

CHAIRMAN NOBER: Well, again, thank you very much. And we'll start with Commissioner Buttrey.

COMMISSIONER BUTTREY: There was a mention earlier in the testimony I think about a desire for a level playing field. What would you say to someone who said that the level playing field does not exist because you don't have any rail labor, you don't have any power requirements, you don't have any right-of-way maintenance requirements, those kinds of things that the railroads have?

MR. MAYO: I guess I would respond by saying TAX itself doesn't have those.

COMMISSIONER BUTTREY: Thank you.

CHAIRMAN NOBER: Okay. Vice Chairman Mulvey?

VICE CHAIRMAN MULVEY: It's been alleged that the railroads show favoritism towards TTX-owned cars, and, by implication discriminate against the cars owned by the private lessors. Do you have any specific examples of such favoritism or discriminatory behavior on the part of the railroads?

MR. THOMAS: Specific examples are difficult to show in the sense of the way the major railroads run their pooling operation. They run a pooling operation in which all of their cars, whether they be TAX or their own, are pooled on their railroad for use throughout their own railroad. So it's a sub-pool within the other pool.

The people who are not contributing to those pools have their cars marketed at a higher rate than the pooling cars, because the railroads claim that they are having operational savings by having the subset within the larger pooling operation.

So from the standpoint of saying discrimination per se goes on, that's difficult to prove. There is some indication -- and we have had indications where the typical markets where TAX has not played, that they are going directly to shortlines now, and so requesting the ability to assign cars to shortlines on those particular railroads. So it is happening.

VICE CHAIRMAN MULVEY: Okay. It has been alleged in the comments that the TTX's pricing strategy is somehow anti-competitive, or the prices are exceptionally low, which would be -- normally considered to be predatory pricing, although this clearly does not seem to be the purpose of TAX -- to drive other lessors out of business.

And, in fact, the evidence shows that the other lessors have expanded their fleets greatly over the last 15 years or so. Is there any evidence that private car operators so far have -- private car lessors, rather, so far have been thwarted in their ability or their desire to expand their fleet and to earn adequate returns?

MR. THOMAS: The expansion that you refer to, most of that was as a result of acquisitions of other incumbents. It wasn't expansions of new car or new capacity per se. Each of us here, especially the two on the right, have acquired a number of other leasing companies in that time frame, and the expansion in our fleets is a result of taking over other leasing companies.

The leasing company life is not a long one for the most part. There are a few notable exceptions, but some of us have been with a number of leasing companies because they have been moved out due to the fact that it is a very cyclical business. It goes way up, and it goes way down. And the issue of TAX is not that they have lower prices, it's that they have a floor.

MR. MAYO: If I could just supplement that, if you look at the Charles River Associates study that's appended to the Trinity filing, they show data which indicates that the leasing companies in the last two years have begun to back away from the purchase of flatcars.

Whereas historically you had seen purchases running at sort of a 50/50 split

between the TAX and the leasing companies, leasing companies are backing away significantly. And what's happening is that it's in the context of where the leasing companies are bumping into the TAX rates being quoted back to them as the so-called market rates that should govern what should be -- the car hire rates to be paid on the leasing company cars.

And the problem is -- TAX acknowledges in their opening filing that the TAX rates are lower than the rates that are the market car hire rates. They say that, and they append exhibits which show that that is the case. And in depreciation what's happening is that when the leasing companies go out to negotiate car hire rates, they are being met by the Class 1 railroads that own TAX saying the TAX rate should apply.

And if they're in an arbitration, arbitrators will point to the TAX rate as an indicator of the market rate, trying to then force the TAX rate onto the leasing company. So the leasing companies can't operate their equipment at those TAX rates, because the TAX rates are basically rates that cover operating costs and including the costs associated with acquiring new equipment but no return on equity.

And so they, by definition, are going to be lower than the leasing company costs, which have to cover operating costs, but also have to have a return on equity component in them.

And what happens is that they basically force the leasing companies out of the markets where TAX has some substantial position, and that's what's going on the last couple of years.

VICE CHAIRMAN MULVEY: So instead of having the forces of supply and demand establishing a market here, rather we have TAX establishing the price, and everyone else is a price follower.

MR. MAYO: That's correct.

