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October 30, 2006

By Electronic Filing

Honorable Vernon A. Williams, Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Ex Parte No. 665, *Rail Transportation of Grain*

Dear Mr. Williams:

Pursuant to the Board's decision in the above-entitled proceeding, served October 11, 2006, Canadian National Railway Company ("CN") submits for the record the enclosed comments.

Sincerely,

A handwritten signature in cursive script that reads 'Theodore K. Kalick'.

Theodore K. Kalick

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE NO. 665

RAIL TRANSPORTATION OF GRAIN

**COMMENTS OF
CANADIAN NATIONAL RAILWAY COMPANY.**

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CANADIAN NATIONAL RAILWAY COMPANY**

On October 6, 2006, the U.S. Government Accountability Office (GAO) issued a report on rates, competition, and capacity issues in the American rail industry. Among other things, GAO reported that, since enactment of the Staggers Rail Act of 1980, the financial health of the industry has improved substantially as railroads have reduced costs and greatly improved productivity. As a result, GAO reported that rail rates have generally declined since 1985.

However, GAO observed that, contrary to this trend, grain rates have increased by 9 percent from 1985 to 2004, and that the amount of grain traffic with comparatively high mark-ups over variable costs also increased during that period. As a result, the STB called a public hearing seeking information and views about market conditions for grain transportation by rail that may have led to GAO's observations. As part of its inquiry, the Board also invited information regarding "the interplay between American and Canadian wheat markets, how the Canadian regulatory system differs from the American system, and what impact these differences might have on grain production in the United States." *STB Decision*, Oct. 11, 2006, at 2. CN welcomes the opportunity to comment.

CN has an extensive rail network that accesses the major grain production regions in the U.S. Midwest, Eastern Canada, and Western Canada and provides grain transportation within the United States, within Canada, and between Canada and the U.S. CN's U.S. grain business consists of corn, soybeans, soybean meal, and various oils, sweeteners, and starches, while in Canada it transports wheat, barley, canola, peas, and various processed products. CN participates in domestic North American markets transporting grain to domestic feedlots, millers, oilseed crushers, and corn processors. We also transport grain destined to offshore export markets via grain terminal facilities located in the United States at the Gulf ports of New Orleans, LA, and Mobile, AL, and in Canada at the ports of Prince Rupert, BC, Vancouver, BC, Churchill, MB, Thunder Bay, ON, Montreal and Quebec City, QC. In 2005, shipments of grain, other crops, and processed products represented 12 percent of CN's carloads and 9 percent of revenues, with export shipments to ports accounting for 43 percent of CN's grain volume.

From a broad perspective, CN would point out that North American railroads are only one of numerous players in the globally driven market for grain, and that in any year, farmers, origin elevators, grain companies, destination elevators, freight forwarders, ocean-shipping companies, purchasers (foreign and domestic), as well as railroads, can affect the flow of grain, the price for grain, and the price to move grain. Grain production and movement demand are extremely volatile, with output in any year dictated by any number of factors. Especially in Western Canada, annual crop production is driven principally by the weather, and particularly by levels of moisture and heat.

Railroads, on the other hand, have extensive capital requirements and, as the Board has long recognized, carriers cannot be expected – nor could they afford – to make investments in infrastructure and capacity to cover peak years that do not occur with regularity. Nonetheless, railroads already extensively invest in grain-carrying capacity, and, given the variable and seasonal nature of the grain business, rail prices must reflect the risk that this capacity will not be fully utilized.

Additionally, the grain transportation markets in which CN operates are highly competitive. In the U.S., CN competes extensively with barge transportation on grain traffic to the Gulf of Mexico, and most corn and soybean processing facilities that CN serves have more than one railroad accessing their facilities and are often truck competitive as well. And in Canada, much of the grain business, and particularly that in Western Canada moving for export, can competitively originate on either CN or CP's grain-gathering network.

For all of these reasons, rather than exhibiting possible abuses of market power, CN would submit that the rather moderate grain rate increases reported by GAO that have been experienced over the last 20 years reflect, as even GAO suggests may be the case, a reasonable operation of the rail transportation market.¹ *GAO Report*, at 3, 43.

Because of the multiplicity of variables, it would likewise be difficult to draw any conclusions on the impact of grain production in the United States as a result of any interplay between the American and Canadian wheat markets and different regulatory frameworks. Western Canadian wheat is marketed differently than American wheat, as

¹ We would point out that the 9-percent increase in grain rates reported by GAO for this period is the nominal increase in grain rates. *GAO Report*, at 9 n.6. On an inflation-adjusted basis, real rates for grain have declined.

there are fundamental and complex differences in wheat marketing institutions, policies and practices north of the border, foremost those surrounding the Canadian Wheat Board (CWB). Virtually all wheat is sold through the CWB, in essence the sole sales and marketing representative for western Canadian producers. All CWB sales revenues are pooled, with the proceeds distributed to farmers after the crop year.

Beyond agricultural policy differences, there remains a much higher degree of regulatory involvement in Canada in the transportation of grain. The revenues that CN and CP can earn for grain traffic moving to Canadian ports for export are subject to a yearly revenue cap – an average revenue per ton – that we cannot exceed for all of the grain traffic that moves on certain routes in the course of that crop year.

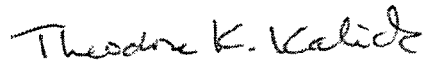
Also, unlike in the United States, there is a long tradition in Canada of government investment in the grain transportation system. The Canadian government historically made investments in grain-dependent branch lines, and constrained railroads from actions to divest such lines, even if unprofitable. It is only relatively recently that railroads in Canada have gained more discretion to rationalize their grain-gathering network in response to traffic levels.

Similarly, between 1970 and 1985, the Canadian government, the CWB, and the provincial governments of Alberta and Saskatchewan acquired more than 19,000 covered hopper cars. These cars still form the majority of the rail car fleet used to move western Canadian grain. The government-owned cars in Canada are 26 years old, on average, and smaller – some considerably smaller – than modern cars in the U.S. fleet.

In any given year, any of these factors may have some impact in relation to U.S. grain production. While, as noted above, it would be difficult to draw any conclusion

about the impact of the different regulatory frameworks or the interplay between the U.S. and Canadian wheat markets on U.S. grain production, CN does believe that, over time, the Canadian regulatory environment for grain transportation and the uncertainty surrounding it will continue to create additional risk for the Canadian railroads in making capital investments in grain-carrying capacity.

Respectfully submitted,



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