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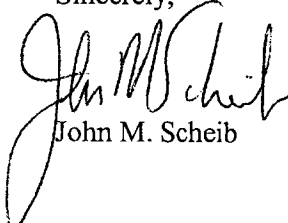
Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

Re: Filing of Written Testimony in Ex Parte No. 658 – The 25th Anniversary of the
Staggers Rail Act of 1980: A Review and Look Ahead

Dear Mr. Williams:

Pursuant to the Board's Notice served on September 14, 2005, in the above-captioned proceeding, Norfolk Southern Railway Company hereby submits written testimony in advance of the October 19, 2005 hearing.

Sincerely,



John M. Scheib

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE 658

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

**WRITTEN STATEMENT OF STEPHEN C. TOBIAS
ON BEHALF OF
NORFOLK SOUTHERN CORPORATION**

I am Stephen C. Tobias, and I serve as Vice Chairman and Chief Operating Officer of Norfolk Southern Corporation. Combining my years at Norfolk and Western Railway Company with my years at Norfolk Southern, I have been on the operating side of the industry for 36 years. It is my pleasure to represent my company at this hearing marking the 25th anniversary of the Staggers Rail Act of 1980.

As you know, Norfolk Southern is one of the nation's premier transportation companies. Its Norfolk Southern Railway subsidiary operates approximately 21,300 route miles in 22 states, the District of Columbia and Ontario, Canada, serving every major container port in the eastern United States and providing superior connections to western rail carriers. NS operates the most extensive intermodal network in the East and is North America's largest rail carrier of automotive parts and finished vehicles.

In this testimony, I will briefly outline the importance of the Staggers Act to the rail industry by contrasting the industry after the enactment of the Staggers Act with the industry before its enactment. In 1980, I was in my eleventh year with the Norfolk and

Western Railway Company, one of Norfolk Southern's predecessor companies. So I have seen the industry from many angles both before and after the Staggers Act. A comparison of the state of the industry in those two periods is critical because it reveals the direct relationship between regulation of the rail industry and the success – or failure – of the industry.

Next, I will address the key challenge that I believe Norfolk Southern, and the industry in general, face in the immediate future. Norfolk Southern will play a crucial role in our economy as demand for freight transportation continues to increase because of our ability to move more freight safely, with less fuel, and in a more environmentally-friendly manner. In times of increasing demand, we must be able over the long term to attract the resources necessary not just to maintain our infrastructure, but to expand it to meet the needs of our customers. As Chief Operating Officer of Norfolk Southern, I spend a great deal of time thinking about how to meet this challenge -- how to serve our customers' growing demand for our service and what resources it will take to meet that demand.

I. The Staggers Act, and the regulatory regime it spawned, permitted railroads to provide better service at lower rates.

The Staggers Act was a historic piece of legislation that gave railroads the tools to become an effective component of the national transportation system. Among its important elements, the Staggers Act:

- Freed railroads and shippers to negotiate terms and rates for shipments and to enter into confidential contracts outside the regulatory regime;
- Provided for a regulatory backstop when railroads and shippers did not enter into a contract to prevent railroads from abusing any market power over shippers without effective transportation alternatives;
- Expanded the power of the Interstate Commerce Commission, and now the Surface Transportation Board, to exempt traffic from regulation and encouraged the use of that power; and
- Made it easier for railroads to shed unprofitable lines.

The results of this statute, which injected market influences into the rail industry and lightened the regulatory thumb on the industry, have been widely documented. Railroads' productivity improved, and many of those productivity improvements were passed on to shippers. Railroads shed unprofitable lines and invested in infrastructure elsewhere. Railroad's became safer.

II. History demonstrates just how significant the Staggers Act was.

Before the Staggers Act, regulation of the rail industry was expansive. No less an observer than the United States House of Representatives commented that: "Regulatory constraints . . . impinged upon management's ability to adjust rates, merge corporate entities, abandon facilities and services, and improve productivity."¹ Rate regulation was pervasive and regulation restricted price competition.²

¹ H.R. Rep. No. 96-1035 at 85 (1980).

