

HARKINS CUNNINGHAM LLP

Attorneys at Law

David A. Hirsh
202.973.7606
dhirsh@harkinscunningham.com

1700 K Street, N.W.
Suite 400
Washington, D.C. 20006-3804
Telephone 202.973.7600
Facsimile 202.973.7610

April 4, 2007

BY E-MAIL (saddler@stb.dot.gov)

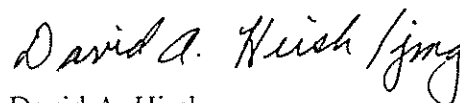
The Honorable Vernon A. Williams, Secretary
Surface Transportation Board
Office of the Secretary
1925 K Street, N.W.
Washington, DC 20423-0001

Re: *Rail Capacity and Infrastructure Requirements* (STB Ex Parte No. 671)

Dear Secretary Williams:

Canadian National Railway Company and its U.S. rail carrier subsidiaries (collectively, "CN") hereby submit this Statement in response to the Board's Notice served in this proceeding on March 6, 2007.

Very truly yours,



David A. Hirsh

Enclosure

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 671

RAIL CAPACITY AND INFRASTRUCTURE REQUIREMENTS

**STATEMENT OF
CANADIAN NATIONAL RAILWAY COMPANY**

Sean Finn
Senior Vice-President Public Affairs,
Chief Legal Officer and Corporate Secretary
CANADIAN NATIONAL RAILWAY
COMPANY
P.O. Box 8100
Montréal, PQ H3B 2M9
(514) 399-6500

Paul A. Cunningham
David A. Hirsh
HARKINS CUNNINGHAM LLP
1700 K Street, N.W., Suite 400
Washington, DC 20006-3804
(202) 973-7600

Theodore K. Kalick
CANADIAN NATIONAL RAILWAY
COMPANY
Suite 500, North Building
601 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 347-7840

Counsel for Canadian National Railway Company

April 4, 2007

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB Ex Parte No. 671

RAIL CAPACITY AND INFRASTRUCTURE REQUIREMENTS

**STATEMENT OF
CANADIAN NATIONAL RAILWAY COMPANY**

Canadian National Railway Company (and its U.S. rail carrier subsidiaries) (collectively, "CN") hereby submits this statement in response to the Board's notice served March 6, 2007, in the above-captioned proceeding ("Notice"). That Notice solicits views and information on: (i) freight traffic forecasts; (ii) capacity constraints and the ability of the railroads to meet rising demand for their services; (iii) infrastructure investment needs; (iv) possible solutions to the challenges presented by growing rail traffic; and (v) the potential role of public-private partnerships and innovative financing in meeting those challenges. Notice at 2.

CN applauds the Board's efforts to focus attention and gather information on the growing need for rail capacity in the United States and to examine the ways in which the Board can best facilitate rail carrier efforts to meet that need. As discussed below, CN believes it can continue to meet the challenges posed by growing freight volumes. It cannot be expected to do so, however, unless regulatory policies make it prudent and economic for it to invest the tremendous amounts of capital that will be necessary to expand rail capacity. CN also sees a role for public-private partnerships and innovative financing techniques in meeting infrastructure investment needs.

A. Through significant infrastructure investment, capital initiatives, and network management, CN has been successful to date in meeting the challenges of increased demand for its rail freight services.

The overall demand for rail freight services is projected to grow sharply in the coming years. The U.S. Department of Transportation predicted in 2002 that demand for domestic and foreign rail freight transportation would increase 55 percent by the year 2020,¹ while in 2003 the American Association of State Highway and Transportation Officials (“AASHTO”) projected rail freight tonnage growth of almost 44 percent by that date.² Earlier this year, in its report on *Future Needs of the U.S. Surface Transportation System*, AASHTO projected rail tonnage growth of 63 percent by 2035.³

CN has been meeting growing demands for its services. Between 2004 and 2005, partially as a result of acquisitions, CN’s system-wide revenue ton-miles increased over 3%, from 174,240 million to 179,701 million. This trend continued in 2006 (even with no further acquisitions), when CN’s revenue ton-miles increased again by over 3%, to 185,610 million.

Although the railroad business will always be cyclical in nature, CN sees significant areas where it expects to participate in handling additional freight traffic. In intermodal, for example, the planned opening of the Prince Rupert Intermodal Terminal on the Pacific Coast of Canada in the fourth quarter of 2007 will position CN to increase its participation in the growing container trade between Asia and North America and backhaul opportunities in return. In other areas, such as bulk commodities, merchandise,

¹ Federal Highway Administration, *Freight Analysis Framework* (Oct. 2002), FHWA-OP-03-006(R).

