

**OVERSIGHT HEARING ON THE SURFACE  
TRANSPORTATION BOARD**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON SURFACE TRANSPORTATION  
AND MERCHANT MARINE  
OF THE  
COMMITTEE ON COMMERCE,  
SCIENCE, AND TRANSPORTATION  
UNITED STATES SENATE  
ONE HUNDRED SEVENTH CONGRESS  
FIRST SESSION

MARCH 21, 2001

Printed for the use of the Committee on Commerce, Science, and Transportation



U.S. GOVERNMENT PRINTING OFFICE

88-036 PDF

WASHINGTON : 2004

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ONE HUNDRED SEVENTH CONGRESS

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## **OVERSIGHT HEARING ON THE SURFACE TRANSPORTATION BOARD**

**WEDNESDAY, MARCH 21, 2001**

U.S. SENATE,  
SUBCOMMITTEE ON SURFACE TRANSPORTATION AND  
MERCHANT MARINE,  
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 9:35 a.m., in room SR-253, Russell Senate Office Building, Hon. Gordon Smith, Chairman of the Subcommittee, presiding.

### **OPENING STATEMENT OF HON. GORDON SMITH, U.S. SENATOR FROM OREGON**

Senator SMITH. Good morning, ladies and gentlemen. I am pleased to call to order the first Surface Transportation and Merchant Marine Subcommittee hearing of the 107th Congress. I am very honored to be chairing this Subcommittee, and I fully intend for us to have an active and productive agenda.

This Subcommittee has enjoyed a long history of bipartisan cooperation, and I assure my colleagues, who I am sure will soon arrive, that I will work to continue that bipartisanship.

As the new Subcommittee Chairman, I am most eager to begin addressing the many challenges and important issues under the jurisdiction of this Subcommittee. In addition to holding hearings on matters of importance to the Members, we will be working to assist the Full Committee Chairman and Ranking Member in developing and moving legislation to reauthorize a number of important Federal agencies and programs that have expired.

These reauthorizations include the Surface Transportation Board, the rail safety program, the hazardous materials transportation program, the Federal Maritime Commission, and the U.S. Maritime Administration. I will note the Committee is already off to a good start with the successful passage of pipeline safety improvement legislation, which passed the Senate in February. Last week, Chairman McCain and I announced the Subcommittee would begin holding a series of hearings on rail transportation, starting with today's oversight hearing on the Surface Transportation Board.

I wanted our Subcommittee's first hearing to address rail issues, because rail transportation is such a critical element of our nation's rail transportation system. Rail freight issues are complicated whether considering rail service or capacity or competition. Moreover, given the Committee has a number of new Members, includ-

ing myself, I believe it would be helpful to all of us if we held a series of hearings to explore the many complex issues involving rail transportation.

In addition to today's hearing, future hearings will focus on the rail industry, including its financial condition, capacity, and long-term capital infrastructure needs. We will also have another hearing which will focus on rail shipper concerns, including reliability, rates, and competition.

Let me say up front I am conducting this series of hearings from an information-gathering approach. Most of us already know there is a line drawn in the sand on certain issues when it comes to rail shippers and the industries, but I am approaching these hearings and topics with an open mind and look forward to hearing the many differing points of view of the interested parties. My goal is to try and find common goal on some of the problems and collectively develop reasonable solutions to those problems, whether through a meeting of the minds or perhaps through legislation.

I know that Chairman McCain shares my strong view that the only way such legislation is going to be advanced is if it is a consensus product, one that can be supported at least in part by both shippers and industry. If I have learned one thing in my public life, it is hard to pass legislation and it is easy to kill legislation, and that is why what I hope to do is foster this consensus-building so we can make progress on critical issues.

I am pleased to kick off this series of hearings with an overview from the Surface Transportation Board chairman, Linda Morgan. Established just over 5 years ago, the Board has issued several thousand decisions affecting our nation's surface transportation system and its users. While the Board's decision may not please all the people all of the time, I think we can all agree that it has demonstrated well what a small agency with limited resources can accomplish with dedicated Board members and a capable staff, and that, Linda, I think is very much a tribute to you.

Let me note that the Board is in the process of rewriting its rules on major consolidations. The Board's proceeding, initiated March 17, 2000, is of great interest to this Subcommittee. I understand, under Senator Hutchison's leadership, a hearing was held last March, just after the Board's merger moratorium announcement. Since that time, the Board has issued its notice of proposed rule-making and has scheduled an oral argument for early next month.

In light of the attention our Committee has been paying to the issue of aviation mergers in recent weeks, we will all be interested in hearing first-hand the direction the Board is taking with respect to major consolidation transactions under its jurisdiction and, should other members join us soon, and we do expect several of them, we will ask them for their opening statements should they have them, but Chairman Morgan, we welcome you, and thank you for taking time to be with us to prepare for this hearing. We are anxious to hear what you have to tell us. The mike is yours.

**STATEMENT OF HON. LINDA J. MORGAN, CHAIRMAN,  
SURFACE TRANSPORTATION BOARD**

Ms. MORGAN. Thank you, Mr. Chairman. I am appearing here today at the request of the Committee to discuss the Board and its

achievements. I have some oral remarks, which I will make brief. I also have submitted written testimony, which I would ask be included in its entirety in the record.

Senator SMITH. Without objection, it will be included.

Ms. MORGAN. My written testimony reviews the Board's accomplishments, particularly in the rail area, since its establishment in 1996, as well as the Board's budget and its ongoing proceeding to examine its major rail merger policy and rules.

My written testimony, I believe, demonstrates that the Board has acted responsibly but aggressively when necessary, and that we have been a positive force in addressing the concerns brought to our attention.

I believe that the Board has been a model of common sense Government, looking for creative solutions to the serious regulatory issues entrusted to it, promoting private sector initiative and resolution where appropriate, and undertaking vigilant governmental oversight and action in accordance with the law where necessary. And I believe that the Board has been a model of efficient and effective Government, doing more with less, tackling hard issues, and resolving cases fairly and expeditiously, and being upheld in court over 90 percent of the time.

My testimony highlights how the Board has handled its responsibilities in this regard. It discusses the service crisis in the West, the 1998 access and competition proceedings that the Board conducted at the request of this Committee, rate and service issues, formal and informal dispute resolution, mergers, and employee matters.

A key focus of the law that the Board implements is to permit the freight rail industry to operate in the marketplace without regulatory interference unless regulatory oversight is necessary to address marketplace imperfections for which the law provides relief.

An important part of the Board's regulatory oversight involves the ability of captive shippers to have real access to a process for challenging unreasonably high rail rates. I know that concerns remain about the burden and the complexity of this process. The Board has responded to these concerns within the context of the law.

We have set deadlines, established procedures, and developed a rate review methodology that works, and under which large shippers that have brought complaints have been successful. We have changed the market dominance rules for rate complaints to make the process simpler, less burdensome, and more accessible for all shippers, and although the court, upon challenge of the railroads, has ordered us to take another look at that case, we will continue to make all of our processes workable and accessible whenever we can.

I know that concerns remain about the ability of the smallest shippers to bring rate challenges. As I pointed out in my letter to this Committee in 1998, I believe that we have done what we can under the statute in this regard. I would be happy to work with the Congress further on this issue.

Another matter that has concerned all of us has been the service problems experienced throughout the rail sector in connection with the recent round of mergers. Although I have not always been sat-

ified with where the industry service record has been, I believe that the Board has been a positive force in helping on both a formal and an informal basis to fix problems that have arisen while averting new ones, and not taking actions that would help some and hurt others.

And I feel that our recent action, which was affirmed in court, imposing a 15-month moratorium while we revisit the Board's merger policy was an important step to ensure that the then-existing service problems were not further aggravated.

By June, we will have held our oral argument and completed our reexamination of our merger policy and rules. I cannot be too specific yet, but given the current configuration of the industry at the Board we are looking to raise the bar for approval so that applicants will bear a substantially heavier burden in demonstrating that a merger proposal is truly in the public interest.

We are looking at requiring merger applicants to affirmatively show that the transaction will enhance competition and improve service. We are looking at requiring more accountability for benefits that are claimed, and a showing that such benefits could not be realized by means other than a merger. We are looking at requiring more details up front regarding service that would be provided, as well as contingency planning and problem resolution in the event of service failures. And we are looking at dealing with a collective bargaining agreement issue that has concerned rail labor in the past.

I know that, regardless of how much we have done at the Board, and how much we can do in the future at the Board, there are those who will say that we have done nothing of substance unless we somehow provide for a regulatory scheme that guarantees every shipper the opportunity to be served by at least two carriers, the so called "open access" approach to regulation.

I hope that the Members of the Committee can appreciate that the Board has acted responsibly to address in a manner consistent with the statute the concerns that have been raised about the rail sector, and to drive change and to otherwise carry out its responsibilities in a way that has moved the industry in a positive direction. I also hope that as we move forward we take the long view and act so as to ensure that the steps that we take will produce the type of rail network we want into the future.

I would be happy to answer any questions that you might have.  
[The prepared statement of Ms. Morgan follows:]

PREPARED STATEMENT OF LINDA J. MORGAN, CHAIRMAN,  
SURFACE TRANSPORTATION BOARD

INTRODUCTION

My name is Linda J. Morgan, and I am Chairman of the Surface Transportation Board (Board). I am appearing today at the Subcommittee's request to provide an overview of the Board's activities since its inception, with a particular focus on actions taken by the Board on various rail transportation issues. The Subcommittee also has asked for information regarding the Board's budget, as well as the Board's proceeding to reexamine its major rail merger policy and rules.

I have testified numerous times before Congress since the creation of the Board. My testimony here attempts to capture the essence of the prior testimony and provide an update on Board activities since my Congressional appearances last year.



## OVERVIEW OF THE BOARD

The Board came into being on January 1, 1996, in accordance with the ICC Termination Act of 1995 (ICCTA). Consistent with the trend at that time toward less economic regulation of the surface transportation industry, the ICCTA eliminated the Interstate Commerce Commission (ICC) and, with it, certain regulatory functions that it had administered. The ICCTA transferred to the Board core rail adjudicative functions and certain non-rail adjudicative functions previously performed by the ICC. Motor carrier licensing and certain other motor functions were transferred to the Federal Highway Administration within the Department of Transportation (DOT). And Congress provided the Board with more limited resources.

