

SURFACE TRANSPORTATION BOARD

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THE 25TH ANNIVERSARY OF THE
STAGGERS RAIL ACT OF 1980: STB Ex Parte
A REVIEW AND LOOK AHEAD No. 658

Room 760
Mercury Building
1925 K Street, N.W.
Washington, D.C. 20423

Wednesday,
October 19, 2005

The above-entitled matter came on for
hearing pursuant to notice at 9:00 a.m., Roger
Nober, Chairman, presiding.

BEFORE:

THE HONORABLE ROGER NOBER	Chairman
THE HONORABLE W. DOUGLAS BUTTREY	Vice Chairman
THE HONORABLE FRANCIS P. MULVEY	Commissioner

AGENDA ITEMPAGEWELCOME:

Roger Nober	5
Douglas Buttrey	9
Francis Mulvey	10

PANEL I: GOVERNMENT ENTITIES.DEPARTMENT OF TRANSPORTATION:

Paul Samuel Smith	14
QUESTIONS	18

PANEL II-A: SHIPPERS:NATIONAL GRAIN AND FEED ASSOCIATION:

Kendell Keith	30
-------------------------	----

AMERICAN CHEMISTRY COUNCIL:

Charles Van Vlack	37
-----------------------------	----

TRANSPORTATION, ELEVATOR & GRAIN MERCHANTS ASSN.:

Chuck Elsea	43
-----------------------	----

GRANITEROCK:

Dan Slavin	49
----------------------	----

UNITED PARCEL SERVICE:

Tom Jensen	53
----------------------	----

THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE:

John Ficker	60
QUESTIONS	70

PANEL II-B: SHIPPERS:EDISON ELECTRIC INSTITUTE:

Charles Linderman	117
Michael McBride	122

WESTERN COAL TRAFFIC LEAGUE:

Duane Richards	124
Thomas Crowley	129

CONCERNED CAPTIVE COAL SHIPPERS:

Michael Loftus	133
--------------------------	-----

NATIONAL RURAL ELECTRIC COOPERATIVE ASSN:

Glenn English	137
-------------------------	-----

ARKANSAS ELECTRIC COOPERATIVE CORPORATION:

Michael Nelson	140
QUESTIONS	147

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AGENDA ITEMPAGEPANEL III: LABOR:TRANSPORTATION COMMUNICATION INTERNATIONAL UNION:

Mitchell Kraus 181

UNITED TRANSPORTATION UNION:

Daniel Elliott 183

James Brunkenhoefer 186

QUESTIONS 195

PANEL IV: FINANCIAL ANALYSTS:MERRILL LYNCH:

Ken Hoexter 203

MORGAN STANLEY:

James Valentine 210

J.P. MORGAN SECURITIES, INC.:

Thomas Wadewitz 217

QUESTIONS 223

PANEL V-A: LARGER RAILROADS:CSX TRANSPORTATION, INC.:

Les Passa 239

BNSF RAILWAY COMPANY:

John Lanigan 247

UNION PACIFIC RAILROAD COMPANY:

James Young 253

NORFOLK SOUTHERN RAILWAY COMPANY:

Stephen Tobias 261

THE KANSAS CITY SOUTHERN RAILWAY COMPANY:

Ronald Russ 264

CANADIAN PACIFIC RAILWAY COMPANY:

Michael Waites 273

CANADIAN NATIONAL RAILWAY COMPANY:

Gordon Trafton 279

QUESTIONS 284

PANEL V-B: SMALLER RAILROADS & RELATED INTERESTS:RAILAMERICA, INC.:

Charles Swinburn 327

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AGENDA ITEMPAGEPANEL V-B: CONTINUED:RAIL INDUSTRY WORKING GROUP:

J. Reilly McCarren 332

GENESEE & WYOMING, INC.:

Charles Marshall 337

COLUMBUS & GREENVILLE RAILROAD:

Roger Bell 342

WHEELING & LAKE ERIE RAILWAY COMPANY:

Larry Parsons 348

QUESTIONS 349

PANEL VI: OTHER INTERESTED PARTIES:SNAVELY KING MAJOROS O'CONNOR & LEE, INC.:

Thomas O'Connor 365

HIGHROAD CONSULTING, LTD.:

Sandra Dearden 371

UNIVERSITY OF MD, SMITH SCHOOL OF BUSINESS:

Curtis Grimm 379

NORTHWEST CONTAINER SERVICES:

Art Scheunemann 382

STRATEGIC RAIL FINANCE:

Michael Sussman 385

QUESTIONS 389

ADJOURN:

Roger Nober 399

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P-R-O-C-E-E-D-I-N-G-S

9:04 a.m.

CHAIRMAN NOBER: Okay. Good morning. The hearing will come to order. 25 years ago Congress passed the Staggers Rail Act of 1980 against the backdrop of the U.S. railroad industry that was clearly in crisis. The plight of the railroads at that time is now documented. Low returns on investment, widespread bankruptcies, insufficient capital for maintenance and improvement and unsatisfactory service.

Now, the five goals of the Staggers Act, as expressed in that legislation, were to assist railroads in rehabilitating the nations rail network to meet the demands of interstate commerce and national defense; to reform federal regulatory policy to preserve a safe adequate economical efficient and financially stable rail system; to assist in the preservation of the viability of the rail network in the private sector; to provide a regulatory process balancing the needs of railroad shippers in the public and to assist in the rehabilitation and financing of

1 the nation's rail system.

2 Now, we have certainly come a long way in
3 25 years and I think it's fair to say that the
4 Staggers legislation gets a lot of credit for that.
5 However, it's also clear from today's testimony that
6 significant areas of concern remain. While in 1980
7 the focus was more on the financial health of the
8 railroad industry, today there are more concerns about
9 competitive climate and service issues.

10 In many ways, the rail roads have returned
11 to financial health. While railroad revenue adequacy
12 was a distant goal in 1980, today that goal appears
13 close to being achieved for some carriers. At the
14 same time, the industry is experiencing noticeable
15 capacity constraints in some areas and we must grapple
16 all of that -- we must grapple with what all of that
17 means for our regulatory process.

18 Now, we scheduled this hearing today to
19 explore these issues in an open forum to which all the
20 stakeholders have been invited. I appreciate the
21 widespread interest that this hearing has generated
22 and look forward to the testimony of all of our

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1 witnesses. There are some of the most interesting
2 questions facing our agency and the stakeholders that
3 will be discussed today and I look forward to an open
4 and somewhat extensive dialogue on them all.

5 Now, before we begin, let me just take a
6 few minutes to review a few procedural points about
7 today's hearing. As you may or may not know, we have
8 over 40 witnesses today presenting testimony on behalf
9 of 35 entities. We have split the day into morning
10 and afternoon sessions to give each of the witnesses
11 a better understanding of when they will be
12 presenting. But this is a hearing and it is
13 impossible to estimate in advance how long it will run
14 or when any one individual witness will testify.

15 I will say that I ask all witnesses to,
16 please, summarize their oral statements in the
17 interest of time. I think I can speak for everyone
18 and say that we have all read each of your full
19 statements and you should not feel obligated to use
20 every second of the time allotted. And consistent
21 with our practice, we will allow all the witnesses on
22 each panel to make full presentations before the

1 Members ask any questions.

2 And, you know, we will rotate among the
3 Members by five minutes at a time. Now, finally, as
4 all of you may know, my term here at the Board expires
5 at the end of the year and I announced last week that
6 I will not be seeking another term as Chairman. So
7 while I may be interested in these issues, I have to
8 confess that my views really aren't that important,
9 since the answers to the questions raised today will
10 be faced in the future by my colleagues or by future
11 Board Members yet identified.

12 To put today's hearings in perspective, it
13 certainly was unimaginable that three years ago we
14 would be having a hearing where the main concerns were
15 that the railroad industry was too healthy and that
16 they were too financially sound. But I'm pleased that
17 we're able to do it nonetheless. So with that, I
18 certainly look forward to, you know a very interesting
19 and provocative day of testimony.

20 I know I have a lot of questions and I'm
21 sure that my fellow Commissioners do as well. And
22 with that I will recognize Vice Chairman Buttrey for

1 any opening statement he may have.

2 VICE CHAIRMAN BUTTREY: Good morning. We
3 have got a lot of track to cover today and I don't
4 want to reduce our velocity with a lengthy opening
5 statement. I've read the statements, so I would hope
6 that those who come with oral presentations summarize
7 their remarks, so we can reduce dwell times as well.
8 I have three guiding principles that will govern how
9 I view these proceedings.

10 Few, if any, really good solutions
11 originate in the halls of Government. Two, any
12 suggestion that all rail resources are being
13 efficiently and equitably allocated will be met with
14 skepticism. And three, the free enterprise
15 marketplace is almost always the best arbitor of all
16 commercial activity.

17 I had a boss once who was fond of saying
18 bring me solutions, not problems. If we are not smart
19 enough to figure out how to serve our customers,
20 someone else will. That admonition seems to be
21 particularly applicable to our proceedings today.
22 Thank you, Mr. Chairman, and I look forward to hearing

1 from all of our witnesses.

2 CHAIRMAN NOBER: Thank you. Commissioner
3 Mulvey?

4 COMMISSIONER MULVEY: Thank you, Chairman
5 Nober. Before I begin my statement, I want to take
6 this time to thank Chairman Nober for his service to
7 the Board, his service to the railroad industry, and
8 his service to the people of America during his tenure
9 as Chairman of the STB. He has done a great job and
10 I've enjoyed working with him tremendously. Thank you
11 very much, Roger.

12 (Applause)

13 CHAIRMAN NOBER: I haven't left yet.

14 COMMISSIONER MULVEY: Oh, I'm sorry, I
15 thought you were leaving.

16 CHAIRMAN NOBER: Shortly.

17 COMMISSIONER MULVEY: I want to add my
18 welcome to those panelists who are attending the
19 hearing today. As we debate the impact, the
20 effectiveness, and the future of the Staggers Rail
21 Act, I would like to start off by noting the obvious
22 that the Staggers Rail Act has clearly helped the

1 railroad industry. It has helped the large railroads
2 to rationalize their route networks, reducing
3 substantially the miles of line.

4 It has helped many small railroads to
5 prosper and grow in numbers. And all railroads are
6 now able to negotiate rates and enter into private
7 contracts with the shippers, making them more
8 competitive with the trucking industry. On the other
9 hand, railroad labor has seen its numbers dwindle over
10 the years, particularly the organized brotherhoods.
11 Many short lines and their customers are limited by
12 paper barriers that restrict their options.

13 Many captive shippers have struggled with
14 the results of differential pricing, although it's
15 clearly necessary for the railroads financial health.
16 Nearly all shippers are concerned about access to the
17 Board's procedures, especially those tendering smaller
18 shipments. Furthermore, despite the productivity
19 gains that the railroad industry has achieved in the
20 last 25 years, the Class I railroads still do not earn
21 their cost of capital or do not earn adequate
22 revenues, at least as calculated by the Board.

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1 Meanwhile, the system has experienced a
2 serious capacity crunch and we have no national
3 strategy to ensure that railroads meet the capital
4 investment needs of our nation's rail infrastructure.
5 Indeed, our national rail policy has not really
6 undergone substantial change in the last quarter
7 century. By contrast, our highway and transit
8 policies are reassessed every six years through the
9 reauthorization process and our aviation policy is
10 reassessed even more frequently.

11 Of course, this reflects the fact that our
12 railroads are privately held and that our highways,
13 airways, and transit rights-of-way are publicly
14 provided. Nonetheless, private ownership per se
15 should not be a barrier to establishing a public
16 policy to support rail infrastructure development.
17 With these interests in mind, I am pleased that we
18 have gathered here today to take a critical look at
19 the state of our national railroad system and our
20 regulatory rail policy in this post-Staggers era.

21 This hearing, I hope, is only the
22 beginning of a larger reassessment effort that will

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1 take place over the next few years and will include
2 studies by the General Accounting Office, I'm sorry,
3 the Government Accountability Office and the
4 Transportation Research Board. I'm certain there will
5 also be Congressional hearings on the matter in
6 addition to conferences around the country addressing
7 the rail needs of the nation.

8 By engaging in this collective endeavor to
9 review our national rail policy, it is my hope that by
10 the time we reach the 30th anniversary of Staggers, we
11 will have a clear and substantial record as to what
12 the successes have been, what challenges remain and
13 most importantly how Congress, this Board and the
14 railroad industry can best meet them. Thank you.

15 CHAIRMAN NOBER: Okay. Well, thank you
16 very much. And before we begin, just a couple of
17 administrative notes. First off, we'll typically, you
18 know, as is my practice, call the panels and go from
19 my left to my right. So I think where you speak will
20 depend as much upon where you sit as anything else.
21 Secondly, if there -- we have an overflow room up on
22 the eighth floor for extra folks. And I would ask if

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1 there are Board staff who are here who could head up
2 there, that would probably be helpful so that we can
3 let the folks who are with the witnesses to sit down
4 in the hearing room.

5 And I think we are closed-circuit
6 televising it up there as well. But if we need more
7 room for stakeholders, we can put folks up on the
8 eighth floor Board room as well. We'll have a closed-
9 circuit TV to this. And with that, why don't we
10 start? Our first witness is from the U.S. Department
11 of Transportation, Paul Samuel Smith, who is, I guess,
12 in our frequent witness club, speaking on behalf of
13 the Department of Transportation of the United States.
14 Mr. Smith?

15 MR. SMITH: Chairman Nober, Vice Chairman
16 Buttrey, Commissioner Mulvey, good morning. My name
17 is Paul Samuel Smith and today it is again my
18 privilege to represent the United States Department of
19 Transportation. In this proceeding, the Board
20 properly takes stock of the 25 years since passage of
21 the Staggers Rail Act of 1980. The Department of
22 Transportation considers the Act a resounding success.

1 We do so because in sum the statute did
2 what it was designed to do. It revitalized the
3 railroad industry and by so doing benefitted shippers
4 and consumers throughout the economy. 25 years ago
5 this was an industry, as you have said, marked by
6 decline in all major respects. High rates, low
7 returns on investment, eroding demand, low model
8 traffic share and excess capacity.

9 Of course, in 2005, all of these factors
10 had been reversed. Average rates are down, return on
11 investment is up, demand is robust, model traffic
12 share has increased and capacity is increasingly
13 scarce. In fact, capacity constraints are no longer
14 confined to cyclical harvest shortages of hopper cars
15 or to the influx of Christmas and holiday goods from
16 Asia.

17 Obviously, overall, economic growth and
18 other factors have played a significant role in this
19 turn around. But the dramatic overhaul of economic
20 regulation brought about by the Staggers Act has been
21 absolutely essential. Notwithstanding these other
22 developments, continuation of the prior restrictive

1 regulatory regime would likely have doomed the rail
2 industry to a much reduced role in today's
3 transportation sector.

4 A price was paid, of course, in the
5 railroad's reversal of fortune. Some might point to
6 the existence of far fewer railroads or far fewer
7 miles of track or far fewer railroad jobs. We
8 suggest, however, that these reflect considerable
9 efficiency gains that have, in fact, largely been
10 passed through to consumers of rail transportation,
11 the shippers. Others made a cry that captive shippers
12 pay rates based upon their demand, rather than upon
13 average costs.

14 But rail carriers absolutely must have
15 this ability to survive and compete. Captive shippers
16 overall are better off, because they do not have to
17 bear the entire fixed costs of rail networks. DOT
18 does agree that implementation of the Staggers Act has
19 not been perfect. Major rail cases consume a great
20 deal of time and money and can only be brought by the
21 largest of shippers. Smaller rate cases simply aren't
22 even brought.

1 We commend the Board for its past efforts
2 to refine its processes in this regard and we
3 encourage continuation of that effort. But the
4 primary challenges facing railroads, shippers, the
5 Government and others today are those resulting from
6 industry success. And since that success is largely
7 owing to the Staggers Act in its implementation, it is
8 the Department's central message in this proceeding
9 that resolving those challenges must not jeopardize
10 that success.

11 For example, it is clear that capacity
12 expansion is necessary to the continued vitality of
13 rail carriers and to the nation's economy. In this
14 capital intensive industry, that requires returns
15 adequate to the purpose over an extended period of
16 time. But the rate making methodologies now in use
17 were developed for a very different industry of a
18 quarter century ago. They basically attend to assume
19 adequate capacity, rather than recognize the need to
20 expand it.

21 It is imperative that rate making
22 provisions be appropriate to the industry of today and

1 tomorrow. The Department will certainly participate
2 in such proceedings, which are designed to work within
3 the framework of the Staggers Act to this end. That
4 concludes my prepared presentation. I would now like
5 to try and answer any questions you may have.

6 CHAIRMAN NOBER: Thank you very much.
7 Vice Chairman Buttrey, do you have any questions?

8 VICE CHAIRMAN BUTTREY: I would just like
9 to ask you if you boil down all that information into
10 a crucible and you apply the highest possible heat is
11 it safe to say that what really happened in Staggers
12 is that the Government got out of the way and let the
13 private sector do what the private sector does best?

14 MR. SMITH: I think that's fair in large
15 measure, not completely, of course. There is still a
16 need, in the Department's view, for some federal
17 oversight since, of course, the rail industry is not
18 competitive in the way that industries with much lower
19 barriers to entry are. But where railroads can be and
20 must be competitive, yes, the Government does need to
21 get out of the way.

22 VICE CHAIRMAN BUTTREY: Thank you.

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1 CHAIRMAN NOBER: Commissioner Mulvey?

2 COMMISSIONER MULVEY: You have testified
3 about how the infrastructure expansion needed to
4 accommodate DOT's own projections of the growth of
5 rail freight traffic will require substantial
6 investment and that railroads need incentives to
7 expand capacity. Could you elaborate on the
8 incentives that the Administration supports,
9 particularly public financing?

10 MR. SMITH: Well, the Department, pursuant
11 to Administration, has been appearing in various fora
12 for some time now indicating the Federal Government's
13 willingness to explore public/private partnerships.
14 Obviously, there are some examples of this and we
15 recognize that given the capital requirements and the
16 long lived nature of railroad facilities that purely
17 private sector sources funding may not be adequate to
18 the overall task and so we are willing to explore
19 incentives, obviously, Government areas or Government
20 levels rather over -- other than the federal level or
21 also involve even locally.

22 For example, the State of Virginia

1 contributes to local VRE services, which, of course,
2 are run on track, they are owned by CSX and Norfolk
3 Southern, to some extent. So there are certainly
4 opportunities to be had out there. We are exploring
5 them. We recognize that those are kind of beyond the
6 scope of Staggers and this Board as well, but they --
7 that's just to say that the challenges are not purely
8 regulatory challenges and not purely for any single
9 agency.

10 COMMISSIONER MULVEY: That's a challenge
11 not only for rail infrastructure, but also highway
12 infrastructure as well.

13 MR. SMITH: Right.

14 COMMISSIONER MULVEY: Recently, the House
15 T and I Committee, proposed \$375 billion for the
16 highway system and I think we wound up \$90 billion
17 short of that. Clearly, if we're going to meet the
18 nation's goals for economic growth and development, we
19 have to have the infrastructure to support it. The
20 question I have is what is the Administration's view
21 of what the federal role should be in developing both
22 public and private infrastructure needs?

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1 MR. SMITH: Well, as someone said earlier,
2 there is -- the infrastructure of the rail network is
3 private as opposed to the other transportation
4 sectors.

5 COMMISSIONER MULVEY: Yes, I said that.

6 MR. SMITH: Which the Federal Government
7 plays absolutely a major role. But increasingly,
8 federal highway funds which traditionally, of course,
9 have gone to the roadway literally are available to
10 those state and local Governments that make the
11 decision to spend some of that money for the
12 assistance of rail facilities. So even with the
13 existing legislation and policies in place, that's an
14 indirect federal support, but often has to be agreed
15 upon with other levels of Government. And we are
16 looking to consider more direct federal rail financial
17 assistance, but that admittedly is in early stages.

18 COMMISSIONER MULVEY: Did the
19 Administration give any thought to an idea that was
20 advanced a couple of years ago about developing a
21 Railway Trust Fund similar to the Highway and Aviation
22 Trust Funds?

1 MR. SMITH: I know it has been thought
2 about, but I don't -- obviously, it hasn't come to
3 fruition and I can't announce anything like that
4 today.

5 COMMISSIONER MULVEY: Okay. Thank you.

6 CHAIRMAN NOBER: Let me ask you a couple
7 of questions. The first is in much of the later
8 testimony this morning we will hear that, I think, the
9 shippers feel that when the Staggers Act was passed
10 there were 35 plus Class I railroads. The number
11 always seems to change a little bit and now there are
12 seven and that services were -- so QED mergers were
13 bad. What's the Administration's view of that?

14 MR. SMITH: I think although there
15 certainly have been a large, large number of mergers
16 and on each occasion the ICC first and then the Board
17 sought to ensure that no rail shipper that was thereby
18 at least two carriers received less than that, it was
19 conditions. And, in fact, the UP-SP merger was
20 probably the best single example of that where
21 Burlington Northern received roughly 4,000 miles of
22 track rights primarily to serve that need of the

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1 shippers.

2 And so from that perspective, we're not
3 aware of any merger related gain in the number of
4 captive shippers. Obviously, there is continuing
5 concerns about the ability of the captive shippers
6 that do exist to realistically bring their cases,
7 because it cannot be that in 25 years every other than
8 -- major shipper has always been satisfied with her or
9 her rail rate. But that's another problem.

10 CHAIRMAN NOBER: No, I've spent a lot of
11 time on that in the past three years and we have had
12 one small case brought. But I'm puzzled as to why
13 there haven't been more. Secondly, I think, much of
14 the testimony this morning will talk about the fact
15 that the Board ought to, you know, revisit some of the
16 core doctrines of the Staggers Act, including the
17 bottleneck, the Midtec and paper barriers. What's the
18 Department's view of those calls to change those
19 doctrines?

20 MR. SMITH: I think it is appropriate as
21 a general matter in light of the very different
22 industry we have today for the Board to consider

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1 seriously the major decisions it made in the past 25
2 years, the ICC made in the last 25 years. Determine
3 if they are still appropriate. We have mentioned
4 specifically in our testimony, of course, rate making,
5 but there are certainly others, such as those. We're
6 not taking any position right now on any of those, but
7 it is fair as a general matter, of course, to
8 reconsider in light of very changed circumstances.

9 CHAIRMAN NOBER: And on rate making, you
10 know, you indicated that your view is that we should,
11 the Board should look at rate making doctrines
12 appropriate to induce capacity. What would that be?
13 What would a doctrine be that would -- I mean, the
14 carriers would say, you know, what would a rate making
15 doctrine appropriate to induce capacity look like?

16 MR. SMITH: Well, it might entail, it
17 would entail an examination of whether the current
18 standards and precedent would find reasonable -- the
19 continued historically higher rates, recent historic
20 rates to expand capacity. And whether there would be
21 incentives once those rates were reasonable perhaps
22 whether they would be actually used for the purpose or

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1 to extend the use for purpose as opposed to just some
2 other corporate desire. There's also lingering,
3 historically it has never meant anything, but the
4 lingering, as you said, approach or concern that there
5 might be for revenue adequacy and how once the
6 carriers to achieve that which, of course, one can
7 project now with consideration of other conditions,
8 one could project that now, how that would affect the
9 outcome of rate cases.

10 CHAIRMAN NOBER: That was going to be my
11 next question. If railroads became revenue adequate,
12 how do you think that would affect rate cases, large
13 or small?

14 MR. SMITH: Well, I'm not sure that I am
15 personally aware that it has ever been spelled out
16 what would happen in that case.

17 CHAIRMAN NOBER: Okay. That's one of the
18 questions of today.

19 MR. SMITH: But I believe that it was
20 always understood, if not expressed, that that would
21 be a factor that would weigh in the balance on the
22 side of a lower, rather than a higher, rate in some

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1 fashion, very gently speaking. And since it is now in
2 prospect that some of the Class I's will be achieving
3 revenue adequacy, then we have to -- I think it is
4 wise to determine whether that should still be
5 understood or not or even fleshed out as to figure out
6 what exactly that does mean.

7 Because even with revenue adequate
8 carriers and even with relatively, in some places at
9 least, scarce capacity, it's also discomfoting to
10 think that some captive shippers might be forced to
11 pay beyond some unknown level that would indeed
12 contribute to the fixed cost and to the returns
13 necessary for capital investment.

14 CHAIRMAN NOBER: Well, let me ask one
15 final question, which is something that will be a
16 theme of today, which is we have never had a revenue
17 adequate railroad, at least, not in anybody's, you
18 know, effective lifetimes. What would one look like?
19 I mean, what would you say some of the indicia of a
20 revenue adequate railroad would be, that the Board has
21 never found before? I mean, obviously, earning your
22 cost of capital is a mathematical equation. Being

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1 deemed revenue adequate is a legal conclusion.

2 MR. SMITH: I have been under the
3 impression, perhaps mistakingly, that a railroad that
4 was found to have earned the cost of capital, at least
5 over some time, was very, very close, legally, to
6 being considered revenue adequate. And so I don't
7 know what other factors would go into that legal
8 conclusion. I suppose that it is possible that there
9 are some, because again that has not been the case in
10 living memory that that is another question that the
11 Board might ask is whether -- are there any other
12 factors that determine that? And it may well be that
13 there aren't.

14 CHAIRMAN NOBER: Well, just, you know, for
15 one year, three years, you know. Somebody once joked
16 to me 22 years, you know, what? That's just something
17 that, you know, a Board will, at some point, have to
18 grapple with.

19 MR. SMITH: That's right. Yes.

20 CHAIRMAN NOBER: All right. Anything
21 else?

22 COMMISSIONER MULVEY: I was just going to

1 add, what Roger was driving at, is that a single year
2 of revenue adequacy of one railroad does not make the
3 industry revenue adequate. How many years must we
4 observe railroads earning their cost of capital in
5 order to declare them revenue adequate? And then the
6 question, of course, is are we accurately and
7 appropriately measuring railroad returns? What is the
8 appropriate measure of those returns?

9 We use return on investment. There are
10 some who suggested in their testimony we should use
11 return on equity. Others suggest that we should use
12 the cash flow. There are a lot of measures of
13 financial performance and we'll hear from the finance
14 people later on.

15 Does the Department have any view as to
16 what's an appropriate measure of railroad financial
17 health?

18 MR. SMITH: We have not to date and do not
19 now. I think that I'm well aware that different
20 parties have championed different indicia of that.
21 That way will, obviously, go on and perhaps you would
22 have more meaning as railroads make more money however

1 measured.

2 CHAIRMAN NOBER: Yes. And sort of
3 following on to that, I mean, if railroads are
4 financially healthy, what is a fair contribution from
5 captive shippers? I mean, what is that? I mean, I
6 don't know. I don't know if anyone knows, but that's
7 a question that's certainly -- you know, I think
8 everyone is going to grapple with and hopefully will
9 be some good discussion about today.

10 MR. SMITH: Right.

11 CHAIRMAN NOBER: Okay. No further
12 questions? Mr. Smith, thank you again for coming and
13 we'll turn to our next panel. We have representing
14 the National -- do we have an extra chair? There is
15 one over there. Rudy, we have an extra chair. Okay.
16 We'll have enough chairs for everyone. We have John
17 Ficker representing the National Industrial
18 Transportation League, Charles Van Vlack representing
19 the American Chemistry Council.

20 I think it is probably easier if you sit
21 in the sort of left, you know, from your right to your
22 left in the order that you're going the panel.

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1 MR. KEITH: On behalf of 900 members of
2 the National Grain and Feed Association, we appreciate
3 the opportunity to be here today to present our views.
4 We think that the Staggers Act has led to many
5 positive outcomes. The railroads have become more
6 profitable, which must continue if rail capacity is to
7 grow. The flexibility created by the Staggers Act
8 gave railroads the ability to better compete for
9 freight, but it also gave the railroads the market
10 power to define the scope of their business and the
11 types of markets that they want to serve.

12 This has had both positive and negative
13 impacts for our industry. Regarding rail capacity,
14 our members are greatly concerned about rail capacity
15 going into the future. In 1980, the railroads carried
16 50 percent of the commercial grain movements in the
17 U.S. Today, that number is about 35 percent. While
18 railroads have become more efficient at moving grain
19 volumes between points through shuttle and unit
20 trains, the rationalization of their infrastructure
21 has led to loss in grain volume to other modes,
22 primarily truck.

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1 There is concern in our industry whether
2 ag shippers can effectively compete with other
3 industries for available rail service going into the
4 future. In today's marketplace, this is brought out
5 in rail service trends. Train speeds for intermodal
6 traffic exceed train speeds on other types of traffic
7 by as much as 50 percent. Ag shippers face more
8 difficulty in obtaining predictable rail service.

9 While intermodal traffic profitability is
10 beginning to increase, we face the situation today
11 where those rail shippers who pay more including some
12 ag shippers are receiving inferior service. This
13 situation confirms that the U.S. and agriculture, in
14 particular, confront a huge freight capacity challenge
15 in the years ahead. To enhance rail capacity,
16 shippers have been required to invest heavily in
17 private rail cars, rapid loading facilities and other
18 equipment.

19 Today private cars make up 65 percent of
20 the hopper car fleet, 100 percent of the tank car
21 fleet. Owning a private car sometimes can be
22 beneficial in receiving better service commitments.

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1 But if there is surplus capacity that develops, the
2 rail carriers tend to pluck the private cars first,
3 thus creating more ownership risk for the shippers
4 than for the carrier.

5 Regarding rail rates, the long-term trend
6 in published real freight rates has been declining.
7 But rail rates are only one component of the total
8 cost of transportation. Considering the ownership
9 increase in private cars and required investment in
10 new plants and equipment, the actual trend in total
11 real cost for transportation is less certain.

12 Over much of the life of the Staggers Act,
13 average grain rail rates have not posed much of a
14 problem, but differential pricing has proven to be a
15 chronic issue for some captive shippers. Differential
16 pricing has been viewed as the appropriate way for
17 railroads to set rates, but just as clearly Congress
18 intended for limits to apply to such pricing in
19 captive situations, and that there be a process
20 established that allows reasonable access to rate
21 relief.

22 We don't think that exists today for small

1 rate cases. We would urge the STB to provide for a
2 more transparent regulatory system for small rate
3 cases that permits the rail customer to evaluate
4 individual situations and for the carrier to
5 accurately determine the risk of losing a case before
6 the STB.

7 Next, I would like to speak to customers
8 and carrier's business relationships, which seem to
9 have deteriorated in the last 10 years. We think some
10 of this conflict arises from a carrier's ability to
11 dictate business terms that are costly or unreasonable
12 to the customer.

13 One example is the grain process, which
14 has been required to purchase tank cars to obtain any
15 kind of rail service for liquid food products. Then
16 when railroad service deteriorates, those same
17 shippers are forced to lease additional cars to make
18 up for the poor performers just to keep plants
19 operating. Then when car cycle times improve, the
20 cars become in "surplus capacity" and the railroad
21 assesses storage charges for the cars. Thus, the
22 shipper is penalized in two ways for unpredictable

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1 rail service.

2 Another example of railroads dictating
3 business terms is rail fuel surcharges. Analysis
4 demonstrates that some carriers' average surcharge
5 exceeds not just the increase in fuel cost, but
6 actually exceeds the total cost of fuel for the
7 average shipment. A carrier's ability to assess
8 exorbitant fuel surcharges is another indication of a
9 lack of effective competition among carriers in the
10 near term.

11 It also should be noted that there is a
12 wide divergence in railroad policy on fuel surcharges.
13 The BNSF Railway recently announced it would ship to
14 a mileage-based surcharge more directly related to
15 fuel cost. The Canadian National has announced two
16 reductions in its fuel surcharge assessment since
17 April of 2005. These carriers should be commended for
18 making attempts to address customer concerns.

19 These types of situations that develop,
20 tank car policies and fuel surcharges, are just two
21 examples, but they need some form of oversight system
22 at the STB to provide more effective and timely relief

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1 than what we have today.

2 We have also had some positive business
3 relationships that have developed between carriers and
4 shippers under Staggers. In 1997 the NGFA, the AAR
5 and the major carriers developed a private arbitration
6 system to handle certain classes of disputes. While
7 this arbitration system addresses neither rates or
8 service matters, it has reduced friction and
9 litigation between grain shippers and carriers.

10 Now, to close, looking ahead. The STB, as
11 the ICC before it, is charged with interpreting the
12 law and Congressional intent. Since 1980, both of
13 these agencies have interpreted the law fairly
14 consistently, emphasizing policy that "enables
15 carriers to earn adequate revenues." As those
16 carriers are now very profitable and nearing revenue
17 adequacy as judged by the STB, we submit that a shift
18 in policy and legal interpretations needs to be
19 seriously considered.

20 Railroad performance suggests strongly
21 that railroad assets are being concentrated
22 increasingly on the movement of intermodal freight,

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1 coal or other hook and haul traffic, such as grain
2 shuttles. This may well be the most profitable
3 business strategy for railroads, but we must ask
4 whether the growing dedication of rail assets to a
5 limited number of rail services threatens to leave
6 many rail customers, including many ag shippers of
7 tank cars, specially covered hopper cars or other non-
8 shuttle movements without a vision of continued
9 affordable rail service.

10 One reason that NGFA's rail arbitration
11 system has proven successful is that for those classes
12 of disputes that are arbitrable on a compulsory basis,
13 both the carrier and the customer are likely to
14 perceive themselves to be at some risk of loss.

15 In an era of high profitability for
16 carriers, to the extent the STB could create that kind
17 of balance in STB oversight and proceedings, we think
18 the market would evolve to more self-discipline,
19 improved market performance and the level of friction
20 between carriers and shippers would be reduced. I
21 look forward to questions.

22 CHAIRMAN NOBER: Thank you very much. Mr.

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1 Van Vlack?

2 MR. VAN VLACK: Mr. Chairman,
3 Commissioners, my name is Charlie Van Vlack and I am
4 Executive Vice President of the American Chemistry
5 Council.

6 ACC member companies, representing nearly
7 90 percent of chemical production in the United
8 States, depend on the U.S. rail industry for the safe,
9 secure and efficient transportation of, approximately,
10 160 million tons of chemical products each year
11 accounting for about \$5 billion in annual railroad
12 industry revenues.

13 ACC appreciates the opportunity to
14 participate in this hearing on Staggers and commends
15 you for bringing attention to the 25th anniversary of
16 this important legislation. To be clear about our
17 views, however, ACC respectfully recommends that STB
18 reverse a long line of Agency policy determinations
19 that are harming the competitiveness of the U.S.
20 chemical industry and other key sectors of the
21 American economy.

22 In the long run, unless reversed, those

1 policies will also impair the ability of the U.S. rail
2 industry to serve all of its customers. To be frank,
3 ACC's concerns is not with Staggers as Congress wrote
4 it, but rather with the way the federal regulators
5 have implemented the law over the past quarter
6 century.

7 The statute clearly and carefully
8 deregulated those rail rate and service matters that
9 take place where shippers really do have competitive
10 alternatives. Because the marketplace works for such
11 rail customers, Congress appropriately removed the
12 unnecessary regulatory involvement of the ICC.
13 Staggers has been successful in that regard.

14 But Congress also recognized that
15 railroads have market dominance over certain shippers.
16 In fact, were it not for those situations, there would
17 have been no need to retain a federal regulatory
18 agency with exclusive jurisdiction over the rail
19 industry. As written, Staggers was meant to regulate
20 only those aspects of shipper/carrier commercial
21 relationships that take place in competitive markets.
22 Clearly, this Agency exists today to deal with those

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1 noncompetitive situations.

2 For fully 63 percent of ACC member rail-
3 served facilities, the shipper has access to only one
4 rail carrier. Those shipments are, therefore, captive
5 to a single railroad. For a captive shipper,
6 regardless of its size or location, the efficient
7 movement of its traffic, in some cases even the very
8 survival of its business, depends on the rates and
9 service provided by that single railroad.

10 In enacting Staggers, Congress wisely left
11 jurisdiction over issues involving railroads and
12 captive shippers with the ICC and now, with the STB.
13 It clearly did not deregulate rail service in
14 noncompetitive situations.

15 So what has happened in the past 25 years?
16 ICC and the STB interpreted Staggers in ways that we
17 believe deprive captive rail shippers of the
18 protections that Congress included in the law. Since
19 Staggers became law, the agencies have refused to
20 recognize its pro competitive features and have
21 instead erected administrative barriers to
22 competition. Here are just a few important examples.

1 First, Staggers allows captive shippers
2 with facilities located in terminal areas to seek the
3 Agency's approval for competitive access to another
4 carrier that also serves that same terminal area. But
5 the precedent created by ICC's Midtec Decision has
6 effectively prevented shippers from even requesting,
7 let alone obtaining, such relief.

8 Thus, despite the existence of this
9 statutory provision, no shipper has obtained
10 competitive access in a terminal area. ACC,
11 therefore, requests that STB overturn Midtec or, at a
12 minimum, conduct a thorough reexamination of its
13 validity after two decades of further consolidation in
14 the rail industry.

15 Second, STB's bottleneck decisions allow
16 a railroad with monopoly power over a segment of a
17 shipper to consignee movement to extend that power to
18 the entire movement. This Agency-created bottleneck
19 doctrine permits a railroad to refuse to quote a rate
20 over a bottleneck segment as long as it can provide
21 service for the entire movement.

22 Yet, Staggers neither includes such a

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1 provision nor requires such an interpretation. The
2 bottleneck doctrine arbitrarily denies a captive
3 shipper access to STB to determine a just and
4 reasonable rate for what may be a relatively short
5 monopoly portion of an overall movement. As a
6 practical matter, this nullifies the other railroad's
7 potential to compete for the non-volumetric portion of
8 the movement.

9 STB should discard its anti-competitive
10 bottleneck doctrine. Railroads should be required to
11 quote a rate for service between any captive origin or
12 destination on its system and any point of interchange
13 with another carrier.

14 should implement a pro competitive policy for short
15 line sales.

16 Finally, another area of concern is
17 railroad mergers. As ACC has noted in the past,
18 railroad mergers inevitably reduce shipper options
19 regardless of the conditions that are applied by the
20 Agency. Bottlenecks are extended when lines serving
21 competitive shippers are acquired by connecting
22 carriers. Efficient service from independent bridge

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1 carriers disappear. Competition for service to new
2 industrial sites is reduced or eliminated.

3 In conjunction with other ICC/STB policies
4 that curtail competition between railroads, mergers
5 have generally harmed captive shippers. There will
6 likely be only one more round of Class I rail mergers.
7 ACC, therefore, recommends that in any future rail
8 merger proceeding, STB's review should focus on
9 enhancing rail-to-rail competition and improving
10 service to shippers.

11 These examples illustrate why ACC is
12 extremely concerned about the Agency's past and future
13 implementation of Staggers. Thank you very much.

14 CHAIRMAN NOBER: Thank you. Mr. Elsea?

15 MR. ELSEA: Good morning. I'm Chuck
16 Elsea, Senior Vice President.

17 COURT REPORTER: Microphone.

18 MR. ELSEA: Pardon me. I am Chuck Elsea,
19 Senior Vice President and Division General Manager of
20 the Flour Mill Markets Division of the Scoular
21 Company. My office is in Salina, Kansas. I am also
22 the President of the Transportation, Elevation and

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1 Grain Merchants Association on whose behalf I appear
2 before you this morning.

3 TEGMA is a North American trade
4 association that brings together railroads, global
5 grain companies, shippers and receivers, ports,
6 storage houses, inspection agencies and others
7 involved in the shipment of North American grain to
8 customers all over the world. We welcome the
9 opportunity to share our views this morning.

10 TEGMA believes that the market-oriented
11 approach of the Staggers Act has transformed the
12 railroad industry and resulted in dramatic
13 improvements that benefit the industry, its customers
14 and U.S. global competitiveness. While it has
15 resulted in improvements for the railroad industry, it
16 has not and cannot solve every problem.

17 As we look ahead, TEGMA strongly supports
18 the continuation of a market oriented approach of the
19 Staggers Act. Agricultural markets are not unlike
20 other markets. They are competitive, dynamic and
21 global in nature. The continuation of reasonable
22 freight charges is an important component in

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1 maintaining a competitive position for U.S.
2 agricultural producers.

3 An efficient, economical transportation
4 and handling industry has kept American farmers
5 competitive in world markets as they face increasing
6 competition from other producers with lower production
7 costs. It's my sense that as they relate to
8 agriculture, transportation costs have remained close
9 to the prices charged in 1980 with increases in rates
10 seen only in the last several years.

11 When you factor in inflation, this
12 represents significant savings and the greatest
13 beneficiaries have been American farmers and
14 consumers. These economies are the direct result of
15 gains and efficiency due to investment in
16 transportation and handling infrastructure by both
17 railroads and handlers of agricultural products.

18 Each fall at the TEGMA Transportation
19 Symposium we hear reports from railroads about
20 increased demand for their services as other markets
21 call for more and more freight to be carried by rail.
22 As grain producers continue to realize rapid gains in

1 efficiency, they rely on the transportation industry
2 to keep up and that requires investment.

3 For railroads to manage volume increases
4 and improve velocity, they need to continue to have
5 the ability to invest in resources such as hopper
6 cars, locomotives and track. It's critical that
7 Government policy continues to promote that level of
8 investment in railroad infrastructure that we have
9 seen over the last 25 years in order for the growing
10 freight needs of our nation to be met.

11 It's clear then that as we look ahead,
12 rail carriers will need access to capital for further
13 investment in infrastructure, maintenance and
14 expansion. In order for the railroads to attract
15 investors, they need to be able to show competitive
16 rates of return. While we have recently seen calls
17 for re-regulation of the railroads, TEGMA strongly
18 believes that such legislation places at risk the kind
19 of infrastructure investment that has helped keep our
20 industry competitive.

21 By forcing freight rates lower or forcing
22 inefficient operation practices, re-regulation could

1 restrict earnings, which would severely limit the
2 railroad's ability to invest in infrastructure. If
3 this investment is curtailed, it's likely that U.S.
4 rail carriers will not be able to keep up with the
5 demands placed upon them by the U.S. economy and our
6 agricultural producers will lose their competitive
7 place in a global market.

8 Rail transportation also must maintain a
9 modern business model. Over time, those that rely on
10 the railroad network will be required to make
11 investments that allow the shipper and the carrier to
12 be more efficient. The Staggers Act gave the railroad
13 industry the pricing flexibility it needed to reward
14 improved productivity.

15 In return, shippers and receivers in the
16 agricultural industry have made substantial investment
17 to support transportation efficiency. This is an
18 example of how shippers and receivers can work with
19 rail carriers to find market-based solutions that move
20 the industry toward more productive operation.

21 TEGMA is pleased with the overall impact
22 of the Staggers Act. There are still opportunities

1 for improvement. One issue that TEGMA is working on
2 is fuel surcharge. While we don't dispute the rights
3 of railroads to utilize fuel surcharge to offset
4 rising fuel costs, we support the development of a
5 market-based tool that allows railroad customers to
6 hedge financial risk associated with fuel price
7 volatility.

8 Establishing a system that allows small
9 shippers to economically challenge the fairness of
10 rail rates is another issue faced by shippers. TEGMA
11 has voiced its support for streamlining the case
12 process at STB, and we believe STB should be given an
13 opportunity to exercise the new guidelines in the
14 substantive case before other remedies are pursued.

15 Another concern involves resource
16 allocation and utilization. The grain industry
17 continually works to improve efficiency, but if we
18 cannot move our grain to market because rail resources
19 are not available, those gains in efficiency and
20 investment are lost.

21 We would welcome an expanded commitment of
22 resources to agriculture by rail carriers as they

1 continue to work to improve their performance and
2 create the capacity for better system velocity and
3 infrastructure additions. This will require continued
4 investment in track, rolling stock and personnel on
5 the part of U.S railroads.

6 In conclusion, we compliment you and thank
7 you.

8 CHAIRMAN NOBER: Excellent. Mr. Slavin?

9 MR. SLAVIN: Good morning. I appreciate
10 the opportunity to give testimony this morning. My
11 name is Dan Slavin. I am the Rail Services Manager
12 for Graniterock Company in California.

13 Graniterock is a 105 year-old family owned
14 construction materials and general engineering
15 contractor. In 1992, Graniterock was a recipient of
16 the Malcolm Baldrige National Quality Award.
17 Graniterock has been doing business with the railroad
18 for its entire 105 year history as the very foundation
19 of the company was first centered around supplying
20 ballast for the railroad's expansion.

21 Later, construction applications took over
22 as the predominant user of our products. However,

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1 these materials are also shipped by rail. Back in
2 1900 the company's main quarry, now called the A.R.
3 Wilson Quarry, was opened in the town of Aromas east
4 of Watsonville, California on the railroad's coastal
5 main line.

6 The company has grown to incorporate rail
7 served locations from San Jose to San Francisco.
8 These locations rely heavily on a single Class I
9 railroad for daily rail service as congestion on
10 highways and in surrounding neighborhoods makes
11 delivery of aggregates by truck impractical and
12 undesired by local municipalities. In the peak
13 construction season, rail shipments run between 90 to
14 115 rail cars daily.

15 For many years rail service has been
16 adequate with a strong sense of teamwork between
17 Graniterock and the railroad. Recently, the service
18 quality level in our area has plummeted as the
19 railroad has sold a main rail yard in San Jose and
20 rearranged equipment and crews. Although a new
21 service plan developed by the railroad was put into
22 place, it has been poorly executed so that significant

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1 delivery problems regularly occur.

2 It is disturbing to hear from railroad
3 senior management don't expect service levels to
4 improve, as a matter of fact it will probably get
5 worse. Keep in mind that our service route end
6 pattern has not changed since the 1960s. We believe
7 that this problem is more widespread than just to
8 Graniterock.

