UNITED STATES OF AMERICA

SURFACE TRANSPORTATION BOARD

+ + + + +

PETITION FOR RULEMAKING TO ADOPT REVISED COMPETITIVE SWITCHING RULES

+ + + + +

DOCKET NO. EP 711

+ + + + +

Wednesday,
March 26, 2014

Surface Transportation Board
Suite 120
395 E Street, S.W.
Washington, D.C.

The above-entitled matter came on for public hearing, pursuant to notice, at 9:30 a.m.

BEFORE:

DANIEL R. ELLIOTT, III Chairman

ANN D. BEGEMAN Vice Chairman

P-R-O-C-E-E-D-I-N-G-S

(9:30 a.m.)

CHAIRMAN ELLIOTT: Hi, good morning everyone. Welcome to the second day of the EP 711 hearing. And I don't know if everyone was here yesterday for my procedural comments but, very similar to every other hearing that we've had.

We have lights in front of us. Those lights, when green, means you start and the yellow light means you have one minute left. And the red light means please wrap up. I won't shut you off when the red light goes off so feel free to at least continue your thought.

And if you need a little extra time, if it's running a little long for whatever reason, I've been pretty generous in allowing that because this is a very important hearing. So I definitely want to hear what you have to say.

So I think that's all I have. Do

you have anything? Okay, why don't we begin with Panel Number V, the Railroad panel. And I believe we are going to start with Ms. Mulligan from BNSF.

MS. MULLIGAN: Good morning, Chairman Elliott, Vice Chairman Begeman. My name is Jill Mulligan. I'm associate General Counsel Regulatory for BNSF Railway. I appreciate the opportunity to testify here before you for the first time.

The Board has initiated this proceeding to gather information regarding the potential impacts of NIT League's competitive access proposal on the national transportation network and the parties who rely on it.

Leading up to this hearing the Board has received sizable submissions detailing the impact of the NIT League proposal on railroads, on shippers qualifying for access under the proposal and for the shippers who would not.

BNSF joins in the comments of the

AAR which address in detail the specific questions raised by the Board as well as the strengths and shortcomings of the various methodologies and assumptions used by the parties to estimate the impact of NIT League's proposal.

I do not intend to reiterate those comments here. My comments today are intended to highlight several general but important principles that BNSF believes that the Board should remain focused on during this proceeding.

First, the Board should promote competition by allowing market forces to govern. Regulatory intervention should be limited to circumstances where market forces have failed to protect shippers from abuses of market power.

The Rail Transportation Policy directs the Board to minimize regulatory control over the rail system and allow, to the maximum extent possible, competition and demand for services to establish reasonable transportation rates.

The Board has been mindful of implementing rules that generally adhere to the principle that markets for rail services should be allowed to operate freely, reserving regulatory intervention for situations where it is necessary to protect from abusive market power.

Where shippers believe that line has been crossed the STB currently provides direct and meaningful remedies. Most notably, the Board continues to refine its standards and procedures to make rate cases more accessible to shippers who believe they are entitled to rate reductions.

Adoption of NIT League's proposal would mark a significant departure from those principles. Under the Board's current regime access remedies are available to market participants but are appropriately limited to instances where serving railroads' actual conduct has required corrective regulatory intervention.

Competitive access remedies, to date, have been properly focused on addressing individual instances of competitive harm. In stark contrast, NIT League's one size fits all proposal requires no individualized showing that there is a service issue, that access by another carrier is appropriate or that a rate reduction is appropriate before an extraordinary remedy kicks in.

As the AAR and my fellow panelists point out, that extraordinary remedy can carry with it significant costs to the rail network and its users. This leads to my second point.

NIT League's reliance on revenue to variable cost ratios as a measure of market power is invalid. NIT League's reliance on R/VC levels as a justification for increased regulation is also invalid. NIT League acknowledges that it has eliminated any need to demonstrate competitive harm before access remedies kick in under its regime.

However, NIT League has argued that it has incorporated at least some element of individualized competitive inquiry into its proposal by relying on R/VCs as a trigger for mandatory switching access.

Specifically, NIT League asks that a movement exceeds 240 percent of its variable costs and is within a prescribed distance from the interchange be presumed to lack competitive alternatives and, therefore, be entitled to mandatory switching.

In doing so, NIT League is making two assumptions. One, that a rail carrier's market power can be assessed by reference to the R/VC for the service. And, two, that crossing an arbitrary line, here 240 percent R/VC of a carrier's system average URCS cost, means that a carrier possesses market power.

These assumptions are simply not correct. BNSF sets rates based on and responsive to market conditions. Those market conditions may permit rates that are high or low relative to BNSF's costs.

The R/VC level for a particular rate does not give the Board meaningful information about the competitive environment for that traffic. While R/VCs may be necessary tools in applying certain rate reasonableness methodologies they cannot legitimately be used as determinants of market power or its abuse.

Equally important, when R/VCs are incorporated directly into regulatory mechanisms it creates perverse incentives. It rewards the higher cost, less efficient railroad and penalizes individual carriers who make capital investments to improve efficiencies.

Capital investments that reduce congestion or improve efficiency would decrease a railroad's operating expenses which, in turn, reduce our variable costs. Examples of those investments are lighter rail cars or more efficient locomotives that reduce fuel consumption.

The result is that without any change in the rate being charged to the shipper, the carrier's R/VC has increased. For significant investments that increase in the R/VC for individual movements would be material. Such a change in URCS alone may increase a rate above the arbitrary 240 percent level contained in the NIT League proposal.

While that would trigger an extraordinary remedy under the NIT League regime, it certainly doesn't indicate an abusive market power. To be clear, while the R/VC has increased, nothing has changed in the competitive landscape. The shipper's rate has not increased.

The railroad has simply undertaken the risk of making a very significant efficiency investment and, as a direct result, has become subject to adverse regulatory intervention where such regulation was not previously justified.

The result is a regulatory system that actually incentivizes inefficiencies and higher costs and disincentivizes the very type of investment the Board should be encouraging.

Third, parties should not use reciprocal switching rules, revisions to those rules, to expand the scope of the Board's jurisdiction to include exempt traffic not subject to STB regulation.

NIT League's petition did not clearly address whether there are categories of movements that would be excluded from switching access and many parties included certain categories of non-regulated traffic in their impact studies. The Board should affirm that no competitive access proposal can be considered that would apply to exempt or contract traffic.

This is consistent with the principles of focused and limited intervention captured in the rail transportation policy and is otherwise required by the jurisdictional limits of the Board's statutory authority.

Finally, the Board could not ignore the effect of reciprocal switching remedies in applying market dominance principles in rate reasonableness cases. In it's July 2012 decision initiating this proceeding, the Board assumed that the NIT League proposal would reduce the agency's role in regulating rates. That is a logical assumption.

Mandated reciprocal switching's purpose is to provide access to competitive alternatives for a shipper that would preclude a finding of market dominance under the statute, thereby streamlining the STB's regulation of rates.

Nonetheless, some shipper interests submitted comments in the proceeding, asking that the Board allow shippers to pursue a rate reasonableness case in addition to a competitive access case. These commentators seek the opportunity to pursue an access case with the additional option of bringing a subsequent rate reasonableness case with a complex market dominance inquiry that, some parties argue, should ignore any alternative carrier access it may have obtained.

These parties cannot advocate for the adoption of the NIT League proposal as an attractive simplification of STB regulation when their intent is to expand, with significant additional complexity, the regulatory rules available to them.

We appreciate the Board's interest in gathering meaningful information from multiple viewpoints on the impacts that would flow from the NIT League proposal. We ask that the Board keep these four important principles in mind for the remainder of this proceeding. I thank you for your time and am happy to answer any questions that you may have.

MS. BROWN: Presentation. Can I be called for presentation? Thank you. Good morning, and thank you for the opportunity to address this board. My name is Cressie Brown and I am CSX Transportation's Vice President of Service Design, and I've been with company for 25 years.

Our team leads the creation of rail transportation services that are aligned with the needs of our customers. Given the complexity of rail networks, we use extensive computer modeling to minimize mileage, handlings and transit time for over 30,000 customer origin and destination pairs.

Our work is focused on achieving high levels of service reliability and predictability which are critical elements in meeting our customers' needs. My purpose today is to provide CSX's perspective on NIT League's proposal for a radically new switching model. The proposal would undermine much of what we have accomplished in the areas of reliability, efficiency and customer service.

One of CSX's core values is it starts with the customer. And we are embracing that in a very real sense. We seek customer feedback and engagement through many avenues that we collectively call the Voice of the Customer. Since 2003 an independent research firm has been conducting surveys of more than 2500 CSX customers annually and we are receiving historically high customer satisfaction marks.

It is a virtuous cycle of pleasing customers, earning more business and generating investments in additional resources and new infrastructure. Customer Advisory Councils are regular face-to-face meetings of our senior management team with customers representing all of our markets.

The customers on these councils rotate so that we gain exposure to the particular needs of all of the markets that we serve. And for the past three years CSX employees have visited 4,000 customer facilities annually to listen to customer concerns and discuss how we can improve service.

We have formed Service Excellence teams that include our union-represented employees who have the most frequent contact with our customers. These cross-functional teams work with local customers to gain insights into their specific business needs. This engagement reinforces that our customer success is our success.

We borrowed from the success of our Safety culture to create a culture focused on customers. We have added service training for 11,000 Train and Engine employees, specifically focused on improving customer service.

Through all of these engagements CSX employees are listening to the Voice of the Customer and acting every day on what they hear. And what they hear is this, service is paramount.

Turning to Slide 3, we are responding to what we hear. And these are actual quotes from our customers, and here's what they tell us.

First, consistency of service is a top priority. Our operating plan is designed to minimize mileage and the number of times individual cars must be handled along their route. Reducing complexity and variability are key elements to improving transit time and service reliability.

In the words of another customer, as cars sit we lose money. We have 200,000 railcars on our lines daily, representing an estimated replacement cost of $19 billion with about half of these assets owned or leased by our customers. That represents a sizable investment by our customers and CSX, and those assets transport a significant inventory of products and commodities critical to our nation's economy.

We are committed to developing an maintaining the most efficient optimized networks. Customers also tell us that they need proactive notification for planning and better results. We have enhanced our processes, technology and staffing at our 24/7 customer service center, all to improve the precision and timeliness of communication and coordination with our customers.

Customers use this information we provide them to plan their resources, production schedules and retail deliveries, enabling them to lower their cost of doing business. On Slide 4 you can see our service measures, all of which represent a positive trend over the past decade.

Improvements and performance mean more consistent, reliable service, increased asset utilization and lower costs for customers who manage their privately owned railcar fleets.

Customers are telling us, and the customer satisfaction index validates, that they are increasingly pleased with our service. And, most importantly, they tell us that, as an industry, we must not go backwards. I am very concerned that the NIT League proposal will force cars to locations where we do not have the resources or infrastructure to handle them.

Predictable traffic flows and effective planning are essential to our ability to provide a reliable service product. And shipment visibility is critical to resource and capacity planning. Unanticipated pop-up traffic that would occur with the NIT League proposal threatens all of this.

The NIT League proposal would adversely affect all shipments across the network. You requested empirical evidence and today I'd like to focus on two real world examples that were included in the video we previously submitted. If you haven't already had an opportunity to review the video we hope you will take the chance.

The first example is going to focus on our carload network. Like other Class I railroads, CSX employs a Hub and Spoke system to handle carload freight. The map highlights our 12 major hump yards. These hump yards serve as classification hubs or sort centers, much like an airline hub for over 30,000 origin/destination pairs.

This Hub and Spoke model enables cars to move across the CSX network in the most efficient manner possible. CSX and other railroad operate other yards where cars are flat switched by a locomotive and crew. A flat switch yard, however, does not have the capacity to accommodate the same level of switching activity as these hump or hub yards.

Important to note is that not all interchanges are performed in yards. Cars can be interchanged, and often are, on the mainline, in sidings or on a single track. One of the NIT League proposal's fundamental flaws is that it assumes that every interchange can function as a hub, and that's just wrong.

Slide 6 illustrates a specific example of a customer that ships cars from Mexico to a facility in Jacksonville, Florida that is served by CSX. Looking at the picture labeled Current Route, CSX receives the cars in New Orleans and moves them to a hub in Waycross, Georgia capable of classifying and sorting the cars for connecting train service to Busch yard in Jacksonville, Florida.

Busch yard is the serving yard for the customer, and this route is highlighted in gold. The customer is located within 30 miles of CSX's Moncrief yard which is an active interchange point with Norfolk Southern. Under NIT League's proposal the shipper could obtain line haul transportation via NS from New Orleans and require CSX to receive the traffic at Montcrief yard.

Montcrief, however, is not a hub or a sort center. Rather, it is a local yard with limited capacity and no connecting train service to Busch yard. To comply, CSX, as illustrated in the picture labeled NIT League Route, would have to take the cars from Montcrief 147 miles north to Waycross where they would be sorted and classified for a train destined to Busch.

This routing adds approximately 300 miles and 3 days to the overall movement. You can clearly see how inefficient this would be and how it would increase congestion and readily degrade asset utilization, transit time and service reliability.

A second example involves unit trains. Unit trains require careful planning and a high degree of predictability to extract all of their efficiencies. The routing of unit trains is over the most direct path and is tightly coordinated.

Slide 8 illustrates the consequences of alternate unit train routing in Baltimore. In Baltimore CSX and Norfolk Southern have an active interchange at Bayview yard. Within 30 miles is a customer that receives unit trains of ethanol.

Today CSX delivers the trains direct from Chicago to the destination. This routing, indicated in gold, is critical in the Baltimore area since the ethanol train is just one of dozens of trains operating through Baltimore each day including other freight and MARC commuter traffic. Under the NIT League proposal, NS would bring the train from Chicago into Baltimore for switching to CSX at the Bayview interchange.

From here the train would be routed, as indicated by the red line, through downtown Baltimore, through the Howard Street Tunnel, passed Oriole Park, the Camden Passenger Station, the Baltimore Ravens M&T Stadium and to the customer's final destination. The difficulties caused by this move are broad and varied and include potential disruptions to tightly scheduled MARC Commuter trains.

In summary, railroads have complex networks which rely on density, efficiency and predictability. It is not in the broader public interest to experiment with a forced switching scheme which would ultimately create less reliable and less cost-effective service for our customers.

Some of the greatest customer service and efficiency improvements in Staggers have been the result of longer, single-carrier hauls and reduced switching. The NIT League proposal turns back the clock on these gains achieved over decades.

We urge the Board to reject this sweeping regulatory restructuring and to maintain the balanced environment that is a pillar of our world-class freight system. Thank you, and I'll be pleased to take any questions.

MR. BAILEY: Good morning. It's a pleasure to be here this morning and be able to speak on behalf of Norfolk Southern as to this subject.

My name is Rush Bailey and I'm Assistant Vice President of Service Management for Norfolk Southern Corporation. I've been employed by Norfolk Southern or an NS subsidiary since 1976. And I've worked in various capacities in both our marketing and operating divisions.

Over the course of those many years I've come to appreciate the complexity of railroad operations, and particularly the nature of network operations, which require consistent performance in each of its components in order to consistently deliver a high level of service to our customers.

Norfolk Southern's rail system includes over 20,000 route miles spanning 22 states on which we essentially run three networks. Each of these share a common set of assets -- track, terminals, locomotives, crews, support systems and railcars.

The largest part of our unit train network is dedicated to coal, but we also have steel, stone, grain, crude oil and other bulk commodity unit trains. Our premium service network consists primarily of intermodal and automotive, and our largest and most complex network is our general merchandise carload network.

The nature of the NIT League proposal is such that it's there, the general merchandise carload network, that I'll focus my comments today. This network is a good proxy for our entire system and the potential impact on network operations.

When discussing railroad network operations I frequently use airlines as an analogy. While it seems odd at first, the models are actually very similar. So imagine, if you will, if airlines were responsible for passengers, not just between terminals but from their actual point of origin, say from home, just outside of Atlanta, to the STB offices here in Washington.

The operation would become much more complex. But the fact is that that's what Norfolk Southern does every day in its general carload network, moving thousands of shipments every day between 8,700 shippers, receivers and interchange points.

Now not every passenger arriving at the Atlanta airport is headed for the STB's offices in Washington. And similar to the airline operations, once at the origin terminal, rail shipments have to be sorted and classified into groups or blocks.

Norfolk Southern has over 32,000 origin/destination pairs and those shipments are grouped into over 1,500 road blocks and 5,000 local blocks. These blocks are then combined into trains in the Terminal 4 in yard.

This process is repeated at intermediate terminals as the shipment progresses across the network and then again, finally, at the destination terminal where the shipment will finally be classified for the customer at the destination or to a connecting carrier at the interchange.

These classification processes or handlings at origin, destination and intermediate terminals make up the bulk of time that a typical shipment spends in transit. In fact, a typical general merchandise shipment will spend only about a quarter of its total transit time in road train service.

In a heavy asset-based industry like ours shipment velocity is a key driver of cost. The faster a shipment's cycle, the higher the utilization of railcars, locomotives, terminals and other assets. Conversely, the slower a shipment cycles, the more units are required to move the same amount of traffic.

And at some point, adding more cars and locomotives to the network has a counterproductive effect of further slowing shipments, as we have seen by past experience in our industry. Velocity is also a key driver of service delivery for rail customers.

Here you see our composite service metric in red. The composite service metric combines our internal measures of on-time train performance, connection performance -- that is getting shipments to their scheduled connections at terminals and plan adherence which measures the execution of work orders by our road trains, essentially pick-ups and set-offs.

The blue line is line haul miles per day. It's a measure of miles that a shipment would travel in a 24-hour period. It includes over-the-road time as well as dwell time at intermediate terminals, passing sidings and interchanges and also non-handling time at intermediate terminals such as crew changes or fueling activities.

This graph clearly shows the correlation that better velocity equals better service. So you might ask about the divergence in lines in the latter half of 2012 and 2013 when network velocity moved to its highest sustained levels we had ever seen.

Norfolk Southern measures service as on-time performance and we define that as neither late nor early. We recognize that either can disrupt customer operations and variation in our operation requires additional asset commitments.

As velocity moved into uncharted levels we found that a number of shipments arriving more than 24 hours early increased significantly. And in the time that's followed we've been reviewing train schedules and minimum connection times to take time out of those schedules, which has a very positive result for both Norfolk Southern and its customers.

Understanding this relationship, Norfolk Southern has successfully focused efforts on maintaining or improving shipment velocity, which is shown here in tan, by minimizing the number of intermediate handlings, which is shown in blue. The improvements have both improved service to our customers and enabled operating efficiencies.

This is where the NIT League proposal because it would result in more handlings per shipment. The impact of increased handlings per shipment is even clearer here where we've plotted our network philosophy as measured by line haul miles per day against the average number of intermediate handlings per shipment trip.

And you can see that each additional handling required by shipment reduces the average velocity for that shipment. More handlings mean reduced velocity and that will result in a reduced service metric, longer transits, more variation in network operations and service delivery.

Longer transits and increased variation in operations also means that rail carriers will have to apply more assets to the same volume of business. All of these changes affect more than just the issued shipment because adding assets to a network to move the same amount of traffic often has the effect of further slowing the network and congesting it.

While a few customers might be willing to accept these tradeoffs, slowing and congesting the network will negatively impact rail carrier service levels and its underlying cost structure. And those effects are likely to be borne by customers.

The effect is not limited to those just directly impacted by this proposal but also those whose shipments may be moving on the same trains or through the same terminals or on or in the same railcars, moving, again, in a network that shares common assets.

In the last few months U.S. rail system has endured shocks from severe winter weather. The result, as you see on this slide, has been a decline in the line haul miles per day compared to 2013. As we all know, the effects from this decline have been felt by many customers across our network, and not just those in the areas affected directly by the winter weather.

Power shortages and railcar shortages are further symptoms of an underlying drop in network velocity and a resulting decrease in cycle times. And although Norfolk Southern is taking many steps to reverse this trend, it takes time to turn the tide. These are exactly the types of effects one should expect from opposal of light NIT Leagues that will increase handlings and therefore decrease network velocity.

In conclusion, these relationships demonstrate that NIT Leagues's proposal and other forced access proposals would be counterproductive to Norfolk Southern's goal of minimizing handlings, increasing velocity, optimizing network operations and service for our customers. I than you for your time.

MR. HALEY: Could we have the slide clicker, please? Could you bring up my slides, please? Good morning. Thank you for the opportunity to speak before you.

My name is Tom Haley. I'm Assistant Vice President, Networking Capital Planning for Union Pacific, a position I've held since 1998. I have over 30 years' experience in the railroad industry. I started with CSX in 1983 and joined UP in 1989 after earning my MBA.

I've worked in Operations, Network Design and Finance. I'm accompanied this morning by Louise Rinn, sitting to my left, Associate General Counsel at Union Pacific. In my role I share responsibility for the design and development of UP's rail network, service plans and capital plans.

In my time at UP we've learned important lessons about the causes of service disruptions and the value to our customers of consistent, excellent service. We've substantially improved our service, and this has translated into increased customer value and satisfaction.

I appreciate the opportunity to discuss NIT League's proposal with you. This proposal would seriously disrupt UP's operations and reduce our ability to provide reliable service to our customers. The proposal threatens the exact success story you see on this slide.

I am specifically concerned that, first, the proposal would increase workload in terminals that are already capacity constrained. Second, the increased workload would degrade service across our network. Third, the proposal would limit our ability to plan and manage our network. And, fourth, the proposal would increase the need for capital investment while reducing our ability to invest.

In short, NIT League's proposal would create significant problems and, at the same time, prevent us from fixing them. Our customers would suffer as a result. Let me explain these concerns.

First, NIT League's proposal would increase workload in terminals that are already capacity constrained. The Board heard Mr. Rennicke's testimony yesterday about the operational complexity of switching cars and how reciprocal switching compounds this complexity.

I'd like to further show how this consumes terminal capacity. Today a typical operation is for a car to move from a customer to a terminal on a local train where the car is switched once for an outbound train. With reciprocal switching the car is switched for delivery to the other railroad, then moved to the other railroad, and then switched again in the other railroad's yard before departing on an outbound train.

The clear result is extra switches. And the extra switches multiply quickly. The arrows are double-headed because switches occur for both loads and empties moving between the two railroads. The complexity increases even further if a third or fourth railroad is involved in the terminal area.

And that's precisely what NIT League's proposal could force upon UP and the other railroads. The number of locations on our network where this could occur will multiple significantly. UP's terminals are not equipped to handle such an increased workload.

We plan for our terminals to operate at fluid capacity levels. This allows for demand fluctuations, weather events and other disruptions. Today we are generally meeting this target. However, forecasts show that transportation demand will increase.

This means we face capacity challenges in many terminals. This isn't just a matter of railroaders getting the job done. The capacity does not exist to do what is being proposed.

The additional switches could force UP well beyond its capacity tipping point in many terminals. And we know from experience that consequences would be severe.

That brings me to my second point, NIT League's proposal will have ripple effects that will harm customers across our network. As the chart in the upper left shows increased switching leads to increased freight car inventory. Every additional switch takes time and introduces the risk of missing a connection.

More switching, therefore, means more dwell time for cars in terminals. And the longer cars stay in terminals the more cars we have on our system. The chart in the upper right shows the problem with increased inventory. The more cars we have on our system, the slower the cars move.

And velocity is the critical driver behind efficient and reliable service. The chart on the bottom left demonstrates this point. Slower velocity harms our service product. And as you can see in the chart on the bottom right, poor service creates unhappy customers.

These charts, read together, are a proof statement of how local changed ripple through a rail network. I've been in my current position throughout the time period reflected in these charts. I've witnessed, firsthand, the effects that additional switching has on our system.

I can confirm the implication of the data. NIT League's proposal would degrade service on our network and harm our customers. And basically, and my third point, UP will not be able to address these service issues using our normal planning and management tools.

Our ability to plan and manage depends on having accurate information about expected traffic flows. We would lose visibility and the ability to manage our operation under NIT League's proposal. This slide shows the problem.

For long-term planning we rely on traffic forecasts that our marketing team develops with our customers. These forecasts drive our capital, resource and service plans, and they're critical because of the long lead times to put facilities and equipment in place.

Qualifying new train crews takes six to nine months, and adding rail infrastructure can take two to three years or more. We already face many challenges forecasting traffic two to three years in advance for our own business. We have no visibility into our competitors' plans which would add a new dimension of uncertainty to our planning.

We also must do tactical planning to adjust our train plans and reposition resources to meet anticipated demand. Again, advanced information is critical because of the lead time required. But we don't have visibility into our competitors' activities with enough lead time to match resources with shifting demand. The ultimate result will be poor service.

Finally, on a day-to-day basis, we make real-time decisions to balance terminal capacity, control the timing of traffic flows and assign resources such as crews and locomotives to handle our line haul traffic. But we do not know how much traffic will require reciprocal switching until it appears on our doorstep.

NIT League's proposal means more traffic would be moving in our blind spots. That brings me to my fourth point. NIT

League's proposal would increase the need to invest in terminal capacity while reducing our ability to invest.

Terminals are an Achilles' heel for the rail network. They are extremely valuable in bundling and unbundling traffic to efficiently move shipments to and from our customers, but they are typically located in congested urban areas and are very expensive to expand, if it's even possible to expand them.

However, if NIT League's proposal is adopted, I believe you will see us invest less in terminals. Terminal investment will be less attractive because of less revenue, increased uncertainty about where to put capacity and whether such capacity will generate an adequate return.

I'd like to make one final point before I wrap up. One of the NIT League witnesses claimed the rapid increase in crude oil traffic proves that railroads can easily handle unpredictable shifts in traffic. In reality, his example proves the opposite.

In UP's largest crude oil lane we began working with customers more than three years ago. We spent a year developing business, operating and capital plans. And then, as business ramped up, we spent another two years methodically investing in facilities and putting resources in place to make the operation successful.

