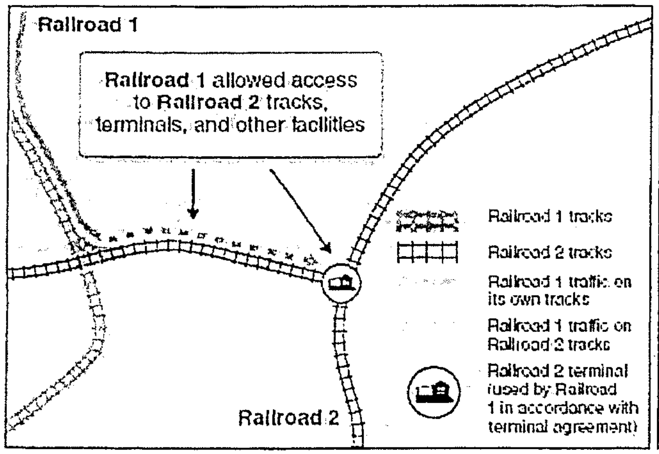
WOLFE TRAHAN

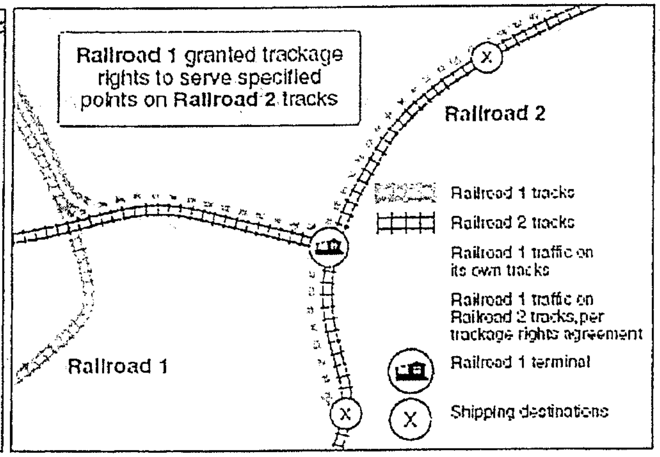
The Wolfe Trahan Rail Regulatory Cheat Sheet

Updated: August 04, 2010

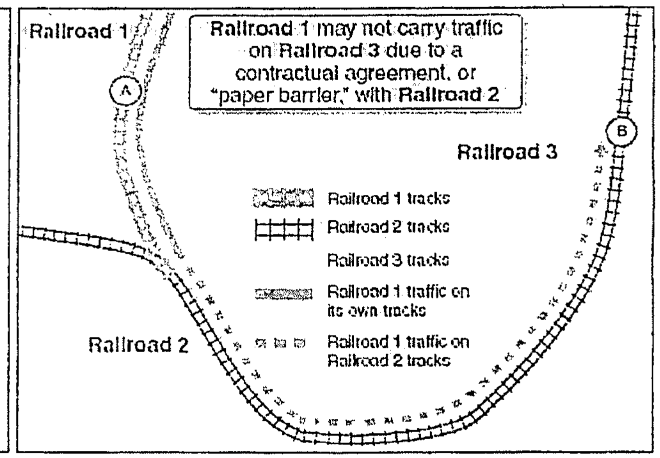
Terminal Agreements



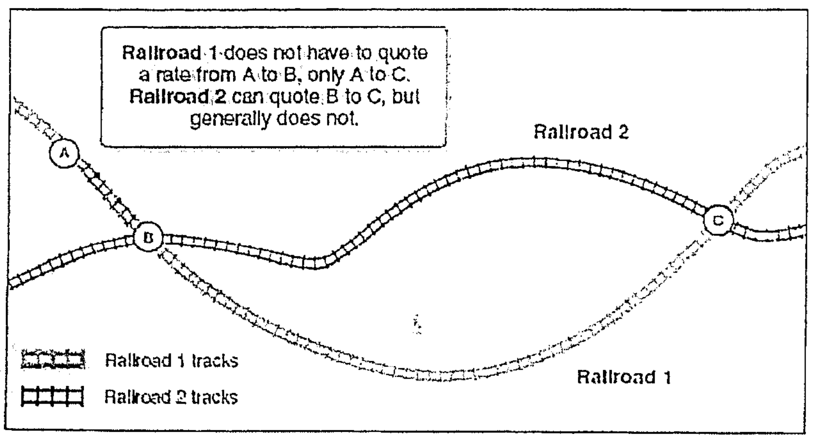
Trackage Rights



Paper Barriers



Rail Bottlenecks



Source: Government Accountability Office; Surface Transportation Board; Wolfe Trahan & Co.

