BEFORE THE
SURFACE TRANSPORTATION BOARD

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Canadian National Railway Company et al. --CONTROL-- Kansas City Southern Railway Company, et al.	Finance Docket No. 36514

COMMENT OF
THE UNITED STATES DEPARTMENT OF JUSTICE

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450 5th Street, N.W.
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Dated: May 14, 2021

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COMMENT OF
THE UNITED STATES DEPARTMENT OF JUSTICE

The United States Department of Justice ("Department") appreciates this opportunity to again share its views with the Surface Transportation Board ("Board"). The Department commends the Board for its intention to carefully scrutinize the proposed merger of Canadian National Railway Company ("CN") and Kansas City Southern ("KCS"), just as it intended to do with a proposed merger of Canadian Pacific Railway Company ("CP") and KCS. The Department is committed to collaborating with the Board in the evaluation of this proposed transaction to pursue our shared goal of protecting and promoting competition in the railroad industry. As with a potential CP-KCS merger, the Department has an interest because of the Attorney General's statutory right to intervene in Class I merger proceedings. *See* 49 U.S.C. § 11325(b)(1).

I. The Board Should Not Permit CN to Utilize a Voting Trust

At this time, the Department is only beginning to evaluate the potential competitive concerns raised by a proposed acquisition of KCS, and for this reason, the Department does not yet take a final position on the merits of a proposed acquisition of KCS by CN. However, this proposed acquisition raises sufficient competition concerns on first blush that the CN should be prohibited from using a voting trust.

On May 6, 2021, the Board approved the proposed CP-KCS voting trust in Finance Docket No. 36500. Notwithstanding this decision, the Board should not permit the proposed CN voting trust because CN's proposed acquisition of KCS appears to pose greater risks to competition than the risks posed by a CP-KCS merger. Thus, even though the terms of CN's proposed voting trust are similar to the terms of CP's proposed voting trust, the Board has good reason to hold CN's proposed voting trust to a higher bar. The Department continues to respectfully disagree with the Board's precedents on the use of voting trusts for the reasons explained in the Department's April 12, 2021 comment (attached as Exhibit A) and urges the Board to reconsider whether its longstanding practice on voting trusts is consistent with sound competition policy. Nevertheless, even under the Board's own existing precedents, the Board can recognize the distinctions between the proposed CN-KCS and CP-KCS mergers and reach a different conclusion about the appropriateness of a voting trust.

The Department's concerns regarding the use of a voting trust in the proposed CP transaction apply with greater force to CN's proposed acquisition of KCS because it raises additional potential competitive concerns. As the Department explained in its prior submission, even two railroads that are "end to end"—i.e., that do not compete to offer parallel single-line service between the same origin and destination pairs—may still compete with one another in important ways. *See* Exhibit A at 8-10. CN insists that these competitive concerns are irrelevant to the analysis of the voting trust because the trust is structured so as to prevent the acquiring firm from exercising any control during the pendency of the Board's review. This argument misses the point: the unity in ownership will diminish the parties' incentives to continue to engage in such competition *even if* the trust successfully prevents the acquiring firm from exercising any actual control.

Even though the Board was not persuaded that these incentive concerns should preclude the use of a trust in a CP-KCS merger, a CN-KCS transaction poses additional dangers to competition stemming from the potential elimination of direct, "parallel" competition on routes served by both railroads, for example between Baton Rouge and New Orleans. In addition, even parallel lines that do not presently serve the same origin-destination pairs may be used to compete to attract "build outs" from a shipper served by one railroad to the network of the other, for example on north-south routes through much of Mississippi. These threats to competition would be present immediately after the CN voting trust is consummated. CN managers would have diminished incentives to compete aggressively against KCS in areas served by both railroads because winning business away from KCS would now hurt CN's shareholders, and vice versa. These specific competitive concerns presented by CN's proposed transaction magnify the general risks associated with voting trusts described in the Department's prior filing.

Given the larger number of competitive concerns presented by CN's proposed acquisition, the Department respectfully submits that CN's use of a voting trust would be even more problematic than the use of a voting trust by CP. Also allowing CN to utilize a voting trust would thus appear inconsistent with the Board's view that trusts should "not be used routinely," and only be available on "rare occasions when their use would be beneficial."[1] In order to preserve the Board's ability to protect competition and to thoroughly review the issues presented by a CN acquisition, the Board should not permit CN to enter into a voting trust.