VICE CHAIRMAN MULVEY: Leasing companies are -- these conditions and these problems existed back in '94, '97, and 2001, when you all had the opportunity to come before the Board and raise these concerns. But nobody objected back then, and now all of a sudden everyone is back here again.

My question is: what has changed that brings everybody forward here today and kept you away from these proceedings or these potential proceedings the last three times they come up?

MR. MAYO: I would suggest the big thing is depreciation. Depreciation only was -- the depreciation decision was in 1994. It's a 10-year phase-in, and the impact of depreciation has been something that has been evolving year after year, and it was only fully effective as of January 1, 2003. So that's a big component in terms of the --

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN NOBER: Well, let me just ask a followup to a question I asked to TAX, which is -- and I always start with the statute and what's the statutory test for approving pooling. And it's -- will it be in the interest of better service to the public or economy of operation? And there's a lot of evidence in the record about that. And will it not unreasonably restrain competition?

Now, you've asserted in your testimony that it does, and let's just assume every competitive that you said is true. Who is being -- who is being affected by that? Rail consumers, railroads, leasing companies, third parties? Who is feeling the harms that you're asserting?

MR. MAYO: Could I take a crack at that unexpected question?

CHAIRMAN NOBER: Sure.

MR. MAYO: I --

CHAIRMAN NOBER: Well, I'm only asking -- I mean, unexpected, I'm only asking because of what the statute says.

MR. MAYO: I'm laughing because you said you were going to ask us this question.

CHAIRMAN NOBER: Okay.

MR. MAYO: The anti-competitive effect is being felt at various levels. We think ultimately the anti-competitive effect is going to be felt at the shipper level, because we think that the net effect of what is going on is that because of the way in which the TAX pricing strategy works, the leasing companies get forced out of equipment areas where TAX is a big player, leaving only TAX and its owners as the suppliers of equipment to those shippers.

CHAIRMAN NOBER: Okay. Now, how do those shippers -- how does that hurt shippers?

MR. MAYO: And if you're a conspiracy theorist, what that means is that the availability of equipment to those shippers becomes -- begins to be constrained because they are -- that equipment is controlled only by TAX and its Class 1 railroad owners. The equipment is not available through the leasing companies.

And with the ability to control the supply of equipment, you've got the ability to control price because you can create capacity issues as to equipment. Providing less equipment allows you to raise prices. And so it is a vehicle to allow an adverse effect on the prices that have to be paid by shippers. That's one component.

A second component of course is the competition with the leasing companies, that in effect it forces out competition between the leasing companies and TAX.

And related question that you had asked was: does the statute mean that we have to consider at all the competitive impact on the leasing companies or the world at large? And I think the clear answer to that question is yes, and the reason the answer to that question is yes is that this Board has the authority to exempt TAX and its pooling operation from the application of the entirety of the antitrust law of the country.

The antitrust law is applied to every element of the activity in which TAX is engaged, and but for that exemption, if that activity, for example, has an adverse effect on the leasing companies, we could pursue that under the antitrust laws but for the exemption. So I think it logically follows that the Board, in granting an exemption, needs to look into and take into account any anti-competitive effect of the pooling authority. Otherwise, it would make no sense that you can grant the exemption.

CHAIRMAN NOBER: I mean, I agree that car supply has been an effect on capacity recently, but the place where it has been most pronounced is an area that TAX doesn't operate at all, which is in grain car, which you all are the market leaders in that area. And this year we had a big, unexpectedly large harvest, and there was a shortage of grain cars. And, trust me, I heard about that on a daily basis.

So that occurs whether -- you know, in a robust leasing market or not. And when the carriers went out to try to, you know, make up some of the ground there were no grain cars to be found, because you all, you know -- it's a cyclical market, and you all weren't wanting to invest in them either.

So, I mean, don't we get that no matter what? I mean, rail is a cyclical business, and sometimes we'll have enough cars and sometimes we won't?

MR. MAYO: The answer to that question is twofold. First and foremost, with the grain you're talking about a seasonal cyclicity as opposed to other types of commodities such as lumber in which they are at the far end of the transportation system.

And when they get to the far end of the transportation system, in order to maximize the revenues that a railroad wants to make because that's what they're in business for, they're not going to take cars all the way to the end of the system. They're going to take them only as far as they need to go with respect to where they can get their next load.

