

**TESTIMONY OF JOHN W. SNOW,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER,
CSX CORPORATION
BEFORE THE
SENATE SURFACE TRANSPORTATION AND MERCHANT MARINE
SUBCOMMITTEE
JULY 31, 2002**

Introduction

Mr. Chairman and members of the Subcommittee, it is a pleasure for me to be here today to discuss with you the progress of the railroad industry under Staggers and related issues with respect to our customers. Both the railroads and our customers have an important parallel interest: the sustainability and growth of our respective businesses. In order for the railroads to meet their objective of sustained growth, it is clear that we must secure adequate revenues that earn our cost of capital over the long run. This has been the unachieved goal of the Staggers Act from the railroads' perspective, one that is important not only to the rail industry but to the customers that it serves. Only a financially strong industry can ensure the kind of service that our customers need to capitalize on their growth opportunities.

The Rail Advantage

For 175 years, railroads have been an essential and enduring part of our nation's transportation infrastructure. The Baltimore & Ohio Railroad, the nation's first common carrier, was founded in 1827, and is part of the rich legacy of my company. The B&O and other pioneer railroads gave rise to the development of the fledgling nation, proved themselves in a variety of conditions that included wartime as well as peacetime, and have established a significant relevance in our modern era by our willingness

to change, adapt and innovate.

Today, U.S. freight railroads – the major Class I's, regionals and short lines – operate more than 144,000 miles of track. As much as 41 percent of all intercity freight moves by rail, yet we generate only about 10 percent of freight revenues. This disparity between tonnage and revenues is explained by lower-rated bulk commodities, which make up much of what we carry. One of those commodities is coal; indeed, railroads carry two-thirds of the coal used to generate America's power needs and to fuel its factories. The automobile industry is a significant customer, too, with 70 percent of motor vehicles transported by rail. Chemical manufacturers, grain producers, and many other sectors of our industrial base rely on rail shipments. As you are keenly aware, passenger and commuter trains operate widely over the freight rail network, and we are constantly monitoring and maintaining our track infrastructure to ensure safety and reliability. Railroads truly do move America.

Railroads are important to the national defense as well. The Department of Defense counts on rail carriers to transport ordnance and supplies during peacetime and in times of war. The Military Traffic Management Command has designated the Strategic Rail Corridor Network, consisting of 30,000 miles of rail corridors, to be essential to the national defense. We work hard at our ongoing and close working relationship with the military to assure its capacity, security and equipment needs. The events of Sept. 11, 2001, called once again on our national defense obligations and were a grim reminder of the increased need to ensure the security of our bridges, buildings, dispatch centers, tunnels, storage facilities, and cross-border and port gateways. We are working within our industry, with our customers and with appropriate regulatory authorities to ensure that our transportation is conducted in the most secure manner possible.

Not to be overlooked is the environmental benefit railroads provide through reduced diesel emissions. Trucks emit from three to 12 times more pollutants per ton-mile than railroads, and traffic by rail means that fewer trucks must operate on our nation's highways. Railroads are three times more fuel-efficient than trucks, which helps to save energy and reduce our dependence on foreign oil.

Safety is, of course, our highest priority, and railroads are a very safe transportation mode. Rail has the lowest employee injury rate among all the modes. Over the last 20 years, the freight rail industry's diligence has resulted in a 64 percent decline in train accident rates and a 71 percent decline in employee injury rates.

At CSX, we operate an exceptionally capital- and labor-intensive business covering 23,000 route miles in 23 states, two Canadian provinces and the District of Columbia with assets that include 200 yards and terminals across the eastern half of the country, 3,600 locomotives and 100,000 railcars. Last year, we hauled 7.1 million carloads of freight more than 228 billion ton-miles. CSX is a significant part of the nation's rail freight network, and while my comments today will often reference my company, our experience is generally reflected across the industry.

