

BEFORE THE
SURFACE TRANSPORTATION BOARD

Canadian Pacific Railway Limited—
Petition for Expedited Declaratory Order

Finance Docket No. 36004

REPLY OF
THE UNITED STATES DEPARTMENT OF JUSTICE

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The Department of Justice hereby replies to Canadian Pacific Railway Limited's petition for a declaratory order from the Surface Transportation Board (STB) regarding the use of a voting trust pending the STB's review of a possible merger between Canadian Pacific Railway Company (CP) and Norfolk Southern Railway Company (NS).¹ The acquiring firm, CP, not the acquired firm, NS, will be placed in trust.² In addition, CP's current CEO, Hunter Harrison, will take over the CEO position at NS,³ while the current President and COO of CP, Keith Creel (Mr. Harrison's handpicked successor), will become CP's new CEO.⁴ The STB should reject the proposed voting trust structure because it risks altering the competitive landscape between the two railroads and indeed the entire rail system in a way that could not be reversed if the STB rejects the merger.⁵

¹ See Decision, ID No. 45088.

² Petition for Expedited Declaratory Order, ID No. 240231, at 1 n.1 [hereinafter Petition].

³ *Id.* at 2 & n.2.

⁴ *Id.* at 9.

⁵ In the alternative, the STB should exercise its discretion to decline to decide CP's unilateral request for a declaratory order. The STB enjoys broad discretion when deciding whether to issue a declaratory order. See *Intercity Transp. Co. v. United States*, 737 F.2d 103, 107-08 (D.C. Cir. 1984). Here, not only is there no pending underlying merger approval request, but also CP admits that the STB will be forced to essentially re-decide the same issues if CP ever submits an actual voting trust application. See Petition at 2, 12-13. Moreover, to the extent that CP argues that the STB lacks sufficient information to decide anything other than what CP specifically requests, CP is essentially admitting that its petition is not ripe for review. See *id.* The STB would therefore be justified in declining to issue any declaratory order at this time.

Competition is the core organizing principle of America's economy,⁶ 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.⁷ The Antitrust 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 investigating and enforcing against antitrust violations that would constitute premature transfers of beneficial ownership or illegal premerger coordination. The Division has an interest in this petition for declaratory order because of the Attorney General's statutory right to intervene in Class I railroad merger proceedings. *See* 49 U.S.C. § 11325(b)(1).

In 2001, the STB strengthened its review of voting trusts in major railroad transactions by requiring the applicant to show that the voting trust will prevent an unlawful control violation and that it is in the public interest, a criterion that includes ensuring "effective competition."⁸ The STB has 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." *Major Rail Consolidation Procedures*, 2001 WL 648944, at *19 n.29; 5 S.T.B. 539, 568 n.29 (June 7, 2001). The Division agrees with the STB that voting trusts should not be used routinely, if at all, during the pendency of a merger review. As explained below, the specific proposal at issue here, which turns the "typical" voting trust on its head by putting the buyer's stock into trust and immediately effecting a management change in the target firm, is even more pernicious in its failure to preserve competition than a typical voting trust. Therefore, this voting trust cannot be justified as a rare occasion where it would be beneficial.

⁶ *See, e.g., N.C. State Bd. of Dental Exam'rs v. FTC*, 135 S. Ct. 1101, 1109 (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.").

⁷ *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.").

⁸ *See* 49 C.F.R. §§ 1180.1(b); 1180.4(b)(4)(iv). Control includes "actual control, legal control, and the power to exercise control, through or by (A) common directors, officers, stockholders, a voting trust, or a holding or investment company, or (B) any other means." 49 U.S.C. § 10102(3). In the major merger context, "[i]n determining the public interest, the Board must consider the various goals of effective competition, carrier safety and efficiency, adequate service for shippers, environmental safeguards, and fair working conditions for employees." 49 C.F.R. § 1180.1(b). "[M]ergers serve the public interest only when substantial and demonstrable gains in important public benefits—such as improved service and safety, enhanced competition, and greater economic efficiency—outweigh any anticompetitive effects, potential service disruptions, or other merger-related harms." *Id.* § 1180.1 (c); *see also* 49 U.S.C. § 11324(b) (listing public interest factors STB must consider in major railroad mergers).

