AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. HRG. 110–886

THE SURFACE TRANSPORTATION BOARD AND REGULATIONS RELATED TO THE FREIGHT RAILROAD INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION AND MERCHANT MARINE INFRASTRUCTURE, SAFETY, AND SECURITY

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

OCTOBER 23, 2007

Printed for the use of the Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE

73–584 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

DANIEL K. INOUYE, Hawaii, *Chairman*

JOHN D. ROCKEFELLER IV, West Virginia
JOHN F. KERRY, Massachusetts
BYRON L. DORGAN, North Dakota
BARBARA BOXER, California
BILL NELSON, Florida
MARIA CANTWELL, Washington
FRANK R. LAUTENBERG, New Jersey
MARK PRYOR, Arkansas
THOMAS R. CARPER, Delaware
CLAIRE MCCASKILL, Missouri
AMY KLOBUCHAR, Minnesota

TED STEVENS, Alaska, *Vice Chairman*
JOHN MCCAIN, Arizona
TRENT LOTT, Mississippi
KAY BAILEY HUTCHISON, Texas
OLYMPIA J. SNOWE, Maine
GORDON H. SMITH, Oregon
JOHN ENSIGN, Nevada
JOHN E. SUNUNU, New Hampshire
JIM DEMINT, South Carolina
DAVID VITTER, Louisiana
JOHN THUNE, South Dakota

MARGARET L. CUMMISKY, *Democratic Staff Director and Chief Counsel*
LILA HARPER HELMS, *Democratic Deputy Staff Director and Policy Director*
CHRISTINE D. KURTH, *Republican Staff Director, and General Counsel*
PAUL NAGLE, *Republican Chief Counsel*

SUBCOMMITTEE ON SURFACE TRANSPORTATION AND MERCHANT MARINE INFRASTRUCTURE, SAFETY, AND SECURITY

FRANK R. LAUTENBERG, New Jersey, *Chairman*
JOHN D. ROCKEFELLER IV, West Virginia
JOHN F. KERRY, Massachusetts
BYRON L. DORGAN, North Dakota
MARIA CANTWELL, Washington
MARK PRYOR, Arkansas
THOMAS R. CARPER, Delaware
CLAIRE MCCASKILL, Missouri
AMY KLOBUCHAR, Minnesota

GORDON H. SMITH, Oregon, *Ranking*
JOHN MCCAIN, Arizona
TRENT LOTT, Mississippi
KAY BAILEY HUTCHISON, Texas
OLYMPIA J. SNOWE, Maine
JIM DEMINT, South Carolina
DAVID VITTER, Louisiana
JOHN THUNE, South Dakota

CONTENTS

	Page
Hearing held on October 23, 2007	1
Statement of Senator Dorgan	3
Statement of Senator Klobuchar	2
Statement of Senator Lautenberg	1
Statement of Senator Rockefeller	5
Statement of Senator Smith	4
Statement of Senator Vitter	7
Letter, dated October 22, 2007, to Hon. David Vitter from Terry Huval, P.E., Director, Lafayette Utilities System	7

WITNESSES

Carlson, Robert L., President, North Dakota Farmers Union; on Behalf of National Farmers Union	65
Prepared statement	67
English, Hon. Glenn, CEO, National Rural Electric Cooperative Association; Chairman, Consumers United for Rail Equity (CURE)	69
Prepared statement	72
Ficker, John B., President and CEO, The National Industrial Transportation League	61
Prepared statement	63
Hecker, JayEtta Z., Director, Physical Infrastructure Issues, U.S. Government Accountability Office (GAO)	26
Prepared statement	27
McGregor, David J., Senior Vice President, NAFTA Logistics, BASF Corporation	54
Prepared statement	56
Moorman, Charles W., Chairman, President, and CEO, Norfolk Southern Corporation; on behalf of the Association of American Railroads	44
Prepared statement	45
Nottingham, Hon. Charles D., Chairman, Surface Transportation Board	9
Prepared statement	10

APPENDIX

Hayes, Evan, Immediate Past President, National Barley Growers Association; Past President, Idaho Grain Producers Association; Member, Idaho Barley Commission; Executive Committee Member, Alliance of Rail Competition, prepared statement	93
Letter, dated October 11, 2007, to Hon. Frank R. Lautenberg from national organizations of agriculture	107
Letter, dated October 19, 2007, (Sent via Facsimile) to Hon. Daniel K. Inouye, Hon. Frank R. Lautenberg, Hon. Ted Stevens and Hon. Gordon H. Smith from Oregon Wheat Growers League	106
Letter, dated October 22, 2007, to Hon. Daniel K. Inouye, Hon. Frank R. Lautenberg, Hon. Ted Stevens and Hon. Gordon H. Smith from Jim Kerr, Commissioner, North Carolina Utilities Commission; President, National Association of Regulatory Utility Commissioners; John R. Perkins, Iowa Consumer Advocate; President, National Association of State Utility Consumer Advocates and Stephen Brobeck, Executive Director, Consumer Federation of America	108
Letter, dated October 30, 2007, to Robert L. Carlson from Matthew K. Rose, Chairman, Burlington Northern Santa Fe Corporation	105
Letter, dated November 5, 2007, to Hon. Frank R. Lautenberg from David J. McGregor, Senior Vice President, NAFTA Logistics, BASF Corporation	104

Page

Letter, dated February 4, 2008, to Hon. Frank R. Lautenberg from Hon. Charles D. Nottingham, Chairman, Surface Transportation Board 109
Matheson, William J., President, Intermodal Services, Schneider National, Inc., prepared statement 103
Response to written questions submitted by Hon. Daniel K. Inouye to:
Robert L. Carlson 125
Hon. Glenn English 126
Charles W. Moorman 118
Response to written questions submitted by Hon. Frank R. Lautenberg to:
Robert L. Carlson 126
JayEtta Z. Hecker 117
Hon. Charles D. Nottingham 109
Response to written questions submitted by Hon. Mark Pryor to:
Hon. Glenn English 128
JayEtta Z. Hecker 117
Charles W. Moorman 119
Hon. Charles D. Nottingham 111

THE SURFACE TRANSPORTATION BOARD AND REGULATIONS RELATED TO THE FREIGHT RAILROAD INDUSTRY

TUESDAY, OCTOBER 23, 2007

U.S. SENATE,
SUBCOMMITTEE ON SURFACE TRANSPORTATION AND MERCHANT MARINE INFRASTRUCTURE, SAFETY, AND SECURITY,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:03 a.m. in room SR–253, Russell Senate Office Building, Hon. Frank R. Lautenberg, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. FRANK R. LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

Senator LAUTENBERG. Good morning. The Subcommittee has come to order. And we'll get started.

I thank all of you for being here so promptly. I assume that that indicates that your statements will also be finished promptly.

[Laughter.]

Senator LAUTENBERG. Take enough time, up to 5 minutes, when you do make your statements. And we're going to try and get through. We're notified that votes will take place at 11:30, and I would hope that we can conclude the business of the hearing by then.

I want to welcome you all here.

Today, we're going to examine the impact of freight rail on the Nation's economy, and what the Federal Government can do to ensure fair and competitive access to quality rail transportation at reasonable rates.

America has an excellent passenger rail system in Amtrak, and Senator Lott and I have a bill to make it even better. But freight rail service is also a pillar of the American economy. This industry carries nearly 26 percent of the Nation's intercity freight. These trains deliver items we rely on every day, from cars to coal. Companies transport their products by rail because it's efficient, especially for large, frequent shippers. And the public benefits, when goods move by rail, with lower consumer prices, and less traffic, less pollution, and less reliance on foreign oil. In New Jersey and elsewhere, each container offloaded from a ship and placed on a train means fewer trucks on the highways.

But these benefits come at a cost. Rail lines are already operating at or above capacity, and that puts a strain on the tracks,

bridges, locomotives, rail cars, and overall infrastructure. With rail shipping projected to increase 44 percent by 2020, railroads need to invest more. To meet future demands to make these investments, railroads must charge adequate and competitive shipping rates to cover their costs. For 25 years, rail shipping rates haven't even kept up with inflation. It only makes sense that the industry has to resort to whatever sources it can to find the funds to make these needed investments. And that could include increased rates. But, as rates change, shippers also must have access to a fair, fast, and affordable way to challenge unreasonable rates and anti-competitive practices by their railroads. And that's why this Surface Transportation Board role is so crucial.

Congress created this Board to decide, on a case-by-case basis, how to balance a strong railroad industry to support our national economy with the need to make sure that railroad customers receive quality service at fair and reasonable rates. The Board has made rulings to improve and simplify the process for shippers who want their charges reviewed, but we're still waiting to see the results of these efforts, and the GAO also looked into rail rates and our current system of economic regulation.

Now, these are clearly areas for improvement in the current system. Senator Rockefeller and other members of the Commerce Committee have introduced legislation to overhaul this system. And, while I have not joined this effort, I agree that the railroad industry must better respond to the needs of its customers. Without better cooperation between shippers and the railroad industry, I expect that Congressional action may eventually be necessary. I look forward to hearing from the Surface Transportation Board and GAO about what improvements we can make now.

Finally, I am deeply disappointed in the Surface Transportation Board majority's decision to let unregulated solid-waste processing on rail properties continue to operate. The Board had a chance to make the law clear and let states like New Jersey protect the health and environment of their residents and communities, but it failed. Now it's clear that Congress must close the loophole the Board left open, which will take more time and leave more residents at risk.

So, once again, I thank all the witnesses for their attendance today. I look forward to your testimony. And to my colleagues, I would allow 3 minutes for an opening statement so that we can see all of the witnesses and hear from them.

Senator Klobuchar?

STATEMENT OF HON. AMY KLOBUCHAR, U.S. SENATOR FROM MINNESOTA

Senator KLOBUCHAR. Thank you, Mr. Chairman. Thank you for holding this important hearing.

In my state, we have a revitalization going on in the rural parts of our state, which is about half our State, and we're seeing, with the demand for energy, some exciting new things. But we basically are heading into a 21st-century rural economy with a 20th-century transportation system. And some of that has to do with the state of the roads and the bridges, but some of it also has to do with what's going on with rail.

And I am particularly interested in the issue that the Chairman raised about the cost for our captive shippers. This is something I heard all over our state, from Bemidji to Worthington, Minnesota. And it's about the fact that captive shippers with access (to many times) only one rail line have been suffering, and it's becoming difficult for them to pay the rates, as they're trying to build their businesses at this time.

And the current system is broken in a number of ways. First, rail customers have been paying unfairly high prices to ship their goods to market. We have a number of examples of times where the pricing was done in a way that prices only to the end of the line, as opposed to segments of the line, so that there are wild differences in how much their charges can be.

Second, rail customers have been denied a fair and efficient process for challenging rail rates and railroad practices. Shippers must pay steep filing fees of over $100,000 just to get their complaint heard. Then they must pay millions of dollars to litigate their case, which is sure to drag on for years.

And, finally, after all that, the Surface Transportation Board's decisions almost invariably tilt in favor of the railroads. The bottom line is that the shippers lose, the railroads win, and the system isn't working for our economy.

To address this problem, I'm pleased to have joined with a number of my colleagues, including my Commerce Committee colleagues, Senators Rockefeller, Dorgan, Snowe, Vitter, and Thune, to introduce Senate bill 953, the Railroad Competition and Service Improvement Act of 2007. This bipartisan legislation has a simple goal, to level the playing field by promoting more reasonable competitive rail prices and by making the Surface Transportation Board more accountable to shippers.

Thank you, Mr. Chairman, for holding this hearing today.

Senator LAUTENBERG. Thank you.

Senator Dorgan?

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Mr. Chairman, thank you very much. Thanks for holding the hearing.

I think it is important that we consider S. 953. Senator Rockefeller, I, and others have worked on it for a long, long while. Much of what we find ourselves doing in this committee is to try to preserve or to restore some competition.

In the area of rail service, railroads are very important to this country. We can't do without railroads. We have to have railroads that work, provide good service; so, they're very important. But there has been this orgy of mergers and this love affair between the big railroads, and they marry up, and now we have four Class I railroads providing 90 percent of the freight rail transportation in our country. What we have, effectively, is unregulated near-monopolies.

Now, it seems to me that it does call for a bit of regulation in areas where regulation is necessary. I hate to say this, but I do it, nonetheless. I think, frankly, the regulatory agency, the Surface Transportation Board, is relatively worthless. I've watched it,

worked with it, hectored it, challenged it for a long, long time as a member of the Commerce Committee, and I, frankly, have very low regard for the what the Surface Transportation Board has done, and not done.

One of the few complaints to have been brought there recently was Basin Electric Power Cooperative in North Dakota. They were challenging new coal rates imposed upon them by Burlington Northern in 2004. The STB found that the doubled rates, which are about four to five times higher than it costs Burlington Northern to move the coal to Basin, were not unreasonably high. That is why, it seems to me, most people don't complain, because, first of all, they can't afford the filing fee, although I should tell you, Senator Klobuchar, I've added an amendment to an appropriations bill this year, that—passed the full Appropriations Committee, that will take the filing fee from, I believe, $178,000 down to $350.

Senator KLOBUCHAR. Very good.

Senator DORGAN. That's progress. And it would be the same fee that you would file, were you able to go to Federal court. Because you're prevented from going to Federal court, I've had the Appropriations Committee pass my amendment taking the filing fee to $350.

My point is not that I dislike the railroads. We need the railroads. But, I think when you have monopolies, or near-monopolies, that treat captive shippers in a manner that they determine how they want to treat them, I think you need to have some effective oversight and some effective regulation. We hope, however, that we could instill some additional competition. That's why we have offered S. 953.

Let me just make one other ironic point. When Basin Electric filed their case, I believe when Mr. Nober was the chairman of the Surface Transportation Board. By the time the case was resolved, Mr. Nober was working for the company that was the subject of the complaint, which describes another significant problem with the Surface Transportation Board.

So, I look forward to this hearing and look forward to the witnesses.

Thank you, Mr. Chairman.

Senator LAUTENBERG. Thanks very much.

Senator Smith, the Ranking Member of the Subcommittee, I welcome you. Please summarize your statement

STATEMENT OF HON. GORDON H. SMITH, U.S. SENATOR FROM OREGON

Senator SMITH. Thank you, Mr. Chairman. I appreciate your holding this hearing.

And I also want to thank our witnesses for being here today.

Since the enactment of the Staggers Act of 1980, we have seen the rail industry undergo a remarkable transformation. The rail industry of the 1970s was over-regulated and in a state of physical and financial decay. Twenty percent of U.S. rail mileage was operated by bankrupt carriers. With the Staggers Act, Congress injected market influences into the system, and the economics of the industry turned around.

Today's railroads carry roughly double what they did in the 1980s, the number of accidents on railroads have been halved, and the rates for most shippers have gone down. Still, there are some in the shipping community who believe that the promises of the Staggers Act have not been fully achieved. They point to persistently high rates and poor service in some areas.

As someone who has operated a business and had to make decisions about whether to ship by rail, barge, or truck, I do understand their concerns. However, I don't agree with the conclusion that some have drawn, that the answer to these shippers' problems is greater Federal regulation in the marketplace.

Last week, we heard from Secretary Peters about the dramatic growth in the movement of freight that is expected over the next two decades. To accommodate this additional freight, we are going to need to make new investments in all modes of transportation. And right now the railroads are the only transportation source that pays its own way.

I believe that we need to keep the railroads on the path where they can continue to generate the revenue and capital needed to increase capacity to meet future demands.

That being said, I do have concerns with some of what we have seen recently with regard to private equity investment in the railroad industry. Private equity firms perform a legitimate function in our economy. Many different sources of capital will be needed to finance transportation infrastructure projects in the coming years.

However, I am concerned about reports of short-term investor goals trumping what is in the best interest of the industry and in the long-term interests of our country.

Last month, the short line railroad that provided service along a 130-mile stretch of rail in southwest Oregon announced that it would suspend service due to safety concerns involving the line's tunnels. To date, the company that owns the line has not given the local communities any assurances of its plans to fix the tunnels or reinstate service. As you can imagine, the situation has generated a great deal of concern and stirred a lot of debate in the State. Recently, the short line's parent company was purchased by a major private equity firm. And right now, people in southwestern Oregon are wondering what this will mean for the future of rail line service. Private equity firms are not just investing in short line companies, they are major investors in a number of Class I railroads.

I look forward to hearing from our witnesses what they believe will be the long-term impact of private equity involvement in the railroad industry.

So, Mr. Chairman, the hearing is very timely for the purposes of my state, and I thank you for holding it.

Senator LAUTENBERG. Thank you.

To our colleagues who have just arrived, I've asked everybody to try and keep their statement to 3 minutes. The record will be kept open for submitted questions.

And, with that, I'd call on Senator Rockefeller.

STATEMENT OF HON. JOHN D. ROCKEFELLER IV, U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Thank you, Mr. Chairman.

My statement will be very short. Senator Dorgan, how long have we been at this?

[Laughter.]

Senator DORGAN. A long time.

Senator LAUTENBERG. I can confirm that.

Senator ROCKEFELLER. In my case, 23 years, with no progress whatsoever. And I would just say, of all the issues in Congress that—confront the American people, this is the one that makes me the angriest, the most outraged, and where I see the most cynical manipulation of the marketplace, where people are upping their profits while sticking it to consumers all over the country in all 50 States plus the District of Columbia. And nobody seems to care. One of the reasons that nobody seems to care is that the railroads—the America Railroad Association has brilliantly managed to stay beneath the radar. That's a very good place for their factual base to be, because it does not stand scrutiny.

But I will have some questions for Mr. Moorman—should he choose to answer them. I find this the single greatest embarrassment in government at this point. The Surface Transportation Board, the former chairman of this committee, ran it for years and years, just as the former committee chairman would have run it; that is, doing nothing, let the railroads have their way; and they have. They have done untold damage in West Virginia and all across the country. They love to make deals, are very good at making little deals, so that they say, "Well, we'll give a little relief to you over here on a bottleneck situation," but, no, no, no, as a matter of broad principle, not at all. I voted for John Snow seven times for Secretary of the Treasury. It's not legal, but I did it. I was so anxious to get him out of CSX——

[Laughter.]

Senator ROCKEFELLER.—that it didn't really make a difference to me where he went or what he did. And I'm not sure what he did at Treasury, either, but it was certainly less harmful than what he did at CSX.

So, I'm going to be here a long time. I'm just approaching my 50th birthday. And——

[Laughter.]

Senator ROCKEFELLER. Senator Dorgan, Senator Klobuchar, and I are going to keep this up until we finally win it. The law is on our side. The railroads are anticompetitive. They're breaking the law. I don't know whether it's criminal or not, but they're breaking the law through their bottleneck arrangements. And they are an embarrassment to our Nation and destructive to our economic progress.

Thank you, Mr. Chairman.

Senator LAUTENBERG. Thanks, Senator Rockefeller.

I also intend to be here for a long time.

[Laughter.]

Senator ROCKEFELLER. Yes, but you disappeared for 6 years, Senator Lautenberg.

[Laughter.]

Senator LAUTENBERG. Senator Vitter?

STATEMENT OF HON. DAVID VITTER, U.S. SENATOR FROM LOUISIANA

Senator VITTER. Thank you, Mr. Chairman. And thank you, Ranking Member Smith, both, for having this hearing. I agree that it's very, very important, and I share most of your concerns about the lack of adequate competition in this industry. And that's why I'm a proud original co-author of the reform legislation we have come together to propose.

I really think a lack of healthy competition in this sector is costing Americans money and costing America jobs. Let me point to one example of each.

In the State of Louisiana, we have a utility system in the area of Lafayette, Louisiana. The City of Lafayette owns it, its own electric generating station. And, to run that station, it has to get its coal from the Powder River Basin, in Wyoming, about 1,500 miles away.

Currently, there are two railroads coming from the Basin that travel to Alexandria, Louisiana, very near Lafayette, Louisiana, so you might think, great, problem solved, competition. Well, unfortunately, you'd be wrong, because, for the last 20 miles to Lafayette, from—between Alexandria and Lafayette, there is only one major railroad provider. And you would think, well, that shouldn't be too big an issue. You have competitive rates for the huge majority of the 1,500 miles, you may have higher rates per mile for the last 20 miles. No, it doesn't work that way, either. Current law and practice allows one rail provider, who controls that last 20 miles, to push its pricing monopoly all the way back the full 1,500 miles to the Power River Basin. And so, they turn a 20-mile monopoly into a 1,500-mile monopoly.

I'd like to submit, for the record, a letter from the Lafayette Utilities System.

[The information previously referred to follows:]

LAFAYETTE UTILITIES SYSTEM
Lafayette, LA, October 22, 2007

Hon. DAVID VITTER,
U.S. Senate,
Washington, DC.

Dear Honorable Vitter:

We understand that the Surface Transportation and Merchant Marine Subcommittee of the Senate Commerce, Science, and Transportation Committee will conduct an oversight hearing on the operation of the Surface Transportation Board on Tuesday, October 23rd. We ask that you submit this letter setting forth the problems the City of Lafayette, Louisiana is experiencing as a captive rail customer of the Union Pacific Railroad.

Railroad captivity, as I will explain in a moment, is costing electric customers in Lafayette an estimated $15 million more annually in 2008 as opposed to the competitive rail rates that we believe we should be paying to move coal to our electric generating plant. This "cost of captivity" translates to an extra $300 yearly for electricity by a medium usage residential customer. Stuller Settings, an international jewelry setting manufacturer who provides 1,700 jobs in Lafayette is paying an extra $110,000 per year for electricity. Finally, schools that are served by the City of Lafayette electric utility are paying an extra $1.5 million per year for electricity due to our captivity. We believe strongly that this tax on the people, companies and educational system in Lafayette is unwarranted and must stop.

Why is this happening? The City of Lafayette owns its own electric generating station to provide power to the residents and businesses of Lafayette. Our coal-fired power plant is fueled by coal from the Powder River Basin in Wyoming. The city purchases the coal at the mine mouth and pays for the transportation to our gener-

ating facility on the Red River near Alexandria, Louisiana. We move the coal in unit trains of hopper cars that we own and maintain. The distance of the movement is approximately 1,500 miles.

In the Powder River Basin there are two railroads that can move our coal, the Burlington Northern and the Union Pacific. However, only the Union Pacific serves the entire route to our plant. About 20 miles from our plant is a switching facility where rail cars from the Kansas City Southern Railroad can be switched to the Union Pacific Railroad for movement into our plant. Thus, for approximately 1,480 miles of our transportation we should have access to competition. We should be able to move the unit trains of coal on the Burlington Northern, to the Kansas City Southern and finally to the Union Pacific for movement into our plants. We realize that we are captive to the UP for the last 20 miles of the movement and are likely to pay much higher rates on that segment. Alternatively, the Union Pacific could bring our coal trains to our plant, but the longest segment, the 1,480 mile segment, should be at competitive rates.

However, the City of Lafayette does not have access to rail competition for any portion of this 1500 movement because the Union Pacific refuses to provide a separate rate to move coal cars from its switching facility with the Kansas City Southern to our plant. Without this rate, we have no option but to move our coal on the Union Pacific for the entire length of the movement—at high, captive rail rates. In the so-called "bottleneck" case decided in December 1996, the Surface Transportation Board sanctioned this practice which allows the Union Pacific to block our access to competition.

Senator Vitter, probably no ruling of the Surface Transportation Board has been more controversial with rail customers than this December 1996 decision that blocks many of us from available railroad competition. A former Chairman of the Surface Transportation Board, in his testimony to the House Railroad Subcommittee in March, 2004, said that rail customers like us could just build a rail line out to the competing railroad, if we wanted access to competition. In our case, that "build out" in 2004 would have cost us about $60 million because we would have been required to build a railroad bridge across the Red River to reach the Kansas City Southern Railroad. I can assure you that this was not a viable option for the City of Lafayette. Since 2004, the two western railroads have not been competing vigorously with each other, but rather are offering standard terms for coal transportation when current contracts expire—so today there is really no railroad competition to which we could build.

We see no sign that the Surface Transportation Board intends to revisit the "bottleneck" decision and require railroads to provide rates that will allow their customers to reach competing railroads. If we are to have access to railroad competition, which we believe was promised in the Staggers Rail Act of 1980, Congress must enact S. 953, the Railroad Competition and Service Improvement Act of 2007. This legislation will release us from our captivity and remove the captivity tax that the residents and businesses of our city are paying.

Thank you, Senator, for your leadership on this important issue. The time for Congress to act is now; every day of delay means our customers are paying another increment of captivity cost in their electric bills.

Sincerely,

TERRY HUVAL,
Director,
Lafayette Utilities System.

Senator VITTER. In it, system representatives say, "Railroad captivity is costing electric customers in Lafayette, Louisiana, an estimated $15 million more annually in 2008, as opposed to the competitive rail rates they should be paying to move coal to their electric generating plant. This cost of captivity translates to an extra $300 yearly for electricity by a medium-usage residential customer." Also, "Schools that are served by the City of Lafayette Electric Utility are paying an extra $1.5 million per year for electricity, due to their captivity." So, that's a real problem for Americans, consumers.

It's also a real problem for jobs. One of our significant industries in Louisiana is the chemical—petrochemical industry and related industries. It is under assault from competition worldwide. And

there are a lot of factors in other countries that, quite frankly, we will never be able to compete with on that factor alone. But there are some things we can control, and railroad rates are one of them; also, the cost of natural gas is another. Those two factors, by far—by far—talk to anyone in that domestic industry—are the two most onerous factors that make them less and less competitive worldwide every year. And that means, over time, exporting good jobs to other countries, other places, including out of Louisiana.

So, this is a real problem, Mr. Chairman. I believe the bill we have rallied around is a real and a reasonable solution, and I look forward to the rest of this hearing.

Senator LAUTENBERG. Thank you very much, Senator Vitter.

They've just changed the time for the votes. So, what I'm going to do is ask all of the witnesses to come to the table at the same time, assuming we've got enough chairs. Do we have them there? And I would urge you to consolidate your statements to 3 minutes, and then we'll have to adjourn for a period of time, as much as an hour, and while I hate to burden the witnesses or my colleagues with decisions about whether or not to miss an opportunity ask questions, I'll leave it optional. The record will be kept open. I ask all of those who will be at the witness table to please respond promptly to written questions. We'll keep the record open for a period of time, but your responses are essential.

And so, with that, Mr. Nottingham, Ms. Hecker, Mr. Moorman, Mr. McGregor, Mr. Ficker, Mr. Carlson, Mr. Matheson—oh, Mr. Matheson is not here, right? He is here? OK—and Mr. English—please—come to the witness table.

All right. And we're going to allow 3 minutes, I remind you. And I'd like not to wield a heavy hammer, so please be conscious. You'll see the red light.

Mr. Nottingham, please?

STATEMENT OF HON. CHARLES D. NOTTINGHAM, CHAIRMAN, SURFACE TRANSPORTATION BOARD

Mr. NOTTINGHAM. Thank you, Senator Lautenberg. It's good to be back in this room with the subcommittee and with you.

My name is Charles Nottingham. I am Chairman of the Surface Transportation Board, and I'll dispense with my prepared 5-minute oral statement and just give a very quick executive overview, if I could, in the interest of the Subcommittee's schedule today.

Over the past 12 months, the Surface Transportation Board has taken a number of proactive steps to reform, streamline, and modernize our oversight and rail regulatory procedures. To summarize some of the highlights of the past year, I'd like to just review the following actions that we've taken.

In September 2006, we instituted a rulemaking proceeding to modernize the way we calculate the railroad industry's cost of capital to more accurately reflect the financial health of the rail industry.

In October of 2006, we reformed the rate review process for large rate cases to streamline and improve the accuracy of the process, to close a loophole that permitted carriers to manipulate the process, and to address a legal vulnerability identified by the U.S. courts of appeals.

In September 2007, we overhauled the procedures for handling smaller rail rate cases so that all shippers will have a practical and feasible means of challenging rail rates. We investigated the fuel surcharge practices of the railroads, and, in January 2007, concluded that their fuel surcharge programs were unreasonable, because they were misleading and because they required captive shippers to bear surcharges that were higher than the increased fuel costs attributable to their traffic.

In November 2006, we held a hearing on issues related to the transportation of grain, to explore whether further changes to the regulatory framework are necessary in that area.

In July 2007, we held a hearing and announced that we are establishing an advisory committee on the transportation of energy commodities to monitor the ability of the railroads to handle the future energy needs of the Nation. And that committee will be meeting for the first time tomorrow, here in Washington.

In August of this year, 2007, we ordered a railroad providing inadequate service to sell its line to another entity that would provide better service to the shippers depending on that service. We recently contracted with an independent economic consulting firm to conduct a sweeping national study of rail competition-related issues, and we'll be reporting to this body next fall, as soon as that study is complete.

The Board has taken a number of steps to ensure that—in an area, I know, of particular concern to the chairman—that waste-handling facilities do not use preemption to subvert appropriate review and regulation.

That was just a few highlights; I'll conclude there and be happy to take questions.

[The prepared statement of Mr. Nottingham follows:]

PREPARED STATEMENT OF HON. CHARLES D. NOTTINGHAM, CHAIRMAN, SURFACE TRANSPORTATION BOARD

Good morning, Chairman Lautenberg, Ranking Member Smith and members of the Subcommittee. My name is Charles Nottingham, and I am Chairman of the Surface Transportation Board (STB or Board). I appreciate the opportunity to appear before this Subcommittee today to address issues related to this Subcommittee's oversight of the Board.

This is my first appearance before this Subcommittee since I became Chairman of the STB in August 2006. It has been an extraordinary year for me personally, and an unusually busy year for the Board. In addition to handling its normal workload of formal actions, the Board has taken numerous steps this year to proactively monitor the rail industry and reform the Board's existing regulations to modernize and improve how we regulate the railroads.

Before elaborating on these efforts in this written testimony, I will first provide an overview of the Board and its responsibilities.

Overview Of The STB

Administration

The Board has kept up with its steady workload, and issued 1,139 decisions and court-related matters in FY 2007, with new cases being filed even as pending cases were resolved. A summary of significant decisions and hearings is included as *Attachment 1* to this testimony. In recent years, the Board experienced an increase in the number of major rail rate disputes and work related to these disputes. In past years, the Board had two or three of these cases pending at any one time. At the end of FY 2007, it had three rail rate cases pending. The Board had one pipeline rate dispute, which was resolved during the fiscal year, and one water carrier rate dispute that was pending at the end of FY 2007, but has since been dismissed. The Board also defended numerous decisions in court during the fiscal year. A list of

court cases decided within the past twelve months and court cases currently pending is attached to this testimony as *Attachment 2*.

Congress has authorized a 150 FTE staffing level for the STB. Currently, we have 141 employees on board. We are actively seeking to fill the remaining vacancies. In addition, we are cognizant that pending legislation on Amtrak and commuter rail issues could require additional Board staff and we have analyzed what our staffing needs will be should the pending legislation become law.

The Board is also aware that it, like many other Federal agencies, is facing a major drain on its human capital through attrition. In the latest government-wide statistics available from the Office of Personnel Management (OPM), the average age of the Federal worker is 45.3 years. The average STB employee is 50 years old. Forty-five percent of the Board's employees have over 25 years of service. Thirty-three percent of those in management positions are eligible for immediate retirement. While it is not expected that the majority of these employees will retire when eligible, the STB has prepared a draft succession planning framework, which it has submitted to OPM, to ensure that the STB has a viable workforce from which to groom future leaders.

Statutory Responsibilities

The STB is charged by statute with resolving railroad rate and service disputes and reviewing railroad restructuring transactions (mergers, line sales, line constructions, and line abandonments). In addition, the Board has limited jurisdiction over certain trucking, bus, household goods, ocean carrier, and pipeline matters.

It is important to note that the substantial deregulation effected in the Staggers Rail Act of 1980 was carried forward by the ICC Termination Act of 1995 (ICCTA), which retains the directive that the Board issue administrative "exemptions" that suspend active regulation in areas where the market is competitive. The Board's governing statute, like virtually all other modern statutes of economic regulatory agencies, assumes that aggressive regulation is not necessary where there is competition, because in such circumstances competition will discipline businesses and prevent market abuse. Our statute, at 49 U.S.C. 10101, establishes a Federal policy "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail," and to "minimize the need for Federal regulatory control over the rail transportation system," but "to maintain reasonable rates where there is an absence of effective competition." It also permits the Board to intervene with respect to railroad rates only "[i]f the Board determines . . . that a rail carrier has market dominance over the transportation to which [the] rate applies." 49 U.S.C. 10701(d)(1).

Under the law, a carrier is considered not to have market dominance where its rates produce revenues that are less than 180 percent of its "variable costs" of providing the service. (Variable costs are the portion of a carrier's costs that change with the amount of traffic handled, unlike the fixed portion of its costs.) Also, if there are competitive alternatives for moving the traffic between the same points—that is, competition either from other railroads (intramodal competition) or from other modes of transportation such as trucks, pipelines, or barges (intermodal competition)—then the Board does not have authority to regulate the rate, even if the revenues exceed 180 percent of the variable costs of providing the service. Finally, the Board has limited jurisdiction over rail transportation contracts between shippers and carriers.

When Congress passed the Staggers Act in 1980, the Nation's rail system was in desperate financial straits. It was burdened with unproductive assets, forced to provide unprofitable services, and hampered by excessive government regulation. Recognizing that a sound, healthy rail transportation system is essential to the Nation's economy, Congress put in place reforms directing that railroads be treated, in most respects, more like other businesses. Since that time, the railroad industry's financial condition has steadily improved. Today the industry is considered by most independent analysts to be relatively healthy.

Unlike most businesses, however, railroads are common carriers. As common carriers, they have an obligation to provide service to the general public on reasonable request. In order to ensure that shippers receive the needed level of service, the railroads' financial resources must be sufficient to maintain a sound and sufficient infrastructure. At the same time, transportation of commodities vital to the Nation's economic wellbeing must be efficient and reasonably priced.

In 1980, the rail system was faced with excess capacity, which made it difficult for railroads to provide service efficiently and on a financially sustainable basis. The Staggers Act made it easier to shed excess capacity and become more efficient in other ways, and the system has now been largely rationalized and made more productive.

In recent years, the U.S. economy has expanded, and the rail network, like other transportation sectors, has become capacity-constrained. Railroads, however, cannot respond as readily to capacity constraints (by quickly building new track and other facilities) as some other transportation sectors can. For example, trucking companies can purchase new equipment or hire new drivers. Not only are rail construction projects expensive and time-consuming, but these projects can generate significant opposition on environmental and community-impact grounds.

On April 11, 2007, the Board held a public hearing focused on rail capacity, traffic forecasts, and infrastructure requirements. Because the Nation's freight rail system will be relied upon to handle significant increases in traffic in the years ahead, the Board wanted to get a better understanding of whether current and planned or forecasted investments will be adequate to meet rail capacity demands, and, if not, what new policies and strategies need to be pursued. That hearing, which lasted 12 hours, brought together representatives of large railroads; short line railroads; Federal, state, regional, and local government interests; many different shipper interests; rail passenger carrier interests; and rail labor. The hearing documented widespread consensus among stakeholders that rail capacity will become increasingly constrained by traffic growth. A representative of one of the Nation's ports testified that container traffic typically carried by truck or rail entering North American ports from overseas will grow by more than 100 percent by the year 2020, from over 48 million Twenty Foot Equivalent Units (TEUs) in 2005 to an anticipated 130 million TEUs. Furthermore, representatives of the large railroads that make up the Class I railroad industry testified that—despite their plans to increase investment levels in the system every year—their anticipated capacity investments will not keep up with forecasted increases in rail service demands. In sum, the rail system's capacity shortfall that we see in many markets today will dramatically worsen unless bold new policies and strategies are adopted.

Another important indicator of the adequacy of an individual railroad's revenues is the railroad's cost of capital. The Board is required by statute to make an annual assessment of the railroad industry's cost of capital. This determination is an input in the Board's review of rail rate challenges and rail line abandonment proposals. A railroad's cost of capital reflects the carrier's cost to raise capital both through debt and through equity arrangements. While the cost of debt is easy to determine, the cost of equity is far more difficult. Indeed, how best to calculate the cost of equity is the subject of a vast literature spanning the fields of finance, economics, and regulation. Since 1981, the Board has been using the same basic approach to estimate the cost of equity, but concerns recently have been raised that the approach is outdated and may be overstating the industry's cost of capital and thus the revenue needs of the industry.[1]

Given the importance of this cost-of-capital figure in many of our regulatory procedures, we launched a rulemaking to improve our methodology and to ensure the accuracy of this important measurement. The comment period is scheduled to close at the end of October, and we will carefully consider all comments before issuing a final rule.

GAO Report and STB Competition Study

The Government Accountability Office (GAO) prepared a report in 2006,[2] and a supplement in 2007,[3] addressing railroad rates, competition, and capacity. The 2006 Report analyzed general trends in the industry and also highlighted particular markets. The 2007 Supplement updated some of the information in the 2006 Report.

As GAO documented in the 2007 Supplement, between 1985 and 2005, rates did not keep pace with inflation for each of the four major categories of rail traffic separately tracked by GAO (coal, grain, motor vehicles, and miscellaneous mixed shipments). Moreover, GAO found that despite an uptick in recent years, rail rates overall for 2005 remained below 1985 levels even in nominal terms. At the same time, the Board's index for tracking changes in railroad costs (the Railroad Cost Adjustment Factor) shows that the costs that the railroads themselves had to pay for the goods and services that they use in their business increased by 80 percent from 1985 to 2005. Thus, the fact that rates overall remained at or below 1985 levels

[1] The cost of equity for 2005 using the current methodology was calculated to be 15.2 percent, compared to 8.4 percent using the proposed methodology; similar disparities are reflected in prior years' calculations (*e.g.,* 2003: 12.7 percent *vs.* 8.0 percent; 2004: 13.2 percent *vs.* 8.2 percent).

[2] The report is entitled *Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed.*

[3] The supplement is entitled *Freight Railroads: Updated Information on Rates and Other Industry Trends.*

even with these recent cost increases demonstrates that, in general, rail rates have been held down for most shippers.

The 2006 GAO Report focused to some extent on concerns over higher rate levels in parts of the agriculture sector. Last November, the Board held a public hearing to obtain information from interested parties about the grain transportation market in general, and in particular about the market conditions in the grain industry that may have caused grain rates to diverge from the long-term general trend of reduced rail rates for most shippers. Because U.S. and Canadian grain producers compete, both with each other and in a global marketplace, the agency also wanted to hear about the interplay between the American and Canadian wheat markets, how the Canadian regulatory system differs from the American system, and what impact those differences might have on grain production in the United States.

There are of course areas—states like North Dakota and Montana—in which rail rates tend to be higher than average, as the 2006 GAO Report points out.[4] That is largely because of the economics of the railroad industry: under principles of "differential pricing," railroads, with high "sunk" costs and with fierce competition for most traffic, are expected to charge more, even substantially more, from their captive traffic than from their competitive traffic if they are to achieve enough revenues to cover their costs and invest in necessary facilities. Although differential pricing is practiced in many other industries—such as airlines, utilities, hotels, and movie theaters—we understand that shippers on the captive end of this differential pricing scale would not be satisfied with the *status quo.* But if differential pricing is to be substantially tempered in the industry, then revenues will have to come from some source other than captive shippers. And if other sources of revenue cannot be found, then infrastructure investment will suffer, as will rail service.

To further address GAO's observations about areas with less competition, the Board recently commissioned an extensive study on the extent of competition in the railroad industry. The study will also assess various policy issues, including current and near-future capacity constraints in the industry; how competition and regulation impact capacity investment; how capacity constraints impact competition; and how competition, capacity constraints, and other factors affect the quality of service provided by railroads. The economic consulting firm Christensen Associates, based in Madison, Wisconsin, has begun work on a contract valued at approximately $1 million to deliver this study to the STB for publication in the Fall of 2008.

Another rulemaking that the Board is currently completing involves interchange commitments that may be part of sale or lease contracts when large carriers sell or lease lighter-density portions of their lines to smaller carriers (referred to by some as the "paper barrier" issue). Some parties take the view that these arrangements have helped facilitate the growth of the short-line industry into a vibrant force in the transportation sector—with well over 500 carriers today operating nearly 46,500 miles of track with nearly 20,000 employees—while others are concerned that they have tended to freeze in place the competitive *status quo,* rather than allowing the development of new competitive options not available before the transaction. A Board decision addressing a request for a general rule regarding such contractual interchange commitments is imminent.

Rate Regulation

As is the case with other industries, when capacity is tight, carriers will seek to raise their rates. As a result of differential pricing, those shippers without competitive options often see their rates rise the most. Thus, with tight capacity throughout the industry today, the Board's rate processes are particularly important, and I will now turn to that matter.

Rate Disputes. Under the statute, the Board is directed to ensure that rates are reasonable while at the same time not precluding railroads from obtaining adequate revenues. Balancing these potentially conflicting objectives is not an easy task. Rates that are too high can harm rail-dependent businesses, while rates that are held down too low will deprive railroads of the revenues needed to pay for the infrastructure investments that are in turn needed to give shippers the level and quality of service that they require. The Board has recently improved its procedures for handling rate cases, with one set of procedures for large rate cases and two other procedures for smaller cases.

Large Rate Cases. With often hundreds of millions of dollars at stake, large rate disputes raise complex questions over the value of the assets needed to serve the shipper, the operating costs to serve the shipper, and the degree of differential pricing a carrier needs to earn a reasonable return. To resolve these large disputes, in

[4] For some areas, rates can be higher because traffic is seasonal and there is little volume during off-peak times.

1985 the Board's predecessor agency, the ICC, created a sophisticated, although complex, approach known as "Constrained Market Pricing," or CMP. CMP provides a framework for the Board to regulate rates while affording railroads the opportunity to cover their costs. Although CMP is premised on the need for differential pricing, CMP principles also impose constraints on a railroad's ability to price, even for their captive traffic.

CMP sets up four potential constraints on railroad pricing. The constraint that is typically used is the stand-alone cost (SAC) test. Under SAC, a railroad may not charge a shipper more than what a hypothetical new, optimally efficient carrier would need to charge the complaining shipper if such a carrier were to design, build, and operate—with no legal or financial barriers to entry into or exit from the industry—a system to serve only that shipper and whatever group of traffic that shipper selects to be included in the analysis. The ultimate objective of the SAC test is to ensure that the complaining shipper is not charged for a carrier's inefficiencies or for facilities or services from which the shipper derives no benefit. This assures that the complaining shipper is not required to unfairly subsidize other customers of the railroad.

Although the U.S. courts of appeals have affirmed every challenged SAC case issued by the Board since the agency was created in 1996[5] (whether they were challenged by the shipper or the railroad involved), during the past few years it became apparent that a loophole gave railroads the ability to "game" the outcome of future SAC determinations. Moreover, in a recent court decision, the Board was warned that part of its SAC methodology was on "shaky ground."[6] Finally, the complexity and costs of litigating a SAC case had increased over time, often costing $3–$5 million and 2–4 years for a shipper to bring, or a railroad to defend, a case. For these reasons, the Board found it necessary in 2006 to make some significant changes in how we will apply the SAC test and how we will calculate the amount of relief in a large rate case. The revisions reflect a significant milestone in the STB's ongoing effort to reduce litigation costs, create incentives for private settlement of disputes, and shorten the time required to develop and present large rail rate cases to the STB. These rules were completed last Fall within 8 months of the notice of proposed rulemaking.

In the first test of our new guidelines for large rate cases, the shippers in two recent cases may have been disadvantaged by the changes. Those cases were initiated under the old rules and decided under the new rules. Because of the unique procedural posture of those cases, the Board has taken the nearly unprecedented step of allowing those shippers to redesign significant portions of their cases if they choose to do so.

Small Rate Cases. In 1996, in response to a Congressional directive, the STB adopted simplified guidelines for assessing the reasonableness of challenged rail rates in cases in which a full SAC presentation is too costly. Under these guidelines, the agency established three "benchmarks" to determine the reasonableness of a challenged rate in a small rate case. The three benchmarks look at the carrier's overall revenue needs, how the railroad prices its other captive traffic, and how comparable traffic is priced.

Shippers, however, noted several shortcomings to the small rate case procedures that discouraged them from filing cases. For example, many stated that it was unclear what shippers would qualify to use the guidelines. In addition, shippers (and railroads) wanted greater clarity as to how the three benchmarks would be applied in a particular case. Shippers also expressed concerns about how railroads might use the discovery process to unreasonably prolong a case. As a result of these ambiguities, no cases were decided under the 1996 simplified guidelines, although two cases were filed and then settled.

The agency held several public hearings on this matter from 2003 through 2007, and its staff met with staff from other economic regulatory agencies to gather information on how those agencies handle smaller disputes. On September 5, 2007, the Board issued a decision updating our process for reviewing rate complaints in cases

---

[5] *See Otter Tail Power Co.* v. *BNSF Ry.,* 484 F.3d 959 (8th Cir. 2007); *Arizona Elec. Power Coop., Inc.* v. *STB,* 454 F.2d 359 (D.C. Cir. 2006); *BNSF Ry.* v. *STB,* 453 F.3d 473 (D.C. Cir. 2006); *PPL Mont., LLC* v. *STB,* 437 F.3d 1240 (D.C. Cir. 2006); *Wisconsin Power & Light Co.* v. *Union Pac. R.R.,* 62 Fed. Appx. 354 (D.C. Cir. Apr. 30, 2003); *McCarty Farms, Inc.* v. *STB,* 158 F.3d 1294 (D.C. Cir. 1998); *Burlington N.R.R.* v. *STB,* 114 F.3d 206 (D.C. Cir. 1997).

[6] In particular, the United States Court of Appeals for the District of Columbia, in affirming one of the Board's more recent SAC decisions that had been challenged by a railroad, explicitly stated that, if the Board were "presented with a model [for allocating revenue for so-called "cross-over traffic"] that took account both of the economies of density and of the diminishing returns thereto, a decision to adhere to its [existing] model would be on shaky ground indeed." *BNSF Ry.* v. STB, 453 F.3d 473, 484 (D.C. Cir. 2006).

too small to warrant the cost of litigating a full SAC case. The Board's decision, which makes the rate review process available to shippers of all sizes, allows smaller rate cases to proceed on one of two tracks. First, freight rail customers may seek up to $1 million in relief over a 5-year period, using a revised version of the three-benchmark test with more predictability built into it. A shipper using that approach would have a Board ruling on its case within 8 months of the filing of its complaint.

Under a second approach, freight rail customers can seek up to $5 million in relief over a 5-year period, by using a process that focuses on whether the carrier is abusing its market power by charging more than it needs to earn a reasonable return on the replacement cost of the infrastructure used to serve that shipper. This is a simpler form of the SAC test that is applied in large cases; it relies on standardization of many of the components in order to reduce the cost and complexity of litigating the case. A Board decision in a rate case brought under this approach would be issued within 17 months after the filing of the complaint.

In finalizing this rule, the Board received a number of suggestions and comments from the shipper community on how to improve that proposal. The Board implemented the following changes to the initial proposal, at the urging of a shipper or to respond to shipper criticisms with the initial approach:

- Modified the eligibility approach to ensure that all captive shippers have a meaningful forum for seeking protection from unreasonable rates by raising the relief available under the simplified guidelines;
- Increased the maximum value of recovery under the "Three-Benchmark" approach five-fold, from $200,000 to $1,000,000;
- Removed the formal "aggregation" approach, which may have unnecessarily prevented a captive shipper that ships to numerous destinations from a single origin from seeking relief under the simplified guidelines;
- Required railroads to participate in mandatory 20-day, non-binding mediation at the beginning of the case;
- Expedited the procedural schedules to the maximum extent practical;
- For the Simplified-SAC analysis:
  - Excluded depreciation on equipment when calculating operating expenses;
  - Removed the annual adjustment process for a rate prescription to make the case simpler and less expensive;
- For the Three-Benchmark analysis:
  - Provided equal access for shippers to the confidential Waybill Sample;
  - Permitted the shipper to submit evidence of "other relevant factors" to rebut certain presumptions established in the methodology.

In addition, the Board rejected numerous proposed changes by the railroad community that were opposed by the shippers. For example, the railroads asked the Board to permit movement-specific adjustments to its Uniform Rail Costing System used to estimate the variable cost of a movement and whether it falls above or below the 180 percent jurisdictional threshold. The Board, at the shippers' urging, rejected that change, which would have made these cases more expensive.

Before the Board's recent changes, the majority of captive rail traffic had been effectively blocked from Board rate review due to the complexity and resulting high costs of the previous procedures. The Board's new procedures—which have been challenged in court by numerous rail interests—ensure that the rate review process will be accessible to all captive traffic that moves under common carrier rates.

In all rate cases, the Board will require mediation up front, which we have found is a good way of encouraging adversaries to narrow their differences and possibly reach a mutually satisfactory settlement. Indeed, earlier this year a small rate case involving Williams Olefins, LLC and Grand Trunk Corporation was resolved privately within only a few weeks pursuant to mediation by Board staff.

Fuel Surcharges. Another matter that has concerned shippers in the past few years is the way the railroads were assessing fuel surcharges. In recent years fuel costs have been unpredictable and volatile, with some sharp upward spikes. Fuel is a substantial component of railroad costs, and carriers have sought to recover their increased fuel costs through surcharges. Some shippers felt that the surcharges they were being assessed were greater than the increased fuel costs that could be attributed to their movements. Captive shippers voiced concerns that the fuel surcharge programs of the carriers, which were expressed as a percentage of the base rate, virtually guaranteed that captive shippers with high base rates would bear the increased fuel costs of other shippers. They also objected to the carriers' practices of "double dipping" by first raising the base rate using an index that in-

cludes changes in fuel costs and then adding a separate fuel surcharge to the same movement.

In May 2006, the Board held a public hearing on the matter. In January of this year we issued a decision declaring it an unlawful practice for carriers to use a fuel surcharge to recover more than the increased fuel costs attributable to the particular movement to which the surcharge is applied. This action, with industry-wide effect, demonstrates that the Board will use aggressively the authority granted to it by statute to stop unreasonable practices, thereby protecting shippers and advancing the public interest.

Service Quality and Railroad-Shipper Relationships

The Board actively monitors railroad industry performance. We receive monthly reports from each Class I railroad, tracking such indicators of congestion and efficiency as the number of freight cars on line, train speeds, and terminal dwell time (the amount of time cars spend in railroad terminals to make connections between trains). Moreover, as it has done for several years now, the Board has asked each of those carriers to provide forward-looking information on how the railroads are preparing to handle end-of-year peak shipping demands in several key markets: agriculture (grain, grain products, and ethanol); coal; chemicals; and intermodal traffic. This year the Board also asked the carriers for their performance goals (with respect to cars-on-line, terminal dwell time, train speed, and employment levels), as well as information on critical capacity-related infrastructure needs this year and their capital needs for increasing capacity in 2008. The carriers' responses are available on our website.

