

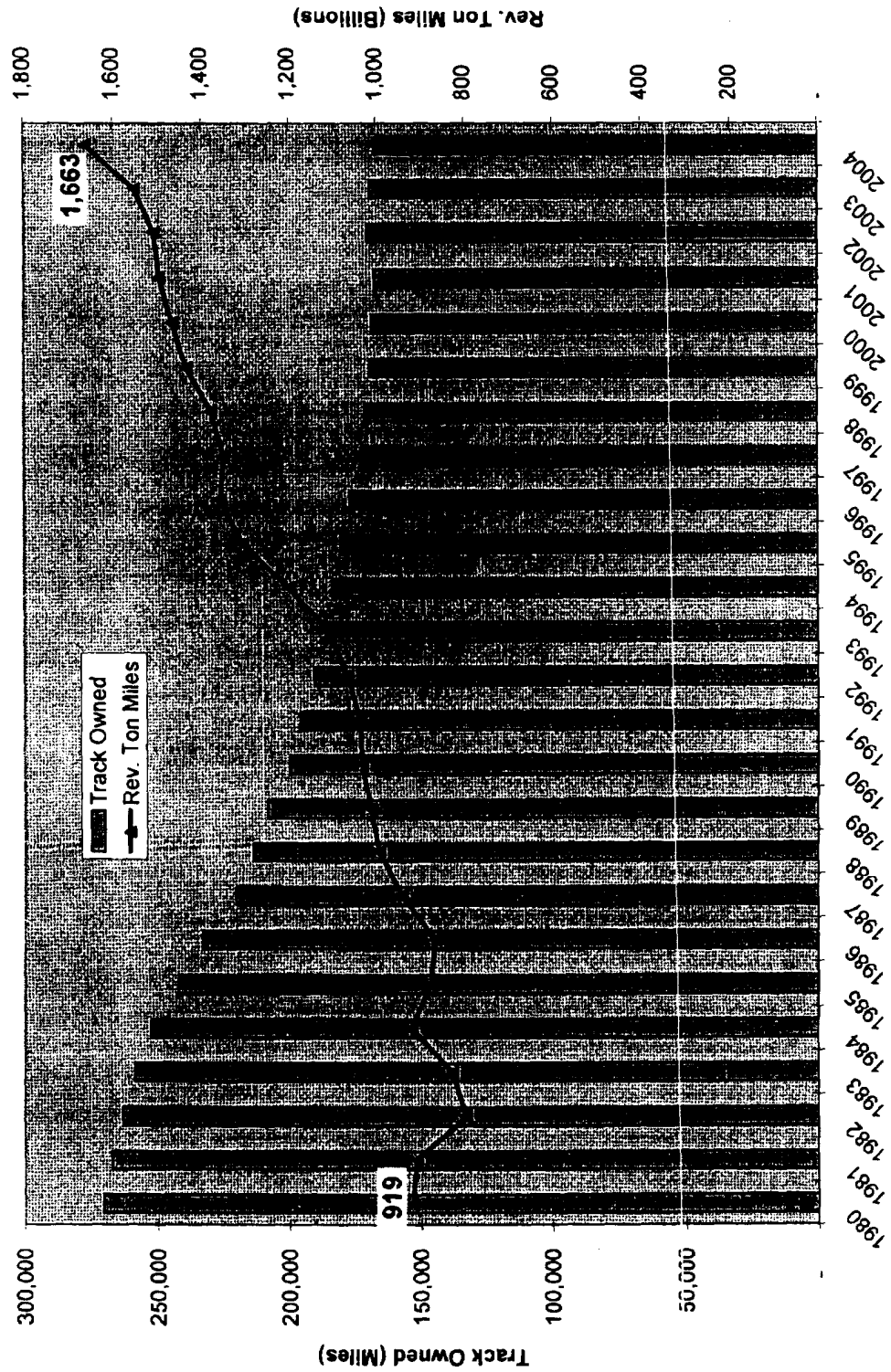
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**Surface Transportation Board
Staggers Act Review Hearing
October 19, 2005**

