

**BEFORE THE  
UNITED STATES SENATE  
SURFACE TRANSPORTATION and MERCHANT MARINE  
INFRASTRUCTURE, SAFETY, and SECURITY SUBCOMMITTEE  
HEARING ON  
OVERSIGHT ON THE SURFACE TRANSPORTATION BOARD AND  
REGULATION RELATED TO RAILROADS**

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**October 23, 2007**

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**WRITTEN STATEMENT OF  
CHARLES W. MOORMAN  
ON BEHALF OF THE  
ASSOCIATION OF AMERICAN RAILROADS**

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Chairman Lautenberg, Ranking Member Smith, and Members of the Committee, thank you for the opportunity to testify about the railroad industry. I am Charles W. Moorman, Chief Executive Officer of Norfolk Southern Corporation. I am pleased to represent today the member railroads of the Association of American Railroads (“AAR”).

As you know, the AAR is the world's leading railroad policy, research, and technology organization focusing on the safety and productivity of rail carriers. AAR members include the major freight railroads in the United States, Canada and Mexico, as well as Amtrak and several short line holding companies. Based in Washington, D.C., the AAR is committed to keeping the railroads of North America safe, reliable, efficient, clean, technologically advanced, and secure.

Norfolk Southern Corporation is a member of the AAR. Norfolk Southern is one of the nation's premier transportation companies. Its Norfolk Southern Railway subsidiary operates approximately 21,000 route miles in 22 states, the District of

Columbia and Ontario, Canada, serving every major container port in the eastern United States and providing superior connections to western rail carriers. Norfolk Southern operates the most extensive intermodal network in the East.

Although I represent the AAR today, my comments will reflect to some extent the experiences of Norfolk Southern. However, I can assure you that the examples of infrastructure investment, pervasive competition in the transportation marketplace, and real-world examples of economics in practice that I provide would be similar to those experienced by other railroads.

In this testimony, I will briefly outline the importance of the rail industry to the nation and of the Staggers Act to the rail industry. Next, I will address the vital role railroads play in meeting our nation's transportation needs. Railroads absolutely must continue to play an ever-increasing role in our economy as demand for freight transportation continues to increase because of our ability to move more freight safely, with less fuel, and in a more environmentally-friendly manner. I then will discuss the substantial investment railroads have made to expand their infrastructure to handle more freight and how railroads must be able over the long-term to attract the necessary resources and to earn a return on their investment. That of course is a truism for almost any industry which wishes to maintain its infrastructure and to expand to meet the needs of customers, but it is particularly relevant given the extraordinary capital requirements of our industry. I will examine how extensive and pervasive competition is in the transportation marketplace. Finally, I will note that legislative and regulatory actions that create disincentives to railroads investing in infrastructure are bad policy because they risk returning the industry to its pre-1980 state. Even if the results of errant policy were

not that dramatic, they would undermine our national goal of having a transportation system in place to meet the growing demand for freight transportation.

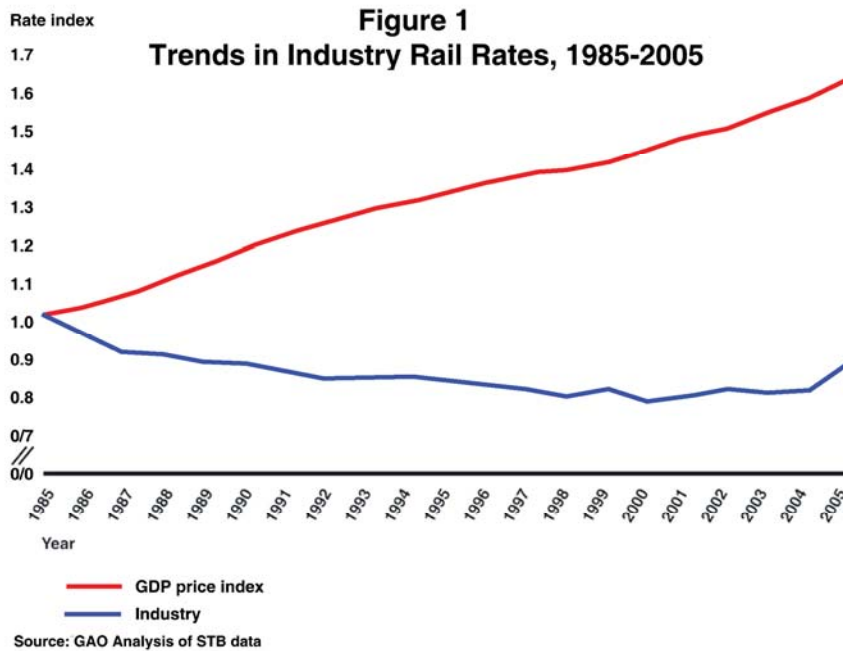
## **I. THE STAGGERS ACT OF 1980 HAS BEEN A RESOUNDING SUCCESS.**

