



**ASSOCIATION OF
AMERICAN RAILROADS**

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August 21, 2008

**Honorable Anne Quinlan
Acting Secretary
Surface Transportation Board
395 E St., S.W.
Washington, DC 20423**

**Re: STB Ex Parte No. 677 (Sub-No. 1) – Common Carrier Obligation of Railroads –
Transportation of Hazardous Materials**

Dear Secretary Quinlan:

**At its public hearing in the above proceeding on July 22, 2008, the Surface
Transportation Board stated that it would hold the record open for 30 days to receive additional
testimony. Attached is the supplemental testimony of the Association of American Railroads.**

Respectfully submitted,

**Louis P. Warchot
Attorney for the Association of
American Railroads**

**BEFORE THE
SURFACE TRANSPORTATION BOARD**

STB EX Parte No. 677 (Sub-No. 1)

**COMMON CARRIER OBLIGATION OF RAILROADS—TRANSPORTATION OF
HAZARDOUS MATERIALS**

**SUPPLEMENTAL TESTIMONY OF THE
ASSOCIATION OF AMERICAN RAILROADS**

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Dated: August 21, 2008

**BEFORE THE
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**SUPPLEMENTAL TESTIMONY OF THE
ASSOCIATION OF AMERICAN RAILROADS**

At its public hearing in this proceeding on July 22, 2008, the Surface Transportation Board ("Board") stated that it would hold the record open for 30 days to receive additional testimony on issues raised at the hearing, including the availability of insurance for transportation of Toxic Inhalation Hazard ("TIH") materials. The Association of American Railroads ("AAR") submits this supplemental testimony to respond to those issues. (Also, attached is a letter from Gregory W. Larson, Senior Vice President, Lockton Companies LLC, which addresses the Board's request for additional information regarding the availability of insurance for TIH materials incidents.)

A. The Public Interest In Safe Rail Transport Is Promoted by Price Anderson-Type Legislation and Board Action on the AAR's Proposal

During the Board's hearing, many parties discussed the Price Anderson Act and the position of the rail industry on legislation, modeled after that act, which would allocate risk and exposure among railroads, shippers, and others. The discussion reflected some confusion about the industry's legislative proposal and the objectives underlying it, which the AAR wishes to clarify here.

By way of background, the Price Anderson Act limits the liability of a nuclear power company from an incident involving the release of nuclear material, including while in transit. It specifically provides for a fund to which all nuclear power plant licensees contribute when an incident occurs. The fund covers any damages in excess of required insurance levels, and also provides an overall cap on liability for each incident. In addition, the law provides that those companies performing as contractors for the Department of Energy are to be fully indemnified by the Federal Government up to the specified overall liability cap.

Under a similar type of proposal suggested by the railroads for TIH materials, rail carriers, TIH materials shippers, and tank car owners, lessors and manufacturers would be required to maintain insurance and be liable for a defined amount of damages arising from a TIH materials release. Any damages above that defined amount would be paid from a fund to which shippers of these materials would contribute, on a pre- and post-incident basis, up to a statutory maximum payment per incident. In this context, following the Price Anderson Act approach, the railroads would be treated as “contractors” with more limited liability than the shippers who, like “licensees,” have the option whether to make and ship TIH materials.

The intent behind this Price Anderson-type proposal is similar to the objective behind the Price Anderson Act itself. That law recognized the public interest in promoting the development of nuclear energy. Similarly AAR’s proposal recognizes that the public interest is better served by having the railroads carry TIH materials until alternative and less hazardous products are found. Recognizing the fundamental premise that TIH transport is necessary, sound public policy dictates a more equitable management of risk, as well as overall limits on liability.

The industry intends for this Price Anderson-type proposal to be a significant first step toward a legislative solution which would have as its underlying objective overall limitations on

liability for TIH materials transport, as the Price Anderson Act has provided for the nuclear industry. If there is a public interest need for TIH materials to be transported, there is a corresponding public interest need for the railroads to be protected against the higher costs and potentially enormous exposure uniquely associated with TIH materials transport.

