

SPRING 2014 UPDATE

SPEECH

NATIONAL COAL TRANSPORTATION ASSOCIATION

Good morning. I'm Dan Elliott, Chairman of the Surface Transportation Board. I'm happy to be here this morning. This conference is a great opportunity for me to meet with stakeholders in an informal setting, to learn about new developments in the industry, and to speak about the work of the Surface Transportation Board. I would like to thank the National Coal Transportation Association for extending its invitation. Even more importantly, I would like to thank NCTA for appearing at the Board's April 10 rail service hearing. Given that we're still in the midst of some fairly significant service difficulties, I'm going to focus the first part of my remarks on that issue and then move to other matters that are happening at the Board.

I know that the recent months have been extraordinarily challenging for many rail shippers, including coal shippers. By and large, rail carriers across the nation have indicated that their level of customer service has suffered. There is some disagreement among stakeholders as to how and why certain railroads found themselves unable to meet expectations, but I think everyone agrees that it has been a very difficult period. It is imperative that things improve as quickly as possible.

A number of factors no doubt contributed to what some call a “perfect storm” for subpar rail service. This winter, sustained frigid temperatures in certain areas, coupled with significant snow accumulations, created challenging railroad operating conditions. This harsh weather brought on mechanical impediments, from frozen switches to failing air-brake pressure. The carriers had to make adjustments to safeguard MOW employees from dangerous working conditions and train crew movements were disrupted due to local conditions. In some areas, railroads reduced their train lengths, requiring additional locomotive power to move the same volume of traffic.

At the same time, traffic increased, sometimes in ways that some railroads acknowledge they did not adequately anticipate. In both the U.S. and Canada, the grain harvest yielded a bumper crop. The same lines carrying that crop yield were those already seeing a marked increase in traffic volumes related to shale oil production – primarily frac sand shipments and unit train movements of oil. Colder temperatures increased demand for electrical generation, putting pressure on utility stockpiles. Intermodal traffic continued to rebound, in connection with the strengthening of the broader economy, bringing additional traffic into the major east-west gateways.

How much of the cause of the service problems is attributable to weather and how much is based on traffic shifts/carrier management decisions is the subject to debate. I know that shippers are frustrated. Today I am going to focus on the resulting service difficulties but, as you can tell from our hearing, we are also trying to get a better understanding of the underlying causes – with an eye toward making sure that the

carriers are doing everything they can do to improve service for all shippers and to learn from this experience going forward.

The Board began to receive a growing number of informal service complaints near the beginning of winter. Shippers and shipper organizations from several different commodity groups - including agricultural, coal, chemical - reached out to the Board, typically through our Office of Public Assistance, Governmental Affairs and Compliance (“OPAGAC”) – the “eyes and ears” of the agency. Their reports included the inability to obtain empty railcars; lost production and potential shut-down scenarios due to delayed delivery of critical raw materials; lost business from severe logistical constraints; and, costly diversion of freight to other modes. Moreover, the operating metrics we always monitor began to show troubling trend lines on train speeds and terminal dwell, particularly on CP and the northern segments of BNSF.

As the service issues increased, OPAGAC, particularly the staff of our Rail Customer & Public Assistance (“RCPA”) program, worked behind the scenes with shippers and railroad contacts to

resolve individual service issues and to mitigate disputes. RCPA held weekly service calls with CP and BNSF, regular calls with operating personnel from other carriers, and conference calls with shipper organizations. It also intensified its monitoring of rail performance measures. Through diligent and aggressive efforts, OPAGAC assisted in averting shut-down scenarios for several chemical and coal shippers, and worked to improve the movement of grain shipments. OPAGAC also had meetings in Fargo, ND with dozens of shippers from several states (and with BNSF and CP) to better understand the service issues. OPAGAC is planning additional field meetings in other impacted areas in the near future.