At CSX, our stated goal is to be the safest North American railroad, and we are well on our way. From 2000 to the first quarter of this year, CSX has shown a 57 percent reduction in derailments and a 48 percent reduction in personal injuries. In a comparison of this year's first quarter and the same period in 2001, derailments were 25 percent lower, and we experienced approximately a 30 percent reduction in personal injuries. Safety continues to improve, as it must. We want our employees to go home in the same condition in which they arrive at their jobs. We want communities to trust us to operate safely, and investors, public officials and other constituencies to share that confidence. My

testimony today will reflect that our safety efforts, as well as other important initiatives, rest upon our ability to invest properly in this capital-intensive business.

As I've shown, we are a vital component of the transportation infrastructure with a keen focus on commerce, national defense, the movement of passengers and commuters, the environment and, most important, safety.

The Impact of Regulation in a Changing Environment

In the mid 1970s, 22 percent of the nation's rail mileage was being operated under the gavel of bankruptcy courts. The equity markets were closed to the industry, and survival became a function of rate increases and deferred maintenance. By the end of the decade, the industry was becoming a wasting critical asset. Even those railroads considered healthy were suffering returns on investment that were dramatically below American industry in general. And with the high percentage of interline traffic – railcars exchanged among two or more carriers – even relatively healthy railroads often were forced to interchange time-sensitive freight with partners whose track conditions and service were substandard. Industrial assembly lines were affected and inventory costs soared due to inconsistent, unreliable rail service. The situation was exacerbated by locomotive shortages and reduced train speeds because of track conditions. The arrival of a railcar was something of a random event. As service deteriorated, market share spiraled downward and many shippers found other modes better able to satisfy their demands for reliable service.

Yet this ailing industry remained vital to the nation's economy, supplying some 37 percent of its intercity freight transportation, creating tens of billions of dollars worth of economic activity, and employing hundreds of thousands of workers. Clearly, something had to be done if railroads were to

continue performing their vital role. Congress, shippers and railroads agreed that a solution addressing the fundamental causes was necessary. Nearly a century after the formation of the Interstate Commerce Commission in 1887, railroads faced extensive competition from other modes of transportation. Despite this intense competition, railroads were still regulated as if they were the pre-eminent mode of freight transportation. Rail rates were set collectively through rate bureaus and could not be raised or lowered without ICC permission. Contracts with customers, so prevalent in the rest of the American economy, were prohibited in the rail industry. In fact, rail regulation became even more stringent to the point that there was regulatory oversight for virtually every management decision. Fortunately, Congress began looking at sound policies that would address the forces that had combined to bring about the railroads' deterioration. Those studies led Congress inexorably to the conclusion that a successful railroad industry could be recreated only through some fundamental reforms, which resulted in the 1976 Railroad Revitalization and Regulatory Reform Act (4R). While a step forward, the 4R Act did not go far enough and additional action was required.

Staggers – A Workable Solution

The Staggers Rail Act of 1980 set out to reform the regulatory ills of the period by reducing some areas of regulation and preserving and enlarging others. Staggers recognized that railroads faced extensive competition in most markets, but that some shippers had fewer choices than others. Staggers addressed that situation by providing a robust regulatory environment to accommodate shipper interests where direct competition did not exist. The basic principle of Staggers recognized that railroads are a business and ought to be permitted to manage their assets and price their services appropriately so as to achieve revenue adequacy and reasonable profitability. Under Staggers, railroads were able to set

reasonable prices that permitted needed re-investment, and negotiate confidential contracts with customers. In the new environment, safety and service improved, as did productivity, and damage to shipments was significantly reduced. With productivity increases, railroads were able to stabilize market share as measured in ton-miles.

