

**UNITED STATES SENATOR
JOHN D. ROCKEFELLER IV**

**Legacy Memorandum:
Freight Rail Industry and
Surface Transportation Board**

LEGACY MEMO

TO: Senator Rockefeller
FROM: Devon Barnhart, Matt Kelly, and Brandon Kaufman
DATE: October 17, 2014
RE: Legacy on Freight Rail Industry, STB, and
Captive Shipper Issues

Senator, this memo details your many contributions to national rail policy as it relates to the Surface Transportation Board (STB), captive shippers, and the freight rail industry. It was drafted with reliance on files from current and former Commerce Committee and personal office staff, records of legislation you introduced and statements you gave, committee reports, statements from other members of Congress, books, press releases, and other materials detailing your many accomplishments over the years.

Throughout your career in public service, you have been a champion for a balanced freight rail system that allows both the railroads and the businesses who use that system to prosper. Unfortunately, captive shippers, many of whom are in West Virginia, have struggled to remain competitive as rail service has declined and rates have increased.

Memo Overview

Senator, this memo will begin with a timeline of your work as it relates to the railroad industry and captive shipper issues in West Virginia. Then, the memo will discuss your work as Chairman of the Commerce Committee and your repeated efforts to bring

balance to the railroad-shipper dispute. The memo then details the financial background of the railroad industry; followed by the Committee’s extensive investigations (2010 and 2013) into the financial status of the Class I rail industry. Finally, the memo provides background information on the United States freight rail network, as well as the Surface Transportation Board (STB).

Note: This legacy memorandum is in draft stage. It will be updated in the coming weeks as former staffers are interviewed.

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Timeline

1 UNITED STATES SENATE, 1985 – 2014

Date	Action
1970-1980	Railroads were experiencing financial difficulty due to inadequate revenue. In 1976 and 1980, Congress passed two pieces of legislation, <i>Railroad Revitalization and Regulatory Act of 1976</i> and the <i>Staggers Rail Act of 1980</i> , reducing railroad rate regulations in an effort to allow for more market freedom and to increase rates through a competitive market.
1985-1987	In 1987, you sponsored S.676, <i>Consumer Rail Equity Act</i> and in 1995, you co-sponsored S.477, <i>Consumer Rail Equity Act</i> , which was introduced by Senator Andrews. These bills were aimed at enforcing the <i>Railroad Revitalization and Regulatory Act of 1976</i> and the <i>Staggers Rail Act of 1980</i> in a manner that ensures reasonable rail rates in areas lacking competitive alternatives of transportation and ensures adequate railroad revenue. On February 21, 1986 and June 24, 1987, the Subcommittee on Surface Transportation, held hearings to investigate these matters.
1993	On January 7, 1993, you joined the Committee on Commerce, Science, and Transportation.
1995	The ICC is abolished and succeeded by the Surface Transportation Board (STB) following the <i>Interstate Commerce Commission Termination Act of 1995</i> .
1996	Mr. Gus A. Owen became a STB Member in 1996. Prior to joining the STB, he was a member of the ICC.

<p>1997</p>	<p>You introduced S.1429, <i>Railroad Shipper Protection Act of 1997</i>. This bill was part of your ongoing efforts to eliminate unreasonable fares that hamper captive shippers, communities and business serviced by one rail carrier and/or lacking alternative transportation options. Your efforts were aimed at eliminating confusion created by previous statutes directing the STB and ICC “to promote our national transportation system ‘by allowing rail carriers to earn adequate revenues and by making ‘an adequate and continuing effort to assist those carriers in attaining revenue levels’ that allow them ‘to attract an actual determination of each railroad’s revenue adequacy” clarifying that the fair rates should include consideration of the shippers not just rail revenue.</p>
<p>1998</p>	<p>William Clyburn, Jr. becomes a STB Member.</p>
<p>1999</p>	<p>On November 15, 1999, Linda J. Morgan, a former ICC member, was confirmed for her second term on STB and President Clinton redesigned her as Chairman.</p>
<p>1999</p>	<p>In 1976, there were 63 Class I railroads and by 1999 there were 8 Class I railroads due to consolidation and mergers. These mergers helped improve the railroads’ financial performance and ability to achieve adequate rates.</p>
<p>1999</p>	<p>You introduced a bill S.621 “that will, twenty years after the Staggers Rail Act, finally deliver the benefits of market competition to the railroad industry and its customers—the Railroad Competition and Service Improvement Act of 1999”, which aimed at ensuring fair rail rates along with adequate revenue. A Government Accounting Office (GAO) report, which you requested due to concerns about railroads setting unreasonable rates, and the consolidation of railroads, prompted you to continue your efforts to improve</p>

	competition.
1999	On February 22, 1999, Wayne O Burkes was nominated to the STB by President Clinton and confirmed by the Senate.
2000	You co-sponsored S.2604, <i>Rail Competition Enforcement Act</i> , requiring that rail agreements and transactions subject to the STB’s approval no longer be exempt from anti-trust laws.
2001	You co-sponsored S.526 introduced by Senator Dorgan, <i>Rail Competition Enforcement Act of 2001</i> , requiring the STB when reviewing agreements for anti-trust issues to consider the effects of the agreement upon the shippers and affected parties. Senator Dorgan, in a statement on your behalves’, stated that the bill was necessary to avoid the monopolies created by “bottlenecking” that unduly burdened shippers.
2001	At the request of the Committee on Commerce, Science, and Transportation, GAO created a report entitled “Surface Transportation Board’s Oversight Could Benefit from Evidence Better Identifying How Mergers Affect Rates” that reviewed the role of the STB in evaluating mergers. The GAO found, in general, that the STB fulfilled its role of evaluating mergers. However, the GAO also found that the STB review would benefit from analyzing other factors that affect rates when considering mergers beyond the merger itself.
2001-2005	You introduced S.1103, <i>Railroad Competition Act of 2001</i> and co-sponsored S.919, <i>Railroad Competition Act of 2003</i> , and S.919, <i>Railroad Competition Act of 2005</i> , “the purpose of this legislation is to encourage a bare minimum of competitive practices among participants in the freight rail industry, which has undergone unprecedented concentration in recent years, to the detriment of virtually all rail customers.”

	While you focused on the national level, in your statement you noted that “[s]hippers of bulk commodities, like coal from mines in West Virginia and grain from the Plains states, must routinely deal with shipments that move more slowly, and at rates much higher than would normally be charged in a truly competitive market.”
2002	On November 14, 2002, the Senate confirmed Roger Nober as a STB Member and President George W. Bush appointed him Chairman on January 4, 2006.
2003	You co-sponsored a bill introduced by Senators McCain and Hollings S. 1389, <i>Surface Transportation Board Reauthorization Act of 2003</i> , which would authorize appropriations to the STB for FY 2004 through 2008. In addition, the bill would allow for rates challenge procedures in addition to making the Chairmanship position subject to Senate confirmation.
2004	On May 21, 2004, the Senate confirmed William Douglas Buttrey and Francis P. Mulvey as STB Members.
2006	On June 21, 2006, the Subcommittee on Surface Transportation and Merchant Marine held a hearing entitled <i>Economics, Service, and Capacity in the Freight Railroad Industry</i> . The Chairman of the Subcommittee, Senator Lott, chaired the hearing, which looked at rail rates and captive shippers.
2006	In August 2006, Charles D. Nottingham was confirmed by the Senate as an STB Member. He served as Chairman from August 2006 until March 2009.
2006	In October 2006, the GAO released a report entitled “Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Captivity Should be Addressed” (GAO-06-1057). The report indicated that there were fewer captive shippers but rates over the threshold for rate relief had increased. The GAO again

