Railroads and Railroad Regulation In a Capacity Constrained Environment

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Transportation Research Forum-New York Chapter

New York City, New York--September 8, 2005

The Railroads and the Surface Transportation Board

Created by ICC Termination Act of 1995

Born out of the Deregulation Movement

Residual Economic Regulation of the Railroads

Far Smaller Staff and Scope of Authority

STB Mission

Exclusive authority to approve of rail mergers

Review rail rates and practices to ensure they are reasonable and not discriminatory

Approval, including environmental review, of

(i) construction of any new rail line or

(ii) abandonment of existing lines

Motor carrier collective ratemaking activities

Rates for non-contiguous domestic water trade

Rates for pipelines not carrying energy products

STB Merger Authority

- Urge to merge 1900-1970
- Mergers in post-Staggers era
- STB merger policy in the 1990s
- Merger moratorium and new guidelines
- Mergers and downstream impacts
- STB categories of merger transactions
  (major, significant, and minor)

STB Responsibilities over Rates and Service

Oversee and Monitor Railroad Practices Nationally

Enforce the Railroads’ Common Carrier Obligation

Ensure that Rates Charged Captive Shippers are Reasonable

Assist Railroads in Earning Adequate Revenues

Calculate the Railroads’ Cost of Capital

Rate Case Resolution-Large Shipments

Determination of Market Dominance

Stand Alone Cost Test—***Fact-based approach rooted in economic reasoning and approved by the courts***

No Substitute for Preparing a Strong Case with Solid Evidence

Strive for a Balance between Railroad's Need to Earn Adequate Returns and Shipper's Need for Fair and Reasonable Rates

Alternative Approaches

SAC approach has been criticized as artificial and overly complex

SAC approach is very costly and time consuming

Only feasible for large shippers

Is it time to look for alternative approaches?

-- Recent Board decisions suggest openness to proposed rulemaking on SAC changes

-- April 26th hearing on the SAC process

Environmental Review

- Approval of new construction
  - DM&E
  - Yucca Mountain
- Abandonment cases
- Offers of Financial Assistance
- Rails to Trails
- Line sales and paper barriers

Recent Changes in STB Procedures

- Greater openness, more public meetings
- Increased reliance on mediation and technical conferences
- Expedited discovery procedures
- Greater shipper and carrier outreach

Past Year in Review

- Board at full strength with confirmation of two new members
- Agency worked off a significant backlog in year
- Held 19 Public meetings on significant issues:
  - Nine Voting Conferences
  - Five Oral Arguments
  - Five Hearings

Year in Review –
Maximum Rate Cases

- Decisions on seven maximum coal rate cases
- Oral arguments in three coal rate cases and one pipeline case
- Also hearings on the SAC process and small rate cases

Year in Review – Service Issues

- Board carefully monitored rail trends and performance metrics
- Worked to facilitate communications between railroads and shippers via for a last year in Houston, Kansas City, Atlanta and San Francisco; this year in St. Louis
- Asked railroads to submit their fall peak plans
- Site visits by Board to PRB, shipper facilities

STB Agenda for Coming Year

Hearings on 25th Anniversary of Staggers Act

Oral argument on ocean rates to Guam

Nationwide Anti-Trust Immunity for Motor Carrier Collective Ratemaking

Continued monitoring of railroad performance and sevice

Growing Capacity/ Congestion Problem

Traffic Congestion Problem is Multimodal

Ports dealing with larger vessels and rapidly expanding international trade

Rail capacity problem is of more recent vintage

Economic regulation fostered excess capacity, especially for the railroads

The Genesis of the RR Capacity Problem

Improved Earnings Still not Revenue Adequate

Railroads "Punished" by Wall Street for Making Capital Investments

Railroads Often Found that Infrastructure Investments Failed to Generate Sufficient Income

Long term Strategy to Reduce Size of Workforce

Added Rail Infrastructure is Long-Lived While Demand Increases can be Short-Lived