The Staggers Act was a historic piece of legislation that gave railroads the tools to become an effective component of the national transportation system. Among its important elements, the Staggers Act:

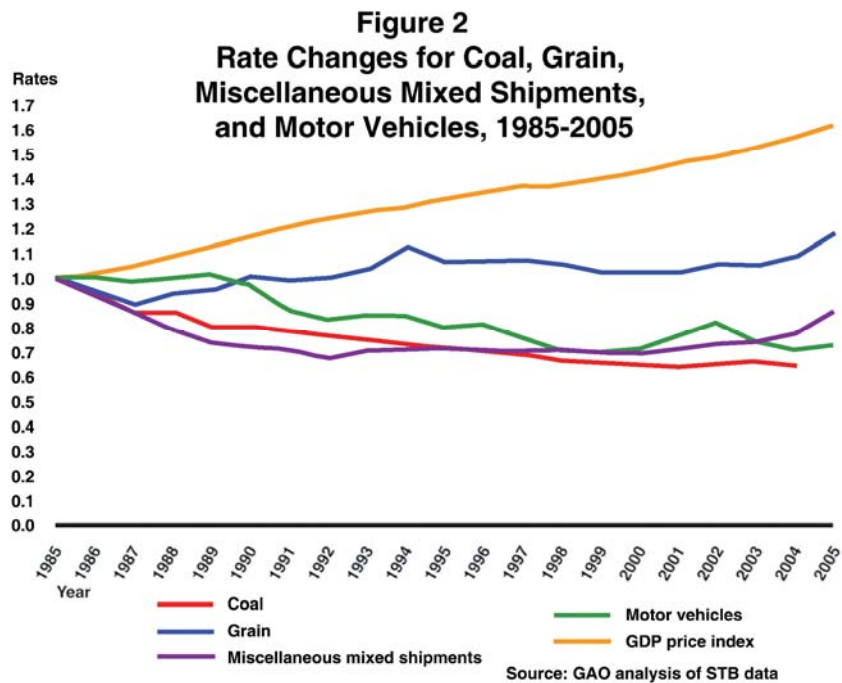
- Freed railroads and shippers to negotiate terms and rates for shipments and to enter into confidential contracts outside the regulatory regime;
- Provided for a regulatory backstop when railroads and shippers did not enter into a contract to prevent railroads from abusing any market power over the minority of shippers without effective transportation alternatives;
- Expanded the power of the Interstate Commerce Commission, and now the Surface Transportation Board, to exempt traffic from regulation and encouraged the use of that power; and
- Made it easier for railroads to shed unprofitable lines.

The results of this statute were vital, but took decades to bear fruit and put the industry on a path to greater returns. The successes were aided by population and demand growth, which are underscoring the need for more of the approaches of Staggers, not less. The fact that Staggers injected market influences into the rail industry and lightened the regulatory thumb on the industry has been widely documented. Railroads' productivity improved, and many of those productivity improvements were passed on to shippers. Railroads shed unprofitable lines and invested in infrastructure elsewhere. Railroads became safer.

Consider the following analysis performed by the Government Accounting Office. In Figure 1, GAO looked at rail rates from 1985 to 2005 and compared it to the gross domestic product ("GDP") price index.



Amazingly, rail rates today are about the same as they were 20 years ago, even before accounting for inflation. Moreover, as shown in Figure 2, GAO’s analysis shows that rail rates for nearly all commodities are as low as they were in 1985, and rail rates for all commodities have increased substantially slower than the gross domestic product (“GDP”) price index.



The results would be even more dramatic had GAO taken inflation into account in its analysis.

Here are my essential points today:

1. The U.S. desperately needs more transportation resources, including more railroad resources.
2. The railroads are the only transportation resource that pays its own way, and the costs are exceptionally high.
3. To keep paying our way and building to meet the nation's growing needs, we have to be able to earn fair returns on that substantial investment.
4. Re-regulation will hurt returns, prevent much new investment, and ultimately hurt service and employment.

