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September 15, 2004

BY HAND

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

2/2005



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

Dear Secretary Williams:

On August 31, 2004, the Surface Transportation Board held a public hearing in the above-referenced proceeding. Commissioner W. Douglas Buttrey was unable to attend that hearing. Accordingly, Chairman Roger Nober provided Mark H. Sidman with a list of questions prepared by Commissioner Buttrey, and requested that Mr. Sidman provide written answers in response to those questions. (Mr. Sidman spoke at the oral hearing on behalf of the small railroads petitioning the Board to adopt regulations for a new class exemption procedure for abandonments by Class II and Class III rail carriers.)

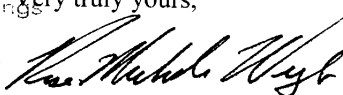
Enclosed for filing in this proceeding are eleven copies of (i) Attachment A, which is the list of questions Commissioner Nober provided Mr. Sidman, and (ii) Attachment B, which is Mr. Sidman's response to those questions.

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

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Office of Proceedings Very truly yours,

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Rose-Michele Weinryb

Enclosures

cc: David M. Konschnik (by facsimile)

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ATTACHMENT A

Questions for Petitioners

- 1. You state in your petition that the proposed exemption is designed to put lines that are abandonment candidates on the market before the traffic base and condition of the line deteriorate. You never mention the Board's class exemption for line sales. Why can't you use that?**
 - 2. Offers of financial assistance are a post-abandonment remedy, and yet you would have us reverse the process and make OFAs the centerpiece of a small carrier's abandonment proposal. Aside from encouraging OFAs, what justification have you provided in your petition for the Board to make the required finding under 49 U.S.C. 10502 that, as a class, abandonments of rail lines by small carriers satisfy the exemption criteria? [Are you saying that the small carrier's business judgment should substitute for the findings the Board must make under the statute?]**
 - 3. Explain how your proposal would allow the Board to meet its obligations under the environmental statutes.**
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ATTACHMENT B

QUESTIONS TO PETITIONERS

Question No. 1

You state in your petition that the proposed exemption is designed to put lines that are abandonment candidates on the market before the traffic base and condition of the line deteriorate. You never mention the Board's class exemption for line sales. Why can't you use that?

Answer:

Whenever a small railroad concludes that a line segment cannot be operated profitably, it will sell the line for continued rail use if possible. On occasion, these sales do occur. However, as a practical matter, once a small railroad has owned a property and has attempted, unsuccessfully, to build a traffic base that supports continued service, the likelihood that another railroad entrepreneur will acquire the line is remote. As a result, small railroads that own unprofitable lines generally must abandon the lines in order to exit those markets.

Small railroads do not lightly walk away from rail lines. When a small railroad determines it cannot operate a line profitably, other railroad entrepreneurs are likely to reach the same conclusion. Small railroads have been enormously successful in buying low-density branch lines and building a sustaining traffic base on those lines. This reflects the fact that the small railroad is service oriented and flexible in a way that the Class I carrier was not. The small railroad is able to focus marketing attention on each shipper and potential shipper on its system, because its small system size makes that a manageable task. In addition, a Class II or Class III carrier typically has a lower cost structure than a Class I carrier, which allows the small railroad to generate a profit in market where a Class I carrier cannot generate a critical mass of traffic. Once a former

Class I branch line has been owned by a small railroad for any length of time, the factors favoring small railroad success have had a chance to work their magic. If a small railroad is unable to build a traffic base, it is usually because the local shippers do not want or need rail service to any great degree. Even if the line is sold for net liquidation value, the new purchaser will have to make a substantial additional investment in motive power, maintenance of way equipment, tools, supplies, office equipment and a variety of other items. The potential purchaser would have to make this investment with the knowledge that the seller was unable to operate the line profitably, and with the understanding that, if the line cannot be revived, it will have to go through the abandonment process in order to recover the salvage value of its investment. Under these circumstances, few entrepreneurs are willing to risk the investment.

In some cases, local communities or local shippers are interested in acquiring a line for continued rail service. In these cases, however, the potential buyers typically are not looking to expend funds any sooner than necessary. As a result, these buyers tend to wait until a line has been abandoned and acquire the line through the offer of financial assistance procedures. This is especially true because, in the OFA process, the potential buyer can request the Board to set the terms of the sale, which in some cases results in a price considerably lower than the owner's view of net liquidation value. Accordingly, the line sale exemption generally will not be a good substitute for the OFA process in an abandonment proceeding.

Question No. 2

Offers of financial assistance are a post-abandonment remedy, and yet you would have us reverse the process and make OFAs the centerpiece of a small carrier's abandonment proposal. Aside from encouraging OFAs, what jurisdiction have you provided in your petition for the Board to make the required finding under 49 U.S.C.

