

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

EX PARTE 671

**HEARING ON
RAIL INFRASTRUCTURE AND CAPACITY REQUIREMENTS**

**STATEMENT
OF
NORFOLK SOUTHERN RAILWAY COMPANY**

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Norfolk Southern Railway Company ("NS") submits these comments in response to the Board's hearing on rail infrastructure and capacity requirements. NS is one of the nation's premier transportation companies. It operates approximately 21,300 route miles in 22 states, the District of Columbia and Ontario, Canada. Therefore, NS takes the issues of capacity and infrastructure very seriously.

NS's own experience illustrates that the demand for freight transportation has grown considerably and is poised to grow further over the foreseeable future. NS has been investing in its infrastructure to expand capacity to meet this growing demand and to continue to invest aggressively, but it takes substantial sums of money because rail assets are very expensive. Even though NS recently has generated returns on investment sufficient to meet its regulatory cost of capital, it is a long way from achieving the goal of revenue adequacy over a sustained period of time. Without sufficient returns and sufficient revenues, NS may not be able to continue to invest to meet tomorrow's transportation needs. Threats to railroad capacity and to railroads' ability to invest in

infrastructure abound today. These threats and must be understood and guarded against if rail is to play the critical role it needs to play to sustain the United States economy over the long-haul.

I. EFFICIENT RAIL OPERATIONS ARE CRITICAL TO U.S. ECONOMY.

The United States is competing in the world economy. To a large extent, the United States economy is dependent on the transportation of goods. Importantly, the commodities the railroads transport are essential to the economy. For example, railroads transport:

- 64% of coal used for electric power;
- 40% of the grain harvest;
- 70% of automobiles made in America; and
- 20% of chemicals.

Railroads transport these good efficiently as well. As the World Bank's Louis Thompson has noted, "[b]ecause of a market-based approach involving minimal government intervention, today's U.S. freight railroads add up to a network that, comparing the total cost to shipper and taxpayers, gives the world's most cost-effective freight service." Put another way, rail freight transportation is one of this country's comparative advantages that help us compete in that world economy.

The demand for freight transportation is growing and will continue to grow. The Department of Transportation has estimated that the demand for freight

transportation would increase by 55 percent between 1998 and 2020.¹ More recently, DOT projected that total freight transportation demand would rise 92 percent from 2002 to 2035, including an 88 percent increase for railroads.² Similarly, the American Association of State Highway and Transportation Officials projected that freight tonnage will grow by almost 57 percent between 2000 and 2020. Whether 88 percent, 55 percent, 57 percent, or some other percent is the exact right estimate is not what is important. What is important is that demand has been growing and is expected to continue to grow substantially. According to some of the materials circulated by Consumers United for Rail Equity (“CURE”), “We’re in a perpetual rush hour for freight. It’s a lot like hitting interstates in Chicago at 5:00pm, every day of the week.”³

Railroads will be critical to meet this growing demand for freight transportation. Railroads will have to play a large role because highways will be unable to absorb that kind of growth in demand for freight transportation. Highways are already choked; and highway capacity is not likely to expand to any significant degree.⁴ Trucking companies cannot find enough drivers even while raising salaries. Increased highway congestion, increasing trucking costs, and higher fuel prices make rail more competitive versus trucks.

¹ U.S. DOT, Federal Highway Administration, *Freight Analysis Framework*, October 2002.

² Federal Highway Administration, *Freight Facts and Figures 2006*, Table 2.1.

³ Quoting Marcia Zarley Taylor, *Rush Hour on the Rails*, (Sept. 7, 2006).

⁴ AASHTO, *Freight Rail Bottom-Line Report*, at 2.

In short, efficient and effective rail transportation is not just a necessity today. It will continue to be vital to the health of the U.S. economy for years to come. NS, along with all of this country's railroads, must look out into the future to plan and invest now for this continuing growth in freight demand.

II. NS IS MEETING THE CHALLENGES THAT TOMORROW WILL PRESENT, BUT SUFFICIENT RESOURCES ARE A PREREQUISITE.

NS – like other railroads -- has invested record sums to increase its capacity and improve its operations while maintaining its focus on safety. But, the biggest challenge NS continually faces is having the resources to maintain its existing infrastructure and to expand that infrastructure to meet the increasing demand for its service and the changing shipping patterns and needs of its customers.