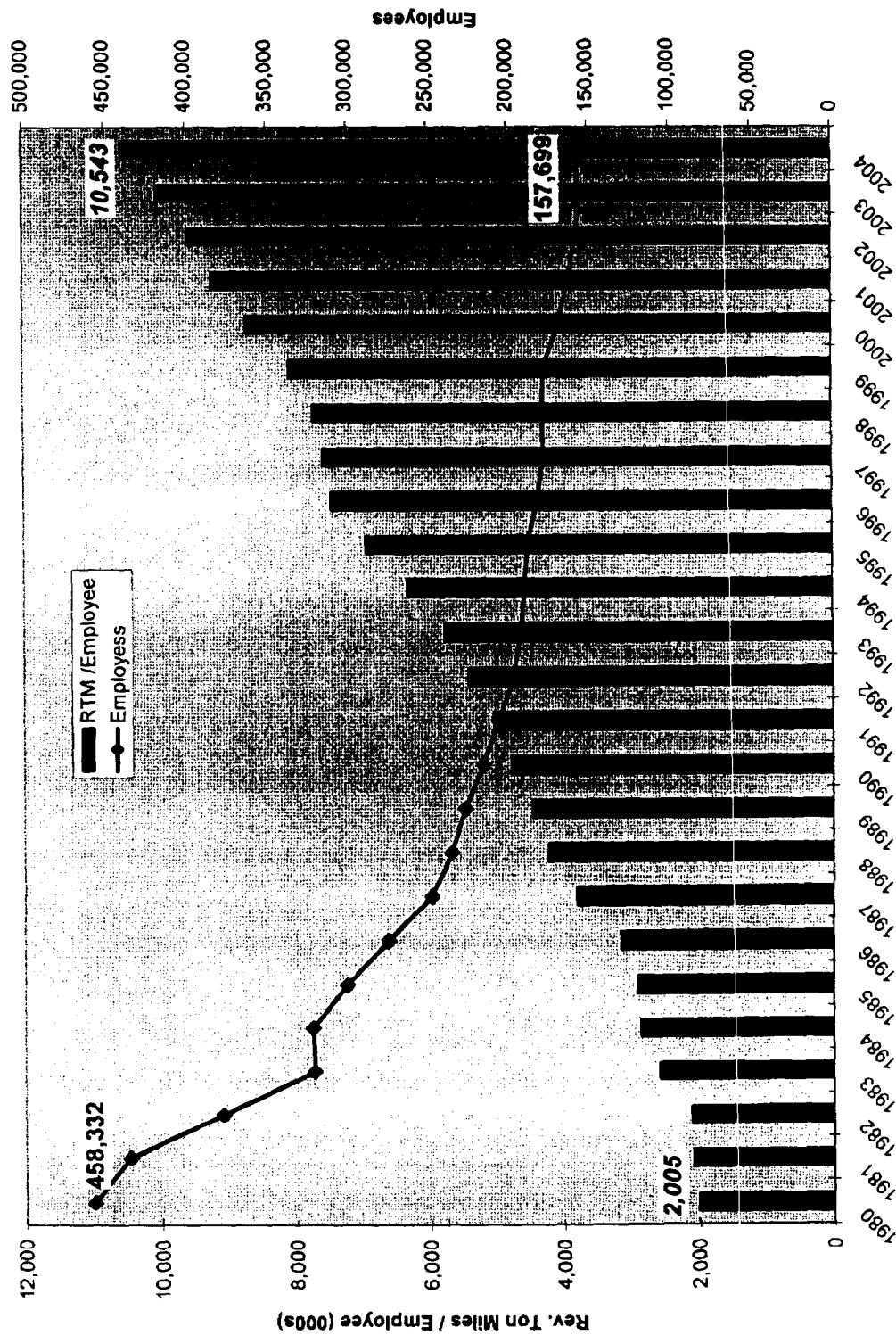
**Thomas R. Wadewitz
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Track Miles Owned and Revenue Ton Miles (Class I Rails)



