TESTIMONY OF
DEB MILLER
ACTING CHAIRMAN
SURFACE TRANSPORTATION BOARD

BEFORE THE
SUBCOMMITTEE ON RAILROADS, PIPELINES, AND HAZARDOUS MATERIALS
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
U.S. HOUSE OF REPRESENTATIVES

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

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

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

AN EVOLUTION OF REGULATION

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

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

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

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

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

In response, Congress passed a series of laws aimed at deregulating the industry, in what many considered a last-ditch attempt to save it. First, Congress passed what is commonly known as the 3-R Act in 1973, in which seven bankrupt railroads were ordered to be merged into one surviving entity that became the Consolidated Railroad Corporation, better known today as Conrail. A few years later, in 1978, Congress continued on the de-regulatory path by passing the 4-R Act, which introduced some relatively modest de-regulatory measures. But the most significant step occurred in 1980, when Congress passed the Staggers Act.

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

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

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

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

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

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

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

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

WHAT DOES THE STB DO?

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

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

The agency's mission is governed by the principles established in the Staggers Act. The Board is charged with promoting an efficient, competitive, safe and cost-effective rail network by enabling railroads to earn adequate revenues that foster reinvestment in their networks, attract outside capital, and provide reliable service. At the same time, the Board is also mandated with working to ensure that effective competitions exists between railroads and to maintain reasonable rates where there is a lack of effective competition. As a Board Member, my job is to strike a balance between these shipper and railroad interests. While those interests are inextricably woven together, they can also diverge. The STB works very hard to take measured actions that are in the spirit of Staggers, and we are acutely aware that every decision we issue impacts real people and real businesses.

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

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

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

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

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

LIVING THE STAGGERS ACT: THE WORK OF THE BOARD

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

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

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

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

Due to these unresolved issues, the Board last April invited public comment on what it means to be revenue adequate and how such a finding should impact the railroads; and how to apply the revenue adequacy constraint in regulating rates, among many other issues. At the hearing, we plan to discuss the parties' views on these matters.

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

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

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

Rate Cases. The Board is also examining our method for regulating railroad rates. It is well-known to our stakeholders that our current process, known as the Stand-Alone Cost test, is cumbersome and expensive. Under the SAC test, a shipper must demonstrate that if a competing railroad entered the market, it could offer the same level of service, cover all of its costs, and still earn a reasonable return on investment, for a price less than what the defendant railroad is charging. Although I believe that the test is based on sound economic principles, it is the execution that creates difficulty, as the process of designing a hypothetical railroad is a herculean task.

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

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

Rail Service. I want to focus on one of the most important issues the Board has dealt with over the last year and a half, and that is consistent and reliable rail service. As I was settling into my new role as a Board Member, changing traffic patterns, demands on service, a bumper grain harvest and frigid weather descended upon the railroads and shippers in the Winter of 2013-2014 in ways that no one anticipated. Service deteriorated across the rail network. Chicago, the epicenter of railroading, was frozen solid. If there was an opportunity for heavy-handed regulatory action, this was it. Instead, the Board responded through a balanced approach consistent with the underlying framework of the Staggers Act. The Board was vigilant, looking for ways to assist shippers and railroads to keep their commodities moving under circumstances that at times seemed impossible. At the same time, we were cautious against heavy-handed regulatory actions that would retard, rather than promote the railroads' recovery efforts and further destabilize the market.

