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BEFORE THE

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HEARING
ON
RAIL COMPETITION AND SERVICE

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Testimony of Charles D. Nottingham
Chairman of the Surface Transportation Board Before the
House Committee on Transportation and Infrastructure
Hearing on Rail Competition and Service

Good morning Chairman Oberstar, Ranking Member Mica, and Members of the Committee. My name is Charles Nottingham, and I am Chairman of the Surface Transportation Board (Board or STB). I appreciate the opportunity to appear before this Committee today to address rail competition and service. The Committee invited me to testify on the financial condition of the railroad industry, the relationship between railroads and shippers, rail competition, concerns with rail service, the role of the STB in resolving disputes between railroads and shippers, and recommendations for improving rail competition and service.

This is my first appearance before this Committee since I became Chairman of the STB in August 2006. It has been an extraordinary year for me personally, and an unusually busy year for the Board. In addition to handling its normal workload of formal actions, the Board has taken numerous steps this year to proactively monitor the rail industry and reform the Board's existing regulations to modernize and improve how we regulate the railroads.

Before elaborating on these efforts in this written testimony, I will first provide an overview of the Board and its responsibilities. I will then address the issues identified by the Committee.

Overview Of The STB

The STB is charged by statute with resolving railroad rate and service disputes and reviewing railroad restructuring transactions (mergers, line sales, line constructions, and line abandonments). In addition, the Board has limited jurisdiction over certain trucking, bus, household goods, ocean carrier, and pipeline matters.

It is important to note that the substantial deregulation effected in the Staggers Rail Act of 1980 was carried forward by the ICC Termination Act of 1995 (ICCTA), which retains the directive that the Board issue administrative "exemptions" that suspend active regulation in areas where the market is competitive. The Board's governing statute, like virtually all other modern statutes of economic regulatory agencies, assumes that aggressive regulation is not necessary where there is competition, because in such circumstances competition will discipline businesses and prevent market abuse. Our statute, at 49 U.S.C. 10101, establishes a Federal policy "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail," and to "minimize the need for Federal regulatory control over the rail transportation system," but "to maintain reasonable rates where there is an absence of effective competition." It also permits the Board to intervene with respect to railroad rates only "[i]f the Board determines . . . that a rail carrier has market dominance over the transportation to which [the] rate applies." 49 U.S.C. 10701(d)(1).

Under the law, a carrier is considered not to have market dominance where its rates produce revenues that are less than 180% of its "variable costs" of providing the service. (Variable costs are the portion of a carrier's costs that change with the amount of traffic handled, unlike the fixed portion of its costs.) Also, if there are competitive alternatives

for moving the traffic between the same points – that is, competition either from other railroads (intramodal competition) or from other modes of transportation such as trucks, pipelines, or barges (intermodal competition) – then the Board does not have authority to regulate the rate, even if the revenues exceed 180% of the variable costs of providing the service. Finally, the Board has limited jurisdiction over rail transportation contracts between shippers and carriers.

Financial Condition of The Nation's Rail System

General Observations. When Congress passed the Staggers Act in 1980, the Nation's rail system was in desperate financial straits. It was burdened with unproductive assets, forced to provide unprofitable services, and hampered by excessive government regulation. Recognizing that a sound, healthy rail transportation system is essential to the Nation's economy, Congress put in place reforms directing that railroads be treated, in most respects, more like other businesses. Since that time, the railroad industry's financial condition has steadily improved. Today the industry is considered by most independent analysts to be relatively healthy.

Unlike most businesses, however, railroads are common carriers. As common carriers, they have an obligation to provide service to the general public on reasonable request. In order to ensure that shippers receive the needed level of service, the railroads' financial resources must be sufficient to maintain a sound and sufficient infrastructure. At the same time, transportation of commodities vital to the Nation's economic wellbeing must be efficient and reasonably priced.

Capacity Constraints. I would like to address how the rail system has changed over the past several years, which is relevant to my later discussion of both rates and service. In

1980, the rail system was faced with excess capacity, which made it difficult for railroads to provide service efficiently and on a financially sustainable basis. The Staggers Act made it easier to shed excess capacity and become more efficient in other ways, and the system has now been largely rationalized and made more productive.