II. The Department's Reply to CN

In its April 26, 2021 filing, CN responded to the Department's April 12, 2021 filing by raising two primary arguments. First, CN argues that a voting trust structure is necessary to put CN on a level playing field with financial buyers that do not hold railroad assets, and thus would not be subject to the Board's review. Second, CN argues that a voting trust is necessary given the length of the Board's review process. Neither of these arguments is persuasive.

[1] *Major Rail Consolidation Procedures*, 2001 WL 648944, at *19 n.29 (STB June 7, 2001).

A. Prohibiting the Use of a Voting Trust Does Not Unfairly Advantage Non-Railroad Buyers

CN contends that the Department's position on voting trusts would inappropriately favor private equity buyers, but in fact it is CN's position that would inappropriately favor buyers that threaten competition. In any industry, a bid by a non-competitor generally will offer greater certainty of deal clearance because a bid by a competitor raises the potential for competitive harm and thus warrants more stringent regulatory review. This is an inherent feature of any competition review, not a unique attribute of the Board's process for railroad mergers. CN's flawed reasoning assumes that private equity would always be the favored buyer in all transactions, in any industry, because a private equity buyer would always face a shorter, less burdensome review, whether reviewed by the Department, the Board, the Federal Trade Commission, the Federal Communications Commission, the Federal Reserve, the Federal Energy Regulatory Commission, or any another federal, state, or foreign authority.

This clearly is not the case. As in any situation where a seller has received acquisition offers from both private equity and strategic buyers, it is up to KCS as the seller to weigh the potential benefit of shorter, less burdensome antitrust or regulatory review against potential benefits that CN, CP, or any other competing Class I railroad may provide, such as a higher purchase price based on projected synergies or expected higher margins from the elimination of a competitor. Strategic buyers, including Class I railroads, can also make their offer more attractive by offering deal terms that confer greater certainty, such as a "hell or high water" clause or a reverse breakup fee. Similarly, to the extent CN has concerns about exclusivity, that is a common provision that CN is free to negotiate with KCS.

But a strategic buyer should not be permitted to structure the deal in a manner that could give rise to anticompetitive effects simply because the alternative would be more expensive. At its core, CN's argument boils down to a desire to use a voting trust to avoid paying more to negotiate alternative terms, such as interim operating covenants, material adverse effects clauses or a breakup fee, or to lose the money that it has already sunk if the deal falls apart. Like any other buyer that competes with its target, CN voluntarily assumed the risks associated with the regulatory review of the proposed transaction. CN should not be permitted to use a deal structure that may cause anticompetitive effects simply because it may save CN money.

B. Railroad Buyers Have Viable Alternatives to a Voting Trust

CN contends that the alternative deal terms identified by the Department are impractical due to the length of the Board's review process, but CN greatly exaggerates the differences between the Board's review and the reviews faced by companies in other industries. It is true that reviews of benign mergers under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act") can be much quicker than a Board review of a rail merger. But that certainly does not mean all HSR investigations proceed faster than the Board's reviews. In the vast majority of transactions notified pursuant to the HSR Act, the antitrust agencies can determine very quickly that there are no competitive concerns presented, and those transactions are cleared within thirty days. But where the merging parties have overlapping businesses in a concentrated industry or where the merging parties may deny suppliers a key customer or customers a key supplier, the transaction is routinely subject to a Second Request, and thus, a longer review timeline to assess potential competition issues.[2] Many merging parties in a multitude of industries assert, as CN has, that their transactions will not harm competition and will benefit customers. Whether the facts bear out those assertions requires investigation and verification. In the Department's experience, a transaction as significant as a merger of Class I railroads could take a year or more even if it were subject to review solely under the HSR Act.

Many merging parties must also contend with review processes lasting more than one year because of simultaneous regulatory review by other federal agencies or antitrust review by enforcers outside the United States. In just the past several years, many high-profile transactions subject to overlapping reviews took 18 months to two years to close.[3] Far from railroads being unique, they face the same obstacles as do many other merging parties in many other industries. Whether the review timeline is longer because of substantive competition issues or because of overlapping reviews, businesses in other industries routinely rely on interim operating covenants and material adverse effect provisions as well as breakup fees to protect their interests.

These commonly-used terms provide alternatives that raise fewer competitive risks than a voting trust, but still provide protection during a lengthy review period and allow the parties to plan for a successful post-closing integration. Because they do not unify the ownership of the two firms, these deal terms better protect both firms' incentives to compete vigorously and to continue their ordinary course of business conduct. It is particularly important to protect these incentives to compete where, as here, CN and KCS appear to compete head to head on multiple parallel routes.