The Developing Rail Capacity Crisis

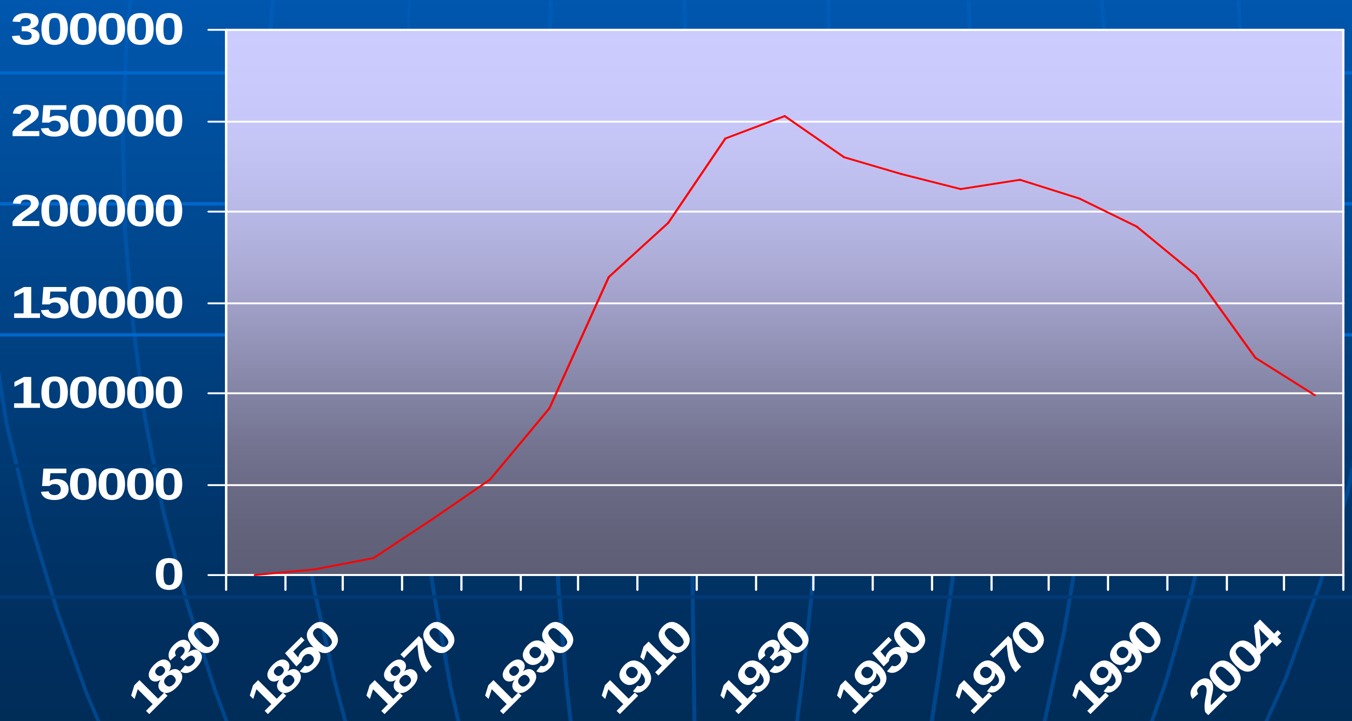
Shrinking Workforce and Infrastructure Partly Offset by Productivity Improvements

But Continuous Increase in Traffic Begins to Absorb “Excess Capacity”