Summary of STB Reauthorization Bill

The Surface Transportation Board Reauthorization Act of 2009 (S. 2889)

Introduced on 12/16/09; Voted out of Senate Commerce Committee on 12/17/09

Sponsored by Senator Jay Rockefeller (4 co-sponsors)

No Companion Legislation Introduced Yet in the House

Wolfe Trahan Expectations: We expect increased noise in the near term, but continue to believe the odds of passage of the bill in 2010 remain below 50%.

Pending STB Rate Cases

Date Filed	Shipper	Railroad	Commodity	Rate Case Type
10/3/2008	Seminole Electric	CSX	Coal	Stand-Alone Cost
12/30/2008	Arizona Electric Power	BNI & UNP	Coal	Stand-Alone Cost
12/30/2008	Arizona Electric Power	UNP	Coal	Stand-Alone Cost
5/3/2010	Total Petrochemicals	CSX	Chemical	Stand-Alone Cost
6/18/2010	M&G Polymers	CSX	Chemical	Stand-Alone Cost

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Issue	What's in the Current Senate Bill? S. 2889	What Could Change?	Winners/Losers from Current Bill
1) Bottleneck Rates - Bottlenecks refer to the captive portion of an otherwise competitive rail movement. Captive shippers want the rails to quote rates between any 2 points on their network where traffic originates, terminates, or can be interchanged. STB precedent states that a railroad is not required to quote bottleneck rates. Shippers complain that this reduces competition and makes them effectively captive to a single railroad. We believe this predominantly affects coal shippers.	Bottleneck rates are required. Standards for "reasonability" will be established by the STB. Quotes can be challenged by shippers via the STB with the burden of proof on the rails.	A positive change for the rails would specify or protect a level of recovery of lost profits for aggrieved railroad.	Negative for all U.S. rails, but there is potentially more risk for CSX & NSC with more captive coal traffic that could be subject to bottleneck rates.
2) Terminal Agreements - Would require one railroad to grant another railroad access to its terminal facilities, enabling both railroads to gain access to traffic coming from shippers off the other railroad's lines. The railroad owning the terminal would then receive a fee from the non-owning railroad. Many U.S. railroads already have voluntary terminal agreements in place.	Terminal access is mandated. Standards for "reasonable" compensation will be established by the STB. Burden of proof shifts to the carrier giving up terminal access.	Potential change could specify compensation for rails giving up terminal access, rather than defer decision to the STB. Short-line railroads could receive exemption.	Negative for all rails, and could be a material impact depending on compensation for incumbent rail.
3) Paper Barriers - Contractual provisions included with a sale or lease of a rail line that restrict the ability of the acquiring short-line to interchange traffic with rail carriers other than the seller or lessor railroad. This can lead to fewer competitive options and thus higher rates for shippers.	Future paper barriers can't be issued without STB approval. Existing paper barriers can now be challenged but short-line rail will potentially receive compensation in cases where legacy paper barriers are overturned.	We don't expect much change as paper barriers seem to be an important issue for shippers and the large rails don't have strong objections.	Bigger issue for small-cap rails, GWR and RA. Could reduce future acquisition opportunities and place existing properties at risk.
4) Antitrust Exemptions - Would strip railroads of their exemptions from federal antitrust laws. Most railroad industry activities, including mergers and acquisitions, are exempt from antitrust laws, as issues within the scope of jurisdiction of the STB may not be litigated in federal or state courts except in an appeal of an STB decision.	There is no antitrust language in the current bill, but Senator Rockefeller (Senate Commerce) is negotiating with Senator Kohl (Senate Judiciary) to include antitrust language.	We expect some softened version of antitrust language (relative to Senator Kohl's stand-alone bill) to be in the final bill.	Negative for all rails; tougher M&A approval process would potentially be negative for KSU.
5) Change in STB Rate Standard - Large Rate Cases - Currently, the Stand Alone Cost (SAC) method is used to determine fair rates, whereby shippers construct a hypothetical railroad. The process is very lengthy and expensive. Some shippers want Congress to mandate a change away from SAC test to one based on actual costs.	No change away from SAC test. Bill requires rate cases to be completed within 1.5 years vs. current cases which typically take 2-3 years.	We don't expect this language will change much from the current version of the bill.	Positive for eastern rails that SAC test will continue as the complex SAC test makes for high burden of proof in the East.
