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SERVICE DATE - NOVEMBER 29, 2000

SURFACE TRANSPORTATION BOARD

STB Finance Docket No. 33556 (Sub-No. 4)

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. 2

Decided: November 28, 2000

This decision addresses the issues raised in the first annual round of the CN/IC general oversight proceeding. Our review of this record indicates that there have been no competitive problems resulting from the merger. The general oversight proceeding will be continued in accordance with the schedule indicated below.

BACKGROUND

In 1999, in 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, STB Finance Docket No. 33556, Decision No. 37 (STB served May 25, 1999) (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.

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 Agreement¹

¹ 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; and a settlement agreement entered into on
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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, 2000,² we instituted this proceeding to implement the general oversight condition. We required CN to file a progress report respecting the CN/IC transaction and invited interested persons to comment on both the status of the transaction and the effects of the various conditions we imposed. CN's progress report was due on July 3, 2000; comments on the report were due by August 18, 2000; and replies to the comments were due by September 5, 2000.

In this decision, we have considered the issues raised in the following pleadings: the CN-1 "First Progress Report of the Canadian National Railway Company" filed July 3, 2000; the comments filed August 17, 2000, by BASF Corporation and Gaylord Container Corporation; the comments filed August 18, 2000, by the United States Department of Transportation (DOT-1), The Kansas City Southern Railway Company (KCS-1), Ontario Michigan Rail Corporation (OMR-1), Wisconsin Central Ltd. (WC-1) and Canadian Pacific Railway Company, Soo Line Railroad Company, and The Delaware and Hudson Railway Company, Inc. (collectively CP); the reply comments filed September 5, 2000, by Joseph C. Szabo (JSC-2) on behalf of United Transportation Union - Illinois Legislative Board (IL-UTU);³ and the DOT-2 and CN-2 reply comments filed September 5, 2000. The CN-1 "First Progress Report" is summarized in the appendix to this decision.

¹(...continued)

April 15, 1998, by CN, IC, and KCS was referred to as the Alliance Agreement or the CN/IC/KCS Alliance Agreement; and a settlement agreement entered into on April 15, 1998, by CN and KCS was referred to as the Access Agreement. We also noted that portions of the Access Agreement amount to an addendum to the Alliance Agreement. See CN/IC Dec. No. 37, slip op. at 14-18.

² 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)).

³ IL-UTU filed a letter with a correction to the JCS-2 submission on September 6, 2000.

COMMENTS AND REPLIES

The Kansas City Southern Railway Company (KCS) states that, despite competitive concerns expressed by certain parties during the Board's consideration of the merger application, the CN/IC/KCS Alliance Agreement has been a qualified success⁴ and the comments demonstrate that the Alliance Agreement has in no way reduced competition or otherwise has harmed shippers. KCS states that, at its best, the Alliance Agreement is a very important strategic agreement that facilitates the creation of new, single-line-like service for shippers. According to KCS, the recently proposed transaction involving common control of CN and The Burlington Northern and Santa Fe Railway Company may have diverted attention from fully implementing the Alliance Agreement, but the conclusion of that proceeding gives KCS and CN the opportunity to expand the scope of the agreement.

Joseph C. Szabo, on behalf of United Transportation Union - Illinois Legislative Board (IL-UTU), and in his capacity as mayor of the Village of Riverdale, IL, contends that the residents and businesses of Riverdale have been adversely affected by the increase in rail traffic following the CN/IC merger and the Conrail transaction.⁵ Specifically, Mr. Szabo contends that there has been a dramatic increase in the storage of trains adjacent to the main line in Riverdale, to the central business district, and to residential homes for extended periods of time. Mr. Szabo contends that the CN/IC proceeding should have assessed the impact of both the CN/IC and the Conrail mergers on railroad congestion in the Chicago area.

BASF Corporation, Gaylord Container Corporation, and Wisconsin Central Ltd., submitted comments in support of the CN progress report and commending CN for its problem-free implementation of the CN/IC merger.

Ontario Michigan Rail Corporation (OMR) complains that, although it is ready, willing and able to finalize a purchase of CN's 50% interest in the Detroit River Tunnel, CN refuses to negotiate in good faith by continually introducing new barriers to completion of the sale. According to OMR, CN's stalling tactics contradict its representation to the Board that it is willing to sell its interest in the tunnel at a fair market value. In view of CN's alleged intransigence and our statement that we will hold CN to its representations, OMR asks us to order CN to transfer its interest in the tunnel to OMR or, in the absence of an agreement within 60 days, to convey its interest pursuant to terms and conditions determined through arbitration.

