

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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Finance Docket No. 36004  
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ENTERED  
Office of Proceedings  
March 9, 2016  
Part of  
Public Record

CANADIAN PACIFIC RAILWAY LIMITED  
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**REPLY TO PETITION OF CANADIAN PACIFIC RAILWAY FOR EXPEDITED  
HANDLING OF PETITION FOR DECLARATORY ORDER CONCERNING  
THEORETICAL VOTING TRUST**

The Brotherhood of Maintenance of Way Employees Division/IBT, Brotherhood of Railroad Signalmen, and International Association of Sheet Metal, Air, Rail and Transportation Workers/Mechanical Division (collectively “Unions”) submit this reply to the petition of Canadian Pacific Railway LTD (“CPRL”) for a declaratory order concerning a theoretical voting trust to the extent that CPRL seeks expedited handling of its Petition.<sup>1</sup>

On March 2, 2016, CPRL filed a petition for a declaratory order 1) that an “inchoate” voting trust structure under which CPRL’s operating subsidiaries (“CP”) are placed in a voting trust (the details of which would be described at a later time-*see* Petition at 2 n. 2, 12, 23) while CPRL acquires control of Norfolk Southern Railway Company (“NS”) could potentially be used to avoid unlawful unapproved control of an additional rail carrier; 2) that it would potentially be permissible for CP CEO Hunter Harrison and several other CP managers to take similar positions at NS while their colleagues at CP remain the managers of CP (Petition at 9). In essence CPRL plans a reverse voting trust under which the already owned railroad (CP) would be placed in trust, rather than the to be acquired railroad (NS); and executives of the already owned railroad (CP) become executives of the target railroad (NS) while CPRL’s other agents at CP continue to

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<sup>1</sup> The Unions will address the merits of the Petition in a later filing.

be the executives at CP.

CPRL also requests expedited handling of its petition for a declaratory order preliminarily sanctioning the hypothetical arrangement. Under CPRL's proposed schedule, responses to its petition would be due within twenty days of CPRL's filing (March 22, 2016), CPRL would file a reply within five (5) days, and the Board would rule before the as yet unannounced NS annual shareholders meeting, but before May 6, 2016. CPRL claims that the declaratory order and expedited handling are necessary because NS shareholders are ostensibly befuddled by concerns about whether the reverse voting trust and executive replacement scheme would be permitted by the Board. According to CPRL, statements of NS executives, and a paper by two former members of the Board have spooked shareholders. CPRL apparently feels that it cannot allay their fears by counter-arguments, so CPLR believes the Board must step in to bless the reverse voting trust and executive embedding plan in concept, and do so before the NS shareholders meeting.<sup>2</sup>

The Unions oppose the schedule proposed by CPRL. Simply to describe the request of

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<sup>2</sup> CPRL claims that NS's responses to CPRL's overtures "appear[] to be intended to discourage stockholder support for a CPRL-NS meeting to discuss the benefits of a merger" and that "a declaratory ruling from the Board providing guidance would remove such uncertainty, and thus leave stockholders free to make decisions about the efficacy of further meetings based on the benefits of a merger, not on ersatz regulatory concerns". Petition at 1-2. According CPRL, "NS shareholders can be free to make their own decisions, however, only if the Board removes the claimed uncertainty by acting on the instant petition prior to NS's upcoming annual meeting". *Id.* at 11. CPRL further contends that NS's arguments "have created a situation where the market cannot function properly, thus requiring the need to file this petition". *Id.* at 6. And Mr. Harrison asserts that "Clear Guidance from the Surface Transportation Board (Board or STB) on this issue is critical to the smooth functioning of the market". Harrison Statement at 2. So according to CPRL, the regulatory agency must intervene to eliminate fear of regulatory action that supposedly is intimidating NS shareholders so that the free market can function without regulatory interference.

CPRL is to demonstrate that it is complex and unprecedented. CPRL itself has said it “raises the atypical question of whether CPRL’s ownership of voting securities in the CP carriers can be held in trust, while CPRL acquires NS and seeks STB approval of a CP-NS merger”, as well as “another matter that the Board as not directly decided” [installation of CPRL’s agents in the top executive spots at NS]. Petition at 8. Indeed CPRL proposes a scheme that the Board has not addressed before that requires research and briefing by interested parties and careful consideration by the Board before it decides an issue of first impression. For those reasons alone, responding parties should not be rushed in answering the Petition and the Board should not be rushed in issuing a decision.

Additionally, as the party seeking expedited handling CPRL has the burden of justifying the rush; and it has not done so. The only basis for the request for speed is the pendency of the yet unscheduled NS annual meeting and concerns that NS shareholders will be persuaded by NS’s arguments and expert opinion that CPRL apparently cannot allay with its own arguments that are set forth in its Petition. CPRL’s concern that it cannot persuade NS’s shareholders is not sufficient reason to jam other parties in their ability to respond to the Petition or to push the Board to move its deliberations faster than it otherwise would.

