UNITED STATES OF AMERICA

SURFACE TRANSPORTATION BOARD

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HEARING

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IN THE MATTER OF: :

Docket No.

REVIEW OF COMMODITY, BOXCAR, : Ex Parte 704

AND TOFC/COFC EXEMPTIONS

:

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Thursday,

February 24, 2011

Surface Transportation Board

Suite 120

395 E Street, S.W.

Washington, D.C.

The above-entitled matter came on for hearing, pursuant to notice, at 10:00 a.m.

BEFORE:

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CHARLES D. NOTTINGHAM Vice Chairman

FRANCIS P. MULVEY Commissioner

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(2:06 p.m.)

CHAIRMAN ELLIOTT: Good morning. Welcome. Today we're going to hear testimony regarding the various commodity exemptions, the boxcar exemptions, and the intermodal or TOFC/COFC exemptions.

Before I get started today, I just wanted to take a moment to express our condolence to the Riser family. Jack Riser, who worked here as a transportation industry analyst, passed away last night.

He's one of our newer employees, he is one of our family, and it's just a very sad, sad day because of that. We'll miss him dearly. So if you could keep his family and his wife, Chris, in your thoughts and prayers, we'd appreciate that. Why don't we just take a quick moment of silence just to remember that. Thank you.

Back to the business at hand, like many issues that come before the Board, these exemptions have a historical context. In the 4R Act of 1976 and the Staggers Act of 1980, Congress reduced the Interstate Commerce Commission's direct oversight of railroads in various ways.

One way it did so was by directing the ICC to exempt railroad activities when it found that regulation is not necessary to carry out the National Rail Transportation Policy, and either the exemption was of limited scope or regulation was not necessary to protect shippers from the abuse of market power.

In the Staggers Act, Congress directed the ICC to pursue exemptions aggressively and to correct any problems that arose through its revocation authority. Consistent with that congressional directive, the Agency exempted numerous commodities, services, and types of transactions from regulation.

An exemption excuses carriers from

virtually all aspects of regulation, even though the Board's continuing jurisdiction over exempted movements also extinguishes any common law cause of action regarding common carrier duties.

So for exempted movements, rail customers can pursue legal remedies under the Interstate Commerce Act only if they first successfully petition the Agency to revoke the exemption. There is a statutory standard for revoking them.

Parties can come before the Agency and seek partial or complete revocation of an exemption. Partial revocation allows a shipper of an exempt commodity to pursue regulatory remedies here at the Board.

For example, in one case the Board revoked an exemption for crushed or broken stone, sand, and gravel in response to a complaint that a railroad was blocking another railroad's ability to fulfill its common carrier obligation. A long time has passed since the Agency began exempting traffic from regulation.

Today exempt traffic accounts for roughly 40 percent of all freight revenue, or about $20 billion per year, so this is a very important matter. That's why the Board has decided that the time has come to have a public discussion about the exemptions and their effect on the rail industry, its customers, and the general public.

Just a few procedural notes regarding the testimony itself. As usual, we will hear from all speakers on the panel prior to questions from the Commissioners.

Speakers, please note that the timing lights are in front of me on the dais. You will see a yellow light when you have one minute remaining and a red light when your time has expired. Please do your best to keep to the time you have been allotted.

I assure you that we have read all your submissions. There is no need to read them here. After hearing from the entire panel, we will rotate with questions from each Board member until we have exhausted the questions.

Additionally, just a reminder. Please turn off your cell phones. I look forward to hearing the testimony of the parties, and I'd now like to turn it over to Vice Chairman Nottingham for his opening remarks.

VICE CHAIRMAN NOTTINGHAM: Thank you, Chairman Elliott. I'll be brief. We have a lot of witnesses today, and I welcome everybody. Thank you for joining us. We have quite a full room here, and I imagine we've got some people on the internet watching via the web, too.

I'll just note a little bit of the history that the Chairman touched on. We were directed to adopt exemptions in a pretty sweeping way by the Congress.

Industries came to us and asked

for these exemptions years ago, and in the ensuing years we've had very few cases. In fact, during my tenure, none that I can think of, where industries or companies have come in and availed themselves of the statutory right that has been in place for many, many years, which is to petition the Board, as the Chairman touched on, for a partial or a complete revocation.

So I look forward to hearing today as to -- regarding whether, if this is a problem, why haven't people availed themselves of the tool that's been available for so many years to seek relief, and if there's something the Board is doing or not doing that makes that process untenable, I want to understand that a little better.

I'm a big believer in self-help. Too often, we encounter interested parties around this town and elsewhere who would rather complain about something than actually take the steps necessary to correct it, and

I'm all about correcting problems and solving problems, and that's what brings all of us, I think, into public service.

So I look forward to hearing from everyone today, and I keep an open mind on this. I urge folks not to read too much into it. The Board historically has conducted oversight hearings on interesting, important issues.

It doesn't mean anything in particular necessarily, but it's an important part of what we do to stay current, to see whether circumstances truly have changed to a degree that might warrant a regulatory adjustment or a recommendation to Congress or some other Board action.

So, with that in mind, I appreciate again the attendance today and look forward to hearing from everybody. Thank you.

CHAIRMAN ELLIOTT: Thank you, Vice Chairman, and now we'll hear from Commissioner Mulvey.

COMMISSIONER MULVEY: Thank you, Chairman Elliott. A personal note to begin with. Jack Riser was part of a team of transportation specialists who briefed me on the state of the railroad industry on a biweekly basis, and I will tell you we will very much miss his contribution. He was an important part of the STB, and he will be missed by all of us.

I am pleased today that the Board is having this hearing, and I look forward to hearing the oral testimony. Several years ago now, I first suggested that it might be a good idea to periodically review exempt commodities and traffic to ensure that the exemptions were still appropriate.

I have always thought that it's important for the Board to be aware of what is going on on the ground in the rail industry that we regulate and the shipping industries that are affected by that regulation. This particular hearing allows the Board to get information from industry participants on whether there have been any major changes in the competitive landscape that would merit the Board's reconsideration of any specific exemption.

After all, the ICC exempted the first commodities more than 30 years ago. That was fruits and vegetables back in 1979, and the last commodity that was exempted was back in 1998, and that was non-ferrous metals.

Between those two periods, more than 100 other commodities types and traffic types have been exempted from regulation following a finding by the Agency that regulation was not necessary, primarily because there was sufficient competition from other transportation modes, chiefly trucking and, to a lesser degree, barge.

Well, much has changed since 1979 in the transportation competitive landscape. There are changes within the railroad industry, changes in the trucking industry, and, to some extent, changes in the barge industry, as well. Likewise, many of the industries shipping exempted commodities have also experienced significant changes.

Some of the pleadings filed in this proceeding suggest that the only mechanism by which the Board can or should be made aware of such changes is in a specific exemption revocation proceeding. I'm sure that this is an issue that we will hear more about today.

In my opinion, however, regardless of any steps the Board could take, I hope that our stakeholders would not have the Board turn a blind eye for decades as to whether or not competitive changes undercut the basis for an exemption. This is particularly so when you are talking about industries characterized by smaller shippers who may not be inclined in the first instance to initiate an exemption revocation proceeding.

Indeed, this hearing could serve

as a way to develop ideas about how the Board could make its exemption revocation process more efficient and more accessible, an effort the Board has recently undertaken with regard to rate reasonableness cases.

Now, to echo what Vice Chairman Nottingham has said, I also want to make clear that this is primarily an informational hearing. I have seen suggestions that the Board is poised to eliminate many or all exemptions, force economic regulation of every commodity, or otherwise return the rail industry to its pre-Staggers condition.

I think that such suggestions encourage our stakeholders to line up with their most extreme positions. Whether you support a particular exemption or not, most would agree that exemptions have played an important role in reducing economic regulation of the railroads and that reduced regulation has contributed to growth and innovation in the railroad industry.

So, from my perspective, this hearing is about ensuring that the Board has the most up-to-date, competitive information about the industry it regulates.

Finally, I want to make note that I believe that most regulations and most regulatory practices such as exemptions should be subject to periodic review to ensure that they still make sense.

Regulations that have outlived their usefulness or serve as an impediment to economic progress with no concomitant benefit to society should be reviewed and repealed if need be. The President has made it clear that he believes that regulations should be efficient and be in place only when they benefit the national well being.

I hope to hear more today about what the appropriate time period should be for reviewing exemptions from STB regulation. Thank you, Mr. Chairman.

CHAIRMAN ELLIOTT: Thank you,

Commissioner Mulvey. Thank you, Vice Chairman Nottingham. Now we'll begin our first panel, starting with Panel I, Federal Government, and we'll hear from the U.S. Department of Transportation, Peter Plocki. You have ten minutes allotted. Thank you.

MR. PLOCKI: Thank you, Mr. Chairman, and good morning, Mr. Chairman and members of the Board. My name is Peter Plocki.

I am the Deputy Assistant General Counsel for Litigation for the U.S. Department of Transportation, and I am presenting the views of the Department in this proceeding. The Department appreciates the opportunity to be heard on this important matter this morning.

The Board has instituted this proceeding in order to review certain categorical exemptions from regulations, specifically exemptions for certain commodities, for boxcar traffic, and for trailer on flat car/container on flat car traffic, which I shall refer to this morning as intermodal services.

Exemption provisions pertaining to railroads go back to the enactment of the Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of 1980, the latter encouraging greater use of exemption authority.

As the Board stated in its instituting notice, this proceeding arises from informal inquiries questioning the relevance and/or necessity of existing exemptions given changes in the competitive landscape and in the railroad industry that have taken place over the past few decades.

The Board requested comments as to the effectiveness of these exemptions in the marketplace, whether the rationale behind any of these exemptions should be revisited, and whether they should be subject to periodic review.

As noted in the Department's filed comments, the Department's best data regarding the railroad industry's performance in these three areas that are subject to this proceeding relates to intermodal services.

Moreover, the Department's rail freight policies have recently emphasized the importance of the development of intermodal services. Accordingly, my comments today, like the Department's filed comments, will focus on intermodal services.

Overall, the post-Staggers Act regulatory environment has allowed railroads to respond to market forces that have demanded lower costs, greater productivity, and more innovation in the form of new transportation services. A significant aspect of these improvements is the growth and evolution of intermodal services.

Over the last few decades, improvements in intermodal services such as double-stacking have increased intermodal capacity and efficiency and have thereby allowed these services to better compete with other modes, particularly in the long-haul market. Thus, for example, in 2007 rail intermodal had a 64 percent share of the market for shipments of greater than 2,000 miles.

In the Department's view, numerous public benefits are to be derived from the continued growth of intermodal services. These include benefits in the area of safety, environmental sustainability, economic competitiveness, state of good repair, and with the billing.

As to safety, rail fatality rates per billion ton miles are significantly lower than for trucks. By moving some of the growth in truck traffic onto rail, there will be a reduction in the growth of truck ton miles with a likely corresponding reduction in truck-related fatalities.

Rail intermodal services also have

an advantage over motor carriage in terms of fuel consumption. With less fuel consumption, fewer greenhouse gases and other pollutants are emitted into the atmosphere. This also carries with it less dependence on petroleum and its sometimes unreliable sources.

For economic competitiveness, rail's ability to offer shippers a total package of lower logistics costs means that savings can be passed on to consumers in the form of lower prices for goods in stores. For U.S. manufacturers, keeping logistics costs low means goods are more competitive in domestic and world markets.

With respect to state-of-good-repair concerns, moving more freight by rail will help contain the public costs of maintaining and repairing the nation's highways. Finally, with fewer trucks on the highways, congestion is reduced, which improves livability.

In light of the myriad public

benefits of intermodal services, it should come as no surprise that the Federal Railroad Administration's National Rail Plan Progress Report submitted to Congress in October of last year laid out a goal of developing strategies to attract 50 percent of all shipments 500 miles or greater to intermodal rail.

To be sure, motor carriers do play and must continue to play a critical role in keeping freight moving safely and efficiently throughout the United States, particularly for pick-ups and drop-offs at the origins and destinations of freight movements.

However, as Secretary LaHood has emphasized, it is the Department's goal to see more freight move via rail, and toward that end the Department has begun to make substantial investments in freight rail's ability to build capacity as part of the Tiger Grant Program created by the American Recovery and Reinvestment Act of 2009, supplementing the significant private investment already being made by freight railroads.

In deciding how to allocate these grant monies, the Department evaluates the public benefits that would be derived from their use on particular projects, and in each instance federal grants have been combined with private sector funds and other public monies.

In light of its commitment to the continued vitality of intermodal services, how, then, does the Department view the intermodal services exemption? The Department observed in its written comments that its ultimate views on exempt traffic, intermodal or otherwise, will be informed by its better understanding of the issues after a factual record is developed by knowledgeable parties.

While the Department has found the comments filed in this proceeding informative, the Department's views on the intermodal services exemption expressed in its written comments have not changed. At this juncture, it is still not clear to the Department what role the intermodal services exemption has had in promoting the growth in intermodal traffic.

While freedom from regulation has allowed railroads to introduce new services without being concerned about the possibility of their rates and practices being regulated, it is highly unlikely that intermodal services would have been subject to regulation even in the absence of an exemption, because intermodal rates have in the past been close to variable costs.

In the future, however, as rail's competitive position is strengthened, particularly on long-haul intermodal movements where it has a significant cost advantage over truck movements, intermodal rates may rise significantly above variable costs.

Thus, the Department continues to believe that this and the other exemptions should be evaluated on their merits and that each evaluation should be based on a careful focused review conducted on, for example, an exemption-by-exemption basis. Thank you.

CHAIRMAN ELLIOTT: Thank you very much, Mr. Plocki. Why don't we go to Vice Chairman Nottingham, if you have any questions?

VICE CHAIRMAN NOTTINGHAM: I have no questions. I just want to thank Mr. Plocki for joining us. It's always good to have the Department before us. Thank you.

MR. PLOCKI: Thank you. It's good to be here.

COMMISSIONER MULVEY: I also want to thank you for coming and speaking before us. It was very informative and very, very useful. I did have one question, though.

You did say that based upon the Department's analysis, the exemptions themselves cannot be credited for the increased rail and intermodal traffic, that the traffic would probably have not been regulated, anyway, because so much of it was below the threshold rates, 180 percent of revenue to variable costs. Is that correct?

MR. PLOCKI: Well, I think the latter half of that is correct. With respect to the first half, I think, you know, we have seen no evidence suggesting that.

I don't think we have definitively analyzed the evidence, because we simply haven't -- or definitively reached a conclusion on that first point, because we simply haven't seen sufficient evidence on that.

COMMISSIONER MULVEY: The exemptions, I think, would help the deregulatory process. The deregulatory process helped the railroads, but making the link between the two I think is more difficult.

MR. PLOCKI: Yes.

COMMISSIONER MULVEY: Thank you.

CHAIRMAN ELLIOTT: I have no

questions, but we do thank you very much for participating. We always appreciate it when the Department comes, participates in our proceedings. Thank you.

MR. PLOCKI: Thank you, Mr. Chairman.

CHAIRMAN ELLIOTT: I'd now like to call forward Panel II, which is the Railroad Interest Panel. Thank you for coming here today to participate in the hearing. We will hear from the American Short Line & Regional Railroad Association first. We'll hear from Richard F. Timmons, and you have ten minutes.

MR. TIMMONS: Thank you, Mr. Chairman and Commissioners. It's good to be here and appreciate the opportunity to testify this morning. I am Richard Timmons, President of the American Short Line & Regional Railroad Association, which is the national trade organization that represents approximately 540 Class II and Class III railroads.

On behalf of our members, I thank

the Board for inviting testimony on the commodity boxcar and intermodal exemptions. The Short Line Association believes that the exemptions are effective, have worked exactly as intended by Congress, and benefit both railroads and shippers.

There is no need to revisit the rationale underlying the exemptions, because petitions to revoke provide sufficient opportunities for aggrieved parties to seek review of those exemptions. Moreover, the low number of revocation petitions filed by aggrieved parties demonstrates that the exemptions are not being abused.

Finally, periodic reviews of the exemptions would force small railroads with limited resources to incur substantial costs to repeatedly defend the exemptions and effectively would shift the burden of proof to the railroads to prove regulation of the subject traffic continued to be unwarranted, which approach would be inconsistent with the statutory mandate in favor of exemptions and certainly at odds with the current regulatory scheme governing petitions to revoke.

The Association urges the Board to refrain from taking any action that would limit or otherwise dilute the effectiveness of the exemptions. Instead, the Board should continue to uphold the statutory mandate to exempt traffic to the maximum extent possible.

Please refer to my extended remarks regarding these points, which are appended to this written testimony as Attachment 2 and are therefore made a part of it by this reference.

Since the passage of the Staggers Act, almost 300 newly formed railroads have acquired light density lines in communities across the U.S. Many short line properties suffered from years of deferred maintenance and service deterioration and are candidates for abandonment.

The short line entrepreneurs

acquired these properties, rehabilitated the track infrastructure, hired and trained staff, and revitalized service in communities that faced loss of rail services.

Today, these small businesses with median annual revenues of just under $2.5 million, operate approximately one-third of the nation's rail lines and play a critical role in the economy of the communities those carriers serve. Despite operating approximately one-third of our system, small railroads earn less than five percent of annual freight revenues.

Under these circumstances, it is evident that small railroads do not have a meaningful market power. These small entrepreneurial businesses do, however, provided essential services to shippers, as well as communities located on light density lines, often in rural areas.

The Board should refrain from taking any action with respect to the exemptions that would adversely affect the regulatory environment in which short lines have been able to thrive. These exemptions are of critical importance to short line railroads, and in practice they have worked as intended with respect to traffic handled by small roads.

Boxcar traffic and exempt commodities are subject to intense inter- and intramodal competition. The vigorous competition for boxcar traffic and exempt commodities has kept prices extremely competitive.

Indeed, according to the Freight Facts and Figures 2009, a copy of the Federal Railroad Administration Handbook, trucks handled 60 percent of the freight tonnage moved by the major transportation modes.

For the short lines, the competition is particularly intense. Traffic moving over shorter distances, that is, 500 miles or less, is particularly susceptible to diversion to truck transportation.

In recent years, larger numbers of heavier trucks and combination vehicles, along with federal legislative initiatives, have made the competition even more difficult. Even for traffic moving longer distances, short lines generally must compete with trucks and waterways, as well as intermodal operators and oil truck operations on the Class Is.

Small railroads by definition operate small systems that are in close proximity to the Class I carriers. Because a short line generally accounts for only a small portion of the mileage of any interline moved, shippers frequently have an opportunity to bypass a small railroad by trucking their cargo to the nearest trans-load facility on a Class I rail system.

Shippers also can bypass short lines by making intermodal shipments that move onto rails at intermodal facilities served by a Class I carrier. These options make small railroads susceptible to traffic diversion in ways that generally do not affect Class I railroads.

Under these market conditions, it is clear that short lines have virtually no opportunity to abuse market power, and effective competition for subject traffic is present. Accordingly, the exemptions are appropriate.

It is also important to note that railroads are not the only beneficiaries of exemptions. By deregulating exempt traffic, railroads are able to compete more effectively in markets that previously were dominated by trucks, for example, the classic issue of fresh fruits and vegetables.

Short line marketing personnel fight a constant battle to preserve market share. The exemption of boxcar traffic and exempt commodities has allowed the free market to function and the short lines to be competitive. Thus, the exemptions benefit shippers by providing them with a competitive alternative to trucks or other modes of transportation.

Such competition forces all modes of transportation to provide more efficient and economical service in order to maintain their market share. Shippers are the beneficiaries of this competition.

Retaining the exemptions is especially important to small railroads, because much of the traffic handled by short lines is covered by those exemptions. We believe that more than 50 percent of small railroad traffic consists of boxcar and exempt commodities.

The exemptions for boxcar traffic and exempt commodities affect a much higher percentage of small railroad traffic than Class I traffic. Compounding this problem has been a 30-year downward trend in railroad general merchandise traffic of approximately 30 to 40 percent. Accordingly, any action by the Board to prevent or limit the exemptions would therefore have a disproportionately adverse impact on small railroads.

A curtailment of the exemptions would be unwarranted with respect to small railroads, because in general those carriers do not have a history of abusing market power, and their service is limited in scope.

According to Railroad Facts, the nation's 556 small railroads operate 32 percent of the railroad miles in the country but earn only 4.22 percent of railroad revenue. This disparity demonstrates that small roads are virtually incapable of abusing market power, either in their dealing with shippers or with connecting carriers.

Similarly, small railroad operations are limited in scope. The average short line operates 71 miles of rail lines and handles approximately 13,000 carloads of traffic per year.

To put these numbers in

perspective, the smallest Class I railroad operates over 5,800 miles of rail and handles over 361,000 carloads of traffic each year. Accordingly, short line operations are limited in scope.

The Board should not engage in general periodic reviews of the exemptions. The revocation framework provides shippers as well as others with an appropriate mechanism for reviewing exemptions for specific abuses.

In addition, because a large percentage of small railroad traffic consists of exempt traffic, instituting periodic reviews of the exemptions would force small railroads, which by definition have limited resources, to repeatedly defend the appropriateness of such exemptions. Small railroads simply lack the resources to do so.

In conclusion, the Short Line Association urges the Board to refrain from curtailing or limiting the exemptions, which would have a disproportionately negative impact on small railroads, to continue to rely on the revocation mechanism currently in place to correct any abuses of the exemptions, and refrain from engaging in periodic reviews of the exemptions that would force small railroads to engage in costly proceedings.

The ASLRRA appreciates the opportunity to submit this testimony in ex parte 704 and would welcome any questions you may have at the appropriate time. Thank you very much.

CHAIRMAN ELLIOTT: Thank you, Mr. Timmons, and now we'll hear from the Association of American Railroads. We'll hear from Mr. Hamberger and Professor Willig.

MR. HAMBERGER: Good morning, Mr. Chairman, Mr. Vice Chairman, Commissioner Mulvey. We appreciate the opportunity to be here this morning.

As usual, I find myself in violent agreement with General Timmons and wish to associate myself with his excellent remarks.

There are four fundamental considerations I hope that the Board will keep in mind as you evaluate the comments and testimony in this proceeding.

Number one, there has been no change in the law or congressional policy favoring exemptions. Statutory provisions, as well as attendant congressional policy and guidance to the Board, has not changed.

By law, the Board is required to exercise its exemption authority to the maximum extent possible. The Board and its predecessor, the ICC, have followed the direction of Congress with respect to granting exemptions.

Through ICTA in 1995, Congress not only validated the Agency's approach to exemptions, but, in fact, actually expanded the Board's mandate to be more aggressive. Since the Board has appropriately followed congressional policy, and that policy has not changed, there is no legal or policy basis for the Board to change its approach to exemptions.

Number two, the statutory test for revocation is that the reapplication of regulation is necessary to carry out rail transportation policy. While Congress mandated the Board to utilize its exemption authority aggressively, it provided for exemptions to be revoked only if there is an abuse of market power by the exempt rail carrier.

Accordingly, the test for revocation is not whether an exemption is still necessary. It is instead whether re-regulation is necessary, and that depends not on the financial condition of the industry, not on whether there are no longer tariff filing requirements, not whether rates may be higher or lower than before.

As my written testimony details and as Professor Willig will explain more fully, the test is whether there is no effective competition for the exempt movements at issue and that the rail carrier is abusing its market power regarding those movements.

It is important to note that the burden of showing the need for revocation rests with the party seeking that revocation. The statute does not provide for the Board to initiate revocation proceeding on its own initiative, unlike proceedings to exempt traffic, which the statute does specifically authorize you to initiate on your own.

Issue three, the testimony in this proceeding does not support any conclusion that there is an abuse of market power regarding any exempt transportation. Even if the Board could initiate a proceeding on its own, the facts do not support any further Board action in this proceeding.

The testimony presented by other parties does not rise to factual presentations necessary to support a petition for revocation of the boxcar intermodal or any entire commodity exemption. You will hear more from other railroad witnesses on this issue. However, I wish to highlight one factor relating to competition for exempt transportation.

As Professor Willig noted in his written testimony, revenue cost ratios for particular commodity or car type movements are not necessarily indicative of an absence of effective competition. However, a low revenue variable cost ratio has been determined by statute to be a conclusive presumption of effective competition.

On the screen you can see that all boxcar traffic revenue variable costs since that exemption was instituted in 1987 is currently at a point below the rate of the RVC in 1987.

Similarly, for all commodities the rate is at approximately 148, 149 percent, far below the 180 percent level for jurisdiction here at the Board, and I will point out that this is matched revenue, and so the actual numbers are probably lower than you see here.

Issue four, reexamining well established and proven underpinnings of rail regulatory policies both in this proceeding and in Ex Parte number 705 introduces uncertainty into the industry. The Board has taken these actions at a critically inopportune moment for the railroad industry and its various constituencies.

After many decades of decline, attributable in large measure to over-regulation for much of the 20th Century, America's freight railroads have succeeded in achieving enviable productivity gains and solid economic growth in an era of decreased regulation.

This has resulted in the railroads achieving improved returns, which in turn has permitted them to reinvest heavily in their systems. The very regulations or absence of regulation being discussed today are the very reason that railroads are such a critical part of the U.S. economy and our nation's financial recovery.

Due to the certainty governing our industry today, railroads have been able to invest $480 billion since 1980 to build a world-class network that reliably and safely delivers for American businesses.

That investment, which must continue unabated in the face of demands for more capacity, improved service, and attendant environmental job creation and other public benefits, has been made possible by the Board's implementation of ICTA consistent with congressional directives. Reexamination with the overhanging threat of possible reversal of those policies introduces uncertainty into the marketplace.

To conclude, the Board has properly utilized the exemption authority granted by Congress to exempt traffic from regulation. These actions have contributed to the ongoing rail renaissance, and there is nothing in the law, in congressional policy, in the testimony in this proceeding which would justify the Board taking any action to reverse the proper course it has followed to date.

Thank you for the opportunity to be here, and I look forward to answering any questions you may have.

DR. WILLIG: Thank you, Mr. Chairman, Commissioners. Notice that the light has stayed green this whole time. I'm about to change that. Maybe I have some extra time.

I do thank you very much for the opportunity to share my views on the economic rationale for the Board-granted exemptions and the framework for evaluating whether to revoke an exemption. I underscore the phrase "economic rationale."

I am an economist. I'm used to working with lawyers all the time, but I prefer to stay on the economic side of that boundary line, and I welcome discussion later from the economic point of view.

So I'd like to start with some basic economic principles. In the freight railroad business, regulation of prices -- I feel like we're -- is only needed when there is an absence of effective competition, and market forces are not able by themselves to generate prices that are conducive to what economists call economic efficiency.

Even stronger than that, though, I think for today's purposes is the statement of principle that where there is effective competition, and we know there are such widespread instances in the industry, it is best by far not to regulate. It's not just regulation ought to be there if we don't have effective competition, but where we do have effective competition, I think as a matter of economics that it's very important not to regulate.

It's important, moreover, in such circumstances to have as much of an institutional commitment as we can to not regulate, because where there is the possibility of competition driving market outcomes, the overhang of the possibility of regulation I think is a real deterrent to negotiations and market forces doing their best for social efficiency for all the parties involved.

I think only with that kind of commitment not to regulate in the face of effective competition, only then will market decisions and negotiations work optimally to create efficient outcomes. I believe that exemptions can foster such good market outcomes by providing some of that targeted commitment through market forces.

From my point of view, when I think about some of the issues at hand, some of the costs of the hearings that may be necessary to investigate the future of examinations, obviously it's a costly process for those involved, but I think there's real economic costs involved in terms of weakening the commitment to staying away from regulation where most likely that regulation is not needed to get competitive outcomes.

So, looking back, the STB's regulation authority is therefore appropriately focused, and it has been appropriately focused on specific markets where there is demonstrable evidence of abuse of market power or at least a high risk of such conduct. Where there is no such evidence, exemptions do help and have helped competition work for the public interest, and that is my view as an economist looking back over the history.

The ICC and the STB have appropriately exempted particular commodities and services from regulation whenever the evidence demonstrated that they were subject to effective competition, whatever the source of that competition, whether it was based on intermodal forces, intramodal, product, or geographic competition. The full range, as you know, has come into the assessments of the degree of effectiveness of competition for the purposes of assessing exemptions.

Your decisions in this area and your predecessors' for exempting boxcar traffic, intermodal traffic, lumber or wood products, rock salt, and so forth, a very long list, were all based, as I read the record, on very well documented empirical evidence of the effectiveness of all of these types of competition in the marketplace. I think it's a really good record as I read it from an economic point of view.

At the same time, as I understand it, your exemption decisions expressly have opened the possibility of revisiting to address any evidence of any specific abuses of market power that might be shown to exist, but you have correctly, I believe, enforced the requirement that any proponent of revocation of an exemption must demonstrate through well supported evidence that the market conditions that originally supported the grant of the exemption have been altered so significantly that reregulation is now required.

These requirements, as I understand it, are well supported, pointed evidence about the traffic that is made to be at issue, instead of some sort of general claims of, "Well, the times have changed. That ought to be enough," or platitudes, if I may, about exemptions "having served their purposes" due to some higher view of railroad profitability, instead of those general platitudes -- it's not that insulting a word, is it? -- but in contrast to really well pointed empirical evidence going to the important subject at hand.

Well, with those generalities expressed, I want to emphasize, apart from platitudes, that rising prices or improved railroad profitability generally are absolutely not appropriate justifications for revoking exemptions. Instead, these dynamics, prices going up, prices coming down, finances of the railroads doing better, sometimes doing worse, are ordinary and frequent outcomes of competitive markets.

These are not signs, either upward or downward, of market power necessarily, because in competitive industries we see finances oscillating back and forth. We see prices going up and down, driven by competitive market forces.

So, if I may -- oh, there it is. Well done. Figure 1, this is in my written testimony, and anybody who like me is a little bit color blind, you cannot tell these line graphs from each other, so I'm here to tell you what my PowerPoint reveals if you have the live computer.

So take a look from the right-hand side of the picture, and I'm going to be going down the list from high to low of these different line graphs. So the very top one on the right-hand side is a broken dark line. That's a trace of the volume of rail traffic as collated by the AAR.

The next one, which looks red even to me, is the AAR's measure of rail productivity. The third one is total revenues, again AAR data. The fourth one down is the AAR view of a broad price index of rail freight traffic.

The next one down is revenue-per-ton-mile, so a price surrogate as collected by Christiansen and Associates, a word about that in a moment. The last line is the marginal cost of rail traffic averaged over the commodities and the volumes in question, again produced by Christiansen and Associates.

This is the Christiansen study of competition that I believe was requested, supported by the Board, and has been updated a few times and which I feel is an absolutely excellent study. Christiansen is a terrific economist, and he's used real state-of-the-art methods here, as well as pertinent data, in my view.

So let's take a look at this and see what it says about the dynamics of the industry. A good anchor is 1980, which is the passage of the Staggers Act, of course.

All these lines come together in 1986 or 1987. There is no significance to that. That's just the base for these indexes, so they're all -- all the indexes are 100 in that year by construction.

What's remarkable, though, is that if you start at 1980, look above 1980, all kinds of good things start to happen right after the passage of the Staggers Act. Productivity, that red line, really jumps. It's been flat all those years. It really takes off right after the Staggers Act.

The pricing lines, they've been flat. Right after 1980 they all start going down in strong ways. Marginal costs start to come down. All kinds of good competitive dynamics begin when real deregulation or the opportunity for deregulation under the Staggers Act sets into the industry.

It's a remarkable sea change, and, in fact, the textbooks on regulation all have charts that look something like this and say, "Oh, my goodness. Look what the Staggers Act did empirically."