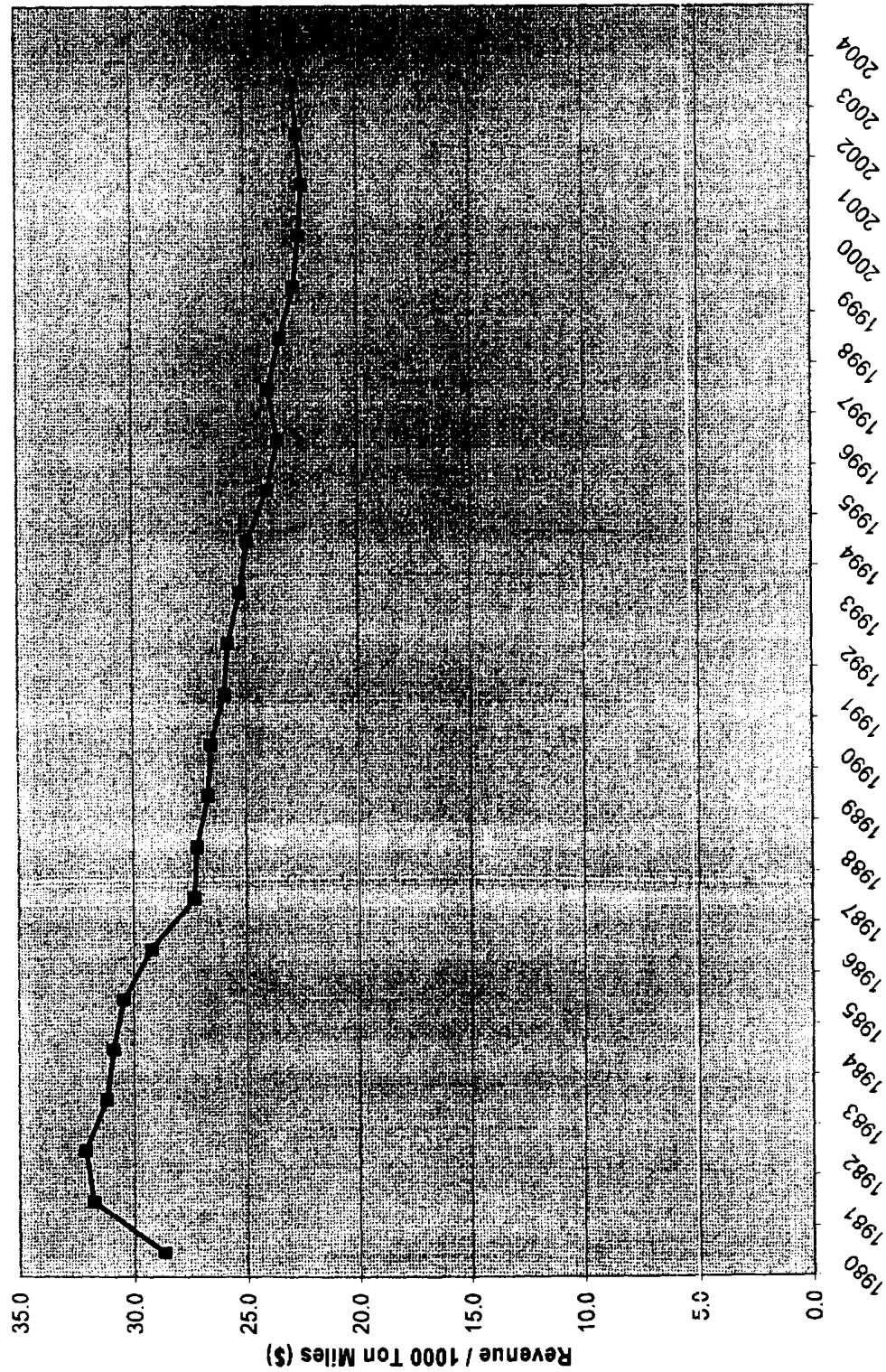
Source: AAR and JP Morgan Estimates

Revenue Ton Miles per Employee and Total Employee count



