

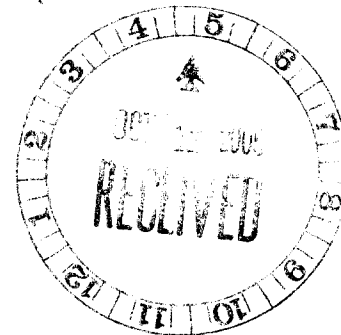
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Via Hand Delivery

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K St. N.W.
Washington, D.C. 20423

RE: STB Ex Parte No. 658, *The 25th Anniversary of the Staggers Rail Act of 1980;*
A Review and Look Ahead

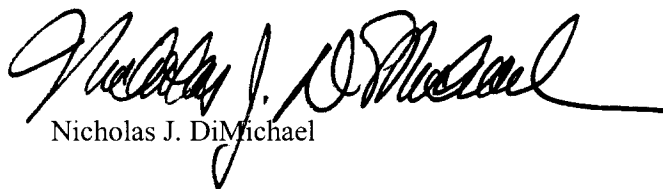
Dear Secretary Williams:

Please find enclosed the original and ten (10) copies of Written Testimony submitted by The National Industrial Transportation League for filing in the above referenced proceeding. Also enclosed is a diskette with a copy of the Written Testimony in Word format.

An extra copy of the Testimony is enclosed for stamping and returning to our offices.

Should you have any questions regarding the foregoing, please do not hesitate to contact the undersigned.

Sincerely,



Nicholas J. DiMichael

BEFORE THE
SURFACE TRANSPORTATION BOARD



Ex Parte No. 658

*THE 25TH ANNIVERSARY OF THE STAGGERS RAIL ACT OF 1980:
A REVIEW AND LOOK AHEAD*

Written Testimony

submitted by

THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

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THE NATIONAL INDUSTRIAL TRANSPORTATION
LEAGUE
1700 North Moore St.
Suite 1900
Arlington, VA 22209

By Its Attorneys

Nicholas J. DiMichael
Thompson Hine LLP
1920 N St. N.W.
Suite 800
Washington, D.C. 20036
(202) 263-4103

Dated: October 12, 2005

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BEFORE THE
SURFACE TRANSPORTATION BOARD

Ex Parte No. 658

*THE 25TH ANNIVERSARY OF THE STAGGERS RAIL ACT OF 1980:
A REVIEW AND LOOK AHEAD*

Written Testimony

submitted by

THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

In a Notice of Public Hearing issued by the Board on September 14, 2005, the Board announced that it would hold a public hearing to provide a forum for the expression of views on the impact, effectiveness, and future of the Staggers Rail Act of 1980 ("Staggers Act" or "Act"). Interested persons, including large and small rail customers, large and small railroad companies, representatives of local communities, and state and federal government officials, were invited to participate. The hearing was intended as an opportunity for interested persons to address broad issues regarding the Staggers Act generally. This Written Testimony is submitted by The National Industrial Transportation League ("League") in response to the Board's Notice.

The League believes that, in a number of respects, the Staggers Act has been a success. In particular, the Act has led to the financial revitalization of the railroad industry, to such an extent that several railroads are now or will likely soon be "revenue adequate" even under the Board's demanding standard. In addition, the Act led directly to the development and wide use

of contracts between shippers and rail carriers, which (at least up until the recent past) became the dominant form of commercial relationship between shippers and rail carriers.

However, since the Staggers Act, there have been substantial changes in the nation's economy and more specifically in the railroad industry. These changes have resulted in new problems for shippers and railroads, and have given rise to new issues for public policymakers, including the Board, to consider. These changes thus make this twenty-fifth anniversary of the Act a particularly appropriate time to evaluate the impact, effectiveness and future of the statute. The League believes that the Board should re-evaluate the future administration of the Staggers Act in light of these changes in the industry. The League therefore warmly commends the Board for holding this hearing, and urges the Board to carefully evaluate the record in this proceeding in order to fulfill both its own regulatory responsibilities in administering the Act, and, if the Board believes it necessary, to fulfill its obligation under 49 U.S.C. 704 to transmit legislative recommendations to Congress.

As noted above, the Staggers Act has clearly been successful in encouraging the financial revitalization of the railroad industry. However, beyond these changes in railroad finances, the past twenty-five years have seen major changes in industry structure, capacity, operations, service, and shipper investment; and in the competition that the rail industry faces from other modes. The League notes that many of the changes in the railroad industry since the Staggers have resulted in an increase in railroad market power and have decreased competitive options for shippers.

In view of these changes, the League believes that the Board needs to become more of an advocate for rail users and more focused on the pro-competitive thrust of the Staggers Act.

Policymakers need to address increasing capacity restraints in the railroad industry, and how to grow capacity in the railroad industry and across all transportation modes. The Board also needs to become more sensitive to service issues, and better design its regulatory processes to address service problems. Finally, the Board should revise its approach to rail-to-rail competition in light of the changes to the industry, and clarify its rate reasonableness standards, in particularly its small case standards and processes.

I. THE STAGGERS ACT HAS BEEN SUCCESSFUL IN SEVERAL KEY RESPECTS

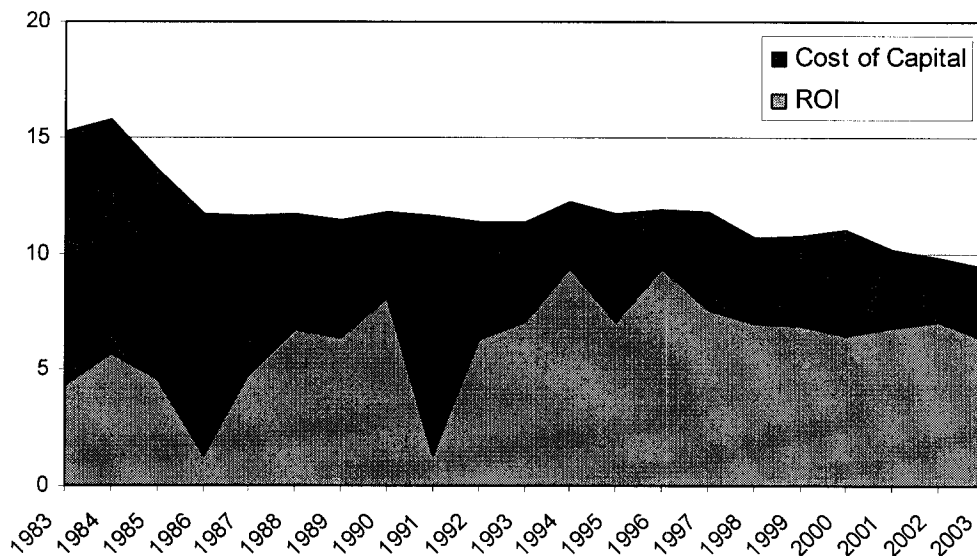
A. The Act Has Been Successful in Encouraging the Financial Revitalization of the Railroad Industry

There is no doubt that the Staggers Act has been a factor in the financial revitalization of the railroad industry. By freeing the industry from unnecessary regulation, the Act permitted railroads to rationalize their systems and to make needed changes in their operations to drive down costs and increase productivity.

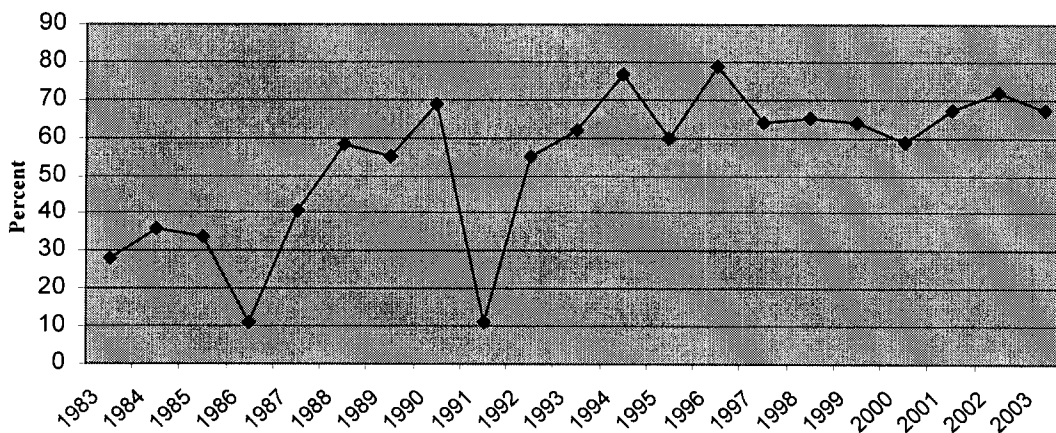
Using just the narrow and demanding regulatory "return on investment" standard followed by the STB and its predecessor the Interstate Commerce Commission, the following graphs show clearly how far the industry has come financially since the passage of the Act. The first graph portrays the railroad industry's cost of capital as determined by the ICC or the STB in each year since 1983,¹ as well as the railroad industry's return on investment over that same time period. The second chart shows the industry's return on investment as a percent of its cost of capital.

¹ The year 1983 was chosen because this was the first year that ROI was calculated on the basis of depreciation accounting, and therefore the industry's ROI in that year is comparable to subsequent years.

Comparison of Railroad Industry ROI and Cost of Capital



Railroad Industry ROI As a Percent of Cost of Capital



In 1983, the return on net investment of the industry was 4.3%, whereas the railroad industry's cost of capital was 15.3%.² In other words, in that year the railroad industry earned just 28% of the cost of capital deemed necessary for revenue adequacy by the Interstate Commerce Commission. In 2003, by contrast, the railroad industry's ROI was 6.33%, whereas

² Association of American Railroads, "Railroad Facts," 1990 edition, pp. 18 and 19. .

the industry's cost of capital was 9.4%.³ Thus, the industry was earning over two-thirds of the cost of capital deemed necessary by the STB for revenue adequacy. In that year, Norfolk Southern had an ROI of 9.1 percent, or just under the 9.4% standard for revenue adequacy determined by the Board.⁴

Since the Board's 2003 revenue adequacy decision published in August 2004, the industry's financial position has improved even further. Though the Board has not officially published its revenue adequacy determination for 2004, it appears that the Norfolk Southern achieved revenue adequacy in 2004 as the Board defines the concept, with a 2004 tax-adjusted ROI of 11.6%, which was well above the likely cost of capital level of around 10%. Moreover, the industry's return on investment is likely to exceed the highest percentage of its cost of capital in any year since the passage of the Staggers Act. The NS is likely to achieve revenue adequacy again in 2005, and the Chief Executive Officer of the Burlington Northern has publicly indicated that his railroad is likely to achieve revenue adequacy in 2005. *Rail Business*, Vol. 11, No. 38 (Sept. 2005), p. 4. Other railroads may achieve revenue adequacy, and even those that don't are likely to close the gap even further. The respected industry analyst James Valentine of Morgan Stanley indicates in a very recent report that in 2005 he expects Canadian National, BNSF, Norfolk Southern and Canadian Pacific – four of the six major Class I carriers --to all earn their cost of capital. James Valentine and Michael Manelli, Morgan Stanley Equity Research, "All Aboard ! Reiterating Bulling View Towards Freight Railroads," September 20, 2005, p. 3. [Hereafter, "Valentine Railroad Report"].

³ AAR, "Railroad Facts," 2004 edition, pp. 18-19.

⁴ *Id.*, pp. 19, 74.

The fact of the matter is, however, that by all standards other than the agency's official determination of "revenue adequacy," the industry has already achieved revenue adequate status as a real-world matter and has likely done so for the past several years. Wall Street has been clearly bullish on the railroad industry for some time, despite the agency's yearly pronouncements that the industry is "revenue inadequate." It is clear that the agency's "revenue adequacy" standard is an extremely demanding one and overstates the financial returns needed for "real world" revenue adequacy. This is likely due to the fact that the industry still has significant investment "on the books" which does not earn its cost of capital, but which also consumes few current resources.

