UNITED STATES OF AMERICA

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SURFACE TRANSPORTATION BOARD

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PUBLIC HEARING

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IN THE MATTER OF: :
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COMPETITION IN THE : Docket No.
RAILROAD INDUSTRY : EP 705
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Thursday,
June 23, 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 8:30 a.m.

BEFORE:

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ANN D. BEGEMAN Vice Chairman
FRANCIS P. MULVEY Commissioner

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8:30 a.m.

CHAIRMAN ELLIOTT: Good morning. Welcome to the second day of the hearing. Good to see the crowd coming back, and just a few procedural matters before we get started.

I thought we had a really good day yesterday of useful testimony and some good questions and answers, so hopefully we'll have more of the same today.

First of all and most importantly, I want to warn everyone about the chairs that you're sitting in at the present time. There's a lever on the side, I believe, so if you hit that lever, you're going to go right down, but it's very easy to get back up.

Don't panic. All you have to do is take a little pressure off and hit the lever and it will go back up. I do it all the time up in our boardroom, and it's, I know, very embarrassing when it does happen.

Second, if you have a PowerPoint,

just a reminder, we ask you, if you have not done so already, to submit that to the Office of Proceedings so that we can make it part of the record, two copies.

You can do that I think electronically also, if that poses a problem for you to do it today, or you can mail it.

Also, the lights, for those of you who haven't been here before, a yellow light will come on when you have one minute to go. You'll have a green light throughout.

When the yellow light comes on, you'll have the warning. Red light will come on, that means your time is up.

Don't stress out too much. As a former practitioner, I know that's a stressful thing. We won't scream at you if you go a few minutes over or a few seconds over, but don't push it.

Anyhow, we'll start off with our first panel of the day, and we'll begin with Ameren Corporation.

Mr. Sobule, you have ten minutes.

MR. SOBULE: Thank you.

Good morning, Chairman Elliot, Vice Chairman Begeman, and Commissioner Mulvey. My name is James Sobule. I am Vice President Deputy General Counsel for Ameren.

On behalf of Ameren, I'd like to thank the Board for taking comments and holding this very important hearing on competition in the railroad industry.

Ameren's the fifth largest consumer of coal in the United States, consuming approximately 39 million tons annually, and is the largest purchaser of Powder River Basin coal. Ameren owns or leases approximately 7,500 rail cars and spends approximately $650 million annually on rail transportation alone.

Rail transportation costs are approximately 55 percent of the total delivered cost of coal to Ameren's plants.

Ameren began spending millions of

dollars converting its power plants from high sulphur Illinois Basin coal to low sulfur PRB coal in the 1990s in response to the Clean Air Act.

While the PRB is roughly ten times further from the Ameren plants than the Illinois Basin coal fields, the competition amongst the railroads at that time provided competitive rail rates that resulted in the use of PRB coal being more economical than using Illinois Basin coal when you added the coast of emission controls.

As Ameren expanded its use of PRB coal, the rail rates continued to drop as a result of competition at that time between the Western Rail carriers until about 2004. At that time, there was a marked change in the competitiveness of the Western Rail carriers, which resulted in rates dramatically increasing.

Prior to 2004, Ameren found that the Western carriers were interested in securing additional business and would compete vigorously to maintain or be rewarded new traffic.

Rail rates gradually decreased from the time that Ameren commenced using PRB coal in the 1990s, largely due to the non-incumbent competing railroad taking contracts as they came due by offering lower rates or the incumbent carrier reducing its rates to keep the building.

As shown on the graph which is in our written testimony, Ameren's rail rates increased dramatically after 2004. Starting in 2004, Ameren found a very different competitive environment among the Western railroads. Railroads appeared to be no longer interested in acquiring coal traffic that was being hauled by the competing carrier.

In every instance from 2004 to 2010, when Ameren issued bids for rail quotes for the UP and BNSF competitive rail supply plants, not a single one of the plants primarily using PRB coal at that time changed carriers as a result of these requests for rates.

In other words, the railroad that was shipping the PRB coal at the time of contract renewal retained the business.

The non-incumbent railroads at the time of the quote or pricing tariff quoted a rate which was on average 43 percent higher than the rate of the incumbent railroad. Because the non-incumbent rate or pricing tariff on average was 43 percent higher than the incumbent rate, the incumbent railroad was able to consistently impose a substantial increase from the prior rate.

Through this 2004 to 2010 time frame, the incumbent carrier was able to propose rate increases to Ameren that were up to an 87 percent increase at the time of contract renewal.

Another phenomenon which began occurring after 2004 was what Ameren refers to as non-responsive bidding. These are carrier responses to rate requests, which indicated to us that the carrier was really not interested in the business.

These types of bids include no responses, responses which imposed extreme, one-sided contract conditions, or which varied materially from Ameren's bid parameters. During this time frame, Ameren received five of these non-responsive types of bids.

Another type of non-responsive bid is the refusal to quote to a non-physical point. Prior to 2004, Ameren was very active in acquiring and building competitive rail access to its power plant.

Ameren's been very supportive of self-help measures and shipper investment in rail transportation infrastructure. In fact, Ameren believes it's been one of the most active shippers in undertaking such self-help measures.

Since 1990, Ameren has constructed

four build-outs at our plants to allow second rail carrier access and also from three short-line railroads. Ameren also purchased a rail line and built numerous barge facilities to allow competitive access to three additional plants.

These facilities were often built by obtaining a favorable rate prior to construction from the competing carrier, which justified the significant investment.

However, after 2004, Ameren found that both the Western carriers had adopted a policy of not quoting to non-physical points. In other words, the railroads would not quote if the physical track had not been built.

This further stifled competitive alternatives, as a shipper is unlikely to invest in new facilities if the rate at the time that they're going to get for doing that is unknown.

I'd also like to take a minute to quickly address a theme that was raised by AAR yesterday in their testimony regarding the value of this proceeding.

We recently heard a similar theme from a railroad in another active docket, and I can assure that Ameren does not view either of those dockets as a waste of resources. We think it's very valuable use of time.

I also want to respond to a few comments made in the May 27th reply comments. The UP stated that shippers have stopped pursuing build-outs because they believe the Board will provide regulatory benefits at a lower cost in the build-out.

I will state emphatically, that's not the reason that Ameren stopped pursuing the build-outs. It's the reason I stated earlier.

UP's reply comments also address the Duck Creek build-out, which the Board is aware, Ameren built in 2005. While the UP did receive some traffic under the build-out, after it was completed, the UP refused to quote a rate until the physical turnout was installed.

Then, in 2007, Ameren had to fight to protect its build-out investment in the proceedings before the Board when the BNSF sought to undermine the benefit of the build-out by actually leasing the BNSF track to the same carrier to which the build-out was made.

Fortunately, the Board saw this and agreed with Ameren and prohibited the proposed railroad transaction.

Ameren would also like to provide some experience in relation to BNSF's witness statement that assertions that some coal shippers that, after 2004, no coal business has shifted between BNSF and UP, are categorically false.

Obviously, we can't speak for all the shippers, and we can't view UP's highly confidential material that they submitted in support of this statement.

However, I can speak to Ameren's

experience from 2004 to 2010, and will once again emphasize that we issued bids for rail quotes for 10 of our competitive rail supply plants, and not a single one of those plants changed carriers as a result of these requests. Very different than the pre-2004 experience.

In addition to rate increases, at the same time, the railroads began imposing mandatory fuel surcharges. Ameren, as you know, has filed comments in the STB proceeding on rail fuel surcharges, and Ameren believes that the diesel fuel surcharges, in combination with the fuel amount that's already embedded in the rates, are allowing for over-recovery of fuel costs for the railroads.

Ameren also notes that both the UP and BNSF address as part of the reply that no regulatory changes are needed because shippers who believe they are being charged unreasonable rates have an avenue of relief at the Board.

That's exactly what Ameren would like for all shippers, including Ameren at its plants where it is invested in self-help infrastructure investments such as build-outs or barging facilities, the right to have a backstop of relief to the Board if the railroad charges or attempts to charge unreasonable rates.

You had wanted some suggestions, and I will give you those now. We've got three of those.

Ameren offers these three suggestions: one, competitive shippers are not currently protected by the STB under the assumption that competition among carriers will protect shippers with competitive options.

However, since 2004, this has not been the case, as I have mentioned. As competitive rates have often approached or surpassed the 180 percent of variable cost jurisdictional thresholds set for captive shippers, the STB should move to interpret the statute, which they can, so that if any rate exceeds this threshold, that rate, prima facie, demonstrates there's a clear lack of effective competition, which could be challenged under STB rate guidelines.

The bar for -- number two, the bar for revenue adequacy is currently set too high to provide meaningful guidance to rail rate issues. This is demonstrated by the fact -- and we heard some testimony on this yesterday -- that railroad financial performance and stock price have remained high -- I'm going to take about a minute here -- despite the recession.

Privatization of the BNSF is another indicator of railroad financial success.

And third is that railroad fuel surcharge recovery should be transparent. The STB should use the cost data collected from the railroads to determine if fuel surcharges are allowing accurate recovery of the railroad's fuel costs.

Thank you again, Commissioners, for the opportunity for Ameren to provide this testimony today on competition in the railroad industry, and we stand ready to assist any way we can.

CHAIRMAN ELLIOTT: Thank you.

We have a Senator approaching, Senator Vitter, so why don't we move the panel up and we'll just make a little time for him, due to his busy schedule.

Good morning, Senator Vitter. You have the floor, and if you run over, Ann's going to tell you to stop.

SENATOR VITTER: Well, good morning, Mr. Chairman. You're very kind. Everybody's busy, but you're very kind to fit me into the schedule so easily.

And Mr. Chairman and members, I am David Vitter. I represent the State of

Louisiana and the U.S. Senate. Thank you for initiating this proceeding to examine the level of competition in the national freight rail system and for providing me the opportunity to visit with you briefly today.

My concern today is those rail customers that are rail-dependent shippers. These customers, for a variety of reasons, can't use truck transportation economically, and don't have available water transport.

And for these rail-dependent customers, there's really no available transportation competition unless they have access to a competing major railroad for at least a part of their transportation route.

In Louisiana, these rail-dependent shippers include many of our chemical plants, some of our coal-fired electric generating plants, some agriculture manufacturing, forest and paper products.

So it's a significant part of our economy in several different sectors. And their inability to access competing railroads means that these rail customers are likely to pay much higher railroad rates often to significant economic detriment, and they often, quite frankly, receive poor or indifferent service because of this as well.

I understand that the record in this proceeding contains a number of very specific and powerful examples of this, and I want to mention two specific ones in Louisiana.

First, the city of Lafayette in Louisiana is a town of about 120,000 people in the heart of the southwest area of my state known as Acadiana.

It has a municipal electric utility that obtains its power from a coal-fired electric plant located in central Louisiana.

The plant uses Powder River Basin coal from Wyoming to generate electricity, and the coal is transported to the power plant in

Louisiana via unit trains and cars owned and maintained by the city utility.

Only one of the two major freight railroads serving the Western portion of the US serves the power plant, although, and this is very significant and powerful to me, access to the second major freight railroad through a large regional carrier is physically available about 20 miles away.

If the city could obtain a rate from its rail carrier for the movement between the switching point with the large regional carrier and the plant, the city would have a chance for competitive rail transportation for all but the last 20 of its 1500-mile coal movement.

However, the rail carrier serving the plant refuses to provide a rate between this point of competition and the plant, thus making the entire 1500-mile movement of the coal to the power plant captive to that single railroad.

According to Congressional testimony by the manager of the city utility system, this 1500 miles of captive coal movement is a tax on a typical household of four in Lafayette of about $200 a year, and on the Lafayette school system of about $1.2 million a year.

This tax on the people of Lafayette and the misallocation of our school funds could be avoided if the railroads were required to provide a so-called bottleneck rate to their customers to move their goods to or from a point where the customer would have access to a second, competing railroad.

This is the way deregulation is supposed to work. It's supposed to result in competitive options. But, because of current regulations, railroads would be required to allow their customers access -- but for those current regulations, railroads would be required to allow access to competing rail systems.

Today, you're also hear an example from PPG Industries, a chemical producer with plenty of facilities in Louisiana, about the inflated freight rates paid on shipments from Lake Charles, Louisiana to La Porte, Texas.

The ability of one railroad to block access to another railroad has resulted in 50 percent higher rail rates for captive movements from Louisianan to Texas, compared to that of similar movements within Texas.

This is another real world example of how accessible reciprocal switching would restore competitive access by giving PPG the option of using a different carrier. This also serves as yet another example of how railroads have been able to protect themselves from competitive markets through the current regulatory policy.

Mr. Chairman, the Board asks if there is a lack of rail-to-rail competition in the rail industry. The testimony filed in this proceeding trumpets what many of us know from talking to our constituents for rail-dependent shippers like the two I've described. There is currently very little rail-to-rail competition in the national freight rail system.

Your record is already replete with statements indicating the adverse effects of this lack of competition on individual companies and persons and local economies, American exports, our national economy, and American jobs.

It's important that the Board not only find that there is a lack of rail-to-rail competition, but also that the current regulations and interpretation of law are part of that problem that must be changed.

Indeed, in a network industry like the national freight rail system, it's very hard to imagine how competitive options can exist for rail-dependent shippers, unless the regulatory program allows rail customers access to other railroads in the network.

Finally, Mr. Chairman and members, I want to leave you with two more brief thoughts. First, on competition issues, the regulatory program today essentially protects railroads from rail-to-rail competition, not rail customers from railroad monopoly power.

This program, in my opinion, has become a classic case of regulations protecting the regulated industry more than the customers of that industry who were the intent of the original protection.

Rail-dependent shippers do not have access to the rail-to-rail competition that they were promised in the Staggers Rail Act, and the rail industry is being protected from operating in the competitive environment that it told Congress it wanted when Congress enacted that in 1980.

As a result, the rail industry is now financially healthy, but the balance between the interest of railroads and shippers that Congress intended in the Staggers Act is missing.

Second, I'm aware that the railroads are making the argument that any changes in the current regulatory system could result in their failure to invest in their own infrastructure.

Mr. Chairman, I simply don't accept this when the proposition is moving an industry from its protected, regulation-based system to a competitive system. Your proposals in ex parte number 705 propose to remove the barriers to competition and move the railroads into a more competitive environment.

Of course, the railroads are also arguing that somehow removing regulatory barriers that prevent rail customers from having access to another railroad system is quote "re-regulation," close quote. That, too, is novel to me, and simply isn't the case.

The railroads asked Congress in

1980 to allow them to compete in the transportation marketplace, rather than be required to obtain prior approval for almost all of their actions from a federal regulatory body.

The railroads got what they asked for, and by the way, I support that, but then persuaded your predecessors to adopt regulatory interpretations that shield them from a lot of competition.

Today, our national interest will be served if the railroads must compete with each other as well as trucks, water transport, and other modes of transportation.

I, for one, am confident that the railroads will continue to invest in their own systems, even if they must participate in a competitive transportation marketplace. In fact, that will be all the more reason for them to have to continue to invest.

You have the authority under current law to make changes to your policies just as other regulatory agencies do, so I ask you humbly, Mr. Chairman, and members, to remove the railroad industry's undue protections from competition by adopting pro-competitive rules on those issues identified in this proceeding.

Thank you very much for the invitation to appear. Thanks for all of your courtesies, Mr. Chairman, and members.

CHAIRMAN ELLIOTT: Thank you very much, Senator.

Just a note, I did visit the PPG facility in Lake Charles, where I happen to have a cousin, and I'm very familiar with the situation. And next week I'm going down to your great state and New Orleans, so I'm looking forward to that.

Thank you very much for coming forward today and expressing your thoughts with us. We greatly appreciate it.

SENATOR VITTER: Thank you very much to all of you.

CHAIRMAN ELLIOTT: Okay. Thank you very much for making time for the Senator. And I believe we're going to start back up with Mr. Oliver.

MR. OLIVER: Well, good morning, Mr. Chairman Elliot, Vice Chairman Begeman, and Commissioner Mulvey.

I appreciate the time being here this morning, and I guess following a US senator makes it a little bit nerve-wracking here for an engineer.

CHAIRMAN ELLIOTT: I've done that before.

MR. OLIVER: So excuse me if I speak a little fast. But I am Vice President of Engineering Construction and Operations for Arkansas Electric Cooperative Corporation. We're a generation and transmission cooperative located in Little Rock, Arkansas, and I'm here to give you AECC's views on the current state of competition in the railroad industry, and recommendations about what the

Board should do to enhance competition for the benefit of not only the rail customers but for the public interest and for the railroads themselves.

So, in accordance with your instructions, we've provided written comments and won't try to summarize those too much this morning, but more to give you a view of my position as an executive responsible for fuel procurement for our coal plants within the state of Arkansas.

AECC owns interest in three major coal plants in Arkansas. There's five units there. We ship a little over 14 million tons of coal annually to those plants, and provide electric service to about half a million consumers in Arkansas.

So, we're not huge, not quite the size of Ameren, but we do have a significant interest in PRB coal deliveries.

And although the rate paid for that transportation is important, I want to kind of point you into some other directions today, too, as far as service. Service is important to us as well, and like many rail customers, we have spent a lot of money investing in rail cars, not to have to be using the railroad industry's rail cars, but have purchased our own train sets.

Based on cycle time, we determine how many train sets we need to provide the service that's reliable to our plants.

And so if a railroad chooses a circuitous route, it increases our maintenance costs on those rail cars, so that's one thing to consider as you look at this.

In addition, if we have poor service from the railroads, we have to have a large stockpile of costs, which the curing costs for millions of tons of coal can get rather expensive.

So even those these real costs are substantial, they can be small in comparison to a problem if we have disruptions to our plant operations.

And in the past, when we've seen disruptions to our plant operations, we've had to go as far as Indonesia to find suitable coal as a replacement for our plants.

And typically, what would happen if we had a disruption in operations, we would try to buy power on the market. And although that seems like a legitimate way to do it, the cost of that power on the market can be substantial compared to our costs of coal generated from our own plants, and in some cases, more than three times the cost of that power, so, that seems like some wildly -- wild situations to where we would have to go to better the service that's provided from the railroads, but, they're real examples. But it seems to be an inefficient way for us to spend our money in order to compensate for the service of the railroads.

Events like this can cost significant increase to the cost of electricity to our members, and we believe that increased competition could improve that, improve the service level to us and other customers.

And if I understand the Board's merger rules correctly, you -- the cost changes experienced by the shippers must be considered equally with the cost changes experienced by the railroads in analysis of the public interest, and to do otherwise would be improperly disregarding the impacts of some effective parties, and would give the wrong overall assessment of the public interest. So, yet that's exactly what happens in remedy of hard economic costs imposed on rail shippers and ultimately the economy.

So AECC believes the best way to improve the reliability, timeliness, and efficiency of rail service to our plants and other plants is to ensure competition is readily available to captive facilities, at least where inadequate performance by the serving carrier produces tangible harm.

The Board has well-defined regulatory measures for addressing unreasonable rates, but it has no equivalent procedures for addressing inefficiency and inadequate service of a serving railroad.

The Board's ability to address rail service and performance problems stemming from rail carrier market power can be found primarily and exclusively in its authority to unleash the forces of competition.

So in other words, we think a strong, competitive railroad market is the best way to ensure adequate service to our facilities.

So we're not asking for increased regulation, I think as the Senator just mentioned. We're not talking about re-regulating, but we are talking about enforcing the competitive market.

So, in most industries other than the railroad industry, when you talk about competition and regulation, they seem to be opposites, and, you know, the railroads, in this proceeding, with all seriousness, seem to be saying that asking for increased competition is asking for re-regulation, and that's not what we're trying to do. We just want to see competition, and we want to see it work effectively in our industry.

So, going back to the 1970s, and it's all been talked about, you know, prior to the Staggers Act, and we don't want to see that go back to that situation either, but if you look at, after the Staggers Act, the railroads were able to become revenue-sufficient. They were able to get back on their feet, produce a vibrant industry, and they were able to attract the capital and investment needed to generate substantial ongoing productivity improvements.

But since the Staggers Act, and since the mega-mergers, what we've seen is a decrease, or it's been pretty much harmful to competition.

What we've seen is a decrease in the rate of productivity improvement and substantially measured adverse impacts to the railroad costs. So, mega-mergers and the bottleneck rule would be one of the problems that has developed a lack of investment, a lack of innovation.

And I think Commissioner Mulvey, you questioned that yesterday about how can you get into a situation with competition. Competition does seem to improve innovation for those industries that are involved in a competitive market.

If I'm looking at a competitive market, I want to distinguish my service or distinguish my product from everybody else. And one way to do that is through innovation, and our written testimony gives evidence of that.

Our expert witness, Mr. Michael Nelson, discussed this further in detail of the importance of innovation and productivity improvement in ensuring the long-run health of the railroad industry.

So a modest increase in competition, that's all we're talking about here is a modest increase, would not undermine the railroads' ability to earn sufficient revenues to attract the capital that they need, and it would provide the needed incentive to encourage the railroads to provide good, reliable, and efficient service.

Now, I don't want to talk about our recent case involving paper barriers, but that recent experience does give evidence for one of the reasons why we need to change the rules.

In that particular case where our co-owner Entergy and ourselves filed a petition to provide service to the independent steam electrics station, we asked the Board to provide a through route.

And although the Board found that

the incumbent carrier had provided inadequate service over extended periods of time, and further found that the through route would have been somewhat more efficient than the existing route, the Board concluded that this was not enough to justify prescribing the through route, and I'm not going to argue about that decision.

However, I have to presume that your decision on that was an accurate interpretation of the existing rules, which I think is evidence of why the rules need to change and provide a little bit more of an obligation on the carrier to prove the reason why competitive access should not be prescribed in that case.

So here's the point I want to make, and the primary purpose that I think the railroads have missed, that the revised competitive access rules would be to provide an incentive for the railroads to improve their service, and right now, the railroads have no reason to fear if they provide poor service, and have any adverse impact or any adverse consequences if those controls are not in place.

The Board has not been applying competitive access remedies for poor service, and therefore, no other railroads can threaten to take that business away, so, but if competitive access rules are modified such that a railroad knows that the consequence of providing poor service will be that another railroad will be authorized to compete for that business, then the incumbent railroad will have a strong incentive to provide good service, and I think that's the bottom line today, that competition should provide strong incentive for the railroads to provide good service.

Sow we're asking that the Board make its actions clear and credible that in the future it would apply competitive access remedies for inefficient, inadequate service, and other specific circumstances. Then the railroads would experience a greatly increased incentive to ensure that those circumstances do not occur.

And as I conclude, since I see my yellow light, let me applaud you for taking on this issue. I know it's going to be tough, and I think what you've seen with the amount of comments you received, the time spent here over the last couple of days, that it's very important.

And I think the charge was laid out by Senator Rockefeller yesterday, as he said it very well, be scrupulous in your review of competition. And I have every confidence that you will do that, and I look forward to the results.

Thank you very much.

CHAIRMAN ELLIOTT: Next, we'll hear from Mr. Wilcox, from Omaha Public Power District.

MR. WILCOX: Mr. Chairman, Vice

Chairman, Commissioner Mulvey, I'm Tom Wilcox. I'm with the law firm of GKG Law PC here in Washington, DC, and I am here on behalf of Omaha Public Power District.

UNIDENTIFIED SPEAKER: Is your thing on?

CHAIRMAN ELLIOTT: Yes, just speak up a little. Thank you.

MR. WILCOX: Is that better?

UNIDENTIFIED SPEAKER: Yes.

CHAIRMAN ELLIOTT: Yes.

MR. WILCOX: Okay. OPPD was part of a group of four utilities who submitted joint initial comments in this proceeding and then submitted a final submission on June 10th, but I am here solely on the behalf of OPPD.

OPPD is an electric utility, and it's a Nebraska Public Corporation and political subdivision. It's headquartered in Omaha. It serves about 340,000 customers in eastern and southeastern Nebraska.

OPPD commends the Board for holding this hearing. It's a timely hearing, and OPPD appreciates the opportunity to add to the record of the proceeding.

OPPD is no Ameren, but its facts are similar. It's a little bit smaller. OPPD owns and operates two coal-fired generating stations, the Nebraska City Station and the North Omaha Station. These plants burn about 7 million tons of PRB coal per year between them.

The initial comments summarized how OPPD first utilized the tools available under the Staggers Act to establish competition between UP and BNSF at its two plants, and there are articles attached to the joint comments that during this time frame that sort of explain how the bidding process went, and how the competition was reported in Omaha.

Nebraska City was captive to BN since 1978, and BN had served North Omaha since 1984. But starting in the early 1990s, OPPD took advantage of the remedies before the Board to create competition that included seeking line construction authority to construct a build-out to the UP down in Nebraska City.

At the same time, OPPD obtained authority to cross the Burlington Northern track coming into Nebraska City over BN's objection, and those two proceedings eventually resulted in OPPD becoming the owner of a common carrier line of rail, similar to Ameren.

OPPD, in exchange for -- in lieu of constructing the build-out, purchased the 56.7 mile line -- long line of railroad that serves Nebraska City plant and was formerly owned by BN. And that's an example of how the tools under the Staggers Act allow for regulatory relief, but they also provide a regulatory backstop, because the end result was a commercial solution, negotiated by BN and UP -- excuse me, BN and OPPD, and established the competitive access.

As part of that process, OPPD now owns a common carrier line of rail and services provided via tracker's rights or operating rights.

Now, OPPD's efforts to create competition facilitated the effective competition OPPD believes was envisioned by the Congress when it passed the Staggers Act.

OPPD's investment, for one thing, created new opportunity for a fellow Omahan in UP. And as the articles explain, you know, in 1998, UP competed very hard for OPPD's business and came up a little bit short, and it was awarded to BNSF. But UP came back in 2003 and underbid -- again, competed hard and won the business from BNSF.

The result was, at this time period, rail and total delivery of fuel costs were significantly reduced. OPPD was able to charge its customers fair prices for electricity, and whichever railroad had the business we believe still operated at profitable levels. And OPPD and the railroads operated under detailed contracts that were tailored to OPPD's movements and the party's respective commercial and operational needs.

In short, OPPD became the rail shipper that Congress envisioned. It should have done -- it should have little or no need to seek STB intervention in its rail transactions.

So, why is OPPD here? Well, it's -- as the joint comments lay out, OPPD's participating because in 2008, they undertook the exact same competitive bidding process that they did in 1998 and 2003, and at the end of that process, it was apparent to OPPD that the prior level of competition that it had enjoyed or experienced at these plants was no longer present.

And that process, combined with higher coal prices, eventually resulted in

OPPD's delivered fuel costs increasing by over $100 million per year, starting in 2009, and caused OPPD to impose the largest residential and industrial rate increases on its customers since 1973.

OPPD is very concerned that this significant apparent change in the coal transportation market -- about this change and its effect on OPPD's ability to continue to charge fair prices to its customers for electricity.

So OPPD therefore reiterates, this is a very timely hearing, and the Board should carefully weight the extent of the material that's been submitted to it, and actively look for opportunities to modify its rules where possible to facilitate effective competition between the railroads.

