INVESTMENT IN THE RAIL INDUSTRY

(110–104)

HEARING

BEFORE THE

SUBCOMMITTEE ON

RAILROADS, PIPELINES, AND HAZARDOUS MATERIALS

OF THE

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March 3, 2008

SUMMARY OF SUBJECT MATTER

TO: Members of the Subcommittee on Railroads, Pipelines, and Hazardous Materials

FROM: Subcommittee on Railroads, Pipelines, and Hazardous Materials Staff

SUBJECT: Hearing on Investment in the Rail Industry

PURPOSE OF THE HEARING

The Subcommittee on Railroads, Pipelines, and Hazardous Materials is scheduled to meet on Wednesday, March 5, 2008 at 11 a.m. in 2167 Rayburn House Office Building to receive testimony on investment in the rail industry. The purpose of this hearing is to examine recent interest by Wall Street investors in the railroad industry, including concerns raised by the activities of the Children's Investment Fund, a hedge fund.

BACKGROUND

The railroad industry is currently enjoying a "renaissance" after many years of poor financial health due to rising costs, loss of market share, and bankruptcies. A 2006 Government Accountability Office report examining the health of the freight railroad industry found that its financial health has improved substantially since passage of the Staggers Act as railroads have cut costs by streamlining their workforces, right-sizing their rail networks, and reducing their track mileage, equipment and facilities to more closely match demand. Freight railroads have also expanded their businesses into new markets—such as the intermodal market—and implemented new technologies, including larger cars.

Over the past 10 years, the seven Class I railroads (Union Pacific ("UP"), BNSF Railway ("BNSF"), Norfolk Southern ("NS"), CSX, Canadian National ("CN"), Canadian Pacific ("CP"), and Kansas City Southern ("KCS")) have reported progressively greater income. The average rate of return on net investment rose from an annual average of 2% in the 1970s to 4.4% in the 1980s, 7% in the 1990s, and 7.4% from 2000 to 2006. From 1996 to 2006, the net income of the seven Class I railroads has increased 205%, from $3.696 billion in 1996 to $7.559 billion in 2006.

This success has led to renewed interest from Wall Street investors. In 2006, Atticus Capital, an activist hedge fund, publicly filed as a major shareholder of the UP, CSX, NS, and BNSF railroads. In February 2007, private equity firm Fortress Investment Group ("Fortress") completed a buyout of short-line rail service provider RailAmerica. In April 2007, Warren Buffett purchased an 11% equity stake in BNSF, as well as holdings in NS and UP. A few weeks later, CSX reported that activist shareholder The Children's Investment Fund ("TCI") had purchased 2.5% of CSX shares.

This activity continued in 2008, with Mr. Buffett increasing his equity stake in BNSF to 18%. TCI is currently engaged in a proxy fight with CSX management after announcing in December it controlled approximately 20% of CSX stock with another fund and that it will nominate an alternate slate of directors to the CSX Board at its May 2008 Annual Shareholder Meeting.

REASONS FOR INVESTMENT BY WALL STREET

Railroads are an attractive investment for investors for a number of reasons. First, railroads currently enjoy greater pricing power than at any other time since passage of Staggers. This is due to increasing highway congestion, truck driver shortages, a strong pricing environment for the railroads and expectations of robust long-term growth in freight demand.

Second, after losing market share to highways for over 40 years, railroads are regaining market share due to: (1) off-shore manufacturing, where large shipments of freight produced in Asia and transported by ocean to U.S. ports lend themselves to longer-haul, non-time sensitive rail shipments within the nation; (2) a sharper focus on reducing fuel costs; and (3) growing public frustration with congested highways.

Third, the railroads are realizing enormous operational improvements. According to a Wall Street analyst, "we see the railroads as only in the middle of their operating turnaround following the merger-related service disruptions of the 1990s, and improving technologies, increasing capacity, and a renewed focus on efficiency should result in continued productivity." These improvements include new and efficient diesel locomotives; longer train lengths, ongoing transitions from trailers to double-stacked containers, and new and extended rail sidings as some of the potential drivers of productivity enhancements for the railroads.

Fourth, railroads are benefiting from secular growth trends in both coal and corn/ethanol (a secular trend is a long-term trend upward or downward. This is in contrast to a smaller cyclical variation with periodic and short-term duration). Increased demand for coal has been a multi-year trend and is expected to grow, as more than 140 coal-fired power plants are expected to come on-line over the next 20 years, according to the Department of Energy. Additionally, corn exports are surging due to consumption in developing Asian countries, as well as greater corn usage domestically for ethanol production. Further, ethanol will continue to grow given the government-mandated doubling of consumption by 2012.

Finally, over the past five years, the average free cash flow return on capital (i.e. operating cash flow minus capital expenditures divided by average debt and equity) for the railroads improved on average from 2% to 5.5% during 2006. Railroads are increasingly able to generate free cash flow through all parts of the economic cycle. Analysts see better free cash growth potential for the

railroads compared to other transportation sectors, especially once the railroads complete major capital expansion upgrades in the next few years. Importantly, railroads are increasingly returning cash flow to shareholders in the form of dividends and stock repurchase programs, with roughly $2 billion programs over the past five years at the five U.S. railroads (UP, BNSF, NS, CSX, and KCS).

THE CHILDREN'S INVESTMENT FUND

TCI is an activist hedge fund founded in 2004. It is registered in the Cayman Islands and headquartered in London. It is one of approximately one of 8,000-9,000 hedge funds, with an estimated $2 billion in assets as of 2005.

Hedge funds are private (not registered with the Securities and Exchange Commission ("SEC")) investment funds that buy and sell all types of securities listed on both public and private exchanges. Much of the investing activities of hedge funds involve aggressive or sophisticated tactics as financial leverage (i.e. borrowing on margin), derivatives, concentrated positions and shorting of securities and financial instruments. Over the past decade, the activities of hedge funds have had a notable influence on stock and bond prices in the U.S. and increasingly international finance markets.

Hedge funds such as TCI are distinct from more traditional investors for a number of reasons. First, traditional investors, such as individual investors, business entities such as mutual funds, trust companies, and financial organizations, are subject to a wide array of regulatory compliance requirements and oversight from both public (i.e., the SEC, the Department of Labor, and federal and state bank examiners) and private (e.g. stock exchanges, accounting rulemaking and standards boards) entities. Hedge funds are often free of much of this regulatory oversight.

Second, hedge funds are generally regarded as high-risk, high-return operations. They are structured to avoid SEC regulation, including limits on the use of borrowed money, strict record keeping and reporting rules, capital structure requirements, mandated adherence to specified investment goals and strategies, bonding requirements, and a requirement that shareholder approval be obtained (through proxy solicitation) for certain fund business. Further, they may only accept funds from "accredited investors," defined by the SEC as persons with assets of $1 million or more. Additionally, hedge funds are commonly understood to utilize aggressive use of portfolio management tactics as financial leverage (i.e. borrowing on margin), derivatives, concentrated positions, and shorting of securities and financial instruments. These high-risk activities may result in a high return for an investor, though it often results in a high degree of failure for a hedge fund. A study by the New York University School of Business found the attrition rate for hedge funds is about 20% per year, and the average life span is about three years.

The performance record of hedge funds is mixed. Some studies find they generally outperform common benchmarks such as the Standard & Poor's 500, but others conclude they have lagged. The short life span of many funds creates obvious difficulties for measurement, including a strong survival bias: the many funds that shut down each year are not included in return calculations. Annual return figures conceal a wide variation from year to year and from fund to fund. In any period, the law of averages dictates that at least a few funds will do extremely well. These success stories may explain the continued popularity of hedge funds, including TCI.

On October 16, 2007, TCI sent a letter to the CSX Board of Directors and established a website (www.strongercsx.com) to publicly air concerns with CSX management. TCI stated these actions were the result of its private attempts to discuss their concerns with CSX management that were "consistently rebuffed." On the date of the TCI letter's publication, TCI owned 17.8 million shares, or 4.1% of CSX, making it CSX's third largest institutional shareholder.

In the letter, TCI advocated CSX management make a number of changes to its current operations, including (1) freezing capital investment until a favorable regulatory environment is achieved, including the outcome of H.R. 2125, the Rail Competition and Service Improvement Act; (2) improving corporate governance at CSX, including changing the Board composition and separating the Chairman and CEO roles; (3) improving management of CSX's capital expenditure budget; and (5) improving its relationship with labor and government regulators, including Congress. In prior correspondence with CSX, TCI made additional recommendations; including increasing its stock buyback program and raising shipper rates 7% each year for 10 years.

A copy of the entire TCI-CSX correspondence is attached at the end of this memo.

On December 19, 2007, TCI announced it had filed a Schedule 13D with the SEC disclosing that they and several individuals had formed a group whose members own in the aggregate 8.3% of the outstanding common shares of CSX. The members of the group also hold in the derivative securities providing economic exposure equivalent to an additional 11.8% of CSX's outstanding shares.

TCI's SEC filing disclosed that it intends to nominate five directors for election to the CSX 11-member Board (not including Chairman and CEO Michael Ward) at its 2008 Annual Meeting of Shareholders. TCI stated in its announcement that its "goal is a strong CSX that can provide the returns shareholders deserve, the service shippers demand, a safety record communities can count on, and a working environment employees can be proud of."

CONCERNS WITH TCI'S INTEREST IN CSX

Due to the reputation of hedge funds' short-term investment outlook, TCI's interest in CSX has raised concerns. TCI previously suggested CSX increase its "buy back" program to 20 percent of outstanding shares each year until leverage reached five times Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA"), an indicator of a company's financial performance. Stock buy backs are a method for a company to return value to its shareholders. Because a company cannot be its own shareholder, repurchased shares are absorbed by the company, and the number of outstanding shares on the market is reduced. When this happens, the relative ownership stake of each investor increases because there are fewer shares, or claims, on the earnings of the company. However, running up debt can also lower a company's bond rating, making it difficult and/or more expensive to acquire capital on the credit market. Maintaining an investment grade rating is important for a capital intensive business like a railroad. If CSX followed TCI's suggestion, it would increase its value to its shareholders to the detriment of its long-term performance. According to a Wall Street analyst, "the railroads are one of the rare industries where under spending on capital expenditures for even a year or two can ensure five or ten years of operating problems."

Second, TCI suggested CSX would make an attractive candidate for a leveraged buyout (LBO) or consolidation. A LBO is the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition. Often, the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquiring company. The purpose of LBOs is to allow companies to make large acquisitions without committing a lot of capital. Wall Street analysts contend activist shareholders or private equity firms may seek the sale of a railroad to a strategic buyer as an exit strategy or unlock shareholder value. While Class I railroads are subject to strict regulatory scrutiny, analysts contend smaller railroads such as KCS and Genesee & Wyoming have characteristics that would be attractive for financial acquisition and would not need to meet the same merger rules. However, analysts view CSX as the most likely consolidation candidate of the larger North American railroads. While LBO economics prefer higher return industries compared to the railroad industry, large private equity firms currently have a virtually unlimited ability to raise capital. This means private equity firms can target industries with lower returns, which makes railroads attractive at a time when they are reporting all-time highs on returns on capital. If CSX were to be subject to a consolidation or LBO, it could disrupt service to many of its shippers and impose an unacceptable impact to the U.S. economy.

Finally, there is little regulatory authority to govern TCI's activities except in extreme instances. As mentioned above, TCI is not regulated by the SEC. Further, the Surface Transportation Board ("STB" or "Board"), which is the economic regulatory agency for the railroad industry, has authority to regulate some railroad transactions, but not others. Any authority that the Board might have over the takeover of a rail carrier by a non-carrier such as an investment partnership or hedge fund would derive from either the provision in the law that applies to acquisitions of rail property by non-carriers[1] or the provision that applies when transfers of stock and control of a company are involved.[2] The latter provision may apply if a non-carrier acquired a single rail carrier that itself owns another rail carrier (for example, a large railroad that owns a small railroad), but it is doubtful that authorization requirement would apply if the two or more carriers being taken over operate as a single integrated transportation system. And the former provision, which generally applies to transfers of physical property, requires Board authorization if a person other than a rail carrier acquires a "railroad line."[3] This provision appears to be focused on discrete lines, not carriers, and would not normally be applied if a non-carrier sought to take over a major rail carrier. Finally, the STB lacks authority over a leveraged buyout or to block an acquisition of a large rail carrier system by a non-carrier, such as TCI.

However, TCI's status as a foreign-owned company would allow its activities to fall under the authority of the Committee on Foreign Investment in the United States ("CFIUS") under the U.S. Department of the Treasury should it attempt to gain a controlling interest in CSX. Section 5021 of the Omnibus Trade and Competitiveness Act of 1988 provides authority to the President to suspend or prohibit any foreign acquisition, merger or takeover of a U.S. corporation that is determined to threaten the national security of the United States. The President can exercise this authority to block a foreign acquisition of a U.S. corporation only if he finds: (1) there is credible evidence that the foreign entity exercising control might take action that threatens national security,

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[1] 49 U.S.C. 10901.
[2] 49 U.S.C. 11323(a)(4) (providing that Board approval and authorization is required for the "[a]cquisition of control of at least 2 rail carriers by a person that is not a rail carrier.").
[3] 49 U.S.C. 10901.

and (2) the provisions of law, other than the International Emergency Economic Powers Act do not provide adequate and appropriate authority to protect the national security.

FORTRESS INVESTMENT GROUP & RAILAMERICA

Fortress Investment Group ("Fortress") is a New York-based global investment firm founded in 1998 that manages approximately $40 billion in assets. Though Fortress was founded solely as a private equity firm, it has since added hedge funds and real estate asset trading to its investment offerings. Fortress is unique from similar investment firms in that it's the first of its kind in the United States to become a publicly traded company, though the investment services it offers are entirely private enterprises.

A private equity fund ("PEF") is a broad term for privately-owned collective investment scheme that invests in companies not traded on a public stock exchange. These funds use non-traditional investment strategies, including venture capital, buyouts, merchant banking, and special situations (investment in a distressed company or specific one-time opportunities). The PEF industry holds over $500 billion in capital and the 20 largest firms control companies with more than four million employees.

PEFs aim to beat investment returns available in the stock market for a small, wealthy group of investors. To accomplish this, PEFs will buy all outstanding shares of stock in a target company and remove it from public trading markets – thus making the target a privately owned entity. Through various mechanisms – including management restructuring, selling unprofitable divisions, and personnel cuts – companies are retooled and turned around, and then often brought back into the public stock markets or sold to another firm. This typically occurs over a period of three to seven years.

A PEF is similar to a hedge fund in comparison to traditional investment vehicles, as both attract high dollar investors, are subject to little regulation, and are high-risk/high-reward ventures. As PEFs are classified as private business partnerships, like hedge funds, their performance can be difficult to track. However, using all information available, the University of Amsterdam released a study in April 2007 concluding that over time, private equity fund portfolios outperform the Standard & Poor's 500 by 3% on average, but underperform the index by 3% ultimately due to excessive fee structures.

In November 2006, Fortress announced its intent to acquire RailAmerica, a short line and regional rail service provider operating approximately 7,800 miles in the United States and Canada. Following necessary approvals from the STB, the acquisition was made complete on February 14, 2007 when shareholders approved the buyout that equaled approximately $1.1 billion.

Fortress stated in its filings with the STB that it saw potential to improve RailAmerica's "efficiency, financial strength, and ability to meet the needs of shippers." In particular, Fortress expected future improvements to be made through "continued investment and improved managerial efficiency." However, RailAmerica's actions following Fortress' acquisition have raised concerns.

Prior to acquiring RailAmerica, Fortress claimed "[to] have no current plans to...abandon any rail lines in connection with the proposed transaction." However, after the acquisition was

complete, RailAmerica announced September 21, 2007 that it would cease rail service on its Coos Bay Branch Line in southern Oregon operated by the Central Oregon & Pacific Railroad ("CORP") due to "unsafe conditions in three tunnels," giving shippers one day to respond to the news.

Following a Federal Railroad Administration ("FRA") investigation to examine the tunnels and assess damage, RailAmerica insisted that despite the railroad's private ownership status, that federal, state, and local governments provide a total of $20 million to repair the tunnels. This issue has yet to be resolved and as a result, local shippers face higher costs, more trucks are on local roads, and the local economy has suffered.

CORP announced December 13, 2007 that service across the Siskiyou Subdivision between Medford, Oregon and Montague, California would be severely limited effective January 15, 2008. Further, if CORP could not reach a sufficient volume of rail cars or level of income on the line, service could cease altogether by April 15, 2008. Freight intended for California headed down the Siskiyou Subdivision is now rerouted north to Eugene and onto a Union Pacific line, the only Class I link for CORP. This cutback in service could mean increased costs for shippers and less competition for rail service.

WITNESSES

Mr. Snehal Amin
Partner
The Children's Investment Fund

The Honorable Joseph Boardman
Administrator
Federal Railroad Administration

The Honorable W. Douglas Buttrey
Board Member
Surface Transportation Board

Mr. John E. Giles
Chief Executive Officer
RailAmerica

Mr. Robin Greenwood
Assistant Professor
Harvard Business School

The Honorable Francis P. Mulvey
Vice Chairman
Surface Transportation Board

The Honorable Charles D. "Chip" Nottingham
Chairman
Surface Transportation Board

Mr. Michael Ward
Chairman, President, and CEO
CSX Corporation

HEARING ON INVESTMENT IN THE RAIL INDUSTRY

Wednesday, March 5, 2008

HOUSE OF REPRESENTATIVES
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE,
SUBCOMMITTEE ON RAILROADS, PIPELINES, AND HAZARDOUS MATERIALS,
Washington, DC.

The Subcommittee met, pursuant to call, at 11:00 a.m., at 2167 Rayburn House Office Building, the Honorable Corrine Brown of Florida [chairman of the Subcommittee] presiding.

Ms. BROWN OF FLORIDA. The Subcommittee on Railroads, Pipelines, and Hazardous Materials will come to order.

The Subcommittee is meeting today to hear testimony on the railroad industry. I have traveled on numerous Transportation Committee CoDels throughout the world to meet with transportation officials and compare and discuss rail and infrastructure systems. Regardless of where I go, whether it is in Russia or other surrounding Eastern European countries, France, Spain, England, or Asia, the transportation ministers and local transportation officials always tell me that the freight rail system in the United States is the best in the world. We are number one.

Freight railroads play a critical role in our Nation's economy, and their infrastructure provides vital commuter and passenger rail service throughout the Country. They employ over 180,000 people and have spent over $10 billion over the last eight years to expand tracks and precious rolling stock. Freight railroads are also charged with transporting hazardous material and carry valuable cargo for the U.S. military.

Further, they are key solutions to improving the environment and dealing with the future growth expected throughout our transportation system.

I am proud to say that CSX is headquartered in my home city of Jacksonville, Florida. They employ over 5,000 people who play a vital role in the local and state economy. The company is also a community partner making numerous donations to local charities and performing community service throughout the city.

Unfortunately, hedge funds and other short-term investors do not often have the long-term interest of the railroad interests in mind. Their demands for cuts in capital expenditures and large rate increases will only serve to slow capacity growth and hurt the industry and the economy in the long run. Because they cannot relocate railroads to foreign countries for cheap labor, short-term investments will squeeze railroads for quick returns at the expense of the

long-term health and competition of the companies and its employees. A short-sighted money grab like this recalls memories of the action leading up to the crisis as we have today.

The Children's Investment Fund, TCI, who has testified that they have been referred to as a locust by the German government and have met serious resistance from the Japanese government where they are trying to force higher energy prices on Japanese citizens throughout their partnership with J-Power.

In the past, Congress has acted to prevent foreign companies from managing U.S. ports operations and U.S. airlines because they want to protect the critical infrastructure from potential harm. The Nation's freight railroads are of critical importance to keeping America's economy moving, and this critical role can be crippled if unknown foreign ownership or short-sighted investors take control of any of them.

I personally believe that unknown and unaccountable hedge funds controlling a freight railroad is something that should be scrutinized by Congress and the Federal agencies that have jurisdiction over this type of transaction. I hope this hearing will be the first step in taking a closer look at the long-term effect on the railroad industry and the economy as a whole.

With this, I will welcome today's panelists, and thank you for joining us. I look forward to the hearing and the testimony. Before I get to Mr. Shuster, I ask that Members be given 14 days to revise and extend their remarks and to be permitted to submit an additional statement and material from Members and witnesses. Without objection, so ordered.

I yield to Mr. Shuster for his opening statement.

Mr. SHUSTER. Thank you, Madam Chairman. Thank everybody for being here today. It is, I think, an indication—we have a full room and the national media is covering this hearing—of the importance of this hearing today.

The last time we had I considered one of the most important hearings we had was on how to fund our highway and transportation needs in this Country, but everybody seemed to be down the hall listening to Roger Clemens and the Baseball League assessing steroids. So I am glad to see that the focus of the attention of the media is on an issue like this that is significant, and I am glad to have a full room here today listening to the testimony.

I am, obviously, very interested in this hearing today. Thee are some serious issues that we need to address to get answers for, and I hope this hearing will go a long way to doing that today. Our Nation's freight railroads are the envy of the world. They are one of the very few that do not receive Government subsidies and, in fact. have been built on private capital. They provide cost-effective service, as I said, without Government subsidies, which is extremely important; and they have had a great safety record, and it continues to improve.

Given the efficiencies of our railroads, it is no surprise that they have attracted the attention of major investors from in this Country and outside this Country. Recently, there have been differences, some questions about the impact of hedge funds on investments in our railroads. While not all hedge funds, I think, can be all categorized as bad, there certainly have been some players out there

that have done some serious damage to some industries, and they do raise concerns as to their long-term investments, or are they long-term investments?

But at the end of the day, hedge funds are accountable to their bottom line and to their investors, as are the railroads accountable to their shareholders. The railroads also have an important distinction, in that they have a common carrier obligation and perform many vital services, including national security interests. Some of these do not add positively to the bottom line of a railroad, and they certainly need to be considered, and we need to have the railroads continuing to perform those services for our Nation.

Our Nation and the economy depends on the free flow of capital, and I think we should encourage private capital to continue to pour into our rail system and all transportation entities in our Country. We do have many safeguards in place to ensure that the public interest is served, the STB rail rates and service quality; the FRA ensures that we have a safe rail system; and the Congress has a duty to vigorously oversee and have oversight to these many concerns.

While I come into this hearing with an open mind to hear what everyone has to say, I still have great concerns and am going to be very interested in hearing from our panelists. As I said, I want to welcome everybody here today and, with that, yield back to the Chairwoman.

Ms. BROWN OF FLORIDA. I am going to yield to Mr. Mica, who is the Ranking Member of the Full Committee for opening remarks.

Mr. MICA. Well, thank you for yielding and also thank you and Mr. Oberstar, Mr. Shuster, for agreeing to hold this important hearing, and it is on a very critical topic. Investment in our Nation's rail industry and how we go about it is very critical to the future of the industry.

Unfortunately, right now a lot of our Nation's infrastructure is up for grabs to the highest bidder, and with weak dollar and cash-rich nations like China and some of the other oil-producing countries, they have an incredible amount of resources to purchase America's highways, rail, and other key infrastructure, and they can be purchased at deeply discounted prices if you just take a minute to look at the exchange rates.

Currently, it is very difficult to assess how much foreign capital has actually been invested in our railroads and our infrastructure. We do not have a good mechanism of tracking all of that. There are some restrictions on investment, as you know, on aviation and ownership, but again I think with the amount of money that is available and our Nation's infrastructure up for sale, it raises a host of fundamental national policy questions.

It is also very difficult for Government to actually assess and evaluate the sincerity of investments, various investment schemes, and whether or not investments are being made for short term or long-term investment and many people are differently motivated in investing and spending that cash on our discounted infrastructure.

Today's hearing, I think, is a good exercise because it will focus attention on some of the concerns that have been raised about protecting public interests in our Nation's rail and infrastructure projects. Currently, as I said, there are little or no restrictions on

investment and rail. We do live in a global economy, and we need to secure and also to attract international sources of financing in the future to assist in building our Nation's infrastructure.

The need to sort out our policy and how that is allowed, permitted, and the rules for the game, also, have to be established. But rail, as you know by its nature, requires huge capital investments. It does not have the same pattern of competitiveness of other industries, and that is why I think, again, this is a very important hearing.

While the STB may monitor rail rates and service quality, investments in rail is still a major public policy consideration. Congress needs to review what is taking place, and Congress needs to decide what terms for investment should be in place to protect pubic interest. But what we do not want to do is stop vital private sector financial investment and capitalization.

I am also pleased that in the second panel, I will not be here, I have to leave shortly, we have Michael Ward, who is the CEO for CSX which is headquartered in Ms. Brown's district and runs through my district. He has acquired that railroad and made some dramatic improvements, and is in the process of making some dramatic improvements that the investors and stockholders in that company have interest in. I have been pleased to work with him in that effort to make his railroad even more successful, even more safe, and operating in the public interest through our district and State and Nation.

So I thank you again for allowing me a few minutes, and I appreciate your work on this important subject.

Ms. BROWN OF FLORIDA. Mr. Space?

Mr. SPACE. Thank you, Madam Chairwoman. Thank you as well for calling this hearing. I would like to thank the Ranking Member for his efforts as well.

I come from Southeastern Ohio, an exclusively rural district that has been hit very hard by this transitioning economy. We suffer from a lot of challenges in this part of Ohio, most of which is encompassed within Appalachia. Lack of access to adequate rail infrastructure is one of those significant challenges.

This is negatively impacting our ability to bring jobs to the region; it is negatively impacting our ability to maintain many of the present jobs we have. The cost of the transportation of goods, whether they be raw materials coming in or finished product going out, is a very significant part of the production process, whether you are a miner, a farmer, or manufacturer. These mounting costs are making it more and more difficult for us to compete.

I think that this body, and certainly the industry itself, has an obligation to do more to improve the infrastructure of rail in Ohio. I understand that CSX, which has a very large presence in Ohio and in my district, is planning two new major and much needed infrastructure improvements in Ohio, and according to the Ohio Rail Development Commission, CSX's infrastructure investment plan in Ohio is estimated to be about $140 million. That is all good.

The problem is we have some very significant concerns over statements registered by the Children's Investment Fund, a significant shareholder in CSX, that would seem to indicate its intent to undertake a corporate takeover as well as an intent to freeze cap-

ital investments. It seems that the significant rate of return that has been accelerating in recent years is not enough. This causes grave concerns to me and many of the manufacturers, miners, and farmers that I represent.

A note from an October 16th, 2007 letter that TCI sent to the CSX board of directors and which was published on its website indicated its advocation that CSX management make a number of changes to its current operations and included among those recommended changes, I find it interesting, were two in particular. One was to freeze capital investment and another was to improve its relationship with Government regulators, including Congress. And I find those two terms mutually exclusive, given the strong need to expand rail infrastructure in Ohio, in particular rural Ohio.

The rail industry, as I mentioned, is critical to our Nation's infrastructure and economic development and, by way of extension, to our national security. As a Member of Congress, I believe we have a responsibility to make sure that the rail industry is able to function properly. Certainly, problems that affect rail service do not simply affect the rail industry itself but the profit margins of many other industries and the livelihood of many people in Southeastern Ohio.

I think this Committee needs to make sure we are looking out for the profit margins of everyone, not simply rail, and with that I yield back.

Ms. BROWN OF FLORIDA. Mr. Cummings?

Mr. CUMMINGS. Thank you very much, Madam Chairlady. I certainly thank you for calling this hearing to consider the increasing investments being made by hedge funds in U.S. railroads.

Our Nation's railroads have recently been enjoying stronger financial help than they have experienced in decades. Growing interest in the railroads shown by major Wall Street investors is, in fact, a testament to that success. However, since railroads are such a critical part of our Nation's transportation infrastructure and because they carry a wide variety of cargoes, including hazardous cargoes through our Nation's communities, it is imperative that investments in railroads be closely scrutinized to ensure that they are in the best interests of the railroads, the safety of our communities, and the transportation needs of our Nation.

Such scrutiny is exceedingly important when the investments are being made by entities like hedge funds that are not subject to the same strict regulatory oversight that other types of investors face from the Federal Government. Of particular concern to me, and I know to Chairwoman Brown, is the apparent effort by the Children's Investment Fund, a hedge fund registered in the Cayman Islands, to gain substantial measurement control over CSX Railroad Corporation for the purpose of making quick returns on stock transactions.

While I certainly have questions about some of CSX's business practices, I am, like many of my colleagues, deeply troubled by the possibility of foreign entities owning, or owning significant stakes in, major pieces of United States transportation infrastructure passing through the heart of our Nation's communities.

In this case, the Children's Investment Fund is known for employing aggressive tactics to maximize shareholder value even to

the detriment of the growth and success of the underlying business concern. The Fund appears now to be attempting to employ these tactics with CSX. For example, the Fund has suggested that in order to yield short-term stock gains, CSX should freeze capital investments or should conduct stock-related transactions that can leave a company with a credit rating at the junk bond status.

In 2001, my district lived through the terrible Howard Street tunnel fire which was caused when a CSX train carrying flammable hazardous material derailed in a tunnel and ignited. The resulting fire burned for days in downtown Baltimore, and the clean-up after the accident cost some $12 million.

More recently during this past fall, CSX experienced small but disturbingly frequent train derailments in the Baltimore area. Like any railroad, CSX Corporation must have as a top priority ensuring the safety and security of the communities through which its cargo travels. Decreased capital investments and declines in corporate creditworthiness will not enable CSX to fulfill this duty, and any entity and particularly a foreign entity that proposes to increase stockholder value at the potential risk of the safety and security of my constituents will face my strong and vigorous opposition.

Similarly, I note that though the railroads have made significant economic gains in recent years, any return to former habits of under-investing in the railroads will immediately threaten the hard-won gains. Today's hearing, to your credit, Madam Chairlady, will give us an opportunity to hear from parties involved in operating and regulating railroads, including CSX Corporation, the Federal Railroad Administration, and the Surface Transportation Board regarding the potential impact of hedge fund investments may have in our Nation's railroads.

I look forward to hearing this testimony and to assessing, under the leadership of our Chairwoman Congressman Brown, whether Congressional action is needed to protect our Nation's railroads from potentially unscrupulous investment practices and, with that, I yield back.

Ms. BROWN OF FLORIDA. Thank you. Now, I would like to yield to the Chairman of the Full Committee, Mr. Oberstar, who is really the transportation guru of the whole world.

Mr. OBERSTAR. Oh, my goodness. Thank you, Madam Chair, but I don't know if I want that weight on my shoulders. But you are very kind. Thank you for convening this hearing.

History is important as we consider the subject matter of today's hearing on hedge funds and private equity funds. It reminds me of a hearing held in this very room 23 years ago by our former Full Committee Chairman and Subcommittee Chairman then of the Aviation Subcommittee, Mr. Mineta. The hearing was entitled, To Regulate Attempts to Acquire Control of Airlines. Then-Chairman Mineta called the hearing in response to efforts of Mr. Carl Ikon to control TransWorld Airlines, at the time one of the Nation's premier air carriers.

In the course of that hearing, Mr. Ikon, seated right at that hearing, made commitments to the Members of the Subcommittee about what he would do once he took control of the airline. Those assurances led the Committee and Congress that, generally—there was quite a substantial outcry from among our colleagues about that

potential takeover—to defer action on the bill. The bill's title was Preservation of International Air Service Act. It would require the Department of Transportation to review pending airline acquisitions by Wall Street investors.

The wheel turns, seems to come around to the same place, a revolution described as a turn in the same direction until you come back to the point where you started, the G.K. Chesterton description. Mr. Ikon failed to abide by the commitments. Once he took control of TWA he sold off a billion four hundred million dollars in assets, gates, aircraft, their trans-Atlantic route. They had a nonstop from St. Louis to London Heathrow, a privileged route, a valuable route. He sold it for $4 million to American Airlines. They made the money back by the end of that year, it was so valuable a service.

That eliminated TWA's ability to compete in the aviation market. It took St. Louis out of international service; it diminished the value of St. Louis as a hub, as a city that could compete in the national/international marketplace.

And then, what did he do with that? Did he reinvest it in TWA? No. He took the cash, diverted the assets to other investments that Mr. Ikon owned, Texaco, and other private investments of Ikon's. And while he committed to improving his relationship with labor, by the end of 1993 TWA's employees were imploring the Committee to do something to get him out, and we finally did. We made him personally responsible for the retirement plan, and rather than do that he left TWA.

But he took with him 10 years worth of frequent flier miles for himself, his family, for whomever else he chose to distribute those valuable assets to. That is the lesson that sticks in my mind as we begin this hearing, a bad taste in the mouth.

The Children's Investment Fund—I have had a visit, personally, with its founder—says there are long-term value-oriented investment fund. They would like CSX to take a number of steps that, personally, I find disconcerting. Diverting capital expenditure investment for stock buy-backs; freezing capital spending in what they call an uncertain regulatory environment, and I expect to have a lively discussion about that subject later on.

Now, these private equity funds often have different priorities than the company whose assets they are acquiring, or have acquired, or have a significant stake in. And those priorities in this case may conflict with the long-term viability of a railroad. An investor often commits his or her money to a hedge fund for a period of time, one to five years, expects a reasonable return on that investment. That puts pressure on the Fund to provide a maximum return on the investment within that window of time.

Now, fortunately, on the Surface Transportation Board, we have some skilled members who understand these issues, especially Mr. Mulvey, who has a Ph.D. in railroad economics and served on this issue for 25, 30 years. He knows the subject matter, and you are not going to hoodwink him. But there are a lot of people who do not have that kind of experience. That is why we have these hearings.

So short-term gains against long-term view, the railroad has been around for 150 years, and the Federal Government, as we dis-

played in the hearing on the Rail Competition Bill, between 1851 and 1871 gave the railroad 173 million acres of public land for the public use, convenience, and necessity, and gave the Railroad the rights to the minerals, the timber, and, as it turned out, oil and gas and coal, and the right to sell that property as their own, which, in many cases they did.

The public has a great interest in the viability of the railroads. It knitted the Country together from east to west and from north to south, provided a new measure of mobility. Today they account for over 40 percent of freight ton miles. It is more than any other mode. They deliver nearly 70 percent of all coal; they deliver 70 percent of the automobiles produced in this Country. There are lots of other factors, but I do not think that those hedge fund investors are looking at the long-term investment requirements of the railroads.

And I remember just 15 years ago when Rob Krebs of BNSF was positioning his railroad to make $2 billion or $3 billion of investment in its roadbed and its rolling stock capital and was told by Wall Street, oh, no, no, you can't do that. You have to return the money to shareholders. And had they made the investments then, they would be in a much stronger position than they are today, and that goes for the other railroads.

So I think, Madam Chair, this is a very critical hearing that comes at a critical time when we have these—just as we had with aviation—investments that divert the energy and the focus and the purpose of transportation. Railroads are facing that issue today.

Ms. BROWN OF FLORIDA. Thank you, Mr. Chairman.

Mr. DeFazio will be our last speaker before we hear from the panel.

Mr. DEFAZIO. Thank you, Madam Chair. Thank you for calling this extraordinarily important hearing.

I think there might be one place for agreement in the room no matter which side of this issue you are on in terms of the investment, is that it would be hard to disagree with the fact that rail is the most efficient way to move freight throughout many routes which are incredibly congested in America; and it is an incredibly valuable asset that need to be optimally utilized, and I think if we start at that point. then we have to determine what these investments mean toward enhancing that capability.

And I am particularly concerned and share a number of the concerns raised by the Chairman and others here today about the difference between a patient capital and, essentially, speculative short-term capital. We do not need speculative short-term capital to invest in the Nation's critical infrastructure, including rail, but we do need patient capital. I think we do need better coordination and perhaps partnership in working with the Federal Government between existing railroads. We need to look at some of, and revisit some of the deregulation which is a historic artifact now because of the closure of a line in my district.

I spent time reading of some of the procedures and rules and regulations regarding feeder line applications and the various forms of abandonment, and they were written in a different era with a different industry and really do not apply to today's world, or should not apply, but they do. And we need to revisit those.

Certainly, I have heard complaints as recently as this morning from captive shippers, so there are a host of issues before this Committee that are extraordinarily important. The Chairwoman traveled with me recently in a Surface Subcommittee to Europe where we saw extraordinary variance in terms of investment. We saw in Britain where their first deregulation was disastrous, and then now they have put together a non-profit to manage their rail bed and do have a vibrant and competitive rail industry, more passenger than freight than we do, and with the private sector paying a fair rate of return for the use of that.

We saw, elsewhere in Europe other very enhanced rail investments being made through, you know, public-private partnerships or public investment, and we need to come to terms with those issues here in United States. But I can say, unequivocally, the one thing we do not need and we perhaps need to consider fitness standards for anyone who acquires over a certain percentage of railroads assets, you know, something that we used to finally get Frank Lorenzo out of destroying airlines after it had gone through—how many did he go through? Three. Three before we got rid of him. We do not need those kind of characters involved in our rail system. It has enough problems. We want to make it better.

Thank you, Madam Chair.

Ms. BROWN OF FLORIDA. Thank you. And now I am very pleased to introduce and welcome our first panel of witnesses here this morning.

Our first witness is Administrator Joseph Boardman of the Federal Railroad Administration.

Our second witness is Mr. Charles D. "Chip" Nottingham, of the Surface Transportation Board.

And the third witness is Mr. W. Douglas Buttrey, a board member of the Surface Transportation Board.

And our final witness for this panel is Vice Chairman Francis P. Mulvey of the Surface Transportation Board.

Let me remind the witnesses that under our Committee rules, oral statements must be limited to five minutes, but the entire statement will appear in the record. We also will allow the entire panel to testify before questioning of the witness.

We are pleased to have all of you here today, and I recognize Administrator Boardman for his testimony. Welcome.

TESTIMONY OF JOSEPH H. BOARDMAN, ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION, U.S. DEPARTMENT OF TRANSPORTATION; CHARLES D. NOTTINGHAM, CHAIRMAN, SURFACE TRANSPORTATION BOARD; W. DOUGLAS BUTTREY, SURFACE TRANSPORTATION BOARD MEMBER; VICE CHAIRMAN FRANCIS P. MULVEY, SURFACE TRANSPORTATION BOARD

Mr. BOARDMAN. Good morning. Thank you, Chairwoman Brown, Ranking Member Shuster, Full Committee Chair Oberstar and other Members. I am pleased to be here on behalf of Secretary of Transportation Mary Peters.

There are those who would say that investment is not FRA's business because safety can be maintained by making spot repairs, adjusting operating speeds, lowering bridge ratings, and catching

defective conditions just before they cause an accident. As applied to a single location at a given point in time, such an approach may be workable; however, common sense tells us and history confirms that at some point management of the railroad will lose the capacity to manage all those developing problems, and if it does not make minimal systematic investments, shippers, railroad employees and the public will pay the price.

There have been two major reasons for under-investment in the basic infrastructure, the first caused by Government over-regulation and the second caused by short-sightedness on the part of rail executives often under pressure from the financial community to show short-term profit. Both are serious; neither can be ignored.

The Staggers Rail Act of 1980 accomplished a dramatic reduction in the economic regulation of the rail industry. Railroads were able to rationalize their systems, set rates that permitted them to recover their cost and make a modest profit, modernize work practices to reduce employee personal injuries and plow back earnings into their facilities and operations so that they could be more efficient.

FRA makes it a point to conference with the railroads on a regular basis seeking to understand their plans for investment and urging attention to areas that seem to need work, as judged by early indicators, FRA safety inspection activities, and actual safety results. FRA will never be satisfied until the entire industry makes additional progress across a broad front of safety issues, but when we talk with rail executives about these issues, they usually understand our concerns and, in general, they share our aspirations for improved safety through investment.

Why would rail executives be willing to elevate safety to a first-rank goal? Certainly, they are interested in safeguarding their employees and the public, but there is something else at work here: safety is great for business, particularly in the era of significant demand and limited capacity.

Department estimates of tonnage on the railroad system will increase by 88 percent through 2035. To meet this growth, the industry is ramping up investment. Up to now, it has been able to rely on significant productivity gains where the railroad industry has moved more freight over smaller networks with fewer employees. The railroads are now expanding capacity on their highest density routes by double or triple tracking and also looking at new cost-effective technological improvements that will also increase capacity.

The new investments that will advance safety, service, and environmental stewardship and asset utilization over the coming years will include a transition to electronically-controlled pneumatic brakes and other technology that will help the locomotive engineer achieve fuel savings and limit in-train forces that can result in derailment.

Under FRA waiver and encouragement, two railroads are presently trying out stand-alone ECP brakes, trains in coal service, and are gathering data to validate the business case for additional investments. In addition, positive train control technologies will play a significant role as well, but only when the practical issues have been wrung out through the kinds of demonstrations now underway.

These are transitions that will unfold over a decade or more, and it will take patience to see results. FRA has issued and enforces a wide range of safety regulations and has sponsored collaborative research with the railroad industry to introduce innovative technologies to improve railroad safety; however, it would be difficult for the industry to accomplish and achieve its positive safety record without the funds to improve and maintain the rail system.

Many investors have come to view railroads as potentially attractive investments. Among the entities increasing investments in the railroad industry are a variety of financial institutions, individuals, and investment funds. These investors are risking their money in belief that the railroads will provide a competitive return on their investment by improving shareholder value. While the interest of these new investors in raising railroad deterrence has in some cases created tensions between them and railroad management, the pressure to improve returns through gains in efficiency is healthy. An efficient railroad is usually a safe railroad.

Let me say it again: safety is great for business. Contemporary railroads will prosper as they provide very reliable service efficiently. A railroad that is capable of doing that year in and year out will make the necessary investments in infrastructure, rolling stock, employee training, and advanced technology, and with proper attention to a good safety culture, the safety record will follow.

The Congress and the FRA help in this process along with laws and regulations that set specific expectations that everyone has to live up to, and we serve as a constant reminder that safety must be the first priority, but often as not, industry will lead the way with investments and innovations to make the railroad work better for all concerned.

Thank you.

Mr. NOTTINGHAM. Good morning, Chairwoman Brown, Ranking Member Shuster, Chairman Oberstar, and Members of the Subcommittee. I appreciate the opportunity to appear before this Subcommittee today to discuss investment in the rail industry, an issue that is vitally important to the freight railroads, their customers, employees, and the Nation's transportation system as a whole.

When Congress passed the Staggers Act in 1980, the Nation's rail system was in desperate financial straits. It was burdened with excess capacity and unproductive assets, forced to provide unprofitable services and hampered by excessive Government regulation. It was not an industry into which many investors wanted to put their dollars.

Since 1980, regulation has been reduced, carriers have been permitted to shed unprofitable lines, and the rail system has rationalized much of its excess capacity. Today the Nation's rail system includes not only the seven major, or Class I, railroads but also more than 500 regional and short-line railroads. Those 500-plus railroads come in many shapes and sizes, from regional carriers that operate a thousand track miles or more and large publicly-traded holding companies that own and operate dozens of short-lines to small, privately held, individual railroads that operate over very short distances with as little as an employee or two. It is a diverse and dynamic industry.

In recent years, the U.S. economy has expanded, and the rail network, like other transportation sectors, has become capacity-constrained. Unlike some other transportation sectors—trucking companies, for example, which can buy new equipment or hire more drivers—railroads cannot respond as readily to capacity constraints by quickly building new track and other facilities.

Railroads are increasing their capital investments, which are the dollars spent on track, right-of-way, and rolling stock that will directly help capacity constraints. Hopefully, this will lead to better service and fewer trucks on our already congested highways. Between 2004 and 2007, the market capitalization of the large railroads has increased by 24.1 percent annually in real terms which indicates that the market expects railroad earnings to continue to be stable or to grow. At the same time capital investment has increased annually by 21.6 percent, again in real terms. It appears that railroads are investing in their infrastructure to the extent that they believe that those investments will pay off in the market.

Consistent with the growth in stock prices, railroads have recently attracted renewed interest from the financial community. Since late 2006 several investment funds, including Berkshire Hathaway, have acquired substantial positions in several Class I railroads.

As you are aware, concerns with recent international investment in railroads remain, and new attention is turning to new investors who have not traditionally invested heavily in railroads such as hedge funds and certain large institutional investors, some of which are international. This latest interest in the rail industry carries with it the possibility of a railroad takeover by a non-railroad entity, and it has raised questions about what role the STB would play in that situation.

When a non-carrier buys a controlling interest in the stock of a holding company that owns several unrelated rail carriers, it must obtain STB authority. For example, Fortress Investment Group sought and received Board approval when it obtained control of the Rail America family of small railroads in 2007. However, if a non-carrier were to acquire a controlling interest in the stock of a single railroad or a single integrated rail system, regulatory approval would not be required in advance under our statute.

With that being said, however, I do not believe that the statute needs to be changed to give the Board more extensive review authority at this time. I understand the concern that an investor, any investor, with a very short-term focus could disrupt interstate commerce if a policy of diverting revenues, degrading service to shippers, and cutting back on capital spending were to be implemented. At this juncture, however, I believe that the Board's existing tools are sufficient to ensure that carriers, regardless of their ownership status, carry out their common carrier obligation as railroads.

The common carrier obligation is the statutory duty of railroads to provide transportation or service on reasonable request. A railroad may not refuse to provide service merely because to do so would be inconvenient or unprofitable. The common carrier obligation, however, is not absolute and service requests must be reasonable.

In recent years, the Board has seen an increasing number of questions arise regarding the extent of a railroad's common carrier obligation. As a result, the Board is holding a hearing next month on April 24th to highlight the common carrier obligation, to provide a better understanding of it, and to assist us in monitoring carriers' compliance with it.

A railroad controlled by a large non-railroad investor would still be bound by the same obligations of all railroads. It still would have to fulfill the common carrier obligation, it still would have to maintain reasonable rates and practices and it still would have to file for abandonment or discontinuance authority if it were not going to provide service over a line.

Under our statute, the Board can investigate and report on the management of rail carriers under our jurisdiction. If the Board were to look into the management of a carrier and find violations of its common carrier obligation, the Board or the Department of Justice could take enforcement action to compel the carrier to comply with the statute and with STB orders. The Board could also, on complaint, find that the carrier violated the statute and award damages.

Given the Board's ability to address potentially negative influences by activist investors, it is important that we not overreact and adopt new policies that might discourage positive investment in railroads. As chairman of the STB, I would like all types of investors, big or small, domestic or international, activist or passive, who abide by the law and who respect our Nation's need for continued improvements in rail infrastructure and customer service to know that our Government welcomes and encourages their willingness to invest in our Nation's privately-owned rail system.

Freight railroads in the U.S. are in reasonably good financial shape and are attracting investors of all types and sizes. The rail industry's ability in future years to continue this trend will largely determine whether the rail sector will have the resources needed to meet growing demand for rail service.

At the same time, the Board will remain vigilant and proactive to ensure that interstate commerce is not harmed by a short-sighted effort to extract large profits at the expense of maintaining the infrastructure and providing reasonable service to rail customers.

I appreciate the opportunity to discuss these issues today and look forward to any questions you might have.

Thank you.

Ms. BROWN OF FLORIDA. At this time, we have three votes, so we are going to stand on official recess, and we will be back right after the vote. We wanted to give you adequate time, we didn't want to rush you, Dr. Mulvey.

[Recess.]

Ms. BROWN OF FLORIDA. Mr. Mulvey, you may begin.

Mr. MULVEY. Well, thank you, Chairwoman Brown, and Ranking Member Shuster, who is not back yet, and Chairman Oberstar, thank you very much for giving me the opportunity to testify before you today on railroad investment issues.

Capital spending on the part of the railroads has increased in recent years, as graph 1 which I have attached to my statement shows. However, when you examine it over a longer period and

when you put it in real dollar terms adjusting for inflation, the picture becomes a little less clear. As also shown in graph 1, real capital investment by the Nation's railroads has been relatively unchanged since the Staggers Act and, in fact, in constant dollar terms it is even less today than it was in 1980.

However, it is also true that the railroads have substantially rationalized their networks. The second graph traces the decline of route miles and track miles operated by the Nation's Class I railroads. These trends toward a shrunken system represent a continuation of a policy of reducing the size of the railroad network that began after World War I, although the pace of abandonments certainly accelerated after Staggers.

Graphs 3 and 4 show that, while there has been some fluctuation, capital investments on a per track mile and a per route mile basis have increased in recent years.

We can make similar observations about locomotives and rolling stock. The railroads today operate far fewer locomotives, but they are dramatically more powerful, roughly 50 percent more powerful than those in 1980.

Class I car fleets are only 40 percent of what they were in 1980, but today's rail cars are bigger, travel longer distances, and in longer trains. Moreover, some of the decline in rail car fleets has been taken up by Class II and Class III railroads and even more so by shippers who now more often provide their own cars.

The upshot is that, despite the smaller network, fewer cars and locomotives, and greatly reduced work force, the railroads are carrying twice as much traffic today as they did in 1980. They are truly doing more with less.

Historically, the railroads were plagued with excess capacity, but system rationalization combined with substantial traffic growth has meant the railroads now experience capacity constraints, and when demand exceeds available supply, prices will rise, and rail industry profits are higher than they have been for decades. One would hope that some of these profits are reinvested to grow the system so the projected growth in rail traffic can be accommodated.

Much of the railroads' investment goes towards maintaining and replacing the capital stock as it wears out. Only about one fifth of rail capital investment goes towards expanding the infrastructure, although that share has been increasing recently. Still it is doubtful that investment by the Nation's railroads will be sufficient to meet the investment need.

And what is that need? A recent study estimated that the railroads will need $148 billion between now and 2035 to meet the forecast demand for service just to retain their relative share of the freight transportation market. The study's authors estimated that revenue growth and productivity improvements by the Class I's could cover part of the need, but still leave a shortfall of nearly $40 billion. And that simply is to maintain their market share.

If we want the Nation's freight railroads to carry more truck traffic, take traffic off the highways and put it onto the railroads, and if we want the railroads to expand the infrastructure so that they can accommodate more inter-city passenger trains and commuter trains, the shortfall would be far greater than this.

The railroads will only invest as much as they feel is justified by current and reasonably foreseeable demand. Building on speculation that traffic will materialize is highly unlikely in an industry with a history of excess capacity and with capital assets that are very long lived.

Questions about the future of the coal-fired power plants, changes in traffic flows through the Panama and Suez Canals, the development of alternative port facilities in Mexico and Canada, the long-term potential of ethanol and other biofuels, and other issues must be answered with much more certainty before the Nation's privately-owned railroads can be expected to dramatically increase their investments.

So where will the monies come from? There are a number of potential sources, all of which hold promise but also can present problems. Investment tax credits are favored by the railroads. Public-private partnerships are favored by the Administration, and a railroad trust fund is a possibility that was favored by a former Member of this Committee, Representative Lipinski. These are all potential sources of investment capital.

However, another source of potential capital investment, hedge funds, has recently become of growing importance. This has attracted the interest of the railroad community, the Congress and other industry observers. The concerns appear to center around whether the relatively short-term strategy of most hedge funds squares with the needs of the railroads for long-term commitments of investment capital, as well as around the nationality of some of the hedge funds investors.

With respect to the latter, I do not believe that the nationality of the investors should necessarily be a concern. After all, historically, America's railroads were largely financed by European investors; still, national security must be a consideration in looking at who is investing in this key component of our infrastructure. Nor would I categorically rule out any particular type of investor or investment strategy as necessarily inappropriate for the U.S. railroad industry.

Having said that, I am concerned about investors who might take over a railroad and proceed to scale back on investment and begin to effectively disinvest in the infrastructure. By the way, Mr. Oberstar, I would like to mention that you would be happy to hear that one of your favorite investors, Mr. Icahn, has recently announced he wants to invest between $400 million and $1.6 billion in CSX.

Mr. OBERSTAR. Beware.

Mr. MULVEY. Beware. As Chairman Nottingham has said, the Board's authority over railroad capitalization is limited primarily to our review of merges and acquisitions, but we can step in and exercise our authority to ensure that railroads fulfill their common carrier obligations. Let me give you an example.

Last year we required a railroad to sell its line to another carrier because the shipper demonstrated that the service that the railroad was providing was not adequate. We can respond when railroads behave in a way that causes them to not fulfill their common carrier obligations, and as the Chairman mentioned, we are holding a hearing on that next month.

But today we are facing a conundrum. We want the Nation's railroads to be operating as efficient private sector enterprises, but we also want them to invest in anticipation of public and private demands for rail infrastructure. As a Nation, we need to decide what we want from our Nation's railroads and how we will be able to finance it.