On July 18, 2007, the Board held a field hearing in Kansas City, Missouri, to examine issues related to the efficiency and reliability of railroad transportation of resources critical to the Nation's energy supply, including coal, ethanol and other biofuels. Speakers at the hearing represented the interests of railroads, utilities, coal shippers, and other energy commodities such as ethanol. To address these issues further, the Board has established a Rail Energy Transportation Advisory Committee (RETAC) to provide advice and guidance to the agency and to serve as a forum for the discussion of emerging issues regarding the railroad transportation of energy resources such as coal and ethanol and other biofuels. RETAC is expected to address matters such as rail performance, capacity constraints, infrastructure planning and development, and effective coordination among suppliers, railroads and energy-resource users. The first meeting of RETAC will be held on October 24.

The Board has a very effective Rail Consumer Assistance Program, run by our Office of Compliance and Consumer Assistance (OCCA), which handles about 100 disputes in a typical year. A few of these informal disputes concern rate issues, but the majority relate to service. The process is easy to use and shipper-friendly. It can be engaged by a simple telephone call, fax, letter, or e-mail. The follow-up by our staff is prompt and effective. Our consumer assistance staff has addressed a variety of issues, in addition to rates and service, including: car supply issues; claims for damages; demurrage issues (charges for holding rail cars for too long); fuel surcharges; employee complaints; and community concerns. Our staff cannot always resolve the issues informally, but they are often successful at bringing the parties closer together and getting them to talk to each other without resorting to litigation or formal Board adjudication.

During the past year, the staff working in the consumer assistance program proactively negotiated changes to the railroad industry's embargo rules (rules that govern temporary stoppage of railroad service due to track damage or other causes) that will do much to hold carriers to their common carrier obligation to their shippers. We also resolved two situations in which the crossing or interchange point between two railroads had been blocked, in each case getting the railroad or railroads involved to work out mutually acceptable compromises. We successfully secured rail service for a new shipper in Texas when a large railroad refused to serve it. We assisted a small grain shipper in Nebraska with a rate dispute, persuading the carrier to compromise with the shipper, and assisted a shipper in Missouri with its freight claims, persuading the carrier to honor the claims. And we assisted a shipper organization by persuading a large carrier to modify its freight car information system to provide information that was needed for the businesses of the involved shippers.

When parties cannot resolve their differences informally, they can engage the Board's formal processes by filing a complaint. For example, the Board may temporarily substitute another carrier for a carrier that is unable or unwilling to provide adequate service on its lines. We have used those rules several times in the past few years. This past year, following up on a 2006 authorization of such alternative rail service at the request of a shipper in Texas, the Board extended the temporary

relief until a long-term solution could be developed. In August, the Board ordered the lines involved to be sold, at a price set by the Board to reflect the value of the property, to either of two entities which the Board found should result in improved rail service to shippers. This particular "forced sale" was complex and lengthy. The Board's decisions demonstrate that we will use every available tool, where necessary, to protect shippers receiving inadequate service.

The Board acted to preserve shippers' service options in a case in Ohio this year involving a railroad that would not let another railroad cross its line. In that case, a Class I rail carrier had unilaterally removed the crossing diamonds that were needed for a short line to serve several potential shippers. The Board made clear that a carrier may not undercut another carrier's ability to fulfill its common carrier obligation by unilaterally severing track of the other carrier that is part of the national transportation system. The Board directed the Class I carrier to promptly reinstall the crossing.

Preemption

One of the most difficult issues facing the Board this year is how to improve the Board's ability to ensure effective regulation of rail operations that handle solid waste. We have made significant progress in this area, and I would like to take this opportunity to highlight some of our recent actions.

The express Federal preemption contained in the STB's governing statute at 49 U.S.C. 10501(b) gives the Board exclusive jurisdiction over transportation by rail carriers. It is important to keep in mind that preemption applies both to cases that require STB licensing authority, and also to some that do not.

New Rail Construction

If a project involves building a new rail line into what would be a new service area for the railroad, it requires a license from the Board and an environmental review under NEPA. In such cases, the Board's existing processes are sufficient to allow full consideration of the environmental and other issues that arise. This is shown by *New England Transrail,* which involves a plan to construct, acquire and operate track in Massachusetts to carry a variety of commodities, including municipal solid waste (MSW) and construction and demolition debris (C&D) for connection to other rail carriers. In that case, the Board, in a preliminary decision issued in July 2007, made clear that the Board will conduct a detailed NEPA review and that New England Transrail will not be allowed to enter the rail business until extensive environmental, safety, public health, and other public interest considerations are fully addressed.

Acquisition of an Existing Rail Line

If a project involves a new carrier seeking to acquire or operate an existing rail line, the new carrier must also obtain authority from the Board. While NEPA review can be triggered, the Board has grown concerned recently that the summary class exemption process used in many of these cases does not always provide enough information about a pending proposal to allow us to handle our regulatory responsibilities effectively and efficiently.

Indeed, we recently have begun a proceeding to consider whether to increase the information required from all of those seeking to use the class exemption procedure to acquire, lease and operate rail lines. In a number of recent cases, including matters involving Freehold, New Jersey and Croton-on-Hudson, New York, the Board has stayed the effectiveness of a notice invoking the class exemption to allow a more searching inquiry and to solicit further evidence. We hope that our rulemaking will improve this process and lessen the need for stay requests.

Construction of Facilities Ancillary to an Already-Authorized Rail Line

Finally, there are those activities that although part of rail transportation, may not be subject to STB licensing. These activities include making improvements to existing railroad operations, such as adding track or facilities—including transload facilities where materials are transferred between truck and rail—at existing railroad locations, to better serve the needs of a railroad's service territory. They also include construction of ancillary spur, industrial, team, switching, or side tracks by an already-authorized rail carrier.

Because no Board license is required in these types of cases, there is no occasion for the Board to conduct a formal NEPA review or impose specific environmental conditions. However, as the Board has repeatedly explained, other Federal environmental laws continue to apply, and state and local police powers are not preempted entirely. In addition, any interested party, community, or state or local authority concerned that the Federal preemption is being wrongly claimed to shield activities that are not "transportation by rail carrier" can ask the Board to issue a declaratory

order addressing that issue. Alternatively, they can go directly to court to have that issue addressed.

The Board tries to be proactive where environmental concerns are brought to our attention. STB staff conducts site visits to rail facilities where MSW or C&D is handled, if appropriate. This month, the Board issued an order in a matter in Yaphank, New York requiring an entity constructing facilities there to immediately cease that activity and to either obtain Board authorization for the construction or a Board decision finding that such activity does not require our approval.

Moreover, some states have adopted regulations, such as New Jersey's 2D regulations, that accommodate Federal preemption but allow the states to inspect and impose other requirements on rail-related waste facilities under the police powers they retain. I believe it would be consistent with everything the Board has said about the scope of preemption that states can apply their regulations to rail-related waste facilities so long as the regulations are not applied in a discriminatory manner and do not unreasonably interfere with the railroad's ability to conduct its operations.

While the statutory and regulatory issues presented in cases involving rail-related waste facilities are quite complex, the public interest and public policy considerations involved in these controversies require policymakers to balance several important, and often conflicting, policies. The Board will continue to work hard to identify and implement administrative and regulatory strategies that improve our ability to ensure effective regulation in this area.

Amtrak

Currently there is pending legislation that would give the STB significant new responsibilities regarding Amtrak. Those responsibilities include resolving performance complaints, assisting in the development of service metrics, and determining compensation between Amtrak and commuter authorities for Northeast Corridor access costs if agreement cannot be reached.

With those increased responsibilities will also come the need for additional Board staff in order to ensure that we have the ability both to meet our current caseload requirements and to provide an evenhanded and efficient resolution of the Amtrak matters entrusted to us. I would be remiss if I did not note that the Senate FY 2008 appropriation for the STB is 5.6 percent lower than the Board's FY 2008 request. But I am certain that all involved will continue to work to ensure that the Board has sufficient appropriations to carry out all of our responsibilities.

Conclusion

The past 12 months have been noteworthy for the number of proactive steps taken by the Board to reform, streamline, and modernize our oversight and rail regulatory procedures. To summarize, some of the highlights of the past year include the following:

- In September 2006, we instituted a rulemaking proceeding to modernize the way we calculate the railroad industry's cost of capital to more accurately reflect the financial health of the rail industry;
- In October 2006, we reformed the rate review process for large rate cases to streamline and improve the accuracy of the process, to close a loophole that permitted carriers to manipulate the process, and to address a legal vulnerability;
- In September 2007, we overhauled the procedures for handling smaller rail rate cases so that all shippers will have a practical and feasible means of challenging rail rates;
- We investigated the fuel surcharge practices of the railroads, and in January 2007 concluded that their fuel-surcharge programs were unreasonable because they were misleading and because they required captive shippers to bear surcharges that were higher than the increased fuel costs attributable to their traffic;
- In November 2006, we held a hearing on issues related to the transportation of grain to explore whether further changes to the regulatory framework are necessary;
- In July 2007, we held a hearing and announced that we are establishing an advisory committee on transportation of energy commodities to monitor the ability of the railroads to handle the future energy needs of the Nation;
- In August 2007, we ordered a railroad providing inadequate service to sell its line to another entity that would provide better service;
- We recently contracted with an independent economic consulting firm to conduct a sweeping national study of rail competition-related issues; and

- The Board has taken a number of steps to ensure that waste handling facilities do not use preemption to subvert appropriate review and regulation.

Of the more important actions that will take place between now and the end of next year, the STB will:

- Issue final rules on how to calculate the cost of capital for the rail industry;
- See that the competition study is completed, and analyze the results and recommendations contained therein;
- Test the new simplified rate guidelines on three newly filed small rail rate disputes (and perhaps more cases, if filed);
- Finish our investigation into the concerns about the appropriateness of certain interchange commitments that large carriers may enter into when they sell or lease light-density portions of their lines to smaller carriers;
- Consult with our new energy advisory committee for guidance on a range of significant issues that affect the public interest in a reliable delivery network for coal and liquid biofuels;
- Continue to examine the infrastructure and capacity needs of the rail network and the railroads' capital investment levels, and to emphasize the critical importance of developing new strategies to meet those challenges;
- Review the recently announced proposal by the Canadian Pacific Railway to acquire the Dakota, Minnesota & Eastern Railroad, as well as the Canadian National Railway's proposal to acquire the Elgin, Joliet & Eastern Railway;
- Improve the Board's ability to ensure effective regulation of rail operations that handle municipal solid waste and related materials;
- Address the current ambiguity as to whether certain types of arrangements between rail carriers and shippers reflect contracts (for which regulatory remedies are unavailable), or whether they reflect common carrier service subject to Board regulation; and
- Prepare the STB to have the capability to address potential conflicts between passenger rail and freight rail operations and to implement potential legislative proposals in this regard.

I appreciate the opportunity to discuss these issues today, and look forward to any questions you might have.

ATTACHMENT 1

Summary of Surface Transportation Board Significant Decisions and Hearings—October 1, 2006–October 16, 2007

Rulemakings

EP 646 (Sub-No. 1) *Simplified Standards for Rail Rate Cases*

- 9/05/07—Modified the Board's simplified rail rate guidelines by creating a simplified stand-alone cost approach for medium-sized rail rate disputes and revising its three-benchmark approach for smaller rail rate disputes. The Board's decision also places limits on the total relief available over a 5-year period under these two simplified approaches.

EP 656 *Motor Carrier Bureaus—Periodic Review Proceeding*

- 5/7/07—Completed periodic review, pursuant to 49 U.S.C. 13703(c), of agreements of motor carriers to engage in rate-related collective activities. The Board terminated approval of the agreements of all remaining motor carrier bureaus. To provide sufficient time for parties to adjust to a new environment without antitrust immunity for motor carrier bureau activities, the decision was made effective in 120 days.
- 6/28/07—Postponed, to January 1, 2008, the effective date of Board's decision terminating its approval of antitrust immunity for motor carrier bureau agreements.

EP 657 (Sub-No. 1) *Major Issues in Rail Rate Cases*

- 10/30/06—Decision adopted procedural and substantive changes regarding proper application of the stand-alone cost test in rail rate cases.

EP 659 *Public Participation in Class Exemption Proceedings*

- 10/19/06—Decision adopted changes in the procedures for certain exemptions to ensure that the public is given notice of a proposed transaction before the perti-

nent exemption becomes effective, and to allow the Board to process these notices of exemption, and any related petitions for stay, in an orderly and timely fashion.

EP 661 *Rail Fuel Surcharges*

- 1/26/07—Found that computing rail fuel surcharges as a percentage of a base rate is an unreasonable practice and directed carriers to change this practice. Board also concluded that the practice of "double dipping," *i.e.,* applying to the same traffic both a fuel surcharge and a rate increase that is based on a cost index that includes a fuel cost component, such as the Railroad Cost Adjustment Factor (RCAF), is an unreasonable practice and directed carriers to change this practice as well. Board announced it would proceed with a proposal to impose mandatory reporting requirements for all Class I railroads regarding their fuel surcharges, in STB Ex Parte No. 661 (Sub-No. 1).

EP 661 (Sub-No. 1) *Rail Fuel Surcharges* [reporting requirement]

- 1/26/07—Proposed to require all large (Class I) railroads to submit a monthly report containing the following information: (1) total monthly fuel cost; (2) gallons of fuel consumed during the month; (3) increased or decreased cost of fuel over the previous month; and (4) total monthly revenue from fuel surcharges.
- 8/14/07—Adopted final rules to require all Class I railroads to submit a quarterly report containing the following information: (1) total quarterly fuel cost; (2) gallons of fuel consumed during the quarter; (3) increased or decreased cost of fuel over the previous quarter; (4) total quarterly revenue from fuel surcharges; and (5) revenue from fuel surcharges on regulated traffic.

EP 664 *Methodology to be Employed in Determining the Rail Industry's Cost Of Capital*

- 8/14/07—Proposed to revise the Board's method for calculating the railroad industry's cost of capital by computing the cost of equity using a capital asset pricing model rather than a discounted cash-flow analysis.

EP 669 *Interpretation of the Term "Contract" in 49 U.S.C. 10709*

- 3/29/07—Requested public comment on a proposal to interpret the term "contract' in 49 U.S.C. 10709 to embrace "any bilateral agreement between a carrier and a shipper for rail transportation in which the railroad agrees to a specific rate for a specific period of time in exchange for consideration from the shipper."

EP 670 *Establishment of a Rail Energy Transportation Advisory Committee*

- 3/9/07—Provided notice seeking public comments on the establishment of a Rail Transportation Advisory Committee to provide independent advice and policy suggestions on issues related to the reliability of rail transportation of resources critical to the Nation's energy supply.
- 7/17/07—Announced the establishment of the Rail Energy Transportation Advisory Committee and requested nominations of candidates to serve on the committee.
- 9/21/07—Announced the appointment of 23 individuals to serve on the newly established Rail Energy Transportation Advisory Committee.

EP 673 *Information Required in Certain Notices of Exemption*

- 10/04/07—Granted a petition filed by 6 Class I rail carriers to institute a rulemaking proceeding to consider requiring more information in notices of exemption for acquiring and operating rail lines and to reconsider the Board's Effingham decision.

Annual Regulatory Determinations

EP 290 (Sub-No. 4) *Railroad Cost Recovery Procedures—Productivity*

- 1/31/07—Proposed to adopt 1.017 (1.7 percent per year) as the measure of average change in railroad productivity for the 2001–2005 (5-year) averaging period, a decline of 0.2 percent from the measure of 1.9 percent that was developed for the 2000–2004 period.

EP 542 (Sub-No. 14) *Regulations Governing Fees for Services Performed in Connection with Licensing and Related Services*

- 4/6/07—Decision adopted 2007 user fee update and revised fee schedule to cover certain costs.

EP 552 (Sub-No. 10) *Railroad Revenue Adequacy—2005*

- 10/23/06—Found one Class I carrier, Norfolk Southern, to be revenue adequate in 2005.

EP 558 (Sub-No. 9) *Railroad Cost of Capital—2005 determination*

- 2/12/07—Denied Western Coal Traffic League's petition for reconsideration of the cost-of-capital decision for 2005. The Board rejected various technical challenges and said that it would address the League's argument that the Board should replace its discounted cash-flow methodology with a capital asset pricing model in a new proceeding, EP 664.

EP 558 (Sub-No. 10) *Railroad Cost of Capital—2006 determination*

- 5/16/07—Instituted a proceeding to determine the railroad industry's cost of capital for 2006 and required comments from all Class I railroads.

Rail Cases

Major Rate Cases

NOR 42088 *Western Fuels* v. *BNSF*

9/10/07—Found that BNSF had market dominance over the transportation at issue, but that the complainant had not demonstrated that the challenged rates were unreasonably high. The complainant was offered an opportunity to submit supplemental evidence.

NOR 41191 (Sub-No. 1) *AEP Texas* v. *BNSF*

- 9/10/07—Found that BNSF had market dominance over the transportation at issue, but that the complainant had not demonstrated that the challenged rates were unreasonably high. The complainant was offered an opportunity to submit supplemental evidence.

No. 42095 *Kansas City Power and Light* v. *Union Pacific RR*

- 3/29/07—Found that the parties had shown cause why the case should not be dismissed (on grounds that the transportation at issue is covered by contract) and directed the parties to submit a proposed procedural schedule.

Small Rate Cases

No. 42098 *Williams Olefins, L.L.C.* v. *Grand Trunk Corporation*

- 2/15/07—Dismissed this small rate complaint after the parties confirmed that they had reached a mediated settlement with the assistance of Board staff.

No. 42099 *et al. E.I. DuPont de Nemours and Co.* v. *CSX Transportation*

- 9/7/07—Decided that three small rate cases filed by DuPont in August would be adjudicated under the Board's new simplified guidelines for small- and medium-sized rate cases, and directed DuPont to supplement its complaints as warranted under the new guidelines.

Acquisition of Control

FD 35031 *Fortress Investment Group—Control—Florida East Coast Ry.*

- 9/28/07—Approved the acquisition of control of Florida East Coast Railway by Newco and Fortress Investment Group LLC.

Construction, Acquisition, or Operation of Rail Lines and Facilities

FD 30186 (Sub-No. 3) *Tongue River RR Co.—Construction and Operation—Western Alignment*

- 10/9/07—Approved Tongue River's application for construction and operation of a 17.3-mile rail line in Montana as part of a route previously authorized for construction to move coal out of the Powder River Basin and modified previously imposed environmental conditions.

FD 34421 *HolRail LLC—Construction and Operation Exemption—In Orangeburg and Dorchester Counties, SC*

- 2/12/07—Denied HolRail's petition to cross CSX's right-of-way, because HolRail's proposal to construct in the right-of-way in the form of a crossing petition was an inappropriate use of the crossing statute, and denied HolRail's request for authority to construct and operate its preferred route.

FD 34797 *New England Transrail—Construction Acquisition and Operation Exemption*

- 7/10/07—Found that New England Transrail would, if authorized, become a rail carrier subject to the Board's jurisdiction, but also found that some of its planned activities related to the handling of construction and demolition debris would extend beyond the scope of rail transportation and therefore would not be subject to Federal preemption from most state and local laws. The Board held an oral argument in this case on 4/19/07.

FD 34909 *CSX, Norfolk Southern and Conrail—Joint Use*

- 10/5/06—Granted a petition for exemption filed by CSX, Norfolk Southern, and Conrail to provide for the joint use and joint rail freight operations over 7.69 miles of abandoned rail line of the former Staten Island Railway Corporation in New York and New Jersey.

FD 34986 *Ashland RR—Lease and Operation—In Monmouth County, NJ*
- 8/16/07—Rejected a notice of exemption by Ashland to acquire and operate 1.5 miles of track in Freehold Township because Ashland failed to provide information on whether it proposed to transload solid waste at a facility on the line to be acquired.

FD 35020 *Northern and Bergen RR—Acquisition Exemption—A Line of the New York & Greenwood Lake Ry.*
- 5/25/07—Stayed the effective date of the exemption to provide additional time for the parties to meet to discuss concerns about the rail facility's compliance with health and safety regulations.
- 6/25/07—Denied further stay of the exemption.

FD 35024 *et al. Washington State Dept of Transportation—Acquisition—Palouse River and Coulee City RR*
- 5/30/07—Granted Washington State DOT authority to acquire a total of 296 miles of rail line from the Palouse River and Coulee City Railroad on an expedited basis in four separate and related transactions.

FD 35036 *Suffolk & Southern Rail Road LLC—Lease and Operation Exemption—Sills Road Realty, LLC*
- 6/1/07—Provided that the exemption in this proceeding would not become effective until further order of the Board and directed Suffolk & Southern to file supplemental information.
- 8/13/07—Directed Suffolk & Southern to file supplemental information required in a prior Board decision and to explain why it sought to withdraw its petition filed in this case.
- 10/12/07—Reopened proceeding in light of evidence that construction of intended rail facilities may be occurring despite prior reports appearing designed to give a different impression and directed that any construction activities cease until the Board either grants construction authority or rules that no authority is needed.

FD 35042 *U.S. Rail Corp—Lease and Operation Exemption—Shannon G.*
- 6/15/07—Ordered that the proposed exemption would not become effective until further order of the Board and directed U S Rail to file supplemental information.

FD 35063 *Michigan Central Railway—Acquisition And Operation Exemption—Norfolk Southern*
- 8/2/07—Commenced a proceeding to consider the petition of Michigan Central Railway to exempt its acquisition and operation of certain railroad lines of the Norfolk Southern Railway Company in Michigan and Indiana.

FD 35068 *Soo Line RR Co. d/b/a Canadian Pac. Ry.—Acquisition and Operation—BNSF Ry.*
- 9/07/07—Granted a petition for Soo to acquire BNSF's interest in and to operate 36.26 miles of rail line in North Dakota previously jointly owned by CP and BNSF and to acquire and operate a contiguous 9.96-mile line owned by BNSF.

Unreasonable Practice Complaints

No. 42060 (Sub-No. 1) *North America Freight Car Association* v. *BNSF Ry. Co.*
- 1/26/07—Denied complaint challenging storage and demurrage charges on empty private freight cars when held on BNSF property beyond a "free time" period. Complainants had alleged that the imposition of such charges, which had not been imposed in the past, was an unreasonable practice, constituted a failure to furnish adequate car service, violates requirements regarding demurrage charges, and violates the shipper allowance provisions.

Requests for Declaratory Order

FD 34527 *Maumee & Western RR Co.—Pet. for Dec. Order—CSXT Crossing Rights at Defiance, OH*
- 5/9/07—Granted request for declaratory order and found that CSXT is obligated to restore the crossing diamonds it had removed at Defiance, unless the parties agree to a different crossing arrangement.

FD 34818 *City of Jersey City, et al.—Pet. for Dec. Order*

- 8/9/07—Determined that Conrail needs abandonment authorization from the Board before it may transfer ownership of the pertinent property for nonrail use.

FD 34865 *Arkansas Midland Railroad Company—Pet. for Dec. Order—Caddo Valley RR Co.*

- 5/2/07—Found that the right of first refusal under 49 U.S.C. 10907(h) [under which a railroad forced to sell its rail line under the feeder line railroad provisions has a right of first refusal if the line is subsequently sold] applies in a situation where the stock of the feeder line buyer is proposed to be sold instead of the asset (line) itself.

FD 34914 T3DesertXpress—Pet. for Dec. Order

- 6/27/07—Granted DesertXpress' petition, finding that its proposed construction is not subject to state and local environmental review, land use restrictions, or other discretionary permitting requirements because of Federal preemption.

FD 35021 *Union Pac. RR Co.—Petition for Declaratory Order*

- 5/16/07—Denied a request by UP for a declaratory order as to whether "Option 2 of Circular 111" (a rate made available by the UP to its customers which depended upon certain commitments from both carrier and shipper as to term, volume, rates and service) was a contract or a tariff. The Board denied the railroad's request on the grounds that such a determination depended on the facts surrounding the execution of each particular Option 2 agreement, and those facts were not placed before the Board.

Forced Sale and Alternative Service

AB–556 (Sub-No. 2) *Railroad Ventures—Abandonment Exemption—Between Youngstown, OH, and Darlington, PA*

- 2/15/07—Reversed the Board's prior decision to the extent that it had considered newly introduced evidence pertaining to certain expenditures and tentatively concluded that none of the $375,000 portion of the purchase price set aside for repairs need be turned over to Railroad Ventures.

FD 34890 *PYCO—Feeder Line Application*

- 8/31/07—Ordered South Plains Switching to sell its rail lines in Lubbock, TX, to either PYCO Industries or Keokuk Junction Railway under the terms set by the Board pursuant to 49 U.S.C. 10907.

FD 34917 *Pioneer Industrial Railway Company—Alternative Service Request—Central Illinois Railroad Company*

- 1/12/07—Denied request for Pioneer to provide alternative rail service over line of Central Illinois but reopened a prior decision granting an adverse discontinuance application that sought removal of Pioneer as a carrier authorized to serve the line.

Motor Carrier Cases

MC–F–21020 *FirstGroup plc—Acquisition—Laidlaw International, Inc.*

- 4/5/07—Approved, subject to opposing comments being submitted, the application of FirstGroup, plc to acquire Laidlaw International, Inc., the parent of Greyhound Lines, Inc. No opposing comments were received, and the decision therefore became effective 5/21/07.

RR 999 (Amendment No. 4 to Released Rates Decision No. MC–999) *Released Rates of Motor Common Carriers of Household Goods*

- 6/13/07—Decision amended the Board's previous decisions authorizing motor carriers of household goods to offer "released rates," under which they limit their cargo liability, to comport with a statutory change in the standard liability of motor carriers for damage to, or loss of, the household goods they transport.

RR 999 (Amendment No. 5 to Released Rates Decision No. MC–999) *Released Rates of Motor Common Carriers of Household Goods*

- 6/13/07—Decision proposed, and sought comment on, three changes to the Board's released rates authorization to enhance the protection of consumers whose household goods are damaged or lost by motor common carriers.

Pipeline Cases

NOR 42084 *CF Industries* v. *Kaneb Pipe Line*

- 11/21/06—Granted the parties' joint motion to approve their settlement agreement without condition and place it under seal.

Water Carrier Cases

WCC 101 *Guam* v. *Sea-Land Service et al.*

- 2/02/07—Denied carriers' motion to dismiss and ordered carriers to submit all additional evidence regarding effective competition in the Guam market by March 19, 2007, and ordered the Government of Guam (GovGuam) to submit its reply by April 18, 2007.
- 8/30/07—Denied petitions for reconsideration filed by GovGuam and the Caribbean Shippers Association and modified the procedural schedule.
- 10/12/07—Granted GovGuam's motion to dismiss its complaint.

Hearings

EP 665 *Rail Transportation of Grain*

- 11/02/06—The Board held a public hearing as a forum for interested persons to provide views and information about the market conditions pertaining to rail transportation of grain.

EP 646 (Sub-No. 1) *Simplified Standards for Rail Rate Cases*

- 1/31/07—The Board held a hearing regarding proposed changes to its procedures for determining the reasonableness of challenged railroad rates in those small- and medium-sized cases in which a full stand-alone cost (SAC) presentation is too costly.

EP 664 *Methodology to be Employed in Determining the Rail Industry's Cost Of Capital*

- 2/15/07—The Board held a hearing regarding the appropriate methodology to be employed by the Board in determining the railroad industry's estimated cost of capital, which would then be used by the agency in future, annual cost-of-capital decisions.

EP 671 *Rail Capacity and Infrastructure Requirements*

- 4/11/07—The Board held a hearing as a forum for interested persons to provide views and information about: rail-freight traffic forecasts; the extent of capacity constraints and the ability of railroads to meet rising demand; the infrastructure investment needed to ensure that the Nation's freight-rail system continues to operate in an efficient and reliable manner; possible solutions to the challenges presented by growing rail traffic and limited capacity; and the potential role of public-private partnerships and innovative financing tools in meeting these challenges.

FD 34797 *New England Transrail—Construction Acquisition and Operation Exemption*

- 4/19/07—The Board held an oral argument in the *New England Transrail* case to permit the parties of record to discuss the extent to which NET's planned activities would constitute transportation by rail carrier and thus lie within the Board's exclusive regulatory jurisdiction.

EP 672 *Rail Transportation of Resources Critical to the Nation's Energy Supply*

- 7/18/07—The Board held a hearing in Kansas City, Missouri, to provide a public forum for examination of issues related to the efficiency and reliability of railroad transportation of resources critical to the Nation's energy supply, including coal, ethanol and biofuels.

ATTACHMENT 2

STB's Record in Court—Since 10/1/2006

Cases Decided on the Merits

Mayo Foundation v. *STB* (8th Cir. No. 06–2031). *Rail Line Constructions.* In response to challenges brought by various environmental groups, community interests located along the line, and others, the court upheld an STB decision on remand reauthorizing Dakota Minnesota & Eastern to construct a rail line to serve coal mines in the Powder River Basin. (4 petitions embraced.) *472 F.3d 545.*

Springfield Term. Ry. v. *STB* (D. Mass. No. 04–12705–RGS). *Rail charges.* In response to a challenge brought by a rail carrier, the court upheld an STB decision addressing court-referred issues as to when a claim for car mileage allowance accrues. (2 petitions embraced.) *472 F. Supp. 2d 89.*

Black et al., v. STB (6th Cir. No. 06–3045). *Rail Labor Protection.* In response to a challenge brought by individual employees who were not supported by their union,

the court upheld an STB decision declining to overturn a labor arbitration ruling. *476 F.3d 409*.

American Orient Express Ry. v. *STB* (D.C. Cir. Nos. 06–1077 & 06–1080). *Rail Passenger Service.* In response to a challenge brought by a business that operates passenger services over lines owned by Amtrak and other rail carriers, the court upheld an STB decision finding that petitioner is a rail carrier subject to Board jurisdiction. (2 petitions embraced.) *484 F.3d 554*.

Otter Tail Power Co. v. *STB* (8th Cir. No. 06–1962). *Rail Rates.* In response to a challenge brought by a shipper, the court upheld an STB decision finding that challenged rates had not been shown to be unreasonably high. (3 petitions embraced.) *484 F.3d 959*.

DHX, Inc. v. *STB* (9th Cir. No. 05–74592). *Water Carrier practices.* The court upheld an STB decision denying a freight forwarder's challenge to rates and practices of two water carriers serving Hawaii.

Pending Cases

Northern Plains Resource Council v. *STB* (9th Cir. Nos. 97–1011, 97–70099, 97–70217, & 97–70037). *Rail Line Construction.* Challenges brought by property owners and others to an STB decision approving the construction and operation of the Tongue River rail line in Montana. Case held in abeyance. (4 petitions embraced.)

Railroad Ventures v. *STB* (6th Cir. No. 05–3157). *Rail Abandonments; OFA Sales.* Challenge brought by a business that bought a rail line, but then provided poor service, to an STB decision regarding one of the terms and conditions for the forced sale of the rail line under offer of financial assistance procedures.

District of Columbia v. *STB* (D.C. Cir. No. 05–1220). *Preemption.* Challenge brought by the District of Columbia government and the Sierra Club to an STB decision declaring that an act of the District of Columbia seeking to govern the transportation of hazardous materials moving by rail through the District is preempted by the Interstate Commerce Act. (2 petitions embraced)

Kershaw Sunnyside Ranches et al., v. *STB* (9th Cir. No. 05–76364). *Adverse Abandonment.* Challenge brought by a landowner to an STB decision denying an application for adverse abandonment of rail track running through a portion of its property.

Tri-State Brick & Stone of N.Y. v. *STB* (D.C. Cir. No. 06–1334). *Preemption.* Challenge by a business that leases property next to a rail yard to an STB decision finding that the petitioner is not a rail carrier and thus not protected from state and local land use laws.

BNSF Ry. v. *STB* (D.C. Cir. Nos. 06–1372 *et al.*). *Rail Rates.* Challenges by various large rail carriers, a carrier association, and a shipper group to an STB rulemaking decision modifying the standards and procedures for addressing large rail rate disputes. (4+ petitions embraced.)

Western Coal Traffic League v. *STB* (D.C. Cir. No. 07–1064). *Railroad Cost of Capital.* Challenge by a shipper group to an STB decision applying established procedure for determining cost of capital for railroad industry in 2005, while exploring in a separate rulemaking whether current method for computing cost of equity should be replaced with some other technique.

North Am. Freight Car Ass'n v. *STB* (D.C. Cir. No. 07–1070). *Rail Charges.* Challenge by a group of railcar owners to an STB decision denying complaint against a carrier's imposition of storage and demurrage charges on empty private freight cars.

HolRail LLC v. *STB* (D.C. Cir. No. 07–1088). *Rail Crossing.* Challenge by a shipper-owned new rail carrier to an STB decision denying request to invoke the crossing statute to use another carrier's right-of-way in connection with the proposed construction of a new rail line.

Caddo Valley Railroad Co. v. *STB* (8th Cir. No. 07–2066). *Feeder Line Sale.* Challenge by a small rail carrier to an STB decision finding that the statutory right of first refusal to repurchase the line applied to the sale of the entire stock of the business.

CSX Transportation, Inc., et al., v. *STB* (D.C. Cir. No. 07–1369). *Small Rate Guidelines.* Challenges by four large railroads and a railroad association to the newly modified small rate guidelines. (5 petitions embraced.)

212 Marin Boulevard, LLC, et al., v. *STB* (D.C. Cir. No. 07–1397). *STB jurisdiction.* Challenge by rail carrier and property developers to an STB decision finding that certain property sold to a developer for residential housing is part of a line of railroad that remains subject to STB jurisdiction until abandonment authority is obtained. (2 petitions embraced.)

Senator LAUTENBERG. Thank you very much.

Now we have Ms. Hecker, please? Thank you. And, also, the 3-minute rule, if you can keep an eye on that. Thank you.

STATEMENT OF JAYETTA Z. HECKER, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO)

Ms. HECKER. Certainly.

Thank you, Mr. Chairman and other members of the Committee. I am very pleased to be here. I'm actually speaking on a body of work that we've done for this committee that included a comprehensive, very intensive review, a 25-year retrospective on the Staggers Act, looking at what's happened to rates, looking at what happened to competition, and looking at the performance of the STB. And I'll summarize some of the comments in each of those areas, very quickly.

The story on rates, I think, as many of you know, they've generally declined since 1985 in most of the commodities. But, most recently, since 2001, they have started to tick up. And, in fact, in 2005, there was the largest annual increase in the 20-year period. So, there has been a 9-percent annual increase in rates just between 2004 and 2005. But rates, overall, are still below 1985 levels and the level of inflation.

On the other hand, on the rate issue, as you know, railroads have shifted many costs to shippers, such as car ownership. And there is a category of reporting that is required, called "miscellaneous revenue," and this category has actually increased more than tenfold between 2000 and 2005, from a little over 100 million to 1.7 billion. This has led us to recommend that STB revise its data collection so that there is more accurate and consistent reporting on railroad revenue data.

On the captivity issue, there are real challenges in accurately measuring captivity, and our comprehensive review of all the data and all the trends and all the correlations continue to raise questions whether there are pockets of potentially captive shippers who are paying much higher rates. At the same time, as many of you know, it's pretty clear that captive shippers really do not have an effective relief process in the way the STB has been working. So, while these pockets are there, and the Staggers Act clearly contemplated that there would be some access, there would be some places where competition might not work, that that opportunity should be there for relief, there has been little relief in the 25 years since the Act.

That led us to recommend a rigorous analysis by the STB of the state of competition, not adjudicate, not wait for cases to come in, not on a reactive basis, but take a comprehensive review. And it was our view that they had the authority to do that. We actually had some debate with them, and there were early views that, "Oh, no, that's not within our authority," and we very clearly defended

that recommendation, and we're very pleased that the Board has, in fact, ultimately, agreed. Although they're not doing the study themselves, they've let a contract, and they have a contractor doing this national review of the state of competition.

Our concern was that it really is time to get some comprehensive data, not the kind of sample overview data that we could collect, but to really determine whether these rates represent the real market forces—there is a strained congestion and capacity problem, so that there are some real factors to rate increases—or whether these really represented abuse of market power. So, we're very pleased that that recommendation is being followed.

We also recommended, as I said, some data improvements, and there has been some, but not very complete, response to our recommendation. And, on the concern for relief, there has been some effort, as the Chairman outlined; and many of those, it's really too soon to tell whether those changes will really result in meaningful relief.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Hecker follows:]

PREPARED STATEMENT OF JAYETTA Z. HECKER, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO)

Mr. Chairman and members of the Committee:

We appreciate the opportunity to testify on the freight railroad industry. As you know, over 25 years ago, Congress transformed Federal regulation of the railroad industry. After almost 100 years of economic regulation, the railroad industry was in serious economic trouble in the 1970s, with rising costs, losses, and bankruptcies. In response, Congress passed the Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of 1980. Together, these pieces of legislation substantially deregulated the railroad industry. In particular, the 1980 Act encouraged greater reliance on competition to set rates and gave railroads increased freedom to price their services according to market conditions, including the freedom to use differential pricing—that is, to recover a greater proportion of their costs from rates charged to shippers with a greater dependency on rail transportation. At the same time, the 1980 Act anticipated that some shippers might not have competitive alternatives—commonly referred to as "captive shippers"—and gave the Interstate Commerce Commission (ICC), and later the Surface Transportation Board (STB), the authority to establish a process so that shippers could obtain relief from unreasonably high rates. However, only a rate that produces revenue equal to at least 180 percent of the variable cost of transporting the shipment can be challenged.

Policymakers continue to believe that the Federal Government should provide a viable process to protect shippers against unreasonably high rates, as well as address competition issues, while still balancing the interests of both railroads and shippers. Over the past 10 years, significant consolidation has taken place in the freight railroad industry, while railroads—particularly Class I railroads [1]—have seen their productivity and financial health improve. Railroad officials express concern that any attempt to increase economic regulation will reduce carriers' ability to earn sufficient revenues and limit future infrastructure investment.

Since the passage of the Staggers Rail Act in 1980, we have issued several reports on the freight railroad industry.[2] We issued our most recent report in October 2006 and, at your request and the request of other members of this Subcommittee, issued an updated report in August 2007 to include 2005 data that was not yet available in October 2006. My comments today are based on those recent reports and will focus primarily on the updated information, including (1) recent changes that have occurred in railroad rates and how those changes compare to changes in rail rates

[1] As of 2004, a Class I railroad is any railroad with operating revenue above $277.7 million.

[2] See GAO, *Freight Railroads: Industry Health Has Improved, but Concerns About Competition and Capacity Should Be Addressed,* GAO–07–94 (Washington, D.C.: Oct. 6, 2006) and *Freight Railroads: Updated Information on Rates and Other Industry Trends,* GAO–07–291R (Washington, D.C.: Aug. 15, 2007). In addition, see the list of related GAO products at the end of this report.

since 1985, (2) the extent of captivity in the industry and STB's efforts to protect captive shippers, and (3) STB's actions to address our recent recommendations. We reviewed STB documents in September and October 2007 to update the information in our recent reports and conducted our review in accordance with generally accepted government auditing standards.

In Summary

While railroad rates have generally declined and declined for most shippers since 1985, rates began to increase in 2001. In 2005 rates experienced a 9 percent annual increase over 2004[3]—the largest annual increase in twenty years—and rates increased for all 13 commodities that we reviewed. For example, rates for coal increased by nearly 8 percent while rates for grain increased by 8.5 percent. However, despite these increases, rates for 2005 remain below their 1985 levels and below the rate of inflation over the 1985 through 2005 period. In addition, over 20 years, railroad companies have shifted other costs to shippers, including railcar ownership. Revenues that railroads report as "miscellaneous revenue"—a category that includes some fuel surcharges—increased more than ten-fold from $141 million in 2000 to over $1.7 billion in 2005. We have recommended that STB revise its data collection methods to more accurately collect data on railroad revenue.

It is difficult to precisely determine how many shippers are "captive" because available proxy measures can overstate or understate captivity. However some data indicate that potentially captive traffic appears to have decreased, while at the same time, data also indicates that traffic traveling at rates significantly above the threshold for rate relief has increased. This trend continued in 2005 as tonnage and revenue from traffic traveling at rates above the statutory threshold for rate relief declined, while a subset of this traffic representing traffic traveling at rates substantially above the threshold (greater than 300 percent of the variable cost of transporting the shipment), increased in 2005. This increase followed declines in 2003 and 2004 but continued a general upward trend since 1985. In October 2006, we reported that STB's efforts to protect captive shippers have resulted in little effective relief for those shippers. We also reported that economists and shipper groups have proposed a number of alternatives to address remaining concerns about competition and capacity—however, each of these alternative approaches have costs and benefits and should be carefully considered to ensure the approach will achieve the important balance set out in the Staggers Act of allowing the railroads to earn adequate revenues and invest in its infrastructure while assuring protection for captive shippers from unreasonable rates.

STB has taken some actions to address our past recommendations, but it is too soon to determine the effect of these actions. Our October 2006 report noted that the continued existence of pockets of potentially "captive shippers" raised questions as to whether rail rates in selected markets reflected justified and reasonable pricing practices, or an abuse of market power by the railroads. Based on STB's statutory authority to adjudicate unreasonable rates and to inquire into and report on railroad practices, we recommended that the Board undertake a rigorous analysis of competitive markets to identify the state of competition nationwide and to determine in specific markets whether the inappropriate exercise of market power is occurring and, where appropriate, to consider the range of actions available to address such problems. STB has awarded a contract to conduct this study and we commend STB for taking this action. It will be important that these analysts have the ability that STB has through its statutory authority to inquire into railroad practices as well as sufficient access to information to determine whether rail rates in selected markets reflect justified and reasonable pricing practices or an abuse of market power by the railroads. The Chairman of the STB recently testified that these analysts would have that authority and access. We also recommended that STB ensure that all freight railroads are consistently and accurately reporting all revenues collected from shippers. While STB has revised its rules on establishing and collecting fuel surcharges, these rules did not address how surcharges are reported in the *Carload Waybill Sample* and STB has not yet taken steps to accurately collect data on other miscellaneous revenues. STB has also taken a number of steps to revise its rate relief process. While these appear to be positive steps, it is too soon to tell what effect these changes will have and we have not evaluated the effect of these changes.

[3] We constructed rate indexes to examine trends in rail rates over the 1985 to 2005 period. In our August 2007 report, we reported a 7 percentage point change in the rate index. Using 1.0 as our 1985 base we reported the change 0.8 to 0.87 from 2004–2005. This 7 percentage point change translates into an annual increase of 9 percent. In this testimony we refer to the annual increase and not the percentage change in the rate index.

Background

In the past, the ICC regulated almost all of the rates that railroads charged shippers. The Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of 1980 greatly increased reliance on competition to set rates in the railroad industry. Specifically, these Acts allowed railroads and shippers to enter into confidential contracts that set rates and prohibited ICC from regulating rates where railroads had either effective competition or rates negotiated between the railroad and the shipper. Furthermore, the ICC Termination Act of 1995 abolished ICC and transferred its regulatory functions to STB. Taken together, these Acts anchor the Federal Government's role in the freight rail industry by establishing numerous goals for regulating the industry, including to:

- allow, to the maximum extent possible, competition and demand for services to establish reasonable rates for transportation by rail;
- minimize the need for Federal regulatory control over the rail transportation system and require fair and expeditious regulatory decisions when regulation is required;
- promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by STB;
- ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes to meet the needs of the public and the national defense;
- foster sound economic conditions in transportation and ensure effective competition and coordination between rail carriers and other modes;
- maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues that exceed the amount necessary to maintain the rail system and attract capital;
- prohibit predatory pricing and practices to avoid undue concentrations of market power; and
- provide for the expeditious handling and resolution of all proceedings.

While the Staggers Rail and ICC Termination Acts reduced regulation in the railroad industry, they maintained STB's role as the economic regulator of the industry. The Federal courts have upheld STB's general powers to monitor the rail industry, including its ability to subpoena witnesses and records and to depose witnesses. In addition, STB can revisit its past decisions if it discovers a material error, or new evidence, or if circumstances have substantially changed.

Two important components of the current regulatory structure for the railroad industry are the concepts of revenue adequacy and demand-based differential pricing. Congress established the concept of revenue adequacy as an indicator of the financial health of the industry. STB determines the revenue adequacy of a railroad by comparing the railroad's return on investment with the industry-wide cost of capital. For instance, if a railroad's return on investment is greater than the industry-wide cost of capital, STB determines that railroad to be revenue adequate. Historically, ICC and STB have rarely found railroads to be revenue adequate—a result that many observers relate to characteristics of the industry's cost structure. Railroads incur large fixed costs to build and operate networks that jointly serve many different shippers. Some fixed costs can be attributed to serving particular shippers, and some costs vary with particular movements, but other costs are not attributable to particular shippers or movements. Nonetheless, a railroad must recover these costs if the railroad is to continue to provide service over the long run. To the extent that railroads have not been revenue adequate, they may not have been fully recovering these costs.

The Staggers Rail Act recognized the need for railroads to use demand-based differential pricing to promote a healthy rail industry and enable it to raise sufficient revenues to operate, maintain and, if necessary, expand the system in a deregulated environment. Demand-based differential pricing, in theory, permits a railroad to recover its joint and common costs—those costs that exist no matter how many shipments are transported, such as the cost of maintaining track—across its entire traffic base by setting higher rates for traffic with fewer transportation alternatives than for traffic with more alternatives. Differential pricing recognizes that some customers may use rail if rates are low—and have other options if rail rates are too high or service is poor. Therefore, rail rates on these shipments generally cover the directly attributable (variable) costs, plus a relatively low contribution to fixed costs. In contrast, customers with little or no practical alternative to rail—"captive" shippers—generally pay a much larger portion of fixed costs. Moreover, even though a railroad might incur similar incremental costs while providing service to two dif-

ferent shippers that move similar volumes in similar car types traveling over similar distances, the railroad might charge the shippers different rates. Furthermore, if the railroad is able to offer lower rates to the shipper with more transportation alternatives, that shipper still pays some of the joint and common costs. By paying even a small part of total fixed cost, competitive traffic reduces the share of those costs that captive shippers would have to pay if the competitive traffic switched to truck or some other alternative. Consequently, while the shipper with fewer alternatives makes a greater contribution toward the railroad's joint and common costs, the contribution is less than if the shipper with more alternatives did not ship via rail.

The Staggers Rail Act further requires that the railroads' need to obtain adequate revenues to be balanced with the rights of shippers to be free from, and to seek redress from, unreasonable rates. Railroads incur variable costs—that is, the costs of moving particular shipments—in providing service. The Staggers Rail Act stated that any rate that was found to be below 180 percent of a railroad's variable cost for a particular shipment could not be challenged as unreasonable and authorized ICC, and later STB, to establish a rate relief process for shippers to challenge the reasonableness of a rate. STB may consider the reasonableness of a rate only if it finds that the carrier has market dominance over the traffic at issue—that is, if (1) the railroad's revenue is equal to or above 180 percent of the railroad's variable cost (R/VC); and (2) the railroad does not face effective competition from other rail carriers or other modes of transportation.

Rail Rates Have Increased Recently But Have Generally Declined Since 1985, While Railroads Have Shifted Other Costs to Shippers

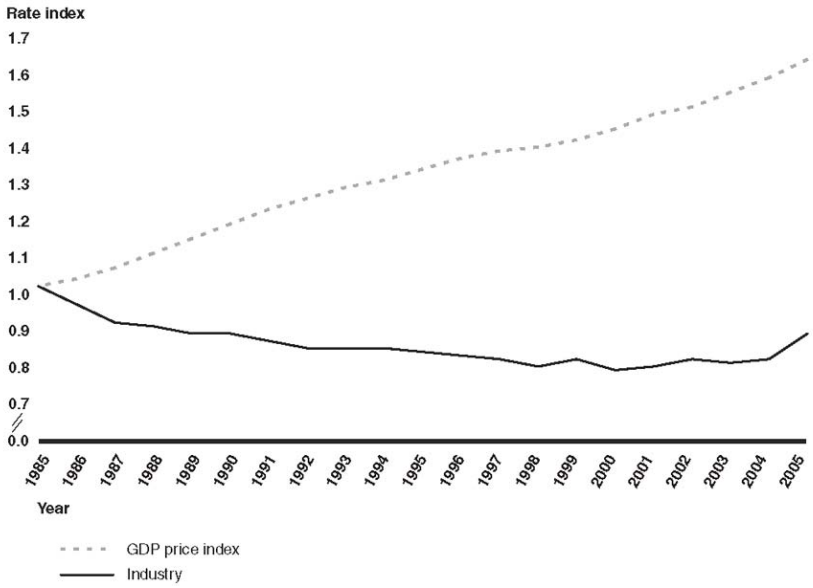
Rail rates have generally declined since 1985, but experienced a 9 percent annual increase between 2004 and 2005—the largest annual increase in 20 years. Although rates have generally declined, railroads have also shifted other costs to shippers, such as the cost of rail car ownership, and have increased the revenue they report as miscellaneous more than 10-fold between 2000 and 2005.

Rail Rates Have Recently Increased But Generally Declined Since 1985

Following a period of general decline since 1985, rates began to increase in 2001. Rates experienced a 9 percent annual increase from 2004–2005, which represents the largest annual increase in rates during the 20-year period from 1985 through 2005. This annual increase also outpaced inflation—about 3 percent in 2005. However, despite these increases, rates for 2005 remain below their 1985 levels and below the rate of inflation for the 1985 through 2005 period, and rates overall have declined since 1985.[4] Because the set of rail rate indexes we used to examine trends in rail rates over time does not account for inflation we also included the price index for the gross domestic product (GDP) in *Figure 1*.

[4] We constructed rate indexes to examine trends in rail rates over the 1985 to 2005 period. These indexes define traffic patterns for a given commodity in terms of census region to census region flows of that commodity, and we calculated the average revenue per ton-mile for each of these traffic flows. The index is calculated as the weighted average of these traffic flows in each year, expressed as a percentage of the value for 1985, where the weights reflect the traffic patterns in 2005. By fixing the weights as of one period of time, we attempted to measure pure price changes rather than calculating the average revenue per ton-mile in each year. Over time, changes in traffic patterns could result in a substitution of lower priced traffic for higher priced traffic, or *vice versa,* so that a decrease in average revenue per ton-mile might partly reflect this change in traffic patterns. The rate index for the overall industry was defined similarly, except that the traffic pattern bundle was defined in terms of broad commodity, census region of origin, and mileage block categories. For comparison, we also present the price index for gross domestic product over this period.

