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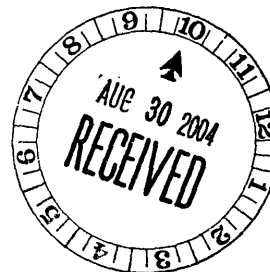
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August 30, 2004



**BY HAND DELIVERY**

Honorable Vernon A. Williams  
Secretary  
Surface Transportation Board  
1925 K Street, NW  
Washington DC 20423

ENTERED  
Office of Proceedings

AUG 30 2004

Part of  
Public Record

Re: STB Ex Parte No. 647, Class Exemption for Expedited Abandonment Procedure  
for Class II and Class III Railroads

Dear Secretary Williams:

Enclosed for filing in the above-referenced proceeding are an original and 10 copies of the testimony of Allegheny & Eastern Railroad, Inc., *et al.*, with respect to the August 31, 2004, oral hearing to be held in this proceeding.

Please acknowledge receipt of this letter by date-stamping the enclosed acknowledgment copy and returning it to our messenger.

Very truly yours,

A handwritten signature in dark ink, appearing to read "Mark H. Sidman".

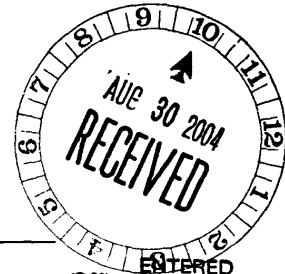
Mark H. Sidman

Enclosures

cc: David M. Konschnik

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**STB EX PARTE NO. 647  
CLASS EXEMPTION FOR EXPEDITED  
ABANDONMENT PROCEDURE FOR  
CLASS II AND CLASS III RAILROADS**



Office of Proceedings

**TESTIMONY OF PETITIONERS**

**AUG 30 2004**

Chairman Nober, Vice Chairman Mulvey, Commissioner Buttrey. My name is Mark Sidman. I am appearing in this proceeding on behalf of 65 small railroads that have petitioned the Board to commence a rulemaking to adopt a class exemption for the expedited abandonment of rail lines. The proposed exemption would apply to Class II and Class III carriers. The Petitioners are hopeful that, following today's hearing, the Board will initiate a formal rulemaking procedure to amend its regulations as we have proposed. As indicated in the Board's scheduling order, I will make my presentation this morning and reserve any unused portion of the 30 minutes allotted to Petitioners for rebuttal.

\* \* \*

When the Petitioners talk in terms of "expedited abandonment," they are not referring to the period from the commencement of an abandonment proceeding at the Board to the date abandonment authority is finally issued. That period would not significantly change under the proposed exemption.

Instead, the Petitioners' use of the term "expedited abandonment" refers to a different and far more crucial period: the time between the day on which a small railroad decides that the prospects of a line segment are hopeless, on the one hand, and the day on which the railroad begins the abandonment process at the Board, on the other. This period - - which I'll refer to as the Pre-filing Period - - is the one that Petitioners seek to shorten.

During the Pre-filing Period, which can last for several years, a small railroad, in order to stem losses on an unproductive line, typically will raise rates to fully compensatory levels, defer maintenance, cut back on capital spending, and reduce service levels. This is not an evil course of action. It is nothing more or less than rational business behavior in the face of little or no demand for service, mounting losses and dim prospects, and there is nothing in the ICC Termination Act or elsewhere that prohibits it.

A small railroad takes these steps because to do otherwise would jeopardize its viability. It cannot and should not continue providing service at a loss and hope to make

it up on volume. The Staggers Act freed railroads from that syndrome almost 25 years ago.

The natural consequence of raising rates and cutting costs is a degradation of the traffic and infrastructure on the line in question. Only after the traffic base has largely disappeared, and the physical condition of the line has deteriorated, will the small railroad commence an abandonment proceeding. More often than not, a railroad delays its filing until there has been no local traffic handled on line for a two-year period, which enables it to utilize the existing notice of exemption procedure for out-of-service lines.

Why would a small railroad wait several years to seek regulatory authority to abandon a line that it had written off long ago as a losing proposition? Why would it allow the financial drain of keeping unproductive assets in place go on any longer than necessary? The unfortunate answer is that, in order to avoid the expense and uncertain result of a contested abandonment proceeding, a small carrier is now best served to file for abandonment only after the traffic is gone and the cost of rehabilitating the line is prohibitive. Then, and only then, can the small carrier be confident that regulatory authority will be forthcoming.

