portions of an origin-to-destination route, and (ii) CPKC single-line service on a competitive route, CPKC must provide the customer with a Rule 11 rate for the former-CP, former-KCS, or former-KCSM portions that reflects a mileage-based prorate of the CPKC single-line rate.

2(a). Require Applicants to adhere to KCS's pledges regarding operations for traffic moving over the Laredo Gateway and at the Laredo Bridge in the KCS/Tex Mex proceeding.

2(b). Require Applicants to provide UP access to any new railroad bridge constructed in Laredo on the same terms as UP's access to the existing bridge.

1. The Board Should Require CPKC to Offer Shippers "Commercially Reasonable" Rates to Gateways Based on a Mileage Prorate of CPKC Single-Line Rates.

Applicants' commitment to keep the Laredo Gateway and other gateways open by quoting "commercially reasonable" Rule 11 rates is neither concrete nor enforceable. Applicants promise that when a shipper asks for a gateway rate, CPKC will "provide the shipper with a Rule 11 rate to the gateway."[246] However, without some established method of evaluating whether the gateway rate provided is "commercially reasonable," the promise to provide a rate is worthless.

"Commercially reasonable" is not a concrete, enforceable standard for establishing rates. There is no mechanical definition of what it means for a rate to be "commercially reasonable."[247] Railroad business practice does not offer any standards. None of UP's contracts calls simply for

[246] APP Vol. 1 at 233, Brooks VS ¶ 46.

[247] Rocker/Turner VS at 19.

rates to be "commercially reasonable."[248] CP likewise does not have contracts that require CP to charge "commercially reasonable rates."[249] CP Chief Marketing Officer John Brooks announced Applicants' commitment to providing "commercially reasonable" gateway rates in a verified statement submitted with the Application.[250] When asked in discovery how a decision-maker would determine whether a rate was "commercially reasonable," Mr. Brooks responded that the process "would involve probably both parties describing why their case or rate was reasonable."[251] When asked whether Applicants proposed any standards a decision-maker could use to make a determination, Mr. Brooks simply said, "No."[252]

In response to written discovery, Applicants said "commercially reasonable" terms simply means terms "established by CPKC in good faith to provide customers with the option of continued movement of rail traffic via an affected pre-Transaction interline route."[253] However, Mr. Brooks recognized that CPKC and a shipper could disagree in good faith about whether a proposed rate is "commercially reasonable."[254]

Ultimately, Applicants made clear how meaningless their promise would be in practice. When UP sought discovery to test KCS's compliance with its commitment in the KCS/Tex Mex

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[248] *See id.*

[249] *See* Ex. 7 (Brooks Tr. 98:7–24).

[250] *See* APP Vol. 1 at 233, Brooks VS ¶ 46.

[251] Ex. 7 (Brooks Tr. 100:25–101:6).

[252] Ex. 7 (Brooks Tr. 101:7–101:10). When CP acquired the Dakota, Minnesota & Eastern Railway in 2008, CP also promised to keep gateways open on "commercially reasonable terms." *Canadian Pac. Ry., et al.—Control—Dakota, Minn. & E. R.R., et al.*, FD 35081, slip op. at 5 (STB served Sept. 30, 2008). Mr. Brooks testified there was no training that told people how to adhere to the open gateway commitment. *See* Ex. 7 (Brooks Tr. 134:6–135:6).

[253] Ex. 3 (KCS and CP's Joint Responses and Objections to UP's First Set of Discovery Requests, Response to Request No. 40).

[254] Ex. 7 (Brooks Tr. 102:19–103:2).

merger to charge "commercially reasonable" rates, Applicants said evaluating compliance was impossible. They said the Board had never established any "metrics" or a "ruler" to determine whether a particular rate was "commercially reasonable," so any effort to prove rates offered by KCS were not "commercially reasonable," even "with full hindsight," would amount to "wild speculation":

> The Board did not define "commercially reasonable" in its 2004 Tex Mex decision. [Citation omitted.] There are no set metrics; there are no dollar caps. There is no ruler by which UP could even determine, at this later date and with full hindsight, whether a particular rate offered for one customer in 2019 for intermodal traffic between Mexico City and Kansas City is "commercially reasonable" without wild speculation.[255]

If UP could never tell, even "with full hindsight," whether a particular rate is "commercially reasonable" because the Board never established any "metrics" or "ruler," then it would be equally impossible for a shipper, an arbitrator, or the Board to enforce the identical commitment made here by Applicants.

In the Application, Applicants acknowledge the need to make "more concrete and readily enforceable" their commitment to charge "commercially reasonable rates."[256] However, they offer no concrete, enforceable proposal of their own.

UP has identified an appropriately concrete, enforceable approach: When a customer asks CPKC to provide rates for (i) CPKC service on only former-CP, former-KCS, and/or former-KCSM portions of an origin-to-destination route, and (ii) CPKC "single line"[257] service on a

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[255] Ex. 19 (Applicants' Reply to UP's Motion to Compel at 12).

[256] APP Vol. 1 at 233, Brooks VS ¶ 47.

[257] The term "single-line" is used to simplify the discussion. The rule would apply even though KCSM might technically offer customers a separate Rule 11 rate for the Mexican portion of a movement that is transported north of the border by KCS, or KCS and CP. As discussed in the

"competitive"[258] route, CPKC must provide the customer with a Rule 11 rate for the former-CP, former-KCS, or former-KCSM portions that reflects a mileage-based prorate of the rate provided for the CPKC single-line service. Mr. Rocker and Professor Salop separately illustrate how such an approach would be applied.[259]

UP's proposed condition is narrowly tailored to address a specific merger-related harm identified by Applicants. It would place all the control in the hands of the shippers that the condition is intended to protect. Shipper control would ensure that the condition protects competition, not competitors:

- The *shipper* decides whether to request gateway rates from CPKC.
- The *shipper*—and only the shipper—receives the gateway rates from CPKC.
- The *shipper* decides whether to ask other railroads for complementary Rule 11 rates to create a competitive through route.
- The *shipper* can easily determine whether CPKC accurately applied a mileage prorate and, if necessary, readily obtain enforcement at the Board.

By protecting competition and not competitors, UP's proposed condition embraces the dynamic nature of the railroad marketplace. CPKC is free to set rates according to its view of the market. Rates are not frozen. CPKC's Rule 11 rates will reflect CPKC's then-current judgment about commercially reasonable rates for the traffic at issue. Rates are not "equalized." CPKC is free to reduce its total rate below what other carriers can match when combining CPKC's Rule

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next note, the rule would also apply even if CPKC could not by itself provide "single-line" transportation from the origin to the destination and had to interchange with another carrier.

[258] The term "competitive" is used to mean CPKC and another railroad are competing for the same traffic, but the rule would apply even if CPKC and the other railroad did not serve the identical origin or destination facility—*e.g.*, if each serves a different intermodal facility in the same area—or if CPKC or the other railroad must interchange with yet another carrier to provide full origin-to-destination transportation.

[259] *See* Rocker/Turner VS at 20; Salop VS ¶¶ 117–19.

11 rates with their own Rule 11 rates. UP could not "cherry pick" business. CPKC would only provide a Rule 11 rate if a customer also requested a single-line rate. And the other carriers never see *any* rates provided by CPKC unless shippers choose to share them in an effort to further stimulate competition. As Professor Salop explains, this shipper-centric, market-based approach avoids the flaws of prior, discredited, gateway protective conditions.[260]

Applicants may quibble about the details of UP's proposal. They may say a mileage prorate might not precisely correspond to their costs or might not allow them to capture every last drop of efficiency benefits their transaction might create. However, UP's proposal ensures that any efficiencies CPKC does not capture will flow to shippers, not CPKC's competitors. Moreover, the prorate will only apply to a fraction of the total rate, so if CPKC can legitimately offer customers better rates and service than its railroad competitors, it will win the business.[261]

Use of a mileage prorate in this type of setting is not a novel idea. UP and BNSF agreed to a similar approach under their "I-5 Agreement" to keep the Portland Gateway open following the *UP/SP* merger.[262] UP's proposal here is more limited in objective, and thus less complicated, than the I-5 Agreement. UP's proposal applies only if a shipper decides to obtain a competitive rate from CPKC, so there is no need to develop a pre-set matrix of potential rates. CPKC would develop a new, confidential, market-based rate whenever a shipper asks for a CPKC rate and a Rule 11 interline rate, and the shipper could easily check compliance by knowing the rate and

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[260] *See* Salop VS ¶ 121 (noting that "CRR is far narrower than the DT&I conditions and is formulated to preserve competition among the carriers. In particular, the CRR does not constrain the single-line rate of the merged firm; it simply bases the Rule 11 rate on the monopoly segment of the carrier's independently-determined rate." (footnote omitted)).

[261] *See generally id.*, ¶¶ 123–24.

[262] *See* Rocker/Turner VS at 22.

miles, and applying simple arithmetic.[263] UP's and BNSF's use of a mileage prorate in the *UP/SP* merger confirms use of a similar approach here would not undermine the legitimate benefits of a CP/KCS transaction.

UP has also used mileage prorates to address divisions of revenue between carriers in other settings. As Mr. Rocker explains {{

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Also, Applicants' own documents show {

}[265] As Mr. Brooks described in his verified statement, the parties entered into the Ice Pick initiative in 2009 and carried it forward until 2012.[266] Ice Pick involved efforts to capture the same types of traffic at issue here. {

}

2. The Board Should Require CPKC to Comply with KCS's Promises Regarding Laredo Gateway Operations and the Laredo Bridge.

As discussed above, Applicants could reduce gateway competition not only by increasing rates but also by reducing service. In the Application, Applicants commit to keep gateways open physically by "maintain[ing] efficient operations serving existing gateways wherever traffic

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[263] *See id*.

[264] *See id*. at 23.

[265] Ex. 7 (Brooks Tr. 66:3–14); *see also* Ex. 20 (Brooks Deposition Exhibit 8 (CP-HC-00006432–6439)).

[266] *See* APP Vol. 1 at 227–28, Brooks VS ¶¶ 30–33.

levels warrant – in terms of both the through train services to and from the gateways as well as the operational capabilities and infrastructure necessary to carry out efficient interchange."[267] Applicants also say they will "inherit and honor" operational commitments regarding the Laredo Bridge and traffic moving via the Laredo Gateway that KCS made when it acquired Tex Mex.[268]

If the Board approves the transaction, it should make CPKC's operational commitments more concrete in two ways. First, it should require CPKC to adhere to the specific commitments KCS made in *Tex/Mex.* The specific commitments (as applied to CPKC) include:

- CPKC will not change the basic structure and operations of KCSM except through negotiations. CPKC's carriers (including KCSM) will continue to cooperate closely and fairly with UP, BNSF and other rail carriers on interline services such as pre-blocking rail cars, improving automated customs pre-clearance procedures, supplying cars for shipments, accommodating run-through train service, providing excellent service, and promptly quoting rates.

- CPKC will honor the terms of all existing Tex Mex and KCSM agreements and will allow such agreements to continue to their full term and not seek to cancel them early, even if it has the legal right to do so.

- CPKC will treat all carriers fairly at the Laredo Bridge. CPKC will abide by the existing dispatching and operating practices over the Bridge, will not make any unilateral changes in the way the Bridge is dispatched and operated, and KCS, Tex Mex, and KCSM will continue to be bound by the contracts and agreements that now govern operations over the Bridge.

- CPKC will ensure safety remains a top priority with regard to CPKC operations at the Laredo Gateway.[269]

By directly requiring CP's compliance with the *KCS/Tex Mex* operational commitments, the Board would appropriately memorialize these significant commitments and avoid potential misunderstandings or confusion.

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[267] *Id.* at 233, Brooks VS ¶ 45.

[268] *Id.* at 232, Brooks VS ¶ 43.

[269] *See KCS/Tex Mex*, FD 34342, slip op. at 13–14; *id.* at 18–19; *see also* APP Vol. 1 at 207, Ottensmeyer VS at 21.

Second, to make the commitments more concrete, the Board should expressly require CPKC to provide UP access to any new bridge CPKC constructs at Laredo on the same terms as it provides UP access to the existing International Bridge. As discussed above, the long-term interests of shippers using the Laredo Gateway require that CPKC continues to have an incentive to cooperate with UP with regard to service and capacity on the bridges used by the two railroads.

B. The Board Should Impose Conditions to Remedy Applicants' Failure to Address Investment in Joint Facilities.

Applicants' failure to address the impact of their planned traffic growth on capacity needs of joint facilities is a separate reason the Board could not conclude the proposed transaction is consistent with the public interest. If the Board approves the transaction despite that significant omission, it should impose conditions to ensure the transaction's implementation is in the public interest, and that CPKC cannot inappropriately force UP and other railroads—and their customers—to subsidize the transaction.

To address these issues, the Board should establish three principles governing Applicants' ability to move forward with their plans: *First*, Applicants must work with owners and users of rail lines and other facilities that would be used jointly by CPKC to identify investments in new capacity necessary to accommodate CPKC's planned traffic growth. *Second*, Applicants must commit to fund necessary investments in new capacity, with other railroads paying their fair share to the extent they use the new capacity in the future. *Third*, Applicants must commit not to increase CPKC operations on affected lines above pre-merger CP or KCS levels until the owners and users of the lines agree sufficient capacity has been added to accommodate the traffic growth. The Board would remain available to resolve disputes at any stage of the process.

UP recognizes these conditions could potentially delay implementation of the plans set forth in the Application. However, Applicants' plans are incomplete, and if Applicants begin to implement them without fully accounting for their effects, the costs will be borne by other railroads and their customers. That would not be consistent with the public interest.

VIII. Conclusion

An unconditioned combination of CP and KCS would likely cause a significant loss of competition, especially for traffic moving via the Laredo Gateway. Applicants also fail to take into account the substantial investments in new capacity required to implement their transaction. UP's proposed conditions would partially mitigate the harms that would result from approval of the transaction. If the Board does not impose UP's proposed conditions, it should deny the Application.

Respectfully submitted,

/s/ Michael L. Rosenthal

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February 28, 2022

CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of February, 2022, I caused a copy of the foregoing document to be served electronically or by first-class mail, postage prepaid, on all parties of record on the service list for Finance Docket No. 36500.

/s/ Michael L. Rosenthal

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

VERIFIED STATEMENT

OF

KENNY ROCKER

AND

JOHN TURNER

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VERIFIED STATEMENT

OF

KENNY ROCKER AND JOHN TURNER

My name is Kenny Rocker. I am Executive Vice President, Marketing and Sales, for UP.[1] I joined UP in 1994 and have held my current position since 2018. Since joining UP, I have held various positions of increasing responsibility in the Marketing and Sales Department, including assignments in Automotive, Chemicals, and the Market Development and Sales Center. I hold a Bachelor's degree in Finance from Tuskegee University.

My name is John Turner. I am Vice President, Network Planning and Operations, for UP. I joined UP in 1998 and have held my current position since 2020. Since joining UP, I have held various positions of increasing responsibility in the Operating Department, including time spent as Director Transportation Service, Superintendent, and General Superintendent. Immediately prior to my promotion to Vice President, I was Assistant Vice President for Network Integration and Scheduling. I hold a Bachelor's degree in Transportation and Logistics from Iowa State University and a Master's in Business Administration from the University of Notre Dame.

I. Introduction And Summary

We are submitting this statement because CP's proposal to acquire control of KCS presents a significant threat to competition for rail traffic moving between the United States and Mexico. We are also submitting this statement because Applicants appear to be expecting other railroads to pay for substantial investments in capacity that would be necessary to implement

[1] In this statement, we use the abbreviations the Board used in Decision No. 11, served November 23, 2021.

their transaction. If the Board were to authorize the proposed transaction, it must impose conditions addressing both issues.

A. The CP/KCS Transaction Presents a Significant Threat to Competition.

Many shippers rely on KCS and its Mexican subsidiary, KCSM, to cooperate with UP and BNSF to provide competitive options for traffic moving between the United States and Mexico via the Laredo Gateway. Currently, KCS has strong incentives to cooperate. KCS must cooperate with UP and BNSF to sustain and grow business on KCSM because its network in the United States has limited reach. CP, however, serves many of the same important U.S. origins and destinations as UP and BNSF. A combined CPKC would be emboldened to *force* shippers to use CPKC single-line routes, rather than *allow* them to use competitive interline routes with UP and BNSF. The proposed transaction would thus reduce the competitive options currently available to shippers at the Laredo Gateway and other gateways in the United States.

We want to be clear at the outset: UP is not opposed to increased competition for U.S.-Mexico traffic or any other traffic that could be served by CPKC. UP is concerned because Applicants' plans for CPKC suggest they would *not* compete for business simply on the merits. Applicants' plans require CPKC to divert significant volumes of traffic from both UP and BNSF using longer, less efficient routes, and without reducing rates. If CPKC could win business by making its service more efficient and attractive, UP would regard the results as procompetitive. However, UP believes CPKC would divert traffic by using methods that reduce shippers' competitive options and compel them to use inferior routes.

Applicants themselves have recognized the very real nature of the concerns the proposed transaction raises for the preservation of shippers' competitive options at gateways, including the Laredo Gateway. Attempting to address those concerns, they promise to keep existing gateways

open on commercially reasonable terms.[2] They also acknowledge that they will inherit the commitments to preserve competition via the Laredo Gateway that KCS made in 2003 when it acquired the Texas Mexican Railway (Tex Mex) and Transportación Ferroviaria Mexicana (TFM) (which is now KCSM).[3]

Applicants' commitments do not go nearly far enough. In Part II.C of this statement, we discuss conditions the Board must impose to protect competition at the Laredo Gateway and other gateways if it were inclined to approve the proposed transaction.

B. Applicants Failed to Fully Address the Investments in Capacity Necessary to Implement the Transaction.

When reviewing the Application, we noticed a significant omission: Applicants failed entirely to address the need for investment in jointly-used infrastructure that would be necessary to implement their proposed transaction. Applicants project substantial traffic growth in a three-year period. Their Application addresses the investment needed to accommodate that growth on lines owned by CP and KCS. But CPKC would also operate on lines owned by UP. For example, CPKC's route between the Laredo Gateway and Shreveport operates over approximately 250 miles of UP-owned lines between Robstown and Beaumont, Texas, including lines through the crowded Houston terminal. BNSF also uses these lines. Applicants made no attempt to address capacity improvements on UP lines that would be necessary to accommodate their planned traffic growth. Applicants also appear to have overlooked the need for additional investment on lines they own but share with UP (and BNSF), acting as if other railroads must accommodate their changes, regardless of the impact on our service and therefore our customers.

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[2] *See* APP Vol. 1 at 232, Brooks VS ¶ 42.

[3] *See id.*

We do not believe the Board could conclude the proposed transaction is in the public interest without fully understanding the impacts of Applicants' plans on other carriers and their customers. If the Board authorizes the transaction, it should not allow Applicants to increase operations above pre-merger levels until they reach agreements with railroads with whom they share capacity that identify and provide for funding of investments necessary to accommodate the traffic levels projected in the Application.

II. CP Control Of KCS Threatens Competition For U.S.-Mexico Rail Traffic.

The Laredo Gateway is *critical* to U.S.-Mexico rail transportation. Shippers who rely on rail service via the Laredo Gateway benefit today from a healthy competitive environment. But CP control of KCS threatens competition for rail traffic at the Laredo Gateway.

A. The Laredo Gateway Is Critical to U.S.-Mexico Rail Transportation.

In 1996, the Board recognized that "Laredo is the principal rail gateway between the United States and Mexico,"[4] and it imposed conditions aimed at preserving effective two-railroad competition north of the border for U.S.-Mexico rail traffic moving via Laredo.[5] The Board again recognized the importance of the Laredo Gateway in 2004, when it conditioned its approval of KCS's acquisition of Tex Mex and TFM on KCS's adherence with a set of pledges to "guarantee that traffic will continue to flow fairly and efficiently at the Laredo Bridge and through the Laredo gateway."[6]

The Laredo Gateway is still the dominant rail gateway between the United States and Mexico. In 2019, rail traffic moving via Laredo accounted for approximately 54% of all rail

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[4] *Union Pacific/Southern Pacific Merger*, 1 S.T.B. 233, 410 (1996).

[5] The Board granted Tex Mex extensive trackage rights over UP, allowing Tex Mex to connect with KCS at Beaumont. *See id.* at 422–26.

[6] *Kansas City S.—Control—The Kansas City S. Ry., et al.*, FD 34342 ("*KCS/Tex Mex*"), slip op. at 19 (STB served Nov. 29, 2004).

traffic (by dollar value) between the United States and Mexico.[7] Even this figure understates the importance of the Laredo Gateway. Geography plays an important role in limiting most shippers' gateway options. For example, movements between UP points in the western Unites States and points in western Mexico naturally flow via the three gateways in western Mexico: Calexico, Nogales, and El Paso. Traffic moving between points in the central and eastern United States (and Canada) and points in eastern and central Mexico cannot effectively use these western gateways.

Of the three rail gateways in eastern Mexico—Laredo, Eagle Pass/Piedras Negras, and Brownsville/Matamoros—Laredo is used by most shippers. In 2019, Laredo accounted for approximately 67% of all rail traffic (by dollar value) moving via these three gateways.[8] The primary alternative to Laredo is the Eagle Pass/Piedras Negras gateway where UP and BNSF connect with Ferromex ("FXE"). Eagle Pass accounted for 32% of rail traffic (by dollar volume) moving via the three eastern gateways in 2019.[9] Brownsville, where UP and BNSF connect with KCSM, accounted for the remaining traffic. UP uses Brownsville principally for traffic moving to points just across the border in the Mexican states of Tamaulipas and Nuevo Leon, which cannot be reached as efficiently via Laredo or other gateways.

The Laredo Gateway's high share of rail traffic is especially notable considering UP's incentives to establish alternative routes via the Eagle Pass Gateway. Over time, and especially after KCS acquired control of KCSM in 2004, UP has worked with FXE to make Eagle Pass a more attractive alternative for customers to reduce reliance on KCSM at the Laredo Gateway.

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[7] *See* Rocker/Turner workpaper "P - Bureau of Transportation Statistics Data.pdf."

[8] *See id.*

[9] *See id.*

UP has an added incentive to encourage movements over FXE: it owns a 26% passive equity interest in FXE.[10] Despite UP's incentives to promote Eagle Pass, in 2019, the Laredo Gateway's share of UP traffic moving via the Laredo and Eagle Pass gateways was 57%.[11]

Focusing on overall traffic shares also understates Laredo's importance, because the gateways handle a different mix of traffic. For certain types of traffic, Laredo's share is even higher. For traffic CPKC is primarily targeting for diversion—that is, finished vehicles, auto parts, and intermodal—the Laredo Gateway's share of UP traffic moving via the Laredo and Eagle Pass gateways is approximately 62%.[12]

In certain geographic markets, Laredo's share is even higher. As an example, Applicants plan to offer service between CP-served points in the Upper Midwest and KCSM-served points in the industrialized regions of central and eastern Mexico. Laredo handles over 90% of all UP movements from origins in Michigan and Illinois (the two largest origins for Mexican rail traffic moving on UP) to destinations in Mexico Distrito Federal and the industrialized Mexican states of San Luis Potosí and Querétaro.[13]

The Laredo Gateway's importance is mostly due to the access it provides to KCSM's network. KCSM and FXE were formed as a result of the Mexican government's decision to privatize its national rail system in the mid-1990s. KCSM was given what was referred to as the "Northeast Concession." FXE operates primarily in western Mexico. KCSM lines run from the Laredo and Brownsville gateways south into the most populous and industrialized regions of

[10] UP has no control over FXE's operations or pricing.

[11] *See* Rocker/Turner workpaper "HC - UP Mexico traffic.xlsx," tab "Gateways."

[12] *See id.*

[13] *See* Rocker/Turner workpaper "HC - UP Mexico traffic.xlsx," tab "States."

Mexico. KCSM directly serves most leading rail freight centers in Mexico, including Monterrey, Saltillo, San Louis Potosí, Querétaro, Toluca, Mexico City, and Veracruz.

A significant portion of current cross-border traffic though Laredo moves to or from points in Mexico served exclusively by KCSM. For example, KCSM has the only service to the major industrial centers of San Luis Potosí and Toluca, and the only access to many locations in Nuevo Leon. Of the more than 300,000 cars and containers that UP interchanged with KCSM in 2019, UP estimates that more than half moved between Laredo and points served exclusively by KCSM. Much of this exclusively served traffic is the finished vehicles, auto parts, and intermodal business CPKC is primarily targeting for diversion. The remainder is mostly traffic Applicants also have squarely in their sights: grain, petroleum products, chemicals, and plastics.

In addition, although KCSM and FXE both serve a number of the same Mexican points, KCSM's route has geographic advantages for movements between eastern Mexico gateways and much of eastern and central Mexico. A comparison of the KCSM and FXE routes between the border and the Valle de México region surrounding Mexico City—Mexico's largest population and consumption center—is illustrative. KCSM and FXE both can access shippers in the Valle de México through a jointly owned railroad, Ferrocarril y Terminal del Valle de México. However, FXE's route from the Mexico City area to Eagle Pass is 55% (392 miles) longer than KCSM's route to Laredo.[14] As one might expect, given the mileage difference, nearly 80% of UP's traffic between the United States and the Mexico City area moves via the Laredo Gateway.[15]

[14] *See* Rocker/Turner workpaper "HC - UP Mexico traffic.xlsx," tab "Mileage." For example, KCSM's route from Laredo to Cuautitlan is 711 miles. FXE's route from Eagle Pass to Cuautitlan is 1,103 miles. *See id.*

[15] *See* Rocker/Turner workpaper "HC - UP Mexico traffic.xlsx," tab "Mexico City."

In sum, KCSM's route structure ensures that competitive access to the Laredo Gateway will remain critical to U.S.-Mexico cross-border rail transportation.

B. CP Control of KCS Would Harm Competition.

The proposed CP/KCS transaction raises red flags that signal the transaction will cause substantial harm to competition for traffic moving over gateways, especially the Laredo Gateway.

Applicants projected a very high level of merger-related benefits to justify the hefty price CP paid to acquire KCS. They will be under tremendous most-merger pressure to produce results. Applicants will have to generate almost all the benefits from increased revenues. The end-to-end nature of their transaction means they cannot generate significant cost savings from rationalizing routes and facilities in the same ways seen in many prior rail mergers. In addition, Applicants' growth projections rely to a large extent on attracting entirely new traffic to the CPKC system—for example, through explosive growth of international intermodal traffic at the Port of Lázaro Cárdenas, and through conversion of truck traffic to rail intermodal traffic.

As a result of these factors, CPKC will aggressively leverage revenue from the one source largely under its control: traffic moving over the Laredo Gateway. In fact, Applicants have projected diverting substantial amounts of traffic from UP-KCSM and BNSF-KCS-KCSM interline routes. If CPKC could divert that traffic by competing with UP and BNSF on the merits, UP would not object. However, Applicants presented no plan for competing on the merits. They say they do not plan to reduce rates. They acknowledge their routes for this traffic will be longer than existing routes. Their only option is using their control of KCSM to *force* traffic to use the CPKC network north of the border—that is, to undermine the competitive options currently available to shippers.

1. Shippers Benefit From Choice and Competition at the Laredo Gateway.

Today, shippers using cross-border rail service via the Laredo Gateway generally have at least two competitive options for the portion of the movement within the United States. UP and BNSF participate in interline movements with KCSM (in BNSF's case, via KCS and, to some extent, via KCSM at the Brownsville Gateway) and compete against each other north of the border. UP and BNSF also interchange cross-border traffic with carriers serving the Eastern United States and Canada to provide competition to points they do not serve directly. In some cases, shippers also have the option to use KCS's network in the United States.

When UP and BNSF compete, each relies on KCSM to handle its traffic between the border and points in Mexico. UP and BNSF traffic moving between KCSM's Sanchez Yard, located just south of the border, and points in Mexico is typically handled in the same train, ensuring equitable treatment. KCSM and UP have cooperated on a wide range of operational matters to provide efficient cross-border transportation offerings to customers, including directional handling of empties and coordination of operations at the Laredo Bridge. KCSM and UP have also worked together on projects to streamline the border crossing process, such as data exchange for blocking and customs purposes. KCSM has also helped UP support customer requirements though the supply of railcars and other services. UP understands that KCSM has coordinated on similar matters with BNSF. Untethered to CP, KCSM has powerful incentives to cooperate with both UP and BNSF on these and other operational matters.

Shippers also benefit from competition for traffic moving via the Laredo Gateway. Most UP cross-border traffic moves under what are referred to as "Rule 11" rates. {{

}} When a shipper requests Rule 11 rates, each carrier participating in an interline route provides the shipper with a confidential rate offer for its portion of the movement. UP and BNSF thus compete to provide service in the United States through their rates and by addressing non-price factors important to the customer, such as transit time, equipment supply, or reliability. KCSM's rates for its portion of the move are constrained by its concern that the combined price might exceed what the customer is willing to pay, and its lack of detailed knowledge about conditions in U.S. markets that are not served by KCS.

UP believes some shippers may not be experiencing the full benefit of competition at the Laredo Gateway. UP believes KCSM may set rates to discourage shippers from using UP, or to earn extra revenue when shippers use UP, where KCS can offer a viable single-line alternative. We never actually know what Rule 11 rates and single-line rates KCS/KCSM offers customers, and many shifting factors can affect railroad ratemaking, which makes discrimination extremely difficult for a customer to detect, much less prove.[16]

Currently, KCS's incentive and ability to engage in anticompetitive strategies are limited. For nearly all UP's cross-border traffic, KCS provides less efficient routes north of the border. KCS has apparently concluded that its interests are best served by setting rates for KCSM-UP traffic to build business on KCSM. CP control of KCS would not make potential CP/KCS routes any more efficient—in fact, Applicants admit that CPKC routes would be, *on average*, 217 miles longer than existing routes for traffic they want to divert.[17] But CP's acquisition of KCS would change the balance of incentives, emboldening CPKC to adopt strategies that would expose a

[16] We recognize KCS/KCSM may technically offer customers a KCSM Rule 11 rate and a KCS Rule 11 rate and bill separately for the portions of the movement in Mexico and in the United States. To simplify our discussion, we refer to the total KCS/KCSM rate as a "single-line" rate.

[17] *See* APP Vol. 2 at 132, Brown/Zebrowski VS ¶ 30.

substantial amount of additional cross-border traffic to anticompetitive conduct and coercive outcomes for customers.

2. CPKC Would be Incentivized to Deprive Shippers of the Price and Service Benefits of UP-KCSM Routings.

Applicants' plans for CPKC traffic diversions show how significantly CPKC's incentives and opportunities to engage in anticompetitive conduct will differ from KCS's incentives today. Unlike KCS, CP serves the locations in the Upper Midwest where large volumes of U.S.-Mexico traffic originate or terminate, including Chicago and Detroit. A CP/KCS combination would give the merged railroad what neither CP nor KCS has today: the possibility of capturing all the profits on large volumes of rail traffic moving between the United States and Mexico.

CPKC's motivation to divert traffic to the merged system is undeniable. Applicants say CPKC would target for diversion the hundreds of thousands of carloads of finished automobiles and containers of intermodal freight currently moving between the Mexican border and points in the Upper Midwest and Canada on UP and BNSF, as well as thousands of cars of other cross-border traffic currently moving in interline service with KCSM. Before the proposed transaction, KCSM's incentive was to work with both UP and BNSF to offer shippers competitive options for moving this business. If CP acquired control of KCS, CPKC's would seek to divert as much of the volume as possible to CPKC single-line service to collect all the profits or make shippers pay CPKC extra if they use interline service with UP or BNSF. By increasing the costs of UP-KCSM and BNSF-KCS-KCSM options, or making those options less attractive from a service perspective, CPKC would be able to enhance its profits in ways detrimental to shippers. In shifting traffic to CPKC, allowing the merged carriers to earn additional profits north of the border, CPKC would deprive shippers of efficient UP-KCS service they enjoy today, and allow CPKC to increase its own rail rates to reflect the cost penalties it imposes on UP.

3. CPKC Would be Able to Use Its Control of KCSM to Make More Efficient UP-KCSM Options Less Attractive to Customers.

Continued competition for U.S.-Mexico traffic moving via the Laredo Gateway depends on KCSM's continued cooperation in providing competitive interline rates and service for traffic moving between Laredo and points in Mexico served by KCSM. If CP acquired control of KCS, CPKC could readily make UP-KCSM options that compete with CPKC routes less attractive to shippers by raising the costs of those options or reducing cooperation on service.

a) Anticompetitive Rate-Based Strategies

KCSM's rates are probably the most important factor in preserving competition at the Laredo Gateway. UP could have the most efficient routes north of the border, receive equal treatment at the Laredo Bridge, and have its traffic treated fairly in Mexico, but if the rates KCSM charges shippers for UP-KCSM movements are too high, shippers would lose the benefits of UP competition.

If CP acquired control of KCS, CPKC would have the power to manipulate KCSM's rates to make competing UP-KCSM service more expensive for shippers, forcing them to switch to less desirable CPKC offerings, or at least causing them to pay more to CPKC if they continued using UP-KCSM service.

A simple example helps illustrate how such a strategy might work: suppose that before CP gained control of KCS, KCSM provided a customer a Rule 11 rate from an origin in Mexico to the Laredo Gateway of $100, and UP and CP both serve the destination. UP has an efficient route and provides the customer a Rule 11 rate from Laredo to the destination of $100. KCS and CP could move the traffic via a longer, slower route with an interchange in Kansas City, but the customer prefers the KCSM-UP route, even assuming that the total rate for each alternative

would be the same. (In reality, the total price for the less efficient route would almost certainly be higher.)

After the transaction, CPKC could try to divert the traffic by raising KCSM's Rule 11 rate to $110, while offering the customer a single-line rate of $200. The customer would then have to choose between accepting the less preferred CPKC route to avoid a rate increase, or paying an additional $10 to KCSM to continue using UP. Either way, CPKC would generate more revenue—by diverting the entire movement and gaining $100 or by gaining an extra $10 for providing the same interline service it provides today. And either way, the shipper would lose—by losing its preferred routing or by paying an extra $10 for the exact same service it receives today.

Our understanding is that CPKC would have a great deal of latitude to increase KCSM's Rule 11 rates to implement anticompetitive rate-based strategies. Within the experience of UP's Mexico Group, statutory maximum rates published by the Mexican government are so high they are essentially unusable. We also understand that, at least in theory, Mexican law includes certain rate antidiscrimination principles, but we are not certain whether they require equal treatment of Rule 11 and single-line rates for cross-border traffic. In any event, CPKC could simply cause KCSM to raise rates for all similar traffic moving between Laredo and points in Mexico, then offset those increases by as much as necessary to attract traffic by reducing the portion of the rate assigned to CPKC north of the border. For shippers with better access to other transportation options, such as truck or barge, CPKC could offer even lower rates by reducing its factor north of the border by a greater amount. For traffic that UP could efficiently route via Eagle Pass in conjunction with FXE, CPKC may decide its best strategy would be to continue cooperating with UP so KCSM can keep its existing Mexican portion of the revenue. But for

significant amounts of traffic moving via the Laredo Gateway, shippers will be pressured to divert their business to CPKC.

CPKC's implementation of such a strategy would hurt shippers and competition, not just UP. CPKC would not be shifting $10 from UP's pockets to CPKC's pockets. In our example, the shipper is forced to choose between (i) receiving inferior service, and (ii) paying more to KCSM while paying the same amount to UP. As we explained above, use of Rule 11 pricing stops KCSM from extracting every last dollar of revenue that might be available due to its market power. As part of a combined CPKC, CP and KCSM would no longer be charging Rule 11 rates for the alternate route. Their additional insight into each other's costs and pricing for the movement, and their combined knowledge regarding the customer's specific circumstances and demand factors, would allow KCSM to more effectively differentiate among customers and better exploit its market power within Mexico.

b) Anticompetitive Service-Based Strategies

Although rate-based strategies would provide the most direct opportunities for CPKC to force traffic diversions, CP control of KCS would also provide opportunities to divert traffic by making UP-KCSM transportation offerings more costly or less attractive in other ways. As explained above, today's competitive UP-KCSM service is built upon, and continues to depend upon, cooperation between the two carriers on a wide variety of operational matters. KCSM would have radically different incentives with respect to cooperation as part of CPKC.

CPKC's potential strategies for making KCSM-UP service less attractive would be as broad and as simple as reducing the high level of cooperation that exists today. With regard to operational cooperation, KCSM could give lower priority to trains carrying UP traffic, especially relative to trains carrying only CPKC traffic. KCSM could deprioritize last-mile service—spotting empty equipment and pulling loaded cars—when traffic is coming from shippers who

use UP service north of Laredo. As we discussed above, KCSM currently has strong incentives to provide excellent service to expand its overall business and because UP traffic is handled on the same trains as its other traffic. However, if CPKC increased its Mexico business as projected, it would be moving more trains with only CPKC traffic and would not have the same interest in providing high quality service for customers choosing UP, rather than CPKC north of Laredo.

CPKC could also reduce competition by giving preferential treatment to its own traffic moving over the International Bridge at Laredo. KCS controls the bridge through its ownership of Tex Mex and KCSM. Operations over the bridge are governed by a 1951 agreement between Tex Mex and a UP predecessor. The agreement provides general terms about Tex Mex's obligations to perform service "impartially," and with "no preference . . . to movements of cars by one of the parties."[18] UP and KCS have implemented the agreement by establishing alternating directional "windows" for moving trains over the bridge. Applicants have indicated they may want to change the current process.[19] UP is always willing to reduce operational delays and improve capacity at the bridge. However, changes to operations that would permit a more subjective interpretation of Tex Mex's contractual obligation must be carefully addressed by the parties to ensure they would not create opportunities to restrict UP's use of the bridge in ways that would harm UP's customers.

Any of these steps would degrade the competitive rail transportation options that shippers enjoy today. Applicants claim that "cooperating with UP at Laredo . . . will be in the self-interest

[18] *See* Rocker/Turner workpaper "C - International Bridge Agreement.pdf."
[19] *See* APP Vol. 2 at 317, OP Plan ¶ 162.

of the CP/KCS system."[20] However, they make clear throughout their Application that their interests lie in diverting traffic from UP-KCSM service to CPKC single-line service.

4. The Availability of UP-FXE Routes Via Eagle Pass or Other Transportation Options Would Not Allow Shippers to Avoid the Transaction's Anticompetitive Effects.

In reviewing the Application, we did not see any detailed discussion about transportation options available to shippers served by KCSM. A substantial number of shippers currently using UP-KCSM service do not have viable intramodal or intermodal alternatives to KCSM service in Mexico. If CPKC tried to divert their traffic by raising KCSM-UP rates or degrading KCSM-UP service, they would have no choice but to pay more, shift their business to CPKC, or both.

UP-FXE service does not provide a competitive option for most of the traffic targeted by Applicants. As we discussed above, more than half of UP-KCSM traffic moves between Laredo and points in Mexico served exclusively by KCSM. Additional traffic moves on UP-KCSM routes to or from points served by both FXE and KCSM where FXE lacks an efficient route to the border. FXE's ability to provide some shippers with competitive options would not protect the large number of shippers without similar options.

In addition, truck and water service are not viable options for the overwhelming majority of traffic Applicants say they will target for diversion to CPKC. Applicants said almost nothing of substance regarding non-rail options for the traffic they will target, and we agree with the only factual statement we saw: "many of the commodity flows in these lanes—like LPG, grain, finished autos, and others—are not well suited to long-distance movement by truck."[21] The only other statement we noted was the substance-free claim that "if the combined CP/KCS tried to

[20] APP Vol. 1 at 232, Brooks VS ¶ 43.

[21] APP Vol. 1 at 226, Brooks VS ¶ 26.

raise rates on KCSM movements that are not rail dependent, the traffic would shift to motor or water carriage."[22] Much of the traffic moving in UP-KCSM service, especially the traffic targeted by Applicants, *is* rail dependent, so motor and water carriage *are not* viable options.

For example, truck is not a viable option for finished automobiles moving from Mexico to the United States. Water transport is an option for some automobiles manufactured near ports and moving to the East Coast. But for finished automobiles moving from Mexican locations to U.S. points that are not on the coast, rail is the only option. As another example, truck can be an attractive option for shippers and receivers of relatively small quantities of auto parts—typically parts moving to a third-party supplier in Mexico. However, for large volume shipments moving directly from parts manufacturers or consolidation centers in the Upper Midwest and East to automobile manufacturers in Mexico, the economics of boxcar and intermodal service are vastly superior to truck service. Many other shippers also rely on rail to transport products to inland points in Mexico in volumes that make trucking inefficient, including shippers of petroleum products, soda ash, grain, steel, and specialized minerals (like ball clay and specialized sand). Again, the fact that some shippers might have truck and water options does not protect large number of shippers dependent on KCSM.

C. UP's Proposed Gateway Rate Remedy and Laredo Operational Conditions Are Narrowly Tailored to Remedy the Adverse Competitive Effects of an Unconditioned Transaction.

Applicants recognize there are valid concerns about the adverse effects of their proposed transaction on competition for traffic moving over gateways, particularly the Laredo Gateway. However, Applicants' proposed solutions are not sufficient to protect against potential harms—as they themselves appear to acknowledge. Applicants commit to keeping the Laredo Gateway

[22] APP Vol. 1 at 208, Ottensmeyer VS at 22.

and other gateways "open," both physically and commercially, but key elements of those commitments are vague, ephemeral, and essentially unenforceable.

UP urges the Board to condition any approval of the transaction on CPKC's use of a concrete, enforceable pricing methodology to ensure the Laredo Gateway and other gateways remain commercially "open." Specifically, when CPKC provides a Rule 11 rate to a gateway at the request of a shipper, the rate should reflect a mileage-based prorate of the rate offered to the shipper for CPKC "single-line" service.[23] As we explain below, UP's proposed approach would allow CPKC to compete vigorously for new business and pursue whatever efficiencies it might obtain as a result of the transaction, while preserving competition for traffic moving over gateways, including the Laredo Gateway.

UP also urges the Board to impose on CPKC the operational commitments relating to the Laredo Bridge and Laredo Gateway undertaken by KCS when it acquired Tex Mex. This would help avoid potential disputes about what it means for CPKC to "inherit" KCS's commitments. As we also explain below, the Board should make clear the commitments apply to operations over any new bridge at Laredo.

1. The Gateway Rate Condition

Applicants recognize their promise to keep gateways open is meaningless if the rate they set for their portion of an interline movement is too high for interline service to be competitively viable. They try to address the concern by promising that the rates and terms they establish will

[23] We put "single-line" in quotes because we recognize that CPKC might technically offer customers a KCSM Rule 11 rate and a CPKC Rule 11 rate and bill separately for the portions of the movement in Mexico and in the United States. To simplify our discussion, we refer to the total CPKC/KCSM rate as a "single-line" rate.

be "commercially reasonable.[24]" However, they never define what it means for rates to be "commercially reasonable." Instead, they say they will try to "find ways to make these commitments more concrete and readily enforceable."[25]

We understand the problem. We are not aware of any mechanical definition of what it means for a rate to be "commercially reasonable." It is not a concept UP uses in pricing traffic. None of UP's contracts call simply for rates that are "commercially reasonable." Railroads and customers operating in good faith may well disagree about whether a particular rate is appropriate in light of market circumstances.

If the Board were to approve the transaction, however, the Board would need to define in *concrete* terms the maximum amount CPKC can charge for their portion of an interline route via a gateway. Applicants' promise would be meaningless if it is not enforceable.

Applicants plainly recognize their promise to charge "commercially reasonable" rates is illusory and unenforceable. We understand that when UP tried in this proceeding to test whether KCS was complying with the commitment it made when it acquired Tex Mex to charge "commercially reasonable" rates, Applicants told UP such efforts amounted to "wild speculation" because the Board never established any "metrics" or "ruler" to determine whether a particular rate was "commercially reasonable":

> The Board did not define "commercially reasonable" in its 2004 Tex Mex decision. [Citation omitted.] There are no set metrics; there are no dollar caps. There is no ruler by which UP could even determine, at this later date and with full hindsight, whether a particular rate offered for one customer in 2019 for intermodal

[24] APP Vol. 1 at 232, Brooks VS ¶ 42.

[25] *Id.* at 233, Brooks VS ¶ 47.

> traffic between Mexico City and Kansas City is "commercially reasonable" without wild speculation.[26]

If Applicants' view is that UP could not, even "with full hindsight," address whether a particular rate is "commercially reasonable," how is a customer, or an arbitrator, or the Board expected to be able to enforce the commitment made here by Applicants?

UP urges the Board to adopt a simple, straightforward approach to defining for purposes of this proceeding what it means for a rate to be "commercially reasonable": <u>When CPKC provides a Rule 11 rate to a gateway at the request of a shipper, the rate should reflect a mileage-based prorate of the rate CPKC provides for its portion of a competing route.</u>

Here is how the prorate would work: a customer wants to ship finished automobiles from Toluca to Chicago. KCSM serves the facility in Toluca; UP and CP have different but competing auto facilities in Chicago. KCSM's route between Toluca and Laredo is approximately 760 miles long. The KCS-CP route between Laredo and Chicago is approximately 1,400 miles long. CPKC provides the customer a single-line rate of $3,000 (net of refunds, rebates, allowances, ancillary charges, etc.), and the customer requests a Rule 11 rate from Toluca to the Laredo Gateway.[27] To calculate the "commercially reasonable" Rule 11 rate, CPKC would simply calculate its mileage-based share (760 miles of a total 2,160 miles) of the total revenue, resulting in a Rule 11 rate of $1,056 ($3,000 x (760 ÷ 2,160)). CPKC would tell the shipper (a) the CPKC miles for both parts of the route (Toluca-Laredo; Laredo-Chicago) and (b) the Rule 11 rate. The customer could then ask UP for its Rule 11 rate from Laredo to Chicago, and decide whether the CPKC rate from Toluca to Chicago provides better overall value than the combination of Rule 11 rates.

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[26] *See* Rocker/Turner workpaper "P - Applicants' Reply to UP's Motion to Compel.pdf."

[27] As noted above, we recognize CPKC might technically offer customers separate KCSM and CPKC Rule 11 rates, but we refer to the total rate offered to the shipper a "single-line" rate to simplify our discussion.

UP's proposed approach is concrete, enforceable, and gives complete control of the process to shippers. The condition is designed to protect shippers, not the railroad competitors of CPKC. The shipper decides whether to even request a gateway rate from CPKC. The shipper (and only the shipper) receives the gateway rate from CPKC. The shipper decides whether to request a Rule 11 rate from another railroad. And the shipper can readily determine whether CPKC accurately applied the mileage prorate and seek to enforce the condition, if necessary—if the shipper has any questions about mileages, it can always ask the competing railroad (or seek out one the many railroad pricing consultants with access to rail mileage data).

UP's condition would not undermine Applicants' incentives to pursue whatever pro-competitive benefits might arise from combining CP and KCS. UP's condition would allow the market to determine the commercially reasonable rate. CPKC would be free to set rates based on to its view of the market and change its rates at any time as market conditions allow. In other words, CPKC's rates would not be frozen.

UP's condition would not produce "equalized" rates. CPKC would have a strong incentive to improve its efficiency and reduce costs. If CPKC is more efficient or willing to accept lower margins than its railroad competitors, CPKC could reduce its single-line rate below what others could match in setting their own Rule 11 rates. In most cases, CPKC's Rule 11 rate would account for only a small portion of the total move. As a result, if CPKC could legitimately offer customers better rates and service than its railroad competitors, it would win the business.

