S. HRG. 109–1159

ECONOMICS, SERVICE, AND CAPACITY IN THE FREIGHT RAILROAD INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION AND MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

JUNE 21, 2006

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ECONOMICS, SERVICE, AND CAPACITY IN THE FREIGHT RAILROAD INDUSTRY

WEDNESDAY, JUNE 21, 2006

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

The Subcommittee met, pursuant to notice, at 10:05 a.m. in room SD–562, Dirksen Senate Office Building, Hon. Trent Lott, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. TRENT LOTT, U.S. SENATOR FROM MISSISSIPPI

Senator LOTT. The Committee will come to order.

Welcome. Looks like we've got a great deal of interest in our hearing today. And we have two outstanding panels that we're going to hear from. So, I'm pleased that we are going to have an opportunity to get the results from a study of freight railroad issues conducted by the Government Accountability Office. These are preliminary results, but it is our first opportunity to hear some details and be able to ask some questions.

There were three major questions that we asked the GAO to examine: What changes have occurred in freight railroad industry since the passage of the Staggers Act, including rail rates and competition in the industry? Two, what do these changes suggest about different approaches to regulating freight railroads? And, three, what are the projections of freight traffic demand over the next 15 to 25 years, the freight railroad industry's projected ability to meet that demand and the potential for federal policy responses?

I strongly believe in the need for a sturdy, dynamic, and economically viable freight rail industry. It's absolutely essential for the future. I've said that privately and publicly, and I'm working on some ideas to contribute positively in that direction. I've started to ask the questions, how many lanes and how many planes can we put on the roads and in the air? The answer to what our needs are is clearly in the freight railroad industry, and we need to encourage that. We need to have a viable industry. And we need to make sure that we don't do anything that's going to slow down or undermine that.

On the other hand, we often hear from rail shippers that are very frustrated about the cost of rail service. They complain about poor service. They deserve to have a recourse that is fair and accessible. And I've met with the Chairman of the Surface Transportation Board, Doug Buttrey, to discuss these problems. He has a number of initiatives underway I hope he'll be aggressive about in that area, and, you know, that he perhaps will have some recommendations to us in the future.

But there has to be a proper balance here. I talk to shippers. I also talk to the railroad industry. I continue to urge both sides to look for common sense answers. However, I've also made it very clear, if some of the problems are not realistically addressed, we will do whatever is necessary to make sure it happens. For instance, if I find any evidence that railroads are using fuel surcharge as a way to make a little extra money, there's going to be a real problem. And I've made that clear, privately; and I'm making it clear publicly now, because that just cannot be what happens on fuel surcharges. We've got enough of a problem in this country now with ridiculous fuel costs and charges, and we can't have people taking advantage of the opportunity to make even more money under difficult circumstances.

So, I don't want to prejudice anything that's going to be said in the hearing, but I wanted to get that marker down early. And I'd be glad to yield to my good friend, the Senator from Montana, Conrad Burns, who has been pursuing this hearing and has been very careful in laying the necessary groundwork. And I'm delighted to see him here.

I would be glad to hear from you, Senator Burns.

STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Senator BURNS. Thank you very much, Mr. Chairman. And thank you for this hearing today. I appreciate that very much, as we've been kicking this thing around for the last 2 or 3 years. And so, I thank you for this hearing. This is the first time that this Committee has taken a step, and what I think is a very positive step, in just having this hearing.

I don't have much of an opening statement this morning, but I want to—there are a couple of items that I want entered into the record. The Alliance for Rail Competition, they have—I want their full statement entered into the record, because we want to get to the questions. We're kind of dealing with a little bit of time limit here, and I don't like that.

Senator LOTT. Senator Burns, let me just say that for you and others that might come in, your entire statement will be made a part of the record, and any additional statements that you'd like entered at this point, we'll put them right in behind your statement.

Senator BURNS. Thank you very much. Appreciate that. And there's a statement by the National Barley Growers Association, and the Montana Wheat & Barley Committee, up in my state, where we have a particular situation that I think needs remedying.

[The information previously referred to follows:]

PREPARED STATEMENT OF THE ALLIANCE FOR RAIL COMPETITION (ARC)

Mr. Chairman and members of the Committee, this statement is submitted for the record on behalf of the members of the Alliance for Rail Competition.

The Alliance for Rail Competition was founded in 1997 by shippers who believe that the shipper community must present a unified front made up of diverse industries across the country in order to garner support for policy reform and balanced solutions to America's freight rail challenges. In ARC, the leaders of the largest chemical companies, the largest carload electric utilities and largest railroad shippers of an incredible variety of goods, have united with the largest group of agricultural interests in the search for responsible solutions.

Of the testimony you will hear today ARC endorses in particular the testimony of Mr. Dale Schuler, President of the National Association of Wheat Growers. Mr. Schuler well represents the agriculture members of ARC in his testimony today.

Freight rail shippers today would face daunting enough challenges in their quest to compete in the global marketplace even if they did not also find themselves captive to a ravenous monopoly. Yes, in many parts of the country whole industrial and agriculture sectors are in the clutches of a monopoly which has been either created or tolerated by misguided Federal policy for decades.

Shippers do not believe that this monopoly is made up of evil people bent on evil purposes. This situation is driven instead by pure, cold economics which has produced a set of incentives counter to both the interests of shippers, the long-term interests of consumers and the country as a whole.

Let's take the issue of capacity.

Today we are told that the system is straining at the seams to move freight. At the same time the railroads are enjoying record profits and are all rated by Wall Street as "buy" items. Well, let's think about that.

It seems that there is financial incentive for railroads to keep capacity down therefore keeping prices high . . . and rising. It's like the hot new toy at Christmas. Everyone knows there won't be enough to go around, so they clamor for the available supply and bid up prices. This is really simple economics. And we just wonder how anyone could expect any business to expand its product . . . or service . . . knowing that the incremental price of that service would immediately fall.

Seeing this force at work every day, shippers have banded together for years now and asked for help from elected policymakers in Washington. For several years shippers have been united in support of S. 919, the proposed Rail Competition Act, sponsored by Senators Burns, Rockefeller and Dorgan on this Committee as well as eight additional Senators. Shippers have rallied behind this bill not because we believe it to be perfect, but because we believe it is a positive starting place for finding solutions to the country's freight rail transportation problems.

Yes, this is the country's problem.

Yet, shippers have felt that their interests and their efforts to seek positive policy changes have been ignored by our leaders in Washington. Why? Is it because it's too hard? Is it because there isn't a real problem?

This is a time of turmoil in Washington and, in all candor, shippers are discouraged when they see lavish parties provided by the railroads at each of the major political conventions. Shippers are discouraged when they see on internet sites that railroads are very high on the list of providers of privately funded trips. Shippers are discouraged when they do not find any relief at the Surface Transportation Board for years running, yet they watch STB commissioners fly off into the sunset joining law firms representing and lobbying for the same railroads they formerly regulated. Shippers are discouraged when they watch staff members of the same STB go to work directly for the railroads and subsequently show up at STB regulatory hearings representing Class I railroads. We suppose this is all legal . . . all within the rules . . . but it surely is discouraging.

Shippers believe that the intent of Congress in enacting the Staggers Act in 1980 was good. But we also believe that a series of unfortunate decisions made by appointed government functionaries has usurped the intent of elected officials like those who serve on this Committee. We are only asking our elected officials to correct these inequities and assert their primacy as the people's representatives. We are asking you to work with us, and the railroads, to find solutions which will propel competitive U.S. commerce through this new century. But it is imperative that you act.

This problem will not solve itself. The financial incentives are working in favor of a status quo that cannot be maintained. Sooner or later this will wind up at your doorstep. The only question is how much it will cost to solve. This is a burgeoning crisis that grows larger each day. So we ask you to act now, even incrementally, to avert crisis and improve the future.

ARC members continue to look to this Congress to provide the leadership and impetus for needed change.

It has become clear to Dow Chemical (Dow) Worldwide that domestic competitiveness is being hindered by the lack of competitiveness in the North American rail market. Dow Chemical, according to Brad Gray, Director of Global Purchasing, . . . "views the world as a single market, rather than an aggregation of regions and blocs. In a single world market, companies from every corner of the world are competing with one another. The current state of the rail market, with unreasonable fuel surcharge practices, unreliable service and limited capacity will continue to hinder Dow's competitiveness in the world market. Railcar transit time has increased significantly. On the U.S. Gulf coast where Dow is the most captive chemical company, a rail executive has indicated to Dow that improvements won't occur until 2010 or beyond. The current service problems, in Dow's opinion, have been magnified by lack of competitive alternatives."

A large Midwestern utility member echoes the captive rail customer concern when it states, "Scarcity increases the price of a commodity and rail transportation is no exception to this. It is preposterous for an industry to act in a monopolistic manner while the regulator, whose job it is to protect the rail customer from monopolistic behavior stands by and does nothing. A regulated monopoly should always face standards of performance that are not abusive to customers in order for that regulated entity to be allowed the "privilege" of being able to receive a regulated rate of return."

Rail shippers are the canary in the coal mine. Seeing us in distress should send an alarm throughout the economy. The only question, it seems, is when you will respond to the alarm. We know that the problem is difficult, but the consequences of inaction are dire indeed.

The members of the Alliance for Rail Competition will meet with any parties, at any venue if it will further this debate and move in a positive direction. But we understand that railroads will continue to vociferously defend the "now" . . . even if it means eating their own future. Our elected policymakers must intervene for the good of the country . . . for the good of us all.

Come let us reason together.

MICHAEL E. GRISSO,
Executive Director.

JOINT PREPARED STATEMENT OF THE NATIONAL BARLEY GROWERS ASSOCIATION AND AMERICAN MALTING BARLEY ASSOCIATION

Mr. Chairman and members of the Committee, the National Barley Growers Association (NBGA) and American Malting Barley Association (AMBA) are pleased to submit this written testimony on behalf of their barley producer and processing members concerning impacts of rail rates and service on the U.S. barley industry.

We estimate more than half of the U.S. barley crop moves to marketing positions by rail. The majority of our barley production region is now captive to one railroad and we pay freight rates well above those rates paid by other grain suppliers who have competitive transportation options. For example, rail rates in North Dakota (largest barley producer) and Montana (third largest producer) are between 250 to 450 percent of the railroad's variable cost—far in excess of the Surface Transportation Board's threshold of unreasonableness of 180 percent. Because of these higher rates and often unreliable service, it is very difficult for barley from our traditional production areas to compete with other suppliers in both domestic and foreign markets.

We pride ourselves on producing some of the highest quality barley in the world, but if we cannot get our product to market competitively then our quality advantages won't matter. U.S. negotiators are trying to help us be more competitive in world markets through the WTO trade negotiations, but again it won't matter if we get the best trade deals if we can't ship our products competitively.

The following are specific rail issues that have directly impacted U.S. barley competitiveness.

Ten years ago, barley comprised about 20 percent of the grain fed to dairy cattle in the large California and western U.S. dairy shed. However, we have lost these once large barley markets to corn because of deliberate decisions by the two dominant western railroads to price unit trains of Midwestern corn into these western feed markets at rail profit levels well below the 180 percent threshold of variable cost.

Captive rates and service have prevented the movement of western U.S. malting barley east to malt processing plants, forcing these plants to source a portion of their needs from Canada. These processing plants need specific varieties of malting barley that are only grown in the western states and Canadian provinces due to agronomic factors. Furthermore, Canadian barley currently moves to West Coast export points at about two-thirds the cost of similar westbound movements in the U.S.

Loss of short lines has become a significant factor in Washington barley competitiveness.

We believe that the unrestrained monopoly power that exists in the U.S. rail industry today has led to inferior service and excessive freight rates, particularly in captive areas. This lack of competition has allowed monopoly railroads to shortchange both feed and malting barley, which typically move in smaller volumes to multiple destinations, in favor of large movements of a single grade crop (like corn) from a single origin to a single destination.

Without a doubt, the U.S. economy relies on a healthy and competitive rail industry. However, we believe that both shippers and railroads will directly benefit from competition in the marketplace. Therefore, we support provisions in Senate Bill 919 that address current abuses of monopoly power in the rail industry and promote a competitive balance between shippers and railroads without increasing regulation.

Thank you for your consideration of our concerns with rail service in the U.S. barley industry.

PREPARED STATEMENT OF THE MONTANA WHEAT & BARLEY COMMITTEE

Thank you for the opportunity to present this testimony for the record of this hearing.

The Montana Wheat & Barley Committee wishes to thank Senator Lott for holding this important hearing and the Montana Wheat & Barley Committee appreciates his valued leadership in seeking solutions to these important issues affecting rail transportation and the rail shippers all over the Nation.

We also want to especially thank Senator Conrad Burns for his tireless leadership on efforts to solve the captive rail customer's problems on the Nation's railroad system. His unceasing and consistent work coupled with an unrelenting push to find solutions to the "railroad problems" has earned Senator Burns a great deal of respect among the Nation's rail shipping communities in agriculture, chemicals, utilities, glass, manufacturing and production plus the consumers that rely on rail for commerce.

You are going to hear from rail customers (shippers) about continuing capacity and service issues. Some will testify about the economics of railroading. The railroads will come to you espousing the virtues of spending more money on infrastructure and that they are doing the best they can. The Surface Transportation Board, after Congress passed the Staggers Rail Act in 1980, allowed and oversaw the most massive concentration of rail power to amass in this country since its formation in 1867. Now is the time for Congress to revisit the Staggers Rail Act after 25 years. We have had more or less continuing railroad capacity and service issues without interruption for almost two decades—ever since the railroads started their march to gobble up all of their competitors.

The rail captive areas of this country see service and capacity issues as symptomatic of the more basic problem—over-concentration of the railroad industry. When four of the five Class I railroads control over 94 percent of the freight revenue generated in this country—Congress should not only be interested, they should be alarmed.

It has never been in the public interest to allow the growth of monopoly industrial base without some form of economic oversight.

I. Introduction

The Montana Wheat & Barley Committee (MWBC) represents the wheat and barley producers of the state of Montana. Montana is a natural resources state with the main economies built upon products of mines, lumber and agriculture, as well as tourism. In order for our bulk products of the mine, lumber and agriculture to have value, they require bulk transportation (rail) to points outside Montana and, in many cases, outside the U.S.

Therefore, the State's economic survival depends on having access to good, affordable, and adequate rail transportation and attendant facilities, with reasonable published notice of rates and rules, so that its shippers can deliver a competitively priced product outside the state boundaries.

Montana wheat and barley producers do not have economic alternatives to rail transportation. They are held captive and tied to rail with no viable alternatives to movement by rail. *The Montana wheat and barley producers are unique because they* *are the bearers of the freight and cannot pass on increased transportation costs. The farmer must absorb all freight costs.* Virtually all other industries have some capability of passing on some or all of its increased costs to their consumers or customers. The farm producers are unique because they operate in an environment where they do not have any control over the price they receive for their crop and they must bear every increase, in all costs, including transportation costs, without any possibility to pass those higher costs on to anyone else. The farm producers who are captive are thus truly without alternative.

II. Montana's Primary Transportation Is a Single Railroad

Montana is a base industry state. In the 1800s, its chief industries were mining, lumber and agriculture. Today, and in the future, Montana's chief industries will be the same three industries: mining, lumber and agriculture, with the addition of tourism. Today, we, in Montana, have one major railroad, the BNSF Railroad, operating as a monopoly in the transportation of bulk commodities from the farm to market.

Outline of Industry in Montana

1. The wheat industry in Montana is characterized by an export-dominant rail movement.
2. The barley industry in Montana is characterized by both an export and domestic market dominated by rail.
3. The lumber industry in Montana is characterized by both an export and domestic market dominated by rail.
4. The coal industry in Montana is characterized by domestic rail movement.
5. The vast majority of these commodities must be shipped out of state.

III. Montana Is an Export State

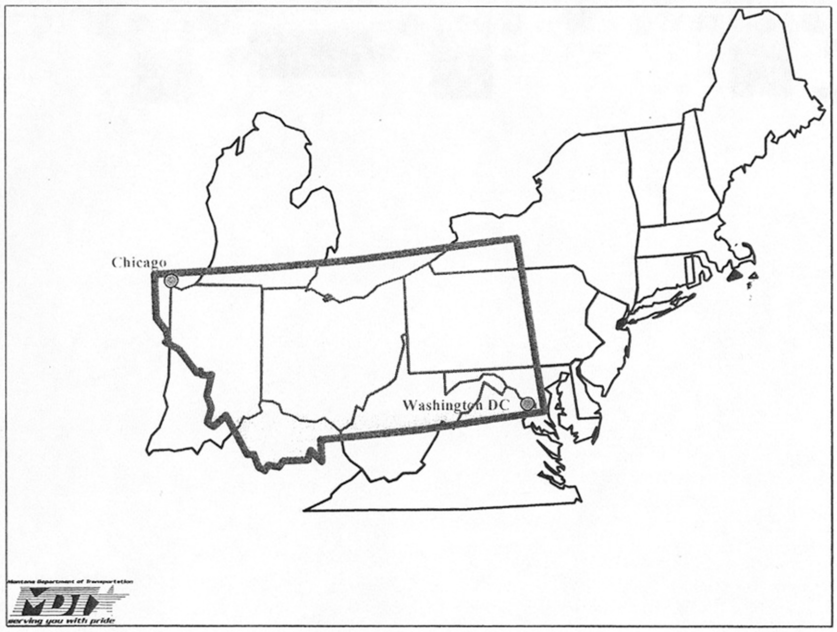
Montana's top four industrial activities are agriculture, tourism, mining and lumber. Montana's economy and wealth is thus highly dependent upon the production and shipment of commodities. In order for these commodities to have value to Montanans, they must be shipped to points outside the state or country to market. It is this absolute reliance upon good, affordable, and efficient transportation that brings me to this hearing today. We hope for a better day, where fairness in regulatory oversight and more rail competition will rule the land. Meanwhile, we struggle every day trying to survive under monopoly domination. Montana grain producers are being required to pay more for this BNSF merger than their counterparts in the grain producing industry where effective rail-to-rail competition exists. That payment has come in the form of increased transit times, increased rail rates and low car supplies.

Montana ranks third among the states in all wheat production. More specifically, it ranks 3rd in spring wheat production and 2nd in durum production. Montana also ranks 3rd in barley production, 3rd in lentils production, 3rd in dry edible peas production, 2nd in Austrian pea production, and 2nd in flax production. Montana originates over 37 million tons of rail traffic, which ranks it 17th in the Nation. At the same time Montana bridged over 78,000,000 tons of rail traffic.

For the farm producer, the cost of transporting grain can represent as much as one-third (1/3) the overall price received for the grain. Basically the Montana farmer works for BNSF every 3rd year.

IV. Montana Rail Transportation Is Predominated by One Carrier

Montana is dominated by a single railroad, the BNSF, which controls 94 percent of the Montana rail system. This makes Montana the #1 rail-dominated state in country. After Montana at 94 percent is Delaware at 83 percent, followed by Idaho at 80 percent, North Dakota at 66 percent, and South Dakota at 54 percent. The BNSF controls over 91 percent of the actual tonnage hauled out of Montana and 92 percent of the rail revenue generated in the state. Since 1975, Montana has seen over 1,900 miles of rail line abandoned (over 37 percent of the rail miles) because there is no rail-to-rail competition. And the distances are large—very, very large. To put this vastness in perspective, if one were to place one corner of Montana over Washington, D.C., the other corner would cover Chicago, IL.



Annually, the Montana producers move about 150 million+ bushel production that is handled by rail from Montana and bear about $200+ million in freight transportation charges per year.

Our Montana concerns are founded on four points:

1. Rail transportation is vitally important to Montana's raw commodity-based economy.
2. Montana's rail system increasingly serves simply as a bridge for long-distance traffic.
3. Increasing numbers of short lines and abandonments have reduced Montana shipper access to Class I rail service.
4. Dominance of one Class I railroad continues as the #1 freight issue in Montana.

V. Service and Capacity

Many have stated that Congress "deregulated" the railroads in the Staggers Rail Act of 1980. Let there be no mistake—Congress DID NOT "deregulate" the railroads, but rather relaxed many of the economic regulations, because Congress feared that many railroads were going bankrupt! Today, however, the landscape has changed. Railroads aren't going bankrupt, rather they have combined into a few, large, monopolistic carriers controlling large areas of the economic vitality of this country, and forcing captive shippers to pay for this "relaxed" regulatory environment. *This "relaxed" regulatory environment allows railroads to insulate themselves from accountability.*

When the Staggers Rail Act became law in 1980, Congress recognized the need to give more pricing freedoms to the railroads to stem the tide of rail bankruptcies occurring in the U.S. *Congress also recognized, that with the newly found pricing freedoms the railroads would enjoy, some shippers would potentially be subject to dominant activities by carriers with less regulatory oversight protection from abuse.* Simply put, less economic regulatory oversight would result in less protection for those shippers who were captive and had no economic alternative to move their goods except by rail. The result would be that some shippers would become "captive" to "market dominant" railroads. The Staggers Rail Act also instructed the Interstate Commerce Commission (ICC) to set up rate guideline procedures to adjudicate the rate issues that would come before it. Congress even set up, under Section 229, procedures whereby shippers who felt they were captive could request adjudication of their rate levels, on a one time basis.

The Montana Wheat & Barley Committee's experience with the ICC/STB in litigation has been less than stellar. Shippers used to take cases to the Surface Transportation Board expecting to get fair and balanced treatment, but shippers haven't found any relief at the STB for a long, long time. They have instead become so discouraged by the precedents of the past few years that only a very few have the funds, or the confidence, to bring a case. Faced with the effects of a railroad monopoly that was withering away a key element of the state's economy, Montana in 1980 filed a class-action and formal complaint (under Section 229 of the Staggers Rail Act). We pursued the *McCarty Farms* case for *17 years*. In this case the *ICC on December 14, 1984 found that the BN had market dominance and that its rates were unreasonable*. The Administrative Law Judge (ALJ) further found that the rates were higher than 300 percent of variable cost! The State of Montana spent $3.2 million, yet the STB in 1997 found that these rates were not excessive! The Board ruled against the farm producers of Montana after changing the regulatory standards twice.

As we stated earlier and it bears repeating, the truly rail captive areas of this country see service and capacity issues as symptomatic of the more basic problem—over-concentration of the railroad industry.

It has never been in the public interest to allow the growth of monopoly industrial base without some form of economic oversight.

In 1980, when Congress passed the Staggers Act, the last major piece of railroad legislation, we had 42 Class I railroads in the U.S. Today, after mergers and acquisitions, we are down to about 5. This has led to more and more businesses being served by only one railroad, exercising virtual monopoly power to price according to its needs, not according to market value and competition. Along with this massive concentration there has been a serious degradation of service and quality. And it has led to rate escalations that threatens American productivity and jobs. Freight rail is the only industry in the country that operates with this lack of competition . . . and exemption from most anti-trust law.

The strength and vitality of America's freight railroads is of vital importance to the Montana wheat and barley producers and to the Nation and its business' ability to remain competitive in the world. We want more railroads . . . not fewer.

But we believe that marketplace conditions would improve both shippers and railroads alike with more competition in the railroad industry. Indeed the current scheme of things where railroads rely on their ability to differential price solely on the basis of captivity is a one-legged stool approach that is doomed to fail. This country can ill-afford the failure of this vital industry. Railroads are not a luxury. Railroads are essential to the American marketplace and our national security. Therefore, it is necessary that public policymakers address this problem and work with all parties toward solutions before a larger crisis presents itself to us all. Left on our present course, we are sure to see a final round of mergers proposed to leave the entire country with only two Class I railroads.

This is an issue that is vital to American competitiveness and productivity and to the retention and creation of American jobs as well as the health of our economy. This lack of competition is like an invisible tax, tolerated if not sanctioned by Federal policy, that works its way into the costs of goods and services across the country. All because the arcane nature of the arguments have baffled and frightened elected officials into inaction.

Oh, there are a lot of confusing arguments being made by opponents of balance. But we in Montana are from the country and we have a simple way of looking at it. The farm producers of Montana and the Members of Congress have been bamboozled. The railroad cry is similar to that of Chicken Little that the sky will fall if ANY changes are made by Congress to their monopoly rail system. No legislator wants to take action that might cause the failure of one of our railroads. Neither do Montanans. No one has a greater interest in sound railroads than shippers, not even the railroads themselves. We do not believe for a moment that proposals to increase competition would cause harm. Indeed, we believe quite the opposite to be true. We don't believe that this mighty 100 year old industry cannot survive in a world where competition is the driver of innovation and progress like every other industry in America. In testimony before the House Transportation Committee in 2005, Dr. Curtis Grimm of the University of Maryland delivered compelling testimony to that effect.

VI. Congress Needs To Look At More Than Just Capacity and Service Issues To Address The Public Interest

The Montana Wheat & Barley Committee is calling upon Members of Congress to address this unhealthy imbalance in the freight rail marketplace. To look at just capacity and service issues without addressing the real problem does little to help the public interest. Capacity and Service issues while severe are only the symptoms and results of a problem of too much concentration in the railroad industry and too little competition.

This Surface Transportation Subcommittee is charged with finding solutions and has many members that have dedicated themselves to seeking real solutions to the massive concentrations issue in American railroading.

This Subcommittee does not have to reregulate the railroad industry nor mandate trackage rights for one railroad over another nor cap rates in order to develop solutions, but it must address that massive concentration that affects over 1/3 of this Nation's rail shippers.

Congress must address a bill which would finish the job of deregulation and take off armor that now protects freight railroads from the real world marketplace that all of us compete in every day.

Indeed, what we in Montana now have is a federally protected monopoly. And it has been our experience that monopolists do not voluntarily embrace change and competition.

VII. The Problems Rail Shippers Face Are Getting Worse Every Year

We know this has been a problem for years . . . but it is getting worse as freight rail consolidation and contraction continue. You only have to look at the car shortage reports on grain shipments the past three harvest seasons that made the front page of the *Wall Street Journal,* or this new change back to tariff-like rates on coal with prices increases up to 100 percent, or the incredible fact that one of our major railroads is paying customers to ship by truck because they can't get their act together and honor standing contracts. The railroads are citing as "force majeure" reasons for their capacity shortfalls thereby barring rail shippers from enforcing legal contract and penalties for late delivery.

With the STB in a state of irrelevance and the railroad industry as seemingly the only party not engaged in the search for constructive solutions, the choices for Congress are clear. DO SOMETHING to prevent a railroad monopoly from further harming the American farm producer, miner, lumber worker and consumers.

The something that is available right now is for Congress to consider and move legislation and changes in public policy. The cost of trying is trivial compared to the astronomical cost of doing nothing and accepting an ever worsening status quo.

The Montana Wheat & Barley Committee believes and trusts that Congress can restore balance to this marketplace.

VIII. Congressional Action is Required

We in Montana didn't ask to become captive shippers! We in Montana didn't want to suffer economically under the highest freight rates in the Nation!

The ICC created this monopoly environment mess in Montana and has ignored their responsibility in creating the economic nightmare. There is an urgent need for Congress to come to grips with the ever-increasing monopolistic power of the national railroads and its effects on the agricultural economy. Today Class I railroads control the agricultural economy.

The Surface Transportation Board is charged with protecting "captive shippers" under current law emanating out of the Staggers Rail Act. The record indicates that the STB and its predecessor, the ICC. have not protected the captive shipper from discriminatory pricing. Indeed, the STB has gone so far afield, that they have renamed the pricing mechanism utilized by the railroads. They call it "differential" pricing! It is simply a rename for "what the traffic will bear." Discriminatory pricing is both unfair to the captive shipper and immoral. Since the merger of the BNSF and the UP/SP, we have NOT seen increased competition in the state reflecting the proportional rate agreements agreed to in the UP/SP merger. Indeed, we have not been able to find one single shipper, grain or otherwise in Montana, that have experienced a single new solicitation by the UP/SP anywhere in Montana. The cycle times on UP and BNSF in Montana are inching up, not what the BNSF nor the UP predicted. The captive shippers are continuing to pay more than their fair share for these mergers.

Any major Class I can, today, control development of any "value-added" grain industry development, simply by not allowing (with monopolistic pricing) any construction of "in-land" value added processing, choosing instead, to move the raw grain to ports. Do they have to reduce the price of moving the grain to the ports in order to keep a "value added" plant from being built? No, they simply, over-price monopolistically the value added plant. That is a true monopoly power that is being sanctioned by the current regulatory system. It must be changed.

IX. Solutions

The solution is very simple. Either control the monopoly pricing or introduce competition. If the national agricultural policy is effective in increasing exports of grain, what is to stop the railroads from "taking" their monopolistic share of these gains? A National Transportation Policy should be developed that requires the STB to consider for comparison, when reasonable rates are prescribed for shippers for whom effective competition does not exist, similar rates produced by rail-to-rail competition for shipment of the same or similar commodities. Our preference at the Montana Wheat & Barley Committee is for more competition among the monopoly railroads, but secured with adequate protection for the truly captive shippers of this country. After all, that is simply good, sound government policy.

Senator BURNS. And I've—we've been working on this for quite a while, so I appreciate you allowing those statements to be made. And thank you for holding this hearing. And I think we should get to the questions.

Senator LOTT. All right. Let's have our first panel come forward, Ms. Hecker and Mr. Buttrey. Thank you very much.

Ms. Hecker is the director of the Physical Infrastructure Team, Government Accountability Office, Washington, D.C. And Mr. Buttrey is Chairman, Surface Transportation Board.

And so, if we could, we'll go to you first, Ms. Hecker.

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

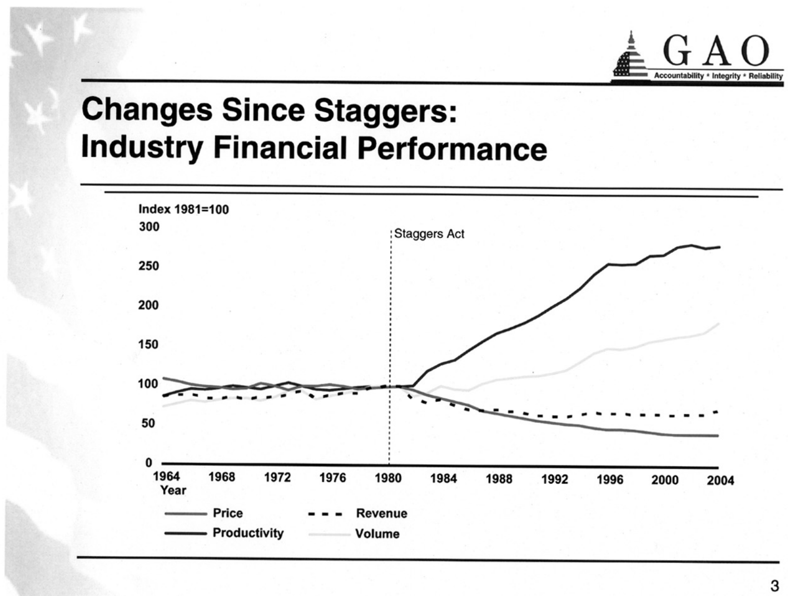
Ms. HECKER. Thank you very much, Mr. Chairman. It's a great honor to be here.

This is, indeed, a critical juncture for this industry and these issues. They really represent issues that are of national economic significance, and not only to the railroads, but to producers, to users and the general population. And I, too, applaud the Committee both for holding this hearing and giving us the opportunity and the honor of having an opportunity to really examine in-depth these really critical issues.

As you said, I'll be presenting very preliminary observations today. I do have a small slide presentation, with a number of charts, and I think a copy was given to each of you. So, hopefully that will assist in my being able to cover the enormous breadth of the issues before us.

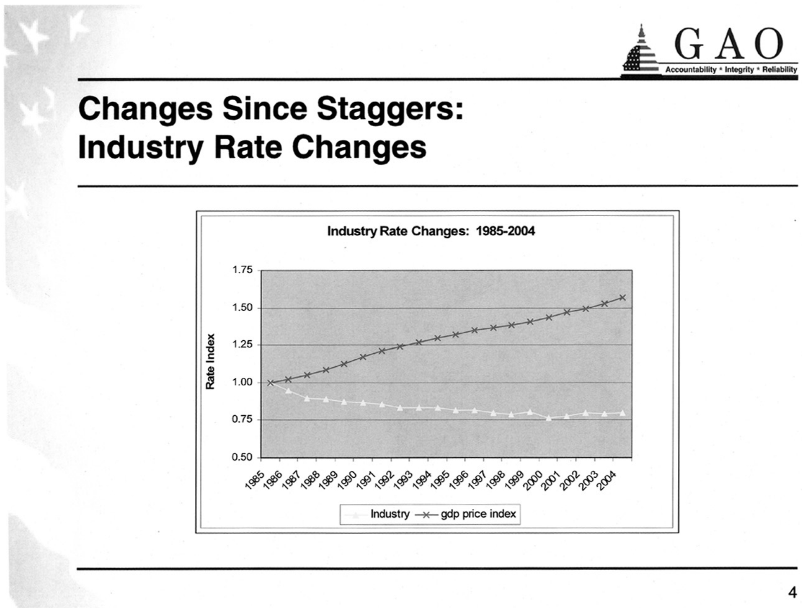
As you outlined, there are three topics that you asked us to address, and we will give you some preliminary observations on all three today. The first was the changes since the Staggers Act—industry performance, rates, and competition issues; the second is what those changes suggest for regulation, and what kind of alternative approaches have been posed to deal with open competition and captivity issues; and, finally, what some potential responses are to future freight demand and capacity issues.

Now, the first chart I have—and I also have a visual that's a little easier to look at—really captures the economic performance of the industry and the changes both before the Act—that middle point in everything is geared to 1980—and after the Act. And, basically, these lines are productivity, price, revenue, and volume. And it is so profoundly telling how the—this industry stagnated under the regulatory environment. You did not have innovation. You did not really have any growth in volume. And mostly you didn't have productivity and efficiencies and improvement. And that's really the hallmark of the failure of regulation. It has a perverse effect on that kind of innovation that's so important.



If you look at the explosion after 1980, the most important one is really that first line, going way up top, and that's productivity. That's the costs being cut, investments being made, new technology, new markets. The second one is volume; you have an enormous increase in volume. And what's good news for the economy and consumers is—prices was the red line—prices are going down.

A little bit more on that, though, the second chart is overall review of industry rate changes. As you know, we've taken a 20-year view. And this basically starts in 1985, goes to 2004, when the most comprehensive data is still available. And the yellow line is basically the changes in rates, using a—an industry price package so that it standardizes and controls for the type of commodity. So, the type can change, and the size of movements can change. And we have developed an index, so you get a more reliable view of changes. So, what we, here, have is that yellow line showing industry rate changes consistently going down.



Now, what I've broken out in the yellow and red line is that it's quite different for different commodities. The yellow—the blue line is—these are reversed—coal is actually the blue—the yellow line on this one. So, that's below the industry average. The red line is grain, and that is clearly above the industry average. But the key thing is that the green line is what's happening to prices overall in the economy. So, you have either relatively steady or declining nominal prices, while you have a 60-percent overall increase in prices in the economy.

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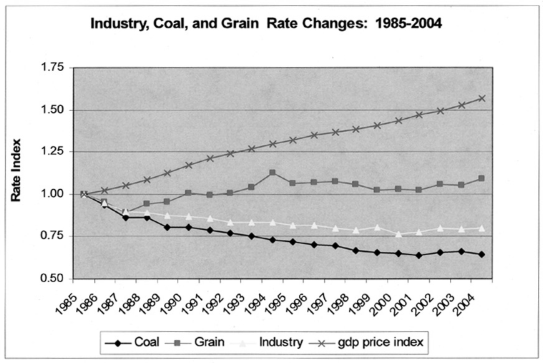
Changes Since Staggers: Rate Changes for Coal and Grain vs Average



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The next one is a map trying to give you a capture of a—an overview of competition. This one basically uses the BEA economic areas. And those yellow areas basically are the number—27 BEA economic areas that are served by only one railroad.

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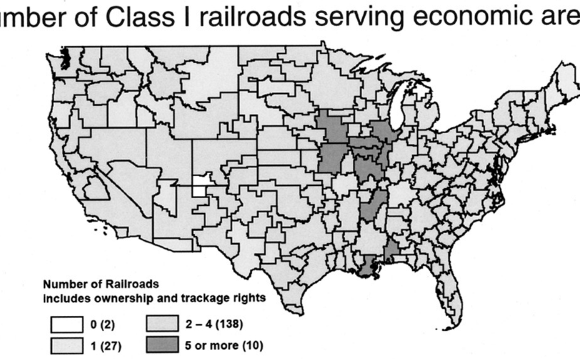
Changes Since Staggers: Competition

Number of Class I railroads serving economic areas



Source: GAO.

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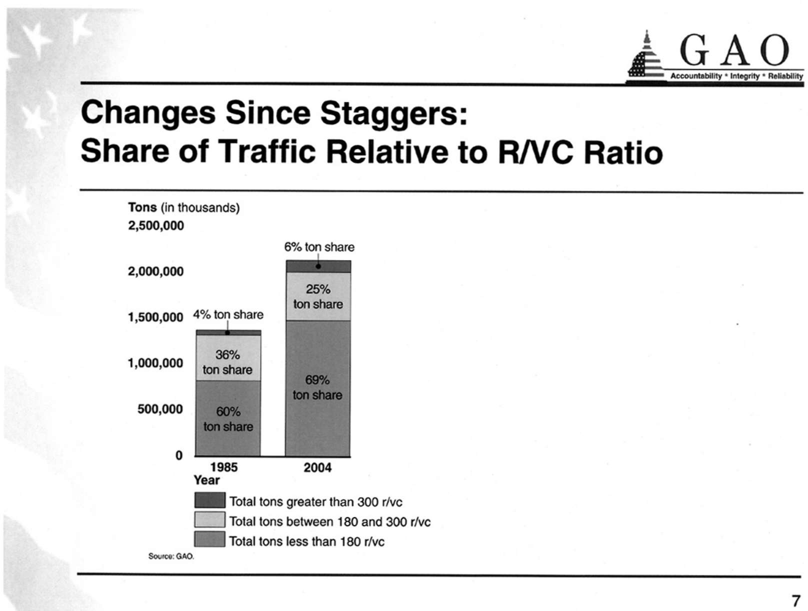
Now, that doesn't give you a complete view of captivity, so we turned to another thing, and that's chart number 7. And, as you remember, the Staggers Act defined a threshold of captivity as paying rates 180—where there was a ratio of 180 of revenue over variable cost. And the concern we have here is, while there has been, actually, a reduction of traffic traveling under a 300-percent mark, there has been a 50-percent increase in the amount of traffic that travels over 300 percent of that ratio. So, while captivity overall by this indicator, is decreasing, those who are captive are paying even more significantly higher rates than they were 20 years ago. So, that's why those average figures are really important to get a way to, to examine the central issue.



I see my time is up, but the bottom line, I know you want to hear. I will——

Senator LOTT. Feel free to keep going.

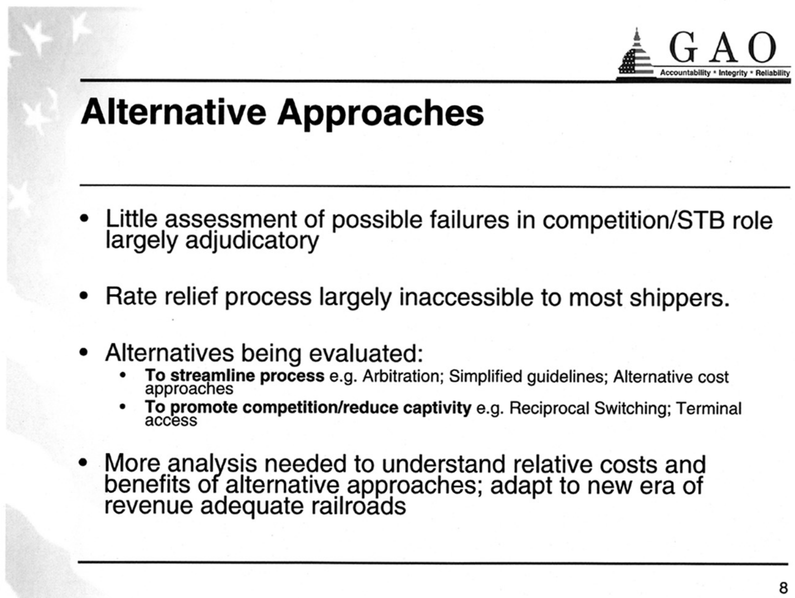
Ms. HECKER. Oh, thank you very much.

Senator LOTT. Your statements——

Ms. HECKER. I'll still try to be——

Senator LOTT.—are very important.

Ms. HECKER.—brief, because I know you want a dialogue here. Slide 8 is then, so what do you do about it? That balance was in the Act. It was carefully crafted and called for. And basically it provided two major things, in our view, for STB—or ICC, originally. It was very broad authority, in our view, for the agency to prevent concentration, to ensure competition. And we have some comments about how that's been addressed. And then, there was the—all the authority to set up an effective relief process for those who were captive.

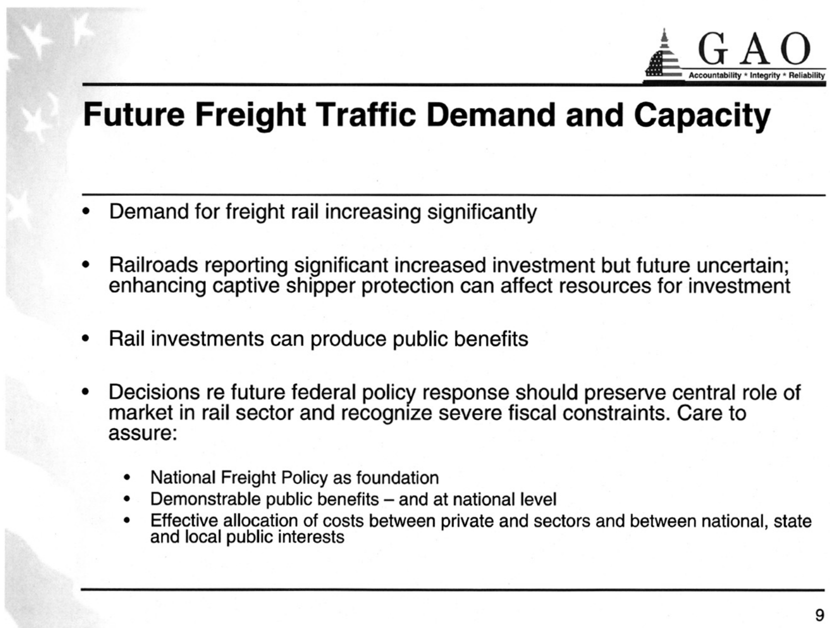


Now, in our view, neither of those protections in the Act have been effectively implemented. So, the original balance, in our view, has not really come into its own.

The first one is an area that is rarely discussed. And, basically, in our view, as I said, the agency really has broad authority to assess the performance of the market, not just in response to a merger request, not just in response to a complaint or a specific filed complaint, but really to be—one of the original acts is promoting competition, and, in our view, and, frankly, in response to many recommendations we've made in the past, the STB largely says that they're adjudicatory. And I think your own statement, Mr. Buttrey, makes clear that there's a primary role in reviewing cases and adjudicating or mediating disputes. The second area, everyone, I think, largely agrees that the relief process has turned out to be largely inaccessible. The alternatives that are under discussion are really along these two areas, either to streamline the relief process—and there are a number of proposals—and to promote competition and reduce captivity. These really are more trying to prevent the problem, rather than—the procedural ones are trying to improve the relief after you've presumably been made captive and not been able to have the benefits of competition. The other one is really getting to the root case and trying to promote competition.

Now, the concern that we have is, because there isn't this rigorous analysis of the whole market and the failures of competition and where there really may be an abuse of market power, as opposed to a real response to very tight conditions in this industry, we believe more analysis is needed of the root problem here to be able to fully evaluate the costs and benefits of alternative approaches. And an enormous shift that's occurred is that we're on the cusp of most railroads becoming revenue-adequate, which is a very good thing, but that is a central component of the evaluation and the process and the regulatory approach. And so, that we're at a turning point of how that may change the regulatory approach.

The freight demand issue, on slide 9, most projections are for significant increases. Railroads are making significant investments. And there is a recognition that there are probably public benefits from rail investments, beyond what rail will invest on their own.