The Board is a three-member, bipartisan, decisionally independent adjudicatory body organizationally housed within DOT. The rail oversight conducted by the Board encompasses, among other things, maximum rate reasonableness, car service and interchange, mergers and line acquisitions, line constructions and abandonments, and labor protection and arbitration matters. The jurisdiction of the Board also includes limited oversight of the intercity bus industry and pipeline carriers; rate regulation involving noncontiguous domestic water transportation, household goods carriers, and collectively determined motor rates; and the disposition of motor carrier undercharge claims. The substantial deregulation effected in the Staggers Rail Act of 1980 (Staggers Act) and the laws governing motor carriers of property and passengers was continued under the ICCTA. The ICCTA empowers the Board, through its exemption authority, to promote deregulation through administrative action.

The period after the passage of the ICCTA presented many logistical challenges. Fewer than half of the personnel who had worked for the ICC were retained by the Board. Yet, the case load remained heavy, and indeed increased in complexity and degree of challenge, particularly with the significant restructuring taking place in the rail industry and the focus of parties on testing the law in certain areas. The Board had to find ways to do more with less.

We hit the ground running, and quickly became what I believe to be a model Federal agency. We were given many rulemaking deadlines in the ICCTA, and we met each and every one of them. We revamped the old ICC regulations to reflect the new law; we streamlined the regulations that remained relevant to make them work better; and we issued new regulations so that we could move cases to resolution more quickly. We have continued to meet our deadlines and to look for ways to handle matters more efficiently. And we have moved cases faster, and as a result have made great strides in clearing up the older docket.

Many of the cases that we have tackled at the Board—some of which had been pending at the ICC for many years, and some of which have been new—have been extremely difficult and controversial. But a principal focus of the Board's work is the belief that parties who bring disputes to the Board want and should have the certainty of resolution and that the Board is here to make decisions in hard cases. Not everyone will like every decision we issue, but our job is to take the controversies that come our way, review the records carefully, and then put out decisions as expeditiously as possible that implement the law to the best of our ability. The competence of our staff and the integrity of our decisionmaking process are reflected in our record of success in court: since I became Chairman (at that time of the ICC) on March 24, 1995, several hundred ICC and Board cases have been decided, about 170 cases have been challenged in court, and well over 90% of those cases have been upheld. Fair and expeditious case resolution and the certainty and stability that come from success on appeal should be key objectives for an adjudicative body such as the Board.

## THE BOARD'S RESOURCES

When the Board was created, it was authorized for 3 years, through September 30, 1998. Because of the controversy surrounding the law that the Board implements, the agency has not been reauthorized. However, it continues to be funded on an annual basis, operating at essentially the same resource level since its establishment in 1996.

*Current Fiscal Year.* The Board's current appropriation for fiscal year (FY) 2001 provides \$17.916 million for 143 staff-years. (This resource level is the result of an across-the-board rescission of \$38,000 from the amount originally enacted.). The appropriation provides that up to \$900,000 in user fee collections may be credited to the \$17.916 million appropriation, thereby allowing the Board's resources to be derived from both funding sources. This credit provision also means, in essence, that our funding this year is guaranteed regardless of the level of user fees actually collected.

*The Budget for the Next Fiscal Year.* In the Board's FY 2002 budget, we requested \$18.889 million and 145 staff-years. The President's budget provides for \$18.457 million and 143 staff-years, which is only a slight decrease from our request and essentially represents a *status quo* budget allowing for relatively constant staffing and funding levels. The FY 2002 budget also includes \$950,000 in user fee collections offsetting the \$18.457 million request under the same appropriation crediting provisions contained in the FY 2001 Transportation Appropriations Act. This provision means in essence that our funding would also be guaranteed in FY 2002.

*User Fees.* Congress continues to expect that some of the Board's funds will come from user fees. Significantly, however, the FY 2002 budget is the first one in which the Administration has not requested full funding by user fees for the Board. And recently Congress through the user fee credit provision has guaranteed the Board's funding level up front.

In this regard, particular concern has been raised about the level of user fees associated with the filing of rail rate complaints. In light of this continuing concern, the Board has held down the user fee levels for these cases for the last 2 years to 20% of the full cost of processing one of them, even though a DOT Inspector General report urged the Board to assess fees that more closely adhere to full costs.

The Board regularly revisits its user fee schedule. Further, we have fee waiver procedures in place to ensure that parties seeking adjudication of matters under our jurisdiction are not precluded access to the Board because of the level of user fees.

*Workload.* The Board continues to accomplish much with limited resources. Although there have been some shifts among workload categories, the Board projects a relatively level overall workload through FY 2002. For example, while we have resolved all of the cases in the motor carrier undercharge docket, there has been a significant increase in rail rate case filings, as well as rail restructuring activity in FY 2001. We project that this trend will continue through FY 2002.

*Future Needs.* In connection with future Board resource needs, I should note two issues. First, the Board must continue to focus on hiring new employees in sufficient time to be prepared to replace the many experienced employees that will be retiring in the next few years. Second, the Board must have the resources necessary to accommodate any legislative changes that Congress might approve.

#### THE BOARD'S OVERALL APPROACH TO ITS RESPONSIBILITIES

I believe that the Board has been a model of "common sense government," looking "outside of the box" for creative solutions to the serious regulatory issues entrusted to it, and promoting private-sector initiative and resolution where appropriate while undertaking vigilant government oversight and action in accordance with the law where necessary to address imperfections in the marketplace. In many circumstances, private-sector initiative can provide for better solutions because it can be tailored to the needs of the individual parties, can go beyond what government is able to do under the law and with its resources, and can create a dynamic in which all the parties to the initiative have been involved in its development and thus are invested in its success. And government can use its presence and its processes to encourage such results and bring parties together in new and constructive ways. At the same time, there are circumstances in which more direct government action is necessary, and in such situations, the Board has used its authority appropriately, creatively, and to the fullest extent in accordance with the law.

The work of the Board has exemplified the balance of private-sector and government action. This balance, for example, was demonstrated in the Board's handling of the rail crisis in the West. In that matter, under the umbrella of an unprecedented 9-month emergency service order, the Board required significant operational reporting, engaged in substantial service monitoring, and redirected operations in a focused and constructive way. The Board was successful in working on an informal basis with affected shippers to resolve service problems, and it was careful not to take actions that might have helped some shippers or regions but inadvertently hurt others. And the Board proceeded in such a way as not to undermine, but rather to encourage, important private-sector initiatives that facilitated and were integral to service recovery, such as the unprecedented creation of the joint dispatching center near Houston, TX, and the significant upgrading of infrastructure.

In addition, responding to the concerns of Members of this Committee, and in particular Chairman McCain and Senator Hutchison, we held extensive hearings on access and competition in the railroad industry, which resulted in a broad mix of private-sector and government initiatives, summarized in my attached letter to Senators McCain and Hutchison dated December 21, 1998 (December 21 letter). Those initiatives included the revision of the "market dominance" rules to eliminate "product and geographic competition" as considerations in rate cases and the adoption of

formal rules providing for shipper access to a new carrier during periods of poor service. They also included the formal railroad/shipper customer service "outreach" forums, which produced the public dissemination for the first time ever of carrier-specific operational performance data by the major railroads, based on the data collection that the Board had initiated during its handling of the service crisis in the West and continued in its monitoring of the acquisition of Conrail by CSX and Norfolk Southern (NS). And the initiatives included the unprecedented formal agreement between large and small railroads addressing certain access issues of concern to the smaller carriers and to various members of the shipping public, the implementation of which the Board continues to closely monitor.

My letter to Congress also highlighted areas in which the Board believed legislation would be required if Congress wanted to fully address certain concerns that had been raised. These areas included small shipper rate relief, certain labor matters, and more open access that, unlike the current law, would not require a threshold showing that the serving carrier acted in an anticompetitive way. Regarding open access, the Board did direct interested parties as part of this rail access and competition proceeding to meet to see if common ground could be found. Those discussions were not successful.

The balance of private-sector and government action is also exemplified by the Board's informal dispute resolution process that it used during the service crisis in the West and more recently in addressing service problems that have arisen from the implementation of the Conrail acquisition. And this process has now been formalized through the establishment of the Rail Consumer Assistance Program, discussed later on, and enhanced through monitoring by the Board of the various customer service programs at the various Class I railroads. Also, the Board has been active in focusing the Class I railroads on improving the operations of the Chicago terminal, a major gateway between the East and the West.

At the same time, the Board has promoted purely private-sector dispute resolution. It imposed as a condition to its approval of the Conrail acquisition the establishment of a privately agreed-to Conrail Transaction Council made up of shipper and carrier representatives for the purpose of discussing implementation problems. With the encouragement of the Board, the National Grain and Feed Association and the Association of American Railroads (AAR) and the National Mining Association and the AAR reached groundbreaking agreements on issues of concern to their respective memberships that provide dispute resolution procedures that are more tailored to the interests of the individual parties. These agreements will hopefully provide a model for other such carrier/customer agreements. Furthermore, the Board has attempted to move in the direction of private negotiation rather than government fiat as the way of resolving employee matters, a trend which I discuss later in my testimony.

In individual cases brought to it, the Board has used its authority fully and creatively. For example, in a case in which Amtrak sought to carry certain types of non-passenger traffic, we interpreted the statute in such a way as to bring about a private agreement between Amtrak and individual freight railroads on the matter after the Board's decision was rendered. In railroad consolidation and construction proceedings, our process has encouraged private-sector solutions with respect to environmental and other issues, but where the private parties have been unable to reach resolution, the Board has imposed conditions to remedy the concerns expressed in a way that preserves the benefits of the transaction under consideration. And with respect to the "bottleneck" rate complaint cases (involving rates for a segment of a through movement that is served by a single carrier), while shipper parties argued that the Board should have gone farther in its rate review, the Board's decisions do provide for rate relief where there is a contract for the non-bottleneck segment, based on a pragmatic reading of the statute that was affirmed in court upon challenge by both the railroads and the shippers.