* * *

The Department remains committed to offering any assistance it can provide as the Board carries out its important mission protecting competition in this industry. The Department appreciates this opportunity to share its views, and looks forward to continuing to work cooperatively with the Board on this proposed transaction and on other matters.

Respectfully Submitted,

Richard A. Powers
Acting Assistant Attorney General
Antitrust Division

May 14, 2021

[2] *See, e.g.*, Ardagh-St. Gobain (announced on January 17, 2013; FTC final order entered on June 18, 2014); Aetna-Humana (announced on July 3, 2015; abandoned on February 14, 2017); Tronox-Cristal (announced on February 21, 2017; closed on April 10, 2019).

[3] *See, e.g.*, Exelon-Pepco (announced on April 30, 2014; closed on March 23, 2016); Dow-DuPont (announced December 11, 2015; closed on August 31, 2017); Bayer-Monsanto (announced on September 16, 2016; closed on June 7, 2018); AT&T-Time Warner (announced on October 22, 2016; closed on June 15, 2018); Siemens-Alston Rail JV (announced on September 27, 2017; European Commission prohibition decision on February 6, 2019); T-Mobile-Sprint (announced on April 29, 2018; closed on April 1, 2020).

CERTIFICATE OF SERVICE

I certify that on May 14, 2021, I caused a copy of the forgoing Comment of the United States Department of Justice to be served via email on the parties of record in this docket.

/s/ Seth Wiener

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EXHIBIT A

BEFORE THE
SURFACE TRANSPORTATION BOARD

Canadian Pacific Railway Limited et al. --CONTROL-- Kansas City Southern Railway Company, et al.	Finance Docket No. 36500

COMMENT OF
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COMMENT OF
THE UNITED STATES DEPARTMENT OF JUSTICE

The United States Department of Justice ("Department") appreciates this opportunity to share its views on the Surface Transportation Board's consideration of the proposed merger of Canadian Pacific Railway Company ("CP") and Kansas City Southern Railway Company ("KCS"). The Department commends the Board for its commitment to carefully scrutinize this proposed transaction—the first major railroad merger in more than two decades—to ensure that it does not harm competition.[1] The Department has an interest in this proceeding because of the Attorney General's statutory right to intervene in Class I merger proceedings. *See* 49 U.S.C. § 11325(b)(1). The Department is committed to working collaboratively with the Board to protect and promote competition in the railroad industry, including by sharing our perspective on pending transactions.

At this time, the Department does not yet have a view on the merits of the proposed transaction, but the Department submits this comment to urge the Board to ensure that the parties do not take any action that would undermine the Board's ability to conduct a meaningful review. Most importantly, as the Department has previously expressed, the Board should rarely, if ever, permit the parties to a proposed merger to use a so-called "voting trust" to effectively consummate an acquisition before the Board has had an opportunity to consider whether the combination would harm competition. More generally, in light of the important issues the Board has raised about the state of competition in the railroad industry, the Board should carefully

[1] *See* Statement of Surface Transportation Board Chairman Martin J. Oberman, Mar. 23, 2021, https://prod.stb.gov/news-communications/latest-news/pr-21-13/.

consider applying its 2001 merger standards and procedures to this case, to ensure it can thoroughly examine the competition concerns raised by commenters.

Competition is the core organizing principle of America's economy,[2] and vigorous competition among sellers in an open marketplace gives consumers the benefits of lower prices, higher quality goods and services, increased access to goods and services, and greater innovation.[3] Within the Department, the Antitrust Division ("Division") is responsible for protecting and promoting competition through enforcement of the antitrust laws and through competition advocacy. The Division reviews mergers in a wide variety of industries including transportation, telecommunications, energy, healthcare, banking and insurance, manufacturing, information technology, and consumer goods and services. The Division also has substantial experience in enforcing rules prohibiting premature transfer of beneficial ownership and illegal premerger coordination.

In 2001, recognizing the significant consolidation that had already taken place in the railroad industry, the Board strengthened its standard of review of major railroad mergers, reemphasizing its commitment to protecting competition for shippers. As the Board explained, "Because of the small number of remaining Class I railroads…we believe that future merger applicants should bear a heavier burden to show that a major rail combination is consistent with the public interest. Our shift in policy places greater emphasis in the public interest assessment on enhancing competition while ensuring a stable and balanced rail transportation system."[4]

In addition to enhancing its scrutiny of the competitive effects of proposed mergers, the Board indicated that it would not permit any applicants to combine their ownership by entering into a voting trust pending the Board's review unless the parties first demonstrated that the voting trust was in the public interest. The Board described its approach as being "consistent with the view . . . that, while voting trusts can serve some public purpose, they should not be used routinely, but rather should be available only for those rare occasions when their use would be beneficial."[5] The Division agrees with the Board that voting trusts should not be used routinely, if at all, during the pendency of merger review.