The industry welcomes continued discussions about its legislative proposal, as well as other legislative options that have the same objective. But this, or any, legislative approach is not a substitute for a Board policy statement clarifying the rail common carrier obligation as the industry has proposed. The timeliness of Congressional action on any legislative proposal is problematic. Meanwhile, the substantial potential liability associated with TIH materials transportation is a matter of urgency for the industry. The AAR's request regarding the reasonableness of liability sharing under the railroads' common carrier obligation is a necessary and reasonable means of addressing the currently untenable situation as promptly as possible. The AAR views any legislative approach as complementary to this request.

Also, as the AAR indicated in its initial comments, if the ultimate goal is improving safety, a legislative policy option in addition to the Price Anderson-type proposal would be federal incentives to eliminate the transport of TIH materials through product substitution, co-location, and other means. All types of long-term legislative and policy solutions should be explored in an effort to address the enormous risks associated with TIH transportation.

B. The AAR's Liability Sharing Proposal Is In the Public Interest and Would Promote Safety

Some parties questioned the public policy and safety implications of the AAR's liability sharing proposal, including whether allowing a rail carrier to be indemnified for its negligence or gross negligence in transporting TIH materials would be against public policy or impede safety.

First, and significantly, under the AAR's liability sharing proposal, the rail carrier would not be relieved from liability for its own acts, whether negligent or grossly negligent. The rail carrier would remain primarily liable for any act of negligence or gross negligence pertaining to its transportation of TIH materials. It would retain liability at levels that far exceed those at which the carrier would normally be exposed for transportation of non-TIH materials (a minimum of \$500 million for Class I carriers).

Because the carrier would continue to bear the primary, \$500 million liability risk of a TIH materials release due to its own negligence, arguments (and cases such as Bisso v. Inland Waterways Corp., 349 U.S. 85 (1955))¹ that the AAR's proposal is contrary to public policy are inapposite. Nothing in the cases cited supports a general proposition that it is against public policy to allow a carrier to share liability.

Moreover, whether a railroad action is consistent with public policy lies within the exclusive jurisdiction of the Board. The public policy and safety benefits of the AAR's proposal were fully discussed in AAR's initial testimony. TIH materials are extraordinarily dangerous, and the carrier faces the risk of extraordinary and potentially ruinous liability each time it transports these materials. Further, these significant liability risks from a catastrophic accident involving TIH materials cannot be fully covered in the rates a railroad charges, nor are these risks anywhere near fully insurable. If such a catastrophic event occurred, there could be a significant adverse effect not only on the rail carrier involved, but on the rail network and its

¹ In Bisso, a tugboat operator acting as either a common carrier or contract carrier sought to enforce a contract with a barge owner (whose barge the tugboat company was towing and which sunk as a result of negligent towage). The contract released the operator from all liability for negligent towing. The Supreme Court held that the towing company was performing a public service and declined on public policy grounds to release the tugboat operator from all liability for its services. In subsequent decisions, Bisso (which was decided under maritime law) was limited to exculpatory clauses in towage contracts completely absolving a towage company from liability. See, e.g., Sander v. Alexander Richardson Investments, 334 F. 3d 712, 719 (8th Cir. 2003).

ability to provide transportation services. Catastrophic losses could bankrupt a railroad, stop new investments for years, and disrupt the national rail system.

Accordingly, liability sharing provisions, as set forth under the AAR's proposal, should include all carrier acts of negligence, including gross negligence. Because of the vagaries of the tort system and the extraordinary risks of the product, if carriers were not able to be indemnified for both negligence and gross negligence, a carrier would still remain subject to a potential "bet the company" proposition each time it transported TIH materials under its common carrier obligation.

In addition, it is not realistic to assert that, if a carrier just operates safely, it need not fear the potential of multi-billion-dollar damage awards due to its negligence or gross negligence. First, not all accidents can be prevented (e.g., crossing accidents where trucks ignore signals or hit moving trains, or derailments resulting from extreme weather conditions). Second, the railroad "factory floor" is over 140,000 miles long and is difficult or impossible fully to protect against tampering against by trespassers, terrorists or other parties. Moreover, even where, by all objective accounts, the railroad operated safely, avoiding significant liability in a major TIH incident would be difficult.