9 I would encourage the STB to encourage the
10 railroads to set service standards, such as on time
11 delivery, avoidance of lost rail cars and the
12 railroads to start measuring themselves against these
13 key standards. The rest of America has been doing
14 this for years.

15 Surely, the concerns about the railroads
16 go far beyond the daily failure to perform for
17 customers. The railroad's position seems to be of
18 driving customers away through some demarketing
19 programs. This really is a failure to perform in
20 support of American business and American citizens in
21 a global economy.

22 I would also recommend that the STB hold

1 hearings on rail rates and fuel surcharge practices of
2 the railroads. Based on publicly available financial
3 information, we have determined that the fuel
4 surcharge is providing a railroad with a hidden rate
5 increase, because surcharge amounts far exceed what is
6 needed to pay for an increased diesel cost.

7 Recent rate increases are not supported by
8 the local market and also work to drive freight back
9 on the highways, which is undesirable. Compared to
10 the fuel surcharges of other industries, including
11 trucking, the railroad's practice of charging much
12 more than is needed for diesel fuel increases in their
13 surcharge is a demonstration of monopoly power that is
14 disruptive in the economy.

15 Finally, there needs to be a better way to
16 resolve the differences between the industry and the
17 railroads. After deregulation, it is now too easy for
18 the railroads to lose touch with their responsibility
19 to their customers and the national economy.

20 In a market area like Graniterock's where
21 there is no other rail options with only one Class I
22 railroad, I would encourage the STB to facilitate a

1 method of arbitrating differences between a railroad
2 and industry when they arise. For example, the
3 railroad will make operational changes that increase
4 railroad cycle times that are harmful to both shipper
5 and railroad, and at the same time will say that there
6 is no additional equipment.

7 Over the past 10 years, most of our
8 changes made by the railroad appear to us to encourage
9 added cost with no benefit and improved service. I
10 would also like to say in addition that a meeting last
11 week with senior railroad management has produced a
12 plan to address and, hopefully, eliminate service
13 level issues that have arisen over the last year.
14 Those are my comments.

15 CHAIRMAN NOBER: Okay. Well, thank you.
16 Mr. Jensen?

17 MR. JENSEN: Good morning, Chairman Nober,
18 Vice Chairman Buttrey, Commissioner Mulvey. My name
19 is Tom Jensen and on behalf of UPS, we commend you for
20 taking time today to consider this important subject.

21 UPS has a vital interest and what I want
22 to do, as Chairman Nober outlined at the outset of the

1 hearing, we all submitted written testimony. I want
2 to highlight a couple of things and paraphrase what we
3 submitted to you already, key points from UPS'
4 perspective in dealing with it in one of our key intermodal
5 rail facilities earlier this year to see that
6 operation firsthand.

7 We have done this since the '60s and it
8 has become a vital part of our worldwide intermodal
9 transportation network. You know, today we pick up
10 and deliver more than 14 million packages each and
11 every day and we service almost eight million
12 customers nationwide. It has been estimated that the
13 value of the goods that are transported through UPS on
14 a daily basis is, approximately, 6 percent of the U.S.
15 gross domestic product. So, indeed, we're a major
16 player.

17 However, in recent years and since the
18 Staggers Act was enacted, we have moved from a
19 domestic focus on certain small package transportation
20 into a variety of other transportation solutions.
21 Today we actively develop logistics and supply chain
22 management solutions for customers around the world,

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1 as do many of our competitors.

2 Service offerings reflect customer demand
3 and new market conditions. A healthy and vibrant U.S.
4 railroad industry not only impacts our customers
5 domestically, but it impacts our customers around the
6 world. Since the passage of Staggers, we initially
7 saw some benefits, frankly. The service and
8 performance enhancements by the railroads were
9 significant and UPS realized those and we continue to
10 work on a daily basis with all our major rail
11 partners.

12 However, I don't think the issue and we
13 don't think the issue related to the financial health
14 of the railroads still exists. They clearly seem,
15 based on balance sheets and stock market performance,
16 in good shape, at this point, and recently trends have
17 concluded, unfortunately, diminished performance,
18 disruptive service and constrained intermodal
19 operations.

20 Throughout this period, railroad mergers
21 haven't helped. In fact, we think the railroads have
22 resisted making adequate capital investments,

1 harnessing technology and providing innovative
2 solutions to the very same market conditions we have
3 changed to.

4 As a major rail partner, as I indicated,
5 we don't believe future railroad mergers are in the
6 public's interest until the service, reliability and
7 performance picture improves significantly. We can
8 look back to the situation with Conrail, which
9 culminated in 1998, and we didn't see the same
10 service, the same service levels, until 2002 and since
11 then they have atrophied dramatically.

12 Our packages these days that are moving on
13 the rails are time sensitive. We're all about
14 service. We don't make widgets. We got to get them
15 from point A to point B in the time that we have
16 guaranteed to our customers. The notion of urge to
17 merge to potentially two rail carriers controlling the
18 entire United States from supply chains to the
19 manufacturing, from manufacturing source to consumer,
20 is troublesome to UPS.

21 By any of the statistics, and I have seen
22 several different ones from the Association of

1 American Railroads, the four major rail carriers are
2 effectively carrying 93 or 95 percent of all U.S. rail
3 freight. Given that scenario, we continue to oppose
4 additional Class I rail mergers.

5 Time in transit is a significant issue for
6 us. The efficiency and speed of the nation's
7 transportation system across all modes, all modes, has
8 increased except for railroad velocity. We ask the
9 Board and our colleagues today to consider what mode
10 of transportation moves slower today than it did 25
11 years ago.

12 We have broad experience in trucking,
13 transportation, aviation. We have seen increases in
14 efficiencies in those modes of transportation and, in
15 turn, we have seen decreased time in transit. This is
16 critical in meeting the demands of our customers given
17 streamlined supply chains, speed to market and
18 adjusted time inventory. The railroad time in transit
19 picture puts our competitiveness at risk.

20 We do recognize, however, the capital
21 intensive nature of the industry and the whole
22 challenge based on capital dynamics of the railroads,

1 and perhaps outside of the purview of the Surface
2 Transportation Board, public policy initiatives
3 addressing infrastructure improvements, capacity,
4 service improvements, enhancing technology should be
5 promoted.

6 In the spirit of what Vice Chairman
7 Buttrey suggested at the outset, we are the solution
8 and we continue to -- would like to explore the notion
9 of a Railroad Trust Fund. We have a Highway Trust
10 Fund to service and provide for and maintain a safe
11 and efficiency federal highway system. We have an
12 Aviation Trust Fund. There are others.

13 If these two, the Highway and the Aviation
14 Trust Fund, are deemed to be in the public interest,
15 why not a Railroad Trust Fund? This would represent
16 public/private investment to address the serious
17 challenge we're facing.

18 Wouldn't improving capacity, safety,
19 infrastructure and technology be in the public
20 interest? From a market perspective, the answer is
21 yes. Frankly, of late we continue to pay more and get
22 less. This year and next year, guess what? Pay more

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1 and get less.

2 Finally, technology, while the railroads
3 have worked to harness technology, we think they can
4 do a better job and we favor policy to stimulate the
5 development of technology that can product tremendous
6 benefits to the network.

7 We have spent billions of dollars over the
8 last 10 years in information technology and today we
9 wrap all kinds of information, and the market has
10 forced us to do this, around a \$6 package or an ocean-
11 bound container of freight. Yet, if we can do that in
12 the market, the railroad still struggles with even
13 basic information about major rail arteries and
14 information on movements.

15 All this being said, let me conclude where
16 I began. The railroads have made a valuable partner
17 in surface transportation for us. We need to look to
18 the network to be more efficient to reduce transit
19 times, better utilization of equipment and address
20 technology moving forward, and we look forward to
21 unique and creative ways to solve these problems.
22 Thank you again for your time.

1 CHAIRMAN NOBER: Thank you very much. Mr.
2 Ficker?

3 MR. FICKER: Good morning, Chairman Nober,
4 Vice Chairman Buttrey, Commissioner Mulvey. It's a
5 pleasure to be here. As you know, I'm the President
6 of The National Industrial Transportation League and
7 unfortunately our Vice Chairman, Curt Warfel, could
8 not attend this morning as he has had a family
9 emergency and had to remain at home.

10 In the last 25 years since the passage of
11 Staggers, the world has changed dramatically. We have
12 seen the industrial sector of the United States
13 decline in relation to the service sector. With a lot
14 of that production moving to Asia, which is
15 dramatically effected the transportation systems, both
16 globally and domestically, and the world has also
17 changed.

18 I would just point out that in 1980, there
19 were very few PCs. There was no Internet. There was
20 no email and a hybrid was a rose. We are in a
21 different environment and we take the opportunity this
22 morning to touch on a few of those changes. The

1 Stagg's Act had two important focuses when it was
2 passed. One was to allow competition to govern rail
3 rates and services to the maximum extent possible.
4 And second, to stabilize and strengthen the financial
5 condition of the rail industry.

6 The Act has been an unqualified success in
7 the second, but much more needs to be done in
8 achieving the first goal. But let's be clear, the
9 rail industry is enjoying a financial renaissance.
10 Industry experts, and you are going to hear from them
11 later today, are clearly pointing to the financial
12 success the rail industry is experiencing and the term
13 revenue adequacy seems to be able to be applied to
14 many railroads now and primarily in the future will be
15 applied to more railroads.

16 I'll quote from a Morgan Stanley report
17 that Jim Valentine put forth, and he will probably be
18 here on the panel later today, that says "There is
19 even greater conviction that the industry will
20 consistently earn its cost of capital over the next
21 year, a feat that it hasn't achieved in decades, led
22 by a secular upward pricing initiative that should

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1 continue into 2006 and beyond. If this isn't evidence
2 of a C-change, I don't know what is." And it also
3 points out that it's not a temporary phenomenon, but
4 a true shift in market conditions.

5 Several factors have caused this: One,
6 the rail landscape has changed. There are a lot less
7 Class Is than there were in 1980. Secondly, the
8 systems have been rationalized resulting in some
9 considerably less track and causing some significant
10 shortages of capacity in key areas. Trucking as a
11 competitive alternative has been impacted by the
12 increased fuel costs and driver shortages. And as
13 mentioned by several panelists, rail customers assumed
14 a greater responsibility for infrastructure such as
15 increased track capacity or car ownership.

16 And these have affected rail customers.
17 Mergers have reduced the potential for rail-to-rail
18 competition by either creating bottlenecks or reducing
19 routing options. The service improvements promise to
20 this Agency and its predecessor in merger applications
21 have not materialized. Rail capacity has allowed, if
22 not encouraged, the rail industry to move away from

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1 individual contracts back to public pricing, which
2 appears to be contrary to the Act. And as this is
3 pointed out by Mr. Slavin, it's demarketing several
4 commodities.

5 Also, the reduced effectiveness of
6 trucking rates is the real competitiveness of it
7 because of the costs. And finally, as customers who
8 have had to invest more, it's rendering it almost
9 impossible to invest more in rail equipment and rail
10 infrastructure, it's made it difficult for them to
11 move away from rails as Mr. Keith pointed out. And as
12 Mr. Jensen pointed out, today's experience of rail
13 customers can be summed up in a very simple sentence.
14 Paying higher rates for less service.

15 Now, League Members have not been
16 unwilling to pay more, but it's a question of
17 receiving value for increased costs. We can clearly
18 point out that the opposite has happened, and that is
19 the result of effective competition being gone leaving
20 customers with little alternatives other than to grin
21 and bear it. And the inability to achieve substantial
22 regulatory relief because of the costs or the time

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1 constraints has further made this problem more
2 difficult.

3 Now, the Staggers Act has restored the
4 sustainable health of the rail industry, but now the
5 Board needs to focus on the other policy in achieving
6 the objectives pointed out in the Act itself. The
7 best protection and the best mode of improving
8 financial health and regulation is the marketplace as
9 Commissioner Buttrey or Vice Chairman Buttrey points
10 out. With enhanced competition simply -- when it is
11 not possible, the Board needs to ensure a timely,
12 effective and cost efficient regulatory protection.

13 In a capacity constrained environment, the
14 Board's regulatory approach should encourage the
15 maximum use of existing capacity in creating
16 incentives for adding more capacity. Enhanced
17 competitive access -- advanced competition advances
18 these objectives by promoting greater collaboration
19 between the rail industry and their customers by
20 identifying the ways to improve.

21 In addition, competition will reward good
22 service and direct new capacity to its most efficient

1 use. Several mentions have been made this morning by
2 previous panelists and also by Mr. Smith taking a view
3 of some of the rules and regulations that have been
4 put forth and decisions that have been put forth over
5 the last many years with a different rail environment,
6 i.e., bottleneck case and the competitive accessors.
7 We'll call it the reciprocal switching.

8 The Board should revisit the bottleneck
9 decision. The bottleneck decision was put in place at
10 a time when rail financial health was in serious
11 jeopardy and the Commission at the time viewed it was
12 necessary. The same can be said for the Midtec
13 decision around access. Those decisions need to be
14 substantially revisited by this Board to take a
15 different look and different approach into the future.
16 The League would welcome the opportunity to
17 participate in any such hearing or proceeding
18 opportunity for the rail industry to sustain and
19 enhance its current financial strength is to improve
20 its service.

21 The Union Pacific Railroad has pointed out
22 in several public forums over the past year that the

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1 improvement of one mile an hour in velocity equates to
2 250 locomotives, 5,000 rail cars and almost 200
3 employees. That is a substantial reduction in cost
4 and a substantial improvement of service. Think what
5 2 or 3 miles an hour could provide. Yet, when we
6 examine the service metrics published weekly by the
7 AAR, we find that this has eroded over the last period
8 of time.

9 Improving service doesn't just benefit the
10 railroads, it benefits the customers, it benefits the
11 country and it lowers operating costs for the railroad
12 allowing them to provide improved service at lower
13 costs and attempt to track more business to their
14 properties and grow their market shares. As our
15 testimony points out, the market share of the rail
16 industry over the past 20 years has been relatively
17 flat, as opposed to other modes. And when you
18 consider the elimination of coal and the non-
19 intermodal freight internationally, it has even
20 declined.

21 Car load business from 2000 -- excuse me,
22 1983 to 2000 has been basically flat. And those are

1 AAR statistics. The Board needs to take leadership in
2 this area as has been pointed out by some of the
3 previous panelists about providing meaningful metrics
4 that get -- to allow everyone to gauge the performance
5 of the rail industry. In addition to the data
6 currently published by the AAR, these metrics should
7 include key traffic lanes and average dock-to-dock
8 performance. A competitive rail market will function
9 more efficiently with such information.

10 In regards to the shippers taking more
11 ownership of rail equipment, I think, it is important
12 that the Board reevaluate its car supply rules. And
13 this has been mentioned by several other panelists.
14 When shippers acquire cars to meet the ongoing demand
15 of their businesses and markets get soft, then the
16 railroads tell them to park their cars and use our's.

17 There needs to be balance in that
18 environment. When the markets soften, then everyone
19 should take part of the hit, not one entity have the
20 ability to rule over the other. The Board needs to
21 also take a look at how it can adjust these rules to
22 supply or to provide the industry with some equity

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1 across the system.

2 Finally, I would like to conclude by
3 saying the Staggers Act has been a substantial factor
4 in the recovery of the rail industry in the financial
5 strength that it has today. But there are many
6 changes that face the rail industry that are different
7 from the ones that faced the drafters of Staggers. In
8 particular, the growing capacity constraints is the
9 opposite situation confronting Congress in 1980.

10 The industry is highly concentrated, motor
11 carriers face increasing difficulties in competing in
12 many markets and shippers have invested an enormous
13 amount of capital in the instrumentalities of rail
14 transportation. These changes as well as the
15 regulatory decisions limiting rail-to-rail competition
16 have increased the rail carrier's market power. These
17 new realities require new responses by our policy
18 makers over the next quarter century.

19 The nation requires a strong and viable
20 rail industry as shippers and carriers confront the
21 need to move ever increasing quantities of goods in
22 the global marketplace over a domestic transportation

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1 system that is increasingly capacity constrained. The
2 needs of all the stakeholders of the industry, rail
3 management and employees, rail customers and rail
4 stockholders must be taken into account.

5 And the rail carriers and their customers
6 must work together within the structure of the
7 competitive transportation market to build a rail
8 system that will meet the needs of the 21st Century.
9 The rail industry helped build our great industrial
10 economy. Will they play the same role in our new
11 economy? The League stands ready to work with the
12 rail carriers of this country, the Board and Congress
13 in the development of that system. Thank you.

14 CHAIRMAN NOBER: Okay. Thank you very
15 much. Commissioner Mulvey?

16 COMMISSIONER MULVEY: Thank you. I want
17 to thank the panel for an excellent group of
18 presentations. Rail rates have been down
19 substantially since Staggers and except for the last
20 year or so it has been down for agriculture as well.
21 But what has been the primary cause of that?

22 To what extent has the shifting of the

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1 equipment supply responsibility from the railroads to
2 the shippers in the agriculture sector been
3 responsible for the rates going down versus other
4 productivity improvements by the railroads? Have any
5 of you studied that or have some estimates as to the
6 share that's due to the disinvestment in equipment?
7 Anybody from the grain industry?

8 MR. KEITH: Commissioner, we don't have
9 any quantitative estimates as to what that contributed
10 to the rail rate decline.

11 COMMISSIONER MULVEY: Because we keep
12 hearing on the one hand the railroads saying they have
13 had tremendous productivity improvements due to
14 Staggers and these have been passed on to the
15 shippers. The shippers say that no, that, part of
16 these lower rates are due to the disinvestment in the
17 car supply. And yet, nobody goes out and quantifies
18 how much of these benefits are due to one or the other
19 action. It would make it easier for us to make
20 judgments about how well Staggers has been performing.

21 On the issue of the fuel surcharges, the
22 railroads argue that their fuel surcharges while to

1 some extent probably exceed the actual cost of a
2 movement, on balance and in total do not cover their
3 total fuel costs. If the railroads were unable to
4 differentially price their fuel surcharges thereby
5 putting a greater burden on the captive shippers,
6 wouldn't they wind up seeing their returns go down and
7 their movement towards revenue adequacy forestalled?

8 So doesn't it make sense that they are
9 going to have to charge some of the shippers more than
10 their fuel cost increase if they are going to cover
11 their fuel cost increases in total, John?

12 MR. FICKER: Thank you, Commissioner
13 Mulvey. Our opinion, and as you know, we have been
14 working on the private side with all of the rail
15 carriers to address this very specific issue along
16 with National Grain and Feed. We believe the fuel
17 surcharges should be exactly what they are to recover
18 that cost. The need for differential pricing belongs
19 in the rate structure, not in the fuel surcharge
20 structure.

21 In most other modes of transportation,
22 fuel surcharges are relatively transparent. You can

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1 identify relatively quickly the current cost and you
2 can estimate the increased cost. We all know what it
3 costs to go to fill up our tanks in our automobiles.
4 We all experience that. We want to know that
5 differential. If the railroads have agreements that
6 do not include fuel surcharges, because they were
7 signed many years ago in a long-term, that's the
8 marketplace working at its finest, which I believe is
9 what Staggers proposed.

10 COMMISSIONER MULVEY: That gets back to
11 the issue of contracting. Contracting is something
12 that Staggers Act gave the railroads the right to do.
13 It allowed them to better compete with trucking. Of
14 course, on the other hand, these long-term contracts
15 sometimes preclude things like fuel surcharges. Are
16 contracts a boon or a bane to railroad competition?
17 Should there be limits on contracting?

18 There was an article recently by a
19 professor at Penn State University which suggested
20 that there may be a need to limit railroad
21 contracting, so they don't enter into long-term
22 contracts that preclude them getting legitimate cost

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1 increases, like fuel surcharges, and result therefore
2 in the railroad's differentially allocating those
3 surcharges in a way that many shippers feel is unfair.
4 So should we put limits on contracting in order to
5 avoid that in the future?

6 MR. KEITH: I don't think we would favor
7 that. I think that is really restricting marketplace
8 freedoms to pursue profitability, to pursue business.
9 Yes, people make mistakes in contracting at times, but
10 it's a business strategy that we think rail carriers
11 need.

12 COMMISSIONER MULVEY: The article, as I
13 recall, suggests that the nature of railroad economics
14 will generally cause railroads to undertake that kind
15 of behavior whenever they have excess capacity, that
16 is, enter into these kinds of contracts, which in the
17 long-term could be counterproductive.

18 MR. FICKER: Mr. Commissioner, could I
19 take a --

20 COMMISSIONER MULVEY: Yes.

21 MR. FICKER: I would agree with Kendell on
22 that. The marketplace should be the arbiter of

1 contract duration, not any regulatory environment.
2 But everyone has to take into account their business
3 structure, their marketplaces. And I think as Vice
4 Chairman Buttrey pointed out in his opening remarks,
5 it's essential that we stand out of the way and allow
6 the marketplace to be the arbiter of these things.
7 And, you know, it's buyer beware.

8 COMMISSIONER MULVEY: Yes, as an
9 economist.

10 MR. FICKER: It's buyer beware.

11 COMMISSIONER MULVEY: As an economist, I
12 have nothing but respect for the functioning of the
13 market mechanism. However, the reason we are here and
14 the reason this Board exists is that there are some
15 circumstances under which the market mechanism might
16 not give the optimum solution and ergo that's why you
17 have a regulatory regime in place.

18 Now, Mr. Slavin, you mentioned the idea of
19 a trust fund concept and when I was on the Hill we
20 worked with Congressman Lapinski to develop such a
21 concept. Do you want to elaborate on how a Rail Trust
22 Fund concept might work? I'm sorry, Mr. Jensen.

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1 MR. JENSEN: I'm sorry, Commissioner
2 Mulvey.

3 COMMISSIONER MULVEY: Yes.

4 MR. JENSEN: That rests with me.

5 COMMISSIONER MULVEY: Yes, yes.

6 MR. JENSEN: Well, I'll tell you, this has
7 been an issue that has been talked about in the past
8 and there's been some movement, might be an
9 exaggeration, on the Hill, but we think it's time to
10 go back and look at that and we have seen them in
11 other modes, as I indicated. We are more than happy
12 to pay our fair share and we think that even given the
13 unique situation where there is private ownership in
14 the infrastructure as you alluded to in your opening
15 comments, Commissioner, we think that can work still.
16 So we think we need to go back and look at that. As
17 far as the exact specifics today, I'm not prepared to
18 tell you or to discuss where we go.

19 COMMISSIONER MULVEY: Yes, the proposal
20 that we had provided several billion dollars a year
21 for railroad infrastructure investment, but it was
22 vociferously opposed by the railroads. I think in

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1 large measure because of the concern about what the
2 quid pro quo would be, ergo what would the railroads
3 be expected to do with regard to access if such a
4 funding mechanism were put in place?

5 So I suppose there needs to be some way of
6 finding a solution that simultaneously involves public
7 support for railroad infrastructure without having a
8 requirement that the railroads would find excessively
9 onerous.

10 MR. JENSEN: I concur. For what it's
11 worth, Commissioner Mulvey, we concur and we have
12 discussed it with railroads directly.

13 CHAIRMAN NOBER: Vice Chairman Buttrey?

14 VICE CHAIRMAN BUTTREY: I would just like
15 to clarify something for my own self here. Several of
16 you seem to be suggesting that the Board order
17 railroads to buy rail cars, tank cars, grain cars,
18 flat cars, whatever. I would just like to clarify in
19 my own mind, is that what you are saying? It seems
20 to me, that you seem to be suggesting that the Board
21 order railroads to buy certain kinds of rail cars and
22 certain amounts at certain times for certain purposes.

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1 And if you are suggesting that, I would
2 like to be cited chapter and verse, if you will, for
3 where that authority would come from.

4 MR. KEITH: We're not suggesting that.
5 I'm sorry if I misled you on that. What we are saying
6 is that the railroad, in essence, defines the
7 marketplace by defining the set of rules that will
8 govern private investments by rail customers. And we
9 think that those rules mitigates they are very one
10 sided. We think it creates risk, more risk for the
11 shipper than a normal competitive marketplace would
12 allow.

13 VICE CHAIRMAN BUTTREY: So what form would
14 that risk take?

15 MR. KEITH: Well, I gave an example in the case
16 of tank cars that, in essence, the shipper has to have
17 the tank cars to get service of any kind.

18 VICE CHAIRMAN BUTTREY: For coal and oil.

19 MR. KEITH: There are reasons for that,
20 because you commit things to certain types of products
21 and the cleaning is less onerous and so forth. But,
22 you know, when there are problems and in terms of

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1 cycle times, you've got to have plants running.
2 You've got to have cars available to fill with
3 product. And so if the cycle times deteriorate a lot,
4 then you've got to release more cars for a while.

5 And then when and if the railroad
6 performance improves, you get so-called surplus cars
7 that then you get to pay storage charges for. And the
8 predictability of service in rail is just a major
9 concern. It has gotten much worse in the last few
10 years. The capacity issues are creating more
11 variability in service. And so the total cost of
12 transportation is increasing at a faster rate than the
13 actual rates themselves would indicate.

14 VICE CHAIRMAN BUTTREY: Yes.

15 MR. FICKER: If I could kind of echo what
16 Mr. Keith has said? The historic relationship was
17 that the rail carriers provided the equipment to move
18 the goods. That was kind of history. Much as, you
19 know, when you send a shipment on UPS or FedEx, they
20 provide the plane. But in reality, what has happened
21 in the last several years is the rail industry has
22 said, you know, we can't afford this. The price of

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1 your product or the rates we are able to charge don't
2 justify our investment, which is the reason, why don't
3 you, Mr. Shipper, invest in your own equipment? So
4 that's what has happened.

5 The problem is, as I mentioned in my
6 comments, was balance. When the markets do soften,
7 then if both are using at 100 percent in the solid
8 market, then they both should be at 75 or 60 or
9 whatever the market adjusts to, rather than the rail
10 industry being able to say oh, use my cars, park
11 your's and then charge storage for that.

12 It's not a matter that the industry is
13 saying to the rail industry, you buy the equipment.
14 What they are saying is treat us fairly. The other
15 concern that has been mentioned before by some others
16 is that the rules for interchange and the rules for
17 maintaining equipment are established by the AAR and
18 committees that are developed in that organization.
19 And those committees are made up exclusively with
20 total voting power by the railroad industry without
21 any participation by those other owners. And so far,
22 they have attempted to become part of those

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1 committees, but have not been successful.

2 VICE CHAIRMAN BUTTREY: Is it safe to
3 assume that a lot of the cars become the warehouse, if
4 you will, for product?

5 MR. FICKER: It happens. I wouldn't say
6 that it doesn't. I think people are becoming more
7 efficient at that, but if a shipper wants to do that,
8 then they need to pay for that. They need to pay for
9 the storage. They need to pay for the equipment or
10 whatever. It's when the service, as Mr. Keith
11 indicated, deteriorates that you have to go out and
12 get more equipment just to maintain your current level
13 of business that gets frustrating.

14 VICE CHAIRMAN BUTTREY: Is it true that in
15 some of these manufacturing facilities the product
16 tends to show up at these facilities at a time when
17 they can't possibly process it that quickly, and then
18 all of a sudden the reverse of that happens and the
19 plant wants to be open and operating 24/7 and it can't
20 operate 24/7, because it's not getting the raw
21 materials it needs to operate?

22 Are you suggesting that the Government

1 intrude into that process in some way?

2 MR. FICKER: Absolutely not. But what
3 users of raw material expect is a consistent flow. If
4 I release and ship 1 ton, 10 tons a day, I expect that
5 10 tons will arrive at that other destination within
6 a reasonable -- in five days or three days. Not that
7 I have shipped 10 tons one day and at the other end I
8 get 100 tons at one crack. That's the problem that is
9 faced by many people today.

10 It's not about wanting the Government to
11 interject in anything. I think these are where the
12 service metrics are so critical and so important. So
13 that people can understand and plan accordingly. The
14 problem is the variability and plan and we have a
15 recipient of the Baldrige Award here, a number of
16 years past, and that's absolutely critical to put
17 processes in place that develop consistency and that
18 same effort needs to be taken in the rail industry.

19 VICE CHAIRMAN BUTTREY: Let's talk about
20 grain for a moment here. We will have some other
21 shippers, I'm sure, later in the day. There is some
22 argument being made or opinions being rendered that

1 some parts of the industry and some parts of the
2 country have reengineered their systems better than
3 others. And that because of that, they are getting
4 better service and they are getting better prices, if
5 you will, because of that.

6 Is there hard evidence in your opinion, in
7 the opinion of the panel or anyone on the panel,
8 particularly, Mr. Keith, that certain parts of the
9 country have invested more and are making a greater
10 effort toward reengineering their systems than others?

11 MR. ELSEA: I'll try that. In the western
12 United States, very clearly, there has been a
13 substantial investment on the part of shippers and
14 train loading facilities and, you know, some of them
15 are shuttle train capable, some of them are just, I
16 guess, what we would call in our company the "big
17 train" model, and that would be a train in size in
18 excess of 75 cars, most of them 110 car units. And we
19 have worked pretty hard to adapt as much of our
20 business model to the utilization of those unit sizes
21 as we can.

22 And as an industry, yes, there have been

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1 substantial gains in productivity that have been made
2 because of that investment. You know, also clearly,
3 Chairman Buttrey, you know, there has been a shift
4 away from grain movements in single cars or movements
5 that go into the manifest model. There has been a
6 move away from that to a move towards these larger,
7 more efficient units. And it works in the west.

8 MR. KEITH: I might just add --

9 VICE CHAIRMAN BUTTREY: It works in the
10 west. When you say the west, you're talking about
11 everything west of the Mississippi River or are you
12 talking about part of the west?

13 MR. ELSEA: West of the Mississippi.

14 VICE CHAIRMAN BUTTREY: Okay.

15 MR. ELSEA: And the places where we
16 struggle and places whereas an industry we're working
17 on improving this would be the places where we
18 interchange with the eastern carriers.

19 MR. KEITH: I might just add there is
20 still a part of the market that really is not
21 conducive to shuttle operations, 100 car trains, and
22 running on a cycle basis. Corn tends to be the

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1 easiest one to make work, because it's a very high
2 volume grain. Wheat, especially grains, things like
3 that are less so and they go into some western flour
4 mills that really can't take those sizes of trains.
5 So you've got to break those trains apart to make that
6 happen.

7 But as an industry, we're always going to
8 have an agriculture, a need for a smaller shipment
9 size than simply shuttle service in certain markets.
10 And those markets are very long distances. Trucks
11 really don't work well for them. And the concern is
12 how much balance do you have in rail service between
13 the shuttle type service and other types of needs in
14 the agricultural marketplace?

15 VICE CHAIRMAN BUTTREY: What size? What
16 size train are you talking about? When you said
17 smaller trains, smaller groups of cars, if you will.
18 Shuttle trains are very long, lots of cars, 125 or
19 whatever.

20 MR. KEITH: Right.

21 VICE CHAIRMAN BUTTREY: Any length.

22 MR. KEITH: There are certain movements

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1 in, I'll say, North Dakota for special type high
2 protein wheats going into say a Minneapolis
3 marketplace that are may in 10 car lots or something
4 like that or even single cars going in the manifest
5 trains. But those are a fairly small part of the
6 marketplace today, but 25 and 50 car units still could
7 be utilized very easily. I mean, that would work best
8 in some of these markets. Flour mills going into the
9 PMW, for instance.

10 MR. ELSEA: If I could add to that? There
11 are opportunities, however, to take the business that
12 Kendell is talking about and cause those to adapt to
13 a larger train model and it is going on today in the
14 Dakotas, in Kansas and in Oklahoma. And BNSF has
15 introduced a tool that they call a destination
16 exploiter train that has gained wide acceptance on the
17 Plains. And we have used a model in our company
18 offered by Union Pacific for a number of years where
19 we take, you know, essentially a 100 car empty set and
20 load that, send it to a gateway and break it up into
21 25 or 30 car pieces to distribute to flour millers.

22 So, you know, the industry has been able

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1 to innovate to some extent to do some of the business
2 that Kendell is talking about, but, you know, again to
3 this point, it can't be the cure all for everything
4 there. But it works. And again, it's another example
5 of the industry trying to figure out how to adapt
6 itself to a transportation model that will serve its
7 customer.

8 VICE CHAIRMAN BUTTREY: You are familiar,
9 of course, with the feeder airline concept, right?
10 Small airlines, feeder airlines.

11 MR. ELSEA: Right.

12 VICE CHAIRMAN BUTTREY: They feed into the
13 greater trunk line system and interface with the
14 faster moving, long haul carriers and freight
15 forwarder model, if you will, where consolidation of
16 freight takes place. Then it is handed off to a
17 carrier to move that over a long distance in a much
18 faster speed. I know UPS certainly is familiar with
19 that.

20 In other kinds of consolidator type
21 functions, do you see possibly a role, a greater role
22 for short line railroads in that kind of model, if you

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1 will, where that model could apply to facilitate, if
2 you will, better service to customers who can't
3 produce and can't consolidate long haul, "fast moving"
4 trains that might be on the long haul routes?

5 MR. ELSEA: Well, just keeping in mind
6 that once that train goes on to a Class I carrier, it
7 needs to comply with what is going on there, in terms
8 of, you know, what fits in my head is anything you can
9 do to keep traffic out of a manifest model is going to
10 improve the velocity at which it travels. So to the
11 extent that that can happen coming off of a short
12 line, sure. We have any number of members who have,
13 and our company also have, assets located on short
14 line railroads that are aggregating big trains and,
15 you know, 100 car trains.

16 VICE CHAIRMAN BUTTREY: Yes.

17 MR. ELSEA: Handing them off to a Class I
18 carrier and serving our customers, you know. And I
19 think if you have got short line railroad activity
20 that can't comply to that business model, it will also
21 struggle.

22 VICE CHAIRMAN BUTTREY: Yes. Well, I am

1 not suggesting necessarily that a Cessna 172 follow a
2 767. What I'm suggesting is that there may be a way
3 to consolidate freight or is there a way to
4 consolidate some of these trains and then hand them
5 off to a carrier that could take them to its final
6 destination?

7 MR. ELSEA: Well, I think it is taking
8 place now.

9 VICE CHAIRMAN BUTTREY: Yes. Maybe the
10 industry could do a better job of that.

11 MR. ELSEA: Perhaps in places. I mean,
12 there are many markets, I believe, where short line
13 railroads are an economic and a viable business model.

14 VICE CHAIRMAN BUTTREY: Yes, yes.

15 MR. FICKER: Commissioner, if I can just
16 add a comment to that? There is a lot of freight that
17 will continue to be in a single car shipment. It's
18 just the nature of the commerce, the business
19 transaction between the supplier and the customer
20 generate a certain volume of goods and those volume
21 will probably not be train load volumes. The question
22 becomes and you are asking, I believe, the right

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1 question how can we utilize the short line environment
2 to help do what they do, which is gathering and
3 distribution very well and facilitate the Class I what
4 they do best, which is moving trains better.

5 I think that merits a lot of discussion.
6 I don't think anyone has the answer to that. But it's
7 a question that needs to be focused on by the broader
8 industry segments, users, short lines and Class Is.

9 CHAIRMAN NOBER: I think our lights are
10 out. Apparently, we're not having the five minutes
11 on, so we'll try to rotate through them and make sure
12 everybody has a chance to ask questions. Starting
13 with me. No, no. I can still do that. Let me just
14 ask for a minute about one of the points that all of
15 you made about the Midtec and bottleneck. I think
16 everybody made that, almost everyone, point in one
17 form or another.

18 We just spent two days up in Canada with
19 five of our seven Canadian counterparts. And I think
20 they have a similar system in Canada to what many of
21 you are advocating the Board, you know, alter its
22 doctrines to. And we spent a lot of time talking to

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1 them about the pluses and minuses of that. Given the
2 concerns that you have raised about adding capacity
3 and ensuring adequate service levels, do you really
4 think that altering the Midtec and bottleneck
5 decisions will -- what do you think the effect of that
6 will be on capacity and service going forward? I
7 mean, if we do what you ask for, what do you think
8 would happen to capacity and service? Anyone?
9 Whoever wants to start.

10 MR. VAN VLACK: All I can say is that the
11 chemical industry operates in an extremely competitive
12 global environment, not only in this country, but
13 everywhere around the world. And our company has
14 found that in a competitive environment they get
15 stronger. They deliver better service. They have
16 been priced down. They attract capital investment.

17 We're just unsure why those market rules
18 wouldn't apply in the case of providing competition to
19 captives and that with the drive performance. And,
20 you know, it would allow us to rethink making capital
21 investment at a lot of these facilities right now.

22 CHAIRMAN NOBER: Why would it do that?

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1 MR. VAN VLACK: Well, right now --

2 CHAIRMAN NOBER: Because rates would go
3 down?

4 MR. VAN VLACK: -- the cost of service and
5 the quality of service. Most of our companies operate
6 globally. In other words, they have plants all over
7 the world.

8 CHAIRMAN NOBER: Yes.

9 MR. VAN VLACK: They have a choice to
10 where they place their plants, to a certain degree.
11 The rail issue is becoming an increasingly important
12 part of that decision. We have facilities Our
13 companies have facilities outside of the U.S. and
14 inside the U.S. making the same product shipping to a
15 customer in the U.S. Some of them find they can move
16 it more cheaply and more quickly to their U.S.
17 customer by sourcing it outside of the U.S. in their
18 own plant.

19 Something is wrong with the system when
20 that works. So what we find our members doing is
21 making capital decisions based upon the ability to
22 provide predictable service at competitive costs. So

1 I think our members would be more inclined to increase
2 capacity, therefore, provide more freight volume to
3 the railroads if they had more certainty regarding how
4 the rate structure was going to operate and regarding
5 the reliability and predictability issues that others
6 have raised here.

7 MR. FICKER: If I can take just a stab at
8 that? The answer to your question, Chairman Nober, is
9 extremely difficult, because my crystal ball is on the
10 rip track and I don't really know the status of what
11 would happen if that were to take place.

12 CHAIRMAN NOBER: But everyone is
13 advocating that.

14 MR. FICKER: I will look north of the
15 border and see that two very profitable and very
16 efficient railroads operate under that environment, at
17 least in the case of what they call interswitching,
18 very successfully. And I think that model could be
19 brought down here. Reciprocal switching used to be a
20 much broader application here in the United States in
21 the '70s when I first started in this industry and it
22 has since declined dramatically.

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1 The opportunity then is for the most
2 efficient mode, the most efficient route to take
3 advantage of that and we are not encouraging that. We
4 are not encouraging efficiency. We are encouraging
5 the status quo. And by encouraging the status quo,
6 there is no incentive to change. There's no incentive
7 for innovation. There is no incentive for
8 improvement. It's just make sure I don't lose what I
9 have got.

10 CHAIRMAN NOBER: Now, one, as I said,
11 having just spent 36 hours with our Canadian
12 counterparts, one difference is that the two Canadian
13 carriers are national systems, whereas ours are
14 regional. So they don't have the short haul/long haul
15 incentive that we seem to have here, which produces
16 one of the problems that you are suggesting. Not that
17 I'm advocating consolidation. I know all of you feel
18 very strongly about that. I don't think I
19 misinterpreted what anyone said. But that is one
20 difference that, you know, at least thought about. I
21 mean, I'm not sure if that makes a difference or not.

22 MR. FICKER: I know there is an awful lot

1 of freight that transpires strictly on either of
2 those, in the west and in the east, so I don't think
3 it's that big a deal.

4 CHAIRMAN NOBER: Let me just ask one more
5 question and then we'll do another round of my
6 colleagues. The second point that I heard a lot of
7 folks raise issues with is demarketing, and that's one
8 that I candidly have been struggling with for the past
9 15 or 18 months. I have heard a lot about it. And I
10 guess the question I would ask is, you know, you all
11 represent businesses, right?

12 And when you make investment decisions or
13 decide where to put your resources, what do you look
14 at? What's the highest return part to your business,
15 right? And so if you decide to demarket or, you know,
16 lop off or not, you know, participate in the lowest
17 return part of your business, you do that every day,
18 right? But a railroad can't do that or if they do,
19 you know, we have folks coming in and raising concerns
20 about that. And there is a legitimate balance to
21 that, which is, you know, you don't want businesses
22 that depend on railroads for their livelihood being

1 put out of business. I mean, that's what regulation
2 is there for.

3 But how do you strike that balance between
4 on the one hand letting railroads act as businesses
5 and focus their assets on the highest return part,
6 which is what everyone of you do, with the need to
7 maintain service to those customers that are captive
8 to railroads? What would you have -- that's what we
9 would have to do. How would you have us do that?
10 What's the right balance to strike there? Does anyone
11 want to try that one?

12 MR. FICKER: Well, let me take a stab, at
13 least, at addressing the concern. Every industry in
14 the capital economic system that we have in this
15 country needs the opportunity to pick and choose what
16 it will do business as. That's not new to anybody.
17 However, when you look at the railroad efficiency and
18 go back to the comments that I made about service
19 velocity, what would happen if we improved that
20 velocity by 5 percent?

21 The demarketing effort wouldn't be so
22 significant at all, because the capacity would be

1 there. It's not just about throwing money at the
2 problem. It's about solving the problem by improving
3 service. Capital is needed to, you know, add capacity
4 in certain key lanes, there's no doubt about that.
5 But a slight improvement in the velocity will give the
6 railroad the opportunity to revisit that freight that
7 they think is no longer, you know, profitable or
8 saleable, because their efficiencies will improve,
9 their profit margin is going to improve.

10 MR. KEITH: This isn't a solution, but one
11 thing that we mentioned in our written testimony that
12 we would favor is for the Board to require the
13 carriers to have metrics that they report on a fairly
14 consistent basis, for the various sectors that they
15 serve. And we're seeing some of the metrics that are
16 being used in the past in terms of performance. The
17 definition is starting to shift and so that the day-
18 to-day are not comparable with the data of history.

19 And at least you could tell how much of
20 service decline you are really confronting in some
21 sectors. I mean, in the ag sector, we think we've got
22 some movements that are higher return to the carrier

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1 today than the intermodal. We think the intermodal is
2 a growth area of the business for railroads. They are
3 going after that. They are more concerned about
4 timely service to the intermodal sector, because
5 that's the way they are going to grow the sector.

6 And that's fine, but it's really coming at
7 a time when our rates are going up increasingly and
8 the service seems to be deteriorating very quickly,
9 too.

10 CHAIRMAN NOBER: Okay. Commissioner
11 Mulvey?

12 COMMISSIONER MULVEY: Let me follow-up on
13 this demarketing issue for a moment. The railroads
14 are somewhat different from other industries. It's
15 not a perfect analogy to say that other industries do
16 things differently. If they chose to cut out a
17 certain line of business, well, that's their choice,
18 but usually the firms that are being cut out would
19 have some alternative.

20 The argument is that in the case of rail,
21 for many shippers, there really isn't any alternative.
22 There's no substitutability. Which gets us to the

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1 question of the common carrier obligation. The common
2 carrier obligation was changed in ICCTA. We have
3 many, many commodities that are exempt from regulation
4 and are not subject to the common carrier obligation.

5 .
6 What is your understanding today, and I
7 ask this of the group as a whole, of the railroads
8 continuing common carrier obligation in light of
9 Staggers and the Interstate Commerce Termination Acts?

10 MR. KEITH: We think the concept still
11 exists in principle. Reasonable service on reasonable
12 requests. Defining precisely what that is is
13 increasingly difficult, but we do think that railroads
14 are granted a franchise by the Government. They are
15 granted certain legal protections by the Government.
16 Therefore, the maximization of profits regardless of
17 cost to certain sectors or customers that
18 traditionally had service, we think has to be looked
19 at. That's part of the job of the STB. And to decide
20 yes, there are limits, how do you impose reasonable
21 limits without hurting the carrier's profitability?
22 But there are tradeoffs there and we think there is a

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1 common carrier obligation under the law.

2 COMMISSIONER MULVEY: Common obligation
3 for all commodities or just certain commodities?

4 MR. KEITH: I wouldn't differentiate. I
5 certainly think it applies to agriculture.

6 COMMISSIONER MULVEY: Okay. And
7 chemicals?

8 MR. VAN VLACK: And certainly chemicals.
9 We would agree with respect to their being a common
10 carrier obligation. It is the whole basis, you know,
11 under which the manufacturer sector in this country
12 operates. We're a very capital intensive industry.
13 Our investments were made based upon a set of rules
14 regarding access to rail shipments. We have not had
15 a lot of alternatives for shipping a lot of our
16 products and we believe that it's part of the balance
17 that needs to take place. Certainly railroads
18 decrease the returns, but you exist to make sure that
19 those returns are reasonable and not excessive.

20 COMMISSIONER MULVEY: But does it apply to
21 intermodal?

22 MR. JENSEN: Yes, it does. Now, you could

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1 argue, Commissioner Mulvey, that we have more options
2 than others. I believe that makes sense, but we've
3 obviously chosen the economic -- made the economic
4 decision to invest resources with the railroads to
5 enjoy certain economies and made the business decision
6 to do so.

7 COMMISSIONER MULVEY: Yes.

8 MR. JENSEN: Yes, we do believe so.

9 COMMISSIONER MULVEY: Yes, might it be
10 true that the substitutability of truck for rail may
11 have changed over time given changes in the
12 characteristics of the trucking industry and the rail
13 industry, for that matter?