We've done a lot of work on these issues. I've studied public/private partnerships in many sectors. And we have two overriding concerns. One is that the policy response should preserve the central role of the market in the rail sector, and not unduly distort the benefits we have from a—an industry driven by a competitive environment. And the other concern is that we have a grave fiscal crisis. There is no money. And you all know that very well. New assistance is borrowing to provide new assistance. So, there's a very high standard to really try to identify new assistance or support programs.

And then, we have three bullets, that it clearly has to be in a broader intermodal context of national freight policy. There have to be demonstrable public benefits, and at a national level. There are local benefits, and a Federal role to capture local benefits may not be justified. And then, in public partnerships, the critical thing is getting an effective allocation of costs between the public and private sector, and between national, State, and local interests.

That concludes this preliminary report. As you've noted, our final report will be out in September, and we hope to more fully explore all of these issues.

But I'd be pleased to take any questions that I can address today.

[The prepared statement of Ms. Hecker follows:]

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

Mr. Chairman and members of the Committee:

We appreciate the opportunity to testify on our preliminary observations on the impact of deregulation of the freight railroad industry. As you know, over 25 years ago, Congress, with the leadership of this Committee, transformed Federal transportation policy. After almost 100 years of economic regulation, the railroad industry was in serious economic trouble in the 1970s, with rising costs, losses, and bankruptcies. In response, Congress passed the Railroad Revitalization and Regulatory Reform Act in 1976 and the Staggers Rail Act in 1980 that substantially deregulated the railroad industry. The 1980 Act encouraged greater reliance on competition to set rates and gave railroads increased freedom to price their services according to market conditions, including using differential pricing—that is, recovering a greater proportion of their costs from rates charged to shippers with a greater dependency on rail transportation. Furthermore, the Act anticipated that some shippers might not have competitive alternatives, and gave the Interstate Commerce Commission (ICC), and later the Surface Transportation Board (STB), the authority to establish a rate relief process so that shippers could obtain relief from unreasonably high rates.

At the request of several Members of this Committee, we have ongoing work providing a retrospective on the performance of the rail industry since the Staggers Rail Act. My comments today focus on (1) the changes that have occurred in the freight railroad industry since the enactment of the Staggers Rail Act, including changes in rail rates and competition in the industry, (2) what alternative approaches have been proposed and could be considered to address remaining competition and captivity concerns, and (3) the projections for freight traffic demand over the next 15 to 25 years, the freight railroad industry's projected ability to meet that demand, and potential Federal policy responses.

To fulfill our objectives, we examined STB's Carload Waybill Sample from 1985–2004 (the latest data available at the time of our review). This document includes data on rail rates, tonnage, Federal regulation, and other statistics but disguises some revenues to avoid disclosing confidential business information to the public. We obtained a version of the Carload Waybill Sample that did not disguise revenues. We also interviewed, and reviewed information from representatives of each Class I railroad in North America,[1] shipper groups, economists, and experts in the rail industry, and held an expert panel consisting of individuals with expertise in the freight railroad industry and the economics of transportation deregulation, interviewed shipper groups, railroads, and economists, and reviewed pending legislation and literature. We also reviewed forecasts of future freight rail demand and capacity, including synthesizing forecasting, and transportation planning literature, and interviewed Federal and state transportation officials, financial market analysts, national association representatives, and transportation experts. While we are aware that service issues such as on time performance and the supply of railcars by the railroads are of concern to many people here today, service issues are not included in the preliminary observations I will present today. Instead, we will leave comments about service to other individuals testifying. My comments today are based on our past body of work on the freight rail industry as well as our ongoing work, which we are conducting in accordance with generally accepted government auditing standards (see Appendix I for a list of our past reports on the freight railroad industry).

In summary:

- The changes that have occurred in the railroad industry since the enactment of the Staggers Rail Act are widely viewed as positive, as the financial health of the industry has improved and most rates have declined since 1985, although concerns about competition and captivity in the industry remain. The freight railroad industry's financial health improved substantially as railroads cut costs through productivity improvements, streamlined and "right-sized" their rail networks, implemented new technologies, and expanded business into new markets such as the intermodal market, which consists of containers and trailers that can be carried on ships, trucks, or rail. Between 1985 and 2000, rates generally

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

declined, but have increased slightly from 2001 through 2004.[2] Several factors could have contributed to recent rate increases, including continuing consolidation in the industry and broad changes in the domestic and world economy and emergence of a capacity constrained environment, where demand exceeds supply. Concerns about competition and captivity in the industry remain because traffic is concentrated in fewer railroads and, although rates have declined for most shippers since the enactment of the Staggers Rail Act, rates have not declined uniformly and some shippers are paying significantly higher rates than others. It is difficult to precisely determine the number of shippers who are "captive" to one railroad because proxy measures that provide the best indication can overstate or understate captivity. However, our preliminary analysis indicates that while the extent of potential captivity may be dropping, the share of potentially captive shippers who are paying the highest rates—those substantially above the threshold for rate relief—has increased. Whether this increase reflects an exercise or possible abuse of market power or is simply a reflection of rational economic practices by the railroads in an environment of excess demand remains uncertain.

- A number of alternative approaches have been suggested by shipper groups, economists, and other experts in the rail industry to address remaining concerns about competition and captivity—however, any alternative approaches should be carefully considered. While a number of approaches have been suggested, I would, based on our preliminary work, like to focus on two areas that are particularly integral to further improvement. First, while STB has broad legislative authority to investigate industry practices and has assessed competition practices—generally in reviewing railroad merger cases—there has been little assessment of competition nationally by any Federal agency of the state of competition nationally and where specific areas of inadequate competition and the inappropriate exercise of market power might exist. Given widespread disagreement about the adequacy of competition in the industry and the fact that proxy measures can understate or overstate captivity, such an assessment would allow decisionmakers to identify areas where competition is lacking and to assess the need for and merits of targeted approaches to address it. These approaches include requiring reciprocal switching arrangements, which allow one railroad to switch railcars of another railroad, and/or terminal access agreements, which permits one railroad to use another's terminals. Second, although the Staggers Rail Act recognized that some shippers might not have access to competitive alternatives and might be subject to unreasonably high rates, there is widespread agreement that the rate relief process does not provide expeditious handling and resolution of complaints, is expensive, time-consuming, and complex, and that, as a result, it is largely inaccessible to most shippers. A number of different approaches have been suggested by shipper organizations and others that could make the process less expensive and more expeditious, and thus more accessible, such as arbitration and increased use of simplified guidelines. Each of the proposed approaches has both advantages and drawbacks. Any alternative approaches to address competition and captivity should be carefully considered to ensure that the approach will achieve the important balance set out in the Staggers Rail Act of allowing the railroads to earn adequate revenues and invest in its infrastructure while assuring protection for captive shippers from unreasonable rates.
- Significant increases in freight traffic over the next 15 to 25 years are forecasted, although many factors can affect the accuracy of these forecasts, and the railroad industry's ability to meet future demand is largely uncertain. Although railroads have reported significant increased investment and have told us that they plan to continue making infrastructure investments, they also expressed uncertainty as to their ability to keep pace with some of the higher projections of future freight rail demand. Besides securing benefits for private rail networks, investments in rail projects can produce benefits for the public—for example, shifting truck freight traffic to railroads can reduce highway congestion. As a result, the Federal and state governments have been increasingly participating in freight rail improvement projects—for example, a number of states are involved in joint projects with the railroads and, in 1997, the U.S. Department of Transportation provided a $400 million loan to the Alameda Corridor Transportation Authority for the Alameda Corridor project to consolidate rail and other freight traveling to and from the ports of Los Angeles and Long Beach.

[2] While rate data are not available for 2005 and 2006, shippers, railroads, and financial analysts we spoke with told us that rates have generally increased during those years.

In addition, in 2005, Congress authorized $100 million for the Chicago CREATE project to improve the rail network in Chicago. Congress is likely to face additional decisions in the years ahead regarding Federal policy toward the Nation's freight railroad system. While our work continues, we would note, based on our past work, that Federal involvement should only occur where demonstrable public benefits exist, and where a mechanism is in place to appropriately allocate the cost of financing these benefits between the public and private sectors, and between national, state, and local interests.

Background

Freight rail is an important component of our Nation's economy. Approximately 42 percent of all inter-city freight in the United States, measured in ton miles, moves on rail lines. Freight rail is particularly important to producers and users of certain commodities. For example, about 70 percent of automobiles manufactured domestically, about 70 percent of coal delivered to power plants, and about 32 percent of grain moves on freight rail.

Beginning in 1887, the Interstate Commerce Commission (ICC) regulated almost all of the rates that railroads charged shippers. Congress passed the Railroad Revitalization and Regulatory Reform Act in 1976 and the Staggers Rail Act in 1980, and these acts greatly increased the reliance on competition in the railroad industry. Specifically, these acts allowed railroads and shippers to enter into confidential contracts which set rates and prohibited the ICC from regulating rates where railroads had effective competition or if the rates had been negotiated between the railroad and the shipper. The ICC Termination Act of 1995 abolished the ICC and transferred its regulatory functions to STB. Taken together, these acts anchor the Federal Government's role in the freight rail industry and have established numerous goals for regulating the industry, including the following:

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

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

Consequently, the Staggers Rail Act recognized the need for railroads to use demand-based differential pricing in the deregulated environment. Demand-based differential pricing in theory permits a railroad to recover their joint and common costs across its entire traffic base by setting higher rates for traffic with fewer transportation alternatives than for traffic with more alternatives. This means that a railroad might incur similar incremental costs in providing service to two different shippers that ship similar tonnages in similar car types traveling over similar distances, but that the railroad may charge quite different rates. In this way, the railroad recovers a greater portion of its joint and common costs from the shipper that is more dependent on railroad transportation, but, to the extent that the railroad is able to offer lower rates to the shipper with more transportation alternatives, the other shipper makes a contribution toward those costs.

The Staggers Rail Act further required that the railroads' need to differentially price its services be balanced with the rights of shippers to be free from, and to seek redress from unreasonable rates. Railroads incur variable costs—that is the costs of moving particular shipments—in providing service. The Staggers Rail Act stated that any rate that was found to be above 180 percent of a railroad's variable cost for a particular shipment was potentially an unreasonable rate and granted the ICC, and later the STB, the authority to establish a rate relief process. In response, the ICC established two criteria for allowing a rail rate case. First, as stated in law, the rate had to be above 180 percent of the revenue-to-variable-cost (R/VC) ratio. Second, the shipper had to demonstrate that it had no other reasonable transportation alternative. Such a shipper is referred to as a "captive shipper."

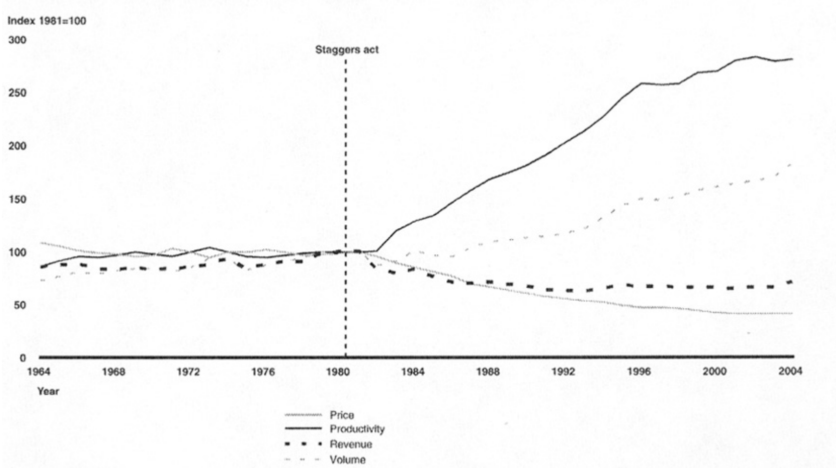
Railroad Industry Increasingly Healthy and Rates Down Since Enactment of the Staggers Rail Act, but Competition and Captivity Concerns Remain

The changes that have occurred in the railroad industry since the enactment of the Staggers Rail Act are widely viewed as positive. The railroad industry's financial health improved substantially as it cut costs, boosted productivity, and "right-sized" its networks. Rates generally declined between 1985 and 2000 but increased slightly from 2001 through 2004. Concerns about competition and captivity in the industry remain because traffic is concentrated in fewer railroads and, although rates have declined for most shippers, some shippers are paying significantly higher rates than others. While it is difficult to precisely determine the number of shippers who are "captive" to one railroad, our preliminary analysis indicates that while the extent of potential captivity may be dropping, the share of potentially captive shippers who are paying the highest rates—those substantially above the threshold for rate relief—has increased.

Railroad Industry Financial Health Improved Substantially

There is widespread consensus that the freight rail industry has benefited from the Staggers Rail Act. Specifically, various measures indicate an increasingly strong freight railroad industry. Freight railroads' improved financial health is illustrated by increases in productivity, volume of shipments, and stock prices. Freight railroads have also cut costs by streamlining their work force and "right-sizing" their rail network, through which the railroads have reduced track, equipment, and facilities to more closely match demand. These measures are shown in Figure 1.

Figure 1: Railroads' Financial Performance: 1964-2004



Source: Association of American Railroads.

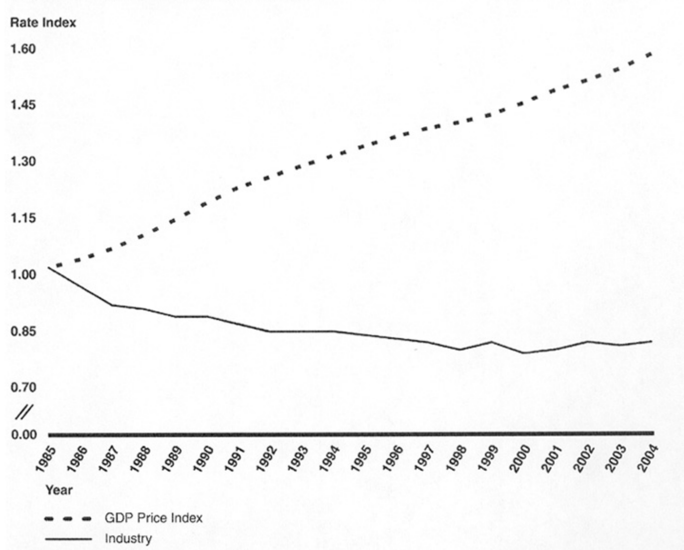
Freight railroads have also expanded their business into new markets—such as the intermodal market—and implemented new technologies, including larger cars, and are currently developing new scheduling and train control systems. Some observers believe that the competition faced by railroads from other modes of transportation has created incentives for innovative practices, and that the ability to enter into confidential contracts with shippers has permitted railroads to make specific investments and to develop service arrangements tailored to the requirements of different shippers.

Rates Declined From 1985 through 2000 and Rose Slightly from 2001 through 2004

Rail rates across the industry have generally declined since enactment of the Staggers Rail Act. Because changes in traffic patterns over time (for example, hauls over longer distance) can result in increases in lower priced traffic and a decrease in average revenue per ton mile, it can present misleading rate trends. Therefore, we developed a rail rate index[3] to examine trends in rail rates over the 1985–2004 period. These indexes account for changes in traffic patterns over time which could affect revenue statistics but do not account for inflation. As a result, we have also included the price index for the gross domestic product.

Although there has been a slight upturn in rates from 2001 through 2004, the industry continues to experience rates that are generally lower than they were in 1985. During this time some costs have also been passed on to shippers, such as having shippers provide equipment. There was a steep decline in rates from 1985 to 1987 when rates dropped by 10 percent. Rates continued to decline, although not as steeply, through 1998. Rates increased in 1999, then dropped again in 2000. In 2001 and 2002 rates rose again. Rates were nearly flat in 2003 and 2004, finishing approximately 3 percent above rates in 2000, but 20 percent below 1985 rates. This is shown in Figure 2.

Figure 2: Industry Rail Rates 1985-2004



Source: GAO analysis of STB data.

These data include rates through 2004. According to freight railroad officials, shippers, and financial analysts, since 2004 rates have continued to increase as the

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[3] We constructed rate indexes to examine trends in rail rates over the 1985 to 2004 period. These indexes define traffic patterns for a given commodity in terms of census region to census region flows of that commodity, and we calculate the average revenue per ton mile for each of these traffic flows. The index is calculated as the weighted average of these traffic flows in each year, expressed as a percentage of the value for 1985, where the weights reflect the traffic patterns in 2004. By fixing the weights as of one period of time, we attempt to measure pure price changes rather than calculating the average revenue per ton mile in each year. Over time, changes in traffic patterns could result in a substitution of lower priced traffic for higher priced traffic, or vice versa, so that a decrease in average revenue per ton mile might partly reflect this change in traffic patterns. The rate index for the overall industry was defined similarly, except that the traffic pattern bundle was defined in terms broad commodity, census region of origin, and mileage block categories. For comparison purposes, we also present the price index for gross domestic product over this period.

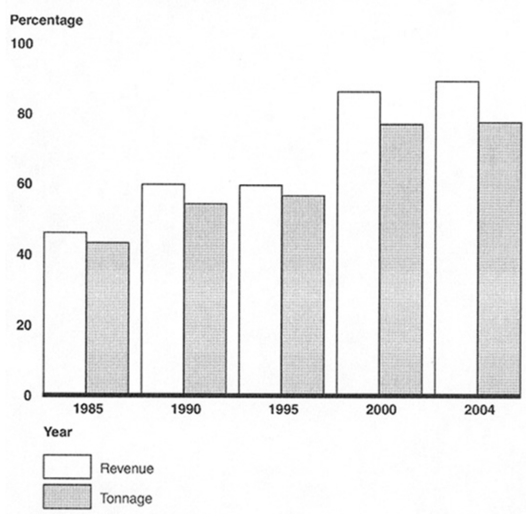
demand for freight rail service has increased, rail capacity has become more limited, and as a result, freight railroad companies have gained increased pricing power.

A number of factors may have contributed to recent rate increases. Ongoing industry and economic changes have influenced how railroads have set their rates. Since the Staggers Rail Act was enacted, the railroad industry and the economic environment in which it operates have changed considerably. Not only has the rail industry continued to consolidate, potentially increasing market power by the largest railroads, but after years of reducing the number of its employees and shedding track capacity, the industry is increasingly operating in a capacity-constrained environment where demand for their services exceeds their capacity. In addition, the industry has more recently increased employment and invested in increased capacity in key traffic corridors. Additionally, changes in broader domestic and world economic conditions have led to changes in the mix and profitability of traffic carried by railroads.

Competition and Captivity Concerns Remain

Concerns about competition and captivity in the railroad industry remain because traffic is concentrated in fewer railroads and even though rates have declined for most shippers since the enactment of the Staggers Rail Act, some shippers are paying significantly higher rates than other shippers—a reflection of differential pricing. There is significant disagreement on the state of competition in the rail industry. In 1976, there were 63 Class I railroads operating in the United States compared with 7 Class I railroads in 2004.[4] As Figure 3 shows, 4 of these Class I railroads accounted for over 89 percent of the industry's revenues in 2004. While some experts view this concentration as a sign that the industry has become less competitive over time, others believe that the railroad mergers and acquisitions actually increased competition in the rail industry because STB placed conditions on the mergers intended to maintain competition. These experts also point to the hundreds of short line railroads[5] that have come into being since the enactment of the Staggers Rail Act, as well as other increased competitive options for shippers from other modes such as trucks and barges.

Figure 3: Railroad Market Concentration, 1985-2004



Source: GAO analysis of STB data.

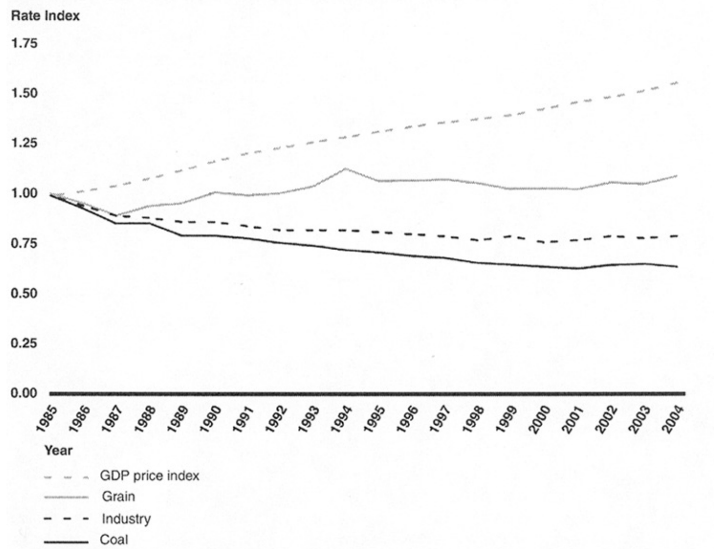
According to our preliminary analysis, some commodities and shippers are paying significantly higher rates than other shippers. This can be seen in rates charged to commodities and at specific routes. Figure 4 compares commodity rates for coal and

[4] In addition to consolidation, which is the main reason for the reduction in the number of Class I railroads, other reasons were carrier bankruptcies and a 1992 ICC change in the threshold for qualifying as a Class I railroad (from $5 million in annual revenue in 1976 to $250 million in 1992).

[5] A short line railroad is an independent railroad company that operates over a short distance.

grain prices from 1985 through 2004 using our rail rate index. As Figure 4 shows, all rate changes were below the rate of inflation and thus all rates declined in real terms. However during that period, coal rates dropped even more sharply than industrywide rates, declining 35 percent. Grain rates initially declined from 1985 to 1987, but then diverged from industry trends and increased, resulting in a net 9 percent nominal increase by 2004.

Figure 4: Industry, Coal, and Grain Rate Changes, 1985-2004

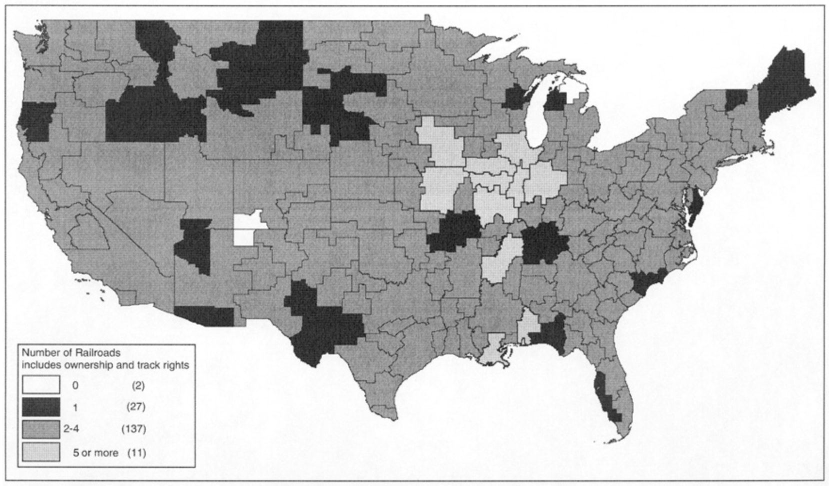


Source: GAO analysis of STB data.

It is difficult to precisely determine the number of shippers who are "captive" to one railroad because proxy measures that provide the best indication can overstate or understate captivity. One way of determining potential captivity in our preliminary analysis was to identify which Bureau of Economic Analysis (BEA) economic areas were served by only one Class I railroad.[6] In 2004, 27 of the 177 BEA economic areas were served by only one Class I railroad. As shown in Figure 5, these areas include parts of Montana, North Dakota, New Mexico, Maine, and other states. We also examined specific origin and destination pairs and found that in 2004, origin and destination routes with access to only one Class I railroad carried 12 percent of industry revenue. This represents a decline from 1994, when 22 percent of industry revenue moved on routes served by one Class I railroad. This decline suggests that more railroad traffic is traveling on routes with access to more than one Class I railroad.

[6] Economic areas are those areas defined by the Bureau of Economic Analysis which define the relevant regional economic markets in the U.S.

Figure 5: Number of Class I Railroads Serving Economic Areas



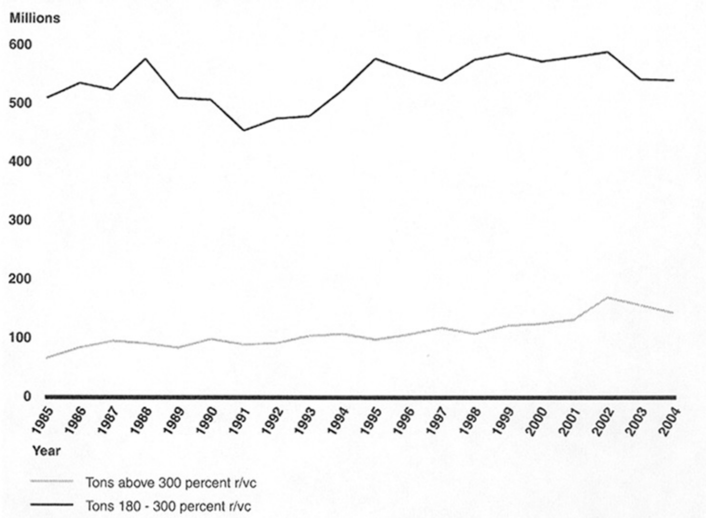
Source: GAO analysis of BEA and GIS data

While examining BEA areas provides a proxy measure for captivity, a number of factors may understate or overstate whether shippers are actually captive. The first two of these factors may work to understate the extent of captivity among shippers. First, routes originating within economic areas served by multiple Class I railroads may still be captive if only one Class I railroad serves their destination, meaning the shipper can use only that one railroad for that particular route. Second, some BEA areas are quite large, so a shipper within the area may have access to only one railroad even though there are two or more railroads within the broader area. Two additional limitations may work to overstate the number of locations captive to one railroad. First, this analysis accounts for Class I railroads only and does not account for competitive rail options that might be offered by Class II or III railroads such as the Guilford Rail System, which operates in northern New England. Second, this analysis considers only competition among rail carriers and does not examine competition between rail and other transportation modes such as trucks and barges.

To determine potential captivity during our preliminary analysis, we applied another proxy measure—the definition of potentially captive traffic used in the Staggers Rail Act. The Act defines potentially captive traffic as any that pays over 180 percent of the revenue-to-variable cost (R/VC) ratio. As a percentage of all rail traffic, the amount of potentially captive traffic traveling over 180 percent R/VC and the revenue generated from that traffic have both declined since 1985.

However, our preliminary analysis indicates the share of potentially captive shippers who are paying the highest rates—those substantially above the threshold for rate relief—has increased. While total tons have increased significantly (from about 1.37 billion in 1985 to about 2.14 billion in 2004), Figure 6 shows that tons traveling between 180 and 300 percent R/VC but have remained fairly constant—an increase from about 497 million tons in 1985 to about 527 million tons in 2004. However tons traveling above 300 percent R/VC have more than doubled—from about 53 million tons in 1985 to over 130 million tons in 2004.

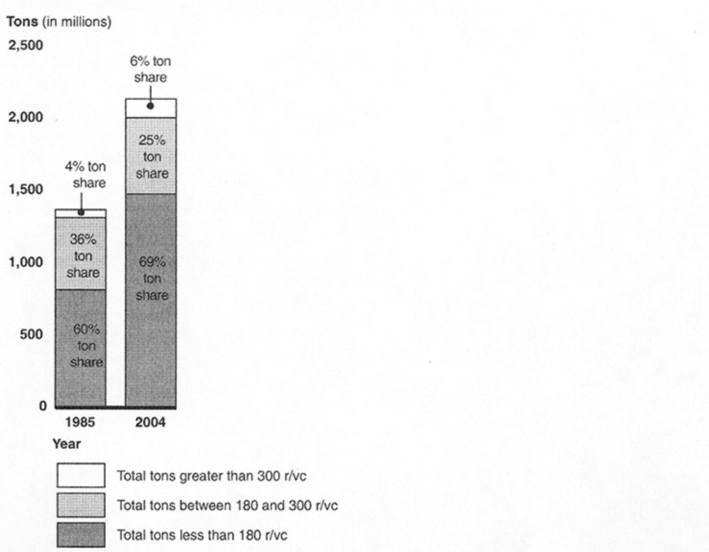
Figure 6: Tons Traveling Over 180 Percent R/VC: 1985-2004



Source: GAO analysis of STB data.

This pattern can also be seen in the share of traffic traveling above and below 180 percent R/VC between 1985 and 2004. As Figure 7 illustrates, the percent of all traffic traveling between 180 and 300 percent R/VC decreased from 36 percent in 1985 to 25 percent in 2004. In contrast, the percent of all traffic traveling above 300 percent R/VC increased from 4 percent in 1985 to 6 percent in 2004.

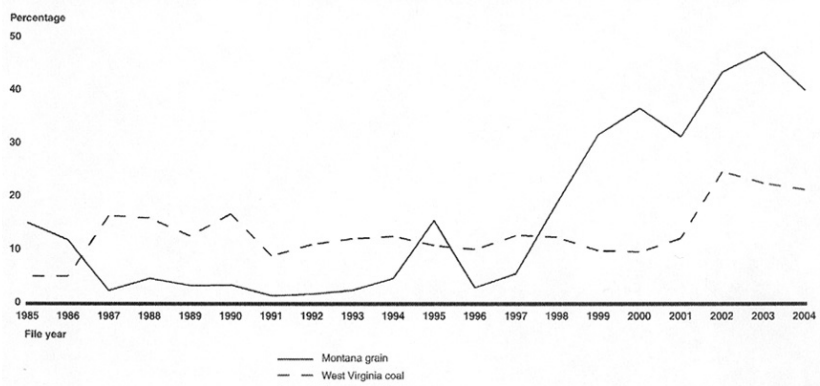
Figure 7: Percent of Traffic by R/VC, 1985 and 2004



Source: GAO analysis of STB data.

Our preliminary analysis indicates that this overall change in traffic traveling over 300 percent R/VC can be seen in certain states and commodities. For example, 39 percent of grain originating in Montana and 20 percent of coal in West Virginia traveled over 300 percent R/VC in 2004. As shown in Figure 8, this represents a significant increase from 1985, when 14 percent of grain in Montana and 4 percent of coal in West Virginia traveled over 300 percent R/VC.

Figure 8: Percent of Tonnage Traveling Over 300 Percent R/VC, 1985-2004



Source: GAO analysis of STB data.

As with BEA areas, examining R/VC levels as a proxy measure for captivity can also understate or overstate captivity. For example, it is possible for the R/VC ratio to increase while the rate paid by a shipper is declining. Assume that in Year 1, a shipper is paying a rate of $20 and the railroad's variable cost is $12. The R/VC ratio—a division of the rate and the variable cost—would be 167 percent. If in Year 2 the variable costs decline by $2.00 from $12 to $10, and the railroad passes this cost savings directly on the shipper in the form of a reduced rate, the shipper would pay $18 instead of $20. However, as shown in Table 1, because both revenue and variable cost decline, the R/VC ratio increases to 180 percent.

Table 1: Possible Changes in R/VC Ratios

Year	Revenue collected	Variable costs	R/VC
Year 1	$20.00	$12.00	167%
Year 2	$18.00	$10.00	180%

Source: GAO.

Although proxy measures have inherent limitations, they can serve as useful indicators of trends in railroad pricing, how the railroads may be exercising their market power to set rates, and where competition and captivity concerns remain. Whether these trends reflect an exercise or possible abuse of market power or is simply a reflection of rational economic practices by the railroads in an environment of excess demand remains uncertain.

Proposed Alternative Approaches to Address Remaining Competition and Captivity Concerns Should Be Carefully Considered

A number of alternative approaches have been suggested by shipper groups, economists, and other experts in the rail industry to address remaining concerns about competition and captivity—however, any alternative approaches should be carefully considered. Two areas—an assessment of competition and addressing problems with the rate relief process—are particularly integral to further improvement. Any alternative approaches to address competition and captivity should be carefully considered to ensure that the approach achieves the important balance set out in the Staggers Act of allowing the railroads to earn adequate revenues and invest in its infrastructure while assuring protection for captive shippers from unreasonable rates.

Assessment of Competition Has Been Limited

Our preliminary work shows there has been little assessment by the Federal Government of where areas of inadequate competition might exist or how changes in industry concentration might be resulting in the inappropriate exercise of market power. Although the STB has broad legislative authority to investigate industry practices, it has generally limited its reviews of competition to merger cases. STB is responsible for reviewing railroad merger proposals, approving those that it finds consistent with the public interest, and ensuring that any potential merger-related harm to competition is mitigated. STB's mitigation efforts have focused on preserving competition, such as granting the authority for one railroad to operate over the tracks of another railroad (called trackage rights). As we reported in 2001, STB found little competition-related harm during its oversight of recent mergers. However, rail mergers can have different effects on rail rates. For example, using an econometric approach that isolated the specific effects of the Union Pacific/Southern Pacific merger on rail rates for certain commodities in two geographic areas—Reno, Nevada, and Salt Lake City, Utah—we found that the merger reduced rates for four of six commodities, placed upward pressure on rates for one commodity, and left rates relatively unchanged for one commodity. In analyzing rail rates as part of merger oversight, STB examines the merger oversight record, which generally focuses on the overall direction and magnitude of rate changes, rather than specific commodities or geographic areas. According to STB officials, in general, the records have not permitted STB to reliably and precisely isolate the effects of mergers on rates from the effects of other factors (such as the price of diesel fuel).

STB is not unaware of concerns about competition. In addition to reviewing competition in terms of mergers, STB has also instituted proceedings to review rail access and competition issues. For example, in April 1998, STB commenced a review at the request of Congress to review access and competition issues in the rail industry. In an April 1998 decision on these issues, STB agreed to consider revising its competitive access rules. However, in its December 1998 report to Congress, STB declined to take further action on this issue because it had adopted new rules allowing shippers temporary access to alternative routing options during periods of poor service. In addition, STB observed that the competitive access issue raises basic policy questions that are more appropriately resolved by Congress. Furthermore, in a December 1998 ruling on a Houston/Gulf Coast oversight proceeding, STB recognized the possibility that opening up access could fundamentally change the Nation's rail system, possibly benefiting some shippers with high-volume traffic while reducing investment elsewhere in the system and ultimately reducing or eliminating service for small, lower-volume shippers in rural areas. Finally, STB adopted new regulations for rail mergers in 2001. These new regulations require the applicant to demonstrate that the merger would enhance, not just preserve, competition.

Given the disagreement about the adequacy of competition in the industry and the fact that proxy measures can understate or overstate captivity, an assessment of competition and how changes in industry concentration might be resulting in the inappropriate exercise of market power would allow decisionmakers to identify areas where competition is lacking and to assess the need for and merits of targeted approaches to address it. The targeted approaches most frequently proposed by shipper groups and others include reciprocal switching arrangements, which allow one railroad to switch railcars of another railroad, and terminal access agreements, which permits one railroad to use another's terminals. We will discuss the potential costs and benefits of these approaches further in our final report. Use of these approaches should be carefully considered to ensure that the approach achieves the important goals set out in the Staggers Rail Act. For example, if these approaches expand competitive options and decrease the number of captive shippers, which could decrease the need for Federal regulation and the need for a rate relief process. On the other hand these approaches could also reduce rail rates and thus railroad revenues and affect the ability of the railroads to earn adequate revenues and invest in its infrastructure.

Rate Relief Process Is Largely Inaccessible, but Different Approaches Should Be Carefully Considered

The principal vehicle through which shippers seek relief from unreasonable rates is the rate relief process. The Staggers Rail Act recognized that some shippers may not have access to competitive alternatives and may therefore be subject to unreasonably high rates. For these shippers, the Act gave ICC, and later STB, the authority to establish a rate relief process so that shippers could obtain relief from unreasonably high rates, as well as more general powers to monitor the railroad industry. Under the standard rate relief process, the Board requires a shipper to demonstrate how much an optimally efficient railroad would need to charge that shipper. Therefore, the shipper must construct a hypothetical, perfectly efficient railroad that would replace its current carrier.

There is widespread agreement the rate relief process is inaccessible to most shippers and does not provide expeditious handling and resolution of complaints. The process is expensive, time consuming and complex, and, as a result, several shipper's organizations told us that it is unlikely they would ever file a rate case. Since

2001, only 10 cases have been filed, and these cases took between 2.6 and 3.6 years—an average of 3.3 years per case—to complete. In addition, while STB does not keep records of the cost of a rate case, shippers we interviewed agreed that the process can cost approximately $3 million per litigant. As a result, shippers told us that, for them to bring a case, the case would need to involve several million dollars so that it was worthwhile to spend $3 million on a case that they could possibly lose. The process is complex because the legal procedures requires that (1) the shipper construct a model of a hypothetical, perfectly efficient railroad and (2) the railroad and shipper have opportunities to present their facts and viewpoints as well to present new evidence.

Congress and STB have recognized the problems with the rate relief process and taken actions to address them. First, Congress required STB to develop simplified guidelines. STB developed guidelines to streamline the process when the value of traffic at stake did not make it feasible to incur the costs of conducting a full rate case. Under these simplified guidelines, shippers do not have to construct a hypothetical railroad and can instead rely on industry averages to try to prove that their rate is unreasonable. Although these simplified guidelines have been in place since 1997, the process set out by the guidelines has not been used. Second, STB worked to improve the standard rate relief process. Specifically, STB now holds oral arguments to begin cases and, according to STB officials, these oral arguments help to clarify disagreements without adding any time to the process. In addition, STB has added staff to process cases.

According to shippers and railroad officials we spoke with, the simplified guidelines are confusing regarding who is eligible to use the process and how it would work. In addition, several shippers' organizations told us that shippers are concerned about using the simplified guidelines because since they have never been used, they believe it will be challenged in court and result in lengthy litigation. STB officials told us that they—not the shippers—would be responsible for defending the guidelines in court. STB officials also said that, if a shipper won a small rate case, STB could order reparations to the shipper before the case was appealed to the courts.

During our preliminary work we identified a number of different approaches that have been suggested by shipper organizations and others that could make the rate relief process less expensive and more expeditious, and therefore potentially more accessible. Each of the proposed approaches has both advantages and drawbacks. These approaches included the following:

- *Increased use of arbitration:* Under arbitration, the two parties would present their case before an arbitrator, who would then determine the rate. This approach would replace the shipper's requirement to create a hypothetical railroad. Proponents of this system argue that it provides both the railroads and the shippers with an incentive to suggest a reasonable rate (because otherwise the arbitrator could select the other's offer) and that the threat of arbitration can induce the parties to resolve their own problems and limit the need for Federal regulation. However, critics of this approach suggest that arbitration decisions may not be based on economic principles such as the revenue and cost structure of the railroad and that arbitrators may not be knowledgeable about the railroad industry.
- *Increased use of simplified guidelines:* The simplified guidelines use standard industry average figures for revenue data instead of requiring the shipper to create a hypothetical railroad. This approach would reduce the time and complexity of the process; however, it may not provide as accurate and precise a measure as the current process. However, as noted above, the use of STB's simplified guidelines has not been fully reviewed by the courts, and many railroad industry experts believe the first use of the guidelines will result in lengthy litigation.
- *Increased use of alternative cost approaches:* For example, STB could use the long-run incremental cost approach to evaluate and decide rate cases. This process, which is used for regulating pipelines, bases rates on the actual incremental cost of moving a particular shipment, plus a reasonable rate of return. This approach allows for a quick, standard method for setting prices, but does not take into account the need for differential pricing or the railroad's need to charge higher rates in order to become revenue adequate. Structuring rate regulation around actual costs can also create potential disincentives for the regulated entity to control its costs.

Again, these alternative approaches should be carefully considered to ensure that the approach achieves the important balance set out in the Staggers Act. A significant factor in evaluating each of these alternatives is the revenue adequacy of the railroads. The Staggers Rail Act established revenue adequacy as a goal for the industry and allowed the railroads to use differential pricing to increase their revenues. The act further gave the ICC (and later STB) the authority to determine the revenue adequacy of the railroads each year. While the specific method for determining revenue adequacy has been controversial, the overall trend in revenue adequacy may be more important. In its last report in 2004, STB determined that one railroad is revenue adequate and that others are approaching revenue adequacy. While it is too early to determine that the industry as a whole is achieving revenue adequacy, this is a significant shift in the rail industry because for decades after enactment of the Staggers Rail Act, the railroads were all considered revenue inadequate.

Different approaches to addressing remaining competition and captivity concerns will likely recognize to some degree the railroads' continued need to more consistently recover their cost of capital and become revenue adequate. The railroads need additional revenue for infrastructure investment to keep pace with increased demand. On the other hand, different approaches also raise the question as to what degree the railroads should continue to rely on obtaining significantly higher prices from those with greater reliance on rail transportation in a revenue adequate environment where total railroad revenues are increasingly sufficient to meet the railroad's investment needs.

Significant Growth in Freight Rail Traffic Demand Is Forecast But Continued Capacity Building Is Uncertain

The demand for freight and freight rail is forecast to increase significantly in the future, although many factors can affect the accuracy of these forecasts. Freight markets are volatile and unpredictable and thus freight demand forecasts may prove to be off the mark. For example, much freight demand is determined by trade that originates outside the United States. Many of the data used to develop these freight demand forecasts are proprietary and a result, we could not assess the validity or reasonableness of the assumptions used to develop the predictions. However, forecasts of freight and freight rail demand are useful as one possible scenario of the future. As the Congressional Budget Office (CBO) observed in a January 2006 report, forecasts of future demand can be viewed as more illustrative than quantitatively accurate.[7]

Major freight railroads have reported that they expect to invest about $8 billion in infrastructure during 2006—a 21 percent increase over 2005—and have told us that they plan to continue making infrastructure investments.[8] Although railroads are sufficiently profitable to be investing at record levels today, it is not certain whether in the future investments will keep pace with the projected demand. Railroads secure private benefits by investing in their infrastructure and have many considerations in making new infrastructure investments such as the need to obtain the highest return on their investment, optimize the performance of their network, and respond to other significant capital needs of rail operations. The railroads we interviewed were generally unwilling to discuss their future investment plans with us as this is business proprietary information. We are therefore unable to comment on how companies are likely to choose among their competing investment priorities for the future.

In addition to securing private benefits for railroad networks, investments in rail projects can produce benefits for the public—some of these public benefits are, as CBO's report pointed out, large in comparison to anticipated private railroad benefits. For example, shifting truck freight traffic to railroads can reduce highway congestion and reduce or avoid public expenditures that otherwise would be needed to build additional highway capacity or provide additional maintenance to accommodate growth in truck traffic. These and other public benefits can be realized at the national, state, and local levels. For example, rail investment may generate benefits to the national economy by lowering the costs of producing and distributing goods. Since rail uses less fuel than trucks, energy use and emissions may be reduced. In contrast, a rail project that eliminates or improves a highway-rail crossing could deliver primarily local public safety benefits by reducing accidents, time lost waiting for trains to pass, and pollution and noise from idling trains and lessening the risk of delays for emergency vehicles at crossings.

In pursuit of these public gains, the Federal and state governments have been increasingly participating in freight rail improvement projects. For example, the State

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[7] Congressional Budget Office *Freight Rail Transportation: Long Term Issues January 2006.*

[8] According to STB, some portion of this $8 billion investment is focused on maintenance as opposed to capacity expansion.

of Delaware spent about $14 million to rehabilitate a bridge in exchange for receiving a fee for each railroad car that crosses the bridge. The Federal Government has also become more involved in freight rail partnerships. Specifically, in 1997 the U.S. Department of Transportation provided a $400 million loan to the Alameda Corridor Transportation Authority for the Alameda Corridor project, which included a number of rail and road improvements to consolidate freight traveling to and from the ports of Los Angeles and Long Beach. These ports are a significant gateway for freight that is imported from Asia and distributed throughout the U.S. In addition, in 2005, Congress provided $100 million to the Chicago CREATE project to improve the rail infrastructure and ease congestion in and around Chicago—the busiest freight rail center in the U.S.

In the years ahead Congress is likely to face additional decisions regarding potential Federal policy responses and the Federal role in the Nation's freight railroad infrastructure. Based on our ongoing and past work, I would like to make three observations. First, any potential Federal policy response should recognize that subsidies can potentially distort the performance of markets and that the Federal fiscal environment is highly constrained. Second, any such response should occur in the context of a comprehensive National Freight Policy that reflects system performance based goals and a framework for intergovernmental and public-private cooperation. DOT initiated this effort by publishing a draft Framework for a National Freight Policy this year for comment. Third, Federal involvement should only occur where demonstrable wide-ranging public benefits and a mechanism to appropriately allocate the cost of financing these benefits between the public and private sectors exists and, to the extent possible, focuses on benefits that are more national than local in scope. Although new freight rail investment tax credits have been suggested, our past work has pointed out that it is difficult to target this approach to desired activities and outcomes and ensure that it generates the desired new investments as opposed to subsidizing investment that would have been undertaken at some point anyway. This approach can also have problematic fiscal impacts because it either lowers tax revenues or leads to higher overall tax rates to offset revenue losses. We will be discussing these areas in greater detail when we issue our report.