5. Recent STB decisions have the potential for significant negative effects on railroad revenues by giving shippers more expeditious ways of reducing our rates, and in the STB's cost-of-capital decision, reducing the costs reflected in rate computations. Indeed, the long-term effects of the latter decision may be quite serious for the industry and for the American transportation system.
6. We are proud to be the safest, most fuel efficient, and environmentally friendly ground transportation by far.
7. We want to help take the load off the highways, reduce U.S. fuel demand, and remain one of the true advantages of U.S. manufacturers.

## **II. RAILROADS PLAY A LARGE ROLE IN THE ECONOMY AND ARE VITAL IN THIS TIME OF GROWING FREIGHT DEMAND.**

### ***A. Railroads Are a Competitive Advantage for the United States.***

Railroads play a critical role in our economy, and their importance is growing. Today's freight railroads are among the few genuine advantages that U.S.-based manufacturers have compared to overseas manufacturers. The commodities the railroads transport are essential to the economy. For example, railroads transport:

- More than 70% of coal used for electric power;
- 35% of the grain harvest;
- 70% of automobiles made in America; and
- 21% of chemicals.

Railroads transport these goods efficiently as well. As the World Bank's Louis Thompson has noted, "[b]ecause of a market-based approach involving minimal

government intervention, today's U.S. freight railroads add up to a network that, comparing the total cost to shipper and taxpayers, gives the world's most cost-effective freight service." Put another way, rail freight transportation is one of this country's comparative advantages that help us compete in that world economy.

***B. Freight Demand Is Growing, But the Ability for Highways to Grow Is Limited.***

The demand for freight transportation is growing and will continue to grow. The Department of Transportation has estimated that the demand for freight transportation would increase by 55 percent between 1998 and 2020.<sup>1</sup> More recently, DOT projected that total freight transportation demand would rise 92 percent from 2002 to 2035, including an 88 percent increase for railroads.<sup>2</sup> Similarly, the American Association of State Highway and Transportation Officials projected that freight tonnage will grow by almost 57 percent between 2000 and 2020. Whether 88 percent, 55 percent, 57 percent, or some other percent is the exact right estimate is not what is important. What is important is that demand has been growing and is expected to continue to grow substantially. According to some of the materials circulated by Consumers United for Rail Equity ("CURE"), "We're in a perpetual rush hour for freight. It's a lot like hitting interstates in Chicago at 5:00pm, every day of the week."<sup>3</sup>

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<sup>1</sup> U.S. DOT, Federal Highway Administration, *Freight Analysis Framework*, October 2002.

<sup>2</sup> Federal Highway Administration, *Freight Facts and Figures 2006*, Table 2.1.

<sup>3</sup> Quoting Marcia Zarley Taylor, *Rush Hour on the Rails*, (Sept. 7, 2006).

Railroads will be critical to meet this growing demand for freight transportation. Railroads will have to play a large role because highways will be unable to absorb that kind of growth in demand for freight transportation. There is a maintenance backlog across the highway system as recently illustrated by the tragic collapse of the highway bridge in Minnesota. The American Society of Civil Engineers (“ASCE”) estimates that the annual need for bridges, roads, and transit is \$94 billion, but that we spend less than \$60 billion.<sup>4</sup> Still the highway trust fund balances continue to decline. In addition, highways are already choked in many parts of the country, which according to ASCE costs drivers \$63.1 billion a year.<sup>5</sup> Given the issues the highway trust fund faces, the limited amount of the Federal budget that is available to cover all discretionary spending, of which transportation is only a small part, and the maintenance needs of our highways and bridges, highway capacity is not likely to expand to any significant degree in the future.

***C. Railroads Will Have to Be Part of the Long-Term Solution to the Nation’s Transportation Needs.***

In short, efficient and effective rail transportation is not just a necessity today. It will continue to be vital to the health of the U.S. economy for years to come. To play that role, railroads must plan and invest years before traffic growth may materialize because of the delays involved in building rail capacity. Of course, to justify that investment, railroads must be able to look out into a predictable future and determine that their investment will be permitted to generate sufficient returns for their owners.

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<sup>4</sup> <http://www.asce.org/reportcard/2005/actionplan07.cfm>

<sup>5</sup> Id.



The need for railroads to expand is not just some railroad talking point. It is the real world – not because railroads say so and not because DOT, AASHTO, and other experts forecast large growth in freight demand – because rail customers say so.