UP's condition also would not allow competitors to "cherry pick" attractive business. CPKC would not be required to establish free-standing Rule 11 rates. CPKC would only provide Rule 11 rates after a customer requests a CPKC single-line rate, so CPKC would know about all potential business opportunities. The competitor railroad would only know about the business if

the customer seeks an alternative to CPKC. The competitor would never be entitled to learn what single-line rate or what Rule 11 rate CPKC quoted a particular customer.

Use of a mileage-based prorate in this type of setting is not a novel idea. UP and BNSF agreed to a similar approach under their "I-5 Agreement" to keep the Portland Gateway open following the *UP/SP* merger. In that merger, UP sold BNSF a line in northern California that created a new BNSF single-line route between the Canadian border and the U.S. Southwest (the so-called "I-5 Corridor"). However, the railroads recognized that BNSF would no longer have incentives to work with UP on an interline basis via the Portland, Oregon gateway for traffic moving between BNSF points north of Portland and points served by UP and BNSF south of Portland. BNSF and SP had previously cooperated closely on such movements. To preserve a UP-BNSF interline option as an alternative to BNSF single-line routes, the parties essentially use a mileage-based prorate of BNSF single-line rates to develop and update a rate factor that UP can use to offer UP-BNSF interline service.[28] UP's and BNSF's agreement to a mileage-based prorate approach in the *UP/SP* merger demonstrates that use of a mileage-based prorate here would not undermine the benefits of a CP/KCS transaction.

UP's proposal here is much more limited in objective, and thus much less complicated, than the actual I-5 Agreement. UP's proposal applies only if a shipper decides to obtain a single-line rate from CPKC, so there is no need to develop a detailed matrix of rates or a system of third-party audits to ensure compliance. CPKC would develop a new, confidential, market-based rate whenever a shipper asks for a single-line rate and a Rule 11 interline rate, and the shipper could readily check compliance by knowing the rates and miles, and applying simple arithmetic.

[28] *See* Rocker/Turner workpaper "HC - I-5 Agreement.pdf."

UP has also used mileage-based prorates to address divisions of revenue between carriers in other settings. {{

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Although Applicants provide no concrete guidelines for setting rates at a "commercially reasonable" level, they identify *when* they would offer shippers "commercially reasonable" rates. They say they will provide a shipper with a Rule 11 rate to a gateway "when a customer requests a rate for only the former-CP or former-KCS portion of an origin-to-destination routing."[29] As we understand Applicants' position, CPKC would provide a Rule 11 rate whenever CPKC would move traffic over a route that includes some combination of premerger CP, KCS, and KCSM lines, and when a competitor railroad (or a combination of competitor railroads) could move the same traffic using an interline route that includes portions of the premerger CP, KCS, and/or KCSM. Thus, for example, the commitment would apply in the example discussed above, where CPKC and another railroad compete by serving facilities in the same area (*e.g.*, intermodal ramps, auto ramps, transloading facilities), even if both railroads do not serve precisely the same facility. As another example, the commitment would apply when multiple railroads interline to compete with CPKC, such as when UP interlines with CSXT or NS to move traffic to the East in

[29] APP Vol. 1 at 233, Brooks VS ¶ 46.

competition with CPKC (or CPKC and NS or CSX). As still another example, the commitment would also apply when a customer wants to move traffic between Mexico and the Meridian Speedway via the Laredo Gateway, and the choice is between a KCSM-UP routing and a KCSM-KCS routing. UP also understands Applicants' commitment would apply when CPKC would eliminate a bridge movement provided by another railroad—for example, when UP would need to interline with KCSM at Laredo and CP at St. Paul for traffic moving between Mexico and Canada.

If our understandings are correct, Applicants would apply a remedy to the right traffic—but a more concrete condition is needed to make the remedy meaningful and enforceable. UP's mileage-based prorate proposal would be an appropriately concrete, enforceable condition.

2. The Laredo Gateway Service Condition

Applicants recognize the same anticompetitive incentives that could lead them to foreclose competition by manipulating KCSM rate factors could also lead them to foreclose competition by reducing the quality of service or cooperation KCSM provides on interline movements. Applicants have committed to keep gateways open by continuing "to maintain efficient operations serving existing gateways wherever traffic levels warrant—in terms of both the through train services to and from the gateways as well as the operational capabilities and infrastructure necessary to carry out efficient interchange."[30] Applicants also say they will "inherit and honor" the specific operational commitments regarding the Laredo Bridge and traffic moving via the Laredo Gateway that KCS made when it acquired Tex Mex.[31]

[30] APP Vol. 1 at 233, Brooks VS ¶ 45.

[31] *Id.* at 232, Brooks VS ¶ 43.

CPKC's operational commitments would be sufficiently concrete and enforceable with two minor additions. First, the Board should expressly condition any approval of the proposed transaction on CPKC's adherence to the specific commitments KCS made in *KCS/Tex Mex*. A condition holding CPKC to its commitment to honor KCS's pledges would be unnecessarily confusing and could potentially lead to future disputes. Also, imposing an express, direct condition would drive home the significance of those commitments.[32]

Second, the Board should make one application of those commitments more concrete. In general, UP believes the operational conditions are clear enough to provide a basis for resolving any disputes that may arise in the future, without unreasonably confining CPKC's flexibility to respond to changing circumstances. However, one aspect of the conditions can and should be made more concrete: ensuring UP's access to any new bridge constructed at Laredo. In 2021, KCS received a Presidential Permit authorizing construction of a second international railroad bridge adjacent to the existing International Bridge in Laredo.[33] KCS and UP have been engaged in constructive discussions about the project. UP expects constructive engagement to continue if the Board approves the proposed transaction. However, for the reasons discussed above, access to the Laredo Gateway is too important to be subject to uncertainty and potential anticompetitive actions. If the Board approves the proposed transaction, it should require CPKC to provide UP access to any new railroad bridge constructed in Laredo on the same terms as UP's access to the existing bridge.

[32] *See* Rocker/Turner workpaper "C - Brooks Deposition Excerpt.pdf."

[33] *See* Rocker/Turner workpaper "P - Presidential Permit.pdf."

III. CP Control Of KCS Threatens To Impose And Shift Costs Of Implementing The Transaction On Other Railroads And Their Customers.

When we reviewed the Application, particularly the Operating Plan, we were surprised by what we did *not* see: Applicants barely discuss the impacts of their proposed transaction on lines and other critical facilities they share with other railroads. Applicants identify additional infrastructure necessary to support projected traffic growth on lines owned by CP and KCS. They describe the new investments needed to ensure their lines continue to "operate fluidly" as one of their "highest priorities."[34] But Applicants never address the new capacity that would be needed to support their projected traffic growth on the lines of other railroads—particularly UP. Nor do they commit to paying for the capacity needed to ensure their transaction does not impair fluid operations on lines owned by other railroads, much less commit to making the issue one of their highest priorities. Applicants also appear to disregard the capacity needs of other railroads operating on lines owned by KCS and CP that would experience significant traffic growth as a result of the proposed transaction. In these circumstances, the Board could not conclude the proposed transaction is in the public interest.

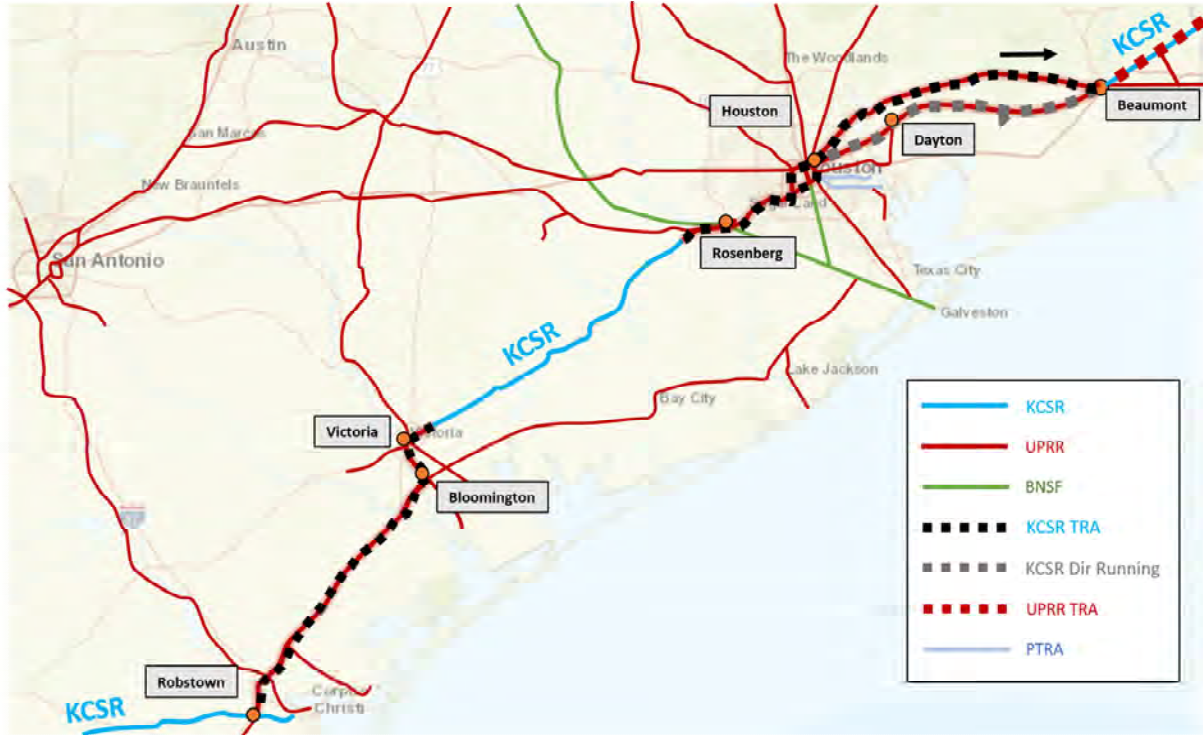
A. Applicants Failed to Evaluate the Impacts of Their Planned Operations Where They Operate Over Other Railroads.

Applicants' failure to address the impacts of their proposed transaction on joint railroad facilities is a major omission from their Application. Applicants share lines and terminal areas with other railroads all along their North-South corridor in the United States. Most significantly, KCS operations between the Laredo Gateway and the center of its hub-and-spoke operations in Shreveport, Louisiana, require use of approximately 250 miles of trackage rights over UP's lines

[34] APP Vol. 2 at 340, 344, OP Plan ¶¶ 238, 244.

between Robstown and Beaumont, Texas, including rights to operate through the crowded Houston terminal area, as shown in the figure below.

Figure 1: Texas Area KCS Trackage Rights



Applicants' post-merger plans depend critically on their use of the Robstown-Beaumont trackage rights over UP. The trackage rights are an essential link in Applicants' route between Mexico and the United States. Applicants project they will more than double KCS's current use of the lines. At the southern end of the trackage rights, from Robstown to Victoria, CPKC traffic will increase from 7.7 trains per day to 16.8 trains per day, an increase of 9.1 trains per day, or 118%.[35] On the northern portion, from Rosenberg through Houston to Beaumont, CPKC traffic will increase from 7.7 trains per day to 16.0 trains per day, an increase of 8.3 trains per day, or

[35] APP Vol. 2 at 364, OP Plan, App. A at 1.

108%.[36] Applicants do not identify any plans to invest in new capacity on any of the trackage rights lines between Robstown and Beaumont.[37] However, accommodating the traffic growth projected in the Application would require new capacity on many or all of these lines.

Robstown/Corpus Christi to West Junction. We can only conclude Applicants never studied the need for additional capacity on the trackage rights lines. Accommodating CPKC's projected traffic growth would require adding substantial new capacity on UP's lines between Robstown and Victoria and between Rosenberg and West Junction in Houston.

On the Robstown-Bloomington segment of UP's lines between Robstown and Victoria, KCS trains must share capacity with UP trains travelling between Houston, Corpus Christi, and Brownsville, and with BNSF trains moving between Houston and Robstown, where BNSF and KCS interchange Laredo Gateway traffic. UP's line between Rosenberg and West Junction is part of UP's Glidden Subdivision, which runs between San Antonio and Houston. The Glidden Subdivision is an important link in UP's Sunset Route between Southern California and New Orleans, and the Rosenberg-West Junction segment is also used by BNSF and Amtrak trains moving to and from Houston.

Currently, capacity on these lines is just sufficient to accommodate the multiple users. Over the past several years, UP has worked cooperatively with KCS to expand capacity on these lines. Since 2015, as part of an agreement with KCS, UP designed and constructed a new 9,595-foot siding near Rosenberg, a 10,100-foot siding at Placedo, Texas, extended its existing Greta and Inari sidings to 10,000-feet, constructed new run-around track at Sinton, Texas, and added Centralized Traffic Control ("CTC") between Robstown and South Odem, and between Victoria

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[36] *Id.*

[37] APP Vol. 2 at 337, OP Plan ¶ 231, Fig. 11.

and Placedo. In the same timeframe, UP also constructed the 10,400-foot Cranell siding. UP is currently planning to construct a new 15,000-foot siding called the Linn siding.

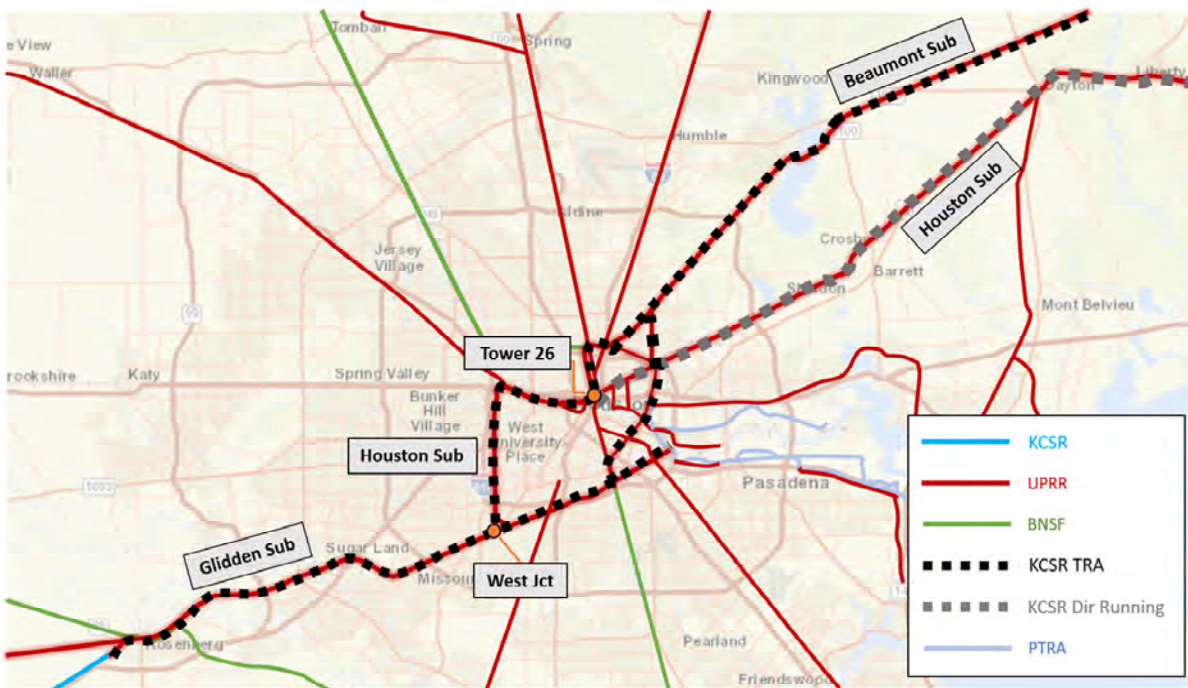
UP's recent and planned expansions of capacity on the trackage rights lines will not be enough to accommodate Applicants' additional traffic. Applicants plan to add eight or nine trains per day on the lines, more than doubling KCS's current use. To put the issue into perspective, the list of projects described above added three or four trains per day of capacity between Robstown and West Junction. Applicants would be adding new, unanticipated traffic. The additional traffic would not be offset by reductions in UP traffic, even if Applicants divert Mexico business from UP. UP moves Laredo Gateway traffic via San Antonio on routes that avoid adding congestion to the Houston terminal area. Applicants will be routing the new trains through Houston.

Houston terminal area. Applicants also fail to address the impact of their projected new traffic on operations in the Houston terminal. Houston is an extremely challenging rail operating environment, even when everything is running smoothly. Operations must be carefully coordinated among UP, BNSF, KCS, Amtrak, and the Port Terminal Railroad Association (PTRA). Time and again, UP has seen how congestion in one part of Houston can rapidly spread throughout the terminal and then across its network. UP devotes a substantial amount of time and attention to planning and executing our operating plan in Houston to prevent local and broader network issues from developing.

KCS has extensive trackage rights in Houston, allowing it to participate in the generally directional flow of traffic through the terminal and interchange traffic with the PTRA. As shown in the figure below, KCS has rights over UP's Houston Subdivision between West Junction and Tower 26, then over the West Belt, which provide KCS access to UP's Beaumont Subdivision. UP, BNSF, and KCS all use the Beaumont Subdivision for traffic moving eastbound towards

Beaumont. Amtrak uses the Beaumont Subdivision for its Sunset Limited train. KCS also has rights from the Beaumont Subdivision directly past UP's Settegast Yard on the East Belt, which connect to KCS's rights on the Glidden Subdivision. UP has also granted KCS rights to move traffic westbound on UP's Houston Subdivision, which runs past UP's Englewood Yard towards Tower 26. This provides UP's dispatchers options to move trains through Houston as efficiently as possible.

Figure 2: Houston-Area KCS Trackage Rights



Applicants plan to add more than eight trains per day to the mix, which could increase train counts on already crowded lines by 25% or more. But Applicants say nothing about how their additional trains will affect operations in Houston. They appear not to have even considered the problem. They make no commitment to invest in the capacity necessary to accommodate their expansion of service. They apparently plan simply to increase their operations and let others address the consequences. We noted that CP's Executive Vice-President Operations, Mark Redd,

was recently quoted as saying, "you can get through Houston pretty quick."[38] That is not true in our long experience with Houston, and his glib statement suggests CP does not fully appreciate the complexities of rail operations in the Houston terminal.

Additional capacity would be needed at several locations in Houston to prevent Applicants' planned jump in traffic from endangering operations in the terminal. UP has not begun to study how to most effectively mitigate the additional demands CPKC's plans would place on operations in Houston. We know from experience, however, that the terminal could not sustain the pressure of an additional eight trains per day—which would equal record volumes—on a constant basis, especially while also addressing normal surges and disruptions. Authorizing such a dramatic growth in train traffic in one of the most sensitive rail operating environments in the country without any plan or commitment to invest in new capacity would be irresponsible.

Applicants' additional trains will also impair service on the eastern end of the Houston terminal. On the eastern end, KCS has trackage rights on UP's Beaumont Subdivision and UP's Houston Subdivision between Houston and Beaumont. BNSF also uses those two lines to move its own traffic between Houston and New Orleans, and as noted above, Amtrak's Sunset Limited train operates over the Beaumont Subdivision. These two lines are fluid at current traffic levels, but both would be at or above their limit if Applicants' traffic in this corridor grows by more than eight trains per day, as is Applicants' plan.

* * *

Applicants' plan to double their train operations between Robstown and Beaumont in just three years would make addressing capacity issues even more challenging. We question whether it would be possible to complete the analysis, design, planning, permitting and construction

[38] *See* Rocker/Turner workpaper "P - Rail Group Interview.pdf."

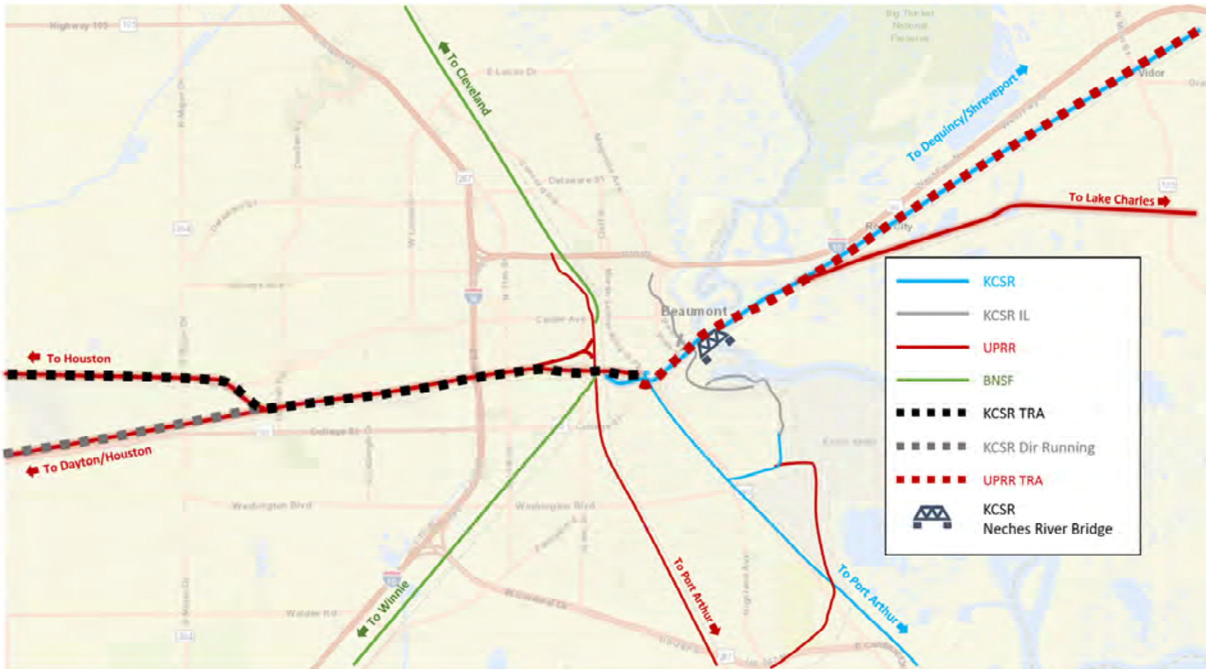
process in the timeframe set forth in the Application. As owner of the lines, our participation is critical. If the Board were to approve the proposed transaction, UP would be willing to work with Applicants to determine how to meet their need for new capacity, and we would be willing to construct new capacity and pay our fair share for any portion of the capacity we use in the future. However, UP should not be required to *subsidize* Applicants' implementation of their merger, either directly by financing the new capacity or indirectly through interference with our own service if Applicants increase their traffic before the new capacity is operational.

B. Applicants Failed to Evaluate the Impacts of Their Planned Operations Where Other Railroads Share Applicants' Lines.

Applicants' disregard for the impacts of their planned operations on others appears to extend to locations where other railroads operate on lines owned by one of the Applicants. UP is concerned by Applicants' lack of plans to add capacity in many locations, and we are particularly concerned about three locations: the Neches River bridge, the paired tracks north of Kansas City between Airline Junction and Polo, and the Twin Cities area. We discuss these three examples below.

Neches River Bridge. KCS owns the Neches River bridge. The bridge spans the Neches River at Beaumont. As shown in the figure below, UP's Beaumont and Houston Subdivisions converge at the western end of the bridge. KCS's Beaumont Subdivision and UP's Lafayette Subdivision (known as the "50/50 Line," because BNSF jointly owns the line) converge at the eastern end of the bridge. The bridge is a single-track choke point.

Figure 3: Neches River Bridge Area



UP believes the Neches River bridge is near or at the limits of its fluid capacity. UP and BNSF operate approximately 25 trains per day over the bridge. Amtrak's Sunset Limited train also uses the bridge, which limits freight operations. The bridge opens several times each day to allow river traffic to pass underneath, further reducing the time available for rail operations. Bridge capacity is also limited by the nature of railroad activity adjacent to the bridge. To the east, UP and KCS move unit trains to the Jefferson Energy Terminal. KCS trains entering and exiting the terminal block the eastern approach to the bridge. To the west, trains operate at reduced speeds over a series of converging and diverging tracks.

Applicants plan to increase traffic on KCS's Beaumont Subdivision from 8.9 trains per day to 20.3 trains per day, and increase of 11.4 trains per day, or 128%.[39] However, Applicants did not identify any need for additional bridge capacity. We believe adding more than eleven

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[39] *See* APP Vol. 2 at 364, OP Plan, App. A at 1.

trains per day to the bridge would put the bridge above any reasonable measure of fluid capacity. {

} In addition, as noted above, the bridge is not available 24-hours a day because it opens for river traffic. We also pause freight rail traffic to accommodate Amtrak trains. Applicants may be reluctant to acknowledge the issue. Adding capacity to the Neches River bridge might be a costly, time-consuming undertaking. But even if Applicants were willing to accept poor service due to an over-capacity bridge, they should not be allowed to impose and shift those costs on UP, BNSF, and Amtrak as the price of their transaction.

Kansas City and the Polo Line. UP has similar concerns with Applicants' failure to provide for capacity investment on the Polo Line. CP and UP access Kansas City from the north using paired tracks over approximately 42 miles between Airline Junction in Kansas City and a location on CP's Kansas City Subdivision called Polo. UP operates approximately eight trains per day on the Polo Line. Applicants plan to increase traffic on CP's Kansas City Subdivision from 2.9 trains per day to 16.9 trains per day, an increase of 14 trains per day, or nearly 500%.[40] However, Applicants did not identify any plan to add capacity on the Polo Line.

CP controls dispatching of the Polo Line. Recently, UP has been forced to invoke the parties' contractual dispute resolution procedure to address persistent dispatching issues. UP is concerned that the problems it experiences when CP operates only three trains per day over the

[40] *See* APP Vol. 2 at 364, OP Plan, App. A at 1.

line would multiply if CPKC operated nearly 17 trains per day over the line. Most lines serving the Kansas City terminal are dispatched by the Kansas City Terminal Railway from a joint dispatching center. The Polo Line is dispatched by a CP employee from a drawbridge near Airline Junction. Although the Polo Line consists of two tracks, the tracks are not operated like double-track lines. Over a long portion of the joint facility, the two tracks are far apart, so trains cannot cross from one line to the other to maximize efficient use of both lines. Each line is generally operated in one direction only. In addition, although the line has a version of Centralized Traffic Control, the system does not allow for full CTC operations, which prevents true centralized dispatching and prevents UP and CP from maximizing capacity on one of the paired tracks when the other is out of service. In light of Applicants' plan to increase traffic by more than 14 trains per day on the Kansas City Subdivision, UP expected some provision for improving the Polo Line. This appears to be another situation in which Applicants have not accounted for shared facilities in planning the proposed transaction.

Twin Cities. Applicants' apparent failure to account for the impacts of their proposed transactions on other railroads' operations extends to their plan for operations in the Twin Cities. Applicants tout their plan to route traffic around Chicago. However, Applicants' plan to route traffic around Chicago will increase the number of trains moving through St. Paul on CP's River Subdivision from 11.9 trains per day to 18.1 trains per day, an increase of 6.2 trains per day, or 52%.[41] But Applicants do not propose adding capacity in St. Paul.[42]

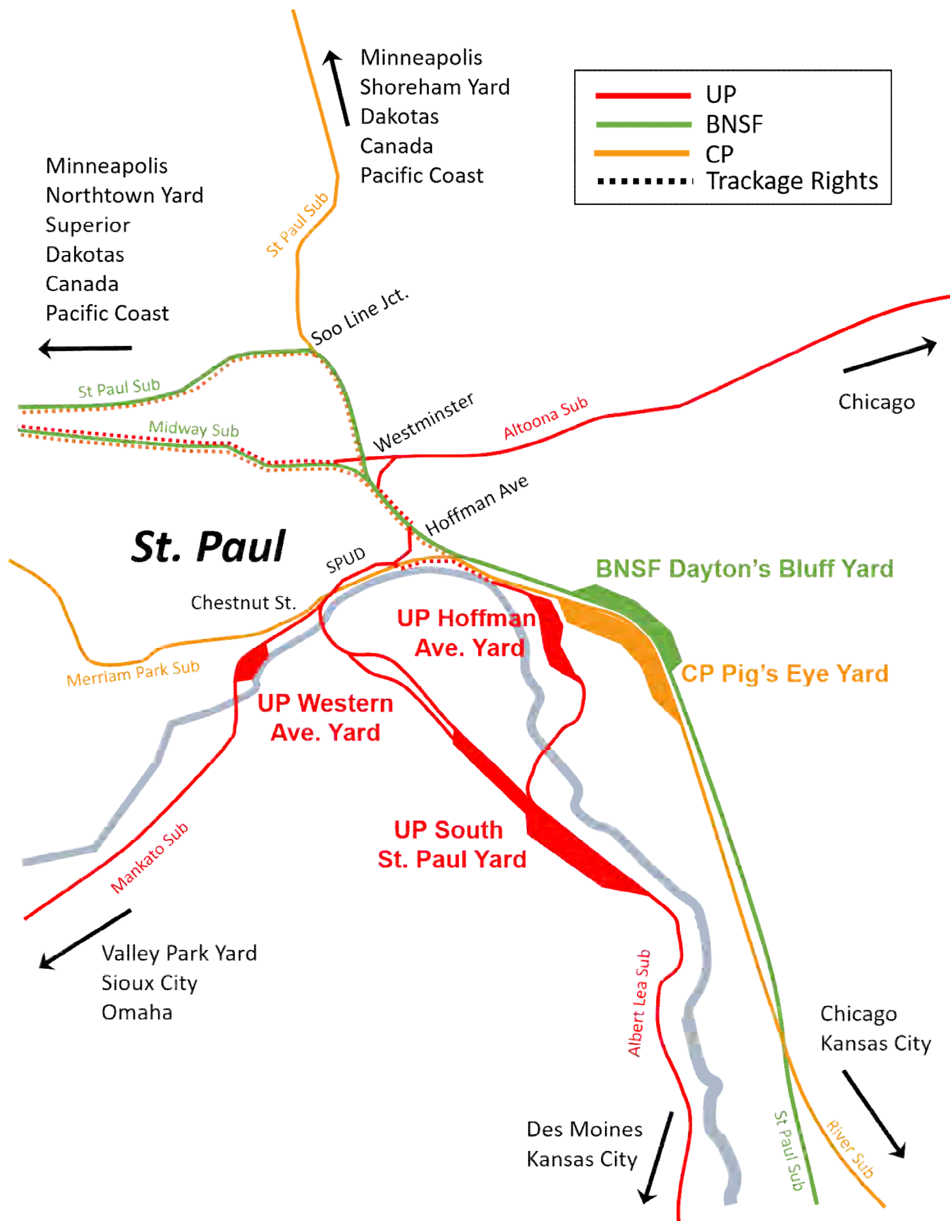
St. Paul can become extremely congested under current conditions. As shown in the figure below, CP's River Subdivision converges with BNSF's St. Paul Subdivision near CP's

[41] *See* APP Vol. 2 at 364, OP Plan, App. A at 1.

[42] *See* APP Vol. 2 at 337, OP Plan ¶ 231, Fig. 11.

Pig's Eye Yard and BNSF's Dayton's Bluff Yard. North of those yards, CP and UP operate using trackage rights on BNSF to connect between their own lines through St. Paul. Specifically, CP uses the rights for its route between Canada, the Dakotas, and Chicago, while UP uses the rights for traffic moving between our Albert Lea Subdivision, Altoona Subdivision, and Mankato Subdivision, and to reach several yards we use in St. Paul.

Figure 4: St. Paul Area



Unless Applicants construct additional capacity, something will have to give. Applicants would be unable to route as many new trains through St. Paul as they plan, because their trains would be blocked by other trains moving through the area. If Applicants did get their new trains through, they would be blocking UP (and BNSF) movements through St. Paul, forcing UP to add capacity to prevent its waiting trains from interfering with our other operations in the terminal. The Board should require Applicants to address the impacts of their proposed transaction in St. Paul, rather than allowing them to ignore the issue and potentially saddle others with the costs.

Other locations. UP's concerns about Applicants' lack of planning, or their lack of regard for the impacts their proposed transaction would have on UP and other railroads, are not limited to the specific areas discussed above. Applicants project significant traffic growth in Shreveport—nearly twelve additional trains per day moving through the terminal[43]—which they describe as the central "hub" of KCS's U.S. operations.[44] Both UP and BNSF use trackage right over KCS in Shreveport as part of their North-South routes between Houston and Chicago. Applicants do not address the impact of their projected traffic growth on the capacity available to UP and BNSF. Applicants also project significant traffic growth on CP's Davenport Subdivision, which crosses UP's Transcontinental main line in Clinton, Iowa, just after UP's main line passes west over the Mississippi River. Applicants do not address how their 300% growth in traffic, from 7.1 trains per day to 21.6 trains per day,[45] would affect this busy spot. In these and other

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[43] APP Vol. 2 at 364, OP Plan, App. A at 1.

[44] APP Vol. 2 at 275, OP Plan ¶ 49.

[45] APP Vol. 2 at 364, OP Plan, App. A at 1.

locations where Applicants' merger-related traffic growth would impinge on the operations of other railroads, Applicants ignore the problem.

C. UP's Proposed Capacity Investment Condition Is Narrowly Tailored to Ensure the Proposed Transaction Is in the Public Interest.

Applicants have not provided sufficient information about their operating plans for the Board to conclude the proposed transaction is in the public interest. They have not acknowledged the harmful impacts of their merger-related traffic growth, much less committed to mitigating those impacts by investing in new capacity required to implement their plans.

If the Board nonetheless authorizes the CP/KCS transaction, UP urges the Board to impose a condition to ensure Applicants' plans are in the public interest. The condition should establish three principles: *First*, Applicants must work with owners and other users of rail lines and other rail facilities that will be used jointly by CPKC to identify investments in new capacity necessary to accommodate Applicants' planned traffic growth. *Second*, Applicants must commit to fund necessary investments in new capacity, with other railroads paying their fair share to the extent they also use the new capacity in the future. *Third*, Applicants must commit not to increase CPKC operations on affected lines above pre-merger CP or KCS levels *until* the owners of the lines agree sufficient capacity has been added to accommodate the traffic growth. The Board would remain available to resolve disputes at any stage of the process.

UP's request is narrow. It would not prevent Applicants from implementing any plans set forth in their Application. However, Applicants failed to address a critical aspect of their plans—the costs they would impose on others. UP's proposed condition would ensure it is not required to subsidize Applicants' transaction.

VERIFICATION

I, Kenny Rocker, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on February 27, 2022.

/s/ Kenny Rocker

VERIFICATION

I, John Turner, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on February 27, 2022.

/s/ John Turner

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

VERIFIED STATEMENT

OF

STEVEN C. SALOP

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1. Qualifications and Assignment

1.1 Qualifications

1. I am Professor of Economics and Law and Georgetown University Law Center, where I teach courses in antitrust economics and law. I am also a Senior Consultant at Charles River Associates. My research and consulting focuses on antitrust, competition and regulation. I have written articles in various areas of antitrust and competition economics, law and policy with various co-authors. These articles have analyzed various economic, policy and legal issues in vertical and horizontal mergers, joint ventures, exclusionary and coordinated conduct. I have also written articles with various co-authors on the competitive effects of imperfect information, oligopoly interaction, network effects and monopolistic competition.

2. My work on the economic analysis and competitive effects of vertical mergers, as well as vertical merger enforcement policy and law, includes articles with various co-authors published in the American Economic Review, Yale Law Journal, Antitrust Law Journal, and the Review of Industrial Organization, among others. I was the lead panelist on the Vertical Merger panel at the FTC antitrust hearings in 2018. Along with several co-authors, I provided comments on the draft Vertical Merger Guidelines in March 2020. I have also written about the shortcomings of those Guidelines, which are now in the process of being revised. I have provided economic consulting on numerous vertical mergers with the Antitrust Division of the Department of Justice, merging parties, and third parties concerned with adverse competitive effects of specific vertical mergers.

3. I earned a BA degree at University of Pennsylvania, Summa Cum Laude in 1968 and a PhD in Economics from Yale University in 1972. Before joining the faculty of the Georgetown Law Center, I was a staff economist at the Federal Reserve Board, the Civil Aeronautics Board, and the Federal Trade Commission (FTC). At the FTC, I also served as the Assistant Director for Industry Analysis and the Associate Director for Special Projects. I have been honored with lifetime achievement awards from the Association of American Law Schools (AALS) Section on Antitrust & Economic Regulation (in 2019) and the American Antitrust Institute (in 2010). My Curriculum Vitae is attached at Appendix A.

1.2 Assignment

4. I am providing this statement at the request of Union Pacific Railroad Company (UP) in connection with the Surface Transportation Board's review of the proposed acquisition of control of Kansas City Southern (KCS) by Canadian Pacific (CP). I have been asked to focus on the effects of the transaction on competition for rail movements between the United States and Mexico through the Laredo gateway. UP relies on a KCS subsidiary, Kansas City Southern de México (KCSM), to transport a significant amount of U.S.-Mexico cross-border rail traffic south of Laredo.

5. I have been asked by counsel for UP to address several issues: (a) the applicability of the one-lump theory to the proposed merger; (b) whether the proposed merger raises substantial concerns of causing anticompetitive effects from foreclosure; and (c) whether there is an administrable methodology that the Board could require the post-merger firm to employ in order to set commercially reasonable interline rates, to prevent anticompetitive foreclosure.

2. Introduction and Executive Summary

6. This proceeding involves the proposed combination of CP and KCS. CP's network in Canada extends from the Port of Vancouver on the Pacific Coast to the Port of Saint John on the Atlantic Coast, and its network in the United States includes connections to Minneapolis, Chicago, Detroit, and Kansas City. KCS's operations center is in Shreveport, and its lines extend north to Kansas City, west to Dallas, east to Meridian, southeast to New Orleans, and south to Beaumont, Corpus Christi, the Laredo gateway, and Mexico. The rail networks of KCS and CP connect at Kansas City.

7. KCSM operates between Laredo (and Brownsville) and the industrial heartland of Mexico under a franchise obtained from the Mexican government. In 2005, KCS acquired a controlling interest in KCSM's predecessor, Transportación Ferroviaria Mexicana (TFM). At about the same time, KCS acquired control of the Texas Mexican Railway (TM). TM had rights to operate on UP lines between a connection with KCS in Beaumont and Corpus Christi, and TM owned its own line between Corpus Christi and Laredo.

8. UP has routes throughout the western United States, including an independent route between Laredo and the Upper Midwest. UP owns a 26% passive interest in Ferrocarril Mexicano (FXE), but has no control over FXE's operations or pricing.

9. UP and KCSM interchange a substantial amount of traffic at Laredo, including large quantities of finished automobiles and automobile parts moving between Mexico and the Upper Midwest. UP does not have its own rail lines in Mexico, and relies on KCSM's lines. At the same time, KCS's route north of Laredo is less efficient than UP's, and KCS does not have lines serving the Upper Midwest. KCS also has an alternative to UP: it moves traffic between Laredo and Corpus Christi, where it interchanges with BNSF Railway. BNSF has its own extensive network in the western United States. Shippers also can use KCS to move traffic between Laredo and Kansas City, where KCS can hand it off to CP. KCS also connects with other railroads at other points on its network.

10. In seeking authority to merge, CP and KCS emphasize the combined company's potential ability to divert a significant amount of traffic from KCSM-UP routes and KCSM-KCS-BNSF routes to single-line routes of the combined railroad (CPKC). My analysis mainly focuses on how CPKC can achieve such diversion by foreclosure arising from higher rates being charged to customers of carriers interlining with KCSM on movements between Mexico and the U.S., via the Laredo gateway.

11. Although the Board has traditionally relied on the "one-lump" theory to presume that end-to-end mergers are procompetitive, my economic analysis summarized in this report leads to the conclusion that the one-lump theory does not support such a presumption in this matter. Modern economic theory has recognized that the one-lump presumption does not apply under certain market conditions, in particular, when (a) the market participants sell differentiated products (i.e., products that shippers do not view as perfect substitutes at equal rates), or (b) the carriers set their rates based on imperfect information about each other's costs and rates. Both of these deviations from the conditions that are necessary to sustain the one-lump theory are present in the markets that will be affected by the proposed transaction. My report provides a series of models and examples based on the economics literature to illustrate these market conditions under which the theory does not apply and the impact that deviations from those conditions will have on the reliability of the presumption in this matter.

12. When the one-lump theory does not apply, an end-to-end merger between a monopoly carrier on one segment and one of the competing carriers on the other segment may have anticompetitive effects. I further conclude that this merger raises serious concerns about the likelihood of such effects on rates and service for shippers using the Laredo gateway. Absent an effective remedy, the merged firm will have both the incentive and the ability to implement anticompetitive strategies that foreclose competitors such as UP and BNSF that rely on interlining with KCSM. Specifically, CPKC will have the incentive and ability to drive traffic to CPKC by raising the rates that KCSM charges for interline movements on

routes where KCSM has an effective monopoly and CPKC competes with UP. As a result of the merger, foreclosure will generate incremental revenue and profits earned by the merged firm on those routes where KCS can interline with CP, over and above what KCS would earn before the merger if it foreclosed UP and BNSF with higher rates. By foreclosing competition from UP and BNSF with these higher rates, CPKC also will be able to raise its own rates and harm shippers. Thus, the post-merger foreclosure incentives rise above the level of any pre-merger incentives.

13. The evidence presented later in this report indicates substantial foreclosure concerns from the proposed CPKC merger. Two examples focused on movements between Chicago and Mexico of finished automobiles and automobile parts show that a hypothetical foreclosure strategy of KCSM charging UP prohibitive rates for these interline movements would be profitable for the merged firm. The merged CPKC would have an increased incentive and ability to raise KCSM interline rates due to the addition of the revenue and profits earned on the CP portion of diverted shipments.

14. Applicants attempt to allay concerns about foreclosure through the expert report of Dr. Robert Majure. He concedes that an end-to-end merger is capable of impairing competition in some circumstances. But Dr. Majure does not describe or explain those circumstances, nor does he analyze foreclosure concerns in depth to demonstrate that those concerns are not present here. Instead, Dr. Majure seems to assume that there must be *no incentive* for a vertically integrated monopolist to foreclose in this case because it must already be capturing all the monopoly profits without foreclosure and without the merger. But Dr. Majure provides no data or analysis to support that assumption. Instead, he attempts to dismiss the possibility of foreclosure by claiming that the prior acquisition by KCS of TM and KCSM's predecessor, TFM, which brought KCS control of the Laredo gateway, did not result in foreclosure. But the only data that Dr. Majure provides to support this claim is a snapshot of northbound traffic shares from 2019, fifteen years after the merger. Dr. Majure's analysis of that limited data sample lacks probative value, however, because it is equally consistent with a finding of "some foreclosure" as with "no foreclosure." Dr. Majure specifically does not address whether the shares he observes would have been different but-for the merger. He also fails to explain why the merger would not increase the foreclosure incentives in light of the ability to capture additional revenue and profits on the CP portion of diverted movements.

15. Dr. Majure also asserts that a vertically integrated merged carrier would have no *ability* to foreclose an unintegrated rival carrier to the detriment of shippers, if that rival can obtain interline service from another unintegrated carrier. To support this assertion, Dr. Majure suggests that shippers could discipline anticompetitive behavior by a post-merger KCSM by

turning to FXE for movements between Mexico and the U.S. However, he offers no evidence that FXE actually provides a viable option for all (or even most) shippers using KCSM. He also fails to address Applicants' economic incentive to raise rates on interline routes, even when shippers might feasibly use FXE, because he fails to acknowledge that CPKC could reasonably anticipate that FXE would raise its own rates in response, thus accommodating CPKC's rate increase and providing CPKC with a reinforcing incentive to raise its rates.

16. Applicants' witnesses Brown and Zebrowski state that the merged firm will be able to divert traffic from UP and others by reducing its costs and increasing its service quality.[1] Their formulation also essentially concedes an ability to foreclose. That is, if a merged firm with a monopoly on one segment can divert traffic by reducing its own costs, then it normally also can divert traffic by raising its rivals' costs. Reducing its own costs allows the firm to gain traffic by decreasing its rates, while raising rivals' costs allows the firm to gain traffic by causing the rivals to increase their rates. After the merger, CPKC can raise rivals' costs by raising the rates it charges for interline movements with those rivals.

17. Vertical mergers can also lead to downward pricing pressure from elimination of double marginalization (EDM). However, to whatever extent EDM may be a significant factor in this matter — and Applicants' submissions, including Dr. Majure's statement, do not suggest that it will be a significant (if any) factor — there is no reason to expect that any such downward pricing pressure from EDM would completely offset and reverse the upward pricing pressure from foreclosure incentives. Although Applicants' experts Brown & Zebrowski have claimed that the merger will result in efficiency benefits, they also assume that diversions from competing interline routes will not be the result of rate decreases. Moreover, UP witnesses have opined that the efficiencies that the parties claim from the transaction are overstated and that the merged firm will have to grow their single-line traffic and revenues by foreclosing, rather than by increasing competition.[2]

18. If the Board is inclined to approve the transaction, it would need to impose a remedy to prevent such harms. One potential behavioral remedy would be to require that when a shipper asks the merged firm to provide a rate for KCSM service that could be used as part

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[1] *Verified Statement of Richard W. Brown and Nathan S. Zebrowski* (October 29, 2021) (*hereinafter*, Brown & Zebrowski V.S.) at ¶¶5, 7, 11 in CPKC Application, *Canadian Pac. Ry. Corp.—Control & Merger—Kansas City. S.* (F.D. 36500) (*hereinafter*, APP).

[2] *See generally Verified Statement of Thomas C. Haley* (February 25, 2022) (*hereinafter,* Haley V.S.); *Verified Statement of Kenny Rocker and John Turner* (February 27, 2022) (*hereinafter*, Rocker & Turner V.S.). These statements, along with this one, are being submitted as part of Union Pacific's Comments on the APP.

of an interline rate with UP and a rate for CPKC single-line service on a competitive origin-destination route, the merged firm must provide the shipper a rate for KCSM service using the type of formula presented in this report for developing competitively reasonable Rule 11 rates. The Board should also protect against non-rate-based methods of foreclosure by requiring the merged firm to refrain from unilaterally changing operations affecting interline traffic moving via the Laredo gateway.

19. Specifically, I suggest that the Board consider the following administrable, readily enforceable formula for developing competitively reasonable Rule 11 rates: The Applicants state that "when a customer requests a rate for only the former-CP or former-KCS portion of an origin-to-destination routing, we will provide the shipper with a Rule 11 rate to the gateway."[3] Using this language, when a shipper asks CPKC to provide a rate for CPKC service on only former-CP or former-KCS/KCSM portions of an origin-to-destination route, and a rate for CPKC single-line service on a competitive route, the merged firm must provide a Rule 11 rate for the former-CP or former-KCS/KCSM portions that reflects a mileage-based prorate of its CPKC single-line rate. The prorate would be equal to the ratio of (a) the miles of the merged firm from the origin point to the interchange point to (b) the miles of the merged firm from the origin to the interchange *plus* the miles of the merged firm from the interchange point to the destination point. As I explain in detail below, this remedial approach allows the merged firm and shippers to obtain the benefits of the transaction, while at the same time protecting shippers from harm.

