

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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HEARING ON REVENUE ADEQUACY

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RAILROAD REVENUE ADEQUACY

WRITTEN TESTIMONY OF CN

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The U.S. rail operating subsidiaries of Canadian National Railway Company, including Illinois Central Railroad Company, Wisconsin Central Ltd., Grand Trunk Western Railroad Company, and Bessemer & Lake Erie Railroad Company (hereafter “CN”)¹ respectfully submit these comments on the Notice of Public Hearing that the Board served on September 12, 2019 in the above-captioned proceedings.

Mr. Bernd Beyer, Vice-President and Treasurer, will testify on CN’s behalf at the Board’s upcoming hearing on December 12-13, 2019. Mr. Beyer oversees CN’s Treasury and Taxation activities. Prior to joining CN, Mr. Beyer spent 12 years with Rio Tinto, a leading global mining and metals company, where he held various positions including Regional Treasurer for the Americas. Mr. Beyer also has experience in the banking and accounting sectors, working with the Bank of Montréal and a major accounting firm in Montréal. Mr. Beyer’s experience offers a unique perspective on the financial needs of the rail industry. Mr. Beyer will be joined at the hearing by Kathryn Gainey, Counsel, US Regulatory Affairs and by outside counsel Matthew Warren.

CN is concerned that potential changes to regulatory policy regarding railroad revenue adequacy would have long-term negative consequences for CN and its rail customers. This is particularly true at a time when demand for rail transportation has softened. CN is dedicated to providing safe and reliable service to its customers and CN invests in its network, locomotives, railcars, and technology

¹ CN’s U.S. rail operating subsidiaries report to the Board on a consolidated, Class I basis under the name of Grand Trunk Corporation, CN’s U.S. holding company.

for the long run accordingly. To do so, CN relies upon a consistent regulatory environment that enables CN to make reasoned decisions about the risk and uncertainty inherent in any potential long-term investment. Changes that increase regulatory uncertainty and risk, including proposals that could restrict a railroad's ability to earn a return on its investments, could discourage such investments and make it harder for CN to compete with other industries to raise necessary capital in financial markets. That capital is necessary for CN to invest in its network and equipment to provide freight rail service for its customers, and CN is concerned that the effect would deteriorate CN's ability to invest.

I. CN's Investments in Its Network, Locomotives, and Railcars Benefit Its Customers

CN invests heavily in its network and equipment. CN needs to continue those investments to provide freight rail service for its customers, to promote network fluidity, and to build resiliency. Unlike many other transportation modes, a railroad must build, maintain, and expand its private network at its own cost. Building and maintaining such a private network is expensive and requires continuous capital to sustain service to rail customers and compete with alternative transportation modes—such as trucking companies—that utilize a federally-funded highway system as their network.

CN's ability to make smart long-term investments in its network and equipment is critical to its ability to provide good service for its freight rail customers. In 2018, CN invested 52% of its operating income into capital investments. Viewed differently, approximately 72% of CN's net income for 2018

was dedicated to capital investments. CN is on track to outpace those numbers in 2019. Strategic investments are required for a variety of reasons, including to improve network fluidity, fulfill federal regulatory requirements, rebuild aging infrastructure, and expand the company's footprint. In 2019 alone, CN has invested in each of those areas.

CN has improved network fluidity by constructing new sidings and siding extensions. Such sidings expand main line capacity, eliminate key pinch points, improve fluidity, and build resiliency. Sidings facilitate efficient train operations by allowing a train to pass another in a rolling meet in CN's mostly single-track network in the United States. Key investments include a new siding project at the international border in Ranier, Minnesota and double track in northern Wisconsin outside Superior.

CN has also invested significant resources to respond to customer demand. To accommodate growing intermodal traffic, we have added capacity, including in Memphis, Tennessee and Joliet, Illinois. CN has also acquired property for a new auto facility in Wisconsin to increase options for automotive customers and improve loaded railcar capacity into the northern Midwest markets.

CN is investing to serve customers in northern Minnesota and Wisconsin in the iron ore supply chain, including acquiring an additional rail/water dock facility in Duluth.

CN continues its substantial investment in Positive Train Control and plans to invest a total of \$1.5 billion to implement PTC on approximately 3,100 route

miles of track by 2020. To implement PTC in the United States, CN has constructed more than 1,600 new communications towers, and has installed centralized traffic control (CTC) on several line segments in conjunction with PTC implementation. The unfunded PTC mandate has required CN to make a massive commitment of capital resources that are not available for other important investments in its network or equipment.