Figure 1: Trends in Industry Rail Rates, 1985-2005

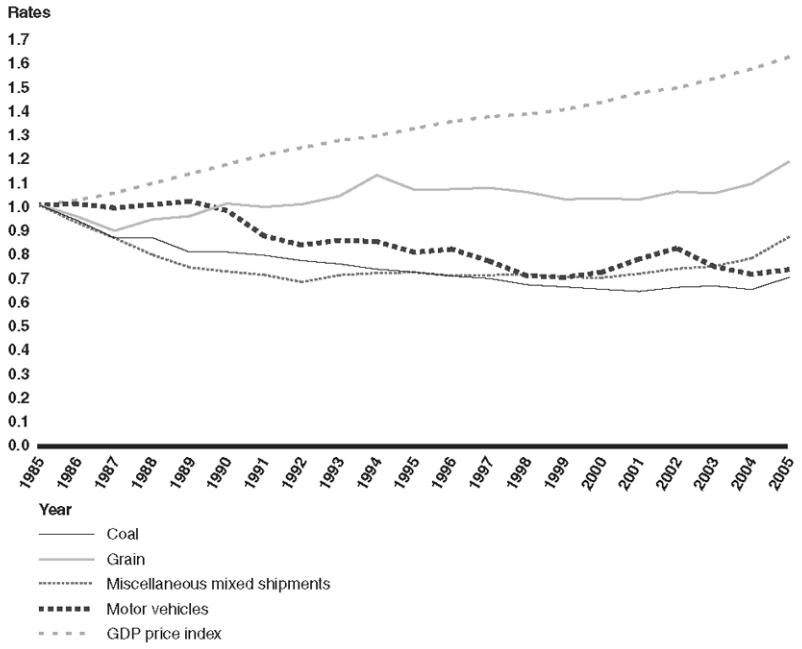


Source: GAO analysis of STB data.

While Generally Declining over the Long Term, Rates for Several Commodities Have Increased in Recent Years

Similar to overall industry trends, rates for individual commodities have increased from 2004–2005. In 2005, rates increased for all 13 commodities that we reviewed. Rates for coal increased by 7.9 percent while rates for grain increased by 8.5 percent. In 2005, the largest rate increase (for fireboard and paperboard) exceeded 11 percent, while the smallest increase (for motor vehicles) was about 2.7 percent. *Figure 2* depicts rate changes for coal, grain, miscellaneous mixed shipments, and motor vehicles from 1985 through 2005.

Figure 2: Rate Changes for Coal, Grain, Miscellaneous Mixed Shipments, and Motor Vehicles, 1985-2005

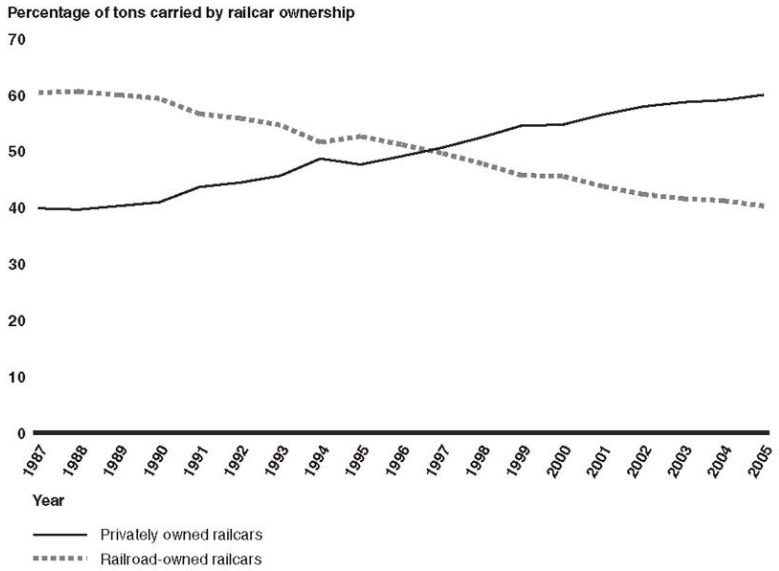


Source: GAO analysis of STB data.

Railroads Have Shifted Costs to Shippers

In 2005, freight railroad companies continued a trend of shifting other costs to shippers. Our analysis shows a 20 percentage point increase shift in railcar ownership (measured in tons carried) since 1987. In 1987, railcars owned by freight railroad companies moved 60 percent of tons carried. In 2005, they moved 40 percent of tons carried, meaning that freight railroad company railcars no longer carry the majority of tonnage (see *Fig. 3*).

Figure 3: Tonnage Carried by Railcar Ownership, 1987-2005



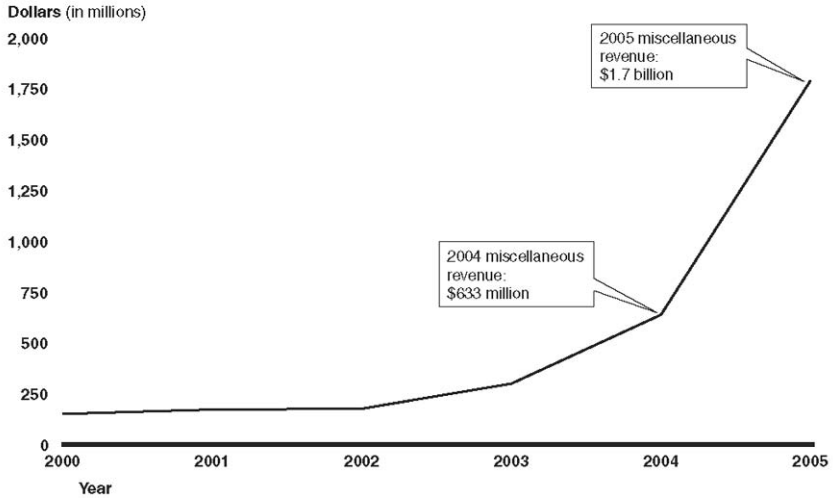
Source: GAO analysis of STB data.

Reported Miscellaneous Revenue, Including Fuel Surcharges, Increased Ten-Fold Since 2000

In 2005 the amount of industry revenue reported as miscellaneous increased ten-fold over 2000 levels, rising from about $141 million to over $1.7 billion (see *Fig. 4*). Miscellaneous revenue is a category in the Carload Waybill Sample for reporting revenue outside the standard rate structure. This miscellaneous revenue can include some fuel surcharges,[5] as well as revenues such as those derived from congestion fees and railcar auctions (in which the highest bidder is guaranteed a number of railcars at a specified date). In 2004, miscellaneous revenue accounted for 1.5 percent of freight railroad revenue reported. In 2005, this percentage had risen to 3.7 percent. Also, in 2005, 20 percent of all tonnage moved in the United States generated miscellaneous revenue.

[5] Fuel surcharges are charges associated with recouping the cost of fuel.

Figure 4: Miscellaneous Revenue Tracked in Carload Waybill Sample, 2000-2005



Source: GAO analysis of STB data.

Captive Shippers Are Difficult To Identify But Concerns Remain and Past STB Actions Have Led to Little Effective Relief

In October 2006 and August 2007, we reported that captive shippers are difficult to identify and STB's efforts to protect captive shippers have resulted in little effective relief for those shippers. We also reported that economists and shipper groups have proposed a number of alternatives to address remaining concerns about competition—however, each of these alternative approaches have costs and benefits and should be carefully considered to ensure the approach will achieve the important balance set out in the Staggers Act.

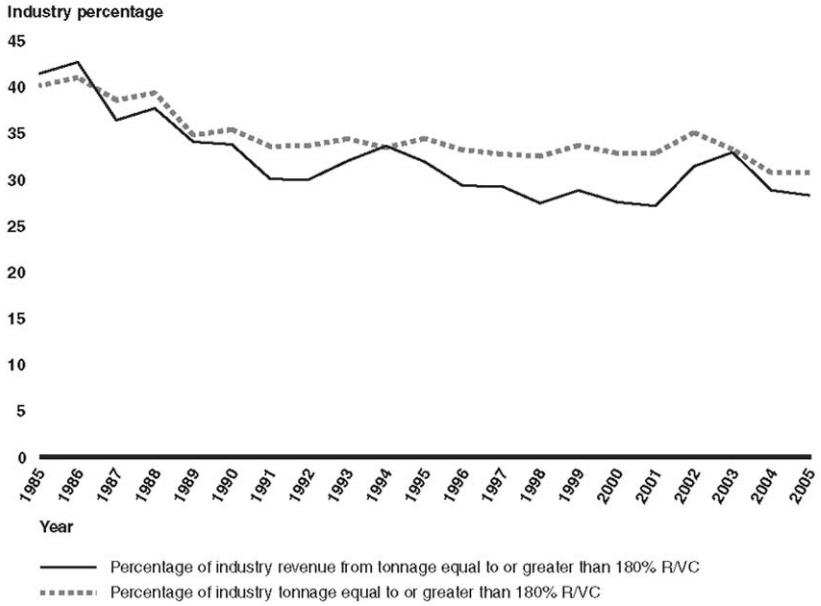
Captive Shippers Remain Difficult To Identify, But Some Measures Indicate Captivity Is Dropping in the Railroad Industry

It remains difficult to determine precisely how many shippers are "captive" to one railroad because the proxy measures that provide the best indication can overstate or understate captivity. One measure of potential captivity—traffic traveling at rates equal to or greater than 180 percent R/VC—is part of the statutory threshold for bringing a rate relief case before STB.[6] STB regards traffic at or above this threshold as "potentially captive," but, like other measures, R/VC levels can understate or overstate captivity.[7] Since 1985, tonnage and revenue from traffic traveling at rates over 180 percent R/VC have generally declined, while traffic traveling at rates substantially over the threshold for rate relief (greater than 300 percent R/VC) has generally increased. This trend continued in 2005, as industry revenue generated by traffic traveling at rates over 180 percent R/VC dropped by roughly half a percent. Tonnage traveling at rates over 180 percent R/VC dropped by a smaller percentage.

[6] Another condition of bringing a rate relief case before STB is a railroad not facing effective competition from other rail carriers or other modes of transportation.

[7] For example, it is possible for the R/VC ratio to increase while the rate paid by a shipper is declining. Assume that in Year 1, a shipper is paying a rate of $20 and the railroad's variable cost is $12; the R/VC ratio—a division of the rate and the variable cost—would be 167 percent. If in Year 2, the variable costs decline by $2 from $12 to $10 and the railroad passes this cost savings directly on to the shipper in the form of a reduced rate, the shipper would pay $18 instead of $20. However, because both revenue and variable cost decline, the R/VC ratio—$18 divided by $10—increases to 180 percent.

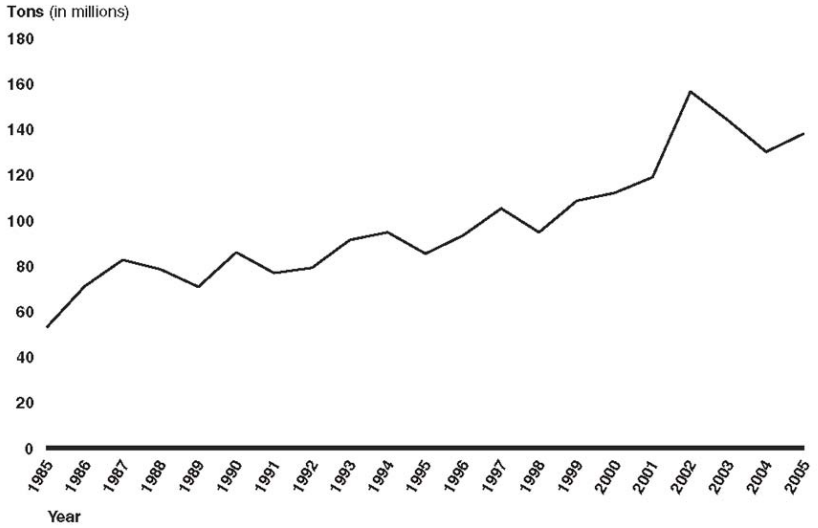
Figure 5: Tonnage and revenue generated from Traffic Traveling at Rates Equal to or Greater Than 180 percent R/VC, 1985-2005



Source: GAO analysis of STB data.

Traffic traveling at rates substantially over the threshold for rate relief has generally increased from 1985 to 2005 (see *Fig. 6*). In 2003 and 2004, the percentage of both tonnage and revenue traveling at rates above 300 percent R/VC declined from the previous year, but each increased again in 2005. For example, the share of tonnage traveling at rates over 300 percent R/VC increased from 6.1 percent in 2004 to 6.4 percent in 2005. *Figure 6* shows tonnage traveling at rates above 300 percent R/VC from 1985 through 2005.

Figure 6: Tonnage Traveling at Rates over 300 Percent R/VC, 1985-2005



Source: GAO analysis of STB data.

Some areas with access to one Class I railroad also have more than half of their traffic traveling at rates that exceed the statutory threshold for rate relief. For example, parts of New Mexico and Idaho with access to one Class I railroad had more than half of all traffic originating in those same areas traveling at rates over 180 percent R/VC. However, we also found instances in which an economic area may have access to two or more Class I railroads and still have more than 75 percent of its traffic traveling at rates over 180 percent R/VC, as well as other instances in which an economic area may have access to one Class I railroad and have less than 25 percent of its traffic traveling at rates over 180 percent R/VC.

STB Has Taken Actions To Protect Captive Shippers But Efforts Have Led to Little Effective Relief

STB has taken a number of actions to provide relief for captive shippers. While the Staggers Rail and ICC Termination Acts encourage competition as the preferred way to protect shippers and to promote the financial health of the railroad industry, they also give STB the authority to:

- *adjudicate rate cases* to resolve disputes between captive shippers and railroads upon receiving a complaint from a shipper;
- *approve rail transactions,* such as mergers, consolidations, acquisitions, and trackage rights;
- *prescribe new regulations,* such as rules for competitive access and merger approvals; and
- *inquire into and report on rail industry practices,* including obtaining information from railroads on its own initiative and holding hearings to inquire into areas of concern, such as competition.

Under its adjudicatory authority, STB has developed standard rate case guidelines, under which captive shippers can challenge a rail rate and appeal to STB for rate relief. Under the standard rate relief process, STB assesses whether the railroad dominates the shipper's transportation market and, if it finds market dominance, proceeds with further assessments to determine whether the actual rate the railroad charges the shipper is reasonable. STB requires that the shipper demonstrate how much an optimally efficient railroad would need to charge the shipper and construct a hypothetical, perfectly efficient railroad that would replace the shipper's current carrier. As part of the rate relief process, both the railroad and the shipper have the opportunity to present their facts and views to STB, as well as to present new evidence.

STB also created alternatives to the standard rate relief process, developing simplified guidelines, as Congress required, for cases in which the standard rate guidelines would be too costly or infeasible given the value of the cases. Under these simplified guidelines, captive shippers who believe that their rate is unreasonable can appeal to STB for rate relief, even if the value of the disputed traffic makes it too costly or infeasible to apply the standard guidelines.

Despite STB's efforts, we reported in 2006 that there was widespread agreement that STB's standard rate relief process was inaccessible to most shippers and did not provide for expeditious handling and resolution of complaints. The process remained expensive, time consuming, and complex. Specifically, shippers we interviewed agreed that the process could cost approximately $3 million per litigant. In addition, shippers said that they do not use the process because it takes so long for STB to reach a decision. Last, shippers stated that the process is both time consuming and difficult because it calls for them to develop a hypothetical competing railroad to show what the rate should be and to demonstrate that the existing rate is unreasonable.

We also reported that the simplified guidelines also had not effectively provided relief for captive shippers. Although these simplified guidelines had been in place since 1997, a rate case had not been decided under the process set out by the guidelines when we issued our report in 2006. STB had held public hearings in April 2003 and July 2004 to examine why shippers have not used the guidelines and to explore ways to improve them. At these hearings, numerous organizations provided comments to STB on measures that could clarify the simplified guidelines, but no action was taken. STB observed that parties urged changes to make the process more workable, but disagreed on what those changes should be. We reported that several shipper organizations told us that shippers were concerned about using the simplified guidelines because they believe the guidelines will be challenged in court, resulting in lengthy litigation. STB officials told us that they—not the shippers—would be responsible for defending the guidelines in court. STB officials also said that if a shipper won a small rate case, STB could order reparations to the shipper before the case was appealed to the courts.

Since our report in October 2006, STB has taken steps to refine the rate relief process. Specifically, in October 2006, STB revised procedures for deciding large rate relief cases. By placing restraints on the evidence and arguments allowed in these cases, STB predicted that the expense and delay in resolving these rate disputes would be reduced substantially. In September 2007, STB altered its simplified guidelines for small shippers to enable shippers who are seeking up to $1 million in rate relief over a 5-year period to receive a STB decision within 8 months of filing a complaint. STB also created a new rate relief process for medium size shipments to allow shippers who are seeking up to $5 million in rate relief over a 5-year period to receive a STB decision within 17 months of filing a complaint. Additionally, STB also stated that all rail rate disputes would require nonbinding mediation.

Shipper Groups and Others Have Suggested Alternative Approaches That Have Costs and Benefits

Shipper groups, economists, and other experts in the rail industry have suggested several alternative approaches as remedies that could provide more competitive options to shippers in areas of inadequate competition or excessive market power. These groups view these approaches as more effective than the rate relief process in promoting a greater reliance on competition to protect shippers against unreasonable rates. Some proposals would require legislative change, or a reopening of past STB decisions.[8]

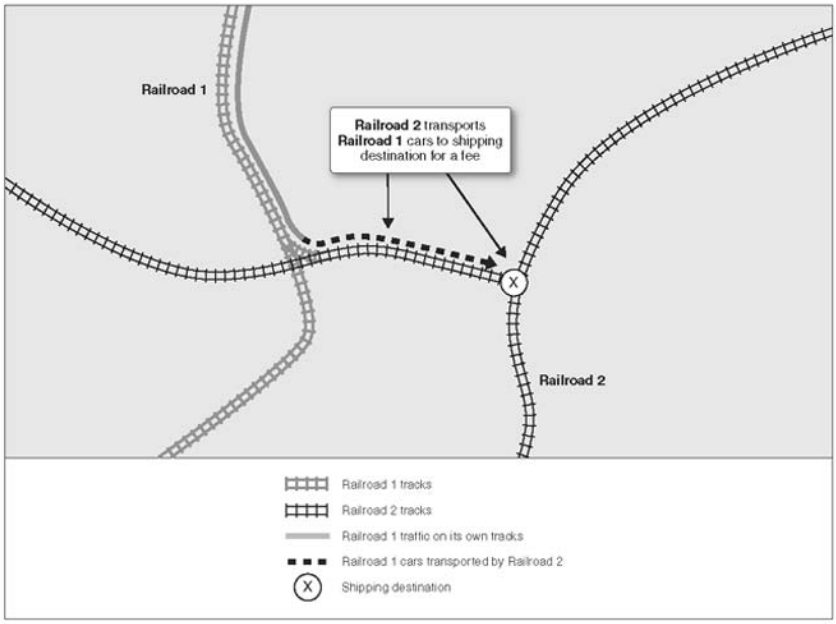
These approaches each have potential costs and benefits. On the one hand, they could expand competitive options, reduce rail rates, and decrease the number of captive shippers as well as reduce the need for both Federal regulation and a rate relief process. On the other hand, reductions in rail rates could affect railroad revenues and limit the railroads' ability and potential willingness to invest in their infrastructure. In addition, some markets may not have the level of demand needed to support competition among railroads. It will be important for policymakers, in evaluating these alternative approaches, to carefully consider the impact of each approach on

[8] Another proposal, articulated by economists Curtis Grimm and Cliff Winston, calls for the elimination of STB. This proposal recognizes that captive shippers have likely been hurt by a lack of competition, but it states that allowing the Department of Justice to review rail mergers instead of STB and ending the potential for reregulation of the industry could lead railroad officials and shippers to negotiate an agreement to address remaining rail competition concerns. Curtis Grimm and Clifford Winston, "Competition in the Deregulated Railroad Industry: Sources, Effects, and Policy Issues," (AEI—Brooking Institution. Washington, D.C.: 2000).

the balance set out in the Staggers Act. The targeted approaches frequently proposed by shipper groups and others include the following:

- *Reciprocal switching:* This approach would allow STB to require railroads serving shippers that are close to another railroad to transport cars of a competing railroad for a fee. The shippers would then have access to railroads that do not reach their facilities. This approach is similar to the mandatory interswitching in Canada, which enables a shipper to request a second railroad's service if that second railroad is within approximately 18 miles. Some Class I railroads already interchange traffic using these agreements, but they oppose being required to do so. Under this approach, STB would oversee the pricing of switching agreements. This approach could also reduce the number of captive shippers by providing a competitive option to shippers with access to a proximate but previously inaccessible railroad and thereby reduce traffic eligible for the rate relief process (see *Fig. 7*).

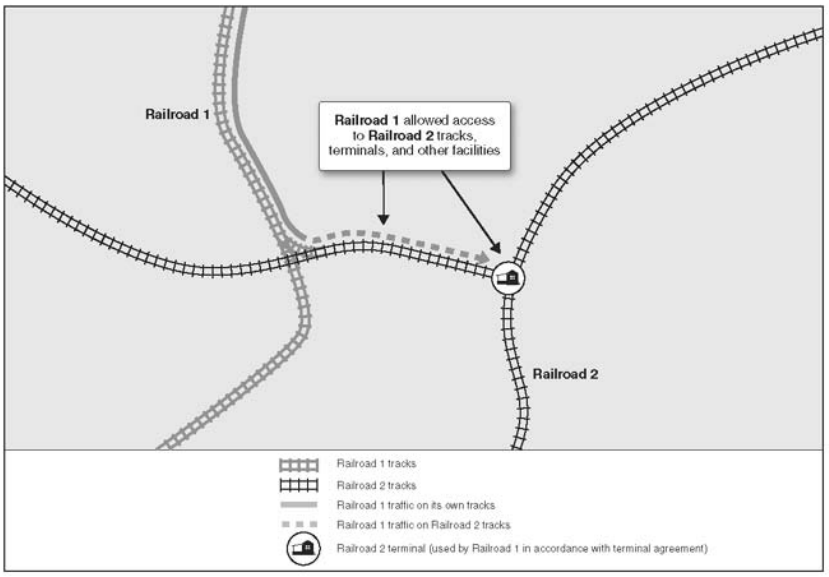
Figure 7: Reciprocal Switching



Source: GAO.

- *Terminal agreements:* This approach would require one railroad to grant access to its terminal facilities or tracks to another railroad, enabling both railroads to interchange traffic or gain access to traffic coming from shippers off the other railroad's lines for a fee. Current regulation requires a shipper to demonstrate anticompetitive conduct by a railroad before STB will grant access to a terminal by a non-owning railroad unless there is an emergency or when a shipper can demonstrate poor service and a second railroad is willing and able to provide the service requested. This approach would require revisiting the current requirement that railroads or shippers demonstrate anticompetitive conduct in making a case to gain access to a railroad terminal in areas where there is inadequate competition. The approach would also make it easier for competing railroads to gain access to the terminal areas of other railroads and could increase competition between railroads. However, it could also reduce revenues to all railroads involved and adversely affect the financial condition of the rail industry. Also, shippers could benefit from increased competition but might see service decline (see *Fig. 8*).

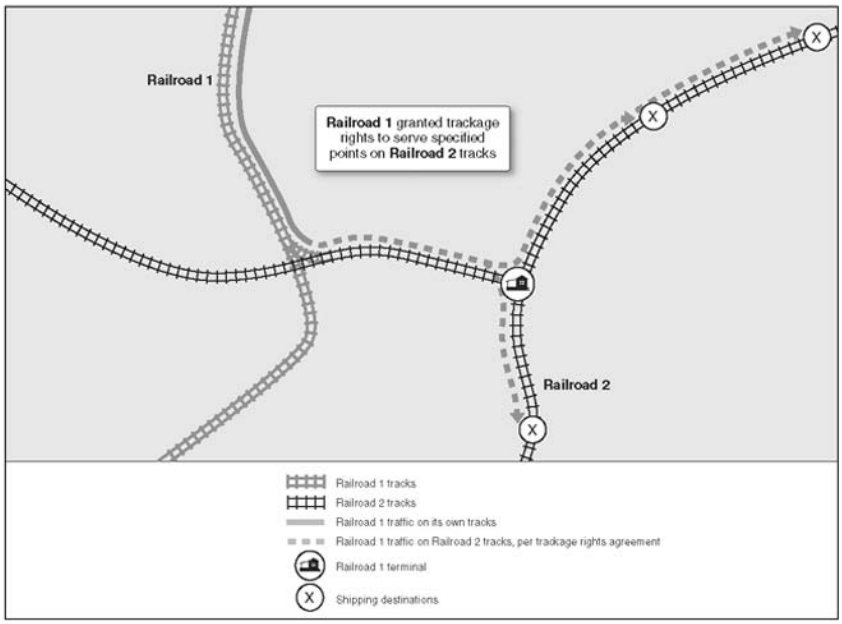
Figure 8: Terminal Agreements



Source: GAO.

- *Trackage rights:* This approach would require one railroad to grant access to its tracks to another railroad, enabling railroads to interchange traffic beyond terminal facilities for a fee. In the past, STB has imposed conditions requiring that a merging railroad must grant another railroad trackage rights to preserve competition when a merger would reduce a shipper's access to railroads from two to one. While this approach could potentially increase rail competition and decrease rail rates, it could also discourage owning railroads from maintaining the track or providing high-quality service, since the value of lost use of track may not be compensated by the user fee and may decrease return on investment (see *Fig. 9*).

Figure 9: Trackage Rights

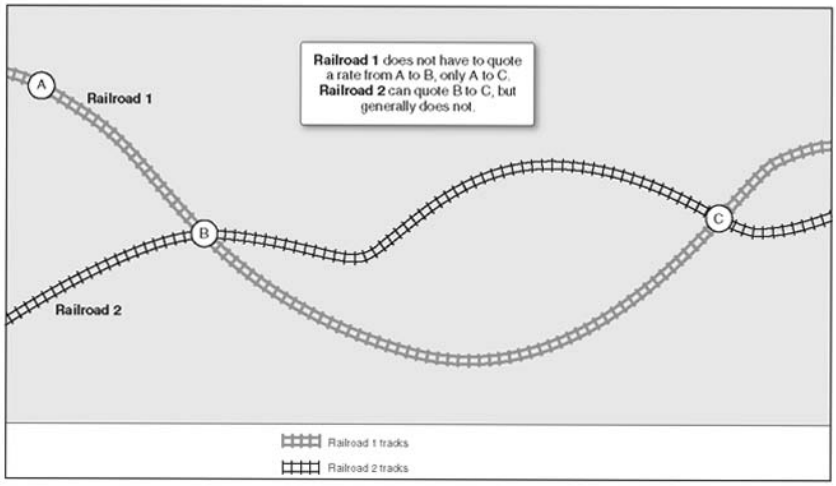


Source: GAO.

- "Bottleneck" rates: This approach would require a railroad to establish a rate, and thereby offer to provide service, for any two points on the railroad's system where traffic originates, terminates, or can be interchanged. Some shippers have more than one railroad that serves them at their origin and/or destination points, but have at least one portion of a rail movement for which no alternative rail route is available. This portion is referred to as the "bottleneck segment." STB's decision that a railroad is not required to quote a rate for the bottleneck segment has been upheld in Federal court.[9] STB's rationale was that statute and case law precluded it from requiring a railroad to provide service on a portion of its route when the railroad serves both the origin and destination points and provides a rate for such movement. STB requires a railroad to provide service for the bottleneck segment only if the shipper had prior arrangements or a contract for the remaining portion of the shipment route. On the one hand, requiring railroads to establish bottleneck rates would force short-distance routes on railroads when they served an entire route and could result in loss of business and potentially subject the bottleneck segment to a rate complaint. On the other hand, this approach would give shippers access to a second railroad, even if a single railroad was the only railroad that served the shipper at its origin and/or destination points, and could potentially reduce rates (see *Fig. 10*).

[9] The U.S. Court of Appeals for the Eighth Circuit affirmed STB decision that a bottleneck carrier generally need not quote a separate rate for the bottleneck portion of the route. *Mid-American Energy Co.* v. *Surface Transportation Board,* 169 F. 3d 1099 (8th Cir.: Feb. 10, 1999). The D.C. Circuit affirmed STB holding that separately challengeable bottleneck rates can be required whenever a shipper has a contract over the nonbottleneck segment of a through movement. *Union Pacific Railroad* v. *Surface Transportation Board,* 202 F. 3d 337 (D.C. Cir.: 2000).

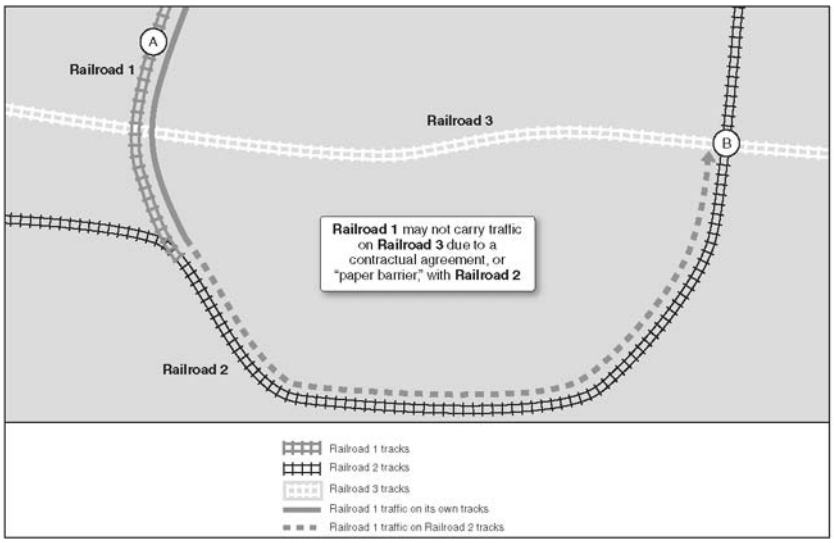
Figure 10: Bottleneck Rates



Source: GAO.

- *Paper barriers:* This approach would prevent or, put a time limit on, paper barriers, which are contractual agreements that can occur when a Class I railroad either sells or leases long term some of its track to other railroads (typically a short-line railroad and/or regional railroad). These agreements stipulate that virtually all traffic that originates on that line must interchange with the Class I railroad that originally leased the tracks or pay a penalty. Since the 1980s, approximately 500 short lines have been created by Class I railroads selling a portion of their lines; however, the extent to which paper barriers are a standard practice is unknown because they are part of confidential contracts. When this type of agreement exists, it can inhibit smaller railroads that connect with or cross two or more Class I rail systems from providing rail customers access to competitive service. Eliminating paper barriers could affect the railroad industry's overall capacity since Class I railroads may abandon lines instead of selling them to smaller railroads and thereby increase the cost of entering a market for a would-be competitor. In addition, an official from a railroad association told us that it is unclear if a Federal agency could invalidate privately negotiated contracts (see *Fig. 11*).

Figure 11: Paper Barriers



Source: GAO.

STB Has Taken Steps To Address Problems, But Actions Are Too Recent To Be Evaluated

STB has taken some actions to address our past recommendations, but it is too soon to determine the effect of these actions. In October 2006 we reported that the continued existence of pockets of potential captivity at a time when the railroads are, for the first time in decades, experiencing increasing economic health, raises the question whether rail rates in selected markets reflect justified and reasonable pricing practices, or an abuse of market power by the railroads. While our analysis provided an important first step, we noted that STB has the statutory authority and access to information to inquire into and report on railroad practices and to conduct a more rigorous analysis of competition in the freight rail industry. As a result, we recommended that the Board undertake a rigorous analysis of competitive markets to identify the state of competition nationwide and to determine in specific markets whether the inappropriate exercise of market power is occurring and, where appropriate, to consider the range of actions available to address such problems.

STB initially disagreed with our recommendation because it believed the findings underlying the recommendation were inconclusive, their on-going efforts would address many of our concerns, and a rigorous analysis would divert resources from other efforts. However, in June 2007, STB stated that it intended to implement our recommendation using funding that was not available at the time of our October report to solicit proposals from analysts with no connection to the freight railroad industry or STB proceedings to conduct a rigorous analysis of competition in the freight railroad industry. On September 13, 2007, STB announced that it had awarded a contract for a comprehensive study on competition, capacity, and regulatory policy issues to be completed by the fall of 2008. We commend STB for taking this action. It will be important that these analysts have the ability that STB has through its statutory authority to inquire into railroad practices as well as sufficient access to information to determine whether rail rates in selected markets reflect justified and reasonable pricing practices, or an abuse of market power by the railroads. The Chairman of the STB has recently testified that these analysts would have that authority and access.

We also recommended that STB review its method of data collection to ensure that all freight railroads are consistently and accurately reporting all revenues collected from shippers, including fuel surcharges and other costs not explicitly captured in all railroad rate structures. In January 2007, STB finalized rules that require railroads to ensure that fuel surcharges are based on factors directly affecting the amount of fuel consumed. In August 2007, STB finalized rules that require rail-

roads to report their fuel costs and revenue from fuel surcharges. While these are positive steps, these rules did not address how surcharges are reported in the *Carload Waybill Sample.* In addition, STB has not taken steps to address collection and reporting of other miscellaneous revenues—revenues deriving from sources other than fuel surcharges.

As stated earlier, STB has also taken steps to refine the rate relief process since our 2006 report. STB has made changes to the rate relief process that it believes will reduce the expense and delay of obtaining rate relief. While these appear to be positive steps that could address longstanding concerns with the rate relief process, it is too soon to determine the effect of these changes to the process, and we have not evaluated the effect of these changes.

Mr. Chairman, this concluded my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

Related GAO Products

Freight Railroads: Updated Information on Rates and Competition Issues. GAO–07–1245T. Washington, D.C.: Sept. 25, 2007.

Freight Railroads: Updated Information on Rates and Other Industry Trends. GAO–07–291R. Washington, D.C.: Aug. 15, 2007.

Freight Railroads: Industry Health Has Improved, but Concerns About Competition and Capacity Should Be Addressed. GAO–07–94. Washington, D.C.: Oct. 6, 2006.

Freight Railroads: Preliminary Observations on Rates, Competition, and Capacity Issues. GAO–06–898T. Washington, D.C.: June 21, 2006.

Freight Transportation: Short Sea Shipping Option Shows Importance of Systematic Approach to Public Investment Decisions. GAO–05–768. Washington, D.C.: July 29, 2005.

Freight Transportation: Strategies Needed to Address Planning and Financing Limitations. GAO–04–165. Washington, D.C.: December 19, 2003.

Railroad Regulation: Changes in Freight Railroad Rates from 1997 through 2000. GAO–02–524. Washington, D.C.: June 7, 2002.

Freight Railroad Regulation: Surface Transportation Board's Oversight Could Benefit from Evidence Better Identifying How Mergers Affect Rates. GAO–01–689. Washington, D.C.: July 5, 2001.

Railroad Regulation: Current Issues Associated with the Rate Relief Process. GAO/RCED–99–46. Washington, D.C.: April 29, 1999.

Railroad Regulation: Changes in Railroad Rates and Service Quality Since 1990. GAO/RCED–99–93. Washington, D.C.: April 6, 1999.

Interstate Commerce Commission: Key Issues Need to Be Addressed in Determining Future of ICC's Regulatory Functions. GAO–T–RCED–94–261 Washington, D.C.: July 12, 1994.

Railroad Competitiveness: Federal Laws and Policies Affect Railroad Competitiveness. GAO/RCED–92–16. Washington, D.C.: November 5, 1991.

Railroad Regulation: Economic and Financial Impacts of the Staggers Rail Act of 1980. GAO/RCED–90–80. Washington, D.C.: May 16, 1990.

Railroad Regulation: Shipper Experiences and Current Issues in ICC Regulation of Rail Rates. GAO/RCED–87–119. Washington, D.C.: September 9, 1987.

Railroad Regulation: Competitive Access and Its Effects on Selected Railroads and Shippers. GAO/RCED–87–109, Washington, D.C.: June 18, 1987.

Railroad Revenues: Analysis of Alternative Methods to Measure Revenue Adequacy. GAO/RCED–87–15BR. Washington, D.C.: October 2, 1986.

Shipper Rail Rates: Interstate Commerce Commission's Handling of Complaints. GAO/RCED–86–54FS. Washington, D.C.: January 30, 1986.

Senator LAUTENBERG. Thank you.

I feel badly, I know that you've worked on these statements that you're making. They all, in full text, will be accepted into the record. So, let me ask your understanding. The rules were changed in the middle of the game, unfortunately. So, whatever you want to summarize as information, please.

And the next witness will be Mr. Moorman.

STATEMENT OF CHARLES W. MOORMAN, CHAIRMAN, PRESIDENT, AND CEO, NORFOLK SOUTHERN CORPORATION; ON BEHALF OF THE ASSOCIATION OF AMERICAN RAILROADS

Mr. MOORMAN. Thank you, Mr. Chairman, members of the committee, for the opportunity to testify.

I'm Wick Moorman. I am the Chief Executive Officer of Norfolk Southern Corporation. I'm here today representing not only Norfolk Southern, but the members of the Association of American Railroads. And I'm very pleased to have a chance to testify about what I consider to be one of the central issues facing our country for the next 20 years or more, and that is, what role will the railroads play in addressing what is clearly a looming transportation crisis that we have in this country? And my message today is a very simple one: How much investment is made in the freight rail system will be largely dependent upon the actions of both the Congress and the Surface Transportation Board.

I'll skip a historical overview, although I lived through the bad days, pre-Staggers. I'll just simply say that you'll recall that, in the 1970s, it was an actively debated issue as to whether or not the rail industry would be nationalized.

Staggers came in, in 1980, and it did two things. The first is, it did facilitate the elimination of excess capacity in the system, and there was an enormous amount of excess capacity. The second was that it provided for differential pricing in our industry. And differential pricing is key to making the economics of the railroad work, and making them viable. It's also important to say that differential pricing is part of almost every industry in this country. It's clearly something that's employed, and it's part of the market system.

Well, by any indication, Staggers has been a huge success, although it took a while coming. There's a chart up here, you can see, about rates. I'll give you some quick numbers. Hundreds of billions have been invested in the rail industry since then, and the rail industry infrastructure is in the best shape it's ever been in. Real rates, adjusted for inflation, are down 50 percent over the same period. Productivity is up 171 percent. And, finally, from the safety perspective—and, I will tell you, we put safety first in everything we do—accident rates are down 80 percent.

Over the past 3 years, our industry has finally moved to the point where we're earning an adequate return, although our returns are still below the norm for American industry. And the good news is, we're making money; the better news is, we're plowing it back into the companies in more and more investment. That should be no surprise, and it's a good-news story from every perspective, be it reducing highway congestion by working with our trucking partners and converting truck traffic to intermodal, hiring new workers in unprecedented numbers, offering much better service to our customers, and offering a much greener alternative, in terms of fuel consumption and reduced CO_2 and other emissions.

In sum, we're ready to play an even larger part in enhancing our Nation's freight transportation infrastructure, and enhancing our Nation's competitiveness.

Let me just briefly say something about what's happening in the regulatory and legislative arena, and that is that the STB, which

the drafters of Staggers recognized as a mechanism for safeguarding against unreasonable rates, is in place, and, as you've heard from Chairman Nottingham, is active. For all of the people you can find who think that the STB has failed the shippers, I would remind you that their other charge was to ensure that the railroads earn a long-term adequate return. And, if you look at our industry, that's not happened, either. And, in fact, if you look at the history of rate cases at the STB, over the last 20 years, they've split, about 50–50, between shippers and the carriers. Nonetheless, the STB is promulgating new regulations that will adversely impact the railroad industry, including the rules at the so-called small shipper. And, in fact, one such small shipper, E.I. DuPont, has filed three rate cases under the new rules.

S. 953, I will just say that we may disagree, but I think that it imposes a regulatory scheme on our railroads, which could be worse than pre-Staggers. It would inevitably erode the profitability of our railroads. It would erode the investment. And it offers the very real possibility of returning us to the dark days of 1970.

Rather, as a public policy, let me urge you to consider S. 1125, the Infrastructure Tax Credit bill sponsored by Senators Lott and Conrad, which, in addition to giving railroads even more incentive to invest in new capacity, gives shippers also that same credit if they want to invest in new capacity or even invest in alternate access to another rail system. It's good public policy. It's good for the country.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Moorman follows:]

PREPARED STATEMENT OF CHARLES W. MOORMAN, CHAIRMAN, PRESIDENT, AND CEO, NORFOLK SOUTHERN CORPORATION; ON BEHALF OF THE ASSOCIATION OF AMERICAN RAILROADS

Chairman Lautenberg, Ranking Member Smith, and Members of the Committee, thank you for the opportunity to testify about the railroad industry. I am Charles W. Moorman, Chief Executive Officer of Norfolk Southern Corporation. I am pleased to represent today the member railroads of the Association of American Railroads ("AAR").

As you know, the AAR is the world's leading railroad policy, research, and technology organization focusing on the safety and productivity of rail carriers. AAR members include the major freight railroads in the United States, Canada and Mexico, as well as Amtrak and several short line holding companies. Based in Washington, D.C., the AAR is committed to keeping the railroads of North America safe, reliable, efficient, clean, technologically advanced, and secure.

Norfolk Southern Corporation is a member of the AAR. Norfolk Southern is one of the Nation's premier transportation companies. Its Norfolk Southern Railway subsidiary operates approximately 21,000 route miles in 22 states, the District of Columbia and Ontario, Canada, serving every major container port in the eastern United States and providing superior connections to western rail carriers. Norfolk Southern operates the most extensive intermodal network in the East.

Although I represent the AAR today, my comments will reflect to some extent the experiences of Norfolk Southern. However, I can assure you that the examples of infrastructure investment, pervasive competition in the transportation marketplace, and real-world examples of economics in practice that I provide would be similar to those experienced by other railroads.

In this testimony, I will briefly outline the importance of the rail industry to the Nation and of the Staggers Act to the rail industry. Next, I will address the vital role railroads play in meeting our Nation's transportation needs. Railroads absolutely must continue to play an ever-increasing role in our economy as demand for freight transportation continues to increase because of our ability to move more freight safely, with less fuel, and in a more environmentally-friendly manner. I then will discuss the substantial investment railroads have made to expand their infra-

structure to handle more freight and how railroads must be able over the long-term to attract the necessary resources and to earn a return on their investment. That of course is a truism for almost any industry which wishes to maintain its infrastructure and to expand to meet the needs of customers, but it is particularly relevant given the extraordinary capital requirements of our industry. I will examine how extensive and pervasive competition is in the transportation marketplace. Finally, I will note that legislative and regulatory actions that create disincentives to railroads investing in infrastructure are bad policy because they risk returning the industry to its pre-1980 state. Even if the results of errant policy were not that dramatic, they would undermine our national goal of having a transportation system in place to meet the growing demand for freight transportation.

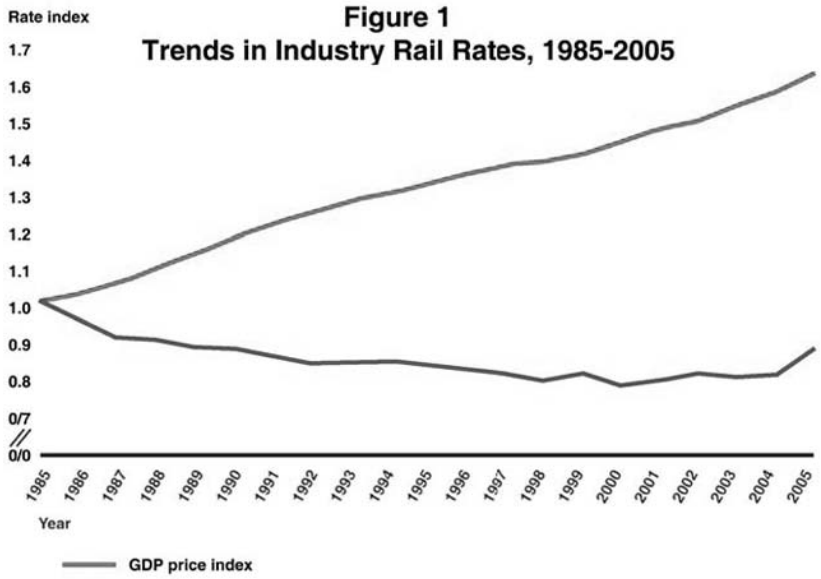
I. The Staggers Act of 1980 Has Been a Resounding Success

The Staggers Act was a historic piece of legislation that gave railroads the tools to become an effective component of the national transportation system. Among its important elements, the Staggers Act:

- Freed railroads and shippers to negotiate terms and rates for shipments and to enter into confidential contracts outside the regulatory regime;
- Provided for a regulatory backstop when railroads and shippers did not enter into a contract to prevent railroads from abusing any market power over the minority of shippers without effective transportation alternatives;
- Expanded the power of the Interstate Commerce Commission, and now the Surface Transportation Board, to exempt traffic from regulation and encouraged the use of that power; and
- Made it easier for railroads to shed unprofitable lines.

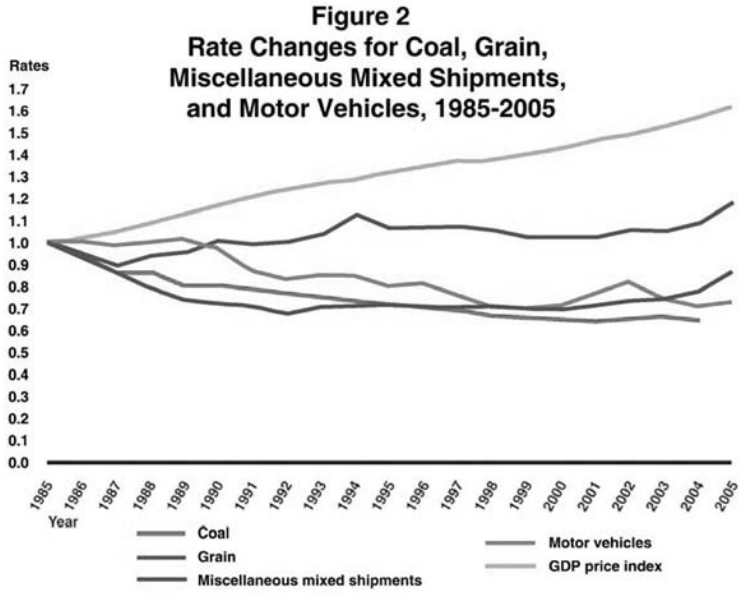
The results of this statute were vital, but took decades to bear fruit and put the industry on a path to greater returns. The successes were aided by population and demand growth, which are underscoring the need for more of the approaches of Staggers, not less. The fact that Staggers injected market influences into the rail industry and lightened the regulatory thumb on the industry has been widely documented. Railroads' productivity improved, and many of those productivity improvements were passed on to shippers. Railroads shed unprofitable lines and invested in infrastructure elsewhere. Railroads became safer.

Consider the following analysis performed by the Government Accountability Office. In Figure 1, GAO looked at rail rates from 1985 to 2005 and compared it to the gross domestic product ("GDP") price index.



Source: GAO analysis of STB data.

Amazingly, rail rates today are about the same as they were 20 years ago, even before accounting for inflation. Moreover, as shown in *Figure 2,* GAO's analysis shows that rail rates for nearly all commodities are as low as they were in 1985, and rail rates for all commodities have increased substantially slower than the gross domestic product ("GDP") price index.



Source: GAO analysis of STB data.

The results would be even more dramatic had GAO taken inflation into account in its analysis.

Here are my essential points today:

1. The U.S. desperately needs more transportation resources, including more railroad resources.

2. The railroads are the only transportation resource that pays its own way, and the costs are exceptionally high.

3. To keep paying our way and building to meet the Nation's growing needs, we have to be able to earn fair returns on that substantial investment.

4. Re-regulation will hurt returns, prevent much new investment, and ultimately hurt service and employment.

5. Recent STB decisions have the potential for significant negative effects on railroad revenues by giving shippers more expeditious ways of reducing our rates, and in the STB's cost-of-capital decision, reducing the costs reflected in rate computations. Indeed, the long-term effects of the latter decision may be quite serious for the industry and for the American transportation system.

6. We are proud to be the safest, most fuel efficient, and environmentally friendly ground transportation by far.

7. We want to help take the load off the highways, reduce U.S. fuel demand, and remain one of the true advantages of U.S. manufacturers.

II. Railroads Play a Large Role in the Economy and Are Vital in This Time of Growing Freight Demand

A. Railroads Are a Competitive Advantage for the United States

Railroads play a critical role in our economy, and their importance is growing. Today's freight railroads are among the few genuine advantages that U.S.-based manufacturers have compared to overseas manufacturers. The commodities the railroads transport are essential to the economy. For example, railroads transport:

- More than 70 percent of coal used for electric power;

- 35 percent of the grain harvest;
- 70 percent of automobiles made in America; and
- 21 percent of chemicals.

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

B. Freight Demand Is Growing, But the Ability for Highways to Grow Is Limited

The demand for freight transportation is growing and will continue to grow. The Department of Transportation has estimated that the demand for freight transportation would increase by 55 percent between 1998 and 2020.[1] More recently, DOT projected that total freight transportation demand would rise 92 percent from 2002 to 2035, including an 88 percent increase for railroads.[2] Similarly, the American Association of State Highway and Transportation Officials projected that freight tonnage will grow by almost 57 percent between 2000 and 2020. Whether 88 percent, 55 percent, 57 percent, or some other percent is the exact right estimate is not what is important. What is important is that demand has been growing and is expected to continue to grow substantially. According to some of the materials circulated by Consumers United for Rail Equity ("CURE"), "We're in a perpetual rush hour for freight. It's a lot like hitting interstates in Chicago at 5:00 p.m., every day of the week."[3]

Railroads will be critical to meet this growing demand for freight transportation. Railroads will have to play a large role because highways will be unable to absorb that kind of growth in demand for freight transportation. There is a maintenance backlog across the highway system as recently illustrated by the tragic collapse of the highway bridge in Minnesota. The American Society of Civil Engineers ("ASCE") estimates that the annual need for bridges, roads, and transit is $94 billion, but that we spend less than $60 billion.[4] Still the highway trust fund balances continue to decline. In addition, highways are already choked in many parts of the country, which according to ASCE costs drivers $63.1 billion a year.[5] Given the issues the highway trust fund faces, the limited amount of the Federal budget that is available to cover all discretionary spending, of which transportation is only a small part, and the maintenance needs of our highways and bridges, highway capacity is not likely to expand to any significant degree in the future.

C. Railroads Will Have To Be Part of the Long-Term Solution to the Nation's Transportation Needs

In short, efficient and effective rail transportation is not just a necessity today. It will continue to be vital to the health of the U.S. economy for years to come. To play that role, railroads must plan and invest years before traffic growth may materialize because of the delays involved in building rail capacity. Of course, to justify that investment, railroads must be able to look out into a predictable future and determine that their investment will be permitted to generate sufficient returns for their owners.

The need for railroads to expand is not just some railroad talking point. It is the real world—not because railroads say so and not because DOT, AASHTO, and other experts forecast large growth in freight demand—because rail customers say so. Recently, a coalition of coal shippers filed comments with the Surface Transportation Board in which they made the case for rail capacity as follows:

> "It is critical, of course, that the railroads maintain adequate capacity and infrastructure to transport coal to utility power plants. As explained above, coal shippers are dependent upon rail carriers to provide needed coal transportation service, and disruptions in this service due to inadequate capacity can impose substantial damages upon electric generating utilities and their customers."[6]

The point is that rail capacity is essential. That coal shipper association wants capacity to handle present "coal traffic volumes" and wants railroads to "stay ahead

---

[1] U.S. DOT, Federal Highway Administration, *Freight Analysis Framework,* October 2002.
[2] Federal Highway Administration, *Freight Facts and Figures 2006,* Table 2.1.
[3] Quoting Marcia Zarley Taylor, *Rush Hour on the Rails,* (Sept. 7, 2006).
[4] *http://www.asce.org/reportcard/2005/actionplan07.cfm.*
[5] *Id.*
[6] Ex Parte 671, *Rail Infrastructure and Capacity Requirements,* Comments of Concerned Captive Coal Shippers, at 11 (April 4, 2007).

of growing coal traffic demands in the future."[7] Shippers of all types are asking for more capacity, but that kind of investment can only be justified if adequate returns on the investment are possible.