20. The remainder of this report is organized as follows. Section 3 explains why modern economic analysis rejects the one-lump theory in the circumstances presented by the proposed transaction. It also sets out general conditions under which end-to-end mergers have anticompetitive effects and the reasons why there are serious concerns of anticompetitive effects on routes where there is a monopolist on one segment and competition on the other, so that a procompetitive policy presumption would not be appropriate in this matter. Section 4 briefly explains why modern economic analysis does not support the view that the presence of a competing interline option like FXE would eliminate the ability and incentive of an integrated carrier to foreclose competition from a downstream rival. Section 5 provides empirical analysis that confirms that the merger raises substantial foreclosure concerns. Section 6 explains why Dr. Majure's analysis of the likely competitive effects of the proposed CPKC merger lacks probative value. Section 7 describes a prescribed formula for developing commercially reasonable Rule 11 rates for the monopoly segment of interline movements. The Appendices present details of the technical

[3] APP., *Verified Statement of John Brooks* (October 29, 2021) (*hereinafter*, Brooks V.S.) at ¶46.

economic analysis and models, as well as my Curriculum Vitae and a list of materials relied upon.

3. Modern Economic Analysis Rejects the Application of the One-Lump Theory to the Proposed Merger

21. The Board historically has relied on the "one-lump" theory to presume that end-to-end mergers with a monopolist in one segment and competition in the other segment will *not* cause competitive harm. In fact, the theory assumes that an end-to-end merger will have no economic effects on profits or rates. In analyzing petitions in opposition to the merger of the Burlington Northern Railroad and the Atchison, Topeka and Santa Fe Railway in 1997, the D.C. Circuit characterized the one-lump theory as a "broadly accepted economic proposition."[4] However, as discussed in detail in this section, the one-lump theory is not broadly accepted today. In fact, modern economic analysis makes it clear that it applies only under very limited market conditions that are not present in the case of the CPKC merger.

22. The economic underpinning of the one-lump theory in rail transport is the so-called "single monopoly profit" theory developed in the early industrial organization economics literature analyzing tying[5] and then applied to vertical mergers.[6] In this economic model applied to vertical mergers, one firm has a monopoly in producing an "input," while there is perfect competition among the competing firms, (*i.e.*, two or more firms with perfect information producing an undifferentiated (homogeneous) "output") that use the input and sell that output to consumers.[7] According to this theory, the monopolist would not need to acquire one or both of the competitors in the output market in order to be able to extract all of its input monopoly profits from consumers. That is, the acquisition does not change anything,

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[4] Western Resources, Inc. v. Surface Transp. Bd., 109 F.3d 782, 788 (D.C. Cir. 1997).

[5] Ward S. Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L. J. 19 (1957). *See* also Aaron Director & Edward H. Levi, *Law and the Future: Trade Regulation*, 51 NW. U. L. REV. 281 (1956); M.L. Burstein, *The Economics of Tie-in Sales, 42* REV. ECON. & STAT. 68 (1960).

[6] R.H. Bork, THE ANTITRUST PARADOX 229 (1978).

[7] The logic of this "vertical" merger model also applies to mergers of complementary products. In that version, there is a monopoly producer of one of the complements and multiple competitors for the other complement. Consumers purchase a bundle of the two complementary products.

absent efficiencies, because there is only "one lump" of monopoly profits that can be extracted by the monopolist, and it can do so either with or without the acquisition.[8]

23. Even assuming that the theory could apply in some circumstances, it is important to recognize that the theory relies on several very restrictive assumptions about markets that greatly limit its applicability to transactions such as the proposed CPKC merger. Modern academic work has confirmed these limitations.[9] As detailed in this report, when there is an upstream monopolist, there are market conditions in which the single monopoly profit theory is upended. These involve conditions under which the competing downstream firms earn a positive margin over costs, arising from the fact that the companies are selling differentiated products or operating with imperfect information regarding each other's prices and costs.[10]

[8] As stated by the ICC in a 1982 decision, "[A] carrier with a destination monopoly will likely push the through rate as high as possible and keep the monopoly profits to itself by playing off competing connecting carriers against one another in setting divisions. That is, the through rate will be at the level maximizing net revenue for the traffic, subject to regulatory limits, and the destination carrier will establish favorable through service with the origin carrier willing to take the lowest division of the through rate for its segment of the movement." *See Union Pac. Corp. —Control— Missouri Pac. Corp*, 366 I.C.C. 462, 538 (1982). The Applicants in the Burlington Northern/Atchison Topeka and Santa Fe merger referred to this as the "one-lump" theory. *See Burlington Northern, Inc.—Control & Merger—Santa Fe Pac. Corp.*, 10 I.C.C.2d 661,749 (1995). *See* also *Western Resources, Inc. v. Surface Transp. Bd.*, 109 F.3d 782, 787 (D.C. Cir. 1997).

[9] *See, e.g.,* Louis Kaplow, *Extension of Monopoly Power through Leverage*, 85 COLUM. L. REV. 515 (1985); Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV.837 (1990); Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J. 513 (1995); Dennis W. Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, 33 RAND J. ECON.194 (2002).

[10] Another general situation involves contractual negotiations with pre-payments, when the upstream monopoly firm negotiates input prices that contain lump sum payments (or take-or-pay contracts or large volume rebates) with each of the two competing downstream firms selling homogeneous products and the price terms offered to one competitor are not observed by the other competitor. In this negotiation structure, the monopoly carrier may be unable to implement the monopoly outcome in the pre-merger market because each firm will fear that the monopolist will opportunistically offer the other firm a better deal, which makes each firm unwilling to agree to the contract terms. However, by acquiring one of the competing carriers and foreclosing the unintegrated carrier, the vertically integrated carrier is able to charge the full monopoly price and earn monopoly profits. Hart & Tirole (1990) describe this result when the monopoly carrier makes take-it-or-leave-it contract offers, rather than engaging in bilateral bargaining. *See* Oliver Hart & Jean Tirole, *Vertical Mergers and Market Foreclosure*, BROOKINGS PAPERS ON ECONOMIC ACTIVITY – MICROECONOMICS 208 (1990). For a scenario with differentiated products and two-part tariffs, *see* R. Preston McAfee & Marius Schwartz, *Opportunism in Multilateral Vertical Contracting: Nondiscrimination, Exclusivity and Uniformity*, 84 AM. ECON. REV. 219-21 (1994).

24. Moreover, the results of modern economic analysis lead to greater concerns that vertical mergers will result in anticompetitive effects.[11] This highlights the need to take the limitations of the one-lump theory into account when determining whether to apply its presumption in a given case.

25. Similarly, vertical merger enforcement today also avoids presuming, based on the single monopoly profit theory, that all such mergers are procompetitive. For example, there have been three recent FTC vertical merger enforcement actions – Illumina/Grail,[12] NVIDIA/ARM,[13] and (most recently) Lockheed Martin/Aerojet Rocketdyne[14] – and a previous DOJ investigation (LAM/KLA) [15] that each involved allegations that the upstream

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[11] *See, e.g.*, Marissa Beck & Fiona Scott Morton, *Evaluating the Evidence on Vertical Mergers*, 273 REV. IND. ORG. (2021); Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 YALE L.J. 1962 (2018); Gregory S Crawford, Robin S. Lee, Michael D. Whinston & Ali Yurukoglu, *The Welfare Effects of Vertical Integration in Multichannel Television Markets*, 86 ECONOMETRICA 891 (2018); Jonathan B. Baker, *Taking the Error out of "Error Cost" Analysis: What's Wrong with Antitrust's Right*, 80 ANTITRUST L.J. 1, 15-17 (2015); Jonathan B. Baker, *Exclusion as a Core Competition Concern,* 78 ANTITRUST L.J. 527 (2013); Serge Moresi & Steven C. Salop, *vGUPPI: Scoring Unilateral Pricing Incentives in Vertical Mergers,* 79 ANTITRUST L.J. 185 (2013); Jay Pil Choi, *Mergers With Bundling in Complementary Markets*, 61 J. IND. ORG. 553, 556 (2008); Yongmin Chen, *On Vertical Mergers and Their Competitive Effects*. 32 RAND J. ECON 667 (2001); Patrick Rey & Jean Tirole, *A Primer on Foreclosure*, *in* 3 HANDBOOK OF INDUSTRIAL ORGANIZATION 2145 (Mark Armstrong & Robert H. Porter eds., 2007); Michael H. Riordan, *Competitive Effects of Vertical Integration*, *in* HANDBOOK OF ANTITRUST ECONOMICS 145 (Paolo Buccirossi ed., 2008); Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J. 513 (1995); Janusz A. Ordover, Garth Saloner & Steven C. Salop, *Equilibrium Vertical Foreclosure*, 80 AM. ECON. REV. 127 (1990); Michael Salinger, *Vertical Mergers and Market Foreclosure*, 103 Q.J. ECON. 345 (1988); Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209 (1986).

[12] *FTC Challenges Illumina's Proposed Acquisition of Cancer Detection Test Maker Grail*, Federal Trade Commission Press Release (March 30, 2021), https://www.ftc.gov/news-events/press-releases/2021/03/ftc-challenges-illuminas-proposed-acquisition-cancer-detection.

[13] *FTC Sues To Block $40 Billion Semiconductor Chip Merger—Vertical deal between chip supplier Nvidia and chip design provider ARM*, Federal Trade Commission Press Release (December 2, 2021), https://www.ftc.gov/news-events/press-releases/2021/12/ftc-sues-block-40-billion-semiconductor-chip-merger.

[14] *FTC Sues to Block Lockheed Martin Corporation's $4.4 Billion Vertical Acquisition of Aerojet Rocketdyne Holdings Inc*. Federal Trade Commission Press Release (January 25, 2022), https://www.ftc.gov/news-events/press-releases/2022/01/ftc-sues-block-lockheed-martin-corporations-44-billion-vertical.

[15] *Lam Research Corp. and KLA-Tencor Corp. Abandon Merger Plans*, Department of Justice Press Release, October 5, 2016, https://www.justice.gov/opa/pr/lam-research-corp-and-kla-tencor-corp-abandon-merger-plans; *See* also *The Interesting Case of the Vertical Merger*, Jon Sallet, Deputy Assistance Attorney General for Litigation at Department of Justice Antitrust Division, Remarks as

firm was dominant and that the post-merger firm could use foreclosure strategies to undermine downstream rivals, to the detriment of consumers. The DOJ and FTC also issued new Vertical Merger Guidelines (VMGs) in June 2020 that did not adopt the single monopoly profit theory and did not presume that vertical mergers involving a monopolist in one market are procompetitive, merger guidelines that now are being revised to correct what the Agencies have characterized as legal and economic errors.[16]

3.1 The Limited Applicability of the One-Lump Theory

26. In this section, I illustrate the one-lump theory and its limitations in a concrete way, by considering the situation where one railroad has a monopoly on one segment of a through movement and merges with one of the two railroads that compete on the other segment to complete the movement. This scenario is illustrated below in Figure 1, which shows a through movement from an origin (O) through a common interchange point (I) to a destination (D). I denote Railroads X and Y as the "originating" carriers, each having routes from O to I. Railroad A is the "destination" carrier. It is a monopolist on the segment from I to D. In the through pricing model,[17] the shipper asks the originating Carriers X and Y for through rate quotes for the entire movement, and X and Y each obtains a (dollar) "division" from destination Carrier A for carriage on the destination segment.[18] Following the use of

Prepared for Delivery at ABA Fall Forum (November 17, 2016), https://www.justice.gov/opa/speech/file/938236/download.

[16] U.S. Department of Justice and The Federal Trade Commission, *Vertical Merger Guidelines* (June 30, 2020), available at https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf. U.S. Department of Justice and The Federal Trade Commission, *Request for Information on Merger Enforcement* (January 18, 2022) at n.3, available at https://www.justice.gov/opa/press-release/file/1463566/download.

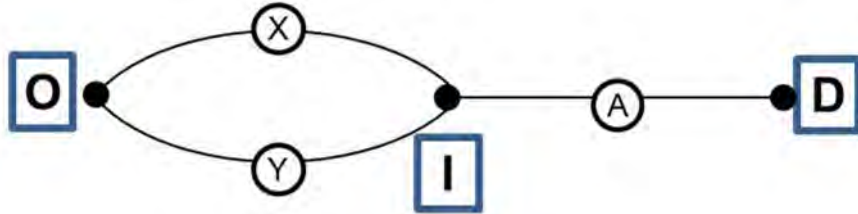
[17] This through pricing framework is the typical economics framework for vertical mergers. In this framework, the monopoly carrier is providing an "input" to the competing carriers, who then sell an "output" (i.e., interline service from O-to-D) to the shippers. Applying the jargon of inputs and outputs, the economics framework typically would refer to the monopoly carrier as "upstream" (*i.e.*, selling an input) and the competing carriers as "downstream" (i.e., selling the "output" to the customer). Most of the economic literature on vertical mergers applies this through pricing (e.g., upstream monopolist and downstream competitor) framework. The economic analysis of mergers of firms producing complementary products is analogous. *See* U.S. Department of Justice and The Federal Trade Commission, *Vertical Merger Guidelines* (June 30, 2020) at 9.

[18] This same framework obviously would carry over exactly to a movement in the opposite direction where the shipper asks Railroads X and Y for through rate quotes.

the term in the industry, Carrier A's *division* is the price or rate it gets for carrying the freight from I to D. [19]

27. If the one-lump theory holds, an acquisition by Carrier A of (say) Carrier X, will not have any anticompetitive effects. This is because Carrier A is presumably already extracting its full monopoly profit by charging a high (dollar) division for its I-to-D segment that is equal to the "one monopoly lump," and the acquisition therefore cannot increase its ability to exploit its market power.

Figure 1:
Illustration of Railroad Interconnection With a Monopolist on One Segment



28. Referring to Figure 1, assume that the two competing carriers (X and Y) on the originating segment O-I sell a homogenous product with identical marginal costs and compete solely on the basis of rates. Also assume that each carrier has perfect information about the other carriers' rates and costs for the movement at issue. Monopoly Carrier A has a marginal cost of $150.[20] Further suppose the competing Carriers X and Y, provide undifferentiated transportation, do not conspire with each other, and have identical marginal costs of $100. Assume also that the shipper has an alternative to rail transport that it would choose if the cost of rail transport were more than its "reservation price" of $400.[21] Thus, the $400 reservation price is the "monopoly" through rate.

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[19] The division is treated as a dollar amount, not an agreed-upon fraction of whatever through rate is charged by the destination carrier. I understand the terminology developed when railroads used to establish divisions as a percentage of the through rate charged to the shipper.

[20] The marginal cost includes a competitive return on investment.

[21] The shipper's reservation price thus is the maximum through rate it is willing to pay, and would shift to another transportation mode or corridor if the quoted through rate exceeds this level.

29. Under these assumed conditions, competition between Carriers X and Y would drive their rate down to their marginal costs of $100.[22] Because Carrier A knows that Carriers X and Y will set their rates at $100 and also knows the shipper's reservation price, monopoly Carrier A would maximize its profits by charging a rate of $300 for its segment. The shipper would pay a total through rate equal to $400 (i.e., A's $300 monopoly price plus X's or Y's $100 rate).[23] This is equal to the shipper's reservation price. The monopoly carrier would earn a profit (i.e., price less marginal costs) of $150 (i.e., $300 - $150).

30. Under these assumed, perfect conditions, Carrier A's acquisition of Carrier X (and/or Carrier Y) would affect neither the total through rate paid by the shipper, nor Carrier A's profit.[24] Carrier A/X would earn the same profit regardless of whether it offered a single-line rate at $400 or its former division rate of $300 for its segment. In the case of a single-line rate, Carrier A/X would earn $400, while incurring the variable costs of $250 (i.e., $100 +$150) from handling the traffic on both segments, for a profit of $150 (i.e., $400 - $250) — the same amount it could earn by agreeing to its former division of $300 and costs of $150 to move the traffic over the I-to-D segment. Thus, according to the one-lump theory, Carrier A would not increase its profit if it foreclosed competition from Carrier Y, either by refusing to interline with Carrier Y or by raising its required division.[25]

31. This example rests on several assumptions, however, that make it apply only to very limited market conditions. It assumes that Carrier A is, in fact, already extracting its single monopoly profit, that is, there are no obstacles that prevent the pre-merger Carrier A from successfully earning that monopoly profit. To reach these results, it assumes that the

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[22] If either carrier offers a rate at some level above $100, the other carrier would undercut it. The model assumes that there is no collusion. The marginal costs include a competitive return on investment.

[23] The economics literature generally uses the term "prices" instead of "rates." I will use the terms interchangeably in this report.

[24] When all the other assumption are made, the one-lump theory still can apply if the shipper has elastic demand. For example, suppose that the shipper would choose to move two units by train if the total through rate were $390 per unit. Then, the monopoly carrier would set the division equal to $290 per unit and the two competing carriers would set through rates of $390 per unit. Because there is perfect competition between the two competing carriers, the monopoly carrier has no incentive to merge with one of the two competing carriers and, if it did, the merger would have no effect on the total through rate paid by the shipper.

[25] In this report, I often will focus on the use of price to foreclose, which I sometimes will refer to as "pricing foreclosure," rather than other non-price forms of foreclosure, such as causing delays, or an outright refusal to interline. Total foreclosure also may involve setting such a high division that interlining is prohibitively expensive for Carrier Y. I will discuss the profitability of a hypothetical total foreclosure strategy in a later section.

carriers are operating with perfect information about each other's costs and prices. And it also assumes that Carriers X and Y are selling homogenous (i.e., undifferentiated) products.

32. Modern economic analysis has confirmed that the one-lump theory does not apply in circumstances that deviate from these assumptions. In addition, absent these assumptions, foreclosure by the post-merger firm often is profitable and harmful to shippers. As I explain in more detail in the next two sections, both types of deviations from the assumed conditions— imperfect information and differentiated products — likely are present in the proposed transaction. Either of them would be sufficient to render the one-lump theory inapplicable in most real-world markets and specifically in this matter.

33. When the one-lump theory does not hold and there is monopoly in one segment but competition in the other segment (or competition in both segments), an end-to-end merger can lead to foreclosure and reduce competition, which in the rail context could take the form of increased divisions or segment fees levied by the monopoly carrier and increased interline rates charged by the competing carriers, higher single-line rates and harm to shippers. Thus, a procompetitive policy presumption also would be inappropriate in this matter.

34. In the absence of a one-lump presumption, these likely anticompetitive effects need to be balanced against any procompetitive benefits. In the polar case of a purely end-to-end merger between two monopoly carriers each protected by prohibitive entry barriers, neither of which faces any actual or potential competition, economic analysis suggests that the merger often can lead to lower rates.[26] This competitive benefit is referred to as "elimination of double marginalization" (EDM) and is driven by the idea that a lower price by one carrier benefits the other carrier by expanding its sales.

35. However, economic analysis demonstrates that the analysis and potential effects of vertical mergers differ substantially when there is competition at one or both levels. In those cases, EDM tends to be smaller because margins are lower. Even in the case of a monopoly carrier on one segment, when prices on the competitive segment exceed marginal costs due to product differentiation or imperfect information, the downward pricing pressure from EDM

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[26] Absent cooperation, each carrier's rate setting would not take into account the benefits accruing to the other carrier from it setting a lower rate. By merging, the carriers would take these benefits into account and charge lower rates. There are two important exceptions, however. When there are monopolists at each level, they may be able to achieve the benefits of cooperation without a merger, relying instead on a contractual agreement or mutual trust, which means that the merger would not lead to lower prices. The role of entry barriers also is important: if these carriers were likely advantaged potential entrants (or entry sponsors) into each other's market, that fear of potential entry might have constrained their pre-merger prices all the way down to the competitive level. If so, the merger then would eliminate those constraints and so would lead to higher prices. See, e.g., Steven C. Salop, *Invigorating Vertical Merger Enforcement*, 127 YALE L.J. 1962, 1976-77 (2018).

often will be smaller than the upward pricing pressure from foreclosure. If a lower price by the merging competing carrier mostly diverts sales away from other competing carriers (that connect with the merging monopoly carrier), rather than expanding total market sales, the incentive to lower prices as a result of EDM could be quite small and is less likely to be the dominant pricing incentive generated by a merger. This is because the loss of profitable divisions on interline sales by the monopoly carrier is an "opportunity cost" of reducing the rate of the merging carrier on the competitive segment.[27] The relative magnitudes of the upward pricing pressure from foreclosure and the downward pricing pressure from merger-specific EDM are discussed below.

3.2 The One-Lump Theory Does Not Hold When the Carriers Have Imperfect Information About Each Other's Costs and Rates

36. Even if the competing firms sell homogenous products—that is, they compete only on price—the "one lump" theory does not hold in a market structure in which each pre-merger carrier faces imperfect information regarding the costs and rates of the other carriers. In such a market, the pre-merger monopoly carrier is generally unable to extract the full monopoly profit from the shipper, but is better able to do so after merging with one of the competing carriers. The merger creates an increased incentive and ability for the merged firm to foreclose rivals, leading to harm to both shippers and unintegrated carriers.[28]

37. This is not a minor exception to the conditions required for the one-lump theory. My understanding is that UP and KCS typically lack perfect information regarding each other's costs and rates offered to the shipper at the time that they quote their rates.[29] The costs incurred by the carriers for a particular shipment, and thus the rates offered by the carriers for that shipment, will differ according to numerous factors.[30] Similarly, where KCSM

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[27] This "opportunity cost" occurs whenever the increased sales resulting from the merged firm reducing its single-line rate to shippers involve diverting profitable sales away from a competing carrier that interconnects with the monopoly segment of the merged firm. For an example of this type of opportunity cost, *see* Carl Shapiro, *Vertical Mergers and Input Foreclosure: Lessons from the AT&T/Time Warner Case,* 59 REV. IND. ORG. 303, 325-26 (2021). *See* also Yongmin Chen, *supra* note 11; Moresi & Salop, *supra* note 11.

[28] This market structure is analyzed in detail in an economics article by Serge Moresi, David Reitman, Steven C. Salop & Yianis Sarafidis, *Vertical Mergers in a Model of Upstream Monopoly and Incomplete Information*, 59 REV. IND. ORG. 363 (2021).

[29] *See generally* Rocker & Turner V.S.

[30] *See* KCS and CP's Joint Responses and Objections to UP's Second Set of Discovery Requests, Response to Request No. 148. ("revenue and pricing are determined on a variety of factors and

provides its revenue requirements to UP and BNSF, KCSM typically does not know the costs of UP or BNSF or the rates they ultimately offer to shippers. Absent knowledge of the rates or costs of the other carriers, each carrier must base its rate offer on its expectations of the likely rates of the other carriers, as well as its own costs. This uncertainty creates the possibility that the monopoly carrier will not be able to set its pre-merger divisions at the monopoly level, which means that it is not earning its "one monopoly lump." Fearing that setting a high rate might lead to a total price above the shipper's reservation price and the loss of the traffic, the monopoly carrier will hold down its rate. A merger that reduces that uncertainty thus increases the likelihood that the merged firm will be able to profitably raise rates post-merger.[31]

38. In the pre-merger market, a monopoly carrier with imperfect information about the other carriers' costs and rates cannot obtain its "single monopoly profit" because it cannot set its own rate to ensure that the through rate is equal to, but does not exceed, the shipper's reservation price. Competition in the pre-merger market with imperfect information leads to the shipper obtaining a through rate below its reservation price some fraction of the time, in particular, when the competing carriers' costs are relatively low for the particular shipper's movement.[32] When their costs are higher, the shipper either pays its reservation price for the rail transport or chooses an alternative mode.[33] Combining the effects of the varied cost realizations for particular movements, the average through rate paid by the shipper in the pre-merger market will be less than its reservation price. In other words, some of the surplus accrues to the shipper and the competing carriers. In Appendix B, this analysis is illustrated with a numerical example.

39. Looking again at Figure 1, contrary to the one-lump presumption, a merger between the monopoly Carrier A and one of the carriers on the competitive segment —say, Carrier X— *does* change the incentives and ability of the merged firm to foreclose, by improving the

considerations, including but not limited to the market, operating and cost considerations, the type of service, volume, risk premiums (such as hazardous materials or high- end commodities), asset availability, network capacity, competitive modes of transportation, and regulatory requirements. The same considerations apply to cross-border rates.")

[31] Moresi et. al., *supra* note 28. In the *Western Resources* case, *supra* note 4 at 791, the D.C. Circuit suggested that better information would not have an adverse effect on shippers. The Commission apparently did not contemplate the possibility that the monopoly carrier would recognize the risk that a high division might make it uneconomical for the competing carriers to set through prices at or below the shipper's reservation price; and that the monopoly carrier would respond to this risk by setting a lower division, and then the competing carriers would have sufficiently low costs such that they would compete the through price down to a level below the shipper's reservation price.

[32] For the general analysis, *see* Moresi et al., *supra* note 28.

[33] When the shipper chooses the alternative, it gains no surplus value, i.e., the shipper obtains the same value as if it paid a rate for rail transport on these carriers equal to its reservation price.

merged carrier's information. After, and as a result of, the merger, the merging carriers will now know each other's costs and prices, and thus will be able to set a single-line rate equal to the shipper's reservation price, extracting the full monopoly revenue from the shipper.[34] At the same time, the merged carrier will have increased incentives to act on its ability to foreclose by setting a high rate for interline service (or revenue requirement).[35] The shipper will end up worse off from the merger because it will always pay a through rate equal to its reservation price.

3.3 The One-Lump Theory Does Not Hold When the Competing Carriers Sell Differentiated Products

40. The previous model assumed the downstream competitors sold homogenous products—that they competed solely on price. However, the transport services provided by rail carriers are generally differentiated, not homogenous. The services can differ with respect to distance from a shipper's business to the origin and destination stations, the speed of the shipment, frequency and reliability, customer service, the likelihood of damage, payment terms, and so on. That differentiation leads rail transport rates to exceed marginal costs.[36]

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[34] The same reasoning and results apply for a Rule 11 rate since the shipper can obtain the rate from the monopoly carrier and then have the bidding competition between the two competing carriers. As with through rates, the shipper gains the benefit of pre-merger competition that allows it to pay a through rate that is, on average, below its reservation price and to earn a positive surplus. After the merger, the shipper is forced to pay a through rate equal to its reservation price and obtains zero surplus. At the same time, the merger increases the profits of the merging carriers and reduces the profit of the rival unintegrated carrier.

[35] The shipper is worse off because it will always pay a through equal to its reservation price, regardless of whether Carrier Y or Carrier X will win the competition post-merger. The merged carrier will set a division for its segment that is relatively high in the following sense. If the unintegrated rival Carrier Y has a sufficiently lower cost than Carrier X, then Carrier Y will win the competition for the shipper's business and the merged carrier will earn a higher profit from supplying interline service to Carrier Y than it would earn from its single-line rate (equal to the shipper's reservation price). This allows the merged firm to let Carrier Y serve the shipper when Carrier Y is significantly more efficient and, at the same time, to extract a portion of the efficiency rent of Carrier Y. See also the numerical example in Appendix B.

[36] *See*, e.g., Laurits R. Christensen Assoc. Inc., A STUDY OF COMPETITION IN THE U.S. FREIGHT RAILROAD INDUSTRY AND ANALYSIS OF PROPOSALS THAT MIGHT ENHANCE COMPETITION (2009) vol 2 at 10-5 ("estimate of the RPTM/MC ratio peaked at 217 percent in 1994 and has ranged in recent years between 150 and 170 percent"). *See* also Laurits R. Christensen Assoc. Inc., AN UPDATE TO THE STUDY OF COMPETITION IN THE U.S. FREIGHT RAILROAD INDUSTRY (2010) at 4-5.

41. When competing carriers sell differentiated products, the one-lump theory does not apply to an end-to-end merger involving a monopoly carrier and one of the competing carriers.[37] Because their products are not perfect substitutes, the competing carriers in the pre-merger market are able successfully to charge through rates that exceed their marginal costs. As a result, the monopolist cannot unilaterally achieve the monopoly outcome, and may have an incentive to merge with one of the two competing carriers. This basic structure applies to the CPKC merger.

42. In this matter, KCSM is a monopoly carrier for some UP movements originating or terminating in Mexico and KCS controls the Laredo gateway. UP and KCS today provide competing, differentiated service. Therefore, there already are foreclosure concerns involving movements on KCSM before this merger, and the CPKC merger exacerbates these foreclosure concerns. This is because the incremental revenue and profits on the CP segments of current actual and potential movement movements increases the financial gains to the merged firm of foreclosure of UP in the form of higher rates, even if the Laredo gateway is open.

43. In the post-merger market, a merged firm has greater ability to act on its incentive to foreclose unintegrated carriers in order to increase its division for the monopoly segment – to get closer to the monopoly profit it is unable to extract in the pre-merger market. This places upward cost pressure on the unintegrated carrier, which in turn places upward pressure on the carrier's through rate, ultimately harming shippers who prefer this interline movement. This also will permit and incentivize the merged firm to raise its single-line rate, thereby leading to harm to all shippers. Even taking into account the possibility of some EDM effects (which Dr. Majure does not suggest), there is certainly no economic basis for a general presumption that a vertical merger in such a market will be either procompetitive or competitively neutral, and there are strong reasons to expect net anticompetitive effects under the circumstances of the proposed transaction.

3.3.1 Simulation Model Analysis

44. When firms (or rail carriers) in vertically adjacent markets merge, the merger can involve foreclosure incentives that lead to upward pressure on prices. This occurs when the merged firm can cause customers of its unintegrated competitors to divert to the merging partner by raising the cost of using the unintegrated competitors. When one merging rail carrier has a monopoly position on its segment, it can foreclose the unintegrated competitors of its merging partner by eliminating their access to its segment or by raising the division it

[37] Economic analyses of vertical mergers with differentiated products dates back to Joseph J. Spengler, *Vertical Integration and Antitrust Policy*, 58 J. POL. ECON. 347 (1950). For more recent articles, *see* the articles cited in *supra* note 11, among others.

charges the unintegrated carrier for movements on its monopoly segment, or its Rule 11 rate for the segment.

45. In the first instance, the magnitude of the incentive to foreclose depends on the margins of the merging carriers and the diversion ratio from the foreclosed carriers to the merging partner. Foreclosure raises the costs of the carriers competing with the merging carrier, either directly if they pay the increased interline rate or indirectly if the increased interline division is paid by the independent carrier. In either case, foreclosure leads to upward pricing pressure on the rates paid by shippers. The merger also can lead to downward pressure on rates from merger-specific EDM, marginal cost savings or product quality improvements. The magnitude of the downward pricing pressure depends on the magnitude of the merger-specific benefits, as well as the opportunity cost discussed above, which also depends on margins and diversion ratios.[38]

46. The ultimate impact of the merger on shippers depends on the tension and magnitudes of these upward and downward pricing pressures. As a general matter, a vertical merger can lead to a diverse set of outcomes. In some cases, the merger can lead to higher rates borne by all shippers.[39] This is the expected outcome when the merger-specific efficiency benefits are small. The merger alternatively can lead to higher rates borne by the shipper customers that rely on interline movements with the foreclosed independent carriers, while leading to lower rates for the shippers that opt for single-line service by the merged carrier. The merger also can lead to lower rates charged to all shippers. This is most likely to occur when both merging parties have monopoly positions and the merger-specific EDM and merger-specific efficiencies are very large. Because carriers do not set uniform rates for all movements, a vertical merger can lead to a diversity of outcomes across commodity groups, routes and specific shippers.

47. What can be predicted is that the one-lump theory is rejected because the carriers' products and services are differentiated. (As explained above, the one-lump theory also is separately rejected because the carriers have imperfect information.) If there are only de minimis merger-specific EDM, marginal cost savings, and quality improvements, then one can predict with confidence that all shippers likely will be harmed. If there are no competitors on both segments, then one can predict that shippers will not be harmed.[40] But in the middle ground, the multitude of factors that enter into the determination of the impact of the merger on shippers means that it is not possible to make definitive general predictions that

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[38] For technical analysis, *see* Moresi & Salop, *supra* note 11.

[39] This was the outcome in the imperfect information model, where the imperfect information plays a analogous role to product differentiation.

[40] However, even this prediction is subject to the caveat noted earlier, *supra* note 26.

all shippers will benefit or that the transaction will be competitively neutral or positive. The facts will matter.

48. With sufficient data, one approach could be to estimate the upward pricing pressure on the through rate for interline movements on unintegrated carriers arising from the foreclosure incentives and, similarly, estimate the downward (or possibly net upward) pricing pressure on the single-line rate of the integrated carrier from the combination of the opportunity cost, merger-specific EDM, and other efficiencies. If the disparity between upward and downward pricing pressure (in either direction) is large, then a confident prediction might be made.[41] In a real-world merger, this prediction could differ across product categories, routes, and shippers. Applicants (and Dr. Majure) did not conduct this analysis.

49. One also could extend this upward and downward pricing pressure analysis by combining those factors into an equilibrium merger simulation model. However, this approach raises the additional complexity of having to assume a specific demand curve and type of competitive interaction among the carriers. Even if the type of demand curve were known, it would be necessary to estimate the structural parameters of demand, which is not simple. It would also be necessary to have detailed information on carriers' margins for both a complete pricing pressure analysis and for simulation modeling. Again, Dr. Majure (and Applicants) did not conduct this analysis.

50. In Section 5, I take a simpler approach to showing the foreclosure concerns from the proposed merger. As described there, I analyze the profitability of a hypothetical total foreclosure strategy by the merged firm, that is, denying UP access to KCSM for movements of finished automobiles and automobile parts between Mexico and Chicago. The merged firm could carry out this hypothetical total foreclosure strategy by raising its rates on interline movements with UP. (While the concern here is more on smaller rate increases than closing the Laredo gateway, the analysis of a hypothetical total foreclosure strategy is a standard, conservative approach to gauging foreclosure incentives. If a hypothetical total foreclosure strategy after a merger is profitable at current rates, that indicates that the merged firm will have an incentive to raise its division or rate charged for the monopoly segment.) That analysis is only illustrative in that it involves only examples of certain movements. It also does not analyze the impact of merger-specific cost savings and quality improvements, although UP witnesses have concluded that those efficiencies are small.[42]

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[41] *See* Moresi & Salop, *supra* note 11. *See* also Serge Moresi & Steven C. Salop, *When Vertical is Horizontal: How Vertical Mergers Lead to Increases in "Effective" Concentration*, 59 REV. IND. ORG. 177 (2021).

[42] Haley V.S. at ¶¶18–36.

51. I have also constructed two versions of a general simulation model that I describe in the remainder of this subsection. They are intended for the limited purpose of showing that the one-lump theory does not apply and that vertical mergers can lead to a wide variety of impacts, even after taking EDM into account. These models demonstrate that there is no economic basis for presuming that end-to-end rail mergers involving a monopoly carrier are procompetitive or competitively neutral. I am not using these simulation models to claim that this particular vertical merger is anticompetitive. Instead, this analysis demonstrates that one cannot use such general simulation models to claim that the proposed merger is procompetitive or even competitively neutral.[43]

52. One version of the model assumes that the carriers quote take-it-or-leave-it prices. The monopoly Carrier A quotes take-it-or-leave-it divisions to the competing Carriers X and Y, and the latter carriers quote take-it-or-leave-it through prices to the shipper, which is a common assumption in economic models of vertical integration. This structure of the model also captures Rule 11 pricing, where the shipper obtains the rates on the monopoly segment (i.e., one rate if the shipper will use Carrier X and a possibly different rate if it will use Carrier Y) and then has a bidding competition between the competing Carriers X and Y, where the information on the monopoly carrier's rates is taken into account. A second version of the model assumes that there is inter-carrier bargaining between the monopoly Carrier A and each of the competing Carriers X and Y over the divisions.

53. The simulation models are designed to capture a variety of demand and cost conditions. These varying demand and cost conditions can be thought of as reflecting the variations in characteristics of shippers, commodities, and origin-destination routes. The simulations thus recognize the effects of a merger may differ across origin/destination markets and commodities.[44] Even within a single origin/destination market for a specific commodity, the fact that the carriers do not set the same rate for every shipper and every movement means

[43] In this regard, I want to emphasize that the models are not calibrated—that is, the values of the demand and cost parameters are not set to replicate any market shares or margins observed in this transaction. For one thing, every market is different. In addition, such calibration would be very difficult, if not impossible, to implement for this merger in an accurate way, and so would be subject to substantial criticisms. For an example of the controversial use of a vertical merger simulation model in litigation, *see* Shapiro, *supra* note 27; *United States v. AT&T, Inc.*, 310 F. Supp. 3d 161 (D.D.C. 2018); *United States v. AT&T, Inc.*, 916 F.3d 1029 (D.C. Cir. 2019).

[44] I also am not claiming that these are the only possible parameter assumptions. I expect that a different set of assumptions or a different demand structure could lead to different results. Such results would not undermine the validity of the conclusions I reach, as the simulation models are intended only to illustrate the diversity of effects of vertical mergers involving a monopoly carrier, the failure of the one-lump theory, and the potentially serious foreclosure concerns that can arise.

that a merger may harm some shippers while benefiting others with different demand characteristics or whose shipments have different costs.

54. The results of the simulation models show that some or all shippers can be harmed from foreclosure effects of end-to-end mergers. They also show the possibility that some shippers can be benefited. Because the simulations cover such a broad range of circumstances to capture different competitive interactions, the models indicate a wide range of possible results for particular shippers. <u>This is precisely the point</u>. While the one-lump theory implies that the price to shippers would not change as a result of a vertical merger when one of the merging parties appears to have a monopoly over certain routes, the simulations show that significant price changes are far from being the exception and, in fact, occur in a broad set of market conditions. Thus, these results make it clear that the one-lump theory does not apply when there is product differentiation in the competitive segment. An end-to-end merger can harm some or all shippers, even after taking any EDM into account. The simulation results thus also make it clear that a general procompetitive presumption cannot be justified with respect to the proposed merger on the basis of economic analysis.

3.3.1.1 Simulation Model with Carrier Take-It-or-Leave-It Pricing

55. The first version of the simulation model analyzes a scenario when the carriers face elastic demand from shippers and set take-it-or-leave-it rates. In the pre-merger market, the monopoly carrier sets divisions to the two competing carriers which then set interline rates. In the post-merger market, the unintegrated and integrated carriers compete for each shipper's movement. The integrated carrier sets a single-line rate and the independent carrier sets an interline rate, which depends in part on the division set by the integrated carrier for its monopoly segment.[45] The simulation model calculates a range of outcomes for a number of demand parameters and costs, which are combined to create a large number of diverse market conditions that lead in turn to a range of pre-merger market shares and rates for the two competing carriers, and divisions for the monopoly carrier. The model follows the railroad literature by assuming that the shippers' demand has a logit demand structure.[46]

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[45] The structure of the technical model equivalently assumes that the monopoly carrier offers its service to its merger partner at a nominal price equal to marginal cost and the merger partner sets the through rate for the shipper, although the merger effects do not depend on the magnitude of this nominal transfer price.

[46] Yanyou Chen, *Network Structure and Efficiency Gains from Mergers: Evidence from U.S. Freight Railroads*, Working paper (2021); Daniel Coublucq, *Demand Estimation with Selection Bias: A Dynamic Game Approach with an Application to the US Railroad Industry,* 94 DICE Discussion Paper (2013); Bart Jourquin, *Estimating Elasticities for Freight Transport Using a Network Model: An Applied Methodological Framework*, 9 J. TRANSP. TECH. 1 (2019).

56. The technical details of the model are described in more detail in Appendix C.[47] In some scenarios, the two competing carriers increase their through rates after the merger and, therefore, all shippers are harmed by the merger. In other scenarios, the interline rate of the unintegrated carrier rises while the single-line rate of the now-integrated carrier falls. In this latter scenario, the shippers that use the unintegrated carrier are harmed but the shippers that use the single-line rate are benefited.[48] Specifically, in this model, the single-line rate of the merged carrier rises when the pre-merger volume share of the merging competing carrier is less than about 25%, and often also when its share is in the 25-40% range. But when its pre-merger share exceeds 40%, the single-line rate of the merged carrier typically falls. Thus, this version of the model illustrates how a vertical merger can harm some or all of the shippers, depending on the particular demand and cost conditions. For this reason, a general or conclusive presumption of no anticompetitive effects resulting from a vertical merger in these market conditions, in the context of imperfect information and/or differentiated products, would not be appropriate.

3.3.1.2 Simulation Model With Inter-Carrier Bargaining

57. In a 1982 order, the ICC suggested that inter-carrier bargaining could lead to market conditions that would support application of the one-lump theory.[49] I have also analyzed a version of the model where the divisions charged by the monopoly carrier to the two competing carriers are determined through bilateral negotiations in which the two negotiating parties have equal bargaining power.[50] (By contrast, the previous version of the model, which included take-it-or-leave-it divisions, effectively assumed that the monopoly carrier has all the bargaining power.) As before, the model assumes that the competing carriers set take-it-or-leave-it through rates to the shipper. The simulation results for this

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[47] The simulation model builds on the approach in Gopal Das Varma & Martino De Stefano, *Equilibrium Analysis of Vertical Mergers*, 65 ANTITRUST BULLETIN 445 (2020), which uses the equivalent of through pricing. This article analyzes both take-it-or-leave-it inter-firm pricing and bargaining, as I do in this report. However, that article provides only a single example for demand and cost conditions rather than a range of market conditions. Gleb Domnenko & David S. Sibley, *Simulating Vertical Mergers and the Vertical GUPPI Approach*, (May 15, 2020) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3606641 also simulates vertical mergers for a range of market conditions, but with a different demand structure and more limited reporting of results.

[48] I am not claiming that it is impossible for both through rates to fall and all shippers to benefit from a hypothetical merger. As I describe in later sections, however, I conclude that the proposed CPKC merger is likely to lead to anticompetitive foreclosure, not lower rates for all shippers.

[49] *Union Pac. Corp. —Control— Missouri Pac. Corp*, 366 I.C.C. 462 (1982).

[50] Economists refer to this as "Nash Bargaining." *See* John Nash, *The Bargaining Problem,* 18 ECONOMETRICA 155 (1950); Ken Binmore, Ariel Rubinstein and Asher Wolinsky, *The Nash Bargaining Solution in Economic Modeling,* 17 RAND J ECON 176 (1986).

bargaining version of the model lead to a variety of pre-merger market shares and rates, as described in more detail in Appendix D.

58. In this bargaining version of the model, the impact of the vertical merger on shippers is more adverse. The merger always leads to an increase in the interline rate charged to shippers who opt for the unintegrated carrier. The merger also almost always leads to an increase in the single-line rate charged to shippers by the integrated carrier. When the single-line rate falls, it decreases only slightly. Moreover, the rate increases typically are larger than those in the previous model where the monopoly carrier sets take-it-or-leave-it divisions.

59. Thus, this inter-carrier bargaining version of the simulation model similarly demonstrates that the one-lump theory does not hold when carriers on the competitive segment offer differentiated products and services. It also indicates serious concerns about shipper harms from foreclosure in markets that have such characteristics. The likelihood and magnitude of shipper harms are higher in this scenario than those in the previous version of the model with take-it-or-leave-it divisions.

3.4 Implications for the Board's Analysis of the Proposed CPKC Merger

60. The economic analysis of vertical mergers carried out in this section shows the inapplicability of the one-lump presumption if the competing carriers are selling differentiated products or if the carriers have only imperfect information about each other's costs and rates. The one-lump theory fails for all but the polar case. Nor can one argue that the world is close to this polar case. Imperfect information and differentiated products are the norm, not the exception. And when there is imperfect information or differentiated products, end-to-end mergers can harm some or all shippers under normal conditions.

61. When the one-lump theory does not apply, there can be incentives to foreclose. Those foreclosure incentives already exist today, because KCS controls KCSM, and they will be enhanced by the merger with CP. This is because adding CP's revenue and earnings increases the financial benefits the post-merger firm will gain by diverting traffic to itself and away from rivals. While EDM might mitigate these foreclosure concerns, the results of the simulation model show how such benefits can and often do fall short. Nor have the Applicants provided any data or analysis to rebut the concerns, which the simulation models support, that the merger could result in anticompetitive foreclosure. Instead, as I discuss further in Section 6 below, Dr. Majure has essentially assumed away foreclosure and apparently has concluded that merger-specific EDM is not important.

4. Modern Economic Analysis Rejects the Assumption that There Is No Incentive or Ability to Foreclose When There Is a Competing Carrier for Each Segment

62. In this section, I briefly analyze the impact of the proposed merger on the portion of the traffic where FXE might be a feasible alternative for the Mexican leg of a rail movement.

63. In his statement, Dr. Majure discusses the situation where the potentially foreclosed rival has an alternative to the merged carrier, and concludes that the merged carrier has no ability (and hence no incentive) to foreclose. However, Dr. Majure does not carry out any actual economic analysis of this issue. Instead, he stops at the assumption that when there is an ostensible perfectly-substitutable alternative routing, this alternative will provide the same effective safeguard against rate increases after the merger as in the pre-merger market.[51] As Dr. Majure puts it,

> Next, consider the other hypothetical shipper, who can readily switch to another railroad or mode of transportation. Perhaps this second shipper can rely on FXE's network in Mexico as a suitable alternative to KCSM for originating its movements. For the shipper with ready alternatives, there would be no *ability* for a combined CP/KCS to force inferior terms on the shipper. Doing so would only lead to loss of the traffic – or failure to attract new traffic – contrary to the company's economic incentives.[52]

64. I understand that many shippers in fact cannot rely on FXE.[53] But, in addition, Dr. Majure fails to take into account that even where the second upstream carrier may provide a practical alternative to the merging carrier, the merger will change the economic incentives of the integrated carrier, as well as those of the unintegrated alternative carrier, in ways that reduce the effectiveness of the competitive safeguards that the alternative carrier provided before the merger.

65. I can explain this result with the following hypothetical scenario drawn from the economics literature. Instead of assuming that a railroad has a monopoly on one segment of a through movement, suppose there is a second carrier on that segment. This scenario is illustrated

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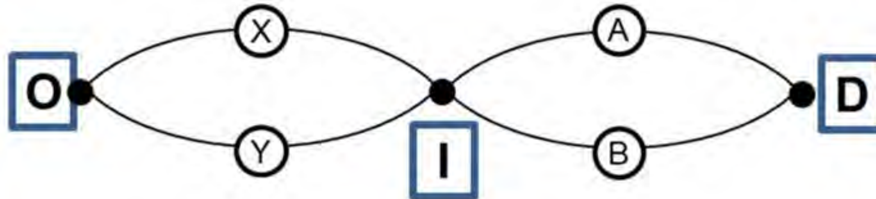
[51] Dr. Majure appears simply to rely on a quotation from the Board's BNSF 1995 merger decision that suggests that a merger will not weaken the "safeguards" provided by alternative carriers. (APP., *Verified Statement of W. Robert Majure* (October 29, 2021) (*hereinafter*, Majure V.S.) at ¶25.)

[52] Majure V.S. *supra* note 51 at ¶25 (emphasis in original).

[53] Rocker & Turner V.S. at 16.

below in Figure 2, where Railroads X and Y compete on the segment from O to I and Railroads A and B compete on the routes from I to D.

Figure 2: Duopoly Competition



66. Assume that Carrier B is not only a feasible alternative to Carrier A, but Carrier B has the same costs and product attributes of Carrier A, so it is a *perfect substitute* for Carrier A, and so there is intense pre-merger competition between Carriers A and B. Consider next the impact of a merger between Carriers A and X. Dr. Majure suggests that the existence of Carrier B would totally deter Carrier A from raising its fee to the unintegrated downstream Carrier Y (or to shippers that want to use Carrier Y).