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

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

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

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

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

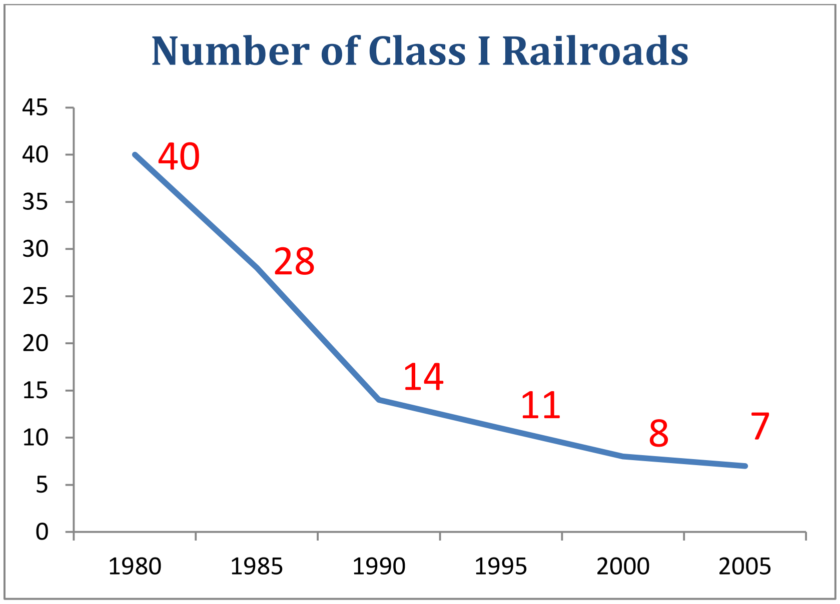
The fact that the Board has initiated these reviews does not mean reregulating or tipping the scales to favor one industry stakeholder over another. Rather, it is to make sure that the Board is utilizing its authorities and executing its responsibilities thoughtfully and in a relevant way to provide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

CONCLUSION

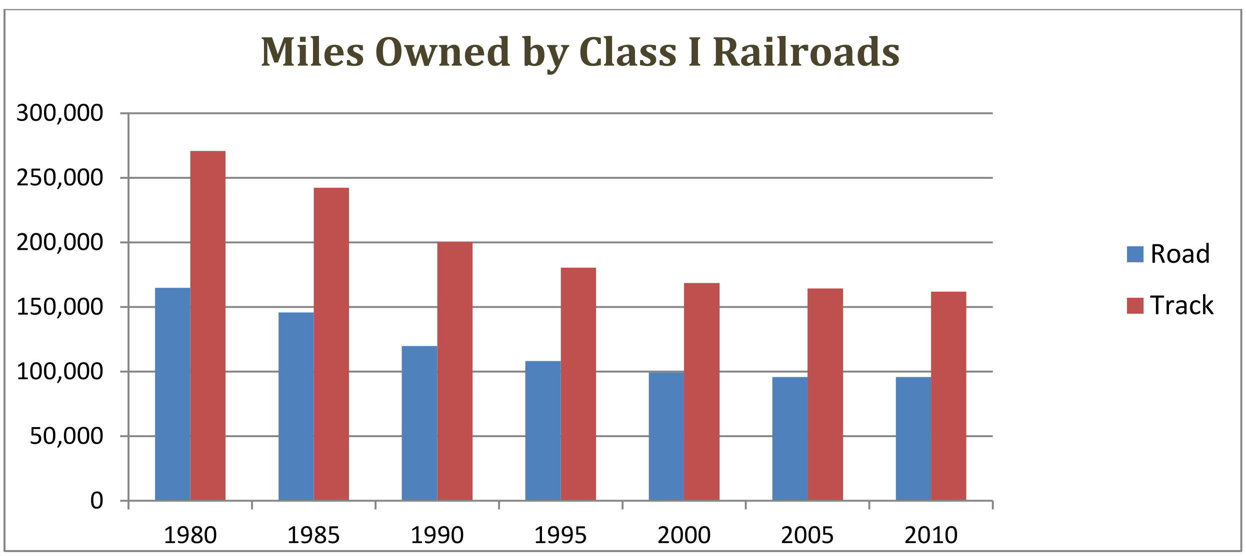
I hope my testimony has provided you with an understanding of how economic rail regulation has evolved over the years, and the types of matters we are handling at the Board. The Staggers Act has been beneficial to stakeholders in the rail industry and the Nation at large for 35 years. Now decades from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

