

BEFORE THE  
SURFACE TRANSPORTATION BOARD

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STB Ex Parte 671

*RAIL CAPACITY AND INFRASTRUCTURE REQUIREMENTS*

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COMMENTS

Submitted on behalf of

THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

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Dated: April 4, 2007

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The National Industrial Transportation League ("League") is pleased to submit these Comments in response to the Notice of Public Hearing served March 6, 2007.

In that Notice, the Board noted that there has been a "growing recognition that rail capacity in the United States has become constrained." Notice, p. 1. In addition, the Board noted that "many forecasts predict that rail freight demands will grow over the next twenty years," citing a January 2006 Congressional Budget Office Report, Freight Transportation: Long Term Issues, at 4-5, for the proposition that railroads experienced a 50% increase in traffic from 1990 to 2003 and that traffic is projected to continue to increase as the economy grows; and a Department of Transportation study for the proposition that multimodal freight tonnage in the United States will rise by nearly 70% between 1998 and 2020. The Board declared:

The convergence of increased demand with constrained capacity has highlighted the need to address what further infrastructure investment will be required to meet these demands. While some railroads have announced significant infrastructure investment plans, some observers have questioned whether that investment alone will be sufficient to meet the transport needs of a growing economy.

The Board is therefore holding this hearing as a forum for interested persons to provide views about freight traffic forecasts; the extent of the capacity constraints and the ability of the railroads to meet the rising demand; the infrastructure investment needed; possible solutions to the challenges presented by growing rail traffic and limited capacity; and the potential role of public-private partnerships and innovative financing tools. In these Comments, the League will address these and other related questions.

At the outset, however, the League would like to note that it has been engaged for over two years in discussions with the Association of American Railroads (AAR) and its rail members over some of these very topics. The League and the AAR have formed two task forces, composed of both shipper and railroad members (including both Class I and short lines), to discuss infrastructure and operational issues of concern. These include a task force on “First Mile-Last Mile” operations, in which issues related to rail originations and delivery have been discussed, and a task force on Capacity and Asset Utilization. The Capacity and Asset Utilization Task Force is broken down into three sub-teams, including a team on Interline Service, Empty Private Fleet Transit, and Rail Traffic Forecasts, the latter of which is attempting to broaden and standardize the use of customer traffic forecasts, to better enable carriers to plan for infrastructure improvements.

I. The Rail Industry Has Experienced Strong Traffic Growth in Recent Years, and Substantial Traffic Growth Is Forecasted For the Future

In the year 2000, there were 281 million people in the United States, an increase of 100 million since 1960. In six years, the nation’s population grew another 19 million, as the nation’s population topped the 300 million mark. Between 1970 and 2000, the U.S. gross domestic product increased from \$3.5 trillion to almost \$9 trillion – an increase of 250%, or far more than the growth in population. Over these three decades, the growth in GDP averaged 3.2% per year.

This substantial growth in population and the nation's growing wealth have required substantial increases in freight transportation. In 1997, 11.1 billion tons of freight valued at nearly \$7 trillion were shipped over the nation's transportation system.<sup>1</sup> According to another source, by 2000, the nation's transportation system shipped 14 billion tons of freight valued at \$11 trillion.<sup>2</sup>

The rail system is dominant in the transportation of bulk commodities, in which its share is approximately 70%.<sup>3</sup> In comparison, "carload" freight is generally dominated by truck: within those commodity groups, rail captures 7% of the tonnage, with truck transporting the rest.<sup>4</sup> However, rail also captures a significant and growing amount of containerized freight (about 16%), though this is concentrated in long-haul markets.<sup>5</sup> Although trucks moved 78% of the nation's tonnage (with rail 16% and water 6%), rail carriers moved 40% of all intercity ton-miles (as distinct from total ton miles) in 2000. The average length of trip by rail in the year 2000 was about 620 miles.<sup>6</sup>

Rail carrier traffic has grown significantly especially in recent years. U.S. rail carriers generated 1.3 billion gross ton miles in 1990, a figure that more than doubled, to 2.9 billion, by 2004.<sup>7</sup> Over the same period, carloads increased from 21.5 million to about 30 million, an increase of 35%, showing that increases were not just in distance and weight, but in the number of carloads handled as well.<sup>8</sup> These increases were driven by such factors as increased coal

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<sup>1</sup> U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau. *1997 Economic Census – Transportation: 1997 Commodity Flow Survey*

<sup>2</sup> Freight – Rail Bottom Line Report, American Association of State Highway and Transportation Officials, p. 13 ("FRBL Report")

<sup>3</sup> *Id.*, p. 26.

<sup>4</sup> *Id.* p. 20

<sup>5</sup> *Id.*, p. 26

<sup>6</sup> FRBL Report, p. 17.

<sup>7</sup> Bear Stearns Equity Research, Report by Thomas Wadewitz, et al., May 2005, p. 12 ("Bear Stearns Report").

<sup>8</sup> *Id.*, p. 14; see also, Association of American Railroads, "Railroad Facts, 2006", p. 24.

production and agricultural trade growth; as well as the increasing constraints on the nation's truck system as a result of the driver shortage and highway congestion. Between 1997 and 2005, the compound annual growth rate for the rail industry has been 1.6%, but 2004 saw a 6% growth rate for the industry, followed by growth of over 2% in 2005.<sup>9</sup> The weekly trend in overall rail volumes (total carloads plus total intermodal units) is up over the past several years.<sup>10</sup>

A key driver of this growth is international trade. In 1990, less than 14% of our economy depended on international trade, but by 2000, this number had increased to about 24%. The value of international imports and exports grew at an annual rate of 9.3 percent during the 1990s, or far more than the growth in GDP. By 2010, thirty percent of our gross domestic product will depend on international trade.<sup>11</sup> Import-export tonnage is expected to increase by nearly 100 percent by 2020, or nearly double the increase for transportation as a whole.<sup>12</sup>

A significant part of this traffic arrives at the West Coast in the form of containers imported from the Far East. The Port of Los Angeles/Long Beach estimates 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.<sup>13</sup>

Rail carriers have experienced a very significant increase in rail intermodal traffic, which has placed substantial demands on the rail system. The chart below shows the long-term trend.<sup>14</sup>

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<sup>9</sup> Presentation by Matt Rose, Chairman, President and CEO of BNSF to NITL, Cincinnati, OH, August 9, 2006.

<sup>10</sup> For an interesting week-over-week analysis from 2003 through mid-2005, see the Bear Stearns Report, pp. 27-28.

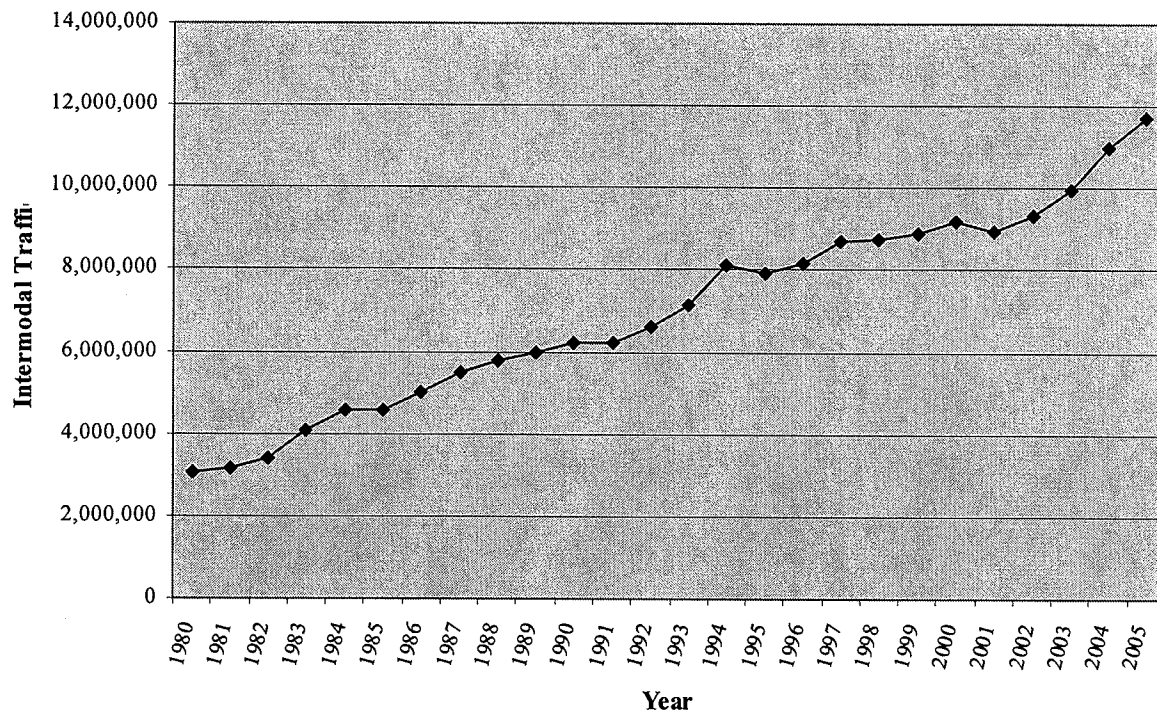
<sup>11</sup> Bottom Line Report, Forward, and p. 10-11.

<sup>12</sup> FRBL Report, pp. 2, 50. The Report notes that the freight rail system also carries 16% of the nation's cross-border NAFTA trade. *Id.*, p. 1.