14 MR. JENSEN: Absolutely. And we're
15 looking into the basis of today's exercise, look back
16 25 years, right?

17 COMMISSIONER MULVEY: Yes.

18 MR. JENSEN: We see an awful lot of
19 changes in that mode as well.

20 COMMISSIONER MULVEY: One last question
21 and this gets to the paper barrier issue and it is
22 addressed to Mr. Van Vlack, although you can all

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1 answer it. The question of paper barriers, is
2 something dear to my heart. Paper barriers, of
3 course, are something that the railroads require from
4 the short lines when they spin them off to ensure that
5 the short lines continue to interchange traffic with
6 them rather than another carrier. These paper
7 barriers are often in perpetuity. Would you favor
8 some sort of limitation on the time of paper barriers?
9 And if so, how long do you think would be a fair time?

10 MR. VAN VLACK: Well, I don't have a
11 comment on the specifics, but it's just paper barriers
12 are just another instance of a case where there are
13 artificial barriers to access the competition being
14 created. Our view is that those kinds of barriers
15 shouldn't be there. They impede service. They impede
16 competitive rates. And so I don't have any specific
17 suggestion as to time limits. But again, it's part of
18 maintaining the balance between the return the
19 railroads are entitled to and the competitive access
20 and service that the major shippers need.

21 COMMISSIONER MULVEY: But the railroads
22 argue that without paper barriers, these short line

1 railroads would never have been spun off and the lines
2 would have simply been abandoned and paper barriers
3 guarantees at least service continues, even if the
4 service is not as competitive. How do you respond to
5 that?

6 MR. VAN VLACK: Well, in the spirit of
7 today's hearing, I think that's one of those balance
8 issues that the STB needs to look at. Is how do we
9 assure the right balance between securing the
10 continuation of those lines to be able to serve
11 shippers and to be able to provide return to the
12 railroads and the kind of service and rates that
13 shippers deserve in this kind of a regulating process.
14 So I believe that's a ripe subject for further review.

15 COMMISSIONER MULVEY: Thank you.

16 CHAIRMAN NOBER: Vice Chairman Buttrey?

17 VICE CHAIRMAN BUTTREY: A question for Mr.
18 Jensen from UPS. You were talking about you being a
19 very large customer and I was wondering if you are at
20 liberty to say today whether you are continuing to
21 increase your trucks on the rail or whether you have
22 had to reduce that, because of problems with the

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1 service?

2 MR. JENSEN: Well, Vice Chairman Buttrey
3 and Members of the Commission, we have had a lot of
4 challenges as we've outlined and in certain segments,
5 certain lanes we have taken some traffic from the rail
6 back to the road, absolutely. As far as quantifying
7 that, I would rather not get into it, but we have done
8 that based on the issue of service, frankly. We've
9 got to serve those customers, our customers. And we
10 don't make widgets. All we do is provide service, as
11 I know you are familiar with from your previous
12 private sector career. It's absolutely critical. We
13 want to partner with them. We want them to be
14 successful and us to be successful with them.

15 VICE CHAIRMAN BUTTREY: Thank you.

16 CHAIRMAN NOBER: Let me go to another
17 subject that folks raised a lot about which is car and
18 car supply, which is something that again there is not
19 -- I think I have been to almost every one of your
20 member's work facilities in some form or another and
21 there is not a visit I made when I did not hear about
22 car supply and the concerns about private car owners.

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1 Some of the issues that you raised about,
2 you know, the shifting of costs and about, you know,
3 some of the rules of post in private car supply. I
4 mean, it's hard not to be sympathetic to that. But
5 what would you have us do about that? I mean, how
6 would we sort of mediate? What kind of rule would
7 make sense to say well, you know, when demand is high
8 and when it peaks and folks buy extra cars and, you
9 know, they will be used, and then when it slackens,
10 what should happen? Who should bear the brunt of the
11 slack?

12 MR. FICKER: I think as I said and I think
13 others would agree with me, that should be born by
14 everyone, because as the rail industry has shifted,
15 the ownership of cars, other than tank cars, which
16 have always been owned by the shipper, they shifted
17 the ownership of these other pieces of equipment.
18 They have encouraged the shippers to do that. They
19 have made the investment. There is a mixture of rail-
20 owned equipment and privately-owned equipment. And as
21 markets decrease, there should be a balance.

22 You should be able to report pretty

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1 clearly that we're using 20 percent less and we're
2 both using 20 percent less, rather than forcing
3 someone to say all right, we have a soft market now,
4 use my cars not your's. Park them. And oh, by the
5 way, you know, you don't have enough track space,
6 we'll charge you storage. That just is a matter of
7 equity.

8 Chairman Nober, I think if you could
9 create some sort of rules that in the downturn those
10 would be effective or if service improves, for
11 example, if service improves to the point where you
12 don't need as much equipment to move the same amount
13 of commerce, then there needs to be a time line when
14 that volume of equipment is extracted from the
15 marketplace, rather than being penalized for meeting
16 your own needs.

17 MR. KEITH: We would like to see some kind
18 of a rapid procedure at the STB for considering what
19 is reasonable in these kind of situations for rules.
20 And it is the railroads are setting market rules that
21 are fairly one-sided and, in fact, create risk for
22 shippers. And they want the shippers to invest in

1 rail cars for capacity reasons. Shippers are not
2 resisting that necessarily, but when they see the
3 impacts on their business fluctuating, mileage rates
4 and for getting cars parked very quickly, that they
5 own their -- they don't think it is fair. And there
6 should be some kind of a fairly quick process at the
7 STB to review those kind of one-sided rules.

8 CHAIRMAN NOBER: Now, shipper after
9 shipper I meet with makes the same point that, you
10 know, when we have to evaluate investing in rail cars
11 without, you know, some assurance of turn time, some
12 assurance of the overall total cost, they can't
13 evaluate the, you know, benefit of investing in that.
14 Now, the flip side is the railroad faces the same
15 situation. So if they don't know what the utilization
16 they are going to get out of their cars is and what
17 the kind of rates they are going to get, are they
18 going to invest in cars?

19 MR. KEITH: Yeah, but they don't face the
20 same kind of risks. They are forcing additional risk
21 on the shipper if they don't incur by their own rules
22 by owning or leasing the cars directly, and that's the

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1 problem. The rules are one-sided.

2 MR. ELSEA: If I may? I think that the
3 industry shippers, receivers and rail carriers needs
4 to focus on the point that John raised a moment ago
5 and that's on improving velocity. You know, if, in
6 fact, we can do that, then we can all operate with a
7 smaller fleet, you know, and take a substantial amount
8 of the volatility, service volatility out of the
9 system. And, you know, whatever our ailments are up
10 and down the table here can nearly all be answered
11 with improved velocity. And so what do we do to make
12 that happen? I think the list is long.

13 MR. FICKER: If I can just add to that
14 comment? And I think you are absolutely right that it
15 is important though that if velocity improves and the
16 investment has been made in these things, that there
17 be a phased out of the equipment without being
18 penalized for requiring that equipment.

19 CHAIRMAN NOBER: What if a regulatory body
20 is faced with saying well, the way to improve velocity
21 is to demarket car load business and focus on unit
22 trains? So a couple of you who run unit trains here

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1 would benefit and a couple of you who run single car
2 service would suffer from that, and the Agency should
3 stay out of that or be involved in it. What would you
4 have us do in that kind of situation, which I would
5 point out we face almost every day?

6 MR. VAN VLACK: I mean, again --

7 CHAIRMAN NOBER: I mean, is Government
8 really the right place to kind of make and evaluate
9 that kind of decision?

10 MR. VAN VLACK: I think to demarket
11 service to shippers who ship in smaller quantities to
12 many customers, again is a fundamental change in the
13 rules of the game and the balance of the Staggers Act
14 was intended to assure. And again, it's a bit of a
15 broken record for us, but when you are captive and
16 because of the nature of your products you don't have
17 a lot of option and because you are capital intensive
18 and you can't pick up and move your plant to some
19 other place, that would thus be a fundamentally poor
20 decision.

21 CHAIRMAN NOBER: Well, I agree. It's a
22 very difficult balance --

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1 MR. VAN VLACK: Right.

2 CHAIRMAN NOBER: -- to regulators to try
3 to look at those and say, you know, if helping one
4 hurts another, you know, that's not the right place,
5 at least in my view, for a Government Agency to be
6 involved. But it's difficult, because what might help
7 velocity for some customers would hurt it for others
8 and vice versa. You know, but that's why we have
9 railroad operating officers, however, to figure that
10 out.

11 MR. ELSEA: You know, if you start from
12 the concept that there are segments of industry that
13 cannot be served in a big train model, and I believe
14 that's the case and there's nothing you're going to do
15 to change that, you know, but perhaps the goal of the
16 transportation industry is to cause everything that
17 can comply to get closer to improving this velocity.
18 That creates capacity for everyone. Now, you know, do
19 you need to -- is that the role of regulatory body?
20 I don't think so. I think the marketplace is trying
21 to do that and admittedly the marketplace is
22 struggling with it. And I don't know that you help it

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1 by trying to regulate it.

2 CHAIRMAN NOBER: Commissioner Mulvey?

3 COMMISSIONER MULVEY: I guess it's part of
4 the problem with how some of these metrics are
5 calculated, such as velocity. Is it a nationwide
6 measure? Some of these problems with lower velocity
7 are found in some markets and not found in others. I
8 wanted to ask you what you thought. We heard about the
9 car supply rules and railroad tank cars, in
10 particular. What in our mission, what in our charter
11 would we use to address those problems? What could the
12 STB do?-- -Is that part of our mission to address
13 those kinds of rules or is that something that the
14 industry needs to work out through the AAR by
15 individual railroads as to how to deal with the terms
16 under which cars are supplied?

17 MR. KEITH: I'm uncertain exactly the
18 direction that should be taken. I think this body,
19 the STB has the authority to make decisions on
20 unreasonable practices. It might be helpful if the
21 car owners had some representation within AAR
22 committees to decide car rules. Certainly, in our

1 industry, when we are moving towards 75 percent
2 private car ownership, it would be nice to have a seat
3 at the table.

4 CHAIRMAN NOBER: John?

5 MR. FICKER: I couldn't have said it any
6 better. Kendell, you, as usual, do a fantastic job.
7 A seat at the table is important. Everyone needs to
8 be able to address the issues. It was all still rail-
9 ownership which it was in 1953 or '54, that would be
10 one thing. But today, the ownership is spread across
11 a wide spectrum. The leasing companies, short line
12 railroads, individual shippers, some short line
13 railroads that are owned by shippers, a plethora of
14 people own rail equipment and those individuals need
15 to be represented in the rule making procedures.

16 COMMISSIONER MULVEY: John, you mentioned
17 about improving velocity and generating stimulating
18 productivity and innovations, etcetera. What one
19 thing drives innovation, productivity improvements in
20 any industry?

21 MR. FICKER: In a word, competition.

22 COMMISSIONER MULVEY: Thank you. I am

1 glad you gave me the right answer. And finally, I
2 remember another question on the issue of captive
3 shippers, the discussion about the number of mergers
4 that took place since Staggers has increased the
5 number of captive shippers and shippers are subject to
6 bottleneck rates, on the other hand, this leaves one
7 individual out there who has argued that, in fact, the
8 number of captive shippers really hasn't changed very
9 much at all in the last 50 or 100 years.

10 Most shippers have only ever been served
11 by a single railroad and that the mergers have not
12 really increased the number of shippers who are truly
13 captive. Does anybody have any information on how
14 captivity has increased since Staggers?

15 MR. FICKER: Commissioner Mulvey, if I
16 could take a stab at that?

17 COMMISSIONER MULVEY: Yes.

18 MR. FICKER: I don't know that I disagree
19 with the comment that maybe there are not more or less
20 captive shippers than there were many years ago. But
21 captivity is not about one end of the distribution
22 chain. It's about both ends of the distribution

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1 chain. It's the origin and the destination, and
2 that's what has happened in this environment. One is
3 now -- if one is restricted, then you are
4 automatically restricted.

5 The classic example is a company that I
6 used to work for, used to be able to ship out of the
7 south, in a southern state up into the Conrail
8 territory, prior to the Conrail divestiture. They had
9 competitive options at their originating plant. The
10 two southern railroads, Norfolk Southern and CSX.
11 When that merger or demerger took place, which ever is
12 the proper term, they lost that capability, because
13 now if it was a CSX destination in the north, the only
14 viable alternative was via CSX. And if it was a
15 Norfolk Southern destination in the north, the only
16 viable alternative.

17 So you have lost movements that had
18 captive -- that had competitive options, because of
19 that particular transaction. And so it's not just
20 about who is a captive shipper. It's about what's a
21 captive origin/destination pair.

22 COMMISSIONER MULVEY: Okay. I understand.

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1 MR. VAN VLACK: I just would like to
2 second that view. I think that's where the increase
3 has been. Our figure is on 60, over 60 percent
4 captive shippers, at least from point of origin,
5 doesn't include the net effect of the customer impact
6 on that.

7 COMMISSIONER MULVEY: Thank you.

8 CHAIRMAN NOBER: Well, finally on that, I
9 would just like to offer an observation I'm seeking of
10 NS and CSX. Last spring, I think before my colleagues
11 got here, we did a couple of hearings on the impact of
12 the Conrail merger looking at the end of the five
13 years. And we did a field hearing up in Trenton, New
14 Jersey looking at the impact of the shared assets
15 areas. Now, much of -- I think the closest parallel
16 we have in the country today to the kinds of switch,
17 reciprocal switching and access that some folks today
18 are advocating is what we did in Conrail in New York,
19 Philadelphia and Detroit.

20 And we had many of the public entities
21 come in and testify in that hearing about the lack of
22 public investment, about the lack of investment and

1 the decrease in rail traffic in those areas. And
2 instead what happened was instead of investing in New
3 York and Philadelphia, we had a lot of -- there was
4 investment in places like Allentown and Bethlehem and
5 Harrisburg, which coincidentally were just outside of
6 the shared asset areas.

7 And I wonder if when folks think about
8 these doctrines, they look at the experience we have
9 had in three of the 10 largest markets in the country
10 and see how they have worked and what they think that
11 would portend if the Agency, you know, again, it's not
12 going to be me, if some future Agency moved to that
13 kind of a doctrine, what we think would happen to
14 investment in those areas. I don't know that that's
15 a direct parallel, but it's something at least that
16 struck me in the course of looking at it.

17 Well, again, I just want to thank you all
18 for your time and your testimony. And I'm sorry for
19 the next panel that we have delayed you a little bit.
20 I'm not sure we have the schedule yet, but why don't
21 we -- again, thank you all very much for your
22 testimony. If anyone has any additional questions, we

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1 can submit them for the record.

2 But we'll move now to our second panel,
3 which is not a coincidence, which happens to all be
4 involved in shipping coal. Okay. Are we going to
5 have enough chairs here? Okay. Well, we have Mr.
6 McBride and Mr. Linderman from the Edison Electric
7 Institute, Mr. Richards and Mr. Crowley, again two
8 familiar faces from the Western Coal Traffic League,
9 Mr. Loftus from the Concerned Captive Coal Shippers,
10 another familiar person here.

11 Mr. English from National Rural Electric
12 Cooperative Association, welcome to the Board, and
13 Michael Nelson from the Arkansas Electric Cooperative
14 Corporation, again, welcome to the Board. I'm going
15 to start with Mr. McBride and Mr. Linderman.

16 MR. McBRIDE: Mr. Linderman will begin.

17 CHAIRMAN NOBER: Okay.

18 MR. LINDERMAN: Thank you, Mr. Chairman.
19 I am Chuck Linderman, Director of Energy Supply at the
20 Edison Electric Institute, and I would like to digress
21 a little bit and go back to what happened yesterday.

22 Yesterday the Senate Energy Committee held

1 a hearing on the winter fuels outlook for this winter.
2 It should be of concern to every person in this room
3 with the cost of national gas supposed to be rising
4 about 50 percent to each of us in this area who are
5 residential gas users, as well as high costs of all
6 the electric fuels as well as other fuels for our
7 wintertime heating season.

8 There are two new concepts under
9 discussion in the Senate as they move to think about
10 Energy Bill No. 2. 1 is called Efficient Dispatch and
11 I want to draw the nexus between efficient dispatch
12 and coal conservation programs that have been running
13 by the railroads and the electric industry to maintain
14 our coal piles.

15 Efficient Dispatch is a term of art that
16 has been developed by the independent power producers
17 as well as, to some degree, with some support from the
18 chemical industry as a way of moving the electric
19 industry to use our most efficient gas powered units,
20 so that we reduce our gas consumption.

21 The drive by the Senate right now is to
22 find ways for the electric industry to reduce its

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1 natural gas consumption as rapidly as possible so as
2 to maintain economic viability for the petrochemical
3 industry and to reduce the pressures on natural gas
4 prices for home heating for this winter. There are
5 very few short-term solutions to this, but
6 nevertheless as much conservation as possible is what
7 is being pushed to the electric industry.

8 That in turn comes back to this concept of
9 adequate delivery of coal transportation, and the fact
10 that you now have power plants and generators
11 operating in at least three states that I am aware of
12 that have coal conservation programs in place where
13 they have been burning their coal generators during
14 the daytime when demand has been the highest to keep
15 costs as marketable and manageable to the consumers as
16 possible, and then burning their higher cost gas units
17 at night when the demand has been lower.

18 That is not acceptable in the current kind
19 of economic environment we find ourselves as a nation
20 with national gas prices north of \$13 again this
21 morning, and we need to find ways to get our coal
22 delivery system and coal supply system in enough sync,

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1 so that we are able to operate those plants without
2 having to turn them down and operate in a coal
3 conversation program.

4 To further understand that, and Glenn will
5 probably be surprised at me endorsing something from
6 a co-op publicly, but certainly the letter from the
7 Arkansas Electric Cooperative Association Corporation
8 does make that plain and I urge the Board and all of
9 you to take that into account very closely.

10 The other thing that occurred yesterday
11 was discussion of coal transportation capacity, and we
12 see a nexus between the Hurricanes Rita and Katrina
13 and an action pending at this Board. Hurricanes Rita
14 and Katrina said to this nation we need to diversify
15 our petrochemical base, our refining base and our
16 natural gas production infrastructure.

17 What do the twin accidents of May 14 and
18 May 15 tell us about coal transportation from the
19 Powder River Basin? That we need to diversify and add
20 to the transportation infrastructure, so that there
21 are alternate routes out of the basin when there is an
22 accident that stops all traffic coming out of the

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1 basin.

2 There is sitting before this Board an
3 application that we hope you can move on shortly and
4 as rapidly as possible to complete the Dakota,
5 Minnesota and Eastern's application, so that it may
6 proceed with financing development as an alternative
7 way out of the basin to give us a little bit more
8 electric reliability or a little more reliability on
9 coal transportation and, as a market solution, I would
10 add to some of the challenges that we as captive coal
11 shippers have faced.

12 And finally, I would urge you gentlemen to
13 think through your role as carriers of a big stick and
14 ask for reports from the carriers on the number of
15 trains that they are actually loading on a daily and
16 weekly basis, the number of trains that they have been
17 asked to load, as well as keeping the pressure on to
18 get the joint line brought back to full capacity as
19 rapidly as possible.

20 And in view of the last discussion, we are
21 all owners of major car freights in the electric
22 industry. The electric industry has financed and

1 brought forward the opportunities for the Burlington
2 Northern and Union Pacific and their predecessor
3 companies in the Powder River Basin, because we built
4 and owned the major car fleets out there.

5 And I would observe in the last panel, for
6 those who are saying they need improved velocity,
7 folks, we all need improved velocity, but there is
8 going to be more heavy coal trains on the system over
9 the next 15 years than you have thought about, too.
10 Thank you. I'll turn it over to Mr. McBride.

11 MR. McBRIDE: Mr. Chairman and Members of
12 the Board, I just want to emphasize a couple of points
13 that Mr. Linderman already made. Number one, one of
14 the very good things this Board did several years ago
15 during the service crisis on Union Pacific was, at our
16 urging, to require the railroads to report every week
17 the number of coal trains they were loading out of the
18 Powder River Basin.

19 We were having a coal crisis, at that
20 time, and the problem was over within about a month
21 because of that report. So one of the things that you
22 can do is not run the railroad, but just focus the

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1 only place in America where it is believed that there
2 are no revenue adequate railroads. When I go to Wall
3 Street, everywhere else I go, everyone says at least
4 three or four of them are revenue adequate. So the
5 time has come to regulate them differently. Thank
6 you.

7 CHAIRMAN NOBER: Thanks. Mr. Richards?

8 MR. RICHARDS: Chairman Nober, Vice
9 Chairman Buttrey and Commissioner Mulvey, my name is
10 Duane Richards. I appear today on behalf of Western
11 Fuels Association and the Western Coal Traffic League.
12 Western Fuels is a not-for-profit cooperative that
13 supplies coal and transportation services to consumer-
14 owned electric utilities throughout the west and
15 midwest.

16 The Western Coal Traffic League is
17 comprised of 20 coal shipper organizations, including
18 Western Fuels, that collectively ship over 140 million
19 tons of Western Coal annually. I am the Chief
20 Executive Office of Western Fuels Association. I do
21 appreciate the opportunity to appear here today.

22 I am joined today by Tom Crowley. Mr.

1 Crowley is President of L.E. Peabody and Associates.
2 He also appears here today on behalf of the Coal
3 League. I will try not to take up too much of his
4 time and give him his five minutes of fame here.
5 Also, I know that there is going to be a fair amount
6 of repetitive discussion on some of these issues, so
7 I apologize for that, but I will go through my
8 comments.

9 As the Board knows, the Staggers Act was
10 a very comprehensive piece of rail legislation, which
11 was designed to balanced the interest of shippers and
12 carriers. On the carriers' side, the Staggers Act
13 contained provisions designed to make it easier for
14 railroads to merge, to ban unprofitable contracts, to
15 enter into confidential service contracts and to
16 freely compete in competitive markets.

17 By and large, the ICC and the STB have
18 applied these provisions in the manner requested by
19 the rail industry. The ICC and the STB have approved
20 an unprecedented number of rail mergers. Thousands of
21 miles of rail lines have been abandoned and railroads
22 have been allowed to freely compete in competitive

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1 markets. The result has been a new era of financial
2 prosperity for the railroad industry.

3 The Staggers Act also contained provisions
4 designed to protect captive shippers from carrier
5 market pricing abuses, provisions designed to promote
6 intermodal competition and provisions designed to
7 ensure shippers receive adequate service. For this
8 hearing, I will divide the shippers' side of the
9 Staggers Act legacy into three general categories.

10 The first category includes provisions in
11 the Staggers Act that, as implemented by the ICC and
12 the STB, have never fulfilled Congress' original
13 intent. First and foremost of these is competitive
14 access. The Staggers Act called upon the ICC and the
15 STB to promote competition in areas where competition
16 was lacking via the terminal trackage rights and
17 reciprocal switching relief.

18 The railroad industry did not like these
19 provisions and succeeded in convincing the ICC to
20 adopt administrative regulations that effectively
21 preclude shippers from obtaining any terminal trackage
22 rights or reciprocal switching relief. Indeed, it is

1 fair to say that shippers are zero for the last 25
2 years in obtaining any relief under these standards.

3 The second category is pro shipper
4 developments that fulfill Congress' intent. These
5 developments included the ICC's approval of the
6 Western Railroad properties, entry into the Powder
7 Basin and, essentially, that was C&W and ultimately
8 the UP's access into the PRB, and that area had been
9 previously solely served by the Burlington Northern,
10 an approval that was obtained over the strong
11 objections of the Burlington Northern.

12 Subsequently, an additional development
13 was the ICC's initial or the ICC's approval of the
14 RCFA, approval that was again obtained over the strong
15 objections of the entire rail industry and that's the
16 rail cost adjustment factor, adjustment for
17 productivity.

18 The ICC's also additional adoption of the
19 Coal Rate Guidelines in 1985 and the ICC's, as well as
20 the Board's approval, of rail build-out applications
21 by captive utility coal shippers. These are all very
22 important developments that greatly assisted many

1 Western Coal shippers.

2 The third category consists of
3 developments in the last few years that are eroding
4 the pro shipper gains identified in my second
5 category. These developments include the ongoing
6 campaign by the duopoly railroads in the west to
7 abandon confidential contract pricing in favor of so-
8 called public pricing tariff authorities.

9 The evident desire of the nation's
10 carriers is to distance themselves from the Board's
11 RCAF indices with the addition of profit-enhancing
12 fuel surcharge mechanisms and the Board's decision in
13 some of the recent coal rate cases. As the Board
14 looks to the future, Western Fuels and the Western
15 Coal Traffic League ask the Board to fairly balance
16 the interest of shippers and carriers in the manner
17 called for under the Staggers Act.

18 On the captive shippers' side, Western
19 Fuels and Basin Electric have a major rate case
20 pending before this Board. I am not here today to
21 discuss our case, but I would encourage the Board to
22 take a closer look at the proposals that we have made

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1 in the case to achieve a fair balance between the
2 interests of captive shippers and the railroads.

3 I would further encourage the Board to
4 observe and respond accordingly to the noncompetitive
5 practices of the railroads as they endeavor to
6 reinstate public tariff pricing on Western Coal
7 movements. Thank you. Those are my comments.

8 MR. CROWLEY: Chairman Nober, Vice
9 Chairman Buttrey and Commissioner Mulvey, my name is
10 Tom Crowley and I am President of L.E. Peabody and
11 Associates Incorporated. Our firm has provided
12 economic services for the Western Coal Traffic League
13 since the League's inception in 1976. I am here today
14 on behalf of the Coal League.

15 As Mr. Richards observed, the Staggers Act
16 has been an unqualified success for the rail industry.
17 Simply stated, since 1980 Class I railroads' revenues
18 have increased significantly. Class I railroads'
19 operating expenses have decreased significantly and
20 Class I railroads' profits are currently at record
21 levels. The Coal League's written statement
22 illustrates these facts through reference to a number

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1 of standard industry metrics.

2 The financial markets have also taken
3 notice. As shown in my first slide, over the last
4 five years Class I railroad stock prices have
5 increased by 133 percent. That would be the red line
6 on the chart. During the same five year period, the
7 S&P 500 stock index dropped by 16 percent. That would
8 be the green line. Obviously, a company's stock price
9 is an important forward looking indicator of the
10 financial health of a business reflecting current
11 operations and the market's expectations of future
12 earnings.

13 The debt rating agencies are also positive
14 on the railroad sector. In its July 15, 2005
15 Transportation Industry Report Card, Standard & Poors,
16 the leading debt rating agency stated, and I quote,
17 "The fundamentals in the North American rail sector
18 remain very favorable."

19 Despite their record profitability levels,
20 the nation's major railroads now frequently claim that
21 they need to raise shipper's rates to fund new rail
22 infrastructure investments. Typically, the railroads

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1 cite to the declining average freight rates since 1980
2 in support of their rate increase arguments. What the
3 railroads never show in these presentations is their
4 declining operating expenses.

5 My second slide compares Class I railroad
6 revenue per ton-mile and Class I railroad operating
7 expenses per ton-mile from 1980 to 2004 for all rail
8 traffic. This slide shows that railroad operating
9 expenses per ton-mile are consistently and
10 substantially below revenue per ton-mile. This trend
11 is particularly true for coal traffic, as illustrated
12 in my third slide.

13 This slide compares the average revenue
14 per ton-mile, the green line, the average variable
15 cost per ton-mile, the blue line, and the annual
16 dollar contribution in millions of dollars the
17 railroads receive for handling Western Coal. As
18 shown, the cost for Western Coal moves has been
19 declining significantly since 1980. This makes sense
20 given the large increases in productivity realized by
21 Western Coal hauling role since the Staggers Act.

22 At the same time, the western carriers'

1 annual revenues have stayed substantially above their
2 cost of providing service. Overall, the differential
3 between revenues and cost has produced significant
4 coal shipper annual contributions to Western Coal
5 hauling carriers' financial positions. These
6 contributions are, approximately, \$2 billion annually
7 over the last 10 years.

8 Almost all of this contribution is
9 captured by the two major Western Coal hauling
10 railroads, the BNSF and the UP. The Class I
11 railroads' record revenues and profits have allowed
12 them to make significant infrastructure investments in
13 the last several years while, at the same time,
14 permitting them to pay record dividends to their
15 shareholders and permitting them to buy back
16 significant segments of their own stock.

17 These results are illustrated in my fourth
18 and fifth slides. My fourth slide shows that over the
19 last five years, Class I railroads' capital spending
20 has approximated \$6 million annually in 2004 dollars.
21 My fifth slide shows the Class I railroads' free cash
22 flow. This metric measures cash available to the

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1 railroads' debt and equity holders after paying for
2 capital expenditures. As shown in this slide, the
3 Class I railroads' free cash flow has been approaching
4 or exceeding \$3 billion annually in 2004 dollars.

5 The record is clear. The Staggers Act has
6 produced significant financial benefits to the
7 railroad industry. It is also clear that in these
8 times of railroad financial prosperity, the railroad
9 industry does not need to increase shipper rates and,
10 particularly, does not need to increase coal shipper
11 rates to fund new infrastructure investment. Thank
12 you.

13 CHAIRMAN NOBER: Thank you very much. Mr.
14 Loftus?

15 MR. LOFTUS: Good morning.

16 CHAIRMAN NOBER: And welcome back to the
17 Board.

18 MR. LOFTUS: Chairman Nober, Vice Chairman
19 Buttrey, Commissioner Mulvey, my name is Michael
20 Loftus and I'm an attorney. I am appearing here today
21 on behalf of the Concerned Captive Coal Shippers.

22 That is a group that includes American

1 Electric Power Service Corporation, the city of Grand
2 Island, Nebraska, Duke Energy Corporation, the
3 Intermountain Car Project, Lafayette Utility System,
4 Platte River Power Authority, Progress Energy, Inc.,
5 Seminole Electric Cooperative, Inc., South Carolina
6 Public Service Authority and South Mississippi
7 Electric Power Association.

8 Each of these companies has one or more
9 coal-fired power plants that are captive to a single
10 railroad. As such, they are subject to rail market
11 dominance and face monopoly pricing power from the
12 railroads that serve them. Several have been or are
13 involved in coal rate cases before this Board. This
14 group also participated in the Board's proceedings in
15 Ex Parte No. 657 addressing concerns with the Board's
16 recent application of the stand alone cost maximum
17 rate constraint in coal rate cases.

18 Concerned Captive Coal Shippers believe
19 the Staggers Act has been highly successful in
20 achieving a number of its goals, in particular those
21 benefitting the rail industry. However, some of the
22 Act's goals that would benefit captive rail shippers

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1 have been frustrated and the balance the Act sought to
2 achieve between railroad revenue needs and protection
3 of captive shippers against excessive rates has not
4 been afforded in recent years.

5 As goals fulfilled, we would include the
6 financial health and stability of the railroad
7 industry, the widespread use of rail contracts, which
8 we view as a boon to the industry and which we believe
9 has had a significant role to play in bringing the
10 industry to where it is today, the rail cost
11 adjustment factor, pro competitive regulatory actions
12 by the ICC in opening the PRB to competition, support
13 by both the ICC and this Agency for construction of
14 rail lines to create competitive access for captive
15 facilities.

16 As goals frustrated by Agency actions, we
17 would include the Midtec Decisions which, as others
18 have described, negated the pro competitive potential
19 of reciprocal switching and terminal area trackage
20 rights, the bottleneck cases, which deny captive
21 shippers the opportunity to rely on competitive forces
22 where available to obtain reasonable rates, paper

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1 barriers, which the Agency has refused to address to
2 date in a meaningful manner to limit their anti-
3 competitive effects.

4 In the current environment, competitive
5 gains have been reduced through rail mergers. The
6 situations where construction of trackage to create
7 competition could be undertaken at reasonable cost
8 have, to a large extent, been exhausted.

9 For coal shippers with the benefit of
10 competitive rail service, particularly in the west,
11 competition is diminishing under public pricing
12 initiatives and the duopoly behavior that coal
13 shippers express concern about in both the BN-Santa Fe
14 and the UP-SP mergers, and railroads are raising rates
15 on captive coal traffic dramatically.

16 As the Concerned Captive Coal Shippers
17 explain in detail, and I will not get into the detail
18 here, in their comments in 657, the goal of the
19 Staggers Act to provide a reasonable balance between
20 the interests of railroads and captive shippers in
21 national rail cases has not been fulfilled in recent
22 years.

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1 Service has been an increasing problem,
2 which is having major adverse effects on captive
3 shippers. Distressingly, it seems that the railroads
4 seem more intent on taking advantage of these
5 circumstances to increase rates than to take the steps
6 necessary to ensure adequate service.

7 The steps that the Concerned Captive Coal
8 Shippers believe should be taken at this juncture are
9 revisiting, through legislation or otherwise, Midtec
10 and the bottleneck cases to allow the pro competitive
11 policies of the Staggers Act to work through effective
12 reciprocal switching and an obligation to provide
13 rates over bottleneck rail segments, provide greater
14 balance and maximum rate making activities by the
15 Agency, whether in SAC cases or cases relying on
16 revenue adequacy principles, greater oversight by the
17 Agency on railroad service reliability and
18 encouragement by the Agency of competitive rail
19 circumstances and competitive railroad behavior in
20 every element of its responsibilities. Thank you very
21 much.

22 CHAIRMAN NOBER: Thank you, Mr. Loftus.

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1 Mr. English, welcome to the Board.

2 MR. ENGLISH: Thank you very much. I
3 appreciate that, Mr. Chairman and Commissioners. I am
4 Glen English. I am the Chief Executive Officer of the
5 National Rural Electrical Cooperative Association.
6 Some of you may not be familiar with what cooperatives
7 are in the electric utility industry, but we have
8 nearly 1,000 that are our members and they are not-
9 for-profit and they are actually owned by the
10 consumers themselves.

11 That number is approaching somewhere in
12 the neighborhood of 40 million consumers in 47 states
13 across this country, and certainly each and every one
14 of them have a big stake in the discussion today and
15 the actions of this particular Board, given the fact
16 that about 80 percent of all the electric power that
17 is generated by electric cooperatives is coal-fired
18 and much of the rest, of course, is gas power and, as
19 you heard Mr. McBride point out, that has become
20 extremely expensive today.

21 I want to take a little different
22 approach, if I could, Mr. Chairman. I noted that in

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1 your biographies, all three of you served time in the
2 United States Congress as staff people and while I was
3 also there as a Member of Congress, I thought maybe I
4 would appeal to you just a bit on some of the
5 experience that you had during those times.

6 If you recall, one of the great
7 frustrations staff people and members alike had was
8 when legislation passed in Congress, it wasn't always
9 implemented in the manner in which it was intended.
10 In fact, many times you wonder if a legislative
11 history ever got read by the people who are writing
12 the rules and regulations and carrying that out.

13 And while I don't believe any of you were
14 there when the Staggers Act passed, I was and I recall
15 the discussion and the debate that took place and,
16 certainly, I would be the first to say that the
17 circumstances have changed dramatically since that
18 time. This is a different time than during that
19 period.

20 I would say, however, that one thing that
21 needs to be underscored, a provision Staggers put in
22 and what he intended for captive shippers, for those

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1 people who could not take advantage of competition
2 that is very real today. It's our estimate roughly 20
3 percent of all shippers are captive shippers and they
4 are being taken advantage of and they are being abused
5 and they are being used to pay for competition where
6 competition exists.

7 Mr. Staggers intended that the Interstate
8 Commerce Commission and, subsequently, this Board make
9 sure that those captive shippers were protected and
10 that's what we hope, that you will look back at that
11 legislative history, maybe go back and read a little
12 of it and weigh the impact that the lack of action by
13 this Board will have in protection to captive shippers
14 and what that really means.

15 This winter we are going to have millions
16 of Americans that are going to have extremely high
17 electric bills and fuel costs and you can do something
18 to help bring a little fairness and equity to the
19 whole electric utility industry by addressing this
20 issue. Thank you very much.

21 CHAIRMAN NOBER: Well, thank you. Mr.
22 Nelson?

1 MR. NELSON: Chairman Nober, Vice Chairman
2 Buttrey, Commissioner Mulvey and Board staff, my name
3 is Mike Nelson. I am a transportation consultant and,
4 on behalf of Arkansas Electric Cooperative
5 Corporation, I would like to say thank you for this
6 opportunity to provide testimony regarding the
7 Staggers Act.

8 In the interest of brevity, I will agree
9 with the speakers who have gone before me regarding
10 the beneficial impacts of the Act for the railroads.
11 The big picture is good. Competitive forces have been
12 unleashed and have largely done what they were
13 supposed to.

14 In my written testimony, I get into some
15 minor detail regarding ways in which, in the wave of
16 mergers that created the current competitive
17 environment, we may have had some unintended losses of
18 competition along the way. On the technical side, the
19 methods used to analyze proposed mergers changed over
20 time and while it was good that we got more refined as
21 we went along, the other side of that is that some of
22 the earlier cases may not have been viewed with the

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1 same sensitivity to issues like crossover effects and
2 source competition.

3 On the flip side of that, early in the
4 merger process you had an environment where there were
5 still many Class I rail carriers and they frequently
6 perceived it to be in their interest to vigorously
7 pursue competitive issues in some of the earlier
8 cases. In some of the later cases, as the number of
9 non-included rail carriers went down, the atmosphere
10 became somewhat more fraternal and there was a
11 tendency for negotiated settlements rather than
12 litigation of competitive issues.

13 Overall, as a result of those factors and
14 other things in my written testimony, I think there
15 were opportunities for the past merger cases to have
16 sort of let slip through the cracks some elements of
17 competition that may not have been considered at all
18 in the record of the case or may certainly not have
19 been blessed by the Board as being an anticipated part
20 of the merger that was being approved.

21 Even the important three to two reduction
22 in the number of competitors that was controversial

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1 and subject to a lot of debate was ultimately approved
2 on the basis of an expectation that it would not
3 produce competitive harm. So whether or not the Board
4 decides to refine its procedures for regulating the
5 rail industry, there may be some situations from
6 things that have been done in the past where something
7 could be done to address competition that, in specific
8 situations, may have inadvertently been lost.

9 On the subject of whether there should be
10 a change in the Board's regulatory practices, I think
11 economic theory would suggest that if you get into a
12 mode of having super competitive earnings that you
13 would really expect to be attracting new entry and
14 additional competitors. In addition, I would
15 understand one of the intents of the Staggers Act to
16 be that, as the financial picture improved for the
17 railroads, that you might have less differential
18 pricing.

19 In deciding, however, when you're at the
20 point of possibly making a change in the regulatory
21 procedures, I'm concerned about the possible reliance
22 on a single measure, be it revenue adequacy or some

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1 other comparable measure. It's a natural feature of
2 competitive markets that not all competitors are going
3 to have the same returns.

4 If you have competitors who undertake bad
5 strategies or make mistakes in their decision making,
6 the function of the market is to punish competitors
7 who make choices like that, and I think we have had a
8 few cases where we have had significant service
9 problems in the rail industry that have resulted in
10 large part from that type of decision making.

11 So I would be more inclined to look at
12 specific events rather than individual measures alone
13 in terms of gauging when it's time to potentially
14 change the view of the role of the Board in regulating
15 the industry.

16 As I made reference to, you have
17 disruptive events from things like decisions as to
18 crew hiring practices and maintenance procedures. You
19 have actions by the remaining two carriers in the
20 public pricing area, and people have made reference to
21 the fuel surcharges where duopolists are starting to
22 move in parallel in ways that they have not in the

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1 past and in a way that's largely outside of the
2 Board's scrutiny.

3 There has been reference to the increasing
4 capacity constraints and demarketing issues.
5 Competition provides protection against all of those
6 things, so it would be reasonable for the Board to
7 conclude that the public interest might best be served
8 by sharpening competitive pressures.

9 CHAIRMAN NOBER: You can feel free to
10 summarize the rest of your testimony.

11 MR. NELSON: Okay. That is pretty much
12 it.

13 CHAIRMAN NOBER: Okay.

14 MR. NELSON: It would extend the view of
15 the role of competition that was originally embedded
16 in the Act.

17 CHAIRMAN NOBER: Thank you. Vice Chairman
18 Buttrey?

19 VICE CHAIRMAN BUTTREY: Not at this
20 moment.

21 CHAIRMAN NOBER: Commissioner Mulvey?

22 COMMISSIONER MULVEY: I want to assure

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1 Congressman English that we have a copy of the
2 legislative history of the Staggers Act, each one of
3 us here, so we --

4 MR. ENGLISH: If I could respond?

5 COMMISSIONER MULVEY: Yes.

6 MR. ENGLISH: You all have got to be very
7 rare Commissioners if you have a copy of the Act in
8 front of you and if you're really reading the
9 legislative history, I commend you.

10 VICE CHAIRMAN BUTTREY: And I also carry
11 a copy basically everywhere I go. I have three
12 documents on my desk and that's one of them.

13 MR. ENGLISH: Spoken like true former
14 staffers. Thank you very much.

15 VICE CHAIRMAN BUTTREY: I would take some
16 issue with your terminology of serving time in the
17 Congress.

18 MR. ENGLISH: Well, there are others that
19 have served time afterwards and all have just --

20 VICE CHAIRMAN BUTTREY: I don't want that
21 to be misinterpreted.

22 COMMISSIONER MULVEY: I think sometimes

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1 it's not a matter of the law not being followed, but
2 when the law is drafted, sometimes we're rushed and
3 sometimes don't always understand all the implications
4 of what we do.

5 I think, for example, with respect to the
6 common carrier obligation, I think many in Congress
7 are surprised to know that when they passed the
8 Interstate Commerce Termination Act that, in effect,
9 they may have compromised that obligation for many,
10 many shippers. So I know some in Congress are
11 surprised to hear that when I inform them of that.

12 I have a couple of questions. One of the
13 things that has been alleged is that some of the
14 electric utilities have, in fact, sold off a lot of
15 their stockpiles in order to take advantage of high
16 prices and that now, they are facing shortages because
17 of that action, as opposed to it being traced to the
18 inability of the railroads to deliver. Can anybody
19 comment on that allegation?

20 MR. RICHARDS: Sold it to who, how?

21 COMMISSIONER MULVEY: Hm?

22 MR. RICHARDS: Sold it to who and how?

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1 COMMISSIONER MULVEY: Put in the market,
2 I assume.

3 MR. RICHARDS: No. Well, as a utility
4 you're buying coal under your contract to deliver in
5 part.

6 COMMISSIONER MULVEY: Or sold the
7 contracts, I guess.

8 MR. RICHARDS: Pardon?

9 COMMISSIONER MULVEY: I guess the
10 contracts were sold or whatever.

11 MR. RICHARDS: I'm not -- I'm really not
12 familiar with any of those. I mean, we have an
13 obligation to serve to our customers and to meet that
14 obligation, we have to utilize the coal that we have
15 under our contracts and deliver it. I'm not aware of
16 that.

17 COMMISSIONER MULVEY: Okay.

18 MR. LINDERMAN: Commissioner Mulvey, I am
19 not aware of that either, and there are some practical
20 difficulties with even doing that, because most coal
21 plants don't have the ability to reload a train or a
22 truck to take coal off-site. And once you have got

1 the coal on-site, you use it to generate and that is
2 the purpose of that fuel supply that has been brought
3 there.

4 If you were going to sell off-site, you
5 might generate more power at a given power plant and
6 put the power up on the grid and use the electric
7 transportation system as a way in which to move the
8 power, but that again becomes a matter of what either
9 the local grid operator or the independent system
10 operator decides to -- how they decide to have the
11 plants run.

12 UNIDENTIFIED SPEAKER: Based on economics.

13 MR. McBRIDE: And, Commissioner Mulvey, I
14 represent several electric utilities who have had coal
15 stockpile problems for the last few years, and not a
16 single one of them has done what you said. The
17 opposite problem has been true. They have had coal
18 stockpiles reduced to a matter of days. I had a
19 utility in the east last winter that was down as low
20 as six days worth of coal.

21 I had another that routinely tries for 50
22 days, was down to 20 days before the worst of the

1 winter hit. The same thing with changes in the number
2 of days with the same picture has generally been true,
3 in my experience, across the country. And people have
4 been trying to get more coal.

5 There have been problems at the mines,
6 too. This is not just solely a rail issue. I have
7 told the Chairman that and I think the Board could be
8 helpful there as well. Some of the mines seem to
9 think that it's up to the railroads to build storage
10 track on the mine property. It isn't. It's up to
11 them just like it's up to us to build a storage track
12 on our property.

13 The mines could be more helpful, so this
14 is not just a rail issue, but the utilities are trying
15 to get all the coal they can right now. Nobody is
16 selling it. They are buying it.

17 COMMISSIONER MULVEY: Yes. My
18 understanding is about half the shortfall of the PRB
19 is due to mine operation problems and about half due
20 to rail transportation problems.

21 We spoke recently with a major coal
22 producer and they are very, very concerned about the

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1 long-term and short-term availability over the winter
2 months, the availability of coal out of the Powder
3 River Basin. And, of course, everyone is looking to
4 the Board to finalize its opinion on the EIS for the
5 DM&E. My concern is that the DME is going to have
6 difficulty in getting financing unless the utilities
7 are willing to sign up for it.

8 Is it your understanding that there are a
9 number of utilities that will be willing to contract
10 with DM&E, so that they can actually get the financing
11 they need to go ahead?

12 CHAIRMAN NOBER: I assume in the
13 hypothetical that we approve.

14 COMMISSIONER MULVEY: In the hypothetical
15 that it gets approved.

16 CHAIRMAN NOBER: Because it's a pending
17 case.

18 MR. McBRIDE: Hypothetically.

19 COMMISSIONER MULVEY: It's a pending case,
20 yes.

21 MR. McBRIDE: Hypothetically, if you
22 approve it, I think the issue will come down to a

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1 simple one and that is will CSX and NS make capacity
2 available for DM&E-originated coal to reach plants
3 served by those two railroads. I think it's
4 unrealistic to expect UP and BN to compete with
5 themselves, if you will, and make such capacity
6 available.