That completes my remarks, and I will be happy to answer any questions.

Ms. BROWN OF FLORIDA. Thank you.

Mr. Buttrey.

Mr. BUTTREY. Good afternoon, Chairman Oberstar, Chairwoman Brown, Ranking Member Shuster, and Members of the Subcommittee. My name is Douglas Buttrey. I have had the privilege to serve as a member of the Surface Transportation Board since May 28th, 2004. I appreciate the opportunity to appear before the Subcommittee today, as you conduct this hearing on investment in the rail industry.

The Board's chairman, Charles Nottingham, has submitted testimony which discusses the issues that are the subject of this hearing today. The chairman's testimony covers everything that I would have said, so rather than duplicating coverage, in the interest of time, I will instead associate myself with his remarks and endorse the chairman's formal filed testimony. And I would be happy to answer any questions that you might have.

Thank you very much.

Ms. BROWN OF FLORIDA. Thank you.

Chairman Nottingham, in your testimony you made a distinction between traditional long-term investors such as Warren Buffett and a non-traditional investor such as the hedge fund. Why is this distinction important? And anyone else that would like to respond to this on the panel.

Mr. NOTTINGHAM. Well, yes. Thank you for the question. It is important for several reasons. One is, up until several years ago, we really didn't see a big influx or big presence of large, the degree and extent and types of large investors in the railroad industry as we are seeing today. It is probably, I would say, a good problem to have, generally speaking, because who would have thought 20 or 30 years ago we would be here talking about possibly too much investment from too many people around the world and elsewhere? So it is in many respects a healthy challenge to have.

It is something we need to be mindful of. Probably Mr. Buffett himself would not describe himself as a traditional railroad investor, because up until recent months and years, he really was not a big investor in the railroads as far as we know. And so whether it is individuals such as Bill Gates, who is a major investor in railroads, privately, or Warren Buffett or these hedge funds—and, of course, "hedge funds" is a label that, frankly, I was not real familiar with until a couple of years ago. I think we used to call them large investors or partnerships, and they come in all stripes and flavors and sizes, and some have outstanding reputations, some have reputations that are a little different than that; but it is worth noting that, generally speaking, across the economy we are seeing more influence throughout corporate America, by large institutional investors, including hedge funds but also large pension

funds and large university funds—for example, endowments—and those large investors often watch each other, of course, and will play off each other.

Mr. Mulvey mentioned the recent interest of Mr. Icahn in the CSX, as well, that has been reported. We do not know his motivations right now, but it is something we are going to stay on top of. So that is just a quick overview in an effort to be responsive.

Mr. MULVEY. One difference is that hedge funds often are more active, and there will be a testimony by Professor Greenwood later on, but they are more activist investors and they often target particular firms with a plan—with a strategy—to make changes. Most other investors tend to be more like Mr. Buffett, for example, and the pension funds, et cetera, traditional investors, they are more passive; they do not seek to make major changes in the railroad operations. That is one major difference.

Another difference is the way hedge funds are structured. They tend to fly under the SEC rules because of restrictions on who can be part of the hedge fund, et cetera, and that has caused some people to be suspicious about hedge funds. Whether or not that is justified is another issue.

Mr. NOTTINGHAM. And, Chairwoman Brown, if I could just follow up, I meant to make this point as well. As I speak with rail industry leaders and investors, and we get visited a lot by analysts from Wall Street and elsewhere and others, I have learned that the days when the investment pool was largely, or significantly, comprised of passive investors, people who are just parking their money into a corporation for many years and maybe checking on it at the end of each year, or periodically, those days are long gone.

All the investors now are making changes on a daily basis to their portfolios. They move in real time, and whether it is electronic commerce or technology that helps with that, that is probably a factor. But what I hear from experts is that there is really no such thing as a large class of truly passive investors that just check on their investments periodically and do not typically make adjustments.

Ms. BROWN OF FLORIDA. Mr. Boardman?

Mr. BOARDMAN. I just wanted to make a general comment, Ms. Brown, and that is, based on my testimony and I think some others have mentioned this, is the necessity in this industry for patience. And whether it is the electronic controlled pneumatic brakes, whether it is a positive train control, whether it is an investment by investors that are private or whether it is by Government as identified even in our RRIF program, our Rail Rehabilitation Infrastructure Financing, the period of time necessary to make these major capital investments requires patience on all investors. Thank you.

Ms. BROWN OF FLORIDA. Mr. Boardman, I have a follow-up for you. You mentioned that safety is good for business, but the only rail-related issue on the table is the positive train control. And for some reason rail has resisted this system. Can you explain why? Because studies show that PTC has a quick pay-back period. Why has the railroad resisted a full-fledged PTC system if they are so concerned about safety?

Mr. BOARDMAN. I think what we can see right now is that if you go on certain sections of the corridor, Northeast Corridor, you are going to see positive train control. I think we would like to see them move faster. NTSB, I think, has as one of their critical elements positive train control.

But I think you are going to see the business case made for that in ECP as we go forward, which is again a requirement for patience in this process. We see people today that are making real progress in positive train control, and the railroads are involved in that.

Ms. BROWN OF FLORIDA. Mr. Shuster, please.

Mr. SHUSTER. Just a follow-up on PTC technologies. We are still not there quite yet, that is correct.

I had thought the second reason was there is a big concern amongst labor that if you put PTC in place, the potential to have just one crew on the train, that is there, and that has some concern with labor that they are going to eliminate jobs. Is that also part of the concern with PTC?

Mr. BOARDMAN. Well, certainly, Mr. Shuster, early on in the process of PRC, one of the elements that was being floated around was one-man crew. And that never got resolved because that did not move forward at that point in time, and that will still be an issue that will have to be dealt with on the labor side of things.

But what we are seeing today with the ETMS system that is already being implemented, that there is success with it, that in we expect in the future that to grow.

Mr. SHUSTER. And staying with safety, if a railroad or the industry were to freeze temporarily infrastructure investment, what is your estimate on how quickly we would see degradation in safety and efficiencies? Is it weeks? Months? A year?

Mr. BOARDMAN. Tomorrow.

Mr. SHUSTER. Tomorrow.

Mr. BOARDMAN. Because I think what we see in the necessity, and I think a railroad up here would tell you that that cannot happen; you cannot freeze investment in the necessity for us to maintain safety and continue to have an operating railroad.

Mr. SHUSTER. Right. With that in mind, the Board, Chairman Nottingham, you had said here that until somebody takes over a railroad, you do not have the authority to act until you see something going on in there. For instance, if there were a situation like that and Mr. Boardman said tomorrow it would happen, how quickly would you expect the STB to be able to respond to that, if you saw it happening? If somebody said, we are freezing today, and we are not in the court system.

If you are in a court system you have to prove that, you have to have a train fall off a track, or you have to have something bad happen. But in light of the fact that we know how important it is to have investment to continue to flow, what would your response be to somebody coming in and saying, we are freezing, or, we are stopping or significantly reducing?

Mr. NOTTINGHAM. That kind of worst case scenario, which by your hypothetical, Mr. Shuster, would flow out of a transaction where a non-rail carrier not needing our pre-approval were to buy a single railroad or gain control of a single railroad, it is correct

we would not have a statutory role in pre-approving that transaction. But as soon as that transaction is done, it is sort of, welcome to our world. You are now a railroad, and we have full oversight over you. We will act very quickly and very aggressively, including working with the Justice department.

If anybody is violating the common carrier obligation, we can direct service over your line, meaning put your competitors on your line. We can talk about what Mr. Mulvey referenced as to what we did in the Lubbock, Texas area last year with a smaller railroad but we actually took the railroad away from the operator, who in that case was acting irresponsibly, and had a forced sale.

And so we know one thing for sure: these investors do want to make money. And the idea of actually having their line taken from them, having their competitors put on the line by the STB or, worst case, us looking at their license to even do business as a railroad and possibly revoking that. These are pretty draconian steps that we have available to us that any profit-seeking enterprise would be wise to stay very, very clear of.

Mr. SHUSTER. Next question, change to accounting using historic costs versus replacement costs. STB uses historic cost and, having somewhat of a business background, I am a little confused as to why the use historic versus replacement. Can you sort of walk me through that and why do you do that?

Mr. NOTTINGHAM. Sure, I will try. It is a big issue that has come up in a number of public forums, including some of our hearings. It came up in our recent cost of capital inquiry where we updated and significantly changed the way we measure the railroad's cost of capital.

In the witness's statement you will have before you in the next panel—from TCI—I noticed in their statement they have an extensive discussion of their position that we should look at and use more often the replacement costs. And there is, I think, some common sense strength behind that argument, which is, in other words, if you are a railroad or any business, or even a homeowner, and you have to look at your infrastructure, whether it is the roof on your garage or other infrastructure—you do not necessarily look at all these in the day-to-day practical, real world, what it cost you 20 years ago to put that roof on your garage. If you have to replace it, what you are worried about is what it is going to cost you when you have to replace it.

Mr. SHUSTER. Right.

Mr. NOTTINGHAM. And when you look at thousands and hundreds of thousands of bridges and tunnels out there across the rail system, the replacement costs are just staggering. Now, I will say the accountants in corporate accounting have used historic costs for many decades. The Board and the ICC before us have used it. It is considered in the accounting profession a very mainstream accepted practice. The railroads have indicated at one of our hearings that they are probably going to come forward in the near future with a proposal for some type of new rulemaking or new policy, and we look forward to seeing that.

Mr. SHUSTER. To use replacement costs instead of——

Mr. NOTTINGHAM. I believe so. That is what they indicated at the hearing, and so we would put that out, of course, if we thought it had some merit, we would put it out for public comment.

And that does, of course, have real implications, too, on how we measure the railroad's financial health.

Mr. SHUSTER. And I wonder if I could just get Mr. Mulvey to respond, if he has the same viewpoint on that.

Mr. MULVEY. Basically, replacement cost makes more sense from an economic standpoint, what it costs actually, what the asset actually is worth today rather than what it was worth 100 years ago. And so replacement cost makes more sense.

The reason why we use historic costs, however, is that getting a handle on what replacement cost would be, would be a very, very Herculean undertaking.

Mr. SHUSTER. I did not hear that.

Mr. MULVEY. A big undertaking. It is something that would take the railroads quite a while to do, but, obviously, we valued the railroads in the past; I believe they were valued back in 1920 when they were returned to the private sector after being nationalized during World War I. Valuation is possible.

You also need to determine which of the assets need to be replaced. Historically, when you had all this excess capacity out there, a lot of those assets were redundant and did not need to be replaced. So you would not want to include those. Today, however, as we move more toward full capacity in the system, virtually all the assets need to be replaced and therefore should be valued.

Now, as Mr. Nottingham said, the railroads, in their testimony a few months ago, indicated that they might be willing to try and find some way of getting a handle on what the replacement costs would be, and we are looking to see whether or not we want to open a hearing on that.

Mr. SHUSTER. Thank you very much.

Ms. BROWN OF FLORIDA. Mr. Oberstar?

Mr. OBERSTAR. I want to thank the witnesses for their presentations. They were all very thoughtfully done and different aspects of the issue.

Let me come back to Mr. Boardman and follow up on the question that Chairwoman Brown asked about positive train control. We have seen figures, cost figures, for the investment in PTC that runs from something I might call more realistic to billions of dollars. Do you have solid figures on what it would cost to install positive train control?

Mr. BOARDMAN. I think we have good estimates, Mr. Chairman, that we could use, depending on the type of positive train control that goes in. We can provide those for you. I do not have them today.

Mr. OBERSTAR. Well, it might be a different matter in the high speed, relatively high speed, Northeast Corridor.

Mr. BOARDMAN. Yes, sir.

Mr. OBERSTAR. And in a different matter in a corridor where you have only a few passenger trains on long-haul surface or commuter lines, is that the case?

Mr. BOARDMAN. Yes. I think, for example, down in Panama right now, Kansas City Southern runs a sort of a positive train control that is fairly simple back and forth across Panama.

Mr. OBERSTAR. One of the impediments to expanding commuter passenger rail service, put a passenger rail service rather than commuter rail because it covers the whole range, is the implementation of positive train control. If you are going to have a really safe passenger system where we are mixing freight and passengers on the same lines, then you need these additional safety devices. Where in France, in Spain, Germany, Italy, Denmark, the freight trains do not run on the lines with passenger rail.

Provide us those figures in different scenarios such as we have discussed, and expand upon that.

Mr. BOARDMAN. We will do that, sir.

Mr. OBERSTAR. And we will make that available to all Members on the Subcommittee.

Mr. Mulvey, your testimony is very intriguing. You have some remarkable data, as you always have. But you discussed in your written submission the 1989 effort of Congress that was vetoed by Bush 41 to—as they call him affectionately in the family—the ICC authority to approve buy-outs by non-carrier investors. Would that be a useful tool for the STB, whether, and considering these in this scenario: one, authority to approve; two, authority simply to review and comment upon?

Mr. MULVEY. I think it would. We have testified before that in the ICC Termination Act of 1995 our ability to initiate investigations on our own was limited. And we have said before that we do think that it is time to revisit some of the limitations that were put on the Board. It was an important process to begin to allow the railroads to become more efficient and more competitive, et cetera, and to cut back on regulatory activism.

But times have changed, and I think it would be useful to give the Board more authority with respect to being able to launch investigations on its own. Today, we have to wait until somebody files a complaint before we can launch a rate case. We did, for example, launch our own investigation of the fuel surcharge issue. We did that under the guise of it being a practice rather than a rate.

We do think that there should be some changes in the legislation now with regard to George Herbert Walker Bush's veto. While that is not dispositive, certainly it is indicative of how we feel about our ability to do anything on this matter, and it may require that we get Congressional legislation again that would not be vetoed by whoever is in the White House when the legislation gets passed.

Mr. OBERSTAR. We do not want to do anything in the legislative arena that is going to discourage investment capability. We want all modes of transportation to be able to attract investment capital that is going to enhance the ability of the various modes to grow, to meet the public demand. And they are common carriers, whether they are trucking, or bus, or interline, or railroads, or the waterways.

But where there is a strong public interest quotient in these investment matters, and where investment could tip the balance

away from the common carrier purpose would be a matter of importance to the public interest, do you not think?

Mr. MULVEY. I agree. I mean, the railroads do have a public interest component, and railroads, as I said in my testimony, are willing to invest up to where they see there is a private return on their private investment capital. And the railroads want the public sector to invest where there are public benefits above and beyond the private benefits. The problem has been how to get those public monies invested in the railroads and get the railroads to agree to accept public assistance, as well as whatever rules and regulations are going to go along with that public money.

I think the railroads feel that if you take the money, well, what does that make you? And so they said, well, we eschew taking public funds. We would rather do it ourselves, and we are doing fine. But as a lot of these studies have shown, if you are looking for the railroads to greatly expand the amount of freight that they handle or even maintaining their market share, or have the capacity to handle more passenger service, the investment is going to have to be significantly greater than the railroads are capable of investing.

Mr. OBERSTAR. Well, the comparison with the airlines is, I think, appropriate, though not exclusively or uniformly applicable throughout the mode. But they are both capital intensive sectors; they are both common carriers; they both serve the broad public interest; they are both vital to mobility of people and goods in our economy. And the concerns we had in the 1980s and early 1990s, when, subsequent to Mr. Meadows' hearings, I held hearings on the subject, was, as you put it so well, not the source or identity of investors but the time frames and the goals for those investments. What are you going to do with these investments?

Now, in the buy-out of R.J. Reynolds, cracker manufacturers could be a dime a dozen. Department stores come and go. But airlines are crown jewels in our transportation. Railroads are unique. We only have four big-class ones, and three sort of Class Is with an asterisk on them, and that is it. And they are responsible for the massive movement of bulk commodities in the economy.

And so what criteria do you establish to evaluate goals for investments and time frames for investments?

Mr. MULVEY. That is difficult. With your analogy to the airlines one of the big differences is that, while the airlines are capital-intensive, most of that capital is in the airports and in the airways' navigation systems, and those are provided by the public sector.

The railroads are the only—well, I should not say only, the pipelines, too, I suppose—but the railroads are the major common carrier that have to provide their own rights-of-way, their own infrastructure. And somebody who is going to take over a railroad needs to have the understanding that that infrastructure is critical to the Nation's overall economic well-being, and to industries other than the railroads.

Too often we look at the railroads, large railroads and shortline railroads working together as if they are the only players. But there is also the shipping public; there is also the economy at large which needs to be taken into account when we are evaluating these investments and investment strategies.

Mr. OBERSTAR. Thank you very much, Madam Chair. I appreciate it, and there are others Members who have questions.

Ms. BROWN OF FLORIDA. Thank you.

We are going to have additional rounds, but, you know, as I sit here I am thinking we are in the middle of a war, and we are talking about aviation. But the railroad is how we, through the military and the common carrier, move that equipment. And I want to know, do we have the tools in place to protect the traveling public—not the traveling, but the military—and making sure that we do not compromise the system?

I am talking to you, Mr. Nottingham.

Mr. NOTTINGHAM. Yes, Madam Chairwoman. We do have those tools and, first of all, we have not seen any problems in that regard, and if we were to, a complaint by anybody connected with the military would be treated by us as the highest priority. We would act on that with immediacy.

And that could include even a licensing type issue of whether such a railroad is even fit to continue to be a player in our system. Anyone who would disrupt military supply or logistics, it is just unheard of, but it is a fair hypothetical to think about. We should be prepared, as we always try to be, for worst case scenarios.

Ms. BROWN OF FLORIDA. Well, I am just thinking that this is something that we need to consider as we move forward. We talk about airline as a common carrier, but we don't send military equipment on airlines but we do through the railroads.

Mr. Boardman, do you want to respond to that?

Mr. BOARDMAN. No, I agree. It is important that the railroads be in a position to handle the Nation's military security needs. Some thing do go by air today, but still heavy equipment and tanks and all of that need to move by rail.

But, as Mr. Nottingham has said, we have not had any complaints from the DOD or anybody else that the railroads are not fulfilling their obligations right now.

Ms. BROWN OF FLORIDA. Mr. Brown.

Mr. BROWN OF SOUTH CAROLINA. Thank you, Madam Chair, and thank you, panel, for being part of this discussion today. I represent Charleston, South Carolina, which is a port city, and we are certainly infected by transportation needs and the railroads being one. And that leads me to my question.

The impact of expansion of the Panama Canal on the East Coast ports cannot be underestimated. Container traffic through Charleston alone is expected to grow by nearly 300 percent by the year 2020 with other regional ports seeing similar increases. And this is my question: What strains will that place on rail infrastructure on the East Coast? And if there are any plans to prepare for it.

Mr. NOTTINGHAM. Congressman Brown, it is an excellent question. Thank you. That trend, increasing and growing trend, even currently as the economy appears to be softening, continues to march forward. In other words, more freight needing to move coming into our ports.

We had a hearing in April of last year where we invited, we had leaders from the port community who participated, and they forecast that we should be getting prepared for, basically, a doubling of port traffic over the next 15 to 20 years, and we do not have the

infrastructure in place in most of our port locations, if not all of them today, to handle a doubling of traffic and containers and trucks and rail. And rail will be, must be, a key to meeting that challenge.

I had the pleasure and the privilege of walking and seeing and touring the port of Jacksonville with Chairwoman Brown last year, and they have some exciting plans and developments there, and I think that that is an example of a port that is well positioned with room to grow with the right kind of smart planning. Charleston is an incredibly dynamic port. I used to work for the Commonwealth of Virginia with the Port of Virginia, and Charleston was a very tough competitor to try to attract business when you had Charleston there.

So we need to focus on—what is the big question—getting our infrastructure developed, making sure we have, and we are going to need, more investment which links back, of course, to this hearing. And just one of my messages today for the Committee is just be cautious about not sending too many signals to investors that they are not wanted because we have not seen any problems yet with any investors from a macro perspective.

We have regional safety-related embargoes. We will hear about them, I am sure, later in the next panel. We have other problem spots, but we do not have a trend of a problem of investors trying to harm rail transportation. We need more investment from everywhere we can get it as long, as I said in my remarks, they respect our laws and have respect for our public interest and our transportation needs.

Mr. BROWN OF SOUTH CAROLINA. Let me follow up on another question to Mr. Boardman. What is your position on the creation of a user fee supported rail infrastructure and trust fund? Would this idea help or hinder the projected freight rail capacity shortfall? And do you agree that it would inject politics into what should be business decisions, or would it invest in improved capacity?

Mr. BOARDMAN. Mr. Congressman, I do not have a position on that. It is not something that FRA generally deals with. We can go back and look and look at a U.S. DOT position on that, but nor the FRA.

Mr. BROWN OF SOUTH CAROLINA. Well, let me ask you one further question. Rail infrastructure lasts a long time, so there is always the temptation of a rail management to defer maintenance to help the company short-term financial position. But lack of regular maintenance would, ultimately, impact safety. Does FRA have any new technology in place which can detect deteriorating track conditions before they actually become a safety hazard?

Mr. BOARDMAN. Absolutely, we do, Congressman. That is something we can talk about. We have, in particular, and most of the railroads today are recognizing a joint bar crack detection system, an automated joint bar crack detection system that was developed by the FRA and is being adopted by the industry.

There is also other technology out there today that it is making improvement, and railroads are beginning to invest in it. One is what we call WILD, which is a roadside detector. It is a wheel-impact load detector. It tells the railroads whether there is too much

weight or if there is an outer-round wheel on the rail today that negatively impacts the ability for the rail to withstand the loads.

There is also other roadside detection systems, whether it is acoustic bearing sensors or hot box detectors, which has been used for a long period of time. And there are many other technologies, and we would be happy to explain those to you and provide additional information in the future.

Mr. BROWN OF SOUTH CAROLINA. Are the railroads pretty responsive once you make that determination?

Mr. BOARDMAN. Yes. We are seeing them develop and make investment in that area. I am always anxious to see them invest faster than they are, and we encourage them in each one of the periodic meetings that we are in to use all of those tools and resources to reduce risk throughout their systems.

Mr. BROWN OF SOUTH CAROLINA. Thank you. Thank you, Madam Chair.

Ms. BROWN OF FLORIDA. Thank you.

Mr. DeFazio?

Mr. DEFAZIO. Thank you, Madam Chair. Chairman Nottingham, as I understand—and I am going to focus in on one merger because it has had particularly, or one acquisition detrimental impact in my district, which is the Fortress Acquisition of Rail America.

From what I can tell in reviewing the documents submitted and the back and forth, it seems like the major focus and pretty much the entire focus, or the only focus of the Board in this matter, was whether or not they intended to try and create linkages in a monopoly as opposed to how they might operate or continue to operate or meet their common carrier obligations.

Is that pretty much what your charge is, and that is what you did in this case?

Mr. NOTTINGHAM. That is a significant part of it, sir. We look at transactions. We look at the impact on competition nationally and regionally. We look at whether any shippers will be left with only one rail carrier.

Mr. DEFAZIO. Or none?

Mr. NOTTINGHAM. Or none, or if they previously had one or more.

Mr. DEFAZIO. Well, mine got left with none, so—okay. So, but yet you do not think you need—you mentioned earlier when you are talking about capital, you said, well, you are really looking at the MNA issues. But I mean once someone takes over a line, what is your scrutiny of their—what do you do on an annual basis to scrutinize their capital investment?

Mr. NOTTINGHAM. We have arranged, we make a revenue adequacy determination on the Class I railroads. We keep and capture——

Mr. DEFAZIO. Revenue adequacy, but, I mean, do you track if the revenue would be adequate to make capital investment? Do you track it to the point of they made capital investment? They have a plan for capital investment? They have a long-term plan to operate the railroad and invest adequately to maintain the capital? That is not part of your charge, really, is it, and you do not do that?

Mr. NOTTINGHAM. It generally is. We generally do, but it is not a question, for example, if a small short-line decides for a year or two they are not going to make any significant capital on——

Mr. DEFAZIO. But that is 10 years. It is in the case of CORP, it was 10 years ownership by Rail America, 10 years of virtually on investment to the point of credible safety problems, which were amazingly and suddenly discovered by Fortress, who apparently didn't do due diligence. It says here in their filing, they have no current plan to abandon any rail lines in connection with the proposed transaction.

Now, how long would your board hold them to that? What do you consider to be current? Is it the day after they sign the papers, week, ten weeks? In their case it was 220 days to closure. Immediately, abrupt, non-notified closure. So you think they were acting in good faith here when they had no current plan to abandon, when they took over and you shouldn't have any concerns about these sorts of things?

Mr. NOTTINGHAM. I want to pick my words carefully. Because we are told we may well have an active complaint brought to us on that very situation soon. And the three board members here will be the three decision-makers on what to do with that complaint. So I will be careful not to characterize the facts on the ground there, but do want you to know we have been very actively engaged, and I have personally, in trying to make sure we get that service restored in Oregon.

We know how important it is. We know it is a serious problem. As you point out, it is a problem that appears to have been developing well before Fortress was on the scene. As FRA has validated, it does appear to be based on some very real safety problems.

Mr. DEFAZIO. I understand the problems. It seems to me there is a problem with the existing system of oversight, when a rail line is able to defer maintenance for more than ten years with no scrutiny, get sold and then 220 days later be shut down because they have problems that have been more than ten years in the making.

I guess my major concern about your testimony is this sort of, all capital is alike, all capital is not alike. And I am not talking about passive investors, but I am talking about whether someone is a predatory investor, some want to strip assets, or someone who is a speculative investor and wants to optimize their current revenues and meanwhile sit on potential assets. In the case of this line, and again, perhaps you can't respond because you are anticipating a complaint, but the point is there is some major potential in that line if we end up with a major container port in Coos Bay, which is being seriously looked at by Maersk.

But in the interim, it is not particularly profitable to operate. So how long would we allow someone to not abandon something but to not operate it and to sit on it because they are betting that it might be worth something down the road but they don't want to help the shippers today and meet their common carrier obligation.

Mr. NOTTINGHAM. As I stated in my statement, the law is very clear on the common carrier obligation. No railroad can abandon or stop service on the line just because they are not making money on it or if it is inconvenient. I will defer to my colleague, Joe Boardman, on the safety——

Mr. DEFAZIO. Well, I get that. I get that. But at a certain point, I have read through those statutes or the rules about abandonment and notification and feeder line. It all really seems based 30 years ago. I really can't believe that you don't think as current chairman that this stuff doesn't refer to a system that doesn't exist any more, which is a few massive, monopoly railroads in this Country with huge feather-bedding problems and other under-investment problems and neglect and all that stuff, shutting off their past interests to today's world which is very different. I just think we do need some new tools, new scrutiny. Vice Chairman Mulvey, would you comment on any of this?

Mr. MULVEY. I share your concern about what is happening in your district. As Chairman Nottingham has said, we have tried to monitor this. We sent people up there to help work with the ports and the shippers and the railroads to see what can be done. And there is a lot of disagreement over who is going to be responsible for, I believe it was $24 million in cost, whether the railroad was responsible or whether or not the shippers had to contribute a substantial amount.

I think one of the problems is that the Board is relatively small. This problem may be one that is not unusual around the Country, where railroads have spun off their shorter line operations. The short-line operator has not made the investments in the infrastructure that they should. This is not brought to our attention. We don't have a lot of ability to do oversight until someone brings it to our attention as a common carrier obligation issue.

So by the time the shut-down occurs, you have safety problems, and we agree with Mr. Boardman that this railroad right now cannot be operated safely. The problem is manifest, and now we have to see what can be done about it.

Mr. DEFAZIO. Thank you. Anybody else? Thank you, Madam Chair.

Ms. BROWN OF FLORIDA. Mr. Westmoreland?

Mr. WESTMORELAND. Thank you very much, Madam Chairman. Talking about the Oregon problem and the Coos Bay tunnel, could you explain exactly why, Mr. Boardman, could you explain exactly why the tunnel was closed?

Mr. BOARDMAN. I can't give you the technical answers to why the tunnel was closed, but it was no longer safe to conduct operations is the answer. In other words, our obligation really is, as I was sitting here thinking, as the Chairman was talking, is that we would be more likely tan anything else to err on the side of greater safety and want to shut down the tunnel if there was a safety concern with that. When we went out to take a look at it, sure enough, and we borrowed some expertise that we didn't have at the time to evaluate the study that was done by the railroad, we agreed that what they were looking at was real, there was a real problem there and there was going to have to be major investment required here in order for this to continue to stay open.

Mr. WESTMORELAND. Would you say that that line being privately owned made it more of a problem than if it had not been?

Mr. BOARDMAN. If it wasn't privately-owned, the alternative would be a public operation, is that what you mean, sir?

Mr. WESTMORELAND. Yes.

Mr. BOARDMAN. I think that the difficulty today, whether you are on the private side or the public side, is finding the resources necessary for you to make the improvements in an area that you might like to improve but may not be able to pay back. That is part of the difficulty that we see in some of the loan applications that we see coming forward, even from the private sector, is they have to be able to pay back, they have to have it.

I think, and I do understand what Congressman DeFazio is saying, that if a railroad or anybody buys the line on speculation for land development, so to speak, or a future opportunity for profit, then that is maddening for those who want to grow their economy in the communities that this operates in. And I don't have a good answer to what to do about that. I think those are the tools that both Chairman Nottingham and Mr. Mulvey were trying to talk about, of how they dealt with that and how they would deal with that. We deal with it very differently, and it is much more clear-cut for us in the sense of looking at it, is it safe, isn't it safe, and if it isn't safe, it should be shut.

Mr. WESTMORELAND. Thank you. No further questions, Madam Chairman.

Mr. DEFAZIO. Madam Chair, if I could just for a moment follow up on that.

Ms. BROWN OF FLORIDA. Yes.

Mr. DEFAZIO. My understanding is prior to the acquisition by Fortress, there was a pending application for a loan or that line to make safety improvements. I don't know if you are familiar with that.

Mr. BOARDMAN. I trust you, having investigated this, Congressman, that that is the case.

Mr. DEFAZIO. A RRIF loan.

Mr. BOARDMAN. Yes. I trust that it occurred, I don't know about it.

Mr. DEFAZIO. I was just wondering, because what you are saying is, in some cases you make a determination or the hard facts are someone can't show they have the wherewithal to pay it back. In this case, I understand, it was just arbitrarily withdrawn. There was no finding that the revenue didn't exist to pay back the loan just when the speculators, excuse me, the Fortress Group took over Rail America. They just withdrew the loan application.

Mr. BOARDMAN. I understand.

Ms. BROWN OF FLORIDA. Let me just say that Mr. Giles, CEO of Rail America, will be on the next panel.

Mrs. Napolitano.

Mrs. NAPOLITANO. Thank you, Madam Chair. There are many, many questions that I would like to put forth, but in the interest of time, I have the one to Mr. Mulvey. This is kind of a question piggy-backing with Congressman DeFazio's question regarding CSX's obligation to carry. They are suggesting, the TCI's recommendation is that they double the rates over the next ten years. What impact would this have on their ability to fulfill, CSX, of the common carrier obligation. And either you or the Chairman, would you care to address that?

Mr. MULVEY. Doubling the rates would probably cause an awful lot of rate cases to be brought before the Board. Certainly that traf-

fic that was truck competitive or otherwise intermodally competitive might in fact leave the railroads and go onto our highways. That traffic that is captive and has no alternative would have no choice but to either pay the rates or bring a case before the Board as being an unfair and unreasonable rate, at which time the Board would launch a proceeding to examine whether the rate was reasonable. If we found it to be unreasonable, we would order the rates to be rolled back.

So we can act if they try to raise the rates too much.

Mrs. NAPOLITANO. How would you be able to then have oversight over whether or not it is reasonable?

Mr. MULVEY. The way it stands right now, the shippers who are being charged these rates will have to bring the case before the Board. Now, the Board has recently undertaken some actions, which are making it easier and cheaper to bring a rate case before the Board. Some of these large rates cases were taking years to process and were costing millions of dollars. We have instituted a number of changes which we hope will speed the process up and lower its cost.

Also, we just instituted a set of procedures for small rate cases which will allow shippers to bring cases before us for a $150 filing fee and to follow one or two procedures, depending upon the value of the case, to get relief from these excessive rates, if indeed a doubling was attempted.

Mrs. NAPOLITANO. What kind of priority would you give those cases?

Mr. MULVEY. As soon as we get them, we open up a proceeding and begin to process them.

Mrs. NAPOLITANO. How are you running them?

Mr. MULVEY. However we need to make sure we have the staff to do it.

Mr. NOTTINGHAM. Those cases would get the highest priority. And those comments, I have seen some of the comments in the public domain about TCI believing perhaps that they could just come in and wholesale dramatically raise rates. I just have advice for folks looking at investing in railroads. It is one thing to do a textbook exercise and talk to some consultants about how you can squeeze more profits out of a going concern.

But in the real world of really operating a railroad and regulated environment with this Committee watching closely, other Committees, our agency, it is not just a textbook clinical exercise. And anyone who thinks they can just come in and double rates and easily walk away with huge profits I think is kidding themselves and showing some naivete. We would expect significant rate complaints to us. As my colleagues has mentioned, we have made it much easier, cheaper and quicker to bring those cases. CSX actually is faced with the first two under our new reformed simplified standards currently under the current management.

Mrs. NAPOLITANO. Great. I have more questions, and I am running out of time. As the railroad industry grows, the railroad companies are putting in investment. But is it sufficient for upgrading their infrastructure, for training employees, for investing in green locomotives? And of course, assisting communities with congestion mitigation and safety?

I can dovetail an accident in Riverside County day before yesterday, that the emergency crews were formulating an action plan but have stayed clear of the derailment because there were two rail cars that contained hydrochloric acid and some other substances, they had to evacuate the whole area.

Are we scrimping in the infrastructure to provide safety mitigation for the communities? Is that part of what you may be looking at as they increase their rate? Are they going to put that back into the infrastructure?

Mr. BOARDMAN. We would provide that information, Congressman, to STB or to anybody else looking at the investment in safety. That is why I jumped in here for the Chairman. I am somewhat familiar with the accident that occurred yesterday as well, and the difficulties that you have had in the past in some of those safety issues. I guess, and earlier on in your question, I would have to say, where would you draw the bar of what is satisfactory. To us, satisfaction is to get to almost a zero tolerance in those kinds of situations. So we need to make sure that there is continuing improvement and process in every one of those categories, whether it is in releases such as occurred yesterday or whether it is in more catastrophic releases or whether it is in just generally improving investment and safety infrastructure throughout California and all the other States across the Nation.

Mrs. NAPOLITANO. Well, specifically because it is the Alameda Corridor, and it is going to be more than just California that is going to have to be addressed in terms of being able to upgrade that infrastructure for the safety of the communities that you are going to go through. So in essence, I don't see any real meat in saying to the railroad companies, you ave had banner years, how much of that are you going to put back into your infrastructure for the safety of the communities where you are going through?

Mr. BOARDMAN. That is exactly right, and it is one of the reasons we meet with them every year to talk about, what are they investing in this year, how are they making improvements. We are basing it on our inspection reports, the real safety data that comes out, and looking for a continuing improvement.

Mrs. NAPOLITANO. But shouldn't it be more than just once a year? People's safety is worth more than that.

Mr. BOARDMAN. I meet with them once a year, every one of them, I make sure that I do that. We have our regional folks meeting with them on a very much more frequent basis.

Mrs. NAPOLITANO. Does that translate to meeting with the communities themselves to be able to assure them that they are taking steps? Because none of my communities have ever even said that they have any contact with anybody, whether State, local, Federal, coming in to talk to them about the safety of their back yard.

Mr. BOARDMAN. I understand. Part of the way we do that is we work with the California Public Utility Commission. They are part of us and part of the agreement that we work with them on. And they have a much closer contact with a lot of those communities, so we do work with them.

Mrs. NAPOLITANO. Which was my reason last year, last budget year, to be able to introduce the ability for them to have some oversight on those areas that you do not. That was my point.

Mr. BOARDMAN. I understand. I understand that issue.

Mrs. NAPOLITANO. Thank you, Madam Chair.

Ms. BROWN OF FLORIDA. Mr. LaTourette.

Mr. LATOURETTE. Thank you very much, Madam Chairman, and I apologize for not being here for the questions.

Administrator Boardman, it is nice to see you again. But if you have already answered this question, then I don't have any questions. Have you been asked at all during the course of the rounds of questioning to opine on one of the proposals that the railroads have put forward in this Congress, and I think the bill has been introduced by Mr. Meeks of New York and Mr. Teaberry of Ohio, relative to infrastructure tax credit?

Mr. BOARDMAN. Mr. Former Chair, Mr. Congressman, the Department has looked at the investment tax credit from the standpoint of we haven't taken a position for or against that. At this point in time we understand it, we understand what the railroads are trying to accomplish here but have not taken a position.

Mr. LATOURETTE. And Mr. Nottingham or any other members of the STB, is that something that you have one, looked at and two, believe that the STB has any dog in that fight?

Mr. NOTTINGHAM. We have looked at it, and I will speak for myself, as the Chair of a decisionally-independent agency, it is a good idea. It is good for job creation, it would allow shippers, and I emphasize shippers, not just railroads, and railroads, big and small, to actually be incentivized to go out and build more rail infrastructure, which is good for safety, good for job creation, good for mobility, good for congestion relief. We need to get moving and ask ourselves every day, what are we doing today to get more rail infrastructure built. And the investment tax credit idea is an excellent idea in that regard. It is not going to solve every problem everywhere, but it will help. And it is something that the last time I checked had some bipartisan support. I am not lobbying for it, you asked ask the question, I think it is a very good idea.

Mr. LATOURETTE. Dr. Mulvey or Mr. Buttrey, do either of you have a different opinion or the same opinion? Dr. Mulvey?

Mr. MULVEY. Not too much different. It can help, obviously. I think one of the concerns that has been expressed is making sure that investments made under the investment tax credit just don't simply substitute for investments the railroad would have made otherwise. So we do need to make sure that this increases net investment rather than simply substitutes tax credit investment that would have been made otherwise. But in terms of getting money into the system, anything would help. I suppose I am a little more skeptical about its chances right now, given the other demands on the budget, but we will see.

Mr. LATOURETTE. Mr. Buttrey, any observation you want to make?

Mr. BUTTREY. I would agree with my colleagues who have already spoken to the issue and I would have nothing substantive to add to what they said. I think it is a good idea as well.

Mr. LATOURETTE. Thank you very much. Thank you, Madam Chair.

Mr. SHUSTER. Madam Chair, could I just follow up real quickly on that question from Mr. LaTourette? I think it is pretty well

known in the Class Is that we need to invest in significant amounts of money. I have some knowledge, but can you address the situation in the short-lines? Is it a greater problem that we see in Mr. DeFazio's case, where there is a tunnel that needs over $20 million? What is the situation among short-lines with the need to invest in infrastructure for not only capacity but more importantly for safety?

Mr. BOARDMAN. I can address it first and then perhaps my fellows can add to it, is that one of the definitions or reasons that we have so many short-lines, over 500 short-lines today, is as a result of the Staggers Act and the rationalization of the system that many of those properties were much less profitable or looked at with the fact that they didn't make as much money as some of the main lines, as the Class Is rationalized them.

So the answer, I believe, is that it is more difficult on the short-lines today to find the resources necessary to make an improvement on a bridge or to make line improvements to compete for the future. It was one of the reasons, again, that the RRIF program was established and worked forward. And I believe also another reason that Congress in the past has approved some tax incentives with the short-line railroads.

Mr. NOTTINGHAM. I would just add to that, Mr. Shuster, that the short-line industry, by experience, has greatly benefitted from the investment tax credits they have received in the past. I have gotten that on good authority from a number of short-lines. And they very much fill that gap, they stand between having no service for many communities and actually having some service. They often are the outgrowth of the Class Is having fully rationalized their network and gotten rid of track that was not highly profitable, especially in a Class I slightly more regulated environment with some higher costs and more labor regulations.

So the short-line role should never be forgotten. They make an incredible impact every day, they are filling a lot of gaps and needs. But you are right, within the short-line community, that is where we are seeing more of these situations of some difficult maintenance and infrastructure condition problems. A lot of them are longstanding, a lot of them go back to the reason the Class I shedded that line to begin with.

Mr. MULVEY. I worked on the investment tax credit for the short-lines. We originally had a bill that was much larger. The study that preceded this was a study by Zeta-Tech, I believe. They identified, this was 10 years ago, about $7 billion in short-line railroad needs if they were going to be able to accommodate the 286,000 pound cars. Now, the investment tax credit that finally passed, I believe, allowed for $1 billion over three years. I don't believe all of those monies have yet been spent.

Meanwhile, I think the need has probably grown over that time. Mr. Boardman mentioned the RRIF program. Unfortunately, that program has taken a long time to get started and has not exactly been spending money like a drunken sailor. There are great needs out there for the short-lines, and we are going to need to find ways of getting more money to them, if they are going to operate safely and continue to be a valuable part of our rail transportation system.

Ms. BROWN OF FLORIDA. Mrs. Napolitano.

Mrs. NAPOLITANO. Thank you, Madam Chair. One more question to Mr. Mulvey. TCI recommends that CSX limit capital spending under certain circumstances, including efforts to fund a greater than normal stock buy-back. Your thoughts?

Mr. MULVEY. The Children's Investment Fund believes that the CSX's capital structure is one that is not reflective of other industries of similar risk and wants them to buy back stock so that they have a debt equity ratio that is more similar to other industries. My wife is a financial analyst, and she would be better able to answer that question, but she is not here. So my best effort is, if you are looking for ways to spend money on the railroads, one would think that investing in the plant and equipment to handle, as I said, the future growth that is projected for the industry is a better spending of the money than buying back stock. But there I am speaking as a public policy analyst as opposed to an investor in the railroads.

Mrs. NAPOLITANO. And the other two gentlemen?

Mr. NOTTINGHAM. Just to point out that as I have learned over the last couple of years and in acclimating to this job, the tension between Wall Street, so to speak, investors and railroads on the very question you raise about the appropriate level of stock buybacks, this goes aback a long time. It predates the recent flurry we have sense of interest by the Warren Buffets and the Children's Investment Funds and large hedge funds. It goes back to the anecdote that Chairman Oberstar mentioned about the former CEO of the Burlington Northern Santa Fe, Mr. Krebs, who launched a very controversial infrastructure improvement investment program against the vociferous criticism and opposition of most of Wall Street and the investment community. Years later, that was shown to be a brilliant tactical decision. That railroad was helped tremendously by those decisions.

It just goes to show that this is an age-old tension about basically, return more money now to investors or invest more in the infrastructure. I think we will see that tension continue to play out in the years ahead.

Mrs. NAPOLITANO. But are you in a position to make any recommendations to those boards of directors, if you will, of the different rail companies, to say to them, your investment now is going to pay off in the future, much like BNSF?

Mr. NOTTINGHAM. I would just generally certainly encourage more investment by the railroads in their infrastructure. At the same time, I try to be wise to what I am not an expert in. Of course, the railroads have to keep their eyes on a couple of different balls. One of them is they have to make their business attractive to investors. If they lose too many investors, then they have no money for their capital infrastructure. So they are constantly calibrating that balance between possibly doing some stock buy-backs, possibly doing some things to make investors happy in the shorter run while also keeping their going concern well invested in.

Mrs. NAPOLITANO. Then the flip side of that would be, how much are they losing in public opinion, because of the derailments and

because they are not upgrading the infrastructure and they are not addressing those issues that are vital to the taxpayer?

Mr. NOTTINGHAM. And the way public opinion often plays out, of course, in publicly-traded corporate America is through activist shareholders. That is what we are partly here today to talk about and the next panel will be, I am sure, very much focused on. Through our shareholder rights we all have, whether you are involved, as many of us are, in the Federal thrift savings plan——

Mrs. NAPOLITANO. But I am talking specifically, when you have derailments, that costs the company, that costs the overall, how would I say, bright name of a rail company doing its job. They are there, but you don't see them. You know they operate. But once you have an accident, then they are in the spotlight and they are not getting—they are getting adverse publicity, to be honest.

Mr. NOTTINGHAM. Right, and it is costly. They are exposed to liability.

Mrs. NAPOLITANO. Right, but how do you balance that? Does that play a part in how they are looking at investments in their infrastructure?

Mr. NOTTINGHAM. I think it does. It has to. Railroads know, as Mr. Boardman pointed out, that safety is good for business and it is bad for business to have a reputation for having safety problems. Investors, whether they be in New York or Hong Kong or London, they look at the safety situation. They look at the reputations of the railroads. Because the exposure there is huge, the liability exposure, if you are a poorly-run railroad and you are prone to accidents, and they pay enormous insurance premiums.

So railroads are very, for their self-interest, not for any charitable or community interest, those might exist, too, those self-interests. But for their self-interests and their profit motive, they want to be as safe as they can. Because nothing is worse for business than having a reputation as an unsafe railroad.

Mrs. NAPOLITANO. And the money they lose in the suits and the attorney fees. Thank you. Thank you, Madam Chair.

Ms. BROWN OF FLORIDA. Now, Mr. Lipinski.

Mr. LIPINSKI. Thank you, Chairwoman. I want to follow along the lines of the questioning of Chairwoman Brown and Chairman Oberstar and also Chairman DeFazio, actually. The concern over what type of impact this type of investment may have on improvements in railroad infrastructure and rail service in the Country, I represent part of Chicago. And we all know it is the rail hub of the continent. Certainly, I have had experience with all the Class I railroads. CSX, in my experience, has generally been very positive in their public responsiveness.

But in addition to that, as you are all familiar with, CREATE, the much-needed rail modernization program, not just for the Chicago region, but for the Nation or really for the continent. In the SAFETEA-LU bill, I was able to work with Chairman Oberstar to get $100 million for that. The Class I railroads have put in $100 million, including CSX, has put that in and is currently moving forward. Hopefully working on that some more, certainly the need of more investment, and more investment in the next Highway Bill.

But it is critical that there is this investment also by the railroads. It is a good example of a good public-private partnership. So

in light of, I am just interested in the Federal Government's perspective, the FRA, STB, in light of what we talked about here, Rail America, what your thoughts are and what type of impact that this type of investment may have on improvements to rail infrastructure in the future.

Let me throw this other part out there also, and leave it out there for comments. Chairman DeFazio raised this issue with Rail America, the rail line abandonment. What type of oversight do you have right now over such things as this, and do you think there is room for a greater oversight on those? Let me throw that out there and get your comments.

Mr. NOTTINGHAM. Well, just real quick, because you touched on some very important issues, Congressman, thank you and thank you for personally showing me the great project when we were in your district over a year ago, with Mr. Mulvey as well. It is a project I have been working on since I was at the Federal Highway Administration on the highway aspect of it and the funding. It is a tremendously important project. It is at the top of the list of important things we could do to improve rail congestion and generally surface congestion.

As most of us know, it takes longer to get across Chicago in a rail car than it does to get from the Port of L.A.-Long Beach to Chicago, in many cases. We can't go forward in perpetuity with that kind of reality. But that is your question, on abandonments and our powers, we do have broad powers. In an abandonment situation or probably I might rephrase your question to an embargo situation, we often see what Mr. DeFazio was just talking about as an embargo situation based on safety grounds.

Generally speaking, I won't speak to any particular case, because we do have one or more coming to us, we believe, the rail carrier has an obligation to reopen the line as promptly as is reasonably possible or to abandon the line and to put up for sale, so another carrier can come in and operate that. Again, you cannot embargo a line or stop service on a line just because it is no longer convenient for you or profitable to operate that. You have to go through the processes and the regulations that we have on the books. So I would hope that answered at least most of your questions.

Mr. LIPINSKI. Mr. Mulvey?

Mr. MULVEY. With regard to the CREATE project, as you are aware, I have been a long-time supporter of it and I have been out there several times. I am glad to see the project is moving forward. It is a very good project, and it is critical to the efficiency of the Nation's rail transportation system. As part of CREATE, there might be some new line construction or there will be some abandonments. One of the Board's responsibilities is to conduct an environmental analysis of any new construction or any abandonments to make sure that they are done in a way that is environmentally sensitive. So we will be involved in any new construction that is associated with CREATE or other projects in the Chicago area. As you are aware, there are certainly other projects in the Chicago area right now that we are watching and monitoring very, very closely.

So any construction or abandonments that are associated with those projects, our Section of Environmental Analysis will undertake the appropriate study.

Mr. LIPINSKI. Mr. Boardman, do you have anything to add?

Mr. BOARDMAN. Only I guess insofar as, I am not sure you were here earlier, Congressman, that the thing I think that is particularly important is the necessity for patience by an investor to be involved in railroad investments because of the time that it takes to have a, not only a pay-back, but also a business case made for some of the technology that is out there and available today.

In particular, just as an aside, as the CREATE project moves forward, there are other things that are occurring around it now which drive it as well. We are seeing some activity now in the private activity bonds, for example, some of the railroads around Chicago. Because as we have discussed in the past, and I have also been involved with this for a long period of time, there is an absolute necessity to fix this problem, and it is going to get fixed.

Mr. LIPINSKI. Thank you.

Ms. BROWN OF FLORIDA. I want to thank the panel, and in closing, I want to know what recommendations you have, and you can submit those to us later, and anything else you want to add, that will ensure that Congress does not endanger future railroad investment by the financial markets, taken in consideration common carrier, our stakeholders, whether it is the union, whether you say to the port, and we are bringing in those big ships. But it doesn't work if we don't have the rail in place and that investment in place, or else you are talking about 3,000 trucks a day, 365 days a year, which would destroy my entire community.

So it is a delicate balance we have here. We want the investment, but we do not want, it is a balance.

Mr. BOARDMAN. I will submit, as you offered, an opportunity in writing to you, Chairwoman.

Ms. BROWN OF FLORIDA. Thank you, Mr. Boardman.

Mr. NOTTINGHAM. I would like to do the same, and continue to work closely with you and your Committee and Subcommittee, Madam Chairwoman. You raised some critical issues. I think hearings like today's are very helpful in that regard. This is a very dynamic and exciting time in the rail transportation world, especially here in the United States. A lot of good things are happening that weren't happening 5, 10, 15, 20 years ago, that are largely good. We have some challenges and some things we need to be watchful for, too, to make sure we don't have any sharp players getting involved looking for a quick opportunity at the public's expense. But I think we have the tools to protect against that. And we look forward to working with you in the months and years ahead.

Ms. BROWN OF FLORIDA. Thank you. I want to make sure that you have the tools that you need.

Mr. Mulvey?

Mr. MULVEY. I just wanted to join the Chairman in thanking you. If we have any suggestions for legislation or legislative changes that we think are necessary, we will provide those to you as well. Thank you.

Ms. BROWN OF FLORIDA. Thank you. Mr. Buttrey?

Mr. BUTTREY. Thank you, Madam Chairman. I have nothing to add.

Ms. BROWN OF FLORIDA. Thank you all very much.

Second panel.

Thank you very much. I would like to welcome and introduce our second panel. Our first witness is Mr. Snehal Amin, a Partner with the Children's Investment Fund. Our second witness is Mr. Michael Ward, Chairman, President and CEO of CSX Corporation. And I want to do a disclaimer here, because I want everybody to clearly understand that CSX is in my district. I have been an elected official for 25 years, and I appreciate the support and the community involvement that CSX has given our community. It is the kind of partner I want all of the companies to be in my community.

Thirdly, Mr. John E. Giles, CEO of Rail America. And our final panelist is Mr. Robin Greenwood, Assistant Professor at the Harvard Business School.

Let me remind the witnesses that under Committee rules, oral statements must be limited to five minutes, but the entire statement will appear in the record. We will also allow the entire panel to testify before questioning the witness. We are very pleased to have all of you here this afternoon, and I would recognize Mr. Amin for his testimony. Welcome.

TESTIMONY OF SNEHAL AMIN, PARTNER, THE CHILDREN'S INVESTMENT FUND; MICHAEL WARD, CHAIRMAN, PRESIDENT AND CEO, CSX CORPORATION; JOHN E. GILES, CHIEF EXECUTIVE OFFICER, RAIL AMERICA; ROBIN GREENWOOD, ASSISTANT PROFESSOR, HARVARD BUSINESS SCHOOL

Mr. AMIN. Thank you, Madam Chairman, Ranking Member Shuster, Members of the Subcommittee. My name is Snehal Amin and I am a Partner at The Children's Investment Fund Management, commonly known as TCI.

I appreciate the opportunity to testify before you and hope to answer three questions for the Subcommittee. First, who is TCI? Second, what does TCI hope to accomplish in the railroad industry, and at CSX in particular? And third, how can we as a Nation avoid a freight transportation crisis?