Now, we, at the joint comments, submitted several general policy ideas in response to your request. But this group mainly focused on providing anecdotal evidence and left the specifics to some of the more -- the bigger groups, and spent a lot more time on the actual specific proposals.

We also join Ameren and others, asking the Board to clarify, in this proceeding, that the rules concerning market dominance permit a finding of qualitative market dominance under Section 10707, even in cases where the shipper has access to two railroads and has enjoyed effective competition in the past, provided that the shipper can make the appropriate showing.

This is not a new proposal, but a request for confirmation of the standard that all market dominance determinations are made on a case-by-case basis.

There is some uncertainty, as Mr. Sobule discussed, uncertainty for dual-served shippers now about the jurisdiction of the Board over their rates, should they believe that they are unreasonable.

Again, thank you very much for the

opportunity, and again, thank you for holding the hearing.

CHAIRMAN ELLIOTT: Thank you, Mr. Wilcox.

Thank you, panel.

I just have a couple specific questions. I think I've already asked some of the broader questions to the panel yesterday that involve coal shippers, so I'll stick more to the anecdotal stuff and examples that you referenced in your testimony.

Ameren, I'm familiar with your build-outs, and just so I'm clear, with respect to the build-outs that have been built and are in existence now, I wasn't clear if you think the railroads are competing right now where you've already built out, or if they're not.

MR. SOBULE: We believe, based upon responses to bids, that even that where we had built out, we got the competition at the time of the build-outs.

CHAIRMAN ELLIOT: Right.

MR. SOBULE: This was all pre-2004. Post-2004, bids that came out, we do not see that level of competition.

CHAIRMAN ELLIOT: Sure. And then I understand your concern with respect to future buildouts, because you're apparently not getting a rate quote where the track hasn't been built out.

Do you have any suggestions as far as solutions for such situations where either you've built out or you would like to build out?

MR. SOBULE: Well, once again, we would obviously like it very much if we could go back to the way the railroads behaved when we did our prior build-outs where there was a willingness to quote a rate to a non-physical point. We didn't have to actually go through and spend the capital for the build-out.

You know, in terms of assistance through the STB and what we could do, you know, I would have to take a look and maybe we could supplement with some ideas of how that would maybe work so we could get back to the level of competitiveness that would basically encourage people to do build-outs again, because frankly, based on both the Ameren experience, the OPPD experience, some of the other ones, I'm not sure you're going to see many build-outs again.

CHAIRMAN ELLIOT: Thank you.

Just one other specific question, Mr. Wilcox. I noticed in your testimony or in your comments, you suggested raising the limits on the simplified SAC. Am I remembering correctly?

MR. WILCOX: That's right.

CHAIRMAN ELLIOT: Okay.

MR. WILCOX: Well, it's mainly simplified SAC. I think there are some utilities out there who have -- and this is not the OPPD, their tonnages are sufficient and they could justify probably the stand-alone cost case. But the comment addresses simplified SAC in that there are utilities with volumes that are lower, yet they still have possible -- a possible challenge of an unreasonable rate, yet the prospect of bringing a full-blown SAC case does not justify the potential damages they could get, considering that their volumes are low.

And so -- yet the $5 million cap that's on simplified SAC now is not, you know, may not be enough in itself.

So that was the proposal in there. And I think that's something the Board has heard before in terms of the three-benchmark caps and the simplified SAC, that maybe they should be increased, too, and that there are potential complaints out there, but the caps are discouraging those type of actions.

CHAIRMAN ELLIOT: Thank you, Mr. Wilcox. That actually perfectly answered what I was going to ask next, so I have no further questions.

Vice Chairman?

MR. WILCOX: It's always good when I can answer two questions at once.

CHAIRMAN ELLIOT: We really appreciate it; speeds up the thing.

VICE CHAIRMAN BEGEMAN: Thank you all. Your testimony is somewhat enlightening, informative, and alarming.

You know, we heard a lot yesterday from the shipper interests, at least the coal shipper interests, that reciprocal switching was -- I'm not saying they said it was the silver bullet, but that certainly is what they're advocating.

I think the three of you, some of you at least you have competition, and competition isn't the silver bullet either, given, at least what you're alleging is happening with the industry.

So, if bottleneck relief and reciprocal switching perhaps aren't the answer, is the answer, from your perspective, the ability to come to the Board to challenge rates, and/or services, or perhaps service issues?

MR. SOBULE: Vice Chairman, that is exactly one of the three recommendations that we made is that we should have the ability, those that have supposed competition, that once again, if we can make the same jurisdictional prima facie case on that, that as a backstop, we would have the ability to say that in fact there is market dominance which is the lack of effective competition. Just because you have competition doesn't mean it's effective, so, it's absolutely correct, we would like to have that.

MR. WILCOX: I would modify that a little bit. As a shipper like Ameren who has invested a lot of time and money in establishing competition, we want competition, that would be the preferred way to establish rates and service terms.

However, if you need to have some

avenue to try to challenge a rate, or if you believe that it's unreasonable because you're not getting the level of competition you need, but I think the Board, you know, the coal rate guidelines were initially designed to provide a kind of a cookbook of a way to -- where someone could calculate what a maximum rate would be to encourage contractual -- you know, solutions, and so I think by having a way you can help competitive shippers, until competition resumes.

And I agree with what was stated yesterday that it's going to take time, it probably will take time, to create a clear set of rules for competitive shippers that would provide that guideline or backstop to have the parties come to the table rather than just file a rate case, because the preferred way is for people to --

VICE CHAIRMAN BEGEMAN: Sort of a threat?

MR. WILCOX: Well, it's like what

was said yesterday. It's not re-regulation if you establish the rules so people understand them, and then so if you have a reciprocal switching rule everybody understands, then the parties can use those rules to come to an agreement on the outside of the Board.

So -- and that's the same with rate rules. If you can supply the parties with the guidelines, then now they know, you know, if you go to the Board, here's the answer, and so let's work around that.

And for competitive shippers, there's a lot of uncertainty now, too, in one of the main issues, which is jurisdiction.

VICE CHAIRMAN BEGEMAN: Mr. Oliver, have you had a chance to utilize the Board's mediation process? You laid out a lot of troubling issues, particularly having to go to Indonesia for your coal.

MR. OLIVER: I'm not sure that we --

VICE CHAIRMAN BEGEMAN: And if you

haven't, I encourage you, and I know the Chairman would encourage you to reach out as well.

MR. OLIVER: And I'm not familiar, and I'm not sure that we have used the mediation process. It does seem interesting. I know in the coal dust decision, we've asked to speak with the railroads and not been able to get that done, so -- but it seems like a good forum in which we could, perhaps, negotiate some of those.

And yeah, going to Indonesia is a far stretch. But I think with us, you know, reliability of service is very important, and so being able to have that coal on the pile is important, too. So we'll exhaust no means -- or every means in order to provide that service.

VICE CHAIRMAN BEGEMAN: Thank you.

CHAIRMAN ELLIOT: Commissioner?

COMMISSIONER MULVEY: Thank you. Indonesia is far away. Of course, China's far away, too, and they're using some of our coal. So, it's a global commodity.

With regard to Mr. Sobule's question about -- issue about the BN and the UP and the failure to compete after 2004, you said that there was a 43 percent differential, and then you said that they raised the rates by 87 percent.

But wouldn't that have allowed the 43 -- wasn't that more than the 43 percent difference? And wouldn't that have allowed for bidding or a shift again in the supplier at that point, or did they both come back with the same rate?

MR. SOBULE: The relation, and I might have been a little bit unclear in how I went through this, if I can try to go back on that, is that the -- no matter where the incumbent carrier came in, the non-incumbent rate was, on average, obviously, 43 percent higher than the incumbent rate.

What that is is that's the rate --

the 43 percent higher than incumbent rate is not of the existing incumbent rate. That was 43 percent higher than the new rate proposed by the incumbent shipper.

COMMISSIONER MULVEY: Okay.

MR. SOBULE: Did that --

COMMISSIONER MULVEY: That's more clear.

MR. SOBULE: And I should have clarified it a little better the first time through. I'm sorry.

COMMISSIONER MULVEY: Well, one of the things that was discussed was build-outs. And I recall, many, many years ago, when I worked for the Congress, the build-out option was not so much that you were expecting the shippers to build-out.

That was a possibility, it was kind of a threat, and that the threat of going to a build-out and going out and hiring surveyors and beginning to make some inquiries or even some acquisitions or rights-of-way in order to accommodate the build-out generally was sufficient to bring the incumbent railroad to the table to say okay, okay, we don't want you to build-out another railroad, let's talk about what a fair rate might be.

And you're suggesting that while that worked for a while, that it -- after 2004, stopped working, or after 2008, stopped working. Or -- is it sort of a matter of that the railroad got it and figured well, this is -- you know, this is -- it's like poker, after a while, you can tell when somebody's bluffing? Would you characterize it that way?

MR. SOBULE: Well, I think that in some instances, what you're saying was correct, that there was -- that the railroads, in some instances, realized well, maybe they really aren't going to spend the capital to build-out.

In Ameren's case, we actually spent the capital and did the build-out, and basically, the rate reductions we got was because the railroads were, in fact, anxious to potentially take market away from the incumbent railroad.

We have, as an example, at our Joppa plant, which was one of the ones where we did the build-out, that contract actually swapped back and forth a couple times after the build-out, because we had created competition.

And at that point, the railroads were interested in competing as opposed to not -- the change of -- whatever reason it occurred after 2004.

So a little bit of what you said, maybe calling the bluff with some folks. With Ameren, we really did do the build-out, and it did result in some change of service from one rail carrier to another.

COMMISSIONER MULVEY: Mr. Oliver, you mentioned about going to Indonesia, and you talk about some of the problems that utilities face with dealing with higher rates or dealing with higher inventory costs and the like.

But you said that the major cost or the major problem would be if you actually had to shut down. And have you ever had to shut down the plants because of lack of coal supplies?

MR. OLIVER: I've only been in this position for a couple of years, but I can speak to some extent, that we've had --

COMMISSIONER MULVEY: Or even brownouts.

MR. OLIVER: We have had to lower the output of the plants due to coal supply. As you begin to look at -- primarily if you look in 2005, after the joint line problems, we had significant decease in coal delivery.

COMMISSIONER MULVEY: Yes.

MR. OLIVER: You're going into the summer, which is our peak period, and you're having to balance those piles and make sure you have enough inventory to make it through the summer. You don't want to shut down the plant completely.

And so we have had to decrease output at the plants due to poor service.

COMMISSIONER MULVEY: But the 2005 problem was one that was due to things that were beyond the railroad's control. Have you had problems -- that is now six years ago. Have you had problems with supplies since then?

MR. SOBULE: Yes, sir. It hasn't been quite to that extent, obviously. That was a major issue.

And I'm going to speak a little bit out of my element, but I will say this, that from my understanding, there were times when the economy was really booming, when Intermodal traffic was significant, that our cycle times, which is the time it takes for the train set to get from the PRB mine to our plant and back, those cycle times increase significantly, and the delivery of coal was less than the contract.

So was it to the extent of 2005? No. Have we seen impacts, due to service? Yes. We have seen poor service since 2005.

Now, as of 2005, it's fairly good, and the cycle times are low. We are attributing that primarily to the fact that there was probably decreasing intermodal traffic. We don't have that insight, but I will say there have been times since 2005 when we have experienced a decrease, so.

COMMISSIONER MULVEY: Every cloud has a silver lining. We've noted that with traffic down for the railroads, that the average speeds up, cycle times go down.

So that's a good point, but that's not necessarily good for the economy as a whole that there are fewer, say, unit intermodal trains out there.

MR. SOBULE: Yes, sir. I think that's correct. And I mean, everybody hopes that the economy's going to rebound. And so, again, that's why we're looking at it from the standpoint of not just rates, but to provide some relief through competition, if we do see a decrease in service, because we do have a definite need for reliability of supply for that energy. So, I'm hoping the economy rebounds, but I hope the service level stays good as well.

COMMISSIONER MULVEY: We're often told that cars on line is a bad metric, that more cars on line is not a good metric -- more cars on line means there's traffic out there. That's not a bad thing. But anyway.

Omaha Power District, Mr. Wilcox, you had a successful build-out, and are you still operating that short line railroad? Is OPPD still operating that short line today?

MR. WILCOX: Well, not today, no, because the UP is the current provider at Nebraska City, and so they use a very small piece of the 56-mile line to get into the plant. The 56-mile line would come into play if BNSF was to get the business back.

COMMISSIONER MULVEY: The Board, when it looks at market dominance, has both a qualitative and a quantitative measure for market dominance.

And the qualitative-based looks and sees whether or not there are other modes that can be effective competitors. The quantitative, of course, relies on our 180 percent of revenue to variable cost ratio to decide market dominance.

Would you suggest that we drop the qualitative one and focus only on a quantitative measure? And is the 180 the correct measure, or should it be lower?

Or -- I would think lower if you -- but should it be higher? Or what would you suggest?

MR. SOBULE: From our point of view, we think we should still have a qualitative and a quantitative measure. The difference that we're saying is that for quote-unquote competitive shippers, that basically that whether it's 180 percent or not, I'm not sure whether that's the appropriate level, but that the jurisdictional threshold, whatever it is, except for captive shippers, that the statute be interpreted so if any rate, including for quote-unquote competitive shippers, exceeds the threshold, that could prima facie demonstrate that there's a lack of effective competition.

COMMISSIONER MULVEY: Anybody else want to comment on that?

MR. WILCOX: Well, obviously, if the jurisdictional threshold is lower, that's beneficial. But I think this also relates to the Board's review of its IRCs costing system as well, in terms of what the number you end up with.

But I do think that for dual-serve shippers, that I agree with Mr. Sobule that the RTC ratio, revenue to cost ratio, it should be a good indicator of whether the rate is presumptively or a rebuttable presumption that it's unreasonable.

COMMISSIONER MULVEY: Thank you. Thank you.

CHAIRMAN ELLIOTT: Thank you very much for your comments today. We greatly appreciate it.

MR. WILCOX: Thank you.

CHAIRMAN ELLIOTT: I now call forward panel number two.

(Pause.)

Welcome. We will begin with Mr. Marsh from CONSOL Energy, Inc., and I believe you have five minutes.

MR. MARSH: I'll keep it very short and brief for you. Thank you for the opportunity.

I'm a Vice President with CONSOL Energy. We're a coal and natural gas company out of Pittsburgh. We move almost 35 million tons on the railroads, and we're one of the largest shippers on both the Norfolk Southern and the CSX.

Our position is slightly different than what I just heard. We've had an excellent circumstance with both the Eastern carriers over the last 15 years that I've been involved with them, and over the last 130 years that my company has dealt with them.

The things I heard just a moment ago would be very alarming if we experienced them. We've not experienced that.

We've found them to be creative, competitive, cooperative, and in my own functionality and in our company's competitiveness in the world marketplace, we've benefitted significantly from these partnerships.

So our position is, please be cautious about any changes that would inhibit investment, because we find this to be a capital gain, a major infrastructure play, and anything that would reduce the ability for our product to move to market would be concerning.

Thank you.

CHAIRMAN ELLIOTT: Thank you.

Mr. Yeager?

MR. YEAGER: Very good. I probably will not be quite as brief, but I'll try to make this brief.

(Laughter.)

Mr. Chairman and Madam Vice Chairman, Mr. Commissioner, we thank you for this opportunity to speak to you today about this very important subject.

A healthy and competitive rail industry is critical to the economy of this country, and also to the continued success of Hub Group, of which I am Chairman and CEO.

Hub Group is a $2.5 billion transportation company employing 1600 white-collar workers and contracting with 1800 truck drivers. We arrange for the transportation of trailers and containers on various Class 1 railroads.

In 2010, Hub Group shipped over 1

million truckloads. More than 700,000 of those truckloads were transported by a rail intermodal.

As a result of using rail intermodal versus conventional over-the-road services for these 700,000 truckloads, 3.1 billion pounds less carbon was emitted into the atmosphere and over 68 million gallons of fuel was saved.

It's obvious that it's in our country's best interests to continue to promote the use of the nation's rail system.

Hub Group, like the railroads, was not always as prosperous as it is today. Founded in 1971 by my father and mother, the first Hub office had no windows and was on the second floor over a flower shop in Hinsdale, Illinois.

I joined this small family business in `75 and have worked at Hub in the intermodal industry for the last 36 years. In the 1970s, unlike today, the rail industry was not the model of the world. I remember well when railroads offered poor service, and seven railroads in the northeast were bankrupt. Even worse for shippers, rates were high and not very competitive with truck.

These difficult days for the rail industry ended with the passage of the Staggers Rail Act in 1980. While it took time to heal this beleaguered industry, the deregulation that followed this act helped promote the healthy and vibrant rail network that we enjoy today.

Since deregulation, I've seen the railroads make substantial investments to their infrastructure and promote new services that have made rail intermodal a forceful and highly efficient competitor to truck.

According to the Association of American railroads, since 1980, average inflation adjusted rail rates have fallen 55 percent, rail traffic volume has nearly doubled, and railroads have invested $480 billion in capital spending to improve those networks.

And not only is rail less expensive today, but service is much faster, it's more consistent, and the loss and damage claims are down substantially due to railroads investing in updated tracks and rail cars.

The ability for the railroads to continue to invest in improved service is critical to the partnership that we have developed with the rails. This partnership has benefitted the environment, it's reduced traffic on our nation's roads, it's saved billions of dollars in shipping costs while contributing to our country's economic growth.

The railroads have supported our business, whether it's import, export, or just purely domestic. Shippers, railroads, consumers, motorists, and the environment are all much better off today due to the far-sighted policy that Congress implemented in 1980.

I know that a few railroad customers in specific rail markets who ship specific kinds of freight believe that expanding rail regulation will benefit their own self-interests.

However, such a shift will do harm to many more companies and individuals in the long run. Taking actions that could reduce railroad efficiency will harm the interests of intermodal customers, as well as the public at large, who benefit from the railroads.

Shippers and the public at large need railroads that are able to invest in the infrastructure expansion, terminals, and rolling stock. I'm very concerned that if the Board makes changes to regulatory policies that it will adversely affect the ability of the railroads to continue investing in their networks.

I'm also concerned that these proposals could negatively affect rail service to customers like us by reducing asset utilization and otherwise impairing the rail network.

Our national rail network has improved dramatically over the past 30 years. We currently have a highly efficient, environmentally friendly, and cost-effective rail system that's primarily funded by these same railroads.

I believe our current regulatory structure is working well for shippers and the public at large, and for these reasons, I ask the Board to reaffirm the current regulatory regime.

Thank you very much.

CHAIRMAN ELLIOTT: Thank you, Mr. Yeager.

We'll now hear from Mr. Rubin from the Intermodal Association of North America.

MR. RUBIN: Thank you.

Chairman Elliot, Vice Chairman Begeman, and Commissioner Mulvey, thank you for allowing the Intermodal Association of

North America the time to express our views on the current state of rail competition.

My name is Steve Rubin, Chairman of the association commonly known as IANA, whose members handle over 90 percent of the freight moved in intermodal service.

I spent the last 20 years in the intermodal industry as a senior operations executive with a major ocean carrier, and most recently as the President and CEO of TRAC Intermodal, the nation's largest intermodal chassis leasing company.

Over the last two decades, I've worked very closely with all the Class 1 railroads as both a customer and a supplier of intermodal services.

At the Board's February 24th hearing to revisit exemptions for commodity, box car, and intermodal, IANA's CEO, Joanne Casey, and other rail executives provided compelling arguments why the exemption on intermodal should be preserved.

My remarks today will focus on how the current regulatory environment for railroads has fostered an era of powerful competition for containerized supply chain logistics that has provided significant benefits to all stakeholders, including shippers, ports and terminals, ocean carriers, motor carriers, and third-party logistics providers.

My core point is that for intermodal rail, competition is a way of life, and in the relatively near future, it will only intensify as infrastructure improvements from the build-out of the Panama Canal, as well as the deeper dredging of our nation's major seaports to handle the world's largest container ships will increase the pressure on the railroads to provide superior service at reasonable, competitive, and market-driven prices.

I've been negotiating service contracts with the railroads for the past 20 years, and I've witnessed first-hand the benefits of the current regulatory environment.

First, mergers have created better end-to-end products with faster, more reliable transit times for service-sensitive shippers, and there's been an unprecedented capital spend invested in network, terminals, technology, and human resources to meet not just current container volumes and trailer volumes but for expected growth far, far into the future.

As both a shipper and a supplier to the rail intermodal industry, I've also experienced the intense competition -- competitive nature of the Class 1 railroads. It's my perception that in the years following the highly active merger period in the mid- to late-1990s, the railroads have only increased their focus on serving their customers and heavily investing in the business to accommodate freight growth.

Intermodal is a complex system of interrelated transportation moves, and I believe the railroad investments have been critical to supporting the 5.7 percent compound annual growth rate for containerized imports and exports over the last 20 years.

Now, today, the railroads not only compete against their geographical competition, Union Pacific versus the BN, CSX versus Norfolk Southern, but because of container port infrastructure development and the growth in canal traffic both through Panama and the Suez, the railroads are now competing quote-unquote across a divide for cargo-rich areas of the Midwest, Ohio, and Tennessee Valleys, the Southeast, and the Gulf Regions.

Now, I know this last point was also touched upon in the February 24th hearing, but I think it bears reviewing, as it speaks to how the current regulatory environment encourages competition and risk-taking investment in the context of market forces.

To illustrate the increasing competitive forces facing railroads in the intermodal segment, let's take a container shipment moving from Shanghai to Cleveland, Ohio.

Their steamship line responsible for bringing the goods from overseas has routing options that span two countries, both North American coasts, and six of the seven Class 1 railroads.

If you also include the option of trans-loading at the port of discharge into the 53 foot domestic container, you not only double the potential routings, but you have introduced motor carrier competition into the equation.

The bottom line is that the railroads have more competition for intermodal freight than ever before, and will only become more so as new infrastructure will push the boundaries of the traditional intermodal supply chain.

While I cannot speak with knowledge on the sole provider rate issues here, the STB has properly identified one of the emerging challenges facing the evaluation of intermodal rate reasonableness, the global multi-modal shipment.

In such instances, which will become truly routine and not just hypothetical, IANA believes the best course of action for the Board would be to stay its current course with regard to rate regulation, and allow the market to establish the best supply-chain routing for the American producers and consumers.

Thank you very much for the opportunity to present to you today.

CHAIRMAN ELLIOTT: Thank you, Mr. Rubin.

Vice Chairman?

VICE CHAIRMAN BEGEMAN: Mr. Marsh,

could you explain what type of service you're provided from the two carriers? Actually, what I mean is, are they providing you a joint rate, or do you operate over them on separate lines, or are they giving you a bottleneck rate?

MR. MARSH: No, our situation is a little unique in the sense that our reach in the East -- we're the largest Eastern coal company, as a producer. And I actually run our Baltimore terminal, which has been tripling its volumes over the last couple years and serving the international marketplace.

So we have the good fortune of having some mines that are served by both railroads, some mines that are single-served, and facilities like our Baltimore terminal that are dual-served.

So having that mix, we are able to work with them tactically at the local level, and the mid-level regionally, and with their executives, where we make joint capital investments.

We support each other in terms of strategies. We work with them to create metrics that allow us to generate efficiencies.

And so what we've seen is both in the rate-making process, there's been competition and creativity. And then more importantly, on the investment and service side, we've seen significant modern business applications that make it to where we can grow threefold in two or three years. So that's been our experience.

VICE CHAIRMAN BEGEMAN: And Mr. Yeager, do you provide service or transport cars or arrange cars for all of the railroads, or just particular Class 1s, or any short lines?

MR. YEAGER: We do actually -- we are strictly on one carrier within the West, and within the East, we utilize both carriers, both CSX and Norfolk Southern.

VICE CHAIRMAN BEGEMAN: And I'll ask all three of you to respond to this.

And Mr. Marsh, you mentioned that, if you were testifying such as the first panel had, you probably would be asking for changes, what are your thoughts on the proposal to allow those with competitive options currently to have access to the Board to challenge a rate?

MR. MARSH: Having oversight and having a general threat if someone gets unreasonable and totally reasonable and consistently reasonable is obviously a benefit. I just don't know how you would do it consistently.

Our biggest caution is simply, please don't do anything that will create enough uncertainty that capital investment will be hesitant, because we've seen very practically and on a day-to-day basis, if you don't invest the capital, the capacity withers, and as the capacity withers, our product doesn't move.

And as important as rates are, which is very important, our ability to move product to market is critical. So I just caution just, please be careful.

MR. YEAGER: I would agree with Mr. Marsh. I do think that we would just be very concerned about the railroads' intent and capabilities of reinvesting in the infrastructure.

In the intermodal industry, we have seen tremendous strides forward from a service perspective. That's make it very truck-competitive.

And for the railroads to handle more business and take it off the highways is critically important, I think, to the future of commerce within this country, and any uncertainty that's thrown in there I think is certainly a hindrance.

MR. RUBIN: Yes, I also follow --

agree with the previous two comments. My entire history in this business of intermodal has been basically in a deregulated environment.

So, Vice Chair, it would be a little difficult to put myself in someone else's position other than it seems that these are complex issues that really require a real deep understanding of the specific facts for each of the shippers.

Beyond that, you know, it's hard for me to comment any further.

CHAIRMAN ELLIOTT: Commissioner?

COMMISSIONER MULVEY: Thank you, Dan.

I recall of course the exemption hearings back in February, I guess it was, when Joanne was here testifying on behalf of IANA.

Of course, we pointed out at the time that intermodal is probably, by definition, the most competitive kind of traffic, and therefore, probably the most warranting of exemption, by intermodal, it can go by many, many modes or by multiple modes.

So, but I want to ask a question about the Staggers Act. I mean, the Staggers Act was passed -- when we passed Staggers Act in 1980, it was part of a larger group of bills that deregulated transportation, aviation, but also in 1980, motor carriers were also deregulated.

And motor carriers were, before 1980, back in the old days of tight transportation regulation, the ICC tried to balance the needs of the various modes, and tried to allocate traffic, depending upon what it saw as the inherent advantages of each mode, etcetera.

And it didn't do a good job of that, ultimately, and the railroads were in serious financial -- it's been suggested that what we need to do is to create the whole promise of Staggers, and that is de-regulate the railroad industry entirely, and let the railroads behave as a competitive industry and as competitive firms, as we do in any other industry, with the probable continued limited anti-trust immunity that they have right now.

Would you think that that would be a proper way to go to just, more with this -- ultimately, I guess it's easier for me to say, I'm finishing out my second term, but the Board, then, would disappear, and you would have a railroad industry that would compete for traffic like any others, and we would rely almost completely on market forces to determine rates and the allocation of traffic.

MR. RUBIN: I guess it could also be easy for me to answer, since I only have six more months in my chairmanship, and Joanne will actually be returning, the next time, I'm sure, that IANA is asked to testify.