The Board has tackled many difficult issues effectively by balancing private-sector resolution and governmental action. This approach has ensured that, in the spirit of the ICCTA, available resources are put to the best use and government does not interfere inappropriately.

#### RAIL RATE AND SERVICE ISSUES

Since I became Chairman of the ICC and then of the Board, the agency has tackled several important rail rate and service matters, and in this regard I believe that we have been responsive to shipper and other concerns in accordance with the law. In particular, we have been committed to resolving formal and informal shipper complaints expeditiously, clarifying applicable standards for resolution of formal complaints, and leveling the playing field to ensure that the formal process is not

used simply to delay final resolution and that it encourages private-sector resolution where possible. I believe that our record reflects those objectives.

*Rail Rate Matters.* The Board has jurisdiction to adjudicate complaints challenging the reasonableness of a railroad's common carriage rates only if the railroad has market dominance over the traffic involved. Market dominance refers to "an absence of effective competition from other rail carriers or modes of transportation for the transportation to which a rate applies." Under the law, the Board cannot find that a carrier has market dominance over a movement if the rate charged results in a revenue-to-variable cost percentage that is less than 180%. If this ratio is over 180%, then the Board determines whether there is effective competition (historically, by considering whether there was effective intramodal, intermodal, geographic or product competition, but more recently, since the Board eliminated product and geographic competition as considerations in market dominance cases, by considering only intramodal or intermodal competition). If there is no effective competition, then there is market dominance. Thus, in considering any rate reasonableness challenge, the first finding that the Board makes is whether the carrier has market dominance over the traffic involved.

To assess whether rates are reasonable, the Board uses a concept known as "constrained market pricing" (CMP) whenever possible. CMP principles limit a carrier's rates to levels necessary for an efficient carrier to make a reasonable profit. CMP principles recognize that, in order to earn adequate revenues, railroads need the flexibility to price their services differentially by charging rates that reflect higher mark-ups over variable costs on captive traffic, but the CMP guidelines impose constraints on a railroad's ability to price differentially.

The most commonly used CMP constraint is the "stand-alone cost" (SAC) test. Under the SAC test, a railroad may not charge a shipper more than it would cost to build and operate efficiently a hypothetical new railroad, tailored to serve a selected traffic group that includes the complainant's traffic. The Board typically uses this test to resolve the large rail rate complaints that are presented to it.

With respect to rate cases, the Board has established deadlines and procedures to expedite the decisional process, and decisions resolving large rail rate complaints have refined the standards for developing the record in these cases. We have resolved the old cases (such as the "McCarty Farms" case that was pending at the ICC for some years) and—although we have recently been flooded with new rate cases that could tax our resources—we have kept up with our statutory deadlines in putting out decisions in the newer cases that have been filed. We have sought to improve the rate review process by, for example, eliminating the product and geographic competition elements from the market dominance rules and by establishing evidentiary procedures (including a decision issued just recently) to allow us to process large rate cases more efficiently. The reviewing court has told us to take another look at the product and geographic competition case after it was challenged by the railroads, but in that case and in other respects, we will continue to try to find ways to make the process work better.

From a substantive perspective, the CMP procedure for determining whether a rate is reasonable or not is now a well accepted way of measuring rate reasonableness for larger rate cases, and of the 4 large rail rate cases that have been decided by the Board, the shippers have won in 3, while the defendant railroad won 1. Our "bottleneck" decisions, which construed the statute as permitting challenges to bottleneck rates (rates for a segment of a through movement that is served by a single carrier) when the shipper has a contract over the non-bottleneck segment, were, as noted, affirmed by two courts after they were challenged by both shippers and railroads. A number of shippers have taken advantage of the opportunity afforded by the bottleneck decisions and have filed "bottleneck" rate complaints with the agency. Consistent with the Board's philosophy favoring private sector resolution, several rate cases have been settled before the agency reached a decision.

The Board at the end of 1996 adopted simplified rules for small rail rate cases. However, no such cases have been brought to date under those rules. Concerns remain that those rules are still too complex. In my December 21 letter, I explained that the Board's rules reflect the statute and the standards that must be balanced, but I also recommended that Congress consider adopting a single benchmark test or some other simplified procedure for small rate cases to address those process concerns. I am prepared to continue to work with Congress on this matter.

*Service Issues.* Over the past few years, we have used our general oversight and specific legal authority, as well as reporting and specific merger-related monitoring, to promote service improvements and resolve service problems. As I discussed previously, the Board applied its formal emergency service order and informal powers judiciously in dealing with the rail service crisis in the West. In addition, we adopted rules that permit a shipper to obtain the services of an alternative railroad when

service is poor. Those rules require prior consultation among all of the involved parties to ascertain whether the problem can be readily fixed by the "incumbent" carrier, and, if not, to make sure that the proposed service will solve the problem without creating new problems. Board representatives are continually in communication with carrier management about general service issues, and they work on an ongoing basis with carriers and shippers to address individual service problems on an informal basis.

More recently, in connection with the Conrail acquisition in the East, we have engaged in extensive pre- and post-implementation monitoring, including the review of significant operational metrics and plans, and have continued to work constructively with carriers and with shippers to resolve service problems. And the Board in November of last year formalized its informal dispute resolution process by establishing a Rail Consumer Assistance Program through which individuals with rail-related problems can contact the Board's Office of Compliance and Enforcement by way of a toll-free number, an e-mail address, or a web site page. I believe that the Board has effectively addressed and can continue to address service issues.

#### RAIL MERGERS AND COMPETITION

*Background on Past Rail Mergers.* One of the areas in which the Board has issued some high-profile decisions involves major rail mergers. Although mergers and other changes in corporate structure have been going on in the rail industry for many years, there has been substantial rail merger activity since the Staggers Act was passed, reflecting what has been occurring throughout the Nation's economy.

On the basis of the governing statute, under my Chairmanship of the ICC and the Board, four Class I rail mergers have been approved, with substantial Board-imposed competitive and other conditions. During this period, the Board evolved in a creative and constructive way in applying its conditioning authority, also incorporating private-sector agreements into the process. The conditions in a variety of ways provided for significant post-merger oversight and monitoring that have permitted us to stay on top of both competitive and operational issues that might arise. They provided for the protection of employees and the mitigation of environmental impacts, and our recent decisions employed a "safety integration plan" that draws on the resources of the Board, the Federal Railroad Administration, and the involved carriers and employees. And all of our decisions have assured that no shipper's service options were reduced to one-carrier service as a result of a merger.

In varying degrees, these mergers have had the support of segments of the shipping public, as well as employees and various localities, and were considered by a number of interested parties to be in the public interest. A variety of shippers actively supported the Burlington Northern/Santa Fe (BN/SF) merger, the inherently procompetitive Conrail acquisition, and the Canadian National/Illinois Central (CN/IC) merger. The Union Pacific/Southern Pacific (UP/SP) merger was opposed by some segments of the shipping community, although it was supported by others. However, the Board believed it was necessary, not only to aid the failing SP, but also to permit the development of a second rail system in the West with enough presence to compete with the newly merged BN/SF.

Some have said that rail mergers are inherently anticompetitive, that they cause service problems, and that we should be discouraging them. In approving these mergers, the Board (and the ICC before that) considered the statutory criteria and concluded that, with all the conditions imposed, they would not diminish competition and in fact could enhance competition; would produce significant transportation benefits; and were otherwise in the public interest. The Board will continue to exercise its oversight authority in accordance with these objectives.

In this regard, in connection with the UP/SP merger, the Board has issued four general oversight decisions and one related to service in Houston (in addition to its actions with regard to the service crisis in the West); it has issued one oversight decision concerning the CN/IC merger; and in connection with the Conrail acquisition proceeding, it has issued one general oversight decision and two decisions regarding Buffalo, one on rates and the other on infrastructure, in addition to the ongoing operational monitoring of the Conrail acquisition.

*New Major Rail Merger Policy and Rules.* These recent mergers have changed the way the rail system now looks. In 1976, there were, by our calculations, 30 independent "Class I" (larger railroad) systems; nine of those systems have since then dropped down to Class II or III (smaller railroad) status because the revenue thresholds for Class I status were raised substantially some years ago; two large carriers went into bankruptcy; and the remaining 19 systems have been reduced to 6 large independent North American systems in the past 23 years (Kansas City Southern remains a smaller independent Class I system). In the United States,

these include two competitively balanced systems in the West and two competitively balanced systems in the East.

Given the changes in the make-up of the rail system in the past several years and developments associated with the most recent round of mergers, when the BNSF and CN rail systems announced their intention to merge in late 1999, the Board, after four days of hearings, issued a 15-month "moratorium" directing large railroads not to pursue further merger activities until the Board has adopted new rules governing large rail merger proceedings. The Board noted that recent merger implementation had not typically gone smoothly, and that the railroad industry and the shipping public had not fully recovered from the service disruptions associated with the previous round of mergers when the BNSF/CN announcement was made. Additionally, the testimony at the hearing confirmed the Board's perception that a BNSF/CN combination would more than likely instigate, in the very near future, responsive mergers involving each of the other four large systems. Therefore, the Board, like numerous parties that testified before it during its hearing, concluded that it needed to revisit its merger rules for large rail mergers in light of the current transportation environment and the prospect of a North American transportation system composed of as few as two transcontinental railroads. I appeared before this Committee a year ago to discuss the moratorium and the merger policy rulemaking.

In instituting its rulemaking to revise the rules for considering large rail mergers, the Board noted the increased concentration in the rail industry, along with the only limited opportunities remaining for significant merger-related efficiency gains. It concluded that the time has come to consider whether the rail merger policy should be revised, as many have suggested, with an eye towards more affirmatively enhancing, rather than simply preserving, competition and ensuring that the benefits of a future merger proposal truly outweigh any potential harm. More specifically, the Board is reexamining its approach to competitive issues; "downstream" effects; the important role of smaller railroads in the rail network; service performance issues; how benefits should be examined and accounted for; how alternatives to merger, such as alliances, should be viewed; employee issues such as the override of collective bargaining agreements (CBAs); and international trade and foreign control issues that would be raised by any proposal of a Canadian railroad to combine with any large U.S. railroad.