Recently, a coalition of coal shippers filed comments with the Surface Transportation Board in which they made the case for rail capacity as follows:

“It is critical, of course, that the railroads maintain adequate capacity and infrastructure to transport coal to utility power plants. As explained above, coal shippers are dependent upon rail carriers to provide needed coal transportation service, and disruptions in this service due to inadequate capacity can impose substantial damages upon electric generating utilities and their customers.”<sup>6</sup>

The point is that rail capacity is essential. That coal shipper association wants capacity to handle present “coal traffic volumes” and wants railroads to “stay ahead of growing coal traffic demands in the future.”<sup>7</sup> Shippers of all types are asking for more capacity, but that kind of investment can only be justified if adequate returns on the investment are possible.

The need for additional capacity was recently highlighted in a study by Cambridge Systematics. In September of this year, Cambridge Systematics presented the NATIONAL RAIL FREIGHT INFRASTRUCTURE CAPACITY and INVESTMENT STUDY. The study is one of many requested by the National Surface Transportation Policy and Revenue Study Commission, established by Congress in 2005. This study seeks for the first time to qualify the need for freight rail infrastructure investments. I would like to highlight some of their findings. “This study indicates that an investment of

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<sup>6</sup> Ex Parte 671, *Rail Infrastructure and Capacity Requirements*, Comments of Concerned Captive Coal Shippers, at 11 (April 4, 2007).

<sup>7</sup> Ex Parte 671, *Rail Infrastructure and Capacity Requirements*, Comments of Concerned Captive Coal Shippers, at 23 (April 4, 2007).

\$148 billion (in 2007 dollars) for infrastructure expansion over the next 28 years is required to keep pace with economic growth and meet the US DOT's forecast demand. Of this amount, the Class I freight railroads' share is projected to be \$135 billion and the short line and regional freight railroads' share is projected to be \$13 billion. Without this investment, 30 percent of the rail miles in the primary corridors will be operating above capacity by 2035, causing severe congestion that will affect every region of the country and potentially shift freight to an already heavily congested highway system.

The projected rate of growth over the next 30 years is not extraordinary, but it comes after two decades of growth in rail freight tonnage that has absorbed much of the excess capacity in the existing rail freight system. Most of the moderate-cost capacity expansions have already been made; future capacity expansions will be purchased at a higher cost because they will require expensive new bridges and tunnels and more track and larger terminals in developed areas.

The Class I railroads anticipate that they will be able to generate approximately \$96 billion of their \$135 billion share through increased earnings from revenue growth, higher volumes, and productivity improvements, while continuing to renew existing infrastructure and equipment. This would leave a balance for the Class I freight railroads of \$39 billion or about \$1.4 billion per year to be funded from railroad investment tax incentives, public-private partnerships, or other sources.

These investment projections assume that the market will support rail freight prices sufficient to sustain long-term capital investments. If regulatory changes or unfunded legislative mandates reduce railroad earnings and productivity, investment and

capacity expansion will be slower and the freight railroads will be less able to meet the US DOT's forecast demand".<sup>8</sup>

**III. THE ABILITY OF RAILROADS TO PLAY A LARGER TRANSPORTATION ROLE DEPENDS ON THE AVAILABILITY OF SUFFICIENT RESOURCES FOR A SUSTAINED PERIOD.**

Let me start by pointing to the stark reality that railroads spend dramatically more than any other industry just to run their physical plant. Five times more of every incoming dollar is needed—five times.

Norfolk Southern – like other railroads – has invested record sums to increase its capacity and improve its operations while maintaining its focus on safety. But, the biggest challenge we continually face is having the resources to maintain our existing infrastructure and to expand that infrastructure to meet the increasing demand for our service and the changing shipping patterns and needs of our customers.

U.S. freight railroads have been devoting enormous resources to maintain their existing infrastructure, to improve their operations and infrastructure and to alleviate the capacity constraints that arise from increasing freight demand. Indeed, from 1996 to 2005, the average U.S. manufacturer spent 3.4 percent of revenue on capital spending. The comparable figure for freight railroads was 17.2 percent, or more than five times higher.

Likewise, Norfolk Southern makes large capital expenditures every year to maintain and expand its infrastructure. Between 2000 and 2006, our capital expenditures have totaled more than \$6.3 billion, while our net income over the same period was only

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<sup>8</sup> "National Rail Freight Infrastructure Capacity and Investment Study"

\$5.2 billion. Over the same period, our expenses for track maintenance were approximately \$2.8 billion. In 2007, Norfolk Southern capital expenditures will be approximately \$1.4 billion, which is almost equal to its total net income from 2006.<sup>9</sup>

The expenditures we make are necessary to maintain and to expand our physical plant and locomotive and car fleet so that we can serve our customers better, handle larger volumes of freight safely, and respond to our customers' changing shipping patterns. At the same time, capacity expansion projects must generate returns sufficient to justify the investment.