And, I'll point out, this was for unit train business in one corridor with an attractive return, not carload traffic shifting in busy terminal areas.

I want to end with my opening chart. UP has diligently worked to reduce switching events, reduce car inventory and simplify transportation plans in order to provide better service for our customers. As the chart shows, we've been successful. This success creates value for our customers.

The NIT League proposal adds

switching and reduces efficiency. It will require capacity that does not exist. It will damage service, perhaps severely. I believe the long-term adjustment that will occur from this will be moving less freight.

The NIT League proposal would reverse the progress we made over the last 15 years to the detriment of our customers. I, therefore, urge you to reject it. Thank you.

MR. KONSCHNIK: Good morning, Chairman Elliott, Vice Chairman Begeman. I'm David Konschnik, and I'm honored to appear before you today.

In my view, the comments do not support a change in the Board's approach in matters of competition and access. The vast majority of the concerns are about rate increases and the levels of rates, especially for coal and chemicals.

A fix for customers' rate concerns is not a fundamental restructure of the rail industry. Adoption of an unprecedented and far reaching reciprocal switching regime would have significant unintended consequences. Rather, the fix is to continue what the Board has always done -- review, revise, test, evaluate and change its rate complaint processes as experience shows is needed.

In my various roles at the ICC and STB over a 30-year career I've seen firsthand how the agency has responded to shipper concerns by making changes to its rate, service and unreasonable practice complaint processes.

The Board has been open-minded and flexible in considering concerns and in trying to improve the processes and make them more efficient and less costly where possible without sacrificing fairness to the parties in individual cases while endeavoring to remain faithful to the congressional charges contained in the Staggers Act and the ICC Termination Act.

Here are a few examples of what the Board has done to try to be responsive to the concerns that the rate complaint process was too long, too expensive and not available to smaller shippers.

The Board has eliminated consideration of product and geographic competition and market dominance determinations, adopted mandatory non-binding mediation, established a new arbitration program for rate and other disputes and improved the discovery process, made changes to procedures and rules to speed up cases including elimination of the ability to movement-specific adjustments to URCS, adopted simplified standards for rate cases including simplified SAC and the Three Benchmark methodology.

Just in the past year the Board has raised the limits on relief for rate reasonableness complaints brought under simplified SAC and Three benchmark, sought comments on how to ensure that the Board's rate complaint procedures are accessible to grain shippers and opened a proceeding in response to a request that the Board abolish the use of the multi-stage DCF model in determining the railroad industry's cost of equity capital.

The Board has also improved the rail customer and public assistance programs. Now, the Board's reforms may not go as far as some would like, but there have been significant reforms and the Board should be congratulated for its thoughtful and analytical approach.

Some of the Board's procedural changes have only recently become effective. Changes that have been in effect for some time appear to have provided great relief for shippers whose rates were too high. These changes should be given time to prove their effectiveness. And the Board can adjust the procedures in the future if it's shown to be necessary.

In the meantime, a case-by-case approach is the best and most reasonable approach. Due to these changes several SAC cases over the past few years have found in favor of the shipper. More recently there have been several SAC and simplified SAC cases that have been settled. And with respect to those that have proceeded to a full Board decision, the shippers have prevailed on most of them.

More broadly, I believe that the Board's decisions that have clarified and simplified the rules have helped to encourage the parties to settle their disputes rather than litigate them. As such, the Board should move forward with that approach rather than moving in the opposite direction in adopting a complex regulatory scheme that will take years to figure out and result in years of litigation and disputes.

Adoption of the NIT League

proposal could result in significant unintended consequences such as some shipper groups benefitting while others pay higher prices or get worse service, network inefficiencies, operational chaos and service problems discussed in detail by others testifying at this hearing, extended legal disputes over the eligibility of a particular shipper or shipment, the compensation to be paid and the implementation of the granted access, potential undermining of the competitive role played by smaller Class Is, regional railroads, short lines, all of whom could have their routes short-hauled and their most profitable traffic cherry-picked by the larger Class Is leading, possibly, to fewer competitive alternatives for shippers.

Overall, I think the Board should be mindful that a little bit of regulation goes a long way and over-regulation risks destroying the ability of the railroad industry to continue to provide the combination of service, efficiency and reasonable rates this agency is committed to achieve. Thank you very much for allowing me to appear here today. I'd be happy to answer any questions you have.

CHAIRMAN ELLIOTT: Thank you very much for your testimony. Most of the testimony focused on issues that would arise, complexities that would arise out of this proposal and the difficulties.

And I think Mr. Rennicke, yesterday, kind of laid it out very clearly. And he showed that if you use the proposal and were involved in the switching that there would be 24 steps to the move. And then he said, normally, if the incumbent railroad handled the traffic it would be six steps.

I don't know if that's the way it occurs all the time, but I think CSX and UP also presented some complexities that would arise as a result of applying the proposal. The question that I have is if it is so much

more complicated and the two railroads are
competing how would the incumbent railroad be
able to be underpriced in those situations?

It seems as if, that the alternate
railroads would have to spend quite a bit
more money on cost to be involved in these
extra moves, I guess, is what I'm getting at.

So, I'm missing some of the logic
on the pricing, that it would seem to me that
the incumbent railroad would generally win in
those situations because of the lack of
complexity in their move compared to the
alternate railroad. Does that make sense?

MR. HALEY: I think so. Want me
to start that out or do you, Cressie?

MS. BROWN: Sure, go ahead.

MR. HALEY: I honestly, I can't
speak to the pricing end of it. I can tell
you that where reciprocal switching does
exist on our railroad to day we see the
phenomena I talked about, which is the
increased complexity, less efficiency, longer

dwell times for cars. So on the pricing side, I really can't comment.

MS. BROWN: I mean, I would just add that in no circumstance where you have forced switching can you envision that it would be less complex, right.

So there is, by definition, and Bill Rennicke did a very good job of laying out a couple of those scenarios, some are more simplistic than others, but in every situation there would be additional handling and additional costs and, by default, more congestion, a slower railroad.

So our concern is not only is that higher cost to railroads collectively, to the entire transportation product, but to our customers because most of the cars that we're moving are customer-owned equipment, right. So for them to handle any degradation in service, any slowing down of our networks, also has a significant cost to all the other customers whose shipments we're moving because they own the equipment that we're moving across our networks.

MS. RINN: If I may, Chairman?

CHAIRMAN ELLIOTT: Sure.

MS. RINN: If you're talking about the reciprocal switching that is happening today that's essentially voluntary.

CHAIRMAN ELLIOTT: Right.

MS. RINN: It's either been commercially negotiated or it was part of a merger condition to protect existing competition. And then it's voluntary in the sense that the merging railroads had the choice to not proceed with the transaction or to go forward with the transaction knowing that they were getting benefits.

And it also is truly reciprocal. We have many bilateral agreements that basically set up charges where we say we'll do the switching for you and you'll do the switching for us, and we'll charge each other the same.

In those circumstances you're not worried so much about the control of the cost and the decision to do it, I guarantee you, is not coming from the operating department. It is basically a commercial decision. It's voluntary, and it's reciprocal.

Here you are talking about a proposal that is going to be forced, and it's going to be unilateral. And, therefore, you're not going to be able to have a single set of fees. You're going to have to take into account all of the costs of doing the movement. It's a completely different approach to the concept of reciprocal switching.

CHAIRMAN ELLIOTT: But if it is your traffic and however we arrive at the hypothetical access price, my reading on the statute was that the parties, the railroads, would have to enter into an agreement and then it would come to us if there wasn't one.

The way I see it is, no matter

what, the alternate railroad would be required to pay more because at least they'd have to pay for the switch on top of whatever rate they're quoting. And then you take into consideration all these complexities added on top of that, it would seem like it would be difficult for them if they were actually competing for that traffic.

It would be difficult for the alternate railroad to win in that fight for that traffic.

MS. MULLIGAN: If I can add to what Lou Anne was saying, I think that the situation where you do actually see that happening, where alternative carrier service is being provided, are instances where we have voluntary switching in place.

And those are places where they, the non-incumbent railroad, the new railroad that's coming in can actually can offer superior service. It might be an alternative rate, sorry, a superior route, some other efficiencies that allow them to compete despite the presence of a switching fee there.

CHAIRMAN ELLIOTT: I guess in that instance if that is the case, and they can offer something that's more efficient, the alternate carrier, wouldn't that make the system more efficient rather than less efficient if they have that ability?

MS. MULLIGAN: Yes and no, in specific instances. I think we would find that a lot of those situations have already been dealt with through voluntary arrangements because every incentive is on the railroads to make those moves happen where there is an efficiency there.

The issue with the NIT League proposal is that nothing contained in that proposal actually leads you to identifying those situations where you could have a superior, more efficient service offering. It's not part of the inquiry.

The switching occurs because the R/VC is 240, not because there's anything particular about that move that says that there's going to be an increased efficiency or a superior operational move.

CHAIRMAN ELLIOTT: Okay.

MR. HALEY: Could I just add to that?

CHAIRMAN ELLIOTT: Sure, go ahead.

MR. HALEY: I think it's unlikely that a route efficiency or there's some other efficiency out there that would overcome the inefficiency of the additional switching.

It's the extra switch events, extra handlings, it's the time, 24 to 36 hours each time you add an event, usually both ends, in both directions, load and empty. And if you just do the math on the miles you would have to save an incredible number of miles to overcome that.

VICE CHAIRMAN BEGEMAN: I'll start with BNSF's chart on some of the key principles that I'd like to hear your views on.

It says the Board should promote competition by allowing market forces to govern. Now, if I think back on the first panel yesterday, I think that's actually what they're seeking. They want to have market forces, instead of one carrier.

So help me understand how the status quo is allowing for captive shippers to have market forces govern?

MS. MULLIGAN: And I think there's a little bit of a problem with language that's being used. I think that one of the issues was saying that, starting at the high level of switching is obviously pro-competitive. Options, access to alternatives, is competitive.

What the shippers are actually seeking is an artificial insertion of competition into a market where it would not otherwise exist. And the proposal is really focused on variable costs, as being the trigger for that. And that proposal, when it focuses on variable costs, it's actually not making any sort of a diagnosis about what the competitive environment is for that traffic.

And so, by referencing variable costs, you're not getting any sort of education about, is the move that's actually occurring inefficient? Is there a superior competitive alternative?

MS. RINN: And, if I may, I found yesterday very striking because the comments were all premised on an absence of competition, when, in fact, we face tremendous competition for the vast majority of our business.

The Board has decided that for regulatory administrative purposes it's too complicated to go into product and geographic and indirect competition and transload competition. And I understand, given your directives and your resources, why you may have made those choices.

But in our world, in the marketing departments of having to deal with it, we are always in negotiations with our customers about whether or not, that the service that we're delivering and the costs that they're paying for it allows them to compete in their market, or whether there are other ways of doing it.

Coal haulings are down, because of natural gas competition. Grain changes, depending on whether or not you have a demand for ethanol and it's taking a short haul to a nearby elevator or by truck to be turned into ethanol, or whether there's a longer distance, or whether there's an export market going up.

Lumber competes geographically, across our business groups. We face intense competition and we use transloads to basically try to win market share from others. And we deal with that all the time in our contract negotiations and in setting our rates.

Sometimes we win the business, and sometimes we lose the business. So all of that competition is going on but this NIT League proposal basically is saying there is no competition, unless we have direct rail-to-rail competition. And they don't want to look at, but are we allowing you to keep, or win, market share verus your competitors?

Likewise, when they're saying that there are no negative impacts on the customers who would be outside whatever the secret radius is going to be. They're ignoring what the impact would be that if a favorite customer is able to us a regulatory regime in order to compel a below market rate, what that does to its competitors.

Now, maybe, the railroad's response is going to be to make up for the revenue by raising its prices or maybe it's going to say I'm going to lose more traffic and more revenue if I don't bring my rates down on the non-favored customers. And so you're going to have secondary and tertiary revenue losses to the railroads.

And all of that is going on in a very complex marketplace. And this proposal is ignoring that marketplace.

MR. BAILEY: If I could add something, I think that there's no doubt that if something like the NIT League proposal went through, there are some customers who would win.

I think what you're hearing from operating folks is that there's a collateral impact. You're congesting terminals, you're adding additional work, extra handlings, and that's going to have an impact on customers who don't get the benefit of that lower rate.

VICE CHAIRMAN BEGEMAN: I'm going to come back to this topic, but, I did want to talk with you and with CSX, and ask if you could discuss the Conrail shared asset area?

How does that work? I'm sure that there were pockets of pain to begin with but it seems that it's been quite successful - in terms that it works operationally.

MS. BROWN: Sure. And I think there's many market differences, and Rush will comment as well. But Conrail is a jointly owned entity by CSX and Norfolk Southern. And when we purchased Conrail collectively we never anticipated to have a residual Conrail, right, it is much more efficient for us to be the single line haul carrier to provide direct service. So it was not envisioned as part of the transaction that we "aspired" to create this Conrail that exists today.

And while they do, and the staff there and Ron Batory and his team (I'm on the Board of Conrail, so I have a lot of interactions with them and responsibilities with Conrail). But they do a phenomenal job for us. But it operates very differently than this switching proposal.

So it is owned by CSX and Norfolk Southern, together, and for over many years and many difficult conversations --

VICE CHAIRMAN BEGEMAN: Can a shipper randomly switch back and forth?

MS. BROWN: The customers in Conrail are open. But CSX and Norfolk Southern are not in there switching those customers for each other.

VICE CHAIRMAN BEGEMAN: I see.

MS. BROWN: We have a residual Conrail who behaves and acts a bit like a terminal company. So entire trains go into Conrail. We work very hard together to coordinate those movements, and to design the operating plan, that works for both owners. But there is a single party in there performing the service on behalf of both owners. And it does behave like a direct line service. So Conrail has no commercial presence and, while it works well, it's not ideal. So it is still a handoff, it still behaves a little bit like a third party, on the move, and we would not design that service today.

VICE CHAIRMAN BEGEMAN: But the customers, can they randomly switch back and forth or is it a known event of what's going to happen - is it a pop-up, to quote what you said, or is it actually.

MS. BROWN: No, it's very --

VICE CHAIRMAN BEGEMAN: -- Or is it much more managed?

MR. BAILEY: Yes.

MS. BROWN: Much more stable.

MR. BAILEY: Yes, each of the customers in the shared asset areas is essentially jointly served by Norfolk Southern and CSX. And then Conrail acts on our behalf. Once we take the train into their terminal, they actually are performing that destination terminal function for us and then distributing those cars to the customer.

It's very different than what NIT League is proposing.

VICE CHAIRMAN BEGEMAN: I understand that.

MR. BAILEY: Yes, so the shared asset is a very highly concentrated, very dense area, lots of customers. So we're not talking about a few customers, you know, a few cars to a couple of customers. We're talking about taking full trains into that operation, and they're essentially acting as our --

VICE CHAIRMAN BEGEMAN: But are the customers frequently taking advantage of their ability to switch? Or has that all sort of settled down and you each have your customers?

MR. BAILEY: I think it's fairly settled down. But they do switch.

MS. BROWN: I think another difference that's important, like I said, is we own this property. So the investment decisions are made collectively. We went through a significant negotiation between the two of us of how costs would be allocated, how we would make capital investment decisions, how we would have the infrastructure to support the business for both owners.

So completely, again, a voluntary arrangement. We purchased Conrail. We both have an ownership interest in this property and we work very tightly together to manage this entity. So it really is not at all reflective of what the NIT League is proposing and does not have all the possible implications, complexities and effects that the NIT League proposal would have.

There is a collective interest, because we're owners, to invest in Conrail, right. There's a collective interest to work together to make sure we have the facilities to support the business, as a whole. And the NIT League proposal is very different, and could be in places where we have absolutely no capability, no capacity, and where there is significant complexity to the network, that we don't have any incentive there, really.

For our customers, our role is to really reduce that complexity. For our customers, our role is to streamline our operating plans, every shipment, so that it benefits all of the customers that we serve.

So we work every day to take every bit of complexity out of this network that we possibly can, not to introduce, and none of us would introduce the types of movements, even the most simple one, that Bill Rennicke outlined yesterday.

VICE CHAIRMAN BEGEMAN: On one of your charts you showed the complexity of, the additional three-day time, the 300-miles, et cetera. Is that an extreme example? I mean, why would a shipper want that?

MS. BROWN: It's an absolutely

realistic example. I suppose if they're getting a rate reduction there are some shippers who would opt for that. I think we've seen, historically, in the rail industry that with some of the problems that we had, we had such complexity and such inefficiency and routes available to customers that they could choose. We have all tried to streamline that. To the point before, where it made sense and where we had multiple railroads serving the same location, we entered into some of those voluntary arrangements to reduce redundancy.

MS. RINN: In fact, I think Ms. Brown is referring to the fact that many of the reforms in the Staggers Act we've forgotten because we've done them, and they happened first. And that was route simplification and eliminating inefficient routes.

But there were cases that the Interstate Commerce Commission was having to decide, where, because there were a multitude of routes, including some extremely inefficient routes, if you had railroads that flagged out of a general rate increase in order to induce the traffic to move that way, it happened.

Now, most of those routes got closed without protest. But there was one case that went to the ICC to decide where soda ash from Wyoming, moving to New York and other eastern locations where the most efficient route was across Iowa and through Chicago and then east, was being routed via Ann Arbor, Michigan to move over a railcar ferry, because you had some smaller railroads that, this is back in the days where they had the 30-plus Class I railroads, that you had smaller railroads that were flagging out of this because they were getting the traffic and they were basically using divisions from other carriers in order to subsidize what was happening.

But you had customers who were willing to accept weeks of delay on getting a shipment because they were getting a lower rate, even though it created gross inefficiency in the railroad network. We have eliminated those sorts of things.

And then the contracts have also come in. But frankly, contracts took longer to take off and get really popular. It was eliminating that type of routing and irrational, inefficient routing because some people want to save money. And if the inefficiency basically is externalized and imposed on somebody else, they're going to go for saving the money.

And I can come up with some even more current examples of what the SP would do for pricing for cash flow purposes, in terms of backhaul traffic. So if, when we say that we're afraid that there will be participants in the marketplace who will, if they can come up with a way of basically saving money, choose an inefficient service option, it is not talking from theory.

We know this from historical experience. And that is why we are afraid.

MR. BAILEY: I think you'd be surprised at how many of those types of examples exist. I think of it like Atlanta. I think, in the NIT League comments they tend to think of these terminals as one entity.

But in fact, our operations in Atlanta are a series of small yards that make up the terminal because, over the years with the mergers, we've ended up with pieces here and there. So you've got several different yards that constitute the terminal, and there have to be movements between those different yards within the terminal area.

And you could likely run into a case where CSX might interchange something to us that we could, in fact, carry to a customer relatively easy if it's served out of that same particular yard. But another customer in the same terminal area, we would, in fact, have to move that car to Macon and then back to Atlanta to get it to that customer.

And I think those are the kinds of things you're going to be faced with, is all these individual cases based on the operations of the railroad.

VICE CHAIRMAN BEGEMAN: That's actually another question I wanted to ask Ms. Brown. You talked about the hub yards versus all the other interchanges that can work. If this proposal, and I know you're here to say this doesn't work, we have that message, but if we were to continue to have a dialogue on this to try to make something work would it be more operationally workable if this was focused more on locations within hub systems rather than a random interchange?

Yesterday, one of the maps showed clearly on the eastern part of the country that there are a whole lot more areas where there are interchanges -- where the red circles were - more than there were on the other half of the country. But is there a way to balance that?

MS. BROWN: I mean, I would say we have a couple of concerns. One is, and very respectfully, we have had a history with this and we are very concerned about the proposal. And even segmenting where these things could occur, we have entered into joint arrangements where it makes sense.

We often do exercises with the help of consultants and very talented people who look at the flows across our networks collectively and where we can make the most efficient routing.

Our overall concern here is where those opportunities exist we try and leverage those. And we do those voluntarily today. Our concern with this proposal is you would have others making those decisions for the industry, and it's a very complex network.

It's a very difficult modeling problem to solve, right.

And we all spend inordinate amounts of time, either individually within our own networks or for opportunities of shipments that are handled between us, to make that the most efficient possible. And any introduction of new complexity, by definition, requires more workload, more time, more handling, more congestion.

You're doing things that are unnatural. And it would not be the people who sit down and try and optimize these networks making those decisions. It would be somebody else forcing those decisions on us. And is has, absolutely has, cascading ripple effects.

You take isolated incidents. You know, Chicago is a great example. It just cascades and those effects start spreading across our networks because it is an integrated network. And any issue anywhere on the network can impact the whole and impact all the customers.

And we like to call it, it's like the perfect or perpetual storm where you constantly have things that we're trying to do that are completely unnatural that don't fit within our service plans. That could happen every day. We don't have the resources, we don't have the infrastructure.

It takes a long -- Tom had a great slide on the lead time. We spend a lot of time preparing for new business development. We don't have, don't typically, have pop-up traffic. We spend a lot of time preparing for business shifts. It takes a lot of time to make sure you have the adequate infrastructure and resources to handle that.

MR. HALEY: Just to follow up and to add to that, my map was up there just for a short time about a future projection on our network. But the red dots which are terminals that are over-committed in the future based on the capacity today, on Union Pacific, are both local yards and hubs. There are both of those there.

And one of the ways that we try to balance is to shift work between the two. So I don't think a hub only or a local yard only approach solves the problem at all.

And the second thing, if I may just follow up, Cressie made a great point about how we all work to take events out, switching events out, to make the service more streamlined and more efficient. And I think that's the great frustration because this is such a big step in the opposite direction.

Part of how we're going to grow in the future is by taking steps out, to live within our infrastructure and to move more freight. And why on earth would we spend our scarce capacity re-switching, re-handling traffic that we already move? It just doesn't make good sense.

MS. BROWN: If I could add one more point on that from a customer perspective. We went through the slide that showed how much time we spend with customers trying to listen to what's important to them. And they have indicated to us that they love the value proposition of rail.

But what is going to be required for them to give us more of their business is service reliability and that that is paramount to them. So we work very hard to take these complexities out. We have every incentive to make our service product more streamlined, provide faster transit and better service to our customers. That's really what we're focused on.

And this goes in absolutely the opposite direction by adding complexity. By definition, it adds complexity. It adds time. And it degrades our service reliability, and that's our primary concern.

VICE CHAIRMAN BEGEMAN: May I keep

going?

CHAIRMAN ELLIOTT: Keep going.

VICE CHAIRMAN BEGEMAN: All right, so back to market power. We have conflicting policies. I think no one would disagree with that, but the Board may require rail carriers to enter into reciprocal switching where it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service.

Not to put words into your mouth, but it seems that the comment earlier was NIT League's proposal is "artificial" market forces. So what is not artificial that the Board could do to promote competitive rail service options that doesn't turn us back to 1979?

Yesterday I asked the second panel because there is a disagreement, a legitimate disagreement, on what the impact of how much traffic would move. You know, the crystal balls are not real clear on either side. Is there some level of competitive switching that the rail industry could live with?

If you just look at the Board's record we know that there are various railroads that are working to assist shippers, to sort of do what some people are wanting to do, more broadly. They're -- I'll just leave it at that, so I --

MS. RINN: I understand where you're coming from. In our world we, likewise, have to balance competing, not always congruent, interests. But I'll make one observation. Successful regulation isn't necessarily measured only by the number of disputes that are officially resolved by an administrative agency in favor of one side or the other.

In fact, you have, the more successful your governance or regulatory scheme, the fewer disputes you have because the parties understand what the rules are and either they're going to comply because it's already aligned with their economic self interest, or they're in a compliance mode.

And if you know what the rules are and you know how you're going to comply with it, then you're going to avoid creating unnecessary or avoidable disputes. And, in fact, that's why the vast majority of your rate cases end up getting settled and even more rate disagreements between customers and railroads get resolved before even getting to the Board.

I would submit that there's already a great deal of competition between the railroads. And we're doing it in other effective ways. One way is we like taking market share from BNSF using transloads. We do that with a lot of traffic. Now that may not work for everything.

But the other thing we have done, and in fact we went from a zero percent market share to more than 50 percent market share on the Powder River Basin is that we had a marketing strategy that we were going to make our customers the low-cost generators in their territory. So they were burning coal that used to be delivered to a power plant that might have been local to the BNSF, but we had the low-cost producer.

So there are all sorts of ways of competition that we're engaged in because it's in our economic self interest. And there are other forms where maybe the marketing department doesn't want to do it that way, but when we say well, here are the results in the regulatory scheme, and you don't want to go there, so I'm suggesting that, to a certain extent, the current standard basically says you need to prove that there's a competitive abuse. We recommend against competitive abuses because we don't want to end up here before the STB. So I'm saying that there are ways of getting success that don't necessarily show up on your radar screen, and it is a successful regulatory scheme.

MS. MULLIGAN: And I think that's exactly right. I would just add to Lou Anne's comments as well that you have, well, she was focusing on the competitive access remedies and remedies that are focused on instances of competitive harm, commercial abuse, market power abuse.

There's also the rate reasonableness standards as well that step in when market power has resulted in an unreasonable rate. And there's a lot of active disputes at the Board about that. But then that's also something that we have, that we take into consideration when we're having negotiations with customers.

Just because it doesn't rise to the level of being an active proceeding before the Board doesn't mean that these rules have real impacts in how shippers and railroads engage with each other.

VICE CHAIRMAN BEGEMAN: You don't have to talk if you don't want to.

MS. BROWN: Sorry. I would just add, from a pure operational perspective, our concern is that you will make transportation less competitive for all of our customers, right. That's part of their cost of doing business. And by implementing this proposal in particular, does nothing to improve the efficiency of freight transportation in the U.S.