The next sea change begins around 2004, when new dynamics set in. Rates begin to increase. Productivity starts to turn down, and marginal costs begin to rise right after 2003-2004, a very different dynamic probably picked off by the huge increases in fuel prices that begin right around those years, and right around those years marginal costs begin to go up, and rates go up right along with the marginal costs, as one would expect under competitive circumstances.

Yes, see, I talk loud, right? Is

that the problem? Big classrooms.

So this dynamic, prices being driven by marginal costs, marginal costs being driven by both productivity and the exhaustion of the easy productivity gains attendant to deregulation and the drivers of wildly increasing fuel costs, are all things that are characteristic of competitive markets and competitive pricing dynamics and in no way support a view of abuse of market power or some generalized weakening of competition in the industry.

Another point to help to make that is, unfortunately, in 2008 or so, way over on the right-hand side, the big recession begins to have effect, and there is a fast decrease in volume. Rates begin to soften, because the demand is really soft due to the decline in the economy.

Meanwhile, there is still capacity congestion in this marketplace, and that's part of the reason why rates begin to increase in the middle of the decade as real congestion in the railroad network, real bottlenecks that raise congestion costs.

And even though the recession really takes a lot out of the growth of volume, it doesn't entirely stop that capacity congestion. So we see rates softening and coming down, but not nearly as much as they would if the capacity congestion problems were fully solved.

Well, hopefully that's going to happen. The railroads have been investing. The number I have is some $74 billion over the first decade of this millennium, despite the turndown of finances during the recession years, and the railroads are making, I understand, significant strides to address the capacity constraints that we see in these data.

This very significant reinvestment in the private freight rail network is inconsistent, if you think about it, with any suggestion which seems to come up in these conversations, the suggestion that the industry might be exercising market power artificially to restrain capacity and thereby drive up rates. That's just not consistent with these data.

The opposite appears to be true. Volume continues to go up. That's not the hallmark of market power at all, and the industry seems to be investing hand over fist as the investors will provide the funds, which is certainly not characteristic of some sort of a conspiracy or a collection of collateral approaches -- I told you -- to try to keep things congested and thereby more profitable.

So, improving profitability is clearly not a sound indication of any need for revocations. My economic bottom line on this, and I can't state this strongly enough, no matter how well or badly any railroad is faring financially overall, competitive services should be free of price regulation.

It's not about the overall finances. It's about market-by-market. Is there sufficient competition to feel like pricing will be driven by efficiency? And that's a market-by-market determination. It does not have anything to do with the overall finances of the railroad.

Likewise, regulation should be considered for services that are truly market dominant and subject to abuse of market power, irrespective of the overall finances of the railroad. This is a neutral principle. It really goes in both directions. So that leaves the question on the table.

MR. HAMBERGER: May I save my time to --

DR. WILLIG: Thank you very much.

CHAIRMAN ELLIOTT: That's fine.

DR. WILLIG: So the question remains. How should the propriety of maintaining exemptions be gauged? It's not overall finances of the railroad.

So I have an economic answer. It's written out at some length in my file testimony, but let me just state it here in a condensed form.

It is if a convincing showing can be made based on facts in evidence, not rhetoric, that a particular movement is no longer subject to the forces of effective competition, resulting in abuse of market power, then the Board, if presented with an appropriate petition, may have grounds to investigate whether reregulation is necessary and appropriate to protect the public interest.

And in such an investigation the Board should, if you'll allow me to give you advice, the Board should take care to focus as narrowly as possible to address the concerns identified and not to sweep them more broadly than necessary, because, again, there are real economic costs to threatening regulation rather than committing to not regulating where there is effective competition.

In other words, any revocation of an exemption should be carefully limited to the particular movements or circumstances as to which an abuse of market power has been shown by rigorous evidence to exist.

So I thank you for your patience. Thank you for allowing me to share my thoughts and concerns. I do think this is an important matter, and again I urge you to proceed with caution and care.

The downside is sending the wrong signals to the marketplace, which could actually threaten the availability of investment funds to help keep up the capacity that we need to handle traffic growth.

My admonition is like the physician's "Do no harm," but please, as an economist would say it, do not eliminate exemptions that well serve the public interest in competition. I thank you very much.

CHAIRMAN ELLIOTT: Thank you,

Professor. Thank you, panel, for your participation. I just had a couple questions. First of all, I just want to clarify on your chart, Mr. Hamberger.

MR. HAMBERGER: Yes, sir.

CHAIRMAN ELLIOTT: On the second part it says, "All non-boxcar commodity." Does that -- does this chart include intermodal?

MR. HAMBERGER: It does not.

CHAIRMAN ELLIOTT: It does not?

MR. HAMBERGER: We did not --

CHAIRMAN ELLIOTT: So the intermodal is --

MR. HAMBERGER: We did not put intermodal here. The testimony from --

CHAIRMAN ELLIOTT: Okay.

MR. HAMBERGER: -- others indicated that that was not particularly an issue of contention. We do have that analysis. I believe currently intermodal is about 132 percent of R/VC.

CHAIRMAN ELLIOTT: Okay, I just

wanted to clarify so I understood the chart. With respect to the overall numbers, the amount of traffic, you know, and R/VC ratios, I was -- I mean, those numbers appear.

Obviously, they're all under 180, and I've seen -- now, in that instance, those are good numbers, and then what about in specific instances where a specific commodity has numbers that are over 180?

We've -- I've had our economist do some waybill analysis, and in one instance we have -- of course, I'm taking the most extreme, crushed limestone, which is a serious commodity. You carry quite a bit of it -- is at what we had for 2009 at 272.

In an instance like that, would you think that is a good indicator of market dominance that the railroads are exercising their market power?

MR. HAMBERGER: Let me start, and then I'll turn it over to the economist. Of course, for you to consider it I would suggest that there needs to be a filing of a petition for revocation, number one.

Number two, as Professor Willig stated, the RV/C is one indicia of whether or not there is competition, whether or not there is abuse of market power, but let me let him to into that in more detail.

DR. WILLIG: Thank you. Economics has a pretty well defined conclusion on using revenue-to-variable cost or revenue-to-marginal cost ratios as possible indicators of market power.

I'm sure you're well aware of this, but, of course, where there are important fixed costs, some cost to the infrastructure, and these are extraordinarily high in railroad and across all industries, somebody's rates are going to have to be well above variable and marginal costs to even begin to attempt full cost recovery on a going forward, long-term basis.

So finding that some traffic has

rather larger than average ratios of revenue to variable costs should not be upsetting at all or in any way viewed as an indicator of the kind of market power or monopoly power that we look to regulation to control.

CHAIRMAN ELLIOTT: Okay, and you're saying it could be an example of how we regulate here with differential pricing?

DR. WILLIG: Yes, that obviously is differential pricing.

CHAIRMAN ELLIOTT: Right.

DR. WILLIG: But I don't look at that, an example of that kind, as necessarily pointing to abuse or exercising --

CHAIRMAN ELLIOTT: Right, and then we had other examples. We had them take a look at how traffic, the amount of traffic traveling, exempt traffic, by commodity traveling at over 180 RV/C ratio has increased from `93 to the present. 2008 was the last number.

I'll give you another example,

which isn't the most extreme, but looking at stone and glass products it went from 14 percent traveling over 180 to 41 percent. It went from 14 to 17 in `98, to 30 percent in 2003, to 41 percent in 2008, and this is once again off the waybill analysis. What about that as an indicator? Same type of question.

DR. WILLIG: Well, I would repeat the same answer but then fill it out a little bit more, because in that time period, particularly as we get to the middle of the 2000s and out to 2008, first of all, fuel costs are rising very fast, and this is a matter of the arithmetic for the way the variable costs are calculated.

They're kind of slow to reflect big upward movements in fuel costs, so some of that changing ratio could be the impact of very fast rising input costs not being fully reflected in the VC data. Likewise, congestion would -- has been a big factor since the last eight years or so in railroad operations, and, of course, the railroad people can speak about that later on today.

Congestion is an important determinant in the market for business but also for economics that goes into appropriate competitive rate-making that you've got a scarcity of the rail resources, which could be the track. It could be the cars. It's proper to see prices rising under those circumstances.

The way we figure variable costs -- we all do it in this industry -- those costs don't really reflect congestion the way the economist's view of marginal costs do. Marginal costs include congestion. It's hard to measure that, but conceptually marginal costs rise a lot when scarce resources become more scarce and there's more congestion.

The VC formula does not reflect that, so we might very well be seeing a large revenue-to-variable cost ratios without there being an enlargement of the true ratio of revenue-to-marginal cost under conditions of fast-rising fuel costs and also under conditions of congestion. I'd be just cautious in reading those tea leaves.

CHAIRMAN ELLIOTT: Thank you. One follow-up on Mr. Hamberger's comment. With respect to having to file a petition in order to initiate consideration of revoking an exemption, I think that's a very strong argument, but at the same time I also look at our cases where we reconsider decisions that have been made by the Board and as a result of changing circumstances or new evidence maybe material error that we do reconsider past decisions. Do you think that would be applicable in this instance?

MR. HAMBERGER: No.

CHAIRMAN ELLIOTT: I'm surprised you said that.

DR. WILLIG: At last, a short answer.

MR. HAMBERGER: In general, I

would say -- not in general. Specifically, the statute directs you to pursue granting exemptions. That is what you are statutorily directed to do, and it lays out a process where the burden of proof is on those seeking the repeal. There has to be a finding that it is necessary for the transportation policy, so I would stand by my statement that it requires a petition to be filed.

CHAIRMAN ELLIOTT: Thank you. I don't have any further questions. Mr. Mulvey?

COMMISSIONER MULVEY: Thank you. Like you, I share the burden of working with lawyers.

(Laughter.)

COMMISSIONER MULVEY: A couple of things. Again, with this revocation of exemptions, you pointed out that we've only had a couple of examples where people have come forth and asked for revocation of an exemption, and we didn't grant it.

One case I'm familiar with was

with cottonseed oil in Texas where it was charged that the particular shipper was not receiving good service from a particular railroad, a short line railroad. The Board revoked the exemption, because cottonseed oil is exempted, and then addressed the problem, I think successfully.

But the shippers often claim that it's not that they can't do it. It's that it's expensive, it's burdensome, and they would do it more often if they felt that the procedures were simplified.

Do you think there is any merit to that argument that the reason they don't ask for more revocations of exemptions is that they're unsure of the Board's process and that there's an uncertainty involved? Ed, do you want to address that?

MR. HAMBERGER: Well, there is, of course, uncertainty in any legal proceeding, so, you know, if what one is looking for before one brings a case is an automatic guarantee that one is going to win, I would suggest that will never happen.

As far as the cost, that is something that is generally between you and OMB as to how you are able to set your filing fees, et cetera, and we certainly have never supported high filing fees. I've always testified in favor of having the Board processes open to the maximum extent possible.

COMMISSIONER MULVEY: And the Board is making an attempt at doing that. We have lowered our filing fees for many things, and we are trying to streamline our processes, so perhaps that might lead to more petitions for revocation.

MR. HAMBERGER: Streamlined processes help not only plaintiffs but defendants.

COMMISSIONER MULVEY: One of the issues that one of your charts for both boxcar traffic and the other is that that's the average for all the traffic in that group, but, in fact, there is always a distribution in any average, and, as the Chairman mentioned, there are some cases that are outlier, or far from average.

We have just some examples of some commodities, some types of traffic where the revenue-to-variable-cost ratio was far, far, far above 180 percent and, more importantly, has been climbing steadily in the last few years.

Do you have any sense of whether there are any commodities out there that are currently exempt that you feel have a more or better case to call for a general revocation of exemption, or should it always be on a case-by-case basis, and should it always be for a specific movement and that there shouldn't be any wholesale commodity revocation? Mr. Willig could also address that. You both could address that.

MR. HAMBERGER: To the extent that a revocation submission can meet the burden of showing that there is a lack of competition, that there is an abuse of market power, and that reregulation is necessary, if that is for a commodity-wide basis or a specific movement, that is up to the petitioner to decide how to file.

What I was trying to get across in these two charts is that, generally speaking, there does not appear to be that kind of rigorous support for commodity exemptions to be revoked, but the Board has a process in place to allow those who feel that their facts can support such a filing to come forth and make the filing.

COMMISSIONER MULVEY: The mean can always hide a lot of outliers.

MR. HAMBERGER: And I will not concede that there is any abuse, but theoretically speaking it is possible that there is an outlier there and suggest again that the Board has in place a process for that theoretical outlier to come forth.

COMMISSIONER MULVEY: Professor Willig, I know that you are a strong believer in the existence of competition. I spent quite a bit of time in the airline business looking at the issue of contestable markets, and I know your views on that, but are there some cases where there seems to be some bands of traffic that are more or less competitive with other modes?

For example, relatively short-haul moves by the short lines. Most of the short-haul traffic tends to be truck competitive, and, of course, if you're near waterways, then you have water competition from barges.

Isn't it true that for most long-distance traffic, regardless of commodity types, but for real long distances rail is really the only option today? There have been important changes in trucking markets. You've got a shortage of drivers. The price of fuel has risen for trucks on a relative basis and relative importance of those, of course, much more for trucking than for rail?

So have there been enough changes in competitive marketplaces, especially for long-distance markets, that there might be some places now where we really should review the overall exemption process, Mr. Willig?

DR. WILLIG: Well, just in terms of the process of today, the railroad marketing officials will be speaking, I think, certainly much accurately than I can to the facts involved in any particular area of traffic that you'd like to ask about.

At the same time, I mean, I'm well aware as an economist, and I know you are, too, that the length of the haul matters a lot in terms of the balance of cost between trucking and rail, but I'm also aware that when it comes to very long haul that mixtures of rail and truck are very empirically important and I think in general attractive to the shippers.

And if there is going to be a

trucking portion of a long haul total movement with rail in the middle someplace, that fosters railroad-to-railroad competition for providing the railroad part of the long-distance haul.

So truck to one or two or three different choices of railroads, trucks at the other end, makes for a relatively more competitive long haul to kind of fill in the gaps that you were alluding to.

MR. HAMBERGER: And, I guess, I would just add for the record if I could that Joanne Casey will be testifying later on behalf of the Intermodal Association of North America. JB Hunt and the HUB Group have also filed written testimony as large intermodal users, and they are very much in support of maintaining the current exemption.

COMMISSIONER MULVEY: Mr. Willig, Professor Willig, you also mentioned the Christiansen study that the Board commissioned a while back and that it was good work. I wonder if you're aware that one of the principal authors of that study has recently completed a paper that shows that the railroad productivity gains, which in the early years were passed on to shippers --

Virtually 100 percent were passed on to shippers in terms of lower rates, but today, over the last four or five years, the railroads have actually kept the benefits of the productivity changes instead of passing them on to shippers. Would that be a suggestion that there has been a shift in terms of the railroad's ability to exercise market power?

DR. WILLIG: I actually haven't studied the paper that you're alluding to, and you're now interesting me a lot in doing it.

COMMISSIONER MULVEY: We'll make sure you get a copy of that paper. I think it's a very interesting one.

DR. WILLIG: If that's what it shows, but without commenting specifically in that paper about the impact of competition, I wouldn't jump to that conclusion just from the fact that you alluded to that productivity gains have continued.

Of course, they've dropped off the last two years when there are other things going on in the market like extraordinary increases in fuel costs, so that would get in the way of what would ordinarily earlier have been that same relationship.

COMMISSIONER MULVEY: That's all for the time being.

CHAIRMAN ELLIOTT: Thank you. Thank you, Commissioner. Vice Chairman?

VICE CHAIRMAN NOTTINGHAM: Thank you, Chairman Elliott. General Timmons, if I could, did I hear correctly you mention that currently there are about 556 short-line railroads? Was that the number?

MR. TIMMONS: Yes, that's correct.

VICE CHAIRMAN NOTTINGHAM: And do you happen to know, if we were to flash back to 1976 when the 4R Act first raised this whole exemption issue and put it very solidly into statute, what the short-line industry looked like back in `76?

MR. TIMMONS: In general numbers about 250, 260, somewhere in that realm.

VICE CHAIRMAN NOTTINGHAM: Do you think there's any connection between or is it just a coincidence that the 4R Act and Staggers were passed in `76, `80, and your association membership has been able to grow thanks to practically a doubling of the number of short-lines operating?

MR. TIMMONS: I don't think there's any question about it. I don't think there was any conscious intent or awareness that the short-line industry would expand as rapidly as it did post-1980.

The interesting developments that that Staggers Act produced was a growth of short-line mileage at about that time of about 8,000 miles of short-line main line track, and today it's slightly under 50,000 miles.

Now, as you know, there were a large number of Class I railroads in 1980, and they had reduced dramatically by 1990, and in the decade of the eighties Class I railroads divested themselves of many, many properties that were less than economically feasible for their purposes.

Small railroad entrepreneurs and others gathered those pieces up, even though they were a little broken down and dilapidated, decided that they could with flat overhead, smaller staffs, and local customer interface thought that they could build them, and they did, and that evolution has continued to this day. Obviously, it's slowed down pretty dramatically, but there is no question that Staggers had a dramatic impact on the small railroad industry.

VICE CHAIRMAN NOTTINGHAM: Thank you. Professor Willig, if I could, thanks for sharing and reviewing the charts. Some were quite familiar, and we appreciate the reference to the Christenson study, too, which about a million dollars of taxpayer money went into that study through the Board.

It's probably the, I would suggest, the most important study that the Board has commissioned in many decades, and I do commend everyone's attention to it. I think it's still very timely and relevant, even though it's just a few years old now.

In the science of economics, how do you account for, I guess I'll say -- I'll just use the phrase sort of the people who aren't winners? You're not here to suggest that every single customer of railroads came out a winner across the country as a result of the deregulatory policies of the seventies and eighties, are you?

I mean, we do hear, of course, from people who say with all seriousness that their situation has worsened. How do you -- how does the sort of science of economics kind of account for that or explain that?

DR. WILLIG: Well, we're always happy to find a situation where everybody is happy, but it's a very rare occurrence in today's world. The normative stance that applied economists, micro-economists frequently adopt takes a look at the size of the pie and tries very hard to support, to understand what the best policies are from the point of view of the total real income generated by, say, a sector of the economy like the freight transportation sector.

The whole idea of differential pricing, which goes back again to Staggers and to the regulatory rule-makings following Staggers, deliberately adopted the point of view, I'm not sure in these words, but the economists know the connection, pricing that would enlarge the size of the pie of real income created by a better performing railroad industry than had been performing prior to the Staggers Act.

Surely, some of those rate changes were up. Some were down. On average, they were way down. That's not to say that some people's rates didn't go up.

The real interesting question, though, is what's the backdrop? What are we comparing what actually happened to, and if the backdrop is more bankruptcies and more dysfunctionality in the entire industry, lack of capitalization, lack of service of the quality that all the shippers need for their own businesses, then it could very well be the case that everybody was benefitted against the backdrop of no well functioning railroad industry at all.

We always talk that way, but here we really have empirical evidence that pre-4R and before Staggers the industry was basically bankrupt, and so it's not wrong to say that all shippers who find railroad freight opportunities important to their business have been benefitted by the entire movement toward rationalization and deregulation.

VICE CHAIRMAN NOTTINGHAM: If I could take a step back and maybe ask a big picture question, in your line of work I assume you get to hang out, for lack of a better phrase, with academics and experts in a variety of fields of regulated industries and the economics of a variety of regulated industries. I'm thinking of the financial sector, energy sector, other sectors.

DR. WILLIG: We do hang out, yes. It's academic conferences. We work hard, but we also --

VICE CHAIRMAN NOTTINGHAM: I'm curious. What's the -- you know, if you look back at what's happened in our economy the last ten years, some of the explosive scandals in the electric utility industry with Enrons of the world and more recently in the financial services sector, we've seen a lot of finger pointing about whether or not a variety of federal and state regulatory entities fell down on the job or didn't fall down on the job.

What do you say to those colleagues when you turn and look at the state of the freight rail industry and how it's been regulated, kind of what the results of that regulatory relationship and oversight have been?

DR. WILLIG: I'm so glad you asked that question, Commissioner. I just filed some testimony this week in a matter of financial regulation under Dodd-Frank, and I must have spent a page and three footnotes saying, "And, for goodness' sakes, try to get it right, the way the ICC and the STB have in railroading."

All the bad things that went on, all the pitfalls that we've learned to avoid since Staggers and since the 4R Act in this industry are real threats when it comes to other regulatory bodies without the experience and, I dare say, the skill that has been developed in this industry.

And I actually wrote, "Don't make the mistakes today that the rail industry has learned to avoid in the last 20, 30 years." Maybe your ears were turning red with embarrassment at the praise, but I just filed that the other day.

VICE CHAIRMAN NOTTINGHAM: I wasn't aware of it, but --

DR. WILLIG: Yes, I'll send you a copy.

VICE CHAIRMAN NOTTINGHAM: Please do. Thank you. Mr. Hamberger, what do you say to your members' customers who sincerely feel that they were not the winners as an outgrowth of the 4R Act, Staggers, and the trend towards deregulation of the rail industry?

Professor Willig has confirmed that there are people who don't come out winners in these circumstances. What should they do? What options do they have, and what can --

MR. HAMBERGER: Well, I have tried to make the same point that the professor made, obviously not as eloquently as he did here this morning, but the point being that a remember system that is 20 percent in bankruptcy with 25 percent of its track on slow orders, which takes too long to get across the country, cannot provide the service needed for this economy.

The President has said he wants to double exports. We take a third of all exports to port. Without the freight rail industry, we're not going to double exports.

We're not going to get the increased employment that the President is looking for out of doubling those exports, and that comes because we were able to pour $480 billion back into the network in the last 30 years.

So that, in my opinion, benefits anybody who ships by rail. Whether or not a particular R/VC ratio for a particular shipment may have gone up or down, I think the professor's point that the pie has grown for everybody is the appropriate way to look at it.

VICE CHAIRMAN NOTTINGHAM: And your members, when they're operating under an exemption, presumably, obviously, they're not dealing with tariffs. They're dealing in the world of contracts, I assume, or various pricing agreements, service agreements with their customers?

MR. HAMBERGER: I'll leave that for the rail panel.

VICE CHAIRMAN NOTTINGHAM: Okay, because I do want to explore what the real world options are for rail customers in the exempt commodity area if they have a problem. I do also want to throw out, and I confirmed this with our people here, that just because one works in an exempt commodity field does not preclude a shipper from coming to this

Board for informal relief through our Rail Consumer Assistance Program.

So I do want to commend -- I'll probably be repeating this a couple times today, because it will be a long day, and I want to make sure folks who are coming in later for later panels hear it, too.

If you are in the exempt commodity field and you have a problem with the way you're being treated by a freight railroad, let the Board know about it. We're working with the freight railroads every day. We have a variety of relationships and a variety of ways to get the railroad's attention.

It's not all bound in statute, and sometimes it's informal, and it's a successful program, the Rail Consumer Program. We resolve thousands of complaints a year, and I did want to commend everyone's attention to that, as well. Thank you. That's all I have.

CHAIRMAN ELLIOTT: Just one quick follow-up question. With respect to the standard for revocation, it's consistently been termed by you to show an abuse of market power as the standard.

As I read the statute, which someone put in front of me, the statute seems to be broader, and I just wanted to clarify why you had chosen, I guess, that aspect of the Rail Transportation Policy.

But the statute requires regulation where it's necessary to carry out the transportation policy of Section 10101 of this title, and is there a reason why you specifically were referring to abuse of market power?

MR. HAMBERGER: Yes. If you'll take a look at the legal appendix to my statement, that comes from prior ICC and STB decisions. That has become the accepted standard.

CHAIRMAN ELLIOTT: All right, thank you, and one final question that I had, this is just a concern I had about the whole process in place at the present time.

Hypothetically, if you have an exempt commodity and they want to come to us, they have a complaint, and as a result they have to seek revocation. They can't go to the state courts or go to the federal courts, because we still have jurisdiction over it.

What would happen in an instance if there was a service problem under a contract, and the party wanted to seek revocation to come to us to deal with that? However, the revocation process, as I understand it, doesn't let you look backward at all.

Do you think there is a void there for a remedy for parties that have a complaint about service or other issues not regarding money? I know with respect to money you come to us, and you have to go prospectively, but doesn't that open itself up for abuse on other issues like service matters and things of that nature? Do you think there's a void there from your understanding of the way the process works?

MR. HAMBERGER: I would prefer, I think, to respond to that in writing.

CHAIRMAN ELLIOTT: Sure. That's fair. I don't have anything further. Do you?

COMMISSIONER MULVEY: A couple of minor questions. Mr. Timmons, welcome back.

MR. TIMMONS: Thank you.

COMMISSIONER MULVEY: You talked about the importance of not getting rid of the exemptions, and isn't it also true that -- you talked about the problems of determining market dominance.

Isn't the 180 percent revenue variable cost ratio the deciding factor? Doesn't that give you protection? When you have relatively few people complaining about short-line movements because most of those would move well below the 180 percent threshold, and so therefore that serves as an effective screen against too many suits being filed especially against short-line railroads?

MR. TIMMONS: Let me just make a general comment about that and then ask Mr. Sidman to comment further, but it seems to me that in the experience that we've had, the 180 percent threshold for short lines may not be as pertinent as it is for Class I railroads.

The very, very short moves that they make and a variety of conditions that they experience and, to be sure, while we do many of the same things the Class I railroad industry does, the small railroads are not mirror images of Class I railroads.

There are vast differences in a variety of things, whether it's operational tempo or hours of service or revenue generation or the settlement mechanisms that are used between the Class Is and their interchange partners, the short-line railroads.

There are vast differences, and so the 180 may not be an appropriate measure or barrier to protect us in that sense. Mark, do you have anything other?

MR. SIDMAN: Commissioner Mulvey, I think I agree with your observation that most short-line traffic would be below the 180 percent variable-cost ratio, revenue-to-variable-cost ratio, but it's really important to understand that with respect to abuse of market power, short lines really are not positioned to do that structurally.

That reflects a couple things, first, that many short lines, perhaps the majority of short lines created since 1980, have ceded pricing authority to their Class I sellers, so they're actually not a pricer in terms of origin-to-destination moves. They have no interaction whatsoever with the customer, and they have a contractual allowance to which they're entitled for every car they handle.

As to those who do have pricing authority, and there is a population of short lines that do have that authority, there are really two constraints on that. One is that they are pricing only a very small portion of the typical move.

So, you know, the rule of thumb number we would normally use as a short line typically is looking at 20 percent or less of the total revenue, but in cases in which it is a pricer of that portion, it has to negotiate typically with the connecting carrier.

That's where the negotiation takes place, and their leverage in those negotiations is really quite limited. So, you know, as a structural matter, short line -- and short lines are completely different from the Class Is, I think, in this discussion.

Having said all of that, they really do need the protection of the exemptions, because the exemptions create a buffer between them and rate cases. You know, before the question was asked of whether maybe there could be a streamlined exemption process, and there was allusions made to the small rate case, which made it more affordable for shippers to bring rate cases.

It's true that it had that effect. What didn't happen in the small rate case is that there were no protections put into place for small railroads that end up as collateral damage in rate cases.

There is a pending case right now where a shipper brought a rate case against two Class I railroads who were named as defendants. A small portion of that traffic actually terminated on a whole bunch of small railroads. What happened in that case was the shipper got on the phone with each small railroad and demanded rate concessions, or it was going to be named as a defendant in the case.

I advised two short lines in that. One had annual car loads of that traffic of less than 100, and the other had less than ten, so, you know, the threat of being dragged into a rate case for a small railroad, certainly under those types of circumstances, is just a complete disaster.

As General Timmons said earlier, the median revenues for a short-line railroad today are $2.5 million per year. These are not companies that can afford to participate in rate cases in which they have no significant traffic at stake or in revocation of exemption proceedings, which might really be important to them, but they just don't have the resources.

You know, those resources today are going to upgrading track to handle 286,000-pound cars, to bridge replacement, to PTC obligations. You know, you have this whole -- this whole laundry list of capital investment that you're asking a $2.5 million a year company to do.

So, you know, as you go forward with this, I would ask that you keep in mind, especially in the rate -- in the small rate case context, keep in mind that very often short lines can end up being very badly abused in those cases without much public benefit, actually, for including them.

COMMISSIONER MULVEY: Thank you. On the short lines, some of the testimony that was in some of the pleadings that we have received has suggested that the exemptions have caused some of the Class Is to be reluctant to interline with the short lines.

Do you care to comment on that, the exemptions that the Class Is say, "Well, we don't want that particular traffic, and so, therefore, since it's exempted, it's not going to be a problem for us to just refuse to interline with the short lines for certain traffic types"?

MR. TIMMONS: My only observation on that would be that would be that that issue of deciding not to take some kind of traffic is clearly -- has clearly existed, but whether that can be tied to exemptions or not, I'm not aware of it.

In other words, the rationale for deciding not to take some kind of traffic or work some kind of arrangement for moving goods is generally in my experience not tied to an exemption, per say.

COMMISSIONER MULVEY: We've heard a lot today about the importance of competition. As economists, we all have paeans to the importance of competition in the marketplace and getting efficient economic solutions. So would you agree, Professor Willig, that agreements that perhaps limit competition would not be in the public interest?

DR. WILLIG: That's a loaded question. You'd have to get more specific, I think. I mean, clearly --

COMMISSIONER MULVEY: I'm talking about -- obviously, I'm getting off the subject here, so I was talking about paper barriers, which, of course, Mr. Hamburger and

Mr. Timmons --

MR. HAMBERGER: Interchange commitments, if you will.

COMMISSIONER MULVEY: Interchange agreements would limit the short line's ability to interchange with a Class I when it's spun off.

DR. WILLIG: No.

COMMISSIONER MULVEY: It was a loaded question, so I'm not going to expect an answer.

DR. WILLIG: As you know and I know, in general often there are agreements which somebody might characterize as limiting competition which are actually an important part of competition, where there are commitments made to deal with one another, which is mutually beneficial and allows more efficiency and lower prices, but a concomitant of that is not dealing so much with the next guy who's complaining about it, so, yes.

COMMISSIONER MULVEY: Thank you

all very much.

CHAIRMAN ELLIOTT: Thank you very much. We really appreciate your participation today.

DR. WILLIG: Thank you for listening.

CHAIRMAN ELLIOTT: Now we'll hear from the third panel, the Shipper Interests. You can please come forward. We will first hear from the Alliance of Automobile Manufacturers. Appearing on their behalf will be Jeffrey Moreno. You have ten minutes. Thank you.

MR. MORENO: Good morning. Thank you. My name is Jeff Moreno, and I am here on behalf of the Alliance of Automotive Manufacturers.

The 12 members of the Alliance constitute 77 percent of all car and light truck sales in this country. The commodities that are shipped are basically all fall within STCC Class 37, which are almost all exempt commodities.

I am sure the Board would prefer to be hearing directly from those who are affected by this particular exemption. My presence here today is indicative of a general or greater concern by Alliance members with the potential for railroad retribution.

That concern is lessened by my speaking here today on behalf of the Alliance collectively. This concern is probably the best example of at least a perception among automotive producers of railroad market competition for portions of their automotive traffic.

I will do my best to answer any questions that you may have this morning. However, if I'm unable to do so, I would be glad to take those questions back to the Alliance and submit supplemental responses in writing.

The STCC 37 automotive traffic has been exempt since 1992. The history here is a little important, because the exemption procedure in that case was not initiated by the railroad industry or any form of petition. It was one of the proceedings that was initiated, self-initiated by the ICC at the time.

Most inbound parts even at that time were already exempt traffic under the intermodal or the boxcar exemptions. Therefore, the ICC in its proposed -- in its decision proposing to exempt automotive traffic focused on what were long-haul, predominantly rail movements that the time and concluded that widespread geographic competition constrained railroad market power at that particular time.