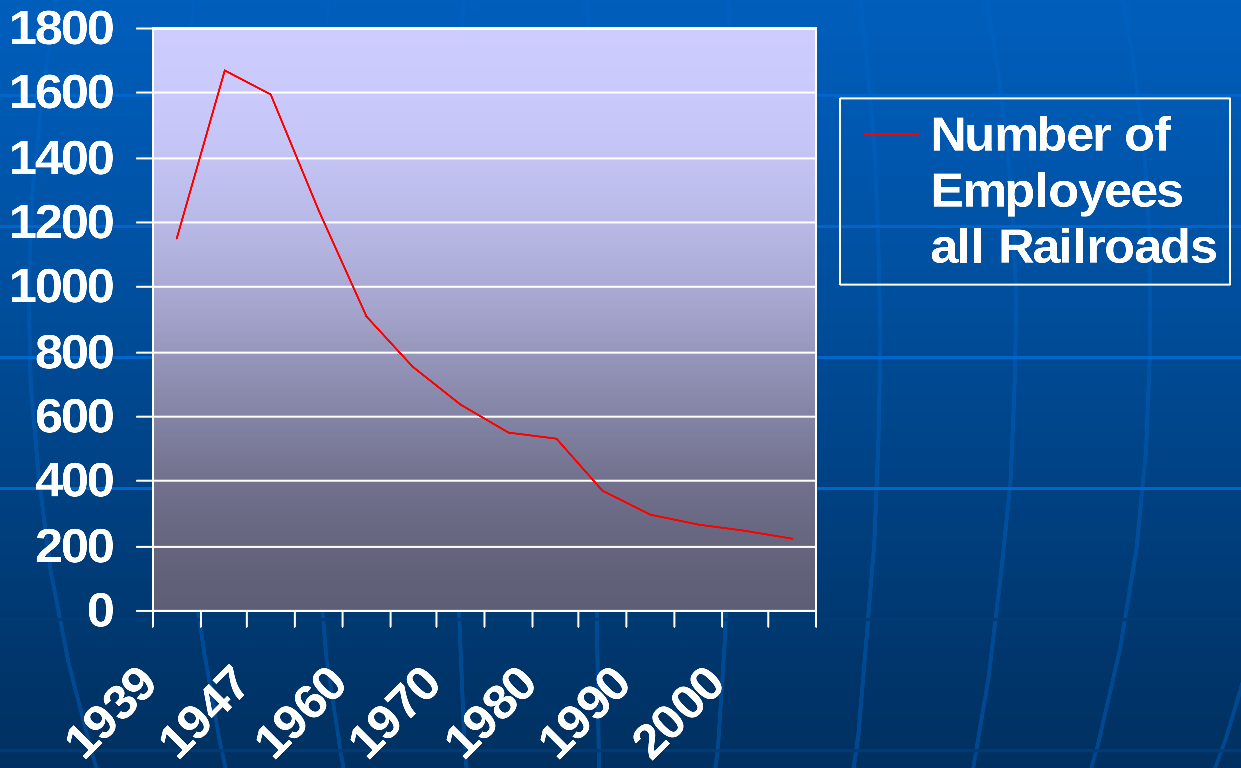
Network becomes More Vulnerable to Stochastic Events