The Board issued an Advance Notice of Proposed Rulemaking (ANPR) in March 2000 instituting its rulemaking to revise its rules for large rail mergers. Following the receipt of public comments on the ANPR and replies to the comments, the Board issued a Notice of Proposed Rulemaking (NPR) in October 2000, proposing new rules for major rail mergers. Over 100 parties are involved in the proceeding, and the Board has given the public the opportunity to file three rounds of comments (initial comments, replies, and rebuttals) on the proposed rules. In addition, the Board has scheduled an oral argument for April 5, 2001, and will hear from over 30 parties. The Board intends to issue its final rules by June 11, 2001, at which time the moratorium is scheduled to expire.

In its NPR, the Board has proposed a new policy statement and rules for future major rail mergers that raise the bar for approval. I have attached a copy of the press release describing the proposed policy and rules. The proposed new rules would require applicants to bear a substantially heavier burden in demonstrating that a merger proposal is in the public interest. Key provisions in the proposed rules would require applicants to affirmatively show that the transaction would enhance competition and improve service. They would require more accountability for benefits that are claimed and a showing that such benefits could not be realized by means other than a merger. And they would require more details up front regarding the service that would be provided, as well as contingency planning and problem resolution in the event of service failures.

#### RAIL EMPLOYEE ISSUES

*Background.* Under the law, the Board becomes involved in rail employee issues as a result of its approval of various types of rail transactions. Certain significant employee issues are raised by Class I consolidations. When larger railroads consolidate, the individual CBAs and protective arrangements into which the merging railroads earlier entered are not always compatible.

The law that the Board administers provides for imposition of the so-called *New York Dock* conditions upon such transactions. The *New York Dock* conditions have their origins in the negotiated Washington Job Protection Agreement of 1936 (*WJPA*), which sets up the framework within which consolidations are to be carried out. *New York Dock* provides (1) substantive benefits for adversely affected employees (including moving and retraining allowances, and up to 6 years of wage protec-

tions for employees dismissed or displaced as a result of the consolidation), and (2) procedures under which carriers and employees are to bargain to effectuate changes to their CBAs if necessary to carry out the transaction, with resort to arbitration and, as a last resort, limited Board review if bargaining is not successful.

When the parties go to arbitration, the arbitrator must make a determination in all areas of disagreement, including the extent, if any, to which it is necessary to override a particular CBA where a change in a CBA is being proposed. In 1991, the Supreme Court confirmed that the law provides that agency approval of a consolidation overrides all other laws, including the carrier's obligations under a CBA, to the extent necessary to permit implementation of the approved transaction.

Employee interests have argued that the override of CBAs is purely an administrative remedy that the Board could administratively reverse, and that the Board in its consideration of appeals from arbitral decisions has too broadly construed when a CBA may be overridden. The override of a CBA, however, cannot be viewed as simply an administrative remedy that the Board could administratively reverse. The 1991 Supreme Court decision (often referred to as the "*Dispatchers*" case, rendered before I arrived at the ICC) and other court decisions have made that clear. The Supreme Court found that, once the consolidation is approved and the labor protection requirements are met, the law ensures that obligations imposed by contracts such as CBAs, or by other laws such as the Railway Labor Act, "will not prevent the efficiencies of consolidation from being achieved."

In short, given its view of the statutory scheme, the Supreme Court did not simply hold that the ICC had the "discretion" to decide whether to find that CBAs could ever be overridden, but rather stated that CBAs are to be overridden, when necessary to do so, because that is what the law and Congressional intent require. Case law since then has clarified the conditions under which CBAs can be overridden. Thus, short of an agreement between labor and management, a change in the law would be required to alter this overall approach and to prevent any override of a CBA. Accordingly, in my December 21 letter, I suggested that Congress consider addressing these issues through legislation if it is concerned about CBA overrides.

*Agency Approach.* The Board over the last few years has attempted to make the playing field more level in this entire area to promote more private-sector resolution. The Board has worked to move away from taking affirmative actions to break CBAs, has taken action to limit overrides in the decisions that it has rendered, and has encouraged private negotiation as a preferred way of resolving related issues. The Board's specific emphasis on negotiation as the preferred way of resolving labor implementation matters has led to an increased number of negotiated agreements in BN/SF, UP/SP, CSX/NS/Conrail, and CN/IC.

More specifically, in its landmark 1998 *Carmen III* decision, the Board held that the authority of arbitrators to override CBAs is limited to that which was exercised by arbitrators giving effect to the WJPA and ICC labor conditions derived from that agreement during the years 1940–1980, a period marked by labor-management peace regarding rail merger implementation. The *Carmen III* decision was not appealed and is now binding on all arbitrators in addressing CBA override issues.

As to review of labor arbitration awards in general, the Board has strictly interpreted its authority to review these awards consistent with the law, has generally deferred to the expertise of arbitrators, and has declined to review and overturn arbitral awards to the extent possible, regardless of whether the arbitral award favored management or labor. It has, however, where appropriate, used the appeal process to encourage private-sector resolution, sometimes through its decision on appeal or other times by staying arbitration awards to provide time for the parties to negotiate further. Disputes impacted by those stays have been ultimately settled by the parties.

The Board is considering the matter of CBA overrides as part of its reexamination of its major merger rules. Along these lines, the United Transportation Union, the Nation's largest rail union, has negotiated its own agreement with the U.S. rail systems to resolve the CBA override issue. The Board has urged that similar agreements involving other employee groups be negotiated.

#### OTHER RAIL MATTERS

I will now mention briefly a few other rail matters that may be of interest to Members of the Committee.

1. *Mergers.* The application of Canadian National Railway to merge with Wisconsin Central Railroad system is anticipated.

2. *Construction Cases.* Pending are the application of the Dakota, Minnesota and Eastern Railroad to extend coal-hauling capability by that carrier into the Powder

River Basin, and several other rail construction cases geared to produce new competition where the market will support it.

3. *Amtrak*. Amtrak has asked the Board to become further involved in the proceeding in which the agency acted earlier to facilitate restoration of passenger service between Boston, MA, and Portland, ME.

#### NON-RAIL MATTERS

Certain issues involving modes other than rail also fall within the Board's jurisdiction. I will briefly describe the Board's jurisdiction and some of the significant pending cases involving other modes.

1. *Motor Freight Carriers*. Apart from the Board's jurisdiction over motor carrier undercharge matters (a docket that the Board recently closed out), the Board's principal involvement with respect to trucking companies relates to rate bureaus. Under the law, interstate motor carriers may enter into agreements under which competitors may discuss certain matters related to rate setting, and if these "rate bureau" agreements are approved by the Board, then activities conducted pursuant to them are immunized from the antitrust laws. The Board is reviewing the records compiled to determine the conditions under which the various motor carrier rate bureau agreements could be approved.

2. *Intercity Bus Industry*. Intercity bus carriers require Board approval for mergers and similar consolidations, and for pooling arrangements between carriers. In recent years, the Board has seen a rise in the number of consolidations within the bus industry. We are watching the bus industry closely in light of the issues that have surfaced in recent months regarding the financial condition of Greyhound and its parent, Laidlaw.

3. *Noncontiguous Domestic Trade*. Before the ICCTA, the ICC regulated inland water carriage, while regulation of the noncontiguous domestic trade (service between mainland points and points in Alaska, Hawaii, or the U.S. territories and possessions such as Puerto Rico or Guam) was bifurcated: the ICC regulated joint water-motor or water-rail rates, while the Federal Maritime Commission regulated "port to port" transportation. The ICCTA transferred all jurisdiction over noncontiguous domestic trade to the Board, requiring carriers to file tariffs, and giving the Board jurisdiction over the reasonableness of rates for service in the noncontiguous domestic trade. A variety of noncontiguous domestic trade cases are pending at the Board, including a formal rate complaint involving the water carriers serving Guam.

4. *Pipeline Rate Regulation*. The Board regulates the rates charged for interstate pipeline transportation of commodities other than water, gas, and oil. In October 1996, in a decision responding to a complaint filed against Chevron Pipe Line Company, the Board found that, at certain volume levels, the tariff rates filed by Chevron for the transportation of phosphate slurry from Vernal, Utah, to Rock Springs, Wyoming, were unreasonably high and had to be reduced. In response to a complaint filed against Koch Pipeline Company, the Board recently found that the rates charged for pipeline movements of anhydrous ammonia from production facilities in southern Louisiana to several Midwestern States were unreasonably high, and it awarded several million dollars in reparations. The Board's decision has been challenged in court.

#### CONCLUSION

Since its inception, I believe that the Board has been proactive and constructive in its approach to the matters that have come before it, and has tried to affect in a positive way those issues over which it has direct jurisdictional control. Taken overall, the Board has produced a significant body of decisions, handled its caseload expeditiously, and resolved complex matters before it in an effective and responsible manner in accordance with the ICCTA. The Board has approached its work with fairness, balancing the many varied and often conflicting interests under the statute in reaching its decisions on the record.

I recognize that there are those who believe that the Board has not done enough in certain areas, particularly in the matters of small shipper remedies, labor matters, bottleneck relief, and open access. As I have outlined in my testimony today, and as I stated in my December 12, 1998 letter to this Committee, I believe that the Board has done what it can under its current statutory authority and has moved issues in new and positive directions. Until the law is changed, the Board will continue to implement current law as we believe Congress intended, using its existing authority fully and fairly, in accordance with the goals of common sense government that I have outlined. I look forward to continuing to work with this Committee, other Members of Congress, and all other interested parties as we tackle the many important transportation issues that continue to confront us.



## ATTACHMENT 1.—LETTER FROM THE SURFACE TRANSPORTATION BOARD

SURFACE TRANSPORTATION BOARD,  
Washington, DC, December 21, 1998.