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

APPENDIX I—RELATED GAO PRODUCTS

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

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

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

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

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

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

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

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

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

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

Senator LOTT. Let's go ahead and hear from Mr. Buttrey, and then we'll ask questions of the both of you.

So, Mr. Doug Buttrey, Surface Transportation Board chairman, thank you for your service, and we'll be glad to hear from you.

STATEMENT OF W. DOUGLAS BUTTREY, CHAIRMAN, SURFACE TRANSPORTATION BOARD

Mr. BUTTREY. Good morning, Mr. Chairman, Ranking Member, members of the Subcommittee.

My name is Douglas Buttrey. I'm Chairman of the Surface Transportation Board. I appreciate the opportunity to appear before this Subcommittee today to discuss the economics of the freight railroad industry as it relates to current service and capacity issues.

This is my first appearance before this Committee since I became Chairman of the Surface Transportation Board on January 5. I'm glad to report that the Board has undertaken several important new initiatives since January in an effort to be proactive and responsive to concerns that have been raised. I will outline these initiatives for you in a moment, but first I'd like to comment briefly on rail capacity and service issues.

At least some of today's issues differ from those that prevailed when the Board last appeared before this Subcommittee. Historically, railroads had excess capacity. However, the U.S. economy has expanded, and the railroad industry, like other transportation sectors, has become capacity-constrained in some areas. The Board has a process in place to help railroads and their customers resolve service and/or rate disputes informally before availing themselves of the Board's formal processes. The Board favors private-sector solutions, but when informal processes cannot produce a solution, the Board is available to provide an adjudicatory forum.

Turning now to the new initiatives since January 1, I would first like to emphasize that the Board has begun a rulemaking to reform the large rate case process in an effort to make it as fair, efficient, and user-friendly as possible. Preparing the evidence that is required in a large rate case and presenting it to the Board can be very time-consuming and expensive for the parties. The Board's staff reviewed the formal rate proceedings that have come before the agency over the past few years, and, in February, the Board issued a Notice of Proposed Rulemaking in an attempt to improve how we handle certain difficult substantive issues that have come in large rate cases. Comments and replies have been filed, and rebuttals are due very shortly.

Because of the scope of these proposed rule changes, the Board has put its pending large rate cases in abeyance. Things are not standing still, however. Recently, the Board issued compliance orders in two of the pending cases to obtain additional evidence that will be needed to resolve those cases regardless of whatever rules are ultimately adopted.

The Board is also committed to improvements in the small rate case area. The Board's staff is continuing to develop new ideas to improve the existing small rate case procedures where we can. I cannot today give you a particular date on which a rulemaking on small rate case issues will be initiated, but I assure you that we're making every effort to come up with better guidance in this area. I expect the proposal to be issued later this summer.

Another matter that has been a serious concern to shippers in recent months is railroad fuel surcharges. Recently, unpredictability, volatility, and spikes in fuel costs are well known. To give parties on both sides an opportunity to address these matters, the Board held a public hearing—an all-day public hearing—on May 11. The hearing was very well attended, but I personally found the shippers and railroads to be worlds apart in their testimony, even as to factual matters. The Board is presently considering what action would be appropriate and helpful in this area.

The Board has also scheduled a public hearing to hear views on the issue of paper barriers. This hearing, on July 27, will explore the pros and cons of these limitations on interchanges that have been imposed in connection with some railroad line sales and leases. After the hearing, the Board will consider claims that such limitations are anticompetitive and what, if any, action is appropriate.

The Board has also instituted a rulemaking proceeding proposing to change the timing for class exemptions that provide an expedited process for obtaining authority for some rail-line acquisitions, leases, and similar transactions.

The Board proposed these changes in order to ensure that the public is given adequate notice of a proposed transaction before the exemption can become effective. Comments and replies have just recently been filed.

Finally, the Board has issued an advance notice of proposed rulemaking and sought comments on a proposed filed by the shortline and regional railroads. They seek a new expedited process for abandonment of rail lines owned by the smaller railroads. Comments and replies have been filed, and the Board will now consider what action, if any, is appropriate.

I hope it is clear from this summary that the Board is listening and sensitive to concerns raised by stakeholders, and has taken several important steps since January that are intended to explore how best to address those concerns within the bounds of our statutory authority. Reforms such as these are, in my view, the best way to address these concerns while maintaining a healthy freight rail network.

I'm glad to be participating on this panel today with Ms. Hecker of GAO, who has presented certain preliminary results of GAO's ongoing railroad study. The Board has been assisting GAO with this study and will continue to work with GAO as it moves forward to complete the study.

I look forward to any questions that you might have. Thank you, Mr. Chairman.

[The prepared statement of Mr. Buttrey follows:]

PREPARED STATEMENT OF W. DOUGLAS BUTTREY, CHAIRMAN, SURFACE TRANSPORTATION BOARD

Good morning Chairman Lott, Ranking Member Inouye, and members of the Subcommittee. My name is Douglas Buttrey, and I am Chairman of the Surface Transportation Board (Board or STB). I appreciate the opportunity to appear before this Subcommittee today to discuss the economics of the freight railroad industry as it relates to current service and capacity issues.

This is my first appearance before this Subcommittee since I became Chairman of the STB on January 5, 2006. The issues that are the subject of this hearing are vitally important to the freight railroads, their customers and employees, and the Nation's freight transportation system as a whole. I commend the Subcommittee for holding this hearing to look into these important matters.

I understand that a representative of the Government Accountability Office (GAO) is also scheduled to testify at this hearing, to present preliminary findings from GAO's study of recent rate changes in the freight rail industry. The Board has been cooperating with GAO on this study, and several meetings have been held between GAO and Board staff on this subject, to discuss the background and exchange information. Board staff has shared with me the contents of a preliminary draft statement of facts from GAO's study. Board staff is currently analyzing that preliminary draft. Once they have completed their analysis they will share it with GAO.

First, I will provide an overview of the Board and its responsibilities, and then I will discuss steps the Board is taking to address the issues that are the focus of this hearing.

Overview of the STB

The STB was created over 10 years ago by legislation initiated by this Committee. The ICC Termination Act of 1995 (ICCTA) established a three-member Board and charged it with the fundamental missions of resolving railroad rate and service disputes and reviewing railroad restructuring transactions (mergers, line sales, line construction, and line abandonments). In addition, the Board was given limited jurisdiction over certain trucking, bus, household goods, ocean shipping company (noncontiguous domestic trade), and pipeline matters. It is important to note that the substantial deregulation effected in the Staggers Rail Act of 1980 was continued under ICCTA. ICCTA empowers the Board, through its exemption authority, to promote deregulation through administrative action. The Board's staff is limited to no more than 150 employees by appropriation.

Two of the Board's main functions are to provide a regulatory forum to address rate disputes between railroads and captive shippers, and to assist shippers with service issues. The Board has created a number of mechanisms to help railroads and their customers resolve disputes before availing themselves of the Board's formal processes. For example, the Office of Compliance and Enforcement operates the Rail Consumer Assistance Program. That program is intended to provide assistance to rail consumers in addressing those issues that have not been resolved through private negotiations. When informal processes cannot produce a solution, however, the Board is available to provide an adjudicatory forum.

Although rates throughout the rail industry have generally declined significantly since the Staggers Act, many shippers believe the Board has not done enough to address shipper concerns in the areas of rate and service disputes. I understand those concerns, and I will next relate the steps the Board is taking to address them.

Shipper Issues

1. Undercapacity

Before I discuss rate and service issues in more detail, I would like to express my view of what it is that makes at least some of today's problems somewhat different from the issues that prevailed when the Board last appeared before this Subcommittee. Historically, railroads were burdened with excess capacity, which made it difficult for them to operate efficiently and earn a profit. In recent years, railroads have become more efficient by rationalizing their systems. At the same time, however, the U.S. economy has expanded, and the railroad industry, like other transportation sectors, has become capacity-constrained in some areas. Unlike some other sectors, however—trucking companies, for example, which can buy new equipment or hire more drivers—railroads cannot as readily respond to capacity constraints by quickly building new track and other facilities. Not only are rail construction projects expensive and time-consuming, but—as I will discuss later—these projects often are extremely controversial and can be the subject of court challenges on environmental issues in particular.

For those reasons, and others that may be beyond their control, railroads have experienced intermittent service problems throughout their systems. To mitigate the effects of their undercapacity, they have reportedly begun rationing service occasionally. According to some shippers, they do this by either embargoing large classes of traffic or by raising rates selectively. Neither of these alleged practices has been brought formally before the Board, and whether the Board could afford relief would depend on the circumstances of any formal complaint that might be brought. If a particular shipper has access to truck service—even if that service might be more expensive or less convenient—it might be unable to meet the market dominance requirement that is a statutory prerequisite to rate relief. And although the statute requires railroads to provide service on "reasonable request," what is reasonable is a case-specific inquiry. Railroads must prioritize competing requests for service, and I cannot say in advance how the Board would rule on any particular complaint alleging that a particular railroad's prioritization was so unreasonable as to be unlawful.

In any event, these concerns might be mitigated if railroads were able to expand their capacity. Such capital planning decisions depend on a variety of factors, such as the cost of new facilities, the likely returns on investment in new facilities, the availability of Federal and state programs to support and/or incentivize infrastructure capacity expansion by freight railroads, and so forth.

2. Rate Disputes

Under the statute, the Board has exclusive jurisdiction to resolve rate disputes in those instances when a railroad has market dominance—in other words, when the railroad is charging a rate higher than the regulatory floor and the shipper has no effective transportation alternative. Under the Interstate Commerce Act, the Board must balance the often conflicting objectives of assisting railroads in attaining revenue adequacy, on the one hand, and ensuring that the rates that individual shippers pay are reasonable, on the other. The balance, as we all know, is not an easy one. Rates that are too high can harm rail-dependent businesses, while rates that are held down too low will deprive railroads of revenues to pay for the infrastructure investments needed to give shippers the level and quality of service that they require. The Board has one set of procedures for handling "large" rate cases and another for "small" cases.

a. Large Rate Cases

The first step in a rate case is a two-part inquiry to determine whether the railroad has "market dominance" over the transportation to which the rate applies. The first part of the inquiry is to determine the "variable costs" of providing the service. The statute establishes a conclusive presumption that a railroad does not have market dominance over transportation if the rate that it charges produces revenues below 180 percent of the variable costs of providing the service, which means that this 180 percent revenue-to-variable cost (R/VC) percentage is the floor for regulatory scrutiny.

If the rate the railroad charges exceeds the 180 percent R/VC threshold, the second part of a market dominance inquiry involves a qualitative assessment in which the Board must determine whether there are any feasible transportation alternatives that could be used for the traffic involved. The Board considers whether there is actual or potential direct competition—that is, competition either from other railroads (intramodal competition) or from other modes of transportation such as trucks, pipelines, or barges (intermodal competition) for transporting the same traffic moving between the same points. If there are effective competitive alternatives for the transportation, then the Board does not have jurisdiction to regulate the rate, even if the rate charged yields an R/VC ratio greater than 180 percent.

If the shipper can show that the railroad is market dominant, then the Board applies its court-approved methodology for rate review known as constrained market pricing (CMP) to assess whether the rate being charged that shipper is in fact unreasonable. CMP provides a framework for the Board to regulate rates while affording railroads the opportunity to cover their costs. CMP is premised on differential pricing, that is, pricing based on the demand for the service provided. CMP principles recognize that, in order for railroads to earn adequate revenues, they need the flexibility to charge different customers different prices based on each customer's demand for rail service. But CMP principles also impose constraints on a railroad's ability to price. Despite the complexity of CMP, the courts have held that it is the most desirable available approach to railroad rate review and that the Board must use it whenever it is feasible.

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

I am aware that some shippers believe that the deck is stacked against them in rate cases brought under SAC. Yet, the Board's rate decisions historically have divided about evenly in terms of shipper wins versus carrier wins. I have attached a table setting forth this information as Exhibit A. Furthermore, nearly all of the

Board's rate decisions that have been challenged in court—whether challenged by railroads or by shippers—have been affirmed.

Nevertheless, the Board is working very hard to reform the large rate case process, in an effort to make it as fair, efficient and user-friendly as possible, given the somewhat competing statutory objectives. It is undeniable that deciding large rate cases is time consuming and costly for both the parties involved and the Board. The Board by statute has 9 months after the close of the record to decide a large rate case, and it can take more than twice that long after the shipper files its complaint for the parties to file all their evidence with the Board. Preparing that evidence and presenting it to the Board can be very time-consuming and expensive for the parties, and the Board devotes a significant amount of staff time and resources to these cases as well.

In recent years, the Board has developed new ways to simplify and speed up the rate review process. It has provided for: non-binding mediation at the beginning of the case, under the Board's auspices, between the shipper and the railroad; expedited procedures to resolve disputes, using Board staff, over what information the parties can be required to give to each other during discovery; technical conferences to resolve, before the actual evidence is filed, certain factual disputes between the parties using the expertise of Board staff; and public versions of all filings with the Board that can protect confidential information but still be read and understood by all parties and the public. These new procedures have for the most part improved the process by helping to move large rate cases forward.

Since I became Chairman, our staff has reviewed the rate proceedings the agency has processed over the past few years, and the Board has issued a Notice of Proposed Rulemaking (NPR) in an attempt to improve how we handle certain difficult substantive issues that have come up. In particular, we are seeking comments on six proposed changes to large rate case procedures. Those changes would focus on how the SAC process ought to arrive at the maximum reasonable rate once it is determined that an existing rate is too high; how the SAC process can better reflect economies of density; how the SAC process can better reflect carrier productivity gains when forecasting future carrier costs; how to simplify the costing process; how to improve the "discounted cash-flow" analysis used to calculate the need for rate relief; and better procedures for reopening or vacating a prior Board decision in SAC cases.

Comments and replies have already been filed, and rebuttals are due shortly. Because of the scope of these proposed rule changes, the Board has put its pending large rate cases in abeyance. Things are not standing still, however. Recently, the Board issued compliance orders in two of the pending SAC cases, to obtain additional evidence that will be needed to resolve those cases regardless of whatever rules are ultimately adopted.

In sum, while major litigation of the type involved in large rate cases is expensive and may appear to be slow, the Board has made progress in helping to ensure that the rate cases before it can proceed faster, cheaper and better. I will make it a priority to continue to make more improvements in this area. I expect significant progress when the pending rulemaking is completed.

b. Small Rate Cases

In 1996, in response to a Congressional directive, the Board adopted simplified guidelines for assessing the reasonableness of challenged rail rates in cases in which a full SAC presentation is too costly. Under these guidelines, the reasonableness of a challenged rate is determined by examining the carrier's overall revenue needs, how the railroad prices its other captive traffic, and how railroads in general price comparable traffic.

Shippers have expressed various concerns over how these procedures would play out in a particular case. They say that the ambiguity of who would qualify to use the small rate case procedures is a serious hurdle that has kept them from bringing cases. They have expressed concerns about how railroads might use the discovery process to unreasonably draw out a case. And shippers (and railroads) have urged the Board to adopt a more precise and predictable rate standard for small cases.

The agency held public hearings on this matter, and its staff met with staff from other economic regulatory agencies to gather information on how they handle smaller disputes. When a small rate complaint was filed last year—the "BP/Amoco" case—we modified some of our processes to make the case move more smoothly. We also provided for agency mediation. We were pleased to see that, largely as a result of these measures, the parties were able to settle the BP/Amoco case at an early stage.

But I know that more needs to be done in the small rate case area, and our staff is continuing to work hard to improve the existing procedures where we can. I cannot give you a particular date on which an NPR will be issued, but I assure you that we are trying to come up with better procedures in this area. I have directed staff to work up a recommendation and would expect a proposal to be issued later this summer.

3. Fuel Surcharges

One matter that has concerned shippers in recent months relates to railroad fuel surcharges. Recent unpredictability, volatility, and spikes in fuel costs are well known. As fuel is a substantial component of railroad costs, carriers have sought to recover their increased fuel costs through surcharges. Many in the shipper community, however, have expressed concern with the way in which these fuel surcharges have been implemented. To give parties on both sides an opportunity to address these matters, on May 11, 2006, the Board held a public hearing. The hearing was well attended, and I found the testimony to be very thoughtful and enlightening. The Board is presently considering what action would be appropriate and helpful in this area.

4. Competitive New Services

Many shippers would like to obtain service from a second, competing railroad. Sometimes rail customers may work with a second railroad to apply for authority to construct a new rail line. The Board's experience over the past several years has shown that new line construction—and there have been several new line constructions over the past few years—can bring competition while maintaining the private-sector characteristics of our rail system. But it can also be costly, and rail constructions, more than almost any other rail activity, generate community concerns that can delay and complicate the process.

The Board must take two regulatory steps before the construction of a new rail line can occur. First, the Board's environmental staff must conduct the necessary environmental review of the project. Second, the Board must consider and balance environmental concerns and the transportation-related merits of the proposed addition to the rail network. The Board has worked hard to expedite consideration of requests to construct rail lines whenever possible, and to approve them when appropriate.

Three of the most controversial projects that the Board has recently addressed are the "*DM&E*," "*Bayport Loop*," and "*Tongue River*" cases. In *DM&E*, the Board, after an extensive environmental review, approved the construction by the Dakota, Minnesota and Eastern Railroad of a line into the Powder River Basin in Wyoming, which, if constructed, will provide enhanced rail transportation options for coal shippers, particularly in the Midwest. The United States Court of Appeals for the Eighth Circuit found on judicial review that the Board had done "a highly commendable and professional job," but it nonetheless remanded the matter to the agency for limited additional consideration of four environmental issues. In a decision issued a few months ago, the Board addressed the issues remanded by the court. The Board's most recent decision has again been challenged in court by environmental and local groups, and construction of the line has not yet begun.

In *Bayport Loop,* the Board approved the construction of a line to provide BNSF Railway Company access into the Bayport industrial area near Houston, to bring competition to the service provided by Union Pacific Railroad Company (UP) to the large concentration of chemical companies located there. After the project was approved, it was tied up in Texas state courts by zoning and other land use objections raised by the city of Houston. Ultimately, the construction became unnecessary when UP and BNSF announced that they had reached agreement to provide these shippers with access to both railroads over the existing UP line.

In *Tongue River,* the Board is now considering the latest version of a longstanding construction case designed to provide a more efficient route for coal from the Powder River Basin to electric utilities. Two portions of the Tongue River Railroad's project to construct and operate a new railroad line in Montana were approved several years ago by the Board's predecessor agency, the Interstate Commerce Commission, and then the Board. However, the project did not go forward as originally proposed, and the carrier presented the Board with an amended proposal for part of the construction. The Board's environmental staff is currently completing its final environmental document. The agency will then determine whether it should approve the redesigned project.

While build-ins can increase competition and provide many benefits, we have seen that at times the construction of new rail lines can be controversial in the communities where the construction would take place. Indeed, both *DM&E* and *Bayport Loop* generated extensive local opposition and spawned court challenges by various citizen and other groups, and environmental issues have also been raised in *Tongue River*.

5. Service Issues

As with other industries, railroads and shippers sometimes have disputes over service. The Board has a very active consumer assistance program that handled a total of 121 disputes during 2005. We cannot always resolve the issues, but we are often successful at bringing the parties closer together and getting them to talk to each other.

The Board has rules that allow us to temporarily substitute a new carrier for an existing carrier that is unable to provide adequate service. We have used those rules several times in the past few years, and we will use them again when appropriate. But I must point out that those rules are not a viable remedy for many of the service issues we see today, because if a line is already clogged up with too much traffic, putting another railroad on the line will not fix the problem and may even present problems of its own. Therefore, while our substituted carrier rules may be very helpful in certain circumstances, probably the best way to address service problems long-term is for new infrastructure to be added to the rail system.

6. Preemption

As you all know, in ICCTA, Congress strengthened the statutory preemption provision that protects railroads from most state and local regulation. Although it may not be the subject of this hearing, I know that preemption is an issue that has concerned many Members of Congress in recent months. I will not go into the preemption issue in much detail here, but I would like to emphasize a few important points.

First, concerned parties always have avenues of recourse if they think Federal preemption is being improperly asserted. They can raise their concerns before the Board in a proceeding that requires a license, or through the Board's declaratory order process where no license is required; or they can choose to go directly to a court. Emergency relief can be, and has been, sought and obtained promptly in each forum.

Second, Federal preemption applies only to rail activities that are conducted by a railroad or its agent, and that are part of "railroad transportation" as defined in the statute. The Board has demonstrated its vigilance in making these fact-specific determinations in the individual cases that have been brought before it, to ensure that only those operations that qualify for the Federal preemption will benefit from it.

Third, even where Federal preemption applies, Federal environmental laws remain applicable, including those that are implemented in part by the states such as the Clean Air Act, the Clean Water Act, and the Solid Waste Disposal Act. In addition, states and local entities clearly retain their reserved police powers.

7. Paper Barriers

The Board has also scheduled a public hearing to hear views on the issue of "paper barriers." This hearing, on July 27, 2006, will explore the pros and cons of these limitations on interchange that have been imposed in connection with some railroad line sales. After the hearing the Board will consider what, if any, action should be taken.

8. Initiatives Concerning Abandonments and Exemptions

Lastly, I want to briefly inform the Subcommittee about some other initiatives that the Board is pursuing that may improve the regulatory process.

The Board instituted a rulemaking proceeding proposing to change the timing for "class exemptions" that provide an expedited process for obtaining authority for some rail lines acquisitions, leases, and similar transactions. The Board proposed the changes to extend the opportunity for the public to raise concerns before the Board in these types of cases. Comments and replies have just recently been filed.

Additionally, the Board issued an Advance Notice of Proposed Rulemaking and sought comments on a proposal filed by a group of short line and regional railroads. They seek a new, expedited process for abandonment of rail lines owned by Class II and Class III railroads. Comments and replies have been filed, and the Board will now consider what action, if any, is appropriate.

Neither of these proposals, if adopted, would dramatically change the fabric of transportation regulation, but both proceedings have been initiated to address areas of concern. The abandonment proceeding was instituted after small carriers raised concerns that the current procedures impose undue hardships on them, while the timing changes to the exemption process were proposed to ensure that the public is given notice of a proposed transaction before the exemption can become effective.

Conclusion

The Board is striving to address the concerns raised by captive shippers, and has several important initiatives underway that are intended to do just that. Reforms such as these are, in my view, the best way to address the concerns raised by captive shippers while maintaining a healthy freight rail network. It is a difficult balance, but one that can be achieved.

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

EXHIBIT A—JUNE 2006

STB Rail Rate Case Results

- *Shipper showed rate unreasonable* (Board ordered reparations for shipments moved while case pending & prescribed rate for future shipments):

1. *Arizona Pub. Serv. Co. et al.* v. *Atchison, T.&S.F.R.R.,* 2 S.T.B. 367 (1997), modified, 3 S.T.B. 70 (1998)—reparations (approx. $23 million) & rate prescription (approx. 40 percent reduction); rate prescription lifted in 2004 due to changed circumstances (earlier-than-expected depletion of coal reserves at mine).

2. *West Texas Util. Co.* v. *Burlington N. R.R.,* 1 S.T.B. 638 (1996), reparations calculated, 2 S.T.B. 683 (1997), aff'd sub nom. Burlington N.R.R. v. STB, 114 F.3d 206 (D.C. Cir. 1997)—reparations (approx. $11.4 million) & rate prescription; prescription revised in 2003 to correct for error.

3. *FMC Wyo. Corp. et al. v. Union Pac. R.R.,* 4 S.T.B. 699 (2000)—reparations & rate prescription (approx. 15 percent reduction) (minerals).

4. *Wisconsin Power & Light* v. *UP,* 5 S.T.B. 955 (2001), modified, STB Docket No. 42051 (May 14, 2002), aff'd, Union Pacific R.R. v. STB, No. 02–1198 (D.C. Cir. Apr. 30, 2003)—reparations & rate prescription (approx. 11 percent reduction).

5. *Texas Municipal Power Agency* v. *Burlington N.&S.F.Ry.,* STB Docket No. 42056 (STB Mar. 24, 2003), modified (STB Sept. 27, 2004)—reparations & rate prescription (approx. 1–3 percent reduction).

6. *Public Serv. Co. of Colo. d/b/a Xcel* v. *BNSF,* STB Docket No. 42057 (STB June 8, 2004), modified (STB Jan. 19, 2005), aff'd sub nom. BNSF Ry. v. STB, No. 05–1030 (D.C. Cir. June 16, 2006)—reparations (approx. $14 million) & rate prescription (approx. 16 percent reduction).

- Shipper failed to show rate unreasonable:

1. *McCarty Farms, Inc. et al.* v. *Burlington N., Inc.,* 2 S.T.B. 460 (1997), modified, 3 S.T.B. 102 (1998), aff'd, McCarty Farms, Inc. v. STB, 158 F.3d 1294 (D. C. Cir. 1998) (grain).

2. *PPL Montana, LLC* v. *Burlington N.&S.F.Ry.,* STB Docket No. 42054 (STB Aug. 20, 2002), reaffirmed after reviewing supplemental evidence (STB Aug. 31, 2004), aff'd, PPL Montana, LLC v. STB, No. 04–1369 (D.C. Cir. Feb. 17, 2006).

3. *Duke Energy Corp.* v. *Norfolk Southern Ry.,* STB Docket No. 42069 (STB Nov. 6, 2003), modified (STB Oct. 20, 2004), dismissed based upon voluntary settlement (STB July 8, 2005).

4. *Carolina Power & Light Co.* v. *Norfolk Southern Ry.,* STB Docket No. 42072 (STB Dec. 23, 2003), modified (STB Oct. 20, 2004), dismissed based upon voluntary settlement (STB July 8, 2005).

5. *Duke Energy Corp.* v. *CSX Transp. Inc.,* STB Docket No. 42070 (STB Feb. 4, 2004), modified (STB Oct. 20, 2004), dismissed based upon voluntary settlement (STB July 8, 2005).

6. *Arizona Elec. Power Coop., Inc.* v. *Burlington N.& S.F. Ry.,* STB Docket No. 42058 (STB Mar. 15, 2005), pet. for judicial review pending, Arizona Elec. Power Coop., Inc. v. STB, No. 05–1136 (D.C. Cir. filed Apr. 22, 2005).

7. *Otter Tail Power Co.* v. *BNSF Ry.,* STB Docket No. 42071 (STB Jan. 27, 2006), modified (STB May 26, 2006), pets. for judicial review pending sub nom. Otter Tail Power Co. v. STB, No. 06–1962 et al. (8th Cir. filed Apr. 10, 2006).

Senator LOTT. Thank you very much. Just a couple of questions.

First, Ms. Hecker, your testimony indicates that the rate relief process at STB is slow and expensive. And I don't see how there can be any debate about that. Mr. Buttrey here has outlined a number of initiatives that they're working on at the Board. Do you have any reaction to those initiatives? And do you have any suggestions of what more could be done to deal with these obvious problems?

Ms. HECKER. I do observe that most of the areas that have been proposed are issues that are being studied. The few that we highlight are the simplified guidelines, looking at alternative cost approaches, streamlining the process. So, I think they are generally being examined. We have not really reviewed those proposals, though, and perhaps we'll continue to work together to be able to share what we've learned so that that can be a component of their review.

Senator LOTT. Well, I hope you would review them and have some input into what they should consider doing.

Now, Mr. Buttrey, GAO has pointed out, and others have pointed out, that small shippers can't use the process used by the larger shippers to challenge a rate because of the cost and the difficulties of the process. What is your position on creating a process that would make it more accessible to the smaller shippers?

Mr. BUTTREY. Well, Senator, the simplified guidelines for small rate cases came out of a request from Congress to actually do that. And so, the Board put its hand to that task and, frankly, thought we had done a pretty good job of that. And so, we were pretty proud of those rules. But, as it turns out, those rules have only been used once since going into effect.

Senator LOTT. Well, what does that mean? Does that mean that they are not effective, or does that mean that maybe there wasn't as much need to have that access as maybe had been indicated?

Mr. BUTTREY. It probably means that we didn't do quite as good a job as we could have or should have perhaps in designing them to make them more accessible. The filing fee is very low. There are expedited procedures in place. But they have been used only once. When that case actually came before the Board, we required the parties to go into mediation prior to the case being prosecuted, and that case was settled between the two parties within about 3 days. And so, we really don't have any example, of a case going forward. So, what we have concluded is that we need to sit down and go over this whole process again and come up with more simplified rules and better processes, and make the system even simpler to use than we had earlier done. And we are in the process of doing that right now.

Senator LOTT. If a shipper wins a case before the STB, and the losing railroad appeals the decision of the courts, who's responsible for defending the position of the STB? Would the shipper bear any of the cost of that appeal?

Mr. BUTTREY. Senator, when the case is decided at the STB, and a party sues, the STB becomes the defendant in that case, and we have to defend that case on appeal.

Senator LOTT. Then the shipper doesn't have to incur cost as a result.

Mr. BUTTREY. No, we do that.

Senator LOTT. Right.

Mr. BUTTREY. We defend our decision.

Senator LOTT. I just have a feeling that there are some entities, perhaps, that are taking advantage of this fuel surcharge issue. And you had a hearing. Based on that hearing, you said that there was a huge divide between, you know, what the shippers are saying of the fuel surcharges and what the railroad's saying. It's kind of like people trying to give you a lecture on supply and demand; I've heard all that before. But usually there's a pretty easy, common sense answer. Either you are or you aren't. Now, I realize you've got to deal with fluctuations, but there's a way to do that. The line is like that. The lines don't go like that. [Indicating.] You know, is this a real problem? And what are you going to do about it?

Mr. BUTTREY. The word I use to describe the testimony that I heard was a total disconnect between what the parties were saying.

Senator LOTT. Basically your job's to try to discern the truth between the two.

Mr. BUTTREY. Pardon me?

Senator LOTT. Your job should be to try to discern the truth between the two disconnects.

Mr. BUTTREY. We need to separate the wheat from the chaff, yes, sir.

Senator LOTT. Yes.

Mr. BUTTREY. And that's what we intend to do. The concern, of course, as you stated in your opening statement, is that—the claim is that the carriers may be using fuel surcharges as a profit center. And it's up to the regulatory process to determine whether that's, in fact, the case or not, and that's exactly what we plan to do. It could be that the methodology used by the shipping public and by the railroads to arrive at these numbers is not uniform. And it could be that there may be some need for uniformity in how these charges are calculated over time. And so, that's one of the things we're going to be looking at. We're going to pursue this very aggressively.

Senator LOTT. I hope you will. I don't want to accuse anybody, but, if anybody is finding a way to make money off this, I consider that to be cheating, flat out, and would be highly offended that that would occur. So, I hope that your effort and my comments and those of others will influence conduct to make sure that's not the case.

Senator Burns?

Senator BURNS. Thank you very much, Mr. Chairman.

I'm really troubled, Mr. Buttrey, by, "Well, that's what we're going to do," and, "That's what we're pursuing," and we've had a year of this, and nothing has been done. I don't know whether you're working 5 days a week down there, and give the full 8 hours, but this is serious. And I—and I'm troubled by that kind of testimony here today. There's no excuse why this hasn't been handled already. There is no excuse whatsoever, in my mind, in watching all this. And I'm going to get very cranky about that.

A statement of future—on your—Ms. Hecker, on your display this morning, "Railroads reporting significant increased investment for future is uncertain. Enhancing captive-shipper protection can affect resources for investment." Would you explain that statement to me?

Ms. HECKER. Well, the first half of it is that there has been a substantial increase by railroads in capital investment, reportedly over $8 billion. There are issues about where that's going and the percent of that that's really just maintenance, as opposed to capacity expansion. So, part of the question that you all asked was—is, "Capacity needs are growing. What are the railroads doing?" So, the first answer was, yes, they are increasing their capital investment. How much of it is going to capacity expansion is an open issue.

The second half of it was to recognize the nexus that clearly exists between any changes in shipper protection. Most of these policy reforms, whether it's reciprocal switching or terminal access, and potentially even a simplified process that has a more expedited settlement that may not be economic-based, but just an arbitrator, for example, those are likely to all increase cost to the railroads. We're not saying they're not justified. Part of our analysis is that what we need is a more fine-tuned assessment of the nature of the captivity, the problem, and what the appropriate remedies are to potentially impose increased costs on railroads, but to recognize that those increased costs will reduce their capacity to invest for the future.

Senator BURNS. Well, I thank you for explaining that to me. In your testimony, you noted the Staggers Act was generally designed to create a healthy revenue-adequate railroad, as well as to provide for competition and shipper protections. You also note that the Staggers Act has been very positive for the railroads. And railroad revenue adequacy is becoming more of a reality—you've already stated that—which I think we all agree is a good thing. But you also note that the shipper complaints about lack of competition are on the rise. And that situation for captive shippers is getting worse in many areas. Now, is it fair to say, then, that the Staggers Act has not achieved the right balance between railroads and shippers, that perhaps the focus on revenue adequacy has overshadowed the need for competition and for shipper protection when there is no competition? Do you think that the Staggers Act has met its goals?

Ms. HECKER. I think you rightly point out that there were a mix of goals. And there's no doubt that it's met its goals in improving the stability and revenue adequacy of the railroads, and, in fact, their growth and dynamic importance for our economy. I've been doing work on railroads, and traveling the world, and the U.S. freight rail system is the envy of the world. There is no other system that is as efficient and that contributes to our economic growth because of its contribution to efficiency in our logistics system.

On the other hand, I think there is some real concern about whether the goals regarding the protection of truly captive shippers has been achieved. It is very, very costly. It is not an accessible system. The data is mixed. And that's our concern, why more analysis is needed, of where the captivity is, because there is not one bit of evidence. We see some evidence, and some of it I shared today, that the amount of traffic traveling under 300 percent of that ratio is substantially increased. So, a lot more shippers are paying relatively less than they were, and that's borne out by the overall rate-decline data.

Our concern is with a very small portion of shippers, who appear to be increasing—it's a small number, but it's increasing—who are paying very substantially above what may be their fair and justified share of railroad costs.

Senator BURNS. So that you and I can discuss this in another venue, how do you define—how would you define "captive shipper"?

Ms. HECKER. Well, it's really—the law says the threshold trigger is the—rate—is over the 180-percent degree, and then it's no available options, either by rail or by other mode, so you're just stuck. You have that one railroad, and that's your only option. The difficulty is in really measuring that and then also coming up with what the right response is. And then, I think—that's why I tried to say that some of the responses that really will promote competition and really increase competition between railroads, and provide more viable options, may justify as much examination as fixing the process after the fact, really trying to focus more on achieving the goals of Staggers that were about ensuring there was more competition.

Senator BURNS. Well, I wish you'd—and my time is up, and I'll move on, but I wish you'd just give me a simple, everyday, man-on-the-street definition of "captive shipper," so you and I can discuss some of these problems, because we hear all this legalese and all this other stuff that runs out, and then you want to add numbers and graphs and all of this. That doesn't make any difference to a farmer in Montana when he thinks he's getting hammered, or people that are shipping coal to powerplants around the country. Let's define what a "captive shipper" is, and then we can address the problems.

Thank you very much, Mr. Chairman.

Senator LOTT. Senator Dorgan?

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

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

I'm familiar with cranky Montanans, by the way.

[Laughter.]

Senator DORGAN. We're neighbors. But we're cranky, as well. I mean, we're damn mad about what's going on with rail rates in North Dakota.

Let me give you an example. And I don't know whether these numbers are current, but they were accurate not very long ago. If you were to put a carload of wheat on the tracks in Bismarck and run it over to Minneapolis, you'd pay about $1,000, put it on a—excuse me, you'd pay $2,400—put it on in Minneapolis, run it to Chicago, about the same distance, you'd pay $1,000. And North Dakota farmers wonder, "Why do we pay twice as much—two and a half times as much?" What's the justification for that?

Ms. Hecker, you indicated there's a question of whether we've truly protected captive shippers. There's no question about that. We truly have not protected captive shippers. I think you were just musing a rhetorical question. And we have not done that. And I would say, with respect to what my colleague from Montana just said, if there's ever an Olympic event for studying, clearly the Surface Transportation Board is a Gold Medal winner here. They have studied and studied and—they've been studying this since I showed up in Congress over two decades go. We've had ten rail rate cases filed since 2001. Before then, it was even more dismal. Ten rail rate cases since 2001, average $3 million apiece to do them, three and a third years apiece. I mean, clearly there's a failure here. Clearly, a failure.

And when you talk about captive shippers, it may be hard for academics to define, but it's not hard for a shipper that's held captive to define, I'll tell you that. I've got people in Dickinson, North Dakota, that are trucking wheat with an 18-wheel truck almost 200 miles east in order to put it on a railcar to run it right back through the farmstead on the track going to the West Coast. And they think that's stupid, that they're required to do that because of the way the system is set up.

But, having said all that, you know, they remixed an Elvis Presley tune 25 years after he was dead. They remixed it and put it out, and it hit the chart—hit number one in the charts 25 years after he died. And it was, "A little less conversation, a little more action, please." He probably wasn't talking about the Surface Transportation Board, but that sure applies. A little less conversation, a little more action, please.

Now, a quick question. Ms. Hecker, you said that the Surface Transportation Board has, quote, "broad legislative authority to investigate rail industry practices," unquote. And yet, I believe you say they have limited their reviews to merger cases, by and large—competition and merger cases.

Ms. HECKER. And rate cases.

Senator DORGAN. Yes. Mr. Buttrey, do you agree with that statement? And, if so, why has the Surface Transportation Board been so reluctant to take action on almost any of the issues that are the thorn under the saddle of folks out there that are held captive?

Mr. BUTTREY. Well, Senator, our charge, as we understand it under the Staggers Act, is to be an adjudicatory body and to hear cases that are brought to us by captive shippers or in large rate cases or service issue cases, or in small rate cases. And we do not believe that we have the authority to go out and set rates on our own.

Senator DORGAN. So, you disagree——

Mr. BUTTREY.—A case is brought to us, evidence is adduced, and you try these matters in the crucible of an adversary proceeding.

Senator DORGAN. So, you disagree with Ms. Hecker that you, "have broad legislative authority to investigate rail industry practices"? You disagree with that?

Mr. BUTTREY. We can have hearings to look into practices that are going on in the industry, and we are doing that.

Senator DORGAN. But my—but the point I was making, and I think the point my colleagues were making, is, cases aren't coming to you, because the system is broken. The small shippers don't feel like they get a fair shake. First of all, it costs way too much, takes too much time, and, when it gets there, they don't think they're going to get a fair result. So, if cases aren't coming to you, and we're hiring an STB—and I—you know, I know I've said the STB is dead from the neck up. I know that's not true. It's just a—your evidence—your being here in person today is evidence that's not true.

[Laughter.]

Senator DORGAN. But the fact is—but the fact is, I've said that because I am so enormously frustrated by this—a regulatory agency that says, "You know what? We're going to sit here. When somebody comes to us, then we're going to wake up and deal with it. But, until then, we're sorry, tough luck." Ms. Hecker says you have broad legislative authority to investigate rail industry practices. My feeling is, if that's the case, if that's her interpretation of the law, and that is the law, then why would you not be aggressively evaluating this issue of competition and taking action, rather than just sitting and waiting until someone brings a case to you?

Mr. BUTTREY. We have rulemaking authority. We only have authority that's given to us by the Congress. And we are trying to administer that, as we understand it to be. And that's the reason we're going through the rulemaking proceedings that we've instituted since January. Many of these regulatory rulemakings that we're pursuing right now, which are, by the way, on a very aggressive schedule, are to address the issues that all of you have raised this morning.

Senator DORGAN. But, do you know what? I heard that 10 years ago, and I heard that 20 years ago. Nothing's changed. It's like Groundhog's Day; we wake up, same day again. And I just—I think what Senator Burns and others are saying, you know, it's time, really, to get serious. This is not a rhetorical question, "Have we truly protected captive shippers?" The answer is, no. No, of course we haven't. And we need to get about the business of doing that. And I'm telling you, Ms. Hecker, the captive shippers in my state would not—whether it's coal or wheat—would not take a look at that rail line and say that, "Yes, we're the beneficiaries of lower rates." That is simply not the case in our area. In fact, they feel they're paying rates that are outrageous, far above that which is justifiable. And so does our state regulatory agency, the Public Service Commission of North Dakota.

Mr. Chairman, I have an Indian Affairs hearing that I'm cochairing with Senator McCain. I have to leave, but I want to thank you for holding this hearing.

And thank both of you for testifying. I hope you understand, we really—at least I really want action. Those of us that have introduced the legislation in our Committee—Senator Burns, Rockefeller, myself, and others—we really want to see something done here that fixes the problem, not have another decade go by and then we have another hearing, and we say, "You know what? We're studying this."

Senator LOTT. Thank you, Senator Dorgan.

Senator Pryor was next to arrive, but he has agreed to yield to Senator Lautenberg, because he has a conflict also.

Senator Lautenberg, we'd be glad to hear from you.

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

Senator LAUTENBERG.—I thank my friend from Arkansas for allowing me this statement. Since I was reelected, there are not many people I am senior to in rank, so I——

[Laughter.]

Senator LAUTENBERG.—have to pick on Senator Pryor. And I thank you, Mr. Chairman.

I ask unanimous consent that my full statement be included in the record.

Senator LOTT. It certainly will be included at this point.

[The prepared statement of Senator Lautenberg follows:]

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

Good morning Mr. Chairman. Thank you for calling this hearing.

Some people think of railroads as a mode of transportation that emerged in the 19th century, dominated the early part of the 20th century, and then slid toward irrelevance.

But the reality is that rail service remains *vital* to our economy and our way of life in the 21st century.

Freight rail lines handled *1.7 trillion ton-miles* of goods in 2005—*a 19 percent* increase from just 2 years before. And railroads posted record *profits.*

The public benefited as well. Rail remains a cost-effective way to move goods, which means *lower prices* for consumers. And every container that is hauled by rail means *one less truck* on our crowded highways, *less pollution* in our air, and *less oil consumed.*

Rail has remained relevant because it is seamlessly *integrated* into our transportation system. Last month the Senate adopted my resolution to commemorate the 50th anniversary of the *intermodal shipping container,* which first sailed from the U.S. from the *Port of Newark.*

Today, shipping containers are the *backbone* of our transportation system. More than 8.7 million containers moved by rail in the United States last year.

It is projected that by the year 2020, freight moved by *rail* will increase *44 percent,* while freight moved by *truck* is projected to increase more than *60 percent.* With highways operating at capacity in many regions, some transportation officials are asking if it would make sense to direct *more* traffic from the roads to the *rails.*

But railroads are operating at capacity as well, so this won't be possible without greater investment in the rail infrastructure.

Although this infrastructure is privately owned, the railroads continue to ask Congress for help in maintaining and improving their tracks and yards.

If we can justify these expenditures, there is no reason why we shouldn't *also* make similar investments in *passenger* rail infrastructure. Senator *Lott* and I have a bill that will begin to create a passenger rail system for the 21st Century, and I hope we are able to bring it to the floor soon.

I want to mention that there is one aspect of our current freight rail regulator system that troubles me—the failure of the Surface Transportation Board to actively enforce *environmental* standards.

Congress never intended for *solid waste processors* to get a *"free pass:* on environmental standards by claiming to be "railroads."

The Surface Transportation Board should act to correct this misinterpretation, before Congress is forced to act.

Thank you Mr. Chairman.

Senator LAUTENBERG. The one part that I'm, kind of, focused on this morning—and we all are aware of the fact that rail is continuing to pick up its obligations to carry freight and so forth, and we're not discussing the details, but it's—we can't fit another truck or—out there on the highways without noticing that things are jammed up. And rail is also, in my view, or I think in the view of many experienced people, that there isn't enough capacity in rail to carry what is anticipated to be a great jump in freight traffic. So, we—that investment has got to come along. But Senator Lott and I have also made a recommendation that we invest in passenger rail service. It has the same beneficial result, and that is getting cars off the highway, reducing pollution, reducing dependency on imported oil. So, we're working hard to get that up front in the—in our agenda.