<sup>13</sup> See, <http://www.polb.com> and <http://www.portoflosangeles.org>

<sup>14</sup> Association of American Railroads, "Railroad Facts, 2006," p. 26.

### Rail Intermodal Traffic



In 2006, rail intermodal traffic was up over 5 percent over the previous year, compared to an increase of 1.6% in total traffic. Railroad intermodal revenue more than doubled between 1990 and 2004, from about \$4 billion to over \$8 billion, and is even higher today.<sup>15</sup> Intermodal rail revenue, which totals about twenty-five percent of all rail revenue, now exceeds that of coal. The growth of containerized intermodal traffic has had profound effects on the railroad system. The traffic tends to be higher speed and higher priority compared to unit train coal or carload merchandise traffic, and therefore "takes up" significant "space" on the railroads' network.

However, as the AASHTO Freight Rail Bottom Line Report notes, most of this growth in intermodal has come in the "long-haul" intermodal market – intermodal hauls of 1,000 miles or more, generally originating on the west coast and destined for Midwestern or Eastern markets.<sup>16</sup> The League believes that the economics have made growing the short-haul intermodal market

<sup>15</sup> Carload Waybill Statistics

<sup>16</sup> See fn. 7 *infra*.

more difficult. It should be noted that intermodal operations, although very efficient from an environmental and operational standpoint, do not necessarily “de-congest” the highway system in the places where the highway system is most congested. Intermodal operations take long-haul trucks off the interstates. However, railroads deliver intermodal loads in congested urban areas, and the trucks must still make deliveries over heavily-congested urban streets and expressways. Thus, intermodal operations by their nature can only be partially successful getting trucks off the road. A substantial increase in carload traffic, in which rail is utilized from origin to destination, would be necessary to mitigate the growth of truck traffic. .

Freight transportation needs are expected to grow substantially in the next twenty years. The respected AASHTO study states that, with moderate growth in the economy – about three percent per year (or less than the average GDP growth experienced over the last thirty years) – domestic freight tonnage will increase 57% by 2020. The highway system will have to carry an additional 6,600 million tons of freight (an increase of 62 percent), and the freight rail system will have to carry an additional 888 million tons (an increase of 44 percent).<sup>17</sup>

The American Trucking Association in 2005 released a report entitled *U.S. Freight Transportation Forecast to 2016*, which predicted that overall freight volume would increase by about 32 percent between 2004 and 2016. According to the ATA report, freight rail tonnage from 2004 would grow annually by 2.4 percent to 2010 and by 2.1 percent to 2016, which implies total growth of a little over 30 percent over this time frame. The growth rates in the ATA study are slightly higher than, but still not appreciably different from, the growth rate

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<sup>17</sup> FRBL Report, pp. 2, 50-51. It should be noted that these figures are based in part on DOT’s own Freight Analysis Framework Project

implied in the AASHTO study (1.9% CAGR)<sup>18</sup> that is applied over a longer (20-year) time frame.

Finally, in 2002, the Department of Transportation projected, using its Freight Analysis Framework, that freight rail tonnage would grow about 55 percent by 2020, a number higher than that implied in the ATA analysis.

Despite the differences in these projections, each of these studies clearly predicts significant growth in the freight rail system over the time periods studied, and growth over the recent past is certainly consistent with the projections. Moreover, even if the growth rates in these studies were only “half right,” the nation would still have to accommodate a substantial increase in rail traffic over the next decade or more.

## II. Rail System Capacity Is Increasingly Constrained

There is growing evidence that the rail transportation system is increasingly capacity-constrained. Since the middle of the 20<sup>th</sup> Century, the rail industry was in a condition of over-capacity, as more and more intercity transportation was carried by truck. Railroads aggressively “downsized” during this period in both track and personnel to fit their resources to a declining demand for their services. Since 1980, Class I Railroad miles of track has decreased more than one-third, from approximately 270,000 miles to about 170,000 miles. In the same time period, the number of employees in Class I railroads has decreased from about 458,000 to only about 155,000 in 2003, a two-thirds decrease.<sup>19</sup> Since that time, the number of railroad employees has increased slightly, but less than the increase in railroad carload growth. However, railroad employee productivity has remained high: ton-miles per employee increased in the six years

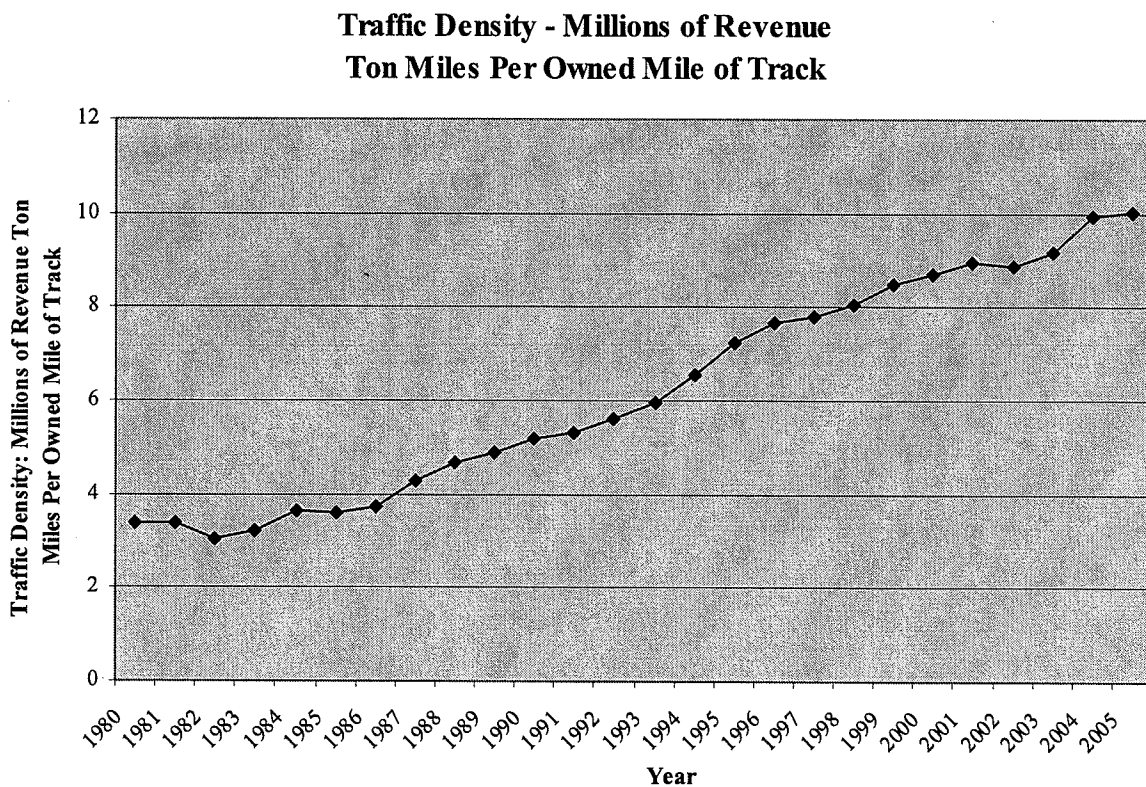
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<sup>18</sup> FRBL Report, p. 56.

<sup>19</sup> Association of American Railroads, “Railroad Facts,” p. 56.

from 1999 to 2005 from about 8 million to 10.5 million, or about thirty-five percent.<sup>20</sup> The effect of numerous rail mergers were clearly a factor in this downsizing, as rail carriers shed what they regarded as redundant plant and personnel.

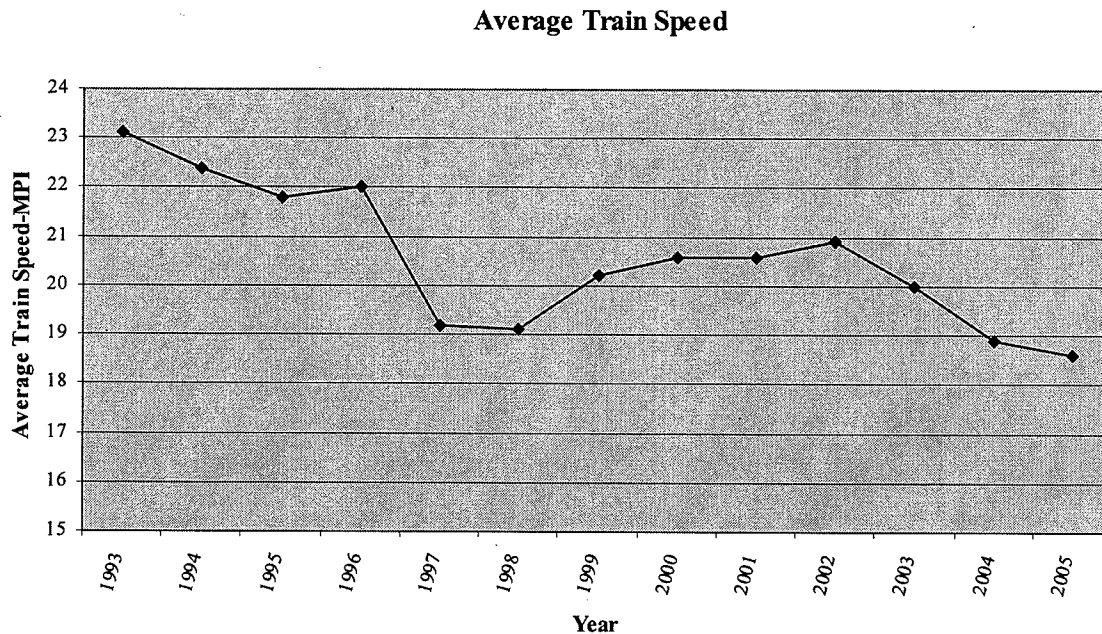
These interlocking trends – increasing traffic and decreasing physical plant and human capital – have meant that traffic density on the nation’s rail system has increased dramatically, and is currently at its highest point by far in the last twenty-five years. This is shown by an analysis of the number of ton-miles per mile of track carried by the nation’s railroads, which is a measure of how intensively the system is being used. As shown below, this figure has tripled in the last twenty years:



