

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB FINANCE DOCKET NO. 36514

**CANADIAN NATIONAL RAILWAY COMPANY, GRAND TRUNK
CORPORATION, AND CN'S RAIL OPERATING SUBSIDIARIES – CONTROL
– KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY
COMPANY, GATEWAY EASTERN RAILWAY COMPANY, AND THE TEXAS
MEXICAN RAILWAY COMPANY**

APPLICANTS' RESPONSE TO DECISION NUMBER 4

Applicants Canadian National Railway Company (“CN”) and Kansas City Southern (“KCS”) respectfully submit the attached documents, which the Board directed Applicants to file in its June 8, 2021 Decision in the above-referenced docket (“Decision No. 4”).¹ Each of the documents was referenced in Applicants’ May 21, 2021 Merger Agreement, which was submitted as Exhibit 8 to Applicants’ pending Joint Motion for Approval of Voting Trust Agreement. In addition, Applicants are submitting a Verified Statement from Kansas City Southern Chief Financial Officer Michael W. Upchurch (“V.S. Upchurch”). In his Verified Statement, Mr. Upchurch provides information about KCS’s pre-existing capital allocation policy and explains that, given the independence established by the voting trust agreement, nothing during the pendency of the trust will adversely affect KCS’s commitment and ability to invest in its network. KCS will continue to

¹ See *Canadian National Railway Company, et al.—Control—Kansas City Southern et al.*, STB Finance Docket No. 36514, Decision No. 4 (served June 8, 2021).

have the freedom, flexibility, and resources to pursue its existing and forecasted robust capital expenditure program during the time period that KCS is held in trust.

1. “The written opinions of the financial advisors referenced in Section 4.16 of the Merger Agreement”²

Section 4.16 of the Merger Agreement states that J.P. Morgan Securities Canada Inc. (“JP Morgan”) and RBC Dominion Securities Inc. (“RBC”) had each provided CN’s Board of Directors with “written opinions, that, as of the date of the respective opinion and based upon and subject to the assumptions, limitations, qualifications and other matters stated therein, the Merger Consideration to be paid to the holders of Company Common Stock in the Merger pursuant to this Agreement is fair, from a financial point of view, to Parent [*i.e.*, CN].”³

Pursuant to Decision No. 4, Applicants have attached the written opinions referenced in Section 4.16 of the Merger Agreement as Exhibits 1 and 2. In addition, Applicants have attached as Exhibit 3 a third fairness opinion that was provided to the CN Board of Directors by Centerview Partners LLC, a separate financial advisor. All three fairness opinions have been designated Highly Confidential under the Protective Order entered in this Docket on April 28, 2021.

² Decision No. 4 at 3.

³ Joint Motion for Approval of Voting Trust, Ex. 8 at 42, *Canadian National Railway Company, et al.—Control—Kansas City Southern et al.*, STB Finance Docket No. 36514 (filed May 26, 2021) (“Merger Agreement”).

In a letter dated June 9, 2021,⁴ Canadian Pacific Railway Limited (“CP”) claims that the Board’s specific order that Applicants provide “the written opinions of the financial advisors referenced in Section 4.16” should not be interpreted to mean those written opinions, but instead should also extend to “backup,” “other related materials” provided to the boards of directors or management of either CN or KCS, and even “internal financial statements or projections.” CP claims that it seeks to “clarify” the scope of Decision No. 4, but it is plainly trying to rewrite it.⁵

The Board’s Decision needs no clarification. The Board specifically asked for the two written fairness opinions by RBC and JP Morgan referenced in Section 4.16.⁶ It did not ask for other materials that RBC, JP Morgan or other financial advisors provided to CN or for “internal financial statements or projections.” CP’s fishing expedition is far beyond the boundaries of the Board’s order.⁷

⁴ While CP dated its letter June 9 and apparently filed it with the Board on that date, CP did not serve Applicants with it until 10:30 AM on June 10.