	recommended that STB consider additional factors to determine whether rate relief would be appropriate (including the railroad's need for adequate revenue). Finally, the GAO encouraged the STB to conduct an in-depth look at the rate relief process and the areas where rates appear to be excessive.
2007	You introduced S.953, <i>Railroad Competition and Service Improvement Act of 2007</i> , again calling for effective competition among rail carriers and "making capitalism work for all parties in the freight rail marketplace, not just for the monopoly railroads" by removing paper barriers and contractual restraints in addition to other changes hampering shippers and other business.
2007	You co-sponsored a bill introduced by Senator Kohl S.772, <i>Railroad Antitrust Enforcement Act of 2007</i> . This bill was introduced to eliminate certain rail carrier exemptions to the antitrust laws as well as introducing other changes to eliminate captive shippers.
2007	October 23, 2007, the Subcommittee on Surface Transportation and Merchant Marine Infrastructure Safety and Security of the Committee on Commerce, Science, and Transportation and Chaired by Senator Lautenberg held a hearing entitled <i>The Surface Transportation Board and Regulation Related to the Freight Railroad Industry</i> . The hearing looked at ways to balance the need for adequate revenue for railroads to maintain infrastructure and the need to set reasonable rates for shippers. You testified before the Subcommittee on about issues relating to bottlenecking, the STB process, and your efforts at change.
2008	You co-sponsored a bill introduced by Senator Lautenberg entitled <i>Passenger Rail Investment and Improvement Act of 2008</i> . S.294. The bill was passed

	by the Senate with amendments and passed the House with amendments after conference.
2009	You became Chairman of the Committee on Commerce, Science, and Transportation.
2009	On August 7, 2009, Daniel R. Elliott III was confirmed by the Senate and on August 13, 2009, he became Chairman of the STB.
2009	You sponsored the Surface Transportation Board Reauthorization of 2009. S. 2889.
2009	You co-sponsored the <i>Railroad Antitrust Enforcement Act of 2009</i> : S.146, which was introduced by Senator Kohl. Among other changes, the bill required the STV to review the effect of an agreement upon shippers and allowed the STB to find railroads subject to the antitrust laws.
2010	On September 15, 2010, you held a hearing entitled <i>The Federal Role in National Rail Policy</i> in conjunction with the release of an Office of Oversight and Investigations report entitled <i>The Current Financial State of the Class I Freight Rail Industry</i> .
2010	The STB decided several rate cases in which they narrowly construed “market dominance” in favor of the railroads.
2011	You sponsored the Surface Transportation Board Reauthorization of 2011. S.158. The bill recommended several changes including removing the STB from the Department of Transportation, set-up accountability systems, and taking steps to avoid captive shipper issues.
2011	On April 14, 2011, Ann D. Begeman was confirmed to the STB by the Senate.
2011	On June 22, 2011, you testified before the STB pushing the STB to take steps to increase competition within the rail industry.

2013	On November 21, 2013, you held a follow-up hearing to your September 15, 2010, hearing entitled “Update on the Financial State of the Class I Freight Rail Industry”. At the same hearing, the committee as considered the nomination of Ms. Debra Miller to be a Member of the STB.
2014	On April 9, 2014, Deb Miller was confirmed by the Senate to the STB.
2014	You introduced S.277, <i>Surface Transportation Board Reauthorization Act of 2014</i> , increasing the number of STB members, broadening the STB’s investigatory authority, and pushing to protect captive shippers.
2014	On September 10, 2014, the Committee held a hearing on service issues nationwide, including congestion and locomotive and railcar shortages. On September 17, 2014, the Committee held a markup and passed S.2777, <i>the Surface Transportation Board Reauthorization Act of 2014</i> , aimed at improving the efficiency and effectiveness of the STB.

Fighting for West Virginia Businesses

1 HISTORY

During your tenure in the Senate, you brought new companies and jobs to West Virginia. During that same time, you worked to maintain and strengthen existing core industries within your State, such as coal, steel, and chemicals. By working to support these core industries and ensuring fair business practices, your efforts have helped keep these companies in West Virginia, allowed them to compete on a national level, and avoided passing on additional expenses to consumers. You have consistently fought against practices within the rail industry that create “captive shippers” across the country, which are those businesses that lack access to alternative forms of transportation thereby preventing them from obtaining competitive shipping rates. However, as you have stated, your interest in this issue was ignited due to the specific ramifications on industries within West Virginia and the lack of interest in protecting captive shippers in the 1980s.

When you became a member of the Senate, the Interstate Commerce Commission’s (ICC) efforts were primarily aimed at making the railroad’s “revenue adequate.” Throughout the 1980s, the railroads financial position improved due to the new laws, mergers, privatization, and improved infrastructure. While the railroads flourished under the ICC and STB, certain shippers were subject to unreasonable rates due to the market dominance of the railroad. In particular, certain industries were harmed due to the commodities they produced as these products, such as coal,

steel, and chemicals, are not easily moved by truck or other alternative forms of transportation.

You have worked to protect captive shippers and force the STB to evaluate the protection these companies have under the “market dominance” test. You stated that,

[I]n West Virginia, some 90 percent of chemical plants are being held captive to a single railroad. I have been trying recently to facilitate a new dialogue between chemical companies and the railroad to which they are captive. The railroad literally said to these Kanawha Valley companies that the only way they'll ever get competitive rail service and rates is through government intervention. Clearly, we need to step back and take a long, hard look at this industry to see where things went wrong and how to set things right again.

You have continued to push the STB to create a balanced system in which railroads earn adequate revenue and shippers are subject to reasonable rates in addition to introducing legislation that further your mission. Industries within West Virginia have realized that benefits of your efforts and recognize your work to support local industries.

Overhauling the Surface Transportation Board

1 SETTING THE STAGE

As you prepared to assume Chairmanship of the Senate Committee on Commerce, Science, and Transportation, it was clear that the Surface Transportation Board (STB) – which had not been reauthorized since it was established in 1995 – was the agency under the Committee’s surface transportation jurisdiction that was most out of date and ripe to be considered in the 111th Congress.

The last specific STB reauthorization bill to be reported out of the Commerce Committee was introduced in 2003 by Senators McCain and Hollings. That bill never gained enough traction to be considered by the full Senate due to the long-standing debate between railroad shippers and rail carriers over STB authority and regulation that the parties – despite your best efforts – were never able to resolve. You had also of course introduced and co-sponsored bills to address competition and service in the railroad industry and to amend STB procedures for the review of rate cases, but they too had been unable to garner the support necessary to be reported out of Committee. Under your leadership, however, there was a greater likelihood that the shippers and carriers would be willing and able to reach an acceptable agreement in 2009.

The STB had instituted some changes to its processes and procedures to address concerns that were raised by bills you had introduced, as well as the McCain-Hollings bill. First, the STB revised its rail rate case review process into a three-tiered

approach that has made it easier for shippers to file rate challenge cases. The first of the cases that was filed under the lowest tier of that three-tiered system was decided in the summer of 2008 in favor of DuPont, which led to more shipper rate challenge cases being filed. The STB also promulgated a new rule requiring that all “paper barriers” be publicly disclosed in advance of STB review of sale or lease transactions and subject to regulatory scrutiny. The STB also improved its rate reasonableness standard by revising its cost of capital to more accurately reflect the capital cost of the rail industry.

Finally, the STB recently released an independent report that it commissioned by Christensen Associates on competition in the rail industry, which provided conclusions and recommendations on addressing capacity, competition, service and other issues in the rail industry. However, there were still improvements to be made to STB’s statutory authority, processes, and procedures, and the changes that the STB had already instituted seemed to open the door to a comprehensive reform proposal.