² Id. at 88.

“Railroading has fallen on difficult times.” That was the way the Department of Transportation summed up the situation in 1978.³

The detrimental effects of this excessive regulation are as well known as the successes of the Staggers Act. In the same 1978 report, the Department found that railroads were unable to attract capital from private sources and unable to maintain their physical plants.⁴

At the passage of the Staggers Act, I was serving as Superintendent of our Pittsburgh Division and had watched as railroads throughout the Northeast failed. The result of that expansive and invasive regulatory regime was bankrupt railroads, including the largest bankruptcy in America to that time – the bankruptcy of the Penn Central. The Staggers Act stopped the decline of the industry.

I think we can all learn from history. And for railroads, it is better to learn from history than to repeat its mistakes. For me, the lesson for the future is that the regulatory regime is a delicate balance. On the one hand, that regime can provide the environment in which America developed the best and safest freight rail system in the world. On the other hand, it can undo the industry.

³ Dept't of Transp., A Prospectus for Change in the Freight Railroad Industry, at 2 (Oct. 1978) (“Prospectus”).

⁴ “Even the healthiest industry does not rely solely upon internally generated cash to finance current capital expenditures – virtually all industries obtain additional funds through the sale of equity or debt. With some exceptions, however, railroad earnings are too low to attract new equity or debt other than for equipment purchases or rollover of old debt . . . As a result, the availability of private capital for future investments may be curtailed, because investors believe that returns generated with the investment of additional capital will not equal returns from alternative investments with similar risks.” Prospectus at 69.

III. America cannot afford to have railroads return to their pre-Staggers state when freight traffic is growing at unprecedented volumes.

Railroads play a critical role in our economy, and their importance is growing. The United States is competing in the world economy. To a large extent, our economy is dependent on the transportation of goods. Transportation is one of this country's comparative advantages that help us compete in that world economy.

The demand for that transportation is growing rapidly and will continue to grow. As you know, the Department of Transportation estimated that the demand for freight transportation would increase by 55 percent by 2020. Similarly, the American Association of State Highway and Transportation Officials projected that freight tonnage will grow by almost 57 percent between 2000 and 2020.

Highways will not be able to absorb that kind of growth in demand for freight transportation. Highway capacity is already tight. The plight of trucking companies has been well-publicized. They cannot find enough drivers even while raising salaries. The cost of trucks and fuel are rising. And highways are choked.

Increased highway congestion and trucking costs favor the inherent efficiency advantages of rail. One train load of freight takes hundreds of trucks off the road. Railroads are three or more times as fuel efficient as trucks, and the railroads' fuel efficiency is rising. Railroads have lower employee injury rates than other modes of transportation and most other industries. And railroads are more environmentally-friendly, with one-third the nitrogen oxide emissions of a truck when calculated on a per ton-mile basis.

As for our company, it appears that demand continues to grow. As our Chairman, Mr. David Goode, observed in his letter to Chairman Nober regarding the 2005 "fall peak," rail traffic volumes have been at record levels, and look like they will continue. Year-to-date traffic levels are strong for us. For the first eight months, our international intermodal volume grew by 12%. Coal and merchandise carload volumes are all well above last year as well.

IV. Our work is not done.

The question I spend a lot of time considering is what we at Norfolk Southern, and we as a rail industry, must do to handle this increasing demand for our service.

A. Today and for the foreseeable future, we must be able to maintain and to expand our infrastructure and capacity.

The biggest challenge Norfolk Southern faces today – not in a few years – is having the resources to maintain our existing infrastructure and to expand that infrastructure to meet the increasing demand for our service and the changing shipping patterns and needs of our customers.