VICE CHAIRMAN BEGEMAN: I will now trade off with you.

CHAIRMAN ELLIOTT: Do you have more?

VICE CHAIRMAN BEGEMAN: I might later.

CHAIRMAN ELLIOTT: Okay. And just two more questions. The first question, I guess, is more for the lawyers. And some of the railroads, in their comments, raised the issue that we don't really have the authority to do what NIT League is proposing today.

And as a result of past regulations that we have put in place regarding competitive access and as a result of the 1996 Interstate Commerce Commission Termination Act those policies were essentially ratified, can the panel speak to that? Do we actually, or is it the railroads' belief that we do not have the power to put in place what is suggested by NIT League?

MS. MULLIGAN: I think that, speaking for BNSF, we've taken the position that, regardless of the authority of the Board, the STB's, sorry, the NIT League proposal is not an appropriate step under the Rail Transportation Policy.

I think it's inconsistent with the direction that has clearly been given by Congress there, in terms of focusing regulation on instances where there's actually an activity that needs to be governed and otherwise allowing market forces to operate.

MS. RINN: We didn't repeat but we agree with the legal analysis in the AAR. I would say we certainly do not question that the Board has statutory authority, in a particular instance, to impose reciprocal switching.

The key difference we have with what the NIT League is proposing is they're basically saying we're going to come up with these conclusive presumptions for a large number of stations and a large number of carloads where you get a pass in basically the high passenger lane when statute written by Congress envisioned doing this on a case-by-case basis.

And we think that there is a fundamental disconnect there which is, in fact, contrary to the law and the congressional policies that are out there as well as your prior decisions.

CHAIRMAN ELLIOTT: And, following up on that, would it be your position that the way this works, and I think the term winners and losers, us choosing winners and losers, was used by the railroads, would you consider that to be an arbitrary use of our powers? Is that more or less what you were getting at?

MS. MULLIGAN: I think it would certainly be a troubling use of your powers. I think that, the question came up previously, aren't there winners and losers already? I think if, by that, people are talking about the fact that, yes, there are carriers, there are, sorry, shippers who have access to two carriers and access to one carrier.

That has been the result of where they've located. This would be something that's very different, I think, than what the Board has previously done which is creating a new category of winners and losers by virtue of implementing a remedy that really doesn't have reference to any actual individualized or issues, competitive service otherwise that a shipper is experiencing.

And I think the panels yesterday identified there are some real impacts to that in terms of shippers.

MS. RINN: I would like to actually go back to some of the points that Jill made during her presentation. The 240 percent as a, you've got market power and if it's under 240 you may not have market power. And that, as a threshold, that's absolutely arbitrary.

I've not seen any evidence in this record that basically says, based on a revenue to variable cost ration which, by the way, can change based on system-wide costs, tells you anything about the particular market circumstances of that individual customer. To my mind, it's a very clear example of something that is arbitrary.

CHAIRMAN ELLIOTT: Okay, putting aside what I just asked about whether or not the 240's arbitrary or if the mechanism itself is arbitrary, yesterday I mentioned, with respect to service, I know that's a serious concern of yours and for good reason.

What if, and I mentioned this yesterday, if we put in place some type of safe harbor for the railroads so if the incumbent has a rate above 240 and someone brings a case of this nature seeking access that the railroad could lower their rate, I assume by tariff, and put it below 240.

And as a result they're automatically in a safe harbor and not covered. Would that eliminate our service concerns that the Panel has presented today?

MS. RINN: No.

MS. MULLIGAN: Yes, I was going to say the same thing. I think one of the issues that's been highlighted with this panel is that it's not so much the volume of switching. It's where it actually occurs.

And so while that proposal might limit the place, the number of places where switching would occur, you could still have switching taking place in some pretty critical places on the network that would have potential service impacts.

But I also think, too, the issue with the safe harbor is that it doesn't really fix the sort of arbitrary nature of the starting point of the proposal which is the 240. You've maybe put a couple protections against that being widespread in terms of the safe harbor.

But you still have the issue that you are putting in place a regulatory remedy where it's really not connected to showing that there's some sort of issue that needs to be addressed.

MS. RINN: And if I could offer, like two practical examples of why 240 would be arbitrary and not make a lot of sense.

One example would be do you really want to have a rule like that that basically says you could be forced to a reciprocal switching opening on TIH.

The fact is that URCS, as you're applying it and for purposes of the market dominance test I understand why you're doing it, you do an unadjusted URCS. But it does not reflect the extra handling that is associated with TIH or other hazardous materials. And it certainly does not weigh the risk that we face in handling TIH.

Those commodities have historically carried a higher margin because of the costs, because of the risks that are associated with handling it. And so it doesn't make a lot of sense to use a system average costing system to set that kind of a basically informal rate cap. It's basically a backdoor way of doing rate regulation.

Another example would be when you're making a lot of investments that are going to benefit a particular community of shippers, so, for example, taking our southern region where a lot of those capacity constrained terminals are, that is where we have a lot of inbound traffic that is associated with the fracking boom.

So to create the natural gas and to create the crude oil at a low cost that then the chemical industry is using to create more domestic production, we're making massive investments. And we need to get a margin on the traffic that's going to be able to pay for those investments.

While I submit to you that they may not like necessarily seeing it, nobody likes to see the price they're paying for something going up, but those are customers who should be paying margins that are going to allow us to make this investment in order to meet their transportation needs now and into the future.

And that's what I've got, is a

concern with having an R/VC ration that you're talking about applying across commodities and across our system.

MS. MULLIGAN: And I would just also add, too, this goes back to my testimony, but when you do incorporate the R/VC at the system level you do have this issue where you are essentially creating a incentive.

Whether it's to stay below the 239 that you're talking about, you remove the incentive for carriers to make efficiency investments because, as a result of making an investment that reduces your variable cost, you could actually tip back up over that level. And you haven't changed your rate, it's just because you've made an investment that does reduce your costs.

VICE CHAIRMAN BEGEMAN: May I ask a question? I'm having trouble, it seems like you're all looking at it from the perspective of not wanting to lose your current shipper, perhaps, or your current revenue.

But why not look at it as a way to get more revenue from more shippers, the people that switch to you? How is that not a potential benefit, long term?

MR. HALEY: I can't get past the issues that I talked about, which is more work and less efficiency in a capacity constrained environment.

And it seems to me, and I truly am not one to speak to all the ins and outs of revenue and the legal issues, but it seems to me something that has a net effect of being less efficient at a higher cost, and at that same time reducing revenue, just can't be a win/win.

VICE CHAIRMAN BEGEMAN: But in the rest of system, where there's competitive service you figured out how to make that work successfully, at least looking at your spreadsheets and what I read.

MR. HALEY: So I think --

VICE CHAIRMAN BEGEMAN: Collectively, I should say.

MR. HALEY: Yes, so I think the issue here is though, again, we're doing something that's less efficient. I mean, it just doesn't make good sense.

MS. BROWN: I mean, I would offer to that as well. I mean, this proposal would absolutely add cost to the rail industry as a whole. It absolutely would make us less efficient because we are adding workload to the system for the same amount of cars.

So you can't add significant amount of work and not add the cost of handling those cars -- the time, the complexity, the congestion. And our customers are very clear to us that what is going to enable us to grow our business is better transit, better service, better reliability.

And until we get there they can't,

they are tightly managing inventories in their own systems, right. So they need to be able to depend on if a shipment is scheduled to be there Wednesday they're production schedule requires us to show up on Wednesday.

And every time that you add complexity in the system our opportunity to be there on Wednesday is diminished. And we don't see a scenario where we can effectively grow our business when we are degrading our service product.

And most of the markets and sectors of our business that are growing, going forward, are very service sensitive markets that are requiring very high levels of predictability, reliability, on-time performance in transit. It's a network. You can't impact pockets of the system without affecting the system.

MS. RINN: Again, just to be concrete about it, we are already growing our business. We're going after folks who have traditionally used trucks and barges. And so we're going after that business.

We go after folks who may be located on a different railroad by transload. And we have built in or we have provided inducements to customers to build-in to us or to expand their capacities on our railroad lines as opposed to expanding their capacity at a plant on another railroad line.

So we are interested in growing our business and we are, in fact, doing it. But we do it with our money or money that basically is paying for that competition where we're sure that we can provide a competitive transportation service.

The model of trying to do it in a way that is inefficient and where, if you come up with the wrong pricing scheme, can have us subsidizing our competition and while making us less competitive is not a way, to us, to basically advance competition. It is basically taking a step back on competition on several fronts.

CHAIRMAN ELLIOTT: Thank you very much for your testimony today. We greatly appreciate you coming out here today and helping us with this important matter. And we will bring up the next panel.

(Off microphone comments)

CHAIRMAN ELLIOTT: Okay, why don't we start with our Panel Number VI, and I believe we'll hear from the American Chemistry Council first.

MR. MORENO: Good morning. I'm appearing today on behalf of the American Chemistry Council because this proceeding is tremendously important to the chemical industry. Three decades of consolidation of the rail industry has produced rail duopolies in the eastern and the western United States.

And perhaps more importantly it has extended the distance over which many chemical production facilities are captive to a single railroad. As a result of this increased captivity the rail industry has been able to impose significant rate increases over just a very short period of time.

These rate increases reduce the ability of U.S. chemical producers to increase economic output and to create new jobs. The NIT League's competitive switching proposal has the potential to restore some of the rail competition that has been lost through past mergers.

This, in turn, would establish a fair and reasonable balance between the often conflicting goals of revenue adequacy and effective competition in the Staggers Act. First slide, please.

Since the Conrail acquisition, which was the last major merger that completed the current eastern and western duopolies, rail rates have increased at an unprecedented pace. You saw this slide yesterday with the NIT League presentation.

And I think it's significant to understand, in looking at this slide, the Conrail acquisition was basically completed in 2000. But there were a few years of basically digesting service disruptions, et cetera. And also there were several years of Board oversight.

As Legacy contracts began to expire you start to see the rail rates deviate from the pace of trucking increases and the pace of inflation, which is strongly suggesting that the railroads are exercising significant newfound leverage over captive shippers as a result of their extended bottlenecks from theses mergers.

A recent study commissioned by the ACC which was included in our opening comments estimated that the chemical industry paid $3.9 billion in charges above the 180 percent R/VC jurisdictional threshold in 2010. Recently ACC released an updated version of this study for 2011 which showed that that premium had increased to $4.5 billion.

The jurisdictional threshold is a significant benchmark for this analysis because it shows how much and how fast rates have increased in the years following the Conrail merger. In just five years, between 2005 and 2010, the amount or the rate paid above the 180 percent threshold increased from $2.2 billion to $3.9 billion, a 78 percent increase.

If you benchmark that against the $4.5 billion in ACC's updated analysis for 2011 that figure jumps to 145 percent over just six years. The analysis also shows that more than one-third of chemical shippers have rates that are above the 300 percent R/VC ratio.

This high fraction of rates above 300 percent confirms the trends that were identified in the GAO and the Christensen Associates reports that have continued and likely have become more pronounced, at least for the chemical industry.

This increase cannot be attributed to higher demand because overall carload volume over 2011 was virtually unchanged from 2005 levels. Yet we can see, for all traffic on the system, the rail premium above the 180 percent had increased by over 90 percent.

Comparisons to Canada illustrate the consequences of reduced rail competition for the competitiveness of U.S. chemical producers. Canada has long had interswitching. And interswitching is a far more liberal form of competitive switching than what the NIT League has proposed.

Within this study that was commissioned by ACC it compared 2010 rail rates to U.S. destinations from Canada origins and from U.S. origins and found that 40 percent of the Canadian origin chemical traffic had R/VC ratios below 180 percent, whereas only 23 percent of the U.S. origin chemical traffic had R/VCs below 180 percent.

The competition that interswitching creates at Canadian origins clearly gives Canadian chemical production facilities an advantage over U.S. locations. And competitive switching would do much to level that playing field for domestic chemical producers.

Restoring competitive balance to the rail industry would reduce the rate premium paid by chemical shippers and would allow the U.S. chemical industry to increase economic output and create more jobs.

The NIT League proposal would restore lost competition from 30 years of rail consolidation by breaking some of the bottlenecks, just some of the bottlenecks, that have grown increasingly longer with each merger.

As a general rule the ICC Termination Act permits the rail carrier, the origin rail carrier, its long haul. That long haul, however, has increased for most shippers after many years of end-to-end rail mergers.

As a result, facilities where the origin carrier's long haul may have been over relatively short distance now find themselves captive to an origin carrier's long haul that extends several hundred miles or, in some cases, even the full distance of the entire route.

This extended long haul created by mergers precludes shippers from using competitors that may be available for the majority of the distance. This is a very simple and basic illustration of that example. We have a pre-merger and a post-merger scenario.

Pre-merger, the origin was still captive to a single railroad, but that railroad had a fairly short distance to travel before it had been handed off to Railroad 2 or Railroad 3 for delivery to the destination. So there was competition between Railroads 2 and 3.

Post-merger between Railroad 1 and Railroad 2, Railroad 1 now has a long haul all the way to the destination that completely precludes the participation of Railroad 3 in any of its transportation options.

The NIT League proposal, if the intersection and the interchange between the new merged railroad and Railroad 3 would occur within this 30-mile radius, it would reverse that effect and, therefore, restore that level of competition.

I would like to address a few of the comments that we heard about service issues and, particularly, some of the stuff we've heard this morning. It's easy for the rail industry to cherry-pick and create doomsday scenarios for this. They have no incentive to acknowledge or even identify those scenarios within their systems where efficiencies might be improved.

But I think, and they've also left off the question of at what levels do these doomsday scenarios kick in. And maybe because that question is a bit of a red herring. As I heard one of the panelists just immediately before me say, it's not the volume of switching, it's where the switching occurs.

Well, what I haven't heard any railroad participant say today is they haven't addressed why NIT League's *** 11:11:36 fore-factored dealing with service concerns wouldn't protect against those scenarios. Where those doomsday scenarios are likely to occur, that would be a defense against reciprocal switching under the NIT League scenario.

In this proceeding the rail industry had described the NIT League proposals as a wealth transfer that is motivated solely by rate reductions. Well, there can be no denying that rapidly rising rail rates have been an important factor in developing this competitive switching.

But the attainment of reasonable rate levels is a central objective of competition. So to the extent that the railroads have been exercising undue market power to charge excessive rates, competitive switching has the potential to introduce competition to keep that power in check.

In other words, what the railroads are calling a wealth transfer is simply competition at work. Furthermore, ACC support for competitive switching is driven by far more than just rates. Providing access to nearby rail alternatives promotes use of the most efficient carriers and routes for each movement and permits manufacturers to design more flexible supply chains.

These are options that are often foreclosed today by the examples that are on the screen where monopoly carrier origin carriers are seeking to preserve their long haul. In contrast, if the incumbent carrier's route is more efficient, based on both price and service, a shipper will continue to use it even after the implementation of the competitive switching.

Competitive switching also is not the death nail for differential pricing. NIT League has demonstrated that the universal traffic potentially eligible for competitive switching is limited and revenue

Furthermore, today's industry does not need to engage in the magnitude of differential pricing that may have been required in the past. The industry is more than financially sound and is thriving by setting records for operating ratios, income earnings per share and railroad stock prices have outpaced the broader market for many years.

Much of the money from the current level of differential pricing is being returned to shareholders through higher dividends and stock buy-backs. Ironically, this is a wealth transfer from captive shippers to railroads that has been facilitated by a lack of rail competition.

Competitive switching is not a panacea, however. For every captive shipper and every captive movement that would be a substantial improvement over the status quo, I'll wrap up quickly here, AC members still harbor substantial concerns that even with competitive switching railroads will not compete.

And the Board's public hearing at Ex Parte 705 revealed broad shipper support for greater rail to rail competition. However, a number of shippers in that proceeding expressed deep concern about railroads willingness to compete.

The Board need not focus on just one issue. It can focus on both regulatory remedies and enhancement of competition. But the Board needs to be cognizant of the fact that two railroads will not always compete. And they must be prepared to address those situations through other regulatory remedies even when competitive switching might otherwise be available.

Therefore, in conclusion, ACC strongly supports competitive switching and urges the Board to proceed promptly to a notice of proposed rulemaking based upon the NIT League's proposal. No further purpose would be served by requiring additional steps before offering specific rules for public comment other than to further delay this very important proceeding for the shipping community. Thank you.

MR. JOHNSTON: Good morning, Chairman Elliott, Vice Chairman Begeman. My name is Eddie Johnston. I've worked for the Dupont Company for 33 years.

I'm here today representing Dupont, a leading science company, and the

Chlorine Institute where I serve as Chair of the Board Committee on Rail Issues. I appreciate the opportunity to address you this morning.

I'm pleased that the Board is open to considering proposals that would improve rail competition. Today our nation's railroads are healthy, profitable and actively reinvesting. Their improved profitability results from improved productivity on one hand and virtually unrivaled pricing power on the other.

During the recent economic recession rail rates escalated three times the rate of inflation. Railroading is once again a great business. America's farmers and manufacturers like Dupont, who pay these increasing prices, are too often faced with no choice for rail service.

Rail-to-rail competition has disappeared for most of us. Dramatic consolidation, the emergence of dominant regional carriers has left three-quarters of all ship points captive to a single railroad. Captive shippers enjoy neither competition nor the dynamics of free market forces for transportation.

At the same time rail is the safest or only practical mode of transportation for many shippers. These shippers and their customers need greater competition. Competitive switching in this proceeding aims at increasing competitive access over existing infrastructure. It is a step in the right direction.

As the Board considers this proposal I urge you to recognize that competitive switching rules stop short of actually creating competition. They make competition possible. Unless the invitation to compete is met with a willingness to compete shippers will not benefit by rates that are set by market forces. And so the Board must not interpret competitive switching rules as creating competition per se.

The three important implications that flow from recognizing the distinction between competitive switching rules and actual competition -- first, the Board cannot rely on competitive switching rules to discipline railroad pricing or limit oversight to the first or last 30 miles without evidence that pricing from origin to destination is indeed being set by competitive market forces.

This is particularly true for products like ammonia and chlorine that railroads have publicly stated they would not carry if they were not required to do so by law. Second, the Board should make clear that the mere existence of competitive switching rules does not disprove market dominance in a rate case.

If railroads able to compete choose not to compete under competitive switching rules, just as they are doing today, shippers are exposed to market dominance and its attendant rates. The opportunity to bring a rate case challenging unfair rates must be preserved with or without revised competitive switching rules.

Finally, I urge the Board to require all railroads falling under the conditions of these rules, both the incumbent railroad and all competing railroads, to provide tariff rates when shippers are faced with no acceptable contract offers.

Although this provision may not stimulate competition, shippers would retain the remedy of bringing a rate case before the Board. You've heard extensive testimony on rail competition through Ex Parte 705, 714, 715 and now this proceeding.

I encourage you to examine that whole record for opportunities that create greater rail-to-rail competition. In conclusion, I urge the Board to proceed to rulemaking on competitive switching with the following recommendations.

Recognizing that competitive switching cannot be interpreted as creating competition per se, the Board should not lessen its oversight over end-to-end rail rates. The Board should unambiguously disallow the use of competitive switching rules alone as a defense against market dominance in a rate case.

And the Board should require railroads subject to competitive switching rules to provide tariff rates when a shipper is not able to obtain a reasonable contract offer. These measures will help preserve the rights of shippers to challenge unreasonable rail rates while creating additional competition for some.

Thank you again for the opportunity to appear today.

MS. DEARDEN: Good morning. I'm here on behalf of Diversified CPC

International because rail-to-rail competition is very important to small and mid-sized customers like Diversified.

Highroad Consulting filed opening comments in this proceeding with supporting analysis in a report prepared by our consultant, Neil Thurston, assessing Canada's regulated interswitching impact on our operations and service to customers. And that has been referenced by numerous parties in the reply comments.

Diversified support the NIT League competitive switching proposal, CSP, with some modifications. Diversified and other shipper representatives have produced adequate evidence to justify opening of the rulemaking proceeding.

Rationalization of the rail network from 26 Class I railroads to 7 had a dramatic impact on competition. Further, in the Board's decision dated July 25, 2012 you commented that the NIT League proposal has the potential to establish discipline and to reduce the number of regulatory proceedings.

This would benefit all parties including the agency, the shippers and the railroads who are currently required to commit time and resources to those proceedings. The railroads contend forced switching will shift traffic flows and put capital investments in infrastructure at risk.

We submit the railroads will have no choice but to continue to invest in their systems simply to keep up with the dramatic growth forecasted by the United States Department of Transportation. Diversified is a relatively small shipper. Yet they have invested more than $2.2 million for infrastructure improvements required to maintain and increase rail shipments.

The railroads seem to have a one-sided view of the need to earn return on investments. In 2004 one of Diversified's customers asked them to develop a new product for the customer's foam packaging operations. Diversified developed the new product which was accepted by the customer.

Diversified acquired additional tank cars and they invested more than $500,000 for the construction of a storage tank farm, blending system, associated pumps and piping for the new commodity. During the three-year period when we had the business the rail rate for this move increased more than 41 percent.

The railroads disregarded our warnings and ultimately priced Diversified out of the business. It is extremely unfair for railroads to encourage customers to develop business that will require capital investments and to subsequently chase the business away with irresponsible pricing practices.

This is only one example of inadequate competition in the railroad industry. One hundred percent of Diversified's rail links have bottlenecks at origin and/or destination. For this particular lane both origin and destination are classic bottlenecks.

While we have not developed a plan to request competitive access we believe it is possible that simply having an option to open industries to reciprocal switching will create a competitive environment that will serve the public interests.

My railroad career started in 1969. As a railroad marketing officer, I had the privilege to learn while working in a regulated industry and to subsequently compete aggressively in a deregulated environment.

We competed in a number of ways, developing marketing and pricing strategies and we implemented strategies to improve the efficiency of the railroad's locomotive and railcar fleets. And there's no question that competition was a motivator to drive efficiency into the railroad's networks.

Based on my experience, I submit that one of the many benefits of CSP will be the continuing development of productivity initiatives that will result in more efficient operations and quality service. The railroad party's allegations that service will decline and costs will increase if CSP is approved is without foundation.

First of all, a single line route is not always the most efficient route. If time permitted I could relate a number of instances where more direct routes were developed by routing a portion of the move over a second carrier.

Further, when selecting carriers and routes shippers consider service and total costs which includes rates, the difference in fuel surcharges, car costs for private equipment and inventory costs. Competitive switching will be optional.

The railroads will have the option to compete and the shippers will have the option to select a preferred carrier and the routes. As a result the competitive market forces will improve the efficiency of operations.

AAR contends that competitive switching will not work in the U.S. because the U.S. rail system is more complex than the Canadian system. Further, AAR witnesses, Phil Ireland and Rodney Case, stated regulated interswitching has been part of their regulatory system for 100 years.

As a result the Canadian interswitching does not lend any support to the proponents of mandated switching in the U.S. which has never had a history of mandated switching. There's no reason to believe that CSP will not work in the U.S. Also, I fail to see the point that regulated interswitching has been part of the Canadian regulatory system for 100 years.

While the rules may have been in place, the first industry to actually access interswitching in Canada was Cominco Fertilizer Company in 1993. Some of the railroads, in their reply statements' reference to the Thurston report, would suggest that Canadian interswitching has had a negative impact on railroad operations.

However, those statements were taken out of context. The remainder of this section of Thurston's report reads, Such switching activities are part of the everyday life of railway operations. For without such operations, mainline functions would not occur in an efficient manner. One might consider such demands on the railway system would lead to inefficiencies and significant negative impacts on railway operations.

As such, outcomes do not appear to be apparent. Over the past 10 to 15 years both CN and CP have driven forward and achieved significant productivity and efficiency gains. Union Pacific's railroad stated they would not have proceeded with the series of consolidations that created the current UP system had they been conditioned at the time by the NIT League proposal.

UP consolidated six railroads into a single system. UP's statement appears to support the theory that the consolidation of the rail industry and the creation of monopolies was strategic and intentional and underscores the need for the Board to take corrective action.

AAR stated it is impossible to know in advance how much switching would occur if the NIT League proposal were adopted. AAR is correct from the standpoint we will be forging new ground. Also, the incumbent railroads would influence the number of shippers that will actually access competitive switching.

However, we have learned from experience that we can predict behavior based on history. Canadian interswitching has been successful. It has established discipline in the industry without any apparent negative impact on railroad efficiency and it has not decreased customer satisfaction.

The report attached to Highroad Consulting's opening comments authored by Thurston and NIT League's witness, Tom Maville, presented a history of the development of interswitching in Canada and evidence that the Canadian railroads have thrived since interswitching was established.

We submit the Board should modify the proposal before issuing proposed competitive switching rules. The process should be simplified, the same or similar to the Canadian model. Shippers should not be required to pass a test to access competitive switching.

A process that would require shippers to assume the cost to retain transportation attorneys and consultants to initiate proceedings that will require proof of market dominance and prove that rates exceeded designated R/VC threshold would not be a practical alternative for small to mid-size customers like Diversified.

This should not be a privilege reserved for very large industries that have significant financial resources to take on such an initiative. Instead, the process should be simple and automatic as it is in Canada. I'm nearly done.

However, if the Board elects to include in the new rules procedures that include calculation of a regulatory benchmark, the benchmark should be fair to all parties. We contend the regulatory threshold should be consistent with that in place for other STB proceedings and that is 180 percent.

However, the problem with URCS continues to exist. URCS needs to be updated or replaced as it produces costs that are not accurate and the costs are grossly overstated. The Canadian Board of Railway Commissioners in 1918 ruled that interswitching is a right, not a privilege.

We encourage the Board to initiate a rulemaking proceeding and to amend the NIT League proposal to simplify the process with the objective to increase competition in the rail industry for all shippers, not just a privileged few.