Again, sort of to reiterate my answer to Vice Chair Begeman, Chairman Mulvey, I've grown up in the basically deregulated industry, and I've seen all the positive benefits that occur when there really is optimal or multiple choices for shippers of rail services.

So having listened to the first panel, as I answered before, it seems that maybe not all the circumstances, depending on the situation, allow for the same sort of, you know, competition that we have in the intermodal industry.

But certainly the railroads have a fierce competitive spirit, and having a regulatory regime that allows the railroads to maintain that fierce competitive spirit, they will take advantage of it, and they will work extremely hard to serve their customers and to certainly serve all their stakeholders including their shareholders.

MR. YEAGER: Well, being the oldest member of this panel, and having lived through regulation and deregulation, I'm very much -- the Staggers Act, I do think, was a tremendous stride forward.

I do think that having a Board that attempts to allocate competition and weigh if truck is better than rail is not appropriate. I do think that with what we have today, that it's actually very effective to Steve's point.

We do see within the intermodal segment a tremendous amount of competition. The railroads are very aggressive, very creative in how, in fact, they go about with their proposals. And so I would suggest that again, maintaining as is would be my advice to the STB.

MR. MARSH: The concern I'd have if it went to just a wide-open, totally different environment, is the barriers to entry in terms of just building railroads, getting the ability to get the land, to build it, the capital involved, that would be -- I'd be concerned a little bit if it just went to a total Wild West environment.

But again, I just think we just need to be cautious to make sure that whatever changes, if any, occur, just do consider the capital impact.

COMMISSIONER MULVEY: Well, the railroads do have monopoly power where they have single-served shippers, but there are limits to how much they can charge.

And the limits are based upon the fact that they need to have their customers, as Mr. Hamberger said yesterday, they don't want to put their customers out of business. Mr. Young said the same thing.

That's who their -- that's where their money comes from is serving customers, so there are limits to what railroads can charge.

The -- in other words, what I'm really asking, is there a need for this Board if you really want to have total competition? Because at least that might generate more innovation, more creativity, more services, etcetera.

The alternative that's been suggested or was suggested many, many years ago was -- maybe perhaps Mr. Yeager and hardly anybody else in this room remembers, that it was suggested that railroads ought to be treated like highways, and that is the railroad network ought to be nationalized, and the railroads -- private railroad companies, then, would compete for the traffic on this publicly owned highway system.

Those are kind of extreme solutions, but they have been suggested.

Do you have any comment on any of those?

MR. MARSH: Fortunately, I don't have sufficient understanding and perspective to comment intelligently.

COMMISSIONER MULVEY: Mr. Yeager?

MR. YEAGER: I would suggest that was probably in times when, as far as the suggestion that we nationalize the rail system itself, that was probably at a time when the railroads had not invested in infrastructure.

And I do think really that private enterprise and the innovations and giving them the ability to continue to earn their cost of capital is certainly the best solution.

MR. RUBIN: Sort of my frame of reference, Commissioner, is on the ocean container side, and there you have some examples where regulatory bodies, given proper guidance and authorization, I think can help.

And look at the Federal Maritime Commission. Look over in Europe where the EU has fully deregulated the ocean shipping liner rates, but yet, they still oversee it, and they still continue to investigate.

So again, I look at those as I think effective regulatory structures that also can effectively promote competition.

COMMISSIONER MULVEY: Of course, in ocean shipping, a large part of the infrastructure, the ports, for example, tend to be quasi-public institutions.

Thank you very much.

CHAIRMAN ELLIOTT: I don't have any further questions. I just want to thank you for bringing your perspective to the hearing today. It's greatly appreciated, and thank you very much.

(Pause.)

Okay. Welcome, everyone. We'll now begin with panel number three, and leading off will be Arkema.

And Mr. O'Leary, you have ten minutes.

MR. O'LEARY: Good morning, Mr. Chairman, Vice Chairman Begeman, and Commissioner Mulvey.

My name is John O'Leary. I'm director of Logistics for Arkema, Inc. On behalf of Arkema, I greatly appreciate this opportunity to appear before the Board today to offer our views on competition in the rail industry.

Arkema is a manufacturer of specialty products, and currently operates 23 manufacturing and research facilities in 14 states with over 22 employees across the United States.

Our US headquarters is in King of Prussia, Pennsylvania, and our parent company is headquartered in Europe with operations throughout the world.

Here in the United States, we routinely use rail carriers to move both raw materials and finished products, and as such, a strong, competitive rail industry is vital to the success of our overall business operations.

We also feel rail transportation is the safest and most secure method of transporting our materials and products. Thus, we wholeheartedly welcome this effort which will hopefully strengthen the rail system for both the railroads and shipping community.

By thoroughly examining this critical area and acting on items that are discussed, the Board can ensure that the rail transportation sector is open, fair, and competitive.

I plan to focus my comments today on Arkema's experience regarding competition in the rail industry and the effects of global competition as it relates to the transportation costs, and also, to discuss some key issues and recommendations for ways to improve the competitive balance in the rail transportation area.

First and foremost, our ability to have competitive rail service at our facilities significantly affects the costs of our products and materials, both in terms of transporting raw materials and process the manufactured products.

Without competitive service, we invariably have higher transportation costs, which directly affects our bottom line, and often results in higher material and product costs, which in turn, affects our ability to compete domestically and globally, and it also affects our ability to expand and grow our business and hire more employees.

In the end, the issues surrounding rail competition and rail access are about jobs and economic costs. In these uncertain economic times, anything that can be done to make US manufacturing more competitive is critical.

Ensuring that companies like Arkema have access to competitive rail and transportation services will help to keep our business and our industry healthy, competitive, and growing.

Currently, over 50 percent of Arkema's finished product volume is shipped via rail. Indeed, without reliable, efficient, and safe access to the rail network, key operations at some of our most important facilities would be seriously jeopardized.

In many cases, the rail access at these facilities is often limited to only one rail carrier. And as you might imagine, with limited transportation options at hand, we have found that our rail transportation costs have increased greatly over the last decade.

Unfortunately, as the rail shipping costs have risen, we have had to either absorb these costs internally or increase our prices to pay for the increased shipping cost. Neither option is good, but this has become our reality in recent years.

With regard to railroad profits, although we are certainly not opposed to industry's making a profit, we are concerned when certain practices have a significant and negative impact on other industries or markets.

For many of our products and materials, we are often unable to pass along the increased shipping cost because competitive forces have driven the individual product prices down.

Thus, we are faced with having to sell our products and materials at a lower price while simultaneously having to absorb increasing shipping costs.

As we evaluate our rail transportation options that are available to us today, we find that we have significantly fewer options than there were 25 years ago. This means fewer competitive-based checks and balances and therefore, higher shipping costs.

Fewer rail options means less competition. Less competition brings higher rates and fewer service options. As noted, higher rail freight costs affects our ability to be competitive, and it affects our ability to expand and grow our businesses and add jobs.

But perhaps most compelling in how captive many of our facilities have become to only one rail carrier, at present, we have true competition, competitive service at both ends of the rail shipment, for only one percent of our shipping lanes.

Further, a full 71 percent of our lanes are captive at both ends of the shipment, and 28 percent of our lanes have competition at only one end.

When the rates for shipments to and from our captive facilities are compared to the shipping rates to and from facilities that have competitive shipping options, we find that the rates for our captive facilities are significantly higher than those at non-captive facilities. In one case, we have seen rates increase as much as 150 percent just in the last five years.

These rates far outpace normal inflationary costs and railroad industry costs. This directly affects our operations, sales, and our ability to invest in our manufacturing infrastructure.

It is also important to consider

our current business situation in the context of the global competitive environment. We must compete not only domestically, but also with companies located in Asia, Europe, and elsewhere.

Unfortunately, we are finding that in many cases, our global competitors have lower transportation costs than we do, despite the fact that they are shipping their materials or products from thousands of miles away.

They can do this because they can ship directly to a port that may be closer to the end user, or to a port that enjoys greater competitive rail service than we have.

Additionally, many global manufacturers examine a myriad of issues when citing new facilities. Transportation costs are a critical component of any such calculus. The competitiveness of American industry is predicated upon an economical transportation and intermodal environment.

The huge advantage the US has over developing nations is that its rail infrastructure network is in place and accessible to all, allowing certain pricing practices to destroy that competitive advantage has to be avoided in the global environment for goods, services and capital.

Therefore, we believe the effects of these international shipping issues, and their impact on competition and shipping rates, should be examined as part of the process as they are increasingly key components of our overall competitiveness.

I would now like to discuss a few key issues and some recommendations regarding improving the competitive balance in the rail industry that we offer for your consideration.

First, let me note, one, our general support of the joint comments that have been submitted by the American Chemistry Council, the Chlorine Institute, CURE, and other interested organizations.

We believe one of the key elements of these joint comments is the discussion on the Board's considerable authority and discretion to take action to support rail competition. And we hope the Board will use this proceeding as a catalyst for improving the competitive balance in the rail transportation agreement.

One issue is the area of reciprocal switching agreements, where we support actions that would allow for increased use of such agreements. These types of agreements have the potential to reduce costs and increase service options for all parties.

One suggestion the Board might consider is developing a pilot program in one or more selected geographical areas that would allow for increased use of reciprocal switching agreements that could be negotiated by all parties.

The lessons learned from such a pilot then could be applied to other parts of the system.

We also support strengthening the ability to use so-called Rule 11 rates where each carrier is given through route quotes a separate rate for their segment rather than one carrier quoting a through rate.

It has been our experience that using Rule 11 procedures has benefitted from this process. This is particularly the case with respect to toxic by inhalation hazard products.

However, it has also been our experience that Rule 11 process has not been available for our non-TIH shipments. In fact, in some cases, a request for such pricing to apply has been denied by some carriers.

Therefore, we would support a review of Rule 11 procedures with the aim of ensuring consistency in the application across the various types of shipments.

Lastly -- if I can have one -- we believe it is also relevant to any review of competition in the rail industry to examine the current process for bringing a rate case.

A key part of the current system of checks and balances in the rail competition is the ability or non-ability of the shipper to bring a rate case before the Board for their consideration.

One factor in deciding whether or not to bring a case is cost. In most cases, the cost remains prohibitively high because of the complicated process and procedures that are required.

Thus, we would also welcome any action that might simplify and streamline the current rate case process.

Again, Arkema greatly appreciates the opportunity to provide our views on competition, and appreciate the Board's looking at this procedure.

Thank you.

MR. BAKER: Good morning. My name is Jeff Baker, and I'm responsible for Dow's rail purchases. And I've replaced Brad Gray today, due to illness.

So, Chairman, Vice Chairman, and Commissioner, thank you for the opportunity to allow Dow Chemical to provide our perspective on this issue.

Dow operates a large fleet of approximately 23,000 rail cars, so we have a significant investment in rail. These cars carry over 110,000 rail shipments each year for multiple North American production facilities.

Our large facilities are captive to a single railroad. That's over 58 percent of our original rail shipments. And then 80 percent of all of our destination rail shipments are also captive to a single railroad.

Less than 25 percent of Dow's total annual US rail shipments are served by more than one railroad.

You've already heard about the

impact carrier consolidation has had on competition. I'd like to focus on several points made by the railroads yesterday, in light of Dow's experience since 2004.

You heard -- you have heard it said that it's not about competition, it's about rates. But is competition precisely about rates, safety and service?

Dow has experienced dramatic increase in our rates for our captive facilities. While the average annual distance and the average tons for Dow's rail transportation since 2004 has been relatively constant, the increases have been greater than 45 percent over that six-year period.

Also, without effective competition, Dow has been unable to negotiate any service-level agreements with the railroads.

The rail rate increases experienced by Dow have been based on business practices which have shown typical monopoly pricing behavior. Contrary to what was said yesterday, we're not claiming that increase in rates is evidence of monopolistic behavior, but it's the way in which the price increases are imposed that make them unfair or unreasonable.

Taking advantage of the fact that a shipper is captive, railroads have used numerous methods to increase rates. This includes a take it or leave it attitude, a refusal to enter into long-term contracts, sometimes even insisting on a 30-day cancellation provision in contracts, fuel surcharges that are not based on any changes in fuel costs, large increases in rail car storage, and increases in track lease charges.

Also, railroads' rates continued to go up even when demand went down. All other modes of transportation at Dow reduced their rates.

In response to these facts, the railroads have made two arguments. First, there are the forms of competition, mainly truck, and the second, the current STB regulatory system, provides an adequate remedy to shippers in the face of unreasonable rates.

Taking these in order, in most cases, the use of trucks is not a viable alternative for Dow or many of its customers. Dow and its customers have built their production facilities around rail transportation. Rail cars reduce the need for permanent storage facilities, which are very costly.

In addition, the volume of commodities that Dow ships creates unique challenges for trucks. Using trucks would result in increased traffic and congestion, increase handling costs, and safety concerns.

The efficiency and safety of rail transportation, especially on the average long distance that Dow ships, which is greater than 1,000 miles, makes trucks not competitive.

As to the adequacy of existing STP

regulatory procedures, as has been pointed out, it's extremely expensive and complicated to file a rate case, especially large rate cases. In addition to the fees for lawyers and experts, the preparation and prosecution of a rate case takes an enormous amount of time and company resources.

These resources would be spent -- provide -- better spent providing goods and services to our customers.

On top of these rate case costs, there's enormous penalty that a company pays for simply bringing a rate case, starting with contract rates that a shipper finds unreasonable.   The alternative, then, is to pay significantly higher tariff rates during the rate case.

The railroads know this is a big disincentive to filing a rate case. The recent increases in rate cases is not due to the recognition that it's an effective remedy. The rates imposed by the railroads have become so unreasonable that the companies see no choice but to incur the costs and risks of a rate case.

So what to do? Dow believes that enhancing rail competition will support the growth of US manufacturing. This can be done by making rail competition more available at origin destinations through reciprocal switching and allowing bottleneck rates.

The success of these measures of course depends upon the reasonableness of switching and bottleneck rates.

In conclusion, Dow has experienced dramatic reduction in US rail competition. This has resulted in significant rate increases, cost shifting, and rail franchise protectionism.

Dow, American companies, and American workers need better access to rail competition.

Thank you for your time.

CHAIRMAN ELLIOTT: Thank you, Mr.

Baker.

We'll now hear from Mr. Smith from E.I. DuPont de Nemours and Company.

MR. SMITH: DuPont is fine.

(Laughter.)

CHAIRMAN ELLIOTT: I appreciate that.

MR. SMITH: Chairman Elliot, Vice Chairman Begeman, and Commissioner Mulvey, good morning.

My name is Keith Smith. I'm the Chief Procurement Officer and Vice President of the sourcing and logistics for DuPont. Thank you for your time to share DuPont's experiences on the current state of rail competition and also to advocate for some policy changes.

America's freight railroads have been vital to DuPont since 1858. Last year alone, we shipped and received over 24,000 rail cars of 100 different commodities.

Therefore, despite the rail

industry's attempt to portray DuPont and other interested shippers as self-interested parties with short-term perspective, DuPont, in this fact, has very strong interest in the long-term success of the American rail industry, because our success depends on a healthy and vibrant rail transportation system.

DuPont, however, does not believe that a healthy and vibrant rail system continues to require regulatory protection from competition, if it ever indeed did.

As the industry has matured and overcome its former financial difficulties, it no longer requires the same degree of regulatory protection, had it been justified based on the facts that have significantly changed over the last decade.

The fundamental question that the Board should be asking in these proceedings is, why are the railroads afraid to compete with one another?

The rail industry has presented --

you know, we're confused. The rail industry has presented two inherently contradictory messages to the Board in this proceeding. On the one hand, they claim that there's no need for the Board to change its competition policies, and that they already are subject to extensive competition from non-in-kind modes of transportation such as trucking.

On the other hand, they claim that enhancing in-kind rail-to-rail competition would reverse their financial progress since the Staggers Act by reducing rail rights.

If trucks have introduced true competition, how can enhanced rail competition have such a dramatic impact upon rail rates? The industry cannot have it both ways.

Furthermore, the rail industry creates a false choice between differential pricing and competition. Differential pricing exists in many competitive industries, such as our own competitive industry with many, many competitors.

It's ludicrous to suggest that competition between just two railroads in the East and two railroads in the West will render both railroads unprofitable. Each railroad should have sufficient knowledge and discipline to know how to price their traffic and remain profitable.

Following the major rail consolidations that ended a decade ago, DuPont has witnessed significant changes in the competitive landscape for rail transportation.

A couple of these changes are, one, railroad mergers have resulted in greater portion of production capacity for many industries that rely on point-to-point shipping to become captive to just one railroad. This has substantially reduced geographic competition.

Consequently, a single railroad that serves a majority of the production points and delivery points for a commodity can establish price and service terms without fear of losing that business to another railroad.

Secondly, as more production capacity has become concentrated in just a few railroads, more traffic is subject to the exercise of bottleneck pricing to ensure that the bottleneck railroad's single-line movement prevails over a joint line movement.

With these two competitive changes,
DuPont has also witnessed railroad behavior that is inconsistent with a competitive marketplace. These behaviors include take it or leave it contract proposals.

Rather than negotiating based on a partnering of the railroads with DuPont to grow our respective businesses, we have seen rates dramatically increase with no benefits or service enhancements that increase downstream customer value and increase the American industry's competitiveness.

For example, we looked at price and transit times for several of our highestvolume lanes. Since 2003, the average rate has gone up 100 percent, and the average transit time has gone up 17 percent.

Competition drives innovation. That results in either lower costs and/or higher value. We see neither one here.

I've run many different businesses in the DuPont company over the last 31 years in very competitive industries. We have to innovate, and we've been successful in lowering the cost for our customers and improving service at the same time. We see neither in these cases here.

Secondly, contract negotiations based on revenue demands for DuPont's full book of business, rather than market-based determinants, in those rare occasions where a railroad has to -- has competition and does have to react to a competitive offer, they simply take that reduction in revenue and move it to a place where there's not competition. So the total revenue coming from DuPont remains the same.

Thirdly, dissociation of contract terms and conditions from rates. In typical negotiations in most industries, there's trade-offs between price and terms. In our contracts here in this industry, we see -- we rarely see that.

Finally, we get fuel surcharges that are not linked to changes in actual fuel costs.

Reduction in rail competition has been detrimental to DuPont's ability to compete against foreign imports. Our foreign competitors can choose strategically where they enter the country and thus where their imports enter the US rail system in order to generate rail competition.

In contrast, DuPont's domestic production that is accessible by rail, 40 of our sites, 80 percent are captive -- or 32 -- to a single railroad, 80 percent of our sites.

As domestic facilities age or

reach capacity, companies like DuPont must decide whether to upgrade their plants or expand their capacity in this country. Just as railroads must justify their infrastructure investment decisions in order to attract capital, so must their customers.

Several railroads witnessed in this proceeding have questioned whether transportation costs in the chemical industry are truly significant enough to drive investment decisions. One of our largest movement of chemicals in the United States has its transportation costs 25 percent of the revenue, not only the cost, but 25 percent of the revenue.

Even when the percentage is smaller, the combination of the transportation cost plus one other factor can significantly hurt business competitiveness, both for DuPont and our downstream customers, and change our investment decisions.

The chemical industry generates

the type of high-skilled and high-paying jobs that this country needs. This country and American workers cannot afford to have railroads drive off DuPont and the chemical industry by stubbornly refusing to compete. This lack of competition is an insidious drag on the American economy.

Today's rail rates are less competitive than they were upon the passage of the Staggers Act. DuPont strongly believes that the reduction in rail competition over the last decade warrants changes in the Board's policy toward enhanced rail competition. The Board has the tools to enhance rail competition, and we humbly believe that now is the time to act.

One of these tools is reciprocal switching. DuPont asks the Board to make reciprocal switching more widely available at reasonable rate levels in order to create competition for captive shippers located in terminal areas that are served by two or more railroads.

Secondly, another tool is de-bottleneck rates. DuPont asks the Board to require railroads to quote de-bottleneck rates.

De-bottleneck rates merely permit shippers to tap into the rail competition that already exists by preventing a bottleneck carrier from using its control over a short-term bottleneck segment to extend its monopoly to the entire through movement.

If necessary to obtain reasonable rates over the bottleneck segment, the shipper can challenge just the bottleneck rate. That would significantly reduce the complexity of rate cases like the one we currently have before the Board between DuPont and Norfolk Southern.

The rail industry protests that the Board should reject these two competitive measures, and instead, continue to rely upon regulation to address the lack of competition.

DuPont is well-versed in these regulatory remedies and is currently pursuing its fifth rate case in as many years.

This process, which is cumbersome, expensive, time-consuming, is not how the American business should have to expend its resources. We'd much rather rely on true rail competition and competitive negotiations with rail carriers.

In a country where our economy is based on free markets and competition, it's ludicrous that we are even engaged in a debate over the merits of competition in the rail industry.

Enhancing rail competition, in conclusion, will have a positive effect on the competition with the industry and customer benefits. As a result of the railroad market power, parts of American industry are disadvantaged not just today, but in the future.

Industries such as bio-fuels will

depend on a competitive and efficient rail system. Without competition, competitive rail rates, and service, the development of such industries in the United States could be delayed to our long-term economic detriment.

Accordingly, greater competition ix needed in the US to ensure DuPont and other US manufacturers and the American consumers are not unfairly shouldering excessive rail rates to the benefits of our national railroads.

Thank you for your time.

CHAIRMAN ELLIOTT: Thank you, Mr. Smith. We'll now hear from Ms. Burns, from Occidental Chemical Corporation.

MS. BURNS: Okay. My name is Robin Burns. I'm the Vice President of Supply Chain for Occidental Chemical.

OxyChem is the leading North American manufacturer of basic chemicals and vinyl resins, including chlorine, caustic soda, and polyvinyl chloride, the building blocks for a range of products.

The chemicals we manufacture are used in water purification, medical supplies, pharmaceuticals, construction materials, and agricultural chemicals. Our products are vital to the economy of the United States. They are manufactured at 21 domestic locations, employing 3,000 people across the central to eastern United States.

In 2010, we shipped 63,000 loaded rail cars, and incurred more than $220 million in rail freight charges. In the five years between 2005 and 2010, which included a sustained period of general economic recession, OxyChem rail rates increased from 30 percent to 160 percent on average.

During this same time, rail costs as reflected in the fourth quarter RCAF's unadjusted and adjusted increased 19 percent and 11 percent respectively. However, in the last two years, from 2008 to 2010, the RCAFU and RCAFA decreased by eight percent and ten percent respectively.

We believe the rail rates increases imposed on OxyChem are directly related to the market dominance of the railroads. Over 70 percent of our origin-destination pairs are served by only one railroad, and many of our products can only be served by rail.

This lack of options effectively provides the railroads with monopoly pricing power.

As a shipper of chlorine, we are well aware of the concerns related to the shipment of TIH materials. However, let me be clear. My comments today have nothing to do with TIH materials. My comments and real-life examples are taken from the greater than 90 percent of our non-TIH moves, including shipments of KOH, caustic soda, PVC plastic pellets, silicates and calcium chloride.

Rail competition effects every single shipper, regardless of commodity. I'd like to take a few minutes to discuss how rail industry rules, agreements, and protocols limit competitive options and illustrate the impact on our business.

Railroad restrictions take many forms, including paper barriers, routing protocols, bottleneck rates, and access pricing. Although the Board has asked for input regarding several areas, I would like to focus on those areas that are particularly problematic for OxyChem.

OxyChem is interested in pursuing an opportunity in Scranton, Pennsylvania. The customer has two locations in Scranton, one served by the DL railroad and the other by the RBMN railroad. Both short-lines interchange with the NS and CP railroads, so multiple routes should be possible.

However, a paper barrier, a true paper barrier, prevents the RBMN from receiving freight from the CP unless the CP originates the freight. Our freight originates in Texas, not served by the CP, meaning the only bridge carrier allowed to interchange to the RPBM is the NS.

This restriction is significant to our business. The door-to-door rates using the CP bridge route to the open DL locations are nearly 19 percent less expensive than the NS bridge route.

It's reasonable to conclude that the paper barrier increases our costs by at least 19 percent. This restriction on competition adds more than $1,800 to the cost of each and every rail car we ship to the closed destination.

As another example of paper barriers, we wanted to consider all routes for 800 rail car per year move of calcium chloride between Ludington, Michigan, and Opelousas, Louisiana.

We sought rates using both the UP and BNSF as a bridge carrier to the AKDN. Although a BNSF route option should be possible, we were told that a paper barrier existed and restricted service to UP routes, and we were unable to get the AKDN to provide rates from their BNSF interchange.

With the help of the STB's Rail Office of Public Assistance, we confirmed that, in fact, no paper barrier exists, and we compelled the AKDN to finally provide their numbers for the BNSF route.

This example illustrates how poorly paper barriers are understood and applied, even by the largest US railroads, and how this lack of transparency can further limit competition.

In requesting this hearing, the STB not only asks for competitive issues, but also for solutions. Shippers benefit from the continuation of rail service to areas that Class 1 railroads might not otherwise support. It's not in the public interest to eliminate all paper barriers, as these can facilitate the start-up of small rail companies that otherwise might not be able to compete.

However, an outright ban on route options is unnecessarily restrictive. Paper barriers need to be reasonable. They should not guarantee the full merge into a railroad that has chosen to divest of their tracks and operations in an area. They should not be evergreen, as the justification for a barrier is probably no longer valid 10 or 20 years after a track sale.

Shippers and even carriers are confused on whether paper barriers are in place. They should be made publicly available to shippers.

A listing of which barriers are in place and for what duration of time would make these arrangements more transparent and prevent short lines from arbitrarily declining to quote competitive business.

Routing protocols also limit our transportation options. While we understand and support the railroads' need for efficient operations, protocol objectives don't always promote the most efficient route.

For example, protocol dictates that shipments between UP-served southern Louisiana and New Jersey CSX and NS-served destinations be interchanged in Salem, Illinois.

Without this protocol restriction, the freight could route via New Orleans, eliminating 484 unnecessary miles from the transit. Additional miles add cost, wear and tear to our rail cars, and inflate our fuel surcharges.

The increase in fuel alone is approximately $200 per car per trip. UP claims that routing even a minor additional amount of additional traffic over New Orleans will cause the system to break down in a matter of days. They also acknowledge that it is the single worst congestion point in the UP system.

However, by detouring traffic and

not dealing with underlying capacity and operating issues, we are using a band-aid to treat a decades old problem.

This is not in the best interest of shippers or the economy, but there are solutions. Years ago, congestion in Chicago was the cause of similar delays. Since then, Class 1's Belt Railroads and shippers have worked to mitigate issues, and today, Chicago interchanges are much more efficient for shippers and carriers alike.

In the Chicago example, some freight was diverted to other gateways, but this was done in a way that didn't significantly detour the freight.

The New Orleans situation is different in that the prescribed solution through Salem adds hundreds of miles to some of our loads. We would like to see open dialogue regarding these and similar issues. Historically, we have been told there is a routing protocol, and that's where the dialogue ends.

We recognize there are challenges, but without working together through open, transparent dialogue, nothing will change.