Furthermore, CP’s own conduct, its own delay in filing this petition, militates against granting an expedited schedule. The plan for a voting trust and embedding CPRL executives at NS was widely discussed in November of 2015, as evidenced by the November 30, 2015 Railway Age article attached hereto as Exhibit 1. Indeed the NS document providing the opinion of former Commissioners Mulvey and Nottingham addressing the planned voting trust (Petition Ex. B) was released on December 7, 2015, and CPRL responded by publishing the contrary

opinion of its counsel (a heavily footnoted document) on December 15, 2015 (Petition Ex. E; also Exhibit 2 to this Reply). CP also published a “white paper” dated February 2016 addressing the voting trust issue (Exhibit 3 to this reply). Then a CPRL press release dated February 16, 2016 (Exhibit 4 to this reply) stated that CPRL would seek a declaratory order from the Board. But despite its prior documents addressing the issues, CPRL waited over two weeks to file the Petition and then sought to limit the time for responses and to hurry the Board’s decision. Given that history, CPRL cannot justify its request for expedition and has no standing to object to the request of other parties that they and the Board have more time than is proposed by CPRL to respond to the Petition.

CPRL’s request is not aided by its citation (Petition at 11) to the time limits for answers to complaints (49 C.F.R. 1111.4 ( c)). Not only is the complaint procedure inapposite here (as it involves assertions of violations of the Act or regulations and typically concerns rate issues- see 49 C.F.R. 1111), CPRL has ignored the rest of the complaint procedure which permits discovery and filing of supplemental evidence over 210 or 310 days (49 C.F.R. 1111.8 and 1111.9). If CPRL wants to rely on the complaint procedures it should propose a schedule consistent with that procedure. More apposite are the Board’s general rules of pleading (49 C.F.R. 1104), specifically the rules on motions and replies (49 C.F.R. 1104.13) which state that a reply to a motion is generally due within twenty days unless otherwise provided, and which state that **“A reply to a reply is not permitted”** (49 C.F.R. 1104.13( c)).

In view of the complexity and unprecedented nature of CPRL’s request, the fact that CPRL has had months to develop its arguments, and CPRL’s own delay in moving forward with its Petition, the Unions submit that twenty days is an inadequate amount of time for responses to

CPRL's Petition. The Unions further submit that CPRL's attempt to grant itself the opportunity to reply to the replies when the Board's rules prohibit replies to replies is wholly inappropriate (especially if that were to mean that CPRL would have two filings whereas respondents would only have one). The Unions submit that parties seeking to reply to the Petition should have thirty (30) days to file their replies (which would require that they be submitted by April 1, 2016), that no replies to replies be permitted, and that the Board take the time it needs to render a considered decision.

Respectfully submitted



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March 8, 2016

CERTIFICATE OF SERVICE

I hereby certify that on this date I caused copies of the foregoing Reply to Petition of Canadian Pacific Railway for Expedited Handling of Petition for Declaratory Order Concerning Theoretical Voting Trust upon the following by First Class Mail:

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March 9, 2016



Richard S. Edelman

**BMWED, BRS, SMART/MD EXHIBIT 1**

## CP-NS: Voting trust and other conundrums

Written by Frank N. Wilner, Contributing Editor

- inShare

Levitation takes two forms among railroads—magnetic levitation relating to futuristic high-speed passenger transport, and stock levitation associated with bidding wars for asset control.

Stock levitation most recently was seen in 1997 when Conrail shares ascended within months from \$85 to \$115 during a bidding war involving CSX and Norfolk Southern (NS). It ended only after Surface Transportation Board (STB) Chairman Linda Morgan sent CSX and NS a message via Washington Post journalist Don Phillips that if they didn't mutually agree on splitting Conrail assets, the STB would impose a third-party settlement neither might like.

Comes now the possibility of a new bidding war—for control of NS in the wake of Canadian Pacific's (CP) initially unwelcome \$28.4 billion solicitation offer called "too low" by NS. A previous unsolicited bid by CP for CSX was rebuffed by CSX management last year and then

abandoned by CP amidst cost anxieties and festering concerns of rail congestion and service problems that made rail merger mavens chary.

Since, rail service-problem fears have faded while NS stock slid some 30% in price, with NS suffering worse traffic losses than its rivals. All this reenergized the still marriage-minded 71-year-old CP chief Hunter Harrison, who thirsts to create North America's first transcontinental railroad.

As "no" rarely is heard as "no" among railroad CEOs whose testosterone levels soar when the word "merger" is uttered and a prey's stock price is considered attractive, NS is now assumed "in heat." In such an environment, CP best beware of another railroad, a rail holding company such as Berkshire Hathaway, or a non-railroad hedge fund entering the fray with higher offers.