Should an incident occur involving the rail transportation of TIH materials, and should the incident result in significant or catastrophic damages to the public, there is little doubt that, plaintiff attorneys will search to find theories supporting claims of negligence and gross negligence. Injured parties often receive damages based upon post-hoc theories of negligence.

Moreover, the difference between negligence and gross negligence often lies in the eye of the beholder. Although legal definitions define negligence and gross negligence,² the distinction

² Various states employ specific statutory or common law definitions of "gross negligence" (or comparable terms) but there is no common definition of the term. See, e.g., Prosser and Keeton on Torts (Fifth Ed 1984), Ch 5 § 34, at

is ultimately a subjective one that makes it difficult for even a legal expert to reconcile the outcomes.³ Additionally, where the doctrine of joint and several liability is applicable, a defendant might be found to bear a very small percent of the liability, but could ultimately become financially responsible for the entire amount of the damages.

With regard to safety implications, as noted in the AAR's initial testimony, the AAR's proposal would promote safety objectives by creating incentives for shippers to reduce public exposure to these extraordinarily dangerous products. To the extent that a carrier may reasonably allocate to shippers a share of the significant liability burdens associated with these extraordinarily dangerous materials, shippers would be incented to reduce unnecessary rail transport of TIH materials, to locate new facilities for manufacturing TIH materials at or close to end-user facilities, and to modify or change manufacturing processes to develop less dangerous forms of TIH materials

In summary, and for the reasons explained in the AAR's initial testimony, it is consistent with public policy for a rail carrier to be permitted to impose reasonable liability sharing requirements as a condition of TIH materials common carriage. If public policy requires rail carriers to carry these extraordinarily dangerous materials, a corresponding public policy justifies a carrier protecting itself against the enormous risks and potentially ruinous liability exposure associated with transporting these materials.

212 ("There is no generally accepted meaning" of "gross negligence") The Restatement (Second) of Torts (American Law Institute 1965) §§282, 500, does not even employ the term "gross negligence" but instead uses the term "reckless disregard of safety" (and also notes the "difficulty in drawing the line between negligence and reckless conduct," §282, Special Note). See also, Prosser and Keeton on Torts, supra at 210-211 (noting difficulty of drawing satisfactory lines of demarcation between negligence and gross negligence)

³ See, e.g., Exxon Shipping Company v. Grant Baker, ___ U.S. ___, (2008), 2008 WL 2511219, slip op. at 12-13 (noting that with respect to state tort cases, "[t]he real problem... is the stark unpredictability of punitive awards" and that cases with "strikingly similar facts" can result in highly disparate outcomes as a result of the "inherent uncertainty of the trial process" (quoting from Supreme Court of Alabama decision in BMW of North America, Inc. v. Gore, 646 So. 2d 619, 626 (1994) (per curiam))

C. Congress' Recent Amendment of 49 U.S.C. § 20106 of FRSA Is Irrelevant to This Proceeding

A question was raised at the hearing as to the effect of the 2007 amendment to the Federal Railroad Safety Act ("FRSA") at 49 U.S.C. § 20106.⁴ This amendment states that state tort claims are permitted against railroads for damages arising out of carrier failure to comply with standards of care under federal safety and security laws. Various shipper groups contended that the amendment somehow evidences Congress' intent to "expand" railroad liability for acts of negligence. They argue that the Board should not allow liability sharing because Congress allegedly voted to increase railroad liability. The FRSA amendment did not "expand" railroad liability and is not relevant in this proceeding.