Throughout the 1980s, railroads learned how to engage in direct competition and to expand their market reach through mergers and consolidations with stronger roads. Shippers benefited from these improvements, too. Most saw significant reductions in prices with the introduction of customer contracts that promoted rate and service negotiations and innovations such as unit trains, in which like commodities are grouped in a single train for a common destination, eliminating the need for intermediate switching. The fact is, an industry on the brink of collapse was put on the path to competitive vigor through a combination of self-help and the Staggers Act. Partial deregulation and mergers were viewed as the twin engines of railroad revival. Yet, a central fact remains: no Class I railroad to date has been able to earn adequate revenues on a sustained basis.

CSX and Staggers

CSX is a progeny of Staggers and bears witness to the positive consequences of this landmark legislation. Coincidentally, on the same day that House and Senate conferees approved Staggers – Sept. 23, 1980 – the ICC permitted CSX to take financial control of the 11,000-mile Chessie System and the 16,000-mile Seaboard System. On Nov. 1, 1980, CSX was officially created and began operating the two systems under its corporate umbrella, though the two rail systems' operations were not completely integrated until 1986. CSX and the industry spent much of the 1980s adjusting to the newfound freedoms and challenges of Staggers, which included productivity gains, cost reductions and

other efficiencies brought about by mergers. Short-line railroads were created as the larger systems shed unprofitable or marginally profitable track segments. These short lines preserved rail service to light density areas, and maintained rail employment for those who otherwise would have been forced to relocate or find other work. After a century-long decline in short lines, 226 new ones were created in the 1980s, a number that grew significantly in the 1990s. CSX produced many of those short lines as our system contracted from 27,000 miles in 1981 to approximately 18,000 miles in 1998, a reduction of about one third (prior to the acquisition of 42 percent of Conrail in the late 1990s.) Even after the Conrail transaction, CSX operated 23,000 miles in 2001, or 4,000 miles below the 1981 level.

With higher traffic volumes concentrated on an increasingly productive network, CSX found its groove in the 1990s with a sharper focus on its rail business and a renewed commitment to improve safety and service to our customers while lowering costs:

- Employee injuries were reduced, often by as much as 20 percent or more on a year-to-year basis;
- Service reliability was emphasized with process improvements and capital investment that included hundreds of more powerful and fuel-efficient locomotives;
- Costs were reduced with Performance Improvement Teams that identified best practices across the spectrum of American business and built action plans to address competitive gaps.

CSX's gains were impressive in the two decades that followed the Staggers Act, particularly in productivity and cost reductions, and that picture is reflected across the railroad industry. Between 1986 and 2001, CSX's revenue ton-miles grew by 62 percent, while the miles of road (including the effects of the Conrail transaction) remained essentially the same. We have significantly increased density as measured by ton-miles per mile of road.

Since 1984, CSX employees and managers have improved productivity by 88 percent. By contrast, according to the Bureau of Labor Statistics, the cumulative improvement in the national multifactor productivity indexes for manufacturing, private business and private non-farm business during 1984-2000 was 24.6 percent, 15.1 percent, and 12.6 percent, respectively. CSX indeed learned to do more with less.

Like all the other carriers, CSX has invested heavily in plant and equipment, which has reduced operating costs substantially. For example, locomotive horsepower capacity has increased by 27 percent since 1986 (from 9.0 million in 1986 to 11.5 million in 2001) while the total number of units remained virtually the same. Much of that is a result of purchases of locomotives using breakthrough alternating-current technology. More significantly, that 27 percent increase in horsepower – contributing to overall operating efficiency – enabled CSX to handle a 69 percent increase in gross ton-miles of traffic during this period.

CSX also has dramatically reduced labor costs while maintaining one of the industry's best relationships with its contract-covered employees. We have developed a New Compact with labor that emphasizes effective communication and openness, which has dramatically reduced misunderstandings and disputes. Our workforce has been reduced by 29 percent in the last 15 years, from 47,803 employees (measured by average employee count) in 1986, to 33,872 employees in 2001. This reduction also included the elimination of large numbers of administrative and support personnel, both contract-covered and managers. CSX also gained significant labor productivity by implementing crew-reduction agreements with labor unions that required substantial buy-out expenses in return for larger long-term cost savings.