What is capacity? Simply defined, capacity is the amount of traffic that NS can transport. For NS, increasing capacity is a multi-faceted process. Sometimes, capacity can be increased by changes in operations (often tested in advance by running simulations with expensive computers and software). In other instances, it results from investing to maintain existing infrastructure to standards that permit faster train speeds. Capacity can also be expanded by investing in additional track, signals, cars, locomotives, and crews. And of course, maintaining the existing infrastructure is necessary to avoid losing capacity. In all instances, maintaining existing capacity levels and expanding capacity takes money.

U.S. freight railroads have been devoting enormous resources to maintain their existing infrastructure, to improve their operations and infrastructure, and to alleviate the capacity constraints that arise from increasing freight demand. Indeed, from

1996 to 2005, the average U.S. manufacturer spent 3.4 percent of revenue on capital spending. The comparable figure for freight railroads was 17.2 percent, or more than five times higher.

Likewise, NS makes large capital expenditures every year to maintain and expand its infrastructure. Between 2000 and 2006, NS's capital expenditures have totaled more than \$6.3 billion, while its net income over the same period has been only \$5.2 billion. In 2007, NS is budgeted to spend another \$1.34 billion this year, which is almost equal to its total net income from 2006.⁵ These expenditures are required to maintain and to expand the NS physical plant and locomotive and car fleet so that NS can serve its customers better, handle larger volumes of freight, and respond to its customers' changing shipping patterns. At the same time, capacity expansion projects must generate returns sufficient to justify the investment.

Despite protestations to the contrary, the facts demonstrate that NS continues to invest to expand its capacity. According to Senator John D. Rockefeller "major railroads invest none of their profits in infrastructure expansion to handle current traffic, much less the expected need in the decades to come."⁶ Nothing could be further from the truth. In 2006, NS among other things:

- Closed a deal to create a joint venture with the Kansas City Southern Railway, which will result in \$300 million dollars of investment mostly to upgrade the rail line between Meridian, Mississippi, and Shreveport, Louisiana, so that the line can move more freight more quickly across the line. Already, 45 miles of formerly nonsignaled territory were converted to centralized train control, 100 miles of crosstie replacement has been completed, 150 miles of ballast and surfacing work has been done, and 45 miles of new rail has been replaced with new rail in three locations.

⁵ Net income for 2006 was \$1.48 billion.

⁶ Floor Statement of Senator Jay Rockefeller upon the introduction of the Railroad Competition and Service Improvement Act of 2007, S. 953.

- Opened a new rail line to the coal-powered Keystone Generating Station in Shelocta, Pennsylvania. The \$44 million public-private partnership trims 51 miles off the trip from Saltsburg, Pennsylvania, to Shelocta and increases the capacity of the plant.
- Began work on the \$62 million Rickenbacker Intermodal Terminal in Columbus, Ohio, which will increase freight capacity in that region by more than 40 percent.
- Added infrastructure in the following corridors: Memphis, TN to Chattanooga, TN; Chattanooga, TN, to Atlanta, GA; Atlanta, GA, to Jacksonville, FL; Charlotte, NC to Manassas, VA; West Virginia Secondary; Columbus, OH, to Cincinnati, OH; Goldsboro, NC, to Morehead City, NC; St Louis, MO to Louisville, KY; and our route to Albany, NY and New England.
- Acquired 142 additional locomotives.

In 2007, NS plans among other things to:

- Begin work on its Heartland Corridor project. This ambitious public-private partnership 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. When completed, NS 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.
- Invest in capacity by making roadway improvements. NS plans to spend \$610 million for rail, crosstie, ballast and bridge programs, including \$73 million in infrastructure investments for increased capacity. In addition, NS plans to spend \$47 million for communications, signal, and electrical projects; \$41 million for maintenance of way equipment; and \$16 million for environmental projects and public improvements such as grade crossing separations and crossing signal upgrades.
- Purchase 53 six-axle locomotives and upgrade existing locomotives at a cost of about \$321 million and spend \$53 million to overhaul other locomotives.
- Purchase 1,300 new higher-capacity coal cars as part of a multiyear program to replace the existing coal car fleet for approximately \$96.5 million.
- Purchase 739 freight cars as their leases expire, certify and rebuild 388 multilevel automobile racks, and add supplemental restraints to multilevel racks for approximately \$21 million.

- Overhaul freight cars at a cost of \$56 million.
- Spend about \$60 million for projects related to computers, systems and information technology, which will enhance safety and improve operating efficiency and equipment utilization.
- Invest in intermodal terminals and equipment to add capacity to the NS intermodal network, increase access and capacity for coal traffic, bulk transfer facilities, and vehicle production and distribution facilities – all at a cost of about \$97 million.

