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THE 35TH ANNIVERSARY OF THE STAGGERS RAIL ACT: RAILROAD DEREGULATION PAST, PRESENT, AND FUTURE

(114–16)

HEARING

BEFORE THE

SUBCOMMITTEE ON
RAILROADS, PIPELINES, AND
HAZARDOUS MATERIALS

OF THE

COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

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Committee on Transportation and Infrastructure
U.S. House of Representatives

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Chairman

Washington, DC 20515

Peter A. DeFazio
Ranking Member

Christopher P. Bertram, Staff Director

Katherine W. Dedrick, Democratic Staff Director

May 8, 2015

SUMMARY OF SUBJECT MATTER

TO:	Members, Subcommittee on Railroads, Pipelines, and Hazardous Materials
FROM:	Staff, Subcommittee on Railroads, Pipelines, and Hazardous Materials
RE:	Subcommittee Hearing on "The 35th Anniversary of the Staggers Rail Act: Railroad Deregulation Past, Present, and Future"

PURPOSE

The Subcommittee on Railroads, Pipelines, and Hazardous Materials will meet on Wednesday, May 13, 2015 at 10:00 a.m. in 2167 Rayburn House Office Building to receive testimony on the 35th anniversary of the *Staggers Rail Act of 1980* (Pub. L. No. 96-448) from representatives of the Surface Transportation Board, the American Chemistry Council, the Association of American Railroads, and the American Short Line and Regional Railroad Association, as well as a Professor of Economics at Georgetown University.

BACKGROUND

Named after former House Interstate and Foreign Commerce Committee Chairman Rep. Harley Staggers (D-WV), the *Staggers Rail Act* was signed into law by President Jimmy Carter on October 14, 1980. The *Act* replaced an outdated regulatory structure that had existed since the *Interstate Commerce Act of 1887*, and is widely credited with saving the freight rail industry in the face of bankruptcy.

The Railroad Industry Pre-*Staggers*

The railroad industry was the first industry in the United States to be regulated by the federal government; it began with passage of the *Interstate Commerce Act of 1887* (ICA), which created the Interstate Commerce Commission (ICC). Over the next century, the ICC's regulatory authority became engrained in nearly all aspects of railroad operations, including rate setting and mandated service structure and practices.

Specifically, railroads were not able to price services based on market conditions, as any proposed change in price required ICC approval. Even as costs and inflation rose, the ICC was reluctant to allow rates to be raised on shippers.

Furthermore, ICC rate regulation established rate floors that kept railroads from undercutting other less efficient modes of transportation. In other words, even in those instances where railroads could compete with other modes, regulations kept them from doing so. Intra-modal competition was also nonexistent as railroads were kept from competing with one another because rate bureaus and rate equalization rules required each railroad to charge the same price for the movement of a particular commodity.

Long-term contracts between railroads and shippers were also barred by the ICC. Railroads could not offer shippers lower rates for guaranteed traffic or privately negotiate specific service levels or specialized service for a premium. Similarly, if two railroads wanted to engage in cooperative service and divide a movement amongst themselves, the ICC rules set the division of the rates and established the terms, with little or no flexibility for the rail carriers.

This involvement in the provision of service meant the railroads could not recover the high costs associated with operating the railroad and investing in infrastructure improvements, equipment, or any additional costs to develop technological advances for the industry. The regulatory environment, therefore, was such that it did not incentivize investment, nor did it allow railroads to attract capital, leading in turn to a loss of market share to other more efficient modes.

On top of the rate-related regulation, the ICC made entry and exit to the industry extremely difficult, essentially precluding consolidation and overextending the network. Railroads could not abandon unprofitable lines, meaning each had to bear the costs of inefficient, low-density lines and continue to provide common carrier service, even though the costs were high and the rates were artificially low. The railroads also faced increased competition from the federally-assisted development of the Interstate Highway System and navigable waterways.

The impacts of over-burdensome regulation were drastic. In the 30 years pre-*Staggers*, railroads' market share measured by revenue ton-miles dropped 33 percent.[1] So, while the intercity tonnage of freight from 1947 – 1977 almost doubled, the railroads carried 91 percent fewer tons than it had 30 years earlier.[2] Further, the total revenue of railroads over that time period dropped from 70 percent to 30 percent. The rate of return on investment averaged between two and three percent, down from more than double that in the 1940s.[3] This led to a number of Northeastern and Midwestern railroads filing for bankruptcy. By the end of the 1970s nearly 22 percent of all rail miles were under bankruptcy protection.[4] In 1978, the Department of Transportation transmitted a report to Congress entitled "A Prospectus for Change in the

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[1] Federal Railroad Administration, U.S. Department of Transportation, *Impact of the Staggers Rail Act of 1980*, March 2011.
[2] Richard Dash, *The Staggers Rail Act of 1980: Authority to Compete with Ability to Compete*, 12 Transp. L. J. 301, 302-03 (1982).
[3] H. Report. No. 96-1430 (1980).
[4] Association of American Railroads, *The Impact of the Staggers Rail Act of 1980*, May 2014.

Railroad Industry," which concluded that the industry would have a capital shortfall of between $16 billion and $20 billion by 1985, leading to significant concerns about deteriorating track conditions, poor service, and safety. In fact, according to the industry, by 1976, more than 47,000 miles of track had to be operated at reduced speeds because of unsafe conditions.

The *Staggers Rail Act's* Deregulatory Features

The *Staggers Rail Act's* overarching goal was the revitalization of the railroad industry, by allowing more competition and removing regulatory burdens. The *Staggers Act* was based on the premise that the competitive market should serve as the model for regulation, and regulatory action should be taken only when market forces are insufficient to deter an abuse of market power. The *Staggers Act* removed regulatory impediments to the railroads' ability to earn adequate revenues.

Entry and Exit Licensing

Prior to *Staggers*, barriers to entry, and more importantly, exit were difficult. The ICC would not freely allow railroads to enter the market to provide service, nor could a railroad easily abandon or discontinue service when the economic forces did not justify the continued service. *Staggers* lessened the requirements for the authorization of new construction of lines, while prohibiting one carrier from blocking another carrier from constructing across its line. These changes would allow railroads to build out and serve new markets. More significantly, the *Staggers Act* reduced the regulatory burdens of exiting from the market by streamlining the process for abandonment of rail lines and discontinuance of rail service. To avoid a discontinuance or abandonment, the *Staggers Act* also provided procedures to allow interested parties to make offers of financial assistance to continue service or purchase the line that was the subject of the abandonment.

The new procedures for exit licensing had several important effects on the industry. First, it allowed railroads to respond to market forces by shedding lines or discontinuing service where demand did not justify the continued costs to maintain the line. In turn, this allowed railroads to increase investment in the plant where demand justified the service and reduce investment where demand did not require the capital expenditures. This change in regulatory structure helped to efficiently size the railroad network based on market forces rather than regulatory requirements.

Second, by including provisions to allow offers of financial assistance and ease the sale of line subject to abandonments, the *Staggers Act* preserved rail service that may otherwise have been lost. In so doing, it spurned the development of the short line and regional railroad industry. Where larger railroads did not see the benefit of operating lower density lines, the short line and regional railroad carriers would purchase those lines and provide more targeted service at lower costs, thus preserving service while developing an industry unto itself.

Competition and Ratemaking Freedom

The primary change to railroad regulation was that the *Staggers Act* introduced competition to the rail industry by allowing market conditions to govern rates. Instead of rigid rate-setting by regulation, railroads themselves could base their particular rate on the demand for service and competitive market forces. It was the first time Congress recognized that different products and different services justified different pricing arrangements (hence the term, differential pricing). Federal regulators were only to step in where either inter- or intra-modal competition was absent and a railroad's market dominance was evident based on the ratio of 180 percent of revenue to variable cost (R/VC) of the railroad.[5]

This new rate regulatory structure left regulatory intervention to situations only where the absence of competition led to an abuse of market power or unreasonably high prices. Thus, it created the leeway to ensure railroads could differentially price their services based on the demand, allowing railroads to recover their high fixed costs.

Staggers also gave railroads the freedom to enter into long-term contracts for service. Not only could the market dictate the rates in the contract, but also the level, quality, quantity, and type of services to be provided. Under the *Staggers Act* contracts were subject to approval by the ICC, and if not approved within the allotted time, the contract went into effect. Once in effect, the movement of traffic under that contract would not be subject to regulation. However, if the contract interfered with the carrier's ability to fulfill its common carrier obligation, the ICC could intercede.

Similarly, the *Staggers Act* allowed the ICC to exempt from regulation types of traffic or particular practices for which there was effective competition. If a traffic type or practice entailed no threat of an abuse of market power, the ICC's authority to exempt that traffic practice from regulation was enhanced.

ICC Termination Act of 1995

In 1995, Congress passed the *ICC Termination Act of 1995* (*ICCTA*), (Pub. L. No. 104-88), which was the last legislative action related to railroad deregulation. *ICCTA* eliminated the expansive ICC and transferred some of its functions, predominantly those related to the regulation of railroads, to the Surface Transportation Board (STB or Board). ICC functions that were not transferred to the STB were either eliminated by *ICCTA* or transferred to the Secretary of Transportation, including functions involving motor carriers and freight intermediaries that were not expressly assigned to the STB.

The three-member, bipartisan Board now has regulatory jurisdiction over railroad rate reasonableness, mergers, line acquisitions, new rail line construction, abandonments of existing rail lines, and the conversion of rail rights-of-way to hiking and biking trains.

[5] Variable costs are expenses that can be attributed to a particular service and that change in direct relation to the provision of that service, e.g., fuel.

The Board is decisionally independent, although it is administratively housed within the U.S. Department of Transportation. The STB's authorization expired in 1998, and the agency has remained unauthorized since that time, each year submitting a budget request directly to Congress for necessary appropriations. The Board has approximately 150 employees and receives a modest annual appropriation of about $32 million that is offset with collections from railroad-shipper filing fees (capped under the appropriations bills at $150,000).

The STB's major responsibilities related to railroads include: overseeing and monitoring railroad commercial practices nationally; enforcing the railroads' common carrier obligations; evaluating challenges to the reasonableness of rail rates; monitoring rail carriers to ensure they are able to earn adequate returns necessary for the continued health of the rail system, which includes calculating the rail carriers' cost of capital; and authorizing construction, operation, discontinuance, and abandonment of rail lines and service.

In addition, the STB has several informal programs to help resolve railroad-shipper disputes, questions on rates and other charges, railroad-car supply and service issues, claims for damage, interchange issues, employee complaints, and community concerns. Finally, the STB has established a Railroad-Shipper Transportation Advisory Council, the Grain Car Council, and the Rail Energy Transportation Advisory Committee to receive input from the railroads and industry on various issues before the Board.

After *Staggers* and Looking Ahead

The post-*Staggers* rail industry has seen marked improvement in rates, revenues, productivity, safety, and volume growth, all largely due to the freedom of the industry to recover its costs and strive toward earning adequate revenues. Freedom to set rates means that technological and productivity enhancements can be pursued since costs can be recovered. Indeed, enhancements in productivity, over 130 percent since passage of the *Staggers Act*, has led to more efficient service and lowered costs.[6] And where cost savings were found, shippers have shared in that reduction. According to the Federal Railroad Administration, shippers have seen a significant decline in rates. Freight rates adjusted for inflation have declined 0.5 percent a year since passage of the *Staggers Act*, compared to an increase of nearly three percent per year in the five years prior to 1980.[7] Although rail rates have seen some increases in the past few years, the industry maintains they are still well below pre-1980 levels.

The railroads' financial health has also improved with the return on investment of the railroads increasing from an average of two to three percent in the 1970s to a projected 12.9 percent in 2014.[8] Similarly, market share has increased to 40 percent.[9] These financial improvements have allowed the railroads to reinvest in the network $575 billion since *Staggers* was passed.[10] Furthermore, the network has been right-sized through the elimination of

[6] Association of American Railroads, *The Impact of the Staggers Rail Act of 1980*, May 2014.
[7] Federal Railroad Administration, U.S. Department of Transportation, *Impact of the Staggers Rail Act of 1980*, March 2011.
[8] Id.; Association of American Railroads (2015).
[9] Association of American Railroads, *The Impact of the Staggers Rail Act of 1980*, May 2014.
[10] Association of American Railroads, *Freight Railroad Capacity and Investment*, Jan. 2015.

inefficient lines or service, many of which are now operated by lower-cost short line railroads, which has also been made possible via decreased regulatory barriers.

While pricing has been a function of market rates, the regulatory policy established by *Staggers* has been designed to protect the public interest by preserving competition and intervening when markets forces fail. Where regulation established many hurdles on the front end to railroads' pricing, now the regulatory structure provides protections on the back end for those instances where market dominance leads to an abuse of market power.

Shippers, however, maintain that while the *Staggers Act* has been successful in many ways, the freight rail service landscape has changed dramatically, leading to disputes between rail carriers and rail shippers over rail rates, access, and service. According to the shippers, "Many shippers – generally those in the chemical, coal, and agricultural sectors with access to only one carrier – believe that the dramatic consolidation of the nation's freight rail network, from 26 Class I railroads in 1980 to four corporations that control more than 90 percent of the market, has led to unreasonable rate increases, service breakdowns, and diminishing competition."[11] These shippers contend that the STB has not taken enough action to protect shippers from rail carriers and that current law has made it difficult for them to obtain rate and service relief.

[11] Hearing on "Freight Rail Service: Improving the Performance of America's Rail System" Before the Senate Committee on Commerce, Science, and Transportation, 113th Cong. (2014) (statement of Cal Dooley, President and CEO, American Chemistry Council).

WITNESS LIST

The Honorable Debra Miller
Acting Chairman
Surface Transportation Board

The Honorable Calvin Dooley
President and Chief Executive Officer
American Chemistry Council

The Honorable Edward R. Hamberger
President and Chief Executive Officer
Association of American Railroads

Ms. Linda Darr
President
American Short Line and
Regional Railroad Association

Professor John W. Mayo
McDonough School of Business
Georgetown University

THE 35TH ANNIVERSARY OF THE STAGGERS RAIL ACT: RAILROAD DEREGULATION PAST, PRESENT, AND FUTURE

WEDNESDAY, MAY 13, 2015

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON RAILROADS, PIPELINES, AND
HAZARDOUS MATERIALS,
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE,
Washington, DC.

The subcommittee met, pursuant to call, at 10:25 a.m., in room 2167, Rayburn House Office Building, Hon. Jeff Denham (Chairman of the subcommittee) presiding.

Mr. DENHAM. The subcommittee will come to order.

This morning's hearing is on the 35th anniversary of the Staggers Rail Act. But before we get started with the hearing itself, I think that it is important to let the American public know that it is with a heavy heart we are given the notice of this tragic accident in Philadelphia. Last night, we saw something horrific that was unimaginable, that we would never expect to see on our passenger rail. So, this morning, myself, Ranking Member Capuano, the chairman, and ranking member would each like to make a statement.

First of all, I want to commend the first responders and the fellow travelers that helped out those that were injured in this accident. We have now seen the Federal officials, both from the National Transportation Safety Board and the Federal Railroad Administration, respond quickly. I think the American public is looking for answers on how this can happen, and we have held several hearings now on rail safety, and that will be the question that this committee continues to follow up on and ask, as well.

Again, we express our condolences to the loved ones who have lost or have someone missing or injured in this accident.

I now turn it over to the ranking member, Mike Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman.

I want to join you in everything you just stated, and I would also just like to just offer my prayers and, I guess on behalf of everyone, to be perfectly honest, to offer the prayers for those who are still in the hospital or suffering. May God bring them a speedy recovery and bring them back to health as quickly as possible.

Thank you, Mr. Chairman.

Mr. DENHAM. The full committee chairman, Mr. Shuster.

Mr. SHUSTER. Thank you, Chairman Denham.

Obviously, it is a horrific accident, as the chairman said, something that, you know, we haven't seen in some time.

The National Transportation Safety Board is obviously up there looking at it. We certainly don't know why. I have heard some politicians already come out and say, "If we would have spent more money." Maybe that is the case, but it is something, I think, we really need to take a serious look at that and, first of all, figure out what happened up there.

The Northeast Corridor is extremely important to the Nation. That is why Chairman Denham and myself worked hard with Ranking Member Capuano and DeFazio to put out a passenger rail reform bill focusing really on the Northeast Corridor, making sure those profits for the Northeast Corridor get put back into the Northeast Corridor.

So, again, it is waiting for some action in the Senate. We hope that they will take a serious look at it and especially with this accident, because hundreds of millions of people ride the Northeast Corridor, not just Amtrak but all those daily commuters from SEPTA, to New Jersey, Massachusetts, Connecticut, and all the way up that corridor. So it is critical we find out exactly what happened up there and make sure that we take the appropriate response to make sure it doesn't happen again.

And, with that, I yield back.

Mr. DENHAM. With that, we will start with our panel members. Let me just first start with opening statements on the hearing this morning.

Railroads have played an important and integral role in this country since railroading came onto the transportation scene in the early 1800s. In fact, most American cities and towns, especially in the Midwest and West, were founded along the railroads.

Today, they are the backbone of the Nation's freight system, transporting 40 percent of all freight volume—more than any other mode. They transport 30 million carloads of freight every year, ranging from coal to agriculture products to intermodal shipments. In fact, our freight rail system is the envy of the world. And countries—as we travel around, we hear most often that other countries are envious and look to emulate our rail system in their countries.

However, it was not long ago when America's freight rail system was in complete disarray. By the 1970s, battered by competition from trucking and airlines and hampered by burdensome regulations, railroads were dying a slow death. Their infrastructure was falling apart. Customers were not getting efficient service. Railroad bankruptcies were an all-too-common occurrence.

Congress tried several acts to fix the system, even going as far as getting into the business of creating railroads, yet nothing seemed to work. It wasn't until the Staggers Act that Congress was able to find the mix of policies to get the system working again. First, it allowed railroads to act more like true businesses, by allowing them to charge market-driven rates rather than ones handed down from Washington bureaucrats. Second, the act allowed railroads to right-size their networks by focusing on rail lines that made economic sense. And, finally, it encouraged the creation of the short line railroads to serve those regional markets that the larger Class I railroads could not do economically. Thirty-five years

later, we can see the benefits of these changes in the strong rail system that we have today.

However, while we have had great success with the Staggers Act, we need to make sure that the regulatory system still works well. The service issues the railroads had last winter was a good reminder of this and of the important role of the STB, the Surface Transportation Board, and the role that they play with rail and with our customers.

So today we are going to hear from the STB, the railroads, and others about the importance of the Staggers Act reforms. I also look forward to hearing the future of how best railroads can serve America.

In closing, I look forward to the hearing and would now like to recognize Mr. Capuano for any opening statement he may have.

Mr. CAPUANO. Thank you, Mr. Chairman. I will keep mine brief.

Basically, the Staggers Act, as we all know, was a great act. It was really an improvement and an advancement in the rail industry. Yet, with all good acts, they require and demand and deserve continuous monitoring and attention and updating and amendments if and when they are necessary.

And, to me, that is what I am hoping to find out from this hearing. Is it working as we hoped? Are there any improvements, are there any tweaks we can make to it? Should we completely leave it alone? Should we roll it back? I mean, not that I would agree with any of those statements, but I want to hear other people's opinions.

And, with that, I will simply yield back. Thank you, Mr. Chairman.

Mr. DENHAM. Thank you.

And the chairman of the full committee, Mr. Shuster.

Mr. SHUSTER. Well, I want to thank Chairman Denham and Ranking Member Capuano for holding this hearing today.

It has been one of the committee's priorities to look at the movement of freight across this country, whether it is by rail, whether it is by highway, by water. So, again, we look forward to, whether we passed WRRDA last year or the surface transportation bill or the FAA reauthorization, making sure we are doing the right things to strengthen all the modes of transportation.

The Department of Transportation is projecting that freight volumes will increase significantly over the next few decades, and we need to prepare for that growth, again, through all the modes.

As Chairman Denham noted, the railroads have played a critical role in moving large quantities of freight long distances. So we need to make sure that we are doing the right things here in Congress to stay out of the way when necessary but to assist where necessary with the transportation system.

After 35 years, it is clear the Staggers Act has been successful, and we can learn from it, what it has done to the railroad and, I think, across all the modes, in ways to upgrade, change our infrastructure.

I always like to point out that the railroads reinvest 19 percent of their revenues—not their profits, their revenues—back into their infrastructure, which in 2015 I believe is projected to be $29 bil-

lion. Volume is up, productivity has increased, safety has improved, and the financial health of the industry is strong.

We have, though, seen some disruptions because of the winter in 2013 and 2015. And, again, there is concern with shippers as to the STB's relief procedures, I think. So it is a good time to revisit the regulatory environment of the railroads.

And in response to some of those concerns, I know our counterparts in the Senate have produced an intriguing bill that we need to take a careful look at. But I hope that when we look at that bill we realize we have a very strong railroad industry. And, over the past 35 years, it has gone from being not strong to very strong. And I think, again, we need to do what is right here in Congress to make sure that we maintain the strength of our railroad industry, which, as Chairman Denham said, is the envy of the world.

And, with that, I yield back.

Mr. DENHAM. Thank you.

I would now like to welcome our panel of witnesses: first, the Honorable Deb Miller, Acting Chair of the Surface Transportation Board; the Honorable Calvin Dooley, president and CEO of the American Chemistry Council; Edward R. Hamberger, president and CEO of the Association of American Railroads; Linda Darr, president of American Short Line and Regional Railroad Association; and John Mayo, professor of economics at Georgetown University.

I ask unanimous consent that our witnesses' full statements be included in the record.

Without objection, so ordered.

Since your written testimony has been made part of the record, the subcommittee would request that you limit your oral testimony to 5 minutes.

Ms. Miller, welcome, and you are recognized.

TESTIMONY OF HON. DEB MILLER, ACTING CHAIRWOMAN, SURFACE TRANSPORTATION BOARD; HON. CALVIN DOOLEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AMERICAN CHEMISTRY COUNCIL; EDWARD R. HAMBERGER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ASSOCIATION OF AMERICAN RAILROADS; LINDA BAUER DARR, PRESIDENT, AMERICAN SHORT LINE AND REGIONAL RAILROAD ASSOCIATION; AND JOHN W. MAYO, PROFESSOR OF ECONOMICS, BUSINESS, AND PUBLIC POLICY, MCDONOUGH SCHOOL OF BUSINESS, GEORGETOWN UNIVERSITY

Ms. MILLER. Thank you very much.

Good morning, Chairman Shuster, subcommittee Chairman Denham and subcommittee Ranking Member Capuano, and members of the subcommittee. My name is Deb Miller. I am the Acting Chair of the Surface Transportation Board. What I would like to do this morning is give you a brief look back at the history of the ICC and a brief look forward, looking at the priorities today of the Surface Transportation Board.

The Interstate Commerce Commission, the predecessor agency of the Surface Transportation Board, was the first Federal regulatory agency, created in 1887. Over time, the ICC grew into a massive organization, with 2,900 employees at its peak.

But, by the late 1960s, the railroad industry in the United States was in decline. One reason was competition from other modes, but another major contributing factor was excessive regulation. Railroads were not given the flexibility needed to manage their business in this new competitive environment. They were governed by burdensome and Byzantine regulations.

By the early 1970s, the situation was so perilous there was even talk of nationalizing the rail industry. In response, Congress passed a series of laws aimed at deregulating the industry. And, in what many considered a last-ditch attempt to save it, the most sweeping of these was the Staggers Act, passed in 1980.

The Staggers Act instituted a number of changes to the regulatory landscape. First, it allowed railroads to more easily abandon unprofitable lines. Second, it made it easier for railroads to merge. Third, it provided exemption authority to quickly approve transactions that were routine and noncontroversial. Most significantly, though, Staggers gave railroads greater pricing freedom. Railroads were allowed to engage in differential pricing, meaning they could charge different shippers different rates depending on the demand for that traffic.

Since passage of the Staggers Act, the railroad industry has become more efficient, productive, and profitable.

In 1995, Congress sunsetted the ICC and created the Surface Transportation Board. Today, the agency's mission is still governed by many of the principles established by Staggers.

The Board is charged with promoting an efficient, competitive, safe, and cost-effective rail network by enabling railroads to earn adequate revenues that foster reinvestment in their networks and attract outside capital and provide reliable service. At the same time, the Board is mandated with working to ensure that effective competition exists between railroads and to maintain reasonable rates where there is a lack of effective competition.

This hearing is particularly timely for me, as the Acting Chair of the Surface Transportation Board. The Board is in the process of reevaluating many of our economic regulatory practices to determine if they are still appropriate for today's environment.

On May 8, we announced that we will conduct two significant hearings. First, the Board will hold a hearing on June 10 to examine whether our rate case methodologies are sufficiently accessible for grain shippers. Second, the Board announced that on July 22 and 23 we will explore issues pertaining to the concept of revenue adequacy.

Revenue adequacy is an economic concept that describes whether a carrier is earning sufficient revenue to cover its costs and earn a reasonable return sufficient to attract capital. The ICC held that rates could be challenged if a railroad were revenue-adequate over a period of years, but no corresponding methodology was ever adopted.

The Board also has another major proceeding that has been pending before us for some time. It involves something called competitive access or reciprocal switching. Reciprocal switching occurs when one railroad that exclusively serves a facility agrees to provide switching services for another carrier for a flat switching fee. These reciprocal switching agreements create rail-to-rail competi-

tion by permitting a competing railroad to offer its own single-line rate even though it cannot physically serve the shipper.

The Board was presented with a proposal for the increased use of reciprocal switching several years ago. I regret to say that the Board has taken no action. I believe the Board owes our stakeholders, who have spent significant resources to develop the record in this proceeding, a decision on what it plans to do with the proposal.

Given the overlap between the issues raised by the competitive access proposal and the proposals raised in our grain rate and revenue adequacy proceedings, my goal after these hearings is for the Board to issue a package of proposals on many, if not all, of these matters.

The Board is also examining our method for regulating railroad rates. It is well known that our current process, known as a standalone cost test, is cumbersome and expensive.

To address concerns related to rate regulation, the Board initiated two studies. First, the Board engaged an independent firm to study rate reasonableness methodologies used in other industries and throughout the world. Second, the Board hired a consulting firm to examine the Board's internal processes for deciding rate cases. The consultant was tasked with studying our internal process and offering recommendations on how we could streamline and improve our case processing so we would be quicker and more accurate.

The Board is also reviewing how to handle nonrate cases to improve and speed up our decisionmaking. The industry is frustrated with our pace, and so am I. It has been one of my priorities since my first week at the Board, and I am hopeful that this set of recommendations, including a set of performance metrics that we are putting in place, will help move the Board forward more quickly.

Mr. Chairman, thank you for giving me this opportunity. I will welcome questions at the end.

Mr. DENHAM. Thank you for your testimony.

Mr. Dooley, you may proceed.

Mr. DOOLEY. Well, thank you, Chairman Denham and Ranking Member Capuano, and it is a pleasure for me to be testifying today on the Staggers Act.

And I represent the American Chemistry Council, and we employ about 800,000 men and women throughout this country. We are the second-largest shipper of commodities by rail in the country, and it is absolutely important for us to have a strong rail industry.

I want to say at the outset, there is no interest among our membership to see a reregulation of the rail industry and go back 20 or 30 years ago. But we do feel that when we have seen what has transpired over the past since the Staggers Act has been implemented: that we have a changed rail landscape that is resulting in a greater consolidation.

And with this greater consolidation of the rail industry, it is changing the marketplace and the competitiveness of the marketplace. Because what we have seen happen in just since—I guess you would go back to 2001, when you had the last major consolidation of the rail industry, we now have basically seven Class I rail

lines out there, of which four are responsible for 90 percent of all shipments.

We think that also can be—you can see a correlation to that increased consolidation to what we have seen is a fairly rapid increase in the shipping rates, which have increased almost 100 percent since about 2000, 2001.

That has also resulted in—that consolidation—in an increased number of shippers that are captive to one rail line. We think now that there is almost—the figures you can—you know, close to 75 percent of all shippers now in our industry are captive to one rail line.

What that is resulting in is a fairly significant increase in rates and cost of shipments. We have done an analysis, using AAR data and STB data, I should say, that has calculated what is the cost of shipments that exceed the 180 percent RVC, recoverable variable cost, that the STB uses to consider whether or not a rate could be challenged. In the last year, that figure was about $20 billion.

Now, we are also concerned not by the aggregate amount of that, because I am not challenging—all those rates are certainly not unjustified. But what we are also seeing is a very rapid increase in the rates that are in excess of that 180 percent. In fact, we have seen a 50-percent increase in the rates, an increase of 300 percent of the RVC, since 2005.

So that is what is being experienced not just by our industry but by shippers throughout the country. And that has resulted in a coalition that we have helped to organize that includes 47 other groups representing manufacturing, agriculture, and energy interests that employ about 4.7 million people and contribute $2.4 trillion in economic output.

And what we are asking for is some commonsense reforms to the Staggers Act and some modifications that Commissioner Miller has articulated. We think it is badly in need of reforms.