We founded TCI to invest with the philosophy we believe in, which is long-term, fundamental investing for the benefit of a cause we believe in, which is helping children in poverty. The majority of our investor base is U.S. institutions, largely prominent university endowments. We are based in London and regulated by the U.K. equivalent of the SEC. And true to our cause, the vast majority of TCI's profits have gone to our charitable foundation, which is dedicated to eliminating disease and poverty amongst children in the developing world.

What does TCI hope to accomplish in the railroad industry and at CSX in particular? The short answer is the full realization of potential. Railroads are the freight transportation answer. They are the cheapest, most efficient, most environmentally friendly form of land-based transportation, and they do not require taxpayer dollars. But as valuable as railroads are to America today, their potential, we believe, is far greater.

If there is one statistic I hope you will remember from my testimony, it is this: U.S. trains sit idle 80 to 90 percent of the time and when they move, they move at an average speed of 20 miles an hour. An idle train is an opportunity lost for shippers, for workers and for shareholders. We can do better.

Smart yards work in Canada; onboard computers work in Brazil; ECP brakes work in South Africa. They should all work in America. American industry is usually at the forefront of technology and service. Why should we not hold our railroads up to the same standard? We at TCI do.

We judge relative to potential, not the past. In CSX, we see the potential to be the best railroad in America. Instead today, it is average or below average on nearly every major metric of performance. Despite this, CSX top management looks to us to be the most highly compensated railroad management team in the world, having taken home $120 million over the past three years and entitled to a golden parachute payment worth a further $95 million.

Industry best pay for lagging performance is a corporate governance failure and one which no truly long-term stakeholder should tolerate. CSX is too important to too many constituencies to let this under-performance persist.

That is why we are nominating a minority slate of five directors out of a board of twelve for the board of CSX. TCI is not seeking and has never sought control of CSX. In fact, if we are successful, only one director on the board of twelve will be from TCI. The four other nominees are former CEOs and directors of some of the best-run railroads in the world, as well as of iconic U.S. companies, such as Disney and Marriott. Together, they would add over 50 years of railroad experience to the CSX board, where today not a single director has any railroad operating experience, except for the Chairman, who is also the President, who is also the CEO.

How can we as a Nation avoid a freight transportation crisis? We work together. We shed historical biases, we embrace change and we focus on constructing solutions instead of battle plans. The cost of not doing so is too great. AASHTO estimates that it could cost shippers and highway users an additional $1 trillion over the next 20 years if the railroads do not increase their capacity. You can increase capacity in one of two ways, either through productivity or through investment. And we need to focus on both.

If U.S. railroads ran as efficiently as Canadian National, we estimate that that would create 30 to 40 percent new capacity in the system, enough for up to 20 years of growth. There are always skeptics, but we believe what CN did is replicable. Our nominees believe it is replicable. And the CN management team believes it is replicable, and they should know, as they have done it.

On investment, I want to make one thing very clear. We have never, and nor would we ever suggest that railroads cut any spending in maintenance or safety. The accusation that we have heard several times so far in this Committee that that has been the case is absolutely untrue.

I would make one other comment with respect to railroad investment, which is, the investment capital market is highly competitive. Railroads early only 1 to 2 percent returns on replacement value, amongst the lowest returns of any industry anywhere in the

world. For the railroads to attract the hundreds of billions of dollars they need to privately maintain and grow their infrastructure, returns must rise, which is why we have expressed concern over the proposed legislation that we believe would actually have the opposite effect.

In closing, let me reiterate that as a truly long-term and engaged investor, we want railroads that are even safer, that provide better service, that attract more customers and therefore earn higher returns. We are committed to doing our part to achieve this objective and we ask others to be as well.

Thank you for your attention. I would be happy to take any questions.

Ms. BROWN OF FLORIDA. Mr. Ward?

Mr. WARD. Thank you, Madam Chairman, Ranking Member Shuster and Members of the Subcommittee. I do appreciate the opportunity to present CSX's views on the important subject of investing in the railroad industry. I am here today as the Chairman and CEO of CSX, and as a railroader with more than 30 years of experience.

I am committed to creating value for all of CSX's shareholders, and that value arises when CSX meets its public service and common carrier obligation to our customers, our 35,000 employees, the communities where we do business and you, the policy-makers who make the laws that shape our operating environment. What is good for CSX shareholders is good for our customers and for our Country.

As you are aware, North America's Class I freight railroads and their outstanding employees are unequaled in performance and safety. They are truly the envy of the world. A well-run and well-maintained national freight rail infrastructure helps strengthen our economy. Railroads take demand off the congested highways and railroads reduce fuel consumption and environmental impacts and create high-paying jobs. Rail transportation is one of the genuine competitive advantages that U.S. businesses have in the global economy.

But that competitive advantage could be put at risk if railroads are pressured to stop investing for the future. Today, some activist hedge funds would have our Nation's railroads stop building new capacity to prepare for future economic growth. That is simply a bad idea.

At a time when we hear constant warning about the Nation's crumbling transportation infrastructure, railroads are investing billions of dollars in private capital to help address those needs. As increasingly congested cities throughout the Country look for answers to passenger transportation needs, public-private partnerships with rail can be part of the solution. And as our military is deployed on missions around the globe, the Nation's freight railroads serve as a critical link in the supply chain.

In face of these important needs, I would urge Congress to carefully examine any attempt by hedge funds to exercise control over a U.S. railroad and compromise the future viability of freight rail transportation. As our Country grows, demand for rail use is growing sharply. U.S. freight volumes are expected to increase 90 percent over the next 30 years. In recent years, every single blue chip

policy study to look at the issue has called for dramatically increased investment in rail infrastructure. This is just not a CSX issue. Every expert agrees that the Nation's freight rail infrastructure requires sharply increased investment to meet the country's growing transportation needs.

The CSX management and the board of directors have been executing a balanced plan that in the past three years has dramatically improved operations and safety while providing shareholders with a greater than 150 percent return. That is better than the rest of the North American rail industry, and better than 94 percent of the S&P 500 companies. We intend to keep those returns attractive for investors by continuing to deliver for our customers and living up to our public responsibilities. That means investing nearly $5 billion of capital on our network between now and 2010 to meet growing demand.

CSX hopes that those who invest see the promise of the industry and share our commitment to safe and efficient service. Wall Street investment in the railroad industry at this time is a truly exciting validation of the benefits rails can bring to today's economy, the environment and the overwhelming traffic needs. But given the importance of railroads, we think Congress should have some very serious questions about what it means to this Country if hedge funds determine the business strategies for critical national infrastructure with core economic and public safety responsibilities.

Let's take TCI as an example. TCI wishes to determine, even control, central business strategies of CSX and other major railroads. Over the last 13 months, TCI has made public statements and private demands, calling for a number of short-sighted strategies, including freezing investments in infrastructure expansion, doubling customer rates over the next decade, doing a leveraged buy-out and more than doubling CSX's debt to junk status.

So let's talk about some of these concepts. The demand that CSX freeze investment in infrastructure is just plain irresponsible. Anyone who understands the rail industry, indeed, the transportation network as a whole, knows we need to maintain and even increase our investments where possible to prepare for future demand. That is true any time, but especially at this critical moment when the Nation is outgrowing its infrastructure.

The Government has designated CSX and the Nation's rail networks as critical infrastructure vital to the Nation's economic interests. We treat it as such and invest millions every year to identify, guard against and prevent threats from those who would do our Nation harm. CSX is also critical to the timely deployment of the United States armed forces, having moved over 10,000 carloads of munitions and vehicles in 2007 alone.

So turning to some of the other ideas of TCI, when a hedge fund demands that an entire industry double its rate over 10 years, you have to question their understanding of the industry, its marketplace and the regulatory environment. When a hedge fund seeks to have a railroad more than double its debt to junk credit status on the eve of the worst credit crisis in a generation, you have to question its understanding of the industry and its capital intensity.

Finally, there is another basic policy question for Congress' consideration that is particularly apt in the context of railroads. It is

the obscurity of these organizations that wish to control strategy of the rail industry. When secretive hedge funds seek to direct strategy for major railroads, I respectfully urge Congress to learn more about who are they, what is their experience, what are their incentives, to whom are they accountable, and most important, what are their real objectives and plans? The decisions these funds wish to drive will affect the quality of business opportunity and life in the United States for decades.

Madam Chairman, I want to express my appreciation to you and Members of the Subcommittee for highlighting this important issue and for your recognition that while increased investment in the railroad industry is a positive development, our company's responsibility to these investors must be balanced with our commitment to our employees, our customers, the communities we serve and most certainly our role in helping the Country continue to achieve its promise.

Thank you, Madam Chairman.

Ms. BROWN OF FLORIDA. Thank you.

Mr. Giles.

Mr. GILES. Good afternoon, Chairwoman Brown, Ranking Member Shuster and Members of the Subcommittee.

My name is John Giles, and I am the CEO of Rail America. I began working in this industry some 39 years ago as a fireman and locomotive engineer on the old Baltimore and Ohio Railroad Company, in Indianapolis, Indiana. I spent the first 12 years of my career in various operating positions for three different railroads and shortly after deregulation, progressed up the management ranks through marketing and eventually executive positions at CSX.

As background to my involvement in Rail America, Fortress executives and I discussed investing in the rail industry for quite some time before seeking to acquire Rail America and taking the company private in February of 2007. Fortress has been active in other transportation and logistics businesses, owning a jet leasing company, a shipping company and other logistical enterprises. The rail industry was a natural extension of their existing stakeholdings in the transportation industry, with railroads being particularly well-positioned to benefit from international trade and expanding global markets.

As we studied Rail America before our investment, we became unified behind the belief that we could operate these properties better and more efficiently. We believed we could engage with customers by more effectively addressing shippers' transportation needs, and thereby creating value with customers, expanding our own business and thereby being successful.

Rail America today is the leading operator of short-lines and regional railroads in North America. We operate in 27 States in the U.S. and 3 provinces in Canada. Most recently, in November of 2007, Fortress also acquired the Florida East Coast Railway, and invited my management team to explore and consider synergies with our Rail America operations.

We currently manage these independent properties as separate and independent companies, but with some common leadership and a goal toward sharing management and operating best practices. As background, almost of Rail America's properties were at one

time or another part of the larger Class I railroad system. While in Class I ownership, these lines were operated as low density, relatively high cost branch lines that the Class Is either sold at auction or leased to companies like Rail America. These lines by definition had infrastructure needs and were susceptible to fragile economic conditions, generally being dependent upon business fortunes of one or sometimes only a few online customers and industries.

By definition, Rail America's rail lines are generally the exclusive route of ingress and egress available to shippers and receivers for accessing the larger Class I rail system. We are the only source of rail access to the broader regional and national rail networks for distribution of shippers, goods and products. Our services are frequently billed by our Class I affiliates through inter-line settlements as a segment in the longer Class I movement.

Like all good owners, Fortress demands that we run a high quality, safe and profitable business operation, one that helps its existing customers to succeed and expand their business and further seeks to expand our rail services to new businesses. We strive for operational efficiency in order to provide Fortress with enhanced shareholder value and ultimately a fair return on its investment.

I will briefly mention the core values that we have developed over time that we live and operate with at Rail America and FEC. And I won't go into any detail, but integrity, respect, fact-based, heads in the game, hands on, and a demanding partner.

Since February of 2007, our new management has taken over these core values and we are driving them through the organization. Early on, a tremendous effort was made toward safety and efficiency, as Rail America had been a laggard in the industry in both areas. Since we have arrived, human factor derailments are down 4 percent, FRA reportable train accidents are down 16 percent, and year to date in 2008 personal injuries are down 60 percent.

Another area of management focus is on improving our capital infrastructure. One of the things that we found is that we needed to bring in more experts and skill sets that were not resident within Rail America. So we recently recruited a bridge and structure expert and we also added signals and communications to our own in-house expertise.

To summarize, Fortress and my management team came to Rail America to create and develop a high-performance organization with the goal of running safe, efficient and profitable railroads. We have made significant strides toward achieving these goals and toward developing an organization that is capable of assuming a leadership role in the American Short-line and Regional Railroad Association, and engaging effectively and responsibly with the Federal Railroad Administration and the Surface Transportation Board.

Our association with Fortress as an owner and shareholder is enabling us to achieve financial, infrastructure and safety improvements. Their ability to assemble and install a new management team with a longer term focus upon operational and safety performance is unburdened by shorter term objectives of public company boards of directors and shareholders.

Two, the reduced expense of operating as a private company as opposed to a public company. Three, access to financial expertise and resources necessary to reduce our cost of capital. And four, Fortress' resources and expertise in identifying, evaluating and acquiring other synergistic opportunities in the rail industry, such as the acquisition of Florida East Coast.

In summary, Rail America and Fortress are committed to the rail industry for the long term, and we will conduct our rial operations, improved safety performance and enhance our capital infrastructure with the long term view in mind.

Are there any questions you would like to ask me?

Ms. BROWN OF FLORIDA. At the proper time, sir, thank you.

And now, Mr. Greenwood.

Mr. GREENWOOD. Madam Chairman Brown and Members of the Subcommittee, it is a pleasure to appear before you today to discuss activist investing, with a particular focus on recent investment in the rail industry.

My comments today draw on research that I have done on hedge fund activism, as well as summarize the contributions of other researchers working in this area. In my own research, I have collected data on every incident of hedge fund investor activism in the U.S. between 1994 and 2006, nearly 1,000 events in total. This large sample of research has been complemented by two case studies and a number of interviews and site visits with activist investors. One of those cases on Kerr McGee, which is an oil exploration and production company, is in many ways quite similar to the investment of TCI in CSX today.

So I hope to provide you with a brief but broad overview touching on four main points. First, what is the proper role of activist investors? In a publicly-traded corporation, minority shareholders have little incentive to spend resources monitoring management, making sure that they take the steps required to maximize shareholder value. If a firm is being mis-managed, small shareholders vote with their feet and sell their shares.

The larger shareholders have more to gain by voicing their complaints. These so-called activists build up large positions in the firm and engage in a dialogue with management, potentially friendly but occasionally hostile, about the best course of action. Most of us in this room, as passive shareholders, benefit directly from the actions of activists, yet importantly, these activists bear all of the costs themselves.

Second, why is there so much more activism today than 10 years ago, and why are hedge funds doing it, as opposed to mutual funds or pension funds? The answer, in my view, lies in the enhanced incentives of hedge fund managers who are paid handsomely on all their gains, typically 20 percent. Compare this with mutual fund managers or pension fund managers who typically will receive a flat fee on assets under management. For them, activism is simply too expensive, both financially and reputationally. So it is not surprising that with the enormous growth of hedge fund capital over the past five to ten years, there has been a similar growth in activism.

Just to give you an idea, there were virtually no activism targets at all in the early 1990s. But in 2006, hedge funds were involved with more than 200 targets in the U.S. alone.

Third, what sorts of firms do activists target and what do they ask management to do? Generalizing is of course difficult, but my research reveals a few common themes. Targets tend to have a high degree of industry concentration. Industries with valuable hard assets but sluggish returns on capital are popular. For example, oil and gas companies were popular targets in 2004 and 2005.

A recurring theme is that firms are under-valued relative to the value of those assets. This is a theme that we see in railroads today. Within this broader theme, activists tend to choose targets that have under-performed relative to their peers. I believe that this is because the management in these under-performing firms is more compelled to listen, not necessarily that they are doing something wrong. What do they ask for? The most common things are spin-offs and asset sales, asking the company to put itself up for sale, asking for more debt, asking for board seats, asking for the removal of a poison pill and reductions in capital expenditures.

But I am not sure, frankly, how much we learn from studying their requests alone. I think they make numerous demands and are quite often happy when companies comply with just one or two.

Fourth, I think the final and most important questions are, what do activists accomplish in practice and how does this relate to shareholder value? The returns to activism have been incredibly high, no matter how you measure it. Around the announcement of activism, the stock price increases by about 5 percent on average, presumably reflecting the gains that investors expect these activists to bring. Following this initial announcement, the stock prices tended to drift up further. In other words, other shareholders are benefiting.

But what are the activists getting rewarded for? This has been the main question in my research. What I found is that the most significant outcome is undoubtedly when activists push the company into a takeover. When this happens, the activist collects a takeover premium of 20 to 50 percent, thus exiting quickly with a handsome gain. Activists have a knack at making this happen.

In most other cases however, activism is sort of a non-event, meaning that the stock price is roughly flat in the period after the activism, adjusted for the performance of the market during that time.

Absent a takeover, I do find that firms who remain independent tend to cut capital expenditures, something that is asked for today, increase leverage, and do indeed become slightly more profitable. But to reiterate, I think what is interesting is that absent a takeover, the stock price is roughly flat around the time of the activism.

In other words, activists have proven themselves to be pretty good at putting companies into play, but not that good at making operational or strategic change. While this may sound negative for so-called strategic activism, I should make it clear that there also isn't any evidence that activism destroys value in those situations.

A final point. I often hear the criticism that activists are short-term investors, not interested in long-term value creation. I certainly agree that activists are short-term, and parts of my research

support that claim. At some level it is obvious in their desire to secure a takeover and get a quick exit. But I think this misses the point that in theory, the rest of the market has a somewhat longer horizon. They wouldn't be willing to reward activism with this high stock price appreciation if they felt that they were destroying long-term value.

Thus, to gauge whether the market believes activists can create value in the rail industry, I think one can learn something from the recent price appreciation. Naturally, you can always argue that the rest of the market has it wrong and management has it right. I think that is not giving investors much credit. Notwithstanding this, I think this is still an open issue in research and I expect future research to have more to say about this important issue.

Thank you and I welcome any questions.

Ms. BROWN OF FLORIDA. Thank you.

The bell has just gone off, but I am going to go to Mr. Rahall. But let me just say, Mr. Amin, I have to tell you, in listening to you, I think I am going to go out and co-sponsor the Chairman's re-regulation bill. Doubling the rates, and you indicated that you think that CSX and the railroad is just average, well, then, everybody tells me what a smart investor you are. If it is just average, why would you want to invest in it?

Mr. Rahall.

Mr. RAHALL. Wow, Madam Chair, you just hit a couple of questions I had.

[Laughter.]

Mr. RAHALL. I do want to thank you for recognizing me, and certainly for holding this hearing today. I commend you and Chairman Oberstar for the tremendous job of leadership you provided, and this hearing certainly highlights the very crucial issue to us in West Virginia. It is no secret that CSX is a valuable partner with our State of West Virginia in so much that we do. They provide jobs, not only in the rail industry, but at an infamous resort known as the Greenbrier, there are an additional 1,500 jobs provided by CSX at that resort as well. That, I might add, just reinforces the partnership between CSX and my State of West Virginia.

I would like to ask Mr. Amin a few questions. And Madam Chair, I ask that my full statement be made part of the record.

Ms. BROWN OF FLORIDA. Without objection, so ordered.

Mr. RAHALL. What is your plan to spend on business with CSX? I have heard you, Madam Chair, mention that, say you want to double rates that the railroad charges, how do you expect that to go over with our shippers of coal in West Virginia, our coal people? We went through this some 10, 20 years ago after de-regulation in which they were facing exorbitant rates, and it was pretty contentious issues at that time, and debate between the coal and rail industries. So have you discussed this with the coal industry in any way? And not only what is their reaction, but what would the consumers' reaction be if, by doubling the rates as you want to do, the price of electricity goes up, the price of power goes up? With the rising price of gas as it is today and other bills that our consumers are facing, the whole scenario just scares me.

Ms. BROWN OF FLORIDA. Would you just yield for a second?

Mr. RAHALL. Sure.

Ms. BROWN OF FLORIDA. My understanding is they have asked the Japanese to raise their rates on the consumer because they are not getting the kind of return they want.

I yield back.

Mr. AMIN. Thank you for the question. Just to clarify one point on Japan, before I get to your question, Congressman Rahall, we have definitely not asked Japan for any rate increases. It is not part of what we are trying to accomplish in J-Power. I am happy to go into detail, more detail if you would like on that situation.

But Congressman Rahall, the question you asked is a very important question, which is, how does rail pricing affect the customer. We spent a lot of time trying to understand rail pricing and a lot of time with customers. We as investors cannot determine the pricing. Our view is the market will determine the pricing for freight rail. We would make one observation, which is, freight rail right now charges roughly 3 cents a ton mile, which is exactly what it charged when the industry was deregulated over 20 years ago.

And in the meantime, over that same period of time, almost everything that the rails move has doubled in price, whether that be coal or agriculture or chemicals. So we have seen for a long time that rail rates were deflationary or flat.

But back to the central point, which is what does TCI think on pricing, we are not in control of pricing. What we are trying to do is add experience to the board of CSX. We haven't called for management change. The management will continue to work in the market environment for pricing.

Mr. RAHALL. What would you do with the Greenbrier?

Mr. AMIN. It is up to the board and——

Mr. RAHALL. Fifteen hundred employees work there.

Mr. AMIN. I understand. And it is a national heritage site, and it is incredibly important. We don't have a view, it is really a question for management and for the board of CSX to determine what to do with the Greenbrier.

Mr. RAHALL. Do you have any plans to reduce jobs, cut jobs, not only to Greenbrier, but in other sectors of the industry?

Mr. AMIN. Our plan is to improve the productivity. It is not our plan, I would say it is what our nominees believe is possible, is that you can really improve the productivity of the system. What does that mean? That means the ability to move more traffic with the same employee base and with the same asset base. That is really what we are striving for.

As I mentioned in my opening remarks, we think if the U.S. railroads ran as efficiently and as productively as Canadian National, which in many ways, in many terms we see as the benchmark, that would create 30 to 40 percent additional capacity that you can move with the same number of rail cars, the same locomotives and the same employee base. That is what we are striving to do. There is no question that over time the freight demands on the railroad system are going to continue to grow. And productivity is one way of allowing the railroads to meet that need.

Mr. RAHALL. You would not be subject to any SEC filings, is that right?

Mr. AMIN. That is not right. We have made an SEC filing. That discloses our position, our full position and our objectives. It is a 13(d) filing.

Mr. RAHALL. It is a what?

Mr. AMIN. It is a 13(d) filing.

Mr. RAHALL. So the plans that you would have for reducing levels of business investment, cutting of jobs, would that have to be filed at the time?

Mr. AMIN. We don't have plans to do that. The SEC filing——

Mr. RAHALL. And should your plans change?

Mr. AMIN. I don't know whether that would have to be filed with the SEC.

Mr. RAHALL. Okay.

Ms. BROWN OF FLORIDA. Excuse me, I will give you time when we return. We are going to break because we have a vote and we have about five minutes left. We are going to come back, we just have one vote, so we will have a small recess.

Thank you.

[Recess.]

Ms. BROWN OF FLORIDA. Mr. Rahall, we are going to start over and give you your five minutes.

Mr. RAHALL. Thank you, Madam Chair. I probably won't take all of that. I appreciate your indulgence and kindness.

Let me follow up with Mr. Amin on the question I asked you about the SEC filings. You said you had filed an SEC filing, Securities and Exchange Commission?

Mr. AMIN. That is correct.

Mr. RAHALL. Was that a voluntary filing or a requirement?

Mr. AMIN. It is a required filing.

Mr. RAHALL. And would you continue to file those if you were to take over CSX as a hedge fund, would you continue to file SEC?

Mr. AMIN. Just to be clear, we have no intention of ever taking control of CSX. We are a minority shareholder, we only get 4 percent. And if we are successful, we will have one person on the board of twelve that is from CSX. The other directors that we are supporting are all directors that are completely independent from TCI, the vast majority of which are people that we didn't even know longer than six months or a year ago. We don't pay them, we have no real relationship with them. They have no obligation to support our views or not.

So we are not taking control in any way of CSX.

Mr. RAHALL. Would you be subject to Surface Transportation Board regulations?

Mr. AMIN. There would be absolutely no change in the way that CSX is regulated. The STB would continue to regulate economically. The FRA would continue to regulate with respect to safety. There is absolutely no change. The only change that we are——

Mr. RAHALL. Well, what exactly are your plans, then? What would your plans be?

Mr. AMIN. I think you would have to ask Michael Ward that. We are not trying to manage the railroad, we are not asking to manage the railroad. We are adding 50 years of railroad experience to a board that right now has no railroad experience.

Ms. BROWN OF FLORIDA. Excuse me, you said the board has no experience?

Mr. AMIN. No railroad operating experience, with the exception of Mr. Ward.

Ms. BROWN OF FLORIDA. Excuse me, would you yield for a second? The people that you are proposing for the board, do they have railroad experience?

Mr. AMIN. Yes, ma'am, they do. Tim O'Toole was the former CEO of Conrail, spent 20 years of his career, his entire career in Conrail. Gil Lamphere was the chairman of Illinois Central and then the Director of Canadian National. Alex Behring ran the Brazilian railroad for nearly a decade, and in doing that reduced the accident rate by 86 percent and made it one of the most technologically advanced railroads in the world. So there is a combined 50 years of railroad experience amongst our nominees.

Ms. BROWN OF FLORIDA. Let me just ask you another question. You have said it, and you said it to me, that you are not paying the board members. Have you had any contact with them? Where do these people come from? Did you see them out?

Mr. AMIN. It is our view that the CSX board and stakeholders would be served by adding railroad experience to the board. So we hired Heidrick and Struggles, which is one of the world's leading search firms, executive search firms, to help us in a process to find directors that we thought would add the relevant experience to the board. I could reiterate, these are not people that we have any long-term relationship with. We didn't know them——

Ms. BROWN OF FLORIDA. I understand you don't have a long-term relationship with them. Have you had any discussions with them?

Mr. AMIN. Yes, we did have discussions with them.

Ms. BROWN OF FLORIDA. And they are your slate that you are putting before the board?

Mr. AMIN. They are nominees that we support for the board of CSX, correct.

Ms. BROWN OF FLORIDA. I yield back.

Mr. RAHALL. Thank you. In regard to your suggestion that I ask Mr. Ward that, I am going to give him a chance to respond, but I want to ask you one last question. And I don't pretend to know the high finances of hedge funds, but I assume your goal is to make money for your shareholders.

Mr. AMIN. Our goal is to create value for investors, that is correct.

Mr. RAHALL. And that would involve buying back shares of CSX, I believe you suggested that to the current management of CSX, that they buy back shares?

Mr. AMIN. There are a variety of reasons, a variety of ways you can create value for shareholders. Share buy-backs are one, investment in capital infrastructure that has a good return on capital is another. Improving productivity is a third. We have advocated all of those.

Mr. RAHALL. Do a few of those involve increasing the debt of the company?

Mr. AMIN. We have advocated that it would make sense, in our opinion, if you can borrow at 5 percent after tax and redeploy that

capital on an infrastructure project that earns 15 percent or stock which we think compounds at a higher rate than that.

Mr. RAHALL. But at least in the bond rating created by a run-up in debt, thereby decreasing the value, decrease the ability of CSX as a capital-intensive railroad, as a capital-intensive company, would that not decrease their ability to invest further?

Mr. AMIN. We believe, and we have done a lot of work with investment banks, that CSX would continue to have access to capital, even if its bond rating was lowered. There is another major Class I railroad today, Kansas City Southern, which has a lower bond rating than CSX and has more than adequate access to capital.

It is not in our interest as a long-term stakeholder to do anything that would harm the long-term health of CSX. And access to capital is certainly an important factor. It is a judgment of, how much debt you have is, we wouldn't put so much debt on it that it would impair the long-term viability of the business and shut the business off for access to capital. If it did that, the stock would be worth zero. If you have debt that you need to refinance and you can't get it refinanced, the company would go bankrupt and our stock would be worth zero. We have a $3 billion position in CSX. We can't afford for that to happen.

Mr. RAHALL. Mr. Ward, would you care to respond?

Mr. WARD. Yes, I would like to respond to a couple of the comments. One, I think the issue around the railroad experience on the board is very much of a red herring. There is no other railroad in the Country that does have the railroad experience that Mr. Amin is suggesting for CSX on their board. And quite frankly, our slate has 60 years worth of railroad experience on it that we are running against the 50 he has. And we have 175 years worth of railroad management experience, within our management team.

The second thing I would like to comment on is the issue Mr. Amin has brought up about the CN versus CSX. I think we are really talking about apples and oranges, sort of like comparing the Canadian Football League against the National Football League. They have very different operating characteristics in Canada, they have a different health and welfare system. I think the more apt comparison is U.S. railroads to U.S. railroads. And among the four major U.S. railroads, basically we are number two on most major comparisons.

The final point I would like to make is, Mr. Amin keeps claiming that TCI is not seeking control of CSX. And just trying to use some common sense, when you are seeking 40 percent of the seats on the board, when you are trying to dictate how much money should be borrowed, when you are trying to dictate where it should be spent, and when you are trying to dictate how your customers should be charged, I don't know what you would call that, but it sure starts to feel like there is much more than an investor interest in our company.

Thank you, Mr. Rahall.

Mr. RAHALL. Thank you, Madam Chair.

Ms. BROWN OF FLORIDA. Mr. Westmoreland.

Mr. WESTMORELAND. Thank you, Madam Chairman. And Mr. Amin, the name, the Children's Investment Hedge Fund seems a peculiar name for a company going around buying railroads. I un-

derstand that you all give it to some charity for children. How long did it take you all to come up with that name, just out of curiosity? Because you all seem like a lot of smart people that are on your board of directors.

Mr. AMIN. It didn't take us long. We have a true devotion to helping children in poverty. The name is not the important thing, the important thing is we really do donate the vast majority of profits that we make as partners that manage the TCI Fund, have been donated to the Foundation. The Foundation now has over a billion dollars that is destined to children in need, mostly in Africa and India. It works very closely with the Gates Foundation and the Clinton Foundation.

Mr. WESTMORELAND. That is an admirable thing, but I don't know how you would feel about CSX donating all of their profits or most of their profits to children or any other charitable organization from what I have seen and what I have read, and your testimony and other things about your hedge fund.

Mr. AMIN. The one distinction I would make is, this is our money. For CSX to donate its money, it is not CSX's money, it is the shareholders' money. We as the shareholders of TCI are voluntarily donating all that money.

Mr. WESTMORELAND. So that is for all the people that invest their money with you?

Mr. AMIN. No, it is not. Let me be clear. Our investors get a return on the fund. We charge a fee to manage the capital. That fee is how we as the partners who manage the fund earn profits. And it is that fee, the vast majority of that fee that we charge to manage the fund——

Mr. WESTMORELAND. Interesting name for it, though, all the same.

Let me tell you, I am really in kind of a quandary about this, because I want to see people invest in our railroads. I want to see those railroads get investments. Because we need it. Our infrastructure needs it. I am just not so sure that the way maybe this Children's Investment Fund is going about it, dictating board members, talking about raising rates and other things, is really the right way to do it. But I am all for investment.

Let me ask you a question. You made some comments, and let me assure you that I know David Radcliffe. He is no back-bencher, he is a very smart man, and I promise you, he takes his job on that board very seriously. So don't underestimate him, because I don't know about his railroad experience, but I do know that they use an awful lot of coal that comes off those railroad cars. I just wanted to make that point to you also.

Talking about splitting the CEO and the chairman, and I am not that familiar with other railroads, but you do have other interests in other railroads, I guess, in the United States, is that true?

Mr. AMIN. That is correct. We have a very large position, a very large investment in Union Pacific, well north of a billion dollars.

Mr. WESTMORELAND. Have you written any of these other railroads a letter, asking them to split the chairman and CEO roles as you have CSX? Or talked to them about replacing some of their board members?

Mr. AMIN. We have not. And the reason we have not done so is because we have confidence in the management teams of the other railroad investments that we have.

Mr. WESTMORELAND. So it is not really a matter of you wanting to separate them, it is just that you don't have any confidence in the current chairman and CEO? Or do you think that it is just a different type of a management, depending on the entity?

Mr. AMIN. One comment I would make is, we think generically across the board, across railroads, across any company in the U.S., it is good corporate governance practice to separate the chairman and CEO. It is difficult for you as chairman to evaluate your own deficiencies as a CEO. There is a reason that we have checks and balances in the U.S. Government, and it should be no different in corporate America. We pushed for it harder at CSX, because we think there are corporate governance failings at CSX, and would highlight a couple of things. One, industry leading pay——

Ms. BROWN OF FLORIDA. Would you repeat what you just said? You think what? I didn't hear what you said.

Mr. AMIN. Excuse me. I think we pushed harder for the changes at CSX, because we think there are corporate governance failings at CSX. I will give you a couple of examples of why we feel this way. One is, as I mentioned in the testimony, the management team is the most highly compensated railroad management team we think in the world, certainly in North America, for performance that is average or below average on almost every metric.

Second, last year the shareholders voted in favor of more than two to one for a proposal to allow shareholders to call a special meeting, and management didn't respond for almost a year, didn't respond for nine months. And when they did respond, they responded in a way that was very disingenuous, that didn't give shareholders that right.

These are things that we view as the board not fulfilling its corporate governance obligation. That is why we are more focused on these corporate governance issues at CSX than at Union Pacific, where we do think the management team is doing a good job and we don't find the same failings.

Mr. WESTMORELAND. So do you have any plans of sending any of these letters out to any of the other railroads that you are involved in?

Mr. AMIN. We have no intention to.

Mr. WESTMORELAND. And let me ask you a question, I am a little slow when it comes to this investing, but why wouldn't you pick another railroad? If you are looking out for your stockholders or whatever, and you think CSX is so bad, why wouldn't you go into another railroad that was more profitable and buy into that to get a better return on what your investment was?

Mr. AMIN. The simple answer is because we think there is a tremendous amount of value that can get created by taking a business that isn't running as well as it could and getting it to its full potential. That difference between the way the business is running and the potential of the business is widest at CSX.

Mr. WESTMORELAND. Well, I am sure that CSX is thankful for your caring so much.

Mr. Ward, did you want to comment?

Mr. WARD. Yes, Mr. Westmoreland, I would like to clear up a few of these statements that in my view are very deceptive and not an appropriate representation of the facts. Where we talk about CSX has been an under-performer, when you are in the top 6 percent of the S&P 500 over the last three years in creating shareholder value, somehow that does not feel like an under-performer in my eyes.

Secondly, on our terrible governance ratings, there is a group called Institutional Shareholder Services who rates the governance of various companies. Within the transportation industry, we are ranked in the top 2 percent and in the S&P 500, we are ranked in the top 7 percent. So that doesn't feel to me like big corporate governance failing.

So I just felt I needed to clarify a few of those distortions. Thank you, Mr. Westmoreland.

Ms. BROWN OF FLORIDA. Mr. DeFazio.

Mr. DEFAZIO. Thank you, Madam Chair.

To shift to another railroad, Mr. Giles, I believe you had the benefit, perhaps of some of my earlier questioning, in particular referring to, well, first of all, let's get it straight, you have extensive experience in rail, 39 years, I believe, that is admirable. You were working for Fortress and I assume were intimately involved in the analysis of Rail America and the acquisitions?

Mr. GILES. That is correct.

Mr. DEFAZIO. Okay. And the statement that I referenced earlier that Fortress had to have, it is out of context, "to have no current plans to abandon any rail lines in connection with the proposed transaction." I guess the question is, since you abandoned abruptly with less than a day's notice a rail line in my district, and proposing to abandon another, and you have a very extensive network, it may very well be that other people have received notice of a proposed abandonment or cessation of service, not technically abandonment, cessation of service, only 220 days after the acquisition. I guess the question is, do you think 220 days fits the assertion about no current plans? Or did you fail to do the due diligence? And if you failed to do the due diligence, it seems that there is a problem in the acquisition.

I would further cite the fact that Rail America was in the process of applying for a RRIF loan for that line. So if they were applying for a RRIF loan, they had deferred maintenance for over 10 years, they had a substantial problem with the tunnels, how come you didn't know about it? And how can have this assertion that you had no current plans to abandon it?

Mr. GILES. I think the assertion made by Fortress is still accurate. We have——

Mr. DEFAZIO. Okay, no current, it just—okay, so we are going to rest on the abandon. You would like to not operate the line, sit on the asset, hope that Maersk goes in there at a future date, you have an incredibly valuable asset and then begin to operate it again. Unfortunately, we will have lost substantial number of local businesses and jobs in the interim. So I guess you aren't proposing to abandon it, you want to sit on it and not operate it, is that correct?

Mr. GILES. No, sir.

Mr. DEFAZIO. Okay, then, what are your plans to re-initiate operation of the line, other than the proposal you made in response to the Governor, which has been rejected by the State?

Mr. GILES. Right. Let me clarify a couple of things for the benefit of the Committee. We didn't just come down and close down the operation. We found and discovered some significant and serious——

Mr. DEFAZIO. Well, wait, wait, Let's go back to your due diligence. You didn't find that when you were examining this, that there's 10 years of deferred maintenance, there's a pending loan application to fix up the immediate safety problem and you didn't know about any of that when you bought the line?

Mr. GILES. I don't believe I said that.

Mr. DEFAZIO. Well, then you are kind of getting a little off the track here. You are saying one thing and another.

Mr. GILES. I don't think I have been allowed to say anything yet.

Mr. DEFAZIO. Well, go right ahead. You can speak plainly, clearly and credibly. Otherwise, I will interrupt you.

Mr. GILES. Thank you for that. I will take advantage of this airspace to correct a couple of things. The first one is, you said earlier that there was virtually no investment on the CORP over a 10 year period of time prior——

Mr. DEFAZIO. Obviously there was inadequate investment, because the tunnels were substantially deteriorated and they were applying for a loan to fix up the tunnels, which you canceled. Or you terminated the process. So you must have been at the point where you terminated the process, which was many months before you closed the line. You must have known there was a problem, is that correct?

Mr. GILES. I was trying to make a statement.

Mr. DEFAZIO. Well, I am just asking you, look, one day's notice, you close the line. We got shippers who have stuff stranded. You could reopen it only to move your own cars out of there. And you are telling me you want to make a statement. I want some answers. If you did your due diligence, were you aware of the problems, the deterioration on that line? Why did you cancel or decide not to go forward with the loan to repair the line? Were you aware of that at the time of due diligence and acquisition? And you are smirking and smiling and that is fine.

Mr. GILES. I am trying to respond.

Mr. DEFAZIO. But look. We want to get this line open. As my Governor said, we are going to get it one way or another. You are going to rest on the word you didn't abandon it, you just shut it. You don't have any credible plans to reopen it, you just shut it. You want to sit on it and hope Maersk goes in there and you get a big bonus out of it. We are going to intervene in that process, the State of Oregon is going to intervene, the port is going to intervene, unless you have a credible plan to reopen that line in the near future.

Now, can you tell me of a credible plan, since we are not getting a really accurate rendition of history here?

Mr. GILES. I am doubtful whether I will be allowed to finish——

Mr. DEFAZIO. Well, because you are not saying anything that is credible.

Mr. GILES. Let me start again. I would like to address a statement you made earlier that said virtually no investment occurred on the CORP in——

Mr. DEFAZIO. It was inadequate investment, all right? Let's leave it at the word inadequate and we will agree. Now, move forward from there. Did you know about the loans?

Mr. GILES. I would like to clarify that we spent $40 million on the CORP over the last six years.

Mr. DEFAZIO. You? You? Were you working for CORP?

Mr. GILES. Rail America. Forty million dollars.

Mr. DEFAZIO. Were you working for Rail America at the time?

Mr. GILES. I was not.

Mr. DEFAZIO. Okay, then, Rail America, prior to the acquisition, by the speculators at the Fortress Group invested some money, an inadequate amount of money, and they knew they needed to invest more, they were applying for a loan and you decided not to go forward with the loan. So let's start with the tense where you evaluated it and where you took it over, not what they may have done before you people took it over and closed it down.

Mr. GILES. Good. Thank you for letting me clarify your earlier statement. I appreciate that.

The second point I would like to make is on the RRIF loan. Rail America, before we got there, apparently looked into the RRIF loan process, never filed a RRIF loan application.

Mr. DEFAZIO. Oh, we understand it wasn't filed. The State of Oregon told us they were told that they were in the process of putting together a proposal at the time of the takeover.

Mr. GILES. It was months after we arrived on the scene and reading the local newspapers in Oregon that we learned about a RRIF loan in the first place. We did not withdraw any such loan, it was never progressed, it was never applied for.

Mr. DEFAZIO. Okay. We understand it was not technically applied for. Were you aware of the deteriorated state of the line at the time you acquired it, in doing your due diligence for your stockholders?

Mr. GILES. Yes.

Mr. DEFAZIO. You were? Okay. So then how does this "no current plans" fit in? If you were aware of the deteriorated condition, and now you have closed it, are we resting on the word abandoned?

Mr. GILES. No.

Mr. DEFAZIO. You didn't abandon it, you are just closing it?

Mr. GILES. No.

Mr. DEFAZIO. It doesn't work, but it is not abandoned?

Mr. GILES. That line would not have been shut down had it not been for the serious continuing deterioration of those tunnels.

Mr. DEFAZIO. Right, but they didn't deteriorate in 220 days.

Mr. GILES. They got gravely worse in that period of time.

Mr. DEFAZIO. Two hundred and twenty days? That is pretty extraordinary. So they were pretty good when you took it over, 220 days later, wow, they were a mess.

Mr. GILES. No, they couldn't have been pretty good when we took them over.

Mr. DEFAZIO. Okay, so then——

Mr. GILES. In June of 2006, the old Rail America team set about the business of trying to improve one of the tunnels. Their plan was to spend a quarter of a million dollars shoring up a portion of the roof. As they began working on that portion of the roof, the unsettled conditions caused another section of the tunnel to cave in. And what was a $250,000 short-term fix became a $2 million problem for one tunnel alone. Service was terminated for about six to eight months on that line. This was in 2006.

So we were aware there were problems and so were you.

Mr. DEFAZIO. Yes, but I didn't acquire it, and I didn't close it. Nor did the State of Oregon, nor did the Port of Coos Bay. So what are your plans, other than your unacceptable plan where you asked to have your operations subsidized, where you asked to have other people contribute for most of the work to reopen the line? Other than the plan you put forward, which the Governor has soundly rejected, what plan do you have to reopen that line? Otherwise, is this a constructive abandonment? You have no plans to reopen it, do you have a plan? Can you tell me of a plan, other than what has been rejected by the State of Oregon, which will require extraordinary financial participation on their part with no ownership?

Mr. GILES. Yes. We have another alternative we want to explore. But before I——

Mr. DEFAZIO. Okay, when we will hear about it?

Mr. GILES. Before I get into that——

Mr. DEFAZIO. When will we hear about it, sir?

Mr. GILES. Soon.

Mr. DEFAZIO. Soon. Could you give me a time line?

Mr. GILES. No, sir.

Mr. DEFAZIO. Okay. So is that something that is going to help you skate through the STB where you are going to be contested, because they are going to go for a feeder line application because we have constructive abandonment and you are going to try to come up with something else that isn't—or is this going to be a credible proposal and who are you going to make it to?

Mr. GILES. I don't know how to respond to all that.

Mr. DEFAZIO. Yes, well, then I guess we will just leave it at that, because I am way over my time. Thank you, Madam Chair.

Ms. BROWN OF FLORIDA. Mr. Giles, as we discussed earlier, there is a major problem. You can elaborate a little bit about when you all acquired the line. Did you not do the due diligence on the conditions of the property that you were buying, the needs and what kind of investment needed to take place?

Mr. GILES. Right. We did some modest amount of diligence in advance of the acquisition. This was a situation where the company was being essentially auctioned. It was in a bid situation. We were able to go visit 8 of the 42 properties that comprised Rail America. And we were compelled to make our bid or choose not to bid based on what we learned from that review.

We did look at the CORP, we looked at it and we knew we had tunnel problems. We didn't understand how grave they were and how imminent they were. But we quickly learned. And so we did our diligence. Perhaps it wasn't sufficient. But I think any acquirer

would have been in the same boat, because you can't get to 42 properties in a very short period of time.

I do think it is a very unfortunate situation, and I agree with you, something should be done. We have marshaled proposal after proposal, we have gone to the State, the Governor, Oregon DOT, shippers, and Union Pacific, all stakeholders. And we have said to them, listen, we have thrown a couple million dollars at this thing many, many times. And it lasts for six to nine months and then you have the same cave-in problems again.

And again, 99 year old tunnels, sandstone, not granite construction, they seek and leak and rain continuously and there is virtually no good drainage within them. There was a good reason why Southern Pacific short-lined this property. It was low profit and high capital. So that is the situation were inherited.

Now, we have gone forward and said, listen, let's get all the stakeholders together and let's all figure out who wants this thing to succeed.

Ms. BROWN OF FLORIDA. Just one second——

Mr. DEFAZIO. Madam Chair, if I could, we are getting a reconstruction of history here. They sprung a proposal in a public press conference which no one had reviewed, none of the stakeholders. They them came to a meeting with the Governor, the Governor made some requests. They got back to him two weeks later, basically reiterating their original proposal.

So it is hard to say there was proposal after proposal and constructive engagement of all the stakeholders. It is the same proposal that they made originally, which is, subsidize our operations, pay for most of our repairs, let us continue to own the asset in case it becomes worth a lot of money some day, and we will operate it if you pay for it.

Ms. BROWN OF FLORIDA. Thank you.

Mr. GILES. Madam Chairman, may I answer one thing, please?

Ms. BROWN OF FLORIDA. I am going to let you finish. But I think it is important to look at the history as we figure out how we are going to go forward. I do think it is important that we get all the stakeholders in the same room. Perhaps you could put together a proposal that could be possibly acceptable. Because one of the things that everybody needs to understand is that with this common carrier obligation, and you have some obligations to transport, whether or not it is profit-making, is not something that is to be considered. Correct me if I am wrong, Mr. Chairman.

Mr. OBERSTAR. Yes, common carrier obligation.

Ms. BROWN OF FLORIDA. Common carrier obligation. So therefore, we know that people are in this business to make money. But money is just one aspect of what you have to do to move the goods. This is a major problem, and I have talked with you about it. I hope that Mr. DeFazio and the other stakeholders, that we can work together to come up with a plan that will be acceptable to everyone.

Mr. DeFazio, would you agree to work with the Chairman?

Mr. DEFAZIO. Certainly, Madam Chair. I asked, in fact, the Governor to convene a meeting and Rail America was represented. The views expressed there by all the other stakeholders, other than Rail America, were quite similar to the views I am expressing here

today. They did, in response to the Governor, send back essentially their original proposal. But if they would like to engage in a constructive discussion that goes beyond their original proposal, I am certain the Governor would be happy to convene another meeting of all the stakeholders.

Ms. BROWN OF FLORIDA. Thank you. You are on that same page, is that correct?

Mr. GILES. I am on that page, and I welcome that. We have been endorsing it all along.

I would like to make one comment, if I may.

Ms. BROWN OF FLORIDA. Yes.

Mr. GILES. I think Commissioner Mulvey said something this morning that is spot-on. He said railroads are more than willing to invest when they can anticipate a return on their investment. When the public benefits dwarf the private benefits, they tend to look toward public-private partnerships.

That is the situation on the Coos Bay line. There is no economic return to me on that line and I am seeking a way to keep the community vibrant and alive and take care of the shippers. But I need help to do that.

Ms. BROWN OF FLORIDA. I hear what you are saying. But one of the ways that, if you decide that you can't do it, then you can abandon the line and then they could work for someone else to take over. But I am hoping that we can work through this. I am certainly willing to work with you and all the other stakeholders.

Mr. LaTourette.

Mr. LATOURETTE. Thank you, Madam Chairman.

Mr. Giles, I don't have any questions for you.

[Laughter.]

Mr. LATOURETTE. Mr. Ward, I do want to, just before I ask questions about the financing on railroads, thank you. As you know, we had a derailment in Painesville, within sight of my district office in Ohio recently. Your company came in, and because of the overtime that was incurred by the fire departments and police departments, handed out $600,000 in checks for the first responders. That made me very popular in Painesville for a day, so I thank you for that.

[Laughter.]

Mr. LATOURETTE. I also want to commend you for the fine work of your staff, particularly Anne Reinke, formerly known as Chettle. So thank you very much for what you did for our constituents.

Mr. Greenwood, I wrote down when you were talking that the activist investors, that your studies show than when just the announcement of activism, that the Children's Fund is going to become involved in investing in the UP or in the CSX, can cause a stock rise of up to 5 percent. Have you studied this particular instance and did that occur for the CSX stock?

Mr. GREENWOOD. I haven't looked at this particular incident. The incidents that I have looked at extend through the end of 2006. But I do believe that there was such an effect around the announcement here. But I am sure they can speak better to that.

Mr. LATOURETTE. Thank you.

Mr. Amin, first of all, thank you for coming in and talking to me a couple of times about the issues that we are going to talk about

here today. I think when we talked, you indicated that your fund owns a little over 4 percent of CSX shares, and the 3G group also owns something like 4.1, 4.3 percent. I saw a press release, though, the other day, that was in the materials, that indicates that you somehow have an additional 11.8 percent of economic interest in derivative securities.

My question to you is, are you and 3G going to show up at the shareholders meeting in May and vote 8 percent? Are you going to show up and vote 20 percent? Are you going to show up and vote more than 20 percent?

Mr. AMIN. Eight percent.

Mr. LATOURETTE. So what is the detail with this other 11.8 percent?

Mr. AMIN. The other 11.8 percent is what is known as a swap, which in simple terms is a contractual arrangement that you have with an investment bank, where if the stock goes up, the investment bank owes you money, if the stock goes down, you owe the investment bank money. It does not entitle you in any way to the stock itself. It is purely a contractual arrangement with an investment bank. We have no ability to vote.

So the amount of stock that we will vote at the AGM will be our disclosed 8 percent.

Mr. LATOURETTE. But then who does vote the 11.8 percent?

Mr. AMIN. If it is voted at all, there may not be stock underlying that 11.8 percent. It is really up to the investment banks that we have the contract with whether they want to own the stock or not own the stock, whether they want to vote it or not vote it.

Mr. LATOURETTE. In your testimony and also in conversations you and I have had, you talk about the fact that this twelve-member board and the proposal that you have made is that you are recommending a slate of five. One has a tie to your firm. You have also indicated that there are other people with railroad experience.

Just by way of something I am familiar with, we used to have a company that manufactured steel in Cleveland called LTV Steel. They got in economic trouble and brought in a new CEO who had knowledge of the steel industry. But then when I looked at his background a little bit further, I found out he was also the same fellow that came to Cleveland and took Diamond Shamrock out of Cleveland down to Dallas, Texas. What he was good at was shutting things down. He wasn't so good at running businesses.

As I looked at two of the members of your proposed slate, one, Mr. Lamphere, who unless I am wrong was a director of both Illinois Central and Canadian National, and I think during his tenure Illinois Central was sold; and the other one, Mr. O'Toole, Timothy O'Toole, was the president and CEO of Conrail from 1998 to 2002. Being in the part of the Country where Conrail operated, I am aware, and this Committee did, I think, yeoman's work to work with the Surface Transportation Board to cause the sale or the divestiture of Conrail between CSX and Norfolk Southern.

So I guess my question to you is, because I have heard you say that you are interested in long-term investment in this railroad and other railroads, is there a pattern here, that the majority of the experience by at least two of these nominees is in selling railroads and not necessarily running railroads?

Mr. AMIN. I would make a couple of observations. First of all, we do not want a sale of CSX, and we have said publicly that we don't want the company to be sold.

With respect to the nominees, the two nominees that you are referring to in particular, the reason that we are supporting them is because between them they have decades of experience running railroads. The decision as to whether or not to sell the railroad is not a decision that Tim O'Toole made. In fact, Tim O'Toole became CEO after the decision to sell Conrail was already made. And Mr. Lamphere was actually one of the lead investors in acquiring Illinois Central.

So I think you could look at it both ways. And Gary Wilson, who is a third nominee, was one of the lead investors in acquiring Northwest Airlines. So I think you could say our nominees have as much experience acquiring as they do divesting.

But the core of their experience, the decades of experience they have, which is why we think they are valuable to the CSX board, is operating experience with respect to the railroads.

The one other point I would mention is CSX, I think in the acknowledgement, that its board did need railroad board operating experience is nominating at this AGM a gentleman who was the CEO of Florida East Coast, which was also recently sold. We don't think that deters in any way from his ability to serve as a valuable director at CSX.

Mr. LATOURETTE. Madam Chairman, may I ask a couple more questions?

Ms. BROWN OF FLORIDA. Yes.

Mr. LATOURETTE. Thank you very much.