There was almost no opposition at all to that proposal by the ICC. It was supported by both the railroads and the automotive industries, and therefore there was really no serious challenge posed to any of the ICC's assumptions stated in the notice.

The auto industry in particular was relatively unconcerned with the exemption at that particular time in history, because the railroads were, in fact, aggressively competing for automotive traffic, and the exemption purported to make this competition even easier by removing such restrictions that were in place at the time as tariff and contract filing requirements.

Since 1992, railroad mergers have increased the number of auto plants that are captive to the same railroad. I believe there were about 12 Class I railroads in `92, and we're down to seven today, but what we really have is large regional duopolies in the eastern and western United States, which have made it easier, effectively not to compete.

There are longer bottlenecks, also, as a result of these mergers, which have increased the distance to the nearest alternative railroad to the extent there is an opportunity to perhaps truck around these bottlenecks.

Legislative changes only three years after this exemption was enacted removed most of the benefits for shippers, because tariffs no longer had to be filed, and neither did contracts, and that was the primary benefit from the shipping perspective.

Furthermore, what we have seen, particularly in the last decade, is that railroad rate increases have rendered trucks cost-competitive at even longer distances. Back in `92, trucks were relatively competitive up to about a 250-mile radius.

Today, trucks are actually competitive up to about a 500-mile radius. That, however, is not due to more efficient truck competition, but it's due to railroads increasing their rates up to the levels of which trucks have been pricing.

During this time, both trucks and railroads have, in fact, raised their rates, but rail rates have increased at a much greater pace, and truck rates have responded to recent economic declines, whereas railroad rates have continued to increase.

I am not here today to advocate a blanket revocation of the STCC 37 exemption. There are substantial intermodal competitive options for large portions of the automotive traffic. There are, however, significant subsets of the STCC 37 that are, in fact, captive to the rail industry.

Focusing first upon finished motor vehicles, trucks dominate the short-haul distance hauls directly to dealers, so today, if a dealership is typically within 500 miles of a production facility, it will typically move by truck to that dealership.

Rail, however, dominates the long hauls to what we call transload ramps, vehicle distribution centers, different -- they're called different names, but essentially these are facilities where the cars are off-loaded from the rail car -- where automobiles are off-loaded from the rail cars, loaded onto trucks, and then continue on to the ultimate dealership, and rail dominates that transportation.

Auto manufacturers cannot simply cost-effectively transload around a rail bottleneck except in very isolated instances when moving their finished motor vehicles. It does occur.

It occurs in very isolated lanes when there is a service problem on that lane, but there simply is not the truck capacity, and, furthermore, there are significant additional costs with adding that extra transload layer. Therefore, it cannot be done in large volumes to bring any competitive pressure upon railroads.

A good example of that is what's happening right now in the automotive industry. Since the beginning of the year, the car supply has been about 14 percent below what is needed for loading cars.

Now, if it were simply an easy task to truck around these rail bottlenecks, most of this deficiency in rail car supply would be addressed by shifting that traffic to truck. It's not happened at local plants. What happens is those cars end up having to go to storage lots and waiting until rail cars are available that can be loaded.

Auto manufacturers also cannot easily or cost-effectively shift their production from a plant served by one railroad to a plant served by a different railroad, even when that theoretically is an option, and it's not an option as much as it was before because of the consolidation of the rail industry.

A second group of traffic is the inbound shipment of auto parts. Now, this is highly truck-competitive for 75 percent of this volume, but there is a 25 percent segment of inbound parts that's moved by rail because it must move by rail.

These are what we call the oversize or the heavy parts, anything such as frames and axels, transmissions. The bulk of that moves by rail, because truck is simply not an efficient alternative option.

We believe the review of the auto exemptions is appropriate to address traffic that is not competitive and that the Board should recognize that due to changes since 1992 that in both the rail and in the auto industries that it should at least undertake a review to evaluate whether the blanket exemption on STCC 37 traffic is currently appropriate or whether some subsets of that traffic should actually still be subject to regulation.

I would like to address one thing, comment that has been in most of the railroad comments and which was raised earlier today in the AAR's testimony, and it was one that surprised me, the statement that the statute does not authorize Board-initiated revocations.

I was baffled to hear that, and I went back to read the statute to see if I had been missing something, but the statute says in 10502(b), "The Board may, where appropriate, begin a proceeding under this section," this section meaning 10502, "on its own initiative or on application by the Secretary or an interested party."

Well, by reference to 10502, they're referring -- 10502 covers both grants of exemptions and revocations of exemptions, and the statute says the Board can do this on its own initiative.

Now, perhaps my railroad colleagues are focusing on the fact that this appears in Subsection (b), which deals with grants, as opposed to Subsection (d), which deals with revocation, but in the statute itself, when Congress intended to refer to a subpart, it used the term "subpart." Here, it used the term "section," referring to all of

10502.

With that, I see my time is coming to a close, but I'll be glad to answer any questions at the appropriate time.

CHAIRMAN ELLIOTT: Thank you, Mr. Moreno. Next we'll hear from the American Forest and Paper Association and the Paper and Forest Industry Transportation Committee, Mr. Lovick. You have ten minutes.

MR. LOVICK: Good morning, Chairman Elliott, Vice Chairman Nottingham, and Commissioner Mulvey. My name is Bill Lovick. I am the Director of Transportation at Temple-Inland for our building products businesses.

In this role, I am responsible for all inbound and outbound shipments of goods and materials that are transported by rail and highway to and from our building products plants. I have worked in various roles over the 16 years that I've been employed at Temple-Inland.

Temple-Inland is a low-cost, highly efficient manufacturing company focused on corrugated packaging and building materials. More than 117 years ago, our company started with a single sawmill and has grown to operate 82 facilities, which are consistent of seven container board mills, also known as paper mills, 59 converting facilities or box plants, and 16 building products plants.

Our company has approximately 11,000 employees and has annual revenue of approximately $4 billion. Our corporate headquarters is located in Austin, Texas.

Our building products business supplies solid wood lumber, gypsum wall board, and fiber products for residential and commercial construction projects. In addition, we produce particle board and medium-density fiber board, also known as MDF, for manufacturing of furniture, flooring, fixtures, cabinets, molding, mill work, and various other uses.

Of all of our businesses, our container board mills, the paper board mills, are the most dependent on rail service. Of our seven paper mill facilities, seven are captive to a single shipper, single railroad.

Many of our paper mill customers are also reliant on rail service, especially those customers whose facilities are constructed specifically to receive rail delivery.

I'm appearing before you today on behalf of the American Forest and Paper Association, also known as the AF&PA, and the Paper and Forest Industrial Transportation Committee, also known as PFITC for short. Accompanying me is Ms. Karen Booth. She's in our audience, counsel for these organizations.

I appreciate the opportunity to share the views of these organizations with you on the important question of whether the STB should undertake a more formal review of the existing exemptions applicable to the paper and forest products industry.

For the reasons explained in our written comments and as expressed here today, we believe that the time has come for this Agency to reevaluate whether the exempting rail transportation of paper and forest from government oversight continues to make sense based on the substantial changes that have occurred in the rail industry since these exemptions were adopted two decades ago.

The benefits of exempt status no longer exist. Our written submission detailed the various commodity exemptions and the boxcar exemption that currently apply to most paper and forest products, as well as the key findings of the ICC that led to the granting of these exemptions.

I will not repeat that information here but would simply note that these exemptions were all adopted by your predecessor, the Interstate Commerce

Commission, between 1983 and 1993.

Over 29 years ago when these exemptions were being considered by the ICC, the railroads and the paper forest industry companies jointly supported the exemptions based on the mutual commercial benefits that could be achieved from removal of burdensome regulatory requirements such as tariff and contract filing which existed at that time.

By exempting our commodities from regulation, railroads could be more responsive efficiently to the market and compete more effectively with trucks by avoiding regulatory delays, which prevented price changes from taking effect immediately.

CHAIRMAN ELLIOTT: Mr. Lovick, would you mind talking into a mic? I just -- I'm concerned that people can't hear.

MR. LOVICK: Is that better?

CHAIRMAN ELLIOTT: Maybe it's the -- is the mic on? Okay. Maybe our mics are affected.

MR. LOVICK: Is that better?

CHAIRMAN ELLIOTT: It's not great.

MR. LOVICK: Better?

CHAIRMAN ELLIOTT: That's better. All right. Thank you.

MR. LOVICK: However, in 1995, Congress adopted changes to law in the ICC Termination Act which eliminated tariff and contract filing and other regulatory burdens that limited the responsiveness of railroads and therefore provided the benefits obtained by exempt traffic to all shippers.

While we strongly supported the reforms adopted in the ICCTA and still do today, several of the key reasons that led to our support for an exempt status evaporated with its passage. Thus, in today's post-ICCTA environment, our exempt status provides no regulatory benefits but, even worse, results in the loss of access of existing regulatory protections.

Regulatory protections on rates

and service have become increasingly important to many shippers across multiple industries based on the current structure of the rail market. We believe that paper and forest product companies should have those same rights.

Between 1983 and 1995, paper and forest companies also were not concerned about insufficient rail competition for their shipments, since there were many more railroads in 1983 than currently exist. While there were still over 40 Class I railroads when the Staggers Act was adopted, we've witnessed the reduction in the number of providers to only seven Class I railroads today.

The consolidation of the rail industry has resulted in many paper mills across the country being captive to only a single railroad. The situation has substantially reduced intramodal and geographic competition for paper and forest products.

The reduced rail competition and captive status of many companies has allowed the railroads to impose double-digit rate price increases and to impose take-it-or-leave-it contract terms based on their substantial market power.

Although truck transportation is an option for shipping paper and forest products, rail transportation is more efficient and cost-effective, particularly for long-haul movements. Many paper mills were built to receive inbound logs and ship outbound products via rail and thus were not designed to handle substantial volumes of trucks.

Weight and size limitations of trucks are also a constraint, and in some regional markets there are truck capacity shortages. Other factors adversely affecting motor carrier costs and competitiveness include driver shortages, increasing cost due to higher fuel, and regulatory changes involving driver's hours of service and the new CSA safety program.

Finally, this Agency cannot ignore the changes in the financial health of the railroads, which has occurred between 1983 and today. As explained in our written testimony, by any measure the railroads are more profitable than ever and have achieved strong financial health.

The railroad's weak financial condition in the early 1980s and 1990s was clearly a factor that the ICC considered when it adopted the exemptions decisions. The very substantial changes in the railroad's economic status is another factor supporting a review of the paper and forest products exemptions.

In conclusion, although there was a broad support from our industry for the ICC to grant the paper and forest products exemptions, in the past 25 years that support has diminished greatly based on the substantial changes that have occurred in the rail industry.

AF&PA and PFITC members are no longer confident that regulation is not necessary to meet the public interest considerations of the National Rail Transportation Policy or that regulation is not needed to protect shippers from market abuses, which I understand are the exemption requirements contained in the law.

We are not asking STB to revoke the commodity exemptions involving paper and forest products at the conclusion of this hearing. Rather, we believe that it would be appropriate for the STB to initiate a more formal review of these exemptions to determine if they are still justified under the current market conditions in the rail industry.

Thank you for the opportunity to present the views of the AF&PA and PFITC here today. I'll be glad to answer your questions at the appropriate time.

CHAIRMAN ELLIOTT: Thank you, Mr. Lovick. Next we'll hear from the National Industrial Transportation League, and we'll hear from Mr. Carlton. You have ten minutes.

MR. CARLTON: Thank you very much, Mr. Chairman, and good morning to you, Vice Chairman Nottingham, Commissioner Mulvey. We really do appreciate the opportunity to be here this morning.

My name is Bruce Carlton. I'm the President of the National Industrial Transportation League. Also accompanying me this morning is Ms. Karen Booth, the League's General Counsel, although she is not sitting here next to us. We have an empty chair, apparently.

Again, thank you for letting us appear before you today to provide the League's views on the very important issue of railroad traffic that is currently categorized as exempt from the oversight of this Board. We warmly commend you for initiating this proceeding to review the existing commodity boxcar and TOFC/COFC exemptions.

The League represents over 600 member companies that range from some of the largest users of the nation's and world's transportation systems to smaller companies engaged in the shipment and receipt of goods.

Rail Respondent is vitally important to many of our members, and within this group are shippers of commodities or users of rail services such as intermodal that are currently exempt from STB oversight.

At the outset, the League would note that in this proceeding the Board is posing an extremely important but very narrow question. The Board is not asking whether it should eliminate or modify all or any one of the existing exemptions at the conclusion of this hearing.

Rather, the Board is simply asking whether, one, it should look at these questions based on very substantial changes that have taken place in the railroad industry since many of the exemptions were adopted, and, two, whether it should begin one or more future proceedings to determine if the Agency's current exemptions should be eliminated or revised.

The League believes that the answer to that narrow question is very clearly yes. Apparently, any number of other witnesses and those who have offered testimony and statements to the Board have already advanced this issue to the second and third round before you have even decided whether you're going to take this matter up for further consideration.

More than 15 and as many as 30 years have passed since the Board's predecessor, the ICC, approved these exemptions. The notion that the conditions that caused the Agency to take these actions have remained unchanged is counterintuitive, to say the least.

As detailed in our written testimony, an examination of the facts shows that over the past two decades major changes have occurred in the rail industry, including substantial reductions in intramodal rail competition, substantial improvements in the financial health of the railroads, and statutory changes to further deregulate the rail industry adopted in the ICC Termination Act of 1995.

Based on the breadth and scope of changes that have taken place since these exemptions were granted and the two to three decades ago, it is completely proper and responsible government action for the Board to examine whether these exemptions should be eliminated or revised.

We believe that the Board should initiate one or more proceedings to evaluate the utility of the existing exemptions based on current market conditions in the rail industry and the governing statute. The

League believes that the National Rail Transportation Policy calls for a fair balance between the interests of shippers and carriers.

When this Agency or its predecessor decides to remove a category of rail traffic from government oversight, it must look at these policies and determine whether an appropriate balance exists and that the interests of the affected parties are protected.

Between 1981 and 1995, when virtually all of these exemptions were approved, there were positive benefits to both shippers and carriers that resulted from the exemptions.

Despite deregulation brought about by Staggers Act, the rail industry was still subject to tariff and contract filings and other pricing regulation during this time period. Exemption from regulation removed paperwork burdens, cut carriers' costs, and it eliminated requirements that made rail pricing practices less responsive to shipper business needs.

Shippers and carriers both benefitted from the granting of the exemptions, and many shippers jointly supported the grant of the exemptions in the ICC proceeding, along with their railroad partners, but when ICTA was passed in 1995, Congress eliminated virtually all railroad tariff and contract filings, along with other limitations on rail pricing practices. ICTA conferred the benefits obtained by shippers of exempt traffic on all shippers.

Today, shippers whose commodities are subject to an exemption receive no tangible benefits from the exemption at all. They simply lose the regulatory protections otherwise available to other shippers. This circumstance, coupled with other major changes in the rail industry, would appear to upset the balance of interest achieved when the exemptions were granted.

The Board has asked in this proceeding whether the basis for the existing exemptions should be revisited. We strongly question whether it is proper to continue the exemptions for some commodities on the basis of benefits that are no longer meaningful. It is time to reevaluate whether some or all of the existing exemptions continue to make sense.

Another key factor underlying the grant of each of the exemptions was the state of competition, but very substantial changes in the structure of the rail industry have occurred in the last 15 years, which have impacted the extent and effectiveness of competition.

Given the substantial consolidation of the rail industry since 1990, the extent of rail-to-rail and geographic competition is surely diminished from where it was 20 years ago. Other modes, especially the trucking industry, are facing both capacity constraints in certain markets and new regulatory requirements.

In particular, the trucking industry is dealing with initiatives from the U.S. Department of Transportation, the CSA 1010 Initiative, possible changes in the hours of service rules, and next up the electronic on-board recorder requirement.

All of these may render the trucking industry a less effective competitor than they were 20 years ago, especially at longer distances. Just last month, the League held a webinar for our members that examined the productivity losses that will flow from DOT's recent hours of service proposal.

Further, the recently issued Senate Commerce Committee financial report on the freight rail industry quotes Wolff research, a very respected industry observer, to the effect that railroads will "likely continue to take market share from the less fuel efficient and increasingly less productive trucking industry."

By all accounts, rail pricing since 2004 has increased well in excess of inflation, an important indication that competition is less effective than it has been in the past.

The League believes that given these and other changes described in our written comments, the Board cannot assume that competition is as vigorous as it was 20 years ago. The changes in the competitive landscape further justify a more formal review of these exemptions.

Finally, another purpose for granting the exemptions was to assist railroads in achieving revenue adequacy by cutting carrier costs and permitting more responsive and efficient pricing practices, but it is very clear that the rail industry is in a much more favorable position economically compared to where it was decades ago when these exemptions were granted.

Thus, it is entirely appropriate, again, for the Board to examine whether these exemptions are still necessary for carriers to achieve financial health when by all accounts they are one of the healthiest industries in America.

While the railroad's testimony asked the Board to ignore the substantial improvements in their financial condition, it unquestionably was a factor reflected in the ICC exemption decisions, and currently it is a factor to be balanced as part of the National Transportation Policy.

In conclusion, it is entirely appropriate, we believe, responsible government action for the Board to examine more thoroughly whether the existing exemptions should be eliminated or modified based on substantially changed circumstances.

Of course, the decision to initiate such a review does not pre-judge what the findings might be. The ultimate findings would need to be based on the evidentiary submissions made in any such future proceeding or proceedings. Again, thank you very much for the opportunity to be here this morning, and we'll answer any questions that you have.

CHAIRMAN ELLIOTT: Thank you, Mr. Carlton. Now we will hear from the Wisconsin Central Group, and speaking on their behalf will be Mr. Varda, and you have ten minutes.

MR. VARDA: Mr. Chairman, members of the Board, thank you for the opportunity to be heard on this subject today. I am legal counsel to the Wisconsin Central Group, an ad hoc rail shippers coalition operating under the auspices of the Wisconsin Paper Council, Wisconsin Manufacturers in Commerce, and the Michigan Forest Products Council.

Our group, under various names, was present, including participation in various ICC proceedings, for the transition following Staggers and the Motor Carrier Act of 1980. In the mid-1980s through the early 1990s, we were present for the withdrawal of the Class Is from Wisconsin and upper Michigan through various spin-offs.

In the late 1980s and through the 1990s, we were present for the creation, consolidation, and successes of the independent Wisconsin Central System, and, of course, we were present for grant of control of the WC system to Canadian National and its aftermath.

The goal of our group is to persuade the Canadian National or by whatever means to assure restoration of Wisconsin Central System level of service and competition for market share for traffic that originates and/or terminates on lines of the former Wisconsin Central System and for CN's main line between Superior, Wisconsin, and Chicago, a transparent plan to mitigate the impact of the increasing international traffic and to provide ample capacity for serving traffic that originates and/or terminates on the lines of the former Wisconsin Central.

From our perspective, the problem today is a failure of competition and competition policy. From our perspective, the primary competitiveness problem is not with captive traffic but rater with non-captive traffic.

Freight competition in our region has changed dramatically since the exemptions were granted and since Class Is have reached their present level of consolidation. The Class I Canadian National, which this Board granted control of the WC system in 2001, has utterly failed to compete for market share on traffic originating and/or terminating in our region on lines served by the former Wisconsin Central System.

CN has strong incentives to not compete for, in fact, to suppress such traffic. Ironically, the Board's efforts to require mitigation of the impacts of the operational changes arising from Canadian National's control of EJ&E, an application that we in Wisconsin and the Upper Peninsula supported, has added incentives for CN to suppress traffic originating and terminating on lines of the former Wisconsin Central System.

Given the exemptions shippers and other stakeholders in our region, including those in the public sector such as the states of Wisconsin and Michigan and communities like those who are in the process of forming the Blue Line Coalition, have no realistic means to get CN's attention to the problem, to say nothing of holding CN accountable or otherwise restoring rail competition in our region.

The Board should investigate potential revocation of the exemptions. CN's treatment of the former Wisconsin Central as described in Wisconsin Central Group's statement illustrates, and we provided a number of very specific examples, illustrates why the Board should do so.

Wholesale revocation of the exemptions is almost certainly not the answer. Small adjustments or targeted revocation of exemptions may better serve to, A, give competition another chance were failure of competition has been the unintended consequence of Class I consolidation, and, B, provide adequate oversight and effective means by which individual shippers might bring attention to such problems on a case-by-case basis.

The independent Wisconsin Central System is a model for the competitive impacts of Staggers' deregulation, specifically in providing first-mile, last-mile retail railroad service competing successfully mostly for non-captive freight.

The independent Wisconsin Central System successfully won back boxcar freight that the Class Is serving Wisconsin and upper Michigan lost to highway in the 1980s. The independent Wisconsin Central System even successfully provided short-haul intermodal services, an example, from Green Bay to Chicago, which with the largest customer and most devoted customer being the nation's largest truckload motor carrier. CN terminated those services.

There is considerably more to this story. That's the reason for our request for investigation. We ask that the Board investigate specifically to conduct an in-depth investigation of the effectiveness of the exemptions, changed circumstances and implications of revocation of the exemptions, and in particular to consider the pros and cons of limited and/or targeted revocation to address failures of competition policy and failures of conditions imposed on Class I consolidations such as those illustrated by the ten years of Canadian National's control of the Wisconsin Central system. Thank you for your consideration.

CHAIRMAN ELLIOTT: Thank you, Mr. Varda. Commissioner Mulvey, do you have any questions?

COMMISSIONER MULVEY: I have a few. Let me begin with Mr. Varda. Are you suggesting that the acquisition by CN of the Wisconsin Central System was not so much designed to incorporate them as part of CN but rather to eliminate them as a competitor and that this is really almost more of a merger issue than anything else, or --

MR. VARDA: Not at all. Excuse me.

COMMISSIONER MULVEY: Okay.

MR. VARDA: Not at all. The Canadian National was quite clear in the proceeding, Docket 34,000, that its purpose was to acquire the Superior-to-Chicago line.

It also promised that I was going to maintain the local characteristics of the Wisconsin Central System, maintain it as a separate division to maintain those local characteristics, the most prominent of which was their -- Wisconsin Central's competitiveness for market share in our region.

COMMISSIONER MULVEY: Compared against trucks, for the most part, you're saying.

MR. VARDA: Yes.

COMMISSIONER MULVEY: Yes. Mr. Moreno, you're here along with the forest and paper products people. Those two industries which particularly have suffered from the current economic turndown.

Are you suggesting at all that the conditions in certain industries need to be considered when the Board makes a decision as to whether or not it's appropriate to revoke exemptions or, for that matter, any other consideration by the Board of a rail shipper matter that should the conditions in your industries should be a factor?

MR. MORENO: I'm not here to

advocate that the exemptions should be revoked because of the financial condition of the automotive industry. In fact, it's hard to draw a broad description of the auto -- across the entire automotive industry in terms of their financial condition.

A couple of years ago, it was primarily the domestics that were in financial straits that fortunately they have recovered and improved and emerged from bankruptcy in a very -- in a much stronger position.

I think it's the ability. It is relevant to the ability of the railroads to exercise their market power. It does suggest that if railroads are continuing to exercise market power even when the industry's own survival is at stake that there could be -- that could be a indicator of market power or the fact that the railroads don't feel that there is competition that's emerging, effective geographic competition, for example. They don't see the threat of imported vehicles, for example, to the domestic industry.

COMMISSIONER MULVEY: Mr. Lovick?

MR. LOVICK: In answer to your first question is that what we're implying, a revocation based on the economic circumstances of our particular markets, no, we're not.

COMMISSIONER MULVEY: Many years ago, back in 1925, I guess, the peak of regulation, the Congress passed what was called the Hoch-Smith Resolution, which required that the ICC take into account conditions in industries, primarily in agriculture, in making its regulations. Fortunately, that never became law, but other things did.

Again to you two, do you see any procedural barriers for filing for a revocation? Someone suggested that it's difficult to bring an exemption revocation proceeding before the Board because of its cost or the complexity, et cetera, and that's why the Board hasn't seen any.

The railroads say we haven't seen any because there is no need for it. Exempt commodities should remain exempt. Do you have any opinions on that, views on that?

MR. LOVICK: I'll share my feelings on that. Specific to building products, it's not movements of a size and scale that you would see for coal and grain. It's much more of a -- I classify it to my management as retail purchasing of transportation, general merchandise type of movements, and we don't have the time.

You can't file for a petition and get it turned around in time to help us for a 100-car movement a year. It just -- there's not a cost benefit to that proposition. When these exemptions were put in place, it was on a macro scale.

I think what we're asking for is to look at it again from a macro scale approach and then, if not revoked, then certainly look at how we could adjust them to better fit into the current and foreseeable market conditions, because market conditions have drastically changed in this nation in the past 20 years. We see things that nobody could have forecast.

MR. CARLTON: Commissioner, could I add just a comment to that footnote? It was earlier suggested by one of the witnesses that the there is no barrier, because your filing fees have come down.

Number one, we salute you. The League salutes this Board for taking the action to reduce filing fees. I think it's the right and proper thing to do in providing some access to the public, improved access, but that's not the issue.

It's not your filing fee, as was suggested earlier. It is the cost involved of diverting executive, corporate executive time to focusing on this issue. There is a real cost to that.

Number two, there is a cost in hiring counsel. With all due respect to the bar that practices here, their intelligence does not come cheaply.

Number three, there is the cost of hiring consultants, perhaps not Professor Willig but others who practice the dismal science, to make these arguments. That is a very costly undertaking, and I would say that's a very high barrier to bringing these types of matters to your attention.

Again, that's why the League is very pleased that you've asked the question, "Should we take a look?" and, again, we think you should take a look. Together.

COMMISSIONER MULVEY: So, are there any suggestions as to what the Board could do to lower the barriers, to streamline the process, and to make it less costly from a resource standpoint.

We have the same thing in our rate cases. We've lowered our rate case filing fees down to a fraction of what they were, but the filing fees were trivial compared to the millions of dollars that it costs to bring a large rate case.

We've tried some other approaches. We have small rate case approaches now, but there may be other things we can do to simplify the process, accelerate the process, and make access to the Board simpler, cheaper, and more effective.

Let me see here. I think that that's all I have for the moment. I might have other questions later. Thank you.

CHAIRMAN ELLIOTT: That's fine. Vice Chairman?

VICE CHAIRMAN NOTTINGHAM: Well, thank you. I thank the panel for being with us today. Mr. Moreno, I think you probably are familiar, this Board has had a very close and positive, long-term working relationship with the auto industry.

I know we've met as a group out in

Auburn Hills in the Detroit area on the premises of one of your big members. I've personally met privately with the CEOs of the auto industry talking about this issue and related issues.

I personally called Class I rail CEOs at the behest and urging of auto industry CEOs to talk about ways to resolve some of these concerns, and we appreciate your being here. I know you represent a diverse group of companies.

Remind us, though, who doesn't the Association, the Alliance, represent? You said you've got 77 percent. Are there a couple of big household names we would recognize that aren't part of the group, just so we know?

MR. MORENO: Well, let me just -- the group is comprised of BMW, Chrysler, Ford, GM, Jaguar, Mazda, Mercedes Benz, Mitsubishi, Porsche, Toyota, and Volkswagen. I mean, that's --

VICE CHAIRMAN NOTTINGHAM: Right, so just, I guess, Honda is one of the ones that's not there.

MR. MORENO: Honda, yes. Honda is not on this list.

VICE CHAIRMAN NOTTINGHAM: They do their own thing or have a different group. Got it. Mr. Lovick, similarly, I think you're probably familiar. This Board has had a very close and longstanding interest and working relationship with the forest and paper industry.

Some of the most difficult and time-consuming cases we've wrestled with in recent years, including -- include the abandonment out in the Coos Bay line out in Oregon where the entire Board in an almost unprecedented fashion took staff out to Eugene, had a hearing in a federal courthouse, and made sure that our processes worked to keep that line running under new ownership.

Similarly, we were up in far

northern Maine in Presque Isle together, thanks to our Chairman's leadership, looking into the very difficult circumstances surrounding the recent abandonment of the MN&A line up in northern Maine that was a particularly tough impact to the forest and paper industry, and we're pleased that that line is going to stay open thanks to the taxpayers of Maine and the folks there.

So we do -- many of these concerns are not completely new to us, and I think we do have some record upon which to understand both what's going on in the auto industry and the paper industry, and, Mr. Carlton, I just want to say thank you for being here.

You and I have had a chance to work very closely together back at DOT headquarters, and I just want to say for everyone's benefit Bruce Carlton was without a doubt one of the top, top tier career civil servants and leaders and just an example of the best of the best there at DOT, and the work you did at the Maritime Administration for many years in advising many Secretaries of Transportation was just incredibly valuable.

I had the privilege of traveling with you internationally with former Secretary Mineta, and we just appreciate the NIT League, having you and having you here today, and thank you.

Mr. Varda, thank you for being here. I understand these are remarkable times in Wisconsin. We're reading more and more, and not just in the sports section but front pages of international papers now, and I'm glad you're not on strike and you fled the state. You fled it for a reason. You're working, and I'm not sure what happened to Mr. Zulger.

MR. VARDA: He had to --

VICE CHAIRMAN NOTTINGHAM: I worry he may be on strike or in hiding, but if he comes late, we hope --

MR. VARDA: He's not on strike,

but they have to figure out what they're going to do for shared revenues from the state, so the communities are in a lot of trouble.

VICE CHAIRMAN NOTTINGHAM: I do understand, but that's really all I've got for this panel.

CHAIRMAN ELLIOTT: Thank you, Vice Chairman. Just a couple questions. Back to the question that I had earlier for the railroad interests: do the shipper interests see any concerns, a possible void in their ability to recover because of the revocation process?

My example had been that you're an exempt commodity, so in order to come before the Board you have to seek revocation, and once you do that, are there things that you believe that you can't recover or receive a remedy because of this process? Is there something, I guess, that's not working in our progress, I guess, is my question.

MR. VARDA: I'd like to answer in

a little different direction. It's out concern is not so much of rates but getting service, and that's the heart of it, and we're not going to recover for the customer dissatisfaction because we had to go by truck rather than rail to facilities that are designed to receive by rail, having to rearrange our outbound shipping because we don't have the capacity to ship by truck where the facility was designed to ship by rail. We'll never recover that.

CHAIRMAN ELLIOTT: Thank you.

MR. MORENO: It's not so much a recovery cost, because what you may save is difficult to quantify by having access to regulation, but I think there is even a value just in knowing that there is a regulatory safety net in those -- in your -- in those situations when you are dealing with railroads where you feel you have no other option and you're in a take-it-or-leave-it situation.

Right now, when you're negotiating

a contract or negotiating over some sort of dispute, you can't say -- or you can't take this to the Board. You're basically at the mercy of what you're being dictated in that circumstance, and there is value in at least having that sort of leverage, that option, because then the railroad also knows you have that option, and it takes that into consideration, as well.

CHAIRMAN ELLIOTT: Thank you. Along those same lines, let's say in the instance of if you wanted to challenge a rate, it seems somewhat confusing, because at the present time your rates are under contract as an exempt.

How would you go about challenging a rate in the instance if you sought revocation, because it would seem like since your rates are all under contract, those would be automatically exempt?

MR. MORENO: The rate, because the rates are in a contract, they are not challengeable, but contracts come up for renewal every so many years, and during those contract negotiations, regulated traffic, if you don't like that contract offer, you can always say, "Give me a tariff rate."

The railroad is required by law to give you a tariff rate, and you have the option to challenge the reasonableness of that rate if you do not like it. An exempt shipper does not have that option.