So what we are suggesting is that we need to give greater attention to improving the administrative process, reforming rate bundling protections, closing rate review loopholes, allowing competitive switching, updating rate review standards, and providing arbitration as an option to streamline rate reviews.

There are clearly regulatory and financial impediments to securing rate relief through STB. STB's own calculations are it costs about $5 million to bring a rate case to the STB. It takes close to 3 years before you get an outcome in that rate dispute case. That clearly is not acceptable.

Now, I think that there is a way forward. And I appreciated Congressman Shuster's acknowledging the action that the Senate took that passed a bill that passed unanimously out of the Senate Commerce Committee. But what we need to do is set aside some of the hyperbolic rhetoric.

And I just want to cite a statement that Ed Hamberger has in his written testimony. He said, "When one looks behind the actions that proponents of reregulation are urging upon Congress and the STB to 'reform' freight rail policy, it is clear that 'reform' is a euphemism for 'force railroads to subsidize us' and that the needs of the railroads and the general public are a distant second to their own narrow desires."

Let me be very clear that the farmers, the manufacturers, the energy producers, that are all part of our coalition are not narrow interests. They are in every congressional district in this country.

What we are asking for is commonsense reforms that have been articulated by STB Commissioners. What we are asking for is commonsense reforms that have been advanced by the Senate. This type of rhetoric does a disservice to shippers that are customers of the rail industry, that need a strong rail industry. It is an insult to Senator Thune and Senator Nelson, who embraced the objectives that are part of the STB reforms that we are trying to advance.

I hope that we can continue to work with this committee to see if we can advance similar legislation that ensures—there is nothing mutually exclusive about a strong and a financially robust rail industry and giving equitable, efficient access to a rate resolution process through the Surface Transportation Board.

Thank you.

Mr. DENHAM. Thank you, Mr. Dooley.

Mr. Hamberger, you are recognized.

Mr. HAMBERGER. Thank you, Chairman Denham, Chairman Shuster, Ranking Members DeFazio and Capuano. Thank you for the opportunity to be here this morning.

Before we turn to the issue of the Staggers Act, I would like to associate myself with the eloquent statements of the leaders of this committee about the horrific accident outside of Philadelphia last evening. Everyone in the rail industry was saddened by what occurred last evening. Our thoughts, prayers, sympathies go out to the victims, their friends, their family.

I had occasion to communicate with Joe Boardman, President of Amtrak, this morning, and he asked me to express his gratitude to the medical personnel, the firefighters, the emergency responders, all of whom were there working through the night tirelessly to try to mitigate the impact of this accident.

I understand the NTSB and FRA are on the scene, as is Joe Boardman. I hope in the days and weeks to come that we will be able to learn a lesson from what happened there last evening, that we will be able to take that lesson, as we try to do with every accident, and apply it into the future so that we can make what is already a safe industry even safer.

If I might turn now to the Staggers Act, it is an interesting juxtaposition to me that we are sitting here in the middle of National Infrastructure Week with pundits from across the political spectrum saying we should be spending more private money on our Nation's infrastructure. On that same side of the ledger, this committee and all of Congress, wrestling with where to find money for the Highway Trust Fund. And on the other side, juxtaposed with that, thanks to the Staggers Act, the freight rail industry quietly goes about its business, spending this year $29 billion, private capital, on the 140,000-mile network that is recognized as the best in the world.

It is the best in the world because of a direct result of a balanced economic system at the Surface Transportation Board. It relies on competition to establish rate and service standards, with a regulatory safety net available to rail customers who need it.

This balanced regulation has allowed railroads to improve their financial performance from the anemic levels prior to the Staggers Act, which Chairwoman Miller talked about, which in turn has allowed the railroads to plow $575 billion, private capital taxpayer money, back into the network. Class I railroads, as I mentioned, will spend an additional $29 billion this year.

Millions of Americans work in industries that are more competitive in the tough global economy thanks to the affordability and productivity of America's freight railroads. We know that if America's future freight transportation demand is to be met railroads must have the capacity to handle it. We are preparing for tomorrow today all over the country, expanding intermodal terminals, double-tracking hundreds of miles of track, installing millions of new rail ties, upgrading signal systems, and building new major rail yards.

These projects are aimed at maintaining and growing the railroads network so that they are better able to serve our customers and provide the safe, efficient freight transportation service our Nation's economy needs. And all of these projects are more likely to be undertaken under today's balanced regulatory system than they would have been under a system of excessive, needless regulation.

This committee knows well that transportation systems are expensive to build and maintain, whether with private or public funds. Railroads are no exception. By any of a number of measures, the capital intensity of freight railroading is at or near the top of all U.S. industries. For example, this year, railroads will spend 19 percent of revenue on capital investment. The comparable figure for U.S. manufacturing is 3 percent.

Looking ahead, the long-term demand for freight transportation will undoubtedly grow. With highway congestion becoming more acute and with public pressure growing to reduce emissions, conserve fuel, and promote safety, railroads are likely to be called upon to do even more in the years ahead. And as our economy evolves, we will be called upon to make additional investments.

For that to happen, there must be appropriate public policies in place. Policymakers should acknowledge that, for reasons of international competitiveness, safety, and economic growth, the United States has a critical and growing need for investment in transportation infrastructure. Private rail investment should be encouraged, and regulations and legislation should not adversely affect railroads' ability or willingness to make those investments.

And I want to thank the committee for its bipartisan letter last year to the STB explicitly acknowledging those facts, dated March 14, 2014, which I would ask be made part of the record.

[The information follows:]

Committee on Transportation and Infrastructure
U.S. House of Representatives

Bill Shuster
Chairman

Washington, DC 20515

March 14, 2014

Nick J. Rahall, II
Ranking Member

Christopher P. Bertram, Staff Director

James H. Zoia, Democrat Staff Director

The Honorable Daniel R. Elliot, III
Chairman
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423

The Honorable Ann D. Begeman
Vice Chairman
Surface Transportation Board
395 E Street, S.W.
Washington, DC 20423

Dear Chairman Elliot and Vice Chairman Begeman:

The Surface Transportation Board (STB) has announced that it will hold a public hearing on March 25-26, 2014 on a petition by the National Industrial Transportation League to modify the Board's standards for mandatory competitive switching.

In connection with this hearing, we would like to express our collective view about the importance of the freight rail industry as a critical component of our nation's transportation system, and impress upon you the importance of maintaining the existing regulatory balance between the railroads and the shipping community.

As the Committee has previously expressed, the United States has the most efficient, affordable and environmentally-friendly freight rail network in the world. With nearly 140,000 miles of track carrying approximately 1.8 trillion ton-miles annually, freight rail is an immense jobs generator and a major economic driver. The industry supports directly or indirectly 1.2 million jobs, including some 180,000 well-paying jobs in the freight rail industry itself. Railroads account for approximately 40 percent of all freight ton-miles in the U.S. – more than any other mode.

The passage of the Staggers Act in 1980 provided for a balanced regulatory system that has allowed the rail industry to build the world's best freight rail system, while protecting shippers in areas where there is no effective competition. Since its passage, average inflation-adjusted rates are down substantially and freight railroads have reinvested $550 billion to increase capacity, maintain existing capacity, and maximize efficiency on their operating networks. In fact, despite a weak economy, railroads have invested more back into their networks over the past five years – approximately $115 billion – than in any five-year period in their long history. This could not have been done, and will not happen in the future, in the absence of the current policy of balanced regulation by the STB that is called for in the Staggers Act – a policy that also has

allowed railroads to concentrate traffic onto efficient routes, promote safer operations, and create fluid transportation systems.

The Department of Transportation estimates that total freight shipments will increase by 62 percent between 2011 and 2040. It is critical that the freight rail industry be able to make the necessary investments to meet this rising demand. Any policy change made by the STB that decreases the railroads' efficiency, and limits their ability to reinvest, grow their networks and meet the nation's freight transportation demands both today and in the future will be opposed by this Committee.

We look forward to hearing from you about how the STB plans to ensure that the freight railroad industry will continue to play a major role in contributing to a strong and vibrant U.S. economy.

Sincerely,

Bill Shuster
Chairman
Committee on Transportation and Infrastructure

Nick J. Rahall, II
Ranking Member
Committee on Transportation and Infrastructure

Jeff Denham
Chairman
Subcommittee on Railroads, Pipelines, and Hazardous Materials

Corrine Brown
Ranking Member
Subcommittee on Railroads, Pipelines, and Hazardous Materials

Mr. HAMBERGER. Today our Nation faces a number of serious transportation-related problems, many of which this committee, to its credit, is working hard to address. I submit to you that it makes no sense to add to that list by trying to fix something that is not broken. The current rail regulatory system is working well, and, because of that, our Nation's freight rail network is working well too.

I will just add at the end, with respect to the bill that came out of committee in March from the Senate Commerce Committee, our industry did not object to that bill, and I expect that it will be moving through the Senate and on its way to the House sometime this year.

Thank you for the opportunity. Sorry I went a little over, Mr. Chairman. I appreciate your allowing me to do so.

Mr. DENHAM. Thank you, Mr. Hamberger.

Ms. Darr, you may proceed.

Ms. DARR. Thank you, Chairman Denham, Chairman Shuster, Ranking Members Capuano and DeFazio, and members of the committee.

In the wake of last night's Amtrak accident, I also wanted to contend the condolences of all those in the short line industry to those that lost their lives, those that are in the hospital, and the family and friends that grieve for them.

I am Linda Darr. I am president of the American Short Line and Regional Railroad Association. We are "the little association that could." ASLRRA is a national trade organization representing the Nation's 550 Class II and Class III railroads. Together, the short line railroads operate nearly 38 percent of the national rail network. We handle in origination or destination one out of every four railcars moving on the national system.

The Staggers Act saved the rail industry from collapse, and, in many respects, it is the parent of the short line industry. The economic freedoms and the regulatory flexibility embodied in the act allowed the railroads to save light-density branch lines rather than abandon them. As a result, short lines have grown from 8,000 miles of track in 1980 to 50,000 miles today.

We operate in 49 States. In 5 States, short lines operate 100 percent of the State's total rail network; in 10 States, we operate more than 50 percent; and in 30 States, we operate at least one-quarter of the rail network.

In creating the modern-day short line industry, the Staggers Act ensured that huge areas of rural and smalltown America would stay connected to the national network. For the small businesses and the farmers in those areas, our ability to take a 25-car train 50 miles to the nearest Class I creates the critical link that allows rail to be their choice for shipping.

The Staggers Act jump-started today's short line industry, but short lines took hold of that opportunity, and short lines made it work. The industry was formed by entrepreneurs who took large financial risks to purchase and rehabilitate light-density lines. Most borrowed heavily from the bank and contributed substantial amounts of their personal capital to make these new ventures work. They are aggressive marketers that fight as hard for single-carload business as they do for unit trains. And that fight for busi-

ness keeps transportation costs as competitive as possible, which is good for our customers and, ultimately, for the Nation's consumers.

Short lines have worked hard on building relationships with their customers. Many of those customers were our partners in helping save even the most marginal lines. They did so by helping finance rehabilitation through realistic rates and by agreeing to meaningful traffic volumes. Today, our customers are the beneficiaries of our success.

Short lines reinvest, on average, as much as 30 percent of annual gross revenues in repairing and upgrading our infrastructure. This is a huge percentage of what we earn, and it is evidence of our real drive to succeed. That investment has been supplemented by important help from Congress in the form of the 45G rehabilitation tax credit, which allows us to invest more of what we earn in improving our infrastructure.

We are grateful to the members of the Transportation and Infrastructure Committee, who have been enormously helpful in shepherding this legislation. This has been the most consequential piece of railroad legislation for the short line industry since the Staggers Act, responsible for leveraging over $1.5 billion in short line capital investment.

Capital investment in railroads is not only about economic growth and jobs; it is also about safety. Every dollar we invest in track rehabilitation makes our tracks safer. The leading cause of train derailments are track-related, and the better our track, the safer our railroads.

We also know that improving safety requires building a strong safety culture on every short line property. To that end, the Short Line Association has partnered with the Congress and the FRA to establish a Short Line Rail Safety Institute to assess the safety practices and the safety culture of individual short lines and to provide support to improve workplace safety.

Track rehabilitation and a strong safety culture are what we need to take the progress we have made under Staggers and make the short line story viable for the long term.

Let me conclude with an anecdote that tells the short line story post-Staggers as concisely as anything I have said here today.

In 1983, 3 years after Staggers was passed, Dick Webb, the father of Watco's current CEO, was a unionized car repairman at the Kansas City Southern. He took out a $25,000 bank loan to begin a rail switching operation in DeRidder, Louisiana, which began Watco Companies. Today, Watco operates 4,600 miles of short line track, employs 3,600 people, and moves over 1 million carloads annually across track that was surely headed for abandonment.

Hundreds of short lines across the country can repeat some version of that story. It is a great American success story, and it was made possible in no small measure by the Staggers Act.

I appreciate the opportunity to be here today, and I welcome any questions.

Mr. DENHAM. Thank you, Ms. Darr.

Mr. Mayo, you are recognized.

Mr. MAYO. Chairman Denham, Ranking Member Capuano, members of the committee, my name is John Mayo. I am a professor of

economics, business, and public policy at Georgetown University's McDonough School of Business.

For 30 years, I have studied the economics of regulation and deregulation in the American economy in a variety of industries, including electricity, telecommunications, cable television, pharmaceuticals, the Internet, as well as the domestic freight rail industry. A summary of my publications and relevant experience is included as an attachment to my testimony.[1]

In 1980, the Staggers Act passed Congress in an overwhelmingly bipartisan fashion. It was signed and enthusiastically endorsed by President Carter. This act fundamentally altered the governance structure of the rail industry, shifting from a highly granular model of regulation to a model in which markets, rather than regulators and rate bureaus, are largely responsible for establishing prices and investment.

Importantly, this legislation was not driven by simple ideology. It did not embrace deregulation out of a belief that markets are always superior to Government. Neither, at the time of the passage of the act, did ideologues argue that steps to free railroads from regulatory constraints should be halted out of a fear that railroads would necessarily harm the public interest.

Rather, the deregulatory measures adopted in Staggers were embraced for a simple and profound reason: Deregulatory steps in the industry were, as a practical matter, not an ideological matter, but a practical matter, being revealed to produce superior economic outcomes for the industry and for the economy more generally.

Legislators from both political parties, economists, and industry observers at the time were all very optimistic about the potential for improved rail performance under the Staggers Act. Of course, optimism on the front end of any legislation is very normal. The real question—the real question—is, how have economic outcomes evolved for consumers, for producers, and for the American economy as a whole in the wake of Staggers?

Fortunately, we now have 35 years of experience with Staggers, and I can tell you with considerable confidence that the governance structure of the act has been significantly and substantially successful. This was recognized in Congress in 1995 when the Senate Commerce Committee declared, quote, "The Staggers Act is considered the most successful rail transportation legislation ever produced, resulting in the restoration of the financial health of the rail industry," end quote.

Consequently, with President Clinton's support, Congress took the additional step of further easing regulatory constraints by eliminating the Interstate Commerce Commission, replacing it with the current Surface Transportation Board. Importantly, the bill transferred authority to the STB, carefully avoiding alteration of the fundamental premises of the Staggers Act.

With the benefits of an additional 25 years now of observation—or 20 years since the observation of the 1995 congressional blessing of the Staggers Act, it is now possible to look afresh at whether the

[1] The summary of John Mayo's publications and experience is attachment A of the addendum to his testimony available online at GPO's Federal Digital System (FDsys) at http://www.gpo.gov/fdsys/pkg/CPRT-114HPRT96276/pdf/CPRT-114HPRT96276.pdf.

act is succeeding in promoting a safe and efficient rail transportation system as is called for in the act.

Economic signals of efficiency include increased output, the breadth and utility of service offerings, reduced cost, and indications of consumer value. And, of course, as with all transportation modes, safety is generally thought of as being measured by or gauged by the severity and frequency of casualties.

While a detailed discussion of these economic metrics is beyond the time permitted by my oral testimony, I have taken the liberty of attaching a recent study that I coauthored with Professors Jeffrey Macher and Lee Pinkowitz, also of Georgetown University, that examines in detail the economic metrics associated with this industry.[2]

We find, as numerous other scholars have, that the liberalizations introduced by Staggers and their subsequent implementation have produced a variety of positive economic indicators and consequences for the industry, for consumers, and for the economy as a whole.

We also identify areas of vulnerability as the future of rail policymaking unfolds. Of particular concern is the prospect that the emerging successes in the industry may be co-opted by the imposition of earnings regulation in the industry. These concerns are discussed in detail in the research article that is appended to my testimony.

Thank you very much for your time and attention this morning. I look forward to any questions.

Mr. DENHAM. Thank you, Mr. Mayo.

I am going to deviate from this morning's schedule just slightly in light of last night's horrific accident and recognize Mr. DeFazio for any opening statement he may have.

Mr. DEFAZIO. Thank you for the courtesy, Mr. Chairman.

And I am going to deviate from my prepared remarks for a few moments here in light of the horrific accident last evening, where 8 people lost their lives and more than 200 were injured. Our hearts and prayers go out to the family and friends of those involved, and hope for a speedy recovery of those who were injured.

We obviously don't know the cause at this point. We always depend upon the good work of the NTSB to bring that result to us, and I look forward to learning and finding out what we can do to mitigate or prevent future accidents.

We do know a little. It was a shared section of track. So that is, you know, the beginnings of, you know, understanding where and how these things happen. But we don't know much else at this point.

However, I will observe—and I find it very, very ironic that, as we sit here, over there somewhere, wherever the appropriations lords sit, they are proposing to cut $290 million from the Amtrak capital grants program.

I would say that that program is already somewhat insufficient since Amtrak has a $21 billion state-of-good-repair backlog. And, you know, it is deteriorating every year, and at the current level

[2] The study is attachment B (page 15) of the addendum to John Mayo's testimony available online at GPO's Federal Digital System (FDsys) at http://www.gpo.gov/fdsys/pkg/CPRT-114HPRT96276/pdf/CPRT-114HPRT96276.pdf.

of investment, if the appropriators don't cut it, it will take about 25 or 30 years to get it up to a state of good repair. And that doesn't deal with some other major projects that would facilitate rail movement, let alone make it safer and in a state of good repair.

So I would hope that our friends on the Appropriations Committee are cognizant of the real world out there, of what happened last night, of what the capital needs of Amtrak are, and will not engage in a shortsighted budget cutting in an area where we already have a $21 billion backlog.

There were two issues—and I will submit my full opening statement for the record—that I really wanted to focus on: short line investments and tariffs or the potential for tariffs for transporting dangerous products.

We have heard from the rail industry about the investments they are making. And they shouldn't have to divert from basic investments that they need to be making in capacity and safety, including positive train control, which we mandated, to deal with concerns or problems caused by shipments of hazardous materials and others.

There was one particular case that got my attention, Powder River Basin coal, where the company was refusing to put a surfactant on it. The dust was coming out; it was getting into the ballast and destabilizing the rail bed. So, since the company was refusing to deal with that, you know, they were taken by BNSF to—BNSF decided to charge an additional tariff. They lost that judgment, even though the STB found that coal dust did propose a danger for the ballast and the rail stability, but they couldn't charge that differential tariff.

I think we need to reexamine that principle and our directives to them in light of current shipments. I mean, if we could send a market signal, we would see probably a lot less chlorine being sent on rail because there are substitutes for unbelievably toxic chlorine, which would cause much more damage in an urban area, potentially, than oil. There are problems with oil, et cetera. So I hope we will look at that.

And, secondly, short line railroads. We had an FRA report on the capital needs, and they found that, although holding companies are able to attract some capital, that the total overall investment needs are about $6.9 billion that are unmet. And I would hope we can find ways to work with the short line railroads to accomplish those necessary investments because they are critical to areas like my Port of Coos Bay and other areas.

So, with that, I would yield back the balance of my time. I thank the chairman for his courtesy. And I apologize that I am going to have to go meet with a bunch of mayors pretty soon and leave.

Mr. DENHAM. Thank you, Mr. DeFazio.

The first question I have: Mr. Mayo, given the history of railroads and the Staggers Act, what is the appropriate role of regulation in this marketplace currently?

Mr. MAYO. Well, from an economic perspective, the role of regulation in general is to correct market failures where the cost of correcting that failure is less than the damage done by the market failure itself.

Now, if we turn to the Staggers Act and to the rail industry itself, I think the place that I would start if I were you is right at the very outset of Staggers there is a set of congressional findings, legislative findings, that, number one, transportation services are, generally speaking, provided under conditions of competition, and, number two, in light of that competition and the general absence of market failures, that unnecessary and inefficient regulations should be removed.

Now, the Staggers Act did that. The Staggers Act peeled away a number of regulations that were deemed to be unnecessary and inefficient. In your situation now and today at the hearing, what you are trying to do is say, how did that work out for us as a Nation?

And I think the good news for you is that it has worked out quite well on the economic metrics. Prices are lower than they were in 1980. Output is massively higher than it was in 1980. The quality of services is higher than it was. Investment has been very robust. Innovation has been very high. And safety is generally improved. On any number of metrics, it has worked out pretty well.

So what I would say is that, in terms of regulatory and legislative oversight—let's call it a light-touch regulatory approach has been very, very successful. That doesn't mean that there can't occasionally be market failures that warrant intervention. It doesn't mean that we ought not have regulatory oversight when market failures do occur. Regulators should be vigilant and move decisively. But, by and large, the light-touch approach has worked very well.

Mr. DENHAM. Thank you, Mr. Mayo.

Ms. Miller, we have heard from shippers quite often about the access to rate cases as well as the cost of rate cases. And, as I understand, the STB has taken a look at several different steps to enhance the accessibility to some of these smaller shippers and medium-size shippers.

Can you explain some of the actions that STB has taken and whether or not that is improving that access?

Ms. MILLER. Yes, Mr. Chairman. I would be happy to address that.

The Board, over a period of time, has taken a look at ways that they can improve access to our processes for smaller shippers. We have put in place something that is called the simplified SAC approach. We also have something we call the three benchmark test.

What we have discovered, though, is that few shippers have found those approaches to be beneficial to them, and, while we have had a few rate cases filed under our streamlined methodologies, it hasn't had the impact we had hoped that it would have.

So I think we need to go back to the drawing board. We have gone back to the drawing board. We need to look for additional ways that we can make our processes more accessible and easier for shippers.

One example of that would be the hearing that we are going to have in June, which is for grain shippers. You know, there has not been a grain rate case filed since 1981. Some might conclude that is because grain rates are quite appropriate so there is no need for a rate case. Certainly, when agricultural groups come in to meet

with me, that is not their view. They do feel that the processes before the Board simply don't suit their needs.

So we need to do some work, see if we can't find some better approaches to come back and present to our shippers and see if we can't make our processes more accessible and more useful.

Mr. DENHAM. OK. Thank you.

And, Mr. Dooley, have you utilized these new provisions that have been put in place by STB? Are they working?

Mr. DOOLEY. In terms of the new provisions, our industry, in terms of the simplified SAC or the three benchmark, I don't think there are any of our member companies that have used that, in part because the caps on awards that you can secure there doesn't justify the cost of expense.

I think Commissioner Miller would state, too, that——

Mr. DENHAM. Big caps meaning that they are too high and it becomes too expensive for the smaller shippers?

Mr. DOOLEY. Yes. I mean, it is—yeah. You still, on a SAC, simplified SAC, there still could be a $3 million to $4 million investment. And then you have a limited ability in terms of what you could be rewarded if you prevailed, that it doesn't justify it.

On the stand-alone cost of SAC is that, you know, we had two member companies, Olin and DuPont, that invested, you know, in excess of $5 million each and brought cases, which both were turned down. And they were turned down, in large part, because they are required to develop their own theoretic railroad, a SAR, a stand-alone railroad. And that process is so cumbersome and expensive, and, you know, we are not in the business of that.

And I would just read a statement that Commissioner Begeman had in regards to the DuPont case. And she stated, "I was struck by the level of detail that must be considered to design a SAR and the high burden it places on both parties, but especially for the shipper, who lacks familiarity with constructing and running a railroad. I am concerned that, in some instances, the task of designing a winning SAR"—so the shipper would prevail—"can be so burdensome, and a single error by the shipper in the design of the SAR can be fatal." This is a clear example of the regulatory problems we face.

And she also stated in another case, "The Board has a duty to ensure that shippers have a viable means to challenge a rate. I already know that is not the case for grain shippers. And the Board should ask whether the SAC process can provide a meaningful gauge of rate reasonableness for carload traffic shippers."

And I think that is consistent with Commissioner Miller's commitment to continue working on this, and it is also consistent with the legislation that passed the Senate Commerce Committee.

Mr. DENHAM. Thank you, Mr. Dooley. My time has expired.

Mr. Capuano?

Mr. Lipinski?

Mr. LIPINSKI. It will take me a second here. I wasn't expecting to be next. But thank you, Mr. Chairman, for holding this hearing.

You know, it would be an understatement to say the Staggers Act has saved the railroad industry, since it really saved our freight system as well as preserving thousands of miles of track for goods movement.

And, as others have said, you know, I have been to Europe, I have been to Asia, and they talk about our freight rail system as the envy of the world. And I certainly think that the Staggers Act has, you know, played a very important role.

Now, that doesn't mean, though, that every railroad has been a good actor and that there haven't been some problems for local communities and sometimes for shippers.

In many instances, we have seen freight railroads do the right thing and work with local communities beyond Federal regulations, obviating the need to expand regulations. I certainly applaud these efforts, and I have been pleased to work with Norfolk Southern, CSX, BNSF, and Union Pacific on CREATE in northeastern Illinois; also working with the railroads and Metra on commuter rail and other issues.

But I have concerns that not all Class I railroads are holding up their ends of the bargain as community members. And I hate to raise this publicly, but I feel the need to do that here.

There is one railroad that I won't name, but I think people will find easy to figure out, I have had a few issues with. This railroad refused requests to slow its trains as they passed close to a local annual weekend-long festival—so that is just a couple days a year—that featured a children's carnival. I have joined this town in asking for cooperation this year and have yet to hear anything 1 month before the event.

I have also asked this railroad to work with commuter rail to add more service, and nothing has moved forward after many years of working on this. I have also heard some complaints from shippers.

Now, I am not asking for more Federal regulations. I think that is the last place that we want to go and only if it is absolutely necessary to do.

But I am wondering, what can be done—I wanted to ask Chairwoman Miller and Mr. Hamberger, if he has any comments to add—what can be done to encourage any bad actors to change their behavior? You know, how do we get everyone on the same page? You know, are there options for STB?

Chairwoman Miller?

Ms. MILLER. Well, I think that is an excellent question. It is certainly one I spend some time thinking about.

We have a minimal number of regulatory tools available to us at the Surface Transportation Board. Truthfully, I don't think that regulatory tools really is what would be useful in the situation. As the professor has pointed out, the rolling back of regulation really has had a profound effect in terms of allowing the freight transportation industry in the United States to really blossom, and we need to be mindful of that.

I know from my own experience in the year that I have been at the Board, fairly aggressively reaching out to both shippers and railroads, doing a fair amount of traveling, that there are certainly frustrations out there on the part of both shippers and communities at times when they feel that the railroads have not been responsive to their concerns.

By the same token, I have seen amazing things that are happening on the rail system in terms of the way that they are im-

proving their processes and becoming more and more productive. And we want to keep that going, as well.

I think one thing that the Board can do, I think we need to be cognizant of providing opportunities, is to be a sounding board, a place where people can come when they have concerns, a place where problems can be aired and we can try to find opportunities to get both shippers, communities, and the railroads to work together to solve them.

And I think that the Board's presence, just the very fact that we are present and at times can bring both parties in for discussions, has been helpful. And I would like to look for more opportunities to do those things.

Mr. LIPINSKI. Thank you.

Mr. HAMBERGER. Mr. Lipinski, thank you for that question. I would be glad to meet with you offline to get the specifics of this particular case.

I would like to point out, however, that all of my members, all of the AAR members have taken voluntary steps to improve safety, whether it is speed limits, increased track inspections, reaching out to their communities, emergency responders, making sure that they are trained for dealing with an incident if a hazardous-material incident does occur.

So, while I understand your frustration at this particular incident, I guess I would take exception with your saying that one of the Class I's is a, quote, "bad actor." I think they are all committed to working with the communities in which they operate and operating at a safe level. But I will be glad to come by and discuss the details of your specific situation.

Mr. LIPINSKI. Thank you. I appreciate that.

And I had other questions I won't be able to get to on reciprocal switching. If we don't have a chance to come back for more questions, I will submit a question for the record.

I yield back. Thank you.

Mr. DENHAM. Thank you, Mr. Lipinski.

Mr. Shuster.

Mr. SHUSTER. Thank you very much.

My question concerns, as I mentioned in my opening statement, the Senate Commerce's STB bill. I am very interested in hearing your views. And could you be concise as to what you may have concerns in it or what you like about it, but if you could be concise.

I will start with Ms. Darr.

