

LEGISLATIVE and REGULATORY UPDATE

*Midwest Association of
Rail Shippers*

Winter Meeting-January 14, 2009

DISCLAIMER

- The views and observations expressed herein are solely those of the presenter only and do not represent any official policy or position of the *Midwest Association of Rail Shippers* or the *MARS Executive Committee*.
- However, the world we live in is not a vacuum and things, especially in Washington, D.C., tend to happen for a reason.

Current Events

- On November 4, 2008 the United States held nationwide elections for a number of important national and state offices.
- All 435 voting seats in the U.S. House of Representatives were up for election, as well as one-third of 100 total seats in the U.S. Senate.

Impact of Election Results

- As expected the Democratic Party retained control of both the House of Representatives and the Senate, and substantially increased their majorities in both Chambers (and on key Committees).
- More importantly the Democrats also retained control of all Committee and Subcommittee Chairmanships in both Chambers, and thus will control the legislative agenda for the next two years.

The New Congress

- The 110th United States Congress officially went out of business on January 2, 2009.
- Any legislation introduced in the 110th Congress, that was not passed by both the House and Senate and signed by the President, is now officially dead.
- The First Session of the 111th United States Congress technically began on January 3, 2009, but did not actually meet for first time until January 6, 2009, when (most) new members were sworn in.

Key Members to Watch

- **Rep. James Oberstar** of Minnesota's Eighth District, now in 18th term, keeps Chair of the House Transportation & Infrastructure Committee; remains one of the most powerful members of Congress.
- His district includes several large paper mills and iron ore mines as well as the Port of Duluth.
- As the largest committee of Congress (75 members) the T&I Committee's #1 challenge will be writing a new surface transportation authorization bill.

Key Members to Watch

- **Sen. Jay Rockefeller** of West Virginia, now in his 5th term, will assume Chair of the Senate Commerce, Science and Transportation Committee.
- Coal shippers are a major constituency and Rockefeller has actively supported so-called re-regulation efforts for the past 20 years.
- He is expected to bring “new character to the committee”; regarded as more active and aggressive than his predecessor.

Strange Bedfellows?

- AAR/Ed Hamberger issued a press release on 12-18-08, saying the "freight railroad industry congratulates Senator Rockefeller on his selection as chairman of the Senate Commerce Committee."
- "Senator Rockefeller's long-time interest in transportation issues....gives him the background to lead this important Committee through this critical time."
- *Wonder if the Senator has seen those CSX and NS television commercials yet?*

But Will it Play in Peoria??

- Former Republican Congressman **Ray LaHood**, from Peoria, Illinois, has been nominated as the next Secretary of the U.S. Department of Transportation.
- While Mr. LaHood's transportation credentials are unknown, he is from new President's home state and reported to be on very good terms with the new White House Chief of Staff; probably more clout than his recent predecessors.
- *AAR issued press release on 12-19-08 calling this "an excellent selection".*

Today's Agenda

- Brief review of activities and accomplishments of the Second Session of 110th U.S. Congress.
- Highlights of the last six months at the Surface Transportation Board.
- Some observations on the next few months.

Infrastructure

- The Short-line railroad tax credit was finally extended by Congress on October 3, 2008; current extension covers all of 2008 and runs through 12-31-09 (good news for Reilly, Tom H. and the rest of our regional railroad friends).
- Will short-line and regional railroads receive any “benefit” from the President’s infrastructure program???

Infrastructure

- *The Freight Rail Infrastructure Capacity Expansion Act* (25% tax credit) died in respective House and Senate Committees.
- Similar bill re-introduced by Rep. Kendrick Meek (liberal Democrat from Florida) in House Ways & Means Committee last week; primary House sponsor of previous bill.
- Legislation benefits shippers and receivers as well as carriers.

Economic Regulation

- *Railroad Antitrust Enforcement Act of 2007* made it out of Senate and House Committees but never came up for full vote in either Chamber.
- Sen. Herb Kohl and Rep. Tammy Baldwin of Wisconsin have already announced new version of this bill for 111th Congress.
- Watch to see if there is infighting again between Congressional Committees for jurisdiction here.

