

## Management's Discussion and Analysis

### Business risks

In the normal course of business, the Company is exposed to various business risks and uncertainties that can have an effect on the Company's results of operations, financial position, or liquidity. While some exposures may be reduced by the Company's risk management strategies, many risks are driven by external factors beyond the Company's control or are of a nature which cannot be eliminated.

Reference is made to the section entitled *Business risks* of the Company's 2015 Annual MD&A for a detailed description of such key areas of business risks and uncertainties with respect to: Competition, Environmental matters, Personal injury and other legal claims, Labor negotiations, Regulation, Transportation of hazardous materials, Economic conditions, Pension funding volatility, Reliance on technology, Trade restrictions, Terrorism and international conflicts, Customer credit risk, Liquidity, Supplier concentration, Availability of qualified personnel, Fuel costs, Foreign exchange, Interest rate, Transportation network disruptions, and Weather and climate change, which is incorporated herein by reference. Additional risks and uncertainties not currently known to management or that may currently not be considered material by management, could nevertheless also have an adverse effect on the Company's business.

There have been no material changes to the risks described in the Company's 2015 Annual MD&A. The following is an update on legal claims, labor negotiations, regulatory matters, and trade restrictions.

#### Legal claims

During the third quarter of 2016, the Company settled the lawsuit that it had commenced in August 2015 against Canadian Pacific Railway Company (CP), certain of its employees and an officer, alleging misuse of confidential information. As part of the settlement, CP agreed, amongst other terms, to make a one-time payment to CN of \$25 million and to extend its undertaking not to hire certain CN employees until December 31, 2018.

#### Labor negotiations

As at September 30, 2016, CN employed a total of 15,306 employees in Canada, of which 11,080, or 72%, were unionized employees; and 6,860 employees in the U.S., of which 5,454, or 80% were unionized employees. The Company's relationships with its unionized workforce are governed by, amongst other items, collective agreements which are negotiated from time to time. Disputes relating to the renewal of collective agreements could potentially result in strikes, slowdowns and loss of business. Future labor agreements or renegotiated agreements could increase labor and fringe benefits expenses. There can be no assurance that the Company will be able to renew and have its collective agreements ratified without any strikes or lockouts or that the resolution of these collective bargaining negotiations will not have a material adverse effect on the Company's results of operations or financial position.

#### Canadian workforce

On March 23, 2016, the Company served notice to commence bargaining for the renewal of the collective agreements with the Teamsters Canada Rail Conference (TCRC) governing approximately 2,500 train conductors and yard coordinators, which expired on July 22, 2016. On June 29, 2016, the Company filed a notice of dispute seeking conciliation assistance. On July 14, 2016, the Minister of Labour appointed two conciliation officers to assist the parties with their negotiations. On September 16, 2016, the Company and the TCRC agreed to extend the conciliation period on a voluntary basis.

On October 12, 2016, the Company served notice to commence bargaining for the renewal of the collective agreement with the International Brotherhood of Electrical Workers (IBEW) governing approximately 700 signals and communications workers, which will expire on December 31, 2016.

The Company's collective agreements remain in effect until the bargaining process outlined under the *Canada Labour Code* has been exhausted.

#### U.S. workforce

As of October 25, 2016, all collective agreements covering non-operating craft employees and six of sixteen collective agreements covering operating craft employees are under renegotiation.

Where negotiations are ongoing, the terms and conditions of existing collective bargaining agreements continue to apply until new agreements are reached or the processes of the *Railway Labor Act* have been exhausted.

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### Regulation

#### ***Economic regulation – Canada***

On June 25, 2014, the Government of Canada launched a statutory review of the Canada Transportation Act. The review concluded on December 21, 2015 when a report was submitted to the Federal Minister of Transport by the Chair of the review panel. The report was tabled in Parliament on February 25, 2016 by the Federal Minister of Transport. It is unclear what actions will be taken by the Government after it has considered the findings of the report and consulted with interested groups, and the potential impact on CN, if any.

On June 15, 2016, the Government of Canada announced that the provisions introduced by Bill C-30, notably with respect to extended interswitching distances and minimum volumes of grain to be moved, which were set to expire on August 1, 2016, had been extended until August 2017.

On June 18, 2016, the liability and compensation regime for rail under the *Safe and Accountable Rail Act* came into force. Under the regime, railway companies are strictly liable for damages resulting from accidents involving crude oil and are required to maintain minimum liability insurance coverage in respect of losses incurred as a result of a railway accident involving crude oil. The Act also creates a fund, capitalized through levies payable by crude oil shippers, to compensate for losses exceeding the railway company's minimum insurance level. CN has provided the Canadian Transportation Agency with submissions respecting the adequacy of its insurance coverage and has started collecting the levy on crude shipments.