⁵ CP did not seek reconsideration under 49 C.F.R. § 1115.3, which would be the only way to request such a substantial change in the Board’s Decision.

⁶ CN notes that the fairness opinions provided in Exhibits 1 through 3 are not “cover letters,” as CP claims, but rather the complete written fairness opinions specifically referred to in Section 4.16.

⁷ Moreover, CP’s attempt to rewrite the Board’s order is plainly self-serving. CP remains interested in acquiring KCS. CP is thus not a mere interested observer to this proceeding—it is an unsuccessful bidder actively trying to resuscitate its rejected merger. Allowing CP to see the materials and analysis that CN’s financial advisors provided to CN and that KCS’s financial advisors provided to KCS would reveal details of strategy and other proprietary and sensitive information that would give an extraordinarily unfair advantage to CP in its ongoing efforts. There is no public interest justification for such a request, only CP’s self-interest.

2. “The Debt Commitment Letters referenced in Section 4.17(a) of the Merger Agreement, including all exhibits and schedules.”⁸

Exhibit 4 is the fully executed Debt Commitment Letter referenced in Section 4.17(a) of the Merger Agreement, which was executed May 21, 2021 by CN, JP Morgan, and RBC. For completeness, Applicants are also enclosing as Exhibit 5 the Fee Letter referenced in Section 4.17(a) of the Merger Agreement. The fees in the Fee Letter have been redacted at the request of JP Morgan and RBC. Exhibits 4 and 5 are designated Highly Confidential under the April 28, 2021 Protective Order.

3. “Section 5.1 of the Company Disclosure Schedules referenced in Section 5.1(a) of the Merger Agreement, together with any other section(s) of the Company Disclosure Schedules that pertain to the Company Capital Allocation Policy referenced in Section 5.1(a) of the Merger Agreement and/or the “[KCS] pre-existing capital allocation policy” referenced in Applicants’ May 26 Motion.”⁹

Section 5.1 of the Company Disclosure Schedules is attached as Exhibit 6 and also designated Highly Confidential. Applicants note that Section 5.1(a) of the Company Disclosure Schedules contains the Company Capital Allocation Policy, and that Section 5.1(b) of the Company Disclosure Schedules contains the exceptions to the Conduct of Business covenants in the Merger Agreement.¹⁰ Because of the Board’s interest in KCS’s pre-existing capital allocation policy, KCS’s Chief Financial Officer Michael W. Upchurch has submitted a verified statement explaining KCS’s capital

⁸ Decision No. 4 at 3.

⁹ *Id.*

¹⁰ Section 5.1 is the only section of the Company Disclosure Schedules that pertains to the Company Capital Allocation Policy or KCS’s pre-existing capital allocation policy.

investment program and its ability to continue that program during the period it is held in trust.

Mr. Upchurch's statement explains that KCS is "very financially sound," and that it "compares very favorably to other Class I railroads in almost every important financial measure."¹¹ KCS's current free cash flow is more than sufficient to fund the long-range plan for capital investment adopted by its Board of Directors. As Mr. Upchurch explains, KCS will continue to pursue that capital investment plan during the trust period: "Under the Merger Agreement, KCS will have substantial cash, liquidity and access to capital markets during the trust period not only to meet our planned investment requirements as approved by our Board of Directors, but also the ability to far exceed that plan if required to do so."¹² In short, during the trust period KCS will continue to have ample resources and freedom to continue its preexisting capital investment strategy, and even to substantially increase capital expenditures if KCS independently decides that additional investments are warranted.

In this and every respect, the CN-KCS voting trust has been designed to ensure KCS's independence and freedom of action during the trust period, and to give CN and KCS the opportunity to demonstrate why they believe that a CN-KCS combination serves the public interests of enhancing competition; strengthening the North American rail network; and providing better service and more choice to CN and KCS customers.

¹¹ V.S. Upchurch at 3, 4.

¹² *Id.* at 7.