In its petition, CP attempts to divorce two inexorably intertwined problems with its voting trust structure, asking the STB separately to consider (1) placing CP (the acquiring firm) in trust and (2) letting Mr. Harrison immediately take control of NS (the acquired firm). The STB should decline CP's invitation to consider each element of its petition in a vacuum.⁹ Similarly, although CP seeks to avoid an STB ruling on whether its voting trust proposal is consistent with the public interest,¹⁰ the STB should consider both unlawful control and the public interest, just as the revised regulation requires. *See* 49 C.F.R. § 1180.4(b)(4)(iv).

The STB should find that the proposal fails under each prong of the revised regulatory requirement—it creates unlawful control violations and is against the public interest. As described below, CP's voting trust and management transfer scheme risks interim competitive harm because it will immediately and irreversibly eliminate the independence of NS, effectively linking NS and CP prior to STB review of the proposed merger. The scheme will also make it difficult, if not impossible, for the STB to accomplish an effective divestiture if it denies the merger application.

1. The Proposed Voting Trust Risks Interim Competitive Harm

Today, CP and NS are independent companies. CP proposes to acquire NS, but before doing so, it seeks a declaration from the STB that blesses elements of a voting trust proposal that would give CP immediate control of NS, *before the STB has had a chance to decide whether giving CP that control is in the public interest*. The voting trust proposal risks harming competition pending merger review because it does not preserve either NS's or CP's independence, and both CP and NS will have the economic incentives and ability to pursue business strategies that align with each other to maximize value for their shared owner rather than each individual company's interests.

Unlike typical voting trusts where the acquired company is put into trust, CP proposes to put itself into trust and CP's current Chief Executive, Hunter Harrison, would take control of NS as its CEO. CP has indicated that such a move is intended to, and would indeed, strip NS of its independence and begin remaking NS immediately, before the STB has a chance to determine whether the merger will harm competition. Indeed, in its petition, CP explains that "Mr. Harrison can start the process of developing similar corporate cultures and operational practices [at NS] during the approval process."¹¹ In reality, then, CP hopes to use Mr. Harrison as its proxy to implement the changes it desires in NS.

⁹ *See* 5 U.S.C. § 554(e) (providing that agency "in its sound discretion, may issue a declaratory order to terminate a controversy or remove uncertainty," and *not* requiring agency to confine itself to answering the narrow questions presented by a party); *Wilson v. A.H. Belo Corp.*, 87 F.3d 393, 398 (9th Cir. 1996) (holding that agency "may issue a declaratory ruling *sua sponte*—even in the absence of any parties before it—to terminate a controversy or remove uncertainty").

¹⁰ *See* Petition at 12.

¹¹ Petition at 15.

Immediate implementation of CP's business strategies at NS is contrary to the public interest in preserving NS's independence during merger review. Preserving the acquired firm's independence pending merger review allows thoughtful consideration by a reviewing agency in determining the full competitive ramifications of a change in corporate control prior to implementation. In order to preserve such independence, the acquiring firm must not take beneficial ownership or operational control of the acquired firm until merger review is complete.¹² The Division has substantial experience with issues of unlawful premerger control, having filed numerous lawsuits based on that determination. *See, e.g.,* Complaint, *United States v. Qualcomm Inc.*, 2006-1 Trade Cas. (CCH) ¶75,195 (D.D.C. April 13, 2006) (Civ. No. 06-672) (alleging that the acquirer substituted its business interests and judgment for those of the acquired firm and exercised operational control over the acquired firm's business prior to completion of antitrust review); Complaint, *United States v. Input/Output, Inc.*, 1999 U.S. Dist. LEXIS 10222, 1999-1 Trade Cas. (CCH) ¶72,528 (D.D.C. May 13, 1999) (Civ. No. 99-912) (alleging that the acquiring firm installed a new management team and restructured business operations of the acquired firm prior to completion of antitrust review).¹³

