



U.S. Department of
Transportation
Office of the Secretary
of Transportation

General Counsel

214911

400 Seventh St., S.W.
Washington, D.C. 20590

October 12, 2005

Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: The 25th Anniversary of the Staggers Rail Act of 1980
Ex Parte No. 658

Dear Secretary Williams:

Pursuant to the Notice served September 14, 2005, submitted herewith is the written Statement of the United States Department of Transportation in the above-referenced docket.

Respectfully submitted,

PAUL SAMUEL SMITH
Senior Trial Attorney
(202) 366-9280

**Before the
Surface Transportation Board
Washington, D.C.**

Ex Parte No. 658

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

**Statement of the
United States Department of Transportation**

I. INTRODUCTION

The United States Department of Transportation ("DOT" or "Department") commends the Surface Transportation Board ("STB" or "Board") for providing a forum to assess the past and explore the future of the Staggers Rail Act of 1980 ("Staggers Act"). The Staggers Act was the most important legislation in a series of major railroad reform and deregulatory measures that included the Railroad Revitalization and Regulatory Reform Act of 1976. Now, twenty-five years later, it is clear to the Department that this legislation has been a resounding success. The major railroads are financially healthy, the industry infrastructure has been modernized, productivity is high, safety is improved, and shippers have enjoyed the benefits of lower average rates.¹

The Board is also correct to take this opportunity to consider whether and how the Staggers Act may best serve the public interest in the future. The railroad industry, indeed the entire transportation sector, faces new challenges not anticipated in 1980. These are the challenges of success: increasing demand for freight transportation, reflecting the growing economy, strains the existing transportation infrastructure. Increased highway congestion, higher fuel prices, and concern about the environment all

¹/ Unless otherwise indicated, general references to "railroads" are to Class I carriers.

contribute to the consistently strong demand for rail service. The Staggers Act was meant to make the industry viable. It has done that. Now it is time to consider whether and how railroad regulation can help the industry meet these new challenges.

II. STAGGERS ACT SUCCESSES

At base, the Staggers Act empowered railroad management to make business decisions more on the basis of marketplace forces and less on the basis of principles of public utility regulation. By curtailing the economic regulation of railroads, this landmark legislation provided carriers with the flexibility needed to compete in an ever more dynamic environment. This freedom manifested itself in numerous ways.

The Staggers Act allowed flexibility in rate setting, differential pricing, and private contracts with shippers. To the surprise of many opponents of the legislation, these factors led to sustained declines in average real (after inflation) rail rates. After increasing briefly during the implementation of the Staggers Act, freight rates have dropped since 1982. Between 1990 and 2003, rates declined by an average of 1.3 percent a year, compared to an average *increase* of 2.9 percent per year in the five years prior to the passage of the Staggers Act. See Chart 1. Despite these lower rates, railroad return on investment rose from an annual average of 2 percent in the 1970's to nearly 7 percent since 1990. Association of American Railroads ("AAR"), Railroad Facts, 2004 Edition ("2004 Facts"), at 18. See Chart 2. Although still below the cost of capital, this improved investment return has enabled railroads to better maintain their track and other infrastructure. Id. at 19; see Chart 3.

The Staggers Act has encouraged rail investment because it is based on sound economic principles. To its credit, the STB's implementation of this legislation has enforced these principles and has provided a healthy balance that resulted in freight rail growth. This regulatory stability over the past 25 years was crucial to railroad investment. Continued consistent application of the Act's economic principles will help sustain investment to handle projected increases in rail traffic.

Since passage of the Staggers Act, rail industry productivity has soared. Railroads could more easily rationalize their systems by abandoning lower density lines or selling those lines to smaller carriers. Since 1980, Class I railroads have reduced their networks (miles of road owned) by 40 percent. *Id.* at 45; see Chart 4. Rationalization and technological advances, such as end-of-train braking devices, allowed railroads to reduce employment levels. Employment by Class I railroads declined by 66 percent, from 458,000 to 155,000 between 1980 and 2003. *Id.* at 56; see Chart 5.