And I—but I do want to mention one aspect of the current freight rail regulator system that troubles me, and that is the failure of the Surface Transportation Board to actively enforce environmental standards. Now, Congress never intended, for instance, for solid waste processors to get a free pass on environmental standards by claiming to be railroads. And I think that the Surface Transportation Board should act to correct this misinterpretation before Congress is forced to act.

So, Mr. Buttrey, I ask, is the Surface Transportation Board doing anything about companies that are essentially focused on solid-waste handling, as it is in New Jersey, who are pretending to be railroads—and I use that comment, kind of, cynically—in order to avoid state environmental laws? Are you familiar with that kind of a condition?

Mr. BUTTREY. Yes, Senator, I am familiar with that situation. It's been brought to our attention, not only informally, but formally at the Board. Just a few days ago, I testified in the House on this very issue of entities of one kind or another trying to hide behind the pre-emption provisions of the Act. I assured the Transportation and Infrastructure Committee at that time—and, by the way, I happen to have a copy of my testimony with me today, and if it's permissible, I could submit that for the record, if that's OK with the chairman, and get that in the record, since you asked a specific question about it.

[The information referred to follows:]

Testimony of W. Douglas Buttrey,

Chairman of the Surface Transportation Board

House Committee on Transportation and Infrastructure

Subcommittee on Railroads

Hearing on Impacts of Railroad-Owned Waste Facilities

10 a.m. May 23, 2006

Good morning, Mr. Chairman. My name is Douglas Buttrey, and I am the Chairman of the Surface Transportation Board. I appreciate the opportunity to testify before you today about Federal preemption for rail-related facilities. I would first like to provide the Subcommittee with an overview of the Board's role, and the role of state and local authorities with regard to such facilities. Next, I will discuss the state of the law on this complex issue which is still being fleshed out by the Board and the courts in individual cases that arise. Finally, because there has been a lot of concern lately about the potential for misuse of Federal preemption in cases involving facilities on rail lines, I will outline how interested parties can raise concerns before the Board and in the courts regarding individual proposals that arise. I will not focus today on the individual cases that have addressed Federal preemption for rail-related facilities, but I have included as part of my written testimony a summary of the relevant case law.

1. The Scope of the Federal Preemption

As all of you are aware, the Surface Transportation Board was created in the ICC Termination Act of 1995 (ICCTA). The express Federal preemption contained in the

Board's governing statute at 49 U.S.C. 10501(b) gives the Board exclusive jurisdiction over "transportation by rail carriers." Congress has defined the term "transportation" broadly, at 49 U.S.C. 10102(9), to include all of the related facilities and activities that are part of rail transportation. The purpose of preemption is to prevent a patchwork of otherwise well intentioned local regulation from interfering with the operation of the rail network to serve interstate commerce.

Both the Board and the courts have made clear, however, that, although the scope of the section 10501(b) preemption is broad, there are limits. While a literal reading of section 10501(b) would suggest that it preempts all other law, neither the Board nor the courts have interpreted the statute in that manner. Rather, where there are overlapping Federal statutes, they are to be harmonized, with each statute given effect to the extent possible. This is true even for Federal statutory schemes that are implemented in part by the states, such as the Clean Air Act, the Clean Water Act, and the Solid Waste Disposal Act.

When states or localities are acting on their own, certain types of actions are categorically preempted, regardless of the context or basis of the action. This includes any form of permitting or preclearance requirement-such as building, zoning, and environmental and land use permitting-which could be used to deny or defeat a railroad's ability to conduct its rail operations or to proceed with activities that the Board has authorized. Also, states or localities cannot regulate matters directly regulated by the Board, such as railroad rates or service or the construction, operation, and abandonment of rail lines.

Otherwise, whether the preemption applies depends on whether the particular action would have the effect of preventing or unreasonably interfering with rail transportation. Types of state and local measures that have been found to be permissible, even in cases that qualify for the Federal preemption, include requirements that railroads share their plans with the community when they are undertaking an activity for which a non-railroad entity would require a permit, or that railroads comply with local electrical, fire, and plumbing codes.

In cases involving facilities that require a license from the Board and an environmental review under the National Environmental Policy Act (NEPA), the Board addresses both the transportation-related issues and any environmental issues that are raised. The environmental review is managed by the Board's Section of Environmental Analysis.

Even where no license is needed from the Board, there are several avenues of recourse for interested parties, communities, or state and local authorities concerned that the section 10501(b) preemption is being wrongly claimed to shield activities that do not rightly qualify for the Federal preemption. Any interested party can ask the Board to issue a declaratory order addressing whether particular operations constitute "rail transportation" conducted by a "rail carrier." Alternatively, parties are free to go directly to court to have that issue resolved. Some courts have chosen to refer that issue to the Board; others have decided the matter themselves. It is worth noting, however, that the Board and court cases on the boundaries of the section 10501(b) preemption have been remarkably consistent, and that the Board and the courts have never reached a different conclusion regarding the availability of the preemption for particular activities and operations.

Finally, in some cases, environmental and safety concerns have been successfully resolved through consensual means, by the railroad and the community working together to address their respective interests.

2. Relevant Precedent on Facilities

Given the strength and breadth of the section 10501(b) preemption, the potential for misuse is a definite concern. Thus, both the Board and the courts have made clear that an entity is not entitled to Federal preemption to the extent it is engaged in activities other than rail transportation. In some cases, solid waste and other businesses have located close to a railroad and claimed to be a rail facility exempted from state and local laws that would otherwise apply, but have been found by the Board or a court not to be entitled to the Federal preemption because the operation did not actually constitute "rail transportation" by a "rail carrier." In other cases, activities and operations at facilities have been found to qualify for the Federal preemption, as part of the transportation conducted by a rail carrier.

Cases involving solid waste transfer, storage and /or processing facilities proposed to be located along rail lines are especially controversial and often raise concerns that the operations could cause environmental harm. In every case, however, interested parties, communities, and state and local authorities concerned about a proposal have recourse to the Board or the courts.

Rail carriers need approval to construct a new rail line under 49 U.S.C. 10901. During the Board's licensing proceedings, parties concerned that all or part of the project is not entitled to preemption have the opportunity to present their views to the Board for consideration in the proceeding. In rail construction cases, the Board also routinely conducts a detailed NEPA review, allowing all interested parties the opportunity to raise any environmental concerns. The Board then takes the entire environmental record into account in deciding whether to grant the license. The Board can, and often does, impose appropriate environmental conditions to address the environmental concerns that are raised. Thus, the Board's existing process has proven to be sufficient to allow the agency to address any issues related to proposed solid waste or other facilities along the line.

If the project involves the acquisition and operation of an existing rail line, or the acquisition of a rail carrier by another carrier or carrier-affiliate, authority from the Board also is required, and NEPA is applicable. Normally, however, a proposal to change the owner or the operator of a line will not have any significant effects on the environment. Therefore, the Board does not always conduct a case-specific environmental analysis. But where there is a potential for significant impacts, and that is brought to the Board's attention, the Board may decide to undertake a full environmental review.

Finally, some activities at facilities on or along rail lines may qualify for the preemption in section 10501(b) but not require Board approval and review, so that there is no occasion for the Board to conduct an environmental review. For example, under the statute, carriers may make improvements and add new facilities (including a solid waste facility) to an existing line without seeking Board approval. Even in these types of cases, however, parties concerned that section 10501(b) is being used to shield activities that do not qualify for the Federal preemption under section 10501(b) can ask the Board to issue a declaratory order, or a stay, or go directly to court to address the status of the facility.

The inquiry into whether and to what extent the preemption applies in a particular situation is naturally a fact-bound question. There have been only a few cases that have come before the Board involving solid waste facilities. The Board and the courts will continue to explore where the boundary may lie between traditional solid waste activities and what is properly considered to be part of "rail transportation," and what kinds of state and local actions are federally preempted, in the individual cases that arise.

Conclusion

In conclusion, it is important to reiterate that, although both the Board and the courts have interpreted section 10501(b) preemption broadly, there are limits on the preemption, which is harmonized with other Federal laws. The question of what constitutes "transportation by rail," according to the statute and precedent addressing the rights of railroads and of state and local authorities under section 10501(b), is still being fleshed out by the Board and the courts in the individual cases that arise. However, it is clear that not all activities are entitled to preemption simply because the activities take place at a facility located on rail-owned property. Of course, cases involving preemption for railroad facilities are likely to remain controversial. But even in cases that do not require review and approval by the Board, parties concerned that the section 10501(b) preemption is being misused in a case involving a facility have ways to raise their concerns at the Board or in the courts.

I appreciate the opportunity to discuss these issues with you today, and would be happy to answer any questions you may have.

ATTACHMENT

Section 10501(b) Preemption

1. Section 10501(b)

- *Gives Board exclusive jurisdiction over "transportation by rail carriers" and expressly preempts any state law remedies with respect to rail transportation; ICA defines "transportation" broadly to include all of the related facilities and activities that are part of rail transportation (section 10102(9))*
- Purpose of section 10501(b) is to prevent patchwork of local regulation from unreasonably interfering with interstate commerce

2. Reach of the Section 10501(b) Preemption

- *Statute not limited to "economic" regulation* (*City of Auburn* v. *United States*, 154 F.3d 1025 (9th Cir. 1998))
- *While most state and local laws are preempted, overlapping Federal statutes (including environmental statutes) are to be harmonized, with each statute given*

effect to the extent possible (*Tyrrell* v. *Norfolk Southern Ry.*, 248 F.3d 517 (6th Cir. 2001) (there is no "positive repugnancy" between the Interstate Commerce Act and the Federal Railway Safety Act); *Friends of the Aquifer et al.*, STB Finance Docket No. 33396 (STB served Aug. 15, 2001) (Congress did not intend to preempt Federal environmental laws such as the Clean Air Act and the Clean Water Act, even when those statutory schemes are implemented in part by the states))

- *Two types of state and local actions are categorically preempted:*

  (1) any form of state and local preclearance or permitting that, by its nature, could be used to deny or defeat the railroad's ability to conduct its operations (*City of Auburn* v. *United States*, 154 F.3d 1025 (9th Cir. 1998) (environmental and land use permitting categorically preempted); *Green Mountain R.R.* v. *State of Vermont*, 404 F.3d 638 (2d Cir. 2005) (preconstruction permitting of transload facility necessarily preempted by section 10501(b)) *and*

  (2) state or local regulation of matters directly regulated by the Board (CSXT Transportation, Inc.—Pet. For Decl. Order, STB Finance Docket No. 34662 (STB served March 14, 2005), reconsideration denied (STB served May 3, 2005), petitions for judicial review pending, *District of Columbia* v. *STB*, No. 05–1220 *et al.,* (D.C. Cir. filed June 22, 2005) (any state or local attempt to determine how a railroad's traffic should be routed is preempted); *Friberg* v. *Kansas City S. Ry.*, 267 F.3d 439 (5th Cir. 2001) (state statute imposing limitations on a railroad expressly preempted); *Wisconsin Cent. Ltd.* v. *City of Marshfield*, 160 F. Supp.2d 1009 (W.D. Wis. 2000) (attempt to use a state's general eminent domain law to condemn an actively used railroad passing track preempted))

- *Otherwise, preemption analysis requires a factual assessment of whether that action would have the effect of preventing or unreasonably interfering with railroad transportation (Dakota, Minn. & E.R.R.* v. *State of South Dakota*, 236 F. Supp.2d 989 (D. S.D. 2002), *aff'd on other grounds*, 362 F.3d 512 (8th Cir. 2004) (revisions to state's eminent domain law preempted where revisions added new burdensome qualifying requirements to the railroad's eminent domain power that would have the effect of state "regulation" of railroads))
- *Notwithstanding section 10501(b), it is permissible to apply state and local requirements such as building, fire, and electrical codes to railroad facilities so long as they are not applied in a discriminatory manner; however, need to seek building permit is preempted* (*Flynn* v. *Burlington N. Santa Fe. Corp.*, 98 F. Supp.2d 1186 (E.D. Wash. 2000); *Village of Ridgefield Park* v. *New York, Susquehanna & W. Ry.*, 750 A.2d 57 (N.J. 2000); *Borough of Riverdale—Pet. for Decl. Order—The New York Susquehanna & Western Ry.*, STB Finance Docket No. 33466 (STB served Sept. 10, 1999, and Feb. 27, 2001)).
- *Railroads are encouraged to work with localities to reach reasonable accommodations* (*Township of Woodbridge* v. *Consolidated Rail Corp.*, STB Docket No. 42053 (STB served Dec. 1, 2003) (carrier cannot invoke section 10501(b) preemption to avoid obligations under an agreement it had entered into voluntarily, where enforcement of the agreement would not unreasonably interfere with interstate commerce))

3. Who Interprets Section 10501(b)?

- *Board in cases that require a license & environmental review*
- *Either the Board in a declaratory order or a court (either with or without referral to the Board) in other cases*
- *When class exemption was invoked to lease and operate 1,600 feet of track for use in transferring construction and demolition waste between truck and rail, the Board stayed the proceeding to obtain additional information* (*Northeast Interchange Ry., LLC-Lease & Oper. Exem.-Line in Croton-on-Hudson, NY*, STB Finance Docket No. 34734 *et al.,* (STB served August 5, 2005))
- *Board has discretion to decide whether to institute a declaratory order proceeding and denied request that it do so to address solid waste operations on property owned by the New York, Susquehanna and Western Ry. in North Bergen, NJ, and other similarly situated solid waste operations, because the North Bergen facility is permanently closed, petitioners failed to point to an alternative site that would warrant continuing with the proceeding, and the railroad and the New Jersey Department of Environmental Protection are involved in ongoing court litigation related to the facility* (*National Solid Wastes Management Asso-*

ciation, Et Al.—Petition for Declaratory Order, STB Finance Docket No. 34776 (STB served March 10, 2006))

4. Case Law on Facilities

- *Preemption applies to proposals to build or acquire ancillary facilities that assist a railroad in providing its existing service, even though the Board lacks licensing authority over the projects*

  i. *Nicholson* v. *ICC*, 711 F.2d 364 (D.C. Cir. 1983)

  ii. *Borough of Riverdale—Pet. for Decl. Order—The New York Susquehanna & Western Ry.*, STB Finance Docket No. 33466 (STB served Sept. 10, 1999, and Feb. 27, 2001)

  iii. *Flynn* v. *Burlington N. Santa Fe. Corp.*, 98 F. Supp.2d 1186 (E.D. Wash. 2000)

  iv. *Friends of the Aquifer et al.*, STB Finance Docket No. 33396 (STB served Aug. 15, 2001)

- *No preemption where the operation does not constitute transportation by a rail carrier*

  i. *High Tech Trans, LLV* v. *New Jersey*, 382 F.3d 295 (3d Cir. 2004); *High Tech Trans, LLC—Pet. For Decl. Order—Hudson County NJ*, STB Finance Docket No. 34192 (STB served Nov. 20, 2002) (both agreeing with New Jersey Dept. of Environ. Protection that there is no preemption for truck transportation of construction and demolition waste en route to transloading facility, even though a railroad ultimately uses rail cars to transport the debris)

  ii. *Grafton and Upton R.R.* v. *Town of Milford*, Civ. No. 03–40291 (D. Mass. Feb. 14, 2006); *Town of Milford, MA—Pet. For Decl. Order*, STB Finance Docket No. 34444 (STB served Aug. 12, 2004) (no preemption for planned steel fabrication facilities that are not part of "transportation")

  iii. *Florida East Coast Ry.* v. *City of West Palm Beach*, 266 F.3d 1324 (11th Cir. 2001) (no preemption for aggregate distribution plant because the plant, although located on railroad property, was not railroad-owned or operated and thus was not part of rail transportation)

- *Activities That Do Qualify for Federal Preemption as Transportation Conducted by a Rail Carrier*

  i. *Green Mountain R.R.* v. *State of Vermont*, 404 F.3d 638 (2d Cir. 2005) (preemption for cement transloading facility in Vermont)

  ii. *Joint Pet. For Decl. Order—Boston & Maine Corp.* v. *Town of Ayer, MA*, STB Finance Docket No. 33971 (STB served May 1, 2001), *aff'd, Boston & Maine Corp.* v. *Town of Ayer*, 206 F.Supp.2d 128 (D. Mass. 2002), *rev'd solely on attys fee issue*, 330 F.3d 12 (1st Cir. 2003) (preemption for automobile loading facility in Massachusetts)

  iii. *Norfolk S. Ry.* v. *City of Austell*, No. 1:97–cv–1018–RLV, 1997 WL 1113647 (N.D. Ga. 1997) (local zoning and land use permitting regulation for railroad facility preempted)

  iv. *Canadian National Ry.* v. *City of Rockwood*, No. 04–40323, 2005 WL 1349077 (E.D. Mich. 2005) (county zoning laws and permitting and preclearance requirements preempted for a railroad's transload facility in Michigan)

I assured the Committee at that time that if entities think they're going to be able to escape environmental review by trying to hide behind the pre-emption provisions of the Act, they have a real surprise in store.

Senator LAUTENBERG. Good. Well, then——

Mr. BUTTREY. I can assure you of that.

Senator LAUTENBERG. Well, I'm here—happy to hear that the STB is examining its position—legal position, that it has the sole jurisdiction to regulate the processing of solid-waste action. So—and that pre-empt states—so, if you would submit—or make that available to my staff, I'd appreciate that.

Senator LAUTENBERG. And, with that, I return the next position to my friend from Arkansas and thank him for very much for permitting me to intervene at this point.

Senator PRYOR. Thank you.

Senator LOTT. Senator Pryor?

STATEMENT OF HON. MARK PRYOR, U.S. SENATOR FROM ARKANSAS

Senator PRYOR. Thank you, Mr. Chairman.

Ms. Hecker, let me ask you, to start. As part of your report here, you mentioned capacity problems in the future in our rail system. Given your investigation and your time that you've spent looking at this, do you have any thoughts on what we can do to address the capacity problems in the future, or is that something that you tend to stay out of?

Ms. HECKER. No, sir. It's actually a part of our review. It's an enormous question, on its own. So, in addition to trying to do 25 years of post-industry performance and all of the relief options, we are addressing that issue. In my opening remarks, what I said is, we are concerned about sweeping proposals. We think that they won't be targeted enough. So, I think a lot of our work in advising the Congress on a potential role to enhance and facilitate and promote increased investment that will generate public benefits is that they be very carefully tailored so that they, in fact, do generate those public benefits and don't just substitute for investments that either the railroads or states would have made anyway.

Senator PRYOR. So, the—if you take an idea like investment tax credits, is that too sweeping, or is that——

Ms. HECKER. In my statement, I do raise concerns about that. I do believe it has the significant potential to just substitute for investments that railroads would have made, and not target it to——

Senator PRYOR. OK.

Ms. HECKER.—where we would generate public benefits.

Senator PRYOR. Great. Well, I'd like to continue that dialogue with you at some point.

Let me ask about your finished report. The report today is a draft report. Is that right?

Ms. HECKER. We don't publicly release draft reports.

Senator PRYOR. OK.

Ms. HECKER. These are preliminary results on a report that's not completed. So, we have more analysis ongoing, but we stand by everything we're saying today.

Senator PRYOR. Do you anticipate that your final report will specify ways in which the STB can improve its procedures and maybe even include recommended legislative changes? Will your final report do that?

Ms. HECKER. The questions that you and others have posed certainly ask us to come up with recommendations. GAO, of course, doesn't make them unless we feel there's enough evidence to really support them. At this point in time, we believe the absence of real understanding and analysis of the captive shipper and the prices they're paying and other factors that may be affecting those really require more evaluation before we're comfortable settling on one solution or another. The point is, we want to make sure a solution targets and solves a problem so that it justifies the costs and inefficiencies that that solution may impose.

Senator PRYOR. OK. Let me ask this. In your review, and given your experience, have you seen any evidence that railroads are not investing in infrastructure in order to limit capacity and, thereby, drive up rates on their customers? Have you seen that?

Ms. HECKER. We've seen no evidence of that.

Senator PRYOR. OK. Let me ask this. As I understand at least part of your report, if I can distill it down, not to put words in your mouth, but it seems to me there is a maxim here that less competition may lead to higher prices. Is that fair to say?

Ms. HECKER. That nails it.

Senator PRYOR. OK. That's—if—I thought I was tracking what you were saying earlier, and I think that's pretty much it. And did you spend a lot of time in the shortline railroad industry? Did you look at that, or did you primarily look at the large rail?

Ms. HECKER. No, unfortunately, given the broad scope of this, we have not spent a lot of time on that issue. And it may be that the issue of their role is part of a fundamental long-term vision of how to improve the competitive state of this industry overall.

Senator PRYOR. Yes. And we—I hear stories about the contracts with the bigger railroads and the short lines and getting from point A to point B, sometimes the way those contracts are structured can move prices up, where, otherwise, they may not. But, again, I think——

Ms. HECKER. And that's an area Mr. Buttrey says——

Senator PRYOR. Yes.

Ms. HECKER.—has been open for review.

Senator PRYOR. Mr. Buttrey, let me—I just have a few seconds left—let me ask, just in general, Do you think your agency needs more statutory authority?

Mr. BUTTREY. Senator, we do not believe that's the case. We believe that we have the statutory authority to do the job. It's just a matter of fine-tuning our rules and our procedures and policies so that they become more user-friendly, so they become simpler, less time-consuming, less expensive. And we're in the process of trying to do that right now.

Senator PRYOR. That's interesting, because, you know, based on what you said earlier, and some of the other questions, maybe I misunderstood, but my impression was that you felt like that there were lots of room for improvement, and that might include more statutory authority, and even more clarity and direction from the Congress. Is that not the case?

Mr. BUTTREY. We don't believe it's the case, at the moment, no, sir.

Senator PRYOR. OK.

Thank you, Mr. Chairman.

Senator LOTT. Thank you very much.

I'd like to ask some more questions. Maybe I'll have a chance to do that privately, but we do have another panel. We really want to hear from them. So, we——

Senator BURNS. I—could I——

Senator LOTT. Did you want to do a followup?

Senator BURNS. I want to—I want—yes, I do.

[Laughter.]

Senator BURNS. I sure do.

Senator LOTT. Sorry about that.

[Laughter.]

Senator BURNS. That's all right. And I appreciate the—I've got a couple of questions for Mr. Buttrey, and it's just to kind of clear up and lay the groundwork on what our problem is.

The scope of the STB jurisdiction—and I see right now where we've got a couple of differing opinions. First, if a railroad and a shipper negotiate a contract, movement of freight, is that contract under your jurisdiction?

Mr. BUTTREY. No, it's not, Senator.

Senator BURNS. Does the answer change if the shipper is captive, and, thus, can't truly negotiate at arm's length with a single provider of that service?

Mr. BUTTREY. If it's a contract between a shipper and a railroad, whether it's captive or not, it's not subject to our jurisdiction.

Senator BURNS. It doesn't make any difference.

Mr. BUTTREY. We do not have the authority to go in and undo a contractual relationship between contracting parties.

Senator BURNS. How much freight is moved under contract in this country, percentagewise? Do you have any idea?

Mr. BUTTREY. I have some staff with me. I could just see if I could get you an answer right now, possibly, from the staff.

Senator BURNS. Well——

Mr. BUTTREY. We could provide that for the record.

Senator BURNS. OK. Well, I'd like—respond to me and the Committee, both.

If you don't have jurisdiction over rail-service issue, what Federal agency or department would have that jurisdiction?

Senator BURNS. Damn good question, huh?

[Laughter.]

Mr. BUTTREY. It is a good question. The short answer to that question is that if there are problems with that contract, those matters would be litigated at the state or federal court level, not the STB level.

Senator BURNS. OK. And I am—and I hear a lot of concern from rail customers about two rulings of the STB that are perceived as preventing competition, in—and in direct conflict with what Congress directed the STB to do, which was to work toward competitive markets, and, of course, protect those shippers. One concern is the bottleneck decision. It essentially says that a railroad does not have to provide the customer a rate to a point where a movement may move onto a competing railroad. Second, both the STB, and the ICC before it, have approved what I believe are anticompetitive contracts known as "paper barriers" in track lease arrangements between major railroads and short lines, meaning that the short lines may only do business with the railroad leasing the track. Even the short line might connect to another major carrier. Your agency has the authority to take the administrative action to promote competition, yet these decisions just do the opposite. Can the STB act on its own initiative to change these rulings, or must someone bring a request to the STB that it change the rulings of these issues? Do they have to be resubmitted or rechallenged?

Senator BURNS. If they don't have to, why can't you do something about it?

Mr. BUTTREY. The bottleneck decision to which you refer was—and you stated the facts absolutely correctly about how that works—was a case that was affirmed by the U.S. Court of Appeals (Cert, denied). That's the law of the land until someone changes the law of the land. And so, we abide by that.

Senator BURNS. All that was a decision by nine lawyers.

Mr. BUTTREY. That was a decision by nine lawyers, yes sir.

[Laughter.]

Mr. BUTTREY. The second question you asked, about possibly anticompetitive effects as a result of line sales or leases or possibly a merger, and the so-called paper-barriers issue is a concern of ours as well, and that's the reason we scheduled a hearing for July 27, to look into that issue, the prevalence of those agreements, and the possibly anticompetitive effects of those matters.

Senator BURNS. Well, see, my legislation in my bill is addressed to three different areas. If it were not for antitrust exemption given to the railroads, I think this would be a—there would be an entirely different landscape and an entirely different approach to what you can do and what Congress has to do.

And I'd—and I will ask you another question. Does the STB take its duty, to provide for competition and protect shippers, seriously, or does it simply sit back and wait for the shippers to jump in? What does it cost—I'm a small shipper—let's say I'm an elevator in Montana. How much does it cost me to file a case with the STB?

Mr. BUTTREY. Well, Senator, in a small rate case, the filing fee is $150, but that does not represent the cost of prosecuting the case, of course. The cost of prosecuting the case is considerable.

Senator BURNS. Do I bear that cost?

Mr. BUTTREY. Pardon me?

Senator BURNS. Do I bear that cost?

Mr. BUTTREY. The plaintiff bears that cost. But if you win that case, you get reparations back over the period of that rate that's being challenged. You get reparations from the railroad, directly from the railroad if you win that case, which could be in the hundreds—maybe not hundreds of millions, but certainly in the millions of dollars for a small shipper, and a lot more for a large shipper.

Senator BURNS. I know you're just racing along with some of these things. It only took, what, 17 or 18 years to clear the McCarty Farms case. And, of course, that was under a new regime. I'd hope we could get more efficient than that. But——

And I've got a couple of other questions. In the essence of time, Mr. Chairman—but I think there are areas that we have to change. And I think it—whenever we define "captive shipper," in other areas where there's competition, the STB, in my notion, doesn't have any jurisdiction at all under those cases. But where we're captive, I think you do. And I think we have to deal with those particular areas.

And I thank the Chairman. And I've got a couple more questions, but we'll get them to him.

The STB hasn't taken action to address the captive-shipper issues on rates, service, and capacity, but it has routinely protected the railroads with regard to the exclusive revenue adequacy. What's the difference?

Mr. BUTTREY. Senator, I'm not sure I understand your question. I'm sorry.

Senator BURNS. Well, you haven't taken any action, as far as—with captive shippers, anyway—on rates, on service, or on capacity. But you've routinely protected railroads on revenue adequacy. I mean, we've heard this from both of you. And I want to know what the difference is. I think this is a double-bit—I think it's a double-bitted ax, and it cuts both ways. So, we've got a little discussion to do about that.

Thank you, Mr. Chairman.

Senator LOTT. Thank you very much to this panel. We appreciate your time and your service.

Now let's go to the second panel. We will have before us Mr. Dale Schuler, president, National Association of Wheat Growers, from Carter, Montana; The Honorable Glenn English, my former colleague from the House of Representatives, corporate executive officer, National Rural Electric Cooperative Association, Arlington, Virginia; Mr. John McIntosh, president of products of Olin Corporation, from Clayton, Missouri—you know about that, don't you, Conrad?; Mr. John Ficker, president of The National Industrial Transportation League, from Arlington; and Mr. Ed Hamberger, president and CEO, Association of American Railroads, Washington, D.C.

If you all would—we'll get you set up here.

[Pause.]

Senator LOTT. Gentlemen, while you're taking your seats, we'll be glad to include in the record your complete statements, if you'd like to sum them up. We do have a vote beginning at 11:15. That's why I was trying to move to the second panel. But if you could all stay within 5 minutes or less, we can hear from all of you before we would have to leave to go vote. I'd like to have an opportunity to ask some questions, but we particularly want to be able to get your testimony on record.

So, if you would, let's begin with Mr. Schuler. Please proceed.

STATEMENT OF DALE SCHULER, PRESIDENT, NATIONAL ASSOCIATION OF WHEAT GROWERS (NAWG); ON BEHALF OF NAWG, THE NATIONAL BARLEY GROWERS ASSOCIATION (NBGA), THE USA DRY PEA & LENTIL COUNCIL (USDP&LC) AND ELENBAAS COMPANY

Mr. SCHULER. Thank you, Mr. Chairman. Can you hear me fine?

Senator LOTT. I don't think it's on.

Mr. SCHULER. OK.

Thank you, Mr. Chairman, Members of this Committee. My name is Dale Schuler. I'm a wheat farmer from Montana, and I'm currently serving as president of the National Association of Wheat Growers. Today, I'm also honored to be representing NAWG and the National Barley Growers Association, the National—or the U.S. Dry Pea & Lentil Council, and Elenbaas Company.

One of agriculture's top priorities continues to be working with Congress to find solutions to the problems caused by the massive concentration of the railroad industry, and specifically finding relief for our members who are captive shippers. I'm very pleased to be here today to participate in this hearing on capacity, economics, and service.

The agriculture industry believes that a viable railroad industry is necessary for our continued success. Since the passage of the Staggers Act in 1980, however, the degree of captivity in many agriculture regions and industry areas has increased dramatically, and America's farmers continue to experience both unreliable service and higher rates.

We have had more or less continuing rail equipment shortages since the railroads started aggressively consolidating and merging in the early 1990's. Twenty years ago, there were multiple transcontinental railroads servicing the farming regions of the country. Today, however, whole states, whole regions, and now whole industries have become completely captive to single railroads as a result of many railroad mergers.

In the wheat industry alone, there are substantial pockets of captivity in Texas, Oklahoma, Arizona, Colorado, Kansas, Nebraska, Wyoming, Idaho, South Dakota, Minnesota, North Dakota, Washington, and Montana. These states make up a majority of the wheat, barley, and pulse-crop growing/producing land in this country. Also, as ethanol production continues to increase, corn producers are seeing continuing service and capacity problems with rail movements of dried distillage grains and ethanol. The barley, dry pea, lentil, and chickpea industries continue to see the railroad industry's efforts to minimize less-than-trainload shipments. In Idaho, pulse crops and barley markets—or marketers—continue to see greater equipment shortages at less-than-shuttle-loading facilities, even when their facilities are adjacent to these shuttle loading facilities.

Farm producers know that increasing the breadth of crop production on their farms can lead to greater efficiency and productivity and higher income, but the Nation's railroad industry does not have the same goal. Instead, its view of efficient movement is moving larger and larger movements of a single-grade crop from a single origin to a single destination. Rail investment in grain movement has been shifted to the grain merchandiser and farm producer, while the service level for less-than-trainload movements continues to deteriorate.

We see value-added agriculture having to invest in rail rolling stock to ensure adequate equipment supply, yet when railroad service levels do not meet railroad-supplied schedules, agriculture is being called upon to continually increase investment in railroad rolling stock.

Because of these pockets of captivity, the cost of transporting grain can represent as much as one-third of the overall price a producer receives for his grain. The cost comes directly from a producer's bottom line. Producers, unlike most other businesses, cannot pass these costs on. Grain producers are price-takers. The market sets the price, and we have no way to influence that price. We're price-takers, not price-makers. Producers bear all of the transportation costs, both to and from the farm, and from the local country elevator to the processor or to the export terminal.

The effect of this rail captivity is that rail rates in the northern plains have increased 40 percent faster than the rail cost adjustment factor, including productivity unadjusted. Where I farm, rail rates as a percentage of the price of wheat have risen from 16 percent in 1980 to more than 30 percent today. Rail rates in Montana and North Dakota are between 250 and 450 percent of variable cost, far above the Surface Transportation Board's rate of unreasonableness, which is currently at 180 percent. These are among the highest freight rates in the Nation, though agriculture rates in excess of 250 percent more than variable cost can be found in virtually all of the states that have captivity issues.

Throughout the Corn Belt and pulse crop areas, rail rates have hit all-time highs as the service continues to be sub-par. In addition to the high cost of rates, rail service has continued to deteriorate. Captive shippers continue to suffer car and service disruptions. Shippers that order railcars well in advance are still experiencing delays of 3 or 4 weeks from the promised delivery dates. This can, and does, cause major problems during and after harvest.

The high rates and lack of service I have just described continue to be especially frustrating for producers in my region who need only to look across the northern border and see where rates for Canadian grain moving westbound, right across the border, are only two-thirds the rates that we pay in Montana. We grow some of the highest-quality grain in the world, yet we're rendered residual suppliers against our Canadian counterparts, and find ourselves at a significant competitive disadvantage in both domestic and foreign markets because of these shipping issues.

Agricultural producers all over the country, however, are concerned that there is currently no regulatory body to address our frustration and complaints. The Surface Transportation Board does not balance these needs of shippers and railroads. The STB has—in the opinion of those I represent here today, have abandoned their lawfully designated role as a regulator of the railroads. The STB continues to allow the railroads to set rates and service practices for captive shippers, and, therefore—for captive shippers that force them to subsidize all other rail shippers. In 2004, car shortages on the BN Northern—the Burlington Northern Santa Fe, by BNSF's own numbers, were more than 70 percent of all of its past-due cars, where in North Dakota, Minnesota, South Dakota, and Montana, which accounts for only about a quarter of their system—the STB, after repeated complaints from grain shippers in Montana and North Dakota, sided with BNSF, allowing them to continue to single out areas of their system that are most captive.

Our members believe that a healthy and competitive rail industry is essential for our continued viability; however, poor service, lack of available cars, increased rail rates, and a regulatory agency that does not meet our needs of shippers are making it difficult for our agricultural producers to remain competitive in a world marketplace.

We believe that the government needs to be the facilitator and the catalyst for increasing competition in this historically strong 100-year-old industry. We believe the railroad industry can survive and prosper in a competitive environment. And, indeed, we know from history that competition breeds innovation and efficiency.

In light of the horrific situation that U.S. grain producers are facing, with major railroads unable to meet common-carrier obligations all over the Nation, it is time for public policy in this area to be re-examined. Agriculture producers believe that both railroads and shippers would be better off with more competition in the marketplace, and many of them, including those organizations I am representing today, support revision—or provisions in Senate 919, which calls for increasing competition without increasing regulation. If enacted into law, we believe this legislation will improve rail transportation by providing fairness and openness in negotiation between railroads and our customers.

I'd like, again, to thank you for this opportunity to be here before this Committee.

[The prepared statement of Mr. Schuler follows:]

PREPARED STATEMENT OF DALE SCHULER, PRESIDENT, NATIONAL ASSOCIATION OF WHEAT GROWERS (NAWG); ON BEHALF OF NAWG, THE NATIONAL BARLEY GROWERS ASSOCIATION (NBGA), THE USA DRY PEA & LENTIL COUNCIL (USDP&LC) AND ELENBAAS COMPANY

Mr. Chairman and members of the Committee, my name is Dale Schuler. I am a wheat farmer from Montana and am currently serving as President of the National Association of Wheat Growers. I am honored to be here representing the National Association of Wheat Growers (NAWG) and testifying on behalf of NAWG, the National Barley Growers Association (NBGA), the USA Dry Pea & Lentil Council (USDP&LC) and Elenbaas Company.

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The effect of this rail captivity is that rail rates in the Northern plains have increased 40 percent faster than the Rail Cost Adjustment Factor including productivity unadjusted. Where I farm, rail rates as a percentage of the price of wheat have risen from 16 percent in 1980 to more than 30 percent today.

Rail rates in Montana and North Dakota are between 250–450 percent of variable cost—far above the Surface Transportation Board's "rate of unreasonableness," which is currently 180 percent. These are among the highest freight rates in the Nation though agriculture rail rates in excess of 250 percent more than variable cost can be found in virtually all of the states that have captivity issues. Throughout the Corn Belt and pulse crop areas, rail rates have hit all time highs as the service continues to be sub par.

In addition to the high cost of rates, rail service has continued to deteriorate. Captive shippers continue to suffer car and service disruption. Shippers that order rail cars well in advance are still experiencing delays of three to 4 weeks after promised delivery dates. This can and does cause major problems during and after harvest.

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NAWG members believe that a healthy and competitive railroad industry is essential for our continued viability, however, poor service, a lack of available cars, increased rail rates and a regulatory agency that does not meet the needs of shippers are making it difficult for agriculture producers to remain competitive in a world marketplace.

We believe that the government needs to be the facilitator and the catalyst for increasing competition in this historically strong, 100-year-old industry. We believe the railroad industry can survive and prosper in a competitive environment and, indeed, we know from history that competition breeds innovation and efficiency. In light of the horrific situation U.S. grain producers are facing with major railroads unable to meet common carrier obligations all over the nation, it is time that public policy in this area needs to be reexamined.

Agricultural producers believe that both railroads and shippers would be better off with more competition in the marketplace and many of them, including those organizations I am representing today, support provisions in S. 919 which calls for increasing competition without increasing regulation.

If enacted into law, we believe this legislation will improve rail transportation by providing fairness and openness in the negotiations between railroads and their customers over rates and service. By simply requiring railroads to provide rates to their customers between any two points on their system, many additional rail customers will gain access to rail transportation competition. In addition, providing for "final offer" arbitration and the removal of "paper barriers" will restore balance to the commercial relationship between the railroads and their customers.

I would like to thank you again for this opportunity. I am ready to answer any questions you may have.

Senator LOTT. Thank you very much, Mr. Schuler.

Mr. English? Old House member, you know about the 5-minute rule, or less.

[Laughter.]

Mr. ENGLISH. I seem to recall the 5-minute rule, Mr. Chairman, thank you very much. Appreciate that.

[Laughter.]

STATEMENT OF HON. GLENN ENGLISH, CEO, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. ENGLISH. Mr. Chairman, I'm here today, not as head of the electric cooperatives, but as Chairman of the Consumer's United for Rail Equity, which is a number of different organizations that have "joined" or "banded" together; namely, known as "captive shippers." We're 20 percent of the rail freight market.

Mr. Chairman, as you've heard from the members of the Committee itself, they're very familiar with the fact that in recent years we're finding that railroad service is becoming less reliable and more expensive, particularly for those who are known as captive shippers. Those of us in the electric utility industry are extremely aware of this. We have seen, in the last 2 years, our coal stockpiles deplenished to a point that was dangerously low. Normally we like to keep a 30-day supply of coal on hand for the utilities. Those utilities, however, that fall in the category of being captive shippers, many of those have found their stockpiles depleted down to a position of less than 10 days. This has improved somewhat in the last few months; mainly because of a mild winter and because of the normal spring maintenance that takes place as far as generators are concerned. I might also say, Mr. Chairman, I think it's partly due to the fact that the Congress is showing increasing attention with regard to this issue and this difficulty.

As far as the problem itself, it is a problem today, but may be a much larger problem for the future. As I think you're aware, Mr. Chairman, the electric utility industry is going to have to build a huge amount of new capacity in the coming years. It has been estimated, over the next 10 to 20 years the capacity for the electric utility industry is going to have to increase over a third. That's a massive amount of construction. And much of that needs to be coal-fired if, in fact, we're going to use the resources we have here at home and to use those resources that are best suited for the generation of electric power. And certainly that is coal. But we're finding a question as to whether it makes sense to build those coal-fired generating plants if we cannot rely on America's railroads to deliver that coal in a timely manner. If they can't do it today, Mr. Chairman, there's a real question whether they're going to be able to do it in the future.

The railroad industry, when we bring these issues to their attention, when issues are asked by the Congress and by the Federal Energy Regulatory Commission, who's also looked into this matter last week, we find the railroads blame the customers, "It's your fault." It's the customer's fault. With regard to the utilities, say, "Well, we're using more natural gas." However, at the same time, the rail industry points out that they're in constant communication with the customers of coal, and they're ensuring adequate supplies are available. And it's hard for me to understand, if they're in constant contact, why they wouldn't know there's increasing use of coal in this country. And if they didn't know it from talking to the customers, then they need to talk to Department of Energy, which makes this information regularly available. As you can see, here is the DOE. Energy Information Administration's use of coal. [Chart] You can see the bottom line, Mr. Chairman, the steady growth. And it takes it on out to the year 2030. So, if there's any doubt in anybody's mind, here it is, provided by the Department of Energy, for all to see.

[The information referred to follows:]

Energy Information Administration/Annual Energy Outlook 2006

Table 25. Comparison of coal forecasts, 2015, 2025, and 2030
(million short tons, except where noted)

Projection	2004	AEO2006			Other forecasts		
		Reference	Low economic growth	High economic growth	PIRA	EVA	GII
				2015			
Production	*1,125*	*1,272*	*1,251*	*1,318*	*1,250*	*1,234*	*1,149*
Consumption by sector							
Electric power	1,015	1,161	1,145	1,199	1,171	1,140	1,071
Coke plants	24	22	21	23	NA	29	19
Coal-to-liquids	0	22	19	27	NA	NA	NA
Industrial/other	65	71	69	72	88[a]	65	66
Total	*1,104*	*1,276*	*1,254*	*1,321*	*1,259*	*1,234*	*1,156*
Net coal exports	*20.7*	*–4.8*	*–4.8*	*–4.8*	*–8.0*	*–17.3*	*–7.7*
Exports	48.0	22.0	22.0	22.0	NA	28.0	28.6
Imports	27.3	26.7	26.7	26.8	NA	45.3	36.3
Minemouth price							
(2004 dollars per short ton)	20.07	20.39	20.04	20.67	NA	19.69[b]	17.82[d]
(2004 dollars per million Btu)	0.98	1.01	0.99	1.02	NA	0.99[c]	0.86[d]
Average delivered price to electricity generators							
(2004 dollars per short ton)	27.43	28.12	27.74	28.50	NA	29.45[b]	28.17[e]
(2004 dollars per million Btu)	1.36	1.40	1.39	1.42	NA	1.48[b]	1.36
				2025			
Production	*1,125*	*1,530*	*1,394*	*1,710*	*NA*	*1,404*	*1,296*
Consumption by sector							
Electric power	1,015	1,354	1,248	1,486	NA	1,329	1,226
Coke plants	24	21	19	23	NA	26	16
Coal-to-liquids	0	146	115	192	NA	NA	NA
Industrial/other	65	71	68	73	NA	60	67
Total	*1,104*	*1,592*	*1,450*	*1,774*	*NA*	*1,415*	*1,309*
Net coal exports	*20.7*	*–62.8*	*–57.9*	*–65.5*	*NA*	*–29.2*	*–15.1*
Exports	48.0	19.6	19.6	18.4	NA	30.1	23.4
Imports	27.3	82.4	77.4	84.0	NA	59.3	38.5
Minemouth price							
(2004 dollars per short ton)	20.07	20.63	19.40	21.73	NA	20.15[b]	16.12[d]
(2004 dollars per million Btu)	0.98	1.03	0.98	1.09	NA	1.02[c]	0.78[d]
Average delivered price to electricity generators							
(2004 dollars per short ton)	27.43	29.02	27.48	30.87	NA	30.12[b]	25.84[e]
(2004 dollars per million Btu)	1.36	1.44	1.37	1.52	NA	1.53[b]	1.25
				2030			
Production	*1,125*	*1,703*	*1,497*	*1,936*	*NA*	*NA*	*1,395*
Consumption by sector							
Electric power	1,015	1,502	1,331	1,680	NA	NA	1,330
Coke plants	24	21	19	23	NA	NA	14
Coal-to-liquids	0	190	153	247	NA	NA	NA
Industrial/other	65	72	68	75	NA	NA	67
Total	*1,104*	*1,784*	*1,571*	*2,025*	*NA*	*NA*	*1,411*
Net coal exports	*20.7*	*–82.7*	*–69.3*	*–89.0*	*NA*	*NA*	*–18.7*
Exports	48.0	16.7	16.4	16.8	NA	NA	22.3
Imports	27.3	99.4	85.7	105.8	NA	NA	41.0

Table 25. Comparison of coal forecasts, 2015, 2025, and 2030—Continued

(million short tons, except where noted)

Projection	2004	AEO2006			Other forecasts		
		Reference	Low economic growth	High economic growth	PIRA	EVA	GII
Minemouth price							
(2004 dollars per short ton)	20.07	21.73	19.91	23.05	NA	NA	15.65 [d]
(2004 dollars per million Btu)	0.98	1.09	1.00	1.15	NA	NA	0.76 [d]
Average delivered price to electricity generators							
(2004 dollars per short ton)	27.43	30.58	28.28	32.79	NA	NA	25.23 [e]
(2004 dollars per million Btu)	1.36	1.51	1.41	1.61	NA	NA	1.22

Btu = British thermal unit. NA = Not available.