In recent years, however, the U.S. economy has expanded, and the rail network, like other transportation sectors, has become capacity-constrained. Unlike some other transportation sectors, however – trucking companies, for example, which can buy new equipment or hire more drivers – railroads cannot respond as readily to capacity constraints by quickly building new track and other facilities. Not only are rail construction projects expensive and time-consuming, but these projects can generate significant opposition on environmental and community-impact grounds.

On April 11, 2007, the Board held a public hearing focused on rail capacity, traffic forecasts, and infrastructure requirements. Because the Nation's freight rail system will be relied upon to handle significant increases in traffic in the years ahead, the Board wanted to get a better understanding of whether current and planned or forecasted investments will be adequate to meet rail capacity demands, and, if not, what new policies and strategies need to be pursued. That hearing, which lasted 12 hours, brought together representatives of large railroads; short-line railroads; Federal, state, regional, and local government interests; many different shipper interests; rail passenger carrier interests; and rail labor. The hearing documented widespread consensus among stakeholders that rail capacity will become increasingly constrained by traffic growth. A representative of one of the Nation's ports testified that container traffic typically carried by truck or rail entering North American ports from overseas will grow by more than 100% by the year 2020, from over 48 million

Twenty Foot Equivalent Units (TEUs) in 2005 to an anticipated 130 million TEUs. Furthermore, representatives of the large railroads that make up the Class I railroad industry testified that – despite their plans to increase investment levels in the system every year – their anticipated capacity investments will not keep up with forecasted increases in rail service demands. In sum, the rail system's capacity shortfall that we see in many markets today will dramatically worsen unless bold new policies and strategies are adopted.

Cost of Capital. In a matter related to the railroads' financial condition and the soundness of their systems, I should point out that the Board is now working on a very important rulemaking that would change how the railroad industry's cost of capital is measured. The Board is required by statute to make an annual assessment of the railroad industry's cost of capital. The cost of capital figure is used to evaluate the adequacy of individual railroads' revenues, and it is also an input in the Board's review of rail rate challenges and rail line abandonment proposals.

A railroad's cost of capital reflects the carrier's cost to raise capital both through debt and through equity arrangements. While the cost of debt is easy to determine, the cost of equity is far more difficult. Indeed, how best to calculate the cost of equity is the subject of a vast literature that sprawls over the fields of finance, economics, and regulation. Since 1981, the Board has been using the same basic approach to estimate the cost of equity, but concerns were raised recently that the approach was outdated and may be overstating the industry's cost of capital and thus the revenue needs of the industry.[1]

[1] The cost of equity for 2005 using the current methodology was calculated to be 15.2%, compared to 8.4% using the proposed methodology; similar disparities are reflected in prior years' calculations (e.g., 2003: 12.7% vs. 8.0%; 2004: 13.2% vs. 8.2%).