New, improved locomotives, larger cars and other innovations have also contributed to more efficient operations. For example, double-stack intermodal service has allowed railroads to capture new markets. Intermodal traffic is now the fastest growing and largest component of railroad traffic, although the railroads continue to carry substantial amounts of bulk commodities. AAR, Weekly Railroad Traffic, at 4, 15. The growth of the coal traffic from the Powder River Basin since 1980 has also been a major plus for Western rail carriers.

These factors, the above-mentioned lower rates, and national economic growth have led to an increase in rail traffic of nearly seventy percent (in terms of ton-miles) over the past 25 years. 2004 Facts at 27. Thus, larger amounts of traffic have been

handled by fewer workers on smaller networks. The result is that since 1980 railroad productivity has nearly quintupled, from 2.1 to 10.1 million revenue ton-miles per employee. *Id.* at 41; *see* Chart 6.

Expanded use of railroads, aided by the Staggers Act, has also been beneficial for the environment. New equipment purchased by rail carriers includes cleaner burning diesel locomotives. Staggers-related efficiencies also helped the environment in at least two relevant respects. First, between 1980 and 2003 ton-miles of freight per gallon of fuel consumed by the industry rose from 235 to 405. *Id.* at 40. Second, the growth in intermodal traffic means that railroads are attracting more freight from trucks, thereby reducing the growth of highway congestion, fuel consumption, and vehicular emissions.

Finally, and most importantly to DOT, railroads are safer than ever. Reduced economic regulation has proven consistent with enhanced industry safety. Accidents per million train-miles have declined from 11.43 in 1980 to 4.02 in 2003. Since the Staggers Act, the number of fatalities, injuries, and illnesses per hundred full-time equivalent railroad employees on duty has fallen about 75 percent (from 11.17 in 1980 to 2.76 in 2003). Federal Railroad Administration, Office of Safety, Railroad Safety Statistics: 2003 Annual Report. Although there are many reasons for the improvement in safety, better maintained track and equipment (funded by higher railroad rates of return) is certainly one of them.

But implementation of the Staggers Act has hardly been free of controversy. The Department is well aware that giving effect to several provisions of the legislation has caused dissatisfaction and led to calls to re-regulate the railroads. Differential pricing, for example, is absolutely critical to a viable railroad industry and the successes listed above.

Although differential pricing has produced declining average rates for many years, it has not meant universally lower rates for every shipper. Captive shippers have not shared in the rate reductions that those shippers with transportation alternatives have enjoyed. Criticism and repeated calls for re-regulation have been the result.

Supporters of the Staggers Act point out that the legislation allows shippers to seek relief from rates they believe to be unreasonably high. Large shippers have done so, and the outcome has sometimes favored them and other times carriers. But it must be acknowledged that major rate cases remain expensive and time-consuming despite the STB's commendable efforts to improve its processes. Worse, small shippers have yet to find truly meaningful access to regulatory relief from high rates. Only one case has been brought, and no cases have been processed, under procedures tailored for these shippers. As DOT discusses more fully below, future rate regulation for captive shippers is likely to remain a contentious issue.

III. FUTURE CHALLENGES

The Staggers Act succeeded in stabilizing and stimulating the rail industry. Since 1980, rail's modal share of the overall transportation market has increased slightly, and railroad carloads have grown from 22.2 million in 1980 to 28.9 million in 2003, an increase of 30 percent in 23 years, or about 1.2 percent a year. 2004 Facts at 24. Rail carriers have been able to accommodate this growth while reducing trackage and employment due to the Staggers-related efficiencies noted earlier.

However, in recent years many industry participants and government observers have noted that railroads appear to be operating at capacity in several important traffic

lanes. As congestion also grows on highways and at ports, it becomes even more important to ask whether railroads can and will add the capacity needed to resolve their congestion problems and to handle projected traffic growth.