67. But economic analysis of this simple model indicates that this conclusion is incorrect.[54] Despite the fact that Carrier B is a perfect substitute for the merging Carrier A, the merged carrier would still have a post-merger incentive to raise its division to Carrier Y. This is because the merged carrier would correctly anticipate that Carrier B would respond by raising the division it charges to Carrier Y. (Carrier B similarly would anticipate that Carrier A will have the incentive to raise its division.) This will lead to both carriers charging higher divisions. Thus, even if Carrier Y selects Carrier B for the origin segment, the higher division paid for that interline segment makes it more likely that the merged carrier will win the bidding, even when it sets a higher through rate than before the merger.

68. Thus, it is erroneous to focus solely on the technical "ability" to substitute. It is also necessary to analyze the impact of the merger on the "incentives" to foreclose. The mere technical "ability" to substitute does not eliminate the incentive of the merged carrier to foreclose by raising its division. To assume otherwise, as Dr. Majure appears to do, amounts to assuming that no vertical merger can raise competitive concerns when there are two carriers on both segments (or, more generally, two firms in each market).

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[54] *See* Ordover et al., *supra* note 11.

69. When Carriers A and B are perfect substitutes with identical costs and quality, the pre-merger competition drives their rates down to marginal cost, so there is no EDM (put simply, there are no margins for the merger to eliminate). However, if they are imperfect substitutes, the carriers may be able to set pre-merger rates that are higher than their marginal costs, which means that a merger may permit some EDM. But there is no economic reason to think that downward pressure on rates will be the dominant factor. In fact, the greater is Carrier Y's ability to substitute between Carriers A and B, the lower is the likelihood that downward pricing pressure will be the driving factor in the merged carrier's incentives and the more likely it is that the rates offered to shippers by both carriers will rise. Moreover, the more inelastic is the aggregate demand for the service provided by Carriers X and Y, the greater will be the merged firm's opportunity cost of lowering its through rate. The opportunity cost also is higher if Carrier A charges a higher pre-merger rate to the independent Carrier Y than to its future merger partner, Carrier X.

70. Thus, economic analysis does not support a general proposition that an alternative upstream carrier eliminates the risk and potential shipper harms from pricing foreclosure that raises the cost of the unintegrated downstream rival. Even if there is a feasible "ability" to substitute, the merged carrier still may have an incentive to raise the fee it charges its unintegrated downstream competitor. This can lead to harm to shippers who end up paying higher rates and perhaps obtaining less preferred service. To the extent that the merged carrier has higher costs—for example, because it has inferior routings—efficiency also may suffer.

71. The structure of competition between UP and the merged CPKC on shipments to and from Mexico is somewhat more complicated than the hypothetical scenario just analyzed. Even when it is a feasible alternative, FXE is not a perfect substitute for KCSM.[55] KCS also currently has some power to raise its fees to CP on interline shipments, which means that there is potential for EDM if CP and KCSM merge. However, one cannot assume that the downward pricing pressure after such a merger will dominate the upward pricing pressure from foreclosure. In fact, if FXE and KCSM are very close competitors for UP, then foreclosure will tend to be more profitable, because the competition would have driven their pre-merger rates virtually down to marginal cost.

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[55] The fact that UP has a partial ownership interest in FXE does not change the results. This is a passive ownership interest. UP does not have any control over FXE's prices. Thus, while UP would take into account that it recovers some fraction of FXE's overcharges on interline movements, that recovery does not make FXE a perfect substitute for KCSM and thus will not eliminate the effects of the foreclosure. Moreover, understanding that UP will "discount" the overcharges in this way gives FXE the incentive to raise its fees by even more than if there were no UP ownership interest.

72. In short, there are substantial foreclosure concerns even for shippers that view FXE as a possible substitute for KCSM. Simply observing that KCSM is not a monopolist, but faces FXE as a feasible alternative—and again, Dr. Majure presents that as a hypothesis, not an established fact—does not eliminate the ability or the incentive of the merged firm to engage in foreclosure strategies against UP on Mexican routes.

5. Empirical Analysis Confirms that the CPKC Merger Raises Serious Foreclosure Concerns

73. Brown and Zebrowski (B&Z) estimate divertible and likely diverted traffic that moves through the Laredo gateway. That is, they estimate a magnitude of traffic that they conclude potentially *could* be diverted from competitors to the merged CPKC. They then judged that a specific fraction of that divertible traffic likely *would* be diverted to the merged carrier as a result of post-merger quality improvements.

74. Figure 3 reports B&Z's estimates of the level of potentially divertible traffic to the merged firm that currently flows over the Laredo gateway as well as B&Z's estimates of likely diversion, with likely diversion being somewhat less than half of the potentially divertible traffic on average. Figure 3 reports the carloads, rather than the associated revenue. This analysis indicates substantial likely diversion, taking B&Z's assumptions at face value that there would be no foreclosure tactics by CPKC.

75. While B&Z assume that there is no foreclosure, their formulation essentially concedes an ability to foreclose by raising rivals' costs of competing interline movements. That is, if an integrated firm with monopoly power on one segment can divert traffic by reducing its own costs, then it normally also can divert traffic by raising its rivals' costs. Reducing its own costs allows the firm to gain traffic by decreasing its prices, while raising rivals' costs allows the firm to gain traffic by causing the rivals to increase their prices. After the merger, CPKC can raise rivals' costs by raising the KCSM rates it charges for interline movements with those rivals.

76. Even taking B&Z's estimates of likely diverted traffic at current rates as a given, the merged firm could further increase the traffic diversion rate by engaging in supplemental foreclosure tactics such as raising KCSM rates on interline movements or non-price foreclosure tactics. If those foreclosure tactics were to drive the diversion up to the level that B&Z viewed as potential diversion, that would involve more than twice the diversion rate they treated as likely. The merged firm has a greater incentive to engage in foreclosure than KCS does currently because shipments diverted from UP will allow the merged firm to capture the carloads (and associated revenue and profit) for the CP segments as well as the KCS segments.

Figure 3: B&Z Estimated Potential and Likely Diversions Through Laredo

Select Traffic Screened as Eligible For Diversion

	Total Originated/Terminated at Laredo		
	Potential Diversion (Carloads/ Containers)	**Likely Diversion (Carloads/ Containers)**	**Percentage Likely Diverted**
Intermodal	{{ }}	{{ }}	{{ }}
Automotive	{{ }}	{{ }}	{{ }}
Metals, minerals and consumer products	{{ }}	{{ }}	{{ }}
Energy, chemicals and plastics	{{ }}	{{ }}	{{ }}
Grain Products	{{ }}	{ }}	{{ }}
Total	{{ }}	{{ }}	{{ }}

Source: Brown & Zebrowski V.S., workpaper "8 - Diversion Identification.xlsx"

77. Extending B&Z's analysis, a strategy of using foreclosure tactics to cause increased diversion likely would be profitable for the merged firm. I will use the illustrative example of diversion of movements of finished automobiles from Laredo to Chicago. I specifically will undertake the common analysis of evaluating the profitability of a hypothetical total foreclosure strategy of completely denying UP effective access to interlining with KCSM by raising KCSM's rates to prohibitive levels.[56] By this analysis, I am not predicting that CPKC will engage in such a total foreclosure strategy. Instead, I am using this analysis as a conservative gauge of the profitability of foreclosure by raising KCSM's rates.

78. To explain the basic methodology of this profitability analysis, suppose that the merged firm were to substantially raise the per carload rates charged for UP movements from Mexico origins to Laredo to prohibitively higher levels, where UP effectively would be totally foreclosed from using KCSM as a practical matter. To illustrate the impact of this hypothetical total diversion strategy on the profits of CPKC, assume initially in an overly optimistic way that UP were able to retain (say) half the movements subject to this foreclosure by trucking the merchandise to Laredo or using FXE instead, despite the higher cost of these alternatives. In that case, the merged firm would sacrifice the revenue and margin on half of the UP movements over KCSM (i.e., the movements that UP would retain by using trucks or FXE) but it would obtain the revenue and margin for carriage from

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[56] Such a profitability analysis is routinely used in merger analysis. *See, e.g.,* Vertical Merger Guidelines (Example 2); Moresi & Salop, *supra* note 11 at 208. The profitability analysis is a conservative approach to foreclosure incentives. *Id.* at 208-10.

Laredo to Chicago on the half of the UP movements that it captures (i.e., the movements that it diverts from UP to itself).[57]

79. To estimate the increase in the revenue earned by the merged firm from this total foreclosure strategy, Figure 4 reports B&Z's estimates of the amount of revenue per carload that the merged firm would earn on movements diverted from UP and other carriers for finished automobile movements. If the merged firm would obtain the current UP rates on the Laredo-Chicago movement on diverted traffic, the merged firm would earn revenue of {{ }}.[58] KCS earns revenue of only {{ }} on KCSM movements that interline with UP at Laredo. Thus, if UP were able to retain as much as half the shipments after it was totally foreclosed from KCSM, the merged firm would gain {{ }} on the U.S. portion on the half of the shipments it captures, while losing the KCSM revenue of {{ }} on the half of the shipments that UP is able to retain. Thus, on balance, the total foreclosure strategy would dramatically increase CPKC's revenue.[59] Assuming that the percentage price/cost margins were not wildly different, the strategy would be highly profitable.[60] For other routes where the potential CPKC revenue gained is higher, foreclosure would be even more profitable.

80. Given these single line and KCSM rates, I next calculate the "critical percentage" of shipments that UP would have to retain in order for the total foreclosure strategy of the merged firm to be unprofitable. The critical percentage is about {{ }} to maintain the

[57] To keep the illustrative example simpler, I assume that BNSF is not a possible alternative carrier for these UP shipments. If it were, the merged firm also could foreclose BNSF from access to these or all Mexican shipments. That would make the analysis more complicated since the rate charged on shipments interlined to BNSF might be somewhat higher than that charged to UP. However, given the huge disparity between gains and losses from the foreclosure strategy, this simplification will not change the results.

[58] The mileage on CPKC would be about 300 miles longer than the UP mileage. However, B&Z assume that the merger would make the CPKC service competitive with UP (absent any foreclosure).

[59] Assuming that UP initially had 200 movements and the merged firm captures 100 of them, the merged firm would earn revenue of {{ }} in total on those 100 movements, while losing revenue of {{ }} on the lost KCSM movements.

[60] To show the profitability despite differential margins with an extreme (worst-case) example, suppose that the dollar margin on the KCSM movement is $1,000 (i.e., about {{ }} rate), while the dollar margin on the Laredo-Chicago movement is only $2,000 (i.e., about {{ }} rate). In this scenario, the merged firm would earn increased profits of $200,000 on those 100 movements gained, while losing profits of $100,000 on the 100 lost KCSM movements for a net increase in profits of $100,000 on those 200 original movements.

same revenue.[61] UP witnesses have explained that such a high retention rate is not viable.[62] While this analysis indicates that the merged firm would increase profits by totally foreclosing UP, it normally is more profitable to raise rates rather than totally foreclose.

81. As noted earlier, I am not suggesting that CPKC would close the Laredo gateway or charge such prohibitive rates so as to completely foreclose UP. Instead, the merger raises serious concerns that the merged firm would partially foreclose by raising KCSM rates on shipments through the Laredo gateway to Chicago and the upper Midwest in order to divert traffic to CPKC to some degree, and possibly also engage in some non-price foreclosure tactics that are difficult to detect.

Figure 4: CPKC Foreclosure Incentives: Finished Automobiles

CPKC Incremental Revenue from a UP Diverted Movement	{{ }}
Average KCSM Revenue for the Mexican Portion of a UP Movement	{{ }}

Sources:

1. Brown & Zebrowski V.S., workpaper "4 - Traffic Screening.xlsx"
2. Brown & Zebrowski V.S., workpaper "8 - Diversion Identification.xlsx"

82. Figure 5 provides a similar analysis for southbound automobile parts from Chicago to Laredo. UP would have to be able to retain at least a "critical percentage" equal to {{ }} of the shipments to prevent this total foreclosure strategy from increasing the net revenue of the merged firm.[63] Again, UP witnesses have explained that such a high retention rate is not viable.[64] And as discussed above, increasing rates by some amount is normally more profitable than totally foreclosing. This also shows a concern that the merger would lead to higher rates charged to UP. And, as with finished automobiles, it will be even more profitable for other movements when revenue gained is higher.

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[61] If UP retained { }} of the carloads, the merged firm's loss of the {{ }} per carload on this {{ }} of the shipments would equal the gain of {{ }} per carload on the {{ }} of shipments diverted by the merged firm. This assumes equal percentage margins on both segments. As noted above, if the percentage margins differ on the two segments, the critical percentage would be adjusted accordingly.

[62] Rocker & Turner V.S. at 11-16.

[63] If UP retained {{ }} of the carloads, the merged firm's loss of the {{ }} per carload on this {{ }} of the shipments would equal the gain of {{ }} per carload on the {{ }} of shipments diverted by the merged firm. This assumes equal percentage margins on both segments. As noted above, if the percentage margins differ on the two segments, the critical percentage would be adjusted accordingly.

[64] *See* Rocker & Turner V.S. at 11-16.

Figure 5: CPKC Foreclosure Incentives: Automobile Parts

CPKC Incremental Revenue from a UP Diverted Movement	{{ }}
Average KCSM Revenue for the Mexican Portion of a UP Movement	{{ }}

Sources:
1. Brown & Zebrowski V.S., workpaper "4 - Traffic Screening.xlsx"
2. Brown & Zebrowski V.S., workpaper "8 - Diversion Identification.xlsx"

83. The Applicants claim that the merger will lead to quality improvements and cost decreases.[65] They might try to argue that these would offset the foreclosure incentives indicated by this analysis. But UP witness Thomas Haley explains that a substantial portion of the single-line cost savings anticipated by Applicants is not merger-related.[66] Further, Mr. Haley explains that Applicants assume traffic will divert to longer, less efficient routes. His testimony suggests Applicants would have to grow their single-line traffic and revenues by foreclosing, rather than by increasing competition. In this regard, while B&Z attribute the diversion to cost and quality improvements, diversion alternatively could be achieved by raising the cost of UP interline movements by increasing the fee charged by KCSM to UP (or to shippers that want to use UP). Rate reductions for the purpose of inducing shippers to switch from UP to CPKC would be unnecessary if the merged carrier foreclosed competing carriers by raising the rate for KCSM's monopoly segment.

84. B&Z also are not claiming that rates on these competing movements will decline. For diverted traffic moving between Mexico and the United States through the Laredo gateway, B&Z apparently attribute all the diversions of traffic to quality improvements, not to rate decreases. This is because they assume that rate reductions are not needed to divert traffic away from UP's interline service on movements through Mexico, even though the diversion will move traffic to longer, less efficient routes. They assume that CPKC would offer rate reductions only "in order to attract traffic away from existing single-line service to CPKC single-line service."[67] Since UP will be interlining with KCSM, it will not be providing single-line service.[68] Thus, B&Z are effectively assuming that the merged firm's rates will

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[65] *See*, e.g., APP., *Verified Statement of Dean Vargas* (October 29, 2021) (*hereinafter*, Vargas V.S.) at ¶41, Table 2.

[66] *See,* e.g., Haley V.S. at ¶¶13–17.

[67] Brown & Zebrowski V.S. at ¶32. ("[W]e 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.") However, they do not treat movements that include KCSM as single-line. *See* Brown & Zebrowski V.S., workpaper "8 - Diversion Identification.xlsx".

[68] Brown & Zebrowski V.S., workpaper "8 - Diversion Identification.xlsx"

stay the same for all cross-border traffic diverted from UP. This assumption also suggests that shippers will not benefit from lower rates.

6. Dr. Majure's Analysis of Traffic Flows at Laredo Lacks Probative Value

85. Dr. Majure reports data on traffic shares for the northbound traffic that KCSM brought to the Laredo gateway from Mexico in 2019. Dr. Majure asserts that this analysis is "consistent" with the absence of foreclosure incentives at the Laredo gateway,[69] implies a preference for single-line service,[70] and demonstrates the potential benefits to shippers from a combination of CP and KCS.[71]

86. However, Dr. Majure's empirical analysis lacks probative value. This single snapshot of shares in 2019 (15 years after KCS's earlier acquisitions of TFM and TM) is equally consistent with the opposite of what Dr. Majure claims. Based solely on the analysis as presented, one cannot conclude one way or the other whether KCS's earlier acquisition resulted in any foreclosure of UP in the past, or whether the merged firm will foreclose UP in the future. Nor does this data provide evidence of a meaningful preference for single-line service or overall benefits to shippers from the merger.

6.1 Dr. Majure's Traffic Share Data Does Not Disprove the Existence of Foreclosure Concerns

87. In Exhibit 2 of his Verified Statement, Dr. Majure presents shares of northbound rail traffic passing through the Laredo gateway in 2019. Dr. Majure's exhibit is reproduced below in Figure 6.

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[69] Majure V.S. at ¶30 ("That sizable percentage is consistent with KCS having an incentive to provide shippers with their preferred route and carrier…").

[70] Majure V.S. at ¶32-33.

[71] Majure V.S. at ¶34.

Figure 6: Reproduction of Dr. Majure's Exhibit 2

{{

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88. Dr. Majure reports that in 2019, KCSM interchanged {{ }} of shipments with UP at the Laredo gateway for which KCS can serve the final destination (Line 1 in Figure 6).[72] He claims that this "sizable percentage is consistent with KCS having an incentive to provide shippers [after the previous merger] with their preferred route and carrier – interchanging as necessary to meet the shipper's preference rather than forcing shippers to use KCS alone."[73]

[72] KCS also interchanges {{ }} of shipments with UP destined for areas that KCS cannot serve. (Line 2 of Figure 6). This equality in the percentage of shipments interchanged might be thought to suggest that KCS is not foreclosing any shipments to areas that it can serve. Dr. Majure properly does not make such a claim. This is because the commodity categories, shipment lengths and values and other factors are not constant. Nor is it likely that the equality would be found for apples-to-apples comparisons or for other years.

[73] Majure V.S. at ¶30.

89. This figure lacks probative value. This is because Dr. Majure provides no counterfactual against which to measure this {{ }} result. Without knowing what percent of carloads *would have been interchanged* with UP at Laredo had the KCS/TFM/TM transactions not been consummated (i.e., in the counterfactual "but-for" world), one cannot reasonably conclude that UP's {{ }} share in 2019 indicates that "interchange activity at the Laredo gateway demonstrates a combined CP/KCS would not have the ability and incentive to preclude its rivals' access to gateways."[74] These shares may be inconsistent with a claim of *complete foreclosure* of UP, but they do not establish that there has been *no foreclosure* arising from interline fee increases or higher KCSM divisions. For example, suppose that UP's share would have been 90% absent foreclosure resulting from the previous merger. In that case, a {{ }} UP share would be indicative of substantial foreclosure.

90. One possible benchmark might be to compare UP's share in 2019 to the level before all the effects of previous transactions occurred. That is, one might compare UP's share before the KCS/TFM/TM transaction versus 2019. As shown in Figure 7, UP's share of northbound shipments was 90% before the acquisitions. By 2019, the share had fallen to {{ }}, as discussed above. Similarly KCS share of southbound was only 9% and it is {{ }}much higher today, as shown in Figure 8 below. Thus, this is equally "consistent" with the acquisitions leading to foreclosure of UP.

Figure 7: Pre-KCS/TFM/TM Shares of Movements via All U.S./Mexico Gateways

Railroad	Northbound	Southbound
UP	90%	79%
KCSR/Tex Mex	3%	9%

Source: Kansas City Southern —Control— the Kansas City Southern Railway Company, Gateway Eastern Railway Company, and the Texas Mexican Railway Company, STB Finance Docket No. 34342 at 12 (2004).

91. As Dr. Majure recognized at his deposition,[75] there are other possible explanations that also are "consistent" with the decline in UP's share post-2004/2005 and the corresponding

[74] Majure V.S. at ¶31.

[75] Deposition of W. Robert Majure, February 7, 2022 at 229, ("It's very hard to make that kind of comparison over a long period like this. And in particular, there are a lot of things that have been changing that would affect this. . . So I would expect changes to happen from investments. I would expect changes to happen from—changes in demand over time. . . So even just the composition of what the traffic is is probably changed somewhat. So those are just some of the reasons why trying to do this over time might lead to a misleading conclusion.").

increase in KCS's share, such as secular improvements in KCS service over this period. These alternatives reduce if not totally eliminate the probative value of the change in the shares. But I note that if Dr. Majure's reasoning regarding the {{ }} in 2019 were to be credited, then so must also be this decline from {{ }} in 2004-2005 down to {{ }}. That is, this large reduction in UP's share over time (and the corresponding increase in KCS's share) equally could be said to be "consistent" with foreclosure by KCS.[76]

92. Dr. Majure's apparent conclusion that his Exhibit 2 rebuts foreclosure concerns also ignores the fact that the foreclosure incentives would be increased after the merger because of the incremental revenue earned on the CP portion of movements diverted to the merged firm from the foreclosure. For example, Figure 6 indicates that there are {{ }} movements to areas not served by KCS today that the merged CPKC could serve and for which UP currently obtains a { }} share at Laredo. These movements are ones that the merged firm could divert from UP, BNSF or others by raising the rate for KCSM's monopoly segment. This is another reason why his Exhibit lacks probative value.

93. In addition, because Dr. Majure does not take into account the likelihood and potential harms from foreclosure, his conclusion that the merger likely will benefit shippers on these routes also lacks probative value.

6.2 Analysis of Southbound Traffic Through the Laredo Gateway Does Not Support Dr. Majure's Conclusion that There Are No Foreclosure Concerns

94. Dr. Majure did not analyze southbound traffic through the Laredo gateway in his report. However, there are similar foreclosure concerns relating to southbound traffic: KCSM could increase the rate for southbound movements interchanged with UP at the Laredo gateway in order to increase the cost to shippers of using UP for the U.S. portion of a movement and thereby increase traffic obtained by KCS instead. Figure 8 presents UP and KCS' 2019 shares of southbound carloads interchanged with KCSM at the Laredo gateway in the same format used by Dr. Majure in his northbound analysis. UP's share of southbound traffic (i.e., share of traffic interchanged at the Laredo gateway from areas KCS serves) is only {{ }}, far less than the {{ }} share Dr. Majure found for northbound traffic.

95. Had Dr. Majure analyzed southbound traffic in his report, and if he had applied his rule on northbound traffic that a "sizable percentage [share of UP] is consistent with KCS having an incentive to provide shippers with their preferred route and carrier … rather than forcing

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[76] Dr. Majure refers to {{ }} rate of interchange traffic as "consistent with KCS having no ability to force shippers into using KCS." (Majure V.S. at ¶31.)

shippers to use KCS alone,"[77] he then should have concluded that UP's "small" {{ }} share of traffic from areas that KCS serves (versus {{ }} share for traffic from areas that KCS does not serve) is "consistent" with a significant foreclosure concern.[78] Similarly, KCS's "large" {{ }} share of southbound carloads from areas is much higher than the {{ }} of northbound traffic he flagged. Thus, Dr. Majure should have concluded that this high rate indicated that foreclosure was occurring.

96. Of course, these metrics also are subject to the same criticism of Dr. Majure's analysis that I made earlier: these figures do not compare this percentage to an estimated percentage in the but-for world absent the merger.

Figure 8: Shares of Southbound Traffic Interchanged at Laredo Gateway with KCSM

			KCS Share at Laredo Gateway		
Area	**Total Carloads**	**UP share at Laredo Gateway**	**Total KCS Share [A = B + C]**	**BNSF to KCS at Robstown or Corpus Christi [B]**	**KCS share before Robstown or Corpus Christi [C]**
KCS serves…	{{ }}	{{ }}	{{ }}	{{ }}	{{ }}
KCS does not serve…	{{ }}	{{ }}	{{ }}	{{ }}	{{ }}
KCS does not serve and CP serves…	{{ }}	{{ }}	{{ }}	{{ }}	{{ }}
… and UP and BNSF do not serve	{{ }}	{{ }}	{{ }}	{{ }}	{{ }}
… and UP or BNSF serves	{{ }}	{{ }}	{{ }}	{{ }}	{{ }}
All traffic through Laredo to Mexico	{{ }}	{{ }}	{{ }}	{{ }}	{{ }}

Sources:
CP-KCS Traffic Tapes, 2019
Confidential Waybill Sample, 2019
CP Intermodal Containers to Railcar Conversion Factor.xls
KCS R-1 Annual Report, 2019

[77] Majure V.S. at ¶30.

[78] Dr. Majure writes that he did not report these southbound traffic figures because "[w]hile UP's concern could have applied to southbound traffic as well, I test the effect on the northbound traffic as I can readily categorize movements of this traffic in terms of whether an interchange with another railroad happened as early in the movement as feasible." Majure V.S. at note 17. However, the primary statistic needed for the southbound analysis is UP's share in areas KCS serves, which can readily be calculated using a definition for "serves" focused on origin points that is comparable to the termination points used in the northbound analysis.

6.3 Dr. Majure's Data Do Not Provide Evidence of a Preference for Single-Line Service

97. Dr. Majure also suggests that the data reported in Figure 6 above demonstrate a shipper preference for single-line service.[79] Dr. Majure specifically points to the fact that KCS has a higher share at the Laredo gateway when it is able to provide single-line service beyond Laredo/Robstown/Corpus Christi ({{ }}, as shown in line 1) than it does for traffic bound for areas where KCS could not deliver to the ultimate destination ({{ }}, as shown in line 2). However, just as it is not possible to draw a conclusion about foreclosure in the absence of an estimate of the outcome absent the merger, it also is not possible to draw a conclusion about shipper preferences for single-line service from Dr. Majure's Exhibit 2. This higher share could have been the result of foreclosure rather than preference for single-line service or some other product differentiation or cost factor.

98. Other data do not indicate a strong preference for single-line service. For example, Figure 9 reports northbound carload shipments through Laredo to Kansas City for finished automobiles. KCS *single-line* movements accounted for only {{ }} of finished automobiles from Laredo to Kansas City, whereas UP *interline* movements accounted for {{ }} of these shipments. Thus, these percentages do not indicate a strong preference for single-line service provided by KCS.

Figure 9: Northbound Finished Automobile Shipments through Laredo to Kansas City-2019

Routing Railroads North of Mexican Border	Total Carloads	Share
KCS Total	{{ }}	{{ }}
KCS-BNSF	{{ }}	{{ }}
KCS	{{ }}	{{ }}
UP Total	{{ }}	{{ }}
UP	{{ }}	{{ }}
Total	{{ }}	

Source: Brown & Zebrowski V.S., workpaper "4 - Traffic Screening.xlsx"
Note: Movements with railroad routing "KCS-NS" are grouped with movements with railroad routing "KCS".

[79] Majure V.S. at ¶32. ("That difference, {{ }} percent [KCS share] where KCS could offer a single-line service compared to {{ }} [KCS share] where they could not, suggests that shippers have a preference for single-line service.").

6.4 Dr. Majure's Flawed Argument that There Are No "Pre-Existing Constraints" on Foreclosure

99. At his deposition, Dr. Majure suggested that it was important to identify whether there was an "unexploited pre-merger way to influence competition that becomes feasible to implement as a result of the merger."[80] He identified this as "one of the conditions for when a vertical merger might have an anticompetitive effect."[81] He also testified that he reached "the conclusion that they don't have any unexploited power in a way that might be unlocked by a merger."[82] In its Response to CSX Interrogatory 27, Applicants' counsel fulsomely described Dr. Majure's statement as demanding identification of a "pre-existing constraint" that prevents CP and/or KCS from engaging in conduct that would lessen competition absent the merger, and that there is a "credible mechanism" by which the merger would make the constraint "no longer bind," so that "unexploited potential to impair competition could be realized" after the merger.

100. Stated more simply, Dr. Majure and the Applicants suggest that it is necessary for the Board or opponents to identify pre-merger constraints on successful foreclosure conduct and explain how the merger would relax or eliminate these constraints. As noted above, Dr. Majure testified that he was unable to identify any such constraints.

101. But such pre-merger constraints are not difficult to identify here. There are legal and economic reasons why CP and KCS would improve their ability to engage in successful anticompetitive conduct by merging rather than cooperating absent the merger. These reasons are the pre-merger constraints that are relaxed or eliminated by the merger.

102. Consider the scenario of foreclosure of UP by KCSM. Absent the merger, it is conceivable that CP and KCS/KCSM could strike a foreclosure contract by which CP would compensate KCS in consideration of KCS engaging in conduct to raise the costs of UP and BNSF for their interline movements (e.g., by raising KCSM rates or delaying shipments of UP and BNSF) in order to cause some shippers to divert to CP/KCS interline movements. The profitability analysis in Section 5 explains that this foreclosure would increase the combined profits of CP and KCS/KCSM. Thus, one might hypothesize that they could reach a mutually beneficial deal to share the profits absent the merger and thus the merger would not have incremental foreclosure effects. Stated differently, this reasoning might be assumed to imply that there is no pre-merger constraint that the merger would unbind.

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[80] *See, e.g.,* Majure Deposition at 90.

[81] *Id.*

[82] *Id.* at 71.

103. However, this would-be pre-merger contract would face an obvious *legal constraint*. The agreement would violate Section 1 of the Sherman Act. As stated, it amounts to a naked exclusionary agreement that would harm competition and competitors. The parties similarly would be in legal jeopardy—in light of both antitrust and STB constraints —if they re-framed the pre-merger contract to make CP the exclusive interline partner of KCS, since the contract would likely harm shippers. These legal constraints are a clear "pre-existing constraint" that would (in the Applicants' words) "limit the feasibility of arrangements CP and/or KCS could have, as separate entities, to align their respective incentives and abilities in a fashion that would lessen competition."[83]

104. This would-be pre-merger agreement also would face an *economic constraint* from the combination of private information and related strategic bargaining incentives of the two parties. CP and KCS/KCSM would have to agree on how to divide the increased profits from the foreclosure. In that negotiation, each side would have the incentive to understate its benefits and overstate its costs in order to claim a larger share of the anticompetitive pie.[84] As a result, they may well fail to reach an agreement, even ignoring legal constraints on such an agreement such as the Sherman Act and other legal restrictions. (Of course, these legal constraints make agreeing on relative costs and benefits and arranging for the side payments even harder, given the need to avoid detection.) The merger solves this problem of private information and strategic bargaining incentives by permitting open communication and eliminating the need to allocate the gains between the two separate parties. Indeed, the Applicants make the analogous argument about such information/bargaining constraints in explaining why CP and KCS would be unable to achieve the claimed efficiency benefits absent the merger.[85]

105. Similar informational/bargaining incentive constraints also would constrain CP and KCS from achieving the foreclosure benefits the merger allows that I discussed in Section 3.2. That section explains how the vertical merger leads to information exchange between the merging Carriers A and X and how that information sharing permits the merged Carrier A/X profitably to raise the division quoted to Carrier Y, while in turn causing shippers to pay higher rates on average. In principle, Dr. Majure might postulate that Carriers A and X could have cooperated in the pre-merger world by exchanging the requisite information and sharing the higher profits. However, this information sharing would be constrained by the

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[83] KCS and CP's Supplemental Joint Responses and Objections to CSXT's Second Set of Discovery Requests, Response to Int. No. 27.

[84] This is a standard constraint when bargaining parties have private information. It has been used to explain why parties do not always settle litigation in advance of spending enormous sums, why there are wars, and other more mundane examples of two parties failing to reach a mutually beneficial agreement.

[85] Brooks V.S. at ¶¶28-36.

same sort of private information/strategic bargaining incentives constraints as above. Each party would have the incentive to misrepresent in order to get a large share of the profits. This is not simply a theoretical constraint. As UP witnesses Rocker & Turner have explained, UP and other carriers maintain confidentiality over their Rule 11 rates quoted to shippers and do not share them with other carriers.[86] Moreover, rational shippers would have the incentive to prohibit such information sharing that would lead to higher rates.

106. Finally, it is important to add that Dr. Majure makes the assumption that there is no foreclosure today, and that any foreclosure incentives are neutralized by the KCS previous and current commitments. However, as discussed above, his claim of no-foreclosure is unsupported, due to the fact that he made no effort to identify what would have occurred in the but-for world absent KCS's acquisition of the Mexican rail assets, as he conceded in his deposition.[87] An assumption that the KCS current commitments also would prevent significant foreclosure by CPKC is flawed because it ignores the fact that CPKC's post-merger incentives to evade adherence to the commitments in order to foreclose are greater than KCS's standalone incentives. This is because the merged firm will capture the larger combined revenue and profits from the foreclosure, as discussed in Section 5. That is, there will be a greater post-merger incentive to evade whatever pre-merger constraints occur from the commitments (or constraints from any other pre-merger impediments that might not be observable to outsiders). And in light of how difficult it must be is to detect violations of the rate commitments (as discussed in the next section), it also follows that foreclosure risks are increased by the merger.

7. A Specific Commercially Reasonable Rule 11 Rate Methodology for CPKC's Monopoly Segments Can Avoid Foreclosure Concerns

107. In this section, I discuss a commercially reasonable Rule 11 rate formula to address foreclosure concerns raised by the merger.

7.1 Applicants' Commitments are Vague and Insufficient

108. The analysis in this report confirms that there are significant anticompetitive foreclosure concerns raised by the merger. Dr. Majure suggests that CP has made commitments sufficient to prevent any foreclosure. As he explains, "CP's willingness to make the same sort of commitments adopted by KCS at Laredo [in the KCS-KCSM merger]. . . " means

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[86] Rocker & Turner V.S. at 9-10. *See* also Deposition of John Brooks, February 4, 2022, at 51-52.

[87] Majure Deposition at 102-107.

that "CP/KCS should be expected to interchange traffic even where it can offer an enhanced service if the shipper, nevertheless, prefers a different routing or wants to use a different carrier."[88]

109. Applicants have stated a commitment, through CP's Executive Vice President and Chief Marketing Officer John Brooks, to maintain Laredo as an open gateway, pursuant to a previous commitment that KCS made in 2003 with its acquisition of what became KCSM.[89] By "open" gateway, Mr. Brooks states first that CPKC will maintain the "operational efficiency" of gateways like Laredo "to maintain efficient operations… wherever traffic levels warrant—in terms of both the through train services to and from the gateways as well as the operational capabilities and infrastructure necessary to carry out efficient interchange."[90]

110. Applicants have also committed generally to maintaining the "commercial viability" of gateways like Laredo, such that "when a customer requests a rate for only the former-CP or former-KCS portion of an origin-to-destination routing, we will provide the shipper with a Rule 11 rate to the gateway."[91] By this commitment, Mr. Brooks states that "we will not make it impossible to construct viable interline options for shippers by refusing to quote commercially reasonable rates."[92]

111. However, this pricing commitment is vague and incomplete. Mr. Brooks' statement does not define either "viable" or "commercially reasonable rates." Nor is it clear whether this commitment applies to KCSM rates to-or-from the Laredo gateway. Without a firm understanding of what this rate entails, the commitment is meaningless.

112. This concern about the vagueness of CP's commitments is buttressed by some of the ambiguities in Mr. Brooks' Verified Statement, which includes many of the promises summarized above but which also raises additional questions. Importantly, Mr. Brooks distinguishes between interlining (a) on routes where the combined CPKC "will not reach" and where they will "obviously" maintain their ability to interchange efficiently (e.g.,

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[88] Majure V.S. at ¶38.

[89] Brooks V.S. at ¶¶35, 42. Brooks further states that "CP also looks forward to stepping into KCS's shoes to continue cooperating with UP on interline traffic over the important Laredo gateway."

[90] Brooks V.S. at ¶45.

[91] Brooks V.S. at ¶46.

[92] *Id*. "Commercial viability" is not the same as "commercial reasonableness." Mr. Brooks' "commercial viability" standard would appear to allow CP to attempt to engage in margin squeezes by raising its Rule 11 rates for its segment of interline movements. That standard would allow substantial single-line rate increases by the integrated carrier, to the detriment of shippers.

interchange with UP at the Kansas City gateway serving Powder River Basin coal)[93] and (b) traffic that either CP or KCS interchange today but that CPKC can potentially "serve better" with their integrated routing post-merger (e.g., service from Mexico through Laredo to the Upper Midwest).[94] Regarding the latter, Applicants offer only a "promise" not to try to foreclose non-integrated competitors that customers may prefer to use because "that would hurt us in the long run by damaging the value of our brand as a promise of customer value."[95] This suggests that Applicants understand the difference between routes on which there might be an incentive to foreclose an interline "competitor," and those with an interline "partner" where this incentive is missing. Yet Applicants make only vague promises not to foreclose competitors, and those are premised only on maintaining CPKC's brand value with customers. This type of commitment is flatly insufficient to protect competition and shippers.

113. Applicants have conceded the fact that its commitments are insufficient. In its letter to the NITL, CP explained this insufficiency as follows:

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}}[96]

114. KCSM states that it sets rates to all users on a non-discriminatory basis.[97] However, a commitment for KCSM to charge the same nominal rate for shipments that interchange with UP at the Laredo gateway as for the same or similar shipments that interchange with KCS

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[93] Brooks V.S. at ¶39. Brooks also refers to these as "friendly" connections—i.e., ones where each partner needs the other to serve the customer. Brooks V.S. at ¶28.

[94] Brooks V.S. at ¶40.

[95] *Id*.

[96] Letter from CP to National Industrial Transportation League (June 25, 2021) (CP-HC-00000851-854) at ¶¶2-3.

[97] KCS and CP's Joint Responses and Objections to UP's First Set of Discovery Requests, Response to Request No. 63. ("All Commercial rates are to be offered to shippers in a non-discriminatory manner. As a result of the interplay of these laws, if KCSM provides one shipper with a rate from Mexico to the Laredo gateway, it must in general also provide other shippers with a similar rate.") KCS and CP's Joint Responses and Objections to UP's Third Set of Discovery Requests, Responses to Request Nos. 176, 186.

would not prevent foreclosure.[98] KCS (or CPKC) can achieve an effective price foreclosure goal by setting a high nominal rate for KCSM that raises UP's costs to whatever level is desired and then setting whatever KCSM/KCS (or CPKC) through rate as desired by adjusting the Rule 11 rate on the KCS segment in the US or the single-line rate.[99] KCS has this discretion. It explains that it sets rates on the basis of numerous factors "including but not limited to the market, operating and cost considerations, the type of service, volume, risk premiums (such as hazardous materials or high end commodities), asset availability, network capacity, competitive modes of transportation, and regulatory requirements."[100] At the same time, KCS has discretion because the portion assigned to KCSM vs. KCS would be purely an accounting matter for the combined corporation.[101]

115. Indeed, Applicants have essentially conceded that it would be impossible for UP (or the Board) to determine whether KCSM's current rates are reasonable or not. As Applicants' attorneys explained in response to UP's Motion to Compel,

> The Board did not define "commercially reasonable" in its 2004 Tex Mex decision. See Tex Mex Decision at 19. There are no set metrics; there are no dollar caps. There is no ruler by which UP could even determine, at this later date and with full hindsight, whether a particular rate offered for one customer in 2019 for intermodal traffic between Mexico City and Kansas City is "commercially reasonable" without wild speculation.[102]

116. A commitment that is not easily enforceable because it lacks any metrics or any basis on which to evaluate compliance offers no protection to competition or shippers.[103] Only an administrable and enforceable methodology for setting and determining commercially reasonable rates for interline movements can mitigate the risk of anticompetitive foreclosure.

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[98] This same basic analysis applies to shipments that interchange with BNSF at Corpus Christi or Robstown.

[99] *See, supra* note 97 at No. 168. KCS and CP's Joint Responses and Objections to UP's Second Set of Discovery Requests, Response to Request No. 148.

[100] *Id.*

[101] It is possible that tax consequences could differ. However, this likely would be a second-order effect.

[102] Applicants' Reply To UP's Motion to Compel (Feb. 7, 2022).

[103] *See*, e.g., Antitrust Division, Department of Justice, MERGER REMEDIES MANUAL (September 2020) at 8, 16.

7.2 A Proposed Commercially Reasonable Rate Formula for CPKC Monopoly Segments

117. The Board should consider the following methodology for the determination of commercially reasonable Rule 11 rates for KCSM movements to-and-from the Laredo gateway. I refer to this methodology as the Competitively Reasonable Rate (CRR) formula. Under the CRR formula, when a shipper asks CPKC for a single-line rate for the portion of a movement served by CPKC and a Rule 11 rate solely for the monopoly portion, CPKC would set KCSM's Rule 11 rate as a prorated percentage of the merged firm's single-line rate for the entire movement. In the case of UP movements involving the Laredo gateway, the CPKC monopoly portion would be the portion from the Mexican origin or destination point to the Laredo gateway. In the case of BNSF movements, the CPKC monopoly portion would be the portion from the Mexican point to the BNSF interchange point at Robstown or Corpus Christi. The prorated percentage in the CRR formula would be set equal to the ratio of the KCSM miles (or the KCSM and KCS miles, in the case of BNSF movements) to the KCSM/KCS/CP single-line miles from the origin to the destination (or to an interchange with another carrier).

118. To illustrate, suppose that CPKC quotes a through rate of $6000 for a class of merchandise for movements from its origin station in Mexico to Chicago. Suppose that the KCSM miles from the origin station to the Laredo gateway represents one-third (i.e., 33.3%) of the miles for the merged firm's full movement to Chicago. In that case, the CRR for KCSM's share of the movement to the Laredo gateway would be $2000 (i.e., 33.3% x $6000). These rates would be disclosed to the shipper, not to the competitors of the merged firm.

119. To paraphrase the Applicant's language that "when a customer requests a rate for only the former-CP or former-KCS portion of an origin-to-destination routing, we will provide the shipper with a Rule 11 rate to the gateway,"[104] the CRR might be phrased as follows: when a shipper requests a rate for CPKC service on only the former-CP or former-KCS/KCSM portions of an origin-to-destination route and a rate for CPKC single-line service on a competitive route, the merged firm must provide a Rule 11 rate for the former-CP or former-KCS/KCSM portions that reflects a mileage-based prorate of its single-line rate. The prorate would be equal to the ratio of (a) the miles of the merged firm from the origin point to the interchange point to (b) the miles of the merged firm from the origin to the

[104] Brooks V.S. at ¶46.

interchange *plus* the miles of the merged firm from the interchange point to the destination point.[105]

120. This CRR formula has several advantages over other more complex methodologies.[106] First, the administrative costs are low. The CRR is straightforward for the merged carrier to calculate and implement. Compliance also can be easily monitored by the shipper, which will be given both rates by the merged CPKC. Thus, it can be enforced the shipper itself. It similarly is simple for the Board (or an arbitrator) to resolve disputes under this approach, unlike the great complexity and interminable disputes associated with efforts to actually estimate the relevant marginal costs of the two segments and other factors.[107] Second, the CRR protects competition. It ensures access to commercially reasonable interline rates; it prevents the integrated carrier from engaging in a margin squeeze against the interline carrier; and it does not permit the unintegrated carrier automatically to see the single-line rate. Third, the CRR does not regulate the single-line rate; it simply sets the Rule 11 rate on the monopoly segment in accordance with CPKC's own rate decisions.

7.3 The CRR Formula Will Not Reduce Competition

121. Applicants might attempt to argue that the CRR formula will force rate equalization and deter rate reductions driven by lower costs in the same way as the now-discredited DT&I

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[105] The Applicant's Michael R. Baranowski has not suggested that KCSM's operating costs should be treated as exceeding KCS's cost. As he stated, "I also assumed, based on high-level comparisons of KCS and KCSM costs per unit of output that KCS URCS costs are a reasonable surrogate for KCSM costs for diverted volumes. (APP., *Verified Statement of Michael R. Baranowski* (October 29, 2021) (*hereinafter*, Baranowski V.S.) ¶22 at 415.) Applying the MSP adjustment avoids any argument that CPKC would be disadvantaged by the CRR methodology.

[106] These complex alternatives might include a specified mark-up over some measure of costs; the rates charged before the merger, adjusted for objectively measured cost and other changes; rates charged on other comparable routes unaffected by the merger; etc. These alternatives all involve judgment calls (e.g., the level of the mark-up; the particular routes or historical period used as benchmarks; any other factors used to adjust rate levels). As a result, they involve higher administrative cost and complexity that also could lead to more disputes and an inability to resolve these disputes quickly.

[107] Allowing the CPKC the discretion to base the division on its own estimate of the relative costs of the two movements would effectively permit it to set a very high rate for the interline segment under the guise of it being reasonable under the circumstances. In its responses to discovery, KCS states that it assigns revenue divisions between KCS and KCSM "based on the circumstances particular to the move, including but not limited to mileage divisions, operating cost considerations, overall base costs (such as higher fuel costs in Mexico or additional security needs), WACC differences in the United States and Mexico, and regulatory requirements (such as TUCE (Max) rate considerations in Mexico)" KCS and CP's Joint Responses and Objections to UP's Second Set of Discovery Requests, Response to Request No. 148. This approach would be impossible for the shipper or a third party to evaluate easily in real time, but rather would lead to more disputes that would be difficult to resolve in an accurate or timely way.

conditions. However, this criticism is not well-founded. This is because the CRR is far narrower than the DT&I conditions[108] and is formulated to preserve competition among the carriers. In particular, the CRR does not constrain the single-line rate of the merged firm; it simply bases the Rule 11 rate on the monopoly segment of the carrier's independently-determined rate. Nor does the CRR require a negotiation with the competing interline carrier.

122. Applicants also might argue that the CRR formula will reduce competition by diminishing its incentive to reduce its rates in response to cost savings achieved by the merger. While it is the case that reductions in CPKC's single-line rates will lead to some reductions in the CRR, the CRR will not reduce competition for several reasons.

123. First, this argument overlooks the fact that the goal and impact of the CRR is to prevent price foreclosure that would otherwise occur, and which would lead to *higher* single-line rates and *higher* rates charged on interline routes. As demonstrated by the economic analysis presented in this report, CPKC will have the ability and incentive to foreclose unintegrated competitors by raising its rates for its portion of interline movements that would allow it to raise its single-line rates. By preventing that foreclosure, competition will be maintained, not deterred.

124. Second, any reduction in the Rule 11 rate caused by the CRR will amount to only a fraction of the reduction in the single-line rate. For example, suppose that CPKC were to reduce its costs by $100 and decided to reduce its single-line rate by $50, taking the other $50 as an increase in its margin. If its monopoly segment accounted for one-third of the mileage of the total movement, the CRR would fall by $15. Even if the interline competitor passed on this entire $15 fee reduction, it would not be able to match CPKC's single-line rate reduction. Thus, CPKC could still gain more business and a higher margin.

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[108] Rulemaking Concerning Traffic Protective Conditions In Railroad Consolidation Proceedings, 366 I.C.C. 112 (1982).

VERIFICATION

I, Steven C. Salop, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on February 27, 2022.

/s/ Steven C. Salop

Appendix A. Professor Salop's Curriculum Vitae

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PERSONAL Born, December 23, 1946; Married to Judith R. Gelman, three children; U.S. Citizen.

FIELDS OF SPECIALIZATION

Industrial Organization, Competition and Antitrust Policy, Economics of Information, Economic Analysis of Law.

DEGREES

Ph.D.	Economics, Yale University, 1972
M. Phil.	Economics, Yale University, 1972
B.A.	University of Pennsylvania, 1968

AWARDS

AALS Antitrust Section Lifetime Achievement Award (2019);

AAI Antitrust Achievement Award (2010);

Summa Cum Laude, with Honors in Economics, University of Pennsylvania, 1968;

Schoenbaum Prize in Economics, University of Pennsylvania, 1968;

NSF Graduate Fellowship, 1968-72;

Phi Beta Kappa, 1968.

EMPLOYMENT EXPERIENCE

Professor of Economics and Law, Georgetown University Law Center (at GULC since August 1981).

Guest Scholar, Brookings Institution, 1990-1991.

