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SERVICE DATE - NOVEMBER 7, 2001

SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 33556 (Sub-No. 4)[1]

CANADIAN NATIONAL RAILWAY COMPANY, GRAND TRUNK CORPORATION,
AND GRAND TRUNK WESTERN RAILROAD INCORPORATED
— CONTROL —
ILLINOIS CENTRAL CORPORATION,
ILLINOIS CENTRAL RAILROAD COMPANY,
CHICAGO, CENTRAL AND PACIFIC RAILROAD COMPANY,
AND CEDAR RIVER RAILROAD COMPANY

[GENERAL OVERSIGHT]

Decision No. 3

Decided: November 5, 2001

This decision addresses the report and comment filed in the second annual round of the CN/IC general oversight proceeding. Our review of the record indicates that, during the second year of oversight, there continue to be no competitive or other problems resulting from the merger. In view of our findings, we are seeking comments on whether this general oversight proceeding should be discontinued.

BACKGROUND

In 1999, in CN/IC Dec. No. 37, we approved, subject to various conditions: (1) the acquisition, by Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated (collectively CN), of control of Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central & Pacific Railroad Company, and Cedar River Railroad Company (collectively IC); and (2) the integration of the rail operations of CN and IC.

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[1] This decision embraces STB Finance Docket No. 33556, Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated — Control — Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central and Pacific Railroad Company, and Cedar River Railroad Company (CN/IC), for the purpose of addressing the pleading filed on June 7, 2001, by Larry G. Thornton entitled "Brief on Appeal Concerning STB Finance Docket No. 33556." See CN/IC, Decision No. 37 (STB served May 25, 1999) (CN/IC Dec. No. 37).

In our decision, we established general oversight for a period of up to 5 years so that we might assess the competitiveness of service provided by CN/IC and KCS under the Alliance Agreement[2] and the effectiveness of the various conditions we imposed. We reserved jurisdiction to implement the oversight condition and, if necessary, to impose additional conditions and/or to take other action to address matters respecting the CN/IC control transaction. See CN/IC Dec. No. 37, slip op. at 8 (item 8), 39-40, 56 (ordering paragraph 1). Accordingly, in a decision served and published in the Federal Register on March 9, 2000,[3] we instituted this proceeding to implement the general oversight condition. We required CN to file a CN/IC progress report and invited interested persons to comment on both the status of the transaction and the effects of the various conditions we imposed.

In response to CN's first progress report, comments were filed by eight parties, including the United States Department of Transportation (DOT). In our first oversight decision, we found that the integration of CN and IC had been successful to date and had not resulted in service failures or produced any evidence or allegation of anticompetitive behavior by CN/IC or by the parties to the CN/IC/KCS Alliance Agreement. See CN/IC Oversight, Decision No. 2 (STB served Nov. 29, 2000), slip op. at 5. Although we did not find significant problems with the CN/IC transaction, we continued the general oversight proceeding by requiring CN to file a second annual progress report and by giving interested parties the opportunity to file comments. Id. at 6-7.

On June 7, 2001, Larry G. Thornton filed an appeal to CN/IC Dec No. 37 entitled "Brief on Appeal Concerning STB Finance Docket No. 33556" and, on June 18 and July 13, 2001, he filed amendments to his prior filings.[4] CN filed its second progress report (CN-4) on July 2,

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[2] In CN/IC Dec. No. 37, The Kansas City Southern Railway Company and Gateway Western Railway Company, and all other wholly owned subsidiaries of Kansas City Southern Industries, Inc., were referred to collectively as KCS. As explained in that decision, CN, IC, and KCS entered into a settlement agreement on April 15, 1998, that was referred to as the Alliance Agreement or the CN/IC/KCS Alliance Agreement, and CN and KCS entered into another settlement agreement on April 15, 1998, referred to as the Access Agreement, portions of which amount to an addendum to the Alliance Agreement. See CN/IC Dec. No. 37, slip. op. at 14-18.