So what happens is the guy at the end of the transportation system is the one who suffers, and he is typically the guy who comes to our group for cars because he is at the end of the system. He doesn't want to have the railroads limit his ability to market his product. His product is -- the railroads are a service, and he is trying to control how he gets his product to market.

CHAIRMAN NOBER: Now, I'm going to go back to Vice Chairman Mulvey in a second, but I just want to ask one followup. In intermodal, we also have a capacity problem. But, again, it's not car supply; it's locomotives and crew. Right? I mean, that's the key -- if we would expect to see the supply anywhere, it would be there. But we haven't, even though we do have capacity problems on the intermodal -- you know, with intermodal traffic. So I offer that as an observation as much as a question.

Frank?

VICE CHAIRMAN MULVEY: Yes. I think the tie between what's going on in the market -- your market, what you call the relevant market, I agree this is the relevant market in terms of the competition between TAX and the lessors, what impact that has on shippers and ultimately what impact that has on the public at large. I mean, it's a little difficult to make those ties, and I think that needs to be thought about.

One of the things that has been suggested is that the TAX claims that car ownership and the pooling of its operations of the cars, the intermodal flatcars and pricing, need to be kept together. It has been suggested that the antitrust immunity for pricing be separated and be removed and that they continue to pool the cars, but they can't establish the price.

TAX argues that that's somewhat disingenuous on the part of the commenters, because if that happened when TAX went to negotiate with the railroads, the owning railroads, etcetera, immediately they would be charged with violating the antitrust laws, and so it would undermine the entire pooling operation.

Can you comment on that?

MR. MAYO: Well, I suppose there are several ways it could be dealt with. One possibility is using some sort of trustee mechanism where you take somebody who is totally independent who has to -- whose responsibility it is to negotiate on behalf of TAX with respect to individual railroads, but remove the owners of TAX from that process but have some independent third party, some entity whose job it is to negotiate bilateral agreements with each of the railroads using TAX equipment.

The other possibility, of course, is giving out the equipment to the owners of TAX, having the owners then negotiate the rates of the equipment, and then having the equipment operated collectively, there are various pools out there operating under a myriad of arrangements.

If you look at the multilevel reload pool, which is relatively confusing in the sense that it's a pool that operates off of TAX flatcars where the TAX rate applies, and railroad flatcars where negotiated rates under depreciation apply, and attached to those flatcars are the auto

racks which are not owned by TAX, but instead are owned by the individual railroads.

The auto racks are separately priced from the underlying equipment, and the auto racks are -- their prices are set by the AAR, and interestingly the auto rack prices are not uniform prices. AAR makes -- I mean, TAX makes a big point that you've got to have fungible pricing with respect to a particular kind of equipment. A particular kind of equipment should have exactly the same rate associated with it. There should be no variation. That's critical to their operation.

That's not the case with respect to the reload pool, because the pricing as it relates to the racks, the racks are priced depending upon their age. The older the rack, the lower the price. So that you've got a very effective pool operating where individual pieces of equipment, the flatcar and the rack associated with it, are priced differentially. And that's operating fine.

There is this new national North American flatcar -- I mean, box car pool, which TAX has just taken over, where there is no ownership in TAX and there is no pricing authority in TAX. And so it is true that there are some old pools that have failed, and they have failed because, as TAX points out, carriers would withdraw equipment when demand went up, or they put in only their bad equipment.

But that's the kind of thing that can be dealt with contractually. I mean, you can contractually require that that not occur. And, moreover, all of that occurred during the period of prescription when car hire rates were set by regulation. Deprescription is designed to come out -- putting aside the issue that I mentioned as it relates to TAX, we think setting an artificially low ceiling on rates.

But put aside that, deprescription is designed to create a market price associated with cars, so that when people get a car and there's a market price associated with it, they feel like that they're getting a fair shake, that the car and the use they get out of it is reflective of its value.

VICE CHAIRMAN MULVEY: TAX argues, of course, that it needs to have the integrated authority, antitrust immunities and authorities in order to make it work and points to it -- all those other pools as having failed for one reason or another because it didn't have that. But you make an interesting response.

I had one other question that I'd like to ask, and that is the intermodal movements have been the fastest-growing part of the railroad business. And I think for the first time now this year intermodal revenues are going to actually exceed coal revenues.