Respectfully submitted,

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Dated: June 14, 2021

CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of June, 2021, a copy of the foregoing Applicants' Response to Decision Number 4 was served by email or first class mail on the service list to Finance Docket No. 36514.

/s/ Matthew J. Warren
Matthew J. Warren

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SURFACE TRANSPORTATION BOARD**

FD 36514

**CANADIAN NATIONAL RAILWAY COMPANY, GRAND TRUNK CORPORATION,
AND CN'S RAIL OPERATING SUBSIDIARIES**

—CONTROL—

**KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY
COMPANY, GATEWAY EASTERN RAILWAY COMPANY, AND
THE TEXAS MEXICAN RAILWAY COMPANY**

VERIFIED STATEMENT OF MICHAEL W. UPCHURCH

BACKGROUND

My name is Michael W. Upchurch. I have been Executive Vice President and Chief Financial Officer for Kansas City Southern (KCS) since October 2008. KCS is a non-carrier holding company that owns and controls The Kansas City Southern Railway (KCSR), The Texas Mexican Railway (Tex Mex), Gateway Eastern Railway, Kansas City Southern de México (KCSM), and other non-rail subsidiaries. Previously, I was senior vice president financial management and purchasing. I joined KCS in March 2008. Prior to my tenure at KCS, I held various positions at Sprint, including as senior vice president – financial operations. I began my career with Price Waterhouse. I hold a bachelor of science in business administration with a major in accounting from Kansas State University and am a certified public accountant.

PURPOSE AND SUMMARY

The purpose of this Verified Statement is to provide background information with respect to the KCS-specific documents that are being submitted today in response to the Board's June 8, 2021 Decision in the above-referenced docket ("Decision No. 4"). Specifically, the Board

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requested Applicants to submit documents related to Section 5.1 of the Company Disclosure Schedules referenced in Section 5.1(a) of the Merger Agreement, together with any other section(s) of the Company Disclosure Schedules that pertain to KCS's capital allocation policy referenced in Section 5.1(a) of the Merger Agreement, including the KCS's capital allocation policy that existed prior to entering into a transaction agreement with CN (KCS's pre-existing capital allocation policies), which is referenced in Applicants' May 26 Motion.

As discussed herein, the Merger Agreement is designed to preserve KCS's pre-existing capital allocation policies during the trust period. It is also designed to ensure that during the trust period KCS will continue to have the freedom and the resources to pursue its existing and robust capital expenditure program without interference from CN. During the trust period, KCS will have substantial cash, liquidity and access to capital markets not only to meet our planned investment requirements consistent with the plan approved by our Board of Directors previous to any merger agreement with either CP or CN, but also the ability to far exceed that plan if it is necessary to do so.

Further, the CN trust agreement is the same as the trust agreement that the STB approved for CP in the Decision issued on May 6, 2021 in Finance Docket 36500. In that case, the STB found on page 10 that:

Here, the trust would preserve Kansas City Southern's existing management, with an independent board of directors and independent trustee; compensation programs would be in place to incentivize Kansas City Southern's management and employees to remain with the company and continue to achieve its independent business objectives; and the record contains no indication that, in the event that divestiture were required, the financial strength or operational capabilities of Kansas City Southern or Canadian Pacific would be compromised or that issues associated with such a process would be problematic for either entity.

In short the STB has already found that KCS would be financially strong if held in a trust like the one proposed by CN. I see no reason for a different conclusion with respect to the CN trust,

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especially given the protections in place in the Merger Agreement that allow KCS to undertake its pre-existing capital allocation plan.

The Board should expeditiously approve the CN voting trust. It is the same as the already approved CP trust. It has the same trustee. The Merger Agreement provides KCS with financial flexibility and freedom to undertake its capital and maintenance plans. Further, so far, over 1,400 stakeholders have supported the CN-KCS combination, voting trust, or both. KCS looks forward to approval of the trust and the opportunity to further present to the STB the substantial benefits of this transaction to our customers and the public.