[3] See Canadian National Railway Company, Grand Trunk Corporation, and Grand Trunk Western Railroad Incorporated — Control — Illinois Central Corporation, Illinois Central Railroad Company, Chicago, Central and Pacific Railroad Company, and Cedar River Railroad Company (General Oversight), STB Finance Docket No. 33556 (Sub-No. 4), Decision No. 1 (STB served and published on March 9, 2000 (65 FR 12623-24)) (CN/IC Oversight).

[4] We note that our rules require appeals to be filed 20 days after the service date of the (continued...)

2001. Only one party, DOT, commented on CN's report. In its comment (DOT-3 filed August 17, 2001), DOT indicates that CN and the Federal Railroad Administration (FRA) continue to work together to ensure a safe and smooth implementation of the CN/IC merger and that, while it is still too early to reach definitive conclusions regarding the transaction, the record thus far indicates that CN and IC have managed their combination successfully. On September 4, 2001, CN filed its reply (CN-5) and DOT filed its reply (DOT-4).[5]

DISCUSSION AND CONCLUSIONS

Overview. CN's progress report submitted in the second oversight year demonstrates that the CN/IC transaction has been successful to date and that the carrier has added new transportation services and improved transit times throughout its system. CN also demonstrates that safety has not been compromised and that labor relations with employees of CN and IC remain on good terms. In the only comment to CN's progress report, DOT states that the record so far indicates that CN has successfully managed its combination with IC.

Moreover, there is no evidence of anticompetitive conduct by the CN/IC system or by the parties to the CN/IC/KCS Alliance Agreement. CN indicates that Alliance Agreement traffic continues to grow and that competition between CN and KCS is vigorous and increasing in the areas where the Alliance Agreement is in effect, particularly in the Baton Rouge-Geismar-New Orleans corridor. CN states that, by selling its interest in the Detroit River Tunnel and transferring operational control to Canadian Pacific Railway Company (CP), it has resolved outstanding concerns regarding the tunnel. According to CN, the Chicago gateway remains open

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[4](...continued)
Board's action; however, Mr. Thornton's appeal was filed more than a year after we issued our decision approving the CN/IC transaction. Nevertheless, we have considered Mr. Thornton's appeal. Mr. Thornton, a former general chairman of the Brotherhood Railway Carmen Division/ Transportation Communications International Union (BRC/TCIU) and an "individual citizen," complains that certain officials of his labor union "colluded and conspired" with Grand Trunk Western Railroad and CN to deprive local members of BRC/TCIU of seniority rights and other New York Dock labor protective benefits. Mr. Thornton also states that he has filed a court action against TCIU and that arbitration is not appropriate because his complaint is against the local union. In our view, Mr. Thornton's complaint is an intra-union matter best resolved internally by the members of his particular union or, if that fails, in court. We therefore are denying Mr. Thornton's appeal.

[5] In its reply (DOT-4), DOT notes that there have been no comments or complaints of service problems, anticompetitive behavior, or unfulfilled representations. DOT states that, although there is no evidence to support any change in the conditions originally imposed, the Board should continue to oversee the long-term implications of the CN/IC transaction.

for North Dakota grain shippers, there have been no complaints regarding lumber pricing practices, and it continues to comply with all environmental conditions imposed by the Board in the CN/IC proceeding. The record on the whole does not show any competitive or other problems stemming from the combination of IC into CN's system.

Comments on Continuation of General Oversight. Our oversight during the first and second years has revealed no significant problems following implementation of the CN/IC merger. The only comment filed in the second year (DOT-3) was positive. While DOT in its reply (DOT-4) urges us to continue to oversee the long-term implications of the merger, we have authority independent of the formal oversight process to enforce or revise merger conditions as warranted upon request or on our own initiative. Therefore, in view of the overall affirmative record in this proceeding, we have preliminarily concluded that our general oversight of the CN/IC transaction should cease. There does not appear to be an evidentiary reason for continuing formal oversight for the full 5-year term or, for that matter, the next year (the third year). Before making a final determination on this issue, however, we will seek comments on whether this general oversight proceeding should be discontinued. Any comments will be fully considered in reaching our decision.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. Comments of interested parties on whether this general oversight proceeding should continue are due November 27, 2001. Replies will be due December 7, 2001.