Every year, we make large capital expenditures to maintain and expand our infrastructure. Since 2000, our capital expenditures have totaled about \$5 billion. These expenditures are required to improve our physical plant and locomotive and car fleet so that we can serve our customers better, handle larger volumes of freight, and respond to our customers' changing shipping patterns. At the same time, capacity expansion projects must generate returns sufficient to justify the investment.

Over the past year, we have focused our capacity additions on key growth corridors. Some examples include track capacity additions in the following corridors:

- Butler, Indiana, to Decatur, Illinois;
- Chattanooga, Tennessee, to Atlanta, Georgia; and
- Memphis, Tennessee, to Chattanooga, Tennessee.

We also are continuing to acquire other components of capacity – locomotives, cars, and crews. We purchased 207 locomotives in 2004, and ordered 52 more in 2004 for delivery for this year's fall peak, and ordered another 50 that will be delivered later this year or early next year. In addition, we have ordered 183 locomotives for 2006. We have continued our long-term leases on another 150 locomotives. Turning to freight cars, this year we are repairing 30 percent more freight cars than last year. We have renewed expiring leases covering 1,148 cars, and we plan to renew leases that expire later this year for another 1,208 cars. We plan to buy-out a lease expiring this year that includes 195 insulated boxcars. Through new leases in 2005, we have acquired 220 covered coil cars, 100 60-foot Plate F boxcars, and 150 50-foot boxcars. As for crews, in 2005, we expect to hire 2,400 conductor trainees and to train 706 locomotive engineers. They are in addition to the 1,441 conductor trainees we hired and the 330 locomotive engineers we trained last year. All these efforts are critical to serving our customers, and they all take money.

In making these investment decisions, we must keep in mind that our goal is to serve all our customers well. That means we must make those investments that are best for the overall network. In many ways, an urban or suburban bus system is a good analogy when we talk about service in a network system. Everyone who rides the bus

would like for it to come at the time that most suits their individual needs. For two riders who live next door to one another, one may want the bus to come at 8:00 to deposit him at his workplace at 8:30, and another may want the bus to come at 8:15 to deposit her at her workplace at 9:00. But bus routes are planned to provide the best possible service to the most people, rather than being tailored to each rider's specific desire. Service on a rail system is much the same. Our customers have different needs and the priorities they place on such factors as transit time, price, safety, damage-free handling, and frequency of service and switching often differ.

We try to balance these competing needs and to invest to provide the best service we can to the most customers. In other words, we invest to maximize our network. If we had only intermodal customers, our investments would be different than if we had only coal or if we had only chemical customers. In fact, we serve thousands of customers with different transportation needs for their thousands of different commodities. The investments we make represent our best judgment as to how to strike the right balance.

Additionally, we keep in mind the need to justify new capacity expansion. For example, the construction of new track or new yard capacity requires investment in assets that have a very long life and that are not easily moved – capacity expansion projects must generate returns sufficient to justify making the investment.⁵

It is especially important that we have the resources and the ability to improve our infrastructure now for three reasons.

⁵ In the Energy Policy Act of 2005, Congress again recognized that industries with high costs must be assured returns sufficient to attract new investment in order to promote expansion of the infrastructure. As I understand that Act, it requires the Federal Energy Regulatory Commission to promulgate new rules that promote capital investment in transmission and that provide a return sufficient to attract new investment in transmission. See Energy Policy Act of 2005, Section 1241.

First, capacity is not limitless. Norfolk Southern remains a fluid railroad on which our cars on-line, average train speeds, and terminal dwell times have been relatively consistent in spite of volume growth. Operations-planning helps us find better and more efficient ways to operate so that we get the most from our existing infrastructure. For example, earlier this year, Norfolk Southern embarked on a complete review of our Thoroughbred Operating Plan (TOP), to assure sufficient capacity for our current business mix, volumes, and expected growth. We called this review TOP II. Nevertheless, operations-planning gets us only so far. Ultimately, we can only operate on the infrastructure we have and with the locomotives, cars, and crews that we can afford.