Hon. JOHN MCCAIN, *Chairman,*  
*Committee on Commerce, Science, and Transportation,*  
*United States Senate,*  
*Washington, DC*

Hon. KAY BAILEY HUTCHISON, *Chairman,*  
*Subcommittee on Surface Transportation and Merchant Marine,*  
*United States Senate,*  
*Washington, DC*

DEAR CHAIRMAN MCCAIN AND CHAIRMAN HUTCHISON: In our letter of June 30, 1998, Vice Chairman Owen and I reported to you on the Board's recent informational hearings to examine issues of rail access and competition in today's railroad industry. After summarizing the testimony, the Board responses to the testimony (including the Board's April 17 decision, copy attached hereto as Addendum A\*), and further actions that might be taken by Congress, our letter reported on certain ongoing private-sector initiatives. The purpose of this follow-up letter is to inform you of the outcome of the Board's proceedings and the private-sector initiatives undertaken as a result of the hearings; and to suggest possible ways in which related issues that are still outstanding might be addressed.

**1. Board Proceedings.** As we pointed out in our prior letter, the Board initiated rulemaking proceedings addressing market dominance and service inadequacies. The Board has completed those proceedings. In *Market Dominance Determinations—Product and Geographic Competition*, STB Ex Parte No. 627 (STB served Dec. 21, 1998), the Board repealed the product and geographic competition tests of the market dominance rules. This change applies to both large and small rail rate cases. In *Relief for Service Inadequacies*, STB Ex Parte No. 628 (STB served Dec. 21, 1998), the Board issued rules giving shippers and smaller railroads opportunities to obtain service from alternate carriers during periods of poor service, using either the emergency service or the access provisions of the law. Copies of these decisions are attached as Addenda B\* and C.\*

**2. Railroad Industry Discussions.** One of the issues that arose at the Board's hearings was the desire of smaller railroads to eliminate industry restrictions on their ability to compete. The Board directed the railroads to address this issue through private-sector discussions. As our earlier letter noted, the large and small railroads separately indicated that they were having some difficulties in reaching agreement, but the Board encouraged them to continue their dialogue, and indicated that it would take action, as appropriate, if they did not reach agreement. We are pleased to report that in September, an agreement was reached, portions of which were formally approved by the Board. A copy of the Board's press release announcing the agreement is attached as Addendum D.\*

**3. AAR/NGFA Agreement.** In our June 30 letter, we advised you that, consistent with the Board's preference that private parties seek non-litigative dispute resolution mechanisms, the railroads were meeting with the National Grain and Feed Association (NGFA) in an effort to arrive at an agreement on a mandatory arbitration program to resolve certain disputes. The Association of American Railroads (AAR) and the NGFA recently announced such an agreement. A copy of the AAR/NGFA press release describing the agreement is attached as Addendum E.\*

**4. Formalized Dialogue Among Railroads and Shippers.** Another issue that arose at the Board's hearings involved the concern of some shippers that railroads had not been adequately communicating with them. To address this concern, the Board directed railroads to establish formalized dialogue with their shippers and their employees, particularly about service issues in general, small shipper issues, and any other relevant matters. The railroads have organized and conducted discrete and formalized meetings with various shippers and shipper groups throughout the Nation. The meetings, which have been attended by Chairman Morgan, were held in Chicago, IL; Houston, TX; Atlanta, GA; Newark, NJ; and Portland, OR. AAR's letter to the Board describing the meetings and the follow-up actions to be taken—including, among other things, issuance of performance reports by each of the large railroads, development of a plan for facilitating interline movements, and continuation of the outreach meetings is attached as Addendum F.\* The Board, which supports the continued dialogue that the AAR letter promises, will be closely monitoring all of these follow-up steps. In addition to the AAR letter, a letter from various shippers regarding those meetings, and Chairman Morgan's response to that letter, are attached as Addenda G\* and H.\*

**5. Additional Railroad/Shipper Discussions.** Other shipper concerns that were raised at the Board's hearings involved railroad "revenue adequacy" and the Board's competitive access rules in general. Concluding that each of these issues could be better addressed initially in a private-sector rather than governmental forum, the Board directed railroads to meet with shipper groups to address the issues under the auspices of an Administrative Law Judge. Although extensive meetings were conducted, the parties could not reach agreement on these issues. Attached as Addendum I\* are copies of the reports that the parties submitted to the Board on their recommendations as to these issues.

*Revenue Adequacy.* Although the concept of revenue adequacy has thus far had minimal real-world impact, the existing judicially approved revenue adequacy measurement, which focuses on a railroad's return on investment, has been a source of controversy. Based on suggestions from railroad and shipper representatives at the Ex Parte No. 575 hearing, the Board directed railroads to meet with shippers with a view toward selecting a panel of three disinterested experts to make recommendations as to an appropriate revenue adequacy standard, and to name a panel and report back to the Board by May 15, 1998. The panel was then to report back with final recommendations on July 15, 1998.

Shippers opposed this approach, contending that it would be expensive and inefficient for them to pay part of the costs of the expert panel, while also paying for litigation associated with the conduct of the proceeding before the panel and the Board (and, presumably, if either side wanted to litigate further, the courts). Ultimately, most of the participating shippers recommended that the Board itself initiate a new rulemaking looking to adoption of a revenue adequacy approach that would permit the Board to consider a variety of financial indicators in determining whether railroads are revenue adequate.<sup>1</sup> By contrast, contending that the multiple indicator approach advanced by the shippers would not provide enough certainty or predictability, the railroads supported the expert neutral panel approach.

*Competitive Access.* The Board directed railroads and shippers to attempt to find common ground, and to meet, negotiate, and report back to the Board by August 3, 1998. After extensive meetings, the parties reached an impasse. The principal areas of concern involved the definition of terminal areas; the scope of reciprocal switching; appropriate compensation to an incumbent carrier; and, perhaps most fundamentally, whether access to other carriers ought to be required only when an incumbent carrier has acted in some sort of an anticompetitive way, or whether it ought to be provided whenever additional competition is determined to be in the public interest.

**6. Possible Resolutions of Revenue Adequacy, Competitive Access, and Small Rate Case Issues.** The Board appreciates the opportunity to assist Congress in addressing the transportation issues that face the Nation during these important times and believes that it has appropriately addressed matters of concern within the scope of the authority given to it by Congress. Nevertheless, it is likely that certain legislative proposals will be discussed in Congress during the next session. Following are some thoughts on some of the issues as to which legislative proposals are likely.

*Revenue Adequacy.* The revenue adequacy issue, in our view, has unnecessarily polarized the transportation community. The underlying policy objective that the Board's regulatory approach among other goals permit railroads to earn adequate revenues is a laudable one that should be retained. As we see it, however, and as we have testified before, the revenue adequacy status of any particular railroad has little practical effect. Revenue adequacy is not a factor in maximum rate cases prosecuted under the "stand-alone cost" (SAC) methodology. It is not a factor in construction, merger, or abandonment proceedings. Revenue adequacy does play a small role in rate cases brought under the "small case" guidelines, but to date, no such cases have been brought. Therefore, Congress may wish to consider legislatively abolishing the requirement that the Board determine on a regular basis which railroads are revenue adequate.

That is not to say that Congress should abandon the concept of revenue adequacy. As we have testified before, in order to oversee the industry, the Board needs to have some indication of how the industry is faring financially. Moreover, revenue adequacy is one of the non-SAC constraints in the Board's "constrained market pricing" (CAMP) methodology for handling larger maximum rate cases. Although, thus far, all railroad rate cases brought under CAMP have been handled under SAC procedures, if a "revenue adequacy" case were brought, the Board would need a basis on which to address it.

<sup>1</sup>The shippers indicated that, given the Board's own resources and their own priorities, they would not object if the Board deferred this rulemaking until a later date.

For those reasons, and because Congress may not wish to abolish the revenue adequacy requirement immediately, the questions that have been raised about the Board's current revenue adequacy methodology cannot be ignored. With its credibility on the issue under challenge by several shippers, however, the Board, with its limited resources, does not plan to undertake the shippers' proposed rulemaking at this time. Rather, given the benefits, the Board continues to support the expert panel approach that was suggested by both shipper and railroad interests during the Board's Ex Parte No. 575 hearings. The shippers are correct that someone would need to provide funding for the expert panel; that costs rise as layers of litigation are added to the regulatory process; and that it is the Board, and not a private expert panel, that is charged with establishing regulatory procedures. Nevertheless, the Board is willing to make a commitment to give great deference to the expert panel, which would be a competent body that would be perceived as neutral if selected after agreement among the private parties. If the private parties were also to give the expert panel deference, rather than to litigate should they disagree with its (and the Board's) conclusions, then not only would the parties' confidence in the objectivity of the process likely be enhanced, but the overall costs also would likely be contained.

*Competitive Access.* In its Ex Parte No. 575 decision served April 17, 1998, the Board addressed in some detail the implications of the competitive access debate. The differences between the railroads and the shippers on the Board's competitive access rules are fundamental, and they raise basic policy issues—concerning the appropriate role of competition, differential pricing, and how railroads earn revenues and structure their services—that are more appropriately resolved by Congress than by an administrative agency. Moreover, the so-called “bottleneck cases,” which involve issues related to competitive access, are still being reviewed in court. For those reasons, although the Board has moved aggressively to adopt the new rules described above to open up access during times of poor service, the Board does not plan to initiate administrative action to otherwise revisit the competitive access rules at this time.<sup>2</sup>

*Small Rate Cases.* As you know, the Board has adopted small rate case guidelines, which apply in cases in which CAMP cannot be practicably used. Under these small case guidelines, the Board reviews the profits that the carrier obtains from the challenged rate from three perspectives: it compares them with the profits that railroads in general earn from comparable traffic; it compares them with the level of profits that the carrier would need to obtain from all of its potentially captive traffic in order to become “revenue adequate”; and it compares them with the profits that the defendant carrier earns on all of its potentially captive traffic. Taken together, these three comparisons are designed to permit carriers to price “differentially” as provided under the law, in a way that will promote their financial health, while still protecting individual shippers from bearing an unfair share of a particular carrier's revenue needs. Although the procedures may sound complex, in fact the information needed to make this sort of a case is readily available at reasonable cost. Moreover, the Board concluded, after reviewing many years of debate, that these guidelines are the only procedures that have been identified that readily address each of the concerns that the Board must consider under the statute.