One indication that rail carriers have reached capacity in some markets is that rail rates seem to have ended their long decline, yet demand for rail service continues unabated. See Chart 1. Railroads now appear able to increase rates as competing modes have been forced to raise their rates at an even faster pace. For example, higher fuel prices and concerns about driver shortages have pushed motor carrier rates up, which has enabled railroads to raise rates and still attract business. The issues are whether increased rail rates will lead to more rate cases and calls to limit carrier rate flexibility, and whether such rates will lead railroads to make the investments necessary to expand capacity.

Limited capacity is also suggested by recent reports of concerns of rail service concerns in the face not only of traffic growth, but also of customer demand for ever higher levels of service, as logistics management becomes more sophisticated. The question here is whether traffic will shift from the railroads to trucks if railroads cannot improve their service, further clogging the highway infrastructure.

Increased rail traffic has also had adverse community impacts in some instances, ranging from blocked street crossings to added noise. It is important to consider the possibility that communities will demand restrictions on railroad operations, prevent the construction of new facilities, or take other steps to limit railroad activities.

Lastly, it remains to be seen whether the "final round" of railroad mergers will occur, leading to transcontinental carriers that serve both coasts and possibly extend to rail systems operating in Canada or Mexico. Such mergers could provide benefits like

nationwide single-line service, but might well raise serious competitive, environmental, and public policy questions.

These are some of the challenges that must be addressed in the future. We explore them in more detail below because it is paramount that efforts to resolve the challenges do not threaten the gains achieved under the Staggers Act.

A.) Rate Regulation Challenges

The Staggers Act allows for flexibility in the way the reasonableness of rail rates is determined.² But this legislation's approach to rate regulation was designed in an era of limited demand for rail services, and of excess system capacity. Neither of these circumstances characterizes today's railroad industry.

DOT has already outlined how the combination of heightened efficiency and marketplace flexibility produced the growth in traffic, lower average rates, and increased financial returns that have characterized Class I railroads since the Staggers Act. Now the growing demand for rail transport services, coupled with capacity limits in certain markets and traffic lanes, has begun to produce behavior from railroads that, while different from that seen before, is economically rational under the circumstances. Both the Union Pacific and the Burlington Northern and Santa Fe railroads, for example, have announced plans to allocate certain services to shippers -- in effect, rationing rail service. If current traffic trends are sustained for the long run, as DOT expects, carriers will have incentives to add service, raise rates, and/or ration services still further.

^{2/} Of course, there are statutory limitations with respect to regulatory thresholds.

The Department has projected an increase of 69 percent in freight traffic between 1998 to 2020. Federal Highway Administration, Office of Freight Management Operations, Freight News: Freight Analysis Framework (October, 2002). We therefore consider it likely that railroads will enjoy high levels of demand for their service for the foreseeable future. The infrastructure expansion needed to accommodate such growth will require substantial time and investment, whether it takes the form of new highway construction, port expansion, dredging, or rail terminals and facilities. High levels of demand in these circumstances will tend to exacerbate tensions between carriers and shippers. The Board should therefore begin the difficult task of exploring how these changes will affect shippers, large and small, and should seek to ensure through its ratemaking and other mechanisms both that the effects of capacity constraints are not unduly imposed on any one class of shipper, and that railroads have the necessary incentives to expand capacity.