The signs of rail system capacity constraints have been widespread. According to AAR, train system speed has declined since the early 1990s: ten years ago, train speed was about 22

<sup>20</sup> *Id.*, p. 41.

miles per hour, but as of 2005, it had dropped over fifteen percent, to about 18.6 miles per hour.<sup>21</sup>



In addition, terminal dwell time on several of the major carriers had increased from February 2004 through April 2005.<sup>22</sup> In a League Rail Committee meeting in 2005, the Union Pacific noted that, for its system, a 1 mile-per-hour increase or decrease in train speed equates to 250 locomotives, 180 TY&E employees, and 5000 freight cars. Thus, capacity constraints are both a cause and a further effect of problems in railroad operations: as constraints appear, operations worsen, which encourages even more congestion, etc.

A sure sign that system capacity is increasingly constrained is higher prices. As noted in the 2005 Bear Stearns Report, “[p]erhaps the most compelling evidence of rail capacity constraints is the strength of the rise in yield growth over the past five quarters.”<sup>23</sup> Bear Stearns

<sup>21</sup> AAR, "Railroad Ten-Year Trends 1993-2002," p. 132; and "Railroad Ten-Year Trends 1994 – 2003," p. 132. The 2004 and 2005 AAR figures were presented by Matt Rose, Chairman, President and CEO of BNSF to NITL, Cincinnati, OH, August 9, 2006.

<sup>22</sup> Bear Stearns Report, p. 37.

<sup>23</sup> *Id.*, p. 37.

reports that, beginning with the fourth quarter of 2003 through the first quarter of 2005, the year-over-year growth in yields for U.S. railroads increased from approximately 1% to over 8%.<sup>24</sup> Pricing increases have continued since the beginning of 2005. According to the AAR, railroad prices, which had declined from 1997 to 2004, have increased since then.<sup>25</sup> In late 2006, Anthony Hatch, an industry financial observer, concluded that this was the “best ever rate environment” for rail carriers.<sup>26</sup> At a recent transportation policy forum sponsored by the League and the Association of Transportation Law Practitioners, Edward M. Wolfe from Bear Stearns & Co. presented a paper on “A Wall Street View of Transportation Funding and Infrastructure,” which is attached to these Comments as Appendix A. As shown in that presentation, rail prices jumped dramatically between 2004 and 2005, and took another dramatic upward jump between 2005 and 2006. Indeed, the Bear Stearns analysis shows that rail prices have increased about 35% from 2002.<sup>27</sup> This is consistent with comments from League members, which indicate that price increases of 30 to 40 percent have been common, with some increases much higher.

### III. The Financial Status of the Rail Industry Is Strong

The financial condition of the rail industry is strong. Most Class I rail carriers have experienced record earnings over the past several years. Most observers believe that the change in the railroad industry’s financial condition is “secular” rather than “cyclical”: it is and will be largely independent of the normal ups and downs of industry as a whole.<sup>28</sup>

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<sup>24</sup> *Id.*, p. 38.

<sup>25</sup> AAR figures presented by Matt Rose, Chairman, President and CEO of BNSF, to the National Industrial Transportation League, Cincinnati, OH, August 9, 2006

<sup>26</sup> Anthony Hatch, “Renaissance: Rail, Returns, Capital and Capacity, presentation November 3, 2006, Fort Lauderdale, FL.

<sup>27</sup> Edward Wolfe, “A Wall Street View of Transportation Funding and Infrastructure,” presented at the NITL/ATLP Spring Policy Forum, March 26, 2007.

<sup>28</sup> *Id.*

For the first time since at least the Second World War, the railroad industry as a whole is earning, or close to earning, its cost of capital.<sup>29</sup> Morgan Stanley expects that railroads overall will generate a return on invested capital of 11% by the end of 2007, with four out of the six major Class I carriers achieving a net return on operating assets of 11% or more.<sup>30</sup> Anthony Hatch, an industry financial analyst, projected in late 2006 that half the industry would earn its cost of capital by the end of 2006.<sup>31</sup> In a recent presentation, Mr. Ed Wolfe of Bear Stearns noted that four out of the six major Class I carriers (BNSF, CN, CP and NS) earned their cost of capital in 2006, with the return on capital of the industry as a whole at 9.8%, or at the industry's cost of capital as calculated by Bear Stearns.<sup>32</sup> Clearly, the days when a majority of Class I rail carriers are "revenue inadequate" have passed.

#### IV. Current Railroad Investment and Investment Needs

In 2004, the railroads spent about \$6.2 billion for roadway, structures, and equipment, an amount that had been relatively stable since 2000. According to Mr. Hatch, over half was devoted to rail, track, ballast and ties; about 13% was spent on locomotives; and the remainder on cars, computers, bridges, etc.<sup>33</sup> According to the AAR, in 2005, railroad capital expenditures

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<sup>29</sup> Analysts in the investment firm of Morgan Stanley have stated that Canadian National, BNSF, Norfolk Southern and Canadian Pacific are or will soon earn their cost of capital. James Valentine and Michael Manelli, Morgan Stanley Equity Research, "All Aboard! Reiterating Bullish View Towards Freight Railroads," September 20, 2005, p. 3.

<sup>30</sup> "Railroad Financial Conditions and Their Implications for Coal Transportation," November 10, 2005, James J. Valentine, Morgan Stanley Equity Research, pp. 9-11.

<sup>31</sup> Anthony Hatch, "Renaissance: Rail, Returns, Capital and Capacity," presentation November 3, 2006, Fort Lauderdale, FL.

<sup>32</sup> Edward Wolfe, "A Wall Street View of Transportation Funding and Infrastructure," presented at the NITL/ATLP Spring Policy Forum, March 26, 2007.

<sup>33</sup> Anthony Hatch, "Renaissance: Rail, Returns, Capital and Capacity," presentation November 3, 2006, Fort Lauderdale, FL.

rose to about 6.4 billion.<sup>34</sup> In 2006, it is estimated that rail capital expenditures increased to close to \$10 billion.<sup>35</sup>

The presentation by Mr. Wolfe which is attached to these Comments as Appendix A noted that total capital expenditures for the six major Class I carriers in 2006 totaled \$10.0 billion, a significant jump from just a few years earlier. For the industry as a whole, capital expenditures represented a substantial increase over the previous year, and totaled about 16.2% of the carrier's revenue in 2006. Mr. Wolfe noted that rail infrastructure spending per mile of track has increased significantly over the last fifteen years, and spending on roadway (as distinct from spending on equipment) has increased significantly as a proportion of total capital spending. (Indeed, rail customers are spending increased amounts on equipment: the percent of the rail car fleet owned by Class I rail carriers has declined substantially over the past twenty years). However, Mr. Wolfe also noted that, while capital spending was increasing in absolute dollars, it was declining as percentage of revenue, and that the cost of added miles of track or terminals was going up, due to higher costs to purchase land and higher materials cost.

However, most of the railroads' capital expenditure is not for expansion, but for repair and maintenance of the existing system. The numbers are not clear, and estimates of the amount of capital expenditures devoted to capacity expansion range from about \$1 billion to about \$2 billion per year.<sup>36</sup> However, AASHTO estimates that an additional \$2.6 to \$4.0 billion annually

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<sup>34</sup> Association of American Railroads, *Railroad Facts*, p. 44.

<sup>35</sup> AAR figures presented by Matt Rose, CEO of BNSF, to the National Industrial Transportation League, Cincinnati, OH, August 2006

<sup>36</sup> Bear Stearns estimates that BNSF spent about fifteen percent of its total capital expenditures on capital expansion from 2000 through 2004, with other rail carriers probably spending a smaller percentage on capital expansion, perhaps seven to nine percent. Bear Stearns Report, p. 24-25. Application of the Bear Stearns estimate means that Class I investment for capacity expansion probably totaled no more than about \$1 billion out of the total of \$9 billion in investment spent in 2006. In contrast, AASHTO's Freight Rail Bottom Line report estimates that Class I railroads spend about \$2 billion annually on infrastructure above and beyond repair and maintenance. FRBL Report, p. 61.

is needed to upgrade the nation's rail system.<sup>37</sup> Thus, whatever the current numbers are, it is clear that current investment for capacity expansion is well short of what is needed to upgrade the system.

V. A Variety of Actions Are Needed to Increase Capacity

The League believes that there are a variety of actions and strategies needed to meet growing freight demands, and increased investment in rails, ties, ballast and the like are only one of them.

Investment in technology is one necessary step. Rail systems are networks, and the application of technology to networks can have a significant impact on the operation of the network. For example, it has been estimated that Positive Train Control could increase rail network capacity by as much as ten to fifteen percent without adding new track. Clearly, rail carriers and policymakers need to encourage the application of new technologies to rail carrier operations.