2. The appeal of Larry G. Thornton in STB Finance Docket No. 33556 is denied.

3. This decision is effective on the date of service.

By the Board, Chairman Morgan, Vice Chairman Clyburn, and Commissioner Burkes.

Vernon A. Williams
Secretary

APPENDIX

The CN-4 Progress Report. According to CN, the integration of CN and IC has progressed smoothly at every stage and the combined railroad continues to deliver efficient, single-line service for shippers. CN states that, during the second oversight year, it has added new transportation services and improved transit times and the utilization of cars and locomotives. CN reports that it continues to have the best operating ratio in the industry and that it has improved safety performance in its railroad operations in Canada and the United States.

During the second year of merged operations, CN indicates that its most significant undertaking was the implementation of a single information technology (IT) system throughout its rail network. The carrier's transfer to a single system—CN's Service Reliability Strategy (SRS)Control—occurred on October 1, 2000, without any disruption in rail service. According to CN, SRS is a set of advanced computer programs that allows it to operate a scheduled transportation service and to track each car or intermodal unit with an accuracy rate of 99.8%. To achieve a smooth transition, CN indicates that it chose a methodical, step-by-step approach featuring training, testing, and rehearsing to ensure that its employees were familiar with the system before it was implemented.

In addition, CN reports that it has instituted a combined system for revenue management, crew assignment, and timekeeping. CN reports that this project—its new Integrated Systems and Processes (ISP) system—provides the platform for financial, supply management, and human resources functions and was introduced across the company on January 8, 2001.

CN states that rail shippers are benefitted by its improved routing through Chicago, advanced traffic management systems, and seamless single-line service. CN states that it is a significant carrier of petroleum, chemicals, metals, minerals, forest products, automobiles, and grain, and that its intermodal business is expanding through faster transit times and the introduction of new services such as RoadRailer. According to CN, it has continued to focus on providing top quality service and avoiding any service disruptions. During the past year, CN indicates that its on-time dock-to-dock performance across its U.S. network has consistently exceeded 90%. CN also reports that, although it has been able to take 5,000 cars out of active service due to increased efficiencies, its systemwide carload volume has increased by 9% during the past year.

CN reports that it works closely with the Federal Railroad Administration (FRA) to ensure that the remaining action plans in its Safety Integration Plan Accountabilities (SIPA) are implemented effectively. According to CN, the FRA reports twice a year to the Board and, in its most recent report, the FRA concluded " . . . CN-IC continues to make good progress on the SIPA items." Since the merger, CN notes that safety in its U.S. operations has continued to improve and that, for the year 2000, the carrier's IC and Duluth, Winnipeg and Pacific operations again won E.H. Harriman Memorial Safety Awards.

In cooperation with its employee unions, CN states that it has adopted a consolidated and standardized set of work rules and practices to promote a safer working environment for all of its employees. CN also indicates that it has concluded 12 implementing agreements with unions representing CN and IC workers and that each of the agreements was reached voluntarily without resort to contract "override" provisions.

During the past year, CN states that it made significant progress with respect to the oversight conditions imposed by the Board when it approved the merger. According to CN, the Board asked for additional oversight information in six areas that were either conditions to, or of concern with respect to, the CN/IC transaction. These areas are: operation of the Detroit River Tunnel; the Alliance Agreement, particularly with respect to competition in the Baton Rouge-New Orleans corridor; appropriate labor protection should unauthorized control through the Alliance Agreement occur; continued access for North Dakota grain shippers to the Chicago gateway; merger-related pricing practices in the lumber industry; and environmental compliance.