CHAIRMAN ELLIOTT: Well, yes, and if the shipper is exempt, how would they go about -- I mean, can they challenge a rate?

MR. MORENO: Not without specifically getting the exemption reworked. Now, there is the possibility of a case-by-case exemption, as opposed to revoking the class exemption.

CHAIRMAN ELLIOTT: Would they have to go about revoking it first, obtaining a tariff, and then challenging it?

MR. MORENO: Yes, and that's kind

of the -- that literally is the problem here. It adds an extra layer in seeking regulatory productions, and there is kind of a backwardness to this in the context of rates.

We discussed that one of the standards that the railroads have said would apply here is abuse of market power. Well, how do you prove abuse of market power when the proof is in the unreasonableness of the rate?

So it gets circular. In order to be able to challenge the rate, you have to prove it's unreasonable, but you can't prove it's unreasonable until you get the -- until you prove abuse of market power.

CHAIRMAN ELLIOTT: Thank you.

MR. VARDA: Mr. Chairman?

CHAIRMAN ELLIOTT: Sure.

MR. VARDA: Many of us don't have contracts in the sense of a contract. It's simply if I'm a log cutter hauling to a landing, you know, the rate is what the railroad tells me it is. It's out there someplace in an exempt publication, but it's not a contract with me. I didn't sign anything.

I'm told what it is, and so there is sort of a void in there between, well, is it a contract? Yes, because it's a bill of lading contract, but is it a contract in the sense of being a transportation contract on which the parties had a meeting of the minds over the, you know, terms and conditions? No. It's much more like a tariff.

CHAIRMAN ELLIOTT: Thank you. I think I'd be remiss -- I asked the rail interests about the R/VC, the amount of traffic that runs over 180 R/VC in my questions to them, and I used some pretty strong examples of where the amount of traffic has increased over time from `93 to 2008, the R/VC, the amount of traffic running over 180.

I looked in the STCC 37 for transportation equipment, and it appears that the R/VC has, in fact, gone down. The amount of traffic over 180 has gone down over time. How do you explain that as an economic indicator with respect to the industry you're representing?

MR. MORENO: Well, that gets back to the issue of the blanket exemption versus the specific subsets. I mean, if you're looking at entirely STCC 37, we don't question or even challenge the fact that there are significant areas where there is competition with the rail industry, but there are also other -- with the truck industry, but there are other areas where the competition does not exist, and I think we would need to drill down deeper into that data in order to see if that holds true at the subsets that we're most concerned about.

CHAIRMAN ELLIOTT: Thank you. Just one final question from me. The railroad interests raised the issue the health of industry. I'm not going to quote them directly but paraphrase it, is not really relevant to this analysis. Do you see that the same way?

MR. MORENO: No, it's not completely irrelevant. As a matter of fact, if you go back to the original grant, the decision granting the automotive exemptions, there is a reference to the financial health of the industry as a reason for granting the exemption.

You can't have it both ways. Now, having said that, it's not the only reason, but it is one of the rail transportation policies, and you're required to examine the rail transportation policies.

CHAIRMAN ELLIOTT: Thank you.

COMMISSIONER MULVEY: Just following up a little bit on that, you mentioned that there are a lot of differences within the transportation equipment sector and that, again, a lot of things are hidden by averages, as we mentioned before. Would you advocate or would you think it would be worth us considering whether or not we ought to revoke the exemptions for certain kinds of traffic that move beyond a certain distance?

I think you mentioned in your testimony that the changes in the industry have caused shipments to become much, much longer, making certain kinds of traffic like oversized pieces, et cetera, and long-distance movements of finished cars, that there should be these distinctions, including some for movements over a certain distance. Do you think that's something the Board should consider looking at?

MR. MORENO: Absolutely. I mean, the Board should be looking at what portions of the traffic are still perhaps captive and require regulatory protection, and if that is based on a distance threshold and the evidence supports that, by all means that would be acceptable.

COMMISSIONER MULVEY: Bruce would

you want to comment on that, also?

MR. CARLTON: No, I would agree. You know, I don't look at this issue as, you know, a single matter. It's the entire collection of the issues that have been discussed here this morning, and, absolutely, it's possible to segment markets and find greater and lesser degrees of competition within what might be seen as a single market, but the segments are very important.

I was astounded by some of the submissions to you and to the staff to the degree of reference to reregulation. I mean, I overwork sports analogies, but it's a head fake. You know, if you watch where my head's going, you think that the basketball player's going there, and, of course, he goes over here and he scores the three-pointer.

It's not about reregulation. The NIT League is not a proponent of regulation of American industry. It is about, you know, providing appropriate statutory relief for shippers, a relief that 30 years ago they gave up willingly, because there were other benefits, and today conditions have changed, and, again, we commend the Board to take a look deep inside that process.

MR. VARDA: Likewise, I'd like to caution that market abuse can occur in short-haul markets. It's a different kind of market abuse. What we're suggesting is the market abuse is you have enough market power elsewhere.

You don't want to compete in that market. You don't want to accept that traffic. That's something you should look into, as well.

COMMISSIONER MULVEY: Just one last question. We have an awful lot of commodities, traffic types, et cetera, that are subject to the exemption, a very daunting task for the Board to review all of those. I was wondering if you had any suggestions as to what rule of thumb the Board might follow in deciding what groups of traffic commodities, et cetera, we might spend some time examining.

Should it be the revenue-to-variable-cost ratio, or do you have something else that you think would be useful for us to consider in looking at whether or not we ought to reexamine a particular exemption? Anybody can answer that.

MR. CARLTON: I wish I had been smart enough to think of that question before you asked it, and I say that with only a little bit of a facetious tone only because if individually exempted shippers and commodity groups and service classes, if we are to believe, as I do, that some of them are quite concerned about retaliation from their carriers, if you were to put a sign-up sheet out in the lobby saying, "If you would like us to look at your particular class or commodity, just sign here," I think that is going to not be attractive to a lot of shippers.

So I think I'm respectfully coming

back around to say I hope you guys come up with a process that allows for a good quantitative assessment that sort of starts to separate the groups into some natural zones for further examination, because I think there's going to be a reluctance from the shipper community to come in and say, "Well, take us."

COMMISSIONER MULVEY: We always hate to hear that retaliation argument. We used to have these meetings every year between the railroads and the shippers, and we asked for comments and questions, and we were told that nobody would raise their hand, because they were afraid of retaliation.

Then we tried to have the questions submitted beforehand without names on them. We tried bags on people's heads, but there is always that argument, albeit the railroads claim that they do not retaliate. It's not in their business interest to do such, but, anyway, thank you very much for your answers.

VICE CHAIRMAN NOTTINGHAM: I just wanted to follow up, if I could, on this issue that's been raised a couple times about concerns about railroad industry retaliation against customers. It's a very -- that's a very serious allegation.

I just wanted to say that in my five years on the Board, almost five years, I have not seen a single documented case. We've asked. We've asked people in prior hearings to please come to us confidentially if they'd like to come to us and explain how that happens and why railroads would want to injure their customers.

And I'm not naive. I understand that in the hustle and bustle of international commerce and competition, you know, tough things can happen occasionally, but we're the regulatory agency. We need to know about that kind of stuff, and there are ways for us to know, but we need people to step forward, and just coming into a hearing and kind of throwing it out there, that's a concern.

With all due respect, I mean, we've got to have a little more than that, and I do appreciate the fact that all of you represent large numbers of constituents and stakeholders, and they've got a variety of major issues on their plate, especially in today's complex economic and regulatory world.

You know, for us, we have to as a Board, and the Chairman's, you know, deeply, intimately familiar with this, we have an allocation of resources issue internally ourselves. We've got to figure out which major issues we're going to take on as a 140-person, give or take a few employees, agency.

And I would say just as one Commissioner speaking for myself, it doesn't help us set priorities if individual stakeholders are not willing to come forward and actually explain to us what the problem is. It's helpful to have associations come forward and say that there could be a problem and we should look at it generally, and maybe we might find out that there is really more of a problem, but we need people.

I mean, many of you represent -- not all of you. Many of you represent companies that are far bigger than any of the railroads and talk about market leverage and all that and with far more influence, probably, in the halls of Congress, some of you, and I just think, you know, we need to --

This Agency would need to see, I believe, as one Commissioner, folks to step forward and actually explain to us the specific problem for you to be able to effectively get this issue, you know, on the front plate. Other Commissioners may have a different opinion. I respect that. I just need to say that. Thank you.

MR. VARDA: Mr. Chairman, I can give you an example. The Consumer Protection Office was kind enough to send a delegation in

2004 to Green Bay to talk to a room full of Wisconsin Central shippers who voiced their concern.

The meeting was at the Railroad Museum, and it was indeed a room full, and they explained their services and the availability. I hesitate to tell you that I don't think there was a single informal complaint that resulted from that.

Everybody walked out of the room with an, "I'm not going to put myself in the way of it," because all of those shippers, while they have non-captive traffic, also have some captive traffic, and they're not just going to -- they're not going to put themselves in that situation.

VICE CHAIRMAN NOTTINGHAM: Well, I appreciate that, but I've been to Wisconsin as a guest of Congressman Petri, who is, I believe, a champion of shipper and transportation issues generally, and I visited with a large group of the Badger-CURE folks, a number of people very interested and concerned about the Wisconsin Central.

I've heard loud and clear how many Wisconsinites deeply miss the good service of the Wisconsin Central and kind of that good attitude they seem to have had to just chase down business, whether it was highly profitable or minimally profitable, and serve all of the customers, and I understand that.

At the same time, in those meetings I made myself available to speak privately with people afterwards, gave them my card, phone number. Nobody called me or pulled me aside privately and said, "This is what I need to tell you," and so I just --

We need to hear a little more specifics about something as serious as retaliation, because I think this Board would stop everything we're doing and dig into that. We've, you know, recently had at least one significant case I can think of taking serious action against a Class I that we felt didn't adequately abide by STB processes, and I'm sure the Board would do similarly if we had a reason to.

MR. VARDA: I think part of the problem is that it may not be that there is retaliation. It's a perception, and so I wouldn't want to be saying I'm pointing a finger at the railroad saying that you retaliated or would retaliate. It's just what the feedback we have on the perception.

MR. MORENO: I would echo it is the fear of retaliation, and no one is willing to put themselves out there to be the guinea pig, become the example, and in many cases retaliation isn't done in a blatantly obvious form.

It can be done in subtle ways, which there are often a dozen or other alterative explanations for it, and it's very hard to say, "Yes, that's the reason the railroad did this," but yet there is a feeling and a perception that that is the reason.

VICE CHAIRMAN NOTTINGHAM: Thank you.

COMMISSIONER MULVEY: I would like to get back to the contestability theory again. You don't really have to actually retaliate. Just a threat of retaliation or the fear of retaliation can be sufficient to discipline the behavior.

CHAIRMAN ELLIOTT: I'd like to thank the panel for their presentations, and I think we'll take an hour lunch break. So why don't we meet back here around 1:05, and we'll start off with Panel IV with the freight railroads. So we'll be in recess for about an hour.

(Whereupon, the foregoing matter went off the record at 12:06 p.m. and resumed at 1:07 p.m.)

CHAIRMAN ELLIOTT: We'll come back into session. We're on Panel IV, who are all before us now, the Freight Railroad Panel, and we will begin with BNSF Railway Company, and we'll have on their behalf Steve Branscum, and you have ten minutes.

MR. BRANSCUM: Okay. Good afternoon, Chairman Elliott and Vice Chairman Nottingham, Commissioner Mulvey. My name is Steve Branscum. I'm Group Vice President of Consumer Products at BNSF Railway. I'm responsible for the overall marketing and development of intermodal business on the railway.

Just making sure everyone's awake after lunch. Okay, anyway, I'm responsible for the overall marketing and development of intermodal business at the railway. I'm also the immediate past Chairman of the Intermodal Association of North America, and I'm the current Chairman of the Intermodal Transportation Institute that's affiliated with the University of Denver.

I have 31 years of experience in the railroad industry, the last 22 of which have been in the intermodal field. I want to thank you for giving me the opportunity to appear here today on behalf of BNSF and to address the value and the importance of the intermodal exemption.

In brief, we believe that this exemption has been an essential element of the development and growth of rail intermodal transportation in the last 30 years. There is no question that the exemption has fostered a highly competitive marketplace across modes, and it has benefitted shippers, motor carriers, ocean carriers, railroads, and consumers.

BNSF offers an array of intermodal services and pricing combinations to our customers, which has been enabled by the exemption and required in the marketplace to grow intermodal as a transportation alternative.

In this climate, we have made substantial investments in our plant and facilities to serve intermodal customers. We believe that the intermodal exemption reflects a successful regulatory policy, which has been effective for over 30 years, and that it should continue.

Now, having said that, I would like to go briefly through a short presentation to try to demonstrate three points. One is that there has been significant growth in intermodal as a result of the exemption, it also has allowed substantial investment by BNSF and other railroads to facilitate the intermodal growth, and that there is significant competitiveness in the intermodal marketplace.

Now, the first couple of slides are fairly elementary, but I think they're important that we can have the right context on intermodal, so just some definitions. Intermodal transportation is transportation by more than one form of -- more than one mode during a single journey. Obviously, the context of the hearing here today is that at least one of those modes has to be rail.

The term "intermodal" has been around for a long time. It's been in the marketplace for 50 years plus, but intermodal has been a significant factor in the marketplace for the last 30 years. Lastly, intermodal is most commonly used to describe the movement of freight in standardized containers and trailers, highway trailers, using at least two modes.

One of the most important aspects of intermodal and probably the least understood is that intermodal -- my slide actually says works best in markets with large concentrated volumes, and I'm almost inclined to say it works only in those markets, and it's not efficient in lower volume markets.

I say that because if you think about intermodal, it is multi-modal. It requires rail and truck connectivity, and it requires that in order to have the proper service levels in the marketplace in order to be able to compete effectively with over-the-road transportation.

Today, intermodal service is very good across the nation. On average, it runs an equivalent to single driver or solo driver highway transportation of about 500 miles a day.

It's pretty commonly accepted out in the marketplace that there are four major benefits to intermodal transportation. One is cost efficiency. It's rare that we are -- that an intermodal solution is not cheaper than a sole highway solution.

Intermodal, because of its scale, has the ability to mitigate highway gridlock, to some extent. It certainly is not a sole solution to highway -- the growing highway gridlock, but it is a way to mitigate.

Third, fuel efficiency. On average, intermodal rail is two to three times more fuel efficient than truck, and because of that fuel efficiency, largely it's also much more environmentally friendly than other forms of transportation, order of magnitude about 50 percent less carbon emissions and particulates.

I think this slide clearly demonstrates the success of the exemption. In the last 30 years, intermodal across this country has grown from about three million shipments a year to almost 13 million, which is a little less than a five percent compound annual growth rate.

Even with that significant growth and substantial volume of intermodal, rail today is still a relatively small portion of transportation modal share, and if you look at only the intermodal portion of rail, it represents about a third of what's shown on this pie chart for rail.

Now, as to competitiveness, it is highly competitive, as I said a moment ago. I know this slide is very busy, but I would focus your attention on the middle column, and that probably best demonstrates the competitiveness.

Intermodal involving rail, there are essentially two types of freight that are involved, international freight, import and export, and domestic freight, and within each of those two broad categories there's a further breakdown of freight into full truckload and less than truckload categories.

In the international sector, in the less than truckload category, almost all freight is moved by air, but in the full truckload sector of international freight, it's moved over the water, obviously, to its destination country, the U.S.

From there, freight has the option of moving to destination markets with hundreds of thousands of trucking companies or those same trucking companies in combination with the major Class I railroads.

Domestic works in a similar manner, but it's a little bit more complex and a little bit more competitive. Domestic you still have the full truckload and less than truckload breakdown.

On the less than truckload freight, a lot of it still even within the confines of the country moves by air, or it moves on the ground with around 700 trucking companies that operate in the LTL and parcel sectors. Again, that freight can move solely over the highway, or it can move in concert with the major Class I railroads.

For the full truckload sector of domestic, again, it can move with -- I don't know what the feedback issue is.

CHAIRMAN ELLIOTT: Why don't we try the second mic? I think that was working in the past.

MR. BRANSCUM: Right.

CHAIRMAN ELLIOTT: I apologize.

MR. BRANSCUM: Is that better?

CHAIRMAN ELLIOTT: Much better.

MR. BRANSCUM: Okay. On the

domestic freight, the last comment here on the domestic freight in the full truckload sector, obviously that freight can move with hundreds of thousands of trucking company all over the country.

There is also a large number, thousands -- I don't have the exact number -- of brokers, intermodal marketing companies, and non-asset providers that play in that particular market, and they work with hundreds of thousands of trucking companies to move this freight.

They also can work in conjunction with the railroad, so bottom line to this complex slide is that shippers have a lot of options when they want to move freight on the ground in the U.S.

I'd like to just demonstrate further levels of competition. On the international freight from Asia, for instance, represented by the orange arrows here, coming to the U.S., the freight can come to the West

Coast.

If it comes to the West Coast of the U.S., then it can be distributed by those hundreds of thousands of trucking companies or those companies and the brokers working in concert with rail, or it can go completely around to the East Coast, where in most cases it's delivered solely by truck.

This slide shows the major markets in the U.S. and how the interstate highway system overlaps all those markets, so just to demonstrate truck competitiveness, and then here is the North American rail system laid on top of that, which shows that they serve all these markets, as well.

The important point here relative to intermodal is that all this rail cannot be used effectively in a competitive environment of truck competition, so railroads have developed these high-density corridors with big markets to serve all the markets in the U.S., and it looks something like this.

You're probably familiar with these corridors. You can recognize the BNSF Transcontinental corridor, the UP Sunset corridor, and so forth. Through these major corridors, virtually every market in the U.S. can be served in combination of rail and truck.

The last few slides here that I'll skip through just simply demonstrate the massive investment that BNSF has made and other railroads have made in intermodal infrastructure and the productivity gains that we've been required to implement in order to stay competitive in the market.

So, in conclusion, I want to say that the intermodal marketplace is very highly competitive. We've invested heavily in our network and will continue to pursue greater efficiencies as we provide an array of service offerings to our intermodal customers.

The exemption, intermodal exemption, has been truly a success story benefitting customers, motor carriers, ocean carriers, consumers, and shippers. The exemption policy should continue so as not to jeopardize the flexibility to provide the essential vitality and the competitive transportation marketplace. Thank you.

CHAIRMAN ELLIOTT: Thank you, Mr. Branscum. Now we're hear from CSX Transportation, Inc. We'll hear from Mr. Gooden. You have ten minutes.

MR. GOODEN: Good afternoon, Chairman Elliott, Commissioner Mulvey, and Commissioner Nottingham. My name is Clarence Gooden. I'm Executive Vice President and Chief Commercial Officer, CSX Transportation.

My career in the railroad industry began in 1970 as a laborer for the Seaboard Coastline, and over the next 40 years I worked in a variety of positions, including President of CSX Intermodal, Senior Vice President of the Merchandise Service Group before assuming my current position in 2004.

I would like to formally thank the STB for this opportunity to express my views on the question presented for today. That is, whether the current exemptions have continuing relevance given the changes in the competitive landscape and the railroad industry.

The answer is a resounding yes. Exemptions remain very important, and my first slide addresses four broad points as to why that is.

The first principle of the Rail Transportation Policy makes clear that there is congressional and economic preference for market-driven solutions. We know this to be true not only from a purely economic perspective as addressed by Professor Willig, but we also know this makes sense from our own practical experience.

Current regulatory scheme has been and remains successful. Railroads and shippers have both benefitted from the exceptional progress made over the last 30 years. We are concerned that any reregulation of the exempt commodities or classes of traffic would threaten to unravel that great success story.

Further, reregulation is also unwarranted because it is clear that competition within the transportation industry is pervasive and abundant. We work every day to win business from trucks, other railroads, and other competitors.

The trucking industry remains the dominant player in the transportation business, as has been the case over my 40-year career. Winning market share from trucks is already an uphill battle, and we're concerned that reregulation will only make that battle tougher.

Finally, an essential ingredient to winning market share and getting freight onto our system is our ability to reinvest and grow for the future. It is our relatively recent financial progress that has made our current unprecedented level of reinvestment possible.

Congress established the principle that market demands and competition should determine rates to the maximum extent possible. That makes economic and common sense, since it's the market that guides virtually every aspect of ours and most businesses.

The markets help us determine what capacity to increase, what services to offer, what equipment to buy, what rates to charge. If we're hindered in our ability to respond to the market, we will make less efficient and therefore wasteful decisions regarding where to put our next dollar.

Knowing where to efficiently and productively put our resources benefits both our customers and the consumers, which is what Congress envisioned. Congress knew that railroad success would be to the benefit of customers and consumers, and that is exactly what we've seen over the last 30 years.

This slide tells the story in dramatic fashion. Prior to Staggers, bankrupt railroads accounted for more than 21 percent of this nation's rail mileage.

Railroads were unable to adequately maintain their systems. More than 47,000 miles of track operated at reduced speeds, and investment in additional or improved infrastructure was difficult to support both strategically and financially.

Now look at what has happened with Staggers. Productivity has skyrocketed. In fact, productivity gains since Staggers are over 11 times the pre-Staggers rate. Volume has increased steadily and ultimately doubled until the dip associated with the great recession.

While I understand that some shippers of exempt commodities are complaining today about their rates, the general facts don't support their story. As you can see from this slide, rates today adjusted for inflation are 55 percent less than what they were when Staggers was passed.

This is the historical context that the Board must confront head-on before it considers whether to reverse course. Today, we have established history of mutual gains and mutual benefits, a history that has allowed railroads to reinvest a remarkable $480 billion in their network and equipment since Staggers.

All of these various advances are interrelated, and they are all threatened to be unraveled by unwarranted regulation. Staggers caused a number of changes for the good, but I'd like to highlight for you the cultural transformation we witnessed from the commercial perspective.

Prior to Staggers, shippers had grown accustomed to relying on public rates and traditional service. On the railroad side, any proposed change in rates or services were delayed by internal regulatory reviews, and that naturally resulted in a slow and conservative approach to change. There was, in essence, a general impediment to trying anything new and creative.

Following Staggers, we shifted to a market-based environment with a new sense of urgency and creativity. Normal market incentives drove new innovations that improved service to our customers and allowed us to operate more efficiently and ultimately profitably.

The intermodal market is a wonderful example of this phenomenon. Intermodal traffic has nearly quadrupled over the last 30 years, rising from three million trailers and containers in 1980 to just under 12 million today.

Presently, intermodal accounts for about 21 percent of U.S. rail revenue, second only to coal and all other rail traffic segments. This would not have been possible without substantial innovations and reinvestment into clearing of the right-of-ways for double-stacked containers, new terminals, and expanded port facilities.

We view our new intermodal terminal in northwest Ohio, which actually began its first day of successful operations yesterday, as a prime example of the innovative tranformation we're seeing in the industry.

It will effectively serve as the hub for all intermodal traffic moving across the northern tier of our network. It features a state-of-the-art terminal design with five wide-span cranes, each as wide as a football field is long.

These cranes are the latest in green technology, taking up less space, creating less noise, and running on electricity, resulting in an 80 percent emissions reduction compared to diesel cranes. In fact, the cranes actually generate electricity as they lower containers. The crane significantly improves car-to-car loading, resulting in increased delivery times and greater service reliability for our customers.

Now I'd like to turn to another reason why reregulating exempt commodities would be wholly unwarranted. Competition is pervasive.

As I said in my opening comments, we compete hard against all of our competitors, but as the statistics on overall tonnage from the Department of Transportation make clear, the trucking industry is by far the dominant player. It commands 67 percent of the total transportation market based on tonnage.

Rail, on the other hand, currently holds a modest ten percent of the transportation pie, only marginally more than the eight percent enjoyed by pipelines. Trucks have been the dominant mode of transportation for as long as I've been in the business.

What's been exciting to see in recent years is the progress we've made in earning business that historically belonged to trucks. We are concerned that reregulating the exempt commodities will re-handicap our ability to compete with the trucking industry and make it all the more difficult to get loads off the highway and onto the rail system.

Now I'd like to turn to a few of the shippers' comments that have focused on the improved financial performance within the rail industry. They assert that financial progress is a justification for reregulation, and that's just flat wrong.

In passing Staggers, it was the goal of Congress to strengthen the railroad industry's financial position and with it the nation's transportation network. That we're closer to that goal than we were 30, 20, or even ten years ago is an affirmation of the course charted by Congress, not a justification for reversing course.

Improved financial performance has laid the foundation for the recent dramatic increases in reinvestment by the railroads in their network and equipment. As you can see on this slide, CSX capital expenditures have closely followed operating income results.

When operating income dipped in 2009, so, too, did the amount that we were able to reinvest in the business, but in 2010 we were able to return to the 2008 level of $1.8 billion, and we plan to increase that amount to an unprecedented $2 billion in 2011. It is precisely this kind of upward trend in reinvestment that's required to meet the projected demands of the future.

This slide shows the most recent projects for freight demand from the Department of Transportation. Demand is expected to increase 68 percent by 2040.

Absent a change in market share, the railroad's portion of that increase would be 1.3 billion tons.

By anyone's standards, that's a big jump from current levels, but as an industry we continue to hear from federal and local governments, from customers and from communities we serve that there is a real need to get more tons off the highway and onto the rail system. In other words, there is an expectation for railroads to grow our current market share, not simply maintain it.

We at CSX view the 1.3 billion ton increase as the floor. We're planning and building for more in the future that well exceeds it. Given our country's growing expectations for rail, as well as our own, we anticipate more competition, not less, as we work to win more business.

We look to reinvest an increasing amount into our network, not less, as we strive to meet future demands, and, as we know, the country is asking for more rail, not less, as we target new goals that go well beyond the volume and productivity increases achieved to date and which also seek to further advance the landmark success we've seen in safety, service, and environmental.

In closing, I appreciate this opportunity to speak on this important topic, and CSX Transportation looks forward to working with the Board in ensuring that the fair, balanced, regulatory scheme envisioned by Congress will continue to allow the railroads to serve the need of its customers and its customers in the future. Thank you very much.

CHAIRMAN ELLIOTT: Thank you, Mr. Gooden. Now we'll hear from Kansas City Southern. You have ten minutes.

MR. OTTENSMEYER: Okay. Good afternoon, Chairman Elliott, Vice Chairman Nottingham, Commissioner Mulvey. My name is Pat Ottensmeyer, and I am Executive Vice

President of Sales and Marketing for Kansas City Southern and the Kansas City Southern Railway Company.

I appreciate the opportunity to present KCS oral testimony on this topic. The Board's notice requested comments on the effectiveness of the exemptions in the marketplace and whether the rationale behind any of these exemptions should be revisited.

KCS experience shows that the intermodal and boxcar exemptions have allowed us to compete more effectively. These exemptions have given us the flexibility to improve the use of our assets and to price our services according to market conditions, equipment availability, and customer demand.

As a result of this market flexibility and several other factors, including our acquisition of Kansas City Southern Dominico, our share of intermodal traffic has grown substantially and is now one of our fastest growing sectors of all of our business.

Okay. As this slide shows, you can see over the recent years, the past three years, our intermodal traffic has grown by about 40 percent since 2008, and if you took this slide back further, you would see tremendous growth from virtually no intermodal traffic to where we are today. In spite of this growth, our market share of intermodal traffic, particularly for cross-border traffic, is still quite small, and I'll talk more about that in a moment.

Similarly, over the past few years there has been a resurgence in transporting commodities in boxcars made possible by a higher percentage of round-trip back-hauls and other equipment utilization improvements made possible through the exemption.

As this slide shows, our boxcar traffic has grown considerably over the last few years, and this growth has been made possible to a large extent through back-hauls and other equipment practices, as I mentioned earlier. The existence of the exemption has allowed us to price our boxcar traffic to encourage utilization of equipment that would otherwise move empty back to its head-haul point of origin.

As an example, we adjust rail rates frequently to respond to truck rates at some of the paper mills that we serve. As trucks bring inbound scrap into paper mills, they are constantly quoting spot or market prices to get the outbound loads.

By being able to respond to these market changes, we have been successful in security a higher proportion of round-trip moves through similar pricing strategies. This enables us to significantly reduce empty miles and improve our overall return on investment per boxcar.

If you look at this slide, you can see the red line at the top measure loaded boxcar miles, and the yellow line is empty car miles. We look at this for many different types of equipment, and you can see there is a divergence in those two lines, so our goal is to manage our business this way to improve the proportion of loaded to empty miles.

It is interesting to note in their comments Packaging Corporation of America points to the fact that they often have difficulty reloading boxcars and that some of the Class I railroads serving their facilities are unwilling to or willing to forego this back-haul revenue.

This has not been our experience, and, indeed, at many of the paper plants we serve we have an active boxcar reload program, and we believe if boxcars were to be reregulated, Kansas City Southern would likely lose the ability to pursue these reloads at the mills, because we would not be able to respond to market conditions as rapidly and that we would lose some of this traffic to truck.

The return on the investment on our boxcar fleet would more likely drop to the point where we would need to reduce our fleet or possibly considering withdrawing from some of these markets.

PCA's comments actually support one of the points made by Kansas City Southern in our testimony, and that is that the Board should not assume that all shippers and railroads share the same practices with respect to the effectiveness of these exemptions.

Some of our greatest successes in generating growth in loaded boxcars has been due to our concentrated efforts to develop reloads, improve the way we utilize our fleet, reduce empty miles and the costs associated with repositioning equipment.

With respect to the second question, whether the rationale underlying the exemptions remains valid in today's marketplace, the believe the answer is yes.

The exemptions were granted on the basis that government regulation was not needed, because the railroad's pricing and services would be constrained by competition provided by other modes, especially trucks, as well as competition from other railroads.

These reasons remain valid today. Indeed, Kansas City Southern faces more truck and rail competition than ever before. This can be shown empirically by examining KCS's market share data in a few commodity groups.

As example, one of our fastest growing businesses is international intermodal traffic moving through the Laredo, Texas, gateway between the United States and Mexico. KCS has a small market share when compared to trucks and the containers being interchanged with other railroads.

As you can see on this slide, the blue line, these re percentages. The blue bar represents truck traffic crossing the border. The yellow line is traffic that we interchange with other railroads at Laredo.

The red line -- there is a red line on this chart. You can barely see it, but it's traffic that we actually move on both sides of the border on the Kansas City Southern network.

While we are competing hard for this cross-border franchise to grow, our market share continues to be small. Trucks continue to dominate this market. At most of the paper mills that we serve, we also face competition from other modes, including truck, and from other railroads.

Again, likewise for intermodal traffic, KCS faces intense competition from other railroads. This slide shows our international intermodal network with the icons representing the locations where we have intermodal facilities.

This next slide shows those same markets in the United States where we have intermodal facilities, and this highlights that in every one of the markets that we operate our competitors also have intermodal facilities. In addition, in some cases there are three or four competing rail intermodal facilities in the same market.

In addition to that, there would be multiple truck terminals in all of these markets. The presence of these other terminals means that the shippers have numerous choices for their trailer and container traffic.

Competition is further intensified in that the numerous third-party intermodal marketing companies and long-haul trucking companies have all established relationships with other railroad competitors and provide competitive alternatives to KCS's service.

As someone who is frequently in contact with shippers of all size, I can certainly confirm to you that the competition facing KCS for the movement of intermodal and boxcar traffic is intense.

The fierce rail and truck competition that justified the boxcar and intermodal exemptions remains powerful constraint on our pricing and service today. This competition has intensified as the IMC and third-party logistics companies have matured since the adoption of the exemptions, and, of course, competition with other railroads continues to be intense.

Finally, I'd like to comment on the next steps to be taken by the Board. Because the exemptions have an effective -- have been an effective competitive tool, we do not believe this Board needs to take any steps further to revoke, either in whole or in part, any of the exemptions covered by this proceeding.