Recent Industry Activity

The 1990s also included another round of significant industry consolidation. Despite intensive planning and numerous examples of precise execution, those acquisitions and mergers caused temporary but significant disruptions to service during their start-up phases.

The most recent major eastern transaction was carried out by CSX and Norfolk Southern, which began operating their respective portions of Conrail on June 1, 1999. Although there were starts and stops at the beginning, the assimilation pains and resulting service problems were largely resolved by early 2000. The integration has been successful for many months, and we are beginning to realize the potential of the acquisition of our 42 percent of Conrail. Safety has improved, service measurements are trending the right way, and almost all of the capital projects to produce those benefits are complete. In preparation for the Conrail transaction, CSX initiated a \$220-million Capacity Improvement Project through Ohio and Indiana, including the construction of 100 miles to make the line double track along its entire length. New intermodal terminals were built in Chicago and Philadelphia. During the past year, we finished three major projects at former Conrail facilities that today are key points on the combined network: Avon Yard near Indianapolis, Frontier Yard in Buffalo, and Selkirk Yard near Albany. In the Chicago area, we completed improvements at Barr Yard. We are adding almost six miles of main track in northern New Jersey, a multi-year project that is now more than 50 percent finished.

Today, all of the key indicators of safety and operational performance are meeting or exceeding goals that we have set: employee injuries, derailments, total cars on line, overall train velocity, freight car dwell time in yards, and on-time departures and arrivals, among them. In recent oversight proceedings, the Surface Transportation Board recognized the significant improvements in CSX and NS service since

the startup phase.

Reduced injuries and fewer derailments are resulting from employee coaching and training, a revolutionary approach to managing safety, and considerable investment in track, signals and infrastructure. Service performance in yards and terminals has improved steadily. Freight car dwell has improved by 35 percent from 2000 to the first quarter of this year. On-time train originations have improved 80 percent, and the percentage of trains arriving at their destinations on time has improved 136 percent. CSX has been emphasizing its local service to customers by measuring car placements or pulls within a specified customer window. Local switching performance during this time has improved 12 percent, and there has been an improvement of 111 percent in originating local trains on time.

Also during this period, overall velocity improved by 24 percent, and merchandise train velocity improved even more, by 34 percent. In terms of congestion as measured by the number of cars on line, the overall rail industry has achieved a 13 percent improvement since the beginning of 2000. At CSX, we have seen a 14 percent improvement in cars on line during the same time period.

To further service improvements, we have created industry alliances that promote fast transcontinental service. These alliances attempt to achieve some of the benefits normally associated with rail mergers and, if coupled with strong financial performance of existing carriers, diminish the likelihood of rail consolidations in the foreseeable future. We are hearing and responding to the additional demands of our customers, making ourselves easier to do business with by using e-commerce and other technology initiatives, and continuing productivity gains. We have translated those service improvements into modal conversion by offering economies and services that entice traditional truck customers to rail. One particular alliance is our Express Lane service with the Union Pacific in which we

ship perishables and wine from the West Coast to markets in the Northeast and Southeast. With this alliance, we are producing truck-competitive transit times. Orange juice from Florida is another consumer product shipped on CSX. For a number of years, we have operated dedicated trains of orange juice from Florida to the Northeast and, more recently, to the Midwest. And we are re-capturing traditional rail products such as steel. Last year, we converted certain metals products to rail by soliciting business directly from the heads of the nation's financially pressed steel producers, creating significant savings for them and increasing our metals business. All told, we added more than 350,000 truckloads of freight worth more than \$130 million to our railroad. This year's target is 450,000 truckloads.