⁴ KCS believes that the Alliance Agreement can be even more successful if CN commits to other joint development projects with KCS.

⁵ See CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company — Control and Operating Leases/Agreements — Conrail Inc. and Consolidated Rail Corporation, STB Finance Docket No. 33388 (Conrail transaction).

OMR submitted letters supporting its comments from United States Congressman John Conyers, Jr. and Congresswoman Carolyn Kilpatrick; Michigan Economic Development Corporation; City of Detroit, MI; City of Windsor, Ontario; Wayne County, MI; Ford Motor Company; Daimler Chrysler Corporation; Port of Montreal; Detroit/Wayne County Port Authority; and an affidavit from Borealis Funds Management Ltd. As part of its OMR-2 filing, OMR submitted two additional letters – one from State of Michigan Governor John Engler and the other from General Motors Corporation.⁶

Canadian Pacific Railway Company (CP), the owner of the other half of the tunnel, filed comments in support of OMR. CP states that, although it previously opposed OMR's divestiture request during the Board's review of the CN/IC application, it now supports OMR's request. According to CP, the clearance of the DRT needs to be increased to handle today's rail cars and CN's control of dispatching is inconsistent with the needed improvements. CP argues that CN should not be allowed to avoid its prior commitment to sell its interest in the tunnel. CP requests that the Board initiate a proceeding to set the price for CN's interest in the DRT if CN and OMR are unable to complete negotiations of the terms and conditions of sale within a 60-day period.

United States Department of Transportation (DOT) maintains that, although CN appears to have avoided the service difficulties that have followed other recent railroad mergers, not enough time has passed to gauge the full impact of the CN/IC merger or the effectiveness of the Board's conditions. DOT therefore recommends that our oversight continue for the foreseeable future. In its DOT-2 reply to comments, DOT states that it considers the ownership of the Detroit River Tunnel to be unrelated to the CN/IC merger itself. Thus, DOT takes no position on OMR's divestiture request.

CN, in its CN-2 reply to comments, states that, because the parties are currently negotiating and there is no impasse, it would be premature and inappropriate for the Board to impose OMR's divestiture condition. CN states that, while it is willing to have the issue of fair market value determined by a neutral third party, it has never agreed to an open-ended commitment to have any and all terms and conditions of a complex agreement written by a third party or the Board. CN also says that it is negotiating with another party, Canadian Transit Company (CTC),⁷ for the sale of its interest in the tunnel. CN maintains that a private resolution

⁶ We also received letters dated September 12, 2000, from United States Congressmen John D. Dingell and David E. Bonior, respectively, supporting private-sector negotiations and requesting the Board not to interfere with that process, absent very good reason to do so.

⁷ By motion (OMR-3) filed September 14, 2000, OMR moves to strike any discussion of CTC in the CN-2 reply on the grounds that CTC is not a party to this proceeding and CTC's
(continued...)

of the dispute should be encouraged and that there is no precedent or need to entangle the Board in this matter.

DISCUSSION AND CONCLUSIONS

Overview. The report and comments submitted in the first oversight proceeding demonstrate that the integration of CN and IC has been successful to date and has not resulted in service failures or operating problems. Since the merger, CN has improved on-time performance, reduced transit times, and increased asset utilization. CN has demonstrated, and no one disputes, that safety has not been compromised and that labor relations with employees of CN and IC are good.

There is no evidence or, for that matter, allegation of anticompetitive behavior by the CN/IC system or by the parties to the CN/IC/KCS Alliance Agreement. According to KCS and CN, the Alliance Agreement is promoting strong competition in the areas where it is in effect, including the Baton Rouge-Geismar-New Orleans, LA corridor. In anticipation of KCS's new access to the Geismar area, CN indicates that customers there have negotiated with both CN and KCS and that rail-to-rail competition is robust. CN also indicates that the Chicago gateway remains open for North Dakota grain and that it has not increased its revenue requirements for CP-originated grain shipments moving through Chicago.⁸

⁷(...continued)

letter to the Board, referred to by CN in its reply, was not served on the parties or contained in the record in this proceeding. Concurrently, OMR filed its OMR-4 petition and reply requesting permission to file its reply to CN's reply. CP filed a similar motion and reply on September 19, 2000. OMR and CP argue that responses, submitted with the requests, are necessary to rebut new evidence in CN's reply and develop an adequate record. On October 4, 2000, CN filed its CN-3 reply to OMR-3, OMR-4, and CP's motion and "rebuttal." Also on October 4, 2000, CTC moved to intervene in this proceeding and notify the parties of its interest. OMR filed its OMR-5 reply to CN-3 on October 13, 2000.