Second, operational changes will be needed to maximize the use of the rail system. Canadian National has shown the benefits of a “scheduled railroad,” a model that other carriers have adopted or are quickly adopting.

Both technology and operational changes are subsumed under the broader heading of productivity increases – getting more out of the existing system. Since 1980, the rail system has become increasingly productive, as shown by numerous measures. As noted above, Class I railroad ton-miles per employee has more than quintupled between 1980 and 2005, rising from about 2 million in 1980 to about 11 million in 2005. Such productivity increases show the existence of and continuing need for a well-trained, dedicated railroad workforce. Other

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<sup>37</sup> FRBL Report, pp. 4, 61, 80.

measures also show increased productivity. For example, for the five year period from 2001 through 2005, the Surface Transportation Board has calculated that overall railroad productivity has increased at a very healthy average of 1.7% per year.

There will clearly need to be additional investment in on-the-ground infrastructure – rails, ties, ballast, bridges, and the like. While the current and expected future financial condition the rail carriers clearly enables them to make the larger infrastructure investments than in the past, it also appears that additional investment over and above the capacity expansions presently contemplated by the industry will be needed to meet future demand.

Finally, it is clear that, given the significant needs for the future, there should be no need for any modal conflict. Under any of the scenarios described in Section IV above, or even if any of these scenarios were “wrong” by fifty percent or more, it is absolutely clear that the “pie” will be growing – not shrinking, or even stable. Existing capacity constraints in the rail network indicate that the industry is having increasing difficulty moving the relatively small freight growth that the industry has experienced over the past two years, much less the wave of increases clearly coming over the next ten to twenty years. The League believes that policymakers need to strongly encourage modal cooperation which will target productivity improvements by all modes to meet the rapidly growing needs of the U.S. economy. Such productivity gains are necessary in order to reduce the amount of capital investment that will be required to support future volume growth.

#### VI. What Can the Surface Transportation Board Do?

The Surface Transportation Board’s authority over the rail industry is broad, but not unlimited. As noted by GAO, however, the agency clearly has the authority to inquire into and report on rail industry practices, including obtaining information from railroads and holding

hearings to inquire into areas of concern.<sup>38</sup> In addition to this hearing, in which the agency will be able to compile a record that should be of assistance to policymakers in the Congress and in the Executive Branch, the League would suggest that the STB could play a useful ongoing role in two areas: information about capacity, and customer input.

A. The Need for Better Information

The agency clearly has broad authority to obtain information from rail carriers. See, 49 U.S.C. §11144 and 11145. Indeed, the League believes that the Board has a responsibility to provide policymakers with viable, objective standards for the industry, and information necessary to make rational policy decisions. With respect to infrastructure and capacity, there are several areas in which better information, or additional information, would be useful.

First, there is clearly a need for a clearer definition and objective measure of “capacity,” including the capacity of a railroad system as a whole and the capacity of segments of the system. It is difficult to know what is the capacity of a rail carrier’s system or any part or parts of that system, and when that capacity has been reached. While the development of such a metric or metrics for the rail industry may not be easy and while complete precision may not be possible, the Board should initiate a proceeding to develop accurate and appropriate definitions and measurements of capacity.

Second, the Board should develop information as to the effects of capacity constraints. At the present time, the data available on the effects of capacity constraints are very broad and general: system train speed, terminal dwell, cars on line, and little else. The true situation on the ground is often lost in the broad averages. The League suggests that additional data would be useful: for example, system velocity in key lanes on individual rail carriers, with breakdowns by

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<sup>38</sup> GAO Report GAO-07-94 Freight Railroads, “Industry Health Has Improved, but Concerns About Competition and Capacity Should Be Addressed,” October 2006, p. 38. See also, 49 U.S.C. §11144, 11145.

commodity or train type (e.g., unit train, mixed carload, intermodal, etc.); and percent of trains running to schedule, in key lanes. Other information may also be useful to policymakers.

Third, the Board should require carriers to better report on capital expenditures for maintenance, versus capital expenditures for expansion. The Bear Stearns Report notes that it is difficult to obtain data on this important matter from carriers' public reports, and some carriers (BNSF and CP in particular) are more complete on this matter than others. Policymakers should have accurate information as to the amount of capital investment going to capacity expansion as distinct from capital investment devoted to maintaining the existing system.

To the extent that any of the above information is confidential or competitively sensitive, the agency has the ability to require the carriers to provide the confidential portions of it under seal, so that the Board and other policymakers may be in a position to evaluate it.

Fourth, the League believes that the Board has been established by Congress as the one agency whose focus is on the rail industry. The League believes that the Board should consider issuing annually a "state of the industry" report, to assist Congress and federal policymakers in prescribing sound national policies for the industry and its customers.

#### B. The Need for Customer Input to Infrastructure Improvements

Rail transportation, and transportation generally, is a "derived" demand – it exists because there is a demand for other goods, which must be transported from the place of production or origination to the place of consumption. Ultimately, it is the customers of rail carriers who suffer from capacity constraints and who benefit from capacity and infrastructure improvements. The final decisions as to where and how to spend limited investment dollars have to be made by rail carrier management, who are in the best position to make those choices. But the League believes that rail carriers need to obtain input from their customers as to the workings

of the network and where investment is needed. The League also believes that the STB can play a role in this process.

Specifically, the League suggests that the STB may desire to direct each Class I rail carrier to create, with the assistance of the Board, a "Rail Capacity and Infrastructure Advisory Committee," composed of representatives of a broad cross-section (carload, coal, grain, intermodal) of that carrier's customers and short line connections, to provide a forum where an individual carrier can obtain input from its customers as to infrastructure needs, and where the rail carrier can brief its customers on its plans for the future.

The League is aware that there have been calls for specific investment amounts to be "set aside" to improve the infrastructure for the transportation of specific commodities or traffic groups. However, the League recognizes that an individual rail system, and the rail system as a whole, is a network, and that investments aimed at a particular segment of traffic will often assist not only the transportation of that traffic, but will also benefit the system as a whole. However, the advisory committee arrangement discussed above would establish a more structured system to provide input and information between customers and carriers as to network capacity and infrastructure needs.

## VII. CONCLUSION

The League appreciates this opportunity to present its views to the Board on this important matter.

Respectfully submitted,

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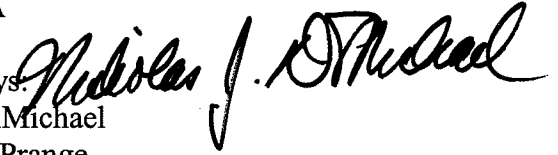
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A handwritten signature in black ink, appearing to read "Nicholas J. DiMichael", written over the printed name.

# **ATTACHMENT**

## **A**

# NITL Spring Policy Forum: *A Wall Street View of Transportation Funding & Infrastructure*

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March 26, 2007

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PLEASE READ THE IMPORTANT DISCLOSURE AND ANALYST CERTIFICATION INFORMATION IN THE ADDENDUM SECTION OF THIS REPORT.

## Railroad Coverage Universe

| Ticker                  | Name                 | Price<br>3/22/2007 | Market Cap. (MM) | Rating       |
|-------------------------|----------------------|--------------------|------------------|--------------|
| <b>Class I Rails</b>    |                      |                    |                  |              |
| BNI                     | BNSF                 | \$80.39            | \$29,366         | Outperform   |
| CNI                     | Canadian National    | \$45.48            | \$23,813         | Outperform   |
| CP                      | Canadian Pacific     | \$55.15            | \$8,681          | Peer Perform |
| CSX                     | CSX Corporation      | \$39.88            | \$18,485         | Peer Perform |
| NSC                     | Norfolk Southern     | \$49.86            | \$20,159         | Outperform   |
| UNP                     | Union Pacific        | \$100.37           | \$27,371         | Peer Perform |
| <b>Short-Line Rails</b> |                      |                    |                  |              |
| GWR                     | Genesee & Wyoming    | \$26.30            | \$1,110          | Peer Perform |
| KSU                     | Kansas City Southern | \$35.49            | \$3,547          | Peer Perform |