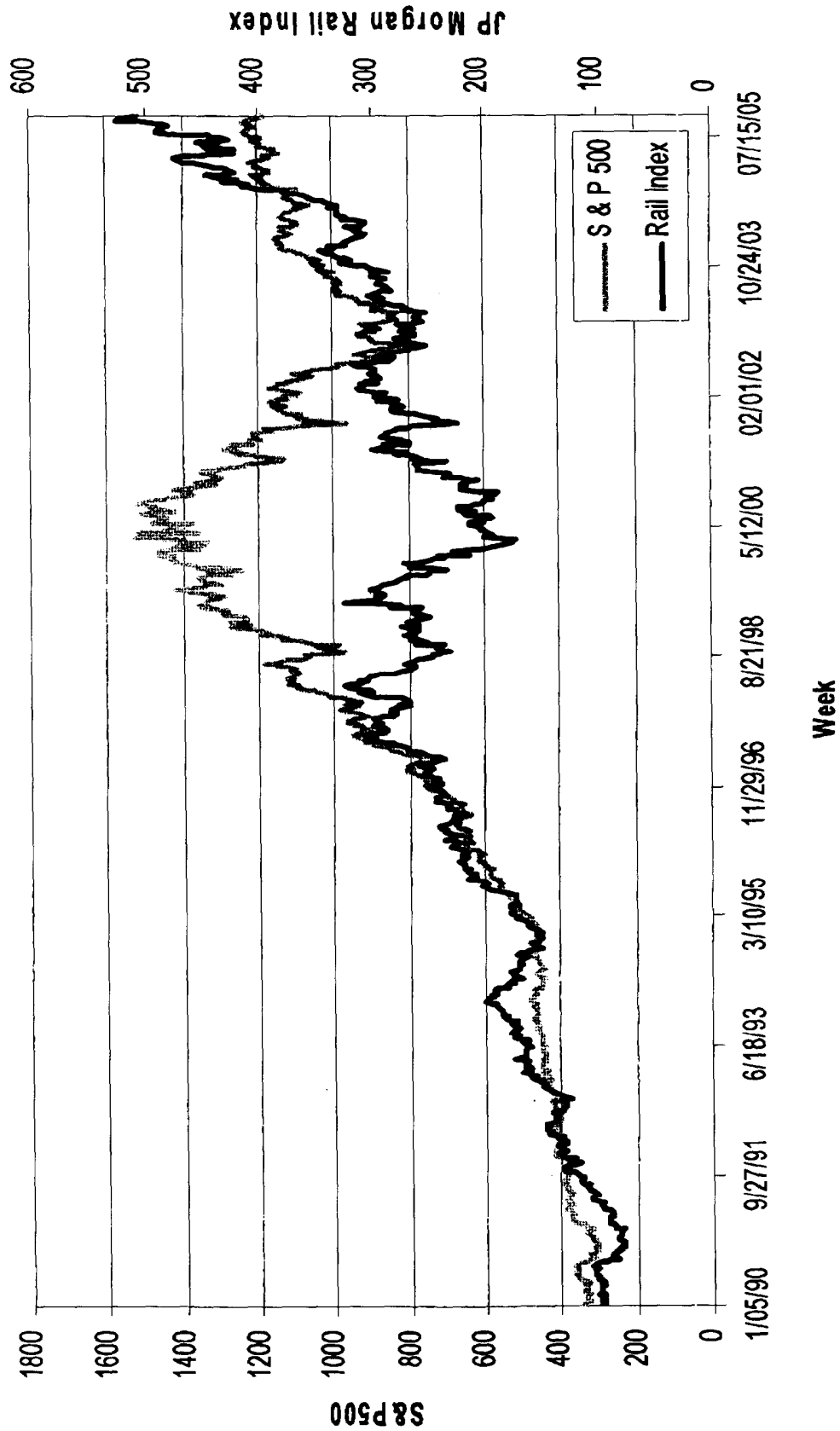
Source: AAR and JP Morgan Estimates

Revenue per 1,000 Ton Miles (\$)