Economic Regulation

- *Railroad Competition and Service Improvement Act* died in respective House and Senate committees (Sen. Rockefeller was lead sponsor of Senate bill).
- Based on past experience should expect a new version of this bill sooner rather than later.

Pair of Legislative Wild Cards

- **Railroad Safety Legislation**
- **CN/EJ&E Merger Fallout**

Railroad Safety Legislation

- Original bill, H.R. 2095 *Federal Railroad Safety Improvement Act*, also commonly referred to as the *Oberstar Rail Safety Bill*, had passed the House of Representatives by a wide margin in October 2007.
- Comparable bill had been introduced in Senate in 2007 with no subsequent action.
- On August 1, 2008 the Senate ignored its own bill and actually passed an amended version of H.R. 2095 by a wide margin.

Railroad Safety Legislation

- Bill sent to Joint Conference Committee to reconcile differences between House and Senate versions.
- Railroad industry had opposed original Oberstar legislation and White House was also on record as “strongly opposed”.
- Future of bill was unknown.
- Then came September 12th Metrolink tragedy at Chatsworth, CA, and ALL bets were off.

Rail Safety Improvement Act

- Congress immediately added Positive Train Control (PTC) requirement to the original legislation.
- Plus an enormous Amtrak authorization for good measure.
- House and Senate quickly agreed to new amended bill renamed the *Rail Safety Improvement Act of 2008 (Division A)*.
- And provoked an interesting response from the railroad industry.

Rail Industry Positive Response

- “The railroad industry would like to commend the leadership of the Senate Commerce Committee and the House Transportation and Infrastructure Committee for the work they did in crafting a comprehensive and far-reaching rail safety bill.” AAR/Ed Hamberger Press Release 9-24-08.
- *Rail industry was recognized by many for their positive approach in this process.*

Rail Safety Improvement Act

- Conservative Senate Republicans threatened a filibuster but thanks to a strange series of events the filibuster was quickly busted.
- On October 2 Senate ratified Nuclear Trade Treaty with India (which President wanted).
- Amended bill (H.R. 2095) finally passed both houses by October 6.
- President Bush signed new bill into law on October 16 (which Democrats wanted).

Rail Safety Improvement Act

- Railway Age Magazine calls it the “most comprehensive rail safety bill in over 30 years”, contains 32 new regulations, 7 amended regulations and huge increases in fines for violations.
- Division B of the bill is entitled *The Passenger Rail Service and Improvement Act of 2008*; includes the largest Amtrak authorization ever at \$13 billion for 5 years.
- **Final bill contains 123 pages.**

Bill Provides For

- Mandatory installation of Positive Train Control (aka PTC) systems on all Class I rail lines shared by passenger, commuter and freight trains, and on freight-only lines used to transport hazardous materials, by 12-31-15; estimated minimum cost of \$2.3 to \$5 billion.
- This technology could increase capacity on some congested mainlines.
- *Who pays the actual costs is unknown at this time (could be all of you).*

Contains Major Labor Changes

- Train & engine service employees are not allowed to work more than 276 hours per calendar month.
- Train & engine service employees are not allowed to work more than 12 consecutive hours.
- Train & engine service employees must have at least 10 consecutive hours of undisturbed rest off duty during 24 hour period.

More Labor Changes

- After 6 consecutive work days train and engine service employees must have 48 consecutive hours off.
- Employee limbo time is capped at 40 hours per month, 30 hours by 2010.
- FRA to establish certification program for railroad conductors by 2010.
- Revisions to current HOS regulations for rail commuter train crews.

Labor Impact

- These are the most significant and sweeping changes in railroad Hours of Service since first implemented 100 years ago (and probably greater than recent changes in HOS regulations for trucking industry).
- One very big net effect of these changes is to reduce the overall size of an already shrinking transportation labor pool.