APPENDIX A

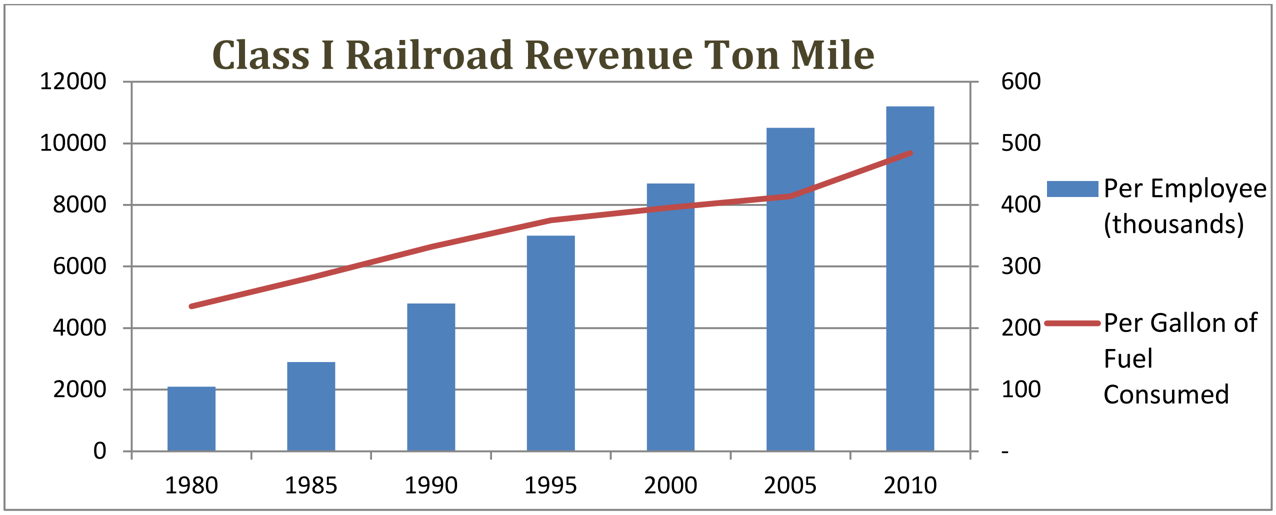
As noted, the Staggers Act reduced the regulatory barriers to railroad mergers, which (as this chart shows) resulted in significant consolidation within the railroad industry. From 1980 to today, the number of Class I carriers has decreased from 40 to seven.



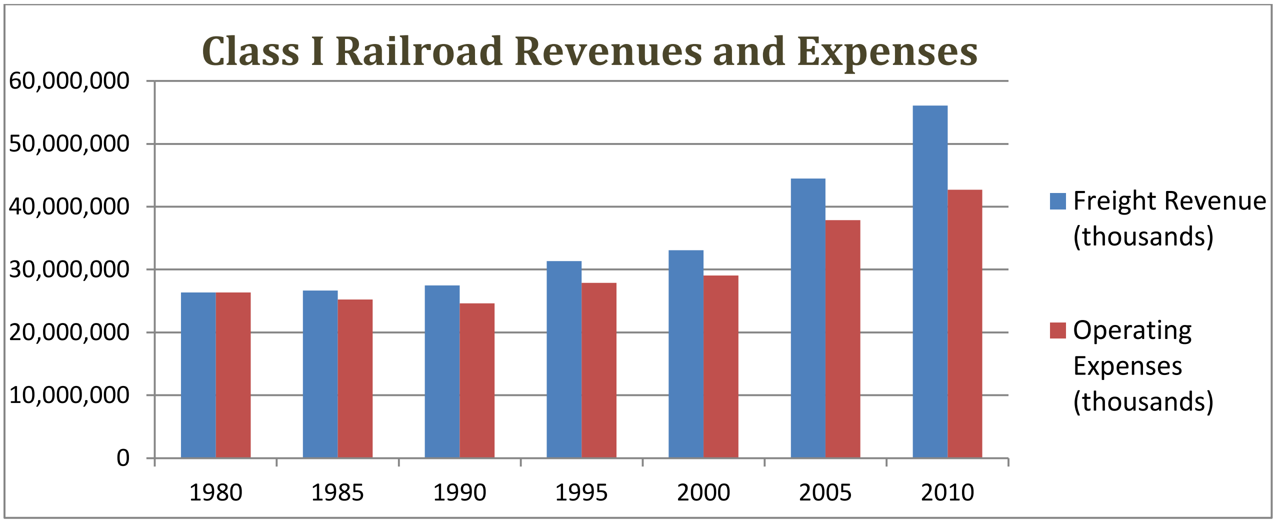
One of the benefits of the Staggers Act was that it allowed the railroad industry to more easily dispose of unprofitable lines. As seen below, the size of the rail network has significantly decreased since the passage of Staggers.