First, Congress' express purpose in amending the preemption provisions of FRSA was not to "expand" railroad liability for acts of negligence. As Congress recognized, "subpart (a) of the [2007 amendment]...contains the exact text of 49 U.S.C. § 20106 as it existed prior to the enactment of this Act. It is restructured for clarification purposes; however, the restructuring is not intended to indicate any substantive change in the meaning of the provision." (H.R. Rep. 110-259, at 351 (2007)). Instead, the legislation was enacted in response to federal court decisions related to negligence claims (arising out of a Minot, North Dakota TIH materials accident) holding that the FRSA preempted state tort claims based upon subject matters covered by federal regulations regardless of the railroad's regulatory compliance. The legislation was simply Congress's attempt to overrule a few court decisions with which it disagreed.

⁴ See "Implementing Recommendations of the 9/11 Commission Act of 2007, P.L. 110-53, 121 Stat. 266 (August 3, 2007) Section 1528 of the bill amended 49 U.S.C. § 20106, which expressly preempts state laws, regulations and orders "related to railroad safety or security."

Thus, the amendment of 49 U.S.C. § 20106 does not reflect a Congressional intent to “expand” carrier liability for acts of negligence.⁵ The legislation does not address or even relate to the scope of the rail common carrier obligation to transport TIH materials at issue in this proceeding. Moreover, the amendment does not limit the Board’s clear authority under its “reasonable practice” jurisdiction to issue a policy statement permitting a carrier to impose reasonable liability sharing and indemnification as conditions of common carriage of TIH materials as proposed by the AAR.⁶

D. The FRA’s Assertion to The Effect That “A Judge as a Matter of Law Would Find a Railroad Is Not Liable If It Is in Compliance with DOT Regulations” Is Incomplete and Not The End of The Story

In its oral testimony before the Board on July 22, 2008, the FRA made an assertion to the effect that “a judge as a matter of law would find a railroad is not liable if it is in compliance with DOT regulations.” This contention is apparently based on the preemption provisions of 49 U.S.C. § 20106, discussed in the previous section, as interpreted in CSX Transportation, Inc. v. Easterwood, 507 U.S. 658 (1993) (“Easterwood”). FRA’s assertion may be technically correct, as far as it goes, but it does not reflect the full extent of railroad liability and exposure or the realities of the courtroom.

⁵ Recent decisions interpreting the 2007 amendment to 49 U.S.C. § 20106 have also rejected the argument that the amendment was intended to expand railroad liability. See e.g. Southern Calif. Regional Rail Authority v. Superior Court, 163 Cal. App. 4th 712, 737 (Cal. App. 2008) (“[T]he legislative history of the amendment reveals Congress did not intend any substantive change in the meaning of” 49 U.S.C. 20106), Smith v. Burlington Northern and Santa Fe Ry. Co., 187 P.3d 639, 646 (Mont. 2008) (“[W]e hold that Section 1528 of the 9/11 Act did not overrule the FRSA preemption analysis as announced in Shanklin”); Crabbe v. Consolidated Rail Corp., 2007 WL 3227584 at *5 (E.D. Mich. 2007) (New subsection (b) of 49 U.S.C. 20106 “was enacted to ‘rectify’ the federal court decisions in” Mehl and Lundeen), Henning v. Union Pac. R.R., 530 F.3d 1206, 1216 (10th Cir. 2008) (“Congress did not overrule Shanklin, but instead provided clarification for courts interpreting Shanklin, establishing FRSA preemption does not apply when a railroad violates a federal safety standard of care.”)

⁶ It should also be noted that the general liability concerns addressed by Congress in its clarifying amendment are not at issue here. The railroads are not seeking to exonerate themselves from liability pertaining to a carrier’s negligence in transporting TIH materials nor in any manner to deprive injured parties of a state or federal forum for personal injury and damage claims arising from their negligent acts. Under the AAR’s liability sharing proposal, the railroads would continue to bear the primary and substantial liability burden for transporting TIH materials, including with respect to carrier acts of negligence.

Legal claims predicated on state law are preempted where the Secretary of Transportation or Secretary of Homeland Security has issued a regulation or order covering the subject of the state law claim. In such instances, the federal regulation, rather than state law, establishes the standard of care for railroads. If the railroad has complied with the federal regulation, it has, by definition, met the standard of care on that subject, and state law claims seeking to impose a different or additional standard are preempted.

