STB Chairman Martin J. Oberman
RailTrends Speech
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Good afternoon. Once again, I am honored and happy to join you at RailTrends. Actually, I am a little surprised I am still asked to join you at RailTrends. I have a few subjects I would like to cover with you today.

First, I would like to note a number of positive developments across the national network.

Earlier this year, the Board approved the CP-KCS merger, the first merger of Class I railroads in more than 20 years. That merger created the first single-line railway connecting Canada, the United States, and Mexico. CPKC has focused this service on growing rail traffic and has committed to shifting approximately 64,000 truckloads annually from road to rail. Among other benefits, there will be an enhancement of intermodal traffic to and from both Canadian and Mexican ports and hopefully stimulation of US ports to up their game.

Since then, there have been a number of other advances towards the goal of better competition for intermodal traffic and moving more freight from truck to rail. Although I make no claim that these developments were direct consequences of the merger, the timing is persuasive. For example, shortly after the merger, UP teamed up with CN and Grupo Mexico, launching a new intermodal service product, called "Falcon Premium," which will connect CN origin points within Canada and Detroit to Grupo Mexico's terminals in Mexico. Subsequently, CN and NS announced a new domestic intermodal service, linking CN-served Canadian markets with Norfolk Southern-served Kansas City and Atlanta. They will offer essentially a "single-line" intermodal product, also with the intent to convert truck traffic to long-haul rail.

Not long thereafter, maritime and logistics services company Crowley teamed up with CN to provide integrated rail and ocean service between Mexico and the U.S. Midwest and Canada, increasing both companies' use of the Port of Mobile. And then last week, CN announced a new arrangement with the Port of Gulfport to also move goods between the Gulf Coast, US Midwest, and Canada.

As you know, since joining the Board in 2019, I have focused much of my attention on the lack of competition among railroads and the need for the Board to use its authority to promote competition wherever possible. All of the developments listed above are signs of increased opportunities for competition between carriers and should benefit not only rail customers but more importantly, our national economy and the general public, with more productivity and ultimately lower consumer prices.

I ask only, what took so long? Every one of these developments was there for the taking long before the CP-KCS merger. But at least we now have movement.

There have been additional promising initiatives which should increase options for shippers and achieve a meaningful shift of traffic from trucks to rail. In particular, not long ago, CP and CSX announced a business deal they say will create a new direct CPKC-CSX interchange connection in Alabama and significantly upgrade track—and therefore train speed—on track connecting with the Meridian Speedway. This initiative is aimed at establishing a new and more efficient freight corridor connecting Mexico, Texas, and the U.S. Southeast while also relieving pressure on other congested terminals like New Orleans. These railroads say the proposal, if approved by the Board, promises to take thousands of shipments off the highways and on to rail.

Also, CSX and the state of Alabama continue to work at greatly expanding CSX's intermodal facility in Montgomery to move more containers coming into the Port of Mobile. And the entire Board recently visited the Port of Savannah which, under the leadership of Griff Lynch, is working with NS and CSX to build new inland ports, replacing permanently the pop-up yards that were used temporarily to relieve congestion at the port during the height of the supply chain crisis. As compared to Mr. Lynch's—and not the railroads—taking the initiative to develop the pop-up yards during the depths of the pandemic, recent changes of leadership at NS and CSX give reason to be optimistic that the railroads will be more enthusiastic partners in future growth projects and not indifferent bystanders.

But perhaps the most encouraging development of this past year—and a sign of what might be the railroads' potential to serve our economy and environment when they put their efforts into it—is the very recent announcement by BNSF and J.B. Hunt of their new Quantum service. BN and Hunt promise to provide 95% on-time delivery of intermodal containers, which they say matches the performance of trucks, but at a lower price.

Hunt says there is a potential of moving between seven and eleven million truckloads to rail. If they are successful, this means eliminating hundreds of millions of tons of CO_2 from the atmosphere and saving massive wear and tear on the highways. The wild and destructive weather patterns of just this past year should underscore why it is so urgent for railroads to up their games to help combat climate change.

Underscoring why the goals of the BNSF-J.B. Hunt deal are so important to the future of our industry, for years, shippers, especially those who do not now use rail, have told us and the railroads that lack of reliability is the principal reason they have given up on rail when they have any alternative. Thus, BNSF's plan to deliver 95% on time performance—the same as truck—is exactly the direction rail needs to pursue to grow traffic—as all the railroads now proclaim—and could set a marker for the rest of the industry to emulate.