Nevertheless, we are aware that certain shippers are concerned that, for small cases, anything other than a single benchmark test could unreasonably impede access to the regulatory process. If Congress agrees, it could adopt specific small rate case standards. As an example, it could provide that, for certain types of cases, all rates above a specified revenue-to-variable cost ratio, or series of ratios, would be considered unreasonable. If this approach were to follow the tenets of the existing

<sup>2</sup>Should Congress choose to review the issue, we would note, as we did in our April 17 decision, that the shape and condition of the rail system that open access would produce is a significant but unresolved issue. Certain shippers assume that the replacement of differential pricing by purely competitive pricing would reduce the rates paid by shippers, and that added competition would result in increased infrastructure investment. The railroads, by contrast, argue that, because their traffic base would shrink, the rates paid by those shippers that would continue to receive service would actually increase, even as overall revenues received by railroads would decline, because the overall traffic base from which costs could be recovered would be reduced. Additionally, as the Board noted in the April 17 decision, carriers could be expected to seek to maintain an adequate rate of return by cutting their costs, which could include shedding unprofitable lines and reducing new investment in infrastructure. Thus, while certain shipper representatives believe that an open access system would ensure better service, concern has been raised that, unless smaller railroads were able to fill in service gaps that could be created, open access could produce a smaller rail system that would serve fewer shippers, and a different mix of customers, that are served today, with different types and levels of, and perhaps more selectively provided, service.

statute, the specifics of such an approach—for example, the cases to which it would apply, and the level or levels at which rates might be capped—would have to balance issues such as differential pricing and railroad revenue need against the fairness in requiring captive shippers to pay substantially higher prices than competitive shippers.

**7. The Override of Railroad Collective Bargaining Agreements.** Another matter that may be presented to Congress next year is the question of limiting the authority of arbitrators under the standard labor conditions imposed by the Interstate Commerce Commission (ICC) or the Board to modify existing collective bargaining agreements (CABS) in the process of implementing approved rail consolidations. This process has become extremely controversial since a decision of the Supreme Court in 1991. That decision, *Norfolk & Western Ry. v. American Train Dispatchers Ass'n*, 499 U.S. 117 (1991) (N&W), held that the exemption from all other laws to carry out approved rail consolidations provided by former 49 U.S.C. 11341(a) and carried forward as 49 U.S.C. 11321(a) extends to existing CABS and operates automatically to permit the override of CBA provisions as necessary for implementation of an approved rail consolidation.

Present practice for implementing Board-approved rail consolidations is for the unions and the railroads involved to negotiate agreements to enable implementation of the Board-approved transaction. If they are unable to agree, the matter is submitted to an arbitrator selected by the parties or the National Mediation Board if the parties cannot agree on the choice of an arbitrator. Because the arbitrator is acting under section 11321(a), he or she has the authority and the obligation to modify existing CABS as necessary to carry out the transaction.

In the recent *Conrail Acquisition*<sup>3</sup> decision, at the request of the various labor organizations, the Board specifically declined to make a finding in its decision approving the transaction that overriding provisions in Conrail CABS was necessary to carry out the transaction. Rather, the Board specifically left the determination of necessity to the process of negotiation and, if necessary, arbitration. Even more recently, in the *Carmen*<sup>4</sup> decision, the Board elaborated on the limitations on arbitrators' authority to modify CABS as permitted by the Supreme Court's N&W decision. In *Carmen* the Board held that overrides of CABS by arbitrators are limited, among other things, to the override authority exercised by arbitrators during the period 1940–1980, an era marked by labor/management peace regarding the implementation of rail consolidations. A copy of the *Carmen* decision is attached as Addendum J.\*

Nonetheless, the Board is aware that labor representatives oppose, and are understandably dissatisfied with, any provision or action that permits overriding any existing CBA provisions. If Congress were to agree with their position, given the Supreme Court decision in *N&W*, some modification of section 11321(a) so as to exclude CABS, or some other legislative expression, could address labor's concerns in this area.

**8. Conclusion.** Again, we appreciate the confidence that Congress has shown by allowing us to play a role in this important process, and we remain committed to providing a forum for constructive dialogue and appropriate regulatory relief. If we can be of further assistance in this or any other matter, please do not hesitate to contact us.

Sincerely,

LINDA J. MORGAN.

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#### ATTACHMENT 2.—NEWS RELEASE

##### SURFACE TRANSPORTATION BOARD ISSUES NOTICE OF PROPOSED RULEMAKING ON NEW RULES FOR MAJOR RAILROAD MERGERS

Surface Transportation Board (Board) Chairman Linda J. Morgan announced today that the Board has issued a Notice of Proposed Rulemaking (NPR) proposing

<sup>3</sup> *CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company—Control and Operating Leases/Agreements—Conrail Inc. and Consolidated Rail Corporation*, STB Finance Docket No. 33388, Decision No. 89 (STB served July 23, 1998).

<sup>4</sup> *CSX Corporation—Control—Chessie System, Inc. and Seaboard Coast Line Industries, Inc. (Arbitration Review)*, Finance Docket No. 28905 (Sub-No. 22), and *Norfolk Southern Corporation—Control—Norfolk and Western Railway Company and Southern Railway Company (Arbitration Review)*, Finance Docket No. 29430 (Sub-No. 20) (STB served Sept. 25, 1998). This decision was not appealed by any party.

\*The addenda referred to have been retained in the Committee files.

new rules for major railroad mergers and consolidations (those involving two or more “Class I” railroads, that is, railroads each with annual revenues of at least \$250 million). The new rules would significantly increase the burden on applicants to demonstrate that a proposed merger transaction is in the public interest, reflecting what Chairman Morgan notes as an awareness of the great risk of failure and the competitive, service, and financial concerns raised in connection with what could be the final round of consolidation in the rail industry. In particular, the new rules would require applicants to show that the transaction would enhance competition, and they would require much more accountability with respect to claimed merger benefits and service. At the same time, in proposing these new rules, the Board indicated that it does not intend to prevent transactions genuinely in the public interest and would continue to look with favor upon private-sector initiatives in the public interest.

**Overall Approach.** A key element of the Board’s proposal is a new policy statement that, together with the proposed rules, represents a major shift in basis from the pro-merger approach that has guided agency merger decisions for the last 20 years. The Board noted that there is no longer the pressing need that the Nation’s largest railroads once had to consolidate their operations to reduce excess capacity because that rationalization has largely been accomplished. Moreover, the Board emphasized that recent consolidations have brought significant transitional service problems that have harmed rail customers and delayed full realization of the merger benefits that were anticipated from those transactions. Accordingly, the Board found it appropriate to propose new rules requiring applicants to bear a substantially heavier burden in demonstrating that a merger proposal is in the public interest.

**Enhancement of Competition.** The Board recognized that any further consolidations in the rail industry are likely to result in some competitive harms, such as the loss of geographic competition, that are difficult to remedy directly. Because of this problem, and because of the likelihood based on past experience of harms from service disruption during the integration period, the Board proposed that it would require merger applicants in the first instance to include provisions for enhanced competition as an essential aspect of their proposals. The Board would give substantial weight to this enhanced competition in making its public interest determination.

At a minimum, the Board would require applicants to propose specific remedies to keep open major existing gateways, retain build-out and build-in options, and preserve the opportunity of shippers in the so-called bottleneck situation to obtain a contract rate for one segment of a movement in order to separately challenge a rate for the remainder of the movement. The Board also would look for other competition-enhancing proposals, such as those related to paper barriers, emphasizing that it encourages innovative ways of enhancing competition throughout the network. The Board noted that, given the import of future consolidation, it was no longer appropriate to limit the focus of its conditioning power to preserving competition and essential services, and that it would impose conditions as necessary to mitigate or offset all types of harm to the public interest, including conditions that would enhance competition. In this regard, it would look carefully at the proposals made by the applicants to enhance competition.

**Assessment of Benefits.** The new rules recognize that there can be economic efficiencies associated with consolidations. However, because claimed benefits in recent mergers have often been delayed or frustrated by transitional service problems, the Board would carefully scrutinize future claims of merger benefits and associated timeframes to ensure that they are well-documented and reasonable projections. The Board would expect applicants to propose additional measures that the Board could take if the anticipated public benefits should fail to materialize in a timely manner. Additionally, the Board would view proposals to enhance competition as public benefits, and the Board would consider whether the benefits of the particular consolidation claimed by the applicants could be realized by means short of a merger through private-sector initiatives, such as joint marketing agreements and interline partnerships.

**Downstream Effects.** The Board also noted that, with only a handful of major railroads remaining, any further merger proposals could trigger other applications that the Board would have to consider. The Board recognized that a transaction involving two Class I rail carriers will affect the entire transportation system, including regional and shortline railroads, highways, waterways, ports, and airports. The Board cautioned that “we must be confident that at the end of the day a balanced and sustainable rail transportation system is in place.” Thus, the Board would assess the likely outcome of any major proposal on the future structure of the industry through an examination of its downstream effects.

**Service and Oversight.** Applicants would be required to submit up front detailed service assurance plans, including contingency plans, to permit the Board’s

staff to assess proposed consolidated operations prior to approval. As part of this process, the Board would expect a discussion of specific service levels to be attained from the proposed transaction. The Board would expand its post-approval monitoring of the implementation of mergers to help ensure that adequate service is provided during the crucial transitional period and beyond. Additionally, applicants would have to establish problem resolution teams and specific problem resolution procedures to ensure that post-merger service problems are promptly and appropriately addressed. The Board would anticipate the establishment of a Service Council consisting of shippers, railroads and other interested persons in each merger proceeding to provide an ongoing forum for the discussion of implementation issues for that transaction. And the Board's proposal would formalize the role of oversight in the merger approval process, with successful applicants required to submit reports on no less than an annual basis, subject to comment by the public, for a period of at least 5 years.

**Employee Concerns.** The Board emphasized that it strongly supports early notice and consultation between the railroads and their employees, and that it prefers negotiated solutions to merger implementation problems. The Board also said that it "respects the sanctity of collective bargaining agreements" and that these should not be changed "except to the very limited extent necessary" to implement a particular transaction. In this regard, the Board urged the railroads and the various rail unions, building upon prior efforts, to negotiate systemwide agreements concerning these issues, and to report back to the Board as soon as possible.