Two basic elements contribute to the current problem. The first is the fact that railroads are a capital-intensive business, with a very long-lived capital base. It is particularly difficult for such industries to expand rapidly without the prospect of both continued higher levels of demand over the useful life of the investment and continued reasonable returns to justify the spending. The second factor stems from current regulatory tools. Rail rates found to be "reasonable" pursuant to traditional means yield profits sufficient to justify the original capital investment and continued operation of the existing infrastructure. A railroad at the limits of its capacity, however, requires substantial investments (e.g., in new terminals, locomotives, cars, additional sidings and crews) to provide additional capacity. Rates that are "reasonable" under current

standards may not provide railroads with the financial incentive to expand existing infrastructure with the speed necessary to accommodate projected traffic demands. DOT accordingly repeats a suggestion we recently advanced in Ex Parte No. 657, Rail Rate Challenges Under the Stand-Alone Cost Methodology: the STB should begin to ensure that its rate methodology allows rail carriers “the opportunity to achieve the revenues necessary to make appropriate investments in capacity ... while continuing to ensure the mobility needed by shippers.” DOT Comments at 4 (filed April 20, 2005).

We also offer an important caveat. It is perhaps ultimately likely that railroad rate regulation will play only a limited role in meeting the challenges facing the nation’s freight transportation infrastructure. But it is important that such regulation contribute to solving these problems rather than compounding them by undoing the successes of the Staggers Act.

B.) Congestion and Modal Share Challenges

As noted, the Staggers Act was intended to revitalize a rapidly declining railroad industry; it was not designed when the industry enjoyed robust growth and faced increasingly limited capacity. In the 10 years preceding 1980 the rail share of domestic inter-city ton-miles declined from 39.8 to 37.5 percent, even though this period was marked by rapid fuel price increases that slowed the growth of motor carrier traffic. 2004 Facts at 32. Since then the railroads have gained this back and more: In 2001, the rail share of this traffic was 41.7 percent. Id.

Economic and vehicular growth have steadily contributed to traffic congestion as portions of the nation’s roadways approach their design capacity. Increases in imports have also led to congestion at ports. The cost of building highways and other

infrastructure is very high, and environmental and other considerations usually lengthen the time it takes to add new capacity. Railroads may be able to alleviate some of the negative effects of growth in highway traffic by continuing to expand their modal share. Studies indicate that railroad capacity expansions could make worthwhile contributions to alleviating the need for new and expanded highways. See American Association of State Highway and Transportation Officials, *Transportation: Invest in America, Freight-Rail -- Bottom Line Report* (2002).³ However, for the reasons already discussed, it may be difficult to provide the funds for rapid railroad capacity increases.

C.) Community Impact Challenges

There are a number of serious challenges relating to the operations of railroads within local communities. The Staggers Act generally reaches such matters only indirectly, in the context of an STB proceeding focused on other subjects, such as railroad mergers.⁴ Yet DOT mentions them here for two reasons. First, to emphasize the breadth of issues that will increasingly demand the attention of industry and government in coming years, without regard to carrier consolidations. Second, to prevent attempts to resolve such issues by modifying the Staggers Act or its implementation in ways that threaten the benefits brought about by the statute.

It is well known that both rail and highway traffic have grown substantially in the past quarter-century, which development has had a number of effects on communities.

^{3/} This document is available online at: <http://freight.transportation.org/doc/freightrailreport.pdf>

^{4/} Responsibility for implementing the National Environmental Policy Act and the power to impose conditions on regulatory approval of railroad mergers has effectively extended the Board's reach into these and similar areas in the context of rail consolidations. State and local governments and others have actively brought their concerns to the Board in such proceedings.

One result has been increasing problems at rail-highway grade crossings. Grade crossings blocked by trains have led many communities to attempt to limit railroad operations at the local level. As roadway congestion and air quality concerns increase, other communities have sought access to railroad rights-of-way for commuter rail and transit systems. Another concern raised by communities is the shipment of hazardous commodities through their towns. Noise and diesel emissions, particularly in areas of severe pollution like the Los Angeles Basin, also give rise to pressures to limit rail operations.⁵

IV. CONCLUSION

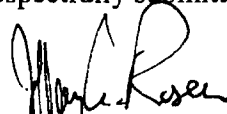
The Staggers Act has been a great success. It has done what it was supposed to do and a revitalized railroad industry is the result. To continue that success for the next twenty-five years will require intelligent use of the tools the statute provides. What that effort must not entail is a retreat from the legislation that produced those results. All

^{5/} This is true regardless of the fact that railroads emit less pollution per ton-mile of freight than motor carriers.

interested parties -- industry, the shipping community, government, and others -- must be open to communication and innovative approaches to funding and increased capacity.