[a] Includes coal consumed at coke plants.

[b] The average coal price is a weighted average of the projected spot market price for the electric power sector only and was converted from 2005 dollars to 2004 dollars to be consistent with *AEO2006*.

[c] Estimated by dividing the minemouth price in dollars per short ton by the average heat content of coal delivered to the electric power sector.

[d] The minemouth prices are average prices for the electric power sector only and are calculated as a weighted average from Census regionprices.

[e] Calculated by multiplying the delivered price of coal to the electric power sector in dollars per million Btu by the average heat content of coal delivered to the electric power sector.

Sources: *2004 and AEO2006*: AEO2006 National Energy Modeling System, runs AEO2006.D111905A (reference case), LM2006. D113005A (low economic growth case), and HM2006.D112505B (high economic growth case). *PIRA*: PIRA Energy Group (October 2005). *EVA*: Energy Ventures Analysis, Inc., *FUELCAST: Long-Term Outlook* (August 2005). *GII*: Global Insight, Inc., *U.S. Energy Outlook* (Summer 2005).

I would suggest, Mr. Chairman, that the real reason that we're running into these kinds of difficulties has to do with a remark that was made by the chairman of Union Pacific, back before the Surface Transportation Board a few years ago. He states to the Surface Transportation Board, "Year after year, the railroads have been increasing their traffic volumes without adding commensurately to their physical capacity." In other words, they're following the same strategy that the airlines have been following for some time, Mr. Chairman, and that is to limit the capacity. With the airlines, it may be some folks can't get a ticket, or they may get bumped off their flight. To them, it's an inconvenience. When it happens as far as our Nation's railroads are concerned with regard to providing supplies for the generation of electric power, what it's going to mean, Mr. Chairman, is that the lights are either going to dim, or they may go out altogether. The impact that that has on this Nation's economy obviously is very severe.

Now, we also have the interesting situation where the railroads are coming before the Congress asking for additional assistance. They'd like a tax credit to help them deal with some of the capacity problems, problems that they say they want to limit in the first place. And that, too, raises some very serious questions for us, Mr. Chairman, particularly when we—in light of the fact that the reported profits for this last year, 2005 over 2004, are very significant, a 30-percent increase in one year for the industry itself. And particular railroads, some railroads that are serving those of us who are captive shippers, I would point out, the Burlington Northern Santa Fe, had, 2005 over 2004, a 93-percent increase in the profits. CSX is reporting a 237-percent increase over the year. And, Mr. Chairman, according to the *Wall Street Journal,* they're saying the ride isn't over yet.

Now, Mr. Chairman, stranded shippers, our cost in the recent time, we're seeing an increase of 350 to 450 percent, in the form of profits. Now, who is paying for this increase, these huge profits that are being made by the railroads? Obviously it's the captive shippers. It's coming out of our hide. But, since it is a monopoly, we obviously aren't receiving the service for what we're paying an excess for.

In the electric utility industry, Mr. Chairman, we have what's known as an obligation to serve. We're obligated to serve the people of this country and provide them with electric power. I would ask you, Mr. Chairman, don't the railroads have an obligation to deliver for the electric utility industry and for the rest of America and our economy?

Thank you very much.

[The prepared statement of Mr. English follows:]

PREPARED STATEMENT OF HON. GLENN ENGLISH, CEO, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. Chairman and members of the Committee:

My name is Glenn English, and I am the Chief Executive Officer of the National Rural Electric Cooperative Association (NRECA). I also serve as Chairman of Consumers United for Rail Equity (CURE), a captive rail customer advocacy group representing a broad array of vital industries—chemical manufacturers and processors; paper, pulp and forest products companies; agricultural commodities producers and processors; cement and building materials suppliers; and many more.

I appreciate this opportunity to appear today to discuss railroad issues that have rapidly risen to the top of the policy agenda for members of NRECA, a trade association consisting of 930 cooperatives providing electricity to more than 39 million consumers living in 47 states. As member-owned, not-for-profit organizations, the obligation of cooperatives is to provide a reliable supply of electricity to all consumers in our service areas at the lowest possible price. We take our obligation to serve very seriously—the wellbeing, safety, and economic health of our members, our communities and our Nation depends on it. Electric cooperatives serve primarily the more sparsely populated parts of our nation, but cover roughly 75 percent of the land mass of the Nation.

Today I want to emphasize for the Subcommittee the very critical issues currently facing rail freight shippers throughout the country, especially those shippers who are "captive" because they are only served by one rail carrier and have limited or no access to competition.

Since the enactment of the Staggers Rail Act in 1980, the railroad industry has dramatically changed. Despite their claims to the contrary, the structure and the practices of the railroads under current law are detrimental to the economic survival of many domestic U.S. businesses and industries. Left unchecked, the *status quo* jeopardizes our national economy and even our national security capabilities. Consider the following:

- In 1980 there were 41 Class I railroads, but today six remain with *four* of them—two in the east and two in the west—carrying about 94 percent of all rail freight.
- More than 20 percent of all rail freight shipments are "captive" to the monopoly market power of only one rail carrier.
- The four major carriers have been allowed under current law to artificially tighten their monopolistic stranglehold over "captive" shippers through practices that restrain competition and deny shippers the ability to freely seek access at points where competition might otherwise be available.
- "Captive" rail shippers are forced in an arbitrary "take-it-or-leave-it" fashion to face enormously higher rail transportation costs than those shippers that have access to competition.
- In areas where competition is minimal or does not exist, the Federal regulatory watchdog established under the Staggers Act to protect "captive" rail shippers—the Surface Transportation Board (STB)—has failed to fulfill its responsibility to ensure that rail rates and practices are fair and equitable and in the overall national best interest.
- Similar to the availability and reliability of adequate electric power, a robust and efficient rail transportation system is critically important to the Nation's economy and security, and requires a common carrier obligation to adequately serve the broader public interest.

I want to recognize the efforts of Senators Burns, Rockefeller, Dorgan—and others who have gone on record—for their keen interest in resolving two major issues facing the rail industry and its customers: the need to mandate regulatory reforms in the industry; *and* the shortfall in U.S. railway capacity. Any legislation moving forward must address both problems.

We commend Senator Burns for introducing S. 919, the Railroad Competition Act of 2005, along with Senators Rockefeller and Dorgan. The legislation would reform many of the anti-competitive practices that the railroads currently exert over captive shippers. S. 919 also recognizes the need to provide some mechanism or incentive to stimulate the capital investment needed to address the current capacity shortfall.

The Captive Shipper/Railroad Monopoly Problem

Mr. Chairman, about 50 percent of the Nation's electricity is generated from coal. In the electric cooperative community, about 80 percent of the electricity generated by our plants is from coal. Very few of our generating facilities are located at coal mine sites, so most of the coal consumed by our plants is delivered by rail.

Under most circumstances, co-ops buy the coal at the mine site and arrange for its transportation, so the shipping agreements are between the railroad companies and the cooperative. Generally, our co-ops provide and maintain the "train sets"—the unit trains that today normally number from 120 to 130 cars. We also provide unloading facilities and make other capital investments related to rail transportation of coal to our plants. Most of these costs were previously borne by the carrier and factored into rates. Today, in the movement of coal to our plants, the railroads basically provide only the locomotives, tracks, crews, and the diesel fuel.

Increasingly, our members must deal with substandard service and higher costs for their coal transportation than ever before. Consolidation of the rail industry has resulted in many of our generators being held "captive" to one single railroad for coal transportation. As a result, these electric generators are subject to railroad monopoly power over price and service with no access to competition. The railroads have extensive exemptions from the Nation's antitrust laws. Under the Staggers Rail Act, the Interstate Commerce Commission (now Surface Transportation Board) mission was to deregulate competitive rail traffic, while also protecting against monopoly abuse of "single served" or "captive" traffic. That protection is not being provided.

Application of the Antitrust Laws. Railroad spokespersons have recently represented in hearings before the House Transportation & Infrastructure Committee and the Senate Energy & Natural Resources Committee that the railroads are subject to "most" antitrust laws. Two quick examples rebut this claim. First, section 16 of the Clayton Act, 15 U.S.C. § 26, prohibits private parties from seeking antitrust law-based injunctions against "any common carrier subject to the jurisdiction of the Surface Transportation Board." Second, the Supreme Court's decision in *Keogh* v. *Chicago & Northwestern Ry.,* 260 U.S. 156 (1922), generally prevents shippers from obtaining treble damages in matters involving railroad freight rates that might be found discriminatory. Following enactment of Staggers, the *Keogh* decision continues to preclude most shipper actions for treble damages against the railroads. *Square D Co.* v. *Niagara Frontier Tariff Bureau, Inc.,* 476 U.S. 409, 422 (1986).

Given the general unavailability for private injunctive actions and treble damages, the recent claims by the railroads that they are fully subject to the antitrust laws is misleading at best.

Compounding the problem, the STB has interpreted Staggers in a manner that allows railroads to deny shippers access to competing railroads, has allowed other anticompetitive practices, and has a rate challenge process so complex, costly and time consuming as to provide virtually no protection to rail customers. For example, freight rates nearly doubled this year for Dairyland Generation and Transmission Co-op in Wisconsin. Unfortunately, given the complexity, the cost, and the history of futile challenges before the STB, Dairyland had no realistic option other than to accede to the "take-it-or-leave-it" demands of the railroad.

Railroads Claim "Rates" Are Down—Shippers Find "Costs" Are Up

In addition to the rail capacity concerns and monopolistic rail business practices being examined by the Subcommittee, Congress should also be concerned about the cost of coal transportation to electric generating facilities that must depend on a single railroad for coal delivery. Coal transportation costs flow straight through to electricity consumers, many of whom—farmers, chemical producers and processors, manufacturers, providers of forest products, paper and pulp, and many more—are already being forced to pay high rail transport costs on the movement of their products because they are also "captive" to a single provider. When co-ops must rely on a single railroad to move coal to our plants, and there is no recourse for a fair rate review, we are in no position to negotiate a mutually acceptable price. Rather, the railroad carrier dictates both price and service. With the railroads largely exempt from the Nation's antitrust laws, the only option available to customers served by a single railroad is to petition the Surface Transportation Board for relief.

Members can refer to the following chart showing a close approximation of the rail rates that apply to "captive" shippers of products versus shippers of those products who are not held hostage to just one Class I rail carrier.

On a Per Ton Basis, Difference Between Captive and Competitive Rates by Commodity & Major Railroad

The following information was calculated by Escalation Consultants, Inc. of Gaithersburg, Maryland. This ''per ton'' information is calculated from the 2003 STB ''Revenue Shortfall Allocation Methodology'' (RSAM) study, the latest study available from the Board.

	NS	CSX	BN	UP
Farm Products Captive Rate	$21.37	$36.74	$45.28	$37.99
Farm Products Non-Captive Rate	$11.88	$20.83	$26.09	$21.29
Coal Captive Rate	$17.56	$17.22	$16.77	$17.00
Coal Non-Captive Rate	$9.76	$9.76	$9.66	$9.53
Chemicals Captive Rate	$36.98	$34.33	$42.57	$38.94
Chemicals Non-Captive Rate	$20.56	$19.46	$24.52	$21.82
Lumber or Wood Captive Rate	$29.43	$36.13	$59.19	$59.49
Lumber or Wood Non-Captive Rate	$16.36	$20.48	$34.10	$33.34
Pulp, Paper Captive Rate	$39.48	$40.82	$62.14	$55.40
Pulp, Paper Non-Captive Rate	$21.95	$23.14	$35.80	$31.05

The railroads have all but perfected the art of using "global" data and statistics to obscure the true impact of their "rates" and their practices in different regions of the country and especially as applied to "captive" rail customers. They will tout graphs demonstrating how "rates" have steadily declined for shippers . . . what they don't tell you is that much of the "cost" of rail transportation that was previously built into the "rate" (the costs of trainsets, maintenance, loading and other trackside facilities) has been shifted over the period onto the backs of the shippers. While "rates" have indeed come down, the "cost" to shippers in many cases has dramatically increased.

Although the railroads suggested they are subject to regulation and that shippers have a right to file complaints, it is important to understand the very limited extent to which railroad rates are subject to review at the STB. Contracts are outside of the STB's jurisdiction altogether (49 U.S.C. § 10709), and the STB has exempted much other traffic (including intermodal traffic) from its rate regulation.

For the small remaining category of traffic that is subject to regulation, the railroads have the initial flexibility to establish any rate they want (49 U.S.C. § 10701(c)). Shippers may challenge a rate, but bear the burden of showing that the carrier has market dominance in both qualitative (an absence of effective competition) and quantitative (the rate exceeds the jurisdictional threshold of 180 percent of variable costs) terms (49 U.S.C. § 10707). The shipper must also prove that the rate exceeds a reasonable maximum under "Constrained Market Pricing," which largely means stand-alone cost (a variant of replacement cost). In recent years, it has been impossible for shippers to get meaningful relief at the STB. In addition, the cases take a long time (at least 2 years to get the first decision on the merits) and are very expensive ($3–5 million at a minimum).

At the end of a twenty-year contract with Laramie River Station, BNSF more than doubled the coal-hauling rate for the plant. On October 19, 2004, a complaint was filed with the STB to review BNSF's rate increases. Rate complaints at the STB are costly, lengthy, complex, and rarely result in any relief for the rail customer. The cost simply to file the LRS/Western Fuels complaint was $102,000, but that filing fee since has been increased to $140,600. By contrast, the cost of filing a similar case in the Federal district court is $150.

In contrast to most other regulatory systems in the nation, the customer must prove first that it is subject to a railroad monopoly, and then must carry the burden of proving that the rate is unreasonably high. In a normal regulatory process, the burden of justifying a rate falls on the monopoly that is being regulated. The rate reasonableness standard under the STB is not the normal "cost plus a reasonable rate of return" test.

The rate reasonableness standard employed by the Surface Transportation Board requires the customer to prove that it can build and maintain its own railroad to move its product at a price less than the rate that is being challenged. This requires the rail customer to employ economists to construct a highly efficient "virtual" railroad that roughly follows the route and bears the same costs at the incumbent railroad. Not surprisingly, this proof is complicated and expensive. To date, LRS and its co-owners have spent nearly $5 million on the prosecution of the rate case, which has been pending almost 2 years. A final judgment is not expected in this case for at least another year.

The situation facing us today goes far beyond just the very high prices being charged captive shippers—both directly and indirectly—by the railroads. Currently, the Nation faces a situation wherein the railroads are either unable or unwilling to deliver reliable supplies of coal to our generators in a timely fashion. So, in a very real sense, our members are paying much more and receiving far less when it comes to rail transportation. Policies must be changed to address a rapidly worsening situation that is harming critical industries. The fact is that electric generation is now threatened by the railroads' poor performance and their lack of reliability.

Current Coal Delivery Problems Adversely Impact Electricity

In a world suffering from shortages of energy supplies, our Nation is blessed with enormous reserves of coal that can provide for electricity and other uses for many decades in the future. Our coal resources are sufficient to meet our energy needs for more than 250 years. Some have referred to the United States as the Saudi Arabia of coal. In a 2001 speech, Vice President Dick Cheney pointed out that the overall demand for electric power is expected to rise by 43 percent over the next 20 years, and that just meeting the demand would require between 1,300 and 1,900 new power plants. That averages to more than one new power plant per week, every week, for the next 20 years. "We all speak of the new economy and its marvels," he said, "sometimes forgetting that it all runs on electric power."

What the Vice President might not have recognized at the time of his speech was that the railroads responsible for moving this strategically important fuel supply were already in the process of making America's most abundant and affordable energy supply scarce and expensive. Electric co-ops are forced to look to South America, Indonesia, and other foreign coal sources because the railroads cannot make timely domestic deliveries.

The delivery system for half the Nation's electricity consists of coal mines, rail transportation, generators, and transmission and distribution systems. Due to rail delivery problems, many of the electric cooperative generators have been concerned as they prepared for this year's summer cooling season. Some generating facilities were dangerously close to a point where continued operation could not be sustained.

Let me focus on the coal delivery problem confronting just one very large coal-fired electric generator in Wyoming—the Laramie River Station (the same plant embroiled in a rate case at the STB). In the spring of 2005, there were two derailments on tracks coming from the Powder River Basin (PRB), reducing rail coal deliveries to 80 percent of previous levels. Deliveries have not yet fully recovered. A BNSF spokesman was recently quoted in *CQ Weekly* saying that it is just "not feasible" to rebuild the LRS stockpile with current demand for coal so high. It is unclear whether those reductions have been imposed across-the-board, or whether the reductions and related matters, including "parking" of trainsets, have been imposed selectively or accidentally, but the result is the same. It enables the railroads to pick "winners and losers" among generating utilities, and to potentially punish and retaliate against those who seek to invoke whatever protections may be ostensibly available.

The three unit (1650 MW) Laramie River Station is located only 170 miles from the coal source and was down to a 3 to 4 day supply of coal in January. This plant is operated by Basin Electric Power Cooperative for 6 not-for-profit utilities. Loss of this major block of generation could create severe reliability problems for its regional grid. Basin provides electricity to its members in 9 states serving over 1.8 million consumers. Because of reliability concerns, Basin notified DOE and the North American Electric Reliability Council of the stockpile situation when coal reserves dropped below 50 percent of normal levels and developed a generation curtailment plan to conserve coal.

Fortunately, the winter was relatively mild, coal deliveries improved during the last few months, and Unit 1 entered a 7-week maintenance outage, which reduced consumption of coal. Since the outage began on April 15, Basin's stockpile has increased to almost 700,000 tons—a 30 day reserve. However, if the plant had been operating at full load during this period, the stockpile would have gained only

100,000 tons to a total of 276,000 tons; a 10 day supply of coal. Now that the plant is once more in full operation, Basin is concerned about coal deliveries for the summer months.

Other co-ops have experienced similar problems and have cut production at those coal plants that are normally the least costly to operate. Electricity generators have resorted to burning more expensive natural gas, purchasing higher cost electricity from the grid, or purchasing more expensive foreign coal and higher sulfur local coal. Arkansas Electric Cooperative estimated that its coal conservation program, using alternate-fuel power generation, cost its customers over $100 million because of the shortage of coal deliveries over the past 12 months to its power plants.

The shortfall in rail coal deliveries has many far-reaching consequences. It is widely acknowledged that there will be at least a 20 million ton shortfall in PRB coal deliveries in 2006. Making up for this shortfall will require the use of about 340-billion cubic feet of natural gas costing about $2.6 billion more than the coal it replaces. The additional use of natural gas instead of coal to generate electricity has also significantly driven up the price of gas across the country, and has increased the costs to those using natural gas as a feedstock for manufacture of their products. Over the past year, restriction in the supply of PRB coal has also resulted in a tripling of the coal spot market price, increasing those prices from roughly $6 per ton to more than $20 per ton.

So, in addition to the market power and rate-setting problems not being addressed, neither does the Surface Transportation Board assert jurisdiction over *railroad customer service issues.* The STB has been completely passive during the current coal delivery problems. For example, when the CEO of Arkansas Electric Cooperative sent a letter on this subject to the STB last August, not only did he never receive a response from the STB, his letter was answered by a Vice President of the Burlington Northern Railroad—the railroad about whom he was complaining!

Railroad Obligation to Serve—Wall Street vs. Main Street

We believe that an overriding national public interest applies to the railroad industry as it does with our electric utility industry. No electric utility—whether a rural electric cooperative, a municipal power system or an investor owned utility—is free to conduct business in any manner it likes, including "maximizing" profits. city officials overseeing municipal utilities are subject to the vote of the people; rural electric co-op boards must earn election by their member-owners; and investor owned utilities are subject to the oversight of both state public service commissions and the Federal Energy Regulatory Commission.

Railroad companies tell only one side of the story, emphasizing freight railroad traffic "constraints"—the "capacity crunch"—while alleging a need for financial incentives to lure the additional capital necessary to modernize and expand America's rail infrastructure and capacity.

We know the infrastructure and the capacity of our railroads need significant expansion and improvement. Railroad constraints—coupled with their exercise of monopoly power over captive customers—have led to ever growing profit levels for the major rail corporations. The railroads and Wall Street have been focused on making large profits while Main Street Americans are focused on the "big picture" of growing and expanding our overall economy—not just one sector.

Morgan Stanley Equity Research N.A. recently released a periodic analysis of railroad financial performance. This analysis was produced for its intended audience, the investor community. The report noted that the major railroads are enjoying robust financial health based on "pricing freedom" and lack of railroad capacity. According to the report, "the six major North American railroads (Kansas City Southern is not included) will see their stocks appreciate 50 percent–100 percent over the next 4 years." ("Air Freight and Surface Transportation," Morgan Stanley Equity Research North America, January 23, 2006, James Valentine).

Since rising stock prices are an indicator of financial health that will attract and retain capital, this analysis clearly suggests that, according to Wall Street the railroads will be "revenue adequate" over the next 4 years. Furthermore, the analyst said that there is little or no regulatory risk in the current Washington environment—an indication that he believes the current STB, Congress and Administration are unconcerned about the "secular pricing" power and other actions of the railroads. "Secular pricing" is the code for the ability of a monopoly to exercise market power in exacting cash from those dependent on the monopoly's goods or services.

We contend that the railroad industry also has—like electric utilities—an obligation to serve the national public interest. This obligation may sometimes be called a "common carrier" obligation, but in the end it means the duty to provide reliable transportation service to all customers at fair and reasonable prices. Without mandating an obligation to serve by the railroads, the economy of this Nation cannot move forward. Adequate, dependable, and reasonably priced rail service is almost as critical to our national and economic security interests as electricity, and the public interest cries out for the imposition of a formal "obligation to serve" mandate in order to correct the current arrogant and abusive tendencies of the railroads.

Some tell us that the economic self-interest of the railroads will solve the railroad service and capacity problems over time. That certainly was the premise of the Staggers Rail Act—deregulate the railroads and they will become healthy and provide the rail service needed by the Nation at fair and reasonable prices. Railroad customers have good reason to doubt that assertion.

In the absence of strong signals from the government about service and capacity to meet the needs of "Main Street" America, the railroads will take their signals only from "Wall Street." Financial analysts today rate railroad stocks high because the railroads possess "pricing power" based on the fact that demand for rail transportation exceeds capacity. Moreover, Wall Street tends to grade railroad stocks down when the railroads make heavy investments in their systems. So, Mr. Chairman, there is significant concern among the rail customer community that actually providing sufficient capacity and reliable service for them will be perceived by Wall Street as adverse to the economic interests of the rail industry.

Questions about future reliable rail service at fair prices are a significant concern to the electricity industry as it attempts to provide the additional coal-fired power plants the Nation will need in the future. Can we depend on reliable rail transportation of coal in the future at a fair and reasonable price?

Assistance to Help Ensure Rail Profits Requires an Obligation to Serve

Finally, Mr. Chairman, we understand the railroads are now seeking legislation to provide a 25 percent investment tax credit and "expensing" provisions for investments in railroad infrastructure. We might very well support such a Federal incentive, but only so long as it includes a package of legislation that also addresses the concerns of rail customers that are subject to railroad monopoly power, and only so long as the tax credit and other benefits are also available to rail customers when they make similar investments in infrastructure to improve overall rail capacity.

Moreover, we recommend that certain conditions should be imposed on the investments that would be eligible for the tax credits and expensing benefits. For example, the investments that qualify should be limited to first prioritize improving the infrastructure that currently provides insufficient service to captive or single-served rail customers. Eligible investments should be focused first on infrastructure improvements that benefit the movement of domestic products and commodities as opposed to infrastructure that benefits imports. Finally, any infrastructure that benefits from the tax credit should be deployed in a pro-competitive manner as suggested in S. 919, rather than further expanding the monopoly market power of the railroads.

The rationale for providing any level of assistance to the railroads is because of the important role they play in our Nation's overall economy. Electric utilities are viewed as absolutely critical not only to the economy, but also indispensable in helping to ensure our homeland security. Railroads obviously occupy a similar role. All reasonable assistance should be provided to ensure the rail transportation system is robust and efficient. However, benefits to help ensure the profitability of the rail industry should come with a clear "obligation to serve" the best interests of Main Street America—not just Wall Street.

NRECA Supports S. 919—The Right Direction for Reform

I mentioned earlier the legislation that Senators Burns, Rockefeller, and Dorgan have introduced that will begin to address many of the current problems facing rail shippers—especially captive rail shippers—as they try to deal with the railroads. S. 919 is a good starting point for discussions among those who truly want to improve the current rail transportation system in this country. We strongly urge this Subcommittee to give a high priority to legislation this year.

Conclusion

Mr. Chairman, thank you for conducting this hearing today. We support a strong and viable rail industry that will provide reliable service to its customers at fair and reasonable prices. The *status quo* will not result in this type of rail system for the Nation. The kinds of reforms suggested in S. 919 must be adopted as Federal policy, and the public benefits that result from competition in the marketplace must be applied to the rail transportation system by removing the rail industry's exemptions from the Nation's antitrust laws.

I can assure the Subcommittee that the 39 million consumer-owners of the NRECA electric cooperative family look forward to working with you, and with all of the other stakeholders involved, in resolving these critical rail transportation issues in an objective and constructive manner.

Senator LOTT. Thank you, Congressman English.

Mr. McIntosh?

STATEMENT OF JOHN L. McINTOSH, PRESIDENT, CHLOR–ALKALI PRODUCTS, OLIN CORPORATION, ON BEHALF OF THE OLIN CORPORATION AND THE AMERICAN CHEMISTRY COUNCIL (ACC)

Mr. MCINTOSH. Chairman Lott, Senator, I'm pleased to be here today on behalf of Olin Corporation and the American Chemistry Council.

With 5,800 U.S. employees, Olin is a leading producer of copper alloys, ammunition, chlorine, and caustic soda. We ship two and a half million tons of products by rail each year. ACC represents the Nation's leading chemical manufacturers.

Today, I want to deliver three essential messages about American competitiveness:

First, my company, my industry, other rail shippers, and the millions of customers we serve, need reliable rail service. Sadly, when it comes to reliability, that train has stalled.

Second, the captive rail customer—that is, the customer with service from a single monopoly railroad, is completely at the mercy of the carrier. Free and fair market forces no longer ride the American rail.

And, third, the Federal oversight process centered on the STB is not working, and, in fact, has harmed rail competition. The system is broken, and Congress needs to fix it by producing—by providing a clear signal to the STB, passing S. 919 and switching the rail industry back onto the antitrust main line.

Let me make this clear. What we are talking about today is our survival and the industry's ability to provide and create jobs.

The chemical industry's customers require a constant flow of high quality products produced and delivered on time at competitive prices. Railroad reliability and service are critical to our economic success; however, that is not what the Nation's railroads are providing, especially to captive shippers. And we see no light at the end of the tunnel.

For a captive customer, the efficient movement of traffic—of its traffic, in some cases, is—in some cases, even the very survival of its business depends upon the rates and services provided by that single railroad. Yet by virtue of being captive, we have no way to negotiate, beg, or buy reliability.

Railroads are experiencing capacity constraints, and tell us that demand exceeds their ability to provide reliable service in key chemical traffic corridors. Yet the U.S. rail industry is financially healthy. In the 1970s, the rail industry was on its last legs when Congress wisely passed the Staggers Rail Act. That legislation led to the success of the U.S. rail industry today. Staggers was intended to protect captive shippers and promote competition. Congress wanted to avoid the captive-shipper penalty that exists today, but the STB has not lived up to that responsibility. Its regulatory interpretations have skewed the Act's intent to bring free market forces to bear on shippers and railroads. And Staggers has left no forum, other than the STB, to address these issues.

Most ACC member facilities have no alternatives to using rail—no alternative to using rail transportation. Sixty-three percent of those facilities have access to only one rail carrier, making them captive.

How did this come about? Rail competition has changed dramatically since 1977, when there were 63 Class I railroads in America. Today, there are just seven, and 90 percent of the Nation's rail traffic is handled by only five. In conjunction with other ICC/STB policies that curtail competition between railroads, mergers have generally harmed the captive shipper. As the inevitable result, entire states, regions, and industries are now captive to a single railroad. You can imagine the difficulty in negotiating a rail contract or a rail rate for a captive facility.

This explains why captive rail rates have reached or exceeded twice the amount of competitive rates. Captive shippers also pay higher fuel surcharges based on those freight rates. For captive chemical shippers, the iron horse has, in fact, become the greedy cash cow. Regrettably, the freight rail marketplace doesn't behave like a free market. A long line of STB policy determinations is harming the competitiveness of the U.S. chemical industry. Staggers did not mandate anticompetitive policies, and the agency has acknowledged that it has the authority to reverse its interpretations, but almost invariably declines to exercise its discretion in favor of pro-competition solutions.

It's time to tear down the barriers to competition, and ACC supports Senate 919, the Rail Competition Act of 2005, a bipartisan bill whose provisions would promote competition and lead to reliable service. I urge you to carefully consider S. 919. And ACC recognizes and thanks Senators Burns, Dorgan, and Rockefeller for their leadership.

Congress should also consider putting the rail industry fully under the Nation's antitrust laws. In our free-market economy, monopolies and the poor service and high prices they foster belong in a museum. Unfortunately, rail impedes our Nation's global competitiveness. We are interested in the financial and operational health of Americans' railroads, but captive customers are—might be forced to close U.S. plants or forego expansion. In the future, where will new chemical jobs be created?

For Olin and our ACC colleagues, railroad monopolies are driving a golden spike through the heart of American competitiveness. That's why Congress must intervene.

Thank you for the——

Senator LOTT. Thank you——

Mr. MCINTOSH.—opportunity——

Senator LOTT.—Mr. McIntosh.

[The prepared statement of Mr. McIntosh follows:]

PREPARED STATEMENT OF JOHN L. MCINTOSH, PRESIDENT, CHLOR-ALKALI PRODUCTS, OLIN CORPORATION; ON BEHALF OF THE OLIN CORPORATION AND THE AMERICAN CHEMISTRY COUNCIL (ACC)

Chairman Lott, Senators, I'm pleased to be here today on behalf of the Olin Corporation and the American Chemistry Council (ACC). Olin, headquartered in Clayton, Missouri, is one of the world's best basic materials companies and a leading

North American producer of copper alloys, ammunition and chlorine and caustic soda. In 2005, Olin posted sales of approximately $2.4 billion. The company has approximately 5,800 employees working in the United States. Olin consists of three businesses:

Olin Brass—the world's leading developer of high performance copper alloys and the U.S. market share leader in copper and copper alloy strip.

Winchester—North America's leading small caliber ammunition producer with powerful global brand name recognition.

Chlor-Alkali Products—the largest producer of chlorine and caustic soda in the eastern United States and the fourth largest nationwide.

I am here today on behalf of Olin's Chlor-Alkali Products business, which is the leading producer of chlorine and caustic soda in the eastern U.S. and one of the largest in North America. Besides chlorine and caustic soda, Olin produces Reductone® and Hydrolin® sodium hydrosulfite and hydrochloric acid.

As one of the Nation's leading producers of chlorine, the company produces an essential chemical that has played a key role in dramatically reducing infant mortality rates and eliminating waterborne diseases around the world. Our chlorine is also used in the manufacture of swimming pool and spa sanitizers. The biggest end use for chlorine, however, is as an ingredient in polyvinyl chloride (PVC) plastics, including everything from vinyl siding and PVC blood bags to vinyl plumbing pipes.

Another work-horse industrial chemical, our caustic soda is used in household and institutional cleaning products, the pulp and paper industry, and the fabric industry. An agent that aids the dyeing of denim and other fabrics, Olin's Reductone® "helps put the blue in blue jeans." Our Hydrolin® sodium hydrosulfite is principally used in treating kaolin clays, which provide filler material for white paper and other paper products. Our hydrochloric acid is used in the process of making aspartame which sweetens products from diet Coke to snack foods and other consumer products.

Chlor-Alkali Products is headquartered in Cleveland, Tennessee and includes manufacturing sites in New York, Georgia, Tennessee and Alabama. Each of these plants offers a low cost base, highly skilled workers and convenient delivery.

Olin and ACC appreciate the Committee's invitation to participate in this hearing on economics, service, and capacity in the freight railroad industry. ACC represents the companies that make the products that make modern life possible, while working to protect the environment, public health, and the security of our Nation. The member companies of ACC depend on the U.S. rail industry for the safe, secure and efficient transportation of approximately 170 million tons of chemical products to customers each year, accounting for more than $5 billion in annual railroad industry revenues.

For a substantial proportion of the shipments from chemical manufacturing facilities operated by ACC members, there is no alternative to using the rail mode. For 63 percent of those facilities, the shipper has access to only one rail carrier. Those shipments are subject to what the Staggers Act refers to as "market dominance," which is often described as being "captive" to a single railroad. (Additional monopoly conditions exist when even a non-captive shipper wishes to supply a customer location that is captive to a single railroad.) For a captive shipper, regardless of its size or location, the efficient movement of its traffic—in some cases even the very survival of its businesses—depends on the rates and service provided by that single railroad.

The chemical industry's customers require a constant flow of high-quality products—produced on time—delivered on time—where they want them—at competitive prices. Railroad reliability and service are critical to our economic success. However, that is not what the Nation's railroads are providing, especially to captive shippers.

Railroads are experiencing capacity constraints. They're telling us that demand exceeds their ability to provide reliable service in key chemical traffic corridors. We believe them because chemical shippers have seen increases in transit time for our shipments. Slower train speeds and increased dwell times for cars in terminals have led companies to add cars to their fleets at considerable cost to hedge against shipment delays.

It's remarkable that this situation exists in the context of a financially healthy U.S. rail industry. In the 1970s, the rail industry was on its last legs. Regulation had hobbled its ability to respond to competitive forces and cover costs. Railroads lacked the capital to properly maintain their tracks. Eight large railroads went bankrupt during that decade. Many more faced extinction. Policymakers gave serious thought to nationalizing the rail freight system.

But cooler heads prevailed. Instead of nationalization, which would have involved a continuing cost of untold billions, Congress wisely chose deregulation. It passed the Staggers Rail Act of 1980. The legislation, in good measure, led to the success of the U.S. rail industry today.

Yet the competitive landscape in the rail industry has changed dramatically since 1980. As a result, shippers have paid a very high price for U.S. rail industry gains. That's because competition—the hoped-for result sparked by Staggers—has largely fizzled out. Under the Interstate Commerce Commission and later its successor, the Surface Transportation Board (STB), the regulatory agency that has authority to address these issues has not done the job.

One reason is that consolidation in the rail industry has reduced the number of Class I railroads (those meeting the STB definition of having operating income exceeding $277.7 million). To be competitive, railroads require competitors. In 1977, there were 63 Class I railroads in America. In 1980, there were about 40. Today, because of massive consolidation, there are just seven Class I railroads serving all of North America. And 90 percent of the Nation's rail traffic is handled by only five major railroads.

Although STB has not been presented with another transaction involving two or more Class I carriers since revising its merger guidelines in 2001, railroad mergers inevitably reduce shipper options, regardless of the conditions that are applied by the agency. Bottlenecks are extended when lines serving captive shippers are acquired by connecting carriers. Efficient service from independent "bridge" carriers disappears. Competition for service to new industrial sites is reduced or eliminated. In conjunction with other ICC–STB policies that curtail competition between railroads, mergers have generally harmed captive shippers.

As the inevitable result, whole states, regions, and industries are now captive to a single railroad.

You can imagine the difficulty we face when it comes time to negotiate a rail contract or a rail rate for a captive facility. Lacking the negotiation flexibility and bargaining power that competition provides, freight rates from the monopolistic railroads continue to rise unchecked.

That explains why captive rail rates may reach or exceed twice the amount of a competitive rate. In 2003, Escalation Consultants, Inc., which provides consulting services to the energy and rail shipper industries, studied captive versus non-captive rail rates for several commodity groups. For chemical companies the average non-captive rate for each railroad was about $16 to $20 per ton. In comparison, captive chemical rail shipments averaged $33 to $48 per ton—more than twice as much.

Heightening ACC's concern is that there is no forum other than STB in which to address issues involving railroads and captive shippers. In Staggers, Congress left those issues in the jurisdiction of the regulatory agency and did not de-regulate rail service in non-competitive situations. But STB has not lived up to that responsibility.

Captive shippers are at a disadvantage in a variety of ways. For example, when basic freight rates are established, fuel surcharges are often calculated and applied as a percentage of those rates. As a result, captive shippers pay more in fuel surcharges because there was no competition when the basic freight rates were established. On May 11, STB held a public hearing on railroad fuel surcharges. ACC's analyst found that those surcharges greatly exceed actual fuel costs due to flaws in the methodologies used in calculating the surcharges. Railroad fuel surcharge practices are unreasonable because of five crucial factors:

- *Fuel surcharges often are not based on actual fuel consumption:* Surcharges should be related to the amount of fuel consumed to provide a specific service to a shipper. Instead, they are based on other, often unrelated factors.
- *Fuel surcharges are inappropriately linked to freight rates:* Rates are based on a wide range of competitive factors, and their differences are not relevant to the amount of fuel consumed for a particular trip.
- *Higher fuel costs are often covered by other means:* Railroad fuel costs are captured through several mechanisms, such as the Rail Cost Adjustment Factor. Adding a fuel surcharge often means fuels costs are recovered more than once by the railroad. Such double jeopardy is unfair.
- *Some shippers are overcharged because others are not subject to fuel surcharges:* Due to certain contracts or other circumstances, some railroads can not impose a surcharge on some customers. But it is unfair and unreasonable to "make up the difference" by unduly raising the charge for customers that do pay surcharges.

- *The reasonability of fuel surcharges can only be determined if there is complete data transparency:* Railroads should report their actual fuels costs in a consistent, comprehensive and uniform manner so that the STB, shippers and Congress can accurately and readily determine the revenue obtained from surcharges.

The flaws in rail fuel surcharge practices are significant. According to the analysis prepared at the request of ACC by the economic and management consulting firm of Snavely King Majoros O'Connor and Lee, Inc., the manner in which fuel surcharges have been calculated and applied by the railroads to all customer traffic has resulted in an "over recovery in the range of $1 billion for 2005. This is the amount by which Class I fuel surcharge revenues collected by U.S. railroads exceed the increased fuel costs incurred by the railroads."

While we believe the issue of railroad fuel surcharges requires prompt action, STB has set no date for a decision.

The irony is that Staggers was intended to protect captive shippers and promote competition. Congress wisely wanted to avoid the captive shipper conditions that exist today. That Act directed ICC (now STB) to "maintain reasonable rates where there is an absence of effective competition." Again, the STB has not lived up to its responsibility, and its regulatory interpretations have skewed the Act's intent to bring free market forces to bear on shippers and railroads.

Regrettably, the freight rail marketplace of today doesn't behave like a marketplace at all. Instead, it's dominated by five powerful monopolies. It's time to tear down the barriers to competition. Accordingly, ACC supports legislation that would reform railroad regulation: S. 919, the Railroad Competition Act of 2005, is a bipartisan bill whose provisions would promote competition leading to better service at competitive prices.

- S. 919 would eliminate "bottlenecks" that allow monopoly carriers to take advantage of their pricing power to prevent competition over a short, competitive portion of a route.
- S. 919 would overturn STB's anti-competitive "Midtec" decision. Staggers allows captive shippers with facilities located in terminal areas to seek STB's approval for competitive access to another carrier that also serves that same terminal area. But ICC's regulatory action in Midtec has effectively prevented shippers from even requesting, let alone obtaining, such relief.
- S. 919 would eliminate so-called "paper barriers" to competition. These are contractual agreements that require a short-line railroad to deliver all or most of its traffic to the major carrier that originally owned the short-line facilities. Such agreements prevent shippers from obtaining competitive service from other Class I carriers that connect to the same short-line.

I urge you to carefully consider these and the other provisions of S. 919.

We also believe Congress should consider putting the rail industry fully under the Nation's antitrust laws. The railroads assert that such legislation is unnecessary, given the "extensive economic regulation" of their industry by STB. But the same railroads claim that S. 919 would be "re-regulation." They can't have it both ways.

In our free market economy, monopolies—and the poor service and high prices they foster—belong in the museums of past history. Major rail customers like Olin see no reason why the rail freight industry can't thrive in a competitive American marketplace. The shelter from competition the freight rail industry now enjoys is unfair to rail customers and to consumers who ultimately pay the bills. It's time for Congress to end unfair and uncompetitive market practices. It's time to return to the original intent of the Staggers Act.

A long line of STB policy determinations is harming the competitiveness of the U.S. chemical industry and other key sectors of the American economy. Unless reversed, those policies will ultimately impair the ability of the U.S rail industry to serve all of its customers.

Congress wrote Staggers to clearly and carefully de-regulate those rail rate and service matters that take place in circumstances where shippers really do have competitive transportation alternatives. Because the marketplace works for such rail customers, Congress appropriately removed unnecessary regulatory involvement. ACC believes that Staggers has been successful in that regard.

But Congress also wisely recognized that railroads have what the law calls "market dominance" over certain shippers. In fact, were it not for those situations, there would have been no need for a Federal regulatory agency with exclusive jurisdiction over rail industry rates and commercial practices, the construction and abandonment of rail lines, railroad mergers, etc. Staggers was clearly meant to de-regulate only those aspects of shipper-carrier commercial relationships that take place in competitive markets. ICC was retained in 1980—and STB exists today—to deal with the non-competitive situations.

The anti-competitive policies implemented by ICC and STB are not included in statutory language. Staggers did not mandate such policies, and the agency has acknowledged that it has the statutory authority to reverse its interpretations. But STB almost invariably declines to exercise its discretion in favor of pro-competitive solutions to railroad issues, unless so directed by Congress.

We are at a critical point. Unless Congress acts to reverse STB's policies, they will ultimately weaken the U.S rail industry, to the detriment of rail-dependent domestic industries and the Nation as a whole.

As businesses dependent on the railroad industry, we are vitally interested in the financial health of America's railroads. We simply cannot operate successfully in this country without a financially viable railroad industry and a secure railroad infrastructure. Indeed, I believe that the ability of American manufacturers and producers to compete in today's global market is highly dependent on the rail freight industry. Today, unfortunately, the rail freight industry impedes—rather than enables—our Nation's global competitiveness. American manufacturers and producers find it more and more difficult to remain competitive against manufacturers and producers outside the United States.

After many years of discussion with representatives of the Class I railroads, ACC is convinced that the carriers will not budge from the status quo in which they have complete market dominance over their captive customers—unless Congress acts. We believe the current business model being followed by the railroads will inevitably lead to their financial brink, costing not only railroad shareholders, but also taxpayers and rail-dependent American enterprise. Even the railroads agree that the gap between their annual income needs and their annual income is expanding, not shrinking. This is despite the fact that they have been allowed to consolidate to achieve cost synergies. These synergies should have allowed them to operate more efficiently and in a fashion that permits them to recover their cost of capital. They've also had the opportunity to transfer less profitable track to short line railroads and they have been able to increase the burden on captive rail customers. The result is simply that those customers with no alternative pay the most.

Pursuing a strategy of continually loading more costs on captive rail customers is not a business model that will result in healthy American railroads in the long run. Captive rail customers will try to escape and the universe of captive rail customers is likely to be reduced over time. Some captive customers will construct rail line "build-outs." Some captive customers will shift their manufacturing activities to facilities that have transportation competition. Some captives will shift their manufacturing to foreign countries, exporting American jobs overseas. Some companies might be forced to close a U.S. plant or to forego an expansion without even having an offshore alternative. Under this business model, the rail industry will be required to load up even more costs on the remaining captives, thus accelerating the cycle.

When considering railroad service, it is important to recognize the "common carrier obligation," under which railroads are required to transport commodities for their customers. The Interstate Commerce Clause of the Constitution grants power to the Congress to write the laws that govern our Nation's commerce. Congress recognized the common carrier obligation as the framework on which the entire national railroad transportation system was founded [49 U.S. Code, Subsection 11101(a)]. And it remains crucial today. Railroads are chartered to operate in the public interest because the public depends on safe and reliable service in the delivery of a wide range of products on which we all depend. The common carrier obligation underlines the role of railroads as a service industry that supports so many critical sectors of the U.S. economy.