Ms. DARR. Thank you, Chairman Shuster.

We are generally supportive. We especially like the provision that allows the board members to talk to one another. We think that that is just good common sense. And we also support the idea of it being an independent agency.

Mr. SHUSTER. Any concerns in it that you—in general, you are OK with it?

Ms. DARR. We are OK with it.

Mr. SHUSTER. Mr. Hamberger said he didn't object to it. I don't know if he——

Mr. HAMBERGER. We did not object to it.

I think that the bill does provide for voluntary arbitration. I would point out that the Board itself set up a voluntary arbitration

program 1 or 2 years ago, I believe, whereby a shipper or railroad would sign up and say, "I hereby agree that arbitration can be used for a case to be brought against me." And, of all the shippers, not one has signed up. One Class I railroad has, but—so I just find it interesting that that is the case.

But, with respect to the committee's action, again, we have no objection.

Mr. SHUSTER. And Mr. Dooley?

Mr. DOOLEY. Yeah, maybe I will start off with the arbitration issue, is that there is an improvement in the arbitration process in the Senate bill.

Ed referred to the existing arbitration that no shipper has utilized, is because there really is no real value to it. It doesn't specifically allow for the consideration and arbitration of rates.

Mr. SHUSTER. Do you think this bill addresses that so——

Mr. DOOLEY. It does.

Mr. SHUSTER. You would anticipate some of your members signing up?

Mr. DOOLEY. And it does have a cap of damages—or a cap on awards of $200,000, which, you are talking in the shipper community, is not worth the effort. In the Thune proposal, they increase that to $25 million. And so you will see a lot more interest and participation in this. And it will be interesting to see if the rail industry will agree to it.

The other issue I would say that we are very appreciative is included in the Thune bill—and it gets to Congressman Lipinski—is the issue of reciprocal shipping. And we appreciate the work that the commission is continuing to do on that.

But if you look at this and why this is an increasingly important issue when you have the consolidation of the rail industry, is that, right now, if you were shipping, say, from Chicago to Long Beach, the Port of Long Beach, and you have two different rail lines there, you have two competitive opportunities, in terms of pricing your shipment. But if you are shipping through a short-haul—or through a Class I railroad into Chicago, today you can't get a rate from that point A to Chicago and then from Chicago to Long Beach. And this doesn't allow for the marketplace to work and give you the access.

What we are hopeful is that, with the inclusion in the Senate bill of consideration of reciprocal shipping, is that we can see a way where we can get a rate quoted from point A to Chicago, we would be willing to pay the cost of that transfer, and then we would have the ability to have a more competitive marketplace from Chicago to Los Angeles or Long Beach.

Mr. HAMBERGER. Mr. Chair, if I might correct Mr. Dooley for the record.

Mr. SHUSTER. Briefly.

Mr. HAMBERGER. Last year's bill that was reported in September had a specific provision directing the Board to proceed on the NIT League proposal. That provision is not part of the bill that was reported out at the end of March. I believe there is a great deal of inference that the Board should draw from the fact that this year's bill is not directing them.

Mr. SHUSTER. OK. I got the point.

Ms. Miller, what are your thoughts on the Senate Commerce STB?

Ms. MILLER. Well, I think it is a regulator's—we didn't necessarily take a position saying we supported it or had problems with it. But, generally speaking, we found it to be a very balanced bill that I think will provide some advantages to the Board and will allow the Board to do its job in a better way. And, generally speaking, we think it is a good bill that will be advantageous.

Mr. SHUSTER. And, Mr. Dooley, instead of you responding here, I would rather the two of you come see me and let's talk about this issue so I fully understand.

Mr. DOOLEY. This only has—you know, Ed was right—it doesn't have a specific requirement. It has a specific requirement that STB concludes their consideration of reciprocal shipping and come to a decision.

Mr. SHUSTER. And you made a comment about Mr. Hamberger saying narrow interest. Well, I don't know about narrow interest, but I know about self-interest. And I have seen the railroads, and I have seen the different industries, yours also, driven by self-interest. I understand that. That is what keeps us all straight, self-interest up here. The Founding Fathers said that is the critical issue that is going to keep us all in line.

But I just want to make sure that, you know, captive shippers, I have had testimony after testimony, I ask the question, who is building facilities? You know, mines, of course, are where the mines are. And the agriculture industry is kind of where it is. But I know that there are manufacturers that actually build facilities to be captive shippers along rail lines. And several years ago, 1 railroad, there were 48 different companies making themselves captive shippers.

So, again, when we are talking about that captive shipper issue, that is something I am always focused on to say who does this to themselves. And I would also like to add I have a place in western Pennsylvania that has connections to three Class I railroads. And I have yet to have a big manufacturer come and locate there when they talk about captive shipping. So, again, that is something I am very interested in. If some of your companies are doing that to themselves, well, I mean, they must be there for a reason. It must be the railroads are providing something that they want, and so again.

And the final issue, if I could, Mr. Denham, on the issue of natural gas, I think you guys have taken the right position. But some of your members don't want to export natural gas because that will possibly drive up their costs. And, once again, I know that is self-interest. But my self-interest is we have got a tremendous amount of gas in Pennsylvania. And we want to share it with the world.

With that, I yield back.

Mr. DENHAM. Thank you, Mr. Shuster.

Mr. Sires.

Mr. SIRES. Thank you, Mr. Chairman. I enjoy watching the Mayweather-Pacquiao fight between you two. Let me just say, first, that my heart goes out to the victims of last night. And I hope that there is a speedy recovery for the people that are hurt and that they determine quickly what happened so we can address it.

You know, I represent the northern part of New Jersey, which is very congested. I represent the ports. And there have been a number of investments over the years between the railroads and obviously the port authority. But I was wondering what can, you know, what policies can the STB and the Congress put in place to continue and maximize the investment into the infrastructure of the railroads? Because in my district it is very important. What policies can we put, can we help out with? Mr. Hamberger?

Mr. HAMBERGER. Thank you, Congressman Sires.

As I tried to point out in my written testimony, there is a direct correlation between the amount of money that railroads can put back into the infrastructure and the amount of money that they can make in the private sector, direct correlation, which is why we have been able to put $575 billion back in since 1980; $29 billion this year; $26 billion last year. As the Congressional Budget Office has observed, profits are both the means and the motive for reinvestment. You have to have an ability to have that revenue to reinvest. And you have to have the expectation that that investment will pay a return. And that means you have to have a balanced economic regulatory system, which I think the Board currently enjoys. I believe that there are process changes that can be made. I commend the Board for the 3–B or the three benchmark approach, the Simplified SAC [Stand-Alone Cost]. I believe they have increased the amount of money that can be recovered under that. The authority that they are going to get from the Senate Commerce bill, should that come into play. So I think there are process changes that can be made, but that the underlying basic economic approaches Dr. Mayo has pointed out is working. And I think, going forward, it should be continued.

Mr. SIRES. Thank you. Ms. Miller, I don't know if you discussed this before, but can you just discuss some of the major proceedings that are pending before the STB Board, and what challenges does the STB face in resolving some of these proceedings in a timely fashion?

Ms. MILLER. Well, let me say a couple of things. One, I was surprised when I got to the Board to discover how many decisions, in fact, pass across the Board. So we tend to focus a lot of our attention on the rate cases, which take years, cost millions of dollars. But, in fact, day to day, there is so much more work that is going on at the Board. So I think, one, it is just good to have that as a reference point, that there are other things that are happening or happening in a very timely way.

I would say a couple of issues related to the Board's ability to move more quickly and do its work in what I would consider to be a better process. One, I want to take the opportunity—and I am most sincere when I say this—to say that one of my biggest surprises when I came to the Board was to discover that we have virtually a Third World computer system which is so arcane and outdated that we just cannot get on top of solving our problems. Our Web site regularly goes down. Our practitioners can't get access to our information. We have massive problems with it and have very little budget to deal with it. One of my highest priorities is fixing our computer system. But it is hard to do it when you don't have a capital budget to fix it. It is a serious issue.

Secondly, we have process problems that we can and should solve ourselves. When I look at what I would consider the process for how the Board deals with rate cases, it is not a rigorous enough process. We are not creating deadlines. And we are not then being disciplined in terms of meeting what deadlines are set. I think that is something we can solve ourselves and that we need to do. One of my first questions when I came to the Board was to ask, what are the performance metrics that we use in order to monitor the Board's own performance, and was met with surprised looks because people didn't even know what I was talking about so one of the things we are doing is to develop a set of metrics. Are we, in fact, meeting goals we should be setting for ourselves in terms of how we are doing our work? I think those things will be hugely beneficial in terms of not just improving how we function as a Board but, quite frankly, better serving the shippers who come to us and better serving the railroads. And I think they are very important.

I would want to say one other thing, the Senate 808 gives greater authority for the board members to speak with each other. I think that would be very helpful. But I also think that the Board has been quite conservative in how it has looked at those issues. It has been quite conservative in how it deals with ex parte communications. Far too often, the Board is making decisions based simply on a written record. And I don't know about any of you, I just know that if all I am doing is reading a record that has been written by attorneys, I am not going to fully understand an issue in a way which will allow me to make a good, on-the-ground, practical decision. And I think it is extremely important that we open up our processes. I feel like many of our Board employees are much too isolated from the industries that we are regulating. And so I want to open that up as well. And I think we can do that in a responsible way that will in significant ways improve our decisionmaking process.

Mr. SIRES. My time has run out. Thank you very much.

Mr. DENHAM. Thank you, Mr. Sires.

Mr. Hanna.

Mr. HANNA. Mr. Mayo, Mr. Hamberger rightly points out that they invested billions and billions of dollars, $29 billion recently. Mr. Dooley would argue that a disproportionate amount of that comes out of his pocket because of the captive shipping, the limited competition, et cetera. The 180 percent benchmark for the RVC ratio would also—Mr. Dooley would argue, that the appeal process is difficult, cumbersome, and, frankly, just not worth it. As someone, I assume, is more independent here than others and less vested, what do you think about that, Mr. Mayo?

Mr. MAYO. Two things: One, the data speak pretty clearly to the issue of investment. As I described it, the light touch regulatory approach has been swimmingly successful. A number of $29 billion of investment this year was used; that's just a fact. And that is an intense level of investment. And that bodes very well not only for current consumers but for future consumers.

Mr. HANNA. But speak to the issue that Mr. Dooley is talking about. I mean, no one is going to argue that it is a wonderful thing to invest their money. The argument that I hear and that I am try-

ing to understand better is the disproportionate because of the lack of captive lines and allegations.

Mr. MAYO. So that brings me to the second issue, which is that how is the investment going to play out for consumers? And there is a regulatory process in place to ensure that rates at the end of the day are reasonable. The STB oversees that regulatory process. If rates aren't reasonable, then the STB can and should step in. But, by and large, what you have seen over the last 30 years is that prices have fallen. As I mentioned in my opening remarks, prices are lower now than they were even in——

Mr. HANNA. That still doesn't speak to the 180 percent RVC benchmark—what you're saying right now—because that hasn't changed.

Mr. MAYO. That benchmark has not changed. And I am not advocating that it should change. That change was part of Staggers. Some rates are below that 180 benchmark. Some are above the 180 benchmark. And the STB has a process, now a three-part process, for allowing consumers, shippers, to come to the STB and make a case that those rates, if they lie above 180, are unreasonable. In the event that the firm is, that there is a captive shipper and that the rates are judged to be unreasonable, there is a mechanism in place——

Mr. HANNA. But I also hear you saying that on a weighted-average basis, it sort of works out.

Mr. MAYO. It has more than worked out. Prices, as I mentioned, on average are considerably below where they were in——

Mr. HANNA. Mr. Dooley, would you like to comment?

Mr. DOOLEY. I guess, you know, first off, you know, I think the 47 associations representing, again, the farmers, manufacturers, energy producers, we don't want to go back. I mean, the Staggers Act made a major improvement in terms of creating a robust rail industry. And we want that to continue. What we are asking for is something—it is not like we are paying a disproportionate share. I wouldn't even go as far as to say that is our complaint. Our complaint as shippers is, is that we do not have access to an efficient and an equitable rate resolution process.

Mr. HANNA. Are you all right with the Senate bill then?

Mr. DOOLEY. We think the Senate bill takes the step in the right direction. It doesn't prescribe any specific outcomes. It really drives the STB to conclude some of their issues that they currently have under review that we think, whether it is, you know, the standalone cost methodology that they are——

Mr. HANNA. Mr. Hamberger, I have got about a minute here.

Mr. HAMBERGER. I would like to associate myself with Chairwoman Miller when she opened, in her opening statement, I wrote it down: quicker and more accurate. That is what we need at the Board. We need quicker. But that needs to be balanced with more accurate. Some of these rate cases have $200 million, $300 million in the balance. So you don't want that done on a coin flip. You want it down quickly, but it has to be accurate. And that is why it takes some time.

Mr. HANNA. Thank you very much. I yield back.

Mr. SHUSTER [presiding]. Thank the gentleman.

With that, Mrs. Napolitano is recognized for 5 minutes.

Mrs. NAPOLITANO. Thank you, Mr. Chairman.

And I do have a couple of interesting observations. Ms. Miller, you indicate your computer, that goes to the issue of being able to have enough adequate staffing to investigate complaints, do you have them?

Ms. MILLER. One of the things that the Senate bill does is provide the Board with investigatory authority. Currently, we are a complaint-driven Board. So we don't initiate any complaints or any investigations. We just respond to the complaints that have been brought to us. In the Senate 808, one of the things it would do is provide us with investigatory authority. And so we certainly would need additional——

Mrs. NAPOLITANO. How about funding for the computer change?

Ms. MILLER. Pardon me?

Mrs. NAPOLITANO. Computers. You say you have outdated computers.

Ms. MILLER. Right. And you are asking if we have the staffing resources to improve our computer systems?

Mrs. NAPOLITANO. And to do a new system of computers.

Ms. MILLER. I think that we have the staff to do it. What we really need still is hardware and software updating. So it is not a staffing problem as much as it is a hardware, software problem that needs to be updated.

Mrs. NAPOLITANO. Which leads me to the other question. My understanding is the Board is supposed to have three members; only two were appointed.

Ms. MILLER. That is correct.

Mrs. NAPOLITANO. They are asking for an increase to five. Would that have an impact?

Ms. MILLER. Mr. Dooley and others could perhaps address this better. Some of our practitioners have felt that the Board is handicapped by having three members because no two members can have a conversation on any topic before the Board. And if we had five members, then at least two members would have the ability to talk with each other. I think that would be extremely helpful——

Mrs. NAPOLITANO. Anybody else?

Ms. MILLER [continuing]. But I think we can also improve it by opening up our ex parte communications.

Mrs. NAPOLITANO. Agree?

Mr. DOOLEY. Yes, I would agree. We think that STB needs to be a more efficiently operating organization. We think the expansion of the number of Commissioners would be a partial solution to that. But also I think we are seeing the evolution of the focus of the STB, is that they did help to get the rail industry back on track. But now we are moving into an area where there is increased consolidation, their focus needs to increasingly shift to ensuring that there is competition in the marketplace.

Mrs. NAPOLITANO. OK. Mr. Dooley, you hit on another point that some of my shippers have brought to my attention, and that is overcharging. Do you want to address that?

Mr. DOOLEY. Well, that gets back to the fundamental issue, I think, that shippers are most interested in, is that having access to or eliminating some of the regulatory and financial impediments

to having access to a rate resolution process. It is, it is not acceptable that a shipper has to commit to paying $5 million——

Mrs. NAPOLITANO. And 3 to 4 years for resolution.

Mr. DOOLEY [continuing]. And 3 or 4 years. So let's find a way that we can fix that which——

Mrs. NAPOLITANO. What will be, what is your recommendation? What would help?

Mr. DOOLEY. I think that, you know, part of it is, you know, reevaluating some of the policies that were put in place 35 years ago. I mean, the whole issue of revenue adequacy, that was a relevant issue, I mean, a very relevant issue back 35 years ago. But I attest that Warren Buffett doesn't make investments in companies that are not revenue adequate——

Mrs. NAPOLITANO. Correct.

Mr. DOOLEY [continuing]. And we need to be evaluating how that is used and calculated in resolving rate disputes.

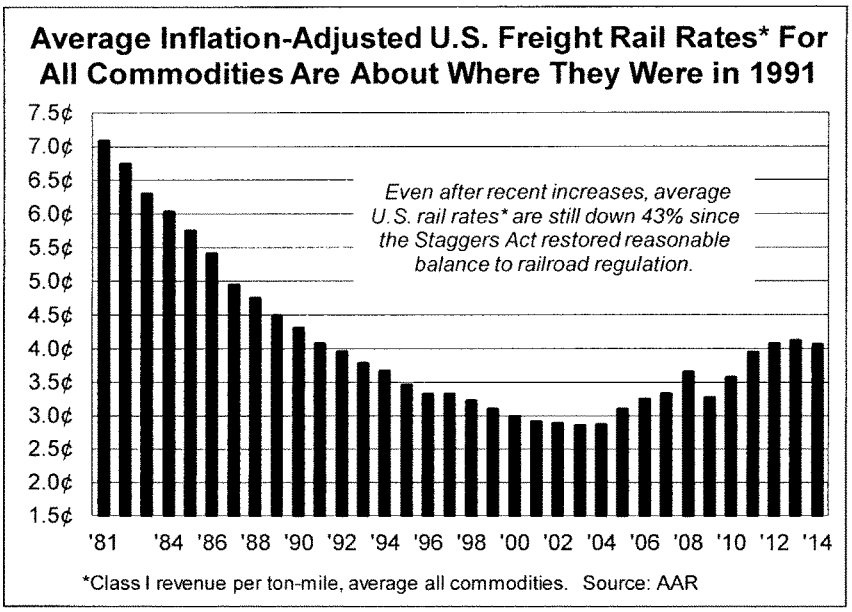
Mrs. NAPOLITANO. Another area of great concern, as we have gone through and talked to is public safety, railroad safety, safety of our grade separation. As you know, I am key on grade separations because the Alameda Corridor-East.

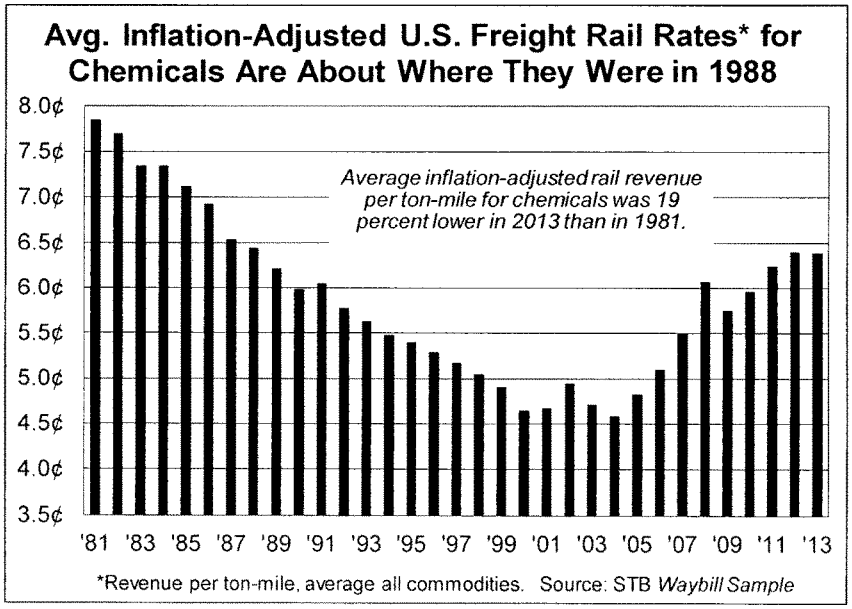
Mr. HAMBERGER. Absolutely.

Mrs. NAPOLITANO. And the safety of anything that comes out of the ports for ontime delivery to the eastern seaboard. So I am just wondering how much of that is going to be continued to be able to address the different aspects of the infrastructure change, whether it is the ties, whether it is the rails, whether it is your locomotives, greener, what is it that is going to affect us?

Mr. HAMBERGER. Well, of course, all of that is where the $29 billion I keep referring to goes, to millions of new ties, new rail, stronger gauge rail, Tier 4 locomotives that are the newest, cleanest locomotives out there that are now being bought. But if I could go back to your previous question for just a quick second, where you talked about overcharging, I would just like to put in the record, I think it may be in my written statement but I would like to draw your attention to it, that the average inflation-adjusted freight rail rates for all commodities are about where they were in 1991. And for Mr. Dooley's members, it is where they were in 1988. So where there is, quote, "overcharging," that is what the Board is there for. And I have expressed our support for quicker but more accurate processes. But I would like to get on the record that the rates being charged today are where they were in 1991, 1988 for the chemical company.

[The information follows:]


Average Inflation-Adjusted U.S. Freight Rail Rates* For All Commodities Are About Where They Were in 1991
7.5¢
7.0¢
6.5¢
6.0¢
5.5¢
5.0¢
4.5¢
4.0¢
3.5¢
3.0¢
2.5¢
2.0¢
1.5¢
Even after recent increases, average U.S. rail rates* are still down 43% since the Staggers Act restored reasonable balance to railroad regulation.
'81 '84 '86 '88 '90 '92 '94 '96 '98 '00 '02 '04 '06 '08 '10 '12 '14
*Class I revenue per ton-mile, average all commodities. Source: AAR


Avg. Inflation-Adjusted U.S. Freight Rail Rates* for Chemicals Are About Where They Were in 1988
8.0¢
7.5¢
7.0¢
6.5¢
6.0¢
5.5¢
5.0¢
4.5¢
4.0¢
3.5¢
Average inflation-adjusted rail revenue per ton-mile for chemicals was 19 percent lower in 2013 than in 1981.
'81 '83 '85 '87 '89 '91 '93 '95 '97 '99 '01 '03 '05 '07 '09 '11 '13
*Revenue per ton-mile, average all commodities. Source: STB Waybill Sample

Mrs. NAPOLITANO. Is there a way to be able to, and I will leave this for the record, to be able to ensure that the complaints received will be resolved in a faster, more expedient manner? The complaints?

Ms. MILLER. Yes. I think there is. And I think we are working on that to improve our processes so that we can ensure that happens. I would want to say, as I said before, we get very focused on these rate cases because, as Mr. Hamberger pointed out, sometimes we are talking about hundreds of millions of dollars that are at stake. So they are very important. They take a lot of our staff time. But every day, every month, decisions are going through our agency that are handled very quickly and are allowing businesses to get back to doing what they need to do.

Mrs. NAPOLITANO. Thank you to the witnesses.

And thank you for your indulgence, Mr. Chairman.

Mr. SHUSTER. Thank you, Mrs. Napolitano.

With that, Congressman Rokita is recognized for 5 minutes.

Mr. ROKITA. I thank the chairman. Good morning, gang. I appreciate you being here. And I appreciate the passion I see in each one of you for the industries that you regulate or are in. I do think you are part of America's 21st-century future. So, again, thanks for being here. Ms. Darr, we have a lot of short-range railroads in Indiana or a lot for us. We seem to like them. General question for you, what is the overall economic outlook for the U.S. short line railroad industry and the future demand for rail transportation? And, in your view, what role should Ms. Miller's agency play to ensure that the U.S. freight rail system can continue to grow, especially with regard to the short lines?

Ms. DARR. Thank you, Congressman Rokita. I would say, first of all, short lines love Indiana. So I think it is a reciprocal relationship.

Mr. ROKITA. We love you. Don't tell CSX.

Ms. DARR. In regard to your question about the economic outlook, I believe it is strong. But that doesn't mean that we can just go along a path and not interject along the way and assume that it is going to remain strong. We have invested in our infrastructure. We have been able to do that through the 45G program. And as I indicated in my testimony, that is not just about economic development. That is also about safety. Making sure that our infrastructure is safe is critical for our growth. Staggers got us this far. Going forward, 45G is going to be absolutely essential to our ability to rehabilitate our track.

And I also think we have done an excellent job of attracting new customers. Short lines have developed a reputation within the industry as being very customer friendly. You have not seen me get into any negative discussion with Mr. Dooley. And I can assure you that all of his, all of his members would be thrilled with the short line performance that they have received to date. And I won't let Mr. Dooley take on any conversation about that, except outside of the room. And then I think also an important part of our growth is the good partnership that we have established with the Class I's. I think that is demonstrated by the work that we are doing with AAR and Mr. Hamberger here. That is going to be very critical. We

rely on them for a lot of our business. And they rely on us to bring the customer to them as well. It is an important relationship.

In regard to what Chairwoman Miller can do in regard to changes in the STB to help us out, it is speed and expedited rulings. And, as Ed said, the speed can't happen without accuracy. Both of those things are absolutely critical. In relation to what we are talking about today, don't roll back Staggers. Anything else that rolls back the Staggers Act is going to put us in a position, as Chairman Denham had said earlier, of being hammered by burdensome regulations. And, as in the past, that was putting us in a position where we were dying a slow death. And we can't go there again.

Mr. ROKITA. Thank you.

And, on that, Mr. Hamberger and Mr. Dooley, would agree, correct? You are all in line on that, with that last statement?

Mr. HAMBERGER. I do certainly would, yes.

Mr. ROKITA. OK. Let the record reflect they are answering in the affirmative. And Mr. Dooley has a footnote.

Mr. DOOLEY. We certainly do not want to see the Staggers Act eliminated. But we think there could be some modifications that, again, give us more equitable access to a rate resolution process.

Mr. ROKITA. OK. At the risk of not getting to you, Mr. Mayo, I need to go to the chairwoman. And I want to, first, thank you for sitting in the chair as you do and actually articulating the fact that you have a strategic plan with goals and rates set to them and that kind of thing inside your office. I think that goes without saying, quite frankly, when you have agencies as big as yours and others that are much bigger. Yet many who sit in that chair don't bring any of that information to us. I am puzzled that your testimony seems to focus on the fact that you don't have a computer system or your technology is behind and this and that. And are you trying to tell me that the appropriations has that much control in micromanaging your budget that well that you couldn't fire a nonperforming employee or 2 or 10 or 20 or 100 and get the computer money you need so that you can expedite these cases with a bit more accuracy?

Ms. MILLER. Well, in terms, overall, just very quickly, we are actually quite a small agency, about 140 people. And the way that we have created any of the funding necessary to try to make improvements to it is by holding positions open and not filling them. Otherwise, we just don't have any kind of a capital budget at all. So we have got nothing to turn to absent that.

I think one of the things that you are saying is that, while I am a firm believer you don't start by saying we need more people to accomplish your job; you start by saying what can we be doing differently to get our jobs done. I have been at the Board for a year. I could not say that we are overstaffed. I would not draw that conclusion at all. And, in fact, there are some real gaps, I think, in skill sets at the Board that we need to be better able to serve both the railroads——

Mr. ROKITA. You don't have one nonperforming worker that you wish you could under the law fire?

Ms. MILLER. I sure do.

Mr. ROKITA. OK.

Ms. MILLER. And I have to say, I come from State government. It is where I worked my whole life.

Mr. ROKITA. Can you tell I came from State government?

Ms. MILLER. And I would tell you that I have found many more ways at the State system to take care of nonperforming employees than I have been able to uncover——

Mr. ROKITA. Maybe we should work together and find a way to get those ideas here.

Ms. MILLER. But I do want to go back to say quickly, because I don't want to give anybody a false impression, we are working very hard to solve our own problems. But I have to say, we have very few tools to do it. And I use this as an opportunity today because I feel so strongly about it. We want to do a better job for these guys, but we need some tools. And you just can't do that, you can't create it out of nothing. And we really don't have the resources necessary.

Mr. ROKITA. My time is up, Mr. Chairman.

I will yield back. We can carry on later hopefully.

Ms. MILLER. Sure. Happy to.

Mr. DENHAM [presiding]. Thank you, Mr. Rokita.

Ms. Hahn, you are recognized for 5 minutes.

Ms. HAHN. Thank you, Mr. Chairman. And thank you for holding this hearing.

I do want to add my voice to those who are expressing, first, shock and then, of course, sympathy for the horrible train accident last night. And I will say, I am one of those politicians that Chairman Shuster was maligning earlier. Even though we have not found out what the cause is—and I am sure we will—this is National Infrastructure Week. And I do know for sure that the funding for our infrastructure in this country is woefully inadequate. I think everybody needs to be investing more in our country's infrastructure. And even sometimes when we find out that the cause of a train accident was human error or something else, it seems that we move away from focusing on, did infrastructure play a role or are we just another bad infrastructure design away from another accident? Folks on the morning news shows this morning were talking about our design, our outdated design of our rails and curves that maybe shouldn't be there and shared tracks.

I think if we really want a rail system and an infrastructure that is the envy of the world, I think we are far from having the perfect infrastructure. And other countries are investing billions more in their rail infrastructure than we are. I still think that is a huge problem. And I think our Highway Trust Fund is running out in a few days. Maybe we will have a short-term fix. But that is no way to run a country. And it is no way to run rail lines.

And no matter what fees we are paying and no matter what disputes we are arbitrating, at the end of the day, I am embarrassed about the infrastructure we have. And we just haven't put the time or effort or money into it.

