



Office of the Chairman

Surface Transportation Board
Washington, D.C. 20423-0001

January 7, 2016

The Honorable Bob Goodlatte
Chairman
Committee on the Judiciary
United States House of Representatives
Washington, DC 20515

The Honorable Tom Marino
Chairman
Subcommittee on Regulatory Reform,
Commercial and Antitrust Law
Committee on the Judiciary
United States House of Representatives
Washington, DC 20515

Dear Chairman Goodlatte and Subcommittee Chairman Marino:

Thank you for your letter dated December 22, 2015, concerning a potential merger of Canadian Pacific Railway (“CP”) and Norfolk Southern Railway (“NS”). In reading our responses to your questions about the role of the Surface Transportation Board (“STB” or “Board”) in reviewing a potential merger, please understand that we must exercise caution to avoid prejudging issues that could arise if a merger application were submitted to this agency. Accordingly, we will endeavor to be as responsive to your questions as possible by providing the general guidance below.

As you noted, the Board adopted its current merger rules in 2001. Among other things, those rules instruct major merger applicants¹ to show that a proposed merger is in the public interest by demonstrating that public benefits, such as improved service and enhanced competition, outweigh potential negative effects, such as potential service disruptions and harm that cannot be mitigated. They also require applicants to address whether claimed benefits can be achieved by means other than a merger. See *Major Rail Consolidation Procedures*, 5 STB 539, 546-51, 553-59 (2001) (“*Merger Rules*”). No major consolidation proposals have been submitted since the adoption of the *Merger Rules*.

Your first question asks whether the Board anticipates any revisions to the *Merger Rules* and whether the Board will continue to consider enhancement of competition as a factor in evaluating proposed transactions. Any revisions to the *Merger Rules* would have to be adopted

¹ A “major” transaction is a control or merger involving two or more Class I railroads. A Class I railroad is one whose annual operating revenue exceeded \$475,754,803 in 2014.

in a notice-and-comment rulemaking. There are no such proceedings under way to change those regulations at this time. Therefore, under the current rules, as part of its weighing of the benefits of a transaction, the Board would consider matters such as improved service and enhanced competition.

Your second question concerns whether the Board would consider the downstream effects of a consolidation transaction – in particular, whether a proposal would lead to other consolidations in the industry – and how the agency would weigh this factor in its overall review. The *Merger Rules* require that “applicants . . . initiate a commentary, to which other parties could respond, that would give us the information we need to rule on what could likely be the first step in an end-game situation in which only two or three competing transcontinental carriers would remain in North America.” More particularly, the Board said, “[w]e can meet our responsibility only if applicants file their preliminary evidence about the evolving structure of the industry that would likely result from their proposal and others like it; if they address the merits of such a structure; if they provide their views on how to deal with potential problems that structure could cause to service, efficiency, and competition; and if other affected parties then come in and express their concerns on a full record.” *Id.* at 582. The *Merger Rules* thus direct the Board to consider, in addressing a major merger application, likely future transactions and their impact.

Lastly, you ask whether the Board has approved an arrangement under which a proposed purchaser’s former Chief Executive Officer (“CEO”) managed the to-be-acquired company during the Board’s regulatory review and what factors the Board considered in approving such an arrangement. The Board has not approved that particular arrangement in the context of a proposed merger between two Class I railroads. The major transactions that have involved, to some degree, proposed management swaps are the following:

- In a 1983 proposed major merger, the Southern Pacific Transportation Company (“SP”) sought to merge with the Atchison Topeka & Santa Fe Railway (“ATSF”). While the merger was pending before the Board’s predecessor, the Interstate Commerce Commission (“ICC”), the holding companies of SP and ATSF were placed under a consolidated entity as part of a voting trust arrangement. During this time, four officers of SP departed to become employed by the consolidated entity. Although the ICC approved that voting trust, it expressed “deep reservations” and imposed numerous conditions upon its approval. See *Santa Fe Southern Pacific Corp.—Control—Southern Pacific Transp. Co.: Merger—The Atchison, Topeka & Santa Fe Rwy. Co. and Southern Pacific Transp. Co.*, 2 I.C.C.2d 709, 715 (1986); *Santa Fe Southern Pacific Corp.—Control—Southern Pacific Transp. Co.: Merger—The Atchison, Topeka & Santa Fe Rwy. Co. and Southern Pacific Transp. Co.*, FD 30400, 1983 ICC LEXIS 70, at *1-2, *14-17 (ICC served Dec. 23, 1983). The ICC ultimately denied the request for merger approval and directed that the consolidated entity divest either SP or ATSF.

- In a 1994 proposed major merger, Illinois Central Railroad (“IC”) sought to acquire Kansas City Southern Railway (“KCS”). The parties proposed a voting trust during the pendency of the transaction. As part of that arrangement, the purchasing railroad’s officers would become officers of the to-be acquired company during the transaction’s pendency. The ICC raised numerous questions about the proposed voting trust and management plan, and took the then-rare step of initiating a formal review process and seeking public comments. Because the IC-KCS deal was terminated by the parties shortly thereafter, the ICC did not rule on those proposed arrangements. *See Illinois Central Corp.—Common Control—Illinois Central R.R. Co. and the Kansas City Southern Rwy. Co.*, FD 32556, 1994 ICC LEXIS 195, at *1-2, *4, *11-18 (ICC served Oct. 19, 1994).
- In a 1998 proposed major merger involving the Canadian National Railway (“CN”) and IC, Hunter Harrison (now CEO of CP) left his position as CEO of IC, the to-be-acquired company, to become Chief Operating Officer (“COO”) of the purchasing company, CN. However, neither the Board’s staff opinion on the voting trust, nor the agency’s subsequent decision approving the merger addressed any proposed management shift. *See Canadian Nat’l Rwy. Co., et al.—Control—Illinois Central Corp.*, et al., FD 33556, 1998 WL 477655 (STB served Aug. 14, 1998); *see also Canadian Nat’l Rwy. Co., et al.—Control—Illinois Central Corp.*, et al., FD 33556, Opinion Letter from Secretary Vernon A. Williams to Paul A. Cunningham (Feb. 25, 1998) (attached).

Please note that there has been a change in the Board’s policy with regard to voting trusts in major mergers since the transactions described above. In *Merger Rules*, the Board stated that it would “take a much more cautious approach” with regard to voting trusts in proposed major mergers. The Board is now required to conduct a more formal review of such voting trusts, which includes a public comment period. In addition to its focus on whether a voting trust insulated the merger partners from unlawful pre-approval control, the Board announced in *Merger Rules* that it would also consider a new factor in assessing voting trusts in major mergers: whether use of the trust would be consistent with the public interest. Therefore, should CP pursue a voting trust arrangement with NS in connection with a request for merger approval, the Board would consider issues related both to unlawful pre-approval control and to the public interest.

Thank you for contacting us. We hope this information is helpful to you. Please do not hesitate to contact us if you have further questions.

Sincerely,

Daniel R. Elliott III
Chairman

Deb Miller
Vice Chairman

Ann D. Begeman
Commissioner