

2016 UPDATE

**J.P. MORGAN AVIATION, TRANSPORTATION &
INDUSTRIALS CONFERENCE**

**New York City
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Good afternoon. I'm Dan Elliott, Chairman of the Surface Transportation Board. I'm happy to be here today.

I'd like to give you a brief update on what's going on at the Surface Transportation Board.

One thing you have heard about is all the discussion of potential railroad mergers. By statute, railroad mergers and acquisitions may only take place if they receive the Board's approval. Based on that authority, any merger that is proposed will be subject to rigorous administrative review before the Board, under rules the agency adopted in 2001.

When it adopted the merger regulations, the Board explained that these rules substantially increase the burden on applicants to demonstrate that a proposed transaction would be in the public interest.

The Board concluded that mergers serve the public interest only when substantial and demonstrable gains in important public benefits—such as improved service and safety, enhanced competition, and greater economic efficiency—outweigh any anticompetitive effects, potential service disruptions, or other merger-related harms.

The merger rules implement these policies by requiring applicants to satisfy a variety of prerequisites. Among many other requirements, if the transaction involves two or more Class I railroads, the applicants must:

- Demonstrate the public benefits they assert the proposed transaction would generate, such as improved service and greater economic efficiency;

- Propose additional measures the Board might take if the promised public benefits fail to arrive in a timely manner;
- Propose remedies to mitigate and offset competitive harms, including harm to competition in product and geographic markets caused by end-to-end mergers, and other risks that the merged carrier would acquire and exploit increased market power;
- Explain how the transaction and proposed conditions would enhance competition, to offset harms that would not otherwise be mitigated; and
- File a Service Assurance Plan identifying the precise steps the applicants would take to ensure adequate service and to provide for improved service. The plan has to include specified information on how shippers, connecting railroads (including Class II and III carriers), and ports across the new system would be affected and benefited by the proposed consolidation. As part of the plan, applicants

must submit service benchmarks and contingency plans for unexpected service disruptions, among other information.

Applicants also have to address whether additional Class I mergers are likely to be proposed in response to their own proposal and explain how these mergers could affect the eventual structure of the industry and the public interest, if they were approved. The regulations further require applicants to discuss whether any conditions imposed on an approval of their proposed merger would have to be altered, or any new conditions imposed, if the Board approves additional future rail mergers.

In addition, the 2001 rules changed the process for the use of voting trusts while applications are pending before the Board. Previously, Board staff issued informal, non-binding opinion letters as to whether a voting trust would result in unauthorized control. But the 2001 rules instituted a formal process for voting trusts: now, applicants who want to use a voting trust for a major transaction have to demonstrate in a public filing that their

planned use of a trust would not result in unlawful control and would be consistent with the public interest. The Board's regulations call for a brief period of public comment, replies by the applicants, and a decision from the Board determining whether applicants may establish and use the trust. This process has to be completed before applicants can start using a voting trust for a major transaction.

Those are some highlights of the Board's rules, but the regulations themselves contain much more detailed requirements. All of these requirements would have to be met for the Board to approve a Class I railroad merger or acquisition.

I'd also like to note that the Board has been posting letters we've received regarding a potential merger of Canadian Pacific and Norfolk Southern. There's a link to those letters in the quick links column on the front page of the Board's website, labeled Merger Correspondence.

Although the Board has not received an application for approval of a potential merger of CP and NS, we did recently receive a

petition for declaratory order related to voting trust issues. That's now pending before the Board, so I can't address it except to say that it will receive careful consideration.

Another significant topic for the Board these days is the STB Reauthorization Act of 2015, which was enacted on December 18, 2015. Before the Reauthorization Act, the Board was administratively aligned with the U.S. Department of Transportation—which meant we received a variety of administrative support from DOT, provided in light of the Board's very small size as an agency. However, we've been decisionally independent ever since the Board was created. The Reauthorization Act separated the Board from DOT entirely, making the Board a wholly independent agency.