CSX is characterized today by consistent improvement, and safety and operational metrics confirm this progress. The next frontier is a zero-injury, zero-accident railroad employing the latest technology to reduce transportation variation and improve shipment management. Our ability to innovate is seen in the recent development of a revolutionary new locomotive operating system designed to reduce fuel consumption and diesel emissions. Our own patented Auxiliary Power Unit could result in annual fuel savings of 30 million gallons once our entire locomotive fleet is equipped. In freezing weather, locomotive operators have always idled diesel engines to keep vital fluids from freezing. The APU automatically shuts down the main locomotive engine idle, while maintaining all critical main engine systems at greatly reduced fuel consumption. The U.S. Environmental Protection Agency recently recognized the APU with a Clear Air Excellence Award.

Through hard work and innovation, CSX and the rest of the industry have made enormous strides in improving safety, service levels and taking out costs.

Capital Intensity and Revenue Adequacy

Despite all this progress on so many fronts, we are haunted by the simple fact that CSX, like the rest of the industry, remains revenue inadequate, thereby failing to achieve the principal goal of Staggers and a key ingredient to the industry's need for sustainable growth. CSX and the other carriers have squeezed inefficiencies out of their systems, and the productivity and efficiency gains have been passed on to consumers in the form of lower prices. The Association of American Railroads data shows that more than two thirds of the industry's productivity gains have been passed through to customers, including those who describe themselves as "captive." The reduction in rates for our customers has applied to a broad range of commodities. For example, coal traffic has enjoyed significant rate reductions. On a revenue per ton-mile basis, CSX's coal rates since 1987 have fallen by more than 37 percent in real terms. Similarly, between 1987 and 2001 the average revenue that CSX received per ton of coal declined, in real terms, by more than 21 percent. These rate reductions are a direct consequence of the partial deregulation – and competition – mandated by the Staggers Act.

By giving railroads greater flexibility in ratemaking, you and your colleagues in the Congress appropriately made rates subject to marketplace disciplines. Intermodal, intramodal, geographic and product competition kept pressure on rates. Utilities today have tremendous market abilities by being able to shift production, wheel power and choose among competing energy sources. We face these competitive forces every day, along with other modal competition from barges, pipelines and trucks. Partial deregulation and changes in the trucking industry have greatly intensified its scope and effectiveness. The trucking industry has traditionally provided higher service quality with its inherent ability to deliver door-to-door and to choose optimum routing over subsidized federal and state

highways and roads. As it should, competition acts as a marketplace regulator of our rates and service.

While declining rates may be short-term good news for shippers, they create significant hurdles for the railroads in terms of achieving revenue adequacy and sustaining growth. As recent history has shown, these lower rates come at a substantial cost to the rail industry as we remain revenue inadequate and unable to earn our cost of capital. Of course, businesses that do not earn their cost of capital are forced by the marketplace to shrink, whereas those that do earn their cost of capital produce growth for themselves and their customers. Since the Staggers Act was enacted, industry revenues have declined 42 percent (adjusted for inflation). CSX's recent experience is in line with the industry's own record. Since 1986, CSX's freight revenue per revenue ton-mile has fallen nearly 43 percent on an inflation-adjusted basis, and 17 percent on a nominal basis, as shown in the table below.

Year	Revenue per thousand revenue ton-miles (adjusted for inflation)	Revenue per thousand revenue ton-miles (nominal basis)
1986	\$35.52	\$35.52
2001	\$20.33	\$29.52

To address our needs for revenue generation and capital investment, and to capture more of the value that we provide the transportation marketplace, we have recently increased prices in selected markets. These price increases are built on the substantial service improvements and overall value we offer.