Let me be very clear: we do not seek a return to the "bad old days" of the 1970s, when several of the major railroads were in bankruptcy and the industry lacked the capital necessary to maintain their systems. Unfortunately, more than a quarter of a century after passage of the Staggers Act, the rail industry apparently continues to fall short of the revenue needed to provide a first class rail system for the Nation.

In fact, the railroads are proposing a 25 percent investment tax credit and first year expensing for infrastructure investments. While some level of investment tax credit for infrastructure may be appropriate, it must be part of a comprehensive solution to rail reliability problems.

There must be a better way for the railroad industry to achieve long-term financial viability while providing efficient, reliable service at prices that will allow American business to compete successfully in the global market. We believe that balanced, fair legislation is needed to bring about a positive relationship between the railroads and the captive customers.

ACC would not ask Congress to resolve issues that could be resolved by railroads and their customers working together to benefit their own industries. But railroad monopoly, supported by STB decisions, is the basic impediment. This dilemma can only be resolved with the intervention of Congress.

Thank you for allowing the American Chemistry Council to present its views, and I would be glad to respond to any questions.

Senator LOTT. Mr. Ficker?

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

Mr. FICKER. Thank you, Mr. Chairman. It's a pleasure to be here this morning and to talk about this important issue that's not only essential to our membership, but also essential to the economy as a whole.

The National Industrial Transportation League is America's oldest and largest association of companies engaged in freight transportation. Our 600-plus members are some of the largest companies in the United States, as well as some of the smallest enterprises, and represent over $50 billion in transportation spending annually.

The League has actively participated with GAO during their analysis, and we've met with their staff and provided information to them in the study. And, actually, several of the members of the League actually participated in the panel of experts that the GAO convened earlier this year. We looked at the GAO testimony this morning, before the hearing, and found it to be right on mark, and we commend their efforts to date.

First, the GAO noted that, while the STB has broad legislative authority to investigate industry practices, there has been little assessment of competition nationally, including areas of inadequate competition. The League agrees that the study of competition and areas of inadequate competition would be very useful to you, as policymakers, and we urge the Committee to consider such a study.

Second, the GAO, as clearly indicated, said that the relief process—the current rate relief process is expensive, time-consuming, complex, and largely inaccessible to most of our members. I have often said that if I was still working in the shipping industry, which I spent 20 years doing, if I had ever decided to bring a rate case before the STB, and I brought that to the management of my company, I ought to be fired. It doesn't work. It's not accessible. And it's not effective. The League strongly agrees with this.

The League presented to the STB, along with 26 other industry associations, numerous suggestions for improving the agency's small-shipment rate complaint process. To date, however, they have not acted on that, although Chairman Buttrey, this morning, indicated there should be something forthcoming later this year. And, to that, we are excited.

In addition, the League concurs that the GAO—with the GAO assessment that there should be alternative approaches considered to mediating disputes, and including and especially emphasize the importance of an expedited, mandatory arbitration process for rate relief and rail—and service disputes. The League believes such a process would offer great potential for resolving disputes between rail users and carriers, both to expediting the dispute process and encouraging settlements. I might point out also that the National

Feed and Grain—Grain and Feed Association has such a process, and it has worked quite effectively for the last 7 or 8 years.

As we all know, the rail industry is laboring under significant capacity constraints for the first time in over 50 years. It's caused congestions across the system. And if you look at the AAR figures, the average train speed has decreased by—from 23 miles an hour in 1993 to 20 miles an hour in 2003. And meaningful service provisions in a contract are virtually impossible to obtain today.

Some service-sensitive rail users, such as UPS, who so stated in a recent GAO panel discussion, has shifted their traffic back to truck, in order to meet the needs of their customers, further exacerbating the congestion we already face on our highways. And this capacity constraint has also substantially increased the pricing leverage of the carriers, which is evident in substantial rate increases across all commodities in the demarketing of less-than-profitable traffic. Most rail users have faced, or are facing, double-digit rate increases along with reduced and deteriorating service. Rate negotiations, as others have mentioned, have become a "take it or leave it" proposition.

Just on Monday of this week, the Council of Supply Chain Management Professionals released its 17th annual State of Logistics Report. That report stated that, between 2004 and 2005, transportation costs jumped by 14.1 percent, a staggering figure and a record, according to the Council. Rail users understand the dynamics of a supply and-demand market environment. They live in it every day. The concern is that they are paying more and getting less.

The inability of the rail industry to meet the demands caused by this is even greater concern for the future. Any projection put out by any organization, whether it's a Government agency, such as DOT, or the association—American Association of State Highway and Transportation Professionals, known as AASHTO, indicates that growth between now and 2025 could be as much as 60 to 70 percent of freight volumes in that period of time. And according to the AASHTO Bottom Line Rail Report, which is often quoted by my associate and friend over here, Mr. Hamberger, rail tonnage is expected to grow by 44 percent, which is, unfortunately, significantly less than what the growth of the economy and freight movement will be. That needs to be addressed.

In order to meet current and future demand, the rail industry must expand its existing capacity. The critical need for infrastructure is clear, yet it is not the only way to improve capacity. The application of technology, such as positive train control, is estimated to add as much as 10 to 15 percent to the current structure. Processes for working with shippers and carriers together will also improve that.

With the financial health of the rail industry no longer an immediate issue, and with enhanced leverage, the railroads have—in a capacity-constrained market—it is a time for deteriorating service—emphasis must shift toward creating value for the shipping public. The creation of value will occur only if railroads and rail users, spurred by incentives in the marketplace, work together to identify sources of productivity gains, cost reductions, in order to provide a consistent level of service and fully utilize existing capacity.

The League believes that the solutions to these problems must come from the private sector and that the League has, over the past years, initiated several efforts. The chairman indicated, earlier, his concern over fuel surcharges. Over the past 9 months, the National Grain and Feed Association, along with the National Industrial Transportation League, has met privately with each of the Class I carriers in North America to present a fuel surcharge study, which I would be happy to make available for the record. And in that effort, we have reached—we are pleased to say that the BNSF and the Canadian National and Canadian Pacific have responded positively, while the eastern carriers have refused.

Additionally, the League, in 2005, chose to remain neutral on Senate bill 919, and, instead, has entered into discussions with the AAR to identify ways that rail users and carriers can work together to find value through the productivity gains and cost reductions that could address the concerns. The League and the AAR have formed a number of tasks for us to examine and address issues concerned with local rail service, capacity, infrastructure, and office administration.

Senator LOTT. Mr. Ficker, I apologize, but we are getting under a real time constraint here. We want to——

Mr. FICKER. I—let me——

Senator LOTT.—hear from Mr. Hamberger.

Mr. FICKER. If I can make one——

Senator LOTT. He deserves a chance to respond to the four-to-one odds here.

Mr. FICKER. If I can make one more comment.

Mr. HAMBERGER. Does that mean I get 20 minutes, Mr. Chairman?

Senator LOTT. Yes.

[Laughter.]

Mr. FICKER. If I can make one final comment, Mr. Chairman, I appreciate it.

We want to work—continue to work with the AAR and the railroads to resolve these problems. We've often heard from you and Congress, "Bring us a solution. Work together. Come—bring the parties together." We intend to do that. And we'd urge the Committee to look at the work that we're doing with the AAR and help us and guide us in that direction so that those efforts can provide the kind of value and direction that this country needs.

Thank you.

[The prepared statement of Mr. Ficker follows:]

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

The National Industrial Transportation League is pleased to have been invited to present testimony on economic, service, and capacity issues in the freight railroad industry. The League is the Nation's oldest and largest association of companies interested in transportation. Its 600-plus members range from some of the largest companies in the Nation to much smaller enterprises. Many members of the League ship via rail, and are vitally interested in the capacity, service, and competitiveness of the Nation's rail industry. But League members also substantially ship via other modes, both domestically and internationally, and the problems of capacity must also be looked at in this broader context, as many modes are facing capacity constraints.

The League actively participated in the General Accountability Office (GAO) study which is in part the subject of this hearing. League staff and the incoming League Chairman met for several hours with GAO staff to discuss rail issues, and provided information developed by the League to assist GAO in its study. Much of the League's discussion with GAO centered on the problem of the rail industry's capacity constraints. Also, the League referred GAO staff to League members for additional information. Finally, in March 2006, the League and several of its members appeared before a panel organized by the GAO to consider the current state of the rail industry and to advise GAO on its study.

As requested by the Committee, the League has reviewed the draft testimony of the GAO, which describes that Office's ongoing work on the performance of the rail industry since the Staggers Act. The League compliments the GAO on its work to date, and concurs with a number of the tentative conclusions set forth in GAO's testimony. The GAO testimony discusses two areas that are particularly integral to further improvement for rail industry policymakers, both of which deserve comment.

First, GAO notes that, while the STB has broad legislative authority to investigate industry practices, there has been little assessment of competition nationally, including areas of inadequate competition. GAO notes that such an assessment of competition would allow decisionmakers to identify areas where competition is lacking and to assess the need for and merits of approaches to address it. The League agrees that a study of competition and areas of inadequate competition would be useful to policymakers, and urges the Committee to consider such a study. In that connection, the League notes that, in its experience, rail competition, in order to be effective, must be present at both the origin *and* the destination of a rail movement. For example, if an agricultural shipper at origin is served by a single rail carrier, the fact that the export grain elevator at destination might be served by more than one railroad does not create rail-to-rail competition under current law, since the shipper at origin cannot require its sole-served origin carrier to interchange with a competing rail carrier for the movement to destination.

Second, GAO indicates that the current rate relief process is expensive, time-consuming, complex, and largely inaccessible to most shippers. The League *strongly* agrees. The League has presented to the STB, along with 26 other industry organizations, numerous suggestions for improving the agency's small shipment rate complaint process. To date, however, the STB has not acted on these suggestions. In addition, the League concurs with GAO that alternative approaches should be investigated, including (and especially) the use of expedited, mandatory arbitration for rail rate and service disputes. The League believes that such an arbitration process has great potential for effectively resolving disputes between shippers and carriers, both through expediting the dispute process and in encouraging settlements.

The rail industry is laboring under significant capacity constraints for the first time in over 50 years. Since 1980, demand for rail transportation has steadily increased while rail capacity has declined. We have reached a point where demand has exceeded the industry's capacity to haul all of this traffic. This has caused congestion over significant parts of the national rail system, resulting in a substantial deterioration in service levels. The AAR's own figures show that average train speed declined between 1993 and 2003, from about 23 miles per hour to a little over 20 miles per hour. [1] Monthly service statistics published by the AAR show that average train speed for the total U.S. shows a decline from 23 miles per hour in 2000 to less than 22 miles per hour in the twelve-month period ending in September 2005. Meaningful service provisions in contracts are virtually impossible to obtain. Some service-sensitive shippers such as UPS, who so stated in the recent GAO panel discussion, have shifted their traffic to truck, further exacerbating the congestion and wear on the Nation's highways.

These capacity constrains have also substantially enhanced the pricing leverage of the rail industry, which is evident in substantial rate increases across all commodities and the de-marketing of less profitable traffic. As stated by GAO in its testimony, four large Class I carriers control almost 90 percent of the industry's revenue. Many shippers are facing double digit rate increases along with reduced or deteriorating service. Rate negotiations have become a "take it, or leave it" proposition for many shippers. We believe that the effects of these capacity constraints in the rail industry on prices is felt across modes. Just 2 days ago, the Council of Supply Chain Management Professionals released the 17th annual "State of Logistics Report." That report stated that, between 2004 and 2005, transportation costs

[1] AAR, "Railroad Ten-Year Trends 1993–2002," p. 132; and "Railroad Ten Year Trends, 1994–2003," p. 132.

jumped 14.1 percent—a staggering figure, and a "record high," according to the Council.[2]

The inability of the rail industry to meet current demand causes even greater concern for the future. *Any* projection of future economic growth indicates that the need for transportation will grow dramatically in the next 15 years. For example:

- The American Association of State Highway and Transportation Officials [AASHTO Report] projects that, with moderate economic growth, U.S. domestic and international freight tonnage will grow by 67 percent between 2000 and 2020.[3]
- According to the AASHTO Report, rail tonnage is expected to grow by 44 percent, which is significantly less than the overall growth in freight tonnage.
- The Port of Los Angeles/Long Beach estimates that containerized imports through that port will grow by 44 percent from 2005 to 2010, by another 34 percent in 2015; and by another 34 percent in 2020—in total more than doubling the traffic through this key facility in just *15* hours.[4]

In order to meet current and future demand, the rail industry must expand existing capacity. This will require both the industry and the policymakers to shift radically from a mind-set of cost control and downsizing, to one of growth and expansion.

Rail users are vitally dependent upon a financially healthy rail system, as there is no way for many of them to efficiently transport their goods to market except via rail. Fortunately, the railroad industry is thriving financially for the first time since the Staggers Act, and well before.

The financial markets have been "bullish" on the rail industry for several years. In a recent Morgan Stanley report,[5] respected analyst James Valentine expressed:

> even greater conviction that the industry will consistently earn its cost of capital over the next few years (a feat not achieved in decades), led by secular upward pricing initiatives that should continue into 2006 and beyond.

This is strong evidence that the financial strength exhibited by railroads is not a temporary phenomenon, but a paradigm shift in rail transportation markets brought about in large part by capacity constraints.

Such statements also suggest that the STB's measure of revenue adequacy significantly overstates the financial returns needed for "real-world" revenue adequacy. For example, despite the financial success of the rail industry over the past several years and reflected in the previously quoted Wall Street assessment of the industry, the STB determined that only one Class I railroad (Norfolk Southern) was revenue adequate in 2004, and that is expected to be the case for 2005 as well. The balance intended in the Staggers Act between allowing competition to establish reasonable rates "to the maximum extent possible" and the policy of fostering a financially healthy rail industry, has been upset by the agency's over-reliance on a questionable methodology of calculating revenue adequacy.

Competition is at the heart of our Nation's economic system. It creates a sense of urgency that enables companies to thrive. It spurs efficiency. It allocates resources in the most efficient manner. Competition, therefore, is essential to encourage the most efficient use of today's capacity constrained rail infrastructure and to spur investment in additional infrastructure. Competition encourages the most efficient use of limited capacity by ensuring that goods are moved over the most efficient route available. Competition also ensures that the capital for capacity expansion flows to the most economically beneficial projects for the rail transportation system. Indeed, increasing capacity would likely lead to increased competition, as rail carriers sought to attract valuable traffic to their system.

With the financial health of the rail industry no longer an immediate issue, and with the enhanced leverage of railroads in a capacity-constrained market at a time of deteriorating service levels, it is time for a more balanced approach. Direct government regulation seldom has been as effective as the marketplace at increasing efficiency. Emphasis must shift toward the creation of value to the shipping public. The creation of value will occur if railroads and shippers, spurred by the incentives of the market place, work together to identify sources of productivity gains and cost reductions in order to provide a consistent level of service that fully utilizes existing

[2] "17th Annual State of Logistics Report," sponsored by the Council of Supply Chain Management Professionals, June 19, 2006, p. 4.
[3] AASHTO Report, p. 50.
[4] See, *http://www.polb.com* and *http://www.portoflosangeles.org*
[5] James Valentine and Michael Manelli, Morgan Stanley Equity Research, "All Aboard! Reiterating Bulling Vies Toward Freight Railroads," Sept. 20, 2005, p. 1 (Valentine Report).

capacity to the maximum extent possible and encourages the addition of more capacity.

The League believes that solutions to these problems must come from the private sector, and the League has over the past year has initiated several efforts at private-sector solutions to various problems.

One set of discussions concerned rail fuel surcharges. This issue has become extremely important to our members, who believe that many of the carriers' fuel surcharge programs have significantly over-recovered the increased cost of fuel as applied to individual movements. Over the past 9 months, the League met, along with the National Grain and Feed Association (NGFA), with representatives of each of the major Class I carriers, to present the results of a Fuel Surcharge Study which the League, NGFA and other groups sponsored, and to discuss areas where individual carriers might consider improving their fuel surcharge programs. Some carriers, specifically the BNSF, the Canadian National, and the Canadian Pacific, responded positively to these discussions with changes in their individual fuel surcharge programs. Other carriers, especially the Eastern carriers, declined to respond.

Additionally, in 2005, the League chose to remain neutral on S. 919, and instead entered into discussions with the AAR to identify ways that shippers and carriers can work together to find value through productivity gains and cost reductions that could address the issues and concerns between them. The League and the AAR have formed a number of task forces to examine and address issues connected with local rail service, capacity and infrastructure, and office administration. For about a year now, these task forces have met several times to identify issues and plan improvements. The League continues to pursue these discussions diligently, and remains hopeful that they will yield positive results. However, the League remains mindful that the status quo—a trifecta of deteriorating service, double-digit rate increases, and serious questions as to whether there are sufficient means and incentives to meet future demand—is unacceptable.

These are matters of significant importance to rail users and it is essential that solutions are found and that resolutions are reached between rail users and carriers. We believe that League membership will need to see some concrete results flowing from the League's discussions with the AAR within a reasonable timeframe. If that does not occur, it is likely that the League's membership would insist that the League review its current position. We urge the Committee to insure that rail carriers and users are moving forward in a serious, focused and positive effort in the development of effective mutual solutions. We would urge the Committee to provide oversight to this process. We would be very pleased to report back to the Committee on the progress of the League's discussions with the AAR and its carriers.

Senator LOTT. Thank you very much.

Mr. Hamberger?

STATEMENT OF EDWARD R. HAMBERGER, PRESIDENT/CEO, ASSOCIATION OF AMERICAN RAILROADS

Mr. HAMBERGER. Thank you, Mr. Chairman. I will try to be brief.

On behalf of the members of the AAR, thank you for the opportunity to discuss freight railroad capacity and others issues here this morning.

Over the years, comprehensive, reliable, and cost-effective freight rail service has been critical to our Nation's economic prosperity. Looking ahead, the United States cannot prosper in an increasingly competitive global marketplace if our freight railroads are unable to meet our growing transportation needs. Railroads must be able to both maintain their extensive existing infrastructure and equipment and build the substantial new capacity that will be required to transport a substantial portion of the predicted 70-percent increase in freight traffic.

Unlike many utilities, which have peak demand capacity built into their asset base for ratemaking purposes, railroads cannot afford to have spare capacity on hand "just in case." Before they invest in new capacity, they must be confident that traffic and revenue will remain high enough to support the capacity in the long term.

Profits, therefore, are critical to meeting capacity demand, as the Congressional Budget Office has observed. According to the CBO, quote, "As demand increases, the railroad's ability to generate profits from which to finance new investments will be critical. Profits are key to increasing capacity, because they provide both the incentive and the means to make new investments," end quote.

Today, I'm pleased to say that after—25 years after the Staggers Act, freight railroads are finally beginning to show tangible signs of financial stability might be within reach. Rail earnings over the past year, while still below the average and median for all companies within the United States, are significantly higher than they have been in the past. This welcome development means that railroads can justify and afford the massive investments and capacity enhancements that will be required to meet future demand. In fact, this year the industry is investing $8.3 billion in infrastructure and investment, up from $5.7 billion just 4 years ago.

Looking ahead, I respectfully suggest that Members of this Committee and your colleagues in Congress do have a critical role to play:

First, heed the findings of the CBO and allow railroads to make the profit necessary to sustain investment in necessary capacity. And as CBO—GAO testified here this morning, all rate changes over the last 15 years were below the rate of inflation, and, thus, all rates have declined, in real terms. Reject any policy that unreasonably restricts future rail earnings and capital cost recovery.

Second, an infrastructure tax incentive would help bridge the gap between what the railroads can afford to invest in infrastructure from a business standpoint and what might bring more benefit to our society. As AASHTO has declared, shipping more freight by rail yields public benefits of clean air, congestion mitigation, and energy conservation, which the public should, therefore, be willing to pay for. This is not a subsidy.

In light of the role that we have played in the development of the economy, Mr. Chairman, I was very disappointed in some of the testimony I heard here earlier this morning on this panel.

For example, in the chemical industry you will see that, over the past 10 years, railroad rates have stayed the same. They haven't gone up in 10 years. What has gone up overall for chemical companies? A 30-percent increase in the producer price index. Everything has gone up 30 percent, led by natural gas and chemical feedstocks. And yet, the gentleman to my right has the temerity and the gall to say that his companies are moving overseas because of rail rates. That's not what his president says. Jack Gerard, President of ACC, says Dow Chemical had a facility that they were going to build in Texas. That facility is now being moved to Oman, in the Middle East. "Why?" Jack asks. Because of natural gas prices, almost solely because of natural gas prices. Jack went on to say, "The high price of natural gas is driving the global chemical industry"—it's a global chemical industry—"out of the U.S." The high price is driving it out of the U.S. I'll accept his apology later.

Moving on to coal. Let's take a look at electricity rates, up 38 percent. GAO says our rates were down 35 percent. We have them down to 32 percent since 1981. I'll take 32 or 38 percent. Our rates are down. Electricity rates are up. We are a retardant on increased electricity rates, not a driver of those rates. And notwithstanding what Mr. English says, according to the Coalcast Stockpile data from energy ventures analysts, dated May 2006, the rail powers stock increase, "the inventory crisis," in parenthesis, in quotation marks, is over. And the report goes on to say that this is not because of a shutdown in the burning. Coal burn recovered in May was 3.7 percent over normal, and stock share—not stock prices—coal stockpiles are still up.

Finally, with respect to agriculture, the input for agriculture prices paid by farmers, 4 percent decline in railroad rates—4 percent decline. The GAO says it was a 9 percent—nominal 9 percent increase since 1985. We have a 4 percent decline since—again, in nominal rates—since 1994, while every other price paid by them to produce their farm outputs has gone up. And I find it very interesting that, just last week, dated June 6, 2006, the National Association of Wheat Growers recommended—represented by my friend down at the other end of the table—put out a white paper addressing the crisis in wheat. And you've talked about—it talks about six or seven different issues, government programs, wheat diseases, the need for new biotechnology. Doesn't mention railroads, doesn't mention transportation costs. Talks about the fact that bread can last longer on the shelf in supermarkets, and, therefore, demand is down. At the end, they announce that a wheat summit has been called for the fall for members of all parts of the wheat chain to come together to develop ideas and policies to address this concern. And I offer our participation in that wheat summit. We are part of your chain, Mr. McIntosh. We want to be part of your economy. It does us no good when chemical plants go to Oman. We don't run railroads in Oman. Jack goes on to say that, of the 120 new chemical plants being planned around the world, 50 are being built in China. We don't run trains in China either, Mr. Chairman.

And I commend Mr. Ficker and the leadership that he has exerted at NIT League, to recognize that working together we can address issues of service. Working together. We have tried to do that with representatives of EEI. We have done it with the short lines. We have done it with the National Grain and Feed Association. We are pleased and honored to do it with NIT League. And we suggest that is the way to address any service issues, working together.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Hamberger follows:]

PREPARED STATEMENT OF EDWARD R. HAMBERGER, PRESIDENT/CEO, ASSOCIATION OF AMERICAN RAILROADS

Introduction

On behalf of the members of the Association of American Railroads (AAR), thank you for the opportunity to discuss freight railroad economics, service, and capacity. AAR members account for the vast majority of freight railroad mileage, employees, and traffic in Canada, Mexico, and the United States.

Comprehensive, reliable, and cost-effective freight railroad service is critical to our Nation. Today, freight railroads serve nearly every industrial, wholesale, retail, agricultural, and mineral-based sector of our economy. And in the words of the former World Bank Railways Adviser, "Because of a market-based approach involving minimal government intervention, today's U.S. freight railroads add up to a network that, comparing the total cost to shippers and taxpayers, gives the world's most cost-effective rail freight service."

Looking ahead, the United States cannot prosper in an increasingly competitive global marketplace if our freight railroads are unable to meet our growing transportation needs, and having adequate railroad capacity is critical to meeting those needs. Railroads must be able to both maintain their extensive *existing* infrastructure and equipment and build the substantial *new capacity* that will be required to transport the significant additional traffic our economy will generate.

Although I'm sure that most rail customers agree with this sentiment, not all of them seem to recognize that if they want added rail capacity, they must be willing to pay for it. Unlike utilities, which have peak-demand capacity built into their asset base for ratemaking purposes, [1] railroads cannot afford to have spare capacity on hand "just in case." Consequently, before they invest in new capacity, railroads must be confident that traffic and revenue will remain high enough to support the capacity in the long term, and that the investment will produce benefits greater than the scores of alternative uses of the funds.

Profits, therefore, are crucial, as the Congressional Budget Office (CBO) recently noted. According to the CBO, "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." [2]

Today, some 25 years after the Staggers Act was passed, freight railroads are finally beginning to show tangible signs that financial sustainability might be within reach. Rail earnings over the past year, while still below average within the universe of all industries, have been significantly higher than their historical norm. This welcome development means that railroads can more easily justify and afford the massive investments and capacity enhancements that will be required if railroads are to continue to play their proper role in meeting our freight transportation needs.

I respectfully suggest that Members of this Committee, your colleagues in Congress, and other policymakers also have critical roles to play. Indeed, a primary obligation of policymakers is to take steps that assist—and, just as importantly, not take steps that hinder—railroads in making the investments needed to provide the current and future freight transportation capacity our Nation requires.

Any policy that unreasonably restricts future rail earnings and capital cost recovery—and especially a swing in the regulatory or legislative environment back to heavy-handed government interference in rail operations—would take railroads away from the sustainability they need. Such an outcome would be harmful at any time, but it would be especially harmful today, given that as a nation we are in dire need of more railroad investments and *more* railroad capacity, not less.

Capacity is a Challenge Everywhere in Transportation Today

"Every aspect of the supply chain is stretched. It's not a question of whether [a congestion crisis] is going to happen. It's a question of when," notes a West Coast port terminal operator." [3] "In 23 years, I have never seen a situation where the supply chain is at capacity. It's busting at the seams," an executive with a major chemicals firm notes. [4] "Our highways, waterways, railroads and aviation networks are simply not keeping up with ordinary demands," says the head of UPS. [5]

To be sure, freight is still being delivered, and there is a tremendous amount of strength and flexibility in our Nation's transportation systems. But as these statements make clear, all freight modes in the United States are facing capacity challenges today.

For U.S. freight railroads, year-over-year quarterly carload traffic has risen in nine of the past ten full quarters, and intermodal traffic has increased in each of the past 16 full quarters, year-over-year. As a result, U.S. railroads today are hauling more freight than ever before. These traffic increases have resulted in capacity constraints and service issues at certain junctions and corridors within the rail network. In fact, excess capacity has disappeared from many critical segments of the national rail system.

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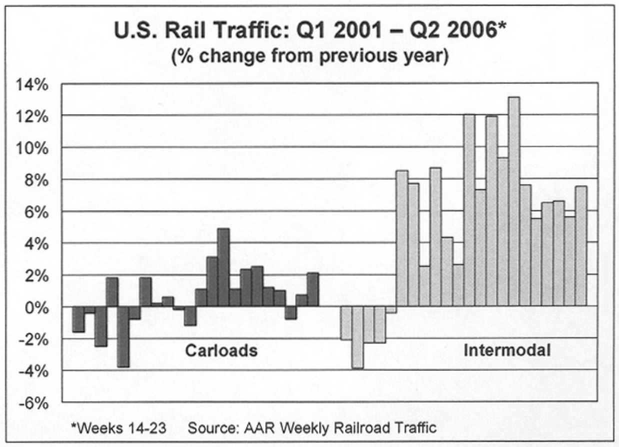
[1] Some utilities, in fact, receive regulatory permission to begin recouping the costs of new generation assets years *before* those assets actually come on line.

[2] Congressional Budget Office, *Freight Rail Transportation: Long-Term Issues* (January 2006), p. 11.

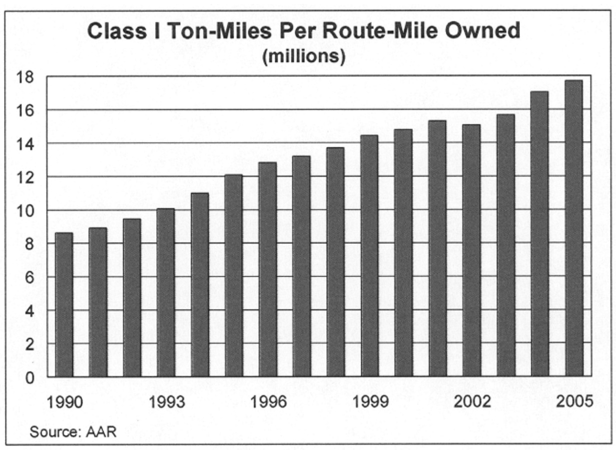
[3] Doug Tilden, CEO, Marine Terminals, quoted in *The Financial Times,* March 14, 2006.

[4] Randy Schaeffer, Manager of Rail Fleet Procurement, Air Products and Chemicals, quoted in *Traffic World,* May 16, 2005.

[5] Michael L. Eskew, Chairman and CEO, UPS, in a speech to the World Affairs Council of Philadelphia, April 6, 2006.



The reality that rail assets are being used more intensively is reflected in rail traffic density figures. From 1990 to 2005, traffic density for Class I railroads—defined as ton-miles per route-mile owned—more than doubled. (Other measures of traffic density, such as car-miles per mile of track, have also shown substantial increases.) Of course, different rail corridors differ in their traffic density and their change in density over time, and individual railroads differ in the degree to which their capacity is constrained overall. Still, there is no question that there is significantly less room to spare on the U.S. rail network today than there was even a couple of years ago.



Railroads work closely with their customers on a regular basis to determine expected traffic levels well in advance in order to help ensure that the railroads have appropriate assets in place. Sometimes, though—as occurred in 2005—actual demand for rail service exceeds expectations.

When this has happened, some shippers and others have inappropriately blamed railroads for not having enough infrastructure, workers, or equipment in place to handle the surge in traffic. But to contend that railroads can afford to have significant amounts of spare capacity on hand "just in case"—or that shippers would be willing to pay for it, or capital providers willing to finance it—is completely unrealistic. Like other companies, railroads try to build and staff for the business at hand or expected to soon be at hand. "Build it and they will come" has rarely been a winning strategy for freight railroads.

Over the past couple of decades, Class I railroads have shed tens of thousands of miles of marginal trackage. They had no choice, because they could not afford to keep it, and it freed resources for use on higher priority core routes. Most of the miles that were shed were transferred to short-line operators, and most of these remain part of our rail network. Even if railroads could have afforded to retain this mileage—and again, they could not—most of it was in locations that would not be useful in ameliorating today's capacity constraints.

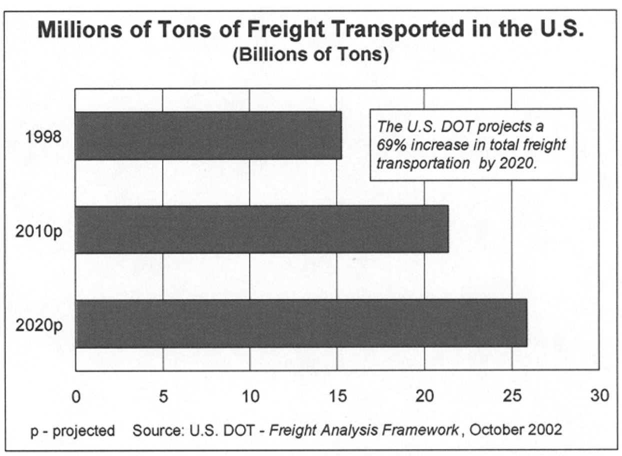
In part, this is because long-lived rail infrastructure installed many decades ago was often designed for types and quantities of traffic, and origin and destination locations, that are dramatically different than those that exist today. For example, only within the last two decades has Powder River Basin coal taken on the enormous importance it currently enjoys. Similarly, the explosive growth of intermodal traffic is mainly a phenomenon of the past 20 years.

When business is unexpectedly strong, railroads are unable to expand capacity as quickly as they might like. Locomotives, for example, can take a year or more to be delivered following their order; new entry-level employees take 6 months or more to become hired, trained, and qualified; and it can take a year or more to plan and build, say, a new siding.[6] And, of course, before investments in these types of capacity enhancements are made, railroads must be confident that traffic and revenue levels will remain sufficiently high to justify the enhancements for the long term. Again, in this regard railroads are no different than the vast majority of their customers.

Freight Transportation Demand Will Increase Sharply in the Years Ahead

No matter the mode, capacity constraints exert a substantial economic toll. As Secretary of Transportation Norman Mineta has noted, "Congestion and inefficiency in transportation are, in effect, hidden taxes that burden every business and every individual, and we must find ways to lighten that load." That "load" could become much worse over the next 15 years if demand for freight transportation grows as quickly as expected.

The U.S. Department of Transportation (DOT) has projected that overall demand for freight rail service (measured in tons) will increase 55 percent (1.3 billion tons) by 2020 from 1998 levels, equal to 2.0 percent per year. The DOT projects a 69 percent increase (10.6 billion tons) in total freight transportation demand.[7]



In a 2005 forecast, economic consultants Global Insight predicted that rail carload and intermodal tonnage will increase by 29 percent (650 million tons) from 2004 to 2016, or 2.1 percent per year. Global Insight expects total freight transportation demand to rise 31 percent by 2016.[8]

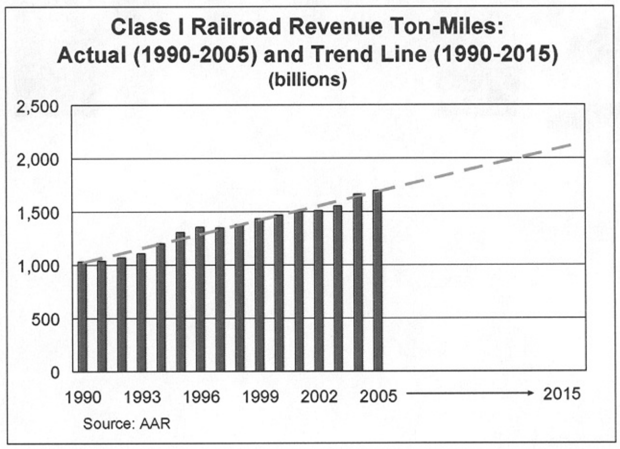
If Class I ton-mile growth from 2005 through 2020 does nothing more than match the rate of growth from 1990 through 2005, rail ton-miles in 2020 will total 2.35 trillion, up 38 percent (or 2.2 percent per year, on average) from the 1.70 trillion in 2005.

[6] This may seem like a long period of time, but it compares favorably with the decade (or more) it can take to build a typical stretch of highway.

[7] U.S. Department of Transportation, *Freight Analysis Framework,* October 2002.

[8] *U.S. Freight Transportation Forecast to 2016,* produced for the American Trucking Associations.

These projections for increases in freight transportation demand should give all of us pause. At full or near-full capacity, transport systems become more fragile. With inadequate redundancy, there are fewer alternative routes and facilities, breakdowns and back-ups proliferate faster and further, and recovery from disruptions takes longer. Ameliorating capacity constraints across modes will entail significant costs, but in the long run the cost is likely to be far less than if we do not adequately address the issue now.



Railroads Are Working Hard on a Variety of Fronts to Increase Capacity

For their part, U.S. freight railroads are well aware that capacity constraints have led to service-related problems on parts of their networks, and they are committed to solving these problems by addressing the host of factors that influence the fluidity and resiliency of freight rail operations.

Spending on Infrastructure and Equipment

Of the many different factors that affect how well a rail network functions, the basic amount and quality of infrastructure and equipment is probably the most important. That is why U.S. freight railroads have been expending, and will continue to expend, enormous resources to improve their asset base. As traffic grows, railroads will have to concentrate increasingly on building new capacity to accommodate that growth—while continuing to maintain existing capacity. But if a railroad is not financially sustainable over the long term, it will not be able to attract the capital necessary to maintain its existing network in top condition, or make additional investments in the replacement or expansion of infrastructure required by growing demand.

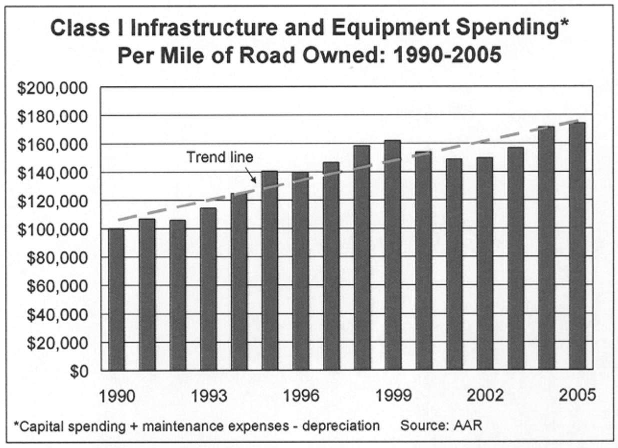
This point is especially relevant for railroads relative to other modes. In contrast to the extensive government funding for truck, barge, and airline infrastructure over the past 25 years, freight railroads have historically received little government financial assistance for infrastructure construction or maintenance. Instead, freight railroads have financed infrastructure improvements (and equipment investments, such as locomotives) almost exclusively through their own earnings and by borrowing.[9]

From 1980 through 2005, Class I freight railroads alone invested some $174 billion in capital and maintenance expenses related to infrastructure, and another $183 billion in capital and maintenance expenses related to equipment. (Non-Class I railroads have invested additional billions of dollars.)[10] Class I railroads typically devote approximately 45 percent of their operating revenue, or $15 billion to $17

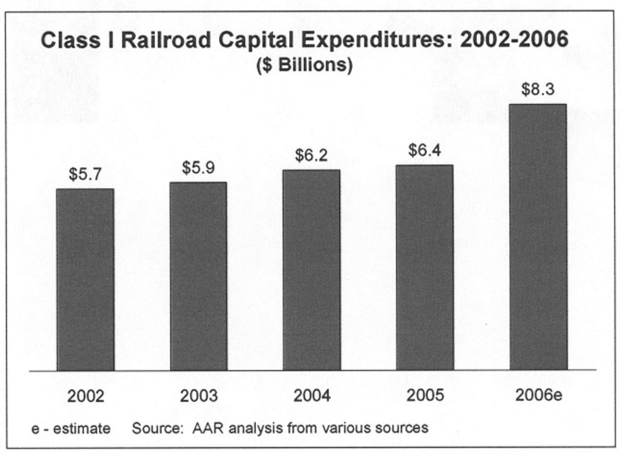
[9] As discussed beginning on page 26, [89 of this document] railroads favor more pronounced use of public-private partnerships for rail infrastructure improvement projects where the fundamental purpose of the project is to provide public benefits or meet public needs, and support tax incentives for rail investments that enhance capacity.

[10] For non-Class I railroads, improving infrastructure to handle 286,000 pound cars is a major issue. The AAR urges Congress to extend the three-year short line infrastructure tax credit, which expires in 2007.

billion per year, toward these purposes, which have been trending higher since 1990 on a per-mile basis.



Moreover, rail spending, which is already substantial, is expected to rise sharply. Based on an analysis of recent railroad financial presentations, press releases, and other sources, it appears that Class I capital expenditures on infrastructure and equipment are set to rise in 2006 to around $8.3 billion, up sharply from around $5.7 billion just 4 years earlier. This huge increase demonstrates the diligence with which railroads are responding to the capacity issue.



The following is just a sampling of the diverse types of capacity-enhancing investments individual railroads have recently made or will soon make:

- BNSF Railway double-tracked 76 miles of main line between Chicago and Los Angeles in 2005, and another 56 miles will be double- or triple-tracked this year. Within a couple of years, the entire 2,200-mile route will be double-tracked. In 2005, BNSF also took delivery of some 400 centerbeam cars (for hauling lumber); 3,700 high-capacity covered hoppers for carrying grain and other commodities; 1,300 rapid-discharge coal cars; and 650 intermodal flatcars with capacity to carry 6,500 intermodal double-stack containers. BNSF also took delivery of 288 new locomotives in 2005 and will add more than 300 more in 2006.
- In 2006, Canadian National will spend $1.2 billion to $1.3 billion on capital programs in the United States and Canada. Included are the reconfiguration of the key Johnston Yard in Memphis, a gateway for CN's rail operations in the Gulf

of Mexico region; siding extensions in Western Canada; and investments in CN's Prince Rupert, British Columbia, corridor to capitalize on the Port of Prince Rupert's potential as an important traffic gateway between Asia and the North American heartland.

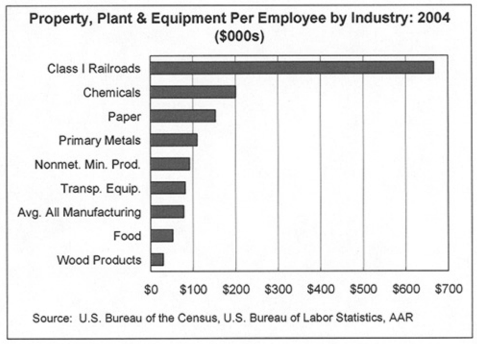
- In 2005, Canadian Pacific finished its biggest capacity enhancement project in more than 20 years by expanding its network from Canada's Prairie region to the Port of Vancouver. The project increased the capacity of CP's western network by 12 percent and improved the route structure from Canada's Pacific coast to the United States. Like other carriers, CP has added new sidings on congested corridors; taken delivery of dozens of new locomotives and newer, higher-capacity freight cars; and hired and trained hundreds of new employees, many of whom will be in the United States.
- CSX recently announced plans to spend $1.3 billion to $1.4 billion per year on capital expenditures in 2006 and 2007, up from approximately $1 billion over the previous few years. In addition to improvements elsewhere, installation of sidings, signals, and other infrastructure on lines between Chicago and Florida and between New York City and Albany will expand capacity and improve service reliability. CSX will also add several hundred new locomotives over the next few years.
- Kansas City Southern is busy integrating its Kansas City Southern dé Mexico subsidiary fully into the railroad's other operations. KCS plans to spend some $120 million in the United States and another $96 million in Mexico in 2006. Particular attention will be given to the construction of new tracks and other improvements at the railroad's Shreveport, Louisiana hub; improvements on the "Meridian Speedway" between Shreveport and Meridian, Mississippi to augment the new rails, new sidings, and new drainage system installed in 2005; and the expansion of rail yards, track upgrades, and new sidings on its "Tex-Mex" subsidiary.
- Norfolk Southern (NS) will purchase more than 220 new locomotives from late 2005 through mid-2006 to augment the hundreds purchased over the past few years. NS is also in the midst of its largest-ever locomotive rehabilitation program—in 2005, 491 locomotives were overhauled and 29 were rebuilt; another 420 will be overhauled and 52 rebuilt in 2006. NS is also beginning its "Heartland Corridor" project, which, among other things, will entail raising clearances at 28 tunnels in Virginia, West Virginia, and Kentucky to allow double-stack intermodal service over the entire route from the Port of Norfolk to Columbus, Ohio and Chicago.
- In 2006 alone, Union Pacific will spend some $1.5 billion to replace track and hundreds of millions more to increase fluidity and capacity. Much of UP's current and recent spending is coal-related, including adding a third mainline from Reno to West Nacco on the PRB Joint Line; constructing a third run-through mainline to speed coal trains through North Platte; and a $35 million Marysville, Kansas bypass to expedite PRB coal trains. Another focus of UP's capacity expansion programs for 2006 is its 760-mile Sunset Route between Los Angeles and El Paso. Today, more than 42 percent of the Sunset Route is double tracked, including 69 miles that were completed in 2005 at a cost of some $100 million. UP plans to double track another 50 miles this year and most of the remainder within a few years. Since 2004, Union Pacific has purchased 713 new locomotives and will purchase an additional 200 in 2006.

The massive investments railroads must make in their systems are a reflection of the extreme capital intensity of railroads. By any of a variety of measures, railroads are at or near the top among all U.S. industries in terms of capital intensity.

For example, from 1995 to 2004, the average U.S. manufacturer spent 3.5 percent of revenue on capital expenditures. The comparable figure for U.S. freight railroads was 17.8 percent, or more than five times higher. Likewise, in 2004 railroad net investment in plant and equipment per employee was $667,000—more than eight times the average for all U.S. manufacturing ($78,000).

