

SPRING 2014 UPDATE

SPEECH

INDUSTRIAL MINERALS 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 Industrial Minerals Association for extending its invitation.

IMA represents companies supporting diverse and important segments of our Nation's economy from energy production to home construction to auto manufacturing to health care. Many mineral products such as sand and gravel, bentonite, soda ash, and phosphate are shipped in high volumes by railroad. For 2012, the latest year for which complete waybill data is available, the industry shipped nearly 1.5 million carloads. In

2013, your industry saw a sustained increase in its carload traffic, which is continuing into 2014. A good portion of this increase reflects the astronomical growth in shipping of frac sand by railroad. Since 2010, the primary origin states in the upper Midwest -- Wisconsin, Minnesota, Illinois, and Nebraska -- have seen ten-fold increases in outbound carloads. I know that reliable and cost-effective rail transportation of your products continues to be critical to your industry.

Given that we're still in the midst of fairly significant rail service difficulties, I'm going to focus the first part of my remarks on this issue and then move to other matters that are happening at the Board.

Recent months have been very challenging for many rail shippers, including members of IMA. By and large, rail carriers across the nation have acknowledged that their performance has suffered. There is disagreement among stakeholders as to how and why certain railroads fell short of service expectations. But, I think everyone agrees that this has been a difficult period. It is imperative that operations improve as quickly as possible.

A number of factors contributed to what some might call a “perfect storm” for subpar rail service. Over the winter, sustained cold temperatures, coupled with significant snow accumulations in certain areas, created challenging railroad operating conditions. The harsh weather caused mechanical failures, disrupted crew movements, and forced some railroads to modify operating practices.

At the same time, traffic patterns changed in ways that certain railroads acknowledge they failed to anticipate adequately. In both the U.S. and Canada, the grain harvest yielded a bumper crop. The same lines carrying that crop were already seeing a marked increase in traffic related to shale oil production – both frac sand and unit train movements of oil. Colder temperatures increased energy demand, putting pressure on utilities to replenish coal stockpiles. And, intermodal traffic continued to rebound, bringing additional traffic into the major gateways.

What portion of the service problems is attributable to weather and what portion is attributable to traffic shifts and carrier

management decisions is subject to debate. Both railroads and shippers are frustrated. At the Board, we continue to actively investigate the service problems to solidify our understanding of the underlying causes – with an eye toward making sure that the railroads are doing everything they can to improve service for all shippers. The railroads must learn from this experience going forward, and implement appropriate contingency measures.

Near the beginning of winter, the Board began to receive a growing number of informal service complaints. Shippers from various commodity groups - agricultural, coal, chemical, and others - reached out to the agency, typically through our Office of Public Assistance, Governmental Affairs and Compliance (“OPAGAC”) – the “eyes and ears” of the Board. 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, operating metrics that we always monitor began to show troubling trends on train speeds and terminal dwell,

particularly on Canadian Pacific and the northern segments of BNSF Railway.

As service issues proliferated, OPAGAC, particularly the staff of our Rail Customer and Public Assistance (“RCPA”) program, worked behind the scenes with shippers and railroads to resolve individual service issues. RCPA initiated 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. Additionally, OPAGAC held meetings in Fargo, ND with dozens of shippers from several states to better understand their service issues.

In the face of increasingly dire reports, the Board Members amplified communications with railroads. Vice Chairman Begeman and I sent a joint letter to the chief executives of CP and BNSF, the railroads 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 requested immediate in-person meetings with senior level

executives, so that we could personally convey our concerns and gain a better understanding of remedial measures. These meetings were held at STB headquarters in mid-February and early March.

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. Mr. Jeff Burket of AMCOL International shared his difficult experience with bentonite traffic moving from Wyoming. Additionally, we received written comments from over 25 parties.

On April 15, the Board issued an order directing CP and BNSF to provide plans to ensure fertilizer delivery in time for the spring planting season. Both carriers are providing data on an ongoing basis with regard to these movements. Additionally, RCPA representatives have held informal meetings with shippers and other interested parties in Sioux Falls, SD and Bloomington, MN, and will host another meeting in Montana, in June.

From my description of the Board's activities, you can see that we use various tools and take a hands-on approach to events in real-time. We obviously only want to take actions that will improve, rather than exacerbate, the situation, and doing that takes careful consideration. I believe that our carefully considered efforts have helped to focus all the stakeholders, especially railroads, on a swift resolution. 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 we will be watching closely to see if that improvement is sustained.

The service issues have shed 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. We pride ourselves on being open and accessible to our stakeholders, and we are eager to make our resources available. I encourage IMA and its members to let us know about their service difficulties. Reliable rail transportation of industrial minerals is a key priority for the Board, in particular because of the downstream consequences of service disruptions for businesses, the economy and the general public. I urge shippers to work with RCPA when you need service assistance.

As big as the service issues are, 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 railroad's idea of profit-maximizing behavior might conflict with the service needs 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 illustrates, we look at emerging problems and try to work proactively with railroads and shippers to find solutions. 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.

After receiving detailed comments on the impact of a competitive access proposal by National Industrial Transportation League, we held a two-day public hearing on the issue in March 2014. 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. We will receive public comments over the summer, and I 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 review. Oral argument was held several 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.

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, in April, 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.” 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 agency administration side, as many of you know, the full Senate confirmed Debra Miller and she joined the Board at the end of April. She served as Kansas Secretary of Transportation for 9 years, and brings over 30 years of transportation expertise to the Board. It is great to have her on board. 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 cases and rulemaking proceedings, so that the Board and its staff can hear directly from our stakeholders such as the IMA and its members. I would be happy to answer questions (at least those that do not relate to pending cases).

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