A Perfect Storm or the Rail Version of Global Warming

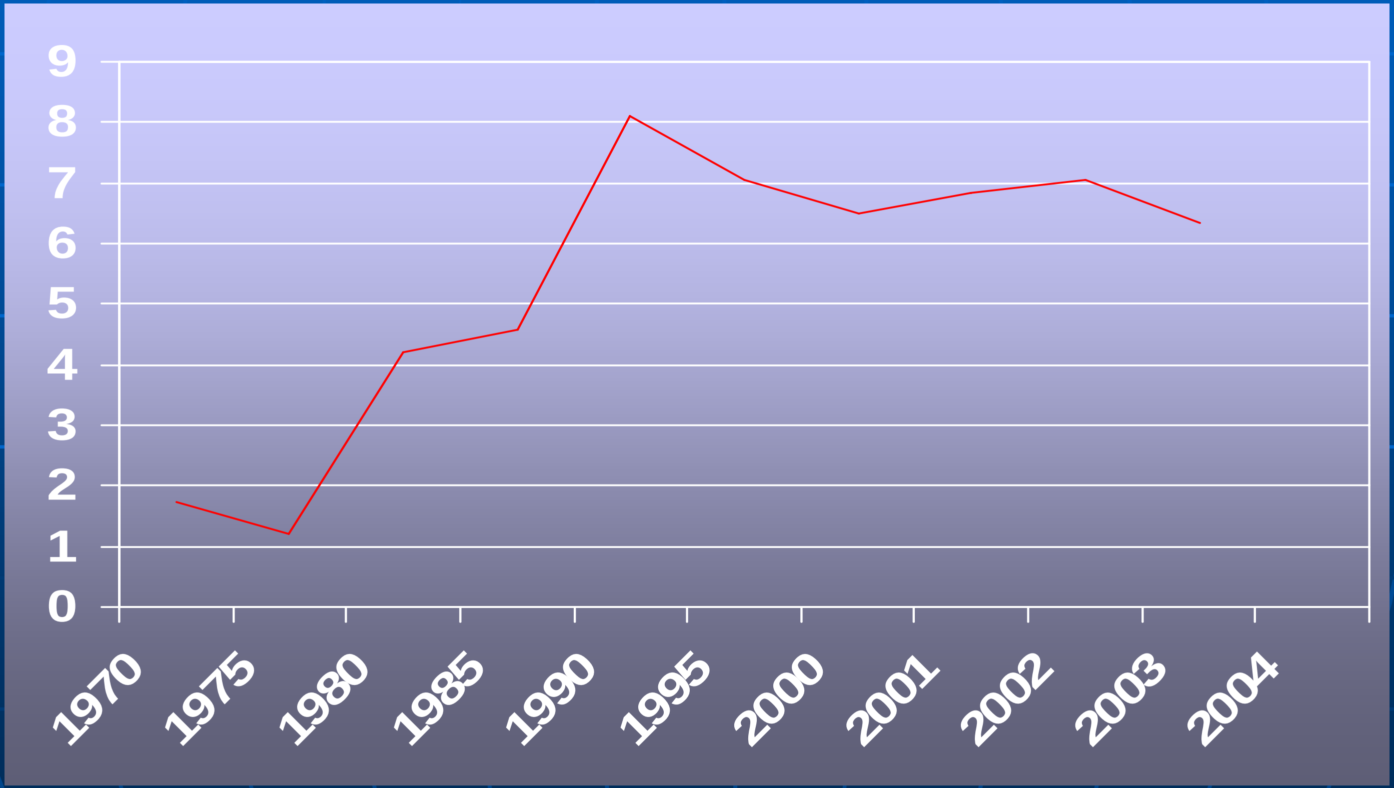
Growth and Decline of Railroad Mileage



Railroad Employment 1939-2003 (in thousands)