2 COMPREHENSIVE REFORM

Immediately after you assumed Chairmanship, your staff met with representatives from the railroads, various chemical, electric utility, grain, auto, paper, and intermodal transportation shippers, and the Surface Transportation Board (STB) in preparation for drafting a new railroad competition and STB reauthorization bill on your behalf. With each group, your staff explained the confidential nature of the discussions and that you were looking to develop a bill that could receive sufficient support to be enacted in the 111th Congress. Each provision of your prior rail competition

bill was reviewed with the groups to examine the core problems the provisions were designed to address, and additional issues not contemplated in your prior bill were also discussed. In general, the representatives were candid and cooperative, and creatively explored different concepts and solutions to some of the identified issues facing the railroad industry and railroad shippers.

Out of these conversations emerged three themes that would define the pursuit of rail shipper issues during your chairmanship: increased rail competition; improved regulatory processes; and a more robust STB.

Increased Competition: The Staggers Act generally contemplated using competition and market forces to discipline rail prices and service rather than through direct Federal regulation. However, the Staggers Act recognized that ‘captive shippers’, rail shippers with no practical transportation alternatives that are served by a single railroad, would still require some direct regulatory oversight and control. In addition, it was clear that in an industry with significant consolidation since the enactment of the Staggers Act, current STB laws, rules, and policies could be altered to promote additional competition to captive markets as a method to control rates and promote quality service – for example by requiring railroads to quote bottleneck and competitive switching rates.

Improved Regulatory Processes: The process for challenging rates or service at the STB was often decried as being too slow and very expensive.

A More Robust STB: Several options existed to increase the authority of the STB and give rail shippers more opportunities to have their problems addressed by the Board, including by giving the STB independent investigative authority and increasing the STB's budget to fund additional staff, investigations, and outreach.

In a May 2009 Dear Colleague letter, you clearly outlined what was at stake and what you intended to accomplish. As it turns out, you also identified in the antitrust issue one of the principal roadblocks that would ultimately prevent your comprehensive STB legislation from being enacted.

I have been working for 25 years to help captive rail shippers get relief from unreasonably high rail rates and a lack of competitive rail service. This issue is critical to West Virginia and many of your states as well, and in these challenging economic times, getting relief from high rail rates is critical to job protection and creation.

Since the beginning of this year, I have been working in the Commerce Committee with my ranking member, Senator Hutchison, Surface Transportation Subcommittee Chairman Lautenberg, and the Surface Subcommittee ranking member, Senator Thune, to craft legislation that will provide meaningful reforms to the STB, the federal agency charged with the economic regulation of the railroad industry. Our bill will break a 25-year deadlock and create greater competitive rail opportunities by meaningfully addressing issues that shippers have raised, such as the railroads' failure to quote bottleneck rates and to engage in reciprocal switching. It will also seek to make the STB a more robust, accessible entity by providing the Board with

greater authority to investigate rail practices and improving the STB's rate dispute process. We expect that this bill will enjoy the support of a broad range of shippers, rail labor, and the freight rail industry.

In an effort to address these same shipper concerns, Senator Kohl has introduced S. 146 to eliminate the industry's limited antitrust exemptions. I am a cosponsor of S. 146 and support it as part of the solution to addressing high costs for captive shippers. However, this legislation will only address one part of the problem and does not provide the comprehensive solution that shippers need.

I believe that we should address the comprehensive STB reform and the antitrust exemption as part of one comprehensive effort rather than considering these bills piecemeal. I look forward to working with all of my colleagues to bring meaningful and comprehensive relief to rail shippers.

3 THE KOHL CRISIS

Another key issue relating to railroad regulation was the bill introduced by Senator Kohl, the Railroad Antitrust Enforcement Act, which would effectively remove elements of competitive oversight of the railroad industry from the STB and give it to the Department of Justice, the Federal Trade Commission, and private citizens. Arguably, Senator Kohl's bill is intended to accomplish the same goals as your railroad competition bills, but would achieve these aims by circumventing the Commerce Committee and the agencies within the Committee's jurisdiction. Both Chairman Inouye and Chairman Lautenberg opposed

Senator Kohl's bill because they believe that changes to the STB's jurisdiction and authority should be handled through the Commerce Committee, where the members have a better understanding of the railroad industry, the STB, and their respective histories. They also believe that the bill would decentralize oversight of the railroad industry and potentially adversely affect the health and viability of the industry as a whole, which could create major complications if the nation's reliance on rail transportation grows as predicted over the next 15-20 years. Senator Kohl will likely reintroduce his bill again in the 111th Congress and will most likely want to move it quickly. The House passed a similar bill through its Judiciary Committee, but it has not received consideration by the full House.

Throughout 2009, you and your staff conducted extensive negotiations with other interested Senators and industry stakeholders to craft a workable bill that upheld the core principles of your previous rail competition proposals. As gargantuan a task as this was in itself, the effort was further complicated by Senator Kohl's more narrow pursuit to revoke the railroads' antitrust exemption. You had supported Senator Kohl's bill when previous Commerce Committee Chairs were unwilling to reform the STB, and were a cosponsor of his bill in the 111th Congress.

However, now that you were Chairman, you had an opportunity to enact the first comprehensive reform to help rail shippers since the enactment of the Staggers Act in 1980, and had been working on a bipartisan basis with Senators Hutchison, Lautenberg, and Thune to develop bipartisan legislation to reauthorize and comprehensively reform the STB. While certain elements of Senator Kohl's bill could be considered as part of a

comprehensive reform package, considering it as a stand-alone measure would undermine your efforts as it would have completely removed any incentive the railroads had to participate in the Commerce Committee process to reform the STB, bringing rail shippers and railroads back to the same stalemate that had blocked progress for too long.

Senator Kohl's bill was reported from the Judiciary Committee in March 2009. While you agreed to cosponsor the bill and supported revisiting the railroads' antitrust exemption, your position was that you and Senator Kohl should work together to comprehensively reform the STB through the Commerce Committee package, bolstered by harmonization with the antitrust bill. Your staff repeatedly asked Senator Kohl's staff to wait and work with you on rail competition issues comprehensively, but he pushed his bill forward despite your reservations, and as the Senate was preparing to recess for Memorial Day 2009, Majority Leader Reid scheduled a cloture vote for the Senate to vote on shortly after it returned.

You indicated that you were going to vote against cloture because of the effect it would have on your ability to accomplish STB reform, and spearheaded a Dear Colleague letter [dated May 26, 2009] with Senators Hutchison, Lautenberg, and Thune urging Senators to do the same.

While we support strengthening the application of the antitrust laws to the railroad industry, and will work to do so as part of a final package, S.146 is much more expansive and touches on matters squarely within the jurisdiction of the Commerce Committee and the subject of our bill. As such, S.146 would likely undermine many of the reforms we are seeking. It

would treat the rail carriers differently from other common carriers and make major changes to rail policy without regard to overall rail policy.

We urge you to oppose cloture on S.146 so that we can address these issues in a comprehensive manner. We look forward to working with all of our colleagues, including those on the Judiciary Committee, to get this right.

Ultimately, you convinced Senator Kohl that his approach would undermine the comprehensive relief that shippers needed, and he agreed to withdraw his pending cloture motion in order to allow the Commerce Committee to complete its work and merge antitrust provisions later on. On June 1, 2009, a day before the cloture vote was scheduled, you and Senator Kohl circulated another Dear Colleague letter announcing the agreement:

We wanted to let you know that we have jointly decided to ask Majority Leader Reid to withdraw the pending cloture petition on S. 146, the Railroad Antitrust Enforcement Act. We share the common goals of making the rail industry more competitive and addressing the longstanding concerns of rail shippers.

The Commerce and Judiciary Committees intend to work together on comprehensive rail competition legislation. We hope shortly to have a bipartisan package that reforms the Surface Transportation Board and repeals the railroads' antitrust exemption available for the consideration by the full Senate. We are working on harmonizing our two efforts to produce a robust reform package.