**Transnational Issues.** The proposed rules also reflect additional attention to international issues related to applications involving Canadian and Mexican railroads. The Board would require applicants to cooperate with the Federal Railroad Administration concerning safe implementation of those transactions, and would require applicants to show that any applications approved by the Board are consistent with the North American Free Trade Agreement and would not undermine the Nation's defense needs.

The NPR was issued today in the case entitled *Major Rail Consolidation Procedures*, in STB Ex Parte No. 582 (Sub-No. 1). Vice Chairman Burkes and Commissioner Clyburn commented with separate expressions. The NPR follows the Board's March 31, 2000 Advance Notice of Proposed Rulemaking (ANPR) in that docket. In the ANPR, the agency instituted a rulemaking and sought public comment on modifications to its regulations governing proposals for major railroad consolidations. The ANPR followed March 7-10, 2000 public hearings held by the Board in the case entitled *Public Views on Major Rail Consolidations*, in STB Ex Parte No. 582.

Comments in response to the NPR are due on November 17, 2000, replies are due on December 18, 2000, and rebuttal comments are due on January 11, 2001. The Board will issue its final rules by June 11, 2001.

Printed copies of the NPR are available for a fee by contacting Da-To-Da Office Solutions, Room 405, 1925 K Street, N.W., Washington, DC 20006, telephone(202) 466-5530. The NPR also is available for viewing and downloading via the Board's website at [www.stb.dot.gov](http://www.stb.dot.gov).

Senator SMITH. Thank you, Chairman Morgan. First, so I understand your agency a little more, you have 143, roughly, employees, and is the issue of authorization affecting your ability to keep current with staffing and workload?

Ms. MORGAN. Well, despite the fact that we have not been reauthorized, we have been funded on an annual basis, essentially a level funding.

Senator SMITH. So that is not an impediment to your continuing?

Ms. MORGAN. It is not an impediment unless people decide to stop funding us because there is no authorization.

Senator SMITH. And I think you indicated in your testimony you win 90 percent of the decisions that are taken to court.

Ms. MORGAN. Over 90 percent, that is correct.

Senator SMITH. Which ones didn't you win?

[Laughter.]

Ms. MORGAN. Well, I referenced, of course, the market dominance decision, which we won in part, but it has been remanded to us for further review. We have lost a couple of cases in the trails use area. If you abandon a line, then that particular line can go for

trails use. There is a conflict between landowners who do not want trails and those who want trails, and some of those cases we have not managed to win on appeal, but the big cases we have won on appeal.

Senator SMITH. I know, given how few railroad companies remain, that shippers are certainly looking to you for your intervention and help, I assume. Do you feel that pressure all the time?

Ms. MORGAN. All the time.

Senator SMITH. I figured you would.

Ms. MORGAN. I feel pressure from many quarters all the time.

[Laughter.]

Senator SMITH. You know, I cannot remember a time with more intensity of complaint from the northwest. When the UP and the Southern Pacific merged and there was a serious deterioration of service, there was literally mills and plants that were laying off people just simply because they could not move inventory.

Is there—I mean, I do not know how many more rail mergers there could possibly be, there are so few railroads left, but in the event that there were, is there a way to better mitigate those kinds of impacts that are just felt very keenly and personally by folks, and they certainly ring our phones off the hook. Can you speak to that particular instance, and I do not think it is a stretch to say that other mergers have had similar problems. Is that accurate?

Ms. MORGAN. Well, certainly with this last round of mergers we have experienced service problems. Obviously, some have been more associated with particular mergers than with others, but as a whole this last round has been difficult, and I certainly understand what the customers in your communities have gone through.

One of the reasons that we are reexamining our rail merger policy and rules is to try to reflect the lessons that we have learned in this last round, and obviously one of the lessons learned has been the difficulty in operational integration when you have a melding of systems that creates integration problems, whether it be with computers or personnel or whatever. The other lesson learned has been the impact of inadequate infrastructure on service, and that was part of what you experienced in your area of the country.

So the proposed rules that we put out in October, on which we will be having an oral argument in April, focus very specifically on getting more details about the service that would be provided in a proposed merger. We want that up front. We want the details up front. We are also looking for more accountability. What is put forth up front, the applicants would be held accountable for it. We also are looking up front for contingency planning and problem-solving in the event that there are service problems.

Senator SMITH. And absent those things, those mitigating factors, you would not allow a merger to go forward?

Ms. MORGAN. We would be looking for the applicants to bring to us very specific details on service, and if those details are not there, then the application would not be able to go forward.

Senator SMITH. Since the Board's creation, how many rail mergers have there been?

Ms. MORGAN. Four. I have overseen four.

Senator SMITH. Suffice it to say you have learned from those four some things that could be very helpful should there be further mergers.

Ms. MORGAN. Yes, and as a matter of fact, when we had the service situation in the West we learned from that, and we carried our lessons into how we established our monitoring for the Eastern merger, and how we have handled that since then. And of course many times I have been asked, have you learned from what has gone on, and I am proud to say that yes, we have, and any agency that does not learn is not doing its job.

Senator SMITH. Are there any mergers on the table right now, and which ones are likely to be anticipated by your agency?

Ms. MORGAN. Well, in terms of major rail mergers, I do not know of any out there being discussed. I certainly would not know what is being discussed in rooms that I am not in at the moment, and I really would not want to prejudge whether we will see any, and what I would do with those.

I would say, though, that I am asked this a lot—will there be more mergers, and I think a lot will depend upon the economy, how our rules are viewed, what the customer view of more mergers is, and finally, what the investor community feels about more consolidation. So I think all those things will come together to answer that question.

Senator SMITH. Linda, I remember from my own business experience when I was selling a big volume of peas to Campbell's Soup in Camden, New Jersey, I could get a pretty good rail price for that volume going across the country, and if I had to, I could take it to Burlington Northern on a different spur.

I also know that when I wanted to ship to Boise, Idaho, for a few pallets it was pretty expensive, but I am wondering how you evaluate those kinds of volume differences, and how you assuage the feelings, if you attempt to at all, of captive shippers, people unlike in my experience, where we are on a UP line, if we had to we could truck to a Burlington line. What do you say to a captive shipper that just does not have any option, and he is paying a lot more to go to Boise than he would to go to Camden, New Jersey?

Ms. MORGAN. Well, the law that the Board implements is based on the assumption that there, first of all, are customers out there who are only served by one rail carrier, which has been the case for a while, and secondly, that prices will differ between various customers, and that for competitive customers, customers where there is more competition, more competitors, those prices might be lower than captive customer rates, which is called differential pricing. Those are the assumptions made in the law that we implement.

So as to what we do in terms of our responsibilities vis-a-vis captive shippers, the law says that where there is no effective competition, the Board is to step in and regulate. As I said in my oral comments, an important part of that is our regulation of rail rates and allowing for a process for captive customers to challenge rates based on the argument that they are reasonably high.

Senator SMITH. And are those challenged on an ongoing basis? Is that one of your biggest workloads?



Ms. MORGAN. Well, in recent years the Board has handled about four of those cases, and recently we have had several filed, so we now have up to 7, I believe, rail rate cases pending.

Senator SMITH. How do they normally come out? What factors would say, this is injurious here and it would not work?

Ms. MORGAN. Under the law there is a certain threshold below which we do not look at a rate and above which we do, and in this regard, we look at the revenue-to-cost ratio, variable cost ratio, and whether there is market dominance or not. Once you get beyond those thresholds, then we evaluate whether the rate is unreasonable based upon what we call the stand-alone cost methodology, which is, create the most efficient railroad and figure out what its costs would be and its revenue flow would be, and then from that you determine whether this particular rate that is at issue is too high or not.

Senator SMITH. And do the railroads understand those formulas pretty well that you follow?

Ms. MORGAN. I think everyone understands the stand-alone cost methodology well. It has evolved, and during the Board's tenure we have refined the standard so that people know what these cases should look like going forward, and we are continuing to do that with each case, so for large shippers the stand-alone cost methodology is well-known and understood.

Senator SMITH. And observed?

Ms. MORGAN. And observed.

Senator SMITH. That then brings me to—I wish he were here. Senator Dorgan has a bill that shifts some of this responsibility to the Department of Justice, as I understand. I do not know all the details of the bill, but I am wondering, in light of what you just told me, how do you factor in the prospect of his bill and what it would do?

Ms. MORGAN. Well, as I understand his bill, it would involve the Justice Department more in the merger process, the rail merger review process. It would also remove any antitrust immunity that would attach once a rail merger is approved, which is the case today. It also would remove immunity for certain other railroad activity. That obviously is a change from where we are today.

This has been a discussion that we have had in the past, should we have the Justice Department more involved in the review of rail mergers, and what I have said on that is that the Justice Department is a party in our processes. They have filed in all of the mergers that they have cared to file in. We have disagreed on one merger, and that was the Union Pacific-Southern Pacific merger. Yes, we disagreed on that. The Board felt strongly that the SP would not survive without a merger with the Union Pacific. So I guess I question what of the current process is broken in that regard.

I think with respect to eliminating antitrust immunity otherwise the question for this Committee would be whether that somehow creates a duplicative agency involvement that perhaps is not necessary. That would be how I would analyze that.

Senator SMITH. I am very pleased to be joined by the Senator from Kansas, Senator Brownback. Do you have a statement or a question?

**STATEMENT OF HON. SAM BROWNBACK,  
U.S. SENATOR FROM KANSAS**

Senator BROWNBACK. Thank you, Senator Smith. Linda, welcome to the Committee. You have been here a number of times before. I have worked with you on a number of issues, and I appreciate your willingness to work with a number of us. If you have already covered this, I apologize, and you may need to cover it again, but I want to go to the rail merger issue and discuss that a little bit with you if I could.

I noted in your testimony, in 1999 the Surface Transportation Board stepped in on the BNSF merger with Canadian National and put a 15-month moratorium in place at that time before proposing some new rules and regs on that. I wonder what do you see now in the offing, of large railroad mergers, or what are you anticipating coming down or toward the Surface Transportation Board on some of these larger railroad mergers?