In making these investment decisions, NS must keep in mind that the goal is to serve all its customers well. In some ways, NS is like the Internet – there are many businesses operating over of a single network of assets. That means NS must make those investments that are best for the overall network. NS' customers have different needs and place different priorities on such factors as transit-time, price, safety, damage-free handling, and frequency of service and switching. NS tries to balance these competing needs and to invest to provide the best service to the most customers. In other words, NS invests to maximize its network. If NS had only intermodal customers, its investments would be different than if there were only coal customers or only chemical customers. In fact, NS serves thousands of customers with different transportation needs for their thousands of different commodities. The investments NS makes represent its best judgment as to how to strike the right balance.

Additionally, NS keeps 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.⁷

In the current growth environment, it is especially important that NS have the resources and the ability to improve its infrastructure now to meet future needs for three reasons.

First, capacity is not limitless. NS remains a fluid railroad on which its cars on-line, average train speeds, and terminal dwell times have been relatively consistent in spite of volume growth. Although operations planning helps NS find better and more efficient ways to operate so that it gets the most from its existing infrastructure, the existing infrastructure and the locomotives, cars, and crews that NS can afford dictate its capacity levels.

Second, capacity is expensive and resources and money are limited. NS simply must choose which projects to fund.

Third, it takes time to build rail infrastructure and capacity. Many projects do not get approved the first time they are proposed because NS simply cannot afford to complete every needed project each year. For example, 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

⁷ 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. That Act appears to require 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.

unclear how long it will take to make it a reality – even though it is clearly needed. Moreover, even when it is approved and fully funded, the design, permitting, engineering, environmental review, and construction of a major project can take years. For example, from the time NS started the environmental permitting process to build a new intermodal yard in Atlanta to the time NS opened its \$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 time required to secure the necessary permits, resources and money available, and the railroad's ability to complete the work in a way that least impacts its ability to serve its customers whose traffic moves on those lines. The good news, however, is that railroad expansion still requires far less time and money than highway expansion.

Given the time it takes to add infrastructure and the long lives of the assets required to expand capacity, it is essential for railroads like NS to take a long view on infrastructure investments. That view is not the view a hedge fund or private equity firm would take when evaluating whether to buy a railroad to wring out cash. But the railroading truth is that it takes resources today to invest for tomorrow. NS intends to continue to maintain and build a strong network to meet future shipping needs, but there are threats to its ability to do so.

III. PROPOSED REGULATIONS AND LEGISLATION WOULD DETRIMENTALLY AND ADVERSELY AFFECT RAIL CAPACITY.

Threats to rail capacity that emanate from Capitol Hill and various regulatory agencies have recently grown stronger. Some of these threats will create

substantial disincentives for railroads to invest. Other threats would directly reduce existing capacity, which would adversely affect all rail customers.

In either case, policymakers must recognize that if such threats become reality, capacity will be reduced and replacing the lost capacity will take significant time and money. To the extent a railroad can still justify investment if a particular legislative or regulatory threat is ever adopted, investments that would have been used to expand capacity to the benefit of all rail customers will have to be made just to return the network to today's level of capacity.⁸

The bills introduced in Congress to re-regulate the rail industry are the leading examples of proposals that will adversely impact whether a railroad will continue to invest in capacity.⁹ If enacted, this legislation would adversely affect capacity and railroads' willingness to continue to invest in infrastructure. These bills are premised on misrepresentations and untruths, including the following:

- *Competition has decreased since 1980.* Actually, shippers who have access to one railroad today have seldom been served by more than one railroad. First, the Interstate Commerce Commission and the Board's merger policies have protected shippers that had access to multiple rail carriers prior to the merger and generally ensured that such shipper had access to multiple carriers after the merger. Second, the Conrail transaction, with its creation of three Shared-Assets Areas, substantially increased competition by providing shippers in those areas access to multiple carriers even though they had access to only one carrier before the transaction. Third, mergers have expanded single-line service, which means more shippers benefit from the inherent efficiencies that resulted from being able to ship from origin to destination on one railroad rather than having to use many railroads to get from origin to destination. For

⁸ The capacity concerns created by the proposed regulations increase the need for the railroad infrastructure tax credit proposal pending before Congress.