Thus, CP is prepared to improve its bid to achieve—more certainly, more quickly and less expensively—a lock-up of a majority of NS shares so as to shut out other NS suitors pending a subsequent STB decision on a CP-NS merger application. As one Class I railroad may not exert operational control over another Class I railroad absent formal STB merger approval, the tendered NS shares would be placed in a voting trust pending regulatory finality.

A voting trust for railroads requires STB approval, which typically occurs in fewer than two months following a request. A subsequent decision on whether to permit a CP-NS merger could stretch more than a year, but no longer than 16 months, per statute, following filing of a formal merger application.

Requisite regulatory hurdles are significant and not confined to CP and NS. Responsive and inconsistent merger applications may follow a CP-NS merger submission. Kansas City Southern could seek inclusion as a condition of merger; other railroads might press for concessions such as line sales; while BNSF might make a play on CN, and Union Pacific one on CSX. Other permutations are possible.

Adding to the fog is that the top institutional shareholders of the major U.S. railroads, whose concurrence in any merger deal is essential, are largely the same—Capital Research, Vanguard Group, State Street Corp. and Black Rock Investment Trust.

### **The Voting Trust Issue**

If CP and NS management reach a merger agreement in principal, CP will pay a yet-to-be-established premium above market value for NS shares—and the voting trust becomes integral to the holding of those shares while regulatory approval is sought for the merger.

Here is where CP shareholders assume a significant risk. As CP will pay a premium above market value for those NS shares placed in a voting trust, their value could plummet sharply should the STB subsequently deny the merger. A dissolution of the voting trust would follow, requiring sale by CP of the NS shares on the open market at whatever price is offered. CP shareholders could end up considerably poorer.

This is why Harrison wishes, under cover of a voting trust, to make a management swap—send CP President Keith Creel, and maybe even himself—to Norfolk to run NS as Harrison thinks it ought to be run; with NS CEO Jim Squires moving to Calgary to “learn” more about CP and the heralded Hunter Harrison productivity-enhancing management method. More in a moment on how this intended management swap could affect an STB decision on a voting trust.

The purpose of the management swap is to tamp down—sharply and quickly, before any STB decision on the merger application—the NS operating ratio, which would increase the value of NS stock substantially, notwithstanding how the STB rules on the merger application. (Operating ratio is a railroad’s operating expenses expressed as a percentage of operating revenue, and is considered by economists to be the basic measure of carrier profitability. The lower the operating ratio, the more efficient the railroad.)

Harrison, described by a Canadian newspaper as a “tough, polarizing rail chief [with] a board of directors totally in his thrall,” peddles himself with Donald Trump-like bravado as a god-from-the machine, able to squeeze from a railroad every penny of waste and every ounce of improved productivity in order to send operating ratios tumbling. To his credit, Harrison did just that on Illinois Central (IC), Canadian National (CN) and CP.

In fact, when CN acquired IC in 1998, it was the only modern merger transaction not plagued by service failures. Harrison, then CEO of IC, became CN’s chief operating officer before becoming CN’s CEO—a fact that may be prominent in a CP-NS merger application that requires a service assurance plan. Harrison’s critics, however, assert that IC, CN and CP are all less complex in route structure and traffic diversity than NS.

### **Harrison’s scheduled railroad model**

If history is a guide, and the CP-NS management swap occurs, Harrison will attempt to turn NS into a scheduled railroad, substituting high hourly pay for existing fixed trip-rates and guaranteeing train crews more predictable days off and starting times. Road and yard distinctions, as well as other costly work rules, would be eliminated and the work force trimmed significantly through attrition. Such a bundle of changes are intended to put productivity improvements on steroids, while annual wages could climb by as much as \$30,000 in order to coax labor-contract changes.

There is, of course, no guarantee the Harrison model would work at NS—or work in time to protect NS share value should the proposed CP-NS merger be rejected by the STB. Time and pushback from rail labor—and even from a justifiably proud NS management—could work against Harrison.

For all of Harrison’s declarations of NS shortcomings, NS is the only major railroad that consistently has been found by the STB to generate revenue equaling or exceeding its annual cost of capital; and no railroad in modern times has posted a consistently better safety record. There are other sobering considerations to the optimism attending the Harrison aura. Former CN Chairman Paul Tellier, who adored Harrison’s abilities, nonetheless winced at Harrison’s oft

abrasive personality. “We try to keep Hunter in a cage so he doesn’t bite,” Tellier once jested. “But he finds a way to get back out and we have to put him back in.”

Indeed. At CN, Harrison was derisively called “the ugly American” by train crews over his brusque manner in seeking productivity improvements. U.S.-based labor union senior officer Carl Vahldick, who had worked closely with Harrison at IC, once was dispatched north in an effort to quell an uprising by conductors.