The facts demonstrate that railroads continue to invest to expand their capacity. Consider some of Norfolk Southern's investments in just the last two years.

In 2006, Norfolk Southern among other things:

- Closed a deal to create a joint venture with the Kansas City Southern Railway, which will result in \$300 million dollars of investment mostly to upgrade the rail line between Meridian, Mississippi and Shreveport, Louisiana, so that the line can move more freight more quickly across the line. Already, 45 miles of formerly non-signalized territory have been converted to centralized train control, 100 miles of crosstie replacement has been completed, 150 miles of ballast and surfacing work has been done, and 45 miles of rail has been replaced with new rail in three locations.
- Opened a new rail line to the coal-powered Keystone Generating Station in Shelocta, Pennsylvania. The \$44 million public-private partnership trims 51 miles off the trip from Saltsburg, Pennsylvania to Shelocta and increases the capacity of the plant.
- Began work on the \$62 million Rickenbacker Intermodal Terminal in Columbus, Ohio, which will increase freight capacity in that region by more than 40 percent.
- Added infrastructure in the following corridors: Memphis, Tenn. to Chattanooga, Tenn.; Chattanooga, Tenn. to Atlanta, Ga.; Atlanta, Ga. to Jacksonville, Fla.; Charlotte, N.C. to Manassas, Va.; West Virginia Secondary; Columbus, Ohio to Cincinnati, Ohio; Goldsboro, N.C. to

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<sup>9</sup> Net income for 2006 was \$1.48 billion.

Morehead City, N.C.; St. Louis, Mo. to Louisville, Ky.; and our route to Albany, N.Y. and New England.

- Acquired 142 additional locomotives.

Norfolk Southern's announced 2007 capital budget includes, among other things:

- Beginning work on its Heartland Corridor project. This ambitious public-private partnership will improve 30 tunnels in four states so that they are able to handle double-stacked intermodal trains. It includes the development of a new Norfolk Southern-owned intermodal facility in Columbus, Ohio, which when fully developed will have the capacity to handle 400,000 lifts per year. When completed, Norfolk Southern will shorten the time it takes for containers to travel from port to plains by over 20 percent and the distance they travel by more than 20 percent.
- Investing in capacity by making capital roadway improvements. Norfolk Southern plans to spend \$610 million for rail, crosstie, ballast and bridge programs, including \$73 million in infrastructure investments for increased capacity. In addition, Norfolk Southern plans to spend \$47 million for communications, signal, and electrical projects; \$41 million for maintenance of way equipment; and \$16 million for environmental projects and public improvements such as grade crossing separations and crossing signal upgrades.
- Making capital investments in intermodal terminals and equipment to add capacity to the Norfolk Southern intermodal network, increase access and capacity for coal traffic, bulk transfer facilities, and vehicle production and distribution facilities – all at a cost of about \$97 million.
- Spending about \$60 million for capital projects related to computers, systems and information technology, which will enhance safety and improve operating efficiency and equipment utilization.
- Investing approximately \$321 million in capital on equipment to:
  - Purchase 53 six-axle locomotives and upgrade existing locomotives (Subsequent to the announced 2007 capital budget, Norfolk Southern also made a commitment to acquire an additional 50 locomotives, 20 of which are expected to be delivered in the fourth quarter of 2007.).
  - Purchase 1,300 new higher-capacity coal cars as part of a multiyear program to replace the existing coal car fleet.

- Purchase 739 freight cars as their leases expire; certify and rebuild 388 multilevel automobile racks; and add supplemental restraints to multilevel racks.
- Renewing expiring equipment operating leases covering more than 2,800 cars.
- Leasing 200 additional construction debris cars.
- Repairing freight cars at a cost of \$56 million. Our repair plan for 2007 reflects a 17 percent increase in repairs over the number of cars repaired in 2006. Norfolk Southern has announced a new car repair facility in Portsmouth, Ohio that will open next year.

In addition, Norfolk Southern is hiring and training 1,300 train and engine employees.

Other railroads could – no doubt – provide a similarly extensive list.

Railroads try to balance their customers' competing needs and invest to maximize their network. If we had only intermodal customers, our investments would be different than if we had only coal customers or only chemical customers. In fact, Norfolk Southern serves thousands of customers with different transportation needs for their thousands of different commodities. The investments we make represent our best judgment as to how to strike the right balance, consistent with the requirement that we obtain adequate returns on our capital and serve our varied customers.