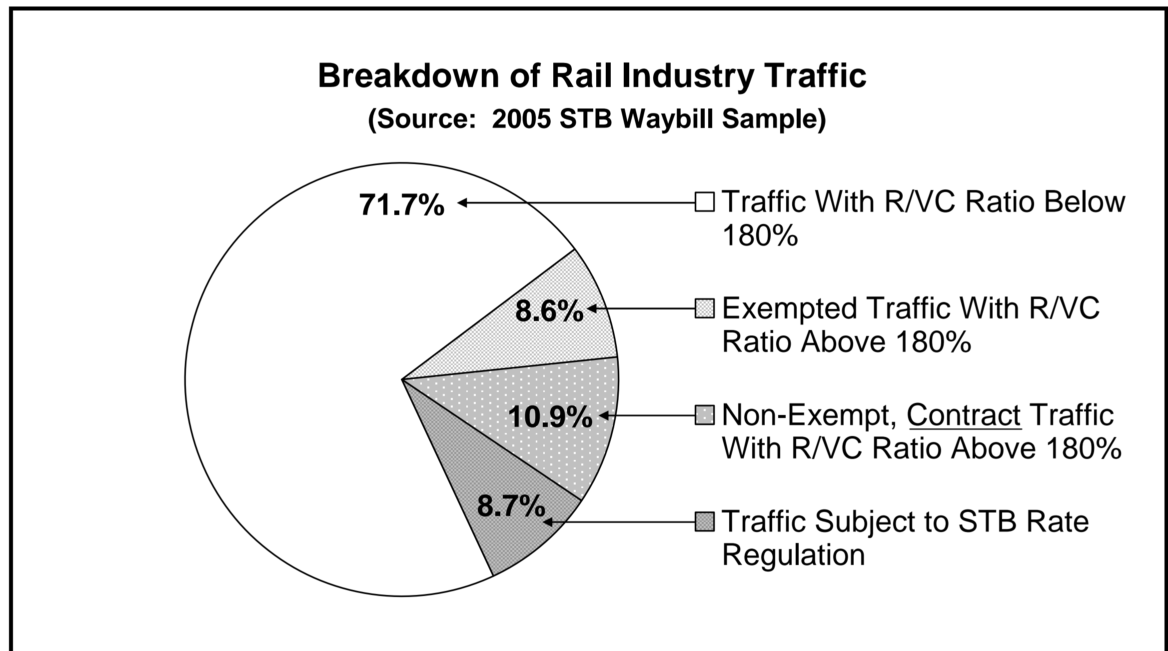
Given the importance of this cost-of-capital figure in many of our regulatory procedures, we launched a rulemaking to improve our methodology and to ensure the accuracy of this important measurement. The comment period should be completed at the end of October, and we will carefully consider all comments before issuing a final rule.

Investor Interest. Recently, there has been extraordinary interest in railroads by hedge funds and other large U.S. and international investors who have not traditionally invested heavily in railroads. This new interest in the rail industry carries with it the prospect of a takeover of a railroad by a non-railroad entity. The STB has received numerous inquiries about how we would respond to such a transaction in view of the fact that the merger and acquisition provisions of the statute address the Board's role only where two or more railroads are involved. The extent of the Board's jurisdiction over an acquisition of a single railroad by a noncarrier is unclear.

Competition

As I have noted, the statute provides that, where shippers have practical competitive choices, or where rates are set at less than 180% of variable costs, regulatory scrutiny and protection is not needed. In the year 2005 (the most recent year for which adequate data are available), over 71% of the traffic that the railroads carried moved at rates less than 180% of variable costs and thus was deemed by statute to have been competitive. Of the remaining 29% of rail traffic that moved at revenue-to-variable-cost ratios above 180% that year, some was traffic that has been exempted from regulation, pursuant to 49 U.S.C. 10502, based on findings that the particular commodities and

services involved have competitive transportation alternatives available,[2] and some was traffic that moved under contract and was therefore outside the Board's jurisdiction.[3] Accordingly, as the following pie chart illustrates, the vast majority of traffic is presumed to benefit from a competitive market (about 91%, based on 2005 data).



Significant concerns are brought to Congress, and the Board, by shippers who either do not benefit from competitive transportation or do not have contracts with their rail carriers. But as we consider policy options to address their concerns, it is important to assess the costs and benefits of those options as they impact all shippers – both the more than 90% of shippers that benefit from competition, and the less than 10% that may not.

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[2] These exemptions cover 29 different commodity groups, including transportation equipment, wood products, pulp and paper products, metal products and food products. In addition, any products moving in intermodal equipment or boxcars are also exempted.

[3] Beginning with the Staggers Act, Congress enacted legislation to ensure that railroads and shippers were free to enter into contracts for rail transportation. Congress generally removed transportation contracts from the agency's jurisdiction. 49 U.S.C. 10709.

The Government Accountability Office (GAO) prepared a report in 2006,[4] and a supplement in 2007,[5] addressing railroad rates. The 2006 Report analyzed general trends in the industry and also highlighted particular markets. The 2007 Supplement updated some of the information in the 2006 Report.

