

FALL 2013 UPDATE
RAIL TRENDS CONFERENCE
FRIDAY, NOVEMBER 22, 2013

Good morning. I'm Daniel Elliott, Chairman of the Surface Transportation Board. I'm very happy to be here this morning. This conference is a great opportunity for me to meet with stakeholders in an informal setting, to learn about new developments in the industry, and to speak about the important work of the Surface Transportation Board. I would like to thank Progressive Railroading for extending its invitation.

As you know, the Surface Transportation Board regulates America's freight railroad system. Our agency's mission is governed by the Rail Transportation Policy, a set of general principles established many years ago by Congress. In short, the Board is charged with striking a balance between shippers and railroads that fosters a vibrant and safe domestic railroad industry, while promoting efficient, competitive, and cost-effective transportation for rail customers. Railroads must be able to earn revenues that allow them to reinvest in their networks and to attract outside capital. At the same time, American companies and farmers must be able to ship their products by rail at affordable prices with responsive and reliable service. Moreover, Congress instructed the Board to minimize its administrative oversight so that the rail industry is moved primarily by market forces, rather than regulation. Because the principles of the Rail Transportation Policy are both complementary and conflicting, our task is seldom easy.

Much has changed since the current regulatory framework was put into place in the early and mid-1980s. We have witnessed the consolidation of the Class I railroad industry to the point where there are only five U.S.-based carriers. Networks are more efficient and safer, and, by and large, service is better. While there are far fewer Class I railroads, we have seen a renaissance in the shortline and regional railroad industry. Class II and III railroads represent a bastion of entrepreneurship, keeping competitive rail service alive for many communities and many shippers.

Over the last three decades, traffic patterns have also changed and continue to do so. Although coal remains the volume leader, intermodal traffic has quadrupled since 1980, with that market

segment now producing significant rail revenues on an industry-wide basis. Ethanol shipments by rail have increased significantly over the last decade, from approximately 40,000 carloads in 2000 to 325,000 carloads in 2010. Now, with the boom in domestic shale gas and oil drilling, our rail network is seeing significant growth related to this industry, including shipments of petroleum, frac sand, and other materials. Coal volumes, by contrast, have decreased from their historic highs only a few years ago, although the emerging coal export market could reverse this trend. Thirty, twenty, and even ten years ago, none of these changes were predicted, and they occurred rapidly.

In short, the rail industry of the 21st century is markedly different than the rail industry of the 1970s and 80s, and vastly different from earlier times. Railroads and their customers are developing increasingly sophisticated supply-chain networks to increase efficiency and lower the cost of moving goods. Although the Class I carriers continue to invest in the “bricks and mortar” side of their business, significant investment is being made in the expansion and construction of new intermodal terminals, and this traffic, driven by globalization, is emerging as the new backbone of the industry. Today, railroads are seeking to “partner with” rather than “compete against” major trucking companies. This is a dynamic and challenging time to be involved in the railroad industry.

Certainly, amidst all of these changes, competition in the rail industry remains a key issue for the Board’s shipper-stakeholders. Indeed, some shippers believe that within the last ten years, the Class I railroads have backed away from vigorous competition. These shippers have approached the Board—and also Congress—for dramatic changes in the regulatory framework. Railroads, on the other hand, have generally sought to preserve the status quo.

Historically, in the rail industry, competition has been viewed as a zero-sum game, pitting shippers against railroads. And, I think we still see that perspective today. In my view, however, the Board’s job is not to pick winners and losers. As a regulatory agency, we don’t want to be in that business, nor do we want to be perceived as such. Rather, the Board’s primary objective must be to implement regulatory policies that are fair to all stakeholders, promote efficiency

across the network, facilitate and reward innovation, and ultimately help to grow the Nation's economy and overall competitiveness.

A few moments ago, I referred to the rapid pace of change in the rail industry, particularly over the last decade. As most in this room know, the Federal government tends to run at a different pace. Change comes slowly, and is often years in the making. I am certain that some would like to see the Board act more quickly in various proceedings, particularly those with industry-wide significance. I want to reassure our stakeholders that the Board is working hard and moving forward on these matters.

However, issues such as competition and rate regulation are complex. And, significant policy changes can have far-reaching consequences. I think it's fair to say that while the current regulatory framework is not perfect, none of our stakeholders desires to return to the hyper-regulated environment that characterized the industry before 1980. As such, the Board must be cautious and deliberate in its approach. And, without going too far into legal jargon, the Board, like any other administrative agency, is bound by past policy and precedent. Charting a new path must be supported by the evidentiary record and defensible in court, or, in the alternative, mandated by new legislation enacted by Congress.