The Department looks forward to working with its partners in this effort.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jeffrey A. Rosen". The signature is stylized with a large, looped "R" and a cursive "J".

JEFFREY A. ROSEN
General Counsel

October 12, 2005

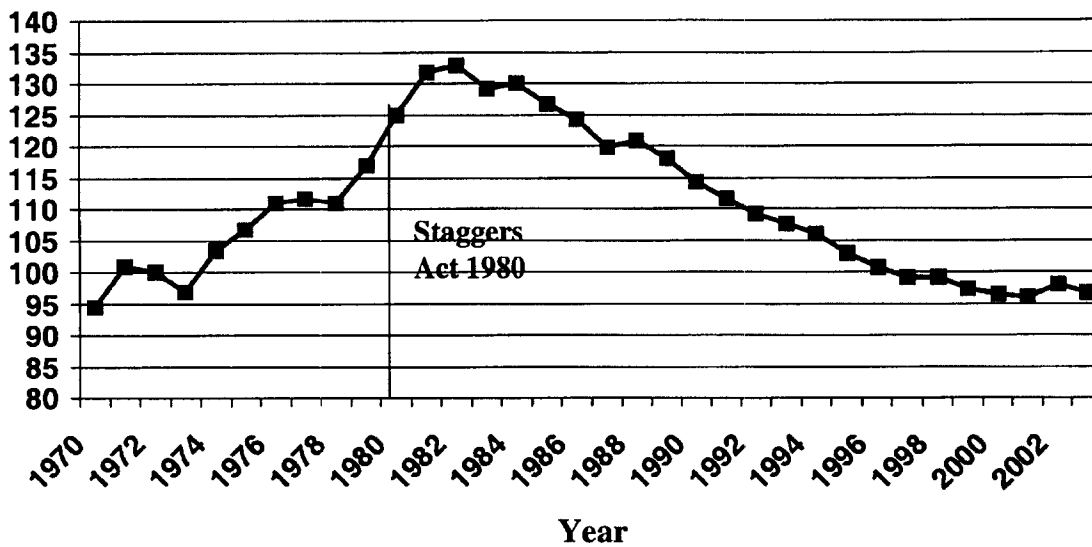
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**Attachments to Statement of the
United States Department of Transportation**