Among other changes, the Reauthorization Act also:

- Increases the Board's membership from three to five Board Members;

- Directs the Board to adjust its existing voluntary arbitration process, including increases in the maximum damage awards;
- Shortens the timelines that apply to large rate case proceedings, including limits on the time allowed for discovery and the time allowed for development of the evidentiary record; and
- Gives the Board authority to initiate investigations.

As with our existing authorities, the Board's ability to effectively exercise the new authorities provided by the Reauthorization Act will depend in part on the resources available to us and the funding we receive from Congress.

The Reauthorization Act provides for two additional Board Members, as I mentioned. As with any Board Member, they will have to be appointed by the President of the United States and confirmed by the Senate. I know from my own re-nomination process that it can take a while and that it's not

always predictable. But the agency looks forward to welcoming the new Members whenever they arrive.

At the Board, fulfillment of all requirements of the Reauthorization Act is well underway. The Act gives us enhanced authorities, and this first year after reauthorization will be one of implementation. We are making great progress in all of the major actions that the Board is undertaking to execute these enhanced responsibilities. In weeks and months ahead, you will see changes to our arbitration program and progress towards establishing rules for our new investigatory authority. Today, the Board issued rules adjusting the procedural timelines for large rate cases to implement the timing required in the Act. We are also considering ideas on how to further change our stand-alone cost rate process to meet this timeline, and today we announced that we would have informal meetings with practitioners, consultants, and other stakeholders to get their input on this subject.

Rail industry stakeholders have waited 20 years for the Board to be reauthorized, and there is no doubt that freight rail

transportation will benefit from the thoughtful provisions of this law. Behind this reauthorization is a message of transparency and increased efficiency. That is what I will deliver to the public.

I'd also like to highlight some of my goals for my second term. One focus for me is improving accessibility of the Board's processes for all stakeholders. The obvious place to start is the Board's rate reasonableness case procedures. The rate case process is increasingly complicated, time consuming, and expensive – a view that I know is shared by many of the agency's stakeholders. During my first term, the Board initiated several reforms, including the adoption of rules that (1) clarified certain revenue allocation issues in large rate cases, (2) raised the award caps for smaller rate cases, and (3) changed the interest rate for damage awards. And, I thought it was important to reduce the fees the Board charges for non-rate related complaints, which the Board did in 2011, lowering fees from \$20,600 to \$350.

I've also worked to turn the Board into more of a problem solver and not just an adjudicator. I grew the Board's alternative dispute resolution program, fostering the agency's use of mediation and broadening our arbitration rules. I bolstered the Rail Customer and Public Assistance program, which informally assists many smaller shippers that may not be in a position to bring a formal case at the Board. Staffed by industry analysts and attorneys, the office has resolved hundreds of transportation matters since the beginning of my term, and is cited by rail shippers and rail carriers alike as a tremendous success at the agency.

But, there is more to do to make sure that all of our stakeholders have a meaningful path to the Board. During my first term, the agency initiated an examination of whether agricultural shippers have meaningful access to the Board's rate reasonableness process, as well as a proceeding regarding the Board's reciprocal switching rules and proceedings related to railroad revenue adequacy and related issues. My goal is to improve access to the Board and complete these proceedings within a year. I'm

working hard to build a consensus of the Board so that my timelines can be met.

For background, here's a quick rundown of the rulemaking process at the Board. The Board can start a rulemaking itself, or someone can submit a petition asking for a rulemaking. The Board can start the proceeding by issuing a notice of proposed rulemaking, which usually proposes specific rules, or an advance notice of proposed rulemaking, which typically raises a more general issue for discussion rather than proposing a particular regulatory action. Either way, the notice is published in the Federal Register, and it usually includes deadlines for public comments. Comments are filed, and in some cases the Board decides to hold a hearing. Once the record is complete, the Board deliberates, and if there are enough votes, it issues a decision. That decision could be, for example, a final rule, a request for comments on a new or modified proposal, or termination of the proceeding.

During my first term, I also engaged an independent firm to evaluate potential alternative rate regulation approaches, with

the goal of reducing the time, cost, and complexity of rate cases. The engagement continues, and I look forward to hearing their conclusions. This is the time to consider new ideas, so that the Board has an effective regulatory process that makes sense today.