In the face of increasingly dire reports, the Board Members also increased communications with carriers. Vice Chairman Begeman and I sent a joint letter to the chief executives of CP and BNSF, the carriers experiencing the most severe service disruptions. We asked for detailed information relating to the causes of the problems and the plans for service recovery. We also requested immediate in-person meetings with senior level executives, so that we could personally convey our concerns and

gain a better understanding of remedial efforts. These meetings were held at STB headquarters in mid-February and early March. Shortly thereafter, WCTL filed a petition explaining that service was declining significantly for coal traffic and asking the Board to commence a formal investigation.

Following WCTL's petition, and in response to the looming service crisis, the Board announced and held a hearing on April 10th in Washington, DC to receive comments from railroad and shipper speakers. From my perspective, there were four key goals: (1) to better understand the nature and extent of service issues across the network; (2) to have the carriers present their plans to restore the network to normal operating conditions; (3) to hear from shippers about their difficulties and their perspective on the proposed solutions; and, (4) to make sure that the flow of information among our stakeholders improved. At the hearing, we heard from 9 separate panels, comprising over 40 speakers, including Senator Thune of South Dakota, FRA Administrator Joe Szabo, and South Dakota Secretary of Agriculture Lucas Lentsch. We also received written comments from over 25 parties.

On April 15, as a result of what we heard at the hearing, the Board issued an order directing CP and BNSF to provide plans to ensure fertilizer delivery in time for the spring planting season. The carriers are providing data on an ongoing basis with regard to these movements. In that decision, the Board indicated that it continues to monitor service issues and is considering further action. We obviously only want to take actions that will improve, rather than exacerbate, the situation, and doing that takes careful consideration.

From my description of the Board's activities, you can see that we use various tools and take a hands-on approach to real-time issues. What do all of the Board's efforts in the service crisis have in common? They are intended to facilitate the recovery of rail service in the most severely impacted areas, and to enhance cooperation among our stakeholders to restore the fluidity and efficiency of the network. I believe that our carefully considered efforts have helped to focus all the stakeholders, especially railroads, on a swift resolution. Although the rail network remains vulnerable and service levels are still sub-

optimal, I am confident that the rail industry has the know-how and expertise to come out of this difficult period. Our job is to hold them accountable for doing that. Some of the most recent data suggest that the industry is turning the corner and gaining momentum, and I will be watching closely to see if that improvement is sustained.

I think the service issues have shed a bit more light on the “hands-on” monitoring and involvement of the Board in the railroad industry, which goes on all the time but often goes unnoticed. Some stakeholders may look at us as an agency that deals mostly with legal and policy matters on paper but we do more than that – and not just during times of crisis. We pride ourselves on being open and accessible to our stakeholders, and we are eager to make our resources available. I appreciate coal receivers and shippers letting us know about their service difficulties. The reliability of the rail energy transportation network remains a key priority for the Board, in particular because of the potential downstream consequences of service disruptions for businesses, the general public, and the economy. Representatives from the Board’s RCPA program are here today

and are available to meet with anyone, shippers or railroads, regarding service issues. I urge coal shippers to continue to work with RCPA when you need service assistance.

As big as the service issues are, as you know, the Board is also handling many other important issues. The agency's mission is governed by the Rail Transportation Policy, a set of general principles established many years ago by Congress. In short, the Board is charged with striking a balance between shippers and railroads that fosters a vibrant domestic railroad industry, while promoting efficient, competitive, safe, and cost-effective transportation for rail customers. Railroads must be able to earn adequate revenues, which allow them to reinvest in their networks and to attract outside capital. At the same time, American companies and farmers must be able to ship their products by rail at affordable prices with responsive and reliable service. In a perfect world, these goals could be seen as complementary, rather than conflicting: Lower rates would attract traffic to the rail system, bringing greater revenues, facilitating re-investment in rail infrastructure, leading to better service, enticing more traffic, and so on . . .