At Norfolk Southern we look into the future and try to determine where we most will need extra investment to increase our capacity. For example, we are planning future investment in the three corridors mentioned above and in several additional corridors, including the following:

- Columbia, South Carolina, to Charleston, South Carolina;
- Fort Wayne, Indiana, to Cincinnati, Ohio;
- Manassas, Virginia, to Harrisburg, Pennsylvania;
- Atlanta, Georgia to Jacksonville, Florida;
- St. Louis, Missouri to Danville, Kentucky; and
- Columbus, Ohio to Cincinnati, Ohio.

Each of these investments will help us move more freight and serve our customers better.

A prime example of our forward-looking view of investment is our Heartland Corridor project. Container traffic from Southeast Asia to East Coast ports has grown rapidly over the past few years. To continue to serve these emerging markets, we have

been pursuing a public private partnership to develop capacity along our mainline from Norfolk, Virginia, to Columbus, Ohio. This ambitious project will make 30 tunnels in four states able to handle double-stacked intermodal trains and will eliminate grade-crossings. It includes the development of a new Norfolk Southern-owned intermodal facility in Columbus, Ohio, which when fully developed will have the capacity to handle 400,000 lifts per year. In addition, we expect the development of the first intermodal facility in West Virginia and a new terminal near Roanoke, Virginia, and the relocation of a short line around Portsmouth, Virginia. When completed at a price of over \$300 million, we will shorten the time it takes for containers to travel from port to plains by over 20 percent and the distance they travel by more than 20 percent.

Second, capacity is expensive and resources and money are limited. Norfolk Southern simply must choose which projects to fund. We cannot fund all projects each year.

We consider two categories of capacity expansion projects during our funding reviews. The first category is large corridor-based initiatives – where infrastructure solutions must be multi-faceted and broad in scope to generate the needed capacity. The second category includes spot projects – projects aimed at more discrete infrastructure needs.

Looking at our Fiscal Year 2006 budget process as an example, we have solicited from our Operating Divisions their wish list of top projects. These are the infrastructure projects that they would most like to see the company fund. The total requests this year are over \$80 million for track and signals – which is more than double our average annual investment in infrastructure enhancements to track and signals over the last five years.

Earlier I mentioned the capacity projects on our corridors from Chattanooga to Atlanta. We have begun a spot approach to this corridor, but we are reviewing a more comprehensive solution. However, for that solution, Norfolk Southern is looking at a price tag of about \$150 million for track and signal infrastructure investments – and those investments will get Norfolk Southern only to the point where the delays caused by train events (for example, meets and passes) remain at their current levels because traffic is growing so fast in those corridors. That investment on one corridor would be about six times our average annual budget for infrastructure enhancements for track and signals.

Third, it takes time to build rail infrastructure and capacity. Although our response to Hurricane Katrina was impressively swift (something I will discuss further), it sometimes takes years for a project to be approved by management, designed, engineered, environmentally reviewed, and constructed. As I mentioned before, many projects do not get approved the first time they are proposed because we simply cannot afford to complete every needed project each year. In fact, the list of projects submitted by our Operating Divisions for review in the FY'06 budget process includes many old favorites that have been on their "wish list" for several years.

Similarly, it took years for the industry to reach agreement on a plan to address rail congestion in Chicago. After several years of effort on this historic public-private partnership, the rail industry, local officials, and state leaders were able to join together to seek congressional funding for the public benefits that would flow from the project. Even today, the project is not fully-funded and it is unclear how long it will take to make it a reality.