Railroad ROI 1970-2003



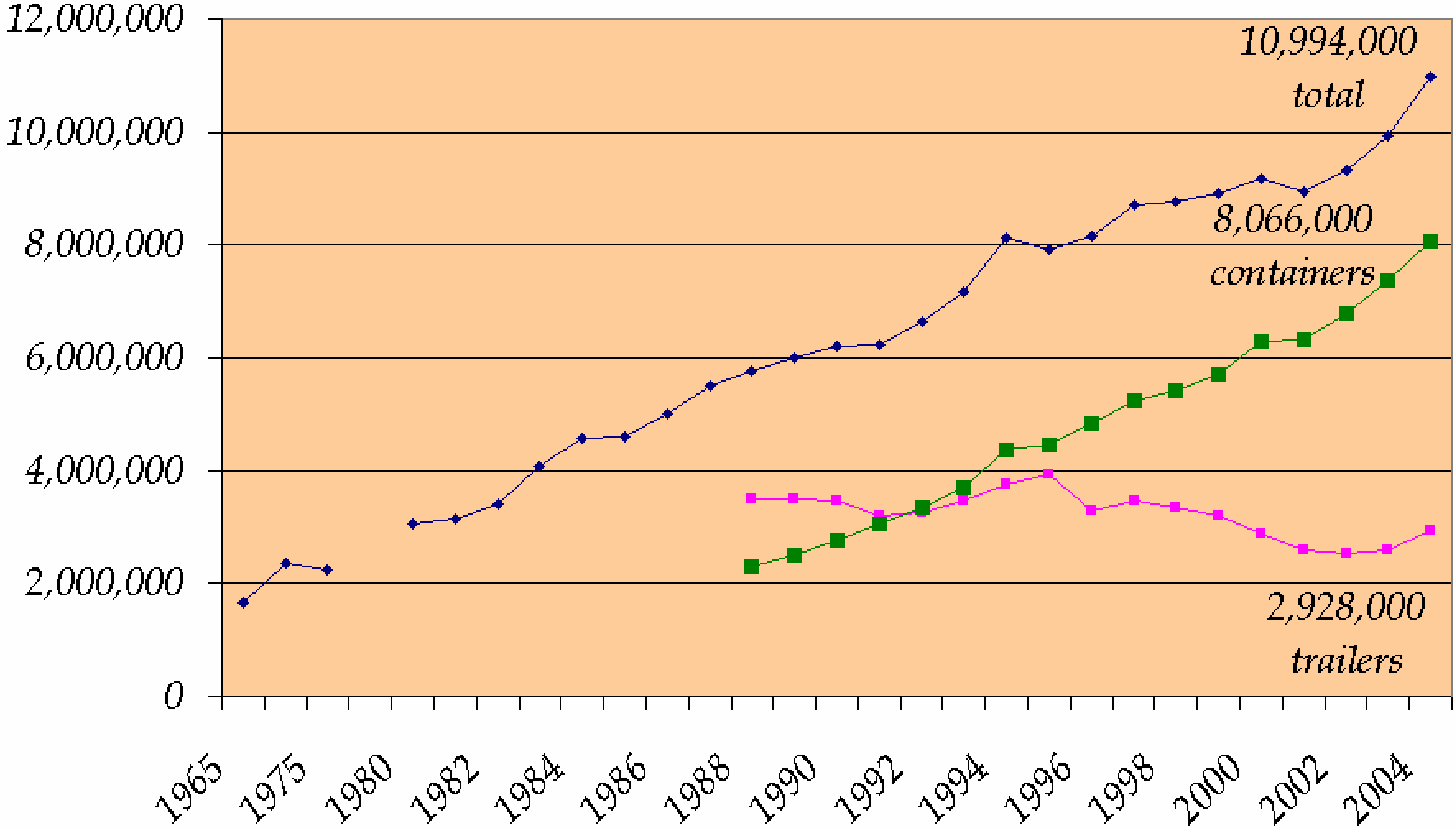
Railroad Cost of Capital and ROI

	Cost Of Capital	BNSF	CSXT	NS	UP	KCS	SOO	GT	IC
1996	11.9%	8.6%	8.9%	13.0%	9.3%	7.2%	23.5%	0.0%	15.2%
1997	11.8%	8.4%	9.8%	13.1%	5.2%	3.6%	12.3%	5.2%	15.8%
1998	10.7%	9.7%	8.1%	10.5%	2.9%	9.1%	4.9%	3.0%	13.6%
1999	10.8%	9.5%	3.8%	5.2%	6.8%	6.4%	2.5%	25.4%	10.0%
2000	11.0%	8.8%	3.6%	5.5%	6.9%	6.3%	5.6%	5.9%	5.9%
2001	10.2%	7.1%	4.6%	8.3%	7.6%	7.0%	5.9%	4.9%	4.9%
2002	9.8%	6.4%	5.2%	9.1%	8.6%	6.5%	5.7%	3.1%	3.1%
2003	9.4%	6.2%	4.0%	9.1%	7.3%	3.7%	.01%	4.5%	4.5%
2004	10.2%	5.8%	4.4%	11.6%	4.5%	8.3%	3.3%	6.0%	6.0%