The industry, according to the ICC's and STB's official determination, has not earned its cost of capital for twenty-five years. In fact, according to the AAR as reported by financial analyst James Valentine, the railroad industry had not earned its cost of capital since 1945,⁵ a state that was probably true even long before that. An industry that has not earned its cost of capital for six decades or more should, under conventional economic theory, be long out of business. Yet, the industry survived, and now thrives, despite still being labeled as "revenue inadequate" by the STB -- a situation suggesting that the agency's "return on investment" measurement is an incorrect one when applied to determine the financial condition of the railroad industry. Individual railroads have had no trouble raising capital of any kind for any purpose for a number of years. The industry's stock has in fact outperformed the S&P 500 Index over a long stretch of time.⁶

⁵ Valentine Railroad Report, p. 3.

⁶ Siegel, Jeremy J., *The Future for Investors*, Crown Business (2005), p. 62. Mr. Siegel notes that the stock of the BNSF, which he calls the "star performer" of the four major surviving railroads, "has achieved an astounding 17 percent annual return since 1980, more than 4 percentage points higher than the S&P 500 Index." *Id.*

In the recent report noted above, the respected financial analyst James Valentine was positive about the industry's current financial condition and extremely bullish on the industry's financial prospects for the future. The summary of his report is worth quoting in full:

**ALL ABOARD! REITERATING BULLISH VIEW TOWARDS
FREIGHT RAILROADS**

Conclusion: Even though the six major North American railroads have seen their stocks rally 15%-60% over the past year, we continue to believe there is sustainable momentum, with conservatively another 15%-30% upside by year-end 2006, led by Norfolk Southern.

What's New: The bullish stance that we've had for the past year was reinforced recently during our meetings with four of the freight railroads as well as additional discussions with our industry sources including large railroad shippers. *We have even greater conviction that the industry will consistently earn its cost of capital over the next few years (a feat not achieved in decades), led by secular upward pricing initiatives that should continue into 2006 and beyond.* We expect improved returns and cash flow, combined with the railroad industry's traditionally stable revenue base, to drive the industry's P/E ratio 100-300 basis above its historical 12.5x forward earnings. Using a basket of comparable companies in other industries as a guide, we could argue the better railroads will eventually trade at a market multiple, which would lead to 30%-40% stock price appreciation by year-end 2006.

What's Misunderstood?: Since the drop in railroad valuations in April, we've seen them pull back on days of rising oil prices or negative economic news, which confirms our view that the Street believes the recent wins by the railroads are more cyclical than secular. Over the next 12-18 months, we believe this view will be disproved, namely that *this industry is headed for higher earnings power and higher valuations due to secular changes in freight transportation, regardless of near-term economic or oil price movement.*

Id., p. 1 [emphasis added]. Mr. Valentine concludes that "*returns in the next decade [for the industry] will be in the 8% - 14% range, which will lead to further P/E expansion.*" *Id.*, p. 3. [emphasis added]

The Morgan Stanley analysis of Mr. Valentine is echoed to a large extent by a Bear Stearns Equity Research Report, May 2005, "Railway Rush Hour – How Long Will Tightness in Rail Capacity and Pricing Gains Persist?", which notes, at page 5: "Given our expectation that

infrastructure constraints are likely to support continuing tightness in rail capacity, we believe that the rails are likely to sustain a solid pricing story well beyond 2005. In our view, continued pricing gains should support EPS growth even in a slowing economy.” The Bears Stearns analysis notes that “secular trends support rail growth beyond the economy.” *Id.*, p. 6.

The key point in the data shown above and in Wall Street’s analysis is that this financial trend is not just a single-year or passing phenomenon. In Mr. Valentine’s words, the industry’s financial trend is “secular” rather than “cyclical.” While the industry, over perhaps the first twenty years or so after passage of the Staggers Act, clearly emerged solidly from the financial distress experienced by the industry in the 1970s, something even more profound has happened over the past two or three years: capacity constraints and other developments (discussed in more detail below) which have moved the railroads to a higher financial level, at which even the agency’s demanding (and unrealistically high) return on investment for “revenue adequacy” standard is likely to be satisfied over significant time periods.

It is clear, then, that for the first time since the passage of the Staggers Act, neither the agency nor Congress need be concerned about the financial health of the freight railroad industry for the foreseeable future, and do not need to orient public policy making with solely the financial health of the railroads in mind. From a financial perspective, policy makers can and should treat the railroad industry as a system, composed of both providers and users: the financial health of both need to be kept in mind.

B. Contracting Under the Act Has Been a Success, Though Its Future is in Doubt

The Staggers Act for the first time clearly permitted the development of transportation contracts between shippers and rail carriers. Quickly after passage of the Act, contracts became

the dominant form of commercial relationship between shippers and rail carriers. As envisioned by the Act, contracts permitted carriers to lock in a base of business, and gave shippers certainty in their transportation costs over a period of time, as well as certain service guarantees.

However, there are now real questions about the future of railroad contracts for many shippers. As discussed further below, recent years have seen a significant return to tariff or public pricing by many rail carriers in a number of industry segments, and shippers report to the League that, even where contracts are offered, the term of the contract is decreasing and meaningful service guarantees are becoming much more difficult to come by.

II. SINCE THE PASSAGE OF THE STAGGERS ACT, THERE HAVE BEEN SUBSTANTIAL CHANGES IN THE U.S. ECONOMY AND IN THE RAILROAD INDUSTRY

In the last twenty-five years, the U.S. economy has changed substantially. The country has seen its industrial sector decline in relation to the service sector as production has shifted to Asia, a development that has had profound effects on both global and domestic transportation. Technology has changed dramatically: in 1980, the year that the Staggers Act was passed, there were no personal computers, there was no email, no internet, and a "hybrid" was a rose. The railroad industry has also changed, and a brief discussion of these changes is in order to set the stage for a discussion of the future.

A. Rail Mergers and the Growth of Short Lines

Since 1980, the number of Class I railroads have declined dramatically, from approximately 40 at the time of the passage of the Staggers Act to just seven today. But even those numbers are deceptive: of the 122,293 miles of road operated in 2003 by these seven Class I carriers, 109,548 miles or 90% were operated by just four of these railroads (UP, BNSF, CSX, and NS); and of the total Class I operating revenue of about \$36.6 billion in 2003, about \$34.0

billion or 93% was generated by these four carriers.⁷ Two of these carriers operate largely in the western part of the U.S., and two in the East. By any measure, the industry is now highly concentrated.

At the same time, the railroad industry has seen a dramatic growth in the number of so-called "short line" rail carriers, which were formed directly as a result of some of the changes made by the Staggers Act. According to the American Short Line and Regional Railroad Association, in 2002 there were 545 short line and regional rail carriers, operating 46,474 miles of track and employing 19,688 people. Almost 60% of these were local line haul carriers (operating 350 miles of track or less), and almost 40 percent were switching and terminal carriers. The remainder (six percent) were regional carriers operating more than 350 miles of track and/or with a revenue over \$40 million. Seventy percent of these carriers had begun operation subsequent to the passage of the Staggers Act. ASLRAA, "Short Line and Regional Railroad Facts and Figures, 2004 edition, pp. 6-7. Short line and regional carriers carried over 9.3 million carloads in 2002. *Id.*, p. 8.

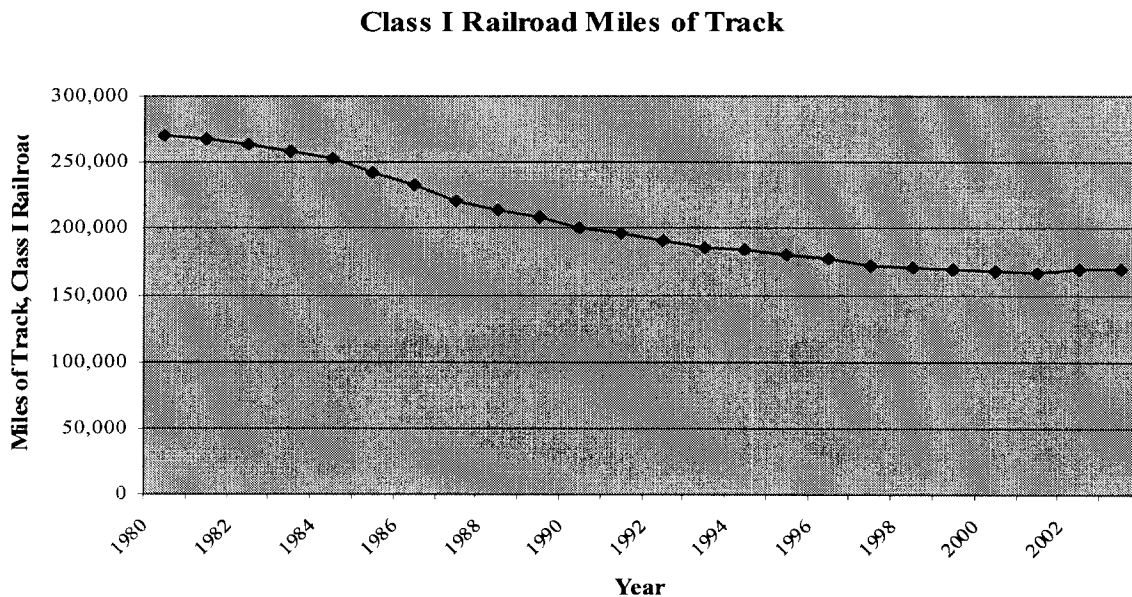
The growth of short lines has been an extremely beneficial development for shippers: these market-responsive and service-focused carriers perform a valuable role, particularly in the "first mile" and "last mile" of rail shipments, and their growth should continue to be encouraged. The Board needs to view these carriers as full partners with the Class I carriers in the shipment of goods by rail.

⁷ AAR, "Railroad Fact," 2004 Edition, Association of American Railroads, pp. 66-67.

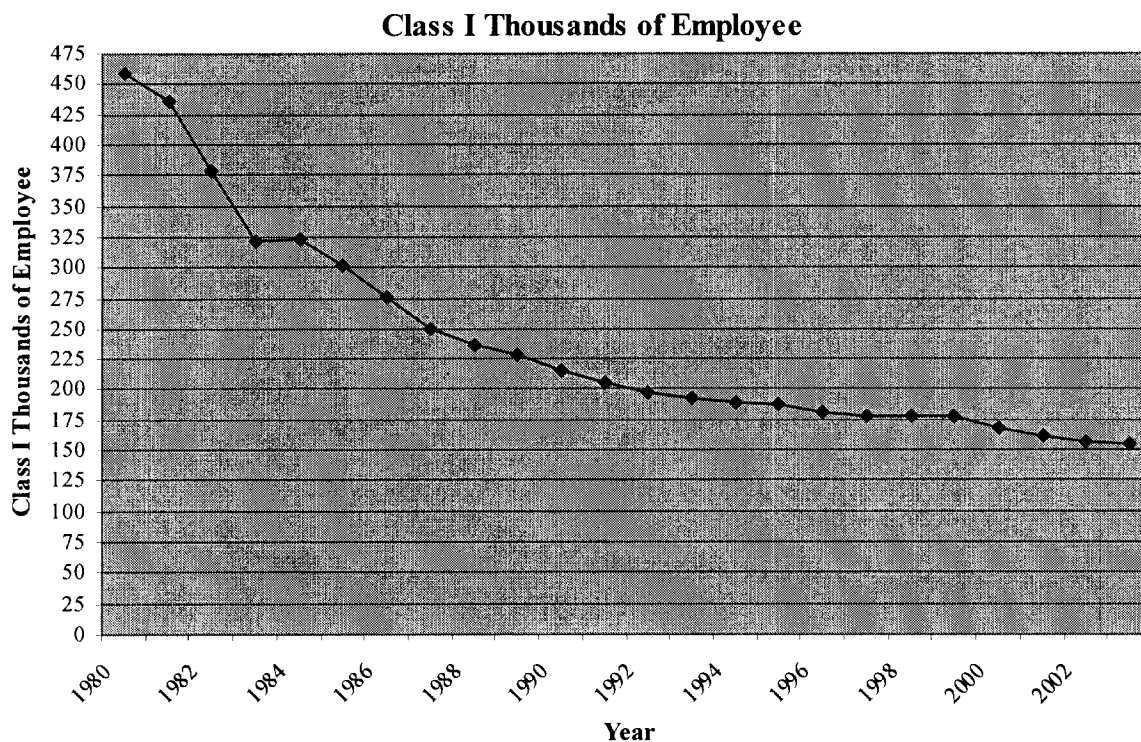
B. Increasing Capacity Constraints in the Rail Industry

Probably the most significant development since the passage of the Staggers Act has been the increasing capacity constraints that are now present in the railroad industry. The Board is well aware of reports from both shippers and railroads indicating that the industry is experiencing substantial capacity limitations. In addition, several kinds of data identify some sources of the constraints now being experienced by the industry.