I do have a bill that I have introduced. It is a freight network bill because I don't think our freight network ought to be competing with our Highway Trust Fund. So I have got a way to take what the shippers are paying in import fees, they pay about $40 billion in import fees, and diverting some of that to a freight net-

work guaranteed revenue stream that we can fund a lot of the things that we are talking about. So I hope we take a good look, unfortunately, in light of this accident, at what, if any, role our infrastructure played or will play in future accidents in this country.

And I just wanted to follow up on something my colleague, Pete DeFazio, was talking about with the short line railroads. And I am a big fan of short lines. A lot of them service our ports, which is a huge role and also a hugely needed infusion of infrastructure funding in and around our ports, the last mile into our ports. I think that keeps us from being globally competitive like we should be. But of the 560 short line railroads currently operating, 27 holding companies control almost one-half of these railroads. And I am concerned that these holding companies, these investment firms, are looking at turning a profit for shareholders more than maybe investing in railroad improvements and safety. And the FRA published a report on the capital needs of short line railroads and found that while holding companies reduce the risk associated with lending capital, funding that is available must be thinly spread among all carriers under their control in order to meet current and ongoing needs. And we know there is about a $6.9 billion need for short line and regional railroads. I would like to hear your comment on that funding mechanism for short rails. And is that a positive thing that we are seeing? Can we do better?

Ms. Darr, I would love to hear from you. I didn't know if, Mr. Hamberger, and, Ms. Miller, if you would like to comment on that as well, the economic structure of who is owning our short line railroads.

Ms. DARR. Certainly we have seen a lot of consolidation, especially in the last few years, particularly one of our largest members. But, altogether, there is really only one and maybe two publicly held companies in the short line business. So I don't know that that would be an accurate representation of our industry. Although certainly there are constraints for publicly held companies that independents don't have, I am not sure that that is, altogether, a bad thing because, obviously, we have seen some tremendous growth as a result of those arrangements.

As to what is needed to allow our independents to grow—and the bulk of my members are independent railroads—45G is absolutely critical to that. And 45G is a tax credit that allows us to take our earnings and reinvest them back into tracking. You made some excellent points about this being National Infrastructure Week and the challenge that we are facing. If the short lines don't have access to that capital, we are not going to be able to do our part of the job for the industry. So, again, I would like to thank everyone on the T&I [Transportation and Infrastructure] Committee for their overwhelming support. We have had great luck with that. But if we don't continue to follow through with 45G and make it permanent, rather than have to fight for it every year and deal with that vulnerability, we are not going to be able to engage in the long-term planning that is necessary.

Ms. HAHN. Thank you. I can hear you tap, tap, tapping back there.

Mr. DENHAM. The time was definitely expired.

Mr. Capuano.

Ms. HAHN. I will yield back.

Mr. CAPUANO. Thank you, Mr. Chairman.

First of all, I want to thank the Board. This has been just as informative as I had hoped it would be. To some extent, this is kind of ending up like a lovefest, which is good. It sounds like we all want to do some minor improvements to the STB to make everybody work a little bit better and make this country better. So I want to thank you all for your input.

But I do want to pick at a couple little things that bother me.

Mr. Hamberger, do any of your member companies haul wheat?

Mr. HAMBERGER. Yes, sir.

Mr. CAPUANO. Do they haul coal?

Mr. HAMBERGER. Yes, sir.

Mr. CAPUANO. OK.

Ms. Darr, do yours haul wheat?

Ms. DARR. Yes. They do.

Mr. CAPUANO. And coal?

Ms. DARR. Yes.

Mr. CAPUANO. Do you know if they haul casino chips, poker chips, or slot machines? You may not know that, but I thought I would ask.

Ms. DARR. Should they?

Mr. CAPUANO. I don't know. If some were to ask, they would?

Ms. DARR. Yes.

Mr. CAPUANO. Mr. Hamberger, do you——

Mr. HAMBERGER. If some were to ask, we have a common carrier obligation, so absolutely.

Mr. CAPUANO. That is what I thought.

Ms. Miller, if a railroad came to and you said, "We haul wheat and so, therefore, we want to build a bread factory on our land in the middle of a residential area and we want to be exempted from all health regulations, we want to be able to make that bread any way we please, not subject to local zoning, not subject to local environmental issues, not subject to local health issues," would the STB approve that as a related activity?

Ms. MILLER. I don't know. In that specific example, I think you are referring to the preemption——

Mr. CAPUANO. You don't know? So you think there is a possibility that the STB would approve a railroad making bread to sell to the general public that is not subject to local health requirements? The problem is your hesitation. The problem is that that is a possibility. Would you approve them if they haul coal? Would you approve the railroad saying, "By the way, we want to process coal, we want to mine coal, we want to dig oil because we haul oil, we want to frack in my backyard, not subject to State or local requirements because Federal law preempts them"? Is there a possibility the STB would say yes?

Ms. MILLER. Well, Mr. Capuano, I think perhaps my hesitation has less to do with not knowing for sure how the STB would act but reflecting on what I do or don't know about any authority we would have if a railroad——

Mr. CAPUANO. Fair enough.

Ms. MILLER [continuing]. Was wanting to build a factory that had nothing to do with transporting or rail transportation.

Mr. CAPUANO. Fair enough. Well, then why in the world would you approve a railroad getting into the hazardous waste business? Why in the world would you approve a railroad getting into the propane business not subject to State or local regulations? Why on earth would you say that anyone would be exempted from local safety requirements, local zoning requirements, when it is not an issue that is directly related to a railroad? Yet you have done that. Why should I have faith that the STB is not just a tool of the railroad industry, and it is truly an independent agency that understands, yes, when it comes to rail, we all want successful railroads. But let's be honest, trash handling is not a core item in any railroad.

Now, I am not saying they shouldn't do it. If the railroad wants to get into the trash business, good luck. But your business, your entity, not necessarily you, I don't know if you were on the Board at the time, said that they were no longer subject to local zoning requirements. Just last year, the STB said they are not subject to local zoning requirements on a propane facility in the middle of my State. I have to tell you, that shakes my trust in the system.

I want the STB to work. And all of the issues that we talk about today, they sound fine; we are heading in the right direction. That is the wrong direction. I would like to know what the STB might ever do about it, except to say: We are sorry. We are going to turn this issue backwards. We are going to do the right thing moving forward and stop this nonsense. Is that possible that that might happen?

Ms. MILLER. I think one of the—I think the issue that is frustrating you—which I appreciate the frustration, I felt it myself—is the way the preemption rules play out. Under the Federal laws, State and local laws are preempted as to having to do with rail transportation. And the frustration I think you are expressing is whether or not we have properly determined whether an activity is a part of rail transportation, or if, in fact, it is something else. I can say that since I have been at the Board, I have a strong sense of importance of the preemption requirements. One of the reasons we, in fact, do have such a strong rail network in the United States is because of preemption. I think it is extremely important that preemption——

Mr. CAPUANO. I am not arguing when it comes to the core business of railroads.

Ms. MILLER. But I would also say, I have seen situations that have come before the Board since I have been there that I have personally found repugnant but that I also believe fall under the preemption requirement. So, even though I personally have not been supportive of what I have seen an entity doing, we have also found that they do, in fact, meet the requirements of preemption.

Mr. CAPUANO. I know what you have found, but you earlier touted your background in State government. I also have a background in State and local government, and I understand there are certain things that are conducive to Federal preemption, which I support in many instances, but I don't think that applies to zoning. I don't think it applies to health. I don't think it applies to the environmental issues. Those are State and local matters, and the Federal Government should stay out of them. And I believe that preemp-

tion was inappropriate, wrong, and should be changed. And I guess you have left me with no choice but to now advocate for legislative change, which I actually think is always the last option.

I think you have made a big mistake. I think you have opened the door to basically sticking your Federal thumb in the eye of every State and every city and town in this country. And I wish that that weren't the case. And I would like to find a way to get the STB to correct that action, but I guess we will have to do it legislatively.

Thank you, Ms. Miller.

Mr. DENHAM. Thank you, Mr. Capuano.

Mr. Mayo, if a wheat farmer and a coal miner opened a bakery—I think we have covered that topic long enough.

I actually have——

Mr. MAYO. I would have gone mute at this point. I would not have answered that. Thank you, though.

Mr. DENHAM. Actually, I have one final question, and that is, you know, a misconception of revenue adequacy. We continue to hear how the railroads are doing so well on Wall Street, but that misconception of revenue adequacy is always out there. Can you explain in a little detail the challenge there?

Mr. MAYO. Sure, and I will try to be concise. The details are in the study that is appended to my written testimony. But what the study does, is to look at the notion of revenue adequacy and to really understand the purpose of revenue adequacy, you need to go back to the time that it was introduced. It was introduced in the 1970s. There was a period when the rail industry was in dire financial and physical conditions. It was literally falling apart. In the 4R Act of 1976, the language first appeared. And it created a benchmark. It said to regulators—then the ICC, now the STB—that the regulators should calculate a number, should calculate whether railroads were earning back their cost plus a cost of capital. So it provided an informational benchmark and a set of guideposts that helped legislators and regulators in assessing whether the industry was coming back and how far it had come back. So that was the legislative intent. It was a purpose. The purpose, I believe, at the time was informational, to create a set of guideposts and benchmarks.

In 1985, the then-ICC introduced a bit of an interpretational change, interpreting revenue adequacy not as an informational benchmark but as a constraint. It was at that time that the word revenue adequacy "constraint" first appeared in the regulatory documents. And, at that time, the ICC indicated that in the rail industry, that railroads should not be entitled to any more revenue than what would exactly cover their cost of capital.

Now, at that time, what happened is, in theory anyway, that regulatory determination would reintroduce back into the rail industry earnings regulations which we had just stepped out of with the Staggers Act. Now, I said in theory it did that because, at that time, the railroads were, largely speaking, and completely revenue inadequate. So it was a theoretical constraint, not a practical one. Now, if you move forward 20—30 years now, the rail industry, as we all know, is doing better financially. They are now being judged

increasingly to be revenue adequate. That is to say they are covering their cost of capital.

Now, to the extent—and this is where the concerns come in in my study—to the extent that the revenue adequacy constraint is then imposed and we reimpose earnings regulations in this industry, that is a risk of some significant backsliding, I think. And so what I would appeal to you, and to the regulatory community is to reestablish the original legislative intent of the revenue adequacy language, and that is as an informational benchmark, which is really a good thing, but to avoid using revenue adequacy as a regulatory hammer.

Mr. DENHAM. Thank you, Mr. Mayo.

Our final question today is from Mr. Babin.

Dr. BABIN. Thank you, Mr. Speaker, I appreciate it.

Mr. Chairman, thank you very much. I had a couple of questions that I would like to ask of Mr. Dooley, if you don't mind. What role can the STB play to ensure that the rail system supports manufacturing, investment, and growth?

Mr. DOOLEY. Yeah, you know, again, Congressman Babin, is I think that, you know, consistent with the Senate legislation, there is a directive there for STB to conclude some considerations of a host of issues that range from the rate resolution issues that are associated with the stand-alone costs, the requirements that, in order to bring a rate case, you have to have required that company to design a rail line and operating, assess the cost of that in order to make a determination of whether or not if you made these new investments, had an appropriate return on capital, whether or not that would result in a rate lower than what was being provided.

But it provides—it is such a complicated process that even the STB Commissioner said they question whether or not that is an equitable and effective way.

What the legislation also does is it asks for STB to conclude their consideration of the issue in terms of reciprocal switching, which again is, you know, with the increased consolidation, with fewer rail lines, Class I's that are providing service, is that there is not as much competition in the marketplace, and so what we think is important is, is that you ought to have a mechanism that can give a shipper the ability to ship from point A to point C through point B, but if there is only one shipper to get you to point B and you have got two shippers there, that there ought to be a way to get a quote from that rate from A to B and then have the opportunity to get a competitive quote from B to C from two rail issues and have the opportunity to pay for the cost of that switch. So we think that there is progress that STB can be making on that front, too, that again will ensure.

We also have some other issues related to rate bundling that is a little more complicated that also could ensure, again, more competition or a more competitive marketplace. And that is what we are asking for. Two things is, when you have increased consolidation, you basically have a duopoly in the rail industry in many regions of the country, and that doesn't necessarily result in quite as a robust marketplace of forces as we think is appropriate. And how do we adjust for that? It is where the equitable rate resolution

process as well as some of these other provisions that could be addressed through STB.

Dr. BABIN. OK, thank you very much.

One other question, I am already—no, I have still got a little time.

Ms. Miller, if I could ask you, the Staggers Act established numerous objectives for U.S. freight rail policy which wanted to minimize the need for Federal regulatory control over the railroads and would allow railroads to earn adequate revenues, providing expedition resolution or proceedings, ensuring effective competition, and maintaining reasonable rates where effective competition does not exist. How well has the STB succeeded in achieving these objectives, and what areas need the greatest attention in the future?

Ms. MILLER. I think if you look back over the last 35 years since Staggers has passed, you would have to say that the STB has done an outstanding job. When you look at the issue of rate regulation to the extent the Surface Transportation Board has any involvement at all, it is only 10 percent, really, of any of the traffic or rate regulation that we even have any oversight over. Anything that is done by contract we are not involved in. That is, the vast majority of what is moving on the freight system today is done under contract. And other situations, even though there may not be a contract, they might be using tariff, there is clearly competition. We are not involved there. So our role really is a pretty small role but in an area that I think becomes very important.

I think that in a year of serving on the Board, my observation is, is that to the extent we are, in fact, to be an arbitrator of whether or not rates are reasonable where competition doesn't exist, if there is a criticism that I would have of the Board, it is that I can understand why shippers feel so frustrated and say to us: You know, we don't really feel like we have an opportunity to bring cases before you.

We can say that we are available. We can say that you can file a rate case, but what we know is that it is going to take 3, 4, 5 years. It is going to cost millions of dollars, and the reality of actually doing that has quite a chilling effect, I think, on a number of shippers.

So Mr. Hamberger made the comment—and he is absolutely right—we are talking oftentimes about hundreds of millions of dollars. There is no way to take that sort of a rate process and turn it into a 6-month activity. The issues are much too complicated. They are much too important. So I am not saying that our goal at the Board should be to rush to judgment on any of these things. Some of these questions are simply going to take some time to get at. But by the same token, I don't think there is any question that there are people who feel they have an issue that they would like to have addressed, who simply don't bring it before us because they think it is hopeless.

Dr. BABIN. Thank you, Mr. Chairman.

I would like to thank all of the witnesses, too.

Mr. DENHAM. Thank you, Mr. Babin.

Ms. Brown, you are recognized for 5 minutes.

Ms. BROWN. Thank you, Mr. Chairman.

First of all, I want to say that last night I started getting calls about the accident that occurred in Philadelphia. And I want everybody to know that my heart goes out to the families and the community at this time.

I mean, I am—rail is so important, and reauthorization of the Staggers Act and investment in rail is crucial. It is absolutely crucial that we work to keep rail, freight rail, and passenger rail separated. And, you know, other countries have figured it out. And we as a people of—in the United States need to get with it. I tell people all the time in Florida: Our competition is not Georgia and Alabama. It is people in other countries that have figured out how to move goods and services.

And when I travel around the world, they ask me: How do you all have such a great freight system? And I want to know from them: How do you have such a great passenger system? And we in the United States need to figure out and we need to invest in making sure that we can move people, goods, and services.

So I want to thank you all for your testimony.

And do any of the members, I know Ms. Miller, he was tapping. Do you want to make any closing statements? And Mr. Hamberger, anybody want to make any closing statements?

You know, I am now on the Committee on Veterans' Affairs, and I appreciate the fact that over 30 to 40 percent of the people in rail are veterans. And I thank you all for continuing to reach out to them because they are ready for employment.

And Ms. Miller, do you want to add anything?

Ms. MILLER. No. I really appreciate your comments and would echo your statements. I have always been amazed by the U.S. transportation system. I think it is extraordinarily important, and I am struck all the time, as you said, you know, our competition—I came from the State of Kansas. I felt the same way. Our competition wasn't the States next door. It is other countries around the world. And I think we need to continue to think that way. And one of our advantages economically is our freight transportation system. It is extremely important that we maintain that advantage.

Ms. BROWN. My colleague, Mr. Dooley?

Mr. DOOLEY. No, I have no other statement, but I, again, thank the committee for the opportunity to testify today.

Ms. BROWN. Thank you.

Mr. Hamberger.

Mr. HAMBERGER. I would just like to on a personal note say I know that you had a Committee on Veterans' Affairs meeting this morning, and the fact that you made it here just underscores your dedication and support for the rail industry, and I just want to thank you for that.

Ms. BROWN. Thank you.

Ms. DARR. Congresswoman Brown, I just wanted to echo on your thoughts about the Amtrak accident last night. And I think, you know, it is appropriate that we talk about safety today. And from the short line perspective there are two critical aspects of safety that we can help out with. One is raising up the safety culture in our industry, which we are able to do through the Short Line Safety Institute, thanks to support from Congress.

And then, finally, focusing on our rail infrastructure. By improving the track, we improve safety, and we are able to do that through programs like 45G. So I think it is a good partnership and appreciate your support for both of those programs.

Ms. BROWN. Thank you. The last comment?

Mr. MAYO. So I, too, would echo your reflections about the need to look abroad for benchmarking and identifying that our real area of competitiveness is best benchmarked around the world, not necessarily here in the States. I would say, in the context of this hearing, that it is really sort of important, once in a while—I mean, we are pretty good at pounding our chests and chanting we are number one in the world, even if we are not necessarily that way. In this particular area, in the area of freight rail policy, I think we have a lot to be proud of. The economic data are very clear. It is rather remarkable as an economist to see an alignment of positive economic indicators in prices, output, innovation, employment, and so on, that have worked so well. So I am just glad to be here and to speak about this bill or this act.

Ms. BROWN. Well, thank you very much.

And like I said, I don't care whether I am in Russia, no matter where I am around the world, they always ask me about our freight rail. And, depending on where I am, whether I am in Europe, or someplace, I am asking them about their passenger rail.

So thank you again all for your testimony.

And Mr. Chairman, I yield back the balance of my time.

Mr. DENHAM. Thank you.

Mr. Cummings, you are recognized for 5 minutes.

Mr. CUMMINGS. Thank you very much, Mr. Chairman. I apologize for getting here so late. I was in another hearing where I am ranking.

I wanted to express my condolences to those who were injured in last night's terrible accident, to the families of the victims who died.

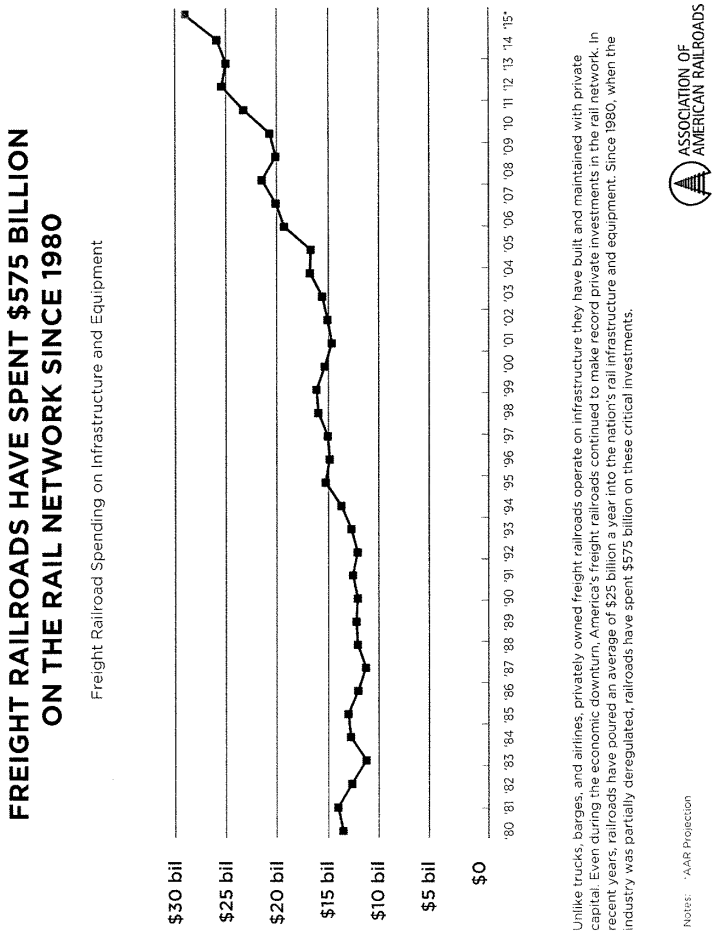
I also want to express my strong support for Amtrak. Tens of millions of passengers ride the Northeast Corridor every year, including me, as we pass through Penn Station in my district in Baltimore. Amtrak is an essential component of our Nation's transportation infrastructure. Sadly, Republicans on the House Appropriations Committee have proposed cutting capital funding for this service by 25 percent in fiscal year 2016.

While we cannot speculate on the causes of last night's accident, the media reports indicate that it occurred in a sharp curve. And there are many such curves and tight turns along this very old corridor. We would never find it acceptable to operate the Congress using 19th-century technology, and yet we continue to operate in many stretches of the Northeast Corridor under 19th-century infrastructure. Rather than cutting our investments, we should be expanding them and taking all steps necessary to bring the Northeast Corridor into a state of good repair.

Now, Mr. Hamberger, can you discuss the trends you have seen in the rail industry's investment in infrastructure both during and after the financial crisis, and have railroad investment trends changed in these years?

Mr. HAMBERGER. Thank you, Mr. Cummings, and you were not here earlier, but I do want to associate myself with your remarks about—as I did earlier, the tragedy last evening. The very interesting chart, which I can provide for the record, what we saw in 2008, 2009, and 2010, was a very minor drop off in the amount of capex that the industry put into the network.

[The information follows:]



If you go back to 2002, the previous recession, 2001 and 2002, we saw a dramatic dropoff. When the economy came roaring back, we were not ready for it, and I think what our members individually decided was why there was some decline, about a 10 percent perhaps, if memory serves, that there was a need to continue to invest. Many of our members kept the employees that they furloughed on part-time status so that they continued to be qualified to be called back and continued to receive their benefits so that those investments continued to be made.

Now, the service disruptions of 2013 and 2014 would undercut my argument that we were ready, but there were a lot of factors that went into that service challenge. But we were—we took the money that we were earning and put it back into the network the same as we are doing now at record amounts.

Mr. CUMMINGS. Now, Ms. Miller, you wrote in your testimony in July, the Surface Transportation Board will hold a hearing to explore issues pertaining to the concept of revenue adequacy. You also wrote that revenue adequacy is an economic concept that describes whether a carrier is earning sufficient revenue to cover its cost and earning reasonable return. And so you indicated that the Board makes the determination about revenue adequacy annually, is that right?

Ms. MILLER. That is correct.

Mr. CUMMINGS. You also wrote that the Board is beginning to see that some of the Class I railroads are becoming revenue adequate across consecutive years. Can you explain how revenue adequacy is calculated and is that threshold of investment and profit that——

Ms. MILLER. No, I think you meant to direct that to the professor at the end of the table.

Mr. CUMMINGS. Oh, I am sorry, Professor.

Ms. MILLER. No, no, I am sorry. I am just teasing you because——

Mr. CUMMINGS. OK.

Ms. MILLER [continuing]. This complicated exercise——

Mr. CUMMINGS. I am tired, so don't confuse me.

Ms. MILLER. I am sorry.

Mr. CUMMINGS. It has been a long day already. Go ahead.

Ms. MILLER. No, I have my cheat sheet——

Mr. CUMMINGS. OK.

Ms. MILLER [continuing]. On how it is calculated. I don't know that we need to go into, you know, the——

Mr. CUMMINGS. But you see what I am getting at? I am trying to figure out, you know, when we talk about the adequacy, I am trying to figure out what the threshold is, and how do we measure that? Do you follow me?

Ms. MILLER. Yes, I do follow you, and so I hope the professor won't be totally offended by the way I am going to no doubt make a mess of his economics. But when we are looking at revenue adequacy, we are not looking at the question of, are railroads profitable? It is a different question. The question is, can they attract adequate capital? Because we want them to be able to attract the capital to continue to expand as they have been. So what we are looking at is a little different question. What the Board does now is it calculates a cost of capital and then does a comparison be-

tween what the railroads—what their revenue is against that cost of capital. And if it is greater than the cost of capital, we would say, for that year, they are revenue adequate.

What we are also trying to determine, and one of the reasons we are going to have the hearing is if you wanted to declare a railroad revenue adequate, should they be revenue adequate for 1 year? Should it be 5 years? Should it be over some period of time? What is that period of time? And so how do we make those determinations? And then, more importantly still, I think the question on the table is, if we concluded there is a railroad that is revenue adequate, does that say anything about how they should be economically regulated? Should it change because they are now in a changed circumstance of revenue adequacy? And those are the questions we are going to be exploring in our hearing in July.

Mr. CUMMINGS. I see my time is expired.

Thank you, Mr. Chairman.

Mr. DENHAM. Thank you, Mr. Cummings.

And thank you to each of you that came to testify today. If there are no other questions, I would ask unanimous consent that the record of today's hearing remain open.

Mr. HAMBERGER. Mr. Chairman, could I possibly, at the risk of offending you, end today's hearing on an upbeat note, perhaps a kumbaya moment between Mr. Dooley and myself? You may not have noticed in this morning's Washington Post, page 11, that the plastics industry is pumping out jobs. A report coming out of the ACC today, $130 billion of investment over the next 5 years in the U.S. That is good news for our jobs. It is good news for the American economy, and I trust it is good news for the railroad because we will get more business from Mr. Dooley. But congratulations to you and your members. It is a very upbeat note and I appreciate you allowing me to put it into the record.

Mr. DENHAM. Thank you. We would ask that each of our witnesses be provided questions—unanimous consent that the record remain open for 15 days for any additional comments and information submitted by Members and witnesses to be included in today's record.

Without objection, so ordered. I would like to thank, again, each of you for being here to testify today. If no Members have anything to add, this subcommittee stands adjourned.

[Whereupon, at 12:27 p.m., the subcommittee was adjourned.]

STATEMENT OF
THE HONORABLE PETER DEFAZIO
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
SUBCOMMITTEE HEARING ON
"THE 35TH ANNIVERSARY OF THE STAGGERS RAIL ACT: RAILROAD DEREGULATION PAST, PRESENT AND FUTURE"
MAY 13, 2015

Thank you, Mr. Chairman, for holding this hearing. In 1979, the once dominant railroad industry accounted for just 36 percent of the intercity ton miles of freight – one-half of the railroads' market share 30 years earlier. As Congress debated the fate of the rail industry, 22 percent of the system was on the verge of bankruptcy and faced a capital shortfall of between $16 billion and $20 billion.

It was clear that Congress needed to act or the industry's failure to achieve increased earnings would have resulted in either further deterioration of the rail system (and safety) or the need for significant Federal subsidies.

By all accounts, the Staggers Act has been a tremendous success. The Act removed the regulatory burdens that had hamstrung the railroad industry for decades, balancing the railroads' need for market-based competition with the shippers' need for reasonable rates and service in the absence of effective competition. This balanced regulation has allowed the railroad industry to reinvest $575 billion since 1980 on improving the performance of their infrastructure and equipment. In 2015, the railroads

anticipate unprecedented spending of about $29 billion to build, maintain, and grow the freight rail network.

At the same time, the Staggers Act put in place procedures for shippers to challenge unreasonable rates at the Surface Transportation Board (STB), and forums for raising concerns about service. Over the years I have heard complaints from the forest and paper industry and others back home about delays in rail service and their need to get products to market. Most recently, those concerns have been focused on the significant increase in the shipment of crude by rail, and the impact it could have on congestion and service.

Two issues that I want to focus on today are short line investments, and my belief that the railroads should be able to charge a tariff for transporting dangerous products, whether it is coal dust or flammable or poisonous-by-inhalation hazardous materials. Under the common carrier obligation, railroads are required to transport these products but they aren't allowed to charge more to deal with the added risk or special handling that may be necessary. Railroad investments aimed at reducing accidents caused by human factors or track defects, such as positive train control, should not be diverted to address the added costs of transporting dangerous goods, which is clearly a shipper responsibility.

Unfortunately, the STB disagrees. In 2012, the Board overturned BNSF's decision to charge coal shippers along the Powder River Basin (PRB) a tariff if the shippers failed to take certain measures to mitigate the impact of coal dust on rail lines. The tariff provisions resulted from studies which demonstrated that coal dust from PRB coal destabilizes the rail bed ballast, which underlies and stabilizes tracks, more than other contaminants. While the STB recognized the dangers coal dust posed for the railroads and allowed the railroads to impose dust suppression rules on coal customers, it ruled that BNSF could not charge a fee for impacts on the railroad or its employees who were potentially harmed by exposure to the contaminants.

I disagree with that decision.