This is a high priority for both of us and we are absolutely committed to finding real solutions that can be enacted into law this year.

4 THE HIGH WATER MARK

With the immediate Kohl crisis averted, attention was turned back to negotiations on a comprehensive bill. Following meetings with the shippers and railroads to walk through the draft bill in November, both sides appeared to support the overall framework, though it was clear that concerns remained. In particular, both sides were wary of the bill's approach to pricing bottleneck rates and the circumstances under which railroads could be compensated for network costs when they are required to open portions of their network to competition.

Per your agreement with Senator Kohl, your staff also continued to work cooperatively on incorporating provisions from his antitrust bill. As many of the provisions could potentially undermine the broad reform you were seeking, your staff was very careful to combine different sections in a way that was complementary to your overall efforts. Senator Kohl remained committed to including a provision that dealt with Department of Justice merger review, and which was in conflict with Senator Hutchison's stated opposition to anything that undermined the Board's sole authority to approve or disapprove a railroad merger. And of course, the antitrust deal would ultimately have to pass muster with the railroads and shippers.

On December 17, 2009, after nearly a year of intense discussions, the Commerce Committee under your leadership made groundbreaking bipartisan progress by unanimously reporting out the Surface Transportation Board Reauthorization Act.

5 NEW YEAR, SAME RAILROAD TACTICS

While you made significant progress in moving the STB Reauthorization bill forward, by January 2010, the railroads had become particularly vocal about their concerns on calls with financial analysts, believing that the regulatory structure would be tipped too far in favor of the shippers. You and your staff continued to work with all stakeholders to move the process forward and get a bill that could be ready for floor action by May or June 2010.

Following December's Committee markup, both the railroads and shippers submitted concerns and for several months, your staff worked with Senator Hutchison's staff, the STB, the railroads, and the shippers to find reasonable solutions to address them. The majority of requested changes were from the railroads, and working through some of those changes proved particularly difficult to do in a way that maintained the integrity and goals of your bill.

In particular, the bottleneck and reciprocal switching pricing mechanism was the central part of the debate over crafting your bill for much of 2009 and early 2010, and was partly the reason why the bill never got much traction with the railroads. The crux of the issue was how clear the bill should be in providing direction

to the STB to “guarantee” the railroads a certain amount of compensation for their network costs as part of the bottleneck rate when they are required to open portions of their network to competition. Three out of 4 class I railroads (BNSF, UP, and CSX) indicated that they would be willing to back down from their hostile posture toward the bill if more clarity on compensation could be provided. The other, Norfolk Southern, was more outspoken and indicated it would not support a bill no matter what language on compensation was inserted. The shippers, meanwhile, were naturally wary of addressing the compensation issue out of concern that it would allow the railroads to lock-in anti-competitive rates.

You also used this time to continue working on finalizing a deal on antitrust issues with Senator Kohl in a manner acceptable to the other cosponsors. Negotiation an acceptable compromise on antitrust was becoming more of a challenge with Senator Hutchison, who seemed to renew her scrutiny of the issue after deciding not to resign her Senate seat while running for Governor of Texas.

6 A STRATEGIC PAUSE

By June 2010, it became clear that further discussions with the railroads in the months leading up to the 2010 elections would not be productive. Norfolk Southern was particularly vocal about its opposition to the bill, with CEO Wick Moorman publicly criticizing it in the press, and the industry generally was unable to define its bottom line priorities, continually coming up with new issues and concerns to raise, and creating the perception that the

railroads were stalling on negotiations to see what political changes might take place after the upcoming 2010 midterm elections. Senator Hutchison also found a new issue to raise, pushing for inclusion of a provision to address the railroad's concerns with the Administration's rulemaking on positive train control. Senator Kohl continued to demand resolution on the antitrust issues before your bill came to the floor, which Senator Hutchison continued to have concerns about. You spoke with Senator Hutchison about her concerns and she agreed to a compromise which your staff believed would be acceptable to Senator Kohl, but it then appeared that Senator Hutchison would only agree to the compromise antitrust language if her concerns over positive train control could be addressed. You naturally had reservations about amending the statutory PTC requirement given the safeguards that PTC will provide for the thousands of West Virginians that live near rail lines hauling toxic shipments.

Rather than spin your wheels, you decided to suspend negotiations. It was believed that taking a break from negotiations would allow the railroads that still appeared to want resolution – and the railroads knew they needed to get this behind them if they wanted the Committee's help in the future – to bring Norfolk Southern along. You made clear that you were absolutely still committed to getting the bill done in 2010, but believed that taking a “strategic pause” from negotiations would allow cooler heads to prevail. It was simply impossible to make reasonable concessions to the railroads when they couldn't seem to figure out what they really wanted.

As the August 2010 recess approached, negotiations remained in suspension. The railroads continued to say publicly

that they were willing to come back to the table, but had yet to approach you or your staff with a prioritized list of their concerns. The shippers continued to express support for moving a bill, but the realities of the election year Senate calendar meant that the chances of getting a bill were slim. As a result, you begin to look at other ways to accomplish your goals of enhancing competition and improving the STB, and potentially motivating the railroads to come back to the table.

7 LEGISLATING AGAINST POLITICAL HEADWINDS

The November 2010 elections only solidified the sense that your efforts would be best focused on pushing the STB to act. Perhaps as the railroads suspected, the 2010 elections significantly changed the prospects of enacting a comprehensive STB reform bill in light of the new House Republican majority, which was more inclined to support the railroads' position. In this new environment, you didn't give up on comprehensive reform legislation, and continued to work in the 112th Congress to find resolution on the major sticking points.

The bottleneck rate provision remained the most difficult and the railroads' top point of opposition. Despite their opposition, the railroads were concerned about what changes Chairman Elliot might make if he investigated competitive access issues, and saw some value in having legislative certainty. The railroads worked to find a compromise the industry could get behind, but were unable because the costs associated with the eastern versus western railroads' networks greatly differed.

On the antitrust front, it looked very unlikely that a package including antitrust provisions could be crafted – Senator Hutchison had held up a deal over concerns about granting individuals the right to sue for injunctive relief. Consequently, Senator Kohl indicated that he wanted to move forward in 2011 with a free-standing bill and asked that you cosponsor. You declined, as it would have undermined the STB’s authority at a time when you were pushing it to make important changes.

In short, Your bill was very unlikely to move forward without making major changes to accommodate the railroads, and the shippers indicated that making major changes may not help them in the long-run, and that they may prefer no legislation to a significantly modified bill. They were also concerned that piecemeal reform could send a signal to the STB and the courts that Congress’ inaction on major issues could indicate that Congress is not interested in making broader reforms, which would hinder the Board’s ability to make changes within its existing authority.

Despite a vigorous attempt to reach a compromise with the railroads, you were unable to move your STB reauthorization bill through the Senate. However, the Senate did pass a number of provisions as part of the surface transportation reauthorization that were aimed at providing limited relief to shippers or increasing Board transparency, including:

- *Compilation of complaints*: This section would require the Surface Transportation Board to establish and maintain a database of complaints received, and post the list quarterly on the STB’s website. This section would require the Board

to receive the permission of those submitting informal complaints for them to be posted.

- *Revenue Adequacy Study*: This section would require the STB to initiate a study to provide further guidance on how to apply its revenue adequacy constraint. It would require the STB to consider whether to apply the revenue adequacy constraint using a replacement costs to value the assets. The study would provide public notice, comment, and an opportunity for hearings. The study would be due within 180 days of enactment, and the results would be reported to the committees of jurisdiction.
- *Quarterly reports*: This section would require the STB to provide quarterly reports to the committees of jurisdiction on its progress toward addressing issues raised in unfinished regulatory proceedings.

The House would not agree to any of the Senate-passed rail provisions in conference.