Instead, the Agency should continue with its existing policy of reviewing complaints about exempt traffic on a case-by-case basis and, where appropriate, revoking the exemption solely to the extent necessary to review and rule on those individual situations. If the Board does intend to take further steps, it needs to consider the different impacts that revocation could have on railroads of different sizes.

As an example, again, in PCA's written testimony, that the industry has not made efforts to develop boxcar reloads. I can't speak for the rest of the industry, but that has certainly been not the case at Kansas City Southern, as we have made significant efforts to develop such reloads.

KCS is especially concerned about the potential unintended consequences to it and other smaller railroads that could result from wholesale revocation of these. From the testimony of the American Short Line & Regional Railroad Association, I understand that they share this view, as well.

As pointed out in their comments and ours, if not done carefully, any efforts to the Board -- by this Board to undo exemptions could actually have the unintended consequence of harming the smaller railroads whose shippers have benefitted from the service and competitive alternatives developed as a result of the exemptions.

Thank you for this opportunity, and I'd be happy to answer questions at the appropriate time.

CHAIRMAN ELLIOTT: Thank you, Mr. Ottensmeyer. We will now hear from Norfolk Southern Railway Company. Mr. Lawson, you have ten minutes.

MR. LAWSON: Thank you. My name is David Lawson, Vice President, Industrial Products for Norfolk Southern. Mr. Chairman, Vice Chairman, Commissioner Mulvey, appreciate the time and also the opportunity to come and speak before you today.

In my 23 years of experience at marketing rail services, I have never heard a customer mention, much less complain about, the existence of any commodity exemptions or class of service or equipment. Many of the filings that are requesting a review or revocation of the commodity exemptions are very general and lack specifics.

They suggest that the railroads have enjoyed a brief, relative brief period of financial viability and now impose -- now want to impose the very regulations that, quite frankly, caused the very need for Staggers.

What I can say is based upon my experience is that there is no general need for regulation of any kind to prevent the abuse of market power by railroads with respect to the exempt commodities due to the pervasive competition from rail, trucks, barge, product, geographic, and source competition.

In Norfolk Southern's experience, the transportation markets for exempt commodities like cement, paper, and forest products, as well as for intermodal traffic, are highly competitive among railroads and between railroads, as well as other modes. I'll share with you one example in one of our markets, our paper markets.

Norfolk Southern serves over 50 paper mills. Two-thirds of those paper mills are located in the southeastern part of the country. As many of us all know, the Florida market is a huge consuming market but doesn't produce a lot in terms of outbound opportunity.

Every day that we compete in the southeastern part of our country serving these paper mills, we're either competing against our Eastern Rail competitor, or in most cases it's against the trucks who are coming out of Florida looking to find back-haul opportunities and thus competing with every opportunity that we have. It's a fiercely competitive market, the paper market.

I spent 11 years, seven of which were in Detroit, managing the accounts of Ford and General Motors in marketing our transportation services to the automotive industry, and I do have to tell you that we find that the comment about the retaliation or the threat of retaliation with regard to dealing with the automotive manufacturers, in our opinion, baseless and reckless to make that kind of a comment without any examples.

Having dealt with Ford and GM for the number of years, I can assure you there is no concern about the fear of retaliation with Ford against the railroads or specifically with Norfolk Southern.

The intramodal competition of finished vehicles is also highly competitive. First of all, the destination facilities and rail cars to finish -- to haul finished vehicles to the unloading facilities or ramps, as we refer to them, are typically owned and have been capitalized by the railroads, not the haul-away carriers.

They are typically bid out by the auto manufacturers, and the railroads intensively compete for this business. Additionally, as far as sole-served assembly plants, I'd like to share with you a couple of examples where there is truly intramodal competition.

More than 25 years ago, our railroad, our company built a loading facility in Detroit. We refer to it as Melfindale on the outside of Detroit. That facility was built to attract vehicles that were manufactured in Canada and Detroit area assembly plants that are trucked away from those assembly plants to that facility to be loaded direct on the rail.

We also have other examples, for example, in Doraville, Georgia, an assembly plant that GM had on the outskirts of Atlanta. One of our competitors built a auto loading facility about 20 miles outside of the assembly plant and trucked every one of the assembly -- every one of the vehicles to that load-out facility 20 miles away from the assembly plant. This was an assembly plant that Norfolk Southern served directly.

Another example where this existed is in Norfolk, Virginia, where Ford Motor Company had a pickup truck plant there. Again, another competitive plant offsite load-out facility was built not far from the assembly plant.

For a number of years, Ford trucked those vehicles to our competitor's site. After the termination of that contract, Norfolk Southern built another facility in order to truck those vehicles away.

So the examples that we have, and there are others, as well, that exist in the automotive marketplace as it relates to finished vehicles, are such that there is truly intramodal competition in the automotive marketplace.

I'd also like to turn and just make a comment about auto parts. The auto parts market is a highly truck-competitive market.

There was mention earlier in testimony today about certain components of auto parts where the rails enjoy a larger share and had to do with, I believe trucks not being competitive in certain markets as it related to engines, transmissions, frames. There's a simple reason for that.

The reason for that is that those components are loaded into highly customized racks that require a round-trip move. The way we price our services is such that that move on the head haul to haul the parts from the component plants to the assembly plant include the return of those racks.

The motor carriers see that as a two-way move and price it as two separate moves. The equipment that we put into these components plants are dedicated to those component plants to haul those specific parts in these highly customized containers from the component plants to the assembly plants and then the empty returns of those racks right back to the component plant.

It's the same thing on the frames. That's the simple reason as to why that's a market that we have participated in for so many years.

The closure of Detroit's big three and the outlying assembly plants has concentrated the remaining parts flows for the short-haul and near-Michigan markets, which is also highly truck-competitive.

NS would respectfully suggest that the proper course of action for the Board to take as a result of these hearings would be to commence proceedings to exempt additional commodities from unnecessary regulation, as suggested in Norfolk Southern's comments. Otherwise, we think this inquiry should be terminated. Thank you for your time.

CHAIRMAN ELLIOTT: Thank you, Mr. Lawson. Now we'll hear from Union Pacific Railroad Company. Mr. Butler?

MR. BUTLER: Good afternoon. Good afternoon. My name is Eric Butler, and I'm the Vice President and General Manager of the Industrial Products Business for Union Pacific Railroad.

Thank you for the opportunity to testify before you today and express my view of the current exemptions and how I believe they assist me in being responsive to my customers in what is a very competitive marketplace.

Today we have the ability to offer creative, rapidly responsive solutions to customer requests for transportation options. During any given week, my team is responding to 125 new requests or proposals for service from customers.

In 2010, my median response time to those customer requests was one day, with the majority of my customers getting a response from us within three days. Naturally speaking, some we could respond to instantaneously. Others may take even a week or longer due to the complexity and the need to be creative, to be competitive.

However, with this rapidly changing marketplace it is imperative that we respond quickly. I believe a revocation of the exemptions will cause an adverse impact on my ability to be responsive to this marketplace.

One indication of the competitiveness of my business is that less than ten percent of the proposals that I get, customer inquiries that I get, result in business shipped on Union Pacific. I define competition as the fact that 90 percent of the customer transportation requests that I get, the customer finds another, more suitable, more competitive option.

I operate in a very competitive business environment. Approximately ten to 12 percent of my business churns annually, and not only do I have effective rail competition, truck competition, and barge competition, but I'm also subject to product source and geographic competition.

In the few remaining moments that I have, I want to share a couple of on-the-ground stories and examples of the competition that I face on a daily basis. My aggregate's a rock business. It's perhaps one of the most competitive markets out there.

While Union Pacific is extremely proud of our aggregates franchise and the fact that a number of customers have chosen to open facilities on our network, rail competition is fierce, and rail still has a very small market share versus truck in the Texas aggregates market, my largest market.

We estimate that trucks have 75 to 85 percent of the total Texas aggregates market share. There is also strong barge competition, particularly barge shipments from the Yucatan Peninsula and Mexico, going to the heart of Houston and the heart of South Texas.

Texas Crushed Stone in Georgetown, Texas, who is also a respondent in this hearing, is a great example of the significant competition in the aggregates market. They are located on a short line that connects to both the PU and the B in Santa Fe.

Not only is there effective rail competition, and I have lost market share to my Western Rail competitor, but there is also significant trucking competition from other quarries in the same geographic area.

We have worked hard to regain the portion of business that we have lost from them, but they have consistently identified that they have had more other competitive options.

Another example of the fierce competition in the marketplace involves another respondent in this hearing, Holcim Cement. In 2009, they opened a four million ton cement facility in St. Genevieve, Missouri, which is estimated to be almost twice as large as any other cement facility in U.S.

This one facility we estimate by our internal estimates can meet half the entire cement requirements for the states of Kansas, Missouri, Minnesota, Nebraska, and Arkansas.

It is our understanding that when this facility was designed and opened, which is closed on the B end, it was designed to have the majority of the shipments barged up and down the Mississippi or the Missouri Rivers and a minority of it railed. However, due to the softness of the housing market and the cement market, Holcim has now broadened their market reach to increase the utilization of this large facility.

They are active with their transportation and product pricing options. They have entered into markets further west than our territory from this one facility and even into Texas, and, as a result, they have taken market share from other UP customers.

This is a great example of the source and geographic competition that we face in our markets. As a result, between 2008 and 2010, my cement business has experienced a 15-point loss in market share just predominantly due to this one situation.

My final example involves a very creative solution we provided to a steel manufacturer moving long-haul steel products by truck from Chicago to Mexico. We designed a multi-modal product using truck, transload, and rail that had a transit time from Chicago to Mexico within two days of the team truck transit time, and it was priced 50 percent below the truck rates.

Despite this, we were still only able to gain about half the market share, the truck market share from this customer moving truck long-haul to Mexico. As you can see, there are a lot of factors, and they're in fierce competition each and every day.

I've learned in my 25 years in the railroad business and in my seven years as a senior commercial office that having the ability to design responsive, flexible, creative, and unique transportation solutions for individual customers is critical to being competitive in this multi-modal environment.

Supply chains are rapidly changing, and in order to ensure the viability of rail, the viability of rail transportation for my customers, I likewise believe we need the ability to remain flexible, creative, and responsive and provide unique solutions for individual customs, and I believe that the current regulatory structure allows us to do so. Thank you for your time.

MS. KREHBIEL: Good afternoon. My name is Julie Krehbiel. I'm the Vice President and General Manager for the Automotive Business Team at Union Pacific, a position I've held for close to six years, and I appreciate your time today.

I'm here to talk about the movement of finished vehicles and automotive parts via rail and other modes of transportation. A few of the automotive shippers have suggested that we are not facing competition in these markets, so I want to talk about the competition that we are facing and how it's changed the way that we do business.

We see competition really in three key areas, three key modes: truck and rail, which I'll talk more about, but also in vessel. The vessel competition is specifically related to the movement of finished vehicles.

There are finished vehicles that could off-load on the West Coast and move rail inland. Instead, they go around the horn and off-load on the East Coast.

We also see vessel competition in short-range markets such as Mexico to the East coast. Obviously, vessel has got a significant cost advantage over rail, so we focus on our speed to market and our damaged redelivery to win this business from vessel.

The truck competition really is pervasive for both finished vehicles and automotive parts. They offer some obvious advantages, speed, flexibility, access to more locations, components that are very attractive, especially now given the tight inventory situations that the automotive customers are facing for both vehicles and production parts.

You would expect that competition in short-range markets, but we also see it in very long-haul markets that may surprise you. We compete fiercely for automotive parts that move between the Upper Midwest and Mexico. In fact, automotive parts move 85 percent by truck, a clear indication of the competitive level that we face.

In the longer range vehicle markets we have fought for years to try to move vehicles via rail from the East Coast as far west as Colorado and Utah, and they have failed repeatedly. The vehicle market on the used side, over 99 percent of that market moves long-haul truck, again a testimony of the competitive level that we face.

It's important that we are able to provide a premium service and to do it at a savings to truck. In order to ship and convert traffic from truck to rail, our customers expect significant savings.

Certainly, the rail competition is very fierce. We compete head-to-head with the Burlington and Santa Fe in the western two-thirds of the United States.

On the parts side, that business can move easily, obviously, via truck but also via rail. Finished vehicle side, we compete head-to-head by offering competing distribution facilities in every key major geographic market in the West, enabling customers options.

It is -- we also have another fierce competitor, of course, in the Kansas City Southern, specifically on movements of vehicles and parts to and from Mexico, and in our business, Union Pacific, that's significant. It's over 40 percent of my annual volume.

I also wanted to talk just for a minute about the issue the Alliance raised about the sole-served facilities contending that because of rail mergers that the number of sole-served facilities has increased, and the facts just don't bear it out.

There has been no facility that has lost an option because of a merger. If any facility is sole-served, it's because it was either that way before the merger or has located since.

In fact, if you look at the most two recent plants built in the U.S., one of those manufacturers chose to locate on a single-serve facility, and I would contend they did that for the same reason that I would do it, because I think there is competition there.

It is not unusual, as Mr. Lawson indicated, for a manufacturer to choose to truck away from a serving railroad to get to a competing railroad. In fact, that's how we served the Oklahoma City plant for a number of years before it closed.

It's obvious that all this competition has changed the way that we do business. We have invested over $688 million in the last 12 years just in automotive. That's either in equipment, facilities, or technology, all focused at improving our service liability and ensuring that we do it in a damage-free basis.

We invest over $33 million annually in equipment. We have the innovative auto-plex, which enables us to move either bi-levels, which hold SUVs, or tri-levels, which hold vehicles, with the same investment dollars. We patented that technology and made it available to other railroads.

We're very focused on offering a premium service that's as close to truck as we can. We have taken 7/10 of a day out of our delivered vehicle transit time, almost a 12 percent reduction last five years, and in 2010 we handled over a quarter of a million of loads of production parts, over 95 percent on time, a testimony that our customers know we can support their just-in-time networks.

So, in summary, it's our customer-focused investment, our ability to offer premium service at competitive rates, and our customers recognize that. In 2010, they rated us a 95 out of 100 in customer satisfaction.

This investment is very specific to automotive, and it's a testimony that we don't take our customers for granted. In fact, I only have five customers, and they represent over 90 percent of my revenue base. Obviously, I can't take them for granted.

We feel this investment is directed at ensuring that we offer premium service, and we do not believe that regulation will do the same. In fact, we think it ultimately will deter investment going forward. Thank you.

CHAIRMAN ELLIOTT: Thank you very much, Mr. Butler and Ms. Krehbiel. As far as questions, Vice Chairman?

VICE CHAIRMAN NOTTINGHAM: Thank you, Mr. Chairman, just a couple. Mr. Lawson, thank you for your remarks. You mentioned near the end that you would support our consideration of additional exemptions.

I guess that begs the question do you have any nominations as to what types of commodities ought to be added to the exempt commodity list or in your experience any particular direction you want to point our attention to as far as looking at additional opportunities for exemptions?

MR. LAWSON: Yes, sir. We

mentioned the specific commodities in our filing, but they would include industrial sand and hydrostethyl alcohol, phosphate fertilizer solutions, and asphalt, and the reasons for that are fairly simple.

We see, based on our experience, that there is intense market competition for these commodities, and there seems to be enough capacity and opportunities for us to compete more effectively, so we would ask the Board to take that under advisement.

VICE CHAIRMAN NOTTINGHAM: Thank you. Mr. Butler, thank you for being here. It's a pleasure to see you. I'm not used to seeing you on the witness stand.

We worked closely together, along with my colleagues, on the Rail Shipper Transportation Advisory Commission, which many people know as the congressionally chartered In-Statute Advisory Commission that does really outstanding work.

Eric, you've been a leader for

years now on that advisory commission. I just want to say thank you. What you've brought to the table there day in, day out at every meeting has been just tremendously useful to our agency but also to shippers. I've received many compliments from small and not-so-small shippers about the usefulness and helpfulness of your contributions to that committee, so thank you.

Thank you to your railroad for making you available at no cost to the taxpayer but at some cost to -- at some great cost to UP as you aren't able to do your regular job and you're with us.

That begs a question. Are you -- with this group here, who's running the railroads, I guess I should say, today, and are we going to have to see a productivity adjustment for the lost productivity today?

MR. BUTLER: Mr. Chairman, maybe we need to do some kind of special proceeding on that, because we've got an awful lot of senior people here to help us understand the history and current daily realities of what the exemption process has meant to shippers and to railroads.

Let's see. I think, really, I'm going to pause there and let my colleagues throw out some questions. Mr. Chairman, I'll send it back to you.

CHAIRMAN ELLIOTT: Sure. Now we'll go to the Commissioner.

COMMISSIONER MULVEY: Thank you. We're looking to see what the revenue-to-revenue cost ratios are for the commodities you suggested.

I found all your testimonies interesting, but they range from how wonderful intermodal is, how great Staggers has been, that boxcar reloads are still important, and that there is plenty of competition, intermodal competition and competition in general. All of that is true, and I think that there is no disagreement between anybody in this room on those facts.

The question, I think, though, is whether there are any commodities at all where there has been enough change in the competitive environment that it might be a valuable exercise for the Board to look and see whether or not the commodity exemption put forward back in 1979 and in the eighties are as sensible as they are today?

The other question I have is why are the exemption process or lack of process so critical to the railroad's ability to meet competition?

It strikes me that much of what the railroads do and much of how the railroads can respond to trucking competition, can be done without the exemptions. Finally, how much traffic, after all, are we really talking about?

It is true that most of the traffic either moves under contract or is well below the threshold of 180 percent revenue-to-variable-cost ratio. That traffic is assumed competitive.

It would not be brought to the Board in terms of a rate or service case, so we're probably only talking about a small part of the traffic, but I would like to be educated as to specifically why the exemption process is so critical to the ongoing success of the railroads. Anybody? The whole group. Anybody can answer that question.

MR. BUTLER: Yes, Commissioner Mulvey, I'll take a shot, and let me just give my appreciation to those nice comments made by the Vice Chair. I have enjoyed my last five years working with the STB and RSTAC. This is my last year, and I will miss the meetings, but I certainly have enjoyed the great dialogue that we've had in the meeting.

Commissioner, you asked several questions. One question, I believe your first question, was dealing with the flex -- or which commodities would we believe, and I would just say, speaking for my industrial products business, I am not aware of any commodity that I am responsible for that does not have significant fierce competition, whether it's rail, whether it's truck, whether it's barge, whether it's source product, geographic competition.

Sitting here today, I can't think of one that does not have significant competitive factors. The reason why I quoted some of the statistics that I quoted was it is interesting to me how many requests for transportation proposals and services we get, and we work competitively to go after them.

I have a great team that works every day, and still there's a very small percent, less than ten percent -- the number is actually closer to five than it is ten -- of those requests that I win, so to me that suggests that there is significant competition.

When you asked the question about

the exemption and how I believe that will impact, I believe, looking at the regulatory regime in the past, that when you look at the publication requirements and the notification requirements --

I have many customers that want us to do quick -- for lack of a better term, I'll call it spot deals, quick-hit deals that they want it to be quick and deal with the project, deal with an issue, and my understanding of the previous construct, I'm not sure we'd be able to deal with those very effectively.

COMMISSIONER MULVEY: Anybody else? You talk about the way things were before the exemption process, and I think that that's something that people seem to think that we're talking about some sort of revocation of all the exemptions.

I think what the Board was looking to see whether or not the exemptions were equally valid as they were before for all commodities and all traffic types, rather than a blanket revocation, going back to the pre-Staggers case where every commodity was regulated and, I think, as the railroads and most economists have rightfully pointed out, we over-regulated to the detriment of our nation's transportation system.

The question really is are there some commodity exemptions that should be examined. We did have one testimony, which I'm sorry he is not here today, and I don't want you to go back and look for yourself, that made a good case. But it has to be on a case-by-case basis, and it needs to be factually driven.

Of all the pleadings that we got, only one of them really had the kind of facts and the kind of analysis that we would be looking for, and we were going to consider whether or not an exemption should continue.

Clearly, there are many, many products where either they were moving under contract or the ratio was such that it's clear that there is very, very intense intermodal and intramodal competition.

The other point I wanted to raise was we had these shares of traffic, shares of revenue, and shares of tons, and we all know that truck dominates tons and certainly dominates revenues, and pipelines also are very big on tons.

When it comes to ton miles, the railroad's market share is even greater than the trucks, suggesting that when you talk about long-haul movements, especially long-haul movements of bulk commodities, rails do have a large share of the market.

I asked this question before, and that is what would you think about looking at the exemptions and perhaps removing the exemptions for certain distance movements, as opposed to the removal of an exemption for any particular commodity? For a commodity at a certain distance, where there really isn't effective competition. Would anybody want to care to comment on that?

MR. BRANSCUM: I'll address that. I think there is a misconception out in the marketplace about market share in intermodal, anyway, on long haul. To put it in perspective for you, let me give you some numbers.

In the western two-thirds of the U.S., you know, the BNSF and the UP territory, BNSF moves about four and a half million intermodal shipments a year, and the UP number I think is about four, maybe a little less than four million, but yet you have to dissect those numbers to really understand share.

About half of that, actually, a little more than half of that, maybe 60 percent of it, is international freight coming into the West Coast, and I think we demonstrated that that's all subject to competition going to the East Coast, and that could even get greater after 2014, when the Panama Canal is widened.

So you set that aside, and then you have roughly 40, 45 percent of those volumes left, which is domestic transportation that's probably going to exist in the western two-thirds of the U.S.

So that would mean BNSF handles about two million shipments a year, UP about one and a half. I'm sorry. I don't know what number I threw out for BNSF. It's about two million a year and UP about one and a half or maybe a little more than that.

There's been some studies recently looking at truck share in existing long-haul intermodal lanes that are offered by BN and UP, and the number is somewhere between seven and ten million truckloads that are still on the highway.

So we have -- looking at it from that perspective, the share could be as low as 20 percent, so I think there is still extreme competition from the trucking industry in the long-haul markets.

COMMISSIONER MULVEY: Is it true that most of those truck movements consist of a single container, whereas a lot of what you're taking and UP is taking are multiple cars that are going to large distribution centers, Wal-Mart for example.

So it really depends upon the nature of the shipment, and if it's a multiple car shipment, it's more likely to go by rail, but if it's a single car shipment, it's more likely to go by truck? Would that be fair?

MR. BRANSCUM: I'm not sure what you're referring to when you say multiple car. Are you talking about multiple stops?

COMMISSIONER MULVEY: Multiple containers. In other words, if you have a ship coming from China and it's got 100 containers on it that are bound to a Wal-Mart distribution center in Arkansas, those would very likely go on a single unit train, whereas if you have one or two containers going to a single warehouse someplace, say, in Nebraska, it's more likely to go by truck?

MR. BRANSCUM: No. You recall I disregarded the international, saying it's competitive to all water service, so I wasn't counting that, so if you count --

A lot of that would move on unit trains out of the ports either in California or the Pacific Northwest to destinations across the U.S., but in the domestic markets, which is represented by the seven to ten million loads that I believe are still on the highway in our existing lanes, that, a lot of that is single truck movements.

COMMISSIONER MULVEY: Of those seven to ten million trucks that are still on those highways, are they averaging the same distance for those hauls?

MR. BRANSCUM: Yes, they're in the same exact lanes that would offer service today.

COMMISSIONER MULVEY: The same market. Okay. Thank you.

CHAIRMAN ELLIOTT: Just to follow up on Commissioner Mulvey's question regarding flexibility, the way I understand it is some of the problems with flexibility were eliminated during ICTA, eliminating the requirement to file the contracts and tariffs. But maybe one of the reasons that people can't be as flexible without the exemptions is the ability to raise the rates at a moment's notice.

I was wondering with -- and I'm not aware of any other hindrances, so if there are any other hindrances, I'd like to hear them, but I was wondering if the Board looked at it in that way, if instead of making it a full revocation -- this is obviously a hypothetical -- and just kept that exemption with respect to whether you can raise or lower a price on the spot, you know, quickly without notice, if that would eliminate some of the concerns that you have regarding flexibility.

MR. BUTLER: I think if you look

at some of the respondents and some of the customer respondents, they gave some other factors in the filings, the written filings, including the concern where customers desire to have very special, unique deals that perhaps the perspective is we were not able to construct some of those deals in the previous environment, as we can when you have exemptions, and I think some of -- at least, one notable customer response gave some examples of those types of things.

CHAIRMAN ELLIOTT: That's all I have. Do you have anything else?

VICE CHAIRMAN NOTTINGHAM: Thanks. I just wanted to follow up on a question I believe I asked Mr. Hamberger earlier, and he kind of referred me to this panel, so I'll ask it here.

What type of contractual or contract-like terms do you offer customers when they explain that time is important to them, that they're in the just-in-time delivery or inventory business, and they'd like to do business with the railroad, but they've got to have some dispute resolution process if the train doesn't show up or if a surcharge surprisingly appears on a bill? What, for any of you, what types of dispute resolution mechanisms or terms are you able to offer, to the extent you can talk about that?

MS. KREHBIEL: It's certainly an automotive, you know, both from a vehicle perspective, as well as production, parts. Service is very important and our ability to hit their service windows.

So although, you know, we can't talk about specific terms and conditions, we certainly have service commitments within the contracts, and, actually, the business is at risk if we don't meet those service commitments. Then there's a process for remedy within the contracts.

VICE CHAIRMAN NOTTINGHAM: I mean, is it fair to say that -- I don't want to use specifics, but I'll throw an example out, a UPS, probably the biggest rail shipper in the country.

If they need some type of dispute resolution mechanism in a contract, you're going to come up with something to get that business. Is that a fair --

MR. BRANSCUM: Absolutely.

VICE CHAIRMAN NOTTINGHAM: -- fair statement to make? What about a smaller customer? I mean, is it only for the super-mega customers that get that kind of attention?

MS. KREHBIEL: No, I mean, certainly from our perspective it's not really the size of the customer. It's the requirements of the business.

Production parts, no matter how big a manufacturer you are, you have to have them there to hit production. Otherwise, it's very costly to you, so it's not really the size of the customer as much as the requirements of the business.

MR. BUTLER: Our focus is really on customer service, so one example is we have what we call a shutdown report, and regardless of whether or not a customer has a contractual service provision with us or not, any customer that is at risk because of our transportation service shows up on that report, which gets widely disseminated, including up to our Chairman.

We figure out what we need to do to address that so that it doesn't happen, and so our focus is really customer service, because we want the long-haul customer relationship and the long-term customer business relationship.

MR. BRANSCUM: I might add to that. In the intermodal world, you know, most of the products that are handled in an intermodal means are retail-related, so it's fast-paced. The products have to get to market.

So, given that, you know, there's a whole range of remedies that are negotiated in contracts, and it's very difficult in this setting to talk about the specifics, but I can tell you that there is always some form of remedy, and, you know, the most extreme is just simply to get off rail and go back to the highway.

You know, within a given contract, we might attempt to limit how much of that could happen, but there is always that solution, at least for some portion of the traffic. The contracts in general are not that long in term, so the ultimate solution is always to go to the competitive options, which is highway.

MR. BUTLER: Yes, and I would like to make one more comment about the focus on service and the remedies, and I would echo what the Vice Chair said earlier this morning. The STB's Office of Consumer Support is, I think, a tremendous resource for the rail shipping community.

I've been the recipient of a number of inquiries from the STB, and I think -- not I think, but I know according to my understanding, every single one of those we've resolved to the satisfaction of the customer, the rail shipper, and the STB.

So, certainly, even if the customer did not have a contractual remedy, that is an option that's available, and I believe, at least speaking for Union Pacific, we've been very responsive to that.

VICE CHAIRMAN NOTTINGHAM: Thank you. That's all I had, Mr. Chairman.

COMMISSIONER MULVEY: I just have one other question. We talked about sole-served shippers before or singularly served shipper, whatever you want to call them.

One of the pleadings mentioned that it's not so much that there was two railroads serving us and now there's only one, but rather that a railroad that was nearby that wasn't competitive was taken over by another railroad, and so you could still go to the other station, but it's now owned by the single railroad, and it's much, much more difficult for the shipper to get to a competitive railroad.

Where you might have had one 50 miles away, perhaps now the nearest one is 300 miles way and so not really accessible. So would you accept that there has been a decline in competition from that standpoint?

MS. KREHBIEL: You know, speaking just to the automotive business, especially in the finished vehicle side, I wouldn't. You know, if you look at every major geographic market, we have got competing rail heads with the Burlington and Santa Fe for sure and mostly also the case, yes, in some cases.

And even in markets that we're not in like San Diego and the BN is, we compete with a truck from our Los Angeles facility and do very well, so, you know, I think, speaking to finished vehicles, we compete head-to-head across the board in the western U.S.

COMMISSIONER MULVEY: Thank you. That's all I have.

CHAIRMAN ELLIOTT: I want to thank the panel. We appreciate your presentations, very informative, and we will move on to the next panel, Panel V. That's the Shipper Panel. Welcome, everyone. We'll begin with Holcim, Inc. Is that correct? And you have ten minutes.

MR. GIOVINAZZI: Thank you. Good afternoon, Chairman Elliott, Vice Chairman Nottingham, and Commissioner Mulvey. My name is Tom Giovinazzi, and I am the Manager of Rail Services at Holcim US, Inc., which I will refer to today as Holcim.

I am here to speak about Holcim's experiences as a captive shipper of an exempted commodity. I commend the Surface Transportation Board for undertaking this much-needed review of categorical exemptions from regulation.

I sincerely appreciate the opportunity to express my concern over a fundamental flaw in the current system, the failure to protect all shippers from potential market abuses. To be clear, Holcim does not support returning to a time of expansive government oversight of the rail industry.

Holcim acknowledges that deregulation has benefitted rail carriers and shippers alike and that efforts to reregulate will ultimately prove detrimental to both parties. Nevertheless, the current system is inequitable and needs to be modified.

In particular, Holcim supports the removal of commodity exemptions to allow for a redress of the grievances encountered by cement manufacturers, a right already afforded to many other shippers under existing federal law. Before I continue, I would like to familiarize the Board with my company's operations and its product.

Holcim is a leader in the domestic cement industry capable of producing more than 13.5 million tons of cement and cementitious products annually. Holcim has more than 1,800 employees and, in 2010, approximately $1 billion in annual revenue.

Over the last decade, we have invested in excess of $2 billion to upgrade and expand our U.S. facilities, including a significant investment in our new Greenfield plant in St. Genevieve County near St. Louis, Missouri.

Our parent company, Holcim Limited, is a global leader in the building materials sector, present in around 70 countries. In 2009, the group supplied over 130 million tons of cement and almost 150 million tons of aggregates and generated $19.4 billion in annual revenue.

Occupational health and safety is a top priority for Holcim. As such, the utilization of safe and eco-efficient transportation options is central to our business success and to ensuring the safety of our employees, contractors, and visitors to our operations.

Holcim serves customers in 44 states through network of 15 production facilities and 59 distribution terminals. In 2010, roughly six and a half million tons of cement moved from our manufacturing facilities to these terminals for final distribution to customers. Forty percent of that volume moved by rail.

Additionally, Holcim relies extensively on rail for the delivery of critical raw materials and energy feed stocks to our facilities to feed their continuous operation.

Cement is a strategic building material. It is the key component of concrete, which is an environmentally responsible building product used to construct and repair a country's vital infrastructure, the backbone of economic growth.

Nearly 50 percent of our product has an end use in the public sector, in roads, airports, bridges, and schools. Unfortunately, our nation's cement manufacturers are often confronted with the high transportation rates and inconsistent service that add to the cost of cement and therefore to the cost of infrastructure, which is ultimately shouldered by taxpayers.