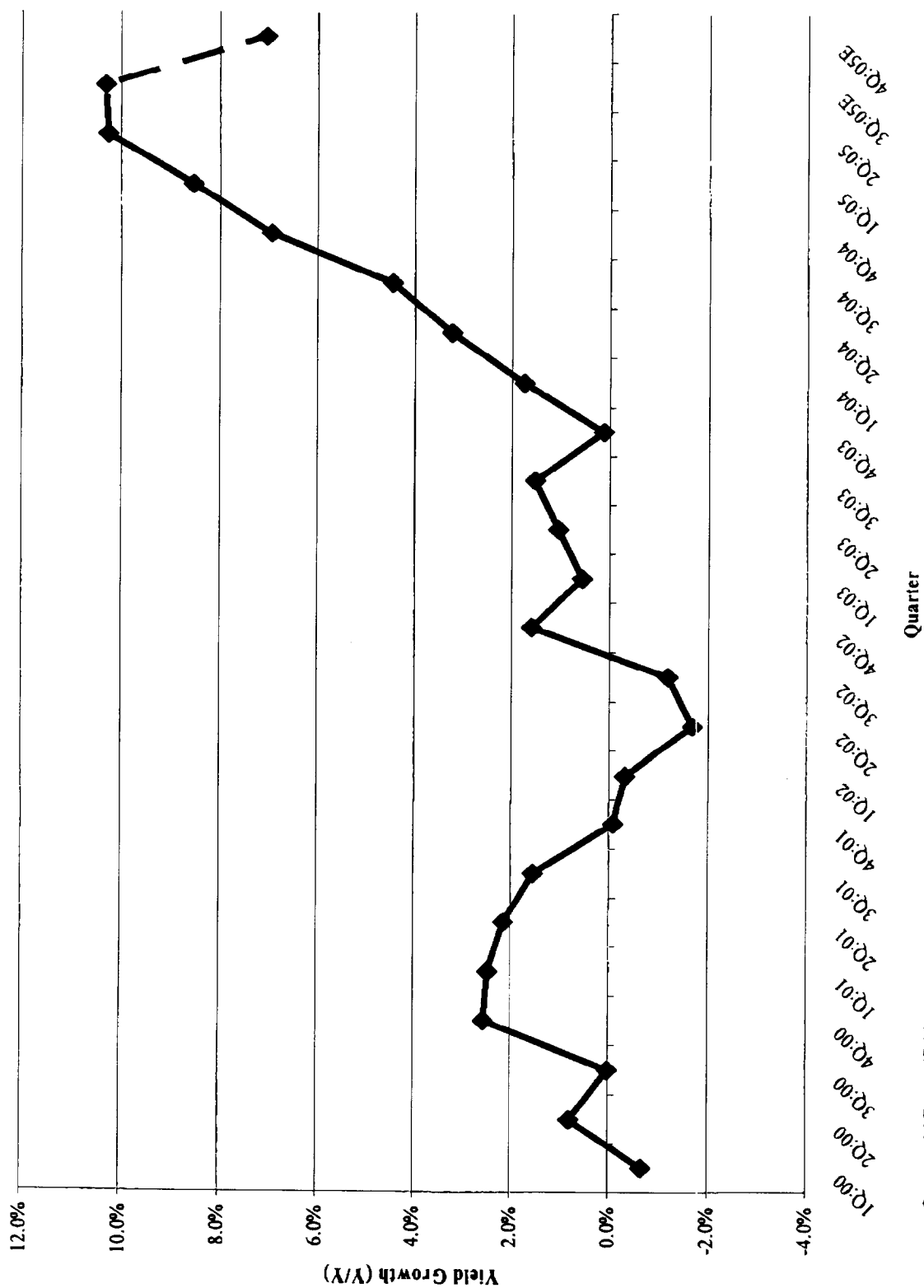
Source: AAR and JP Morgan Estimates

JP Morgan Rail Index and S&P 500



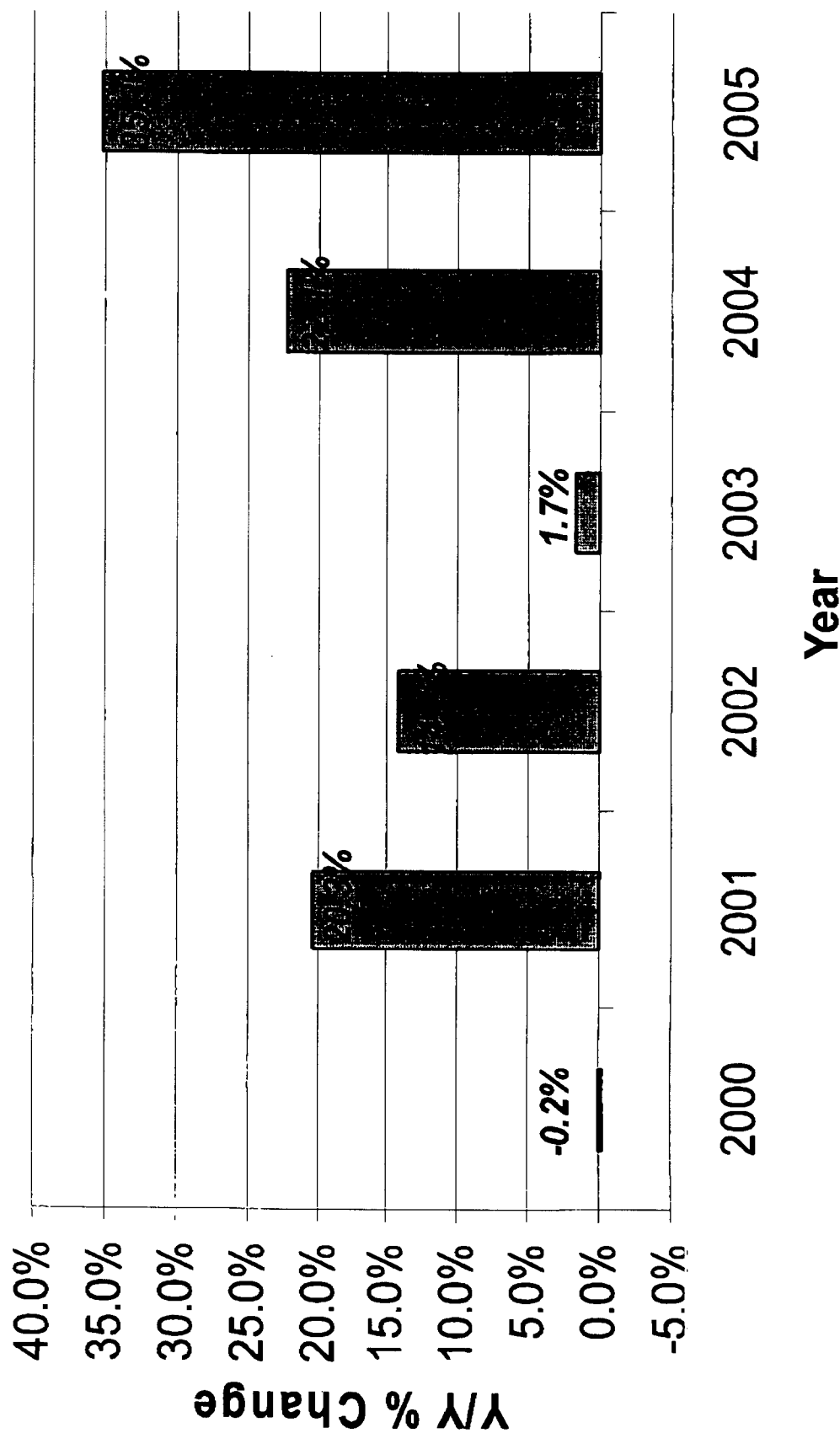
Source: Factset and JP Morgan Estimates

US Rail Average Y/Y Revenue per Car Growth



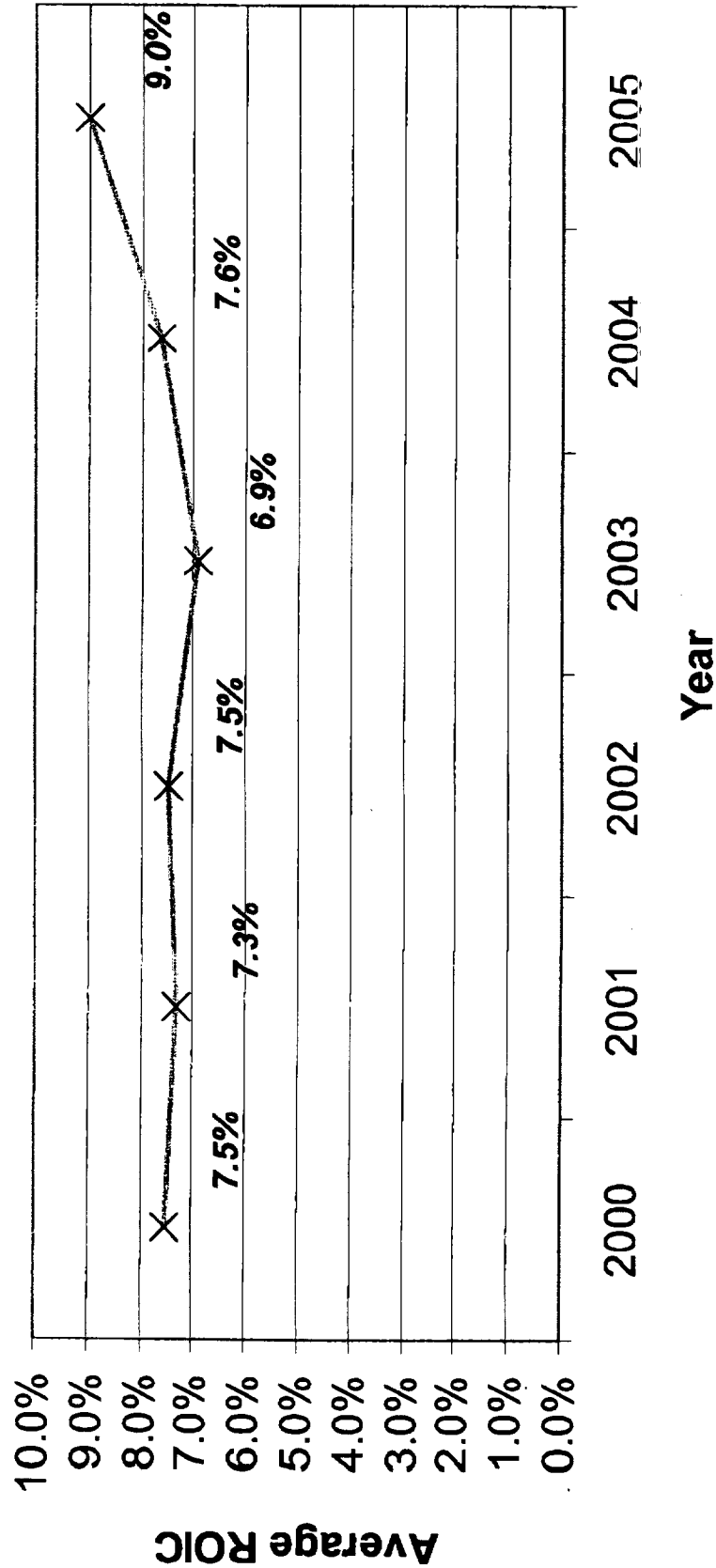
Source: AAR and JP Morgan Estimates

Rail Average EPS Growth



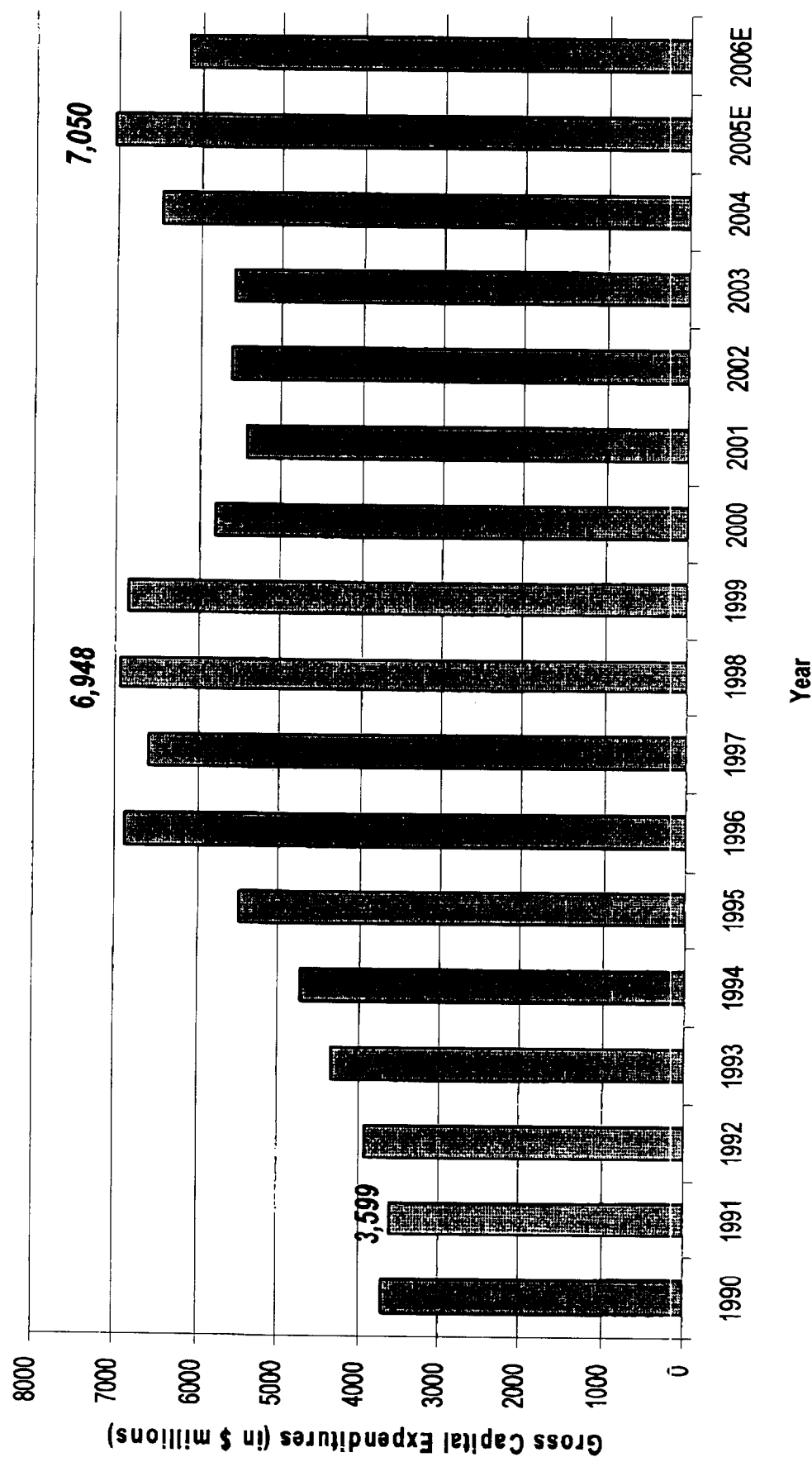
Source: Company Reports and JP Morgan Estimates

Rail Average Return on Capital



Source: AAR and JP Morgan Estimates

US Rails Total Capital Expenditures



Source: AAR and JP Morgan Estimates

Testimony for US Surface Transportation Board Hearings
Staggers Act of 1980: A Review and Look Ahead (STB Ex Parte No. 658)

Testimony of:

Thomas R. Wadewitz

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1) A Look at the Rail Industry Since 1980 and the Staggers Act

First I would like to take a look at major trends in place since the Staggers Act and the significant deregulation of the rail industry which took place in 1980. The first chart (see chart 1) shows track miles owned by the Class I railroads from 1980 through 2004 as bars along with a line showing Class I revenue ton miles. The long term trend of declining Class I miles of track is driven by both a rationalization of excess rail line capacity (closing certain branch lines) and a process of selling track to short line railroads which could operate with lower costs and make money operating lines with limited freight density. Despite the consistent decline in track miles maintained, revenue ton miles for the Class I rail group rose by about 81% from 1980 through 2004 or a Compounded Annual Growth Rate of about 2.5%.