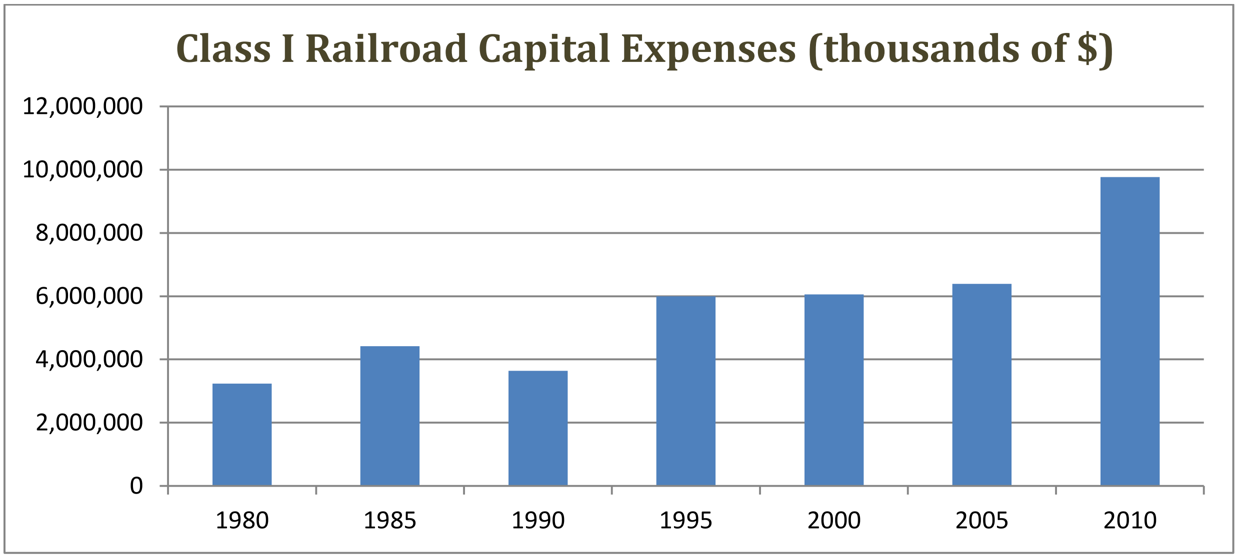
The reforms instituted by the Staggers Act increased the railroad's efficiency, as the chart below demonstrates. After passage of Staggers, the railroads significantly increased the revenue earned per ton-mile (i.e., the amount earned from moving a single ton a single mile).



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



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



APPENDIX B

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

Year	Industry Cost of Capital	BNSF Railway	CSX Transp. Inc.	Grand Trunk Corp. (CN)	KCS Railway	NS Railway	Soo Line Railroad (CP)	Union Pacific
		Based on Individual Railroad's Return on Investment						
2013	11.32%	**14.01%**	10.00%	**11.84%**	8.67%	**12.07%**	**12.03%**	**15.39%**
2012	11.12%	***13.47%**	10.81%	10.19%	9.54%	**11.48%**	5.15%	**14.69%**
2011	11.57%	***12.39%**	11.54%	8.74%	10.76%	**12.87%**	7.13%	**13.11%**
2010	11.03%	*10.28%	10.85%	9.21%	9.77%	10.96%	8.01%	**11.54%**
2009	10.43%	8.67%	7.30%	6.04%	6.51%	7.69%	6.28%	8.62%
2008	11.75%	10.51%	9.34%	9.89%	7.72%	**13.75%**	9.29%	10.46%
2007	11.33%	9.97%	7.61%	10.11%	9.37%	**13.55%**	**15.25%**	8.90%
2006	9.94%	**11.43%**	8.15%	9.47%	9.31%	**14.36%**	**11.60%**	8.21%
2005	12.19%	9.76%	6.23%	8.07%	5.89%	**13.21%**	8.89%	6.34%
2004	10.11%	5.84%	4.43%	5.95%	8.30%	**11.64%**	3.28%	4.54%
2003	9.40%	6.2%	4.0%	4.5%	3.7%	9.1%	0.9%	7.3%
2002	9.75%	6.4%	5.2%	3.1%	6.5%	9.1%	5.7%	8.6%
2001	10.19%	7.1%	4.6%	4.9%	7.0%	8.3%	5.9%	7.6%
2000	11.03%	8.8%	3.6%	5.9%	6.3%	5.5%	5.6%	6.9%
	Bold indicates year in which railroad was Revenue Adequate							
	* indicates that figure was revised from original calculation, based on decision in FD-35506 (July 25, 2013							