Capital Expenditures as a % of Revenue for Various U.S. Industries: Avg. 1995-2004	
Average all manufacturing	**3.5%**
Food manufacturing	2.6%
Transportation equip. mfg.	2.8%
Machinery manufacturing	3.0%
Wood product mfg.	3.0%
Petroleum & coal products mfg.	3.0%
Fabricated metal product mfg.	3.5%
Chemicals manufacturing	4.4%
Plastics & rubber products mfg.	4.5%
Paper manufacturing	4.7%
Computer & electr. product mfg.	5.0%
Nonmetallic mineral product mfg.	5.4%
Electric utilities	11.6%
Class I Railroads	**17.8%**

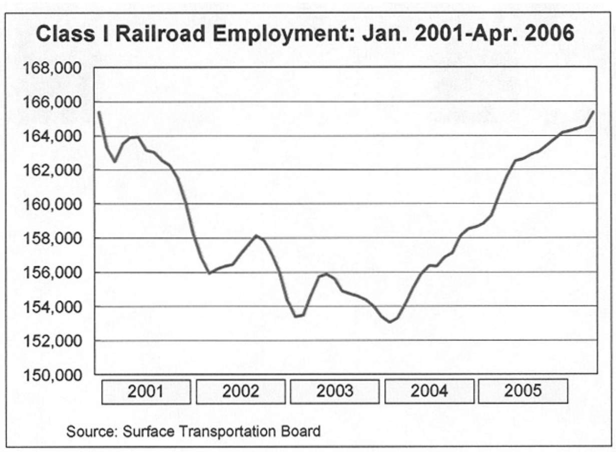
Note: Utilities are 1999-2004
Source: U.S. Bureau of the Census, AAR, EEI



The bottom line is that railroading is extraordinarily expensive, and simply cannot be done "on the cheap." And because when they make major investments, railroads are committing capital to assets that can have a life span of 30 years or more, adding rail capacity can be accompanied by substantial financial risk. That's why railroads, as noted earlier, need to be sure that the market will support additions to capacity over the long-term. As a former NS official remarked in comments to the Transportation Research Board, "Any capacity enhancing project (be it fixed plant or locomotives or cars) has to be compared to all of the other demands on corporate capital and the returns must be attractive. Further, all investments must be consistent with a company's ability to raise capital. However 'worthy' a capacity project might be, it must, in the end, lead to improved financial returns." [11]

Aggressive Hiring

Rail capacity is a function of personnel in addition to infrastructure, and railroads have been aggressively hiring and training crews to expand capacity. After decades of steady decline, rail employment has been on the increase since 2004. According to STB data, overall Class I employment in April 2006 (the most recent month for which data are available) was 3 percent higher than in April 2005 and 7 percent higher than in April 2004.



[11] James McClellan, "Railroad Capacity Issues," background paper for Research to Enhance Rail Network Performance: A Workshop, Transportation Research Board, April 5–6, 2006.

Infusion of Technology

Technology has always played a key role in expanding rail capacity. Control systems have become more sophisticated; trains have become longer and heavier; locomotives have become more powerful and more reliable; and track structures have become more robust and thus less prone to outages for maintenance or because of failure.

Many of the dramatic technological advancements that have increased railroad efficiency (and safety) by helping to protect freight cars, locomotives, track, and cargo before damage, costly repairs, traffic holdups, and derailments occur have been developed and/or refined at the Transportation Technology Center Inc. (TTCI) in Pueblo, Colorado, a wholly-owned subsidiary of the AAR that is generally considered to be the finest rail research facility in the world. Just a few of these technological advancements include:

- *Wayside detectors* that identify defects on passing rail cars—including overheated bearings and wheels, dragging hoses, deteriorating bearings, cracked axles and wheels, and excessively high and wide loads—before structural failure or other damage occurs. Some of the newest wayside detectors being developed use *machine vision* to perform higher-accuracy inspections through the use of digitized images, which are then analyzed using computer algorithms.
- Trackside *acoustic detector systems* use "acoustic signatures" to evaluate the sound of internal bearings to identify those likely to fail in the near term. These systems supplement or replace existing systems that identify bearings already in the process of failing by measuring the heat they generate.
- Advanced *track geometry cars* use sophisticated electronic and optical instruments to inspect track conditions, including alignment, gauge, and curvature. TTCI is developing an on-board computer system that provides an even more sophisticated analysis capability of track geometry, predicting the response of freight cars to track geometry deviations. This information will better enable railroads to determine track maintenance needs and help improve the safety of day-to-day rail operations.
- One of the most straightforward ways to add capacity to a rail network is to pack more freight on each train, and railroads have been doing that ever more aggressively. In 1995, for example, the average coal car carried on a Class I railroad held just under 103 tons of coal. By 2005 that figure had risen to nearly 112 tons, a 9 percent increase. But heavier loads are far more damaging to track structures than lighter loads. Researchers at TTCI and elsewhere are engaged in efforts related to this *heavy-axle load* (HAL) service. HAL-related work is underway on rail steels, insulated joints, bridges, welding, maintenance practices, and more.

Freight railroads have always been at the forefront in the use of computers and information technology, and today railroads are rapidly expanding their use of these technologies to improve overall efficiency and the fluidity of their operations, thereby adding capacity without adding infrastructure.

For example, advanced computer modeling software is used in a wide variety of rail applications, from automating rail grinding schedules [12] and improving customer demand forecasting to optimizing yard operations. CN, for example, is implementing what it calls "SmartYard," complex computer software that identifies and analyzes every possible combination and outcome for sequencing cars in a large classification yard and simultaneously updates and communicates the car processing plan. The result is more efficient, faster yard operations. Other railroads are engaged in similar efforts.

Recognizing that another way to add capacity is to move more trains faster over the same length of track, railroads are also working with their suppliers to design, implement, and improve innovative computerized "trip planning" systems. These highly-complex systems automatically incorporate and analyze a mix of ever-changing variables (*e.g.,* crew and locomotive availability, terminal congestion, the different priority status of loads of freight, track conditions, maintenance plans, weather, etc.) to optimize how and when cars are assembled to form trains and when those trains depart.

Trip-planning systems are just one way that railroads are trying to improve equipment "cycle time"—*i.e.,* the total time it takes for a freight car to be loaded, hauled to destination, unloaded, returned to the same or a different shipper, and loaded again.

[12] Rail grinding is a maintenance procedure for removing rail corrugations and surface defects, and for restoring the shape of rail to improve wheel and rail interaction and extend rail life.

The benefits of increased efficiency explain rail efforts to "supersize," automate, and increase the velocity of traffic flows where practical. For example, railroads and their grain customers collaborate to consolidate grain loading at high-speed "shuttle loader" elevators. Railroads gain by improving the efficiency of their operations; shippers gain because the efficiencies produce railroad cost savings that are passed through in the form of lower rates. The efficiencies of shuttle operations can be striking. At BNSF, for example, a typical grain car in shuttle service hauls approximately three times more grain over the course of a year than a typical grain car in non-shuttle service.

Expanded over a network, operational efficiency can free up substantial capacity for other uses. At one major railroad, for example, a one mile-per-hour increase in system-wide velocity could mean that 250 locomotives, 5,000 freight cars, and 180 train and engine employees would be freed up to move additional traffic.

Cooperative Alliances and Collaborations

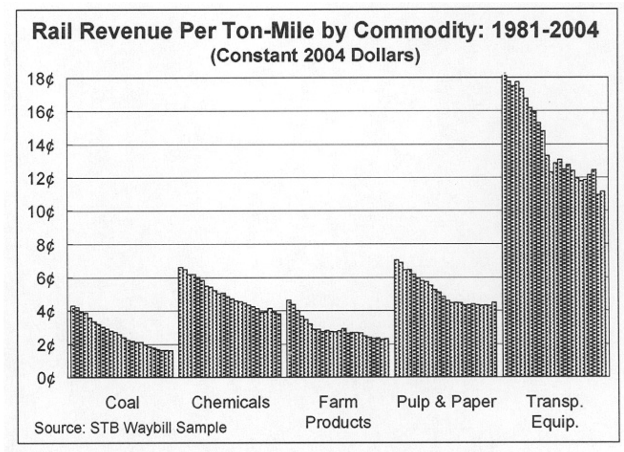
Railroads are also entering into operational alliances with each other which often rely on non-standard techniques to achieve desired results. These innovative collaborations lead to improved capacity utilization, lower costs, and better service. For example:

- A recent BNSF and CN track-sharing agreement will improve network fluidity and infrastructure capacity, principally in Vancouver, Chicago, and between Memphis and southern Illinois. Under the agreement, the railroads will exchange track and rail infrastructure, and CN will grant trackage, haulage, and other access rights to BNSF.
- CSX and UP are now operating their "Express Lane" service to haul fruits and vegetables by refrigerated rail car from California and the Pacific Northwest to population centers on the East Coast. UP and CSX also offer a similar "Wine Connection" service for wine movements. These joint ventures improve the utilization of rail assets and enhance the efficiency of coast-to-coast transportation.
- A KCS–NS joint venture will increase capacity and improve service on the "Meridian Speedway," a rail line between Meridian, Mississippi and Shreveport, Louisiana, that is crucial for transporting freight between the Southeast and the Southwest. KCS will contribute a 320-mile rail line between the cities, while NS will invest $300 million in cash, substantially all of which will be used for capital improvements to increase capacity over a four-year period. The capital improvements will include signal systems, extended sidings and stretches of double track.
- UP and CN have reached a routing protocol agreement to streamline their exchange of rail traffic at major gateways and reduce rail congestion in the Chicago area. Under the protocol, CN and UP are directing rail traffic flows through the most efficient interchange locations, thereby improving transit times and asset utilization.
- NS and CP recently began a partnership under which NS runs trains on CP trackage in New York state and then hands off the trains to CP, which hauls them across the border for further interchange or final delivery in Canada. The agreement allows NS to replace the inefficient and circuitous route it previously had to use for trans-border operations. In addition, NS hauls CP trains between other points in New York, thereby allowing CP to improve the efficiency of its own operations.
- UP and CP recently strengthened their alliance at Eastport, Idaho, where CP hands off grain trains to UP for delivery to Pacific Coast ports. Working with customs authorities, the railroads have improved the customs clearance process, eliminating a major bottleneck that had been backing up trains at the border. The result has been a significant decrease in dwell time and a sharp increase in daily train count at the interchange.

Railroad Rate Trends Since Staggers

With passage of the Staggers Rail Act of 1980, U.S. freight railroads were generally freed to price their services in the open marketplace, with government price regulation (which had been pervasive prior to Staggers) remaining only where it was determined that railroads did not face effective competition. Staggers allowed railroads to enter into confidential rate and service contracts with shippers and gave railroads freedom to operate over routes they found to be most efficient. Railroads responded to their new pricing freedoms by sharply increasing productivity and competing more effectively.

Most rail productivity gains have been passed on to shippers in the form of lower rates. In inflation-adjusted terms, rail revenue per ton-mile (RPTM) was relatively flat prior to Staggers, but has fallen 57 percent since then. Similarly large rate reductions have occurred over nearly all commodity types (including coal, agricultural products, and chemicals) and across geographical areas.



RPTM is often used as a surrogate for rail rates because it measures both the actual payments made by rail customers and the bases for which the rates are assessed—weight and distance. Although RPTM can be affected by changes in length of haul, commodity mix, equipment ownership, and other shipment characteristics, studies that have controlled for such factors have confirmed that the decline in RPTM reflects a real drop in rail rates.

Numerous studies confirm the sharp drop in freight rail rates. For example:

- In September 2004, the U.S. Department of Energy's Energy Information Administration (EIA) released a report on rail rates for coal delivered under contract from 1979 through 2001. The report found that contract rail coal rates peaked in 1984 at $17.52 per ton, then declined by nearly 42 percent, to $10.19 per ton, by 2001. On a revenue per ton-mile basis, the EIA reported that rail rates declined 60 percent in real terms from 1979–2001, compared with a decline in barge coal rates of 38 percent and an increase in truck coal rates of 73 percent over the same period.

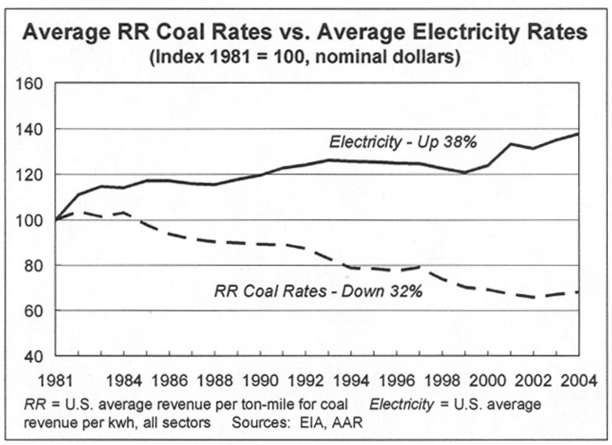
  The September 2004 EIA report was an update to a similar October 2000 study covering 1988 to 1997. In that study, the EIA found that "Although the share of coal transported by railroads increased, the average rate per ton to ship contract coal by rail fell steadily (a 25.8 percent decline) during the study period . . . The general finding of declining rates was also substantiated when the rates were calculated as a rate per ton-mile, a rate per million Btu, or rates between specific supply and demand regions." According to the EIA, on a RPTM basis, the average contract coal rate fell 41.4 percent from 1988 to 1997, and "the decline . . . was a response to competitive markets."
- In a June 2002 report, the U.S. General Accounting Office (now the Government Accountability Office) released a rail rate analysis covering 1997 to 2000. The GAO found that "From 1997 through 2000, rail rates generally decreased, both nationwide and for many of the specific commodities and markets that we examined." The June 2002 report was an update to a similar April 1999 GAO report covering 1990 to 1996. In the June 2002 study, the GAO noted that "[t]hese decreases followed the general trend we previously reported on for the 1990–1996 period and, as before, tended to reflect cost reductions brought about by continuing productivity gains in the railroad industry that have allowed railroads to reduce rates in order to be competitive."
- In December 2000, the Surface Transportation Board (STB) released the latest in a series of periodic reports entitled "Rail Rates Continue Multi-Year Decline." The STB found that "inflation-adjusted rail rates have fallen 45.3 percent" from 1984 to 1999. The STB continued, "[T]he very significant rate reductions . . . imply that shippers would have paid an additional $31.7 billion for rail service

in 1999 if revenue per ton-mile had remained equal to its 1984 inflation-adjusted level. . . . It is important to note that all types of rail customers, and not just those with competitive transportation alternatives, must have received some portion of the rate reductions we have measured here." The STB also found that "an increase in the average length of haul is not responsible for the preponderance of the rate declines that we have identified. We find that real railroad revenue per ton has fallen 43.7 percent since 1984, nearly identical to the decline of 45.3 percent obtained when using ton-miles."

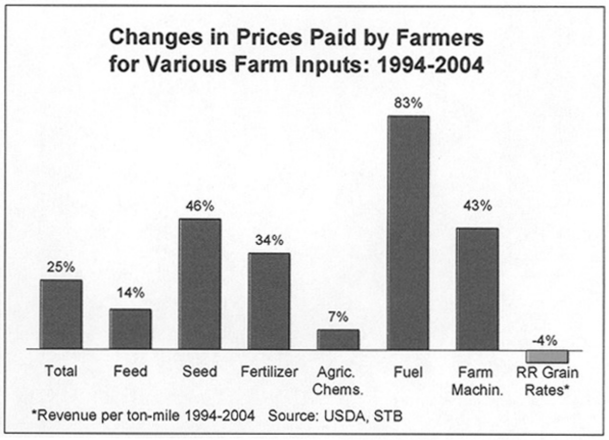
- A study published in September 2000 by scholars at the University of Maryland and The Brookings Institution noted that "[D]eregulation was not just a boon for the rail industry. Shippers benefited too. Based on the first decade of deregulation, one study found that the annual benefits to shippers from lower rates and improvements in service time and reliability amounted to at least $12 billion (1999 dollars). And, . . . shippers have generally continued to benefit from lower rates."

Competitive rail rates help rail users control the prices of their goods.

For example, from 1981 to 2004, average railroad coal rates (as measured by coal RPTM in nominal terms) fell 32 percent, while average electricity prices rose 38 percent.



Over the same period, rail RPTM for chemicals rose less than 1 percent. During this same period, prices paid by chemical companies for liquefied refinery gases, which are a major chemical industry feedstock, rose 147 percent, while the producer price for chemicals themselves (many chemicals are intermediates for other chemicals) rose 33 percent.

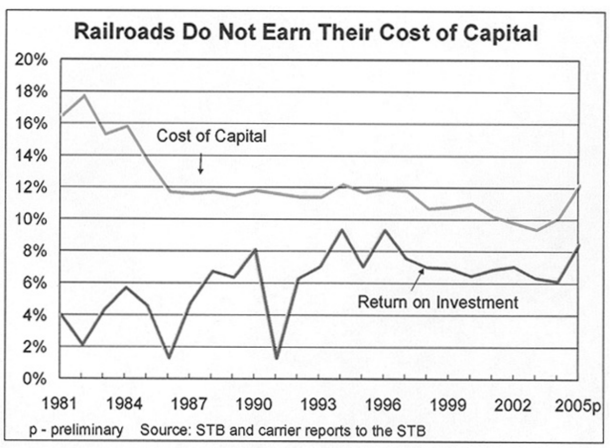


Likewise, from 1994 to 2004, the prices paid by farmers for most farm inputs rose: up 46 percent for seed, up 34 percent for fertilizer, and up 83 percent for fuel. During this same period, the average rail rate for grain (as measured by grain RPTM) fell 4 percent. Clearly, railroads have been doing their part to help keep U.S. agriculture competitive.

Railroads Must Be Financially Healthy to Expand Capacity

Since Congress passed the Staggers Act, railroads have only slowly made progress toward the goal of long-term financial sustainability. Financial sustainability is essential if railroads are to have any hope of meeting future rail capacity needs.

This slow progress is documented in the STB's annual revenue adequacy determinations. A railroad is "revenue adequate"—*i.e.,* it is earning enough to cover all costs of efficient operation, including a competitive return on invested capital—when its rate of return on net investment (ROI) equals or exceeds the industry's current cost of capital (COC). This standard is widely accepted, approved by the courts, and similar to that used by public utility regulators throughout the country. It is also consistent with the unassailable point that, in our economy, firms and industries must produce sufficient earnings over the long term or capital will not flow to them. As a prominent Wall Street rail analyst recently noted, "Earning the cost of invested capital is not the end goal, but the entry ticket to the race . . . without which Wall Street will squeeze investment." [13]



[13] Anthony Hatch, "Six for 06: Trends To Watch in Rail," *The Journal of Commerce,* January 2006.

During the more than 25 years in which railroad revenue adequacy determinations have been made, railroads have significantly narrowed the COC vs. ROI gap, but a gap still remains.

Rail customers certainly understand the importance of earning the cost of capital over the long term. A spokesman for a major Florida electric utility noted, "If we can't make an attractive investment for the shareholder, then we are going to have a very difficult time going in the marketplace and competing for dollars." [14] The CFO of a major U.S. chemical company stated, "We want to create spread above the cost of capital through the cycle." [15] And the CEO of a major U.S. forest products company recently stated "Each of our businesses continues to assess the ability of their individual facilities and product lines to earn the cost of capital. Those that cannot make the grade do not belong in our portfolio." [16]

Railroads agree with this sentiment, which is echoed by firms in every sector of the economy. Without the ability to cover total costs and earn adequate returns, railroads—like electric utilities, chemical companies, forest products firms, or any other firm—would be unable to maintain (much less increase investment in) their networks and could not sustain themselves over the long term.

Last month, the Edison Electric Institute (EEI) released a document that defends the sometimes substantial price increases electricity consumers are facing in many parts of the country. EEI writes:

> "Clearly, electricity is an indispensable commodity that is crucial to our daily lives and to our Nation's continued economic growth. And the costs needed to reinforce the Nation's electric power system are worthy long-term investments. The bottom line is that we are living in a rising cost environment, and electricity prices have been a great deal for many years. Even with expected rate increases, electricity prices are projected to remain below the rate trends of other goods and services. In fact, the national average price for electricity today is significantly less than what it was in 1980, adjusted for inflation. Of course that is small comfort to customers who will be opening costlier electric bills in the coming months. And no one—utility, regulator, or customer—is eager to see electricity prices increase. The unavoidable reality, however, is that we all must address the fact that in order to ensure that electricity remains affordable and reliable, we must help shoulder the expense of reinforcing and upgrading our electricity infrastructure. It is the only way to be certain that electricity will be there when we need it, and at a price we can afford over the long term" [17]

Railroads wholeheartedly agree with this sentiment too. It *is* critical to our Nation's economy and standard of living that we upgrade and reinforce our electricity infrastructure.

We also think that EEI's statement above is just as valid, if not more so, if the word "electricity" were changed to "freight railroading." Looking ahead, the United States cannot prosper in an increasingly competitive global marketplace if our freight railroads are unable to meet our growing transportation needs, and having adequate railroad capacity is critical in meeting these needs. Like utilities, railroads must be able to both maintain their extensive existing infrastructure and equipment and build substantial new capacity. Railroads could not do this if their earnings were unreasonably restricted, any more than utilities could.

Even in 2005 Railroads Had Substandard Profitability

Without question, 2005 was a good year for railroads financially—revenue and net income were both up substantially. Frankly, it's about time the rail industry had a year like 2005, and they require them going forward. Improved rail earnings should be viewed as a welcome development because it means that railroads are better able to justify and afford the massive investments in new capacity and upkeep of their existing systems that need to be made.

That said, no one should get carried away regarding railroads' *relative* profitability in 2005, because the fact is, in 2005—when railroads were hauling record levels of traffic and had sharply higher-than-historical profitability—rail industry earnings were *still* substandard compared with other industries.

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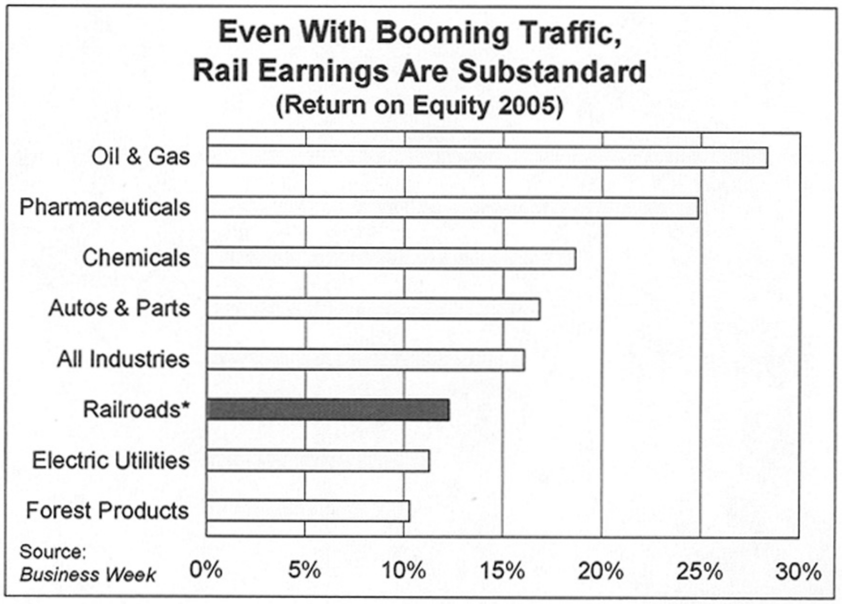
[14] Spokesman for Florida Power & Light, quoted in *The Palm Beach Post,* January 16, 2005.

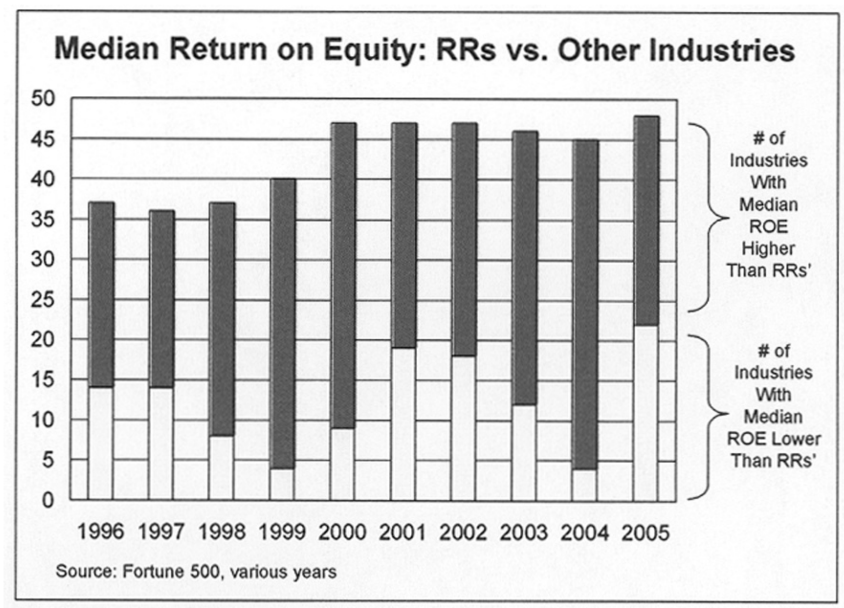
[15] Rich Lorraine, SVP and CFO, Eastman Chemical Co., at the Morgan Stanley Basic Materials Conference, February 21, 2006.

[16] Steve Rogel, Chairman, President & CEO, Weyerhaeuser Co., Q4 2005 Weyerhaeuser Co. Earnings Conference Call, February 3, 2006.

[17] EEI, *Rising Electricity Costs: A Challenge For Consumers, Regulators, And Utilities,* May 2006.

Return on equity (ROE) is commonly used as an indicator of short-term profitability. According to *Business Week* data covering the S&P 500, in 2005 the average ROE for the four largest U.S. railroads was 12.3 percent—a substantial improvement over the 7.8 percent recorded in 2004, but still well below the 16.1 percent average for all firms in the S&P 500 for 2005. The railroad ROE was well below the median for chemical companies in the S&P 500 (18.7 percent) and only moderately higher than the median for electric utilities (10.8 percent) in the S&P 500.





Data from the *Fortune 500* tell a similar story. In 2005, the median ROE for the railroads in the *Fortune 500* was 14.1 percent, less than the *Fortune 500* median of 14.9 percent and well below the ROE of numerous major rail customer groups.[18]

Fortune 500 Return on Equity: 2005

Industry	ROE (in percent)
Household & Personal Prod.	41.5
Petroleum Refining	25.8
Mining, Crude-Oil Prod.	23.6
Pharmaceuticals	23.4
Food Consumer Products	21.8
Industrial & Farm Equip.	21.1
Computers, Office Equip.	19.7
Oil & Gas Equip., Services	18.9
Metals	18.3
Chemicals	18.1
Medical Products & Equip.	17.3
Beverages	16.4
Aerospace and Defense	16.3
Fortune 500 Median	*14.9*
Motor Vehicles & Parts	14.6
Railroads	*14.1*
Pipelines	13.5
Electronics, Electrical Equip.	12.1
Engineering, Construction	11.8
Utilities: Gas & Electric	10.4
Energy	7.4
Food Production	6.2
Packaging, Containers	4.6
Telecommunications	4.2

Source: Fortune 500

In each of the 20 years from 1986 to 2005, the median ROE for Class I railroads was less than the median for all *Fortune 500* companies, and in 15 of the 20 years, the median railroad ROE was in the lowest quartile among *Fortune 500* industries.

Thus, even the improved rail earnings in 2005 are generally no more than (and in most cases less than) what non-regulated companies and industries earn.

In any case, whatever may be the minimum level of earnings, profitability, or solvency considered adequate to declare a railroad "healthy" for short-term investment purposes, the primary point to remember is that only a return on investment in excess of the cost of capital over a *sustained* period can signify that railroads are financially healthy.

Reregulation is Not the Answer to Railroad Capacity and Service Problems

Unfortunately, rail critics have wrongly seized upon railroads' "record profits" in 2005 to support their claims that railroads should be forced to reduce their rates to certain shippers. This viewpoint—that short-term increased railroad profitability to moderate levels justifies a reinstatement of onerous restrictions on rail earnings—is exceedingly shortsighted and should be rejected.

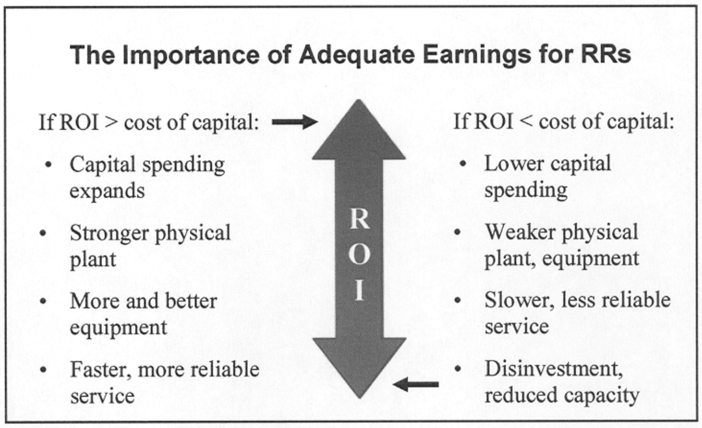
Railroads have had to battle efforts to reregulate the industry since the Staggers Rail Act partially deregulated railroads in 1980. It is beyond the scope of this testimony to discuss in any detail the many ways in which reregulatory legislation (like S. 919, the "Railroad Competition Act of 2005") is misguided.

It should be noted, though, that the primary objective of those who call for rail reregulation is lower rail rates, even though, as discussed above, railroads are not earning excessive profits. Lower rail rates would translate directly into lower rail earnings. But proponents of reregulation ignore the fact that rail investments in infrastructure and equipment, like most private investment decisions in our economy, are driven by expected returns. The hundreds of billions of dollars invested in U.S. freight railroads since Staggers would not have been provided if not for the investors' expectation that the opportunity for a competitive return promised by Staggers would remain.

Under reregulation, rail managers could not commit, and rail stockholders would not supply, investment capital needed to improve service and expand capacity, because the railroads considering such investments would not have a reasonable op-

[18] The median railroad ROE for *Business Week* and *Fortune 500* differs because different definitions were used. *Business Week* uses net income excluding discontinued operations; *Fortune* uses net income including discontinued operations. *Business Week* uses average shareholders' equity for a year; Fortune uses end-of-year shareholders' equity.

portunity to capture the benefits of those investments Disaster might not occur overnight, but there would be little or no capacity expansion—something that certainly would have a near-term and significant adverse effect.



The financial community, on whom railroads depend for access to the capital they need to operate and expand, has consistently supported the view that, under reregulation, an era of capital starvation and disinvestment would return. They understand that no law or regulation can force investors to provide resources to an industry whose returns are lower than the investors can obtain in other markets with comparable risk.

Proponents of reregulation cannot avoid the fundamental fact that shippers must be willing to pay for the rail service and rail capacity they say they need, and the market is far superior to the government in determining who should pay.

Some in the electric power industry are among the most vocal proponents of restrictions on rail earnings. Their advocacy of restrictions on railroads are not consistent with their claims regarding the need for cost-recovery and regulatory certainty in electricity transmission—a sector of the electricity industry with some parallels to railroading.

A representative of the Edison Electric Institute, for example, wrote "I cannot overemphasize the need for FERC to establish and put into effect a durable regulatory framework that says if I prudently invest a dollar in transmission infrastructure, that I will be able to fully recover that dollar, along with my cost of capital, through electricity rates. Such a framework is essential to raising the substantial and nearly unprecedented amount of capital necessary to construct needed, cost-effective transmission facilities." [19]

Likewise, the National Rural Electric Cooperative Association has noted that it "believes that the best way to attract capital to transmission at reasonable rates is to give investors greater certainty that they will receive a return on their investment." [20] The rail industry can think of no better way to create *un*certainty for their own capital providers "that they will receive a return on their investment" than proposals such as S. 919. Such legislation is bad economics and bad public policy and should be rejected. It would mean *less* rail capacity when we need *more*.

Public Involvement in Freight Rail Infrastructure Investment

Freight railroads will continue to spend massive amounts to improve and maintain their systems. But even with their improved financial performance, funding constraints will likely prevent railroads from meeting optimal future rail infrastructure investment needs entirely on their own. As AASHTO noted in its *Freight Rail Bottom Line Report,* "The rail industry today is stable, productive, and competitive, with enough business and profit to operate but not to replenish its infrastructure quickly or grow rapidly." [21]

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[19] Statement on behalf of the Edison Electric Institute by Alan J. Fohrer, CEO, Southern California Edison, to FERC, April 22, 2005.

[20] Comments of the National Rural Electric Cooperative Association Proposed Rulemaking Promoting Transmission Investment Through Pricing Reform," FERC Docket No. RM06–4–000, January 11, 2006, p. 17.

[21] AASHTO, *Freight Rail Bottom Line Report,* p. 3.

In its analysis, AASHTO estimated that railroads will need to carry an additional 888 million tons of freight annually by 2020 just to maintain their current market share. AASHTO also found that railroads will need $175 billion to $195 billion of infrastructure investment over this period to accommodate this traffic growth, and projected that railroads will be able to fund the majority of this investment—$142 billion—from their own retained earnings and borrowing. Unfortunately, according to the AASHTO analysis, the $142 billion will be enough to enable railroads to handle only half of their expected increase in traffic.

This funding shortfall means that many rail projects that would otherwise expand capacity and improve the ability of our Nation's farms, mines, and factories to move their goods to market; speed the flow of imports and exports; relieve highway congestion; reduce pollution; lower highway costs; save fuel; and enhance safety will be delayed—or never made at all.

I respectfully suggest that it is in our Nation's best interest to ensure that optimal freight railroad capacity enhancements are made. Two ways that policymakers can help make this happen is by taking greater advantage of public-private partnerships for freight-railroad infrastructure projects and by introducing tax incentives for rail infrastructure projects that enhance capacity.

Public participation in freight rail infrastructure projects is justified because the extensive benefits that would accrue to the general public by increasing the use of freight rail would far exceed the costs of public participation. For example:

- *Highway congestion*—Highway congestion costs the U.S. economy more than $63 billion per year, but trying to eliminate it by focusing solely on highways is not practical because building more highways is becoming prohibitively expensive and time-consuming. Given budget constraints, environmental concerns, and other factors, we will be unable to simply build our way out of highway gridlock. Freight railroads, though, significantly reduce the costs of highway congestion and the need to build costly new highways. A single intermodal train takes up to 280 trucks (equivalent to more than 1,100 cars) off our highways. Trains carrying other types of freight take up to 500 trucks (equal to around 2,000 cars) off our highways.
- *Fuel efficiency*—Railroads are three or more times more fuel efficient than trucks. On average, in 2004 railroads moved a ton of freight nearly 410 miles per gallon of fuel. If just 10 percent of the intercity freight that moves by highway moved by rail instead, fuel savings would approach one billion gallons per year.
- *Pollution*—The Environmental Protection Agency (EPA) estimates that for every ton-mile of freight carried, a locomotive emits substantially less nitrogen oxides, particulates, and carbon dioxide than a typical truck.
- *Safety*—Fatality rates associated with intercity trucking are four times those associated with freight rail transportation. Railroads also have lower employee injury rates than other modes of transportation. Railroads and trucks carry roughly equal ton-miles of hazardous materials, but trucks have 16 times more hazmat releases than railroads.

This point was also made by AASTHO, which that "Relatively small public investments in the Nation's freight railroads can be leveraged into relatively large benefits for the Nation's highway infrastructure, highway users, and freight shippers."[22] The Congressional Budget Office has also concluded that public investment in rail infrastructure should be considered: "Another way of addressing the underpayment of infrastructure costs by railroads' competitors is to provide financial assistance to the railroads." Echoing AASHTO, CBO observed that, "[p]roviding Federal aid for a rail investment might be economically justified if the net social benefits were large but the net private benefits to railroads were insufficient to induce them to make such an investment."[23] The Transportation Research Board has reached a similar conclusion, noting that "Greater public investment to relieve bottlenecks may improve efficiency—perhaps even in facilities that formerly were exclusively private . . . "[24]

Public-Private Partnerships

As Members of this Committee know, U.S. freight railroads are, with few exceptions, privately owned and operated, and have traditionally financed their infra-

[22] AASHTO, *Freight Rail Bottom Line Report,* p. 1.

[23] Congressional Budget Office, *Freight Rail Transportation: Long-Term Issues* (January 2006), p. 22.

[24] Transportation Research Board, *Critical Issues in Transportation* (January 2006), p. 3.

structure investments overwhelmingly through their own earnings and by borrowing from outside capital providers.

Capital providers, however, insist that railroads focus their limited investment funds on projects that promise a direct financial benefit to the investing railroad. While these projects may well provide substantial public benefits—such as reduced highway congestion, cleaner air, improved safety, and enhanced mobility—from a railroad's and capital provider's point of view, these are secondary to the project's financial return. This kind of imposed discipline by the financial markets is necessary and appropriate in a market economy, but it discourages investments that would yield significant public benefits but only limited financial benefits to the railroad.

A way to help states and localities improve rail networks that generate public benefits is through a more pronounced use of public-private financing partnerships for rail infrastructure improvement projects. Partnerships are not "subsidies" to railroads. Rather, they are an acknowledgement that private entities should pay for private benefits and public entities should pay for public benefits.

Partnerships reflect the fact that cooperation between interested entities is far more likely to result in timely, meaningful solutions to transportation problems than a go-it-alone approach. Without a partnership, projects that promise substantial public benefits in addition to private benefits are likely to be delayed or never started at all because it would be too difficult for either side to justify the full investment needed to complete them. In contrast, if a public entity shows it is willing to devote public dollars to a project equivalent to the public benefits that will accrue, the private entity is much more likely to provide the private dollars (commensurate with private gains) necessary for the project to proceed.

Going forward, the best-known public-private partnership involving freight railroads is the Chicago Region Environmental and Transportation Efficiency Program, or CREATE. Conceived in June 2003, CREATE is a $1.5 billion program involving the State of Illinois, the city of Chicago, and the major freight and passenger railroads serving Chicago designed to modernize and improve Chicago's highway and rail transportation networks. Installing grade separations between tracks and highways will speed vehicle travel and reduce congestion and delays for motorists; updating track connections and expanding rail routes will reduce rail transit times; and adding separate, passenger-only tracks in key locations will remove numerous bottlenecks that have slowed passenger and freight movements in the region for decades.

Investment Tax Incentives

Another way to bridge the funding gap between the level of investment that will bring the most benefit to our economy and what railroads are likely to be able to afford on their own is to implement an investment tax credit for rail capacity enhancement projects.

Under an investment tax incentive program for rail infrastructure, projects to expand freight rail capacity—by increasing the volume, weight, or speed of freight that can be carried—would be eligible for a 25 percent tax credit. Examples of qualifying capacity-expanding investments include raising tunnel clearances to accommodate double-stacked intermodal containers; upgrading single track lines to double or triple tracks; adding and lengthening sidings; strengthening bridges to carry heavier loads; and constructing intermodal terminals. In addition, new locomotives could also qualify for the credit if they met certain capacity-enhancement and other requirements.

Eligibility for the credit would extend to any taxpayer that makes a qualifying expenditure, not just railroads. For example, a shipper that built a rail spur from a distribution center to a main line would be eligible, as would the builder of a rail intermodal terminal.

Infrastructure capital expenditures that do not qualify for tax incentives would be expensed (the expensing option would not apply to locomotives). This would place capital cost recovery for rail infrastructure on the same basis as competing modes of freight transportation (*i.e.,* highway and waterway), which "expense" their infrastructure costs.

For a railroad considering whether to fund a new infrastructure project, the tax incentive would effectively reduce the cost of the project and thus lower the risk that the project will not generate the level of return needed to make it economically viable. Thus, the incentive would be enough to help worthwhile projects get built sooner, but would not be enough to cause economically unjustified projects to go forward.

Conclusion

U.S. freight railroads do a remarkable job in meeting the needs of an extremely diverse set of shippers. Railroads move tens of thousands of railcars to and from thousands of origins and destinations every day. The vast majority of these shipments arrive in a timely manner, in good condition, and at rates that shippers elsewhere in the world would love to have.

Still, it is clear that transportation capacity will have to increase as the economy expands. The railroads are committed to meeting these increased capacity needs primarily through private capital, but only if the regulatory structure gives the railroads an incentive to make the necessary investments. Policymakers can help ensure that rail capacity is adequate to meet our future freight transportation needs by ensuring that harmful economic reregulation is not instituted, engaging in more public-private partnerships for rail infrastructure projects, and instituting targeted tax incentives for projects that expand rail capacity.

Senator LOTT. Thank you, Mr. Hamberger.

We'll have a cooling-off period now.

[Laughter.]

Senator LOTT. The Committee will recess, so I can go vote. We do have two votes, back to back. But we'll be able to get those and come right back. Senator Burns may be able to get back before I do, and there will be an opportunity then for some questions.

Thank you all very much.

We'll be at recess for the next 15 minutes.

[Recess.]

Senator BURNS. [presiding] We'll get—go back to the fire here—firing line. And I want to apologize. We can schedule everything in this body but votes, you know.

And had you concluded—Mr. Hamberger, had you concluded your——

Mr. HAMBERGER. I believe I more than——

Senator BURNS.—statement?

Mr. HAMBERGER.—concluded, yes, sir.

[Laughter.]

Senator BURNS. You more than concluded?

Mr. HAMBERGER. Thank you.

Senator BURNS. And I would—I'd go into a little question-and-answer, then. I think it—Trent is coming back. I hope he does, anyway. And we'll get this rounded up. But I just happen to believe that this happens to be a very, very important issue. It is important enough that to give it just a brush-by is just wrong. And I think there are some things that have to be brought out on the table and talked about it. And I like what Mr. Ficker said, that we have to work together.

I am not interested in re-regulating the railroads. I'm not interested in that at all. I'm interested, however, in dealing with those areas where we only have one railroad. We weren't sent to this Congress to stand idly by and see what monopolies do in certain areas.

Mr. Hamberger, your case of—rates have gone down, and your efficiency has increased a little, but not the greatest. But that is not the case in captive areas. And that's what we're talking about here, is where the STB could not, probably, deal with something where you have competition, but they do have the authority to deal when there's only one railroad or you have captive shippers. And they have not done that. And that's the reason for this hearing. That's the reason that we have S. 919, is to point out to America that we've got some very serious problems in some areas. We have the same thing when we start talking about telecommunications up here, in this same committee, of a—which—a committee that I used to chair and had quite a lot to do with writing the telecommunications policy and to force out new technologies and this type thing.

Now, there are also new technologies, as far as running the railroad. I can't run a railroad. My dad wanted me to go to school to be an engineer, and I told him I didn't want to drive no train.

[Laughter.]

Senator BURNS. But we've got serious problems in those areas. And I—to be right honest with you, the big railroads have failed to come to the table. And so, we're going to forge on with this piece of legislation, if we can. But we're going to deal with those areas that we think we can deal with.

Now, I've got a question for this panel, and I want to hear some discussion on it. I've seen a dramatic increase, over the next year, of shipper concerns on rates and service. I will tell you, we're headed for—in this fall—and get ready for it—we are seeing more grain contracted for delivery from the combine this year than ever before. And there's a reason for that. Our stocks are about half what they've been. Mr. Schuler knows about this. And we're seeing a price increase, as far as the farm is concerned. What I want to do is get all that increase back to the farm, as much as we can. But we're going to run into a car shortage this fall, I think, because our crop looks fairly good. If the big white combine doesn't go down across our farm, I think we're going to do that.

Congress seems unwilling to take action to address these legitimate and very serious complaints. And we've seen more of them. Everywhere I travel across this country, I hear these complaints. So, I know that where there's smoke, there's fire.

I'd just like for anybody, in this question—can they tell this committee why—why now? Why is our competitiveness and job creation over the long term in question now? Why are we seeing these pockets of captive shippers? Why are we seeing them now? Have we exhausted all remedies outside of legislative action? And are there alternatives to Congressional answer—action—that you, or we, should pursue? I think those are legitimate questions, and I think they're the questions this committee has to address.

Who'd like to take the first shot? Congressman English?

Mr. ENGLISH. Thank you very much, Senator. I appreciate that.

The—I think there are several reasons for it. And I can certainly speak to the electric utility side as it affects our members' electric cooperatives. I think a lot of this has to do with—there were long-term contracts that were agreed to some time ago, and those contracts are running out. And we've also seen the situation, no question about it, as I quoted earlier, there is an effort on the part of the railroads to get rid of their capacity. They testified before the Surface Transportation Board as to that's the objective, and they've managed to do that. So, the other part of it comes down to the question of reduced capacity. They've also reduced the number of employees on the railroads themselves. That started in 2000. And now we've got the old contracts running out, these new contracts coming on. And, as far as it applies to the stranded shippers, the people who find themselves hostage to monopolies, they're getting—they're the ones that are catching it in the shorts, and those are the people that you're hearing from.