With that as background, I will tell you about some of the current matters before the Board:

As many of you know, the Board is currently examining competitive rail access in a proceeding referred to as "Ex Parte 7 - 11." This case is an outgrowth of our general examination of competition in the rail industry back in 2011.

In the wake of that investigation, in the summer of 2011, we received a petition from the National Industrial Transportation League asking us to adopt new competitive access rules. By "competitive access," a term of art, I mean the way a shipper served by only one railroad can obtain access to a second railroad through a regulatory process. NITL proposed a four-part test, setting standards that would allow a captive shipper to gain access to a competing carrier at an interchange point within a reasonable distance of the shipper.

After an initial review of NITL’s petition, we found that we could not make a ruling without a better understanding of the proposal’s repercussions across the industry—for both railroads and shippers. Therefore, we asked our stakeholders for information such as:

- which rail interchanges would be affected;
- how many shippers would qualify for relief;
- the effect on rates and service for shippers who would qualify for relief;
- the effect on rates and service for shippers who wouldn’t qualify;
- how the incumbent and competing railroads would be affected in terms of rates and operations;
- the overall effect on railroad traffic volumes, efficiency and revenues; and lastly,
- how we should price competitive-access, if it were to be granted.

Our stakeholders submitted detailed comments, and, last August, we announced a public hearing on October 23rd. Unfortunately, due to the government shutdown, we were forced to postpone the hearing, which will be rescheduled for the near future. In the meantime, the Board’s staff is reviewing the comments from our stakeholders.

Returning to a point I mentioned a few moments ago, it is our objective to ensure that regulatory policies support an efficient, reliable, innovative and competitive rail transportation network. NITL’s proposal clearly has potentially significant implications for the industry and, if adopted, it would alter our regulatory policy. As such, it is incumbent on the Board to gather and consider as much relevant information as possible before reaching a decision.

The second initiative arising from our examination of competition involved reforms to rate regulation. Many captive shippers reported that they don’t bring rate cases because of exorbitant litigation costs and the complexity of our Stand-Alone Cost (“SAC”) test for large rate cases. We were also reminded that our simplified rate case rules have been underutilized, despite past

efforts to remove obstacles. Both issues were cause for concern. Our power to regulate rail rates can be effective only if our procedures are truly accessible to shippers.

Accordingly, in July 2012, the Board proposed several reforms to make rate cases less daunting. In July of this year, we adopted those rules after public notice and comment. I'll give you a quick overview of the key changes.

To promote our simplified-SAC procedures as a feasible alternative to a traditional SAC case, we removed the \$5 million cap on damages. With no limit on relief for simplified-SAC cases, we're optimistic that more shippers will use these streamlined rules to seek relief from unreasonable rates.

Similarly, we increased the relief available under the Three-Benchmark test—our other simplified rate case framework—from \$1 million to \$4 million. Having now processed a number of these cases, the Board believes that the \$1 million ceiling was not in line with the costs of litigating a case.

In addition to the changes in the relief caps, the Board made certain technical changes to the traditional SAC test. In particular, we modified the manner in which the revenue from crossover traffic is allocated between the hypothetical, stand-alone railroad and real-world railroad. Despite this change, we remain concerned about parties “gaming” the results of the SAC test, using crossover traffic. Going forward, we'll monitor this issue to determine if additional changes are necessary.

In the same decision adopting these reforms, we announced that we would start a new proceeding to look at whether grain shippers have meaningful access to rate relief. We know that many grain shippers are captive. But, despite our efforts to simplify our rate case procedures, we have not received a formal rate complaint from a grain shipper in over 30 years. In this new initiative, we will seek input on the ability of grain shippers to effectively seek relief for unreasonable rates.

On this point, I should mention that we have an active proceeding, initiated by the State of South Dakota, challenging Canadian Pacific on its adherence to representations made during its acquisition of the Dakota, Minnesota & Eastern Railroad. Many grain shippers and shipper associations have submitted filings, and we know that there are significant issues at stake.

I want to briefly mention the final rules that we adopted in September, which augment the disclosure requirements for interchange commitments commonly known as “paper barriers.” The newly-adopted rules require the proponent to provide more information about the interchange commitment and to notify affected shippers. The goal is greater transparency so that both the Board and interested parties can better evaluate competitive issues potentially arising from a proposed transaction.

On the technical side, we’ve proposed changes to our rail costing methodology, the Uniform Rail Costing System—known as “URCS”—so that it better reflects railroads’ economies of scale in handling larger shipments. This is important because we use URCS in determining our jurisdiction over a rate that has been challenged in a rate case. We also intend to examine whether a Department of Energy fuel index can continue to be used by railroads as a basis for their fuel surcharges.