Although more shippers have taken advantage of the revised rate case guidelines, railroads continue to make it difficult for shippers to benefit from them.

For example, most railroads will only offer contract rates as a bundled package, eliminating the option of shipping a few high-cost, high-volume lanes under tariff rates to allow the option of requesting STB review.

Effectively, the railroads use the threat of much higher tariff rates on our many small-volume lanes to prevent us from filing a small or any rate case.

In 2008, OxyChem contacted the Board's informal rail customer and public assistance program, and were told, quote, "unfortunately, the railroads can and frequently do bundle rates in contract rate proposals. They are required to provide a tariff rate to a shipper upon request, but the decision to offer contract rates is the railroad's alone."

Quite frankly, this is the reason that many shippers have not been able to seek relief from the Board. Shippers cannot afford to pay tariff rates on all lanes while a rate case is tried.

In closing, I want to again illustrate how our shipping costs effect our business. Recently, we shut down several OxyChem plants. These decisions were partly due to our rapidly escalating rail freight rate.

We made these difficult decisions after much deliberation, and after weighing all options. We know from personal experience that the unrestrained escalation in rail rates impacts our ability to compete.

CSX, in their comments, claimed

that rail rates constitute less than 3 percent of the delivered price of ammonium phosphates.

A recent analysis of OxyChem's freight rates show that rail freight accounts for 10 to 15 percent of the delivered price of our products, and up to 25 percent of our manufacturing costs.

For OxyChem, rail freight rates are material and directly impact our ability to compete nationally and globally.

We are grateful for the opportunity to comment on competition in the rail industry. It's time for the Board to revisit these items. Times have changed. Today, we have an unbalanced playing field.

Anti-competitive behavior and artificial barriers limit our choices and compound the inequities. We are hopeful that the specific examples cited by OxyChem will help the Board understand the current state, and find reason to move to a more balanced future state.

CHAIRMAN ELLIOTT: Thank you, Ms. Burns.

We'll now hear from Mr. McIntosh from Olin Corporation.

MR. McINTOSH: Good morning. Thank you. Mr. Chairman, Madam Vice Chairman, Commissioner, we're pleased to be here today on behalf of Olin to comment on the issues that are in this docket relating to competition.

I've been a corporate officer at Olin for 12 years and have been in the industry for many more years than that. And our view of competition in the rail industry is very simple. For a captive shipper, there is no competition in the rail industry.

Because of that, for a captive shipper, we are faced every day and at every renewal of contract or discussion with the railroads with rates that exceed what would be reasonable for the railroads to earn a reasonable profit.

In addition to the excessive rates, captive shippers are subject to onerous terms and conditions, and we recently have experience with an indemnity obligation and a tariff that we would be subject to that would essentially force us to be an insurer of the railroads against the negligence of potential third parties.

We appreciate the Board's effort to address these issues today and hope that as a result of all the facts that you uncover that there will be some changes so that competition can be returned to a very important part of our business.

Our company is headquartered in Clayton, Missouri. I'm testifying today on behalf of our Chlor Alkali products division, which has plants stretched across the continental US, including a site in Canada. And as a result of that, we deal with predominantly and many of the Class 1 railroads.

We've been involved in the US chlor alkali industry for over 100 years, and were one of the first commercial suppliers of chlorine in the United States. We're a publicly traded company, been listed on the stock exchange since 1917, and it's our intent to continue to grow and service the public for another 100 years.

As a producer of chlorine, we produce an essential chemical, and a chemical essential to everyday life. And Robin mentioned some of the uses.

I would say that in summary, for the majority of the applications for chlorine that we serve in our customer portfolio, there are no reasonable substitutes for the product that we make and produce and transport to them.

Chlorine products and their derivatives have a substantial impact on the US economy. This is an industry of consequence contributing more than $46 billion per year. We contribute many billions of dollars directly to the US economy, directly as the industry itself.

Chlorine is vital to our security. It's been deemed an essential asset to critical infrastructure. It's used in materials that are significant and part of the defense establishment, including such things as bulletproof vests, helmets, parachutes, etcetera. It is essential to our nation's health, to our nation's economy, and to our nation's security.

For Olin, the importance of rail transportation can be measured by the fact that we've been in the transportation of chemicals for more than a hundred years. We ship each year more chlorine by rail, we believe, than any other producer in the world. The importance of reasonable transportation rates for that commodity and all of the other commodities that we ship cannot be overstated.

Due to the nature of the chemicals

we ship and the volume of the chemicals that are part of our portfolio, there is no reasonable economic alternative to shipping by rail.

Rail transportation is critical to the safe shipment of our chemicals, particularly chlorine, as it keeps large volumes of these chemicals off the nation's highways for what in our system are mostly long-distance routes that cannot be economically served by any other mode besides rail.

Rail executives have indicated that this is a TIH issue, or this is an issue associated with the kinds of chemicals that we're transporting. We disagree strongly.

And consistent with Robin's comments, we find that the issues with rail competitiveness, for our business, are not commodity-specific, but apply to every commodity that we ship, and cannot then accept the railroads' position.

And even if we accepted it, it's our belief that Class 1 railroads shouldn't really be allowed to decide which industries in the United States should succeed and which shouldn't.

Because there's no reasonable alternative to shipping our products by rail, rail rates are a critical concern to us. An increase in rail rates has a direct effect on the prices that our customers pay for not only our products, but for downstream goods that are made with the products we produce through other manufacturers.

In some instances, we have manufacturers with supply contracts that set prices, and the cost of unreasonably high rate -- rail rates are directly born by the manufacturer.

Obviously, manufacturers such as Olin can take steps to protect itself from risks, and we do that every day in terms of buying insurance for natural disasters and other events like that. But there is no means to ensure ourselves from unreasonably high rail rates that a captive shipper is subject to today.

Our facilities, every one of our facilities, 100 percent, are accessible only by a single railroad, so we are truly the poster child for the impact of a totally captive company to the rail industry.

Because of that lack of competition, we are subject to whatever rates, terms, or conditions the monopoly railroad chooses to impose on us at our locations.

In our written submission in Exhibit A, we documented what we thought was a series of events associated with our experience in moving chlorine from our plant in Alabama to a customer location in Texas.

The entity, Sunbelt, is the producing location, and we feel it describes and is a perfect example of how the lack of competition has skewed the reasonableness of the entire process, and penalizes a captive shipper such as Sunbelt in this case.

The numbers are, we believe, compelling, not more than -- or less than 15 years ago, the initial rate of movement of this commodity over this route was less than $1,500 a car. Today, the tariff rate for that same movement is almost $12,000 a car, an increase of over 800 percent from the original rate, the greatest rate increase we have really seen since 2002. And during that period of time, the line haul rate for this specific route has gone up 600 percent.

Further, as we documented, there has -- we have been systematically denied, when small windows of opportunity were created by other actions, either as a result of STB rulings, or other actions in the rail industry, we've been systematically denied the ability to compete by using different routing protocols or a possibility of Rule 11-type shipments.

We believe the dramatic increase in rates is clearly the result of the current regulatory scheme, and there is nothing that is based on preventing captive shippers such as Olin from being subject to this, you know, rate abuse and the unrealistic burdens that we face every day.

There are tools available to us, and we understand those tools, but we consider that those tools do not adequately address our concerns.

There have been comments made about the fact that some of the tools create a long period of time between the filing of a rate case, as an example, with the findings. There are cases where the cost is estimated to be very high. For our Sunbelt rate, it's estimated to be more than $12 million to prosecute that.

We believe that our experience in Sunbelt provides a pointed illustration in the way that captive shippers are treated, and there is really no current adequate avenue of relief.

We're not the only shipper that's captive, and others have testified as to the similar situations that they find themselves in.

We have commented in our submissions that we believe a rate variable cost ceiling may be the simplest solution to the unreasonable rate request imposed on captive shippers. We still believe that to be the case, and we noticed in commentary by the Department of Agriculture that they had a corresponding sense of that as a potential remedy for this situation.

We also believe that there's one key message that really summarizes the situation we're in. There have been comments by the AAR characterizing that these hearings were not necessary, that it was a whack the pinata event where chemical shippers were really just looking for a windfall and a reduction of chemical rates.

I consider that to be, nothing could be any further from the truth than that. What we're talking about, for a captive shipper, a company like mine, is survival.

We cannot, in the business model we have, continue to survive the rate increases that we have seen over recent history. And for us, it is a matter of survival.

We thank the Board for initiating this proceeding and hearing the comments from all the interested parties.

CHAIRMAN ELLIOTT: Thank you, Mr. McIntosh.

We'll now hear from Mr. McGarry from PPG industries.

MR. McGARRY: Thank you, Chairman Elliot, Vice Chairman Begeman, and Commissioner Mulvey.

Michael McGarry, Senior Vice President for PPG. And we appreciate the opportunity to testify, as well as to supplement the testimony you've already heard from Senators Rockefeller and Vitter.

PPG was founded in 1883, so when you talk long-term, we're one of six companies that has been paying dividends for more than 100 years. We're a global manufacturer of chemicals, protective coating, glass, and fiberglass, with over 14,000 employees in the United States and 60 countries with sales exceeding $13 billion.

Like John and others at this table, we're also one of the largest manufacturers of chlorine, a commodity classified as TIH. In our facilities, we have four, as well as two other facilities that receive chlorine by rail.

And as you know, chlorine is almost exclusively transported by rail. It's the safest overland shipment method. We do not ship chlorine by truck. Although we can ship chlorine to a limited extent by barge, it's less than 1 percent of all volume in the US, and less than 1/10th of 100 percent of all customers in the US can receive it by barge. Thus, our company is highly dependent upon the rail transportation system.

At our captive facilities, PPG has experienced skyrocketing rates. The cost of shipped chlorine from our Natrium, West Virginia plant is 85 percent, 85 percent higher, than Lake Charles, where we have three railroads.

The railroads have openly communicated their desire not to haul our chlorine. Ironically, they would not be able to be in business without chlorine chemistry, which I continue to remind them of that. The lack of desire to haul chlorine has caused the railroad to price this traffic at many times higher than our non-TIH traffic.

We've seen our overall costs to ship increase by more than 100 percent in six years, which I think we can all agree is slightly higher than inflation. And recently, PPG has had to forgo a business opportunity in our Natrium plant where the cost to ship was higher than the product's selling price.

In effect, the railroads are trying to dictate to whom we can sell chlorine to and which chlorine producer wins the business. This is totally unacceptable.

Unreasonable rail rates should not dictate business opportunities. The shipper should be able to choose which business to pursue or forgo, not the railroads.

Even where PPG has competition at the origin, we are still forced to pay inflated rail rates. For example, at La Porte Texas, where we ship out of Lake Charles' three railroads and Lake Charles, captive at La Porte, we pay 50 percent higher costs on the chlorine that goes to Houston, exact same routes, exact same distances. So we're definitely being hindered.

As a captive rail shipper, we also

have little chance to control or prevent the cumulative effect of raising rail rates. While the railroads argue that the chemical companies are adequately protected by the current regulatory system because they can file a rate case with the STB, let me assure you that we do not agree that lengthy, uncertain, and expensive litigation is the proper solution.

For a large rate case, we've estimated that the litigation costs and tariff premiums that we would have to pay would be upwards of $20 million, which prevents many companies from filing a rate case.

In addition, the artificially high tariff rates published by the railroads don't offer a lot of benefit even for small and medium rate cases, so the effect of the relief would be minimal.

And thus, PPG supports a regulatory system that would allow it access competitive rail service, for our transportation rates to be established by working in a competitive market environment.

As many speakers before me have said, the contract rates and terms are rarely negotiated with railroads. Rather, they are dictated to the customer. This is especially true for TIH traffic.

The normal checks and balances established by the laws of supply and demand do not apply to the railroads. PPG believes that our ability to compete effectively in the chemical industry is being hamstrung by a lack of competitive rail service.

We are currently investigating a significant opportunity in our Natrium, West Virginia plant, with the Marcellus Shale opportunities, where there's an opportunity for a billion dollar chemical plant, and it's being delayed by competitive rail access.

We believe the Board should resoundedly change its policies to facilitate greater competition. We believe that increase in access to more than one rail carrier at our captive facilities would help address this problem.

And our company believes the Board should open one or more proceedings immediately after this hearing to modify its policies, specifically, one, expanding reciprocal switching agreements; two, a reversal of the Board's current bottleneck rule; three, a mechanism to put in place to cap the RVC ratio on TIH products to avoid the expensive and time-consuming rate cases.

According to the historical AAR statistics, TIH products are only .25 percent of shipment, but .5 percent of revenue, so the railroads would not be materially harmed by this offer.

And fourth, although the railroads are required to quote tariff rates for an OD pair, the railroads' use of their market power and leverage to only provide all-tariff or all-contract rates do negatively affect shippers' ability to file a rate case.

Therefore, we would offer and advocate a simplification of changes to the Board's large rate case procedures that would reduce the timing and the complexity and cost associated with that.

And finally, I appreciate your time. And obviously, we're open for questions.

CHAIRMAN ELLIOTT: Thank you, Mr. McGarry.

Thank you, panel, for all your comments.

Commissioner?

COMMISSIONER MULVEY: Thank you. These estimates as to the cost of bringing a complaint before the Board or a case before the Board are very different from what we usually quoted. We usually hear it costs between $3 million and $4 million to bring a case before the Board, and we estimate the time it takes.

And we have made some efforts to simplify our large rate case procedures, where we have tried to lower the cost and reduce the time to make our processes more available.

But these estimates of $12 million and $20 million are truly alarming to me, because that suggest that our processes are not available. And I know we have our Office of Consumer Affairs, and I'm glad to hear that some of you have taken advantage of that and been successful. But I was wondering if it is possible for you to explain to us why you think that the costs are so high. You do not necessarily need to do it here, but provide some documentation as to why you believe it costs so much and why the estimates are so out of line with what we've experienced in the course of bringing the large coal rate cases brought by the utilities? Could you gentlemen do that, PPG and Olin?

MR. McINTOSH: We'd be happy to.

COMMISSIONER MULVEY: Thank you,

because that is disturbing.

I mean, there's a lot of pressure on the Board to make its procedures, its processes more open to shippers, and when we hear that we're becoming -- according to you and according to these numbers, less open rather than more open. That is, in fact, truly disturbing.

MR. McGARRY: If I could tell you, the biggest reason why is you have to go from a contract rate to a tariff rate, so your rate goes up an exponential amount. And you have to pay that tariff rate until such time as the Board --

COMMISSIONER MULVEY: But you get reparations on the tariff rate, then, don't you?

MR. McGARRY: We have some, but typically, they won't quote you just a tariff rate.

COMMISSIONER MULVEY: Okay. Olin again, too, Olin proposed in its testimony that the Board revisit its merge decisions and impose new conditions on the mergers.

And although the Board has the authority to issue supplemental orders in merger cases, what you suggest would actually be making major changes to access and piggybacking them on the mergers that were approved long ago.

What would be the most straightforward way to address competition issues today? It's very, very difficult to unscramble the eggs, as you might say.

MR. McINTOSH: It would be nice if I could sit here and tell you that we believed that the answer to -- for a captive shipper like Olin, was just to change some of the Board's policies to create competition.

In our industry, that works, because as I sit here at the table with other companies that I compete with day in and day out, competition works. Competition does provide better services and lower prices to the customers we serve.

Our Amendment -- or appendix to our original filing, though, talked about the Sunbelt situation in a manner in which quite honestly, there is the potential for competition in that move now.

And the railroads will not step forward and avail themselves of the opportunity to compete for a multi-million dollar lanes of potential revenue. We don't understand that.

So the changing of policies to create competition, while that may work for some industries, it may not work for the rail industry in this situation, because I'm facing a real-life case where Class 1 railroads are refusing to quote on business that they have an opportunity to attempt to quote on and compete with with other Class 1 railroads.

So, for us, I believe that in order to get a remedy that works for a captive rail shipper, that it's going to take not only things which create competition but it's going to create incentives such as the revenue cap -- revenue over variable cost cap that we have advocated in our testimony and that Professor Pittman has advocated in some work he's done for the Department of Justice in his study of these issues.

It's going to create things like that as well, and quite honestly, from our perspective as a captive shipper, that may be the easiest place to start.

COMMISSIONER MULVEY: Putting caps on rates is something that would be a real departure from -- I mean, 180 rail -- revenue variable cost is a rate which decides whether or not we should bring a case when it is not really a cap.

And so I think there's always some concern about what economists would call effectively crass regulation, but at any rate, it is a suggestion.

You also notice the size and the

importance of the chlorine industry. We had the Chlorine Institute here yesterday, and they gave a very good testimony.

And you point out that the revenues or the economic impact, rather, of chlorine on the economy is $43 million a year. I find that interesting that that's approximately the revenues of all the Class 1 railroads together.

So it's an important commodity, and it's an important industry, and I would think it's important for the railroads to continue to move it. But the railroads, as you know, are concerned about the potential liability, should there be a TIH spill.

We had a serious one, for example, a while back, in Graniteville, South Carolina, where several people were killed. And I -- while we haven't had anything that's catastrophic, thank goodness, there's always that concern.

Now, the railroads also move spent

nuclear materials, and those are also of course potentially very, very dangerous. There hasn't been an event yet, but if there is an event, the liability is limited by the Price-Anderson Bill, which covers -- protects railroads from catastrophic liability in moving spent nuclear materials.

Would you be supportive of a Price-Anderson kind of legislation, protecting the railroads and moving TIHs or PIHs?

Any one of you can answer that, I think.

MR. McINTOSH: Well, you know, under a separate docket, when the STB was looking at this issue, I believe there were several comments made that that was one option that would potentially solve or potentially deal with the liability issue that the railroads were raising about TIH shipments.

But I want to emphasize again that when I look at competitiveness, this is much broader for our business than just TIH shipments. And in all honesty, we ship more volume of chemicals that are non-TIH chemicals than we do TIH chemicals, in my company.

And when we look at rail competitiveness, it is not commodity non-competitiveness. It is rail as a mode non-competitiveness. And it applies whether we're talking about shipping chlorine or caustic or KOH or bleach or any of the other chemicals that we make in our basic commodity chemical business.

So although the liability piece, you know, is a part of it, and may also require some solutions that don't exist in the marketplace today, I would again respectfully submit that this competitiveness is a broader and more far-reaching issue than the issue of TIH.

COMMISSIONER MULVEY: Anyone else want to comment on that?

MR. McGARRY: Commissioner Mulvey?

COMMISSIONER MULVEY: Yes?

MR. McGARRY: If I could, a couple of things to comment on. First of all, if you look at the two unfortunate and tragic accidents, both of those were 100 percent within the control of the railroads' operation.

So in this case, everybody sitting at this table has invested millions and billions of dollars into process safety in our own facilities, and we have pipelines that extend hundreds of miles to transport our product, and we take that.

So, there were conscious decisions along the way to have, you know, dark track. There were conscious decisions to have product moved in such a manner that allowed these accidents.

So you have to say, where does that lie? But when the railroads come to us and say, they want us to indemnify us, for your actions, your gross negligence actions? That doesn't make sense. Who in a normal, competitive environment would ever accept a statement like that?

COMMISSIONER MULVEY: The railroads, of course, all get that but for the presence of these materials, we wouldn't have the liability.

So, simply because they're carrying them or have to carry them under their common carrier obligation, that therefore, that's -- that that's a problem they want to share with the -- they want the industry to share.

MR. McINTOSH: I go back to actual testimony I made during one of the STB dockets on liability, and I would say this again. If -- and I've made this offer before to the railroads, and so far have had no takers.

If the railroads want to come to me and demonstrate to me what the incremental cost of liability is associated with TIH shipments and allow me to make a business decision comparing that with the supposed incremental cost in rail freight for that commodity that I have seen since the early part of this decade or last decade, then I would be willing to enter into a business discussion about, is there an appropriate way to resolve that issue? I made that offer back then, had no takers. I still have had no takers in dealing with that issue.

COMMISSIONER MULVEY: Thank you.

Paper barriers, although not a part of this hearing, and I've been outspoken on the paper barrier issue in the past, and I do have some concern about paper barriers, but my understanding of paper barriers from the railroad industry agreement is that it relates to traffic that is on the line at the time the new railroad is spun off and created, and that the paper barrier refers to the requirement of delivering that traffic to the railroad, the parent railroad, or the spinning-off railroad.

But I thought I heard you, Ms. Burns, suggest that this was a situation where this was new traffic that was going to be precluded by a paper barrier, and that, according to my understanding, is not -- is not consistent with what I believe to be the Railroad Industry Agreement.

MS. BURNS: That's correct. Our example was new business. But I think it gets to my point that there's a lot of confusion. You know, we don't know if it's past business, new business, future business. We don't even know if they exist. You know, it's the perception of one, in one case, so.

COMMISSIONER MULVEY: Well, we didn't know they existed either. We were told at a previous hearing that nobody knew how many paper barriers were out there.

Then we discovered in testimony, and we verified yesterday, that in fact, the short line association had done a poll of its members and determined how many paper barriers were extant.

We do know that they do give

waivers to those paper barriers, they say very, very frequently, so we do know that happens.

At any rate, so, I think information about these should be forthcoming. They have said they're going to supply them to us, so that will be, I suppose, ultimately in the record.

But yes, if it's a new business, it should not be precluded by a paper barrier. At least, that's my understanding.

MS. BURNS: We would be very interested in seeing the list, so.

COMMISSIONER MULVEY: So are we.

I think, I want to be clear that a little earlier, before the last panel, I didn't mean to suggest. I was being more theoretical, I didn't mean to suggest that shippers do not need to be protected from potential monopoly abuses.

One of the reasons why the Staggers Act did carve out and create -- one of the reasons why they did create some railroad regulation is that though we do recognize that there is certain potential for railroads to have monopoly power and be able to exploit monopoly positions. It is our job to balance the need for railroad revenues versus the need to protect shippers from abuse.

Let me ask the group as a -- how would you create better access. I've heard many proposals, including eliminating bottlenecks, requiring reciprocal switching, et cetera. If any of those proposals were adopted by the Board, how would they change your day-to-day dealings with the railroads, if we adopted, say, reciprocal switching?

How would that -- and would we be able to make sure that the railroads continue to invest in their facilities, if indeed they had to engage in reciprocal switching?

Or would there be a concern that railroads might reduce the amount that they're willing to invest in a facility where they had to do reciprocal switching?

Anybody want to take that one on?

Mr. Smith?

MR. SMITH: Yeah, frankly, you know, day-to-day, obviously, there'd be a lot more give and take. And, you know, the cause and effect, as we put it forward, is that would create more interest, more detailed understanding of the actual costs. Competition, I truly believe in the long term, causes innovation.

The innovation is going to make improvements that will creatively bring parties together to come up with solutions that will reduce costs, that will reduce transit times, and so, you know, exactly how, on a day-to-day basis, yes, we'd be much more intimate, much more open.

And our belief is that would create more competition, that would create more innovation. At the end of the day, they would be more successful, and we would be more successful as an American industry because of those more detailed interactions.

Our belief as well, we talked about the millions of dollars of -- you know, causing, you know, these cases. We've been through that. We're in one now.

And our belief is that it takes a long time, and it's very, very complicated. And one of the reasons it's so complicated is because of the current policies around reciprocal switching and bottleneck pricing.

And we believe our current case and the past cases would be simplified greatly if those were in, if we did have these day-to-day negotiations, interactions.

A lot of the line -- the lanes and the rate cases we're bringing together would not be there, because of this competition. So they would simpler, they would be quicker.

You know, right now, we're estimating several million dollars over the next period of time to, you know, prepare and litigate this upcoming case. But that doesn't include the increases in price and the tariffs in the meantime that we may get back, but we may not.

So, you know, it is -- these order of magnitude estimates, I can believe.

COMMISSIONER MULVEY: We can't discuss your case before us right now, but of course, as you know, it is different from most of the utility cases, because it represents so many more lanes of traffic than we're normally dealing with when we're dealing with a utility case. But is before us right now, and so we can't really discuss it here.

MR. SMITH: Yes.

COMMISSIONER MULVEY: I'm going to have a few more questions, but I'm going to pass it on to somebody else, and maybe we can come back, if you want, Mr. Chairman.

CHAIRMAN ELLIOTT: Okay. Yes, I just have one question. I do want to, you know, note that I've been to many of your plants across the country.

In fact, I've been to the Natrium plant and the Lake Charles plant, so I've seen especially the amount of effort you put into safety. I commend you for it, and it's incredible what you do.

I'm going to go to Arkema. As you -- if you were here yesterday, I asked a question to the railroad CEOs about your proposed pilot program and was very, very warmly received.

(Laughter.)

I'm being -- for the record -- being facetious. Yes, I don't want to be misquoted. And, but, as you could tell, I took an interest in it.

And you discussed it a little bit in your testimony, but could you give me a little bit more detail of what you had in mind with respect to a pilot program, if you have gone that far? I mean, I know that's --

MR. O'LEARY: Well, first of all, one of the things that we have to remember is that reciprocal switching agreements already exist, you know, in a number of places.

CHAIRMAN ELLIOTT: That was going to be my next question.

MR. O'LEARY: So, I can't sit here and tell you which ones, or where, but -- and they're successful, and they do save money. And the railroads have figured out how to operate in that environment.

When we were bouncing around the ideas of, you know, well, let's pick a geographical area, you know, personally, Houston, or something like that, but --

(Laughter.)

-- and look at, just a pilot, maybe even pick a particular product. Maybe there's a limit on the volume, you know, that you know, because the railroads have talked about their investments and all of that, but that's pretty much as far as we've gotten with it.

But, you know, again, what has made the agreements that are in place today successful? I mean, you know, does the Board look at that and then move forward and say, we're going to try a pilot program?

CHAIRMAN ELLIOTT: Thank you. That's very helpful.

Vice Chairman?

VICE CHAIRMAN BEGEMAN: Mr. O'Leary and Mr. McIntosh, you touched just very briefly on Rule 11 rates, and suggesting that maybe the Board could do more to, I guess, promote them, could you just comment, and help educate me on what the Rule 11 rates are? I'm also going to ask this of the next panel.

I've read a little bit about them, and I don't know that what I've read is giving me the full picture. But if you could help give me some clarity.

MR. O'LEARY: Well, first of all,

normally, you get a through rate. So the origin railroad, let's say, goes to the delivering railroad, and they get their division, and they put together a rate, and you get a rate.

So you don't really know the cost or the rate factor associated with each railroad. You have one rate.

What Rule 11 does is basically, each rail would give you a separate rate.

VICE CHAIRMAN BEGEMAN: So is it sort of like a bottleneck rate?

MR. O'LEARY: No, it's -- you basically get two rates instead of one. And there's issues around paying freight bills and doing like, you know, things like that.

But if you have a route that goes from Houston to Florida, you know, and you have two railroads, instead of getting one rate, you will get two rates. You know, you'll have two separate rates.

VICE CHAIRMAN BEGEMAN: And you go

to the carriers separately --

MR. O'LEARY: Yes.