This business about freeze. Has that been accurately portrayed, that it is your recommendation to the CSX board of directors that until this re-regulation issue gets sorted out in the United States Congress that they should freeze further capital investment?

Mr. AMIN. I appreciate your asking the question, because it is a very important point. We believe all investment that is economically justifiable should be made——

Mr. LATOURETTE. Including new capital investment?

Mr. AMIN. Including new capital investment. One of the things that would make capital investment not economically justifiable is if the returns on that capital investment are either not forecastable because the regulatory framework is not stable, or if there is proactive moves by Congress to potentially reduce those returns. We are concerned about some of the legislation that is being considered, and it is not only our view, but the view of other CEOs in the railroad industry and also the vast majority of Wall Street analysts and investors, that some of this proposed legislation would reduce the returns.

The statement that we made was that in a situation where that risk is heightened, and we understand every year since Staggers, there has been a bill in one form or another that could potentially reduce the returns, it has never had as much momentum or perceived risk as it does currently.

So our view, and the statement that we made was, in that heightened risk stage, it is prudent to freeze expansion cap-ex, not maintenance cap-ex, not cap-ex that is being spent on safety, but

as Dr. Mulvey stated before, roughly one fifth of the capital expenditures of these railroads is expansion cap-ex. That is the cap-ex that we are talking about.

Mr. LATOURETTE. Let me, because I have already exhausted my time, I just have one further observation. I think you have just said what I thought I asked you, and that is that you wouldn't not do any maintenance, everything is for safety, but in this heightened concern, whether or not we are going to have re-regulation of American railroads, you would not, if you were successful in convincing CSX, no new capacity projects?

Mr. AMIN. When the risk of re-regulation is at a heightened level.

Mr. LATOURETTE. Okay. Two things, anther Wall Street analyst indicated that the railroads are one of the rare industries where under-spending on capital expenditures for even a year or two can ensure five or ten years of operating problems. I happen to agree with that. Second thing, the regulations, the re-regulation threat that appears to be causing so much angst, not only at your fund but other investors, is the baby of our Chairman, whom I happen to have the greatest fondness for and the greatest respect. But I will tell you, I will never, ever be supportive of the days before Staggers. On this, we are going to respectfully disagree.

So from an investment standpoint, I think that if you are going to wait for the Cure Bill and the Cure Coalition to prevail, it is going to be a long time before CSX or any other railroad in this Country will build anything.

Thank you very much for your patience.

Ms. BROWN OF FLORIDA. I am going to yield to the Chairman, but Mr. Amin, I want you to know that you moved me toward signing onto the bill.

Mr. Oberstar.

Mr. OBERSTAR. Well, thank you. This has been a very interesting exchange this afternoon, a lively exchange of the kind that we have not had in a while, and a very productive one.

Mr. Amin, let me just get right to the point. How do you draw a direct line from any provision or from the totality of the bill that I have introduced to stimulate competition in the rail sector to reduction of revenues?

Mr. AMIN. There are certain provisions of the bill that we would point to in this regard. One, for example, is Section 32 of the bill. It is our understanding that that section mandates that rates be regulated on the basis of historic costs. And the risk with doing that, I will use an example that Jim Young, the CEO and Chairman of Union Pacific gives, which hopefully illustrates the potential danger of doing this. Union Pacific has a bridge that washed out in a storm. The bridge was on their books for $600,000. When they went to replace that bridge, it cost them $20 million to replace.

If the rates that they were allowed to change on that bridge only reflected $600,000 of value, they would never have the money or the economic incentive to replace the bridge at a cost of $20 million. That is the concern that we see, the historic cost, the book values of these railroads have no reflection whatsoever to the true economic values of their assets.

Mr. OBERSTAR. Your interpretation is just exactly that, an interpretation. Those are not the words of the Act, and your inference that the bill will directly regulate rates is simply not accurate. I wrote the language, I know.

The Staggers Act did not eliminate Government governance, regulation or oversight of railroads. It greatly reduced the economic regulation of railroads. It left open a medium for the shippers and consumers to appeal to a government entity in the event that they are being mistreated, subjected to unreasonable, unfair, confiscatory, whatever else you want to call them, rates, and an opportunity to appeal those rates and for this Surface Transportation Board to exercise some independent judgment on whether competition is being unfairly squeezed out.

That is the purpose of my legislation, is to strengthen the access of shippers and consumers to the mediating role of the Surface Transportation Board. Do you think it is reasonable, do you think it is pro-competitive for a petitioner against an unfair rate to pay a quarter of a million dollars just to file a complaint?

Mr. AMIN. I don't have a particular view on the rate that people——

Mr. OBERSTAR. Well, you're criticizing the whole bill, now, just tell me, give me an answer to that question. Is that fair or not?

Mr. AMIN. Chairman Oberstar, I honestly don't have a view. One thing I would add, which I think we agree on, and we have said this to the commissioners of the STB, we do believe that the rate case process right now is too long and too costly to shippers. We don't understand why it takes three years and costs $5 million for a shipper to bring a rate case to the STB and——

Mr. OBERSTAR. That was my next question, is, what about the fairness of the process by which, so you are saying that that is unfair?

Mr. AMIN. We completely agree and we have given suggestions to, we have met privately with Dr. Mulvey and given him suggestions for how we think the process might be expedited in a way that gives more access to shippers, in a way that is much more time efficient and much more cost efficient for the shippers.

Mr. OBERSTAR. You have demonstrated yourself to have a considerable knowledge of the rail industry. What about the bottleneck rule, without having to on my part elaborate what it means?

Mr. AMIN. We followed up with our counsel after the meeting that we had, and it is our determination based on that that a shipper today can break the bottleneck if they are able to contract on the non-captive part of the route. They can force a railroad to provide a rate for the captive part of that route.

Mr. OBERSTAR. I think that will come as a surprise to a great many of the short-line railroads.

Mr. AMIN. It may. We can——

Mr. OBERSTAR. Which is why they are asking for relief.

Mr. AMIN. I can't answer that on behalf of the short-lines. But I am happy to provide the legal analysis of our counsel to the Committee.

Mr. OBERSTAR. Well, the Association of American Railroads has done that vigorously on behalf of the Class Is. I find their argu-

ment unpersuasive, but I would be happy to receive your legal counsel's opinion on the matter.

You say that it is irresponsible to make long-term investments without knowing the long-term returns. That was in your letter to CSX of last fall. That is sound on itself. Long-term returns, you continue to say, are unknowable while the regulation risk persists at this heightened level. Kind of news to me that that is a heightened level of risk when you have a Republican in the White House who is not inclined to sign the bill if we succeed in getting it through both bodies. You are presuming some things that are not in the real world, although I am going to work as hard as I can to make sure that it does get to the President.

Mr. AMIN. We would never underestimate your power, Mr. Chairman. To be fair, our advisors in this situation, one of our advisors had advised us that there was a 50-50 chance of the bill in its current form passing. That was a concern to us and that is the basis on which—it may be wrong.

Mr. OBERSTAR. Those are better numbers than we had two years ago.

Mr. AMIN. But that is the advice that we had gotten from one of our advisors in Washington, DC.

Mr. OBERSTAR. All right, well. But there is uncertainty in all that you undertake in the marketplace. Why is this uncertainty such a big stumbling block for you?

Mr. AMIN. Chairman Oberstar, that is absolutely right. Our job as investors is to assess uncertainty and ascribe a price to it. That is what we do as investors. Everything that we do, you are right, is uncertain. There are some risks that are greater than others. As we have discussed, there are some elements of this bill that, in our interpretation, and maybe our interpretation is wrong and needs to be corrected, but in our interpretation, posed a risk. I would say it is not only our interpretation, it is the interpretation of most of the management teams in the industry and most of Wall Street. It could be that we have all misinterpreted.

But it is our job to evaluate risks and assign prices to those risks. That is what we do every day.

Mr. OBERSTAR. Well, the particular provision of the bill is not a mandate upon the Surface Transportation Board, it is not a requirement. But in any event, we are at a stage, we have had a hearing on the subject matter, we are exploring options for the various provisions of this bill, we want to achieve fairness in rail service and fairness for competition in this business. We went from 60 railroads in 1980 to 7, I usually say 4, but we will include the 3 dwarfs and say, all right, so it is 7.

But there are not a great many markets in which they compete head to head. And where competition is likely to surface in this business is from the short-lines, and they ought to at least have an opportunity to compete on a fair and equitable basis.

There are the other impediments and obstacles to shippers in the marketplace that I think this legislation will open the door to overcome and reduce the stranglehold that the railroads have, frankly, on the shipping environment. Now, it is a delicate balance that we are trying to achieve here. We want to keep the railroads strong, successful, profitable. But we also want to be fair to shippers. And

I don't think they have been consistently fair to shippers or to other competitors. And I think the legislation gives us an opportunity to engage in a constructive discussion with the railroads, with others like yourself who are investing in, and we will continue that dialogue.

We are going to, my intention, my purpose is to move legislation to create a more fair, equitable rail competition environment that is beneficial to railroads, but also primarily to shippers and consumers. I look forward to working with you on that.

Thank you, Madam Chair.

Ms. BROWN OF FLORIDA. Thank you, Mr. Chairman.

We have a series of four votes. I am going to go to Mr. Brown, then we are going to take a recess and come back. Mr. Brown?

Mr. BROWN OF SOUTH CAROLINA. Thank you, Madam Chair. I will be brief.

Thank you, gentlemen, for coming to continue this dialogue.

Mr. Amin, the TCI has accused CSX of reckless spending on capital improvements. Can you give this Committee any examples of this reckless spending and where would you like to see CSX management cut back on capital spending?

Mr. AMIN. Our concerns with respect to CSX were that their capital spending program has not been justified to shareholders. What I mean by that is, they have not disclosed to shareholders where the capital is being spent and what types of returns that capital is obtaining. We asked, we have asked publicly and we asked before the CRS investor day they had with all their shareholders that they use that opportunity to share with their shareholders where the capital was being spent. And they unfortunately did not. And there are a series, I think we included in our testimony quotes from other Wall Street analysts that were equally disappointed in the company's unwillingness to discuss where that capital was being spent.

Mr. BROWN OF SOUTH CAROLINA. Let me share with you, I am a tree farmer back in South Carolina. I know a little something about long-term investments. But as an investor, I sure like a quick return. I am wondering, for a firm that was just found in 2004, has your track record after just a few years, how you expect anyone to believe you have a CSX interest above making a quick Euro?

Mr. AMIN. We appreciate the question, because I think it is easy to paint all hedge funds or all investors with one brush. I will give you a couple of observations that will hopefully help in his. One of the things that we have been advocating very publicly is ECP brakes. ECP brakes only work if the entire fleet of rail cards are equipped with them. At the most aggressive estimate, it would take five years to equip the U.S. rolling stock with ECP brakes. So for the next five years, it is only a capital expenditure with no return. If we didn't have the intention of being a long-term shareholder, it would be completely irrational for us to advocate spending on ECP brakes.

Union Pacific is another example where we have, as we have disclosed, a very large position in Union Pacific. We own approximately 4 percent of Union Pacific, similar to our ownership stake in CSX. And we have been supportive of that management team.

The Union Pacific has a larger capital expenditure program than CSX does. The reason we are supportive is we have confidence in that management team. They have shared with us the strategic rationale for making that investment. That investment also, although it won't earn a real return until after 2011, according to the UP management. So that is a long—you wouldn't advocate, you wouldn't support those types of investments if you didn't plan to be around.

I will give you just one other example which hopefully will be helpful. One of our largest investments over the history of the fund is the German stock exchange called Deutsche Borse. It was unfortunately another situation where we were activists. At the time, people said the same thing, our fund had only been in operation for a year, that we were going to be short-term. And the stock doubled——

Ms. BROWN OF FLORIDA. Sir, what was one of your largest investments?

Mr. AMIN. It was Deutsche Borse.

Ms. BROWN OF FLORIDA. That is the one that came into Jacksonville and cost us 500 jobs. Continue.

Mr. AMIN. No, it is not. It is not. Deutsche Borse is not in Jacksonville. I think you are——

Ms. BROWN OF FLORIDA. It is not in Jacksonville, but it bought out a bank, and it cost us 500 jobs in Jacksonville, Florida.

Mr. AMIN. No, I respectfully would like to correct that. I think you are referring to ABN Amro, which is a different investment. As I mentioned——

Ms. BROWN OF FLORIDA. Were you party to that investment?

Mr. AMIN. It is a different investment.

Ms. BROWN OF FLORIDA. The answer is yes or no, were you party to that investment that cost me 500 jobs in my city?

Mr. AMIN. We were an investor in ABN Amro.

Ms. BROWN OF FLORIDA. You can finish answering Mr. Brown's question.

Mr. AMIN. I would like to just correct something on the ABN Amro situation, which is, ABN Amro sold the bank that was located in Jacksonville to CitiGroup before we were active in ABN Amro. So I think there is no way that anyone could attribute what happened in Jacksonville to TCI's involvement. It took place, the sale of that bank to CitiGroup took place before our involvement in ABN Amro. So it is a really a discussion that needs to be had with CitiGroup, in which we have never been a shareholder.

But back to the point on Deutsche Borse, the stock doubled. Most of the people that thought we were going to be long-term sold. It tripled, it then quadrupled and it quintupled. And we are still there, we are still there today as a shareholder in Deutsche Borse, even thought we have made five times our money. And if all we wanted to do was a quick 50 percent, we would have sold out three and a half years ago.

So I would encourage and I would ask that people look at our track record and what we have asked for publicly to evaluate whether we really are a long-term shareholder.

Mr. BROWN OF SOUTH CAROLINA. Madam Chairman, I am not sure how much time we have left before the votes, but thank you, gentlemen, for your participation.

Ms. BROWN OF FLORIDA. Since I know most of us have not had lunch, we have four votes. We are going to recess and we will be back around 4:30. Thank you.

[Recess.]

Ms. BROWN OF FLORIDA. The Subcommittee will come to order.

Let me just say that I hope that we can finish up in the next 30 minutes.

Mr. Amin, I didn't ask, when we first came here, to have you sworn in. But I just want you to know that it is a criminal offense to lie to Congress. But I guess it is no criminal offense to try to mislead us. So I have a series of questions that I am going to ask after Mr. Shuster finishes. And I want you to try to be as truthful as you can with the answer. Okay?

Mr. Shuster.

Mr. SHUSTER. Thank you.

I guess the one thing that has come out of today that, although, Mr. Amin and Mr. Ward don't agree on a lot of things, the one thing they do agree on is the opposition to the re-reg bill, which I think that we can all, well, at least on this side of the aisle, many of us and the two of you, and I would say the three of you at the table, would agree that that is something we don't want to see. Because it would be bad not just for the railroad industry, but investors, customers.

Most importantly in my view is, it would be bad for the American taxpayer. Because I think that is a prescription to have the railroads come back here in five years, ten years, and say, we can't afford the $20 billion, $60 billion, $100 billion, whatever it is, so the American taxpayer is going to have to do it. That being said, I at least find that common ground reassuring here today.

Mr. Amin, I think it is pretty clear there is, in this Committee, and you have heard today that there is a great concern about long-term investment. And you said that the Children's Fund is, you are long-term investors. Although some of your initial letters and statements, not necessarily from you but from Children's Fund I think have a lot of us thinking we are not sure if that is, if you are just saying that to get in with the railroad, allow the Congress to put our guard down.

But a couple of things you said, and you have addressed some of them today, I would just like to go over a few of them. You said freeze investment on capacity expansion. Because of the re-reg bill, there is uncertainty. But even in the 1990s, when the chairman of the board of BNSF saw a lot of uncertainty, and he still plowed in billions of dollars, and everybody said, he is crazy, and then lo and behold, six years later, five years, seven years later, what he did was what all the other railroads wish they had done.

So you say long-term investor, you say freeze capital, everybody looks to BNSF and says what they did was the right thing. So it doesn't add up to me. That is the first thing.

Second thing is doubling the rates over 10 years. If you ever wanted to see a re-reg bill come to the House Floor, jack the rates up 7 percent every year, and you are going to have an avalanche

of customers come to Congress saying, you have to stop this. That is the second thing that you came out and said, that even though you are against the re-reg bill, once again, that is a prescription, to me, for Congress to do something to protect the shippers.

The third thing, I will get them all out and then I will go back over them with you, in the leveraged buy-out. I don't know where that came from, but I understand, and to me, a leveraged buy-out is you want to take the company private so that you can do what you want to do as a private firm, which gives you a lot more flexibility and ability to do those things that you want to do.

And the fourth thing is to increase the debt level. I guess it was a year ago that you stated at Bear Sterns conference, increasing the buy-back of the stock to up to 20 percent to increase the debt by up to five times the earnings. I guess there are a couple of reasons you could do that, but the first thing that comes to my mind is you raise the debt, strip all the cash out, so you are not spending your cash, so you can take it and do what you want.

So those four statements that I heard, some of them you refuted, some of them I don't think you have convincingly refuted, give me great concern about what your long-term intentions really are. So if you want to go through, and if I missed one, I will make sure I bring you up to speed on it.

Mr. AMIN. Thank you for the opportunity to clarify on these four statements.

On the first, on freezing investment, it has always been our view as a long-term investor that you can only make investments so long as they are in an adequate return. We are not the only people who say that. I think all investors would say that. There are quotes from three railroad CEOs in our testimony that say exactly the same thing, the common theme being you can only make investments if you earn an adequate return.

It is our view that H.R. 2125 would impede the railroad's ability to do that. We acknowledge that there has been a bill in that form introduced in the House every single year since Staggers. It is not the existence of the bill in and of itself that causes us concern. What causes us concern is there is now a triumvirate of Congress in terms of Congressional power and Chairman's Oberstar's strong view that that bill needs to be passed, together with heightened frustration from shippers, together with labor. That is a triumvirate that is very, very powerful and very concerning to us as a shareholder. That is a new phenomenon. That we believe heightens the risk.

Now, that risk has been somewhat diminished as labor has become neutral. But at the time that we were evaluating this and at the time we made the statement, it was the advice of our Washington counsel that there was a 50-50 chance that that bill in that form would pass. And that is a very, very significant risk to us as a shareholder. And it is in that context that we made that statement.

Mr. SHUSTER. You took the position in the company, it was last spring, roughly?

Mr. AMIN. That is correct.

Mr. SHUSTER. And right about that time is when I believe Chairman Oberstar initiated that. So my question would be, why did you make the investment if you thought that was a real possibility?

Mr. AMIN. At the time that we made the investment, we didn't feel like the risk was as high as it had developed to be over the course of the summer and the fall. Maybe that was us not being as attuned to the risk or the risk actually increasing. I don't know which one of those two it was. But we became dramatically more concerned about it in the fall.

The one other thing I would add to that is that we have spent a lot of time in Washington, D.C. trying to stay on top of this issue. We have offered to meet with every single Member of this Rail Subcommittee, we have met several times with the Surface Transportation Board, several times privately as well with the FRA, to make sure that we are fully aware of what is happening in Washington. It is very important to us as a shareholder.

And you would only, frankly, invest the amount of time to do that if you had an intention of being here for a long period of time. It is personally damaging to our reputation if we invest all this time and then sell out. It is damaging for our reputation in the U.S. capital markets. Hopefully that addresses the freeze investment question.

The one other thing I want to clarify on that is that we have never said, as we have been accused of, that we would cut any investment in maintenance and in safety.

Mr. SHUSTER. I didn't say that.

Mr. AMIN. In terms of the rates, it is our view that as a shareholder, we don't control the rates. The rates will be determined by management and the market. Mr. Ward and the management of CSX and all the other railroads will determine the rates.

The one observation we make is that since deregulation, the rates that the railroads have charged are roughly the same. They are roughly the same as the rates they were charging in 1980. The value of almost every good that they move is up roughly 100 percent. So in real terms, the shippers are paying half the price that they paid in 1980. That is purely an observation that we make.

Mr. SHUSTER. Isn't that good? Because the railroads then have become so efficient that they can offer in real dollars a price that is lower than it was 20 years ago. Obviously they are making money. So that is an effect of efficiency and good management for the industry. Correct?

Mr. AMIN. I completely agree. I think what has changed now from the past 20 years, or frankly, since the interstate highway system was built is we are no longer in a situation where there is tremendous excess capacity in the railroad network. So the railroads now have to earn adequate returns so that they can continue to invest and grow the network.

That is a fundamental shift from the situation that we have been in for the past few decades, where there wasn't that demand or there wasn't that demand to grow the network. So it wasn't imperative that the railroads earn an adequate return on replacement value. When you look at the returns on replacement value, they are 1 to 2 percent. These are not the levels of returns that are going to attract the $150 billion or hundreds of billions of dollars, de-

pending on different people's investments, that the railroads are going to need to grow their infrastructure.

Mr. SHUSTER. That gets back to, you said, the statement somewhere came out that I read that you wanted to increase the 7 percent a year. Once again, that is something that—that is a dramatic increase. That is what is going to draw the fire of Congress because you are going to have the agriculture community, the energy, chemical, all the people that are involved now coming to us even stronger. So once again, as the Chairwoman said, that is a formula for re-regulation. So it seems to me that it doesn't quite add up.

And I take you at your word that you have spent the last six months, I think, having an awakening that, oh, my goodness, Washington can affect us a hell of a lot more than we thought they could.

Mr. AMIN. On the third point of the leveraged buy-out, we raised the idea of the leveraged buy-out with the management team, we asked them if they were interested in thinking about it and they were. They invited us to speak with their bankers about the opportunity to do that. It was not something that we forced upon the company. We actually, upon doing our own work, and we have now been studying the industry for a couple of years and have spent millions of dollars studying it, determined ourselves that it wasn't the right conclusion, that a leveraged buy-out was not the right income. We stated publicly in a speech in May in front of a thousand railroad investors that we didn't think a leveraged buy-out was the right solution.

The reason that we raised it is, we think it is important for railroad management teams, and frankly for any management board of any company, to constantly evaluate ways of creating shareholder value. Raising ideas and bringing solutions or potential opportunities to create value isn't necessarily an activist thing. There is nothing wrong with asking questions, is there a better way to do this, is there a better braking technology, why don't we use ECP brakes. Can positive train control create value, why not run a precision scheduled railroad like they do in Canada?

These are questions that we have for management that we wanted to engage with a constructive dialogue with management on. We have been able to do that in certain situations. I would again point to our relationship with Union Pacific, which I think is very constructive. We asked very similar questions and we got good answers. And as a result, we have confidence in the management team there.

But merely asking the question of, is an LBO the right thing to do, we don't think is wrong for us to do as a shareholder. It is when people don't ask questions that you end up with the Enrons of the world.

Mr. SHUSTER. I agree with that, I think as a shareholder you have every right to ask those questions. That is not something that I am concerned about here today. I think you should be asking those questions. Just the way you have gone about the whole operation, again, it leads me to some great questions that obviously we are asking here.

Then the final thing, the debt level, increasing it substantially.

Mr. AMIN. The debt level, yes, sure. It is our view that all of the railroads, and this is not CSX-specific, all of the railroads have additional debt capacity that they could use to redeploy higher returns. Whether that is to buy back stock or to make capital investments, that would not in any way jeopardize the long-term health or the capital availability or the debt availability of these business.

We have done a tremendous amount of work, we have worked with investment bankers, and we have come to our own views of how much debt capacity there is. But borrowing debt at a cost of 5 percent after tax and redeploying it in capital investment projects or in your own stock at 15 percent is value accretive. If that debt is available—there is debt available for the railroads today. We are in one of the worst credit markets that we have been in probably since the early 1990s. And the railroads still have access to that debt.

So that to us is an indication that there is another source of capital here in the context of the discussion that we are having here, which is how are we going to grow and meet the rising demands for infrastructure, it is productivity and it is capital. Well, that is a huge source of capital. It is not just equity capital that we control. It is a source of capital that we should actively evaluate to see whether it makes sense to use.

But the one point I would make is, people say, well, what you are trying to do is strip out all the cash from the company and leave it dry. It is not in our interest as a long-term shareholder to do that. Putting a company in a situation where it could potentially be bankrupt means our $3 billion investment in CSX would be worth zero.

Mr. SHUSTER. I guess that is the whole question here is, long-term, short-term, short-term it is in your interest to do it, long-term it is not. Again, there is great doubt about, and as I said earlier, we don't paint everybody with that broad brush that hedge funds are all bad, because I think it is important that there is capital flowing into the railroads. And there are two sides of the coin, that is what we are trying to get at here today.

I know I have gone way over my time, but I wonder if we could give Mr. Ward an opportunity.

Ms. BROWN OF FLORIDA. Mr. Ward, I am going to give you adequate time to respond. We have a couple more Members and you can just jot down and I will give you an opportunity to close, if that's okay. Is that okay?

Mr. WARD. Yes.

Mr. SHUSTER. Thank you.

Ms. BROWN OF FLORIDA. I am going to Mr. DeFazio, but first, I want to ask Mr. Greenwood a question, since you are here. For years, I went to the Transportation Conference where we discussed railroads. And for years, the railroad industry was in the black, and now it is just beginning to operate—I mean, it was in the red. Red. Black is what you want. So now——

Mr. SHUSTER. She didn't want to say that, because red means that is a Republican State.

[Laughter.]

Ms. BROWN OF FLORIDA. So now it is in the black. I heard Mr. Amin make the comment that it is okay for this debt, so that even

though the bond rating would go down, can you clarify that for us? And while you are talking, you made some analysis in your paper, which I thought was very good, about the food industry. But the difference is, we only have a limited number of railroads.

And it is part of their mission, with the common carrier, is because, our military and the shippers and all of that, and the stakeholders and the union. So it is a little bit more complicated than the restaurant. Because if, for example, I don't want to go to a certain restaurant, I can go to another one. That one can close, or some of you all can cook at home. I don't know, my notes say somebody could cook at home, that is not me.

So would you explain that?

Mr. GREENWOOD. Yes. I think a good example of that was in Kerr McGee, that is a case that I have studied a lot. Kerr McGee was an oil exploration and production company. They were targeted by the activist investors JANA and Icahn about two years ago. One of the things that was asked for was pretty similar, which was, they asked for a reduction in capital expenditure, and they asked for repurchase of shares. Now, at the time, some of the analysts who were covering the stock warned about a possible credit downgrade.

Now, having said that, I think that was a risk that was on the table. But having a credit downgrade doesn't mean that the move is necessarily value-reducing. Just by definition, the more debt that you take on, the more risk you put on those debt holders. And so their debt is going to be more risky and you will face this possibility.

But what you saw was when the repurchase took place, you saw this quite substantial increase in the stock price. I think it was probably 3 to 7 percent, something like that, on the day. It is hard to say unambiguously that a downgrade is a bad thing.

Ms. BROWN OF FLORIDA. One last thing. There has been lots of discussion about raising the rates on shippers, I think it was said 7 percent a year. In your analysis, do you think that this would cause Congress to immediately pass a re-regulation bill.

Mr. GREENWOOD. I wouldn't be able to speculate on that.

Ms. BROWN OF FLORIDA. I would speculate on it.

Mr. DeFazio.

Mr. DEFAZIO. Madam Chair, just to follow up on that point, what alternative, since you are an economist, there is something known as monopoly pricing. And I don't think you can say there is a viable trucking alternative to retail. Many of these shippers do not have access to another railroad. So as the Chair postulates, if you were looking at 7 percent a year for 10 years, basically doubling, using the rule of the sevens, how can we say this is somehow a market-based system? It is not market-based in that there are no alternatives, according to a free market and Adam Smith and—I mean, I guess they have an alternative, they can just go out of business, not ship their product or whatever. But they don't have a viable alternative.

Mr. GREENWOOD. Sir, as an economist, I am absolutely aware of the anti-trust issues and the possibility of monopoly power being linked to the ability to raise prices in the future. I don't know enough about the rail industry in particular to draw that conclu-

sion here. So I would note that of course it is theoretically possible, but I wouldn't really be able to make further comment on that.

Mr. DEFAZIO. And I was going to ask you about, again, but since you say you really don't know that much about rail, but the point is, you have heard some discussion of the common carrier status. There is a public benefit here which needs to be protected. I do see some potential conflict between what we hear about value or return or whatever else and the possibility of these leveraged buy-outs or investors getting in who have a different agenda. And there was a proposal which was vetoed by Bush One to essentially have a fitness review if looking at it, even though you are not an expert on the industry, where we have to balance both some public benefit, common carrier status and the need to attract investment. Do you think that perhaps having some fitness review to determine whether or not we are attracting the Warren Buffets of the world, which I look at as much more patient, long-term capital, or other investors that I would suggest are not so long-term and not so patient? I say patient for us, but I am just putting it to you.

Mr. GREENWOOD. I think you can enter into a very dangerous situation where you are trying to evaluate the motives of the investor rather than the outcome of what the investors do. One argument that I am fond of says that if investors were really short-term and made significant value destroying decisions, they would be penalized for that in the market by other investors.

Mr. DEFAZIO. How is that? I mean, I come in, I raid something, I make them strip out a bunch of value, the stock goes up, I sell, I made a bunch of money. I could retire to my overseas tax haven and how do I get penalized?

Mr. GREENWOOD. Because the overall pie has shrunk. So the remaining value of that equity would have shrunk if other market participants are sort of correctly evaluating——

Mr. DEFAZIO. It is all about timing, though. You could have done that, gotten out and you would have screwed the people who are still there.

Mr. GREENWOOD. I think I would disagree with that in the sense that, it is assuming that the other investors don't know what is going on. Otherwise, they would have penalized——

Mr. DEFAZIO. There could be a run, but maybe you are just first out the door. I mean, maybe, maybe not.

I am not going to reopen a dialogue with Mr. Giles, but I thought you might want to correct something you said earlier, because I just was a bit impassioned carrying on about other things. But I am certain you know that the Coos Bay line was not closed for six months, it was the Siskew line which you are now proposing to abandon, because of a fire in a tunnel. There was never a prior closure on the Coos Bay line. So I just thought you might want to correct the record there.

Mr. GILES. You are incorrect.

Mr. DEFAZIO. Well, I have UP sitting behind you, they don't agree, nor does my staff, nor does anybody else know. If you could provide me documentation of a six month closure of the Coos Bay line, an area which I have represented for 21 years in Congress, we would be shocked.

Mr. GILES. Done.

Mr. DEFAZIO. Okay, great.

Ms. BROWN OF FLORIDA. Mr. LaTourette.

Mr. LATOURETTE. Thank you, Madam Chairman.

I just have two quick areas that I want to take up with you, Mr. Amin. You will have to forgive me on the first one, because I am not in your business and I was asking about 8 percent versus 20 percent. So if you have it some place in front of you, it is your press release of December 19th, 2007. The last sentence of the first paragraph, the members of the group also hold derivative securities providing economic exposure equivalent to an additional 11.8 percent of CSX's outstanding shares.

I thought what I heard you telling me was that you don't own them, and if the stock goes up, you somehow have a deal with people that you get paid, you get a fee from the people who do own the shares. Is that how that works?

Mr. AMIN. That is correct.

Mr. LATOURETTE. Okay, I just didn't understand.

Thank you. The other question, when we were voting, I read a Wall Street Journal story. And I don't know if it cost Ms. Brown 500 jobs or not, but I am familiar with your company's involvement on ABM Holdings and also there have been a couple of stories I have read about J-Power in Japan.

My question has to do with whether or not it is coincidence that you, Atticus and 3G have all decided at the same time to make investments below the 5 percent threshold, which would require an additional SEC filing, at the same time, with the same Class I railroad. And if it is not coincidence, could you explain to the Committee the relationship that you and your fund have with Atticus, its managers and owners, Mr. Rothschild and Mr. Barakett, your relationship, if any, with 3G and its manager, Mr. Behrens? And again, if it is coincidence, that will be the answer, we are not going to get to B. But if B, you talk about the relationship, if you could discuss with us when, if ever, you discussed with them individually or together the idea of buying a United States railroad, particularly CSX.

Mr. AMIN. The short answer is that it is coincidence. When we decided we thought the railroads were interesting, it was a private decision that TCI made. I actually don't know when Atticus and 3G acquired stock. We have never had any agreement to work together until December, when we had agreed to work together with 3G, at which point we made the SEC filing.

Mr. LATOURETTE. And that was the plan that you had to elect a non-majority?

Mr. AMIN. Correct.

Mr. LATOURETTE. But until that time, no discussions between your fund and these other two funds?

Mr. AMIN. Until that time, no agreement to work together in CSX or in any other railroad.

Mr. LATOURETTE. And I don't want to be too careful with words, but I understand no agreement, I am asking you did you ever had any discussions.

Mr. AMIN. We have had discussions with lots of other shareholders, including Atticus ad 3G Capital about the rail industry. All these discussions were after we found out that they were inves-

tors in the industry, through public disclosure. Specifically now, we have discussion with as many rail shareholders as possible because, in order for us to be successful in this proxy contest with CSX, we need 10 shares for every share that TCI owns to vote in support of us. So we actively have dialogues.

Mr. LATOURETTE. Do you know if Atticus or 3G have a similar ownership position in the UP that you have talked about, Union Pacific?

Mr. AMIN. I am sorry, I didn't hear the question.

Mr. LATOURETTE. Do you know, just based upon your own knowledge, whether or not CSX is the only United States railroad that the three of you have made an investment in, or are you aware that 3G and/or Atticus have also made investments in the Union Pacific that you talked about?

Mr. AMIN. Yes, I believe they have both publicly disclosed that they have investments in Union Pacific as well.

One other point I would make is, we have seen just from the public disclosures that Atticus has been selling their stock in CSX. So if the insinuation is that we are working together as a group, I think the fact that they have sold the vast majority of their position, at least according to their public filings, would indicate that is not the case.

Mr. LATOURETTE. Well, two things, I wasn't making an insinuation, I was asking a question. And two, because words do matter, I have enjoyed the times that you have come in and chatted with me. I think you are a good guy and a good businessman. I happen to think Michael Ward is a good guy and a good businessman.

There was a letter, after you sent your first letter, and then CSX responded, you send a second letter. And just because words do matter, and maybe where fights get taken to a different level, I would just commend your attention to page 2 of your second letter back where you expressed disappointment with CSX's response to your suggestions. And in the second full paragraph after the quote by Mr. Young of Union Pacific, the sentence said "Michael Ward rejected the question outright by responding ignorantly." Now, you may disagree with how he runs his railroad, and I think as a shareholder you have every right to ask questions. But a phrase like "responding ignorantly" I don't think rises to the level of public discussion and discourse.

So I would just, maybe ignorantly means something else to you than it means to me. But that is kind of a——

Mr. AMIN. It doesn't, and I think it was a mistake on our part.

Mr. LATOURETTE. I appreciate your saying that.

Mr. AMIN. Sometimes in these situations, when you have $3 billion at stake you get a little carried away.

Mr. LATOURETTE. I get that. Listen, I am just glad you are not closing a bridge in DeFazio's district.

[Laughter.]

Mr. LATOURETTE. Thank you very much, Madam Chairman.

Ms. BROWN OF FLORIDA. Okay. I have a couple of questions, there are a couple of things I want you to clear up. First of all, the Japanese situation. And the rate-raising and what you proposed to the Japanese government.

Mr. AMIN. In J-Power, which is a public utility in Japan, what we have proposed——

Ms. BROWN OF FLORIDA. Give us a one minute on what happened. Bring us up to date.

Mr. AMIN. I will do my best. I will note that I am not responsible for that position, so my knowledge of it is somewhat limited. And we are happy to add details to the record.

Ms. BROWN OF FLORIDA. I am just trying to get a pattern of how you operate.

Mr. AMIN. Sure. What we have asked from J-Power was initially an increase of their dividend. They were paying a very low dividend, even by Japanese standards, to their shareholders. We thought they should increase that. We didn't, our view, and it is similar in Deutsche Borse as it is in CSX, it wasn't our demand that they do it because we asked for it. What we said is, let's have the shareholders vote. If the shareholders decide that they don't want to vote in favor of it, that that is fine. But ask the shareholders what they would like.

We asked the same thing in Deutsche Borse when Deutsche Borse was attempting to acquire the London stock exchange, we just said, this is a transformational acquisition for you, you should ask the shareholders whether the shareholders think it is the right thing to do or not. And it is the same in CSX. We are not saying, we are just going to put our people on the board. As I mentioned, we need 10 shares, for every share that we own, we need another 10 shares to win the favor of our nominees for us to be successful.

But going back to J-Power, that was the first thing we asked for. The second thing that we have asked them for is targets, return on capital targets long term. The return on capital at J-Power has been deteriorating. And the management has had no plan or no public plan, at least, to fix that. And when you see the returns deteriorate without any solution or any evidence of a plan, that is very concerning as a shareholder. I think those are the two things that we have asked for.

I can categorically say, I confirmed this yesterday with the partner that manages our Asia business, that we have never asked for a rate increase in Japan.

Ms. BROWN OF FLORIDA. Okay. That is not exactly what I read, but if you say you didn't. You didn't ask for a rate increase, what did you ask them to do, then?

Mr. AMIN. We asked for the things that I just mentioned. The one, this is what we asked of the company. We have asked of the government to allow us to increase our ownership in J-Power above 10 percent, and that is a filing that in Japan, if you want to exceed 10 percent, you have to go to the government and get their approval. So we have asked that of the government.

Ms. BROWN OF FLORIDA. Okay. You noted that industry around the world is investing in new technology, we talked about the railroads, and our industry, particularly CSX, is falling behind. However, most observers think that U.S. freight railroad is the best in the world.

My question to you is why you didn't invest in some of those that you think are so far ahead of us?

Mr. AMIN. We agree that the U.S. freight railroad system is the best in the world.

Ms. BROWN OF FLORIDA. Who do you think is the best in the world?

Mr. AMIN. We agree that the U.S., the U.S. freight railroad system is the best in the world.

Ms. BROWN OF FLORIDA. Would you say that again?

[Laughter.]

Mr. AMIN. We agree that the U.S. freight railroad system is the best in the world.

Ms. BROWN OF FLORIDA. Okay.

Mr. AMIN. That is not to say, though, that it can be better. That is what we are striving for. We are not saying that the Brazilian system is better or the Canadian system is better. What we are saying is, you can learn from people that do one thing better than you. So the entire Brazilian system may not be better, but they have onboard computers that cost $20,000, they developed it, they had the initiative, they developed it themselves, and they reduced fuel consumption by 20 percent. And they sell this technology.

So it is not a debate of is Brazil a better railroad system than the U.S. The question for us is, does it make sense to implement a similar technology if it can save 20 percent of your fuel bill when oil is at $100.

Ms. BROWN OF FLORIDA. You know, excuse me, but I have been going to these workshops, I haven't been recently, because we haven't had any recently, but wherein one gallon of gas will take a train from here, Washington, to New York. So we are investing in the new technology. I have seen the commercials on TV. I think that we are going green here.

Mr. AMIN. We completely agree. The railroads are the most fuel-efficient form of land-based freight transportation. There is no question.

Ms. BROWN OF FLORIDA. That is right. And as we move forward, we know in this Congress that we have to invest in the infrastructure. We are looking at creative ways to do that.

When I go around, and we have been going around to different areas talking to people who are really interested in investing in our railroad industry, whether we are talking about freight or passenger, because eventually we need to go to double-tracking, so that we can really get passenger rail running and freight rail and them not intersect together. It is an exciting time for us.

But I am not interested in, well, it is not just me, you can tell from my colleagues that we have some real concerns about your intention. I think what was said earlier is that we need patience, long-term patience. And that is not what I am hearing from you.

I know you have hired a lot of great people here and a lot of lawyers and a lot of lobbyists. But you are going to hire a lot more if you try to destroy our industry. Because it is a partnership between a lot of stakeholders, the unions, the shippers, the military, I mean, it is a lot of things that the railroad, and it is the fight between even the cities that don't want certain things to go through their community. So it is a balancing act, as I told you before.

Mr. AMIN. We don't disagree, Chairwoman Brown. I can only assure you that it is not our intention to do anything that harms CSX or the U.S. railroad industry. It is absolutely not our intention to do that, and it would be against our interests as a long-term shareholder.

Ms. BROWN OF FLORIDA. I know you heard the Chairman say earlier, he sat up here 23 years ago and was listening to somebody's word, and the word didn't mean anything. Ronald Reagan said, trust but verify. I am going to make sure that we can verify whatever is happening to this industry.

Mr. AMIN. I absolutely agree. That is all that we ask, is judge us by our actions.

Ms. BROWN OF FLORIDA. Do you have anything else that anyone else wants to say? Because I am going to let Mr. Ward have the last word. Anything that you want to say? I hope you understand what we have said, we have said it over and over again about raising these rates on these shippers.

Mr. AMIN. No. I understand. I think there is one comment I would like to close with, which is again, just to bring this back to what we are trying to accomplish here, is not TCI taking control. The most fundamental thing we are trying to do, which is a right of any shareholder in a capitalist system, is to seek shareholder representation on the board. If you don't think the board is doing a good job, that is your most fundamental way to try to change that. And again, the nominees that we have put forth are not TCI nominees. We have no control over them. The reason that we put them——

Ms. BROWN OF FLORIDA. Now, that I don't think is altogether true. You had a search committee to look for them and you have had dialogue with them. So the fact is, you are telling us that you are not paying them, you need to understand that we have some knowledge of what you are saying. And don't lawyer talk me.

Mr. AMIN. Madam Chairman——

Ms. BROWN OF FLORIDA. What I am saying is, I understand what you are doing.

Mr. AMIN. I can assure you, Madam Chairman, that I have no control, if I go to Gil Lamphere, who has been a railroad investor for 20 years, probably one of the most successful railroad investors in our generation, and I have a view that he disagrees with, he is going to vote with what he thinks is right if he is on the board of CSX. Gary Wilson has been one of the leading businessmen in this Country for decades. He was the CFO of Marriott, he was the CFO of Disney, he is on the board of Yahoo, he was the chairman of Northwest Airlines for 15 years. I can express my view to Gary Wilson, and I hope he would listen. But he certainly is not going to vote on a board the way that I want him to vote.

Ms. BROWN OF FLORIDA. I am not making that decision. But I just want you to know that the decisions you are making are going to have repercussions here and other places. You just need to understand that.

Mr. AMIN. We understand that.

Ms. BROWN OF FLORIDA. Okay. So you are going to be paying a lot more of those people behind you.

Mr. AMIN. I am sure they are excited.

[Laughter.]

Ms. BROWN OF FLORIDA. They are excited, I know.

Mr. GILES. Before Mike speaks, may I just make one statement, Madam Chairman?

Ms. BROWN OF FLORIDA. Yes.

Mr. GILES. That is, I agree with the sentiments that we talked about earlier today, and I want to assure you that our company has been looking for a win-win out of this and will continue to do so. I wanted to pass along those assurances to you.

Ms. BROWN OF FLORIDA. Thank you. And we are going to move forward on this, because you understand this is a very sensitive situation, and we have to work to see how we can get it resolved. I am willing to work with you on that.

Mr. GILES. Thank you.

Ms. BROWN OF FLORIDA. Mr. Ward.

Mr. WARD. Thank you, Madam Chairman. I would like to thank the Committee today for calling this hearing, because I think at least for me it has been very enlightening.

You can tell from our dialogue today that TCI is a group of very clever people and they are very good at choosing their words as to the way they talk about things. They are not always factually bound, but they are very clever. The 12 to 13 months they have been involved with our company, they have come up with four flawed ideas, all of which would have been a mistake to implement. They were short-sighted, not understanding the business or the environment in which we operate.

As I best could tell, in answer to the questions that Mr. Shuster asked, I think they are largely disavowing those ideas, but I am not totally certain of that. I guess there is no way to really say if their slate of 40 percent of our directors, because it is their slate, does succeed, what ideas they may be pushing at that time is a little unclear, because their ideas change quite a bit based on circumstances as to what they think is important to do.

What I can address for you, though, is what we will do at CSX, which we have been doing. Contrary to some of the remarks today, we do not have poor returns, nor do we have poor governance. Our returns are in the top 6 percent of the S&P 500 over the last three years. I don't know how that can be categorized as poor results. Our governance ratings by ISS, which is the group that does that here in the United States, gives us very high ratings, 98 percent in transportation, 93 percent overall. That doesn't sound like poor governance to me.

The idea of splitting the chairman and CEO is much more of a European idea than it is an American idea. Here in America, the common practice in the S&P 500 is the chairman and CEO role are combined. If you want to talk about best practices, the chairman and CEO were split at both Enron and WorldCom. So I guess it is not necessarily the best governance model.

In addition to the returns we have produced, we have given guidance to Wall Street that our earnings per share will be increasing 15 to 17 percent over the next period through 2010. So clearly we have not only delivered for our shareholders, we continue to.

But there are more constituents than just our shareholders. We are doing a much better job for our customers now. The ratings we

get from our customers say that the service they are receiving from us is very good, the best they have seen from us and one of the best within the industry. If we look at our employees, our safety numbers, we have improved our personal injuries by 50 percent.

We are now ranked second in the United States, only behind the Norfolk Southern in personal injury prevention. We have improved our train accidents by 42 percent, we are again number two behind the Norfolk Southern in the U.S. railroads. So we are running a safer, better service railroad, and we continue to additionally improve that.

The other thing we are going to do is we are not concerned about what the Congress may do. We think that they are wise and will make wise decisions around these issues, around deregulation. We intend to continue to invest in our business and we have said publicly we will be investing $5 billion through 2010. We will build the capacity to help the national infrastructure in this Nation.

The only thing I can assure this group is you have a team that has been delivering, will continue to deliver, and we will fight any attempts that will knock us off the path of serving those four audiences. So I thank the Committee for its attention and interest.

Mr. SHUSTER. May I, Madam Chairman?

Ms. BROWN OF FLORIDA. Yes.

Mr. SHUSTER. The first thing I would like to caution you on, Mr. Ward, don't bet on Congress making wise decisions.

[Laughter.]

Mr. SHUSTER. And I am one of 435, and I know I am indicting myself.

Ms. BROWN OF FLORIDA. You are excluding me, right?

Mr. SHUSTER. I included myself.

The Canadian National, whose operating ratios are the highest in the industry, they operate in a different system up there, for one, I know the track sharing agreements are very different up there. Let me make my three points and you can educate me on that.

The second is that when the government privatized them, did they invest, I think I read they invested billions of dollars to try and get the track, their infrastructure up to speed, which I think would have an effect on their operating ratios. And third, their scheduled rail, is that the right terminology? How does that fit into CSX companies?

Mr. WARD. Well, Mr. Shuster, as you well know, there are a lot of differences between railroads. The Canadian Railroad does have the best operating ratio in the North American railroads, there is no question about that. They have a very streamlined operation, a lot of their business is grain and coal. They do not run through many major urban centers. It is a very streamlined railroad. It is sort of a T, if you will.

And quite frankly, it has a much lower operating ratio than any U.S. railroad, not just CSX. The railroads in the United States tend to have operating ratios between, say, 71 and 78. So the CN at 60 is in an entirely different league, somewhat because of their simplicity, somewhat because of the health and welfare benefit systems in Canada.

So I think most people who really understand the industry would not draw a direct comparison between and American railroad and a Canadian railroad. As I said before, it is like comparing NFL football and CFL football.

That being said, if you look at the progress, and there is no question our company was not running extremely well three years ago, and I think quite frankly, some of TCI's criticisms three years ago would have been quite appropriate. We have improved the fastest in the last three years of all the major railroads in all the prime categories, and largely are in the number two position in most categories that are relevant, rather than hand-picked, cherry-picked measures as TCI likes to do.

So we think we can improve. As far as our future guidance, we say we can get our operating ratio to the low to mid-70s, which is at this point best among the U.S. railroads. So we are certainly on a path that I think will be creating a lot of value for TCI and their investment in us. I think there is a little bit of an apples and oranges comparison there between the two, and you are quite right, the government did spend a lot of money to build a very good infrastructure for the Canadian National public.

Mr. SHUSTER. What about the scheduled rail service?

Mr. WARD. I think they were the pioneer in moving toward a scheduled rail network. I think you will actually find that most U.S. railroads have moved to some scheme similar to that. They may not call it a scheduled railroad. We have on our railroad what we call the One Plan, which is having strong discipline to taking and having the train leave when it is supposed to leave and be a much more disciplined operation. So I don't think that the other rails in the United States might be quite as strict as the Canadian National is, but I think all of them have moved to a similar methodology for a lot of their movements.

Mr. SHUSTER. How is the response from the customer? I was in business before, and if you run a schedule very disciplined, sometimes your customers go, wait a minute, that is not when I want to be there. If you are running something that scheduled, are the customers appreciative of it? How is the customer satisfaction?

Mr. WARD. Actually, I will speculate on this, and this is secondhand, of course, my understanding is that customers whose needs are met well by the Canadian National are very, very happy with their service. Generally they are not too willing to tailor their services if a customer has a somewhat different need. Those customers might not be quite as delighted with what the CN produces.

Mr. SHUSTER. Thank you.

Ms. BROWN OF FLORIDA. Thank you. Any further comments? Yes, sir.

Mr. AMIN. I just want to make a couple of comments related to Mr. Ward's statement. The comparison of Canadian National, Mr. Shuster, is incredibly important. There are certainly significant differences between Canadian National and the U.S. railroads.

That being said, Hunter Harrison, who is the CEO of Canadian National, grew up in the U.S. railroads, he grew up in Burlington Northern, a U.S. railroad, was then the CEO of Illinois Central. He is convinced that what they have accomplished in Canadian National can be replicated. There are a couple of differences, while

there are advantages that Canadian National has, there are a couple of disadvantages that they have. One is they have a less favorable regulatory system. Their ag rates are regulated. And there is more forced access.

Mr. SHUSTER. What is regulated?

Mr. AMIN. Their agriculture rates are regulated. And there is more forced access in Canada.

Second, the weather conditions that the Canadian railroads have to deal with across the board are much, much worse in the winter than they are here, and weather can have an enormous effect. Avalanches on the Canadian National Railroad have a huge effect on the performance of that business.

Third, unit trains, as I think we all know, are the most efficient form of running rail. And Canadian National has a lower percentage of unit trains than the U.S., which would indicate that they should run less efficiently and have a worse operating ratio than the U.S. railroads. We certainly acknowledge that there are differences.

And again, I am not here to testify as an expert on the railroads. That is why we were supporting nominees that have that railroad experience, that share the view. Can you do everything that Canadian National has done? No. You can't. Every business is different. All we are saying is we should hold ourselves up to a higher standard. They have shown that tremendous improvement can be made.

Don't forget, Canadian National was, in 1995, was the worst railroad in North America in almost every metric. At the time, the U.S. railroads were running at approximately an 80 percent operating ratio. Canadian National was running at a 97. And Wall Street thought Canadian National, for all the reasons I just mentioned, could never get to be as efficient as the U.S. Well, in that period, they have gone from a 3 percent earnings margin to a 40 percent earnings margin.

Now we are all saying, well, there are differences and the U.S. railroads can never get to Canada. We can always justify the status quo. But our only point is, there must be something we can learn from what they are doing to implement in the United States.

Ms. BROWN OF FLORIDA. You know, I am just so confused, though, if you think they are doing such a good job, why you didn't put your money with them.

Mr. AMIN. Because as an investor, there are two things that are important. One is the quality of the business; the other is can you improve the business from where you are today to that potential.

Ms. BROWN OF FLORIDA. But you think they are doing such a good job, that would be a good investment of your money.

Mr. AMIN. I think Canadian National is doing a fantastic job. I think there is more value that can be created at CSX than there can be at Canadian National, because Canadian National is already doing these things. If we implement this at CSX——

Ms. BROWN OF FLORIDA. But some of the things that you are recommending would jeopardize CSX and jeopardize your investment. For example, what you said about freezing growth investment until the fate of the re-regulation bill is known. You have said several things here in your memo that will jeopardize your investment. If you think Canadian investment is such a good deal, I just don't

know why you didn't invest your money there? I don't know anything about investments. But I am just wondering why you didn't do that.

Mr. AMIN. All I can reiterate is——

Ms. BROWN OF FLORIDA. Because I think that in the U.S., we have the best freight in the world. I am not saying we cannot improve. But I don't want to duplicate what they are doing in Canada. They have health insurance. That is not something that our rail may necessarily have to deal with.

So it is not apples and oranges, and I do understand football and the little league, what he is saying, so I do understand that.

Mr. AMIN. I don't know how to respond to that.

[Laughter.]

Mr. AMIN. All we are saying is, if there is someone that we can learn from, even though we are the best railroad system, the best freight railroad system in the world, we don't question that to be the case, but we can always improve.