Sector Weighting: Railroads - Market Weight

# Capex by Company; Capex as a Percent of Total Revenue

|                     | 1995           | 1996           | 1997           | 1998           | 1999           | 2000           | 2001           | 2002           | 2003           | 2004           | 2005           | 2006            | 2007E           | 2008E           | 5-Yr. Avg.     | 12-Yr. Avg.    |
|---------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|-----------------|-----------------|-----------------|----------------|----------------|
| BNI                 | \$1,935        | \$2,722        | \$2,598        | \$2,767        | \$2,526        | \$1,762        | \$1,608        | \$1,505        | \$1,726        | \$1,990        | \$2,179        | \$2,614         | \$2,750         | \$2,350         | \$2,003        | \$2,161        |
| CNI (US\$)          | 377            | 373            | \$634          | 722            | 738            | 743            | 684            | 598            | 749            | 825            | 975            | 1,141           | 1,392           | 1,364           | 858            | 713            |
| CP (US\$)           | 477            | 369            | 579            | 736            | 567            | 385            | 359            | 357            | 493            | 519            | 731            | 698             | 774             | 792             | 559            | 522            |
| CSX                 | 972            | 1,220          | 943            | 1,115          | 1,256          | 859            | 879            | 1,036          | 1,059          | 993            | 1,136          | 1,639           | 1,400           | 1,308           | 1,173          | 1,092          |
| NSC                 | 939            | 957            | 960            | 966            | 912            | 731            | 746            | 695            | 720            | 1,041          | 1,025          | 1,178           | 1,340           | 1,340           | 932            | 905            |
| UNP                 | 1,903          | 2,076          | 2,101          | 2,110          | 2,158          | 2,315          | 2,196          | 2,359          | 2,071          | 2,402          | 2,869          | 2,742           | 3,150           | 3,150           | 2,489          | 2,275          |
| <b>Total (US\$)</b> | <b>\$6,604</b> | <b>\$7,717</b> | <b>\$7,815</b> | <b>\$8,407</b> | <b>\$8,157</b> | <b>\$6,795</b> | <b>\$6,472</b> | <b>\$6,550</b> | <b>\$6,818</b> | <b>\$7,770</b> | <b>\$8,914</b> | <b>\$10,012</b> | <b>\$10,806</b> | <b>\$10,304</b> | <b>\$8,013</b> | <b>\$7,669</b> |
| Canadian Rails      | 855            | 742            | 1,213          | 1,459          | 1,305          | 1,128          | 1,043          | 955            | 1,242          | 1,344          | 1,705          | 1,839           | 2,166           | 2,156           | 1,417          | 1,236          |
| US Rails            | 5,749          | 6,975          | 6,602          | 6,948          | 6,852          | 5,667          | 5,429          | 5,595          | 5,576          | 6,426          | 7,209          | 8,173           | 8,640           | 8,148           | 6,596          | 6,433          |

## % Change (Y-o-Y)

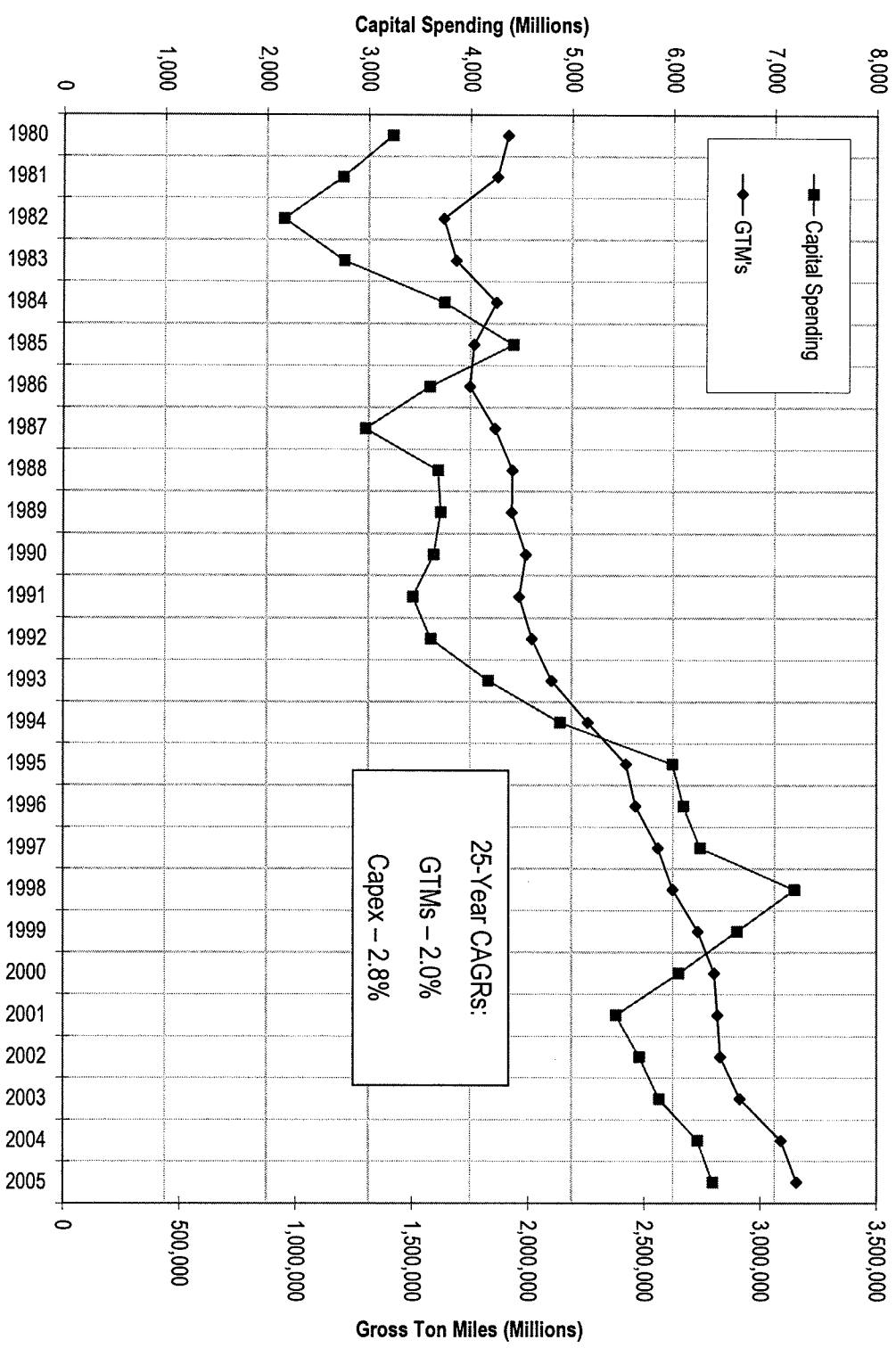
|                     | 1995         | 1996         | 1997        | 1998        | 1999         | 2000          | 2001         | 2002        | 2003        | 2004         | 2005         | 2006         | 2007E       | 2008E        | 5-Yr. Avg.  | 12-Yr. Avg. |
|---------------------|--------------|--------------|-------------|-------------|--------------|---------------|--------------|-------------|-------------|--------------|--------------|--------------|-------------|--------------|-------------|-------------|
| BNI                 | 13.7%        | 40.7%        | -4.6%       | 6.5%        | -8.7%        | -30.2%        | -8.7%        | -6.4%       | 14.7%       | 15.3%        | 9.5%         | 20.0%        | 5.2%        | -14.5%       | 10.6%       | 5.1%        |
| CNI                 | -            | -1.1%        | 69.9%       | 13.9%       | 2.2%         | 0.7%          | -8.0%        | -12.6%      | 25.2%       | 10.2%        | 18.1%        | 17.1%        | 22.0%       | -2.0%        | 11.6%       | 12.3%       |
| CP                  | -            | -22.8%       | 57.1%       | 27.2%       | -23.0%       | -32.2%        | -6.7%        | -0.7%       | 38.4%       | 5.1%         | 40.9%        | -4.5%        | 11.0%       | 2.3%         | 15.8%       | 7.2%        |
| CSX                 | 9.3%         | 25.4%        | -22.7%      | 18.2%       | 12.6%        | -31.6%        | 2.3%         | 17.9%       | 2.2%        | -6.2%        | 14.4%        | 44.3%        | -14.6%      | -6.6%        | 14.5%       | 7.2%        |
| NSC                 | -6.9%        | 2.0%         | 0.3%        | -0.4%       | -4.6%        | -19.8%        | 2.1%         | -6.8%       | 3.6%        | 44.6%        | -1.5%        | 14.9%        | 13.8%       | 0.0%         | 10.9%       | 2.3%        |
| UNP                 | 29.0%        | 9.1%         | 1.2%        | 0.4%        | 2.3%         | 7.3%          | -5.1%        | 7.4%        | -12.2%      | 16.0%        | 19.4%        | -4.4%        | 14.9%       | 0.0%         | 5.2%        | 5.9%        |
| <b>Total (US\$)</b> | <b>30.1%</b> | <b>16.9%</b> | <b>1.3%</b> | <b>7.6%</b> | <b>-3.0%</b> | <b>-16.7%</b> | <b>-4.8%</b> | <b>1.2%</b> | <b>4.1%</b> | <b>14.0%</b> | <b>14.7%</b> | <b>12.3%</b> | <b>7.9%</b> | <b>-4.6%</b> | <b>9.3%</b> | <b>6.5%</b> |
| Canadian Rails      | -            | -11.9%       | 63.5%       | 20.6%       | -10.4%       | -15.7%        | -7.3%        | -6.6%       | 31.8%       | 7.6%         | 29.5%        | 6.3%         | 16.5%       | 0.1%         | 13.7%       | 8.9%        |
| US Rails            | 13.3%        | 21.3%        | -5.3%       | 5.2%        | -1.4%        | -17.3%        | -4.2%        | 3.1%        | -0.3%       | 15.2%        | 12.2%        | 13.4%        | 5.7%        | -5.7%        | 8.7%        | 4.6%        |