10502 that, as a class, abandonments of rail lines by small carriers satisfy the exemption criteria? [Are you saying that the small carrier's business judgment should substitute for the findings the Board must make under the statute?]

Answer:

The Petitioners believe that (i) the application of 49 U.S.C. § 10903 to abandonments is not necessary to carry out the transportation policy of section 10101, and (2) the abandonment transactions are of limited scope. Accordingly both prongs are met by the Petitioners' proposal.

Section 10502(a) provides that the Board, "shall exempt a person, class of persons, or a transaction or service whenever the Board finds that the application in whole or in part of a provision of this part –

- (1) is not necessary to carry out the transportation policy of section 10101 of this title; and
- (2) either –
 - (A) the transaction or service is of limited scope;
or
 - (B) the application in whole or in part of the provision is not needed to protect shippers from the abuse of market power."

Petitioners urge that the Board find that the two-pronged test of § 10502(a) is met as applied to abandonments of rail lines by Class II and Class III carriers, as a class. The application of 49 U.S.C. § 10903 -- the section of the ICC Termination Act that governs abandonments -- to small railroads is not necessary to carry out the rail transportation policy of section 10101 (the "RTP"). In fact, a review of the RTP reveals that section 10903 actually hinders most aspects of the RTP.

Section 10101(1), which states a policy -- "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail" -- is not advanced by procedures under section 10903 that result in

small railroads being forced to operate rail lines for years after those lines have been determined to be unprofitable. A regulatory procedure that results in a small railroad being required to incur losses for years, until it is "safe" to file for abandonment, does not facilitate rates established by competition and demand for services.

Section 10101(2), which states a policy -- "to minimize the need for Federal regulatory control over the rail transportation system and to require fair and expeditious regulatory decisions when regulation is required" -- is not advanced by procedures under § 10903 that turn the abandonment of a rail line into a multi-year process during which a small railroad incurs losses and cannot redeploy assets. In light of the fact that abandonment authority is obtained in the overwhelming majority of cases in which it is sought (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%), section 10903 certainly does little to minimize federal regulatory control over small carriers.

The policy set forth in section 10101(3) -- "to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by the Board" -- is hindered, not promoted, by section 10903. In the drawn out period between the date on which the small railroad determines the line cannot be operated profitably and the date on which the railroad begins the abandonment process at the Board (the "Pre-filing Period"), small carriers reduce maintenance and capital spending on the line to be abandoned. This results in deterioration of the rail infrastructure, which has safety implications. At the same time, by freezing the assets on an unproductive line during the Pre-filing Period, small carriers are unable to invest the value of the assets on

the abandonment candidate in lines that support rail service, which hinders small railroads from improving the safety and efficiency of those lines.

The policy set forth in section 10101(4) -- "to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and the national defense" -- and the policy set forth in section 10101(5) -- "to foster sound economic conditions in transportation and to ensure effective competition and coordination between rail carriers and other modes" -- likewise are hindered by applying section 10903 to small railroads. When small railroads are required to endure years of unnecessary losses and years in which they cannot redeploy assets, those carriers cannot compete effectively with other railroads or with trucks and barges.

The policy set forth in section 10101(6) -- "to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital" -- is not advanced by applying section 10903 to small railroads. When a small railroad seeks abandonment authority, it is because it cannot generate sufficient revenue to justify operations on the line in question. A carrier that concludes it must abandon a line very often raises rates to fully compensatory levels because it has determined that continuing to provide service at a loss in hopes of building traffic is no longer an acceptable business strategy. A long, drawn out abandonment process does not advance the goal of maintaining reasonable rates.

The policy set forth in section 101001(7) -- "to reduce regulatory barriers to entry into and exit from the industry" -- is obviously not advanced by applying a long, drawn

out process under section 10903 to small railroads that desire to abandon lines, especially since, as noted above, the denial rate for abandonment cases between 1996 and 2001 was less than 3.5 percent.

The policy set forth in section 10101(8) -- "to operate transportation facilities and equipment without detriment to the public health and safety" -- similarly is not served by section 10903. Carriers defer maintenance on abandonment candidates, which affects the safety of the operations on those lines. At the same time, the delay in obtaining abandonment authority prevents small railroads from investing all or part of the value of those lines in capital improvements on other segments of their systems.

The policy set forth in section 10101(9) -- "to encourage honest and efficient management of railroads" -- is not advanced by the protracted abandonment process under section 10903. The efficient management of railroads would allow small railroads to quickly exit markets that cannot sustain rail service and redeploy assets to markets that do support such service.

The policy in section 10101(10) -- "to require rail carriers, to the maximum extent practicable, to rely on individual rate increases, and to limit the use of increases of general applicability" -- is not advanced by the abandonment procedures under section 10903.