Ms. BROWN OF FLORIDA. Absolutely. But I am very concerned about this hostile takeover that you are talking about here.

Mr. AMIN. I can only reiterate, we are not taking control. It has never been our intention to take control. I can tell you right now, we have never sought it and we don't seek control. It is not what TCI does. We have never, in the history of our fund, taken control of any business. Like we said, if we are successful, only one person, one voice out of twelve voices will be from TCI.

Ms. BROWN OF FLORIDA. Okay. Mr. Ward, anything additional?

Mr. WARD. We are getting very clever again. They have five members they have nominated, one is theirs. And yes, they may not be technically seeking control, but I will reiterate what I said earlier. When you are trying to control or nominate 40 percent of the board, telling you how much to borrow, how much to spend, where to spend it, what technologies you ought to be deploying and what you ought to be charging your customers, that may not be technically "control." But in most people's world, that would sure feel very, very close to it.

Thank you, Madam Chairman.

Ms. BROWN OF FLORIDA. I want to thank the witnesses for their testimony and the Members for their attendance and cooperation. This hearing is adjourned.

[Whereupon, at 5:30 p.m., the Subcommittee was adjourned.]

Statement by Congressman Jerry F. Costello
Committee on Transportation and Infrastructure
Subcommittee on Railroads
Hearing on Investment in the Rail Industry
March 5, 2008

Thank you, Madame Chairwoman, for calling this important hearing on investment in our rail industry. I would like to welcome today's witnesses.

Over the past 10 years, the financial health of the railroads has improved substantially. From 1996 to 2006, the net income of the seven Class I railroads has increased from $3.696 billion to $7.559 billion. The railroad industry shows great promise and helps alleviate many public policy challenges, such as infrastructure investment; national security; highway congestion; and environmental improvements.

While I am pleased there is such an interest in investing in our railroads, I have concerns with hedge fund investment in this valued infrastructure. In the examples that we have here today, hedge funds seem to have a very short term approach to the rail industry, thereby advocating junk debt borrowing, freezing capital investments; and leveraged buyouts. Further, in the case of RailAmerica, there were cutbacks in service, increased cost for shippers, and less competition for rail service.

I am a strong supporter of our transportation infrastructure and believe that rail is a necessary component. We must all be committed to improving our transportation infrastructure so that our constituents; our communities; and our commerce do not suffer and I believe any investor, including hedge finds, must invest with those goals in mind.

That said, I again welcome today's witnesses and look forward to their testimony.

Remarks of US Representative Nick Rahall
Hearing on Investment in the Rail Industry

Committee on Transportation and Infrastructure, Subcommittee on Railroads, Pipelines, and Hazardous Materials
2167 Rayburn House Office Building
March 5, 2008

Madam Chairwoman, thank you for giving me the opportunity to speak here today. Also, I want to thank you for showing strong leadership by holding this hearing. As you know well, this is an issue of serious concern to the Members of this Committee and I look forward to hearing the testimony of the witnesses assembled here today.

I also want to thank Chairman Oberstar for all that he does as Chair of this great Committee.

I would like to begin by noting, with great satisfaction, that our railroad industry has been going through a renaissance of sorts in recent years. After too many years of less than desirable financial health due to various factors, it is good to see the industry returning to its rightful place in the American transportation economy.

The renaissance and recovery that our railroad industry has gone through also brings greater expectations from share holders—which brings us here today.

Before I dive right into the deep end of the pool, however, I want to say that my great State of West Virginia has a long and special relationship with railroads. In West Virginia, coal and the railroads are bound together like rails and ties. Both must do well for either one to prosper.

It is, after all, railroads like CSX in West Virginia that are the engines carrying our coal from deep within our wild and wonderful hills to the plants that power our smallest towns and light our most important streets.

Streets like Independence, Constitution, and Pennsylvania Avenues—which, I am pleased to add, are powered by the coal that has ridden the rails to arrive in this, our capitol city.

Further, railroads nation-wide, railroads like CSX, are also an engine of economic growth. In my State of West Virginia, CSX is one of out largest employers—providing jobs for more than 2,000 railroad employees. These are good-paying jobs that are

crucial to the continued growth of the communities in my District, my State, and my Country.

On top of employing our citizens, carrying our coal, and improving our quality of life, CSX also owns one of West Virginia's most sacred treasures, The Greenbrier. As those of you who have been there know, The Greenbrier is like no other place on Earth. Bathed in a rich history and even richer future, this resort employs 1,500 people and, by its presence, reinforces the partnership that CSX has with the people of West Virginia.

West Virginia's relationship with the railroad industry goes even deeper. The Rahall Transportation Institute at Marshall University in Huntington has served as a valuable resource for CSX in the past, especially with the conductor training program. The relationship between CSX and the Rahall Transportation Institute has been very beneficial to all parties involved, especially the public, and it is my sincere hope that it will continue well into the future.

Madam Chairwoman, Chairman Oberstar, I once again thank you for your courageous leadership on this Committee, and I look forward to this crucial hearing.

TESTIMONY OF SNEHAL AMIN, PARTNER

THE CHILDRENS INVESTMENT FUND

BEFORE

THE HOUSE OF REPRESENTATIVES

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

SUBCOMMITTEE ON RAILROADS, PIPELINES AND HAZARDOUS MATERIALS

INVESTMENT IN THE RAIL INDUSTRY

WEDNESDAY, MARCH 5TH 2008

11:00 AM

2167 RAYBURN HOUSE OFFICE BUILDING

Good morning Chairwoman Brown, Ranking Member Shuster and Members of the Subcommittee. My name is Snehal Amin. I am a partner at the Children's Investment Fund Management (UK) LLP ("TCI")[1]. I am here today at the Subcommittee's request to discuss investment in rail infrastructure.

There have been many questions and concerns raised about TCI and its intentions with respect to its investment in the United States Rail industry. Whatever your preconception of TCI, we ask that you allow us a chance to explain who we are and what we stand for, and judge us by our actions.

TCI is a London-based investment manager founded in 2003 and authorized and regulated in the United Kingdom by the Financial Services Authority. We have a long-term, value-oriented investment philosophy, and it is with that philosophy that we have a nearly $5 billion investment in US railroads. Our investment approach is not complex – we simply try to invest in high quality businesses whose competitive advantages should allow them to generate positive returns for a long time. We are not mysterious foreigners – we are Americans and Britons and the majority of our investors are US institutions, largely US university endowments. Our objective is not a secret – railroads that are even safer, that provide better service, attract more customers, and therefore earn higher returns.

We are committed long term investors. In fact, we ask our own investors to commit their capital to us for years at a time so we can be faithful to our investing philosophy. We analyse a company's prospects over the coming decades, not the coming quarters or years. We also believe in doing a few things very well. Traditional investors will hold 50+ equally-weighted investments in their portfolio, which does not allow them to devote the time and energy to understanding any one of those investments extraordinarily well. At TCI, our top five investments typically represent 60-70% of our fund, and we strive to understand these businesses better than any other investor in the world. US railroads are our largest holding and we have devoted several years of time and millions of dollars to developing and deepening our understanding of the industry. As you can imagine, we plan to stay.

An overview of TCI and short biographies of our key partners is provided in Appendix A.

Our Vision

We are excited about the prospects for the US railroad industry. Railroads can, and must continue to, play a critical part in meeting America's growing freight transportation needs. Railroads are the cheapest, most efficient and most environmentally friendly form of land-based freight transportation, and they don't require taxpayer dollars – a public-policy panacea if ever there was one.

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[1] The Children's Investment Fund Management (UK) LLP is an investment manager and manages a fund called the Children's Investment Master Fund. For the purpose of simplicity, both the investment manager and the fund itself will be referred to as TCI

As valuable as railroads are to America today, their potential is even greater, and that is what we should all find truly exciting. Over the last 100 years, the industry has transformed itself from one operating under heavy regulation to one that competes in the free market. This transformation has taken decades, and while rail market share has nearly halved as they have lost share to trucks, it has brought enormous benefits to shippers – since Staggers rates are down while volumes, service and investment are up. However, as the railroads were trying to adapt to the dynamic competitive market, many opportunities were left unexplored. As we look into the coming decades, we see the potential for US railroads to capture these opportunities.

Today we live in a world where almost every handheld device can have GPS, and where you can send a letter cross-country, be guaranteed delivery the next morning and track it every step of the way, all for just $20. So why in today's world do we accept that we cannot track where our trains carrying millions of dollars of goods are, or know precisely when they will arrive? Technology has revolutionized many industries, and railroads should be no exception. US trains sit idle 90% of the time. When they are moving they move at an average speed of 20 miles per hour, and the likelihood of the train reaching you on-time is little better than a coin toss.

It is time for the US railroads to, again, become leaders – smart-yards work in Canada, positive train control works in Brazil, ECP brakes work in South Africa, they should all work in America. The US is the global leader in technology, service and management practices in almost every industry. Why should we not hold US railroads up to the same standard? We have heard many excuses ('it's an old industry,' 'it's just not the way it's been done in the past,' 'it's too complicated to make change') but frankly, we don't buy them. Companies and entire industries around the world, new or old, complicated or simple, have 'revolutionized' (including railroads like Canadian National and All America Latina Logistica in Brazil) when there was a driving force for positive change and an unwillingness to accept anything short of total success. This is what we ask of railroad managements and boards.

It is with this in mind that we determined there needed to be Board changes at CSX. The ability to nominate and elect directors is one of the most fundamental rights of a shareholder under American law, and one we believe that should be exercised when incumbent Board directors are not capable or willing to fulfil their duties, a situation we believe exists at CSX. Following this statement are both the letter we sent to the Board of CSX in October 2007 outlining our concerns related to the company's performance and corporate governance, as well as the press release announcing our intention to nominate a *minority* slate of five directors out of a Board of twelve. TCI is not seeking and has never sought control of CSX. In fact, if we are successful, only one director on the Board of twelve will be from TCI. What we do seek is a strong Board with relevant experience, and our nominees bring over 50 years of railroad experience with them, as well as senior executive experience at iconic American companies like Disney and

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Marriot. Three of our nominees are American, one is British, and one is Brazilian. Short biographies of the nominees are included in the press release.

However for US railroads to become leaders again, *all* stakeholders (shippers, workers, management, shareholders, policymakers and regulators) must work together. We must all shed historical biases, embrace change, and focus on constructing solutions instead of battle plans. While no one of these stakeholders can guarantee success, any one of these stakeholders can guarantee failure.

In our view, the greatest threat to this vision is re-regulation of the rail industry. De-regulation has been an unquestionable success. As mentioned, since passage of the Staggers Act, rates are down while service, volumes and investment is up. We should not forget that prior to Staggers over 20% of the industry was in bankruptcy and there was $16-20 billion in deferred maintenance investment that needed to be made. De-regulation and the private markets have addressed these issues. That is not to say that all issues have been addressed. For example, we agree with shippers that the rate case process should be faster and cheaper (but it must be based on replacement cost). We also believe service levels need to rise, and technology provides a path to doing so. We also understand the frustration that many shippers, and labor, feel because some railroad managements take an unnecessarily aggressive approach towards them, as some do towards us as well. These are market issues, and we are confident that over time the market will address them. The shareholders, at least, understand that customers are king and workers are the true backbone of companies, and positive relations with them is essential to success. The market has a way of dealing with managements that do not understand this.

The risk is that instead of allowing the market forces to work to address the issues at the heart of shipper frustration, legislation such as H.R.2125/S.953 will be enacted to address the issues. This legislation will have unintended and unfortunate consequences for railroads, labor, shippers and the investment community – particularly, shrinking the network.

We do not believe policy makers want to reduce investment, and thereby shrink the railroad network, and in fact even those in favour of H.R. 2125/S.953, want to see better service and more capacity (as do we). Studies show that $100 billion investment by railroad shareholders can save taxpayers and shippers $1 trillion over 20 years, a 10x return. Yet, the potential consequences of actions in Washington could have exactly the opposite effect – constraining investment, shrinking the railroads and putting more trucks on the highway. The irony of Washington DC seeking more investment while debating legislation that would dramatically reduce investment is something we have tried hard to understand. Our conclusion is that while legislators and regulators are well-meaning, there are a few fundamental misperceptions about the industry (perpetuated by special interests) that result in advocacy for legislative and regulatory changes that are unintentionally against the public's interests. Railroads will face an unprecedented

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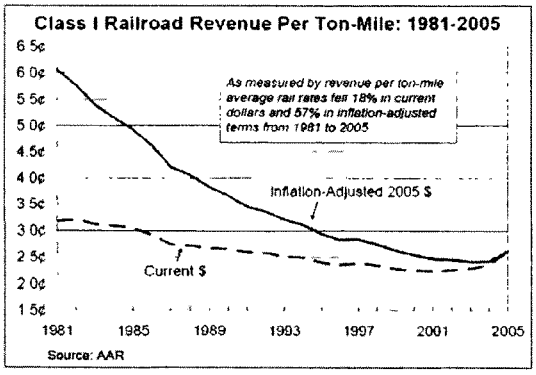
challenge over the coming decades to meet growing demand – in particular $300+ billion of investment. Misperceptions, and legislative/regulatory changes based on them, should not threaten their prospects to succeed.

In this testimony, we seek to address the main misperceptions we believe exist. We hope an open, honest and fact based discussion will lead to the right public policy outcomes. As is often said 'in God we trust, everyone else must bring data to the table.'

Misperception #1: Rail Rates Are Too High

Rail rates are an emotional issue for many, and we understand that nobody ever wants to pay more for anything. So when studying the issue of rail rates we approached the issue from many different angles. Our conclusion, based on the data, is that rail rates are not too high. In fact, rail rates in the US are economically half of what they were 25 years ago and are the cheapest unsubsidized rail rates in the world.

Shippers are paying less now to move freight by rail, in absolute dollars, than they did 25 years ago. The GAO confirmed this in September, stating "rates for 2005 remain below their 1985 levels and below the rate of inflation." In fact, when you include inflation, shippers are paying *half* of what they paid for rail 25 year ago.



By comparison, consumer prices over this period have doubled. Truck rates over this period have doubled. In fact, every major shipper category has increased prices way in excess of their rail rate increases over this period. As the table below illustrates, coal, agriculture and chemical shippers have increased their prices to their customers by 80% on average since 1980, while the rail rates they pay have been roughly flat over that time. Why is it fair for the shippers to raise their rates, but unfair for the railroads to do so?

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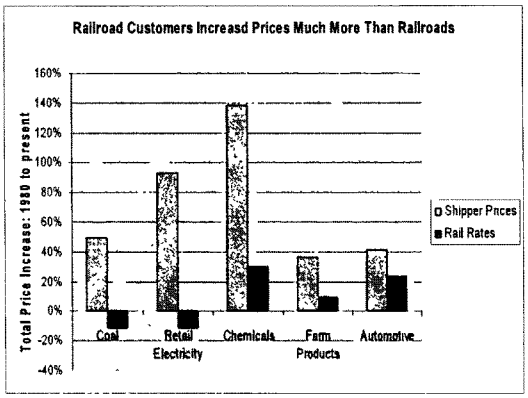

There are instances of large rail rate increases, sometimes 100% increases, but these must be placed in context. These are often contracts signed many years ago, which did not contain fuel surcharges and with rate deflators, that the railroads have been honouring despite making losses serving these shippers at these rates. When these contracts come up for renewal, there will of course be large one-time uplifts to bring the rates to market. As fuel costs grow and demands on capacity increase, why shouldn't the market reflect this? It is no different from the price of airline tickets around Thanksgiving or hotels on Memorial Day weekend.

Rail rates in the US are also the cheapest unsubsidized rates in the world. Even with subsidies, and every major country in the world subsidises railroads except the US, Canada and Mexico, US rail rates are the second cheapest in the world. Shippers in other industrialized nations like Germany, Japan and France pay rail rates that are 2-5x as much as their US competitors. So we question the claim we often hear that high rail rates are forcing shippers to re-locate abroad. The facts indicate that US rail rates are a global competitive *advantage* for shippers, not a disadvantage.

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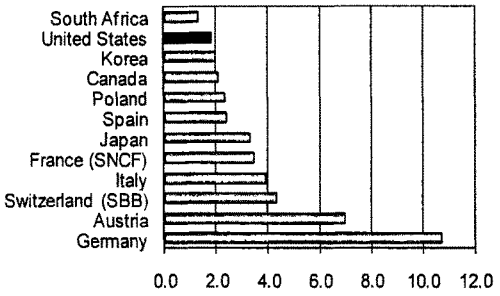
International Rail Freight Charges (US cents/km)



The great rate debate will no doubt continue to rage on. We would all like to pay less for everything. It is important however to understand that rates have only been increasing for a few years, after declining for two *decades*, that they are cheap relative to other countries and that they have not risen anywhere near as much as shippers' own prices have.

Misperception #2: Railroads Are Making Too Much Money

As private investors in the sector we are always puzzled when we hear that the railroads are "making too much money." When we analyse the railroads, we genuinely come to a different conclusion. Yes, they are making record profits. But profits themselves don't tell you much – if railroads had never earned more than $9 and now they earned $10, that would be a record, but still a paltry sum.

Why don't "record profits" tell you much? Because it is impossible to judge profits unless you know how much money was invested to generate those profits. Take for example a bookstore I set up many years ago that made a record profit of $10,000 this year. How well am I doing? Impossible to say because you don't know how much I invested to set up the store. If I spent very little setting up a little neighbourhood book shop, then my $10k of profit would be great. But if I had spent $1m creating a giant superstore, then profits of only $10k would be an awful result. It's only a 1% return on my investment. Profits must be considered relative to how much capital was needed, and the relationship between the two is the returns (profit/capital). Only if the returns are exceeding the cost of capital can one even begin to argue that railroads are earning too much money.

US railroads today earn very low returns, 1-2% we estimate, well below their cost of capital and well below even interest on US government debt. Railroads earn lower returns than almost all of their customers, including utilities, chemicals, steel, aggregates and consumer products companies.

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The 1-2% returns we estimate for railroads are based on replacement cost, and differ from returns published by the STB that are 8% or higher, which are based on *historic* cost. The simple difference is how you estimate the capital in the business – based on what it is worth today (replacement cost) or based on what you paid for it when you made the original investment (historic cost)? In a business where you must re-invest at today's costs, you must also evaluate returns at today's cost. There is virtually no economic decision that an individual or company makes based on historic cost – it is largely irrelevant, and returns based on it do not give you a true reflection of the health of a business.

Consider the following – if you bought a home in Manhattan 50 years ago for $100k and it is now worth $1m, you certainly wouldn't sell it for your original purchase price of $100k. Nor would you accept an offer from a tenant who offered to pay you a fair rent based on the original purchase price, instead of a fair rent based on the value of the home today. What decision, if any, would you make based on the original purchase price of the home?

Railroads were built decades ago and the cost of the land, steel and labor at the time they were built bears absolutely no relation to what it costs to replace and maintain the networks today, as they must do. In fact we estimate it would cost the railroads **5-7 times** as much to replace their networks today as the STB thinks their assets are worth. Going back to the property in Manhattan – if you could only rent it out based on 1900 rental prices would you ever invest in a paint-job or upgrading the bathroom today? Probably not, because the rent would never be high enough to make it worthwhile. The same logic applies for railroads.

We are encouraged that the STB recently re-affirmed that "current cost accounting is theoretically preferable to original cost valuation." The use of replacement/current cost accounting in a regulatory setting has sound economic basis and is successfully used around the world for businesses with long-lived assets like railroads. We recognise that it may be complex to implement a replacement cost methodology. However, today's method is so off base that even an indicative replacement cost measure would be more accurate. In this case, it is better to be approximately right rather than precisely wrong.

Why do returns matter? Because institutional shareholders like TCI are no different from you. You probably shift your savings around to the best performing stocks, mutual funds and deposit accounts. In the same way, shareholders invest their capital wherever they believe the returns will be highest. One of the most basic principles of a free market is this: capital will flow to wherever it achieves the highest risk adjusted returns. Reducing railroad returns will mean less capital flowing into the industry, and thus less investment by railroads in the vital infrastructure the country needs. It's that simple. So when you look at a menu of returns that looks like the

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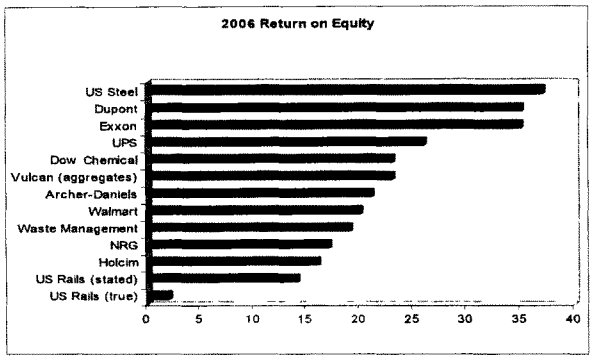
following, it is clear that railroad returns must increase for them to compete for and attract capital.



The need to compete for capital is just as true for railroads as it is for their customers that are publicly traded companies, as the following statements indicate:

> *"Where we can generate higher than cost of capital returns, IP will invest in our North American assets."* International Paper

> *"If we can't make an attractive investment for the shareholder, then we are going to have a very difficult time going in the marketplace and competing for dollars."* Florida Power and Light

While all industries compete for capital, the need for capital is greatest for railroads. Railroads are by far the most capital intensive major industry in the country, re-investing 17% of revenue (versus approximately 3-5% for the average S&P500 company), and these capital needs will only grow over time. Railroads will likely need to invest $100 billion over the next 20 years to accommodate expected freight transportation growth and another $200 billion to maintain the existing infrastructure.

Failure on the rails part to do so, which would be virtually guaranteed if returns are not improved significantly from here, would mean more trucks on the highway, more shippers complaining about service and more pollution in the atmosphere. Based on a study done by AASHTO, we believe if railroads did not invest for growth, it would cost shippers and highway users an astonishing $1 trillion in 'collateral damage' from increased congestion and higher freight rates, not to mention the environmental impact. Why? Because trucks consume 3x as much fuel and charge 5x as much per ton-mile as

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rails, because highways cost 5-10x as much to build as rail lines, and because 1 train can move as much as 400 trucks.

Allowing shareholders to invest $100 billion so that taxpayers and shippers can save $1 trillion seems like an obvious public policy choice, and something everyone should agree to do, but the returns for shareholders need to be there.

Misperception #3: Railroads Still Owe For Their Land Grants

As surely as the Promontory Spike was driven into the ground, railroads have fully repaid the nation for the land grants they received, and actually done so "several time over." Two Federal agencies, Congress and the Supreme Court have all affirmed this. If anything, the government and the nation were the net beneficiaries of land grants, not the railroads.

The history of railroad expansion is a fascinating and instructive tale. Policymakers saw railroads as vital for strong national defence, developing the nation's vast western provinces and improving trade links with Asia. But Congress recognised the construction risks as "hazardous in the extreme", and thus provided inducements to the railroads to overcome the private sector's lack of enthusiasm for such a "forlorn hope". In the end though only 7% of the nation's rail system was built using land grants and only 12% of all land granted by the government went to the railroads.

Crucially however, these land grants were not gifts to the railroads. On the contrary, land grant railroads provided free or deeply discounted carriage to government traffic (especially the US military and the Post Office). Troops and supplies could now move quickly and cheaply to the West rather than make the perilous and costly journey around Cape Horn. The land grants were also intentionally "checkered" and because the newly laid rail lines provided access to markets the alternate patches of land the government kept usually doubled in value, offsetting the 'cost' of the land grants.

Decades later, two Federal agencies, Congress and the Supreme Court have all declared the railroads to be free of further obligations. In 1943, the Board of Investigation and Research concluded that the rate discounts "fully counter-balanced these aids which were given many years ago". In 1977, the Department of Transportation went further in saying "the federal government has been a net beneficiary of its railway aid program". The House said in 1945 that the time had come to "close its books" on the issue of land grants, the debt having "long been extinguished".

In fact, it was estimated that in 1946 the value of the land received by the railroads was $550 million. However, by then the value of government traffic discounts and appreciation of the checkered government land were worth $1.6 billion, or nearly 3x the value of the land grants. On top of that, railroad expansion enabled the colonization

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of the West, improved national security and created new trade links: all priceless benefits to the nation.

If this was not enough, most railroads have been in and out of bankruptcy after receiving grants. Readers of an esteemed legal journal such as this can probably agree that legacy debts should not continue to burden a company after a restructuring, any more than a father's debts burden his children. "Speak now or forever hold your peace" is as true in bankruptcy as in marriage.

There is absolutely no question that railroads play a vital role in America's infrastructure, but there is no basis we believe to treat railroads differently from other equally important industries. The perception that land grants, which in the end financed a very small part of the network and which were repaid several times over, result in an ongoing public obligation is unfounded given these facts.

Misperception #4: Railroads Are Over Recovering On Fuel

While many misperceptions are perpetuated innocently, this is one we find particularly misleading. So much so that if the "study" by Snavely King and the American Chemistry Council (ACC) which suggested that the railroads over-recovered fuel costs by $6 billion was audited in the same way as financial statements, it would be considered fraudulent we believe. We welcome conflicting data and different view-points, as they will result in a more enlightened view, but intellectual dishonesty such as that shown in the ACC study has no place in the debate and shouldn't be tolerated. When corrected, the same data suggests the railroads have actually under-recovered fuel expenses.

The ACC's methodology used to calculate the supposed over-recovery is flawed. Let's say you are a railroad and I contract with you for carriage. We agree a base rate of $100 and a fuel surcharge of $1 for every $1 that the oil price exceeds $20 per barrel; while simplistic this is basically what the fuel surcharge does, it compensates for fuel prices above a certain base level. If in year 1 the oil price is $20, then I should pay you only the $100 base rate. If in year 2 the oil price rises to $30, then I should pay you the $100 base rate + $10 fuel surcharge. Now lets say in year 3 the oil price stays at $30, should I owe you a fuel surcharge or not? Of course I should, and it should be $10 again as oil is $10 above the base level. But according to the ACC the study, you would be entitled to $0 in surcharge revenue because the oil price in year 3 didn't increase over year 2. In fact the ACC methodology is so absurd that if in year 4 oil went back to $20, it would suggest that the rate I pay you is $100 base rate – $10 = $90, because oil prices went down from year 3 to year 4.

This is simply not how the fuel surcharge works, or is meant to work, or how it should work. The fuel surcharge is meant to compensate for fuel prices above a certain

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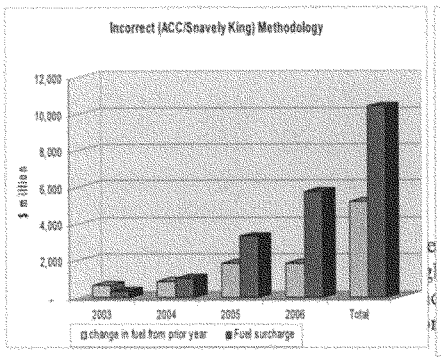
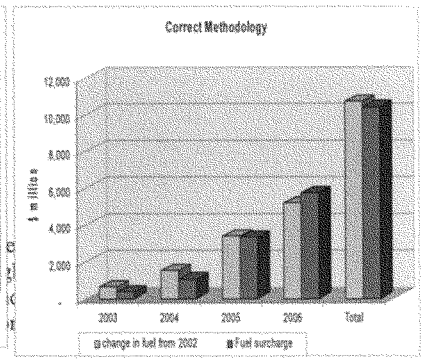
base level (2002), and all that matters is the fuel price this year versus that base year, not fuel price this year versus last year.





Misperception #5: Railroads are taking advantage of shippers by differential pricing

We often hear the complaint of one shipper saying he pays more than another shipper moving the same goods the same distance in another state, or similar complaints on the basic premise that all similar moves should pay similar rates. This is what pricing was like prior to Staggers, and resulted in a quarter of the industry being in bankruptcy. The fact is, you need people that can afford to pay more, or that cost more to service, to pay more than those who can not or do not. To understand why, we think airlines provide an instructive analogy.

It is almost certain that when you fly the people sitting next to you paid a different fare to fly than you, either higher or lower. One can argue that this isn't 'fair' as everyone is travelling on the same plane, getting the same meal and going to and from the same places. The reason airlines must charge this way, however, is that they are fixed cost businesses and therefore they need to get as many passengers on the plane as possible to dilute all of the fixed costs of flying. When a passenger pays a lot for a ticket (a fully flexible ticket for example), he allows the airline to charge discounted rates for other customers and thus attract flyers that otherwise wouldn't be able to afford flying. If on the other hand all passengers on the same flight had to pay the same price, there would be no 'discounted' fares and thus many passengers would no longer be able to afford to fly, and therefore the cost for each passenger that could afford to fly would go up (because you have the same fixed cost but fewer passengers from which to recover the costs). Therefore the airline fares must rise, which results in even fewer passengers (as even fewer can now afford to fly), which leads to even higher costs per passenger, which leads to even higher fares, and again the cycle continues. The result is the flight is either

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cancelled because there are not enough passengers to justify the flight, or the airline uses a much smaller plane and only the wealthy can afford to fly, and they pay even more than they used to pay on the bigger plane when more passengers helped offset the fixed cost. Who wins? Nobody really – those that can afford to fly will pay more than they used to, and many that used to be able to afford to fly on discounted fares can no longer afford to. The logic is no different if railroads are not able to differentially price – there will be less rail service, and those shippers that use it will pay more than they used to.

The simple truth is differential pricing brings down the overall cost per shipper, and thus the overall rates that shippers pay, by attracting as many shippers as possible to use the network. If you eliminate or limit differential pricing, railroads will be forced to abandon lines and rail rates will increase. Everyone loses – fewer jobs, less rail service, more trucks on the road, more pollution, and less profitable railroads. We view this as the unintended consequence of many sections of H.R.2125/S.953. Legislating the use of historic cost and subjecting railroads to 'baseball' arbitration are all forms of limiting or eliminating the ability for differential pricing.

Conclusion

We want railroads that are even safer, that provide better service, attract more customers, and therefore earn higher returns. We are committed to doing our part to achieve this objective. We ask others to be equally so. We ask rail managements to embrace change and look forward instead of backwards. We ask shippers and labor to be patient as we try to affect change to push for more constructive relations, a better and safer working environment and better service/value. We ask the regulators to provide a cheaper and faster rate case process (based on replacement cost) and a stable, fair and transparent regulatory framework that reflects economic reality. Lastly, we ask lawmakers to allow the forces for change to run their course, which will address many of the concerns we know exist today, and to consider all of the consequences of proposed legislation. Unintended or not, the consequences are real.

In closing, I'd like to leave you with the following quote by Paul Tellier, the former CEO of Canadian National Railroad: *"There will always be skeptics. We hear their voices whenever we try to do something that has never been done before in railroading"*

Thank you for your time today. I'd be pleased to answer any questions you might have.

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APPENDIX A

Key Facts	
Fund name:	The Children's Investment Master Fund (TCI)
Investment Manager:	The Children's Investment Fund Management (UK) LLP
Headquarters:	London, UK
Fund inception:	January 2, 2004
Assets:	$15bn+
Regulation:	Authorized and Regulated by the Financial Services Authority (FSA) in the United Kingdom

Investment Philosophy

TCI's mindset is to invest in businesses, not stocks. We perform thorough bottom-up research on companies and industries. TCI invests for the long-term – looking out decades, not just years or months. We are also firm believers in strong corporate governance, and the need to defend shareholders' rights. We strive to be active and constructive shareholders, including serving on boards of companies in which we have a significant investment, such as Link REIT (Honk Kong listed REIT, $5 billion market cap)

This long-term investment philosophy is supported by our capital base being stable. Our investors must commit their capital to us for a multi-year period.

We aim to perform not only for our investors, but also for charity. The majority of our profits are received by the Children's Investment Fund Foundation (www.ciff.org), a charitable foundation that focuses on helping impoverished children in the developing world.

TCI's principals are predominantly British, American and European.

Key Achievements	
Barron's:	"World's No.2 Best Performing Global Hedge Fund" based on cumulative returns over three years to June 30, 2007
Eurohedge Awards:	"Overall Fund of the Year" in 2004 and 2005 "Event Driven Fund of the Year" in 2005
Hedge Funds Review:	"Best New Launch" in 2004

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Investor Base By Geography		
US: 57%	Europe: 37%	Rest of the World: 6%
US Endowments and Foundations		
45 institutions	23% of assets	24 US university endowments
Other Investors		
European not-for-profits: 14% of assets		
Sovereign Wealth Funds: 1% of assets		

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Key Biographies – TCI Investment and Business Teams	
Christopher Hohn – Chief Investment Officer *Experience:* 2003- TCI, London – Managing Partner 1996-2003 Perry Capital – Portfolio Manager *Former Member of the Board of Rothschild Investment Trust (RIT): 2005-2007*	*Citizenship:* United Kingdom *Education:* 1991-1993 Harvard Business School, MBA 1985-1988 Southampton University (UK) BSc Accounting/Business Economics
Patrick Degorce *Experience:* 2003- TCI, London – Partner 1997-2003 Merrill Lynch Investment Management – European Equity Manager 1993-1997 CCF – Corporate Finance Associate	*Citizenship:* France *Education:* 1993-1997 Delta (France), Postgraduate 1992 Institut d'Etudes Politiques (France), BA Political Science, MPhil Economics
Snehal Amin *Experience:* 2004- TCI, London – Partner 2000-2004 Goldman Sachs, Vice President – Merchant Banking (Private Equity) 1995-1998 Goldman Sachs, Analyst – M&A Investment Banking	*Citizenship:* United States *Education:* 1998-2000 Stanford Graduate Business School, MBA 1992-1995 University of Michigan, BA

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Stuart Powers *Experience:* 2004- TCI, London – Partner 1998-2004 Cazenove – Sell Side Equity Analyst, European Markets 1994-1998 Deloitte & Touche – General Audit, ACA Qualified	*Citizenship:* United Kingdom *Education:* 1989-1993 University of Oxford, BA Modern Languages
Oscar Veldhuijzen *Experience:* 2005- TCI, London – Partner 2002-2004 Philips Investment Management, Investment Manager Asian Equities 2000-2002 Goldman Sachs, Asian Research Sales 1998-2000 Pictet Asset Management, Investment Manager Asian Equities 1997-1998 HSBC Capel, Research Analyst 1994-1997 General Electric, Global Financial Analyst	*Citizenship:* Netherlands *Education:* 1987-1992 Erasmus University Rotterdam, MSc Business Economics
John Ho *Experience:* 2005- TCI Asia, Hong Kong – Analyst 2003-2005 Citadel Investment Group – Senior Equities Analyst 2000-2003 The Boston Consulting Group – Consultant 1999-2000 UNSW Australia, School of Banking and Finance – Lecturer	*Citizenship:* Australia *Education:* 1995-1999 UNSW Australia, BComm Finance, BSc Mathematics

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Alexander Baring *Experience:* 2006- TCI, London – Partner 2001-2006 JP Morgan Cazenove – Pan-European Sell Side Analyst	*Citizenship:* United Kingdom *Education:* 1997-2000 Bristol University, MSc Physics and Philosophy
Rishi Sunak *Experience:* 2006- TCI, London – Partner 2001-2004 Goldman Sachs – Analyst Executive Director – Merchant Banking (Private Equity)	*Citizenship:* United Kingdom *Education:* 2004-2006 Stanford Graduate Business School, MBA (Fulbright Scholar) 1998-2001 University of Oxford, BA Philosophy, Politics and Economics
Shen Li *Experience:* 2007- TCI Asia, Hong Kong – Analyst 2005-2006 Texas Pacific Group – Analyst 2004-2005 Morgan Stanley Real Estate Fund – Analyst 2001-2004 Morgan Stanley Investment Banking – Analyst	*Citizenship:* Hong Kong *Education:* 1998-2001 Columbia University – MSc Financial Engineering, BSc Applied Mathematics

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Philip Green *Experience:* 2007- TCI, London – Partner 2002-2007 Merrill Lynch – Sell Side Analyst 1995-2002 Goldman Sachs – Analyst/Co-Head Pan European Utilities 1994-1995 Lehman Brothers – Side Sell Analyst 1982-1994 PriceWaterhouseCoopers – Audit and Corporate Finance, Privatization, ACA Qualified	*Citizenship:* United Kingdom *Education:* 1978-1982 University of Newcastle Upon Tyne, BSc Geotechnical Engineering
Fernando Delgado Nevares *Experience:* 2007 TCI, London – Partner 1997-2007 Cazenove – Director/Analyst 1995-1997 Stone & McCarthy Research – Analyst 1994-1995 Arthur Andersen – Audit Assistant	*Citizenship:* *Spain* *Education:* 1989-1993 ICADE, ESC REIMS – Diploma
Robb LeMasters *Experience:* 2008- TCI, London – Partner 2004-2007 Highbridge Capital Management – Vice-President Rel Value / Event Driven Group 2001-2003 Forstmann Little – Analyst 1999-2001 Morgan Stanley – Financial Analyst, M&A and Restructurings	*Citizenship:* United States *Education:* 2003-2005 Harvard Business School, MBA 1995-1999 University of Pennsylvania – The Wharton School, BSc Economics

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Joseph O'Flynn - Chief Financial Officer *Experience:* 2006- TCI, London – CFO 2004-2006 Merrill Lynch – Equity Financing Control 1996-2004 Goldman Sachs, Finance and Regulatory Reporting 1992-1996 Moylan Mulcahy & Co.	*Citizenship:* Ireland *Education:* 1988-1992 University College Cork, BComm, FCA Qualified, Member of Institute of Chartered Accountants, Ireland
James Hawks – General Counsel *Experience:* 2006- TCI, London – General Counsel 2001-2006 Baker & McKenzie – Senior Associate, Tax Division 1998-2001 Taylor Joynson Garrett, Tax Associate 1997-1998 Treasury Solicitors, Lawyer	*Citizenship:* United Kingdom *Education:* 1992-1996 Bristol University, LLB Law Degree ICSL Bar Vocational Course
Rahul Moodgal – Head of Investor Relations *Experience:* 2005- TCI, London – Head of Investor Relations and Business Development 2004-2005 Union Bancaire Privee – Senior Client Relationship Manager 1998-2004 TT International – Client Relations and Business Development 1995-1998 Keele University – Lecturer in International Relations	*Citizenship:* United Kingdom *Education:* 1995-2005 London School of Economics, MPhil Economics 1994-1995 London School of Economics, MPhil Government 1993-1994 Cambridge University, MPhil Economics and Politics of Development 1990-1993 Keele University, BA International Relations and Chemistry

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Board of Directors of TCI

Christopher Hohn | *Citizenship:* United Kingdom

Christopher Hohn was the Portfolio Manager leading the European event driven investment strategy at Perry Capital from 1997 to the start of 2003. This strategy employed capital in the main Perry Partners L.P. fund from 1997 to 2003 and from June 2000 to May 2003 in the separate Perry Capital European Fund ("PEF"). PEF was awarded the Eurohedge Event Driven Fund of the Year in 2001 and 2002. He led the establishment of a London office for Perry Capital in 1998. From 1994 to 1995, he was an Associate at Apax Partners in London and from 1989 to 1991, a Manager in the Corporate Finance Division of Coopers and Lybrand in London. Mr. Hohn joined Perry Capital in 1996. Christopher graduated from Harvard Business School in 1993 with an MBA (high distinction) and from Southampton University (UK) in 1988 with a BSc. in Accounting and Business Economics (1st Class Honors) in 1988. He is a Chartered Financial Analyst.

David DeRosa | *Citizenship:* United States

David DeRosa is the president of DeRosa Research and Trading, Inc. He is also an Adjunct Professor of Finance and Fellow of the International Center for Finance at the Yale School of Management. In previous times he was a Managing Partner of Quadrangle Investments, LLC, a hedge fund, and before that a Director of Swiss Bank Corporation's proprietary foreign exchange trading group. Dr. DeRosa received his Ph.D from the Graduate School of Business of the University of Chicago in finance and economics and his A.B. in economics from the College of the University of Chicago. He is the author of "*In Defense of Free Capital Markets / The Case Against A New International Financial Architecture*" (Bloomberg Press 2001), "*Options on Foreign Exchange*", *second edition (Wiley) 2000)*, "*Managing Foreign Exchange Risk*" (Irwin 1996), and is the editor of "*Currency Derivatives*" (Wiley 1998). He serves on the boards of directors of funds managed by Rubicon Fund Management, BlueCrest Capital Management, GSA Capital Management and Preston Capital Management.

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Linburgh Martin	*Citizenship:* Cayman Islands

Linburgh Martin is the Managing Director of Close Brothers (Cayman) Limited. He is a member of the Institute of Chartered Accountants in England & Wales and a member of the Society of Trust and Estate Practitioners. He is a former trustee of the Public Service Pension Board, a former council member of the Cayman Islands Society of Professional Accountants and a former member of the board of directors of the Cayman Islands Monetary Authority. Upon graduating from the University of Kent at Canterbury, Linburgh joined Ernst & Young in London. Having completed his training and qualifying as a Chartered Accountant he returned to the Cayman Islands practice of Ernst & Young in the audit division. During his time in the audit division in London and the Cayman Islands he managed a portfolio of clients which included insurance companies, banks, hedge funds and large manufacturing concerns. In 1994 he moved to Chartered Trust, which was an affiliate of Ernst & Young. He became managing director and a shareholder in 1998. Chartered Trust was acquired by Close Brothers Group plc ("Close Brothers") in April 2001. Chartered Trust has been integrated into Close Brothers and now operates as Close Brothers (Cayman) Limited, which is licensed by the Cayman Islands Monetary Authority to provide trust, company and mutual fund administration.

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October 16, 2007

Board of Directors
CSX Corporation
500 Water Street
Jacksonville, FL 32202

Dear Board of Directors:

As you are aware, The Children's Investment Master Fund (TCI) is a long-term, value-oriented investment fund that currently owns 17.8 million shares, or 4.1% of CSX. This makes TCI one of CSX's largest shareholders. TCI is an engaged, long-term investor with a track record of helping companies reach their potential with management's cooperation, or without it. While some investors seek short-term gains, TCI has a long-term view – our outlook is decades, not years, or months, or weeks.

Over the past year we have repeatedly, but unsuccessfully, attempted to engage in a constructive dialogue with the Board and top management of CSX on concerns we have about the business. Except for a single 'one-on-one' meeting with Oscar Munoz, top management and the Board have refused all our offers to meet privately. Over the past few months, CSX has refused even to return our calls or to allow us to attend meetings at CSX with an analyst and other investors.

Instead CSX management has opted to communicate through a paid advertising campaign and an abbreviated investor day. The investor day reaffirmed to us the weakness of the CSX management team and strategy. We conclude this weakness must be made public as our attempts to discuss it privately have consistently been rebuffed. We do so in the interest of TCI investors, as well as CSX employees, customers and shareholders.

It is our view that CSX management does not fully understand the economics of the business, is cavalier about potential risks, is undisciplined about spending, is unrealistic about future prospects, is complacent about operational under-performance and is unnecessarily adversarial towards labor, shippers and shareholders. We hold the Board accountable for these failings.

We have a simple long-term desire – a stronger CSX. CSX has the potential to be the leading railroad in the United States – providing the best service, running the safest network, generating the highest returns and thus able to invest to fully meet America's freight transportation needs now and in the future. CSX's legacy dates back to America's first railroad; it should return to its rightful place as America's best.

Unfortunately, the glaring and unavoidable fact is that on virtually every major metric of operational and financial performance, CSX today is last or near last among the five major North American railroads. Perhaps the only exception is executive compensation – Michael Ward made $36 million over the past two years, the highest compensation of any CEO in the industry.

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The issues at CSX are real, meaningful, and addressable. We therefore urge the Board to act immediately and act voluntarily to strengthen CSX's corporate governance, management, business performance, and the Board itself. The Board should:

- Separate the Chairman and CEO roles
- Refresh the Board with new independent directors
- Allow shareholders to call special shareholder meetings
- Align management compensation with shareholder interests
- Provide a plan to improve operations
- Justify the capital spending plan
- Promote open and constructive relations with labor, shippers and shareholders

Failure to take these actions would, in our opinion, be negligent of your duty to shareholders.

We urge the Board to be open-minded as it reads this letter as we share a common goal – to ensure that CSX is a strong and viable company able to provide the service that its shippers demand, a working environment that its employees can be proud of, and the returns that its shareholders deserve. Achieving operational excellence and maximizing shareholder value are inextricably linked, not mutually exclusive.

We also urge open-mindedness as the views and frustrations expressed in this letter are widely held. Relations with labor, shippers and shareholders are strained. The Board should question whether the views of so many constituencies could really be wrong. The Board should also question why Warren Buffett, a legendary investor known for identifying and backing good management teams, has chosen to invest in each of the major US railroads, except CSX.

Not open to question is the fact that CSX lags its peers on almost every major operational and financial metric. It is not just the fact that CSX ranks poorly on these metrics that causes us concern. It is the fact that management refuses to acknowledge the underperformance, discuss it with shareholders, or present a plan to address it.

The Board should know that TCI is also a shareholder in other US railroads. However, the other management teams have been willing to engage in an open and constructive dialogue with us, through which we have gained confidence in their abilities and strategies. We had hoped for a similarly constructive relationship with CSX.

CSX has a long and rich tradition. It is an essential part of America's infrastructure and commerce. It is a vital artery for thousands of businesses, large and small. It is the fruit of labor and source of livelihood of tens of thousands of workers. It helps fund retirements, scholarships and the lives of hundreds of thousands of investors through pension funds, university endowments and personal investment accounts. A CSX that operates at anything less than its fullest potential is a disappointment and disservice to all.

I. Corporate Governance

Sound corporate governance is essential to successful performance – it provides checks and balances, accountability and aligned incentives. Corporate governance at CSX is lacking in all of these criteria and shareholder confidence in the Board needs to be restored. We therefore ask the Board to take the following actions:

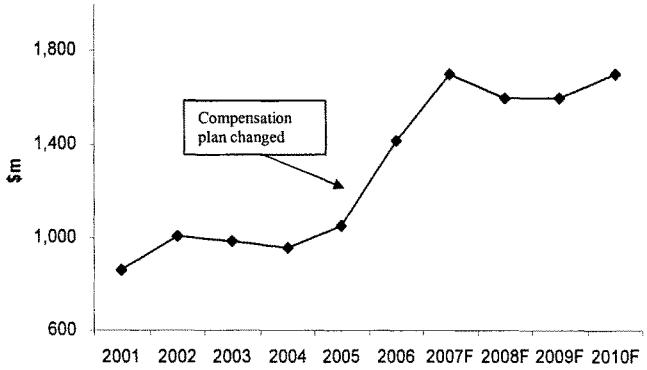
- **Separate the Chairman and CEO Roles**. This is widely recognized as a 'best practice' in corporate governance; how can a Chairman independently question his own failings as a CEO? Further, we believe Michael Ward's interests are not reflective of and not aligned with CSX shareholders. His comments in a recent Bloomberg interview are telling – in response to a question on how CSX would spend its cashflow, he drew an analogy to a farmer winning the lottery who, when asked how he would spend the winnings, answered that he would "keep farming *until every penny of it is gone*." The farmer may do as he wishes with his own money, but Michael Ward is managing ours – the shareholders'. We fear he wants to spend everything he can, whether it creates shareholder value or not. His consistent personal sales of CSX stock while increasing CSX's spending speaks volumes, as if to say "this spending is good enough for your [shareholder] capital, but not good enough for mine."

- **Change Board Composition.** While one independent director has some railroad background, not a single independent director has direct railroad management experience, leaving the Board unable to credibly challenge management. In addition, over half of the independent directors have been on the Board for over a decade, leading us to question their independence, as does the fact that our requests to the Board to discuss concerns about management were flatly denied. Who should shareholders speak to on these issues if not the independent members of the Board? The Board needs to be refreshed with new independent directors acceptable to large shareholders, including TCI, who not only respect and invite the views of shareholders, but also have the railroad or other relevant business expertise to challenge management, and the courage to do so. Shareholder confidence in the Board needs to be restored.

- **Allow Shareholders to Call Special Meetings**. At CSX's most recent annual shareholder meeting, shareholders voted *overwhelmingly* (nearly 2.3 votes in favor for every 1 vote against) in favor of amending the bylaws to allow shareholders to call special meetings, and yet the Board has failed to act on this. We believe the threshold should be set at 10% for any individual or group of shareholders. Michael Ward said at the investor day that allowing shareholders to call special meetings was still under consideration by the Board. We view this statement as disingenuous – it does not (or certainly should not) take five months to make this decision. In fact, the Board has found the time to amend the bylaws twice since the shareholder meeting, including incorporating the majority voting resolution, which passed by a much smaller margin (only 1.3 votes in favor for every 1 vote against). If the Board has decided to ignore the views of its shareholders, it should immediately make that decision public. Ignoring the issue, or the shareholders who care about it, is poor corporate governance, and unwise.

- **Align Management Compensation with Shareholder Interests.** Shareholder value is created by increasing returns on capital, and that is how management should be compensated. In fact, that is largely how they are compensated at the four other large Class I railroads. However, at CSX long-term executive compensation is now predominantly tied to the company's operating ratio. Improvements in the operating ratio can be 'gamed' by accounting adjustments or re-allocations from operating costs to capex, and 'bought' by investing in projects that would directly or immediately improve the operating ratio instead of projects that earn the best risk-adjusted returns on capital. For example, it provides a clear incentive to buy assets instead of lease them, irrespective of which is better economically[1]. We note that since the Board changed compensation away from free cash flow, CSX's annual capex budget has increased by over 50%.

CSX Capex



[1] The $200 million project highlighted at the investor day to replace leased with owned locomotives illustrates this point. There are two effects from this that improve the operating ratio. First, it will move the financing component of lease expense (currently an operating cost) to interest expense. Second, the lease term is typically shorter than the depreciable life, so lease expense is being replaced by a smaller depreciation expense. These effects would occur irrespective of whether the transaction truly created shareholder value. Therefore management would be able to improve the operating ratio, and increase its compensation, despite not creating shareholder value.

II. Operational Improvement

CSX is not a well run railroad in our opinion. Unlike management, TCI does not benchmark relative to history and claim success; we benchmark relative to potential and assess failure. As you can see below, CSX is last or near last among the five major North American rails on almost every key operational metric (ranking is best at top to worst at bottom)[2].

Velocity	Dwell Time	Accident Rate	Labor/Sales	Cost Inflation	Cost / Unit Inflation
CN	CN	NSC	CN	CN	CN
BNSF	NSC	CN	BNSF	NSC	NSC
UP	BNSF	***CSX***	NSC	UP	UP
NSC	***CSX***	BNSF	UP	***CSX***	BNSF
CSX	UP	UP	***CSX***	BNSF	***CSX***

While the type of network can make a difference, this chart makes clear that CSX's underperformance is not due to its network type – there is one of each type of railroad (eastern, western and Canadian) that consistently outperforms CSX. The issue is management. This is our belief, the belief of nearly every ex-railroad (including ex-CSX) executive and employee we have spoken with, the belief of nearly every railroad research analyst, and it is what the data shows. We simply cannot ignore all of these views and facts. The following from industry analysts sum up well what we believe is a commonly shared view:

> *"...we see no reason why initiatives at CSX cannot result in substantially better margins. A failure to achieve such margins over time could suggest it is more an issue of management." William Greene, Morgan Stanley*

> *"We think ~6% price increases and mid-single digit y/y gains in average train speeds and terminal dwell should be generating more operating margin improvements than we've seen so far. There's still a lot of fat on this pig." Rick Paterson, UBS*

A well run business with sound corporate governance would never be referred to as a 'pig.' The fact that CSX is because of its weak management is tragic. CSX is a coveted franchise with a storied history – the Board shouldn't tarnish this by giving anyone reason to refer to the company in this way.

While the underperformance is dramatic, management's refusal to acknowledge it compounds our concern. At the investor day, management once again failed to provide any specific long-term operating targets. Management's operating ratio target (low-to-mid 70s operating ratio by 2010) can be achieved by price increases alone, as the following analysis illustrates. This leaves

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[2] TCI Analysis. Based on publicly available data for 12 months ended June 30, 2007. Cost inflation is based on operating expenses excluding fuel and depreciation.

us to conclude that management has no plan to improve the operations, or at least not a plan they can be held accountable for by shareholders.