² AASHTO, *Freight-Rail Bottom Line Report*, at 2 (2003).

³ AASHTO, *Future Needs of the U.S. Surface Transportation System*, at 18 (2007).

and automotive, plus increasing opportunities to leverage its rail franchise through its new global forwarding subsidiary, CN Worldwide, for traffic originating in Europe and South America as well as Asia, CN sees additional opportunities to handle increased traffic.

Using its scheduled railroad model, CN has been able to date to handle additional volumes of traffic both efficiently and without significant service problems or capacity constraints. On-time performance during 2006 in CN's carload business, which is measured against a tight compliance window, reached close to 90% across CN's network (and 95% in the U.S.), in spite of harsh winter weather conditions at various times throughout the year. Further, average car velocity (the number of miles traveled per day from origin to destination) and average dwell time (the average car time in terminals between arrival and departure) each improved by 10% in 2006 compared with 2005.

CN has been able to maintain the fluidity and performance required to provide a high level of service to its shippers through a combination of significant infrastructure investment, capital initiatives, and network management. CN's capital-spending program is aimed at ensuring that its infrastructure is sufficient to meet customer needs. In 2006, CN's capital expenditures totaled more than \$1.5 billion system-wide, representing 20% of CN's revenues.⁴ Over \$270 million of that was used in the United States. At the end of last year, CN announced its intention to increase capital spending in 2007 to \$1.6 billion, with almost \$335 million allocated to the United States.

CN is careful to invest its capital dollars strategically in an effort to obtain the greatest benefit for its expenditures. One example is CN's siding extension and line

⁴ Capital expenditure figures are stated in Canadian dollars.

capacity improvement program, which is designed to eliminate pinch points, to upgrade signals, and to improve velocity throughout the CN network. Longer sidings result in fewer train-starts, reduced dispatching, maintenance and crew costs, and increased network fluidity. By the end of 2006, CN had invested nearly \$300 million for these improvements, of which roughly \$80 million was spent in 2006.

During 2006, CN also announced a \$115 million project to rebuild and upgrade CN's Johnston Yard freight switching facility in Memphis. This facility has experienced steadily increasing traffic volumes in recent years, and this investment will position Johnston Yard to handle existing traffic and future traffic growth in the region efficiently. The project is expected to be completed in 2008.

CN has also invested heavily in an effort to improve its rail yard efficiency, which has important implications for overall network efficiency. A major part of that effort is CN's development of SmartYard[®], a computer program that helps to reduce dwell time and support schedule integrity. SmartYard[®] consists of two modules: Workload Planner[®], which creates, communicates and continuously updates the car processing plan for all users; and SmartAnalyst[®], which identifies and analyzes every possible combination and outcome for sequencing cars. Once SmartYard[®] has been rolled out to CN's yards, another element of SmartYard[®] will be introduced – Dynamic Track Assignment[®] – which is designed to optimize classification-track capacity in coordination with the other modules. Once fully implemented these systems are expected to reduce transit times and further improve the reliability of CN's service.

Finally, in addition to capital investments, CN has tackled the challenge of handling increased traffic volume by working with other railroads to improve the

performance of the overall North American rail network through various initiatives intended to promote efficient, fluid freight movements throughout the system. CN announced in 2004 and 2005 a series of bilateral routing protocol agreements with its four major U.S. interline partners. These routing protocols serve to reduce costs industry-wide by placing rail traffic on the most efficient and least congested route, regardless of ownership. This improves both transit times and asset utilization, thereby making more efficient use of existing capacity. CN currently has routing protocol arrangements in place with CSX Transportation, Inc., Union Pacific Railroad Co., BNSF Railway Co., and Norfolk Southern Railway Co. It also has various co-production agreements in Canada with Canadian Pacific Railway Ltd.

Compliance with the routing protocols reached 98 percent during 2006. As a result, 200,000 railcars annually are moving on more efficient, less congested gateways, with resulting benefits to the overall rail system. CN believes that similar collaborative efforts among the carriers can produce similar kinds of capacity-adding efficiencies.

B. Through its decisions and actions, the Board will play an important role in CN's and the railroad industry's efforts to meet the demands of projected traffic increases.

With the United States facing a critical need for additional investments by the major railroads in network infrastructure, it is more important than ever for the Board to recognize the importance of providing the railroads with the opportunity to earn adequate revenues on a sustained basis and of allowing the railroads to operate their networks efficiently, without unnecessary regulatory interference.