In 2016, CP proposed to acquire Norfolk Southern ("NS"), and proposed to use a voting trust to consummate the acquisition prior to a full review by the Board. The Division filed a

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[2] *See, e.g.*, *N.C. State Bd. of Dental Exam'rs v. FTC*, 574 U.S. 494, 502 (2014) ("Federal antitrust law is a central safeguard for the Nation's free market structures."); *Standard Oil Co. v. FTC*, 340 U.S. 231, 248 (1951) ("The heart of our national economic policy has long been faith in the value of competition.").

[3] *See, e.g.*, *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 695 (1978) (The antitrust laws reflect "a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services . . . . The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain–quality, service, safety, and durability–and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers.").

[4] *Major Rail Consolidation Procedures*, Fed. Carr. Cas. (CCH) ¶ 38348; 2001 WL 648944, at *3 (June 7, 2001).

[5] *Id.* at *19 n.29.

comment expressing serious concerns with that procedure,[6] and the proposed merger was ultimately abandoned. Although the proposed CP/NS voting trust contained additional features which significantly heightened the Division's concern, the Division explained that even more "traditional" voting trusts raise serious concerns and undermine the Board's ability to conduct a meaningful review of the transaction at issue.[7] For the reasons discussed below, the Division maintains that view today.

The Board's 2001 merger rules rightly set a high bar for both proposed transactions and applicants' use of voting trusts. Although the Board indicated that a merger involving KCS might warrant a waiver from the 2001 rules, the Division respectfully submits that the concerns about voting trusts apply with equal force to this transaction, and thus the Board should protect the integrity of its review process by holding the parties to the same standard before permitting them to proceed with their proposed trust. More generally, as the first major rail merger in over two decades, this proposed transaction presents important and novel competition issues that have the potential to significantly reshape the industry. The Board should seriously consider applying all of its 2001 rules to the review of this transaction, and in any event should carefully analyze the competition concerns raised by the deal and rigorously scrutinize any claimed benefits.

1. Voting Trusts Alter the Firms' Competitive Incentives

When a company acquires its rival, the dynamics between the two companies are fundamentally altered. "Whether held separately or not, the acquiring firm generally maximizes its profits by reducing competition with its new subsidiary."[8] Even where the acquirer cannot exert control over the acquired firm (e.g., it has acquired only a minority stake), the acquiring firm will have less incentive to compete with its rival in the marketplace:

> An acquisition of part of the stock of a competitor may affect the situation and competitive decisions of either company. The acquired firm might be prejudiced, or the competitive zeal of each firm might be reduced. Indeed, these effects could be realized even at fairly small ownership percentages. For example, if GM were a 10 percent shareholder in Ford, it might not have enough shares to assert significant control, but it might be inclined to be far less aggressive against a firm in whom it had a significant investment . . . . [T]he acquiring firm's market decisions might now be affected not only by their impact on its own operations but also by their impact on its investment—both on dividends and on capital value—in its competitor.[9]

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[6] Comments of the U.S. Department of Justice, Canadian Pacific Railway Limited—Petition for Expedited Declaratory Order, FD No. 36004, Apr. 8, 2016.
[7] *Id.* at 9.
[8] Areeda & Hovenkamp, *Antitrust Law*, ¶990 (2015).
[9] *Id.* at ¶1203 (internal citations omitted).

Thus, even if a voting trust successfully insulates the acquired railroad from the direct control of the acquiring railroad, each company will have less incentive to compete with the other.[10] Under the voting trust, both companies' managers will have the incentive to maximize value for their shared owners rather than their individual company's interests. In this case, CP will have less incentive to compete in a way that might reduce KCS's profits, because CP is the ultimate claimant to those profits. For its part, absent the voting trust, KCS's own shareholders would have an incentive to protect the independent value of KCS's assets going forward in case the deal were to fall through, even if that means vigorously competing with CP. With a voting trust in place, however, KCS's shareholders are no longer independent, and so will have no incentive to take any action that would diminish the value of the combined company.[11]

Similarly, during the pendency of the Board's merger review, KCS and CP will have every incentive to make strategic decisions that favor their common shareholders and assume the merger will be approved. For example, if KCS is choosing between alternative business plans that would involve cooperating with either CP or an alternative interline partner—and thus bring benefits to CP or the other partner—it may choose to cooperate with CP because doing so will directly benefit KCS's own shareholders. Importantly, such decisions may have long-term effects on competition and consumers. For instance, KCS will make decisions regarding new track construction and old track closure with an eye toward interchanging KCS traffic with CP in the future. Such decisions may be at the expense of interchanges with other railroads, even though these other interchanges may be better for KCS's customers and KCS itself. Given the lengthy lifespan of rail track and other infrastructure, these decisions can have significant long-term impacts, regardless of the outcome of the Board's merger review.