With the exception of OMR-3, the OMR and CP requests will be granted in the interest of developing a complete record. Because we are permitting CTC to intervene and OMR to file additional rebuttal, OMR's objections to CN's reference to that party are moot.

⁸ Similarly, with respect to CSX and NS, there are weekly Operational Monitoring Data reports filed with the Board in the Conrail transaction, which reflect fluid operations for the Chicago terminal generally. The Board's Office of Compliance and Enforcement continues to monitor the impact of the CN/IC merger and the Conrail transaction on railroad operations in the Chicago area and elsewhere.

Divestiture Of DRT. CP and OMR have failed to show the nexus between their divestiture request and any anticompetitive impact of the CN/IC merger. In their comments, CP and OMR contend that CN's alleged stalling and lack of good faith in negotiations violate CN's representation that it would sell its interest in the DRT for fair market value. Such violations, according to CP and OMR, warrant our reconsideration of their previously sought divestiture relief. The only specific condition that we did impose regarding the DRT was to hold CN to its representation that it will not oppose improvements that economically benefit the tunnel partnership. After that condition was imposed, no one, including CP, has proposed any improvements to the DRT. Because no improvements have been proposed, CN cannot be considered in violation of that condition. Although we did refer to CN's willingness to sell its tunnel interest in our decision, we denied the requests of CP and OMR that we force CN to sell its interest in the DRT because we found that measure unnecessary and not in the public interest. See CN/IC Dec. No. 37, slip op. at 35. Instead, we encouraged the parties actively to pursue a private-sector solution to their concerns. Id. at 36. And, because those negotiations remain ongoing, it would be premature and counterproductive for us to insert ourselves into that process now.⁹ Additionally, we stated that, as part of our oversight condition, we would monitor issues related to investment in and operation of the DRT. Id. at 8, 36, 39, and 56. We will continue to do so as appropriate.

Continuation of General Oversight. The second annual round of the general oversight proceeding will be conducted in accordance with the schedule set forth below.

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

It is ordered:

1. The respective motions by OMR and CP for leave to file replies to CN's reply, and CTC's motion to intervene and notify the parties of its interest, are granted.

1 ⁹ We see no need to impose a time limit on negotiations as suggested by CP.

2. The requests for divestiture by CP and OMR, and the OMR-3 motion to strike portions of CN's reply, are denied.

3. CN shall continue to file annual progress reports. CN's second annual report is due on July 2, 2001; comments of interested parties will be due on August 17, 2001; and replies will be due on September 4, 2001.

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

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

Vernon A. Williams
Secretary

APPENDIX

The CN-1 Progress Report. According to CN, the CN-IC combination has been a success story and, in virtually every instance, its new system exceeded its projections. CN states that the CN-IC merger has resulted in an efficient single-line service alternative featuring improved reliability, reduced transit times and more efficient use of assets. Throughout the past year, CN states that it has maintained positive relations with labor unions representing employees at CN and IC¹⁰ and that safety has not been compromised.¹¹

CN maintains that customers are demonstrating support for its new rail alternative in the rapidly expanding market for north-south trade. Without the need for an interchange between CN and IC and with routing options that bypass Chicago, CN states that it is reducing transit times and providing more reliable delivery for customers. According to CN, carloads moving over both CN and IC grew by 120% in 1999 compared to 1998 and the combined system is now achieving better than 90% on-time delivery for customers. It indicates that the merger has resulted in improved equipment utilization, reduced yard dwell times, increased yard productivity, and a more-fluid, efficient network. CN maintains that it is the most efficient railroad in North America, with an operating ratio that was 10 points better than the average of its peer group in 1999, and that it is a financial leader in the rail industry with strong cash flow and earnings that meet or exceed the expectations of the financial community.