	2007	2008	2009	2010
Revenue	10.0	10.6	11.1	11.7
price growth		*5.5%*	*5.5%*	*5.5%*
volume growth		*0%*	*0%*	*0%*
Operating expenses	(7.8)	(8.0)	(8.3)	(8.5)
cost inflation		*3.0%*	*3.0%*	*3.0%*
Operating income	2.2	2.5	2.9	3.2
Operating ratio	***78%***	***76%***	***74%***	***73%***

The analysis set forth above assumes *no* volume growth, *no* earnings contribution from growth investment and *no* productivity or efficiency improvement. Nevertheless, the operating ratio achieves management's 'low-to-mid 70s' target by 2010[3].

The lack of spending discipline seems to us to be cultural. Take for example the fact that every major US railroad has responded in some way to the current soft environment, except CSX. Norfolk Southern, already noticeably more efficient than CSX, cut operating costs so that in H1 2007 they were actually 2% *below* the absolute level of costs in H1 2006, despite inflation; in contrast, CSX's costs are *up* 4% in the same comparison. Burlington Northern *cut* its 2007 capex budget *twice* (in contrast, CSX *raised* its capex budget *twice*). Union Pacific has managed to keep cost growth lower than CSX despite having much stronger volumes.

The inescapable conclusion is whatever CSX is doing, it could be doing it better and its competitors, in fact, are. Since Michael Ward was appointed CEO, the gap in operating ratio between CSX and both Norfolk Southern and Canadian National, the industry leaders, has actually widened. Yet somehow the Board has found it acceptable to make Michael Ward the highest compensated CEO in the industry over the past two years. We must question the Board's judgment.

While we recognize that CSX's share price has performed well over the past several years, and its operations have improved, we note that both improvements are off of a low base; this low base seems largely attributable, to us, to poor execution of the Conrail integration. As a senior manager at CSX over the past decade, and in particular as the VP responsible for the Conrail merger planning and integration, Michael Ward was at least partly responsible for CSX being at that low base in the first place. It seems irrational to us to reward someone merely for making some progress towards getting the company out of a mess he was largely responsible for getting the company into. Frankly, a similar logic could be applied to longstanding members of the Board.

[3] TCI Analysis. Pricing assumption based on an extrapolation of management guidance.

We therefore recommend the Board and management take the following actions:

- **Present to shareholders a detailed and credible plan to improve operations.** Investors need both a clear idea of management's view of the potential to improve the business as well as yardsticks to judge their ability to execute on their plan. This requires a detailed operating plan with specific long-term operational and cost targets, not simply operating ratio targets (as the operating ratio is impacted by both price and operations).

- **Re-evaluate the absolute levels of management compensation.** In addition to changing the primary metric on which compensation is based, the Board should consider whether the absolute levels of payouts are reasonable. To be clear, we have no issues with managements being well paid. However, we have serious issues with managements being overpaid (i.e., well paid but under-delivering).

III. Returns on Capital

Does the Board really believe CSX is close to earning its cost of capital? Economically, CSX earns just a 1-3% return on its capital, not the ~9% management proclaimed at their investor day[4]. While return on invested capital (ROIC) may be used for accounting or regulatory purposes (inappropriately we believe), it shouldn't be the focus of dialogue between management and shareholders if it doesn't reflect economic reality. In this case, it certainly does not. We are therefore surprised that management chose to focus on ROIC and disappointed that we as shareholders, instead of the Board or management, must explain how to evaluate true economic returns for the company you are entrusted to manage. We question whether CSX management understands the economics of the business. If they do, they are being disingenuous in asserting they have 'earned the right to spend' because CSX is close to earning its cost of capital; obviously this claim cannot be made on the true returns.

Returns must be calculated on the fair value of the capital today. This is best approximated by replacement value, which we estimate is close to $100 billion for CSX, as opposed to the approximately $16 billion management uses as a capital base. The $16 billion is the invested capital *at historic cost* as opposed to at today's cost. Why does management, and the Board, believe CSX should earn a fair return only on the historic cost of its land and network as opposed to the value of that land and network today? You cannot buy the land for the same price as you could in the 1800s, nor can you buy locomotives for the same price as you could 30 years ago, nor can you replace rail for the same price as you could 20 years ago. Using historic cost is the same flawed logic as a landlord charging rent on a 100 year-old home based on what it cost to buy the land and build that home 100 years ago, as opposed to a rent based on the value of that home today.

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[4] CSX earns a taxed-EBIT of roughly $1.3 billion, which is a 1% return on the $100 billion replacement value we estimate. No matter how one calculates replacement value, it is unthinkable that the replacement value for CSX could be below $50 billion, implying at most a return of 3%.

In our mind there is simply no justification for publicly asserting to shareholders that CSX is "achieving returns approaching cost of capital in 2007" when the reality is CSX's returns will likely not approach its cost of capital for decades.

We therefore ask the Board and management to take the following actions:

- **Present a corrected *Stronger Returns on Long-term Investments* slide.** Management needs to present to shareholders a truer reflection of the returns CSX generates. This requires an estimation of replacement value, but even a rough approximation of replacement value will suffice to make the point. It is better to be approximately right than precisely wrong.

- **Ensure that all returns-based decisions reflect economic reality.** There are many decisions that management and the Board make based on return on capital, including pricing and capital investment decisions. We fear these decisions are being made on overstated returns, leading to wrong decisions.

IV. Capital Spending

US railroads could require up to $150 billion of growth investment over the next 30 years to meet America's growing freight transportation needs. CSX's management is putting the ability of CSX, and the other major US railroads, to make the needed future investments at severe risk by advocating an illogical and undisciplined capital spending plan. Reckless spending will undermine confidence in CSX and the railroad sector, and will result in less access to capital for them all. This is of great concern to us, as we firmly believe that shareholder value is created through *sustainable* investment in safety, maintenance, infrastructure and training.

Recognizing this fact, the CEOs of all of the major US railroads, with the notable exception of Michael Ward, are trying to establish credibility as *disciplined* guardians of capital, as their comments in recent letters to the STB show:

> *"As a private company, BNSF will only invest in added capacity to the extent we believe we can earn an adequate return on those investments." Matt Rose, CEO of Burlington Northern*
>
> *"Increased investment in additional capacity cannot always be economically justified if it becomes questionable whether a company can meet its cost of capital on an ongoing basis." Wick Moorman, CEO of Norfolk Southern*
>
> *"The owners of the Union Pacific (our shareholders) have a fiduciary responsibility to ensure that management will operate the Company in a profitable manner and make prudent decisions regarding future capital investments." Jim Young, CEO of Union Pacific*

These CEOs recognize that capital spending must be economically justified, as the inevitable consequence of spending recklessly is losing the confidence of the owners of the business, who

will have no choice but to restrain future capital spending. Individuals who overspend lose their creditworthiness and thus their ability to spend in the future. The underlying logic and result is no different for shareholder-owned companies.

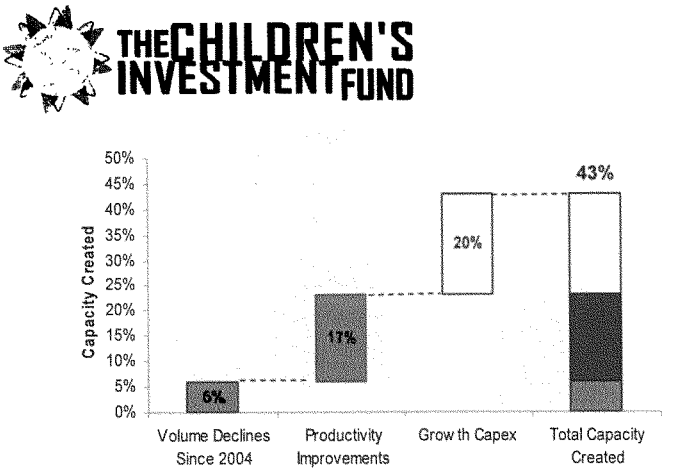
Further, just as over-extended subprime lending has resulted in a crisis of confidence among all lenders – resulting in even prime borrowers now finding it difficult to obtain mortgages – CSX's undisciplined spending plan could prove damaging for all US railroads, even the disciplined ones. Unfortunately, as many companies and sectors have learned, once confidence is lost it can take years or decades to be re-established.

So while Michael Ward's seeming objective to spend "until every penny of it is gone" may sound like it addresses the long-term investment need of the industry, it actually undermines it. Reckless spending is a short-term strategy, with the dire long-term consequence of less access to capital for CSX and other US railroads. US railroads are in the infancy of a very exciting growth phase; CSX management should not ruin it by undermining shareholder confidence, as they are doing.

To protect CSX's ability to invest sustainably in the future, the Board must work to re-establish shareholder confidence. This confidence has been undermined by management's unwillingness or inability to justify a capital spending plan that seems totally out of touch with the economic reality, as well as by glaring inconsistencies between management's statements and actions regarding maintenance capex.

Growth investment. Management has consistently over-estimated volume growth for CSX, and as a result has spent for growth that CSX has not delivered. At CSX's 2005 investor day management forecasted annual volume growth of 2-3%, accommodated by $1.2 billion in annual capex. Since then volumes have declined and yet the capex budget has increased.

We firmly believe in making investments to meet the future needs of the business, but the estimate of future needs should be realistic and credible. Estimating that CSX volumes will be 43% above current levels by 2010 is neither. Yet 43% growth by 2010 seems to be what management is estimating, as the following analysis illustrates:



Please refer to footnote 5 for details

The ~23% spare capacity CSX already has (6% volume decline + 17% capacity created through productivity) seems adequate for a decade of 2-3% annual volume growth. Yet management has increased the capex budget *twice* in 2007. It is certainly reasonable for shareholders to question why management believes 43% volume growth by 2010 is realistic, especially in light of a weakening and uncertain US economy, and considering management's consistent over-estimation of volume growth historically.

We acknowledge these are very rough system-wide approximations, but even if the estimates are half of these amounts, what leads management to conclude volumes will be even 20% higher than current levels by 2010, much less 43% higher? We are not the only ones seeking an answer to this question – the JP Morgan analyst commented after the investor day as follows:

> *"We walked away without much conviction or visibility to how they will transition from several years of no volume growth to meaningful volume growth in the future"*
>
> *"We lack visibility to improved volume performance for CSX that would help justify the strong investment"*
>
> *"In our view, the combination of a very strong capital spending plan with an unfavorable medium-term volume outlook is not a good recipe for upside for this stock"*

---

[5] TCI Analysis. 43% comprised as follows: (i) 6% volume decline since 2004 implies at least 6% excess capacity today; (ii) since Q2 2004 dwell time and velocity have improved by 18% and 5% respectively, which we estimate creates 17% capacity assuming trains spend 90% of their time dwelling and 10% moving; (iii) management stated at the 2005 investor day that capex equal to 12-13% of revenue would finance 2-3% volume growth, implying roughly $100 million of capex for 1% volume growth. The 2007-2010 capital budget includes over $2 billion of expansion capex (per Oscar Munoz's presentation at the Merrill Lynch conference, June 2007), so approximately 20% volume growth.

There is a striking analogy here, with important lessons that hopefully do not have to be re-learned. The last time mature network-oriented businesses expected this type of growth was the telecom companies in the dot com era. Almost without exception, the growth did not materialize, huge value was destroyed, the management teams were replaced and access to capital thereafter was (and in many cases still is) significantly diminished. Confidence in the telecom sector has still not fully recovered.

Management may argue that the capital spending is not just for capacity increases, but also for productivity gains and efficiency improvements. However, in the railroad business, productivity gains are essentially capacity increases and, as discussed, management's operating ratio guidance seems to include no benefits from productivity or efficiency gains. All of this begs the question – where is this $2 billion of shareholders' capital going, and for what returns? The Board should be asking this question, but management's inability to answer it leaves us to conclude that it isn't.

Maintenance capex. Senior management had *repeatedly* told us in the past that they had *not* been under-investing in the network and there was no further 'catch-up' capex required post-2006[6]. Yet at the investor day management announced a huge increase in the annual rail and tie replacement program and suggested they had underspent previously; this was the message that the market took away:

> *"Detailed capex forecasts suggest underspending in prior years, which could hinder future returns...In fact, Michael Ward, the company's CEO, suggested that the company's irregular capital spending in prior years may be to blame for some of the higher capital expenditures near-term" William Greene, Morgan Stanley*

Based on GTMs and useful lives, the old level of rail and tie replacement seems appropriate, and it is also consistent (GTM-adjusted) with the replacement program at Norfolk Southern, widely considered the industry leader in network maintenance. This would suggest that management is now bloating the maintenance capex budget and wasting valuable shareholder capital. Alternatively, we could conclude that management *had* under-invested and had misled us and others about doing so. If this was the case, we find the under-investment of capex when compensation was free cashflow-based, and then catching up on capex once the compensation system had moved away from free cashflow, to be questionable at best.

Not only is confidence in CSX management undermined by a capital spending plan that seems economically unjustifiable and inconsistencies related to maintenance capex, it is also undermined by their advocating an approach to capital allocation, the 'balanced approach', which lacks financial logic. The 'balanced approach' is an easy way out for a management that is unable or unwilling to truly distinguish the merits of various options for capital deployment.

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[6] In late 2006 both Oscar Munoz and David Baggs told us on different occasions that maintenance capex would be $850-900 million. Alarmingly management has raised this by over 25% to $1.1 billion in the latest capital budget (per Oscar Munoz's presentation at the Merrill Lynch conference, June 2007).

Capital should be allocated to where it is able to achieve its highest long term, risk-adjusted return.

Instead CSX is allocating capital based on an arbitrary 'balance' and a pre-determined preference, based on Michael Ward's comments, to invest in new projects irrespective of whether better returns can be achieved elsewhere, and to return capital to shareholders via dividends instead of share repurchases, despite the stock being fundamentally cheap in our opinion[7].

A company's ability to invest continuously for the long-term rests on management's ability to maintain confidence and credibility with its shareholders. CSX is not an exception to this rule, and this confidence does not exist today. To re-establish it, management and the Board need to prove rationality, discipline and integrity to us and the other shareholders. Capital allocation deserves rigorous analysis and a transparent and financially solid logic. Management has provided none of that in our view. We therefore ask the Board and management to take the following action:

- **Justify the 2007-10 capital spending plan to shareholders.** It is time to shed biases, be transparent and realistic, and commit to deploying capital in the best interest of shareholders. Management should present details of each key project in the capital plan, the main pricing and volume assumptions, and the expected after-tax returns, so if growth investment is resumed it is done with the support of shareholders[8]. We acknowledge that this level of disclosure is not customary, but it is necessary – the Board has failed to provide proper oversight and discipline, so the shareholders must. Shareholders need the information to hold management accountable for delivering returns. It is, after all, our capital.

V. Response to Regulatory Pressure

Over the past year, the STB has issued several decisions against the railroads, including those related to smaller shipper rate cases, fuel surcharges and the cost of capital. The STB's slashing of the cost of capital coupled with a refusal to simultaneously consider replacement cost has significantly increased regulatory risk.

We do not believe CSX management fully appreciates the regulatory and legislative risks facing the industry. In fact, CSX management is fanning the anti-rail flames and thus only increasing these risks by massively overstating CSX's true returns.

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[7] We recognize that CSX's returns significantly more capital via buyback than dividends. However, Oscar Munoz's statement at the investor day is alarming, "our Chairman in particular has a strong affinity for returning value to share owners through this methodology [dividends]." The buyback versus dividend decision should be based on what most shareholders desire and on whether the stock is cheap or not. It should not be based on a Chairman's attachment to dividends.

[8] As discussed further in this letter, all growth capital spending should be frozen until the heightened risk of re-regulation passes. If the risk passes, management should proceed with a plan that is economically justified to shareholders.

We therefore ask the Board and management take the following actions:

- **Educate policymakers and regulators on the true state of the industry.** US railroads earn lower economic returns than almost any industry in the world, and CSX earns among the lowest returns even within that group. Instead of portraying this truthful state of the industry, management is focused on developing a paid advertising campaign about how wonderfully CSX is performing. In addition to being a waste of management time and shareholder money, it is simply not true. CSX needs to stop the sloganeering and start the education. If railroads can not earn adequate returns on replacement value they cannot justify investment, which means even more trucks on the highway, even more shippers complaining about service, and even more pollution in the atmosphere.

- **Provide the STB a practical methodology to estimate replacement value.** Replacement value or current cost accounting are widely accepted and used standards for both accounting and regulation around the world. In its recent cost of capital decision, the STB not only opened the door for the railroads to present a methodology that would allow calculation of returns on replacement cost, but cited its predecessor, the ICC, in saying that a replacement cost methodology was *preferable* to use of historic costs. Yet, the STB also has claimed that a practical methodology for estimating replacement cost has not been presented to it. This is a dramatic failure on the rail industry's part, and it needs to be rectified immediately by CSX alone or in conjunction with other US railroads.

- **Freeze growth investment until the fate of the re-regulation bill is known.** It is irresponsible to make long-term investments without knowing the long-term returns, and the long-term returns are unknowable while the re-regulation risk persists at this heightened level. This is a sad outcome, and ironic as Washington acknowledges the railroads' need to make long-term investments, and yet it is the uncertainty emanating from Washington that ensures such investments cannot be justifiably made.

VI. Management Approach to Key Constituencies

It is completely counter-intuitive to us that at the time of the brightest long-term prospects for the industry, putting the heightened risk of re-regulation aside, CSX has managed to alienate its workers, its customers, and its owners. Railroads are unique in American industry in that they have the largest self-managed workforce in the country, touch nearly every sector and every community, and re-invest the highest level of capital per revenue dollar of any major industry. Thus, while good relations with workers, customers and owners are always important, they seem essential for railroads.

Yet, in our experience, and those relayed to us by others, CSX management has too often taken an 'us versus them' approach, resulting in tension instead of solutions. We strongly urge the Board and management to re-evaluate this adversarial approach, as workers will be more productive, shippers more accommodating, and shareholders more understanding if management fosters an open, collaborative and constructive relationship with all of them. All of our interests should be, largely, aligned.

We hope you receive this as a constructive letter from an informed shareholder with a simple aim – a better and stronger CSX. We have no desire to be disrespectful to the Board or the management team. Our views of CSX, as with all of our investments, are based on the facts. We do not have preconceived notions of the right actions or strategies a company should pursue. We have supported management in many of the companies in which we invest, and opposed it in others. We have supported acquisitions and increased investment in some companies in which we invest, and opposed it in others. Our view is always informed by an open-minded and objective assessment of the facts and the situation. As our record shows, our views have usually proven over time to be in the best long-term interest of the companies in which we invest. To us, this is being a good shareholder, and that is what we strive to be.

We hope you appreciate that it is incumbent on us to raise these issues on behalf of all of the stakeholders of CSX, and as we are guardians of others' capital and have a duty to act in their best long-term interests, as you do to act in ours, the shareholders'.

We sincerely hope you will act now -- and act voluntarily -- to address the serious issues facing CSX. We are available, as always, to discuss issues relevant to CSX.

Sincerely,

Chris Hohn
Managing Partner

Snehal Amin
Partner

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TCI AND 3G FORM GROUP OWNING 8.3% OF CSX SHARES AND AN ADDITIONAL 11.8% ECONOMIC INTEREST

PLAN TO NOMINATE MINORITY BOARD SLATE OF FIVE DIRECTORS

NEW YORK, DECEMBER 19, 2007 – The Children's Investment Fund Management (UK) LLP ("TCI") and 3G Capital Partners, LTD. ("3G") today filed a Schedule 13D with the Securities and Exchange Commission disclosing that they and several individuals have formed a group ("Group") whose members own in the aggregate 8.3% of the outstanding common shares of CSX Corporation (NYSE: CSX). The members of the Group also hold derivative securities providing economic exposure equivalent to an additional 11.8% of CSX's outstanding shares.

The filing also disclosed that the Group intends to nominate five directors for election to the Board of Directors of CSX at its 2008 Annual Meeting of Shareholders.

The Group believes its nominees will strengthen CSX's Board by adding strong independent directors with a shareholder orientation, a broad range of railroad and other relevant experience, and a firm commitment to improving CSX's operating performance and corporate governance.

Christopher Hohn, Managing Partner of TCI, said, "CSX's incumbent Board has overseen a railroad that for many years has lagged its peers on many of the key metrics of operational and financial performance. Rather than engage in a constructive dialogue with one of its largest shareholders, the CSX Board has consistently ignored our substantive concerns and failed to hold management accountable for continuing operational underperformance. Our goal is a strong CSX that can provide the returns shareholders deserve, the service shippers demand, a safety record communities can count on, and a working environment employees can be proud of. To this end, we are nominating to the Board the principals of two major shareholders and three distinguished independents with meaningful railroad experience. We are committed to working constructively with members of the Board to help improve CSX for the benefit of all of its stakeholders."

The director nominees are:

- **Christopher Hohn**
  Before founding TCI in 2003, Mr. Hohn spent seven years at Perry Capital and was the portfolio manager leading its European investment strategy from 1997 to 2003. Mr. Hohn has previously served on the Board of RIT Capital Partners plc, which is publicly listed on the London Stock Exchange.

Key reasons Mr. Hohn is being nominated and can add value to CSX are:

- Mr. Hohn has a long and successful track record of fundamental investing and actively maximizing value of public companies, including the Deutsche Börse Group, ABN AMRO, and Euronext N.V.
- Mr. Hohn has successfully advocated for strong corporate governance and shareholder rights in situations around the world.
- TCI owns approximately 4.2% of CSX's outstanding shares.

Mr. Hohn received a B.S. degree in Accounting and Business Economics (1st Class Honors) from Southampton University and an M.B.A. degree (high distinction) from Harvard Business School.

➢ **Alexandre Behring**

Mr. Behring is the Managing Director of 3G, a private investment firm. Previously, he spent 10 years at GP Investments, Latin America's largest private-equity firm, including eight years as a Partner and Member of the firm's Investment Committee. He served for seven years as CEO of America Latina Logistica (ALL), Latin America's largest independent railroad and logistics company, which operates more than 13,000 miles of track in Brazil and Argentina. He continues to serve on the Management Committee of ALL's Board.

Key reasons Mr. Behring is being nominated and can add value to CSX are:

- Mr. Behring is a unique combination of a large CSX shareholder (3G owns approximately 4.1% of CSX's outstanding shares) and an experienced, accomplished, hands-on railroad executive.
- Under his leadership, ALL's accident rate was reduced by 86%, locomotive productivity increased at a double-digit compound annual growth rate, and its EBITDA margin improved from 6% to 42% through the third quarter 2007.
- ALL is now one of the most efficient and technologically advanced freight railroads in the world and has also been voted several times by its employees as one of the best companies to work for in Latin America.
- As a publicly traded company, ALL's market capitalization of $6.5 billion is over 30 times the amount Mr. Behring and his partners paid for the company 10 years ago.

Mr. Behring received a B.S. degree in Electric Engineering from Pontificia Universidade Católica and an M.B.A. degree (high distinction) from Harvard Business School. He is also a locomotive engineer.

➢ **Gilbert Lamphere**

Mr. Lamphere is the Managing Director of Lamphere Capital Management, a private investment firm. Previously, he was a Director of Canadian National Railway, Chairman of Illinois Central Railroad prior to its sale to Canadian National in 1998, and a Director of Florida East Coast Industries (a railroad and real estate company). He also participated in the acquisition, financing, and oversight of MidSouth Rail. Mr. Lamphere has served as a Director of nine other public companies, including Carlyle Industries, Inc., Cleveland-Cliffs Inc., R. P. Scherer Corporation, Global Natural Resources Corporation and Recognition International, Inc. Earlier in his career, Mr. Lamphere was a Vice President of Mergers & Acquisitions at Morgan Stanley.

Key reasons Mr. Lamphere is being nominated and can add value to CSX are:

- Mr. Lamphere has been Chairman or a director at three of the most successful and efficient railroads in North America.
- During his tenure on the Boards of Canadian National and Illinois Central, where he worked closely with Hunter Harrison, the Companies' operating ratios improved from 76% to 64% and from over 90% to 63%, respectively.
- Mr. Lamphere is deeply knowledgeable of the best practices in railroad operations and a proven value-added railroad board director.

Mr. Lamphere received an A.B. degree in Economics from Princeton University and an M.B.A. degree (high distinction) from Harvard Business School.

➢ **Timothy O'Toole**
Mr. O'Toole has over 25 years of railroad industry experience. He is currently the Managing Director of the London Underground, where he is responsible for operating and rebuilding the Tube, the world's oldest metropolitan railway. Previously, he served as President and Chief Executive Officer of Conrail from 1998 to 2001. During his more than 20 years at Conrail, he served in various senior management roles, including Senior Vice President of Law and Government Affairs, Senior Vice President of Finance and Chief Financial Officer, Vice President and Treasurer, and Vice President and General Counsel.

Key reasons Mr. O'Toole is being nominated and can add value to CSX are:

- Mr. O'Toole was a prominent figure in the transaction splitting the former Conrail business between CSX and Norfolk Southern, providing him with first-hand knowledge of CSX's assets and operations.
- Under his leadership, Conrail achieved record financial results and safety performance. Similarly, under his leadership the London Underground has improved service and safety and moved record numbers of passengers, all while undergoing an historic rebuilding program.
- Mr. O'Toole was made an Honorary Commander of the British Empire in recognition of his performance following the terrorist attack on London's transport system in 2005.

Mr. O'Toole received a B.A. degree in English Literature (Maxima Cum Laude) from LaSalle University, a J.D. degree from the University of Pittsburgh School of Law, and an Honorary Doctor of Humane Letters degree from LaSalle University.

➢ **Gary Wilson**
Mr. Wilson was a principal investor and Co-Chairman of the Board of Northwest Airlines from 1991 to 1997 and Chairman from 1997 to 2007. From 1985 to1990, he was Chief Financial Officer and a director of The Walt Disney Company and served on its Board until 2006. Prior to joining Disney, Mr. Wilson served for 11 years in senior executive positions at Marriott Corp., including Executive Vice President and Chief Financial Officer, Head of Corporate Development, and Treasurer. He is a current director of Yahoo! Inc. (NASDAQ: YHOO) and CB Richard Ellis Group Inc. (NYSE: CBG).

Key reasons Mr. Wilson is being nominated and can add value to the CSX Board are:

- Mr. Wilson has a track record – as an executive, director and investor – of leading major companies through strategic transitions and creating substantial shareholder value. He is also a strong advocate of improved corporate governance in public companies.
- Mr. Wilson successfully transitioned Marriott from an owner-operator to the more profitable and scaleable business model of a hotel management company.
- During his tenure as CFO, Disney's market value increased significantly and Mr. Wilson expanded its hotel and theme park assets while utilizing innovative financing techniques.
- Mr. Wilson was an investor in and a director of Progress Rail, one of North America's largest providers of railroad products and services.

Mr. Wilson received a B.A. degree from Duke University and an M.B.A. degree from The Wharton School of the University of Pennsylvania.

For further information, please visit www.strongercsx.com.

About TCI
TCI is a London-based asset manager founded in 2003 which manages The Children's Investment Master Fund. TCI makes long-term investments in companies globally. The management company is authorized and regulated in the United Kingdom by the Financial Services Authority. The majority of TCI's profits go to The Children's Investment Fund Foundation, a non-profit organization focused on improving the lives of children living in poverty in developing countries.

About 3G
3G manages a private investment fund that invests in global equities and special situations. 3G Fund L.P. leverages its deep industry and operating expertise in different sectors to identify attractive, long-duration investment opportunities.

# # #

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April 18, 2008

John Drake
Subcommittee on Railroads, Pipelines, and Hazardous Materials
U.S. House of Representatives
2165 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Drake:

Please find below our responses to the questions asked of us in the letter from Chairwoman Brown dated March 20, 2008.

Question 1: In your testimony, you say that CSX should freeze any new capacity expansion spending until the regulatory climate in Washington is resolved. You also said that while you are not calling on CSX to freeze spending on maintenance there shouldn't be new capital expansion expenditures unless there is an adequate return on investment. I'm hearing that the military needs CSX to build almost a dozen new rail spurs around the Port of Charleston to improve deployment operations for the military. This would be new cap-ex spending that would have minimal if any return value to the railroad. In your expert opinion, is this an investment CSX should be making?

Answer: As I testified, expanding capacity is an important goal for all railroads, whether it is to meet the needs of a specific shipper, like the U.S. military, or another key customer. The issue is how to expand, and where. The Port of Charleston is a key deployment center for the military, and CSX, as a Class I railroad, has obligations that it must meet as a common carrier. The Chairman of the Surface Transportation Board discussed this point during the hearing in response to a question from the Chair about the importance of military shipments. The question and response were:

> **MS. BROWN:** Thank you and we're going to have additional rounds but you know as I sit here, I'm thinking, we're in the middle of a war and were talking about aviation but the railroad is what we through the military and the common carrier move that equipment and I want to know, do we have the tools in place to protect the traveling public, not the traveling public but the military and make sure that we don't compromise the system? I'm talking to you Mr. Nottingham.
>
> **MR. NOTTINGHAM:** Yes madam chairwoman. We do have those tools and first of all we have not seen any problems in that regard and if we were to, a complaint by anybody connected with the military would be treated by us with the highest, as a highest priority. We would act on that with immediacy and that could get down to a core of licensing type issue of whether such a railroad is even fit to continue to be a player in our system. Anyone who would disrupt military supply or logistics, it's just unheard of but it's fair and hypothetical to think about. We should be prepared as we always try to be for worst case scenarios.

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Question 2: Your website "strongerCSX.com" offers an opportunity to learn more about the TCI-backed slate of nominees by clicking a link titled "About Our Board Nominees." During the hearing, you stated that TCI would only have one person on the Board if it was successful, and the other directors would be completely independent from TCI. Additionally, in the filing with the SEC, your slate of five is called the TCI Group. I am a little confused by this contrast with what you said at the hearing and how you treat your Board nominees in filings and on your website, so can you provide clarification?

Answer: During the hearing, I indicated that only one of the five proposed minority slate of board members was from TCI – Chris Hohn, the founder of the company. Although the other proposed board members are a part of the slate being proposed, none of them are employees of TCI or are being paid by TCI to stand as nominees. We would be happy to arrange a meeting at a later date to discuss with you the backgrounds of the slate of minority directors we are supporting.

Question 3: Mr. Amin, during the hearing you stated that the "vast majority" of the TCI-backed slate of nominees to the CSX board were people you haven't even known longer than six months or a year. Can you describe the process used to select these nominees? Did any of them have any interest in joining the CSX board prior to your contact with them?

Answer: As I testified, in reviewing our issues with CSX, and the lack of responsiveness to our issues, we decided to put together a group of people with strong or other relevant railroad experience as an alternative to the current group of directors. I explained that we asked one of the top search firms in the United States to help identify individuals that met a high standard – and one that should be applied to CSX generally – nominees that include people with direct, hands on, experience in the rail or transportation sector. Additionally, the nominees should be strong, independent voices, holding management to account and upholding the highest standards of corporate governance. We believe that the slate being proposed en bloc that we support, a normal and standard practice for proxy fights over directors, represents high quality individuals with more than 50 years experience in the rail and transport sector – and that includes proposed directors that have worked directly with the military and security issues that all railroads must address. As for the desires or interests of any of the individuals in joining the CSX board prior to their participation on the minority slate, it is a question perhaps best posed to each of the individuals, as I am more familiar with their interest today in helping to strengthen CSX.

Question 4: As you know, the relationship between railroad management and railroad labor is historically a difficult one to master, but when the two work together, great things have happened for the railroad industry and our nation. Can you please describe

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TCI's position on management/labor-relations and what direction Mr. Hohn and the TCI-backed board nominees would like the company to take in its relationship with rail labor?

Answer: The rail management-labor relationship is an issue that is the responsibility of the management of CSX. We are only a minority shareholder in CSX, and if successful will be only a minority voice on the Board. We are concerned however, based on discussions with union leaders and direct correspondence we receive from CSX employees, that there appears to be a culture of intimidation at CSX. We are told that a disproportionately high number of intimidation cases reported to the UTU, for example, are from CSX. I believe the situation was so serious that it was the matter of a Congressional hearing in 2007. We are also concerned with what we consider to be a relatively poor safety performance at CSX. We would like to see a better relationship between CSX and its employees, based on a improved focus on safety and on constructive dialogue to solve issues. Without the help and support of labor, CSX can not reach the heights of success we believe are possible.

Question 5: I'm interested to hear which five Board Members on CSX's current Board you want to replace and why?

Answer: We are continuing to assess the current board composition, and no decisions have been made with respect to which current directors we will not support. We would be happy to arrange a meeting at a later date to discuss with you the backgrounds of the slate of minority directors we are supporting.

Question 6: In your testimony, you claim to be a long term investor. I understand that long terms means different things in different industries and I would like some clarification. Do you mean 3 years, 5 years, 10 years, or longer?

Answer: As we discussed at the hearing, we ask our investors to commit for long periods of time so that we can make long term investments in companies. If you look at the types of things we are advocating for CSX, like ECP brakes, these are the types of changes that take years to recoup an investment on. We will continue to advocate such long term solutions that create capacity and improve service for CSX in a thoughtful and thorough manner. In addition, if we were solely out to make a "quick buck", given the rise in CSX's share price, we would simply have sold our position, and taken the substantial profits from the sale and moved on. But we see enormous long term potential for CSX, and want to see it flourish to the best of its abilities.

Question 7: During your response to one of my questions at the hearing you talked about Electronically Controlled Pneumatic Brakes (ECP). I want to follow up with you

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on that system, since I believe it is very important to the future of our freight rail system.

a. As you know, about a year ago the Federal Railroad Administration provided waivers to Norfolk Southern and BNSF to test ECP braking on revenue service trains. Is TCI aware that it is common practice for a system to be tested by only a few at first and is TCI monitoring the results of those tests?

Answer: Yes. We appreciate the need for rigorous testing of new technologies and our discussions in Washington with regulators and others only confirms our view that new technologies can create significant new capacity. We also recognize that such actions, like ECP brakes, will take time to implement company- and industry-wide.

b. During the FRA hearing on the waiver application from NS and BNSF, Dana Maryott of BSNF stated that in his company's view, implementation of ECP braking is not yet at the point where it provides an adequate return on investment. Mr. Maryott also stated that there needs to be sufficient data gathered to prove, from a financial standpoint, that ECP breaking will actually improve train velocities. What are your views on Mr. Maryott's comments in light of your reluctance to invest unless there is an adequate return?

Answer: As I testified, ECP brakes offer the promise of significantly increasing capacity in the railroad sector, capacity that will be needed to meet future demands, from all sectors, including the military. ECP brakes have been a success in other countries, and according to research conducted by a major consulting firm for the FRA, ECP brakes are likely to result in good returns.

c. What regulatory environment should ECP brakes operate under?

Answer: Like all new technologies, safety is a key consideration, and as noted, the process to review and approve the introduction of capacity-enhancing technology, or any new technology, must move forward at appropriate speed. We trust that the appropriate Federal reviews will occur and we would look to the Federal Railroad Administration to address any safety issues.

Question 8: At the hearing, you stated that a vast majority of your individual profits are given to your charity. I'd like to hear more about the charity.

a. How much, in dollars, does TCI give to the children's fund charity?

b. Who runs this charity fund and do they have any relations to TCI management?

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c. How much, in dollars, does the charity spend on management costs and how much actually is spent on the children each year?

d. Does the charity reinvest its contributions in your hedge fund and if so how much, in dollars

e. Am I correct in assuming that each TCI individual gets a tax credit for their donations to this charity?

Answer: As I testified, a very substantial majority of the profits deriving from the investment management fees that TCI earns are (and have been since the inception of TCI) received by our charitable foundation, The Children's Investment Fund Foundation ("CIFF"). .

The mission of CIFF is to "demonstrably improve the lives of children living in poverty in developing countries by achieving large scale and sustainable impact." In doing so, CIFF often works closely with other foundations, including the Clinton Foundation. Additional details about the organization and its efforts are available at its website www.ciff.org. The President and CEO of CIFF is Jamie Cooper-Hohn, who has more than 15 years' experience in the non-profit sector, including work at the Shine Trust, Gould Partners, The Center for Policy Alternatives and degrees from Smith and the Kennedy School of Government at Harvard. She is the wife of Chris Hohn and does not receive any compensation for her work. The Chief Operating Officer of CIFF is Peter McDermott, who, prior to joining CIFF, had a distinguished career with UNICEF for 17 years, having held positions in Africa, Europe and the US. CIFF has staff in the UK, India, Kenya, Malawi and Uganda.

While CIFF's funds are waiting to be disbursed, they are managed mostly by TCI.

The individuals at TCI receive no tax credits for the funds received by CIFF.

Respectfully submitted,

Snehal Amin
Partner

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Written Statement of
Joseph H. Boardman,
Administrator,
Federal Railroad Administration
U.S. Department of Transportation
before the
Subcommittee on Railroads, Pipelines, and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives

March 5, 2008

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Written Statement of

Joseph H. Boardman,

Administrator,

Federal Railroad Administration

before the
Subcommittee on Railroads, Pipelines, and Hazardous Materials
Committee on Transportation and Infrastructure
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March 5, 2008

Chairwoman Brown, Ranking Member Shuster, and other members of the Subcommittee, I am pleased to be here today, on behalf of Secretary of Transportation Mary Peters, to discuss private investment in the railroad industry. As you know, safety is the primary mission of the Federal Railroad Administration (FRA), so I would like to start and finish my testimony with a strong reminder that steady, properly-scaled investment in rail infrastructure facilities, rolling stock, employee training, and emerging technology is absolutely essential to achieving a high level of safety, and for the industry to meet the demands of its customers and the challenges of the 21st century.

There are those who will say that investment is not FRA's business, because safety can be maintained by making spot repairs, adjusting operating speeds, lowering bridge ratings, and catching defective conditions just before they cause an accident. As applied to a single hazard at a single location, at a given point in time, such an approach may be workable. However, common sense tells us, and history confirms, that at some point management of the railroad will lose the capacity to manage all of those developing problems if it does not make minimal systematic investments. Shippers, railroad employees, and the public will pay the price.

There have been two major reasons for under-investment in the basic infrastructure—the first caused by Government over-regulation, and the second caused by short-sightedness on the part of rail executives, often under pressure from the financial community to show short-term profit. Both are serious, and neither can be ignored.

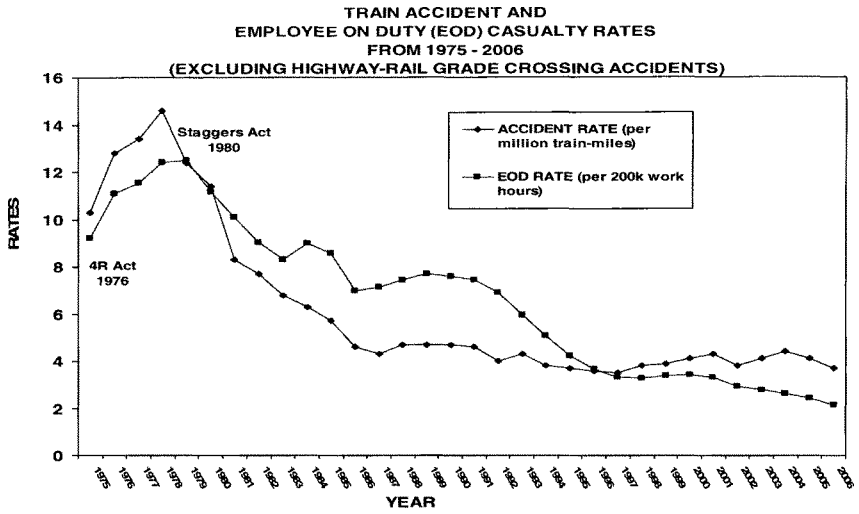
When the Interstate Commerce Commission (ICC) spun off its safety function to the FRA in 1967, the railroads were grossly overextended, with many more miles of railroad than the existing traffic could support, and very little regulatory latitude to rationalize their systems. The construction of the interstate highway system had fundamentally altered the competitive balance in surface transportation, but railroads were constrained by strict rate regulation that was little changed from the days when railroads lacked effective competition.

Conditions were ripe for the bankruptcy of major railroads in the East and Midwest during the 1970s. Once-proud railroads began suffering frequent derailments, often accompanied by spectacular releases of hazardous materials. The Congress tried to address the emerging safety issues through the Federal Railroad Safety Act of 1970 and subsequent enactments.

But safety regulation alone could not turn the tide. It was necessary that railroads have both the will and the means to manage their assets and operations safely. And, at the same time, the Congress recognized that rail service was essential to the Nation.

By 1973 when Congress had to step in to form the Consolidated Rail Corporation (Conrail), seven major railroads in the Northeast were bankrupt and could not be reorganized independently. Conrail received large infusions of cash from the Federal Treasury, and with major legal reforms to relieve the burdens that had been borne by its predecessor "railroads in reorganization." In 1976, through the Railroad Revitalization and Regulatory Reform Act (4R Act), the Congress began to nudge the ICC toward a more flexible approach to economic regulation. Finally, with two major Midwest railroads mired in bankruptcy, the Staggers Rail Act of 1980 (Staggers Act) accomplished a dramatic reduction in the economic regulation of the rail industry.

The effects on safety of public investments in the Northeast rail system and the substantial de-regulation of freight railroads in general yielded dramatic improvements in safety. Railroads were able to rationalize their systems, set rates that permitted them to recover their costs and make a modest profit, modernize work practices to reduce employee personal injuries, and plow back earnings into their facilities and operations so that they could be more efficient.



Does that mean that everything was destined to go well in perpetuity thereafter, as some invisible hand guided the industry toward ever safer and more profitable operations? Not entirely. Over the past decade and a half, some railroads, at certain times, seem to have lost the vision to invest wisely for the long haul. If an insufficient level of investment goes on for awhile, we begin to see evidence in the form of increased derailments, bridge problems that are discovered almost too late through rough ride reports, and consequent disruptions to operations that themselves may introduce other hazards.

FRA makes it a point to conference with the railroads on a regular basis, seeking to understand their plans for investment and urging attention to areas that seem to need work, as judged by early indicators, FRA safety inspection activities, and actual safety results. FRA will never be satisfied until the entire industry makes additional progress across a broad front of safety issues, but when we talk with rail executives about these issues, they usually understand our concerns and, in general, they share our aspirations for improved safety through investment.

Why would rail executives be willing to elevate safety to a first-rank goal? Certainly they are interested in safeguarding their employees and the public, but there is something else at work here. Safety is great for business, particularly in an era of significant demand and limited capacity. For example, identifying or preventing broken rails will lead to the prevention of derailments that can cause significant delays as maintenance crews take the track out service to fix the problem. To combat this problem, railroads work hard through internal rail flaw testing and rail grinding to find flaws before the rail

breaks. But they also need to buy new rail, because at some point the cumulative tonnages and rail head wear are such that testing and grinding the rail is no longer sufficient. New rail is a capital cost that will return value for many years to come, but it will detract dollar-for-dollar from the funds available to pay dividends in the current fiscal period. As a result, a CEO who attends to this kind of long-term need may not rate the most favorable reviews in financial press.

There are many kinds of safety-relevant investments that railroads can make. If the subject matter is fixed infrastructure, the choices are somewhat constrained, but railroads and their suppliers get better at this every year, as new maintenance-of-way equipment and better materials are brought to bear. Today's locomotives and cars are significantly better than their predecessors, both with respect to efficient operations and safety, and the railroads' voluntary investments in wayside detection systems are paying off handsomely by identifying developing problems before they reach criticality. Investments in facility improvements can make it easier and safer for yard crews and mechanical forces to do their jobs, while reducing the cost of switching cars, and a number of major rail yards have been rebuilt over the past few years.

These investments are also important to meet the future growth in traffic. The Department estimates that tonnage on the railroad system will increase by 88 percent through 2035. To meet this growth, the industry has been ramping up investment. Up to now it has been able to rely on significant productivity gains, where the railroad industry has moved more freight over a smaller network with fewer employees. The railroads are now expanding capacity on their highest density routes by double- or triple-tracking and looking to new cost-effective technological improvements that can also increase capacity.

The new investments that will advance safety, service, environmental stewardship and asset utilization over the coming years will include a transition, starting with unit train service (e.g., coal, intermodal), to electronically controlled pneumatic (ECP) brakes and other technology that will help the locomotive engineer achieve fuel savings and limit in-train forces that can result in derailment. Under FRA waiver and encouragement, two railroads are presently trying out stand-alone ECP brake trains in coal service and gathering data to validate the business case for additional investments. In addition, Positive Train Control technologies will play a significant role, as well, but only when the practical issues have been wrung out through the kinds of demonstrations now underway. These are transitions that will unfold over a decade or more, and it will take patience to see the results.

FRA has worked closely with the freight railroads to reduce both the frequency and the severity of railroad accidents. FRA has issued and enforces a wide range of safety regulations and has sponsored collaborative research with the railroad industry to introduce innovative technologies to improve railroad safety. However, it would be difficult for the industry to accomplish and achieve its positive safety record without the funds to improve and maintain the rail system.

Many investors have come to view railroads as potentially attractive investments. Among the entities increasing investments in the railroad industry are a variety of financial institutions, individuals, and investment funds. These investors are risking their money in the belief that railroads will provide a competitive return on their investment by improving shareholder value. While the interest of these new investors in raising railroad returns has, in some cases, created tensions between them and railroad management, the pressure to improve returns through gains in efficiency is healthy. An efficient railroad is usually a safe railroad.

In today's environment, the economic regulatory framework must ensure that access to capital and the ability to make investments are not discouraged. Currently, high levels of demand for rail services are exacerbating tensions between carriers and shippers, with some shippers calling for more oversight on rail rates and revenues. Since 1980, the Surface Transportation Board (Board or STB) and its predecessor, the ICC, have administered railroad economic regulation in a way that has provided a favorable climate for rail infrastructure investment. The Board recently issued new rules that are intended to speed up the procedures for adjudication of "rate reasonableness" cases, and for small shippers, the Board has issued guidelines that would give them improved access in pursuing a case. Additionally, it has just completed a proceeding for determining railroad cost of capital. The implications of this decision will affect railroad revenue adequacy, could make more rates subject to regulation, and thus alter investment incentives. It is important that the regulatory framework contribute to solving capacity problems rather than compounding them by not impeding the industry's ability to attract capital. The industry today is earning higher revenues and higher returns, but at this time is still not earning the STB-defined cost of capital.

Let me say it again: safety is great for business. Contemporary railroads will prosper as they provide very reliable service efficiently. A railroad that is capable of doing that, year in and year out, will have made the necessary investments in infrastructure, rolling stock, employee training, and advanced technology; and, with proper attention to a good safety culture, the safety record will follow.

The Congress and FRA help this process along with laws and regulations that set specific expectations that everyone has to live up to, and we serve as a constant reminder that safety must be the first priority. But, often as not, industry will lead the way with investments in innovations that make the railroad work better for all concerned.

Testimony of W. Douglas Buttrey
Member, Surface Transportation Board
395 E Street, SW; Washington, D.C. 20423; (202) 245-0220

Before the
Subcommittee on Railroads, Pipelines, and Hazardous Materials
of the
House Committee on Transportation and Infrastructure
Hearing on Investment in the Rail Industry
11:00 A.M., March 5, 2008; 2167 Rayburn H.O.B.

Good morning Chairwoman Brown, Ranking Member Shuster, and Members of the Subcommittee.

My name is Douglas Buttrey. I have had the privilege to serve as a Member of the Surface Transportation Board since May 28, 2004.

I appreciate the opportunity to appear before the Subcommittee today as you conduct this hearing on investment in the rail industry. The Board's Chairman, Charles Nottingham, has submitted testimony which discusses the issues that are the subject of this hearing. The Chairman's testimony covers everything that I would have said. Rather than duplicating coverage of the same topics, I will instead associate myself with and endorse the Chairman's formal, filed testimony.

I stand ready to respond to any questions the Subcommittee may wish to address to me.

RailAmerica, Inc.

John E. Giles
President and Chief Executive Officer

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Committee on Transportation and Infrastructure's Subcommittee
on
Railroads, Pipelines, and Hazardous Materials

Topic: Investment in the Rail Industry

1. My name is John Giles and I am the Chief Executive Officer of RailAmerica. I began working in this industry thirty-nine (39) years ago as a Fireman and Locomotive Engineer on the Baltimore and Ohio Railroad Co. in Indianapolis, IN. I spent the first twelve (12) years of my career in various operating positions for three (3) different railroads and, shortly after deregulation, progressed up the management ranks through Marketing and, eventually executive positions at CSX.

   I retired from CSX in 1999 but, shortly thereafter, returned to work with each of two (2) private equity firms in their respective acquisitions and operation of short line railroads. In 2000, I was hired by Blackstone Capital Partners to serve as Chief Executive Officer at Great Lakes Transportation, an operator of short line railroads, rail switching operations, and of eight (8) Great Lakes shipping vessels. My management group and I streamlined operations at Great Lakes Transportation and the company was later sold, in late 2003, to Canadian National Railway. I, once again, retreated into retirement only to re-emerge to work with Fortress Investment Group in its acquisition of RailAmerica and, later, of Florida East Coast Railway. Today, my management team operates RailAmerica's portfolio of 41 short line railroads and is also extending its management supervision over Florida East Coast Railway.

2. As background to my involvement with RailAmerica, Fortress Executives and I discussed investing in The Rail Industry for some time before seeking to acquire RailAmerica and taking the Company private in February of 2007. Fortress had been active in other transportation and logistics businesses, owning a jet leasing company, a shipping company, and other logistical enterprises. The rail industry was a natural extension of their existing stake holdings in the transportation industry, with railroads being particularly well positioned to benefit from international trade and expanding global markets. As we studied RailAmerica before our investment, we became unified behind the belief that we could operate these properties better and more efficiently; we believed that we could engage with customers by more effectively addressing shipper's transportation needs, thereby creating value with customers and, in turn, expanding our business to a greater extent than our predecessors.

3. RailAmerica, today, is the leading operator of short lines and regional railroads in North America. We operate in twenty-seven (27) United States and three (3) Canadian provinces (Map as Appendix A). Most recently, in November 2007, Fortress acquired the Florida East Coast Railway and invited my management team to explore and consider synergies with our RailAmerica operations. We currently manage these independent properties, RailAmerica and FEC as separate and independent companies, but, with some common leadership and a goal toward sharing management and operating best practices.

4. Almost all of RailAmerica's properties were, at one time, part of the larger Class I railroad systems. While in Class I ownership, these lines were operated as low-density, relatively high-cost branch lines that the Class Is either sold at auction or leased to companies like RailAmerica. These lines had infrastructure needs and were susceptible to fragile economic conditions, generally being dependent upon the business fortunes of one, or only a few, on-line customers and industries.

5. By definition, RailAmerica's rail lines are generally the exclusive route of rail ingress and egress available to shippers and receivers for accessing the larger Class I rail system. We are the only source of rail access to the broader regional and national rail networks for distribution of shippers' goods and products. Our services are frequently billed by our Class I affiliates through interline settlement as a segment in the longer Class I rail movement. While the lower density and rural nature of most of our lines preclude rail competition from parallel routes, our services are challenged to remain cost-effective by constant competition from trucks.

6. Like all good owners, Fortress demands that we run a high-quality, safe and profitable business operation, one that helps its existing customers to succeed and expand their businesses and further seeks to expand our rail services to new businesses. We strive for operational efficiency in order to provide Fortress with enhanced shareholder value and, ultimately, a fair return upon its investment.

7. Guiding our Company and our overall efforts are the following core values that all of our employees are expected to adhere to:
    - INTEGRITY
      We speak and act with truth and honesty.
    - RESPECT
      We treat others as we wish to be treated.
    - FACT-BASED
      We make recommendations and decisions based upon objective evidence.
    - HEADS IN THE GAME
      We continuously seek to improve, and we remain focused on our challenges.
    - HANDS ON
      We actively strive for results in our areas of responsibility, and we help one another for the success of the team. We are all expected to contribute to performance improvement.
    - DEMANDING PARTNER
      Our standards are high. We expect from others what we expect from ourselves, and we collaborate to achieve the best results for all.