In this case, the applicant may argue that that these concerns do not apply because CP and KCS do not meaningfully compete with one another, but this argument puts the cart before the horse. It is the duty of the Board to determine whether a merger of two railroads would harm competition; allowing the parties to combine their ownership before the Board has reached a determination as to the merits makes a mockery of the Board's authority. In some cases, the facts may be simple and the Board may be able to reach a conclusion quickly, while other cases may require a lengthier review, but that is for the Board to determine, not the merging parties. If and when the Board concludes that the transaction is in the public interest, including that the transaction would not harm competition, then the Board should expeditiously permit the parties to fully combine their operations—but not before.

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[10] *Cf.* Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), at § 13 (noting that acquisitions of equity stakes in competitors can cause harmful competitive effects "even if [the acquirer] cannot influence the conduct of the target firm"); *see also* Russell Pittman, *The Strange Career of Independent Voting Trusts in U.S. Rail Mergers*, 13(1) J. Comp. Law & Econ. 98-99 (Feb. 2017) (discussing the incentive effects of voting trusts and summarizing pertinent economic literature).

[11] *See* Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶1203 (4th ed. 2015) (explaining that where one firm acquires a stake in another, each firm's decisions will be affected not only by their impact on its own operations but also by their impact on the other firm).

2. Voting Trusts May Prevent the Board from Effecting a Successful Divestiture

The Board strengthened its standard of review for proposed voting trusts, in part, because of concerns that, if it were to ultimately conclude that the transaction was not in the public interest, it would be unable to prevent harm through a divestiture.[12] The Board is correct to be concerned about successful divestiture after implementation of a voting trust. The Board's predecessor, the ICC, similarly expressed concern when analyzing one proposed voting trust that it feared would prevent a meaningful ability to review a merger, noting "when the [ICC] finally addresses the [proposed merger], the agency will be presented with a *fait accompli*."[13] The Division believes that all voting trusts inherently threaten the Board's meaningful ability to review mergers, and risk presenting the Board with a similar *fait accompli*.

First, the changed incentives that exist during the pendency of a voting trust may result in the company taking long-lasting actions that can make it significantly less competitive than it was before the merger closed and the voting trust was implemented. Thus, the divested company may be weaker than it would have been absent the merger, so competition will not be fully restored by divestiture.

Moreover, in a specialized and concentrated industry like the railroad industry, it is possible that the only companies willing and able to acquire the divested assets without creating antitrust concerns are entities without railroad experience. This lack of experience in the industry may decrease the divested company's ability to compete, making the company unable to operate profitably or attract investors in the newly divested company. In this particular transaction, the applicant has noted that a private equity company was also interested in purchasing KCS, and thus the Board can be confident that a suitable buyer would materialize in the event a divestiture was necessary. But there again the Board is unseated from its proper role—at this stage, the Board knows nothing at all about this prospective buyer or whether its purchase of KCS would serve the public interest, and yet could be faced with no choice but to acquiesce to a divestiture to this buyer because of a lack of alternatives.

The Board recognized similar divestiture concerns when it amended its merger rules to include review of Class I voting trusts in 2001. Specifically, the Board stated:

> [T]oday there would likely be cases where there would be *no* remaining railroad bidders acceptable to us to buy the shares held in a voting trust if we were to deny a major control transaction or impose conditions that the applicants choose not to accept. Bidding limited to nonrailroad entities poses the risk of serious financial harm to applicants and, more importantly, poses risks to their customers as well.[14]

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[12] *See Major Rail Consolidation Procedures*, 2001 WL 648944, at *19.
[13] *Illinois Cent. Corp*, 1994 WL 575784, at *3 (I.C.C. Oct. 21, 1994).
[14] *Major Rail Consolidation Procedures*, 2001 WL 648944, at *19.

Alternatively, if the company's assets are divided among several smaller buyers, competition may not be fully restored. A major market participant would be lost, even if several smaller market participants become somewhat larger as a result.