CN states that its Alliance Agreement with KCS provides customers access to Mexico's largest rail system, effectively linking all three NAFTA nations. According to CN, Alliance Agreement traffic (defined as carloads carried by CN, IC and KCS or IC and KCS) grew 18% in 1999 compared to 1998 and the growth rate continued in the first quarter of 2000 compared to the first quarter of 1999. CN reports that Alliance Agreement traffic moving into and out of

¹⁰ CN indicates that it has completed 11 implementing agreements with ten unions representing workers at CN and IC and has committed to minimal job dislocation with the very real likelihood of creating more jobs as traffic increases. During this process, CN states that it has not invoked arbitration to override any collective bargaining agreement.

¹¹ According to CN, safety has not been a problem during the integration. At the time of the merger application, CN submitted a Safety Integration Plan (SIP) for review and approval. The Federal Railroad Administration (FRA) reports on the progress of the plan directly to the Board twice a year. In its September 2000 report, FRA indicated that, as of July 31, 2000, CN/IC has completed 48 of 84 SIP initiatives and is generally on schedule in implementing the remaining items, with the exception of its plan to introduce common dispatching systems and operating rules for its U.S. operations, which has now been pushed back to 2001. FRA will continue to monitor the progress and report its findings to the Board.

Mexico expanded by 116% and that, at Jackson, MS,¹² traffic forwarded from CN and IC to KCS grew by 46% in 1999 compared to 1998.

CN maintains that, under the Alliance Agreement, strong competition continues to exist in the Baton Rouge-Geismar-New Orleans corridor at points served by both IC and KCS and that for same origin-destination-commodity movements into and out of these points, rates per carload on CN-IC movements declined in 1999 compared to 1998 rates. Beginning on October 1, 2000, KCS gained access to rail freight traffic to which CN has access in the area of Geismar, LA, under a haulage agreement with CN.¹³ CN states that, in anticipation of KCS's service, customers have negotiated contracts with both CN and KCS and competition has begun in earnest between KCS and CN at Geismar.

During the Board's review of the CN-IC merger application, the issue of access through the Chicago gateway for North Dakota grain originating on CP for export from the Gulf was raised. CN stated at the time that it had no incentive to ignore North Dakota grain traffic by closing the gateway and that it would not discourage or refuse to handle North Dakota grain traffic delivered by CP. In its report, CN indicates that, although the Chicago gateway remains open and it continues to take traffic from North Dakota grain shippers that is transferred from CP at Chicago, this traffic volume is dependent on world market conditions and has been variable over the past 3 years – dropping in 1998 and again in 1999.¹⁴ CN states that, as an example of its willingness to continue handling this traffic, it has not increased its revenue requirements, i.e., rate divisions, for traffic received at Chicago.

In the CN-IC merger proceeding, CP and OMR argued that CN would actively inhibit improvements to the Detroit River Tunnel, placing traffic through that route at a competitive disadvantage to traffic through the CN-owned St. Clair Tunnel route.¹⁵ Although CP and OMR asked the Board to order CN's divestiture of its ownership in the Detroit River Tunnel, we denied this request and instead encouraged the parties to pursue a private-sector solution. In

¹² Jackson is the principal interchange gateway for the Alliance Agreement.

¹³ See CN/IC Dec. No. 37, slip op. at 32-33.

¹⁴ Through full year 1999, CN and IC (prior to July 1, 1999) handled 1,041 carloads of North Dakota grain through the Chicago gateway. Of those, 324 cars were delivered by CP. During the first quarter of 2000, CN indicates that it has handled 523 carloads of North Dakota grain, with 183 of those delivered by CP.

¹⁵ The Detroit River Tunnel Company is owned by an Ontario partnership in which CN and CP each have a 50% interest.

addition, we accepted CN's representation¹⁶ that it would not exercise unfairly any rights it may have under the partnership agreement to oppose any proposed tunnel improvement project that has sufficient engineering, operational and economic merit to attract the necessary capital for its construction without derogating the value of CN's existing investment in the partnership.¹⁷ CN reports that, since the Board's approval of the CN-IC merger application, CP has not proposed any capital improvements to the Tunnel.

CN reports that it is meeting the environmental compliance commitments it made to the Board in the CN-IC control proceeding. CN specifically outlines its compliance with respect to hazardous material transport conditions (Condition Nos. 1 through 7), environmental justice conditions (Conditions Nos. 8, 9 and 10), construction conditions (Conditions Nos. 11 and 12), and safety integration (Condition No. 13).

¹⁶ See Applicants' Brief, CN/IC-56A at 158.

¹⁷ See CN/IC Dec. No. 37, slip op. at 35-36.