That covers the highly significant proceedings on the freight side of our regulatory oversight. However, I would be remiss if I did not mention our activities on the passenger side.

In June, we authorized the California High-Speed Rail Authority to construct a 65-mile, high-speed passenger rail line between Merced and Fresno, California, which will be the first section of the planned statewide California High-Speed Train System. The Board’s authorization is subject to environmental conditions and the condition that the High-Speed Authority build the route designated as environmentally preferable by the Federal Railroad Administration.

In this case, I think the initial question from a lot of folks was: “Why is the Board involved with a California high-speed passenger rail plan at all?” It’s a fair question.

Under the law, the Board has jurisdiction over transportation by a rail carrier between a place in a state and a place in the same state, if the transportation is nevertheless “part of the interstate rail network.” In this case, we concluded that California’s proposed high speed system would be part of the interstate rail network, in light of its plans for extensive interconnectivity with Amtrak.

So, in fact, we do have a role to play. And, the California High-Speed Rail Authority recently filed a petition for exemption to construct a second section of its line, from Fresno to Bakersfield, California.

In addition to talking about our formal proceedings, I want to take this opportunity to talk about the Board’s Alternative Dispute Resolution processes. As many of you know, during my tenure, I’ve worked hard not only to develop an effective program for alternative dispute resolution but also to promote its use by our stakeholders. This is part of my effort to move away from the “shipper versus railroad” mindset that I referred to earlier, and to promote practical and creative solutions that are “win-win,” rather than “win-lose.” I think that a skilled arbitrator or mediator can often lead parties to mutually beneficial outcomes that are far less likely once the parties become locked into adversarial litigation.

First of all, our Rail Customer and Public Assistance Program—which we refer to as “RCPA”—continues to be a valuable resource for our stakeholders by helping to broker informal settlements. Staffed by industry analysts and attorneys with a wide-ranging experience, RCPA has had great success in fixing problems before they snowball into formal complaint proceedings. Quite often, they do this just by getting the parties on the phone and talking together to address basic, underlying issues.

RCPA also fields stakeholder questions about STB procedures and regulations. If you need informal guidance or advice, please reach out to RCPA and make use of their expertise.

Additionally, I'm happy to announce that, this past summer, the Board adopted final mediation and arbitration rules creating an arbitration program under which shippers and railroads may agree in advance to voluntarily arbitrate certain types of disputes.

Arbitration will be voluntary, but binding. Stakeholders can agree in advance to arbitrate certain types of disputes, subject to a \$200,000 cap on damage awards. Parties can opt into the program at any time. Parties can also arbitrate on a case-by-case basis without opting into the overall program. Parties can also opt out, but they can't quit in the middle of an ongoing proceeding.

For mediation, we also made similar changes. The new rules establish procedures under which the Board may order parties to mediate certain types of disputes, on a case-specific basis, even if both parties haven't agreed to mediation. The Board will be able to order mediation, or grant a mutual request for mediation, at any time in an eligible proceeding.

These new rules reflect our preference for alternative dispute resolution instead of formal proceedings, wherever possible. We've even launched a new "Litigation Alternatives" webpage on the Board's website for information on our activities in this area.

Turning to legislative developments, there is not much to report, at least for the near term. I'm sure that you are well-aware of the challenge in passing major legislation in the current political climate, and, of course, the government shutdown. In the aftermath, Congress will be preoccupied with passing a budget and renewing the debt ceiling to avert another crisis. In the meantime, our staff continues to liaise with the Hill to provide our perspective on legislative proposals, and to brief representatives and their staff on issues related to our work and the larger railroad industry. We all share a common interest in preserving a national railroad system that serves our economy efficiently and expeditiously.

As I'm sure you have heard, the President nominated Debra Miller to succeed Frank Mulvey as the Board's Commissioner. Ms. Miller would bring a wealth of transportation experience to the Board, having served as the first woman to head the Kansas Department of Transportation in 2003 and the longest-serving Secretary of the Kansas Department of Transportation. Her

nomination is moving forward in the confirmation process and she had her hearing yesterday, November 21, before the Senate Commerce Committee.

On the institutional side, our budgets are becoming even tighter, and we are trying to do more with less. We were very fortunate to avoid furloughs, except, of course, during the shutdown. Despite these challenges, we've managed to retain much of our talented workforce, and to recruit effectively from the private sector. It helps that we've been named the Best Place to Work among small government agencies for the past four years.

In closing, I want to thank you for this opportunity to speak about the Board and its work. I would be happy to answer questions, and please feel free to approach me, after this session.

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