Under the Board's revenue adequacy analysis, the railroad industry in the United States as a whole has been revenue inadequate since adoption of the Staggers Rail Act in

1980. During the past few years, however, industry performance has begun to improve to the point where some carriers have begun to earn their cost of capital on a short-term basis. With improved financial results and increased demand for freight rail service, CN and other major carriers have begun increasing capital expenditures beyond already high levels to provide for the infrastructure investments required to meet this growing demand.

Unfortunately, the improved financial results of certain carriers have led to calls in some quarters for regulatory changes that would effectively penalize the railroads for making progress toward long-term revenue adequacy and undermine the railroads' incentives and ability to continue to invest in their networks. Many of these arguments are currently before the Board in pending rulemakings. In Ex Parte No. 575, *Review of Rail Access and Competition Issues – Renewed Petition of the Western Coal Traffic League*, for example, shippers are encouraging the Board to interfere with and diminish the value of the Class I carriers' networks by overriding their arm's-length agreements to sell or lease lines to short-line operators. In Ex Parte No. 664, *Methodology to Be Employed in Determining the Railroad Industry's Cost of Capital*, shippers are seeking to have the Board jettison the well-established Discounted Cash Flow methodology that has been used successfully for the past twenty years to make annual cost of capital determinations. In Ex Parte No. 646 (Sub-No. 1), *Simplified Standards for Rail Rate Cases*, shippers are encouraging the Board to regulate as much traffic as possible under the crude Three Benchmark approach, which would not adequately take into account the need for the railroads to achieve sustained revenue adequacy.

Given the growing need for rail freight capacity, one of the most important things the Board can do is assure that its decisions in these proceedings are fully consistent with

the statutory goal of promoting long-term railroad revenue adequacy as well as the goals of eliminating unnecessary federal regulation and allowing, to the maximum extent possible, competition and demand to dictate reasonable rates. 49 U.S.C. § 10101(1)-(3).

Some of the very real choices facing the Board and other regulators that could have substantial impacts on the ability and incentives for carriers to make continued infrastructure investments may be illustrated by considering movements of hazardous materials such as toxic-by-inhalation hazards (“TIHs”). As CN discussed at length in Ex Parte No. 646 (Sub-No. 1), numerous new safety and security restrictions are now or will likely soon be imposed by the Department of Homeland Security’s Transportation Security Administration (“TSA”) and USDOT’s Pipeline and Hazardous Materials Safety Administration (“PHMSA”) on rail movements of these commodities.⁵ Given the added cost and intrusiveness of some of these proposals, it is critical that they be carefully tailored to the purposes they are intended to serve. The Board may be able to play a useful role in sensitizing these other agencies to the very real costs and inefficiencies of some of their proposals.

The Board is also confronting in Ex Parte No. 646 (Sub-No. 1) the important related issue of whether or not to permit adjustments in small rate cases to system-average costs produced by the Uniform Rail Costing System in order to permit consideration of the rapidly rising costs involved in the transportation of hazardous

⁵ See Rail Transportation Security, Docket No. TSA-2006-26514, 71 Fed. Reg. 76,852 (proposed Dec. 21, 2006) (to be codified at 49 C.F.R. Parts 1520, 1580); Hazardous Materials: Enhancing Rail Transportation Safety and Security for Hazardous Materials Shipments, Docket No. RSPA-04-18730 (HM-232E), 71 Fed. Reg. 76,834 (proposed Dec. 21, 2006) (to be codified at 49 C.F.R. Parts 172, 174).

materials.⁶ As it previously indicated, CN believes it is imperative for the Board to allow for consideration of these real and increasing costs and that the failure to do so would inappropriately elevate simplicity over accuracy. More to the point for purposes of this proceeding, doing so would invite rate litigation that could drain rail carriers' resources and constrain rail carrier pricing in ways that are contrary to statutory requirements and the Board's policies in support of sustained rail carrier revenue adequacy and continued investment in rail infrastructure.

Apart from its economic regulation of railroads, there are other measures that the Board might take to promote future investment in needed rail capacity. For example, the Board might consider organizing efforts by the railroads and shippers to project future traffic growth over capacity-constrained lanes. This could help lead to efforts to direct investment dollars more efficiently. In addition, as the agency charged with economic regulatory oversight of the nation's railroads, the Board could also lend its expertise and support to the use of public-private partnerships and innovative financing tools that include the use of public funds to pay for the public benefits generated from rail infrastructure investments.