7 So the key to this is going to be whether
8 DM&E can get the coal to the power plants, because
9 there are relatively few on its system, and there are
10 many people in discussions right now with DM&E and
11 otherwise to try to solve that kind of problem. But
12 it's hard to contract with somebody who can't get the
13 coal to you, so you need the participation of the
14 carriers who deliver the coal.

15 COMMISSIONER MULVEY: Thank you.

16 CHAIRMAN NOBER: Well, let me ask a
17 slightly different question. I know many of you at
18 this table are concerned about rates and there is no
19 subject I have probably heard more about in my three
20 years here than coal rates.

21 Do you think that the -- or at least the
22 methodology by which the Board determines the maximum

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1 reasonable rate for coal would change if railroads
2 were found to be revenue adequate and, if so, how
3 would you see it change?

4 MR. LOFTUS: If I might take a shot at
5 that. I think the coal rate guidelines, of course,
6 identify four constraints and this Board has only
7 dealt with one, stand alone costs. Revenue adequacy
8 is identified as a constraint and although it's not
9 fleshed out in detail, the guidelines certainly
10 suggest that there should be new limits imposed on the
11 extent of differential pricing on captive traffic for
12 a revenue adequate carrier.

13 And the clearest situation where that
14 would come into play, it would seem, is a rate
15 increase. If a carrier is revenue adequate, and we
16 recognize that is not a snapshot analysis, if the
17 carrier is revenue adequate, it got there with the
18 rates on that traffic at the level they were prior to
19 the increase that the carrier seeks to obtain on that
20 traffic.

21 And so in those circumstances, certainly,
22 you need to take a hard look. One of the things that

1 has hung captive coal shippers in recent rate cases
2 before this Board has been a very stringent burden of
3 proof in a very complicated case scenario, and
4 certainly you could look at imposing a burden of proof
5 on the railroad in those circumstances if it wants to
6 seek a greater degree of differential pricing on a
7 captive movement as a revenue adequate carrier.

8 MR. CROWLEY: May I just add to what Mr
9 Loftus was saying? It was a number of years ago when
10 CFI Industries versus Georgia Pipeline came before the
11 Interstate Commerce Commission and offered evidence on
12 the revenue adequacy constraint and the maximum rate
13 was determined using those guidelines. So there is
14 information available.

15 CHAIRMAN NOBER: Believe it or not, the
16 case is still here.

17 MR. CROWLEY: Well, not that part of the
18 case.

19 CHAIRMAN NOBER: Cases, they never die.
20 They just sort of fade away or just stay here forever.

21 MR. CROWLEY: But there is some guidance
22 available as to how to implement that standard.

1 CHAIRMAN NOBER: But the question is
2 should it be implemented, because I guess the follow-
3 up is what is a fair contribution from captive
4 shippers in world where railroads are financially
5 healthy?

6 MR. MCBRIDE: Mr. Chairman, the answer to
7 your first question is absolutely yes, because the ICC
8 promised us 20 years ago that the revenue adequacy
9 constraint would be implemented when the railroads got
10 there. I am not going to go over the same ground Mr.
11 Loftus did on rate increases, but I absolutely agree
12 with him.

13 But now let's look at the issue from the
14 perspective of the carriers. They are going to say we
15 need rate freedom and you can't take that away from
16 us. Well, here is where the Board really could be
17 focused and maybe address the problem. I was looking
18 at data again yesterday from the Public Waybill Sample
19 File, data of this Agency, and consistently over the
20 last 10 to 20 years about 15 to 20 percent of rail
21 traffic appears to be below 100 percent of variable
22 cost.

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1 That was true as of the latest data that
2 is available in 2002 and 2003. Now, either the data
3 is wrong or railroad rate making practices are wrong,
4 and we shouldn't be subsidizing that traffic any
5 longer when there are capacity constraints. It is
6 literally crazy to be carrying traffic in a capacity-
7 constrained environment below the actual variable cost
8 of that traffic.

9 So the first step of Long-Cannon is to
10 find out why that is happening, if it is happening,
11 and if it isn't happening, correct the data. The
12 second thing to do --

13 CHAIRMAN NOBER: Hopefully, the carriers
14 can address that after lunch.

15 MR. MCBRIDE: Well, okay, good. I would
16 love to hear the answer to it because, for example,
17 they claim intermodal traffic is much more profitable
18 today than it used to be, but we never see the data.

19 Now, the second thing in Long-Cannon is
20 the traffic between 100 and 180 percent of variable
21 cost. Again you have to ask yourself in a capacity-
22 constrained environment, why can't we move coal? Why

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1 can't the chemical companies move chemicals? Why
2 can't the grain people move grain? And, instead,
3 we're moving traffic that is below average
4 profitability.

5 It's crazy and that's where the Board
6 could really be focused instead of saying you need to
7 be able to raise rail rates on captive traffic still
8 higher. You don't. In a revenue adequate
9 environment, you should be focused instead on
10 maximizing profitability and this goes to your
11 question, Commissioner Mulvey, about the common
12 carrier obligation. It still exists.

13 The railroads have to carry everything,
14 except gold and silver bullion and money because of
15 the decisions of this Board, all right, because of
16 Jesse James. But everything else is entitled to a
17 rate, but the railroads can set any rate. Those are
18 the words of the statute on that traffic, subject only
19 to review by this Board.

20 So there is absolutely no reason, for
21 example, why lines of railroad in this country that
22 carry largely deregulated traffic have demand

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1 exceeding capacity, such as was the reference to the
2 Sunset Line in a letter to the Board this summer.
3 Unless the rates are not set at a level adequate to
4 get the return, that that traffic ought to be
5 provided. That's where your focus really could be.
6 Why is this extreme cross-subsidy still going on?

7 CHAIRMAN NOBER: Vice Chairman Buttrey?

8 VICE CHAIRMAN BUTTREY: To anyone on the
9 panel. Is it true that there is an inverse
10 relationship between the ton-mile and revenue for
11 intermodal traffic and for coal? I didn't mean to
12 make it that hard.

13 MR. CROWLEY: That would suggest that,
14 well, the ton-mile --

15 VICE CHAIRMAN BUTTREY: Intermodal traffic
16 weighs less and pays more.

17 MR. CROWLEY: Yes.

18 VICE CHAIRMAN BUTTREY: And coal weighs
19 more and pays less. Is that true or not?

20 MR. CROWLEY: Yes.

21 VICE CHAIRMAN BUTTREY: That's true?

22 MR. CROWLEY: I would say that's a true

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1 statement.

2 VICE CHAIRMAN BUTTREY: Okay. Wouldn't it
3 seem logical that something that's tearing up your
4 railroad would be charged more?

5 MR. CROWLEY: Well, it's being charged.
6 I assume you're talking about the coal now.

7 VICE CHAIRMAN BUTTREY: I'm talking about
8 the coal.

9 MR. CROWLEY: It's paying rates that cover
10 all of its costs for tearing up the road, as you put
11 it. I mean, all of the costs that are included below
12 that rate level are being covered and then some. The
13 contribution is what you need to look at, not what the
14 rate of the costs are, but how much money is that
15 contributing. That was the focus of the chart I tried
16 to explain earlier this morning.

17 Coal is paying its share and then some.
18 I think that's the message you want to take away, and
19 I think if you looked at intermodal fairly, it
20 wouldn't be paying its way. I don't think it's making
21 a contribution. I know it's not making the
22 contributions that coal is. I'm not sure it's making

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1 any contribution in total.

2 CHAIRMAN NOBER: Interesting. Frank?

3 COMMISSIONER MULVEY: Well, presuming the
4 railroads are that irrational, and that is
5 presumption, why would you carry something if you
6 can't cover your variable cost?

7 Obviously, one of the first laws of
8 economics is that you never price below variable cost
9 unless, of course, you have entered into some sort of
10 long-term agreement, which doesn't allow you to raise
11 rates as your costs go up. And that is getting back
12 to the contracting issue, which I believe everybody
13 has said here, that you have to have long-term
14 contracts in the utilities industry in order to sell
15 the utility bonds and build the utility plants.

16 So, on the one hand, we need the long-term
17 contracts but on the other hand, there's certainly
18 cases where these long-term contracts have frustrated
19 the ability of the railroads to raise rates in
20 response to increase in demand and causing this
21 problem.

22 MR. RICHARDS: Commissioner Mulvey, the

1 long-term contracts were in place when the railroads
2 believed that the rates were going down as they had in
3 the past. And now that they believe the rates are
4 going up in the future, they want shorter term
5 contracts. It's really that simple.

6 MR. McBRIDE: And Commissioner Mulvey --

7 COMMISSIONER MULVEY: Well, we're talking
8 here more about intermodal movements and others, as
9 opposed to the coal --

10 MR. RICHARDS: I was referring to coal
11 history.

12 COMMISSIONER MULVEY: Okay.

13 MR. McBRIDE: There are two responses, I
14 think, to your question. Why would they carry traffic
15 below 100 percent of their variable cost?

16 The first answer you put your finger on.
17 There apparently are historic contracts that are below
18 100 percent of variable cost. Those should not be the
19 responsibility of the shippers, the captive shippers
20 on other parts of the system. Consistent with your
21 stand alone cost model, we should be responsible for
22 the parts of the system we use not the parts we don't.

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1 And the second answer to your question is,
2 unfortunately, about 20 years ago the ICC addressed
3 this issue in Ex Parte 355 on the subject of directly
4 variable cost, and concluded that it was all right in
5 an excess capacity environment for railroads to be
6 carrying traffic above their directly variable cost,
7 but below their total variable cost.

8 I would submit to you that is a policy
9 that ought to be relooked at and reconsidered in light
10 of the capacity constraints that we're now
11 experiencing.

12 MR. LOFTUS: And if I might add to that,
13 Commissioner Mulvey. The costs that are used for
14 regulatory purposes are not necessarily the costs that
15 guide the railroads' business decisions and, in fact,
16 this Board has refused to look into the books that the
17 railroads keep for making their own pricing decisions.

18 They have been very clear that they don't
19 price on regulatory costs. They have internal
20 management costs and those are probably significantly
21 lower than the variable costs that you would get for
22 regulatory purposes.

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1 COMMISSIONER MULVEY: But directly
2 variable costs, you're referring to what is normally
3 considered to be, approximately, marginal costs,
4 right?

5 MR. McBRIDE: No, I --

6 MR. LOFTUS: I think it's below that.

7 MR. McBRIDE: I think it's even below
8 that.

9 COMMISSIONER MULVEY: Below marginal
10 costs?

11 MR. McBRIDE: I think, and Mr. Crowley may
12 recall, but I think there were just a few categories
13 of cost, such as fuel cost, labor cost and some
14 maintenance.

15 MR. CROWLEY: Yes, line haul cost deleting
16 and clerical, but I think the --

17 COMMISSIONER MULVEY: It's close to
18 marginal cost, but --

19 MR. CROWLEY: Close to marginal cost, yes.
20 I think the answer is what both Mr. McBride and Mr.
21 Loftus were talking about. It's the level of cost
22 that we're talking about that goes into the railroads'

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1 decision as to whether or not to take the traffic. Is
2 that cost level the same as the level of cost you use
3 in evaluating that traffic? And I think the answer to
4 that is no, it is not, it's different. How do we get
5 those two cost measures in line?

6 COMMISSIONER MULVEY: One other question,
7 and that is with regard to the stand alone cost
8 process that we use for evaluating large rate cases,
9 it has been charged that the eastern utilities cannot
10 win a rate case today. Western utilities have some
11 chance.

12 Would you care to comment on the
13 difference between the eastern and western situations
14 and why the eastern utilities would be at a
15 disadvantage given our procedures?

16 MR. CROWLEY: I would love to. How much
17 time do you have?

18 COMMISSIONER MULVEY: You have two
19 minutes.

20 MR. CROWLEY: There seems to be a
21 perception in this Agency that when you move coal in
22 the east, it's different than when you move coal in

1 the west. There seems to be a perception that a
2 trainload or a unit train of coal moving in the east
3 somehow moves differently than it does in the west.

4 Now, I admit that the geography is
5 somewhat different in the east and it's more
6 mountainous and hillier, but set that aside for a
7 moment and everything else is basically the same.
8 Now, why that translates into such high stand alone
9 costs in the east as compared to the west is --

10 CHAIRMAN NOBER: Well, there is one
11 difference and this is something that we grappled
12 with, I grappled with in the eastern cases, which is
13 in the west coal is sourced from one place and then
14 distributed out through the network. In the east it's
15 sourced from many places and then funneled into the
16 one plant.

17 So the stand alone cost, rightly or
18 wrongly, makes you take into account all the fingers
19 sourcing the coal. Whereas, in the west, you know,
20 you only have to look at the one line from origin to
21 destination. That I think would be the one amendment
22 I would make to your point.

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1 MR. CROWLEY: Well, I would disagree with
2 that as well. I think that the evidence that was
3 presented in the eastern cases showed very clearly
4 that coal originated, trainload coal originated at
5 trainload tipples and that was the traffic, the base
6 of the traffic that was moved. There was --

7 CHAIRMAN NOBER: But there were 40 of
8 them.

9 MR. CROWLEY: Pardon me?

10 CHAIRMAN NOBER: There were 40 of them.

11 MR. CROWLEY: 40 trainload movements?

12 CHAIRMAN NOBER: No, 40 origination
13 points.

14 MR. CROWLEY: There were a number of them,
15 but they were all trainload originations.

16 CHAIRMAN NOBER: I think it was something
17 like 40, if I recall, in all three, as opposed to one
18 in the PRB. Now, that's one, you know, with triple
19 track.

20 MR. CROWLEY: But the economics --

21 CHAIRMAN NOBER: I'm not here to argue.

22 MR. CROWLEY: No, I understand.

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1 CHAIRMAN NOBER: I just think that is a
2 difference.

3 MR. CROWLEY: But I am here to argue. The
4 economics of coal are such that it doesn't make any
5 difference where all the coal is. It's that train and
6 how that train efficiently moves from origin to
7 destination.

8 CHAIRMAN NOBER: Correct. But if the SAC
9 test makes you have to build the infrastructure for
10 the 40 different mines, that's why in eastern --
11 that's the answer to Frank's question.

12 MR. CROWLEY: Yes. Okay. I thought you
13 were talking about a gathering problem versus a
14 trainload.

15 CHAIRMAN NOBER: No, it's that you have to
16 build all 40 origination points through the mountains
17 of Appalachia.

18 COMMISSIONER MULVEY: You have to model
19 that.

20 CHAIRMAN NOBER: And not --

21 MR. CROWLEY: Absolutely.

22 CHAIRMAN NOBER: And it was --

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1 COMMISSIONER MULVEY: And that's the
2 difference between the two.

3 CHAIRMAN NOBER: No, but that's the
4 difficulty. You can't get the density on the line
5 that you get coming out of the joint line, right?

6 COMMISSIONER MULVEY: And my question was
7 whether or not there was any way of addressing that,
8 any way of adjusting our processes so we can get
9 around those kinds of problems and make it more
10 comparable across the country. That's where I was
11 trying to go with that.

12 MR. CROWLEY: Well, I think it's more the
13 amount of investment and the amount of operating costs
14 that came out of those decisions when compared to
15 those same two metrics out of the western cases. To
16 buy a ton of steel or to buy a tie or to buy a ton of
17 ballast costs the same in the east and the west, and
18 we were seeing unit costs at any measure for any
19 component of this infrastructure considerably higher
20 in the east than the west, which was something that
21 confused us.

22 MR. LOFTUS: Commissioner Mulvey, if I

1 might add, in the eastern cases the Board accepted
2 operating plans in each of them that were grossly less
3 efficient than the operations in place today for those
4 carriers.

5 You will recall that the gathering
6 operations that Norfolk Southern and CSX sponsored in
7 those cases has multiple -- very short trains for
8 multiple car movements moving from individual loading
9 points to the gathering yards. SAC analysis is
10 supposed to be a least cost, most efficient analysis,
11 and the operating plans accepted -- I understand, you
12 know, why you defaulted to those.

13 COMMISSIONER MULVEY: I wasn't here then.

14 MR. LOFTUS: Oh, I'm sorry. I didn't mean
15 to tar you with that. But the point is that --

16 CHAIRMAN NOBER: Tar is a strong word.

17 MR. LOFTUS: -- those operating plans
18 could have been corrected, so that they were at least
19 as efficient as the carriers' operations, but they
20 weren't.

21 And so it's one of those rare situations
22 where you don't -- in that contested area of the case,

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1 which drove a large part of the costs and a large part
2 of the investment costs for the stand alone railroad,
3 the operation that was used to model it was less
4 efficient than actual. And so I would not accept the
5 proposition that you cannot, under stand alone cost,
6 have a winning case in the east.

7 CHAIRMAN NOBER: Okay. It's more
8 difficult.

9 MR. LOFTUS: It is more difficult.

10 CHAIRMAN NOBER: Is that fair?

11 MR. LOFTUS: Yes.

12 CHAIRMAN NOBER: Vice Chairman?

13 VICE CHAIRMAN BUTTREY: Just an
14 observation. There was a suggestion made earlier
15 that, somehow, the information about what is happening
16 on the Powder River Basin is not readily available.
17 That may be true in terms of filing reports or
18 information or whatever.

19 I would observe that the two carriers
20 serving the Powder River Basin have been very
21 forthcoming with the Board about information about
22 what is happening out there and why, their view of

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1 why, and there is no shortage of information to this
2 Board anyway or to this Commissioner, and I presume to
3 the others, about information about what is actually
4 happening out there and what we think the reasons are
5 for that happening.

6 So just to clear that up from my
7 perspective anyway, there has been volunteer
8 information coming in regularly about what's happening
9 out there.

10 The other observation is about setting
11 aside the geography or whatever in terms of a SAC
12 analysis or whatever, sort of like the doctor who
13 tells his patient he has cancer, but he has a cure for
14 that and it involves surgery, which may kill you. But
15 setting that aside, we do have a cure. I don't think
16 you can set those things aside. I think those are
17 very real considerations.

18 CHAIRMAN NOBER: Thank you.

19 MR. McBRIDE: May I just respond briefly,
20 Mr. Vice Chairman?

21 VICE CHAIRMAN BUTTREY: Yes, sir.

22 MR. McBRIDE: Because it was me who, it

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1 was I who, suggested that the Board did something
2 useful by asking for that coal loading information
3 several years ago. And I agree with you. We can find
4 out from UP & BN how many coal trains they are loading
5 in the Basin. But when I ask the question or when you
6 ask the question, it's a great deal of difference.
7 And I wasn't just confining myself to the west. I'm
8 also speaking to the east.

9 And the point is that the active
10 observation of a regulated entity by the regulator
11 often alters its behavior. Now, if the Board simply
12 signals what its greatest concerns are to the
13 carriers, that may cause a change in behavior.

14 CHAIRMAN NOBER: Well, to follow-up on
15 Doug's point, a group of utility executives came and
16 met with me in the early part of the summer and
17 expressed concern about the PRB and as a result of
18 that, we did ask for weekly calls and updates with the
19 two western carriers and have been getting that,
20 including having their -- you know, talking to their
21 senior managers and several people in the audience
22 several times about it as well as Mel's shop, talking

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1 to them, I think, on a weekly basis.

2 So we have been doing it. And
3 particularly, when shippers ask, I can't think of a
4 single instance when shippers have asked us to do
5 something like that that we have not. So, you know,
6 I believe strongly in doing it. So I think we already
7 have. We don't necessarily publicize it. But the
8 same with some of the metrics that came up, you know,
9 I spent a long time with the carriers this spring
10 trying to get them to revise their metrics. Some of
11 the voluntary changes made in metrics, somewhat
12 unhappily, but I think ultimately they all came around
13 to some measure.

14 MR. McBRIDE: Well, let me share with your
15 colleagues what I said to you privately when we last
16 met, which was that in addition to the act of sort of
17 getting that sort of information from the railroads,
18 and I do regret your departure, Mr. Chairman, and
19 that's why I want to make sure they know what I shared
20 with you, which is I think this Board could provide a
21 great service in contacting the mining industry and
22 finding out why we're having these loading problems in

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1 the Basin as well.

2 And why they don't consider it their
3 responsibility to build adequate storage tracks, so
4 that when there is a spot in the queue, they have got
5 a coal train ready to load. And why they are not
6 better able to deliver the coal that the utilities
7 have under contract. This is a three part problem
8 between the utilities, coal mines and the railroads.
9 And we need the mines to understand what our needs are
10 just as much as the railroads.

11 CHAIRMAN NOBER: Well, let me just make a
12 final point, which is part question, part point, which
13 is, you know, on the one hand we hear the very
14 legitimate concerns of utilities about the increase in
15 coal rates and the impact that that's having on
16 customers and it's hard, you know. As regulators, we
17 have to be sympathetic to those kinds of concerns.

18 On the other hand, we heard the concerns
19 that Mr. Linderman raised, and we've heard from
20 several other sources about how are we going to meet
21 the increase in demand for coal movements, east and
22 west? And unfortunately, do you think that acting in

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1 Things have changed. But the policies and
2 the actions and the methods in which the,
3 particularly, captive shipper situation is being dealt
4 with is much like it was in the 1980s. And what I'm
5 suggesting is now is the time to go back and look at
6 the intent of the law and balance this out a bit and
7 look at the possibility of shipping some policies to
8 deal more with the reality as it exists today as
9 opposed to where we were 20 years ago.

10 MR. RICHARDS: Well, I think the policy of
11 increasing competition is where we need to look at.
12 It has been the success on the part of the Basin, you
13 know, where we have had the competition, we have had
14 two carriers, we had the rates that have provided the
15 investment that they needed, you know, in the Basin.
16 So I think as long as the policies move towards
17 increasing competition, whether it is bottleneck or
18 whatever, you know, I think there is advantages. The
19 more we can reduce the number of captive shippers, I
20 think the healthier we'll have the industry.

21 We, obviously, rely, the three of us, the
22 producers and the utilities and the railroads, we all

1 depend upon each other to be healthy. We don't have
2 any interest in not having a healthy industry of all
3 the parties. But competition has been successful.

4 MR. LOFTUS: I would just add briefly
5 that, you know, I think, our clients would want us to
6 say that it is critical that the railroads have the
7 capability to provide transportation services they
8 rely upon to get the coal they need to run their
9 plants. You know, there has been a lot of talk about
10 constraints, but I'm not aware of any well-documented
11 analysis as to where those constraints are and how
12 much it would cost to fix them, what cars are
13 effected, etcetera.

14 But the other thing I would add is, you
15 know, how many coal rate cases have you really had in
16 the last 25 years? I would suggest to you it's not
17 that many.

18 CHAIRMAN NOBER: Relatively few.

19 MR. LOFTUS: Relatively few. And, you
20 know, particularly, in an era where you could contract
21 with the railroads where they were responsive to
22 individual companies concerns and wanted to meet

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1 those, you know, they were able to work out and work
2 their way around a lot of those things.

3 CHAIRMAN NOBER: Well, if you look at the
4 case file, I know you do since you are involved in
5 many of them, I mean, it was typically one a year or
6 so for many years and then we had a spate of 8 or 10
7 in a one or two year span and then it's dropped off to
8 basically one a year again. So, I mean, what has
9 happened the last couple of years, I know is well-
10 documented that shippers are concerned about this are
11 more in line with historical rate filing paces than it
12 has been in the past. Maybe not. Mr. English?

13 MR. ENGLISH: I would also point out, Mr.
14 Chairman, it's -- for a smaller shipper, this is a
15 very expensive proposition.

16 CHAIRMAN NOBER: Yes.

17 MR. ENGLISH: You bring a case here,
18 you're talking about \$3 to \$5 million and you're
19 talking about two years. And I know many of our
20 members who have had grievances have been reluctant to
21 bring them, just simply because of the fact two years
22 from now what difference is it going to make? And so

1 there is a timeliness and a cost factor that is
2 involved here. There ought to be some way that this
3 can be expedited and those with grievances feel more
4 welcome to bring those grievances forward and can do
5 so without such a huge expense.

6 COMMISSIONER MULVEY: One last thing.
7 Could you go back to slide 2, Mr. Crowley? Well, if
8 not, if it's difficult --

9 MR. CROWLEY: No.

10 COMMISSIONER MULVEY: Whoops.

11 MR. CROWLEY: This is the operating
12 revenue?

13 COMMISSIONER MULVEY: Yes, that's the one.
14 Go back to that one. Not that one, the other one.
15 The second slide. That's it.

16 MR. CROWLEY: That one?

17 COMMISSIONER MULVEY: Yes. Just looking
18 at that revenue per ton-mile and variable cost per
19 ton-mile. It appears as though the differences is
20 narrowing and that the operating ratio seems to be
21 worsening. Is that what your slide is suggesting?

22 MR. CROWLEY: No, no. This is just a

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1 subset of traffic. This is just Western Coal traffic.

2 COMMISSIONER MULVEY: Oh, it's just
3 Western Coal, okay. I see. Okay. Thank you. That
4 was my question.

5 CHAIRMAN NOBER: Thank you. Well, again,
6 thank you all very much. I know we face some of the
7 most difficult issues of all in dealing with coal
8 customers and I wish I could say in my tenure that we
9 have been perfect in how we have implemented or we
10 tried very hard, I can tell you that. And again,
11 thank you for your thoughts.

12 UNIDENTIFIED SPEAKER: Thank you.

13 CHAIRMAN NOBER: And we'll move on to the
14 next panel, which is again some well-known individuals
15 to the Board. James Brunkenhoefer, Jim Stem and Dan
16 Elliott from the United Transportation Union and
17 Mitchell Kraus from the TCU. Gentlemen? Take one of
18 the comfortable chairs.

19 MR. STEM: I give my time to my boss, Mr.
20 Chairman.

21 UNIDENTIFIED SPEAKER: The two mouth
22 pieces want to go first.

1 CHAIRMAN NOBER: Okay. Mr. Kraus, you are
2 to my left, so you draw short straw.

3 MR. KRAUS: Yes, I did. I got the short
4 straw. I should say good afternoon, Chairman Nober
5 and the other Commissioners. I'm Mitch Kraus. I'm
6 general counsel for the Transportation Communications
7 Union and I'm here today to speak on behalf of a group
8 that has not prospered as a result of the Staggers or
9 at least as a result of the Staggers as interpreted by
10 the ICC and then subsequently this Board.

11 The result from the perspective waiver of
12 Staggers has been a reduction in jobs, short line
13 sales and for those shots remaining as short line
14 carriers in many instances a reduction in
15 compensation. These transactions were justified under
16 a carefully devised legal fiction that characterized
17 these short lines as being sales involving non-
18 carriers. Notwithstanding that an overwhelming
19 majority of short line purchasers have been fully
20 owned subsidiaries with carrier corporations and
21 numerous short lines.

22 These transactions do not involve labors

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1 of the industry. They are certainly being made by --
2 not being made by small corporations. These are not
3 the so-called mom and pop types of businesses. While
4 capital has been transferred from the short line
5 purchasers to the Class I railroads, these
6 transactions have not necessarily resulted in
7 meaningful investment in upgrading the purchase lines.

8 The numbers of jobs have been
9 significantly reduced as a result and those losing
10 employment that entirely now receive only limited
11 separation pay. Generally, as I said, salaries for
12 those remaining employees has also been reduced. All
13 of this has been able to be done by avoiding the
14 protective benefits and regime that was part of the
15 statute and part of what had heretofore been the
16 precedent that the Board had established regarding
17 protective benefits for employees.

18 What I wanted to do today, all of this is
19 history that has been set forth in 20 years of
20 decisions and there is no need really for me to go
21 into any detailed review and the Board is certainly
22 well aware of it, principally, was to raise certain

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1 questions that I think the Board ought to be focusing
2 on for the future. And one would be whether it is
3 equitable to continue this process of short line
4 transactions when the big losers are the employees and
5 the gainers seem to be the Class I railroads, which,
6 as prior speakers have all indicated and as we're well
7 aware, are enjoying record profits.

8 Second, whether the highly profitable
9 Class I railroads with responsibility to serve the
10 public welfare should be able to continue to engage in
11 the wholesale of abandonment of their rail systems.
12 And finally, whether short line subsidiaries of large
13 corporations should be permitted to buy tracks without
14 any responsibility to invest in upgrading it and
15 whether the Class I seller can sell these tracks
16 ending their responsibility for upkeep.

17 We think any fair assessment going into
18 the future should include these factors and most
19 particularly, obviously, our concern is the effect on
20 employees and the loss of protection as a result of
21 these transactions. Thank you very much.

22 CHAIRMAN NOBER: Thank you. Mr. Elliott?

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1 MR. ELLIOTT: Chairman Nober, Vice
2 Chairman Buttrey and Commissioner Mulvey, thank you
3 for the opportunity to speak. I'm going to put aside
4 what I planned on saying, because I don't want to be
5 entirely redundant and you've already read the
6 testimony. I'm here, obviously, on behalf of the
7 United Transportation Union. Also, another reason I
8 want to keep it short is because I wanted to allow Mr.
9 Brunkenhoefer, who is much more entertaining than me,
10 to speak.

11 CHAIRMAN NOBER: He's more entertaining
12 than everyone.

13 MR. ELLIOTT: Yes, exactly. And I think
14 the audience will appreciate that. Just a couple of
15 quick notes and with respect to the Staggers Act
16 itself, obviously, the United Transportation Union is
17 appreciative of what it did for the rail industry by
18 taking it basically from the brink of disaster up unto
19 what has been stated today as being healthy for the
20 first time in quite some time.

21 However, what labor wanted to point out,
22 obviously, I'm not an economist, but I just wanted to

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1 point out that some of these gains were achieved on
2 the backs of labor. Obviously, the number of
3 employees in rail labor have decreased significantly
4 over the past 25 years. That is, obviously, a grave
5 concern for the United Transportation Union and its
6 members, who have suffered dearly as a result of that.

7 Also, along those same lines, during this
8 time period, obviously, there have been, as Mr. Kraus
9 mentioned, numerous line sales, short line sales,
10 branch lines resulting in the short lines and the
11 regional railroads and, obviously, that was done
12 originally under Section 10901 and I'm not going to
13 bore you, because a lot of that argument has been
14 changed as a result of the ICC Termination Act.

15 But the frustration still remains with
16 labor. I constantly receive phone calls regarding
17 these line sales. It's very upsetting. I mean, in
18 the early days the explanation was that this was done
19 based on the Staggers Act with a tenuous
20 interpretation, I say at best, of Section 10901
21 resulting in these line sales and the elimination of
22 job protection. It was very difficult to explain to

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1 our members that result.

2 And what we were pointing towards,
3 obviously, is there has been some distrust as a result
4 of those decisions and views of the legislative scheme
5 in that manner. What we would like to do is just be
6 more engaged in the process and not to feel blindsided
7 down the road. As a result, we're just here to make
8 that point clear, because without the operating
9 employees and the other employees, these trains would
10 not operate.

11 And now, I will turn it over to -- oh, I'm
12 sorry, I did that last time. I'm finished.

13 CHAIRMAN NOBER: Mr. Brunkenhoefer?

14 MR. BRUNKENHOEFER: I'm James
15 Brunkenhoefer. My nickname is Broken Rail. I work
16 for the United Transportation -- member for the United
17 Transportation Union. I have been told by some I'm
18 the most important guy in the room, because this is
19 Washington and I have the biggest PAC. Based on that,
20 I'm going to talk about what nobody else in the room
21 wants to talk about, which is the big elephant in the
22 room, which is politics.

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1 My cohorts here are exactly right. We
2 made a deal railroads came to us in the late '70s and
3 said we're all going to drown together. Help us. So
4 we formed a partnership, poured a lot of our
5 membership's money into saving the industry. We had
6 600,000-something people in the industry then. We are
7 down to about 200,000 now and the promise that was
8 made to us was we would have more jobs and we would
9 have more secure jobs.

10 These nice gentlemen have just told you
11 how secure those jobs are. And it has been the
12 actions by your predecessors that has allowed this
13 game to go on about short lines and about protections.
14 Now, what the result of that has been has been a
15 transference of wealth from our hip pockets into the
16 dividends and the bonuses of others, all in the name
17 of efficiency and deregulation.

18 What that has spilled over to in politics
19 is what these gentlemen have told you is about a lack
20 of trust. When the railroads now come to us and say
21 let's work together to help this industry, we tell
22 them to go take a hike or go to someplace hot that

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1 rhymes with swell and it's not Arizona, because of
2 what this Board did to break that trust in line sales,
3 because what this Board did and using excuses and
4 shams to talk about line sales and talk about
5 releases.

6 So because we got burned so badly after 25
7 years, we can barely have a relationship that is very
8 important to the industry as a whole. The politics of
9 reality is that in the political game, we're worth
10 about 200 votes in the House every day, any day of the
11 week. So everybody else in the industry has got to
12 start off and get 218 out of the 235 that's left,
13 because we don't think we can make a deal any more,
14 because after the deal is made, those that we trusted
15 to keep the deal, which is a regulatory body, didn't.

16 Now, so I don't know how many victories
17 they got out of line sales and out of leases. It's
18 that, I think that there is an economic thing that my
19 economist friend would tell you it's called there is
20 a cost of lost opportunity. So there's a lot of
21 things we didn't do together that we could have done
22 together in partnership, because we had lacked the

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1 trust.

2 So that's all water under the bridge.
3 Those were terrible accusations to make against your
4 predecessors and not against you all, but I hope it's
5 something that you take in in the vision of the
6 future.

7 Now, it really warms my heart to be here.
8 I'm not used to being in a room where Fortune 500
9 corporations are calling for socialism or where they
10 come forth and say I want to bring more Government
11 regulation into the deals that we have. And so as
12 those that would call, accuse me of being a pinko
13 commie left wing subversive, to hear a whole group of
14 Fortune 500 corporations talk about using regulatory
15 power to do things, vote me yes, but I have a
16 different agenda.

17 The first thing I would like to have is
18 something that some of the people complained about, is
19 I wish you would put rules in for staffing levels. I
20 don't think you will ever use them, but because of the
21 strong pressures of the marketplace, in order to make
22 certain targets that Mr. Valentine and others will

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1 talk about, Mr. Wadewitz and others will talk about
2 here, is is that they take head counts out.

3 Well, when you take head counts out
4 because of our terrible, terrible, wonderful seniority
5 rules, they are not taken out the same. So at the
6 time they go to take head counts out to satisfy Wall
7 Street, we may already be short at Kansas City, Saint
8 Louis or Chicago. I picked those locations, so you
9 can't figure out which carriers I'm picking on. I'm
10 trying to be evenhanded, being mean to all of them.

11 So because you don't have staffing levels
12 at a location, and we may have -- be significantly and
13 severely short of people, then no hiring takes place
14 in order to make the dividends. Then the customers
15 don't get their trains. And all over the United
16 States in the last year we have had trains that, like
17 my friend Fred Emmet said, look like dead buffalo
18 carcasses laying all over waiting on crews to move
19 them.

20 Now, we have done what we can. The loss
21 is not only the shipper. The losses to us is fatigue.
22 We're not home with our families. We get injured. We

1 make bad decisions. We run trains together. Then the
2 carriers hire an awful lot of young, inexperienced
3 people and they have to learn the hard way and they
4 run trains together. And so because no one has the
5 responsibility or step forth to ask for our staffing,
6 everybody suffers, but then I'm pro-Government
7 regulation. I like to have the Government involved.

8 Next is competition. I'm married to a
9 strikingly attractive and brilliant woman named Judy
10 Sinkin. We have a basement at home and Judy's
11 basement, my basement, is now an exercise room. We
12 needed a new floor.

13 Well, we went and, of course, I have the
14 opportunity of going out and sitting in my SUV and
15 reading on Saturday afternoons while we go from
16 everyplace from Expo to Wal-Mart looking for flooring.
17 These are real opportunities of togetherness and
18 relationship I think everyone can relate to.

19 So she came up with a product that there
20 is no competition for. So since you all can override
21 law, would you all open up the patent and allow some
22 competition, because I don't want to pay that damn

1 high price for that floor. It's unreasonable. It's
2 unconscionable and I am so enthusiastic to hear that
3 the chemical industry here believes in competition,
4 because I can use some in my basement.

5 And so if we're going to open up the
6 railroad lines and where their franchises are, where
7 they have put their capital cost, and sit down and say
8 in order to get competition, we're going to open it to
9 other people to come in to bring rates down. If it's
10 reasonable for the goose, then the gander is is that
11 they should go over to Omaha or Norfolk or Fort Worth
12 or Jacksonville and hand over a whole stack of patents
13 and to let the railroads make the difference up in
14 competing with their shippers.

15 I think it's a completely reasonable,
16 balanced situation and if you all will do that, I
17 think that I won't need labor protection. I believe
18 I will be able to get very healthy from money, very
19 healthy money from my members. Now, the carriers
20 don't -- the shippers don't understanding what they
21 are talking when they talk about competition. When
22 you go -- and this is my summation, Roger.

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1 CHAIRMAN NOBER: Okay. I was going to
2 address your floor.

3 MR. BRUNKENHOEFER: Okay.

4 CHAIRMAN NOBER: Because I finished my own
5 basement.

6 MR. BRUNKENHOEFER: Is that what the
7 shippers are familiar with, is a marketplace that
8 allows market entry and market exit. In the railroad
9 industry, market exit is called abandonment. So if
10 you force in competition, and the whole idea of
11 competition is there are winners and there are losers,
12 and the losers in this case would be like when Eastern
13 Airlines went out of business if you took the airport
14 away or one of the 5,000 truck lines went out of
15 business, you went out and ripped up the interstate.

16 And so if the shippers are correct and
17 they are ready to -- they need to ask am I, as the
18 shipper, ready to live with the downside of
19 competition, and the downside of competition is there
20 will no longer be anyone there to provide you an
21 economically sound, environmentally friendly way of
22 moving transportation, of moving your goods.

1 I don't think that the shippers appreciate
2 what happens. We lost a great deal of Milwaukee Road.
3 We have lost a great deal of the American railroad
4 system. When we lose an airline, somebody immediately
5 comes in and leases the gate, leases the planes and
6 goes to business.

7 And so what we don't want to see is in the
8 zest of this wonderful "let's get the Government
9 involved in the free marketplace" is that somehow or
10 another we end up losing a very necessary system of
11 transportation that in many places have already been
12 lost forever. We want a healthy railroad industry.

13 I want them to make lots of money, so we
14 can take it away from them. I don't want the shippers
15 taking it away from them. We are entitled to it,
16 because we're going to spend it on health care. We're
17 going to spend it on wages. We're going to spend it
18 on retirement.

19 And so as I have watched these companies
20 fight among each other, I recognize going back to my
21 original point that the only losers in Staggers was
22 our 400,000 jobs who the wealth of those people have

1 been transferred and shared between the shipper and
2 the railroads. And I will shut up.

3 CHAIRMAN NOBER: Thank you very much.
4 Commissioner Mulvey, can you possibly have any
5 questions?

6 COMMISSIONER MULVEY: I have only one
7 word. Bamboo. Bamboo flooring is a lot cheaper
8 than --

9 MR. BRUNKENHOEFER: Can you call Judy?

10 CHAIRMAN NOBER: Can't use it in the
11 basement. It absorbs moisture.

12 COMMISSIONER MULVEY: Oh, my God. Now,
13 you tell me.

14 MR. BRUNKENHOEFER: Would you call Judy
15 and sell her on it? I'm ready.

16 CHAIRMAN NOBER: Okay.

17 COMMISSIONER MULVEY: A question to the
18 group in general. The American Short Line Railroad
19 Association points out that more than half of all
20 short lines are unionized. Would you want to address
21 that fact, that unionization seems to be spreading
22 among the short lines, offsetting some of the problem

1 of deunionization of the industry?

2 MR. BRUNKENHOEFER: We have got 85 percent
3 of the entire membership on our Class I railroads.
4 Now, anybody who wants to do a deal that you end up
5 with half when you had 85 percent. You want to call
6 that favorable, I'm ready to play poker with them.

7 MR. ELLIOTT: I would also like to add
8 that while we are organizing where we can on the short
9 line railroads, the wage and benefit package certainly
10 aren't at a par with Class I's.

11 COMMISSIONER MULVEY: One of the issues
12 that was raised by one of you is the issue of sham
13 transactions. The Board in the Sagamore Decision
14 defined to some extent, what a sham transaction ought
15 to be.

16 My question to you is do you think that
17 the Sagamore Decision ought to be precedent or the
18 Sagamore case was, obviously, a case where the
19 transaction was a sham, but all transactions do not
20 have to look like Sagamore in order to be a sham. Or
21 do you think the Board should be broadening how it
22 looks at a transaction in determining whether or not

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1 it's a sham transaction?

2 MR. KRAUS: Well, my concern isn't so much
3 looking at the concept of sham. I think it's looking
4 at -- and that's not the term I used in my
5 presentation. My concern is really that you have got
6 these short line carriers who are coming before the
7 Board as if it's just this one piece of line that they
8 are purchasing, and the transaction is analyzed from
9 that perspective and labor protection is analyzed from
10 that perspective.

11 And the reality is in most of these
12 transactions, and you're familiar with the players,
13 they are holding companies. They are major
14 corporations. They own a significant number of short
15 lines and I don't think it's fair to analyze that
16 transaction from the perspective that you're dealing
17 with some sort of mom and pop operation that is a "new
18 investor" in the industry.

19 These are people who are well-established
20 players in the industry and use that artifice, if you
21 will, to avoid labor protection. So that was the
22 point I was trying to make and not get into the sort

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1 of legal definition of what is and isn't a sham.

2 I don't know whether that technical word
3 fits what I'm saying or not, but the underlying
4 economic reality is these guys own -- they are players
5 in the industry. They own a number of short lines.
6 They are railroad operators and, in my judgment, these
7 transactions employees should be able to receive the
8 kinds of protections that Interstate Commerce Act had
9 historically long established.

10 And my understanding of the Staggers Act,
11 there is no evidence that the labor protection was
12 supposed to be "deregulated." So I guess that's where
13 I was coming from. That may not be an adequate answer
14 to your question, but it's the best I can do.

15 MR. ELLIOTT: If I could just add along
16 the line that Mr. Kraus didn't address. Some of the
17 more recent transactions, and I won't get into this in
18 depth, but there appears to be quite a bit of control
19 kept by some of the Class I carriers and that has been
20 quite a concern for our members when they see that
21 there is that type of control. So, I mean, that order
22 is a sham.

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1 Obviously, Sagamore was a blatant sham.
2 In fact, that was my case and I remember the owner of
3 the company, Indiana Hi-Rail, I believe it was, was on
4 the phone with my boss and he asked him who was the
5 owner and president of the new company. He said, of
6 course, I am. So, I mean, that was the affidavit, so
7 that was a blatant sham in that instance.

8 MR. BRUNKENHOEFER: Just one thing. We're
9 not after -- we're not trying to beat up on the short
10 lines. We're talking about a transaction here and
11 we're talking about the relationship and, although we
12 use short lines, this comes from the Class I carriers
13 who are, essentially, encouraging this.

14 I wouldn't want anybody to believe that we
15 -- in other words, we recognize those people only
16 taking advantage of the game. What we want to do is
17 stop the game.

18 COMMISSIONER MULVEY: Yes. I have some
19 concern about the long-term leases partly because of
20 the lack of independence sometimes of the railroad
21 leasing the line and also, of course, the impact on
22 labor and on lost jobs.

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1 MR. BRUNKENHOEFER: We have one Class I
2 that sits down at the table with us and tells us that
3 we are going to make concessions on certain of our
4 collective bargaining agreements, are they going to
5 lease out all their yards, and the yards will all
6 become new railroads and they will do the switching
7 for the line haul carrier.

8 And they can't exist without those yards.
9 That is like saying I'm going to have -- I'm going to
10 run an airline, but I'm going to lease out -- I'm not
11 going to use any airports. I mean, it's not going to
12 happen. But they use that threat to come to us to
13 make concessions. Now, where do those concessions
14 come from? Families.

15 CHAIRMAN NOBER: I probably know better
16 than to ask a question, so I will make a statement and
17 people can decide whether or not they want -- which
18 is, you know, obviously, the issues that you raise are
19 difficult ones, because on the other side of it are,
20 you know, shippers and communities that rely on rail
21 service that might not be economical under Class I
22 cost structures or Class I work rules or whatever the

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1 case may be and, you know, 30 percent of all traffic
2 originates or terminates on a short line.

3 So I know you said you weren't here to
4 attack short lines and it's a difficult balance
5 between, on the one hand, you know, wanting to
6 preserve the legitimate concerns that you have all
7 raised and, on the other hand, allowing more marginal
8 service to continue, which keeps the industry healthy
9 overall.

10 And the good news is for the first time in
11 many years, you all are growing. There are more --
12 you know, the railroads are hiring, which I think has
13 not occurred for many, many decades overall, that they
14 are actually growing the numbers. So I will quit
15 while I'm ahead.

16 MR. BRUNKENHOEFER: In the case of the
17 yards and the terminals, that is nothing more than a
18 labor game to get concessions from us. This is not
19 real and so, I mean, nobody is going to come in and
20 use the ABC railroads who are going to lease -- you
21 know, and just throw a name out. Burlington Northern
22 is not going to live without Argentine Yard in Kansas

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1 City.

2 So it's real simple. UP is not going to
3 live without Neff Yards in Kansas City. It's just
4 that simple, KCSS NOC Yard in Kansas City. Those
5 railroads are not going to exist if you're having a
6 real transaction of where somebody is doing a new
7 railroad, and this case is nothing more than they are
8 leasing off their service company to break -- they are
9 signing a new contract to break my contract.