According to CN, it has resolved outstanding concerns regarding the Detroit River Tunnel, then owned by a partnership in which CN and CP each held a 50% interest. CP's concerns centered on the allegation that CN would inhibit improvements to the tunnel, placing traffic through that route at a disadvantage to traffic moving through the CN-owned St. Clair Tunnel. In response, CN committed that it would not block any proposed improvements to the tunnel and that it would be willing to sell its interest at fair market value. In its report, CN maintains that CP's concerns regarding the Detroit River Tunnel were satisfied when, in February 2001, it sold its interest in the tunnel to Borealis Transportation Investment Trust, which is controlled by the Ontario Municipal Employees Retirement System. CN states that CP continues to hold a half interest in the tunnel, that CP is in the process of replacing CN as the operator of the tunnel, and that CN, along with CSX Transportation, Inc. and Norfolk Southern Railway Company, continue to hold trackage rights permitting them to run trains through the tunnel.

Through KCS and its affiliates, CN states that its Alliance Agreement gives it access to Mexico's largest rail system, effectively linking all three NAFTA nations. CN reports that Alliance Agreement traffic (defined as carloads carried by CN, IC and KCS or IC and KCS) grew 19.8% in 1999 and that, while the growth rate slowed in 2000 to 9.8%, traffic moving into and out of Mexico grew by 54% with an increasing proportion of more profitable business. At the Alliance Agreement's principal interchange at Jackson, MS, CN indicates that traffic forwarded from CN and IC to KCS grew by 46% in 1999 compared to 1998, but declined by 2% percent in 2000. CN states, however, that growth in traffic interchanged at Springfield, IL, and St. Louis, MO, more than offset the decline in traffic moving via Jackson.

CN asserts that, under the Alliance Agreement, strong rail-to-rail competition continues to exist in the Baton Rouge-Geismar-New Orleans corridor at points served by both IC and KCS. According to CN, for same origin-destination-commodity movements into and out of these points, rates per carload on CN/IC movements during 1999 and 2000 declined compared to 1998 rates. Beginning on October 1, 2000, CN reports that KCS gained access to CN traffic in the Geismar area under a haulage agreement with CN and that CN experienced both rate compression and traffic diversion as a result of KCS's competition. As further evidence of increased competition between KCS and CN in the New Orleans-Baton Rouge corridor, CN indicates that it recently filed a petition with the Board for authority to construct a 3.2-mile rail line to the ExxonMobil Chemical Company polyolefins plant in north Baton Rouge, one of the largest producers of polypropylene in the world that is currently solely served by KCS.

CN notes that, while North Dakota grain shippers raised a concern of foreclosure of the Chicago gateway for grain originating on CP for export via the Gulf, the Board agreed with CN that there was no incentive to ignore North Dakota grain traffic by closing the gateway or discouraging CP's participation. According to CN, the Chicago gateway remains open and CN has not increased its revenue requirements (divisions) for traffic received at Chicago. CN states that its division formula remains unchanged since 1995. Of the 1,189 carloads of North Dakota grain handled through the Chicago gateway for the full year 2000, CN reports 230 interchanged with CP; during the first quarter of 2001, of 474 carloads, CN reports 117 interchanged with CP.

CN states that, during the CN/IC proceeding, certain parties alleged that Canadian lumber producers had engaged in unfair pricing practices concerning transportation provided by CN, which had adversely impacted U.S. lumber wholesalers. In addressing the matter, the Board stated that, while there was insufficient evidence to substantiate the allegation, it would retain the right to impose oversight conditions to remedy any merger-related actions that would harm the U.S. lumber industry.[6] In its report, CN states that it is not aware of any complaints of unfair pricing practices in the lumber industry related to the CN/IC transaction, nor of any action taken by the United States Department of Justice or the Federal Trade Commission concerning these allegations.

As regards environmental conditions, CN reports that it continues to comply with all of the conditions imposed by the Board in the CN/IC control proceeding. CN specifically outlines its compliance with respect to hazardous material transportation (Condition Nos. 1 through 7), environmental justice (Conditions Nos. 8, 9 and 10), construction (Conditions Nos. 11 and 12), safety integration (Condition Nos. 13 and 14), and monitoring and enforcement (Condition No. 15).

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1 [6] See CN/IC Dec. No. 37, slip op. at 39.