\* \* \*

No one benefits from a multi-year Pre-filing Period in which service levels plummet, traffic dries up and rail infrastructure deteriorates beyond repair. Less and less rail traffic moves over the line, and soon the presence of the railroad doesn't even serve as an effective stalking horse to keep truck or barge rates honest. Moreover, the low level of activity on the line contributes little in the way of employment opportunities, as the jobs were eliminated early in the Pre-filing Period.

In the meantime, the railroad has tens of thousands of dollars of unproductive assets tied up on a barely operating branch line. And, at the end of the day, having gone through this wasteful exercise, the railroad almost always obtains the requested abandonment authority. Between 1996 and 2001, the Board granted abandonment authority in 521 cases, and denied authority in 18 cases, which is a denial rate of less than 3.5%. And in those few cases in which abandonment authority was denied, the railroad likely could have achieved the opposite result had it just put off filing a while longer. A small railroad rarely makes that mistake a second time.

\* \* \*

Once abandonment authority is obtained, the offer of financial assistance ("OFA") procedures under 49 U.S.C. § 10904 kick in. These well-intended procedures were designed to preserve rail service by compelling an abandoning carrier to sell the subject line for constitutional minimum value to a third party willing to continue rail service. But by the time the OFA procedures are triggered, it is simply too late. There are no buyers for lines that have little or no traffic and that require the expenditure of vast amounts of money for rehabilitation. Although a line might have been attractive to

potential buyers on the day the railroad decided it couldn't be operated profitably, that's rarely the case after several years of reduced maintenance and capital spending. It should come as no surprise that, between 1996 and 2001, offers of financial assistance were made in just four percent of proceedings in which abandonment authority was obtained.

\* \* \*

The Petitioners' proposal would address this broken system, and eliminate the death spiral of a line slated for abandonment during the Pre-filing Period.

The essential features of the proposed class exemption are as follows:

First, a Class II or Class III railroad that utilizes the exemption can abandon the line in question by use of a notice filing. The abandoning railroad need not make a showing that the subject line cannot be operated profitably. Small railroads will no longer have an incentive to delay the abandonment and OFA process until there is so little traffic on the line that its profitability assessment is beyond challenge. The class exemption shifts the focus from second guessing a small railroad's profitability analysis, to saving preservable lines and redeploying unproductive assets.

The second essential feature of the proposed exemption is that it provides shippers, local governments and the railroad industry at large with more time to consider and evaluate an OFA. Under the proposed class exemption, the carrier must provide all active shippers on the line during the past 3 years with at least 40 days' notice prior to filing its abandonment exemption, which is significantly more than even the application process, which requires as little as 15 days.

In addition, at least 30 days prior to filing the notice, the carrier must, for three weeks, publish notice of the abandonment not only in a local county newspaper as is required today, but also in a nationally distributed railroad trade publication, thereby widening the pool of potential purchasers. The published notice must contain detailed information aimed at providing potential purchasers with the data necessary to evaluate an acquisition.

The required information includes, among other things:

- details concerning the line and connecting carriers,
- the condition of the line and the cost to rehabilitate it to FRA class I condition,
- the carrier's calculation of net liquidation value, and a waiver of any right to value in excess of NLV,

- a statement that the abandoning carrier will provide access to third party connections, via trackage rights or haulage, if the abandoned segment would connect only to the abandoning carrier, and
- a statement that the abandoning carrier will supply upon request, the so-called Supporting Data, which includes three years' worth of revenue and carload data, as well as an inventory of the rail infrastructure and information concerning bridges, and the like.

All this information is available to potential purchasers before the carrier even files for abandonment. All told, shippers, communities and the railroad industry at large will have had the necessary information to assess the line and determine if an OFA is plausible for as many as 140 days. For comparison purposes, in the existing out-of-service exemption, an OFA is due just 30 days after notice of the abandonment is filed in the Federal Register, and the abandoning carrier is not required to publish any substantive information on the condition of the line prior to filing or in the filing itself. Likewise, in a petition for exemption filing, no substantive information is required to be made available prior to the filing.

The third essential feature of the proposed exemption is that the environmental and historic reporting, which now must be done prior to filing for abandonment, may be done after the abandonment is effective. In this way, if an offer of financial assistance is made and the line is purchased, neither the abandoning carrier, the Board, nor a multitude of state and federal agencies will have needlessly wasted time and money on an exercise that serves no purpose.