Since the Staggers Act, the miles of track and the number of employees for Class I railroads have declined dramatically:



Source: AAR, "Railroad Facts," 2004 edition, p. 45, and other years' similar data.



Source: AAR, "Railroad Facts," 2004 edition, p. 56 and other years' similar data

The AAR's figures show that since 1980, miles of track owned by Class I rail carriers have declined by about 40 percent,⁸ and the number of employees have declined by about two-thirds.

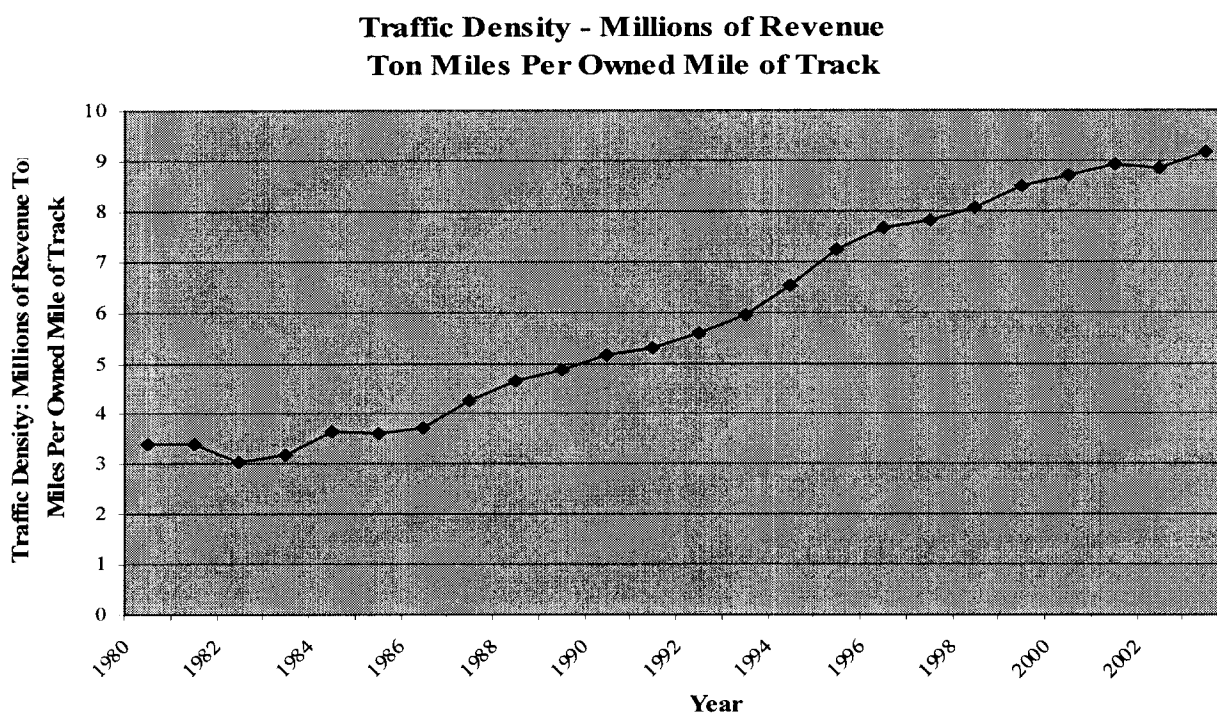
What is important about these figures is not only the magnitude of the declines since 1980, but also the fact that the declines have largely leveled off since about 2000 (in fact, the number of miles of track owned has increased since its low point in 2001, the first time that this has happened since 1929.⁹ This suggests that the rail industry has reached the point at which it cannot shed any more track or employees – it has reached the point that it needs all the

⁸ The decline in the number of track miles by Class I railroads does not come close to being counterbalanced by the increase in the number of short line miles. The total short line industry in 2002 owned or leased about 30,000 miles of track, with government owning about 9,000 miles of track. ASLRAA, "Facts and Figures," 2004 edition, p. 7. Some of this track was owned by short lines even before the Staggers Act. In contrast, between 1980 and 2003, Class I carriers experienced a reduction in over 100,000 miles of track. AAR, "Railroad Facts," 2004 edition, p. 45.

⁹ *Id.*

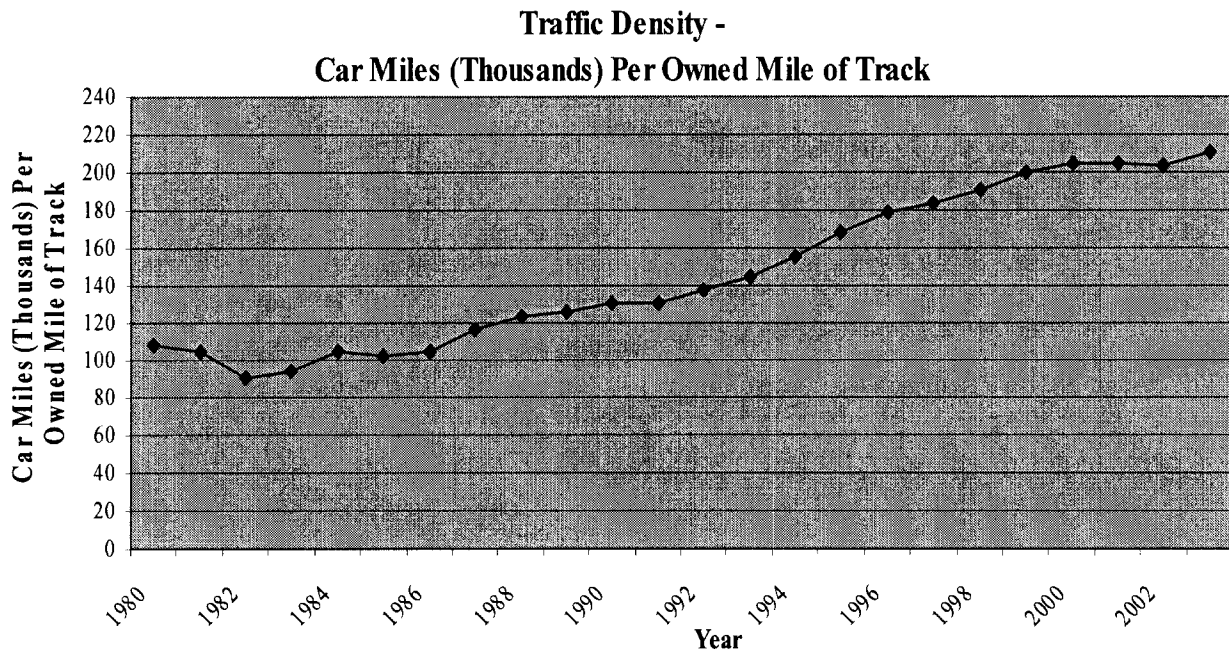
employees and track that it has. Indeed, reports have indicated that some rail carriers are adding employees, for the first time in many, many years.

The significant limitation on railroad capacity is dramatically confirmed by data which the AAR uses to determine traffic density -- millions of revenue ton-miles per owned mile of track -- and a related figure, millions of revenue car-miles per owned mile of track.¹⁰ Both of these figures since the Staggers Act show huge increases in traffic density, plus a recent leveling off of density increases, apparently as the capacity of the system is being reached.



Source: AAR, "Railroad Facts," 2004 edition, p. 42

¹⁰ The car mile figure appears to the League to be a better sign of the possibility of congestion, since ton-miles are affected by the weight of loadings (a factor not important in system congestion), whereas car-miles better capture the amount of "space" on the railroad being taken up by increased traffic.



Source: AAR, "Railroad Facts," 2004 edition, p. 34 and p. 45 and other years' similar data

These figures show that since 1980, ton miles per owned mile of track have approximately tripled, and car miles per owned mile of track have approximately doubled. However, since 2000, these increases have begun to level off.

Significantly, these increases in traffic density have not, on average, come from increases in the number of tons per car or in the number of cars per train. According to the AAR's own figures, the number of tons per carload is less in 2003 than it was in 1980 (67.1 in 1980 versus 62.3 in 2003),¹¹ and the number of cars per train is virtually the same as it was in 1980 (68.3 in 1980 versus 68.9 in 2003).¹² While clearly rail carriers are putting many more tons in some cars than they did in 1980 and more cars on some trains, the changes in traffic mix, including the growth of light-loading intermodal traffic, has apparently kept average growth in these

¹¹ AAR, "Railroad Facts," 2004 Edition, p. 37.

¹² *Id.*, p. 35.

categories flat. Thus, rail carriers appear to be putting, on average, more and more trains on a system whose amount of track and number of employees have significantly declined since 1980. And, given the flattening out of all of these figures over the past two or three years, they do not appear to be able to do this any longer, at least not nearly to the extent that they have in the past. As the AAR notes regarding its traffic density measure: "[a] higher figure [of millions of revenue tons per owned mile of track] indicates greater utilization efficiency, but can also signal the risk of congestion." *Id.*, p. 42. Reports from both shippers and railroads clearly indicate congestion issues in the rail industry.

C. Reductions in Competition from Other Modes

Historically, the major competitors to rail carriers have been motor carriers, across a part of the railroads' traffic base. However, there are many reasons to believe that competition by motor carriers has in recent years been significantly less effective.

Motor carriers have had a difficult time finding drivers, and the recent changes to Hours of Service regulations for motor carriers have only exacerbated the problem. Mr. William Graves, President of the American Trucking Associations, has noted in a recent speech that the "driver market is the tightest it has been in 20 years," and a May 2005 study by the ATA shows that the trucking industry will face a huge shortage of drivers over the next 10 years, a fact that will likely require carriers to pay their drivers substantially more, a result that in turn will have a dampening effect on the competition that motor carriers will provide in the future.¹³ Insurance rates have substantially increased, and dramatic hikes in fuel prices since 2004 have hit the motor carrier industry hard, since fuel is a significantly larger part of the motor carrier industry's

¹³ This increase in the cost of drivers and other costs will have an effect on intermodal traffic as well, whose motor carrier portion is likely to increase.

cost structure compared to the rail industry. The Valentine Railroad Report notes that the trucking industry has been hard-hit by both fuel and non-fuel costs in recent years, *id.* at pp. 9-10, and Mr. Valentine concludes that "truck's pain is railroad's gain." *Id.*, p. 10. Finally, there appears to be little possibility at the present time that size and weight restrictions for the motor carrier industry would be eased, facilitating competition with railroads over a larger portion of the transportation business.

Given the recent hike in fuel and non-fuel costs, there is increasing question as to how much truck competition plays in restraining rail rates for commodities moving more than a few hundred miles. The Valentine Railroad Report indicates that railroads price only about twenty percent of their business against long-haul trucking. *Id.*, p. 9. Indeed, in an even more recent report published by Morgan Stanley, almost 60% of the railroad industry's revenue has a "low" or "somewhat low" sensitivity to being priced directly against truckload motor carriage. Morgan Stanley Equity Research, James Valentine, Chad Bruso, Michael Manelli, "Freight Pulse 9 - Shippers See Railroad Rates and Truck Capacity on the Rise," October 4, 2006, p. 7 [hereafter "Valentine Freight Pulse 9 Report"]. These include such major product groups to the U.S. economy as coal, chemicals, farm products, crushed stone and sand, and petroleum.¹⁴

It is very notable that Mr. Valentine places in this category "Intermodal (international)", which he indicates has a "somewhat low" likelihood that railroads price this segment directly against trucks. Thus, even in a traffic category that conventional wisdom might suggest is highly truck-competitive, the market has changed: evolving international and domestic traffic patterns; shipper, railroad and public investments; and other factors have all combined to

¹⁴ The Valentine Freight Pulse 9 Report characterizes the remaining 22% of the railroads' traffic base as having "moderate" price competition by trucks. This category includes such commodities as motor vehicles, primary forest products, and metals. *Id.*

give rail carriers unprecedented pricing power even in what has been thought of as "truck-competitive" markets.