MR. KEPLER: Good morning, Chairman Elliott and Vice Chairman Begeman. I'm Dave Kepler, an Executive Vice President with the Dow Chemical Company. And I really appreciate the opportunity to testify today on competitive switching.

I think it's one of the important steps towards achieving a competitive rail transportation system, one that we all feel is worth continuing to invest in. Dow is an American manufacturing company that is making investments that will create higher quality jobs for our country.

Nearly 800,000 Americans rely on the chemical industry for employment. And for every one of these jobs there's another six jobs that are created in the U.S. economy. And so Dow, with others in our industry, are working hard to ensure that we have the right competitiveness through the right policy in energy, education, regulatory and infrastructure policy.

The U.S. needs sound policy and a comprehensive strategy for the transportation sector and investment in its infrastructure if we are to improve the global competitiveness of the U.S. manufacturing sector. It's in our interest to make sure the policy continues to have and encourage investment in the rail sector.

The rail industry has undergone multiple rounds of consolidation that has been mentioned earlier, down to seven railroads today. This has resulted in fewer choices for shippers and much longer bottleneck segments that really limit and close down options for shippers.

Regulatory policy has accepted this reduction in competition in favor of promoting railroad revenue adequacy. But with the level of railroad consolidation that has been allowed it is overdue to establish a greater balance for supplier options.

The U.S. rail system enables the American manufacturer to move product at scale. Therefore, U.S. rail policy should not put a captive manufacturer at a disadvantage versus, say, importers that have a choice of competitive entry points. The chemical industry, for example, pays on average 20 to 30 percent higher than it pays at competitive locations with less service options.

Importers can choose their points of entry based upon competitive rail rates that reap the benefits of this differential.

It also limits other carriers from taking that differential on reinvesting and other options and services. The magnitude of this is hardly justified that the revenue performance that the rail industry has today.

So we believe that there is a responsibility today, along with the tools we have, to address the current competitive imbalance between shippers and railroads. Those include promoting this switching to address captivity over short distances, establishing bottleneck rates and making sure the rate case process becomes more accessible by reducing the cost, time and effort of these cases.

The Board developed its current standards for reciprocal switching back when the rail industry was struggling financially. And frankly, the market power was more dispersed. But after 30 years that situation has changed dramatically.

As I noted at the outset, there

was significant rail consolidation since the 1980s which means even more market power and scale for the railroads. And that actually should mean more service options for the shippers, not less. And we don't have that today.

According to the recent Staff Report from the Senate Committee on Commerce, Science and Transportation the rail industry regularly and consistently has been setting records for operating ratios, operating income and shareholder earnings. This evidence demonstrates that a major goal of the Staggers Act to rehabilitate railroad financing has been achieved.

The fact now enables the Board to give greater attention to the other major goal, the promotion of effective competition among railroads which has yet to have been realized.

The League's competitive switching proposal contains long overdue revisions to the Board's competitive access rules. The present rules are onerous. The shippers have not then, to my knowledge, even attempted to use them in order to obtain competitive switching for more than 20 years.

The League's proposal presents a less onerous yet modest standard for switching and is predicated upon a reasonable distance to a working interchange. This type of rule could extend competitive options to a meaningful amount of rail traffic without destroying the rail industry's ability or incentives to make capital investments.

Our perspective, Dow's perspective on the importance of adopting an accessible and meaningful form of competitive switching is based on our experience both in the U.S. and in Canada where a form of competitive switching known as interswitching has existed for many decades.

Dow's U.S. facilities are competitively handicapped by the lack of rail competition which competitive switching would alleviate. In North America we operate a fleet of over 20,000 railcars and carry over 110,000 rail shipments to over 2,100 of our customers from multiple North American production facilities, some of which are open and others closed to the competitive rail service.

On the whole, Dow and its customers are impacted since we are one of the largest chemical shippers in the country. Dow's largest plants in Freeport, Texas, Plaquemine and Taft, Louisiana represent over 58 percent of Dow's U.S. origin rail shipments. All are captive to the same railroad and 80 percent of Dow's U.S. destination shipment are captive to one railroad.

Thus, even if the Board were to adopt the League's proposal, a significant part of our traffic would continue to be captive, yet we still support the League's proposal for the portion of the traffic that it would benefit.

We support this competitive switching. It's based on our experience in Canada which has been a more constructive and balanced approach. We operate major facilities in western Canada and really have benefitted through Canada's interswitching regulations.

As a result, Dow sees a fair system with the ability to foster rail competition that improves service, routing options and actually has increased investing by the railroads and the shippers with that type of system.

As I noted on the outset of my remarks, there will be renaissance in American manufacturing that can create new investment and job opportunities, that a competitive transportation system is key to continuing that trend.

Competitive switching is one step

that will help bring us closer to promoting competition for shippers and rail transportation and promises to improve rail service, provide better routing options and establish competitive rates, all of which are important for American manufacturers to be competitive in the global marketplace.

Just as railroads are doing, Dow is making significant investments in capital improvements and expansions. We have announced a $4 billion investment to expand our largest integrative sites in the U.S. Gulf coast.

Because those locations are held captive to a single rail carrier, our captive rail volumes will increase. Because everyone benefits from this investment, our country could have higher paying jobs in both the rail and manufacturing sector. We need to support these significant investments by Dow and others to ensure our products are moved to customers in the most effective, efficient and fair manner.

In fact, the existence of competition, Dow believes, will result in the development of new and more efficient routing. So our premise is that this actually will simplify and improvement services and encourage investments.

And I don't have a slide with me but one example in our Louisiana rail supply chain, Dow estimates that competitive switching would remove 1 million miles from its supply chain for an average reduction of 200 miles per shipment.

So in reality, when we use the airport analogy, it's not just the complexity to the interchange. The reality is we can take, in the long haul, a lot more simplification and actually reduce complexity in shipment which results in more efficiency in our supply chain and the railroad's.

For this reason, Dow is asking the Board to act upon the League's competitive switching proposal by initiating a notice of proposed rulemaking. Thank you.

MR. RINE: Chairman Elliott, Vice Chairman Begeman, my name is Phillip Rine. I'm Director of Logistics for Auriga Polymers Charlotte, North Carolina.

I hold Commercial Logistics responsibilities for Indorama Ventures Oxide & Glycols in Bayport, Texas, Starpet Inc. in Ashburn, North Carolina, AlphaPet Inc. Decatur, Alabama, Auriga Polymers, Inc. Spartanburg and Greer, South Carolina. All four Indorama companies are captive shippers.

I have over 35 years' logistics experience in general and chemical and plastics transportation experience, in particular. Previous employers include Allied Chemical, City Service, AE Staley, Ashland Chemical, Degussa Corporation, Aristech Chemical, Kerr McGee Chemical and Vista Koch Industries.

I've served two 3-year commissions

as a member of the Pennsylvania Governor's Rail Freight Advisory Committee under Thomas Ridge representing the chemical industry for the state of Pennsylvania. I appeared before the Service Transportation Board before the Conrail merger, representing the chemical and plastics industries and served on the Conrail Transaction Council after the CSX and NS acquisition of Conrail was completed.

My experience predates Staggers Act, shipper railroad contract negotiations and railroad mergers that followed. I have direct experience in two rate reasonableness cases. I'm accompanied today by Mr. Tom O'Connor of the Tom O'Connor Group, who has assisted in the preparation of the testimony being provided today and is available also to respond to questions.

It is a pleasure and a privilege to appear before the Board today representing Indorama Venture's companies. Thank you for the opportunity.

The need for revised competitive switching rules is widely recognized. NIT League filed its petition over two years ago following hearings at the conclusion of the EP 705 docket on competition in the industry. In its January 2011 STB decision instituting EP 705 the Board stated it is time for the Board to consider the issues of competition and access further.

The record in EP 705 amply shows that existing regulatory rules have only partially achieved the purpose of the Staggers Act. For many shippers in a wide range of industries, some of whom are captive shippers, access to competition has been reduced or eliminated.

Indorama intends to show that competitive switching is advisable. It meets a need and can be accomplished with minimal adverse affects. Many parties have noted, and Indorama strongly supports the position, that the revised competitive switching rules should not block access to rate reasonableness remedies.

When the competitive switching rules are revised they must clearly provide that where an otherwise captive shipper utilizes the revised rules to obtain additional rates from a competing railroad the existence of those rates should not be considered as effective competition, and there should be no exemption of rates that are in a contract.

By doing that you will further provide a barrier for shippers to access the benefits of competitive switching. Railroads sometimes have shown tendencies to serve their own interests to the diminishment of captive shipper interests and the public interest.

Examples of favoring railroad interests over captive shipper interest and the public interest include excessive rates and charges, paper barriers, over-recovering fuel surcharges, restricted routing and other techniques that impede access to more reasonable rates.

Indorama management's experience spans the time period including the passage and implementation of the Staggers Act. We have observed often that as competitive alternatives decrease rates increase. The proposed revised competitive switching rules can serve to mitigate some of the adverse effects of this loss of access to competitive alternatives.

Indorama operates extensively in both the U.S. and Canada. In our experience and observation the Canadian competitive switching process operates effectively. It provides major benefits and does not result in adverse affects.

The record in Ex Parte 711 shows that potential impact on railroad revenues and traffic volumes would be relatively small. USDA and US DOT each independently found that the impact on railroad revenues and traffic volumes would be relatively small.

Analysis entered in evidence indicate that while 37 percent of CN and CP traffic was eligible for interswitching in 2011 less than 4 percent of the Canadian traffic is interswitched annually. This also indicates that the proposed competitive switching will have a minor impact on railroad revenues and volume.

Indorama expects that the costs related to interswitching will be offset by additional revenues. The remaining net cost, if any, can be shared with the shippers involved. Indorama is open to the idea of sharing the cost, of gaining access to competitive rail switching.

Indorama supports the NIT League proposal which will help remedy several issues centering on access to competition while recognizing and accommodating the ongoing need for railroads to maintain adequate financial strength and continue to build efficiency and productivity.

A reasonable access price can be developed for use in competitive switching. Indorama supports the use of a mutually agreed trackage rights fee or a haulage rights fee for covering the costs associated with reaching the competitive switching carrier.

Both trackage rights fees and haulage rights fees are well established concepts in the rail industry. If the parties in a given switching access situation do not agree to such fees we recommend that the Board prescribe a reasonable access fee.

My testimony today focuses on two principle commodities transported for Indorama. These commodities are PET and MEG. Tom O'Connor Group has analyzed the 2011 Board's confidential Waybill file made available for us in this proceeding.

Moreover, the Tom O'Connor Group has analyzed and will also rely on analysis of Indorama data. Indorama will present charts showing aggregate summaries of PET and MEG, the two major Indorama commodities, as well as other Indorama products moving along similar routes of movement.

The data will be drawn in part from the Board's 2011 Waybill data. These data are germane to determining the reasonableness of the rates charged or proposed by rail carriers serving Indorama.

Indorama previously requested Tom O'Connor Group to review the benchmark and benchmark the level of Indorama rail rates. Analysis for Indorama included rail rates for inbound and outbound movements of MEG and outbound shipments of PET.

The methodology we used to calculate variable cost follows the procedures used in the Board's rate reasonableness proceedings. We find that the proposed 240 R/VC is a reasonable first-step guideline. However, our preference would be 180 percent R/VC as presented by other interested parties in this proceeding.

In conclusion, analysis of Indorama data found that many of the Indorama lanes produced an R/VC greater than or equal to the 240 percent. These results support the need for the pro-competitive benefits of the NIT League proposal.

Our analysis allayed concerns which may be voiced by some parties that the NIT League proposal could cause dislocations in markets. The relatively high R/VC results indicate that with competitive switching a competing railroad may secure some additional rail business at rates which are still highly profitable.

Practical experience suggests that the endemic railroad would likely retain the business in many, if not most, cases. This indicates that while shippers may achieve modest gains, there would be little adverse impact on other shippers.

Our conclusion is that the NIT League proposal will have beneficial effects in PET and MEG markets without leading to significant adverse effects on other shippers or the rail system as a whole. The points outlined in this summary support implementation of the NIT League proposal.

And Indorama recommends that the Board do so by granting the NIT League petition and instituting a rulemaking to adopt the revised competitive switching rules. Thank you for your attention. We'll be glad to answer any of your questions.

VICE CHAIRMAN BEGEMAN: Thank you. I think, for the most part, I really have just one question for all of you. And a couple of you certainly touched on it. You specifically did, Jeff.

But given what the prior panel, and what the rail panel said yesterday about the impact of this proposal if it goes forward, what it would do to rail operations, systems - three times the length of time to deliver a product.

Clearly, that would give one pause if it turned out to happen across the network. Obviously, you represent either various shippers, or you are shippers yourselves, who really want service. That's what this is all about, affordable, efficient service. If you can just comment on their concerns, and why that isn't giving you pause.

MR. MORENO: If I can just start off by saying a lot of these are red herrings because the question is why would a shipper, I think you yourself asked that question of the last panel, why would a shipper choose one of these far more complicated alternatives.

Well, the important factor, if service is the ultimate objective, they may not choose that more complicated factor. They probably won't. But the point here is they have the choice. And for some shippers it may be they may be willing to pay a premium for better service.

Other shippers, the service isn't as, the timeliness or the predictability of the service is not as important for them. We've heard a lot of analogies drawn to the airline industry here. And the airline, and I think someone yesterday compared a direct flight to a flight that goes through a hub and spoke.

Well, yes, all other factors equal, anyone would choose the direct flight. But we still have a lot of passengers out there who choose to fly through connections because they get a better rate that way. And for them it's not as important to get the direct flight and to pay for the direct flight.

And anyone who's flown today

typically knows that you will pay more for that direct flight versus the cheaper options. I'll leave it to the individual shippers on the panel to talk about their specific circumstances.

MS. DEARDEN: Well, first of all, I would like to think that we could work with the incumbent railroads as opposed to having to go through this process. However, I don't believe that this is going to have a negative impact on service because, like Jeff said, people are going to make the right decisions for their company and that's going to be based on efficient operations.

Currently, we have numerous situations where the railroads have developed routing protocols that produce very circuitous routes. And it seems like the intent of the routing protocol is to get the origin carrier a longer haul. But it's not the most efficient route. It actually increases the miles on the route significantly.

If there are situations where you could change the interchange. We have pushed back on some of those routing protocols and we have succeeded at getting the interchange points changed, giving so that we did have a more efficient route.

But it takes a lot of effort to do business with the railroads. And to try to come up with something that's good not only for the shipper but also for the railroads, because you have to understand it from the railroads put of view. But I just don't see that this is going to have a tremendous impact on the railroads.

If you look at the number at the estimate in the NIT League proposal it's not going to impact on a huge amount of carloads. But I do think it will add, put discipline into the system. And just having the option to request for reciprocal switching will establish competition, and I think that should be our goal.

Our goal should actually to be able to work with railroads as opposed to running to the STB every time we have a complaint.

MR. JOHNSTON: I think in the argument here there's a premise that the existing state of affairs for captive shippers gives them, in fact, the best service under the best terms. And that's simply an assertion. There hasn't been any evidence presented here that, in fact, that is always the case or most of the time the case.

So I suggest you test that premise, first of all. It might very well be that with, in certain cases with competitive switching there might, in fact, be improvements in service. There might. And furthermore, I would say, as a shipper, we look at the whole package.

We want reliable service. We want

efficient transportation. We want cost-effective transportation, and we want safe transportation. It's that whole package that we're always going to look at and make the choices.

MR. KEPLER: Okay. In our situation, you know, I mentioned we have 20,000 railcars, we have 110,000 shipments. So it's, we don't turn them around a lot in a year for the amount of shipments. There's a lot of capital investment there. So service is a huge deal to us.

And I think when we work with, and we have a good relationship with our sites in working with the railroads on safety, service and routing is a key issue in terms of how we manage that. If I look at the example in Canada we always, it's not that we pick one or the other and use it just about negotiations.

They've invested in our site to make sure they have flexibility at the interchange. We always have had two suppliers there in my decade of working with that and we've had it, as far as I know, almost always. Having two, having multiple choices, especially in times like winter or hurricanes or whatever provides a huge safety net for us in managing, to have options.

And I think just the ability to look at not only the interface of this 30 miles but how you really route across this network give you better options with that. So our view is that this will encourage investments and actually optimize the networks better, and you'll do it more on a commercial basis rather than trying to deal with all the rules set.

MR. RINE: I think, first of all, we're talking about competition. There's absolutely no incentive for a shipper to sacrifice service when he's trying to negotiate between two or three carriers. The shipper also is not interested in adding to congestion which would increase transit time.

We have heavy investments in railcars. We have heavy investments in assets for manufacturing plants. We're interested in those assets, railcars, moving expeditiously through the supply chain to get back to reload, to ship more product.

We size our railcar fleets to meet our production and sales needs. We don't have excess cars just to, you know, you just keep loading them thinking well, this car's going to get back in two or three or six months. That's not reality in this industry.

And I think to focus on the service side in the rail system is something you need to do. But also I can cite many examples where we've worked with the operation people in the railroads. And we've had some good local success.

And we've had some projects we've worked on operationally that the rail operations people would agree to, even went through the unions and got the approval to do it, moving back and forth between individual railroad yards to bypass interchange tracks that were not adequate to handle the volume only to be not approved by the commercial side because they cut a deal somewhere in some other state.

There's been a lot of work, as been previously mentioned, with the railroad to try to do business. It shouldn't be that hard. And I'm appalled at some of the examples that are used. I've been in this business a long time, worked with a number of different companies.

I've never seen any of what I heard yesterday and today. That must be something in a boardroom somewhere or something. That's foreign to me.

MS. DEARDEN: All right, one comment on I'd like to make is when I was at the Railroad I attended the more daily morning operating meetings because I had a lot of unit train traffic. And in those meetings, I attended over probably a 12-year period, I cannot once remember any discussion relative to inefficient operations as a result of reciprocal switching.

Number two, they do have daily reports of the car inventory on the system. But the purpose of that, of monitoring the number of cars online is to control the per diem cost that they have to pay to the connecting railroads. There was, it had nothing to do with the impact on operations. It was strictly to control the per diem costs.

So I think a lot of the examples that the railroads presented today and yesterday have been like the sky is falling, you know, the world's going to come to an end. I just believe the railroads, it's not that the railroads don't want reciprocal switching per se. I think it's that the railroads don't want any change at all.

MR. O'CONNOR: I'd like to offer a comment as well. I have looked at dozens of companies in detail. And what I find is that when I'm dealing with a captive situation, almost invariably, the rates are significantly higher, holding all else equal.

And that goes across companies. It goes across railroads. It is almost axiomatic, that as the captivity of the traffic increases the rates go up. As the absence of competition increases the rates go up.

And it's important to be clear about what we're recommending here and what we're evaluating here. As Jeff stated at the outset of this panel, this is a voluntary operation. The NIT League proposal would have a couple of pre-conditions which, if you met them, you would be allowed to ask the competing carrier to offer the service.

If asked, the competing carrier might decline to offer. The incumbent carrier might respond with a better deal. You would be allowing the creation of competition and with it you would be solving all sorts of issues that just would never arise.

We'd be allowing the market to operate just by dropping that barrier and asking a lot of the questions we ask. Would somebody else like to handle this traffic? That's all we're saying here. That's all we're saying. It's voluntary.

VICE CHAIRMAN BEGEMAN: No, I think they're saying you have to handle it, aren't they?

MR. O'CONNOR: I'm sorry?

VICE CHAIRMAN BEGEMAN: Or, is it you're saying, you have to handle it?

MR. O'CONNOR: No. No, the proposal, as proposed, would not compel a competing carrier to come in. It would allow the competing carrier to offer its services, which might either be -- well, first of all, they might not be offered.

Secondly, if offered, they might not be adequate to the task and they might not be accepted.

VICE CHAIRMAN BEGEMAN: Don't you have a common carrier obligation to provide service?

MR. O'CONNOR: Well, I'm sure there's a common carrier obligation to provide service. But what we have here is a situation where you're preventing that competing common carrier from stepping forward to ask can I provide this service. That's what we're talking about here in practical effect.

And if you have two people competing you're going to get a better deal. There's almost no question about it.

MR. RINE: One other comment, please. There was comments made about chaos and not knowing where cars were at. We have systems where we track our cars. In fact, we have some fleets we have two tracking systems on cars.

So we know where our cars are at all the time and if there's a question we have people that follow those cars daily. That's their job. They interact with the railroads. But we have systems where we know the temperature of a car inside and outside. We know where that car is at, we know what time it was there, date and time.

So I'm not sure, now we've lost cars too. And then we've had to go out to rail yards and find them for our self. But the idea that you don't know where your cars are at, those are exceptions. Those are not what goes on every day in our business.

MR. O'CONNOR: I want to reinforce that also. When you think about, and I think you raised this question earlier, you posited a merger. We've had discussions of mergers in the course of these two days.

Now I've appeared as a witness in

merger cases for railroads and for shippers, both, generally analyzing a proposed merger and asking for conditions that would meet specific defects that we found on the merger.

Now what we're talking here is vastly simpler than a merger. And UP has consolidated down from a half a dozen or so to the current UP. And I participated in a couple of the merger proceedings that resulted in the four that we know have.

The complexity of that kind of an operation is vast and it's been mastered. They rose to the challenge. They did it. And in that particular one, as a matter of fact, I was representing a series of clients, most of whom were opposed to that merger.

But it got resolved. UP bore down, solved the problem, gave it some, came back. They got it done. They get it done.

If you look at the data that's presented to you on a quality basis and the rail cost adjustment factor, and you just compare the rail cost adjustment factor unadjusted for productivity and adjusted for productivity, no matter what the period, and we're talking 20, 30 years here now, no matter what the period, no matter what the challenge, no matter who's running the railroad, the productivity line, the productivity keeps getting better and better.

They keep rising to the challenge, rising to the challenge.

MR. KEPLER: I think in the last panel there was a little discussion around this which is my experience and our experience at Dow is when you're in a position where you have the competition, if another entrant's going to come in, they're going to factor the service in.

So the questions that were being asked about well, if this is going to actually, if this interchange costs more service, that is going to be factored in. That cost will be factored into the competitive rate.

And then the carrier will determine well, do I make a capital investment to improve that service or do I find that that's an expense I can build, still be competitive because of my long haul or whatever.

So I think the fact is the choice and the price will come, that's where the choice comes. And what we've seen in other, in Canada, was the competition is there to make the choices, and it's balanced not just on that one point of service but how I invest to improve that service or how I manage my long haul network to get better optimization out of that.

CHAIRMAN ELLIOTT: Just a few questions. Some of these things are just to kind of nail down what the proposal is specifically. There still seems to be some confusion with respect to whether exempt traffic would apply.

And I probably should have asked the panel yesterday this question when NIT League presented. But maybe Mr. Moreno can speak to that, whether or not that is part of the proposal.

MR. MORENO: I think that's an issue for specific notice of proposed rulemaking. Obviously, the NIT League proposal is predicated on some determination of market dominance. And exempt traffic always has the option to seek a removal of that exemption, either the class exemption or on a movement specific basis.

There is at least language in the current CFR under the Exempt Traffic section that does suggest that showing a market dominance would basically remove the exemption in these situations.

And so that may already be addressed, although the question is, well, is this market dominance or is it the market dominance showing that the NIT League's proposing or is it the market dominance showing that you require in a rate case, for example.

But those are issues that I think are appropriate to be addressed in a rulemaking proceeding.

CHAIRMAN ELLIOTT: Okay, second question, with respect to the 75 percent presumption, there was some concern raised in some of the rail testimony and comments, that that number could possibly be manipulated and by pushing more traffic onto one carrier in these situations, in trying to meet that number.

I can see, common sense wise that makes sense. But in the real world is that going to happen or can it happen?

MS. DEARDEN: I'd like to comment on that.

CHAIRMAN ELLIOTT: Sure.

MS. DEARDEN: Diversified has a plant in Mississippi that's single-served by a carrier. And that carrier's been very difficult to work with in terms of establishing competitive rates.

And so, as a result, that plant has not performed at the level that it was intended when they built that plant in, I think it was the early 90s that they built it. And so, as a result, they are doing some local truck moves.

But they're not reaching destination markets they had initially planned to meet to access by rail. So, for example, they have a distribution plant in Miami for, it's a distribution tank for shipments to the Carribean.

We were thinking, or they were thinking, we weren't working for them at the time. They were thinking that they would be able to ship from Mississippi to Miami cheaper than going from the Illinois plant. Well, instead, we're still shipping from Illinois because it's more cost-efficient.

Bottom line is we're not going to be able to demonstrate at that plant, even though the rates are unreasonable with the incumbent carrier, we're not going to be able to prove that, meet that 75 percent test because a good portion of the shipments are going truck instead of rail. And we're not going to be able to prove market dominance.

But in fact, unless things change, that plant is at jeopardy and the people that are employed down there, they're jobs are in jeopardy because unless that situation changes and unless we get competitive rail rates it's very possible they'll close the plant.

CHAIRMAN ELLIOTT: Another question, a couple of you raised the consolidation of the rail industry as one of the reasons for some of the higher rates and this upswing in the rates by the Class Is, and then in Mr. Moreno's final exhibit he provided an example.

And I haven't been involved in a merger. I think the last one was '96. But wouldn't, in that situation that was laid out here, wouldn't the Board have remedied that situation of a two to one going to, in this situation, by allowing trackage rights out to Railroad 3 in that situation?

It's just, it's been a while so I don't remember exactly.

MR. MORENO: Yes, if we can put up my slides, up again, this example. This is not a 2-to-1 example. It was a captive shipper pre-merger. It was a captive shipper post-merger.

CHAIRMAN ELLIOTT: I see. Okay.

MR. MORENO: So the Board does not consider that a loss of competition. But the fact of the matter is, in this example, the shipper lost competition over the vast majority of the distance of its route, but the Board has never recognized that as a loss.