Visiting Professor, Massachusetts Institute of Technology, Spring 1986.

Visiting Interdisciplinary Professor, Georgetown University Law Center, July 1981-June 1982.

Associate Director for Special Projects, Bureau of Economics, Federal Trade Commission, January 1980-June 1981.

Assistant Director for Industry Analysis, Bureau of Economics, Federal Trade Commission, September 1979-January 1980.

Deputy Assistant Director for Consumer Protection, Bureau of Economics, Federal Trade Commission, December 1978-September 1979.

Economist, Division of Consumer Protection, Bureau of Economics, Federal Trade Commission. July 1978-December 1978.

Visiting Professor, Department of Economics, University of Pennsylvania, September 1977-June 1978.

Economist, Office of Economic Analysis, Civil Aeronautics Board, September 1977-July 1978.

Economist, Federal Reserve Board, July 1972-September 1977.

Adjunct Professor, Department of Economics, George Washington University, September 1975- January 1978.

PUBLICATIONS

Books and Reports

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"Economic Reasoning for Lawyers: Cases and Materials" (2010)

SELECTED PROFESSIONAL ACTIVITIES

Co-Chair, Georgetown Global Antitrust Enforcement Symposium (2013- present)

ABA Antitrust Masters Course (2016, 2014, 2012, 2010)

American Antitrust Institute (AAI) Advisory Board

ABA Antitrust Presidential Transition Taskforce (2012)

Associate Editor, JOURNAL OF INDUSTRIAL ECONOMICS (1997-2000)

Advisory Committee, FTC Hearings on Global and Innovation-Based Competition (1996).

Associate Editor (Industrial Organization), JOURNAL OF ECONOMIC PERSPECTIVES (1987-1993).

ABA Antitrust Task Force on Second Requests (1990).

Advisory Board, Georgetown Project on Treble Damages (1986-1987).

Associate Editor, JOURNAL OF INDUSTRIAL ECONOMICS (1983-1988).

Associate Editor, INTERNATIONAL JOURNAL OF INDUSTRIAL ORGANIZATION (1984-1989).

Secretary, Antitrust Section, American Association of Law Schools (1983-1984).

Memberships: American Economic Association, American Bar Association, Phi Beta Kappa.

Nominating Committee: American Economic Association, 1982.

Economics Editorial Advisor, JOURNAL OF CONSUMER RESEARCH, 1982.

OTHER ACTIVITIES

Senior Consultant, Charles River Associates

President, Salop Economics Inc. (1982-present)

Board of Directors, Charles River Associates (1998-2008)

Board of Trustees, The Lowell School (1989-1995)

Appendix B. Numerical Example of Foreclosure with Imperfect Information

The analysis of pre-merger and post-merger competition can be illustrated with a numerical example where the shipper obtains through rates from the competing carriers. The results do not depend on the specific parameter values of the example.[109] As in the example of the one-lump theory (see paragraphs 36–39 above), suppose that the shipper's reservation price is $400 and that demand is inelastic (say, equal to 1 unit) for any price below $400. However, assume now that instead of the competing carriers each having a cost of $100, their costs for the specific movement for the specific shipper may be different and may fall anywhere (independently and uniformly) within a range of $50 to $150, so that the cost of either competing carrier is equal to $100 *on average*, but may differ for a particular shipper's movements. Assume further that neither competing carrier knows the other's cost and, more importantly, that the monopoly carrier does not know the costs of the competing carriers. To show the effect of imperfect information in the simplest context, one can continue to assume that the monopoly carrier's cost is $150 and that the competing carriers know this cost.[110] Furthermore, when the competing carriers bid for the shipper's movement, one can assume for simplicity that they each observe the division that the monopoly carrier has quoted to the other competing carrier.

Under these conditions, in the pre-merger market, each competing carrier will offer a through rate to the shipper that depends on its own total cost, its expectations about likely rates offered by the other competing carrier, and the bid process used by the shipper.[111] The total cost of a competing carrier includes the division quoted by the monopoly carrier, which I discuss further

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[109] Moresi et al., *supra* note 28, demonstrates that the one-lump theory is rejected under general conditions when the monopoly carrier has imperfect information regarding the competing carriers' costs and the shipper has inelastic demand up to its maximum reservation price. The numerical example presented in this appendix is consistent with that article, and the equilibrium prices reported here were calculated using the formulas provided in the article.

[110] If the monopolist's costs also vary, the analysis is more complicated. But the one-lump theory still does not apply.

[111] In the formal model of Moresi et al., *supra* note 28, the carriers' "offers" are their "best" (i.e., minimum) price offers. The shipper chooses the carrier by running sequential bid rounds where each carrier continues to lower its prices until one of the carriers drops out. A carrier will drop out rather than bid below its costs. Thus, in this situation, the winning bidder will be the carrier with the lower cost realization. But it will be paid a price above its own costs, at a level just below the cost of the other, higher cost carrier. For example, if the two carriers have costs of $80 and $120 respectively for a particular movement, the $80 cost carrier will win the competition and be paid a price of $119.99, that is, approximately $120. In technical economic terms, this is equivalent to what economists denote as a "second price" auction. However, as shown in that article, the main post-merger results are the same in the scenario where the carriers make sealed-bid offers, what economists denote as a "first price" auction, and the pre-merger results have the same expected value.

below. Each competing carrier thus will offer a through rate to the shipper that depends on its costs for the specific movement and will have an incentive to offer a higher through rate in situations where its costs are higher. The shipper will then choose the movement with the lowest through rate.

The monopoly carrier bases its own division quotes on its imperfect information about the competing carriers' likely costs and mark-ups. To illustrate, suppose that the monopoly carrier knows that the competing carriers have costs in the $50-$150 range, but does not know the actual costs or resulting contributions to the through rate each will bid to the shipper in its through rate offer. It would not make economic sense for the monopoly carrier to set a division higher than $350. If it did, the competing carriers would be unable to offer through rates that do not exceed the shipper's reservation price of $400, even at the minimum cost of $50.

Applying the analysis in the Moresi et al. article, the monopoly carrier will quote a division to each competing carrier of $283.33 to maximize its *expected profits*.[112] Each competing carrier would then form its own through rate offer to the shipper using this quote from the monopoly carrier, along with its own cost and its expectations of the cost and resulting rate of the other competing carrier. Note that, if a competing carrier's cost is higher than $116.67 (which is possible since costs are anywhere between $50 and $150), then that carrier will not bother to bid since it cannot offer a through rate below the shipper's reservation price of $400. However, if both competing carriers have costs below $116.67, then the winning bid is less than $400 and thus the shipper will obtain some "surplus" value. For example, if the through rate paid is $390, the shipper will obtain a surplus of $10 (i.e., $400 - $390). But if the costs are sufficiently high – say, each competing carrier has a cost of $120 – then the two competing carriers will not be able to offer rates below the shipper's reservation price of $400, and so the shipper will go elsewhere.

To summarize, competition in the pre-merger market with imperfect information leads to the shipper obtaining a through rate below its reservation price some fraction of the time, in particular, when the competing carriers' cost realizations are relatively low. When their cost realizations are higher, the shipper either pays its $400 reservation price for the rail transport or chooses the alternative. Combining the effects of the various possible cost realizations for particular movements, the average through rate paid by the shipper (conditional on the shipper using rail transport) will be less than its reservation price. The monopoly carrier is unable to extract the full monopoly profit margin, contrary to the one-lump theory. Instead, some of the surplus accrues to the shipper and the competing carriers.

Consider next the effect of a vertical merger between the monopoly carrier and one of the competing carriers on the other segment. After the merger, the vertically-integrated carrier

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[112] The pre-merger equilibrium division of $283.33 is obtained using the formula in Moresi et al., *supra* note 28.

offers a division to the independent competing carrier, and then the two carriers bid through rates to the shipper. However, when the now-integrated monopoly carrier quotes the division to the independent competing carrier, it does so based on the perfect information it now has about the cost of its merger partner and – as before – on the imperfect information it has about the cost and through price offer of the unintegrated competing carrier.[113]

One possible strategy is for the integrated carrier to offer a full monopoly single-line rate of $400 to the shipper and a prohibitively high division to the independent carrier that makes it impossible for the independent carrier to offer a through rate that does not exceed the shipper's $400 reservation price. Since the independent carrier's costs are no less than $50, the monopoly carrier can quote a division of $350 or more, in which case the through price offered by the independent carrier to the shipper necessarily will exceed $400. An equally profitable alternative would be to offer a division to the independent carrier such that the merged firm would earn the same profit margin from the division as it would from its single-line rate of $400. For example, if the costs of the merged carrier for the entire movement are $270 (i.e., $150 incurred by the monopoly carrier and $120 incurred by the merging competing carrier), it could earn profit of $130 (i.e., $400 - $270) by winning the movement at its single-line rate of $400. Alternatively, the merged carrier could quote a division of $280 to the independent carrier; the latter would win against the single-line bid of $400 whenever its cost realization is smaller than $120 (i.e., $400 - $280) and the merged carrier would earn a profit of $130 (i.e., $280 - $150) regardless of which carrier wins the bidding competition.

But a more profitable strategy is for the monopoly carrier to offer a single-line price to the shipper of $400 and quote a division to the independent carrier that is somewhat higher (i.e., between $280 and $350 in the above example) and will assure that the monopoly carrier earns a *larger* profit (than $130) if the independent carrier wins the interline movement than the monopolist would earn if it won the single-line bid at $400. To illustrate, suppose the costs of the merged carrier for the entire movement are $270 (as before) and the monopoly carrier quotes a division to the independent carrier of $315.[114] If the independent carrier's costs exceed $85, then it will not be able to bid a through rate of less than $400 and still cover its costs, in which case the merged firm will win the movement at a single-line rate of $400 and earn profits of $130 (i.e., $400 less its costs of $270). But, if the independent carrier's costs are below $85, then the merged firm would earn profits of $165 (i.e., $315 minus its costs of $150) on the interline segment (since the independent carrier has sufficiently low costs to offer a through rate below $400). For example, if the independent carrier has costs of (say) $80, it would have total costs of

[113] The single-line rate offered by the merged carrier to the shipper accounts for "elimination of double marginalization" (EDM) incentives from the merger.

[114] The post-merger equilibrium division of $315 is obtained using the formula in Moresi et al., *supra* note 28.

$395 (i.e., $80 + $315 for the interline segment) and in principle could offer a through rate between $395 and $400. It would have the rational incentive to offer a through rate of just below $400, say a rate of $399 (or even $399.99). This is because it would properly anticipate that the merged firm was offering a single-line rate of $400. Thus, the independent carrier could offer a rate of $399 (or $399.99) to the shipper and still win the movement. As a result, the shipper would pay a total through rate of virtually $400.

To summarize, the vertical merger harms the shipper. The shipper pays a total through rate of $400 if the cost realization of the unintegrated competing carrier is $85 or above, and a rate of virtually $400 if the competing carrier's cost is less than $85. These $400 rates are equal to the shipper's reservation price, so the shipper obtains zero surplus. Thus, after the merger, the shipper always pays $400 for rail transport (in which case it obtains no surplus).[115] By contrast, the shipper sometimes does obtain a positive surplus in the pre-merger world as a result of the imperfect information. This occurs when the costs of the competing carriers are relatively low so that the winning rate is less than the shipper's reservation price.

The merger harms the shipper by improving the information available to the merged carrier and, in this numerical example, gives the merged carrier an incentive to foreclose the independent carrier by raising the interline fee from $283.33 to $315.[116] Post-merger, the rate paid by the shipper will never be less than $400 (or $399.99). The higher rate resulting from the merger also leads the profits of the monopoly carrier and its merger partner to rise, relative to their pre-merger profits.

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[115] In this numerical example, the highest cost realization of a competing carrier is $150 and the cost of the monopoly carrier is $150, and therefore the maximum total cost is $300, which is smaller than the shipper's reservation price of $400. It follows that, post-merger, the shipper always obtains at least one bid at $400 (from the merged carrier). Moresi et al., *supra* note 28, also consider situations where the maximum total cost is higher than the shipper's reservation price, in which case post-merger the shipper sometimes does not obtain any bid and must use an alternative transport mode.

[116] In general, the division quoted to the independent carrier can increase or decrease post-merger. *See* Moresi et al., *supra* note 28, Proposition 3. However, the shipper is nonetheless always harmed.

Appendix C. Equilibrium Simulation Model With Upstream Monopoly and Differentiated Products, Downstream Duopoly: Take-It-or-Leave-It Offers

This technical appendix describes the first equilibrium simulation model.

C.1. Description of the Merger Model

In the model, there are two rail transport segments. The monopoly segment is served by a single monopolist carrier, referred to as Carrier A. The competitive segment is served by two competing carriers, referred to as Carriers X and Y. Shippers use these carriers for their through movements. There are thus two competing rail options for a shipper. One option is to use Carriers A and X, and the other option is to use Carriers A and Y. The model assumes that shippers view these two options as non-homogeneous, differentiated transport services.

In the pre-merger market, Carriers A, X, and Y each sets its rate to maximize its own profit. The model formally assumes through pricing both pre-merger and post-merger.[117] It further assumes that Carrier A quotes divisions for its segment to the two competing Carriers X and Y. Given these divisions offered by Carrier A, the competing Carriers X and Y offer through rates to shippers.

In the post-merger market, Carriers A and X operate as a single vertically-integrated Carrier A/X, that sets a single-line rate to the shipper and a division to Carrier Y, in order to maximize its total profits from the two segments. The model assumes that Carrier A/X quotes a division for its monopoly segment to Carrier Y, and then the two Carriers A/X and Y compete by offering through rates to the shipper.[118]

There are two common technical interpretations of shipper demand in this model. One interpretation is that there are numerous shippers with the same general disutility from price, but with idiosyncratic preferences for carriers, so that not all shippers select the same competing carrier. Under this interpretation, each of the two competing carriers faces a demand function that measures the total demand for its services and that depends on the two through rates set by both competing carriers. A second interpretation is that the carriers have imperfect information about the shipper's preferences. Under this interpretation, each of the two competing carriers faces a "demand function" or a winning probability function that measures the probability that

[117] The model also captures Rule 11 pricing when the shipper obtains the rate on the monopoly segment before the competing carriers set their competitive quotes.

[118] The model follows the basic approach in Das Varma & De Stefano, *supra* note 47. *See* also Domnenko &. Sibley, *supra* note 47.

the carrier will be selected by the shipper and that depends on the two through rates offered to the shipper.[119]

In addition, there also are two technical interpretations of the structure of the shippers' bid requests and the associated bidding competition. One interpretation is that each shipper specifies the total volume it wants to ship, runs a "first-score" auction for all of its volume, and each of the two competing carriers submits a (sealed) bid for the shipper's entire volume.[120] Under this interpretation, each of the two competing carriers faces a winning probability function and rates are total payments for the specified volume. EDM here reflects the fact that a lower bid to the shipper leads to an increased probability of winning the shipper's business. Another interpretation is that each of the two competing Carriers X and Y (or A/X and Y after the merger) posts its unit rate (e.g., per carload) and then, based on the posted unit rates, a shipper with particular preferences for a volume of shipments chooses which carrier to use and how much volume to ship.[121] Under this interpretation, each of the two competing carriers faces a demand function for its transport services that is "downward sloping" (such that a higher price yields lower demand), and rates are per unit of volume shipped.[122]

The simulation model is run for many different values of the demand and cost parameters, so as to generate a range of pre-merger market shares (or winning probabilities) and prices, and a variety of merger effects on prices of rail transport services.[123]

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[119] Quoting a lower rate increases the probability of winning.

[120] A first-score auction generalizes a first-price auction by allowing carriers to offer differentiated products and allowing shippers to choose the product with the highest score (i.e., utility net of price). A first-score auction where non-price product characteristics are fixed is equivalent to a Nash-Bertrand pricing game where shippers select only a single product, as is the case under a standard logit demand structure. *See* Nathan H. Miller, *Modeling the Effects of Mergers in Procurement*, 37 INT'L J. IND. ORG 201 (2014).

[121] Under this interpretation, shippers' behavior is somewhat different than in the standard logit model since they choose both a carrier and a volume. (In the standard logit model, all shippers want to ship one unit and each shipper chooses a single carrier to transport that unit.) Nevertheless, the model assumes that the competing Carriers X and Y face demand functions that have a logit-like shape.

[122] Post-merger, one can think of the monopoly carrier (Carrier A) transferring its service internally to the merger partner (Carrier X) at a nominal price equal to marginal cost, although the merger effects do not depend on the magnitude of this nominal transfer price.

[123] By contrast, Das Varma & De Stefano, *supra* note 47 consider only a single numerical example.

C.2. Description of the Simulation Analysis

The simulation model is formulated as a two-stage game:

> Stage 1. Carrier A sets the divisions that Carriers X and Y must pay to Carrier A for transport services on Carrier A's monopoly segment. Carrier A sets the divisions to maximize its own profit. (Post-merger, Carrier A/X sets the division that Carrier Y pays for transport services on the monopoly segment. Carrier A/X maximizes its total profits, i.e., the total profits of former Carriers A and X.)
>
> Stage 2. Carriers X and Y compete for the shippers' business by simultaneously setting through rates.[124] Each carrier seeks to maximize its own profit. (Post-merger, Carriers A/X and Y simultaneously set through rates. Carrier A/X sets its single-line rate to maximize its total profits, i.e., the total profits of former Carriers A and X.)

The pre-merger model is solved using backward induction. This involves deriving the equilibrium rates set by Carriers X and Y (in stage 2), for any given divisions set by Carrier A (in stage 1), and then deriving the equilibrium divisions, assuming that Carrier A correctly anticipates how changing the divisions would affect the through rates of the two competing carriers and hence their volumes of transport on the monopoly segment. The post-merger model also is solved in a similar way using backward induction.

The model assumes that shippers have heterogeneous preferences over the carriers' services. Following the railroad literature, the model assumes that carriers face demand functions (or winning probability functions) that have a logit structure.[125] The model further assumes that each shipper has three shipping options available: Carrier X and Carrier A; Carrier Y and Carrier A; and an alternative mode of transport for the entire through movement. Under the logit structure, the first two options are called the "inside goods" and the third option is called the "outside good."

The model captures the heterogeneous preferences of shippers by using the standard discrete choice modeling approach and applying it to a large number of different bidding competitions. Each bidding competition is different because there are many different through movements (e.g., different origins and destinations) and many different product categories. As discussed earlier, each bidding competition can be interpreted as involving either a large number of heterogeneous shippers or a single shipper with preferences that are unknown to the competing carriers. Thus, a

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[124] The model assumes that Carriers X and Y engage in standard Bertrand-Nash competition with differentiated products and perfect information about each other's cost and demand functions.

[125] *See* Yanyou Chen, *Network Structure and Efficiency Gains from Mergers: Evidence from U.S. Freight Railroads*, Working paper (2021)

shipper may have a preference for Carrier X over Carrier Y, even if both carriers charge the same through rate, while a different shipper may have a preference for Carrier Y over Carrier X.[126]

For each bidding competition, the utility of a shipper from using Carrier X or Carrier Y depends on (i) a demand "fixed effect" that is specific to the carrier (V_X or V_Y) and is the same for all shippers; (ii) the through rate charged by the carrier (p_X or p_Y); (iii) a "price coefficient" (b) that is the same for all shippers and captures the shippers' marginal utility of income and affects the elasticity of demand faced by the carriers; and (iv) an idiosyncratic preference shock (e_{jX} or e_{jY},) that captures each shipper's personal preferences. The utility from using the outside good is, without loss of generality, normalized to a shock e_{j0} (i.e., the systematic component of the utility for the outside good, which is common across shippers, is normalized to zero).

The underlying demand structure can be summarized as follow:

- The utility of shipper j from using Carrier X is given by: $U_{jX} = V_X - b*p_X + e_{jX}$
- The utility of shipper j from using Carrier Y is given by: $U_{jY} = V_Y - b*p_Y + e_{jY}$
- The utility of shipper j from using the outside good is given by: $U_{j0} = e_{j0}$

The model is solved for the following parameter values in order to generate a very broad range of results:

- Three possible values for each of the two fixed effects V_X and V_Y (i.e., 8, 12, and 16);
- Three possible values for the price coefficient b (i.e., 0.05, 0.075, and 0.1);
- Three possible values for each of the two unit costs of production incurred by the two competing Carriers X and Y (i.e., 20, 25, and 30).
- Three possible values for the unit cost of production incurred by the monopoly Carrier A (i.e., 5, 7.5, and 10).
- The "preference shocks" $\{e_{jX}, e_{jY}, e_{j0}\}$ are distributed over $[-\infty, +\infty]$ with Gumbel (extreme value) distribution and are independent of each other.[127]

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[126] *See* Steven T. Berry, *Estimating Discrete-Choice Models of Product Differentiation*, 25 RAND J. ECON. 242 (1994); Jeffrey M. Perloff & Steven C. Salop, *Equilibrium with Product Differentiation*, 52 REV. ECON. STUD. 107 (1985); Simon P. Anderson, André De Palma, & Jacques-François Thisse. *Demand for Differentiated Products, Discrete Choice Models, and the Characteristics Approach, 56* REV. ECON. STUD. 21 (1989).

[127] This is a standard assumption. *See, e.g.,* Gregory J. Werden and Luke M. Froeb, *Unilateral Competitive Effects of Horizontal Mergers*, in Paolo Buccirossi (ed.), ADVANCES IN THE ECONOMICS OF COMPETITION LAW (2006).

It follows that the simulation analysis comprises a total of 729 different combinations of the demand and cost parameters (i.e., $3^6 = 729$). Each combination can be thought of as corresponding to a different bidding or price competition.

C.3. Simulation Model Results

The simulation model generates a sample of pre-merger equilibrium outcomes ("pre-merger bidding or price competitions"). For each pre-merger outcome, the simulation model computes the post-merger equilibrium outcome and calculates the merger effects on prices.

The simulation results can be summarized as follows. These results are then illustrated in the Figures below.

a. Result 1: The merger of Carriers A and X always leads the vertically-integrated Carrier A/X to increase the division (W_Y) charged to the unintegrated Carrier Y.

b. Result 2: The merger of Carriers A and X always leads to an increase in the through rate (P_Y) that carrier Y charges to shippers.

c. Result 3a: The merger of Carriers A and X tends to lead to an increase in the through rate (P_X) that the merged Carrier A/X charges to shippers when the pre-merger volume share (S_X) of merging Carrier X is less than about 25%, and often also when that share is in the 25-40% range.

d. Result 3b: The merger of Carriers A and X tends to lead to a decrease in the through rate (P_X) that the merged Carrier A/X charges to shippers when the pre-merger volume share (S_X) of the merging Carrier X exceeds about 40%, and sometimes also when that share is in the 25-40% range.

The following Figures show these results. Each dot represents a different bidding or pricing competition (with a different set of cost and demand parameters).

Figure C1 shows (on the vertical axis) the post-merger percentage changes in the division (W_Y) charged to the unintegrated Carrier Y for all the various values of the pre-merger equilibrium volume share (or winning probability) of merging Carrier X implied by the model (on the horizontal axis).[128] To make it easier to read, Figure C2 shows the same results but restricts attention to bidding or pricing competitions where Carrier X has a pre-merger equilibrium volume share (or winning probability) smaller than or equal to 50%. Figure C3 and Figure C4

[128] The shares (or winning probabilities) are calculated excluding the outside good.

respectively show the post-merger percentage changes in the through rates (P_Y and P_X) that the unintegrated Carrier Y and the merged Carrier A/X charge to shippers.

Figure C1

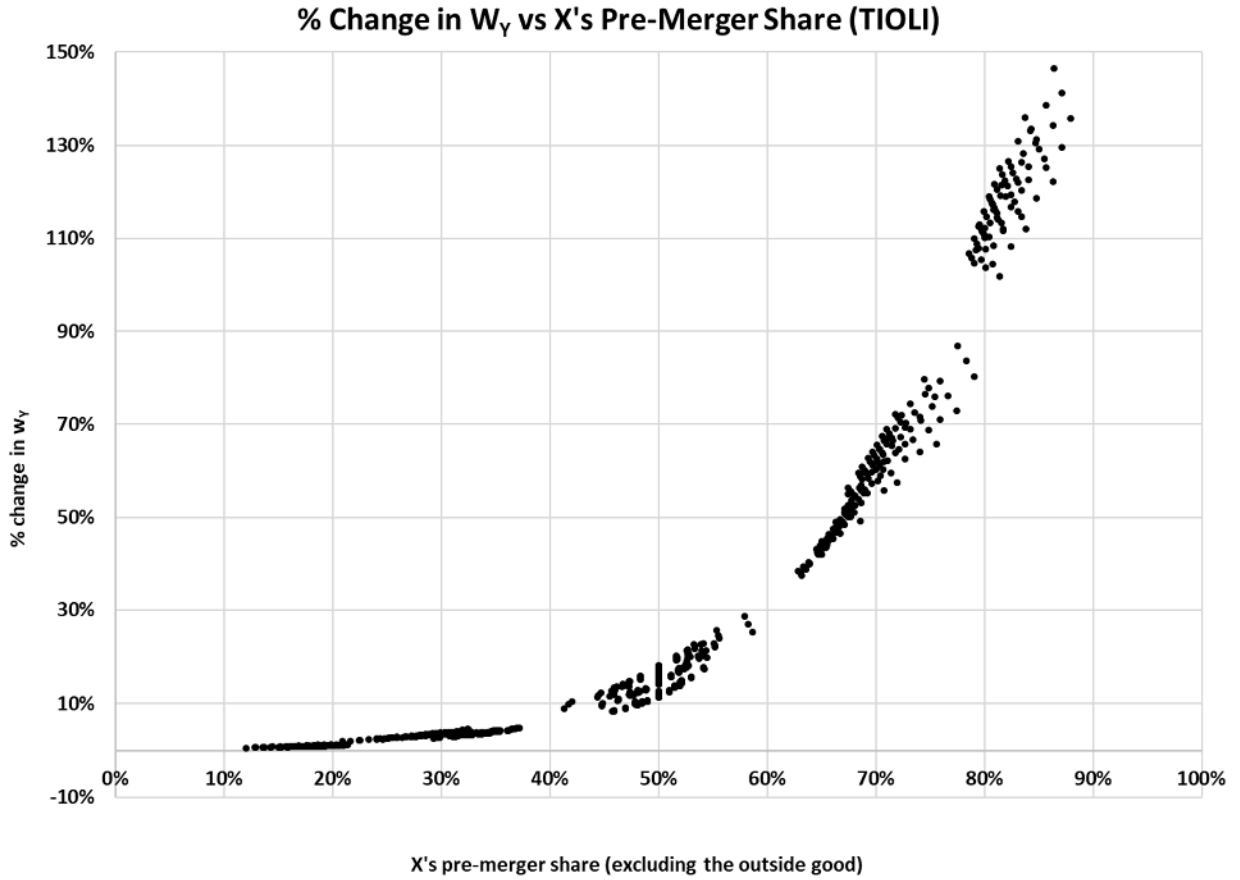


Figure C2

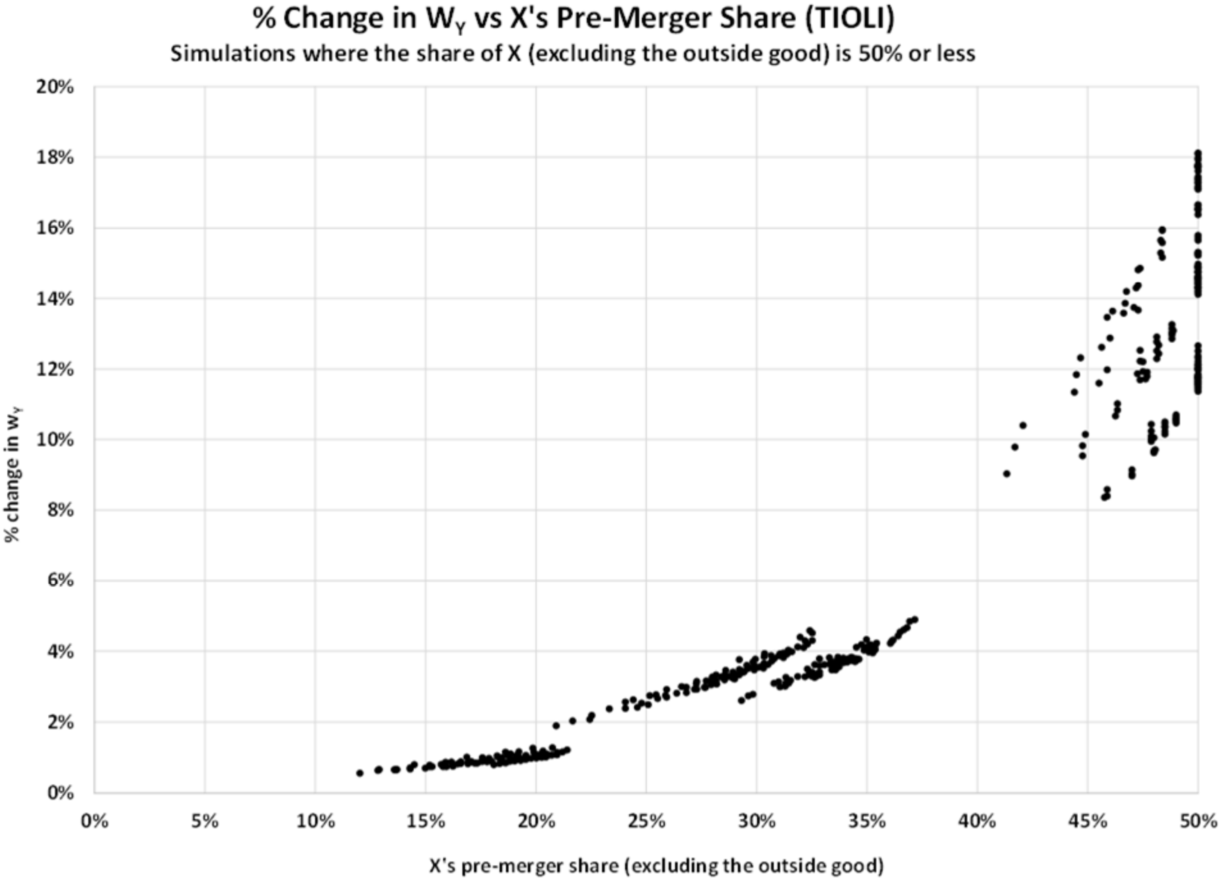


Figure C3

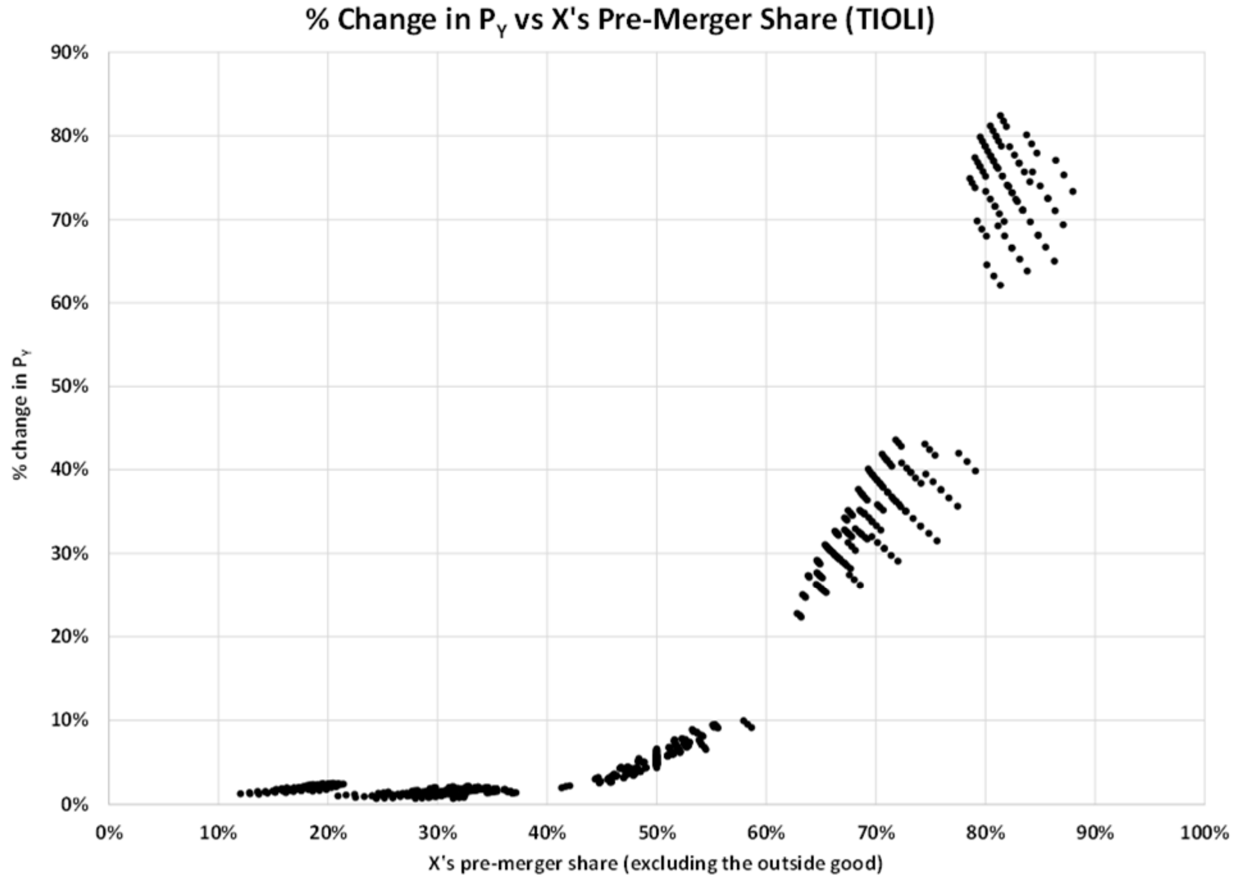
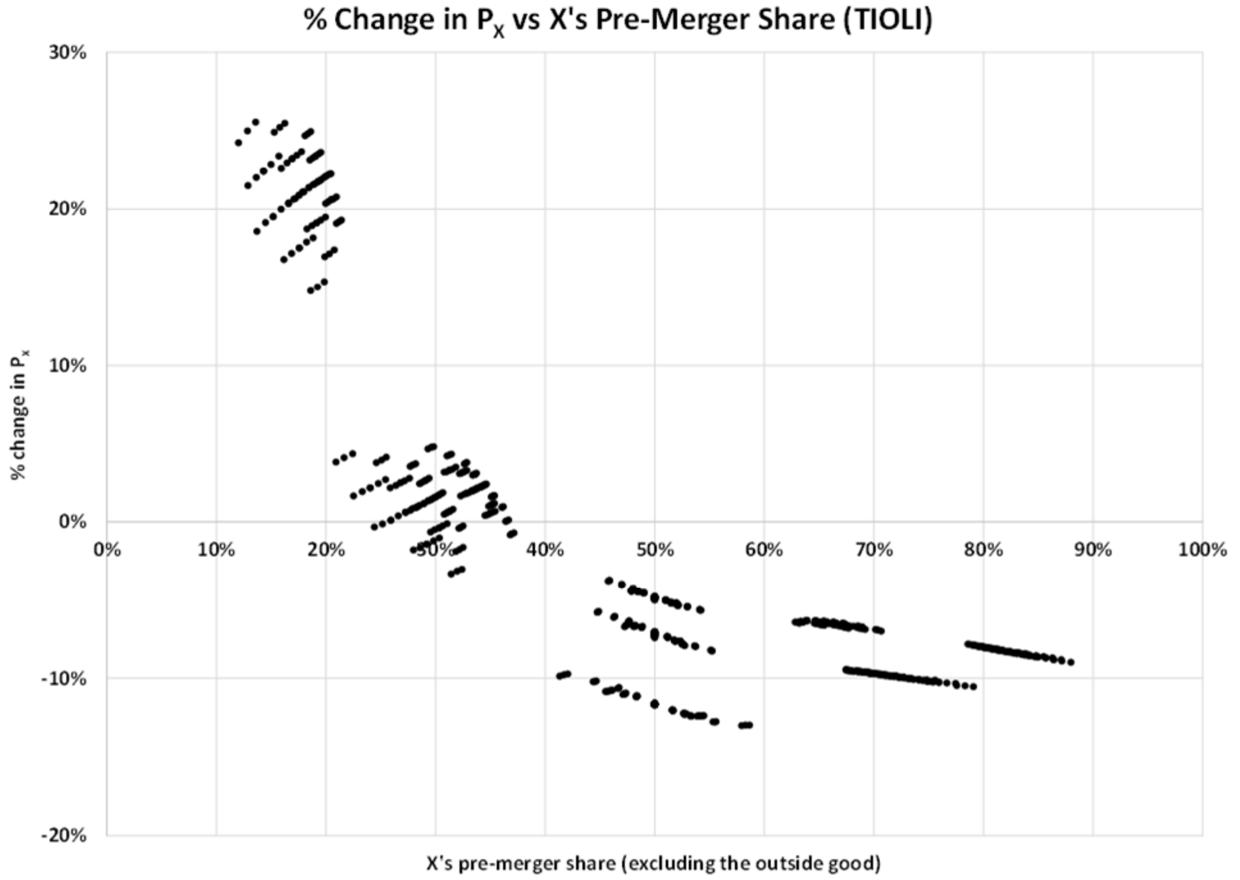


Figure C4



Appendix D. Equilibrium Simulation Model With Upstream Monopoly and Differentiated Products, Downstream Duopoly: Inter-Carrier Negotiations

This appendix describes the variant of the equilibrium simulation model described in Appendix C with inter-carrier negotiations. Since many assumptions are the same in the two models, I will focus mainly on the differences between the models.

D.1. Description of the Merger Model

In the pre-merger market, Carriers A and X negotiate the division for Carrier X's through movements, and at the same time Carriers A and Y negotiate the division for Carrier Y's through movements. Given these negotiated divisions, the competing Carriers X and Y offer through prices to shippers.

In the post-merger market, Carriers A/X and Y negotiate the division for Carrier Y's through movements, and then the two Carriers A/X and Y compete by offering through rates to the shipper.

D.2. Description of the Simulation Analysis

The simulation model is formulated as a two-stage game:

Stage 1. Carrier A simultaneously negotiates bilaterally with each of Carriers X and Y over the division for each carrier's through movements. (Post-merger, Carriers A/X and Y negotiate the division for Carrier Y's through movements.) The model assumes that negotiating carriers have equal bargaining power.[129]

Stage 2. Same as in Appendix C.

The pre-merger model is solved using backward induction. This involves deriving the equilibrium rates set by Carriers X and Y (in stage 2), for any given divisions negotiated between Carrier A and Carriers X and Y (in stage 1), and then deriving the equilibrium divisions negotiated among the three carriers, assuming that all three carriers correctly anticipate how changing the divisions would affect the through rates of the two competing carriers and hence

[129] I use the standard Nash-in-Nash bargaining assumption. *See*, for example, Allan Collard-Wexler, Gautam Gowrisankaran, and Robin S. Lee, "*Nash-in-Nash*" *Bargaining: A Microfoundation for Applied Work*, 127 J. POL. ECON. 163(2019).

their volumes of transport on the monopoly segment and the competitive segment. The post-merger model also is solved in a similar way using backward induction.

The model is solved for the same sets of parameter values as in Appendix C.

D.3. Simulation Model Results

The simulation model generates a sample of pre-merger equilibrium outcomes ("pre-merger bidding or price competitions"). For each pre-merger outcome, the simulation model computes the post-merger equilibrium outcome and calculates the merger effects on prices.

The simulation results can be summarized as follows. These results are then illustrated in the Figures below.

- Result 1: The merger of Carriers A and X always leads to the vertically-integrated Carrier A/X negotiating a higher division (W_Y) with the unintegrated Carrier Y.

- Result 2: The merger of Carriers A and X always leads to an increase in the through rate (P_Y) that carrier Y charges to shippers.

- Result 3: The merger of Carriers A and X almost always leads to an increase in the through rate (P_X) that the merged Carrier A/X charges to shippers.

The following Figures show these results.

Figure D1 shows (on the vertical axis) the post-merger percentage changes in the division (W_Y) negotiated with the unintegrated Carrier Y for all the various values of the pre-merger equilibrium volume share (or winning probability) of merging Carrier X implied by the model (on the horizontal axis). Figure D2 shows the same results but restricts attention to bidding or pricing competitions where Carrier X has a pre-merger equilibrium volume share (or winning probability) smaller than or equal to 50%. Figure D3 and Figure D4 respectively show the post-merger percentage changes in the through rates (P_Y and P_Y) that the unintegrated Carrier Y and the merged Carrier A/X charge to shippers.