As GAO documented in the 2007 Supplement, between 1985 and 2005, rates did not keep pace with inflation for each of the four major categories of rail traffic separately tracked by GAO (coal, grain, motor vehicles, and miscellaneous mixed shipments). Moreover, GAO found that despite an uptick in recent years, rail rates overall for 2005 remained below 1985 levels even in nominal terms. At the same time, the Board's index for tracking changes in railroad costs (the Railroad Cost Adjustment Factor) shows that the costs that the railroads themselves had to pay for the goods and services that they use in their business increased by 80% from 1985 to 2005. Thus, the fact that rates overall remained at or below 1985 levels even with these recent cost increases demonstrates that, in general, rail rates have been held down for most shippers.

The 2006 GAO Report focused to some extent on concerns over higher rate levels in parts of the agriculture sector. Last November, the Board held a public hearing to obtain information from interested parties about the grain transportation market in general, and in particular about the market conditions in the grain industry that may have caused grain rates to diverge from the long-term general trend of reduced rail rates for most shippers. Because U.S. and Canadian grain producers compete, both with each other and in a global

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[4] The report is entitled *Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed*.

[5] The supplement is entitled *Freight Railroads: Updated Information on Rates and Other Industry Trends*.

marketplace, the agency also wanted to hear about the interplay between the American and Canadian wheat markets, how the Canadian regulatory system differs from the American system, and what impact those differences might have on grain production in the United States. I am pleased to see that you are hearing today directly from the U.S. Department of Agriculture and representatives of the agricultural sector on these issues.

There are of course areas – states like North Dakota and Montana – in which rail rates tend to be higher than average, as the 2006 GAO Report points out.[6] That is largely because of the economics of the railroad industry: under principles of "differential pricing," railroads, with high "sunk" costs and with fierce competition for most traffic, are expected to charge more, even substantially more, from their captive traffic than from their competitive traffic if they are to achieve enough revenues to cover their costs and invest in necessary facilities. Although differential pricing is practiced in many other industries – such as airlines, utilities, hotels, and movie theaters – we understand that shippers on the captive end of this differential pricing scale would not be satisfied with the status quo. But if differential pricing is to be substantially tempered in the industry, then revenues will have to come from some source other than captive shippers. And if other sources of revenue cannot be found, then infrastructure investment will suffer, as will rail service. Indeed, Congress has recognized that all shippers – even captive shippers – benefit when railroads are permitted to engage in differential pricing. As the House of Representatives explained in 1980 (H.R. Rep. No. 1035, 96th Cong., 2d Sess. 39-40):

> In the absence of the regulatory flexibility which permits differential pricing, all shippers would be harmed. If traffic which moved at low rates were forced to pay higher rates, the traffic would disappear to other modes.

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[6] For some areas, rates can be higher because traffic is seasonal and there is little volume during off-peak times.

> When the traffic moved to another mode, the contribution to fixed cost made by that traffic would also disappear. The result is that the remaining commodities would have to make up for the fixed cost formerly paid by the traffic which moved to another mode, resulting in higher rates for the remaining traffic.

To further address GAO's observations about areas with less competition, the Board recently commissioned an extensive study on the extent of competition in the railroad industry. The study will also assess various policy issues, including current and near-future capacity constraints in the industry; how competition and regulation impact capacity investment; how capacity constraints impact competition; and how competition, capacity constraints, and other factors affect the quality of service provided by railroads. The economic consulting firm Christensen Associates, based in Madison, Wisconsin, has signed a contract valued at approximately $1 million to deliver this study to the STB for publication in the Fall of 2008.

The Board also continually seeks to protect and promote rail competition. Its current major merger rules require an applicant to demonstrate that the transaction would enhance competition where necessary to offset negative effects of the merger, such as competitive harm or service disruptions; its earlier merger decisions protected competition by ensuring that no shippers became captive to a single carrier as a result of a merger; its approval of the "Conrail Transaction" resulted in the availability of two-carrier service for several areas that had previously been served by a single carrier; and in decisions in a variety of individual cases, the Board has prevented larger carriers from interfering with the ability of smaller carriers to meet their obligation to provide service.