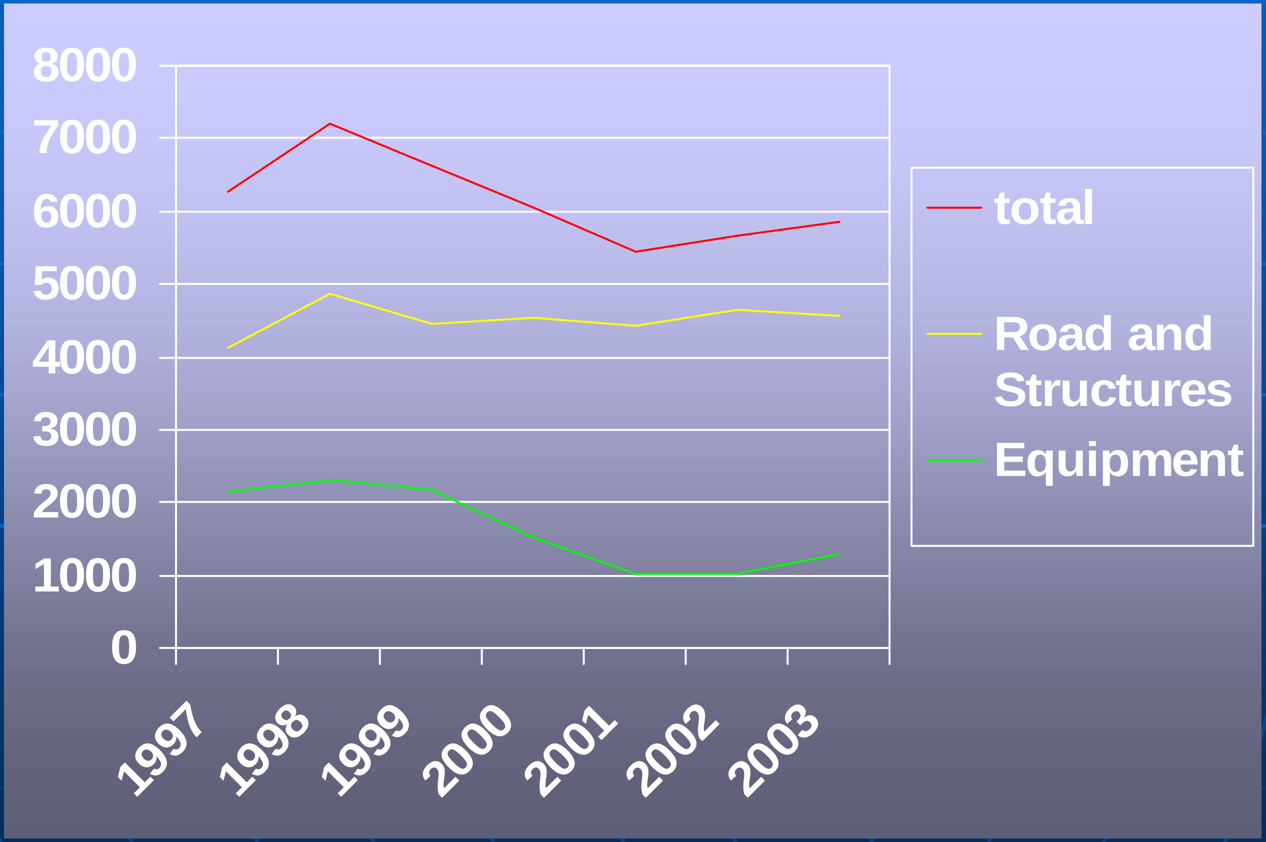
Short term Capacity Problems

- Expanding Economy Led to Surge in Imports
- Large Grain Harvests in 2003 and 2004
- Growth in Export Coal Market
- Crew Shortages due to Wave of Retirements
- Equipment Shortages due to Reduced Purchases
- Cutbacks in Capital Spending Programs
- Tight Capacity in Trucking Industry due to Driver Shortages, Higher Fuel Costs, HOS Rules, etc.

Intermodal Shipments beginning 1965



Class I Capital Expenditures
(in billions of current $)



Carrier Responses to Recent Capacity Problem

More Cars and Locomotives Bought and Leased

Accelerated Hiring and Training of Train Crews

Some Infrastructure Expansion Efforts

Price Rationing of Available Capacity

Railroads Choosing who they will Serve and the Common Carrier Obligation

Long-Term Rail Capacity Constraint Factors

Demand for Freight Rail Transport Projected to Grow by 60%-70% over Next Two Decades

Railroads' Inability to Earn Cost of Capital

Pressure from Wall Street to Reduce Capital Costs and Improve ROI

Long-Term Contracts Limit Railroad Pricing Flexibility

Railroads tend to Bid Long Term Contract Rates Down to Long Run Marginal Costs

Approaches to the Transportation Congestion Problem

Build more Physical Infrastructure

Adopt technological innovations

Make better use of existing facilities

Promote shipper and traveler behavioral changes

All have potential but all limits

Infrastructure Capacity

SAFETEA-LU– 2 years late and $90 billion short

$286.5 billion over 6 years is 38% more than was provided for in TEA-21back in 1998 but far short of $375 billion estimated need

Contains a rail title but far from intermodal legislation

Expands the RIFF program to $35 billion and makes shippers eligible

Rail Capacity Investment

Railroads Support Limited Public Sector Role

Public/Private Partnerships (Alameda Corridor, CREATE)

Railroad Trust Fund Concept

Investment Tax Credits

-Short Lines and the 286K lb. Car Problem

-Class I Access and Limited Fiscal Capacity

- RIM and RIFF

Thank You, Any Questions?