This is largely attributed to the fact that transportation by rail of cement and several other important commodities used in the manufacture of cement have been exempted from protections under federal law since the early 1990s.

In these exemption decisions, the Interstate Commerce Commission noted that the transportation of these materials was competitive with intermodal, intramodal, and geographic competition existing in many markets. However, in the two decades since these exemptions were imposed, much has changed.

America's manufacturers undoubtedly benefit from a robust transportation network. However, given the regional nature of the cement industry, there are, unfortunately, limited competitive transport options available to cement manufacturers.

Average cement shipments are in the range of 350 to 400 miles. However, truck transportation is not economical much beyond 175 miles, and only three of Holcim's 15 production facilities have access to water transportation for domestic shipments and then only to select markets.

As a result, the cement industry relies on rail transportation to move approximately 50 percent of all shipments between cement plants and distribution terminals, according to 2006 U.S. Geological Survey data. Not surprisingly, the railroads are the only viable option for Holcim to maintain a meaningful presence in many North American markets.

It is therefore highly important to our industry that the railroads provide reliable, efficient, and cost-effective service to enable manufacturers to meet demand for their product, but more than 80 percent of the country's cement plants are captive to a single railroad.

Due to the absence of competition, cement manufacturers may encounter unreasonably high rail rates and may not receive adequate service. Holcim is not immune to these unfavorable market conditions, as only three of our 15 production facilities are serviced by more than one Class I railroad, and the potential for competition at these three facilities is negated by the fact that all of our receiving terminals are single-served.

With no competitive options and no

federal protection, captive shippers of exempted commodities such as cement manufacturers may face unrestrained shipping costs and unreliable service and are ultimately put at a competitive disadvantage.

Substantial changes in the competitive landscape and the railroad industry have occurred that call into question the relevance and/or necessity of some of the existing commodity exemptions. Unless these exemptions are revoked so that manufacturers, unlike shippers of non-exempted products, cannot seek Agency protection for the imposition of unreasonably high rail rates.

Such exemptions also prohibit these manufacturers from raising concerns about a rail carrier's refusal to provide service on reasonable request or from contesting various unreasonable practices in which a rail carrier might engage.

As a shipper of a strategic building material, Holcim needs a robust rail industry to support the nation's economic growth. Holcim must have access to a competitive rail transportation system to ensure timely and cost-effective delivery of cement to those who construct and repair our nation's infrastructure.

Revocation of cement-related exemptions would permit Holcim, if needed, to protect itself from abuses of market power by rail carriers. The Agency must address the plight of captive shippers of exempted commodities, for the Staggers Act not only directed the Agency to pursue exemptions aggressively, but also instructed it to correct any problems arising as a result of such exemptions through its revocation authority.

In conclusion, Holcim respectfully requests that the commodity exemptions on hydraulic cement and materials used in the manufacture of cement be revoked. I sincerely thank you for this opportunity and will answer questions at the end if needed.

CHAIRMAN ELLIOTT: Thank you, Mr. Giovinazzi. Next we will hear from Packaging Corporation of America. Mr. Ridley and Ms. Calabro, you'll have ten minutes.

MS. CALABRO: I'd like to thank the Board for listening to this subject matter today. My name is Dina Calabro. I am the Transportation Manager for Packaging Corporation of America. Next to me is Mr. Bruce Ridley, PCA Mill Manager from our Tomahawk, Wisconsin, mill.

Packaging Corporation corporate office is located in Lake Forrest, Illinois. Our industry is corrugated boxes and container board cells. Annually, sales are $2 billion yearly. Our four paper mills and 68 corrugated box plants, approximately we produce two million tons of container board per year, equivalent to 20,000 rail cars and 45,000 trucks.

Our liner mills are located in

Jackson, Tennessee, and Valdosta, Georgia. Our median mills are located in Tomahawk, Wisconsin, and Filer City, Michigan.

PCA integrates 80 percent of their paper manufactured and is consumed by the PCA box plants. Thirty-nine of our plants are rail served.

PCA's product background. Roll stock is our commodity. Increasing competition in container board industry, service, and quality is what we sell.

Rail is essential to PCA transportation plan. The industry is going towards larger rolls, 110-inch rolls, 130-inch rolls. This can only be shipped by rail.

Our shipping dynamics have changed within the last ten to 15 years. Rail used to be our main mode. Overall, currently we are shipping 50 percentage tonnage moving rail and 50 percent tonnage moving truck. It was 75 percent rail and 25 percent truck.

As an example, one rail car equals

two to three trucks. By shifting to truck, there is more stress on the national transportation infrastructure and gridlock on our highways.

PCA's goals and reasons for attending today's hearing. Ask the STB to investigate the effectiveness of boxcar and commodity exemption.

PCA is not a advocate of either side but rather asks the Commission to study whether or not the exemption is still practical. We want to correct unreasonable practices that impede competition with other modes.

PCA rail transportation concerns. Number one, diminishing competition from railroad service. Consistency and timeliness is not as good as truck.

Pricing. Boxcar supply, we are constantly being -- we have shortage of our boxcar orders on a weekly basis at some of our mills.

Our boxcar quality has moving upward as far as a percentage of rail cars that we have to reject. The number of cars, we have taken a survey over the last year, and the percentage at our mills are just going up, the cars that we cannot accept to put our product in.

Number two item we would like to talk about today is boxcar utilization and boxcar reload effectiveness. An average boxcar turns 12 times per year or one to two per month. We would like to reduce our rail operation cost, and we could also reduce the railroad's rail operation cost.

To date, we are not able to accomplish that. We have cars that we load our roll stock into a facility, and we'd like to reload that car back with scrap to our mills.

There are restrictions on rail cars that belong to other lines that we were not able to use, so the car goes back empty.

Not all railroads are participating in the national boxcar pool.

Accountability of railroads as partners. Sometimes it's, in my experience, it's been a one-way relationship. Annual rate increases are norm. Railroad dictates their intentions without requesting customer feedback, like reducing switching days.

No consequences for service interruption. Railroad causes mis-switches, misrouted cars, and transit delays that can put our facilities in a shut-down mode, and we're always occurring demerge, whether we're guilty until proven innocent to prove that we have caused the emerges.

Also, the role of the short line has diminished. Three out of our four mills are served by short lines. They are leveraging service over volume of cars that we need to ship per day.

In closing, PCA is interested in continuing success partnership with railroads.

Railroads are integrated to PCA's transportation strategy. Competitive service and competitive rates are most important.

PCA is interested in the STB to investigate the past and current effectiveness of boxcar exemption policy. Thank you. Would you like to say anything, Bruce?

CHAIRMAN ELLIOTT: Thank you very much. Now we'll hear from Mr. Weaver from the Weaver Popcorn Company. You have ten minutes.

MR. WEAVER: Thank you. Thank you, members of the Board, for holding this valuable hearing today. It was suggested by our short line partner, the Wabash & Central Railroad in northeast Indiana, that I come today and share some of my concerns with you all, and, again, we are a very happy customer of Packaging Corporation of America, actually, as well, so thank you for the good supply.

What I'd like to try and to today is you all have received a lot of information today that's very broad in scope, and I'd like to try and offer up a little bit of a granular perspective.

We are a -- Weaver Popcorn is a smaller company. Our only business is popcorn. Popcorn is a market that is heavily and increasingly export-oriented, so we have a very heavy reliance on the intermodal system of this country.

I spend a lot of my time overseas selling popcorn, and I will tell you a lot of the commentary that you received today is very true. I often run into foreigners who marvel at how efficient the American railroad has become, so I really think, quite frankly, the standard that Staggers set has really paid off.

Having said that, I don't think you ever sit on your laurels, and, you know, you always need to address how you can improve further. I think that's probably why you all called this meeting today and are considering various discussions.

The key for the export market in the popcorn commodity is that we're a very weight-sensitive, very freight-sensitive commodity, and right now the way this country's intermodal service is structured, it's an absolute mandate that companies such as mine have to truck their product before it can achieve -- before it can hit the rail or the ship.

What that obligates people like me who are trying to export products to is our weights per container are set by the first leg of the journey to Shanghai, Mumbai, or Alexandria, so my dray to Chicago really determines my weight all the way to Shanghai.

For a small company such as mine, one product, all popcorn, that's a big competitive disadvantage, and so, you know, when I export a container here in the United States, I ship about 21 tons per container at the most.

Most of the competition in my

industry is from Argentina. They have different restrictions on weight there. They can ship 25, 26 tons per container.

Now, my job is not to complain about the terrible Argentine, you know, those evil Argentine guys. My job is to grow volume, so, you know, we came up with a proposal working with our short line to load export containers directly onto cars that we would lease.

We would use equipment to load the cars that we would pay for ourselves as a company. All we needed was for our short line to take it up to Fort Wayne and for it to be picked up by the Norfolk Southern and taken to the various export ports.

That would, for our company, a small company, much smaller than all the other companies here today, that would yield by my estimate almost an immediate 30 percent increase in export volume because of that elimination of the freight disadvantage.

Now, again, we're just one company, but, again, I think that provides an example of although many things are going very well in the last 25, 30 years in the rail industry, a lot of productivity improvements, very impressive charts and graphs today, I do think there are some things you should look at in terms of these exemptions, particularly around the intermodal, where I think a lot of the intermodal, just the inherent productivity of that transportation medium, you're almost inherently going to grow that over boxcars in a two or three decade as boxcars became -- or as containers became more available.

So what I kind of would like in closing to say to you is just, quite frankly, consider whether or not increasing the reach of the intermodal network, allowing companies like my own, Weaver Popcorn, to load containers at the railroad would make sense, and thank you for your time.

CHAIRMAN ELLIOTT: Thank you, Mr.

Weaver. I only had one question. It was directed towards Holcim.

Your -- I took a look at hydraulic cement, the STCC for that and the R/VC ratios, the traffic that runs, the percentage of traffic that runs over 180, and from `93 it was 21 percent. In `98, it went up to 26. 2003, it went up to 41 percent, and 2008 was 44 percent.

So I'd say that is one of the extreme examples of the percentage of traffic running over 180 for revenue over variable cost, making kind of a significant economic statement as far as indicating some possible market power use.

Can you -- I know you talked about captive plants and things of that nature in your testimony, but can you tell me, if anything, what's changed since 1993 to 2008 as far as the competition that you see with respect to railroads?

MR. GIOVINAZZI: Well, I've only

been in the cement industry a short time, so from a cement standpoint I couldn't answer that question, but I've been in the rail industry since 1970.

I think that Commissioner Mulvey is hitting close to the point of what we're all trying to say here. I don't think -- I can tell you for a fact Holcim doesn't consider the railroads the enemy or a bully, even.

You know, I don't think that our experiences are bad with the railroads, but we have a piece of our business that I think anyone who has a business and has to negotiate rates, if you have no alternative and then you have no voice, what ultimately can you do, and the person you're negotiating with for that rate or for that service realizes you have no voice? I mean, I think that's the piece of this that we're focused on.

I would stand with the railroads before I would ever want to see the railroads reregulated. I think all the charts we've seen today prove out, and I'm not saying anything that anybody here doesn't already know, the railroads are far better at railroading than the government is and really any of the shippers are.

I also realize that there's -- pick a number -- 5,000 shippers and seven railroads, and so there is always going to be a complaint. There is always going to be someone dissatisfied.

Someone's rates are always going to be too high, but I think those numbers also proved out that there are a number of industries that are already removed from the exemption, and the numbers were still good.

I mean, the railroads are able to, I think, work in that environment, and I think that what we're looking for is just a process that doesn't overburden the railroads, doesn't overburden this Board, but that just gives us a voice for those lanes where we have no competition.

Again, Commissioner Mulvey, when you were talking about mileage, maybe that's a starting point for that. Where you can't truck it effectively, you don't have any access to barge, you don't have any access to additional railroads, maybe it's a starting point where you say, "Okay, these lanes, at least, when you come together, if there is no agreement between railroad and shipper, then maybe we have a voice." That's it.

CHAIRMAN ELLIOTT: Thank you. Vice Chairman?

VICE CHAIRMAN NOTTINGHAM: Thank you, Mr. Chairman. I also wanted to recognize Bruce Ridley as another outstanding member of our Rail Shipper Transportation Advisory Committee. You've been a member for a long time and a real valuable addition to that group, along with Eric Butler, whom I mentioned earlier.

I just wanted to recognize you,

Bruce. Thank you for being here. Thank you for what you do for the Agency and for the shipper community on the RSTAC Committee.

Mr. Giovinazzi, it occurs to me that freight railroads are actually pretty big consumers of concrete, aren't they? They often like to show us their new concrete rail ties on some of their high-density lines. Are they buying some of that, I hope, from Holcim?

MR. GIOVINAZZI: I'm hoping so.

VICE CHAIRMAN NOTTINGHAM: Maybe you can get some leverage that way. They -- you've got something they need, and they've got something you need, but far be it for me to give you advice. I just throw that out there.

Mr. Weaver, I've got lots of questions for you, but they really relate to the consumption and proper preparation of popcorn, and we'll have to wait for another proceeding.

MR. WEAVER: I'll stay after.

VICE CHAIRMAN NOTTINGHAM: But I'd love to improve my ratio of popped kernels to unpopped kernels.

MR. WEAVER: We're working on it.

VICE CHAIRMAN NOTTINGHAM: I'm sure you could help me with that, but I won't take up everyone's time on that today. But, seriously, you mentioned a situation you were trying to achieve some efficiencies working with one of the Class I railroads.

Did I hear it correctly? Did that -- what's sort of preventing from happening? It sounds like you had a good idea that would save some money, increase efficiency, make your company more competitive, but the --

MR. WEAVER: We've -- it's actually our Class III, the Wabash Central, and we have not received any response from the Norfolk Southern, and we've been asking for a number of years, which is, again, just one of our concerns. Again, it's a capital-neutral, you know, equipment-neutral, we feel, approach for the Norfolk Southern.

VICE CHAIRMAN NOTTINGHAM: Well, if I could, Mr. Chairman, ask that our Rail Consumer Assistance Office get in touch with Mr. Weaver if you'd be willing to --

That's exactly the kind of problem I think we might be able to help with sometimes just bridging communication gaps and problems between shippers and railroads where a shipper wants to try a new approach or do something innovative and it doesn't at first glance sound convenient or interesting to the railroad, but with a little bit of extra communication often we can see success there, so let's try to give that a chance. I'm sure the staff can track you down, given your presence here today.

Let's see. On the container weight limits, Mr. Weaver, if you could just elaborate on that. Argentina and other countries have higher weight limits is your understanding?

MR. WEAVER: That's correct. I think in Europe they're 25 tons, and Argentina I'm not entirely sure, but 26 is what my competitors are shipping. I'm not sure if they're maximum or not.

VICE CHAIRMAN NOTTINGHAM: I'm real familiar with truck size and weight limits from my highway work in the past, but is it the trucking leg of your move that really constrains that, or is it also the rail leg?

MR. WEAVER: The rail leg will constrain me below 26 tons because of the weight limits on my Class III, but we can do 25.4 tons, I believe, is the number I've been given.

VICE CHAIRMAN NOTTINGHAM: Thank you. That's all I had, Mr. Chairman.

CHAIRMAN ELLIOTT: Commissioner?

COMMISSIONER MULVEY: In line with Vice-Chairman Nottingham's point about the Railroad Consumer Protection Program, I'll have someone from there talk to you, and hopefully they can help you out. Also, have you considered filing a case-specific revocation request?

MR. WEAVER: After we filed our paperwork, I got a number of solicitations from third-party consultants saying, "For a fee, we'd love to help you fill that out," which, you know, is definitely something we might approach. Typically, we don't like to -- we're a low overhead operation.

COMMISSIONER MULVEY: Okay. Mr. Giovinazzi, you were saying that more and more you need modification. Something like 50 percent of your outgoing movements are by rail. That changes by distance, though? The further you're going out, the more it is rail-related, rail-oriented?

MR. GIOVINAZZI: As a general statement, that's correct, right.

COMMISSIONER MULVEY: So you would think that there is some possibility, some usefulness of looking at distance, a distance-based approach to the exemptions and seeing whether or not certain commodity times distances might be more appropriate for revoking the exemption than doing so on a general basis.

MR. GIOVINAZZI: Well, again, to that point, as a general statement, within 175 miles or so you can usually get some truck competition. When you're single served, either at origin or destination, you're pretty much locked into that railroad, and if it's much over 175 miles, then again you really have very limited negotiating ability if the rate is a rate that just doesn't work for you in that lane.

COMMISSIONER MULVEY: It's my understanding that, and I could be wrong on this, but has there been a decline in the number of manufacturers in the cement industry over the last few years so that the distances are getting longer from origin to destination?

MR. GIOVINAZZI: Again, I'm new to the industry, so I'm not positive what the answer to that is, but I can tell you that as a general statement, cement is a regional business, and that's because the demand is sort of just-on-time type of demand. If the weather turns against somebody, that might delay a job for three or four days, and then all of a sudden you need five more, six more cars of cement.

COMMISSIONER MULVEY: To PCA, hello, Bruce. It's nice to see you again. You're saying that you're making larger and larger rolls, and bigger rolls have to be moved by rail rather than by truck.

On the other hand, you say that it used to be 50/50, and now it's 75 percent truck, 25 percent rail. That doesn't seem to jive with the larger rolls. You should be moving more by rail if the rolls are getting larger.

MS. CALABRO: Well, the mills that

produce the larger rolls, we're just basically producing the larger rolls heavier at the two liner mills.

MR. RIDLEY: And just to make sure you get your numbers right, they're 50/50 now. It was 75 percent truck. Excuse me, 75 percent rail and 25 percent truck.

COMMISSIONER MULVEY: Right.

MR. RIDLEY: Now it's 50/50.

COMMISSIONER MULVEY: Now it's 50/50. That's what I meant, but you switched more towards truck, even though the rolls are getting larger. That's what I was wondering about.

MS. CALABRO: Well, those larger rolls are shipping by rail. We pay premium just to ship them by rail.

COMMISSIONER MULVEY: Okay.

MS. CALABRO: We have no alternative. We have to ship them by rail.

MR. RIDLEY: The point being we do have some captive product.

COMMISSIONER MULVEY: Okay. Thank you. That's all I have.

CHAIRMAN ELLIOTT: Thank you very much for your informative presentations, and I think we're off to the next panel, so you may be seated. The next panel is Panel VI, and that is the Intermodal Interests Panel.

I think there is only one person, our second panel of one, and our panel speaking today from the Intermodal Association of North America is Joanne Casey, and you have ten minutes.

MS. CASEY: Thank you very much. Good afternoon, Chairman Elliott, Vice Chairman Nottingham, and Commissioner Mulvey. My name is Joanne Casey, and I'm the President and CEO of the Intermodal Association of North America, otherwise known as IANA.

Accompanying me today is our general counsel, Mr. John Bagillio, and I appreciate the opportunity to appear before the Board today to elaborate on the written comments that IANA did provide to you and to encourage you to maintain the current exemption for trailer on flat car and container on flat car transportation service.

I apologize in advance for repeating some of the information that you already heard today. I think it's an occupational hazard and the time of day, so I'll try to be brief.

I've been employed with the freight transportation industry for more than 25 years. I started my career in the early eighties, about the same time that the Motor Carrier and Staggers Act, as well as the subsequent intermodal exemption were being debated and made into law. I focused exclusively on the intermodal industry since assuming my position at IANA in 1997.

Our Association's members consist of hundreds of transportation service providers from all of the intermodal modes, including railroads, ocean carriers, motor carriers, and third-party logistics companies and intermodal marketing companies. They handle approximately 90 percent of the intermodal shipments moving through the global supply chain.

Railroads are an essential link to the integrated multi-modal services needed to meet freight transportation demands both today and in the future, and it was the recognition of the railroad's importance by Congress and the ICC 30 years ago that led to the exemption of TOFC/COFC rail service from regulatory oversight.

The initiatives that flowed from that decision have contributed directly to the growth of intermodal service, both domestically and internationally, which in turn has been a key component to the revitalization of the railroad industry.

The ICC's decision in ex parte 230 sub number 5 was based on the conclusion that TOFC/COFC service was very competitive with comparable motor carrier service, that sufficient intra-rail competition existed, and that regulation was not needed to protect shippers against abuses of market power. Those same relative conditions exist today and justify the continuation of the intermodal exemption, and I think that several metrics support this view.

In the most recent Commodity Flow Survey, CFS, that was released by the Bureau of Transportation statistics at the end of last year -- it had data through 2007, by the way -- it shows that motor carriers transport approximately 70 percent of the goods both by value of and by weight in tons.

The corresponding shares for multi-modal transport, and they define multi-modal as parcel, truck and rail, truck and water, and rail and water, are 16 percent for value and 4.4 percent, respectively, and I don't believe we've heard that number today.

The National Rail Plan Progress

Report issued by the Federal Railroad Administration last September documented the level of competition among the modes by length of haul and commodities transported, and I know we've discussed that earlier.

For retail goods, consumer durables, and other manufactured commodities, rail, intermodal, and truck transportation are considered competitive alternatives for hauls ranging from 500 to 2,000 miles.

The final example comes from the American Trucking Association's publication, U.S. Freight Transportation Forecast. That analysis includes a comparison of revenues earned and tons transported by truck and specifically rail intermodal service. Some of the other numbers were larger aggregates.

2010 motor carrier revenues were estimated at 87.9 percent of the nation's total freight bill versus 1.3 percent for rail intermodal. Motor carrier tonnage was estimated at 68.6 percent and rail intermodal tonnage, 1.6 percent.

Regardless of the unit of measure, the relative market shares of truck versus rail intermodal have not changed significantly over the last decade. Freight volumes have grown in total, and so to use an analogy that was used earlier today, the pie itself is bigger, but the rail intermodal piece is still small compared to that of the trucking industry.

The numbers show that shippers, including a large portion of the nation's top motor carriers, including UPS, are exercising their ability to determine how much cargo to transport solely over the road or via intermodal services, and it's based on prevailing commercial conditions absent any kind of market dominance or market abuse of power.

Maintenance of the TOFC/COFC exemption I think is also supported by some recent programs and decisions that the current administration and federal regulatory agencies have made.

The President's National Export Initiative, with a goal of doubling exports by 2015, cites a reliance on continued improvement of rail intermodal market share and intermodal connections, that last mile between the terminals.

Another White House directive that was mentioned earlier was the Executive Order issued by the President in January that called for review of all regulations that place unreasonable burdens on business, stifle innovation, impact growth and jobs, and create unnecessary paperwork requirements.

Most recently, the Federal Maritime Commission, last week on the 16th, made a decision to exempt non-vessel operating common carriers from the requirement to use published tariffs as the basis for their pricing, thus allowing this intermodal transportation intermediary to negotiate rates directly with their customers.

The success of intermodal transportation service is reliant on an equilibrium among the modes. I don't think I have to tell anyone that.

Economic regulation of one segment such as the removal of rails, intermodal exemption could have adverse impacts on the other modal partners, causing a disruption in pricing and service offerings currently afforded to shippers.

It could also impact the competitive balance between the modes if regulatory scenarios differed among the transportation providers, and delays that may be associated with regulatory oversight of the rail's intermodal services and pricing of those services could render their actions untimely and non-responsive to customers' needs, and I believe we've heard that, as well.

In conclusion, I'd like to look

back on some legislative history, if you'd allow me. When the Staggers Act was being crafted, Section 10505F, now number 10502, of the Act was introduced as a floor amendment by Pennsylvania Congressman Alan Ertle.

His justification for the amendment was that greater use of TOFC/COFC service would conserve fuel, would reduce highway maintenance and railway operating costs, increase productivity, and help maintain American competitiveness in the world economy and that regulatory structure had heretofore inhibited intermodal growth by isolating modes from one another, the silo theory.

The past is often a predictor of the future, and I would submit that Congress and Ertle's rationale in introducing the amendment that led to the creation of rail intermodal exemptions is still applicable today, 30 years later. I thank you for allowing me to make these comments this afternoon, and I'd be happy to respond to any questions that you might have for me.

CHAIRMAN ELLIOTT: Thank you, Ms. Casey. Commissioner?

COMMISSIONER MULVEY: Thank you for your testimony, Joanne. We talked a lot today about the railroad industry and the changes that have occurred in the railroad industry but not so much about trucking, and it's my understanding there have been substantial changes in the trucking industry over the last couple of decades.

One, of course, the fuel costs have increased, and fuel is a more important component for trucks than for rail. There is also a driver shortage, which I think continues to persist, and there are other restrictions, more congestion, et cetera.

All of these should lead to a switch in the rail-truck market share, but you suggest that the market shares have remained fairly stable and the pie as a whole just growing. How do you reconcile that, or is there a change in the distribution?

When you say market shares are the same, how are you measuring that? Is that tons, or is that number of movements, or is that ton miles or what?

MS. CASEY: Really, all of the above, the value of the goods, the tonnage, and the percentage within any of the markets. I think certainly trucking is going to be faced with a lot of challenges, as we all are and have been.

The contention that these challenges for the motor carrier industry are going to make them less competitive and then have a heavier reliance, whether it's the compliant safety analysis, whether it's the hours of service or electronic onboard recorders, I think it harkens back to the relative percentage of rail intermodal.

I hate to keep harping on that, but I don't think, regardless of the challenge that the motor carrier industry are faced, that the rail component, which is small by nature, is going to be significantly impacted by any kind of shifting in motor carrier regulatory requirements.

If you go back and look at the relative shares, whether it's tons or value, they really have been consistent, and rail intermodal service in general has never been any higher than ten percent. It's usually less, so you're talking about ten percent versus relative 70, 80 percent of the market.

COMMISSIONER MULVEY: It's interesting, because the railroads say intermodal is sort of where the growth is going to be for the railroad sector, and the purpose or the desire is to increase the railroad's profit share over time, but exactly how much that will be true is still in question.

MS. CASEY: I think absolutely. It's market-driven.

VICE CHAIRMAN NOTTINGHAM: Ms. Casey, thank you for your very helpful testimony, very data rich, exactly the kind of information we need to review these types of issues, and, Mr. Mulvey, I don't know if this answers your last question, but if I understood the previous testimony and Ms. Casey's testimony, yes, railroads have experienced an uptick in earnings attributed to intermodal business, but part of that I believe is related to the growing pie, right, Ms. Casey? The total amount of traffic is growing?

MS. CASEY: Right.

VICE CHAIRMAN NOTTINGHAM: The overall modal split has not changed that much if I understand your testimony correctly.

MS. CASEY: That's correct. If you look at some of the studies, you have projections of freight either doubling, or I think that's been cut back a little bit recently. The U.S. Chamber has done some studies that have projections, but I feel strongly that there is going to be more than enough freight to go around.

It will be distributed according to how it has been in the past, and the intermodal piece of that service is very competitive, and it'll have to continue to have the flexibility in service and pricing in order to remain competitive, vis-a-vis some of the other components of intermodal, whether it be water or a third party or motor carrier, which is a component itself.

VICE CHAIRMAN NOTTINGHAM: Thank you. That's all I have.

COMMISSIONER MULVEY: I guess the other point is since this is so competitive and since it's known that historically the intermodal revenue-to-variable-cost ratio has been much below 180 percent, it strikes me that this would not be one of the cases where we would be talking about a revocation of the exemptions. Intermodal almost by definition would not be an area where this Board would be looking to revoke the exemption, simply because the evidence is so overwhelming that it is a competitive market.

On the other hand, that is not true for all the commodities. For some of the commodities, those revenue to reasonable cost ratios are much higher, and it's not as clear that it's as competitive as the intermodal market.

Would you -- I know you represent the Intermodal Association of North America, but you're also a transportation expert, so would you care to comment on the broader issue of the exemptions?

MS. CASEY: In terms of the R/VC, I don't have any direct knowledge of the various exempted commodities on that, and unlike Mr. Hamberger, who deferred to me on the R/VC for intermodal, I would defer back to him, and his 130 I think is a reasonable number. IANA deals primarily in operations.

We do not get involved in rates and pricing.

CHAIRMAN ELLIOTT: Thank you very much, Ms. Casey, for coming today and sharing you're thoughts with us.

MS. CASEY: You're quite welcome. Thank you.

CHAIRMAN ELLIOTT: Now we will hear from the final panel, Other Interests, Panel VII. First we'll hear from CNJ Rail Corporation. Mr. Strohmeyer, you have five minutes.

MR. STROHMEYER: Thank you, Chairman Elliott. Good afternoon, members of the Board. My name is Eric Strohmeyer, and I would just like to briefly add one brief comment to the Board's hearing today that I feel might have some advantage to the Board's deliberation in this proceeding.

We've heard a lot about revoking exemptions and whether or not it would be prudent or not prudent or whether it should or should not be revisited. I would simply offer in respect to intermodal, in particular, TOFC and COFC exemptions, that the Board also consider one additional reason for not revisiting the TOFC and COFC revisions.

Insomuch as I believe that while the other economic reasons are also justification, I also believe it also serves as a proverbial wax seal to the Pandora's that might be opened if you decided to lift the TOFC/COFC exemption, and I'd like to just briefly give you a two-minute oversight here in the post-Staggers Act of 1980.

From 1980 to 2000, the intermodal market itself has matured over the years. Services that were contemplated in the 1980s grew into the 1990s.

Vice Chairman Nottingham had mentioned the use of the term "stack train," which first originated in 1983 with Sealand and Maersk service off the East Coast and eventually grew into the 1990s. We saw many of the market develop stack train operators.

In fact, that became a term that we've come to readily expect in the marketplace today is a stack train operator.

That didn't exist pre-Staggers, and so you might ask, "Well, what's the Pandora's box? What's the reference to stack train operators and the potential for an adverse impact?"

I point the Board to a case that I think even Commissioner Mulvey might have been involved with many moons ago, well, not too long ago, about 2005, where the Board did a careful analysis of a tour train operator, and you're probably saying, "What in the world does this have to do with it?"

But after looking at the relationship between the operator of that train and how their customers interacted with the person, how the service was developed, how the contracts were written between the rail carrier, and how that service was ultimately marketed to the end consumer, it was determined that that entity was a carrier by the Board. It was the American Orient Express case.

Now, if you take that same basic scenario and apply it to a stack train operator, an independent entity set up by either steamship companies or rail companies, they act independent of the national rail system, but they offer door-to-door or ramp-to-ramp services just like a CSX or a BNSF would.

As such, they in essence provide a market -- market this service to the shipping public, and one of the reasons why the Board has never had to ever ask the question is a stack train operator a carrier subject to the Board's regulation has been under the intermodal exemptions. It's an unrelated commodity. There is no need to address the issue.

However, if you decide to address the issue and say, "Well, we want to consider revoking the exemption," then comes the question of, "Are these potential stack train operators" --

I'm using stack train operators simply because they're the most obvious, but it then raises the possibility of how do you regulate a carrier that isn't a railroad, even though they might be a common carrier subject to the Board's jurisdiction.

And I won't go into great detail over how that would potentially adversely impact a rate scenario. It's just a situation that the Board hasn't had to look at, and these various types of services have matured and grown and evolved in the 20 years since the Staggers Act was created, and you have lots of new different elements in the marketplace today that the Board just simply hasn't looked at extensively.

That would be simply my closing comment that I would simply done is I don't know if I -- I've looked myself to see if the

Board from 1996 to the current term has ever done anything where they made a formal public inquiry, anyway, into the various relationships between shippers and shippers' agents and the railroads and made a determination as to, you know, all of these various little nuances.

But I would simply suggest that before the Board consider revoking an intermodal exemption it might just simply want to ask the question how would this affect many of the relationships that have evolved over the time? -- how I would prefer to end my brief comment here and thank the Board for giving me five minutes to make that comment.

