

Railroad Regulation Going Forward

STB Review of Staggers Act: October 19, 2005

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Staggers Act – Looking Back

PROS

- Stable regulatory regime
- Improved efficiency and lower rates
- Bankruptcies halted
- Growth of short lines

CONS

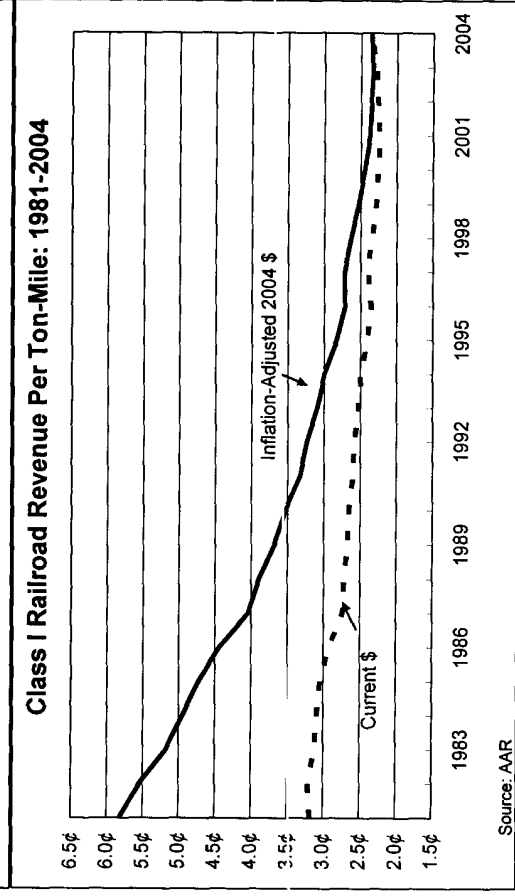
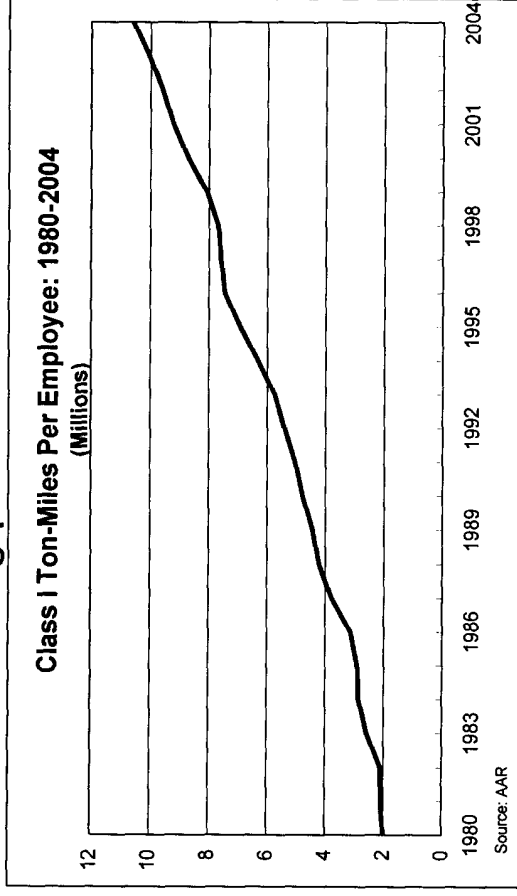
- Struggle for revenue adequacy continues
- Pending capital decisions to solve endemic capacity constraints

Overall the railroads are healthier
Shippers are moving more volume at lower rates

Track Record – Post Staggers

Freedom to manage ... efficiency improvements ... falling prices

- New freedom to manage operations in commercial environment
 - To accommodate growth of 80%, increase between 1980 and 2004
 - To improve resource use and achieve efficiency gains
- Average rail rate decline through post-Staggers era
- Rate decline deceleration reflects strengthening demand
 - RTMs have grown 3.3%/yr in the past decade versus 1.9%/yr in 1980-94



Long Term Sustainability

- Revenue adequacy is macro-level gauge of sustainability over time
- Threshold below which major fixed capacity investment are unlikely
- Excessive regulation = divestment
- Private sector capital markets are acid test
- Post Staggers, improved performance from:
 - Rationalization, productivity and cost reductions