D. Operational Changes and the Growth of Shipper Investment and Activities

There have been numerous operational developments in the rail industry since the Staggers Act, but two are particularly important: (a) growth in shipper investment in the rail industry and the assumption by shippers of functions that used to be performed by rail carriers; and, (b) the growth of unit trains and the decline in the emphasis on carload operations.

The past twenty-five years have seen a remarkable shift in car ownership in the railroad industry. In 1980, Class I railroads owned 1.168 million cars, and shippers and car companies owned about 440,000 cars, or only about 26% of the total 1.7 million freight car fleet (about 100,000 cars were owned by other than Class I rail carriers). *Id.*, p. 51. By 1990, the total number of freight cars in service had declined precipitously, to 1.2 million cars (a drop of nearly 30%), but the total number of non-railroad cars had increased to about 450,000, a figure that represented 37 percent of the total number of cars. By 2000, the number of railroad cars had dropped again, from 761,000 in 1990 to 692,000 in 2000, a decline of nearly 10 percent, while the number of non-railroad cars had again risen from about 450,000 in 1990 to more than 688,000 in 2000, a massive increase of more than fifty percent. In that year, non-railroad freight cars for the first time comprised more than fifty percent of the total car fleet. By 2003, the total non-railroad freight car fleet was 54 percent of the total number of cars.¹⁵ *Id.*

¹⁵ Not only did the number of shipper-owned cars increase dramatically after the Staggers Act, but the kind of cars owned by shippers changed substantially as well. Before the Staggers Act, a significant percentage of shipper-owned cars were tank cars, which had traditionally been supplied by shippers, with carriers paying a mileage allowance. But in the years following Staggers, many other types of cars began to be owned by shippers, including open-top hoppers for coal movements; covered hoppers for chemicals; and others.

Thus, in the twenty-five years since the passage of the Staggers Act, the number of non-railroad cars increased by more than fifty percent, and comprises more than half of the total rail industry car fleet. In sharp contrast, the number of railroad freight cars declined from 1.270 million to just 590,000, a drop of nearly 55%, and now railroad freight cars comprise less than half the total of rail cars in service. Indeed, if Class I rail carriers are only considered, the drop has been even more precipitous: Class I rail carriers, despite moving and handling virtually every car on the nation's rail system, in 2003 controlled just 467,063 of the 1,278,980 cars in the system, or just 37 percent of the freight cars in the industry. *Id.* This represents a huge change from "traditional" railroading, in which the Class I carriers themselves supplied most of the instrumentalities of transportation. This shift in car ownership means the assumption of much more than just the purchase price of the cars: all related maintenance, taxes, etc. are also shifted.

Beyond car ownership, shippers have invested massive amounts in other incidents of transportation such as rapid loading facilities. Even more importantly, shippers have assumed substantial functions that prior to the Staggers Act were performed by railroads as a part of their railroad service, such as waybilling. Shippers have also invested heavily in and perform new administrative functions such as tracking and tracing, paperless invoicing systems, etc.

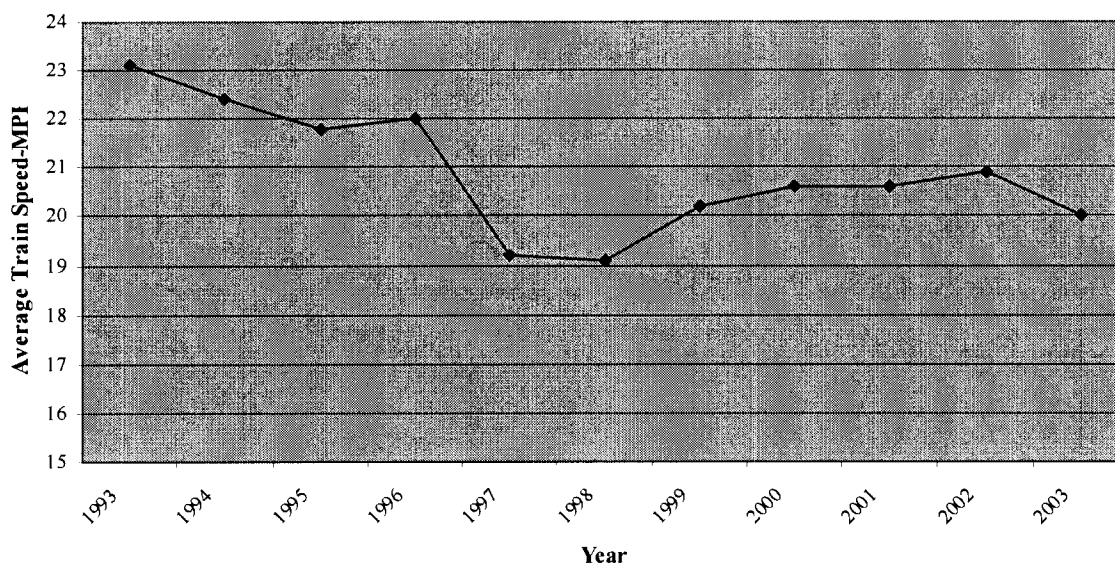
Additionally, the years since the Staggers Act have seen a marked shift in railroad operations, away from carload and multiple car operations, toward unit train operations. Significant parts of the railroad industry's operations are now performed in shuttle or unit-train-type operations, including coal, grain, intermodal, and others. In this shift, carload shippers feel themselves the "stepchild" of the industry, paying more and getting less.

E. Service Trends and Service Problems in the Railroad Industry

The years since the Staggers Act have also seen substantial service problems. Some of these were related to the wave of mergers that took place from 1995 to 2000, and some of the changes in shippers' investment in cars can be traced directly to these problems. In the four years between 1995 and 1999, non-railroad cars increased by approximately 112,000, or more than the number in any four-year period before or since back to 1929, an astounding twenty-percent increase in the number of non-railroad cars in just that four-year period. *Id.* This four-year period was the time of severe service problems in the railroad industry, starting with the UP/SP merger in 1995, and ending with the purchase of Conrail by Norfolk Southern and CSX in 1998. Because of those service problems, shippers that were tied to the railroad system for their transportation had to acquire, and did acquire, large numbers of cars to be able to meet their customers' needs.

There is significant anecdotal evidence from shippers that service in the railroad industry has not improved significantly since the mergers of the 1990s or even since the Staggers Act, but there is little hard data – a topic further addressed below. What limited hard data there is suggests that service levels have not yet recovered from the service problems that began almost a decade ago. For example, the AAR's own figures indicate that average train speed has actually declined between 1993 and 2003:

Average Train Speed



Source: AAR, "Railroad Ten-Year Trends 1993-2002," p. 132; and "Railroad Ten-Year Trends 1994 – 2003," p. 132.

In addition, the AAR also publishes average train speeds, by month, for each of its members, as well as total U.S. figures, for more recent time periods. Attached as Appendix A to these Comments are three charts, showing: the average train speed for the BNSF, CSX, NS and UP from January 2000 through September 2005; a chart showing the Total U.S. average train speed; and a chart showing the average terminal dwell times for each of these railroads from January 2001 through September 2005.¹⁶ Over this recent time period, average train speed for the total U.S. shows a decline from about 23 miles per hour in the year 2000, to less than 22 miles per hour for the most recent 12-month period reported. Since the beginning of 2002, average train speed for all four major U.S. carriers has declined steadily. Similarly, since about the middle of 2002, average terminal dwell for three of these four carriers has remained

¹⁶ The four-carrier charts are through December 2004 for BNSF, which changed its method of calculating terminal dwell and train speed in January 2005.

essentially flat or has deteriorated (i.e., terminal dwell has increased), while terminal dwell has improved for only one carrier.

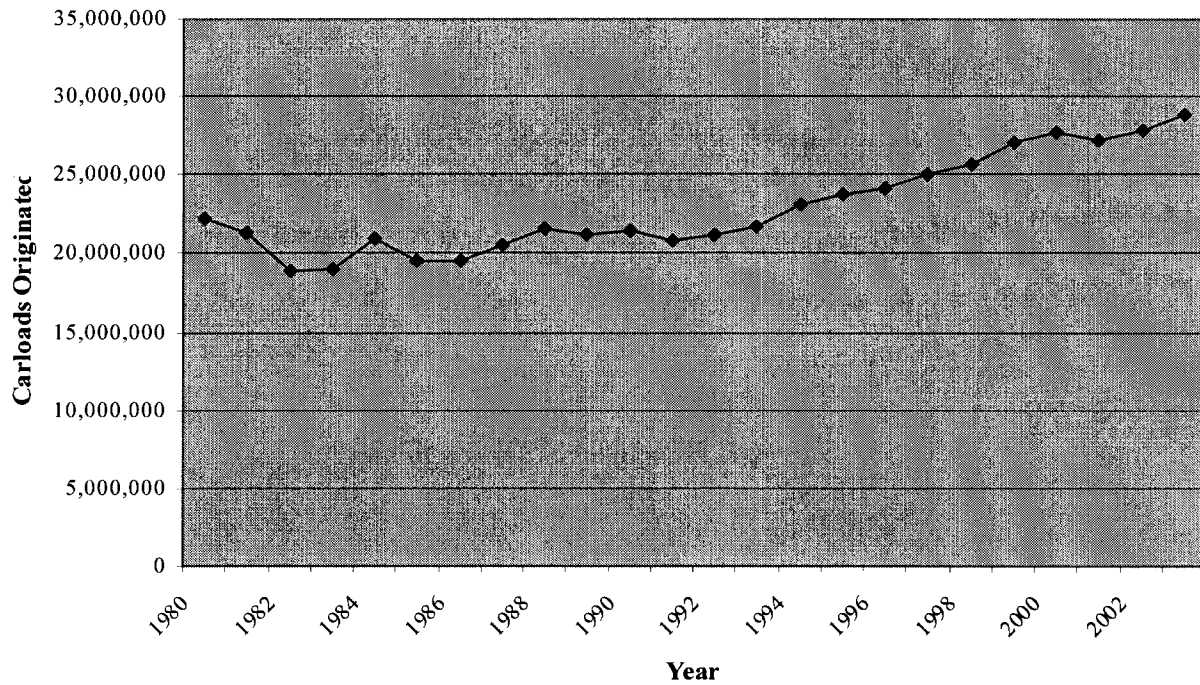
Another source of information is surveys of shippers, which have consistently shown growing shipper dissatisfaction with rail service. The Valentine Freight Pulse 9 Report, for example, notes that, in a comprehensive survey done by Morgan Stanley over a number of years of nearly 300 heavy freight customers, shippers in the survey gave railroads in 2005 a score of only 5.8 out of ten for "delivery when expected," a decline of ten to twenty percent in this key area from scores on this factor reported in 2001 to 2003. Valentine Freight Pulse 9 Report, p. 3.