The need for additional capacity was recently highlighted in a study by Cambridge Systematics. In September of this year, Cambridge Systematics presented the NATIONAL RAIL FREIGHT INFRASTRUCTURE CAPACITY and INVESTMENT STUDY. The study is one of many requested by the National Surface Transportation Policy and Revenue Study Commission, established by Congress in 2005. This study seeks for the first time to qualify the need for freight rail infrastructure investments. I would like to highlight some of their findings. "This study indicates that an investment of $148 billion (in 2007 dollars) for infrastructure expansion over the next 28 years is required to keep pace with economic growth and meet the U.S. DOT's forecast demand. Of this amount, the Class I freight railroads' share is projected to be $135 billion and the short line and regional freight railroads' share is projected to be $13 billion. Without this investment, 30 percent of the rail miles in the primary corridors will be operating above capacity by 2035, causing severe congestion that will affect every region of the country and potentially shift freight to an already heavily congested highway system.

The projected rate of growth over the next 30 years is not extraordinary, but it comes after two decades of growth in rail freight tonnage that has absorbed much of the excess capacity in the existing rail freight system. Most of the moderate-cost capacity expansions have already been made; future capacity expansions will be purchased at a higher cost because they will require expensive new bridges and tunnels and more track and larger terminals in developed areas.

The Class I railroads anticipate that they will be able to generate approximately $96 billion of their $135 billion share through increased earnings from revenue growth, higher volumes, and productivity improvements, while continuing to renew existing infrastructure and equipment. This would leave a balance for the Class I freight railroads of $39 billion or about $1.4 billion per year to be funded from railroad investment tax incentives, public-private partnerships, or other sources.

These investment projections assume that the market will support rail freight prices sufficient to sustain long-term capital investments. If regulatory changes or unfunded legislative mandates reduce railroad earnings and productivity, investment and capacity expansion will be slower and the freight railroads will be less able to meet the U.S. DOT's forecast demand."[8]

III. The Ability of Railroads to Play a Larger Transportation Role Depends on the Availability of Sufficient Resources for a Sustained Period

Let me start by pointing out that railroads spend dramatically more than other industries for capital expenses. The average amount of every incoming dollar that goes to capital spending on the railroad is five times more than the average U.S. manufacturing company—five times.

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

U.S. freight railroads have been devoting enormous resources to maintain their existing infrastructure, to improve their operations and infrastructure and to alleviate the capacity constraints that arise from increasing freight demand. Indeed, from 1996 to 2005, the average U.S. manufacturer spent 3.4 percent of revenue on capital spending. The comparable figure for freight railroads was 17.2 percent, or more than five times higher.

Likewise, Norfolk Southern makes large capital expenditures every year to maintain and expand its infrastructure. Between 2000 and 2006, our capital expenditures have totaled more than $6.3 billion, while our net income over the same period was only $5.2 billion. Over the same period, our expenses for track maintenance were approximately $2.8 billion. In 2007, Norfolk Southern capital expenditures will be approximately $1.4 billion, which is almost equal to its total net income from 2006.[9]

The expenditures we make are necessary to maintain and to expand our physical plant and locomotive and car fleet so that we can serve our customers better, handle larger volumes of freight safely, and respond to our customers' changing shipping

[7] Ex Parte 671, *Rail Infrastructure and Capacity Requirements,* Comments of Concerned Captive Coal Shippers, at 23 (April 4, 2007).

[8] "National Rail Freight Infrastructure Capacity and Investment Study".

[9] Net income for 2006 was $1.48 billion.

patterns. At the same time, capacity expansion projects must generate returns sufficient to justify the investment.

The facts demonstrate that railroads continue to invest to expand their capacity. Consider some of Norfolk Southern's investments in just the last 2 years.

In 2006, Norfolk Southern among other things:

- Closed a deal to create a joint venture with the Kansas City Southern Railway, which will result in $300 million of investment mostly to upgrade the rail line between Meridian, Mississippi and Shreveport, Louisiana, so that the line can move more freight more quickly across the line. Already, 45 miles of formerly non-signaled territory have been converted to centralized train control, 100 miles of crosstie replacement has been completed, 150 miles of ballast and surfacing work has been done, and 45 miles of rail has been replaced with new rail in three locations.
- Opened a new rail line to the coal-powered Keystone Generating Station in Shelocta, Pennsylvania. The $44 million public-private partnership trims 51 miles off the trip from Saltsburg, Pennsylvania to Shelocta and increases the capacity of the plant.
- Began work on the $62 million Rickenbacker Intermodal Terminal in Columbus, Ohio, which will increase freight capacity in that region by more than 40 percent.
- Added infrastructure in the following corridors: Memphis, Tenn. to Chattanooga, Tenn.; Chattanooga, Tenn. to Atlanta, Ga.; Atlanta, Ga. to Jacksonville, Fla.; Charlotte, N.C. to Manassas, Va.; West Virginia Secondary; Columbus, Ohio to Cincinnati, Ohio; Goldsboro, N.C. to Morehead City, N.C.; St. Louis, Mo. to Louisville, Ky.; and our route to Albany, N.Y. and New England.
- Acquired 142 additional locomotives.

Norfolk Southern's announced 2007 capital budget includes, among other things:

- Beginning work on its Heartland Corridor project. This ambitious public-private partnership will improve 30 tunnels in four states so that they are able to handle double-stacked intermodal trains. It includes the development of a new Norfolk Southern-owned intermodal facility in Columbus, Ohio, which when fully developed will have the capacity to handle 400,000 lifts per year. When completed, Norfolk Southern will shorten the time it takes for containers to travel from port to plains by over 20 percent and the distance they travel by more than 20 percent.
- Investing in capacity by making capital roadway improvements. Norfolk Southern plans to spend $610 million for rail, crosstie, ballast and bridge programs, including $73 million in infrastructure investments for increased capacity. In addition, Norfolk Southern plans to spend $47 million for communications, signal, and electrical projects; $41 million for maintenance of way equipment; and $16 million for environmental projects and public improvements such as grade crossing separations and crossing signal upgrades.
- Making capital investments in intermodal terminals and equipment to add capacity to the Norfolk Southern intermodal network, increase access and capacity for coal traffic, bulk transfer facilities, and vehicle production and distribution facilities—all at a cost of about $97 million.
- Spending about $60 million for capital projects related to computers, systems and information technology, which will enhance safety and improve operating efficiency and equipment utilization.
- Investing approximately $321 million in capital on equipment to:
  - Purchase 53 six-axle locomotives and upgrade existing locomotives (Subsequent to the announced 2007 capital budget, Norfolk Southern also made a commitment to acquire an additional 50 locomotives, 20 of which are expected to be delivered in the fourth quarter of 2007.).
  - Purchase 1,300 new higher-capacity coal cars as part of a multiyear program to replace the existing coal car fleet.
- Purchase 739 freight cars as their leases expire; certify and rebuild 388 multilevel automobile racks; and add supplemental restraints to multilevel racks.
- Renewing expiring equipment operating leases covering more than 2,800 cars.
- Leasing 200 additional construction debris cars.
- Repairing freight cars at a cost of $56 million. Our repair plan for 2007 reflects a 17 percent increase in repairs over the number of cars repaired in 2006. Nor-

folk Southern has announced a new car repair facility in Portsmouth, Ohio that will open next year.

In addition, Norfolk Southern is hiring and training 1,300 train and engine employees. Other railroads could—no doubt—provide a similarly extensive list.

Railroads try to balance their customers' competing needs and invest to maximize their network. If we had only intermodal customers, our investments would be different than if we had only coal customers or only chemical customers. In fact, Norfolk Southern serves thousands of customers with different transportation needs for their thousands of different commodities. The investments we make represent our best judgment as to how to strike the right balance, consistent with the requirement that we obtain adequate returns on our capital and serve our varied customers.

In the current and expected growth environment, it is especially important that railroads have the resources and the ability to improve their infrastructure now to meet future needs for three reasons. First, capacity is not limitless. Second, capacity is expensive. Third, it takes time to build rail infrastructure and capacity.[10] Given the time it takes to add infrastructure and the long lives of the assets required to expand capacity, it is essential for railroads to take a long view on infrastructure investments, which is how we manage our business at Norfolk Southern.

Today, railroads are investing in capacity to address the growing demand for freight transportation and have incentive to do so. Uncertainty across the regulatory and legislative landscape is making it challenging to determine whether railroads should continue to invest at current levels. If the government creates disincentives for railroad investment, then the question is who will pay for the transportation capacity the Nation will need in the future.

IV. Competition in the Transportation Marketplace Is Greater than Ever

Some shipper groups have called for legislation to re-regulate the railroads. These calls are based on a desire to artificially lower rates, not on competition. Today there is more competition in the transportation marketplace than ever, and re-regulation would hobble railroads and ultimately customers.

First, railroads face competition from other modes of transportation. Motor carriers are the railroads' largest competitor. Railroads also compete vigorously against other modes, including barges and pipelines. Motor carriers are the railroads' competition for intermodal traffic. When the railroad gains that business, trucks are removed from the highway system and less fuel is consumed. But trucks compete with railroads to transport many commodities and have the vast majority of intercity freight. While railroads have approximately 40 percent of the intercity freight ton-miles, railroads have only 10 percent of the intercity freight revenues. There are a number of examples where railroads compete against trucks; for example in 2001 Norfolk Southern constructed a new Intermodal terminal for serving the Cleveland area. In 2000, our volume in the Chicago-Cleveland lane was 10,500 units. In 2006, we handled 75,961 units—an increase of 621 percent. The response in 2001 to our new facility and train services in the lane was immediate and significant, with our monthly volumes tripling once the facility opened. Prior to this, much of this volume had been trucked to/from Chicago. Also in 2001, Norfolk Southern began serving the Georgia Port Authority's new Mason ICTF facility in Savannah, which allowed for direct ship to train transfer of containers, combined with direct line haul service to Atlanta and points beyond, and thus avoiding the delays associated with using the local port belt railroad to access the pier or a dray to our off pier terminal. Being only 250 miles to Atlanta, truck was the predominant mode in this lane. At the same time, as the new terminal opened, Norfolk Southern added additional dedicated intermodal trains in the lane, allowing us to strongly compete with trucks in terms of transit time. As truck capacity in the Savannah area continues to tighten

[10] For example, it took years for the industry to reach agreement on a plan to address rail congestion in Chicago. After several years of effort on this historic public-private partnership, the rail industry, local officials, and state leaders were able to join together to seek Congressional funding for the public benefits that would flow from the project. Even today, the project is not fully-funded, and it is unclear how long it will take to make it a reality—even though it is clearly needed. Moreover, even when it is approved and fully funded, the design, permitting, engineering, environmental review, and construction of a major project can take years. As another example, from the time Norfolk Southern started the environmental permitting process to build a new intermodal yard in Atlanta to the time it opened its $110 million facility in Austell, Georgia was about 5 years. Just how many years it takes to make a project a reality depends on the time required to secure the necessary permits, local opposition, resources and money available, and the railroad's ability to complete the work in a way that least impacts its ability to serve its customers whose traffic moves on those lines. However, while delivering highway and environmental relief, railroad expansion still seems to require far less time and money than highway expansion.

and container volumes moving through the port continue to increase, more and more traffic is being diverted off the highways and on to Norfolk Southern. Since 2000, volume has grown 528 percent in this lane. It continues to grow in 2007, despite the overall slow down in the industry. We have been able to handle this traffic because rail provides a better value. But, the bottom line is that trucks are a real constraint in the marketplace.

Barges are also a key competitor. Recently, Norfolk Southern was able to win some business from barges; however, our customers can go back and forth. Alabama Electric Cooperative, which had received coal by barge, recently awarded Norfolk Southern a coal transportation contract. In another example, we were able to move to rail chemical business that Rohm and Hass had transported by barge. Again, barges are also real and threatening competitors.

Additionally, many large railroad customers are large companies, a number with resources far in excess of the railroads. These companies know how to maximize their leverage. Most large companies have multiple rail-served facilities with some of the facilities served by one railroad, some facilities served by another railroad and some facilities served by two railroads. The customer uses its traffic at the dually-served facilities to negotiate a better rate/service package on traffic at the single-served facilities. That is one source of leverage. Another source is product competition. For example, assume we are the sole serving carrier at a chemical plant that ships to numerous receivers. When the receiver can use another product in lieu of the one produced at our solely-served facility, if our rate is too high, we will lose the business. The STB won't allow us even to mention product competition in a rate case, but our customers "mention" it often to us. It is real. Another major source of competition is geographic competition. For example, while Norfolk Southern has chemical and coal plants that are served only by us, our customers often have similar facilities served by another railroad. If our rate is too high, our customer will increase production at the facility served by another railroad and we lose business. Utilities have yet another source of competition that could be viewed as a combination of product and geographic competition. Instead of producing electricity at its coal-fired, solely-served facility, it has the option of producing electricity at one of its other facilities that do not use coal or purchasing electricity produced elsewhere by other utilities. In short, even where there is only one railroad serving a facility, there are market factors at play. These competitive constraints are real.

Look at the most recent GAO report. Rail rates in 2005 were at about the same level they were 20 years earlier—and that does not take inflation into account! If rail rates are increasing due to increased demand, that is what is supposed to happen. There is clearly no *structural* problem. If railroads had unchecked monopoly power, the numbers in the GAO report would never have occurred.

Third, competition even among railroads has increased since 1980. Shippers who have access to one railroad today have rarely been served by more than one railroad. Policymakers should understand that Staggers did not degrade historic options. If they ask any shipper who complains of having only one railroad serving its facility: "when in history did your facility get served by more than one railroad," they are likely to hear "never" in the overwhelming majority of cases.

Moreover, the Interstate Commerce Commission and the Board's merger policies have protected shippers that had access to multiple rail carriers prior to the merger and generally ensured that such shippers had access to multiple carriers after the merger.

Other areas have been opened to multiple carrier access when single carrier access was all that previously existed, such as the Bayport Loop in Houston, Texas, as a result of the Board's policies to promote build-ins where the economic sense of such a build-in is shown by private entities putting up the money. In the Union Pacific/Southern Pacific merger, the STB created over 4,000 miles of new trackage rights and gave competitive access to every new shipper that locates on them.

Additionally, mergers have expanded single-line service, which means dramatically more shippers benefit from the inherent efficiencies that resulted from being able to ship from origin to destination on one railroad rather than having to use many railroads to get from origin to destination.[11] For example, Norfolk and Western was a coal railroad, while Southern Railway was a more diverse railroad. Given their individual geographic reaches, however, neither could have developed what has become the Norfolk Southern intermodal system. Neither Norfolk and Western

[11] What mergers removed was the need in many instances for a customer's shipment to be moved by multiple carriers—and the inefficiencies associated with the interchanges that were needed between railroads. That is dramatically different from an assertion that mergers have lessened competition for customers who have never had their origin or destination served by more than one carrier.

nor Southern Railway reached New York. Norfolk and Western reached Chicago but not Atlanta. Southern Railway reached Atlanta but not Chicago—so neither had the size, scope and density to develop an effective and competitive intermodal network. Absent the mergers, there would still be more railroads, but with fewer resources and access to fewer markets, which would not be better for rail customers.

Some shippers claim that the government should mandate access, so that customers who have never been served by more than one railroad can receive service from multiple railroads. They argue that government access—such as mandated switching, trackage rights, terminal access, and interline rates—is competition. Actually, it is not. Railroads require expensive infrastructure to serve a facility. There have been build-ins by railroads and build-outs by shippers at facilities that can generate enough rail traffic to justify service by two or more railroads (again, resulting in an increase in competition since 1980), but most shipper facilities simply do not generate that level of traffic. In other words, there is not enough money to support two railroads at most shipper facilities, which is why relatively few facilities have ever had service by more than one railroad. True market competition does not keep two competitors in a market—or force more competitors into a market—that will support only one. These shippers really want the government to force one railroad to subsidize another railroad by providing below market access to its lines, which would remove any incentive for the owning railroad to invest in such infrastructure.

V. Policymakers Should Reject Legislation and Regulation That Will Create Disincentives for Railroads To Invest in the Infrastructure Needed To Meet the Growing Demand for Freight Transportation

Any legislation or regulatory action that would result in railroads being unable to invest would be bad transportation policy at any time. But legislation or regulatory action that would result in railroads being unable to invest would be particularly bad at this time, when the Nation needs railroads to expand.

We know it is bad policy because of history. The Staggers Act was adopted because the U.S. railroads were breaking. Re-regulation of the railroad industry will result in the catastrophe the industry saw before the adoption of the Staggers Rail Act of 1980, which was marked by rail bankruptcies, decrepit infrastructure that resulted from years of inability to invest in maintenance, and government bailouts. But it will be much worse now because the entire transportation infrastructure is strained in a way it was not then.

Before the Staggers Act, regulation of the rail industry was expansive. The U.S. House of Representatives said: "Regulatory constraints . . . impinged upon management's ability to adjust rates, merge corporate entities, abandon facilities and services, and improve productivity." [12] Rate regulation was pervasive and regulation restricted price competition.[13] "Railroading has fallen on difficult times." That was how the Department of Transportation summed up the situation in 1978.[14]

The detrimental effects of this excessive regulation are well known, as are the successes of the Staggers Act. In the same 1978 report, the Department found that railroads were unable to attract capital from private sources and unable to maintain their physical plants.[15] Indeed, the Interstate Commerce Commission tracked standing derailments, which were railcars that were not moving but that simply fell off the tracks because the tracks were in such poor shape.

Railroads throughout the Northeast failed. The result of that expansive and invasive regulatory regime was bankrupt railroads, including the largest bankruptcy in America to that time—the bankruptcy of the Penn Central. The government had to step in and create what came to be known as Consolidated Rail Corporation or Conrail. Only the Staggers Act stopped the decline of the industry, which took many years to reverse. We need to be clear that the Staggers success was hardly an overnight sensation. It has literally taken decades for the railroads to reach a level of returns that allows new investment to serve the Nation's needs.

---

[12] H.R. Rep. No. 96–1035 at 85 (1980).

[13] *Id.* at 88.

[14] Dept. of Transp., *A Prospectus for Change in the Freight Railroad Industry,* at 2 (Oct. 1978)("Prospectus").

[15] "Even the healthiest industry does not rely solely upon internally generated cash to finance current capital expenditures—virtually all industries obtain additional funds through the sale of equity or debt. With some exceptions, however, railroad earnings are too low to attract new equity or debt other than for equipment purchases or rollover of old debt. . . . As a result, the availability of private capital for future investments may be curtailed, because investors believe that returns generated with the investment of additional capital will not equal returns from alternative investments with similar risks." Prospectus at 69.

Already, recent efforts by the Surface Transportation Board, which at a minimum are injecting uncertainty into the industry and at worst could substantially impact our ability to earn our cost of capital, are causing us to look hard at our willingness to invest in the future. In the last month, the Board has issued erroneous calculations of our industry cost-of-capital, which is based on historic costs of assets with long-lives rather than on the cost of actually replacing the assets, and expanded options for shippers to gain rate relief, which options could result in a downward rate spiral and rate compression.

Are we returning to a legal regime that restricts the railroad industry's ability to invest in infrastructure? Are we on the path to having the industry look like it did before 1980? I am very concerned that we are headed down that path. The results may not be that dramatic right away. But any policy that deters private investment in transportation capacity moves us further from the national goal of building a transportation system sufficient to handle the growing demand for freight transportation.

Legislative and regulatory threats to rail capacity will create substantial disincentives for railroads to invest. If railroads are unable to invest in their own capacity, who will make up the difference? Or, will freight just stack up around the country because there is not enough capacity to move it? Such threats would directly reduce existing capacity, which would adversely affect all rail customers. If enacted, such legislation would adversely affect railroads' ability to justify many investments in infrastructure that will be needed to handle tomorrow's freight. Policymakers must recognize that if such threats become reality, capacity will be reduced and replacing the lost capacity will take significant time and money.

Instead, policymakers should focus on ways to make it easier for private companies to invest in infrastructure, which is why I encourage you all to support legislation to provide tax credits to railroads that invest in capacity.

VI. Conclusion

A railroad's ability to transport customers' shipments is dependent on capacity. Capacity is dependent on private companies, who are responsible to their shareholders to make good investments and to provide a return on the shareholders' investment, earning returns that justify investments in capacity. Today, railroads are stepping up to meet the growing demand for freight service that is projected over the coming decades. Their investments are allowing them to not only compete against each other, but to compete against all modes of transportation, such as trucks and barges. Whether railroads will be able to continue to do so, will depend on policymakers making wise choices and not creating disincentives to such investment.

Senator LAUTENBERG. Thanks very much.

Now we have Mr. McGregor, please.

STATEMENT OF DAVID J. MCGREGOR, SENIOR VICE PRESIDENT, NAFTA LOGISTICS, BASF CORPORATION

Mr. MCGREGOR. Chairman Lautenberg, Ranking Member Smith, members of the subcommittee, my name is David McGregor. I'm the Senior Vice President responsible for logistics for BASF Corporation, headquartered in Florham Park, New Jersey.

BASF ships over 40,000 rail cars per year, at a cost exceeding $125 million annually, so I think you can understand why we have such a keen interest in this matter.

This hearing is well timed, as we feel strongly that the Surface Transportation Board is in need of legislative reform. Under the current statutory scheme, and given the regulatory mechanisms now in place, captive rail shippers like BASF, are at an extreme disadvantage. An effective means for relief from unreasonable rates or poor service by the Nation's railroads is absent at the STB. In our view, the current system is broken. Reform is needed. Congress should act.

Today, many rail shippers operate under a monopoly situation. Fifty percent of BASF's production sites are serviced by only one

railroad where no competitive alternative exists. It's hard to believe that, in this day and age, monopolies can exist, but they do. No, we're not talking about the board game Monopoly, with Boardwalk or Park Place, but real-life towns with real-life people. Take, for example, BASF's Washington/New Jersey site, where the serving railroad has proposed rate increases of up to 165 percent, or at our Spartanburg, South Carolina, site, where the railroad proposes a 96-percent increase. Such outrageous increases would not happen if a competitive alternative existed or if this STB enforced its mandate. The impact of being captive perhaps wouldn't be as bad if we had a more proactive STB to turn to when disputes arises. But we don't. The average cost of an STB rate case is $3 million, and it can take upwards of 3 years to litigate. Even if a shipper somehow prevails, at best it breaks even after you consider cost and time. The current system provides a no-win situation for shippers.

Next, I'd like to invite the subcommittee to look at the matter of differential pricing. The STB says that this sanctioned-pricing scheme is required for the financial well-being of the industry. It argues that individual captive shippers must suffer, in comparison to their marketplace competitors for the common good to provide the railroads adequate margins to sustain the capital spending necessary in their industry. In our view, the STB has overlooked the fact that the concept arbitrarily applies rate and service disadvantages based on nothing more than geographical misfortune, where, by the luck of the draw, some shippers are captive to one railroad. The net result is to make American manufacturing less competitive.

Next, we'd like to recommend that the STB abandon its theoretical concept that rail-to-rail competition is not important. It is. Rail-to-rail competition is critical in those instances, for example, where there are limited or no modal alternatives to rail. Further, the STB seems to have accepted at face value oversimplified arguments about alleged shipper leverage over the railroads. Perhaps its members have never sat across the table from a railroad that threatens 100-percent or more rate increases at a captive facility unless excessive rate increases are accepted at other noncaptive sites.

The STB seems fixated with the notion that if railroads were to operate in a market free of protections, they would be forced to lower their rates to a point that would undermine their ability to reinvest in their business. That is faulty thinking. For example, BASF and thousands of other manufacturers are able to maintain similar levels of capital investment through the sale of our products without the market protections the railroads enjoy.

In conclusion, BASF is not asking for reregulation, as some have suggested. We're simply asking that the STB do what Congress had intended, and, where necessary, provide it with the tools to maintain a level playing field for railroads and shippers alike.

This issue boils down to one of simple fairness and equity. We believe that S. 953, introduced by Senators Rockefeller, Dorgan, Klobuchar, Cantwell, Thune, and Vitter of this subcommittee, will restore fairness and equity to the STB proceedings.

Thank you for this opportunity, and I'm prepared to answer your questions.

[The prepared statement of Mr. McGregor follows:]

PREPARED STATEMENT OF DAVID J. MCGREGOR, SENIOR VICE PRESIDENT, NAFTA LOGISTICS, BASF CORPORATION

Good morning, Mr. Chairman, Ranking Member Smith, and Members of the Subcommittee. My name is David McGregor, and I am Senior Vice President for North American logistics for BASF Corporation, headquartered in Florham Park, NJ. At BASF, I have responsibility for all modes of transportation, all warehousing, and all distribution activities. I am pleased to be here today on behalf of BASF to assist the subcommittee with its oversight of the Surface Transportation Board (STB).

In the opinion of BASF, this hearing is well timed, with the STB presently in need of legislative reform. Under the current statutory scheme and with the regulatory mechanisms now in place, captive commercial rail shippers, like BASF, are placed at an extreme disadvantage, without the means for effective relief from unreliable service at unreasonable rates imposed by the railroads. I respectfully urge this subcommittee to look carefully at the practices of the STB, as they relate to the commercial rail industry. My testimony here today will describe the following:

- BASF's status as a "captive" commercial rail shipper.
- How prior STB decisions have promoted a failed *status quo*.
- The unfairness in current pricing.
- Why the STB underestimates the importance of rail to rail competition.
- The STB should be promoting free and open markets.
- BASF's support for S. 953, a means for reforming and improving present STB practices and procedures.

I trust that the views of BASF will not be shared by all those who are appearing with me as witnesses, including the STB and the railroads. We have some serious disagreements on how and even whether STB reform is necessary. But, as we have worked collegially in the past with the railroads on matters such safe handling, rail car design, and satellite tracking technology, I remain hopeful that we can reach some common ground on STB reform.

BASF: The Chemical Company

As one of the largest chemical companies in North America, BASF is a responsible producer of materials for a variety of industries. With over 16,000 employees and nearly 50 U.S. production sites, we provide catalysts to vehicle manufacturers, ensuring trucks, buses, and automobiles run as clean as possible. We maximize home energy efficiency with formaldehyde-free insulating products, and our dispersions serve as the frame for water-based paint and coating products. In short, BASF has become The Chemical Company. With the highest emphasis on safety, we ship 40,000 rail cars a year to move our products to market, with an annual cost exceeding $125 million.

Monopolies Do Exist: Captive Rail in America

For most Americans, the term "monopoly" refers to the board game that uses locations like "Boardwalk," "Park Place," and in keeping with the theme of this hearing, "Reading Railroad." But it will interest this subcommittee to learn that monopoly is actually a very real thing for commercial rail shippers in this country. Instead of "Boardwalk," "Park Place," and the other popular squares on the game board, we invite the subcommittee's attention to towns like Washington, NJ; Freeport, TX; and Spartanburg, SC, homes to BASF manufacturing sites, where one railroad—and only one railroad—goes in and out of the facilities. These facilities and many others like them across America are commonly referred to as "captive" rail sites, and they are routinely subject to abuses by the railroads.

In a very recent example of abusive railroad rate practices, consider the "take-it or leave-it" offer detailed below (Table 1). These are actual per-car rate offers, involving traffic where BASF is captive to only one railroad monopoly, including commodities in some instances, which are prohibited from moving by truck as a matter of policy. You can see that on this small sample alone, BASF will be subject to rate increases totaling $7.9 million, and exceeding 100 percent on average.

Table 1									
Origin		Destination		Old Rate	New Rate	Dollar Change	Percent change	Annual Loads	Total Additional Cost
GEISMAR	LA	WASHINGTON	NJ	$6,836	$18,106	$11,270	165%	355	$4,000,850
GEISMAR	LA	WHITESTONE	SC	$5,849	$11,441	$5,592	96%	322	$1,800,624
PLAQUEMINE	LA	WHITESTONE	SC	$6,622	$10,274	$3,652	55%	137	$500,324
GEISMAR	LA	WYANDOTTE	MI	$3,240	$7,695	$4,455	138%	93	$414,315
PLAQUEMINE	LA	WASHINGTON	NJ	$5,404	$12,177	$6,773	125%	124	$839,852
BAYPORT	TX	WHITESTONE	SC	$8,631	$12,118	$3,487	40%	108	$376,596
								1139	$7,932,561

BASF has concluded that for the time being, filing an STB rate case, with historic average cost and duration of $3 million and 3 years, is not a worthwhile effort. The current process simply does not provide the shipping community with a meaningful remedy or relief. The STB's most recent decision on September 7, 2007, which favored the railroad over Basin Electric Corp., despite a 100 percent rate increase, certainly offers little hope.[1] The STB is now considering a railroad's latest request to dismiss DuPont's recent filing, arguing that "rate cases involving hazardous materials should not be determined under a methodology that is less rigorous than a stand-alone cost analysis."[2] Only time will tell if the STB will accept this argument, allowing the railroad to change the rules in the middle of the game. Given these actions and decisions, we are left with the unfortunate opinion that in today's regulatory environment, a rate case filing with the STB offers no value to the shipping community.

Recent STB Decisions Promote Failed Status Quo

Historic and noteworthy STB missteps, which precede the current chairmanship, include acceptance of inappropriate mergers and the ongoing failed rate dispute process. The former includes the UP/SP merger and the NS/CSX split up of Conrail, which many characterize as near disasters in both operational and financial terms. The Government Accountability Office (GAO) characterizes the current failed rate dispute process as inaccessible to shippers and rarely used.[3]

While I must commend the current Chairman for his noteworthy efforts to quickly enact improvements in a difficult and complex environment, the questionable quality of even the most recent decisions and actions, offer evidence recognizable to even the layman, that today's STB requires reform. Ten months after the GAO recommended that the STB perform a study of the competitive environment of freight railroads for example, the STB reluctantly accepted. The STB's passive attitude in both establishing the study and subsequently permitting another full year to pass before requiring its results in late 2008, fall well short of the sense of urgency demonstrated by the GAO.

Next, consider the STB's January 2007 ruling on unfair railroad fuel surcharges practices amounting to a $6.4 billion overcharge to their customers.[4] Despite the fact that Congress explicitly states, "it is the policy of the U.S. Government to encourage honest and efficient management of railroads,"[5] the STB took no action on this fuel scheme for a full 3 years after the railroads initiated it. The STB then dedicated considerable time and effort debating its jurisdiction to even consider the issue. This predisposition toward inaction and great care repeatedly exercised to avoid perception of exceeding procedural jurisdiction, lends itself to the consistent benefit of the railroads and to the consistent detriment of shippers.

Once the STB conceded that its office, not another, was the appropriate body to review this railroad matter, only disappointment followed in the form of an ineffective decision, with astonishing failings highlighted by the following:

a. The STB recommended, *but failed to mandate,* the use of a consistent fuel index across railroads. In the words of dissenting STB Vice Chairman Buttrey, "the use of a single well recognized index would make fuel surcharges more transparent to the shipping community, the public, and the STB, and to impose

[1] *Western Fuels Association, Inc.; and Basin Electric Power Cooperative* v. *BNSF Railway Company,* STB NOR42088 0 (STB served Sep. 7, 2007).

[2] *DuPont, E.I DuPont De Nemours and Company* v. *CSX Transportation, Inc.,* STB NOR 42100 (STB filed Aug. 31, 2007).

[3] GAO, *Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed,* GAO–07–94 (October 2006).

[4] Rail Fuel Surcharges, STB Ex. Parte No. 661 (STB served Jan. 26, 2007).

[5] 49 U.S.C. 10101.

reporting requirements without mandating a specific index seriously undercuts the effectiveness of that reporting."[6]

b. The STB failed to prescribe a consistent, best practice methodology, or peg/base level across carriers. This means one railroad can continue to charge fuel based on mileage, another on ton mileage, and another by railcar weight. Some may set the peg/base level at a WTI $64 barrel level, others at WTI $26, or any other unlimited combination of methodologies and peg/base levels. Beyond transparency concerns highlighted by Vice Chairman Buttrey, this great shortcoming clearly increases the administrative burden for shippers, and more importantly, increases the likelihood of continued carrier manipulation, such as the post-decision increase to base freight rates that several carriers applied on April 26, 2007, offsetting the reduction in fuel surcharge revenues in full. While astonishing to many, this is not surprising under current STB oversight.

c. The STB prescribed that a quarterly report must be provided from each Class I carrier regarding total fuel expenditures and consumption, keeping the report narrow "to avoid the regulatory burden."[7] Such narrow reporting is nearly useless toward achieving the end of ensuring honest and efficient management of railroads, and without some broader level of reporting, it is impossible to determine if rail shippers continue to be exploited on an individual basis. Clearly, after exposing an exploitive practice, the regulatory burden should not be the height of concern.

These missteps and the ongoing rate case debacle are important to be sure. My greater concern however, falls to deficiencies in STB policy underpinnings that truly damage the intended balance between shippers and railroads.

Rail Pricing: Where Is the Fairness? Where Is the Relief?

The STB sanctions "differential pricing," the industry preferred term which applies when a railroad charges a premium to customers that are captive to only one railroad monopoly, and have no other options. The STB says that this sanctioned pricing scheme is required for the financial well being of the industry. It argues that individual shippers must suffer against their marketplace competitors for the common good, in order to provide railroads adequate margin for their high levels of capital spending and maintenance.

Reason and cause aside, the STB has overlooked the fact that this concept applies arbitrary and disproportionate rate and service disadvantages to shippers on the strict basis of their geographical misfortune and nothing more. The *differential* penalty for a shipper that has access to only one railroad monopoly, compared to a neighboring shipper that has access to two railroads, will typically result in rail rates that are 50 percent higher. Further, this effect is wide spread and growing, where The World Bank's Louis Thompson, cites an estimate 40 percent captivity rate in 1980, has grown to greater than 50 percent today,[8] chiefly due to the STB's lax historic merger oversight. The STB makes no apologies for this failing however, and in fact appears to accept the argument that rail to rail competition is not important.

The STB Underestimates the Importance of Rail to Rail Competition

When the STB advises that rail to rail competition may not matter if another mode is available, even at higher cost,[9] it demonstrates a preference for textbook theory over real world practice. Rail to rail competition is first and foremost critical in those instances where there are physical and economic limitations to modal shifts, applicable to shippers across industry, including chemical, coal, agriculture goods, and more.

While shippers know that arguments about potential shipper leverage against railroads has been oversimplified, the STB seems to have accepted them at face value. For example, one railroad argues that large customers can use their traffic at dually served facilities to negotiate a better rate/service package on traffic at the captive monopoly served facilities.[10] I believe that members of the STB accept this

[6] Rail Fuel Surcharges, *supra* note 4.

[7] *Id.*

[8] The World Bank, *Regulatory Developments in the U.S.: History and Philosophy,* pg. 11 (March 2000).

[9] Testimony of W. Douglass Buttrey, Chairman, STB, Before the Senate Subcommittee on Surface Transportation and Merchant Marine, Hearing on Economics, Service and Capacity (June 21, 2006).

[10] Testimony of Charles W. Moorman on Behalf of the Association of American Railroads, Before the House Transportation and Infrastructure Committee, Hearing on Rail Competition and Service (September 20, 2007).

notion, because they have never sat across from a railroad that threatens 100 percent rate increases at captive facilities unless excessive rate increases are accepted at the dually served facilities, such as the example we detailed above in Table 1. In these instances, rail to rail competition is critical.

The Association of American Railroads (AAR) represents that rail to rail competition will develop if there is sufficient demand.[11] Shippers understand the fallacy of this idea, but are not confident that the STB embraces it. While there are rare exceptions, barriers to entry seldom permit new carrier competition, in that new railroads simply do not have access to the thousand of miles of land grants that were provided to the industry in it's infancy over 100 years ago.

Closing this topic, The World Bank clearly disagrees with the STB. The World Bank advises that "the concept of rail to rail competition being less important than intramodal competition, becomes highly questionable in countries where the rail share is high."[12] This point becomes moot however, as the STB takes the position that extended application of free market competition among railroads would dry investment, an incorrect concept on many levels.

The STB Should Be Promoting Free and Open Markets

The STB acts under the principle that if railroad monopolies were required to operate in free and open markets, they would suddenly begin pricing services at unsustainable levels, generating inadequate infrastructure capital. In reality however, we must presume that railroads, like any business would instead act responsibly and with self control, pricing services at reasonable and sustainable levels, posing little risk to investment capital supply.

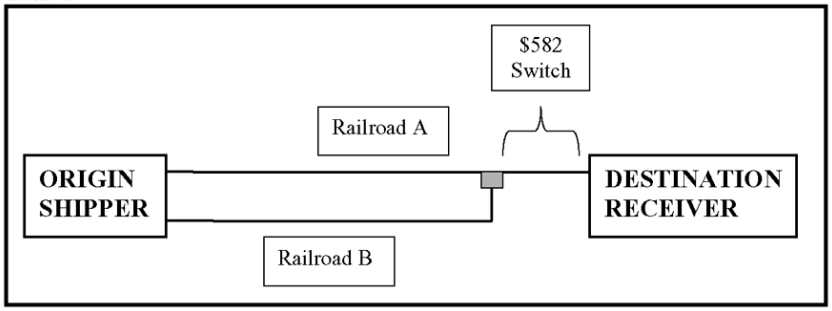
Like railroads, the operations of chemical producers are highly capital intensive. In 2006, BASF's North American capital and maintenance spending totaled $944 million; 2007 spending is projected at $1.1 billion. Industrywide, chemical producers spend $23.5 billion annually on capital investment compared to railroad's $8.4 billion. Further, chemical producers incur $20.8 billion in Research and Development spending, compared to railroad's $300 million.[13] I ask this distinguished Subcommittee, why do the railroads require regulatory subsidies in the form of monopoly permissive treatment, to fund similar capital spending levels that BASF and the chemical industry fund through the sale of its products, without capital flight, under free market conditions?

Competitive access already works in U.S. We invite the subcommittee to look at BASF's Geismar, LA facility, which ships nearly 10,000 rail car loads annually, and is served by the Canadian National (CN). In 1999, competitive access was granted to the Kansas City Southern (KCS). The CN and the KCS have shared in this business for years, with the CN providing KCS access to the business through a reasonable reciprocal switch charge, which the KCS pays for on a large volume of traffic. The CN accepts this compensation, and year after year moves the business with strong and sustainable service and no sign of capital erosion.

A similar opportunity allowed us free market access to two competing railroads, where the origin of the movement in question is jointly accessible by railroad A and railroad B (Table 2), both having tracks into the site, but the destination is served by the tracks of only railroad A, while railroad B's tracks are located just a few miles away. For a reciprocal switch charge of $582, paid by B to A however, railroad A will move railcars those remaining few miles for railroad B, allowing railroad B to effectively access the destination and compete for the business. In our example, railroad B under-bid railroad A's rate offer by 35 percent, willingly, and despite the additional reciprocal switch cost that railroad B incurred and railroad A did not. This demonstrates again, that the competitive access model does indeed work in the U.S. today, and that with the establishment of reasonable and sustainable interswitching rates, it can continue to work and even thrive.

[11] AAR, Overview of Railroad Regulation, (June 2007).
[12] The World Bank, *Final AICCF: Directions of Railway Reform,* Pg. 4 (September 2001).
[13] Bureau of Economic Analysis (2005).

Table 2



These examples highlight how competitive access works in the U.S. rail industry today, sustainably, and without capital flight. For more convincing evidence I ask this Subcommittee to examine the Canadian rail industry. Free market access is not only permitted but required under Canadian rail oversight, and Canadian railroads, similar is size and structure to their U.S. peers, not only succeed, but thrive under such constraints, running significantly more profitable operations, again, without, and have seen no such investment flight.

In summary, and to quote Dr. Curtis Grimm, former economist at the Interstate Commerce Commission's Office of Policy Analysis, what we saw from the Staggers Act of 1980, and in these examples is that "when faced with new competitive opportunities, railroads cut costs and increase productivity." If open market competition were permitted, the same will happen again.[14] Corroborating Dr. Grimm's view, the variance in operating ratio across railroads, ranging from near 60 percent to near 80 percent, provides certain evidence that opportunity for productivity gains remain. History also tells us that railroad oversight has been and should continue to be dynamic.

A Solution Has Arrived: Support S. 953

The solution for many of the problems that I have described lies with S. 953, the Railroad Competition and Service Improvement Act, a bill introduced by Senator Rockefeller, a member of this subcommittee. This bill has received bipartisan support and presently has 11 cosponsors. In addition, it enjoys private sector support from a cross-section of American industry that ships by rail, including chemistry, paper, glass, fertilizer, petroleum, electrical utilities, and the farming community. BASF hopes that today's oversight hearing will lead to the subcommittee's favorable consideration of S. 953.

In particular, S. 953, if enacted, will ensure customer access to rail competition, establish a workable rail rate challenge process, mandate a proactive Surface Transportation Board, and clarify railroad obligation to serve.

I'd like to finish with one important thought. While the Staggers Act of 1980 is used by many as a near synonym for rail deregulation, it was by no means the only legislation in this area. Rail regulatory policy in fact has been amended every 12 years on average since 1887 (see Appendix 1), where we are now into the 27th year of Staggers, with no updates to reflect the significant challenges the industry faces. I believe that the greatest mistake we can make now, in fact the only fatal mistake, is further inaction.

Conclusion

Thank you very much for the opportunity to present testimony and assist the members of this subcommittee in the panel's oversight of the STB. BASF looks forward to being an active partner with the subcommittee, the railroads, and the STB itself, as we seek to find common ground on the ways to improve service by the STB to commercial rail shippers. I would be pleased to answer any questions that subcommittee may have for me.

[14] Testimony of Curtis M. Grimm Before the House Subcommittee on Railroads (March 2004).

APPENDIX 1

Railroad Regulatory History

Interstate Commerce Act of 1887

Elkins Act of 1903

Hepburn Act of 1906

Mann-Elkins Act of 1910

Transportation Act of 1920

Emergency Transportation Act of 1933

Transportation Act of 1940

Reed-Bulwinkle Act of 1948

Transportation Act of 1958

Railroad Revitalization and Regulatory Reform Act of 1976

Staggers Act of 1980

Senator LAUTENBERG. Mr. Ficker?

STATEMENT OF JOHN B. FICKER, PRESIDENT AND CEO, THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

Mr. FICKER. Thank you, Mr. Chairman, members of the committee.

My name is John Ficker. I'm President and CEO of The National Industrial Transportation League, a 100-year-old organization that represents shippers and carriers. We have a long history with the rail industry. In fact, in 1907 that was probably the primary method of moving goods throughout the country.

We have done a bit of a history lesson here this morning, and I will only re-emphasize the fact that the framers of the Staggers Act had two goals in mind. One was to encourage the rail industry to retain and obtain financial well-being and health, and the other was to rely on competition to be the marketplace arbiter, rather than regulation.

To that extent, there has been great success in the area of financial stability in the rail industry, and nothing could be more proof of that than the current investment cycle. I think, Senator Smith, you asked a question about private equity investment. When Warren Buffett invests over 17 percent in Burlington Northern Santa Fe, that says something to me about the financial health of the industry. When the UP reports, yesterday, or the day before, a 34-percent increase in third quarter profits, that says that the industry is healthy financially. So, let's give the framers of the Staggers Act a pat on the back and say, "Job well done."

As far as the private equity firms, I share your concern, Senator, with that, and we're watching that very closely. But other things have changed in that marketplace in the last many years. Obviously, the mergers that were mentioned earlier, the capacity constraints, the massive abandonments of excess capacity through the 1980s and 1990s, and the growth in our economy has led to a capacity-strained environment, both on rail, truck, and even at our ports; and service challenges continue. The operating environment of the railroads has changed from one of massive amounts of single cars to large numbers of unit trains of coal, grain, and intermodal traffic. And also, they've begun to shift away from the contracting authority that was granted by the Staggers Act to more public pricing in order to be able to adjust more rapidly to the pricing mechanisms and the market conditions.

Many of our members deal in the commodity business and understand the ebbs and flows of a commodity market. But the challenge in planning for transportation spending over a period of time has become increasingly difficult.

And I would like to comment, if I could, for a moment, on the Surface Transportation Board. We've very pleased at the work of the STB has done over the last year under the leadership of Chairman Nottingham. Several things I'll mention, that he already alluded to. First being the fuel surcharge change that took place earlier this year. We're very pleased that that took place. We believe it should be further expanded to all modes—all carriers—or, excuse me, all shippers, not just those that are regulated by the STB. Second, we believe that the cost of capital exercises currently going on, proceeding before the STB, is an important one to be considered. It's about time, we believe, that the—Wall Street and financial communities recognize that the rail industry was successful. I believe the Board should recognize their revenue adequacy, as well. It's kind of a wonderment to me that the Board could say that the railroads were in terrible shape when Wall Street was touting them as an incredibly sharp investment idea.

And, finally, the proposal that's in front of the Board is the same methodology that the Federal Reserve Board uses.

Earlier, it was mentioned, the simplified rate-case procedure. We believe that that's a step in the right direction, but we're concerned about some of the components of that, and we've asked the STB, along with 41 other associations, to take a look at some of the components of that, and the details, to make it more advantageous.

And, finally, I'd like to mention an effort that the NIT League has been involved in for over a year. We believe the best solution to the problems between shippers and carriers, as Senator Smith alluded to, is a private-sector solution, not a legislative solution. We believe—and we have been working with the railroads over the last year to develop a simple, fast, and expeditious methodology that's fair to both parties, to allow disputes to be resolved in a confidential manner, allowing that—those disputes to come forward, both from the rail side and from the carrier side. And we are pleased to say that we're in discussions with the AAR and the railroads at this very moment. I would love to have the opportunity to brief the staff and the Senators and the members of the committee on our particular proposal, to see where we can help in this

environment, as, again, we believe strongly that the best solution is a private-sector solution.

I thank the committee for this opportunity, and look forward to your questions.

[The prepared statement of Mr. Ficker follows:]

PREPARED STATEMENT OF JOHN B. FICKER, PRESIDENT AND CEO, THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

The National Industrial Transportation League is pleased to have been invited to present testimony on the Surface Transportation Board (STB) and regulation related to railroads. The League is the Nation's oldest and largest association of companies interested in transportation. We recently celebrated our 100th anniversary. Its 600-plus members range from some of the largest companies in the Nation to much smaller enterprises. Many members of the League ship via rail, and are vitally interested in the capacity, service, and competitiveness of the Nation's rail industry. But League members also substantially ship via other modes, both domestically and internationally, and the problems of capacity must also be looked at in this broader context, as many modes are facing capacity constraints.

Throughout its history, the League has been active in rail matters before Congress, the Interstate Commerce Commission, its successor agency the Surface Transportation Board, as well as in private sector discussions and negotiations with railroads both individually and collectively. The League has always supported a strong and viable rail network to provide the essential transportation services in support of both the defense of the United States and the economic vitality of our country. As Committee members know well, the Staggers Rail Act changed the regulatory landscape of the rail industry from one that was heavily controlled by government regulators to one that emphasized competitive markets as the primary and most efficient arbiter of the relationship between shippers and carriers, and where regulation was confined to those instances where there was a lack of effective competition. The framers of the Staggers Act had two primary goals, to restore financial health to the rail industry, which at the time was facing major financial challenges; and to make competition, not regulation, the guiding force in the rail transportation market.

Since the passage of the Staggers Act much has changed. A once-tenuous rail industry financial environment has morphed into a positive one. Today, the rail industry is recognized by Wall Street as financially successful and one to be considered by today's investors. Nothing could provide more evidence of this change than the recent investment by one of America's most respected investors, Warren Buffett, who has taken a major stake in BNSF. Additionally, major investment houses such as JP Morgan Chase, Morgan Stanley, Bear Stearns and Credit Suisse all have indicated that the rail industry has become an attractive investment opportunity—a further indication of the financial health of the industry. Finally, the fact that many railroads have begun stock buyback programs is an indication of their internal confidence in their financial strength and stability. This past week, America's largest railroad, the Union Pacific announced a 27 percent increase in 3rd quarter profits on 34 percent increase in operating revenue. This is clear evidence of the achievement of one of the major goals of the Staggers Act.

Since the implementation of the Staggers Act many other factors have changed the transportation environment. Mergers have consolidated the industry from over 40 Class I carriers to just seven. At the same time, there has been major growth in the number of short line railroads. The U.S. economy has undergone significant changes as well, which have in turn caused major changes in the rail industry. Massive growth in imported consumer products has led to significant growth in intermodal movements. Increase in the movement of unit trains of coal, grain and other products have strained a system that had for years been reducing capacity. A combination of traffic growth; change in traffic mix; driver shortages in the motor carrier industry; and reductions in rail capacity through abandonments, have all led from a system once characterized by excess capacity across all modes, to a situation in which there are across-the-board capacity shortages, not only in rail transportation, but in trucking as well. This period also saw an enormous increase in fuel costs. These factors have strained the transportation system, causing congestion at key points both in truck, rail and ports. To meet the ever-growing demand, rail carriers encouraged rail shippers to acquire additional equipment, which put further pressure on an already-strained system. Service levels deteriorated as evidenced with the peak season problems encountered in 2004.

All of these forces have created a rail industry far different from the ones the framers of the Staggers Act worked to correct. The capacity constraints caused rail carriers to shift their focus away from seeking additional volumes and instead to try to restrict the volume of traffic handled. A new word entered the rail transportation lexicon: "de-marketing." With rapidly increasing demand, railroads found themselves in the enviable situation of being able to significantly increase prices charged to shippers well beyond the increase in costs incurred. The mark for "whatever the market would bear" increased substantially. While many League member companies are in commodity businesses that deal with price fluctuations based on supply and demand, they now found a situation of rapidly increasing rail transportation costs.

The Staggers Act provided carriers and shippers the opportunity to enter into contracts to allow predictable costs for shippers and predictable volumes for carriers. The introduction of capacity constraints has allowed carriers to discontinue offering contracts to many shippers and to shift to public pricing. This approach permits rail carriers to adjust prices more rapidly, thus impacting shippers' ability to plan their transportation costs. In many cases shippers had little recourse when carriers increased prices since there were few or no competitive alternatives to rail transportation.

The League actively participated in the Government Accountability Office (GAO) study which is in part the subject of this hearing. League staff and several League members met with GAO staff to discuss rail issues, and provided information to assist GAO in its study. Much of the League's discussion with GAO centered on the problem of the rail industry's capacity constraints. In March of last year, the League and several of its members appeared before a panel organized by the GAO to consider the current state of the rail industry and to advise GAO on its study.