CHAIRMAN ELLIOTT: Okay. Now that makes sense.

MR. O'CONNOR: There is also a simple way to evaluate the loss of competition. In the BNSF merger we were addressing loss of competing service in the category called 4-to-3.

By the time we got to the UP merger a few years later the 4-to-3s were gone. The 3-to-2s were pretty much gone, and it was 2-to-1 and there weren't that many of those. So you can see, in having 4-to-3 be an issue, as that merger process really got underway and then they disappeared.

And what we're talking about here is a remedy for some of that loss of competition. Staggers was extremely successful. I was at AAR when Staggers was proposed and I was more or less a briefcase carrier at that part of the deal but I can claim some credit for it. And it worked very, very well.

All we're asking for here is a little attention to the loss of competition. The 4-to-3s are gone.

MR. KEPLER: The other point, I think, is it's 30 years, so it's dynamic. So what you had examined at that transaction, the traffic patterns on the rails significantly changed.

So while you're looking at what the market is at the time, the market's significantly different in terms of the commodities that are shipped and where they're shipped. And that's part of the dynamics of how we, you know, how things get manufactured and shipped here. So it changes.

The fact that you've consolidated to seven carriers creates a different structure. And you put this rate structure in place when there was 20. And now our view is you've got scale in these companies, investment capability, that flexibility would actually encourage more investment.

CHAIRMAN: And -- go ahead.

MR. RINE: Excuse me. Yesterday there was a lot of discussion about, you know, it would cost more money and there was, I think, an example about a balloon and you push in on one side of it. And I think the explanation about how they were going to recover that money, they would get it from another shipper, you know, it wouldn't be fair, and so forth.

When I appeared in the Conrail merger the Chairman of Service Transportation Board asked me a question, last all of the panel. Said if we do what you shippers would like us to do the railroads tell us they're going to go bankrupt. And I said well, the only thing I can tell you, what's in the public record.

Conrail testified that when they had two railroads competing, them being one of them, the rates were about 30 percent less. If they had three railroads competing the rates were lower than that. And what really caught my attention was Conrail also said the last two years that Conrail existed was the most profitable years in Conrail's history.

And they were competing with one or two other railroads. They were profitable and they weren't going bankrupt.

CHAIRMAN ELLIOTT: To that point, with respect to those of you who have either facilities or clients that, where this would not be applicable, does that cause you any concern with respect to their balloon analogy that the rate increases will be pushed onto those shippers who do not have the reciprocal switching option available?

MR. JOHNSTON: So this is the so-called winners and losers argument, right?

CHAIRMAN ELLIOTT: Right.

MR. JOHNSTON: First of all, I think we need to recognize that in today's environment there are already winners and losers. Mr. Kepler made reference in his remarks to foreign competition who are bringing goods to the United States and have choices that American manufacturers do not.

And I would suggest that to some degree the current regime is creating winners and losers, and in some cases those winners are foreign companies and foreign governments and foreign workers to the detriment of U.S. manufacturers and U.S. workers and the benefit to the U.S. economy.

The other observation that I would have is that some improvement in competition is better than no improvement in competition. And so while some will benefit and others will not, it's time to begin walking down this road and this is a way to start.

MR. KEPLER: Yes, I would say it's not to clear to us that we're going to be competitively advantaged. And as I mentioned, a lot of our stuff will still be captive. But I think the idea that we're working towards a system that has flexibility is very important.

I think the other thing to recognize is that shipments aren't static. So, I mean, we have 30 percent rail turnover a year in terms of where we ship to based on the customer. So what may be competitively advantaged today may be disadvantaged tomorrow. And that's the dynamics of just how the value change work here.

So I think what we're looking for is something that kind of makes things flexible and clear and transparent, and that can be done on a transaction basis from a shipper to a carrier. And ultimately that puts a better environment for everybody to compete in.

MR. MORENO: I think it's also important to understand that the advantage that foreign producers obtain occurs even if those foreign producers still have to use our

U.S. rail system once they come into the country because they have a choice of which port of entry they come into and, therefore, which railroad they use.

And therefore, they have that competition that competitive switching would provide to domestic producers.

CHAIRMAN ELLIOTT: One final question. Mr. Kepler, you raised, I thought, and interesting point. And I haven't really heard it discussed a lot in the proceeding but you mentioned that there are other routes.

You mentioned, the carriers mentioned the inefficiency from the switching, but you mentioned that there were inefficiencies on the longer haul portions where you use more inefficient routes. And I believe Ms. Dearden also mentioned that.

Is that a common occurrence or is that just anecdotal?

MR. KEPLER: I think it's, you

know, back to the point on where, with the airline. I'm not always sure that's a good metaphor but, I mean, a carrier will, an airline will try to keep you on the same plane regardless of how, or same system regardless of how efficient that is.

And that's what happens here. So when you look at the boundary issues of where we ship, especially if you do it nationally, and you look at what the best route is, it's the long haul can get optimized if you look at it from a holistic point of view.

So now when we did the value chain around Louisiana those are the two or three manufacturing facilities that go all around the country. And we would have similar models, I think, in other aspects.

I think also, from the safety point of view, both, everybody should be trying on the hazardous side which is a small percentage of what we ship to minimize the route miles. This system doesn't encourage that because you end up going with a carrier that optimizes around themselves.

So, no, I think it is a very predominant thing that we need to look at.

CHAIRMAN ELLIOTT: I know that Dow did not submit lengthy comments, more of a supportive letter, but was there any data put in the record with respect to the longer routes being used in these situations? I cannot recall that.

MR. KEPLER: We can --

CHAIRMAN ELLIOTT: I'm not --

MR. KEPLER: -- speak with the ACC. We can, yes.

CHAIRMAN ELLIOTT: No, I'm not asking for additional data. I'm just saying is there any in the record I could look at now. I do not want to reopen this record.

MR. KEPLER: Yes, we'll go, I think we did so I'll go back and try to get a reference for you.

CHAIRMAN ELLIOTT: Okay, thank you

very much. Okay, thank you very much for your testimony. We greatly appreciate it. And I believe we have our final panel, which I believe has been cut down to one party.

Okay, Mr. MacDougall, I believe you are our last party.

MR. MACDOUGALL: Perhaps everything's been said. Who knows. I'm here on behalf of Samuel J. Nasca who is the New York State Director, Legislative Director for the UTU.

As we stated in our comments that UTU has merged with the sheet metal workers but it's in the process of a fender bender, that merger. And so there may be further name changes and so on at the conventions this June and August.

One thing I'd like to concentrate on, if you'll excuse me, with is the absence of any information in this record as to the effect on employees. We raised that. So did KCS, Norfolk Southern and CSX.

And taking a legalistic standpoint, that's very difficult for me to see how you can go forward with the specific employee protection and the issue in the statute, section in the separate subsection C2 when the NIT League says well, we'll just wait until you have your notice of proposal with NIT League.

And it seems to me that where the statute specifically says things they have not met their burden of proof. And they have all kinds of experts and they can have consultants and they can make some estimates as to what the impact will be or likely to be on rail employees.

And that defect, I think, is just, this is monumental, how anybody can prepare a case when the statute says certain things. I might add that in the C1 there's the reference to the public interest.

You can prescribe these things on the public interest or it can be competition.

And the impact on rail employees is a factor of the public interest. That's been in a number of Supreme Court decisions. It's not, I mean, it's a separate thing but that the failure of proof come with anything on an employee impact, I think, defeats the petition for rulemaking.

You may want to defer certain things like the 75 percent rule, something like that, for rulemaking. But you cannot afford a specific statutory requirement.

And one other thing, another thing that I'll conclude with, that's come to my mind watching this for the last two days, I want to point out that I think the Board lacks expertise in dealing with yards. And why is that?

The reason for it is that by Section 109.06, you are not to consider the construction, operation, abandonment or discontinuance of switching tracks. And as the result of that, the past, that's been given to the state commissions.

Now nobody has it. You were trying to set up a consumer advocate thing, people can enquire about problems they have in the yards. But over the years you have not become involved very much in yard works, in yard operations.

And therefore, there's a lot of questions, a lot of discussions and a lack of knowledge, really, on your ability to administer such a rulemaking. And this has happened ever since 1920. You never had jurisdiction over the yards.

And therefore there's a lot of questions, how does it work. Well, it's complicated. It's, you know, if you have worked on a railroad you know what yards are. It's a complicated thing.

And about 25 percent of all the Train and Engine wages paid is in four switch groups. And that doesn't even include trains that are operating in and out of yards or away trains.

So yards are an important thing. And when you wanted to find out about yards in the Powder River Basin you sent some of your staff out there, at the invitation of the rest of us, to look at yard operations out there in Montana.

So there's this lack of experience. Now you do, you have had some, read cases and other cases involving yards. I've been a practitioner for over 50 years. There's been a certain number of them, but it's not the basic work that you've done in the railroad industry because it's been excepted from your jurisdiction. Thank you.

CHAIRMAN ELLIOTT: Just one question. With respect to the labor protection that is mentioned in the statute, is there any type of labor protection that you would propose or recommend?

MR. MACDOUGALL: Well, I've thought about that and it came to my mind that, of course, the Legislative Department of the organization doesn't get into those protectionist issues. And so the answer has to come if they assign a Vice President, if it goes forward.

But it would appear that in the terminal situation there would be problems of New York Dock and N&W, conditions that would be the things which you might pattern things after. As for the line haul, which is very serious, like if you have an operation from Powder River Basin, yet at that the destination power plant there's a terminal 30 miles away with another carrier you're going to have a big employee protection bill, something like that.

And that would be more like the Oregon Short Line or that I say this is out of my expertise, out of my authority actually and it may be that they have to fashion some special rules like they did at the Wisconsin Central rulemaking for Class II acquisitions of certain short lines.

CHAIRMAN ELLIOTT: Thank you, Mr. MacDougall. I'm glad that the fire alarm didn't go off this time in the middle of your testimony. Do you have anything there?

Well, I have about two and a half hours of closing remarks so -- no, thank you very much everyone for coming to a two-day hearing. I know that's a large commitment and we greatly appreciate it.

We also appreciate what our staff has done by bringing this together today. It's been quite an undertaking. And we will take the testimony and comments under advisement.

And the hearing is hereby adjourned. Thank you.

(Whereupon, the hearing in the above-entitled matter was concluded at 12:29:18 p.m.)

C E R T I F I C A T E

This is to certify that the foregoing transcript

In the matter of: PETITION FOR RULEMAKING TO ADOPT REVISED COMPETITIVE SWITCHING RULES

Before: STB

Date: 03-26-14

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

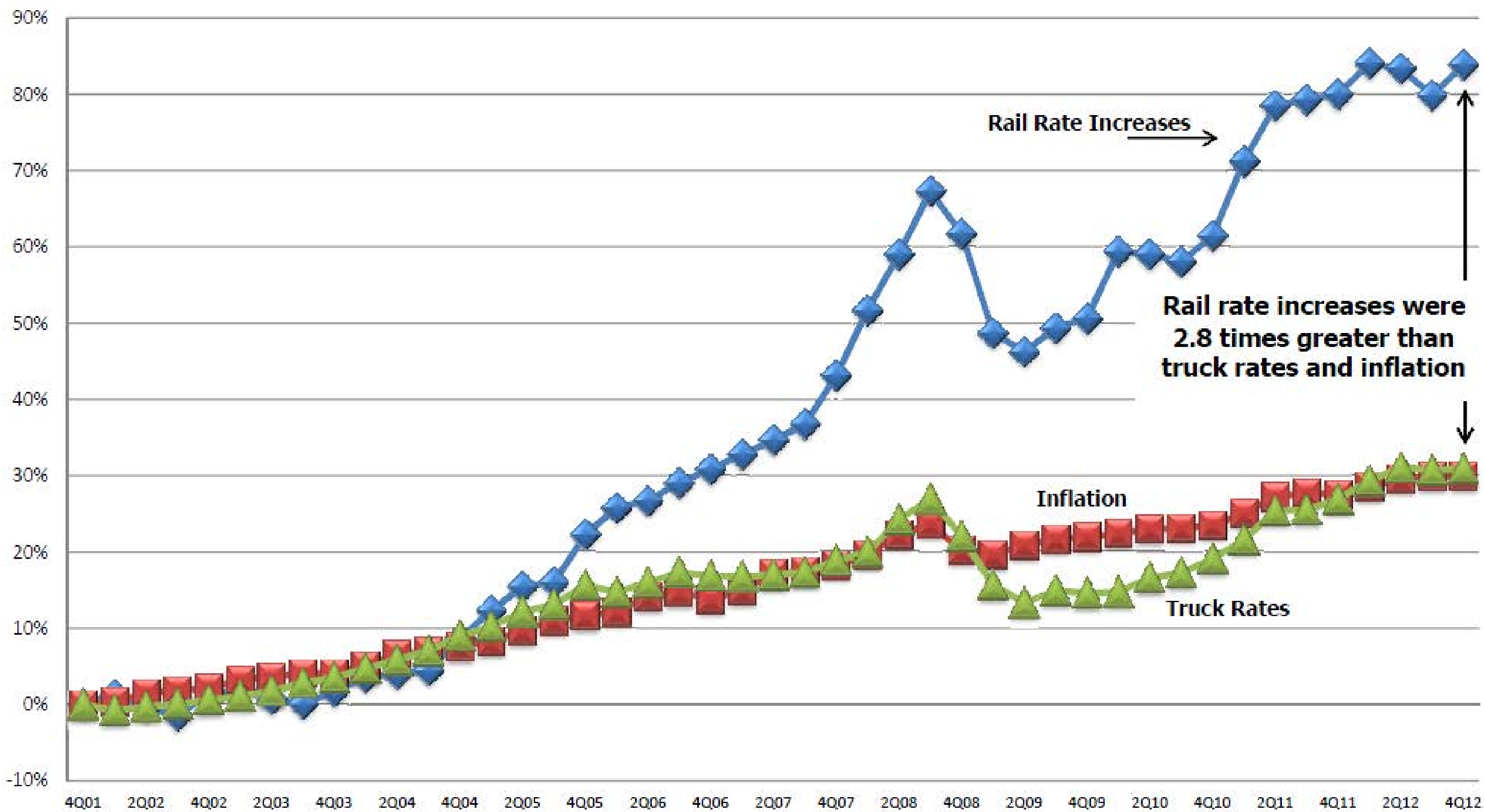
Court Reporter

Ex Parte No. 711
Petition for Rulemaking to Adopt Revised Competitive Switching Rules

Testimony of the
American Chemistry Council

March 26, 2014

Rail Industry Consolidation has Allowed Railroads to Increase Rates Dramatically More than Inflation and Trucking



The number of large railroads in the US have reduced from 26 in 1980 to only 7 by 2001. Following 2001 the percent increase in Rail Rates on the Big Four U.S. railroads has been 2.8 times greater than Inflation and Long Haul Trucking

Source: Rail Rate Increases - Big four railroad's average revenue per car isummed up from their SEC filings. Trucking Rates - BLS Long Haul Truck Rate Index , Inflation - uses CPI

Analysis of Freight Rail Rates for Chemical Shippers

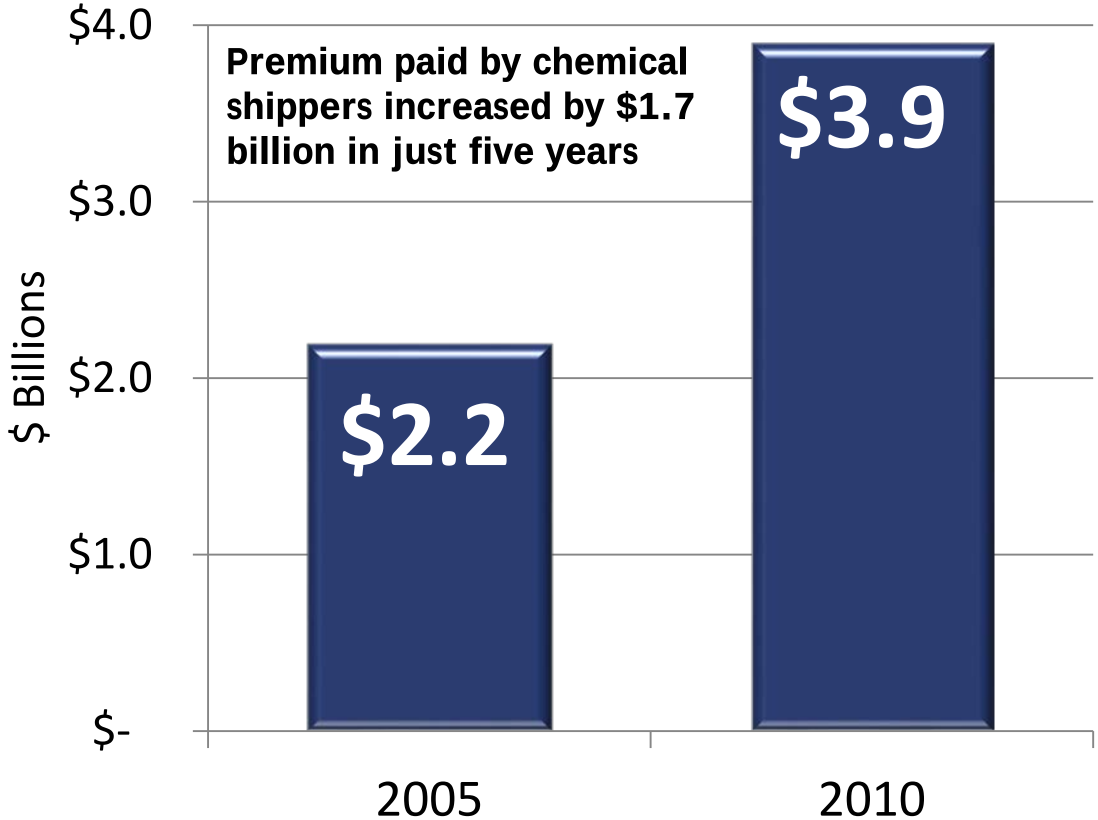
The premium paid by chemical shippers for rates above 180% RVC totaled more than $3.9 billion in 2010

$3.9 Billion Cost to Chemical Shippers

RVC Range	% Total Carloads	Premium for Rates above 180% RVC
<180	24.7%	--
180-240	23.0%	$402,945,412
241-299	16.7%	$665,473,520
>300	35.6%	$2,880,710,533
Total	**100.0%**	**$3,949,129,465**

Analysis of Freight Rail Rates for Chemical Shippers

From 2005 to 2010, the cost premium for chemical shipments increased substantially

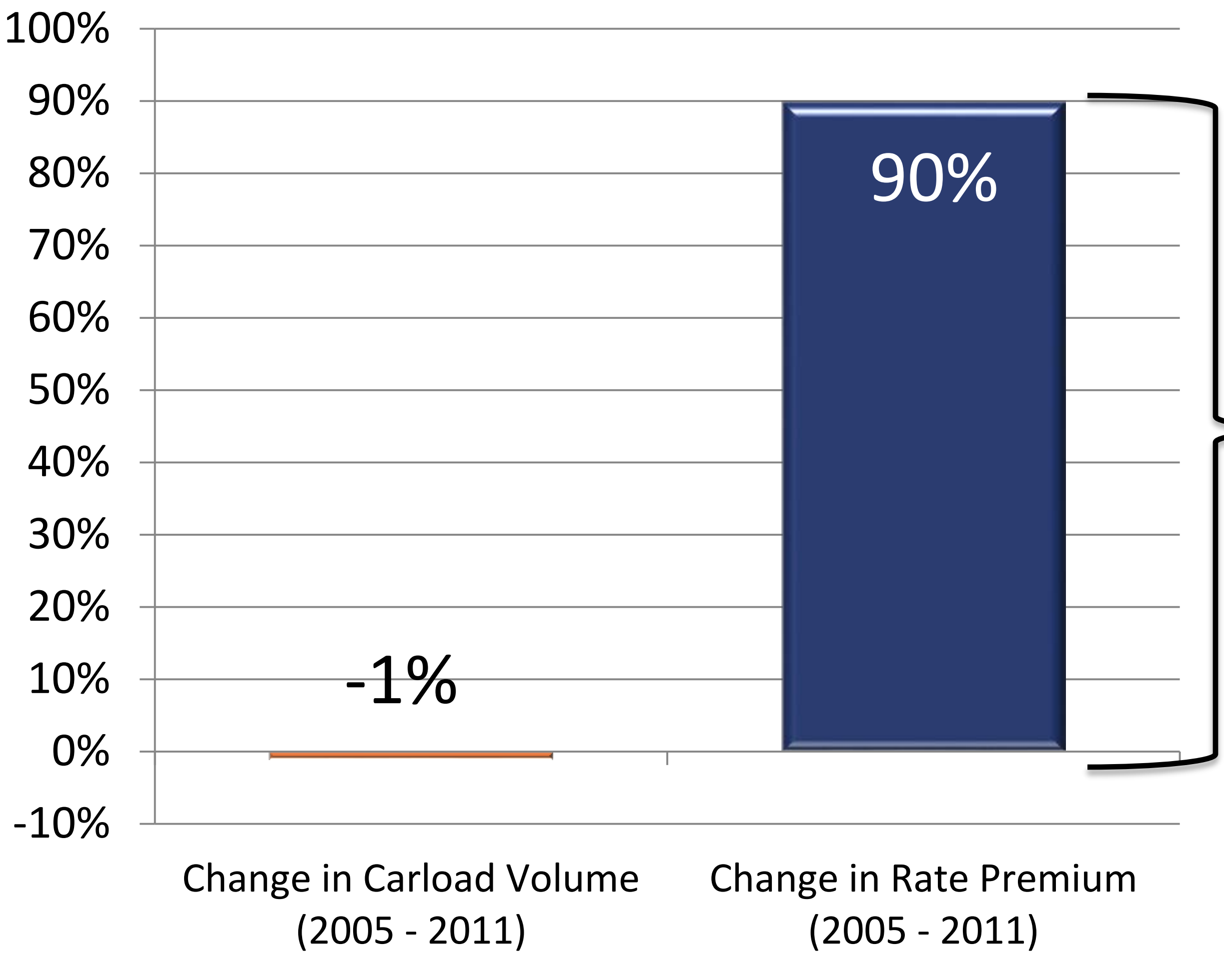


From 2005 to 2010:

- The number of carloads that moved at rates below 180% RVC dropped from 40% to only 25%.
- The number of carloads above 300% RVC increased from 25% to over 35%

Railroad Pricing Power – Not Demand or Costs – Is Driving Rates Higher

What other industry can get away with charging much higher prices even as demand drops?