VICE CHAIRMAN BEGEMAN: -- to get the rate, and you say, take me from, I don't know, Florida to New Orleans?

MR. O'LEARY: Right. Yes. And then New Orleans to Houston. So --

VICE CHAIRMAN BEGEMAN: And does the origin carrier know you're going further?

MR. O'LEARY: Most of the time, yes. Yes.

VICE CHAIRMAN BEGEMAN: Do they always give you a rate?

MR. O'LEARY: No.

(Laughter.)

There has been a reluctance to do that, on the case of some railroads. And some railroads, they've very willing to do that.

Our experience on TIH products is that they are willing to break that up.

VICE CHAIRMAN BEGEMAN: Yeah, I guess so, but --

MR. McINTOSH: Madam Vice Chairman, let me just comment.

In a lot of cases, a request for a Rule 11 rate flies in the face of the railroad wanting to give you a rate to a destination that is not the final destination of the shipment, or to a destination in which there is competition and in which that competition could create a situation where the originating carrier could lose the rest of the route to a competing carrier.

And so they are very reluctant to give you a Rule 11 rate into a competitive situation, which could potentially impact their ability to move, you know, a shipment through either its entire route, or through a majority of the route.

And they would rather, in my experience, chose to give you a inter-line rate, in which case -- in most cases in which the originating carrier maximizes the amount of the route that is theirs before they hand it off in an inter-line rate, you know, a joint rate situation, to the delivering carrier.

There are some cases where Rule 11 rates exist, but they're not very frequent. And again, they're not typically -- they create a situation where a railroad could, in essence, walk into a competitive situation, which they're very remiss to do.

MS. BURNS: And as a shipper, our preference for Rule 11s is two-fold. One is, today, we're relying on the originating carrier to negotiate on our behalf. We feel much more comfortable negotiating on our own behalf, and feel like that's much more effective.

The other is that when you challenge that rate, there's a lot of finger-pointing, and we don't have visibility to figure out, is it really the first part of the move, or the second part?

So, to us, it provides visibility,

and we know exactly where we need to start negotiating, and where we need to go for improved pricing.

VICE CHAIRMAN BEGEMAN: Mr. Smith, as you know, I'm new to the Board, and I am aware that you've had a number of -- I think you said five cases in five years.

Could you just sort of give me a recap of what that experience has been like for you, what the outcome has been? I think that you have been utilizing some of the smaller procedures. Has it been successful?

MR. SMITH: I guess the --

VICE CHAIRMAN BEGEMAN: Not about the one that's pending, but --

MR. SMITH: Right, we've had three smaller cases and one large rate case. The three smaller cases, you know, got to a certain point in the process. The larger rate case came in and intervened, went to mediation, and then there was a settlement we can't talk about.

So at the end of the day, getting the facts on the table, having the Board look, you know, using their -- the rules and the boundary conditions there, did force reasonableness in the process, and therefore --

VICE CHAIRMAN BEGEMAN: And your mediation was outside of the context of the Board? Is that correct?

MR. SMITH: Right. Right. Right. And you know, so at the end of the day, we saw the investment in the litigation and the preparation of the case and the increased tariffs in the short term outweighed or -- you know, outweighed the risk, and so we went ahead and moved ahead with that.

That's why we're doing the case today, but again, repeat that if we had some of these other changes in policies, that would have made them all a bit simpler and a bit quicker.

VICE CHAIRMAN BEGEMAN: Mr. Baker,

has Dow utilized the processes at the Board? You've talked a lot about the rates, and --

MR. BAKER: We're watching a couple of the rate cases very closely, but we have not proceeded with a case at this time.

VICE CHAIRMAN BEGEMAN: And I think I really just have one final comment or question for anybody who would like to respond to it.

On the one hand, we're hearing, we need more competition. We need the Board to act to inject competition.

Equally, we're hearing from other shippers who have competition that the carriers are not competing.

But if the carriers, if it's true, aren't competing, you know, to do something on reciprocal switching or bottleneck may not give you the solution that you're hoping for.

So, I'm just -- I'm struggling with what the right thing to do is. I know maybe we all are, but I'd just appreciate your comments. I mean after hearing from the shippers that have competitive options, you're still advocating for reciprocal switching and bottleneck.

Do you have any new concerns based on the testimony of what you're hearing that that may not be the solution?

Anybody?

MR. SMITH: You know, again, we see the reciprocal switching and the de-bottleneck, not going to solve all of the problems.

They will increase competition, which is a good thing, but it's not going to cover all of the issues. So there has to be some means to go in and say, is this reasonable competition, you know, through a Board process.

And again, that does increase competition. Every industry I've been in, when competition steps up, innovation, creativity comes in and forces solutions, versus being able to rest on a monopolistic situation that says, okay, to meet my earnings, I can move prices as I see fit, versus, if I don't compete here, if I don't compete here, if I don't get creative and improve my efficiency, my innovation, and my service, I'm not going to, I'm not going to survive.

So, you know, again, make these policy changes, continue to have the accessibility and maybe a more streamlined process is necessary to increase the overall competition. I don't have any further concerns.

The only concern I would have about a pilot and reciprocal switching is if you did go for a pilot -- you know, pilots work if everybody's incentive is to make it work. If you've got one of the parties' incentive to make it fail, you know, they can make it fail. So we have to be very careful the way we design any pilot.

MR. McGARRY: I think from PPG's perspective, we'd be interested in more options, because we think more options lead to more competition, and I don't think it could be worse than what we have now.

CHAIRMAN ELLIOTT: Thank you.

Commissioner?

COMMISSIONER MULVEY: Just briefly, I agree with you about competition spurring innovation. I mentioned yesterday the experience in Japan, for example, where most of the analyses done in economics looking at what spurred Japanese innovation in automobiles and cameras, etcetera, was, in fact, the competition between all the firms.

But, competition -- and in your industries, too, even though many of your companies have been around a long time, many of your products are relatively new.

But the railroads are a very, very mature industry, and a lot of the opportunities for innovation, a lot of the opportunities for productivity gains, seem to have been captured. The rate of growth of productivity gains has very much slowed down, especially in the last three or four years.

Do you think that the railroads are still able to innovate, and to reduce costs, become more efficient, etcetera, given the fact that they are a mature industry?

Or do you think that it's going to be difficult for them to become more competitive and become more efficient, and that any loss of any competition might simply mean a loss of revenue, and therefore, make it difficult to attract capital?

Could you --

MR. SMITH: I give an example. You know, one of our very successful products is sulfuric acid. I mean, that's as old as dirt, much older than the rail system. It's one of the first chemicals realized and invented.

We've reinvented that product many

times. You can imagine over the course of the year, DuPont does portfolio management, says, you know, why are we in this true commodity chemical?

But over the years, we've been able to look at that, find ways through, you know, difficult times where margins were low, where competition was in there, where we didn't see the way to make money, sit back, you know, look at it differently.

We're looking at it now as more of a service-type industry for the refining industry. So there are ways -- I mean, you have no idea, in my mind, you know, with a commodity product, what its possibilities are until you're forced to compete and innovate.

MR. McINTOSH: I would comment, I can't speak for what the railroads can or can't do from where they currently sit today, but you can make an argument that many of us at this table represent industries that are just as mature and have been around just as long as the railroads have been in their business.

And what I find hard to believe is that in today's world of technology and information and of all of the other opportunities that are out there that didn't exist 15 years ago, in some cases, five years ago, that there aren't opportunities for any industry, regardless of how mature it is, as just evidenced by the example of sulphuric acid, to compete, to improve productivity.

And I think the constraint isn't the mature industry or anything else. I think the constraint is the fact that they don't have to compete.

They don't have to compete, so there's not a drive to innovate and improve. And I think if they had to compete, they'd figure out a way to do it, just like the rest of us have to figure out how to do it.

COMMISSIONER MULVEY: Thank you.

Mr. Smith, you also mentioned

about fuel surcharges not being tied to cost. And we had a hearing on fuel surcharges a couple of years ago, and we issued a ruling requiring that the railroads no longer tie fuel surcharges to the rate that they charge, which disproportionately fell on captive shippers who paid higher rates because of differential pricing.

But we told them that it had to be tied to cost. And now we're hearing, and not just from this panel today, but elsewhere, that in fact, the fuel surcharges still are not tied to cost.

Could you give an example as to why they're not tied to cost, and how they're being levied at DuPont?

MR. SMITH: Yes. My understanding, and I don't have a deep, detailed understanding of this, but, you know, the fuel surcharges come in, and they're not required to give us the logic and the justification about, okay, bring it back to say, okay, fuel oil moved, and therefore, how does this -- does it reflect directly in the rate? So it's a mystery, so to speak.

MR. McGARRY: I can add to that. Especially where it's embedded in a contract, they say they don't have to follow the FCB because it's a contract.

COMMISSIONER MULVEY: Oh, okay. Thank you. Thank you.

On rates, many of you cited that rates have gone up substantially, much more than the overall inflation rates, no matter how that's measured.

But what I don't understand is what the period has been. Very often, there are these contracts that go on for 10 or 20 years, and then the rate goes up, but -- and it's always reported, well, the rate was this last year, and next year, it's that. But it also often reflects the fact that the rate had been fixed for a long time.

So on some of these cases where

quoted 151 percent increase in rates are such as you talked about at Arkema, I don't know what the time period was, what that was reflecting. Was it reflecting one, two, five, ten, or 15 years?

Obviously, over a 20 year period, 151 percent rate increase might not be that extreme. Could you comment on that? Many of you had examples.

MR. O'LEARY: Yes, when I mentioned 150 percent, that's over a five-year period. That is specific to a TIH move, so I'll be honest about that.

COMMISSIONER MULVEY: Okay.

MR. O'LEARY: And it was coming off a four-year contract. But it wasn't just the first year. I mean, it was the second, you know, and then you have one-year agreements. So, it's the first year, the second year, the third year, we saw significant double-digit increases.

COMMISSIONER MULVEY: Anyone else

want to comment on that?

MS. BURNS: The time frame that we quoted was also five years, 2005 to 2010. We have come off some longer-term agreements. However, during that time frame, the majority of our contracts were shorter-term, from one to two years, so these are year over year increases.

COMMISSIONER MULVEY: And finally, also, to Occidental and Ms. Burns, you indicated that Occidental shut down some plants because of rising rail rates.

We received four or five feet worth of testimony on these issues. So, I don't recall necessarily whether or not you identified those and why, precisely why the increase in rail rates was the straw that broke the camel's back, so to speak, in terms of having to close them down.

MS. BURNS: They were not in our written comments.

COMMISSIONER MULVEY: If you could

provide some of those, you know, that would be helpful.

MS. BURNS: And give you those details? It was one of many factors, but I can tell you that they were captive locations, and we had seen significant increases, and they were part of a decision of making the ultimate decision.

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

CHAIRMAN ELLIOTT: Thank you very much for your comments and your responses today.

Thank you, Arkema, for your idea. And we'll bring up the next panel.

Okay. Now, we'll begin with panel number four for the day. I think we're going to start out with BNSF.

Mr. Lanigan, you have ten minutes.

MR. LANIGAN: Thank you, Chairman Elliott, Vice Chairman Begeman, and Commissioner Mulvey.

I'm John Lanigan, Executive Vice President and Chief Marketing Officer of BNSF railway. I'm responsible for sales, marketing, customer service, economic development, and additionally, I'm responsible for intermodal and automotive operations and the rail car management for our corporation.

As I move to the first slide, this was a vision statement that was created shortly after the merger of Burlington Northern and Santa FE.

And I won't read it to you, but what it really implies is that we want to serve customers, and we want our customers to grow. And that's a mantra that has been true at our company for well over a hundred years, but certainly since the merger of the two companies.

You've seen different versions of this slide before. This is the revenue version of the transportation pie in the United States. You can see, obviously, that motor carriers are the dominant provider from a revenue perspective, and railroads are the second-largest.

And from a public policy standpoint, and also from a standpoint of the opportunity for our industry to grow, clearly, moving freight from the highway to rail is a critical aspect of the future of our industry.

When we talk about competition, we talk about it many forms. Obviously, we compete with other railroads. We also compete vigorously with trucking and the intermodal world. Also in ag, as you heard yesterday, the majority of ag business moves by truck, and also in many of the industrial products' areas that we serve.

Pipelines, interestingly enough, have become a bigger competitor of late with the finding of the shale oil and shale gas reserves in this country and the exploration of those reserves.

For example, we're hauling full

unit trains of crude oil out of North Dakota from the Bakken shale because there is no pipeline in the Bakken shale at this point. And so it's created a tremendous opportunity for us, and one in which we hope to compete as they consider putting pipelines in that area as well.

And then we also compete on the inland and coastal waterways with barges in our ag, coal, and bulk areas.

There's been a lot of discussion about the lack of competition since 2004. This slide is from AARCS 54 data from the mergers in the late `90s through the week ending 5/29/2011.

The orange line is the market share of BNSF. The grey line is the market share of UP. You can see clearly that we compete. You can see clearly that the market share has shifted over time, and continues to shift today.

There have been many assertions

made by the coal shippers at this proceeding, and we wanted to address it head-on. There's been many comments that there's been a lack of competition in the West since 2004, and we believe that's just simply not true, and these statistics back that up.

In 2004 alone, BNSF won new business to 13 plants and lost business to four plants. From 2005 to 2011, we've won new business or increased share to 30 plants, and lost business to 21 plants.

And during that period of time from 2004 to 2011, coal delivery to 11 plants changed hands more than once. We serve about 75 different coal-generating plants, and if you added up all those numbers, that's a significant portion of the total plants that we serve that we've either won or loss business or the business has changed hands since 2004.

And finally, we believe that it's not true that competition does not exist where a shipper awards business to the incumbent railroad.

In fact, I was profoundly dismayed this morning by the comments of one of the coal shippers who has asserted that we have not competed for business. And in fact, after this proceeding, we'll send you a confidential letter detailing an opportunity that we bid on earlier this year that went multiple rounds in which we lowered our price twice and still did not gain the business. We will demonstrate to you that competition is alive and well in the coal market in the Western U.S.

As you look at what's happened to BNSF since the merger, growth was slow in the early years of the merger, and then in the 2003/2004 time frame, our growth really accelerated at unprecedented rates.

Shippers enjoyed declining rates from the implementation of the Staggers Act into the early 2000s. Excess capacity and cost reductions were absolutely critical for the railroads as we attempted to heal our networks, but also, dealing with the aftermath of the mergers and taking out redundancies caused by the mergers, back office consolidation, redundant lines, the sale of low-density lines to short line organizations, etcetera.

We worked for 25 years to take those costs out of the network, and the shippers benefitted greatly by reduced rates over that 25-year period of time.

As you can see, our productivity was increasing still dramatically from the time of the merger of BN Santa Fe all the way into the 2003/2004 time frame, and then you can see that it's kind of evened out. And this is a productivity measure, a thousand GTMs, gross ton miles per employee.

So, our efficiency was really dramatically improving over time, but we kind of ran out of the low-hanging fruit that Commissioner Mulvey talked about in the fact that we had taken into consideration all of the merger efficiencies that we could ring out of it, that the elimination of low-density lines, etcetera, crew consists haven't changed in quite some time, so we've had the same labor situation for a long period of time.

So you can see from 2004 through 2008, although we've made incremental gains in productivity, certainly nowhere nearly what we had seen in the past when we really had the low-hanging fruit that we could go after.

But as far as innovation, there were some comments made by the last panel about spurring innovation. At BNSF, we have an innovation process.

In fact, every year, we create a series of initiatives that are designed to try to find some of the next big things that will help us be more efficient and more effective.

This year, we have 21 separate large initiatives that we're working on that are the responsibility of senior leaders in the organization to lead and put teams together to prosecute those initiatives.

Some of them bear no fruit, but each year, a number of them do bear fruit. And our goal is to at least off-set 50 percent of any inflation factors through these initiatives. And we're also hoping at some point to get big bangs so that we can see greatly improved productivity in the future.

This is a picture of our investment in the network. Another thing that you've heard from many of the panelists over the two days thus far is that our service has gotten better over time, and this is why. If you look at the investment in the network, particularly from 2004 on, and compare it with the investment in the network prior to that, we have invested significantly more capital over the last six or seven years than we had in years preceding.

And that has allowed us to provide better service to our customers by renewing existing assets, building new assets, new terminals, additional track, in some cases, double, triple, and even quadruple track in the Powder River Basin following the weather events in 2005.

And we have greatly improved our service because we've been able to invest in the network and our owners, both when we were a public company and now that we're a private company have supported that, because of our improving returns over time.

I think this slide tells a very, very telling story. This is indexed to one, in 2000, the relative movement of our operating expense per thousand gross ton miles and the growth rate of our freight revenue. And as you can see, they mirror each other very, very closely.

There's a little deviation in the 2009/2010 time frame, and that's easily explainable. During the recession, we took out assets very, very quickly, and downsized our business in response to what was going on in the recession and the loss of traffic because of the recession.

And as we are building the network back up, traffic has come on faster than we've been rebuilding assets, but this year, you'll see that cost curve go back to the historic norm.

The other thing you should take away from this is the fact that you can see that our costs per GTM increased dramatically starting in that 2004 time frame.

Finally, I won't read these slides to you because many of the comments made here were made by the rail panel yesterday, but I think I bring a different and unique perspective to this hearing.

I spent 16 years with Schneider National, one of the largest truckload motor carrier groups in the United States. Arguably, the truckload motor carrier industry is the most competitive industry in America from a standpoint of transportation, freight transportation, thousands and thousands of competitors, all of whom can serve every customer.

When I think about how we competed when I was a Schneider versus how we compete today at BNSF, I see no difference. We compete hard for our business. We look at each opportunity as an opportunity for us to grow and an opportunity for us to help our customers grow.

CHAIRMAN ELLIOTT: Thank you, Mr. Lanigan.

We'll now hear from Norfolk Southern. I believe we're starting with Mr. Manion.

And you have ten minutes.

MR. MANION: Well, good morning, Commissioners. On behalf of Norfolk Southern Railway, I'm Mark Manion, Executive Vice President and Chief Operating Officer. And with me today is Jim Hixon, Executive Vice

President of Law and Corporate Relations.

Two major points Norfolk Southern has made in this proceeding are that number one, any policy change would undermine past rail investment in infrastructure, future investment in infrastructure, innovation, and the economic benefits of rail throughout the US. And secondly, that proposals such as forced access and forced interchange would adversely affect the rail network, rail operations, and accordingly, the shipping community generally.

First, the Board should take care not to undermine the substantial investment railroads like Norfolk Southern have made in this nation's rail infrastructure and the innovation that is underway.

It's been widely documented that there's a crisis in transportation infrastructure looming. Railroads, however, are private companies spending their private dollars to make sure that efficient and safe rail transportation remains a competitive advantage for the United States.

Now, Norfolk Southern itself has invested billions of dollars over the last ten years. The uncertainty in traffic flows that forced access and forced interchange would create would make investment more problematic and harder to justify.

The ability for customers to shift traffic would make it difficult to predict whether a particular investment could be justified. In addition, Norfolk Southern's developing or implementing numerous innovations to improve its service, so that it can compete even more aggressively against other railroads and other modes of transportation in the surface transportation marketplace.

An example of this is our unified train control system. This is analogous to an air traffic control system on steroids. Where an air traffic control system allows a controller to coordinate and manage plane movements, UTCS safely and efficiently coordinates train movements and maintenance work into a dispatch system.

It allows dispatcher to see trains well in advance of their arrival in the dispatcher's territory. But UTCS does more than air traffic control systems, because it prioritizes trains and determines the optimal place for them to meet and pass each other.

Norfolk Southern is the only railroad in the world pursuing movement planning at this level of sophistication. Importantly, UTCS is only as good as the information it's provided, including infrastructure, resource capabilities, operating objectives, and operating plan.

One of the critical pieces of information that must be provided are train flows. Because forced access or forced interchange removes predictability in rail movements by allowing shippers to alter movements on a whim, one of the key UTCS inputs, that being the operating plan, would be undermined.

Second, forced access and forced interchange would generate serious adverse network effects. Running a massive network is incredibly complex, with multiple types of traffic, such as intermodal, coal trains, grain, and others, all using the same set of limited resources.

Norfolk Southern's rail operations are designed to both meet customer needs and to function effectively, efficiently. We should meet the different needs, we must meet the different needs of different customers.

To be able to hone operations to get the most out of our resources, Norfolk Southern must be able to make reliable predictions about its future operating patterns. We go to great effort to go into the future and predict traffic flows to plan our resources. Forced access and forced interchange would undermine our ability to plan ahead and adequately place resources where they'll be needed.

Now OPD, or our operating plan developer, is a technological tool that allows us to plan the movement of each of more than 170,000 rail cars currently on the NS system. It uses algorithms to evaluate a host of variables, such as the least handlings for cars, the fewest crew districts to operate, the shortest distance, in order to determine the most efficient and safest route for each of the cars or blocks of same destination cars and trains.

If the shortest route has curves or speed restrictions, it takes that into account and finds the most efficient route, even if it's a longer distance. Forced access and forced interchange proposals would nullify the decades of effort Norfolk Southern has put into streamlining its network.

Forced access would create

operation problems. With two railroads operating on the same infrastructure, it would increase the number of locomotives and cars needed. It would create new crew qualification issues.

Now similarly, forced interchange would create operational problems by altering traffic flows inefficiently. I'd like to compare two interchanges. One, my example I'm using, is one in Cleveland, Ohio, and the other in Marion, Ohio.

And here on the map, you're looking at an efficient interchange at Cleveland and an example of an inefficient interchange at Marion.

Rockport Yard, which is the yard in Cleveland, is on the lower left of the slide, and it is an interchange point between Norfolk Southern and CSX. That yard has ample capacity to interchange hundreds of cars. It is secure. It's very efficient.

Importantly, cars received are

immediately classified in the yard and forwarded on outbound trains. As you can see, there's been substantial investment in infrastructure at this facility.

All right. Now, turn to Marion, Ohio. The interchange at Marion is a single track. There is little infrastructure in place. Only about 35 cars can be interchanged here, and even then, they must be forwarded to Columbus to be classified.

Furthermore, any trains working this interchange block the main line.

In this comparison between a Cleveland interchange and a Marion interchange, under forced interchange, customers could opt for Marion. You clearly see Marion's less efficient interchange point, and in fact, it would result in congestion and delay.

While a modest amount of interchange is currently handled by local trains today at Marion, you can see that increased interchange would be very inefficient, stopping through trains, blocking the main line, adding work events, and in the end, delaying all our customers' freight.

Finally, as the safest Class 1 railroad for the 22nd year, a benefit of reduced handlings and work events is the reduction of injuries and accidents. Adding more work events increases the risk of injuries and accidents, and that is something that we and the government should strive to avoid.

MR. HIXON: Good morning. Norfolk Southern has submitted to the Board substantial comments on opening and reply, and we'll not repeat all those points that we've made.

Now, unsupported allegations have been made in the papers that do not withstand scrutiny.

Some say that railroads harm export. The actual facts tell a very different story. There we go.

As you can see, exports have grown steadily since 1992, except during times of recession. In fact, US exports in March 2011 were the most reported in history.

For Norfolk Southern, export traffic excluding import traffic, even when you exclude the -- even excluding truck work traffic -- even exceed import track even when you remove the export coal -- I'm sorry, if you get to that slide -- shows that even our, if you take out the export coal, our exports are growing faster than our imports.

Now, in conclusion, Norfolk Southern urges the Board to recognize a lack of justification for proposing changes to existing regulations dealing with access to the rail network, and we ask that you terminate this proceeding.

Thank you.

CHAIRMAN ELLIOTT: Thank you, Mr. Hixon, Mr. Manion.

Thank you, panel, for your help today, especially with the operational matters. I know that matters that it came up quite often yesterday, so it's nice to hear those thoughts.

Mr. Manion, just with respect to the charts that you had, you pointed to the Cleveland interchange facility and the Marion. And I think I've seen both of them, just because I used to live near there.

Now I could see where there would be a dilemma having some form of forced access at the Marion facility. Obviously, it's not fit for any additional traffic.

But what if, instead, that we had a forced access only in facilities where there are proper facilities, like the Cleveland yard? Would that pose a problem operationally?

MR. MANION: We don't want to stop a shipment to switch it, to handle it to another train, unless it's absolutely necessary to do so, and that's why we've spent so much time and so much investment on our computerized planning capability.

When -- and I referred to our operating plan developer before, and that has allowed us to get to a point where, when we route a shipment from origin to destination, this planner takes into its calculation all the different efficiencies and inefficiencies that are out there and it's going to route it in the most effective way to get the shipment to the customer.

Now, if part of that has to do with changing from one train to another, keeping in mind that for most of general merchandise traffic, to get from origin to destination, you know, going across country in many cases, most cars don't ride on one train the whole way.

And so it's necessary to, in a lot of cases, as many as three different times during the course of a car's trip, they will change from train to train, and we have the cars do that at the most efficient points.

But we don't do it with any more frequency than we have to, because these terminals, like the one that we're talking about at Cleveland, these are absolute cost. They cost us money.

There's no revenue that comes out of stopping and handling a car at these locations, so we certainly don't do it any more often than we have to.

So, to your question, if we have to stop a place like Cleveland is where we will do it, but we're certainly not going to do it anymore than we have to.

CHAIRMAN ELLIOTT: What about the counterpoint that I think one of the shipper groups made with respect to reciprocal switching; that, because they're not going to be taking the train, they're just going to get off, their crew's going to get off and your crew's going to get on, would that alleviate some of your concerns?

I have to say, I'm not an operations expert here, although I worked with guys that did it for 16 years. One of the shippers' arguments, that says that it's not less efficient in reciprocal switching, said that if they pull their train in, and then you're taking a train from there because it's reciprocal switching, that it would just be a matter of switching crews.

So, if a CSX train pulled in, the NS train -- NS crew would get on.

MR. MANION: I think there -- I have heard some of the dialogue surrounding reciprocal switching, and honestly a lot of what is being discussed is really foggy to me. I think there's -- I don't know how a good an understanding there is as to what reciprocal switching is, frankly.

I think people are talking outside of what current-day reciprocal switching is. And, you know, just briefly, to help clarify, when reciprocal switching is in place, that is taking -- the traffic is being conveyed from one railroad to the other, either at the origin point or the destination point.

And in most cases, that is taking place because one or the other railroad doesn't have a route, or doesn't have a good route to wherever the shipment is going.

So, that's reciprocal switching. Now, this business about -- I think some of these other things that are being discussed really are more what we would call forced interchange, where there is some kind of an interchange of traffic mid-route. And any time you change horses mid-route, you have got inefficiencies.

Something that is center to operations on a railroad is velocity. It is all about velocity. And we spend a tremendous amount of money on systems and on infrastructure to be as seamless as we can to continually increase our velocity. Because when we increase velocity, when we do the type of things that keep shipments from having to stop, whether it's at the origin or the destination or the mid-way point, when we do that, everybody wins.

The customer wins, because they get their shipment more promptly. It's a faster through-route. And, it's more predictable, because we are better able to stay on the schedule that we have promised our customer, and we do that.