As the GAO study points out, the needs of the rail industry and its marketplace have changed dramatically and these changes require a new approach. There must be an increased emphasis on value provided by the rail industry to shippers and to the economy as a whole. Creative and collaborative approaches must be the new mindset. Carriers must have the opportunity to realize a fair return on their investment while providing shippers with quality service. Carriers and shippers must be increasingly flexible to deal with rapidly changing circumstances.

The most significant challenge the rail industry and its customers face is the need to expand existing rail capacity to meet with growing demand. The Association of American Railroads (AAR) released a study, *National Rail Freight Infrastructure Capacity and Investment Study,* in September indicating that projected growth in rail volumes will require major investments. The report was done by Cambridge Systematics, in cooperation with the railroads themselves, points out that in the next 28 years an investment of $148 billion to meet the projected demand. The American Association of State Highway and Transportation Officials (AASHTO) has released a study in May called *America's Freight Challenge* indicating rail freight demand will increase by 69 percent based on tons and 84 percent based on ton-miles by 2035. According to the U.S. Chamber of Commerce, by 2020, even with modest economic growth, the total domestic tonnage carried by the U.S. freight system will increase by almost 67 percent and international trade will nearly double.

These many factors require the STB to adjust its regulatory approach to deal with this new reality. It is no longer appropriate to utilize past practices to respond to today's marketplace. First and foremost, the STB needs a more balanced regulatory approach. The League is pleased that under the leadership of Chairman Nottingham, the STB appears to have adopted such an approach. Earlier this year the STB announced a more fair and balanced approach to fuel surcharges. In this connection, the League believes that if railroads desire to cover the changes in their cost of fuel, they should be able to apply a cost-based fuel surcharge to all rail shipments, whether they are commodities regulated by the STB or not. However, if rail carriers enter into contracts that do not allow for the application of such cost-based surcharges, those remaining shippers that are subject to fuel surcharges should *not* be made to make up, for the shortfall in fuel cost recovery.

The STB's recent proposal to modify its calculation of the rail industry's cost of capital is also a positive development. That decision more closely aligns the STB's calculation of the rail industry's cost of capital with that used by the Federal Reserve Board. The change is long overdue: it was a cause for wonderment that, while Wall Street analysts were touting the financial strength of the rail industry, the STB was citing the industry's poor financial condition. If the STB follows through with its proposal, the view of the financial community and the view of the regulatory agency would be more reasonably aligned. We urge the STB to act promptly to adopt its proposal.

The recently announced decision on Simplified Rate Case standards is also in part a step in the right direction, although the League is still seriously concerned about several important aspects of the decision. This effort, mandated by Congress over 10 years ago, was recently released by the STB. The League has been active in this proceeding for years and believes that shippers need an reasonable approach to resolving rate disputes with carriers—one of the services the STB is directed to provide. The League believes that this decision, while in part a step forward, needs further changes. The League, along with 41 other associations and entities, has recently asked to the STB to reconsider its decision in a number of important respects. The League looks forward to early and favorable action by the STB on its petition. A matter of some concern is the recent action by the AAR and five Class I railroads in filing a petition for judicial review of this decision with the D.C. Appellate Court which could suggest that the railroads intention is to impact the positive direction of the STB.

However, the League believes that the optimal solution to the issues confronting shippers and rail carriers is a private sector agreement that will address the needs of both. The League has been engaged with the railroads through the AAR in just such discussions. The League has developed a proposal that would provide an alternative dispute resolution methodology for shippers and carriers that would be simple, fair and expeditious. It is the League's hope that such an agreement would provide the framework for a new relationship between the parties, allowing all parties to quickly resolve their differences and focus on the larger issues facing our freight transportation industry. As these discussions are on-going, we do not believe it is appropriate to discuss them publicly. The League would be pleased to brief Members and staff at their convenience.

The League is pleased to have the opportunity to present our views before the committee and looks forward to helping in developing solutions to deal with the challenges of meeting the growing transportation needs of our country.

Senator LAUTENBERG. Thank you very much, Mr. Ficker.

Mr. Carlson?

Mr. CARLSON. Right here, Mr. Chairman.

STATEMENT OF ROBERT L. CARLSON, PRESIDENT, NORTH DAKOTA FARMERS UNION; ON BEHALF OF NATIONAL FARMERS UNION

Mr. CARLSON. Thank you, Mr. Chairman, thank you, members of the Committee, for allowing me to attend this very important hearing.

My name is Robert Carlson. I'm President of the North Dakota Farmers Union, representing more than 40,000 member families. In addition, I am representing the concerns of affiliated grain cooperatives that market farmers' grains in my state and the region. And I'm also representing the National Farmers Union and its 300,000 members nationwide.

I will abbreviate my written remarks considerably and try to make some key points.

Number one, Farmers Union supports passage of Senate bills 772 and 953. For the record, the rail industry has said its current prosperity is due to the Staggers Rail Act of 1980. There's widespread consensus that railroads are enjoying financial rewards due to deregulation. But these rewards are literally coming at the expense of captive shippers, such as farmers on the Northern Great Plains. Senate bill 772 and 953 are the only hope family farmers and locally owned grain elevators have in restoring a measure of fairness that otherwise has been left behind in this era of deregulation.

We are at the mercy of Burlington Northern Santa Fe. We are customers. Indeed, we're captive customers, which ought to make us more valuable to BNSF. That captivity, however, means we

have no realistic shipping options. Service and rates, as determined by the railroad, can literally dictate which shippers prosper and which ones are sidetracked.

During the car shortage of 2003 and 2004, BNSF records show that 70 percent of the past-due orders for grain cars were for shippers in North and South Dakota, Montana, and Minnesota, areas that qualify as captive to BNSF. Farmers and elevator managers are equally frustrated by unjustly high rates and extremely poor service.

This is a strong statement, but true, that I'm going to make next. I would prefer a grain elevator manager tell you some of the horror stories I have heard. Unfortunately, the Surface Transportation Board does not have a witness protection program.

[Laughter.]

Mr. CARLSON. Elevator managers say they prefer not to voice their concerns out of fear of reprisal. BNSF does have the market power to make or break its own customers. I understand this. I served on a board of a large farmer-owned grain elevator cooperative. Farmers do pay the freight. If freight rates go up, the price elevators, in turn, pay farmers for their crops goes down. This puts farmers in my State at a huge price disadvantage, as compared to farmers in Nebraska, where BNSF faces significant competition from Union Pacific, and, subsequently, shipping rates are less.

And therein lies the problem. Captive shippers pay more than those who have options. The Staggers Act allows and encourages railroads to use differential pricing. They can charge a North Dakota elevator significantly more to move a carload of grain 400 miles to Minneapolis than to move the same car another 400 miles from Minneapolis to Chicago. Why is this, given the distance and cost is roughly the same? Because two railroads compete for traffic over the 400 miles between Minneapolis and Chicago.

Rates in Montana and North Dakota are between 250 and 550 percent of variable costs, significantly higher than the STB's benchmark of excessive.

I'll move to my conclusion.

I would ask Congress to pass Senate bills 772 and 953 to restore a measure of competition to rail transportation. Railroads are sounding the alarm that these policies will lead to reregulation. We don't think that's true. Paper barriers, final-offer arbitration, and rail quotes over rail segments are all provisions in this legislation that will provide access to increased competition and provide captive shippers access to rate and service problem resolution.

We also ask Congress, simultaneously, to make the STB more accountable to shippers and to make rate challenges more affordable and accessible to captive shippers, whose pockets are not nearly as deep as the rail industry, and whose pockets have been emptied by a rail industry whose market power is virtually unchecked.

Thank you.

[The prepared statement of Mr. Carlson follows:]

PREPARED STATEMENT OF ROBERT L. CARLSON, PRESIDENT, NORTH DAKOTA FARMERS UNION; ON BEHALF OF NATIONAL FARMERS UNION

Hello, and thank you to the Senate Subcommittee on Transportation for the opportunity to visit with you today. I am grateful to be a member of this panel of people who have a vested interest in this Nation's rail transportation system.

My name is Robert Carlson. I am a farmer. Today, I am speaking on behalf of the more than 40,000 member families of North Dakota Farmers Union. In addition, I am representing the concerns of the affiliated farmer-owned cooperative grain elevators in my state, and I am also representing National Farmers Union and its 300,000 members nationwide.

For more than 10 years, I have been President of North Dakota Farmers Union, a general farm organization that has served farmers, ranchers and cooperatives for more than 80 years. Rather than give narrow focus to a specific crop or type of livestock, Farmers Union is able to see the entire picture of family farm agriculture. Our focus is to strengthen the viability of family farms for generations to come. In this quest, we have and continue to look well beyond the farm gate. We take a keen interest in what customers are demanding of us. Those customers could be consumers buying groceries, bakeries buying four or another nation seeking a shipload of soybeans.

Depending on market demand, our crops may be bound for the export terminals of the Pacific Northwest, flour mills near Chicago, feedlots in southern states or ethanol plants in Iowa, to name a few. Our nation's rail system is vital in terms of national security and economic growth. The viability of this Nation's family farms and ranches is entirely dependent on railroads. I'd like to say this is a win-win partnership for both producers and railroads. Sadly, it is not.

Railroads in general have put rural America low on the list when it comes to service. And, in areas where little if any true competition exists, railroads have squeezed excessive profits from farmers and grain elevators, while in return giving us a "take it or leave it" level of service.

Farmers Union supports passage of Senate Bills 772 and 953. The former being the Railroad Antitrust Enforcement Act of 2007, the latter being the Rail Competition and Service Improvement Act of 2007. For the record, the rail industry has said its current record prosperity is due to the Staggers Rail Act of 1980. There is widespread consensus that railroads are enjoying financial rewards due to deregulation. These rewards are literally coming at the expense of captive shippers such as farmers on the Northern Great Plains. Senate Bills 772 and 953 are the only hope family farmers and locally-owned grain elevators have in restoring a measure of fairness that otherwise has been left behind in this era of deregulation.

We are at the mercy of BNSF, a company that itself seems merciless in treating grain elevators and farmers as if they were a nuisance. We are customers. Indeed, we are captive customers which ought to make us more valuable to the BNSF. That captivity, however, means we have no other realistic shipping options. In a free enterprise system, competition drives innovation, lower costs and better service. Railroads are quick to serve intermodal customers between, say, Chicago and Seattle, as that traffic can be won away by a competing railroad that also serves both end points. BNSF gives far less attention to serving grain elevators in North Dakota because that grain has no other realistic way to move to market. In fact, grain has been piled up as grain elevators run out of storage on account of a lack of trains. Why would BNSF do this? Because the grain isn't going anywhere, allowing the railroad to get around to delivering cars when it is more convenient to them. In this process, grain elevators and farmers wait on the sidelines to market their grain. Service and rates as determined by the railroad can dictate which shippers prosper and which ones are sidetracked.

During the car shortage of 2003–04, BNSF records show that 70 percent of the past due orders for grain cars were for shippers in North and South Dakota, Montana and Minnesota—areas that qualify as captive to BNSF. Farmers and elevator managers are equally frustrated by unjustly high rates and extremely poor service.

I would prefer a grain elevator manager tell you some of the horror stories I have heard. Unfortunately, the Surface Transportation Board does not have a witness protection program. Elevator managers say they prefer not to voice their concerns out of fear of reprisal. BNSF does have the market power to make or break its own customers. I understand this: I served on the board of a large farmer-owned grain elevator cooperative.

It is worth noting that farmers really do pay the freight. When you buy a car, you pay a transportation fee. If you buy something online, you pay for the packaging and shipping. Yet when a grain elevator ships wheat to a flour mill or for export, the elevator pays the railroad. If rail freight rates go up, the price elevators in turn

pay farmers for their crops will go down. This puts farmers in my state at a huge price disadvantage as compared to farmers in Nebraska, where BNSF faces significant competition from Union Pacific and, subsequently, shipping rates are less.

As you know, the Interstate Commerce Commission was abolished in 1995. In its place, Congress created the Surface Transportation Board which was told to limit its level of oversight (read: regulation) of the railroads. The STB has made it extremely difficult for shippers to challenge rail rates as excessive. The costs to do so are enormous in terms of time and money. Further, farmers and grain elevators have little expectation the STB would order and police any effective change in the event the rail industry was found guilty.

My state used to be served by five Class I railroads. Today, only two operate in the state as a result of mergers. Mergers have reduced more than 40 Class I railroads in 1980 to seven today. And of these, four—two in the West, two in the East—effectively control more than 90 percent of the traffic. While that may not seem like a true monopoly, it clearly shows market dominance. Further, as these railroads tend to exclusively serve vast areas of territory in which there is no effective competition, they have become monopolies. In the Upper Great Plains, BNSF does not lose sleep at night over the threat of competition from trucks, river barges or Union Pacific.

We appreciate our short line and regional railroads. In most cases they are models of customer-friendly service. But it is important to remember they are not competition to the Class I lines. In fact, they are indebted to the Class I railroads for car supply, pricing and off-line service. Short lines, regionals and Class I railroads all could be more innovative and competitive if paper barriers would be removed to allow for a more competitive interchange of cars to seek lower shipping rates. This kind of consumer approach is what most Americans are used to. As an example, you are not forced to buy your groceries from a specific store, you are free to choose. These bills are meant to give shippers more choices in routing their products to market.

Therein lies the problem. Captive shippers pay more than those who have options. The Staggers Act allows—encourages—railroads to use differential pricing. They can charge a North Dakota elevator significantly more to move a carload of grain 400 miles to Minneapolis than to move the same car another 400 miles from Minneapolis to Chicago. Why is this, given the distance and cost is roughly the same? Because two railroads compete for traffic over the 400 miles between Minneapolis and Chicago.

According to law, the STB may entertain a rate challenge from a shipper providing the railroad is charging a rate that is in excess of 180 percent of variable costs and the railroad faces no effective competition. The Government Accountability Office (GAO) has found that "traffic traveling at rates significantly above the threshold for rate relief has increased. We (GAO) reported that STB's rate relief process to protect captive shippers has resulted in little effective relief for those shippers." In 2006, the GAO raised the question of "whether rail rates in selected markets reflected justified and reasonable pricing practices, or an abuse of market power by the railroads?" The GAO further found that some areas with access to a single Class I railroad "also have more than half their traffic traveling at rates that exceed the statutory threshold for rate relief."

Rail rates in Montana and North Dakota are between 250–450 percent of variable costs—signifcantly higher than the STB's benchmark of excessive. Why, then, are shippers not lining up to file rate complaints with the STB? Cost and complexity come to mind. Few shippers are willing to risk the tens of thousands of dollars (some estimates suggest it would take several million dollars) and years that pursuing a rate case will demand. Even more telling is shippers have little hope the STB would—or could—order any meaningful action should the challenge be successful. Most shippers have observed the STB does a better job advocating for the rail industry's right to earn an "adequate" profit as opposed to limiting the rail industry from using market power to charge as much as possible from shippers who are at their mercy.

GAO singled out STB's rate relief process as "inaccessible to most shippers (and) expensive, time consuming and complex."

This obstacle has deterred many shippers from even trying to seek relief from what are, by STB definition, excessive rates. This is why the North Dakota Legislature in 2003 and again in 2005 appropriated state funds to support a rate case filing before the STB. Both North Dakota Farmers Union and North Dakota Farm Bureau contributed toward this initiative.

In January 2007 the STB ruled the railroads were overcharging customers through a fuel surcharge. One study estimated the railroads pocketed $3 billion due to overcharging. Adding insult to injury, the railroads had been linking fuel sur-

charges to rates, meaning captive shippers had to pay even more than other shippers to cover the railroad's cost of fuel. The surcharges had nothing at all to do with the actual increase of fuel prices relating to the fuel consumed to move grain from an elevator to a buyer. The STB did tell railroads to link fuel surcharges to actual distance of each car movement, which made sense. The STB did not ask the railroads to refund the overcharges.

The railroads have taken advantage of grain shippers, especially captive shippers in the Upper Great Plains. This is not a healthy business arrangement. It is hardly a partnership, though it ought to be. Another item worth noting is that grain elevators have invested huge sums of capital in adding miles of rail sidings and grain storage to handle unit trains, which ostensibly make the railroads more efficient in the short run and leave the elevators deeply invested for the long haul.

In North Dakota, 90 percent of our spring wheat—and we grow the most in the Nation—moves by rail, the balance by truck. According to the Upper Great Plains Transportation Institute, more than 80 percent of all North Dakota grains and oilseeds move by rail. And, I hasten to mention that Canadian Pacific has limited route miles in North Dakota. BNSF remains the 700-pound gorilla in the room. Yet for the few fortunate grain elevators that do have access to both Class I railroads in my state, the shippers prefer using Canadian Pacific by a factor approaching five-to-one.

As it stands, captive shippers are living with higher rates. The railroads are using market power to extract every extra dime of profit possible. The STB has not protected captive shippers from being exploited. I could go on at length about the service and pricing abuses that exist.

Rather, I would ask Congress to pass Senate Bills 772 and 953 to restore a measure of competition to rail transportation. Railroads are sounding the alarm that these policies will lead to reregulation. This is not true. Not at all. Paper barriers, final offer arbitration and rate quotes over rail segments are all provisions in this legislation that will provide access to increased competition and provide captive shippers access to rate and service problem resolution. We also ask Congress simultaneously to make the STB more accountable to shippers and to make rate challenges more affordable and accessible to captive shippers whose pockets are not nearly as deep as the rail industry—and whose pockets have been emptied by a rail industry whose market power is virtually unchecked.

Senator LAUTENBERG. Mr. English, please?

STATEMENT OF HON. GLENN ENGLISH, CEO, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION; CHAIRMAN, CONSUMERS UNITED FOR RAIL EQUITY (CURE)

Mr. ENGLISH. Thank you very much, Mr. Chairman.

I'm Glenn English. I'm the Chairman of the Consumers United for Rail Equity. I'm also the Chief Executive Officer of the National Rural Electric Cooperative Association.

Mr. Chairman, the focus here is on stranded shippers, not shippers in general. Stranded shippers, that 20 percent of the traffic that is being abused. We have a chart that was put up by the railroads, focusing with regard to the rates. Well, let's focus on one with regard to the difference between those who have competition and those who do not. And, as you can see, there is a vast difference. This is exactly what Harley Staggers was concerned about in 1980 when he put this legislation together and put a provision in there to protect stranded shippers.

Now, the General Accounting Office has just pointed out that the rate challenge process of the Surface Transportation Board is inaccessible to most rail captive customers. And the rate reductions claimed by the railroads since the Staggers Act, to a large extent, are due to railroads shifting cost to customers. Now, that's the real issue that we have before us, Mr. Chairman. This is something that we've lived with for 27 years. The intent of the Staggers Act has not been carried out. Those who tout the Staggers Act are not

people who tout all the provisions of the Staggers Act, nor do they enthusiastically support that.

Now, obviously, this legislation set up a—an entity, a body—first, the Interstate Commerce Commission and then the Surface Transportation Board—to address this issue, to protect the captive shippers, to protect them against a monopoly, to protect them against abuse. The system has not worked. That's basically what the GAO report says: It has not worked, and it is not working today. And the Congress has done absolutely nothing to require that the intent of the law has been carried out.

Now, the question is raised, Mr. Chairman, as to why. Why hasn't the Surface Transportation Board done their job? Why haven't they carried it out, in 27 years? Why haven't they done this? And I would suggest to you that, certainly the perception of the captive shippers—and, I would go further than perception; I think it is badly obvious as to why they haven't carried it out, and I would point to an article, that I believe has been handed out to all the Senators, from Frank Wilner in the Argus *Rail Business,* on August 27, 2007. He makes the point—and I think it's a very good one—he states, "Were the public to perceive judges had a favorable bias toward an industry that subsequently hired them away from the courts, anarchy would follow." But that's exactly what has happened in this case. If you go back and review each and every member of the Surface Transportation Board since it has been created, every former member has gone to work for the railroads. Now, I know, in the Congress, myself included, certainly had a cooling-off period before we could go work and come back to the Congress. There are 100 Senators, 435 House Members, the President of the United States, to review all of our work. But, even then, we had a cooling-off period that we couldn't, in fact, come back and lobby our colleagues or talk to our colleagues. Now, I understand, for the Senate, it's 2 years—2-year cooling-off period. There is no cooling-off period, as far as the Surface Transportation Board. These people go to work over there, and each and every one of them knows where they're going to go to work after they leave the Surface Transportation Board. Each and every one of them do.

[The information referred to follows:]

Argus *Rail Business*—August 27, 2007

PERCEPTION OF BIAS AT STB

by Frank Wilner

Justice is said to be blind—except to the facts—and rightly so. Were the public to perceivejudges had a favorable bias toward an industry that subsequently hired them away from thecourts, anarchy would follow.

So what's going on at the STB and its predecessor Interstate Commerce Commission (ICC),where shipper perception is that the agency exhibits a favorable bias toward railroads?

Regulators say the perception is incorrect. But consider the facts creating the perception:

- The previous two chairmen of the STB were hired by the railroads they regulated. LindaMorgan became Union Pacific's (UP) principal outside legal counsel at Covington & Burling, filling avacancy created when UP hired her predecessor to head its law department in Omaha.Meanwhile, Roger Nober departed the STB to become outside legal counsel to BNSF(and other railroads) at the firm of Steptoe & Johnson; and, one year later, was hireddirectly by BNSF to head its law department in Ft. Worth.

- CSX hired former STB member Jake Simmons as a consultant.
- The Association of American Railroads (AAR) hired former STB member William Clyburnas a consultant.
- CSX hired former ICC Chairman Reese Taylor as a consultant.
- BNSF predecessor Burlington Northern hired former ICC member Betty Jo Christian asoutside counsel.
- BNSF predecessor Burlington Northern hired former ICC Chairman Darius Gaskins tohead its marketing department, and later elected him chief executive.
- Short line railroad holding company RailTex elected former ICC Chairman HeatherGradison to its board of directors.
- The AAR hired former ICC member Karen Phillips, now a Canadian National lobbyist.

Senior STB/ICC seniorstaff members also have been offered lucrative employment by railroads:

- Northern Southern (NS) hired Nober's chief of staff, John Scheib, who formerly was outside counsel to UP.
- The AAR hired Simmons's attorney-adviser, Dennis Starkes.
- NS hired Simmons's chief of staff, Rick Crawford.
- BNSF predecessor Santa Fe Railway hired ICC Secretary Sidney Strickland.
- UP predecessor Southern Pacific hired ICC's Congressional relations officer, Alex Jordan.
- The AAR hired ICC department head Alan Fitzwater, subsequently a Burlington Northernlobbyist.
- The AAR hired ICC Acting Secretary Nancy Wilson.

The STB, meanwhile, has hired numerous railroad officials to senior positions.

- STB chief economist William Huneke, and STB economists William Brennan and Randy Resor, are former Association of American Railroads employees. Also, STB economist Michael Boyles previously was employed by a consulting firm performing economic evidentiary work for railroads in rate reasonableness cases decided by the STB.
- Current STB member Douglas Buttrey appointed as his chief of staff, Alice Saylor, a former senior officer of the American Short Line and Regional Railroads Association, and previously a railroad attorney.
- Current STB Chairman Charles Nottingham hired as his chief legal adviser, Scott Zimmerman, who had been outside regulatory counsel for NS.
- Senior STB attorney Ray Atkins is a former attorney with UP's outside law firm, Covington & Burling.

Not for more than half a century has someone with a shipper background been confirmed by the Senate to the ICC/STB. That was Rupert Murphy, nominated by President Eisenhower in 1955. The lone STB senior employee in recent years with shipper experience, Gerald Fauth, departed four years ago.

None of this is meant to suggest there has been—or is—any wrongdoing at the STB or its ICC predecessor. It is meant to explain why shippers perceive a bias in decisionmaking, and why Congress is advancing legislation to force the STB to protect shippers from rail monopoly power as promised by the Staggers Rail Act of 1980.

Now, you tell me, if you know where you're going to go to work before the fact, if you know that every one of your predecessors has gone to work for the Surface Transportation Board, if, in fact, if you're a staff member over there, a senior staff member, virtually every one of those staff people have gone to work for the Surface Transportation Board, now you tell me, is that going to influence your decision? The perception of those of us who are captive shippers, it certainly does. We think it's obvious. This matter needs to be corrected.

The last time there was a favorable ruling coming out of the Surface Transportation Board—and I'm talking about just a little bit

of correction, just a little bit of correction—was back in 2001. My goodness, this is so rare that it is just outrageous.

Mr. Chairman, I'd say that this calls for action. We have to pass some kind of legislation to bring around a correction.

Now, over in the other body, whenever I testified over there, quite frankly, frustration overcame me. I've got to say that. But I just said, you know, golly gee, if you're not going to live up to this provision of the Staggers Act, why don't you repeal it? Have the nerve to repeal it. Don't give the Surface Transportation Board a fig leaf of somehow they're taking care, looking after those people who are supposedly under their protection—namely, stranded shippers—under the law, as it is provided.

Now, this, I think, makes it very obvious, Mr. Chairman, the perception is there. And I can assure you that if the American people ever come to focus their attention on the Surface Transportation Board, then we will see that kind of outrage that this article portrayed.

Thank you, Mr. Chairman.

[The prepared statement of Mr. English follows:]

PREPARED STATEMENT OF HON. GLENN ENGLISH, CEO, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION; CHAIRMAN, CONSUMERS UNITED FOR RAIL EQUITY (CURE)

Mr. Chairman and members of the Committee:

My name is Glenn English. I am the Chief Executive Officer of the National Rural Electric Cooperative Association. I also serve as Chairman of Consumers United for Rail Equity (CURE), a rail customer advocacy group representing a broad array of vital industries—chemical manufacturers and processors; paper, pulp and forest products; farmers; cement and building material suppliers; and many more. Mr. Chairman, members of this coalition have experienced deteriorating service and sharply increased rates and appreciate the leadership shown by committee members Senators Dorgan, Rockefeller, Cantwell, Klobuchar, Vitter and Thune in the effort to address the longstanding problems facing rail customers.

As member-owned, not-for-profit organizations, the obligation of electric cooperatives is to provide an affordable and reliable supply of electricity to our consumers. We take our obligation to serve very seriously. The personal and economic health of our members and our communities depends on it.

Mr. Chairman, we believe there is also an overriding national public interest in the operation of the rail system. The railroad industry is not just another private sector industry. Railroads provide vital services important to a range of national interest activities from the movement of war material, to distribution of some of the most important domestic energy sources, to providing vital links in the supply chain that bring domestically produced commodities and manufactured products to domestic and international markets. Unfortunately, we believe the railroads are not as serious about their obligation to serve the public interest as is my industry. They have consistently failed to fulfill their basic "common carrier" obligation.

Mr. Chairman, we believe that the system established by Congress to ensure competition in the national rail system and to protect "captive" rail customers from railroad monopoly abuse is not working. The Surface Transportation Board (STB) is failing in its responsibility to rail customers and to the Nation. We believe that the STB cannot and will not correct its mistakes in a timely manner and that legislation, such as S. 953, the Railroad Competition and Service Improvement Act of 2007, must be enacted if rail customers are to receive the access to competition and protections from monopoly abuse promised in the Staggers Rail Act of 1980.

The Staggers Rail Act of 1980 Today: Not What Harley Staggers Envisioned

Twenty-seven years ago, Congress passed the Staggers Rail Act of 1980. A review of the debate from this landmark legislation reveals that Members of Congress envisioned a far different regulatory regime and a far different national rail system than is in place today. Mr. Chairman, my then colleague in the House, Harley Staggers, spoke of a bill that would "assure a healthy vibrant system of railroads across the United States, and yet it would provide timely review to the Interstate Commerce

Commission (ICC) by captive shippers who feel they are facing exorbitantly high rates charged by the railroads." Upon signing the Staggers Act, President Carter announced that the proposal would "benefit shippers throughout the country by encouraging railroads to improve their equipment and better tailor their service to shipper needs."

Unfortunately for the consumers in this country, these predictions have only partly become true. This nation's few remaining major railroads are exceedingly prosperous, thanks to their unrestrained ability to increase prices at will and transfer almost every imaginable cost to the shipper. But, clearly the railroads are not tailoring their service to shipper needs. In fact, high costs and unreliable service have become the accepted norm for most railroad companies, and shippers simply have nowhere to turn for relief.

Members of Congress need to be able to see their legislation carried out in the manner in which they intended. Many legislators talk about the Staggers Rail Act and the success it had in bringing back vitality to the rail industry, and there is a lot of truth to that. But, the provisions with regard to protecting captive rail shippers from abuse by monopoly railroads have not been in keeping with what Harley Staggers intended.

There is something to be said for understanding the intent of the law, and what was promised. When I was in Congress, I became very frustrated when a piece of legislation was passed and was sent over to the Administration or some regulatory body, only to be interpreted differently than what was intended when it passed. That is what we have occurring here.

Captive shippers need the Staggers Rail Act carried out as intended by Congress. That means that we need the faithful implementation and enforcement of those protections that Harley Staggers and his colleagues wrote into the legislation. That is not taking place today. That's the bottom line.

The private interests of the railroad industry—but not the public interests of the Nation—continue to be protected by a Surface Transportation Board that is unwilling to provide adequate oversight of the railroad industry or to restrain their unbridled exercise of market power over captive customers. Under the watch of the STB (and its predecessor the ICC) the railroad industry has been allowed to consolidate from more than 40 major railroads in 1980 to just four major railroads today that carry over 90 percent of the Nation's rail freight. That's what this issue comes down to. Any entity that requires rail service, is not served by two of the remaining railroads and must rely on railroads for transportation has no access to transportation competition. That rail customer must do business with the railroad that holds the customer captive on any terms dictated by the railroad. That's what's known as monopoly power.

The STB shows bias toward the railroad industry monopolies and against the legitimate interests of rail customers. Recent STB actions suggest that—without major reform—shippers and consumers will continue to be at the mercy of a greedy railroad industry. That, we believe, threatens the health of our economy and in many instances our national security interests.

Government Accountability Office: Concerns About Competition and Captive Rail Rates

The Government Accountability Office (GAO) issued a report last fall outlining a pervasive and increasing lack of competition in the rail industry. The GAO report, first issued in October 2006 and supplemented and updated on August 15, 2007, was requested by a number of Members on this Committee. The GAO found that rail prices are on the rise and a significant number of rail customers are paying more than three times what it costs the railroads to move their freight.

The GAO concluded:

- "Concerns about competition and captivity (in the rail industry) remain as traffic is concentrated in fewer railroads."
- "[The Surface Transportation Board's] rate relief processes are largely inaccessible and rarely used."
- "We believe that an analysis of the state of competition and the possible abuse of market power, along with the range of options STB has to address competition issues, could more directly further the legislatively defined goal of ensuring effective competition among rail carriers."
- "Significant increases in freight traffic are forecast, and the industry's ability to meet them is largely uncertain."
- "Costs, such as fuel surcharges, have shifted to shippers, and STB has not clearly tracked the revenues the railroads have raised from some of these charges."

The GAO report showed that freight rail rates are continuing to rise, even as carriers shift more and more costs to rail customers. Railcars owned by freight railroads no longer carry the majority of tonnage. The GAO study concluded that railcar ownership has shifted by 20 percent since 1987, with rail company cars carrying only 40 percent of the load in 2005, compared with 60 percent in 1987.

Railroad Profitability: A Golden Age of Railroading

Opponents of any changes in railroad policy have said for at least 20 years that current rail policy is necessary to ensure the financial viability of the rail industry and that the rail industry will go broke if any constraints are put on its existing monopoly power. Now, the rail industry is not going broke, they're in the black and thriving on Wall Street. Obviously America's major railroads are doing very well financially. Meanwhile, rail customers have waited two decades to see the Surface Transportation Board, and its predecessor the ICC, carry out the promises that were made in the Staggers legislation. Rail customers need these promised benefits today.

Simply put, the railroads have turned the corner from the difficult days that led to the Staggers Act and are now clearly able to attract and retain the capital they need to run their railroads and run them profitably. What we actually have today are record profits, record share prices, and enough revenue in the rail industry for the major railroads to buy back billions of dollars worth of their stock. We're seeing that happen today. This mature, basic American industry has become the darling of hedge funds and other aggressive investors. Why? Because railroads enjoy pricing power over an ever-increasing number of their customers.

I have a chart that compares the difference in rail transportation prices paid by customers with access to competition and those rail customers without access to competition. The rates have declined steeply for rail customers with access to competition and are remaining relatively low. Where there is no competition, the rates are going up. The chart shows average competitive and captive rates for four different commodity groups in the first quarter of 2007. There is no way that this variation in rates between captive and competitive rail customers is meeting the intent of the law. The promise that was made twenty-seven years ago is not being carried out here. The blatantly defective implementation of the Staggers Rail Act by the STB is unacceptable to rail customers, and it should be unacceptable to Congress.

STB Process Is Broken

The GAO study also concluded that the rate relief processes of the STB are largely inaccessible and rarely used. Now why would they be rarely used? Well, I would suggest that those who are captive shippers see little hope that the Surface Transportation Board will provide any meaningful relief from high railroad rates. The railroads say they are already subject to strict regulation and that shippers have a right to file complaints with the STB regarding rates. This—of course—is far from the truth. It is important to understand the very limited extent to which railroad rates are subject to any review by the STB.

Only an extremely small set of rail rates are eligible to be considered for any relief by the STB and these rates are not "regulated" in the classic sense of that term. Classic regulation requires regulators to protect the public interest over the private interest. In this case, the STB has turned into an agency that protects the private railroad monopoly interests. Here is how they do it.

Any rail movement for which there is a rail contract is exempt from the STB's jurisdiction altogether. In addition, the STB has exempted from its jurisdiction much other traffic (including intermodal traffic) from its regulation. STB Chairman Nottingham testified to the House Transportation and Infrastructure Committee on September 25th that only 10 percent or less of rail rates are subject to review by the STB.

For rail traffic that is "captive" and thus subject to regulation, the railroads have the initial flexibility to impose any rate they want without seeking any form of "prior approval" from the STB. The rail customer may then challenge the rate, but only if the rail customer can prove to the STB that the customer has no economically viable option but to use the railroad in question (an absence of effective competition) and the rate is at least 80 percent higher than the direct cost to the railroad of moving the customer's freight (the rate exceeds the jurisdictional threshold of 180 percent of variable costs).

The rail customer then has the right to seek rate relief from the STB, but only if the rail customer can prove to the STB that the rate exceeds a reasonable maximum. This reasonable maximum is called "stand alone cost"—what it would cost the customer at current prices to build and operate its own railroad to move its own freight. Since the STB cannot reduce a rate to a level below 180 percent of variable

costs, captive rail customers will always pay at least 80 percent more than it is costing the railroad to move their freight. The rail customer in a "stand alone cost" case must pay a filing fee to the STB of $178,200 to begin this process.

Congress did not provide in legislation this rate standard or this process in which the rail customer bears all burdens of proof. This process was developed by the STB and the Interstate Commerce Commission before it. The Staggers Rail Act simply directs the regulatory agency to ensure "reasonable rates" for those rail customers without access to competition while allowing the railroads the chance to generate sufficient revenues to attract and retain capital.

In recent years, it has been impossible for shippers to obtain meaningful relief at the STB. While the jurisdictional threshold (or minimum a rail customer must pay) is set at 80 percent above the railroads' direct cost, shippers have been unable to get any rate relief when their rates amount to 3 to 5 times—or more—the direct cost of moving the freight in question. Extracting margins of 300 to 500 percent from rail customers, who have no alternative but to use a single monopoly railroad for transportation, is not in any sense "reasonable" and is not what Congress intended. These enormous rates on individual rail customers are not fair and are simply not in the best interests of the Nation.

The STB's September 10th decisions in the Basin Electric and AEP West Texas cases underscore that the STB process is fundamentally broken. After Basin's long term contract with its rail carrier expired, the rail carrier—Basin's only option for moving coal to its power plant in Wyoming—doubled its rates to Basin and refused to provide a long term contract. Basin brought a rate complaint to the STB. After Basin and the other owners of the plant invested 3 years and more than $6 million, the STB on September 10th ruled that Basin should receive no relief from these rates. In the case, Basin proved that the new rate (as of today) is more than 6 times the direct cost to the railroad of moving the coal and, if the rate were to remain in place for twenty years, would escalate to over 8 times the direct cost to the railroad. Mr. Chairman, in this case the STB essentially sanctioned a $1 billion transfer from electricity customers of the owners of this plant to Burlington Northern over the next 20 years.

Basin played by all of the rules. They submitted volumes of evidence supported by dozens of expert witnesses—the most comprehensive rate case ever presented to the STB. They responded promptly and completely to the STB's every request and filed multiple rounds of supplemental information. They had a strong case and met all of the evidentiary requirements for establishing the unreasonableness of the involved rates.

After Basin had submitted mountains of evidence in this case and the evidentiary record was closed, the STB implemented new rules it claimed will improve the rate challenge process. The STB promised these changes would not prejudice Basin's case and, over the objections of Basin and all other rail customers with pending rate cases, applied these new rules to pending cases, including Basin's case. The STB was wrong. In its final decision the Board admitted the new rule changes were prejudicial to Basin and may have destroyed any prospects for this nonprofit electric cooperative to obtain rate relief.

The clear message from the STB to Basin customers is that the STB will protect the private economic interests of the monopoly railroads no matter the costs to the public. A second message may be even more troubling: the STB doesn't really understand the implications of its rules and its rules changes.

Will the STB Correct its Implementation of the Staggers Rail Act Without Legislation? No! Three Examples:

Mr. Chairman, some Members of Congress and others acknowledge that the STB processes are not operating properly—as the October 2006 GAO report verifies—but want to believe that the STB can and will make adjustments in its policies to get back on track implementing the Staggers Rail Act properly. Rail customers have heard this argument before. In fact, we have heard it for at least a decade since the last major rail merger left the Nation with essentially four major railroad systems. We see no evidence that the STB is on track to correct its implementation of the Staggers Rail Act.

I. The Rate Process Does Not Work

Rail customers have complained that the rate process doesn't work. The GAO report says it's "inaccessible" to most rail customers. I just discussed the changes the STB recently made to its "large rate case" rules—which hurt rail customers. The STB also had "small rate case" rules. The rules that have been in place for 10 years have been used twice, with both cases being settled. Three "small rate cases" were

recently filed by DuPont. Currently, 36 rail customer groups oppose the new "small rate case" rules and have asked the STB to reconsider these rules.

II. Rulings Block Access to Rail Competition

Rail customers point out two rulings of the STB sanctioning railroad practices that artificially prevent rail customers from accessing rail competition.

In the "bottleneck" decision of 1996, sometimes referred to as the "quote-a-rate provision," the STB decided that a railroad is not required to move a customer's cars to a junction where that customer could reach competition on another railroad. This ruling has resulted in captivity for many rail customers. Chairman Nottingham, in his testimony to the Senate Judiciary Committee on October 3rd, said that the "bottleneck" issue was the issue he heard the most about during his pre-confirmation visits with stakeholders and others. But in the 14 months since becoming Chairman, he hasn't had time to "get his arms around" this issue. Without Congressional directive, this issue will not be resolved fairly by the STB.

The STB also sanctions a second anti-competitive practice that allows major railroads to include in their track lease contracts with short line railroads provisions that prevent the short line from doing meaningful business with any railroad other than the railroad from which it obtains its track. These provisions are called "paper barriers" or "tie-in agreements." Since many short line railroads interconnect with more than one major railroad, these "paper barriers" are major impediments to competition. The STB held a hearing on this issue and indicates that it will issue a decision before the end of October. There is no indication of whether the STB will ban these types of agreements at all, only ban them for the future, or allow them conditionally. Since there are several hundred short line railroads operating under these contractual limitations, rail customers are extremely interested in what the STB will rule with regard to existing agreements.

The fact, Mr. Chairman, is that more than a year after GAO's recommendation that the STB study rail competition has the STB agreed to a study of competition issues. The study will take at least a year Meanwhile, the STB has taken absolutely no action on the second part of the GAO's recommendation that they act to ensure competition—and rail customers suffer from lack of competition every day while the STB ponders.

III. Fuel Surcharges

The STB has not moved from its passive position to a more pro-active regulatory oversight position even though the rail system has consolidated to four major carriers—consolidations that were all approved by the STB, sometimes over the objections of the Department of Justice. An example of the problems caused by this passivity is the abuse of fuel surcharges by the major railroads.

Last summer, when this Subcommittee conducted its last STB oversight hearing, fuel surcharge abuses were a focal point of the hearing. At this Subcommittee's hearing, the Acting STB Chairman testified that the Board couldn't determine who was right on the issue: the major railroads or their customers. Seven months later, the STB finally ruled that the customers were right. In January of this year, the STB held that the railroads were abusing the fuel surcharge program and often "double dipping" on fuel costs. The STB ordered the railroads to change their practices by the end of April 2007.

The STB did not, however, fine the railroads, order refunds or credits to rail customers for overcharges or act early to enjoin this practice until the railroads could justify its fuel surcharges to the STB. The result: a recent study performed for the American Chemistry Council put the price tag on fuel overcharges at $6.4 billion.

This entire problem could have been avoided if the STB had acted pro-actively, as they are empowered to do, to enjoin this practice early until the railroads could justify their practices. As it is, the railroads have pocketed their ill-gotten gains before the STB acted with no penalties for their past unreasonable practices.

IV. Conclusion

Mr. Chairman, these examples illustrate why the STB is not on track to correct its misapplication of the Staggers Rail Act. Moreover, even if the Board were to suddenly decide to correct its practices, it will take years of agency action and further years of litigation while the railroads test the legality of any "improvements" before any new concepts of the STB are tested fully. For these reasons, enacting S. 953 is a more certain and faster avenue to ensure that the STB is implementing the Staggers Rail Act as intended by Congress.

Implement the Staggers Act Or Repeal It

If Congress doesn't believe there is a compelling crisis for captive shippers under the *status quo,* then the honest thing to do is to repeal the Staggers Act. Either Con-

gress should insist on its will being carried out, or it should repeal the law that was intended to ensure competition and protect rail customers. Rail customers have heard the worn refrain before: give the STB a little more time, they are trying to correct their problems, "next year, next year." How many years do we have to go before the Congress says enough is enough? The STB gets interested in rail customer issues only when Congress is interested in this issue. If Congress says we will not do anything but give the STB a little more time, the STB's interest in reforming its practices will cease as the focus of Congress moves on to other issues.

Rail customers are in crisis and we need action now.

S. 953 Is the Solution: Reform Is Not "Re-Regulation"

S. 953, the Railroad Competition and Service Improvement Act of 2007 puts the STB back on track to implement the Staggers Rail Act of 1980 as it was intended. This legislation is a constructive and balanced approach to correcting the problems at the Surface Transportation Board.

I want to address two allegations that are being made by opponents of this important legislation. First, many opponents charge that the legislation "re-regulates" the Nation's railroads. This allegation of "re-regulation" is flat wrong, as the CEO of Union Pacific conceded in his testimony to the House Transportation and Infrastructure Committee on September 25th on the House companion legislation to S. 953. What the railroads call "re-regulation" refers only to requiring that the STB serve—as Congress intended—the public interest rather than only the private monopoly interests of the railroads.

Here Are the Facts

No railroad rate that is not subject to regulation by the STB today will become subject to regulation under S. 953. No provision of S. 953 empowers the STB to take any action that could be termed as "re-regulatory" under the most generous interpretation of that term.

However, S. 953 does improve the process for determining if a railroad rate to a rail customer without access to competition is reasonable. But this legislation does not broaden the universe of rates eligible for this review process. The bill also does not reduce the minimum level of rate that qualifies for review by the STB. That minimum is a rate that is 80 percent more than the direct cost to the railroad of moving the freight in question.

The bill overturns the "quote-a-rate" and "paper barrier" decisions of the STB—two improper interpretations of the Staggers Rail Act that allow the railroads to prevent their customers from reaching a competing railroad. These provisions are "pro-competitive" and will extend competitive deregulated rail service to more rail customers. Efforts to ensure competition in the freight rail industry are to ensure that the STB's rate challenge process works are not re-regulatory.

Second, opponents of S. 953 use a graph that shows railroad rates declining significantly since 1980. This graph confuses the issue by introducing irrelevant information. The data represents *all* railroad rates, not just the rates paid by rail customers without access to competition. Until the last few years, the majority of rail customers did have access to competition and their rates have declined significantly. The rates of the minority of customers without access to competition were not declining, but were "averaged out" by the declining overall competitive rates. If the railroads were to show a graph of captive rates over the last two decades, that graph would go in exactly the opposite direction from the graph showing declining rates.

Mr. Chairman, S. 953 will provide the tools necessary for the STB to ensure that there is competition in the rail industry and that captive rail customers have a fair process for challenging rates. The bill will achieve the goals envisioned by Harley Staggers in 1980. Rail customers need an equitable forum to voice their concerns and a regulatory agency that operates in the public interest rather than for the private interests of the Nation's Class I railroads.

Conclusion

Mr. Chairman, thank you for conducting this hearing today. We look forward to working with this Committee and with all of the other stakeholders involved to resolve these critical rail transportation issues in an objective and constructive manner.

Senator LAUTENBERG. Thank you.

Let the elapsed time that ran over not be an endorsement. Mr. English, don't take any comfort from that.

Mr. ENGLISH. Well, I just assumed it because I was last, Mr. Chairman, and you were trying to be kind to me.

Senator LAUTENBERG. Because you were so unspecific about the things that——

[Laughter.]

Mr. ENGLISH. Well, I'll be happy to read all the names into the record.

Senator LAUTENBERG. Thank you very much.

[Laughter.]

Senator LAUTENBERG. We had expected the vote to kick off at 11; and it has not. So, we'll take advantage of the time.

But I would ask, among the witnesses, if we were to recess for 45 minutes, whether that time for you to sit with us and review some questions is available to any or all of you. For those who can't, we understand. And, in terms of my colleagues?

Senator ROCKEFELLER. Mr. Chairman, I think that—the votes don't start until 11:30.

Senator LAUTENBERG. This is not sleight of hand, I can tell you.

[Laughter.]

Senator LAUTENBERG. They just changed the vote to 11:30.

Now, let's go back, and you all repeat your testimony.

[Laughter.]

Senator ROCKEFELLER. Now we can have two glorious rounds of questions.

Senator KLOBUCHAR. Right. We're ready to go.

Senator LAUTENBERG. All right. What we'll do is try to limit our questions to 3 minutes to see how far we can go along, with four, five, six of us here now—4 minutes, and see what that does for us. And I'll start.

Ms. Hecker, in 2005, members of the Commerce Committee, including me, asked your agency to examine rail shipping rates and infrastructure needs. Now, in your opinion, is the system working as it should?

Ms. HECKER. Well, there was that balance that was in the Act, and, basically, there is unmistakable evidence that an industry that was near collapse has been recovered, and, as many of you said, has become an important economic engine in this whole economy. So, we have a vital, efficient, and very important and functioning rail industry.

The balance that was called for, in our view, has not really been fully implemented. It's the inefficiency, the inaccessibility of the captive or the stranded shipper that really, in our view, has been an area that requires far more attention.

Senator LAUTENBERG. So, it is not working, you say, as it's intended. Are there any specifics that you would point to where you think it's failed?

Ms. HECKER. Well, one is in the attitude, in our view, of the way the Board has seen itself. It's seen itself as reactive, in our view, responding to cases that were brought before it, and not really taking an affirmative role in monitoring and promoting competition. And it's our view, as Mr. Ficker pointed out, a preeminent element of the Staggers Act was to rely on competition, not *laissez-faire,* just leave it alone and hope it'll come, but actually the ability to promote competition. And there are a number of areas where the

Board could take some action. Some of them are old rule—rulemakings that would need to be revisited. But there are some ways they could really enhance the functioning of the market.

Senator LAUTENBERG. Mr. Nottingham, do you think that renewed interest in the railroad industry by Wall Street, including large hedge fund investors, might have any negative effects on the industry or its ability to safely move our Nation's freight?

Mr. NOTTINGHAM. Mr. Chairman, it's hard to say. It obviously depends on their conduct—their future conduct, and their actions. I will say, generally speaking, we welcome, at the Board, more investment in the rail sector, I think, as a taxpayer personally and a consumer—I would say that more investment is needed. We have a huge infrastructure capacity problem, and we're way behind. We had a major hearing on this topic in April.

I know there is a lot of uneasiness, because these are some new people. Some of them operate from—with foreign addresses on their return envelopes. And it's not always clear that they necessarily have a deep passion for railroading and providing better rail service. But that remains to be seen. And the minute any of them actually enters the rail business, we will be spending quality time with them and watching them very carefully, and using every tool in our toolbox to make sure they conduct themselves in the public interest.

Senator LAUTENBERG. Thank you.

Mr. McGregor, in the case of BASF, what impact has excessive rail shipping rates had on consumers, in your view?

Mr. MCGREGOR. Well, we clearly have to pass those costs on to our customers. I mean, if you look at, for example, in selected lanes at one captive site that we have, we've seen annual increases—in 1 year—of over $8 million. You know, clearly we have to pass those costs on to our customers, and that makes us less competitive in the global economy.

Senator LAUTENBERG. Thank you.

Senator Smith?

Senator SMITH. Thank you, Mr. Chairman.

Mr. Nottingham, I noted in my opening statement that there is a rail line in the Coos Bay area, now owned by a private equity firm, giving no assurance at all to their willingness to spend money to maintain these tunnels. Layoffs have occurred in the timber industry, in particular an entire section of my State is being affected by this. I'm wondering if, as the Chairman of the STB—do you believe that the private equity in some way compromises a railroad's common carrier obligation? Do you think that it is something that I should be concerned about? I know Coos Bay is.

Mr. NOTTINGHAM. Senator Smith, thank you for the question. We don't have any information to indicate to us that there is any linkage between the type of investors or the type of ownership structure or the background of owners and any problems out in the rail network. Now, that's not to say there are no problems. We're monitoring, working very closely with your constituents in the—at the Coos Bay Port and the related stakeholders. Yesterday, we received, for the first time, a written description of specific problems out there. We knew about those problems before, because we've

been in discussions. I met with their attorney, just last week. The——

Senator SMITH. But, do you feel the STB has a role in making sure that investments are made and maintenance is done, so that these situations don't occur? Do you have the authority? Do you feel like you're on top of the situation?

Mr. NOTTINGHAM. Yes, sir, we do. I have to be a little careful at delving into the details of that matter, because it may well come to us formally. Right now, it's in the informal stage. But, generally speaking, in a case such as Coos Bay, but not speaking about that case, in particular, so I don't have to recuse myself if it comes to us formally, a railroad has the responsibility to keep its rail lines open and running effectively for its customers, or it has an obligation to abandon and make room for someone else. And that's what we'll be looking at. Will the railroad step up and put forward a prompt repair schedule for that line? And, if not, will it be abandoning and allowing other carriers? And we have heard there could be some interest in other carriers. West Coast——

Senator SMITH. From what you know, the——

Mr. NOTTINGHAM.—port access is a prime—is prime real estate.