Labor Impact

- Changes in the HOS go into effect in 6 months (July 16, 2009); does anyone have a clue as to what is going to happen in July???
- Impact of these changes on Class II and III railroads still being determined.
- *Based on recent history changes could lead to crew and capacity shortages during future peak periods (maybe a good question for today's luncheon speaker?).*

CN/EJ&E Fallout

- Extremely nasty and absurd public fight over CN's acquisition of EJ&E led to several equally bizarre developments in Congress; some sobering examples of how government works (or doesn't).
- In June 2008 Rep. Peter Roskam (IL-6) introduced bill (H.R.6476) that would basically allow Federal government to take control of any rail line they wanted for commuter rail (so much for private property rights).

CN/EJ&E Fallout

- Roskam allegedly wanted to save EJ&E right-of-way for Metra's dubious Star Line Service (which current EJ&E management has never supported), but this was also great way to kill the deal by making railroad useless for freight.
- Ironically Roskam, who represents one of the most conservative Congressional districts in America, was acting like the biggest liberal since Eleanor Roosevelt.
- Fortunately this bill died in Committee.

CN/EJ&E Fallout

- Since transaction opponents did not like the probable outcome of existing Federal regulations on railroad mergers, they decided to use their clout and connections to change the rules in the middle of the game.
- The result was introduction of H.R. 6707, *Taking Responsible Action for Community Safety Act* (aka TRAC); any resemblance here to main opposition group, also called TRAC, was purely (you-fill-in-the-blank).

CN/EJ&E Fallout

- Bill was introduced on July 31, 2008, and made retroactive to cover any pending merger cases that had not been decided by 7-31-08 (wasn't that convenient).
- Would place transactions involving only one large railroad and smaller railroads (Class 2 and 3) under the same standard now applicable for merger of two or more large railroads.

CN/EJ&E Fallout

- Bill would also amend existing standard to specifically include certain safety and community impacts, along with effects on passenger transportation, as mandatory criteria for analysis.
- Bill would effectively make railroad mergers an open ended process again and return us to the "*good old days*" of 1974, when ICC took 10 years to issue a final decision in the UP-Rock Island transaction.

Congressional Budget Office Said

- H.R. 6707 would impose a private-sector mandate.
- “Because of new standards railroads could be prohibited from engaging in certain transactions that would otherwise be allowed.”
- “It is also uncertain the extent to which railroads would have to forgo business opportunities or what the value of those lost opportunities would be.”
- *Also require additional 10 STB employees and \$2 million per year to implement.*

An Impartial Assessment

- Congressional testimony by *Dr. Joseph Schwieterman, Director Chaddick Institute, DePaul University, Chicago.*
- *No other transportation mode providing intercity service in the U.S. is subject to the kind of criteria established in HR 6707.*
- *The unintended result would be....an impediment to any effort toward finding cooperative solutions to community issues involving railroads.*

Testimony

- *Act would greatly expand the number of transactions subject to STB approval...there is a risk that it will become an impediment to rail-service improvements.*
- *Act risks shifting the responsibility for solving some of the problems of rail transportation from their roots – in state and federal policy– to private railroad companies (and YOU their customers).*

End Result

- H.R. 6707 was personally introduced by Chairman Oberstar in T&I Committee on 7-31-08, with 22 co-sponsors including Bean, Biggert, Foster and Roskam.
- Reported out of Committee after summer recess in record time on 9-24-08.

End Result

- Was narrowly defeated on a unique procedural vote of full House of Representatives during a special Saturday session on 9-27-08; thankfully dead for now.
- But the bill would have passed if it had been voted on under normal House rules.

Surface Transportation Board

- Consists of three Commissioners all of whom are appointed by the President and confirmed by the Senate.
- The Chairman is appointed directly by the President and the Vice Chairman is elected by the Board.
- Current Chairman Charles D. Nottingham is a Republican Commissioner appointed by President Bush; new President will appoint a new Chairman, probably a Democrat.