The policy in section 10101(11) -- "to encourage fair wages and safe and suitable working conditions in the railroad industry" -- is not advanced by the drawn out process that small carriers go through when abandoning lines under section 10903. The losses incurred by small railroads as a result of their inability to exit from markets that do not sustain rail service, reduce small railroad profits. This, in turn, reduces the ability of

those carriers to provide better compensation and benefits to their employees. Similarly, losses that reduce profits make it more difficult for small railroads to improve working conditions by upgrading track and equipment.

The policy in section 10101(12) -- "to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination" -- is not advanced by applying section 10903 to small railroads. Small railroads that are abandoning lines do not have market power, as evidenced by the fact that they are unable to generate sufficient revenues from the traffic moving over the subject line.

The policy set forth in section 10101(13) -- "to ensure the availability of accurate cost information in regulatory proceedings, while minimizing the burden on rail carriers of developing and maintaining the capability of providing such information" -- is not advanced by section 10903. The application procedure under that section requires extensive data in Uniform System of Accounts format, which Class II and Class III carriers are not otherwise required to produce.

The policy set forth in section 10101(14) -- "to encourage and promote energy conservation" -- is not promoted by applying section 10903 to small railroad abandonments.

The policy set forth in section 10101(15) -- "to provide for the expeditious handling and resolution of all proceedings required or permitted to be brought under this part" -- is completely undermined by a process that causes a small railroad to wait to file for abandonment authority until the traffic is gone from the line and the rail infrastructure has deteriorated.

The foregoing demonstrates that the application of Section 10903 to abandonments by small railroads is not necessary to promote the RTP. In addition, rail line abandonments by small railroads are limited in scope, thereby satisfying the other statutory criteria for a class exemption. Small railroads operate low traffic density lines that are typically less than 100 miles of track. A review of abandonments by small railroads in 1999 and 2000 indicates that the average length of the line was less than 25 miles. Under such circumstances, abandonments by small railroads are limited and scope.¹

Question No. 3

Explain how your proposal would allow the Board to meet its obligations under the environmental statutes.

Answer:

The environmental and historic reporting requirements under the proposal are consistent with the Board's current regulations at 49 CFR §§ 1105.6 and 1105.8, and with prior decisions by the Board (or its Office of Proceedings). The key points under the proposed class exemption are as follows:

- (i) a small railroad may delay preparation of an environmental and/or historic report until after the completion of the offer of financial assistance ("OFA") process;
- (ii) a small carrier may *discontinue* service over the line upon the effective date of the exemption, *but only if* the railroad certifies² that

¹ The statutory criteria for a class exemption requires that abandonment by small railroads *either* be limited in scope *or* not require regulation to protect shippers from market power abuse. In addition to being limited in scope, abandonments by small railroads also do not subject shippers to market abuse. See discussion above regarding Section 10101(12).

² Although Section 1152.50(d)(2)(ii)(B) of the proposed regulations appears simply to require a "statement" rather than a certification, Section 1152.50(d)(7) of those regulations refers to such statement as a "certification".

- (a) such a discontinuance will not exceed the threshold levels set forth at 49 C.F.R. § 1105.7(e)(4) or (5),³
 - (b) the railroad does not plan to alter or dispose of 50 years old or older properties that are under the jurisdiction of the Board, and
 - (c) if the OFA process is unsuccessful, the small railroad will file the appropriate historic and/or environmental reports; and
- (iii) the small railroad may *not abandon* the line until after it complies with all applicable environmental and/or historic reporting requirements.

Under the proposed class exemption, the timing of the environmental/historic reporting process for abandonments changes, but not its substance. If the OFA procedure is successful, environmental and historic reports, as applicable to abandonments, will not be necessary. By delaying the environmental/historic reporting requirements until after the termination of the OFA process, the small railroad, the Board and other federal and state agencies will no longer risk wasting their limited resources on an unnecessary environmental/historic reporting process. However, if the OFA process is not successful, the small railroad still must comply with all of the current environmental and historic requirements in order to abandon the rail line.

With respect to a discontinuance, the current environmental regulations at 49 C.F.R. § 1105.6(b)(3) provide that an environmental assessment typically will be prepared for a discontinuance of freight operations. However, 49 C.F.R. § 1105.6(c)(2) provides that environmental documentation typically is not necessary for any action in which the thresholds at 49 C.F.R. § 1105.7(e)(4) or (5) are not exceeded. Under the proposal for the new class exemption, the small railroad cannot discontinue service

³ In the Petition for Rulemaking, reference to these environmental threshold levels was inadvertently phrased as “1105.7(e)(4) *and* (e)(5),” (emphasis added), or simply as “1105.7(e)(4)-1105.7(e)(5).” It is intended that discontinuance prior to an environmental and/or historic report will not be permitted if *either*

unless it certifies that the discontinuance will not exceed either of those threshold levels.

Thus, the proposal is consistent with the current regulatory language governing environmental requirements for a rail line discontinuance.