\* \* \*

The proposed exemption is consistent with the statutory provision that addresses abandonments. Section 10903(d) of the ICC Termination Act provides that a rail carrier may abandon part of its railroad lines only if the Board finds that the present or future public convenience and necessity require or permit the abandonment. The Board and the courts have interpreted this statutory provision as requiring the Board to engage in a balancing test: to weigh the burden on the carrier of continuing operation of the line, against the burden on shippers and communities resulting from a loss of service.

The balancing of the interests at stake here favors adoption of the proposed notice of exemption procedures. The new regulations will eliminate any incentive for a small railroad to neglect a line for several years prior to filing for abandonment authority. By eliminating the death spiral during the Pre-filing Period, the proposed exemption increases the likelihood that a rail line will be purchased for continued rail use. The line will have far more traffic, and will be in far better condition, at the time the abandoning carrier seeks authority to abandon its operations under Petitioners' proposal.

The prospects of continued rail use will be enhanced further by the new OFA procedures in the proposed exemption. Comprehensive traffic and revenue data and

detailed information regarding the condition of the line will be made available widely, and potential offerors will have as many as 140 days to consider the prospects of the line. In addition, the abandoning carrier must provide the acquiror with access to third party connections, through trackage rights or haulage, if the abandoned segment will connect only to the abandoning carrier.

The small railroad, on the other hand, will be able to cut its operating losses and obtain the value of its assets, either through the proceeds of an OFA sale or by selling the track and other materials on the line. This will provide the railroad with funds for capital investment, equipment acquisition or reduction of debt. The railroad will be able to use the value of the assets from the abandonment to serve shippers and communities where conditions favor the provision of rail service.

On the other side of the ledger, little is lost as a result of adopting a class exemption for expedited abandonment by Class II and Class III carriers. From the moment a small railroad identifies a segment as an abandonment candidate, and takes appropriate steps to cut losses, the value of that rail line as a transportation alternative plummets. This is borne out by the fact that, from 1996 through 2001, more than half of the abandonments filed at the Board were pursuant to the two-year out-of-service exemption. Although the rail line may be physically present during the death spiral in the Pre-filing Period, its presence confers little benefit to the shippers and communities located on it. And, at the same, shippers and communities located on viable lines end up, effectively, subsidizing the losing operations on the abandonment candidate.

The Pre-filing Period doesn't confer much benefit on employees either. Abandonment candidates are almost always low density lines that get infrequent service. Few, if any, employees are still headquartered on those lines; they have long since been transferred to where the traffic is. Because the traffic levels produce insufficient revenues, the lines are characterized by low maintenance levels. The employees who maintain these lines spend most of their time working on the portions of the small railroad's system that can sustain service. Abandonment of these lines sooner rather than later rarely will result in a material reduction in force. In any event, the proposed exemption would not change the labor protection afforded to employees who are adversely affected by abandonments.

As with shippers, however, employees will benefit from an abandonment process that allows a small railroad to deploy capital in a rational way. If a carrier can cut losses and obtain the value of the rail assets on an unproductive line, that carrier is better able to upgrade maintenance and undertake capital projects on the portions of its system that support rail service, all of which results in higher activity levels and safer working conditions for employees.

\* \* \*

The likelihood that small railroads would abuse a notice of exemption procedure is remote. On average, small railroads operate less than 100 miles. These carriers have

extremely limited commercial opportunities and it is highly unlikely that they would walk away from segments that have even a prospect of being operated profitably. The hallmark of short line operations, as the Board has noted, is hands on, highly responsive customer service. These companies do not walk away from business lightly. But in the event a small railroad incorrectly assesses the situation and seeks to exit a market that can sustain rail service, then an entrepreneur, shipper group or governmental entity likely will step in to acquire the line under the enhanced OFA procedures.

Shippers apparently understand the futility of requiring small railroads to remain in markets they have determined to be unsustainable. The National Industrial Transportation League, through counsel, has filed comments in this proceeding. In those comments, the NIT League, which is one of the largest shipper groups in the country, urges that the Board institute a rulemaking on the proposed exemption. Moreover, the League has said:

As a substantive matter, the League believes that the proposal advanced by the Petitioners has fundamental merit. A simplification of the regulatory process for Class II and Class III carriers that permits abandonments and offers of financial assistance to proceed before rail infrastructure deteriorates will strengthen the rail network.

The NIT League indicates in its comments that it would like to see some of the time frames in the proposal extended so as to allow better development of offers of financial assistance. Although the League does not provide any details as to the extensions it would seek, the Petitioners believe that certain extensions would be appropriate. These are the kinds of details that would be best addressed in a formal rulemaking.