Finally, in addition to ongoing efforts by individual States and local jurisdictions to promote increased Amtrak and commuter rail service on freight railroads' infrastructure, there is Congressional interest in providing additional operating rights and preferences for commuter rail lines operating over the freight network similar to those provided to Amtrak. As with the proposed TSA and PHMSA security and safety

⁶ Although the proceeding is no longer pending, a similar issue concerning whether to permit adjustments to system-average URCS costs was presented in Ex Parte No. 657 (Sub-No. 1), *Major Issues In Rail Rate Cases* (STB decision served Feb. 27, 2006), which is currently on appeal.

regulations for TIH movements, the Board can play a significant role in educating the relevant legislative committees on the impact such proposals may have on carrier efficiencies and investment incentives, the importance of ensuring that freight rail operations are not impeded, and the need for such proposals to be carefully tailored.

C. CN favors the appropriate use of public-private partnerships and innovative financing tools.

Public-private partnerships and other innovative financing techniques such as publicly subsidized loans, loan guarantees, or tax incentives can play a useful role in promoting freight railroad infrastructure improvement projects. Used appropriately, these approaches make good economic and policy sense because of the high cost of railroad infrastructure projects, the mix of public and private benefits they bring, and the benefits of close cooperation in the planning and execution of such projects. Some of the many public benefits that may be realized from rail infrastructure projects include reduced pollution (since railroads are environmentally friendly and more fuel efficient than trucks), reduced highway congestion, new or enhanced passenger rail services, improved safety, and faster and more efficient freight transportation itself. As AASHTO concluded based on an analysis of various scenarios with different levels of rail infrastructure investment made over 20 years, “relatively small public investments in the nation’s freight railroads can be leveraged into relatively large public benefits for the nation’s highway infrastructure, highway users, and freight shippers.”⁷

CN believes, however, that public-private partnerships, like the CREATE Project as originally conceived, should adhere to three key principles. First, they should be used only where there is a mix of public and private benefits from a project, or where

⁷ AASHTO, *Freight-Rail Bottom Line Report*, at 1.

significant efficiencies can be realized by coordinating public and private infrastructure changes. Second, the cost of public funding should be proportionate to the public benefits produced. Third, public funding for such projects should not provide a competitive benefit for one rail carrier over another.

Like public-private partnerships, other innovative financing mechanisms, such as Federal or State tax incentives, loans, loan guarantees, and lines of credit, can also play a useful role in promoting rail infrastructure programs. These include existing programs such as the Transportation Infrastructure Financing and Innovation Act (“TIFIA”), which provides federal credit assistance for infrastructure projects, and the Railroad Rehabilitation and Improvement Financing Program (“RRIF”), which provides loans and loan guarantees for such projects. It also includes proposals such as the Freight Rail Infrastructure Capacity Expansion Act of 2006, which was introduced as a bill in Congress last year⁸ and is expected to be reintroduced this year. That bill called for a 25% federal tax credit for investment in new track, intermodal facilities, yards, locomotives, and other rail infrastructure projects that expand rail capacity.

CN believes such innovative financing programs should likewise adhere to the same three basic principles outlined above and thus are appropriate only so long as public benefits will be produced, public funding will be proportionate to public benefits, and their structure and administration is such that the financing is available on equal terms to all similarly situated rail carriers and is not used to provide an unfair competitive benefit for one rail carrier over another.

⁸ S. 3742, 109th Cong. (2d Sess. 2006).

Conclusion

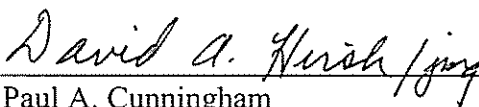
Through the use of significant, targeted investments and strong management, CN has been meeting and can continue to meet the challenges posed by projected increases in freight traffic. CN's efforts and those of the other freight railroads can be best supported by policies that provide railroads with an opportunity to earn their cost of capital on a sustained basis and minimize interference with the railroad's efficient operation of their own networks. In addition, CN supports the appropriate use of public-private partnerships and innovative financing to help meet the future transportation needs of the public and the shipping community.

Respectfully submitted,

Sean Finn
Senior Vice-President Public Affairs,
Chief Legal Officer and Corporate Secretary
CANADIAN NATIONAL RAILWAY
COMPANY
P.O. Box 8100
Montréal, PQ H3B 2M9
(514) 399-6500

Theodore K. Kalick
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Suite 500, North Building
601 Pennsylvania Ave., N.W.
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