Through Mr. Harrison's move to NS, CP's plan has the explicit purpose of substituting its interests and judgment for NS's and restructuring NS's operations during the pendency of the merger review.¹⁴ Mr. Harrison has stated that he plans to bring his "precision railroading" strategy to NS. His plans could include changes to NS's interchanges with other railroads or other efforts to change the competitive landscape of the railroad industry.¹⁵ Rather than implement Mr. Harrison's strategies, NS's current management has already developed an independent plan to improve efficiency by cutting costs by \$650 million by 2020.¹⁶ NS's independent proposal reportedly will involve cutting employees, decreasing overtime, consolidating two divisions, and ceasing operations on certain tracks.¹⁷ The STB should not allow CP to prevent NS from

¹² If an acquirer exercised operational control over the acquired company during a Department of Justice or Federal Trade Commission merger review, it would constitute a violation of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (commonly referred to as the "HSR Act"), 15 U.S.C. § 18a, and potentially be a violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, as well.

¹³ *See also* Complaint, *United States v. Flakeboard Am. Ltd.*, 2015 U.S. Dist. LEXIS 33629, 2015-1 Trade Cas. (CCH) ¶79,045 (N.D. Cal. Feb. 2, 2015) (Civ. No. 14-4949); Complaint, *United States v. Smithfield Foods, Inc.*, 2010 U.S. Dist. LEXIS 13457, 2010-1 Trade Cas. (CCH) ¶76,880 (D.D.C. Jan. 25, 2010) (Civ. No. 10-120); Complaint, *United States v. Gemstar-TV Guide Int'l, Inc.*, 2003 U.S. Dist. LEXIS 12494, 2003-2 Trade Cas. (CCH) ¶74,082 (D.D.C. July 11, 2003) (Civ. No. 03-198); Complaint, *United States v. Computer Associates Int'l, Inc.*, 2002 U.S. Dist. LEXIS 23039, 2002-2 Trade Cas. (CCH) ¶73,883 (D.D.C. Nov. 20, 2002) (Civ. No. 01-2062).

¹⁴ Thus, this situation is not analogous to NS independently seeking to hire a new executive and identifying Mr. Harrison as the successful candidate. Instead, CP will thrust him upon an unwilling NS.

¹⁵ *Cf. Flakeboard*, 2015-1 Trade Cas. (CCH) ¶79,045 (competitive impact statement) (noting that target firm's plant that closed during merger review was unlikely to reopen, even though merger was abandoned). Specific competitive harm is unknown at this time because the record is bereft of the information needed to analyze the full extent of competition between CP and NS.

¹⁶ *See* Norfolk Southern, *Executing on Our Strategy*, Feb. 2, 2016, http://www.sec.gov/Archives/edgar/data/702165/000070216516000155/nsbrochure_020216.htm.

¹⁷ *See* Jacob Bogue, *Troubles for trains as the demand for 'stuff' slows*, Washington Post, Feb. 3, 2016, https://www.washingtonpost.com/business/economy/troubles-for-trains-as-the-demand-for-stuff-slows/2016/02/03/0a812614-c907-11e5-a7b2-5a2f824b02c9_story.html.

independently pursuing its own, potentially procompetitive, plan during the pendency of the merger review. As the D.C. Circuit has acknowledged, interim competitive harm can result from the consummation of a transaction, even if the two companies are preserved as separate entities pending merger review, if “the acquired company was planning prior to the acquisition to embark on a new pro-competitive venture.”¹⁸

Changed management could also irrevocably alter NS’s relationships with its customers and employees. Mr. Harrison has stated, “I view my role as not simply to present a plan of how the railroad can be more efficiently and effectively operated, but also to bring about a culture change among employees at all levels.”¹⁹ CP’s petition treats these potentially drastic changes to NS as a positive feature of its proposed voting trust scheme, asserting that “[a] head start has the added benefit of aligning organizational cultures and operating practices.”²⁰ Such premature integration is contrary to the public interest in keeping the entities independent pending merger review.²¹

During the pendency of the STB’s merger review, it is also essential to maintain CP’s independence from NS and their joint parent company. CP’s proposal attempts to do so by placing CP in trust. However, this proposal fails to acknowledge that CP’s remaining management will continue pursuing the goals of its parent company, which will also own NS.