However, even where a railroad complies with a federal standard, there could be other state tort claims that could arise from a TIH materials incident and whose subject matters are not covered by federal regulations. Thus, existence of federal regulations would not absolve railroads of tort liability for those claims, despite complying with the federal regulations.

As noted above, federal regulations preempt only claims that cover the same subject. Federal regulations do not cover all areas from which a state law negligence claim might arise. When accidents occur, plaintiffs typically will allege every imaginable claim addressing every aspect of the accident and covering the conduct of every conceivable defendant. These claims will, of course, be developed in hindsight, when it suddenly becomes clear what might have been done to prevent the accident. Experienced plaintiffs' counsel will develop legal claims that are not covered by federal regulations, and will do their best to convince juries to conclude that there is some basis for finding some defendants negligent under those theories of liability. Railroads routinely face liability for such claims.

The Easterwood case, in which the U.S. Supreme Court first interpreted the FRSA preemption provision, demonstrates that federal regulations do not translate into a "no liability" finding. The Court held that the plaintiff's claim that the railroad was operating its train too fast was preempted, because FRA had issued train speed regulations and the carrier had complied.

However, the Court permitted the claim that the railroad had failed to install adequate warning devices to stand because federal regulation on that subject did not apply. As an aside, the Court also made it clear that, even if certain claims, such as excessive train speed, are preempted, "related tort law duties" may not be. Easterwood, 507 U.S. at 675, n.15.

Another example showing that compliance with federal regulations does not relieve a carrier of liability is Norfolk Southern v. Shanklin, 529 U.S. 344 (2000) ("Shanklin"), a Supreme Court decision that addressed a split in the federal circuits that had developed over interpretation of the Easterwood decision. The Court reversed the Sixth Circuit and held that the use of federal funds to install the warning devices at a crossing preempted a state law claim that the railroad had failed to install adequate devices. However, the case did not end there. Though the warning device claim was preempted, the case went back for retrial on an alternative theory that the railroad had negligently failed to remove vegetation around the crossing (an activity that was not preempted or covered by federal regulation). The result, a verdict of \$1.4 million against the railroad, was affirmed on appeal. Shanklin v. Norfolk Southern, 369 F.3d 978 (6th Cir. 2004).⁷

No amount of attention to safety or assiduous compliance with federal regulations can guarantee that a railroad will escape liability after an accident. When that accident involves the transportation of TIH materials, even a small chance of being found liable becomes a huge risk. Accidents involving TIH materials have the potential to result in catastrophic and devastating

⁷ Another striking example is In re New Orleans Train Car Leakage Fire Litigation, 795 So.2d 364 (La App 4 Cir 2001). In that case, which involved a fire resulting from a leaking tank car containing liquid butadiene (which is not a TIH), a railroad was found liable for compensatory damages plus an astounding \$850 million in punitive damages, even though there was no finding that the carrier had violated any federal regulations. (On the contrary, the National Transportation Safety Board had found that the probable cause of the accident was an improper gasket that a chemical company had installed on the tank car [National Transportation Safety Board, NTSB/HZB-88/01, Hazardous Materials/Railroad Accident Report, Butadiene Release and Fire From GATX 55996 at the CSX Terminal Junction Interchange in New Orleans, Louisiana, Sept. 8, 1987, at 62]). The court stated that "compliance with government regulations does not preclude tort liability." *Id.* at 379, n. 2. (The original jury award of \$2.5 billion in punitive damages was reduced by the trial court to \$850 million. The case was ultimately settled.)

loss, and consequently enormous financial liability, potentially enough to put a carrier into bankruptcy. Had the accident in Shanklin occurred in an urban area and involved a train that derailed and released even a small amount of TIH materials, the \$1.4 million verdict against the railroad easily could have been \$1.4 billion, or much more.