In that political environment, your efforts were best focused on making sure the STB felt pressure to act within its existing authority.

8 PUSHING FOR ADMINISTRATIVE ACTION

The STB enjoys relatively broad authority in its organic statute, and thus not every issue you were pushing to advance in your comprehensive reform bill actually required new legislative authority. Additionally, you sensed potential in STB Chairman

Dan Elliott, who at his 2009 confirmation hearing had promised to make the Board a more responsive and balanced entity toward shipper concerns. You continued to encourage Chairman Elliot to move forward with his regulatory and administrative agenda, which would have addressed several issues you tried to correct in your bill.

Even before the election, for example, in September 2010 you held a hearing on National Rail Policy at which Elliot and Deputy Secretary of Transportation John Porcari testified. During this hearing, you presented a report your staff had prepared revealing the overall health and profitability of railroads. You argued that the current state of the railroad industry called for revisiting and modernizing STB rules and procedures for rail competition. This hearing was a good first step in publicly making the case for the need for reform at the STB—which you refrained from doing while you were negotiating the STB bill in Congress. Highlighting these issues publicly put the railroads on the defensive, let shippers know that you were working for them, and made clear to the STB that you expected results. Shippers were energized by your public stance against the railroads. The hearing also kept the pressure on STB and Chairman Elliot, and made clear that you would not stand for business as usual.

At the hearing, Elliot committed to examining the rules the agency has in place regarding rail-to-rail competition, exploring changes to the commodity exemption system to determine if any should no longer be presumed competitive and therefore should have access to the STB, continuing to reexamine the Uniform Rail Costing System model to make sure the STB's evaluations of the

rail industry are fair, and fostering better shipper-railroad relationships.

In March 2011, you met with Chairman Elliot to receive an update on the Board's exemption and competition proceedings, and to encourage him to take bold action. Up to this point, Elliot had generally been responsive to your requests to review captive shipper issues, and would be making several key decisions over the next several months on proceedings that he had committed to initiating at your September 2010 hearing. But Elliot was also feeling pressure in the opposite direction from the House, where Transportation and Infrastructure Committee leaders (including Ranking Member Rahall) sent a letter to the STB asking it to oppose any changes that would upset "the existing regulatory balance between railroads and shippers." You encouraged Elliot to be as aggressive as he could and signaled that you intended to weight in publicly with your opinion at upcoming proceedings.

For example, you continued to press Elliot on creating rail-to-rail competition by revisiting the Board's competitive switching rules, which had not been changed since the 1980s, prior to massive consolidation in the industry. You also encouraged the Board to improve their reporting of service complaints and operational metrics in order to provide more transparency into railroads' service issues.

In June 2011 you testified as part of a STB proceeding on competition in the railroad industry, urging the Board to take what action they could to bring some balance toward shipper concerns:

So, I am here to urge you to be scrupulous in your review of competition in the rail industry. After this review, I encourage you

to act boldly where you can and where you can't, make incremental changes. But doing nothing is not an option.

You must regulate for the future of the industry—not continue to solve the rail industry problems of the past that have already been remedied.

You also provided concrete recommendations for improving the STB's rules, processes, and procedures to increase competition and reduce cost burdens for captive shippers. Specific priorities you identified were increasing competition, improving the regulatory process to make the Board more accessible, and making the Board more robust. Testifying at the hearing was a way to remind Chairman Elliot, the other STB commissioners, the railroads, and the shippers that you remained engaged in this issue and that you expected the STB to be proactive in addressing the shippers problems, despite urging from other members to retain the status quo.

You were also focused on getting the STB the resources it needed to effectively carry out its mission. Earlier in the year, you had written to Senate Appropriations Committee Chairman Inouye and Transportation-HUD Subcommittee Chairman Murray requesting that funding for the STB be increased, noting that:

For far too long, the constricted resources of the Board have prevented it from responding to the legitimate concerns of rail shippers. This increase in funding will immediately enable the Board to better act within its existing regulatory authority.

9 THE HOLLOW PROMISE OF THE ELLIOT STB

July 2009 – Elliot Confirmation Hearing

In his testimony, Chairman Elliott stated to you and the Committee that he would “intend to be as responsive and accessible as possible and will work with you to reach a balanced solution to these contentious issues between shippers and rail

Over a year later, little had changed. You began to express frustration about the lack of progress at the STB on addressing rail shipper concerns in a balanced and timely manner. On multiple occasions both you and your staff pressed Chairman Elliott to live up to his commitments to move the Board beyond its historic status quo as a railroad-friendly entity that ignored the needs and rights of the shippers. You demonstrated a willingness to support Chairman Elliott in reforming the Board, including by advocating for increases in the Board’s funding to provide it the additional resources it needs to become a more robust and timely acting agency. Despite repeated interactions, the Board continued to move stunningly slowly on matters before it and made little progress in becoming a more balanced entity.

When confirmed, you had high hopes for Chairman Elliott, as he committed to taking the Board in a new direction to create a more balanced scenario between the railroads and the shippers. However, despite this commitment, however sincere, Chairman Elliott and the Board made little progress in achieving reform. While the Board has shown some willingness to initiate actions on important issues, including competition in the rail industry, it has had little success, or little willingness, to reach a final conclusion.

Some of the reason that the Board had not completed initiatives it began may be one of two things – (1) the Board was afraid of coming out with a decision that undermines that railroads' current status quo or (2) Chairman Elliott was wary of coming out with a decision that he believes will disappoint you.

As to the question of why the STB had not made significant process in becoming a more balanced organization under Chairman Elliott's leadership, there were a number of reasons. When confirmed as Chairman, Mr. Elliott was new to Washington and appeared to have little appreciation for the political dynamic surrounding the STB. The STB is largely employed by long-serving staff, which appears to be content to maintain an overly railroad-friendly environment and ensure the status quo is maintained in the regulatory world. These are the very individuals who primarily advise Chairman Elliott on matters before the STB, so it's little surprise that there was not a more a dramatic shift in activity to provide a more balanced, even shipper-friendly atmosphere.

Despite pressing Chairman Elliot and the Board in general, and despite Elliot's commitment to create a more balanced scenario between railroads and shippers, there was no improvement in the STB's slow pace of activity and seeming lack of progress in addressing any number of issues, ranging from its proceeding evaluating competition in the rail industry to a specific rate case involving a constituent company you met with in June 2012– M&G polymers – that had been dragging on for years and continued to cost the company millions. Coming out of the meeting, you suggested that, in lieu of writing a letter to the STB expressing your concerns about its slow pace on the M&G case

and other pending actions, you would be interested in writing a letter to President Obama to express your view that the lack of timely action by the STB was undermining his efforts to boost domestic manufacturing.

On July 23, 2012, you wrote to President Obama:

I am concerned that the slow pace of activity and seeming lack of action at the Surface Transportation Board (STB) is hampering our nation's economic competitiveness. For over a quarter century I've been working to make sure that businesses that ship their goods by American railroads get a fair deal and that the railroads serve their essential role in getting good and commodities to their destinations efficiently for the benefit of the consumer and the U.S. economy. However, the slow pace or seeming lack of action at the agency charged with regulating the rail industry – the STB – continues to result in a scenario in which shippers of highly exportable goods are subject to burdensome rail rates, negatively affecting their ability to grow their export market presences.

You have made promoting U.S. exports a key initiative of your administration. However, I believe the lack of competition in the rail industry and, relatedly, lack of action at the STB, are hampering this initiative. I am not alone in this view. In March 2011, your Export Council identified STB reform involving rail competition as a key mechanism to creating efficient and cost-effective interstate commerce and promoting exports. Unfortunately, as we have seen over the past year, the STB has not heeded this recommendation and has pursued a policy of inaction and lack of urgency.