The Interstate Commerce Commission (ICC), the STB’s predecessor, has recognized that placing the acquiring railroad in trust suggests that there may be continued control of that railroad by the parent company, which holds an interest in both of the merging railroads. The current President and COO of CP, Keith Creel, has already been named the successor to Mr. Harrison after he moves to NS.²² Mr. Creel is Mr. Harrison’s protégé, having worked closely with him at CP for three years.²³ In announcing the planned change in leadership, Mr. Harrison explained that “[b]ehind me to step right in and not lose the beat is Keith Creel.”²⁴ By appointing Mr. Creel as CEO, CP contemplates continuity with current management continuing to run the

¹⁸ *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1086 (D.C. Cir. 1981) (R. B. Ginsburg, J.).

¹⁹ See Petition, Verified Statement of E. Hunter Harrison at 3.

²⁰ Petition at 23.

²¹ See S. Rep. No. 95-28, at 3 (1976) (explaining that, without effective premerger review, it can be “impossible to restore the competitive conditions that existed prior to the merger”). Importantly, if the STB approves this proposed voting trust arrangement, it will be difficult to ensure that NS maintains its independence by monitoring the voting trust and modifying its terms if problems arise because NS will not be the firm placed in trust. Moreover, even if the STB could impose conditions on NS or CP, these conditions could not prevent the risk of anticompetitive harm. Cf. *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1508 (D.C. Cir. 1986) (Bork, J.) (holding that, due to the possible transfer of confidential information, “even a severe hold separate order” was inadequate because “if an employee of [the merging parties], whether deliberately or inadvertently, violated the district court’s no transfer rule, or if the district court mistakenly approved an apparently innocent transfer, substantial irreparable harm might result”).

²² Petition at 9.

²³ *Executive Profile of Keith Creel*, <http://www.cpr.ca/en/about-cp/executive-profiles/keith-creel> (last visited Mar. 14, 2016).

²⁴ Canadian Pacific, *Transcript: CP Addresses the Financial Community*, Dec. 8, 2015, <https://www.sec.gov/Archives/edgar/data/16875/000119312515399120/d102114d425.htm> [hereinafter Dec. 8 Transcript].

railroad, but with knowledge of specific goals for integration with NS, as well as shared knowledge of Harrison's strategy for precision railroading and operation of the rail system.²⁵

The ICC expressed concern about a similar proposed voting trust between Illinois Central and Kansas City Southern. *Illinois Cent. Corp.—Common Control—Illinois Cent. R.R. Co. & the Kansas City S. Ry. Co.*, Fin. Doc. No. 32556, 1994 WL 575784, at *2 (ICC Oct. 19, 1994). The acquiring firm proposed to place its own railroad, Illinois Central, in trust and the ICC noted that:

[The] tendency to continue to maintain present operations also suggests that there may be continued control of [Illinois Central (ICRR)] by [the parent corporation (IC Corp)] notwithstanding the creation of the voting trust. ICRR has been under the control of IC Corp, and the managers of the railroad presumably know and understand IC Corp management. Tuned into IC Corp's business philosophy and plans, ICRR's management could anticipate IC Corp's desires. The trustee may be unable to alter this force of habit. The railroad's management might act, not in the interest of ICRR, but in the interest of the carrier's past and potentially future corporate parent, IC Corp. Thus it is conceivable that IC Corp may continue its control of ICRR during the trust period.

Id. at *4.²⁶ The STB's concerns in that case should also apply to CP's proposal.²⁷ Whoever CP's trustee would be, the proposal indicates that the railroad would be run by Mr. Creel and other subordinate current managers, who, as in *Illinois Central*, "know and understand" their ownership, are "tuned in" to the "business philosophy and plans" of their owners, and can "anticipate . . . desires" of the company's parent, which would also own NS.