This past October, BNSF announced that it will apply a $1,000 surcharge for each older crude tank car it has to transport. The charge, which went into effect in January, adds about $1.50 a barrel to the cost of transporting oil. I understand shippers oppose the charge. From my standpoint, the railroads have implemented extensive measures to reduce risk in the transportation of crude by rail, from re-routing trains to slowing traffic on the system to investing in more resources for emergency response and training. They should be able to charge fees to offset those costs rather than divert them from needed infrastructure and technological improvements. Again, if they are forced to ship it, they should be able to

charge for it. I think this issue is something we should address in any STB or hazmat reauthorization bill the Committee plans to consider this Congress.

With respect to short line investments, in 2007, the Coos Bay Line in my District was embargoed by the Central Oregon and Pacific Railroad, which was owned at the time by a holding company called RailAmerica. The railroad gave less than 24 hours notice to shippers and industry along the south coast of Oregon that it would be shutting down the line due to unsafe tunnel conditions, resulting in the immediate loss of hundreds of jobs and leaving shippers suddenly without a viable way to get their goods to market for months.

At my request, the Federal Railroad Administration (FRA) inspected the tunnels and confirmed that the line had been allowed to deteriorate for about a decade to such a degree that repairs were necessary before safe operations of the line could resume. Soon after, I secured funding to help the Port purchase the rail line and rehabilitate and repair it, and I worked with the STB to resolve issues with the carrier. However, the events that led to the embargo raise significant concerns over the financial stability of short line railroads, the state of their infrastructure, and the role of these holding companies.

The Staggers Act encouraged the sale of light-density lines, rather than their abandonment, to preserve rail service. In the decade following Staggers, more than 250 short line railroads were formed. Today, there are more than 560 short line railroads operating in the U.S., **but 27 holding companies control almost one-half of these railroads.**

In October 2014, the FRA published a report on the capital needs of short line railroads which found that, while holding companies reduce the risk associated with lending capital, funding that is available, "must be thinly spread among all carriers under their control in order to meet current and ongoing needs," including track to handle 286,000-pound loads and bridges. Moreover, the FRA estimates that the overall total investment needs are about $6.9 billion. We need to work together to find ways to address this critical need.

I look forward to hearing from the witnesses on these and other issues.

TESTIMONY OF DEB MILLER

ACTING CHAIRMAN, SURFACE TRANSPORTATION BOARD BEFORE THE SUBCOMMITTEE ON RAILROADS, PIPELINES, AND HAZARDOUS MATERIALS

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

THE 35TH ANNIVERSARY OF THE STAGGERS RAIL ACT: RAILROAD DEREGULATION PAST, PRESENT, AND FUTURE

Good morning Chairman Shuster, Ranking Member DeFazio, Subcommittee Chairman Denham, and Subcommittee Ranking Member Capuano, and Members of the Subcommittee. My name is Deb Miller, and I am Acting Chairman of the Surface Transportation Board (STB or Board). This is my first appearance before the Subcommittee since becoming a Member last April. Thank you for this opportunity to appear before this Subcommittee on the 35th anniversary of the Staggers Act.

Let me begin my testimony with a history of how the Board came to regulate under the Staggers Act, and an overview of its responsibilities.

AN EVOLUTION OF REGULATION

The Interstate Commerce Commission, the Board's predecessor agency, was the first Federal regulatory agency, created in 1887 with the passage of the Interstate Commerce Act. The ICC was charged with closely regulating shipping rates and preventing price discrimination by interstate railroad carriers.

In 1920, Congress amended the Interstate Commerce Act in ways that changed the regulatory regime for the railroad industry. Although the ICC was already regulating the railroads, this law gave the ICC more authority and brought more functions under its purview. With this expanded regulatory mission, the ICC grew into a massive agency, with 2,900 employees at its peak at its headquarters and field offices all across the U.S.

In some ways this expanse of power would be the ICCs undoing. By the late 1960s, the railroad industry was in decline. The causes were numerous. There were economic factors, such as the creation the interstate highway system, which in turn led to the rise of the trucking industry. Other modes of transportation, such air travel, and energy pipelines, also grew. These new modes of transportation severely diminished the railroads' market share for the movement of goods and people.

But another major contributing factor to the industry's decline was excessive regulation. Many of the regulations in place at the time did not give the railroads sufficient flexibility to manage their business in this new competitive environment, and were oftentimes burdensome and byzantine. In particular, railroads had very little pricing flexibility and thus could not adapt to the changing market conditions. If a railroad wanted to change its rate to compete with trucking companies for a customer's business, it had to obtain permission from the ICC. These rate adjustment proceedings, which could take years, often led to a determination that the railroad could not lower its rate because the rate would be out-of-line with the rates charged to similarly- situated traffic. As a result, the railroad was often forced to keep in place a rate that was not at all based on the demand for that particular traffic.

By the early 1970s, this excessive and outdated regulation scheme had contributed to the financial ruin of many railroads. Many were in bankruptcy and those that were not often did not have sufficient revenue to maintain their lines, resulting in deterioration of the physical network. In the most extreme cases, the steel rails had been so poorly maintained that they collapsed under the weight of the trains (these were called "standing" derailments). The situation got so perilous that there was talk of nationalizing the railroad industry.

In response, Congress passed a series of laws aimed at deregulating the industry, in what many considered a last-ditch attempt to save it. First, Congress passed what is commonly known as the 3-R Act in 1973, in which seven bankrupt railroads were ordered to be merged into one surviving entity that became the Consolidated Railroad Corporation, better known today as Conrail. A few years later, in 1978, Congress continued on the de-regulatory path by passing the 4-R Act,

which introduced some relatively modest de-regulatory measures. But the most significant step occurred in 1980, when Congress passed the Staggers Act.

The Staggers Act greatly reduced the federal regulatory role in regulation of the freight railroad industry. Notably, the Staggers Act allowed railroads to more easily abandon unprofitable lines, which in turn allowed them to spend their limited resources on those lines that were more vital to their survival. After passage of Staggers, the size of the railroad network went from 270,623 miles of track in 1980 to 162,306 miles of track in 2012. Although today the railroads might like to have back some of the lines that they abandoned, overall this reduction in the size of the network was positive in that it led to a more manageable rail network.

Another significant aspect of the Staggers Act was that it made it easier for railroads to merge. This led to significant consolidation in the industry. Some would argue that the consolidation eventually went too far, but in the immediate aftermath of Staggers, the result was clearly positive, as these mergers resulted in some parts of the network that might have otherwise been liquidated through bankruptcy to survive.

From the ICC's perspective, one of the most important changes made by Staggers was that it gave the agency "exemption" authority. Under this authority, the agency could exempt transactions from the normal and cumbersome approval processes if the transaction was limited in scope and regulation was not necessary to advance the national Rail Transportation Policy. If some transactions were routine and noncontroversial, the ICC had the authority to approve them quickly. This not only allowed the railroads to start making quicker business decisions, but reduced the regulatory burden on both them and the agency.

This exemption authority is still central to the STB's regulatory scheme. The Board has created a series of "class" exemptions, in which transactions that meet specific criteria can obtain necessary Board authorization through a notice; if no objections are submitted, the authorization becomes effective automatically. The majority of Board approvals are obtained using these class exemptions.

The most significant impact on railroads made by Staggers was that it gave the railroads greater pricing freedom. There were a number of different components to this pricing freedom. First, railroads were allowed to engage in differential pricing, meaning that they could charge different shippers different rates, depending on the demand for that traffic. Although this meant that some shippers –those that are captive to the railroad – would be charged higher rates, it also meant that railroads could offer lower rates to win the business of those shippers that did have other transportation options. Differential pricing enabled the railroads to capture revenues from new customers – revenues that helped cover the railroad's costs of operating and maintaining their networks. With an improved network and more reliable rail service, Staggers can be said to have benefitted all rail industry stakeholders, even those captive shippers forced to bear the costs of the higher rates.

The second element to the pricing freedom granted to the railroads under Staggers was the elimination of the ICC's ability to judge the reasonableness of rates where there was effective market competition. Under Staggers, a shipper could not challenge the reasonableness of a rate, unless it exceeded a specific threshold revenue-to-variable-cost (R/VC) ratio (which today is set at 180%) and the shipper lacked other viable options for moving its product. This gave railroads an incentive to offer lower rates where they could. It also ensured that the ICC would only become involved in situations where shippers were truly captive to the railroad.

Lastly, the Staggers Act granted the railroads greater pricing freedom by allowing them to enter into contracts. Prior to Staggers, all rates were set forth in tariffs, which were filed with the ICC and made publicly available. The railroads could not charge rates that differed from these tariffs and, as noted, could only modify their tariffs with permission from the ICC. This meant that the tariff rate applied to all shippers, even though that rate might be too high to attract a customer's business. With contracting authority, railroads could privately negotiate lower rates for individual customers, often in exchange for guaranteed volumes. This ultimately resulted in more consistent revenue streams, which gave the carrier's enough financial stability to make long-term investments that had been lacking prior to Staggers. In addition, Staggers permitted the railroads to keep these contracts confidential, which further helped in their negotiations with individual customers.

Since passage of the Staggers Act, the railroad industry has become more efficient, productive, and profitable. There has been a significant consolidation of Class I railroads and the development of an expansive short line railroad industry. Staggers opened a pathway that reversed the rail industry's declining health, leading to what some call a "rail renaissance." (See Appendix A for various data demonstrating the increased financial health of the railroad industry since the passage of Staggers.) In 1995, Congress sunsetted the ICC and created the Surface Transportation Board through the ICC Termination Act of 1995 (ICCTA).

WHAT DOES THE STB DO?

The Board's core mission remains the same as the mission set for the ICC in 1887: to serve as the economic regulator for the freight railroad industry. While the vast majority of the agency's work involves economic regulation of the freight railroads, the STB also has limited oversight of pipeline carriers, intercity bus carriers, moving-van companies, trucking companies, and water carriers engaged in the non-contiguous domestic trade. In addition, the Board has limited but important regulatory authority involving Amtrak. Our authority has been expanded recently by the Passenger Rail Investment and Improvement Act of 2008 (PRIIA). However, the Board's duties pertaining to freight railroads take up most of its attention.

While the Board is administratively housed within the U.S. Department of Transportation, the STB is a bipartisan, decisionally-independent regulatory agency. The Board is composed of three members – although we currently have only two members – nominated by the President and confirmed by the Senate for five-year terms. The Board's chairman is designated by the President among the three members. Assisting the Board in carrying out its responsibilities is a staff of approximately 140 employees, with extensive experience in economics, law, accounting, transportation analysis and logistics, environmental matters, finance, and administration.

The agency's mission is governed by the principles established in the Staggers Act. The Board is charged with promoting an efficient, competitive, safe and cost-effective rail network by enabling railroads to earn adequate revenues that foster reinvestment in their networks, attract outside capital, and provide reliable service. At the same time, the Board is also mandated with working to ensure that effective competitions exists between railroads and to maintain reasonable

rates where there is a lack of effective competition. As a Board Member, my job is to strike a balance between these shipper and railroad interests. While those interests are inextricably woven together, they can also diverge. The STB works very hard to take measured actions that are in the spirit of Staggers, and we are acutely aware that every decision we issue impacts real people and real businesses.

The Board's regulatory mission can essentially be broken down into three categories of activity: adjudications, licensing, and data collecting.

Under its governing statutes, the Board adjudicates disputes between shippers and railroads on the reasonableness of carriers' rates and service practices. In some instances, the Board also adjudicates disputes between the carriers themselves, or between railroads and local communities in which their lines are located. In this adjudicatory capacity, the Board functions like a specialized court (with the Board Members serving as the "judges"), following many of the same protocols and procedures that would be used in a court setting. The Board does not have the authority to initiate adjudicatory proceedings on its own. Rather, the Board can only rule on a matter if it is brought by the filing of a formal complaint.

The most controversial and high-profile adjudications at the Board involve railroad rates. In these cases, shippers try to demonstrate that the rate they are being charged is unnecessarily high. Aside from rate complaints, other issues that are often the subject of complaints include the common carrier obligation (whether a railroad is required to provide service to a shipper and what that level of service should be); unreasonable practice (whether a requirement being imposed on shippers by a rail carrier is fair); and Federal preemption (whether an attempt by a local or state government to regulate a railroad conflicts with the Board's jurisdiction). The Board was given the role of adjudicator in railroad disputes because of the subject matter expertise in economics and railroad operations that are often needed to reach a fair and equitable solution.

Licensing is the second major activity performed by the Board. In order to ensure that railroads are not engaging in transactions that could result in excessive market power, competitive abuse, or a deterioration of rail service, the Board must approve any entry to, exit from, or

consolidation within, the transportation market. Accordingly, the Board must approve any requests by rail carriers to purchase, construct, or operate over lines; to merge or enter into corporate affiliation arrangements; or to abandon lines that they no longer wish to operate. For the most part, these transactions are not controversial and, as noted, the railroads obtain approval for the majority of these transactions using the Board's class exemption processes. However, in those cases where there is concern from shippers, the Board studies the possible effects of the transaction to ensure that it is in the public interest.

The third major aspect of the Board's mission is data collection. In order to assess the state of the railroad industry, the Board requires rail carriers to submit various economic reports and data. The Board then takes most of this information turns it into tools that it uses for regulatory purposes, or that it makes available to the public for their own uses. Most notably, the Board requires the Class I carriers, to submit an annual accounting report (called an R-1). The Board also collects a sample of waybills, which are documents generated for all rail shipments that contain information about the particular shipment, including origin; destination; carrier; and amount paid. This data is used to analyze traffic flows and trends in pricing for specific commodities. The Board also uses the waybill data and R-1 information to generate its Uniform Rail Costing System (URCS), which is a tool that estimates a railroad's costs for specific shipments. Finally, the Board produces an inflationary index of railroad costs called the Railroad Cost Adjustment Factor (RCAF) on a quarterly and annual basis.

LIVING THE STAGGERS ACT: THE WORK OF THE BOARD

This hearing is particularly timely for me as the Acting Chairman of the STB. Just as the Subcommittee is surveying the last 35 years of the Staggers Act, the Board is in the process of evaluating many of our economic regulatory practices to determine if they are appropriate for today's rail industry. Many of the STB's policies originate from the start of Staggers when the railroad industry was in dire financial straits. But the environment in which Staggers was passed is much different from today's world. The railroad industry is no doubt stronger, more productive, and financially sound, while shippers' needs and have evolved. As regulators, an assessment of our practices derived from the Staggers Act is necessary to ensure their relevance to today's rail industry.

Grain Rates. On May 8, 2015, the Board announced that it will be conducting two very significant hearings. First, the Board will hold a hearing on June 10, 2015, to examine whether our rate case methodologies are sufficiently accessible for grain shippers. No grain shipper has brought a rate complaint before the agency since 1981. The Board requested comments from our stakeholders over a year ago to hear their views on why this is the case. Many of our stakeholders offered interesting comments. I look forward to be able to have a face-to-face dialogue with our stakeholders about this issue.

Revenue Adequacy. The second hearing the Board will be holding will explore issues pertaining to the concept of Revenue Adequacy, on July 22-23, 2015. Revenue Adequacy is an economic concept that describes whether a carrier is earning sufficient revenue to cover its costs and earn a reasonable return sufficient to attract capital. The Board makes a determination annually to see if the Class I railroads are revenue adequate for that year. The agency does so by comparing the Class I railroad's return on investment to the rail industry's cost of capital for that year. The ICC held that if a railroad is revenue adequate over a period of years, a shipper could argue that the railroad does not need to continue charging it such high rates.

However, the ICC did not further specify over what period of time a railroad needed to be revenue adequate. The ICC specifically stated that the fact that a railroad is found revenue adequate in a particular year does not make it revenue adequate for the purposes of being subject to a rate challenge; rather, it has to be an undefined period of time. Nor did the ICC specify any methodology for determining whether a rate charged by a revenue adequate railroad is reasonable. However, the Board is beginning to see that some of the Class I railroads are becoming revenue adequate across consecutive years. (See chart in Appendix B for the Board's annual revenue adequacy determinations dating back to 2000.) Accordingly, the filing of challenges to rates on the basis of revenue adequacy is now a real possibility.

Due to these unresolved issues, the Board last April invited public comment on what it means to be revenue adequate and how such a finding should impact the railroads; and how to apply

the revenue adequacy constraint in regulating rates, among many other issues. At the hearing, we plan to discuss the parties' views on these matters.

Reciprocal Switching. The Board also has another major proceeding that has been pending before us for some time. It involves competitive access, or more specifically, the concept of reciprocal switching. "Reciprocal switching" refers generally to arrangements between railroads where one railroad that exclusively serves a facility agrees to provide switching services for another carrier, usually for a flat switching fee. These reciprocal switching agreements create rail-to-rail competition by permitting a competing railroad to offer its own single-line rate, even though it cannot physically serve the shipper's facility.

The National Industrial Transportation League (NIT League) presented the Board with a proposal for increased use of reciprocal switching. Under its current rules, the Board can only order reciprocal switching if a shipper shows that its serving rail carrier has engaged in anticompetitive behavior. The NIT League proposal would change this so that a shipper would be entitled to a presumption in favor of reciprocal switching if there is a reasonable interchange within 30 miles of the shipper's facility (or within a defined switching district) and if: a) the revenue to variable cost ratio is 240% or b) the railroad handled 75% of the shipper's traffic for the past year.

I regret to say that this proceeding has been pending at the Board for far too long. The Board asked for extensive data about the impact the proposal would have on the industry back in July 2012. Despite the fact that our stakeholders spent significant resources to provide the Board with this requested information, it has not acted. The Board owes them a decision on what it plans to do with the proposal. Given the overlap between the issues raised by NIT League's proposal and the comments we received in our grain rates and revenue adequacy proceedings, my goal after our hearings this summer is for the Board to issue a package of proposals on many, if not all, of these matters.

Rate Cases. The Board is also examining our method for regulating railroad rates. It is well-known to our stakeholders that our current process, known as the Stand-Alone Cost test, is cumbersome and expensive. Under the SAC test, a shipper must demonstrate that if a competing

railroad entered the market, it could offer the same level of service, cover all of its costs, and still earn a reasonable return on investment, for a price less than what the defendant railroad is charging. Although I believe that the test is based on sound economic principles, it is the execution that creates difficulty, as the process of designing a hypothetical railroad is a herculean task.

The Board is aware of this reality and has taken some steps to address the concern, but more needs to be done. As noted, the Board will have a hearing in June to examine whether agricultural shippers have meaningful access to the Board's rate reasonableness process. We are asking for input from interested parties on the ability of grain shippers to effectively seek relief from unreasonable rates, including proposals for modifying existing procedures, or new ones altogether.

Additionally, in response to the increasingly complicated rate cases that are being filed before the agency, last year (at the direction of former Chairman Dan Elliott) the Board initiated two studies to be performed by outside consultants to try to improve the rate case process. First, the Board engaged an independent firm to study the wide variety of rate reasonableness methodologies used in other industries and throughout the world. We are hopeful that the results of this study will provide new ideas for methodologies that could be instituted to decide whether a rate is reasonable or not. Second, the Board hired a consulting firm to examine the Board's internal processes for deciding rate cases. Over the last few years, rate cases have increased in scope and complexity, putting a greater strain on Board staff and resources. The consultant was tasked with studying our internal process and offering recommendations on how the process could be streamlined so that cases are processed more efficiently, quickly, and accurately.

Rail Service. I want to focus on one of the most important issues the Board has dealt with over the last year and a half, and that is consistent and reliable rail service. As I was settling into my new role as a Board Member, changing traffic patterns, demands on service, a bumper grain harvest and frigid weather descended upon the railroads and shippers in the Winter of 2013-2014 in ways that no one anticipated. Service deteriorated across the rail network. Chicago, the epicenter of railroading, was frozen solid. If there was an opportunity for heavy-handed regulatory action, this was it. Instead, the Board responded through a balanced approach consistent with the underlying framework of the Staggers Act. The Board was vigilant, looking for ways to assist

shippers and railroads to keep their commodities moving under circumstances that at times seemed impossible. At the same time, we were cautious against heavy-handed regulatory actions that would retard, rather than promote the railroads' recovery efforts and further destabilize the market.

The Board Members met with railroad executives regularly and engaged in weekly check-ins and traffic data reviews. When shippers' concerns arose that fertilizer would not make it into the ground in time for planting season, the Board issued a weekly monitoring order to ensure that railroads delivered the product in time. In the same vein, the Board ordered two Class I railroads to file weekly reports on their service to the agricultural community in the upper Midwest. As a result, we saw measured and steady improvement in service to this sector, as the two carriers significantly reduced their backlog of outstanding orders. In response to concerns from coal fired electric utilities, we required a major carrier of western coal to describe in detail its plans and processes for responding to acute coal shortages that could potentially threaten reliable generation. Shipper demand in our multiple hearings and field meetings for transparency in information led to a data order on all Class I railroads.

Based on the information that the Board has been receiving, rail service seems to have improved significantly. As a major step towards improving the Board's ability to monitor potential service issues, we issued a Notice of Proposed Rulemaking that, if adopted, would require the railroads to permanently report data on service performance. The information that we have tells me that rail service has improved since 2013-2014, and that Class I carriers are making steady gains in their service metrics and our shippers are generally reporting better rail service. We believe that our actions in the past year were consistent with Congressional policy, as reflected in the Staggers Act.

Amtrak and Passenger Rail. The Staggers Act did not generally impact the Board's role in regulating Amtrak and passenger rail; rather, the Board's responsibilities in that area derive from other laws, such as PRIIA. However, in carrying out these responsibilities, I believe that the Board must take the same view as it does in applying Staggers; we must try to balance the needs of the freight carriers against those of its customer – in this case, that customer being passenger rail carriers (such as Amtrak) who operate over the freight carrier's track. Although the passenger rail

carriers are admittedly a different type of customer, many of the lessons learned in how to balance the needs of freight carriers and shippers can be applied in this context as well.

Board Processes. The Board is also taking a hard look at its processes to ensure that they are fair, timely and accessible. I know that the industry is frustrated with our pace in processing cases, and I assure you that this is something I have been paying particular attention to since my first week at the Board.

Another major step in the right direction has been the Board's recent engagement of administrative law judges at the Federal Energy Regulatory Commission. This will facilitate more efficient and effective resolution to discovery disputes, thereby enabling our small staff to focus on the substantive issues in our proceedings.

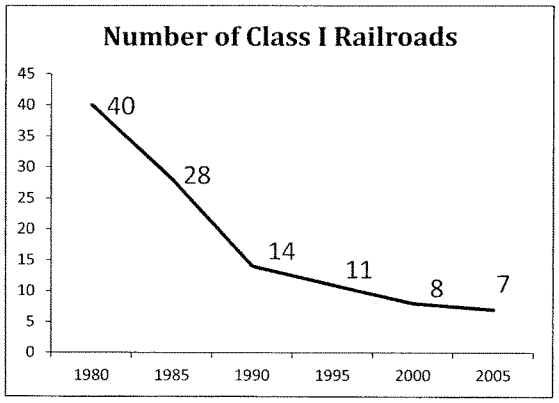
The fact that the Board has initiated these reviews does not mean reregulating or tipping the scales to favor one industry stakeholder over another. Rather, it is to make sure that the Board is utilizing its authorities and executing its responsibilities thoughtfully and in a relevant way to provide the maximum benefit to the public. That means shippers, railroads, the communities the rails run through, citizens who work in the plants and factories out of which commodities are shipped, and government on all levels.

CONCLUSION

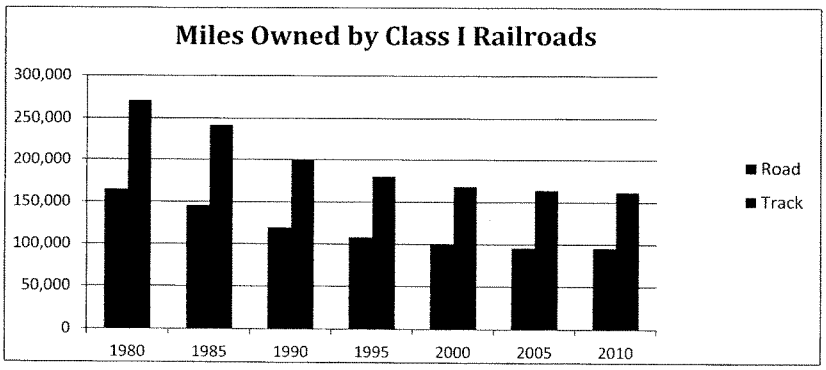
I hope my testimony has provided you with an understanding of how economic rail regulation has evolved over the years, and the types of matters we are handling at the Board. The Staggers Act has been beneficial to stakeholders in the rail industry and the Nation at large for 35 years. Now decades from the original passage of Staggers, and now facing a different rail landscape, the Board looks forward to continuing our balanced approach of regulation under its framework.

APPENDIX A

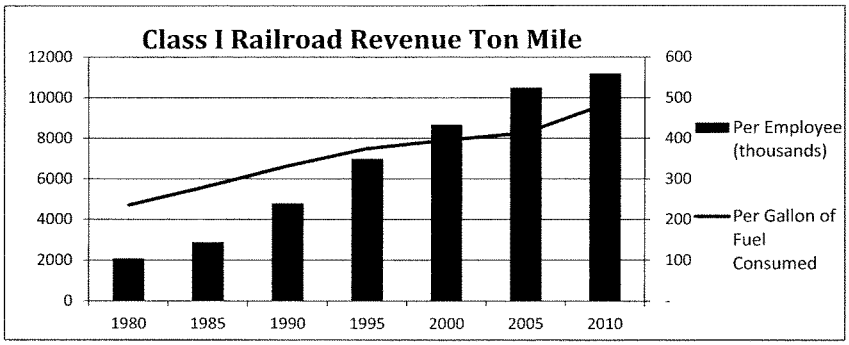
As noted, the Staggers Act reduced the regulatory barriers to railroad mergers, which (as this chart shows) resulted in significant consolidation within the railroad industry. From 1980 to today, the number of Class I carriers has decreased from 40 to seven.



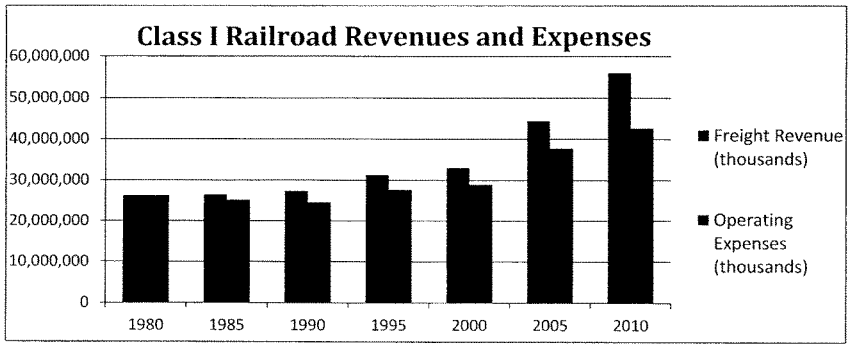
One of the benefits of the Staggers Act was that it allowed the railroad industry to more easily dispose of unprofitable lines. As seen below, the size of the rail network has significantly decreased since the passage of Staggers.



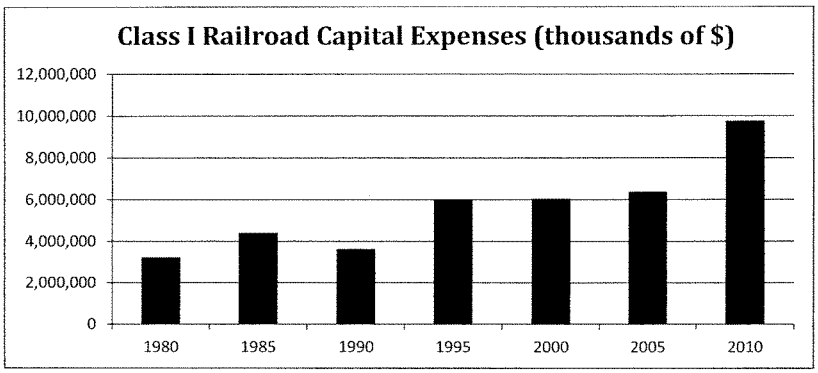
The reforms instituted by the Staggers Act increased the railroad's efficiency, as the chart below demonstrates. After passage of Staggers, the railroads significantly increased the revenue earned per ton-mile (i.e., the amount earned from moving a single ton a single mile).



Another indication of the success of the Staggers Act is the fact that railroad industry's revenues have increased at a greater pace than expenses.



The increased revenue that the railroads began to earn after passage of Staggers enabled the industry to invest back into its system. Since Staggers, the amount spent on capital expenses has increased every year. This year, the railroad industry is expected to invest more than $25 billion.