## % of Revenue

|                       | 1995         | 1996         | 1997         | 1998         | 1999         | 2000         | 2001         | 2002         | 2003         | 2004         | 2005         | 2006         | 2007E        | 2008E        | 5-Yr. Avg.   | 12-Yr. Avg.  |
|-----------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| BNI                   | 23.7%        | 33.2%        | 30.9%        | 30.9%        | 27.5%        | 19.1%        | 17.5%        | 16.8%        | 18.3%        | 18.2%        | 16.8%        | 17.4%        | 17.4%        | 13.9%        | 17.5%        | 22.5%        |
| CNI                   | 10.7%        | 10.5%        | 18.0%        | 20.9%        | 20.9%        | 20.3%        | 18.7%        | 15.4%        | 17.7%        | 15.9%        | 16.3%        | 16.8%        | 20.0%        | 18.2%        | 16.4%        | 16.8%        |
| CP                    | 18.7%        | 14.5%        | 24.5%        | 31.5%        | 24.1%        | 15.6%        | 15.0%        | 15.3%        | 18.8%        | 17.3%        | 20.1%        | 17.3%        | 18.8%        | 17.9%        | 17.7%        | 19.4%        |
| CSX                   | 13.7%        | 17.1%        | 13.1%        | 15.6%        | 19.1%        | 11.9%        | 12.2%        | 14.4%        | 14.2%        | 12.4%        | 13.2%        | 17.1%        | 14.2%        | 12.5%        | 14.3%        | 14.5%        |
| NSC                   | 15.2%        | 15.3%        | 15.1%        | 15.3%        | 14.6%        | 11.9%        | 12.1%        | 11.1%        | 11.1%        | 14.2%        | 12.1%        | 12.5%        | 13.9%        | 13.1%        | 12.2%        | 13.4%        |
| UNP                   | 20.1%        | 20.5%        | 21.0%        | 22.3%        | 21.2%        | 21.4%        | 20.3%        | 21.1%        | 17.9%        | 19.7%        | 21.1%        | 17.6%        | 19.3%        | 18.1%        | 19.5%        | 20.4%        |
| <b>Total Class 's</b> | <b>18.2%</b> | <b>21.5%</b> | <b>20.0%</b> | <b>21.0%</b> | <b>20.6%</b> | <b>16.1%</b> | <b>15.5%</b> | <b>15.9%</b> | <b>15.4%</b> | <b>16.1%</b> | <b>15.8%</b> | <b>16.2%</b> | <b>16.2%</b> | <b>14.4%</b> | <b>15.9%</b> | <b>17.7%</b> |
| Canadian Rails        | 14.7%        | 12.5%        | 21.2%        | 26.2%        | 22.5%        | 18.0%        | 16.9%        | 15.3%        | 18.2%        | 16.6%        | 18.2%        | 17.1%        | 19.4%        | 18.0%        | 17.1%        | 18.1%        |
| US Rails              | 17.0%        | 18.5%        | 20.4%        | 22.7%        | 21.2%        | 16.7%        | 16.0%        | 15.7%        | 16.4%        | 16.3%        | 16.6%        | 16.5%        | 17.3%        | 15.6%        | 16.3%        | 17.8%        |

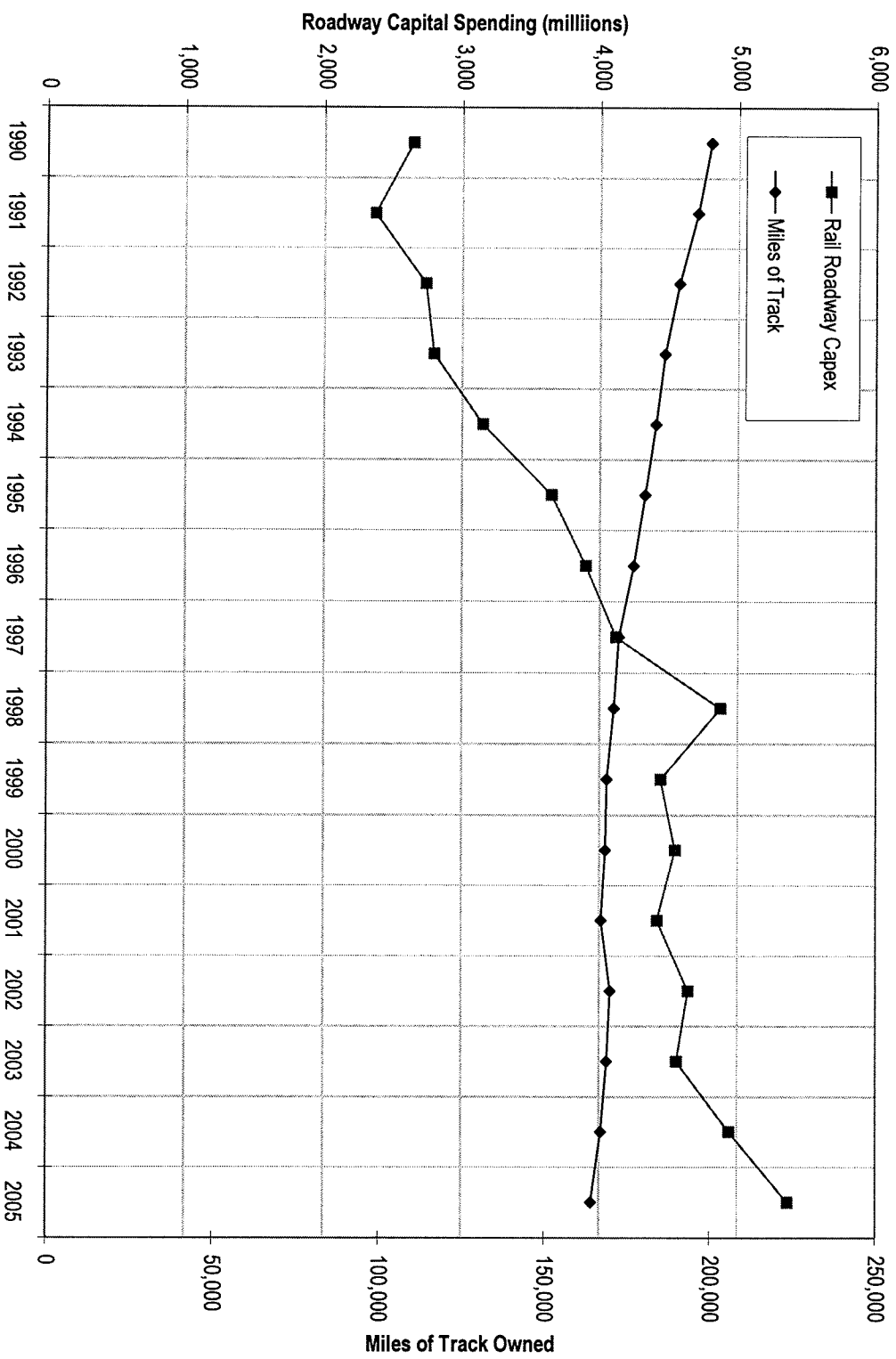
Note: Includes off-balance sheet leases; 5 and 12 year averages through 2006  
Source: Company reports; Bear Stearns & Co. estimates

# Historical Capex Tracks Gross Ton Miles



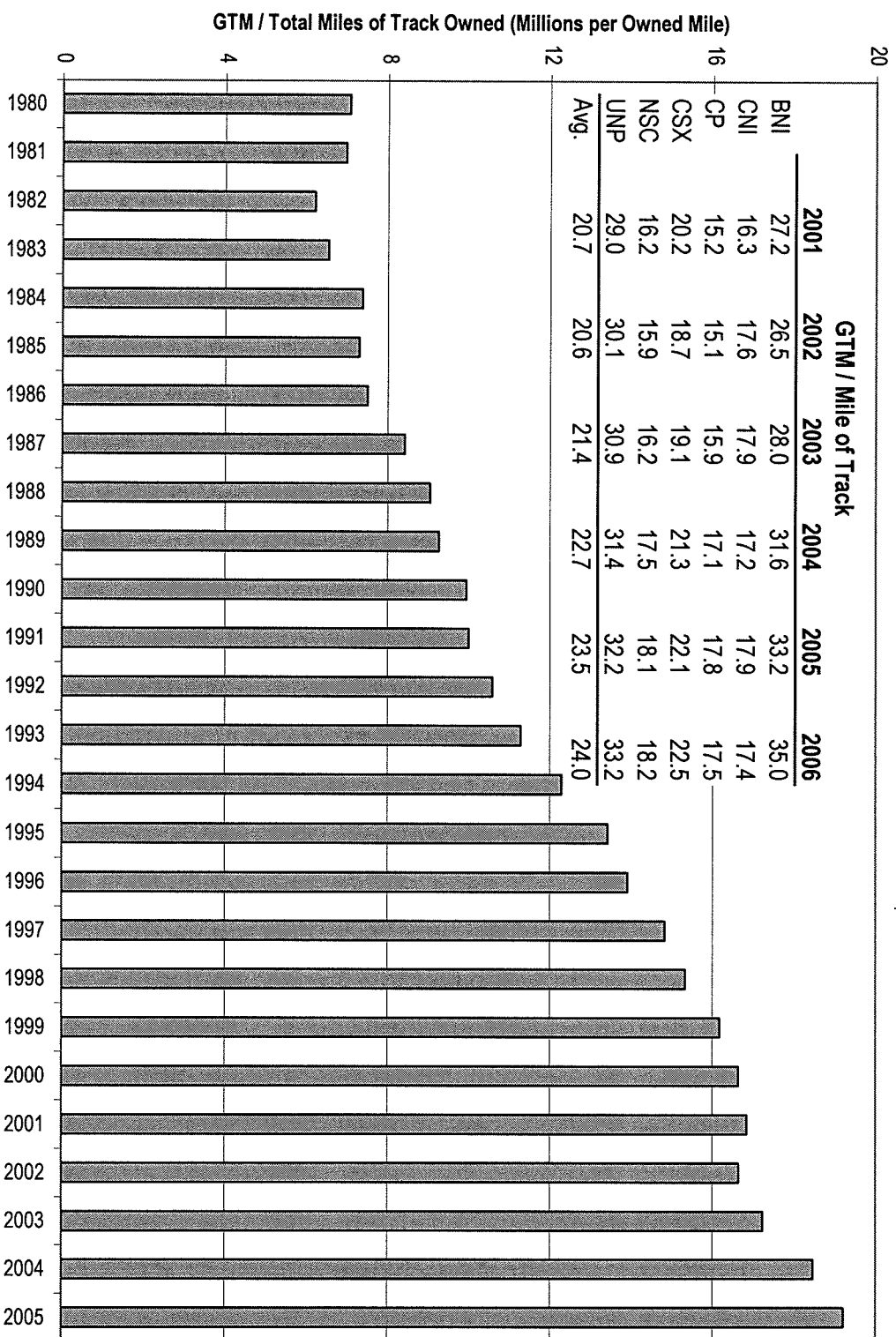
Source: Association of American Railroads; Bear Stearns & Co.