No evidence of exorbitant earnings since Staggers

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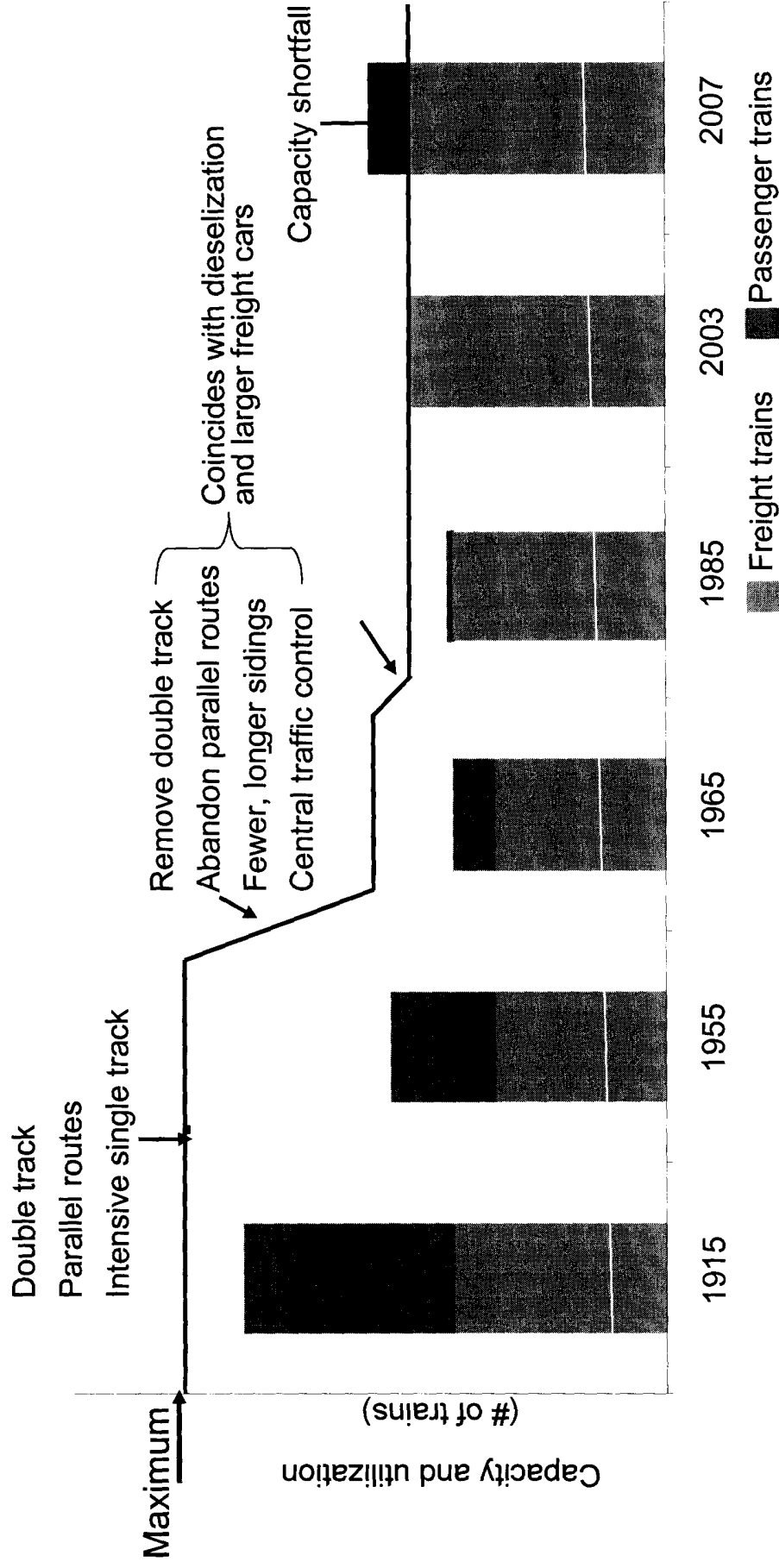
Railroad Industry – Looking Forward

- Past 25 years saw railroads rationalizing overcapacity:
 - Staggers framework allowed this to happen concurrently with rate decreases benefiting shippers
- The next 25 years will require:
 - Economic incentive & regulatory stability
 - Huge investment in fixed assets required to meet demand growth >50%
 - Per AASHTO, ~\$50 billion **increment** required for rail to preserve market share over next 20 years

Going forward network capacity is THE issue

Network Capacity- Emerging Story

Like others - CPR network holiday ending



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Rail Regulation – Looking Forward

- **Build-on the best features of Staggers:**
 - Stability
 - Commercial incentive to improve productivity
 - Targeted regulation
 - Case by case dispute resolution mechanisms
- **Future regulatory environment should:**
 - Incent railroads to undertake capacity investments
 - Capital markets' perception will drive level of capacity funding
 - Carriers and shippers interests in capacity are aligned
 - Foster rail competition by providing:
 - Market driven pricing - best system for resource allocation
 - Financial incentives to productivity improvements

Building efficient transportation network to handle nation's growth