APPENDIX B

STB's Annual Revenue Adequacy Determinations (2000 – 2013)

Year	Industry Cost of Capital	BNSF Railway	CSX Transp. Inc.	Grand Trunk Corp. (CN)	KCS Railway	NS Railway	Soo Line Railroad (CP)	Union Pacific
		Based on Individual Railroad's Return on Investment						
2013	11.32%	**14.01%**	10.00%	**11.84%**	8.67%	**12.07%**	**12.03%**	**15.39%**
2012	11.12%	***13.47%**	10.81%	10.19%	9.54%	**11.48%**	5.15%	**14.69%**
2011	11.57%	***12.39%**	11.54%	8.74%	10.76%	**12.87%**	7.13%	**13.11%**
2010	11.03%	*10.28%	10.85%	9.21%	9.77%	10.96%	8.01%	**11.54%**
2009	10.43%	8.67%	7.30%	6.04%	6.51%	7.69%	6.28%	8.62%
2008	11.75%	10.51%	9.34%	9.89%	7.72%	**13.75%**	9.29%	10.46%
2007	11.33%	9.97%	7.61%	10.11%	9.37%	**13.55%**	**15.25%**	8.90%
2006	9.94%	**11.43%**	8.15%	9.47%	9.31%	**14.36%**	**11.60%**	8.21%
2005	12.19%	9.76%	6.23%	8.07%	5.89%	**13.21%**	8.89%	6.34%
2004	10.11%	5.84%	4.43%	5.95%	8.30%	**11.64%**	3.28%	4.54%
2003	9.40%	6.2%	4.0%	4.5%	3.7%	9.1%	0.9%	7.3%
2002	9.75%	6.4%	5.2%	3.1%	6.5%	9.1%	5.7%	8.6%
2001	10.19%	7.1%	4.6%	4.9%	7.0%	8.3%	5.9%	7.6%
2000	11.03%	8.8%	3.6%	5.9%	6.3%	5.5%	5.6%	6.9%

Bold indicates year in which railroad was Revenue Adequate

* indicates that figure was revised from original calculation, based on decision in FD-35506 (July 25, 2013

Committee on Transportation and Infrastructure
U.S. House of Representatives

Bill Shuster
Chairman

Washington, DC 20515

Peter A. DeFazio
Ranking Member

Christopher P. Bertram, Staff Director

Katherine W. Dedrick, Democratic Staff Director

June 8, 2015

The Honorable Debra Miller
Acting Chairman
Surface Transportation Board
395 E. Street, SW
Washington, D.C. 20423

Dear Ms. Miller,

Thank you for your testimony before the Subcommittee on Railroads, Pipelines, and Hazardous Materials on May 13, 2015, concerning "The 35th Anniversary of the Staggers Rail Act: Railroad Deregulation Past, Present, and Future." I am pleased you appeared and testified on behalf of the Surface Transportation Board. The Subcommittee gained valuable insight from the information you provided at the hearing.

Enclosed please find additional questions for written responses for the record. The Subcommittee appreciates your written responses no later than June 22, 2015. Please provide an electronic version of your response via email to George.riccardo@mail.house.gov.

If you have any questions please contact Mike Friedberg of the Subcommittee at (202) 226-0727.

Sincerely,

Jeff Denham
Chairman
Subcommittee on Railroads, Pipelines, and
Hazardous Materials

Enclosures

Committee on Transportation & Infrastructure

Republican Questions for the Record

Question for Chairman Miller

In Mr. Dooley's written testimony, he explained that "Consolidation has reduced the number of Class I railroads from 26 in 1980 to only seven today, with four essentially operating like regional duopolies that control 90 percent of the market." By statute the Surface Transportation Board, depending on the type of consolidation, merger, or acquisition transaction, must take into account the effects of the transaction on competition among rail carriers, often resulting in mitigation measures to ensure there is no lessening of shippers' access from two rail carriers to one rail carrier and/or from three rail carriers to two rail carriers. Please identify for the record:

- Any consolidation, merger, or acquisition transaction that left a shipper without access to the same number of rail carriers that it had prior to the transaction;
- The shipper and its geographic location that had its access to a rail carrier reduced by the transaction; and
- The railroad to which that shipper had access prior to the transaction but due to the transaction lost such access.

Deb Miller, Acting Chairman
Surface Transportation Board
Response to Republican Questions for the Record
June 18, 2015

Question:

In Mr. Dooley's written testimony, he explained that "Consolidation has reduced the number of Class I railroads from 26 in 1980 to only seven today, with four essentially operating like regional duopolies that control 90 percent of the market." By statute the Surface Transportation Board, depending on the type of consolidation, merger, or acquisition transaction, must take into account the effects of the transaction on competition among rail carriers, often resulting in mitigation measures to ensure there is no lessening of shippers' access from two rail carriers to one rail carrier and/or from three rail carriers to two rail carriers. Please identify for the record:

- Any consolidation, merger or acquisition transaction that left a shipper without access to the same number of rail carriers that it had prior to the transaction;
- The shipper and its geographic location that had its access to a rail carrier reduced by the transaction; and
- The railroad to which that shipper had access prior to the transaction but due to the transaction lost such access.

Answer:

When two or more Class I rail carriers seek to consolidate, they must obtain prior STB approval. Under the public interest standard of 49 U.S.C. 11324, the Board must consider, among other things, whether the proposed transaction would have an adverse effect on competition among railroads. In approving a transaction as consistent with the public interest, the Board may impose conditions to mitigate potential adverse competitive effects.

Since passage of the Staggers Act in 1980, the Board (or, earlier, the Interstate Commerce Commission) authorized, as consistent with the public interest, a number of large mergers, including: the acquisition by Burlington Northern of the Atchison, Topeka & Santa Fe (the BN/SF merger) in 1995; the acquisition by Union Pacific of Southern Pacific (the UP/SP merger) in 1996; the joint acquisition and division of Conrail by CSX and Norfolk Southern (the Conrail transaction) in 1998; and the acquisition of the Illinois Central by the Canadian National (the CN/IC merger) in 1999.

The agency's reasoning for approving each of these mergers was case-specific, but in each case, the agency specifically addressed the potential anticompetitive impacts. (It should be noted that the agency denied merger authority in the proposed Southern Pacific/Sante Fe transaction in 1986 when it found the transaction not to be consistent with the public interest because of concerns regarding anticompetitive impacts.) To mitigate potential anticompetitive impacts, in approving mergers, the agency has imposed conditions to ensure that no shipper that had previously had physical access to two railroads would become captive to a single railroad (called a "2-to-1" shipper).

However, the agency generally has not imposed mitigation when the number of railroads serving a shipper would, through the merger, be reduced from three carriers to two (called a "3-to-2" shipper), based on the agency's case-specific findings that access to two railroads would still provide sufficient to competition post-merger. Nor has the agency imposed conditions to mitigate reductions in service that were not caused by the merger at issue. Because the agency generally has not imposed mitigation for "3-to-2" shippers in its merger approvals, the Board does not have evidence of each instance in which a shipper's access may have been reduced from three carriers to two. However, by imposing mitigation that preserves access to two carriers at all 2-to-1 points in all consolidations, mergers, or acquisition transactions, no shipper should have become captive as a direct result of any of the agency's merger approvals.

Written Statement of
Cal Dooley
President and CEO
American Chemistry Council

Representing
The American Chemistry Council

Before the
United States House of Representatives
Transportation and Infrastructure Committee
Subcommittee on Railroads, Pipelines, and Hazardous Materials

Regarding a Hearing on
"The 35th Anniversary of the Staggers Rail Act: Railroad Deregulation Past, Present, and Future"

May 13, 2015

My name is Cal Dooley. I am the President and CEO of the American Chemistry Council (ACC), the national trade association representing chemical manufacturers in the United States. I am testifying today on behalf of our member companies and the nearly 800,000 men and women who make up America's business of chemistry.

First, I would like to thank Chairman Denham and Ranking Member Capuano for holding today's hearing on this important subject.

It is said that the railroads are the backbone of the U.S. economy. With 96 percent of all manufactured goods touched by the business of chemistry, our industry is certainly at the heart of the U.S. economy as well. Both of our industries are vital to the economic health of the nation, and the success of our industries share a strong link.

The chemical industry is one of the largest customers of the U.S. freight rail system. Thanks to the shale gas revolution, our industry is projected to grow significantly in the coming years, with more than $140 billion in new factories, expansions, and restarts already announced, meaning that our reliance on the rail system will only increase in the future.

Because of the growing importance of freight rail issues, ACC has joined with 47 other groups in a newly formed Rail Customer Coalition (www.freightrailreform.com). The Coalition represents a wide range of U.S. manufacturing, agricultural, and energy interests who are working together on freight rail issues that are of strong interest to our industries.

Collectively, the Rail Customer Coalition members represent industries that provide 4.7 million jobs, contribute $2.4 trillion in economic output, and comprise the bulk of freight rail customers. Members of the coalition include trade groups representing automobile manufacturers, farmers, steel manufacturers, investor-owned electric companies, and rural electric cooperatives, among others.

I appreciate the invitation to be here today to discuss how we can work together to continue the progress achieved under the Staggers Rail Act of 1980 and how we can move our nation's freight rail policies forward.

This important law, which deregulated the freight rail industry, made many changes that have helped restore the health of the railroads and their ability to serve their customers.

The Staggers Rail Act has been successful in many ways, but the freight rail service landscape has changed dramatically since its passage. Consolidation has reduced the number of Class I railroads from 26 in 1980 to only seven today, with four essentially operating like regional duopolies that control 90 percent of the market.

Today, more than three-quarters of U.S. rail stations are served by only one rail company, leaving customers captive to a single freight rail provider with no alternative if service or rates are unsatisfactory.

Under the Act, Congress created the Surface Transportation Board (STB) and tasked the Board with fostering a healthy and competitive freight rail system. Efficient rail service; reasonable shipping rates; and when necessary, a timely, effective, and equitable way to resolve disputes

between freight rail companies and shippers are critical to our success. However, a review of the facts suggests that the STB has been unable to live up to its task.

A recent survey of ACC members found that rail issues factor heavily into domestic investment decisions. In fact, more than a quarter of ACC members report that rail transportation issues have hindered domestic investments.

New economic analysis of publicly available data from the railroad industry shows that rail rates have increased more than 98 percent over the past decade, about three times the rate of inflation. ACC recently commissioned a study (summary attached) to explore the full economic impact of these increases. The study found that in 2013, 67 percent of all rail rates exceeded 180 percent of the railroad's revenue-to-variable cost (RVC) for that movement. The RVC ratio is an important measure because any rate greater than 180 percent RVC could be subject to STB review for potentially being unreasonably high. Commodity shippers paid total premiums of more than $19 billion for rates above this 180 percent RVC threshold.

Many rates were even higher. In fact, a quarter of rail rates exceeded 300 percent RVC.

This growing premium is forcing shippers to divert significant resources from research and development, operations, investment, expansion, and hiring to pay extremely high rail shipping rates.

As the title of this hearing notes, it has been 35 years since Congress passed the Staggers Act. Furthermore, the STB hasn't been reauthorized since it was created 1995 and could benefit from an update to help better equip the Board to handle today's challenges.

ACC and the Rail Customer Coalition are urging Congress and the STB to modernize the Board's approach for tackling key issues, including the following:

- **Enhance the Efficiency of the STB:** The Board should be able to take a more proactive role to address issues, and the STB Commissioners should be able to directly communicate with each other. The Board should have adequate resources and staff to fulfill its statutory mission.
- **Reform Rate Bundling Protections:** The STB should deter practices that use an "all or nothing" approach to contracting rail rates. It should actively review whether or not the "bundling" of contract proposals for multiple rates is used to undermine a shipper's ability to challenge unreasonable rates. The Board should prevent such abusive practices from occurring.
- **Close Rate Review Loopholes:** The STB should eliminate outdated exemptions and allow shippers to seek review of unreasonable rates for shipping certain products such as automobiles, food, lumber, and metals. The Board should no longer automatically assume that shippers of these products have access to competitive service. It should review rate review exemptions and eliminate those that no longer make sense.
- **Allow Competitive Switching:** Market forces should have a greater influence over rates by increasing rail-to-rail competition through competitive switching. The STB should permit shippers to have their freight moved to a competing rail line if another Class I railroad is reasonably accessible. The Staggers Rail Act envisioned competitive

switching, but it has never been allowed at the STB because of a decision made in the mid-1980's that effectively precludes its use by shippers.

- **Update Rate Review Standards:** The STB should implement a more efficient, workable method to review and determine the reasonableness of freight rail rates for captive shippers that accounts for the dramatic changes in the railroad industry. The STB should recognize that railroads are financially sound and adopt a simpler and fairer standard for reviewing rates.
- **Provide Arbitration as an Option to Streamline Rate Reviews:** The STB should allow an alternative means to resolve rate disputes through a third party arbitrator. The Board should create a process that would allow shippers and the railroads to each present a final proposal for the rate in dispute. At the end of the process, the arbitrator must choose one of these proposals—giving each side the incentive to work towards a fair and practical solution.

A healthy, efficient, and affordable freight rail system is essential to the success of the chemical industry, many other manufacturers, and the U.S. economy overall. We firmly believe that greater competition and a more equitable approach to resolving rate disputes are not mutually exclusive with a thriving, profitable freight rail system.

Thanks to the sensible reforms of the Staggers Act, the railroads are no longer in dire straits and now are financially sound. No one wants a return to the pre-Staggers era and the policies that hobbled the freight rail system. However, it is clear that we are once again at an important juncture and the status quo is no longer working. It's time for change.

Over the past few years, the STB has made some changes to its policies, but they have not gone far enough to resolve many of the ongoing problems. Every policy reform we support is consistent with the policy goals set forth by the Staggers Rail Act. We want to move things forward so we can allow the market and the STB to operate more effectively.

The Rail Customer Coalition supports the proposal crafted by Senate Committee on Commerce, Science, and Transportation Chairman Thune and Ranking Member Nelson that reflects the input of numerous stakeholders and responds to the growing support for modernizing the STB.

The reasonable reforms in their bill will make many important changes, such as streamlining the STB's overly burdensome rate review standards, providing reasonable arbitration procedures to resolve rate disputes, and allowing the Board to be more proactive in resolving freight rail issues. Moreover, the legislation will allow both railroads and shippers to thrive, while encouraging the growth of the U.S. economy.

The bipartisan legislation passed out of the U.S. Senate Committee on Commerce, Science, and Transportation by a unanimous vote, and we are urging Congress to act on these important reforms.

We greatly appreciate the strong interest this Committee has shown on this important issue, and we look forward to working with you to foster a strong freight rail system.

SUMMARY OF FREIGHT RAIL STUDY

Analysis of the Premium Railroads Charge Shippers

March 2015

Introduction

U.S. producers depend on rail service to ship their products to their customers. As railroads consolidated and government rules protected railroads from competition, freight rail rates skyrocketed by 98 percent over the past decade – more than three times the rate of inflation and three times as much as truck rates have increased. While a strong rail industry is vital to the U.S. economy, excessive rates can be a burden on U.S. manufacturing and provide a competitive advantage to foreign producers. To better understand these impacts, Escalation Consultants quantified the premiums railroads charge U.S. manufacturers in a report entitled, Analysis of Freight Rail Rates for U.S. Shippers.

Methodology

For this study, Escalation Consultants examined Class I railroad rate data from the Surface Transportation Board's (STB) Public Use Waybill sample for all major commodity groups shipped by rail. Data was analyzed for 2013, the most recent year available from STB, and for 2005. Escalation Consultants calculated the railroad's revenue-to-variable-cost ratio (RVC) for each shipment that originated or terminated in the U.S. RVC is an important indicator for freight rail rates because a rate greater than 180% RVC is subject to potential STB review for being unreasonably high.

For each group of related commodities, Escalation Consultants calculated the average rate for shipments below 180% RVC (those assumed to be competitive) and the average rate for shipments above 180% RVC (those potentially non-competitive and subject to STB jurisdiction). The difference between these average rates is presented as the shipper's rate 'premium.' Escalation Consultants further broke down the potentially non-competitive rates by RVC ranges (180-240%, 240-300% and above 300%) to show the impact of the highest rates on the total premium. Data are reported for all commodities combined, as well as for major commodity groups and individual products within each group.

Summary of Findings

These key findings are based on the Public Use Waybill sample provided by the railroads to the STB:

- In 2013, more than half (67 percent) of all rail rates exceeded 180% RVC.

- The average rate for carloads above 180% RVC was $1,338 higher than the average rate for carloads below 180% RVC, meaning that shippers paid a 49% premium for these shipments.
- As a result, the total rate premium paid by commodity shippers in 2013 was nearly $19 billion.
- The commodity groups with the largest total rate premiums were chemicals ($5.3 billion), coal ($4.1 billion) and transportation equipment ($1.7 billion).
- Many rates were far above the STB's jurisdictional threshold of 180% RVC; for example, one quarter of rates exceeded 300% RVC, or three times the railroad's variable cost.
- From 2005 to 2013, the total rate premium paid by commodity shippers increased 121% while the carload volume declined by 2.4%.

RAIL CUSTOMER COALITION LETTER

March 24, 2015

Dear Members of the Committee on Commerce, Science, and Transportation:

We are writing to you on behalf of a broad range of manufacturing, agricultural, and energy industries, urging you to support S. 808, "The Surface Transportation Board Reauthorization Act of 2015".

Our groups are committed to modernizing the Surface Transportation Board (STB) so that it works better for both the railroads and the large and small American businesses that rely on them. The reforms in this bill would help accomplish that goal and help make the STB operate in a more timely, efficient, and equitable manner.

The bill introduced by Chairman John Thune and Ranking Member Bill Nelson would reauthorize the STB for the first time since it was created and would make the Board a more effective agency for handling freight rail issues. The legislation would streamline rate case procedures, create a meaningful alternative dispute resolution process, and require an analysis of the rules under which the Board operates. Other common-sense improvements include allowing the Board members to discuss agency matters with each other, permitting the Board to launch its own investigations, and creating much needed timelines for completing cases.

Much has changed since Congress created the STB to address freight rail issues. Now, it must ensure that the Board is properly equipped to deal with the dramatic transformation of the railroad industry and serve as a viable, timely forum for both shippers and railroads.

Quite simply, the legislation proposed by the Chairman and Ranking Member will make important and necessary improvements that are consistent with the direction Congress set for the STB when it was first created. We strongly urge you to support "The Surface Transportation Board Reauthorization Act of 2015" and its swift passage by the Committee.

Agricultural Retailers Association

Alliance for Rail Competition

Alliance of Automobile Manufacturers

American Chemistry Council

American Farm Bureau Federation

American Forest & Paper Association

American Fuel & Petrochemical Manufacturers

American Public Power Association

Chemistry Council of New Jersey

Consumers United for Rail Equity

Edison Electric Institute

The Fertilizer Institute

Foundry Association of Michigan

Georgia Chemistry Council

Glass Packaging Institute

Growth Energy

Institute of Scrap Recycling Industries, Inc.

Louisiana Chemical Association

Louisiana Chemical Industry Alliance

Louisiana Industrial Development Executives Association

Manufacture Alabama

Manufacturers Association of Florida

Michigan Agri-Business Association

Michigan Bean Shippers Association

Michigan Farm Bureau

Michigan Chemistry Council

Midwest Food Processors Association

Missouri Forest Products Association

National Association of Chemical Distributors

National Association of Wheat Growers

National Farmers Union

National Industrial Transportation League

National Rural Electric Cooperative Association

Nebraska Soybean Association

Nebraska Wheat Growers Association

Plastic Pipe and Fittings Association

Portland Cement Association

PVC Pipe Association

Society of Chemical Manufacturers and Affiliates

South Dakota Farmers Union

Steel Manufacturers Association

Texas Chemical Council

Vinyl Building Council

The Vinyl Institute

Vinyl Siding Institute, Inc.

Wisconsin Corn Growers Association

Wisconsin Electric Cooperative Association

Committee on Transportation and Infrastructure
U.S. House of Representatives

Bill Shuster
Chairman

Washington, DC 20515

Peter A. DeFazio
Ranking Member

Christopher P. Bertram, Staff Director

June 8, 2015

Katherine W. Dedrick, Democratic Staff Director

The Honorable Calvin Dooley
President and Chief Executive Officer
American Chemistry Council
700 Second Street, NE
Washington, DC 20002

Dear Mr. Dooley,

Thank you for your testimony before the Subcommittee on Railroads, Pipelines, and Hazardous Materials on May 13, 2015, concerning "The 35th Anniversary of the Staggers Rail Act: Railroad Deregulation Past, Present, and Future." I am pleased you appeared and testified on behalf of the American Chemistry Council. The Subcommittee gained valuable insight from the information you provided at the hearing.

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If you have any questions please contact Mike Friedberg of the Subcommittee at (202) 226-0727.

Sincerely,

Jeff Denham
Chairman
Subcommittee on Railroads, Pipelines, and Hazardous Materials

Enclosures

Committee on Transportation & Infrastructure

Republican Questions for the Record

Question for Mr. Dooley

In your written testimony, you explained that "Consolidation has reduced the number of Class I railroads from 26 in 1980 to only seven today, with four essentially operating like regional duopolies that control 90 percent of the market." By statute the Surface Transportation Board, depending on the type of consolidation, merger, or acquisition transaction, must take into account the effects of the transaction on competition among rail carriers, often resulting in mitigation measures to ensure there is no lessening of shippers' access from two rail carriers to one rail carrier and/or from three rail carriers to two rail carriers. Please identify for the record:

- Any consolidation, merger, or acquisition transaction that left one of your members without access to the same number of rail carriers that it had prior to the transaction;
- The member company and its geographic location that had its access to rail carriers reduced by the transaction; and
- The rail carrier to which that member company had access prior to the transaction but due to the transaction lost such access.

American Chemistry Council
Response to Committee on Transportation & Infrastructure
Republican Questions for the Record

Thank you again for the opportunity for ACC President and CEO Cal Dooley to testify before the Subcommittee on Railroads, Pipelines and Hazardous Materials concerning the "35th Anniversary of the Staggers Rail Act: Railroad Deregulation Past, Present and Future." ACC is pleased to respond to the Subcommittee's follow-up question for the record.

The question posed by the Subcommittee pertains to just one of several means by which rail mergers have impacted competition. Specifically, the question refers to railroad transactions that reduced "shippers' access from two rail carriers to one rail carrier and/or from three rail carriers to two rail carriers." ACC would like to respond to several related aspects of this question: the inadequate protections provided in STB merger conditions; the loss of competitive options resulting from extended bottleneck segments; and the broader impacts of railroad consolidation on ACC member companies.

STB has disavowed any need to protect against reductions from three to two rail carriers

Although the STB, and the ICC before it, typically imposed conditions upon mergers to preserve a shipper's access to two rail carriers if the merger otherwise would reduce that shipper's access to a single carrier, the agency has allowed mergers to reduce horizontal competition by refusing to take mitigation measures to ensure there is no lessening of shippers' access from three rail carriers to two rail carriers. The STB directly addressed this issue in the *UP/SP* merger when it rejected evidence of competitive harm at 3-to-2 locations submitted separately by shippers, competing rail carriers, and the U.S. Department of Justice.[1] Since passage of the Staggers Rail Act of 1980, neither the ICC nor STB has imposed any measures to ensure there is no lessening of shippers' access from three rail carriers to two as a result of a merger.

STB failed to address the loss of competitive options from extended bottleneck segments

While the Committee's question focuses on the "horizontal" effects of lessening a shipper's access to carriers at a facility, a larger concern is with the "vertical" effects of rail mergers that have gone unrecognized by the agency. Most of the adverse competitive impacts from rail industry consolidation are the vertical effects of extending a shipper's captivity to a single rail carrier over ever greater distances with each merger that has occurred. For example, assume that prior to a merger:

- a shipper offers traffic for rail transportation from Point A to Point C (which is 500 miles);
- from A to B (which is 50 miles), the shipper is captive to Railroad 1; and
- from B to C (which is 450 miles), the shipper has a choice between Railroad 2 and Railroad 3.

[1] *Union Pac. Corp. et al. --Control and Merger -- Southern Pac. Rail Corp. et al.*, 1 S.T.B. 233, 387-90 (1996) ("*UP/SP*").

Now assume that Railroad 1 acquires Railroad 2, in what is typically described as a "vertical" or "end-to-end" merger. Although the shipper still is captive to Railroad 1 at the origin after the merger, that captivity has increased from 50 miles to the entire 500 mile distance, because the STB allows an origin railroad to protect its long-haul (*see* 49 U.S.C. §10705(a)(2)), which post-merger is the entire distance from A to C. In other words, Railroad 1 no longer is required to interchange the shipper's traffic with Railroad 3 at Point B, because Railroad 1 can transport the traffic over the entire distance from A to C post-merger. Thus, as a consequence of the merger between Railroads 1 and 2, the shipper has lost access to Railroad 3 as a competitive alternative for 90% the length of this movement (from B to C) that was competitive pre-merger.

Despite the intuitive nature of the foregoing illustration, the STB has refused to recognize any adverse impact upon competition when a merger extends the distance over which a shipper already is captive to one of the merging railroads. In several merger decisions, the ICC and STB rejected claims that shippers would lose competition as a consequence of mergers that extended their captivity over greater distances. The issue has been addressed most extensively in the *UP/MP* and *BN/Santa Fe* merger decisions, in which the agency concluded that market power is neither created nor increased by consolidation of a monopoly segment carrier with a competitive segment carrier.[2] Furthermore, the STB has rejected shipper attempts to undo this vertical harm by requiring rail carriers to provide separate rates for their bottleneck (*i.e.*, captive) segments and their competitive segments of a movement. This would enable the shipper at least to benefit from competition along a route where a potential interchange point exists.[3] ACC submits that these decisions were mistaken and have contributed substantially to an increase in railroad market power today.

Additional Examples of anti-competitive actions facilitated by railroad consolidation

The following examples are by no means exhaustive, but illustrate the type of anti-competitive impacts experienced by ACC member companies.

Remaining Class I railroads leverage their control over bottleneck segments to prevent shippers from accessing competitive rail service. A compelling example was provided by Olin Corporation, an ACC member, in April 2011 testimony to STB (Comments Submitted by Olin Corporation for STB Ex Parte No. 705 – Competition in the Railroad Industry). Olin's testimony discusses the shipment of chlorine from its plant in McIntosh, AL to a customer in LaPorte, TX. This is Olin's largest volume lane in North America, with more than 2,700 carloads per year. NS had raised rates for this lane by approximately 600% since 2002. Although competitive access exists in Mobile, AL (a mere 40 miles from Olin's plant) that would have provided a more direct and efficient route to its customer, the testimony describes how the Norfolk Southern Railroad systematically denied Olin access to this rail competition.

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[2] *See Union Pac. Corp. et al.—Control—Missouri Pac. Corp. et al.*, 366 I.C.C. 462, 537-42 ("*UP/MP*"); *Burlington Northern, Inc. et al.—Control and Merger—Santa Fe Pac. Corp. et. al.*, 10 I.C.C.2d 661, 747-57 (1995) ("*BN/Santa Fe*"). It is notable that the Burlington Northern Railroad (a predecessor to BNSF) took diametrically opposite positions in these two merger proceedings, arguing that there would be a loss of competition in the *UP/MP* merger but that there would not be any competitive loss in the *BN/Santa Fe* merger.

[3] *Central Power & Light Co. v. Southern Pac. Transp. Co.*, 1 S.T.B. 1059 (1996), *clarified* at 2 S.T.B. 235 (1997).

Another example of anticompetitive behavior was experienced by ACC member, Tronox Corporation. The company was planning to move an transload operation from a Norfolk Southern facility in Charlotte, NC to a location closer to Tronox's customer in Florence, SC. CSXT refused to offer competitive rates to locations on its network simply because the traffic was already being served by another Class I railroad. Such behavior is simply unimaginable in a truly competitive market.

The STB record in Ex Parte 705 is replete with additional examples non-competitive behavior even when two railroads have direct access to a shipper.

As to the merger effects identified above, the horse already is out of the barn because the mergers that caused these competitive harms cannot be undone. But the Congress, and to a lesser extent the STB, can mitigate these harms by adopting and applying competition-enhancing measures to restore some of the lost competitive balance, such as by providing greater access to competitive switching and permitting bottleneck rate challenges. However, because remaining Class I railroads may act as duopolies with little incentive to compete with each other, such remedies do not guarantee meaningful competition.

STATEMENT OF

EDWARD R. HAMBERGER
PRESIDENT & CHIEF EXECUTIVE OFFICER
ASSOCIATION OF AMERICAN RAILROADS

BEFORE THE
U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

SUBCOMMITTEE ON RAILROADS, PIPELINES AND HAZARDOUS MATERIALS

HEARING ON THE 35th ANNIVERSARY OF THE STAGGERS RAIL ACT: RAILROAD DEREGULATION PAST, PRESENT, AND FUTURE

May 13, 2015

Association of American Railroads
425 Third Street SW
Washington, DC 20024
202-639-2100

Introduction

On behalf of the members of the Association of American Railroads (AAR), thank you for the opportunity to testify on the 35th anniversary of the Staggers Rail Act of 1980. AAR members account for the vast majority of North American freight railroad mileage, employees, and revenue.