As you know, railroads are critical to the success of our nation's economy. Rail is vital to the domestic production of goods and I am fully supportive of a vibrant, healthy, and competitive rail system. However, today only four major freight railroads dominate rail transportation in our nation, with each exercising virtual monopoly power in their geographic territories. The presumption of federal law is that rail customers have access to competition, although in reality competition is virtually non-existent for most shippers that must use railroads for transportation. If a rail customer lacks access to competition and believes its rail rates or service is unreasonable, it can petition the Surface Transportation Board for relief.

Just last June, I testified before the Board about this very issue at its hearing on competition in the railroad industry. At this hearing, rail customers, including particularly large manufacturers, created a strong record that there is insufficient competition. In fact, the record contains specific information by individual companies showing that unreasonable rail rates have resulted in American jobs being relocated overseas, that American exports have suffered from this problem and that some companies have deferred investment in our economy due to this problem. Yet, over a full year later, the Surface Transportation Board has taken no action on this issue.

Until we see a more competitive environment in our national freight rail system, the only course of action for companies facing prohibitively high rail rates is to petition the STB for relief from such rail rates that threaten their businesses. One need not look further than my state of West Virginia to see how burdensome the current process can be. One of my constituent companies has an

ongoing rate case before the STB that has been pending for over two years and is only halfway completed. This company estimates that it is paying \$60,000 per week in excess rail transportation costs while this case is pending, resulting in total costs of prosecution at the Board in excess of \$20 million. Every day the case is pending, my constituent is disadvantaged significantly in the marketplace. And this is only one case. Over time, I have heard similar complaints for numerous companies from around my state and across the country. It is beyond me why it should take a regulatory body so long to come to a determination on a single case. At a time when you have directed agencies of the Executive Branch to streamline their processes, I find it inconceivable why the Board has not followed suit and taken action on the above two cases and others that remain pending.

Mr. President, every day that passes in which the STB does not take action is a day that numerous shippers around the country continue to pay prohibitively high transportation costs. These costs directly affect companies' bottom lines and their ability to provide goods for export at competitive prices. I urge you to take action to ensure that the Surface Transportation Board acts in a timely manner to address the multiple matters that have remained pending on its docket for far too long. Thank you for your time and attention to this matter.

You also took the additional step of engaging Senators Durbin and Brown – both of whom had strong personal relationships with Elliot – to express your concerns and get them to push the Chairman to act. You expressed to Senators Durbin and Brown that, unless you saw a dramatic uptick in activity and

production at the Board, you would not be inclined to support Elliot's re-nomination at the end of 2013. Further, your staff met with Elliot about these concerns that same week and had a very frank conversation about your concerns.

Whether coincidence or not, in late July 2012 – on the heels of your efforts to push it to act – the STB announced two initiatives focused on taking steps to better protect shippers from unreasonably high rail rates. In the first decision, the Board proposed to reform its rules for rail rate disputes to allow a more accessible, equitable process for shippers. Stand-alone cost (SAC) rate cases are very expensive and lengthy to adjudicate, in part because these cases require the shipper contesting a rate to design a hypothetical railroad in order to judge a railroad's real world rates. However, very few shippers used the Board's more simplified rate case procedures because of limits on potential rate relief. To address this, the STB proposed to eliminate the rate relief cap for simplified SAC cases. The Board also proposed to double the relief available to shippers other its other simplified approach, the Three-Benchmark method. In addition, the Board proposed raising the interest rate that railroads must pay on reparations to shippers, if they are found to have charged unreasonably high rates.

The proposed changes were a direct result of the STB's June 2011 hearing on "Competition in the Railroad Industry" at which you testified. One of the key points in your testimony was the need to make the Board more accessible to shippers to contest unreasonably high rates. In addition, your STB reform legislation included a number of measures to make the Board

more accessible to shippers, including provisions to revise the maximum amount of relief available to shippers.

In its second initiative, the Board approved considering a proposal submitted by the National Industrial Transportation League – a key shipper stakeholder group – that would take concrete steps toward increasing rail-to-rail competition through reciprocal switching. In short, reciprocal switching requires a railroad to transport cars of a competing railroad. In the proceeding, the Board will specifically consider a proposal submitted by the NITL that would allow certain shippers held captive in terminal areas access to a competing railroad, if there is a working interchange within 30 miles.

Should the Board end up adopting the NITL’s proposal, or something similar, it could have a fairly dramatic effect on the regulatory environment. For one thing, it would likely reduce the number of cases brought before the Board by shippers, as there would be a measurable increase in cases where competition exists between at least two railroads. As with the rate case decisions, your STB reform legislation contained provisions aimed at addressing the reciprocal switching issue. As such, a positive more shipper-friendly outcome of this proceeding would be another step forward to achieving the goals you set forth through your legislative efforts regarding captive shipper issues and the STB in general.

10 PUSHING THE STB TO ADDRESS SHIPPER CONCERNS

On April 2, 2014, the STB announced that it was seeking comments in Docket No. Ex Parte (EP) 722 regarding the Board’s

method for determining railroad revenue adequacy, as well as the revenue adequacy component used in judging the reasonableness of rail freight rates. Due to changes in the industry, the STB decided to review its methodology for determining rail revenue adequacy. The STB has historically evaluated rail revenue adequacy based upon stand-alone cost constraints rather than “how the revenue adequacy constraint would work in practice in large rail rate cases”. The STB held a hearing on September 4, 2014, to discuss Docket No. EP 722.

On September 5, 2014, you submitted comments to the STB on EP 722 and railroad revenue adequacy. Your comments urge the STB to consider shippers, individuals, and businesses when reviewing an agreement and determining revenue adequacy. As highlighted in your letter, the Staggers Act mandated that the STB ensure railroad revenue adequacy, but also provide a method for captive shippers to challenge rates. Since most railroads are now “revenue adequate” under the STB’s existing test, [this was highlighted in your November 2013 Commerce Committee report] you urged the STB to consider other constraints and develop a more balanced system.

Shining a Spotlight on the Rail Industry

1. INTRODUCTION - STAGGERS PAVING THE WAY

The railroad industry was not always financially solvent. In drafting the Staggers Act, Congress sought to modify existing rail transportation policy by “promoting a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues.” In short, Congress passed the Staggers Act in an attempt to restore financial stability to the U.S. freight rail network.

Specifically, Section 205 of Staggers required the ICC (and subsequently the STB) to begin annual determinations of “which rail carriers are earning adequate revenues.” To implement that requirement, the ICC began a proceeding and ultimately came to the conclusion that “the only revenue adequacy standard consistent with the requirements of [Staggers] is one that uses a rate of return equal to the cost of capital.” To this day, the Board annually determines which rail carriers are revenue adequate by comparing a carrier’s rate of return with their cost of capital.

Revenue adequacy is also an important component of the Board’s determination for judging the reasonableness of rail freight rates. In 1985, the Coal Rate Guidelines case established a set of principles known as constrained market pricing, which imposes three main constraints on which a railroad may charge differentially higher rates on captive traffic; revenue adequacy, management efficiency, and stand-alone cost. With respect to revenue adequacy, the ICC observed in that case:

“[The] revenue adequacy standard represents a reasonable level of profitability for a healthy carrier. It

fairly rewards the rail company's investors and assures shippers that the carrier will be able to meet their service needs for the long term. Carriers do not need greater revenues than this standard permits, and we believe that, in a regulated setting, they are not entitled to any higher revenues. Therefore, the logical first constraint on a carrier's pricing is that its rates not be designed to earn greater revenues than needed to achieve and maintain this revenue adequacy level."