⁹ *Railroad Competition and Service Improvement Act of 2007*, S. 953.

- example, Norfolk and Western was a coal railroad, while Southern Railway was a more diverse railroad. Given their individual geographic reaches, however, neither could have developed what has become the NS intermodal system.¹⁰ Absent the mergers, there would still be more railroads, but with fewer resources and access to fewer markets, which would not be better for rail customers. Fourth, other areas have been opened to multiple carrier access when single carrier access was all that previously existed, such as the Bayport Loop in Houston, Texas, as a result of the Board's policies to promote build-ins where the economic sense of such a build-in is shown by private entities putting up the money.
- *Only direct rail-to-rail competition counts.* Actually, it defies logic and economics to measure competition by solely looking at direct rail-to-rail competition. Motor carriers are the railroads largest competitor. Railroads also compete vigorously against other modes, including barges and pipelines. Additionally, most large railroad customers are large companies with resources far in excess of the railroads. These companies know how to use leverage by bundling their business and by making the railroad well aware of the product and geographic competition their products face. They also know how to use product and geographic competition for rail transportation by, for example, producing their product at other locations not served by the railroad with which it is bargaining. Utilities can leverage their ability to generate or purchase electricity elsewhere when negotiating rates for coal transportation to facility served by one railroad. In short, railroads face abundant competition.
- *Government mandated access -- such as mandated switching, trackage rights, terminal access, and interline rates -- is competition.* Actually, it is not. Railroads require expensive infrastructure to serve a facility. There have been build-ins by railroads and build-outs by shippers at facilities that can generate enough rail traffic to justify service by two or more railroads, but most shipper facilities simply do not generate that level of traffic. In other words, there is not enough money to support two railroads at most shipper facilities, which is why relatively few facilities have ever had service by more than one railroad. True market competition does not keep two competitors in a market -- or force more competitors into a market -- that will support only one. These shippers really want the government to force one railroad to subsidize another railroad by providing below market access to its lines.

¹⁰ Neither Norfolk and Western nor Southern Railway reached New York. Norfolk and Western reached Chicago but not Atlanta. Southern Railway reached Atlanta but not Chicago. So neither had the size, scope and density to develop an effective and competitive intermodal network.

- *The number of Class I railroads has declined from 40 in 1980 to 4 today.* Actually, by today's standards of what constitutes a Class I railroad and after removing double-counts of railroads that were already operationally-integrated, there were only 22 Class I railroads in 1980. And today, there are 7. Thus, although there has been consolidation in the railroad industry, it has not nearly been to the extent described by advocates of re-regulation. And as previously discussed, this consolidation has, if anything, increased customer rail access and lowered rates.

If enacted, this legislation would adversely affect capacity and railroads' willingness to continue to invest in infrastructure and leave some lines to wither on the vine.

Current legislative and regulatory proposals would not only deter capacity investment but would consume existing capacity to the detriment of all rail customers. Legislation recently passed by the House of Representatives is one example. Section 124 of the Rail and Public Transportation Security Act of 2007 would require railroads to re-route rail shipments containing highly hazardous materials around cities regardless of whether it makes logical sense from an economic or security perspective.¹¹ Instead, it would merely shift risks to other communities and lengthen the time and distance those commodities spend on on rail lines, which can never be totally secured. But, legislation that mandates re-routing any rail traffic would substantially alter rail operations, and those changes will consume existing capacity to the detriment of farmer, utilities, steel mills, ports, the military, and many other rail customers.

The Department of Homeland Security's Transportation Safety Administration has proposed regulations regarding the rail transportation of certain hazardous materials. One proposed regulation -- the proposed chain of custody and control rules -- will result in altered operations that will harm some or all of the

¹¹ See *Rail and Public Transportation Security Act of 2007*, H.R. 1401, Sec. 124.

customers that ship on the rail network.¹² To comply with the proposed rule, NS would have two options if a receiver located in a High Threat Urban Area did not have a secured area in which the railroad could place a car or was unavailable to receive the car in person as the rule would require. NS could leave the cars outside the shipper's facility if (1) it would not impair further rail operations and (2) NS has personnel available to stay with the cars and to maintain an unobstructed view of the car so that the cars are not left unattended.¹³ Or, NS would have to return those cars to (or in the first-place leave those cars in) an NS yard where they would occupy track space (as long as an NS employee maintained a clear line of sight); then NS would have to use additional crew and track capacity to re-deliver the rail car at another time. The result of these less efficient operations is to reduce the number of customers a crew can serve before the crew exhausts its work time under the Hours of Service Act. Or it may take multiple crews from multiple shifts to complete the same industry job. In either case, service to customers is adversely affected because these cars will also consume track space for longer periods of time. All the extra actions NS would have to take will make rail operations less efficient by consuming capacity, which will slow the network absent further capacity-expanding investment.¹⁴

¹² See 71 Fed. Reg. 76866 & 76872-75 (proposed 49 CFR 1580.107(e)).