From the food on our tables to the cars we drive to the shoes on our children's feet, freight railroads carry the things America depends on. Approximately 570 freight railroads operate in the United States today (only Hawaii does not have at least one) over a network of nearly 140,000 miles. Railroads account for close to 40 percent of our nation's intercity freight ton-miles — more than any other mode of transportation. By linking businesses to each other here and abroad, freight railroads have played a crucial role in America's economic development for more than 180 years. Today, they serve nearly every agricultural, industrial, wholesale, retail, and resource-based sector of our economy.

Every year, railroads' efficiency and service reliability save their customers — and, ultimately, all U.S. consumers — billions of dollars. Today, millions of Americans work in industries that are more competitive in the tough global economy thanks to the affordability and productivity of America's freight railroads. A few years ago, the American Association of State Highway and Transportation Officials (AASHTO) estimated that if all freight rail traffic were shifted to trucks, rail shippers would have to pay an additional $69 billion per year. Adjusted for increased freight volume and inflation, that figure is probably close to $100 billion today.

Rail is also *the* environmentally friendly freight transportation option. In 2014, U.S. freight railroads moved a ton of freight an average of 479 miles per gallon of fuel. That's roughly equivalent to transporting one ton from Buffalo to Boston, or Long Beach to Tucson,

on a single gallon of fuel. On average, trains are four times more fuel efficient than trucks. Since greenhouse gas emissions are directly related to fuel consumption, that means moving freight by rail instead of truck lowers greenhouse gas emissions by 75 percent. A single freight train can replace several hundred trucks — enough to replace a 12-mile convoy of trucks on the highways — freeing up space for other motorists while reducing highway wear and tear and the pressure to build costly new highways.

As the Federal Railroad Administration has noted, "By many measures, the U.S. freight rail system is the safest, most efficient and cost effective in the world." Ours is at or near the top among all countries in terms of miles of freight railroad, the condition of freight rail infrastructure and equipment, the amount of freight carried by rail, rail productivity, and other key rail-related measures. And unlike freight railroads in many parts of the world, nearly all of America's freight railroads are privately owned and operated. Unlike our trucks, barges, and airlines, America's freight railroads operate almost exclusively on infrastructure that they own, build, maintain, and pay for themselves.

The global superiority of U.S. freight railroads is no accident. Rather, it is a direct result of a balanced regulatory system, embodied in the Staggers Act, that relies on the marketplace to establish most rate and service standards. This balanced regulation has allowed railroads to improve their financial performance from anemic levels prior to Staggers to much healthier levels today, which in turn has allowed them to plow back hundreds of billions of dollars — again, their own funds, not taxpayer funds — into improving the performance of their infrastructure and equipment. The benefits to rail customers and our economy at large are immense.

We cannot be complacent, though. Looking ahead, our nation's economic prosperity and ability to compete successfully in the global marketplace require vibrant, effective freight railroads. But to be viable and effective, especially in the face of projected increases in freight transportation demand in the years ahead, railroads must be able to both maintain their *existing* infrastructure and equipment and build the substantial *new* capacity required to handle the additional traffic they will be called upon to haul.

Members of this committee have a critical role to play. I respectfully suggest that one of your primary obligations should be to refrain from taking steps that hinder railroads in earning enough to make the investments they need to sustain themselves and provide the current and future transportation capability our growing nation requires.

In this regard, it is crucial that the current balanced railroad regulatory framework embodied by the Staggers Act be retained. If artificial regulatory or legislative restraints are put into place that unnecessarily and unreasonably restrict rail earnings, rail spending on infrastructure and equipment will shrink. Either taxpayers will have to make up the difference or the industry's physical plant will deteriorate, needed new capacity will not be added, and rail service will become slower, less responsive, and less reliable. Why would anyone want an outcome like that?

Today, our nation faces a number of serious transportation-related problems, many of which this committee, to its credit, is working hard to address. It makes no sense to add to that list by trying to fix something that isn't broken. The current rail regulatory system is working well, and because of that our nation's freight rail network is working well too.

To be sure, challenges remain. Foremost among them is the need to find ways to make an already safe rail system even safer. Working with their employees, their customers,

their suppliers, and policymakers at all levels, railroads will continue to seek solutions to their safety challenges while continuing to make the massive private investments needed to meet tomorrow's freight transportation needs.

In my testimony below, I will briefly recap what the Staggers Act did and why it was necessary, outline some of the many ways the Staggers Act has benefited our nation's economy, and discuss why it's so critical for the health of our economy and our standard of living that the current balanced regulatory system Staggers created be retained.

The Rail Industry Before the Staggers Act

In 1887, Congress passed the Interstate Commerce Act, creating the Interstate Commerce Commission (ICC) and making railroads the first major U.S. industry to become subject to comprehensive federal economic regulation. Over the next 93 years, the federal government would come to control broad aspects of rail pricing, service, and asset utilization.

The results were disastrous. Entire books have been written on the subject, but suffice it to say here that by the 1970s, archaic regulations, in conjunction with intense competition from other transportation modes, had driven the rail industry to the brink of ruin. Consider:

- During the 1970s, more than 20 percent of the nation's rail route mileage was accounted for by railroads operating under bankruptcy protection.
- Between 1970 and 1979, the rail industry's rate of return on net investment never exceeded 2.9 percent and was as low as 1.2 percent. Rail investors could earn far more putting their money in a passbook savings account than investing it with railroads.
- Railroads lacked the capital to properly maintain their tracks. By 1976, more than 47,000 miles had to be operated at reduced speeds because of poor track conditions. Deferred maintenance was in the billions of dollars and the term "standing derailment" — when stationary railcars simply fell off badly maintained track — entered the railroad lexicon.
- By 1978, the rail share of intercity freight had fallen to 35 percent, down from 75 percent in the 1920s.

Excessive and oppressive railroad regulation was largely to blame. As the U.S. Department of Transportation noted in 1978, "The current system of railroad regulation ... is a hodgepodge of inconsistent and often anachronistic regulations that no longer correspond to the economic condition of the railroads, the nature of intermodal competition, or the often-conflicting needs of shippers, consumers, and taxpayers."[1]

The status quo was untenable. Congress had two options: nationalization, at a continuing cost of untold billions of dollars, or deregulation and greater reliance on the free market. Congress wisely chose deregulation and passed the Staggers Rail Act of 1980.

Major Provisions of the Staggers Act

In passing the Staggers Act, Congress recognized that railroads faced intense competition from trucks and other modes of transportation for most freight traffic, but prevailing regulation prevented railroads from earning adequate revenues and competing effectively. Railroad survival required a new regulatory structure that allowed railroads to, in effect, establish their own routes, tailor their rates to market conditions, and differentiate rates on the basis of demand. Congress mandated that, going forward, rail transportation should be governed principally by the marketplace — that is, by private actors making decisions about the use of privately-owned property — though with regulation continuing where railroads did not face effective competition and as a remedy for anticompetitive conduct by railroads.

Consistent with these principles, the Staggers Act eliminated many of the most egregious regulations that prevented railroads from meeting the needs of their customers reliably and efficiently. For example, Staggers:

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[1] U.S. Department of Transportation, *A Prospectus for Change in the Freight Railroad Industry*, October 1978, p. 25.

- Allowed railroads to price competing routes and services differently. Prior to Staggers, rates were set by "rate bureaus," which recommended general rate increases that applied across the board to all railroads. Rates were equalized over all routes between a given origin/destination pair, without regard to differing costs. The Staggers Act gave railroads freedom to price according to market demand and to operate over their most efficient routes.
- Allowed railroads to enter into confidential contracts with shippers. Such contracts were virtually unknown prior to Staggers because of regulatory restrictions.
- Expanded regulators' authority to exempt categories of rail traffic from regulation if regulation was not needed to protect shippers from an abuse of rail market power. For example, traffic that could easily be carried by railroads' trucking competitors could be exempted.
- Streamlined procedures for the abandonment and sale of rail lines. Prior to Staggers, the ICC required railroads to continue service on thousands of miles of rail lines that lacked enough traffic to be operated profitably.
- Directed that the ICC, when it adjudicated the reasonableness of rail rates, had to take into account a railroad's need to earn adequate revenues.

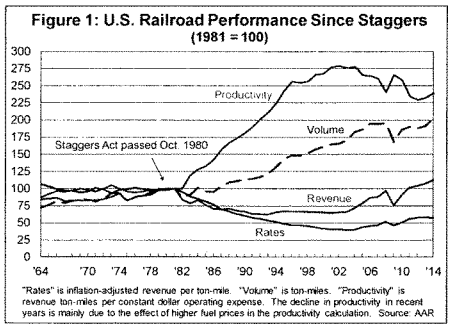
One of the fundamental principles of the Staggers Act was something that had been essentially ignored for decades prior to it: if our nation is to have a viable, efficient, privately owned freight rail system, someone has to be willing to pay for it, and the market is far superior to the government in determining who should pay. Railroads were given the freedom to utilize their assets and price their services like most other businesses could.

Importantly, the Staggers Act did not completely deregulate railroads. In addition to retaining authority over a variety of non-rate areas, the ICC, and now its successor, the Surface Transportation Board (STB), retained the authority to set maximum rates if a railroad is found to have "market dominance" and to take other actions if a railroad engaged in anticompetitive behavior.

The Post-Staggers Era

The Staggers Act has been one of the most successful transportation-related pieces of legislation in history, yielding tremendous benefits for rail customers and our economy:

- Average inflation-adjusted rail rates (measured by revenue per ton-mile) are down 43 percent since Staggers was passed. This means the average rail shipper can move close to twice as much freight for close to the same price it paid when Staggers was passed (see the lowest line in Figure 1).
- Rail volume today is twice what it was when the Staggers Act was passed (see the dashed line in Figure 1).
- After decades of decline, rail market share has grown. It is now close to 40 percent when measured in ton-miles, more than any other transportation mode.



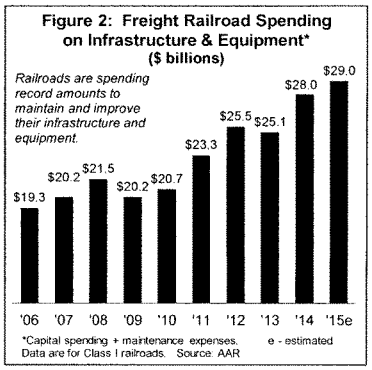
- Railroads are stronger financially. Return on investment, which had been falling for decades, rose to 4.4 percent in the 1980s, 7.0 percent in the 1990s, and 9.4 percent from 2000 to 2014. As discussed further below, improved rail earnings are a positive development because they allow railroads to make the massive investments needed to keep their track and equipment in top condition and help their customers grow in a very competitive global economy.
- Thanks to their improved financial health, freight railroads have been able to reinvest $575 billion of their own funds back into their operations to create a national freight rail network that is second to none in the world. Railroad spending is discussed in more detail below.
- Railroads are much safer. The train accident rate in 2014 was the lowest ever, and the employee injury rate and grade crossing accident rates were near record lows. Railroads know that the safety challenge never ends and are continuing to find ways to further improve the safety of their operations.
- Since Staggers, railroads have increased their productivity far more quickly than most other industries. Overall rail industry productivity was flat for many years prior to Staggers, but is up nearly 140 percent since then (see the top line in Figure 1).
- Service and reliability have greatly improved as America's freight railroads have become the most efficient and productive in the world.

These tremendous gains are exactly the kinds of results that Congress hoped for when it passed the Staggers Act. The challenge for members of this committee and other policymakers is to ensure that those gains are not squandered and that our nation's freight rail system remains the envy of the world.

Freight Rail Spending on Infrastructure and Equipment

As noted above, prior to passage of the Staggers Act, much of the U.S. rail infrastructure base was in miserable condition, mainly because railroads lacked the funds to properly build and maintain it. This changed with the passage of the Staggers Act. Railroads responded to the act's balanced reforms by rationalizing and upgrading their systems, dramatically increasing productivity, improving service, sharply lowering average rates for their customers, and reinvesting heavily in productive rail infrastructure and equipment.

Indeed, from 1980 to 2014, America's freight railroads have spent $575 billion on capital expenditures and maintenance expenses related to locomotives, freight cars, tracks, bridges, tunnels and other infrastructure and equipment. That's more than 40 cents out of every revenue dollar, invested right back into a rail network that keeps our economy moving. In recent years, despite weak economic conditions, railroads have been spending more than ever before, including $28 billion in 2014 and an expected $29 billion in 2015 (see Figure 2).



Put another way, America's freight railroads today are spending more than $500 million per week — of their own funds, not government funds — on their infrastructure and equipment. This is an extraordinary level of funding, a clear indication of the remarkable diligence with which railroads approach capacity and infrastructure issues. Railroads know that if America's future freight transportation demand is to be met, they must have the capacity to handle it. They are preparing for tomorrow today, all over the country:

- Norfolk Southern plans to expand its Austell, Georgia intermodal terminal to accommodate an additional 1,000,000 containers by 2022. This $13.4 million expansion includes new track, three new truck chassis storage lots, and a new state-of-the art lift crane. The expansion will mean better service for the region's intermodal shippers while removing trucks from the surrounding highways.
- Over the last few years, Genesee & Wyoming's Arizona Eastern Railway has been working on a $30 million project to upgrade and rebuild its line with new rail, ballast, thousands of new ties, and devices called turnouts that allow railcars to move from one track to another. These and other enhancements have already allowed the railroad's customers to significantly increase their output and capacity, thereby creating additional jobs in southeastern Arizona.
- As part of a multi-year effort to enhance the fluidity of its network, BNSF Railway is laying a second track alongside an existing track over a 150-mile stretch between Minot, North Dakota and Snowden, Montana. This track segment has seen huge volume increases since 2009; the expansion will enhance safety and allow BNSF to serve customers in the region more efficiently and reliably.
- Canadian National may be headquartered in Canada, but about 30 percent of its traffic volume is in the United States, particularly in and around Chicago. Over the past five years, CN has invested well over one billion dollars on its Midwest operations, helping the railroad accommodate increased demand, freeing up rail capacity inside Chicago for other railroads, and helping its customers compete better in their end markets.
- CSX recently added additional tracks and lift cranes to its northwest Ohio intermodal hub to meet growing demand. Thanks to this expansion, the facility, which first opened in February 2011, can now process one million containers annually. That's one million potential trucks off the roads. The facility has provided countless businesses in small- and medium-sized markets throughout the region access to highly efficient intermodal service for the first time.
- Kansas City Southern is spending more than $18 million on a stretch of track between Laredo and Corpus Christi, Texas to install approximately 80,000 crossties, replace six miles of rail, enhance more than 170 road crossings, and add structural improvements to the International Bridge in Laredo. Together, these projects will expand capacity and enhance safety at a key location for imports and exports.
- Union Pacific is investing in a new rail yard in Hearne, Texas to better connect fast-growing Texas markets with the national freight rail network. The Hearne facility, known as a classification yard, will serve as a sorting facility, akin to a hub airport, helping to move goods to market faster. The new facility will help meet the region's growing need for building materials and consumer goods while removing trucks from congested Texas highways.
- Canadian Pacific (CP) is installing a centralized traffic control (CTC) system across much of its network, with a focus on its corridor from Canada into Chicago. CTC increases available capacity on CP's network by increasing velocity and allowing additional trains per day. It also improves safety by providing centralized notification of rail breaks and misaligned switches.

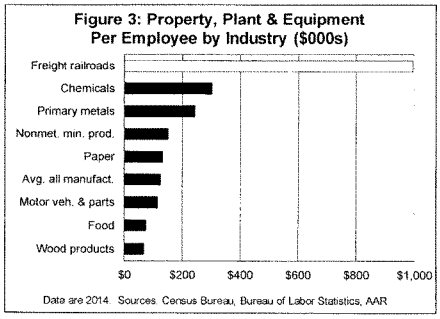
These are just a few examples of the thousands of similar projects that freight railroads undertake each year. Some of these projects cost railroads a few thousand dollars; others cost hundreds of millions of dollars. Whatever their cost, all of the projects are aimed at maintaining and growing railroads' networks so that they are better able to serve their customers and provide the safe, efficient freight transportation service our nation's economy needs. And all of them are far more likely to be undertaken under today's balanced regulatory system than they would be under a system of excessive, needless regulation.

Financial Realities Facing Freight Railroads

This committee knows well that transportation systems are expensive to build and maintain, whether with private or public funds. Railroads are no exception: to put it bluntly, you don't get a best-in-the-world freight rail network, like the United States has, on the cheap.

By any of a number of measures, the capital intensity of freight railroading is at or near the top among all U.S. industries. For example, in recent years, U.S. freight railroads have spent an average of 19 percent of revenue on capital investment. The comparable figure for the U.S. manufacturing sector as a whole is around 3 percent.

Similarly, railroad net investment in plant and equipment per employee (a measurement that incorporates cumulative capital spending over many years) is far higher than other industries. As Figure 3 shows, the figure for freight railroads for 2014 — $997,000 per employee — is nearly eight times the average for all U.S. manufacturing ($126,000). Finally, firms in different



industries require very different quantities of land, equipment, and other assets to operate effectively. Firms, including railroads, with very high levels of assets require higher profits in order to cover the costs of those assets.

Because U.S. freight railroads are overwhelmingly privately owned and must finance the vast majority of their infrastructure and equipment spending themselves, this spending is accompanied by substantial financial risk. Back in 2006, the Government Accountability Office correctly noted that, "Rail investment involves private companies taking a substantial risk which becomes a fixed cost on their balance sheets, one on which they are accountable to stockholders and for which they must make capital charges year in and year out for the life of the investment. A railroad contemplating such an investment must be confident that the market demand for that infrastructure will hold up for many years. This is in sharp contrast to other modes such as highway infrastructure, which is paid for largely by public funds."[2]

Accordingly, railroad capacity investments must have a reasonable expectation that they will generate an adequate return over a long period of time. For this reason, adequate rail earnings — again, over the long term — are critical for capacity investment. As the Congressional Budget Office (CBO) noted, also in 2006, "As demand increases, the railroads' ability to generate profits from which to finance new investments will be critical. Profits are key to increasing capacity because they provide both the incentives and the means to make new investments."[3]

The GAO's and CBO's comments are just as valid today as they were when first made. If a railroad is not financially sustainable over the long term, it will not be able to

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[2] Government Accountability Office, *Freight Railroads: Industry Health Has Improved, but Concerns About Competition and Capacity Should Be Addressed*, Oct. 2006, p. 56.

[3] Congressional Budget Office, *Freight Rail Transportation: Long-Term Issues*, Jan. 2006, p. 11.

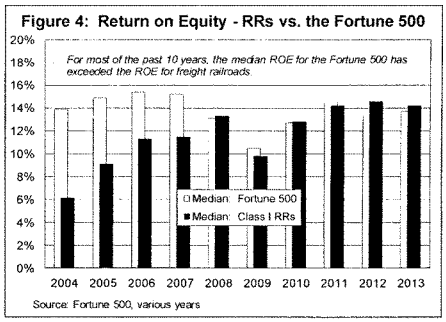
make capacity investments to maintain its existing network in a condition to meet its customers' demands or make additional investments in the replacement or expansion of infrastructure required by growing demand.

Major freight railroads face additional constraints because they are either publicly traded or are subsidiaries of publicly traded companies. As such, they must provide their shareholders a return commensurate with what those shareholders could obtain in other markets with comparable risk. If railroads are viewed as returning less to shareholders (because of misguided regulations or any other reason) than comparable investment opportunities, then capital will flee the rail industry or will only be available at much higher costs than we see today.

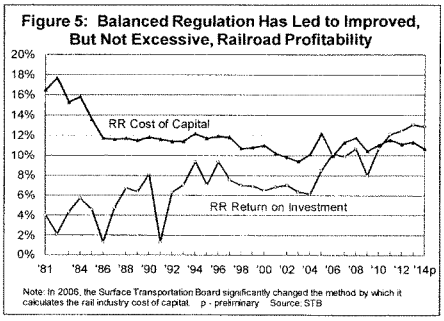
These points — that railroads must be able to earn sufficient revenue that they can invest in and grow their networks, and that, as public companies, they must provide their shareholders with a return that will entice capital providers to invest their money with railroads — are foundational. The ability to invest in their networks allows railroads to improve safety, provide the levels of service that their customers demand, and create the efficiencies needed to help ensure that our economy is competitive in global markets.

Railroads acknowledge that their financial performance in recent years has been much improved compared to earlier years, with some railroads recording "record profits." Until recently, rail profitability was generally poor relative to most other industries. Thus, an improvement from earlier years may be a "record," yet may still yield levels of profitability that are only about average compared with the earnings achieved by most of the other industries against which railroads compete for capital.

One example that illustrates this point is return on equity (ROE), a measure of profitability that reveals how much profit a company generates with the money shareholders have invested. Figure 4 shows that the ROE for the rail industry has improved over the past few years, but it is still only about average compared to the Fortune 500. To use a baseball analogy, a hitter with a lifetime batting average of, say, .225 isn't automatically headed to the Hall of Fame when his batting average goes up to, say, .250.

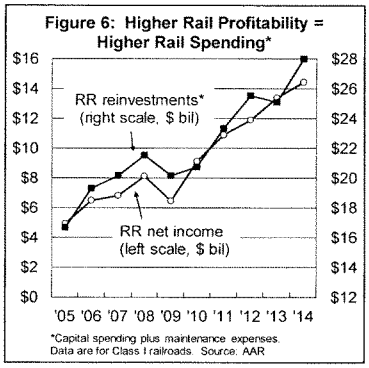


Likewise, Figure 5 shows that there used to be a huge gap between the rail industry's cost of capital and its return on investment. There is hope that this gap will be closed, on a long-term basis, in the years ahead. If America's freight railroads are to fully deliver their potential benefits to the economy, such an outcome should be regarded as one step along the path toward sustainability, not as the final destination.



Make no mistake, the rail industry is encouraged by the improvements in its financial condition in recent years, and they will work to see that those improvements continue. But it would be a tremendous mistake for policymakers to view recent improvements in rail earnings as a reason to cap rail earnings through price controls, artificial competitive

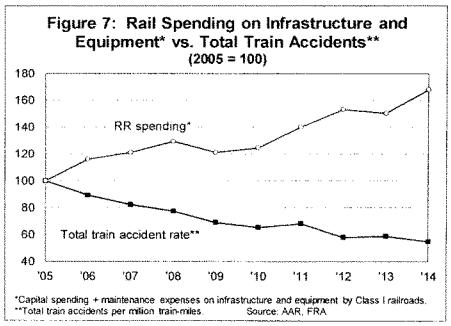
constraints, or by other means. This would encourage capital to flee the industry, threatening railroads' ability to reinvest in their networks. Higher rail earnings have made it possible in recent years for railroads to plow back record amounts of their own funds on the locomotives, freight cars, tracks, bridges, tunnels and other infrastructure and equipment they need to keep the U.S. freight rail network in world-best condition and to meet our nation's growing transportation needs. Take away rail earnings today and you limit rail capacity and service capability for tomorrow. As Figure 6 shows, you can't have one without the other.[4]



Thanks to the vast sums railroads have poured back into their networks — something that could never have happened without Staggers — U.S. freight rail infrastructure today is in better overall condition than ever before. No other transportation mode can say this. Even more remarkably, rail infrastructure is in the condition it's in because of private spending, not public spending. Indeed, the term "crumbling infrastructure" applies to many of our highways, waterways, and transit systems, but with few exceptions it does not apply to our nation's freight railroads. Prior to the Staggers Act, it did. Without appropriate public policies, it could again. We can't let that happen.

[4] Chemical firms, some of whom are at the forefront of those who want to re-impose onerous regulations on railroads, understand this point well. At a February 19, 2015 conference, the CEO of Air Products and Chemicals, a major U.S. chemical producer, asked, "Why do we deserve to maintain our [pricing] margin? So that we can continue to invest and create new products for our customers... [I]f we don't do that, then our margins will go down. Then in order to keep the investors happy, we would have to cut R&D, we would have to cut development, and as a result five years from now, our customers wouldn't have what they need. So, it's really for the good of our customers that we need to be a viable organization."

It's also important to note that railroads' infrastructure and equipment spending, made possible by the Staggers Act reforms, play a crucial safety role. Preliminary data indicate that 2014 had the lowest train accident rate in history. Railroads are proud of this fact, but they also know that the pursuit of safety never ends. And they know that virtually every project they pursue to replace existing assets or build new capacity also enhances safety in one way or another. For example, a railroad might replace lighter weight rail with heavier rail made from a higher quality steel that is more durable and can better handle heavy trainloads than the rail it replaced. For many rail investments, improving safety is the primary reason the investments are made in the first place. For example, railroads have installed large quantities of trackside detectors that identify defects on passing rail cars — including overheated bearings and damaged wheels, dragging hoses, deteriorating bearings, cracked wheels, and excessively high and wide loads — before structural failure or other damage occurs. The correlation is clear: as railroads' spending on their networks rises, safety improves (see Figure 7).



Upsetting the Existing Regulatory Balance is Not Consistent With Staggers

From the time the Staggers Act was passed, advocacy groups have sought to amend it or make changes to the regulatory regime it spawned that would fundamentally alter the landscape in which railroads operate. The changes these self-interested groups seek would grievously harm our nation's freight transportation capability and deviate sharply from Congress's intent in passing the Staggers Act.

At their most basic level, proponents of railroad reregulation believe that railroads charge them too much and that the use of differential pricing by railroads is unfair. They seem to discount the notion that a railroad must balance the desires of each customer to pay the lowest possible rate with the requirement that the overall network earn enough to pay for all the things needed to keep it functioning now and into the future. Rhetoric from rail industry critics about "competition" cannot change the fact that railroads must be able to cover their costs or they will not be able to maintain or expand their infrastructure and provide the services upon which their customers and our nation depend.

Indeed, when one looks behind the actions that proponents of reregulation are urging upon Congress and the STB to "reform" freight rail policy, it is clear that "reform" is a euphemism for "force railroads to subsidize us" and that the needs of the railroads and the general public are a distant second to their own narrow desires.

Changes that proponents suggest in the current railroad regulatory regime are based on a fundamental misrepresentation of what the Staggers Act was all about.

First, nothing in the Staggers Act is meant to imply that the only competitive force that matters is rail-to-rail competition, that service to a shipper by a single railroad is equivalent to monopoly power, and that all rail shippers therefore have a right to service by more than one railroad. Rather, Staggers was premised on the understanding that the market — not regulatory or legislative fiat — would determine which markets have sufficient demand to sustain multiple railroads and which do not. Staggers encourages the creation of additional competition through private investment and initiative, but it does not seek to artificially manufacture additional competition through governmental intervention. Claiming that every market can sustain two railroads just because some markets can is like saying that every city

can support two major league baseball teams just because New York and Chicago can. A world in which multiple railroads chase every, or nearly every, customer has never existed.

Second, Staggers 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 other local or national objectives at the railroads' own expense. Thus, Congress did not intend to force railroads to provide service that does not pay its way.

Third, Staggers was not meant to force a railroad to price one shipper's movements at the same rate as another shipper's movements, or to cap rates at some percentage of variable costs. Instead, Staggers explicitly recognized differential pricing as essential for railroads. Only by pricing in accordance with the varying demands for rail service (with reasonable regulatory protections against unreasonable rates) can railroads efficiently recover all of their costs, serve the largest number of rail customers, and maintain the viability of the nation's rail system.[5] Of course, shippers are not always thrilled with the prices they are able to negotiate with the railroads. Virtually every purchaser of goods or services, including railroads, would like to get a better deal than what they have from their suppliers. But there is no question that, since Staggers, the vast majority of railroad rates are market-based and driven by competition — just as Staggers intended.

Fourth, Staggers was not meant to be a vehicle through which one railroad could be ordered to make its facilities available for use by another railroad. Under current regulation, unless a railroad is found to have engaged in anticompetitive conduct, it can determine for itself how to utilize its assets. The experience prior to Staggers, when regulators again and

[5] For more on why differential pricing is necessary in the rail industry, see https://www.aar.org/BackgroundPapers/Differential%20Pricing%20in%20the%20Rail%20Industry.pdf.

again deemed their judgment superior to that of rail management in the allocation of rail assets, with dismal consequences for railroad efficiency, should not be repeated.

The need for efficiency helps explain why railroads strongly oppose efforts to reverse existing policy under which the STB must first find that a railroad serving a terminal area is engaged in anti-competitive conduct before the STB can order the railroad to "switch," or interchange, traffic to another railroad when such an interchange is not necessary for freight delivery. Adding an interchange to a movement that is currently handled in single-line service adds substantial time, complexity, and costs to that movement. Over the years, railroads have invested tens of billions of dollars and enormous effort into concentrating traffic onto routes that are the most efficient for rail customers as a whole. Part of this effort has been the development of very efficient and streamlined terminal switching. The result has been sharply higher productivity, reliability, and asset utilization, and lower average freight rates for rail customers. Forced switching would destroy these terminal efficiencies, compromise the service improvements they have created for rail customers, and raise rail costs. The added switching activity that would be required, the increased possibility of service failures caused by that new switching activity, and the complex operations that would be required to bring about the new interchanges would disrupt rail traffic patterns, produce congestion in rail yards, and undermine efficient service to customers.