Figure D1

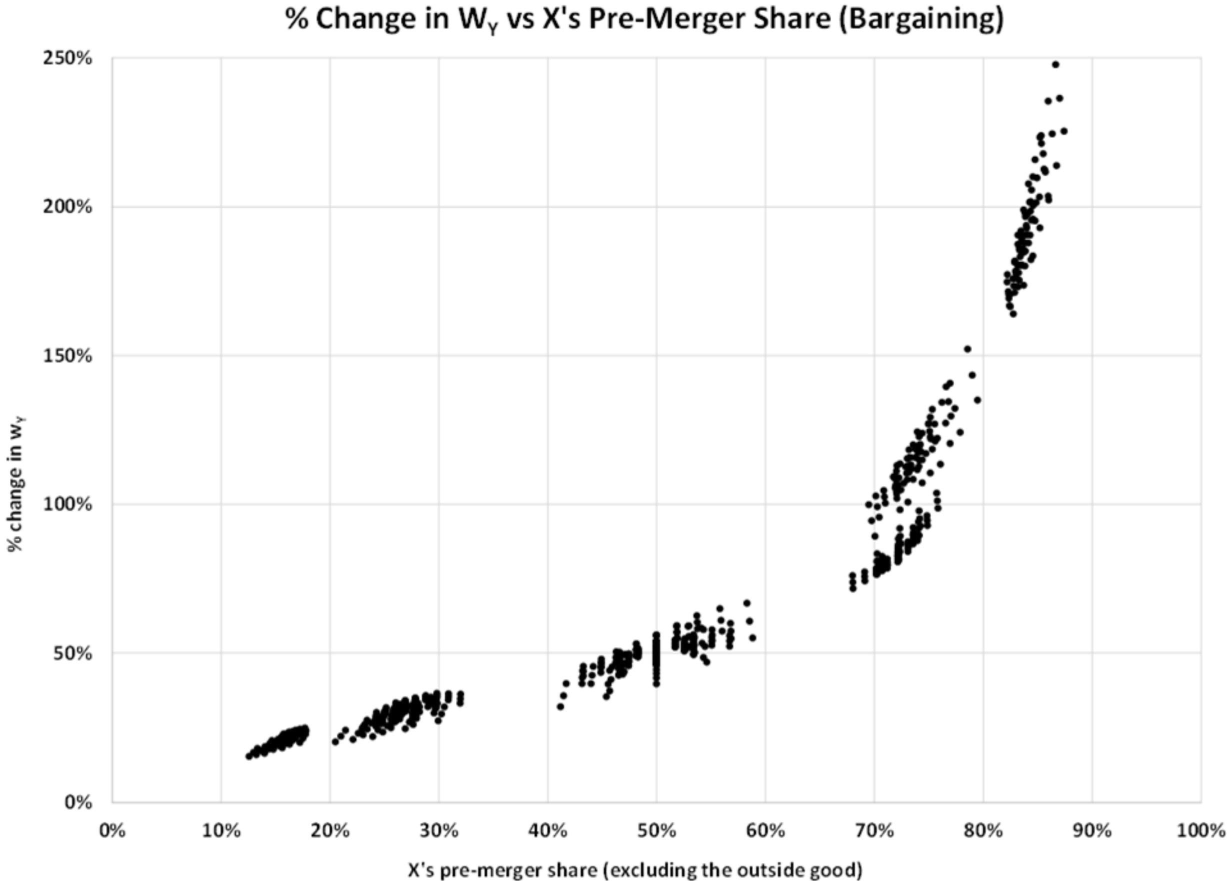


Figure D2

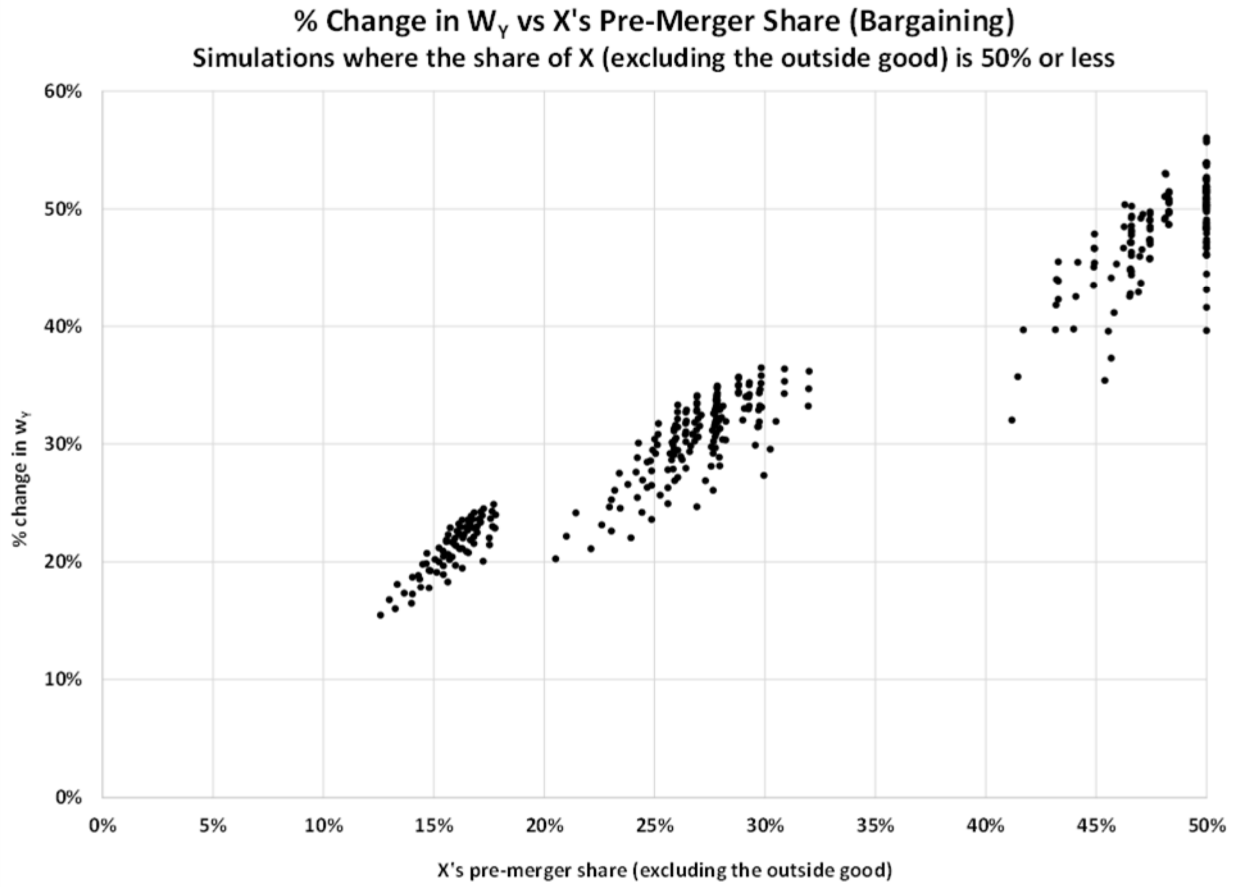


Figure D3

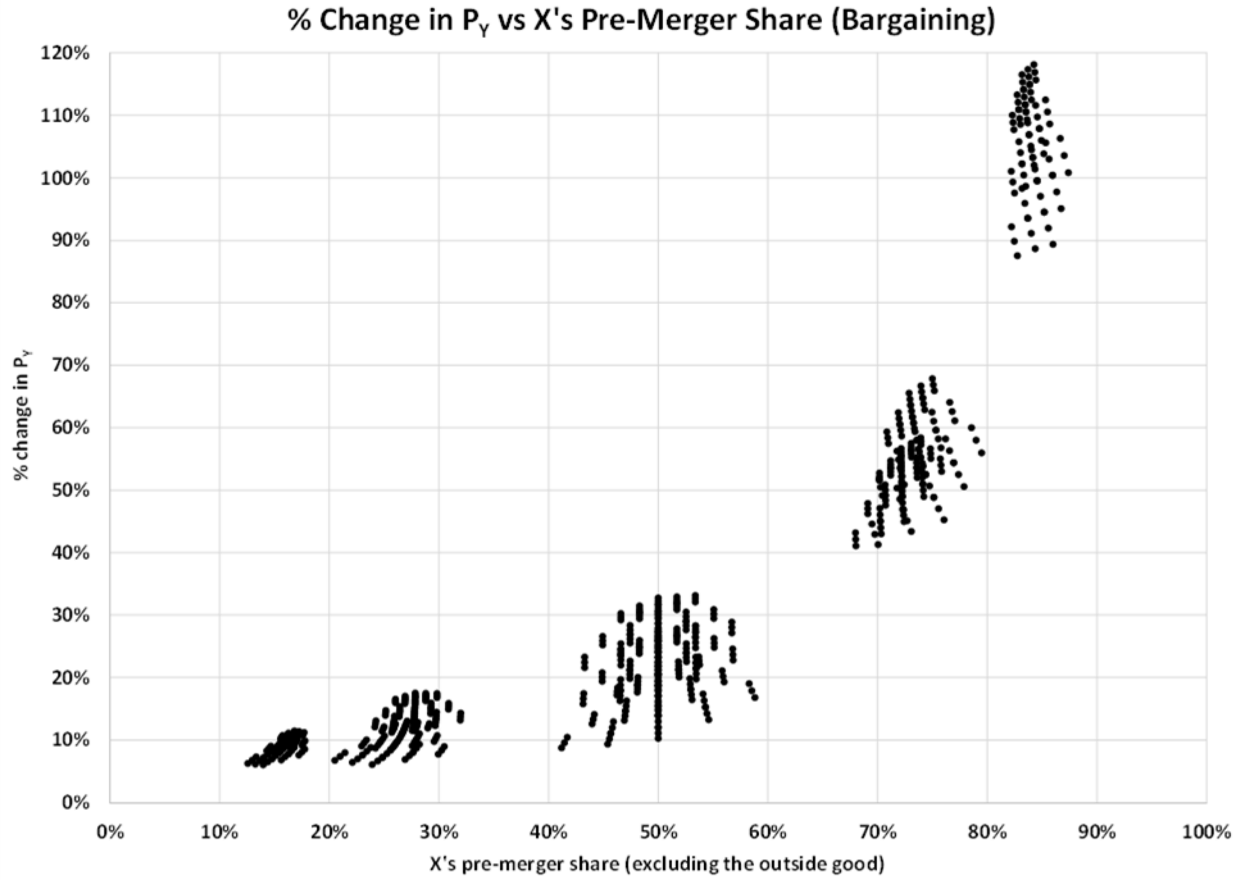
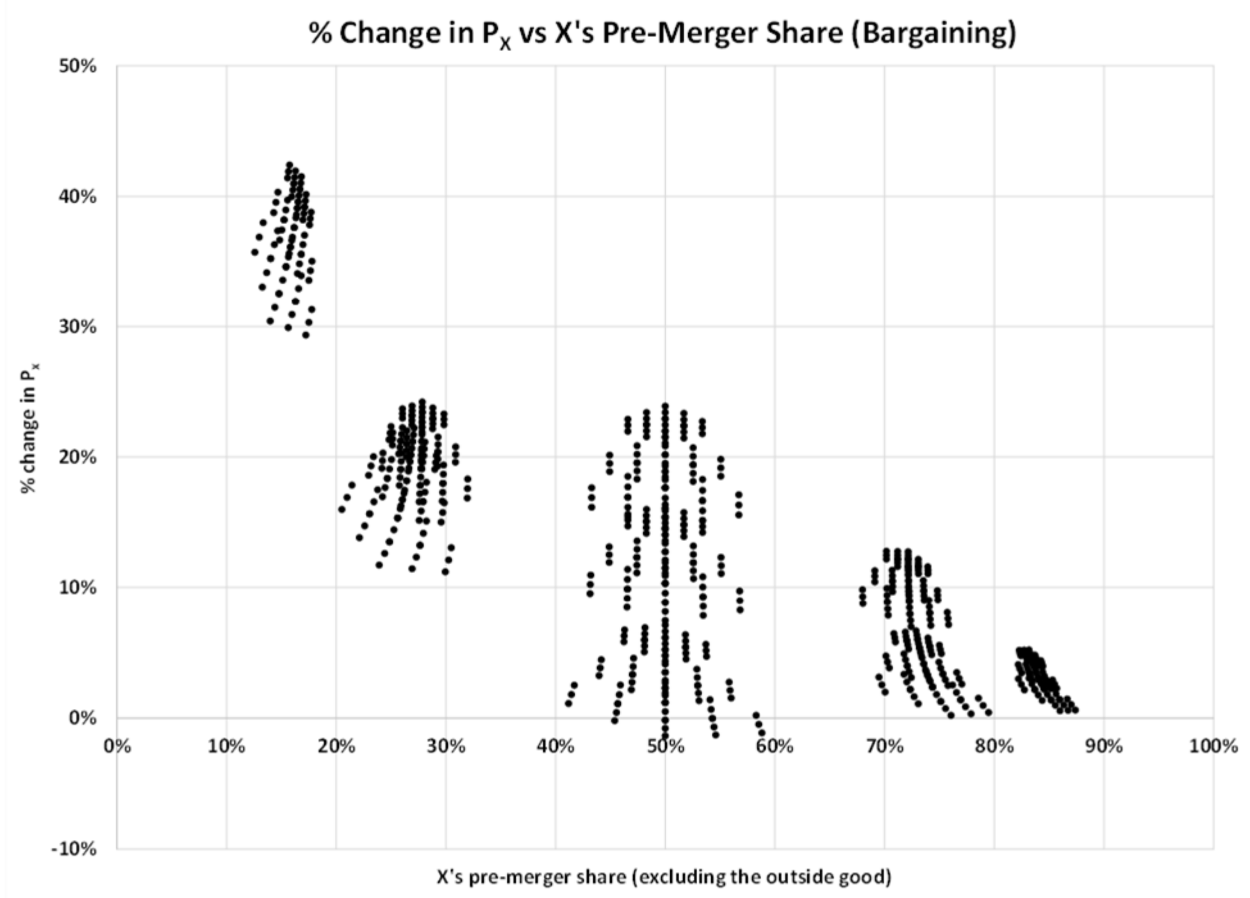


Figure D4



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- Verified Statement of Richard W. Brown and Nathan S. Zebrowski (October 29, 2021)

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

VERIFIED STATEMENT

OF

THOMAS C. HALEY

VERIFIED STATEMENT

OF

THOMAS C. HALEY

1. My name is Thomas C. Haley. I retired in 2019 as Vice President – Network Planning & Operation for Union Pacific Railroad Company (UP). I worked in the railroad industry for 36 years, from 1983 until 2019. More than 30 of those years were with UP.

2. I have extensive experience with railroad operations and finance. I began my railroad career as a college intern with CSX. After graduation, I became a full-time management employee and was assigned to field operations and locomotive management roles. I joined UP's Finance department while earning my Master's in Business Administration in finance and transportation from Indiana University in 1989. In 1993, I moved to UP's Operating department and advanced through several positions until being appointed Assistant Vice President – Network Planning in 2001, followed by my promotion to Vice President – Network Planning & Operation in 2014.

3. As Vice President – Network Planning & Operation, I led the team responsible for UP's service design function, which is charged with taking a holistic view of UP's network and creating transportation plans to deliver high-quality service for UP's customers efficiently and productively across its network. I also oversaw UP's resource planning function, which is charged with assuring UP has the resources in place—the tracks and yards, equipment, and workforce—to execute its service plans. In addition, I led UP's Joint Facilities team, which makes and manages agreements for tracks and other facilities shared with other railroads. My Network Planning team and I were also involved in arranging interline service with other railroads.

4. On behalf of UP, I served on the boards of the Terminal Railroad Association of St. Louis and the Port Terminal Railroad in Houston and oversaw the activities of others on my team who served on the boards of several other jointly owned railroads. I also led UP's Network Development team, which helped develop and coordinate public-private partnerships, including the CREATE project in Chicago, and also helped coordinate projects with commuter rail agencies, including the Capital Corridor and ACE services in northern California, Metra in Chicago, and Metrolink in Los Angeles.

5. Over my many years at UP, I have been involved in many strategic railroad industry issues involving mergers and interline service. I have first-hand knowledge of UP's entire network and substantial portions of the nationwide railroad network. I have traveled with Canadian Pacific Railway (CP) leaders over CP's route between Kansas City and Minnesota, and with Kansas City Southern Railway (KCS) executives on most of the KCS/ KCSM route between the Mexico City area and Laredo, Houston, and Shreveport. I am familiar with rail facilities in the Kansas City area, including the 42-mile joint facility between Polo and Airline Junction that CP uses to access Kansas City (which is shared with UP), the connection between CP and KCS, and CP's and KCS's shared Joint Agency yard.

6. As Vice President – Network Planning & Operation, I helped develop plans and negotiate the terms for KCS's investments in capacity on the UP-owned lines between Robstown and Victoria, Texas, and between Rosenberg and Beaumont, Texas, that are used by KCS to connect with its KCSM concession in Mexico via the Texas Mexican Railway (Tex Mex). My team and I were also involved in designing and improving the UP-KCSM interline service plan and reciprocal blocking arrangements for moving traffic over the Laredo gateway.

7. I have previously testified and filed written statements about rail operations and service before the Surface Transportation Board. I testified at the Board's March 2014 hearing in *Petition for Rulemaking to Adopt Competitive Switching Rules*, Ex Parte No. 711, and the Board's April 2014, hearing in *United States Rail Service Issues*, Ex. Parte No. 724. I also submitted written comments for UP in *Reciprocal Switching*, Ex Parte No. 711 (Sub-No. 1), *Simplified Standards for Rail Rate Cases*, Ex Parte No. 646, and *Major Issues in Rail Rate Cases*, Ex Parte No. 657.

I. Introduction And Summary

8. I am providing this statement at the request of UP in connection with the Surface Transportation Board's review of the proposed combination of CP and KCS (the Applicants).

9. I was asked to address whether Applicants' projected merger-related benefits from the proposed transaction are consistent with Applicants' Operating Plan and real-world network conditions and outcomes Applicants would face when operating a merged CPKC system.

10. Applicants have set themselves an extraordinarily high bar, projecting merger-related benefits of over $1 billion annually (in 2025 dollars) through a combination of revenue growth from traffic gains and operating cost savings.[1]

11. My review of the Operating Plan and related materials in the Application and accompanying workpapers led me to three main conclusions:

- ***First*****,** Applicants' projected operating costs savings are small, amounting to just 3.1% of CP's and KCS's current combined operating costs, and most of the savings are not merger-related. Applicants project savings by "optimizing" the

[1] *See* APP Vol. 1 at 351, Vargas VS ¶ 41, Table 2.

two railroads' "base" operations at current traffic levels. Most of Applicants' projected savings reflect CP plans to improve current KCS and KCSM operations. These changes could be accomplished without merger.

- ***Second*****,** Applicants' projected revenues from traffic growth are unrealistic, at least within the 3-year timeframe described in their Application, and especially considering the exceptionally low operating costs that they project. Applicants expect to achieve an operating ratio of 30% on the growth traffic, which is unrealistic on such large volumes of additional traffic.
- ***Third*****,** Applicants' projected revenues from traffic diversions also appear unrealistic. Applicants' routes between Mexico/Texas markets and Chicago/Twin Cities/Upper Midwest markets are significantly longer and less efficient than UP and BNSF alternatives. I do not believe that Applicants could meet their traffic diversion goals by solely competing for business on the merits.

12. I discuss each of these points in more detail below.

II. Applicants' Projected Operating Cost Savings Are Very Small, And Almost All Could Be Achieved Without A Merger.

A. Applicants Do Not Project Substantial Operating Costs Savings.

13. Applicants say that "[c]ombining the CP and KCS rail networks into a single network unlocks tremendous opportunities for efficiency gains."[2] This is an overstatement. In their exercise of optimizing current operations, Applicants identify opportunities for efficiency gains and cost savings. Relative to the total operations of the two railroads, these opportunities

[2] APP Vol. 2 at 283, OP Plan ¶ 76.

are not large, and most of them involve KCS/KCSM operational improvements, which could be accomplished without merging with CP.

14. CP's and KCS's total operating expenses in 2019 were a combined $5.57 billion.[3] Applicants project merger-related operating savings of just $172.8 million annually.[4] In other words, even taking all Applicants' projected operating savings into account, their total projected savings amount to only 3.1% of their current combined operating expenses. Railroads regularly achieve similar levels of productivity improvement as part of their normal course of business without merging with other railroads.

15. Applicants' actual opportunities for merger-related efficiency gains and cost are very limited. The CP system and KCS system connect at just one location: Kansas City. Every post-merger CPKC route will be basically the same as every pre-merger CP-KCS route. This means that a CP/KCS merger does not create the same opportunities for efficiency gains and costs savings from new and improved train services for existing traffic as many earlier rail mergers. By contrast, UP's merger with Southern Pacific produced a dozen or more significantly shorter, more efficient routes by combining the two rail systems.

16. In Kansas City, CP and KCS already share a yard, referred to as the Joint Agency yard. Their only duplicative facilities are headquarters facilities. This means a CP/KCS combination does not create the same opportunities for efficiency gains and cost savings from improving terminal operations as many earlier rail mergers. By comparison, UP's merger with Southern Pacific allowed the merged railroad to create significant efficiency gains and cost

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[3] *See* APP Vol. 1 at 132 (CP Historical 2019 Operating Expenses of $3.59 billion); *id.* at 134 (KCS Historical 2019 Operating Expenses of $1.98 billion).

[4] *See* APP Vol. 1 at 74, App. B (Summary of Benefits Exhibit).

savings by combining and coordinating their operations at the many locations where both railroads had terminal facilities before they merged.

17. Applicants' main opportunity to achieve merger-related operating savings comes from changes to operations that would improve their handling of cars that CP and KCS currently interchange in Kansas City. That opportunity is very limited, as I explain below.

B. Most of Applicants' Projected Operating Cost Savings Could Be Achieved Without A Merger.

18. A sound analysis of merger-related operating cost savings must count only those reductions in costs that could not be accomplished but for the merger. Operating cost savings attributable to a merger of CP and KCS are those involving changes in handling traffic that the two roads interchange with one another, plus operational consolidations at common points. In this case, the amount of traffic interchanged between the two railroads is relatively small, and there is a single common point: Kansas City.[5] In their optimized operating plan, CP and KCS identify changes to the handling of 75 cars per day of traffic interchanged between them at the common point, Kansas City. Applicants identify no operational consolidations at Kansas City because the Joint Agency yard is already a shared facility. The 75 cars per day are evidently handled today on a single pair of scheduled CP trains that operate north of Kansas City, trains 474 and 475, which also handle CP's interchange with the other railroads in Kansas City.[6]

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[5] *See* APP Vol. 2 at 295, OP Plan ¶ 109 ("CP and KCS intersect only in Kansas City, where they already share yard facilities, and the two railroads have no overlapping or parallel routes. As a result, there will be no change in the principle routes operated by either railroad. There will be no abandonments or discontinued operations anywhere on the combined system as a result of the Transaction.").

[6] *See* APP Vol. 2 at 311–12, OP Plan ¶¶ 148–49. Applicants mention interchanging "bulk trains" with flexibility to change crews at Kansas City, or at KCS's IFG facility or on CP at Polo, which are 23.4 miles south or 42.1 miles north of Airline Jct. in Kansas City, respectively. *See* APP Vol. 2 at 311, OP Plan ¶ 147. There does not appear to be a post-merger change in bulk unit train operations. Applicants' discussion of changes in blocking in the optimized plan

Applicants identify operational changes that will eliminate the need to switch or handle the 75 cars per day of interchange traffic. Therefore, cost savings from changes in handling the 75 cars per day of traffic interchanged between the two railroads are merger-related. Cost savings from operational changes internal to KCS and KCSM to implement Precision Scheduled Railroading ("PSR") are not attributable to the proposed merger. CP and other railroads did not require mergers to implement PSR in their operations.

19. In their Application, Applicants address the changes to their operations in Kansas City that would result from their transaction. Applicants say traffic that CP and KCS interchange in Kansas City will no longer need to be processed in Kansas City.[7] This results in a decrease of 75 switch handlings per day in Kansas City.[8]

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consistently identifies manifest, auto, and intermodal traffic as being affected, not bulk traffic. *See* APP Vol. 2 at 296–99, OP Plan ¶¶ 112–16; *see also* APP Vol. 2 at 423–24, OP Plan App. F (New Blocks Optimized Plan).

[7] *See* APP Vol. 2 at 300, OP Plan ¶ 120 ("Under the Optimized Plan: the separate KCS Shreveport to Kansas City and CP Kansas City to St. Paul blocks and trains would be combined, with new blocking at Shreveport that will eliminate the reprocessing of traffic that currently takes place in Kansas City. *The result is an average reduction in transit time of 26 hours.* Comparable changes would be made for southbound flows in this corridor, with St. Paul building blocks for Shreveport and beyond.") (Emphasis in original.); *see also* APP Vol. 2 at 298, OP Plan ¶ 114 ("The decrease in cars per day at Kanas City is a reflection of no longer terminating CP and KCS train symbols at Kansas City, and the impact of longer distance blocks supporting a through train service.").

[8] *See* APP Vol. 2 at 297, OP Plan ¶ 112, Table 3. Applicants also identify changes that would reduce switching at KCS's International Freight Gateway. The changes do not involve traffic KCS interchanges with CP, {

} *See* Haley workpaper "HC - Operating Plan Deposition Excerpts."

Material within single braces ("{ }") has been designated "Confidential" under the Protective Order in this proceeding. Material within double braces ("{{ }}") has been designated "Highly Confidential." Confidential and Highly Confidential materials have been redacted from the public version of this statement.

20. To put that number into perspective, 75 saved switch handlings is about 1/10th of 1% of the 56,545 car handlings currently conducted on the combined railroads each day.[9]

21. Applicants calculated the 75 switch handlings reduction by comparing operating statistics generated under two different operating plans: a "base" plan and an "optimized" plan. The "base" plan reflects the separate CP and the KCS blocking and train plans that were in effect in the first quarter of 2021.[10] The optimized plan reflects Applicants' view of how a combined CPKC would operate to optimize efficiency,[11] based on CP's application of precision scheduled railroading (PSR).[12] Applicants modeled how "base year" traffic would be handled under both plans to identify changes in various operating statistics, including car handlings, that would result from implementation of the optimized plan.[13]

22. If I were calculating merger-related cost savings, I would look at the car costs and switch costs saved in connection with the 75 cars per day that would no longer be switched in Kansas City, net of the costs of any additional handling upstream and downstream to enable the cars to "overhead" Kansas City. If all of the handling in Kansas City is counted as savings, with no additional upstream or downstream costs, the total savings comes to $457,710 per year. The math is simple. Applicants say that they will save 26 hours per car on transit time in Kansas

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[9] In their Operating Plan, Applicants' identify the number of "intermediate handlings" under their base plan as 22.01 million annually. *See* APP Vol. 2 at 287, OP Plan ¶ 86, Table 2. Applicants' workpapers contain the daily amount. *See* Baranowski workpaper "HC - Base to Optimized Operating Plan Savings.xlsx," tab "Base to Optimized Metrics."

[10] *See* APP Vol. 2 at 283, OP Plan ¶ 75.

[11] *See* APP Vol. 2 at 283, OP Plan ¶ 76.

[12] APP. Vol. 2 at 285, OP Plan ¶ 77 ("In developing the Optimized Plan, CP drew on its unparalleled experience with PSR . . . .").

[13] *See* APP Vol. 2 at 284–85, OP Plan ¶ 80, Table 1. Applicants appear to use a mix of CP's 2019 traffic data and KCS's 2020 traffic data to generate their operating statistics. *See* APP Vol. 2 at 283, OP Plan ¶ 75 n.4.

City,[14] and that an average railcar costs $4,800 per year, or $0.55 per hour, to lease and maintain.[15] Applicants also say the cost of a car handling is $2.42 per car.[16] I believe the $2.42 per car switch cost is significantly understated, but Applicants furnished it.

23. It could well be argued that the $457,710 annual savings estimate associated with eliminating the switching on 75 cars per day at Kansas City actually *overstates* merger-related operating savings for CP/KCS because this could be accomplished by the two railroads today through an interline service agreement. This is common practice in the industry. Railroads build blocks for each other to eliminate switching at interchange gateways. Nothing prevents KCS from agreeing today to build a "St. Paul" block for CP in Shreveport, if CP agrees to build a "Shreveport" block for KCS in St. Paul. Applicants further imply that there will be locomotive dwell savings associated with eliminating the 75 car switches per day in Kansas City. If locomotives are sitting idle in Kansas City because of CP-KCS interchange traffic, then this time could similarly be eliminated by executing a run-through locomotive agreement. Railroads do it all the time. CP and KCS do it elsewhere on their railroads.[17]

24. When Applicants calculate merger-related operating cost savings, they point to $52.59 million in annual savings based on comparing certain "operating metrics" produced by

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[14] *See* APP Vol. 2 at 300, OP Plan ¶ 120.

[15] *See* APP Vol. 2 at 329, OP Plan ¶ 204 ($4,800 ÷365 ÷ 8=$1.64).

[16] *See* APP Vol. 1 at 407, Baranowski VS ¶ 8, Table 2 (1.4921 SEMs x $1.6207 per SEM = $2.42).

[17] Even counting savings from improved locomotive utilization would add annual merger-related savings in the $345,000 to $515,000 range. In my experience, a locomotive in mixed freight road service operates 12,000 to 18,000 miles a month, or 400 to 600 miles per day. Applicants say the cost of a locomotive unit mile is $1.1702. *See* APP Vol. 1 at 410, Baranowski VS ¶ 11, Table 5. Achieving an extra day's utilization of two locomotives for one year would save approximately $345,000 to $515,000 (2 x (400 to 600) x $1.1702 x 365).

their optimized plan with "operating metrics" produced by their base plan.[18] What explains the massive difference between my calculation and Applicants' calculation? The simple answer is that Applicants' calculation reflects optimizations of KCS's (and KCSM's) base operating plan that are not related to the proposed transaction.

25. As Applicants themselves acknowledge, their optimized operating plan is really just an application of PSR to the KCS system.[19] Applying PSR might produce significant operational savings for KCS, but KCS could achieving those savings without merging with CP. PSR and its elements are now commonly applied in the railroad industry.

26. Applicants' focus on changing KCS operations is easy to see in their Operating Plan. It is especially clear in Table 3, which shows the locations of changes in anticipated yard workloads between the base and optimized plans.[20] Nearly all the locations with changes are on KCS, and the overwhelming majority of changes in workload involve KCSM yards in Mexico. In Table 3, the only exclusively CP location is Nahant at a scant 16.5 cars per day. This is less than 2% of the Table 3 changes (>10 cars per day), indicating that over 98% of the operational change is on the KCS/KCSM. If you remove Kansas City because it is a joint location, 92% of the changes are on the KCS and KCSM.[21]

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[18] *See* APP Vol. 1 at 412, Baranowski VS ¶ 15, Table 9.

[19] *See* APP Vol. 2 at 283, OP Plan ¶ 77.

[20] *See* APP Vol. 2 at 297, OP Plan ¶ 112, Table 3.

[21] If you look the Applicants' more detailed workpapers, the percentage changes are essentially the same. *See* OP Plan workpaper "HC - Cars Per Day by Yard.docx."

27. Another way to see the same point is to look at Applicants' proposed changes to train plans by comparing the base to the optimized plans. All of the train plan changes involve KCS and KCSM trains, with the exception of one train that would run through Kansas City.[22]

28. Applicants calculate their $52.59 million in "operating metric" savings based mainly on their changes in train plans. They say they could save 4,558 train miles per day by implementing their optimized plan, and they calculate cost savings that would follow from the reduction in train miles.[23]

29. As I said above, the best way to look at merger-related savings is to focus on changes in how cars are handled, not how trains are named. Train plans are designed to move cars. There are many different ways you can design a train plan to get cars from their origins to their destinations. What really matters is changes in how the cars are handled. In a CP/KCS transaction, the only merger-related changes involve cars that no longer require switching in Kansas City because that is the only traffic whose handling changes directly because of the merger. Changes in the train plan can be enacted now, independent of merger.

30. However, Applicants calculate cost savings using costs relating to train miles, so I want to briefly address how those costs might be used more appropriately in this case. I would focus on the trains carrying the 75 cars per day that would no longer require handling at Kansas City. In the optimized plan, those cars would be on the KCS 260/261 train pair, which would

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[22] *See* APP Vol. 2 at 406–21, OP Plan App. C–E.

[23] *See* Baranowski workpaper "HC - Base to Optimized Operating Plan Savings.xlsx," tab "Base to Optimized Metrics." Applicants also use reductions in locomotive unit miles (LUMs), but their calculation of the reduction in LUMs flows from their calculation of the reduction in train miles. *See* Baranowski workpaper "HC - CP Operating Plan Output Cost Metrics Model.xlsx," tab "Model." Applicants also calculate savings from reductions in locomotive gross ton miles, again, they calculate reductions in gross ton miles based on reductions in train miles. *See id.*

travel a total of 2,363 miles per day, according to Applicants.[24] Since the new train pair replaces the existing 474/475, which today handles CP's interchange traffic for all railroads in Kansas City,[25] the train pair clearly handles more than a total of 75 cars in both directions. The 75 cars would be approximately one-third of the total capacity of both trains 260 and 261.[26] The costs associated with one-third of 2,363 train miles, or 788 train miles,[27] calculated using the same methodology as Applicants, plus the costs savings associated with a reduction in 75 car handlings per day, the result is $9.05 million, not $52.59 million.[28]

31. Again, I am not saying that KCS could not reduce train miles and generate cost savings. CP's optimized plan seems to reflect solid ideas for improving KCS and KCSM train plans. However, KCS could implement an optimization plan and generate savings without a merger. Most large railroads have implemented some version of PSR without merging with other railroads.

32. Applicants also calculate certain merger-related operating savings in addition to savings based on "operating metrics." However, those calculations generally suffer from the same flaw—they reflect savings that could be achieved without a merger.

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[24] *See* APP Vol. 2 at 419, OP Plan App. E.

[25] *See* APP Vol. 2 at 311–12, OP Plan ¶¶ 148–49.

[26] Applicants say their optimal train size north of Kansas City will be 10,000 feet. *See* APP Vol. 2 at 338, OP Plan ¶ 234. A pair of daily trains (260 and 261) at 10,000 feet have a theoretical capacity of 275 to 300 cars at a typical 65 to 70 average feet per car. The 75 cars per day in question would therefore amount to 25 to 27% of train capacity. Since the real world falls short of optimal, regarding the 75 cars as roughly one-third of train capacity seems more realistic. The 75 cars would be approximately one-third of train capacity if actual train sizes were in the range of 7,500 to 8,000 feet, at 65 to 70 feet per car. Note that my conservatism here *increases* the merger-related savings estimate.

[27] It does not matter whether the cars get on or off the train between Shreveport and St. Paul. I conservatively assume they stay on the train the whole way.

[28] *See* Haley workpaper "Train Mile Savings Calculations.xlsx," tab "Summary Tables."

33. For example, Applicants calculate fuel savings of $26.57 million in the first year post merger. They say those savings reflect their assumption "that the fuel consumption for the combined CP/KCS system will mirror the improvement projected internally at CP based on a regression of horsepower per ton and gross ton-miles."[29] Changes to improve fuel efficiency of the KCS/KCSM are not merger dependent. Fuel conservation practices are widely known and practiced across the railroad industry. If better fuel consumption practices exist, KCS does not need to merge with CP to adopt them.

34. Applicants also identify savings in locomotive depreciation and lease costs. But as Applicants acknowledge, their calculations are driven entirely by the reduction in LUMs from their optimization of KCS's train plans,[30] so only a small fraction could possibly be counted as merger-related.

35. Applicants also describe projected operating savings from freight cars and procurement, but those do not change the overall picture. Applicants do not project any freight car savings from applying the optimized plan.[31] Finally, they say they might achieve $4.18 million in procurement savings from increased bargaining leverage.[32] These savings hardly amount to "tremendous opportunities for efficiency gains."

36. In sum, Applicants' claimed merger-related savings are very low to begin with, and to the extent they reflect viable strategies for improving KCS's operations, most could be achieved without a merger.

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[29] APP Vol. 1 at 408, Baranowski VS ¶ 9.

[30] APP Vol. 1 at 409, Baranowski VS ¶ 11

[31] APP Vol. 1 at 411, Baranowski VS ¶ 13, Table 7.

[32] APP Vol. 1 at 412, Baranowski VS ¶ 14, Table 8.

III. Applicants' Projected Revenues From Traffic Growth Appear Unrealistic.

37. Applicants' projected cost savings from operational synergies plainly are not large enough to provide their projected $1 billion plus annually in merger benefits. To get there, Applicants also rely on projections of massive traffic growth and a huge leveraging of productivity. From my operating perspective, their growth plan is unrealistic.

38. To be clear, I am not second-guessing Applicants' business evaluation of the various targets of traffic growth that are addressed in their "growth" operating plan. Rather, I am providing my perspective on whether Applicants could realistically achieve the projected traffic growth, within the projected timeframe, at the projected operating costs levels.

39. Applicants' projection of merger benefits relies on capturing traffic that is currently moving on highways, through other ports, or on other railroads. Applicants project total growth in traffic by {{ }} cars and intermodal containers by 2025.[33] Of that total, {{ }} has some existing connection to CP or KCS—that is, CP or KCS handles part of an existing movement and expects to extend its haul.[34] The remainder is traffic that Applicants say they will attract to the Port of Lazaro Cardenas, divert from truck to rail, attract by creating new routes and new services, or attract from other railroads.[35]

40. Applicants' growth operating plan shows the massive increase in the amount of traffic to be accommodated on their North-South corridor between Mexico and the Midwest in

[33] OP Plan workpaper "1.Proposed Final FTI Rail to Rail Diversion Results for Merger Application_matching Finance with Truck to Rail.xlsx," tab "All Volumes;" *see also* APP Vol. 1 at 427, Baranowski VS ¶ 55, Table 16 (509,490 "Diverted Carloads/Units" by 2025).

[34] *See* OP Plan workpaper "HC - 1.Proposed Final FTI Rail to Rail Diversion Results for Merger Application_matching Finance with Truck to Rail.xlsx," tab "All Volumes" {{ }}

[35] *See generally* APP Vol. 1 at 243–302, Wahba/Naatz VS.

just 3 years. Applicants' growth operating plan shows massive growth south of Kansas City on top of an already solid base. Trains per day increase from 11 to 25 between Kansas City and Shreveport, and from 9 to 20 between Shreveport and Houston.[36] Those are 127% and 122% increases, respectively—more than *doubling* the train traffic on these already busy routes.

41. I do not believe there is any precedent for so much growth across such a long corridor in such a short period of time for an end-to-end merger.

42. I noticed in Applicants' capacity investment plans that capacity is provided only for the trackage owned by CP and KCS/M.[37] Applicants are silent on the capacity needs on the significant trackage rights territory on Union Pacific from Beaumont, Texas, through Houston to just south of Rosenberg, Texas, and from Victoria, Texas, to Robstown, Texas, near Corpus Christi. Applicants' growth plan seeks to approximately double KCS volumes on these segments in three years, to 19-20 trains per day on a base of 9-11 trains per day.[38] Of the {{ }} carloads and containers of existing and new rail business they plan to capture, approximately {{ }} or roughly {{ }} would move over these segments.[39] The most significant capacity challenges in the entire CP/KCS merger are likely to be faced in this territory, including a major bridge at Beaumont and the Houston terminal area, one of the most complex and sensitive rail facilities in North America. Even if the capacity needs of the trackage rights territory are tackled immediately, difficult projects, such as the Neches River bridge and facilities to accommodate the growth in the constrained urban Houston area, are unlikely to be

[36] *Compare* APP Vol. 2 at 452, OP Plan App. N, *with id* at 454, OP Plan App. O.

[37] *See* APP Vol. 2 at 337–44; Op. Plan ¶¶ 231–44.

[38] *Compare* APP Vol. 2 at 452, OP Plan App. N, *with id* at 454, OP Plan App. O.

[39] *See* Operating Plan workpaper "HC - 1.Proposed Final FTI Rail to Rail Diversions for Merger Application matching Finance with Truck to Rail.xlsx." {{ }}

designed, permitted, and completed in three years. This is a major hole in Applicants' Operating Plan, one completely ignored.

43. Moreover, to be successful, Applicants must not only attract all of their projected growth traffic and accommodate it, they must also handle the traffic at an exceptionally low incremental cost. Their calculations imply a 30% operating ratio on all the growth.[40]

44. Applicants plainly recognize the issue and propose a very aggressive plan for handling the traffic. Their growth plan says CPKC will grow carloads by {{ }} in Year 3, resulting in an increase of 21.3% in total car-miles and an increase of approximately 20% in gross ton-miles on the *entire* CP/KCS combined network, compared to both the optimized plan and to today's levels.[41] Yet total train miles will increase by only 11.6% compared to their *optimized* plan, and by only 7.4% compared to today's operation.[42] Also, by assuming significant improvements in train size and velocity, Applicants say they will increase train hours by only 1.1% compared to their *optimized* plan, and actually *reduce* train-hours by 3.7% compared to today's operation.[43] This would represent an astounding increase in productivity.

45. Applicants' exceptionally aggressive operating plans extend to their plans for car handlings. Applicants' growth plan reflects an increase in intermediate handlings of only 3.5% compared to their *optimized* plan.[44] That is, Applicants plan to handle approximately 20% more traffic with only 3.5% more car handlings as compared with their *optimized* operation at today's traffic levels.

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[40] *See* APP Vol. 1 at 427, Baranowski VS ¶ 55, Table 16 ($306.3 M in total incremental costs, and $1.02 B in incremental revenues).

[41] APP Vol. 2 at 287, OP Plan ¶ 86, Table 2.

[42] *Id.*

[43] *Id.*

[44] *Id.*

46. Applicants' growth operating plan appears even more aggressive when one considers the reduction in car handlings already reflected in their optimized plan. Applicants reduced total car handlings by 1.8% from their base plan to their optimized plan—mostly by assuming KCS and KCSM implement PSR. Then, in their growth plan, they show the traffic moving over their North-South corridor will double or triple, driving up gross ton-miles and car miles on the CPKC network by 20% and 21.3%, respectively. Yet, they say car handlings on the combined network will increase over the base plan level by just 1.6%. Stated differently, Applicants project accommodating network-wide growth of approximately 20% with 1.6% more car handlings than CP and KCS perform network-wide today. This would be an extraordinary result. Applicants have very lofty aims.

47. I recognize that large volume growth, if actually achieved, can create significant leverage in railroad operations. But I have never seen growth occur to the degree, or leverage obtained to the extent, that Applicants are projecting.

48. Applicants' aggressive assumptions are further illustrated in their calculations of the incremental costs of handling their projected traffic growth. Applicants project they will generate incremental revenues of $1.02 billion at an incremental cost of $306.3 million in 2025.[45] These numbers imply that the operating ratio for the massive body of traffic that Applicants plan to attract to CPKC would be in the ballpark of 30%.[46]

49. Rail traffic with a 30% operating ratio exists in some circumstances. However, where a railroad is growing traffic to this extent on top of a sizeable existing base, operating ratios would be much closer to average. Best in class operating ratios are in the 55-60% range.

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[45] APP Vol. 1 at 427, Baranowski VS ¶ 55, Table 16.

[46] Operating ratio is simply operating expenses divided by revenue.

Even CP, which touts its expertise in PSR, had an operating ratio of 60.2 in the third quarter of 2021.[47] Applicants are simply not being realistic when they assume they can divert large amounts of traffic from other railroads and modes at an operating ratio that is roughly half CP's average.

IV. Applicants' Projected Revenues From Traffic Diversions Appear Unrealistic.

50. If the Board approves the proposed transaction, CPKC will face intense pressure to deliver on their aggressive revenue and growth projections. I know this from my own experiences with railroad mergers.

51. Applicants' revenue projections rely to a large extent on speculation that they will be successful in attracting new traffic to CPKC, as noted above. Their most readily available source of additional revenue to meet promises to investors is what they call "extended hauls"—for example, taking traffic that KCSM currently interchanges with UP at Laredo for movement to Chicago, and diverting the business to a single-line haul on KCS to Kansas City, then CP to Chicago.

52. Applicants' project they will divert substantial quantities of traffic by offering "single-line service," but they offer no concrete reason why customers would willingly choose CPKC routes over existing interline routes.

53. CP-KCS have a fundamental routing disadvantage—that is, their routes are longer, slower, and otherwise less efficient than available alternatives. Applicants implicitly recognize their fundamental routing disadvantage when they show that, for traffic they

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[47] *See* Haley workpaper "P - CP Third Quarter Earnings Release.pdf."

considered to be divertible, CPKC routes would be, *on average*, 217 miles longer than the existing movement, or approximately 12% longer.[48]

54. Moreover, Applicants do not propose to offer rate reductions to attract all this traffic.[49] They cannot afford to make such promises: their ambitious revenue projections assume they successfully divert traffic to create extended hauls *at existing rates*.[50]

55. CPKC's routing disadvantage is even greater for vast amounts of traffic they say they will actually divert. A prime example is the one I mentioned above: UP traffic currently moving between Chicago and Laredo, which is interchanged with KCSM.

56. The Chicago-Laredo lane is of particular significance in this case. Of Applicants' projected diversions of 137,416 intermodal containers, about 60% involve movements between Mexico and Chicago, or Mexico and Detroit (which would move via Chicago).[51] Of Applicants' projected diversions of 33,218 automotive carloads, about 60% involve movements between Mexico and Chicago (including traffic to Chicago interchanges with CSX and NS).[52]

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[48] *See* APP Vol. 2 at 132, Brown/Zebrowski VS ¶ 30, Table 6.

[49] Applicants 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." *See* APP Vol. 2 at 133, Brown/Zebrowski VS ¶ 32. Traffic that UP interchanges with KCSM is not "existing single-line service." *See id.* at 149, Brown/Zebrowski VS ¶ 64 (asserting that "CP/KCS would offer the only single-line service in the market" for automotive carloads moving from Mexico into the United States).

[50] *See* APP Vol. 2 at 163–66, Brown/Zebrowski VS ¶¶ 90–96 & Table 28. The $513.1 million in incremental revenue from diversions reflected in Brown/Zebrowski Table 28 was incorporated into the calculation of $1.02 billion in incremental revenues that appears in Table 16 of Mr. Baranowski's Verified Statement. *See* APP Vol. 1 at 415, Baranowski VS ¶ 23; *see also id.* at 427, Baranowski VS ¶ 55, Table 16. The $1.02 billion figure is the same one that appears in Applicants' Summary of Benefits exhibit. *See* APP Vol. 1 at 74, App. B.

[51] *See* APP Vol. 2 at 144, Brown/Zebrowksi VS ¶ 55, Table 15.

[52] *See* APP Vol. 2 at 149, Brown/Zebrowski VS ¶ 63, Table 18.

57. According to Applicants' own calculations, CPKC's route between Laredo and Chicago would be {{ }} while the average of existing movements handled by other carriers is {{ }}.[53] The {{ }}

58. When I was at UP, we used a variety of metrics to compare alternative routes. Those metrics include not only mileage, but also more detailed calculations to assess the relative efficiency and potential performance of routes, including rise and fall (total grade change) curvature, fuel consumption, and simulated transit time.[54] I asked UP to provide me those metrics to permit a more detailed comparison of alternative routes between Laredo and Chicago.

59. The more detailed data confirm what a simple mileage comparison indicates: a CPKC route from Chicago to Laredo would be substantially less efficient and slower than UP's existing route, and slower than BNSF's route using an interchange with KCS at Robstown. I summarize the results in the table below:

Chicago-Laredo Route Comparison[55]

Railroad	Miles	Rise and Fall (ft)	Curvature (degrees)	Fuel (gal)	Simulated Transit Time (hr)
UP	**{{**				
BNSF					
CPKC					**}}**

60. Comparisons of routes to Texas markets, including Dallas and Houston, also favor UP and BNSF routings as compared to CPKC routings.

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[53] *See* Brown/Zebrowski workpaper "HC - Rail to Rail Diversions Summary.xls," tab "Table 6," row 34.

[54] Simulated transit time is also known as unimpeded run time—it measures a run time based on the maximum speed limits of the route with no traffic interference. It is a useful measure to compare the relative performance potential of alternative routes.

[55] *See* Haley workpapers "HC – BNSF TPS Chicago-Laredo.xlsx"; "HC – CPKC TPS Chicago-Laredo.xlsx"; "HC – UP TPS Chicago-Laredo.xlsx."

61. A CP/KCS transaction cannot change the underlying route structure. The two railroads connect only in Kansas City. The post-merger CPKC route from Laredo to Chicago will be the same as pre-merger CP-KCS route.

62. This means every car that Applicants manage to divert to their route will move over a longer, slower, less efficient route, with increased fuel consumption. Stated differently, if CPKC succeed in diverting traffic from other railroads, they will reduce overall rail network efficiency and consume more fuel on the traffic diverted from other railroads, generating *negative* environmental impacts on that traffic.

63. CPKC will face a similar situation when moving traffic to Texas and Gulf Coast markets. Applicants' own data show significant circuity in Chicago-Dallas lanes and for traffic moving from a variety of Canadian origins to Texas destinations, to pick just a few examples.[56]

64. How will Applicants respond to the pressure to divert traffic to meet their revenue projections? They have boxed themselves in regarding rate reductions. Their Application does not suggest they can somehow overcome their routing disadvantage and beat the transit times of their competitors to and from the Laredo Gateway. CPKC, UP, and BNSF must rely on KCSM service within Mexico. I believe it is unlikely that Applicants could meet their traffic diversion goals by competing for business on the merits.

V. Conclusion

65. Based on my review of the Application, including the accompanying verified statements and work papers, I do not believe that Applicants can achieve the projections they have set out. I am not saying that the Board should not allow them to try, but the Board should

[56] *See* Brown/Zebrowski workpaper "HC -Rail to Rail Diversions Summary.xls," tab "Table 6."

ensure that when Applicants seek to divert traffic or compete for new business, they compete on the merits.

66. I believe it is especially critical to protect against outcomes of a CP/KCS merger that might impair current competitive options for rail traffic. The Board should not direct how rail traffic moves, but it should ensure that customers can select options that provide them with their desired combination of service and price. The best way to ensure efficiency and excellent service is to ensure that traffic is free to flow to the carriers and routes that provide the best service and value to rail customers.

VERIFICATION

I, Thomas C. Haley, declare under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on February 25, 2022.

/s/ Thomas C. Haley

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

VERIFIED STATEMENT

OF

LUIS F. DE LA CALLE

VERIFIED STATEMENT

OF

LUIS F. DE LA CALLE

My name is Luis F. de la Calle. I am the founding partner at De la Calle, Madrazo, Mancera, S.C. (CMM), and have served as its managing director since its creation in 2004. CMM specializes in economics, regulatory processes, and international trade. I am trained as an economist and hold a doctorate in Economics from the University of Virginia. Prior to joining the private sector, I served as Undersecretary for International Trade Negotiations in Mexico's Ministry of the Economy. Before that, I served as Trade and NAFTA Minister at the Mexican Embassy in Washington, D.C., participating in the crafting and implementation of the North American Free Trade Agreement ("NAFTA").

At CMM, I have regularly advised clients on competition issues in Mexico and participated as an expert witness in economics before the Federal Economic Competition Commission (Comisión Federal de Competencia Económica) ("COFECE"), the Mexican antitrust body. In 2011, in preparation for the drafting of a new antitrust law, which broadened COFECE's authority, I was retained by the Economy Commission of the Lower House of the Mexican Congress to prepare and present a comparative analysis of competition laws, including those of Mexico, Chile, South Korea, the US, Australia, Canada and the EU. In 2014, I testified before the House on reforms in connection with establishment of COFECE and on the special procedures on barriers, essential facilities, and effective competition included in the new antitrust law.

My positions and experience in both the public and private sectors have given me broad knowledge of U.S.-Mexico cross-border traffic and the Mexican laws and regulations

governing rail competition, as well as familiarity with the agencies and procedures involved in implementing these laws and regulations.

In this statement, requested by Union Pacific Corporation ("UP"), I discuss how Mexican laws and regulations governing railroads and competition and implementation of these laws and regulations by Mexican agencies ought to be considered in evaluating competitive aspects of the merger between Canadian Pacific Railway Limited ("CP") and Kansas City Southern ("KCS") (the "CP-KCS Merger"). In Section I, I explain why Mexican laws and regulations and any enforcement activity by Mexican authorities cannot be relied on to prevent potential anticompetitive effects of the CP-KCS Merger on cross-border rail traffic. I explain that Mexican laws and regulations do not clearly prevent a merged CP/KCS from setting rates in a manner that would reduce competition for cross-border rail traffic. I also explain that the Mexican antitrust and railroad agencies will be unable to timely and effectively design and enforce remedial measures to reverse potential anticompetitive practices resulting from the CP-KCS Merger. In Section II, I explain that COFECE has approved the CP-KCS Merger with no conditions, but with no indication that the agency considered potential effects of the merger on competition for US-Mexico cross-border traffic. Finally in Section III, I stress that measures UP will ask the Surface Transportation Board ("STB") to impose requiring that CP/KCS not discriminate against competitive connections and that it offer competitive rates for connecting cross-border traffic would be consistent with Mexican law and would not be regarded as interfering with the prerogatives of Mexican agencies.

I. Mexican Laws and Regulations Cannot Be Relied on to Prevent Anticompetitive Effects of the CP-KCS Merger on Cross-Border Traffic.

U.S.-Mexico cross-border rail traffic has increased significantly in recent years, and this is a key reason for CP's interest in acquiring KCS. Indeed, the high valuation of the CP-KCS Merger is testimony to the potentially significant value of a North-South rail backbone linking Canada, the Central U.S. and Mexico. The Laredo crossing is a particularly valuable part of this backbone. The cross-border exchange at Laredo is by far the fastest route connecting Mexico to the U.S. and Canada, with a wide range of connecting options in the U.S. Kansas City Southern Mexico, S.A. de C.V. ("KCSM"), a KCS subsidiary, owns the only route that extends south from Laredo. To date, KCSM has had incentives to work not just with KCS, but also with UP and BNSF Railway to move traffic North-South from the Mexico-U.S. border, including at the key Laredo crossing. Shippers have benefited from having strong competitive alternatives involving both single-line service and service by competitive interconnections.

