

Watershed

JASON SPILKIN OCTOBER 2025



The late legendary Ewing “Hunter” Harrison (“HH”) is gone but not forgotten. His ideology lives on at railway corporations across America, where his protégés still practice what he preached. HH pioneered “precision railroading”, an original operating model, which focuses on running trains on time (like passenger trains) as opposed to waiting until they are full to the brim. By defying conventional wisdom, HH was able to minimise “dwell time” in yards, enhance efficiency and reliability, boost volume, and reduce costs. He was the embodiment of a “railroader”, and in the industry there is no greater honour than to be known as one of them. HH had no ivy league MBA, only a high school diploma. His first job was a railcar oiler, and he climbed his way to the top of the corporate ladder the old-fashioned way, rung by rung.

Jim Vena, current Chief Executive Officer (“CEO”) of Union Pacific (“UNP”), has a much more impressive academic resume than his mentor. However, Vena learned to be a railroader, not in university halls, but peering over HH’s shoulder for 11 years at Canadian National (“CN”), where Vena enjoyed a 39-year career before retiring as Chief Operating Officer (“COO”) and crossing the border to Omaha, Nebraska.

In the United States, “class one” railroads refer to the long-haul networks, which focus on shipments of commodities, industrial products and shipping containers all the way from coastal ports to the interior and back. Back in the 1980s there were dozens of them, but over time they have consolidated to six today. There is little overlap regionally. UNP and Burlington Northern Santa Fe (“BNSF”) operate only in the western half. Norfolk Southern (“NS”) and CSX are located solely in the eastern states. CN and Canadian Pacific (“CP”) traverse the centre from Canada in the North to the Gulf coast in the South. Hence, on most routes, Class 1 rail is a duopoly business.

Until recently, most observers believed that the last ever Class 1 merger was consummated two years back, when CP acquired Kansas City Southern (“KCS”). The regulator allowed the transaction primarily because there was no network overlap. Also, it expanded CP’s network down the central traverse, south of Kansas and onto the Gulf coast and Mexico, removing an interchange, creating more competition on those routes.

However, in July this year, UNP and Norfolk Southern Corporation (“NSC”) announced their intention to merge, creating “America’s First Transcontinental Railroad”. Nearer term, the deal should be earnings accretive from the second year, which seems lacklustre. However, the longer-term acceleration in earnings growth seems compelling.

There are three possible ways a railroad can grow volumes: (1) increasing volume from existing customers, (2) winning new customers, and (3) extending network reach. This merger achieves all three, hence revenue synergies could persist longer term. UNP notes 95% of interchanges occur on routes of over 2,000 miles, evidencing that the extra time and cost of interchange renders rail unfeasible on shorter hauls. By removing interchanges, UNP could win new customers in so-called “watershed markets” - those sub-1,000 miles either side of the Mississippi river, where rail is not currently contemplated.

Cost synergies could play out over a much longer time horizon too, than a typical merger. To win union approval, UNP management has undertaken not to make any job cuts and rely solely on natural attrition to right size the labour force longer term. Worker attrition has proven to be a steady margin tailwind over much of the past two decades. By way of example, UNP’s network size has not changed from 2007 to 2022 and yet its labour force has reduced by 40% cumulatively (3.25% annually). Labour productivity (employee per carload) improved by over 25% over that 15-year period, which contributed to an almost 9 percentage points push in employee cost margin. Natural attrition typically runs at a mid-single digit rate annually, hence synergies will play out over time as all those interchange employees do not need to be replaced, i.e. jam tomorrow and not today.

The regulatory barriers remain the biggest hurdle. The legislation requires the Surface Transportation Board (“STB”) to determine whether a proposed merger is in the “public interest”, whereby the associated benefits outweigh the harms. Typically, the STB evaluates the effects on competition, customer service, investment, safety, employment and environmental impact. UNP has done their homework on the CP KCS deal and addressed those factors as best they can. Ultimately, it’s up to individual STB commissioners to decide and they were previously split 3-1 when approving the CP KCS deal.

If approved, the merger could benefit customers by eliminating costly interchanges, shave “a day or two” off transit times, providing a faster, more fluid and reliable, single line service, from coast to coast. It would also strengthen competition with trucking on shorter hauls, which would benefit the environment. UNP notes that “one intermodal train removes more than 550 trucks from the highway and is 75% more fuel-efficient”. Duplicated corporate overhead costs could be cut, some of which could be passed on to customers. Where UNP and NS networks overlap, UNP intends to mitigate the risk of customers losing access to two rail options by disposing of one line to a competitor, so as to guarantee two rail options. Vena points out that there are fewer than twenty affected customers and the overlap area is miniscule. Unsurprisingly, labour unions initially opposed the deal, notwithstanding UNP has guaranteed jobs for all their employees, including existing multi-year wage agreements, highlighting that they see the merger primarily as a growth play.

After the announcement, speculation simmered that Berkshire Hathaway (which owns BNSF) might bid for CSX, as similar synergies would be achievable, and not doing so would put BNSF at a competitive disadvantage against western competitor, UNP. Moreover, the STB might be more amenable to approving simultaneous mergers (to create a transcontinental duopoly) as opposed to just one (which would create a single transcontinental monopoly). However, Warren Buffet doesn’t like paying a premium, especially on top of a speculative rally. Berkshire subsequently announced that they were not in the market to buy another railway and rather entered an interchange partnership with CSX. Buffet is not just thrifty, but patient too. If the UNP NSC deal were approved, then BNSF, as part of the Berkshire behemoth, would be in a much stronger position to pounce on a scrawnier CSX.

Changes in the White House may have created a 4-year window of opportunity. President Trump’s administration is rampantly rolling back regulatory overreach, which they believe is throttling growth. Under former US President, Joe Biden, the proposed merger would probably have been prohibited. However, Vena has been schmoozing senior Trump officials in Washington and claims “they understand the value of what we are proposing... and they think it’s an absolute win for the country.” Trump’s business-friendly choice for STB chairman, Patrick Fuchs, plans to

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Primus believes his termination to be legally invalid and is exploring legal options. He won't have to wait long for clarity. The legislation states that the President may only remove a STB board member "for cause" – which there is not in this instance. However, the US Constitution, as interpreted by the Supreme Court ("SCOTUS"), trumps (pun intended) congressional legislation. To date, SCOTUS precedent has concurred that commissioners can only be fired for cause – ever since *Humphrey's Executor v. United States (1935)*. However, that precedent is being challenged by the administration at SCOTUS in a separate, but related matter. The President contends that the constitution gives him broad authority over the entire executive branch, hence he can fire any commissioner, at will and without cause. If Trump wins, it will overturn 90 years of precedent (and regulatory creep) and have implications for all "independent" agencies such as the STB and Federal Reserve, which were founded long after the constitution was first written in 1787. SCOTUS currently has a conservative majority, with a track record of overturning unconstitutional doctrine. Indeed, Justice Clarence Thomas noted recently, precedents are not "the gospel".

Vena claims he came to UNP with "a list of things to do, a plan of dreams, ideas and what's possible". His idea for a transcontinental railroad would, back then, have been on the list of dreams. Luckily, all the stars seem to have since aligned, and he will get his one and only chance. It is now or never. Vena seems confident the deal will be approved and so are we. It could be the crowning achievement of his 48-year career and forever etch his name, alongside his mentor, HH, as a "railroader". For Vena, there would be no greater honour. As UNP shareholders, we are holding our thumbs.



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