I. KCS IS FINANCIALLY STRONG

I would like to initially point out that KCS is a very financially sound company with a strong credit rating and financial measures similar to many other Class 1 railroads. We are extremely proud of our vastly improved financial strength over the past 20 years. We have achieved this financial strength by focusing on disciplined financial principles to ensure the viability of KCS for many years into the future.

Since the Great Recession of 2008 and 2009, KCS has improved its credit rating assigned by Standard and Poor's from B+, to BBB, a six ratings category improvement, which puts KCS solidly in the investment grade category like all other Class I railroads. This movement within the investment-grade rankings represents unprecedented improvement in the Class I rail group over the past decade plus. During this period of time, KCS has nearly doubled its annual revenue; improved its operating ratio by nearly 20 percentage points; improved our free cash flows from a cumulative break even position for the period 2001 to 2015 to generating \$1.9 billion in cumulative free cash flow during the past 5 years; and improved our debt leverage ratio from over 4 times debt/EBITDA, to an expected 2-2.5 times leverage ratio by the end of 2021.

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KCS has also successfully managed its debt structure during this period. We currently have one of the lowest weighted average debt rates across our portfolio of debt obligations in the Class I rail industry at 3.9%. Our average maturities are 21 years, with no debt due until 2023. This provides KCS with substantial financial flexibility during the trust period. In fact, the 2023 debt maturities have been fully hedged from a Treasury Rate perspective with the hedges in place having a \$136 million profit at March 31, 2021. Our current plans are to refinance the 2023 debt maturities.

We improved our financial position without sacrificing capital investment. We have continued to invest in our core network to ensure a strong service and safety environment for our customers and employees, respectively, and we are committed to managing our balance sheet in a fashion that allows us to continue this strong financial position during the trust period. Indeed, KCS has significant financial resources available to fund continued operations and capital investments. Currently, KCS has in excess of \$300 million in cash on its balance sheet, and an undrawn revolving credit facility providing \$600 million of available credit.¹

In addition to the nearly \$1 billion in liquidity, KCS has ample access to the capital markets, as evidenced by our April 2020 debt issue of \$550 million during the world wide pandemic. In fact, investor demand for KCS newly issued debt was four times the notional deal size. KCS believes we have approximately \$2 billion of incremental debt capacity without jeopardizing our BBB credit rating.

As a result of all the measures we have taken, KCS compares very favorably to other Class I railroads in almost every important financial measure including revenue growth,

¹ KCS has already secured consent for the change of control from participating lenders. This ensures access to this liquidity continues through the voting trust period.

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operating ratio, EBITDA, EPS growth, free cash flow yields, debt leverage ratio, liquidity, interest coverage ratio, and funds from operations to debt ratio.

Today, KCS generates substantially more cash flow than is required for our annual investment needs. Specifically, in our last completed fiscal year KCS generated a record \$554 million of excess cash over and above our investment requirements (free cash flow) despite a decline in our revenue due to the world wide health pandemic. In 2021, KCS expects to generate at least \$700 million in free cash flow. We have more than sufficient access to capital to fund our three year capital investment plan.

II. THE MERGER AGREEMENT PROVIDES KCS WITH CONTINUED FLEXIBILITY TO UNDERTAKE ITS CAPITAL INVESTMENT PLANS

From my understanding of the Board's Decision No. 4, the Board appears to want to confirm that the Merger Agreement would not interfere with or limit KCS's capital investment plans. I want to unequivocally say that the Merger Agreement provides KCS with more than adequate resources to make continued capital investments consistent with the three-year, long-range plan that had been approved by the KCS Board of Directors before entering into a merger agreement with CN.