One has to examine the crucial investments BNSF is making to enable it to promise this kind of reliability. Unlike some of its U.S. counterparts, BNSF has not held back on major capital spending to build necessary infrastructure—and I mean expansion capital beyond routine replacement of rails and ties. BNSF is investing $1.5 billion in Barstow to build entirely new intermodal capacity. In addition, BN has double tracked almost all of its southern Transcon and is now investing millions to effectively complete the triple tracking of that route through Kansas. The railroad is triple tracking its difficult areas in California so faster trains can get past slower traffic.

For a railroad to deliver 95% reliability, this is the kind of spending that is required. But are the other railroads taking the necessary steps to a similar place? Just saying that one has a "70 miles per hour railroad"—as touted by Union Pacific—for example, does not satisfy. What good does it do for a train to be able to go 70 miles per hour when its customers are still waiting for their shipments with unreliable service at the other end?

For example, UP has recently reported that its car velocity is up to 210 miles per day with a goal of reaching 220 miles. But, if the trains are actually moving at 70 miles per hour, they are covering those 210 miles in 3 hours.

Try as I might to understand this industry in the nearly five years I have been at the Board, I still cannot understand what those trains are doing for the other 21 hours each day. Is this PSR? Is it built into the plan for the precision and the scheduling to just have them sit without moving? If so, being precise and scheduled is not doing much for the economy, or the shippers, or for the PSR railroad, for that matter.

So aside from the admirable approach taken by BNSF to improving its physical infrastructure, what has been the record of the industry as a whole? In the last 14 years, across all Class Is, the railroads have extracted $253 billion dollars—that's over a quarter of a trillion—of profits out of their businesses and sent them back to their shareholders in buybacks and dividends.

One might say that number is staggering. At the same time, over the same 14 years, railroads report spending less than $40 billion total on so-called expansion capital, which adds to the railroads capacity to operate faster and more reliably. That is a total of less than $3 billion per year spread across all Class Is—a pittance when compared to over 1½ trillion dollars in revenues generating $336 billion in net income during the same period. I talk about this issue every year—because it's fundamental to the endemic problem in this industry.

Even more disturbing was the railroads' decision during the same time to slash their workforces. Again, I talk about this every year because it is essential to understanding the railroads' health. In the years leading up to the pandemic in 2020, in relentless pursuit of lower ORs, the Class Is got rid of about 20% of their workforce—a reduction of approximately 30,000 employees. When the pandemic hit, the railroads—with no meaningful forethought—immediately fired another 10%—or another approximately 13,000 workers. So by late summer of 2020, the Class Is had about 42,000 fewer workers than just prior to the onset of the PSR craze.

As carloads began to quickly return during the summer of 2020 and throughout 2021, service deteriorated so badly that the STB conducted urgent hearings in April 2022 to address what one Wall Street analyst aptly described as a "service crisis." Since those hearings and the STB's ordering the four U.S.-based Class Is to develop service recovery plans, the railroads fortunately have begun efforts to reverse the drastic cut in work force; as of today, there are approximately 9,000 more workers across all Class Is than at the low point in 2020. But that still leaves us many thousands of workers fewer than in late 2019 and about 32,000 fewer than during pre-PSR times.

And while, with significantly lower volumes traversing the networks, current service metrics have improved and many shippers report improved service, it's essential to keep in mind that we are measuring that improvement against an extraordinarily low bar. We still have a long way to go to build up the railroad industry to the point where it can truly compete with the reliability of trucks and, even more importantly, provide the resources American industry needs to grow.

Why do we have an industry in which the business owners demand that so much of the profits be removed and sent back to them instead of investing in the business for long-term growth and long-term profitability? Logic tells us that these stockholders must be under the impression that they can get richer by pulling their money out of railroads and investing in other industries, ever chasing the rainbow of a better return.

Why? I think the answer is twofold. First, for too many years, much of the corporate leadership of these railroads utterly failed to lead, failed to enlighten their owners that the railroads will succeed in producing a better and longer return on investment if they spend more of their profits on building infrastructure and retaining the workers needed to regain their share of the market, which they have been consistently losing to truck over the past few decades---and even more importantly, attract new customers and more revenue.

Second, this failure of corporate leadership did not happen in a vacuum. Sometime around 15-20 years ago, you folks on Wall Street discovered the money that could be made by rail monopolies. Monopolies can raise prices and cut costs by cutting both the quality and quantity of output and thereby generate enormous short-term profits, or to put it in terms gifted to us by the inimitable Tony Hatch, this triggered the birth of the cult of the OR.