CHAIRMAN ELLIOTT: Thank you, Mr. Strohmeyer. Next we'll hear from the Mercury Group. Mr. Dickman, you have five minutes.

MR. DICKMAN: Chairman Elliott, Vice Chairman Nottingham, Commissioner Mulvey, STB staff, and interested parties, thank you for the opportunity to appear before you today.

I am Craig Dickman, the CEO of Breakthrough Fuel, a company focused on bringing transparency of fuel consumption, fuel cost, and emissions to freight movements. I am also here on behalf of the Mercury Group, a shipper energy study group working to use this transparency to better manage the fuel costs that result from shipping products to market.

The question we submit today is does a consolidation of the Class Is combined with the exemptions impeded adoption of marketplace alternatives to industry-wide use of fuel surcharges?

Today you've invited comments on whether to investigate and attempt to resolve a conflict, a conflict between shippers and the railroads arising not only from their unique respective economic interest but also from an apparent lack of trust on some key business terms.

Fuel and fuel surcharges are one of the main areas of conflict. The conflict and the underlying lack of trust will neither be resolved by revoking the exemptions in question today nor by leaving them intact, but it will -- but the opportunity that is created is to advance marketplace transparency.

It's easy to understand why today's surcharge environment creates conflict. Shippers are being asked to pay for fuel costs that have virtually no relationship to the freight being moved.

Fuel surcharges based on percentage of revenue models have been called unreasonable except or only for non-exempt freight, and even mileage-based surcharges using the Department of Energy's EIA Index do not accurately capture the fuel costs associated with freight movement.

I found it particularly interesting and illustrative today when Professor Willig, as he was walking through the data, highlighted a couple of occasions where fuel moves too fast for the data to allow precise understanding, and that's the same challenge that shippers, rail, and other interested parties run into.

The economic distortion included within fuel surcharges, whether it's the timing is not correct, the geography, the pricing, all creates a situation where virtually every freight transaction has economic distortion built in.

Now, it's easy to understand how we got here. When fuel costs first spiked and fuel surcharges were introduced, transparency was impossible. Information and technology was not available, and the ability to manage fuel cost was neither important nor possible.

Well, that's not today's marketplace. Fuel prices are high and getting higher and greatly impact the competitiveness of a shipper's product.

Technology now exists to make

transactions routine and inexpensive, and transparency available today creates the opportunity for a far more effective competitive marketplace, but the key is that the payment for fuel cost between the shipper and the carrier be based on actual fuel market conditions and not an artificial index.

When shippers are able to see, understand, and pay the railroads for the real price of fuel, they can make informed decisions and improve the competitiveness of their product.

In a transparent market, a shipper will see the benefits and the differences between different transportation modes. For the first time, shippers will be able to understand the gallons, the emissions, and the market fuel cost of their transportation decisions.

They will see the impact of using more efficient carriers, shipping from different locations, and including alternative fuels into their process, and they will understand the impact of decisions on their carbon footprint. Today, reducing emissions can be a competitive advantage.

In total, shippers will have the necessary information to make decisions that make their products more competitive, but the benefits of transparency are not exclusive to shippers. When the railroads are paid accurately for fuel costs they incur to move freight, it will support a more efficient competitive market.

Simply, what's the benefit of being a more fuel-efficient mode if it's not visible to those that are choosing which mode to ship, and what's the benefit of better fuel economy and lower emissions if it cannot be accurately calculated by those using the service?

Transparency will connect the benefits with the decisions and the most efficient mode and carrier relationship.

Further, transparency creates the opportunity for shippers and their transportation providers to move from being adversaries on this issue, which is almost inevitable, to collaborators focused on how to best manage fuel, the most volatile of all transportation costs.

As a path forward, we respectfully ask the Board to formally review questions regarding the exemptions and the implications on index-based surcharges, which have been highlighted in our verified testimony, and move toward a more transparent pro-competitive marketplace that we've discussed today. Thank you.

CHAIRMAN ELLIOTT: Thank you, Mr. Dickman. Now we'll hear from the United Transportation Union, New York State Legislative Board. Mr. McDougall, you have five minutes.

MR. MACDOUGALL: Thank you. I'm here on behalf of Samuel J. Nasca, who has been the New York State Director of the UTU for 27 years, and I believe he has the distinction of being the longest-serving full-time State Director in that Union, and he has participated in many ICC and STB proceedings over the years.

I'm not going to read you the statement and the little argument that I put in for it. I'd like to give a little background and explain the interest of UTU people that have participated in the various exemption proceedings. I checked over the weekend, and since 1976 there have been 18 of them.

Eighteen of those commodity proceedings that you have listed have been -- there's been UTU representation generally in opposition to it. There was one in which they participated and they were successful, and that was the export coal exemption case, which the ICC turned down some years ago.

The general interest of employees

are that they see the exemption process not as a way to compete for traffic but to get rid of traffic, and there is some basis of experience on that under the surcharge cases which occurred, the branch line surcharges which were in effect for about five years or more.

The carrier railroad rate changes were based to get rid of traffic, not to charge more and have the shippers be happy and ship more. It was to discourage the traffic preparatory to abandonment or if they just didn't want to handle that particular commodity, and there have been over six of those cases actually went into the federal courts during the late 1970s, early 1980s.

So there's a feeling that to be exempt, which really the railroad don't want to handle boxcar traffic. They don't want to handle vegetables, and so therefore we generally support regulation or the possibility for a federal agency such as the ICC or the STB to give relief to protect traffic.

Now, what's been the change in the last five or ten years? The big change has been the great recession of the last five years where the economists and a lot of politicians look down on marketplace economics.

The market is often irrational. We don't always get the best result from the marketplace. The word "competition" does not appear in Section 10502. This Agency looks to competition, and if they say, "If there's a lot of competition, we don't need regulation." Exact opposite is the case.

If there's a lot of competition, you've got to have regulation so that it's fair. That's why we had the 04 section. In other words, you could have lower rates between two points and higher rates intermediate.

The fact of competition is not a ground for exempting traffic. It's the opposite. If traffic -- if the traffic is moving okay, the shipper has relief under the rate relief.

You know, Congress has set up a rate schedule where the market dominance, there's a regular formula, RV ratios and so forth, but to say that if an industry -- a commodity is competitive; therefore, we deregulate it, it's just the opposite.

That's when you want regulation. That's why we have a Federal Trade Commission. It's why we have an anti-trust division of the Department of Justice, to regulate competition, because competition is often irrational.

It gives us recessions. It causes all sorts of diseconomies in our country, and therefore we have to regulate competition. That's the generally the position that organized labor has had and the UTU Directors feel that the exemption process --

It's a warning signal, see.

That's what you get for being the last person. This is a test.

CHAIRMAN ELLIOT: The hearing is over. We don't have any further questions, so thank you for coming today. Please, everyone, exit in an orderly manner, and the hearing is adjourned. Thank you.

(Whereupon, the above-entitled matter was adjourned at 3:17 p.m.)

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C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: Review of Commodity, Boxcar, and TOFC/COFC Exemptions

Before: Surface Transportation Board

Date: 02-24-11

Place: Washington, DC

was duly recorded and accurately transcribed under my direction; further, that said transcript is a true and accurate record of the proceedings.

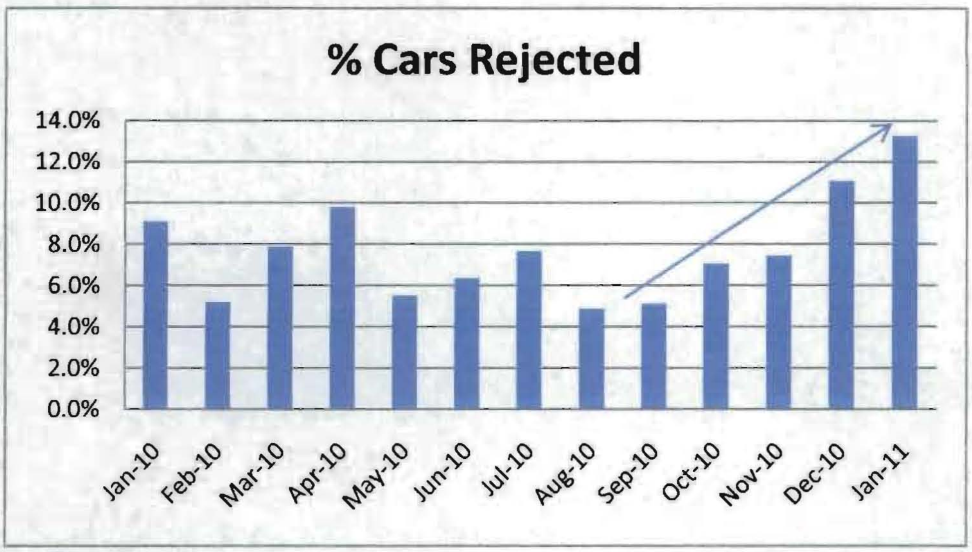
Neal R Gross

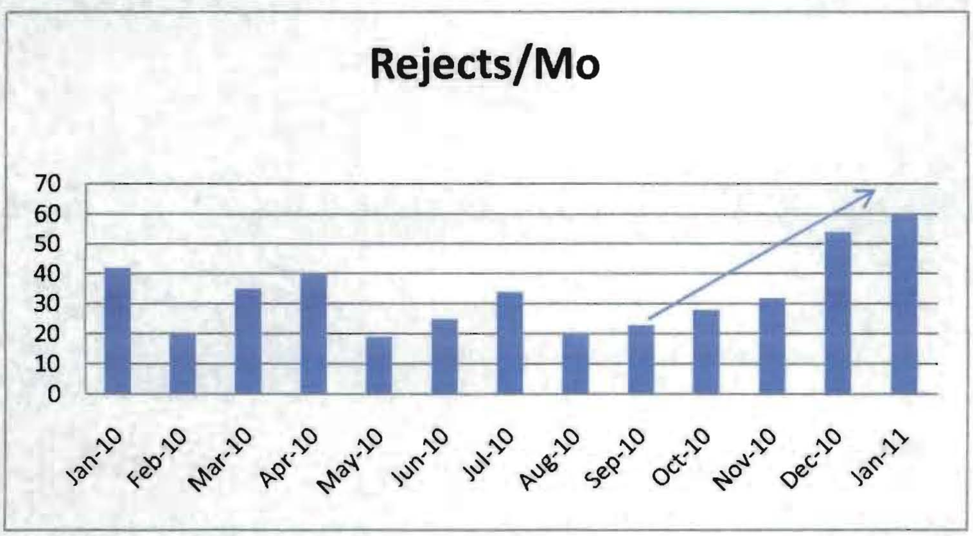
Court Reporter

PACKAGING CORP. of AMERICAN

Data From Tomahawk Railway 2010. 2011

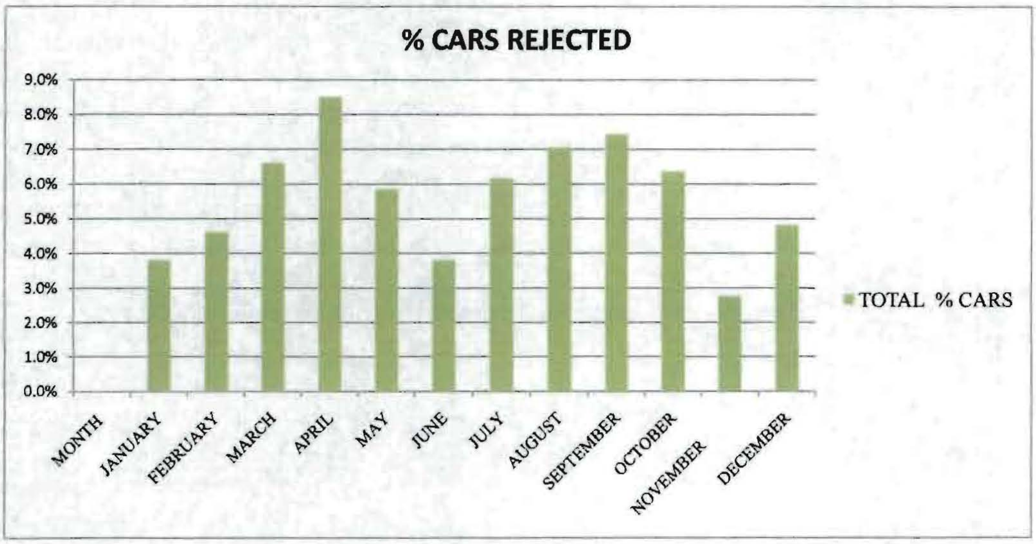
	#Loads	#Rejected	%
Jan-10	461	42	9.1%
Feb-10	384	20	5.2%
Mar-10	444	35	7.9%
Apr-10	408	40	9.8%
May-10	344	19	5.5%
Jun-10	393	25	6.4%
Jul-10	443	34	7.7%
Aug-10	410	20	4.9%
Sep-10	448	23	5.1%
Oct-10	396	28	7.1%
Nov-10	429	32	7.5%
Dec-10	487	54	11.1%
Jan-11	452	60	13.3%
Total:	5499	432	
Avg:	423	33.2	7.7%

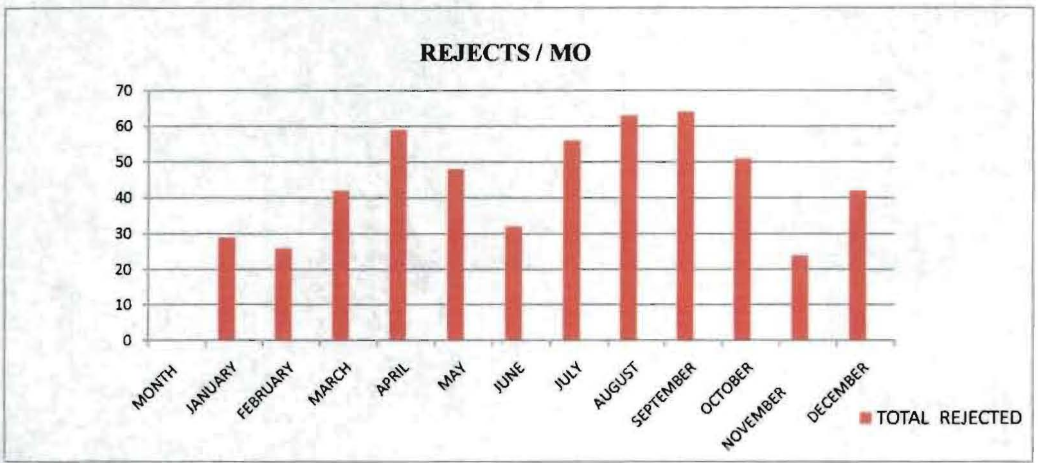




PCA COUNCE RAILROAD PERFORMANCE 2010 (% OF REJECTED BOXCARS)

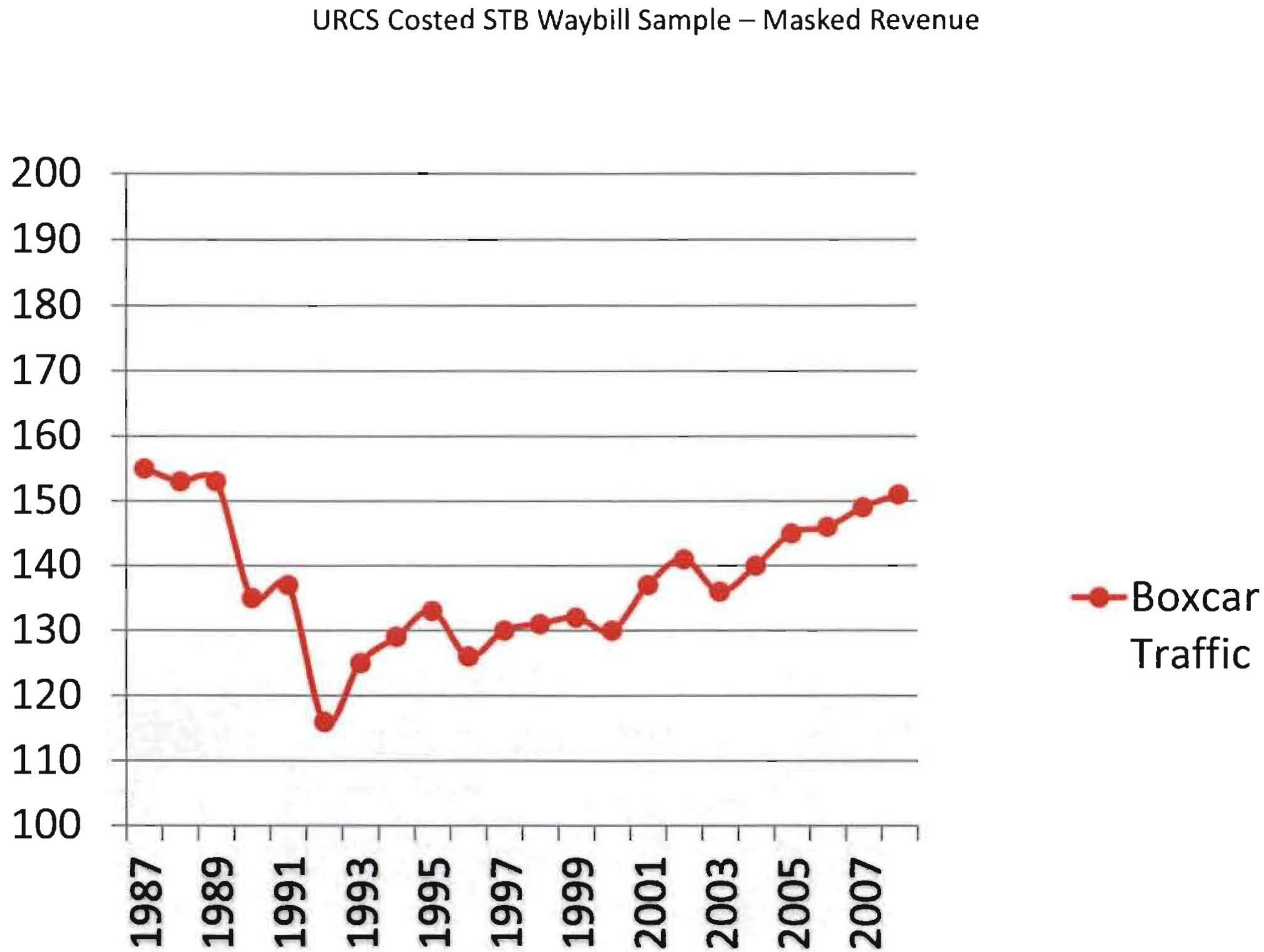
MONTH	TOTAL CARS SHIPPE	REJECT BOXCA	% CARS REJECTED
JANUAI	761	29	3.8%
FEBRU/	563	26	4.6%
MARCH	635	42	6.6%
APRIL	694	59	8.5%
MAY	820	48	5.9%
JUNE	841	32	3.8%
JULY	908	56	6.2%
AUGUS	892	63	7.1%
SEPTEN	860	64	7.4%
OCTOB	802	51	6.4%
NOVEN	869	24	2.8%
DECEM	871	42	4.8%
TOTAL	9516	44.7	5.7%





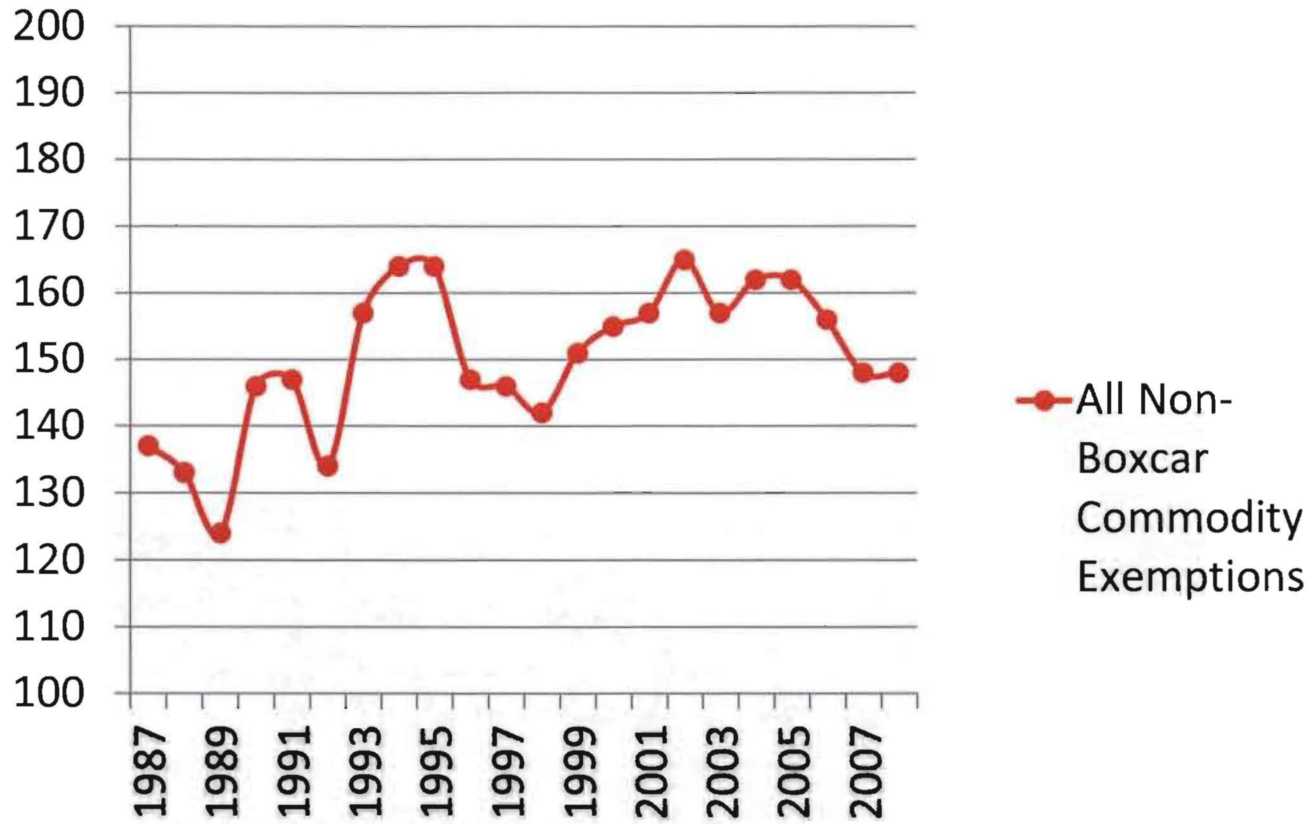
AMERICAN SHORT LINE

All Boxcar Traffic - R/VC Since 1987



All Non-Boxcar Commodity Exemptions - R/VC Since 1987

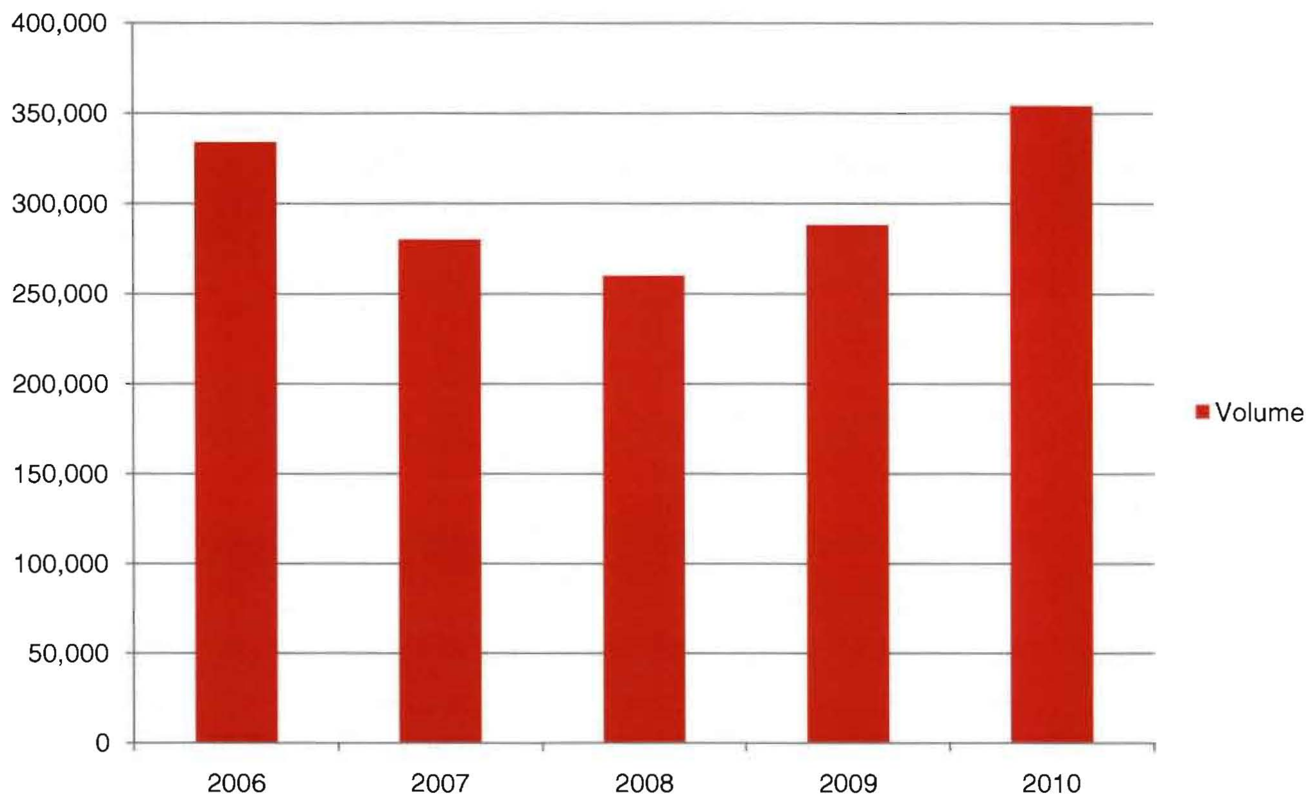
URCS Costed STB Waybill Sample – Masked Revenue



SURFACE TRANSPORTATION BOARD

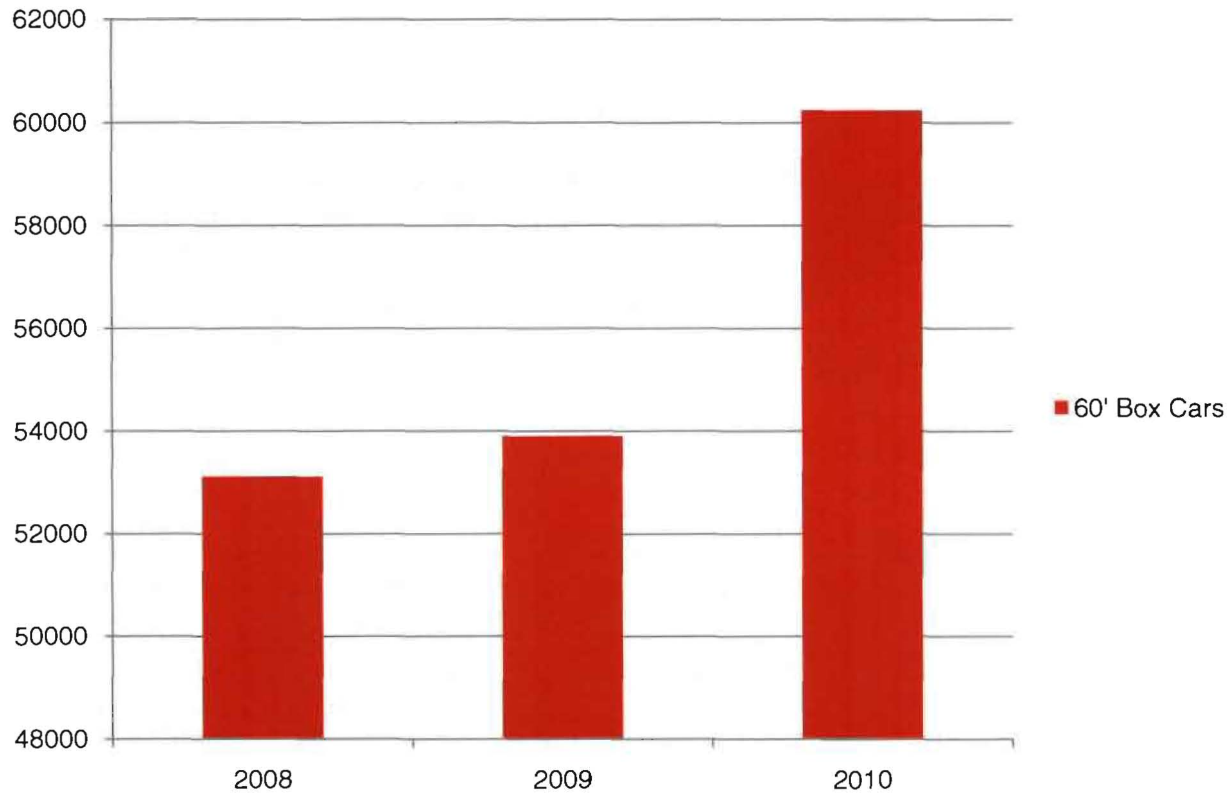
PATRICK J. OTTENSMEYER
EXECUTIVE VP OF SALES & MARKETING

INTERMODAL GROWTH (VOLUME)



SOURCE: KCS Waybill Data

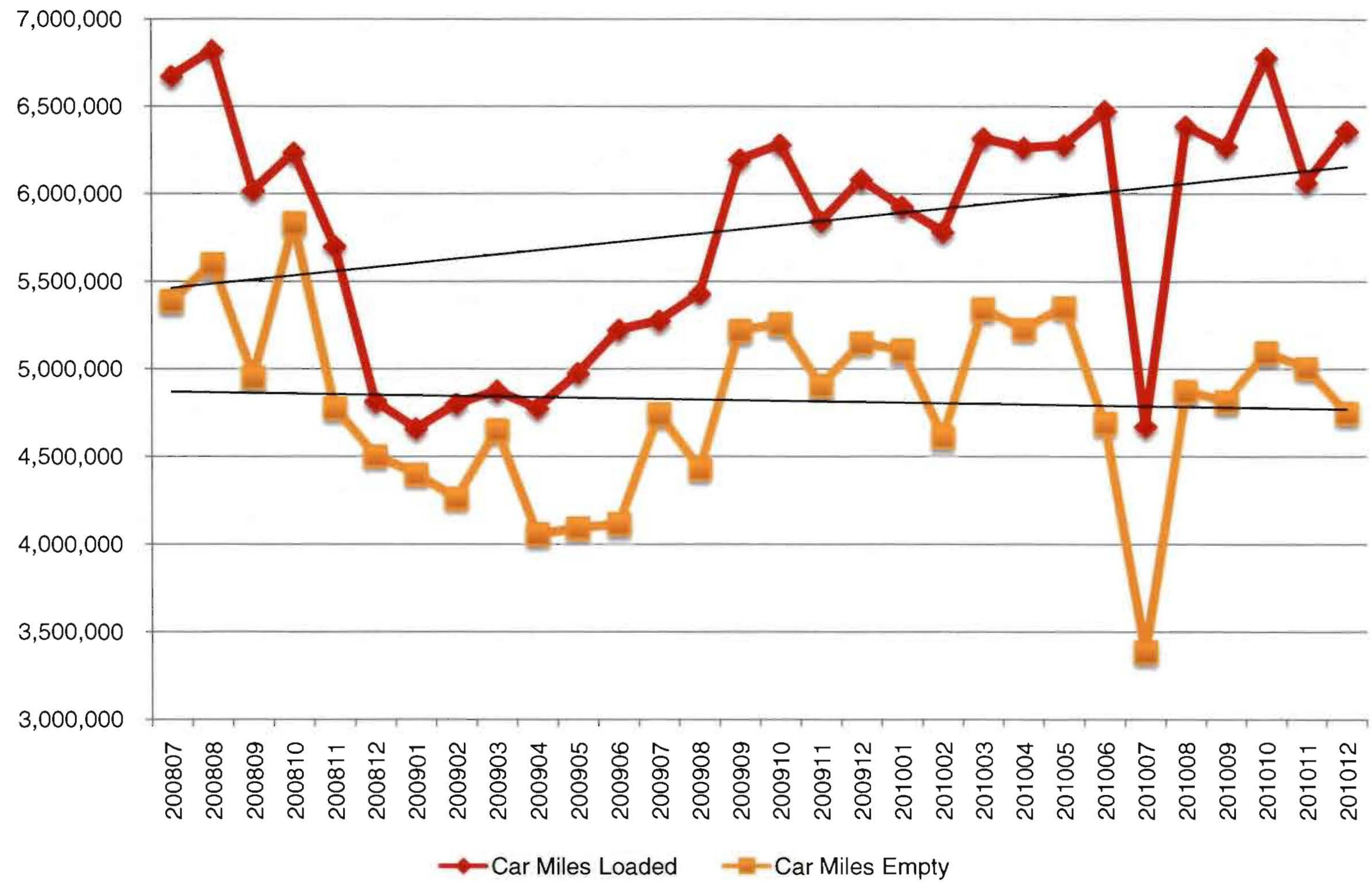
BOX CAR TRAFFIC (UNITS)