The so-called Harrison productivity-enhancement model was, in fact, developed at IC with substantial input from United Transportation Union Vice President Corky Swert; yet twice rejected by the rank-and-file before productivity payments successfully sweetened the deal. More recently, conductors on CP’s U.S. subsidiary Soo Line rejected a Harrison hourly rate concept, while labor leadership on CP subsidiary Delaware & Hudson (parts of which have since been sold to NS) declined even to consider the concept.

Such are the hazards of assuming early productivity enhancements at NS.

Perhaps the greatest peril to STB approval of a voting trust is the envisioned management swap. Yes, voting trusts have been approved in the past—such as when Southern Pacific (SP) and Atchison, Topeka & Santa Fe (ATSF) sought merger approval, only to have it dissolved when the STB denied the transaction. Billionaire energy tycoon Phil Anschutz stepped in to purchase a financially struggling SP, later merging it with Union Pacific, while ATSF and Burlington Northern combined to create BNSF.

But as the proverb reads, “That which is past is dead.” Railroads and their regulatory agency have entered a new age with changed rules and perceptions.

### **Too Big to Fail?**

Recall that when BNSF and CN sought merger approval in 2000, the STB put the transaction on hold for 15 months while formulating new merger rules to meet what the STB considered changed conditions in the rail industry—not the least of which is concern that U.S. railroads already had become “too big to fail,” as was proven with banks during the financial meltdown of almost a decade ago.

The BNSF-CN merger application voluntarily was withdrawn, meaning a CP-NS merger would be the first to be considered under the STB’s new more-stringent-than-ever merger rules, which contain a revised procedure for voting trusts—a privilege to be granted by the STB and not a right. With regard to voting trusts, the rules state:

“[W]e are responsible for ascertaining whether a proposed transaction would undermine the financial integrity of the applicant carriers. If prospective applicants make larger tender offers for controlling stock interests in other rail carriers, they risk having to sell these assets at a greatly reduced price if we do not approve the control application or if they choose not to consummate it.

“Therefore, we believe that, with only a limited number of major railroads remaining, we must take a much more cautious approach to future voting trusts in order to preserve our ability to carry out our statutory responsibilities.”

The STB seeks to assure that, going forward, it does not act as an enabler of financial risk compromising CP’s ability to fund future capital investments and normalized maintenance for itself, or for its U.S. subsidiaries—Dakota, Minnesota & Eastern, Delaware & Hudson and Soo Line.

### **Jiggery-Pokery?**

Comes now the more problematic hitch. The STB’s voting trust procedures require independence in the operation of the railroad held in trust. If the Harrison-intended management swap, perhaps essential to protecting the share value of NS should a merger be rejected by regulators, is viewed as jiggery-pokery by the STB—an attempt to circumvent required NS operational independence—voting trust approval could be in deep doo-doo.

As Harrison sees things, during STB deliberations on the 1998 successful CN-IC unification, the STB allowed a voting trust for IC during which time Harrison, then IC’s CEO, was sent to CN as chief operating officer. So why not now? Well, IC was a relatively small railroad during a different era. Times have changed—that which is past is dead—and new regulators sit in judgment.

So last week, Harrison hinted he might, instead, place CP in voting trust rather than NS. Some attorneys say such a tactic might avoid required STB approval of a voting trust of NS, while still allowing CP to lock up control of a majority of NS shares and make the management swap. It could be a perilous strategy, as seeking to involve the STB in a three-card Monte game run by Hunter Harrison’s creative attorneys might not be the sanest of strategies to gain voting trust or merger approval.

What CP should not be inviting in this effort is an unnecessary court challenge and its attendant delay. As CN and BNSF learned when fighting the 15-month merger moratorium in 2000 that cost them their merger, investors providing the acquisition cash are prone to having second thoughts when the calendar drags.

### **As for Open Access**

While a discussion of pro-competitive elements required by the STB for approval of mergers under its current rules is beyond the intent of this column, there is one curious element of this proposed transaction that could bite shippers more than railroads, notwithstanding that most railroads stand in opposition.

Harrison promises that if a CP-NS combination fails to provide adequate service or competitive rates, he would allow a competing railroad to utilize CP-NS tracks to reach otherwise sole-served customers (open access), and quote line-segment rates in bottleneck situations. Such are opposed by most railroads while craved by most shippers.

Yet giving previously sole-served shippers access to another railroad could eliminate the second of two required pre-conditions for bringing a rate challenge before the STB—a ratio of revenue to variable costs exceeding 180% AND evidence that the shipper has no effective transportation alternatives. Most, if not all, potential rate challenges by aggrieved shippers could thus be eliminated were open access a condition of the merger's approval—but just on CP-NS.