In the current and expected growth environment, it is especially important that railroads have the resources and the ability to improve their infrastructure now to meet future needs for three reasons. First, capacity is not limitless. Second, capacity is expensive. Third, it takes time to build rail infrastructure and capacity.<sup>10</sup> Given the time

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<sup>10</sup> For example, it took years for the industry to reach agreement on a plan to address rail congestion in Chicago. After several years of effort on this historic public-private partnership, the rail industry, local officials, and state leaders were able to join together to seek congressional funding for the public benefits that would flow from the project. Even today, the project is not fully-funded, and it is unclear how long it will take to make it a reality – even though it is clearly needed. Moreover, even when it is approved and fully funded, the design, permitting, engineering, environmental review, and construction

it takes to add infrastructure and the long lives of the assets required to expand capacity, it is essential for railroads to take a long view on infrastructure investments, which is how we manage our business at Norfolk Southern.

Today, railroads are investing in capacity to address the growing demand for freight transportation and have incentive to do so. Uncertainty across the regulatory and legislative landscape is making it challenging to determine whether railroads should continue to invest at current levels. If the government creates disincentives for railroad investment, then the question is who will pay for the transportation capacity the nation will need in the future.

#### **IV. COMPETITION IN THE TRANSPORTATION MARKETPLACE IS GREATER THAN EVER.**

Some shipper groups have called for legislation to re-regulate the railroads. These calls are based on a desire to artificially lower rates, not on competition. Today there is more competition in the transportation marketplace than ever, and re-regulation would hobble railroads and ultimately customers.

First, railroads face competition from other modes of transportation. Motor carriers are the railroads' largest competitor. Railroads also compete vigorously against other modes, including barges and pipelines. Motor carriers are the railroads'

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of a major project can take years. As another example, from the time Norfolk Southern started the environmental permitting process to build a new intermodal yard in Atlanta to the time it opened its \$110 million facility in Austell, Georgia was about five years. Just how many years it takes to make a project a reality depends on the time required to secure the necessary permits, local opposition, resources and money available, and the railroad's ability to complete the work in a way that least impacts its ability to serve its customers whose traffic moves on those lines. However, while delivering highway and environmental relief, railroad expansion still seems to require far less time and money than highway expansion.

competition for intermodal traffic. When the railroad gains that business, trucks are removed from the highway system and less fuel is consumed. But trucks compete with railroads to transport many commodities and have the vast majority of intercity freight. While railroads have approximately 40 percent of the intercity freight ton-miles, railroads have only 10 percent of the intercity freight revenues. There are a number of examples where railroads compete against trucks; for example in 2001 Norfolk Southern constructed a new Intermodal terminal for serving the Cleveland area. In 2000, our volume in the Chicago-Cleveland lane was 10,500 units. In 2006, we handled 75,961 units—an increase of 621 percent. The response in 2001 to our new facility and train services in the lane was immediate and significant, with our monthly volumes tripling once the facility opened. Prior to this, much of this volume had been trucked to/from Chicago. Also in 2001, Norfolk Southern began serving the Georgia Port Authority's new Mason ICTF facility in Savannah, which allowed for direct ship to train transfer of containers, combined with direct line haul service to Atlanta and points beyond, and thus avoiding the delays associated with using the local port belt railroad to access the pier or a dray to our off pier terminal. Being only 250 miles to Atlanta, truck was the predominant mode in this lane. At the same time, as the new terminal opened, Norfolk Southern added additional dedicated Intermodal trains in the lane, allowing us to strongly compete with trucks in terms of transit time. As truck capacity in the Savannah area continues to tighten and container volumes moving through the port continue to increase, more and more traffic is being diverted off the highways and on to Norfolk Southern. Since 2000, volume has grown 528 percent in this lane. It continues to grow in 2007, despite the overall slow down in the industry. We have been able to handle this traffic



because rail provides a better value. But, the bottom line is that trucks are a real constraint in the marketplace.

Barges are also a key competitor. Recently, Norfolk Southern was able to win some business from barges; however, our customers can go back and forth. Alabama Electric Cooperative, which had received coal by barge, recently awarded Norfolk Southern a coal transportation contract. In another example, we were able to move to rail chemical business that Rohm and Hass had transported by barge. Again, barges are also real and threatening competitors.