The CP-KCS Merger could give the merged company substantial market power in the Canada-U.S.-Mexico corridor. UP is understandably concerned that the combined CP/KCS will have strong incentives to discriminate against connections with (and within) the United States. Among other things, UP argues that the combined railroad could raise KCSM rate factors for Laredo traffic while reducing CP/KCS rates north of the border, effectively raising rates for shippers using UP service north of Laredo, making those routes less competitive than CP/KCS/KCSM routes, or otherwise engage in anticompetitive strategies.

Mexican law and regulations would not clearly prevent the potential anticompetitive conduct that UP has identified, creating uncertainty about how Mexican agencies and courts

would treat any disputes about such discriminatory conduct. Moreover, it is clear that, in light of this uncertainty, the numerous procedural hurdles a complainant would face, and experience to date with the relevant Mexican agencies, it would take many years before a final decision is issued on a complaint by shippers or other carriers about CP/KCS/KCSM rate discrimination against connecting carriers handling cross-border traffic.

A. Mexican Law and Regulations Would Not Clearly Prevent CP/KCS from Setting Rates in a Manner That Would Discriminate Against Cross-Border Connections.

Mexican law and practice do not clearly prevent the type of discriminatory rate practices that UP expects CP/KCS could adopt after they consummate their merger. Following the privatization of the Mexican railway sector in the late 1990s, Mexican rail service has been subject to the Railway Service Law (Ley Reglamentaria del Servicio Ferroviario) (the "RSL") and the Regulations of the Railway Service (Reglamento del Servicio Ferroviario) (the "Regulations").[1] Jurisdiction over rail rates is split between two agencies, COFECE, the Mexican antitrust agency, and the Railway Transport Regulatory Agency (Agencia Reguladora del Transporte Ferroviario) (the "ARTF"), with overlapping responsibilities. COFECE's authorities, including those for merger control and conduct of investigations, are defined by the Federal Economic Competition Law (Ley Federal de Competencia Económica) (the "FECL"). ARTF, created in 2015 as part of an amendment to the RSL, is a unit within SICT. ARTF took over responsibility for rail tariff regulation (as well as interconnection of railways and enforcement of the RSL).

[1] The Regulations were issued by the Secretary of Infrastructure, Communications and Transport ("SICT") (previously named Secretary of Communications and Transport) in 1996 pursuant to the RSL.

Under the RSL and the Regulations, carriers may freely set their rates as per Articles 46 of the RSL and 170 of the Regulations. Carriers must file their maximum rates with the ARTF for each of their routes; once a maximum rate is registered, the carrier cannot charge more than that rate for the traffic on that route. However, a carrier may return to the agency and file a higher rate whenever it wishes.

Although concession holders (like KCSM) are free to set their rates, the RSL and Regulations contain a procedure through which certain parties may challenge a carrier's registered rates. However, to make such a challenge a party must first obtain a ruling from COFECE that effective competition does not exist in the relevant market.[2] See Article 47 of the RSL. To my knowledge, this procedure for challenging a rate has seldom been used. So far as I am aware, neither the ARTF nor COFECE has ever investigated a case involving allegations of discrimination in freight rail rates.

Mexican authorities likely would not take any action against an overall CP/KCS/KCSM rate for traffic moving between Mexico and the U.S. if the KCSM portion of the rate was offered in a non-discriminatory manner to all shippers under equal conditions. Mexican railroad law does contain a requirement that carriers set rates in a non-discriminatory manner. Under Article 170 of the Regulations, a carrier's maximum rates "shall be applied in a non-discriminatory manner and shall be the same for users in equal conditions." Carriers may charge less than their maximum rates if they grant these discounts

[2] And for such ruling, the procedure set forth in Article 96 of the FECL governing investigation and determination of market conductions (including matters concerning effective competition) needs to be followed, and such ruling can be challenged through an *amparo* claim. An *amparo* proceeding is one in which the plaintiff alleges that a governmental act is unconstitutional, in which the act can be challenged on the grounds that the act was contrary to the applicable law, equivalent to a cassation appeal.

to "users in a non-discriminatory manner and in equal circumstances", and "shall consider the specific characteristics of each service, according to the classifications established pursuant to the Regulations." But there is no reason to believe that this requirement of non-discrimination would apply to more than the KCSM portion of an overall rate.

The KCSM's Concession includes several provisions requiring non-discriminatory conduct. Section 2.1 of the Concession states that KCSM must provide rail services "under equitable and non-discriminatory conditions with respect to opportunity, quality and price." Section 2.2 of the Concession requires that KCSM provide interconnection services "with connecting railroads of other countries under fair and non-discriminatory conditions in regard to timeliness, quality and price" and that "[a]ny difference … in the rates applied must be based on specific circumstances that justify such distinctions being made." But these provisions do not appear to address an increase in KCSM rates that was the same for both connections at Laredo (UP and CP/KCS), as part of a strategy by CP/KCS to divert cross-border traffic from KCSM-UP routes to CP/KCS/KCSM routes.

In the period since the rail industry was privatized, there have been no developments suggesting that Mexican regulators would apply Mexican laws and regulations to a carrier's discriminatory use of rates to disadvantage connecting carriers at the U.S.-Mexico border. Since 2014, when COFECE gained broader authority, it has opened only two investigations into the railway sector, neither of which involved cross-border traffic or allegations of discriminatory rates. COFECE closed a 2016 investigation, which involved trackage rights markets[3], due to methodological errors by its Investigative Authority, resulting in

[3] Five relevant markets were defined, each one defined as the interconnection services in trackage rights modality (relevant service), in each of the railway network of five different concessionaries and/or economic interest groups (each a geographic market).

insufficient evidence to establish the lack of effective competition in the markets at issue. To my knowledge, the closing of the procedure was not challenged by any economic agent. In a 2020 COFECE declaration (issued in the procedure opened in 2018), which involved the rail freight transportation of four chemical products, each in routes with origin/destination in the south of the State of Veracruz[4], COFECE issued, in 2020, a declaration of lack of effective competition in certain Mexican markets[5]. The decision regarding the 2018 case has been challenged through multiple appeals (*amparo* claims filed in Federal District Courts), which have been pending for two years and could result in annulment of the COFECE decision. Since the COFECE decision did not relate to cross-border traffic or rate discrimination, the decisions on the appeals will not shed any light on UP's concern about potential discriminatory rate setting by CP/KCS/KCSM.

In 2021, COFECE published a report on competition in freight rail service. While the report raised concerns about several aspects of competition in the freight rail sector, to my knowledge it has not yet led to the opening of any investigations to identify potential solutions to the alleged lack of competition. In any event, the report did not address conduct relating to cross-border traffic or rate practices for interconnections more generally. Thus, the report does not suggest that the Mexican laws and regulations would be read to address the concerns UP has raised about the potential for CP/KCS's use of discriminatory rates in connection with cross-border moves. As before, there is no assurance that Mexican

[4] Defining as a separate relevant market the rail freight transportation of a single product in a separate route. Thirty one markets were initially defined by the Investigative Authority.

[5] In twenty five out of the thirty one initially defined by the Investigative Authority.

regulators would apply Mexican laws and regulations, or the KCSM's Concession terms, to address any discriminatory rate practices CP/KCS may adopt following the merger.

Since its creation in 2015, ARTF's regulatory activity has been very limited. The agency has opened only three tariff regulation procedures[6] (each opened and decided in 2020), all based on COFECE's 2020 declaration (issued in the procedure opened in 2018), imposing tariff regulations in each of the twenty five relevant markets where COFECE determined the lack of effective competition (i.e., only for certain specific routes for the transportation of a particular chemical) and, to my knowledge, each of these decisions has been challenged through administrative annulment procedures and *amparo* claims. At this point, it does not appear that ARTF is becoming an effective regulator of the rail industry.

So far as I am aware, neither COFECE nor ARTF has ever investigated a case involving rate discrimination. Thus, it is unclear how either agency would respond to a complaint about the sort of discriminatory rate conduct UP anticipates as a result of the CP-KCS Merger.

B. There Is No Assurance That Shippers or Competing Carriers Could Obtain Enforcement of Mexican Law, Regulations or the KCSM Concession Terms to Remedy Anticompetitive Rate Practices by CP/KCS.

Even if it were clear that provisions of Mexican law, regulations, or the KCSM Concession could be applied to remedy the anticompetitive rate practices that CP/KCS might adopt following the merger, there is no question in my mind that efforts to enforce such provisions would be ineffective. Because COFECE did not impose conditions on the CP-KCS Merger to prevent use of rate practices that discriminate against cross-border

[6] One for each concessionary that operates certain routes that were defined as the geographic dimension of the relevant markets involved.

connecting traffic (see below), a victim of such practices would have to pursue burdensome procedures in an effort to obtain remedial measures. For example, in order to obtain a rate decision from ARTF, a victim of anticompetitive rates would first have to seek from COFECE a declaration of lack of effective competition under Article 96 of the FECL. For such an investigation, an applicant must present extensive information to define the relevant market and establish substantial market power under the terms of the antitrust law.

Article 96 investigations are lengthy and complex. To date, COFECE has conducted four investigations under Article 96 (two being the ones opened in 2016 and 2018 in the railway sector). The three investigations that went forward to conclusion had an average time of 16 months from start of the procedure to its closing. Other COFECE investigations (focused on barriers to competition or essential facilities under Article 94 of the FECL) have taken an average of 21 months from start to closing. In one case involving airport slots, it took four years to complete the proceeding, including an *amparo* procedure.
A declaration of barriers to competition or declaration of an essential facility under Article 94 of the FECL could lead COFECE to order measures to eliminate the barrier or regulate the access to the essential facility. However, the first time COFECE tried to use this new authority, it was challenged in an *amparo* procedure in the case involving airport slots referenced previously. The tribunal concluded that the investigation had infringed the regulatory purview of the SICT. In 2021, COFECE unsuccessfully challenged SICT jurisdiction over allocation of slots in saturated airports before the Mexico Supreme Court, which confirmed SICT jurisdiction over slots.

Turf battles between Mexican regulatory agencies add to the standard delay and dysfunction that accompany any effort by the agencies to enforce provisions addressed to

anticompetitive conduct. Another recent complication is COFECE's inability to vote on certain matters, including the special procedures related to barriers to competition or essential facilities (prescribed by Article 94 of the FECL), due to lack of a quorum in its plenum of commissioners. To date, COFECE has had to suspend one investigation due to lack of a quorum, the result of a decision by Mexico's President to put a hold on nominations.

ARTF tariff regulation has been limited in part as a result of the split of responsibilities between that agency and COFECE. As explained above, in order for ARTF to proceed with tariff regulation, COFECE must first issue a declaration of lack of effective competition in the market at issue. Since its inception ARTF has opened only three tariff regulation procedures, all based on the 2020 declaration (issued in the procedure opened in 2018). Each ARTF decision has been challenged through federal annulment procedures and *amparo* claims, none of which has yet been ruled on. In any case involving claims of anticompetitive rates, there is a potential for overlapping agency authority and turf battles, since provision of rail services in an anticompetitive manner could be seen as a breach of both the FECL and the RSL. ARTF decisions may be appealed to federal administrative and judiciary tribunals and in some cases could be challenged directly by *amparo* proceedings in federal courts. Moreover, challenges to ARTF's actions can include litigation seeking the issuance of preliminary injunctions against the agency issued by administrative or judiciary courts, adding a new layer of complexity as well as potential delays.

Thus, even if it were clear that a shipper or competing carrier could invoke Mexican laws and regulations in an effort to remedy any discriminatory rate practices by CP/KCS, seeking relief through the ARTF and/or COFECE would entail lengthy administrative and

judicial procedures. The situation is complicated by the split of authority between COFECE and ARTF, creating more opportunities to challenge their acts – before multiple administrative agencies and/or administrative and judicial federal courts in Mexico.

Given the uncertainty about whether anticompetitive rate practices can be addressed under Mexican laws and regulations, the absence of effective enforcement by the antitrust and rail regulation agencies, and the complexities resulting from the split of jurisdiction between the two agencies, the STB cannot assume that Mexican agencies will provide effective remedies for potential anticompetitive rate practices of the type that UP believes a combined CP/KCS is likely to pursue following the merger to take cross-border traffic from competitors. I have seen no indication that this situation is likely to change in the foreseeable future.

II. COFECE Has Approved the Merger of CP-KCSM With No Conditions.

On October 4 and 5, 2021 KCS and CP filed a merger control notice with each of COFECE and the Federal Institute of Telecommunications (Instituto Federal de Telecomunicaciones) (the "FTI").[7] On November 25, 2021, COFECE issued a decision unconditionally clearing the CP-KCS Merger. The four-page decision states only that "from the assessment undertaken by this Commission, it is considered that, if the notified transaction is carried out, it would have low probabilities of affecting competition." Based on this very brief statement I cannot tell whether COFECE had any concern about, or

[7] Because KCSM and Ferrovalle (in which KCSM has a 25% interest) have certain telecommunication concession titles, the FTI, which serves as the antitrust authority in the broadcasting and telecommunications sectors, handled the assessment of concentration in the telecom sector. In its decision, issued on November 3, 2021, the FTI cleared the transaction unconditionally. It considered that CP has no activities in the telecommunications and broadcasting sector and determined that the CP-KCS Merger would not have any anticompetitive effects in telecommunications and broadcasting services.

conducted any assessment of, whether the transaction could affect competition in cross-border rail traffic. It is likely that COFECE concerned itself only with competition within Mexico and that it did not consider any potential competitive impact of the merger within the United States.

III. THE STB'S IMPOSITION OF CONDITIONS REQUIRING CP-KCS-KCSM TO OFFER COMPETITIVE RATES AND NOT DISCRIMINATE AGAINST COMPETITIVE CONNECTIONS IS CONSISTENT WITH MEXICAN LAW AND WOULD NOT INTERFERE WITH THE PREROGATIVES OF MEXICAN AGENCIES.

I understand that UP plans to ask the STB to impose conditions on the CP-KCS Merger that would require CP/KCS to comply with commitments they are offering regarding the Laredo Bridge and use of their control over KCSM to ensure that KCSM continues to work with UP on cross-border traffic via the Laredo Gateway and continues to provide commercially reasonable rate factors that allow UP-KCSM services to remain competitive. UP will urge the STB to include conditions that would more specifically define when KCSM rate factors will be considered commercially reasonable.

Imposition of such conditions by the STB would not interfere with the role of any relevant Mexican governmental agency or conflict with Mexican legal principles. As discussed above, Mexican railroad law requires that KCSM cooperate with its connections on a non-discriminatory basis, including on the rates it sets and the services it provides. Commitments CP and KCS have made appear designed to ensure that their control of KCSM does not adversely affect the way KCSM behaves with respect to its other connections, including UP, on international traffic flows. This is entirely consistent with Mexican law and regulations.

Mexican authorities would not question the STB's role in taking steps to protect competition for international traffic flows that benefit U.S. customers. No agency of the

Mexican government has taken on the protection of rail competition in the United States that depends on cooperation from KCSM for the portion of the movement from Laredo south. In general, the Mexican agencies (COFECE and ARTF) are not concerned with competition on the U.S. segment of traffic originating in or destined for Mexico; they focus entirely on competition in Mexican territory. Requiring CP/KCS to use its control of KCSM to ensure that KCSM works with UP on traffic moving across the border and quotes commercially reasonable rates for UP-KCSM cross-border interline movements would not interfere inappropriately in internal Mexican affairs nor require KCSM to do anything inconsistent with Mexican legal requirements. Such a requirement would be consistent with the principles of non-discrimination reflected in the RSL and the KCSM's Concession.

Although the RSL and KCSM's Concession title contain certain provisions addressing discriminatory pricing practices by KCSM, and such practices could be assessed under the Mexican antitrust regime, this is not a practical concern. There is no precedent that I am aware of that establishes whether these anti-discrimination provisions could be applied to KCSM and U.S. connecting carriers other than CP/KCS and to the sorts of discriminatory rate practices that are the focus of UP's concern. As noted above, to my knowledge, neither the ARTF nor COFECE have ever investigated a case involving allegations of rate discrimination. And as explained above, seeking remedies from the ARTF and/or COFECE would entail lengthy administrative and judicial procedures – a situation complicated by the split of authority between COFECE and ARTF, raising multiple opportunities to challenge their acts. In these circumstances, it is clear that action by the STB to address concerns about rate discrimination affecting cross-border traffic would not be regarded as interference with the prerogatives of Mexican antitrust and rail agencies.

Imposition of conditions by the STB would also be consistent with the terms of the United States-Mexico-Canada Agreement ("USMCA," the successor to NAFTA). Under Article 21.1.2 of the USMCA a Party is not prevented from "applying its national competition laws to commercial activities outside its borders that have an appropriate nexus to its jurisdiction." I believe the STB's imposition of the non-discrimination conditions requested by UP would fall within this provision.

VERIFICATION

I, Luis F. de la Calle, declare under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on February 23, 2022

/s/ Luis F. de la Calle

EXHIBIT 1

[REDACTED]

EXHIBIT 2

[REDACTED]

EXHIBIT 3

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

KANSAS CITY SOUTHERN AND CANADIAN PACIFIC'S JOINT RESPONSES AND OBJECTIONS TO UNION PACIFIC RAILROAD COMPANY'S FIRST SET OF DISCOVERY REQUESTS

Pursuant to 49 C.F.R. Part 1114, Subpart B, 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 and Hudson Railway Company, Inc. (collectively, "Canadian Pacific" or "CP") and Kansas City Southern, The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company (collectively, "KCS"; together with CP, the "Applicants") hereby respond and object as follows to Union Pacific Railroad Company's First Set of Discovery Requests to Applicants (the "UP Requests") served on November 8, 2021 in connection with the above-captioned proceeding.

GENERAL OBJECTIONS

The following General Objections apply to each of the UP Requests and shall have the same force and effect as if set forth in full in response to each individually numbered UP Request.

1. Applicants object to the UP Requests and to each Definition, Instruction and Request contained therein to the extent they purport to impose upon the Applicants burdens

Request No. 39:

Produce documents sufficient to show the post-acquisition growth of traffic to/from Central Maine & Quebec Railway US Inc.

Response to Request No. 39:

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants will provide non-privileged and non-duplicative documents responsive to this Request that they are able to locate after a reasonable search.

Request No. 40:

Describe in detail the meaning of the phrase "commercially reasonable terms," as the phrase is used on page 14 of the Creel VS.

Response to Request No. 40:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is unduly burdensome and not proportional to the needs of this proceeding. Applicants further object to this Request on the grounds that the Application speaks for itself. Applicants further object to this Request to the extent that it improperly calls for legal analysis, arguments or conclusions.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that the phrase "commercially reasonable terms" as used in this context (Application Vol. 1 at 1-169) refers to Applicants' commitment that they will keep affected gateways open on commercially reasonable terms. Applicants will continue to support efficient interchange from an operational standpoint, and they will also offer shippers commercial terms that support interline transportation options that shippers have chosen, if shippers desire such options in the future. Thus, the referenced "terms" are those that CPKC

would be prepared to offer to potential rail transportation customers (or, if desired by a customer, to other railroads for purposes of constructing a through rate) in connection with post-Transaction interline rail services for shipments handled on an interline basis prior to the Transaction and for which the Transaction made possible new CPKC single-line alternatives. Such terms would be "commercially reasonable" in the sense that they would be established by CPKC in good faith to provide customers with the option of continued movement of rail traffic via an affected pre-Transaction interline route if that route was preferred by a shipper.

Request No. 41:

Describe in detail the Applicants' "detailed integration planning," as described on page 16 of the Creel VS, in relation to operations via the Laredo gateway.

Response to Request No. 41:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is unduly burdensome and not proportional to the needs of this proceeding. Applicants further object to this Request on the grounds that the Application speaks for itself. Applicants further object to this Request to the extent that it improperly calls for legal analysis, arguments or conclusions.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that Applicants' detailed integration planning includes the work undertaken to prepare the Operating Plan, described in detail in Exhibit 13 to the Application, as well as the planning relating to service assurance and IT systems described in detail in the Verified Statement of James Clements and the planning relating to labor force needs described in detail in the Verified Statements of Chad Rolstad and Myron Becker, and also reflected in the Labor Impact Exhibit. *See also* Verified Statement of John Brooks at 23-25

Request No. 99:

Produce all documents discussing whether KCS or KCSM is collecting "the full measure of returns associated with its existing market power." *See* Majure VS at 15.

Response to Request No. 99:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is overly broad, unduly burdensome, and not proportional to the needs of this proceeding. Applicants further object to this Request as unduly burdensome and overly broad as it seeks "all" documents underlying an economic concept. KCS does not discuss whether it or KCSM collects "the full measure of returns associated with its existing market power" in its ordinary course of business.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that KCS does not have any responsive documents.

Request No. 100:

Produce all documents discussing whether KCS rates or KCSM rates are subject to "a regulatory constraint." *See* Majure VS at 16.

Response to Request No. 100:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is overly broad, unduly burdensome, and not proportional to the needs of this proceeding. Applicants further object to this Request as unduly burdensome and overly broad as it seeks "all" documents regarding regulation of KCS or KCSM rates. Applicants further object to this Request to the extent that it seeks documents protected from discovery by the attorney-client privilege, attorney work product doctrine or any other applicable

privilege, protection, immunity, law, or rule. Applicants further object to the extent that the information is publicly available or in UP's possession.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants refer UP, and incorporate by reference, Applicants' Objections and Responses to Request Nos. 63 and 64.

Request No. 101:

Produce all documents discussing whether KCSM rates are constrained by "competitive pressure from other rail . . . options." *See* Majure VS at 16.

Response to Request No. 101:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is overly broad, unduly burdensome, and not proportional to the needs of this proceeding. Applicants further object to this Request as unduly burdensome and overly broad as it seeks "all" documents discussing whether KCSM rates are constrained by "competitive pressure from other rail options." Applicants further object to this Request as unduly burdensome and overly broad as it seeks "all" documents underlying an economic concept. Applicants further object to this Request to the extent that it could be interpreted to refer to any document in which KCSM competes with a competitor and this would entail a substantial part of KCS business and encompass nearly all business documents. Applicants further object to this Request to the extent that it seeks documents protected from discovery by the attorney-client privilege, attorney work product doctrine or any other applicable privilege, protection, immunity, law, or rule. Applicants further object to the extent that the information is publicly available or in UP's possession.

Subject to and without waiving the General Objections and specific objections, Applicants respond that KCS does not maintain documents in the ordinary course of business that discuss the extent to which KCSM rates are "constrained by 'competitive pressure from other rail…options'" and thus has no responsive documents.

Request No. 102:

Describe what the term "level of access" means, as the phrase is used on page 17 of the Brown/Zebrowski VS, and how various "levels of access" factored into the diversion analysis performed by Messrs. Brown and Zebrowski, and produce all workpapers addressing how "level of access" factored into the diversion analysis performed by Messrs. Brown and Zebrowski.

Response to Request No. 102:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is overly broad, unduly burdensome, and not proportional to the needs of this proceeding.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that the term "level of access" as used on page 17 of the Brown/Zebrowski VS (Application Vol. 2 at 2-129) refers to the extent to which CP or KCS would likely be able to provide service for the traffic at issue at origin and/or destination. For example, Messrs. Brown and Zebrowski considered whether CP or KCS or a connecting shortline served the stations where the traffic was originated and terminated, whether CP or KCS had served the pertinent shipper facilities in the past or in connection with shipments of the same or different commodities to or from alternative destinations or origins, whether a CPKC route between the origin and destination would be unduly circuitous, whether alternative origin or

EXHIBIT 4

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CPR-5

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 34342

KANSAS CITY SOUTHERN
— CONTROL —
THE KANSAS CITY SOUTHERN RAILWAY COMPANY
GATEWAY EASTERN RAILWAY COMPANY,
AND THE TEXAS MEXICAN RAILWAY COMPANY

ADDITIONAL COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY

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DATED: September 30, 2004

PUBLIC VERSION - REDACTED

CPR-5

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 34342

KANSAS CITY SOUTHERN
— CONTROL —
THE KANSAS CITY SOUTHERN RAILWAY COMPANY
GATEWAY EASTERN RAILWAY COMPANY,
AND THE TEXAS MEXICAN RAILWAY COMPANY

ADDITIONAL COMMENTS OF CANADIAN PACIFIC RAILWAY COMPANY

Pursuant to the Board's *Decision No. 11* served in the above-captioned proceeding on August 31, 2004, Canadian Pacific Railway Company and its wholly-owned subsidiaries, Soo Line Railroad Company ("Soo") and Delaware and Hudson Railway Company, Inc. ("D&H") (collectively, "CPR") submit these additional comments concerning the application of Kansas City Southern ("KCS") to acquire control of The Texas Mexican Railway Company ("TexMex").

As indicated in its prior submissions, CPR takes no position as to whether the proposed KCS/TexMex control transaction ought to be approved. *See* CPR-3, Comments filed August 4, 2003 at 1. However, if the Board decides to approve KCS' application to control TexMex, CPR urges the Board to impose a condition requiring Applicants to enter into one or more written agreements that would assure non-Applicant carriers serving the "NAFTA Corridor" future access to the Laredo gateway on commercially reasonable terms. Such a condition is necessary to preserve effective rail competition for traffic moving between points in Canada and the United States, on the one hand, and points in Mexico, on the other hand, in the event that KCS' plan to acquire both TexMex and TFM, S.A. de C.V. ("TFM") is successful.

Applicants acknowledge that the continued growth of NAFTA trade depends upon the availability of competitive transportation alternatives for traffic moving to/from Mexico. *See* KCS-10/TM-10, Supplement to Application at 13. Yet, while Applicants vaguely assert that they would "keep the Laredo gateway open on commercially reasonable terms" (*see, e.g., id.* at 4, 24), they have not committed on the record to any specific measures to assure that result. Instead, Applicants have suggested that carriers interested in access to the Laredo gateway seek to negotiate "a private agreement to ensure that KCS abides by this commitment." *See* CPR-3, Comments, Attachment 1 (Letter dated July 21, 2003 from Mr. Mullins to Mr. Meyer at 2). The condition proposed by CPR would simply require Applicants to follow through with their own suggestion by entering into a written agreement (or agreements) defining the "commercially reasonable" terms upon which non-Applicant railroads (and the shippers that they serve) will be able to access the Laredo gateway in the event that KCS creates its proposed "NAFTA Rail" system by acquiring both TexMex and TFM.

The reasons why such a condition is both necessary and appropriate are discussed in detail in CPR's prior submissions. As CPR demonstrated, the Laredo gateway plays an indispensable role in the movement of rail freight to and from Mexico – indeed, nearly 90 percent of all traffic handled by CPR to and from Mexico currently moves via Laredo. *See* CPR-3, Comments at 4; CPR-4, Reply Comments filed September 2, 2003 at 3. The Board has frequently acknowledged that Laredo "occupie[s] a position of separate and surpassing economic significance" among the rail gateways serving the U.S. – Mexico border. *Union Pacific Corporation, et. al. – Control and Merger – Southern Pacific Rail Corporation, et al.("UP/SP")*, 1 S.T.B. 233, 422 (1996) (emphasis added).[1]

[1] *See also id. at 565* (Laredo "the premier Eastern Mexico gateway"); *Santa Fe Southern Pacific Corp. – Control – SPT Co.*, 2 I.C.C. 2d 709, 797 (1986) (Laredo "by far the most important" Mexican rail gateway); *id.* at 894-895 ("Laredo historically has been the foremost international rail gateway to Mexico").

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KCS' proposal to acquire both TexMex and TFM would give it control of one of the two U.S. carriers serving the Laredo gateway as well as the only carrier (TFM) providing connecting service to/from points in Mexico. If the "NAFTA Rail" system were to exercise that control in a manner that closed the Laredo gateway commercially to competing railroads (*e.g.*, by refusing to participate in interline routes on reasonable terms), the competing services by CPR and others (in conjunction with UP) in the NAFTA Corridor would be severely impaired. The condition requested by CPR is designed to assure the continued viability of those competing rail routes following the creation of a NAFTA Rail system.

Nothing that has occurred since the Board suspended these proceedings in October 2003 obviates the need for such a condition. As Applicants acknowledge, "the differences between the previous transaction and the revised transaction [now before the Board] are minor in nature and do not involve any changes in the substantive areas of concern" that the Board must consider in this proceeding. KCS Status Report filed August 16, 2004 at 3 (emphasis added). *See also Decision No. 11* at 5. While the revised KCS/TMM Stock Purchase Agreement commits KCS to comply with existing protocols regarding "use and operation" of the International Bridge at Laredo (*see* Revised Stock Purchase Agrt., § 5.1), it contains no provision that would require Applicants to preserve the commercial access of competing carriers to the Laredo gateway. Even KCS' limited commitment to observe protocols for operation of the International Bridge would be rendered moot if KCS acquires TFM, which controls the southern half of the bridge. Thus, KCS' revised proposal – like its prior submissions – fails to give substance to its representation that the Laredo gateway will remain open to KCS' competitors on commercially reasonable terms.

Moreover, recent events have made a KCS acquisition of TFM more likely than it was at the time the Board suspended this proceeding in *Decision No. 10*. The Board's action was

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triggered by the decision of the shareholders of Grupo TMM, S.A. ("TMM"), on August 18, 2003, to reject the KCS/TFM Acquisition Agreement, and TFM's subsequent exercise of its right to repurchase from KCS the 51 percent interest in Mexrail upon which KCS' control application was predicated. However, on March 22, 2004, an arbitration panel ruled that shareholder rejection of the KCS/TFM Acquisition Agreement did not authorize TMM to terminate the Agreement.[2] In the wake of that decision, KCS and TMM renewed their negotiations regarding the sale of TFM, and TMM agreed to support KCS' application to the Mexican Foreign Investment Commission ("MFIC") for authority to acquire a controlling interest in TFM.[3]

On September 16, 2004, MFIC gave notice that it was denying KCS' application to acquire TFM. However, in a joint press release, KCS and TMM stated:

> "KCS and TMM are actively involved in discussions with the FIC and believe that they are close to an agreement to resolve these matters. KCS and TMM will seek reconsideration of this decision and remain confident that they should ultimately obtain approval of the transaction.[4]

KCS and TMM have also agreed to extend the deadline for closing under the KCS/TFM Acquisition Agreement until June 15, 2005 "to provide additional time to complete the transaction." *Id.*

Thus, it now appears that TMM is actively supporting KCS' efforts to acquire TFM, and that the prospects for completion of the KCS/TFM transaction are considerably better than they were prior to the suspension of these proceedings in *Decision No. 10*. The danger that future rail competition via Laredo might be compromised by a NAFTA Rail system wielding exclusive

[2] *See* Attachment 1, "Interim Award in Arbitration Between TMM and KCS" (press release issued by TMM on March 22, 2004).

[3] *See* Attachment 2, "KCS Clarifies Obligations Under Stipulation Agreement" (press release issued by KCS on April 12, 2004).

[4] *See* KCS Sixth Status Report, filed September 16, 2004, Attachment, "Kansas City Southern and Grupo TMM To Seek Reconsideration of Mexican Foreign Investment Commission Decision" (joint press release) at 1 (emphasis added).

control over that vital gateway is likewise heightened. So long as KCS continues to pursue an acquisition of TFM, the public interest requires that the Board, in ruling on the KCS/TexMex control application, take into account "the broader transaction, incorporating the related KCS/TFM component," as contemplated by *Decision No. 2*.

KCS continues to take the position that the Board "has no legal authority" to consider the competitive effects of KCS' strategy to create a combined KCS/TexMex/TFM system. *See, e.g.*, KCS-10/TM-10 at 3, n.2. Most recently, in refusing to respond to discovery requests inquiring about the status of the KCS/TFM transaction, KCS asserted: "Whether or not KCS acquires control of TFM is irrelevant inasmuch as acquisition of TFM, which operates entirely in Mexico, is a proposed transaction that is beyond the jurisdiction of the STB and is, instead, subject to the jurisdiction of Mexican authorities." *See* KCS' Responses and Objections To Union Pacific Railroad Company's Fourth Set of Discovery Requests to Applicants, filed September 8, 2004 at 4-5. *See also id.* at 6 (objecting to production of documents analyzing possible acquisition of TFM on the grounds that "[t]he requested documents, insofar as they relate to KCS's interest in acquiring control of TFM, are irrelevant because that matter is outside of the Board's jurisdiction").

KCS is wrong. As the Board has correctly observed, KCS' proposal to acquire TFM, while subject to regulation by Mexican authorities, has "broader potential implications in the U.S." *Decision No. 2* at 11. Accordingly, "<u>the role played by TFM in the U.S.-Mexico NAFTA corridor cannot be ignored</u>" in considering the merits of the KCS/TexMex proposal. *Id.* at 10. For that reason, the Board instructed Applicants to supplement their application with evidence addressing the potential effects of a KCS/TFM consolidation on rail competition in the United States. *Id.* at 10-11 (emphasis added). More recently, the Board's order restarting this proceeding expressly extended the requirement (imposed in *Decision No. 10*) that KCS file

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periodic status reports "detailing new developments (if any) in its efforts to acquire control of TFM." *Decision No. 11* at 6.

These rulings leave no doubt that the Board can – and should – consider the potential effects of KCS acquiring control of TFM in deciding whether to approve the KCS/TexMex transaction. The Board should likewise exercise its conditioning authority in this case to assure that a prospective "NAFTA Rail" system could not undermine future rail competition at the Laredo gateway. Indeed, this proceeding presents the only opportunity for the Board to do so, because KCS will not be required to return to the Board for authority to acquire TFM. (A condition imposed by the Board now, but made contingent upon KCS succeeding in acquiring TFM, would not impose any burden on Applicants if KCS abandoned its pursuit of TFM.)

As CPR has previously shown (CPR-4, Reply Comments at 2-3), Applicants' settlement arrangement with the National Industrial Transportation League ("NITL") – which Applicants have asked the Board to impose as a condition – does not mitigate the potential for competitive harm in the event that a combined "NAFTA Rail" system gains control of the Laredo gateway. Both Applicants and NITL frankly acknowledge that "[t]he NITL-KCS Agreement will not require NAFTA Rail to establish and maintain commercially reasonable contract or common carrier rates and charges with respect to traffic interchanged between UP and TFM at the Laredo Gateway." *See* NITL-4/KCS-17, Letter to Mr. Meyer dated August 18, 2003 at 1. The KCS-NITL settlement applies only to U.S-Mexico cross-border movements in which KCS and/or TexMex are the participating carriers, and preserves interline competition only at interchange points other than Laredo. The KCS-NITL Agreement does not address the ability of non-Applicant railroads to access the Laredo gateway on commercially reasonable terms following the creation of a "NAFTA Rail" system, and therefore does not respond to the competitive concerns identified in CPR's comments.

The Board's prior decisions demonstrate a strong commitment to ensuring that railroad mergers do not undermine the goals of NAFTA. *See, e.g., UP/SP*, 1 S.T.B. at 421-426 (imposing trackage rights condition to preserve TexMex's ability to compete for U.S.-Mexico rail traffic via Laredo); *Canadian National Ry. Co., et al. – Control – Illinois Central Corporation, et al.* (served May 21, 1999) ("*CN/IC*") at 35-36 (condition imposed to prevent interference with rail tunnel serving US/Canada gateway at Detroit). The Board also routinely requires applicant carriers to abide by any representations they make on the record. *See, e.g., Canadian National Ry. Co. et al. – Control – Wisconsin Central Transportation Corp., et al.,* (decision served September 5, 2001) ("*CN/WC*") at 12-14 (condition holding applicants to representations regarding preservation of rail gateways); *CN/IC* at 7, n. 21 (1999) (condition holding applicants to all representations made in writing and at oral argument); *CSX Corporation, et al. and Norfolk Southern Corporation, et al. – Control and Operating Leases – Conrail, Inc. et al.*, 3 S.T.B. 196, 387 (1998) (applicants required to adhere to all representations made during proceeding).

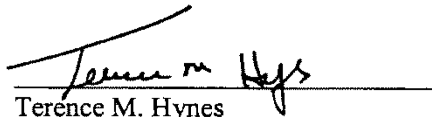
It is equally appropriate for the Board to exercise its conditioning authority in this case to compel Applicants to adhere to their promise to keep the Laredo gateway open on "commercially reasonable terms" by requiring them to enter into binding written agreement(s) setting forth the terms upon which competing carriers will be able to access Laredo in the event that KCS acquires control of both TexMex and TFM. Such agreement(s) should apply to all rail routings via Laredo, including the TFM-UP routes excluded from the scope of the KCS-NITL Agreement. The specific terms of such an arrangement can be left, in the first instance, to negotiation between Applicants and other carriers serving the NAFTA Corridor. If the parties fail to reach agreement, the Board could then act as needed to define such terms.

CPR's proposed condition is necessary to preserve effective competition for rail traffic to/from Mexico in the event that TexMex and TFM come under the common control of KCS. Given the unique importance of the Laredo gateway to NAFTA trade, the Board should act in this proceeding to assure that a KCS-TFM consolidation does not compromise the competitive rail system serving the NAFTA Corridor.

CONCLUSION

For all of the foregoing reasons, and those set forth in CPR's Comments (CPR-3) and Reply Comments (CPR-4), CPR respectfully requests that the Board condition its approval of the proposed transaction by requiring Applicants to enter into binding written agreement(s) specifying commercially reasonable terms upon which competing railroads (including CPR) can route traffic to or from Mexico via the Laredo gateway in the event that KCS acquires control of both TexMex and TFM.

Respectfully submitted,



Terence M. Hynes
Gabriel S. Meyer
Sidley Austin Brown & Wood
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Paul Guthrie
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Gulf Canada Square, Suite 500
Calgary, Alberta T2P 4Z4 CANADA
(403) 218-7474

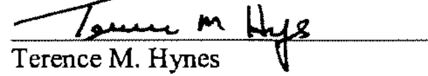
Counsel for Canadian Pacific Railway Company

DATED: September 30, 2004

CPR-5

CERTIFICATE OF SERVICE

I hereby certify on this 30th day of September 2004, that I caused copies of the foregoing Additional Comments of Canadian Pacific Railway Company to be served, by hand-delivery on Applicants' counsel, and by first-class mail, postage prepaid, on all other Parties of Record.



Terence M. Hynes

EXHIBIT 5

[REDACTED]

EXHIBIT 6

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934
(Amendment No.)

Filed by the Registrant ☒ Filed by a Party other than the Registrant ☐

Check the appropriate box:

☐ Preliminary Proxy Statement

☐ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

☒ Definitive Proxy Statement

☐ Definitive Additional Materials

☐ Soliciting Material under §240.14a-12

KANSAS CITY SOUTHERN
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

☒ No fee required.

☐ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

☐ Fee paid previously with preliminary materials.

☐ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

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"*The KCS Merger Proposal—Opinion of Morgan Stanley*" and "*The KCS Merger Proposal—Opinion of BofA Securities*" on pages 72 and 85, 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 1 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

EXHIBIT 7

[REDACTED]

EXHIBIT 8

[REDACTED]

EXHIBIT 9

[REDACTED]

EXHIBIT 10

UP-8

REDACTED – TO BE PLACED ON PUBLIC FILE

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

UNION PACIFIC RAILROAD COMPANY'S MOTION TO COMPEL

<u>EXPEDITED HANDLING REQUESTED</u>

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Attorneys for Union Pacific Railroad Company

January 27, 2022

may be somewhat over-inclusive, it may be somewhat under-inclusive. That's why you run searches and see what happens.

I've done this before. I've been on live phone calls with opposing counsel where we have adjusted the search terms to generate reasonable numbers of potentially responsive documents. I'm not sure why you've run a bunch of commodities other than plastics, and I don't think I ever asked for Intermodal, but 13,000 hits for "benzene" for one year seems like a reasonable start (especially because this is apparently for multiple people, since you say you got 11,000 hits for benzene, grain, and intermodal for one senior person). Now add terms designed to identify documents in which KCS addresses UP-KCSM moves and also addresses both single-line and interline pricing, and I suspect the number will shrink further. If you've pulled the data, it should be easy to run the tests. And if it turns out most of the hits come from spreadsheets, we can talk about excluding those documents, or making other changes to produce a reasonable number of hits.

Regards,

Mike

From: WMullins@bakerandmiller.com <WMullins@bakerandmiller.com>
Sent: Tuesday, January 18, 2022 5:25 PM
To: Rosenthal, Michael <mrosenthal@cov.com>
Cc: Cyrm@sullcrom.com; Agarwal, Pratik <PAgarwal@cov.com>; Sarnoff, Zachary A. <sarnoffz@sullcrom.com>; Vandergrift, Sophia A. <vandergrifts@sullcrom.com>; David Meyer <david@meyerlawdc.com>; eglavich@bakerandmiller.com; AMcDonald@bakerandmiller.com
Subject: RE: FD 36500 - Follow up regarding meet and confer

[EXTERNAL]

Mike, below we respond to your January 10 email. Responses in Red. The production we intended to go out last week will be out later today or tomorrow morning.

William ("Bill") A. Mullins
Partner
Baker & Miller PLLC
Suite 300
2401 Pennsylvania Ave, N.W.
Washington, D.C. 20037

(202) 663-7823 (Direct)
(202) 663-7849 (Fax)
The above message may be privileged, confidential and protected from disclosure by attorney/client. work product or other privileges. If you believe that it has been sent to you in error, do not read it. Please reply to the sender that you have received the message in error. Then delete it. Thank you.

-----"Rosenthal, Michael" <mrosenthal@cov.com> wrote: -----

To: Cyr
From: "Rosenthal, Michael" <mrosenthal@cov.com>
Date: 01/10/2022 10:03AM
Cc: "Agarwal, Pratik" <PAgarwal@cov.com>, "Sarnoff, Zachary A." <sarnoffz@sullcrom.com>, "Vandergrift, Sophia A." <vandergrifts@sullcrom.com>, David Meyer <david@meyerlawdc.com>, Bill Mullins <wmullins@bakerandmiller.com>
Subject: RE: FD 36500 - Follow up regarding meet and confer

Thanks very much for your responses. I have a few follow-up questions.

1. I realize you might have prepared this response before reviewing the email I sent yesterday, but with regard to UP Request No. 4, I have not seen any material reflecting communications with customers (and others) asking them to contact the STB or others to support the proposed transaction. While I do not expect applicants to produce copies of every document actually sent to every potential supporter, I suspect there were some standard communications and a list of recipients. If I've overlooked that information in the production, please tell me where to find it. If applicants did not solicit support statements through written communications, please let me know.

RESPONSE: In today's (or tomorrow morning's) production, KCS is producing a number of letters to third parties, template support letters sent to customers/shippers, and letters sent to US government officials. We will also provide the lists of third parties/officials who received the letters (if not obvious from documents).

2. With regard to UP Request No. 5, as indicated in the email I sent yesterday, our review of the depository points to the existence of additional submissions to COFECE and or IFT. Such documents are referenced in the documents that were produced (or so my Spanish speaking colleagues tell me).

RESPONSE: KCS is searching for and will produce additional substantive documents provided to COFECE and IFT relating to the Proposed Transaction.

3. With regard to the requests you say are complete, could you tell me where I can find documents produced in response to UP Request Nos. 70, 74, 90, 93, 113, and 122 (or confirm that your searches did not identify responsive documents).

RESPONSE:

Below are the Bates numbers for documents that are responsive primarily to the Requests you identified. As you are aware, UP's requests are extremely broad and documents may be responsive to multiple requests, including the ones you identified. This list is not intended to be comprehensive of every document that may be responsive.

Request No. 90 was mistakenly included as completed last week. Documents responsive to this request are in today's production at Bates numbers: KCSR-HC-00015675 to KCSR-HC-00015784.

UP 70 & 113: KCSR-HC-00012593

UP 74: These documents may be found under the Venue folder "HIGHLY CONFIDENTIAL - Ice Pick Documents"

UP 93: KCS does not have non-privileged documents responsive to this Request.

UP 122: KCSR-HC-00011604

KCSR-HC-00011609

KCSR-HC-00011611

KCSR-HC-00012594

KCSR-HC-00012599

KCSR-HC-00012615

KCSR-HC-00012664

KCSR-HC-00012678

KCSR-HC-00012706

KCSR-HC-00012717

KCSR-HC-00013031

4. With regard to UP Request Nos. 94 through 94, I appreciate the additional information. To be clear, are you saying that when a customer with a U.S. facility that is accessible to both KCS and UP wants to send its product to a Mexican destination served by KCSM, the same KCS personnel would set both the KCS-KCSM single line rate and the KCSM Rule 11 rate that the customer can use in conjunction with a UP Rule 11 rate (or would provide KCSM's revenue requirement to UP if the railroads offer a joint through rate)? Also, are you saying the Pricing Review Board generally addresses both single-line rates to be offered by KCS-KCSM and rates KCSM offers for shippers that want to interchange traffic with UP at Laredo?

In any event, I would not characterize the major limiting factor in the searches I'm proposing as "UP" and "rate." I'm not looking for all documents setting rates when UP interchanges traffic with KCSM or KCS. I'm looking for documents where the U.S. side of the movement is served by both KCS and UP. I expect the documents would include the terms: (1) UP (or Union Pacific), KCS, and KCSM; <u>and</u> (2) "single-line" or "KCS-KCSM" or "KCSM-KCS" (or whatever terminology KCS personnel use when quoting single-line KCS-KCSM rates); <u>and</u> (3) "Rule 11" or "UP-KCSM" or "KCSM-UP" (or whatever terminology KCS personnel use when quoting KCSM rates for traffic interchanged at Laredo with UP). I'd also suggest

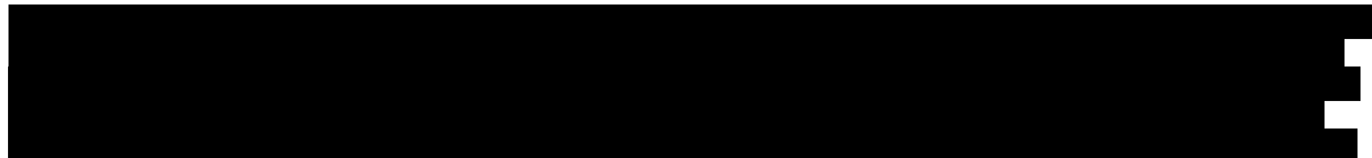
focusing the initial search on Plastics, so I'd propose including (4) Plastics, polypropylene, polyethylene, polyvinyl, polystyrene, or 28211!.

RESPONSE:

We are trying to provide some background on KCS's pricing practice in light of your requests and the searches you are asking for, and not attempting to put all of KCS's pricing into an email. To that extent, when we explained the pricing groups day-to-day work, we were doing so with a focus on what your search terms ask us to do: search and produce five years-worth of day-to-day routine business.

To back up a bit, the problem here is that your requests are based on a misconception of how KCS pricing works. Your requests assume that KCS and KCSM price separately (or have independent pricing groups) and that by seeking communications between the two, you would get a picture of how rates are set. This assumption is incorrect.

KCS has a core pricing team for all rates, US and Mexico. KCS and KCSM do not have separate pricing groups - and therefore communications between the two is not dispositive.



We already explained the basic considerations underlying pricing in our Response to UP's Request No. 148, served December 7. The Pricing Review Board reports provide insight into higher level pricing strategy.