#### ***Economic regulation – U.S.***

On March 28, 2016, the Surface Transportation Board (STB) issued a notice of proposed rulemaking to revoke previously granted exemptions of five commodities from regulatory oversight: (1) crushed or broken stone, (2) hydraulic cement, (3) coke produced from coal, (4) primary iron or steel products, and (5) iron or steel scrap, wastes or tailings.

On April 29, 2016, the U.S. Court of Appeals for the District of Columbia Circuit ruled that the *Passenger Rail Investment and Improvement Act of 2008 (PRIIA)* violates the due process rights of freight railroads, and consequently, that the performance standards jointly promulgated by Amtrak and the Federal Railroad Administration (FRA) pursuant to PRIIA are unconstitutional. On July 28, 2016, the STB issued a final rule defining Amtrak "on-time performance" under Section 213 of PRIIA, but determined not to proceed with its proposed policy statement on preference issues. The rail industry has challenged the STB's on-time performance decision in the U.S. Court of Appeals for the Eighth Circuit. On September 15, 2016, the STB resumed the proceeding on Amtrak's amended complaint as to the single Amtrak service on CN's Illinois Central Corporation line.

On August 3, 2016, the STB issued a notice of proposed rulemaking to adopt revised competitive access regulations to allow a party to seek a reciprocal switching prescription on the grounds that it is either practicable and in the public interest or necessary to provide competitive rail service.

On September 7, 2016, the STB issued an advance notice of proposed rulemaking seeking comments on procedures that could comprise a new rate reasonableness methodology for use in very small rate disputes that would be available to shippers of agricultural products and all other commodities.

On September 8, 2016, the STB made its annual revenue adequacy determination for Class I carriers for 2015. The STB determined that four of the seven Class I carriers were revenue adequate, among them Grand Trunk Corporation, which includes CN's U.S. affiliated operations.

#### ***Safety regulation – Canada***

On April 28, 2016, Transport Canada issued a Protective Direction under which railways are required to provide municipalities and first responders with data on dangerous goods to improve emergency planning, risk assessment, and training.

On June 1, 2016, the Minister of Transport proposed amendments to the *Transportation of Dangerous Goods Act* to improve reporting requirements by carriers respecting shipments of dangerous goods to enhance public safety and improve local emergency response.

On June 18, 2016, Transport Canada proposed Locomotive Emissions Regulations under the *Railway Safety Act* to limit air pollution and align Canadian standards with U.S. regulations.

On July 25, 2016, Transport Canada issued a Protective Direction which accelerates the phasing out of DOT-111 tank cars in crude oil service by November 1, 2016.

#### ***Safety regulation – U.S.***

On March 15, 2016, the FRA issued a Notice of Proposed Rulemaking establishing a requirement for a minimum of two crewmembers on most train movements, with the second crewmember needing to be physically located on the train, except in certain circumstances. The FRA will consider possible scenarios for use of a one person crew, but some element of a safety assessment will be involved with each scenario.

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On July 13, 2016, in coordination with the FRA, the Pipeline and Hazardous Materials Safety Administration announced proposed regulations for oil spill response plans and information sharing for high-hazard flammable trains to improve oil spill response readiness and mitigate effects of oil-related rail incidents.

### ***Positive Train Control***

The Company filed its annual progress report with the FRA on March 31, 2016 and its first quarterly progress report on July 31, 2016.

No assurance can be given that these and any other current or future regulatory or legislative initiatives by the Canadian and U.S. federal governments and agencies will not materially adversely affect the Company's results of operations or its competitive and financial position.

### **Trade restrictions**

On October 12, 2015, the Softwood Lumber Agreement (SLA) between Canada and the U.S. expired. The SLA included a clause that prevented the U.S. from launching any trade action against Canadian producers for one year after the expiration date of the SLA. This moratorium period ended on October 12, 2016 and a new agreement has not been renegotiated, which presents a risk that Canadian softwood lumber shipments to the U.S. may be impacted by future trade disputes.

There can be no assurance that any trade action taken by the Canadian and U.S. federal governments and agencies will not have a material adverse effect on the volume of rail shipments and/or revenues from commodities carried by the Company, and thus materially and negatively impact earnings and/or cash flow.