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July 17, 2006

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The Honorable W. Douglas Buttrey  
Chairman  
Surface Transportation Board  
1925 K Street, NW  
Washington, DC 20432  
United States

Dear Chairman Buttrey:

This letter responds to your June 28 letter requesting information on CN's service plans for the remainder of the year.

### **General Operations**

CN's business strategy is guided by five core principles: service, cost control, asset utilization, safety, and people. Our efforts to increase speed, efficiency and reliability through the execution of our precision railroading concept are ongoing and constant.

CN operates regularly scheduled trains that leave at predetermined times. Under this disciplined process, CN handles individual car movements according to a specific plan where possible to meet agreed-upon customer commitments. Each trip plan is tailored to a specific customer location, day of week, and time of release, and describes the handling of shipments from origin to destination.

Our scheduled operating plan recognizes anticipated seasonal changes in business and can accommodate other business changes that may occur. As a result, we do not make structural changes to our scheduled railroad on a seasonal basis but, rather, make adjustments based on changes in customer forecasts throughout the year.

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We are making such adjustments at present with respect to grain movements. Due to the excellent U.S. crop that will be harvested later this year, the elevators already are beginning to move their stored grain in significant volumes so as to be able to accommodate the fall harvest. This presents a challenge not only because of the sheer volume of the traffic, but also with respect to staffing issues because we traditionally allow more employees to take vacation in the summer to make sure we have sufficient numbers of employees to handle fall freight movements. We currently are experiencing a backlog of basic orders for grain cars; it is important to note, however, that in addition to basic car orders, which are filled on a first-come, first-served basis with no guarantees, our customers do have options available to move their grain by paying a premium based on our auction or by buying Premium Service Trains.

Overall, CN is operating at a high level of efficiency, with our trip plan compliance in the U.S. at 95.5 percent year-to-date through June 30, compared to 94.4 percent for the same period last year. Notwithstanding the current challenge with grain, we have sufficient capacity throughout our system to handle the strong freight volumes we expect to continue to see throughout the remainder of 2006, and we are confident that we will be able to meet our customers' needs.

### **Network Fluidity**

We also continue to work 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.

As we have reported previously, CN announced in 2004 and 2005 a series of routing protocol agreements with our U.S. interline partners; these routing protocols serve to reduce costs industry-wide by placing rail traffic on the most efficient and least congested routing – regardless of ownership. This improves both transit times and asset utilization, thereby making the most efficient use of capacity. CN currently has routing protocol arrangements in place with CSX, Union Pacific, Burlington Northern Santa Fe, and Norfolk Southern, as well as various co-production agreements in Canada with Canadian Pacific.

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The routing protocols have been successful in achieving their objective. In June 2005, we achieved an 85 percent compliance rate on the protocols with the four largest Class I carriers; this compliance increased to 98 percent in June 2006. As a result, more than 200,000 railcars annually are moving over more efficient, less congested gateways, with resulting benefits to the overall rail system.

We nevertheless remain concerned about the fluidity of the rail network due to congestion at certain gateways, particularly Chicago. As you are aware, Congress provided substantially lower funding last year for the CREATE infrastructure program than the level that had been sought by CREATE's proponents. As a result, it is anticipated that CREATE will proceed at this time only with a subset of components commensurate with the lower funding provided. As Phase I of CREATE does not include any projects that benefit CN, we are not contributing financially to CREATE for this phase of the initiative. CN remains a CREATE participant, and we are hopeful that the currently unfunded portions of CREATE ultimately will receive the necessary federal funding for this public/private partnership. However, even if additional significant funding is provided by the government, it will take years before the full benefits of CREATE can be realized. In the meantime, we continue to believe that all of the railroads serving Chicago need to work together to reduce the amount of traffic that moves unnecessarily through Chicago.

#### **Infrastructure Investment/Capital Initiatives**

CN has an aggressive capital-spending program, aimed at ensuring that our infrastructure is sufficient to meet customers' demands. In 2005, our capital expenditures totaled US\$1.1 billion systemwide – roughly 19 percent of our revenues, while we anticipate spending US\$1.3 billion in 2006; roughly US\$900 million of our 2006 expenditures are for infrastructure, over US\$270 million of which will be used in the United States. As part of this effort, we are engaged in a major siding extension and line capacity improvement program to eliminate pinch points, upgrade signals, and improve velocity throughout our network. By the end of 2006, CN will have invested nearly US\$300 million for these improvements, of which roughly US\$80 million will be spent in 2006.

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CN also announced earlier this year our \$100 million project to rebuild and upgrade our 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 efficiently handle existing and future traffic growth in the region. We anticipate completion of this project in late 2008.

In addition, to improve rail yard efficiency, which has important implications for overall network efficiency, CN has developed 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 all possible combinations and outcomes for sequencing cars. SmartYard is being implemented on a pilot-project basis at our MacMillan Yard in Toronto, and we plan to expand it to other CN yards later this year.

### **Customer Communications**

We keep in contact with our customers through a variety of means. Our Account Managers and Customer Support Representatives communicate routinely with customers by phone, fax, and e-mail, and CN's Executive Vice President – Sales & Marketing, James Foote, sends mail and e-mail communications on major issues. With respect to specific shipments, our customers can utilize our e-business tools to track their shipments, and we also remain in close contact with our customers in those cases where disruptions occur, communicating service issues proactively by e-mail and by posting the information on the CN website. We also send a State of the Railroad e-mail to customers who subscribe to that service, and our Customer Service Representatives communicate directly with customers on service issues.

To the extent that service issues arise, CN's Service Department, headed by Michael Mohan, Vice President – Service, is responsible for resolving them. Our Service Department focuses on three elements of the service model – namely, making it easier for customers to interact with CN in the order-taking process, quickly responding to customer issues that have not been resolved through normal business channels, and engaging in proactive quality control initiatives.

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Lastly, CN also participates in initiatives with customer groups. One such example is the work of CN and other railroads with the National Industrial Transportation League (NITL) on its "first mile/last mile" initiative, which is intended to improve local service for rail customers. We also have been working with other rail carriers and the NITL and its members over the past 15 months on the "capacity/asset utilization team." Railroads and their customers are working together to identify and implement initiatives to address rail industry capacity issues and to enhance asset utilization.

CN's goal is to ensure that our customers receive the best transportation product available. I appreciate the opportunity to comment on our service offering and would be pleased to provide any additional information you may require on this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "E. Hunter Harrison", with a long horizontal flourish extending to the right.

E. Hunter Harrison  
President and  
Chief Executive Officer

cc: Vice Chairman Mulvey  
Edward R. Hamberger