I mean, we tell our customers, when we sign up for the business, we say, you will get your -- you'll get your shipment in x number of days, and increased velocity very much allows us to meet those targets.

So the customer wins when we increase velocity. But the other great thing about it is is that the costs drop out when we increase velocity, because our assets turn more quickly. We get more turns out of equipment, and we get more turns out of our locomotives and our cars.

And when you get more turns out of your assets, you either, a, don't have to buy as many of them in the first place, or b, you've got more assets for increased business down the road.

So it's all about velocity when it comes to operating a railroad. And these things we're talking about, whether it's the forced interchange, or the forced access, or stopping at Cleveland and finding another crew, another railroad to take it over, which is not something we want to happen, because it flies right in the face of increased velocity. All these things that are being discussed about stopping traffic slows velocity.

CHAIRMAN ELLIOTT: Thank you. Actually, I think at some point in there, I think I got the answer I was looking for, so I do appreciate that.

MR. LANIGAN: Mr. Chairman, could I add something to that?

CHAIRMAN ELLIOTT: Sure.

MR. LANIGAN: I think most of the customers have talked about reciprocal switching were single-car type customers, not unit train customers like the example that you gave.

Each and every day, we take unit trains of coal, of ag, etcetera, through gateways. Our crew gets off and the Norfolk Southern crew or a CSX crew jumps on and continues on to destination. That's a normal part of our operation every day.

CHAIRMAN ELLIOTT: Let me follow up on that with respect to your operations. Are there voluntary reciprocal switching agreements in place now that you believe are working effectively, operationally speaking?

MR. MANION: There are about 13 percent of our traffic is open to switching, and it's open to switching. It doesn't necessarily mean that it's taking place, but it's open to switching.

And as I said, those are cases in most instances -- those are cases where one or the other railroad doesn't have a good route to get to destination.

So, current-day reciprocal switching arrangements are what I would call more a matter of necessity, just from a practical standpoint, because one railroad can't get all the way where the car needs to go.

So, do they work? Yes. We make them work. Do they work as well as if you didn't have to have those additional handlings at the origin or destination? You're darn right.

It doesn't work nearly as well, because you've got to take -- you've got more crews involved, you've got more infrastructure involved, you've got one crew that has to deliver to a siding or a spur track or whatever the arrangement is.

Those cars are going to sit there

for some period of time, and it's not as slick as one might think. Maybe they're going to sit there for 12 hours. Maybe they're going to sit there for more than two days.

And then they get picked up by another crew, and they get re-handled. So it's not -- it's something we try to avoid, but it can't be avoided in all cases.

CHAIRMAN ELLIOTT: Okay, I think that probably answers my follow-up question, which was, why wouldn't it also work in a forced access situation? But you explained that it's not as practical to have the extra switch or whatever is involved in a connection.

MR. MANION: Well, and the reciprocal arrangement, while it is inefficient, it is not as onerous as the forced access concept, because under forced access, you not only have this same arrangement with inefficiencies, with the extra infrastructure you have to have, with the coordination of crews, but now you are into a situation where you've got two different parties, two different railroads, both working their operation over the same set of railroad tracks, having to coordinate, and that sets up a whole new layer of inefficiencies.

CHAIRMAN ELLIOTT: Thank you. That's very helpful.

I'll give one softball to Mr. Lanigan, since he's a Cleveland Indian fan.

On one of your charts, with respect to efficiencies, I noticed in 2010, you had a significant increase, I thought almost even more than -- and I wasn't even comparing it to 2009, but overall. And I was just wondering, it seemed quite significant, and if you could explain how that happened.

MR. LANIGAN: Well, as you know, Mr. Chairman, during the recession, we stored a lot of cars, we furloughed people, we took a lot of cost out of the business very, very quickly. And in 2010, we were slow to bring a lot of the assets back on because we couldn't predict the recovery. We couldn't -- customers were reluctant to give us forecasts, because they couldn't forecast their markets.

So we spent the entire year -- I would call chasing the demand and coming up short from a standpoint of having the appropriate assets.

This year, you're going to see that reversed because one, we're hiring 5,000 people this year. We're adding rail cars, we're adding locomotives, our record capital expenditures this year, etcetera. That curve's going to bend again.

It was really just a function of the timing of the recession and coming out of the recession.

CHAIRMAN ELLIOTT: Thank you.

Vice Chairman?

VICE CHAIRMAN BEGEMAN: Thank you.

Mr. Manion, Chairman Elliot asked

a number of the questions that I wanted to ask, and probably everyone in the room except me understood something that you said, so just bear with me, if you don't mind.

I thought what you said was that typically, there can be maybe three switches from your origin to destination. But then I thought you also said when you were describing to us what reciprocal switching really is, versus an interchange, that it only happens at an origin or a destination.

So, I guess I'm -- how can it happen three times if it's only in two places?

MR. MANION: Right. Let me try to do a better job of explaining that.

During the course of business for traffic that we'll say is just totally within Norfolk Southern's control, in most cases, for general merchandise traffic, our shipments aren't able to ride one train all the way from the origin to the destination point. And, you know, it's -- we're kind of a big spiderweb in the East, if you will.

And to get a shipment cross-country to its destination, on the average, it will ride on three different trains. Does that make any sense so far?

VICE CHAIRMAN BEGEMAN: Yes.

MR. MANION: Okay.

VICE CHAIRMAN BEGEMAN: So they're interchanging?

MR. MANION: And that is not referred to as -- interchange is between two different railroads. When we stop at -- we have major terminals, major what we call hump yard terminals throughout our system, and they're designed to reclassify or to classify cars to put same-destination cars all together in blocks and ultimately in a train where they all want to go to the same location.

So, as we move those cars and trains through our system, we're simply what we call making connections, and that's something we put a lot of emphasis on.

Within our own railroad, we are operating trains on time, on schedule, so they get -- and every single car has a -- every shipment has a schedule. Not to get to deep detailed about it, but it is, it's a detailed, complex business.

Every car has a schedule, and across the railroad, it has a schedule of how it is going to route, what blocks it's going to be on, what trains it's going to ride.

And so it's necessary that we keep trains on time so that they will get to the next yard or terminal point and connect -- I said connections -- connect to the right train, right car on the right train, in order to, again, get to the next terminal, if that's where it's going, and go through this process again.

Now, all of that is separate and distinct from reciprocal switching and interchanges that go on between two different railroads, and they are two distinctly different things.

And with your reciprocal switching, that's just a case where one railroad is not able to handle it the whole way, and they either -- maybe they have a reciprocal switching arrangement at one end of the railroad or the other, and, we -- and in other cases, we will interchange a car from one railroad to the next because we may not be going where that car needs to go.

Does that help?

VICE CHAIRMAN BEGEMAN: Yes. Thank you.

And you also mentioned 13 percent of your traffic is open to reciprocal switching.

MR. MANION: Right.

VICE CHAIRMAN BEGEMAN: I think that's what you said. Do you happen to know what the general percentages would be for the other carriers, how much it is system-wide?

MR. MANION: I really don't. I'm

not inclined to think it would be radically different, but I don't know the answer to that.

MR. LANIGAN: Ours is a little bit higher than that. It approaches 20 percent.

VICE CHAIRMAN BEGEMAN: Would both of you respond regarding the testimony from the intermodal representative, why is it that the carriers seem to compete so heavily for the intermodal traffic?

Is it because that's where the money is versus what we're hearing about the coal traffic?

MR. LANIGAN: Well, for openers, I think we compete for all traffic, so I want to make sure that that's clear.

VICE CHAIRMAN BEGEMAN: And your testimony did make that clear.

MR. LANIGAN: I think the difference with intermodal is that a truck can go anywhere. And I spent 16 years in the trucking industry, and a truck can go anywhere.

But a single truck, single driver, is more expensive than a train, economics, to haul containers or trailers.

We have two individuals on the train hauling up to 300 or so containers, 150 trailers, depending on the configuration of the train, which would take 300 or 150 truck drivers to do the same work.

So we have a distinct cost advantage against truck, but we're not as flexible. We can't go door-to-door like a truck can, and I think what's happened over time is that we've developed the density of the networks, both in the West and in the East, to provide frequent enough service that we can work with our trucking partners to develop a service that is very close to truck-like from an overall timing standpoint, but yet has the economics of rail embedded in them, and that's what's created that competitive environment in intermodal.

VICE CHAIRMAN BEGEMAN: I sort of gave you a heads up that I was going to ask about Rule 11 rates. Could I get your perspective as far as how it works with your system, and when you offer them, and when you don't?

MR. LANIGAN: We do Rule 11 rates all the time. In some cases, we offer them to customers, and some customers prefer them, and some don't. In other cases, customers will ask us to quote a Rule 11, and we'll do it anytime a customer asks us to do it.

VICE CHAIRMAN BEGEMAN: And are they utilized more frequently now, or are they less so?

MR. LANIGAN: Much more frequently than, say, five years ago. I don't know what the percentage is, but it's a significant increase in Rule 11 rates over the last five years.

VICE CHAIRMAN BEGEMAN: And do you have a sense of why that might be? I know that the chemical shipper mentioned that they'd like to have control over -- and like to know what they're paying for from each carrier, but --

MR. LANIGAN: I think that nails it on the head. The customer wants more transparent information on how their shipment is moving.

VICE CHAIRMAN BEGEMAN: And are there times when you won't provide one?

MR. LANIGAN: I'm not aware of any, when we've been asked to provide one.

VICE CHAIRMAN BEGEMAN: Did you want to comment on, from your perspective?

MR. MANION: Well, I would comment on the fact that we compete so heavily in all the different modes of business, and just like John said, I don't care if it's your general merchandise, your ag, your automobile business, coal business, intermodal business, and we're living proof of it, because we lose business.

Fortunately, we gain business, too, but it is fiercely competitive out there. And, you know, it goes back to the point I was trying to make about how we try to maintain a scheduled operation and increase our velocity so that we can provide the kind of service that a customer needs, because if we can't provide the service, we lose it.

And even our -- I mean, even our employees are involved in this, as strongly involved as they are in our safety process, which we take a lot of pride in, they are well aware that their paycheck comes from the customer, and if we don't provide service like we promise, we'll lose it.

VICE CHAIRMAN BEGEMAN: That's all I have for now.

CHAIRMAN ELLIOTT: Thank you.

Commissioner?

COMMISSIONER MULVEY: Thank you. Adjectives mean a lot. I know that we hear about captive shippers from one side, and we hear about singly-served shippers from the other side.

So -- the word forced access is interesting. Basically, we're talking about open access. That's the term that's usually used. No one is forcing a railroad to interchange. You may be forcing the owning railroad to accept interchange, but you're not forcing the other carrier to enter into the agreement.

A question for Norfolk Southern. You said that forced access or open access would be harmful because it would make traffic flows unpredictable. But the railroads already have had reciprocal agreements for years and years and years, albeit, they have been going down in recent years on most lines. And that presumably also would alter traffic flows.

So what would make a Board-regulated rule on reciprocal switching requiring more open access so much more worse than what you have today?

MR. MANION: Well, Commissioner, the reciprocal arrangements we have today are ones that we have agreed to. They're ones where we have -- we have ourselves said customer x is open to switching. So under that arrangement, we plan around that. It's less efficient, but we plan around that.

And with an open access arrangement, traffic would be routing through another carrier, through this open access arrangement, I presume, in one instance, and in another instance, the customer may find it more desirable not to route through that interchange point, and we'd be handling it.

And the uncertainly leaves us at -- or would leave us at a point where we never know where to invest our money in infrastructure. Are we going to be handling that business and consequently be able to get a viable return on our investment in infrastructure? Or not? And so it would make the whole thing very unpredictable.

COMMISSIONER MULVEY: But investments in infrastructure are always unpredictable. You invest because you believe the business is going to be there.

Hopefully, you get lucky, as in the case of one person at that one railroad on that panel. You make an investment, and eventually, they come, and you have the advantage of having made it.

And sometimes, the investments are made a little earlier, and they don't come when expected, and so you lose. So there's always that risk when you invest in infrastructure, that you're going to get the business or be able to accommodate the business.

You mentioned also --

MR. LANIGAN: Commissioner, if I might add --

COMMISSIONER MULVEY: Yes.

MR. LANIGAN: -- but you're making

that investment based on your best projections about the business that you have and the way that business is going to grow, and if that becomes completely unpredictable, you won't make the investment.

COMMISSIONER MULVEY: But shippers or consumers, however you want to label them, they always have a choice of who they're going to go to, not always, obviously, but often have a choice of where they're going to go, and that's one of the things that makes our capitalist market society work, that there are effective suppliers and effective demanders who have some choice.

So as we said before that for example, reciprocal switching or open access can lead to inefficiencies and take longer to shift a car to another railroad, et cetera, but those all increase transport cost, and increase the time for transport.

And those would be decision points that a shipper would look into and say, well, I can maybe have an interchange, or I can have open access, but it's going to take me a day or two longer, and I don't want that, so, I'm going to stay with my existing railroad -- continuing to have, say, have Norfolk Southern do it, rather than take advantage of the open access, because it would take longer, and it would increase the cost.

Wouldn't that be true? Wouldn't some of those things be caught up in the rate structure?

MR. MANION: Commissioner Mulvey, what I come back to is this open access arrangement in any situation builds in additional costs, and it flies right in the face of what we're trying to accomplish.

Excuse me for the somewhat pedestrian analogy, but if I want to use UPS to ship a package from my home in Virginia Beach up to my mother in Boston, and I go to the UPS counter and say, well, I'd like to ship this to Boston, but when that package gets to Boston, I'd like you to transfer it to the United Postal Service and have them deliver it to her, that doesn't make any sense whatsoever, because we all know how disruptive and costly that is. But that is not far away from what we're talking about here.

COMMISSIONER MULVEY: Right. But if you wanted to pay, and if UPS said, well, we can do that, we'd have to call the postal service, they would have to send a truck over, pick it up, and move it out and that's going to cost an extra $20, and you said, fine, I'll pay the extra $20, because that's how I want it to go, wouldn't that be your right? Why should you be denied that right, then?

MR. MANION: I don't think there's a lot of -- could that be done? Yes, it could. Is that logical? I don't think it's logical at all.

COMMISSIONER MULVEY: And then you wouldn't do it, because it's not logical, nor would a shipper do it, if indeed, it didn't make some sense.

We're presuming here, I think, that with open access, that the shipper would see a benefit and do it, not that the shipper would just ignore the fact that it was going to take longer, or ignore the fact that there are additional inefficiencies and additional costs, no?

MR. MANION: Commissioner, I really don't think that's the case. I'm getting the sense that -- you know, with all good intentions, I think this is a case of individual customers who see a one-off possibility to get a lower rate in their instance, but the reality is is that the overall costs in terms of our infrastructure costs, in terms of our not being able to provide good service anymore, in terms of a downward spiral of overall service, all that would deteriorate, while this individual customer is saying, hm, I think I can create a situation here where I can lower my rate by a little bit.

COMMISSIONER MULVEY: So you're suggesting the road to Hades is paved with these good intentions.

MR. MANION: I couldn't have said it better, actually.

COMMISSIONER MULVEY: Well, I couldn't have said it differently, because there's a mixed group here.

A couple of the charts I had some questions about. All the charts were in nominal terms, in terms of the capital expenditures, rather than in real terms? In other words, they're in current dollars rather than constant dollars?

MR. LANIGAN: They were the dollars in the year that they were --

COMMISSIONER MULVEY: That's current dollars.

MR. LANIGAN: Current dollars.

COMMISSIONER MULVEY: If it would have been constant dollars, there might have been a little less draconian changes from year to year, or --

MR. LANIGAN: A little bit, sure.

COMMISSIONER MULVEY: With regard to one of the Norfolk Southern capital, the last one was 2011, which was B, and what does the B stand for? Was that a projection, or was that a year-to-date, or what? I didn't see -- I didn't quite catch it on that, the capital expenditures for 2011 for Norfolk Southern?

MR. MANION: Budget.

COMMISSIONER MULVEY: Oh, budget. Oh, okay. Thank you. So we don't know what the actual expenditures were, or would be for that year?

MR. MANION: No, I mean --

COMMISSIONER MULVEY: Are you on budget on that?

MR. MANION: -- historically, I mean, historically, that will be about where it comes in, and frankly, in a good year, it might bump up a little from the --

COMMISSIONER MULVEY: Well, that's quite a bit higher than in 2010. That's quite good.

One last question and that was in regard to the UCTS program that you have, would that be able to be what the PTC -- a full PTC system would do. Would that be a kind of a prelude? Or, if you have to adopt to adopt PTC, would that replace UTCS, or would UTCS complement PTC?

MR. MANION: No, they are two different things, and what UTCS does not do is take over control of the movement and have the ability to stop it if the engineer isn't doing -- isn't handling their train they way they should.

COMMISSIONER MULVEY: But PTC does that. My question, I guess, is, does PTC -- especially if it's a full system of PTC, would that give you some of the same things you're getting now with UTCS?

MR. MANION: No, it doesn't. In fact, it doesn't give you any of those same things.

COMMISSIONER MULVEY: Okay. So they are two separate, hopefully complementary, but not competing, but certainly they're systems that accomplish --

MR. MANION: They're two separate things. The big difference is that with UTCS, there is a lot of efficiency built in. Efficiencies allow us to do a better job with a scheduled railroad, efficiencies for fuel saving and handling environmental concerns, and so when we spend money on UTCS, we are getting a big return on our investment. When we spend money on PTC, we're not getting a return on investment. And you're familiar with the stats.

COMMISSIONER MULVEY: We all know the numbers. Would UTCS improve your ability to handle open access if that came down the road? Would UTCS be something that would enable -- facilitate your ability to handle an open access requirement?

MR. MANION: No, actually, UTCS would be quite disrupted by any kind of an open access or open interchange type scenario, and I'll tell you the reason for that.

UTCS is only as good as --- like any computer system, it's only as good as the information that you give it.

And with open access or open interchange, all of a sudden, you are throwing in a wide variety of permutations as far as different flows for traffic, and when you throw all that in the mix, UTCS is going to have a much harder time being efficient.

And you know, simply put, what UTCS and the movement planner portion of UTCS does, what it does is it looks at all the different variables going on around it, whether it's other trains that are hours away, as much as eight hours out.

It looks at what the topography of

the railroad is. It looks at what trains are entering the system, and if there suddenly are, I'll just say, unplanned or unknown movements that are showing up through open access points or open interchange points, it is disrupting to the planning function of UTCS.

COMMISSIONER MULVEY: So it wouldn't allow UTCS to optimize the efficiency of the yard?

MR. MANION: You said it better.

COMMISSIONER MULVEY: It would be sub-optimal.

John, one last thing for you, and that is you were talking about the evidence of competitiveness in the coal fields, changing of service to plants between the major railroads.

Hasn't there also been some of that too on the intermodal side in the West Coast, that haven't there been changes from one railroad to another for large amounts of intermodal movements at the same time, over the last few years?

MR. LANIGAN: Yes, there has been some shifting of business between us and UP on the West for intermodal as well.

COMMISSIONER MULVEY: So that also suggests that there's also some competitiveness out there.

MR. LANIGAN: We've shifted businesses, Commissioner, in every one of our lines of business, coal, ag, industrial, and intermodal on a year-to-year basis.

We have to replace ten to fifteen percent of our business through losses, etcetera, on an annual basis. So, yes, there's competition all the time across all of our businesses.

COMMISSIONER MULVEY: Okay. Well, thank you very much. Thank you very much.

VICE CHAIRMAN BEGEMAN: I have one last question for you, Mr. Lanigan. I know you were here yesterday, certainly during the afternoon when Western Coal testified, and I asked them about the chart that indicated that the competitive traffic was actually at a higher rate than the captive traffic. And I'm wondering if you care to comment on that chart.

MR. LANIGAN: For our total book of business, captive traffic remains higher than competitive traffic overall on an average basis.

VICE CHAIRMAN BEGEMAN: But not on Powder River Basin coal?

MR. LANIGAN: I can't specifically answer that, Vice chairman. I don't have that information at my fingertips.

VICE CHAIRMAN BEGEMAN: All right. Thank you.

CHAIRMAN ELLIOTT: Thank you very much. We appreciate you coming today.

We'll bring forward panel number five. Just for everyone's information, I think we're just going to plow ahead and not have lunch today, because we're making pretty good progress here, and I think that will just prolong things, especially for people who have flights to catch or maybe want to catch an earlier flight to get home.

Also, for this panel, we may have another speaker come in where you'll have to get up again. So I just wanted you to be aware of that. But you will have your full speaking time.

Okay. Why don't we get going with panel number five? We'll start out with Diversified CPC International.

Mr. Frauenheim, you have ten minutes.

MR. FRAUENHEIM: Thank you, Mr. Chairman.

CHAIRMAN ELLIOTT: We need you to get that mike, speak into the mike, otherwise, the court reporter can't --

MR. FRAUENHEIM: Thank you, Mr. Chairman.

CHAIRMAN ELLIOTT: Great.

MR. FRAUENHEIM: My name is Bill Frauenheim. I am Vice President of Operations at Diversified CPC International --

CHAIRMAN ELLIOTT: I see I've been abandoned by my fellow board members here, so --

MR. FRAUENHEIM: -- a leading manufacturer and distributer of liquified gas, aerosol propellants, and specialty gas liquids in North America.

I'm responsible for the operations of Diversified CPC's liquified gas processing facilities in the US.

My role as Vice President of Operations includes the Diversified CPC's transportation function that reports to me. For the past 13 years, Hydro Consulting Limited has helped us manage our rail transportation. They keep me informed on transportation issues, and I frequently participate in meetings with carriers.

Diversified CPC has filed initial comments and reply comments in this proceeding, and we endorse initial comments and reply comments submitted by interested parties and by West Lake Chemical Corporation.

Diversified CPC is headquartered in Channahon, Illinois, and has six manufacturing and distributing facilities in North America, with 48 employees. Even though Diversified CPC is considered a leader in the aerosol propellant industry, Diversified is considered a small shipper.

We have 37 rail lanes. Volumes in those lanes range from 1 to 181 tank cars annually. Between inbound tank cars and outbound product tank cars, we ship about 1,000 tank cars per year.

Diversified CPC relies on Class 1 railroads for inbound shipments and raw materials to deliver products to customers. While we also ship by truck for shorter distances, some customers request rail deliveries, and truck transportation is not always a practical alternative for long-haul moves.

Therefore, rail is a critical part of our operation and the ability for competition to be competitive.

The railroads have adopted a position that rail rates declined in real terms during a 30-year period following enactment of the Staggers Act, and that shippers have benefitted from the cost savings. Further, they try to justify aggressive pricing practices based on the need to build and maintain their infrastructure.

I cannot comment on the general statement by railroads that rail rates have declined since enactment of the Staggers Act. What I do know is our cost of doing business with the railroads have increased, and we frequently need to remind the railroads that Diversified CPC has also invested capital for infrastructure improvements so that we can increase freight volumes with the railroads.

For example, Diversified CPC has invested more than $2.2 million at its rail-served plants for infrastructure improvements required to maintain and increase rail shipments.

We cannot always pass those costs through to our customers. These projects included rail infrastructure improvements and storage at our Petal, Mississippi facility; installation of additional rail car unloading stations, rail car risers, and bulk storage tanks at our Anaheim, California, Petal Mississippi, and Miami, Florida and Sparta, New Jersey plants.

The Channahon, Illinois plant was originally constructed with three sidings and eight tank car loading and unloading stations. Prior to the latest expansion to add a fourth siding, we added four additional tank car loading and unloading stations, and bulk storage for a new product blend shipped exclusively by rail.

The plant now has 16 tank car loading and unloading stations, effectively doubling the loading and unloading facilities of the regional plant design. The plant can now handle up to 24 tank cars on its four sidings.

While Diversified CPC has invested capital in infrastructure to increase rail shipments, the railroads seem to have a one-sided view of the need to earn adequate return on investments.

In 2004, one of our customers asked our company to develop a new product for our customer's foam packaging operations. We developed the new product, which was accepted by our customer. Diversified CPC acquired additional tank cars, and we invested more than $500,000 in construction of a storage tank farm, blending system, and associated pumps and piping for the new commodity.

During the three years that we had

the business, rail costs for this move increased more than 41 percent. We're in a very competitive business in the aerosol propellant industry, and in our other business units as well.

The railroads disregarded our warnings, and ultimately priced Diversified CPC and the railroads out of the business. After we lost the business, the carriers asked what they could do to help in the recovery of the business.

They re-established the rate that applied prior to the last increase, but unfortunately, it was too late.

While we understand the need for the railroads to earn an adequate return, it was extremely unfair for the railroads to encourage us to develop business that required capital investment and then subsequently chase the business away with irresponsible pricing practices.

We believe that this example

demonstrates that the competition in the railroad industry may be inadequate. For this particular lane, both origin and destination are classic bottlenecks. 100 percent of Diversified CPC's rail lanes have bottlenecks at origin and/or destination.

While we do not have an agenda to request competitive access at all locations, I believe it possible that simply having an option to open industries to reciprocal switching would create a competitive environment that will serve the public interest.

We have one plant that is not operating according to plan that could benefit if served by a second carrier. Our plan when locating that plant was to serve customers by rail and truck. However, outbound rail rates proposed from that plant have not been competitive, so we've been forced to serve those customers from other origins.

We believe it likely that rail

volumes and production at that plant would increase if served by another carrier.

Diversified CPC does not have an agenda to file complaints with the STB to seek relief from unreasonable rates. First of all, we prefer to resolve issues directly with the railroads, where possible. Second, current procedures are not practical alternatives for small shippers like Diversified CPC.

The railroads contend shippers do not need competition, so long as we have regulations. In other words, if we do not like rates, we can file a rate case with the STB.

This clearly indicates that the railroads are out of touch with customers, or maybe they simply don't care about our business.

When the Board developed new proceedings and standards for small rate cases, it was a step in the right direction. However, they offer no practical recourse for small shippers like Diversified CPC as the litigation costs would outweigh the potential gain.

This is evident by the fact that recent rate cases have been filed by very large companies, including DuPont, Total Petrochemicals, and M&G Polymers.

The cost of litigating a rate case under current procedures, including the small rate case and simplified SAC procedures, prohibits most shippers, and especially small shippers like Diversified CPC, from seeking relief at the STB, leaving us little or no recourse.

Small shippers like Diversified CPC should have access to seek Board protection from unreasonable rates and unfair practices.

Mr. Chairman, in conclusion, competition in the railroad industry, in our view, is inadequate. We commend the Board for initiating this proceeding.

We encourage the Board to create some additional competitive marketing alternatives to shippers, including practical solutions for small shippers.

Potential alternatives include simple access to reciprocal switching and variable cost thresholds for switching costs. Finally, the Board should review current rate reasonableness standards and rate case procedures and consider changes that may be necessary to establish a simple procedure that would give small shippers like Diversified CPC the ability to seek Board relief from unreasonable rates and unfair practices.