The Board has also facilitated new competition with its many decisions authorizing construction of new lines. One example of how the Board worked diligently to enhance

competition is reflected in the agency's decisions authorizing the construction by the Dakota, Minnesota and Eastern Railroad (DM&E) of a line into the Powder River Basin in Wyoming designed to provide enhanced rail transportation options for coal shippers, particularly in the Midwest. In that case, the Board, after an extensive environmental review, a few years ago approved the construction of the new line. The United States Court of Appeals for the Eighth Circuit found on judicial review that, while the Board had done "a highly commendable and professional job," the agency needed to further consider four specific environmental issues. The Board issued a second decision addressing those issues, and about 9 months ago that decision was upheld by the court after again being challenged by environmental and local groups opposed to the proposed project.

One issue that is now pending before the Board involves interchange commitments that may be part of sale or lease contracts when large carriers sell or lease lighter-density portions of their lines to smaller carriers (referred to by some as the "paper barrier" issue). Some parties take the view that these arrangements have helped facilitate the growth of the short-line industry into a vibrant force in the transportation sector – with well over 500 carriers today operating nearly 46,500 miles of track with nearly 20,000 employees – while others are concerned that they have tended to freeze in place the competitive status quo, rather than allowing the development of new competitive options not available before the transaction. A Board decision addressing a request for a general rule regarding such contractual interchange commitments is imminent.

Rate Regulation

As is the case with other industries, when capacity is tight, carriers will seek to raise their rates. As a result of differential pricing, those shippers without competitive

options often see their rates rise the most. Thus, with tight capacity throughout the industry today, the Board's rate processes are particularly important, and I will now turn to that matter.

Rate Disputes. Under the statute, the Board is directed to ensure that rates are reasonable while at the same time not precluding railroads from obtaining adequate revenues. Balancing these potentially conflicting objectives is not an easy task. Rates that are too high can harm rail-dependent businesses, while rates that are held down too low will deprive railroads of the revenues needed to pay for the infrastructure investments that are in turn needed to give shippers the level and quality of service that they require. The Board has recently improved its procedures for handling rate cases, with one set of procedures for large rate cases and two other procedures for smaller cases.

Large Rate Cases. With often hundreds of millions of dollars at stake, large rate disputes raise complex questions over the value of the assets needed to serve the shipper, the operating costs to serve the shipper, and the degree of differential pricing a carrier needs to earn a reasonable return. To resolve these large disputes, in 1985 the Board created a sophisticated, although complex, approach known as "Constrained Market Pricing," or CMP. CMP provides a framework for the Board to regulate rates while affording railroads the opportunity to cover their costs. Although CMP is premised on the need for differential pricing, CMP principles also impose constraints on a railroad's ability to price, even for their captive traffic.

CMP sets up four potential constraints to railroad pricing. The constraint that is typically used is the stand-alone cost (SAC) test. Under SAC, a railroad may not charge a shipper more than what a hypothetical new, optimally efficient carrier would need to

charge the complaining shipper if such a carrier were to design, build, and operate – with no legal or financial barriers to entry into or exit from the industry – a system to serve only that shipper and whatever group of traffic that shipper selects to be included in the analysis. The ultimate objective of the SAC test is to ensure that the complaining shipper is not charged for a carrier's inefficiencies or for facilities or services from which the shipper derives no benefit. This assures that the complaining shipper is not required to unfairly subsidize other customers of the railroad.

Although the U.S. courts of appeals have affirmed every challenged SAC case issued by the Board since the agency was created in 1995[7] (whether they were challenged by the shipper or the railroad involved), during the past few years it became apparent that a loophole gave railroads the ability to "game" the outcome of future SAC determinations. Moreover, in a recent court decision, the Board was warned that part of its SAC methodology was on "shaky ground."[8] Finally, the complexity and costs of litigating a SAC case had increased over time, often costing $3-5 million and 2-4 years for a shipper to bring, or a railroad to defend, a case. For these reasons, the Board found it necessary in 2006 to make some significant changes in how we will apply the SAC test and how we