Senator SMITH. From what you know, this particular situation—I don't want you to answer in a way that you have to recuse yourself, but, I mean, it really does seem that the obligation that the railroad has to its common carrier responsibility is really lacking. And so, anything you can do to put the spurs in these folks, a lot of people are counting on that, and I would appreciate anything and everything you can do, and as soon as you can do it.

Mr. NOTTINGHAM. Senator, we will continue to work in a very focused manner on that. We were in touch yesterday—my office was in touch with the Federal Railroad Administration, which, of course, has the lead on the safety concerns. The railroad in question has cited severe safety concerns of a human-life-threatening-type potential nature. We don't know that those concerns are valid for a fact. We will defer to FRA. They apparently have done a visit and inspections, and they should be making a report very soon. And then, we look forward to working with the port to make sure they have the opportunity to avail themselves of all the legal tools that we can then use to resolve that problem out there.

Senator SMITH. Well, I thank you for that. Only one other question, Mr. Nottingham. In your testimony, you talked about the growing capacity demands that will occur in the next 10 to 15 years. Now, that is going to require a tremendous amount of investment. Obviously, there are many feelings about this, how it's best accomplished, whether through re-regulation or by letting the private markets accomplish this. You are undoubtedly familiar with the bills that are being presented. What do you think these bills, if passed, would have—what impact would they have on competition, on the marketplace, actually, providing the investment to make these capacity enhancements?

Mr. NOTTINGHAM. Well, Senator, your question goes to the very heart of the top rail transportation policy problem before us as a country. And it's a problem that, unfortunately, many of the witnesses today just skipped on by or barely touched on——

Senator SMITH. So, do we——

Mr. NOTTINGHAM.—which is the——

Senator SMITH.—do we need——

Mr. NOTTINGHAM.—capacity crisis that we face.

Senator SMITH. Yes. I mean, so, do we best do this—meet the capacity demands through reregulation or through investment?

Mr. NOTTINGHAM. I do have concerns that some of the proposals mentioned this morning do not appear to work to actually provide the benefits, not only to meet the capacity problems that you and I are talking about right now, but also actually don't work to help shippers, which is unfortunate, it'll come back to our agency, presumably, to take the blame if they don't work as implemented. We will implement, as best we can, any regime this Congress enacts into law, but I do have some concerns, and we have not been asked for a formal assessment of any of the Senate bills that were mentioned this morning, I don't believe, but we'd be happy to do that, upon request.

Senator SMITH. Thank you very much.

Senator LAUTENBERG. Thank you very much.

Senator Klobuchar?

Senator KLOBUCHAR. Thank you, Mr. Chairman.

I wanted to follow up, Mr. Nottingham, about some of the things that Mr. English was raising, and that is just because the situation seems so one-sided here, I was interested to learn about the fact that your two immediate predecessors left the Surface Transportation Board to represent the railroads, one joined the law firm that represents Union Pacific, the other took the General Counsel position at Burlington Northern. And I wondered if you had numbers on how many other staff members have gone to join railroads.

Mr. NOTTINGHAM. Senator, I don't have those numbers with me today. We're an agency of about 140 employees. We are managed by a three-person Board, confirmed by this committee. It's bipartisan. I can say to you that none of the three members of the Board have any past affiliation with railroads. I can certainly say I do not. And I have conferred repeatedly, because this issue is a little bit of a canard that comes up amongst people who, frankly, work full-time as lobbyists or stakeholders for one perspective. Have there been some high-profile cases in the past? Absolutely, yes. Does that make my life a little more complicated some days? Yes. I wish, you know, it wasn't so easy to point at——

Senator KLOBUCHAR. Is there a cooling-off period between when someone leaves the employment of the Surface Transportation Board and goes to a railroad?

Mr. NOTTINGHAM. Well, I've been a Federal employee off and on for upwards of 8 or 9 years, and when I left Federal service previously, I went to State government, so I've never really personally had to explore the cooling-off process, and thinking about a future career in the private sector. But I am told that we are covered by the same laws that cover the entire Executive Branch, which do include a cooling-off period.

Senator KLOBUCHAR. Do you know how many staff members you'd hire that have captive-shipper experience? I know there are a lot of people who have been hired from the railroads. Could you give me numbers on how many you've hired that have had that kind of experience on the other side?

Mr. NOTTINGHAM. Sure, I can—I'd be happy to give you both those numbers for the record, if we could.

I can—I'm pleased to introduce to you today, because she's sitting behind me, my Chief of Staff, Rachel Campbell, who worked in the private sector for shipper interests, primarily, in her law career. And that's just one example. We don't—it should be of no surprise that when we look for expertise in the rail transportation sector, we actually get some people who apply who have expertise and experience in the rail transportation sector. I don't think we want to send—put a sign up saying those people are not wanted. Many of them come with different——

Senator KLOBUCHAR. I'm not suggesting that. I'm just trying to figure out—it seems as though, given the money that it costs to bring a claim, the issues we're seeing on that chart with the rate differential, that there should be some action taken. I'm not seeing that action, so I'm trying to figure out what the motivation is.

And, I guess, the other question that I have, for Ms. Hecker, is, in this report you did in October 2006, you asked the Surface Transportation Board to do a study, and I think they waited 10 months to begin that study, and we're not going to see the required results until late 2008. Do you think we can just wait for them to act, when we've seen no action, as Mr. English was pointing out, in terms of decisions, to help these shippers? Or do you think it would be reasonable to proceed with some legislation?

Ms. HECKER. Well, we have not specifically reviewed legislation. The concern that we had is that there are significant costs and risks to many of the actions that the Board could take, or legislative actions. And there is a continuing national interest in the economic viability and investment by this industry. And I think everyone agrees that we can't handle all the freight on the roads, and we need to have growing capacity on the railroads. So, there is a balance issue, and it is true that many of these actions do have the potential to reduce railroad revenues. And, therefore, it was our recommendation, and, we believe, the facts of a far more comprehensive, rigorous review than has ever been done—not reaction to a particular case—many of the shippers who are captive were captive before all the mergers, and no one's looked at those conditions. So, this comprehensive review, in our view, from a public policy standpoint, is the way to go, and then wait and see what the Board does with it. I mean, the study is just a study to get the evidence, and the real action then is, when we get the evidence, what the appropriate actions are to restore that balance.

Senator KLOBUCHAR. And so, I'm supposed to go back to my State and tell these captive shippers, whose rates have, in some cases, doubled, tripled, that they should wait for a study by a Board that hasn't found in their favor——

Ms. HECKER. Well, the reality is—you know, we talk about rates going up; rates have mostly gone down, for every single commodity, for 25 years; and it's one of the few industries. So, we have a more efficient industry. There are rates going up, and that's what happens in an economy where there is a constrained capacity. So, it's tighter all around, and that's why I think we need far more factual review of whether some of these recent rate increases actually represent market conditions or a real abuse of market power.

Senator KLOBUCHAR. Another way to do it and I will finish with this—is if we had a process that made it easier for people to challenge the rates. That process was set up. It is not easy for them to challenge them. So, then they are left with awaiting a study that we're told we'll get in late 2008. And that's why I'm pleased to hear that Senator Dorgan has taken the initiative to at least try to get those fees reduced so it's easier for them to challenge the rates.

Senator LAUTENBERG. Thank you very much, Senator Klobuchar.

Senator Vitter?

Senator VITTER. Thank you, Mr. Chairman.

Mr. McGregor, I think that you said—correct me if I'm wrong—that in your company's rail universe, about half of what you deal with are—is on the captive side, and about half of what you deal with has some competition.

Mr. MCGREGOR. That's correct.

Senator VITTER. If you compare those two halves, what do the prices look like?

Mr. MCGREGOR. Well, in some cases, as we said, the prices are extremely high. For example, on the captive side. I mean, we illustrated, in our testimony, that in some cases they approach at least 50 percent more than the noncaptive areas.

Senator VITTER. And, on average, how much higher do you think they are?

Mr. MCGREGOR. I would say, on average, probably in the realm of 50 percent.

Senator VITTER. OK. I also want to explore whether, actually, that captive situation impacts the noncaptive side. Are there situations, in terms of negotiations with railroads, where they actually use a captive line to impact and increase the rates beyond what they could otherwise on the noncaptive side?

Mr. MCGREGOR. In fact, I'm glad you asked that question, because that, in fact, is the case. I mean, currently, we are in negotiations where we're faced with significant increases at captive sites where we, in fact, have a competitive alternative for the total book of business that this particular service and railroad enjoys. When we have, basically, suggested that we're going to move that noncaptive business to a competing railroad, the response that we get from the railroad is, "Well, that's fine, you can go do that, but on your captive business, we're basically going to generate the same amount of revenue that we had previously." So, I'm just a simple logistician, quite frankly, and—at the end of the day, though, that seems like an egregious sort of abuse of a monopoly power.

Senator VITTER. So, in fact, the existence of some captive lines also impacts the rates on your noncaptive lines.

Mr. MCGREGOR. Absolutely.

Senator VITTER. OK.

Mr. Moorman, do you think that negotiating practice is fair or right or should be allowed?

Mr. MOORMAN. That's a negotiating practice that obviously cuts both ways, because we have lots of customers with lots of noncaptive traffic who attempt to bundle their business, and do so successfully.

I would make one point about Mr. McGregor's testimony——

Senator VITTER. But if you can just answer the question first, do you think that practice by the railroads——

Mr. MOORMAN. I think——

Senator VITTER.—of saying, "You move what you want on the noncaptive side, but the result is going to be rates going even more through the roof on the captive side"?

Mr. MOORMAN. Well, I would say that, in some situations, that's what the rail industry has to do if, in fact, it's going to be able to continue to invest in the way that it is today. Deferential pricing is not a practice that is uncommon in other industries.

I would point out one other thing, if I might, about the BASF testimony. And I would actually ask, Mr. Chairman, that you think about a hearing about this. One of the issues that concerns BASF, along with other chemical shippers, is that a lot of the material they're shipping, and some that's in question, is the so-called toxic inhalation hazard material. And, as you know, there are lots of issues in our industry and in—from the standpoint of public policy about the shipment of this material and the liability imposed. And that's one of the considerations that we have been looking at in thinking about this traffic.

Senator VITTER. So, to go back to my question, Mr. Moorman, you acknowledge that the presence of, maybe, a few captive lines also increases the rates in many situations on noncaptive lines beyond the competitive level——

Mr. MOORMAN. I——

Senator VITTER.—through bundling.

Mr. MOORMAN. Business is bundled, not only in the railroad industry, but in a lot of industries.

Senator VITTER. So, that monopoly situation flows over and impacts——

Mr. MOORMAN. It's a——

Senator VITTER.—a whole lot of——

Mr. MOORMAN. Well——

Senator VITTER.—lines that you would otherwise say are competitive.

Mr. MOORMAN. I would disagree with your characterization of "monopoly," but I would say, where traffic is less competitive, do we use that in negotiations with customers for their entire book of business? Yes, we could. Just as they use in negotiations traffic that is more competitive.

Senator VITTER. The other specific example I used is the Lafayette Utility System, where they have competition, they have choices for 1,480 miles of the 1,500-mile length between there and Powder River Basin, but they don't have choices, they don't have competition, in the last 20 miles. Do you think it's right, fair, should be allowed, for the lone carrier for the last 20 miles to extend its monopoly for the whole 1,500 miles?

Senator LAUTENBERG. We've been—if you have a very short response, or otherwise we're going to have to move on.

Senator VITTER. I would like some response, Mr. Chairman. Thank you.

Mr. MOORMAN. I would say that the economic reality is that the rail industry should be allowed to capture an adequate return on its investment for the entire route.

Senator VITTER. I'll take that as a yes.

Senator LAUTENBERG. Thank you.

Senator VITTER. And, Mr. Chairman, if I——

Senator LAUTENBERG. I'm sorry, we have colleagues here. Everybody wants to have a chance. I can't sacrifice their time. If you have other questions to submit, please do it in writing.

Senator Dorgan?

Senator DORGAN. Mr. Chairman, thank you very much.

Ms. Hecker, you talked about rail rates going down. But this hearing is about captive shippers. Have you broken out what has happened to rates with respect to captive shippers, as opposed to all rates?

Ms. HECKER. It's very hard to do that. So——

Senator DORGAN. I know it's hard.

Ms. HECKER.—in fact, we don't have detailed data like that.

Senator DORGAN. So, you've not done that?

Ms. HECKER. We have it by commodity, and we've broken it out by region.

Senator DORGAN. I understand. Have you broken it out by captive shippers?

Ms. HECKER. No, we've not been able to do that.

Senator DORGAN. That's the point of the hearing.

Ms. HECKER. And that's why we recommended the study.

Senator DORGAN. Right. And that's the point of the hearing.

Mr. Nottingham, first of all, when I said the STB, I felt, was worthless, it's not you, personally, or your staff. I just think, as an agency, it has disserved what I think should be an effective referee's role, and not only you, but your predecessors, have not done nearly as much as we would have expected. But the "worthless" quote is not about you, personally, it's about an agency and its response.

You say, "Railroads are expected to charge more, even substantially more, from their captive traffic than from their competitive traffic if they are to achieve enough revenues to cover their costs and invest in necessary facilities." I mean, that answers the issue here in front of us, doesn't it? You're saying, as Chairman of the Board, railroads are expected to charge more for their captive traffic. If you were captive, you think you would like that, you think you wouldn't be here objecting?

Mr. NOTTINGHAM. Sir, thank you for the introduction to your question. And I did—I noted you did say "relatively worthless," and I took that as a huge——

Senator DORGAN. Well, I modified it.

[Laughter.]

Mr. NOTTINGHAM.—step forward. In my review of past hearing records, you never—it was never that kind, so I think we're taking a huge leap, and I'll take pride in that.

[Laughter.]

Senator DORGAN. I eliminated the word "relatively," actually. I modified it in the second case.

[Laughter.]

Mr. NOTTINGHAM. But, thank you, and I will answer your question.

Senator DORGAN. All right.

Mr. NOTTINGHAM. Of course captive shippers should not be expected to be happy about differential pricing. That's why I've made it a point to go visit and spend time with them, and hear about their specific situations in Montana, in Brainerd, Minnesota, and elsewhere. And that's why we're doing this unprecedented study. We need to get a handle on that. But it is—we need to be straightforward and say that the framers of Staggers knew exactly what they were doing, that there was a differentially priced regime they were putting in, just as we all don't pay the same price for our airline seats when we're on an airplane, and, if we go to a movie theater——

Senator DORGAN. Well, Mr. Nottingham——

Mr. NOTTINGHAM.—at different times of day or at different age groups, we pay different ticket prices. This is not a unique concept, differential pricing. But, the answer to your question is, no, I don't expect captive shippers to be pleased with it.

Senator DORGAN. All right. But this is not equivalent to seeing a movie. This is an essential transportation. There are people that are held captive.

Now, you said that, when you went around and visited with folks, you found the most recognized issue, the one raised most often with you, was the bottleneck issue. And you've been there 14 months, I don't see any movement to fix that or deal with it the so-called quota rate, or the bottleneck issue. So, after a year or so, should we expect, on an issue that you heard the most about, that you'd take some action?

Mr. NOTTINGHAM. Well, we—the main reason we haven't done anything specific on the bottleneck policy issue is, one, it is pending in the legislation here today, but, two, we are in the midst of an unprecedented series of reforms at the Board, and it's literally a capacity question. We have the railroads all over us in court trying to stop our reforms, for the record, at the same time we have the shipper groups saying we're in—sort of this bizarre, friendly relationship with the railroads.

We are—the cost of capital rulemaking we have with us today is probably the single most significant change the STB or the ICC has ever proposed in leveling the playing field between shippers and railroads. That, combined with the new small rate case resolution process, plus the larger case resolution process——

Senator DORGAN. Well——

Mr. NOTTINGHAM.—plus the—what we did proactively—on our own initiative, contrary to what Ms. Hecker said—on our own initiative on the fuel surcharge, you cannot find an agency in this town being more proactive, I would submit, than the STB right now.

Senator DORGAN. Well, except for the fuel surcharge. You ordered the railroads to change their practices—after a lot of pressure, you finally ordered them to change their practices; you didn't order any refunds. And the fact is, it was determined they were charging more for the fuel surcharge than the fuel cost them. And you didn't order any refunds. But my point is this. My point is that you've been there for 14 months now, the bottleneck issue has been around forever. Don't blame your inaction on the fact that we've got legislation going on, and don't tell me that the industry that

opposes reform is unique. Every industry that is subject to some reform is going to come here to an agency or to the Congress and say, "We don't like that. We don't want you to do anything." And the STB certainly satisfies that urge.

So, if I might make one final point. Mr. Carlson, we tried to get some elevator grain operators to come here and testify. None of them would testify. Not one elevator grain operator manager would come here. And you had the reason why in your testimony. Would you repeat that, why they wouldn't testify?

Mr. CARLSON. Well, they get discriminated against in rates and the service, obviously, especially in service. If you have a competing grain elevator in your town, and one company, one operator, complains about service from BNSF, and the other doesn't, guess which one's going to get the cars to take that grain that's piled on the ground? We've got—as a result of captive shipper status in our State, we've got take-it-or-leave-it service, high rates, we even have—Senator, you—I'm sure you know this—our conservative, fiscally tight-fisted State legislature has twice—two legislative sessions, 2003 and 2005—appropriated State funds to bring a rail rate case to the STB. So, I mean, this is a serious problem, and it's 20-some years that we've been experiencing this. And finally we're beginning to see some attention.

Senator DORGAN. Mr. Chairman, thank you very much.

Senator LAUTENBERG. My pleasure.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Chairman Nottingham, I'm just going to pick up on something that Senator Dorgan said, but you failed to answer, and that is that the Board did investigate these areas, fuel charges by AAR members, but I want to ask the question, why did you not ask for refunds?

Mr. NOTTINGHAM. Senator, thank you for the question, because I was hoping to have a chance to answer it. The simple reason we have not ordered refunds in the fuel surcharge area is primarily due to the fact that we've not received a single formal complaint requesting refunds.

Senator ROCKEFELLER. I see. So you know it's a problem, but nobody's come to you, and so, you haven't had to do anything.

Mr. NOTTINGHAM. We have corrected the problem using——

Senator ROCKEFELLER. Is that passive or is that aggressive?

Mr. NOTTINGHAM. It's incredibly aggressive. The Board has never acted as aggressively.

Senator ROCKEFELLER. How are you aggressive?

Mr. NOTTINGHAM. We, on our own motion, sir, with no complaint, did something the Board had never done before, which is conduct an unreasonable-practice inquiry over threats of litigation by the railroads that we didn't have that authority.

Senator ROCKEFELLER. Right. And then did nothing about it.

Then did nothing to solve it.

Mr. NOTTINGHAM. We ended that practice and set a new national model, and we'd be happy to look at any complaint. In our country, sir, one has to actually present some evidence——

Senator ROCKEFELLER. Does it occur to you that——

Mr. NOTTINGHAM.—of wrongdoing to get some justice.

Senator ROCKEFELLER.—as Mr. McGregor said—and I agree, I'm not going to say whether you're worthy or not worthy, but I've never seen an STB Chairman or Board which has done anything but make our situation worse or contribute to the comfort of the railroads. I think Mr. McGregor also pointed out that the cost of bringing a suit, of bringing something before you can get up to $3 million. I go over many, many, many years of history of this in my State and on this committee and nobody's ever come to you. They don't come, because they know they can't afford to come, because you're going to turn them down anyway, and they're not going to get their money back, so they don't come. Do you deny that?

Mr. NOTTINGHAM. Sir, I recognize, that is a huge problem and challenge. It has been largely remedied, in our view, by some ambitious actions in the last year. We have completely retooled and rewritten the procedures to bring small rate cases, as well as the larger ones, which do cost—we've been very clear, and recognize this is a problem, formally in writing—$3 to $4 million, and we've heard about cases of $5 million. Currently, under our new rules, though, sir, you can come in, and, for a $150 filing fee, get up to a million dollars in recovery within 8 months, guaranteed. And DuPont is in the process, we understand, of taking advantage of that. We look forward to seeing how those cases play out, and then we can discuss——

Senator ROCKEFELLER. Thank you.

Mr. NOTTINGHAM.—how our new rules are actually working.

Senator ROCKEFELLER. Thank you. Mr. Moorman——

Mr. MOORMAN. Yes, sir?

Senator ROCKEFELLER.—does your railroad have any situations where you serve a customer, at either the origin or the destination of a movement, with some segment where there is a potential for competitive traffic, but for which you refuse to provide a shipper rate quote so they can negotiate with another railroad? Do you have any such situations?

Mr. MOORMAN. Yes, sir, I'm sure we do.

Senator ROCKEFELLER. Yes, I'm sure you do, too. And why do you decide not to do that?

Mr. MOORMAN. Because we feel that it is appropriate for us, in a market, to quote a through rate to allow us to return an adequate—earn an adequate return on the investment we've made in the entire route.

Senator ROCKEFELLER. Do you know, Mr. English—I have several heroes in this committee, and you're one of them—on this panel—Harley Staggers, a West Virginian, passed this Act, and 20 percent of those, as you say, were stranded railroads. And what's interesting, they didn't put into the law, at that time, any sanction for criminal behavior. If they had done that, I sorely suspect that there would be a lot of people at this table who weren't just coming year by year to complain about something that never gets fixed because the railroads always get their way out of it, that there would be criminal charges, because they are violating a Federal statute, in my judgment, in a criminal way. But, in that it's not in the law, nobody can proceed that way.

Finally—you don't disagree.

Mr. ENGLISH. No, Senator, I think you're absolutely right. It—but I'm sure that—I knew Harley Staggers, as well, and served with him, and I'm sure that this—the way this has played out, that it's certainly nothing in—along the lines he intended. If he had foreseen this, I think he might have put those provisions in, and then we'd have someone else we could turn to for stranded shippers.

Senator ROCKEFELLER. Wouldn't that be nice? Of course, they'd still have to go through the STB.

Mr. ENGLISH. That would be very nice. There would be a lot of people in jail.

That's correct.

Senator ROCKEFELLER. Final question, Mr. Chairman, to Mr. Moorman. John Snow and some of his predecessors always have enjoyed having their Board meetings at The Greenbrier Hotel in West Virginia. That is one of our proudest hotels, most wonderful hotels. A lot of people have been to The Greenbrier, but not been to West Virginia.

[Laughter.]

Senator ROCKEFELLER. I'm just wondering, when you're talking about making a profit so that you can upgrade your stock and track and all the rest of it——

Mr. MOORMAN. Yes, sir.

Senator ROCKEFELLER.—and, in that The Greenbrier is losing money, how do you justify The Greenbrier? How do you boast about that?

Mr. MOORMAN. Well, Norfolk Southern doesn't own The Greenbrier.

Senator ROCKEFELLER. Oh, you're not CSX.

Mr. MOORMAN. No, we're not—no, you—no, I——

Senator ROCKEFELLER. Well, I'm just going to——

Mr. MOORMAN. We're looking for simple prison accommodations rather than The Greenbrier, I guess.

[Laughter.]

Mr. MOORMAN. But we don't own it.

Senator ROCKEFELLER. Well, I think you got me on that one. Every time I look at somebody, I just see CSX.

[Laughter.]

Mr. MOORMAN. Yes, sir. And we—could I say, Senator, we don't want to be viewed as collateral damage in this. So—we don't own The Greenbrier.

Senator ROCKEFELLER. No, you're considered, not as collateral, but as major damage.

[Laughter.]

Senator LAUTENBERG. Thank you.

We're being granted, by omission, more time, so we'll use a little bit more of it.

And, I ask anyone, on the panel, is there a clear benefit to the consumer if Congress takes up legislation impacting rail rates?

Mr. ENGLISH. Yes, sir, I think, you know, the—again, we get back to this question. Every consumer who receives or buy—purchases any products from any stranded shipper is going to be paying more than they would otherwise have to pay for that product. There's no question. That gets passed along. Whenever our electric

cooperatives have to import coal from Indonesia because of the fact they can get it cheaper than they can from West Virginia or from Wyoming, something's wrong. Something is wrong. And, obviously, that cost gets passed along. There's no—we're not-for-profit, there is nothing else that we can do than that.

So, you know, the point here, Senator, is that this is wrong. There is no two ways about it. The Surface Transportation Board is not operating the way Harley Staggers intended, and somebody needs to fix it or repeal it, one of the two.

Senator LAUTENBERG. Mr. Moorman, what do you think?

Mr. MOORMAN. Senator, let me point out that, for the vast majority of rail traffic which is competitive, the consumer is an enormous beneficiary, and has been a beneficiary, as the charts show you, for a long time. And I'll give you just one example of our business, which is our intermodal business, which now comprises more than 20 percent of our volumes on—in the rail industry, and at Norfolk Southern. The consumer benefits, because our rates are lower than trucks. The consumer benefits, because trucks come off the highway. And the consumer benefits, from an environmental standpoint, because we're the more environmentally friendly way to do things. And I can cite you lots of examples beyond intermodal in lots of our business sectors where there is——

Senator LAUTENBERG. Yes.

Mr. MOORMAN.—transportation competition, and it's fierce, every day.

Senator LAUTENBERG. Yes.

Ms. Hecker, do you have a view on this?

Ms. HECKER. Actually, I think it's a very important question, because, while we definitely agree that the intention to protect shippers has not been fulfilled, we also would reiterate that the importance of an efficient, well-performing, and, in fact, growing railroad industry continues to be very much in the national interest. And I just wonder whether, if there is legislative action that does something to try to restore the balance, recognize that that will definitely reduce railroad profits and investment, and balance it with the debate, that is already in this committee, about how to support expansion of railroad capacity. So, there are two national interests here, and whether there might be some potential to marry them.

Senator LAUTENBERG. Thank you.

Senator Klobuchar, and we'll try to divide up the minutes, take a couple each, then Senator Rockefeller. And we're not going to reinstate the committee process. We'll finish this now.

Senator KLOBUCHAR. Thank you. Appreciate it.

I just had some questions—there has been a lot of debate about the status of competition, and I think that, the railroads have made clear that there is competition in certain areas in the country. But I was just looking at that GAO study last year, and it compared two grain shipping routes, from Minot and Sioux Falls to Portland, and the railroads carried comparable volumes, but the price from Minot was double that from Sioux Falls. And so, Mr. Moorman, do you know what the difference was, why that would be?

Mr. MOORMAN. No, I—that's not an area we serve, and I'm not familiar with any of the specifics.

I will say that it is entirely possible, on two different routes, to have two very different cost structures, in terms of the infrastructure that's employed, the maintenance that's required, and the assets that are used, and how quickly they turn. But there are so many variables in railroad costing that I just don't know the answer to your question.

Senator KLOBUCHAR. Would you be surprised if the answer that was that the Minot route was served by just one Class I railroad, and the Sioux Falls had two?

Mr. MOORMAN. It wouldn't surprise me. But, again, I don't know what the underlying economics of the moves are.

Senator KLOBUCHAR. Mr. Nottingham, when you have a situation like that—and then I know Senator Rockefeller has some questions here, this will be my last one—do you see why we would be interested in some kind of regulation so that wouldn't happen? It wouldn't have to be rate regulation. We're just trying to change the system so that it's easier for these captive shippers to make their case.

Mr. NOTTINGHAM. On an emotional level, I can understand why some would want to see change. But if you really get into the economics and look at the repercussions, we have a system of differential pricing, it's a flat-out fact, and we're not waiting for a study or for GAO to remind us of that. It's—everyone knows that we have a system of differential pricing. What that means is, some people pay higher rates, some people pay lower. There are a lot of shippers out there probably paying below so-called market—you know, really low rates, because of this system. They're not in the room with us, although, actually, Mr. Ficker probably represents a number of them. I'll let him speak for that, but he represents probably the most diverse group of shippers here.

So, that is a reality. If there are abuses of that, though—statements like "100 percent more" or—as a percent of what? We need to look at specific cases.

Senator KLOBUCHAR. Well, this is a pretty clear study. I mean, it's double the rate. And I just want to add one more thing. For our shippers, they're not that emotional, they're just looking at their accounting records.

Senator LAUTENBERG. OK.

Senator Rockefeller, you're the cleanup hitter here.

Senator ROCKEFELLER. Good.

Mr. Carlson—I'll make it quick—do you think it's fair to say that every time a North Dakota grain shipper is overcharged, or, as Senator Dorgan points out, made to haul his grain to a distant elevator via several trips in a tractor-trailer, just to load it and bring it back through his property, that, as a result there will be the effect of every loaf of bread being more expensive, every bag of frozen vegetables being more expensive, every gallon of ethanol being more expensive, and that the 20 percent of the shippers, which is what this whole hearing is about—not all the good things that have happened, environmentally friendly whatever—"environmentally friendly" and "railroads" don't sync with me very well in West Virginia, but I'll try to deal with it positively—but isn't that the effect of it—the cost to the consumer goes up?

Mr. CARLSON. Cost to the consumer goes up, absolutely, Senator. And the cost to the shipper, the farmer, goes up, as well.

Senator ROCKEFELLER. Do you worry about the railroads' financial condition? Do you stay up at night worrying about that?

Mr. CARLSON. We want to see the railroads be able to provide service, and, in a competitive environment, they do. But, when they're in a captive environment and have captive shippers, what happens is, you don't get service, you get sort of a take-it-or-leave-it service, and you pay a higher price; you don't get any benefit. So, yes, we don't want the railroads to be operating like they were in the 1980s or something like that, but we don't want to be gouged. It doesn't seem fundamentally fair to us that, if you're a captive shipper, you're price-gouged, and, if you're in a competitive area—we're, in effect, subsidizing somebody who's getting too low a rate. That doesn't sound like a good system.

Senator ROCKEFELLER. Isn't it true, sir, that this whole hearing is actually about the 20 percent who are getting gouged because there is no competition? All the other conversation is nice, but has no relevancy to this hearing. Everybody knows that the 80 percent where there is competition, where there used to be 50 Class I railroads, like—when I got here, there are now four—but the 20 percent that are getting gouged because of the bottlenecks and all the rest of it, that's what this hearing is about. And the final result is that prices for people are going up, while railroads are making money that they should not, in a fair system, make.

Mr. CARLSON. Thank you for bringing that to the attention of Congress with this hearing.

Senator LAUTENBERG. Thank you.

I note with interest that we've managed to complete this abbreviated session.

I thank each one of you. Again, I know there is a lot of work that goes into preparation for your being here, and—am sorry that we had to rush you along. But I do note, Senator Rockefeller, that the recent House hearing on this topic lasted 9 hours.

[Laughter.]

Senator LAUTENBERG. Mr. Ficker, were you there?

Mr. FICKER. We were all there, and thank you so much for not doing that to us.

Senator LAUTENBERG. Thank you all.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF EVAN HAYES, IMMEDIATE PAST PRESIDENT, NATIONAL BARLEY GROWERS ASSOCIATION; PAST PRESIDENT, IDAHO GRAIN PRODUCERS ASSOCIATION; MEMBER, IDAHO BARLEY COMMISSION; EXECUTIVE COMMITTEE MEMBER, ALLIANCE FOR RAIL COMPETITION

Mr. Chairman and members of this Committee, my name is Evan Hayes. I am a wheat and malting barley producer from American Falls, Idaho, Immediate Past President of the National Barley Growers Association, past President of the Idaho Grain Producers Association (IGPA) and Member of the Idaho Barley Commission. Additionally I serve on the Executive Committee of the Alliance for Rail Competition.

I am pleased to submit this testimony on behalf of the Alliance for Rail Competition (ARC), the National Barley Growers Association, the Idaho Grain Producers Association, Idaho Barley Commission and the agricultural community. The members of the Alliance for Rail Competition include utility, chemical, manufacturing and agricultural companies and agricultural organizations. Producers of commodities as wide ranging as soybeans, dry beans, lentils, rice, wheat, peas and sugar beets all have expressed concerns similar to those I will share with you today. Together, these organizations represent growers of farm products in more than 30 states.

Barley and wheat growers know that an effective railroad system is necessary for the success of our small grains industry. However, we continue to face many problems with rail rates and service. Over time, rail customers in the United States have grown more captive. As captivity levels have risen, a larger and larger share of the cost of transportation has been shifted to rail customers and state and local governments. Helping our members find solutions to rail freight problems remains a top priority for our state and national organizations, leading to our alliances with ARC and many other commodity coalitions and to our support of S. 953, which would provide a number of remedies to rail shippers.

The U.S. Trade Representative has been working diligently for a number of years to open up markets for agricultural trade through vehicles such as NAFTA, FTA's and WTO to facilitate a more competitive U.S. agricultural industry. However, all of this good work will have no positive effect if we cannot get our products to export points competitively with rest of the world. We are the only major world suppliers with a monopoly railroad between us and our markets which have the capability to take out all of the profit in the transaction.

Effects of Growing Rail Captivity

Since the passage of the Staggers Rail Act of 1980, the degree of captivity in many barley and wheat growing regions has increased dramatically, and America's farmers continue to experience both unreliable service and higher freight rates. We have had continuing rail equipment shortages since the railroads started aggressively consolidating and merging in the early 1990s. Producers know that increasing the breadth of crop production on farms can lead to greater efficiency and higher income, but rather than a focus on diversity, railroad companies view efficiency as hauling larger and larger movements of a single grade crop from a single origin to a single destination. Rail investment in grain movement has been shifted to the grain merchandiser and farm producer while the service level for less-than-trainload movements continues to deteriorate. We see value-added agriculture having to invest in rail rolling stock to ensure adequate equipment supply, yet when railroad service levels do not meet railroad-supplied schedules, agriculture is frequently called upon to even further increase investment in railroad rolling stock.

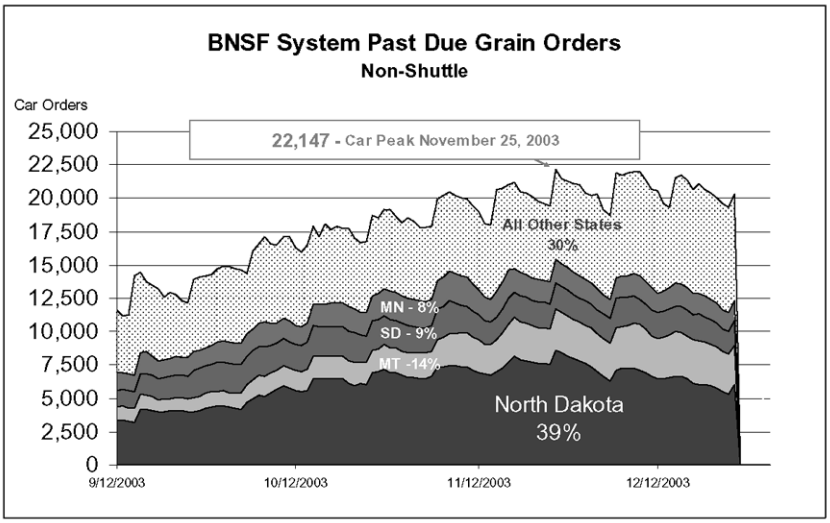
Twenty years ago, there were multiple transcontinental railroads servicing agricultural regions. Today, however, whole states, whole regions and now whole industries have become completely captive to single railroads as a result of many railroad mergers. In the grain industry alone there are substantial pockets of captivity in Texas, Oklahoma, Arizona, Colorado, Kansas, Nebraska, Wyoming, Idaho, South Dakota, Minnesota, North Dakota, Oregon, Washington and Montana. Because of

these pockets of captivity, the cost of transporting grain can represent as much as ⅓ (or higher) of the overall price a producer receives for his or her grain. This cost comes directly from a producer's bottom line. It is important to keep in mind that producers, unlike other businesses, cannot pass their costs on; as price takers and not price makers, producers bear all transportation costs both to and from the farm and from the elevator to the processor or export terminal.

Rail captivity has led to rail rates in the Northern Plains that have increased 40 percent faster than the Rail Cost Adjustment Factor including productivity unadjusted. Rail rates in Montana and North Dakota are between 250 and 450 percent of variable cost—far above the Surface Transportation Board's "threshold of unreasonableness" currently at 180 percent. Agricultural rail rates in excess of 250 percent of variable cost—among the highest freight rates in the Nation—can be found in virtually all of the states that have captivity issues.

Service also continues to be a major issue in farm country. During the 2003 car shortage, data produced by Burlington Northern Santa Fe (BNSF) showed that the most captive areas on the system were singled out for the highest level of past due grain orders. Of the 22,147 cars that were past due, more than 70 percent of the past due orders were in the captive northern tier states of Montana, Minnesota, North Dakota and South Dakota, though this area of the country makes up less than 20 percent of that rail system.

In October, the Government Accountability Office issued a report, GAO 07–94, *Freight Railroads—Industry Health Has Improved, But Concerns About Competition and Capacity Ought to Be Addressed,* available in full at *http://www.gao.gov/new.items/d0794.pdf,* confirming what we in the captive shipper industry have been stating for years: those areas that are captive pay the highest freight rates yet receive some of the worst service.



Wheat Is On the Ground in The Grain States—and More Harvesting To Do

Following the grain harvest in 2007, there were more than 10 million bushels of Colorado wheat stored on the ground primarily in areas where there was a lack of adequate rail service—captive branch line areas. Colorado did not experience a record crop—while the 2007 Colorado winter wheat crop was above average at 87.75 million bushels, it was well below the all-time record crop of 134.55 million bushels, produced in 1985, and the most recent high of 103.2 million bushels in 1999, and was smaller than wheat crops produced in 10 of the last 28 years. Yet millions of bushels sat on the ground because they were produced in areas served by single railroads with no rail-to-rail competition—areas we call captive.

Since 80 percent of Colorado's winter wheat moves by rail to export position in the Gulf of Mexico and the Pacific Northwest—too far to truck—the railroads know wheat on the ground will still be there when they get ready to move it. While U.S. wheat prices are at record highs, Colorado producers and elevator operators are being shut out of the market because they are located on captive rail lines. One of

the railroads has suggested that the reason for wheat on the ground in Colorado is that wheat is not being marketed. How cruel is that statement. When the railroad won't supply adequate car supply—wheat cannot be marketed in an orderly manner—but does anyone on this Committee believe that with record high prices any elevator would not like to market all of the grain they can get their hands on—*providing* they can move the grain. Compounding this problem is that the corn and millet harvests are just beginning and these commodities cannot be stored on the ground. The lack of rail cars creates an economic embargo on Colorado wheat producers, keeping them from fully participating in these record high prices. I am advised by Darrell Hanavan, Executive Director of Colorado Wheat Administrative Committee, that this has resulted in wider basis than normal and a loss of 25 to 50 cents per bushel to wheat producers. I am also hearing reports that producers cannot deliver wheat to elevators because they are plugged, and these producers are contemplating storing their millet and corn crops on the ground because their farm storage is full—and there may not be any relief in sight until December or January.

I am also advised that, along with Colorado, there is wheat has been stored on the ground in South Dakota, North Dakota, Montana, and Washington. In Idaho, wheat has been stored on the ground for up to 3 months. In order to create wealth for farm producers, we need to ship what we produce. In Idaho, more than 50 percent of our wheat is shipped into export channels.

States With Rail Captivity Continue To Lose Economic Base Due to High Rail Costs

One of the major malting barley customers that I sell to located a new malting plant in Idaho 4 years ago to supply its Mexican breweries. After one and a half years of negotiation to find a competitive transportation relationship with the single railroad that served this area, the brewing VP told the Idaho Governor in a meeting I attended that if the company knew when they planned to put this plant in Idaho what they know now about the effects of captivity, they would never have located in Idaho.

There have been many news reports in Idaho over the last few years of plant closings where the companies have publicly stated that one of the main reasons for shutting down have been high transportation costs. In the potato industry, Idaho supplied potatoes to the JR Simplot plant in Heyburn, Idaho (famous for McDonald French fries) for many years until the plant was shut down and moved to Canada, meaning the loss of hundreds of local jobs. Mr. Simplot told us the reason was high freight costs, and, indeed, most of the shipment of frozen and fresh potatoes in my area today has been forced to trucks.

In February 2002, the FMC Corporation's closed its Astaris, ID phosphorous plant (loss of 440 jobs). The *Idaho State Journal* newspaper reported, "Using the Monopoly game as an example, Paul Yochum detailed how delivery costs at FMC hurt the company. If you land on a railroad in Monopoly, you pay the owner $25. Unless he owns all four railroads, in which case you pay him $200. We once negotiated with several railroads, but following several buyouts, the number of (rail) owners plummeted and our negotiating leverage stopped." Yochum went on to add, "FMC's foreign competitors can pick from any number of shipping lines; we are at a significant disadvantage to foreign producers delivering goods."

The UP is so very proud of their monopoly that they have recently issued their *own* Monopoly version of the game, called *Union Pacific-Opoly*—collector's edition. In this game, the UP recognizing the power of their own monopoly states that if you land on the Denver-Rio Grande you must pay "four times the amount shown on the dice," however, if you own both the Denver-Rio Grande and the Western Pacific—you are allowed to charge 10 times the amount shown on the dice."

Malsters in Idaho have told me that delays in rail service continue to threaten their existence because railroad delays cause cash-flow problems.

When the railroad decided it didn't want to haul sugar beets about 10 years ago, it just quit hauling in Idaho and now, with one exception, all beets in Idaho have been forced to truck.

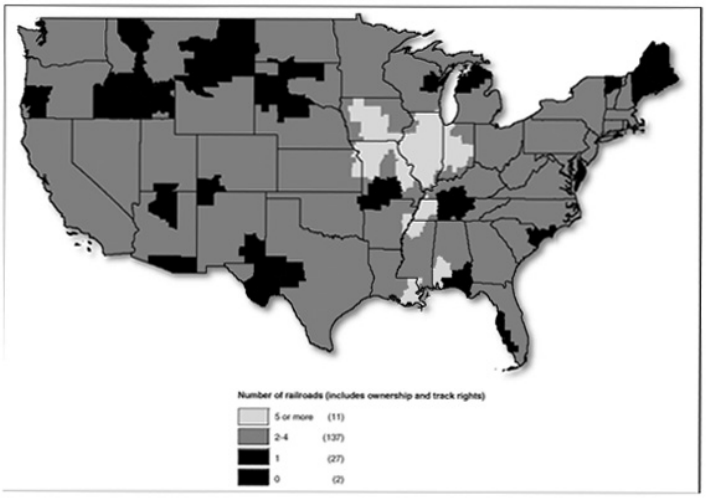
It is important to realize that rural communities wherever they are located need access to world markets to bring wealth back to our communities. Without reliable, equitable and efficient rail service, we cannot access and compete in that world market.

From shipping points throughout the farm producing areas of the United States, as the GAO report and our data show, we pay some of the highest freight rates because we are captive in our region to a single railroad. Concentrations of railroads in this country in the last 20 years have forced more and more farm product into trucks hauling further and further each year.

Grain Rail Rates

The GAO report I referenced earlier found that the entirety of the western United States is served by one or two railroads. Large areas shaded in black in *Figure 12,*[1] below, illustrate the portions of Oregon, Idaho, Montana, North Dakota, South Dakota, Colorado, Texas, Oklahoma and Arkansas that are served by a single railroad.

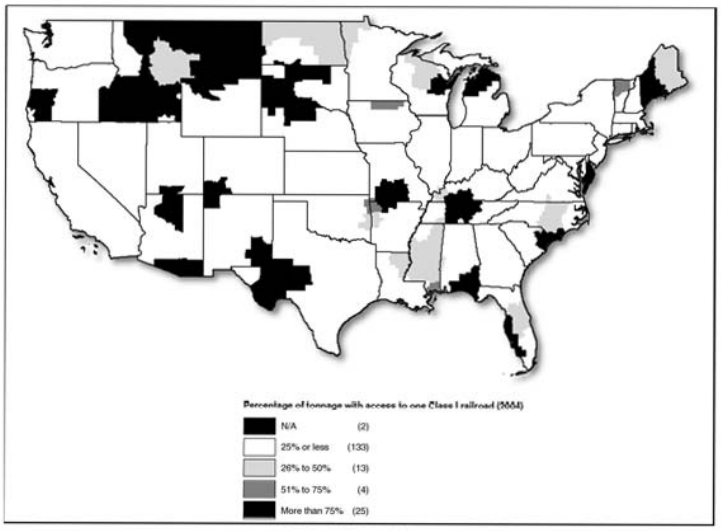
Figure 12: Number of Class I Railroads Serving Economic Areas, 2004



Source: GAO analysis of BEA and GIS data.

Additionally, the GAO showed that all industry tonnage originating with access to one Class I railroad mirrors the previous graph—*Figure 13.*[2]

Figure 13: Percentage of All Industry Tonnage Originating in Economic with Access to One Class I Railroad, 2004



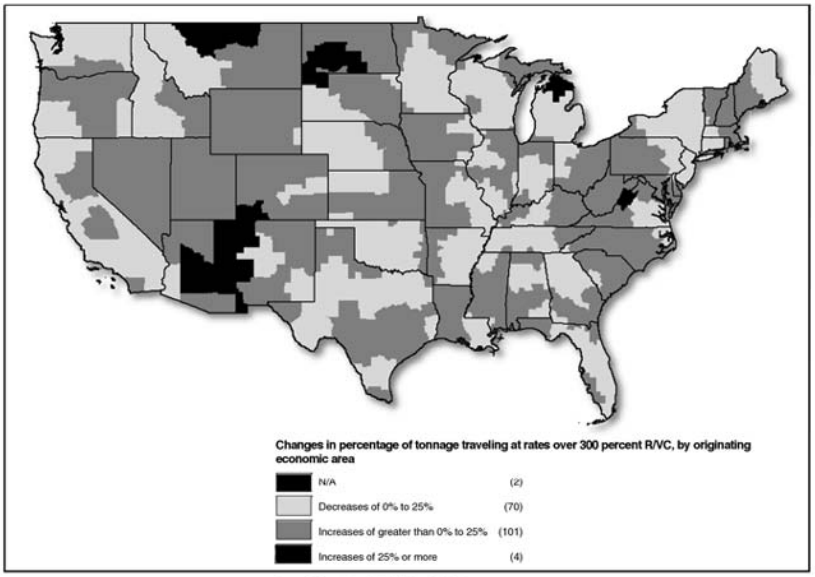
Source: GAO analysis of BEA, DOT, and STB data.

[1] GAO Report 7–94 *Freight Railroads, Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed,* Page 26

[2] *Ibid,* Page 27.

The GAO pulls these observations together with *Figure 18,* which shows changes in tonnage traveling at rates over 300 percent R/VC from 1985 to 2004.[3]

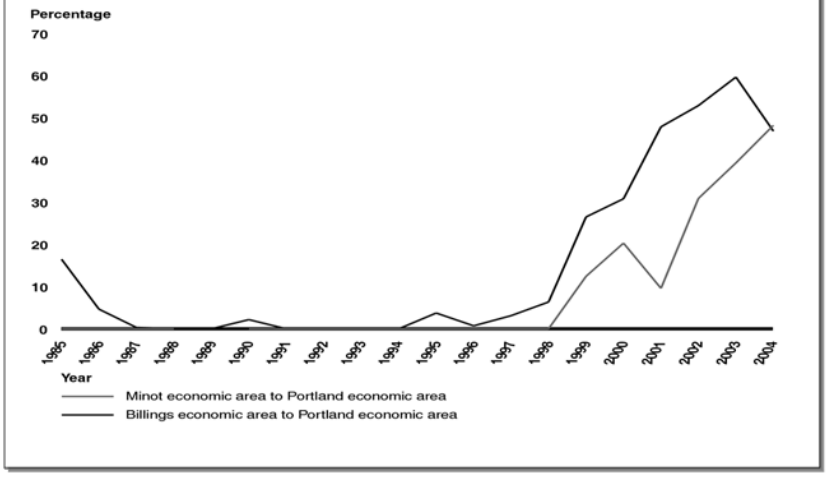
Figure 18: Changes in Percentage of Tonnage Traveling at Rates over 300 Percent R/VC, by Originating Economic Area, 1985 through 2004



Source: GAO analysis of BEA, DOT, and STB data.

Page 35 of the GAO report confirms what wheat and barley producers experience everyday.

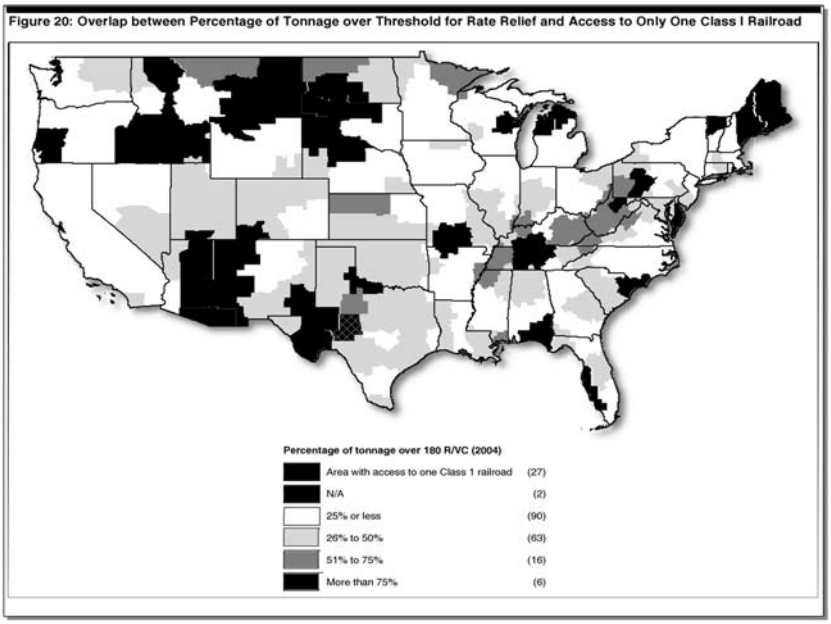
Figure 19: Long-distance Grain Route Changes in Percentage of Tonnage Traveling at Rates over 300 Percent R/VC, 1985-2004



Source: GAO analysis of STB data.

[3] *Ibid,* Page 34.

Finally, the GAO report correctly establishes the link between single railroad access and elevated percentage of tonnage above the threshold for rate relief.

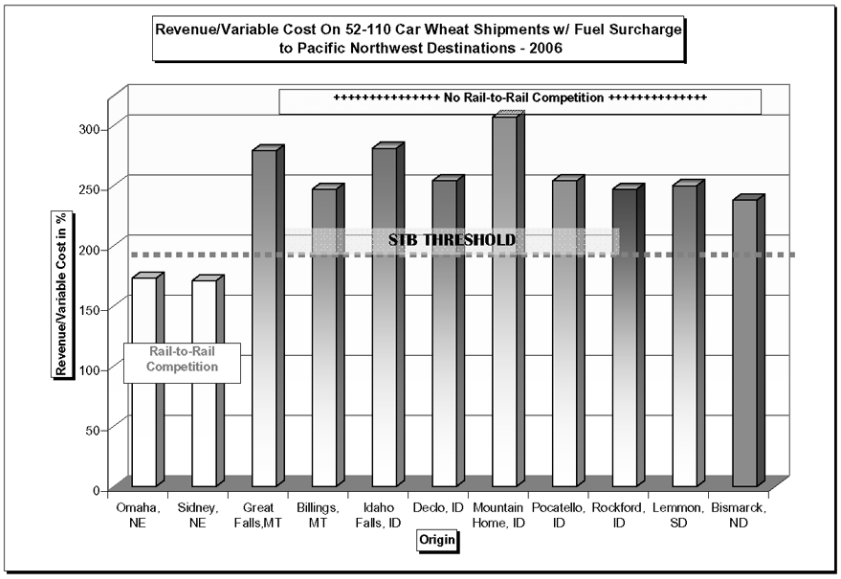


Source: GAO analysis of BEA, DOT, and STB data.