They also help to cover our enormous capital investment. Safe and efficient railroad transportation requires vast amounts of capital investment for track, signals, and structures; for locomotives and freight cars; for communications and data processing; and for technology application. Unlike federal highways, the inland waterways, and the nation's airways and airports, rail infrastructure

is not subsidized. In future legislative debate, the question of dealing with modal inequities will be a critical one. When track is upgraded, when facilities are improved, when new equipment is purchased – rail carriers must make those expenditures. Freight rail carriers invest more than 20 percent of their revenues back into their systems, in comparison with other industry sectors that on average invest less than 4 percent of their revenues. And it takes more for railroads to earn revenues. Rail carriers require \$2.72 in invested capital to generate just \$1 in revenue. In comparison, the trucking industry requires 70 cents of invested capital to earn each revenue dollar. In addition to capital expenditures to improve and upgrade roadway, structures and equipment, railroads spend large amounts for routine annual repair and maintenance needs. These activities are just as critical to safe and efficient railroad operations as activities capitalized over multiple years.

Although CSX's capital investments have fluctuated from year to year, they have been substantial and have trended upward. Since 1986, CSX has made approximately \$11.6 billion in capital expenditures, of which \$7.1 billion was for road, \$2.2 billion for locomotives, and \$1.3 billion for cars and other equipment. CSX has generally increased the amount of its capital expenditures as it has generated additional total revenues. The amount of CSX's capital investments is particularly striking because these investments have been made even as CSX's revenue per revenue ton-mile declined from 1986-2001 by more than 40 percent on an inflation-adjusted basis.

CSX's capital expenditures for 2001, and the capital expenditures approved in its 2002 Capital Plan, are substantial. In 2000-2001, our railroad spent \$840 million and \$860 million in capital investment in each of those years, respectively. That compares to operating income of \$713 and \$847 million, and a free cash flow deficit of \$373 million in 2000 and positive free cash flow of \$77 million in

2001 (Conrail included). CSX's 2002 Capital Plan anticipates approximately \$920 million in capital expenditures.

As I mentioned earlier, our industry needs to earn its cost of capital to achieve sustainable growth. The results for 2000-2001 show that we have invested heavily in our rail properties while achieving limited operating profits and, as seen in 2000, incurring a negative cash flow. Clearly, if we are unable to improve upon these financial results, the marketplace will dictate shrinking investment in our rail assets, and that would be detrimental to our customers, employees and core business.

With needed improvements to our revenue, we expect that the revenue adequacy shortfall will again narrow and, in fact, that has already begun to happen. In 2001, after three years of decline, CSX's return on investment was 4.6 percent – which represented an increase from the previous year's level of 3.6 percent. The gap between the 2001 return on investment and the cost of capital for that year (as calculated by the AAR) was 5.6 percentage points – below the gaps of 7.0 and 7.4 percentage points for 1999 and 2000, respectively. Similarly, CSX's operating income increased.

Nonetheless, the other factors that have contributed to the reduction in CSX's return on investment may continue. Both before and after the Conrail transaction, CSX's revenue levels consistently remained far below what would be required for its return on investment to equal or exceed the industry cost of capital. In 2000, for example, CSX's total revenues of \$6.1 billion were \$1.065 billion below the level that would have been required for the return on investment to equal the cost of capital.

Despite CSX's expectations that its return on investment will improve, and that the revenue adequacy shortfall will decrease in the future, the shortfall is likely to continue to be substantial. As I

indicated previously, CSX has passed on a significant part of its cost savings realized through productivity gains to customers to remain competitive.

A recent report from the General Accounting Office to the House Committee on Transportation and Infrastructure confirmed that, for the period studied between 1997 and 2000, rail rates generally decreased. The Surface Transportation Board determined that the overall trend of declining rates is consistent with its own studies and analyses, and the Department of Transportation also agreed with the GAO conclusion. A substantial part of the remaining cost savings has been devoted to capital investment.

Although we continue to develop ways to improve productivity, we must realistically look to the future, recognizing that our large productivity gains of the past will likely not be duplicated absent unforeseen consolidations or technological advances. Thus, at this time, our industry's best hope to achieve adequate revenues is through a more aggressive focus on enhancing revenues, even as we continue our efforts to reduce costs wherever possible.