The proposed voting trust also aligns the economic interests of both CP and NS, which risks further competitive harm during the pendency of the STB's review.²⁸ Under the voting trust, both companies' managers will have the incentive to maximize value for their shared owner

²⁵ See Canadian Pacific, *Transcript: CP Addresses the Financial Community*, Dec. 16, 2015, <http://www.sec.gov/Archives/edgar/data/16875/000119312515406416/d107888d425.htm> [hereinafter Dec. 16 Transcript] ("Keith is our — our designee CEO.").

²⁶ The transaction fell apart within a month of the ICC's request for comment, so the ICC never had the opportunity to provide its final views on the voting trust. See 1994 WL 617583 (ICC Nov. 3, 1994). See also *E. Tex. Motor Freight Lines, Inc.—Control & Merger—Consolidated Copperstate Lines*, 109 M.C.C. 213, 217-19 (ICC 1969) (finding unlawful control violation in motor carrier case where, inter alia, new owner suggested the new manager who was appointed by trustee).

²⁷ As the STB pointed out, there has been no instance in which the STB or its predecessor, the ICC, approved a similar premerger acquisition of control in a major railroad merger. Letter from Surface Transportation Board to Bob Goodlatte, Chairman, & Tom Marino, Subcommittee Chairman, Committee on the Judiciary, U.S. House of Representatives (Jan. 7, 2016) <https://www.stb.dot.gov/stb/docs/MergerLetters/STB%20Response%20to%20House%20Judiciary%20Committee%20January%202017.pdf>.

²⁸ CP and NS appear to compete head-to-head in a few geographic markets (e.g., the route between Chicago and Detroit and for hauls to and from Kansas City, Chicago, Detroit, and Buffalo). In addition, any coordination between CP and NS could hurt the rest of the railroad industry by foreclosing other railroads' ability to interchange or interline with CP or NS or lease rights on CP or NS railways.

rather than their individual company's interests. Absent the voting trust, NS's own shareholders would have an incentive to protect the independent value of NS's assets going forward in case the deal were to fall through. Once the merger closes and the voting trust is in place, NS's shareholders are no longer independent. NS's shareholders, who are now the same as CP's shareholders, will act in an economically rational way to maximize the profits for the combined firm.²⁹

For example, if NS 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 will choose to cooperate with CP because doing so will directly benefit NS's own shareholders. Importantly, the decisions NS and CP make during the pendency of the merger review may have long-term effects on competition and consumers. For instance, market participants have raised concern that NS will make decisions regarding new track construction and old track closure with an eye toward interchanging NS traffic with CP in the future.³⁰ Such decisions may be at the expense of interchanges with other railroads, even though these other interchanges may be better for NS's customers and NS itself. However, even if other railroads offer better terms than CP, Mr. Harrison and NS will be inclined to evaluate CP's proposal in light of having shared ownership (not to mention the hope that they will merge in the future). Given the lengthy lifespan of rail track and other infrastructure, these decisions have significant long-term impacts, regardless of the outcome of the STB's merger review.

This concern is heightened because Mr. Harrison has intimate, detailed knowledge of CP's most sensitive competitive confidential information, and NS, through Mr. Harrison, will immediately gain knowledge of CP's customers, contracts, pricing, and long-term and short-term plans.³¹ CP, through Mr. Creel, will know how NS will operate under Mr. Harrison. This threatens to undermine competition between NS and CP across the entire scope of the companies'

²⁹ 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).

³⁰ See, e.g., Reynolds Hutchins, *CP-NS merger would fuel biggest rail industry shake-up since Staggers Act*, *joc.com*, Jan. 26, 2016, http://www.joc.com/rail-intermodal/class-i-railroads/canadian-pacific-railway/cp-ns-merger-would-fuel-biggest-rail-industry-shake-staggers-act_20160126.html; Jeff Perlman, *Tension over proposed railroad M&A runs high among Class I players*, *Logistics Management*, Jan 14, 2016, <http://www.logisticsmgmt.com/article/tension-over-proposed-railroad-ma-runs-high-among-class-i-players>.