# Rail Infrastructure Spending Per Mile of Track Continues to Rise



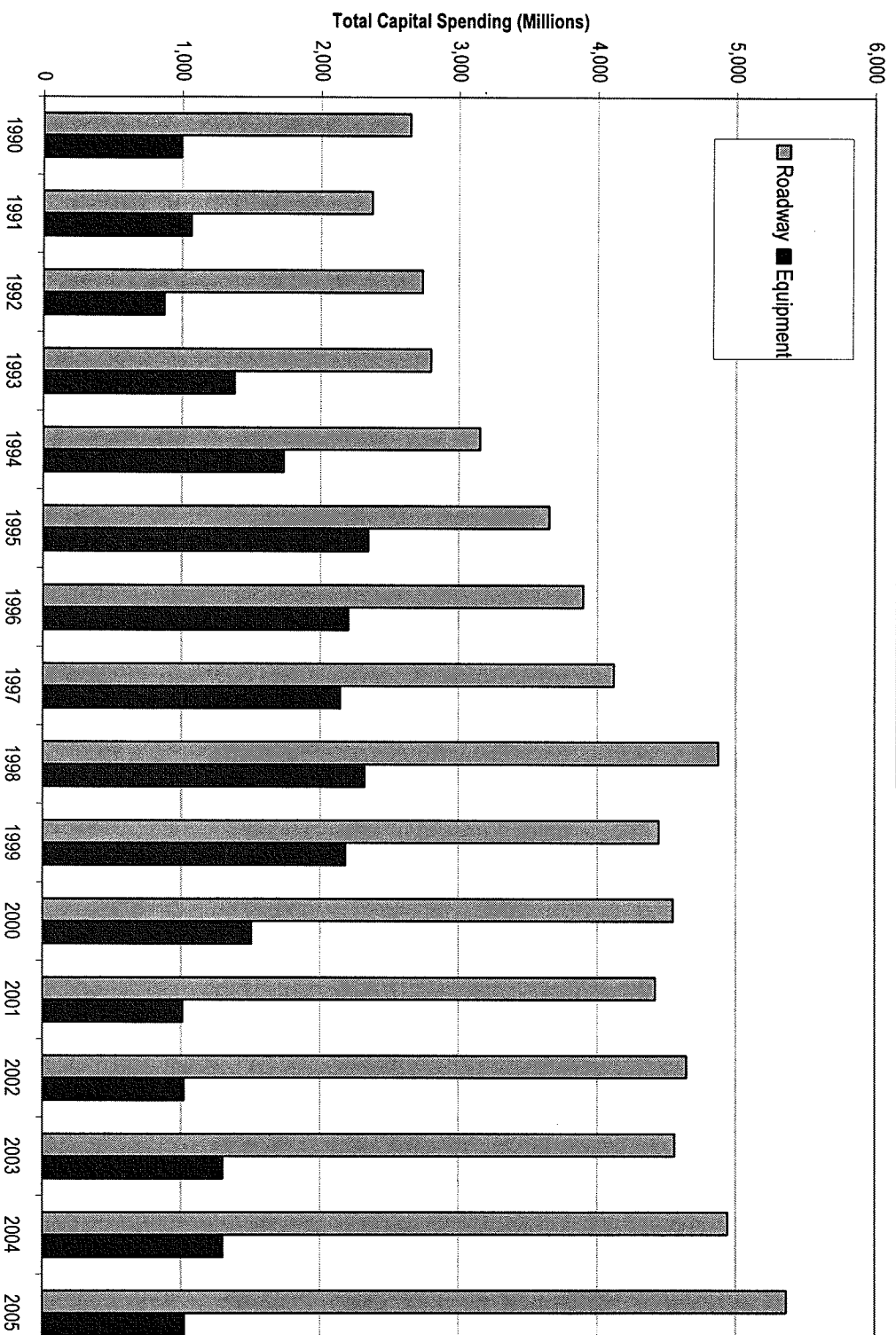
Source: Association of American Railroads; Bear Stearns & Co.

# GTM's Per Mile of Track Owned – Density and Productivity on the Rise



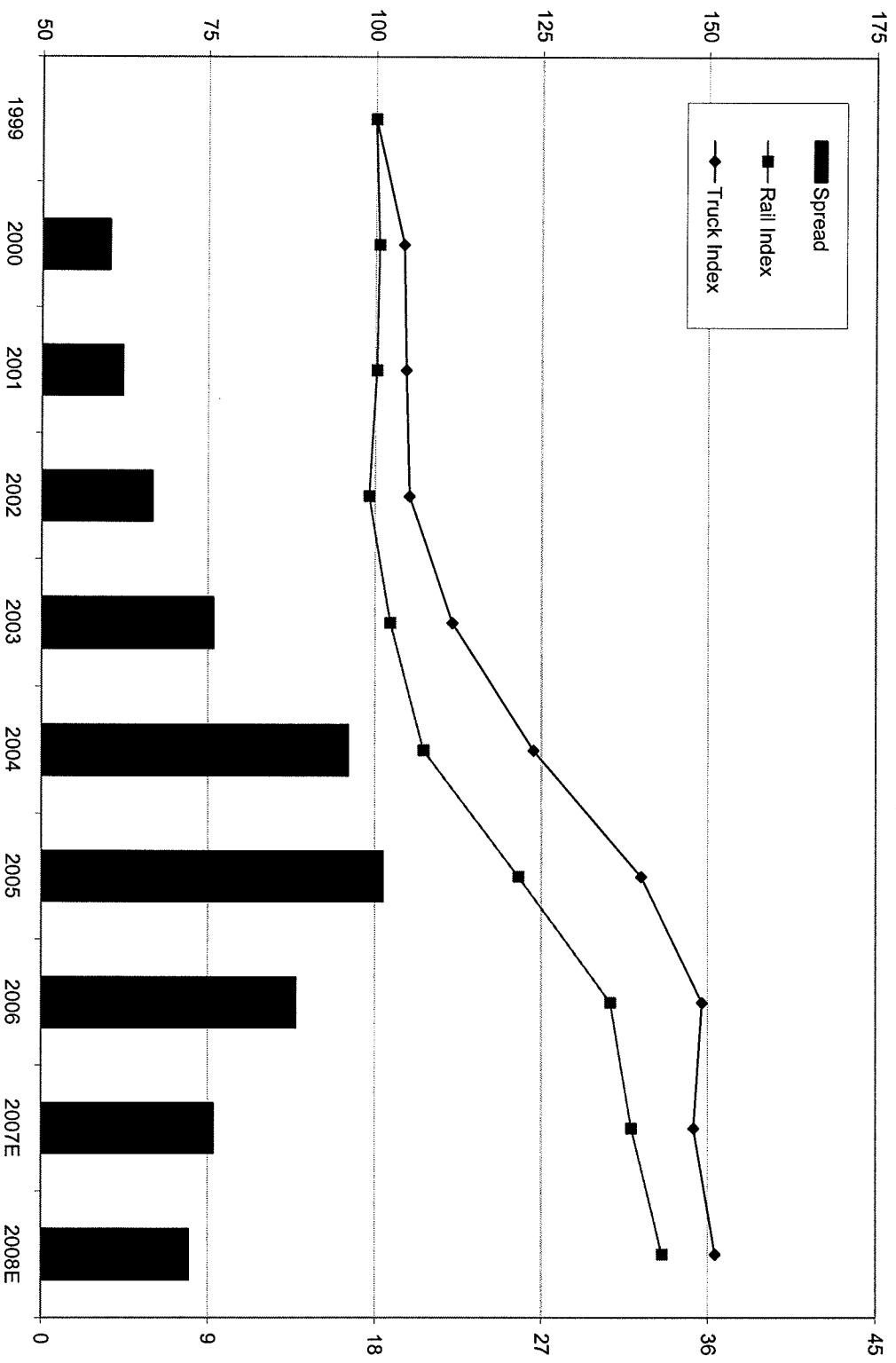
Source: Association of American Railroads; Bear Stearns & Co.