The acquiring railroad may instead propose simply spinning off the acquired railroad to its own shareholders, but this would do nothing to restore competition. If the Board ultimately rejects the merger, it makes no sense to block the transaction on competition grounds yet sanction common ownership of both railroads—it is the commonality of ownership that creates the diminution of competition. As the Supreme Court pointed out in rejecting a proposed spin off to shareholders in an antitrust case, when the shareholders of one company (such as du Pont) vote a sizeable portion of the stock of another company (such as General Motors):

> Common sense tells us that . . . there can be little assurance of the dissolution of the intercorporate community of interest which we found to violate the law. The du Pont shareholders will ipso facto also be General Motors voters. It will be in their interest to vote in such a way as to induce General Motors to favor du Pont, the very result which we found illegal [under the antitrust laws].[15]

3. The Division's Review of Transactions Under the HSR Act

When considering how best to review mergers under its own statutory authority, the Board may benefit from considering the history of review of other mergers under the Clayton Antitrust Act. When the Clayton Antitrust Act was first passed, there was no requirement that merging parties wait to consummate transactions. Parties to unlawful transactions adopted the tactic of completing "midnight mergers" to frustrate the government's ability to protect competition. Although the government retained the ability to challenge transactions even after they were consummated, in practice it was often difficult to fully restore competition after a merger was completed through a divestiture.[16] To address this serious problem, Congress passed the Hart-Scott-Rodino Antitrust Improvements Act of 1974 ("HSR Act"), which provided that merging parties must notify the government and observe a waiting period before consummating their transaction.

After the HSR waiting periods expire, when the government brings suit to enjoin a merger, companies sometimes argue that they should be permitted to consummate their acquisitions pending final resolution of the case as long as they "hold separate" the two firms so that one could be divested should the merger ultimately be found illegal. A hold separate order

[15] *United States v. E. I. du Pont de Nemours & Co.*, 366 U.S. 316, 331 (1961).
[16] *See, e.g.*, Statement of Peter W. Rodino, Jr. on the 25th Anniversary of Hart-Scott-Rodino, https://www.ftc.gov/enforcement/premerger-notification-program/hsr-resources/pno-news-archive/statement-peter-w-rodino ("Together, we stopped 'midnight mergers'. . . . [T]he harm that some of these mergers could cause - the harm could be irreparable. The government spent years in litigation fighting just one merger. But even when it won, competition was often impossible to restore. The merged company already had closed plants, cut jobs and scrambled assets. Consumers ended up the losers, left paying higher prices. That had to be corrected.").

is very similar to a railroad voting trust—both attempt to keep one merging company separate and independent from the other, despite a unity in ownership, during merger review.

Although in the 1970s and 1980s courts sometimes did permit parties to consummate transactions subject to hold separate orders,[17] over time courts rightly began expressing skepticism that hold separate orders could protect competition. In *FTC v. Weyerhaeuser Co.*, then-Judge Ruth Bader Ginsburg persuasively explained that "even if all or part of an acquired company is held separate from its acquiring parent, competition between the enterprises will not retain the vigor it had prior to the merger."[18] Judge Ginsburg held that courts should not issue hold separate orders "absent careful review of the particular features of the proposed merger and a reasoned determination from the evidence that the milder restraint will operate as an adequate preservative (impeding interim harm, and safeguarding eventual divestiture) and, in view of the equities entailed, genuinely serve the public interest."[19] This case has been interpreted to establish a presumption that mergers generally should be enjoined—not permitted to proceed subject to a hold separate—pending merger litigation.[20] Today, the Division typically utilizes hold separate orders only for the limited purpose of preserving an asset that the parties have *already agreed* to divest, and even then, in recognition of the reality that "it is unrealistic…to expect that hold separate and asset preservation provisions will entirely preserve competition," the Division only permits the hold separate for a short period.[21]

4. The Purported Benefits of Voting Trusts Can Be Obtained in Less Harmful Ways

Historically, parties have argued that voting trusts are necessary to protect against the risks created by a lengthy regulatory review. However, in the Division's extensive experience, firms have developed other contractual mechanisms that protect against regulatory risk, even during lengthy review periods, while still preserving competition. Mergers subject to the HSR Act can occasionally take a year or more to reach final decision, yet parties are able to manage this risk without a voting trust. Mergers subject to approval by other regulatory agencies, such as the Federal Communications Commission or the Federal Energy Regulatory Commission, also