2 2010 COMMERCE COMMITTEE MAJORITY STAFF INVESTIGATION AND REPORT

In 2010, the Commerce Committee issued a Majority Staff Report entitled "The Current Financial State of the Class I Freight Rail Industry" which documented how, unlike thirty years ago, the railroad industry, in particular the Class I's, were achieving record profits and aggressively increasing prices for their customers. Using the companies' Securities and Exchange Commission (SEC) filings, quarterly investment calls, industry analyst reports, and other sources, the Committee staff report concluded that the freight rail industry has more than achieved the Staggers Act's policy goal of restoring financial stability to the U.S. rail system. Among other things, the 2010 report found that:

- In the same year (2008) that the rail industry told the STB that its profitability was lagging behind other sectors of the economy, Fortune magazine rated railroads as one of the top five most profitable industries in the U.S. economy.
- While the railroads tell their regulators they are not making high enough profits to cover all of their long-term capital

investment needs, the Class I railroads are using billions of dollars of their profits to buy back stocks and boost the short-term values of their stocks for their shareholders.

- Although the railroad industry claims that it still has difficulty attracting sufficient amounts of investment dollars, Warren Buffett and other investors have been pouring billions of investment dollars into the companies.

In conjunction with the release of the 2010 report, you chaired a hearing on the federal government's role in national rail policy. While that hearing emphasized progress being made on the national rail system, you reiterated your disappointment with the freight rail industry's resistance to change and how the status quo was adversely affecting shippers, passengers, and consumers. Excerpts from your hearing statement are below:

Today's hearing is about progress. It's about what's required to modernize our transportation system so our businesses and our workers can stay competitive in the 21st century. It's about leveling the playing field. And it's about how when we do that, America is stronger in the global marketplace and that means jobs and economic security.

One of the keys to this progress is our national rail system. We all understand that our highways and skies are continuing to get more crowded. That means rail is going to have to become a higher priority. I am pleased that the Obama Administration is hard at work on this important issue, and I appreciate the Administration's efforts to aggressively implement the important infrastructure programs created by Congress.

...

While today's hearing is about progress, it's also about the lack of progress we have seen over the last few decades. It's about the natural tendency of big corporations to fight to maintain a status quo that works well for them, but that will not get us where we need to go for the future. Of course I'm talking about the freight rail industry.

Thirty years ago, the freight railroads were really struggling. Congress responded by amending the law to give the railroads an opportunity to do business differently. I'm not sure I agree with how the law was written back in 1980, but I think it's pretty clear that the reforms worked from the railroads' point of view.

Today, I am releasing a staff report that documents just how well the big Class I freight railroads are doing these days.

What this important report tells us is that the railroads are earning 12 and 13% profit margins, which puts them at the top of the Fortune 500. And they're just getting more profitable because they're raising their shipping prices by an average of 5% a year. But the railroads say different things depending on their audience.

When they're talking to the Surface Transportation Board, Mr. Elliott's agency, they act like it's still 1980. They say they're barely making enough money to keep the lights on. But when they're on their quarterly calls with Wall Street investors, it's a very different story. These companies tout their high profit margins and their power to dictate prices to their customers. And at the same time they're telling Congress that they don't have enough money to invest in needed capital projects, they're using billions of dollars of their profits to reward their shareholders with dividends and stock buybacks. This is all happening at a time

when shippers all over our country are paying more than their fair share to transport their goods to their customers – paying more because they have no other alternative.

As I have said many times before, we need a rail system that works not just for the freight railroads, but for all – shippers, passengers, and consumers. Unfortunately, it has felt at times like the railroads – some much more than others – have attempted to delay this process, hoping that these reforms will die if they can only stretch the process out through the elections. I am proud that for the first time in 30 years, this Committee reported out a bill – in a bipartisan way – that would update our rail regulations to reflect the economic realities of 2010. This legislation may not be on the cover of all the newspapers in the country each and every day but its benefits for communities small and large throughout America cannot – and should not – be underestimated.

Along with my cosponsors, Senators Hutchison, Lautenberg, Thune, and Dorgan, we have engaged the stakeholders in a dialogue to address their concerns before bringing the bill to the Senate floor. I want everybody in this room to know that whether we do it this year or next year, railroad reform is going to happen. Either Congress will do it, or it will need to be done through regulation.

A EXECUTIVE SUMMARY

Thirty years ago, Congress made sweeping changes to the laws regulating freight railroads to give the industry the opportunity to improve its finances and its ability to compete against other transportation modes. The Staggers Rail Act of

1980 allowed freight railroads to get rid of unprofitable lines and to consolidate their operations. The law also allowed the railroads to charge lower rates to their customers who operated in a competitive environment, and higher rates to customers who were —captive to one railroad carrier for transportation service.

A review of the Class I railroads' recent financial results shows that the Staggers Act's goal of restoring financial stability to the U.S. rail system has been achieved. The restructuring of the industry that the Staggers Act set into motion thirty years ago has produced a so-called —rail renaissance. The four Class I railroads that today dominate the U.S. rail shipping market are achieving returns on revenue and operating ratios that rank them among the most profitable businesses in the U.S. economy.

After struggling with declining market share and rates in the years after the Staggers Act became law, the railroads have now regained their pricing power and begun increasing railroads' share of the freight transportation market. Unlike other transportation modes such as trucking, the railroads have been able to maintain their high profit margins even during the sustained economic downturn of 2008-10. Freight railroads have been assuring their investors the companies will take advantage of this —robust pricing environment and continue to push rate increases on their customers.

The companies' strong financial performance has attracted billions of new investment dollars, including the unprecedented \$34 billion dollar purchase of the BNSF railroad by Berkshire Hathaway, the operating company of the investor Warren Buffett. Buffett predicts that BNSF and the other large Class I railroads will show —steady and certain growth over the coming decades.

In spite of the obvious financial strength of the Class I railroads, their industry association, the Association of American Railroads (AAR), continues to tell Congress and the Surface Transportation Board (STB) that the freight rail industry is not yet financially stable and is not yet capable of meeting its capital needs without the differential pricing powers the Staggers Act gave the railroads in 1980. As the rail industry continues to operate profitably and to aggressively exercise its pricing power, these claims need to be more carefully scrutinized.

3 2013 COMMERCE COMMITTEE MAJORITY STAFF UPDATED REPORT

In November 2013, the Commerce Committee issued an update to the 2010 Committee Majority Staff Report that examined the financial state of the rail industry. The report concluded, similar to the 2010 report, that the financial performance of the dominant Class I freight rail companies was at its strongest point since the Passage of the Staggers Act in 1980.

In issuing the report, you noted that “The Staggers Act was designed to give a boost to the rail industry during a time when railroads were struggling – but today the railroads are enjoying tremendous financial success.” “At this point, the evidence is clear that the dominant freight railroads are financially strong.”

You further commented “It is not any secret that I think that – more than three decades after the Staggers Act – the Surface Transportation Board (STB) needs to take a close hard look at whether large freight rail companies now enjoy an unfair competitive advantage.” This report was released on the same

day that Debra Miller's nomination to the STB was considered before the Committee.

A BACKGROUND

Specifically, the Majority Staff Report provided updated information on the financial status of the freight rail industry to better assist policymakers on whether the current rail regulatory system is meeting an important goal of the Staggers Act – that is “to provide a regulatory process that balances the needs of carriers, shippers, and the public.”

In September 2010, the Senate Commerce Committee Majority Staff issued a report examining the financial performance of the dominant Class I rail companies, based on review of public filings and statements by these companies. This report found that these companies were generating significant profits for their owners, investing substantial capital in their networks, and competing successfully against other transportation modes.

The updated 2013 report the Committee issued was also based on public filings and statements of the dominant publicly traded Class I freight rail companies. Based on this review, the report found that in the past four years these companies have been achieving new financial performance milestones, reporting quarterly or all-time company records in operating ratios, operating income, and earnings per share.