Facing the Future

Fortunately, demand for freight transportation is increasing. The Federal Highway Administration recently projected that demand for freight transportation will double over the next 20 years, with rail intermodal transportation estimated to grow almost 5 percent per year, the highest growth rate among the surface modes.

As CSX looks toward meeting our customers' needs in the future, we of course begin with the overriding goal of ensuring a safe, environmentally clean and efficient mode of transportation. A few weeks ago, this Subcommittee held a hearing to consider rail safety issues. CSX has specific action

plans in place to achieve our goal of becoming the safest North American railroad and reaching our ultimate goal of zero injuries and zero accidents.

To meet safety and service goals, CSX must achieve a level of revenue and income that can attract capital at favorable rates and sustain our system in the long run. CSX's revenue-inadequate status makes it more difficult for us to attract capital. CSX must compete with all users of capital in the investment market, and therefore needs to produce a return on equity that is comparable to, and competitive with, other industries with similar risks. CSX, however, has consistently generated lower returns on equity than that of S&P 500 companies as a group. Unless we can produce this return on equity, CSX will find it difficult to fund all of the necessary capital expenditures.

Here, as I mentioned before, that challenge will become far more difficult if certain parties are successful in persuading you to reverse the Staggers Act reforms and transfer more of the benefits to some customers at the expense of other customers and the railroads. When Staggers was introduced in 1979, Sen. Howard Cannon (then-Chairman of the Senate Commerce, Science, and Transportation Committee) noted that "most observers agree that economic regulation has exacerbated the railroads' problems." Then-Secretary of Transportation William Coleman described the pre-Staggers era as characterized by an "ever-expanding web of outmoded and often irrational economic regulation."

Of course, the Staggers Act did not completely deregulate railroads. In addition to retaining authority over a variety of non-rate areas, the Surface Transportation Board today has the authority to set maximum rates or take other appropriate actions if a railroad is found to have abused market power or engaged in anti-competitive conduct. This forms a "safety net" to address the needs of some customers who believe that their rail traffic is not subject to any effective competition. Nonetheless,

some groups seek to jettison the regulatory reform that has worked so well and replace it with a kind of regulatory approach that has failed previously. While proposals to alter the current system of railroad regulation include different approaches, most of these ideas have been suggested in the past, some during your deliberations on the ICC Termination Act of 1995. Wisely, you rejected them.

The end result of these proposed changes is the same: the government would force railroads to lower their rates to favor certain customers while disadvantaging other customers, rail investors, rail employees, and the general public. These proposals would alter in a fundamental manner the nation's rail policy by artificially manufacturing rail-to-rail competition. By contrast, real-world decisions today about which markets will – and will not -- sustain multiple railroads set the level of competition.

These proposals to undo the Staggers Act would wrest power from the marketplace and return it to the government. Control of the day-to-day operation of freight railroads would be stripped from the private sector, including the setting of rates, operating conditions, yard usage, and other elements necessary to provide rail service. By artificially requiring more competition than a market has shown is sustainable, legitimate competition eventually would be reduced. Railroads are already revenue inadequate and would be further behind if those proposals are successful. If demand-based pricing were eliminated as sought by some shippers, railroads would not be able to recover the costs of providing service across their systems. Shippers having the greatest demand pay a higher markup than do those with less demand, so that variable costs are covered and railroads are able to obtain different contributions to their high fixed costs from the most customers possible.

Every segment of the economy engages in this kind of demand-based “differential pricing.” A business traveler pays more for an airline ticket obtained at the last minute than does a passenger on the

same flight who was able to make a reservation days or weeks in advance. A movie matinee ticket costs less than a ticket for an evening performance, a fact that reflects the relative market demand for each viewing. The matinee crowd, with its lower demand for movies, benefits by watching the same movie for a lower price, but the evening crowd also benefits because the theater's fixed costs are shared by more movie audiences. In this way, evening viewers pay less than they otherwise would if theaters did not show matinees.