Ms. MORGAN. Well, as I indicated before you came in, certainly I do not want to prejudge what might come to me and how to handle that, but in terms of whether there will be more mergers, as I indicated to Chairman Smith a minute ago, a lot of it will depend upon how our rules are viewed, our final rules once they come out in June, how the economy is, how customers view more mergers, how investors view more mergers. Whether there are discussions going on about more mergers right now, obviously I do not know that one way or the other.

What I did not say to Chairman Smith, but I will say to you, is that I certainly hope that we will have a period here where we focus on operations, focus on day-to-day business, focus on running the rail network, and providing better service with the system we have today. And of course one of the reasons for the moratorium was to create some stability in the industry while we reviewed our rail merger policy and rules.

Senator BROWNBACK. Do you feel like the rules you have in place now are sufficient to handle another round of potential large mergers if they were to come down the road in a year or two?

Ms. MORGAN. Well, the rules that we now have in place we determined are not sufficient, and that is why we have a moratorium in place and are reexamining our policy and rules. Obviously, we hope that the final rules that we issue in June of this year will be appropriate for whatever may come to us in terms of a final round of mergers.

And as I discussed earlier, the proposed rules we put out in October raised the bar, and put a burden, a substantially heavier burden, on the applicants as it relates to competition and service and accountability for benefits.

Senator BROWNBACK. I am sorry you are having to cover terrain over a second time.

Ms. MORGAN. That is OK. Maybe I said it better the second time. It gives me a second bite at the apple.

Senator BROWNBACK. I am sure you said it great both times, and I apologize for that, but that has been a big issue in my State, is to watch that, and watch what takes place.

I think a number of people were very happy with the moratorium put in place last time, just let us put a pause here, we are not ex-

actly sure what all of this is going to lead toward, and I thought pause was the right way to put it, not say no, we are not going to do this, and we are going to prevent these, but more of a pause, and taking some time.

One other narrower, State-specific issue for me is that we are trying to get some of these short-line railroads to expand into the State instead of track being abandoned, and there is an ongoing effort in the States to try to put together public financing to help upgrade some of the short line railroads. We have got a big one in central Kansas. Are you familiar with this issue?

Ms. MORGAN. Yes.

Senator BROWNBACK. There is a substantial mileage of track with heavy agriculture and a fair amount of manufacturing, so that it sits well within a rail service, and it needs rail service, but the financing on it has been tough to come up with for a short-line operator to come in and upgrade the track sufficiently to run it on an economically competitive basis.

I just want to make sure you are aware of it, and that we are going to try to do what we can to get the help to be able to upgrade these facilities to be able to maintain that trackage. Any suggestions you have, ways that this can be done, or that it can be handled better or more likely to be successful would obviously be appreciated.

Ms. MORGAN. Well, the Board staff has been working with some of the customers in Kansas on this whole issue of abandonments in Kansas, and so that is why I am intimately familiar with some of what you have been experiencing in the State, and I know there was a discussion of a moratorium on abandonments in the State, and we will continue to work with you on that.

Many times when we get into these issues we are able to bring parties together on an informal basis, get the right people together to make the right thing happen, which does not necessarily require regulation on our part, but is more of an informal process and an intervention in the private sector way to move the issue.

Senator BROWNBACK. It has been my perspective over time that one of the best things Government can do is create the right atmosphere, create the right atmosphere for this to move forward and to try to encourage it so that the private sector looks at it and says, well, we do not think we are going to have impediments from Government because they are trying to encourage and facilitate this, and whereas if it is more standoffish from Government a lot of times they might say, well, this is going to take us more time, it is going to take us more effort, more resources to do this because we do not have that encouragement, that atmosphere that is encouraging, and so I appreciate your helping us out with that. We could sure use that line.

We are glad to see you still on the task, and focused on keeping our railroads running.

Ms. MORGAN. Thank you.

Senator BROWNBACK. Thank you, Mr. Chairman.

Senator SMITH. Thank you, Sam.

Linda, just a couple more things. We have talked around the open access issue, something that shipper groups often advocate. I

wonder if you can speak to how differential pricing could be carried out in an open access environment. Does that work?

Ms. MORGAN. Well, as I indicated before, the basis for the law that is in place now is that there would be differential pricing so that some rates would be higher than others, depending upon the marketplace.

If legislation were to pass to provide for open access, a guarantee of two rail carriers for every shipper, then the net effect of that presumably would be to bring rates down, which of course I know customers want, and in the short term that would happen, but then as I have indicated before, that would have an impact on the revenues coming into the system and you would not have the differential pricing impact that you have today, because all the rates would come down. Then you would create a revenue shortfall problem, which over the long term could result in a smaller network than what we have today, with less investment going into the infrastructure.

Senator SMITH. I would like to focus on that last point you are making, because I think it is really somewhat unique to the rail industry. The amount in investment and infrastructure, I mean, is absolutely enormous. If you went to a system like that, or a statutory requirement, what does that likely mean to the willingness of a railroad to invest in its infrastructure for the future?

Ms. MORGAN. Well, I think as I said there would be two issues. One would be, of course, the amount of money that is available to do whatever is necessary, and that, of course, was the genesis of the Staggers Act originally, that we had an industry that was not financially sound, and we needed to create a system in which it could get sounder through a revenue flow that made more sense in terms of needs.

But the second issue is one of incentive, I think, and that is what you are also getting to, and that is, if someone is brought onto the tracks of a particular carrier, you would obviously have the issue of price, how much should that access be worth to the carrier onto whose track someone has entered to ensure reinvestment. You also have issues of private property, and someone else using private property, and so that creates possibly a disincentive for investment. And I think what we have seen in Britain, where you have a split between operations and the infrastructure, is that the incentive to invest in the infrastructure is not there the way it would be if the operations and the infrastructure were together in the same operation.

Senator SMITH. What kind of shape is the rail infrastructure in?

Ms. MORGAN. Here in the United States today?

Senator SMITH. Yes.

Ms. MORGAN. Well, the industry has put a lot of money over the last several years into infrastructure in general, and also in the context of the mergers that have been approved. We are now seeing a slowing in that, and that, of course, has to do with the economy, and it has to do with the view on Wall Street investors that perhaps the investment to date have not produced the kind of returns that it should have.

In any event, we are seeing a slowing in the investment, and we need to always be concerned about a slowing in the investment, be-

cause in order to ensure that you have good service into the future and the potential for improved service into the future, you need to make sure that investment in the infrastructure can continue.

Senator SMITH. So any effort to go statutorily to an open access concept would have to allow a user fee, or some sharing of infrastructure burden, and that is a given, is it not?

Ms. MORGAN. Well, you would have to make sure that both the marginal cost and the fixed cost of the network are covered, and that is the challenge, really, in the rail industry. And then, of course, otherwise I guess you could go to a system of federally funding the infrastructure, but again I am not sure that that is necessarily something that anybody is embracing today.

Senator SMITH. I have not heard anybody propose it around here. [Laughter.]

Senator SMITH. Linda, you have been very, very helpful, and I would note that you are joined by two members of your Board, and I would like to introduce them. They are Wayne Burkes—Wayne, if you would stand—and William Clyburn as well. We welcome you both, and thank you for your service, and Linda, we thank you for the job you are doing. You are always in the cross-hairs, and it is not easy, but it is necessary, and you handle it very, very capably.

We thank you for that, and we thank all of you for attending this morning. It has been helpful. It is a good start, and there are many more hearings to come of the competing interest in this issue, so thank you all, and with that, we are adjourned.

[Whereupon, at 10:15 a.m., the Subcommittee adjourned.]



## A P P E N D I X

PREPARED STATEMENT OF HON. JOHN D. ROCKEFELLER IV,  
U.S. SENATOR FROM WEST VIRGINIA

Thank you Mr. Chairman. Welcome to the Committee and to the Surface Transportation Subcommittee. I look forward to working with you on issues of importance to my constituents, and to the entire nation, that will come before this subcommittee. I commend you for beginning to address the state of our country's railroad system so early in your chairmanship, and I applaud you for committing to three hearings on the various issues involved.

Good morning, Chairman Morgan, and welcome back.

As Ms. Morgan knows, and as I suspect Chairman Smith has heard, in the past I have been primarily interested in the workings of the STB, and its predecessor the Interstate Commerce Commission, with regard to these agencies' oversight of the freight rail industry, and in particular, the efforts both agencies have taken to ensure that railroads and rail shippers, not to mention the frequently forgotten end-use consumers, each enjoy the benefits of the competitive rail market that Congress believed it was setting up with the passage of the Staggers Act more than twenty years ago.

I have had the opportunity to discuss this issue with and before Ms. Morgan on a number of occasions. Given that history, I am quite sure she will be happy to hear that after a brief description of the Board's responsibilities regarding rail competition and the current merger moratorium and rulemaking, I intend to refrain from belaboring the point, at least for today.

Mr. Chairman, it is important for all of our Members, especially our new Colleagues, to understand what the STB is called upon to do. When the 104th Congress terminated the ICC, we were careful to not leave the rail freight industry operating in a vacuum. We entrusted the STB with the authority to regulate the nation's freight rail carriers, including authority over rail mergers and responsibility for protecting the rights of rail labor. Many people who have followed this issue during the past few Congresses know that I have not always been convinced that the STB has acted with the broadest possible understanding of the power I believe Congress intended it to have.

Two relatively recent actions by the Board that I believe may demonstrate the appropriate level of concern for rail competition are the moratorium and subsequent rulemaking regarding rail mergers. As the industry has moved rapidly toward corporate consolidations that may further reduce the competitive nature of the rail freight hauling, the STB took action that may result in the Board giving a more searching and appropriate inquiry to railroads seeking approval of their mergers. With the rulemaking proceeding set to conclude later this year, I expect to give the Board's recommendations a searching inquiry of my own, and I look forward to discussing the matter further with Ms. Morgan.

Once again, I want to express my thanks to Chairman Smith for devoting his time and intellect to these important issues. I know that in the months to come, as the Subcommittee considers oversight and reauthorization of the STB, we will continue to look to you for leadership on the issues that will come before us.

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