CN also is rebuilding infrastructure throughout its network, including the St. Charles Airline bridges in Chicago and the Bonnet Carré Spillway bridge in Louisiana. Replacing the Bonnet Carré Spillway bridge is expected to be a multi-year infrastructure project that will cost in excess of \$75 million.

Additionally, as the Board is aware, CN has proposed to acquire the Massena Lines, which run through New York State, expanding its footprint in the United States through the addition of over 230 miles of track, which will maintain railway service in this area.

And 2019 marks the 10-year anniversary of CN's acquisition of the Elgin, Joliet and Eastern Railway (EJ&E), which created the fastest rail route around the congested Chicago terminal, improved interchange through the Chicago gateway, and reduced congestion for all railroads by moving more traffic out of Chicago from congested lines and onto the EJ&E. This acquisition allowed CN to reduce overall delivery times by approximately 24 hours and directly benefit customers whose freight moves via the Chicago terminal. Since the acquisition of the EJ&E, CN's trains now move twice as fast through Chicago. The purchase and integration of the

EJ&E involved investing hundreds of millions of dollars on infrastructure improvements, including a four-direction loop connection at Matteson, Illinois between CN's Chicago Subdivision and the EJ&E to allow seamless movements between those lines, and major upgrades to the EJ&E's Kirk Yard, which has become CN's principal yard facility in the Chicago terminal. These investments have enhanced service for our customers.

CN also has been investing heavily in equipment. As of the end of the third quarter, CN had accepted delivery of 135 new locomotives in 2019, with another five anticipated in Q4, for a total investment of approximately \$500 million. CN has also expanded its fleet of rail cars. In 2018, CN acquired nearly 1,000 centrebeam cars and over 600 boxcars to rejuvenate the fleets serving our forest products and metals customers. CN is also acquiring 1,000 new-generation higher capacity grain hopper cars over the next two years to replace aging equipment and meet the growing needs of our grain customers. CN received 500 of those new grain hopper cars, 325 additional new centrebeam cars, and an additional 430 boxcars in the first half of 2019. Acquisition of locomotives and cars supports CN's rail service for its customers as they work to grow their businesses.

CN is investing heavily in technology to enhance safety and to promote proactive repair of track and cars that will benefit network fluidity and keep goods moving. For example, CN has developed an autonomous track inspection program and automated car inspection portals, which will over time allow for earlier detection of track and car defects to increase safety and enable repairs to be

scheduled proactively before an urgent defect arises that requires track or cars to be taken out of service for repairs. Performing track and car inspections at track speed will enable CN to detect defects without impacting network fluidity, meaning that CN will be able to get product to our customers more safely and more efficiently. CN is excited about the opportunities these and other advanced technologies offer.

II. Rail Investments Take Time to Complete and Long-Term Certainty is Important to Incentivize Investment

All of these investments require long-term planning and financial certainty, as well as a reasoned assurance that CN will be able to realize an appropriate return on its investment. CNs investments typically are 40 or more year-long investments (assuming the average life of a locomotive or segment of track). While locomotives and cars may move around the network to adjust to demand, cars are often commodity-specific and rail infrastructure is immovable, all of which heightens the risk for rail investment. And investments in infrastructure, track, bridges, locomotives, and railcars can take years to complete. The permitting processes (for wetlands, for example) themselves can take years. Even after long-term planning and a commitment of resources to validate a proposed investment, any capital expenditure involves risk and uncertainty.

As an example, CN has invested heavily in rail infrastructure in Wisconsin to provide rail service to frac sand mines, in particular to convert what was manifest shipment traffic to unit train service. CN reconstructed long-inactive track on its Barron Subdivision, rehabilitated other track on its Whitehall Subdivision, and added thousands of feet in siding capacity to accommodate CN rail service from

Wisconsin to US-based oil basins as well as in Western Canada for frac sand producers to meet projected customer demand. CN also added yard capacity and a new crew reporting location in Blair, Wisconsin. The frac sand market, however, has encountered structural challenges from shale oil volatility and decisions by some US-based and Canadian energy companies to source sand locally, contributing to unforeseen risks and lessening the value of CN's previous investment. In recent years, local sands have come into the marketplace and displaced frac sand from Wisconsin mines, reducing demand for Wisconsin frac sand. CN relied on projected demand for Wisconsin frac sand several years earlier in making its rail infrastructure investment determinations. Those investments are largely sunk costs, for one cannot simply pick up an improved rail line and move it to a different location. These inherent characteristics of rail investments increase the risk to rail carriers of sudden changes in markets. While CN remains committed to continue working with CN served frac sand producers, terminal operators, well service companies and energy producers, this example highlights the risk involved in rail investments.