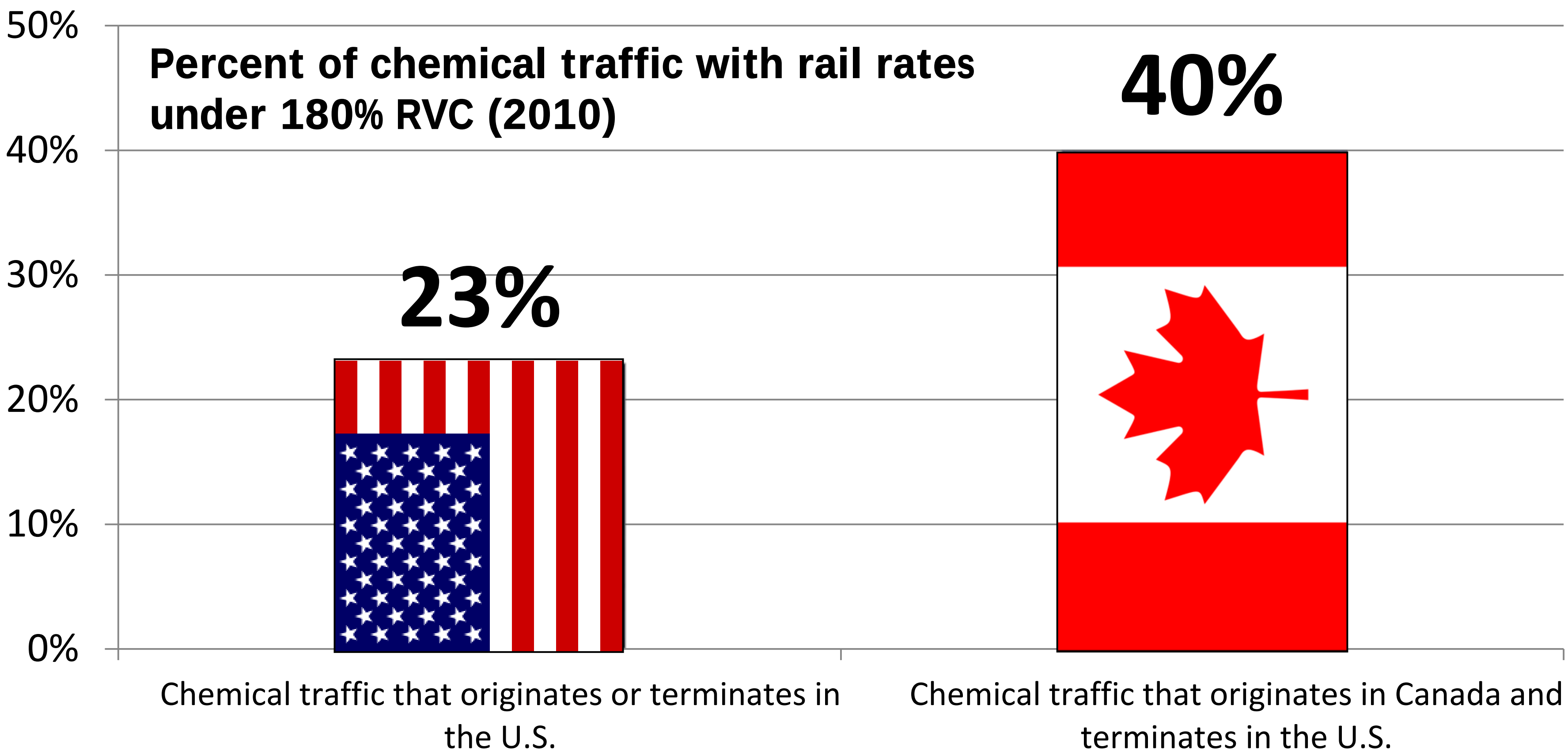


The Common Sense Gap

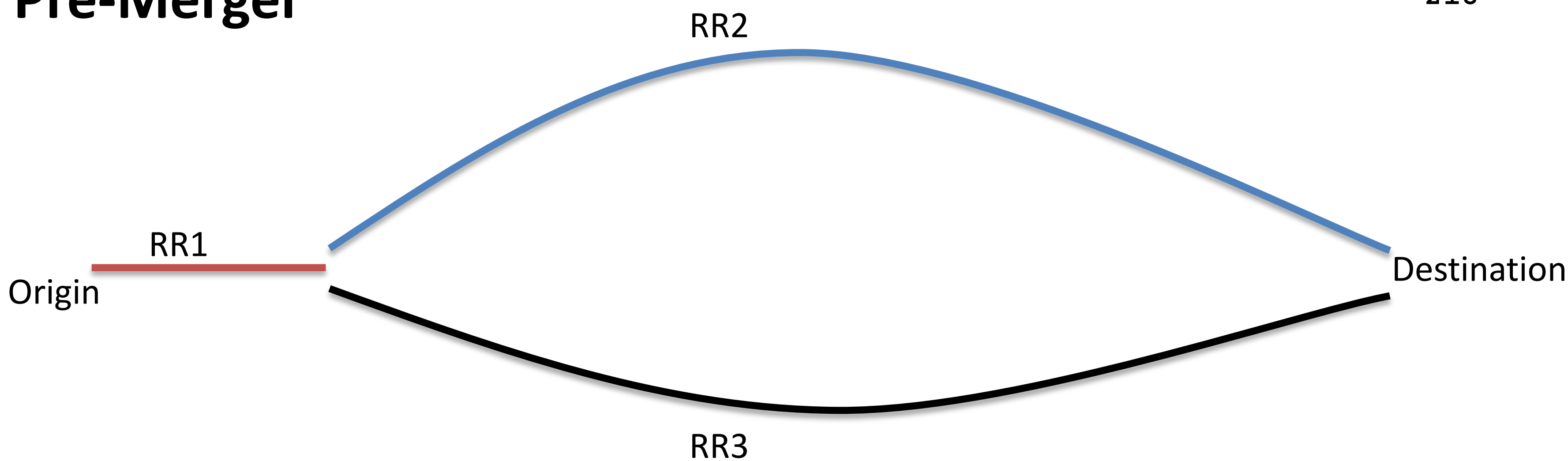
Competitive markets simply do not work like this

Analysis of Freight Rail Rates for Chemical Shippers

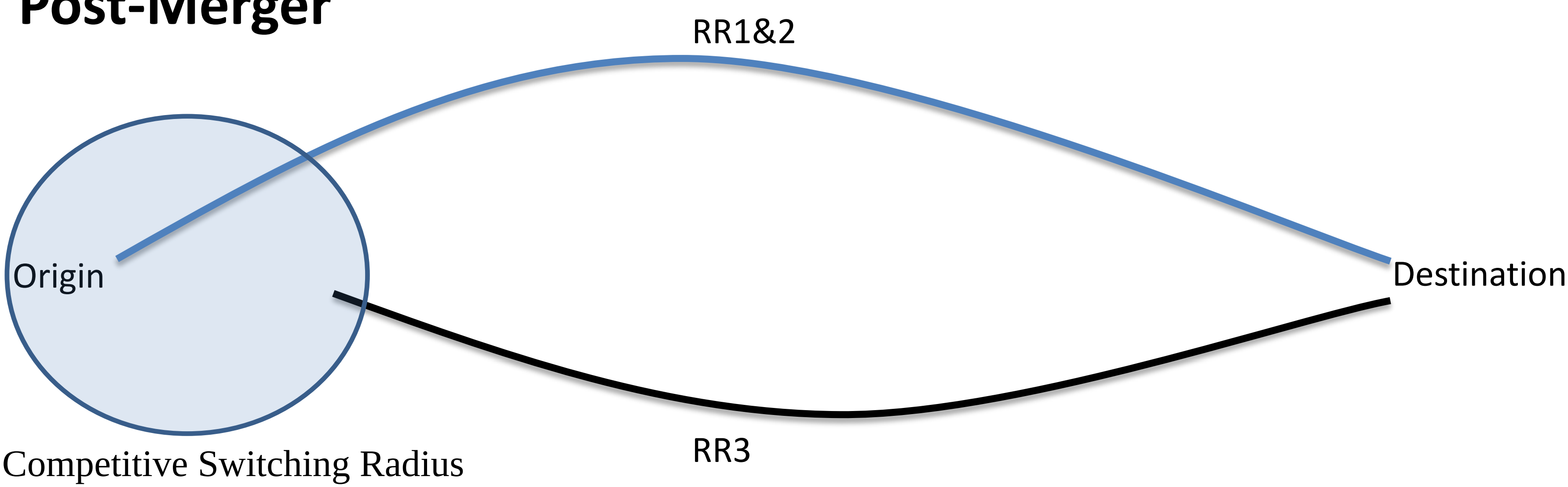
Canada's policies allow for more rail competition – enabling chemical producers to ship at lower rates and providing Canada with a substantial competitive advantage



Pre-Merger



Post-Merger



STB Hearing: Ex Parte No. 711

Testimony of BNSF Railway Company

Jill Mulligan, Associate General Counsel

March 26, 2014

Key Principles

- The Board should promote competition by allowing market forces to govern. Regulatory intervention should be limited to addressing actual abuses of market power.
- Reliance on R/VCs to measure market power—much less market abuse—is invalid and disincentivizes efficiency investments.
- Movements not subject to STB regulation could not be subject to the NITL switching regime.
- The Board cannot ignore the effect of reciprocal switching remedies on market dominance in rate reasonableness cases.

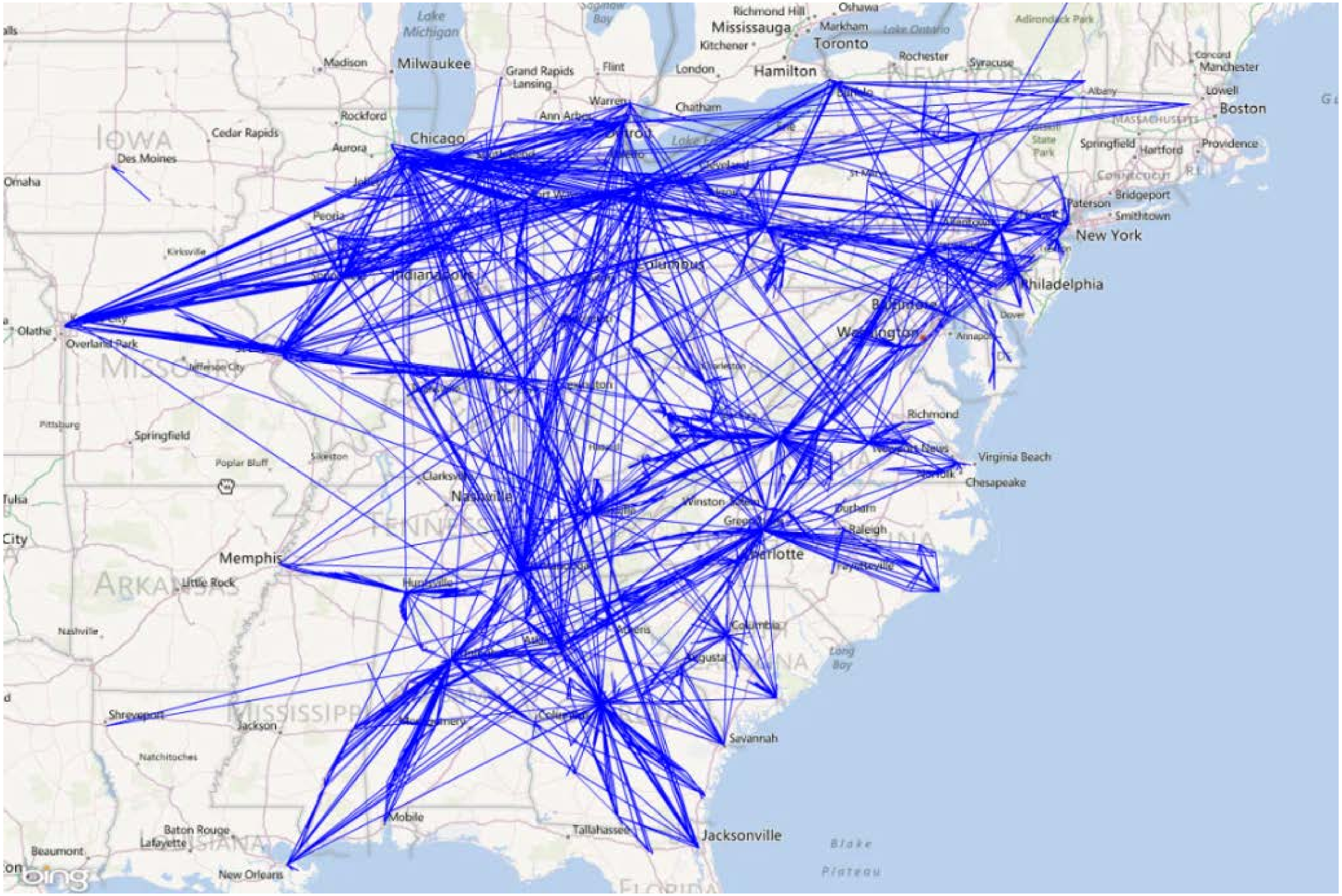
NS Line Haul Mile Per Day (LHMpD) Study

Rush Bailey, Assistant Vice President Service Management

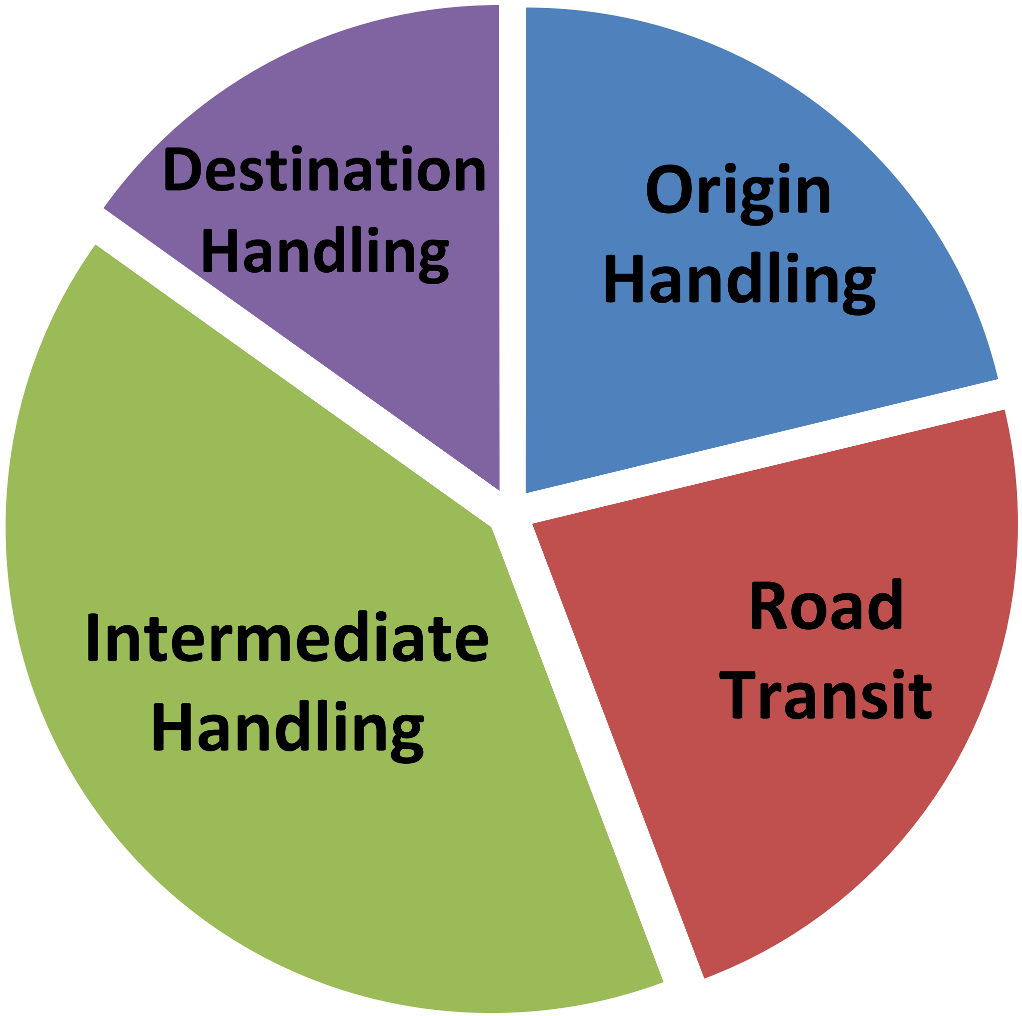
STB Hearing on Ex Parte 711

March 26, 2014

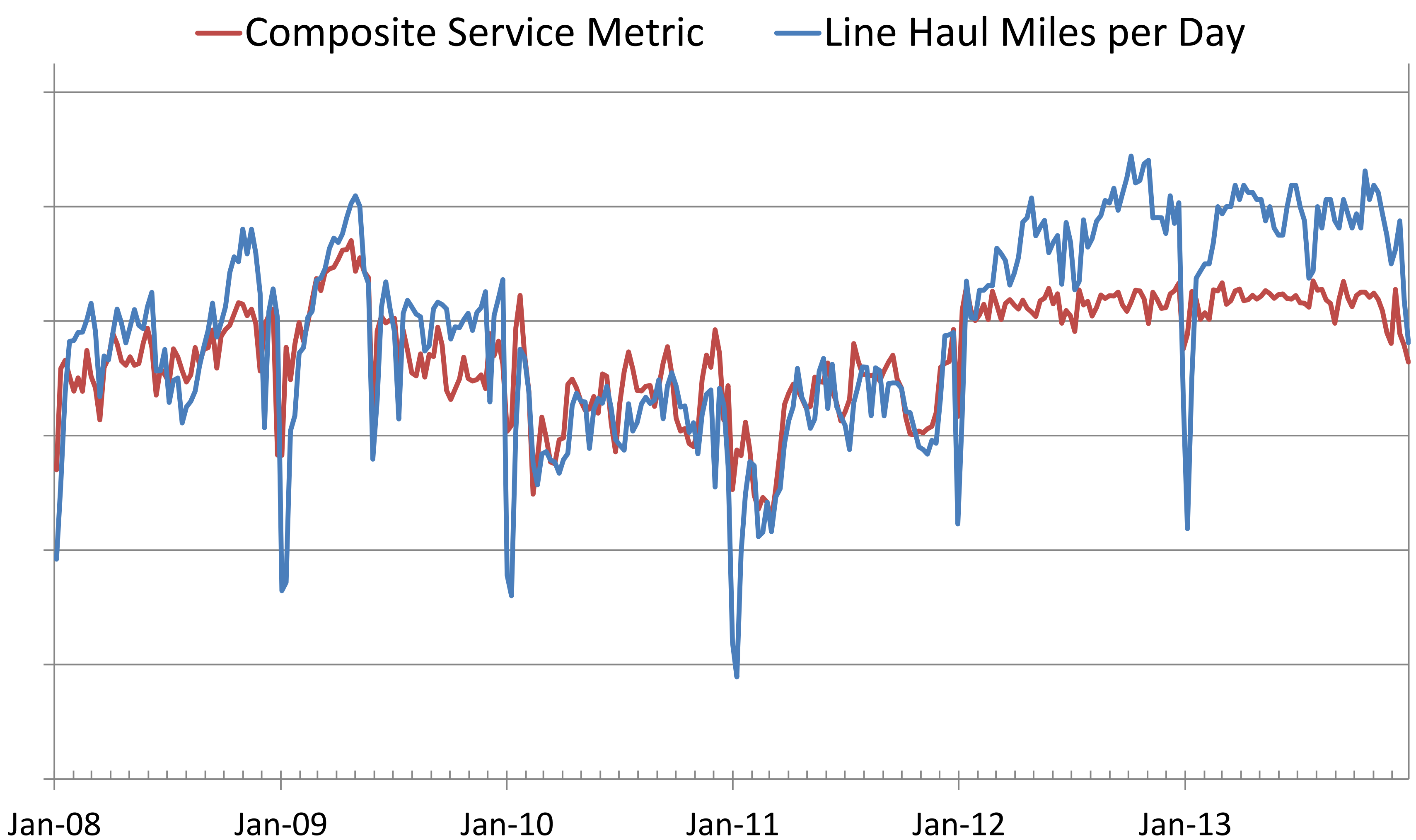
NS ROAD HAUL AND LOCAL BLOCKING NETWORK



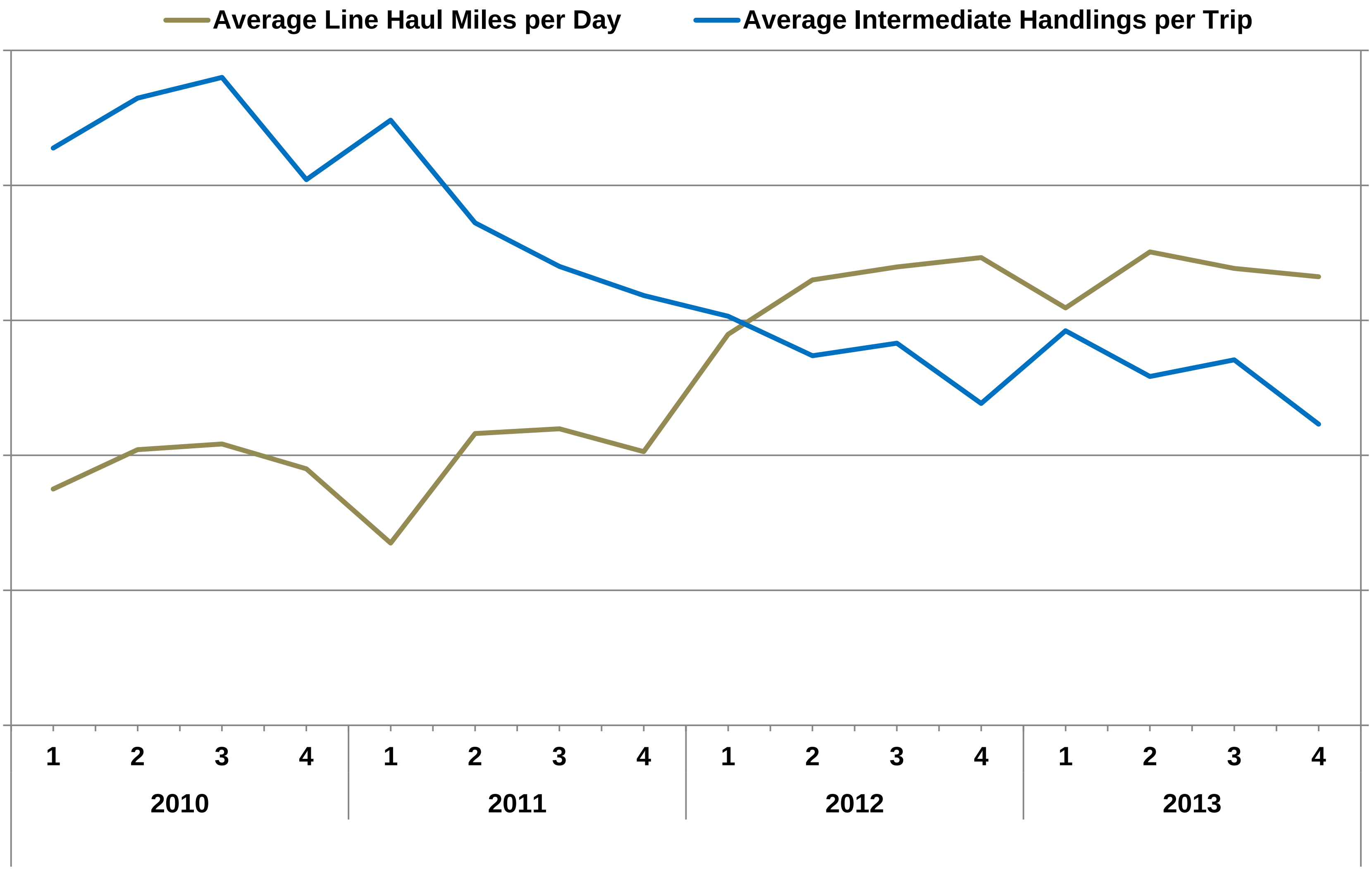
MERCHANDISE TRANSIT CYCLE TIME ALLOCATION



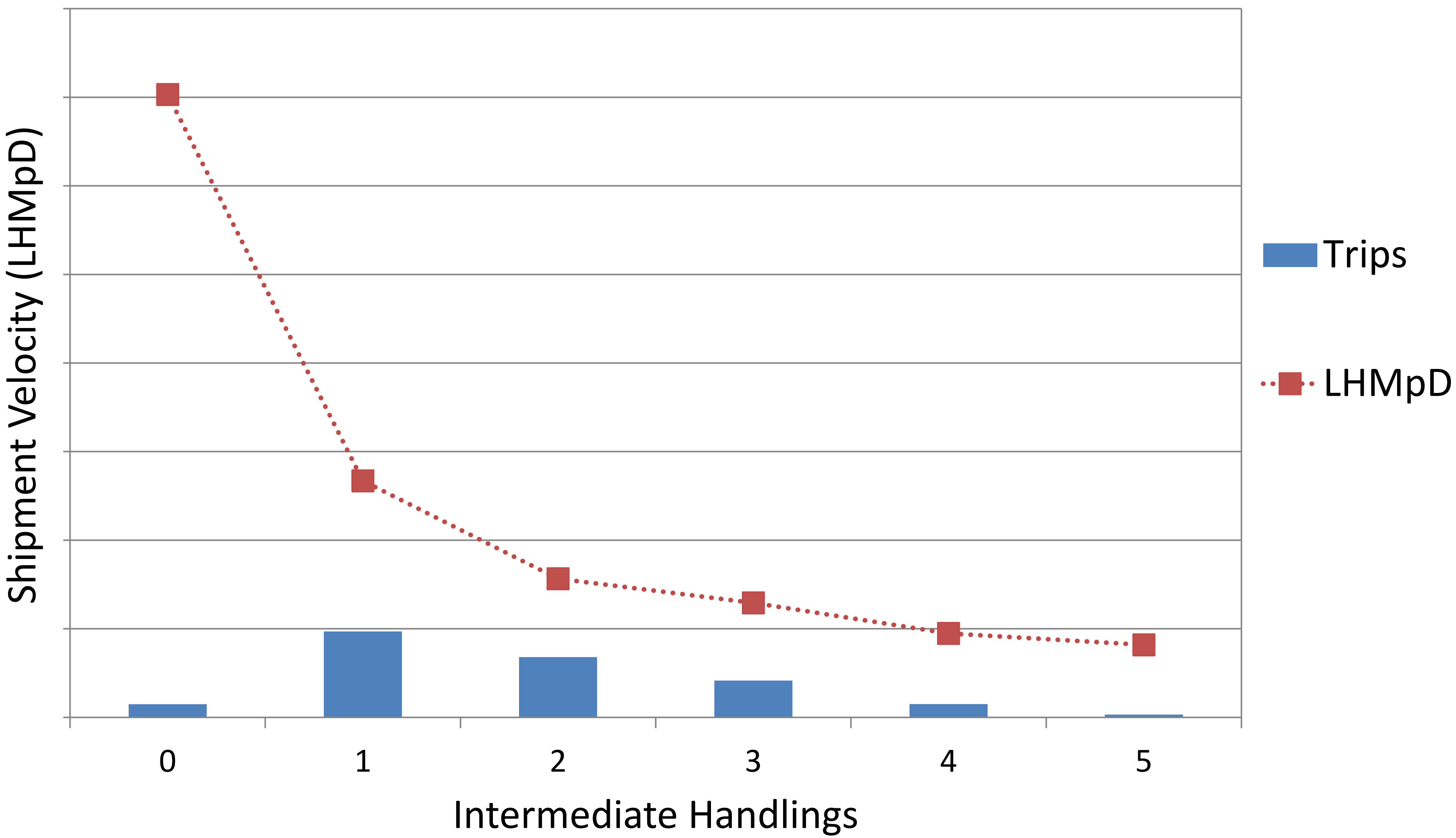
COMPOSITE SERVICE AND LHMPD – 2008-2013



SHIPMENT VELOCITY V. INTERMEDIATE HANDLINGS

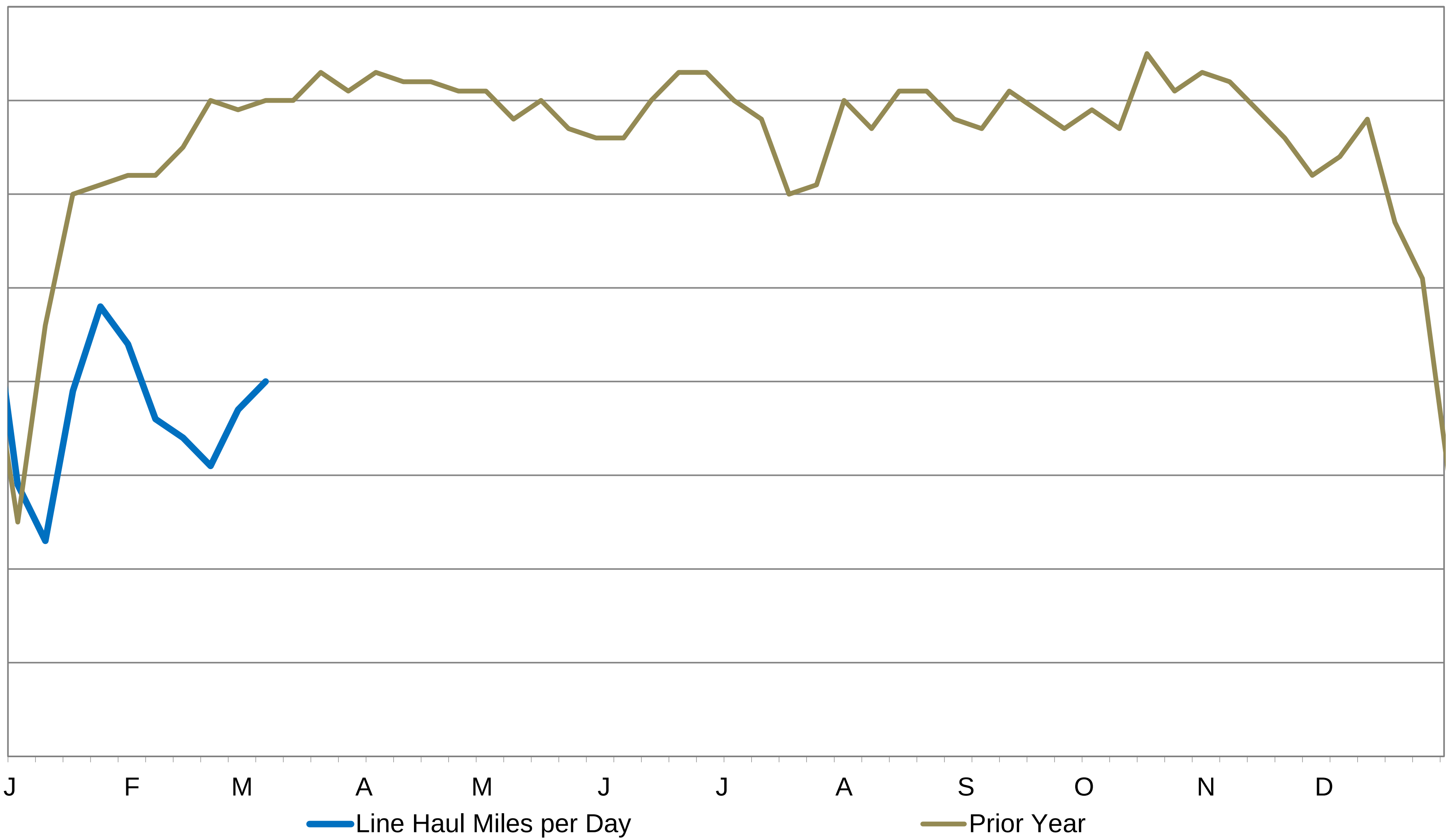


SHIPMENT VELOCITY AND NUMBER OF INTERMEDIATE HANDLINGS



Line Haul Miles Per Day (Network Velocity)