10 CHAIRMAN NOBER: Okay. That goes beyond,
11 I think, what I was getting to, of course, but I
12 appreciate that. Anyone else? Okay.

13 COMMISSIONER MULVEY: Thank you very much.

14 CHAIRMAN NOBER: Well, gentlemen, thank
15 you all very much.

16 UNIDENTIFIED SPEAKER: Thank you.

17 CHAIRMAN NOBER: Appreciate your patience
18 and now, we'll start with our last panel of the
19 morning or afternoon, wherever we may be.

20 Ken Hoexter from Merrill Lynch, Tom
21 Wadewitz from J.P. Morgan Securities and Jim Valentine
22 from Morgan Stanley. Gentlemen, and then what I think

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1 railroads on where they need to be focused.

2 The second thing you can do, under the
3 statute Congress gave you the authority to report to
4 it if there is a need for change in national freight
5 transportation policy. Even if you don't have the
6 power to fix some of these problems, you certainly
7 have the power to put the spotlight on some of these
8 problems.

9 And so I think, you know, that big stick
10 you carry that Mr. Linderman just referred to is a
11 very powerful weapon under today's circumstances. We
12 need Congressional action. You have heard this from
13 some people on some of the other panels already on a
14 number of these areas. We don't have to necessarily
15 change the Staggers Act, but we need Congress to focus
16 on rail transportation capacity. That is the single
17 biggest problem that many people in this room are
18 facing.

19 And with that and the number of people on
20 the panel, I think I will just defer to any questions
21 you may have about rate making, revenue adequacy or
22 the rest, except to say one last thing. This is the

1 one area has an impact on the other if we -- you know,
2 if the Board takes actions that have the effect of
3 limiting rates, that that has the effect of
4 discouraging investment and capacity or vice versa or
5 do you think the two of them could be -- the two of
6 them are consistent with one another?

7 Can we have an active regulation of rates
8 at the same time while inducing the adequate capacity?
9 Because that's the balance. I mean, I'm not sure, you
10 know, we want to make sure that we don't take an
11 action in one that impacts the other and vice versa.
12 They are both legitimate concerns. Mr. English?

13 MR. ENGLISH: Mr. Chairman, again, I think
14 this goes back to the point that I made earlier. And
15 that is that things have changed a lot in 25 years.
16 That we have this tendency of policy being built on
17 top of policy. And given -- and from what we have
18 heard today and I think from what I have heard out of
19 you gentlemen, there is an acceptance that the
20 railroad industry is doing far better today than it
21 was in 1980, that we have had great strides and great
22 improvements.

1 we'll do after this panel, we'll take a brief break
2 for lunch and we'll pick up with the carriers soon
3 thereafter.

4 Okay. I think we're all sort of shifted
5 over. All right. Sir, if you're ready, why don't we
6 start with you, which is a little off my left to
7 right, but you seem to be ready to go, so why don't we
8 get started? You need to just speak into the
9 microphone.

10 MR. HOEXTER: I guess I'm not going to use
11 slides then. Chairman Nober, Vice Chairman Buttrey
12 and Commissioner Mulvey and my fellow distinguished
13 panelists, my name is Ken Hoexter. I am Merrill
14 Lynch's Senior Airfreight Surface and Marine
15 Transportation Analyst. I have been a research
16 analyst for more than 12 years having worked at Lehman
17 and Goldman prior to Merrill.

18 And one thing is quite clear. We're
19 witnessing a historic period in the rail industry as
20 rates have increased quite significantly over the past
21 year and a half, capacity is filling up on the rail
22 industry for improved asset utilization and the

1 railroads are improving their margins to the best
2 level in more than a decade.

3 But the question I believe we're here
4 today to ask is are the rails profitable? And profits
5 can be measured in many ways, such as financial
6 reporting or looking at net income improving from one
7 year to the next, as well as by cash flow measures
8 such as are they generating real cash flow, enabling
9 the stock buy-backs, dividend increases and are their
10 shareholder moves established by different companies
11 over the past couple of years.

12 A few things to note. Earnings by and of
13 themselves do not send a clear picture. As we have
14 learned from some companies like Enron and WorldCom
15 and a host of others, earnings by and of itself can
16 leave certain statistics to debate in some contrast to
17 some of the true GAAP numbers that we see. We also
18 understand that cash is king, but just having cash
19 flow and increasing or paying a dividend and buying
20 back stock does not necessarily indicate that a
21 company is earning a return on its investment.

22 To understand returns, we look at after

1 tax returns on a total capital, after tax returns on
2 total capital. To get there, and just a quick kind of
3 run-through of the actual math of what return on
4 invested capital is, we take a look at in the
5 numerator, you have got your rolling four quarters of
6 net income plus your interest expense after tax plus
7 we take the present value of operating leases and take
8 the interest expense on the operating leases after tax
9 in your numerator.

10 So we're including every sort of financing
11 in the equation, and then you divide it by the average
12 debt. Inside the debt you have got capital leases
13 along with the total debt, including accounts
14 receivable, securitization and then, again, present
15 value of operating leases. So we're trying to get --
16 to make the income, the net income, the returns that
17 the rails are actually generating, completely
18 indifferent to how the company has financed itself.

19 We're aiming really just, again, to derive
20 what the companies' returns are on their entire base
21 of invested capital indifferent to how they financed
22 it, because if the companies don't earn a return, then

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1 shareholders should demand that the company not
2 reinvest in the business and instead distribute any
3 cash, because an investor can make real economic
4 profit in other investments.

5 Investors don't want too big of a
6 dividend, because they are trusting management to earn
7 returns on their investments. It's a lot of
8 background on the equation, but after decades the
9 rails as a group are closing in on earning their cost
10 of capital.

11 Canadian National has been operating above
12 its cost of capital since 2001. We believe Burlington
13 Northern reached its cost of capital last quarter and
14 that, based on our estimates, Norfolk Southern will
15 reach it by year end 2005 with CP, CSX and UP
16 improving, but still about 150 to 200 basis points
17 away from our cost of capital target.

18 The whole concept of rails striving to
19 reach their cost of capital is still relatively new
20 coming from the debate from the companies, but quite
21 important to focus on as it dictates the capital
22 spending levels both for reinvestment and expansion

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1 for years to come.

2 Since its scheduled rail focus in the
3 early part of the decade, Canadian National has been
4 keenly focused on earning solid returns even causing
5 Hunter Harrison, the CEO and president, to once ask
6 why. If intermodal is making so little money at that
7 time, why are they even in the business. Either make
8 a return or make the business stand on its own or get
9 out.

10 And this was a landscape change in thought
11 for the rails at that time. It looked like they were
12 trying to achieve double digit growth and intermodal
13 was the way to beat the trucks at the growth game,
14 returns be damned. This mentality was built during
15 the '80s and '90s.

16 CHAIRMAN NOBER: Is this an antitrust
17 violation, the two of you?

18 MR. HOEXTER: So this is just a quick
19 chart. This is the last couple of years of the
20 returns as the rails -- you can see just in 2005 some
21 are actually catching up to their return on invested
22 capital levels and some are still just below the line.

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1 And as I mentioned or I will get there in
2 a second, on the rails, this mentality of intermodal
3 growth at all costs was built during the '80s and '90s
4 when the rails had a tremendous amount of capacity on
5 their networks. Nevertheless, Burlington Northern
6 jumped on board with its diligent focus on yield
7 improvements, recognizing that price deflation would
8 never help it achieve true economic returns and so why
9 invest more capital?

10 In November 2003 at their Chicago Analyst
11 Day, the company focused its entire Analyst Day on how
12 each segment was going to earn its cost of capital.
13 A year later in Kansas City, Burlington again focused
14 its entire Analyst Day on how each segment could
15 increase utilization without increasing cap ex,
16 because it couldn't yet justify capacity expansion
17 despite its quarterly volumes jumping 10 percent year
18 over year in 2004.

19 The result industry-wide has been a
20 tightening of capacity as witnessed by Union Pacific's
21 velocity dropping 4 miles per hour after the past two
22 years' or 15 percent. With the carriers comfortable

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1 that reinvesting in core operations will lead to
2 return on capital, many companies have dusted off
3 capacity expansion plans, something shippers demanded
4 along with better service at the AAR's recent customer
5 forum in Saint Louis, but a move that is not likely to
6 be made in a changing regulatory environment.

7 With one of its mandates to assure a
8 viable rail infrastructure, the STB has set the
9 environment over the past few years that has
10 encouraged the rails to increase cap ex as a group.
11 In looking at the six largest Class Is, they have
12 invested \$7 billion in 2003 up to our target of about
13 \$8.5 billion in 2006, a 23 percent increase or a 7
14 percent four year cager.

15 CSX, UP and CP have each engaged in
16 significant capacity expansions. These moves to
17 increase long-term capacity are made only because the
18 carriers believe the structure is right to reinvest in
19 a return on invested capital greater than cost of
20 capital opportunity. If that opportunity is removed,
21 which has taken about 20 years for them to achieve
22 again, the desire for reinvestment may disappear.

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1 Thank you.

2 CHAIRMAN NOBER: Again, Mr. Valentine,
3 we'll go left to right. Sorry, Tom. We'll get to you
4 next.

5 MR. VALENTINE: I think we need just 30
6 seconds here to move laptops. Tom, are you going to
7 go next?

8 CHAIRMAN NOBER: Tom, do you want to --

9 MR. WADEWITZ: Go ahead, Jim. You're
10 there.

11 MR. VALENTINE: Okay. Great. Well,
12 first, before I start going through my slides, I want
13 to thank the Board here for giving me this opportunity
14 to speak. By way of background, I am Morgan Stanley's
15 Equity Research Analyst responsible for researching
16 the North American Freight Transportation Sector,
17 which includes the railroads.

18 As a representative of the financial
19 community, my thoughts today are those from an
20 investor's perspective, as all three of our firms, we
21 have investment banking divisions, but we are here
22 today to talk about it from an investor's perspective.

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1 That's our role as a research analyst.

2 While Staggers has clearly removed some of
3 the burden of former regulation, we can't call it a
4 resounding success. The long-term success of any
5 enterprise is to ensure that it can regenerate itself,
6 which for a company means that it must generate enough
7 revenue to cover all costs, including the costs of
8 returns for shareholders.

9 Despite all the benefits of Staggers, the
10 industry still has not consistently earned its cost of
11 capital in the 25 years of deregulation and, thus,
12 shareholders have not been properly compensated for
13 the use of their capital.

14 The good news is that we forecast this
15 trend to reverse in the next year or two which, if
16 sustained for many years, could be a sign that
17 Staggers is a success. Rather than spend time here
18 dwelling on the past, it's probably useful to
19 highlight our forecast for the future, because that's
20 what we do here on Wall Street, is forecast.

21 My fairly upbeat forecast for the industry
22 wouldn't be possible had the railroads not been

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1 deregulated. As I'm sure we'll hear from the
2 railroads later today, deregulation has allowed them
3 to shed unused assets giving them the freedom to make
4 decisions based on the economic reality of supply and
5 demand that have ultimately resulted in better
6 earnings, cash flow and returns.

7 It took us about 25 years to get here, but
8 the industry finally appears to be approaching a good
9 financial health. The first slide here of numbers is
10 our forecast for the four major U.S. railroads for
11 2005 through 2008.

12 And as you can see in the rightmost
13 column, the compound annual growth rate that we
14 estimate includes annual carload growth of about 3.5
15 percent. That is about the rate of industrial
16 production so, you know, it's nice, but it's not above
17 a trend line for industrial America.

18 Yields or revenue per carload, we have it
19 increasing about 5 percent per year, but this is led
20 by a large spike in fuel surcharges in 2005. If you
21 strip this out, the figure would be closer to about 3
22 percent, which is simply in line with inflation.

1 Most importantly, we expect operating
2 income to grow at about 15 percent per year over that
3 time period, which is well above most other industrial
4 sectors in the United States. And these trends are
5 much better than anything we have seen in the past 25
6 years of deregulation.

7 This success is being led by, we would
8 say, two major factors. First, after about 90 years
9 the railroads have finally worked off their excess
10 capacity and, second, the trucking sector's costs are
11 going up at unprecedented levels. I also work on the
12 research on the trucking side and we're seeing their
13 costs go up at 4, 5, 6 percent a year compared to
14 about 1 percent historically.

15 That is because of higher driver costs,
16 because driver demographics are shifting. The
17 equipment fuel emissions are causing higher equipment
18 and fuel costs and then just fuel prices in general
19 hurt trucks more than rails, and these higher trucking
20 costs make the railroads more competitive.

21 Before I go through this next slide, I
22 want to preface that one basic fact in that investors

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1 pay for profitable growth. And in this slide here you
2 will see their earnings per share growth rate for four
3 major railroads and, once again, '05 and 2006 are our
4 estimates, that's depicted in blue, and the overall
5 market, financial market, we're using the S&P 500,
6 which is the yellow bars.

7 And I think it's clear that the recent
8 improvements by the railroads is resulting in better
9 EPS growth in the typical U.S. industry. And if our
10 forecasts prove correct, we'll see the railroads grow
11 their earnings or EPS by about 23 percent next year
12 compared to only about 7 percent for the S&P 500.

13 Better earnings are leading to better
14 returns, which we show on this slide here. At Morgan
15 Stanley we take the traditional ROI or return on
16 invested capital computation a step further by putting
17 all of the off balance sheet assets back on balance
18 sheet and eliminating the distorting impact of pension
19 assets and liabilities to compute a return on net
20 operating assets or RNOA, as we call it, which is a
21 more clear picture of how management is utilizing the
22 company's asset base.

1 As you will see in this chart, we have
2 sorted the railroads from left to right based on their
3 current RNOA. If you imagine a line across the chart
4 at about 9 percent like Ken was showing for the
5 assumed cost of capital, you will see that for 2005,
6 the green bars, that four of the six major North
7 American freight railroads will likely earn or even
8 exceed their cost of capital.

9 This next slide provides a historical
10 perspective on returns, as well as our forecast for
11 the major six freight railroads for 2005 through 2008.
12 If our forecasts prove correct, we'll see at least two
13 consecutive years of the industry earning its cost of
14 capital. Although, I should note that our forecasts
15 are helped by the Canadian railroads, which are at the
16 higher end of the industry.

17 To help illustrate that Wall Street still
18 doesn't believe that the railroads are going to
19 consecutively earn their cost of capital into the
20 future, here is an analysis that we did. We sorted
21 through 1,600 stocks followed by Morgan Stanley's
22 North American Research Department and we came up with

1 a basket of 12 stocks that our analysts forecast to
2 have similar financial metrics as we forecast the
3 railroads to have over the next three years.

4 You will see in the top here that
5 investors are currently willing to pay about 12.5
6 times the railroads 2006 earnings, but only -- but as
7 much as 13.7 times 2006 earnings for companies and
8 other industries with similar financial
9 characteristics. My point here is that we need to see
10 the railroads earn their cost of capital over an
11 entire cycle before they are going to be afforded a
12 higher evaluation multiple similar to other
13 industries.

14 For anybody who wants some of the details
15 here, I can have a report I can email to you. So in
16 conclusion, our upbeat view towards the earnings and
17 returns would not be possible if the benefits of
18 Staggers are not allowed to continue to play out. We
19 should note for the first 25 years -- for the first
20 time in 25 years, we are hearing railroad investors
21 encourage some management teams to reinvest in the
22 business, because returns have finally reached

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1 acceptable levels.

2 Net reverses trends we saw in the late
3 '90s when investors were beating up management to say
4 cut back, get back. Yes, the industry is generating
5 some of the best returns since at least World War II,
6 but we're still not at the point where the entire
7 industry consistently earns its cost of capital.

8 And once again, I would like to thank the
9 Board for this opportunity to present our perspective
10 from the investment community.

11 CHAIRMAN NOBER: Thank you, Jim. Mr.
12 Wadewitz?

13 MR. WADEWITZ: Thanks. Well, thank you to
14 the Chairman and the Commissioners for the opportunity
15 to testify before you this morning. What I would like
16 to do is take you through some charts and just provide
17 some perspective on where the railroads have come
18 from, what the Staggers Act has done, and I think some
19 important thoughts looking forward for what's
20 necessary for the railroads really to make an effort
21 to invest in capacity looking forward and the type of
22 regulatory support they need for that.

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1 So on this first chart what we have is
2 looking at these charts, the first three are all 1980
3 to 2004. Based on AAR data, you see that track miles
4 are down, that's in the bar chart. You see that
5 revenue ton-miles are up. It's about 2.5 percent
6 compound annual growth rate over 1980 to 2005. What
7 we see is rationalization of the track infrastructure
8 towards the higher density, higher freight density
9 network. In our view, that means it's a rail system
10 which has a better chance of earning its cost of
11 capital. So that's a constructive trend for the
12 railroads.

13 The next chart, yes, I'm sure you have
14 seen charts like this, is looking at employment in the
15 rail industry, looking at productivity is the bar
16 chart. That shows you significant gains in
17 productivity for the industry over time. That moves
18 up at about a 6.9 percent cager, that's revenue ton-
19 miles per employee. This is another nice chart for
20 the railroads. And then this third chart, this is a
21 nice chart for the shippers. This shows revenue per
22 thousand ton-miles for the industry.

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1 And what you will note is from the peak in
2 1982 rates went up slightly at the beginning. Yet,
3 we've got a 30 percent decline in nominal terms to the
4 trough level which is about 2001. So certainly some
5 good news for the shippers on the rate side, but bad
6 news for the rails there. So I think when you look at
7 these first three charts all in, you will say well,
8 deregulation has been good from the perspective that
9 there have been very significant productivity gains
10 for the railroads and then the shippers have
11 participated in this, in some of this good news as
12 well.

13 This next chart that I have for you looks
14 at the stocks. This is an index of the major rail
15 stocks. In the S&P 500 it is the green line here.
16 What you will note is in the early '90s, through the
17 mid-'90s, the rails generally moved up along with the
18 S&P 500. I think it was a good period in terms of
19 earnings performance, in terms of growth. In the mid-
20 '90s you had a lot of optimism about the potential for
21 if some of these major systems were put together, what
22 would be the cost side opportunities, the cost

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1 synergies as well as revenue synergies?

2 Now, you can see as the rails fall off,
3 it's a combination of two things. Those clearly were
4 not realized. Instead the financial performance fell
5 pretty sharply. At the same time, the S&P was up on
6 a lot of exuberance about technology stocks. As we
7 look to the right of that chart, I think what we have
8 seen is now the railroads have actually moved up above
9 the S&P 500 over this time in terms of what their
10 performance would look like and I think that's largely
11 a function of long-term demand catching up with
12 supply, getting pricing gains, also a function of a
13 stronger industrial economy.

14 The next chart here, supporting what has
15 been the better performance of the stocks. More
16 recently, this shows for the U.S. railroads, the
17 average year over year yield increase or revenue per
18 car increase on a quarterly basis, we go back to the
19 beginning of 2001. You will note this sharp move up
20 that really started in first quarter 2004. And this,
21 in my view, is the primary driver of the improvement
22 and earnings performance and also the move up in the

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1 rail stocks.

2 The next two charts here, this shows rail
3 average earnings growth. You have pretty good
4 earnings on recovery from mergers in 2001/2002. And
5 then more recently, '04/05, very strong earnings
6 growth for the group. 22 percent in '04 and what we
7 forecast 35 percent on average of the major railroads
8 in 2005. This returns chart also shows some of that
9 positive momentum in the industry that we have. And
10 again, we think that's not only the result of an
11 improvement in the economy in 2004, but more
12 importantly the result of a significant move up in
13 pricing as shown by that yield chart.

14 Now, the last chart that I want to provide
15 for you here, this is a U.S. railroads, not the
16 Canadians. It's total capital expenditures for the
17 major railroads from 1990 through what we forecast
18 through 2006. I want to note two things here. You
19 see the move up to the stronger level of spending in
20 the mid-'90s. I think was a result of significant
21 optimism with respect to both potential for growth and
22 potential coming out of the mergers what could be done

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1 with these properties.

2 Now, a lot of that wasn't realized
3 quickly. We saw some, you know, struggling on the
4 operating side. We saw the economy weaken in 2001.
5 And so you see those capital numbers fall off really
6 quickly. What I would submit to you is that as the
7 rails improve their earnings performance, as they
8 realize if they have expectations for future
9 profitable growth, then their capital expenditures can
10 rise quickly.

11 I think that's important, because at the
12 end of the day, we want a system that has the capacity
13 and the investment, so that it can support growth of
14 the shipping community. So with that, what I would
15 say to you, just the last thought, supply and demand
16 and competitive dynamics are really driving much of
17 the total pricing equation for the railroads. But
18 regulatory factors also have a meaningful impact.

19 In my view, the railroads did produce
20 returns above their cost of capital, which seems to be
21 realistic looking forward, shouldn't be penalized for
22 reaching that. If you go back and then you start to

1 price down their captive traffic, then I think that
2 penalizes the railroads and I think it will actually
3 hurt and work against their incentive to invest and
4 provide more capacity.

5 With that, I'll thank you for the time.

6 CHAIRMAN NOBER: Thank you very much.

7 Commissioner Mulvey?

8 COMMISSIONER MULVEY: With regard to the
9 railroads earning their cost of capital now, in large
10 measure, of course, they have been reducing the size
11 of their infrastructure and cutting back and getting
12 rid of excess lines, et cetera, to the extent that
13 today we now have a capacity crisis. There is
14 insufficient capacity on many routes. This is causing
15 problems for other sectors of the economy. We must
16 remember that the demand for rail transportation is a
17 derived demand, something that serves the needs of all
18 the rest of the economy.

19 Is there any way of ensuring that we can
20 get investments in the rail transportation
21 infrastructure which might cause it to be somewhat
22 larger and have some excess capacity without Wall

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1 Street penalizing the railroads for doing so? Can we
2 take into account the public needs of the railroad
3 infrastructure.

4 MR. VALENTINE: Yes, I guess, there is no
5 way to ensure it is going to happen with 100 percent
6 certainty, but if -- I'm kind of going back to one of
7 the points I made that it is stunning, I have been
8 doing now going on 14 years now and only in the last
9 three or maybe six months, I'm actually hearing
10 investors for the first time say I would like the
11 railroad to invest in the business. And it's because
12 they are coming close. And by the way, that's not
13 across the board with all six. You can figure out who
14 I'm talking about in terms of who is earning their
15 cost of capital is where they want that to be spent.

16 So, you know, you put yourself in the
17 shoes of a CEO or a CFO that has to go to the board
18 and if they say look, we're going to go add some more
19 rail yards and some more locomotives, because we're in
20 a tight capacity situation, and they aren't even
21 earning the returns on their existing capital, it's
22 just not going to fly. So to the extent that for the

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1 railroads that are earning their cost of capital, I
2 think we are going to naturally -- the invisible hand
3 is going to work and we're going to see this capital.

4 In fact, we're seeing cap ex go up on some
5 of the railroads right now to try to increase some of
6 this capacity. But it really comes down to the fact
7 that they have got to be an environment where they can
8 consistently, over an entire cycle of the asset base,
9 generate good returns.

10 COMMISSIONER MULVEY: Yes. Well, one
11 would hope so. The problem, of course, is that we
12 don't have adequate capacity to move the coal out of
13 the Basin and we don't have the capacity to move
14 containers from the west coast to the east coast to
15 meet Christmas needs and all of that.

16 MR. VALENTINE: Right.

17 COMMISSIONER MULVEY: We don't have the
18 capacity to move the grain to ports, to markets when
19 it is needed to meet the farmers' needs, et cetera,
20 and the railroads are making a lot of money. The
21 question is: 'is there a divergence between the
22 desirable private infrastructure and a desirable

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1 public one?''

2 MR. VALENTINE: No, I don't think it's
3 divergence. I think the problem is that over the last
4 -- this is -- these are really long assets and this is
5 the one thing I have had a tremendous amount of
6 respect for the Board over the years that appreciates
7 this. That, you know, if you wanted to go put in
8 another, you know, the PRB has 270 miles that are \$1
9 and \$2 million a mile to put in, for an increased
10 capacity, we can't do it in a matter of six months.
11 It's going to take a multi-year phase-in program.

12 You want to expand the Transcon Line from
13 Chicago to LA, but BN and UP, I think, are each
14 putting in 60 to 100 miles of double track this year.
15 That's a major project for them for a 2,000 mile
16 stretch of track. So the point is that, from my
17 perspective, we can't make this happen quickly. And
18 if we are going to have it happen, namely the
19 railroads are going to say we will commit to put in
20 all this double track and buy locomotives and have 20,
21 30, 40 assets, they are going to make sure they are
22 going to get good returns over the entire life.

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1 MR. HOEXTER: If you take a look at the
2 last couple of years, you know, the move to go
3 reinvest wasn't really caused because they were
4 looking at expansion opportunities. These were solid
5 opportunities, especially with where pricing has gone.
6 Before it was, you know, our philosophy slow down,
7 because we're getting so jammed, so we're just
8 fighting to keep pace and that's probably the worst
9 area. And so that's when investors have punished them
10 for going and making those kinds of long-term
11 investments to keep pace with just the kind of volume
12 levels you were doing.

13 I think as Jim is kind of highlighting it,
14 if you're going forward now in a different
15 environment, we're now, as they move to earn that cost
16 of capital, you don't want to kind of ring the bell
17 the minute they hit the cost of capital and say okay,
18 thanks for hitting your target and now, we're going
19 to, you know, push you right back under by holding the
20 rates at that level.

21 So as long as they, as Jim kind of said,
22 through that cycle, can do it, then you've got such a

1 long-term investment strategies. We're starting to
2 see the companies now go out and talk about that
3 expansion that you're looking for, but it's going to
4 be a long process to get that kind of volume
5 commitment in there.

6 UNIDENTIFIED SPEAKER: There is -- go
7 ahead.

8 MR. WADEWITZ: Yes, just a short comment
9 to that. I think the most important thing you can do
10 is give the railroads confidence that there is going
11 to be stability, because these investments are very
12 long-term. And if they have confidence that there
13 will be regulatory stability and when they earn their
14 cost of capital, they are not going to have
15 significant downward pressure on rates on the captive
16 business, then I think they will make those investment
17 decisions.

18 Also, when you look at where they invest
19 over time, if they have expectations for future
20 growth, which they tend to in the west in coal, they
21 tend to overall in intermodal, they will make those
22 investments over time. So, you know, I think

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1 stability in future expectations are really critical
2 from a regulatory perspective.

3 CHAIRMAN NOBER: Let me ask this. When
4 you were going through the presentations from the
5 railroads, at the top end of both, of all the
6 presentations were the two Canadian railroads. Now,
7 this morning several of the shippers advocated making
8 regulatory changes to make the U.S. system more in
9 line with Canada's. And, you know, people have
10 objected to that, because of the concerns that they
11 would have about the railroad's financial health.

12 But the two healthiest railroads, at least
13 by some measures today, were Canadian, which operate
14 under that system. What is your view of the effect of
15 those kind of changes in the United States or are
16 there differences that would make it inapplicable?
17 Whoever wants to take that one on. I know you -- I'm
18 sure you have looked at this.

19 MR. HOEXTER: It's a leading question.

20 CHAIRMAN NOBER: No, I'm not trying to
21 lead. I'm just honestly trying to ask what do you
22 think the effect would be?

1 MR. HOEXTER: It's a leading question, but
2 it's also a little bit -- it's a tough one for us to
3 answer in front of them. But it's I think a little
4 bit more to do with the way that they have managed
5 technically.

6 UNIDENTIFIED SPEAKER: In front of us,
7 yes.

8 MR. HOEXTER: Thank you. I think the way
9 they have managed, the operation is a little bit
10 different. I mean, I guess, if you take a look at the
11 Canadian National, the one that leads all over the
12 charts, with their scheduled rail concept and what
13 they have done since acquiring Illinois Central and
14 Wisconsin Central and kind of sustaining that business
15 plan, it's a different way that they have run the
16 entity as well as, you know, different regulatory
17 infrastructure setup. It's a host of things. It's
18 not just one simple regulatory picture.

19 MR. VALENTINE: And, you know, I'm not so
20 much concerned about, you know, what the railroad is
21 thinking what I'm going to say, but I think the
22 investors do, and I think -- because they are the ones

1 that ultimately pay our salaries. And so I think we
2 would be a little hesitant to be here saying yes, it
3 would be great to put the U.S. railroads in a
4 situation where they would lose some of their pricing
5 power.

6 Now, whether they would lost 1 percent of
7 it or 30 percent of it, because of the change in the
8 rules, to make it more like Canada, I don't know. But
9 at least intuitively, I don't know why it would be a
10 positive for the U.S. railroads to have that change.
11 In terms of I don't see how it would increase the
12 returns.

13 MR. WADEWITZ: I would say in comparing
14 the Canadians with the U.S. railroads, you can have
15 differences in how much traffic overlaps between the
16 two. You can have differences in the type of traffic
17 mix. And so I think it can be a little bit difficult
18 to exactly make that comparison, but I would also have
19 to agree with what Jim is saying. There is -- you
20 know, from an investor perspective, anything that is
21 going to put significant downward pressure potentially
22 on rates, is not going to be, you know, a positive for

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1 investors or a positive for more capacity investment
2 as you, you know, appropriately highlight, Roger, with
3 your shared asset area for Conrail example.

4 CHAIRMAN NOBER: Our Agency's measure of
5 return of the, you know, revenue adequacy is slightly
6 -- or at least return on invested capital seems
7 slightly different than yours and I think we keep
8 coming up with numbers that are a little below what
9 yours are in terms of the railroads return on equity.
10 And, in fact, this year showed at least in a draft
11 decision, which I know counsel will blanch at, it
12 showed several of the carriers going down when your
13 numbers all showed them going up, and it hasn't been
14 published, because I sent it back several times to say
15 that, you know, how can we credibly say the return on
16 invested capital is going down when every public
17 presentation, including the carrier, says it's going
18 up?

19 We still haven't fully resolved it yet.
20 I think it has to do with asbestos. But even so, I
21 mean, much of the testimony this morning had to do
22 with the fact that the shippers feel the railroads are

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1 healthy enough. What's your sort of take on that?

2 MR. VALENTINE: So the question is are
3 they healthy enough? You know, at Morgan Stanley
4 we've got just teams of people that spend literally
5 thousands of man hours to work on this whole, what we
6 call, model wear initiative, which is to basically
7 make every company anywhere in the world that we
8 follow comparable on an apples-to-apples basis.

9 And part of the way we do this is go
10 through the, you know, 800 lines of a company's income
11 statement, financial statement to put everything on a
12 comparable basis, taking off balance sheet assets,
13 putting them on balance sheets, taking the assets of
14 the pension or the liabilities and trying to take
15 those aside and say look, that's not -- if you haven't
16 had this gain because of the Wall Street returns in a
17 given year, that's not something management manages.

18 So ultimately what we are left with is
19 this return on net operating asset calculation that we
20 use. And, you know, as you saw in the presentation
21 that you looked there and you can see CSX and Union
22 Pacific probably won't even earn their cost of capital

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1 in 2006 and maybe not even in 2007. And I'm fairly
2 bullish, you know, positive and optimistic about
3 what's happening in the industry. I think a lot of
4 that has to do with some things that have happened on
5 the property over the last few years, as opposed to a
6 lengthy period of time.

7 But here, you are prone to Northern and
8 Norfolk Southern, at least among the U.S. carriers, we
9 think well-handedly meet and even exceed their cost of
10 capital here over the next year or two. So I think
11 you've really got the carriers in two camps.

12 COMMISSIONER MULVEY: Yes. Alfred Kahn
13 and others have been critical of the way the STB and
14 the ICC Board have calculated revenue adequacy and
15 cost of capital. I'm sure you are familiar with the
16 way we do it and some of the criticisms Mr. Kahn has
17 made. He suggested return on equity or the free cash
18 flow, which was presented up here, as a better measure
19 of the railroads' financial health. And a lot of,
20 less sophisticated critics sometimes say well, look,
21 the railroads have no problems going to capital
22 markets. They can borrow at extremely low rates and

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1 so where is the problem? how can you say they are not
2 profitable, not making their cost of capital? How can
3 they have survived for 20, 30, 40 years and never make
4 their cost of capital. That seems incongruous. Do
5 you want to comment on that?

6 MR. VALENTINE: Sure. Well, I think there
7 is a difference. Companies can be in this gray zone
8 between not earning your cost of capital, but being
9 able to service your debt. And if you are self-
10 financing, if you're one of these four U.S. railroads
11 and you are self-financing, namely you are able to
12 generate enough return to cover your 6 or 7 percent
13 interest expense, you know, percent on your debt, then
14 you are able to survive and continue. But that
15 doesn't make it to the point where you are actually
16 earning your cost of capital.

17 Companies, industries can thrive in that
18 gray zone for years and years and years. But
19 eventually what happens is the shareholder base gets
20 fed up and says okay, enough is enough. And, in fact,
21 I remember Rob Krebs at Burlington Northern, who I
22 have a lot of respect for, but back in the mid-'90s he

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1 said "If we build it, they will come." And what he
2 meant is instead of spending about a billion of cap
3 ex, which is our maintenance capital expenditures,
4 they spent \$2.5 to \$2.8 billion for three years in a
5 row and shareholders started getting frustrated.

6 In fact, they were questioning, you know,
7 should Rob be in this job? What's he doing? This is
8 a dying industry. It doesn't earn the cost of
9 capital. He is spending all this capital. Well, we
10 have Rob to thank in the existing BN management now
11 for the fact that they have been able to take all this
12 intermodal business when these ships are coming into
13 LA and Long Beach. So, you know, I guess, over the
14 long-term, we really have got to look at this over the
15 long-term and realize that if companies don't earn
16 their cost of capital, the shareholders in the boards
17 will go back to these individuals and say no, you
18 can't expand. So, you know, there's quite a wide
19 range between going bankrupt and being able to --
20 namely, being able to conserve your debt and still not
21 be able to earn your cost of capital.

22 COMMISSIONER MULVEY: Yes, Rob Krebs was

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1 like Wayne Morse about Vietnam. He was prematurely
2 correct.

3 MR. HOEXTER: Commissioner Mulvey, if I
4 can just throw in one sentence?

5 COMMISSIONER MULVEY: Yes.

6 MR. HOEXTER: Not that what Jim just said
7 -- I mean, I think you don't want to forget about the
8 equity holder. Obviously, there is, you know, the
9 debt holder at the end of the day. It's a lower risk
10 investment, because if the assets get distributed,
11 they are in line to get the assets. So the equity
12 holder is going to demand that higher return. So
13 that's why you can't forget about that. So you can
14 get cash flow. You can have positive earnings at the
15 end of the day, but you can't forget the equity of
16 taking that larger risk to get the return on that
17 investment.

18 COMMISSIONER MULVEY: Yes.

19 MR. HOEXTER: And that's the important
20 side of that equation.

21 COMMISSIONER MULVEY: And, in fact, our
22 calculation, I think, weighs more toward equity than

1 borrowed capital by about 2 to 1.

2 MR. VALENTINE: We will gladly provide all
3 the detail on how we get to our return calculations,
4 if anybody in the STB wants that to figure out why we
5 differ from at least Morgan Stanley.

6 COMMISSIONER MULVEY: Thank you.

7 CHAIRMAN NOBER: Okay. Well, again, thank
8 you all very much for coming. I know you are the
9 subject of a lot of discussion this morning, so we
10 were glad to be able to hear it from you directly.
11 And it's about 1:15. Why don't we break for 20
12 minutes until 1:35, give folks a chance to run out and
13 grab a sandwich and we will take up only 35 minutes
14 late, so it's not too, too bad considering we're the
15 Government.

16 (Whereupon, the hearing was recessed at
17 1:13 p.m. to reconvene at 1:44 p.m. this same day.)
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A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

1:44 p.m.

CHAIRMAN NOBER: Okay. Well, I think we are ready to begin. Our side of the aisle was on time. Okay. Well, I think we have a panel again of folks who are very well-known to the Agency. From CSX we have Les Passa, from BNSF Railway John Lanigan, President of UP Jim Young, Chief Operating Officer of Norfolk Southern Steve Tobias, Chief Financial Officer of K.C. Southern Ron Russ, Chief Financial Officer of Canadian Pacific Michael Waites and the head of U.S. operations from C.N. Gordon Trafton.

Okay. Gentlemen, thank you and we'll go from my left to my right as is our tradition.

MR. PASSA: Okay. Thank you, Chairman Nober, Vice Chairman Buttrey, Commissioner Mulvey, it's my pleasure to be here to represent CSX and talk about Staggers at 25, a success story. And I might add, I have been in this industry nearly 27 years and I have a maybe somewhat unique perspective in that I did grow up in a pre-Staggers railroad family in the bankrupt Northeast rail system. The experience it has

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1 given me is that that is not a place you really want
2 to be, that we have come a long way and that we have
3 opportunity in front of us. Staggers plays a
4 significant role in that evolution.

5 How has that done that? It has allowed
6 the rail industry to reshape its business. It
7 recognized the need for sustaining revenue adequacy.
8 It promoted differential pricing to the market to
9 allow us to compete. It permitted efficiencies to
10 consolidations and it has resulted in a rail system,
11 a rail freight system that is really the envy of the
12 logistic systems in the world.

13 Consolidations that we have gone through
14 have led to longer hauls, fewer interchanges and have
15 improved efficiency. On our own network Chessie
16 Seaboard basically allowed us to be more responsive to
17 customers, to provide faster service and really begin
18 to strategically position the company for growth in
19 the Sun Belt. The Conrail split filled in the gaps in
20 the two eastern networks, provided balanced
21 competition to the east and introduced key competition
22 back in key markets in the northeast.

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1 Now, I might add a good example of our
2 ability to utilize these new networks is given the
3 situations we have confronted in the Gulf with the
4 hurricanes and our ability to react and to redirect
5 trains and service with our partners in the industry
6 over alternate gateways in an attempt to continue to
7 drive freight to the customers.

8 Now, as the vice president of strategy, my
9 responsibilities take a look at really to look forward
10 and take a look at where the industry is going and
11 where our company is going. And I believe that we are
12 at a crossroads here. Transportation demand, as
13 stated by many of the panelists earlier, is really at
14 record levels and it is continuing to grow. The mix
15 between domestic manufacturing and imports and exports
16 is continuing to change and the demographics of the
17 change in consumption markets evolving over time.

18 That growth is expected to continue. It
19 will come from growth and population. It will come
20 from growth in the economy. It will come from growth
21 in the service and consumption markets. And it will
22 come from growth in imports. If you look at this

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1 chart and you even take half the rate of growth, the
2 growth is really stunning.

3 Despite the rapid growth of service and
4 imports, the industrial production in our economy
5 continues to grow. This is a good thing for the rail
6 industry. Our customers are becoming increasingly
7 competitive in a global environment.

8 Now, the interesting crossroads is that
9 again this chart reflects the history back to 1980,
10 the date of the Staggers Act. And the bars are really
11 the forecasted changes and the number of miles
12 traveled on the highway, since 1980, and you can see
13 it is about 125 percent basis points above where it
14 was in 1980. And the changes in lane miles on the
15 highway infrastructure. The vehicle miles has
16 considerably exceeded weigh mile capacity. It's
17 pretty obvious highway infrastructure construction is
18 not keeping pace with transportation demand.

19 We all know that highway infrastructure
20 investment is increasingly difficult and expensive to
21 build. And we are all suffering at the hands of those
22 highways today, whether it be a commuter or rail

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1 passengers or our customers who are suffering delays
2 in their own logistic systems.

3 Now, we believe CSX's market is well-
4 positioned to take care of this demand. The
5 population centers that we serve, the amount of
6 disposable income that is in the eastern territory and
7 the consumption and future consumption which is going
8 to take place. We also, as we look out at the
9 markets, realize that traffic growth is not just at a
10 consistent level across our network. So as we look at
11 our network, in the northern part of our network we
12 see traffic growing at about a little less than a 2
13 percent compound annual growth rate over the next four
14 or five years. But that's off a very, very large base
15 of traffic we have in the north.

16 As we look over time, we see rapid growth
17 beginning to occur in the mid-south in the southern
18 markets on our system. With that and with the ability
19 to predict, we believe the look out at predictable
20 ability to market our freight, we have committed to a
21 series of infrastructure expansion projects that we
22 recently announced this past August in New York. That

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1 will be a rate of spend which is over the next two
2 years \$300 to \$400 million per year over the \$1
3 billion in capital investment we put into our planned
4 infrastructure on a normalized basis.

5 And that expansion will take place across
6 our network north of New York along, what we call, the
7 River Line to get goods in and out of New York along
8 that high dense northern market, between Chicago and
9 the southeast at many points to reflect the changes
10 that have taken place in the vast growth and
11 demographics of the economy and the country's
12 population centers. And you see the little egg over
13 to the left, which is really towards Saint Louis
14 Gateway to accommodate the shift of coal sourcing to
15 the Illinois Basin and the Powder River and Colorado
16 sources that UP and BN serve.

17 And not only are we investing in this
18 growth, but our customers are also investing in this
19 growth. So that we believe they see things the same
20 way we do. In our merchandise business, which is our
21 batch carload business, new ethanol facilities and
22 feed mills, private investment going into our property

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1 along with some investment on our own part to
2 compliment these facilities, such as plastics transit
3 facilities.

4 In the coal business, for the first time
5 in many years, new power plants actually getting ready
6 to go on-line and more new projects being inventoried.
7 You see the clustering of those in the southeastern
8 United States consistent with our previous slide and
9 the capital investment we're going to be putting into
10 the property.

11 Intermodal, the growth and intermodal are
12 both important development on the east coast and
13 intermodal logistics centers that our western carriers
14 have been developing in Chicago that we are looking at
15 in the Midwest, in the Mid-Atlantic and in the Florida
16 markets.

17 And automotive, we just recently in
18 Montgomery, Alabama opened a new Hyundai plant and we
19 expect that the foreign transplant continued growth in
20 the United States in auto parts and plant facilities.

21 So what is this all about? It really
22 means driving towards the goal, sustained revenue

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1 adequacy. CSXT's ability to invest is growing. We
2 have had solid revenue growth over the last couple of
3 years in particular, significant productivity gains
4 and more to come. Our capital structure remains
5 strong. We have solid free cash flow, improving
6 returns enhancing the value of the company, as you
7 heard the financial community talk about the industry
8 in general.

9 And we have continued investment for
10 growth, recoverability and reliability on our network,
11 because that is what our customers are looking for,
12 reliability and recoverability. Our focus will remain
13 on earning the right to spend. We will focus it
14 around key strategic routes, corridors and equipment
15 and we must earn the cost of capital consistently and
16 sustainably over a long period of time in order to
17 have confidence that we can continue to plow these
18 investments into our company.

19 In the end, it really starts with the
20 customer, because what we are about is moving freight.
21 We believe there is more customer demand, as we have
22 heard today and as we believe as we look out into the

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1 marketplace, and that will mean more volume for our
2 company in this industry. Sustained revenue adequacy
3 is essential for making the long-term capital
4 investments we have to make to be able to accommodate
5 that freight. And that investment and infrastructure
6 will deliver growth for the industry, reliability,
7 safety and recoverability. Thank you.

8 CHAIRMAN NOBER: Thank you very much.

9 MR. LANIGAN: Good afternoon, Chairman
10 Nober, Vice Chairman Buttrey, Commissioner Mulvey.
11 I'm John Lanigan, Executive Vice President and Chief
12 Marketing Officer at BNSF Railway. And rather than
13 rehash my submitted statement, I would like to touch
14 on a few points that came up during the morning this
15 morning to make it more topical from a standpoint of
16 addressing some of the concerns that the customers and
17 others raised this morning.

18 First, I think it is clear that everyone
19 of my colleagues that joins me today wishes we had
20 better service today. There is not a railroad in
21 North America that wishes that the service levels were
22 where they are today. But let's talk for just a

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1 moment around how we got to where we're at.

2 If you look over a 20 or 30 year period,
3 and I have a little different perspective in that I
4 spent 16 years in the trucking industry from shortly
5 after deregulation of the trucking industry until
6 2000. And so I saw a market in the trucking industry
7 that under deregulated environment became easily the
8 most efficient and most effective trucking
9 infrastructure in the world. And I bring that
10 background with me to the rail industry.

11 And as I think about the long-term volume
12 growth of the rail industry over a 20 or 30 year
13 period, it was more in the 2 percent or so range of
14 annual volume growth. Last year at BNSF, we handled
15 10.5 percent more units than we handled in 2003.
16 About 5 times what the historical growth patterns
17 were. There was no headlights on that type of volume
18 growth coming our way. But if you think about what
19 has gone on in the economy over the last couple of
20 years, you can understand how it did happen. But you
21 can also understand that you couldn't anticipate it.

22 Some of those factors included what is

1 going on in the trucking industry, the industry that
2 I came from, and the difficulty that they are having
3 in finding qualified truck drivers and maintaining an
4 adequate truck driver fleet. Recently, Governor
5 Graves, who lead the American Trucking Association,
6 indicated that the Association believes that the U.S.
7 is 20,000 truck drivers short of needed capacity today
8 and they anticipate that that could go as high as
9 100,000 over the next five to six years. That's
10 having a direct impact on the demand for rail
11 services.

12 When you look at natural gas prices in the
13 \$13, \$14, \$15 per mil in cubic feet, for the first
14 time in a generation, coal is becoming the energy of
15 choice or the fuel of choice for the energy industry
16 and has created unprecedented demand for hauling coal
17 throughout the United States. Those are just a couple
18 of examples of things that have happened over the last
19 couple of years that have now put a spotlight on the
20 rail industry.