CHART 1

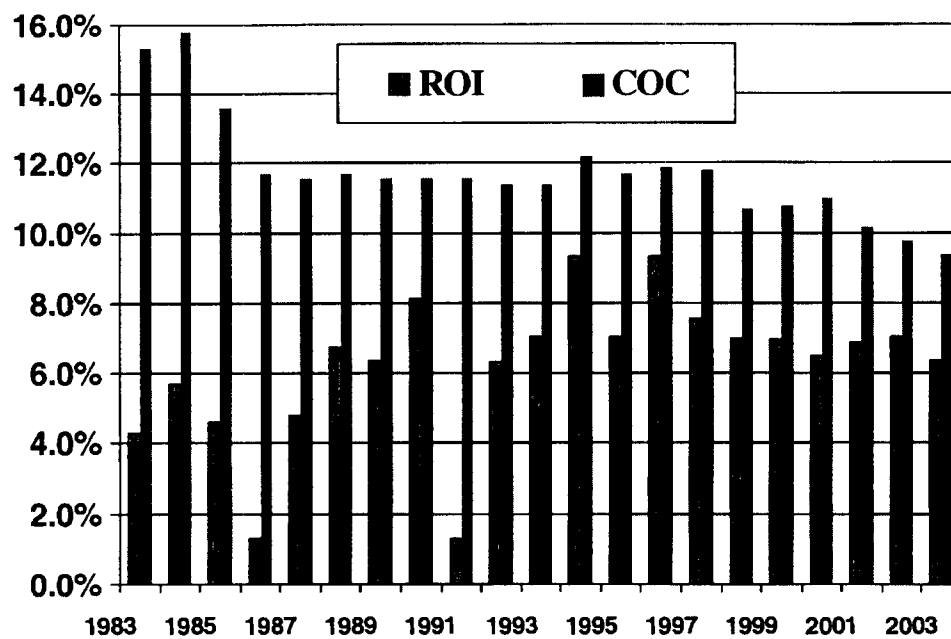
Railroad Rates After Inflation 1972=100



Sources: U.S Bureau of Labor Statistics, Producer Price Index for Line-Haul Railroads;
U.S. Bureau of Economic Analysis, Implicit Price Deflator for Gross Domestic Product,
"News Release: Gross Domestic Product and Corporate Profits," Table 6.

CHART 2

Cost of Capital (COC) vs Return on Investment (ROI)

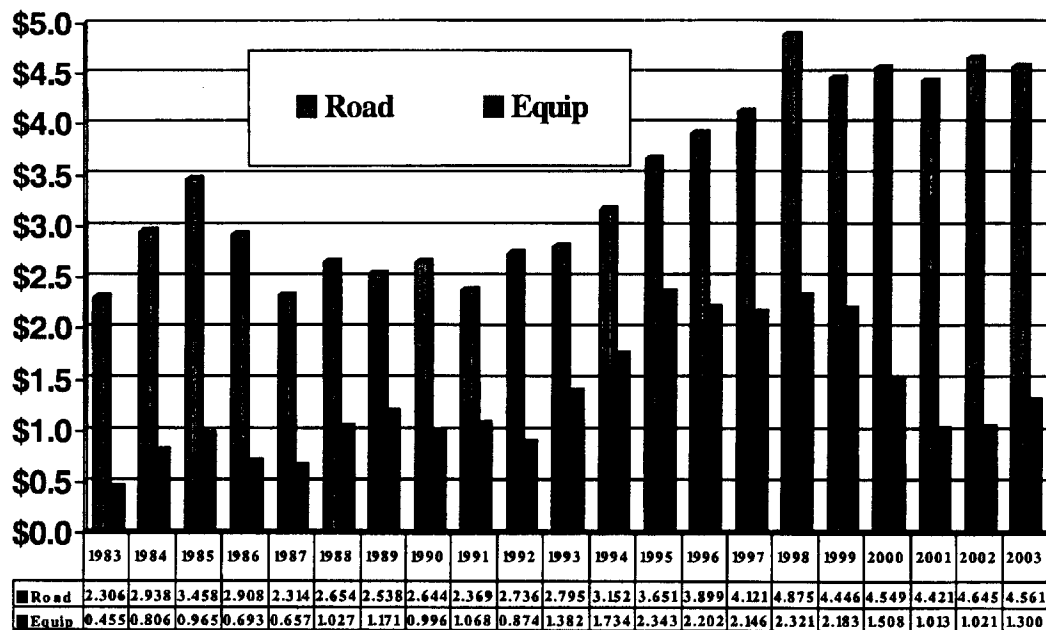


ROI represents the NROI to average net investment in transportation property. STB calculates the pre-tax cost of debt and the post-tax cost of equity for a total cost of capital.

Source: Assn. of American Railroads, "Railroad Facts," pp. 18-19 various years.