In short, the chart above, combined with the charts in Appendix A and the reports by shippers, suggests that the service promises of the rail mergers of the mid-1990s have yet to be realized

F. Growth in International and Domestic Intermodal Traffic

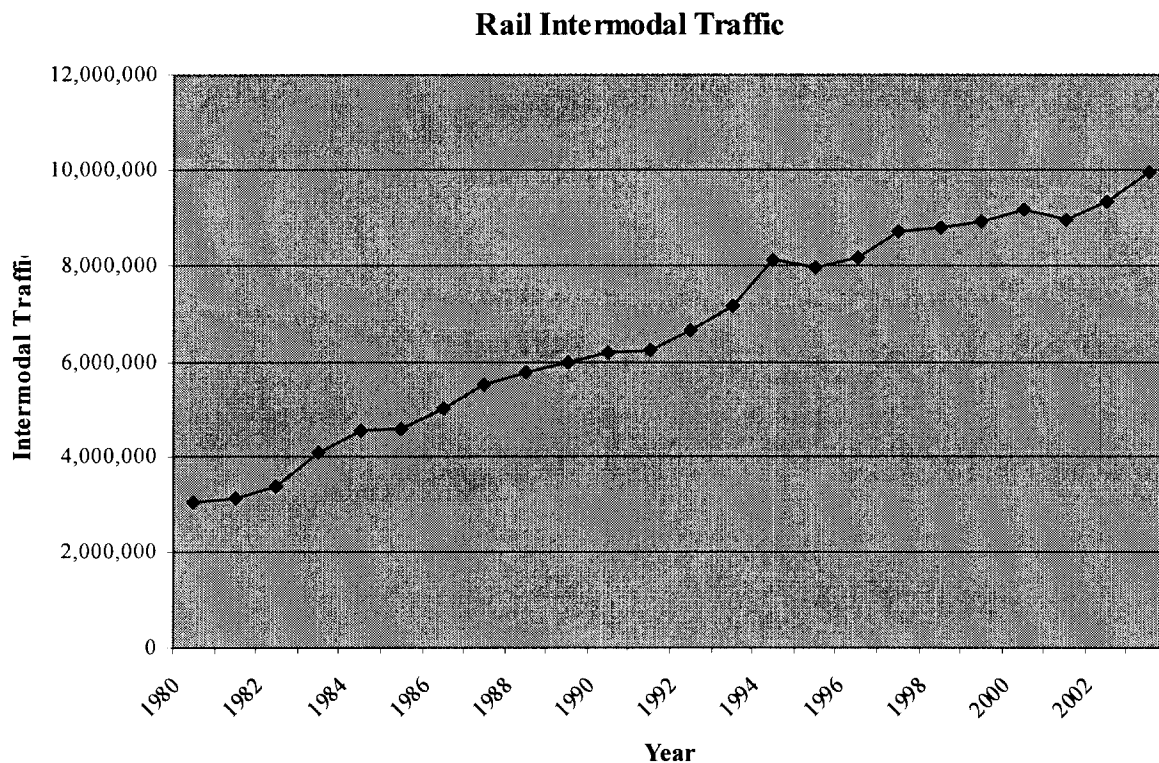
Since 1980, the number of carloads originated by the rail industry has increased approximately thirty percent, though given the twenty-five year time period involved shows only slow growth per year -- an average of only about 1 percent per year. As discussed at page 28 below, in recent years rail carload originations have not kept pace with U.S. industrial production. The chart below shows the number of carloads originated per year since 1980:

U.S. Rail Industry - Carloads Originated



Source: Railroad Facts 2004 edition, p. 24 and other years' similar data

What has changed significantly in railroads' originations over this time period is one particular type of traffic – intermodal. Since 1980, intermodal traffic has more than tripled, increasing from about 3 million units per year in 1980, to approximately 10 million in 2003. Indeed, it appears that the modest growth overall in railroad traffic since 1980 has come almost entirely from massive growth in the intermodal segment.



Source: Railroad Facts 2004 edition, p. 26 and other years' similar data

The growth of intermodal has had profound effects on the railroad system. The traffic tends to be higher speed and higher priority compared, for example, to unit train coal or merchandise traffic, and therefore "takes up" significant "space" on the railroads' network. A significant part of this traffic comes from the West Coast in the form of containers imported from the Far East, a fact that has caused congestion on certain lines, and a significant need to upgrade both West Coast receiving facilities and the intercontinental network from the West. Though intermodal was long believed to be carried at rates just above incremental cost, recent anecdotal evidence suggests that pricing has moved up significantly.

G. Shift From Contracts Back to Public Pricing, and Changes in Contracts

In the past several years, a final significant change has taken place – the shift from contract back to public pricing. This development has been widely reported in the press, and the League is well aware of this change. League members report that the pace of this change seems to be gaining a considerable amount of momentum among the railroads. The change permits railroads to increase prices on little notice, but leaves shippers with little certainty in their transportation arrangements; few remedies for poor service; and subject to extremely restrictive (and perhaps unlawful) rules on loss and damage.

Contracts have been affected as well. While it is impossible to make certain judgments given the confidential nature of contracting, general information from shippers suggests that contracts have become of much shorter duration; contain few if any service guarantees; are subject to a variety of accessorial and surcharges; and often are little more than a promise by the shipper to ship a certain amount or percentage of goods and a price for transporting the goods. In short, it appears that the railroads are implementing a strategy of having few private contracts with shippers that have any real teeth or meaning to them.

III. MANY OF THE KEY CHANGES IN THE RAILROAD INDUSTRY SINCE THE STAGGERS ACT HAVE RESULTED IN AN INCREASE IN RAILROAD MARKET POWER AND HAVE DECREASED COMPETITIVE OPTIONS FOR SHIPPERS

It is very clear that a number of the changes that have taken place in the transportation industry since the passage of the Staggers Act have resulted in an increase in railroad market power and decreased options for shippers.

Railroad mergers have reduced the number of railroad competitors to just two in the East and two in the West. These mergers have reduced the number of competitive routing options as

merged carriers have closed formerly competitive gateways. Combined with the agency's ruling in its 199_ "bottleneck" decision, which eliminated the right of shippers to choose a competitive joint-line route when one railroad could provide single-line service, mergers have extended railroad bottlenecks and have turned potentially competitive routings over at least part of a movement into single-line captive movements. Rail mergers have also decreased even the indirect leverage represented by product and geographic competition, as widely-separated plants are today much more likely to be served by the same railroad. The extreme concentration of the industry, coupled with the increased use of public pricing — itself a practice whose growth has been facilitated by the small number of rail competitors in the industry -- has made the possibility of price leadership and conscious parallelism much more likely. With the growth in public prices, it becomes much easier for the two remaining competitors in the East and West to monitor each other's prices, and by their reactions to each other more easily manage their desired level of prices.

Beyond the competition-dampening effects of rail mergers since the Staggers Act, there have been other developments that have tended to increase rail market power. Increasing shipper investment in instrumentalities of transportation that used to be supplied by rail carriers themselves, such as cars and rapid loading facilities, have tied rail-dependent shippers even more tightly to the use of rail. A shift to truck competition becomes even more difficult if a company has to "write off" millions of dollars in rail-related investments, even as the price of rail transportation increases and the consistency of rail service declines.

As noted above, changes to the trucking industry have also increased the ability of rail carriers to exercise market power, as changes in fuel prices, driver shortages, increases in insurance and other costs, and other factors have caused trucks to be less and less competitive to

rail carriers over a larger segment of the railroads' traffic base. The Valentine Railroad Report noted that non-fuel truckload trucking costs increased twelve percent in the two-year period from 2003 through 2004. They are expected to jump another seven percent this year, for a total non-fuel cost increase of nearly twenty percent in just three years. Valentine Railroad Report, p. 9. When these non-fuel cost increases are combined with the large fuel cost increases recently experienced, this places motor carriers at an even greater competitive disadvantage. As noted above, the Valentine Freight Pulse 9 Report concluded that "approximately 80% of the industry's revenue is generated by customers where modal shift to truck is not a very realistic option" Valentine Freight Pulse 9 Report, p. 7. Even the transportation of motor vehicles, usually considered to be truck-competitive, was rated by the Morgan Stanley team as having only "moderate" truck competition. *Id.*

The move away from contracts and toward public pricing gives rail carriers much more opportunity to change prices quickly, and much less responsibility for the quality of service. Conversely, shippers have less and less certainty over their transportation costs, and at present, few remedies for poor service.

Overarching all of these trends is the growing realization that the rail industry is experiencing serious capacity constraints. As the Valentine Railroad Report notes, "after 90 years, the railroads have run out of excess capacity." Valentine Railroad Report, p. 8. It concludes: "[t]his lack of excess capacity has shifted the railroad's marketing philosophy from one of *incremental pricing* to one of *full cost recovery* pricing, including their cost of capital, a philosophy not used for such a broad range of railroad commodities in at least 50 years." *Id.* [emphasis in original]. The Board is well aware that shippers have been experiencing railroad "de-marketing" of less desirable movements through price hikes, and very substantial rate

increases for the traffic base as a whole. The Morgan Stanley survey confirms these reports: "Shippers responses [to the Freight Pulse 9 survey] confirm our view that *railroad pricing is rising at unprecedented levels.*" Valentine Freight Pulse 9 Report, p. 1 [emphasis added]. This pricing story, more than anything, confirms that rail carriers are under fewer competitive restraints than at any time since passage of the Staggers Act.

IV. PUBLIC POLICYMAKERS NEED TO RE-EVALUATE FUTURE REGULATION OF THE INDUSTRY IN LIGHT OF THESE CHANGES TO THE RAILROAD INDUSTRY

A. The Board Should Be More Balanced in Its Regulatory Approach

For twenty-five years, the ICC and the STB have been focused on protecting the financial health of the railroad industry. The League believes that the regulatory agency went too far in that direction, and did not give enough emphasis to the equally important competitive thrust of the Staggers Act. The very first policy implemented by the Staggers Act was "to allow, to the maximum extent possible, competition and the demand for rail services to establish reasonable rates for transportation by rail." 49 U.S.C. 10101(1). The third policy set forth in the Act, to "allow[] rail carriers to earn adequate revenues," is clearly important, but it is not on a higher plane than the desirability of competition to set prices in the rail industry.

New conditions require new responses. With the financial health of the industry no longer an immediate issue, and with the increasing market power of rail carriers, the Board should be more balanced in its regulatory approach. This does not mean that the Board should return, even if it could, to the comprehensive scheme of regulation prior to the Staggers Act. Rather, increased emphasis must be placed on the creation of value to the shipping public in a competitive marketplace. Perhaps the most consistent "message" that the League hears from its shipper members, especially in the recent past, is: "I wouldn't mind paying for higher rates, as

long as I was getting something for the extra money. But I'm paying a lot more, and getting less."

Indeed, railroads and shippers need to become better partners, not worse. No one wants to return to the highly confrontational structure of direct regulation that existed prior to the Staggers Act. The creation of value will only occur if railroads and shippers, spurred by the overall structure created by the regulatory system, work together to identify sources of productivity gains and cost reductions, and work to change systems and processes to incorporate those changes. Particularly in the service area, there needs to be a greater level of collaboration between shippers and carriers to operate as a true rail network, otherwise the level of service consistency needed in order to maximize current capacity will not be fully realized. The League strongly supports a collaborative approach, but in order for it to work, there must be benefits for shippers as well as railroads, and both parties need to act to ensure that it is successful.

It is highly unlikely that shippers and rail carriers will ever see all of the resources that the rail transportation industry needs to grow the capacity of the system, and therefore the industry, both shippers and carriers, will have to squeeze the very best out of the resources that it has and any increased resources that are brought to bear. As discussed further below, the forces of competition must play a large part in extracting greater and greater efficiencies, since direct governmental regulation has seldom been nearly as effective as the competitive marketplace in increasing efficiency. On the other hand, monopoly or oligopoly has also seldom been effective in creating value or efficiency.