21 And with the concerns around service and
22 the absolute service levels, I know at BNSF we have

1 hailed more freight last year, 10.5 percent more units
2 than the year before. And off of that base, we're
3 going to haul probably 5 percent more units this year
4 than last year, somewhere in that range. Just
5 unprecedented volumes historically and we're very
6 proud that we have been able to say yes to our
7 customers a lot more often than we have said no during
8 that period of time.

9 But it hasn't come without a cost. It has
10 come with a cost of congestion. It has come at a cost
11 of some of the service metrics that we were used to
12 providing. And, in fact, if you looked at the 2001,
13 2002 time frame, at least at BNSF, those were all time
14 highs in service in the history of the company. And
15 so this unprecedented very rapid build up of demand
16 and volume coming toward the American railroad
17 industry is one that, I think, we should all
18 understand that we have been working hard to handle,
19 but it has not been without its pain.

20 As we think about these complex networks
21 then, another thing comes to mind and that's the
22 rationalization of the rail network over the last 30

1 or 40 years, particularly since deregulation. What
2 has been rationalized at least at BNSF is not mainline
3 capacity. It's not terminal capacity. It's not
4 capacity in and out of major metropolitan or major
5 producing and consuming markets. It has been branch
6 lines that are under utilized, under performing and
7 under appreciated.

8 And as we rationalize those lines, many of
9 the proceeds that were gained from rationalizing those
10 lines were put back into the core infrastructure to
11 build out the infrastructure so that we could handle
12 Powder River Basin coal, for example, or so we could
13 handle intermodal shipments as well. So when we think
14 about the investments that we made, all I have to do
15 is go back three years. Three years ago, we hit the
16 bottom from a standpoint of return on invested capital
17 at BNSF and that resulted in us investing \$1.5 billion
18 of capital expenditures that year.

19 This year we will invest about \$2.2
20 billion, three years later. And the reason that we
21 have gone from \$1.5 billion to \$2.2 billion is because
22 we are earning a better return on our investment.

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1 It's as simple as that. And the Wall Street analysts
2 showed you some slides today that indicated that not
3 only do they support that, but that the investors are
4 now finally coming to the table for the first time in
5 the generation saying we would rather have you put
6 money back into the infrastructure than to pay us in
7 dividends.

8 So we may have underestimated in the late
9 '90s, early 2000s what the volumes might be in
10 2004/2005. Quite frankly, I don't think any of us had
11 a crystal ball to be able to see that we would rise
12 above historic 2 percent or so volume increases on a
13 year over year basis. But we think that we are
14 peddling very hard to take advantage of the
15 opportunities at hand, but also to provide longer term
16 the service that our customers are asking for and the
17 service that they deserve.

18 So in closing, as you think about future
19 policies that the STB may consider as it regards to
20 the Staggers Act and the anniversary of the Staggers
21 Act and the regulation of the rail industry, I
22 encourage you to think about policies that will

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1 stimulate the growth and infrastructure and the rail
2 industry. And it's really predicated upon the rail
3 industry achieving a long-term consistent cost of
4 capital, so that we can gain the confidence of our
5 investors and so that we can put more money into this
6 business. Thank you.

7 CHAIRMAN NOBER: Thank you very much. Mr.
8 Young?

9 MR. YOUNG: Don't start the clock yet.

10 CHAIRMAN NOBER: We'll spot you the extra
11 time.

12 MR. YOUNG: Okay. Good afternoon,
13 Chairman Nober, Vice Chairman Buttrey and Commissioner
14 Mulvey. I think we all agree the Staggers Act has
15 been a tremendous success. In fact, I'm not certain
16 you could find another industry in terms of change
17 that has had this much success in the last 20 or 25
18 years. But I also agree, I think it is premature to
19 declare victory. Many of the investments that we
20 think about in our business are 20, 25 year kinds of
21 time lines, so time will tell how the success will go.

22 We all agree capacity is constrained.

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1 There is a chart up here that shows whatever forecast
2 you want to use. The American Truckers Association,
3 DOT, AASHTO all shows volume increasing. We will have
4 a cycle. Commissioner Mulvey, as an economist, it's
5 probably time to come through here, but I think
6 structurally things have changed for us here.

7 Next slide, Mike. This is a discussion
8 about transportation infrastructure not just the
9 railroad industry. This shows a chart here that says
10 what's happened on the highway system. You've heard
11 it consistently, density has increased here. When you
12 look at vehicle miles traveled per lane mile, you
13 could flip the same chart up there for the railroads
14 and show a huge increase in productivity. In fact,
15 the railroad, Union Pacific, alone in the last seven
16 or eight years has increased its density by 50 percent
17 in terms of gross ton-miles per train mile.

18 The question, obviously, is one of trucks.
19 I spend a significant amount of my time in front of
20 our customers. What is interesting in those
21 discussions, I see a frustration that truck service is
22 expensive. Truck service in many cases is not

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1 available. They want the railroad to solve the
2 problem. That's a great problem for this industry to
3 have in terms of where we're going forward here, but
4 I don't think that in terms of I don't see anything
5 that will change here on the infrastructure side of
6 this that's going to solve this either way.

7 One of the other things I see in our
8 customer meetings, the logistics piece in many of our
9 businesses now is in the top priority when you think
10 about many of our businesses. I'm in more businesses
11 where the CEO is involved, the president is involved,
12 it's now moved into the top five kinds of issues going
13 forward.

14 Next slide. This is a chart here that
15 shows Union Pacific's volume. Even with our
16 challenges we've had, we continue to set record
17 volumes every year. I agree with what you have heard
18 up here, we all are focused and need to provide better
19 service. The fact is that we are handling more
20 volumes, even though Mother Nature has hit us a few
21 times, but our ability to recover has certainly been
22 improved over time. You look at the AASHTO report and

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1 it's raising a pretty significant issue for all of us
2 which is talking about where will that investment come
3 from as we look forward here?

4 Next slide. If you look at this chart
5 here, this one to me really kind of tells the story
6 here. If you look at the base case, what's needed in
7 terms of capital investment in the rail industry? If
8 we simply meet what we think industrial production
9 will be over the next 15 years, it says the industry
10 needs to invest \$175 to \$195 billion. That's greater
11 than the current asset values of the companies today.
12 That's simply to maintain market share with the
13 highway system going forward here. You will also
14 note, if there is no growth, we've got \$100 to \$125
15 billion of investment simply to keep up with
16 maintenance.

17 These are some of the points in our system
18 where you can look at some of the volume. In
19 particular, look at the Sunset Corridor, which we have
20 talked to you about, the acquisition of Southern
21 Pacific. You will note there in 1998 we were running
22 30 trains a day. October of last year, we were

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1 running 45. This year we're running 50. So we have
2 had a huge increase in volume.

3 You look at South Texas, again, another SP
4 area where we went from 10 trains a day in a corridor
5 and up to 18. You look at the Iowa Corridor, a lot of
6 that handles coal. Our running went from 59 to 69 a
7 year ago. We're running right now about 70 or 75. So
8 clearly, volume has been increased in our business.

9 I have used this chart several times in
10 terms of when we look to the next five years, these
11 are the major areas in our network that we have some
12 very critical decisions to make about investment.
13 Sunset Corridor, I'll tell you, the demand there far
14 exceeds the capacity. It's a thousand mile railroad.
15 A third of it is double track, two-thirds single
16 track. The price tag for investment there is \$2.5
17 million a mile. So we have a major decision to make
18 about how fast we want to invest in this business.

19 If you look at total capital expending,
20 the numbers are pretty big. There is no industry that
21 spends capital as a percent of revenue. This is UP
22 here. We've been running 18, 19, 20 percent of our

1 revenue over time. I think the next closest is
2 probably about 7 or 8 percent, if you look it across
3 the board here. We're going to spend record levels of
4 capital this year. Part of that commitment of capital
5 is we are seeing our ability to start to improve our
6 margins and give price in the marketplace.

7 If you look here, this is the issue for
8 us. The returns aren't there. UP is lagging. Many
9 of our partners here, in terms of where they are going
10 in returns, we will come around. But the real
11 fundamental issue here is one on what's happening with
12 returns in this business.

13 This is a pretty straightforward chart.
14 It talks about where do you want to put the capital?
15 Where do you want to focus your returns here? We are
16 seeing a significant amount of focus in the areas
17 where the most efficient customer base is where scarce
18 resources are allocated in terms of hauling goods.

19 Next slide. This slide here is a view
20 from the rating agency and I think it's important to
21 keep in mind here while this industry shows that we
22 are above investment grade, it doesn't take much to

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1 move us back below. The margin for error when you
2 look at cash flows in this business, the huge amount
3 of capital, it can quickly deteriorate as well as it
4 has moved up.

5 To wrap it all up here, demand for
6 transportation is growing. We all agree with that.
7 I see that is going to be satisfied in several areas.
8 We have to get the returns up and this isn't just
9 about pricing. This is about efficiency in our
10 network. This is about good industrial engineering
11 that you look at processes. This is about efficiency
12 in our network, investment and technology going
13 forward. Adding capacity is expensive. A price tag
14 easily is about \$2.5 million a mile right now to put
15 new railroad in. So it's a real challenge.

16 When you look here, item 3 here, expanding
17 the rail network will require higher earnings, not
18 regulation that reduces earnings. We have had this
19 discussion. Investment is only going to come from two
20 places, either from our shareholders in the investment
21 community or the Government. And I don't see the
22 Government actually bailing this industry out in terms

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1 of putting significant capacity in.

2 Scarce capacity must be used efficiently.

3 One of the things we are seeing and it really varies
4 with each customer base, as I said in many of these
5 areas the strategic focus on transportation has been
6 raised in many of our customers we deal with here.
7 One of the things we are talking with and we've
8 partnered with a lot of our customers, we can sit down
9 together and look at how do we get the most out of the
10 train station infrastructure?

11 And some of those solutions are simple.
12 It's work seven days a week. Operate 24 hours a day.
13 Many customers work Monday through Friday and it does
14 restrict capacity going forward here and we see a lot
15 of our customers that are committed in working with us
16 to increase through efficiency. So the bottom line,
17 how large a rail network do we want?

18 The industry when you look at it, as I
19 said, it's not -- I think it is healthier, but we have
20 a long ways to go before we declare victory in terms
21 of the state of this business. Thank you.

22 CHAIRMAN NOBER: Thank you very much. Mr.

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1 Tobias?

2 MR. TOBIAS: Thank you, Chairman Nober,
3 Vice Chairman Buttrey, Commissioner Mulvey. It is my
4 pleasure to represent Norfolk Southern at this
5 proceeding. I started with Norfolk and Western and
6 had the pleasure to migrate in '80 to merger with --
7 consolidation with Southern Railway and had that
8 experience and have put in 36 years of principally
9 operating line duties and currently serve as chief
10 operating officer of NS.

11 I think the successes of the Staggers Act
12 have been widely recognized here. And there were
13 certainly many discussions and publications that
14 attest to that. The contrast between the pre-Staggers
15 rail industry to the post-Staggers demonstrates how
16 significant the regulatory regime is to the success or
17 failure of this particular industry.

18 I'm struck by the fact that many of the
19 comments that you are hearing today are similar in
20 context. It's not verbatim, but it's not something
21 that we sat and contrived. Not the least of our
22 commonalities is our gauge which is 56.5 inches. We

1 share many other similarities and many other issues
2 for the successes that we have had of late. We still
3 have a very long way to go.

4 Freight volumes are increasing at Norfolk
5 Southern as they are in the industry. NS is focused
6 on what we must do to provide the safest, the best
7 rail transportation and service to our customers in
8 the face of a very large increasing demand. Running
9 the scheduled operation and reducing variability are
10 the two major focus points for NS in this particular
11 environment.

12 We are focused on serving all of our
13 customers and by doing what is best for the network,
14 making decisions that impact the complexity of what we
15 do across the broad spectrum of our system and not
16 just moving problems around. We invest heavily to be
17 prepared to handle more freight and provide better
18 service to many different customers who have many
19 different shipping patterns and different
20 requirements, many of which shift and ebb and change
21 on a daily and a weekly basis.

22 The investments that we make are again

1 based on the overall health and benefit of the network
2 in total. They don't come cheap. They fall into
3 areas of track investment, much like our Heartland
4 Corridor, which is a corridor investment and projected
5 somewhere in the neighborhood of \$300 million. We
6 invest in locomotives, both from an acquisition and a
7 leasing standpoint, rail cars fall in the same
8 category, crew hiring and training of our people.

9 We invest in information technology. At
10 NS we have invested heavily in our thoroughbred
11 operating plant and our operating plan developer which
12 allows us to model and respond in a very short period
13 of time to "what if" scenarios. What if Hurricane
14 Katrina does strike? What should our response be?
15 What will our service configuration be and what
16 adjustments do we need to make in our network that
17 allow us to respond to that type of an event and bring
18 our service back to a standard that meets the need in
19 an emergency situation or some other non-standard
20 event?

21 All of these things require a lot of
22 money, and probably more importantly, they require a

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1 great deal of lead time and they are long-lived
2 assets. We try to be very judicious in the
3 application of that money and that spend, because the
4 long-lived tenure of those assets has far reaching
5 impacts if we make a significant mistake.

6 Rail investment is critical to our future.
7 The Staggers Act was critical. It created the best
8 rail system in the world, in my opinion. Our system
9 is a competitive advantage for America. I really
10 don't think we can afford to lose that. We must have
11 the resources to continue to improve, encourage growth
12 and reach the potential over the much longer term.
13 Thank you.

14 CHAIRMAN NOBER: Thank you. Mr. Russ?

15 MR. RUSS: Chairman Nober, Vice Chairman
16 Buttrey, Commissioner Mulvey and Members of the STB
17 staff, good afternoon. I am Ron Russ. I'm the
18 Executive Vice President and Chief Financial Officer
19 of The Kansas City Southern and it's wholly owned
20 Class I subsidiary, The Kansas City Southern Railway
21 Company. I joined KCS in 2002. I have spent 28 years
22 in the rail industry, including service at Wisconsin

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1 Central, the Sioux Line and the Milwaukee Road when
2 the Staggers was enacted.

3 I would like to thank the Board for
4 allowing KCS the opportunity to provide its input on
5 the Staggers Act and it's implementation. As an
6 overall comment, it has been my observation that
7 without the Staggers Act and the way it was
8 implemented by the Board and its predecessor, the
9 industry would not have survived as we know it. In
10 KCS' opinion, the Act should not be changed in any
11 significant way nor should the Board change its
12 precedent implementing that Act.

13 In explaining why and how KCS has come to
14 that conclusion, let me share a brief history of KCS
15 and the role KCS today plays both domestically and
16 internationally. Then I would like to discuss the
17 importance of attracting sufficient capital in the
18 rail industry, the role capital plays with respect to
19 the rail industry's infrastructure needs and why
20 Staggers is critical to that role.

21 In 1980, when Congress passed the Staggers
22 Act, all railroads were struggling to survive. The

1 KCS was no different. With the passage of Staggers
2 and the deregulation of the rail industry, KCSR, like
3 the industry as a whole, was able to adjust its
4 revenues to market conditions, increase its investment
5 and infrastructure and improve service. As we
6 approached the 1990s, massive consolidation of the
7 industry left Kansas City Southern, the smallest of
8 the remaining Class I railroads.

9 Kansas City Southern was either going to
10 be acquired, continue to shrink or going to grow.
11 Under the leadership of our Chairman, Mike Haverty,
12 Kansas City Southern decided to grow. Kansas City
13 Southern did so through a series of mergers,
14 acquisitions, alliances, marketing and haulage rates
15 with many of my colleagues here at the table.

16 None of these franchise strengthening
17 actions would have been possible in a pre-Staggers
18 regulatory structure nor would Kansas City Southern
19 have been able to undertake these actions if the ICC-
20 STB had implemented Staggers in a different way or
21 taken a more activist role in the marketplace.

22 Today, Kansas City Southern remains the

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1 smallest of the Class I railroads. Nonetheless, it
2 plays a significant role in providing shippers with an
3 independent competitive presence in the marketplace.
4 The Staggers Rail Act along with aggressive and
5 focused management has allowed Kansas City Southern to
6 become a critical alternative for rail transportation,
7 both domestically and internationally.

8 For example, The Kansas City Southern's
9 Meridian Speedway, which is what we call a rail line
10 between Meridian, Mississippi and Dallas, Texas, holds
11 great promise for the movement of intermodal freight
12 in the Transconscontinental market, that is the most
13 direct connection from the U.S. southwest and west
14 coast to Atlanta and southeast U.S. markets.

15 Likewise, NAFTA holds great promise for
16 our company. With our ownership of Kansas City
17 Southern Railway, the Tex-Mex Railway and TFM under
18 one single holding company, Kansas City Southern now
19 presents the best competitive alternative for the
20 movement of NAFTA traffic to and from Mexico and it
21 presents the greatest opportunity for growth in the
22 future. Most of the growth will come from increased

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1 projected trade between Canada, the U.S. and Mexico.
2 Some will come from the development of a port at
3 Lazaro Cardenas.

4 However, most of that growth will come
5 from our ability to move traffic from other modes,
6 including off our highways and onto our rail system.
7 Most of the overall NAFTA trade is transported by
8 other modes. Of the overall cross border traffic
9 between the U.S. and Mexico, rail represents only a 20
10 percent share. We intend to change that. We will do
11 so by providing the most cost effective, safest and
12 most environmentally responsible way to move the ever
13 growing volumes of freight that will be required along
14 the NAFTA Trade Corridor in the future.

15 However, we cannot do this if Stagger
16 changes and the industry is re-regulated. This Board
17 and Congress must resist the urge to change the
18 Staggers Act in a way that would hamper efforts of the
19 rail industry to better compete with the other modes
20 in the NAFTA Trade Corridor. Calls by some for the
21 regulation of rate making freedoms, such as the
22 requirement to establish bottleneck rates, both

1 domestically and internationally to and from our
2 borders or for this Agency to be involved in setting
3 the divisions to and from gateways should be rejected.

4 Such regulation would eliminate the
5 railroads' ability to achieve adequate returns and
6 price according to the market. Perhaps the most
7 critical component to Kansas City Southern's ability
8 to continue to provide an effective competitive rail
9 alternative and to increase the rail industry's share
10 of the overall NAFTA trade market is the need for the
11 railroads to achieve adequate returns.

12 In spite of the successes of the Staggers
13 Act or perhaps I should say despite the successes of
14 the Staggers Act, the nation's railroads both large
15 and small are at a crossroads. KCS like the other
16 railroads is finding it more and more difficult to
17 replace, improve and expand its infrastructure in
18 order to keep pace with the increased traffic growth.
19 We are very close to being completely capacity
20 constrained. Yet, capacity can only be increased with
21 new capital.

22 As you know and like the trucking

1 industry, railroads finance virtually all their own
2 right-of-way, both in terms of maintenance and
3 improvements. KCS like the other rail carriers must
4 increase its revenues and raise sufficient capital to
5 not only maintain an existing infrastructure, but at
6 the same time plan for and build for future traffic.
7 This is a challenging task. This year domestically in
8 the U.S., Kansas City Southern will spend,
9 approximately, \$65 million for maintenance cap ex, \$56
10 million in rolling stock, IT and other assets just to
11 maintain our existing infrastructure.

12 That's about 17 percent of our operating
13 revenues. On top of that, Kansas City Southern will
14 spend yet another \$42 million more to expand the
15 capacity of our rail infrastructure and \$60 million
16 more for new high horse powered locomotives. KCS
17 could easily spend 100 percent of these amounts and
18 more to accommodate all the capacity expansion
19 projects necessary for KCS to truly build for the
20 projected growth of the system.

21 Obviously, that would be unrealistic. But
22 we do need to do revenues, so that we can raise the

1 new capital needed to expand our system and meet the
2 demand of rail transportation for the future. To
3 illustrate the challenge we face at Kansas City
4 Southern, for example, within the confines of our
5 existing revenue base, both The KCS and Tex-Mex are
6 undertaking a significant number of capital projects
7 to expand capacity for the future, from yard expansion
8 in Shreveport to adding CTC at several locations on
9 the Meridian Speedway to putting new sidings and
10 double tracking at numerous locations.

11 Recently, Tex-Mex obtained a \$50 million
12 RRIF loan from the FRA to rehabilitate the Tex-Mex
13 Line in south Texas. These projects are necessary for
14 KCS to remain competitive for the existing traffic
15 dates. But that is not enough. KCS must plan for the
16 future and we are doing so. KCS is working with third
17 parties to arrange for the necessary financing to
18 rebuild and rehabilitate the Victoria to Rosenberg,
19 Texas Corridor, so as to free up capacity on the UP
20 Lines used by Tex-Mex by its trackage rights.

21 KCS is also funding existing grade crossing
22 relocations, closures with state, federal and private

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1 dollars as necessary to improve safety and eliminate
2 congestion. All of these projects require significant
3 funding strategies, funding that is many times
4 difficult to come by in the capital markets witness
5 the RRIF loan for the Tex-Mex.

6 The bottom line is that the railroads like
7 KCS and others continue to prosper and plan for the
8 future. We need to have access to capital for the
9 capacity improvements that we must have for the
10 property to grow. KCS can raise revenues and improve
11 capital picture by cutting costs using Government
12 funding mechanisms and in public/private partnerships
13 will find significant benefits to improve the railroad
14 and improve the railroad in the public interest.

15 By looking at ways to improve productivity
16 through technology investment and through items such
17 as federal capital investment tax credit for Class I
18 railroads like those granted to Congress -- to the
19 short by Congress, to the short line railroads, would
20 also help. But all these options have limits. The
21 best way to ensure the necessary capital continues to
22 remain available is for the STB to ensure railroads

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1 like KCS can earn adequate returns.

2 We urge you to not tamper with the
3 Staggers Act going forward. Thank you.

4 CHAIRMAN NOBER: Thank you very much. Mr.
5 Waites?

6 MR. WAITES: Thank you very much, Mr.
7 Chairman, Vice Chairman Buttrey, Commissioner Mulvey.
8 We are pleased to be here this afternoon. Allow me to
9 say that Canadian Pacific conducts its operations in
10 the U.S. through subsidiaries, Delaware and Hudson
11 Railroad in the U.S. Northeast and also the Sioux Line
12 Railroad in the U.S. midwest. That ties together the
13 twin cities to Chicago up to Detroit with running
14 rights and also tieing into the west to CPR's western
15 Canadian Lines to border crossings.

16 I think it's also very helpful to note
17 that of CP's total revenue is about \$4.5 billion
18 Canadian, about 30 percent of those revenues are
19 transborder revenues and so we're very much talking
20 about a system of transborder shipments about \$1
21 billion in U.S. dollar terms and also we're talking
22 about global traffic movements and supply chains and

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1 rail, obviously, is one part of that overall system.

2 I would like to abbreviate our comments.

3 Much has been said by my colleagues on the success of
4 Stagers, so I'm not going to repeat that. What I
5 would like to do is just draw your attention to this
6 slide. It's towards the end of our submission. And
7 this is really our picture of what is happening at CPR
8 and I think it draws a picture of what perhaps might
9 be happening to various degrees at other railroads.

10 But you can see this is entitled "CPR
11 Network Holiday Ending," and what you have here is on
12 the top you have a line running from west to east and
13 that line depicts the physical capacity of the track
14 and road bed capacity of our railway and this is an
15 illustrative depiction, but you might think of it as
16 an index spaced relationship. The histograms and the
17 why excess talk about the amount of that capacity that
18 we are utilizing.

19 So, for example, in the early 1900s, at
20 the far left, you can see that we had excess capacity,
21 but you can see in terms of number of trains versus
22 that capacity that the excess was moderate, but it

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1 nevertheless existed. The top part of the histogram
2 is passenger trains. And, obviously, as we saw the
3 development of roads and highways, the amount of
4 capacity dedicated to moving passengers declined over
5 time, as something we have all seen.

6 And as you see that come down clearly,
7 there were movements on the freight component, but as
8 we move to the right, you can see that, in fact, that
9 capacity crushing got even greater and that was not a
10 sustainable proposition for railroads. And so
11 railroads did what they only could do, that was to
12 ration capacity and to rationalize systems. And so
13 what was happening was we shrunk the railroads so that
14 the revenue adequacy was not there. We had to get rid
15 of the capital base and that's how we did it.

16 As we move to the right you can see we
17 removed double track. We abandoned parallel routes.
18 We moved to fewer longer sidings. We went to
19 centralized traffic control, today the equivalence of
20 that of positive train control and so on. As you get
21 into the '80s, we had a lot of improvements,
22 productivity improvements in terms of rolling stock,

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1 improvements in car fleet, car utilization, locomotive
2 technology and so on.

3 But the key take-away here is as you move
4 to the right hand side of this chart, we're moving
5 from an era of surplus capacity to an era of surplus
6 demand. And clearly price signals have to reflect
7 that kind of movement. And I think the question as we
8 started our submission by asking the questions did
9 Stagers work? What worked, what didn't work? I
10 think the question here is as we go forward, do we
11 think that Stagers is what we need to go forward?

12 And we believe the answer is very much
13 yes. So let me try and explain that. Maybe we could
14 take this slide down, at this point, if that could be
15 done. But as we move forward, what do we see? We see
16 increasing trends to containerization. We see
17 increasing short line roles originating traffic. We
18 see increasing trends toward coproduction with our
19 colleagues up here in short lines. We see more
20 opportunity for collaborative demand management
21 working with shippers and this includes things like 7
22 x 24 loading schedules and so on.

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1 We think that we have to look at the
2 entire supply chain. This includes ports, terminals,
3 mines and other pieces of infrastructure that fit into
4 that overall chain. And I think there will be an
5 emerging and increasing clarification around the world
6 of trucks, which certainly with the current fuel price
7 differentials trucking plays a key role in terms of
8 originating and distributing traffic. But railroads
9 do the best job moving heavy tonnages long distances.

10 And a consequence of that, which you have
11 heard about this afternoon, is, obviously, a huge
12 demand for investment in railroads. And the reason we
13 believe that Staggers is still very much applicable is
14 because it plays a market based solution to those
15 challenges. So to Vice Chairman Buttrey's comments
16 earlier this morning, we don't believe we need
17 regulatory help to work on those opportunities as we
18 go into the future working with shippers on demand
19 management coproduction and so on.

20 We think those opportunities are there for
21 us to have. And that the marketplace and the value of
22 proposition will be there if it is allowed to work.

1 What that means fundamentally is our ability to price,
2 our ability to generate a return on assets, it enables
3 us to access capital markets, so it's critical for us
4 to do that.

5 There is one other point that I would
6 really like to stress here is when we look forward to
7 these types of investments, the investments we're
8 looking at are different types of investments to what
9 we, I wouldn't say typically done, but more recently
10 done over the '80s and over the '90s. A lot of those
11 investments are investments in rolling stock. And
12 they have some fairly unique characteristics in
13 contrast to what we're looking at here.

14 But for example, in cars and locomotives
15 they are more physically discrete. You can put them
16 in. You can take them out. They come in smaller
17 divisible increments. So if the demand isn't there,
18 you can try and match those leases if, in fact, that's
19 the way you acquire them and finance them to those
20 various levels of demand. They are easier to redeploy
21 on a sublease as an example. There is a different
22 risk profile around that type of investment.

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1 The investment that we're looking at here,
2 this is an investment in physical infrastructure. We
3 can't move that. It can't go anywhere and so what we
4 have to have in order to do that is we have to have
5 revenue adequacy over the investment cycle and that
6 will enable us to invest. And I would suggest to you
7 that if we have that over the investment cycle and
8 we're looking for sustained investment, I think we
9 have to have sustained revenue adequacy. That is the
10 only way that this will move forward.

11 And so I wanted to highlight that key
12 distinction. We do need stability. We need the
13 commercial incentive to improve the productivity. And
14 the way we do that, obviously, is to go back to those
15 capital markets that we heard about about midday today
16 and we argue for that capital on a risk adjusted
17 competitive return basis. And that, in fact, or
18 those, I should say, are, in fact, the rules that we
19 have to deal with going forward. That concludes my
20 comments. Thank you.

21 CHAIRMAN NOBER: Thanks. Mr. Trafton?

22 MR. TRAFTON: Chairman Nober, Vice

1 Chairman Buttrey, Commissioner Mulvey, thank you for
2 the opportunity to share with you my perspective on
3 the 25th anniversary of the Staggers Act.

4 It was through a summer employment
5 improvement that I landed a job with a Class I
6 railroad a few years before the enactment of the
7 Staggers Act. When I made my decision to go to work
8 for a railroad, there were those who questioned why,
9 after earning a college education, I would want to
10 work for a company that is in a regulated industry
11 that then and now is not well-understood by the
12 general public and the shipping community.

13 Their view was if you were going to do
14 that, you might as well go to work for the utility or
15 a Government. I'm sure that there are many factors
16 that contributed to my final decision that I no longer
17 recall, but the one I do remember was a transportation
18 professor. He described to me the potential and the
19 likelihood of a renaissance in the railroad industry
20 when, not if, the industry became deregulated.

21 With a view and some additional research,
22 I took a leap of faith that has brought me here today.

1 I can tell you from my own personal experiences how
2 accurate my professor was in describing that
3 renaissance that has occurred over the past 25 years.
4 Much more is still to come.

5 Seeing it as a business and as a business,
6 we have to produce a service that attract customers.
7 Without them we have no business. In order to compete
8 with other transportation companies, we need to assure
9 investors that we have an opportunity to earn our cost
10 of capital. Finally, we must pursue efficiency and
11 innovation in product and our practices. I believe
12 that the Staggers Act has given the CN and other
13 railroads the opportunity to accomplish all three of
14 these objectives.

15 As a business, we have to reinvest in our
16 plant. Hundreds of millions of dollars each year are
17 spent on maintaining and renewing our equipment and
18 facilities. CN will spend, approximately, \$1.6
19 billion this year. New rail, new ties, new ballast
20 are added each year as we maintain and expand our
21 network in addition to many other items that include
22 IT services and the like.

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1 As a practice, we do not seek Government
2 funding in our day-to-day operations. We spend
3 additional millions each year recovering from such
4 events as hurricanes. Also as a business, we must
5 innovate and continually improve efficiency or fall by
6 the wayside like many others in the past. Peak and
7 off-peak pricing by day of the week, intermodal
8 reservations, routing protocols are examples of our
9 efforts.

10 We at CN are here for our customers. Why?
11 Our customers' success assures shareholder and
12 employee success. We are, therefore, always looking
13 forward to new ways to provide value to the customers
14 in order to secure the profits available when we
15 create that value, and we need a regulatory system
16 based on market principles like that provided by the
17 Staggers Act to assure that we can keep creating new
18 value.

19 The difference between the Staggers Act
20 and other regulatory approaches is that other such
21 approaches impose inefficient and uneconomic
22 regulation while Staggers imposes efficient and

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1 economic regulation.

2 Now, there are those that talk about re-
3 regulation and the need to "fix" the railroad
4 industry, but I would suggest to you that it isn't
5 because the railroad industry is broken, but that
6 change has been hard to accept for those in today's
7 world that continue to view the railroads as a
8 utility.

9 Instead, the Staggers Act has provided us
10 with the ability to operate as a business by giving us
11 the opportunity to earn our cost of capital, create
12 the desire to compete by offering better and better
13 services and has generated the need to innovate and
14 improve safety, efficiency and service.

15 At CN we have five core principles we live
16 and work by each day, service, cost control, asset
17 utilization, safety and people. These five principles
18 are all interrelated and not one more important than
19 the other.

20 Service, which is to us doing what we say
21 you will do all the time. While we're not perfect and
22 we do fail, our service goal is always 100 percent

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1 every day. Cost control. It's not about cutting
2 cost, but about a cost effective and efficient
3 operation. Asset utilization. They are not free. We
4 are a very asset-intensive business and we must
5 maximize their use. Safety. Don't get people hurt
6 and don't have accidents. No job is more important
7 than safety. People. Recruit the right people.
8 Develop them with the right skills. Motivate them to
9 do the right things and provide leadership.

10 I believe all five of these principles are
11 aligned with what the authors of Staggers had in mind.
12 We cannot thrive with a system that will limit our
13 ability to achieve these goals and principles. I know
14 the Staggers Act works and I will leave it to the
15 lawyers and economists to tell us whether there is any
16 way to improve on that Act. So far I have not been
17 shown one. Thank you.

18 CHAIRMAN NOBER: Thank you very much.
19 Commissioner Mulvey, do you want to start?

20 COMMISSIONER MULVEY: Sure. In the past,
21 the Class I railroads have been opposed to virtually
22 every form of public spending until the era of

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1 public/private partnerships was ushered in by the
2 Alameda Corridor and up until recently, hopefully, now
3 the CREATE project.

4 And I applaud the willingness of the
5 railroads to work within the PPP model, but you really
6 shouldn't be waiting for an authorization bill, they
7 roll around every decade or so, to support public
8 funding. You should have partnerships with every
9 state department of transportation, city council, even
10 the Federal Government, and work with them to help
11 expand railroad capacity.

12 I would like to ask the railroads how
13 successful they have been in implementing
14 public/private partnerships especially on the state
15 and local levels. Anybody care to start with that?

16 MR. LANIGAN: We have had varying degrees
17 of success. A lot of it has had to do with things
18 like commuter rail projects and things along those
19 lines that are local projects, not necessarily Amtrak
20 related, like the Sounder System in Seattle, but it
21 has been somewhat limited.

22 I think there has actually been greater

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1 success with short lines, because they are considered
2 to be local companies and, therefore, attract a
3 different level of understanding or interest from
4 local and state Governments.

5 COMMISSIONER MULVEY: Anybody else?

6 MR. YOUNG: I would say for Union Pacific,
7 we look at it, we really don't have a choice. Many of
8 the communities we operate in, we are part of the
9 community. We get to know the local officials very
10 well. The most successful projects that we see are
11 ones that are realistic in nature. They can have more
12 immediate benefits.

13 It's a partnership where the economic
14 value we are willing to put in, where there is a
15 benefit for our shareholders, we will put that capital
16 in and then the communities will fund where they see
17 the environmental benefit for them. You know, there
18 are a lot of ideas out there on public/private
19 partnerships.

20 Unfortunately, when you look at the amount
21 of money that's on the table, they are never going to
22 happen probably in our lifetime. So we're very active

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1 with them, trying to keep it realistic and get
2 benefits as quick as we can.

3 MR. PASSA: At CSX I think we see the same
4 thing. This really seems to be in many ways in its
5 beginning form and we have got active discussions
6 going on in a couple of states, and I believe the
7 states are all getting themselves to different levels
8 of competency on that as well. So it's something that
9 we expect quite a big role in the future and along the
10 lines of benefits that both Jim Young and John have
11 spoken about, so we see that as a part of the future.

12 MR. WAITES: I would like to add, I think
13 it is in a stage of evolution and I think, candidly,
14 railroads have been apprehensive about getting into
15 those transactions for fear of losing control of
16 assets. And I think, candidly, public officials have
17 been concerned about being involved in projects,
18 working with railroads and perhaps being perceived as
19 putting public funds into privately owned assets.

20 I think CREATE is a good example of where
21 that is evolving and some of the fundamental
22 principles there include complete transparency as to

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1 what those project costs and returns are and, very
2 importantly, funding in accordance with the benefits
3 that each party derives. Now, that's not an easy one
4 to solve, but I think it is evolving.

5 COMMISSIONER MULVEY: The CREATE project,
6 of course, is one that right now is on hold because of
7 insufficient public funding. Do any of you care to
8 speculate on the future of the CREATE project now that
9 we only have \$100 million in the Highway Bill for it?

10 MR. TOBIAS: Steve Tobias, NS.
11 Commissioner Mulvey, my sense and the sense that I
12 have gotten from the representatives on the CREATE
13 Project is that all of the roads are uniformly still
14 engaged and behind the CREATE Project. We have put a
15 tremendous amount of work into this effort over the
16 last six years.

17 It's probably a landmark point from the
18 standpoint of the roads that are involved and the
19 communities that are involved in a commitment to a
20 project that brings great benefit both to the freight
21 application here, but also the public sector.

22 MR. LANIGAN: I do think that when you

1 think about how these sorts of projects slow down
2 though when we think about overall capacity additions
3 to the network, this is one of the primary issues.
4 We're involved at BNSF Railway in a project in
5 southern California right now where we have been
6 selected by the Port of Los Angeles to develop a new
7 near dock intermodal facility.

8 From the time we first approached the port
9 to the time that we believe our best guess as to when
10 that facility will be up and running will be somewhere
11 in the range of seven to eight years, only one of
12 which is construction.

13 And so when we think about this rapid need
14 for capacity in the rail industry, we need to think
15 through the fact that many of these projects take a
16 long time to get off the ground because of local
17 regulations, environmental regulations, things along
18 those lines and, quite frankly, I think that's
19 something the Board can help both educating and also
20 helping to push policy in those directions as well.

21 COMMISSIONER MULVEY: One last question
22 before I pass it on. When we look at the numbers that

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1 everybody presents, whether it be AASHTO or whether it
2 be ATA or DOT, and then your own forecasts for your
3 own spending for capital needs, it does fall short.
4 You just don't get enough money spent on capital
5 investment, including maintenance as well as
6 expansion, to meet the projected forecasts and demand.
7 So, there is this gap.

8 It was suggested by somebody earlier today
9 that maybe a Railroad Trust Fund similar to the
10 Highway and Aviation Trust Funds might be in order.
11 And I understand your concerns about what that might
12 entail for you in terms of the quid pro quo, but do
13 you see any way in which something like that could be
14 developed so that monies could be made available for
15 rail capital infrastructure without the railroads
16 losing control over their operations?

17 MR. YOUNG: I think our best bet here,
18 trust funds do concern Union Pacific, because the
19 question becomes one as to what strings go along and
20 what part of that trust fund gets committed to
21 community projects versus projects that actually
22 expand freight capacity?

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1 You said earlier CREATE is several hundred
2 million dollars short. I think when you think of the
3 concept of a trust fund, everyone will have their eye
4 on that transportation dollar. I think an
5 alternative, and we have had some discussion, there is
6 talk about the concept of an investment tax credit for
7 rail infrastructure.

8 I think that is something that really
9 needs to be considered going forward. It's a
10 partnership with the individual railroad and the
11 Government to apoint, but there is incentive there and
12 it could be very much targeted on freight capacity
13 going forward.

14 MR. TRAFTON: I share Jim's concern on the
15 trust fund in the sense that our company in
16 particular, I think, stays away from dollars from the
17 Government or local funding because of the strings
18 attached. My concern would be similar in that you
19 never know in these trust funds where the money is
20 going to go, and I think there's enough trust funds
21 out there to show the history that they don't go to
22 what they were designed to do initially.

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1 But I think there's other alternatives and
2 one of which has to be the marketplace. The
3 marketplace has to dictate what happens and where. A
4 lot of our capital investments are in the main line.
5 They are our main corridors. They are our main yards.
6 A lot of what you see, and not unlike what I think Mr.
7 Lanigan had indicated earlier, is that what you see
8 are the reductions in areas that are the branch lines
9 or areas where six cars a week may be going out.

10 The real question is how do we survive in
11 those kind of lines, and those are the kinds of
12 situations that you have seen over time, that short
13 lines have sprung up. Other people have come into the
14 business and serviced those properties. In some cases
15 states actually buy the property and operate the
16 railroad.

17 The only concern I have when a state gets
18 involved, again, is you're taking taxpayer money to
19 operate that railroad and, again, there is enough, I
20 think, companies out there to operate and look at it
21 from a market standpoint.

22 MR. PASSA: I guess the last point is

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1 wherever this takes us, the idea of sustained revenue
2 adequacy comes with sustained public policy as well.
3 So as we go forward trying to develop public/private
4 partnerships, the rules and the players can't keep
5 changing their mind and changing their ideas, because
6 then we end up with stops and starts and we don't have
7 a continuous process, because these things do take a
8 very long period of time, as John pointed out.

9 COMMISSIONER MULVEY: Well, surely no one
10 is suggesting that trust fund monies would be
11 earmarked for uneconomic projects. That doesn't --

12 CHAIRMAN NOBER: It never happens.

13 COMMISSIONER MULVEY: It would never
14 happen.

15 CHAIRMAN NOBER: Commissioner Buttrey?

16 VICE CHAIRMAN BUTTREY: Thank you.
17 Someone referred this morning to -- I think they
18 called it the elephant in the room idea. I was
19 sitting here trying to think of something a lot more
20 scary than an elephant, and I came up with dragon.
21 Dragons are kind of scary to me, so I wanted to speak
22 for a moment or talk for a moment about the dragon in

1 the room. It might not scare anybody else, but it
2 scares me.

3 If you read through all of these
4 statements, there is a common thread that runs through
5 there, and one of those common -- there are several
6 common threads, but there is one common thread that
7 runs through there and it's not a general thread.
8 It's a visceral thread. And when you meet that
9 visceral claim, if you will, you get it in very
10 impressive terms and that is the subject of fuel
11 surcharges.

12 I don't know how we got to this place, but
13 there doesn't seem to be any feeling anywhere in the
14 shipper community, I think to a person, that there is
15 virtually no credibility that attaches to the
16 methodology or the practice of fuel surcharges in the
17 railroad industry right now.

18 Now, I don't know how we got to that point
19 and I'm not saying, I'm not claiming personally that
20 there is no credibility. I am just saying that that's
21 what the community is saying and I would be interested
22 in knowing what the responses are of the Class I

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1 railroads to that situation.

2 I am one of those people who likes to
3 believe everybody, but sometimes it's hard to do,
4 especially when the claims are so opposite, so
5 disparate, and I just wondered if any of you had any
6 comments about where we are and how we got to where we
7 are on fuel surcharges.

8 And I'm not talking about the accepted
9 fact that fuel has gone up in price and that people
10 expect to pay for those kinds of increases. I would
11 just like to see if anybody has any comment about
12 that.

13 MR. YOUNG: I will give it a shot here.
14 Yes, you go back in time where this industry passed
15 very little fuel on and I think in the inception when
16 fuel jumped \$35 a barrel, \$40 a barrel, most views
17 were it's temporary, it will come back down again.

18 We know what the trucking industry does in
19 terms of when you look at their fuel surcharge
20 programs. We have looked at many different models.
21 We know our partners have put a new proposal on the
22 table. We believe the way we approach this thing is

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1 fairly reasonable.

2 We have looked at different segments. We
3 have cut it by length of haul. We have cut it by the
4 weight, the type of train, and it comes reasonably
5 close. It gets more complicated. You think of
6 manifest service and you start thinking of applying a
7 mileage-based comparison on a manifest train. Well,
8 where does the fuel come in that is consumed in the
9 terminal switching the engines or switching the cars?
10 There is a huge fuel consumption factor that is at the
11 local terminals.

12 Much of that could be reflected in the
13 rate, because it can be a higher cost business in
14 terms of the service. So we're very much aware of it.
15 We have sat down regularly with our customers to walk
16 through what we see in the fuel surcharge, but I don't
17 again see a perfect model here going forward.

18 MR. LANIGAN: I think the Board is aware
19 that in March BNSF announced that we are going to move
20 to a mileage-based fuel surcharge program starting
21 January 1st of next year.

22 When I joined the company three years ago

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1 with my trucking background -- as an aside, when I
2 returned from serving in Operation Desert Storm to my
3 job at Schneider National, my second day back the
4 Chairman said you're in charge of our new fuel
5 surcharge program, because we got killed while you
6 were away at the war.

7 And so we embarked on implementing a fuel
8 surcharge program, which was mileage-based. And in my
9 first couple of years at BNSF we looked at the program
10 that we had in place, which was percent of revenue-
11 based, and it really came from an historic base, the
12 fact that for the most part in the rail industry there
13 is not a mileage-based revenue program, so it was not
14 easy to correlate to a mileage-based fuel surcharge
15 program. We don't charge for our services that way
16 like the truckload motor industry does.

17 But in the end, as we analyzed it at BNSF,
18 we felt that we could implement a mileage-based fuel
19 surcharge program and have a more direct attachment or
20 corollary to the actual usage of fuel on a train-by-
21 train basis. And so we have been preparing to do that
22 now all year, systems changes, etcetera, educating our

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1 customers.

2 What is extremely surprising is in the
3 last 30 to 60 days, the number of customers that have
4 come forward and have asked us not to go forward with
5 this program because of the change that they would
6 have to go through.

7 Either they cannot acquire IT resources or
8 the complexity of having one system with us and
9 another system with other railroads, but you would be
10 shocked at the number of customers that, on face,
11 value, agree that this would be the way to go, but are
12 not currently prepared or want to move in that
13 direction.

14 MR. WAITES: I might add, if I can tag
15 onto Jim Young's comments, you know, not so many years
16 ago we were buying West Texas Intermediate for \$30,
17 \$35 a barrel. That was about three or four years ago.
18 And not so many years ago you were seeing cracking,
19 distillate margins from refiners on a good year at
20 \$1.50 a barrel, perhaps a little more.

21 Today you're seeing those numbers at \$8,
22 \$10, \$12 a barrel on cracking margins. We're seeing

1 crude prices in the \$60s, and I think what we started
2 with in a well-intentioned way was to put in place
3 proxies to be fair to recover the cost.

4 Given the magnitude of the change, there
5 needs to be more transparency on the exact match, and
6 I think all of us are looking at those things to
7 explain it, but a very large change in a very short
8 period of time, which is part of what is manifesting
9 itself and how it's playing out at this point.

10 VICE CHAIRMAN BUTTREY: Thank you.

11 CHAIRMAN NOBER: Well, let me ask this.
12 We heard a lot of discussion about this this morning.
13 You know, I know that there is a mathematical equation
14 to determine when you're earning your cost of capital,
15 which is something that you all spend a lot of time
16 thinking about, but then there is a legal conclusion
17 that we would have to come to, which is when is a
18 carrier revenue adequate.