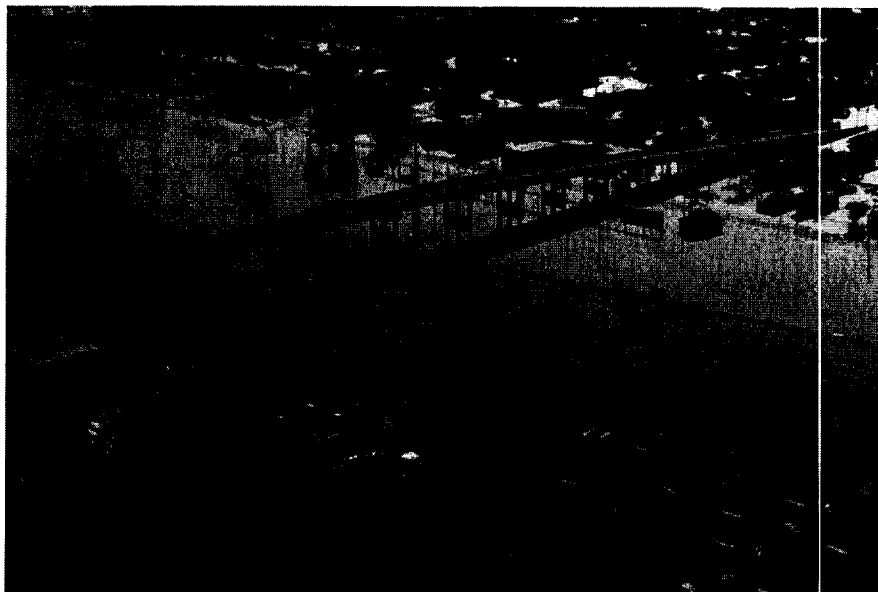
Even when they are approved and fully funded immediately, the design, permitting and construction of a major project can take years. For example, from the time we started the environmental permitting process to build a new intermodal yard in Atlanta to the time we opened our \$110 million facility in Austell, Georgia was about five years. Just how many years it takes to make a project a reality depends on the resources and money available and our ability to complete the work in a way that least impacts our ability to serve our customers whose traffic moves on those lines.

B. It takes resources to respond to ordinary weather and unusual events and to plan continually for efficient operations.

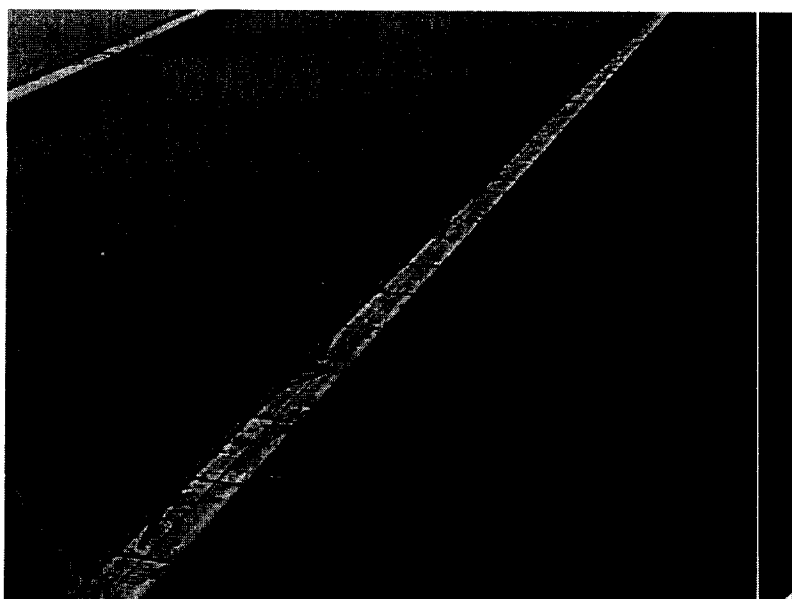
An ongoing challenge is to have the resources available to respond to the effects of ordinary weather and infrequent events like hurricanes. We must also invest the time and money to plan properly so that we have the most efficient operations on our railroad. These are the real-world costs that every railroad must incur to serve its customers.