Search terms do not resolve the undue burden problem. We ran test terms for the year 2019. For just one year: the term "benzene" brings back over 13,000 hits; "Grain" brings back almost 100,000 hit. BNSF has a similar request but asked for different commodities, including "intermodal" which brings back over a million hits for one year. Running benzene, grain, and intermodal against one senior level person brought back over 11,000 hits for one year for one person.

As such, there are some basic conceptual problems for running your proposed search. First, your (1) will pick up any instance of KCSM-KCS/KCSM-UP, which means, for example, the search will pick up every document that has in it "KCSM-KCS" and "KCSM-UP" and "plastic." Second, using "AND" as a connector means that those terms may have nothing to do with each other. This is a problem for complex spreadsheet that include disparate information. Add on top of that, as you recognize, people do not always use the official terms like "Rule 11" or "single-line" and may use shorthand, customer names, origination or destination, or other identifying language, which can greatly expand the number of terms to run. On top of that, you asked for five commodities that themselves have multiple terms. You suggested six different terms under the single commodity "plastics." You also asked for "field crops" which KCS does not recognize. We assume you mean "grain" which is a huge category and could consist of grain, soy, corn, wheat, rice, and so on, as well as STCC numbers, as well as grain by-products, such as DDG. Multiply the number of commodity terms, with the number of people, with possibly five years of

day-to-day communications, and you are asking KCS to run over a hundred search combinations and pull, search, and review millions of documents. Tweaks and alternative searches suffer from the same issues.

As we tried to explain, because there are no separate teams between KCS and KCSM and the core pricing team develops pricing on an individual basis, your Requests essentially demand KCS produce its day-to-day routine business documents for a period of five years. Specific commodities may narrow down what KCS has to produce, but the burden of searching and determining responsive documents still requires an effort that far exceeds the probative value. (We again question the value of these documents. In order to be useful in any regard, UP would have to reverse engineer individual rate discussions over time between multiple people, assuming that all relevant documents can even be identified let alone produced. Otherwise, any attempt to use a rate discussion would devolve into a debate about whether the rate discussion is complete, accurate, and representative.)

We produced the Pricing Review Board reports for your requested commodities in today's production and they may be found at Bates numbers KCSR-HC-00015675 to KCSR-HC-00015784. We invite you to review these and, if you are still missing something you need, please explain what you need so that we can get you helpful documents.

Cc: Agarwal, Pratik <PAgarwal@cov.com>; Sarnoff, Zachary A. <sarnoffz@sullcrom.com>; Vandergrift, Sophia A. <vandergrifts@sullcrom.com>; David Meyer <david@meyerlawdc.com>; Bill Mullins <wmullins@bakerandmiller.com>
Subject: RE: FD 36500 - Follow up regarding meet and confer

[EXTERNAL]

Mike,

Please see responses from CP and KCS below, in black.

Thanks,

Marc-André Cyr

Sullivan & Cromwell LLP

T: (857) 209- 1986 | cyrm@sullcrom.com

EXHIBIT 11

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

KANSAS CITY SOUTHERN AND CANADIAN PACIFIC'S JOINT RESPONSES AND OBJECTIONS TO UNION PACIFIC RAILROAD COMPANY'S SECOND SET OF DISCOVERY REQUESTS

Pursuant to 49 C.F.R. Part 1114, Subpart B, 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 and Hudson Railway Company, Inc. (collectively, "Canadian Pacific" or "CP") and Kansas City Southern, The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company (collectively, "KCS"; together with CP, the "Applicants") hereby respond and object as follows to Union Pacific Railroad Company ("UP")'s Second Set of Discovery Requests to Applicants ("Second UP Requests") served on November 22, 2021 in connection with the above-captioned proceeding.

GENERAL OBJECTIONS

The following General Objections apply to each of the Second UP Requests and shall have the same force and effect as if set forth in full in response to each individually numbered Second UP Request.

1. Applicants object to the Second UP Requests and to each Definition, Instruction and Request contained therein to the extent they purport to impose upon the

Response to Request No. 147:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is cumulative, overly broad, and unduly burdensome. The Applicants further object to this Request as duplicative of UP's Request No. 89.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants incorporate by reference the Applicants' Joint Response to UP Request No. 89.

Request No. 148:

Describe in detail how KCS sets rates for KCSR and KCSM, or allocates revenue between KCSR and KCSM, for traffic interchanged between KCSR and KCSM.

Response to Request No. 148:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is cumulative, overly broad, and unduly burdensome. The Request refers to the substance of much of KCS business, including its day-to-day operations, and lacks a reasonable limitation. As such it is vague and ambiguous, rendering the Request unduly burdensome and not proportional to the needs of the proceeding. The Applicants further object to this Request to the extent that it is duplicative of UP's Requests Nos. 93-97.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that, generally, revenue and pricing are determined on a variety of factors and considerations, including but not limited to the market, operating and cost considerations, the type of service, volume, risk premiums (such as hazardous materials or high-end commodities), asset availability, network capacity, competitive modes of transportation, and regulatory requirements. The same considerations apply to cross-border rates. Once the overall

rate is determined, revenue divisions are assigned between KCSR and KCSM based on the circumstances particular to the move, including but not limited to mileage divisions, operating cost considerations, overall base costs (such as higher fuel costs in Mexico or additional security needs), WACC differences in the United States and Mexico, and regulatory requirements (such as TUCE (Max) rate considerations in Mexico).

Request No. 149:

Produce an electronic copy of the "KCS Runtimes/Capacity Calculations" and "KCS Capacity Calculations/Project list" spreadsheets embedded in workpaper "FD 36500 - Work Paper - HC - Capacity - Methodology.pdf."

Response to Request No. 149:

In addition to the General Objections set forth above, Applicants object to Requests Nos. 149 and 151-162 on the grounds that they are cumulative, unduly burdensome and not proportional to the needs of this proceeding.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that the documents UP requests are embedded in the Workpapers that Applicants made available to UP already. Nevertheless, if UP has difficulty reading or using a particular embedded document, Applicants will respond to reasonable requests for assistance.

Request No. 150:

Produce an electronic copy of CP-related spreadsheets containing the same type of information as the spreadsheets addressed in Request No. 149.

EXHIBIT 12

REDACTED PUBLIC RECORD VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

KANSAS CITY SOUTHERN AND CANADIAN PACIFIC'S SUPPLEMENTAL JOINT RESPONSES AND OBJECTIONS TO CSX TRANSPORTATION'S SECOND SET OF DISCOVERY REQUESTS

Pursuant to 49 C.F.R. Part 1114, Subpart B, 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 and Hudson Railway Company, Inc. (collectively, "Canadian Pacific" or "CP") and Kansas City Southern, The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company (collectively, "KCS"; together with CP, the "Applicants"), and pursuant to several meet and confer discussions with CSXT Transportation ("CSXT") regarding its motion to compel ("Motion"), filed on January 20, 2022 in response to Applicants' initial response and objections ("Initial Response"), served on January 10, 2022, hereby supplement their Initial Response as follows to CSX Transportation's Second Set of Discovery Requests to Applicants ("Second CSXT Requests"), served on December 24, 2021 in connection with the above-captioned proceeding.[1]

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[1] By making these Supplemental Responses, Applicants do not concede the merit of any assertion made by CSXT in its Motion, and reserves all of its positions in connection therewith.

Movements, origin stations, and destination stations) for the transportation of goods to, from, or through the United States.

Response to Interrogatory No. 11:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is vague and ambiguous. Applicants further object to this Request on the grounds that it is overly broad, unduly burdensome and not proportional to the needs of this proceeding, including because it requests identification of "all" documents without a reasonable scope limitation. Applicants further object to this Request to the extent it seeks the identification of documents that are accessible to CSXT. Applicants further object to this Request to the extent CSXT construes this Request as a "contention interrogatory."

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that documents responsive to this Request are contained in the Application and accompanying Workpapers.

In further response to additional inquiries and pursuant to the parties' meet and confer discussions regarding this Request, Applicants respond by referring CSXT without limitation to the 100% traffic tapes and Carload Waybill Sample ("CWS") data that is available to CSXT.

Interrogatory No. 12:

Regarding customers served by KCSM or KCS, Identify all Analyses or other Documents You contend support the claim that "A combined CP/KCS would not be expected to have any incentive to affect the competitive terms available to a Solely-served shipper because KCS would already be collecting the full measure of returns associated with its existing market power," as stated in the Majure V.S. ¶ 24.

Response to Interrogatory No. 12:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is vague and ambiguous. Applicants further object to this Request on the grounds that it is overly broad, unduly burdensome and not proportional to the needs of this proceeding, including because it requests identification of "all" documents without a reasonable scope limitation. Applicants further object to this Request to the extent it seeks the identification of documents that are accessible to CSXT. Applicants further object to the extent this Request asks Applicants to perform a special study.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that documents responsive to this Request are contained in the Application and accompanying Workpapers. In particular, the referenced statement of Dr. Majure was not based on any specific documentary evidence in the possession of Applicants.

In further response to additional inquiries and pursuant to the parties' meet and confer discussions regarding this Request, Applicants respond by confirming the quoted language is based on Dr. Majure's economic analysis and does not reflect an analysis that was specific to any particular customers or rates.

Interrogatory No. 13:

Identify each origin station, each destination station, and each shipper that KCSM serves in Mexico for which You contend that FXE is a "ready alternative" to KCSM as stated in the Majure Verified Statement ¶ 25.

Response to Interrogatory No. 13:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is vague and ambiguous. Applicants further object to this Request

on the grounds that it is overly broad, unduly burdensome and not proportional to the needs of this proceeding. Applicants further object to this Request to the extent it seeks the identification of documents or information that are accessible to CSXT. Applicants further object to the extent this Request asks Applicants to perform a special study. Applicants further object to this Request on the grounds that it misconstrues the Majure Verified Statement.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that Paragraph 25 of the Majure Verified Statement reflects the application of economic theory to a range of potentially applicable facts, and does not make contentions of fact regarding specific individual stations and shippers.

In further response to additional inquiries and pursuant to the parties' meet and confer discussions regarding this Request, Applicants provide this further narrative response: Paragraph 25 of the Majure Verified Statement refers to the group of shippers that have "ready alternatives," where FXE could be one of those alternatives for such shippers. This statement was not based on a contention regarding any particular shipper's actual competitive options, though Applicants likely will assert that many KCSM shippers have effective transportation alternatives. As referenced in Dr. Majure's statement, the illustrative shipper with "ready alternatives" was presented to illuminate the range of possibilities envisioned by economic theory and analysis.

Interrogatory No. 14:

Identify all Analyses or other Documents You contend support the claim that FXE is a "ready alternative" to KCSM for each origin station, each destination station, and each shipper Identified in response to Interrogatory 13.

likely to significant opportunities for CP/KCS for reasons of circuity, shipper access, or other factors.

Interrogatory No. 27:

Identify all Analyses or other Documents You contend support the claim that competitors "would not likely be foreclosed," see Majure V.S. ¶ 34, on routes originating or terminating in Mexico, Including all Analyses or other Documents Concerning, as regards Movements to, from, or through Mexico via Laredo or other U.S./Mexico border locations:

a. KCSM market shares of those compared to those of other carriers competing for those Movements.

b. CPKC market shares compared to those of other carriers competing for those Movements

c. The competitively significant elements of KCSM service quality compared to those of other carriers competing for those Movements, Including route miles and cycle times.

d. The competitively significant elements of CPKC service quality compared to those of other carriers competing for those Movements, Including route miles and cycle times.

e. The shipper's total costs for using KCSM compared to the shipper's total costs for using other carriers competing for those Movements, Including KCSM rates and any costs shippers would to pay for services provided KCSM by other carriers, Including any haulage, trackage rights, terminal service, or switching fees.

f. The shipper's total costs for using CPKC compared to the shipper's total costs for using other carriers competing for those Movements, Including CPKC rates and any costs shippers would to pay for services provided CPKC by other carriers, Including any haulage, trackage rights, terminal service, or switching fees.

g. CPKC's ability to raise KCSM's rates or reduce KCSM's service quality Concerning Movements to or from stations in Mexico via Laredo to stations in the US. or Canada that can be served by CPKC or another carrier.

h. The economic impact on CPKC from raising KCSM's rates or reducing KCSM's service quality Concerning Movements to or from stations in

Mexico via Laredo to stations in the US or Canada that can be served by CPKC or another carrier.

i. Analyses of any conditions CPKC anticipates using to keep Laredo and other gateways open to interchange.

j. Any foreclosure Analyses Concerning KCSM.

k. Any Analysis of railroad rate regulation in Mexico.

Response to Interrogatory No. 27:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is vague and ambiguous. Applicants further object to this Request on the grounds that it is overly broad, unduly burdensome and not proportional to the needs of this proceeding, including because it requests identification of "all" documents without a reasonable scope limitation. Applicants further object to this Request to the extent it seeks the identification of documents that are accessible to CSXT. Applicants further object to the extent this Request asks Applicants to perform a special study.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that documents responsive to this Request are contained in the Application and accompanying Workpapers.

In further response to additional inquiries pursuant to the parties' meet and confer discussions regarding this Request, Applicants provide this narrative response. CSXT requested in meet and confer discussions that Applicants provide a narrative response regarding the competitively significant elements Dr. Majure considered in making the assertions CSXT states he made in this Request.

As Dr. Majure explained at his deposition on February 7, 2022, the conditions that would raise concern about possible foreclosure are not evident in a combination of CP with KCS.

Without foreclosing Applicants' ability to provide any further explanation if needed, those conditions may be summarized as follows:

1) a pre-existing constraint that can be shown to limit the feasibility of arrangements CP and/or KCS could have, as separate entities, to align their respective incentives and abilities in a fashion that would lessen competition;

2) a credible mechanism by which the combination of CP and KCS makes the constraint no longer bind (i.e., a demonstration that some theretofore unexploited potential to impair competition could be realized); and

3) an assessment of the overall costs and benefits of engaging in such a strategy relative to other possibilities available to the combined firm which may be mutually inconsistent with such a strategy.

In contrast, Dr. Majure identified constraints on greater efficiency and competitiveness of CP/KCS options that would be relieved by the CP/KCS combination, which would allow the combined firm to pursue procompetitive strategies—specifically, the difficulties discussed in Mr. Brooks' Verified Statement that have kept CP and KCS, as separate companies, from achieving services via interchange that are equivalent to single-line service. By shifting the set of achievable outcomes, this pro-competitive opportunity for the combined firm, and the lack of any anti-competitive potential, makes their choice of profit-maximizing strategy after their combination likely to be one that is procompetitive as Dr. Majure concludes.

Interrogatory No. 28:

Identify all Analyses or other Documents You contend support the claim that "a combined CP/KCS will have incentives and ability to compete more effectively, rather than an incentive to impair competitors" on routes originating or terminating in Mexico. *See* Majure V.S. ¶ 35.

EXHIBIT 13

[REDACTED]

EXHIBIT 14

[REDACTED]

EXHIBIT 15

[REDACTED]

EXHIBIT 16

[REDACTED]

EXHIBIT 17

[REDACTED]

EXHIBIT 18

[REDACTED]

EXHIBIT 19

PUBLIC VERSION - REDACTED

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET No. 36500

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. CANADIAN PACIFIC RAILWAY LIMITED, ET AL.

– CONTROL –

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

APPLICANTS' REPLY TO UNION PACIFIC RAILROAD COMPANY'S MOTION TO COMPEL

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BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET No. 36500

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. CANADIAN PACIFIC RAILWAY LIMITED, ET AL.

– CONTROL –

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

APPLICANTS' REPLY TO UNION PACIFIC RAILROAD COMPANY'S MOTION TO COMPEL

Canadian Pacific[1] and Kansas City Southern[2] (the "Applicants") file the following Reply to Union Pacific Railroad Company ("UP")'s Motion to Compel (UP-8), served on Applicants on January 27, 2022 (the "Motion to Compel" or "Motion").

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[1] Canadian Pacific 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 and Hudson Railway Company, Inc. (collectively, "CP").

[2] Kansas City Southern, the Kansas City Southern Railway Company ("KCSR"), Gateway Eastern Railway Company, and The Texas Mexican Railway Company (collectively, "KCS"). KCS also has a subsidiary in Mexico, Kansas City Southern de Mexico ("KCSM"). KCSM is not an applicant in this proceeding. The Board does not have jurisdiction over KCSM as it operates in Mexico. KCSM provides rail service in Mexico pursuant to a Concession granted by the Mexican government. However, for purposes of this motion, KCS includes KCSM.

INTRODUCTION

UP issued three discovery requests seeking communications between KCS and KCSM concerning rates for cross-border traffic via the Laredo gateway. UP confirmed that the purpose of its discovery requests is to understand how KCS prices the Mexico-leg of cross-border traffic. *See* Mot.'s Ex. C, at 2-3 ("The issue that UP sought to address with its discovery requests [Nos. 94, 95, and 96 is]: how does KCS/KCSM price single-line movements and the rates it offers for interline movements when it is competing with UP for business moving between Mexican points and points in the U.S. served by KCS."); *see also* Mot. at 4 ("UP therefore propounded document requests designed to examine directly KCS's rate-setting practices when KCS presently has incentives to foreclose competition.").

To that end, KCS produced documents which demonstrate how KCS/KCSM sets prices, including documents which discuss KCS's policies, procedures, and compliance program. KCS also produced documents which provide further detail regarding KCS's high level pricing strategy and considerations for certain opportunities. In response to KCS's production of its pricing policy, UP issued 30 new discovery requests on January 26, demanding a five-day turnaround. Without waiting for this discovery, UP filed this Motion to Compel on January 27, 2022. Counsel for KCS asked UP to review the new discovery, as it would directly address how KCS prices. *See* Exhibit A. UP refused to withdraw its Motion, again claiming that the purpose of the discovery was to understand "how KCS actually prices its single-line service and KCSM's interchange services where UP and KCS compete for business originating and terminating in Mexico." *Id.* Applicants responded to the 30 requests within five days, on January 31, 2022, and produced related documents the following day. UP did not supplement or amend its Motion to inform the Court that it received additional information. To date, KCS has produced:

- KCS's pricing policy documents, which explain the policy underlying rates for Mexico-based movements, including procedures and specific factors KCS considers when making pricing decisions, Mexican regulations that may impact prices, and KCS's compliance program. These documents show how KCS determines rates for KCSM-carried traffic in Mexico, irrespective of the interline partner.
- Rates justifications considered for rate differentiation made under the pricing policy.
- Results of KCS's compliance program under the pricing policy.
- Reports from KCS's "Pricing Review Board," which provide snapshots of considerations for specific bid opportunities between 2018 and 2021 and give insight to high-level strategy considerations for making rate offers. KCS produced the Pricing Review Board reports for certain commodity groups UP specifically requested such as grain, automotive, chemicals, and petroleum.
- Long-range planning documents, which include specific opportunities, general considerations, and pricing strategy.

Additionally, KCS:

- Responded to <u>30 discovery requests</u>, on an expedited five-day turnaround, explaining in detail how the KCS Mexico-leg pricing policies worked. Multiple times, KCS explained that KCS has not, does not, and cannot discriminate in Mexico-leg rates regardless of whether UP or KCSR is the interline partner.
- Explained how revenue and pricing was determined generally, including the underlying factors typically considered such as market conditions, operating and

cost considerations, types of service, volume, risk premiums, and asset availability, and explained that divisions between KCSR and KCSM were established for similar considerations such as mileage divisions, operating cost considerations, base costs (such as higher fuel costs in Mexico), and regulatory requirements.

- Explained the meaning of "commercially reasonable" as used by Applicants in response to a number discovery requests as well as in the Application itself. *See, e.g.*, Ex. B, Applicants' Joint Responses and Objections to UP's First Set of Discovery, Nos. 61, 62, 65.

With substantial discovery responding to UP's requests, UP changed tacks, arguing it is entitled to broad discovery of thousands of KCS's day-to-day business documents in order to confirm KCS's past compliance in pricing with its obligations under the Board's 2004 "Tex Mex" Decision.[3] This broad discovery seeks information not on "how" KCSR/KCSM prices generally, but to confirm rate offers on an individual, customer-by-customer basis, including all potential discussions concerning possible rates or negotiating tactics for multiple commodities, routes, and possibilities, and for several years. *See* Mot. at 9 (a policy "is no substitute for discovery designed to explore whether the policy is being followed. UP's discovery requests are aimed at obtaining exactly that type of information.")(emphasis added).

Board precedent is very clear that, "discovery requests must be narrowly drawn, directed toward a relevant issue, and not used for a general fishing expedition." *Duke Energy Corp.* v. *Norfolk So. Rwy. Co.*, 2002 WL 1730020, at *3 (S.T.B., July 26, 2002). UP's requests are not

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[3] *Kansas City Southern – Control – The Kansas City Southern Railway Co., et al.*, at *16-19. STB Fin. Docket 34342, Decision No. 12(served Nov. 29, 2004)("Tex Mex Decision")

reasonable, narrowly drawn, and are not directed to a relevant issue, and thus do not meet this well-established standard. To satisfy such broad requests, KCS would potentially have to search many thousands of documents, including years' worth of day-to-day email communications. Using search terms and a limited commodities list does not reduce the burden that UP seeks to impose. As KCS explained to UP, rates are developed over time on an individual customer basis. KCS would have to conduct a special study just to know for which customers, and for which lanes KCS competes with UP.

Concerns regarding a special study aside, the requests demand significant resources even using search terms. KCS ran a number of searches for UP and BNSF (which, in some of its requests, sought similar information). BNSF at least limited its requested searches to specific commodity products, and yet still the average terms yielded over 20,000 results per year. UP does not address the inherent overbreadth of requests that demand review of five years' worth of day-to-day communications. UP acknowledges in its Motion that its response has been to try different terms.

These discovery requests impose significant burden for little, if any, probative value. UP would have to reverse engineer each rate discussion on a granular, individual bid basis, with likely only pieces of each puzzle available. The value of any "example" would be questionable at best and likely subject to a distracting and expensive sideshow. For these reasons, the Court should deny UP's Motion to Compel.

ARGUMENT

I. Because UP made improper assumptions about how KCS prices, its overly broad requests target the wrong information.

KCSM was granted a Concession by the Mexican government to provide exclusive rail service from the Laredo gateway into Mexico. If a U.S. carrier wants to participate in a

movement of traffic via the Laredo gateway, KCSM provides the Mexico-leg portion of the movement. Shippers have various choices of rail carriers for the U.S.-portion of the movement, depending on where the shipment is going. When quoting a rate for a movement that starts (or ends) in Mexico, KCSM provides the rate for the Mexico side and other U.S. carriers, such as UP and KCSR, provide the rate for the U.S. side.

This is the impetus for UP's discovery. UP contends that KCS's (and post-merger, CPKC's) control over KCSM pricing will provide KCS (or CPKC) with the ability to increase "the rate KCSM quotes for interline service with UP, so that a KCSM-UP option will no longer be a viable alternative for customers." Mot. at 3.[4] UP propounded discovery "to examine directly KCS's rate-setting practices when KCS presently has incentives to foreclose competition." Mot. at 4. The substance of UP's requests seeks KCS to "produce all documents the reflect communications between KCS and KCSM regarding rates (for KCS, KCSM, and UP) for traffic to be handled by UP via the Laredo gateway." *See* Mot. at 5.

UP propounded requests seeking communications between KCS and KCSM because it <u>thought</u> that KCSM and KCS operated separate pricing groups that developed rates between the two. Mot. at 5 ("Through these requests UP sought to obtain internal communications that would reveal KCS and KCSM pricing strategies where KCS competes with UP in the United States for business originated or terminated by KCSM in Mexico."). However, as was explained to UP in the meet and confer process on these requests, KCS has <u>one</u> core pricing team for both

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[4] UP seems to argue that the discovery is aimed at confirming if KCS has manipulated KCSM rates in the past (Mot. at 4) while at the same time saying that KCS currently must cooperate with UP, and that the real threat is the merger and the future CPKC (Mot. at 3). Since UP is admitting that KCS currently cooperates with UP and provides commercially reasonable rates, then discovery of KCS's past rate discussions is pointless.

U.S. and Mexico. Communications between KCS and KCSM are not dispositive to understanding KCS pricing strategy.

Once KCS understood through meet-and-confers with counsel what information UP was interested in understanding, KCS produced pricing strategy reports and its pricing policy. These documents show KCS's pricing strategy considerations and how KCS prices the Mexico-leg of cross-border rates. Pursuant to UP's additional January 26 discovery requests, KCS produced, on an expedited five-day turnaround, substantial information on KCS's pricing practices for the Mexico-leg rates. UP (along with all other interested parties) is now in possession of KCS's pricing policy; 30 interrogatory responses that provide detailed information on how KCS's policies, procedures, and compliance program work; and information that demonstrates that KCS <u>cannot</u> discriminate Mexico-leg rates based on the interline partner. *See* Mot. at 3.

II. Because UP's discovery requests would require a special study and impose an obligation to conduct an unreasonable search, the requests impose undue burden on KCS that search terms cannot address.

UP originally stated that it issued these requests to understand KCS's pricing strategies for cross-border traffic via the Laredo gateway. *See* Mot. at 5. If this were all that was sought, then the above-enumerated discovery KCS produced would respond fully to these requests.

UP continues to seek this discovery, however, which indicates it is interested in more than simply "how" KCS prices. UP argues it is its right, and within the scope of proper discovery in this proceeding, to confirm the "commercial reasonableness" of <u>every</u> individual, customer-by-customer, rate offer made over the last five to 18 years. *See* Mot. at 9.

This far exceeds the bounds of appropriate discovery. UP's discovery seeks review of all of KCS's rate development documents for the past five to 18 years.[5] KCS explained to UP that its rates are developed over time, through an iterative process and on a granular level, by customer and by lane. Putting aside the effort involved to search for all responsive documents, and assuming KCS had a 100% return rate, KCS would have to produce thousands of documents. This is not a multi-year DOJ litigation, but a tightly scheduled regulatory proceeding.

The burden on KCS of searching for responsive documents to these requests is enormous. KCS does not track rate development by who the competitor may be. In order even to identify which documents are relevant, KCS would have to undertake a significant special study to figure out which customers and which lanes compete with UP—for every commodity. UP's Motion does not address the fact that its requests require a special study. *See* Mot. at 8.

The use of search terms does little to mitigate the undue and unreasonable burden placed on Applicants as a result of these requests. During the parties' December 1, 2021 meet and confer, UP suggested it would provide five commodities to limit searches, and KCS agreed that, if the searches were reasonable, it would produce responsive documents. UP waited three weeks—until mid-day on Friday, December 24, Christmas Eve—to identify its five commodities. *See* Mot.'s Ex. C at 16. KCS undertook further investigation of how to conduct searches and determined that, even with limited commodities and running searches, the results would be too burdensome. *See* Mot.'s Ex. C at 15. As KCS explained in its response on January

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[5] UP originally sought documents for an 18-year period, from 2004 to present. Due to KCS's document retention policy, KCS informed UP during the first meet and confer that documents going back 18 years likely didn't exist, but that documents from around 2016 to present may exist.

5, 2022, the searches would return customer-by-customer granular discussions, unnecessary for the proceeding. Mot.'s Ex. C at 14-15. Attempts to explain why were met with UP's insistence to try terms. *See, e.g.,* Mot.'s Ex. C at 5-6, 8-9, 12. When KCS tried running terms with no success, UP's only response was to try more search terms.[6] *Id.*

As KCS explained, the requests misunderstand KCS pricing and the commodities are large; therefore, without a special study to know which customers and times period are at issue, search terms have to be broad:

> UP and competition with UP is not dispositive. Individual customers, individual lanes are. We ran your proposed search strings just as you suggested in order to try to narrow the request. 206 documents came back and that is with the fact that the search picks up iterations of "up" (such as duplicate, supposition, update, and up). Not a single document was responsive. Not one document had "KCSM-KCS" or "KCSM-UP." The vast majority of documents had nothing to do with pricing or rates. Not one document discussed UP, let alone in terms of lanes or rates or competition.
>
> This is why KCS originally ran just the commodities as terms when trying to determine the scope of a reasonable search. Benzene, the narrowest commodity you asked for, returned 13,000 documents for one year. There is no clear way to distinguish between rate discussions that are relevant [meaning a customer or lane in which UP or BNSF competes with KCS] and just any rate discussion without reading the document and knowing beforehand that UP and KCS compete for it.

See Mot.'s Ex. C at 1-2. UP's response was to file this Motion to Compel, which reneges on UP's agreement to limit commodities and now seeks an order compelling KCS to produce documents on <u>all</u> commodities. Mot. at 9. This request exponentially expands the burden.

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[6] It should be noted that while BNSF is seeking similarly broad discovery, BNSF agreed to and identified narrow searches on specific products (*e.g.,* "refrigerator" or "humidifier" or specific product ID codes). Yet even these, more limited search strings returned an unreasonable amount of hits. The string (("UP" OR "Union Pacific" OR "BNSF") AND KCSM) AND ("Ojo Seco" AND ("3632112" OR refrigerator)) returned <u>25,815 hits</u> for the year 2019 alone.

Nothing in UP's motion indicates why UP would need all commodities when it believed five was sufficient. UP's request is purely punitive. For this reason alone, UP's motion should be denied.

Discovery is broad, but it is not unlimited. Various principles provide discovery parameters, including undue burden or expense. 49 C.F.R. § 1114.21(c); *see also Tongue River Railroad Co., Inc.—Rail Construction & Operation—In Custer, Powder River & Rosebud Counties, Mont.*, 2014 WL 4457251, at *3 ("[D]iscovery may be denied if it would be unduly burdensome in relation to the likely value of the information sought."); *Canadian Pacific Railway Company—Control—Dakota, Minnesota & E. Railroad Corp.*, Finance Docket No. 35081 (STB Decision No. 8 served Mar. 27, 2008) ("CP/DME Dec. No. 8") at 4-5 (denying discovery where the request is so broad as to require review of all of the party's documents related to grain in order to determine if relevant documents exist.). UP seeks documents that represent, at a minimum, five years of KCS's ratemaking business. Search terms cannot overcome the foundational problems that such requests require a special study to make search terms viable.

III. The discovery sought by UP lacks probative value.

In 2004, the Board imposed a condition on KCS that it keep the Laredo gateway open on "commercially reasonable" terms as part of its approval of KCS's acquisition of the Texas Mexican Railway Company. *See* Tex Mex Decision at *16-19. The Board rejected UP's efforts at that time to impose stricter, more concrete conditions. *Id.* As UP indicated, "[t]he Board has said, for example, that party seeking conditions involving more than a promise of 'commercially reasonable rates' must 'rebut' the presumption that 'end-to-end' mergers – combinations of railroads that connect only a single point – will not affect consumers adversely." Mot. at 4. But the evidence is not aligned with UP's goals. Shippers who believed that KCS has attempted to

close the Laredo gateway, or offer non-commercially reasonable rates, had a number of avenues to complain, including to the Board. None have, ever. Applicants responded to numerous discovery requests aimed at "commercially reasonable" terms, and KCS confirmed that not a single shipper has complained they were not offered "commercially reasonable" terms. *See, e.g.*, Ex. B, Applicants' Joint Responses and Objections to UP's First Set of Discovery, Nos. 61, 62, 65 & 79. As nothing supports UP's efforts, the only remaining option is to fish through the KCS's rate discussion documents to try to engineer an example of KCS offering a "non-commercially reasonable" term.

Even if relitigating the 2004 acquisition were relevant (which it is not), if KCS is compelled to comply with these burdensome discovery requests, the results have little, if any, probative value. Assuming KCS performed a special study to determine which customers and lanes were responsive, a search would produce only pieces of rate discussions. Assuming UP could piece something together, it would then have to figure out whether that discussion is "commercially reasonable." The Board did not define "commercially reasonable" in its 2004 Tex Mex decision. *See* Tex Mex Decision at 19. There are no set metrics; there are no dollar caps. There is no ruler by which UP could even determine, at this later date and with full hindsight, whether a particular rate offered for one customer in 2019 for intermodal traffic between Mexico City and Kansas City is "commercially reasonable" without wild speculation. There is little benefit to such an exercise for this proceeding, and the *de minimus* value does not outweigh the burden on KCS to produce the documents that would be required to undertake it. *See Tongue River*, 2014 WL 4457251, at *3 ("[D]iscovery may be denied if it would be unduly burdensome in relation to the likely value of the information sought.").

CONCLUSION

Discovery in this matter must be appropriately limited to the impacts of the proposed merger, and whether CP's acquisition of KCS causes competitive harm or changes KCS's incentives. Applicants have produced significant volumes of information. Applicants have worked diligently and in good faith—spending an enormous amount of management and attorney time, money, and resources—in order to collect, review, and produce responsive documents. To date, Applicants have made 11 productions, culminating in a production of an additional 3,257 responsive documents, totaling more than 36,000 pages, as well as numerous narrative interrogatory responses and a number of informal, expedited discovery requests.

UP asked for and received discovery on how KCS prices the Mexico-leg of movements on which UP competes with KCS for cross-border traffic. Applicants have responded to interrogatories on pricing and "commercially reasonable" terms. To the extent UP argues that KCS's past pricing is relevant, UP has a multitude of methods to test its theory: KCS's pricing policies from 2015 to present; rate justification examples (setting out how and why rates differ); compliance program review results; a number of interrogatories relating to "commercially reasonable" terms; KCS's waybill data demonstrating the actual rates offered and accepted; and pricing strategy documents. All of this material has been produced and is in UP's possession.

The efforts required to review and produce five years' worth of email communications detailing customer-by-customer discussions is not justified. This is not an oversight case. There is no active complaint about KCS's compliance. No shipper or railroad received a "non-commercially reasonable" rate or ever complained to the Board about KCS pricing. Because the discovery sought by UP is unnecessary and burdensome, Your Honor should deny UP's Motion to Compel.

Respectfully submitted,

Dated: February 7, 2022

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Counsel for CP

CERTIFICATE OF SERVICE

I hereby certify that I have caused the foregoing Applicants' Reply to Union Pacific Railroad Company's Motion to Compel to be served electronically or by first-class mail, postage pre-paid, on all parties of record in these proceedings.

/s/ Julia Adrian
Julia Adrian

February 7, 2022

From: "Rosenthal, Michael" <mrosenthal@cov.com>
To: "WMullins@bakerandmiller.com" <WMullins@bakerandmiller.com>
Cc: David Meyer <David@MeyerLawDC.com>, "eglavich@bakerandmiller.com" <eglavich@bakerandmiller.com>

Date: Friday, January 28, 2022 11:13AM
Subject: RE: FD 36500 - Motion to compel

Bill,

As much as I'd like to find a simple solution, I can't see how the discovery responses would resolve the issues UP is trying to address through the motion to compel. The information UP is seeking through the motion to compel would address how KCS actually prices its single-line service and KCSM's interchange services where UP and KCS compete for business originating and terminating in Mexico. I don't see how an explanation of the policy document could provide equivalent information.

Regards,

Mike

From: WMullins@bakerandmiller.com <WMullins@bakerandmiller.com>
Sent: Friday, January 28, 2022 10:51 AM
To: Rosenthal, Michael <mrosenthal@cov.com>
Cc: David Meyer <David@MeyerLawDC.com>; eglavich@bakerandmiller.com
Subject: Re: FD 36500 - Motion to compel

[EXTERNAL]

Mike

I would like to request that you review our answers to UP's 3rd set of discovery and then let's talk about your motion to compel. I think our answers to your 3rd set should go a long way to show how KCSR and KCSM set prices, the process, and provide you with the background and information that you need. If after you review the answers, we can then talk about your motion to compel.

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(202) 663-7849 (Fax)
The above message may be privileged, confidential and protected from disclosure
by attorney/client. work product or other privileges. If you believe that it
has been sent to you in error, do not read it. Please reply to the sender that
you have received the message in error. Then delete it. Thank you.

-----"Rosenthal, Michael" <mrosenthal@cov.com> wrote: -----

> To: Bill Mullins <wmullins@bakerandmiller.com>, David Meyer <David@MeyerLawDC.com>
> From: "Rosenthal, Michael" <mrosenthal@cov.com>
> Date: 01/27/2022 07:53PM
> Subject: FD 36500 - Motion to compel
>
> David and Bill, I've attached a highly confidential version of a motion to compel that we just filed. The only potentially HC information is in Exhibit C, and it would not be HC as to KCS.
>
> Regards,
>
> Mike

[attachment "UP8_MTC_HC_012722.pdf" removed by William Mullins/bakermiller]

EXHIBIT B

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 36500

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

KANSAS CITY SOUTHERN AND CANADIAN PACIFIC'S JOINT RESPONSES AND OBJECTIONS TO UNION PACIFIC RAILROAD COMPANY'S FIRST SET OF DISCOVERY REQUESTS

Pursuant to 49 C.F.R. Part 1114, Subpart B, 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 and Hudson Railway Company, Inc. (collectively, "Canadian Pacific" or "CP") and Kansas City Southern, The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company (collectively, "KCS"; together with CP, the "Applicants") hereby respond and object as follows to Union Pacific Railroad Company's First Set of Discovery Requests to Applicants (the "UP Requests") served on November 8, 2021 in connection with the above-captioned proceeding.

GENERAL OBJECTIONS

The following General Objections apply to each of the UP Requests and shall have the same force and effect as if set forth in full in response to each individually numbered UP Request.

1. Applicants object to the UP Requests and to each Definition, Instruction and Request contained therein to the extent they purport to impose upon the Applicants burdens

information that is substantially old, and information and documents may no longer be available or complete, or difficult to find.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants will provide non-privileged and non-duplicative documents responsive to this Request that they are able to locate after a reasonable search (to the extent any such documents exist).

Request No. 61:

Describe in detail the meaning of the phrase "commercially reasonable terms" as used on page 17 of the Ottensmeyer VS.

Response to Request No. 61:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is unduly burdensome and not proportional to the needs of this proceeding. Applicants further object to this Request on the grounds that the Application speaks for itself. Applicants further object to this Request to the extent that it improperly calls for legal analysis, arguments or conclusions.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that the phrase "commercially reasonable terms" as used in this context (Application Vol. 1 at 1-203) refers to the same commitment addressed in Applicants' Response to Request No. 40.

Request No. 62:

Describe in detail how KCS has implemented the condition on the KCS-TM-TFM transaction requiring it to "keep the Laredo gateway open on commercially reasonable terms," as described on page 21 of the Ottensmeyer VS.

Response to Request No. 62:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is overly broad, unduly burdensome, and not proportional to the needs of this proceeding. Applicants further object to this Request to the extent that it improperly calls for a legal analysis, arguments, or conclusions. The KCS-TM-TFM transaction was approved in 2004, almost 17 years ago to the day. The condition that KCS "keep the Laredo gateway open on commercially reasonable terms" has been in place since that time. It is unduly burdensome and not proportional to the needs of this proceeding to describe in detail every interaction that has occurred between KCS and any other party regarding implementation of this condition since 2004. Further, Applicants object to this Request to the extent that it seeks a legal conclusion or legal analysis regarding which terms, or how terms, are "commercially reasonable" or to the extent the Request requires a special study regarding terms implemented since the KCS-Tex Mex-TFM transaction. Applicants further object to the extent this Request seeks confidential and proprietary information that is neither relevant nor proportional to the needs of this proceeding. Applicants further object to this Request to the extent it requires KCS to conduct a special study.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants incorporate by reference their Response to Request Nos. 40 and 61. Applicants further respond that applying KCS's commitment to "keep the Laredo gateway open on commercially reasonable terms" by its nature calls for flexibility in light of the specific circumstances of any individual shipper's request.

KCS notes that the Board declined in the 2004 proceeding to impose further conditions as proposed by BNSF, UP, other railroads and shippers, and further declined to more

definitively define "commercially reasonable terms." The Board also did not require the NITL Agreement to be imposed as a condition to the merger; allowing that to remain a private agreement between KCS and NITL. The Board held that any competitive concerns regarding the transaction were addressed by holding KCS to its pledges to keep the Laredo gateway open. *See KCS/Tex Mex*, Decision No. 12 at 17 (STB served Nov. 29, 2004).

Further, while KCS made the pledges willingly and voluntarily, parties were not without recourse if KCS failed to abide by its commitments. KCS submitted status reports following the consummation of the transaction to ensure a smooth transition. Parties could have brought issues before the Board in a variety of ways. No party has ever brought either a formal or informal complaint to the Board regarding KCS's implementation of the "Laredo Gateway" condition. The KCS-NITL Agreement provided dispute resolution where terms were unsatisfactory. No shipper since 2004 has raised a dispute under the NITL Agreement. As set forth in Mr. Ottensmeyer's Verified Statement, since the KCS-Tex Mex-TFM transaction, KCS confirms that "there has not been a single complaint from railroads or shippers that KCS and KCSM were foreclosing the Laredo gateway in any way." *See* Ottensmeyer VS at 22 (Application Vol. 1 at 1-208).

<u>Request No. 63:</u>

Identify the "Mexican law" that purportedly "requires KCSM to give a rate to/from the Laredo gateway." *See* Ottensmeyer VS, page 21, footnote 18.

<u>Response to Request No. 63:</u>

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is unduly burdensome and not proportional to the needs of this proceeding, including because UP has the same access to "Mexican law" as KCS, all of which is

publicly available. Applicants note that the legal paradigm governing KCSM's predecessor was litigated extensively in the *KCS/Tex Mex* proceeding, in which UP submitted substantial comment and expert analysis of the Mexican law at issue here.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that the "Mexican law" referred to in the Ottensmeyer V.S. at 21 n.18 (Application Vol. 1 at 1-207) is a shorthand for the body of legal principles applicable to and that interplay with rail rates in Mexico. This includes, without limitation, statutes, regulations, court opinions, decrees, and other official standards. The principal laws related to KCSM's use and enjoyment of the Concession granted it are the Concession Law and Mexican Railway Law and related regulations.

The principal laws related to KCSM's use and enjoyment of the Concession granted it are the Concession Law and the Regulatory Railway Service Law ("LRSF"). The LRSF obligates KCSM to provide public freight rail transportation service ("SPTFC") to all users on a non-discriminatory basis. KCSM also has the obligation to register its maximum freight rates with the Mexico's Railway Transport Regulatory Agency ("ARTF"). These maximum tariff rates are known as "TUCE" rates. KCSM has the right to offer shippers discounts from the TUCE rates. These are known as "Commercial rates." All Commercial rates are to be offered to shippers in a non-discriminatory manner. As a result of the interplay of these laws, if KCSM provides one shipper with a rate from Mexico to the Laredo gateway, it must in general also provide other shippers with a similar rate.

Request No. 64:

Produce all documents studying, analyzing, or discussing the "Mexican law" identified in response to Request No. 63.

Response to Request No. 64:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is overly broad, unduly burdensome, and not proportional to the needs of this proceeding. Applicants further object to this Request to the extent that it seeks documents protected from discovery by the attorney-client privilege, attorney work product doctrine or any other applicable privilege, protection, immunity, law, or rule. This Request is not limited in scope in any manner, either to KCSM, KSC, or in any way as to the operations of a railroad. This Request is not limited in geographic scope nor temporal scope. This Request is overbroad and unduly burdensome to the extent that it seeks documents not relevant or proportional to the needs of this proceeding. Further, this Request clearly seeks documents that are privileged and otherwise protected from disclosure.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants will provide non-privileged and non-duplicative documents responsive to this Request that they are able to locate after a reasonable search (to the extent any such documents exist).

Request No. 65:

Identify the "remedies" that shippers will purportedly have "to ensure" KCSM provides commercially reasonable rates and terms to/from the Laredo gateway so shippers can "utilize KCSM/UP or KCSM/BNSF routings." *See* Ottensmeyer VS, page 22.

Response to Request No. 65:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is overbroad, unduly burdensome, and not proportional to the

needs of this proceeding. Applicants further object to this Request to the extent that it improperly calls for legal analysis, arguments or conclusions.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that among the remedies available to shippers to ensure that CPKC keeps the Laredo gateway open on commercially reasonable terms are: (a) enforcement of the agreement entered into between KCS and NITL to do so with respect to traffic affected by the KCS/Tex Mex/TFM transaction, which provides contractual remedies (*see* Verified Statement of John Brooks at 21 (Application Vol. 1 at 1-232)), (b) enforcement of the condition imposed on KCS in the *KCS/Tex Mex* proceeding requiring KCS to honor its commitment to keep the Laredo gateway open on commercially reasonable terms, which provides remedies available to the Board to enforce compliance with this commitment; and (c), as noted in Applicants' response to Request No. 14, enforcement of the condition that Applicants anticipate the Board will impose requiring them to honor the commitment they have made in this proceeding to keep the Laredo gateway open on commercially reasonable terms. In addition, and more fundamentally, Applicants will be disciplined by the marketplace, in the sense that they would face the loss of traffic opportunities to alternative rail routes or other transportation options were they to insist on commercially unreasonable terms or otherwise "close" a gateway that shippers would prefer to use.

Request No. 66:

Produce all documents supporting the statement on page 22 of the Ottensmeyer VS that "if the combined CP/KCS tried to raise rates on KCSM movements that are not rail dependent, the traffic would shift to motor or water carriage."

intended to provide illustrations of the kinds of obstacles referenced in the quoted phrase from Paragraph 33 (*see* Application Vol. 1 at 1-228).

Request No. 78:

Describe the meaning of the phrase "traffic that naturally flowed over our route network," as the phrase is used on page 17 of the Brooks VS.

Response to Request No. 78:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is unduly burdensome and not proportional to the needs of this proceeding. Applicants further object to this Request on the grounds that the Brooks VS speaks for itself.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants respond that the quoted phrase (Application Vol. 1 at 1-228) refers to traffic that shippers chose to route via CP-KCS interline routes even in the absence of an alignment of economic interests between the two railroads and resulting investments by them in service or rate improvements that would have made CP-KCS interline routes more attractive relative to the alternatives available at the time.

Request No. 79:

Identify any shipper that has inquired about arbitrating a dispute under the agreement between KCS and The National Industrial Transportation League on page 20 of the Brooks VS, and produce all documents regarding any such inquiry.

Response to Request No. 79:

In addition to the General Objections set forth above, Applicants object to this Request on the grounds that it is overly broad, unduly burdensome, and not proportional to the

needs of this proceeding. The KCS-NITL Agreement was entered into in 2004, 17 years ago, and has been in effect since that time. It is unduly burdensome to identify "any shipper" and produce responsive documents regarding a shipper that has only made "inquiry" about the arbitration provisions of the agreement from 2004 to date, nor is such effort proportional to the needs of this proceeding. Applicants further object to this Request to the extent that it seeks confidential and proprietary information that is not relevant to the subject matter of the proceeding.

Subject to and without waiving the General Objections and the specific objections set forth above, Applicants can respond that no shippers have invoked the Agreement's dispute resolution and, based on reasonable inquiry, no shippers have even "inquired" about the Agreement's arbitration remedy in at least the past 13 years.

Request No. 80:

Produce all documents studying, analyzing, or discussing the meaning of the phrase "commercially reasonable rates and terms," as used on page 22 of the Brooks VS.

Response to Request No. 80:

In addition to the General Objections set forth above, Applicants object to this request on the grounds that it is overly broad, unduly burdensome, and not proportional to the needs of this proceeding. Applicants have previously defined "commercially reasonable terms" (Requests No. 40, 61, & 71), and responded to Requests relating to how the conditions and terms requiring "commercially reasonable terms" have been and will be implemented (Requests No. 62 & 65), and incorporate those Responses by reference. Because the application of the "commercially reasonable terms" standard is by its nature flexible, the Request could be read as encompassing nearly every document that "discusses" a rate or term relating to the Laredo

EXHIBIT 20

[REDACTED]