The Board has an important part to play in this relationship. It can establish the overall competitive (or non-competitive) structure of the industry; it can set the rules for the commercial

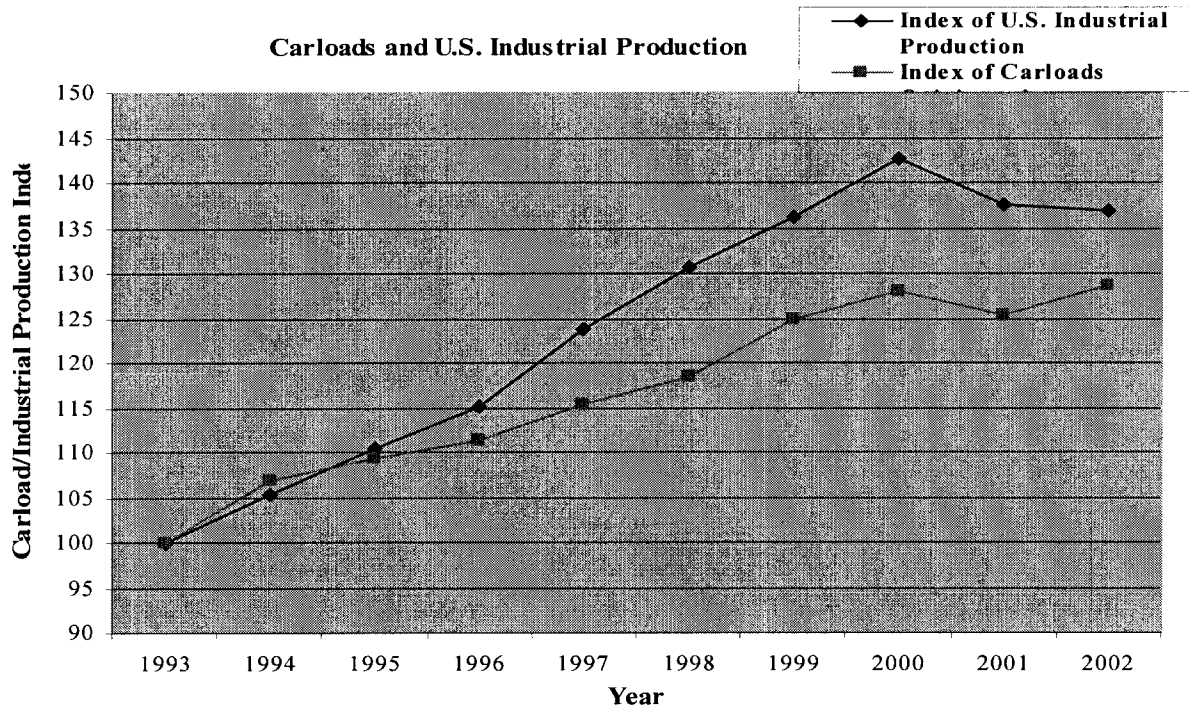
relationship; it can, in the case of market abuse, directly regulate prices and practices. The railroads no longer need to be protected: their financial condition is strong, and getting stronger. Shippers, on the other hand, have fewer effective competitive choices than they had at the time of the Staggers Act and for a number of years beyond. The Board needs to be sensitive to these changing market dynamics, and more sensitive to issues of potential market abuse.

B. The Railroad Industry Must Grow Its Share of Intercity Freight

It is crucial that the railroad industry grows and prospers, for the good of the shipping public and the good of the country. Any projection of future economic growth indicates that the need for transportation will grow dramatically in the next 15 years. The respected "Freight-Rail Bottom Line Report," published by the American Association of State Highway and Transportation Officials ["AASHTO Report"] projects that, with moderate economic growth, U.S domestic and international freight tonnage will grow between 2000 and 2020 from 15.2 billion freight tons to 24.5 billion freight tons, an increase of 67 percent. AASHTO Report, p. 50. Rail tonnage is expected to grow by 44%, or significantly less than the overall growth in freight tonnage. The situation at key choke-points is even worse. The Port of Los Angeles/Long Beach recently released estimates showing that containerized imports through that port will grow from 15.5 million TEUs in 2005 to 19.6 million TEUs in 2010 (a growth of 44%), to 26.6 million in 2015 (a growth of another 34%); to 35.3 million TEUs in 2020 (a growth of another 34%) -- well more than a doubling of traffic through this key facility in just 15 years.¹⁷

But the fact of the matter is that, for a long time, the railroads have not kept pace with the growth of transportation needs. The chart below shows that the rail industry's carload growth has not kept pace with U.S. industrial production in the ten-year period between 1993 and 2002.

¹⁷ See, <http://www.polb.com> and <http://www.portoflosangeles.org>

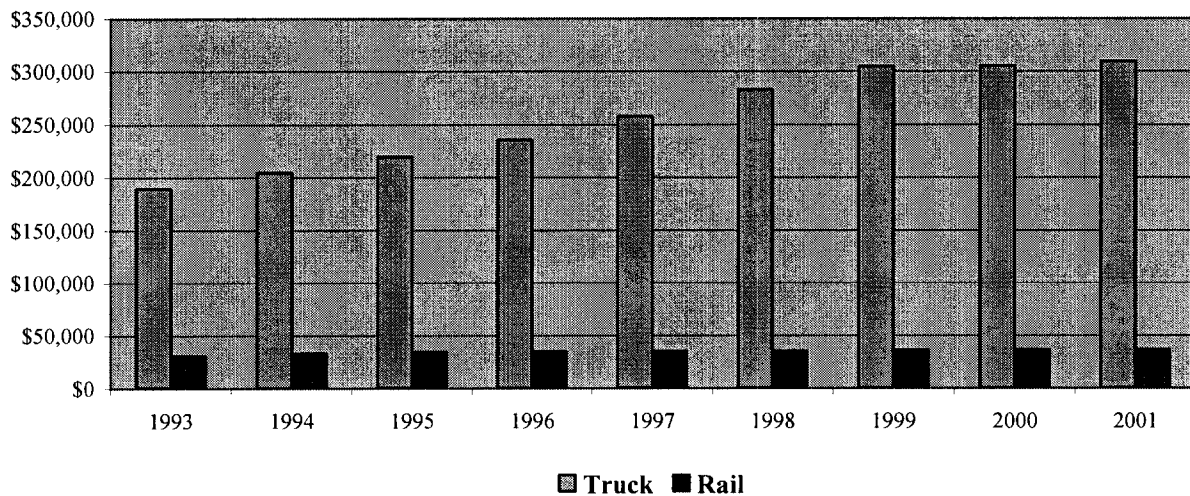


Source: AAR Railroad Ten Year Trends 1993-2002, p. 43 and 44.¹⁸

The carload growth data noted at page 21 above show that rail intercity freight traffic has grown very modestly since the Staggers Act. Other figures show that rail revenue has also grown very slowly, while the revenue of intercity freight traffic carried by truck has grown substantially, even in just the last ten years. Railroad's share of intercity freight traffic revenue has thus dropped significantly over time:

¹⁸ More recent data published by the AAR shows that, even on a ton-mile basis (which is more favorable to rail carriers, who carry heavy-loading commodities), rail ton-miles have not quite kept pace with U.S. industrial production over the period from 1994 to 2003. "AAR Railroad Ten-Year Trends 1994-2003, p. 44.

Modal Revenue Growth – 1993-2001 (\$000,000)



Source: Association of American Railroads, "Railroad Ten-Year Trends 1994-2003," p. 26 [data for 2002 and 2003 not available at time of printing]

C. Public Policymakers Need to Address How to Grow Capacity in the Railroad Industry and Across All Transportation Modes

The railroad industry is the victim of trends that have been moving at this point in the opposite direction: strong growth in the amount of transportation needed by the country to maintain its standard of living, and a long-term decline in the railroads' physical plant as they used existing plant more and more efficiently. But from a mindset of cost-control and downsizing, the railroad industry has to shift radically and rapidly to a mindset of capacity expansion.

Demand is very likely to outstrip capacity growth in the current model. The railroad industry is capital-intensive, and railroad investment is expensive. With the reduction in the number of carriers through mergers, it is questionable whether rail carriers on their own have the ability to expand capacity at the rate that it needs to grow. Indeed, in the current concentrated market, there is a question as to whether the industry even desires to grow at a pace that, in the

short term, would increase the supply of railroad transportation services and therefore decrease price.

The fact of the matter is that the country does not need railroad capacity to grow at the same pace as the growth of the economy or transportation generally: it needs to grow faster. For reasons of energy independence and environmental concerns, and because it will be even more difficult to expand the nation's road system easily in the face of increasing public opposition to new roads through densely-settled existing communities, the railroads' share of intercity freight has to grow. The growth in freight generally will tax every mode, and there will be increased freight for all modes. The question is not whether one mode will be "disadvantaged" vis-à-vis another mode in this growth: it is whether all modes, together, can handle the job.

Public policymakers need to confront this issue, and quickly. Public policymakers need to address how to grow capacity in the railroad industry, and to integrate that growth in capacity with the trucking industry, which will in many cases be required to bring the freight "the last mile." Modal collaboration will be essential. The Staggers Act did not really address this matter: it didn't have to, given the substantial overcapacity in the railroad industry in 1980. The League understands that this will require new resources, and that the Board, as a regulatory agency, will have only a marginal part to play in the development of new resources. But the Board, as the overseer of the industry, should strongly communicate this need to the Congress, and recommend that the Congress should more strongly address the problem.

D. The Board Needs to Become More Sensitive to Service Issues, and Its Regulatory Protections Must Be Better Designed to Address Service Problems

In a just-in-time business environment spanning the globe, inventory is "warehoused" in large part on the nation's transportation providers. The League has been a leader in identifying

service as one of the key issues: for example, it was very active at the time of the UP/SP service crisis, and it organized two service forums in 2004 regarding the UP and CSXT service problems in that year, in cooperation with the Board and the railroads. The League is well aware from its members that service reliability has become a larger and larger part of the shipper's concern. Moreover, as noted above, the League believes that there has been a decline in contracts containing significant service guarantees and an increase in the incidence of public pricing whose service requirements fall within the Board's statutory authority. Thus, the quality of rail service should become a larger part of the Board's focus.

There are several things that the Board can do in the service arena.

First, the Board should develop and require much better data on rail service, to enable cross-carrier comparison and comparison of service trends over time. After the UP/SP merger debacle in the mid-1990s, the Board required the UP to publish a few broad service measurements. Over time, these service measurements: average train speed, terminal dwell, cars on line, and few other service metrics, were published by the AAR. But there are numerous weaknesses in this data: it is too general; it is published by the AAR only for the recent past and thus it is difficult to make comparisons over time; and it is subject to changing and sometimes inconsistent definitions by the rail carriers themselves, which limits the usefulness of the data.¹⁹

The agency clearly has the authority to compel carriers to submit data in a format selected by the STB and to make that data public if it is not competitively sensitive. The agency should do so. In addition to the data being published by the AAR, the agency should require

¹⁹ The BNSF, for example, has changed the way that it measures terminal dwell. For a while, both "old" and "new" methods were published, so that a continuity of comparison could be made. The League understands that this is no longer done, so it is impossible to compare dwell over time. Moreover, it does not appear that the BNSF's definition is the same as the definition used by other rail carriers. The BNSF's change has also affected its calculation of average train speed.

railroads to publish metrics for key lanes, and average dock-to-dock rail performance should be measured and published. The League believes that railroad have moved to create increasing amounts of data as they have begun to move toward a more scheduled railroad system.

Railroads have complained in the past that it is difficult to make cross-carrier comparisons, and have used that assertion to argue against more detailed reporting of data. The kernel of truth in this statement should not be taken too far. It is inconceivable that, for example, BNSF does not have a very good idea of UP service metrics in key corridors, and does not evaluate the efficiency of its own system at least partly in relationship to service provided by its competitor. The same is likely true of the NS and CSX. Somewhat inconsistently, railroads have argued that data should not be made public because it is competitively sensitive. At the level of data that the League is talking about, it is extremely difficult to credit such an argument. Moreover, even if, for example, transit times in key corridors are a point of comparison between carriers, wouldn't the competitive market work better if this information were known by the shipping public?