Norfolk Southern simply cannot allow an issue that develops because of the elements – or because of a natural disaster – to go without a response. Like a rain storm in Boston that grounds a plane bound for Atlanta, which in turn means the flight from Atlanta to Houston that was to use the same plane is delayed, an issue in one place in a network has a ripple effect. For Norfolk Southern, a problem in Ohio that is allowed to fester eventually affects Atlanta, Harrisburg, or some other place on our system or some place on the system of another railroad.

Accordingly, we must have the resources to address the effects of ordinary weather. Wind, rain, cold, and heat take their toll on track, cars, locomotives, crossing gates, bridges, and signals. As a result, there will always be a need to repair



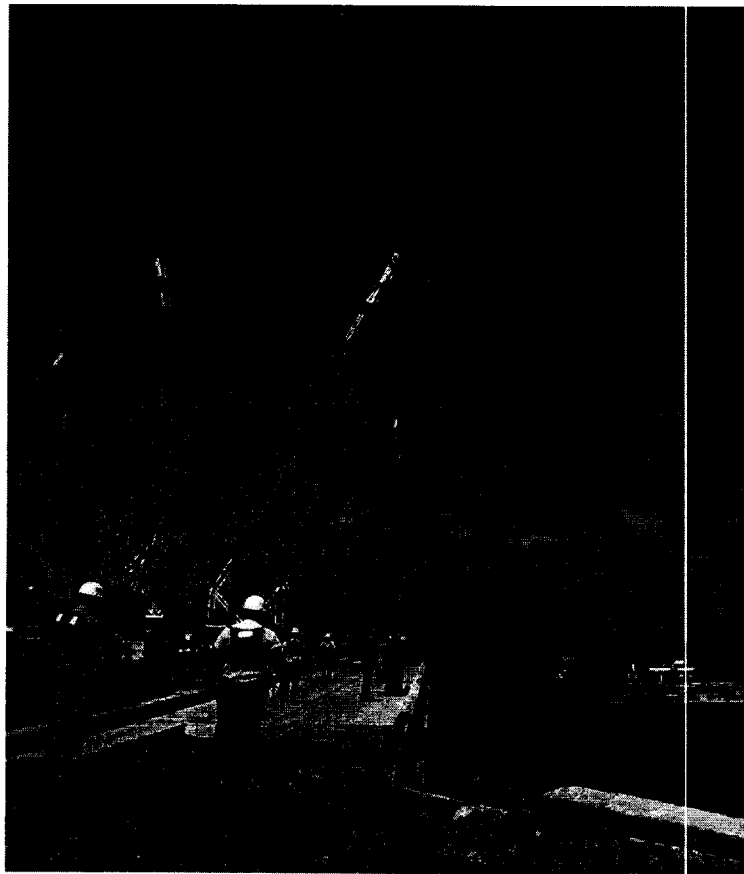
As you can see, Norfolk Southern's Oliver Yard in New Orleans was underwater. Our intermodal terminal was underwater as well.



Our track on the bridge across Lake Pontchartrain was in the water.

In the wake of Hurricane Katrina, our engineering department and maintenance-of-way team responded as they always do – quickly, efficiently, and safely. As soon as the hurricane had passed, we conducted emergency track inspections of 1,400 miles of

track. Once our damages were known, we moved additional personnel, equipment and material into place. At the height of our restoration operations, we focused 450 employees and contractors, including rail, tie, and surfacing gangs; helicopter services; 9 barges and cranes; 11 tugs; 7 work boats; and numerous trailers and vehicles. We arranged accommodations for lodging and meals for all. The following pictures are examples of what the recovery effort looked like.





By September 13, we were operating trains across Lake Pontchartrain. Today our intermodal terminal and Oliver Yard have reopened, and we stand ready to move freight when our shippers or their receivers in the New Orleans area need us.

Hurricane Katrina is a prominent example of the need to have the resources to respond to what nature throws at us. Hurricanes, snow storms, rock slides, floods and the like must all be dealt with in an efficient and expeditious manner or else service to our customers will suffer.