CHART 3

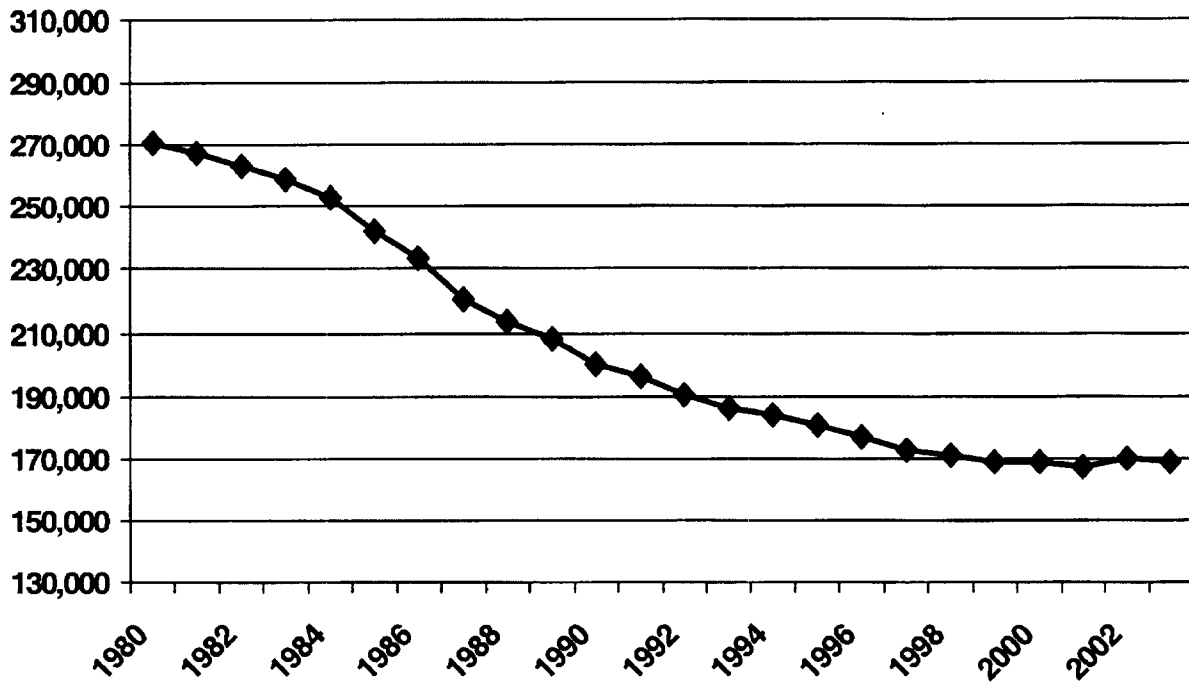
Class I Railroads Capital Expenditures (Dollars in Billions)