[17] *See, e.g.*, *FTC v. PepsiCo, Inc.*, 477 F.2d 24, 31 (2d Cir. 1973).
[18] *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1086 (D.C. Cir. 1981) (R. B. Ginsburg, J.).
[19] *Id.* at 1087.
[20] *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1507 (D.C. Cir. 1986) (Bork, J). *See also FTC. v. Swedish Match*, 131 F. Supp. 2d 151, 173 (D.D.C. 2000) (issuing an injunction rather than defendants' alternative hold separate order).
[21] *See* U.S. Dep't of Justice, Antitrust Division, *Merger Remedies Manual*, at 28-29, Sept. 2020, https://www.justice.gov/atr/page/file/1312416/download ("It is unrealistic, however, to expect that hold separate and asset preservation provisions will entirely preserve competition. For example, managers operating entities kept apart by a hold separate provision are unlikely to engage in vigorous competition. Likewise, customers during the period before divestiture may be influenced in their purchasing decisions by the merger, even if the soon-to-be-divested assets are being operated independently of the merged firm pursuant to a hold separate provision. Similarly, there may be some dissipation of the soon-to-be-divested assets during the period before divestiture, notwithstanding the presence of a hold separate or asset preservation provision—valuable employees may leave and certain investments may not be made. For these reasons, hold separate and asset preservation provisions do not eliminate the need for a speedy divestiture."); *accord* Dep't of Justice, *Antitrust Division Policy Guide to Merger Remedies*, 28-29 (2004), http://www.justice.gov/sites/default/files/atr/legacy/2011/06/16/205108.pdf.

sometimes require lengthy reviews, but to the Division's knowledge, no other U.S. regulatory agency permits a mechanism similar to a voting trust.

Parties whose mergers are reviewed under the HSR Act or by other agencies address antitrust regulatory risk up-front and allocate this risk in the merger agreement, by negotiating break-up fees, divestiture and litigation commitments, regulatory efforts clauses, material adverse change clauses, and other terms.[22] In other words, merging parties can, and often do, implement other risk-shifting mechanisms to address regulatory risk in ways that do not pose the same threats to competition.[23] And these contractual mechanisms preserve the integrity of each agency's review process, without requiring complex or risky divestitures to restore competition in the event the transaction is ultimately ruled illegal. There is no reason these same techniques could not be used in the railroad industry.

5. *The Board Should Carefully Consider the Competitive Implications of the Proposed Merger*

In addition to applying the 2001 standards for voting trusts, the Board should carefully consider applying the remainder of its 2001 merger standards to this proposed transaction, including requiring the parties to rigorously substantiate any claimed benefits from the merger.[24] The Board adopted the 2001 rules because it determined that prior regulations "were outdated and inadequate to address future major rail merger proposals" given past merger-related service disruptions, concerns about further consolidation of the Class I railroad industry, and doubts about the potential benefits of further consolidation.[25] Since that conclusion, the Board's Rate Reform Task Force has noted that, "As a result of mergers, there are now only seven class I railroads, and they have rationalized their routings and increased rates."[26] Other observers have also detailed how Class I railroads have been able to charge higher prices and earn greater margins since the last wave of mergers.[27]

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[22] *See, e.g.*, Darren S. Tucker & Kevin L. Yingling, *Keeping the Engagement Ring: Apportioning Antitrust Risk with Reverse Breakup Fees*, 22 Antitrust 70 (2008); Brian Burke & John Fedele, *Think Again—Allocating Antitrust Risk in a Climate of Protracted Investigations*, CPI Antitrust Chron. (May 2016).

[23] *See* Russell Pittman, *The Strange Career of Independent Voting Trusts in U.S. Rail Mergers*, 13(1) J. Comp. Law & Econ. 100-02 (Feb. 2017).

[24] *Major Rail Consolidation Procedures*, 2001 WL 648944, at *5 (noting "substantial concern" about additional consolidation and that "we do plan to take a more skeptical, 'show me' attitude toward claims of merger benefits"); *accord* Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), at § 10 ("Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.").

[25] *Major Rail Consolidation Procedures*, 2001 WL 648944, at *2.

[26] Rate Reform Task Force, Report to the Surface Transportation Board, at 11, Apr. 25, 2019, https://prod.stb.gov/wp-content/uploads/Rate-Reform-Task-Force-Report-April-2019.pdf.