The strong financial performance of the freight rail industry is particularly remarkable as this was accomplished in a time when much of the rest of the American economy was struggling to

recover from a deep recession, and overall rail volumes were below pre-recession levels.

B EXECUTIVE SUMMARY

In September 2010, Chairman Rockefeller issued a Senate Commerce Committee Majority Staff Report on the financial condition of the freight railroad industry. Relying on financial information that the dominant Class I freight railroads regularly report to their investors, the Staff Report concluded that the freight railroad industry had recovered from the serious financial problems that prompted Congress to pass the Staggers Rail Act of 1980. The report found that, three decades after the Staggers Act, the Class I freight railroads were financially sustainable and highly profitable companies.

Understanding the financial condition of the railroads is integral to assessing whether the current regulatory system effectively balances the interests of railroads, shippers, and consumers. Because railroads were struggling financially when the Staggers Act was enacted, the regulatory system that was built on that law places heavy focus on helping railroads earn higher revenues. For example, under the Staggers Act, shippers that do not have access to other transportation modes (“captive shippers”) subsidize the freight railroads’ revenues by paying transportation rates that far exceed the railroads’ costs. If the railroad industry is now proving to be financially viable for the near and long term, policymakers will need to consider whether regulatory changes are in order to make sure the industry does not enjoy unfair advantages.

Because the debate over freight railroad policy continues both in Congress and at the Surface Transportation Board (STB), Commerce Committee staff recently reviewed the railroad industry's latest financial reports to update the findings of the September 2010 Staff Report. These financial reports, as well as the public statements the companies' executives have recently made to their investors and Wall Street analysts, show that the financial performance of these companies is at its strongest since the passage of the Staggers Act. The positive financial trends identified in the 2010 Staff Report have continued in the most recent years, and the railroads appear confident they will continue for the foreseeable future.

Specifically, the 2013 Committee staff report found:

- In every reporting period since the last quarter of 2009, at least one of the three largest publicly traded Class I freight railroads set an all-time company quarterly record for operating ratio, operating income, or earnings per stockholder share (EPS);
- In the past four years, these companies broke records for operating ratios in 29 of the 48 quarters, with Union Pacific having a streak of 8 consecutive quarters in the most recent reporting periods. A decrease in operating ratio means a company is keeping more income after operating expenses are removed from revenue;
- In 30 of the past 48 quarters, the companies set new records for operating income – or the amount of income left over after subtracting a company's operating expenses from

its gross profit. It is a measure of the profitability of a company's basic business activities;

The railroads have also achieved record results in earnings per share (EPS) for stockholders, with Union Pacific breaking its EPS record in 15 of the last 16 quarters, and Norfolk Southern setting records for 6 straight quarters in 2011 and 2012;

- In the last few years the STB routinely has been finding these companies to be “revenue adequate” under an analysis that examines a company's return on investment in relation to the industry's cost of capital. This trend stands in stark contrast to the decades following enactment of the Staggers Act, where railroads in the vast majority of years were found not to be “revenue adequate;”
- The companies' publicly traded stock shares have performed significantly better in recent years than the Standard and Poors stock market index; and
- Increasing free cash flow of the companies in the past few years has enabled them to increase capital expenditures at the same time they boost dividend payments and stock buyback programs. For example, between 2006 and 2010, CSX increased its dividend per share payments by 445% and the cumulative value of its share buyback grew from \$500 million in 2006 to \$5.6 billion in 2010.

Background

1. U.S. FREIGHT RAIL NETWORK

Today, the U.S. freight rail network is considered to be one of the most dynamic and efficient freight systems in the world. However, this was not always the case.

Prior to enactment of the Staggers Act in 1980, railroads were experiencing traffic losses due to regulatory policies and procedures that were preventing them from adjusting their rates to reflect changing market and cost environments. This led to financial strain in the industry, ultimately resulting in the bankruptcy of many railroads by the late 1970s. In 1980, with the passage of the Staggers Act, railroads were given greater autonomy to set rail service rates.

Specifically, the Staggers Act permitted railroads to charge lower rates to customers who operate in a competitive environment and higher rates to customers who are “captive” to one railroad carrier for transportation service (i.e., demand-based differential pricing). The Staggers Act also lowered many regulatory barriers to help the railroads better rationalize their networks, such as decreasing the difficulty for railroads to abandon unprofitable lines.

Despite these extensive regulatory changes, the Staggers Act still envisioned a role for the Federal government to guarantee that captive shippers were not subject to unreasonable rates or poor service and invested the Interstate Commerce Commission (ICC), later to become the Surface Transportation Board (STB, or Board), with the authority to oversee the railroad industry.

Prior to the passage of Staggers, nearly 20 percent of the U.S. rail mileage was operated by bankrupt carriers. Since that time however, mergers and reorganizations have changed the rail industry significantly. Today, railroad mileage has been cut in half to approximately 140,000 miles, ownership of the Class I railroads have been consolidated from approximately 40 to 7 carriers, and rail traffic and productivity have risen significantly. These increases in traffic and productivity have helped create a strong pricing environment for rail carriers, particularly those with fluid networks and good service.

This pricing power has led to record profits and revenues for rail carriers, especially the Class I's, in recent years. In 2012, the seven Class I railroads of Burlington Northern Santa Fe (BNSF); Canadian National (CN); Canadian Pacific (CP); CSX; Kansas City Southern (KCS); Norfolk Southern (NS); and Union Pacific (UP) reported approximately \$68 billion in freight revenues.

1. SURFACE TRANSPORTATION BOARD

The STB is the agency charged with overseeing the economic regulation of the rail industry. It is a three-member, bipartisan, independent board administratively housed within the Department of Transportation (DOT). The STB was established by the ICC Termination Act of 1995 (ICCTA; P.L. 104–88). During the 15 years following passage of the Staggers Act, the ICC—which was responsible for administering the Staggers Act—was significantly downsized. The ICCTA continued the deregulatory theme of the preceding 15 years and repealed or eliminated certain authorities granted to the ICC, dissolved the ICC, and

assigned many of the ICC's remaining economic regulatory authorities to the Board.

The Board's responsibilities include jurisdiction over railroad rate and service issues and rail restructuring transactions (mergers, line sales, line construction, and line abandonments). In addition, the STB has jurisdiction over other, non-rail matters pertaining to certain trucking company, moving van, and non-contiguous ocean shipping company rate matters; certain intercity passenger bus company structure, financial, and operational matters; and rates and services of certain pipelines not regulated by the Federal Energy Regulatory Commission.

Additionally, the Board's responsibilities were expanded under the Passenger Rail Investment and Improvement Act of 2008 (PRIIA; P.L. 110-432) to include authority to investigate the causes of delays to passenger trains and to mediate disputes between commuter rail authorities and freight railroads regarding commuter rail use of freight railroad tracks and rights-of-way. The Clean Railroads Act of 2008 (P.L. 110-432) also clarified the Board's authority with regard to solid waste rail transfer facilities and the issuance of land-use exemption permits.

Through its annual budget requests, the Board has consistently sought additional staffing and funds to allow the Board to carry out the new statutory responsibilities as well as meet the increased demands of its rail economic regulatory responsibilities. In FY 2009, the Board employed 141 full-time equivalents at its headquarters office in Washington, D.C., to implement its responsibilities. From 2008 through 2010, more shippers filed rail rate disputes than in previous years and the STB's workload related to these disputes has increased.

Congress has not enacted comprehensive legislation to reauthorize the Board in the 12 years since the STB's authorization expired in 1998. However, as discussed above, the railroad industry has continued to experience changes that began following passage of the Staggers Act, and there is continued concern that the Board's authorities granted in ICCTA are not sufficient to keep pace with these changes. This bill is intended to make the Board's authorities consistent with the needs of the railroad industry today and to prepare it to better address the needs of the rail industry in the future.