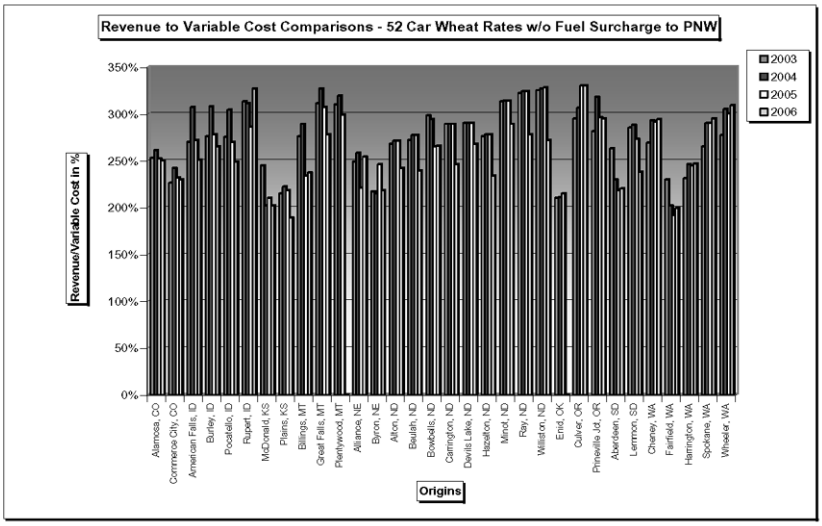
Our consultant's[4] research of R/VC levels on grain from the western growing areas confirm what the GAO found. (Please see the *2006 Montana Rail Grain Transportation Survey and Report,* prepared for the Montana Rail Service Competition Council and A Joint Survey and Analysis by the Montana Department of Transportation and Whiteside & Associates, at: *http://rscc.mt.gov/docs/Rail__Grain__Transp__Survey__2006__Final__05__22__07.pdf*).

In examining the R/VC levels on rates to common destinations of the Pacific Northwest, we find large areas moving at rates considerably above the threshold. The chart below shows that areas where little or no rail-to-rail competition exists are exposed to much higher R/VC, in line with the GAO study. This graph shows points in Montana, Idaho, South Dakota and North Dakota that experience R/VC levels upwards to 300 percent. This analysis can be done for points in all parts of the grain growing areas of the country.

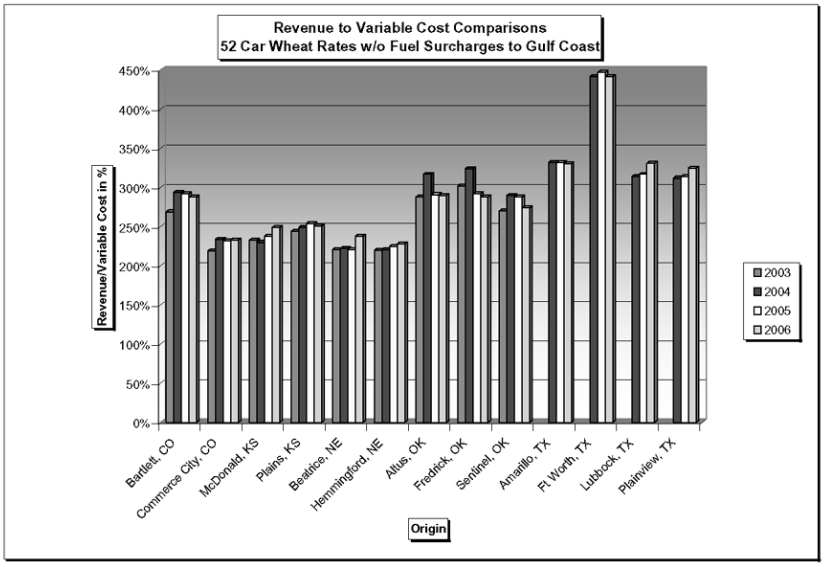
[4] Whiteside & Associates, Billings, Mont.



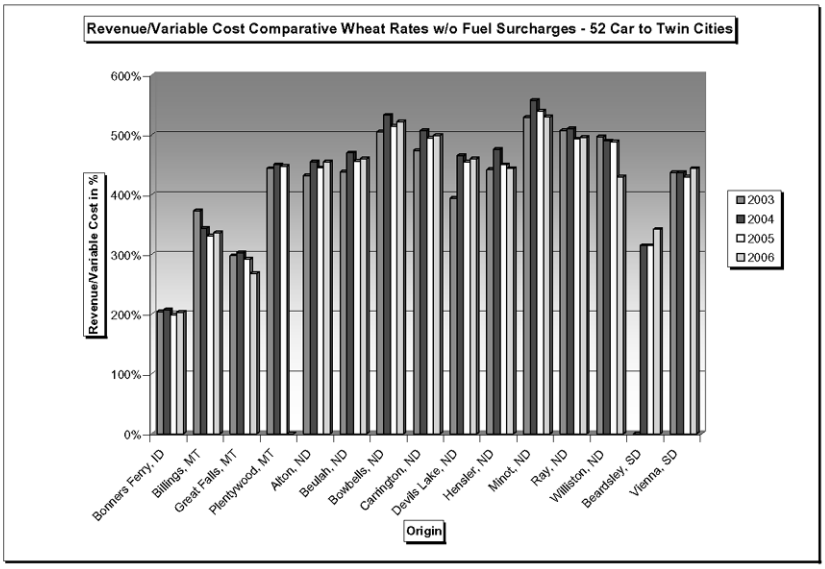
A historical look of the R/VC ratios for various markets further confirms the conclusion presented by the GAO. The chart below shows that, between 2003 and 2006, without fuel surcharges, R/VC ratios were well in excess of the threshold on movements from origins all over the Plains to the Pacific Northwest. If railroad-applied fuel surcharges were added to these rates, the R/VC ratios would be even higher.



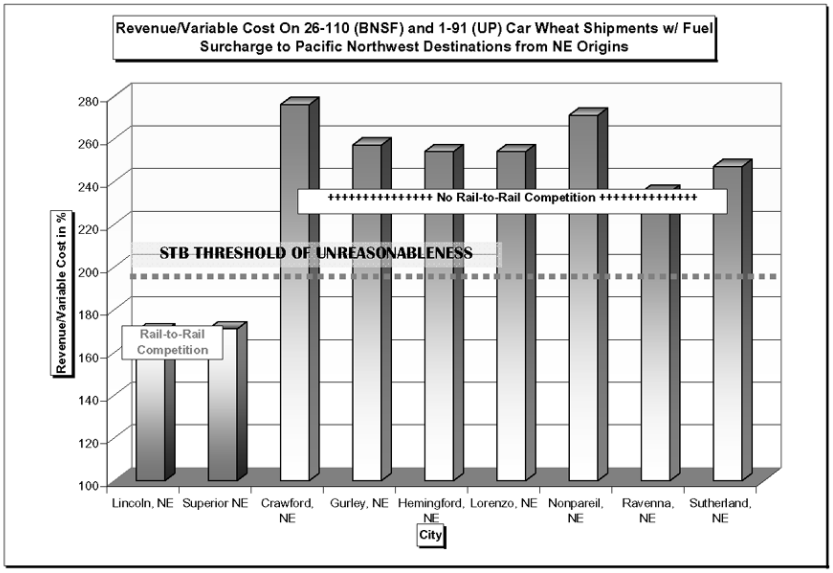
Examination of R/VCs from 2003–2006 into the Gulf Coast finds a similar story. Origin states including Colorado, Kansas, Nebraska, Oklahoma and Texas routinely see wheat rates well above the threshold and some as twice as high as the threshold level.



The highest R/VC historical numbers can be found in the movements into the Twin Cities from across the Northern Plains. The chart below illustrates rates as high as 500+ percent R/VC over the 2003–2006 period. In all of these examples, we did not select certain points but found that the analysis agreed with the GAO report that the trend is consistent all over affected states. Here the affected states (which also have little or no rail-to-rail competition) are Idaho, Minnesota, Montana, North Dakota and South Dakota.



What is clear is that the areas of the country served by single and dual rail are experiencing increasing rate levels that are not found in areas that have some rail-to-rail competition.



Perhaps not noticed by the GAO, however, was the timing of the sharp increase in the percentage of tonnage traveling at rates over 300 percent of revenue to variable costs, which began rapidly increasing in 1997–1998 at the same time the Surface Transportation Board allowed the BNSF merger and the Union Pacific/Southern Pacific merger—mergers that eliminated the last vestiges of rail competition in the western half of the U.S.

While one might debate the exact level of the R/VC costs with railroad experts, what is indisputable is the highest R/VC is found in the captive areas in Arizona, California, Colorado, Idaho, Kansas, Minnesota, North Dakota, Nebraska, South Dakota, Oklahoma, Oregon, Texas and Washington. We also know that the grain experience is mirrored in coal, silica, sand, plastics, chemicals and many other industries covering the width and breadth of this country.

I would echo what ARC wrote in comments in STB's Ex Parte 665, "At every turn, grain producers face Board-created barriers to reasonable rates, adequate service, and rail to rail competition that the STB shows little inclination to remedy. In these and other respects, the promise of the Staggers Rail Act is belied by the way its provisions have been interpreted by the ICC and STB, so as to insulate the railroad industry from effective regulatory oversight *and* from marketplace discipline."

The Transportation Cost Shift

We recognize the need of railroads to make an adequate return, but remain concerned that the Surface Transportation Board has not focused on the price being paid by producers and has not seen fit to provide reasonable remedies to guard against market abuse. The evidence presented by GAO studies in 2006, 2002 and 1999 all point to the same conclusion—that the STB is not adequately protecting large parts of the country from market abuse where no competition exists.

Railroads' claims to this Committee and to the Surface Transportation Board that their rates are falling neglect the fact that costs are being shifted to agricultural producers in captive areas. Transportation costs for farm producers and state governments are actually rising.

One of the most comprehensive studies on the effects of this cost shifting was conducted by the Montana Department of Transportation and Whiteside & Associates in March 2006 *(http://rscc.mt.gov/docs/Rail_Grain_Transp_Survey_2006_Final_05_22_07.pdf)*. The report came to eight conclusions:

1. Grain is being hauled farther and farther over the state and county highway systems.

2. The majority of farm producers have experienced increasing hauling distances over the past 10 to 20 years. More than 70 percent of Montana grain producers are hauling their products farther than they were 10 years ago, and

100 percent of those hauling farther than 10 years ago are also hauling farther than they were 20 years ago. This trend reflects the transition to a smaller number of elevators located in the state. Distances to local elevators continue to increase in all of the Plains states; data from all respondents shows an average one-way haul today of 37.19 miles compared to an average haul of 17.35 miles 10 years ago (an increase of 114 percent) and 9.69 miles 20 years ago (an increase of 285 percent).

3. Those farm producers experiencing increased haulage are hauling more than three times as far as those farm producers who have not experienced any increased hauling distances.

4. The non-wheat crops are experiencing significantly greater hauling distances even than wheat crops, further burdening alternative and rotational crop practices.

5. Some counties show average hauling distances upwards of 80 miles.

6. The 2006 harvest in Montana could be best described as a tale of two cities—with winter wheat showing average to above average yields and spring wheat, durum, barley, pulse, peas and lentils showing average to below average yields.

7. The vast majority of farm producers have the capability to store most, if not all, of their grain production.

8. Even with the diversity of yields, most Montana farm producers experienced elevator pluggings multiple times during harvest due to lack of rail cars.

This all adds up to an increase in the portion of transportation costs being borne by farm producers and the state as railroads continue their push to serve fewer and fewer facilities. As there are fewer, smaller elevators serving as the principal markets for our crops, farm producers have to pursue markets for their crops farther and farther away from their farms, meaning more and ever distant trucking.

Captive shippers also continue to suffer car and service disruption. Shippers that order rail cars well in advance are still experiencing delays after promised delivery dates. This can and does cause major problems during and after harvest and costs both the farm producer and elevators loss of income.

The high rates and lack of service continue to be especially frustrating for producers in our northern wheat growing states who need only look across the border to see a much more effective system. Canadian freight rates on wheat westbound—right across the border—are only ⅔ of the rail rates our growers pay in Montana. U.S. wheat growers produce some the highest quality wheat in world, yet are often rendered residual suppliers against their Canadian counterparts and find themselves at a significant competitive disadvantage in both domestic and foreign markets because of these shipping issues.

There is currently no effective regulatory body to address these frustrations and complaints. The Surface Transportation Board does not balance the needs of shippers and the railroads. In fact, we believe the STB has abandoned its lawfully designated role as a regulator of railroads.

Fixing the Problem

Railroad market power should not foreclose access to otherwise competitive grain elevators, ports, coal mines or chemical plants.

The railroads' common carrier obligation and historic concerns about discrimination are related issues that should be re-examined.

- Should it really be the case that a railroad is free to decide which of two similarly-situated shippers succeeds and which one fails, so long as every mile of track over which they are served is not identical?
- Is it really in the public interest for railroads to force industry consolidation, notwithstanding the demise of smaller elevators, mines, power plants and factories nationwide, because unit train service is more efficient?
- Should intermodal freight always displace bulk freight for an extra penny a ton in profit?

We have reports of railroads raising their rates just to drive off unwanted rail traffic, thereby abandoning common carriage. We also have reports of the railroads refusing to service locations that the railroads deem operationally unacceptable. The result appears to be that railroad market power is being exerted to create haves and have-nots in the shipping community.

Conclusions

Agricultural growers together with the members of the Alliance for Rail Competition truly believe that a healthy and competitive railroad industry is essential for

their continued viability. However, with poor service, a lack of available cars, increased rail rates and a regulatory agency that does not meet the needs of shippers, it is increasingly difficult for agricultural producers to remain competitive in a world marketplace.

We believe that the government needs to be the facilitator and the catalyst for increasing competition in this historically strong industry. We believe the railroad industry can survive and prosper in a competitive environment and, indeed, we know from history that competition breeds innovation and efficiency. In light of the horrific situation U.S. grain producers are facing with major railroads unable to meet common carrier obligations all over the Nation, it is time that public policy in this area needs to be reexamined. The Alliance for Rail Competition and the agricultural community believe the STB and its predecessor, the ICC, have failed to protect the interests of the captive rail shippers as the Staggers Rail Act intended. It is time that Congress step up to the plate and protect the interest of captive rail shippers.

Grain producers, along with members of ARC, believe that both railroads and shippers would be better off with more competition in the marketplace, and we strongly support provisions in S. 953, a bill that calls for increasing competition without increasing regulation. We fervently believe that final offer arbitration as outlined in S. 953 will provide a host of benefits where competition cannot physically be created. Providing for "final offer" arbitration and the removal of "paper barriers" will restore balance to the commercial relationship between the railroads and their customers.

We believe this legislation will improve rail transportation by providing fairness and openness in the negotiations between railroads and their customers over rates and service. By simply requiring railroads to provide rates to their customers between any two points on their system, many additional rail customers will gain access to the benefits of rail transportation competition.

PREPARED STATEMENT OF WILLIAM J. MATHESON, PRESIDENT, INTERMODAL SERVICES, SCHNEIDER'S NATIONAL, INC.

Honored members of the Senate Committee on Commerce, Science, and Transportation:

My name is Bill Matheson. I am President of Schneider's Intermodal Services, one of the largest providers of truckload intermodal services to our Nation's shippers. As such, we are both customer to the railroads and a supplier to the shipping customers. Our job is to manage the entire door-to-door experience for the customer, linking the rail line-haul services with box provision, drayage, and customer service. Rail-based intermodal service is inherently complex. We are the glue that holds it together. That gives us the unique perspective on the commercial regulation of rail-based intermodal that I am pleased to offer you today.

I start by underscoring that the current form of commercial rail freight transportation regulation has clearly succeeded. Since deregulation in 1980, rail rates have decreased dramatically at the same time the carriers have increased their profitability. The cost of American goods has fallen while the performance of our infrastructure has increased. As a Nation we have increased our already significant lead in global transportation performance.

It is true that, since 2001, rail rates have increased, at times significantly. While naturally any increases are challenging, so far we are not unduly troubled by those increases, for two reasons. First, the increases are largely due to real increases in costs, notably fuel. Second, the increased margins that have also occurred are the normal market consequence of an industry making the transition from 60 years of excess capacity to tight capacity. Moreover, there is ample evidence that much of the resulting increase in profit has flowed directly into increased capital spending on rail infrastructure. As veterans of the wide-scale rail service failures of the late 1990s, we believe that that our rail infrastructure is in need of increased investment in both maintenance and capacity. We are glad to see it occurring.

To date, market forces have prevented the escalation of this market power to unreasonable levels. We are reassured, for instance, that the current freight downturn has worked to somewhat ease rate pressure. The market continues to work.

We can, however, see two factors that could change that equation. First, renewed and sustained economic expansion on top of the relatively tight capacity conditions existing in the current marketplace could outstrip the ability of the industry to increase capacity. Market abuses could occur under those conditions. We recommend that the Surface Transportation Board monitor and encourage rail investment in capacity, for line of road, terminal operations, and equipment. Continued rail invest-

ment in capacity is a necessary condition of the current successful deregulated design.

Second, competitive intermodal service has precariously survived the widespread merger movement that began in the 1970s and accelerated with deregulation. We retain competitive choice in most major markets, but clearly have less choice than before. Approval of additional mergers would upset the current fragile equilibrium. Moreover, recent experience with large scale mergers has revealed major service disruptions with little evidence of offsetting market benefit. We urge the Surface Transportation Board to approach additional mergers with extreme caution.

In summary we believe that, if the Surface Transportation Board works to ensure adequate rail investment and tight oversight of mergers, it will not have to resort to the much more problematic policy tool, renewed rate regulation. That tool has demonstrated limited efficacy in the past and must be reserved to remedy only the most dramatic market failures. We are clearly not in that situation today.

BASF CORPORATION
Florham Park, NJ, November 5, 2007

Hon. FRANK R. LAUTENBERG,
Chairman,
Subcommittee on Surface Transportation and
Merchant Marine Infrastructure, Safety, and Security,
U.S. Senate,
Washington, DC.

Dear Chairman Lautenberg:

Thank you once again for permitting me to testify before the Subcommittee on October 23 regarding oversight of the Surface Transportation Board (STB) and regulation related to railroads. I respectfully submit this letter, which I ask be entered into the record of the hearing, as my response to a comment concerning the movement of toxic inhalation hazard (TIH) commodities. During the hearing, it was stated that the additional risk railroads incur in transporting TIH commodities should serve as yet another justification for egregious rate increases.

First, let me be clear: safety and secure handling are the highest priorities for BASF throughout the company. Our employees complete rigorous training and testing. Our equipment, including the railcars that we own, receive the highest levels of inspection and maintenance. Oversight, crosschecks and documentation are regular parts of our processes and procedures.

In logistics, my area of responsibility, whether we are shipping a TIH or non-TIH product, safety is number one on our list. Further, our record supports our efforts. Consider BASF's shipment of ethylene oxide (BO), a TIH used widely in laundry detergents and hospital cleansers. BASF and its equipment have yet to be the cause of a rail accident or harmful release where BO was shipped. We are proud of this record, and we are doing everything we can to ensure that it continues.

The railroads however, have a different record. In recent years, there have been a number of instances where railroad employee missteps and track problems resulted in derailments or accidents involving TIH shipments. In at least two cases, these incidents resulted in fatalities, followed by costly litigation. To mitigate the financial impact of their negligence and the corresponding litigation risk, railroads have imposed egregious rate increases on these TIH movements, up to 250 percent in 1 year.

Despite the contrast between BASF's TIH safety record and the one belonging to the railroads, we have invested significant time and effort to develop a workable solution. We have no choice quite frankly, given the current regulatory vacuum at the STB. So with the help of nearly a dozen insurance carriers, solicited both domestically and internationally, BASF developed a tower of liability coverage that would indemnify the railroads from *their own* negligence. The plan would cost BASF millions in premiums, but since it mitigates the railroad's TIH liability risk, in hopes of returning to more normal rate increases, we have pushed ahead. We offered this arrangement nearly 2 months ago, but the railroad's response has only been repeated delay.

Given this situation, we are beginning to wonder how sincere the railroads are. They publicly state TIH risk as justification for egregious rate increases and risk/liability transfer provisions, yet when offered a solution, their silence is deafening. Many in the shipping community conclude that despite our good faith efforts, our only accomplishment has been to call the railroad's bluff on yet another rate increase scheme, not surprisingly, left unchallenged by the STB.

I appreciate the opportunity to submit my response. If there are any comments or questions regarding this submission, I would be pleased to address them. I look forward to continuing to work with the subcommittee on STB oversight and reform.

Sincerely,

DAVID MCGREGOR,
Senior Vice President,
NAFTA Logistics.

BURLINGTON NORTHERN SANTE FE CORPORATION,
fort Worth, TX, October 30, 2007

Mr. ROBERT CARLSON,
President,
North Dakota Farmers Union,
Jamestown, ND.

Dear Mr. Carlson:

I had the opportunity to review your testimony presented to the Senate Commerce Committee with regard to rail re-regulation. While I disagree with many of your comments, and will set forth my perspective below, I am particularly concerned about your allegation that BNSF Railway Company (BNSF) retaliates against grain elevator facilities whose managers speak against BNSF.

I have confidence that our car ordering system is transparent to the marketplace; our allocation process is transparent, and car orders are assigned and generally filled on an oldest-order basis. This ensures that there is no discrimination between customers. If there are instances of retribution or intimidation of which you or others are aware, I would like to be informed personally. Not only is such a discrimination incompatible with our corporate values, but it would be the subject of discipline, if true.

I do not believe your testimony takes into account our current track record of service, customer outreach and responsiveness in North Dakota. Admittedly, in 2004, BNSF had service issues related to grain car availability, overall growth of volumes across the railroad and a large harvest. In the years since 2004, we have made record investment in grain cars and locomotives, and we have also initiated an Ombudsman program to improve not only North Dakota rail service, but to strengthen ties and understanding between the company and its customers there. It has been very successful, and we have replicated the Ombudsman program across our agriculture network.

BNSF Ombudsman Jon Long has lived and worked in North Dakota for 3 years, meeting one-on-one with virtually all of the non-shuttle or single-car elevators in the state. He has assisted customers in correcting service problems such as car order procedures, timely car order fill, track leasing and other issues. With an Ombudsman acting as "trouble shooter" and with overall service improvements related to improved railroad velocity and capacity, we have worked very hard to make it clear that we value all of our customers and their business. Furthermore, we encourage our customers to frankly share their customer experiences with Mr. Long, especially when we are not meeting their expectations.

This year, North Dakota wheat shipments are up 18 percent, and we have kept up with the unprecedented demand and large harvest. We now have 31,000 grain covered hopper cars and have spent hundreds of millions of dollars on our agriculture business so that we would be prepared for the opportunity to move record harvests to the marketplace. The BNSF Ag Marketing team was very pleased to have received a number of unsolicited compliments this year from the grower and elevator trade groups in North Dakota for rail service in light of the impressive harvests.

I also want to address your statements regarding BNSF rates. The average BNSF wheat rate Revenue/Variable Cost ratio is less than 180 percent—not the 250 to 450 percent that you shared in your testimony. Further your comments regarding North Dakota rates and comparing them with Nebraska rates are inaccurate. Grain movements of comparable mileage on our network are, for the most part, similar, regardless of geographic location and whether or not the origin and destination are served by more than one railroad. Any additional variance in rates is not related to being served by one railroad, but rather a difference in grain markets at that particular point in time. As you know, Nebraska mostly produces Hard Red Winter Wheat, while North Dakota produces Spring Wheat and Hard Red Winter Wheat. The respective crops are. flowing to entirely different markets and customers, each with a differing set of economic circumstances that vary with supply and demand.

As you can see, I have copied Senator Dorgan and the North Dakota Congressional delegation here, and I am requesting that he submit my letter to you to the Senate Commerce Committee for inclusion in the public record for the hearing at which you testified. It is not my intent to challenge you personally; however, I feel I must address the misleading impression left by your October 23 testimony.

As our customers in North Dakota know, Kevin Kaufman, BNSF's Group Vice President, is responsible for our agriculture business and is available to discuss any aspect of our service in North Dakota. I invite you to contact him or Jon Long to learn more about BNSF's ongoing outreach to its customers. It couldn't be more different than what you portrayed in your testimony, and I invite you to learn more about it.

Sincerely,

MATTHEW K. ROSE,
Chairman, President and Chief Financial Officer,
Burlington Northern Santa Fe Corporation.

cc: Senator Byron Dorgan
Senator Kent Conrad
Congressman Earl Pomeroy

OREGON WHEAT GROWERS LEAGUE
Pendleton, OR, October 19, 2007 (Sent via Facsimile)

HON. DANIEL K. INOUYE,
Chairman,
Committee on Commerce, Science, and Transportation,
U.S. Senate,
Washington, DC.

Hon. TED STEVENS,
Ranking Minority Member,
Committee on Commerce, Science, and Transportation,
U.S. Senate,
Washington, DC.

Hon. FRANK R. LAUTENBERG,
Chairman,
Committee on Commerce, Science, and Transportation,
U.S. Senate,
Washington, DC.

Hon. GORDON H. SMITH,
Ranking Minority Member,
Committee on Commerce, Science, and Transportation,
U.S. Senate,
Washington, DC.

RE: SUPPORT FOR RAILROAD COMPETITION AND SERVICE IMPROVEMENT ACT OF 2007—S. 953

Dear Chairman Inouye, Ranking Member Stevens, Chairman Lautenberg, and Ranking Member Smith:

As a statewide trade association representing more than 4,000 wheat, barley, rye, triticale, canola, and mustard producers in Oregon, the Oregon Wheat Growers League offers this correspondence in support of S. 953 the Railroad Competition and Service Improvement Act of 2007.

Oregon's producers are absolutely dependent upon a cost effective and efficient rail system as more than 80 percent of the wheat crop grown in Oregon is destined for export year in and year out. If the crops grown in the far reaches of the countryside cannot be shipped affordably to the Port of Portland for export, the growers lose their ability to compete in the global marketplace. Rail transportation remains a critical component to the agriculture industry as farmers bring inputs (fuel, fertilizer, machinery, etc.) to the farm and ship the resulting production of commodities to both domestic and international markets. The agricultural industry is the only industry in America where farmers pay retail for their inputs and sell their manufactured goods *(e.g.,* crops) into the wholesale market and pay the freight both directions. Unfortunately the lack of competition among the railroads has resulted in unreasonably high rates and unreliable service for agriculture producers.

S. 953 is critically important to ensure rail customers have access to competitive rail service and that those rail customers without access to competition are protected from unreasonable railroad rates and practices and have access to reliable and affordable rail service. We believe S. 953 goes a long way toward addressing the problems U.S. agriculture has had and will continue to have with lack of rail competition and unreliable service in the absence of meaningful legislation. The Or-

egon Wheat Growers League urges you to continue your efforts to move S. 953 through Congress.

Sincerely,

MIKE NOONAN,
2007 President,
Oregon Wheat Growers League.

TAMMY L. DENNEE,
CMP, CAE, Executive Director,
Oregon Wheat Growers League.

cc: John Richards—Office of Senator Rockefeller

October 11, 2007

Hon. FRANK R. LAUTENBERG,
U.S. Senate,
Washington, DC .

Dear Chairman Lautenberg,

As leading national organizations representing a variety of agriculture interests whose members depend on rail for a significant portion of their transportation needs, we are writing to express our strong support for S. 953, the Railroad Competition and Service Improvement Act of 2007.

Rail transportation remains a critical component to the agriculture industry as it moves commodities to domestic and international markets from the producers in rural America. We continue to be supportive of safe, efficient, and economical rail infrastructure system. However, the lack of competition among the railroads has resulted in unreasonably high rates and unreliable service for the agriculture producers, which could result in loss of market share to international competitors.

S. 953 is critically important to ensure that rail customers have access to competitive rail service and that those rail customers without access to competition are protected from unreasonable railroad rates and practices and have access to reliable rail service. The legislation also includes provisions such as final offer arbitration, which are especially important to the agriculture industry.

We believe S. 953 goes a long way toward addressing the problems U.S. agriculture has had and continue to have with lack of rail competition and unreliable service. The legislation has a significant co-sponsorship from Senators representing agriculture constituencies. We hope that you would join them in co-sponsoring and actively supporting this important legislation.

Sincerely,

ALLIANCE FOR RAIL COMPETITION
AMERICAN SOYBEAN ASSOCIATION
AMERICAN SUGARBEET GROWERS ASSOCIATION
NATIONAL ASSOCIATIONS OF WHEAT GROWERS
NATIONAL BARLEY GROWERS ASSOCIATION
NATIONAL CORN GROWERS ASSOCIATION
NATIONAL FARMERS UNION
UNITED STATES BEET SUGAR ASSOCIATION
USA DRY PEA & LENTIL COUNCIL
U.S. DRY BEAN COUNCIL
USA RICE FEDERATION

NARUC, NASUCA, CFA
October 22, 2007

Hon. DANIEL K. INOUYE,
Chairman,
Senate Committee on Commerce, Science, and Transportation,
Washington, DC .

Hon. TED STEVENS,
Ranking Minority Member,
Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Hon. FRANK R. LAUTENBERG,
Chairman,
Surface Transportation and Merchant Marine Infrastructure, Safety, and Security Subcommittee ,
Washington, DC .

Hon. GORDON H. SMITH,
Ranking Minority Member,
Surface Transportation and Merchant Marine Infrastructure, Safety, and Security Subcommittee,
Washington, DC.

Dear Senators:

We are writing in support of S. 953, the Railroad Competition and Service Improvement Act of 2007. This legislation corrects problems in the Surface Transportation Board's implementation of the Staggers Rail Act of 1980 that were identified and verified in the October 2006 report of the Government Accountability Office (GAO).

The October 2006 GAO report found that there is a lack of competition in the national rail system, that the Surface Transportation Board (STB) is not exercising its authorities to ensure rail customer access to competition and that the rate challenge processes of the STB are "inaccessible" to most rail customers. We strongly agree with the findings of the GAO.

Our specific concerns focus on the movement of coal to our Nation's electricity generating facilities. Today, approximately 50 percent of the Nation's electricity supply is produced from coal-fired electric generators. In most cases, coal is moved from the mines to the generator by rail. Often, there is only one available railroad for the movement, in which case the electricity generator is subject to the monopoly power of the railroad when it comes to rates and service. Except where public service commissions find that a utility has incurred coal transportation costs imprudently, every dollar of excessive rail rates or extra costs incurred due to railroad delivery problems flows straight through to the customers of the utilities that own these "captive" generating facilities.

On September 25, Terry Huval, the Director of Utilities for Lafayette, Louisiana, and current Chairman of the Board of the American Public Power Association, testified to the House Transportation and Infrastructure Committee that the "cost of rail captivity" to the universities, community colleges and schools in Lafayette, Louisiana, is $1.52 million annually!

We encourage you as leaders of the Senate committee of jurisdiction over the Surface Transportation Board to ensure that rail customers have access to competitive rail transportation where possible and pay reasonable rates when they don't by ensuring the enactment of S. 953, the Railroad Competition and Service Improvement Act of 2007 in this Congress.

Sincerely,

JIM KERR,
Commissioner,
North Carolina Utilities Commission.
President,
National Association of Regulatory Utility Commissioners.

JOHN R. PERKINS,
Iowa Consumer Advocate,
President,
National Association of State Utility Consumer Advocates.

STEPHEN BROBECK
Executive Director,
Consumer Federation of America.

SURFACE TRANSPORTATION BOARD,
Washington, DC, February 4, 2008

Hon. FRANK R. LAUTENBERG,
Chairman,
Subcommittee on Surface Transportation and Merchant Marine Infrastructure, Safety, and Security,
U.S. Senate,
Washington, DC.

Dear Chairman Lautenberg:

At the oversight hearing on the Surface Transportation Board (STB or Board) and regulation related to railroads on October 23, 2007. I committed to provide the Subcommittee with a written response to a question asked by Senator Klobuchar. Senator Klobuchar asked how many STB staff members have experience working for shippers.

The STB recently completed a staff survey, in which all of the Board staff was encouraged to participate. The survey had a 93 percent response rate, which included 126 responses. The survey covered a wide range of workplace issues and included a few questions about the employment history of our staff. Twelve employees responded in the survey that they previously worked for or on behalf of shippers or shipper interests. Twenty five employees responded that they have worked for rail interests. The vast majority of our staff arc long-term Federal employees with no direct experience working for shippers or railroads. None of the three Board members has ever worked for rail interests.

I hope the Subcommittee finds this information helpful. If I can provide any additional information, please do not hesitate to contact me.

Sincerely,

CHARLES D. NOTTINGHAM,
Chairman,
Surface Transportation Board.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. FRANK R. LAUTENBERG TO HON. CHARLES D. NOTTINGHAM

Question 1. We know railroads are operating at capacity in places because Amtrak trains are seriously delayed when they travel over freight lines. At my request, the Inspector General's office is currently investigating the impact of these delays on Amtrak's costs and revenue. While the investigation is not complete, the initial impression is that Amtrak is losing tens of millions of dollars because of these delays. Are these delays simply a matter of poor dispatching practices?

Answer. The Surface Transportation Board has no authority to collect data regarding Amtrak delays, nor is Amtrak required to report any information about costs or finances to the STB. Accordingly, I do not know whether or not Amtrak delays are simply a matter of poor dispatching practices because of operational issues.

Question 2. After 3 years of examining railroad 'fuel surcharge' programs, the Board found that some were unfair. How should rail shippers who overpaid go about getting refunds?

Answer. The Board's inquiry into fuel surcharge programs began in March 2006, when it issued a notice that it would hold a hearing in May 2006, in STB Ex Parte No. 661, *Rail Fuel Surcharges.* The proceeding concluded less than a year later (not 3 years) in January 2007 when the Board found it unreasonable for railroads to apply what they label as a fuel surcharge if the charge is not limited to recouping increased fuel costs that have not been reflected in the base rate. The Board found that railroads should not call a charge a fuel surcharge if it is designed to recover more than the incremental cost of fuel attributable to the movement involved, or if the cost is being recovered through the application of an escalator to a base rate that already incorporates changes in fuel costs.

The Board did not, however, limit the total amount that a carrier can charge, through a combination of base rates and surcharges, for providing rail transportation. Nor could the Board do so without individually examining the reasonableness of the total amount charged for a particular shipment. For that reason, and because the Board may not award damages if a party has not filed a complaint, the agency did not attempt to determine whether damages would be due in particular situations. Rather, if shippers want to be reimbursed for charges paid, they will have to request refunds from the carriers and, if they are not satisfied with the re-

sponse, bring actions individually. Complaints for overcharges (charges in excess of those contained in the applicable shipment documents) can be brought through either a complaint to the Surface Transportation Board or a civil action in court pursuant to 49 U.S.C. 11704(b). Complaints for damages resulting from violations of the Interstate Commerce Act must be addressed to the agency rather than a court. To date, no shipper has brought a complaint to the Board concerning a particular application of a fuel surcharge.

Question 3. Some shippers have stated that they are reluctant to bring cases before the STB because they say it is expensive, time-consuming, and could lead to reprisal from the railroads. Should Congress grant the Surface Transportation Board the ability to actively investigate rates or services, as opposed to considering them only when a case is brought before it?

Answer. While I do not believe that the STB requires additional statutory authority in order for the agency to accomplish its mission and implement our governing statutes, I am generally supportive of the notion that Federal regulatory agencies should be able to initiate investigations under appropriate circumstances and when reasonable suspicion exists to trigger such an investigation. The power to initiate government investigations must, however, be carefully managed to prevent abuse and to prevent unreasonable costs and burdens being placed on law-abiding regulated entities. The ability of an agency to initiate investigations should never be construed as an alternative to the agency making an informed and balanced decision based on a complete record documenting the views of interested parties. The Board's current practice of largely relying on the adversarial process initiated by a complaint to build a detailed and balanced record upon which to make decisions works well and should not be abandoned. Additional authority granted to the Board should only supplement and enhance this adversarial process, not replace it. Additionally, any extension of STB powers along these lines would require additional staff and budget resources, which would necessitate a thorough workload plan and staffing assessment prior to initiating any such change in authority.

By way of background, the Board has the authority to look into problem areas on its own motion, as it did in the case of fuel surcharges. *See* 49 U.S.C. 721(a) (the Board shall carry out the Interstate Commerce Act; enumeration of a particular power does not exclude another power the Board may have to carry out the statute); 49 U.S.C. 721(b)(1) (the Board has authority "to inquire into and report on the management of the business of carriers"). The Board does not, however, have the authority to award relief for past actions except upon complaint. *See* 49 U.S.C. 11701(a) (the Board may institute an investigation that could lead to an award of damages only upon complaint).

Before 1996, section 11701(a) authorized the Board's predecessor, the ICC, to initiate an investigation on its own initiative. The deletion of the own-motion investigation provision was intentional. *See* H. Conf. Rept. No. 422, 104th Cong., 1st Sess. 194 (1995) (the adopted House provision changed the underlying "source of the agency's authority to investigate rail matters under its jurisdiction, [which] is now limited to action on the basis of a complaint, not on the agency's own motion"). *See also* 49 U.S.C. 10704(b) (the Board may begin rate proceedings only on complaint).

When addressing particular shipments, the Board must necessarily depend upon the parties to develop an adequate record upon which to make a fully informed decision, and upon the adversarial process to ensure that it has adequately considered all sides of an issue and the potential ramifications of the possible actions available to it. Considering that millions of dollars are often at stake in these complex commercial disputes, it is not surprising that shippers and railroads choose to invest large sums of money and significant time in an effort to prevail in this adversarial process.

I am not aware of any particular instances of a railroad "reprisal"; any evidence of such conduct can and should be brought to the Board's attention for appropriate corrective action. I can assure you that any instance of reprisal by any party before the STB would be handled as a high priority matter and would trigger strong sanctions.

Finally, while the STB's adjudicative processes, like other commercial litigation, can be expensive and time-consuming, I believe that the Board's recent actions will substantially reduce the costs and time involved in bringing a rate complaint. In September 2007, in STB Ex Paste No. 646 (Sub-No. 1), *Simplified Standards For Rail Rate Cases,* the Board revised its rate review procedures to ensure that small- and medium-sized freight rail rate disputes can be resolved in a simplified, expedited and affordable manner.

The new procedures allow freight rail customers with small rate disputes to obtain an award of up to $1 million in rate relief, with a Board decision issued within 8 months of filing a complaint. The filing fee for this simplified process is $150. The

Board's new procedures also provide, to customers with medium-sized rate disputes, another avenue under which they can obtain an award of up to $5 million in rate relief, with a Board decision issued within 17 months of filing a complaint. Customers can choose which process they would like to use. Moreover, in an effort to minimize litigation, the Board will require non-binding mediation at the outset in all rail rate disputes.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO HON. CHARLES D. NOTTINGHAM

Question 1. The October 2006, GAO report criticizes the STB for failing to ensure rail customer access to competition in the rail industry. Rail customers in my state complain particularly about "paper barriers"—provisions in track lease agreements that prevent short line railroads from doing a meaningful amount of business with any major railroad other than the railroad from which the short line leases its track. I understand that the Antitrust Division of the Department of Justice, in a 2004 letter to the then chairman of the House Judiciary Committee, indicated that these agreements might violate the antitrust laws but for the railroad exemption from the antitrust laws. What is the STB doing to address the issues surrounding these so-called "paper barriers"? Do you believe the STB has an obligation to address this issue?

Answer. The Board has recently addressed this issue. After examining the matter, the Board concluded in October 2007 that it would be inappropriate to assume, as some parties would prefer, that every contractual agreement of this sort is contrary to the public interest. Rather, because both the terms of such interchange commitments and the situations in which they are used vary so much, the Board found it better to look at these provisions on a case-by-case basis, so that any benefits of such arrangements can be examined together with the problems they may cause. The Board is in the process of revising its rules to ensure appropriate Board scrutiny of existing arrangements and arrangements that may be proposed in the future. The Board's decision was issued in October 2007, in STB Ex Parte No. 575, *Review of Rail Access and Competition Issues—Renewed Petition of Western Coal Traffic League.*

I believe that a wholesale retroactive canceling or amending of contracts agreed to by informed businesses would be troublesome from a legal, policy, and business perspective. For transactions not completely undone, there could be significant problems regarding adjustment of the compensation between the parties to the original transaction on an *ex post* basis. Because of the multifaceted, interdependent nature of provisions in sale/lease agreements, a determination of adjustments could be complex and prone to litigation, which, depending on the contracts, could take place at the Board, before an arbitrator or in the courts. In the meantime, ongoing business relationships could be disrupted *en masse,* and critical investment and marketing decisions might be put on hold. Moreover, some short lines operate with marginal cash reserves and could be significantly weakened if they had to operate under less favorable terms or provide compensatory adjustments to the seller/lessor carrier.

Some parties assume that these types of agreements are anticompetitive, but as the Board observed in its decision in STB Ex Parte No. 575, many of these agreements helped promote competition by empowering short lines and enabling them to enter into deals that would otherwise have been prohibitively expensive. No shipper faces less competition as a result of an interchange commitment than it would have faced had the line remained in the hands of the larger railroad. Moreover, the line may have been an under-served, under-maintained branch line, with the larger railroad focusing its attention on its larger, main-line customers. If so, a more attentive short line may provide smaller shippers with better service and improved access to the national rail system than they might otherwise have had. Thus, as the Board explained in its STB Ex Parte No. 575 decision, "viewed *ex ante* (*i.e.,* before the sale or lease of the facilities), the agreements may have been beneficial and furthered the public interest in a number of ways, including better service and/or better rates, and the creation or strengthening of short line railroads that have the potential to expand into other markets, and thereby ultimately add to competition."

Finally, I should point out that railroads would face difficulty attracting investment in a regulatory climate in which the Board rewrites the terms of contracts between railroads regardless of the circumstances.

Question 2. At the outset of the implementation of the Staggers Rail Act in 1980, this legislation predicted a reliance on competition to set rates and gave railroads increased freedom to price their service according to market conditions, including the freedom to use differential pricing—that is to recover a greater proportion of

their costs from rates charged to those shippers with a greater dependency on rail transportation. At the same time, the legislation anticipated that "captive shippers" would likely exist where competition was lacking. Therefore, the ICC, and later the STB was established to provide a process through which shippers could obtain relief from unreasonably high rates.

What major changes have occurred within the industry since the enactment of the Staggers Act that would lead to an increase in "captive shippers"? Does the STB's current process meet the needs of today's shippers that may be suffering from "captive" rates? What is the STB doing to ensure that the Board continues to work in an industry that has evolved significantly since the Staggers Act into one consisting of only seven Class I railroads?

Answer. The Staggers Act, passed in 1980, was intended to enable rail carriers to rationalize their systems to enhance the industry's efficiency and improve the industry's financial health. As a result, various railroad mergers were proposed, and most were approved, with substantial competition-protecting conditions, by the Board and the ICC. The agency ensured that none of those mergers caused any shipper that had previously been served by more than one railroad to become captive to a single railroad.

While the rail system now has fewer Class I long-haul carriers, there is an increasingly large number of smaller short-haul lines that handle the traffic. As for rates, as the GAO found in its recent reports, rail rates overall have declined substantially since the Staggers Act, although there has been a recent slight uptick, and there are some pockets in which particular captive shippers may be paying more. Moreover, while acknowledging that it is difficult to determine the precise number of captive shippers, GAO's analysis indicated that the extent of captivity is dropping. Since 1985, GAO found that the amount of potentially captive traffic traveling at rates over 180 percent of variable cost and the revenue from that traffic have both declined. (Revenues generated from traffic traveling at rates over 180 percent of variable cost decreased from 41 percent of all rail revenues in 1985 to 29 percent in 2004.)

A major concern in recent years is that infrastructure is becoming inadequate to meet current demand for service. Therefore, the agency must engage in a difficult balance so that it does not preclude carriers from earning sufficient revenues to invest in needed capacity while also protecting captive shippers from paying unreasonably high rates.

I believe that we have adapted our processes to address the current environment. We recently significantly reformed our procedures for handling both large cases, in STB Ex Parte No. 657, *Major Issues in Rail Rate Cases,* and small rate cases, in STB Ex Parte No. 646 (Sub-No. 1), *Simplified Standards For Rail Rate Cases.* For large rate cases, we changed our procedures to correct various flaws that had been brought to our attention that required broad methodological changes, some favored by shippers, others by railroads, and one favored by neither side but necessary to keep the rate review process manageable and sensible. For small- and medium-sized freight rail rate disputes, the new procedures are designed to make the process affordable and expedited.

We are also in the process of revising the way we calculate the rail industry's cost of capital, in STB Ex Parte No. 664, *Method to Be Employed In Determining the Railroad Industry's Cost of Capital,* so that our decisions will more accurately reflect the current health of the industry in today's environment.

Additionally, to better understand the current competitive environment the STB has contracted with Christensen Associates, an economic consulting firm with extensive experience analyzing the transportation sector and other markets, to conduct an independent study that will assess the current state of competition in the freight railroad industry in the United States. The study should include a comprehensive analysis of a wide range of issues including competition, capacity, and the interplay between the two. The study will also examine various regulatory policy alternatives. We expect that it will be completed in the fall of 2008.

The Board has taken other actions as well to address changes in the industry and in rail transportation needs:

- We investigated the fuel surcharge practices of the railroads, and required carriers to change the manner in which such surcharges are calculated.
- We held an informational hearing on issues related to the transportation of grain.
- We are in the process of providing for full disclosure of the terms of any contractual interchange commitments that accompany the sale or lease of rail lines.

- We held a hearing on emerging energy issues and established an advisory committee on transportation of energy commodities to monitor the ability of the railroads to handle the future energy needs of the Nation.
- We held a hearing to examine the current and future infrastructure and capacity needs of the rail network, and the railroads' capital investment levels and strategies to meet those challenges.
- We are exploring the ambiguity in certain new types of rail pricing arrangements that have aspects of both contract rates (for which regulatory remedies are unavailable) and common carrier rates (which are subject to Board regulation).

Question 3. In the GAO's supplemental report released in August of this year, they cite fuel surcharges as being hard to clearly define and tie directly to the cost of fuel. They also cite "miscellaneous revenues" reported by the railroads as being difficult to clearly identify. What has the STB done to improve upon their data collection to clearly understand and identify these surcharges and revenue sources?

Answer. In August 2007, in STB Ex Parte No. 661, *Rail Fuel Surcharges,* the Board finalized its new requirement that all Class I rail carriers submit a quarterly report of fuel costs, consumption, and surcharge revenues, due 30 days after the end of each reporting period. That report must include the total fuel costs and the total number of gallons of fuel consumed, for all freight, yard and work train locomotives. Also to be included in that calculation is fuel charged to train and yard service ("function 67—Locomotive Fuels") and all other fuel used for railroad operations and maintenance, including motor vehicles and power equipment not charged to function 67—Locomotive Fuels. Carriers must also report the total increase or decrease in the cost of fuel and the total fuel surcharges billed for all traffic. They also must break out the total fuel surcharges billed on regulated traffic.

In addition, in December 2007, in STB Ex Parte No. 385 (Sub-No 6), *Waybill Sample (Clarification),* the Board instructed carriers that participate in the "waybill sample" (a statistical sampling of freight bills) to report fuel surcharge revenue in the same field, so as to achieve uniformity in the reporting of fuel surcharges.

These actions were taken as part of an ongoing effort to ensure that fuel surcharge revenues are properly reflected. We will continue to monitor and address how surcharge revenues are reported.

Question 4. A second obstacle to competition, according to the rail customers in Arkansas, is the refusal of a major railroad to provide a rate to take a customer's cars to a competing major railroad. Apparently, the STB allowed this practice in a December 1996, case called the "bottleneck" case. What is the STB doing about this "bottleneck" issue?

Answer. The Board's judicially affirmed "bottleneck" policy reflects the long-established principle of railroad law that a shipper generally may not require a carrier that can provide the full "through" service from origin to destination to carry the traffic for only part of the move and turn the shipment over to a competitor for the remainder of the haul. The bottleneck policy was addressed 11 years ago in response to attempts by coal shippers to limit the ability of railroads to price differentially. Under differential pricing, a railroad may charge higher rates to captive shippers with greater (more inelastic) demand. What that means is that shippers that do not have competitive alternatives, and that have less flexibility in how much rail service they need, will generally pay higher rates than those that either have transportation alternatives or that can adjust how much they ship based on how much the carrier charges. Thus, if there is only one railroad that can provide service between a coal mine and a power plant that depends upon receiving a certain number of coal shipments, the carrier may be able to charge a higher rate than it could if there were another, competing carrier that could also provide the service.

In the bottleneck cases, the utility companies sought the ability to break up their movements into separate legs, in an attempt to get a lower rate on the segment of the move where they could use a competing carrier, and to be able to bring a separate rate challenge for the shorter bottleneck segment of the move.

The Board found that shippers cannot break up a through movement in this manner, because ordinarily a carrier has a statutory right (in section 10705) to use a routing that protects its "long haul," and because the Supreme Court has made clear that only the entire rate from origin to destination can be challenged. *See Great Northern Ry.* v. *Sullivan,* 294 U.S. 458, 463 (1935) (a shipper's "only interest is that the charge shall be reasonable as a whole"). The only exception that the Board could find to these longstanding legal principles is when there is a separate rail transportation contract with another carrier for a segment of the move. The Board found that the more recently enacted provision that entitles shippers and carriers to enter into such contracts for transportation outside the Board's jurisdiction (see section

10709) supersedes the law applicable to non-contract transportation. Therefore, shippers are free to enter into contracts that achieve the result of bypassing the bottleneck rule and those contracts fall outside of the STB's purview.

I understand the consumer-rights appeal of empowering rail customers to break up trip segments into their component parts so that they can drive down the rates. But the bottleneck policy reflects the long established legal framework under which the rail industry has operated. I do not believe that categorically changing the way that the industry operates would be appropriate without further study and analysis. We have engaged a contractor, Christensen Associates, to examine various competitive issues over the next year, and we anticipate that the contractor will examine the bottleneck issue.