E. The Board Need Not Update the URCS System in Order to Develop Movement-Specific Costs of Handling TIH Materials in Rate Proceedings

The Board asked whether the Uniform Rail Costing System ("URCS") should be opened to determine whether the costs of handling TIH materials are fully captured and properly fully allocated to those movements. While AAR supports fully allocating the costs of TIH materials to the movements that cause those costs, a reexamination of URCS would not be a simple matter. Rather, it would be a daunting effort that could well extend over many years. The Board should also recognize that it is not possible to fully quantify the risks and associated costs of handling TIH materials. Furthermore, AAR does not believe that it is necessary to recalibrate URCS in order to develop movement-specific costs for shipments of TIH materials.

Most of the elements of URCS are closely interrelated, and a change in one component, or the assumptions supporting that component, would, drive changes elsewhere in the model. These new modifications would then cascade throughout the complex structure, eventually resulting in the Herculean task of rebuilding the whole URCS system from the ground up.

While the Board may wish to undertake this task in the future, AAR does not believe that it is necessary for the purpose of determining movement-specific costs for TIH materials shipments. Rather, AAR believes that the Board should allow railroads to introduce specific, verifiable evidence in individual rate cases of the actual costs of handling TIH materials that are not reflected in URCS

The Board surely understands that any effort to redesign URCS, even for the limited purposes of this proceeding, will require extensive resources over an extended period of time. Further, it can be made unnecessary by adoption of a relatively simple process that recognizes verifiable cost evidence outside the URCS system.

F. Additional Liability Should Not Be Placed on Class I Railroads Under the American Short Line and Regional Railroad Association's Proposal

The American Short Line and Regional Railroad Association ("ASLRRA") presented a liability sharing proposal comparable to that offered by the AAR. Under the ASLRRA proposal, railroads would be required to maintain certain specified levels of insurance and shippers would be required to maintain insurance and share liability with the railroads above specified thresholds. However, the ASLRRA's proposal departs from the AAR's proposal by placing potential exposure for TIH materials incidents on Class I railroads where a Class I railroad was not involved with the incident. The ASLRRA's proposal provides that, in cases where interline movements are involved and the TIH materials incident occurs on a short line, the Class I railroad would have primary liability above the short line's insurance coverage limits to the level of the Class I railroad's insurance limits. After the Class I railroad's limits are reached, the shipper would share the liability.

The ASLRRA's proposal to allocate liability to Class I railroads is inconsistent with what should be the desired public policy goals in this proceeding. Those goals should be to protect and preserve the rail network for the transportation of all commodities by limiting the risks to the railroads associated with TIH materials incidents and by incenting shippers to minimize TIH materials transport. It is the shipper who is responsible for manufacturing and requiring the transportation of the TIH materials that create the extraordinary risk. Shifting even more risk to Class I carriers will not affect Class I behavior. Unlike the shipper, who has a choice, the Class I

railroad is involved in the movement because of its common carrier obligation. Moreover, placing additional liability and cost burdens on a Class I railroad may redirect funds away from investment in the rail network and may make insurance even harder to obtain.

If an incident occurs on a short line, the shipper should bear the primary risk and liability above the short line's insurance coverage.

G. The Insurance Coverage Currently Available to Class I Railroads for TIH Materials Transport Limited to Approximately \$1.1 Billion and In the Event of a Major TIH Materials Incident Could Become Unavailable

As noted above, the Board requested additional information regarding the availability of insurance for the transportation of TIH materials. The attached letter from Mr. Gregory W. Larson, Senior Vice President, Lockton Companies LLC, responds to the Board's inquiry. Mr. Larson's letter notes the limited availability of insurance for the Class I railroads and the precarious future environment for insurance coverage.

As Mr. Larson notes, insurers have responded to the September 11, 2001 terrorist attacks and subsequent notable events (such as Hurricane Katrina, terrorist bombings in the United Kingdom and Europe and the Graniteville, SC accident) by reevaluating their risk in offering liability insurance, focusing on the "almost unquantifiable exposure" related to TIH materials incidents.