And this cult has led to rising stock prices and huge payouts to shareholders at the expense of capital investment and a strong work force. And corporate leadership did not consist of innocent bystanders. They knew what it takes to run a robust railroad—and were capable of doing so. Yet, because they are compensated substantially by stock and stock options, they were happy to be rewarded by rising stock prices and payouts based on stripping their companies of needed resources.

Has Wall Street learned anything from the service meltdown of the last few years, which railroad management conceded at our hearings was caused by a severe shortage of rail workers? Before I answer that question, let's look at some of the good signs among some of the Class Is.

I already pointed out the initiatives of both the CP-KCS merger and the actions of other railroads to develop their own approaches to increasing intermodal service and competition to the single-line service across the North American continent. More importantly, new leadership at some of the railroads has shown a much more enlightened approach to investing in needed assets, both human and physical.

In particular, Alan Shaw at NS and Tracy Robinson at CN have, for more than a year, publicly committed their railroads to cease engaging in furloughs as volumes on their networks move through hills and valleys—all in contrast to the drastic cuts by previous management.

CSX has also committed to ceasing furloughs. And under the leadership of Joe Hinrichs, CSX was the fastest of the big four railroads to achieve its service recovery targets after last years' service hearings and has sustained its performance since then. At BNSF, Katie Farmer has also disavowed the furlough mantra and I already described her railroads significant investments in its infrastructure. Keith Creel at CP, too, has no furlough plans and has shown a clear entrepreneurial spirit and a willingness to invest, not only in the KCS acquisition, but in other parts of his network.

UP also has a new CEO who I have gotten to know in the past few weeks. While I am prepared to say that we ought to give Mr. Vena more time to show what he's going to do with the railroad, in sharp contrast with other railroads, his first few moves leave me concerned—if not unnerved and bewildered. Since Mr. Vena took office in mid-August, UP has engaged in four separate reductions of force—furloughing 94 mechanics almost immediately, followed by more than 40 carmen—then astonishingly, announced furloughs of 1350 maintenance of way workers starting two days from now—November 19—until sometime in January. In fact, the notices to furloughed maintenance of way workers went out yesterday. These furloughs will necessitate reducing previously budgeted maintenance during the last six weeks of this year by tens of millions of dollars. And, if budgeted for this year, presumably it is maintenance that needs to be done. Thus, this is a lot of maintenance that will be deferred until next year—or what can only be called "deferred maintenance"—historically not helpful in the railroad industry.

The Brotherhood of Maintenance of Way Employes estimates that as many as 400 of these furloughed workers will never return—as was the experience with the massive furloughs during the pandemic. Will these steps of deferring planned maintenance result in slow orders and deteriorated service? Only time will tell—but it's a real concern,

Ironically, UP's stated reason for these furloughs is that the railroad is over budget in maintenance spending because of, as it says, "catastrophic weather events" this past year. And are the folks at UP such perfect weather prognosticators that they can assure us there won't be another polar vortex in January which would require the efforts of those hundreds of furloughed workers? Last winter, UP embargoed three entire Midwestern states because of the snow.

In any event, after the maintenance of way furloughs were announced, Mr. Vena capped off these efforts by terminating 5% of UP's management positions. All of these reductions come after UP had already reduced its overall workforce by around <u>**33%**</u> since 2015.

It's not that UP doesn't have the cash to keep these workers employed. As it has done historically, the railroad is committed to paying hundreds of millions of dollars in more dividends by year's end. And it has already paid out $1.8 billion in dividends this year.

Indeed, UP tells us—and I am reading from UP's corporate email to the union—that the furloughs result because of "necessary budget controls in today's business environment." In other words, the most natural explanation for these furloughs and reductions is to make UP's year-end financials look better.

What's troubling is that Wall Street analysts know that these adjustments to the financial statements don't reflect real improvements in performance—and that they are just accounting maneuvers aimed at supporting UP's stock price. And these actions come after we just finished a period during which UP, alone among the railroads, was subject to two emergency service orders during 2022—the first issued by the STB in over 10 years—and a year during which it had instituted a massive upsurge of 1100 embargoes annually, which it called "congestion embargoes" and which it conceded at our public hearings last December were largely caused by crew shortages. Fortunately, since those hearings, UP has largely abandoned the so-called "congestion embargo" program.

So, the important question remains: Has Wall Street learned anything? Will it be friend or foe of encouraging railroads to help grow the nation's economy and get trucks off our highways?