I appreciate the opportunity to comment on the competition in the railroad industry, and we're hopeful that this information that we have submitted will contribute to the process that will lead to a comprehensive decision that will address these difficult and challenging issues.

Thank you.

CHAIRMAN ELLIOTT: Thank you very much. We'll next hear from M&G Polymers.

You have ten minutes.

MR. FOURNIER: Thank you. Chairman Elliot, Vice Chairman Begeman, and Commissioner Mulvey, good afternoon.

My name is Fred Fournier, and I'm the Global Marketing and Sales Director for M&G Polymers USA. I'm here to testify on the current state of rail competition as experienced by M&G, and to support changes in the Board's policies that would enhance rail-to-rail competition.

M&G Polymers is the North American operation of M&G Group, which is a global producer of polyethylene terephthalate, or PET. PET is a plastic that's used in packaging applications. It's used in making plastic bottles, food packaging, carpet fibers, among many others.

Despite our global presence, M&G is a family-run business that manages to compete on the highly competitive world stage through technological innovation and lean operations.

We produce PET at two plants in North America. One is located in Altamira, Mexico, and the second in Apple Grove, West Virginia.

We also recently have just announced plans to construct a new facility at a location in the Gulf Coast that is yet to be determined.

M&G has a strong commitment to investing in the United States, but that commitment has been sorely tested by our experience as a rail captive shipper in our West Virginia facility.

As I'm sure you're well aware, M&G is in the midst of a rate case against CSX, which is the sole rail carrier at our West Virginia plant.

Our decision to pursue that case was not made lightly or without lengthy discussions with CSX, and this is because of the significant cost and time associated with rate cases.

Before we decided to construct a new plant on the Gulf Coast, we had focused our attention on expanding the West Virginia facility, which also would have significantly increased the number of rail shipments from that plant.

However, we could not justify that expansion based on our rail costs. Despite sharing that fact with CSX, we still cannot obtain rates for a contract for a term that made sense to us.

Although we are challenging our existing rail rates at the Board, we cannot defer our investment, that decision, for two to three years while waiting for an uncertain outcome, nor could we have challenged CSX rates on movements several years into the future to locations to be yet determined.

Therefore, we were forced to

search for other sites for this project.

In M&G's experience, railroads routinely inhibit or restrict competition even where such competition may appear to exist, at least on paper.

For example, when M&G has attempted to use rail to truck trans load to get around a bottleneck destination carrier, the railroad serving the bulk terminal frequently asks us, wanting to know, what is the ultimate destination of the subsequent truck shipments before they quote a price.

The railroad has no need for that information except to determine whether the trans load is being used to bypass another railroad.

Railroad marketing personnel have told us on more than one occasion that they have no interest in trans load traffic when we have the option to ship by rail directly on a competitor.

When railroads lose competitive

business, they make up for the lost revenue through the remaining captive traffic. Despite railroad arguments that shippers can leverage their competitive traffic to get rate concessions on their captive traffic, the reality is that the railroad really enters into negotiations with a revenue target that it's going to hit, whatever combination of captive or competitive rates will get it there.

At competitive destinations, another example, railroads will use the needs of M&G's customers for storage tracks to foreclose competition. The customer, our customer, will direct M&G to ship to its lease track on railroad A, which precludes M&G from using railroad B.

Because M&G, not its customer, pays the freight, M&G is left holding the bag for the higher line haul freight bill.

Some other evidence that competition is lacking includes the following:

rail rates have steadily and significantly increased, even through the recent severe recession, while other supposedly competition modes decreased rates.

The second one is, despite the potential for significant additional traffic from Apple Grove expansion, CSX was unwilling to offer rates and a contract term that would provide reasonable rates for a sufficient length of time to justify the expansion at West Virginia.

Because CSX serves a majority of the PET production in the United States, there also is very little geographic competition. Moreover, where geographic competition still exists from foreign production, CSX has been non-responsive.

For example, PET shipments to the Pacific Northwest are equidistant from M&G's Mexico plant and from our West Virginia plant. We source those customers from our Mexico plant, and this is because the rates are much lower getting it from Mexico to the Northwest.

Moreover, M&G has lost business to foreign imports at destinations that were as far as 400 miles from the nearest port because our transportation costs were not competitive.

The rail industry contends that trucks provide adequate competition, even when rail may not. This simply is not true for the plastics industry. Over 85 percent of M&G's North America production is delivered to our customers in rail cars.

Most of the remaining 15 percent is delivered by truck, goes to customers that don't have rail access, customers that purchase less than rail car quantities, or they're rail-served customers where they require expedited shipments.

This is because our customers have a choice between rail and truck. They almost uniformly require rail.

Rail cars are not just transportation vessels. They are storage vessels as well. Like most PET producers, M&G does not have an extensive storage silos field at our production plants. Since most of our customers receive rail deliveries, we use the rail cars for storage.

Even when we ship by truck, the truck is trans-loaded from a rail car into the truck. Even when we ship -- excuse me. Likewise, our customers, they also rely on rail cars for storage because they also do not have extensive storage silos.

This is the predominant industry practice. Consequently, trucks are rarely competitive alternatives to rail for M&G.

When it comes to the changes to enhance rail competition, although we are availing ourselves of the regulatory remedies for unreasonable rates, even as we speak, its costs are enormous. You've heard that before.

Our case right now just came to the one-year anniversary, and we're looking at another one or two years before it will be settled.

Right now, we've spent $7.3 million in the first year, or through May of this year. Over 60 percent of that is in the tariff rates. So as Commissioner Mulvey had said, it is quite an expensive process, and I think it far exceeds what you originally thought might be the cost of doing it. To be honest, it exceeded what I thought it would cost.

We were prepped and told that it could cost $10 or $11 million. I think you'll see that we're looking that it may cost us between $15 and $20 million before we're done. And this is -- and this again is responsible for consultants, attorneys, but overwhelming, this tariff rate that we have to pay during the meantime.

So, the opportunity cost to go through your process is going to cost me $15 million, and I think that's too much.

So if the Board cannot streamline

its rate case process, it needs to find ways to enhance competition where it does not exist, and to allow competition to work more effectively where it does exist.

M&G would much prefer to allow a competitive market for rail service to determine reasonableness of its rail rates. The Board can and should modify its existing policies to facilitate such competition through the requested reciprocal switching and bottleneck rates that you've been hearing about for the last two days.

Reciprocal switching enhances competition by eliminating very short bottleneck segments that are the only barrier to competition rail service.

Bottleneck rates simply unlock competition that already exists over non-bottleneck segments. It also has the potential to greatly simplify the determination of reasonable bottleneck rates.

In closing, I thank the Board for

the opportunity to share M&G's perspective on rail competition and the policy changes that could foster greater competition in the rail industry.

M&G stands prepared to work with the Board, with the railroads, and others in the industry to enhance rail competition, improve its efficiency of the rail transportation system wherever possible, on which our nation's economic well being, we understand, so much depends. Thank you.

CHAIRMAN ELLIOTT: Thank you very much for your comments.

We'll next hear from United States Gypsum. You have ten minutes.

MR. MACKO: Thank you.

Chairman Elliott, Vice Chairman Begeman, and Commissioner Mulvey, thank you for the opportunity to offer comments to you today on ex parte 705 covering competition in the railroad industry.

My name is George Macko, and I'm

manger of transportation for the United States Gypsum company, a subsidiary of USG Corporation, headquartered in Chicago.

For brevity, we'll refer to ourselves as USG in our comments.

I'd first like to provide a few qualifying statements on who we are, what we ship, and the scope of our rail operations in North America, and then offer comments specific to the subject of this meeting.

USG is North America's leading producer of gypsum wallboard, joint compound, and a vast array of related products for the construction and remodeling industries. We are also the global leader in the manufacture of ceiling suspension systems and are recognized as the premier manufacturer of acoustical panels and specialty ceiling systems.

Through our subsidiary L&W supply, we are also the nation's largest distributor of drywall and related building products, serving the trade via a network of more than 160 distribution centers throughout the US.

USG ships an array of raw materials and finished products throughout the US, Canada, and Mexico via the North American rail and intermodal networks. We are a manifest, unit-trained, intermodal and export shipper with total rail network activity exceeding 25,000 shipments per year.

33 of our 36 manufacturing facilities are rail-served by a combination of five Class 1 railroads and 11 short lines, and we lease approximately 400 rail cars to support inbound raw materials and unit train operations.

The subject of this hearing is strategic in nature, and very important not only to USG but to our country as a whole. When distilled down, it's really about two key issues: one, managing the country's transportation infrastructure into the future, and rail's critical role in that process, and two, reaffirming the fundamental value of America's free market economy and understanding the dynamics of supply and demand.

Over the last five to seven years, the railroad industry has clearly turned the corner on profitability. Much to our satisfaction, they've been very diligent and have prioritized investing those profits back into the railroad resulting in higher productivity and expansion of operations.

Some observers have referred to these profits and operating improvements as a rail renaissance, and we couldn't agree more. This increased profitability has been the focus of intense debate, and has resulted in a call for change by a number of shippers. The calling of this hearing is but one example.

It's USG's position that this renaissance was the intended objective of the Staggers Act. One only need look at the before and after picture. Prior to Staggers, the railroad industry was dying and systematically broken, with no means for reinvesting.

Although it's been a long journey since Staggers, we've seen Class 1 mergers, consolidation in the short line industry, work rule changes, falling and rising rail rates, innovation in technology all culminating in the momentum of the last five to seven years.

Unmatched by any industry in the country if not the world, the railroad industry is now voluntarily investing almost 20 percent of sales back into the business to make itself more reliable, more competitive, and to answer the growing transportation needs of the country.

As a shipper, we cannot afford to see this progress stopped or throttled. The US economy and our transportation network needs the railroads profitable, growing, investing, and hauling more freight for our country.

In our opinion, the issue here is not about the level of railroad profits, are they fair, but rather, are the railroads responsibly reinvesting those profits for the benefit of the shipper community and the country.

Our answer to that is emphatically, yes, and they should continue.

We're going to combine our comments on a number of related issues identified by the Board, including alternate through-routes, terminal facility access --

CHAIRMAN ELLIOTT: Mr. Macko? We have Senator Franken here, so if you could just hold that thought, and we'll have you up here shortly. I appreciate your understanding.

SENATOR FRANKEN: Where would you like me?

CHAIRMAN ELLIOTT: Right here up front, right where you are, that would be great.

SENATOR FRANKEN: Thank you, Mr. Chairman, for accommodating me.

Chairman Elliott, members of the Board, thank you for holding this hearing on competition in the rail industry, and for giving me the opportunity to testify today. I want to thank the gentleman who just interrupted their own testimony.

I can't tell you how important railroad -- rail-to-rail competition is for shippers in Minnesota. Whether you're talking about agricultural products or electric utilities or manufacturers, they all depend on rail for shipping.

It's critical that we have a competitive rail industry that provides affordable rates and reliable service for American shippers, both to keep jobs here in America and to keep American industries competitive in the global marketplace.

This issue is deeply personal to

me. I moved to Minnesota when I was four years old. My dad didn't graduate from high school, and he didn't have a career as such, but my grandfather, my mom's dad, owned a quilting factory out East, and he gave my dad a chance to start up a new factory in the Midwest.

So he moved to Albert Lea, Minnesota, a small town in southern Minnesota, to start a quilting factory.

My Dad was a great dad, but he wasn't a great businessman, and the factory failed after only two years, and then my Dad decided to move us all up to the Twin Cities where, essentially, I grew up.

Years later, I asked my Dad, why Albert Lea? And he said, well, your grandfather -- and that's how he talked, he was from New York -- your grandfather wanted to open a factory in the Midwest, and the railroad went through Albert Lea.

So, I said, well, why did the

factory fail?

He said, well, it went through Albert Lea, but it wouldn't stop.

(Laughter.)

Basically, the railroad shook him down to ship his goods, and it was so expensive that the factory failed.

Now, I'm going to date myself here. That story is 50 years old, and sadly, I don't think things have changed all that much for shippers in Minnesota over those 15 years.

The railroads may be doing a heck of a lot better, but in my two years in office, as I've traveled around Minnesota, I've heard nothing but terrible stories from shippers, companies in a variety of different industries in Minnesota who all are struggling to get big Class 1 railroads to play fair and quote them equitable and reasonable rates.

These businesses have come into my office in DC and told me stories of rate hikes and unreliable service and of unexpected tariffs being tacked on to their normal bills.

I've also heard from some companies who have decided that it's cheaper to import products from overseas into the US rather than producing them and shipping them out of a plant in Minnesota where they are captive to a single railroad that's charging them an arm and a leg for transportation.

That's just not right, and you don't need to be an economist to see that. It isn't just bad for small business and for farmers in this country. It's absolutely terrible for our nation's economy.

Most of these shippers don't want to say anything publicly, because they realize it would be a fight between David and Goliath, and that they fear retaliation. And that alone should tell you that there is something unfair going on here if a shipper can't come in and publicly say something for fear of retaliation.

These businesses need to maintain their relationship with the one railroad that serves them, and they've got no other way to ship their goods.

In my view, that's one of the most telling signs that we don't have a competition rail industry in America today, this fear that these shippers have, that they are too scared, as I said, to speak for fear of retaliation. We've got a major problem, and if we don't fix it, we're being complicit in handicapping US industries in the global economy.

That's the point I want to really drive home today. And I realize I am not alone on this point. The President's Export Council, chaired by the CEO of Boeing, agrees with me on this.

In a letter to the President back in March, the Council identified Surface Transportation Board reform as part of a national strategy to make American industries more competitive in the global marketplace.

And I know the Department of Justice and Department of Transportation and USDA and GAO are all saying exactly the same thing.

It's the responsibility of this Board to protect shippers from anti-competitive practices in the rail industry. Congress has given you broad authority and the flexibility to take action. It's time to examine the STB's policies and make necessary changes to protect shippers from unreasonable rates.

Now, there is no question that we need a financially healthy rail industry to have a strong economy, and thanks to STB policies over the last three decades, we've got a profitable rail industry today. Class 1 railroads are some of the most profitable businesses in our country today.

Despite a sluggish economy, over the last several years, railroads are announcing record earnings that have allowed them to more than double their dividend payments to stockholders and spend billions more repurchasing stock.

We have a very healthy rail industry, and that is a good thing. But it's only one side of the coin. We can't have a healthy rail industry at the expense of shippers, and there are things that the STB can do now to make sure shippers remain competitive.

The GAO has laid out several possible open-access policies that the STB should strongly consider to increase competition in the rail industry. I know that USDA and others have laid these out in detail in their filings, so I won't spend a lot of time or any time delving into these right now.

But I hope the STD -- sorry, STB --

(Laughter.)

-- Surface Transportation Board, absolutely a clean, healthy group --

(Laughter.)

-- so far as I know --

(Laughter.)

-- will take a serious look at these overdue proposals.

I'd also like to encourage the STB to reconsider its current accounting polices that allow the inclusion of acquisition premiums in a railroad's asset base.

I led a bipartisan group of senators in a letter to the Board in March on this topic, and I appreciated your reply indicating that you would consider a shift in this policy.

The Board's treatment of acquisition premiums put captive shippers at risk because they have no choice but to pay higher rates passed on to them by the railroad. And ultimately, it means that a smaller number of shippers will meet the 180 percent threshold that's required to challenge rates before the STB.

I strongly urge you to address

this issue when you're considering ways to improve competition in rail markets.

In closing, I'll just say that contrary to how this issue is often portrayed, rail competition isn't about shippers versus the rail industry. It's about the health of the American economy and keeping America competitive in the global economy.

That's in everyone's interest, shippers, railroads, and the millions of people that work in these industries.

I hope the Board will act soon to make sure that American industries can stay competitive in our increasingly global marketplace.

Thank you once again for the opportunity to testify, and for taking -- accommodating my schedule, and I appreciate your careful consideration on these issues.

Thank you.

CHAIRMAN ELLIOTT: Thank you, Senator Franken. We appreciate you taking the time and sharing your views with us.

SENATOR FRANKEN: Appreciate it. Thank you.

CHAIRMAN ELLIOTT: We've been called much worse, so.

(Laughter.)

SENATOR FRANKEN: Sorry. I'm sorry about that slip.

CHAIRMAN ELLIOTT: That's okay.

(Laughter.)

SENATOR FRANKEN: It will never happen again.

(Laughter.)

CHAIRMAN ELLIOTT: Okay. We can bring up the prior panel.

Mr. Macko, I believe we were in the midst of your testimony.

MR. MACKO: I'll pick up wherever I left off.

CHAIRMAN ELLIOTT: I'm sure you can't match the prior testimony, but give it your best shot.

MR. MACKO: I'll do my best.

The subject of this hearing is strategic in nature, and very important not only to USG but to our country as a whole.

When distilled down, it's really about two key issues -- managing the country's transportation infrastructure into the future and rail's critical role in that process, and reaffirming the fundamental value of America's free market economy in understanding the dynamics of supply and demand.

We're going to combine our comments on a number of related issues identified by the Board including alternate through routes, terminal facility access, reciprocal switching agreements, bottleneck rates, and access pricing.

When we look at this combination of subjects, it would be humanly impossible for a shipper not to get excited about the prospects of totally opening up the existing rail network.

Shipping from an origin with access to multiple carriers to destinations served by multiple carriers could be viewed in some circles as nirvana. While it's easy to get swept up into the thrill of the thought, we have to pause and remember, these are private rail networks owned and built by the railroads.

Investments to grow and expand were made on the basis of what these investments would return to the railroad in terms of productivity, profits, or new business. They were not made on the basis of investing for the entire railroad industry and competitors.

As a free market driven company, we at USG would struggle with the notion of investing not only for ourselves and our customers but also for the benefit of our competitors.

The railroad industry should not be viewed any differently. Efforts to open the system will directly impact the railroad investment decisions of the future by adding a very awkward decision element of how would our competitors expect to benefit from our investment.

In our opinion, in a free market economy, that concept defies any level of logic. There have been many published studies that project the condition of the nation's transportation network over the next 20 to 30 years, and a few were referenced in yesterday's testimonies.

These subjects all have a common thing. Without significant investment, the US transportation network's productivity and capacity relative to demand will decline, particularly in our metropolitan centers.

The challenges are distributed amongst all modes of transportation. The highway issues are extremely complex, and indicate the need for staggering amounts of money and coordination at the federal, state, and local levels.

In our opinion, our highway system has no clear direction or solution in sight, and the future is not bright.

While rail has a similar large investment need, the actions necessary to move forward are significantly different. As a private network, the railroad industry funds its own maintenance of business and capacity growth.

Over the last few years, they've also created a number of unique private/public partnerships to enhance and accelerate this investment process.

The bottom line is that the railroad industry is poised to address the growing needs of the country's transportation network, and do it primarily by itself, and most importantly, without a burden to the US taxpayer.

It is USG's fundamental belief that a dollar invested in rail for the future will move more freight, move it safer, and move it more environmentally friendly than that same dollar invested in any other competing mode.

We cannot afford to do anything that will stymie this process. We could surely go into significant detail on each of the operational issues identified by the Board. It's USG's view that as attractive as some of these ideas may sound on the surface, they cannot be pursued and implemented at the potential expense of the railroads investing for the shipping community and the nation's future.

Our future ability to efficiently and cost-effectively move our goods to market is far too important and critical to the long-term success of our business than the short-term revenue shift that these changes may bring.

Railroad profits should not be shifted to other parts of the supply chain, but rather retained and invested in the growth of the existing rail network.

We use a variety of transportation modes to serve our business. With the total transportation spent of approximately $400 million annual, rail represents about 15 percent of our total spend.

While predominantly a truckload shipper, we use rail and lanes where it offers us the best value. Rail is the most efficient and safest mode for moving our products in those lanes.

Let me emphasize this point. We utilize rail in select lanes because it's the most competitive mode when compared against alternatives. The process has served us well since Staggers, and we see no basis for changing these market-based rail solutions into the future.

In summary, America's free market system is unmatched anywhere in the world. The fundamental objective of companies operating in a free market is to be profitable, so one can invest in one's business's future and the future of one's customers.

Since returning to profitability, that's exactly what the railroads have done and continue to do. As stated earlier, the shipping community and our transportation needs the railroads profitable, growing, investing, and hauling more freight for our country.

The railroad system is not broken. It's not in need of a tweaking, and it does not need a shift towards regulation. The objectives of the Staggers Act are being met and fulfilled every day.

The industry has adapted. It's healthy. It's reinvesting in itself and is growing to meet the future needs of the nation.

True to the act's original intent, the objective now is to let the progress continue, and to let our valued business partners continue to grow the best railroad network in the world.

Thank you.

CHAIRMAN ELLIOTT: Thank you, panel.

Vice Chairman?

VICE CHAIRMAN BEGEMAN: Sir, I think you just mentioned that 15 percent of your transportation is via rail. Is that what you said?

MR. MACKO: Yes.

VICE CHAIRMAN BEGEMAN: And I know you also mentioned that you're from Chicago. When you choose to utilize rail, do you have competitive options, or are you -- I mean, Chicago certainly is a big gateway.

MR. MACKO: We review all modes. We review modes between rail carriers --

VICE CHAIRMAN BEGEMAN: But I mean as far as rail-specific, do you have multiple carriers that you utilize?

MR. MACKO: We do have facilities that are multi-served, shipping to facilities in some cases that are multi-served.

And I think the important thing to notice or to reference is to be careful that we don't misinterpret open access. I can cite several examples where we have an open access, multi-carrier solution. But you know what, no two railroads are built alike.

I can cite an example of our facility in West Texas that routinely ships rail to the Denver market, on both railroads.

One railroad's route is 800 plus miles. The other railroad's route is 1400 miles. The rates are not the same, nor should they be. Open access does not guarantee the same route to destination.

And so when we look at -- when we look at routes, we look at, what are our available rail alternatives, available truck alternatives, and available intermodal alternatives, and we work with all three modes.

VICE CHAIRMAN BEGEMAN: Well, I think you're in a lucky position compared to a lot of the shippers that have testified, because they truly are captive, particularly the chemical guys in one of the previous panels, who was strictly had no option other than rail.

Sir, you indicated that the processes that the Board for bringing rate complaints just still are sort of out of reach for you. Do you have any specific recommendations of what the Board could do, should do, to address you concerns?

MR. FRAUENHEIM: Our outbound rail shipments, rail spend, annually is about $2.6 million, so trying to litigate a rate case for a company of my size, as Fred said, it costs a lot of money. It's just not open for us.

Our revenue to variable cost ratios for our average shipment is about 400 percent, which is more than twice what the 180 percent that would allow us to potentially put through a rate case.

I really don't have an answer for you of what you can do. I did pick up this handy little brochure coming in this morning--

VICE CHAIRMAN BEGEMAN: Good.

MR. FRAUENHEIM: -- the Rail Customer and Public Assistance Program. I wasn't aware of this program.

It sounds like it may be a very good alternative for small shippers like myself, so, I'll look into that further. So it might be that my coming here, that this was very beneficial, so, we'll see.

COMMISSIONER MULVEY: Yes, I'm glad that might be helpful to you, because our group has been successful on numerous occasions, and hopefully, that will be helpful for you.

You made the point for M&G that the tariff rate is one of the real problems, having to pay the tariff rate while the case is being pursued.

Unfortunately, one of the problems historically was that that was not always the case. What the ICC used to do was, it would suspend a rate. And so the railroad could not charge the rate that it was proposing until the ICC decided.

Well, then, and unfortunately I would say perhaps as now -- some of these cases did drag on longer than you would like. And meanwhile, the railroad had to forgo all the revenues. And so even if the railroad won the case and was eventually able to raise the revenues, it was not able to raise them retroactively, and so that was lost revenue for the railroad.

It was one of the things that contributed to the railroad's financial debilitation over the years. And I think that's one of the reasons why we allow the railroads to put the tariff into effect, and then we will give reparations if indeed the shipper ultimately wins.

So I think that shippers need to understand, there's a reason -- there's sort of a method to the madness, if you like, while you --

MR. FOURNIER: It's totally unfair today, though.

COMMISSIONER MULVEY: But Unfortunately, that's the approach. Perhaps there's a way of splitting the baby. I don't know, to put half the tariff in, or part of the increase in, or -- I just don't know how you would deal with that.

Obviously, if we could processes the cases more quickly, that would certainly mitigate against the shipper paying the rate for an abnormally long period of time.

You mentioned that the cost of litigation was $15 million to $20 million you were looking at, I thought you were saying, someone said that, $11 million?

You said that, yes. And I was

wondering again if indeed that was -- if you had any documentation for that, and again, what part of that was paying the tariff, and what part of that was the litigation cost.

MR. FOURNIER: We ran out -- we ran out of here when you raised that question with one of the other panels to find out what we had spent, because I remembered yesterday with our attorney, he said that basically, we're right on the anniversary of one year since we filed.

So, I said, okay, let's see how much we've spent so far. So we went out there, and we got it, and now this documentation, I'll sign.

(Laughter.)

But it's small. I'm just going -- legal and consulting, $2.6 million.

Pretty heavy, right? But that's what it costs these days.

Tariff, $4.7 million.

And it isn't one lawyer or one

consultant. I mean, you know, to do one of these things is rather involved, as you know better than I --

COMMISSIONER MULVEY: Right.

MR. FOURNIER: -- whereas I'm finding out. But really, so it's $2.6 and $4.7, that's through May. So, that's considerable.

In fact, I came in here thinking that, okay, we'd do this reciprocal switching, we'd do this open lane, wonderful.

Then I'm hearing, my God, that doesn't guarantee you anything, right? It may be an avenue that someone said yesterday could, over a period of time, maybe a couple, three years, people will start to compete.

But these railroads are great. They can just sit back and just not take it -- you know, take advantage of the opportunity, you know, and we're dead.

But I think the speed of getting this thing done, I mean, right now, we're very confident of our case. It's one that is before you. Speed is the big thing.

I don't know if this could go down to a six month process, but then your staff would probably want to throw stuff at you, because you'd have 1,000 cases, you know?

So I don't know the answer, but I do know one thing. The speed needs to be there, and the expense, it is prohibitive for a lot of companies.

And ours, we finally -- I mean, and we discussed this a long time, and it was a very tough decision, but I think it had to be the right one, based on the options.

COMMISSIONER MULVEY: We will admit that it's a complex process, but we'll also point out that it is one that has been approved by the courts. I think the ICC in the past, did have approaches that were simpler, quicker, but did just not pass muster.

And this SAC process that we use,

the stand-alone cost process, is one which makes use of accepted economic theory and analysis, and has been blessed by the courts.

Just one more question I have. You talked about this new plant you're building on the Gulf Coast?

MR. FOURNIER: Yes.

COMMISSIONER MULVEY: Now, is that being built in America, or is that being built -- the Gulf Coast is a big place, so is it being built in Mexico/Central America, or is it being built in the Gulf Coast of the United States?

MR. FOURNIER: Gulf Coast of the United States.

COMMISSIONER MULVEY: Okay. Well, thank you very much.

CHAIRMAN ELLIOTT: I just have one question. It's a question I've asked pretty much all the shipper panels, and just, we've heard a lot of testimony that the railroads really aren't competing, even where there's competition available, and the conclusion that's been drawn by various groups is if they're not competing, access isn't going to help.