And you can take a look at that chart. Let's put that chart back up there, if we could. The one that deals with stranded shipper costs. The point that I would make here, Senator, is the fact that it's very obvious, when you look at these rates, that—what are being charged captive shippers today. New contracts that are being made. When you've got people that are paying 350 to 450 percent of what—in the way of profits, compared to 6 to 8 percent where there's competition, it's pretty obvious where the money's coming from. It's coming from those 20 percent of the shippers, and they're being taken advantage of. And I'll be very candid with you, my folks feel like they're being ripped off.

Now, Senator, there's one other point, too. The Surface Transportation Board's supposed to take care of these problems. You made that point earlier. And you're absolutely right. But when my members—and I've got letters here from a member who wrote the chairman of the Surface Transportation Board, and the letter gets answered by the head of the railroad. There's a serious question in the minds of my members as to who in the world's running the Surface Transportation Board and who is it that they are supposed to go to for some kind of relief from abuse? And——

Mr. HAMBERGER. You know, Senator, you asked a very thoughtful question. Maybe we should try to answer it.

Mr. ENGLISH. The Surface—the——

Mr. HAMBERGER. And, in my opinion, you—the——

Senator BURNS. Hang on, now. Let's let—we'll let Mr. English finish, and then you can make your point, Mr. Hamberger.

Mr. HAMBERGER. Thank you.

Mr. ENGLISH. So, I think you have a convergence of these kinds of issues, Senator, that's bringing about the kinds of complaints that you're hearing about, and certainly the kinds of concerns that I'm hearing about from our membership, if, in fact, we're going to be building all this generation to meet our members' needs for the future. So, I think all this is converging at this time.

Senator BURNS. Mr. Hamberger?

Mr. HAMBERGER. You asked a very thoughtful question, Senator, about why is there a capacity constraint now. And I would suggest to you that it is not just a capacity constraint on freight railroads, it is a capacity constraint on the highways, it is a capacity strain on the pipelines, the inland barge and towing industry, the ports of our Nation. All are feeling the effect of increased economic activity, increased imports and exports. With respect to the freight rails themselves, we have seen a spike in demand for coal, dramatic increases. As I testified before the Senate Energy Committee—I believe you were there last week—in 2002, 2003, and 2004, demand for coal was less than in 2001. It's—it shot up dramatically in 2005. It's still up now, in 2006, because natural gas went to $16 a million-cubic-feet. It's now back down to about $6, and it'll be interesting to see whether or not that demand for coal is still there.

At the same time, the trucking industry experienced a 136-percent turnover in drivers. So everybody quit once, and then a third of them quit again—136-percent turnover, $3 a gallon for diesel fuel. Demand for freight rail went up there, as well.

So, with the intermodal growth, the demand in coal, the booming economy, there was a demand—not just in railroads, but across all of the modes of transportation. That's why we're investing $8.3 billion this year, to try to expand our capacity to deal with that demand.

Senator BURNS. Mr. Ficker?

Mr. FICKER. I could just add a couple of points. And I would, first of all, concur with my colleague, Mr. Hamberger, about the economy, as a whole, is—impacted transportation. Our organization represents companies that ship via all modes of transportation—rail, barge, ocean freight, and highway freight, as well—and virtually in every mode, there is capacity constraints. Whether it's driver shortages, whether it's railroad operating crew shortages, whether it's diesel fuel prices, whatever it is, all of these have impacted the movement of goods in this country. And the staggering—and I have to use the word "staggering"—growth in imports, and the focus that's happened, especially when you look at the ports of L.A./Long Beach, the enormous amount of activity down there, and growing to almost 9,000—or 9 million TEUs a year—that's the containers a year—it's becoming difficult to take it away. And the rail industry has struggled to meet that need.

And the pressure to meet that need comes from the retailers, which, in turn, comes from you and I, when we want to go to the store and buy whatever it is we want to buy. Unfortunately, there was not the capacity built into that infrastructure initially to make that happen. If you'd have told me 15 years ago that we would be importing stuff from China to the extent we are today, I'd a looked at you and suggested that maybe you were thinking something was a little weird.

We have experienced a dramatic economic change in globalization that's impacted all of us. And what's happened, the way we see it, is that the railroads have focused on that and left some of the other carload freight, which—I represent primarily, the carload world—and some of the freight that's domestically—they focused on getting their act together on the international side, and—to deal with that capacity constraint, and probably left a little of the other information—or a little work on the other side of the capacity to a later date. This not means they're not going to address it, but they're focused on getting that intermodal demand met right now.

And that's where the conflict comes. That's where the challenge comes in. There is just not enough capacity out there to move it. As the AASHTO report clearly points out, you're going to have growth in the 60- to 70-percent area over the next 20 years, and they projected that the railroads will only grow by 44 percent.

I would assert to the Committee that the rail industry section of the pie must grow in percentagewise, not just grow as the pie grows. That's the critical nature of what's going on here. The answers are not easy. They're difficult. They're going to be—require the input of government, both at the local and Federal level. They're going to require the input of the users of transportation.

And they're going to require the input of the users of—the providers of rail transportation.

And I would encourage the railroads to sit down with all of us, as we've done already, and start trying to come up with solutions for these problems. They're not going to be easy. It's going to take leadership across the board. And without that sort of effort, we're going to find ourselves in a very difficult position.

Mr. HAMBERGER. We concur.

Senator BURNS. Mr. McIntosh?

Mr. MCINTOSH. Senator, I'd like to respond to your question about remedies that have been pursued outside of congressional action, because I think there's a telling story there.

Industry—the chemical industry has tried to create a solution to this service reliability problem in the same way we would attempt to resolve other commercial issues with other suppliers, vendors, other people we deal with. Many years of work and attempts to change the environment and the accountability with STB have been unsuccessful, as has been alluded to several times.

What's important to the industry—the chemical industry and to our customers are predictability and repeatability, both in our costs and our service level. Recognizing that we are captive shippers, we have approached the railroads directly, and acknowledged that we would be willing to pay higher freight for a level of service and reliability that would be guaranteed. We have been told no. No discussion, no interest. There are no contracts that I have been a party to where any kind of performance guarantee on service or reliability has been entertained by any railroad that I do business with. And so, consequently, having been unable to affect the environment in any other way, and without the benefit of competition as a captive shipper, our only recourse, at this point in time, we believe, is to turn to Congress.

Senator BURNS. Mr. Schuler?

Mr. SCHULER. Thank you, Senator Burns.

In the GAO report, they've clearly stated that railroads have, over the years, attempted to shift their industry to what they're calling right-sizing, where they've reduced both—or all—they reduce track, equipment, and facilities. This has made them more efficient, this has made them more productive, without a doubt; but yet, they fail to pass those savings on to the shippers, especially those who are captive. And also, in that report it is said that rail rates are increasing in areas because of excess demand. Well, the railroads voluntarily created that excess demand by reducing their supply of cars and tracks and other facilities.

And also, grain rates have increased across the country, 9 percent nominally, and that's adjusted for gross domestic product. Other industries may have declined, but grain sees—continues to see increasing rates, especially those captive shippers who are, more and more, paying even higher rates.

Responding to claims that we aren't inviting the railroad to visit with us, we have sat down with the railroad, pleading for rate relief, especially for our captive shippers. We are holding a wheat summit this fall, in September, to address the crisis that we see in agriculture, where our costs are increasing above where our profits will—or our revenues will provide us a profit. One of the invitees is Burlington Northern Sante Fe Railroad to participate in that conference. They're also attending our board meeting this coming October in Denver to visit with us. So, we are having negotiations with the railroad to try to find relief.

We've been trying to find relief for 25 years, with the McCarty Farms versus BN case that drug on for 17 years in the courts, with no relief for farmers. We have visited with the railroads, we've pleaded with the railroads to provide us better service and fairer rates, with no—to no avail. We've talked with the Surface Transportation Board, trying to get an effective mechanism that'll provide relief for these higher rates. And yet, no relief. We feel, and it's my personal opinion, that this—it's long overdue that we have some mechanism. And if it's legislation, that's what it needs to be, with this Senate 919 bill, to provide relief for our producers.

Thank you.

Senator BURNS. Mr. English?

Mr. ENGLISH. I just want to make one other comment, too, Mr. Chairman. For many our members, stranded shippers, we're paying more now for the freight to move the coal to the generating plant than the coal itself costs. The difficulties in reliability our members have run into have become so bad that in some locations they're now importing coal from Indonesia, as opposed to buying coal in this country, simply because of the fact they can't rely on the railroads and some exorbitant issues that surround the cost of that shipment. This doesn't make any sense.

And while we talk about, "Well, we ought to sit down and talk together and work this stuff out," you know, that's what the Surface Transportation Board's supposed to do. And if the Surface Transportation Board isn't doing the job, it's broken. And I would argue, if there's no one that seems to be debating that issue, that they're seriously broken, then the Congress ought to fix it. That's the job of the Congress, is to fix that. And until we get that resolved, captive shippers are going to be abused. There's just no two ways about that. There's no logical way in which you can say that the railroads should be able to make 350–450 percent profit off of captive shippers and, at the same time, leave the captive shippers at the tail end of the bus. We get the last deliveries, because that's where the monopoly is.

We heard about the investment the railroad's going to be making in the future. I'd like to know how much of that investment is going to be made on the coast, as opposed to the interior part of the United States. I'd like to know how much of that is going to be invested to delivering goods from China, as opposed to delivering goods internally here in the United States. I would suggest, and strongly suspect, that that's where the investment's going to be made. It's on the coast, delivering imported goods, not taking care of deliveries here in this country.

Senator LOTT. [presiding] Well, I might say that, representing a coastal state, it sounds good to me.

[Laughter.]

Senator LOTT. They invest along the Mississippi Gulf Coast, that'd be fine.

Thank you all for being here, again. Mr. Hamberger, since you have been outnumbered by a high percentage here, would you like to respond to anything that's——

Mr. HAMBERGER. Mr. Chairman——

Senator LOTT.—been said about——

Mr. HAMBERGER.—thank you. And let me just observe that, in the immediate parlance, I may have gotten a little hot earlier. I may have—frustration bubbled over, and I apologize to you——

Senator BURNS. I'm glad I wasn't here.

Mr. HAMBERGER.—and to the Committee, and certainly no affront was intended either to the dignity of this Committee nor to the respect we owe to all of our customers. And so, I would just like to get that on the record.

There are several issues I guess I would like to respond to. Let's start with grain. And Mr. McIntosh indicated that grain rates have gone up. That is correct. From 1985 to 2004, they've gone up 9 percent, in nominal terms; which means, adjusted for inflation, they have gone down. Meanwhile, the consumer price index, according to the GAO, has gone up 60 percent. So, we are a good deal. We recognize that we need to keep our customers competitive in world markets.

Let me address the issue of where the investments are going to be made. We are a private sector industry. And, in fact, the investments must be made where the returns warrant those investments. And, in some cases, that means that the revenue-to-variable-cost ratio may have to be higher to warrant investment, to make sure that there is, indeed, a network there, that there is, indeed, service to all parts of the country. It is our intent, and from what I can tell, the Union Pacific and Burlington Northern Sante Fe just announced an additional hundred-million dollars to be spent triple-tracking the joint line coming out of Wyoming. So, the investments will be made exactly where the traffic warrants it and where the demand is. And that's the way it should be. We are a private sector industry.

Senator LOTT. Anything else, Conrad?

Senator BURNS. Well, I'm sure going to write out your statement, and then we're going to have a little visit about it.

Mr. HAMBERGER. Yes, sir.

Senator BURNS. I have no other questions, but I just want to say that we've got a greater problem here. We may have identified where part of that problem is today, but I think we're in a position now where it's going to take some legislative fix. And I've got to be talked out of that, one way or the other. And right now, I'm not in that mode.

Mr. HAMBERGER. We'll be in to see you.

Senator BURNS. OK. But I've just got to believe just this. I've picked up two or three reports in the last, oh, probably 6 months that says, even though they look at their efficiency and their proficiency in the railroads—and darn if I can find any of them that goes above 65 percent. We know that the trains are running slower. We know we're down from around 24 miles an hour to around 20 miles an hour in some—in most cases. That tells me that we've got some bed problems. And—or whatever—but, nonetheless—and I see those coal trains roll out of Wyoming and Montana. You say you want to triple track in Wyoming, we'd take a little triple track in Montana, too. But you don't see that happening where there is no competition. That's the point we've got to make. You've got UP and Burlington running a common bed. And we know common beds, in some circumstances, work. But we don't see that kind of improvement in the infrastructure where there's only one railroad.

So, I thank the witnesses today. And I thank them for their information. I thank them for being very frank, because I think it's going to take some very, very frank talk in order to fix this situation for these areas that were up there in yellow. I've got to get a color code on this guy's printer, because I have a hard time delineating all that.

But I want to thank every one of you for coming. This has been a very important hearing.

Thank you.

Senator LOTT. Thank you very much——

Mr. HAMBERGER. Thank you, Mr. Chairman.

Senator LOTT.—to the panel and the previous panel. We appreciate it. We'll look forward to working with you in the future.

The hearing is adjourned.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

A P P E N D I X

SURFACE TRANSPORTATION BOARD
Washington, DC, June 26, 2006

Hon. TRENT LOTT,
Chairman,
Senate Subcommittee on Surface Transportation and Merchant Marine,
Commerce, Science, and Transportation Committee,
Washington, DC.

Dear Mr. Chairman:

Thank you for the opportunity to testify on June 21, 2006, before your Subcommittee on economics, service, and capacity issues in the freight railroad industry. This was a very important hearing and, because of its importance, I would like to correct, for the record, certain troubling statements made by two of the witnesses.

First. Mr. Dale Schuler, testifying on behalf of the National Association of Wheat Growers, stated that the Board, "after repeated complaints from grain shippers in Montana and North Dakota, sided with BNSF, allowing them to continue to single out the areas of their system that are the most captive." While I have personally heard complaints on my two trips to Montana, I am aware of no such complaints to the Board, either formally or informally.

Second, the Honorable Glen English, testifying of behalf of the National Rural Electric Cooperative Association, stated that with regard to rates "[i]n recent years, it has been impossible for shippers to get meaningful relief at the STB." I would point to Exhibit A of my written testimony, which illustrates that shippers over the last 10 years have prevailed in almost half of the rate cases, and each of these decisions has been upheld on judicial review. With respect to issues concerning coal shipping to power plants, I would note that the Board, which has exclusive jurisdiction over rail transportation, has not received even one complaint from any power company in recent months.

Sincerely,

W. DOUGLAS BUTTREY,
Chairman.

PREPARED STATEMENT OF ROSS B. CAPON, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF RAILROAD PASSENGERS

Thank you for the opportunity to submit comments for the record in your June 21 hearing on "Economics, Service and Capacity in the Freight Railroad Industry." Thank you also for holding a hearing on such an important topic.

Beyond that, we appreciate your strong support for intercity passenger rail, particularly as reflected in S. 1516, and S.A. 1627.

The National Association of Railroad Passengers has both a specific and a general interest in a healthy, reliable railroad network where average speeds are increasing, not decreasing, and where high profile customers like UPS are adding traffic to the network, not moving it from rails to trucks out of frustration over slow rail service.

Our specific interest, of course, is to see that railroads do a good job of running Amtrak and commuter trains. Amtrak's current and recent experience is not good. In addressing our Association's board of directors on April 28, Amtrak Acting President and CEO David Hughes said that, where Amtrak uses freight railroads, on-time performance dropped over 50 percent from 1999 to 2005. It appears that things have gotten still worse this year.

Capacity problems are a major factor. If an Amtrak train is delayed on a single-track railroad while a fleet of freight trains are allowed to run in the opposite direction, that likely is a reasonable decision by the dispatcher, though perhaps also an indication that the railroad should be double-tracked.

Another major factor, however, is bad dispatching, for example, when a slow freight is dispatched just ahead of Amtrak, or when a freight train is switching on the mainline in front of Amtrak. On June 10 at Terrell, Texas, Amtrak's northbound *Texas Eagle* (Train 22) was delayed over 30 minutes while a rock train switched on the mainline. Some of these sorts of delays appear to reflect contempt for Amtrak higher up in railroad management. We urge the Committee to take whatever action it can to improve Amtrak on-time performance in the near term. The rest of this statement is devoted to longer term track capacity issues.

The Association's general interest in rail reflects our belief that greater reliance on freight and passenger rail would serve the national interest. This belief is widely shared by the general public, as reflected in a Harris poll conducted in December (before the more recent run-up in gasoline prices). Rail is widely recognized as maximizing energy and economic efficiency, minimizing environmental damage, and increasing the safety of our overall transportation system.

Regarding energy, the recently-published *Transportation Energy Data Book: Edition 25* (2003 data) again shows the extent to which railroads are more energy efficient than both domestic water carriers and trucks. Rail averaged 344 British Thermal Units (BTUs) per ton-mile compared with 417 for water carriers. "Heavy single-unit and combination trucks" consumed 23,461 BTUs per mile, while railroads' averaged 15,016 BTUs per freight car mile.

Unfortunately, the U.S. faces a huge challenge just for rail to maintain its existing market share. As Association of American Railroads (AAR) President and CEO Edward Hamberger explained at page 26 of his prepared statement:

> "AASHTO [in its *Freight Rail Bottom Line Report* released in January, 2003] estimated that railroads will need to carry an additional 888 million tons of freight annually by 2020 just to maintain their current market share. AASHTO also found that railroads will need $175 billion to $195 billion of infrastructure investment over this period to accommodate this traffic growth, and projected that the railroads will be able to fund the majority of this investment—$142 billion—from their own retained earnings and borrowing. Unfortunately, according to the AASHTO analysis, the $142 billion will be enough to enable railroads to handle only half of their expected increase in traffic. This funding shortfall means that many projects that would otherwise expand capacity and improve the ability of our Nation's farms, mines, and factories to move their goods to market; speed the flow of imports and exports; relieve highway congestion; reduce pollution; lower highway costs; save fuel; and enhance safety will be delayed—or never made at all."

In other words, even if we can achieve the policy shifts needed to allow rail to maintain its market share, truck traffic would continue to increase in absolute terms as the economy grows. [The AASHTO report was issued by its Standing Committee on Rail Transportation, which at the time was chaired by Joseph Boardman, the current Federal Railroad Administrator.]

AAR favors public-private partnerships and investment tax incentives. As an example of the former, he cites the $1.5 billion Chicago "CREATE" project (Chicago Region Environmental and Transportation Efficiency Program) "involving the State of Illinois, the city of Chicago, and the major freight and passenger railroads serving Chicago." The difficulty CREATE has had getting adequate funding, especially the small share Federal contribution to date, reminds us how tough the needed "policy shifts" will be. If Chicago has this much trouble, what will come of a similar, badly needed project for New Orleans that is under development?

The AASHTO figures Hamberger cites suggest public funding needs for freight rail are between $33 billion and $53 billion through 2020. Some of the legitimate, capacity-enhancing investments that will depend on public support may be not lend themselves so obviously to specific "publics" for the "public-private partnership" to work. Indeed, there may not be enough "CREATEs," that is, projects with benefits that draw in public partners, to yield public funding anywhere near $33–53 billion.

Thus, there needs to be consideration of how to develop a Federal program that identifies and addresses other projects. Developing such a program potentially involves traversing a minefield of objections—from railroads that oppose any Federal action with the slightest impact on the competitive positions of different railroads, and from shippers that want Federal investment on railroads conditioned on provisions the railroads would consider unacceptable "re-regulation."

The investment tax credit AAR supports presumably also would help close the big gap AASHTO identified, by stimulating more private sector investment than AASHTO projected. NARP's supports the investment tax credit, but believes that there should be an emphasis on capacity that also benefits intercity and commuter passenger trains or that improves the efficiency of publicly supported entities. Continued tax benefits should be tied to reliable operation of passenger trains—at least 90 percent on-time performance. The magnitude of the benefits could be increased where the investment speeds up scheduled running times and/or permits more frequent passenger train operation.

Obviously, we strongly support the on-time performance provisions in S. 1516.

Finally, having cited AASHTO's freight report and its spending recommendations, I need to highlight two items related to rail *passenger* investments.

- AASHTO's other January 2003 report, Intercity Passenger Rail Transportation, said about $17 billion needs to be invested in intercity passenger rail corridors over the next 6 years, and $43 billion over the next two decades.
- Amtrak's Fiscal 2007 Grant Request recommends, as a "strategic investment option," a $50 million capital matching program aimed at "chokepoints" on the freight network, and says the program could be administered by DOT, in cooperation with Amtrak, the freight railroads and the states.

Both of the above would benefit freight operations, just as many passenger-inspired investments already have benefited freight—notably, in California, capacity improvements for the Los Angeles Metrolink (commuter rail) system and on BNSF's San Joaquin Valley line, and restoration of double-track west of Sacramento on Union Pacific.

Thank you, Mr. Chairman, for your yeoman efforts to create a funding mechanism that would let the Nation begin to address these needs.

Thank you for considering our views.

PREPARED STATEMENT OF THE BURLINGTON NORTHERN SANTA FE RAILWAY (BNSF)

BNSF believes that the GAO study finding with regard to grain rates in Montana to be overstated in at least two respects:

1. The data relied upon by GAO in its study did not take into account various discounts and other allowances from BNSF's published grain rates that were being paid by BNSF in 2004. There are three separate discounts paid on a regular basis on each shuttle train movement of grain originating in Montana. First, under its Origin Efficiency Program, BNSF pays the shipper a discount of $100 per car provided that the shuttle train is loaded within 15 hours. Second, under its Destination Efficiency Program, BNSF pays the receiver of the shuttle train $100 per car provided that the shuttle train is unloaded within 15 hours. Third, the holder of the shuttle train certificate is paid $100 per car for each trip made pursuant to the holder's volume commitment under the shuttle certificate. These discounts amount to $300 per carload of grain moving in shuttle trains originating in Montana and are paid on the vast majority of shuttle train movements in Montana. Any accurate calculation of the revenue/variable cost ratio must take account of these discounts.

2. Also, since 2004 BNSF has taken significant rate reductions to its shuttle train rates for wheat originating in Montana. For example, at the beginning of 2005, the per car rate on wheat moving in a shuttle train from Collins and Macon, Montana, was $2,811 and $3,629 for movement to the Pacific Northwest. Through a series of rate decreases during 2005 and 2006, the current per car wheat rates in shuttle trains are $2,481 for Collins and $3,175 for Macon. These reductions amount to about 12 percent. Similar rate reductions have taken place from other Montana origins. The GAO study, because it used earlier data, does not reflect these very significant rate reductions.

The impact of the first point indicates that the GAO finding that 39 percent of grain tonnage moving in Montana at a Revenue/Variable Cost (R/VC) ratio in excess of 300 in 2004 is substantially overstated. The second point shows that today the amount of tons moving in Montana producing a R/VC ratio in excess of 300 would be even smaller.

PREPARED STATEMENT OF THE PORTLAND CEMENT ASSOCIATION (PCA)

The Portland Cement Association (PCA) appreciates the opportunity to submit testimony to the Subcommittee regarding economics, service and capacity issues in the freight railroad industry. The current national rail policy and lack of capacity impedes portland cement manufacturers from effectively and efficiently delivering an essential commodity needed to build our Nation's vital infrastructure and strengthen our Nation's economy. With more than 80 percent of portland cement manufacturing plants served by (or "captive" to) a single Class I railroad the current rail policy is unnecessarily contributing to higher construction costs.

What Is Portland Cement?

The term "portland" cement is not a brand name—rather, it is a generic name for the type of cement used in concrete, just as stainless is a type of steel. Portland cement is a manufactured powder that acts as the glue or bonding agent that forms concrete. As an essential construction material and a basic component of our Nation's infrastructure, portland cement is utilized in numerous markets, including the construction of highways, streets, bridges, airports, mass transit systems, commercial and residential buildings, dams, and water resource systems and facilities. The low cost and universal availability of portland cement ensures that concrete remains one of our Nation's most essential and widely used construction materials.

Portland Cement Association

PCA is a trade association representing cement companies in the United States and Canada. PCA's membership consists of 31 companies operating 102 manufacturing plants in 36 states. PCA members account for 98 percent of cement-making capacity in the United States. The cement industry is a crucial component of one of the largest segments of our Nation's economy—the more than one trillion dollar construction industry. Nearly every construction project requires portland cement. In 2005, 127 million metric tons of portland cement were consumed in the United States; in fact, cement is the second most consumed commodity on the planet, second only to water.

U.S. Cement Industry Demographics

The cement industry operates manufacturing plants in 36 states, producing nearly 96 million metric tons of portland cement in 2005. Cement manufacture is a highly capital-intensive industry. Cement companies invest millions of dollars annually to upgrade manufacturing equipment and phaseout more costly and less energy efficient operations. Between 1994 and 2003 the cement industry invested $7.542 billion in new capital investment. The construction and permitting costs of a new greenfield cement plant can easily exceed $250 million. Only two greenfield plants have been constructed within the past 10 years.

Cement is produced from various abundant raw materials including limestone, shale, clay and silica sand. These minerals are ground and heated in large rotary kilns to temperatures as high as 3,400 degrees Fahrenheit. The heat of the combustion fuses these materials into clumps of an intermediate material called clinker. When the clinker is discharged from the kiln, it is cooled and later ground with a small amount of gypsum to produce the gray powder known as portland cement. Different types of portland cement are manufactured to meet various physical and chemical requirements.

Portland cement manufacturing facilities use an enormous amount of energy. In fact, energy is the largest cost component in the manufacture of portland cement. The U.S. cement industry is largely coal fired with 81.3 percent of all plants using coal, coke, or some combination of the two as primary kiln fuel in 2004. The domestic cement industry is the largest industrial consumer of coal. Much of the coal utilized to heat cement kilns on a 24/7 basis is delivered by rail.

The cement industry is regional in nature. Most cement manufacturing plants are located in rural areas near large limestone deposits, the principal ingredient in producing cement. However, at the same time plants also must be located near markets because the cost of shipping cement quickly overtakes its value. As such, customers traditionally purchase cement from local sources. Texas, California, Florida and Pennsylvania, are the leading cement manufacturing states, respectively, producing nearly 36 million tons in 2005 or 37.4 percent of domestic cement production.

U.S. Cement Manufacturers Rely on Railroads

Considering the regional nature of the cement industry, it is critical that there are reliable and cost-effective transportation options available. Average cement shipments range between 250 to 300 miles. Truck transportation is not economical beyond 125 miles. As such, the cement industry is reliant on railroads to deliver our product beyond the economical range of trucks. Several cement plants have access to water transportation for domestic shipments. The railroads have sometimes argued that these cement facilities are not captive since there are alternative modes of transportation available. This simply is not the case. Domestic portland cement manufacturers rely on rail transportation to move 50 percent of all shipments between cement plants and distribution terminals, according to 2004 U.S. Geological Survey data, the most recent independent figures available. About 95 million tons of cement was produced domestically in the same year. Most bulk cement shipments are from the manufacturing plants to the more than 400 regional distribution terminals, where the cement is then delivered by truck to local contractors and ready mixed producers. It is vitally important to our industry that the railroads provide reliable, efficient and cost-effective service to meet the widespread demand for our product. As mentioned earlier, more than 80 percent of U.S. cement manufacturing plants are captive to a single railroad. Due to the absence of competition, these plants are charged substantially higher rates and usually receive poor service. On the other hand, dual rail-served facilities typically have lower rates and more reliable service.

The railroads also transport millions of tons of inbound coal shipments to fuel cement manufacturing plants each year. There are examples within the industry in which cement plants that are served by two railroads receive coal from a supplier that is captive to a single railroad. There are also instances where both the cement plant and the coal supplier are captive to a single railroad. These situations result in unnecessarily high rail rates that add to the cost of cement and, ultimately, to construction costs. PCA members have also reported situations in which they were forced to transport coal to the cement plant by truck, at a substantial cost, due to delivery failures by the railroad. In these instances, the situation confronting the cement plants were desperate: they had only a day or two of coal supply on hand.

U.S. Cement Industry Largely "Captive" and Service Suffers

The Staggers Act of 1980, which removed regulations of the railroad industry where transportation competition exists, has improved the industry's efficiency and financial stability. However, since deregulation, there has been a sharp decline from 63 Class I railroads in 1976 to just four major Class I railroads today handling 90 percent of the Nation's rail traffic. This consolidation has contributed to diminished competition as well as ineffective and inconsistent rail service for the cement industry and many others.

Inconsistent and unreliable service from the Class I railroads is one of the most serious problems the portland cement industry confronts in our efforts to bring an affordable and essential product to market. Service encompasses many aspects of rail transportation, including picking up rail cars (typically covered hoppers), on-time delivery of rail cars, providing empty rail cars, handling issues, questions about the condition of the rail cars, and settling claims for service failures. The cars supplied by the railroads are typically old, poorly maintained and frequently a safety concern. Our members report that as many as 15 percent of the empty rail cars delivered to manufacturing plants in a given week are being rejected.

In recent years, several cement companies have been forced to purchase private rail cars since the Class I railroads have refused to add cement rail cars to their fleets. This, in addition to the declining and inconsistent service, has increased the need for more rail cars to deliver the same tonnage. Meanwhile the railroads have added tariff provisions charging for the storage (demurrage) of private rail cars. This results in further increased costs to the cement shipper while providing no incentive to the rail carriers to improve their service.

Further compounding the problem is the fact that at some locations, the railroad will only quote freight rates to the cement company if the cement company uses their (system) rail cars. In short, no product will move from that origin unless the railroad is collecting revenue for the use of their rail cars. In other instances, the railroads quote rates such that the difference in cost of a movement in a private rail car is so great that private rail car transports are not economical. Rail car supply is a classic Catch 22 situation that adds unnecessarily to the cost and inefficient shipment of our product and, ultimately, to construction costs.

While service continues to decline, cement manufacturers are experiencing sharp rail freight rate increases. For example, some rates increased more than 23 percent in 2005, according to some cement companies. Indeed, transit times on empty return cars have increased by more than 13 percent in some instances, increasing fleet storage costs.

PCA Supports Service Provisions in Legislation

The cement industry has no recourse regarding rates since cement (officially "hydraulic cement") is classified as an exempt product from rate regulation by the Surface Transportation Board (STB). Since the STB has done little to address service issues, we believe Congress should enact legislation expanding the STB's authority in this area. The STB should be required to post a description of each complaint from a customer about rail service. The legislation should also require the Board to submit an annual report to Congress regarding rail service complaints and describe the procedures the Board took to resolve them. Further, either party should be allowed to submit a dispute over rail service to the STB for "final offer" arbitration. These provisions are included in bipartisan legislation (S. 919), *the Railroad Competition Act of 2005.* These service provisions contained in S. 919 do not constitute "re-regulation," a term coined by the railroad industry to overstate the perceived negative impact of the legislation.

We believe strongly that the lack of rail competition is the fundamental issue associated with these problems. PCA believes it is important to strike a balance between regulation of the railroad industry while also assuring rail competition. PCA believes that the intent of Congress in the Staggers Act was only to deregulate the railroads where competition exists. Unfortunately, the implementation of the Act has resulted, often, in deregulation even where there is no transportation competition—with predictable results such as those we are reporting.

The following example further illustrates the unintended consequences of the Staggers Act, as implemented, on a captive shipper.

PCA member Holcim (US) Inc. established HolRail, a limited liability corporation, to construct and operate a two-mile rail line that would provide competitive rail service to the Holcim cement manufacturing plant in Holly Hill, South Carolina. Presently, Holly Hill is served only by CSX Transportation, Inc. (CSX). The proposed line would connect to a rail line owned by the Norfolk Southern Railroad Company (NSR).

Holcim is one of the largest suppliers of portland and blended cements and related mineral components in the United States. It ships more than 20 million tons of cement and related materials each year, of which 16 percent moves by railroad. Holcim has 14 manufacturing facilities and approximately 70 distribution terminals across the country and employs approximately 2,500 people in the United States.

The Holly Hill production facility manufactures a variety of cement and masonry products and relies on rail transportation to receive inbound raw materials and to ship outbound products. In August 2003, Holcim completed a plant expansion project that increased the size of the facility and doubled output capacity to two million tons of cement per year. A substantial portion of Holly Hill's production is shipped by rail to Holcim distribution terminals to serve markets that are over 100 miles from the facility. Because trucking cement over distances greater than 100 miles is uneconomic and impractical, Holly Hill requires reliable, economic, and efficient rail transportation to reach optimal plant utilization.

When the Holly Hill plant operates at full capacity, the plant annually receives 3,500 inbound rail cars with fuel and raw materials and ships out 10,000 rail cars with cement. As the only rail carrier with direct access to the Holly Hill plant, CSX transports all inbound raw materials and outbound products that move by rail. CSX's service track record is weak. Its service is unreliable and inadequate, and CSX appears to be completely indifferent to Holcim's requirements and requests for service improvements. For example, CSX has refused to allow Holcim to use its private railcar fleet to transport Holly Hill's products even when CSX cannot provide its own cars to meet the needs of the plant! CSX recently eased its objection to this practice. The CSX equipment is in poor condition and is routinely rejected at the Holly Hill facility. By contrast, two other cement plants in the Holly Hill area that are not captive to a single railroad are freely allowed to ship product in private cars without the restrictions that CSX imposes on Holcim.

In addition to CSX's inadequate railcar service and its restrictions on private cars, CSX charges Holcim rates that exceed those paid by the two nearby cement manufacturers that have competitive rail service. By obtaining rail competition, through its "build out" to NSR, Holcim will place Holly Hill on equal footing with other comparable cement facilities that have access to more than one railroad.

CSX's consistently poor service, which has caused Holcim to lose business opportunities in the past, simply cannot meet the needs of Holly Hill's expanded production capacity. Holcim believes that competition between CSX and NSR at Holly Hill will produce more responsive, more reliable, and better rail service. Improved rail service will support the facility's increased production and allow Holcim to supply distant markets and to compete in new markets.

Additionally, rail-to-rail competition will lead to a reduction in rail rates, making Holly Hill more competitive with non-captive producers. Accordingly, HolRail, the Holcim subsidiary, has filed a petition with the STB to construct a two-mile rail line, running south from the Holly Hill plant to the NSR line. The petition is currently pending before the STB.

Another example of the unintended consequences of the Staggers Act involves a captive east coast cement company that must transport cement 300 miles by rail to its distribution terminal to meet customer demand. The applicable rail rate is so outrageously high the cement company concluded that importing cement from China to the east coast is less expensive than shipping it 300 miles by rail.

Demand for Cement to Increase

United States cement consumption reached a record high during 2005, peaking at 127 million metric tons and reflecting growth of 5.6 percent over strong 2004 levels. The near term outlook for the cement market remains strong. Growth in cement consumption is expected to materialize due to continued increases in construction activity as well as increases in the use of concrete and cement per construction dollar spent. Despite the likelihood that the growth boom in residential housing construction may be nearing an end, gains in nonresidential and public construction are emerging as new sources for growth in construction activity. Gains in these areas are expected to outweigh modest declines in residential construction—resulting in a continuation of growth in construction activity. Furthermore, various influences suggest that the increases in concrete and cement usage per dollar of construction activity will continue. The combination of sustained strength in construction activity and cement usage per dollar of construction activity is expected to result in new cement consumption records in 2006 through 2007 and beyond. From 2005's record levels, cement consumption is expected to grow 3.5 percent in 2006 and another 2.5 percent in 2007.

Cement and concrete are literally one of the building blocks of our Nation's economic growth. Strong cement demand reflects the need for business to expand commerce by way of increasing its physical properties, whether it be retail shops, warehouses or office buildings. It also reflects the need for Federal, state and local governments to build new schools, improve its road systems and general infrastructure. It also reflects the need to build new housing to meet growth in population and household formation. Furthermore, according to the Bureau of Census, the United States population is expected to grow by 68 million persons in the next 25 years. As a result, new demand for commercial, public and residential construction activity will increase. According to PCA's long term forecast, cement consumption is expected to grow from 127 million metric tons in 2005 to 200 million metric tons in 2030.

To meet the future U.S. cement and concrete requirements, the United States cement industry currently is engaged in its most aggressive capacity expansion in the industry's history. Based on announced and permitted plans, by 2010 the industry will add 18.6 million metric tons (20.6 million short tons) of clinker capacity—representing a 19.8 percent increase over 2005 capacity levels and a $4.1 billion commitment. The capacity expansion reflects a mix of greenfield sites, plant modernizations, and expansions of existing facilities. In addition, the industry is committed to the expansion of its import facilities—amplifying the industry's commitment to expand all sources of supply to meet the national economy's rising need for cement and concrete. At least 63 percent of the new capacity expansion and modernizations underway at existing facilities are captive to a single railroad. Although three greenfield facilities are scheduled to start production during this period, the cement industry is largely limited to modernizing and expanding its capacity at existing facilities because of high construction and permitting costs to build a greenfield cement plant. Since cement industry capacity expansion must follow projected market demographics largely based on population growth, much of the expansion will occur in the southern and western regions of the United States where the vast majority of the cement facilities are captive to a single railroad. In short, the cement industry is forced to expand capacity where it is captive to a single railroad—despite our industry's concern about that captivity.

While the industry has proven it commitment to providing reliable and adequate supplies of cement and concrete to meet U.S. needs, these efforts are partially offset by existing rail constraints. The existing lack of adequate rail capacity impedes portland cement manufacturers from effectively and efficiently delivering its product to the marketplace. The rail capacity shortfall relative to existing requirements of the economy is reflected in a rapid run-up in rail freight rates—rising by 11.7 percent in 2005 according to the Bureau of Labor Statistics. As the economy grows and more cement capacity is put in place, it is likely that existing rail constraints will be exaggerated, potentially leading to a repeat of the large rate hikes experienced in 2005. Furthermore, it is important to recognize that other essential building materials rely heavily on the railroads to move product to market—amplifying the adverse consequences of rail constraints on overall economic growth.

Construction currently accounts for approximately 6.7 percent of total economic activity. One out of every 18 jobs in the U.S. is directly employed by the construction industry. Since 2000, growth in construction employment has accounted for 30 percent of the United States' total employment growth. Very little construction activity can materialize without utilizing concrete at some stage of the construction project. Impairment in the ability to deliver cement to market efficiently, impairs construction activity and represents an issue that could impede future growth in this important sector of our Nation's overall economic activity.

Freight Railroad Infrastructure Tax Credit

The Class I railroads state that they are committed to expanding capacity and improving service, spending an estimated $6.6 billion for capital expenditures in 2005 and projecting to spend a record $8 billion in 2006. To further enhance capital improvement and increase capacity, the Class I railroads are seeking a 25 percent Federal tax credit to leverage private investment in rail infrastructure improvements and other capital expenses. The proposal reportedly would also make the tax credit available to certain shipper funded rail projects.

PCA supports increasing investment in the Nation's rail infrastructure to meet the current and future freight transportation needs. As the Class I railroads report profit increases, now is the time for the railroad industry to bolster investment to expand capacity and improve service, especially for captive shippers that typically pay much higher rates and experience poor to marginal service.

PCA would be inclined to support a tax credit if Class I railroads are required to invest in rail capacity projects that would provide relief to captive shippers. This requirement would have the benefit of reducing highway congestion, creating a more efficient freight rail system for all shippers, including particularly domestic shippers who generally are the ones that are captive, and heavy truck traffic on our highways and local streets, thus reducing highway maintenance cost. Requiring that the tax credit for rail capacity enhancements be focused on the infrastructure needed to serve captive rail customers would be the most prudent and sound use of taxpayer dollars. The cement industry also believes that Congress should further study the concept and feasibility of a railroad trust fund, similar to the Highway Trust Fund, to finance rail capacity and capital projects. Finally, we want to see any tax benefit for the railroad industry coupled with legislation that addresses the concerns of railroad customers that the rail industry be more competitive.

The higher rates and unreliable service often associated with captive cement plants often forces our industry to transport cement by bulk tank truck to distribution terminals and customers at a much higher cost. It is critical that cement manufacturers maintain adequate inventories of product to meet contractor demand. Contractors utilizing portland cement in large-scale concrete paving projects, for example, need a constant and reliable supply of cement to meet construction time tables and to plan for weather delays and other construction complications. Just as contractors expect timely shipments of cement from the cement company, it is the obligation of the railroad, we believe, to deliver shipments of cement in a timely manner.

Conclusion

U.S. manufacturers need a vibrant and profitable rail industry to support our Nation's economic growth. The portland cement industry is a vital component of our Nation's construction industry, which supports the backbone of our Nation's growing economy. It is essential that the portland cement industry have access to a competitive rail transportation system to ensure that our product is delivered in a timely and efficient manner to our customers who build our Nation's critical infrastructure fostering economic expansion. With more than 80 percent of the cement manufacturing plants and a similar ratio of the industry's 400 distribution terminals held captive to a single railroad, combined with the inadequate service at these facilities, only adds to our Nation's construction costs. Demand for cement is forecast to increase for the foreseeable future, only exacerbating this problem.

PCA strongly urges the Subcommittee to further examine S. 919, *the Railroad Competition Act of 2005,* especially provisions that would expand STB's authority over service-related issues. This provision, among others, would help provide some relief for captive industries, such as the cement industry.

Thank you for the opportunity to submit testimony to the Subcommittee on this important issue.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. CONRAD BURNS TO W. DOUGLAS BUTTREY

Question 1. I hear a lot of concern from rail customers about two rulings of the STB that are perceived as preventing competition—in direct conflict with what Congress directed the STB to do, which was work toward competitive markets and protect shippers where there is no competition. One concern is the "bottleneck" decision that, essentially, says that a railroad does not have to provide a customer a rate to a point where a movement may move onto a competing railroad. Second, both the STB and the ICC before it have approved what I believe are anti-competitive contracts—known as "paper barriers"—in track lease agreements between the major railroads and short lines meaning that short lines may only do business with the railroad leasing the track, even though the short line might connect to another major carrier.

Your agency has the authority to take administrative action to promote competition, yet these decisions do just the opposite. Can the STB act on its on initiative to change these rulings or must someone bring a request to the STB that it change its ruling on these issues? If you can, then why don't you?

Answer. The STB has the authority to initiate hearings and rulemaking proceedings to address issues like those described above. As an illustration, we are having a hearing on July 27 to examine the role of "paper barriers" in the rail industry. That hearing will explore questions such as whether the agreements are anti-competitive, whether they are harmful/beneficial, the extent of such agreements in the industry and the agency's remedial powers.

The Board has not acted to modify the bottleneck decision, which was premised on pronouncements by the Supreme Court in *Great N. Ry.* v. *Sullivan,* 294 U.S. 548 (1935). Since the 1980 Staggers Act and the 1995 ICCTA did not disturb any portion of the Court's ruling in the 1935 decision, the Board has concluded that that decision is settled law.

Question 2. To what extent can the STB initiate investigations of railroad practices in markets where it sees abuses of pricing power, or severe deficiencies in service?

Answer. The STB has broad authority to issue emergency service orders for a total of up to 270 days to address clearly emergency situations in freight rail service. Under 49 U.S.C. 11123, our emergency powers can be used to address serious rail service disruptions whether they result from damage to rail tracks and facilities, from serious congestion of the rail network, or from the inability of a carrier to meet its transportation obligations for whatever reason. The STB can exercise these powers on its own initiative.

In contrast, under 49 U.S.C. 11704, we cannot investigate the reasonableness of common carrier rates unless the shipper files a formal complaint with the Board.

Question 3. Does the STB take its duty to provide for competition and protect shippers seriously, or does it simply sit back and wait for shippers to jump through all the hurdles and expense of filing an actual rate case?

Answer. We take our duty to protect captive shippers very seriously. In the last 6 months, we have initiated a series of proceedings to investigate general complaints from the captive shipper community, addressing such issues as fuel surcharges, paper barriers, and the complexity and expense of our rate cases. But if a complainant wants rate relief, the statute requires that it first file a complaint with the Board. For a large rail rate dispute, a captive shipper would seek relief under our Constrained Market Pricing guidelines, which is an expensive process. If, however, the value of its case cannot justify the expense of a full stand-alone cost presentation, the captive shipper may use our simplified guidelines, and pay only a $150 filing fee.