The need for efficiency also helps explain why railroads oppose reversing existing "bottleneck" policy[6] and forcing railroads to prioritize certain types of traffic over other types.

[6] In "bottleneck" situations, one railroad can move freight from an origin to an intermediate point, and from that intermediate point on to a final destination, and at least one other railroad can also move the freight from that intermediate point to the final destination. For more on the bottleneck issue, see: https://www.aar.org/BackgroundPapers/Bottleneck%20Policy%20-%20Dont%20Fix%20What%20Isnt%20Broken.pdf.

In addition to putting at risk several billion dollars in rail revenue each year, reversing existing bottleneck policy would lead to huge disruptions in railroads' physical operations because it would force railroads to route traffic without regard to network efficiency. In essence, a few shippers would be able to disrupt rail operations and raise costs for everyone else. Likewise, forcing railroads to prioritize certain types of traffic over others would force railroads to sacrifice what's good for their customers as a whole for what's good for just a small segment of their customer base.

Fifth, the Staggers Act was not intended to prevent railroads from engaging in practices that improve efficiency or from offering incentives to shippers that make efficiency improvements themselves. Thus, for example, railroads often offer shippers lower rates to move their product in larger shipments. The lower rates result in more efficient movements in the marketplace. Under this system, the market — not railroads — decides whether investments in facilities designed to handle more efficient shipments are appropriate.

Sixth, nothing in the Staggers Act supports efforts to cast aside the fundamental tenet of the economics of competition that says that where competition exists, there should be no regulatory intervention. Because the vast majority of rail freight movements are subject to an array of competitive forces — including competition from trucks and barges, product competition[7], and geographic competition[8] — the vast majority of rail movements should

[7] Substituting one product for another in a production process — for example, generating electricity from natural gas (which is not carried by railroads) instead of coal (which is). This is far from a hypothetical example. To illustrate, in an April 29, 2015 earnings call, the CEO of Southern Company, one of the largest U.S. utilities, said "[O]ur diverse generation fleet enables us to quickly adapt to constantly changing market conditions with the ability to utilize the most cost efficient generation resources at any particular point in time. When natural gas prices are low, for example, we are able to take advantage by burning more natural gas and less coal."

[8] The ability to obtain the same product from, or ship the same product to, a different geographic area. For example, clay is used for taconite pelletization in Minnesota. This clay is available from Wyoming mines served by one railroad and from Minnesota mines served by another. Iron ore producers can play one railroad against the other for clay deliveries.

likewise be free of governmental oversight. Unfortunately, proposals by some rail critics, including the proposals regarding forced switching and "bottleneck" policy noted above, would unjustifiably subject huge swaths of rail traffic to governmental rate and service regulation, putting billions of dollars in rail revenue at risk.

Finally, Congress, through Staggers, has provided (and the ICC and STB have implemented) effective remedies to protect shippers from abuse of market power or anti-competitive behavior. But Staggers was not designed to allow those unhappy with either the rates they are charged or STB decisions in rate cases to simply abandon the use of sound economic principles as a basis for rate decisions or to ignore the fundamental principle that railroads need to earn sustainable revenues.

Remedies for unreasonably high rail rates are available if it can be shown that the railroad does not face effective competition for the traffic at issue. Upon finding a rate unreasonably high, the STB is authorized to award reparations and to prescribe maximum rates for the future.

The STB has recognized that the procedures it uses in large rate cases — when hundreds of millions of dollars might be on the line — are not appropriate in all cases, especially when the amount at issue is relatively small. In response, the STB has instituted for smaller cases new alternatives that are far less expensive and time consuming. Railroads support making the STB rate and service adjudication processes accessible to all shippers, but the procedures used must be based on sound economic principles.

Misleading Claims by Rail Industry Critics

Proponents of additional regulations on railroads claim to have only the best intentions. They don't want to "reregulate" railroads, they say; they only want more healthy

"competition" that will make railroads stronger, within the spirit of the Staggers Act. They insist they "don't want to undermine the ability of railroads to function and make needed investments." They just want to update "outdated policies" that are "not equipped to handle today's challenges."

Don't let them fool you. When one looks at the actual policy changes that proponents of this view are urging upon Congress and the STB, it's clear that what they seek would substantially increase government control over crucial areas of rail operations in ways that would lead to a loss of efficiency, responsiveness, and potentially billions of dollars in rail revenue each year. It's unavoidable that rail investments and service would suffer greatly.

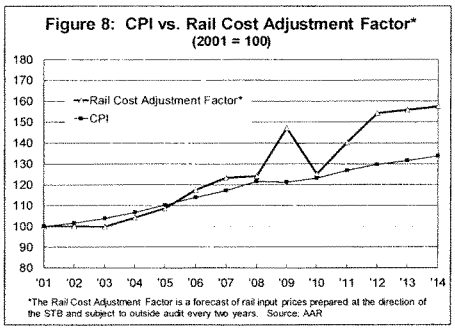
It's an unfortunate reality that, when trying to make their case, rail industry critics sometimes resort to misleading claims. For example, they complain that "railroad rates have surged 98% over the last decade – more than three times the rate of inflation."[9]

No one disputes that rail rates on average have risen in recent years. But as noted above, America's privately-owned freight railroads operate almost exclusively on infrastructure that they own, build, maintain, and pay for themselves. Higher rail earnings, made possible in part by those higher rail rates, have enabled railroads to plow back record amounts to keep the U.S. freight rail network in world-best condition.

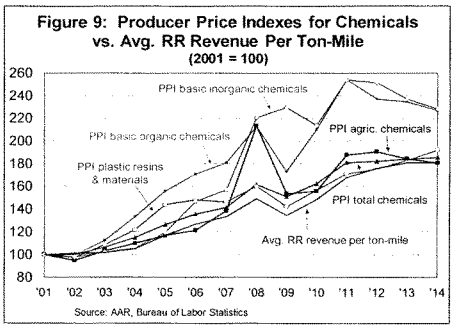
Putting aside that point, the claim that rail rates have increased "more than three times the rate of inflation" is irrelevant because the overall consumer price index (CPI, the basis for the "three times" claim) does not measure rail input costs. A price index that does is the Rail Cost Adjustment Factor (RCAF). The RCAF is prepared by the AAR under the direction of the STB and is subject to independent outside audit every two years. Since 2001, the RCAF

[9] This and other statements in this section come from various statements found on the web site of "The Rail Customer Coalition" (www.freightrailreform.com).

has risen much more quickly than the CPI (see Figure 8). That being the case, it would be surprising if rail rates had *not* risen much more quickly than overall consumer prices.[10]



It's ironic that some of the rail customer groups who complain about railroad rate increases in recent years have seen the prices they charge increase even faster. For example, according to data from the Bureau of Labor Statistics, average prices for chemicals, as measured by the producer price index, rose 85 percent from 2001 to 2014; prices for key chemical subsectors rose even more (see Figure 9). Meanwhile, average railroad revenue per ton-mile, unadjusted for inflation, rose 81% over the same period. In other words, the rail rate increases that the chemical industry is so upset about are no more than, and usually less than, the chemical industry's own price increases over the same period.



Finally, rail industry critics are wrong when they make the tired claim that "railroad consolidation has led to skyrocketing rates that are shielded from market forces." Like most U.S. industries, freight railroads have consolidated over the past 35 years. Rail mergers have

[10] It should be noted that railroads set their prices based on the value they provide to their customers, not on their input costs. So do firms in virtually every industry, including rail critics who don't want railroads to do what they do themselves.

not, however, reduced intra-railroad competition. Because of conditions placed on every major post-1980 rail merger, shippers that had multiple railroads serving them prior to the merger still had multiple-railroad service following the merger. The precedent that rail customers should not go from two-railroad service to one via a rail merger is so well established that in the most recent major rail mergers (more than 10 years ago), the merging railroads addressed such situations even before applying to the STB for approval.

Looking to the Future

The long-term demand for freight transportation in this country will undoubtedly grow. In fact, the Federal Highway Administration forecasts that U.S. freight tonnage will rise 45 percent by 2040. Railroads are the best way to meet this demand. With highway congestion becoming more acute and with public pressure growing to reduce emissions, conserve fuel, and promote safety, railroads are likely to be called upon to do even more in the years ahead, given their substantial advantages in these areas over other transportation modes. Demands for use of freight-owned track by passenger trains are mounting and will probably continue to grow. And, of course, as our economy evolves — as exemplified in recent years by the growth in rail intermodal traffic, chemicals, crude oil, sand, and other rail commodities — railroads will continue to be called upon to make additional investments in their networks to provide the efficient, reliable, and cost-effective freight transportation service that their customers, and our nation, need to prosper.

For that to happen, there must be appropriate public policies. Policymakers should acknowledge that for reasons of international competitiveness, safety, and economic growth, the United States has a critical and growing need for investment in transportation infrastructure. Private railroad investment in transportation infrastructure should be

encouraged, and regulations and legislation should not adversely affect railroads' ability or willingness to make those investments.

Conclusion

The deregulatory reforms of the Staggers Act have been tremendously successful. The flexibility Staggers provided has enabled railroads to rationalize and upgrade their systems, reinvest well over half a trillion dollars in productive rail infrastructure and equipment, generate higher levels of service, dramatically increase productivity, and improve safety — while, at the same time, sharply lowering average rates for shippers.

These successes could not have happened without a 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. The current system strikes an appropriate balance between providing railroads the freedom to compete effectively in the marketplace and providing shippers with a regulatory safety net if there is an abuse of railroad market power.

It may well be that particular elements of the current regulatory regime can be improved, and the rail industry is always willing to work with this committee, others in Congress, the STB, and other parties to identify areas where improvement might be made. That said, going forward, railroads need the continued flexibility that deregulation has offered in order to efficiently handle the rapidly expanding transportation needs of our economy. At a time when the pressure to reduce government spending on just about everything — including transportation infrastructure — is enormous, it makes no sense to enact public policies that would discourage private investments in rail infrastructure that would boost our economy and enhance our competitiveness.

STATEMENT OF

LINDA BAUER DARR

PRESIDENT

AMERICAN SHORT LINE &

REGIONAL RAILROAD ASSOCIATION

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE'S

SUBCOMMITTEE ON RAILROADS, PIPELINES, AND HAZARDOUS MATERIALS

REGARDING

THE 35TH ANNIVERSARY OF THE STAGGERS RAIL ACT: RAILROAD DEREGULATION PAST, PRESENT, AND FUTURE

MAY 13, 2015

American Short Line and
Regional Railroad Association
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Thank you Chairman Denham, Ranking Member Capuano and Members of the Committee. My name is Linda Darr and I am President of the American Short Line and Regional Railroad Association (ASLRRA). ASLRRA is a national trade organization representing the nation's 550 Class II and Class III railroads as well as 480 railroad suppliers and contractors that serve the railroad industry. Together short line railroads operate 50,000 miles of track or nearly 38% of the national railroad network. We are often called the first mile/last mile of the nation's railroad system and we handle in origination or destination one out of every four rail cars moving on the national system. On behalf of our members I thank the Subcommittee for giving us the opportunity to comment on the Staggers Act.

As Mr. Hamberger has said, the Staggers Act literally saved the railroad industry from near total collapse. In many respects the Staggers Act is also the parent of the short line industry as we know it today. The economic freedoms and regulatory flexibility embodied in that Act allowed the railroads to save light density branch lines rather than abandon them. The results were quite remarkable. Short lines have grown from 8,000 miles of track in 1980 to 50,000 miles today. They operate in 49 states. In five states short lines operate 100 percent of the state's total rail network. In 10 states they operate more than 50 percent of the railroad network and in 30 states at least one quarter of the rail network.

In saving the Class I industry the Staggers Act preserved the private national railroad network. In creating the modern-day short line industry the Staggers Act insured that huge areas of rural and small town America would stay connected to that national railroad network. For the small businesses and farmers in those areas, our ability to take a 25-car train 50 miles to the nearest Class I interchange is just as important as the Class I's ability to attach that block of traffic to a 100-car train and move it across the country. Tens of thousands of rail customers cannot make the journey across the country without Class I railroad service. But they can't start that journey without short line service.

Staggers jump started today's short line industry but I am proud to say that short line railroaders took hold of that opportunity and made the most of it. Today's short lines come in all shapes and sizes. Some are members of rail holding companies, some are large regional entities, and some

are small family owned businesses. Together they represent a diverse, dynamic and entrepreneurial collection of small businesses that have moved well beyond the traditional short lines of America's railroad lore. They are aggressive and agile companies that make wise use of the resources available to them. They employ a skilled, productive workforce, offering them a good quality of life and they place considerable emphasis on training that workforce to be as safe as possible. Above all, they are aggressive marketers that fight as hard for single carload business as they do for unit trains. And that fight for business helps keep transportation costs as competitive as possible which is good for our customers and ultimately for the nation's consumers.

Let me put a little more detail around a number of items that I think have contributed to short line success.

First the short line industry is blessed with a large number of entrepreneurs who took large financial risks to purchase and subsequently rehabilitate these light density lines. Most borrowed heavily from the bank and contributed substantial amounts of their personal capital to make these new ventures go.

Second, short lines have worked hard on building relationships with their customers. In the beginning many of those customers were our partners in helping save the most marginal lines. They did so by helping finance rehabilitation through realistic rates and by agreeing to meaningful traffic volumes. The short lines have continued to work closely and cooperatively with our customers. As many of you know the short line industry undertook an aggressive campaign to secure a rehabilitation tax credit in 2004 and I am pleased to say that our customers played an active and perhaps decisive role in that effort. Thousands of individual shippers have publicly supported the creation and the extension of the credit and communicated with their own Congressmen about the benefit they derive when their railroad infrastructure is improved.

Third, short lines reinvest on average as much as 30 percent of their annual gross revenues in repairing and upgrading their infrastructure. In absolute dollar terms this does not compare to

the huge private investment the Class I railroads have made, but it is a huge percentage of what we earn and it is evidence of our drive to succeed.

That investment has been supplemented by some very important help from Congress in the form of the so-called 45G rehabilitation tax credit which I alluded to earlier. The Members of the Transportation & Infrastructure Committee have been enormously helpful in shepherding this legislation through the legislative process and for that we are very grateful.

The credit was first enacted in 2004 and has been extended numerous times, most recently through December, 2014. We in the short line world believe this has been the most consequential piece of railroad legislation for our portion of the industry since the Staggers Act of 1980. The tax credit has been responsible for leveraging over $1.5 billion in short line capital investment. Just to give you some idea of the magnitude of this the National Railroad Tie Association estimates that the tax credit has resulted in the purchase of between 500,000 and 1 million ties annually over above normalized short line purchases. I might add, in the spirit of current debates on Capitol Hill, that every one of those ties is produced in the United States. Under the statute, short lines must spend one dollar for every 50 cents in tax credit up to a credit cap equivalent to $3,500/mile. And to be clear, the government is not giving us 50 cents, but rather is letting us invest more of our own earnings in capital investment. I think economists of every stripe will agree that maximizing capital investment is what grows our economy and creates jobs.

As of today we have 161 co-sponsors of our tax credit extension legislation and our goal is always to get more than the 218 needed for passage on the House Floor. I would be remiss if I did not use this opportunity to ask those of you who have not yet co-sponsored the legislation to please consider doing so.

Capital investment in railroads is about economic growth and jobs, but it is also about safety. Every dollar we invest in track rehabilitation makes our track safer. The overwhelming majority of train derailments are track related and the better our track the fewer derailments. There has been and will continue to be vigorous debate among transportation policy makers about the best

ways to insure and improve railroad safety. I think everyone in the railroad industry understands how important safety is. But in the last few years the railroad industry has been confronted with an avalanche of new rules, regulations, and technological requirements. The cost of these new mandates will run into the hundreds of millions if not billions of dollars. And we believe in many instances the proposed solutions are not supported by the science or by the experience and that their contribution to improving safety are negligible at best.

We can certainly discuss and debate the exact proper balance between cost and benefit but it seems to me we are getting seriously out of balance. The economics of everything the government is suggesting is enormously consequential and I hope that your Committee in particular can encourage a thorough consideration of these issues.

Before I leave the issue of safety let me briefly describe a short line initiative that we believe will help our members get at one of the key factors in improving safety. The Short Line Association has partnered with the Congress and Federal Railroad Administration to establish a Short Line Railroad Safety Institute which will become central to our Associations' mission moving forward. Our goal is to draw from the best and most current safety knowledge in the industry and to build an advisory board from all facets of the railroads, academic and research disciplines and to use their advice.

In our pilot phase, the Institute will engage a group of full-time safety experts who will assess the safety practices and safety culture of individual short lines, and make recommendations for changes. Our safety assessors will dig deep into short line operations and survey employees to make a realistic and unbiased determination of what needs to be changed or improved. The assessments will be confidential and we believe that confidentiality will provide an opportunity for candid and constructive criticism in a way that might not otherwise be possible. We expect to hear some very critical things, even on those properties that believe they have good safety plans in place. But that's our intention. This is not an effort to show that we are committed to safety, it is an effort to make us better tomorrow than we were the day before.

The Congress and the FRA has provided us the startup funds for this enterprise and we hope to have it up and running very shortly.

Your hearing today is to mark the 35th Anniversary of the Staggers Rail Act and it is an Anniversary well worth noting. The Staggers Act saved the national railroad industry and it was instrumental in creating the modern day short line industry. There are very few sitting Members of Congress that were here in 1980 and so there is little institutional memory of how bad things were for the industry. Your hearing today does a great service in helping explain to those who did not live through the darkest days of railroading the importance of this legislation.

I would like to conclude with a short anecdote that probably tells our story as concisely as anything I have said here today.

WATCO Companies is a prominent short line railroad holding company and its Executive Vice President currently serves as Chairman of our Association. In 1983, three years after the Staggers Act passed Dick Webb, the father of the current CEO of WATCO was a unionized car repairman at the Kansas City Southern. He took out a $25,000 bank loan to begin a rail switching operation in DeRidder, Louisiana which began WATCO Companies. Today WATCO operates 4,600 miles of short line track, employs 3,600 people and moves over 1 million carloads annually across railroad track that was surely headed for abandonment.

Hundreds of short lines across the country can repeat some version of that same story. It is a great American success story and it was made possible in no small measure by the Staggers Act.

I appreciate the opportunity to be here today and I welcome any questions.

STATEMENT OF JOHN W. MAYO

PROFESSOR OF ECONOMICS, BUSINESS AND PUBLIC POLICY

GEORGETOWN UNIVERSITY, MCDONOUGH SCHOOL OF BUSINESS

Hearing on

"The 35th Anniversary of the Staggers Rail Act:

Railroad Deregulation Past, Present and Future"

Before the House Subcommittee on Railroads, Pipelines, and Hazardous Materials

May 13, 2015

Chairman Denham, Ranking Member Capuano and members of the Subcommittee:

My name is John Mayo. I am a Professor of Economics, Business and Public Policy at Georgetown University's McDonough School of Business. I am also the Executive Director of the Georgetown Center for Business and Public Policy.

For 30 years I have studied the economics of regulation and deregulation in the American economy in a variety of industries including electricity, telecommunications, cable television, pharmaceuticals, the Internet, as well as the domestic freight rail industry. A summary of my research publications and relevant experience is included as an attachment to this testimony.

In 1980, the Staggers Act passed Congress in an overwhelming bi-partisan fashion. It was also signed and enthusiastically endorsed by President Carter.[1] This Act fundamentally altered the governance structure of the rail industry, shifting from a highly granular model of regulation to a model in which markets, rather than regulators and rate bureaus, are largely responsible for establishing prices and investment.

Importantly, this legislation was not driven by simple ideology. It did not embrace deregulation out of a belief that markets are *always* superior to government. Neither at the time of the passage of the Act did ideologues argue that steps to free railroads from regulatory constraints should be halted out of a fear that large railroads would *necessarily* act against the public interest. Rather,

[1] When signing the Act, President Carter observed "By stripping away needless and costly regulation in favor of marketplace forces wherever possible, this act will help assure a strong and healthy future for our Nation's railroads and the men and women who work for them. It will benefit shippers throughout the country by encouraging railroads to improve their equipment and better tailor their service to shipper needs. America's consumers will benefit, for rather than face the prospect of continuing deterioration of rail freight service, consumers can be assured of improved railroads delivering their goods with dispatch." Available at http://www.presidency.ucsb.edu/ws/?pid=45284\

the deregulatory measures adopted in Staggers were embraced for a simple and profound reason. Deregulatory steps in the industry were as a practical – not ideological – matter being revealed to produce superior economic outcomes for the industry and for the economy more generally. Legislators from both political parties, economists and industry observers at the time were all optimistic about the potential for improved rail performance with the Staggers Act. Of course, optimism on the front end of any legislation is normal. The real question is how have economic outcomes evolved for consumers, for producers and for the American economy in the wake of Staggers.

Fortunately, we now have 35 years of experience with the Staggers, and I can tell you with considerable confidence that the governance structure of the Act has been significantly successful.

This was recognized by Congress as early as 1995, when the Senate Commerce Committee declared, "The Staggers Act is considered the most successful rail transportation legislation ever produced, resulting in the restoration of financial health to the rail industry."[2] Consequently, with President Clinton's support, Congress took the additional step of further easing regulatory constraints by eliminating the Interstate Commerce Commission, replacing it with the current Surface Transportation Board. Importantly, the bill transferring authority to the STB "carefully avoided alteration of the fundamental premises of the Staggers Act."[3]

With the benefits of an additional twenty years of observation since the 1995 Congressional blessing of the Staggers Act, it is now possible to look afresh at whether the Act is succeeding in promoting "a safe and efficient rail transportation system"[4] as called for in the Act.

Economic signals of efficiency include increased output, increases in the breadth and utility of service offerings (manifested by increased modal market share for rail), reduced costs, and indications of consumer value (favorable raw prices, prices after accounting for cost changes, and quality of service). As with all transportation modes, safety is principally gauged by the frequency and severity of casualties.

While a detailed discussion of these retail economic metrics is beyond the time permitted by my oral testimony, I am taking the liberty of attaching a recent study that I co-authored with Professors Jeffrey Macher and Lee Pinkowitz also of Georgetown University's McDonough School of Business that examines the economic metrics associated with the industry. We find, as have numerous other scholars, that the liberalizations introduced by Staggers and their subsequent implementation have produced a variety of positive economic consequences, for the industry, for consumers and for the economy as a whole.[5]

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[2] REPORT OF THE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION on S. 1396 NOVEMBER 21, 1995, p. 3.
[3] Ibid, p. 7.
[4] §10101a(3).
[5] Beyond our analysis, see *inter alia*, Burton, Mark L., "Post-Staggers Railroad Oversight as an Example of Results-Based Regulation," working paper, University of Tennessee, February 2015; Carew, Diana G. and Michael Mandel, "US Investment Heroes of 2013: The Companies Betting on America's Future," Progressive Policy Institute, (2013); McCullough, Gerard J. and Louis S. Thompson, "A Further Look at the Staggers Act: Mining the Available Data,"

We also identify areas of vulnerability as future rail policymaking unfolds. Of particular concern is the prospect that the emerging successes in the industry may be coopted by the imposition of earnings regulation in the industry. These concerns are discussed in detail in the research article that is appended to my written testimony.

Thank you very much for your time and attention today, and I look forward to any questions that you might have.

Research in Transportation Business and Management 6 (2013): 3-10; Burton, Mark L., "The Economic Regulation of US Railroads: Understanding Current Outcomes and Deliberating a Future Course," *Journal of Transportation Law, Logistics and Policy* 78 (2011): 271; Caves, Douglas W., Laurits R. Christensen and Joseph A. Swanson, "The Staggers Act, 30 Years Later," *Regulation* 33 (2010): 28; Eakin, B. Kelly and Philip E. Schoech, "The Distribution of the Post-Staggers Act Railroad Productivity Gains, *Christensen Associates, University Bay Drive, Madison* (2010); Eakin, Kelly, et al., "A Study of Competition in the US Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition: Executive Summary," (2008); Gaskins, Darius W., "Regulation of Freight Railroads in the Modern Era: 1970-2010," *Review of Network Economics* (2008): 561-572; Winston, Clifford, "The Success of the Staggers Rail Act of 1980," *AEI-Brookings Joint Center for Regulatory Studies* (2005); Ellig, Jerry, "Railroad Deregulation And Consumer Welfare," *Journal of Regulatory Economics* (2002): 143-167; Wilson, Wesley W., "Cost Savings And Productivity in The Railroad Industry," *Journal of Regulatory Economics* (1997): 21-40; Burton, Mark L., "Railroad Deregulation, Carrier Behavior, and Shipper Response: A Disaggregated Analysis," *Journal of Regulatory Economics* 5 (1993): 417-434; Barnekov, Christopher C. and Andrew N. Kleit, "The Efficiency Effects of Railroad Deregulation in the United States," *International Journal of Transport Economics (1990): 21-36;* McFarland, Henry, "The Effects of United States Railroad Deregulation on Shippers, Labor, and Capital," *Journal of Regulatory Economics* 1 (1989): 259-270; Ferguson, Lucy, "Regulation and Innovation: The Case of Piggybacking," *Eastern Economic Journal* 5 (1979): 453-462; Houston, Douglas A., "A Note on Railroad-Shipper Transactions: Appropriation, Private Contracts, and Regulation," *Transportation Journal* (1979): 60-66.

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May 13, 2015

Chairman Bill Shuster
Committee on Transportation and Infrastructure
U.S. House of Representatives
2251 Rayburn House Office Building
Washington, DC 20515

Re: Support for HR 2204

Dear Chairman Shuster,

On behalf of the Town of Grafton, Massachusetts, I write in support of HR 2204, filed by Congressman Jim McGovern. A suburb of the City of Worcester, Grafton is picturesque New England town of about 18,000 people. Grafton and its residents are currently facing a crisis: the siting of what will be the largest liquid propane gas ("LPG") facility in the Commonwealth of Massachusetts in a residential zone, in close proximity to many homes, the Town's K-2 elementary school, a park/playground, library, and in the Town's Water Supply Protection Overlay District established to protect one of the Town's aquifers.

This disastrous siting decision has been made by the president of a local short line railroad, Grafton & Upton Rail Road ("GURR"). GURR recently acquired a parcel of land upon which a single family farmhouse stood for over a century. It leveled the home and began construction on its LPG facility. In addition to bringing in LPG by rail and transloading it into four 80,000 gallon tanks for temporary storage, GURR is planning a massive trucking operation —GURR president estimates 2,000 rail cars of propane will arrive annually, with each rail car translating to numerous tanker trucks that will be transporting LPG through Grafton's neighborhoods.

This shocking siting decision is possible only due to GURR's claim to federal preemption under the Interstate Commerce Commission Termination Act (ICCTA) of 1995. In September of 2014, the federal Surface Transportation Board issued a decision holding that all local zoning and environmental regulations are preempted, and therefore

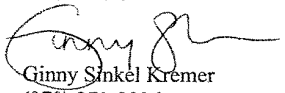
the Town can do absolutely nothing to regulate any of GURR's transloading or trucking activities related to its planned LPG facility.

It should go without saying that the STB's decision is devastating to the abutters, whose environment, quality of life, and even potential health and safety will be threatened. Additionally, an expert appraiser has determined that, after the construction of the facility, their homes – their biggest financial assets – will be rendered unmarketable. The STB's decision is also very disturbing to the parents of the 5 through 7 year old children who will attend school in the shadow of the facility. The Town's leaders are alarmed at the prospect of this massive industrial operation taking place on roadways and infrastructure not designed or constructed to support such an operation, as well as near sensitive environmental receptors such as ponds, wetlands, and one of the Town's aquifers.

The history and statutory context of the ICCTA make clear that Congress did not enact the preemption provisions of that law to shield such wildly inappropriate siting decisions. Rather, the main purpose of the predecessor to the ICCTA, the ICA, was to prevent the prevalent abuse of shippers captive to railroads at a time when there were few transportation alternatives available. For decades, the States and federal regulators shared regulatory authority over rail carriers, and the extension of federal reach under the ICCTA only supplanted what had been the States' previous role in railroad regulation. In fact, in enacting the ICCTA, Congress did not intend to preempt State or federal law except with respect to direct *economic* regulation. It certainly did not intend to supplant traditional police powers, such as local zoning and environmental regulations enacted directly by the people to determine what uses and protections should be available in their own cities and towns.

Nonetheless, the STB has steadily eroded the ability of states and localities to protect their citizenry from these kinds of outrageous siting decisions by rail carriers. Congress recognized that and recently amended the ICCTA to prohibit rail carrier abuse of the preemption doctrine in the context of solid waste facilities. HR 2204 would simply extend that protection to states, localities, and people with respect to LPG facilities. On behalf of the Town of Grafton and its residents, I urge swift passage of this bill.

Very truly yours,



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Cc: Peter DeFazio, Ranking Member
Jeff Denham
Michael Capuano
Jim McGovern
Timothy McInerney, Grafton Town Administrator

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