19 When do you all believe a carrier crosses
20 the line from earning your cost of capital to being
21 legally revenue adequate? Whoever wants to -- don't
22 everyone speak up at once.

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1 MR. YOUNG: Well, I will give it a shot
2 again here. We go back to my CFO days. You know, at
3 the end of the day the market is going to determine
4 revenue adequacy. I mean, we can crank through
5 formulas.

6 The formulas are all pretty directionally
7 correct, but I will tell you there is nothing magic
8 about hitting a number, because at the end of the day
9 you still are going to look your board of directors in
10 the eye, you are going to look your shareholders in
11 the eye and you're going to have to justify growth
12 investment.

13 And while you may have a company that is
14 deemed revenue adequate today, when you're making 30,
15 40 year types of investment decisions, double tracking
16 the Sunset Corridor, there has got to be
17 sustainability there. There has to be room when you
18 think about that revenue adequacy. Again, I think
19 it's not a point here that all of a sudden that this
20 industry is healthy.

21 It's sustained over time and, in fact, I
22 think we want to look at -- as we think about it as

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1 UP, going beyond revenue adequacy or going beyond your
2 basic cost of capital, to us would drive even more
3 growth investment.

4 MR. LANIGAN: I think the financial
5 community certainly focuses on return on invested
6 capital and similar types of metrics. But to Jim's
7 point, if we believe that this demand environment for
8 rail services will sustain itself over a longer period
9 of time than just one or two or three years, then we
10 need to continue to improve our returns and keep them
11 at a consistently high level, so that we can take
12 investments to the level at which we can then
13 ultimately be much closer to satisfying market
14 demands.

15 And I think that that's -- the part of the
16 disconnect right now is the fact that with this rapid
17 run-up of demand over a relatively short period of
18 time, the perception is is that we don't want to
19 handle the freight or we can't handle the freight. It
20 really was more of a case of having inadequate returns
21 for such a long period of time that we could just not
22 afford to be ahead of the game at all as an industry.

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1 And so when the tidal wave came, we
2 weren't prepared. We weren't prepared for these kinds
3 of levels of freight to be able to sustain service and
4 volume at the same time, and so a longer term for us
5 to get back to the service levels that we had in the
6 early 2000s when freight volumes were much, much
7 lower, the level of investment is daunting required to
8 handle that.

9 MR. RUSS: At Kansas City Southern we have
10 been constrained by our balance sheet in terms of
11 growing our top line and getting revenue adequate.
12 We're a little different than my colleagues here at
13 the rest of the -- at the panel here.

14 With our investment at TFM, we believe
15 that we're going to make the investment now, because
16 it will come, because we believe that the growth
17 prospects of the combined network will get us to that
18 point of being revenue adequate. But right now we're
19 still playing a catchup game in trying to be in a
20 position to be revenue adequate at some future time.

21 CHAIRMAN NOBER: Well, many of the
22 carriers, many of the shippers this morning expressed

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1 the view that at least in certain -- you know, they
2 expressed two views. One is that the carriers are
3 healthy enough, they are financially healthy enough,
4 and that you ought to change your doctrines to take
5 that into account. And secondly, they said that to
6 explain why that is, that some of the carriers just
7 have too much market power. They are too strong and
8 they are utilizing it in ways that are harmful to
9 customers.

10 How do you respond to some of those
11 contentions that were made this morning?

12 MR. WAITES: I would maybe try and lead
13 off on that response. I think that in terms of our
14 financial position today, bear in mind we have been as
15 an industry revenue inadequate for some considerable
16 time. Following along with the discussion we have
17 just had, for us to invest going forward, it has to be
18 there for us to have an expectation of revenue
19 adequacy and it has to be on a sustained basis.

20 And so in terms of our financial position
21 now versus moving forward, there is a very strong
22 correlation between our ability to invest, so I do not

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1 agree with the position that we're sufficiently strong
2 and we don't need further price increases and so on,
3 which is what I had interpreted from some of the
4 messages this morning.

5 I think that is the key point that I would
6 like to make on that. It has to be there for us to
7 invest or else we can't do it.

8 MR. PASSA: Just a note on the investment
9 that we're going to make in our corridor between
10 Chicago and, basically, the southeast, that is to
11 accommodate the growth of a very diverse customer base
12 from the agricultural industry to the coal industry to
13 the intermodal industry.

14 And our ability to look out and be
15 confident that the ban will be there long-term and
16 that we will be able to earn sufficient earnings to
17 make that investment and further investments is part
18 of the formula that we have to look at.

19 MR. TRAFTON: We are in a situation where
20 we have done well in recent years, recent times, and
21 at the same time though we have got -- as you know
22 with our railroad, it has been a patchwork of a lot of

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1 other carriers that have made up CN here in the United
2 States. We're in the midst of some expansion, but
3 also some significant investments, particularly in the
4 yard side, tens of millions of dollars in the near
5 future in terms of expansion and additions to our
6 yards in the U.S. property alone.

7 I think from a revenue standpoint, you
8 know, to think that you're there today and you won't
9 be tomorrow, you just don't know. The history is such
10 that it's not proven that it has been sustained over
11 time and I think it's also indicative, as my
12 colleagues have already mentioned earlier, that you
13 don't build that capacity overnight. You don't train
14 train crews overnight. You don't build the railroad
15 capacity. You don't get a locomotive overnight.
16 Getting signal systems is at least a year out.

17 All those things take time and it's like
18 anything else. The process is much longer for a lot
19 of reasons, but to believe that we're there and it's
20 time to change and do something different, I think, is
21 way premature.

22 MR. LANIGAN: Clearly, there's different

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1 markets that we serve that have different dynamics
2 from a standpoint of the modes of transportation they
3 rely on, but in many of our markets the customer has
4 the ultimate market power. You heard from UPS today
5 who said that on certain moves, they have actually
6 moved freight off the rail back to over the road.

7 That's the ultimate market power. If we
8 don't prove ourselves on a day in and day out basis to
9 be the value that the customer is looking for, then
10 they will seek another solution, and that is where the
11 balance comes in the equation between the power of the
12 customer who has the ultimate decision as to how they
13 move their freight and who they move their freight
14 with.

15 And again, granted, we have some different
16 scenarios with different types of customers, but we do
17 have a large number of customers that have equal or
18 more power when it comes to market decisions.

19 CHAIRMAN NOBER: Commissioner Mulvey?

20 COMMISSIONER MULVEY: Returning to the
21 fuel surcharge question, some of the shippers have
22 suggested that the fuel surcharges have become a

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1 profit center for the railroads. My understanding is
2 that the fuel surcharges are designed to be cost
3 recovering.

4 And my question is do any of the railroads
5 right now cover all of their increased fuel costs
6 through the fuel surcharges? Is anybody covering the
7 total cost of increased fuel?[panelists No] So fuel
8 surcharges still fall short of the cost.

9 They should be based on cost, agreed.
10 And, obviously, one based on mileage is probably more
11 closely related to cost than one based on the waybill.
12 But it would even be better if they were ton-mile-
13 based taking into accounts such things as terrain.

14 Has anybody looked at a ton-mile-based
15 fuel surcharge taking into account terrain
16 differences?

17 MR. LANIGAN: What we have done with our
18 fuel surcharge program, the mileage-based fuel
19 surcharge program, is it inherently takes that into
20 consideration. We have different tables for the
21 different types of commodities, which take into
22 account the average tons per train, the number of

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1 locomotives per train, etcetera, so we believe that we
2 have built that into our mileage-based fuel surcharge
3 tables.

4 COMMISSIONER MULVEY: So it's not simply
5 mileage-based?

6 MR. LANIGAN: That's correct.

7 COMMISSIONER MULVEY: Okay. Positive
8 train control is something that has been looked at for
9 quite some time and many have suggested that positive
10 train control, if fully implemented, would greatly
11 improve railroad safety but, almost as important, also
12 improve railroad productivity. One recent study by
13 Zeta-Tech out of Philadelphia suggests a payback
14 period on positive train control of less than two
15 years, about 18 months, and that's not even taking
16 into account the safety benefits.

17 I know the industry historically has pooh-
18 poohed the idea of positive train control as being
19 cost ineffective based upon earlier studies, but has
20 the industry or any of you as individual railroads
21 looked again at positive train control today to see
22 whether or not it may make more sense for the

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1 industry?

2 MR. TOBIAS: Commissioner, I'm sure you're
3 familiar with the --

4 COMMISSIONER MULVEY: Illinois?

5 MR. TOBIAS: -- Illinois Dock Project,
6 which was supported and funded by the AAR along with
7 the FRA and a number of different contributions from
8 appropriate suppliers. Have we looked at it?
9 Absolutely.

10 NS most recently announced a pilot
11 project. Actually, it's more than a pilot project.
12 It is an implementation roll-out of a PTC-based
13 application in South Carolina, and we're excited about
14 it actually. As to the Zeta Tech findings, I'm not
15 familiar with that particular study, so it would be
16 inappropriate to comment, but technology is alive and
17 well here.

18 COMMISSIONER MULVEY: Yes. I mean, it has
19 made a lot of progress since it was looked at the
20 first time. I think costs have come down. GPS is
21 becoming more widely available and it is ever growing
22 more precise every day.

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1 Did anybody else look at the Zeta Tech
2 study or are any of you familiar with it?

3 MR. LANIGAN: I haven't seen the study,
4 but we have a system also called Electronic Train
5 Management System that we have been piloting in
6 Illinois, as well, a separate system from the
7 industry, and we're lining up the stars and moons from
8 the standpoint of the timing and the funding and the
9 paybacks as well. So I think, ultimately, we're all
10 looking at these sorts of systems and, ultimately,
11 they will be part of the infrastructure. It's just a
12 matter of timing and funding.

13 MR. YOUNG: I was going to say we
14 actually, as an industry, have committed to a common
15 functionality, because whatever the Burlington
16 Northern puts in or Norfolk Southern puts in, it's
17 going to have to operate on our individual railroads.
18 So there are a lot of different terms, but it is a
19 form of positive train control.

20 And we are running a pilot right now. In
21 fact, I think -- I know CSX, we're all looking at the
22 same concept, but the key was functionality here. And

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1 we went through some good benefits there from a safety
2 perspective.

3 MR. RUSS: Kansas City Southern is
4 currently involved in a PTC project on its property in
5 Panama on the 47 mile railroad parallel in the canal.

6 COMMISSIONER MULVEY: One last question,
7 and that is the CN and CP both operate under a
8 slightly different regulatory regime and
9 interswitching or reciprocal switching, is required up
10 in Canada and you are two of the more profitable
11 railroads of the seven Class I's.

12 Do you find the interswitching to be a
13 burden on you or does it improve the competitive
14 situation in Canada for shippers?

15 MR. WAITES: That is correct. We have
16 interswitching in Canada. I think, you know, the
17 general comment around the profitability of Canadian
18 railways versus U.S., there are, as you might expect,
19 a number of reasons why that could be different,
20 things like health care costs, traffic density and
21 different types of traffic and so on and so forth.

22 You're correct. We do have

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1 interswitching. However, in Canada, interswitching
2 has a long, long history. It has been around a very
3 long period of time and sufficiently long whereby
4 capital investment decisions have been made
5 understanding that interswitching is in place. And I
6 believe you know that in Canada the interswitching
7 rate is set by the Canadian Transportation Agency --

8 COMMISSIONER MULVEY: Right.

9 MR. WAITES: -- on a variable cost
10 function relationship, but I think that's an important
11 distinction. If we know what the rules are prior to
12 making capital investment decisions, that is one set
13 of circumstances I think in Canada, if we found out
14 after the fact, after making capital investments, that
15 the rules were different, I think we would have
16 suffered more.

17 Having said all of that, I think the net
18 effect of interswitching is to push the rates down
19 candidly. But at the end of the day, if we can't
20 recover those revenues from other shippers, it's less
21 revenue and that means less investment and less
22 capacity, but we have grappled with that.

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1 So I think there are separate issues in
2 terms of profitability versus a regulatory
3 environment, although they can be related.

4 MR. TRAFTON: I would have to second Mr.
5 Waites' comments. And in addition, I think you have
6 to take it in the context, too, as he has indicated,
7 these rules and regulations that we have in Canada
8 versus what we have in the U.S., and I am no expert on
9 Canadian rules and regulations, but the fact is is
10 that they exist up there for a lot of different
11 reasons.

12 And I think that whether interswitching
13 works in Canada or it doesn't and whether it works
14 here, I think it has to be applied and looked at to
15 see what kind of fit it would have or application it
16 would have here in the U.S. Personally, I don't --
17 again, from a regulation standpoint, I don't view that
18 having somebody else involved in setting those rates
19 is the right thing to do.

20 That is my personal view and that's our
21 company's position. But from the standpoint that we
22 live with it, because that is the way it is, and it's

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1 not unlike some of the other legislation that is in
2 place in Canada or the regulations that we have in
3 Canada that are different here.

4 To think that we can cherrypick certain
5 things that fit in Canada or look like they fit in
6 Canada or maybe somebody thinks works well in Canada
7 and to put it in place here in the U.S. and say that's
8 the fix, you wouldn't have to go too far to look at
9 health care and a few other areas to say that no one
10 has ever found that silver bullet, and I would
11 question whether or not we would actually be harming
12 ourselves in the long run.

13 CHAIRMAN NOBER: Commissioner Buttrey?

14 VICE CHAIRMAN BUTTREY: Just to touch on
15 fuel surcharges one more time. It's my understanding
16 that some customers pay fuel surcharges and some
17 customers don't pay fuel surcharge.

18 Is that true across the board or is that
19 limited to a particular type of customer or is it
20 limited to a particular geographic area or a certain
21 commodity or how does that work? Is that true and
22 sort of how does that work?

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1 MR. TRAFTON: At least at CN it's due to
2 contracts. If we have a contract in place, and I
3 suspect it's the case with most railroads, that does
4 not allow for it until that contract becomes due or we
5 can renegotiate or in some way instil a fuel
6 surcharge, that is what prevents us from applying it
7 across the board.

8 MR. YOUNG: It's similar at UP if there is
9 a contract in place, but we do now have -- as the
10 contracts roll off, we're all going to a standard fuel
11 surcharge across all the business groups.

12 MR. TOBIAS: I think you will find that
13 it's similar for all of us.

14 VICE CHAIRMAN BUTTREY: Okay. Thank you.

15 MR. TRAFTON: I think one other thing to
16 point out there, too, is what we have also learned, I
17 think all of us over time, is that these long-term
18 contracts of 5, 10, 25 years in some cases don't work.
19 Obviously, in the case of fuel surcharge, nobody ever
20 envisioned probably back five years ago when they
21 signed a 25 year contract that fuel would be what it
22 is today.

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1 And I think what you will find over time,
2 too, based on these contracts, as they are renewed, at
3 least in our company, they won't be renewed for a
4 long, long term. I mean, two to three years may be an
5 exception to the rule.

6 VICE CHAIRMAN BUTTREY: Two to three years
7 would be an exception to the rule?

8 MR. TRAFTON: Right. Anything beyond that
9 would be an exception. Excuse me. That would be more
10 the norm in what we look at today.

11 CHAIRMAN NOBER: Well, let me ask. Again,
12 many of the customers this morning were concerned.
13 You know, they claim that they are captive shippers
14 and that they have seen their rates go up and up and
15 up and their service go down.

16 First of all, do you all agree with that,
17 I mean, agree with those assertions that were being
18 made this morning?

19 MR. TOBIAS: I don't particularly agree,
20 at this point in time, that NS' service has gone down.
21 We are certainly consistent within parameters that,
22 from an operating perspective, we find acceptable.

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1 MR. YOUNG: From a UP perspective, you
2 know, I would agree. The service has gone down when
3 you look backwards. Part of it is our own doing that
4 we're correcting right now in terms of hiring, buying
5 more locomotives, putting capacity into our network.
6 We are the highest density railroad in North America
7 and we're working very hard in terms of improving
8 those service levels.

9 I have said all along what comes with
10 price, service has to be there for the value at the
11 end of the day. One of the things I do see happening
12 though in the network and with a lot of our customers
13 is because of the scarcity of transportation resource,
14 the inefficiencies are starting to show up in the
15 network when you look at it.

16 And our only tool today, it's rough, is
17 price to try to manage flows in a very, very difficult
18 one called embargoes. But you bring an industrial
19 engineer outside of this industry and have him sit
20 down and look at what you deal with in a capacity
21 constrained corridor, he will tell you 9 times out of
22 10 you're going to fail, because you don't have an

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1 efficient mechanism of controlling flows.

2 And we have used pricing to try to do
3 that, to try to manage flows long-term. But I would
4 agree our service has deteriorated, but it is moving
5 back up right now.

6 MR. TRAFTON: Chairman Nober, I think you
7 have to also define what service is, because I suspect
8 that as you hear it when you're out and about, service
9 isn't just transit. It's car supply. It's
10 cleanliness. It's a lot of other factors when it's
11 all said and done.

12 I would suggest, at least at our company,
13 we have seen improvements in transit time performance,
14 and our overall trip plant performance is in the 92,
15 93 percent and at least in the U.S. properties,
16 consistently around the 95 percent. But at the same
17 time, I can tell you that I know of car shortages we
18 have in the U.S., car shortages for a lot of reasons.

19 Grain this time of the year, what tends to
20 happen, happens every year. Nothing is new and there
21 are backups due to a lot of factors this year that
22 have not been the case in the past, the hurricane

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1 being one of them, but also crops that were not
2 expected to be good turned out to be excellent. At
3 the same time, you have other commodities as well.
4 Log cars in some of our locations are in short supply,
5 but the demand has changed.

6 And at the same time what is not
7 understood by a lot of folks is that the distribution
8 system, for instance in the case of logs, that used to
9 be between Point A and Point B is now triangulating
10 between -- because customers in the log business are
11 exchanging logs for whatever, for reasons that have to
12 do with the quality of the product, and as a result
13 lengthening the length of the hauls.

14 That requires more equipment. The more
15 you lengthen that length of haul, which we like, the
16 more you're going to have to add more equipment over
17 time. Those things were not forecasted or
18 communicated ahead of time enough that we could do
19 something about it. And in the short-term, at least
20 what we see in the case of cars is a potential
21 shortage.

22 MR. WAITES: Now, I would like to add one

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1 comment. I mean, maybe I can use an example. We had
2 a large bulk shipper come to us about a year ago and
3 on very short notice wanted to increase the tonnage 40
4 percent over a base level of tonnage in the contract
5 and on very short notice, and we did a lot of things
6 to move that tonnage. Clearly, we're incented to do
7 so. We moved an increase of 26 percent not 40 percent
8 and we were declared a failure by our customer in that
9 example.

10 And I use that to illustrate the fact that
11 on a given shipment, what is service, we are moving a
12 lot more tons and I think that is, Mr. Chairman, an
13 opportunity for all of us working with shippers to
14 improve service.

15 MR. PASSA: And also the reinvestment in
16 rolling stock that needs to take place across each of
17 the business areas, so being able to price to the
18 market, to be able to reinvest in different types of
19 equipment is something that, as we talk about earning
20 the right to invest, we look at each of our equipment
21 types and our customers, in many cases, want us to
22 continue to provide that rolling stock.

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1 CHAIRMAN NOBER: Let me ask one last
2 question. One of the most difficult sort of
3 challenges that we face or at least that I faced in my
4 three years here are customers coming to us and saying
5 our service is a problem, our rate is a problem, X, Y
6 or Z is a problem, the carriers are demarketing us and
7 balancing, on the one hand, the legitimate concerns of
8 a captive shipper who may not have alternatives with,
9 on the other hand, the legitimate, you know, concerns
10 of the railroad to try to allocate their resources and
11 put them to the highest return and the most -- you
12 know, to the most efficient usage of their network.

13 As we go forward this is going to increase
14 and not decrease these kinds of conflicts, and how
15 should the Agency look at those? I mean, that's what
16 I do every day, is try to look at those and every one
17 of you have heard about that in one form or another.

18 MR. TOBIAS: I'm not the marketing guy,
19 but I will make a simple run at this. To me many of
20 the things that crop up as significant issues between
21 our customer base and ourselves really need to be
22 addressed on a bilateral basis, and to the extent that

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1 they will come to the table and sit down so we can
2 have a meaningful discussion rather than, and I'm not
3 casting any aspersions here, a political posturing, we
4 might find that we get a better resolution and a
5 better solution.

6 MR. TRAFTON: I would agree and at the
7 same time I would also suggest that better
8 communications, forecasting ahead known volumes. Not
9 unlike my friends in the CP, we have had several,
10 numerous cases actually, over the past year where
11 volume that no one had ever anticipated is moving for
12 a lot of reasons that have to do with the world
13 market.

14 But I think when you look at it,
15 communication sometimes is broke, the process is
16 broke, and if anything else, what I would suggest that
17 this body do is to encourage that more between the two
18 parties, as opposed to getting involved in the
19 political ramifications that sometimes come out of
20 this.

21 MR. LANIGAN: I think demarketing is an
22 interesting word in that it implies that you are

1 trying to chase something off or push something away
2 or what have you, and it's really -- you know, if you
3 look in the current environment, it's really not a
4 demarketing issue.

5 And when I listened like the coal panel
6 this morning talk about their perception that returns
7 on intermodal are so far below coal, one, it's false
8 and second, they made the direct suggestion that we
9 demarket intermodal to the benefit of coal when that
10 really wouldn't solve anything.

11 These are big networks that rely on the
12 interplay of the various commodity types that we haul
13 to position equipment, to position locomotives, to
14 position crews, etcetera, and it's not as simple as
15 saying -- it's kind of like you look at your children.
16 Do you love one more than another? The answer is no,
17 you love them all and, you know, we really want to
18 serve our customer base across its breadth and provide
19 the type of service that they deserve and that they
20 are paying for.

21 COMMISSIONER MULVEY: You answered my
22 question as to why you're carrying traffic that

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1 doesn't cover your cost like intermodal traffic, so I
2 won't go on with that.

3 I will ask though, to stay along with the
4 demarketing idea, it has been also alleged that
5 railroads are picking and choosing winners and
6 deciding who they are going to carry and who they are
7 not going to carry, who they are going to serve and
8 who they are not going to serve. This is contrary to
9 the old notion of the common carrier obligation.

10 What do you see is the common carrier
11 obligation of the railroads today and the future?

12 MR. YOUNG: I believe the obligation here
13 is one that we have a right to, to some extent, choose
14 and the market is choosing. When you look in the
15 transportation sector today, it's not a function of
16 winners. It's a function of when you have a scarce
17 resource, it's going to flow to the most efficient
18 producer and consumer and that is going to be a
19 function of return. It's going to be a function of
20 investment and customers.

21 I have customers today that believe they
22 have a strategic advantage, because they have made

1 investment in highly efficient load/unload. They have
2 committed to work 24 hours, seven days a week and
3 we're partnering with them. They also look at us to
4 say should I subsidize the less efficient customer?
5 And what is happening again when you look at it
6 overall -- and we have the largest manifest network
7 out of all the railroads, and it's probably one where
8 you look at that has the most opportunity for
9 efficiency improvement.

10 But I have a real divergence of customer
11 groups that recognize strategically that we need to
12 work together to improve throughput and their concern
13 with me again is one on are they being penalized
14 because they are willing to make the investment.

15 COMMISSIONER MULVEY: Anybody else on the
16 common carrier obligation? Thank you.

17 CHAIRMAN NOBER: Well, I would just ask
18 finally, I know everybody wants to wrap up, but just
19 one last question, which I can ask, because I'm a
20 short timer, which is what is the right role of
21 regulation for captive customers?

22 I mean, what do you all think a regulatory

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1 body like ours should do for customers who are captive
2 who don't have alternatives in a world where you're,
3 you know, financially healthy?

4 MR. YOUNG: Well, you have tools in place
5 today. When you look at our customer base, I look at
6 maybe 70 percent or so have competitive options. That
7 can be a geographic substitution. It can be
8 competition with another railroad. It can be the
9 trucking industry coming through. Then there is
10 another 30 percent that fall into the captive area and
11 there are mechanisms out there today that, I think,
12 offer some protection when you look at it.

13 I have seen many cases and what is
14 happening here in many cases, again, the more
15 efficient and the higher return business will get the
16 scarce resource. In many cases where you compare a
17 captive customer to an open customer, there is no
18 secret. There is a rate differential that has been
19 out there for years, but that rate differential is
20 shrinking in terms of the spreads and, in a lot of
21 cases, the captive customers are the first one where
22 we're going to commit the resources.

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1 CHAIRMAN NOBER: Anyone else? Well,
2 again, thank you all for your patience and for your
3 time and sitting through the questions.

4 And we will turn now to our next panel,
5 which is Larry Parsons from the Wheeling & Lake Erie
6 Railway Company, Roger Bell from the Columbus &
7 Greenville Railway, Charlie Marshall from the Genesee
8 & Wyoming, Reilly McCarren from the Rail Industry
9 Working Group and Charlie Swinburn from RailAmerica.

10 Are we ready to go? Okay. Well, once
11 again, I know they set you up in order, but I usually
12 start from my left, so Mr. Swinburn, you draw the
13 short straw.

14 MR. SWINBURN: Thank you. Mr. Chairman,
15 Vice Chairman Buttrey and Commissioner Mulvey, thank
16 you for allowing me to present my views today on the
17 Staggers Act.

18 By way of background, RailAmerica is a
19 large short line holding company operating in North
20 America. We own 47 railroads operating over 8,900
21 miles of track in 27 states and six Canadian
22 provinces.

1 Our company exists because of the Staggers
2 Act. Our employees have their jobs because of the
3 Staggers Act. Many of our shippers receive railroad
4 service only because of the Staggers Act. Many of the
5 small and rural communities in which we operate are
6 far better off because we are there because of the
7 Staggers Act. All that is because the Staggers Act
8 streamlined the procedures governing the abandonment
9 and sale of non-economic rail properties by the Class
10 I railroad industry.

11 Since 1980, the number of short line and
12 regional railroads has more than doubled from less
13 than 250 to 550. One out of every four carloads in
14 the United States originates or terminates on a short
15 line or a regional railroad.

16 We short line and regional railroads have
17 succeeded by offering our customers a higher level of
18 service at lower rates than they were able to get
19 before the Staggers Act. The shippers we serve are
20 disproportionately located in rural and otherwise
21 under-served areas of the country. Our employees
22 often live in the communities we serve. Our trains

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1 link these small communities and their shippers to the
2 national and international transportation networks.

3 Short lines often provide their
4 communities with the first real opportunities to grow
5 that they have seen since the middle of the last
6 century. In my submitted testimony, I give three
7 examples of how short line railroads in our
8 RailAmerica family have provided significant stimulus
9 for renewed economic growth in communities that had
10 gone stagnant.

11 Importantly, the examples I give are not
12 isolated examples. Short line railroads elsewhere
13 have similarly succeeded through a combination of
14 customer-oriented philosophy, lower cost structures
15 and aggressive marketing strategies.

16 As to where the short line and regional
17 rail industry will go in the future, my expectation is
18 for more of the same. The industry will continue to
19 grow. Shippers and communities will continue to be
20 well-served. From my point of view and that of my
21 company, no changes to the Staggers Act or to the
22 Board's administration of its provisions are

1 necessary.

2 Before closing, I would like to share two
3 observations about the more general effects of the
4 Staggers Act. I do so from the perspective of one
5 who, as a much younger person working in the
6 Department of Transportation as the Deputy Assistant
7 Secretary for Policy, managed many of the Department's
8 efforts in response to the railroad industry crises of
9 the 1970s, as well as the Department's efforts in
10 support of deregulation of the industry and,
11 specifically, in support of the Staggers Act.

12 First, those few who call for re-
13 regulation of the railroad industry are simply not
14 mindful of the lessons of history. When I joined the
15 DOT in 1971, the railroad industry was reeling from
16 the shock of the bankruptcy of the Penn Central. By
17 1980, 20 percent of the system's route models were
18 operated by bankrupt railroads.

19 Congress had been forced to pump money
20 into the industry and the specter of nationalization
21 was real. There is no question, but that the sorry
22 state of affairs that the industry had reached by 1980

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1 was directly traceable to 93 years of failed
2 Government regulation. The Government cannot
3 successfully replace the marketplace in controlling
4 decision making in the railroad industry. Nothing has
5 changed in the last 25 years to cause me to believe
6 differently.

7 Second, the Staggers Act has worked even
8 better than those of us who argued for it in 1980
9 expected. I testified then to Congress that
10 deregulation of the industry would give well-run
11 railroads a shot at returning to a reasonable level of
12 profitability and that safety and service to shippers
13 would improve. However, I never dreamt that the
14 results would be as dramatic as they have been.

15 Data in the Association of American
16 Railroads comments sent to you before the hearing show
17 almost a threefold increase in rail industry
18 productivity in the past 25 years while, at the same
19 time, rail industry traffic rose by 80 percent.

20 Yet, even while the industry was
21 benefitting from those accomplishments, the shipping
22 community also benefitted from significant decreases

1 in rail rates, as shown by the fact that inflation
2 adjusted revenue per ton-mile fell by 60 percent
3 through 2004.

4 I conclude that the Staggers Act has
5 worked phenomenally well. To retreat now from its
6 basic premises would be folly That completes my
7 testimony, Mr. Chairman. Thank you.

8 CHAIRMAN NOBER: Thank you very much. Mr.
9 McCarren?

10 MR. MCCARREN: Yes. Thank you very much,
11 Chairman Nober, Vice Chairman Buttrey and Commissioner
12 Mulvey. While my paycheck these days reads the
13 Arkansas and Missouri Railroad, I am here representing
14 the Rail Industry Working Group of which I am the
15 short line co-chairman.

16 The Rail Industry Working Group was
17 organized in the year 2000 to interpret and administer
18 the Rail Industry Agreement. It's comprised of
19 representatives of the seven Class I railroads
20 operating in the United States along with seven Class
21 II and III representatives, the AAR and the American
22 Short Line and Regional Railroad Association.

1 While originally an ad hoc group, it is
2 now chartered under the revised Rail Industry
3 Agreement. The most important thing about the Rail
4 Industry Working Group is that it is a private sector
5 solution established to administration of interline
6 relationships in an evolving and increasingly
7 complicated industry. The number of short lines has
8 more than doubled since Staggers and the complexity of
9 the business relationships and the amount of traffic
10 they handle has increased geometrically.

11 The Rail Industry Agreement was adopted in
12 1998 with substantial urging from the STB and then
13 Commissioner Linda Morgan or Chairman Linda Morgan to
14 address concerns of the Class II and Class III
15 railroads about maximizing their potential under the
16 new arrangements that were just really becoming
17 revealed.

18 The agreement addressed access issues,
19 notably paper barriers, interchange service, car
20 supply, reciprocal switching and heavy axle loads, and
21 its general intent was to maximize the ability of
22 short lines to gain new traffic and handle it

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1 efficiently.

2 But the RIA evolved. As any time when
3 there is a significant change in the terms of trade
4 affecting a broad swath of an industry, there is a
5 break-in period. And after a few years, we determined
6 that some of the language was ambiguous. Some of the
7 original intent may not have fit changing
8 circumstances. In any event, the railroad industry
9 had transitioned in those ensuing five years.

10 Consequently, after a long process of
11 examination and negotiation, the rail industry has
12 updated the Rail Industry Agreement. We have improved
13 the definition of new business, established some
14 bright lines and new clarity. We continue to focus on
15 maximizing short line traffic potential without
16 cannibalizing existing rail system traffic.

17 This mechanism improves the public utility
18 of the rail system by allowing the system to handle
19 more traffic than it otherwise could. In the terms of
20 an economist, of which I am not, but we have certainly
21 well-represented on the Commission, it is a movement
22 towards what might be called Pareto efficiency in the

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1 short line/Class I relationship.

2 Our philosophy to this day continues with
3 the Rail Industry Working Group to maximize short line
4 opportunities to gain new traffic in an interline
5 environment and to keep existing traffic on rail. We
6 promote short line service as a solution to first
7 mile/last mile issues that have gained publicity
8 recently with respect to the merchandise carload
9 network, and we strive to maximize network efficiency
10 through the utilization of both large and small
11 railroad assets.

12 Specifically with respect to paper
13 barriers, which have been an issue and the subject of
14 another proceeding, the nature of paper barriers has
15 changed over the roughly 20 years since the modern
16 short line era began. Originally, short line sales
17 were predominantly lines that were abandonment
18 candidates and would otherwise have been bike trails
19 had not short lines come along to take them over.

20 Over time, substantially larger branch
21 line opportunities have become available to short line
22 companies, and the issues for the Class Is have been

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1 less ones of outright abandonment than return on
2 invested capital and ability to reinvest in the
3 fringes of their network.

4 However, many of these lines still have
5 profitable traffic for their Class I owners and
6 without some sort of paper barrier or access
7 restriction, many of those lines would not, could not
8 be sold due to revenue or contribution risk and, thus,
9 the lines would remain in a sort of limbo, unable to
10 warrant reinvestment, unable to warrant marketing
11 effort but, yet, too valuable to exit the Class I
12 fold.

13 Whereas, in short line hands, what we find
14 is these lines experience traffic growth almost
15 uniformly. Customers returned to the rail system who
16 had forsaken it years earlier and infrastructure
17 investment increases in almost all cases from what it
18 had been in the Class I environment.

19 In summary, there is a large public
20 benefit associated with the transfer of these lines to
21 the short lines. In today's climate, frankly, the
22 formal RIA applications on paper barrier waivers are

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1 scarce. Only one to two a month generally come on our
2 agenda.

3 However, many informal resolutions are
4 achieved because of the terms of trade set forth by
5 the RIA while other issues have assumed at least equal
6 importance and the RIWG has moved on to address car
7 supply and interchange service as the next challenge
8 if improving the overall interline relationship. That
9 is the end of my comments. Thank you very much.

10 CHAIRMAN NOBER: Well, thank you. Mr.
11 Marshall, welcome back.

12 MR. MARSHALL: Thank you.

13 CHAIRMAN NOBER: You have been a long time
14 member of our Outside Advisory Council of the Rail
15 Shipper Transportation Advisory Committee, and we
16 thank you for your service on that and welcome you
17 today.

18 MR. MARSHALL: Well, thank you, and it's
19 a pleasure to be here and it's a pleasure to have seen
20 25 years of the Staggers Act at work. I am Vice
21 Chairman of Genesee & Wyoming. We're a short line
22 holding company. We have about 3,300 miles of track

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1 in the United States and similar or somewhat larger
2 holdings in other countries.

3 I am here really in the context of being
4 the ultimate captive shipper. Short lines, if you
5 think about it, can't make their product somewhere
6 else or use another mode of transportation. If we're
7 going to succeed, the Class I railroads have to
8 succeed and then we have to live with them as
9 partners. And so that's the way we try to think of
10 our business and that's the way we think of the
11 Staggers Act.

12 Now, if you take it one step further, for
13 us to succeed in this joint product that we make
14 between short lines and Class Is, the traffic, the
15 merchandise traffic, the retail traffic that we tend
16 to handle on short lines, must compete on the Class
17 Is, must compete for capital and must compete for
18 track space. If our traffic isn't as good as other
19 kinds of traffic, we will in the natural course of
20 economic events be forced out and we don't want that
21 to happen.

22 So that leads me to three points I want to

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1 make today. First of all, the Staggers Act is
2 wonderful in our view. It has been a big success and
3 one of the reasons that it has been successful is that
4 it has let normal economic forces play in the railroad
5 business, which had never happened before.

6 Now, there are problems. Yes, there are
7 capacity problems and there are service problems, but
8 those in my view aren't ones that can be fixed with
9 regulatory adjustment. They are ones that are going
10 to require economic adjustment, commercial adjustment,
11 and they are something that, I think, everybody in the
12 business is focused upon.

13 The second point I want to make is that
14 paper barriers, much criticized, are also much
15 misunderstood and are not susceptible to regulatory
16 adjustment with constructive effect. If you think
17 about it, paper barriers are just like requirements
18 contracts in any other business. A supplier says to
19 a buyer if you will buy everything you need from me,
20 I will give you a break, and that is really what paper
21 barriers are.

22 They are an agreement between a Class I

1 and a short line that the short line will favor that
2 Class I with all of the business or pay a penalty.
3 And, generally speaking, there can be a negotiated
4 change in those paper barriers for a price and the
5 short line either decides to pay that price or not.
6 But we think that the creation of short lines, as
7 Reilly just said, is very important to increasing the
8 efficiency of the railroad business overall and to
9 increasing the competitiveness of the merchandise
10 freight that we handle.

11 Anything that takes money away from the
12 Class I, and thereby makes our business less
13 competitive and shifts that money to us, is not in the
14 long run good. That might surprise you, but unless
15 our joint product with the Class I succeeds
16 competitively, we're going to fail. So we don't want
17 artificially to take money from the Class Is and
18 transfer them to the short lines or the shippers,
19 because it will make the product less competitive and
20 that is not good.

21 Finally, the third point I want to make is
22 that there are some residual regulations on Class II

1 railroads by statute, but the size of Class II
2 railroads is now out of proportion with the size of
3 railroads in the industry. In my written testimony,
4 there is a graph at the end of it and it shows a
5 number of big bars, which represent Class I railroads.

6 And then there is a tiny little green spot
7 over on the left side, which is the maximum size of a
8 Class II railroad, and that just to us doesn't make
9 sense and I am suggesting that we all get together and
10 find a way to redefine Class IIs or the division
11 between Class IIIs and Class IIs to a higher level.

12 The reason for that is to make short lines
13 even more competitive, to make it easier for the Class
14 Is to create short lines, because short lines, we
15 think, make merchandise traffic, make the product of
16 many shippers much more competitive against those unit
17 trains that we heard about this morning.

18 So we support the Staggers Act. We think
19 that paper barriers should be adjusted by commercial
20 means and not regulatory means, and we would like to
21 see the line between Class IIIs and Class IIs
22 redefined to a higher level. Thanks.

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1 CHAIRMAN NOBER: Thank you very much. Mr.
2 Bell?

3 MR. BELL: Thank you. Thank you for the
4 opportunity to be here. I am here today representing
5 the Columbus & Greenville Railway and to go along with
6 Charlie's graph here, we're probably that little green
7 dot compared to everybody else who have been up here.
8 We operate about 75 miles of railroad between Columbus
9 and Greenville, Mississippi.

10 I want to begin by giving just a sketch of
11 a history of our railroad prior to Staggers, some
12 examples of some positive effects that we have had and
13 conclude with a couple of thoughts and some subjects
14 of concern as our industry looks to the future.

15 Our railroad, like a lot of railroads,
16 goes back into the late 1800s. Its predecessor
17 struggled for some 50 years until the mid 1920s when
18 it finally became consistently profitable. In many
19 years it carried in excess of 200,000 passengers even
20 in a state like Mississippi, but by the late 1940s
21 passenger trains had to be discontinued.

22 But to give you an idea of the financial

1 wherewithal of the C&G, back in 1946 it purchased five
2 new 1,500 horsepower diesel locomotives and was one of
3 the first short lines to completely dieselize its
4 locomotive fleet. Throughout the '50s, the railroad
5 traffic basically was stagnant, showed little growth,
6 and that continued through the '60s and the '70s.

7 Declining traffic and deteriorating track
8 conditions took train schedules down to one train a
9 day, one train each way each day, and poor service and
10 derailments commonplace as track and bridge
11 maintenance continued to be deferred. In 1972 it
12 became part of the Illinois Central Gulf. Through the
13 merger of the IC and the GM&O, conditions only
14 worsened. Three years later the line was saved from
15 abandonment when a small group of local shippers and
16 railroaders purchased the line.

17 Like many small short lines or branch
18 lines of that era, the C&G had been stymied by the
19 burdensome and regulatory environment of the period,
20 absent of incentives or a chance for progressive and
21 value-enhanced service. Once a profitable and
22 successful operation, the C&G had been unable to adapt

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1 or benefit from those changes for decades and, almost
2 after 100 years of operation, it was on the verge of
3 collapse and headed for abandonment.

4 With Staggers, small rural carriers like
5 C&G now have the opportunity to publish rates specific
6 to customer needs on a one day notice, issue
7 quotations and contracts and negotiate divisions with
8 our Class I connections.

9 Small carriers learned to effectively
10 utilize the benefits and exploit those efficiencies
11 made available through Staggers. Those benefits kept
12 C&G operating, allowed new efficiencies and provided
13 optimism. Some traffic was lost due to the poor
14 service and competitive disadvantage, but new
15 opportunities developed. It was a period of
16 transition.

17 One particular success story that I want
18 to share with you began in the early 1980s with the
19 development and growth of aquaculture in the State of
20 Mississippi, farm-raised catfish, and grow it did with
21 total feed production exceeding 850,000 tons annually
22 by the late 1990s, now estimated to be a half billion

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1 dollar a year industry.

2 Two of C&G's largest customers are fish
3 feed mills using rail to transport the vast majority
4 of their 350,000 tons of grain and feed ingredients
5 annually. This is significant to C&G, but the
6 greatest value came through an innovative three party
7 agreement, which included a customer, C&G and our
8 Class I partner, Canadian National.

9 Our track and bridges were not safe to
10 handle 286,000 pound loads nor the unit trains the
11 customer needed to penetrate preferred grain markets
12 in the upper midwest. In return for a volume
13 commitment by C&G and the customer, a 10 year
14 agreement was reached whereby CN provided funding to
15 complete the upgrade of C&G's track and bridges,
16 increasing capacity to accommodate heavy loads and
17 unit trains to those feed mills.

18 The value to the customer was far more
19 than the improved efficiency or the higher track
20 capacity, providing an option to buy large quantities
21 of grain from abundant supplies throughout the grain
22 belt dramatically reduced its feed cost. For the CN,

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1 they got increased revenue and improved utilization on
2 its equipment with efficient long haul service, and
3 the C&G's lightweight rail was replaced and the
4 bridges rebuilt.

5 Safety and efficiency were vastly
6 improved. Customers gained confidence in rail.
7 Reliability and traffic to the feed mills continued to
8 grow, and none of this could have happened or would
9 have happened without the enactment of Staggers. I
10 believe the C&G story has a common thread with many
11 short lines serving rural America today. Our greatest
12 asset and our opportunity to succeed lies in our
13 ability to provide quality service and to work with
14 our Class I connections.

15 The advent of Staggers has given short
16 lines the opportunity to provide such a service, but
17 equally important is the inert medium that allows
18 individual railroads and railroad operators to
19 exercise the flexibility and the creativity to adapt
20 and develop the specific service needed and required
21 by our customers to comply with their needs and
22 compete for their freight.

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1 In conclusion, I believe today the STB
2 reflects on our industry with a great degree of
3 satisfaction, pleased in large part with the results
4 of 25 years of Staggers, however restrained with a
5 degree of caution and prudence as we enter into an era
6 of great demands on our nation's transportation
7 industry.

8 The STB, keeping an ever watchful eye on
9 the new challenges brought about by Staggers, the
10 issues of capacity, aging rail car fleet, increased
11 rates with add-on surcharges and the areas most in
12 need of investment to keep our industry fluid and in
13 good fiscal health.

14 The creation of short line railroads all
15 across America under the vigilant oversight of the STB
16 has offered competitive value to a significant portion
17 of the shipping community and the transportation
18 industry, and our entire nation recognizes and depends
19 heavily upon this tremendous benefit.

20 The STB is the gatekeeper, the helmsman
21 standing guard with the power, the authority and the
22 acumen to act and respond to the new challenges as

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1 they develop, a position I endorse and urge this Board
2 to maintain. Thank you.

3 CHAIRMAN NOBER: Thank you very much. Mr.
4 Parsons, welcome.

5 MR. PARSONS: Thank you. Larry Parsons,
6 Wheeling & Lake Erie. We're a 750 mile region or
7 Class II railroad, 400 employees, and we exist first
8 off to operate safely for the benefit of our employees
9 and customers. I want to thank the staff and the
10 Commissioners for reading my testimony.

11 I can summarize it by saying I came over
12 25 years from disliking the Staggers Act to admiring
13 the wisdom for where it has brought our industry.
14 Having sat through the hearings today, I would like to
15 make three additional points if I may.

16 CHAIRMAN NOBER: Please.

17 MR. PARSONS: I am quite discouraged to
18 hear customers say now that our nose and toes are out
19 of the water, that is far enough and probably ought to
20 go back under.

21 We are embarking on a four year project
22 aided by the RRIF Program and the investment tax

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1 credit to put far more capital into our property than
2 our book value, and that is because we believe in this
3 industry and I think this century, given what we have
4 seen from the Surface Transportation Board in the
5 past, will make this century better than the last one.
6 If that were to reverse, I think we would change
7 course.

8 CHAIRMAN NOBER: Okay. Well, thank you
9 very much. Vice Chairman Buttrey?

10 VICE CHAIRMAN BUTTREY: Yes. I posed a
11 question some weeks ago to a member of the short line
12 family, shall we say, to help me understand better
13 what the capacity, the unused and under-utilized
14 capacity of the short line railroads is right now.
15 That is a subject that really interests me a lot.

16 It seems like every time the subject of
17 short line railroads comes up, everybody stands up and
18 applauds, because the sentiment out there seems to be
19 that the short line railroads are doing a spectacular
20 job and have done a spectacular job and I think you
21 are to be commended for that.

22 But having said that, until somebody

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1 proves otherwise, I am convinced that there is a lot
2 more you could do and I'm wondering if you could
3 estimate for me or take a shot at estimating to me
4 what the unused and under-utilized capacity of the
5 short line system is right now.

6 MR. PARSONS: I'll take a crack at that.

7 VICE CHAIRMAN BUTTREY: Good.

8 MR. PARSONS: I would say close to zero.
9 We are -- part of a capital projects, we're adding
10 sidings, upgrading track speeds and yes, we could, you
11 know, help here and there, but you got to remember the
12 capacity has to fit in a network and most of our
13 capacity does not fit into a network. That is why it
14 has been short lined.