But, as all of you know, things don’t always work out as we might wish; a rail carrier’s idea of profit-maximizing behavior might not be the same as that of a particular shipper, and, on top of that, various forces can and do disrupt the market. Often, these disruptive forces spawn conflicts between railroads and their customers, requiring the attention and involvement of the Board. Although we are often referred to as an industry “watchdog,” I want to assure you that we do not simply “watch” events from inside the Capital beltway, waiting for formal cases to be filed. As our response to the service issues demonstrates, we look at emerging problems and try to work proactively with railroads and shippers to find solutions. Thus, our role goes beyond refereeing legal, economic and policy disputes and includes doing what we can to ensure that the rail system is functioning properly to support the Nation’s economy. During my tenure, I have strongly supported this aspect of our mission. With that said, I want to briefly summarize our more significant legal and policy matters:

As many of you know, the Board is currently examining competitive rail access in a proceeding referred to as “Ex Parte 711.” This case is an outgrowth of our general examination of competition in the rail industry back in 2011.

In the wake of that investigation, we received a petition from the National Industrial Transportation League (“NIT League”), in the summer of 2011, asking us to adopt new competitive access rules. By “competitive access,” I mean how a shipper served by only one railroad can obtain access to a second railroad through a regulatory process. NIT League proposed a four-part test, setting standards that would allow access to a competing railroad at an interchange point within a reasonable distance of the shipper.

After an initial review of NIT League’s petition, we found that we could not make a ruling without a better understanding of the proposal’s repercussions across the industry—for both railroads and shippers. Therefore, we asked our stakeholders for information such as:

- which rail interchanges would be affected;
- how many shippers would qualify for relief;
- the effect on rates and service for shippers who would qualify for relief;
- the effect on rates and service for shippers who wouldn't qualify;
- how the incumbent and competing railroads would be affected in terms of rates and operations;
- the overall effect on railroad traffic volumes, efficiency and revenues; and,
- how we should price competitive-access, if it were to be granted.

Our stakeholders submitted detailed comments, and, in March 2014, we held a two-day public hearing on the proposal. We heard from, and were able to directly question seven witness panels, comprised of proponents and opponents of the proposal. These presentations were very informative, and helped to crystallize some of the key issues. I know that everyone wants a timeframe for when the Board will determine whether to issue

proposed rules. I do not have that for you today, but please know that we continue to carefully review the record and the testimony in this important and complicated proceeding.

In the area of rate regulation, we initiated a new proceeding in December 2013 to look at whether grain shippers have meaningful access to relief. We know that many grain shippers are captive. But, despite our efforts to simplify our rate case procedures, we have not received a formal rate complaint from a grain shipper in over 30 years. Opening comments in the proceeding are due May 12th, and July 11th is the date for reply comments. We will review the submissions of our stakeholders to examine whether there are hurdles preventing grain shippers from challenging unreasonable rates. I also anticipate that we will hold a public hearing in this case.

Our inquiry into rate relief for grain shippers follows a rulemaking from July 2013, where we adopted several reforms to improve our rate reasonableness case procedures. I'll give you a quick overview:

Regarding our simplified procedures, we removed the \$5 million cap on damages in Simplified-SAC cases. With no limit on relief for simplified-SAC cases, we hope that more shippers will use these streamlined rules to challenge unreasonable rates in appropriate cases. Similarly, we increased the level of relief available under the Three-Benchmark test -- our other simplified rate case framework -- from \$1 million to \$4 million. The higher ceiling better reflects the costs of litigating a case and potential damages.

In SAC cases, the Board made certain technical changes. In particular, we modified the manner in which the revenue from cross-over traffic is allocated between the hypothetical, stand-alone railroad and real-world railroad. We also adjusted the interest rates due on damages. (As is not unusual, these changes to the Board's rate procedures are the subject of judicial appeal. Oral argument was held a couple of weeks ago.)

On the technical side of our work, we've proposed changes to our rail costing methodology, the Uniform Rail Costing System -- known as "URCS" -- so that it better reflects railroads'

economies of scale in handling larger shipments. This is important because we use URCS in determining our jurisdiction over a rate that has been challenged in a rate case. We are reviewing the comments filed in response to the proposed rule. Separately, we are also seeking comments on whether a Department of Energy fuel index should continue to be used by railroads as a basis for measuring their fuel surcharges.