Here's some evidence—which is not promising. A few examples will suffice. Last May, CN held an investor call and laid out its plans to increase capital spending as a percentage of income. Listen to the call. The analysts in the room did not greet Tracy Robinson and her plans with applause. But to Tracy's great credit, she has stood her ground and continues to commit CN to increasing its capital program to enable it –hopefully—to grow its volumes.

Then, in October, at NS's third quarter earnings call, Alan Shaw was met with significant pushback from a number of analysts over NS's difficult financial picture this year, to a large extent caused by a unique event in East Palestine. Even to the point of one analyst suggesting that NS hire a so-called "PSR expert" while completely ignoring NS's industry-first decision to create a new position of Vice President of first mile/last mile and hiring a respected short-line expert for the job—exactly what the industry needs if it's going to improve local service, which is where a major portion of service failures occur.

Again, showing the kind of back bone his industry needs, despite the Wall Street pushback, Alan stuck to the commitments he announced last December to not lay off workers when carloads dropped—as they have this year—and instead continue to build the railroad's resources in an effort to out-compete and provide good service as volume returns.

By contrast, at the UP third quarter earnings call, despite the announcements of large layoffs, I didn't hear any analyst challenge Mr. Vena on whether UP was embarking on a path of reducing its resources to the detriment of its customers. So, the pressure from Wall Street against robust investment by railroads is not gone.

As we have seen over a number of years, this approach has resulted in a non-virtuous circle—with Wall Street rewarding with praise those CEOs who cut spending regardless of the negative impacts on service, rail customers, and ultimately the U.S. economy. That praise for these tactics causes stock prices to rise, thereby rewarding these same CEOs whose compensation depends largely on stock. This, of course, incentivizes them to continue the failure to spend what is necessary to provide the kind of reliability that all concede is a prerequisite if the railroads are going to grow volume. Thus, it will take a strong-willed CEO to buck that pressure and instead undertake to educate his or her shareholders—and the board if necessary—on just why there will be better long-term benefits to their return on investment by putting more of the profits back into building and maintaining the railroads' resources, a strategy which will benefit shippers and the public, as well as the railroads' owners.

The obvious question is why should a government official be standing up here making pronouncements as to how shareholders should invest their money? It should be just as obvious that the reason is that these shareholders have put their money in not just any industry, but in an industry which has been imbued with a public interest mandate—the common carrier obligation—since it came into existence two hundred years ago, a concept inherited from medieval England hundreds of years earlier, as was much of our legal tradition.

Based on what I have seen over the last five years, it's clear to me that reliance on the common carrier obligation has been allowed to atrophy, not only by the railroads and their customers, but perhaps by the Board as well. So, let's review that doctrine for a moment to compare its requirements to how the railroads have too often operated in recent years, as though the doctrine had disappeared. And I want to emphasize that these ideas are not the wishful thinking of some reform-minded STB Chairman named Oberman. Rather, they come from the highest authorities in our legal system.

One hundred and twenty-six years ago, the U.S. Supreme Court explained the fundamentals of the doctrine. This is so important that I'm going to read verbatim what the Court said in 1897:

> "It must also be remembered that railways are public corporations organized for public purposes, granted valuable franchises and privileges, among which the right to take the private property of the citizen without his consent [in invitum] is not the least; that many of them are the donees of large tracts of public lands, and of gifts of money by municipal corporations, and that they all primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders."

[<u>United States v. Trans-Missouri Freight Ass'n</u>, 166 U.S. 290, 332–33, 17 S. Ct. 540, 555–56, 41 L. Ed. 1007 (1897).]

That they all primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders.

> "The business which the railroads do is of a public nature, closely affecting almost all classes in the community, —the farmer, the artisan, the manufacturer, and the trader. It is of such a public nature that it may well be doubted, to say the least, whether any contract which imposes any restraint upon its business would not be prejudicial to the public interest."

[United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 332–33, 17 S. Ct. 540, 555–56, 41 L. Ed. 1007 (1897).]

The clarity, certainty, and significance of this requirement is magnified when you realize that these words were written by Justice Rufus Peckham, one of the most conservative and notorious anti-government regulation theorists on the Court during the progressive era and the Gilded Age of railroad wealth. You can look it up. So, if Justice Peckham could understand and underscore the importance of not draining the railroads' resources through excessive shareholder payouts, so should we all.

This law was not changed by the idolized Staggers Act. Rather, that Act restated the common carrier requirement and emphasized that the statute incorporated the common law doctrine. And to be absolutely clear, since Staggers, the Federal courts have uniformly reasserted the doctrine's basic tenets articulated by the Supreme Court decades earlier.