Section 5.1 (a) of the Merger Agreement with CN outlines the Company Capital Allocation Policy, which provides that "up to 40 to 50% of available cash (defined as net cash provided by operating activities) shall be used on a rolling four-quarter basis for capital projects and strategic investments." This is more than sufficient to fund KCS's capital needs as approved by the KCS Board of Directors prior to the merger and under a standalone company. This is also fully consistent with what KCS communicated to the investing public in November 2020 regarding what was necessary to meet our business goals. Under the Merger Agreement, KCS

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will also have access to \$600 million of available credit under its undrawn credit facility, plus access to the capital markets in the event we would be required to fund incremental investments.

In Schedule 5.1 (b) of the Company Disclosure Schedules of the Merger Agreement with CN, we are provided additional flexibility by CN to make necessary capital investments beyond what our Board of Directors approved in the KCS three year Long Range Plan (LRP).

Specifically, the CN Merger Agreement allows KCS to incur up to \$700 million in capital expenditures (per Article 5.1 (xiv)), and \$140 million in other investments. Cumulatively, this allowable level of investment for 2021 is \$840 million, or approximately 45% more than what KCS had originally planned to spend, as authorized by the KCS Board of Directors.

KCS's LRP provides for capital and other investments of {{ [REDACTED] }}
{{ [REDACTED] }} Subject to any unforeseen global economic conditions, we see no issues or concerns in our Merger Agreement with CN that would prevent KCS from making our planned investments. In fact, CN and KCS have ensured that, during the time period that KCS operates as an independent company in voting trust, we will have significant flexibility to increase our investment needs to support growth or other customer needs above our LRP, if KCS deems it necessary to do so.² CN has also committed, as outlined in Schedule 5.1(a)(4) and Schedule 5.1 (b), to provide additional flexibility to KCS to use its business judgment in making other financial decisions, such as increased compensation, loans to subsidiaries, employee retention obligations, severance arrangements, and annual incentive payments, among other things. Furthermore, while in trust, we are not contemplating any

² It is noteworthy to mention the CN Merger Agreement provides a level of flexibility for KCS to fund financial obligations at a minimum equal to, and in some cases more generous than the terminated Canadian Pacific merger agreement allowed. Because the STB has approved the CP voting trust under the CP merger agreement, and the CN Merger Agreement provides the same or better financial capability and flexibility, I can find no basis from a financial public interest standpoint to deny the CN voting trust.

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reductions to our capital investment programs as outlined in our three-year, long-range plan, and given the end to end nature of the CN-KCS network, we have no significant overlap in planned investments with CN's capital investment program that would provide KCS or CN with an incentive to not invest.

CONCLUSION

Under the Merger Agreement, KCS will have substantial cash, liquidity and access to capital markets during the trust period not only to meet our planned investment requirements as approved by our Board of Directors, but also the ability to far exceed that plan if required to do so. KCS should be in an exceptionally strong position to come out of trust even if the CN/KCS merger is not approved after STB review. We have full confidence in the merits of the transaction as proposed and look forward to the approval of the voting trust and then the STB process to evaluate the merits of the transaction. But, in the unfortunate circumstance of not being granted approval, for all of the reasons already noted, KCS would be in excellent financial position to continue as an independent company. KCS is financially healthier today than it has ever been; we expect to remain that way in trust and intend to continue to invest in accordance with our plans. There is nothing in the Merger Agreement that requires us to deviate from these plans, and the voting trust and Merger Agreement are fully consistent with KCS's plans as a standalone company. I would ask for expeditious approval of the voting trust.

VERIFICATION

I, Michael W. Upchurch, declare under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this statement.

Executed on this 14th day of June, 2021.



Michael W. Upchurch
Executive Vice President and Chief Financial
Officer for Kansas City Southern

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Exhibit 1

Written Fairness Opinion of J.P. Morgan Securities Canada, Inc.

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Exhibit 2

Written Fairness Opinion of RBC Dominion Securities, Inc.

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Exhibit 3

Written Fairness Opinion of Centerview Partners, LLC

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Exhibit 4

Debt Commitment Letter

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Exhibit 5

Fee Letter

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Exhibit 6

Disclosure Schedules Section 5.1

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