While historically it has been a low budget business, and it has been argued that that is primarily true because of the price ceiling imposed by truck competition, and some of the commenters argued that, in fact, truck competition really is not all that strenuous, especially for long distance movements, and that trucks aren't nearly as competitive for those movements as is often claimed.

Has anyone recently tried to calculate the cross-price elasticity of demand?

MR. MAYO: It comes up in the merger cases, and my guess is the last time there was a look at it was probably in the Conrail merger, which is the last case that was sort of fully developed. If you look at the 1989 TAX decision, in there there's a reference to what I -- what you see recited time and again, and that is that there is roughly a 1,000-mile limit associated with beyond 1,000 miles trucks aren't competitive with a move that's a rail move. And short of 1,000 miles, trucks are competitive, and it's more difficult for rail to compete.

So you see that number a lot, and probably the last time I would guess that it was looked at -- I can't remember specifically -- was the Conrail merger.

VICE CHAIRMAN MULVEY: Well, that's the all or nothing, but that -- but actually, of course, it's a continuum. And as you get for longer distances, it becomes more and more inelastic. But I was wondering if anybody had actually tried to recalculate the measures. I know the AAR used to do that, but I don't believe they do it anymore. They did it for various kind of commodity groups and various distances, but --

CHAIRMAN NOBER: I have one last question, which is, in his testimony Mr. Goode asserted that one of the reasons to allow TAX to move into non-flatcar business, some of the ones that you've all been critical of, is that it lets the railroads manage their risk, that if they're going after new business or different business that rather than the carrier itself having to invest capital in that type of car for business that may or may not materialize, it lets sort of this pool bear the risk, and, you know, they can buy it by the mile if you will.

How would you all respond to that?

MR. MAYO: A short-term lease does the same thing. I mean, we lease equipment from three months to seven years. If you're going after a new -- if you're going after a new source of traffic, and you're uncertain about its longevity, a short-term lease of equipment is one clear answer to that.

MR. THOMAS: And railroads had that traffic for a while, but the manufacturers changed the way they built trucks. I mean, they used to build them on trucks and they were called ITTX cars, where they piggybacked them this way and loaded them on 89-foot cars. So when the manufacturers started to put the bed on the trucks at the same place they built the truck, it made it harder to ship by rail at that time until this new car type has been developed.

And if they develop a new car type, they ought to be allowed to do it. I mean, it's not a question of saying that we want to say R&D should go away in any way, shape, or form.

CHAIRMAN NOBER: I have one final question. That was supposed to be my final question. Now I really have a final question, which is TAX has asked for a 15-year term. You have all asked for five. What would be the advantage to all of you of a shorter term, other than, you know, more frequent -- can you lay out why we should do that, why we should allow a shorter term?

MR. THOMAS: One of the things that I tried to point out was when the ICC made the decision to allow pooling at that particular time the intent was for that pooling to apply to shippers. It has now been extended beyond just shippers, and it applies to 97 percent, as Sandy pointed out, of the center beam cars.

Now, we'd like you to take a look at that and see if that's within the keeping of what was intended in 1989. Things change so fast in today's market that those kinds of issues we believe will come up in that time frame, and having explained to you that it's much easier to come to you in this kind of setting than it is to say, "Oh, by the way, you know, we think you ought to open up a hearing again," it's much easier for us to come in this type of setting.

CHAIRMAN NOBER: Okay.

VICE CHAIRMAN MULVEY: Mr. Chairman, I have one more question that relates to this. The North American Freight Car Association argues that AAR Rule 2 apparently allows for the free-running cars without the need for pooling. If you could comment on that.

And they also ask for an STB study as to whether or not the benefits of pooling intermodal flatcars can be achieved without it. Do you think that kind of a study would be useful?

MR. THOMAS: Well, part of what goes on is when Rules 1 and 2 were in effect, it was a way in which to protect the owner from receiving a value for his car. The cars

were being provided by the railroads at that particular time. So in order to get the value of putting a car into the system, he had to have a way of getting it back to load on his particular railroad.

Now, the cars are not being provided by the railroads, so -- in general. They are being provided either by TAX or us. Those types of issues don't apply to the railroads per se anymore. In fact, for most of the cars they have, they would be glad to have them used.

CHAIRMAN NOBER: Okay. Well, again, thank you very much for patiently answering everybody's questions.