Additionally, many large railroad customers are large companies, a number with resources far in excess of the railroads. These companies know how to maximize their leverage. Most large companies have multiple rail-served facilities with some of the facilities served by one railroad, some facilities served by another railroad and some facilities served by two railroads. The customer uses its traffic at the dually-served facilities to negotiate a better rate/service package on traffic at the single-served facilities. That is one source of leverage. Another source is product competition. For example, assume we are the sole serving carrier at a chemical plant that ships to numerous receivers. When the receiver can use another product in lieu of the one produced at our solely-served facility, if our rate is too high, we will lose the business. The STB won't allow us even to mention product competition in a rate case, but our customers "mention" it often to us. It is real. Another major source of competition is geographic competition. For example, while Norfolk Southern has chemical and coal plants that are served only by us, our customers often have similar facilities served by another railroad. If our rate is too high, our customer will increase production at the facility served by another railroad

and we lose business. Utilities have yet another source of competition that could be viewed as a combination of product and geographic competition. Instead of producing electricity at its coal-fired, solely-served facility, it has the option of producing electricity at one of its other facilities that do not use coal or purchasing electricity produced elsewhere by other utilities. In short, even where there is only one railroad serving a facility, there are market factors at play. These competitive constraints are real.

Look at the most recent GAO report. Rail rates in 2005 were at about the same level they were 20 years earlier – and that does not take inflation into account! If rail rates are increasing due to increased demand, that is what is supposed to happen. There is clearly no structural problem. If railroads had unchecked monopoly power, the numbers in the GAO report would never have occurred.

Third, competition even among railroads has increased since 1980. Shippers who have access to one railroad today have rarely been served by more than one railroad. Policymakers should understand that Staggers did not degrade historic options. If they ask any shipper who complains of having only one railroad serving its facility: “when in history did your facility get served by more than one railroad,” they are likely to hear “never” in the overwhelming majority of cases.

Moreover, the Interstate Commerce Commission and the Board’s merger policies have protected shippers that had access to multiple rail carriers prior to the merger and generally ensured that such shippers had access to multiple carriers after the merger.

Other areas have been opened to multiple carrier access when single carrier access was all that previously existed, such as the Bayport Loop in Houston, Texas, as a result of the Board’s policies to promote build-ins where the economic sense of such a build-in is

shown by private entities putting up the money. In the Union Pacific/Southern Pacific merger, the STB created over 4,000 miles of new trackage rights and gave competitive access to every new shipper that locates on them.

Additionally, mergers have expanded single-line service, which means dramatically more shippers benefit from the inherent efficiencies that resulted from being able to ship from origin to destination on one railroad rather than having to use many railroads to get from origin to destination.<sup>11</sup> For example, Norfolk and Western was a coal railroad, while Southern Railway was a more diverse railroad. Given their individual geographic reaches, however, neither could have developed what has become the Norfolk Southern intermodal system. Neither Norfolk and Western nor Southern Railway reached New York. Norfolk and Western reached Chicago but not Atlanta. Southern Railway reached Atlanta but not Chicago -- so neither had the size, scope and density to develop an effective and competitive intermodal network. Absent the mergers, there would still be more railroads, but with fewer resources and access to fewer markets, which would not be better for rail customers.

Some shippers claim that the government should mandate access, so that customers who have never been served by more than one railroad can receive service from multiple railroads. They argue that government access -- such as mandated switching, trackage rights, terminal access, and interline rates -- is competition. Actually, it is not. Railroads require expensive infrastructure to serve a facility. There have been

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<sup>11</sup> What mergers removed was the need in many instances for a customer's shipment to be moved by multiple carriers -- and the inefficiencies associated with the interchanges that were needed between railroads. That is dramatically different from an assertion that mergers have lessened competition for customers who have never had their origin or destination served by more than one carrier.

build-ins by railroads and build-outs by shippers at facilities that can generate enough rail traffic to justify service by two or more railroads (again, resulting in an increase in competition since 1980), but most shipper facilities simply do not generate that level of traffic. In other words, there is not enough money to support two railroads at most shipper facilities, which is why relatively few facilities have ever had service by more than one railroad. True market competition does not keep two competitors in a market -- or force more competitors into a market -- that will support only one. These shippers really want the government to force one railroad to subsidize another railroad by providing below market access to its lines, which would remove any incentive for the owning railroad to invest in such infrastructure.

**V. POLICYMAKERS SHOULD REJECT LEGISLATION AND REGULATION THAT WILL CREATE DISINCENTIVES FOR RAILROADS TO INVEST IN THE INFRASTRUCTURE NEEDED TO MEET THE GROWING DEMAND FOR FREIGHT TRANSPORTATION.**

Any legislation or regulatory action that would result in railroads being unable to invest would be bad transportation policy at any time. But legislation or regulatory action that would result in railroads being unable to invest would be particularly bad at this time, when the nation needs railroads to expand.