While five years ago, Class I railroads could purchase up to \$1.5 billion in liability insurance, since that time, the number of insurance carriers has decreased while premium costs have significantly increased. The railroad industry is viewed by insurers as an "extremely volatile" risk, and only a small amount of insurers are willing to deploy their capacity in the industry (at any price). Currently, available insurance for the Class I railroads is limited to approximately \$1.1 billion with large self insured retentions (typically \$25 million) required. If

another event involving a significant or major release of TIH materials occurs, there could be a collapse of available capacity for the rail industry.⁸

The AAR and its members appreciate the initiative and effort of The Fertilizer Institute ("TFI") to address the risk and exposure associated with the transport of TIH materials through its insurance proposals. However, notwithstanding TFI's good faith belief, the attached statement from Mr. Larson suggests that such an approach focused solely on insurance coverage is not likely to be the ultimate solution. The levels of insurance coverage proposed by TFI for any specific TIH materials incident does not appear to be available in the insurance market.

As noted above in this testimony, the AAR believes that its current liability sharing proposal is necessary to provide immediate relief to the rail industry and to further appropriate public policy objectives. However, over the long term, legislative approaches that limit liability and incent initiatives to limit the transport of TIH materials must be the goal. The AAR and its members would offer to work with TFI and other organizations toward that end

⁸ It should also be noted that liability policies typically include terrorist-related claims. In the event of a major terrorist act involving a Class I railroad that results in significant damages, foreign insurers (who provide 90 percent of the \$1.1 billion of the liability insurance available to Class I railroads) would not be covered by reinsurance protections of The Terrorism Risk Insurance Act of 2002, Pub. L. 107-297, 116 Stat. 2322, 15 U.S.C. § 6701.



August 20, 2008

**The Association of American Railroads
50 F Street NW
Washington, DC 2001-1564**

Re: Availability of 3rd Party Liability Coverage for Class I Railroads

At the request of the Association of American Railroads, attached is my assessment regarding the following two issues:

- 1. How much 3rd Party Liability (Excess Liability) coverage is available to Class I Railroads?**
- 2. What would be the likely impact of another significant event involving Toxic Inhalation Hazards (TIH) / Poison Inhalation Hazards (PIH) release on a railroad?**

I would be pleased to discuss this in greater detail if requested.

Sincerely,

**Gregory W. Larson
Senior Vice President**

attachment

Lockton Companies, LLC
3rd Party Liability Coverage for Class I Freight Railroads
August 15, 2008

Executive Summary:

- Liability Insurance capacity for Class I Railroads is very constrained and has declined by approximately 30% in the past 5 years. The estimated current capacity is approximately \$1.1 billion.
- The number of "lead" Class I railroad insurers is very limited and unlikely to grow in the foreseeable future.
- Among other insurance industry challenges, the Graniteville accident brings heightened concern for insurers regarding rail transportation of TIH/PIH commodities.

Background

Before the terrorist attacks September 11, 2001, many underwriters believed that a potential worse-case loss scenario would likely come from two jumbo jets colliding in mid-air over a populated area. The injury to persons and property was determined based upon various assumptions of value and aggregated to a total loss figure. The terrorist attacks of 9/11 re-shaped the minds of many and redefined catastrophic exposure and loss costs.

Subsequent to the attacks on 9/11, many other events have challenged insurers in providing historical catastrophic insurance limits. Some notable events include:

- Hurricanes Katrina, Rita & Wilma (KRW)
- Terrorist bombings in the United Kingdom and Europe
- Depressed capital markets and concerns over inflation
- The Graniteville, SC accident

Class I Railroad Capacity

Looking specifically at the rail industry, there are unique challenges to insurers stemming from their desire to quantify risk. Traditional concerns of bodily injury and property damage to 3rd parties due to crossing accidents and derailments, while significant, do not come close to quantifying the risk. Insurers are most concerned with the almost unquantifiable exposure related to a large release of TIH/PIH in a congested area.