# Roadway Vs. Equipment Spending



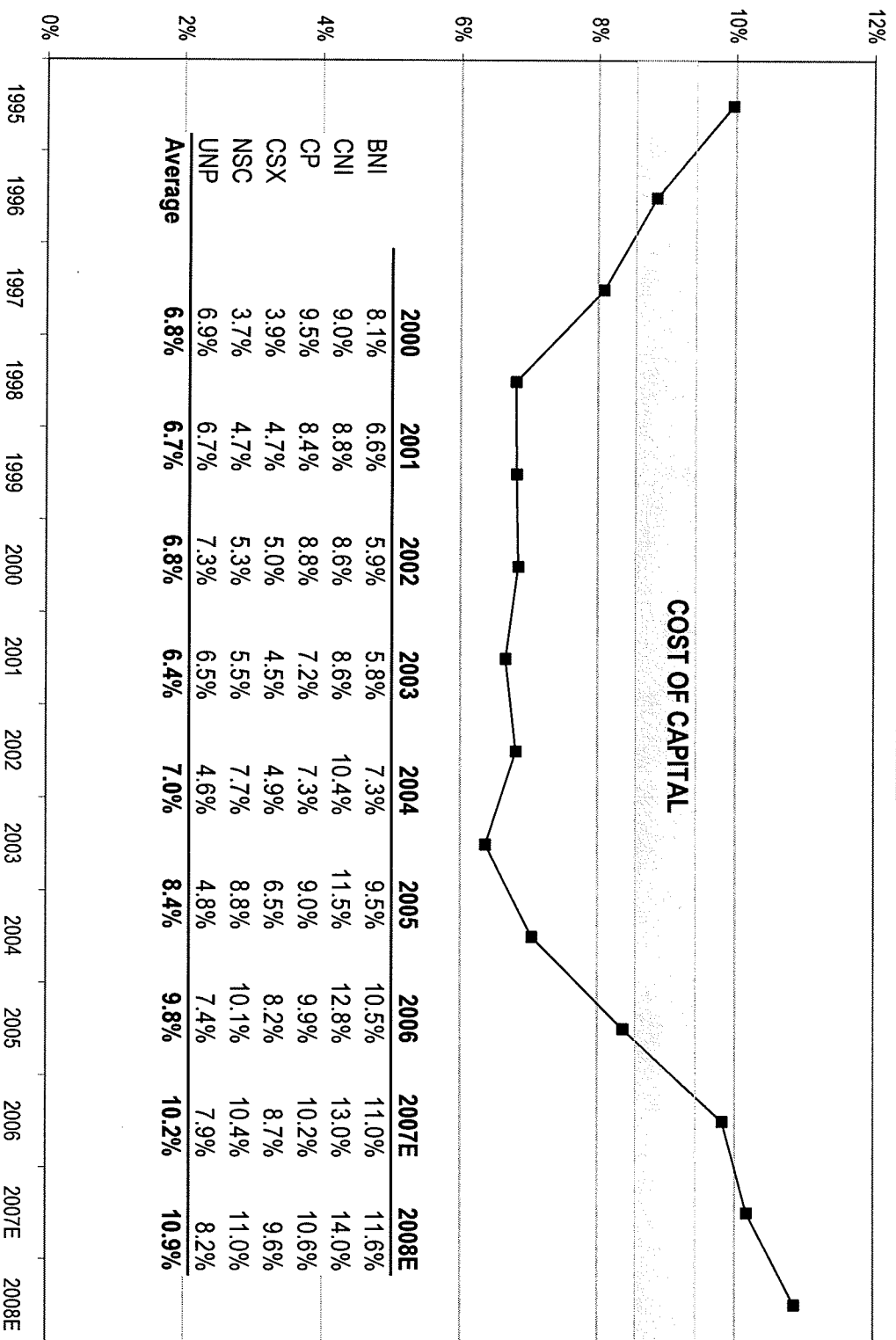
Source: Association of American Railroads; Bear Stearns & Co.

# Rail and Truck Pricing Index Since 2000



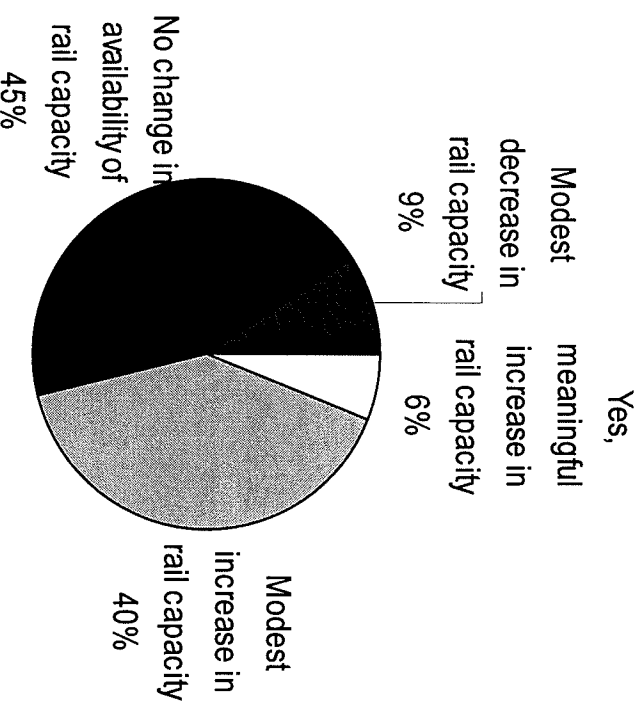
Note: Rail Index Includes BNI, CNI, CP, CSX, NSC, UNP; Truck Index Includes CVTI, JBHT, KNX, SWFT, WERN  
Source: Company reports; Bear Stearns & Co. estimates

# BEAR STEARNS Four of Six Rails Earned Their Cost of Capital During 2006



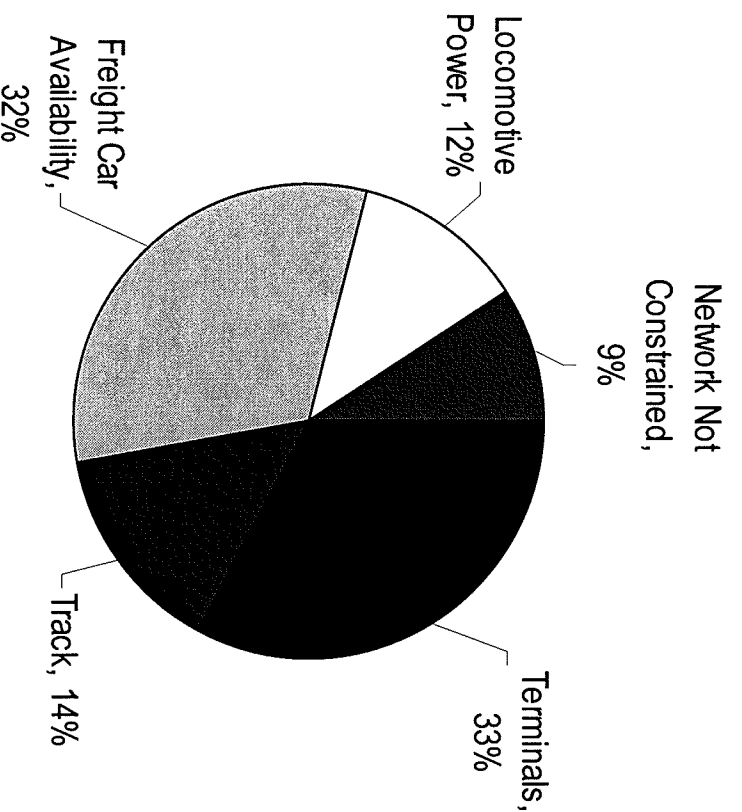
Note: Return on capital = Net Income minus Other Income, divided by average shareholder's equity plus total debt including off-balance sheet debt  
Source: Company reports; Bear Stearns & Co. estimates

# Shipper Expectations for 2007 Rail Capacity - From our 4Q:06 Survey



- ☐ Shippers expect stable to modestly improved Rail capacity
- ☐ Last year, 50% of shippers expected no change in capacity, 27% of survey respondents expected increased capacity, and 23% expected capacity to decline

# Shipper Survey – “Where are the Greatest Capacity Constraints?”



- Car and locomotive issues easiest to address – 1-2 year timeframe
  - But Shippers increasingly responsible for car fleet
- Track constraints – significantly more expensive at \$2.5 million per mile – 3-5 years to address
- Terminal capacity additions are most expensive and can take the longest – difficulty in obtaining real estate / environmental and political obstacles

# Update on Current Regulatory & Political Environment

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- ❑ **Rail fuel surcharge regulations announced on January 26<sup>th</sup>**
  - We estimate affects less than 20% of rail traffic
  - All Class I's on path to compliance
- ❑ **STB announces April 11 hearings on Rail Capacity & Infrastructure**
- ❑ **Other current STB issues:**
  - Paper barriers, small and large rate cases, cost of capital
- ❑ **Congress taking a closer look at the Rails**
  - Current bill to remove antitrust exemption
  - Likely future re-regulation bill
  - 100% container inspection bill refuses to die
  - 25% tax credit on expansion capital spending has not been re-introduced in the current session
  - Overall, tougher political environment for the rails with Democratic leadership, but WE DON'T EXPECT ANY MAJOR REGULATORY CHANGES
- ❑ **LONGER TERM, WE EXPECT FAVORABLE REGULATORY AND POLITICAL ENVIRONMENT TO SUPPORT RAILS AND MOVING FREIGHT OFF THE HIGHWAYS.**

# Summary of Trends

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- Capital spending increasing in absolute dollars...
- ...But declining as a percentage of revenue
- Cost to add miles of track or terminals going up
  - Higher costs to purchase land
  - Higher materials costs
- Returns on capital improving
  - Pricing flows to bottom line
  - Strong freight demand – Coal, Asia, Grain
  - Improving productivity

# Important Disclosures

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Edward M. Wolfe

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