Surface Transportation Board

- Nottingham's term of office as STB Commissioner expires 12-31-10.
- Commissioner W. Douglas Buttrey's term of office expired at end of 2008 but he can stay in office until replacement is confirmed by the Senate.
- The Bush replacement nominee was never confirmed by Senate so this open seat probably filled by a Democrat nominated by new President.

Surface Transportation Board

- Vice-Chair Francis Mulvey is a Democrat, whose term expires in 2012; at time of appointment he was working for Mr. Oberstar on House T&I Committee staff.
- A leading candidate for Chairman.
- *Can probably expect high level of STB activism to continue if not increase!!!*

Rail Mergers and Acquisitions

- STB approved acquisition of the DM&E Railroad by Canadian Pacific Railway for \$1.5 billion on September 30, 2008; this included DM&E subsidiary Iowa, Chicago & Eastern (FD35081).
- Board specifically said that CP/DM&E may not transport coal from Wyoming's Powder River Basin unless Board prepares a full EIS and approves specific operations.

Rail Mergers and Acquisitions

- STB finally approved acquisition of the EJ&E Railway by Canadian National Railroad on December 24, 2008, with an effective date of January 23, 2009 (FD35087); kudos to Union Pacific for some excellent supporting testimony.
- The final decision contains an **extraordinary and unprecedented** level of environmental mitigation conditions for the size of this transaction; equal in scope to much larger Conrail deal in 1999.

Rail Mergers and Acquisitions

- On 1-5-09 Village of Barrington and Will County both filed Petitions for Stay of effective date with STB and DC Circuit Court of Appeals; outcomes unknown.
- On 1-6-09 Canadian National filed a Motion to Strike with STB.
- *The saga continues but the clock is still ticking.*

Rail Mergers and Acquisitions

- On 9-25-08 the Board ordered a limited EIS (and delay) on Norfolk Southern – Pan Am Railway's joint venture in northeast (Pan Am Southern Railway), even though originally classified as "minor" transaction (FD35147); environmental assessment finally issued on November 24, 2008.
- *This action, combined with CN/EJ&E, probably sign of things to come.*

Cost of Capital Calculation

- Board found that the rail industry's after-tax cost of capital for 2007 was 11.3%, a 1.39% increase from 2006 (STB Ex Parte 558, Sub-No. 11).
- In a related decision only two Class I railroads, Norfolk Southern Railway and Soo Line Railroad, were found to be revenue adequate in 2007 vs. 3 in 2006, (STB Ex Parte 552, Sub-No. 12).
- According to the Board, Soo Line had the highest ROI and CSXT the lowest.

Cost of Capital Calculation

- The September 2008 decision was the second one to use the Capital Asset Pricing Method (CAPM) to calculate the cost of equity, a key component of the cost of capital.
- This change in methodology was adapted by the STB in January 2008 (Ex Parte 664).
- *Impact of change hard to determine.*

Railroad Revenue Adequacy

- On October 24, 2008, the STB denied a petition by the Association of American Railroads (AAR) seeking to institute a rulemaking proceeding to consider the use of replacement cost methodology in the Board's annual revenue adequacy determination (Ex Parte 679).
- Original petition filed on 5-1-08.

Competition Study

- On November 3, 2008, the Board announced the release of Christensen Associates' *A Study of Competition in the U.S. Freight Railroad Industry and Analysis of Proposals That Might Enhance Competition*.
- An excellent analysis of very complex problems and issues; found no easy answers, simple solutions, or free lunches.
- Both sides of the regulation debate have used study results to "claim victory".

Competition Study

- On November 6 the Board asked for public comments on Study to be submitted by 12-21-08; 14 organizations submitted written comments which make for very interesting reading (Ex Parte 680).
- For many the report has been a Rorschach test; people tend to see what they want to see in the results.
- **Read it yourself and make up your own mind.**

Freight vs. Passenger

- In 2008 Congress passed the *Passenger Rail Investment and Improvement Act* (as Division B of the landmark Safety Bill).
- This act “enhances” the Board’s role in disputes between freight railroads and Amtrak and others, regarding cost and service aspects of both commuter and intercity rail passenger service (EP 683).
- Public hearings in February; will STB now become the referee between freight railroads and passenger train supporters for access to limited mainline capacity??