Thus, railroads other than CP-NS would NOT be required to provide open access and elimination of bottleneck pricing. CSX, for example, could then poach on NS sole-served points without fear of similar poaching by NS. The investment funds whose holdings are spread among numerous U.S. railroads may not cotton to such market destabilization and withhold their shares in NS from CP.

As for the extension of open access and bottleneck pricing to other railroads as a condition of other mergers, many railroads and investors assert it could chill future investment in affected facilities. They stand in disagreement with economists over the theory of “conscious parallelism,” which predicts two competitors will not destabilize the status quo; that a third competitor, not contemplated by open access, is required for market destabilization.

DraftKings and FanDuel promise big payoffs for predictive-skill talent involving professional sports. That's small potatoes compared to wins and losses faced by those with cash in this game. Interesting times, indeed.

*Frank N. Wilner has chronicled every merger since the mid-1850s in his book, [Railroad Mergers: History, Analysis, Insight](http://www.transalert.com/cgi-bin/details.cgi?inv=BKMERG&cat=14), available from Simmons-Boardman Books at <http://www.transalert.com/cgi-bin/details.cgi?inv=BKMERG&cat=14>.*

**BMWED, BRS, SMART/MD EXHIBIT 2**

## CP Makes Third Offer to Acquire NS

December 17, 2015

Another day, another offer from Canadian Pacific to Norfolk Southern.

On Wednesday, CP told investors that it is now offering NS shareholders the opportunity to receive for each share of NS stock, \$32.86 in cash and 0.451 shares of stock in the combined CP-NS, and 0.451 per share of a contingent value right that will have a maximum value of \$25.

CP described the CVR as a liquid security that can be sold by NS shareholders and converted to cash at or after the time that the transaction is consummated in May 2016.

Each CVR would entitle the holder to receive a cash payment from CP equal to the difference between the CP-NS share price during the relevant measurement period, which would be from April 20, 2017, to Oct. 20, 2017, and \$175/share (with no payment in the event CP-NS share price is above \$175/share), up to a maximum of \$25/CVR.

CVR holders would receive a cash payment on Oct. 25, 2017, of up to \$3.4 billion.

CP said its revised offer for NS reflects CP's confidence in the ultimate value of the transaction and represents an approximately \$10 per NS share of additional consideration based on the current trading price of CP.

It also provides insurance on the ultimate trading value of CP-NS stock because the CVR will be a highly liquid, easy-to-value security.

CP said that given the expected CP-NS trading price in 2017, it doesn't expect to have to make a payout under the CVR.

The newly combined company of CP and NS would be able to finance any potential payment under the CVR in October 2017 with additional borrowings while maintaining its investment grade credit rating.

Based on CP's estimates of the intrinsic value of CP-NS, the revised offer represents a 61 percent to 78 percent premium to the undisturbed NS share price.

The initial response of NS to the third CP proposal was noncommittal.

NS said its board of directors will carefully consider the CP proposal, but other than the inclusion of a CVR, the offer did not change any of the terms of the prior reduced proposal dated Dec. 7, 2015, that was previously unanimously rejected by the NS board.

Nor did the latest CP bid address the regulatory risks and uncertainties inherent in the proposed combination, NS said.

In a previous statement, NS said, "if CP is confident that its proposed voting trust structure works, CP can seek a declaratory order to that effect from the STB now."

CP's latest offer was outlined during a conference call with analysts that featured CP CEO E. Hunter Harrison, CP Chief Financial Officer Mark Erceg and CP shareholder Bill Ackman of Pershing Square Capital Management.

CP has said that the NS board thus far has refused to discuss a merger even though Harrison held one meeting with NS Chairman, President and CEO James Squires.

"I just don't understand why they won't talk," Harrison said.

Ackman told the investors that if the NS board won't allow its shareholders to have an up or down vote on the CP proposal then CP might push for a proxy vote to replace NS management and the board of directors at NS annual meeting next May.

Tags:[Canadian Pacific](#), [Class 1 railroad mergers](#), [CP-NS merger talks](#), [E Hunter Harrison](#), [Norfolk Southern](#), [railroad mergers](#)

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## CP Counters NS Points With its Own White Paper

December 16, 2015

Canadian Pacific disputed the assertion of Norfolk Southern that a merger of the two railroads would not find favor with the U.S. Surface Transportation Board.

CP issued its own white paper in an effort to counter a similar document that NS released last week.

"As such, their white paper is based largely on inaccurate assumptions, rumor, speculation, and conclusions that are unsupported by fact or law," CP said. "We would not presume to predict the conclusion of the current STB. We are, however, confident that the STB will not prejudge the transaction, and that whatever voting trust structure and merger application is ultimately presented to the STB for regulatory approval will be considered fairly and impartially."

The NS white paper was written by former STB commissioners Frank Mulvey and Chip Nottingham.

CP continues to argue that the merger's voting trust structure is legal and would receive STB approval. Saying there is precedent for the trust, CP said it would put itself in trust for the 16 months that the STB would take to review the merger.