2014 vs. 2013*



* Through week ending March 7

How tomorrow moves

CSX Transportation
Ex Parte 711 Comments

Cressie Brown, VP Service Design

It starts with the customer and CSX is listening

Over 2,500 third-party independent customer surveys annually

Customer Advisory Councils for all markets

Over 4,000 annual customer site visits

Frequent cross-functional Service Excellence meetings across the network

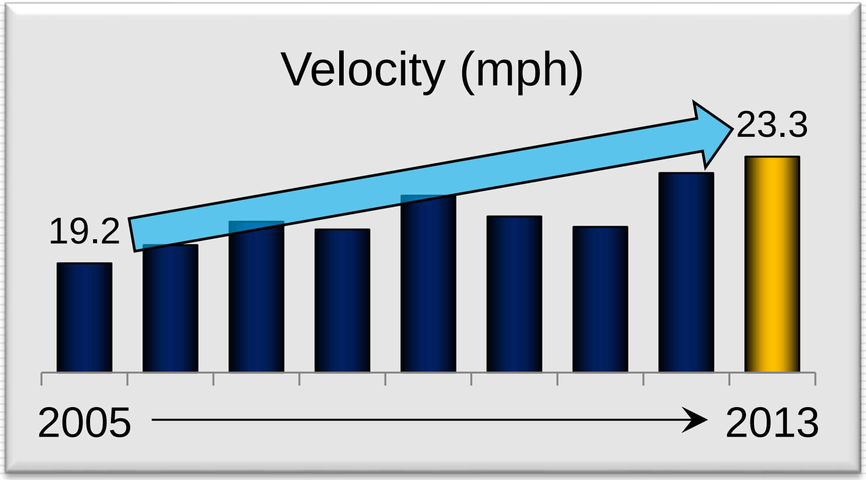
Customer Focused Culture: All employees, every day

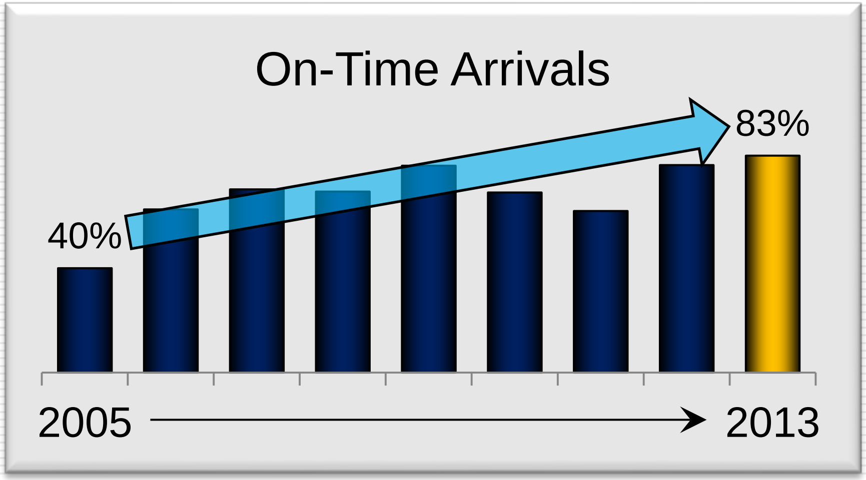
Customers tell us: "Service is paramount"

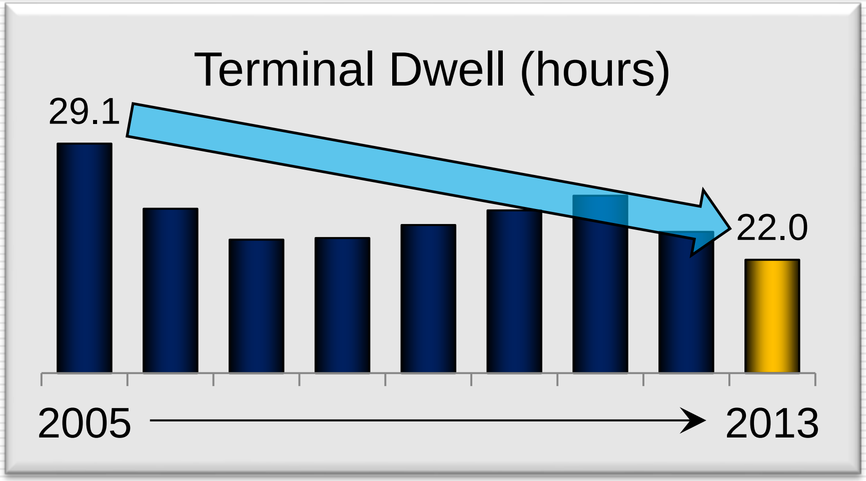
CSX is responding to the voice of the customer

Service Predictability	■ ***"Consistency of service is a top priority"*** ■ Improving transit times and service reliability
Enhanced Efficiency and Asset Utilization	■ ***"As cars sit, we lose money"*** ■ Driving improved railcar utilization for customers & CSX
Improved Communication and Coordination	■ ***"Proactive notification for planning and results"*** ■ Providing information for customers to plan resources

Service gains demonstrate customer commitment







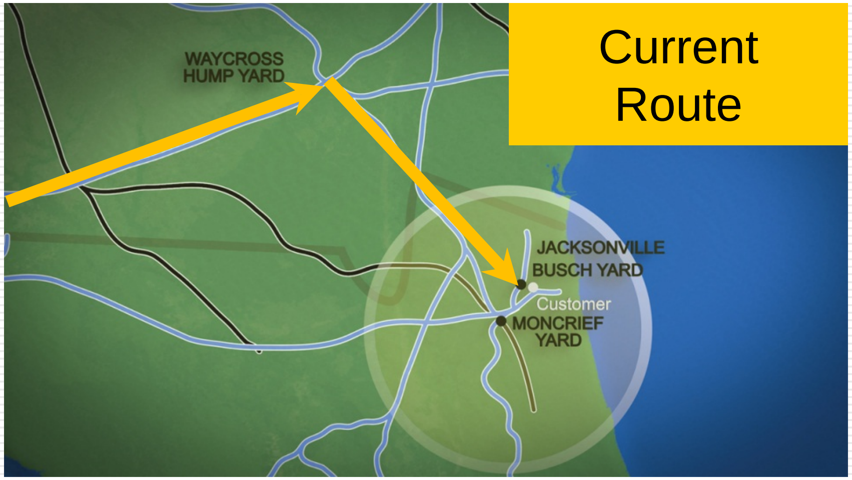
How tomorrow moves

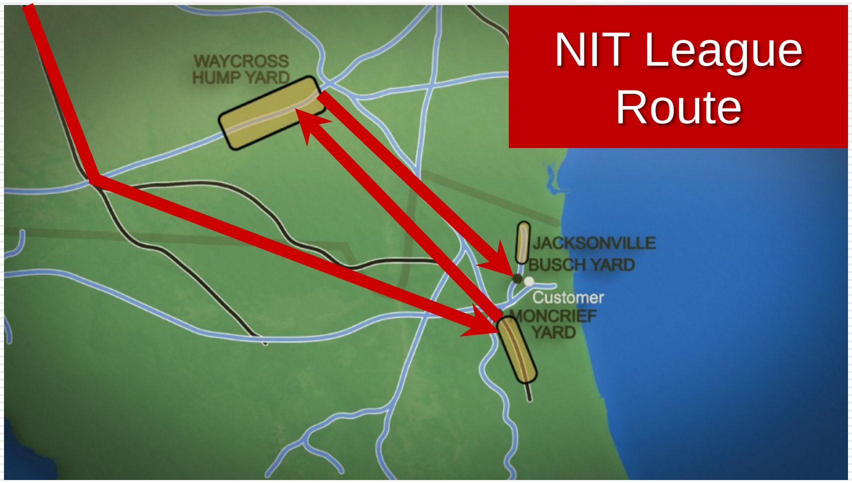
NITL proposal threatens to disrupt hump efficiency

CSX Hump Yards

- Carload traffic flows rely on hump yards for processing
- Hump yard “hubs” are safe, efficient and reliable
- NITL assumes all interchange locations can act as hubs
  - *Smaller yards rely on less efficient flat switching*
  - *Often, capacity doesn’t exist*

Potential outcomes: Jacksonville carload example





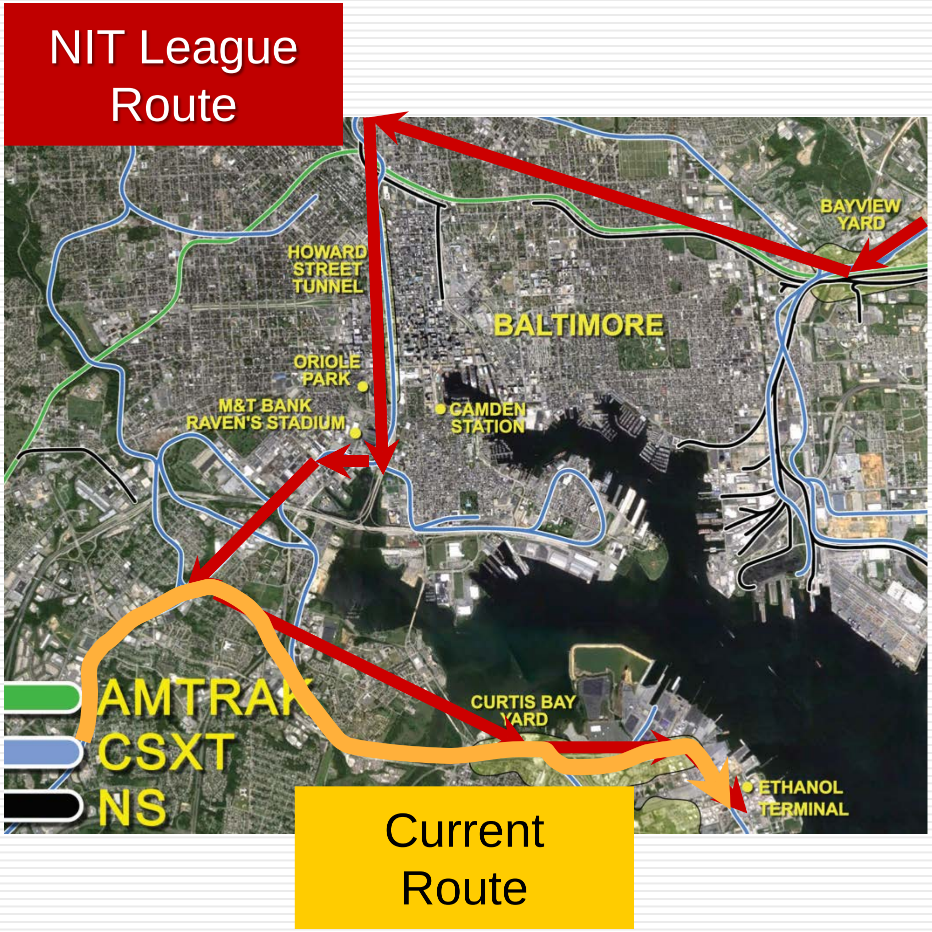
- Reduced efficiency of hump yard processing
  - *Forces traffic to small interchange location, out of route to hump and back to local yard*
- Increases transit by three days and nearly 300 miles
  - *Creates inefficiency and uncertainty*
- Disrupts critical first mile - last mile service
  - *Cars already spend 50% of time in local service*

Proposal also threatens unit train predictability

Unit Train Business

- Unit train service requires planning, predictability
- Routing depends on most direct path, current traffic mix
- Proposal brings disruption to tightly coordinated network

Potential outcomes: Baltimore unit train example



- Proposal could force traffic over indirect, congested routes
  - *CSX wouldn't be able to regulate traffic flow from other rails*
- Creates congestion with far-reaching consequences:
  - *Baltimore effect is likely to extend beyond the local area*
  - *Passenger traffic impacted*

Summary

Service Predictability	■ Railroading is a network operation that relies on density, efficiency and predictability
Enhanced Efficiency and Asset Utilization	■ Forced switching would create less reliable, less efficient service for customers
Improved Communication and Coordination	■ Proposal introduces uncertainty and unpredictability, driving costs up

NITL proposal risks turning back the clock on decades of customer service gains

Ex Parte 711 Hearing

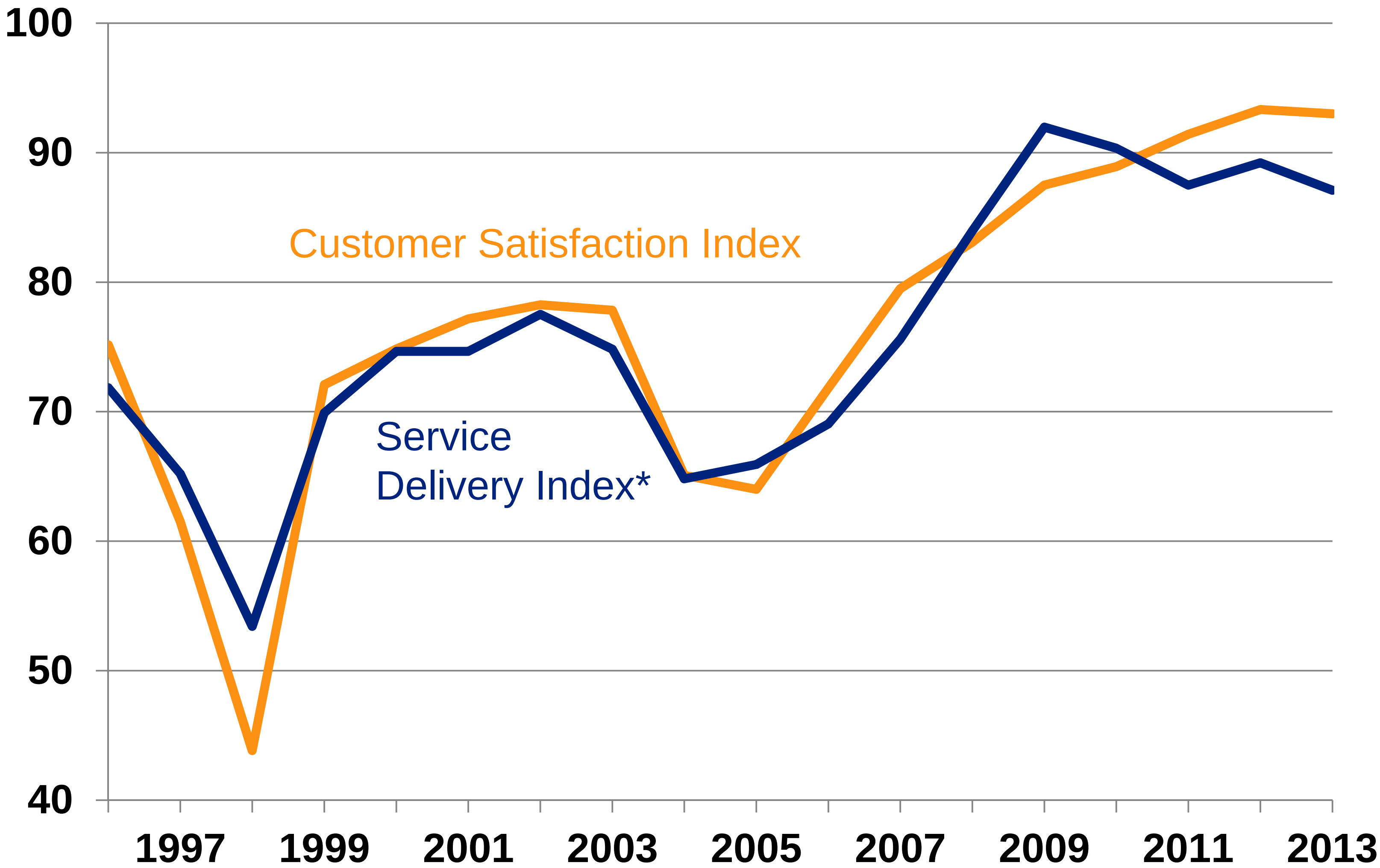
Tom Haley, Assistant Vice President -
Network and Capital Planning

March 26, 2014

UNION PACIFIC

BUILDING AMERICA®

Service Drives Customer Satisfaction

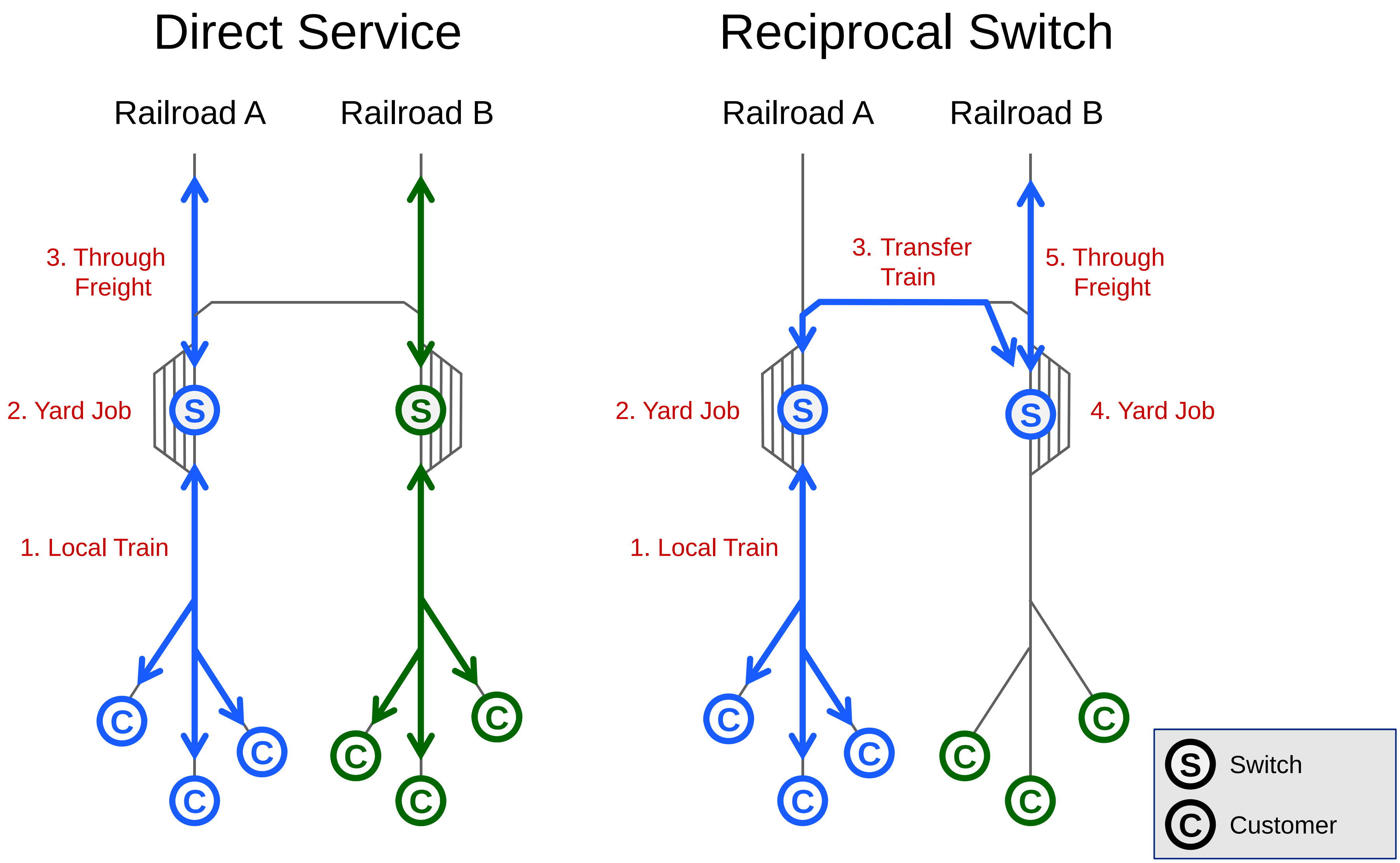


* Includes Early Deliveries

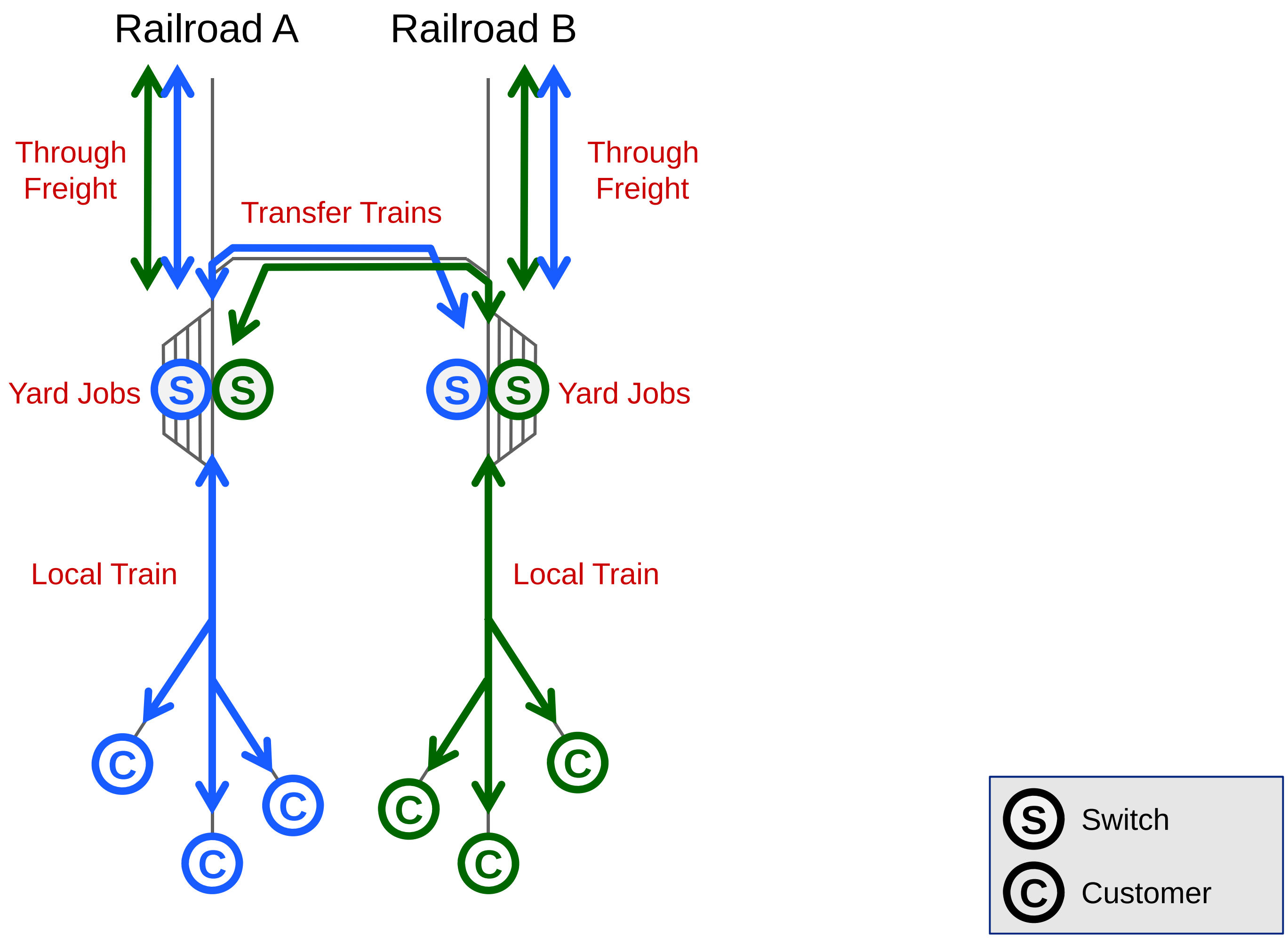
NIT League Proposal Threatens Progress

- **Increases workload in constrained terminal areas**
- **Degrades service across the network**
- **Limits ability to plan and manage the network**
- **Increases need for capital investment while reducing ability to invest**