Second, the Board should make an attempt to better define its authority over rail service. The Board's statutory authority in service matters is subject to very general standards (service on "reasonable request"; service with "reasonable dispatch"). Obviously, the Board needs to be extremely careful in service matters, to avoid adverse impacts on one shipper as it tries to cure the service problems of another shipper. Moreover, the legal standards governing the Board's authority are fact-specific. Yet, these standards cannot be meaningless, and both the courts and the agency in the past have made attempts to define what service on "reasonable request" means. See, *Alstom Power v. Norfolk Southern Railway Company*, Civil No. L-01-622, U.S. District Court, District of Maryland, July 12, 2004; *Minneapolis & St. Louis Ry. Co. v. Pac. Gamble*

Robinson Co, 215 F.2d 126, 134 (1954) (the law requires “of every carrier the utmost fairness and good faith on its part in dealing with the shipper and in the discharge of its duties to him.”). The Board needs to have the means to hold carriers accountable for reasonable service.

Finally, the League is concerned about the increasingly onerous conditions being imposed by rail carriers on loss and damage claims. Section 11706 requires that carriers limit their liability only in accordance with that section, and courts have ruled that this exception to the public policy in favor of full liability is to be construed narrowly. See, *Rohner Gehrig Co. v. Tri-State Motor Transit*, 950 F.2d 1079, 1083 (5th Cir. 1992). Courts have also held that, before a liability limitation may become effective, the railroad has to provide the shipper with a reasonable or fair opportunity to choose between two or more levels of liability. *Hughes v. United Van Lines, Inc.*, 829 F.2d 1407, 1419-1420 (7th Cir. 1987).

There are real questions as to whether all of the carriers’ liability rules comport with these requirements. While some carriers appear to offer both full and limited value rates in their public prices, other railroads do not do so. But even railroads that do offer a choice of full versus limited liability rates, full liability rates are at two or three times limited value rates, making the “choice” essentially meaningless. Carriers’ liability rules sometimes require the burden of proof to be on the claimant; establish no presumption of carrier fault, and impose other limitations that might be in direct contradiction to the requirements of the Carmack Amendment.²⁰ Reasonable rules on loss and damage are an important element of good service.

²⁰ See, for example, BNSF Rules Book 6100-A

E. The Board Must Revise Its Approach to Rail-to-Rail Competition in Light of Changes in the Industry

For many, many years, the League has argued that the Board should change its extremely restrictive policies on rail-to-rail competition. The increased market power of rail carriers vis-à-vis shippers and increasing capacity constraints in the rail industry makes this more urgent now than at anytime in the past, and at the same time, insures that such a change would not, as the railroad industry has argued for many years, result in crippling economic losses.

Competition is at the heart of this Nation's economic system. Competition creates a sense of urgency that enables companies to thrive. It spurs efficiency. Competition allocates scarce resources in the most efficient way possible, according to their economic value. In the railroad industry, effective rail-to-rail competition is only present if there is a choice of rail carriers both at origin and at destination.

Increased railroad competition would be particularly valuable in a capacity-constrained environment. Reasonable economic access, such as through a reversal of the agency's "bottleneck" decisions and a lowering of the extremely high barriers for reciprocal switching, would permit shippers to access rail carriers that they cannot currently access, who may have under-utilized capacity. In a capacity-constrained environment, it simply makes no sense to keep shippers captive to one railroad when other carriers might be able to move goods more efficiently.²¹

Moreover, greater reliance on the competitive market would be economically efficient, since capital for capacity expansion would naturally flow to the most economically beneficial

²¹ Railroads have claimed that, if a competitive route is really more efficient, then the railroads themselves will decide to utilize that route. But railroads have a number of reasons not to share traffic when that traffic can be carried on their system, foremost being a desire not to share profits with a competing carrier. Moreover, the competitive market, and not one of the carriers, should make this decision.

projects for the transportation system, without uneconomic barriers being thrown up by one rail carrier.

Finally, given the capacity constraints in the rail system, a move to a more competitive railroad marketplace would not lead to economic ruin, as the industry has asserted in the past. As Mr. Valentine noted, rail carriers have, in the current environment, moved from a system based on incremental pricing to a system based on full cost recovery pricing, including recovery of the cost of capital. Valentine Railroad Report, p. 8. If the Board would increase rail-to-rail competition in the current capacity-constrained environment, even in the short term the overall level of revenue to the industry would not decline drastically, but would be allocated more efficiently among rail carriers. In the longer term, individual rail carriers and the railroad system as a whole would be spurred to greater efficiencies through the competitive process.

In short, the League urges the Board to revisit and revise both its bottleneck decisions and the standards imposed by its interpretation of its Ex Parte 445 rules in *Midtec* and other cases. The League would note that neither of these changes would result in one carrier operating over the lines of another, but would simply provide a shipper with economic access to the lines of a nearby, potentially competing carrier.

F. The Board Needs to Revise and Better Define Its Standards and Speed Up Its Processes

The twenty-fifth anniversary of the Staggers Act is an appropriate time for the Board itself to revisit its standards and procedures. Indeed, in a capacity-constrained environment, the Board should analyze and re-think the role of differential pricing as the industry moves, as Mr. Valentine noted, from an era of incremental pricing to an era of full-cost recovery pricing.

1. The Board should develop standards and procedures for adjudicating small rate cases

On July 16, 2004 in Ex Parte 646, *Rail Rate Challenges in Small Cases*, the League joined with many other organizations in calling for the Board to establish a “bright line” test for qualifying for small rate cases; to facilitate the processing of small rate cases; and to better define its standards for adjudicating small rate cases. The League still strongly believes that the Board should make the changes recommended in that submission.

On June 6, 2005, the Board issued an important decision in the case of *BP Amoco v. Norfolk Southern*, the very first case filed under the Board’s “small case” guidelines. That decision, which was explicitly limited to the circumstances of that case, did a number of specific things: (a) it set a 200-day schedule for adjudicating the case; (b) it set a three-phased procedure for determining eligibility, winnowing certain evidence, and issuing a decision; (c) it established procedures for expediting discovery; (d) it ruled that parties were to use URCS Phase III costing, and that no movement-specific adjustments would be permitted; (e) it would utilize only the RSAM unadjusted for efficiency; and, (f) it would choose either the complainant’s or defendant’s comparison group for calculating the R/VCcomp factor, and would not select its own comparison group.

Assuming that the *BP Amoco* procedures foreshadow similar procedures in future cases, the League applauds the Board’s determination not to permit small cases to take years and millions of dollars to litigate. The decision to utilize Phase III costing and forbid movement-specific adjustments appears reasonable, although there are still a number of questions as to what is meant by “movement-specific adjustments” and whether there should be any exceptions to that rule.

However, the League strongly disagrees with the Board's decision to utilize the RSAM unadjusted for efficiency, and believes that it is legally unsupportable and economically irrational. In a capacity-constrained environment, there is no reason for any traffic to be carried at below variable cost, and indeed the burden should be on the rail carrier to show why traffic is not recovering at least its long-run variable costs.

2. The Board should attempt to simplify its large-case standards and procedures

Few if any League members are able to utilize the Board's large-case standards, which take millions of dollars and three to four years to litigate. Given the experience that the Board has had in adjudicating large cases, the Board should investigate whether, on a case-by-case basis as it did in the *BP Amoco Chemical* case, it can develop procedures that would substantially speed and simplify the processing of large rate cases. Otherwise, the most accurate and economically-supported rate standard will be unavailable to the very large majority of rail shippers.

3. The Board should analyze the role that differential pricing should play in the regulatory scheme in a capacity-constrained environment

One of the cornerstones of the ICC's and the Board's regulatory scheme since the Staggers Act has been the concept of differential pricing, the notion that rail carriers should price inversely to demand, that demand-inelastic customers should pay more for rail carriage than demand-elastic customers, and that the Board should recognize this principle in its regulatory review of the reasonableness of a rate to a captive shipper. However, under the statute, the Board is also bound by the notion of revenue adequacy, which is not only a goal, but as the agency has recognized in a regulated setting, also over time a limit. As the agency noted in its decision in *Coal Rate Guidelines – Nationwide*, 1 I.C.C.2d 520, 535 (1985):

Our revenue adequacy standard represents a reasonable level of profitability for a healthy carrier. It fairly rewards the rail company's investors and assures shippers that the carrier will be able to meet their service needs for the long term. Carriers do not need greater revenues than this standard permits, and we believe that, in a regulated setting, they are not entitled to any higher revenues. Therefore, the logical first constraint on a carrier's pricing is that its rates not be designed to earn greater revenues than needed to achieve and maintain this "revenue adequacy" level. In other words, captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs [footnote omitted]."

In a capacity-constrained environment, carriers can price non-captive traffic at levels that more closely approximate full cost pricing, including the cost of capital. Indeed, Valentine Railroad Report makes clear that railroads are already doing this to an extent not seen in several generations.

But the necessary extension of this development is that differential pricing should have less of a part to play in the pricing of regulated, captive traffic, in order for a railroad to achieve revenue adequacy. As more and more railroads are likely to approach or even exceed the rate of return necessary for revenue adequacy, the Board itself needs to re-think the extent of differential pricing necessary for captive traffic and the role that differential pricing should play in the Board's evaluation of reasonable rates for captive shippers. Indeed, given the changes in the transportation marketplace, the Board may need to re-think just how "competitive" traffic that was formerly considered "truck-competitive" now really is. It is clear that the business landscape within which the regulatory authority of the Board must operate is very different now than it was when the Staggers Act was passed. These are difficult issues, and the League is willing to work with the Board and the railroads to explore potential solutions.

4. The Board should investigate and create standards for rail surcharges and accessorials

Rail shippers have become concerned about carriers' increasing use of accessorials and surcharges as a means to raise revenue rather than cost-recovery. League members increasingly report that these charges are multiplying rapidly, without checks and balances. The League has also heard numerous expressions from its members that many railroads' fuel surcharge programs appear to permit an over-recovery of increased fuel costs. The League has met with a number of carriers over the past several months to voice these concerns about some of these fuel surcharge program. Recently, BNSF has announced a significant change in its fuel surcharge program to attempt make it fairer and more reflective of the actual increase in the cost of fuel, and while the League is still waiting to see the final results of this revision, it warmly applauds BNSF's efforts in this area. The CN has also made positive changes in its fuel surcharge program.

The League believes that surcharges and accessorials should be cost-based. However, the reasonableness of the surcharges or accessorials does not fit easily into either the Board's large case procedures or its small case guidelines, and, depending on the circumstances, it is often not clear whether these should be considered under the Board's reasonable rate or reasonable practice authority, or both. The Board should analyze this matter, and clarify how it would adjudicate challenges to such charges.

V. CONCLUSION

The substantial changes experienced by the railroad industry in the twenty-five years since the Staggers Act make this a particularly appropriate time for a review of the effects of this landmark legislation and a look ahead to the challenges of the future. The Staggers Act was clearly a substantial factor in the financial revitalization of the rail industry, by freeing the

industry from outmoded regulation and by permitting rail carriers to rationalize their systems. The Staggers Act also contributed to that financial revitalization by permitting the shedding of uneconomic assets through abandonments and by encouraging the growth of lower-cost short line carriers.

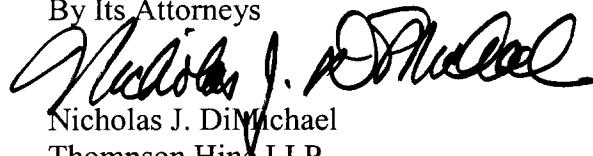
But there have been many changes that make today's railroad industry very different from the one faced by the drafters of the Staggers Act. In particular, the industry faces growing capacity constraints, the opposite situation confronting the Congress in 1980. The industry is now highly concentrated; motor carriers face increasing difficulties in competing in many markets; and shippers have invested heavily in instrumentalities of rail transportation. These changes, as well as regulatory decisions that have limited rail-to-rail competition, have increased rail carriers' market power vis-à-vis shippers. These new realities require new responses by policymakers over the next quarter century.

The nation requires a strong and viable rail industry to meet the challenges of the future, as shippers and carriers confront the need to move increasing quantities of goods in a global marketplace over a domestic transportation system that is increasingly capacity-constrained. The needs of all of the stakeholders in the industry – rail management and employees, rail customers, and rail stockholders – must be taken into account, and rail carriers and their customers must work together within the structure of a competitive transportation market to build a rail system to meet the needs of the 21st Century. The League stands ready to work with the nation's rail carriers, the Board, and the Congress in developing that system.