6) Change in Rate Dispute Process - Small / Mid-Sized Rate Cases - The STB recently established the Three-Benchmark approach, which provided a faster and cheaper method for reviewing small and mid-sized rate cases. Shippers want to increase the limits on the size of reparations.	Bill increases maximum relief under the Three-Benchmark test from $1M to $1.5M and increases maximum relief under Simplified SAC from $5M to $10M.	We don't expect this language will change much from the current version of the bill.	Likely bigger negative for CSX and UNP, with greater percentage of small shippers.
7) Increase in Size / Resources / Scope of the STB - The STB currently consists of 3 commissioners and 150 employees with a $25M annual budget. There is a sense that the small size of the STB and its low budget prevents the agency from being an effective means of rate dispute.	Bill increases Board members from 3 to 5; Bill gives STB much more power to determine final ruling on most of the issues above.	We suspect the Board's timeline for rulemaking proceedings required by the bill could be lengthened.	Modest negative for rails with bigger and broader STB in their lives.
8) Arbitration as Alternative for Rate Disputes - Currently, shippers can only challenge rail rates through the STB. Shippers want to establish a process for arbitration separate from the normal rate dispute process. Arbitration would provide shippers with another avenue to dispute rates.	Bill gives STB the authority to establish binding arbitration to resolve rail rates, practices and common carrier service expectation disputes. Sets maximum damages at $250K per year.	Positive change for the rails would limit arbitration to only a small number of shippers.	Modest negative for all rails as it potentially gives STB authority over non-rate related issues such as rail service and other practices.
9) Positive Train Control - The rails are mandated to install PTC (train collision prevention technology) on their networks by the end of 2015. The rails expect more than $5B of total spending to comply with this unfunded mandate.	Legislation does not address funding for PTC.	Language could be added to include some form of funding for PTC over the next 6 years.	Funding for the rails or some form of tax credit would be a material cash (not EPS) positive.
10) Reciprocal Switching - Would require railroads serving shippers that are close to another railroad to transport cars of that competing railroad for a fee. Shippers would then have access to railroads that do not directly reach their facilities. This is similar to mandatory inter-switching in Canada, which enables a shipper to request a 2nd rail's service if that 2nd rail is within ~18 miles. Many U.S. railroads already have voluntary switching agreements in place, but they are not mandatory.	Legislation does not address reciprocal switching.	We don't expect any change that would add reciprocal switching to the bill.	UNP likely would have been viewed as the biggest loser, as switching could open up its chemicals franchise in Houston to competition. Current bill removes a major risk for UNP, in our view.
11) Trackage Rights - A railroad would be forced to grant another railroad access to its tracks, enabling both railroads to interchange traffic beyond terminal facilities for a fee. This is similar to the Australian railroad open-access system.	Legislation does not specifically address trackage rights.	We don't expect a change to add trackage rights to the bill.	Broad-based trackage rights would have been a significant negative for all rails.
12) Replacement Cost Methodology - The STB currently uses historical cost (book value) in its annual return on investment (ROI) calculation; however, the rails have petitioned the STB to switch to replacement cost, which would materially reduce each rail's ROI well below its cost of capital. Much of the rail infrastructure in the U.S. was built 100+ years ago, and would cost a lot more to replace than what is valued on the rails' books currently.	STB must consider use of replacement cost methodology, but this change is not mandated. In the past, the STB has stuck with book value after weighing the issue.	We believe it's unlikely that the bill will mandate a change to a replacement cost methodology.	Change to replacement cost would have been a significant positive for rails, particularly NSC as they are closest to being revenue adequate.

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