Source: Assn. Of American Railroads, "Railroad Facts," p. 44, various years

CHART 4

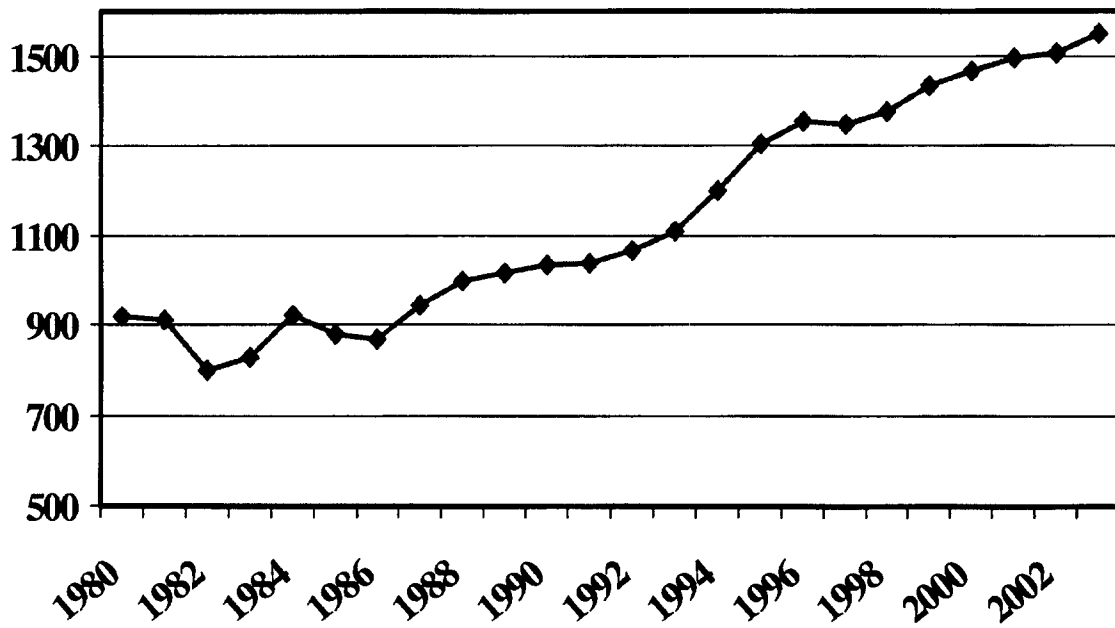
Class I Railroads Track Miles



Source: Assn. of American Railroads, "Railroad Facts," p. 45, various years.

CHART 5

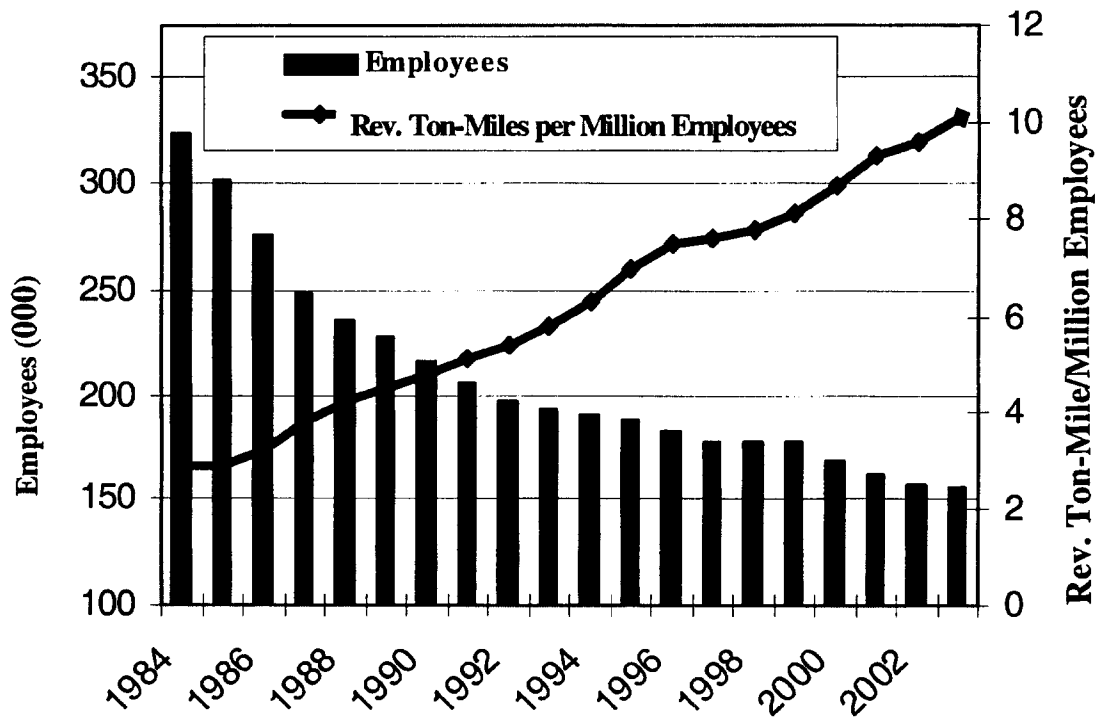
Class I Railroads Ton-Miles (billions)



Source: Assn. Of American Railroads, "Railroad Facts," p. 27, various years.

CHART 6

Class I Employment and Productivity Trends



Source: Assn. of American Railroads, "Railroad Facts," pp. 41, 56, various years.