Since 1980, rail industry employment (Class I rails) has fallen meaningfully as a result of productivity gains falling from about 460,000 people in 1980 to around 160,000 in 2004 (see Chart 2). The combination of growth in revenue ton miles and the decline in rail industry employment has driven a consistent rise in productivity since deregulation. Productivity, as measured by Revenue Ton Miles/ Employee, has risen at a Compounded Annual Growth Rate of 6.9% from 1980 through 2004.

Rail industry productivity gains have been impressive and a portion of the productivity gains were passed onto shippers in the form of lower rates as shown in the following chart for Revenue Per 1000 Revenue Ton Miles (see Chart 3). This metric for price has followed a generally declining trend since the Staggers Act. From a peak of slightly higher prices in 1982, revenue per revenue ton mile fell 30% to the trough level in 2001. After modest increases in this overall metric for price in 2002 and 2003, revenue per RTM rose about 3% in 2004. We believe that there is likely to be an even sharper rise in revenue per RTM in 2005 give what we have seen in the reported rail financial results for the 1st half of 2005. From a financial analyst point of view, the rise in rail transport prices is a significant positive factor which appears to be the greatest driver of growth in earnings and improvement in returns over the past two years.

In the following chart we look at the performance of our major rail stock index from 1990 through the present time. This chart shows that the rail index followed a similar patten of price appreciation to the S&P 500 until the mid 1990s. In the 1995 / 1996 timeframe our rail index outperformed the S&P 500 driven largely by enthusiasm about the potential benefits from consolidation in the industry. In my view, two primary factors drove underperformance of the railroad stocks in the late 1990s compared to the S&P 500.

First, significant integration issues occurred following two of the major transactions which caused deterioration in financial performance. Second industrial stocks were out of favor as there was a pronounced focus on the technology and telecommunications sectors of the market. Since the fall off in the late 1990s the railroad stock index has generally performed well as have most of the major groups of transportation stocks.

2) Recent Trends and the State of the Rail Industry (from a financial analysts viewpoint).

It appears that the long term trend of growth in demand for rail transportation finally caught up with available capacity, and the past two years have been a period of much tighter rail capacity compared to the historical norm. As a result rail transportation rates have risen significantly in 2004 and 2005. The following line graph (see Chart 7) shows average yield growth for the major US railroads on a year-over-year basis including the impact from fuel surcharges. Clearly the rails have enjoyed a period of strong pricing which appeared to really gain momentum in the second half of 2004. While the situation of tight capacity has had a negative impact on rail service for several railroads and many shippers have received less reliable rail transport service, it has also been a significant positive from an investor perspective. The trend of rail EPS growth has closely followed the pattern of rising yield growth. The average Return on Capital (see Chart 8) for the major US rails showed a meaningful move up in conjunction with the period of strong pricing. At the present time my estimates show two of the four major US railroads and both Canadian railroads earnings their cost of capital in 2005. I don't attempt to precisely identify the cost of capital for each railroad but instead view it as a range of 8%-10% over the long term.

I have highlighted the improvement in rail company financial performance over the past two years, and now I will discuss capital spending and the response of the railroads to the situation of tight capacity and improving financial performance. From a trough level in 2001, the railroads have sharply increased their capital spending in 2004 and 2005. We expect 2006 to be another year of peak type of capital spending as the railroads continue to focus on both rolling stock (locomotive, railcars) and infrastructure capacity (track, terminals). In our view, the improvement in financial performance driven by strong prices has been a critical factor in the willingness of the railroads to ramp up their capital spending and capacity investment significantly. Our sense is also that this represents a positive outlook for future rail volume growth.

3) Future Trends and Our View on Rail Regulation.

Looking forward, I have an optimistic view of future demand for rail transportation. In my view, growth in rail coal and intermodal volumes are both driven in part by secular trends, beyond the economic cycle, which are likely to persist. In addition, long term issues such as rising utilization of highway capacity are likely to support growth in rail transportation. I believe that continued improvement in financial performance and achieving railroad financial returns which consistently exceed their cost of capital are factors which are necessary to support railroad capital spending and capacity increases

which can support long term growth in demand. A trend of stronger rail pricing has been paramount to the improvement in rail financial performance over the past two years. While the pace of price increases may be more modest looking forward, I believe that continued pricing gains are the most important factor necessary to support favorable trends in rail financial performance. Although surface transportation supply / demand and competitive dynamics drive much of the pricing equation, regulatory factors also have a meaningful impact on rail pricing. To this point, the Staggers Act has provided a backdrop for significant rail industry productivity improvements and consistent growth in the tonnage transported by rail. Given recent favorable trends in rail financial performance, it appears possible that most of the railroads may produce a return on capital which exceeds their cost of capital. In my view, a regulatory regime which does not penalize railroads for earning their cost of capital would facilitate future rail investment in capacity so that the industry could handle growth in demand for rail transportation. Thank you for the opportunity to present.



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