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[7] *See Otter Tail Power Co. v. BNSF Ry.*, 484 F.3d 959 (8th Cir. 2007); *Arizona Elec. Power Coop., Inc. v. STB*, 454 F.2d 359 (D.C. Cir. 2006); *BNSF Ry. v. STB*, 453 F.3d 473 (D.C. Cir. 2006); *PPL Mont., LLC v. STB*, 437 F.3d 1240 (D.C. Cir. 2006); *Wisconsin Power & Light Co. v. Union Pac. R.R.*, 62 Fed. Appx. 354 (D.C. Cir. Apr. 30, 2003); *McCarty Farms, Inc. v. STB*, 158 F.3d 1294 (D.C. Cir. 1998); *Burlington N.R.R. v. STB*, 114 F.3d 206 (D.C. Cir. 1997).

[8] In particular, the United States Court of Appeals for the District of Columbia, in affirming one of the Board's more recent SAC decisions, explicitly stated that, if the Board were "presented with a model [for allocating revenue for so-called "cross-over traffic"] that took account both of the economies of density and of the diminishing returns thereto, a decision to adhere to its [existing] model would be on shaky ground indeed." *BNSF Ry. v. STB*, 453 F.3d 473, 484 (D.C. Cir. 2006).

will calculate the amount of relief in a large rate case. The revisions reflect a significant milestone in the STB's ongoing effort to reduce litigation costs, create incentives for private settlement of disputes, and shorten the time required to develop and present large rail rate cases to the STB. These rules were completed last Fall ─ within 8 months of the notice of proposed rulemaking.

Small Rate Cases. In 1996, in response to a Congressional directive, the STB adopted simplified guidelines for assessing the reasonableness of challenged rail rates in cases in which a full SAC presentation is too costly. Under these guidelines, the agency established three "benchmarks" to determine the reasonableness of a challenged rate in a small rate case. The three benchmarks look at the carrier's overall revenue needs, how the railroad prices its other captive traffic, and how comparable traffic is priced.

Shippers, however, noted several shortcomings to the small rate case procedures that discouraged them from filing cases. For example, many stated that it was unclear what shippers would qualify to use the guidelines. In addition, shippers (and railroads) wanted greater clarity as to how the three benchmarks would be applied in a particular case. Shippers also expressed concerns about how railroads might use the discovery process to unreasonably prolong a case. As a result of these ambiguities, no cases have been decided under the 1996 simplified guidelines, although two cases were filed and then settled.

The agency held several public hearings on this matter from 2003 through 2007, and its staff met with staff from other economic regulatory agencies to gather information on how those agencies handle smaller disputes. On September 5, 2007, the Board issued a decision updating our process for reviewing rate complaints in cases where the cost of a

full SAC case is not warranted or practicable. The Board's decision, which makes the rate review process available to shippers of all sizes, allows smaller rate cases to proceed on one of two tracks. First, freight rail customers may seek up to $1 million in relief over a 5-year period, using a revised version of the three-benchmark test with more predictability built into it. A shipper using that approach would have a Board ruling on its case within 8 months of the filing of its complaint.

Under a second approach, freight rail customers can seek up to $5 million in relief over a 5-year period, by using a process that focuses on whether the carrier is abusing its market power by charging more than it needs to earn a reasonable return on the replacement cost of the infrastructure used to serve that shipper. This is a simpler form of the SAC test that is applied in large cases; it relies on standardization of many of the components in order to reduce the cost and complexity of litigating the case. A Board decision in a rate case brought under this approach would be issued within 17 months after the filing of the complaint.

Before the Board's recent changes, the majority of captive rail traffic had been effectively blocked from Board rate review due to the complexity and resulting high costs of the previous procedures. The Board's new procedures ensure that the rate review process will be accessible to all captive traffic that moves under common carrier rates.

In all rate cases, the Board will require mediation up front, which we have found is a good way of getting adversaries together. Indeed, earlier this year a small rate case involving Williams Olefins, LLC and Grand Trunk Corporation was resolved privately within only a few weeks pursuant to mediation by Board staff.