During that time, CP CEO E. Hunter Harrison would become the head of NS. Earlier reports indicated that Harrison offered NS Chairman, President and CEO James Squires the post of CEO of CP.

Harrison has proposed severing all of his ties with CP, including participating in the railroad's retirement program, after he takes over as NS chief.

“Under Mr. Harrison’s management, we expect that NS’s operations will materially improve,” CP said in its white paper. “Rather than cause financial harm, we believe that the use of a trust for CP and the transfer of Mr. Harrison to become CEO of NS will vastly improve the operations and value of both railroads.”

The CP white paper said the potential downstream effects of a CP-NS merger would not be a basis for the STB rejecting the combination out of hand.

Nor does CP believe that a merger with NS would trigger a wave of mergers among other Class 1 North American railroads.

“A CP+NS merger does not create a dominant carrier that would necessitate a reflexive merger in response,” CP said. “Rather, CP+NS would be better able to compete with the other large carriers. In this way, the merger adds competitive balance to the industry, making the industry more competitive as a whole.”

Tags: [Canadian Pacific](#), [Class 1 railroad mergers](#), [CP-NS merger talks](#), [Norfolk Southern](#), [railroad mergers](#), [Surface Transportation Board](#)

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**BMWED, BRS, SMART/MD EXHIBIT 3**

# CP-NS: A Comprehensive Approach to Regulatory Approval

The status quo  
is not an option  
for North American rail

FEBRUARY 2016



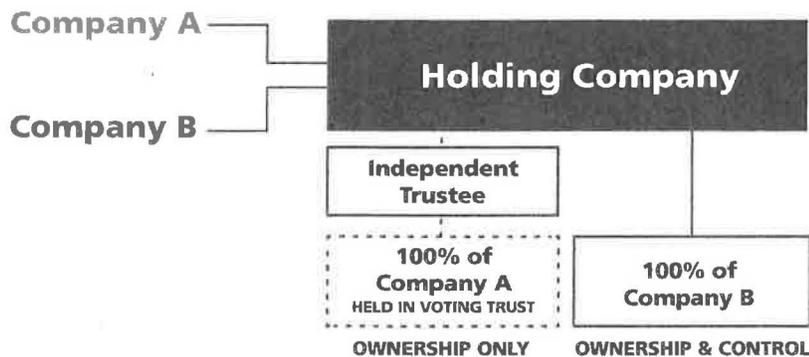
how service will be achieved and propose remedies to alleviate any identified disruptions.

Applicants are also required to discuss downstream effects, or, in other words, potential impacts stemming from any other future hypothetical mergers. This would “initiate a commentary” that allows the STB “to develop a consistent set of principles for analyzing all of the applications that could be brought to us in such a final round of mergers.”<sup>3</sup>

These new STB policies do not “reflect an anti-merger bias” or “reverse a statutory policy favoring mergers.”<sup>4</sup> In fact, the STB reaffirmed that it “welcomes private-sector initiatives that enhance the capabilities and the competitiveness of the transportation infrastructure,” and recognizes that Class I mergers can “advance our nation’s economic growth and competitiveness through the provision of more efficient and responsive transportation.”<sup>5</sup> Importantly, the rules do not change the Staggers Act mandate to approve transactions that advance the public interest<sup>6</sup> and minimize regulatory control.<sup>7</sup>

These updated rules, although untested, establish a clear process for reviewing proposed Class I mergers, provide for the development of a full evidentiary record and the opportunity for all interested stakeholders to participate and raise concerns in an open and transparent proceeding, ensuring that the public interest is well-served.

## THE PRACTICALITY OF VOTING TRUSTS



As part of the merger process, voting trusts have been used in hundreds of transactions as effective insulation against the unlawful exercise of control over a railroad prior to STB approval. Without them, railroads would face a major

<sup>3</sup> Major Rail Consolidation Procedures, STB Ex Parte No. 582 (Sub-No. 1), at 44 (served June 11, 2001) (“Merger Rules Decision”).

<sup>4</sup> *Id.*, at 12 n.12.

<sup>5</sup> 49 C.F.R. § 1180.1.

<sup>6</sup> 49 U.S.C. § 11324(c) (“The Board shall approve and authorize a transaction under this section when it finds the transaction is consistent with the public interest”).

<sup>7</sup> 49 U.S.C. § 10101(2) (U.S. policy is “to minimize the need for Federal regulatory control over the rail transportation system”).

impediment to transactions involving more than one carrier and thus be at a severe disadvantage vis-à-vis non-rail bidders.<sup>8</sup> Voting trusts also protect against potential lessening of competition among carriers by placing the stock of one carrier in the hands of an independent trustee while the STB considers the transaction. In addition, voting trusts enable the target carrier's stockholders to receive consideration prior to regulatory approval, thus removing their exposure to regulatory risk during the STB process.