For example, in 1998, 18 years after Staggers, the Eighth Circuit Court of Appeals stated:

> "At the very heart of the common carrier obligation is the belief that railroads are in a position of unique public trust." The Court highlighted "the well-established principle that railroads 'are held to a higher standard of responsibility than most private enterprises.'" The Court concluded that under this principle, "a railroad may not refuse to provide services merely because to do so would be inconvenient or unprofitable."

[GS Roofing Prod. Co. v. Surface Transp. Bd., 143 F.3d 387, 393, 391 (8th Cir. 1998).]

And of great importance, the law is clear that in a common carrier case, the burden is on the railroad "to provide a reasonable explanation" in order to justify its failure to provide service. [State of Montana v. BNSF, NOR 42124, slip op. at 7 (STB served Apr. 26, 2013).] This is a crucial point. So as the STB has ruled, a rail carrier cannot make its [common carrier] service contingent upon guaranteed profits from that service. [Pejepscot Indus. Park, Inc. d/b/a Grimmel Indus.—Pet. for Dec. Ord., FD 33989, slip op. at 13 (STB served May 15, 2003).]

As another federal Appellate Court explained, "[a] carrier must anticipate problems and provide against them" and "is required to use diligence and care in the performance of its duties," concluding that, "[t]he carrier is not excused if the interference with its service could have been avoided by forethought." [Johnson v. Chicago, M., St. P. & P. R. Co., 400 F.2d 968, 972 (9th Cir. 1968).]

And earlier this year, the STB, albeit not unanimously, adhered to these principles when we ordered rail service based on the unexceptional proposition that if a railroad has capacity to provide the service requested, at least without disrupting service to other customers, the common carrier obligation mandates that it do so.

What do we learn from this quick course in common carrier law? First, that there is sound public policy behind the common carrier doctrine and its prioritizing protection of the public interest for at least three reasons:

1. The very existence of the railroads as businesses resulted to a large extent from government—that is, the public's largess;
2. For the most part, railroads operate as monopolies for a major portion of their customers; and
3. As should be obvious to this crowd, the very existence of many of those customers—and the U.S. economy as a whole—depends in large part on a full-throated freight railroad network. Indeed, the railroads are the foundation of at least 40% of the U.S. economy.

Second, for all of these reasons, unlike almost any other business in the United States, fundamentally, a railroad cannot simply sit on its hands as problems and foreseeable needs pile up and then say that it can't carry a shipper's load because it doesn't have the means to do it.

So the reason why a government official is standing up here and re-emphasizing that the nation's railroads have an obligation to provide funding for the resources needed to allow rail-dependent industries to not only survive, but to thrive; in order to ensure that the public interest in a strong and growing economy is served; and in these times of climate crisis, to use the railroads' vast resources to help alleviate that crisis, the reason is simple: it's the law.

The railroads "primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders."

So here's some free advice to all railroad CEOs: The next time Wall Street analysts or even your own shareholders push back on your spending more money on capital and labor and less on buy backs and dividends, just say: "Justice Peckham made me do it."

In closing, as many of you know, my first five-year appointment to the Board expires on December 31. After much consideration of the work the Board and I have been able to accomplish and my own circumstances, I have decided that I will not seek re-appointment for a second term. I will, however, continue to serve several months into next year under the statutory holdover provision. I still have much work to do and many initiatives to complete. I have informed President Biden's administration of my plans. I look forward to saying more over the next few months about lessons learned—and opportunities for our country—achievable through a robust railroad industry, including possible paths on how we might get there.

It has truly been a privilege to serve in this role with the teamwork of four other truly thoughtful, committed, independent, and constructive board members, along with an extremely talented and dedicated organization of professionals and support staff. I have developed deep respect and appreciation for this industry, not only its challenges and complexities, but its enormous responsibility to the nation.

Railroads, with government help and on their own, have played an essential role in enabling the United States to develop by far the world's most advanced and successful economy, which has contributed, in an overall sense, to our country's top standard of living. And yet, as constructive as the industry has been, it has not yet lived up to its real potential. Rail service and productivity could be so much better, and I think we all know it.

My efforts at the STB—even when they may have been annoying to some members of the industry—have all been aimed at pushing and nudging the industry towards achieving that immense but as yet unrealized potential. I am confident that day will come, and I will be watching for it as my personal adventure continues after leaving next year. Thank you.