Norfolk Southern also must have the resources to plan train movements, model our system, and do the things necessary to have an efficient network. Creation of the TOP plan and our recent review of that plan through TOP II are time consuming and expensive. But the payoff is there because it allows us to determine where to add train capacity to handle projected growth. As part of that review, we used the Operating Plan

Developer, which allows us to model “what if” scenarios relating to changes in volume and traffic mix so that we can make changes in our operations as efficiently and expeditiously as possible.

The Operating Plan Developer is a story itself. Norfolk Southern developed OPD as a tool for operating plan design, evaluation, and improvement; interline studies; network balancing; yard, block, and train rationalization studies; and contingency planning in response to major disruptions, such as Hurricane Katrina. It was developed and refined over the last three years at a cost of about \$2 million. OPD is a good example, but only one example, of our use of costly information technology to make ourselves better. These expensive reviews of our operations and the development, implementation, or both of new technologies all across our railroad help us to serve our customers better.

C. We must remember the changing world in which we live, and railroads must have the ability to respond to it.

Another on-going challenge is calibrating our rates to reflect modern cost drivers, like insurance and the risk to the railroad’s franchise.

We take great pride in our safety record. Last May, it was my honor to accept the Gold Harriman Award for 2004 on behalf of the employees of Norfolk Southern. It was our 16th straight award and represented our continuing commitment to safety as our highest priority.

We spend time and conduct training on safety every day. Every month I lead a team of senior railroad managers around different parts of our system to meet with managers, employees, and labor representatives to discuss safety issues and to set safety

policy. We also train local firefighters and police in emergency response. We have a "go-team" of managers who are trained engineers and conductors who can be on the ground and work on site in the event of an accident. These are the hidden costs of railroading – lots of money is spent just to make sure we are operating as safely as possible.

At the same time, when tragedy hits, we all suffer. In January of this year, a tragic accident occurred on our railroad when a train derailed and a car carrying chlorine breached, killing nine people and forcing the evacuation of about 5,400 people.

Importantly, that accident highlighted the risk to the Norfolk Southern franchise, and to all railroads' franchises, of carrying highly hazardous materials. It also highlighted the risks to insurance companies, which have significantly increased premiums because we handle highly hazardous materials. In light of recent incidents involving hazardous materials, the cost of insurance coverage has increased dramatically and may not even be available should insurers stop offering insurance for the transportation of such materials. We will have to examine how to recover our increased costs, including the cost of the risk we assume by transporting highly hazardous materials that we are required to transport under our common carrier obligation.

V. The Staggers Act and the regulatory regime must permit us to continue our work.

The regulatory environment must permit railroads to earn the revenues they need to meet their customers' needs. We look forward to a day when Norfolk Southern is able to meet the cost of capital for a sustained period of time. Like other railroads, we are raising rates for some of our services. Although we recognize that higher rates are

difficult for some customers (because since the enactment of the Staggers Act, rail rates declined), those rates do not signal a flaw in the regulatory regime. Rather, they reflect the laws of supply and demand and the need for railroads to have the resources to do their job well.

The regulatory regime also must permit railroads to find creative ways to work together to resolve capacity issues so that the customers benefit. A recent example of this creativity is the work Norfolk Southern has done with the Delaware and Hudson and the Canadian National in the Buffalo, New York, area – parts of which the Board had to approve. These railroads have become more efficient because of that effort and customers are seeing the benefits. In times of growing demand for rail service, limited capacity, and limited resources, railroads will likely continue to find creative ways to provide better service to customers.

Due in large part to the successful balancing of interests in the Staggers Act and to its successful implementation by the Interstate Commerce Commission and the Board, our freight rail system is the best in the world. It is a key competitive advantage for the United States. Norfolk Southern is proud to play an important role in maintaining that advantage. We believe it is an advantage America cannot afford to lose.