15 MR. MARSHALL: On our railroads we --

16 VICE CHAIRMAN BUTTREY: Let me follow-up
17 on that if I could. What is it that's keeping you
18 from fitting into the network?

19 MR. PARSONS: Well, you know, we, for
20 example, have detour agreements and occasionally, in
21 the case of an emergency, we'll detour a CSX or an NS
22 train between two points, but it's not a good way to

1 do it and it's only in an emergency and we don't have
2 the capacity to do that on an ongoing basis in terms
3 of siding capacity or track structure at today's date.

4 VICE CHAIRMAN BUTTREY: Someone else was
5 going to --

6 MR. MARSHALL: Yes. I was just going to
7 say there is a great deal of capacity within the
8 limits of most short lines, but we don't provide a
9 complete product and unless there is connecting
10 capacity on the Class Is, we can't get the freight all
11 the way to where it wants to go.

12 The significant limitations on short line
13 capacity are in the weight, which the track structure
14 will carry. Cars are getting heavier and so we need
15 heavier track. Some lines can take the heavier cars
16 and some can't. The other limitation at the moment is
17 that there is -- the locomotive supply in the entire
18 nation is very tight.

19 MR. SWINBURN: I would add, Vice Chairman
20 Buttrey, that the capacity question varies
21 significantly across our 47 railroads determined in
22 large part by the nature of the commodities carried

1 and the demand for capacity.

2 As an example, we have got a railroad in
3 the midwest, in Kansas, that primarily carries
4 agricultural products and during the agricultural
5 season is full, could not carry any more than the
6 trains we're running back and forth. For large parts
7 of the year it's empty, not really empty, but it's not
8 very utilized.

9 What we try to do is maintain all of our
10 railroads on what we call fit for purpose spaces. We
11 put the investment into the railroad that is needed to
12 match the traffic that is available. That railroad,
13 for example, because it's carrying grain, can carry it
14 at pretty slow speeds and large parts of the railroad
15 are limited to 10 miles an hour and that's fine.

16 Other railroads that are primarily
17 carrying industrial products we're moving at 40 miles
18 an hour and they take significant capital investment
19 to keep them there. It is generally true that if
20 there were more demand across the entire system, we
21 could find more capacity to meet that demand, but it's
22 a demand and commodity type situation.

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1 CHAIRMAN NOBER: Commissioner Mulvey?

2 COMMISSIONER MULVEY: Thank you. Thank
3 you for coming today. I have been a long time fan of
4 the short line railroads and some of you may know, I
5 worked very hard while I was on the T and I Committee
6 to secure the investment tax credits for the short
7 lines to deal with the 286K problem, and I'm glad to
8 see that those funds are being used and that short
9 lines are continuing to serve many, many shippers who
10 otherwise would not be served.

11 I want to address this question of paper
12 barriers, because it is one that is of particular
13 interest to me. I did not accept the analogy about
14 the buyer and the supplier, simply because most buyers
15 will have an option to go to another supplier. As one
16 of you pointed out, you are the ultimate captive
17 shippers. You really don't have any other options to
18 go to another supplier. Therefore, you must negotiate
19 with the railroads.

20 And secondly, most suppliers and buyers do
21 not enter into contracts that go on in perpetuity.
22 There is some limit as to how long those contracts go

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1 on and, at some point, when the parties feel that the
2 value has gone out of that contract, they can go
3 elsewhere and contract anew. That is not the case
4 with paper barriers, which do go on in perpetuity.

5 I find the perspective interesting that
6 you are better off or you're happy with requirements
7 that restrict your ability to negotiate. In general,
8 the more negotiation positions you're able to take,
9 the better your hand in negotiations, the better off
10 you are in achieving what you want. This is
11 interesting in the sense that because you have these
12 paper barriers, you really have no credible threat to
13 the Class I railroads and you are pretty much price
14 takers and service takers.

15 I would like to get your perspective on
16 this, because I hear from a number of railroads and
17 shippers and we have even had testimony before this
18 Board in cases where paper barriers really have
19 frustrated operations.

20 Unless paper barriers go on in perpetuity
21 I am not opposed to the notion of paper barriers, per
22 se. I think sometimes they are a legitimate part of a

1 sale or a lease, but when they go on forever and ever
2 and cannot be sunsetted, then I think there is a
3 problem and you don't have the ability for the short
4 line to eventually bring competition to the Class I
5 railroads in those markets.

6 Anybody want to comment on that?

7 MR. MARSHALL: Let me try, because I
8 realize this is unpopular and counterintuitive, the
9 position that I have and am convinced of. Forever is
10 a long time and we have seen railroads buy out paper
11 barriers, railroads like Reilly's, and we have
12 negotiated our way out of paper barriers on some of
13 our railroads on commodities that the Class Is aren't
14 interested in handling.

15 But the issue about should we put some
16 sort of sunset on paper barriers will have a chilling
17 effect on the willingness of Class Is to create short
18 lines, and if there are not to be more short lines for
19 merchandise handling lines, I think that that
20 business, which today is less competitive than the
21 unit trains, will be in danger.

22 I think it is in the public interest to

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1 have as much of the retail railroading in this country
2 in the hands of short lines as possible, and to monkey
3 with paper barriers is to jeopardize that short line
4 growth in my view.

5 COMMISSIONER MULVEY: We agree that there
6 should be more short lines and that short line should
7 prosper. I would disagree or I would question the
8 notion of the Class I railroads creating the short
9 lines, and it strikes me that the short lines should
10 be firms that are independently created and come to
11 operate these lines, as opposed to being the children
12 and the controlled children at that of the Class I.

13 So that is my concern, not that the short
14 lines don't grow and prosper, but rather that they be
15 truly independent entities at some point.

16 CHAIRMAN NOBER: Do you want to follow-up?

17 COMMISSIONER MULVEY: Well, I only have
18 one other question, and that is with regard to Mr.
19 Swinburn. I noted in your testimony that you said
20 that the Staggers Act worked even better than you
21 expected in 1980 and you mentioned the teachings of
22 the staff economist at DOT combined with common sense

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1 told you it was going to be a good thing.

2 And I just wanted to say that I was one of
3 those staff economists, not one of the ones who taught
4 you, obviously, but nonetheless I was associated with
5 those individuals, and I just want to say that that
6 group who consisted of Jim Hagen, Dave DeBoer, Gerald
7 Davies, Jim McClellan, Bill Loftus, and others, was
8 truly one of the most talented groups, that has ever
9 worked in the Federal Railroad Administration, at
10 least in my memory.

11 So I was wanting to give credit to those
12 people who helped create the Staggers Act. I'm sorry,
13 and also Ed Hamburger, who is sitting in the audience.

14 MR. SWINBURN: I certainly agree with your
15 evaluation, Commissioner.

16 CHAIRMAN NOBER: Let me ask you all. Some
17 of the testimony this morning raised two issues. One
18 was paper barriers, which Commissioner Mulvey has
19 already asked you about. The second was concern from
20 our labor representatives this morning for the Board
21 to take a more -- to give more scrutiny to purchases
22 or change the regime for purchases of short lines by,

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1 essentially, holding companies.

2 What is your reaction to those comments
3 that were made earlier?

4 MR. PARSONS: I can sympathize, because I
5 was the Operating Vice President during the first 15
6 years of Stagers, and it did force us to rationalize
7 what was going on in trains. And when Stagers was
8 passed we had four and sometimes five people on a
9 train, a caboose, and it was comfortable. Everybody
10 was happy, but it sure as hell wasn't efficient.

11 We have still got two people on trains and
12 that is not efficient. In most cases we can do it
13 with one. So change is painful, but I don't think
14 Jim's characterization of how ill-treated the
15 employees were in the process is accurate. I think
16 attrition has taken care of most of them.

17 The Railroad Retirement Act has just
18 accelerated the retirement process, which is hurting
19 us, and I think one of the challenges we have in this
20 industry is finding people to work in it that are
21 dedicated to it. And even though we're -- I look at
22 our employees and it's not unusual to find people in

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1 train service making over \$70,000 a year in our employ
2 and, you know, we consider that a decent wage. It's
3 not as good as a Class I, but it's certainly nothing
4 to be ashamed of.

5 So I think, yes, his membership has gone
6 down and I hate to say it, but it's going to go down
7 a hell of a lot more, I think, and I don't think
8 anybody in this room can change that or should.

9 MR. SWINBURN: One point of clarification
10 in case there is some confusion. We don't, and I
11 think it's true of most short lines, have any problem
12 being unionized. About half of our railroads are
13 unionized and I would have to say that there is really
14 no difference in operating or financial performance
15 between those that are unionized and those that are
16 not.

17 It's true, as Larry said, that the
18 transition to our industry of many of these lines did
19 result in personnel dislocations for the employees who
20 previously were on those lines, but it's also true,
21 and if you get a chance to look at the three examples
22 of communities that we think we have revitalized with

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1 our operations, that we have brought a lot of
2 additional jobs to those communities, people that were
3 not working in facilities that were moribund and in
4 places where there was simply no rail activity.

5 And you also have to think about the
6 alternative to the short line industry. A lot of the
7 lines upon which Jim's members were working probably
8 would not be operating today if it wasn't for the
9 short line industry and I don't know where those jobs
10 would be.

11 MR. MARSHALL: Just something on the
12 holding company point. Most of our railroads of any
13 substantial length are unionized either by Jim or the
14 engineers, but the railroads are very different and
15 they have very different agreements even where the
16 same union is involved. We have some coal railroads
17 where labor makes a lot.

18 We have some light density railroads where
19 the agreements are much thinner. They comport with
20 local wages for doing other kinds of work. So if you
21 look at this from a holding company perspective, do
22 you want to assess the higher wages against the light

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1 density railroad and have it probably abandoned or do
2 you want to bring down the wages of the home
3 railroaders where the railroad is a little richer and
4 can afford more?

5 I think the present system of
6 differentiating railroad by railroad according to the
7 local circumstances that serves labor well. We think
8 we build jobs not only locally, but also for the Class
9 Is that we feed and this, the present system, is
10 working.

11 CHAIRMAN NOBER: Well, let me ask one
12 follow-up on a point Charlie made, Mr. Swinburn made,
13 which is how are you able to operate properties
14 efficiently that the Class Is couldn't make, you know,
15 couldn't either find -- either couldn't operate
16 efficiently and wanted to abandon or were kind of in
17 that netherworld that you described in your testimony?

18 What is it that you all or your properties
19 do that a Class I can't or doesn't?

20 MR. PARSONS: I will give an example.
21 We're 15 years-old. The original investors didn't get
22 a lump of coal. The current owners have had it for

1 about 12, 11 and a half, 12 years and I found more
2 money on the sidewalk leaving the airport last night
3 than we have taken out of it.

4 So you won't find many Class Is that are
5 willing to live with that equation. Every penny that
6 we generate, the cash flow goes back into the property
7 and we give attention to detail, to the customers, at
8 a level that a Class I cannot and we can make
9 decisions very quickly, and those all bode well and
10 over that period of time we have doubled our revenue
11 through a lot of good luck and hard work.

12 MR. BELL: Our operation, obviously, is
13 much smaller than Larry's and those same things apply
14 at our place. In addition to that, our employees I
15 think have somewhat of what you would refer to as a
16 family type attitude and the train crew on our
17 railroad doesn't mind doing locomotive start-up work
18 that maybe on a Class I would require more than one
19 craft to get the job done. So it's a lot of
20 flexibility and a great attitude from our employees,
21 which I think is a great thing for us.

22 MR. MARSHALL: Local management. The same

1 guy is in charge of marketing and operations, so we
2 promise what we can deliver and we deliver what we
3 promise.

4 MR. MCCARREN: I will comment in my
5 capacity as the Chairman of the Arkansas and Missouri
6 Railroad since the Rail Industry Working Group doesn't
7 actually operate railroads of its own.

8 I think one of the most fundamental
9 principles is the organizing principles of a local
10 railroad are very different from that of a
11 transcontinental line haul railroad. And our whole
12 business model is built around pickup and delivery
13 service, short line hauls, and our labor hiring, our
14 labor agreements if we have them, the equipment we
15 use, the way we maintain our track, everything is
16 built around that organizing principle.

17 A Class I railroad is built around the
18 organizing principle of hauling large volumes long
19 distances on high density track. It's a very
20 different principle. It's very difficult for them to
21 be good at what we do. It's equally difficult for us
22 to be good at what they do.

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1 CHAIRMAN NOBER: Anyone else? Do you want
2 to comment?

3 MR. SWINBURN: I will say that all of
4 those apply to us, Mr. Chairman, particularly as with
5 Charlie's company, which is also widespread, local
6 management makes a big difference. Our general
7 managers are entrepreneurial in nature. Their
8 employees are all willing to pitch in. Even though,
9 as I said, half of our railroads are unionized, again,
10 there is no difference in the willingness of the
11 employees to take on multi-tasks, do things that
12 probably in Class I the craft system would not allow
13 them to do.

14 And finally, I would say you would be
15 surprised to get out there and see that a lot of the
16 rail we use is secondhand rail. A lot of the
17 locomotives we use are locomotives that have come down
18 through the Class I system and we bought them out the
19 bottom. You learn how to do that and make it safe and
20 successful when you have got the kind of local
21 management that we do.

22 CHAIRMAN NOBER: Okay. Well, thank you

1 all very much and for your patience sitting through
2 eight hours of hearing to get here, but we appreciate
3 it.

4 And our last panel of the day. Okay. Our
5 first panelist is Tom O'Connor From Snavely King,
6 Sandra Dearden from HIGHROAD Consulting, Curtis Grimm
7 from the University of Maryland, Art Scheunemann from
8 Northwest Container Services, Michael Sussman from
9 Strategic Rail Finance and Paul London. I'm not sure
10 he's here. If he's not, we'll end five minutes
11 earlier as well. So Mr. O'Connor?

12 MR. O'CONNOR: Thank you so much. Thank
13 you so much and thank you for having us here today.
14 If I had to sum up my remarks in three words, it would
15 be Long-Cannon and mediation.

16 UNIDENTIFIED SPEAKER: Somebody might have
17 kicked it out.

18 COMMISSIONER MULVEY: Well, the light is
19 on.

20 MR. O'CONNOR: Here we go. Okay. How are
21 we doing?

22 CHAIRMAN NOBER: Excellent.

1 MR. O'CONNOR: Okay. To begin, if I had
2 to sum up the remarks in three words, it would be
3 Long-Cannon and mediation, and we'll be showing you
4 some data today that support the advisability of
5 mediation and, arguably, the benefits that will flow
6 from it as well.

7 The experience since Staggers clearly, and
8 we have heard practically no dissent on this, market
9 solutions are preferred. Rail regulatory assistance
10 is needed in some situations and we believe that's
11 primarily in captive situations. There is some
12 discussion around that, but there was no discussion
13 really that denied that captive situations exist.

14 The most effective form of assistance, it
15 seems to me anyway, in captive situations is mediation
16 facilitated by the STB. We have applied that formula
17 with my company working on behalf of BP-Amoco with
18 Mike McBride whom you have heard already today from
19 New Bethlehem and I think all -- and working with NS,
20 I might add, in that, and I think all of the parties
21 would regard the outcome as successful, including the
22 STB.

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1 And the basic formula is it combines the
2 strengths of all of the parties at issue in a flexible
3 way to use all of the knowledge that is available and
4 to focus on the issues that count deferring, if you
5 need to discuss it at all, peripheral issues for
6 later.

7 Now, we heard a little bit about the
8 legislative history and you have it, I have it. Many
9 of our careers have intertwined around the Staggers
10 Act, certainly mine has. And one of the primary add-
11 ons to the Staggers Act was Long-Cannon. And
12 basically, Long-Cannon 1, 2 and 3, which I have got up
13 on the board there and appeared in my testimony as
14 well, is basically talking about being fair and
15 equitable and being efficient about the production of
16 revenue, broadening the revenue base. That is really
17 what it amounts to.

18 Here I'm looking at Long-Cannon 1 and I'm
19 using a metric that is available. It comes out of the
20 STB waybill sample, so these are STB data or,
21 basically, the same data I have shown you from time to
22 time in prior appearances here.

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1 What we have up here is the percentage of
2 rail freight revenue, which is moving at rates below
3 variable cost. We're leaving off to one side for the
4 moment whether this is the measurement of variable
5 cost, but this is standard or x, is what it is, as
6 implemented by the STB staff and before them, the ICC
7 staff. And what you see, basically, is that anywhere
8 from 15 percent to as much as about 20 percent and,
9 most recently, about 18 percent of the revenue is
10 moving at rates below variable cost, just a fact.
11 Okay. We'll come back to that.

12 Long-Cannon 2. Here what we're looking at
13 is the amount of traffic, which contributes only
14 marginally to fixed cost and the extent to which, if
15 any, rates on such traffic can be changed to maximize
16 the revenues from such traffic. And here what we're
17 looking at, again, this is the STB waybill sample and
18 ICC before it. The graph covers the entire span of
19 years. And you can see that in the high year, 1987,
20 the average revenue cost ratio on the waybill sample
21 was 139 percent and, most recently, 133 percent. And
22 Long-Cannon 2 is are we maximizing?

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1 Long-Cannon 3. Long-Cannon 3 mandates
2 consideration of the carrier's mix of rail traffic to
3 determine whether one commodity is paying an
4 unreasonable share of the carrier's overall revenues,
5 and I have showed you this graph before in prior
6 appearances. Again, it comes from the 2002 waybill
7 sample.

8 We see that chemicals had 61 percent of
9 its revenue above 180 percent, coal 44 percent,
10 overall 31 percent, that's all traffic taken together,
11 has revenue above 180 percent. And 5 percent, by the
12 way, that's where the intermodal would fall in, in
13 that category there. And intermodal, we could debate
14 about whether intermodal is cost precisely --
15 correctly in the waybill sample. I would not assert
16 that it is, but it's cost uniformly throughout the
17 time period. That's the key point I'm focusing on
18 here.

19 What do we recommend? What do we support?
20 We support private commercial negotiations and a
21 primary approach resolving rate reasonableness
22 challenges unequivocally. We recommend STB-assisted

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1 mediation for small shipment rate cases as an
2 effective and efficient addition to STB services and
3 it worked quite well in BP-Amoco, I thought.

4 A minor technical point just as I'm going
5 by here. We will need, of course, to access and
6 verify the underlying data. We're working right at
7 the moment with staff doing that, with STB staff, and
8 we'll continue to do so. Is it going to cause a broad
9 impact? I don't think so.

10 What we have here, recall now that if the
11 commodity revenue is below RCR 180, it's exempt. And
12 as you can see here for most of the commodities that
13 we're talking about, including chemical, a significant
14 portion of it just drops out right on that
15 characteristic alone. So it's very unlikely to
16 unleash a wave of cases toward you, and that concludes
17 my remarks. Thank you so much.

18 CHAIRMAN NOBER: Okay. Well, thank you
19 very much. Ms. Dearden?

20 MS. DEARDEN: My name is Sandra Dearden.
21 I am President of HIGHROAD Consulting, which is a full
22 service transportation and consulting firm, which

1 means we consult on all modes for domestic and
2 international traffic. However, it seems that rail
3 has become our niche. About 60 percent of our firm's
4 business is on rail-related projects.

5 We have a diverse client base that
6 includes shippers and railroads, including Class I
7 railroads. Today I am representing the views of some
8 of my clients that are rail customers. Prior to
9 starting HIGHROAD, I spent 26 years in the railroad
10 industry. My most recent position was General Manager
11 of Marketing and Sales for a Strategic Business Unit
12 at Chicago Northwestern Transportation Company.

13 In this verified statement, I would like
14 to discuss the impact on businesses in the United
15 States since Staggers has been enacted, and I would
16 like to offer some suggestions for changes to be
17 considered, which I think could enhance the current
18 system.

19 Rail customers and the railroad industry
20 have realized significant benefits from the Staggers
21 Rail Act. We gave the railroads the right to
22 establish rate and service agreements with rail

1 customers. Railroad marketing personnel, including
2 myself, responded enthusiastically to the opportunity
3 to work in partnership with customers to develop
4 markets and on supply chain initiatives.

5 High volume business with major customers
6 was confirmed in multi-year contracts, some with terms
7 as long as 20 years. Because of the long-term
8 contracts, rail customers initiated long range
9 planning and committed capital to their transportation
10 and supply chain infrastructures feeling confident
11 that they were assured certain rate and service
12 levels.

13 At the same time, the railroads also
14 invested capital for equipment, track and yards
15 knowing the business would be there to cost justify
16 their investments. This was good for the railroads,
17 the rail customers and the economy.

18 Post-Staggers was really fun to work in.
19 We were operating in a new entrepreneurial business
20 environment and we formed cross-functional teams that
21 applied out of the box thinking to our planning
22 processes. Examples of team initiatives included

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1 alternative route analysis and strategic allocation of
2 assets.

3 These initiatives, in addition to new
4 labor agreements negotiated by the railroads, resulted
5 in new, improved productivity and reduced cost,
6 enhancing the railroad's ability to compete. The
7 primary focus of railroad management personnel was on
8 contribution growth and today, while there is
9 significant room for improvement, the railroad
10 industry is healthy and profitable.

11 I believe that many of the problems we
12 face today have developed because the rationalization
13 of the rail infrastructure has simply gone too far.
14 The super-sized railroads are so big and bureaucratic,
15 it seems they cannot respond quickly to problems and
16 opportunities. Railroad operations are sluggish,
17 which contributes to increased cost.

18 This has also impacted on the rail
19 customers operating in supply chain costs as customers
20 have realized increased costs due to plant shutdowns,
21 labor costs associated with service failures or from
22 emergency trucking required to keep plants open. Some

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1 railroads have increased the size of the private rail
2 car fleets, which increases their cost but, more
3 important, it also contributes to the already
4 congested system.

5 One of our clients has 3,500 tank cars.
6 Although his company's increased car costs associated
7 with inefficient rail operations was documented and
8 significant, two railroads declined his company's
9 invoices to recover some of the costs on the basis
10 there were no service commitments in the contracts.

11 Shippers are not allowed to function on a
12 level playing field. While they are required to pay
13 demurrage when cars owned by the railroads are not
14 unloaded and released on a timely basis, there are no
15 measurements or processes in place that allows rail
16 customers to collect when railroads do not handle
17 their equipment with reasonable dispatch.

18 Currently, the STB has a new process to
19 arbitrate disputes between shippers and carriers on
20 service failures. However, the STB does not currently
21 have the authority to mandate and enforce solutions.
22 The term "reasonable dispatch" needs to be defined and

1 a process developed that is fair, but not
2 administratively burdensome giving the customers
3 recourse in those situations where abuse of the
4 private equipment has been repetitive and significant.

5 Another problem that contributes to the
6 cost increases incurred by shippers that move their
7 products on private cars is out of route movement of
8 empty cars, which results in charges for excess empty
9 miles. Mileages for some of the empty moves are more
10 than 200 percent higher than those for the loaded
11 moves due to the railroad's choice of the return route
12 for the empty car.

13 These problems are compounded by a high
14 incidence of railroad reporting errors. One example
15 was an empty move from Chicago to Joliet, Illinois.
16 The mileage reported for that empty move by the
17 railroad was 444 miles. When challenged, the
18 railroads have worked with us to address these
19 problems, and we have succeeded in mitigating charges
20 for excess empty miles.

21 However, it has been our experience that
22 we're required to call their attention to these moves

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1 even though they often present opportunities for the
2 railroads to improve their own operating efficiencies
3 and to free up capacity. While this is not a problem
4 to be addressed in the legislation, it is a symptom of
5 an even bigger problem, the lessening of competition
6 that would present an incentive for railroads to
7 improve the efficiency of operations.

8 Instead, the railroads' response to high
9 cost and capacity problems is to simply pass the
10 problems through to the customers, increasing rates
11 and accessorial fees and, in some cases, announcing
12 new accessorial charges.

13 Railroads submit that rail rates have
14 declined substantially since Staggers was passed.
15 However, you have to be careful when you look at this.
16 It's somewhat misleading, because there has been a
17 dramatic shift in responsibility to the shippers to
18 provide equipment for the moves and, in most cases,
19 the private car rates do not compensate the customer
20 for use of the private cars. Therefore, a comparison
21 of pre-Staggers versus post-Staggers rates and
22 revenues do not present an accurate picture.

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1 Currently, the railroads appear to be out
2 of control with their pricing practices, demanding
3 double digit increases in addition to the double digit
4 fuel surcharges, and they have been very aggressive
5 transitioning rates from contracts to tariffs. And
6 it's apparent that the motive is that they want the
7 ability to announce increases and charges on short
8 notice.

9 The impact of railroad pricing practices
10 and tactics on manufacturers in North America has been
11 very significant, but there is a saturation point. A
12 chemical manufacturer, as an example, faces increased
13 rates and fuel surcharges not only on their finished
14 products, but also on their inbound raw materials.
15 Compiled, the fuel surcharges alone can increase costs
16 by more than 30 percent.

17 For a manufacturer with \$140 million rail
18 spin, double digit fuel surcharges equate to big
19 dollars. At 10 percent he is paying \$14 million and
20 at 16 percent more than \$22 million a year.

21 CHAIRMAN NOBER: If you wouldn't mind
22 summarizing your testimony.

1 MS. DEARDEN: Okay. Sure.

2 CHAIRMAN NOBER: We're a couple of minutes
3 over. That's okay. We have all read what you
4 submitted.

5 MS. DEARDEN: Okay.

6 CHAIRMAN NOBER: But, please, you can --

7 MS. DEARDEN: Well, I think one of the key
8 points, like Tom alluded to, is we need a better
9 system for addressing reasonableness. The rate
10 reasonableness should include not only the rates, but
11 also other factors such as the fuel surcharges. Also,
12 URCS, which has been used in measuring cost, does not
13 reflect the cost the way that the railroads view their
14 costs internally and there is better systems to do
15 that. What do you want me to talk about, Roger?

16 Also, one of the significant things. I
17 really think the STB should have more staff and
18 authority to monitor the industry and inaccurate and
19 illegal publications to make sure that the industry
20 behaves the way it should.

21 CHAIRMAN NOBER: Okay. Well, thank you
22 very much. Mr. Grimm?

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1 MR. GRIMM: Good afternoon. My name is
2 Curt Grimm. I am the Dean's Professor of Supply Chain
3 and Strategy at the University of Maryland. I am very
4 pleased to participate in this hearing on the 25th
5 anniversary of the Staggers Act.

6 My remarks draw on almost 30 years of
7 experience in rail policy matters, including extensive
8 academic research in this area. In addition, I had
9 the privilege to work at the Interstate Commerce
10 Commission during 1981 which was, of course, the first
11 year that the Staggers Act was being implemented.

12 The Staggers Act is a component of a
13 significant trend towards microeconomic reform
14 worldwide and has been manifested largely as
15 deregulation in the United States. Traditional public
16 utility regulation has given way to markets and
17 competition across a number of industries. U.S. rail
18 deregulation provided a greater reliance on free
19 markets to promote railroad profitability and public
20 benefits. As detailed by many of today's speakers,
21 clearly, Staggers has boosted rail profitability.

22 A Brookings Institution study, in which I

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1 participated in the early '90s, evaluated the economic
2 effects of surface freight deregulation, thus
3 encompassing both Staggers and the Motor Carrier Act.
4 This study found that, in aggregate, shippers had
5 benefitted, as well, from surface freight
6 deregulation. Based on 1977 dollars, shippers reaped
7 \$11 billion in annual benefits and, adjusting to
8 today's dollars, that's about \$27 billion in annual
9 benefits.

10 Rail deregulation has clearly been a
11 successful policy. Looking back, the key point, in my
12 opinion, is that the infusion of competition into
13 freight transportation markets has been the driver of
14 economic benefits. Going forward, in my opinion,
15 policy makers should preserve and enhance rail
16 competition to continue and extend the benefits of
17 Staggers.

18 Now, my students often ask me for book
19 recommendations and I'll take the liberty to provide
20 a couple on today's topic for further reading. Now,
21 as my second choice, I'm very pleased to highly
22 recommend the book written by Paul London, who I

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1 thought was going to be my panel mate today, maybe he
2 still will be, but he has written a book The
3 Competition Solution, which I would highly recommend.

4 And London goes through the move towards
5 competition, both resulting from deregulation and
6 freeing up of some of our trade restrictions and
7 posits with, I think, quite a convincing array of
8 evidence that the economic performance of the U.S.
9 economy, which has, of course, been very good for the
10 last 20 years, is primarily the result of these
11 movements towards increased competition. As I say,
12 it's an excellent book well worth reading.

13 My first choice, of course, is my own
14 Brookings Monograph, The Economic Effects of Surface
15 Freight Deregulation. We're still trying to overtake
16 Harry Potter as the number one Amazon.com ranked book.
17 With your help, I think we can do it.

18 I would like to close my remarks today by
19 saluting the Commissioners and the staff of the ICC
20 and the STB whose outstanding work over the past 25
21 years in implementing Staggers has provided
22 significant benefits to the public. Thank you.

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1 CHAIRMAN NOBER: Well, thank you very
2 much. I confess, we do have Harry Potter in our
3 house. We don't have your book.

4 MR. GRIMM: Okay. All right. Remedy
5 that.

6 CHAIRMAN NOBER: And if it's under \$20, I
7 could accept that, but if -- Mr. Scheunemann?

8 MR. SCHEUNEMANN: Good afternoon. Art
9 Scheunemann, Northwest Container Services, Seattle,
10 Washington, Portland, Oregon. Deregulation has been
11 a win-win for Northwest Container Services. It would
12 have been difficult for a small company like ours to
13 leverage a business relationship with a Class I
14 railroad in the previous regulated environment.

15 Deregulation, in our view, has promoted
16 cost and service rationalization in this,
17 profitability and opportunity on both sides of our
18 relationship with the Class I railroads. We're a 22
19 year-old company, so we have been in this business
20 almost as long as the railroads have been deregulated.
21 We have five facilities, soon to be seven, in the
22 Pacific northwest, soon a facility in California

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1 between Oakland, California and the lower San Joaquin
2 Valley.

3 We're an intermodal short haul rail
4 service provider. We move containers to and from
5 steamships to rail and move our intermodal rail cars
6 from our facilities to our facilities then the to
7 customer. We own our own facilities or partner with
8 port authorities as operators of port intermodal rail,
9 river barge operation facilities. We own our own rail
10 cars, custom built, double stacked, intermodal rail
11 cars that by this year's end will give us the ability
12 to move upwards of 200 containers per train on a daily
13 basis in the Pacific northwest.

14 We employee a fleet of 135 trucks that
15 provide gray services from ship to rail at the harbors
16 to the customer. We are a hook and haul operation.
17 We contract for power and corridor usage with two
18 major Class I railroads, the Union Pacific Railroad
19 and the Burlington Northern-Santa Fe, our partners.
20 Short haul in our business model is 300 miles or less
21 and our shortest route is 160 to 180 miles between
22 Seattle, Tacoma and Portland.

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1 We are very profitable. We provide
2 quality revenue to both the Union Pacific and the BN
3 and we don't compete with their core of business.
4 Business model works, it works in the Pacific
5 northwest. It will work in California and it will
6 work in other parts of the country. We move 110,000
7 plus containers on rail between Seattle, Tacoma,
8 Portland, Pasco and have a new facility starting up
9 next month in the Columbia Basin of eastern Washington
10 that will connect to the Port of Tacoma.

11 That is 110,000 truck trips off of the I-
12 5/I-90 Corridor that has reduced congestion, that has
13 reduced road wear and improved their quality. It is
14 our contribution to social engineering in the
15 transportation industry.

16 We are not a class railroad. We are not
17 a railroad nor do we aspire to be, but we know a lot
18 about the rail business and we have a longstanding
19 partnership with UP and BN. And to be sure we are
20 dependent on the UP and the BN in our core business
21 which rises and falls with their success or failures.
22 In that context, we are very supportive of their

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1 efforts at reducing congestion through investment and
2 power infrastructure and capacity.

3 Again, a win-win relationship made
4 possible, in our view, through deregulation and a
5 great example of that economic opportunity gained
6 through less regulation rather than more. Thanks.

7 CHAIRMAN NOBER: Well, thank you very
8 much. Mr. Sussman, I apologize, but you'll be our
9 last witness of the day.

10 MR. SUSSMAN: Well, mostly looking ahead.

11 CHAIRMAN NOBER: You have our condolences.

12 MR. SUSSMAN: Great timing.

13 CHAIRMAN NOBER: Please.

14 MR. SUSSMAN: Yes. Since 1994 when I
15 founded Strategic Rail Finance, I met with over 150
16 Congressional Offices and most of the entities
17 responsible for federal transportation policy. I have
18 developed relations with almost every state's rail
19 office. Along the way, I have coordinated financing
20 for projects in 21 states.

21 In these 12 years, I have met so many
22 individuals with tremendous railroad experience and

1 intellect, both in the private sector and the public
2 sector, as we have in this room today. I have seen
3 that we aren't short on intelligence, but we are
4 woefully short of cohesive coordination of that
5 intelligence. I believe that none of us are as
6 intelligent alone or in adversarial debate as we are
7 in a thoughtful collaborative dialogue.

8 25 years after the Staggers Act can we now
9 shift from competition for survival and into working
10 together for the long-term dynamic growth of North
11 America's utilization of freight rail transportation?
12 Yes, we can, but accomplishing this requires a much
13 higher level of coordination and collaboration that
14 what we see in most industries and indeed what we see
15 in the rail industry.

16 Most importantly, to produce growth that
17 actually contributes to the quality of life and the
18 economic well-being of our continent, we must provide
19 the right framework. That framework consists of:
20 One, a clear set of measurable goals toward which to
21 set our commercial and public policy sites. Two, an
22 intellectually sound multi-discipline, multi-

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1 stakeholder forum for teasing out win-win approaches
2 to growing the rail industry. And three, increased
3 coordination of public sector and private sector
4 financial and business interests and resources.

5 Economic statistics for industry growth
6 have often been amorphous and misleading. We can no
7 longer afford to invest without clear goals. And we
8 can no longer assume that what is best for the most
9 successful competitors will trickle down to support
10 the whole system. It is time to collectively ask and
11 answer what do we want our rail system to do for us as
12 a nation and a continent?

13 The process for determining these goals
14 must be mediated amongst wide multi-stakeholder
15 concerns utilizing leading edge group and
16 collaborative methodologies. Only in this way can we
17 implement plans that satisfy long-term goals as well
18 as short-term goals and public interests as well as
19 private interests. When we agree on the results we
20 want from our railroad system and how to measure our
21 progress toward those goals, I believe we will have a
22 heightened concern for the ongoing decrease in rail

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1 service to rural and urban America.

2 Too many small and large businesses are
3 suffering from a diminished or an entire loss of rail
4 service. It is time to move beyond the fear that
5 coordination and collaboration in the best interest of
6 the community or the country is somehow anti-
7 capitalist or anti-American. Maximizing and managing
8 competition is an incomplete regulatory principle.

9 There is no beneficent marketplace that
10 somehow economizes all the self-centered activities of
11 individual commercial enterprises and then delivers to
12 the community the services and systems it deserves.
13 It is time to establish a new regulatory principle
14 that integrates thoughtful collaboration with useful
15 competition. This new principle will provide the
16 regulatory framework for all of our hard work and
17 investment to be more effective and profitable.

18 Funding for freight rail development will
19 flow in record amounts from around the world as it did
20 in the 19th Century when private sector funding
21 sources are presented with an assertive and cohesive
22 industry business plan for growth. Government can

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1 play its most productive role by stimulating and
2 facilitating this planning process.

3 I have conceptualized the methodology for
4 this public/private sector collaboration. I look
5 forward to the Board's input into making it a reality.
6 Thank you for this time to speak.

7 CHAIRMAN NOBER: Okay. Well, thank you
8 very much. Commissioner Mulvey?

9 COMMISSIONER MULVEY: Let's see, Ms.
10 Dearden, the railroads have invested very, very
11 heavily in computer technology and in car tracking
12 systems over the last decade. In fact, all the
13 railroads are demonstrating what they are doing in
14 terms of improving their tracking systems. Have you
15 seen some improvements over the past decade in the
16 railroads' abilities to keep track of their cars and
17 equipment? You sort of suggested that you haven't
18 seen improvements.

19 MS. DEARDEN: It depends upon the
20 railroad. Some railroads are doing a better job at
21 managing their property than others. The one -- there
22 is one western carrier that is causing my client

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1 significant increase in charges for emergency trucking
2 and plant shutdowns.

3 COMMISSIONER MULVEY: But overall, in
4 general, are most of the railroads doing a better job
5 in tracking their cars and tracking shipments?

6 MS. DEARDEN: In general, but, you know,
7 what happens is when they do, it seems like when
8 something goes wrong, they are so large and so
9 bureaucratic, it's very hard to get past the first
10 line customer service people who actually just report
11 what they see on the computer screen and get a problem
12 resolution. The size of the organization is very
13 difficult to deal with.

14 COMMISSIONER MULVEY: And do you think
15 that has been exacerbated by the consolidation of the
16 industry?

17 MS. DEARDEN: Yes.

18 COMMISSIONER MULVEY: Okay. Dr. Grimm,
19 you estimated \$27 Billion, in current dollars and in
20 benefits to shippers from railroad deregulation. Does
21 that take into account the costs that have been passed
22 on to the shippers, in terms of increasing

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1 responsibility for providing equipment and things or
2 is that not net of that?

3 MR. GRIMM: Well, first, that was the
4 combined effects of both rail and truck deregulation.

5 COMMISSIONER MULVEY: Okay.

6 MR. GRIMM: We looked at both together, so
7 the number I gave you was both, rail and truck.

8 COMMISSIONER MULVEY: How much of that was
9 rail and how much of that was truck? Do you recall?

10 MR. GRIMM: I think about -- some is
11 intertwined, but I think it's probably about 40
12 percent rail, 60 percent truck.

13 COMMISSIONER MULVEY: Yes.

14 MR. GRIMM: In terms of the benefits to
15 shippers. We looked at both service quality impacts
16 and rate increases or decreases, in other words rate
17 effects as the foundation of analyzing benefits, so we
18 were not able to get into the issue that you raised,
19 for instance, to the extent there are additional costs
20 that have been passed on to shippers. That would not
21 have been measured in our study.

22 COMMISSIONER MULVEY: You are a great

1 believer in the competitive solution and so am I. One
2 of the things I have been talking about is the
3 elimination or reduction in the terms of paper
4 barriers in order to provide for potentially more
5 competition to the Class I railroads from these
6 spinoff Class III railroads. Could you opine on
7 whether or not you think paper barriers are something
8 that should be sunsetted?

9 MR. GRIMM: Well, I think overall a
10 direction of trying to empower the short line and the
11 regional railroads as well as the smaller Class Is is
12 a very good strategy. I think similar to the airline
13 industry under deregulation, I think it's the smaller
14 companies that have been the most innovative. They
15 have been the most cost efficient. They have a lot of
16 potential to not only invigorate the industry with
17 much needed competition, but also to show the way for,
18 I think, a lot of additional efficiency benefits.

19 Again, as we have seen in the airline
20 industry with companies like Southwest and now a lot
21 of other small carriers that are kind of shaking up
22 and I think greatly improving the airline industry to

1 create benefits for the customers. Of course, in the
2 railroad industry, you have significant entry
3 barriers, so we need to be more creative about how we
4 can empower these smaller companies.

5 But I think there are many opportunities
6 out there. For instance, the DM&E Project is one
7 example where you have a smaller railroad that wants
8 to expand and I think those efforts very much need to
9 be supported. We also had the instance in the UPSP
10 merger case where Montail Rail Link was very ready,
11 willing and able to acquire the central corridor line,
12 the parallel line between UP and SP if there were a
13 divestiture as a competitive solution to the parallel
14 aspect of that merger.

15 And again, that was another kind of
16 opportunity that we had to empower the smaller
17 railroads. I think there is a lot to be said for
18 removal of the paper barriers. And again, some of the
19 previous discussions suggested that may be possible if
20 we renegotiate the contracts with the railroads or buy
21 them out, and I think as with a lot of the efforts to
22 infuse the industry with competition, I think some

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1 kind of public assistance to the railroads as in a
2 sense of compensation.

3 So in other words, you could compensate
4 for whatever harm has been done or to the extent you
5 are changing terms of the contract, you could
6 potentially compensate in terms of capital funding and
7 so on, which is being talked about anyway, but in
8 conjunction, work together with the stimulation of
9 competition. So I think there is a lot of potential
10 there for removal of paper barriers.

11 COMMISSIONER MULVEY: Thank you.

12 CHAIRMAN NOBER: Vice Chairman Buttrey?

13 VICE CHAIRMAN BUTTREY: I'm afraid I'm
14 going to mispronounce your name. I want to be sure I
15 pronounce it correctly.

16 MR. SCHEUNEMANN: Scheunemann.

17 VICE CHAIRMAN BUTTREY: Scheunemann, okay.
18 Thank you. Mr. Scheunemann, when you were mentioning
19 your partners, as you call them, UP and BN, I think
20 you said, I didn't hear you mention anything about
21 turning over any traffic to either CP or CN. They
22 operate in that vicinity as well. Do you do any

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1 business with them?

2 MR. SCHEUNEMANN: No. Part of the problem
3 is that our service that we provide in the Pacific
4 northwest can't rail to Vancouver because of bridges
5 and tunnel limitations and double stacking
6 limitations. So our concentration has been the Puget
7 Sound region, Portland and eastern Washington and the
8 Columbia River, and as I mentioned, expanding into
9 California.

10 VICE CHAIRMAN BUTTREY: Okay. Thank you.

11 CHAIRMAN NOBER: Well, I just have one
12 question for Mr. O'Connor. I know you mentioned our
13 small rate case proceeding and talked about some of
14 your proposals for how to handle small disputes as
15 fitting in with what happened in the small rate case
16 proceeding that you brought and has been resolved.
17 Some of the other witnesses this morning were, you
18 know, concerned about the small rate case procedures
19 and thought that more needed to be done by the Board.

20 As one of the few alumna of the actual
21 process, what's your take on whether more needs to be
22 done or whether the process, you know, can work as it

1 is?

2 MR. O'CONNOR: I agree that more needs to
3 be done. And it seems to me that the best way to
4 proceed is to have more cases brought and to focus in
5 particular. As you recall, we had a mediation track
6 followed by a litigation track. And the mediation
7 track was 30 days and the litigation track was 200
8 days. And it resolved itself in the mediation track
9 in about three days.

10 Now, it resolved itself through the
11 collective action of the STB staff, the Norfolk
12 Southern, BP and perhaps a little bit from their
13 advisors. Getting the people in the room focused on
14 first identifying the problem and then working through
15 the problem to work out a compatible solution, that
16 was the key.

17 Now, if we had tried to define a set of
18 policy regulations that would have embraced everything
19 that happened during even those three days, it would
20 have been probably a proceeding that would have gone
21 on for perhaps months, perhaps years. But getting the
22 people engaged focused on the problem, identifying the

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1 problem, put the peripheral issues off to one side,
2 don't waste energy on the peripheral issues, worked
3 quite well. I think that's the way to go.

4 CHAIRMAN NOBER: Do you think more cases
5 will be brought?

6 MR. O'CONNOR: I can assure you more cases
7 will be brought.

8 CHAIRMAN NOBER: Okay. Well --

9 MR. SUSSMAN: Mr. Chairman, if I may?

10 CHAIRMAN NOBER: Yes, sir.

11 MR. SUSSMAN: I would like to suggest
12 another way to look at the paper barrier question.
13 The perspective that I would like us to be looking at
14 the rail system is how attractive is it to the
15 shipping public, to the shipping community? How
16 attractive is the rail system as a whole? When you
17 are out in the field and you are working with
18 potential customers of the rail system, the number of
19 freight options, the number of shipping options, the
20 number of connections a short line or a regional
21 railroad has is the number one factor in its ability
22 to attract new customers.

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1 So in an environment where the key mood is
2 competition for survival and you say to one railroad
3 do I want to give this customer access to my
4 competitor, so that he has more competitive options to
5 come back to me to have me lower my price, it's very
6 understandable that that railroad A would say no, I
7 don't want to give that option to that shipper.

8 If we were in a growth mode, clearly if
9 railroad A provides more options to its customers so
10 that it can ship via railroad B as well as railroad A
11 and access more of the distribution, marketplace
12 sales, marketplace and supply marketplace, and
13 railroad B gave its customers access to the other
14 railroads, then the whole railroad system becomes more
15 attractive and provides more of a service to the
16 country.

17 That's how I believe we should be looking
18 at paper barriers as well as many other issues around
19 competitive access.

20 CHAIRMAN NOBER: Well, again, I want to
21 thank all of the witnesses, both this panel and for
22 all the panels for their, you know, very interesting

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1 and provocative and thoughtful testimony. I know a
2 lot of folks spent a lot of time waiting and, you
3 know, I think it was a very, very valuable hearing for
4 the Agency and for the Commissioners. Hopefully more
5 for my fellow Commissioners than for myself, since
6 anything that comes out of it, obviously, will be
7 involving them more than myself.

8 But anyway, again, I want to thank all the
9 witnesses for their patience and my fellow
10 Commissioners for their hard work and the staff for
11 their hard work in preparing for it. And if there is
12 nothing further, the Board stands adjourned. Thank
13 you.

14 (Whereupon, the hearing was concluded at
15 4:44 p.m.)
16
17
18
19

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This is to certify that the foregoing transcript in the
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Before: Surface Transportation Board

Date: October 19, 2005

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