A few weeks ago, we announced another proceeding to examine revenue adequacy for the railroad industry. The Board is required by statute to determine on an annual basis which railroads earn adequate revenues. In the past, we have periodically adjusted our methodology, which was originally established by our predecessor, the Interstate Commerce Commission. During the past decade, both the structure of the rail industry and the flow of commerce have changed significantly. We determined that a new examination of our standards is in order, and we have requested comments from stakeholders on this process. Opening comments are due July 1, 2014. Reply comments are due on August 15, 2014. We anticipate holding a public hearing in this case.

Also this month, we issued final rules governing liability for the payment of demurrage, completing a proceeding that we initiated in December 2010. Under our new rules, a person receiving rail cars from a rail carrier for loading or unloading who detains the cars beyond the “free time” provided in the governing tariff will generally be responsible for paying demurrage, if that person had actual notice, prior to rail car placement, of the demurrage tariff establishing such liability. Our rules will hopefully resolve conflicting interpretations of demurrage liability flowing from two Federal court decisions that reached different conclusions in cases with very similar facts. In this same proceeding, we also clarified a statutory provision related to liability for payment of rates, finding that it applies to line-haul rates but not charges for demurrage.

I also want to mention the final rules that we adopted last September, which enhance the disclosure requirements for interchange commitments—commonly called “paper barriers.” I know this issue has been important to certain coal shippers. The new rules require submission of more information about an

interchange commitment and advance notice to affected shippers. The goal is greater transparency so that we can give additional scrutiny to those transactions that may pose competitive issues contrary to the public interest.

We have also made progress revamping the Board’s Alternative Dispute Resolution (“ADR”) processes. As many of you know, during my tenure, I’ve worked hard not only to develop an effective ADR program but also to promote its use by our stakeholders. This is part of my effort to get beyond the “shipper versus railroad” mindset, and to facilitate practical and creative solutions that are “win-win,” rather than “win-lose.” I think that a skilled arbitrator or mediator can often lead parties to mutually beneficial outcomes that are far less likely to emerge from expensive adversarial litigation.

Last summer, we adopted final arbitration and mediation rules. For arbitration, we created an “opt in” program in which shippers and railroads may agree in advance to arbitrate certain classes of disputes. We chose matters that are often inconvenient to litigate: demurrage, accessorial charges,

misrouting or mishandling of rail cars, and tariff rules and practices. Parties can also voluntarily agree to arbitrate other disputes on a case-by-case basis. A three-person panel or a single arbitrator will preside, and damage awards are capped at \$200,000. Cases are designed to move quickly, reaching a decision in six months or less—faster, typically, than a formal proceeding before the Board.

For mediation, we made similar changes. The rules establish procedures under which the Board may order parties to mediate certain types of disputes, even if both parties haven't agreed to mediation. The Board will be able to order mediation, or grant a mutual request for mediation, at any time in an eligible proceeding. Unless the parties want to use a non-Board mediator, we will appoint Board staff as mediators. Our staff is especially well-suited because they understand both sides of the issues and have specific expertise, which should make each side comfortable with the process. The parties would be required to pay the expenses of outside mediators.

The Board is always here to resolve disputes that parties can't. However, when ADR can help parties reach a mutually acceptable solution, I strongly encourage parties to give it a try in lieu of formal proceedings. We've even launched a new "Litigation Alternatives" webpage on the Board's website for information on our activities in this area.

On the institutional side, as many of you know, the full Senate confirmed Debra Miller as a new Board Member on April 9. She served as Kansas Secretary of Transportation for 9 years, and brings over 30 years of transportation expertise to the Board. Commissioner Miller started at the Board yesterday, and I look forward to working with her. Additionally, we expect to hire to fill a number of positions that have been vacant for some time. We also anticipate replacing our retiring employees. My goal is to maintain our highly-talented workforce and to recruit effectively from the private sector and other agencies – it helps that we've been named the Best Place to Work among small government agencies for five years running.

In closing, I want to thank you for this opportunity to speak about the Board and its work. The Board will continue to conduct public outreach and hold hearings on significant matters and rulemaking proceedings, so that the Board and its staff can hear directly from our stakeholders such as the NCTA and its members. I would be happy to answer questions.

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