Respectfully submitted,

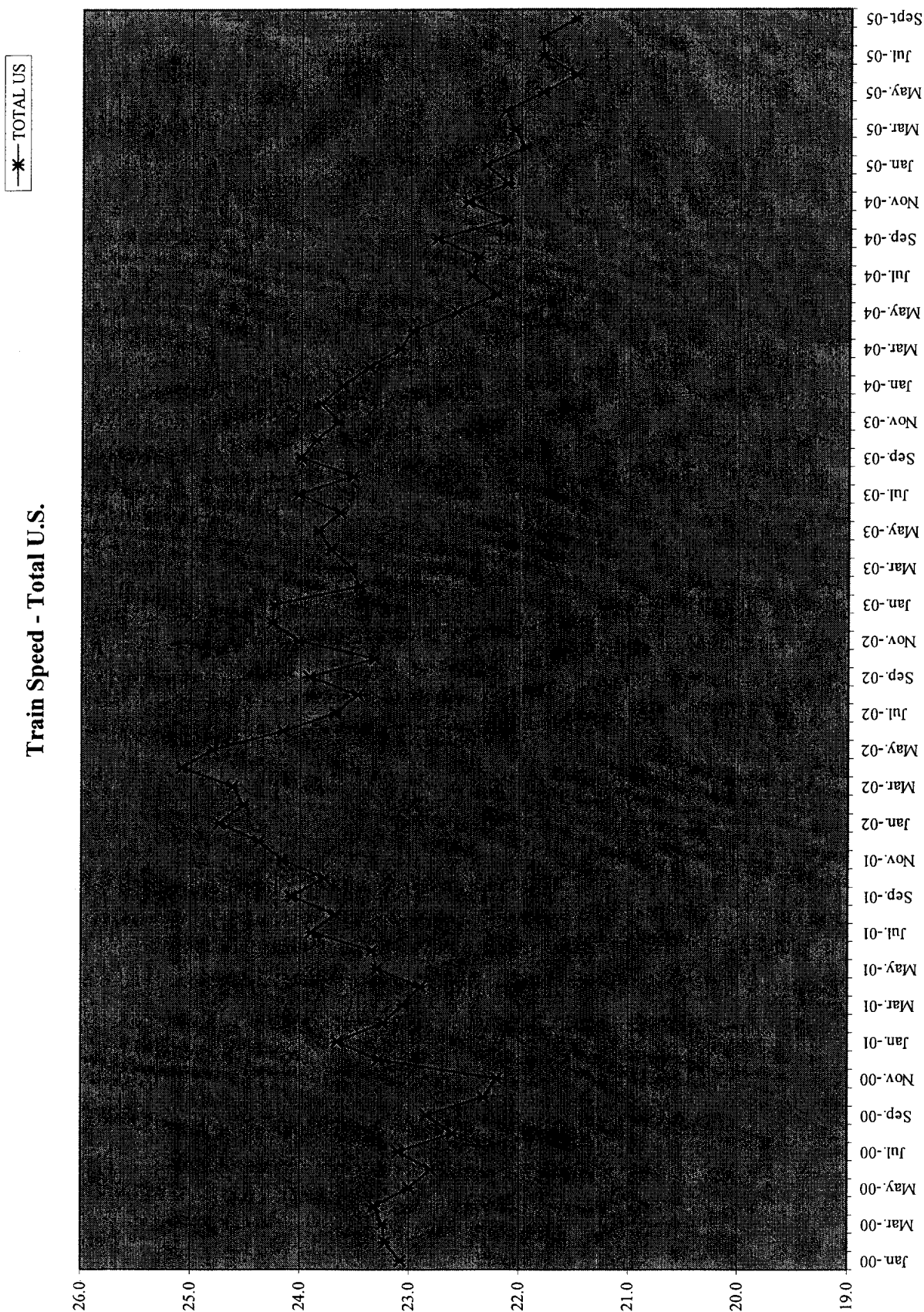
THE NATIONAL INDUSTRIAL TRANSPORTATION
LEAGUE
1700 North Moore St.
Suite 1900
Arlington, VA 22209

By Its Attorneys

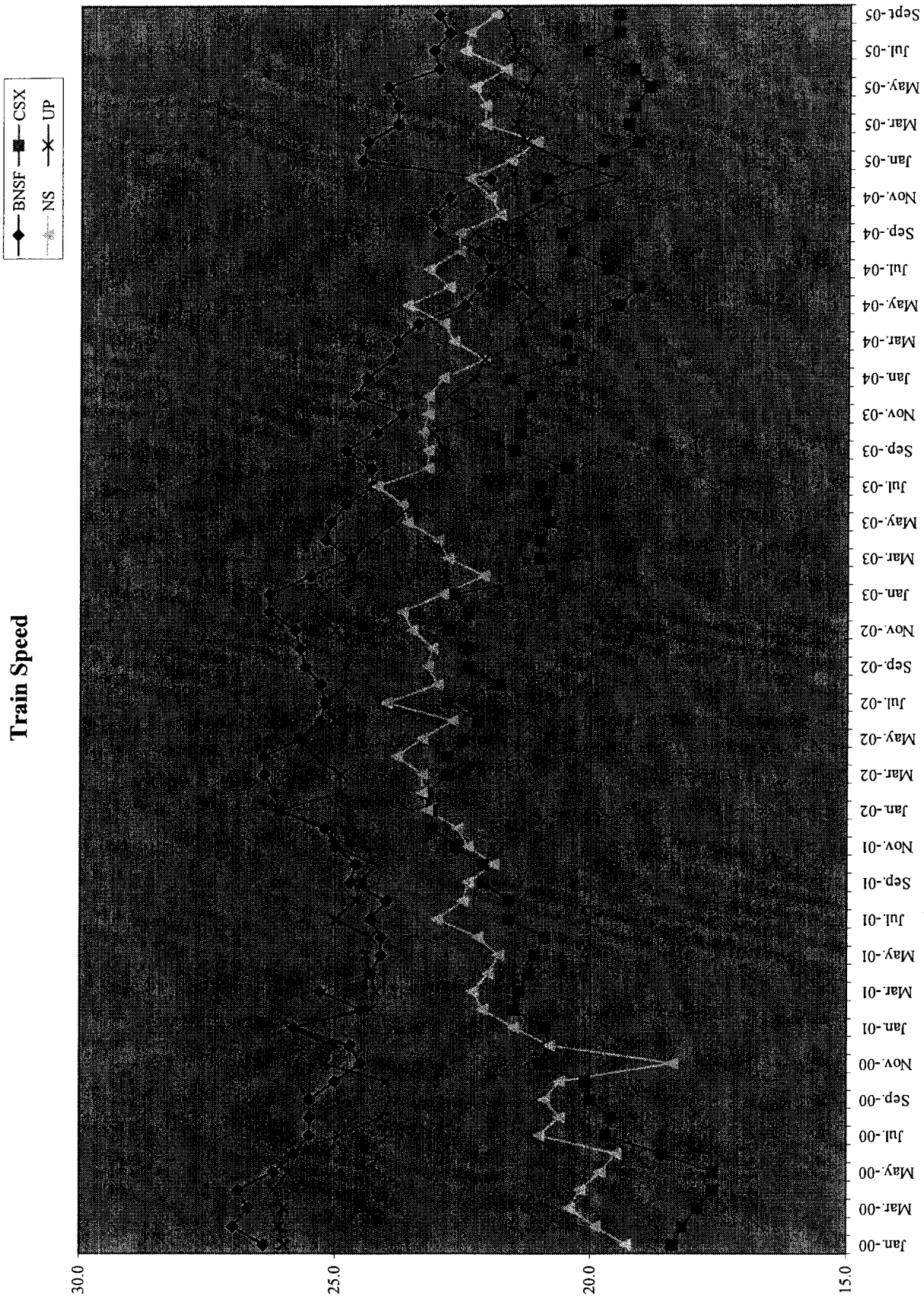
A handwritten signature in black ink, appearing to read "Nicholas J. DiMichael".

Nicholas J. DiMichael
Thompson Hine LLP
1920 N St. N.W.
Suite 800
Washington, D.C. 20036
(202) 263-4103

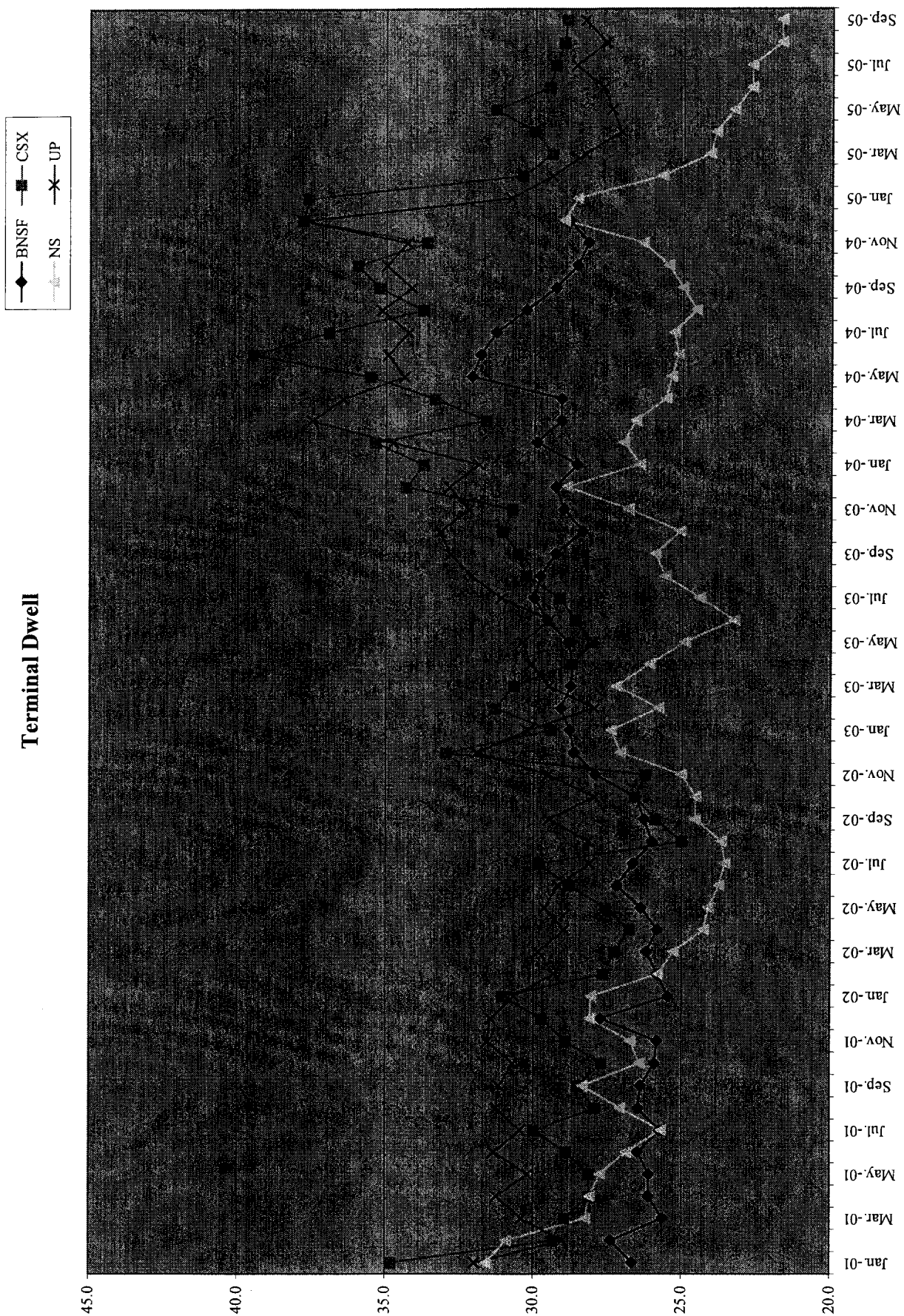
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