Previews of Upcoming Features

- Ex Parte 681, Notice of Proposed Rulemaking issued January 5.
- Should accounting and financial reporting rules be updated to include true (or actual) liability costs of transporting hazmat (specifically mentions T-I-H).
- This action is a direct result of financial impacts of Canadian Pacific hazmat incident at Minot, ND in 2002 and a similar hazmat incident on Norfolk Southern at Graniteville, S.C. in 2005.

Upcoming Features

- Combined with the Board's previous hearing under Ex Parte 677 regarding railroads' common carrier obligations to transport hazardous materials, looking at an action with potentially enormous implications for chemical shippers.
- Ex Parte 676, Notice of Proposed Rulemaking issued January 6; to amend and clarify rules regarding disclosure requirement in rail contracts.

Bush Admin Farewell Gifts

- Two important last-minute decisions in late November 2008 from the U.S. Dept. of Transportation.
- **FMCSA** issued final revised rules on truck drivers hours of service; opponents already on the move here.
- **FRA** issued new regulations on the nationwide routing of rail hazmat shipments (25 pgs. in Federal Register).
- Both issues are very controversial and will probably be revisited by Obama Administration.

Bush Admin Farewell Gifts

- From Dept. Of Homeland Security (DHS), on November 11, 2008 the Transportation Security Administration (TSA) issued its final set of Rail Security Rules.
- This 200-plus page document “establishes security requirements for freight railroad carriers, intercity commuter and short-haul passenger train providers....and rail operations at certain, fixed-site facilities that ship or receive specified hazardous materials by rail.” (questions referred)

The Outlook?

- On January 20, 1981, Ronald Reagan told the American people that “government is not the solution to our problem; government is the problem”.
- That marked beginning of the so-called Reagan Revolution, which held that more government is a bad thing and less government is a good thing.
- That phase of American history officially ended at 11:01pm, Eastern Standard Time, November 4, 2008.

The Outlook?

- We are at a tipping point in our history; clearly a paradigm shift either has or is now occurring.
- *Back to the Future? Déjà vu all over again?*
- Well it looks and feels a lot like January 1933 again.
- Remember that like FDR President-elect Obama will arrive in the nation's capital for his inauguration by train.

The Outlook?

- There is going to be enormous government investment in all forms of infrastructure; probably the greatest public works program since The New Deal.
- We ALL need to work together to make sure that freight projects of ALL kinds are included in the mix; what have YOU done?
- Rumors that funding for CREATE may be included in the early stimulus package, or will Durbin & The Gang drop the ball again like they did in 2005???

The Outlook?

- Public funding almost always comes with “strings attached”, which in a democracy like ours is probably not a bad idea.
- But we know that the freight railroads are bitterly divided on the entire issue of public financing of railroad infrastructure.
- Industry positions range from enlightened approach of BNSF’s Matt Rose to some CEO’s who are totally opposed to any kind of public funding.

The Outlook?

- Will the freight railroads accept terms and conditions attached to any public money offered, or will they turn their backs on largest public works program in 75 years?
- *And then what happens?*
- Union Pacific recently told the state of California “thanks but no thanks” (*an interesting question for today’s luncheon speaker?*).

The Outlook?

- Like 1933 government regulation is now seen as a very strong positive rather than a negative.
- Federal government is already re-regulating the entire financial services industry, and on verge of nationalizing the US automotive industry; railroad industry is clearly playing defense here.
- Big question is will railroads get swamped by the coming tidal wave of government re-regulation or can they weather the storm?

The Outlook?

- *Is it renaissance, reformation or revolution???*
- *Probably a combination of all three.*
- *Hard to predict but the rail industry is definitely in for some dramatic change.*

QUESTIONS

Copies of presentation are
available on request.