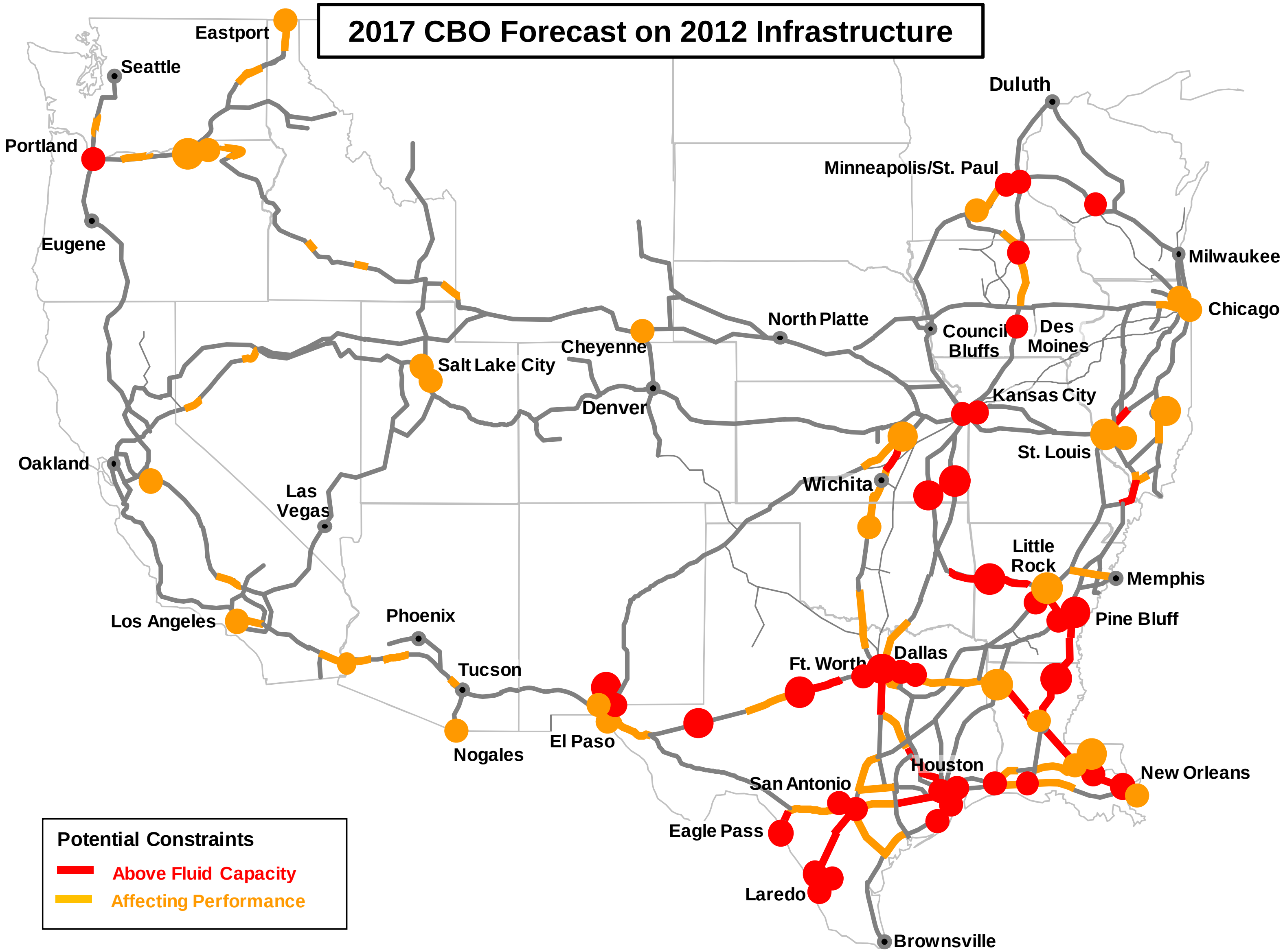
Direct Service is Clean and Efficient



Reciprocal Switch Adds Work and Complexity



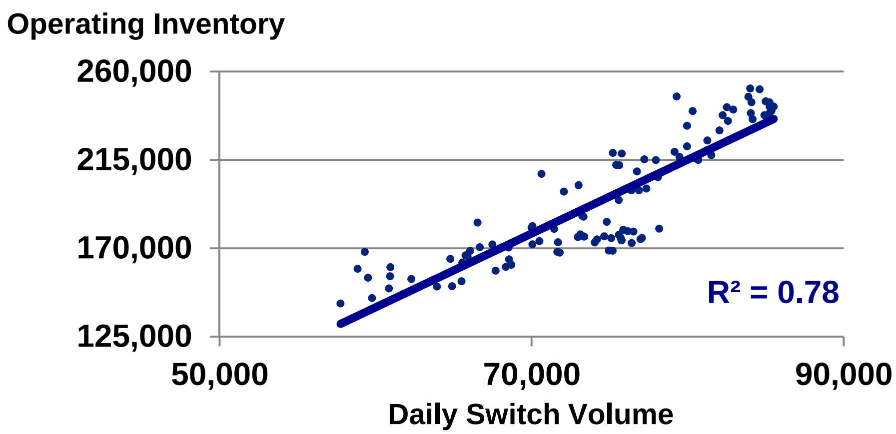
Network Capacity



Source: UP Opening Comments, Figure 13

Additional Switching Degrades Service

Switch Events Increase Operating Inventory

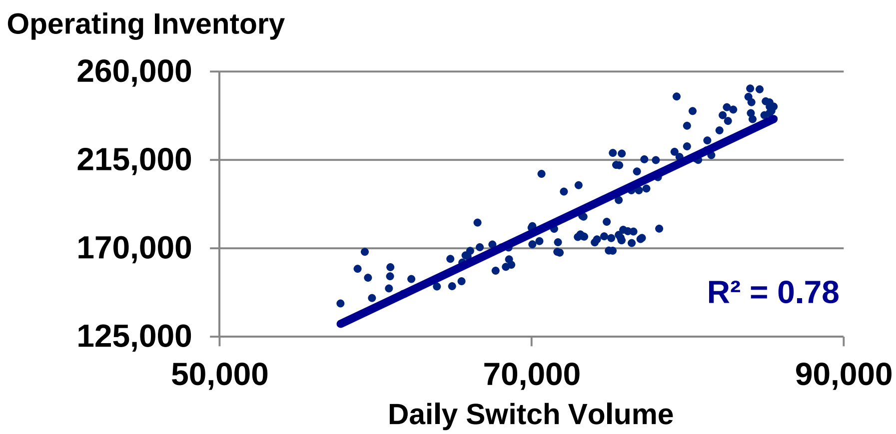


Operating Inventory = All cars on trains and in yards

Monthly UPRR Data: 2005-2013

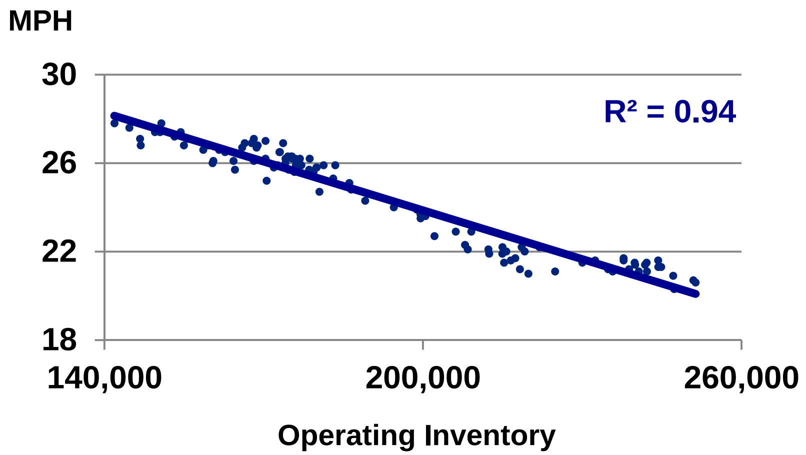
Additional Switching Degrades Service

Switch Events Increase Operating Inventory



Operating Inventory = All cars on trains and in yards

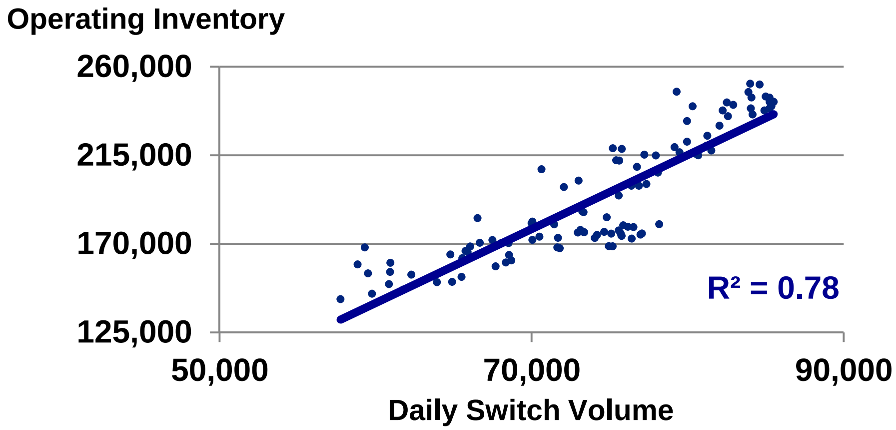
Operating Inventory Decreases Velocity



Monthly UPRR Data: 2005-2013

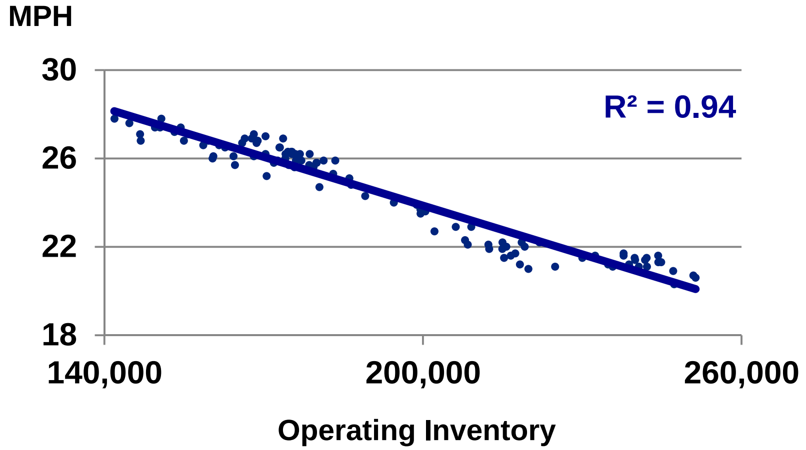
Additional Switching Degrades Service

Switch Events Increase Operating Inventory

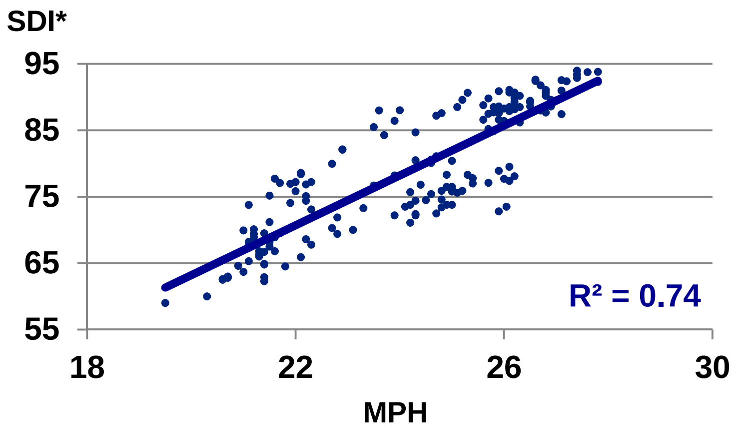


Operating Inventory = All cars on trains and in yards

Operating Inventory Decreases Velocity



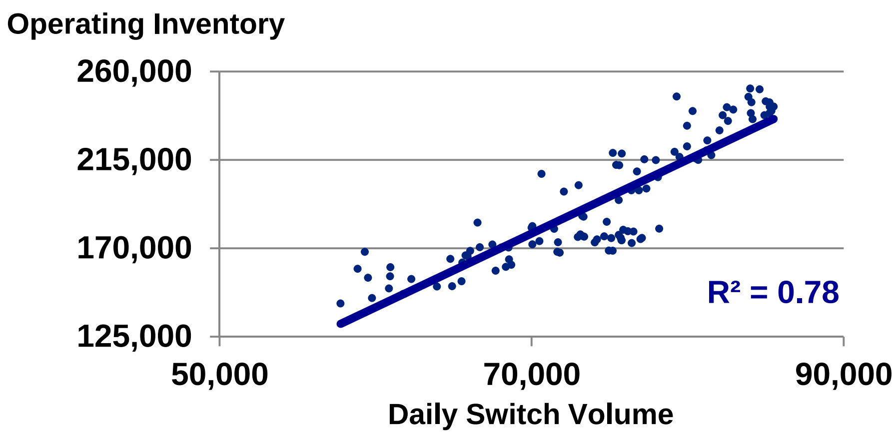
Slower Velocity Hurts Service



Monthly UPRR Data: 2005-2013 * Includes Early Deliveries

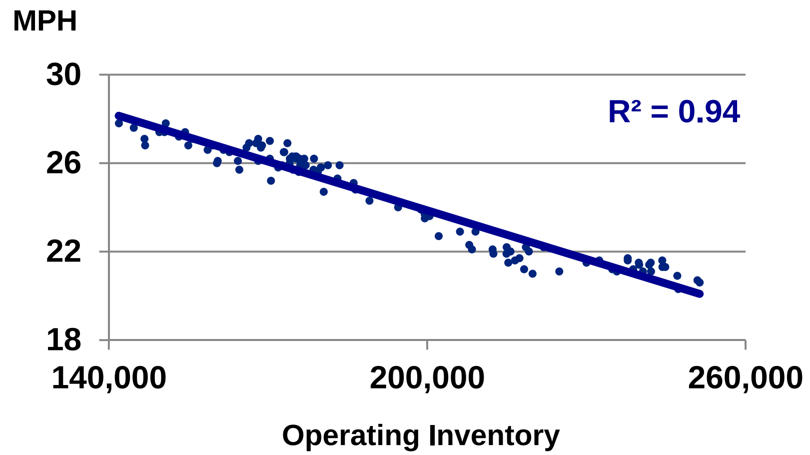
Additional Switching Degrades Service

Switch Events Increase Operating Inventory

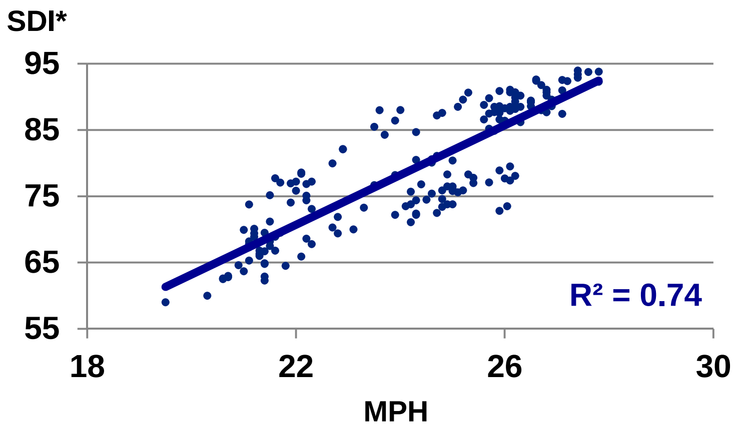


Operating Inventory = All cars on trains and in yards

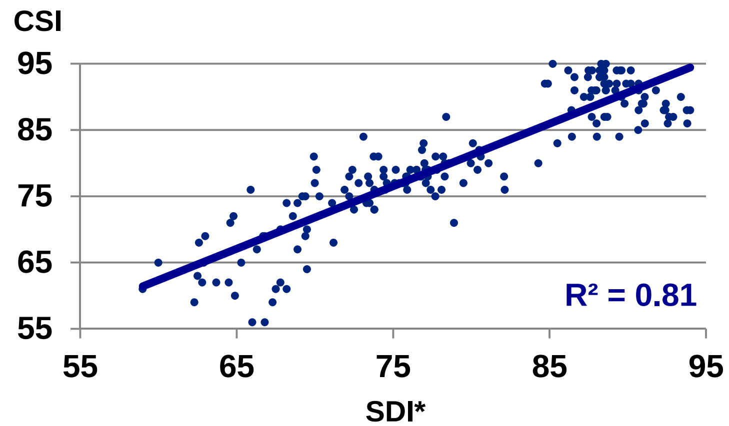
Operating Inventory Decreases Velocity



Slower Velocity Hurts Service



Poor Service Hurts Customer Satisfaction



Monthly UPRR Data: 2005-2013 * Includes Early Deliveries

UNION PACIFIC BUILDING AMERICA®

NIT League Proposal Decreases Ability to Plan and Manage Resources

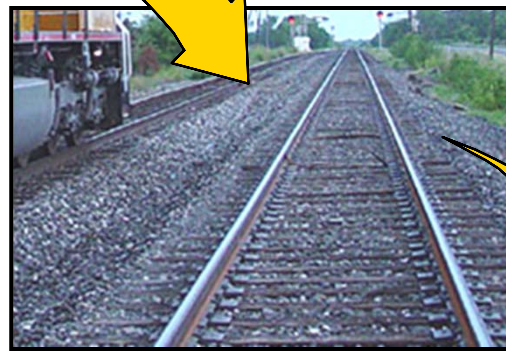
Timeframe	Objective	Issues
1. Long-term Facility & Resource Planning • Capital • Crews / Equipment	Acquire	• Uncertainty in longer-term traffic forecasting -- - What - Where - How much / how far

5 Critical Resources

Lead Times in Italics

- ✓ Right Amount
- ✓ Right Place
- ✓ Right Time

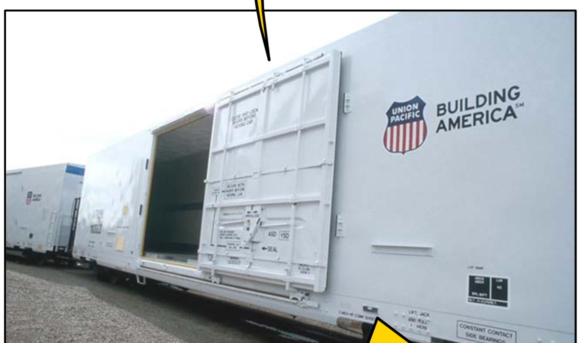
Workforce
6 – 9 months



Main Lines
18 – 36 months

Locomotives
12 months

Terminals
18 – 36 months



Freight Cars
12 months

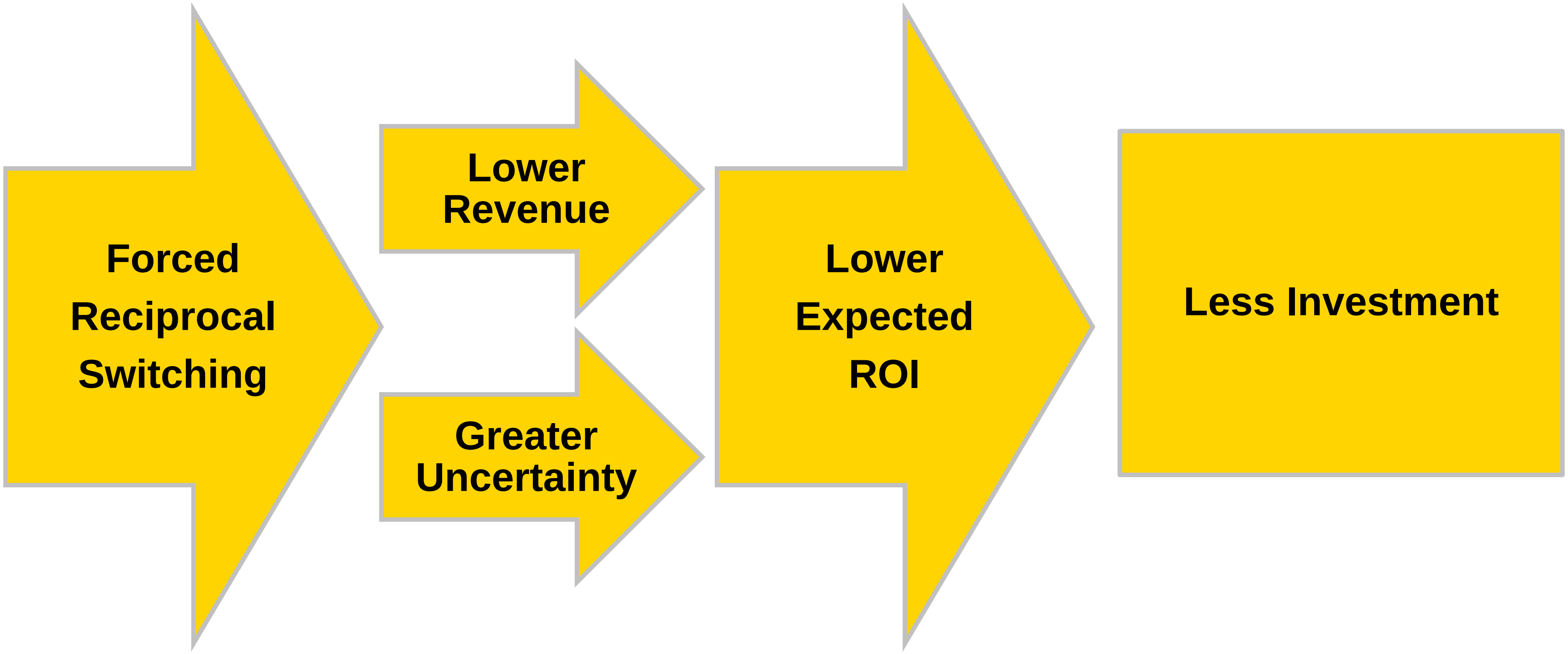
NIT League Proposal Decreases Ability to Plan and Manage Resources

Timeframe	Objective	Issues
1. Long-term Facility & Resource Planning • Capital • Crews / Equipment	**Acquire**	**• Uncertainty in longer-term traffic forecasting --** - **What** - **Where** - **How much / how far**
2. Tactical Planning • 2-10 day horizon • Train plan • Position resources	**Position**	**• Uncertainty in short-term demand forecasts** **• Lack of time to relocate resources**

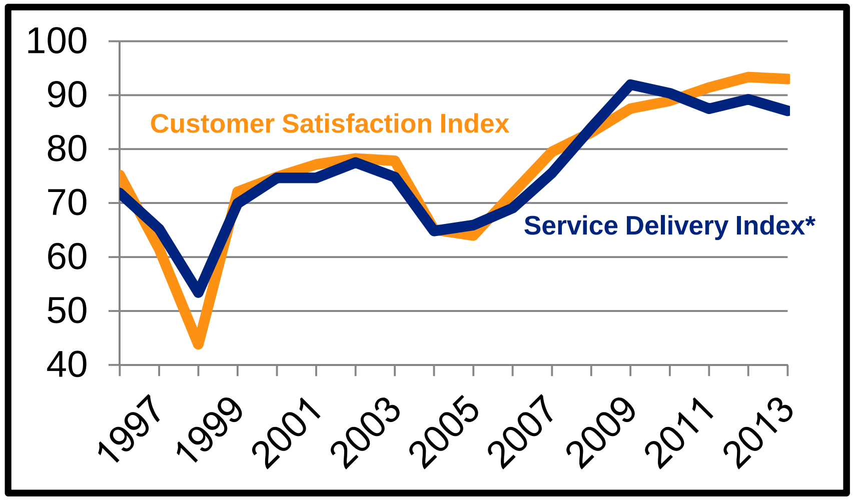
NIT League Proposal Decreases Ability to Plan and Manage Resources

Timeframe	Objective	Issues
1. Long-term Facility & Resource Planning • Capital • Crews / Equipment	**Acquire**	• **Uncertainty in longer-term traffic forecasting --** - **What** - **Where** - **How much / how far**
2. Tactical Planning • 2-10 day horizon • Train plan • Position resources	**Position**	• **Uncertainty in short-term demand forecasts** • **Lack of time to relocate resources**
3. Real-time Network Management • Balance terminals • Control the flow • Assign resources	**Assign**	• **Blind spots in managing daily traffic flows** • **Resources won't match demand**

NIT League Proposal Will Reduce Investment



NIT League Proposal Threatens Progress



- Increases workload in constrained terminal areas
- Degrades service across the network
- Limits ability to plan and manage the network
- Increases need for capital investment while reducing ability to invest