³¹ See Dec. 8 Transcript, *supra* note 24 (“Norfolk is really the railroad that requires the turnaround. And Hunter’s going to be there and that’s not going to be in trust. So, it’s less awkward to execute a turnaround at NS if it’s not in trust.”).

operations.³² Additionally, this is the type of competitive information that each of the new CEOs cannot unlearn or forget.³³

2. CP's Divestiture Plan Will Not Restore Independence

One of the STB's main concerns about voting trusts is the harm to the public interest associated with any divestiture. See *Major Rail Consolidation Procedures*, 2001 WL 648944, at *19; 5 S.T.B. at 567-68. In the proposed Illinois Central/Kansas City Southern voting trust, the ICC specifically noted that a party raised concerns about the voting trust structure making immediate changes to the target's management because "when the [ICC] finally addresses the [proposed merger], the agency will be presented with a *fait accompli*." *Illinois Cent. Corp.*, 1994 WL 575784, at *3. The voting trust proposal from CP similarly fails to preserve the STB's jurisdiction and ability to review and authorize mergers. If the STB rejects the merger application, a divestiture order would not restore competition because the divestiture plan will result in common ownership for an unknown period of time, the railroads will have had the incentive and ability to implement complementary plans during the pendency of merger review, potentially making any divestiture a *fait accompli*, and the transfer of confidential information cannot be corrected by divestiture.

If the STB ultimately rejects the merger, CP has laid out a divestiture plan that would spin CP off to the same shareholders that own NS.³⁴ It is a non-solution to a very real problem. It makes no sense to block the transaction on competition grounds yet sanction common ownership of both for the foreseeable future.

Overlapping ownership creates serious competitive concerns. As the Supreme Court has pointed out, 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].

³² For example, because NS will know CP's plans to service particular routes, offer certain terms to customers, or set up or deny interchanges to other railroads, NS can coordinate its decisions accordingly. As pointed out above, NS will have an incentive to coordinate its actions with CP. If the voting trust is established, the combined entity's shareholders will be earning profits on both firms pending the merger review.

³³ These effects are possible, even if all the parties involved endeavor to follow the STB's rules regarding unlawful control. To the extent that any party does not wish to follow the STB's rules, however, it would be difficult for the STB to effectively detect and punish violations.

³⁴ Dec. 16 Transcript, *supra* note 25 ("[If t]he STB does not approve the transaction, then the holding company CP-NS is going to have to separate CP from NS, and it will either spin CP to shareholders or spin NS to shareholders, but these will go back to being publicly traded companies [Y]ou get two new stock certificates in the mail, one for CP and one for NS and then you're done.").

United States v. E. I. du Pont de Nemours & Co., 366 U.S. 316, 331 (1961).

In addition, as explained above, by the time the STB denies a merger application, each company may have already implemented long-term strategic decisions that would not be rational absent unity of ownership.³⁵ The companies may even try to implement changes that make divestiture more difficult in an attempt to deter or prevent a divestiture order.

Finally, any divestiture is doomed to failure because the transfer of confidential information cannot be corrected through divestiture. The confidential information that Mr. Harrison would bring to NS and that Mr. Creel would retain from Mr. Harrison at CP cannot be unlearned.³⁶

3. *Voting Trusts in General Raise Serious Competitive Concerns*

Although this is a particularly egregious example of a voting trust inconsistent with the public interest, in the Antitrust Division's view voting trusts are insufficient to preserve competition during the pendency of merger review, and are highly likely to lead to continuing competitive concerns even if a successful divestiture can be accomplished.³⁷

When a company acquires its rival, the dynamics between the two companies are inextricably altered. "Whether held separately or not, the acquiring firm generally maximizes its profits by reducing competition with its new subsidiary." Areeda & Hovenkamp, *Antitrust Law*, ¶990 (2015).