8. Since the February 2007 acquisition, our new RailAmerica management team has driven these core values through our organization and, by increasing the transparency of our management objectives, we have heightened awareness to personal and train safety. We have devoted significant time, energy and resources into educating our new and existing employees as to our operating rules and practices, as well as the safety rules, and we have raised the bar on personal accountability for their safety and the safety of their colleagues, along with overall train safety. Each and every safety incident (injury, derailment, etc.) is advanced to the Chief Executive Officer for review and consideration of appropriate corrective measures and disciplinary action, if warranted. In order to properly align employee incentives with management initiatives, we introduced a new Safety Incentive Plan that rewards employees by up to six percent (6%) of their annual compensation for working safely and not damaging cars, locomotives, shippers and goods. Our results in 2007 are encouraging:

   - Overall Human Factor Derailments are down 4%, 2006 = 91, 2007 = 87
   - FRA Reportable Train Accidents are down 16%, 2006 = 58, 2007 = 49

   but, we expect even more dynamic improvements in 2008 as the benefits of the Safety Incentive Plan take hold.

9. Another area of management focus is upon improving our capital infrastructure. As I have said, RailAmerica's properties were divested by the Class Is, over the past twenty-plus (20+) years, for good and valid reasons. It is fair to say that when the Class Is were contemplating abandonment of those lines, or tuning them over to short lines like us, very little capital investment went into these lines and maintenance was scaled back to minimum levels. RailAmerica inherited those lines with pressing infrastructure needs, and where and how to apply our capital resources remain a constant management challenge.

   So, in facing this concern, RailAmerica's management team undertook the task of determining precisely how much money and where to invest into capital improvements to our 5,000 bridges and almost 7,000 miles of mainline tracks. Given the capital needs and the low margins in many of these lines, it is incumbent upon us to apply that capital with a rifle-shot approach and not a shotgun. Accordingly, we have enhanced our engineering staff such that we now have highly-skilled and well-educated Chief Engineers physically located on each of the five (5) geographic regions within RailAmerica.

   We recently recruited a Bridge and Structure expert, a skill set that was not resident and available to us until the fourth (4th) quarter of 2007. In addition, we recently hired an expert in Signals and Communications to add to our own in-house expertise.

10. To summarize, Fortress and my management team came to RailAmerica to create and develop a high performance organization, with the goal of running safe, efficient and profitable railroads. We have made significant strides toward achieving these goals and toward developing an organization that is capable of assuming a leadership role in the American Short Line & Regional Railroad Association (ASLRRA), and engaging effectively and responsibly with the Federal Railroad Administration (FRA) and the Surface Transportation Board (STB).

11. Our association with Fortress, as our owner and shareholder, is enabling us to achieve financial, infrastructure and safety improvements by certain key advantages as compared to RailAmerica's previous public company ownership model:

    (i) The ability to assemble and install a new management team with a longer term focus upon operational and safety performance unburdened by the shorter term objectives of public company boards of directors and shareholders;

    (ii) Reduced expense of operating as a private company, as opposed to a public company, together with the ability to manage toward a longer term earnings and performance horizon and not be burdened by quarter-to-quarter performance results upon stock price;

    (iii) Access to financial expertise and resources necessary to reduce cost of capital. At the time of acquiring RailAmerica, Fortress arranged for refinancing of our assets on more favorable terms, and Fortress is now taking the lead on pursuing project-based refinancing that affords access to international capital markets and promises even further reductions in cost of capital; and

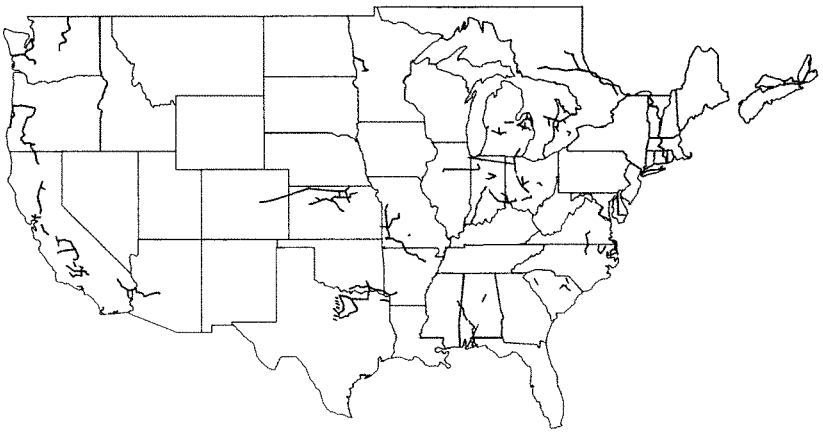
    (iv) Fortress' resources and expertise in identifying, evaluating and acquiring other synergistic opportunities in the rail industry, such as the acquisition of Florida East Coast Railway, as well as the capability of pursuing industrial development and related transportation industry opportunities, all of which can improve the efficiency and performance of RailAmerica's railroads.

In summary, RailAmerica and Fortress are committed to the rail industry for the long term and we will conduct our rail operations, improved safety performance and enhance our capital infrastructure with the long term view in mind.

Are there any questions you would like to ask me?

Appendix A

RailAmerica Network



Activist Investing

Testimony
of
Robin Greenwood
Assistant Professor of Business Administration
Harvard University
Phone: (617) 495-6979

Before the
Subcommittee on Railroads, Pipelines, and Hazardous Materials
Committeee on Transportation and Infrastructure
United States House of Representatives

January 29, 2008

Chairman Oberstar and Subcommittee Chairman Brown, it is a pleasure to appear before you today to discuss activist investing, with a particular focus on recent investment in the rail industry. I am an Assistant Professor of Business Administration at Harvard Business School.

My comments today draw on research that I have done on hedge fund activism, as well as summarize contributions of other finance researchers in this area. What is investor activism? Gillan and Starks (1998) define an activist as an investor who "tries to change the status quo through 'voice', without a change in control of the firm." In my own research, I have collected data on every incident of hedge fund investor activism between 1994 and 2006, nearly a thousand events in total. This large sample research has been complemented by two case studies and a number of interviews and site visits with activist investors. The objective in all of this research, which is similar to my objectives here today, is to understand the causes and consequences of investor activism.

I will address four broad sets of questions. First, what is the proper role of activist investors? Second, why is there so much more activism today than ten years ago, and why are hedge funds doing it? Third, what sorts of industries do activists target, and what do they ask management to do? Fourth, in practice, what do activist investors accomplish, and how do their accomplishments increase shareholder value? In answering these questions, I hope to shed light on the objectives and likely consequences of investor activism in the rail industry.

To preview my discussion, allow me to summarize the main conclusions in advance.

First, activism is here to stay: Both in theory and in practice, activists play an important role in monitoring management, who occasionally veer off track. Without proper oversight, managers may reward themselves excessive compensation and perks, remain in power too long, build corporate empires, or otherwise squander investors' capital.

Second, the data support the idea that, on average, activists have a positive impact on the stock price. An investor that simply bought all of the firms that had been the targets of shareholder activism between 1994 and 2006 would have earned annual returns of just over twenty percent.[1] While it is true that this value tends to be created in corporate transactions such as a takeover, as opposed to via operational change, shareholders benefit nonetheless. As such, I see no particular cause of concern that the rail industry is the target of activism today. That is not to say that activists *always* create value—one can point to several examples where they were wrong (but even in these examples, it would be a stretch to claim that the activists do not seek improvement of shareholder value).

Third, activists already have to pay most of the costs of their work, while management can fund their opposition with money from shareholders. Activists also have to be careful to protect their reputation as shareholder advocates. Thus, I believe that regulations are already strongly in favor of management, perhaps too strongly.

Fourth, analysis of activism targets over the past decade reveals a number of common themes to activist demands. Not unlike the current focus on the rail industry, targets tend to have a high degree of industry concentration. Industries with valuable hard assets but sluggish returns on capital are popular targets. One recurring theme is that firms in an industry are undervalued relative to the replacement value of their assets (this theme probably also applies to railroads). Within this broader theme, activists tend to choose targets that have underperformed relative to their peers, because management in underperforming firms is more compelled to listen. Thus, in my view the most important function of the activist is similar to that of a financial market arbitrageur- he/she shines light on a company that could be worth more, and tries to get management to take steps so that this value is recognized by the market, often via a takeover.[2] Absent a takeover, activists typically ask for reductions in capital expenditures, increases in leverage, and share repurchases. But from the perspective of creating shareholder value, none of these outcomes come close to a takeover, in which the activist immediately secures a 20-50 percent return. One implication is that the overall success of activism should depend on takeover interest in the market. Anecdotal evidence from the credit crunch of August and September 2007 appears to confirm this intuition. During this time, private equity interest in debt financed buyouts declined dramatically, and activists saw corresponding drops in the value of their portfolios – many of the firms they had targeted had been purchased in the hope of a takeover. In the press, these research findings have received some attention because they have been perceived as being critical of activists, in the sense that they imply that activists have less success creating value when they focus on operational change, as opposed to a change in control via takeover. I think this mischaracterizes the research: Activists demonstrably create value, but it is important to have a realistic view of what they can and cannot accomplish - they are investors, after all, not managers. An analogy helps: there is an important role for pointing out that a patient is sick and locating a doctor, even if one is not personally qualified to administer the medicine.

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[1] See Greenwood and Schor (2008a), Table A1.
[2] A similar point has been made by Brav et al (2007).

Fifth and finally, one often hears the criticism that activists are short-term investors, not interested in long-term value creation. This is a red-herring, meant to turn the focus away from the performance of management and towards the objectives of the investors, which are irrelevant. I certainly agree that activists are short-term investors, (despite what they occasionally claim!). But this misses the point that the rest of the market has a long horizon, and would not be willing to reward activism with a higher stock price if it felt the activist were destroying the long-term prospects of the business. Thus, to gauge whether the market believes activists can create value in the rail industry, one need look only as far as the share price appreciation.

I. The proper role of activist investors

What is the proper role of activist investors? This question should be the starting point of any dialogue on investor activism. To answer it, a simple thought experiment is useful.

Imagine a privately held firm that owns a large piece of land in the center of town. On this piece of land, the owner, a chef, runs a small restaurant. The owner is not a particularly good cook, and so the restaurant is not as profitable as it might be if it were run by someone else. For the sake of illustration, suppose that the restaurant produces after tax profits of $100,000 per year, but a well-run restaurant would produce profits of $300,000. In this sense, the owner is destroying $200,000 per year of economic value by operating the asset at less than its full capacity.

In a well-functioning capital market, another entrepreneur may recognize the hidden value of the property, and offer the owner a high price. But, the owner is within his rights to refuse, choosing to do as he pleases. Perhaps he derives some non monetary benefit from running the restaurant, or perhaps he is overoptimistic about his prospects.

Things are different if the property is owned by a public corporation, and the chef works as a manager of that corporation. As a custodian of shareholder capital, the manager has a fiduciary responsibility to maximize shareholder value. This means that no matter how much he might enjoy cooking, it is his obligation to seek another chef to operate the restaurant better, or to find a buyer for the business.

Because the chef enjoys cooking, it is unlikely that he will take either of these steps without some kind of encouragement. The encouragement can come from several places. One of these is the board of directors, who can facilitate a dialogue between shareholders and management. The board may compare the performance of the restaurant to other restaurants in the area, for example, asking the chef why it is not more profitable. In extreme and incredibly rare circumstances, the board may fire the recalcitrant manager, or seek sale of the business. The board is a useful device because individual shareholders, who each own small stakes in the firm, lack incentive to invest their time and energy to persuade management to do otherwise. For small

shareholders, it often makes sense to simply "vote with their feet," by selling their shares and investing in another firm.

The board of directors may act as a filtering device for implementing shareholder proposals. Simply complaining does not make a shareholder right about the best course of action to maximize firm value. Reasonable people can disagree about the proper direction. On the minus side, most boards are stacked with insiders, or with members that have been on the board so long as to effectively be insiders. And, unlike in the United Kingdom, the position of Chief Executive Officer (CEO) and Chairman of the Board are often occupied by the same person, leading to weaker board incentives to monitor performance. The proper functioning of boards has been an active area of research in recent years. Lucian Bebchuk at Harvard Law School has written extensively on the ineffectiveness of boards as shareholder advocates, but some others disagree.[3]

Because boards can be unresponsive, it often makes sense for shareholders to confront management directly. Large shareholders, in particular, have stronger incentives to hold management accountable, and increasingly in recent years, they have become more vocal about the steps that firms should take. In the context of our example, what does this mean? An investor could buy 5 percent of the business, file a 13-D, and publicly (or privately) confront the manager about the lack of success in the restaurant business.[4] Or, more commonly, the investor could ask that management put the business up for sale. In practice, who fills this role? Recently, it has been hedge funds.

Even in the simplified example of an underperforming restaurant, activism could take on a number of forms. In the first, the activist points out that the chef is no good and that he needs to go to culinary school or get replaced for the restaurant to become more profitable. We might call this "operational" activism. In the second variety, which is more common in practice, the activist isn't quite sure what the problem with the chef is, but the activist can see that the restaurant is making less profit than a similar restaurant next door. In this case, the activist might push for greater management accountability. We might call this "governance" activism. In the final variety, the activist is able to see that the land would be more valuable if it were used as a parking lot, and simply pushes for outright sale to a strategic buyer. We might call this "financial" activism. As I will discuss, the "financial" activism is the most successful in the data, at least from the perspective of creating shareholder value. It's not surprising- activists' talent lies in identifying assets that are undervalued. But it is often tough for outsiders to identify whether activism is really operational or financial in nature: while activists will often call for operational changes, they are investors at the end of the day, not managers, and will be satisfied if they make money on their position. Another issue is that activists typically make lots of requests, but are satisfied if management delivers on one or two.

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[3] See, for example, Lipton and Savitt (2007).

[4] On attaining 5 percent ownership in a public company, an activist is required to file a 13-D form with the Securities and Exchange Commission. These documents are publicly available.

To summarize, the proper role of investor activism is to take actions that will force managers to increase shareholder value. The rest of my comments will address how closely this description of activism fits with the realities of hedge fund activism over the past ten years. Real firms are much more complicated than the restaurant in my thought experiment, and thus there is often considerable disagreement about the proper way to maximize value. Even in the simple example above, it is clear that the activist may have incomplete information about the true opportunities facing the firm. The question is, on balance, whether activist investing gets us closer to the ideal.

II. Why is there so much more activism now than ten years ago, and why are hedge funds doing it?

While one might expect large shareholders to play a role in the governance of US corporations, the reality until recently was quite different. The consensus in academic research is that, until the late 1990s, large shareholders did not have much impact on corporate performance. For example, Karpoff (2001) and Romano (2001) conclude that institutional investor activism as a whole has done little. Karpoff et al. (1996), Wahal (1996), and Gillan and Starks (2000) report that shareholder proposals have historically done little to improve firms' operations. On the few occasions where investors have attempted to remove management from their jobs, they generally encountered resistance, were faced with high costs, and were unsuccessful.[5] Some pension funds, like Calpers, had success in their shareholder proposals, but they were the exception rather than the rule.

Why, historically, have large shareholders been so ineffective at monitoring management? Some argue that large institutions face conflicts of interest in this endeavor – the firms that they hold in their portfolios are also potential clients in their pension fund business. A better explanation lies in the performance incentives faced by the managers of these funds. Specifically, the compensation of most mutual fund managers is not especially sensitive to performance. Thus, even though their funds own large stakes in public companies, the managers themselves have little incentive to spend time, energy, and money fighting with management.

In recent years, however, hedge funds have embraced shareholder activism. **Figure 1** shows the dramatic increase in the number of hedge fund activism events since 1994. Europe and Asia have had similar growth in activism. Why have hedge funds taken up the role as activists? In contrast with mutual funds, hedge fund managers receive a significant share of the profits of their investing activities. In addition, many hedge funds are quite concentrated, with a few large positions constituting the bulk of their portfolio. With many funds now managing tens of billions of dollars, this means that their individual positions in companies can total $500 million or more.

[5] See Brav et al. (2006), Black (1990), Roe (1994), Bainbridge (2005), Kahan and Rock (2006), Black (1998), Karpoff (2001), Romano (2001), Bebchuk (2005a, 2005b).

As a result, hedge funds are incentivized to spend considerable resources on a particular position. Thus, hedge funds have filled an important gap.

How does the market view the actions of hedge fund activists? On average, the reaction is positive. Several recent papers show that firms targeted by hedge fund activists between 2004 and 2005 earn abnormal returns upon announcement of their involvement. Brav, Jiang, Partnoy, and Thomas (2006) find that the announcement of hedge fund activism generates abnormal returns of between 5 and 7 percent in a short window around the announcement. In addition, the authors document modest changes in operating performance around the activism. Klein and Zur (2006) document abnormal returns of approximately 7 percent in a longer window around the announcement of activism. Becht, Franks, Mayer, and Rossi (2006) also find that activist investments of the UK pension fund Hermes significantly outperformed benchmarks. Clifford (2007) shows that hedge funds earn a significantly higher return on their activist positions compared to their passive positions. In our research, we have performed a similar exercise using all activist events between 1994 and 2006. **Figure 2**, attached, shows the average abnormal stock returns (meaning, net of the performance of the market) around days when hedge funds announce their activist intentions.[6] Prices rise by an average of about four percent. And, in the months subsequent to the activism, prices continue to go up. But, as I discuss later, much of this is driven by the prospect that these firms will eventually be taken over.

Another way to look at the performance of investor activism is to ask what returns an investor would have achieved, had the investor simply bought all firms that were targeted by activists? The returns to that hypothetical investment strategy are shown in **Figure 3**. The figure shows that this strategy outperformed the market, by as much as 12 percent per year. Thus, no matter how it is measured, activism has benefitted shareholders.

III. What kind of firms do activists target, and what do they ask for?

Table 1, attached, summarizes the industry composition of activism targets. The table shows that activism events tend to be concentrated at the industry level. In my experience, this is because the activism is based on an industry-wide theme. Let me provide an example. The example comes out of a case I teach in our first year finance course at Harvard Business School.

Kerr-McGee was an oil and gas exploration and production company that was acquired by Anadarko in mid 2006. Prior to the takeover, Kerr-McGee was targeted by activist investors Carl Icahn and Jana Partners for poor results in exploration activity, as well as being undervalued. The activist investors proposed that KMG (a) sell it Titanium Dioxide business, (b) reduce capital expenditures on exploration, (c) enter into a forward contract to sell oil at prevailing prices, and (d) use the proceeds of all of the above to repurchase shares. Why ask for

[6] Formally, we choose the date on which the 13D is filed as the period when the market learns about the activist's intentions. A 13D filing is required once an activist attains a 5 percent position.

these things? Kerr-McGee was trading at a substantial discount to the value of the oil that it had already discovered. The activist investors felt that the price did not reflect this value, perhaps because the market penalized the stock price for poor exploration results in previous years.

Was this theme unique to Kerr-McGee? Not at all. A similar analysis would have yielded the same conclusion for virtually any of the U.S. based exploration and production companies at the time. And more generally, this theme is recurring in many activist events: Industries with valuable hard assets but sluggish returns on capital are popular targets.

Why pick on Kerr-McGee and not one of the other oil companies? Here I can only speculate, but I believe that activists target the weaker firms in an industry, firms in which the management does not have a record to fall back on. These firms are more likely to agree to the "arbitrage" that is proposed by the activists, whatever form that might take. The evidence is consistent with this- activism targets have underperformed the average firm in the industry by more than 20 percent in the two years before the activist gets involved.

Kerr-McGee is a useful example of activism in another way. While one could argue that the firm was destroying value in its production activities (and that the role of the activist was to stop this value destruction), I think it is not so clear. Certainly, after the fact, it looks as if management was not overpaying for new oil resources (*ex-post*, oil prices have increased considerably since 2004). What then, is the function of the activist? In my view, the activist shone light on a business that had been improperly valued by the market and undermanaged. I believe this is a greatly overlooked aspect of activism: the press focuses more on the operational demands, whereas the main contribution of the activist is closer to that of an arbitrageur- an investor who clarifies to the rest of the market what the asset is actually worth. And part of this process involves tweaks to operational strategy.

Turning to the large sample research I conducted with Michael Schor, we attempted to categorize the demands of the activist in each of about a thousand activist events. In each instance, we read news releases and regulatory filings to get an idea of what the activists were after. These classifications are summarized below and shown in **Table 2**:

Engage Management: The activist intends to engage or discuss issues with management to "increase shareholder value" or makes a general statement that shares are "undervalued" without including any specific plans or proposals. This is the least aggressive form of activism. (45.54% of hedge fund activist events), but often ends in a takeover nonetheless.

Capital Structure: The activist targets capital structure issues. This type of activism relates to a recapitalization, stock or debt issuance, restructuring of debt, dividends or a stock buyback. (10.08% of hedge fund activist events).

Corporate Governance: The activist targets corporate governance issues. This type of activism can include a call to declassify the board, remove a poison pill, elect activist-selected directors, or fire a company officer or board member. The corporate governance classification also applies

to activism that targets issues of board or executive compensation, corporate fraud, and lack of transparency. (21.94% of the hedge fund activist events).

Business Strategy: The activist critiques excess diversification and the level of investment in some business lines or cites poor operating strategy at target. (4.59% of hedge fund activist events).

Asset Sale: The activist calls for the target to sell itself or certain assets in order to maximize shareholder value. This classification can also represent an offer by the activist itself to takeover the target. (18.11% of the hedge fund activist events).

Block Merger: The activist blocks a proposed merger, usually because it deems the terms of the deal unfavorable to target shareholders. Often, the activist will demand a higher price. (5.61% of the hedge fund activist events).

Financing/Bankruptcy: The activist provides financing for a target in bankruptcy or financial distress. (1.40% of the hedge fund activist events).

Strategic Alternatives: Activist requests that the target pursue various strategic alternatives for the firm, including a spinoff of an underperforming division. (2.42% of the hedge fund activist events).

Proxy Contest: The activist files under Schedule 14A with the SEC, signaling an intention to solicit proxies from shareholders either to elect its own proposed director(s) or to adopt a shareholder proposal that the activist has submitted or plans on submitting. (9.06% of the hedge fund activist events).

The most represented categories above are *Engage Management*, *Corporate Governance*, and *Asset Sale*. Thus, in most incidents, the objective of the activist is to raise the stock price (engage management), to improve the governance of the firm, or to secure a takeover.

IV. What do activist investors accomplish, and how does this relate to shareholder value?

It turns out that there is not that much correlation between what activists ask for, and what they accomplish. We followed up on each of the events to see what happened after the activist made his/her initial demands. We read press releases and regulatory filings up to eighteen months after the initial activist involvement. We also computed statistical measures of improvements in operational performance after the event. Naturally, for firms that were taken over, it was not possible to compute these measures.

Starting with our assessment of outcomes based on news, we present the tabulation in Table 4. The outcomes we consider are as follows: *Merger or Asset Sale Completed:* the target

completed a merger or sale of either all or part of its assets; *Merger or Asset Sale Announced*: the target announced a merger or sale of either all or part of its assets (that either was later cancelled or is still pending); *Merger Called Off or Bid Increased*: a merger announced prior to the activist intervention involving the target was either called off or the bid price was increased; *Spinoff Completed or Announced*: the target announced a spinoff of one of its divisions that was either completed or is still pending; *Target Hires IB or Begins Auction*: the target hired an investment banking firm to explore strategic alternatives or began an auction process for either all or part of its assets without any further news of an announced or completed deal; *Shares Repurchased/Special Dividend*: the target announced an intention to repurchase its shares or pay a special dividend; *Greenmail*: the target bought back its shares from the activist; *Removal of Poison Pill*: removal, suspension, amendment or expiration of the target's poison pill; *Resignation of CEO/CFO/Chairman:* the announcement of resignations by the targets CEO and/or CFO and/or Chairman of the Board; *Board Seats Granted to Activist*: activist gains seats on the target's board of directors, either through a proxy contest or deal with the target; *Proxy Defeated* : the activist's proxy fight, either for directors or a shareholder proposal, was defeated at the target's shareholder meeting; *Activist Cuts Position Below 5%:* the activist reduce its stake in the target to below 5% of the shares outstanding thereby ending their 13D filing requirements; *Financing/Bankruptcy Agreement*: the target announces a financing deal, with either the activist and/or a third party as creditor. The financing agreement can pertain to cases where the target is about to enter, is in, or is about to exit bankruptcy; finally, *No News*: we could not find any further information about the company after the initial activist filing.

The table shows that "No News" is the most common outcome. That is telling—in most cases, we never hear from the activist again. In these cases, the average stock returns associated with activism is approximately zero (meaning that the activist neither creates, nor destroys value). The next most common outcome is that the activist manages to secure a takeover. On occasion, we also find that the activist manages to get a share repurchase or special dividend, or secure corporate governance improvements such as board seats or a resignation of top management.

Our statistical analysis of operating performance leaves us with similar conclusions. The most significant outcome is clearly a takeover. Absent a takeover, we find that firms that remain independent tend to cut capital expenditures (something that is requested in the current campaign of TCI against CSX), increase leverage, and become slightly more profitable. On other accounting-based measures of performance, such as asset growth or dividend payout ratios, we don't detect much of an effect.

How do the outcomes achieved by activists relate to shareholder value? It turns out that for the vast majority of cases, the stock price is roughly flat around the time of the activism. However, when a merger or asset sale is completed, stockholders collect between 20 and 40 percent returns, in the form of a takeover premium. This result is seen in **Figure 4**, where I partition activist events into those in which the target was eventually taken over, and those in which the target remained independent.

A more rigorous analysis would calculate average returns for firms under each set of outcomes. The conclusions, however, remain virtually the same: targets of investor activism earn high returns only in the subset of events in which the activist successfully persuades the target to merge or get acquired. The majority of activism targets – firms that do not end up being acquired – earn average abnormal returns that are not statistically distinguishable from zero, though our expectation was that the change in value would be positive. This result applies to both announcement returns, as well as to the long-term returns following the initial activist filing. This does not mean that one cannot identify isolated examples in the data where the activist creates value and the target remains independent – my observation is simply that these cases are the exception, rather than the rule.

As discussed earlier, this finding has some implications for forecasts of activism going forward. If activists are only successful when they are able to secure a takeover, then presumably they will be less active during times when market-wide takeover interest is low. Consistent with this, evidence from the credit crunch of August and September 2007 confirms this basic idea. During this time, private equity interest in debt financed buyouts declined dramatically due to spikes in interest rates. Many activists saw corresponding drops in the value of their portfolios – many of the firms they had targeted had been purchased in the hope of a takeover, the probability of which declined when rates fell. Activist investor Carl C. Icahn made this especially clear when he told The New York Times in August 2007 that the credit crunch was going to make it more difficult to generate high returns using activism.

V. Conclusions

Investor activism plays a vital role ensuring that management of public corporations is responsive to the demands of its owners. In recent years, hedge funds have become increasingly activist in their investments. Generalizing over all these investments, activism has been a successful strategy for investors.

Part of the success of activism in recent years has been a vibrant takeover market, fuelled by demand from private equity buyers. As takeover interest falls, we might expect the returns to activist strategies to fall, and hedge fund interest in pursuing these strategies to also fall. But this does not lessen their potential benefits. In an economy where most large firms are public corporations, it is important to have institutions that make sure that firms are delivering value to their owners.

There is enormous variety in what activists accomplish, and how those accomplishments correlate with shareholder value. However, some generalizations are possible. Activists tend to target industries with valuable assets but sluggish returns on capital. And within these industries, activists target lagging firms. Activists tend not to have a great record at fostering operational improvements, but nevertheless create significant value for shareholders, primarily by encouraging transactions in which there is a change of control. Thus, a realistic view of activists

is that they are akin to financial market arbitrageurs – spotting assets that are out of favor and getting management to take steps to get the prices back. A forecast is that the arrival of activists in the rail industry is a good predictor of future industry consolidation and takeover activity.

Activists already have to pay most of the costs of their work, while management can fund their opposition with shareholder money. As a result, I think most hedge funds are extremely cautious in their approach to activism. Successful activists typically have many other positions in which they act as passive investors. And even the most aggressive hedge funds, in my experience, use activism as a measure of last resort, preferring a constructive dialogue instead. And most hedge fund managers are aware of the massive reputational costs of being wrong in an activist investment, and are therefore careful in their analysis. At the end of the day, activists must convince other shareholders if they want to accomplish change. On balance, therefore, I would not favor rules that made activism any more difficult.

A final point: I often hear the criticism that activists are short-term investors, not interested in long-term value creation. This is a red-herring. I certainly agree that activists are short-term investors, and parts of my research support that claim. At some level, it is obvious in their desire to secure a takeover and get a quick exit from whatever position they have taken. But this misses the point that the rest of the market has a long horizon, and would not be willing to reward activism with a higher stock price if it felt that activists were destroying the long-term value. If the market felt that activists were a distraction rather than a benefit, the stock price would fall as soon as investors found out about the involvement of activists. Thus, to gauge whether the market believes activists can create value in the rail industry, one need look only as far as the share price appreciation. Naturally, one can always argue that the rest of the market has it wrong and management has it right, but this is not giving investors as much credit as they deserve.

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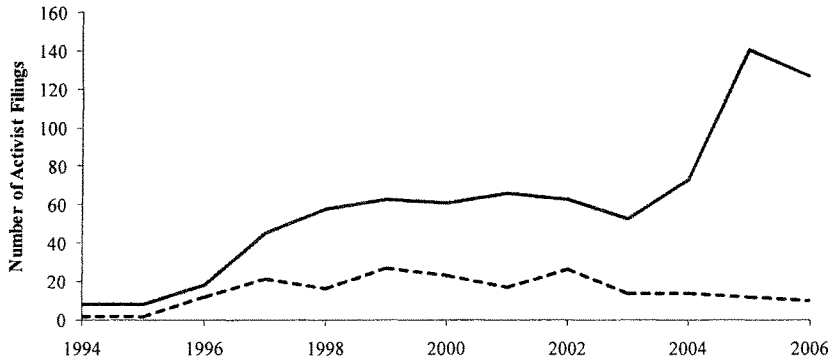
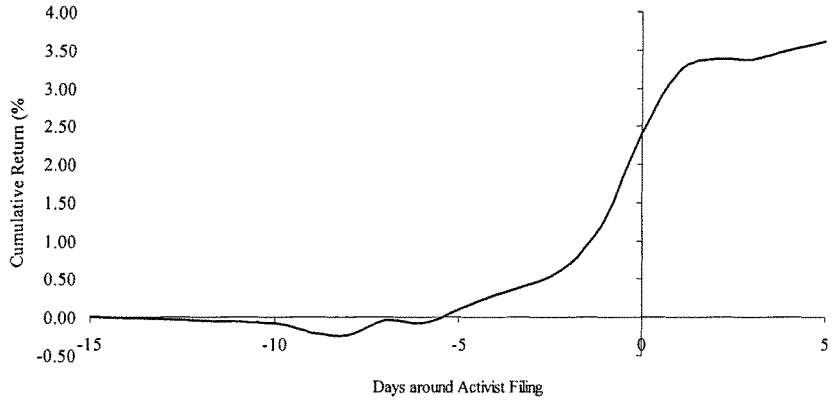
Figure 1
Number of 13D Activist Filings by Year and Type of Activist
(solid line – Hedge Fund Activist, dashed line – Non-Hedge Fund Activist).



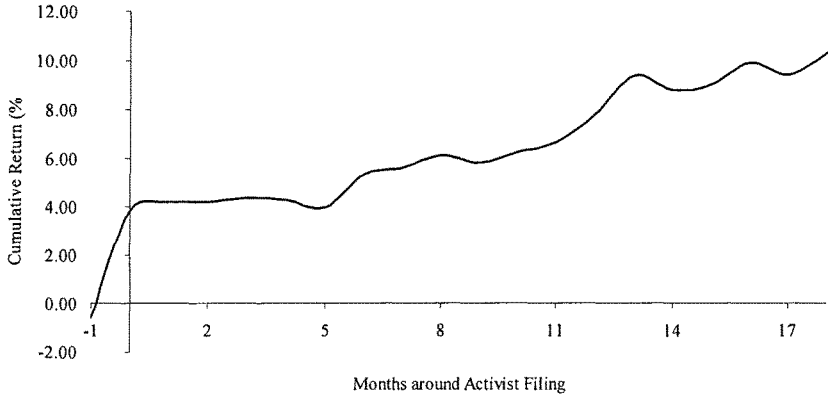
Notes: The figure plots the number of activist 13D filings in each year, by activist type. Activist events are culled from 13D filings with the SEC. Repeat filings with the same purpose of transaction are ignored for the purposes of the annual count. The figure is from Greenwood and Schor (2008).

Figure 2
Stock Returns around Shareholder Activism

Short-term abnormal returns (until 5 days after the 13D filing)



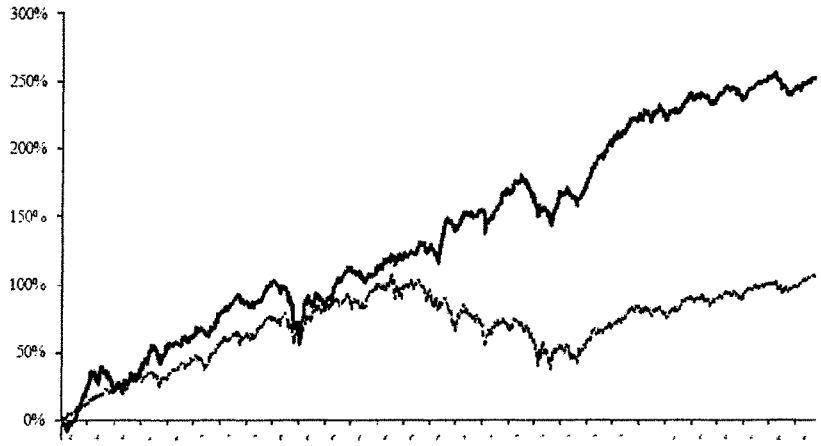
Long-term abnormal returns (until 18 months after the 13D filing)



Source: Greenwood and Schor (2008a)

Figure 3
Returns to a strategy that purchases all stocks targeted by activism

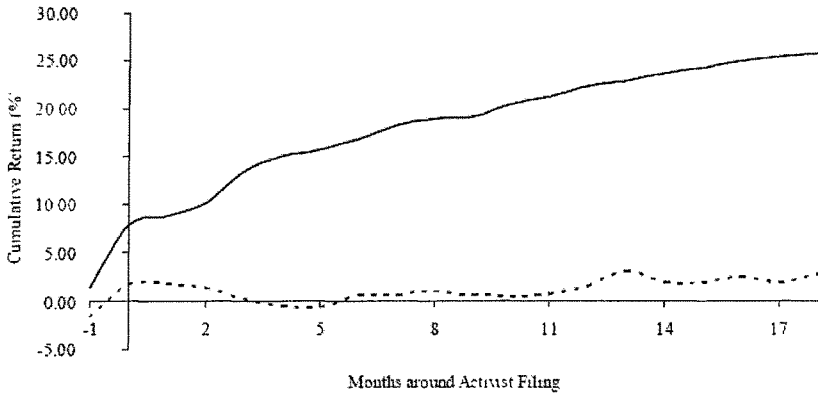
The top line denotes returns to this strategy. The bottom line denotes returns to buying the market index. The time period is 1994-2006.



Source: Greenwood and Schor (2008a), Figure A1

Figure 4
Long-term abnormal returns around activist filing, by outcome

(solid = targets that were eventually acquired; Dashed = all other outcomes)



Source: Greenwood and Schor (2008a), Figure 3

Table 1
Number of Activist Events by Year

	Hedge Fund	Non-Hedge Fund
1994	8	2
1995	8	2
1996	18	12
1997	45	21
1998	58	16
1999	63	27
2000	61	23
2001	66	17
2002	63	26
2003	53	14
2004	73	14
2005	141	12
2006	127	10
Total	784	196

Source: Greenwood and Schor (2008a)

Table 2
Industry concentration of activism activity

Industry	Number of Activist Events
Business Services	93
Chemicals & Allied Products	58
Electronic & Other Electric Equipment	56
Holding & Other Investment Offices	47
Industrial Machinery & Equipment	41
Communication	32
Instruments & Related Products	31
Eating & Drinking Places	26
Wholesale Trade - Durable Goods	22
Electric, Gas, & Sanitary Services	21
Miscellaneous Retail	20
Engineering & Management Services	20
Health Services	19
Paper & Allied Products	18
Depository Institutions	17
Oil & Gas Extraction	16
Printing & Publishing	15
Primary Metal Industries	15
Transportation Equipment	15
Wholesale Trade - Nondurable Goods	15
Apparel & Other Textile Products	14
Rubber & Misc. Plastics Products	14
Insurance Carriers	14
General Merchandise Stores	13
Food & Kindred Products	12
Security & Commodity Brokers	11
Motion Pictures	11
Fabricated Metal Products	10
Real Estate	10
Other	116
Total	822

Source: Author's analysis

Table 3
Activist events by type of request

	Hedge Fund	Non-Hedge Fund	Total
Engage management –	357	44	401
Capital structure	79	12	91
Corporate governance	172	95	267
Business strategy	36	12	48
Strategic Alternatives	19	10	29
Asset sale	142	26	168
Block merger	44	20	64
Financing/Bankruptcy	11	4	15
Proxy contest	71	6	77

Source: Greenwood and Schor (2008a)

Table 4
Activist events by outcome

Outcome	Number
No News	379
News:	
Asset Sale Related:	
Merger or Asset Sale Completed	178
Merger or Asset Sale Announced	48
Merger Called Off or Bid Increased	12
Spinoff Completed or Announced	7
Activist Takes Over Target	7
Target Hires IB or Begins Auction	14
Capital Structure (non asset sale	
Shares repurchased/Special Div.	23
Greenmail	4
Corporate Governance:	
Removal of Poison Pill	15
Resignation of CEO/CFO/Chairman	25
Board Seats Granted to Activist	96
Proxy Defeated	14
Other:	
Activist Cuts Position Below 5%	35
Financing/Bankruptcy Agreement	17

Source: Greenwood and Schor (2008a)

Before The
U.S. House of Representatives
Committee on Transportation and Infrastructure
Subcommittee on Railroads, Pipelines, and Hazardous Materials

March 5, 2008 Hearing
Investment in the Rail Industry
11:00 A.M.
2167 Rayburn House Office Building

Testimony Of
Vice Chairman Francis P. Mulvey
Surface Transportation Board
395 E Street, SW, Suite 1290
Washington, DC 20423-0001
(202) 245-0210

Good morning Chairwoman Brown, Ranking Member Shuster, and other Members. Thank you for this opportunity to testify on investment in the rail industry.

Several months ago, at the September 25, 2007 full Committee hearing on rail competition and service matters, I expressed concern about potential "hedge fund" purchases of a significant stake in a railroad, followed by divestiture of the railroad's assets, deferred maintenance, and a rolling back of capital improvement programs. I noted that these actions could result in deterioration of service to shippers and a return to the "bad old days" of the 1970s when railroads were hemorrhaging cash and unable to adequately maintain the rail plant. Ultimately, a strategy of reduced investment could lead to a failing firm and less railroad capacity.

In a letter dated October 24, 2007, I and my fellow Board Members responded to several follow-up questions from Committee Members, one of which was about the limits of our authority over rail acquisitions, and specifically about investment in rail carriers by certain types of investors. We noted that, as it currently stands, the Board does not appear to have any authority under existing law to limit such investments by hedge funds or other "short term" investors.

Today, I would like to elaborate on my prior testimony on the topic of investment in the rail industry. First, I would like to review the investment trends in the industry and then turn to the topic of the Board's authority in this area.

During the period between the Staggers Rail Act of 1980 and 2006, annual investment in rail plant and equipment trended upward in nominal dollars, but has remained relatively static when adjusted for inflation. In fact, compared to 1980, capital spending in constant dollar terms was 20 percent less in 2006 (see graph 1 attached).

Of course, it is also true that the rail plant has shrunk over the years. Miles of Class I railroad track have declined from 340,779 miles in 1980 to just 162,056 miles today—a reduction of more than 50 percent. Similarly, miles of road served by the Class I's have fallen from 207,334 miles in 1980 to 94,942 miles in 2006 (see graph 2 attached). Net investment per track mile or road mile has fluctuated since 1980, but is on balance much higher today (see graphs 3 and 4 attached). Likewise, the locomotive and freight car fleets are also much smaller today than they were at the time the Staggers Act was passed. There were 28,094 locomotives operated by Class I carriers in 1980, compared to 23,732 in 2006. But, today's locomotives are much more powerful. The average locomotive has 51 percent more horsepower per unit than in 1980.

The railroads' freight car fleets are even more reduced than their locomotive fleets. While the Class I railroads' freight car fleets comprised 1,168,114 cars in 1980, there were only 475,415 cars in service in 2006. Some of this decline was offset by growth in the fleets operated by Class II and Class III railroads, and the spinning off of car supply responsibility to shippers and other car suppliers. Class II and III railroads grew their fleets from 102,161 cars in 1980 to 120,688 cars in 2006. More dramatically, shippers and other car companies expanded their car fleets from 440,552 cars in 1980 to

750,404 cars in 2006. Despite the overall reduction in the freight car fleet, today's cars have much greater capacity. The typical car can handle nearly 25 percent more tons than the average rail car in 1980. In addition, the railroads operate more cars per train and the trains travel longer distances today. The result is that the nation's freight railroads now generate roughly twice as many ton-miles of service as they did in 1980. In fact, the rail share of the intercity freight transportation market has grown from its low point of 37.5 percent in 1980 to 42.3 percent in 2003—the last year for which data are available.

So, physical infrastructure has shrunk, the rail labor force has been reduced significantly and traffic has expanded. The result is that the railroads have gone from a situation of pervasive excess capacity to one in which they face capacity constraints. The upshot, of course, is that, as demand has exceeded supply, prices have risen and the railroads today are more profitable than they have been in decades. One would anticipate that some of these profits would be plowed back into the infrastructure so that the railroads could continue to accommodate further growth in demand.

Indeed, the railroads have begun to invest more into growing the infrastructure. While railroad-specific data are not available, it is generally thought that about one-fifth of rail capital spending for infrastructure is used for expansion. In 2007, the AAR estimates that the Class I railroads spent $1.9 billion for expansion of capacity through the building of new roadway and structures. This represents a steady increase in recent years in spending for capacity expansion. For example, Class I railroads spent $1.1 billion in 2005 and $1.4 billion in 2006 to expand the infrastructure. The railroads are

reducing their spending on capacity somewhat in 2008, due to the recent downturn in rail traffic demand. Over the past several weeks, a number of the Class I railroads have announced their capital expansion budgets for 2008:

- BNSF Railway Company announced it plans to spend a total of $2.45 billion in 2008 on capital expenditures compared to $2.59 billion in 2007, of which $950 million will go toward capacity *expansion*. It will spend approximately $350 million *less* on its capital expansion program than it spent last year.[1]

- Norfolk Southern Corporation plans to spend 29% of its $1.425 billion capital expenditures budget --- about $413 million --- on growth and productivity projects such as infrastructure and terminal expansion investments, strategic opportunities, and projects to improve its productivity and efficiency.[2]

- Union Pacific Railroad will spend $840 million to expand its network and terminal capacity in 2008. This represents about a quarter of its total $3.1 billion budget for capital expenditures, and this total budget is about the same amount it spent last year.[3]

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[1] "BNSF Announces $2.45 Billion Capital Commitment Program," *available at* http://www.bnsf.com/media/news/articles/2008/01/2008-01-29b.html; "Class I capex plans for 2008 are mixed," Argus Rail Business at 5 (Feb. 11, 2008).
[2] Remarks of Debbie H. Butler, Exec. V.P. Planning and Chief Information Officer, Norfolk Southern Corp., Financial Analysts' Meeting, New York, NY, Jan. 23, 2008, *available at* http://www.nscorp.com/nscportal/nscorp/Investors/Executive%20Speeches/2008/dhb012308.html.
[3] "Union Pacific Announces 2008 Capital Plan," *available at* http://www.uprr.com/newsinfo/releases/financial/2008/0201_capital.shtml?print; "Class I capex plans for 2008 are mixed," Argus Rail Business at 5 (Feb. 11, 2008).

- Canadian National Railway is targeting C$1.5 billion in capital spending for 2008, approximately C$500 million of which will go toward expansion projects.[4]

A recent report by Cambridge Systematics[5] for the AAR estimated that $148 billion will be needed for rail infrastructure capacity expansion to accommodate the projected growth in rail traffic demand through 2035. Of this amount, the Class I railroad share is $135 billion. This projection is for expansion capacity only, and does not include spending to maintain and support the new lines, acquire additional cars and locomotives, or operate, maintain and replace existing facilities. The report projected that the Class I railroads could supply $70 billion from earnings growth and an additional $26 billion from productivity savings to partly cover the $135 billion. This would still leave a shortfall of nearly $40 billion, or about $1.4 billion annually. And this is what is needed to simply sustain the status quo in terms of the rail market share. If the nation is serious about shifting substantial volumes of truck traffic off our streets and highways, the amounts needed and the size of the shortfall will be far greater than the Cambridge Systematics' projection.

Where will these monies come from? There are a number of potential sources, all of which have promise and problems. Investment tax credits, public/private partnerships, and the establishment of a railroad trust fund as advanced by a former member of this Committee are all potential ways to close the gap. However, there is another source of

[4] "Class I capex plans for 2008 are mixed," Argus Rail Business at 6 (Feb. 11, 2008).
[5] *National Rail Freight Infrastructure Capacity and Investment Study* (Sept. 2007), (prepared for Association of American Railroads by Cambridge Systematics, Inc.), *available at* http://www.aar.org/Newsroom/Capacity_Investment_study.asp.

investment capital that has recently gained the attention of many in the industry and in the Congress—investments by hedge funds—and I want to focus the remainder of my remarks on that subject.

Hedge funds and other non-traditional rail investors have recently become significantly involved in railroads. Because these types of firms are believed to have time horizons of five years or less and strategies of maximizing short-run returns, there are concerns that their investment strategies will run counter to the needs of railroads for long-term capital investment. Thus, investment in the rail industry by hedge funds could be at odds with the public interest and common carrier aspects of the rail industry. Railroads have a fundamental common carrier obligation to provide rail service upon reasonable request, and there is a public interest component to the Board's regulation of certain rail transactions. When investors demand a relatively quick return on their investments, that could result in deferred maintenance or a deterioration of assets and could conflict with the railroad's obligation to provide service to shippers and communities.

I want to stress that it is, categorically, not the source or identity of investors that is of concern, but the timeframes and goals for the investments. As you know, the rail industry is capital-intensive, with long-lived assets, and long lead times for the replacement and improvement of assets. Thus, investors with the goal of reaping short-term profits may be at odds with the very nature of this industry. A "long term" investment for a private equity firm may be 5 years. But in the rail industry, that is a

short period of time. Can a short time frame for rail investment result in a commitment to expansion capital? Can it even result in preservation of the status quo? The answer may depend on how actively the investors become involved in the management and strategic decisions of the railroad.

What is the Board's ability to address these concerns? If rail investment—or disinvestment—manifests itself in reduced service, the Board already possesses the power to replace an owner or operator of a line who is unwilling or incapable of providing adequate service, under our "feeder line" and directed service provisions.[6] We have used these provisions several times in the past few years. For example, following up on a 2006 authorization of alternative rail service at the request of a shipper in Lubbock, Texas, the Board extended the temporary relief until a long-term solution could be developed. In August 2007, the Board ordered divestiture of the lines involved, at a price set by the Board to reflect the value of the property, to enable improved rail service to the affected shippers.[7]

Concerning our jurisdiction over investments, as we stated in our letter of October 24, 2007, the Board has authority to regulate some railroad transactions, but not others. Any authority that the Board might have over the takeover of a rail carrier by a non-carrier such as an investment partnership or hedge fund would derive from either the

[6] 49 U.S.C. 10907 & 11123.
[7] PYCO Indus., Inc. –Alternative Rail Service—South Plains Switching, Ltd., STB Finance Docket No. 34889, et al. (STB served Nov. 21, 2006); PYCO Indus., Inc.—Feeder Line Application— Lines of South Plains Switching, Ltd., STB Finance Docket No. 34890, et al. (STB served Aug. 30, 2007).

provision in the law that applies to acquisitions of rail property by non-carriers[8] or the provision that applies when transfers of stock and control of a company are involved.[9] The latter provision might apply if a non-carrier were to acquire a single rail carrier that itself owns another rail carrier (for example, a large railroad that owns a small railroad), but under agency precedent the authorization requirement would not apply if the two or more carriers being taken over operate as a single integrated transportation system. And the former provision, which generally applies to transfers of physical property, requires Board authorization if a person other than a rail carrier acquires a "railroad line."[10] This provision appears to be focused on discrete lines, not carriers, and I do not believe that it would normally be applied if a non-carrier sought to take over a major rail carrier.

The question of the agency's jurisdiction over leveraged buy-outs arose in 1989 with respect to a proposed takeover of Chicago and Northwestern Transportation Company, then a Class I rail system, by Japonica Partners. In response to a request from the Senate Commerce Committee, the agency's predecessor, the ICC, prepared a report in which it analyzed the relevant statutory provisions and concluded that it would be difficult as a matter of law for the ICC to exercise jurisdiction over the proposed transaction.[11] Reacting to the ICC's report, Congress quickly moved to give the agency responsibility for approving such transactions.[12] In particular, the legislation would have required ICC approval for a non carrier to acquire direct or indirect control over a Class I

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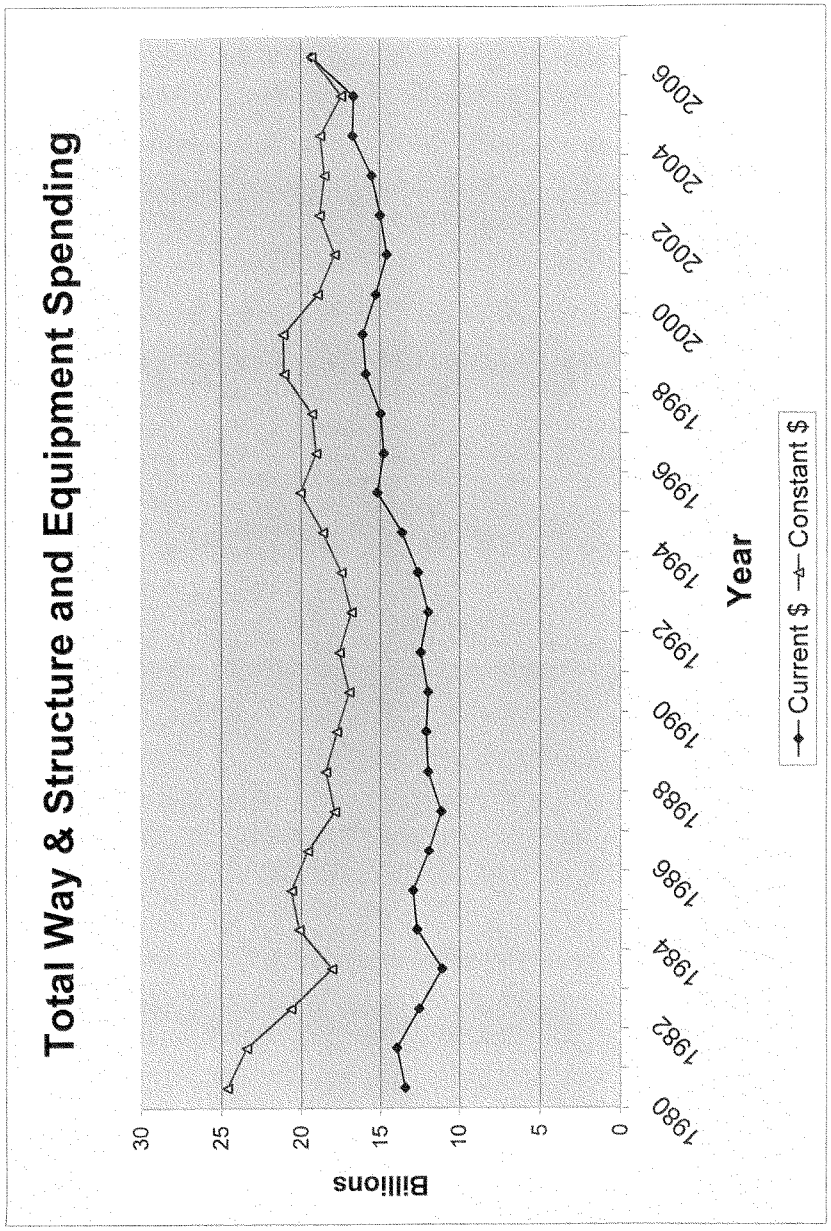
[8] 49 U.S.C. 10901.
[9] 49 U.S.C. 11323(a)(4) (providing that Board approval and authorization is required for the "[a]cquisition of control of at least 2 rail carriers by a person that is not a rail carrier.").
[10] 49 U.S.C. 10901.
[11] See Letter to the Hon. J. James Exon re: ICC Ex Parte No. 480 from ICC Commissioners (May 15, 1989).
[12] See Amtrak Reauthorization and Improvement Act of 1990, H.R. 2364, 101st Cong. § 8 (1990).

rail carrier. President George H.W. Bush, however, vetoed the legislation because he viewed it as a counterproductive step backward from prior deregulatory legislation. Although not dispositive, this legislative history tends to confirm that the agency would lack approval authority over the acquisition of a large rail system by a noncarrier.