Railroads are no different from these and other businesses. The Staggers Act specifically identifies differential pricing as essential to the rail industry. Mandating that competition occur through governmental intervention would drive down rail rates to the point that full cost recovery would not be possible. Over time, the railroads would have to reduce their costs, either through foregoing maintenance, reducing the frequency or the quality of their service, deferring acquisition of new equipment, or by other drastic cost-saving methods. Ultimately, customers would lose service – precisely the opposite of the Staggers' goals and objectives.

Also of concern is legislation introduced seeking to change the so-called "bottleneck" cases at the STB. Under these proposals, a bottleneck railroad would have to agree to carry traffic only on the bottleneck segment of a route, even if it is able to serve the entire route and its rate for the entire route is reasonable. This is yet another attack on differential pricing. Consistently since at least the 1920s, bottleneck railroads have been able to choose how they want to route shipments and structure freight rates. In so doing, they perform like trucks and barges which favor their long hauls and avoid the inefficiencies of multiple carriers in a single movement.

But some shippers want to change the law to require a separate rate for the bottleneck portion.

Then they could challenge the bottleneck rate as unreasonable under maximum rate regulation, even if the rate for the entire movement is reasonable. A shipper could thereby obtain competing rates for the non-bottleneck segment and combine them with the bottleneck rate. If this were to happen, the number of rate cases brought for resolution to the STB would skyrocket, and carriers would be deprived of the efficiency and revenue secured from their long hauls. Indeed, rates for non-bottleneck segments would be reduced almost to their variable cost, while regulation would limit the bottleneck segment rate. This would result in a huge revenue loss for rail carriers that would not be offset by expense reductions. This legislation would take us back to where we have already been, to a world of stifling rules, crumbling infrastructure and overriding safety concerns.

These assaults on differential pricing all have fundamentally the same result: preventing railroads from earning revenues sufficient to operate their systems efficiently and making investments in the infrastructure necessary to remain competitive and operate safely.

The future of the railroad industry is one of cautious optimism, based on the successes since the Staggers Act and the trends toward productivity improvements. I suggest respectfully that you in Congress must make fundamental decisions about the industry. Will it be an industry characterized by marketplace decision-making where customers have the opportunities to move their products at fair rates, and carriers are fairly compensated for their service? If so, we will see reinvestment of revenues in capital spending and efficient, productive rail operations. On the other hand, if unnecessary regulations and governmental intervention instead burden the rail industry's future, their harmful effects will again impair service to customers and deprive railroads of sufficient revenues to cover the costs of the national rail system.

Conclusion

I urge the Subcommittee to focus on the future and to ensure that this industry, which is such a critical element of the nation's infrastructure, is able to achieve sustainable growth and appropriate reinvestment. Although the debate over economic regulation will continue, the record of Staggers is clear. Staggers has worked very well for the vast majority of the shipping public, with improved service and reduced rates. For the railroads, Staggers has fostered further competition and a new focus on the need to achieve revenue adequacy. At this juncture, the railroads have produced good results and shared them with the shipping public. However, the carriers now need to improve their revenue adequacy to ensure their continued investment in plant and people and their future profitability. Changes to Staggers now sought by certain shippers would only threaten our ability to provide safe, efficient and economical rail service and disable our return to a sound economic base. Rather than reversing our progress, we should now more directly focus our energies on fostering investment in rail infrastructure through both traditional capital markets and transportation policies that eliminate current biases against rail freight.

Mr. Chairman and members of this Subcommittee, please let me assure you that we at CSX will continue our efforts to provide our customers with the safest, most dependable service possible. We ask you to resist the calls by some to intervene in the marketplace, and we urge you to stay the course on the Staggers Act. The genius of the law today is that it delicately balances the legitimate interests of shippers in having dependable service at fair rates with the understandable need of railroads to earn sufficient revenues to reinvest in their highly capital-intensive infrastructure.

I appreciate the opportunity to appear before you today, and would be happy to answer any

questions.