Fuel Surcharges. Another matter that has concerned shippers in the past few years is the way the railroads were assessing fuel surcharges. As you know, in recent years fuel costs have been unpredictable and volatile, with some sharp upward spikes. Fuel is a substantial component of railroad costs, and carriers have sought to recover their increased fuel costs through surcharges. Some shippers felt that the surcharges they were being assessed were greater than the increased fuel costs that could be attributed to their movements. Captive shippers voiced concerns that the fuel surcharge programs of the carriers, which were expressed as a percentage of the base rate, virtually guaranteed that captive shippers with high base rates would bear the increased fuel costs of other shippers. They also objected to the carriers' practices of "double dipping" by first raising the base rate using an index that includes changes in fuel costs and then adding a separate fuel surcharge to the same movement.

In May 2006, the Board held a public hearing on the matter. In January of this year we issued a decision declaring it an unlawful practice for carriers to use a fuel surcharge to recover more than the increased fuel costs attributable to the particular movement to which the surcharge is applied. This action, with industry-wide effect, demonstrates that the Board will use aggressively the authority granted to it by statute to stop unreasonable practices, thereby protecting shippers and advancing the public interest.

Service Quality and Railroad-Shipper Relationships

The Board actively monitors railroad industry performance. We receive monthly reports from each Class I railroad, tracking such indicators of congestion and efficiency as the number of freight cars on line, train speeds, and the amount of time cars spend in railroad terminals to make connections between trains (referred to as "terminal dwell"

time). Moreover, as it has done for several years now, the Board has asked each of those carriers to provide forward-looking information on how the railroads are preparing to handle end-of-year peak shipping demands in several key markets: agriculture (grain, grain products, and ethanol); coal; chemicals; and intermodal traffic. This year the Board also asked the carriers for their performance goals (with respect to cars-on-line, terminal dwell time, train speed, and employment levels), as well as information on critical capacity-related infrastructure needs this year and their capital needs for increasing capacity in 2008. The carrier's responses were due by September 14th; we are reviewing those responses and shortly will release them to the public.

On July 18, 2007, the Board held a field hearing in Kansas City, Missouri, to examine issues related to the efficiency and reliability of railroad transportation of resources critical to the Nation's energy supply, including coal, ethanol and other biofuels. Speakers at the hearing represented the interests of railroads, utilities, coal shippers, and other energy commodities such as ethanol. To address these issues further, the Board is establishing a Rail Energy Transportation Advisory Committee (RETAC) to provide advice and guidance to the agency and to serve as a forum for the discussion of emerging issues regarding the railroad transportation of energy resources such as coal and ethanol and other biofuels. RETAC is expected to address matters such as rail performance, capacity constraints, infrastructure planning and development, and effective coordination among suppliers, railroads and energy-resource users. The Board has sought public suggestions for candidates for RETAC membership, and it will announce its selections soon.

The Board has a very effective Rail Consumer Assistance Program, run by our Office of Compliance and Consumer Assistance (OCCA), which handles about 100 disputes in a typical year. A few of these informal disputes concern rate issues, but the majority relate to service. The process is easy to use and shipper-friendly. It can be engaged by a simple telephone call, fax, letter, or email. The follow-up by our staff is prompt and effective. Our consumer assistance staff has addressed a variety of issues, in addition to rates and service, including: car supply issues; claims for damages; demurrage issues (charges for holding rail cars for too long); fuel surcharges; employee complaints; and community concerns. Our staff cannot always resolve the issues informally, but they are often successful at bringing the parties closer together and getting them to talk to each other without resorting to litigation or formal Board adjudication.

During the past year, the staff working in the consumer assistance program proactively negotiated changes to the railroad industry's "embargo rules" (rules that govern temporary stoppage of railroad service due to track damage or other causes) that will do much to hold carriers to their common carrier obligation to their shippers. We also resolved two situations in which the crossing or interchange point between two railroads had been blocked, in each case getting the railroad or railroads involved to work out mutually acceptable compromises. We successfully secured rail service for a new shipper in Texas when a large railroad refused to serve it. We assisted a small grain shipper in Nebraska with a rate dispute, persuading the carrier to compromise with the shipper, and assisted a shipper in Missouri with its freight claims, persuading the carrier to honor the claims. And we assisted a shipper organization by persuading a large carrier to modify its

freight car information system to provide information that was needed for the businesses of the involved shippers.