SOURCE: KCS Waybill Data

KCS Box Cars Total Car Miles Load vs Empty

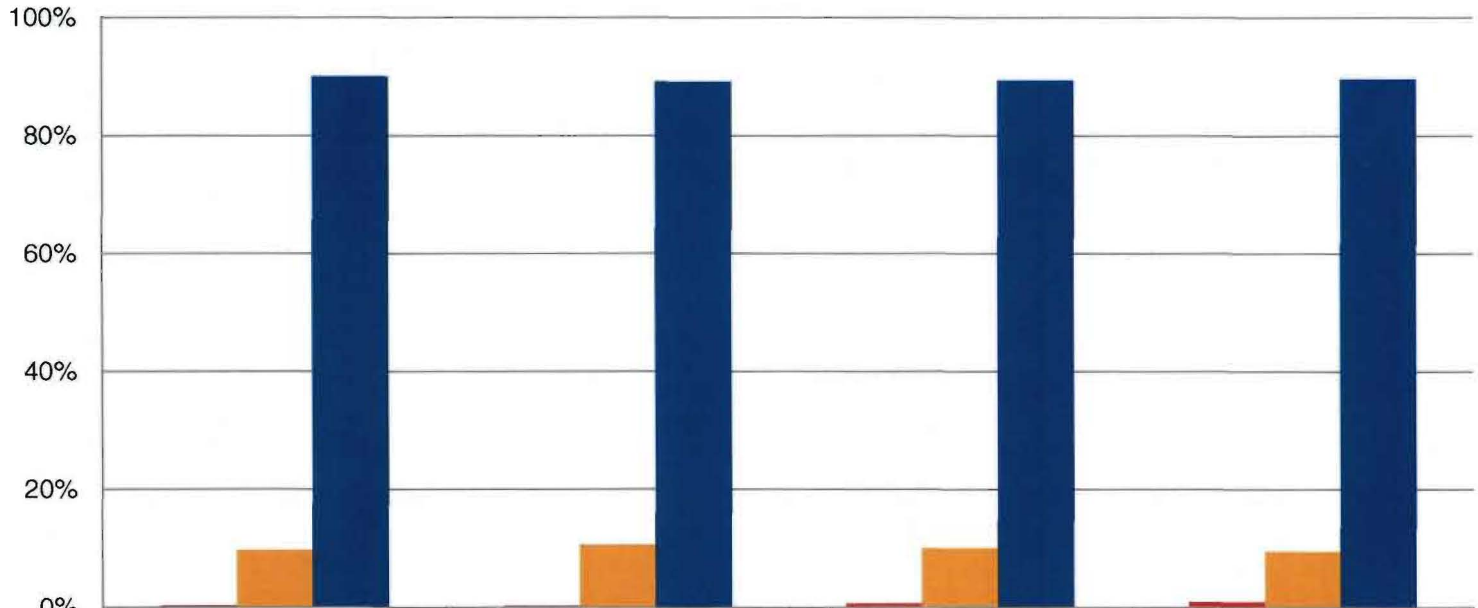
July 2008 through December 2010



SOURCE: KCS Waybill Data

LAREDO: BORDER CROSSINGS/ENTRIES

Intermodal Cross-Border Market Shares

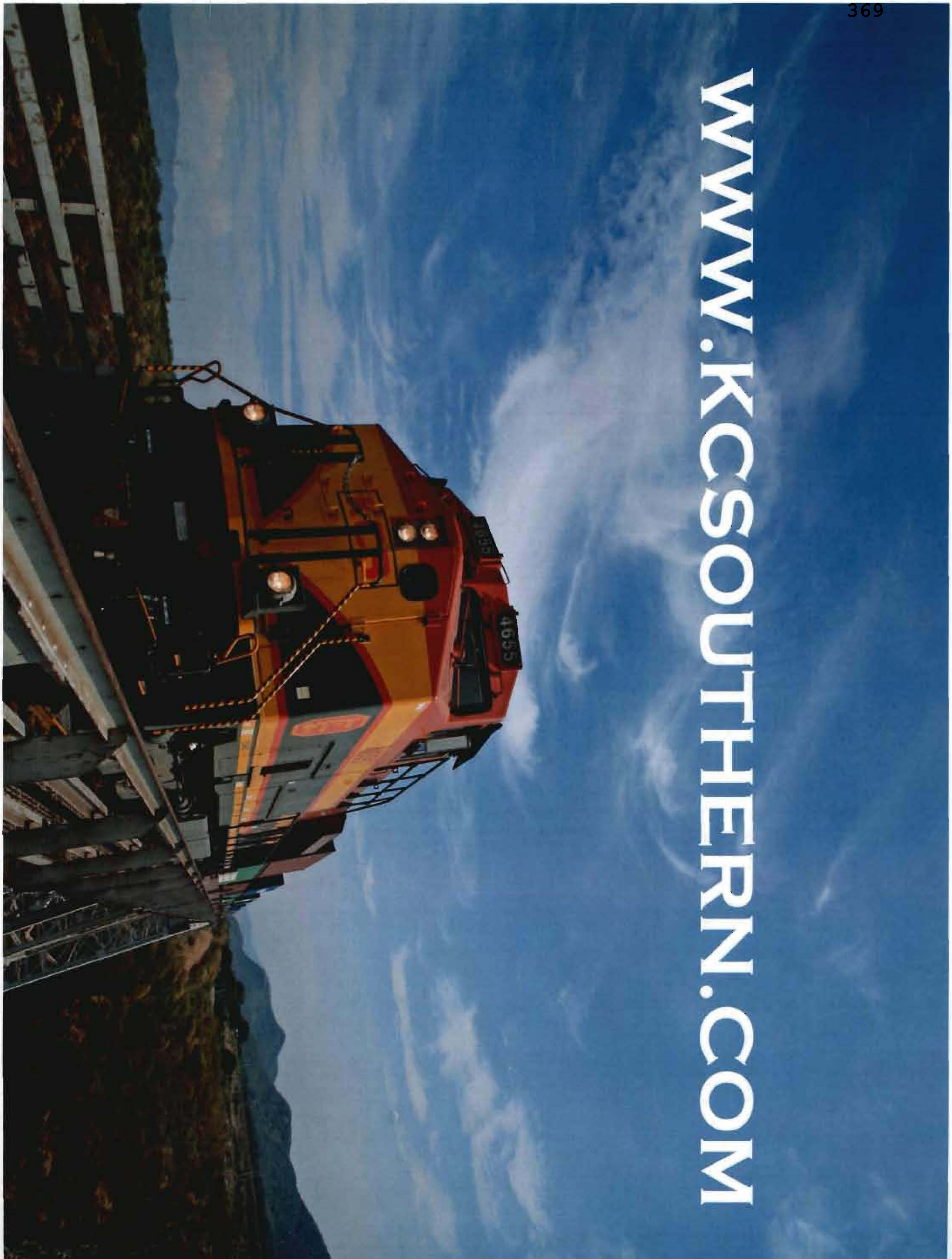


	2007	2008	2009	2010 (through June)
KCS	0.35%	0.27%	0.66%	0.95%
Interchange	9.66%	10.62%	10.03%	9.49%
Truck	89.99%	89.11%	89.31%	89.57%

SOURCE: KCS, U.S. Department of Transportation – Research and Innovative Technology Administration

KCS INTERMODAL NETWORK

INTERMODAL FACILITIES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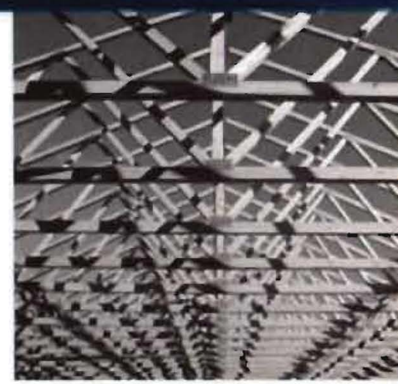
CSX
How tomorrow moves



STB Exemption Hearing, EP 704
February 24, 2011

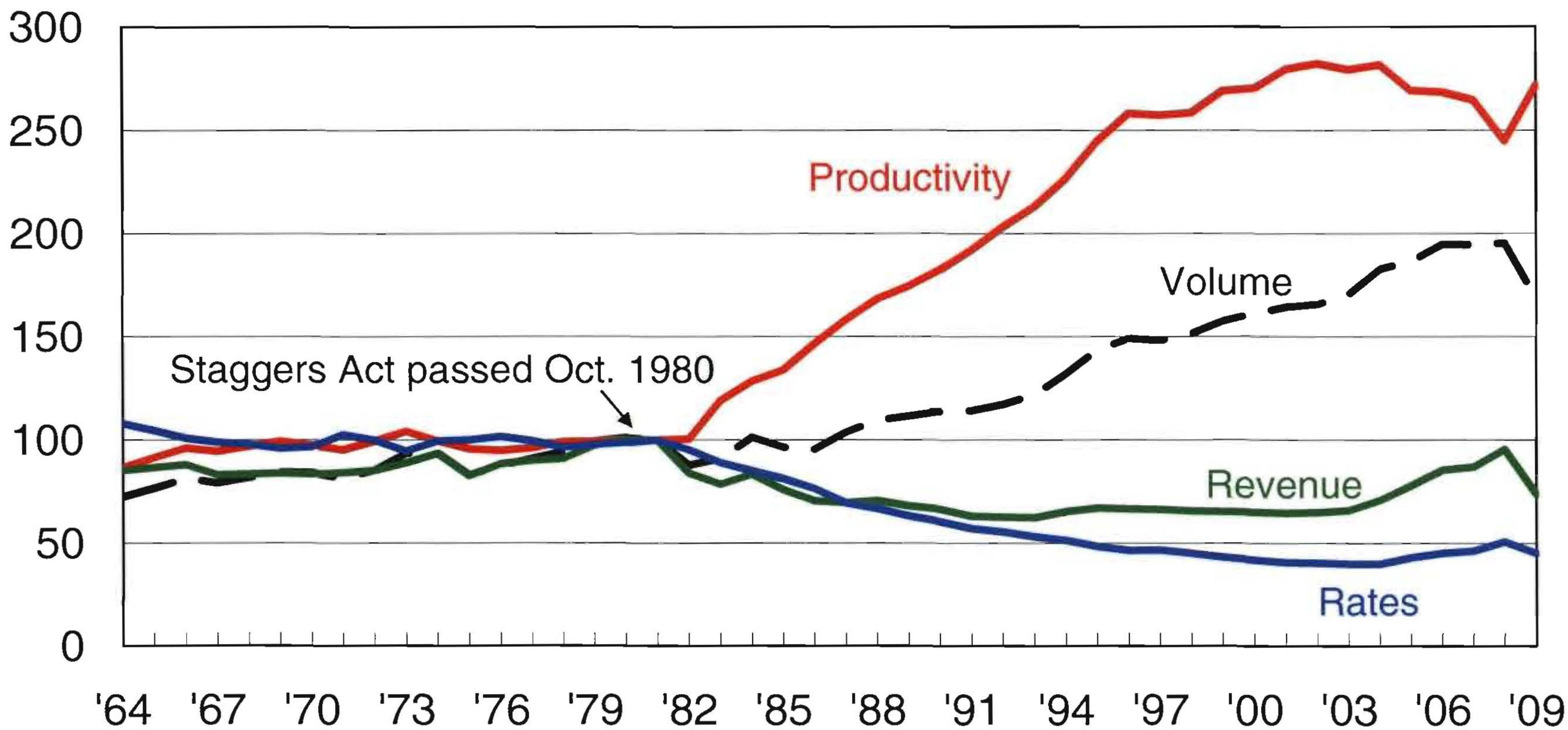
Executive Summary

- Congressional and Economic Preference for Market-Driven Rates and Services
- Experience Shows that the Current Regulatory Scheme is Working
- Competition Has Been and Remains Pervasive
- Continued and Increased Reinvestment is Required to Meet Present and Future Expectations

Market-Driven Solutions

- Primary Principle of Rail Transportation Policy:
  - Competition and demand should establish reasonable rates, to maximum extent possible
- Markets Guide Every Aspect of our Business:
  - What capacity to increase
  - What services to offer
  - What equipment to buy
  - What rates to charge
- Ultimate beneficiaries are the customers and consumers

Performance and Rates Since Staggers



"Rates" are revenue per ton-mile; "volume" is ton-miles. Source: AAR

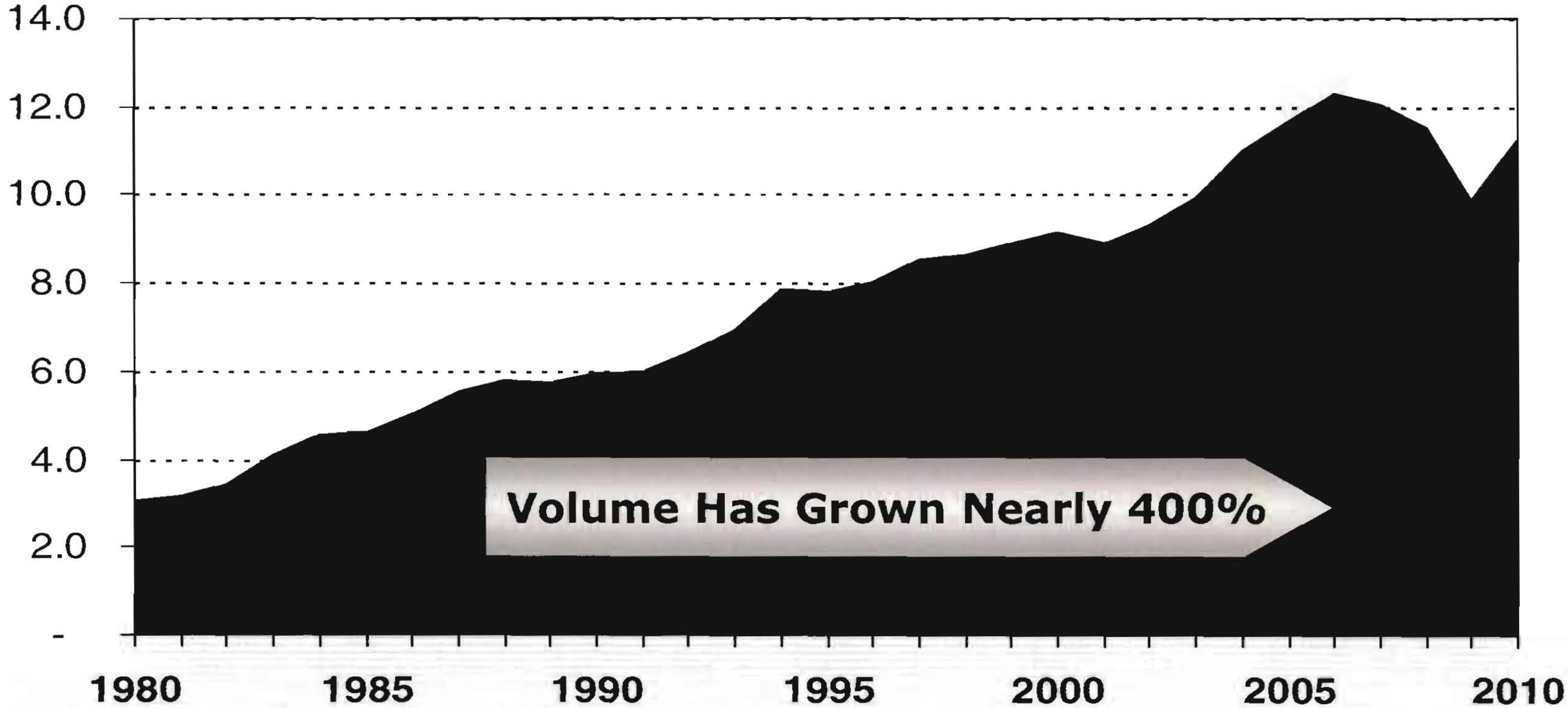
Post-Staggers Cultural Transformation

- Pre-Staggers Mentality:
  - Shippers accustomed to relying on public rates and traditional service
  - Railroad initiatives on rate adjustments and service experiments were delayed by internal regulatory review processes, and threat of being challenged
  - Result: disincentive for shippers and railroads to try anything new
- Post-Staggers Cultural Change:
  - Railroads shifted to a market-based environment
  - Normal market incentives drove new sense of energy and creativity
  - Result: improved service, increased efficiencies, and unprecedented reinvestment

Intermodal Success Story

Intermodal Loadings Growth

(millions of units)

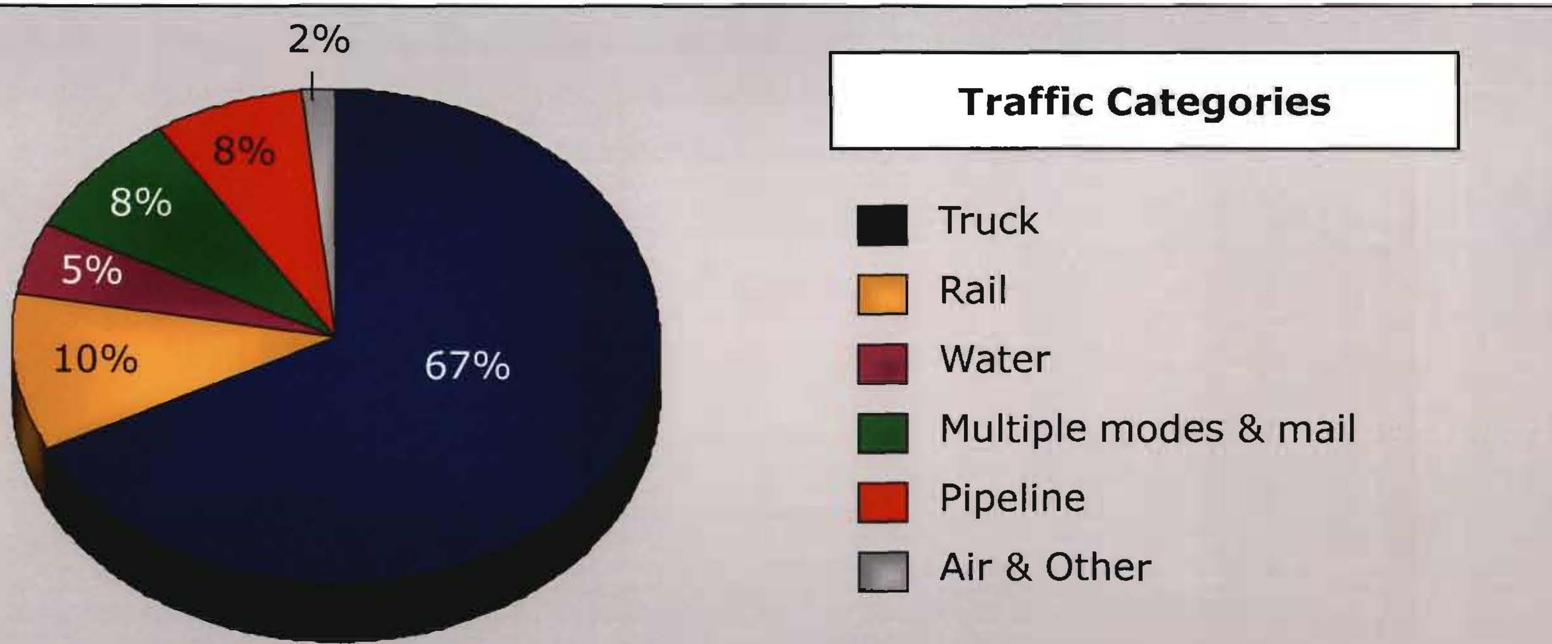


Source: AAR Weekly Railroad Traffic, AAR Fact Book

Northwest Ohio Intermodal Terminal

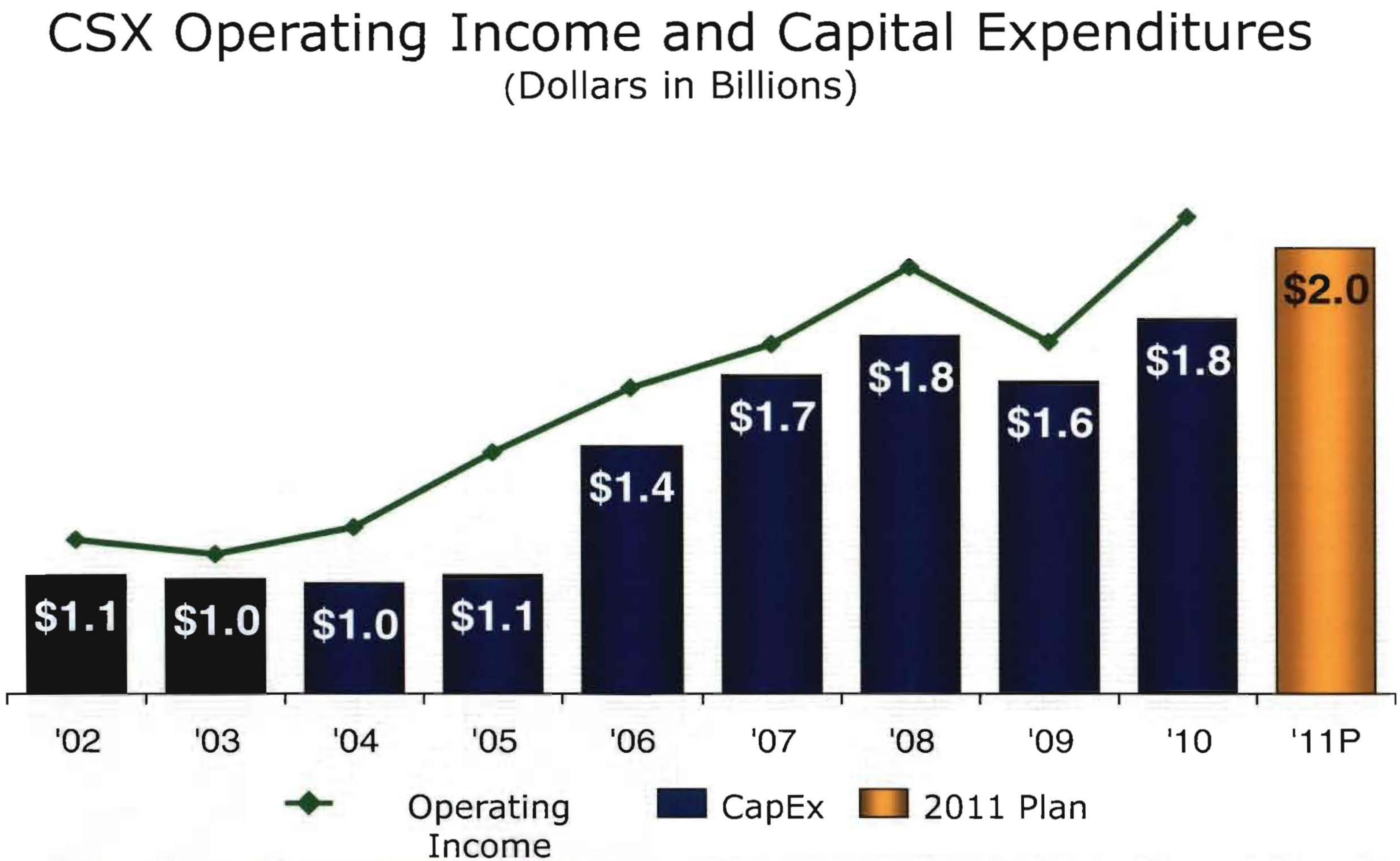
Competition Is Pervasive

Shipments by Transportation Mode 2009
(millions of tons)



Source: U.S. Department of Transportation, Federal Highway Administration, Office of Freight Management and Operations

Financial Progress Allows for Reinvestment

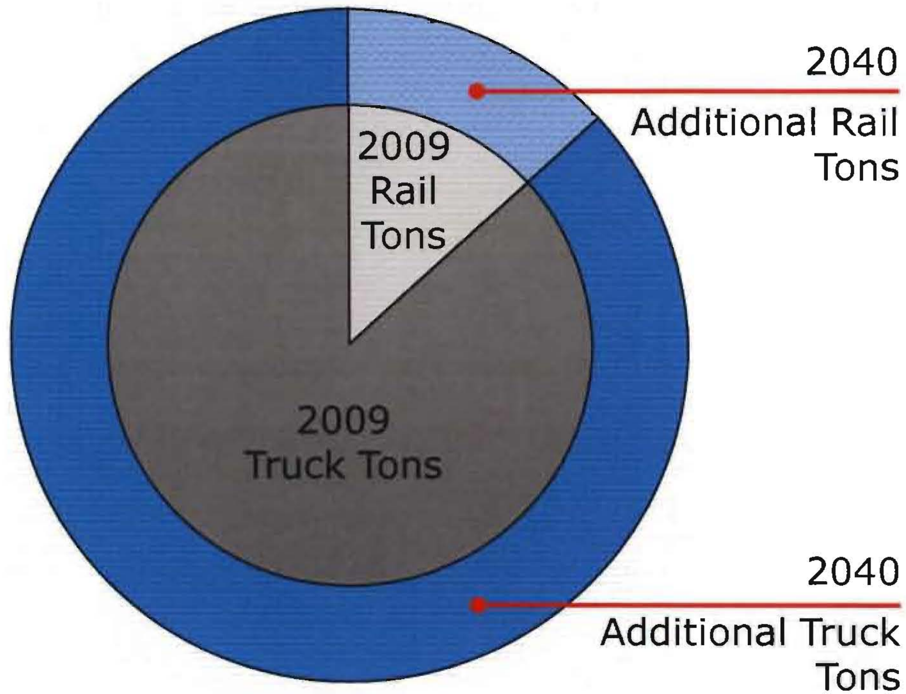


How tomorrow moves

The Need for Reinvestment Has Never Been Greater

- Freight demand projected to increase 68% by 2040
  - 16.1B → 27.1B Tons
- At current market share, Rail is expected to handle 1.3B increase in tons by 2040
- Due to Rail's efficiency and environmentally friendly nature, America expects rail to increase market share

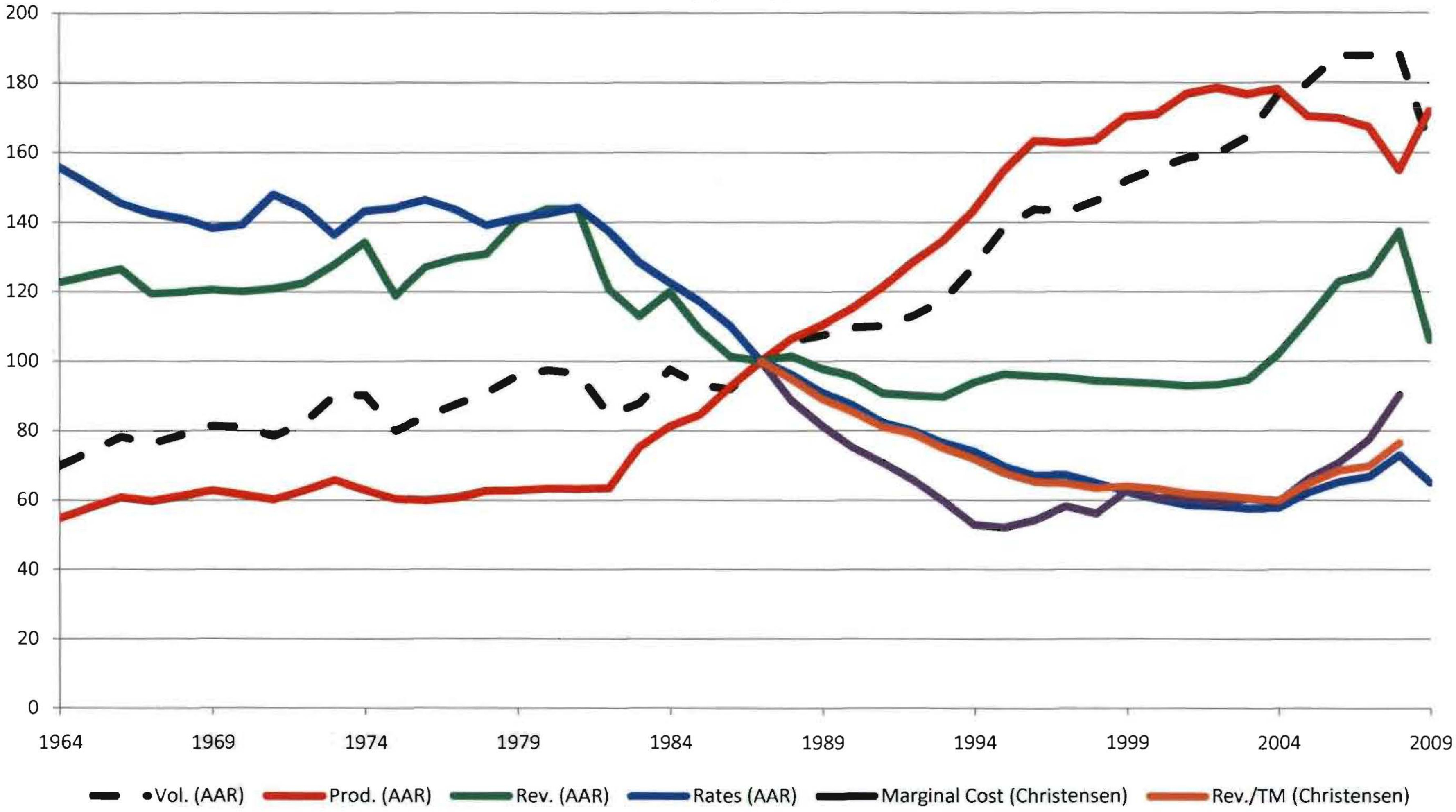
Freight Demand: 2009 and 2040



Source: *U.S. Department of Transportation, Freight Analysis Framework 2010*

How tomorrow moves CSX

Figure 1
RAIL RATES, REVENUES, PRODUCTIVITY , TRAFFIC VOLUMES, AND MARGINAL COSTS
1964-2009



Source: AAR (Vol. (in ton-miles), Prod., Rev., and Rates (in RPTM)) and Laurits A. Christensen Associates, Inc. (Marginal Cost and Rev./TM) using data from *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals that Might Enhance Competition* (Madison, WI, November 2008).