

Although the Conrail Transaction contemplated that the vast majority of Conrail's assets (*i.e.*, all assets included in the Allocated Assets category) would become part either of the CSX rail system or of the NS rail system, these assets were not transferred outright to CSX and NS. Rather, these assets were transferred to NYC and PRR for operation by CSX and NS, respectively; and each of NYC and PRR was a wholly owned subsidiary of CRC. On the Split Date: (1) CRC transferred to NYC ownership of the CRC railroad assets designated for CSX's exclusive use and operation (*i.e.*, the NYC Allocated Assets), and CRC transferred to PRR ownership of the CRC railroad assets designated for NS's exclusive use and operation (*i.e.*, the PRR Allocated Assets); and (2) NYC entered into an Allocated Assets Operating Agreement with CSXT, granting CSXT the exclusive right to operate and use the assets of NYC, and PRR entered into an Allocated Assets Operating Agreement with NSR, granting NSR the exclusive right to operate and use the assets of PRR. Ownership of the NYC and PRR Allocated Assets remains within the corporate structure of Conrail, but the operation and general day-to-day management of these assets is now conducted separately by CSXT and NSR, respectively.

Under the terms of the Transaction Agreement and the LLC agreements establishing NYC and PRR, CSX has the right to manage NYC and to designate its officers and directors, and NS has the right to manage PRR and to designate its officers and directors. Certain major decisions of NYC and PRR, however, have been reserved to CRC, which can act in that respect only with the indirect approval of both CSXC and NSC pursuant to their respective 50% voting interests in CRC's ultimate parent (CRR Holdings).

The NYC and PRR Allocated Assets Operating Agreements have fixed terms of 25 years (with options for two subsequent renewal periods), and require return of the subject rail assets by CSXT to NYC and by NSR to PRR upon termination or expiration of the agreements. The agreements also provide that an Operating Fee (analogous to rent) is to be paid by each operating railroad (CSXT and NSR) to its respective counterparty (NYC and PRR) quarterly. The agreements further provide that, every 6 years after the Split Date, the Operating Fee is to be revalued and reset to the then-current

operation and control of this equipment were allocated to CSXT or NSR pursuant to equipment subleases and other operating agreements.

"Fair Market Rental Value," defined as the rent that would be negotiated at arm's length between parties under no compulsion to lease.

The Proposed Transaction

Petitioners now propose to transfer ownership of NYC and PRR, through a series of intermediate steps, from CRC to CSXT and NSR, respectively. Petitioners indicate that they will carry out the proposed transaction pursuant to a "Distribution Agreement" (the form of which is attached to the petition as Exhibit 4). Subject to the receipt of an appropriate ruling from the Internal Revenue Service (IRS) that the proposed transaction will qualify for tax-free treatment, petitioners anticipate completing the proposed transaction in a series of five consecutive steps, occurring at approximately the same point in time.⁶

First Step: CSXT will create a new wholly owned subsidiary corporation (referred to as NYC Newco), and NSR will create a new wholly owned subsidiary corporation (referred to as PRR Newco).⁷

Second Step: CRC will transfer 100% of its membership interests in NYC to NYC Newco, which will issue to CRC common stock sufficient to provide CRC 99.9% of the then-outstanding common stock of NYC Newco; and CRC will transfer 100% of its membership interests in PRR to PRR Newco, which will issue to CRC common stock sufficient to provide CRC 99.9% of the then-outstanding common stock of PRR Newco. As a result of this step in the proposed transaction, CRC will own 99.9% of the common stock of and will control NYC Newco (which will wholly own and control NYC), and CRC will also own 99.9% of the common stock of and will control PRR Newco (which will wholly own and control PRR). As a further result of this step in the proposed transaction, CSXT will own 0.1% of the common stock of NYC Newco, and NSR will own 0.1% of the common stock of PRR Newco.

⁶ The form of the Distribution Agreement attached to the petition as Exhibit 4 provides for, among other things, revisions (in the nature of conforming changes) to the Transaction Agreement, and termination of the NYC and PRR Allocated Assets Operating Agreements. Petitioners advise that certain of the exhibits and schedules to the Distribution Agreement, including those identifying Conrail's existing debt obligations, will not be completed until shortly before the consummation of the proposed transaction, and therefore have been omitted from the form Distribution Agreement that is attached to the petition as Exhibit 4.

⁷ Petitioners advise that these new subsidiary corporations will be created before the consummation of the proposed transaction. Petitioners add that the names "NYC Newco" and "PRR Newco" are illustrative; the newly created corporations may have different names.

Third Step: The 99.9% of the stock of NYC Newco owned by CRC will be transferred successively up the Conrail corporate family ladder from CRC to CRR, from CRR to Green Acquisition, and from Green Acquisition to CRR Holdings. CRR Holdings will transfer the NYC Newco stock to CSX Rail Holding Corporation (CSX Rail) and CSX Northeast Holding Corporation (CSX Northeast), each of which is a wholly owned subsidiary of CSXC. CSX Rail and CSX Northeast will transfer the NYC Newco stock to CSXC; and CSXC will transfer the NYC Newco stock to CSXT. Similarly, the 99.9% of the stock of PRR Newco owned by CRC will be transferred successively up the Conrail corporate family ladder from CRC to CRR, from CRR to Green Acquisition, and from Green Acquisition to CRR Holdings; CRR Holdings will transfer the PRR Newco stock to NSC; and NSC will transfer the PRR Newco stock to NSR.⁸ As a result of this step in the proposed transaction, CSXT will wholly own and control NYC Newco (which will wholly own and control NYC) and NSR will wholly own and control PRR Newco (which will wholly own and control PRR).⁹

Fourth Step: NYC will be merged with and into NYC Newco, with NYC Newco as the surviving company; and PRR will be merged with and into PRR Newco, with PRR Newco as the surviving company. As a result of this step in the proposed transaction, the business, assets, and operations of NYC will reside in a wholly owned subsidiary of CSXT (NYC Newco), and the business, assets, and operations of PRR will reside in a wholly owned subsidiary of NSR (PRR Newco).

Fifth Step: NYC Newco will be merged with and into CSXT, and PRR Newco will be merged with and into NSR, thereby completing the consolidation of NYC's business, assets, and operations within CSXT and the consolidation of PRR's business, assets, and operations within NSR. As a result of this step in the proposed transaction, the assets of NYC and PRR will be

⁸ There appear to be, on the NS/PRR side of the third step in the proposed transaction, no intermediate entities comparable to CSX Rail and CSX Northeast.

⁹ Shortly before closing, CSX and NS will obtain an independent valuation of NYC and PRR by an investment banking firm. If the respective fair market values of NYC and PRR are not equal to 42%/58% of their combined value at the time of closing, CSX and NS will seek to agree on steps to resolve this disparity. Unlike the periodic revaluation required under the current corporate structure, this valuation will be conducted only once, and any resulting adjustment (referred to as the "True Up") will be consummated on the closing date of the proposed transaction.