When parties cannot resolve their differences informally, they can engage the Board's formal processes by filing a complaint. For example, the Board may temporarily substitute another carrier for a carrier that is unable or unwilling to provide adequate service on its lines. We have used those rules several times in the past few years. This past year, following up on a 2006 authorization of such alternative rail service at the request of a shipper in Texas, the Board extended the temporary relief until a long-term solution could be developed. Late last month the Board ordered the lines involved to be sold, at a price set by the Board to reflect the value of the property, to one of two prospective buyers. This particular "forced sale" case was complex and lengthy. The course of the Board's decisions demonstrates that we will use every available tool, where necessary, to protect shippers receiving inadequate service.

The Board acted to preserve shippers' service options in a case in Ohio this year involving a railroad that would not let another railroad cross its line. In that case, a Class I rail carrier had unilaterally removed the crossing diamonds that were needed for a short line to serve several potential shippers. The Board made clear that a carrier may not undercut another carrier's ability to fulfill its common carrier obligation by unilaterally severing track of the other carrier that is part of the national transportation system. The Board directed the Class I carrier to promptly reinstall the crossing.

STB Actions

The past 12 months have been noteworthy for the number of proactive steps taken by the Board to reform, streamline, and modernize our oversight and rail regulatory procedure. To summarize, some of the highlights of the past year include the following:

- In September 2006, we instituted a rulemaking proceeding to modernize the way we calculate the railroad industry's cost of capital to more accurately reflect the financial health of the rail industry;
- In October 2006, we reformed the rate review process for large rate cases to streamline and improve the accuracy of the process, to close a loophole that permitted carriers to manipulate the process, and to address a legal vulnerability;
- In September 2007, we overhauled the procedures for handling smaller rail rate cases so that all shippers will have a practical and feasible means of challenging rail rates;
- We investigated the fuel surcharge practices of the railroads, and in January 2007 concluded that their fuel-surcharge programs were unreasonable because they were misleading and because they required captive shippers to bear surcharges that were higher than the increased fuel costs attributable to their traffic;
- In November 2006, we held a hearing on issues related to the transportation of grain to explore whether further changes to the regulatory framework are necessary;
- In July 2007, we held a hearing and announced that we are establishing an advisory committee on transportation of energy commodities to monitor the ability of the railroads to handle the future energy needs of the Nation;
- In August 2007, we ordered a railroad providing inadequate service to sell its line to another carrier that would provide better service; and
- We recently contracted with an independent economic consulting firm to conduct a sweeping national study of rail competition-related issues.

Of the more important actions that will take place between now and the end of next year, the STB will:

- Issue final rules on how to calculate the cost of capital for the rail industry;
- See that the competition study is completed, and analyze the results and recommendations contained therein;

- Test the new simplified rate guidelines on three newly filed small rail rate disputes;
- Finish our investigation into the concerns about the appropriateness of certain interchange commitments that large carriers may enter into when they sell or lease light-density portions of their lines to smaller carriers;
- Consult with our new energy advisory committee for guidance on a range of significant issues that affect the public interest in a reliable delivery network for coal and liquid biofuels;
- Continue to examine the infrastructure and capacity needs of the rail network and the railroads' capital investment levels, and to emphasize the critical importance of developing new strategies to meet those challenges;
- Review the recently announced proposal by the Canadian Pacific Railroad to acquire the Dakota, Minnesota & Eastern Railroad;
- Improve the Board's ability to ensure effective regulation of rail operations that handle municipal solid waste and related materials;
- Address the current ambiguity as to whether certain types of arrangements between rail carriers and shippers reflect contracts (for which regulatory remedies are unavailable), or whether they reflect common carrier service subject to Board regulation; and
- Prepare the STB to have the capability to address potential conflicts between passenger rail and freight rail operations and to implement potential legislative proposals in this regard.

Conclusion

I appreciate the opportunity to discuss these issues today, and look forward to any questions you might have.