¹³ To "ensure that the rail car is not left unattended at any time during the physical transfer of custody" means "an employee or authorized representative of either railroad would be physically present" with an "unobstructed view of the rail car." 71 Fed. Reg. 76873.

¹⁴ Slower operations increase, at least to some extent, the need for locomotives, rail cars, and crews. A study by ZETA-TECH Associates relies on an estimate that 250 additional locomotives, 500 additional cars and 180 additional employees is the cost of a decrease of one mile-per-hour. Randolph R. Resor, ZETA-TECH Assoc., Inc., *The Business Benefits of PTC*, (Apr. 13, 2004).

IV. POLICYMAKERS SHOULD FOCUS ON PROPOSALS THAT WILL CREATE INCENTIVES FOR RAILROADS TO CONTINUE EXPANDING CAPACITY.

Absent the adoption of poor public policy, NS expects to continue to invest to improve its system. But the resources currently available to railroads – and such resources are under attack in many legislative initiatives and regulatory proceedings – will not be enough to meet all the demand for freight growth. As AASHTO reported in its *Freight-Rail Bottom Line Report*, “[t]he rail industry today is stable, productive, and competitive, with enough business and profit to operate but not to replenish its infrastructure quickly and grow rapidly.”¹⁵ Policymakers should embrace proposals to inject federal aid into rail infrastructure.

Senator Lott’s legislation to provide an investment tax credit for railroad infrastructure investment is one such good proposal.¹⁶ That legislation would provide a 25 percent tax credit for investments in new track, intermodal facilities, yards, locomotives, and other infrastructure that expands rail capacity. All businesses, including railroads, shippers, ports, and trucking companies would be eligible for the tax credit. This legislation is directly responsive to The Congressional Budget Office in its January 2006 *Freight Rail Transportation Long-Term Issues* report, which proposed that “[a]nother way of addressing the underpayment of infrastructure costs by railroads’ competitors is to provide financial assistance to the railroads.”

The societal benefits of the tax credit proposal clearly justify its adoption. In addition to helping to alleviate the spiraling problem of highway congestion, railroads

¹⁵ AASHTO, *Freight Rail Bottom-Line Report*, at 3.

¹⁶ In the 109th Congress, the legislation was S. 3742.

are three or more times more fuel efficient than trucks. Moreover, the Environmental Protection Agency estimates that for every ton-mile of freight carried, a locomotive emits substantially less particulates and carbon dioxide than a truck.¹⁷ The American Society of Mechanical Engineers estimate that 2.5 million fewer tons of carbon dioxide would be emitted into the air annually if 10 percent of intercity freight now moving by truck were converted to rail.¹⁸ Congress has a clear incentive to put substantial transportation dollars to work in rail.

V. CONCLUSION

Capacity expansion and investment in infrastructure are long-term decisions because rail assets are so expensive and generally have a long life. Nevertheless, in the current environment, railroads are investing heavily in their network to meet the current and projected growth in demand for freight transportation. But, there are threats to the railroad industry's ability to continue to invest. The participation of financial entities looking to make a quick buck rather than taking the long view is one threat.

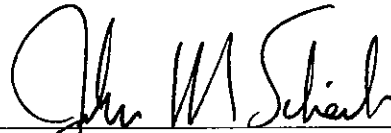
But the greatest threat is government action. Whether by legislation, or regulation, or both, government action that would substantially alter the economics of the industry and restrict railroads' ability to become revenue adequate by meeting their cost of capital over a sustained period of time would jeopardize (1) efficient transportation at a time when the country needs it the most; (2) railroads' ability and willingness to invest

¹⁷ AASHTO, *Freight Rail Bottom-Line Report*, at 29.

¹⁸ AASHTO, *Freight Rail Bottom-Line Report*, at 29.

and expand; and (3) undermine one of the United States comparative advantages in the world economy.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "John M. Scheib", is written over a horizontal line.

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Dated: April 4, 2007