And I note that in June 2015, the Transportation Research Board of the National Academy of Sciences, or TRB, released a report with recommendations to Congress regarding improvements in the economic regulation of freight rail. TRB presents many thought-provoking ideas with respect to the future of freight rail economic regulation, and I'm excited to see what changes may develop from their recommendations. At the Board, we are looking into how we might be able to take some of these ideas into account as we consider our own regulatory improvements.

At the same time, internally, I'm working on best practices and improving the Board's case management – not just for rate cases but for all cases. As an agency, we must always look for ways to be more efficient. It is simply good government to innovate and improve.

Specifically, last year, I started a process to examine best practices for the Board to use in adjudicating cases, starting with our most complex cases – rate reasonableness cases. As part of this process, I brought in experts to aid us in taking a close look at the Board’s rate case procedures and to recommend things we can do to improve them. It’s great to see the initiative I put in place last year start to bear fruit, and I have every reason to believe this will lead to positive changes in the way the Board manages case workflow.

These efforts are ongoing, and we have arrived at a number of steps we can take to help cases run more smoothly. I’m not talking about whether to use SAC or another methodology. Rather, I’m talking about issues related to how our own employee teams coordinate with one another within a complex process. It takes a lot of people and hours to get big decisions out of the door, and I want to make sure that we use our resources efficiently. We already have put into place several process improvements. For example: (1) we are making greater use of technical conferences with parties early so we can

discuss evidentiary issues that come up in specific cases; (2) we are issuing evidentiary instructions following the technical conference so that we communicate clearly the Board's expectations with regard to evidence; (3) we are making internal management structure changes for rate cases; (4) we are improving coordination of staff working on a case; and, (5) we are setting additional milestone markers within our internal workflow.

The improvements that we developed and are implementing for the rate case process will flow to other types of cases. These are long-term steps, some of which will depend on our agency budget going forward. The benefits of these process improvements should begin to take effect as the Board continues to adjudicate rate cases.

A third area of focus for me is making sure the Board gets the data it needs to properly monitor rail service. During the severe disruptions in service that affected the railroad industry from late 2013 through 2014, the Board began collection of railroad service data on a temporary basis. That effort was well-

received, and stakeholders have expressed to me that the data collection has been extremely helpful to them as well.

Currently, the Board is considering a proposed rule to establish a permanent collection of service data. As part of that effort, I introduced the idea of waiving the Board's ex parte rules for this rulemaking proceeding to allow informal meetings between stakeholders and the Board's technical staff. The Board issued a decision putting this idea into effect in November, and the meetings concluded in December. We included measures to ensure public notice, fairness, and transparency, such as publishing meeting summaries on the Board's website. These informal meetings allowed open and candid conversations between STB staff and stakeholders regarding the highly technical data questions at issue in this proceeding. I believe that dialogue between stakeholders and STB technical staff was especially valuable and efficient in these informal circumstances, without the formality of appearing before the Board Members. The meetings were a success, and I look forward to moving ahead with this important proceeding to establish permanent data reporting.

We also continue to communicate regularly with the Class I railroads and shipper groups, making sure we're ready to assist in any way we can. We know how important it is to the Board's stakeholders to have access to this data for their own logistics and planning decisions. It is equally important for the Board to have the tools it needs for monitoring, staying on top of industry developments, and looking ahead.

At the STB, here's what we're seeing in terms of how rail transportation is working these days. Overall, the networks are experiencing improved fluidity and more reliable and timely service, compared with the late 2013-2014 period. We are not hearing about supply-chain disruptions affecting large numbers of shippers. Many factors have contributed to these positive developments, including capacity expansion projects that are paying dividends. At the same time, we've seen softer demand for other commodities, in particular coal, which is down significantly, and this has freed up railroad resources. We will continue our careful monitoring of rail performance.

In closing, I want to thank you for this opportunity to speak about the Board and its work. The Board will continue to conduct public outreach and hold hearings on significant matters and rulemaking proceedings, so that the Board and its staff can hear directly from our stakeholders. I would be happy to answer questions.

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