We know it is bad policy because of history. The Staggers Act was adopted because the U.S. railroads were breaking. Re-regulation of the railroad industry will result in the catastrophe the industry saw before the adoption of the Staggers Rail Act of 1980, which was marked by rail bankruptcies, decrepit infrastructure that resulted from years of inability to invest in maintenance, and government bailouts. But it will be much

worse now because the entire transportation infrastructure is strained in a way it was not then.

Before the Staggers Act, regulation of the rail industry was expansive. The United States House of Representatives said: “Regulatory constraints . . . impinged upon management’s ability to adjust rates, merge corporate entities, abandon facilities and services, and improve productivity.”<sup>12</sup> Rate regulation was pervasive and regulation restricted price competition.<sup>13</sup> “Railroading has fallen on difficult times.” That was how the Department of Transportation summed up the situation in 1978.<sup>14</sup>

The detrimental effects of this excessive regulation are well known, as are the successes of the Staggers Act. In the same 1978 report, the Department found that railroads were unable to attract capital from private sources and unable to maintain their physical plants.<sup>15</sup> Indeed, the Interstate Commerce Commission tracked standing derailments, which were railcars that were not moving but that simply fell off the tracks because the tracks were in such poor shape.

Railroads throughout the Northeast failed. The result of that expansive and invasive regulatory regime was bankrupt railroads, including the largest bankruptcy in

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<sup>12</sup> H.R. Rep. No. 96-1035 at 85 (1980).

<sup>13</sup> Id. at 88.

<sup>14</sup> Dept. of Transp., A Prospectus for Change in the Freight Railroad Industry, at 2 (Oct. 1978) (“Prospectus”).

<sup>15</sup> “Even the healthiest industry does not rely solely upon internally generated cash to finance current capital expenditures – virtually all industries obtain additional funds through the sale of equity or debt. With some exceptions, however, railroad earnings are too low to attract new equity or debt other than for equipment purchases or rollover of old debt . . . As a result, the availability of private capital for future investments may be curtailed, because investors believe that returns generated with the investment of additional capital will not equal returns from alternative investments with similar risks.” Prospectus at 69.

America to that time – the bankruptcy of the Penn Central. The government had to step in and create what came to be known as Consolidated Rail Corporation or Conrail. Only the Staggers Act stopped the decline of the industry, which took many years to reverse. We need to be clear that the Staggers success was hardly an overnight sensation. It has literally taken decades for the railroads to reach a level of returns that allows new investment to serve the nation's needs.

Already, recent efforts by the Surface Transportation Board, which at a minimum are injecting uncertainty into the industry and at worst could substantially impact our ability to earn our cost of capital, are causing us to look hard at our willingness to invest in the future. In the last month, the Board has issued erroneous calculations of our industry cost-of-capital, which is based on historic costs of assets with long-lives rather than on the cost of actually replacing the assets, and expanded options for shippers to gain rate relief, which options could result in a downward rate spiral and rate compression.

Are we returning to a legal regime that restricts the railroad industry's ability to invest in infrastructure? Are we on the path to having the industry look like it did before 1980? I am very concerned that we are headed down that path. The results may not be that dramatic right away. But any policy that deters private investment in transportation capacity moves us further from the national goal of building a transportation system sufficient to handle the growing demand for freight transportation.

Legislative and regulatory threats to rail capacity will create substantial disincentives for railroads to invest. If railroads are unable to invest in their own capacity, who will make up the difference? Or, will freight just stack up around the

country because there is not enough capacity to move it? Such threats would directly reduce existing capacity, which would adversely affect all rail customers. If enacted, such legislation would adversely affect railroads' ability to justify many investments in infrastructure that will be needed to handle tomorrow's freight. Policymakers must recognize that if such threats become reality, capacity will be reduced and replacing the lost capacity will take significant time and money.

Instead, policymakers should focus on ways to make it easier for private companies to invest in infrastructure, which is why I encourage you all to support legislation to provide tax credits to railroads that invest in capacity.

## **VI. CONCLUSION.**

A railroad's ability to transport customers' shipments is dependent on capacity. Capacity is dependent on private companies, who are responsible to their shareholders to make good investments and to provide a return on the shareholders' investment, earning returns that justify investments in capacity. Today, railroads are stepping up to meet the growing demand for freight service that is projected over the coming decades. Their investments are allowing them to not only compete against each other, but to compete against all modes of transportation, such as trucks and barges. Whether railroads will be able to continue to do so, will depend on policymakers making wise choices and not creating disincentives to such investment.