So my question has been, if you had your preference, if this is applicable to you, would you rather the Board pursue open access, or look towards improving the rate process? Like you said, Mr. Fournier, you know, speeding up the process, something like that, that might make it a little more useful to you?

MR. FOURNIER: Speeding it up would definitely be the big key. But when you're paying, you know, 300, 400 percent of variable cost, it's -- it's not hard to figure out that these guys don't want to negotiate very much.

And they like your process, as you heard, because it is so lengthy, because they can do a rope-a-dope with us. I mean, they can just sit back and let is flail away and spend like crazy. And it just goes on and on.

So I think anything to expedite it in a proper fashion, as you say, one that's careful, and it's correct, so it's got to be the right decision type of process. But I think that definitely is needed.

CHAIRMAN ELLIOTT: And I might not have -- the question might kind of lost a little bit, but would you prefer us to improve that process as opposed to -- if we went one way or another, would you rather us work on improving the regulatory process through rate cases, or would you rather us look more towards open access?

MR. FOURNIER: If we could do open access and it resulted in competition, or if you did the other and it resulted in competition, I'd be happy with either.

Right now, I'm getting very concerned. Two days ago, before I walked in here, I think it was an easy answer for me. I'd have said the open access.

After listening today and understanding that some people that are dual-served, they're in worse shape than I am, because they can't even come to you, whereas, as captive shipper, at least I can come to you.

So, you know, it's a tough question. I don't have a right answer, but whichever one can get me to competition faster would be the one I would chose, and unfortunately, I'm not the judge of that. I don't know.

CHAIRMAN ELLIOTT: Thank you.

Anybody else care to take a crack?

MR. FRAUENHEIM: Mr. Chairman, I had mentioned that one of our plants is underperforming versus our plan for that facility, and that facility has -- there's another railroad that's only about six miles away from that facility.

If that facility was served by two different railroads, it's our estimation we could increase our volumes from that plant. We've had rate offers at that facility as high as 1076 percent RVC, and obviously, we're not shipping on that lane, because frankly, we couldn't afford it.

CHAIRMAN ELLIOTT: Thank you.

MR. MACKO: One quick comment. You know, as I listened to comments over the last day and a half, it's clear there are a number of shippers who have rate concerns. Obviously, a rate process in front of the STB I think would be well served.

As a shipper and other shippers in the marketplace who are thriving under the existing network setup, we are concerned about across the board changes that have the potential impact on capacity and the ability of the railroads to operate for our benefit.

And so we would be very, very concerned about broad-based operational solutions that could negatively impact concerns like USG has relative to the railroad networks' capabilities and future needs.

This issue of transportation network for the country, to us, is extremely big, extremely significant.

CHAIRMAN ELLIOTT: Thank you. Those were actually very helpful answers. And thank you very much for your comments. And I think we're going to head on to the last panel.

COMMISSIONER MULVEY: Thank you. We can begin. Let me see. Are all of the panelists here? I see Mr. Strohmeyer, Mr. Varda here.

Is Mr. Dickman here, and Mr. Kemp?

Okay. Well, Mr. Varda, do you want to begin? Jim will be back in a few minutes.

MR. VARDA: Vice Chairman Begeman and Commissioner Mulvey, thank you for undertaking this proceeding and for the opportunity to speak today.

I am setting aside our previously

submitted written testimony to simply summarize the main points and to provide a couple of observations prompted by testimony given by others over these two days.

As background, the associations and shippers in our group were present in the 1980s for the collapse of the Class 1s serving what became the Wisconsin Central Lines, principally in Wisconsin and upper Michigan.

We were present for the formation of the Wisconsin Central and its competitive successes through the 1990s, and we have been present for the failure of the competitiveness under the control of Wisconsin Central by Canadian National over the last decade.

We've participated in all of the related ICC and STB proceedings.

Our initial comments and written testimony describe this experience, including specific examples that demonstrate that the independent WC, to have been a competitive model for non-captive freight, and since controlled by the CN, an ongoing example of the failure to compete for non-captive freight.

Our principal point is this: the Board cannot effectively review the state of competition in the railroad industry without addressing more broadly the current state and future prospects of the railroad industry's competitiveness for non-captive freight.

The burden carried by those subject to differential pricing is, after all, and perhaps, in large part, a function of the effectiveness of the industry's competition for non-captive freight. And by that, we mean freight which contributes to going concern value with revenue-variable cost ratios between 100 and 180.

The few allusions to non-captive freight in the record thus far are simply insufficient. Mr. Hamberger's last comment yesterday, leaving on a high note, as it were, suggested railroads work with their shippers to move the available freight. His testimony, his comment was echoed by Mr. Lanigan today.

Mr. Burkhardt said, and I'm paraphrasing, an intelligent railroad will not let truck-competitive freight get away if the railroad feels able to quote a rate that will move the freight.

Indeed, Mr. Burkhardt's statement was absolutely and positively true of the Wisconsin Central on his watch and until Wisconsin Central came under the control of Canadian National.

Speaking to the Wisconsin Department of Transportation annual freight rail conference, November 19, 2008, Mr. Burkhardt described a skew in the North American railroad industry between Class 1s on the one hand and regional railways and short lines on the other.

He characterized the Class 1s as having quote, "restructured into plain vanilla, high-volume trunk operations with scant interest in running distribution networks and light-density lines."

You might juxtapose Mr. Burkhardt's statement to the passionate description by Mr. Manion today of the importance of velocity, the importance of the efficiency of the operation, and maybe consider, would Mr. Manion's train stop in Albert Lea for the quilts, or deliver supplies to Albert Lea merchandise freight? There is a tension between the trunk line operations and merchandise.

In contrast, much like the testimony of General Timmons and Mr. Ogborn yesterday, Mr. Burkhardt characterized successful regional and short lines as concentrating management efforts on rebuilding single-car networks and containerization, focused on customer's requirements, service, and price, and keeping unremitting pressure on cost.

This latter description is how the

independent Wisconsin Central successfully took lots of trucks off the highways. Examples are provided in our initial comments.

It has not been that way for most of the last ten years under CN control, though we are, since our previous testimony in February, cautiously optimistic that the CN is now or may now be ready to address some of those problems we described to you.

The Midtec mill that gave its name to the precedent and the standard for competitive access discussed in testimony yesterday is located at Kimberly, Wisconsin, on the Wisconsin Central lines.

It has been closed due to the recession. Before closing, among other railroad service problems, the mill was receiving only approximately 60 percent to 80 percent of the boxcars it ordered, despite the fact that the railroad had similar cars in storage.

The 60 to 80 percent means that

the railroad's rates for the mill's non-competitive -- non-captive, highway-competitive freight would have moved at least 20 percent to 40 percent more carloads.

The railroad had already sold the freight. The freight was not taken away by vigorous truck competition. Trucking the freight was the default when the railroad failed to serve.

What does not to compete or failure to compete mean? From our perspective, one way to answer the Chairman's question is, not to compete means that the railroad has set a rate or negotiated a rate, but fails to provide the equipment and the service.

Could we make a case of failing to deal or foreclosure under the Midtec competitive use standards? Maybe, but of course, only after a successful petition to revoke the boxcar and commodity exemptions.

That's not going to happen. The

Board is not going to hear about this type of railroad competitiveness problem, at least not until fuel prices or other factors make trucking prohibitive.

Again, from our -- the perspective of our experience, a better standard or an element of the standard for granting competitive access for non-captive freight might be if the incumbent railroad is not moving the freight, let the other guy have a chance to compete the freight off the highway.

That's why we said in our initial comments and testimony that the competitiveness problem, from our perspective, has more to do with the service than rates. We provide a number of other examples in our written testimony.

Rail carloads, for example, from Packaging Corporation of America's Tomahawk Mill, as well as three others around the country, down from 70 percent to 50 percent since 2005. 2,400 carloads per year from another mill, which WC's competitiveness had increased from 1,000 a year, now down to as few as 20 per year, since about 2003, with the difference having been returned to truck. There are many other examples in the written testimony.

Talk about rising rates yesterday, rising rail rates yesterday. The question we think that you should address is, are Class 1 rates rising because as a result of the consolidations, the railroads' differential pricing of relatively captive freight has become more effective, allowing them to pick and choose when to accept or to simply forgo the challenges and risks of capturing contribution to going concern value from non-captive freight?

Or, in Mr. Burkhardt's words, allowing the Class 1s to focus their attention on plain vanilla, high-volume, trunk line operations with scant interest in running distribution networks and light-density lines, retail railroading that competes with trucks?

This is why we are skeptical about the Board's changing its access rules or its policies until it has fully investigated and understands the state of competitiveness in the railroad industry for non-captive freight.

Thank you.

CHAIRMAN ELLIOTT: Thank you.

We'll now hear from Mr. Dickman from the Mercury Group.

I believe you have ten minutes.

MR. DICKMAN: Chairman Elliot, Vice Chairman Begeman, Commissioner Mulvey, staff and interested parties, my name is Craig Dickman. I would like to thank you for the opportunity to appear before you today.

The Board has asked for ideas to improve the competitive marketplace, and at the same time, have a minimum negative impact on the financial health of the industry.

With that charge in mind, I would like to discuss an option, bringing transparency of fuel and energy cost to the rail industry that we believe will improve the competitive marketplace for both rail shippers and the rail industry alike, provide for the financial health of the industry and do so in a sustainable way, allow some of the inherent benefits of rail transportation, improved fuel economy, lower emissions, to move from being an interesting concept to actually creating a competitive advantage for the rail and for US shippers.

And I believe that this can be advanced through a spirit of collaboration and cooperation, and doesn't require intervention or regulation.

With that in mind, I wanted to share some information with you today, and I've got some slides, if I can touch on them for a moment.

As part of the Mercury Group, and for background, we're a shipper group focused on managing energy costs across the supply chain. So we work not only with rail and intermodal, but work with truck and work with marine and energy costs in total.

And we were asked by a group of our clients to provide insight on the energy costs of some intermodal movements. This specific study we completed focused on 184,674 unique freight movements, and included movements between 1,000 and 2,000 miles, and used dry freight containers, just to narrow the study.

I'd like to share some of that data. The first chart in what we have indicates really why this is an important and timely issue. Intermodal fuel costs have grown, and the chart highlights the time period from January of 2010 through yesterday, actually. And you can see that it's grown to be a quarter of the total cost, actually more than a quarter of the total cost of moving goods is now the fuel surcharge component of intermodal.

For shippers, they need to be able to understand these costs to make effective decisions on how to move their products. For railroads, this is a significant cost, most likely, their most volatile cost, and they must capture and recover it in order to maintain their financial well-being.

The challenge, however, is that today's marketplace makes it virtually impossible for a shipper to understand the fuel consumption, the fuel costs, or the energy-related emissions associated with moving their goods, and which are so critical to their decision-making process.

It's also a challenge for the rail providers and the intermediaries involved in intermodal transactions. Inherent economic distortion is embedded in today's practices, and requires transportation providers to know that virtually every movement has the incorrect fuel cost, and then folks hope by magic that at the end, it all works out relatively close.

That's why we always see transportation providers qualify their earning statements by saying that fuel costs and misalignment of fuel surcharges distort earnings, and that's why we heard at your February 24th hearing, one of the economists mentioned that some of the data that's looked at is difficult to digest because some of the timing issues associated with fuel cost.

Now, as we explore the data further and look at the next chart, what I'd like to highlight here is the real fuel market behavior that's taking place.

There's three aspects to this chart. The green line is the daily pricing for crude, which some folks use to manage their fuel economy. The blue line is the Department of Energy that is used by many folks to capture fuel surcharge costs. And then the real diesel market price, updated daily, is highlighted in the red, and that gives you an idea of the behavior as it exists for compared to those other indexes.

A couple of things we see as we look at this. You know, first you see the DOE index both mutes the daily price changes and frankly misses some of it, and the crude behavior, while an interesting underlying indicator of the raw material of diesel, has a different supply/demand characteristic, and doesn't really represent the costs as they occur.

So, if we shift for a moment and take a look at these in change terms, going back to that January 2010 time frame, what we see is that a surcharge that's based on the DOE index, such as if we look particularly -- it's a little hard to see, but around the June 10th time frame, you can see a separation of the real fuel market behavior from the DOE index, and that creates a distortion in the underlying cost.

Conversely, if you look at crude

and look at market cost and move out to September, you can see a real separation of those costs, and that change would not allow for reasonable or fair reimbursement. And that's just one of the examples of the economic distortions that underlie fuel surcharges and creates problems for the shipper and rail community alike.

When you look at individual movements, those problems become even more exacerbated.

And now as we move to the fuel charges associated with those movements, this next chart, I pull forward the two lines that cover the Department of Energy index as well as the real fuel market behavior, and then we add to it the 184,000 movements that we had and what the rail fuel surcharges that accompany those movements were, based on the price mechanisms.

What you can see when we look at that is that the relationship between real fuel costs and what the rail fuel surcharges were become exaggerated and distorted when there's movements.

This happens to be in about an 18-month period, whereby fuel costs were largely rising. And so what happened is you see that separation of real fuel cost from fuel surcharges, and how it grew during this period of time.

If we would look at a time when fuel prices dropped dramatically, and it's a little hard to see, but if you look around that March 2010 time frame, you can see one of the few times that fuel dropped during this period.

The surcharge numbers actually fell below real market costs, and would have resulted in under-recovery.

So it really highlights some of the challenges that exist with the current methodology and with the behavior that takes place, and it's really artificial behavior that challenges both the shipper and the carrier.

So I wanted to highlight today just a couple of the challenges that we see with the current methods. Because of this exaggerated behavior, when compared to the actual fuel marketplace, it ends up being a winner and loser in virtually every movement and every fuel transaction.

That does not set up for a healthy relationship between the shipper and carrier when it comes to fuel programs.

The fact that fuel surcharges are detached from the underlying markets also creates significant challenges for the shipper. It's difficult for them to budget, because even if they are able to guess what fuel prices will be, they can't necessarily understand the impact of fuel surcharge on how that relationship is.

It makes mode decisions difficult. Ironically, shippers make decisions every day between truck and rail, and in this period, you can have times when the fuel prices are going down, fuel surcharges are going up, and the mode that should be the most fuel-efficient, rail or rail intermodal, actually is at a disadvantage.

And we've seen folks shift freight to truck, not because of the real behavior that's taking place, but because the truck market adjusts fuel costs differently than the rail industry does.

And we also see problems that shippers have had with hedging and managing their risk cost. This price distortion, the fact that there's a disconnection between the real fuel market costs and the fuel surcharges, creates a situation where it doesn't qualify for hedge accounting, and many companies are either not able to hedge in a way they would because of this separation, or have found in the past that they thought they were hedged, but the underlying market's behavior didn't mirror what their charges were, and they ended up paying increased costs and losing the benefits of a hedge.

It's our belief that this analysis indicates that the current marketplace methodology is inefficient and does not support an open and competitive marketplace.

At the same time, we believe the opportunity to do so exists today. We believe that, you know, bringing energy life cycle transparency and a common view of fuel costs, both pricing and consumption related to fuel movements, will enable better decision-making.

It's possible to have an accurate reflection of fuel cost and price movements that will ultimately build trust between the shipper and the carrier, and alignment of the fuel market with the reimbursement provided to transportation providers will also ensure that their earnings aren't distorted, that they're recovering this most volatile cost, and that the shippers are able to make adequate decisions.

Further, we believe the result will be that rail and rail intermodal movements will become more competitive, and when we have these principles applied, lead to more conversion of freight to rail.

We also don't believe that these movements will take place organically. We believe it will take a clear and decisive public policy to move the industry toward a more open and transparent --

(Coughing.)

Sorry.

(Pause.)

Oh well. I think I'm okay.

CHAIRMAN ELLIOTT: You're back.

MR. DICKMAN: Yep. So we think there's a real opportunity here, and believe that an operation of -- excuse me. Thanks, John.

Again, we believe there's an opportunity for public policy to create this change. And what we'd like to see is not necessarily a quest for regulation, but a movement to create a dialogue, and would like to participate -- that members of our organization and our shipper community would like to participate in that, and believe that we can really bring an open and transparency of fuel, one of the most difficult costs to manage, and one of the areas that brings some real consternation between the two parties into one where real collaboration can be fostered.

Thank you.

CHAIRMAN ELLIOTT: Thank you, Mr. Dickman.

Mr. Strohmeyer, I believe you have two minutes.

MR. STROHMEYER: Thank you, Mr. Chairman, and thank you for giving me the opportunity to speak today.

I had not originally intended to participate in this proceeding, but I'm grateful to the Board for the opportunity.

I've provided the Board with some written comments. Unlike some people, I actually enjoy going last, because it allows me to depart from some of my written testimony and talk about a little bit about what I heard.

And there were two points that I felt more than what I wrote in my written testimony that may need -- I wanted to address. One was the Chairman's idea of a pilot project. A couple of ideas that had been circulated, and one point for the new Vice Chairman on some of the representations that had been made with regards to reciprocal switching and open access.

So the first point I'd like to briefly make, aside from the fact that I don't think regulation or looking at stuff at this point in time with regards to open access or reciprocal switching necessary, a pilot project, I think, would suffer from some severe legal challenges, one of which I think is fatal.

But I do believe that a partial project is somewhat possible without creating a legal headache. And one of the issues that had been raised previously, and for some reason, nobody talked about it, was, as a result of the Conrail merger, we had the creation of two of the largest open access areas as part of the process, along with all the associated operational headaches. The Board had direct monitoring of that for almost ten years, in fact, just recently gave that up in 2008.

So, for some reason, the Class 1s completely decided to ignore discussing anything about the trials and tribulations of the competitive access issue that occurs within over 400 miles of track in some of the most important markets in the United States with regards to competitive rail access. And that issue had not been addressed prior to that.

So subsequently, I felt that it was something that the Board may want to consider. And I know my time is up here. But I did have some ideas on what you might be able to do for a potential pilot project, if the Board is interested in hearing about them.

CHAIRMAN ELLIOTT: Thank you very much.

Commissioner?

COMMISSIONER MULVEY: Nothing too much. In terms of the Wisconsin Central, I was privileged to work for the state Wisconsin on the first state Wisconsin rail plan, and Wisconsin has always been very much involved in rail. And in fact, back in those days, the WC was pretty much one of the best Class 2 railroads in the country, and it gave very, very good service. So I do follow what's happening with Wisconsin and Wisconsin Central and the CN with particular interest. So that's pretty much all I wanted to say on that.

With regard to the fuel surcharges, do you feel that what the Board tried to accomplish, back when it had its hearing and its rules, that that we had -- we were going in the right direction? We're trying to tie the fuel surcharges to fuel consumption.

Do you have any way that you think that we can actually do a better job of that? There seems to be a lot of shippers saying that the fuel surcharges still aren't reflecting consumption of fuel, and it's still unclear what -- because we have these indices.

You had the West Texas crude measure as well as the DOEs. Would it be better to just tie it to that, as opposed to a case-by-case analysis?

MR. DICKMAN: Well, a couple of thoughts. You know, first off, I think the Board definitely moved in the right direction with the move away from percentage-based fuel surcharges. You know, when you look at percentage-based surcharges, they really do blow out, and so I think the fact that you made that change is very positive.

I think the fact that the industry as a whole didn't move to it across all commodities and for intermodal as an example, continue to use percentage-based programs, is a sign really that the industry doesn't move easily, and I think it would be helpful if the industry frankly moved on intermodal and others to -- away from the percentage-based movements first. So I think it is moving in the right direction.

I do think that it used to be very difficult from a technology standpoint to capture fuel costs, capture fuel consumption, but in this day and age, with information availability, with real-time access to data, we find the ability to capture fuel costs and consumption in real-time as something that's very possible.

The organization that we're part of actually has processed so far over 14 million movements on the day of the shipment to identify the rail costs and the rail consumption in order to get down to a very specific movement level of what the behavior is of fuel costs.

And so we think there's a number of things that can be done to start moving toward a more accurate measure, start eliminating the economic distortion, whether it's the timing, the geography, the fuel tax, the different impacts of the market, there's some real opportunities to move toward a very transparent marketplace.

And it's amazing when you think of, you know, really the underlying mechanisms haven't changed from the times back in the `70s when the first fuel programs started in with the fuel crisis, and all the advances of technology haven't really been applied to something that's now 25 percent of the cost of moving these goods.

COMMISSIONER MULVEY: Thank you. One point on the revocation of exemptions. When you mentioned that, you sounded as though you said it's not going to happen, that the Board wouldn't entertain that.

The problem was, we really don't get many requests for revocation of exemptions unless they're specific revocations in order to deal with a specific problem. In my time here at the Board, I can recall one revocation, and that was to deal with a problem in Texas with cottonseed oil.

But I think the Board would entertain a revocation of exemption if it was put forward. But it's not as though the Board would dismiss those out of hand. And I'm not sure if you're indicating that in your statement.

Mr. Varda?

MR. VARDA: I was referring to revocation relative to a competitive access problem, not the fuel --

COMMISSIONER MULVEY: No, and that's what I meant. I didn't mean with the fuel. I meant revocation of exemption with regard to a class exemption or a commodity exemption, or a --

MR. VARDA: I think when you look at a shipper like Midtec Mill, and you look around, similar facilities, similar problems, in our experience.

The shipper's not going to petition and come here. They're going to put it on truck, you know, until trucking is so prohibitively expensive -- in other words, until the non-captive person move towards being more captive, you're not going to hear about it. And there's a lot of opportunity cost and waste in between this time and that time, and that's what we're concerned about.

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

VICE CHAIRMAN BEGEMAN: Just a

question, Mr. Dickman. As far as the collaboration and what the data points are that you ultimately conclude, where does that information go?

How is that information then made public or transparent to the shipper, or to the carrier, to whoever needs to know what the rate impact is?

MR. DICKMAN: That's a great question. We started working with shippers in 2005. And what we do is calculate the price on every given day for every given movement, and then provide it to the shipper and to the rail provider, so it's part of an agreement between the two.

So what's happened is we've got shippers who have decided to move toward this more market-based fuel program. We've had meetings with all their providers.

So, as an example, we may have one shipper whose connected with 250 different transportation providers. We're connected electronically with all of them. Everybody agrees on the rules in advance.

And then every time a freight movement is moved, we're calculating, auditing, and providing that data to the people who are involved in the transaction.

So there's absolute transparency. So now the shipper has an understanding of what's the fuel cost, what's the consumption, what are the emissions. It's the same information the transportation provider has, frankly, in many occasions, the same information that the fuel provider has, because they're part of this transaction as well. And it really has changed decision-making a great deal.

If I can share one example, we have a shipper who was making a decision between trucking movements and intermodal movements, and their customer was concerned about intermodal because of the additional transit time and the fact that it would take some additional inventory.

But by providing this transparency, they were able to go to their end customer and say, we've got a real opportunity here. If you're able -- if you allow us to move this on intermodal, we can take out this much fuel. It will remove this many emissions, and that is a tradeoff that we'd like to discuss around whether it's worth a little bit more inventory or not.

So it changes the whole discussion and the dialogue when everyone has that transparent information, and we've seen some really interesting innovative decisions made from having it, where now, those get hidden.

You know, the rail industry talks about improved fuel economy and emissions. It's absolutely correct. But if the shipper can't see the benefit and move it out to their marketplace, behavioral change doesn't take place.

And what we want to do is connect

that -- the facts with that behavioral change. And then again, I think we find that rail is more competitive, and it enhances the competitive position of those individual shippers as well.

VICE CHAIRMAN BEGEMAN: One final thing. I know that you wanted to mention something to me, and your time ran out. If you could briefly just touch on that.

MR. STROHMEYER: Oh. You've heard a couple of discussions today about three terms, reciprocal switching, open stations for switching, and open access.

And in listening to your questions over the time and many of the answers that you have been previously given, you sort of got the -- I was given the impression that you sort of were lumping this all into one category.

And I didn't know if you were aware, they are three very distinctively different types of access, each with their own little nuance, and I was kind of surprised that the Class 1s couldn't better articulate what the various versions were between the two.

Reciprocal switching has always been, if you're interested in knowing, the -- reciprocal means to reciprocate. You give me something, I give you something.

It was voluntary agreements within -- where two railroads would cross, let's say, if Senator Franken's plant was a mile up the road or two miles up the road from where these two rail lines would intersect, and he was on carrier A, and a grain mill would open up on carrier B two miles from the junction and where it was mutually beneficial, instead of building independent branch lines to go serve each of those respective customers, the railroads would open, through reciprocating, I will switch the facility on your behalf, and you can switch this facility on my behalf, and the customers would have access at both those points.

And they were done basically through mutual reciprocation, and that was a voluntary agreement amongst the railroad as opposed to a forced access.

The next portion that you hear would sometimes, you know, it's the give and take that was given for various uses of their system, and they would prescribe that in their rates and how it was structured.

The other one was where they would open a station for switching, which is usually at the request of a specific customer, a particular customer would -- the railroad would say, you know, customer A, in order to locate the plant on my facility, he had certain moves that, let's say, went -- tended to lead to going to a natural carrier.

So what would happen is, as an inducement to locating the plant, the railroad would open a station to competitive access through that.

And then of course, the third process, which is one that every railroad will have a cringe over, which is true open access, which means any carrier can come in and actually service a facility, and that sends chills down every railroad's spine, including my own.

And I didn't know if anybody had adequately explained that to you, and what the various components were.

VICE CHAIRMAN BEGEMAN: I think I got it after I asked the question; I was a bit confused the first time.

MR. STROHMEYER: Yes. There were three distinctive types of services and how they got into the marketplace, and I was hearing people talk about one size fits all. They were usually negotiated amongst the railroads themselves, and that was simply to avoid buildouts primarily through mutual agreement. It was a much more efficient way of doing it.

But I just thought I would bring that to your attention in case you weren't clear -- nobody had given a clear explanation as to what it was.

CHAIRMAN ELLIOTT: Thank you very much. I don't have any questions.

I just wanted to note, coincidentally, I will be in Tomahawk, Wisconsin in August, so I look forward to -- actually, I went to camp in Rhinelander, so, it will bring back bad memories.

Anyhow, I am very thankful for your participation and for everyone's participation. I think it's been a successful hearing.

Two procedural notes before we adjourn and take all the comments under advisement. First of all, for those of you who haven't heard, if you have presented any type of PowerPoint, we ask you to provide two copies of that to the Office of Proceedings in the appropriate manner for filing.

Also, final procedural comment, we will keep the record open for 30 days. There's been a lot of questions and answers, and sometimes people weren't able to answer questions or maybe want to clarify some of the questions -- I mean answers that they gave.

So we will keep the record open for 30 days to give people the opportunity to supplement with respect to those matters. I think that will be helpful to the Board and probably helpful to yourself.

So, with nothing further, thank you very much, and the hearing is now adjourned.

(Whereupon, the above-entitled matter was concluded at 1:58 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: Competition in the RR Industry

Before: STB

Date: 06-23-11

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