

**House Committee On Transportation and Infrastructure
Hearing on Rail Competition and Service
September 25, 2007**

**STB CHAIRMAN CHARLES D. NOTTINGHAM
ORAL STATEMENT**

Good afternoon Chairman Oberstar, Ranking Member Mica, and Members of the Committee. My name is Charles Nottingham, and I am Chairman of the Surface Transportation Board. This is my first appearance before this Committee since becoming Chairman of the STB in August 2006, and I appreciate the opportunity to appear before you today to address the important issues of rail competition and service, the relationship between railroads and shippers, the state of the railroad industry, and the role of the STB in resolving disputes between railroads and their customers. I will briefly summarize my written testimony.

Ensuring effective competition is one of the central goals of the nation's rail transportation policy. Yet throughout railroad history there have been some rail customers who do not enjoy the

full benefits of a competitive market. What do we mean when we refer to captive traffic that falls under the jurisdiction of the STB's regulation of rates? Our most recent data indicates over 71% of the nation's rail traffic moves at rates deemed by statute to have been the product of a competitive market. Of the remaining 29%, some is traffic that is exempted from regulation because the particular commodities and services involved, such as intermodal traffic, have competitive transportation alternatives available, and some is traffic that moves under private contract and is therefore outside the Board's jurisdiction. Less than 10% of the nation's freight rail traffic is recognized as captive and eligible for STB rate regulation. As we focus on this important, but relatively small portion of rail traffic at the STB, we strive to assess and anticipate how our regulatory and policy decisions might impact the broader universe of rail customers as well as national transportation policies, such as the development of an efficient system of interstate commerce.

As is the case in many markets, some freight rail customers pay higher rates than others. Under the principle 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 as well, it is understandable that shippers on the captive end of this differential pricing scale would not be satisfied with the status quo. As policy makers examine alternatives to this longstanding differential pricing system, several important questions merit consideration, including: if the railroads’ ability to differentially price their services based on the market forces of supply and demand is significantly constrained, who will make up the difference? Who will end up paying more? How will the railroads in this highly capital-intensive industry maintain their existing infrastructure, not to mention attract additional private investment needed to expand

their capacity to meet projected dramatic growth in future demand for access to the rail network?

The Board recently commissioned the economic consulting firm Christensen Associates to conduct 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 study team will have the full benefit of all of the STB's powers to inquire into and gather information from the freight rail industry. I look forward to briefing this committee on the results of this study next year.

Examples of ways that the STB promotes competition can be found in our major merger rules; in cases where we impose competition-protecting conditions such as in previous merger cases; in other cases where the Board has prevented larger carriers

from interfering with the ability of smaller carriers to meet their obligation to provide service; in our management of the federal environmental review process required for the proposed construction of new rail lines; and in decisions authorizing the construction of those new rail lines.

With regard to the financial condition of the nation's rail system, I can report that our data reinforces what others will report today – the rail industry has gradually recovered from its pre-Staggers Act state of ruin and the industry is currently in good health.

The Board is currently awaiting final comments on an important rulemaking that proposes to change a key measure of the financial health of the railroads – the annual cost of capital determination. That calculation ties into our required annual determination of the railroads' revenue adequacy and is also a significant factor in rate cases and other Board proceedings. I believe that the Board must continue to examine all of our

procedures and to constantly explore improvements, no matter how controversial the issue may be to stakeholders.

As for the rail system's physical condition, in recent years, the U.S. rail network, like other transportation sectors, has become capacity-constrained. On April 11, 2007, the Board held a public hearing focused on rail capacity, traffic forecasts, and infrastructure requirements. At the hearing, we heard a broad consensus that rail capacity will become increasingly constrained by traffic growth. It is clear that the rail system's capacity shortfall that we see in many markets today will dramatically worsen unless bold new policies and strategies are adopted. The energy sector is especially vulnerable to rail capacity constraints and service problems. I am committed to improving communications and coordination between the rail sector and its energy customers in the coal, ethanol, biodiesel, utility and related businesses. The Board recently formed a new federal advisory committee consisting of industry leaders in the energy and rail sectors and charged with advising us on these issues. The Committee 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 committee's first meeting takes place in October. I look forward to keeping this Committee apprised of its progress.

The Board's procedures for handling rate disputes are particularly important, and I will now turn to that issue. Under our statute, the Board must 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 too low will deprive railroads of revenues sufficient to pay for the infrastructure investments needed to give shippers the level and quality of service that they require.

The Board has recently improved its procedures for handling rate cases. In the fall of 2006, we made some significant changes in how we apply the Stand-Alone Cost test and calculate the amount of relief in large rate cases, in an effort to reduce litigation

costs, create incentives for private settlement of disputes, and shorten the time required to litigate large rate cases. And just this month, the Board revised its rules for reviewing rate complaints in smaller cases where the cost of a full SAC case is not warranted or practicable. The new rules allow smaller rate cases to proceed on one of two tracks. First, freight rail customers may seek up to \$1 million in relief using a revised version of the three-benchmark test with more predictability built into it. Under a second approach, customers can seek up to \$5 million in relief using a new, simplified version of the Stand-Alone Cost test. The Board's new procedures ensure that the rate review process will be accessible to all captive traffic that moves under common carrier rates.

Another important issue that the Board is keeping a close eye on relates to fuel surcharges imposed by railroads. In January of this year we issued a decision declaring it an industry-wide 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 ended an

industry practice of charging fuel surcharges as a percentage of a shipper's base rate regardless of the actual fuel costs associated with the transportation of the shippers' goods. The Board will aggressively use the authority granted to us by statute to stop unreasonable practices, thereby protecting shippers and advancing the public interest. It is worth noting that the Board investigated and acted on the fuel surcharge problem on our own initiative and without any formal complaint. This Board has not received a single formal complaint about fuel surcharges. We will remain vigilant on this issue and will expeditiously review any formal complaints related to fuel surcharges or other unreasonable practices or unreasonable rates.

Moreover, in addition to our processes for adjudicating formal disputes, we have an effective Rail Consumer Assistance Program, which is available as a resource for seeking assistance in informally resolving disputes. Since the program's inception several years ago, 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); employee complaints; and community concerns. In many instances, informal dispute resolution and problem solving by the STB is an effective alternative to litigation.

In sum, the STB is actively engaged in the pursuit of enhanced competition, the implementation of accessible and affordable dispute resolution procedures, and continuous process improvement aimed at making our agency a more effective economic regulator of the freight rail industry. Our initiation of a major national study of the state of rail competition and related policy alternatives, along with our recently improved rate dispute resolution procedures, our pending rule on how the railroads' cost of capital should be measured, and the other proactive steps outlined in my full statement, all combine to demonstrate this Board's strong commitment to providing robust regulatory oversight of the freight rail industry. I look forward to the opportunity today to discuss our record of reform in more detail

and to returning to this committee in the future to report on our progress.

Thank you.

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