Like investments in track, CN's investments in locomotives and cars take time to implement. It can take multiple years for a vendor to complete an order of new locomotives or new cars. By the time a railroad receives the locomotives and cars it has ordered, the question becomes whether customer demand has changed. In response to increased customer demand in December 2017, CN ordered 260 new locomotives from GE Transportation in Fort Worth, Texas. At more than \$500

million, it was CN's largest new locomotive purchase order since 2012, and it was GE's largest order since 2014. The first locomotives did not arrive until July 2018, and CN had to lease locomotives to immediately boost locomotive capacity during the interim. By the time the order was close to being completed in 2019, overall demand for rail transportation had softened.

III. Increased Regulatory Uncertainty Could Undermine a Railroad's Ability to Compete for Capital to Finance These Investments

Another aspect of planning for investments is the need for CN to compete in the financial markets and maintain our credit. As with other companies who compete for capital on the financial markets, CN relies upon investors to help fund these important projects. A substantial portion of these investors are long-term investors on the bond markets, who are investing on a thirty-year timeline. Regulatory certainty is particularly important to these investors, as is an understanding that the regulator is committed to allowing railroads to earn a reasonable return on infrastructure investments. CN is particularly concerned that the "revenue adequacy" suggestions in the Rate Reform Task Force report being considered by the Board at the oral argument could make a railroad like CN a riskier investment and thus less attractive to investors. This could make it more difficult or expensive for CN to raise the capital it needs to deliver new and innovative transportation solutions to its customers and to invest in its infrastructure to safely move product across North America. If investors perceive railroads as facing a higher risk of not being able to earn a reasonable return on their investments, then those investors may begin to offset that risk by demanding

higher returns in the form of increased interest rates. Higher interest rates would increase the cost of capital for a railroad and ultimately our costs.

IV. Increased Regulatory Uncertainty Could Undermine a Railroad's Internal Decision to Proceed With Any Given Investment

As described above, many of CN's investments are long-term projects that take years to implement from conception to implementation. Regulatory uncertainty could increase the risk of these projects and make it more difficult internally for CN to decide to proceed with any given investment.

The Board's policies should mitigate—rather than exacerbate—the risks that a railroad confronts in making decisions about investments in its network and equipment that will benefit freight rail customers. Added regulatory uncertainty could heighten the risk of investment in the railroad while also increasing the risk for the railroad in pursuing new investment in its network and equipment. This will result in fewer capital projects. In the long term, such uncertainty will negatively impact network fluidity, customer service, and the overall competitiveness of freight rail as a transportation option in the United States.

The Board's proposals are coming at a time when demand for freight rail transportation has decreased. Indeed, North American railroads, including CN are all facing headwinds, with quarterly volume growth slowing in 2019 compared to the prior year. Uncertainty regarding US trade negotiations and tariffs has contributed to a softening of rail volumes. Added regulatory conditions imposed upon the industry's ability to earn and keep revenues would be particularly ill-timed.

V. The RRTF's Revenue Adequacy Proposals Would Not Provide A Forum For Small Rate Cases at the Board

CN understands the desire of the Board to re-examine its rate reasonableness processes to ensure that the Board is available to a small customer that wants to challenge a railroad's rate in a small case. CN appreciates the good faith efforts of the Rate Reform Task Force to think creatively to identify potential changes to the Board's rate case methodologies. However, given the potential ramifications for the freight rail network upon which customers depend, CN respectfully suggests that the Board's efforts would be best directed toward identifying ways to improve and streamline its existing rate case methodologies, while also exploring ways to improve its procedures for alternative dispute resolution. CN requests that the Board not make any regulatory changes that could impact CN's ability to continue to make investments into its network that benefit not only CN, but our customers, their end users, the national economy, and the communities in which we operate.

Respectfully submitted,

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