In 2001, due to concerns regarding the potential risk of financial harm to the carrier in trust in the event regulatory approval is denied and the carrier must be divested, the STB required that Class I applicants seek pre-approval following the submission of the notice of intent to file a merger application. To gain approval, applicants must show that the proposed trust would insulate the carrier in trust from unlawful control and would be consistent with the public interest.<sup>9</sup> Insulation from unlawful control is demonstrated by showing the voting trust is irrevocable and the trustee independent. The public interest standard is satisfied by showing either that the risk of financial harm from divestiture is low or that countervailing public benefits outweigh the risk.<sup>10</sup> The STB rules on such requests after a "brief" notice and comment period.<sup>11</sup>

In considering voting trust structures that also involve management swaps, the STB has focused on the risk to competition. Consistent with its mandate and policy to minimize regulatory control, the STB does not ordinarily intervene in personnel decisions and has rejected calls to do so in the context of a voting trust. If specific concerns regarding the potential for unlawful control can be demonstrated, the STB has relied on its authority to set conditions that address such concerns by limiting the types of communications and operations in which the swapped officers or directors can engage.<sup>12</sup> If the STB is concerned about future misconduct, the STB relies on the well-tested independent voting trust structure to prevent this possibility and the STB's oversight and enforcement authority to resolve such problems if they ever arise.<sup>13</sup>

Of the 144 voting trusts that have been used since the Staggers Act of 1980, none have been rejected despite several challenges, including some involving management swaps.

<sup>8</sup> See, e.g., *Water Trans. Ass'n v. ICC*, 715 F.2d 581, 586 (D.C. Cir. 1983) (holding that allowance of voting trust was consistent with policy to minimize need for Federal regulatory control as rejection would have foreclosed railroad from "common acquisition device of the tender offer" and could "foreclose acquisition entirely").

<sup>9</sup> See 49 CFR § 1180.4 (b)(4)(iv).

<sup>10</sup> Merger Rules Decision at 29.

<sup>11</sup> 49 CFR § 1180.4 (b)(4)(iv).

<sup>12</sup> See e.g., *Santa Fe Southern Pacific Corp.-Control-Southern Pacific Trans. Co.: Merger-The Atchison, Topeka And Santa Fe Ry Co. and Southern Pacific Trans. Co.*, 1983 ICC LEXIS 70, \*\*15-16 (Dec. 22, 1983) (refusing to prohibit management swap during voting trust which "under normal circumstances," ICC "would be powerless to prevent").

<sup>13</sup> *Id.* at 19 (finding concerns regarding potential exercise of unlawful control to be without merit "given the fact of a voting trust designed and monitored so as prevent impermissible cooperative action" and noting that ICC retained plenary authority to address specific problems).

This record largely reflects that the principles central to a voting trust – independence and irrevocability – were established many decades ago and are embodied in the STB’s regulations.<sup>14</sup>

## **CONGRESS ESTABLISHED THE STB AS AN INDEPENDENT AGENCY TO PROTECT AGAINST POLITICAL INFLUENCES**

The STB operates under the Staggers Act’s basic regulatory mandate to minimize regulatory control over the rail industry. In order to insulate the STB from political pressures causing deviation from this long-standing statutory mandate, Congress established the STB as a decisionally independent agency, albeit with administrative ties to the Department of Transportation (DOT). This independence remains central to the STB’s role. For example, during the Kansas City Southern and Texas Mexico Railway proposed merger hearings (July 31, 2003), then Chair Roger Nober stated that he was, “wary of attempts by competitors to politicize mergers. Congress made our Agency independent, and vested us with exclusive merger review authority to avoid precisely that circumstance, where merger review becomes subject to political influence.”<sup>15</sup>

In December 2015, Congress not only reauthorized the STB, but also strengthened its independence by severing its administrative ties to the DOT. Moreover, although news of the proposed CP-NS transaction was public, no changes were made to the STB merger policies. Clearly, Congress continues to have confidence in the STB to carry out its mandate on mergers.

## **CP’S APPROACH TO REGULATORY APPROVAL IS THOUGHTFUL AND COMPREHENSIVE**

CP has carefully reviewed the new STB merger rules and standards, including those of the voting trust structure, and has a thoughtful and comprehensive plan to address the regulatory process.

In general, the proposed CP-NS merger would more than satisfy the public interest standard by offering enhanced pro-shipper options, including elimination of bottleneck pricing and modified terminal access, and important public benefits, such as single line haul, access to new markets, improved asset utilization, routing efficiencies, and increased capacity.

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<sup>14</sup> 49 CFR Part 1013.

<sup>15</sup> Transcript of Public Hearing on Proposed “KCS-TEX MEX” Railroad Merger (July 31, 2003) (available at [www.stb.dot.gov](http://www.stb.dot.gov)).

