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Railroad's chief caught in a loop

Deal for EJ & E trackage facing stern opposition

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When Canadian National Railway Co. meets with investors Tuesday in Chicago, one notable exception will be missing from the list of accomplishments it can rattle off since last year's annual meeting in New Brunswick: its \$300 million acquisition of key operations of the Elgin, Joliet and Eastern Railway Co.

Canadian National's deal to acquire the EJ&E from U.S. Steel Corp. remains bogged down in controversy, stymieing President and Chief Executive E. Hunter Harrison's longtime drive for efficiency at the transcontinental railway.

Announced in September, the purchase of the EJ&E was meant to give Canadian National a quicker route through Chicago by rerouting its trains in an arc around the city, rather than sitting idle on tracks waiting to get through the heart of the city. Railway gridlock in Chicago is well-documented and long-standing; it is the only place in the United States where six of the seven largest railroads meet.

But since Canadian National's plans were announced, local governments, community groups, legislative leaders, railway experts, commuter rail lines, local business leaders, shippers and even other railroads have been vocal in their support or opposition.

Meanwhile, the U.S. Surface Transportation Board, which regulates the nation's railroads, first gave Canadian National a small victory in agreeing to consider the acquisition as a minor transaction. But the board also said it wanted an environmental impact study completed before making its decision, and a ruling is not expected until near year's end.

Monday night, while Harrison was presenting his case to a private dinner of more than 100 guests, a coalition of opposition community groups was printing 500 copies of a letter that it hopes to distribute to shareholders entering the annual meeting at the Peninsula Hotel.

After overseeing a railroad network that stretches some 20,300 miles in 16 U.S. states and eight Canadian provinces, one that reported annual earnings last year of almost \$2.16 billion Canadian, Harrison admits the controversy over a 198-mile stretch of track caught his company off-guard.

"We certainly didn't anticipate the scope of the opposition," he said Monday. "I lived in the western suburbs for 20 years. I had a lot of people I called friends until this."

The importance of the U.S. to Canadian National has grown significantly since the railroad bought the Illinois Central Railroad in 1999 and Wisconsin Central Railroad in 2001. Not only does Canadian National generate more than half its revenue from shipments to or within the U.S., but half of its shareholder base also is there, including its largest investor, Microsoft's Bill Gates.

Owning the EJ&E, which stretches from Waukegan around to Joliet and over to Gary, would make Canadian National more attractive to shippers because the railroad could speed freight faster through the area by rerouting it through the suburbs. It now can take up to 30 hours to move a train from one side of Chicago to another, Canadian National said.

The rail line also is critical to the growth of an intermodal facility Canadian National opened last year in Prince Rupert, British Columbia, which is designed to give shippers a path from Asia into the United States that is less congested than the overcrowded ports of Los Angeles and Long Beach, Calif. More than three-quarters of the cargo that passes through Prince Rupert is headed to or coming from Canadian National's U.S. hubs like Chicago and Memphis.

"What shippers are looking for is an alternative," said Lee Klaskow, a senior research analyst at Longbow Research. "They want their goods to get into the U.S. and they don't want any hang-up."

While the deal would unblock 180 crossings used by Canadian National in Chicago and close-in suburbs, it would add to the traffic at 133 crossings. If issues with communities can't be worked out, and the Surface Transportation Board's requirements are onerous, Harrison said he will kill the deal, route shipments elsewhere and not make the substantial investments that are planned in Canadian National's facilities in south suburban Homewood and Markham. But he's not ready to walk away from the deal yet.

The transaction is likely to be the last chapter in a 44-year career for Harrison, who has a contract until the end of next year, when he turns 65. The Memphis native started in the industry in the mid-1960s, literally learning the business from the ground up. His first job was as a carman-oiler, which meant he crawled underneath cars to squirt oil in all the right places.

Several railroad jobs later, he joined the Illinois Central in 1989 and began making his mark in the industry for his efforts to enforce "precision railroading," which meant running freight trains on a schedule, much as passenger trains always have operated. By 1993, he was the president and CEO of the railroad.

Five years later, when Canadian National acquired Illinois Central, he joined the company as an executive vice president and chief operating officer. He has served as president and CEO since January 2003.

CN's financial performance "has been among the best in the industry since 1999," said Ann Heffron, a Zacks Equity Research analyst, in a note to clients.

Harrison doesn't understand the argument of foes who want access to goods but don't want trucks on their roads or freight trains at crossings slowing down vehicular traffic.

"Where do people want the business to go?" Harrison said. "The rails built this country. The rails have helped build communities. Now they say, 'We want to be a bedroom community. We want you out of here.'"

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