Before reviewing the available 3rd party liability capacity in the marketplace, it's important to define 'capacity'. Specific to Class I Railroads, liability capacity is best defined to include these major coverages:

- Bodily Injury
- Property Damage
- Pollution Liability
- Terrorism

Globally, there are (5) known sourcing arenas for Excess Liability insurance (i.e. liability insurance provided by insurers in excess of required self-insured retentions): the US, Bermuda, London, Continental Europe and Asia. When combined, it is estimated that approximately \$3 - 3.5 Billion of liability capacity exists for general industry insureds (not including Class I Railroads). This figure is a bit misleading as many multi-national carriers provide capacity in multiple venues but may not be willing to provide their maximum limit for a single insured in each venue.

Looking at the current excess liability capacity available for the Class I railroad industry, the estimated current aggregate limits and sourcing arenas allocate as follows:

CLASS I RAILROAD 2008 SUMMARY OF EXCESS LIABILITY CAPACITY

UNITED STATES	\$ 100,000,000
BERMUDA	\$ 525,000,000
LONDON	\$ 275,000,000
EUROPEAN	\$ 200,000,000
TOTAL	\$ 1,100,000,000

Five years ago, Class I railroads could purchase \$1.5 billion in liability limits. Since that time the number of carriers willing to provide coverage has significantly decreased while the premium cost has significantly increased. Today, available capacity has shrunk to a approximately \$1.1 billion.

Impact of Reinsurance

A primary driver of insurance capacity and coverage extensions / restrictions comes from re-insurers. In many cases, insurers look to transfer some of their own risks to other insurers known as re-insurers. They may do this on either a 'treaty' or 'facultative' basis. Treaty re-insurers take risk of loss that occurs to an insurer's 'book' of business that includes a large number of insureds. In many cases, these re-insurers place exclusions on their reinsurance policies for railroad risks. In these situations, the insurer is unable to accept railroad exposures due to the lack of supporting re-insurers. Facultative re-insurers insure loss on a individual insured basis, many of the carriers that offer capacity above buy this 'backstop' type coverage specifically for its Class I railroad insureds.

The availability of both treaty and facultative reinsurance has been factored into our estimate of global insurance capacity available to Class I railroads. Lack of global reinsurance capacity has resulted in less insurance capacity available to Class I railroads (currently approximately \$1.1billion) than that available to non-Class I railroad general

Underwriters are looking closely at liability exposures associated with Class I railroads. Submissions provided by brokers must be very detailed in terms of providing an overview detailing maintenance of way and equipment investments made to avoid a potential derailment. Security is a major factor as well.

Conclusion

In conclusion, I am concerned that current liability capacity available to Class I companies may decrease at a time when such companies are looking to purchase more, not less liability limit. As stated above, the losses associated with September 11, 2001 shifted worse case scenario expectations. It is not difficult to envision a liability claim against a Class I railroad arising from a TIH/PIH materials release that could significantly exceed \$1billion, especially if you replay the Graniteville event in a different location and time of day. If a claim of this type occurs, there could be a complete collapse of available risk transfer capacity available to Class I railroads.

About Lockton

Lockton Companies LLC, headquartered in Kansas City, Missouri is the largest privately owned, independent insurance brokerage and consulting firm in the world. With almost 4,000 professionals serving more than 15,000 clients, Lockton is recognized for it's leadership and innovation in risk management brokerage and consulting services. Lockton serves clients in many industries including the Transportation & Rail practice.

Greg Larson joined Lockton Companies Dallas in August 2007 as a Senior Vice President and Risk Management Unit Leader. Prior to joining Lockton, Greg was a Senior Client Executive and Managing Director at Marsh USA based in Dallas. His career at Marsh began in 1993 as a casualty marketing executive specializing in the design and implementation of large Primary Casualty and Excess Liability programs. Before joining Marsh, Greg was employed in various Primary Casualty & Excess Liability underwriting positions at American International Group in their Dallas and Houston offices. Those positions included analyzing exposure, designing coverage and developing premium levels for large, complex clients in a variety of industries.