³⁵ For example, if CP's management makes an economically rational decision that takes this unity of ownership into account (e.g., by building an interchange with NS, or at least taking a step towards doing so), this decision could come at the expense of CP's value as an independent railroad. Therefore, if CP was divested, it could be worth less as a standalone railroad.

³⁶ Cf. *FTC v. Weyerhaeuser Co.*, 665 F.2d 1072, 1086 (D.C. Cir. 1981) (R. B. Ginsburg, J.).

³⁷ See *Weyerhaeuser*, 665 F.2d at 1086. *Weyerhaeuser* established a presumption against entering hold separate orders in lieu of injunctions pending merger review. *Id.* at 1085-87; accord *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1507 (D.C. Cir. 1986) (Bork, J.). A hold separate order pending merger review is similar to an STB-style voting trust because both attempt to keep one merging company separate and independent from the other, despite a unity in ownership, during merger review. Because of the similarities between this form of hold separate order and a voting trust, the same competitive concerns apply.

The Division has also expressed skepticism about the ability of a hold-separate order to preserve competition pending completion of a divestiture. See 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>:

It is unrealistic . . . to think that a hold separate provision 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 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 agreement—valuable employees may leave and critical investments may not be made.

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.

Id. ¶1203 (internal citations omitted).

Allowing an acquisition to close through the implementation of a voting trust also increases the risks of coordination. As pointed out in Section 2 above, when the acquisition closes and one of the companies is placed in a voting trust, one company completely owns the other, so all of the two firms' profits go to the same owner or owners.

Further, the STB strengthened its review of voting trusts, in part, because of its divestiture concerns. See *Major Rail Consolidation Procedures*, 2001 WL 648944, at *19; 5 S.T.B. at 567-68. The STB is correct to be concerned about successful divestiture if a voting trust is utilized. The changed incentives that exist during the pendency of a voting trust may result in the company taking short and long-term 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 will be weaker than it would have been absent the merger, so competition will not be fully restored by divestiture. In the extreme case, it could even be a designed plan of the acquirer to diminish the competitive presence of its rival.

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 shareholders to invest in the newly divested company.

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

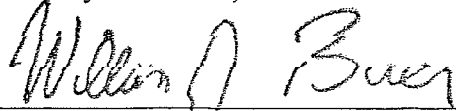
Major Rail Consolidation Procedures, 2001 WL 648944, at *19; 5 S.T.B. at 568. Alternatively, if the company's assets are divided among several smaller buyers, competition may not be fully restored. A major market participant would be lost, even if several smaller market participants become somewhat larger as a result. And, as discussed above, a shareholder spin-off presents other serious competitive concerns.

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 at the same time still preserving competition. Parties whose mergers are reviewed 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 of the agreement. In other words, merging parties can, and often do, implement other risk-shifting mechanisms to address regulatory risk, and those mechanisms present far less competitive concern. Therefore, the STB was right to limit the use of voting trusts to "rare occasions." *Major Rail Consolidation Procedures*, 2001 WL 648944, at *19 n.29; 5 S.T.B. at 568 n.29.

Conclusion

For the reasons given above, the Division believes that this voting trust is fundamentally flawed. It will not preserve NS or CP as an independent entity and will risk harm to current and future competition. Finally, a divestiture likely cannot successfully restore lost competition. Accordingly, the Division believes that this voting trust would create unlawful control violations and would be inconsistent with the public interest. The STB should reject the proposed voting trust and management transfer plan.³⁸

Respectfully Submitted,



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³⁸ In the alternative, the STB should decline to consider CP's request for declaratory relief. *See supra* note 5.

CERTIFICATE OF SERVICE

I hereby certify that I have caused a copy of the Reply of the United States Department of Justice to be served this 8th day of April, 2016, via first-class mail upon the following:

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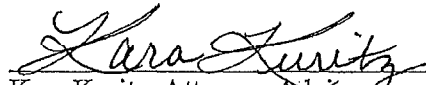
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