In addition, the current regulatory language governing historic reporting requirements for a rail line discontinuance would not appear to apply to the discontinuance of a rail line under the proposed class exemption. Under 49 C.F.R. § 1105.8(a), the historic reporting requirement applies to an action under 49 CFR § 110.6(c)(2) (*i.e.*, an action in which neither threshold set forth at 49 CFR § 1105.7(e)(4) or (5) is exceeded), *only if* such action “will result in the lease, transfer, or sale of a railroad’s line, sites or structures.” As noted above, under the proposed class exemption, a small carrier is not permitted to discontinue service without an environmental and/or historic report, unless the railroad certifies that the action will not exceed the applicable thresholds in section 1105.7(e)(4) or (5). Accordingly, the historic reporting requirement should not apply to a discontinuance under the proposed class exemption, because such a discontinuance will not result in a transfer, sale or lease of the applicable rail property.

Even if the historic reporting requirements applied to a discontinuance under the proposed class exemption, the current regulations provide an exception to those requirements at 49 C.F.R. § 1105.8(b)(1). That exception applies to “[a] sale, lease or transfer of a rail line for the purpose of continued rail operations where further STB approval is required to abandon any service and there are no plans to dispose of or alter properties subject to STB jurisdiction that are 50 years old or older.” Under the proposed class exemption, (i) a small railroad must certify that it has no plans to alter or dispose 50

of the thresholds in 1105.7(e)(4) or (e)(5) is exceeded, which is consistent with the current regulatory language at 49 C.F.R. § 1105.6(c)(2).

or more years old properties that are under the jurisdiction of the Board, and (ii) the small railroad does not yet have authority to abandon the line.⁴ Thus, the new proposal is similar to an already-existing exception to the historic reporting requirements.

Moreover, decisions by the Board (or its Office of Proceedings) repeatedly have treated the discontinuance of a rail line as exempt from both the environmental and historic reporting requirements. *See* AB-837X, *Long Island Rail Road Company – Discontinuance of Service Exemption – In Garden City, Long Island, NY*, served Sept. 6, 2002 (stating that “[t]his proceeding is exempt from environmental reporting requirements under CFR 1105.6(c) and from historic reporting requirements under 49 CFR 1105.8(b)”); AB-55 (Sub-No. 641X), *CSX Transportation, Inc. – Discontinuance Exemption – In Knox County, TN*, served Jan. 2, 2004 (same); STB Docket No. AB-565 (Sub-No. 15X), *New York Central Lines, LLC – Discontinuance Exemption – In Henry County* and STB Docket No. AB-55 (Sub-No. 639X), *CSX Transportation, Inc. – Discontinuance Exemption – In Henry County, IN*, served Dec. 5, 2003 (same); AB-490X, *Greenville County Economic Development Corporation – Discontinuance of Service Exemption – In Greenville County, SC*, served July 18, 2003 (noting that the railroad “intends to discontinue service over the line and to facilitate possible future operations in the event it is successful in securing funds to repair the line” and stating that because the railroad’s “discontinuance of service will merely result in the cessation of service over the line, this proceeding is exempt from the [environmental and historic] reporting requirements...and no environmental documentation will be prepared”), *notice of exemption dismissed on other grounds*, served Jan. 29, 2004; STB Docket No. AB-55

⁴ Under the proposed regulations, Section 1152.50(d)(7) provides that “[t]he authority to abandon shall become effective 30 days after the carrier has complied with the applicable [environmental and historical

(Sub-No. 620X), *CSX Transportation, Inc. – Discontinuance of Service Exemption – In Raleigh County, WV*, served July 19, 2002.⁵

Finally, permitting a small railroad that files for abandonment to discontinue the line shortly before it obtains abandonment authority is similar to permitting a railroad to impose a temporary embargo on its line. A railroad currently may embargo its line, thereby discontinuing service thereover, without complying with any environmental or historic reporting requirements.

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provisions], subject to any conditions imposed by the Board.”

⁵ But see e.g., STB Docket No. AB-501X, *Longhorn Railway Company – Discontinuance Exemption – In Burnet, TX*, served April 1, 1997 (rejecting petition because it did not comply with environmental requirements); AB-55 (Sub-No. 584X), *CSX Transportation, Inc. – Discontinuance Exemption – in Hudson County, NJ*, served Dec. 8, 2000 (stating that “[a]n environmental assessment (or impact statement) is normally made available in abandonment or discontinuance proceedings, but under 49 CFR 1105.6(d), the Board may modify the environmental requirements in appropriate circumstances”); STB Docket No. AB-55 (Sub-No. 618), *CSXT Transportation, Inc. – Discontinuance – At Memphis, In Shelby County, TN*, served Oct. 28, 2002 (stating that “[t]he Board is also required to consider the environmental and energy impacts of the proposed discontinuance”).