I am particularly concerned about the potential impact on the railroad industry's ability to engage in differential pricing if a carrier's participation were limited to a very small portion of those movements that it would otherwise depend upon to cover the current portion of its fixed and common costs. Differential pricing is common in all modes of transportation, and carriers depend on differential pricing to provide enough revenue to cover the fixed and common costs that cannot be attributed to specific traffic. Under any other approach, such as an assigned weight-and-distance approach or cost-plus approach, railroads would end up losing whatever traffic could move by another carrier or other mode of transportation offering lower rates, such as trucks, thereby adding to highway congestion and safety problems. And without the ability to make up the difference in order to obtain sufficient revenues, carriers would lack the means or incentive to reinvest sufficiently in their rail systems to continue to provide the level of rail service that our Nation needs. In the end, with railroads earning substantially lower revenues the size and shape of the rail system could change in ways contrary to the public interest. The natural outgrowth of such a scenario would be that carriers would focus their more limited revenues on their high-volume, low-cost routes, and would invest less in maintenance and service to higher-cost routes, thereby adversely impacting captive shippers and many rural and other regions.

Question 5. The GAO's supplemental report concluded that the STB has the statutory authority and access to information to conduct rigorous analysis of competition in the freight rail industry that would rely on more than sample data. Do you agree with this assertion? Has the STB undertaken such an analysis to determine whether rail rates in selected markets reflect justified and reasonable pricing practices or an abuse of market power by the railroads? Do you have adequate funding and/or personnel to conduct such analysis and collect relevant data? Why to this point have you not completed such a study? How long would it take to conduct such a study?

Answer. The GAO report issued in November 2006 recommended that an independent study of competition in the rail industry be conducted. The STB was unable to conduct such a study immediately on its own without jeopardizing its work on important initiatives such as those to reform its rail rate review procedures for small cases and to revise how it calculates the cost-of-capital for the rail industry. The Board's FY 2007 funding, however, which was contained in the appropriations bill enacted on February 15, 2007, was adequate to commission a study by an outside contractor, and on March 1, 2007, the agency began a procurement process to award a contract. Last fall the Board entered into a contract with Christensen Associates to perform the study. The agency will provide adequate support personnel as needed from our present full-time staff. The study will be quite complex and resource-intensive, and that is why it will take the contractor a full year to complete. This study will be published toward the end of this year.

Question 6. I understand that the STB is in the process of finalizing new reporting requirements for rail companies to report fuel surcharges and miscellaneous revenues to the STB. Where is the STB in this process? How would you rate the STB's current ability to accurately collect this type of data?

Answer. I would give the STB a positive rating for its current ability to accurately collect data on fuel surcharges and miscellaneous revenues. As I indicated in the answer to *Question 3,* the Board has finalized new reporting requirements for fuel surcharge data that will demonstrate how the carriers are complying with the agency's directive that fuel surcharges be appropriately tied to fuel cost increases. The Board will also address a recently filed petition suggesting that fuel surcharge revenues should be reported as a separate item in the Waybill Sample. We will continue to make any appropriate refinements to the data collected.

Question 7. In 2005 the electric utilities were not getting enough coal delivered for their power plants. The CEO of Arkansas's rural electric generating company wrote the Chairman of the STB seeking assistance with this problem. I am told that my constituent never got a response to his letter from the Chairman of the STB,

but rather received a letter in response from the railroad that was in question. What legal authority does the STB have to assist a rail customer, such as my rural electric utility, that believes it's not receiving sufficient coal deliveries from its rail carrier? Why did the Arkansas Electric Cooperatives not receive a response from the STB? Why would a company sending a letter to the STB specifically and receive a response from the rail company in question and not the STB?

Answer. The Interstate Commerce Act, at 49 U.S.C. 11101(a), requires rail carriers to provide transportation or service on reasonable request. However, there are a variety of valid reasons, consistent with the common carrier obligation, why a particular shipper may not receive the exact level of service it wants at the exact time it wants it. The Board stands ready to ensure that carriers meet their common carrier obligation so that shippers receive services that are reasonable under the circumstances.

Service complaints or problems can often best be handled informally. In carrying out its mandate, the STB has established a very effective Rail Consumer Assistance Program, run by our Office of Compliance and Consumer Assistance (OCCA), to assist shippers with their service complaints. OCCA handles about 100 disputes in a typical year, the majority of which relate to service. The process is easy to use; it can be engaged by a simple telephone call, fax, letter or e-mail. The follow-up by our staff is prompt and effective. Our consumer assistance staff can often bring the parties together and address their issues in a manner satisfactory to all interests. If the attempts at informal resolution are not successful, the shipper can then file a formal complaint with the Board. Such a complaint will be heard on a public record, and the Board's decision will be appealable in court.

I should note that on July 18, 2007, after hearing about coal supply concerns from a variety of sources, the STB held a field hearing in Kansas City, Missouri, to examine issues related to the efficiency and reliability of railroad transportation of resources critical to the Nation's energy supply, including coal, ethanol and other biofuels. Speakers at the hearing represented the interests of railroads, utilities, coal shippers, and other energy commodities such as ethanol. To address these issues further, the STB has established a Rail Energy Transportation Advisory Committee (RETAC) to provide advice and guidance to the agency and to serve as a forum for the discussion of emerging issues regarding the railroad transportation of energy resources such as coal and ethanol and other biofuels. RETAC is expected to address matters such as rail performance, capacity constraints, infrastructure planning and development, and effective coordination among suppliers, railroads and energy-resources users. RETAC has already held its first meeting and has gotten off to a good start.

I can not tell you why the CEO of Arkansas Electric Cooperative, Mr. Gary Voight, did not receive a response to his 2005 letter directly from the then STB Chairman, to whom the letter was addressed. I can tell you that it was referred to OCCA for informal handling. In the past, OCCA would sometimes forward such correspondence to the carrier involved in an attempt to engage the parties in dialogue. Since I became Chairman, I have made sure that OCCA does not contact the carrier involved or forward correspondence to the carrier without first obtaining clearance from the complaining shipper or other party. I also ensure that all letters addressed to me (other than those that might be construed as pleadings in pending cases, as to which I cannot respond on the merits because of the prohibition against *ex parte* contacts) are answered promptly.

I recently called Mr. Voight, and apologized for the fact that he did not receive an appropriate response from the STB. I also informed Mr. Voight that it is my practice to respond to all inquiries. I was pleased to learn from him that rail service and coal stockpiles are greatly improved today, compared with 2005.

Question 8. How many rate challenge cases are currently filed with the STB? How long does it take to process a case and make a determination? What is the average cost of a case to a shipper and a railroad?

Answer. There are currently three small rate cases and one large rate case pending before the STB for an initial determination as to the reasonableness of the challenged rates. There are two other large rate cases in which the agency has made an initial determination and the shipper has sought reconsideration by the Board (and, in one of those cases, the shipper plans to revise its evidentiary presentation at the Board's suggestion). Deciding large rate cases is time consuming and costly for both shippers and railroads.

The time and expense to process a rail rate case depends upon the size of the case. In a large rate case, where tens of millions of dollars or more are often at stake, the Board must use the most precise approach feasible for the case. In those cases, shippers typically proceed under the Board's "stand-alone cost" (SAC) test. It can take as much as a year and a half for the parties to develop a complete evi-

dentiary record, and another 9 months for the Board to fully review the record and prepare its decision. While the Board does not collect information regarding the cost of rate cases, we have been advised that shippers have spent as much as $4.5 million to pursue such a case, although the Board expects that figure to be considerably lower with the reforms that it has recently made to the process. In any event, the time and expense associated with a large rate case is not out of line with what it takes to litigate complex commercial disputes of this magnitude in the courts.

For smaller rate cases, the Board's procedures should be considerably less expensive. For the smallest category of cases, those in which the rate relief sought does not exceed $1 million over a 5-year period, the Board will issue its decision within 8 months after the complaint is filed, and we expect that neither party would need to spend more than $250,000 to present its case.

Finally, for a medium-sized rate case, one in which the rate relief sought does not exceed $5 million over a 5-year period, the Board will issue its decision within 17 months after the complaint is filed, and we expect that neither party would need to spend more than $1 million to present its case.

Question 9. What is your opinion of establishing an independent arbitration board to assist the STB with case load?

Answer. I do not believe that an independent arbitration board is necessary. The STB is fully capable of carrying out the mandates of the Interstate Commerce Act itself. The STB does not have a serious backlog of cases, we meet our statutory deadlines, and as I have discussed above, we have taken significant steps to streamline and simplify our decisional processes in important areas.

One reason I do not generally favor mandatory, binding arbitration is because the very "rough justice" that virtually unreviewable arbitral decisions can produce can undercut the predictability that the Board seeks to provide for shippers and railroads. Indeed, although some parties tout the Canadian system of arbitration, my understanding is that it produces inconsistent and unpredictable results that are not necessarily based on any economically sound methodology and that can interfere with the development of reasonable business plans.

Moving beyond rate disputes, I would note that, because arbitral rulings have no precedential value and are not available for review or research, they would not provide a resource of knowledge to assist in resolving similar disputes. Less rigid and far less expensive alternative dispute resolution mechanisms, such as mediation, can be done by the STB's trained staff while still allowing parties the opportunity to obtain a formal Board resolution of the dispute should the mediation fail. I should note that our mediation policy has worked well and that two small rate cases, *BP-Amoco* v. *Norfolk Southern* and *Williams Olefins, L.L.C.* v. *Grand Trunk Corporation* were successfully mediated by Board staff in the last 2 years.

Question 10. Do you believe the Board approved "stand alone cost" (SAC) model, that compares the rates charged by a railroad with the rates that would be charged by a fictional competing railroad is the best method for determining market dominance or whether a shipper's rates are unreasonable or difficult to prove?

Answer. The Board's constrained market pricing methodology, which includes the SAC test, is the best method that I am familiar with for purposes of resolving large rail rate disputes. Railroad rate regulation, like rate regulation in other industries, is complex. The courts have concluded that the Board's sophisticated "constrained market pricing" methodology, which includes the SAC test, is an appropriate methodology that simulates the results of a competitive market in the rail industry. Under SAC the complaining shipper is required to pay for the costs of its service, plus a reasonable profit, but it is not required to bear the costs of carrier inefficiencies or of facilities that are not used for its own traffic.

I am always open to new ideas, and I would entertain any suggestions as to a new rate methodology, but to date, it has not been demonstrated to me that there is any better method of regulating rail rates in major cases. SAC allows railroads to price differentially while still limiting charges to those attributable to a particular shipper's service, plus a share of the reasonable return needed on the carrier's fixed costs. Were the SAC test discarded, the Board would have to fundamentally alter how the reasonableness of rail rates is judged. I am concerned that a return to a cost-based approach would not allow for demand-based differential pricing. That, in turn, would deny railroads the ability to cover all of their costs (including a reasonable return on capital) as a result of the business reality that railroads serve a customer base that includes both captive and competitive traffic. Because the competitive traffic would not pay its allocated portion of the fixed and common costs if a less expensive transportation alternative is available, a carrier must have the ability to charge more to its captive traffic to make up the shortfall. And over the long run, the captive traffic is better off under demand-based differential pricing than it

would be under a cost-based approach, because demand-based differential pricing allows the carrier to retain the traffic with competitive alternatives, which makes some contribution to the fixed and common costs, thereby reducing the amount that the remaining traffic base needs to cover.

Finally, I would note that the SAC test is not used to determine whether a carrier has market dominance over the traffic to which a challenged rate applies.

Question 11. Has the STB considered altering this method or reducing the burden of proof from the shippers?

Answer. As I have discussed, the Board already has made substantial strides at simplifying the way the SAC test is administered, including some major substantive changes to the methodology. The Board has also substantially improved the way it will handle smaller rate cases, as I have also discussed. I believe that those changes will improve the process substantially for both types of cases and reduce the litigation burdens on a shipper significantly. The Board has not sought to fundamentally change its judicially approved basic approach for assessing rate reasonableness, and no party has brought to the agency a reasonable alternative.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. FRANK R. LAUTENBERG TO JAYETTA Z. HECKER

Question. You note in your testimony that rail rates have increased in recent years. This could be because of new pricing power by the railroads or just increased market prices for transportation generally. Have you looked at whether rates for truck and maritime transportation have increased as well?

Answer. We did not examine how rates for maritime and truck transportation have changed in recent years. We recognize that some of the same factors that influence railroad shipping rates could also influence rates for maritime and truck transportation. However, we are not able to say how the railroad rate increases that we reported compare with rates changes for other modes commonly used for freight shipments, because such an examination was outside the scope of our review.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO JAYETTA Z. HECKER

Question 1. In October, 2006, the GAO filed a report on the state of the freight rail industry pursuant to a request from a number of Members of this Committee, including myself. The GAO supplemented that report on August 15, 2007. We requested this report in March 2005. The main portion of the report was issued in October, 2006 and supplemented with 2005 data on August 15, 2007. One of your major recommendations was that the STB study the lack of competition in the rail industry and take necessary corrective action. The STB has finally commissioned a study on the lack of competition in the rail industry, but has it made any public commitments to address this issue after the study is completed?

Answer. We are not aware of any specific plans or commitments the Board has made on this issue beyond commissioning the study. STB announced in September 2007 that it had awarded a contract for a comprehensive study on competition, capacity, and regulatory policy issues to be completed by the Fall of 2008. As you know, our recommendation to the Board was twofold; one, that it undertake a rigorous analysis of competitive markets to identify the state of competition nationwide, and two, that it consider the range of actions available to address the inappropriate exercise of market power should it learn of such problems in specific markets. We commend STB for commissioning this study. The steps the Board takes after it receives the results will be critically important to addressing the issues associated with the continued existence of pockets of potentially "captive shippers" that we discussed in our October 2006 report.

Question 2. The GAO found that the rail customer protections at the STB were largely "inaccessible" to rail customers due to filing fees, complexity of the processes, the cost of pursuing a case at the STB and the time required to pursue relief at the STB. Is that correct? What recommendations has GAO proposed for improving the rail rate relief process for rail customers?

Answer. While we did not offer specific recommendations, in 2006 we reported that STB's standard rate relief process was widely viewed as inaccessible to most shippers and we highlighted a number of potential alternative approaches. Specifically, we found the process was expensive, time consuming, and complex. We also reported that the simplified guidelines had not effectively provided relief for captive shippers. We discussed the pros and cons of alternative approaches that shipper

groups, economists, and other experts in the rail industry have suggested might provide more effective remedies than the rate relief process, including such remedies as reciprocal switching (where railroads transport cars of a competing railroad for a fee) and trackage rights (where one railroad grants access to its tracks to another railroad).

Since our report was issued in October 2006, STB has taken steps to refine the rate relief process by, among other things, (1) revising procedures for deciding large rate relief cases by, for example, placing restraints on the evidence and arguments allowed in these cases, (2) altering its simplified guidelines for small shippers to enable shippers who are seeking up to $1 million in rate relief over a 5-year period to receive an STB decision within 8 months of filing a complaint, and (3) creating a new rate relief process for medium-size shipments to allow shippers who are seeking up to $5 million in rate relief over a 5-year period to receive an STB decision within 17 months of filing a complaint. These appear to be positive steps that could address longstanding concerns about STB's rate relief process. However it is too soon to determine the effect of these changes on the process, and therefore we have not evaluated their effect.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. DANIEL K. INOUYE TO CHARLES W. MOORMAN

Question. What are the biggest challenges when it comes to adding new commuter/passenger operations to your railroad, and what would be the impact on that if the so-called railroad competition bill passed the Congress?

Answer.

Passenger/Commuter Rail

The biggest challenge regarding adding new commuter/passenger operations is finding ways to accommodate the passenger operations *without* adversely affecting current or future freight operations. Often, this means that capacity must be expanded to make room for passenger trains.

Because of a huge increase in rail freight traffic in recent years, there is much less room to spare on the U.S. rail network today than there was even just a few years ago. Thus, train "slots" have become increasingly scarce on many rail corridors. When passenger trains fill these slots, it erodes freight railroads' ability to serve those areas because those slots are not available to freight trains.

Moreover, because of the generally higher speed at which they operate and their typical priority status, passenger trains consume more infrastructure capacity than freight trains and create freight train delays as they travel across the freight rail network. Further allowing passenger trains to fill these slots at below-market prices would make this situation even worse, resulting in a major subsidy from freight to passenger railroads.

Freight railroads agree that passenger rail has a potentially important role in alleviating highway congestion in certain corridors, and freight railroads are committed to working reasonably and cooperatively with Amtrak and commuter railroads to help them succeed where practicable. But the goal of reducing pollution, highway congestion, and greenhouse gas emissions by expanding passenger rail will not be realized if passenger trains interfere with freight service and, as a result, force freight onto the highways or prevent railroads from meeting the huge future growth in freight transportation demand that the U.S. DOT and others expect.

The Railroad "Competition" Bill

If the so-called railroad "competition" bill (S. 953/H.R. 2125) passed Congress, the impact would be overwhelmingly negative—for shippers, railroads, rail employees, and the economy at large.

Freight railroads need more capacity, not less. The demand for freight transportation has grown and is projected to continue to grow. The United States Department of Transportation ("DOT") has estimated that the demand for freight transportation will increase by 55 percent between 1998 and 2020. More recently, DOT projected that total freight transportation demand will rise 92 percent from 2002 to 2035, including an 88 percent increase for railroads. Similarly, the American Association of State Highway and Transportation Officials projected that freight tonnage will grow by almost 57 percent between 2000 and 2020.

In fact, a recent study by Cambridge Systematics found that railroads need an estimated $148 billion in *new* capacity by 2035 to be able to handle the freight traffic increase predicted by DOT. That amount is on top of the hundreds of billions of dollars necessary to maintain and replace *existing* rail infrastructure over the pe-

riod and in addition to massive amounts necessary to maintain, replace, and expand locomotives, freight cars, and other rail-related equipment.

But the whole point of S. 953/H.R. 2125 is to force railroads to lower their rates to certain favored shippers (most of whom are more profitable than railroads) to below-market levels. These forced rate reductions would translate directly into lower railroad earnings—potentially billions of dollars per year—taking railroads *away* from the financial sustainability they need.

Consequently, spending on track and equipment would shrink; the industry's existing track and equipment would deteriorate; needed new capacity would not be added; and rail service would become slower, less responsive, and less reliable. It would be impossible for railroads, in the face of the huge revenue loss they would confront from reregulation, to make the massive ongoing investments in capacity expansion our Nation desperately needs.

America has a great freight rail network. It just needs more of it, and S. 953/H.R. 2125 will not help achieve that.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO CHARLES W. MOORMAN

Question 1. What would be the impact of Senator Rockefeller's bill (S. 953) on the railroad industry should it pass Congress?

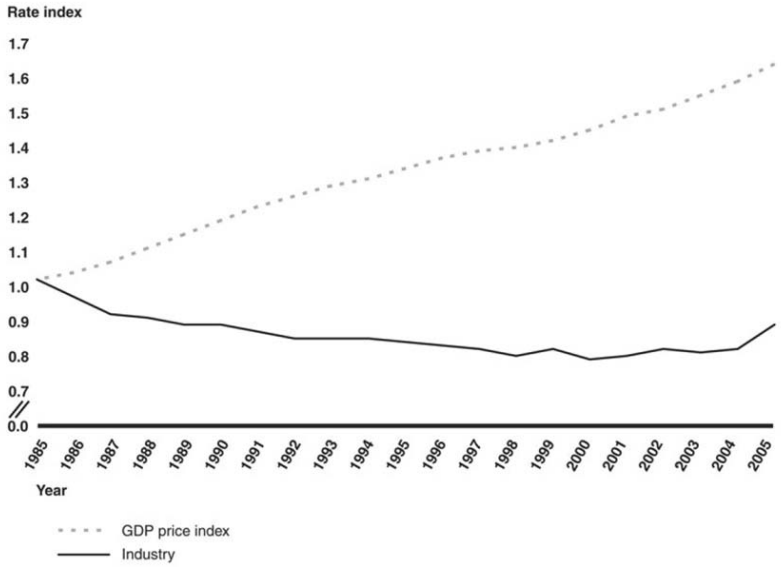
See section on The Railroad "Competition" Bill above.

Question 2. According to the GAO report, industry rates for 2005 increased by approximately 7 percent from 2004 levels. Why do you believe there was an average rate increase that exceeded inflation?

Answer. Any number of market forces can result in rates rising more or less than the inflation rate during any one period of time. During the period between 2004 and 2005, demand for rail transportation increased markedly. Although railroads have invested substantially in infrastructure, the rapid growth in rail traffic (or "demand" for rail service) during that period meant that, on some critical corridors and at some locations, rail capacity (or "supply") tightened. Whenever supply tightens or grows slower than demand, economists expect prices to rise. So, we should not be surprised that market forces work in the rail market in the same way that they work in other markets. Additionally, when multiple-year contracts expire rate increases reflect what has transpired in the market during all the years since the parties entered into the contract.

Recent railroad rate increases for some shipments over the past couple of years also need to be put in context. As measured by revenue per ton-mile, average U.S. freight rail rates continue to be a bargain. As measured by revenue per ton-mile, average U.S. freight rail rates have fallen 55 percent in inflation-adjusted terms from 1981 to 2006. In addition, a recent GAO report, which included the following chart, also demonstrates that rail rates substantially lagged economy-wide inflation. The deviation would be even greater had GAO taken inflation into account.

Figure 1: Trends in Industry Rail Rates, 1985-2005



Source: GAO analysis of STB data.

Another way to put the recent rate increases into perspective is to compare rail rates to the prices of other products in our economy. Looking at data from the Bureau of Labor Statistics, we can compare the prices from January 1984 to November 2007. On the one hand, the price of gasoline is up over 150 percent; the price of electricity is up over 45 percent; the price of potato chips is up over 45 percent; and the price of a whole chicken is up over 35 percent.

No one could reasonably believe that rates should decrease forever, or that rail rates should not keep pace with other general economic indices. Rail rates have a long way to climb before they are even on par with the increases of other commodities or of general economic indices.

Moreover, railroads need to earn adequate returns. Unlike trucks and barges, which travel on heavily-subsidized highways and waterways, U.S. freight railroads finance the vast majority of their infrastructure spending themselves. They need to be able to earn enough to do this, which is why adequate rail earnings are critical. As the Congressional Budget Office has noted, "[a]s demand increases, the railroads' ability to generate profits from which to finance new investments will be critical. Profits are the key to increasing capacity because they provide both the incentives and the means to make new investments."

As their traffic continues to grow, railroads will have to concentrate increasingly on building substantial new capacity in addition to maintaining and replacing their existing infrastructure and equipment. In order to expand infrastructure and service, railroads—like every other business in a free market economy—must obtain from their customers the resources they need to support the growth their customers want and need.

Question 2a. Are increases evenly distributed across all of your routes?

Answer. I cannot speak to how other railroads price, but NS prices traffic according to market factors. Different market factors affect different traffic. Some of those factors include the volume of traffic the customer will tender; the unique characteristics of the rail movement; the length of haul; the level of equipment utilization that results from the customer's ability to load and unload railcars or from the amount of time the equipment will have to move empty; the availability of other modes of transportation; the length of contract term; the projected costs for NS to move the traffic; the availability of rail capacity; and other market factors. Accordingly, rate increases (or decreases) vary by customer, by commodity, by route, or all of the above.

Question 2b. Where did your company increase rates the most? Why?

Answer. NS's rates increased the most where the market forces dictated larger rate increases.

Question 2c. Where are some of the highest increases among your customers?

Answer. The highest rate increases tend to be in situations where a customer's long-term contract expires. In those situations, the extent of the changes in the market forces since the last contract was negotiated is greatest.

Question 2d. Is there a particular shipper (industry) that is leading the complaints against the industry on rail issues? Why do you think they are so vocal?

Answer. It appears that most complaints regarding rail issues emanate from shipper groups representing the electric utility, chemical, and grain industries. In a sense, it seems that railroads might be a sort of a scapegoat for other competitive pressures.

For example, the chemical industry cannot do much to influence the extremely high price of natural gas, the industry's primary feedstock. Railroads are a much smaller cost to the chemical industry, but are an easier "target."

Much of the electric utility's discourse is promoted by electric cooperatives and their consultants and trade association spokesmen. For decades, electric cooperatives have worked hard to obtain and retain a set of special advantages not available to most businesses. By advocating reregulation of freight railroads, electric cooperative hope to gain yet another government-conferred special advantage.

And while freight railroads have been an essential and highly cost efficient lifeline to the domestic and international market for our agricultural sector, sometimes those who have not taken full advantage of potential rail efficiencies or who are geographically or competitively challenged vis-à-vis other producers are not fully accepting of the underlying market dynamics.

The Staggers Act of 1980, which partially deregulated railroads, has been a tremendous success. Staggers, however, did not bestow on railroads a special public service obligation, verging on the governmental, to subsidize other businesses, compensate for regional disadvantages or characteristics, or serve as the instrument for advancing local objectives or special interests at the railroads' expense.

Question 2e. Does the STB have a requirement to protect "captive shippers" from unfair rail rates?

Answer. "Fairness" is an imprecise and qualitative concept. For example, some rail customers seem to believe that "fairness" means that railroads should charge the same rate to all shippers to transport their product the same distance. Other shippers apparently think that "fairness" requires a rail rate for a given route to be no more than a certain markup over the costs of that route alone, regardless of a railroad's system-wide revenue needs. And still other rail users may consider it "unfair" ever to lose a case brought before the STB.

That said, the STB *does* have the statutory and regulatory authority to determine whether a particular rail rate exceeds a reasonable maximum and take certain other actions if a railroad is found to have "market dominance" or to have engaged in anticompetitive behavior.

Indeed, STB guidelines impose a set of constraints that prevent railroads from abusing their pricing freedom. The most important of these constraints is the stand-alone cost ("SAC") test, which in theory is firmly rooted in sound economic theory. The SAC test acts as a surrogate for competition in those instances where competitive markets do not exist by determining the total costs that a hypothetical, efficient new railroad would incur to construct and operate a rail line to serve the traffic in question. If the rates charged by the existing railroad generate revenue higher than what the SAC test finds necessary to recover the full costs of the hypothetical railroad, the existing railroad's rates are considered to be unreasonably high.

In such an instance, the STB can order the existing railroad to lower its rate to the level of the hypothetical railroad and pay reparations to the complaining shipper. If the existing railroad's rates are lower than those of the hypothetical railroad, the existing railroad's rates are considered reasonable. Because the SAC test estimates the current cost of replacing the needed rail service, it guarantees that in the long run shippers pay no more for rail service than would be charged by an efficient new entrant.

The STB recently issued new rate reasonableness guidelines in which it created two additional tests that shippers with so-called small rate complaints and medium-sized rate complaints can use. Although these new procedures require less time, expense, and effort to bring and adjudicate, certain aspects of these new guidelines are worrisome. For example, they do not require the STB to actually examine the transportation at issue, which means the risks and costs associated with transporting highly hazardous materials may not be properly taken into account.

Question 2f. Do you believe the current Revenue to Variable Cost or Stand Alone Cost formulas for determining unfair rail rates and captivity is adequate?

Answer. Railroads believe that the current regulatory regime—under which competition and market forces are the determining factors in setting rail rates and service standards in most cases, with maximum rate and other protections available to rail customers who truly need them—is, by and large, an appropriate one. It strikes a reasoned balance between providing railroads the freedom to compete effectively in the marketplace and providing shippers the means necessary to combat actual abuse of railroad market power and anticompetitive railroad behavior, where it may exist.

The SAC test in general is the most appropriate and in theory is an economically-based test—which the STB itself has repeatedly noted. However, the STB last year enacted a new set of rules to alter the stand-alone cost test. NS believes that several of these changes are inconsistent with the underlying economic basis for the test and are appealing those limited changes. Regulatory mechanisms for assessing the reasonableness of rates that are not economically-based are worrisome because they may not appropriately account for the needs for investment in and replacement of the Nation's rail system.

NS is very concerned about recent regulatory actions that seem to be altering the balance in rail regulation that has served the United States well since the Staggers Act of 1980. A major objective of the STB is to ensure the long-term strength and health of railroads—because strong and healthy railroads are in the best interest of the public. Several recent STB decisions are troubling because they could have the effect of undermining the ability of our country's railroads to play as strong a role as possible in addressing our growing transportation crisis. Going forward railroads need the continued flexibility that deregulation has offered to efficiently handle the rapidly expanding transportation needs of our domestic economy and sustain our Nation's domestic efficiency and international competitiveness.

Question 3. According to the GAO's supplemental report, fuel surcharges in 2005 tripled from 2004 levels ($633 million to over $1.7 billion). Also, "miscellaneous revenue" accounted for 1.5 percent of revenue in 2004 and rose to 3.7 percent in 2005. Can you explain why these charges would increase by that much?

Answer. Again, on matters of rates and charges, I can only address NS and cannot comment on what other railroads may or may not be doing. But it should not be surprising that revenues from fuel surcharges increased over this period. First, the average price of West Texas Intermediate nearly doubled between January 2004 and December 2005. Second, as contracts that did not include a fuel surcharge provision expired during this time period, fuel surcharge provisions were included in new contracts during the course of negotiations, which meant more and more customers began to pay fuel surcharges.

Question 3a. Were these increases universal for all customers that you serve?

Answer. As noted above, some customers with long term contracts did not pay fuel surcharges during this period. Other customers may have negotiated other terms, such as higher base rates in lieu of a fuel surcharge or for an individualized fuel surcharge.

Question 3b. Should railroads reimburse customers if they were overcharged for fuel rcharges?

Answer. NS cannot speak for other railroads and their fuel surcharge policies. But, NS does not accept the premise of the question that customers could have been overcharged.

Today, NS does not charge a fuel surcharge on traffic that NS originates and that moves pursuant to public tariffs. We do, however, negotiate contracts that include a fuel surcharge mechanism of one variety or another. These mechanisms are intended to reflect the changes that occur in the marketplace for transportation services as fuel prices fluctuate. For example, trucks are our largest competitor. But we know that rail is more competitive *versus* trucks at higher oil prices. One reason NS has a fuel surcharge mechanism is to reflect the relative nature of that competitive advantage over our competition. Fuel surcharges therefore are not intended to serve as a straight-pass through of fuel costs.

It is important to understand that NS strives to set its overall prices at market levels. We use the market as our gauge when negotiating contract arrangements and when determining the appropriate level of our public rate authorities. The total price—whether the transportation rate, a fuel surcharge, other charges, or a combination of these items—must be at market levels. Maintaining rates at market levels is critically important in these times in which more capacity investment is needed.

Question 4. I understand the capital intensive nature of the rail industry, but I also understand that freight railroads are currently sufficiently profitable and are reinvesting at a high rate.

Answer. Railroads' financial health has improved over the past couple of years. But even in 2006, when railroads hauled more freight than ever before, their "record" earnings were still *below* most other industries.

Return on equity ("ROE") is a common profitability measure. According to Value Line data, the ROE for the rail industry in 2006 was 14.0 percent—possibly the best ROE for the rail industry ever. By contrast, the median ROE in 2006 for the 89 industries (encompassing approximately 1,700 firms) that Value Line tracks was 16.7 percent—19 percent higher than the rail figure. In fact, in 2006 railroads ranked just 58th among the 89 industries Value Line tracks.

ROE data from the Fortune 500 tell a similar story: rail profitability is substandard compared to most other industries, even in 2006 when railroads had "record" profits.

In other words, what was probably the best financial year ever for railroads was not enough to get them even to the halfway point among all industries. Given this result, railroads respectfully disagree with the claim that they are "sufficiently profitable."

Moreover, improved rail earnings were a primary goal of railroad deregulation in the first place. The effectiveness of deregulation should not lead anyone to conclude that it is no longer needed.

Railroads are doing their part regarding re-investment. Since Staggers, U.S. freight railroads have spent approximately $400 billion on capital expenditures and maintenance expenses related to their infrastructure and equipment. Railroads are investing record amounts—investments were higher in 2006 than ever before and are thought to have been higher still in 2007 (with increasing amounts going to capacity expansion)—in an effort to provide reliable, efficient service to current customers and meet the tremendous growth in freight demand everyone is predicting. Absent any changes in the legislative or regulatory regime that creates disincentives for railroads to invest, they expect to continue to invest massive amounts of private capital to ensure the U.S. freight rail system remains the world's best and can handle the freight transportation needs of our economy.

Question 4a. Can you explain how your company is currently reinvesting to expand rail opportunities for shippers that are currently strained due to capacity and facility shortages?

Answer. U.S. freight railroads have been devoting enormous resources to maintain their existing infrastructure, to improve their operations and infrastructure, and to alleviate the capacity constraints that arise from increasing freight demand. Indeed, from 1997 to 2006, the average U.S. manufacturer spent 3 percent of revenue on capital spending. The comparable figure for freight railroads was 17 percent, or more than five times higher.

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

At the same time, NS keeps in mind the need to justify new capacity expansion. For example, the construction of new track or new yard capacity requires investment in assets that have a very long life and that are not easily moved. Therefore, capacity expansion projects must generate returns sufficient to justify making the investment. At NS, many projects do not get approved the first time they are proposed because NS simply cannot afford to complete every needed project each year.

In the current environment in which freight demands are forecasted by many groups to increase substantially over the next 20–30 years, it is especially important that railroads have the resources and the ability to improve its infrastructure now to meet future needs because (1) capacity is expensive and resources and money are limited and (2) it takes time to build rail infrastructure and capacity.

For example, it took years for the industry to reach agreement on a plan to address rail congestion in Chicago. After several years of effort on this historic public-private partnership, the rail industry, local officials, and state leaders were able to join together to seek Congressional funding for the public benefits that would flow from the project. Even today, the project is not fully-funded, and it is unclear how long it will take to make it a reality—even though it is clearly needed.

Moreover, even when it is approved and fully funded, the design, permitting, engineering, environmental review, and construction of a major project can take years. For example, from the time NS started the environmental permitting process to build a new intermodal yard in Atlanta to the time NS opened its $110 million facility in Austell, Georgia, was about 5 years. Just how many years it takes to make a project a reality depends on the time required to secure the necessary permits, resources and money available, and the railroad's ability to complete the work in a way that least impacts its ability to serve its customers whose traffic moves on those lines. The good news, however, is that railroad expansion typically requires far less time and money than highway expansion.

Given the time it takes to add infrastructure and the long lives of the assets required to expand capacity, it is essential for railroads like NS to take a long view on infrastructure investments. But the railroading truth is that it takes resources today to invest for tomorrow. NS intends to continue to maintain and build a strong network to meet future shipping needs, but legislative and regulatory changes are real threats to its ability to do so.

Question 4b. Are your reinvestment efforts primarily focused on improving rail rates, access and service for routes currently serving areas of tight demand?

Answer. In making its investment decisions, NS focuses on making our overall rail network more efficient and on serving all its customers well. NS' individual customers have different needs and place different priorities on such factors as transit-time, price, safety, damage-free handling, and frequency of service and switching. NS tries to balance these competing needs and to invest to provide the best service to the most customers. In other words, NS invests to maximize its network. If NS had only intermodal customers, its investments would be different than if there were only coal customers or only chemical customers. In fact, NS serves thousands of customers with different transportation needs for their thousands of different commodities. The investments NS makes represent its best judgment as to how to strike the right balance.

Accordingly, we spend money in a variety of areas. For example, in 2006, Norfolk Southern among other things:

- Closed a deal to create a joint venture with the Kansas City Southern Railway, which will result in $300 million of investment mostly to upgrade the rail line between Meridian, Mississippi and Shreveport, Louisiana, so that the line can move more freight more quickly across the line. Already, 45 miles of formerly non-signaled territory have been converted to centralized train control, 100 miles of crosstie replacement has been completed, 150 miles of ballast and surfacing work has been done, and 45 miles of new rail have been replaced with new rail in three locations.
- Opened a new rail line to the coal-powered Keystone Generating Station in Shelocta, Pennsylvania. The $44 million public-private partnership trims 51 miles off the trip from Saltsburg, Pennsylvania to Shelocta and increases the capacity of the plant.
- Began work on the $62 million Rickenbacker Intermodal Terminal in Columbus, Ohio, which will increase freight capacity in that region by more than 40 percent.
- Added infrastructure in the following corridors: Memphis, Tenn. to Chattanooga, Tenn.; Chattanooga, Tenn. to Atlanta, Ga.; Atlanta, Ga. to Jacksonville, Fla.; Charlotte, N.C. to Manassas, Va.; West Virginia Secondary; Columbus, Ohio to Cincinnati, Ohio; Goldsboro, N.C. to Morehead City, N.C.; St. Louis, Mo. to Louisville, Ky.; and our route to Albany, N.Y. and New England.
- Acquired 142 additional locomotives.
- Acquired 400 rapid-discharge, aluminum coal cars.

Norfolk Southern's announced 2007 capital budget included, among other things:

- Investing in capacity by making capital roadway improvements. Norfolk Southern plans to spend $610 million for rail, crosstie, ballast and bridge programs, including $73 million in infrastructure investments for increased capacity. In addition, Norfolk Southern plans to spend $47 million for communications, signal, and electrical projects; $41 million for maintenance of way equipment; and $16 million for environmental projects and public improvements such as grade crossing separations and crossing signal upgrades.
- Making capital investments in intermodal terminals and equipment to add capacity to the Norfolk Southern intermodal network, increase access and capacity for coal traffic, bulk transfer facilities, and vehicle production and distribution facilities—all at a cost of about $97 million.

- Spending about $60 million for capital projects related to computers, systems and information technology, which will enhance safety and improve operating efficiency and equipment utilization.
- Investing approximately $321 million to:
  - Purchase 53 six-axle locomotives and upgrade existing locomotives (Subsequent to the announced 2007 capital budget, Norfolk Southern also made a commitment to acquire an additional 50 locomotives.).
  - Purchase 1,300 new higher-capacity coal cars as part of a multiyear program to replace the existing coal car fleet.
  - Purchase 739 freight cars as their leases expire; certify and rebuild 388 multilevel automobile racks; and add supplemental restraints to multilevel racks.
- Renewing expiring equipment operating leases covering more than 2,800 cars.
- Leasing 200 additional construction debris cars.
- Repairing freight cars at a cost of $56 million. Our repair plan for 2007 reflects a 17 percent increase in repairs over the number of cars repaired in 2006. Norfolk Southern has announced a new car repair facility in Portsmouth, Ohio that will open next year.

Obviously, our people are another critical asset. Expenditures made to hire, train, and pay crews are not capital dollars, but clearly additional crews expand our capacity. NS is hiring and training 1,300 train and engine employees this year.

Finally, NS keeps in mind the need to justify new capacity expansion. For example, the construction of new track or new yard capacity requires investment in assets that have a very long life and that are not easily moved—capacity expansion projects must generate returns sufficient to justify making the investment.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUYE TO ROBERT L. CARLSON

Question 1. As you know better than anyone, there has been a record wheat crop this year, only to be followed by record wheat sales due to the favorable global wheat market. An unprecedented 80–90 percent of this year's crop has already been sold in addition to wheat in storage. Is it fair to criticize railroads for struggling to haul in a few months what they normally haul in a year?

Answer. Farmers, ranchers, and their cooperatively-owned supply and marketing businesses are grateful for the investment in line capacity improvements, locomotives and higher capacity cars undertaken by U.S. railroads. However, in recent years, railroads have literally sidetracked grain shipments in order to run "piggyback" and intermodal container trains due to limited crew availability and track capacity. It makes good business sense to give priority service to the traffic which is most likely to be lost in highly competitive markets. Grain shippers understand they do not warrant priority service, yet they have been frustrated when car deliveries have lagged well behind what would seem reasonable delivery times. Railroads need flexibility in managing the challenges of shifts in demand for shipping—this should not come at the expense of captive shippers who have little access to effective alternatives.

Question 2. A large part of your testimony centered on captivity and lack of an additional rail carrier, but isn't capacity a larger issue? Capacity is more constrained than it was several years ago, not only on rail, but in trucking and barge transportation as well. If you had service from two capacity constrained railroads, how do you think it would change service levels?

Answer. Overall capacity is an issue. In fact, North Dakota grain shipments to the Pacific Northwest were significantly delayed because the railroads serving North Dakota were unable to obtain track time on another railroad that served the export terminals—the latter railroad having capacity constraints of its own. We appreciate that railroads are enjoying a surge in demand unthought of a decade ago. We can empathize with the capital intensive nature of railroads, and that decisions made today to expand capacity will have to be supported by difficult-to-project business volumes for years to come. Railroads have had good success in generating new traffic, thanks to the constant flow of consumable goods-laden containers from China, unit coal trains fanning out from Wyoming, and ethanol tank trains, to name a few. Farmer-owned grain elevators too have made significant investments in heavier and longer sidings and additional storage and handling facilities to load unit trains. Agricultural shippers have done their share to make railroads more efficient in terms of equipment usage and turnaround times. I do believe the free market system

works in that competition may achieve rate and service improvements which were once the focus of the ICC. Absence of competition will not resolve capacity concerns; however, competition may encourage railroads to take corrective measures to keep trains rolling regardless of whether they are loaded with DVD players or durum wheat. Rural communities have lost thousands of miles of railroad track and service as the industry rationalized its overcapacity. The rail industry has transitioned from too much capacity and too little profitability to an environment in which profitability seems healthy related to too little capacity.

Question 3. I often hear from wheat trade association representatives that wheat rail rates keep climbing to unreasonable levels making them uncompetitive in domestic and global grain markets. Does it make sense that a railroad would price you out of the marketplace—after all, if you're not selling your products, the railroads aren't hauling them and therefore losing a business opportunity?

Answer. I recently met with two officials of Burlington Northern Santa Fe who offered an example of a grain rate in Montana that actually priced farmers—and the railroad—out of a specific market because the competing railroad in Canada had a lower rate for the same crop. The BNSF officials said they reviewed and ultimately reduced the rate to allow farmers to sell grain that in turn moved on BNSF rails. Unlike two service stations across the street from each other, railroads may be blind to situations in which their own rates are costing them business. The question is, will a railroad be willing to entertain a request from shippers to lower a rate? Again, if the railroad already is running at full capacity, it naturally will be selective in encouraging less profitable traffic. From a business point of view, the railroads might be lauded as managing assets to generate the best return for investors. From the farmers' point of view, discouraging some agricultural traffic would be a costly mistake. Farmers have much more to lose than railroads.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. FRANK R. LAUTENBERG TO ROBERT L. CARLSON

Question. In your testimony, you note that shipping grain from a North Dakota grain elevator to Minneapolis costs much more to move than shipping it about the same distance to Chicago. Similarly, you can get an airline ticket from Washington to Fargo for $464 to go 1,340 miles, but you can get a ticket to Los Angeles from Washington for half that price, to travel twice the distance. If this sort of demand-based pricing is accepted in other industries, why is it unfair for rail shippers?

Answer. The example given helps illustrate the complexities of pricing for different markets. If just one airline were serving the Nation's coastal markets, it might well charge a higher price regardless of the actual air miles or cost per mile to operate as compared to routes for which competition cuts into market share. Washington and Los Angeles are served by numerous airlines all competing for market share. Burlington Northern Santa Fe dominates its market in North Dakota. Shippers have no realistic alternatives, other than to pay higher freight rates as compared to farmers in states whose agricultural shippers have competing railroads and/or navigable waterways. The concern by North Dakota farmers is simple: are railroads using market dominance to charge excessively high rates which may, in effect, be subsidizing "sale" rates charged in other states to keep business? Captive shippers—be they wheat farmers in the Midwest or power generation plants in the South—do have legitimate concerns regarding both service levels and rates relative to shippers that enjoy access to competitive options. In a free market, companies will charge what the market will bear. Is this universally fair? Not necessarily. And this is why Congress and the Surface Transportation Board has the role and authority to consider the viewpoints of the rail industry, the shippers who have voiced concerns over the industry's pricing and service approaches, and the consumers who overall are affected by the situation. The questions remain, what is a fair rate, and what is excessive, and whom will determine this benchmark and make sure it is fairly applied?

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. DANIEL K. INOUYE TO HON. GLENN ENGLISH

Question. The 2006 GAO report, in its description of the various shipper-mitigation remedies found in the Rockefeller bill, states that while some shippers could see increased head-to-head rail competition and reduced rates, it is also likely to discourage railroads or cost them sufficient business as to prevent further investment leading to capacity restraints, reduced maintenance, and lesser service. Is that in

a shipper's best long term interest? Didn't utilities across the country claim that 2005 coal delivery disruptions could have been avoided had the railroads invested in more infrastructure? Do you share that belief? What is your opinion of the railroads current reinvestment methods?

Answer. The public policy adopted by Congress in 1980 was that transportation competition rather than government regulation would govern the relationship between the railroads and their customers. Where no competition is available, the Federal regulatory agency is to ensure that the prices paid by rail customers are reasonable.

Rail customers believe that the major problem they confront today is a lack of access to railroad competition coupled with a lack of effective regulation by the Surface Transportation Board in those instances where the rail customer does not have access to rail competition. In other words, rail customers are not receiving the benefits of the policy adopted by Congress in 1980: access to competition; effective regulation where there is no competition. Rail customers seek the benefits Congress intended when it passed the Staggers Rail Act of 1980.

As you know, rail customers are most concerned about two anticompetitive policies sanctioned by the STB: "bottlenecks" and "paper barriers". Specifically, we seek the reversal of current "bottleneck" policy such that a railroad is required to provide a rate to take its customer's freight to a competing railroad and the repeal of "paper barriers" such that short lines are free to do business with any major railroad with which they can physically interchange traffic. If these two policies are reversed, the number of captive rail customers will be reduced but not totally eliminated. Where there is new competition, we would expect the rail rates to drop, but we would also expect the rail traffic to increase across competitive routes.

We are not at all convinced that increased competition in the rail industry would lead to reduced investment in the rail industry or even reduced profitability. The railroads and Wall Street hail the Staggers Act for leading to their improved financial performance today. The Staggers Act replaced government regulation with competition. Having hailed the Staggers Act for allowing them to compete, the railroads should not be allowed to complain that providing the actual level of competition contemplated by Congress in 1980 will hurt them financially. We know anecdotally of many instances where non-competitive rail rates have moved freight from the railroads to trucks. There is no reason that a more competitive rail industry couldn't attract even more freight from the Nation's highways.

American economic policy is clear: there should be no price regulation of competitive markets; but there must be government price regulation where an essential service is being provided in the absence of competition. If Congress were to determine that there must be less competition in the rail industry, which provides an essential transportation service to the Nation, then there must be effective government price regulation that is much more rigorous than the current STB system. Rail customers would prefer to avoid more government regulation by ensuring increased access to railroad competition.

Rail coal customers across the Nation believe that the coal delivery problems of 2005 and 2006—some of which continues today—could have been avoided if the two railroads providing coal transportation from the Powder River Basin had maintained their tracks properly. Rail customers were paying prices, often captive rail prices, that included funds for track maintenance. We do not know why the railroads suspended maintenance of the critical tracks coming from the Powder River Basin, but they have admitted that they did and we believe the failure to remove coal dust that had accumulated in the ballast of the tracks is what led to the derailments and the resulting service disruptions.

As for the railroad reinvestment strategy, we believe that the major railroads are taking money generated by captive rail customers and investing heavily in container traffic movements. As Wall Street makes clear from time to time, reinvestments in captive movements is not viewed as a wise investment since the railroads can increase their profits from these movements by simply increasing their prices without running any risk that an investment might not prove to be prudent. Those of us who use Powder River Basin coal are pleased that the two railroads serving the Basin are investing $100 million or so to improve the shared tracks from the Powder River Basin. However, this is a small investment against the $8 billion in revenue that all the major railroads generated in 2006 from the movement of coal. This is a particularly small investment when one recognizes that the western railroads are in the process of forcing their customers to pay extra to prevent the accumulation of coal dust on their tracks and the coal-burning utilities normally are required to provide all of their own coal cars—a cost traditionally borne by the railroads.

Recently, the Republicans on the House Transportation and Infrastructure Committee had a public "round table" discussion of the railroad infrastructure invest-

ment issue. The entire conversation focused on the investments needed for container traffic—the vast majority of which is imported rather than exported goods. Thus, in addition to the captive rail customer belief that they are paying unreasonably high rates so that the railroad industry can invest in non-related traffic, some captive rail customers are domestic manufacturers whose products (or the consumer products manufactured from their products) are being displaced by foreign products imported in containers, the movement of which they are subsidizing. This is a result not intended by Congress and highly frustrating to domestic manufacturers who are fighting to remain competitive in the global market.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. MARK PRYOR TO HON. GLENN ENGLISH

Question 1. In November 2000, the STB established its Rail Consumer Assistance Program (RCAP) in an effort to allow the public informal access to agency staff and to expand the opportunity for private sector resolution of railroad-related issues. This program provides shippers with access to informal assistance with any type of rail related transportation problem.

Has this program benefited shippers? Does this provide adequate representation or assistance from the STB? How can the STB improve its assistance to shippers facing rail rate problems or other problems with rail companies?

Answer. Our experience is that this informal "jaw boning" process is no substitute for legal protections for rail customers. In fact, one of the most odious examples of the inadequacies of STB rail customer remedies occurred with one of your constituents. In the Summer of 2005, when the Burlington Northern was falling short in its coal deliveries to Arkansas Electric Cooperative, Inc., Gary Voigt, the CEO of Arkansas Electric, wrote the Chairman of the STB, Roger Nober, in August 2005 complaining of the failure of coal deliveries. Mr. Nober, who is now Vice President for Law and General Counsel of Burlington Northern, never responded to Mr. Voigt's letter. However, in November 2005, Mr. Voigt received a dismissive response to his letter not from the STB, but from a Vice President of the Burlington Northern! To date, Mr. Voigt has never received a response from the STB to his August 2005 letter to the STB Chairman. So much for the adequacy of the STB "jaw boning" process.

The STB can best improve its assistance to shippers facing rail rate problems or other problems with rail companies in two ways. First, the STB needs to adopt pro-competitive rules and a workable rate challenge process, as well as rules to enforce the railroad obligation to serve, as intended and directed by Congress in 1980. Second, the STB needs to be pro-active, as opposed to passive, in discharging its responsibilities to Congress to protect rail customers from railroad monopoly abuse.

Question 2. According to the GAO's supplemental report, fuel surcharges in 2005 tripled from 2004 levels ($633 million to over $1.7 billion). Also, "miscellaneous revenue" accounted for 1.5 percent of revenue in 2004 and rose to 3.7 percent in 2005. Do you know why these charges increased by that much? Should shippers be reimbursed if they were overcharged?

Answer. We believe that the steep rise in "miscellaneous revenue" reflects fuel surcharge overcharges by the major railroads. Indeed, in January 2007, the STB found that the railroads had been abusing their fuel surcharge mechanism and were "double dipping" through these surcharges. However, the STB neither quantified the overcharges nor ordered refunds to rail customers.

The American Chemistry Council commissioned a study by a railroad economic research firm named Snavely King Majoros O'Connor & Lee, Inc. The study, which was released in September 2007, found that the total overcharge by five of the seven Class I railroads was $6.4 billion for the period 2003 through the first quarter of 2007. Of course, we believe that the STB should direct the railroads to return the overcharges to their customers. The STB deserves some credit for finally acting to stop this abusive practice. However, most pro-active regulatory agencies of either the Federal or state governments would have acted earlier to stop these practices and would have ordered refunds immediately.

○