\* \* \*

The Petitioners urge that the Board use its power under § 10502 of the ICC Termination Act to adopt the class exemption that we have described. Section 10502 provides that the Board shall exempt a class of persons or a transaction whenever it finds that a section of the Act (1) is not necessary to carry out the Rail Transportation Policy, or RTP, set forth in Section 10101 and (2) either the transaction is of limited scope or the application of the section of the Act in question is not needed to protect shippers from the abuse of market power.

As set forth in detail in the Petition, the proposed exemption promotes 11 of the 15 provisions of the Rail Transportation Policy, and is inconsistent with none. The proposed exemption simultaneously (1) increases the likelihood of preservation of service over viable lines through the OFA process, by beginning the process before the condition of the line and its traffic base has deteriorated, and (2) allows a small carrier to limit its losses and efficiently reallocate critical resources to other parts of its system. The

exemption will promote a sound, safe, efficient and competitive transportation system, thereby advancing several goals of the RTP.

Similarly, by encouraging small carriers to file for abandonment authority promptly; and by enabling carriers to delay the environmental and historic reporting process until after the OFA is complete; and by limiting the instances in which a small carrier files a petition only to be told later to file an application, the proposed exemption advances the twin goals of (1) minimizing the need for regulatory control, and (2) promoting the expeditious handling and resolution of proceedings.

Finally, the exemption requires widespread publication of information to potential buyers and prevents small carriers from having to compile extensive data it does not have in order to file an abandonment application. In this way, the exemption promotes the policy of making cost information available while minimizing the burden on the carrier to produce such information.

The proposed exemption also is limited in scope. The typical small railroad operates less than 100 miles of track. A review of abandonments by Class II and Class III carriers in 1999 and 2000 indicates that small rail abandonments average less than 25 miles. The lines have low traffic density in all cases. The Board has consistently found abandonments of these types of lines to be limited in scope.

Although the second prong of the test in § 10502 for the appropriateness of an exemption is satisfied by the showing of limited scope, it should be noted that the alternative prong - - that regulation is not necessary to protect shippers from abuse of market power - - is also met. Small railroads that cannot operate a line profitably obviously do not have market power - - *i.e.*, the power to raise rates - - over those shippers. Either the shippers on those lines are not tendering enough traffic to keep the lines in service -- which suggests those shippers are taking care of their transportation needs in other ways -- or, they simply don't have transportation needs of any magnitude.

Thus, the proposal satisfies the criteria for a class exemption, and addresses the unique characteristics of the small railroads as a class. Small railroads have limited commercial opportunities and are loath to walk away from a line they believe can be operated profitably. Under the existing regulatory procedures, the small railroad will often wait to file for abandonment until the out-of service exemption becomes available. This delay both drains the small railroad's limited resources and all but eliminates the possibility of a successful OFA. The proposed exemption recognizes the unique characteristics of small railroads in the context of rail line abandonments, and provides a procedure whereby small railroads, as a class, can abandon rail lines in a manner that advances the goals of the Rail Transportation Policy.

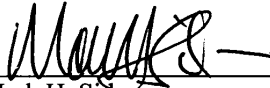
Under the proposed notice of exemption procedure, the focus would be shifted from second-guessing the profitability determination made by a small railroad, to making a line that otherwise will go into a death spiral available for purchase by entrepreneurs, shippers and communities, when the traffic base still exists and the line has not suffered

years of deferred maintenance. This approach recognizes that the existing regulations do not save lines from being abandoned; instead, those regulations simply delay the inevitable abandonment and virtually assure that the abandoned lines will not be acquired for continued rail use.

The meager "benefits" that result from the delayed filing for regulatory authority - - arguably, a few more years of increasingly deteriorating service - - are more than offset by the negative effects of freezing unproductive assets in place, when the value of those assets could be reinvested in those portions of the small railroad's system that require capital investment. We note in this regard that the American Short Line and Regional Railroad Association estimates that upgrading small railroad tracks to accommodate 286,000-lb. cars - - an effort that will benefit shippers and communities - - will cost the industry approximately \$7 billion. A rational deployment of the small railroad's investment in a line destined for abandonment will improve service elsewhere on the railroad's system, to the benefit of shippers, employees and communities.

For all of these reasons, Petitioners urge that the Board commence a formal rulemaking to adopt the proposed exemption. I would like to reserve any remaining time for rebuttal, and I would be happy to answer any questions you may have.

Respectfully submitted,



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