As to downstream mergers, while CP believes that further consolidation is inevitable and necessary to support future economic growth, a combined CP-NS would still be smaller than both UP and the BNSF, and therefore creates no pressure on other carriers to merge in order to remain competitive. Instead, CP-NS would be better able to compete intermodally and intramodally, which in turn increases balanced competition as a whole. Like the CP-NS proposal, approval of any future downstream merger must be determined on its own merits to be in the “public interest”.

As to a voting trust, CP would structure one to meet the independence and irrevocability requirements. With regard to the public interest showing, CP is confident that in the unlikely event that divestiture is ordered because the merger is disapproved, it and the carrier-in-trust and both their customers and shareholders will be, at a minimum, in the same financial position they were when the trust was approved, and, indeed, that the more likely outcome would be that they all have benefited while the voting trust structure is in place. Consequently, the risk of harm from divestiture is quite low. In addition, CP is also confident that it can show several public benefits that would accrue to customers from approval of the trust structure, including reduced costs and increased efficiency and competitiveness of NS’ operations.

It has been suggested that the STB would entertain a declaratory order motion seeking an advanced indication on a voting structure that has not yet been agreed upon by CP and NS. It is difficult to imagine why the STB would expend valuable time and resources to address whether a voting trust could be used, when the STB’s own precedent and regulations provide well-established certainty as to how and when a voting trust will be approved. It is also difficult to imagine why the STB would entertain a hypothetical question about possible voting trust structure and related conditions,<sup>16</sup> when its own regulations set clear procedures for review of an actual, formulated voting trust presented to it for approval. As such, CP will not be seeking a declaratory order from the STB on a voting trust structure.

## **THE IMPORTANCE OF A FAIR AND OBJECTIVE STB REVIEW OF THE CP-NS PROPOSAL**

Under the new rules, a merger is in the “public interest” if there are “substantial and demonstrable gains in important public benefits.” Applicants are encouraged to propose provisions for “enhanced competition” in order “to assure a balance in favor of the public interest.”<sup>17</sup>

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<sup>16</sup> CP anticipates that the trust structure including management changes would be the subject of negotiations and agreement between the parties. In addition, voting trust decisions focus largely on the financial harm if divestiture is ordered. See Merger Rules Decision at 29. But NS financial data to calculate the necessary baseline and projected income and balance sheet financial statements for that analysis are unavailable to CP prior to a merger agreement.

<sup>17</sup> 49 CFR 1180.1(c).

**BMWED, BRS, SMART/MD EXHIBIT 4**

## CP Press Release 2/16

# Canadian Pacific to seek declaratory order from U.S. Surface Transportation Board

February 16, 2016

Canadian Pacific (TSX:CP) (NYSE:CP) today announced it will seek a declaratory order from the U.S. Surface Transportation Board (STB) confirming the viability of the voting trust structure that CP has suggested as part of its proposed merger with Norfolk Southern Corp. (NS). CP urges NS, consistent with its duties to its shareholders, to assist constructively in this effort, but intends to proceed regardless of NS's cooperation.

"While we remain fully confident in our comprehensive regulatory plan, shareholders of both CP and NS have recommended that we seek this declaratory order as a means to better understand the STB's views on the proposed voting trust model ahead of any formal application," said E. Hunter Harrison, CP's Chief Executive Officer. "We still think this action is unnecessary, however, we believe listening to the shareholders – the owners of our respective companies – is important."

Voting trusts have been used in hundreds of transactions involving regulated industries, including 144 transactions overseen by the STB since deregulation of the rail industry in 1980. Trusts, besides protecting against unlawful control violations, are a key means of reducing the risk that the regulatory approval process will either interfere with the marketplace's assessment of a merger or be used as a tool by management to fend off would be acquirers.

While the declaratory order presents a hypothetical proposed trust – outside the established STB procedure for seeking formal trust approval – CP is hopeful that the STB will be able to offer clear guidance that will satisfy shareholders' concerns before their voices are heard on CP's pending resolution.

Earlier this month, CP submitted a resolution to NS shareholders to ask their board of directors to meet with CP to discuss the clear benefits of a business combination that would create a true end-to-end transcontinental railroad that would enhance competition, benefit the public and drive economic growth.

"NS has cited supposed regulatory uncertainty regarding the voting trust model as a reason not to talk to CP, and NS proposed that we seek a declaratory order. We are skeptical that the STB will give a definitive ruling, especially when NS will not even sit down with us, but we are willing to go the extra mile if that is what it takes to get NS to the table," said Mr. Harrison.

CP strongly believes that a combined railroad would offer unparalleled customer service and competitive rates that will support the success of the shippers and industries it serves, and satisfy the STB and Canadian regulators.

For more information on CP's proposal to NS, visit [CPconsolidation.com](http://CPconsolidation.com).