[27] *See* U.S. Senate Committee on Commerce, Science, and Transportation, *The Current State of the Class I Freight Rail Industry*, at 9-10 (Sept. 15, 2010) (describing increased "pricing power" and higher margins for Class I

Although on its face this transaction may raise fewer competitive problems than other possible combinations of Class I railroads, the Board should carefully consider the competition implications posed by this transaction. As the Board has recognized, a railroad merger can harm competition even if the parties do not compete head to head to provide single-line service between the same origin and destination pairs. As one example, railroads can also compete through "source competition"—that is, the ability of shippers to choose between railroads that can carry their goods to (or receive goods from) different endpoints.[28] As the Board has explained:

> [S]ignificant losses in geographic competition could occur even where carriers truly are "end-to-end," because there are many commodities (such as phosphate and soda ash) that have a limited number of sources. Similarly, a merger between BNSF and a Canadian carrier, even if largely end-to-end, could raise potential competitive concerns in western export wheat markets. End-to-end carriers that compete with each other geographically would stand to gain market power if we were to approve their merger without imposing effective conditions, which, as discussed above, could be difficult.[29]

Railroads can also compete by serving portions of longer multi-carrier or multi-modal shipping routes. For instance, CP and KCS might each provide part of competing multi-modal routes between Asia and the eastern United States, or might compete to serve north-south routes by each partnering with other rail lines. A merger could reduce this type of competition by depriving current or future interchange partners of CP or KCS of a means to compete for this traffic, and thus reduce choices for shippers and ultimately raise prices.

Class I railroads that do not compete on a day-to-day basis for current shippers may compete in broader ways that are socially important, for example in seeking to attract new shippers to locate on their lines and in the adoption of technological and productivity enhancing innovations; or, correspondingly, they may coordinate tacitly or explicitly in anticompetitive

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railroads); U.S. Gov't Accountability Office, *Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should be Addressed*, at 13-16 (Oct. 6, 2006) (documenting rate increases from 2000 to 2004, and explaining "the rail industry has continued to consolidate, potentially increasing the market power of the largest railroads. …[A]ccording to freight railroad officials, shippers, and financial analysts, since 2004, rates have continued to increase as the demand for freight rail service has increased, and rail capacity has not kept pace with demand.").

[28] *See* Statement of Interest for the United States, *In re Rail Freight Fuel Surcharge Antitrust Litigation*, MDL Docket No. 1869, at 12-13 (July 13, 2020), available at https://www.justice.gov/atr/case-document/file/1294246/download (explaining that two hypothetical railroads that interline to serve a move from San Francisco to New York, with one carrying the traffic from San Francisco to Chicago, the other from Chicago to New York, could still compete with one another for the business of a shipper in Chicago: "Thus, if a Chicago-based shipper disliked western carriers' rates to San Francisco, it could shop for a lower price and send its product instead to New York on an eastern carrier if a market for its product existed in both cities. Western and eastern carriers are rivals in this scenario – they are not competitively neutral and they are certainly not partners."); Russell Pittman, *Options For Restructuring The State Owned Monopoly Railway*, Railroad Economics 182 (2007).

[29] *Major Rail Consolidation Procedures*, 2001 WL 648944, at *11.

actions.[30] The Board has rightly been attentive to such concerns,[31] and should carefully consider these issues when evaluating this transaction or other potential rail mergers.

Thus, before permitting additional consolidation, the Board should thoroughly examine the competition concerns raised by commenters and ensure that this transaction would not exacerbate these trends. As the Board recognized in adopting the 2001 major rail consolidation procedures, the consolidation that has already occurred in this industry means "There is little margin for error as we proceed ahead."[32]

The Division is committed to offering any assistance it can provide as the Board carries out its important mission protecting competition in this industry. The Division appreciates this opportunity to share its views, and looks forward to continuing to work cooperatively with the Board on this transaction and on other matters.

Respectfully Submitted,

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Antitrust Division

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[30] *See* Comment of The Freight Rail Customer Alliance et al., Apr. 1, 2021, at 3 (expressing concern that that "the reduction in Class I railroads from seven to six, even if unaccompanied by further consolidation, will facilitate further rate and practice coordination in what is already a highly concentrated and coordinated industry.").

[31] *See, e.g.*, *Petition for Rulemaking to Adopt Revised Competitive Switching Rules Reciprocal Switching*, No. EP 711, 2016 WL 4594257, at *8 (July 25, 2016) ("[T]he consolidation of class I carriers … could lead to reduced competitive options for some shippers and thus should be considered."); Rate Reform Task Force, Report to the Surface Transportation Board, at 11, Apr. 25, 2019, https://prod.stb.gov/wp-content/uploads/Rate-Reform-Task-Force-Report-April-2019.pdf ("As a result of mergers, there are now only seven class I railroads, and they have rationalized their routings and increased rates.").

[32] *Major Rail Consolidation Procedures*, 2001 WL 648944, at *50.

CERTIFICATE OF SERVICE

I certify that on April 12, 2021, I caused a copy of the forgoing Comment of the United States Department of Justice to be served via email on the parties of record in this docket.

Robert A. Lepore
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