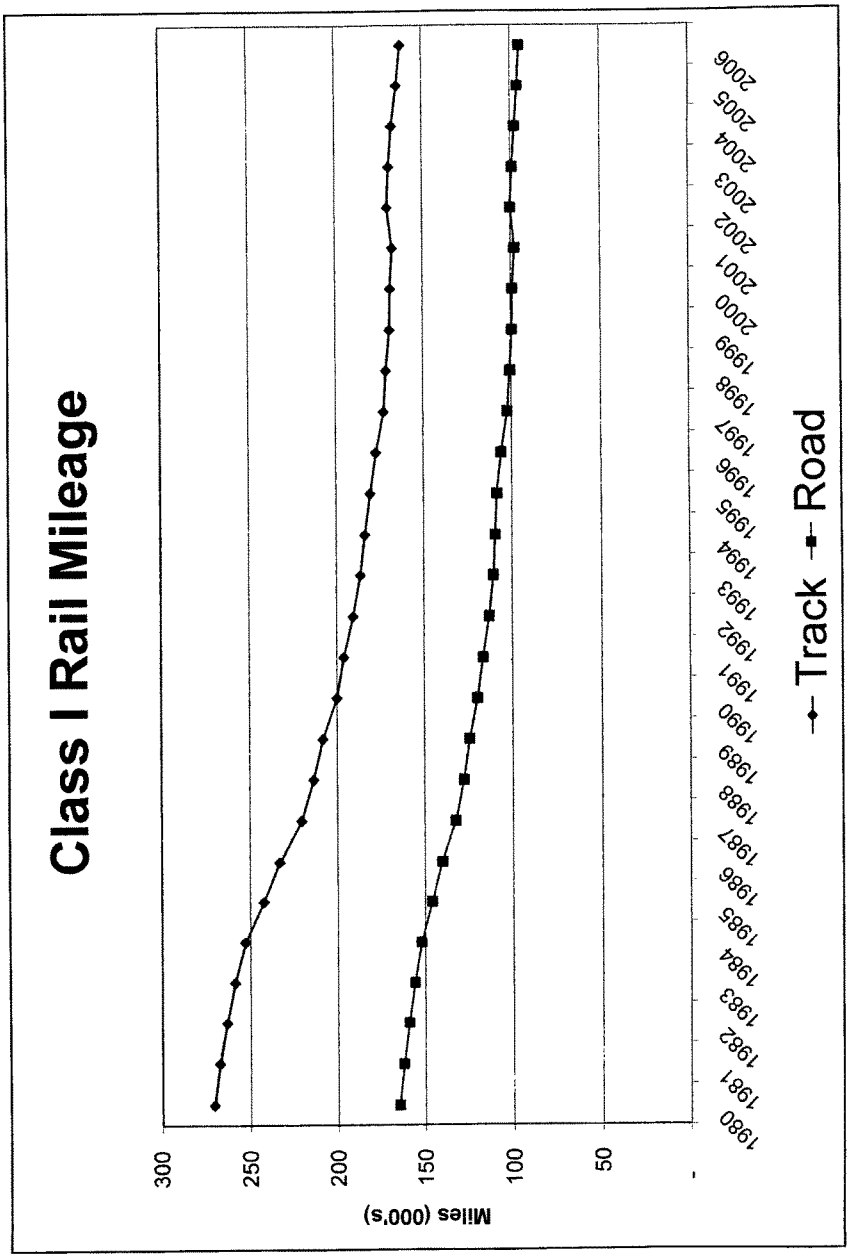
In closing, I would like to note that while the Board generally does not have the power to order what investments are made or how much is spent on the rail plant, it does have the power under the existing statute to remedy severe service deterioration problems, which is the ultimate concern of shippers and communities. We as a nation need to find ways of encouraging, not discouraging, investment in the rail plant to ensure our continued mobility.

Thank you for the opportunity to testify today. I look forward to answering any questions you may have.

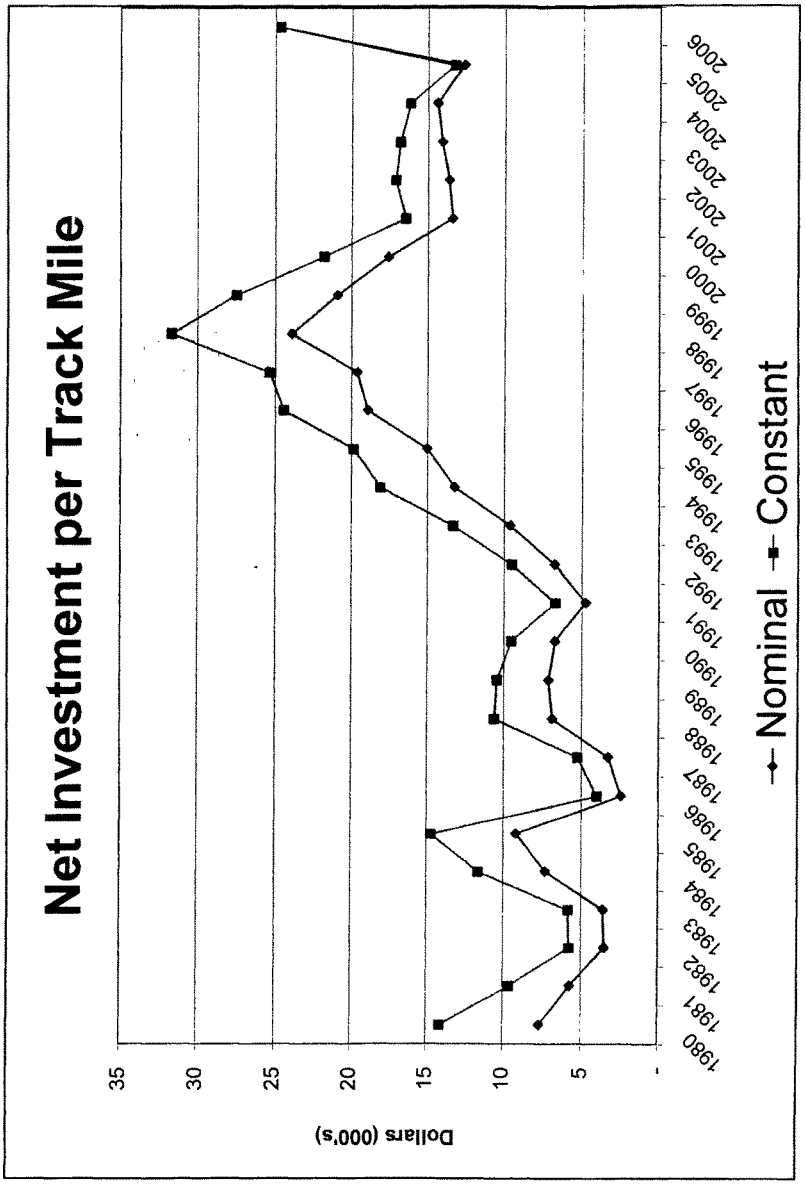
GRAPH 1


Total Way & Structure and Equipment Spending
Billions
30
25
20
15
10
5
0
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
Year
Current $
Constant $

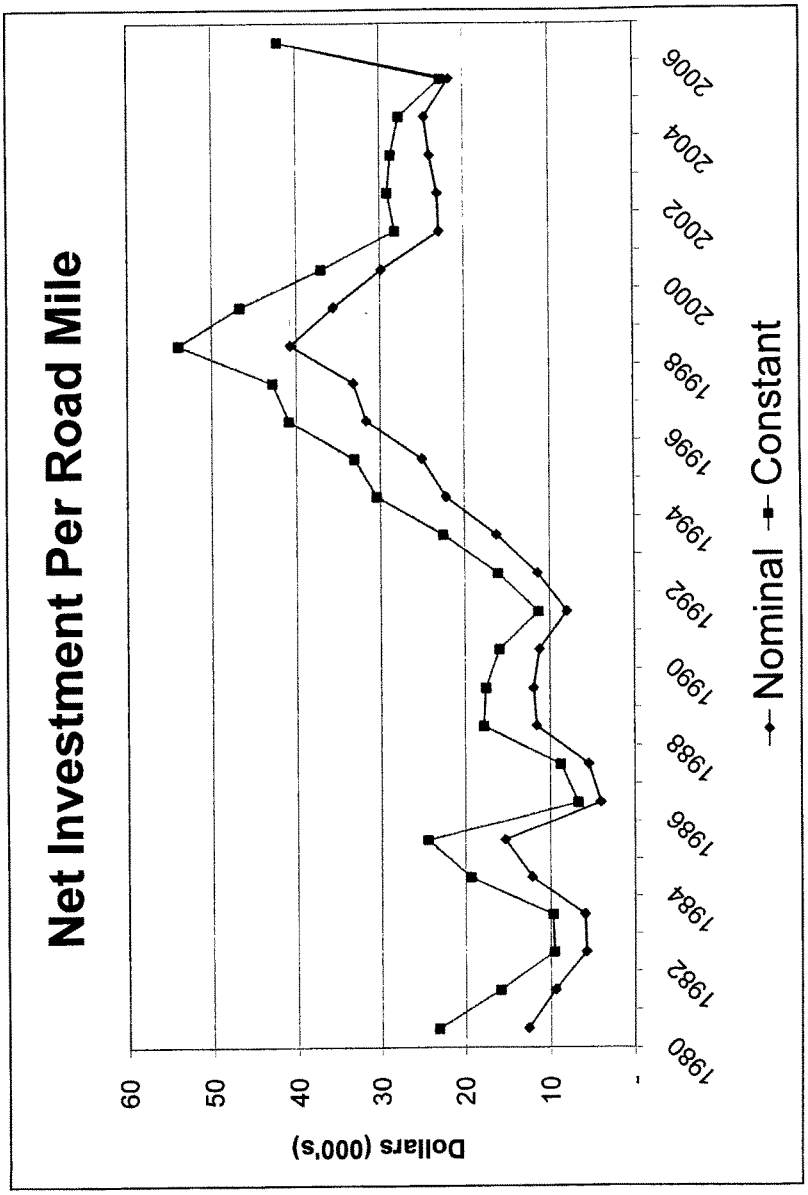
GRAPH 2


Class I Rail Mileage
Miles (000's)
300
250
200
150
100
50
-
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Track
Road

GRAPH 3


Net Investment per Track Mile
Dollars (000's)
35
30
25
20
15
10
5
-
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Nominal
Constant

GRAPH 4


Net Investment Per Road Mile
Dollars (000's)
60
50
40
30
20
10
-
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
Nominal
Constant

TESTIMONY OF

CHARLES D. NOTTINGHAM
CHAIRMAN

SURFACE TRANSPORTATION BOARD
395 E STREET, SW
WASHINGTON, DC 20423
(202) 245-0200

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

SUBCOMMITTEE ON RAILROADS, PIPELINES,
AND HAZARDOUS MATERIALS

AT A HEARING REGARDING

INVESTMENT IN THE RAIL INDUSTRY

March 5, 2008
11:00 A.M.
Room 2167 Rayburn House Office Building

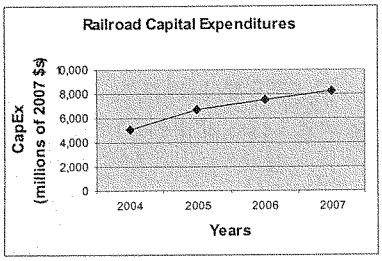
Testimony of Charles D. Nottingham
Chairman of the Surface Transportation Board
Before the Committee on Transportation and Infrastructure
Subcommittee on Railroads, Pipelines, and Hazardous Materials
Hearing on Investment in the Rail Industry
11:00 a.m. March 5, 2008
2167 Rayburn House Office Building

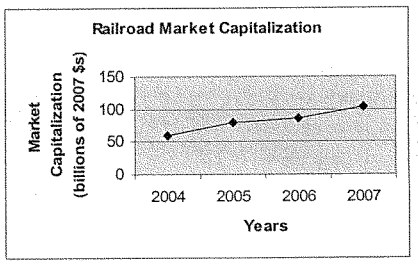
Good morning Chairwoman Brown, Ranking Member Shuster, and Members of the Subcommittee. My name is Charles D. Nottingham, and I am Chairman of the Surface Transportation Board (Board or STB). I appreciate the opportunity to appear before this Subcommittee today to discuss investment in the rail industry, an issue that is vitally important to the freight railroads, their customers and employees, and the Nation's freight transportation system as a whole.

When Congress passed the Staggers Act in 1980, the Nation's rail system was in desperate financial straits. It was burdened with excess capacity and unproductive assets, forced to provide unprofitable services, and hampered by excessive government regulation. It was not an industry into which many investors wanted to put their dollars.

Since 1980, regulation has been reduced, carriers have been permitted to abandon unprofitable lines, and the rail system has rationalized much of its excess capacity, particularly its lighter-density lines. In recent years, however, the U.S. economy has expanded, and the rail network, like other transportation sectors, has become capacity-constrained. Unlike some other transportation sectors – trucking companies, for example, which can buy new equipment or hire more drivers – railroads cannot respond as readily to capacity constraints by quickly building new track and other facilities. Not only are rail construction projects expensive and time-consuming, but these projects can generate significant opposition on environmental and community-impact grounds.

Nevertheless, as shown by the following charts, it appears that railroads are increasing their investments in road, plant, and equipment at a rate that is consistent with the financial market evaluation of railroad future growth prospects:[1]





Between 2004 and 2007, the market capitalization of the large railroads (reflecting end-of-year stock values) has increased by 24.1 percent annually in real terms, which indicates that the market expects railroad earnings to continue to be stable or to grow. At the same time, capital investment has increased annually by 21.6 percent, again in real terms. Thus, it appears that railroads are making investments to the extent that they believe that those investments will pay off in the market.

Consistent with the growth in stock prices, railroads recently have also attracted renewed interest from the financial community, which apparently views the railroads' future as relatively bright in light of the recent increase in traffic and anticipated future traffic levels. Indeed, since late 2006, several investment funds, including Berkshire Hathaway, have acquired substantial positions in several Class I railroads.

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[1] Capital expenditure data are from BNSF, UP, CSX, NSC, and KCS financial reports filed with the SEC. Market capitalization data are from BNSF, UP, CSX, and NSC and reflect end-of-year market value of stock outstanding. Nominal values are adjusted by the GDP deflator.

While some have expressed concern with recent international investment in railroads, such financial markets have historically contributed to the financing of U.S. railroads, and international investors remain active today in the numerous U.S. industries that are a part of the global marketplace. However, concerns have surfaced regarding investors who have not traditionally invested heavily in railroads, such as hedge funds and certain large institutional investors, some of which are international. This new investor interest in the rail industry carries with it the possibility of a takeover of a railroad by a non-railroad entity. The STB has received numerous inquiries about how we would respond to such a transaction.

The "merger and acquisition" provisions of the Interstate Commerce Act provide that when two or more rail carriers seek to consolidate through a merger or common control arrangement, or when a noncarrier buys multiple carriers, prior approval of the Board must be obtained.[2] Also, the "line sale" provisions of the Act require noncarriers to obtain Board authority before they can build or buy a particular rail line.[3] Non-railroad investors, however, do not typically buy individual rail lines; they buy stock in a carrier or carrier system.

When a noncarrier buys a controlling interest in the stock of a holding company that owns several unrelated rail carriers, it must obtain STB authority, as Fortress Investment Group did when it obtained control of the RailAmerica family of small railroads in 2007. Were a noncarrier to acquire a controlling interest in the stock of a

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[2] See 49 U.S.C. 11323.

[3] See 49 U.S.C. 10901.

single railroad or a single integrated rail system, I do not believe that regulatory approval would be required under the statute.

The question of the agency's jurisdiction over takeovers involving a single rail system arose in 1989 with respect to a proposed takeover of Chicago and Northwestern Transportation Company by Japonica Partners. In response to a request from the Senate Commerce Committee, the ICC prepared a report in which it analyzed the relevant statutory provisions and concluded that it would be difficult for the ICC to exercise jurisdiction over the proposed transaction. Reacting to the ICC's report, Congress quickly moved to give the agency responsibility for approving such transactions. In particular, legislation that would have required ICC approval for a noncarrier to acquire direct or indirect control over a Class I rail carrier was approved by Congress in 1989. President George Herbert Walker Bush, however, vetoed the legislation, citing the "unprecedented new regulatory review requirement" that the new legislation would have imposed on the ICC.[4] Although not dispositive, this legislative history tends to confirm that, under the existing statute and agency precedent, the agency lacks authority to approve the acquisition of a single rail system by a noncarrier.

I do not believe that the statute needs to be changed to give the Board more extensive review authority. The Board's governing statute specifically gives the Board authority to inspect carrier records and to "inquire into and report on the management of the business of carriers providing transportation and services subject to [the Board's

[4] President's Message to the House of Representatives Returning Without Approval the Amtrak Reauthorization and Improvement Act of 1990, 1 Pub. Papers 718 (May 24, 1990).

jurisdiction]."[5] Moreover, under the Rail Transportation Policy of 49 U.S.C. 10101, the Board, in regulating the rail industry, is to take into account, among other things, the need to "ensure the development and continuation of a sound rail transportation system," to "foster sound economic conditions in transportation," and to "encourage honest and efficient management of railroads."[6] Because the acquisition of voting control of a single rail system could affect the management of the acquired firm, the Board could inquire into and report on it under 49 U.S.C. 721, much as the ICC did with the proposed takeover of Chicago and North Western Transportation Company by Japonica Partners in 1989.

More importantly, any owner – even a current rail owner – has the capability of over-leveraging its firm's assets, neglecting to maintain its capital infrastructure, or degrading service. Regardless of ownership, I believe that the Board has sufficient tools already to ensure that carriers, regardless of their ownership status, carry out their common carrier obligation as railroads. Were the Board to look into the management of a carrier and find that the carrier's owners were stripping its assets so that the carrier could not carry out its common carrier obligation, the Board or the Department of Justice could take enforcement action to compel the carrier to comply with the statute and with STB orders. The Board could also, on complaint, find that the carrier violated the statute and award damages.

I understand the concern that a dominant investor with a very short-term focus could harm the long-term prospects of a particular company as well as disrupt interstate

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[5] 49 U.S.C. 721(b)(1).

[6] 49 U.S.C. 10101 (4), (5), and (9).

commerce if a policy of diverting revenues, neglecting shippers, and cutting back on capital spending were to be implemented. A railroad controlled by a large non-railroad investor, however, is still bound by the same obligations of all railroads: it must fulfill the common carrier obligation; it must maintain reasonable rates and practices; and it must file for abandonment or discontinuance authority if it is not going to provide service over a line. Given the Board's ability to address concerns that may arise in the future, I would not recommend doing anything at this time to deter needed investment in the industry.

Given the magnitude of rail infrastructure needs and the lack of alternative sources of funding, Congress and the STB should be very careful to avoid sending signals to the financial markets that we do not welcome and encourage investment in the privately owned rail system. Freight railroads in the U.S. are in reasonably good financial shape and are attracting investors of all types and sizes. The rail industry's ability in future years to continue this trend will largely determine whether the rail sector will have the resources needed to meet growing demand for rail service. The Board will remain vigilant and proactive to ensure that interstate commerce is not harmed by a short-sighted effort to extract large profits while neglecting the infrastructure and rail customers.

I appreciate the opportunity to discuss these issues today, and look forward to any questions you might have.

Office of the Chairman

Surface Transportation Board
Washington, D.C. 20423-0001

May 5, 2008

The Honorable Corrine Brown
Chairwoman
Subcommittee on Railroads, Pipelines,
and Hazardous Materials
U.S. House of Representatives
Washington, DC 20515

Dear Chairwoman Brown,

Thank you for inviting me to testify before the Subcommittee at the hearing on Investment in the Rail Industry, held on March 3, 2008. At the conclusion of the first panel, you asked us to submit any recommendations that would "ensure that Congress does not endanger future railroad investment by the financial markets . . ." I would like to provide the following as my written response for the record.

Given the magnitude of rail infrastructure needs and the lack of alternative sources of funding, Congress and the Surface Transportation Board (STB) should avoid adopting laws and regulations that discourage investment in our privately-owned rail system. The rail industry's continued ability to attract investment capital will determine whether railroads will have the resources needed to meet projected growth in demand for rail service and capacity.

The STB will remain vigilant and proactive to ensure that interstate commerce is not harmed by a short-sighted effort to extract large profits while neglecting the infrastructure and rail customers. I hope the Subcommittee finds this information helpful. If I can provide any additional information, please do not hesitate to contact me.

Sincerely,

Charles D. Nottingham
Chairman

Testimony of:

Michael J. Ward, Chairman and CEO

CSX Corporation

on

"Investment in the Rail Industry"

before the

United States House of Representatives

Committee on Transportation and Infrastructure,

Subcommittee on Railroads, Pipelines, and Hazardous Materials

March 5, 2008

Washington, D.C.

CSX Corporation
500 Water St.
Jacksonville, FL 32202
(904) 359-3100

Chairwoman Brown, Ranking Member Shuster and Members of the Subcommittee:

Thank you for your time today, and for considering CSX Corporation's views on the important subject of investment in the rail industry.

I come to you today as the Chairman and CEO of CSX and as a railroader with more than 30 years of experience. I am committed to creating value for all CSX shareholders. That value is created when CSX meets its public service and common carrier obligations to our customers, our 35,000 employees, the communities where we do business, and you, the policymakers who make the laws that shape our operating environment. When CSX delivers exceptional performance, our customers, our shareholders and our country all benefit.

My testimony will cover three areas: 1) CSX's business, and the service that it provides to our nation; 2) our track record and future plans to meet and exceed the expectations of all of our company's stakeholders; and 3) the harmful implications for our country if railroads were to respond to outside pressures to reduce capital spending and cease investing for the long-term.

The Role of Freight Rail and CSX in the American Economy

As you are aware, North America's Class I freight railroads and their outstanding employees are unequalled in terms of operations and safety. They are truly the envy of the world. Their performance helps to strengthen our nation's economy in a safe, secure way that saves fuel and reduces congestion on the roads and highways. According to the Association of American Railroads, full-year 2007 U.S. carloads totaled 16,952,288. Full-year 2007 U.S. intermodal loadings were 12,026,660 trailers and containers. Total volume for the year was estimated at 1.76 trillion ton-miles. Railroads serve as the circulatory system of the U.S. economy, and efficient and reliable rail transportation is one of the genuine competitive advantages that U.S. businesses have in the global economy.

At CSX, we see robust demand and opportunity for freight rail service in the years ahead. As this committee recognized in a hearing held on January 17, 2008, U.S. freight rail movements are expected to increase 92 percent over the next 30 years. To meet the increasing transportation demands of the American economy the rail industry must continue to make significant investments in its infrastructure.

In recent testimony before this Committee, Surface Transportation Board (STB) Chairman Charles Nottingham noted:

"...in recent years, the U.S. rail network, like other transportation sectors, has become capacity-constrained. On April 11, 2007, the Board held a public hearing focused on rail capacity, traffic forecasts, and infrastructure requirements. At the hearing, we heard a broad consensus that rail capacity will become increasingly constrained by traffic growth. It is clear that the rail system's capacity shortfall that we see in many markets today will dramatically worsen unless bold new policies and strategies are adopted. The energy sector is especially vulnerable to rail capacity constraints and service problems."

As Chairman Nottingham stated in his testimony, the railroad industry has a direct and profound impact on our entire economy, since the goods moved by the freight rail industry are critical to the economic well-being of our entire nation. Therefore, railroads must invest prudently in order to meet future demand.

Our Business

At CSX, we strive to be the most progressive North American railroad. We are improving faster than the rest of the excellent freight rail industry on nearly every measure, including safety, customer service, and financial performance. We now rank among the industry's best companies in safety, service and corporate governance. Our

35,000 employees' efforts have made tremendous strides in meeting customers' needs and creating significant value for all CSX shareholders.

We have a balanced and disciplined plan to invest for the future of our rail network – to add additional capacity, newer equipment and technology, and improved transportation infrastructure and security. CSX operates 21,000 miles of track serving 23 states and the District of Columbia, and we are investing to meet the heightened demands of our customers and our economy in the years ahead, while continuing to provide exceptional returns to our shareholders.

Our company connects to 70 ocean, lake and river ports, and more than 230 short-line and regional railroads. CSX services 36 automobile distribution centers, 165 bulk intermodal terminals and rail-to-truck transload facilities, 130 active coal mines, and 105 coal-fired power plants and cogeneration facilities.

We serve virtually every major industrial and population center east of the Mississippi river with an average of 1200 trains per day. These trains carry everything from coal that creates energy to heat our homes, to the fertilizer that feeds America's harvest, to the orange juice we drink with our breakfast. There are four principal segments of our transportation business: 1) coal, coke and iron ore; 2) automotive; 3) general merchandise; and 4) intermodal, which involves freight that moves between rail, trucks and ships.

In 2007, CSX delivered 1.9 million carloads of coal, coke and iron ore, accounting for 26 percent of the company's revenue. Eighty percent of that coal is used for domestic energy production. That same year, CSX also delivered 439,000 carloads of finished autos and auto parts to the 19 vehicle assembly plants and distribution centers we currently serve. Three new auto plants scheduled to open by 2010 will be served by CSX as well.

CSX also transports general merchandise such as phosphates and fertilizers, chemicals, forest products and paper, metals, food, and other consumer products that earned our company $5 billion in revenue in 2007. Our intermodal service combines the long-haul advantages of rail with the flexibility of trucking. CSX's 40 Intermodal facilities serve every major market east of the Mississippi.

We also serve more specialized customers, like the United States military. CSX carries the equipment and supplies our military needs to deploy efficiently and keep America secure. In 2007, our company moved more than 9500 carloads of vehicles, tanks and armaments – from Fort Drum in New York, the Letterkenny Army Depot in Pennsylvania, Fort Campbell and the Bluegrass Army Depot in Kentucky, Fort Eustis in Virginia, and Fort Stewart in Georgia – to interchange points with western railroads and East coast ports in Florida, the Carolinas and Philadelphia. From these ports, equipment and supplies are shipped to the men and women protecting our nation around the world.

The Benefits of Freight Rail to Our Nation

In our global economy, where the distance between the producer and the consumer is longer than ever, freight rail provides a timely, cost-effective, environmentally-friendly and safe mode of transportation. For this reason, more and more customers are turning to railroads – including CSX – to meet their transportation needs.

At a time when crude oil has passed the $100 per-barrel threshold, freight rail is a cost-effective transportation solution that enhances our energy security and reduces our dependence on foreign oil. A typical CSX freight train delivers the equivalent of 240 truckloads, with dramatically lower fuel consumption. That not only reduces traffic congestion; it saves fuel for everyone. In fact, with increasing fuel efficiency CSX can now move a ton of freight 436 miles on a single gallon of fuel.

CSX also helps to relieve congestion on the roads and highways by providing critical infrastructure that is relied upon by more passenger and commuter rail networks than any other railroad. Though we are a freight railroad, 17.4 million passengers travel over CSX track each year on Amtrak and commuter railroads.

For our company, these environmental and commuter benefits are just the beginning. Since 1980, we have taken steps to improve our fuel efficiency by 73 percent.

And in the past five years, our subsidiary, CSX Transportation, Inc. (CSXT), has invested more than $1 billion to upgrade its fleet with more efficient, low-emission locomotives.

I am proud that in March 2007, CSX became the first Class I freight railroad to join the Environmental Protection Agency's Climate Leaders program, pledging to annually inventory and publicly report its greenhouse gas emissions and establish a voluntary goal for reducing them. And just last month, our company also became the first North American railroad to launch a "carbon calculator," an online tool available at www.CSX.com that lets anyone compare the greenhouse gas emissions savings when freight is shipped on CSX, rather than by truck.

These initiatives aren't just good for our environment, they help build our business. When we save money by running our railroad in a more fuel efficient fashion, we can reinvest those resources in capital improvements that help us better serve our customers.

Our Commitment to Safety

When our railroad is operated efficiently and effectively, it also operates safely. At CSX, we have invested in and created a safety culture that has driven across-the-board improvement in safety. This investment made 2007 the safest year in our railroad's history. Since 2004, CSX has achieved a decrease in personal injuries of nearly 50 percent, an industry leading improvement. Over the past three years, CSX has reduced

train accidents by 42 percent – also an industry leading improvement. Our ultimate goal is zero accidents. Not only do we want to do better, regulators expect us to do better.

As Federal Railroad Administrator Joe Boardman noted in a January 3, 2008 statement, "[CSX] must stay focused, and not be distracted from making the necessary long-term investments in infrastructure, technology and employees that will strengthen its safety culture and performance."

CSX has pioneered unique safety and security partnerships with state governments to help protect and secure the communities where we do business. CSX has reached agreements with the states of Kentucky, Maryland, New Jersey and New York to share a proprietary CSX technology developed by our company that provides state emergency management officials and first-responders with immediate access to information about the locations of our trains and the contents of railcars under our control, including hazardous material shipments. CSX is also the only railroad currently sharing this security information with the Department of Homeland Security's Transportation Security Operations Center (TSOC), and we are working to enter similar arrangements with other states as well.

Strong Operating and Financial Performance

It's not a coincidence that our improvements in safety and security closely track improvements in operating performance. CSX led North American railroads in train

velocity and dwell improvement over the past three years, and CSX operational improvements over that period were driven, in part, by strategic capital investments in the network. For example, the capacity expansion projects that CSX completed in 2006 improved velocity on the coal route to power plants in the South by 40 percent and on the critical corridor from Chicago to Jacksonville by 14 percent in the following year. Operating performance improvements such as these have benefited our customers, our employees and our shareholders, but they would not be possible without continued investment in our infrastructure.

Since 2004, CSX operating income has nearly doubled, and our surface transportation operating ratio has improved to its best level in a decade – 76.4 percent for the fourth quarter of 2007. Operating ratio, which is inverse margin or the ratio of operating expenses to operating revenues expressed as a percentage, is a widely used performance measurement in the railroad industry.

As CSX performance has improved, shareholders have been rewarded. The value of CSX's stock has improved more than 150 percent in the last three years, which has provided shareholders with a return better than the rest of North America's Class I railroads and 94 percent of all Standard & Poor's 500 (S&P 500) companies

In the third and fourth quarters of 2007 CSX delivered exceptionally strong financial performance in the face of increasing economic uncertainty. In 2007, our

surface transportation revenue exceeded $10 billion for the first time and our operating income increased to $2.2 billion, a 14 percent increase over 2006 levels.

This improvement in operating performance and shareholder value has been driven by a six-person CSX senior management team with more than a century of combined railroad experience, and overseen by our Board of Directors, executing a balanced plan that has resulted in share repurchases and disciplined capital expenditures while meeting – and exceeding – the expectations of our stakeholders.

Returning capital to our shareholders through dividends and share repurchases is a key part of our long-term financial plan. Through the fourth quarter of 2007, CSX repurchased more than $2.1 billion of its common stock – almost 50 million shares – as part of its current $3 billion share repurchase program, which we plan to continue through 2008. Further, since 2005, the company's quarterly dividend has tripled. Returning capital to our shareholders through dividends and share repurchases is a key part of our long-term plan to create further value.

At the same time, we have invested more than $4 billion of capital in our network in the last three years to meet heightened demand, and we intend to increase investment to nearly $5 billion over the next three years to continue to meet that demand. This capital expenditure plan will also create jobs, increase value for our customers and shareholders and strengthen our nation's economy.

A significant percentage of that capital investment goes to pioneering technology initiatives that make our railroad run both more efficiently and more safely. For example, CSX has already installed Event Recorder Automated Download (ERAD) systems on 1500 locomotives, and by the end of 2009, CSX will have ERAD installed on 3000 locomotives. The ERAD system uses state-of-the-art WiFi technology to capture data from locomotive onboard computers as they pass through terminals, and CSX uses that data to improve train handling and increase fuel efficiency. Initiatives such as ERAD and NOWS place CSX at the forefront of railroad technology advances.

Recognized Corporate Governance Leader

At CSX, one of our core values is "right results the right way." While we are pleased with our record of improving operational performance and creating shareholder value, we are equally proud of the corporate governance structure that allowed us to achieve these results. As of January 18, 2008, CSX has a Corporate Governance Quotient (CGQ®) that is better than 92.6 percent of S&P 500 companies, and 98 percent of transportation companies. That ranking reflects the depth and breadth of corporate governance policies in place at the company, which include:

- Election of the entire board annually;
- Majority vote election of the board in uncontested elections;

- Majority vote (as opposed to supermajority vote allowable under Virginia law) on major events impacting shareholders such as charter amendments and mergers;
- Presiding independent director;
- No poison pill; and
- A limit on senior executive severance payments.

The improvements that CSX's Board of Directors, its management and its 35,000 employees have made over the last four years have allowed us to reward our shareholders, improve customer service, meet the needs of passenger and commuter rail agencies, and do so in a safe, secure, and environmentally responsible fashion that is consistent with the highest standards of corporate governance.

But our company's management, its employees and its Board of Directors believe we can achieve much more. By 2010, our goal is to reach an operating ratio in the low-to-mid 70's, through a combination of service improvements and productivity initiatives, which will allow the company to continue to capture greater value from its transportation businesses. We want more emerging markets to look to freight rail – and to CSX – to meet their transportation needs, and we want to continue to improve on safety.

Today, however, all of these achievements and aspirations are put at risk.

Our National Rail Infrastructure Requires Ongoing Investment

As a publicly traded company, CSX must balance the interests of all of its stakeholders. Above all else, we must continue to create value for our shareholders – both in the near and long term – but the interests of some hedge funds who have invested in our company and our industry are not aligned with long-term shareholder interests or the interests of our other constituencies. These hedge funds seek to satisfy their short-term investment horizon by pushing policies that will have long-term detrimental implications for our shareholders, our customers and the rail industry.

At CSX, we believe that to continue to deliver safety and service improvements while meeting the vital transportation needs of our country, we must continue to invest for the future. But our investment plan has been challenged by a group of hedge funds that has purchased a significant stake in CSX, and in other Class I railroads as well.

We know little about these funds, except that two foreign hedge funds organized in the Cayman Islands – The Children's Investment Fund (TCI) and 3G – claim to have together purchased a 20.1 percent economic interest in our company (8.3 percent in actual share ownership, and 11.8 percent in derivative interests that had not been previously disclosed in public filings) and announced this position in a joint news release. You may be surprised that such a large foreign investment in our company does not trigger an automatic review by the Committee on Foreign Investment in the United States

(CFIUS), or, further, that these foreign hedge funds are largely unregulated and beyond the reach of Federal oversight.

The most vocal and active of these funds, (TCI) has made a variety of requests in its many public statements, letters and meetings with CSX leadership over the last 13 months. TCI has called for a number of short-term strategies – including freezing investments in infrastructure expansion, doubling customer rates over the next decade, doing a leveraged buyout, and more than doubling CSX's debt and reducing our credit rating to junk status.

Such actions might permit hedge funds like TCI to turn a quick profit, but over the long term could limit our ability to invest in critical rail infrastructure and be harmful to our shareholders, customers, and all those who rely on a safe, secure and well maintained CSX rail network.

Labor Concerns

Three of the labor unions that represent CSX locomotive engineers, maintenance-of-way and other transportation employees have expressed substantial concerns about TCI's plans for our company. A few of their concerns are excerpted below:

From the Brotherhood of Maintenance of Way Employees Division (BMWED):

TCI began this dispute with a letter to the CSX Board of Directors saying, among other things, that "relations with labor . . . are strained." While BMWED has its share of disagreements with CSX management, no one from TCI contacted BMWED to find out our opinion on labor relations. If TCI is willing to make accusations about labor relations without talking to labor, what else have they alleged without foundation?

From the Brotherhood of Locomotive Engineers and Trainmen:

The industry has also attracted aggressive hedge fund investors, such as The Children's Investment Fund, or TCI. These hedge fund investors are typically out for only one thing — money for shareholders. They're out to earn money for investors, sometimes at the expense of the company in which they invest.

From The Transportation Communications International Union (TCU):

If past actions by the hedge fund are any guide, employees too would suffer as a result of their single-minded drive to increase stock prices. TCI previously invested in ABN Amro, a Dutch bank with worldwide locations. They broke the bank up – investors profited, while 550 ABN Amro employees in Jacksonville, Florida lost their jobs.

Finally, let me highlight CSX's position on the need for our nation's railroads to invest for the future:

1) Expansion Capacity. Anyone who understands the rail industry – indeed, the transportation network as a whole – knows that we need to maintain and even increase our investments where possible to prepare for future demands for our service. In order to continue to move coal from the mines of West Virginia, juice from orange groves in Florida, ethanol from the heartland of our nation, and armaments for our military, our company has a strategic capital spending plan to upgrade its existing track, ties, bridges, and signals, add track to improve our network and better serve our customers – your constituents – over the long-term. If our nation's railroads reduce capital spending and cease investing for the long-term – due to pressure from hedge funds or for other reasons – our rail network would suffer, resulting in service deterioration and impaired on-time performance.

2) Passenger Service. CSX tracks carry more Amtrak and commuter trains than any other North American railroad. Investing less money in our network would mean less ability to serve the future needs of communities that want to alleviate highway congestion by turning to commuter rail, and could have significant adverse consequences for Amtrak operations as well as commuter operations in Virginia, Maryland, Florida, Massachusetts and elsewhere.

3) Military Transportation. CSX is critical to the timely deployment of the United States Armed Forces. Compromising our rail network would undermine our ability to carry the goods that the military needs to deploy efficiently and keep America secure.

4) Environment. Limiting investment in the railroads would also pose a real threat to our nation's environment. This Subcommittee is all too aware of concerns over climate change, the States' compliance with tougher clean air standards, and high energy prices. With continuing investment, CSX stands ready to meet our nation's rapidly-growing freight demands – while addressing these important concerns. In order for CSX to continue to offer the most environmentally-friendly and energy-efficient way to move goods on land, we must invest in: 1) newer and cleaner locomotives; 2) fuel efficiency technologies; and 3) network maintenance and expansion.

5) Safety and Security. When it comes to safety, a newer and more efficient railroad is a safer and more secure railroad. Improving safety is not just about switches, handbrakes, and global positioning systems. It's about investing in employees (nearly one-in-five CSX employees is a veteran of our armed forces, a ratio we hope to increase) and infrastructure to create a safety culture that also allows us to better serve our customers. We intend to stay focused on enhancing both safety and security. A continued investment in operational safety and security is critical in the post 9-11 threat environment. The government has

designated CSX's rail network critical infrastructure that is vital to the nation's economic interest. We treat it as such, and invest millions every year to identify, guard against, and prevent threats from those who would do our nation harm.

In conclusion, Madam Chairwoman, on behalf of CSX's Board of Directors, its management and its employees, I want to express my appreciation to you and members of the Subcommittee for highlighting this important issue. I also thank you for your recognition that while increased investment in the railroad industry is a positive development, our company's responsibility to its investors must be balanced with our commitment to our employees, our customers, the communities we serve, and, most certainly, our role in helping this country achieve its public policy objectives.

CSX
CORPORATION
Michael J. Ward
Chairman, President
Chief Executive Officer

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April 18, 2008

The Honorable Corrine Brown
United States House of Representatives
Washington, DC 20515

Dear Chairwoman Brown:

Thank you for the opportunity to provide further information for the record concerning certain issues raised during the March 5, 2008 hearing on *Investment in the Rail Industry*. Specifically, the subcommittee requested elaboration on the inherent operational differences that make it difficult to directly compare the performance of Canadian railroads, particularly CN, to American railroads and further detail on the relative operating ratios of CSX and other railroads.

First, let me state that the two large Canadian railroads are both strong competitors for CSX and the other American railroads and important partners in meeting the growing transportation and trade demands for North America in the global marketplace. At CSX, we constantly evaluate our performance against the competition to improve on what we already do well and to learn from the experience of others. At the same time, we recognize that comparisons become more difficult and less instructive as you look further afield, and that fundamental differences as simple as geography limit our ability to directly compare CSX operations to those of other railroads. In response to your specific questions about differences between CSX and CN, I have provided a few examples here.

With the exception of CN, all large North American railroads regularly report performance on common operating measurements to the Association of American Railroads (AAR). The AAR publishes these common measurements, which can help the public evaluate changes in a particular railroad's operating performance over time. However, the AAR prominently cautions on its website that differences in fundamental operating characteristics and measurement techniques make it impossible to directly compare statistics between different railroads. Nevertheless, AAR performance measurements at least provide a uniform framework – a common language, if you will – for discussing railroad operating performance. Because CN does not report operating statistics using the standard industry measurements, we lack even a common language to discuss performance.

Railroad operating statistics are often not comparable because of significant differences in the geographic territory over which the railroads operate. For example, CSX operates much of its network along the densely populated I-95 corridor in the Eastern United States. In Boston, New York, Philadelphia and Washington, D.C., CSX rail lines pass through the urban core of some of our nation's most densely populated cities. Access to these large markets provides CSX a substantial competitive advantage, but it also has a substantial impact on train operations, making it difficult to compare CSX statistics such as train velocity to those of railroads operating predominately in less densely populated areas. In contrast, while CN operates in large cities such as

Chicago and Toronto, its network also crosses thousands of miles of sparsely populated western Canada, where the major cities such as Thunder Bay and Saskatoon do not pose the same operational challenges that CSX faces in traversing the Eastern seaboard. Even outside major cities, population density has a significant effect on railroad operations. For example, the frequency of grade crossings, which impact the efficiency of train movements, is much greater in more populated areas.

Because CSX serves the densely populated I-95 corridor and other major urban centers, passenger traffic on the CSX network is also often dramatically higher than that of other railroads. CSX hosts more Amtrak traffic than any other railroad, and CSX shares track with robust commuter passenger operations throughout the network, including in Boston, New York, New Jersey, Philadelphia, Washington, D.C. and Miami. Again, owing in large measure to geography, CN's operations do not host passenger traffic on the scale found at CSX. Although VIA Rail Canada, the Canadian intercity passenger equivalent to Amtrak, operates over CN track, the total volume of VIA Rail traffic is dramatically less than Amtrak. Amtrak now carries roughly 25 million passengers annually, while VIA Rail serves less than 5 million. Furthermore, as in the United States, the overwhelming majority of intercity passenger traffic in Canada flows along the eastern corridor from Windsor to Quebec City. As in the United States, this leaves the vast expanses of CN's western network almost devoid of passenger traffic.

In addition to these fundamental operating differences, the Canadian railroads also have a different cost structure than their U.S. counterparts because of the Canadian state health care system. While CN maintains a presence in the United States, its large employee base in Canada alters the financial impact of health care costs, potentially skewing operating margins relative to the American railroads.

Nevertheless, under the current management team, CSX has substantially improved its operating ratio relative to CN. From 2004 to 2007, CSX operating ratio improved 9 percent, while CN improved by 3.3 percent. Over the same period, Union Pacific's operating ratio improved by 8.1 percent. The improvements in operating ratio at CSX reflect the disciplined plan executed by this management team, which has driven CSX to the best stock performance in the industry over the last three years.

I would like to thank you again for the opportunity to appear at the March 5th hearing, and I commend you for your attention to these important issues. Please let me know if the subcommittee requires any further information.

Sincerely,

Michael Ward

FEB. 29. 2008 12:24PM 309-347-8541 NO. 1741 P. 2

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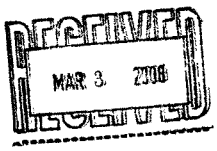

February 29, 2008 Fax (202)225-0699

Facsimile Transmission – Two Pages

Honorable James Oberstar
Chairman, Committee on Transportation and Infrastructure
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Honorable John Mica
Ranking Member, Committee on Transportation and Infrastructure
U.S. House of Representatives
2313 Rayburn House Office Building
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Honorable Corrine Brown
Chairwoman, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives
2336 Rayburn House Office Building
Washington, DC 20515

Honorable Bill Shuster
Ranking Member, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee Transportation and Infrastructure
U.S. House of Representatives
204 Cannon House Office Building
Washington, DC 20515

Dear Committee on Transportation and Infrastructure Members:

I represent 300 U.S. employees of Aventine Renewable Energy, Inc. in asking for your attention to an issue that could have major consequences on the efficient movement of corn and ethanol, as well as thousands of other products produced in this country and elsewhere.

As a long-time customer of the freight rail industry – and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials – I would urge you to carefully consider the very important negative implications of a demand by certain hedge funds that U.S. railroads limit or freeze their investment in America's rail infrastructure.

"Providing clean, renewable energy for the world"
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These activist hedge funds – some of them foreign owned and operated – have recently become substantial shareholders of rail companies like CSX and are pushing them for ill-advised changes.

As you know, railroads, which have always been critical to the country's economic well-being, are becoming increasingly vital to the nation as a result of more imports, traffic on the highways, truck driver shortages, fuel price increases and the need for environmental solutions. My company, Aventine Renewable Energy, Inc., demands that freight rail companies expand capacity to serve us safely, reliably and for the long-term. In other words, what my company needs – what the nation needs – is exactly the opposite of what these hedge fund investors are demanding of railroads.

Very simply, railroads must be permitted to continue making critical infrastructure investments, which lead to improvements in operational and financial performance, while strengthening the U.S. economy. Most importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security.

Certain event-driven hedge funds want the money that would otherwise go into the railroads to go into massive share repurchases that would yield a short-term "pop" in the stock price. That's good for these hedge funds, but not good for my business or the economy.

By destabilizing the railroads through costly and disruptive proxy contests and by influencing strategic planning and capital investment without regard for long-term consequences, these hedge funds threaten far more than the railroads themselves. This is worrisome to me, and also should be to you.

The United States will struggle if it fails to meet its growing transportation needs, and railroads are a critical part of the solution. We simply cannot rely on long and costly highway fixes.

So I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy, as well as their long-term shareholders.

Thank you for your consideration of this important matter.

Best Regards,

Ronald H. Miller
President/CEO
Aventine Renewable Energy, Inc.

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February 27, 2008

Honorable James Oberstar
Chairman, Committee on Transportation
And Infrastructure
U. S. House of Representatives
2365 Rayburn House Office Building
Washington, D.C. 20515-2308

Dear Committee on Transportation and Infrastructure Members:

I am the owner and president of Big Bend Agri-Services, Inc. located in Cairo, Georgia. We at Big Bend Agri, along with a southeastern and sometimes national customer base, depend immensely on our distribution of goods and services thru the railway systems of the U.S. but predominately thru the CSX rail system.

It is our understanding and as a long-time customer of the freight rail industry – and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials – I would urge you to carefully consider the very important negative implications of a demand by certain hedge funds that U.S. railroads limit or freeze their investment in America's rail infrastructure.

These activist hedge funds – some of them foreign owned and operated – have recently become substantial shareholders of rail companies like CSX and are pushing them for ill-advised changes.

As you know, railroads, which have always been critical to the country's economic well-being, are becoming increasingly vital to the nation as a result of more imports, traffic on the highways truck driver shortages, fuel price increases and the need for environmental solutions. My company, Big Bend Agri-Services, Inc., demands that freight rail companies expand capacity to serve us safely, reliably and for the long-term. In other words, what my company needs – what the nation needs – is exactly the opposite of what these hedge fund investors are demanding of railroads.

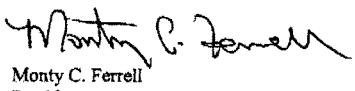
Very simply, railroads must be permitted to continue making critical infrastructure investments, which lead to improvements in operational and financial performance, while

strengthening the U.S. economy. Most importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security.

So I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy, as well as their long-term shareholders.

Thank you for your consideration of this important matter.

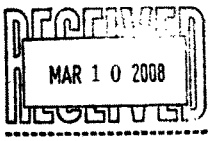
Best Regards,



Monty C. Ferrell
President
Big Bend Agri-Services, Inc.

MaR-03-2008 12:46 From:RYU260722 5618208624 To:U S House of Reps P.2/3

RR



March 3, 2008

Facsimile Transmission – Two Pages

Honorable James Oberstar
Chairman, Committee on Transportation and Infrastructure
U.S. House of Representatives
2365 Rayburn House Office Building
Washington, DC 20515-2308

Honorable John Mica
Ranking Member, Committee on Transportation and Infrastructure
U.S. House of Representatives
2313 Rayburn House Office Building
Washington, DC 20515

Honorable Corrine Brown
Chairwoman, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives
2336 Rayburn House Office Building
Washington, DC 20515

Honorable Bill Shuster
Ranking Member, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee Transportation and Infrastructure
U.S. House of Representatives
204 Cannon House Office Building
Washington, DC 20515

Dear Committee on Transportation and Infrastructure Members:

I represent 15,730 U.S. employees of CEMEX in asking for your attention to an issue that could have major consequences on the efficient movement of building and construction materials, as well as thousands of other products produced in this country and elsewhere.

As a long-time customer of the freight rail industry – and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials – I would urge you to consider the very important negative implications if U.S. railroads were to limit or freeze their investment in America's rail infrastructure.

As you know, railroads, which have always been critical to the country's economic well-being, are becoming increasingly vital to the nation as a result of more imports, traffic on the highways, truck driver shortages, fuel price increases and the need for environmental solutions. My company, CEMEX, demands that freight rail companies expand capacity to serve us safely, reliably and for the

Florida Region
1501 Belvedere Road, West Palm Beach, FL 33406 USA, (561) 833 5555

long-term. In other words, what my company needs – what the nation needs is exactly the opposite of what certain hedge fund investors are demanding of railroads.

Very simply, railroads must be permitted to continue making critical infrastructure investments, which lead to improvements in operational and financial performance, while strengthening the U.S. economy. Most importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security.

By destabilizing the railroads through costly and disruptive proxy contests and by influencing strategic planning and capital investment without regard for long-term consequences, these hedge funds threaten far more than the railroads themselves. This is worrisome to me, and also should be to you.

The United States will struggle if it fails to meet its growing transportation needs, and railroads are a critical part of the solution. We simply cannot rely on long and costly highway fixes.

So I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy, as well as their long-term shareholders.

Thank you for your consideration of this important matter.

Best Regards,

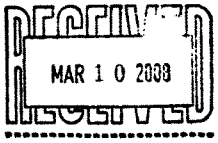
Cliff Kirkmyer

Cliff Kirkmyer
Vice President, Aggregate Division
Florida Region

CK/dm

RR

CONSOL ENERGY.



CONSOL Energy Inc.
Consol Plaza
1800 Washington Road
Pittsburgh, PA 15241-1405

phone: 412/831-4416
fax: 412/831-4191
e-mail: petelilly@consolenergy.com
web: www.consolenergy.com

PETER B. LILLY
President - Coal Group

March 3, 2008

Facsimile Transmission – Two Pages

Honorable James Oberstar
Chairman, Committee on Transportation and Infrastructure
U.S. House of Representatives
2365 Rayburn House Office Building
Washington, DC 20515-2308

Honorable John Mica
Ranking Member, Committee on Transportation and Infrastructure
U.S. House of Representatives
2313 Rayburn House Office Building
Washington, DC 20515

Honorable Corrine Brown
Chairwoman, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives
2336 Rayburn House Office Building
Washington, DC 20515

Honorable Bill Shuster
Ranking Member, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee Transportation and Infrastructure
U.S. House of Representatives
204 Cannon House Office Building
Washington, DC 20515

Dear Committee on Transportation and Infrastructure Members:

I represent 7,300 U.S. employees of CONSOL Energy Inc. in asking for your attention to an issue that could have major consequences on the efficient movement of coal as well as thousands of other products produced in this country and elsewhere.

MAR 03 '08 10:58AM CONSOL OPER ADMIN P.2/3

As a long-time customer of the freight rail industry – and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials – I would urge you to carefully consider the very important negative implications of a demand by certain hedge funds that U.S. railroads limit or freeze their investment in America's rail infrastructure.

These activist hedge funds – some of them foreign owned and operated – have recently become substantial shareholders of rail companies like CSX and are pushing them for ill-advised changes.

As you know, railroads, which have always been critical to the country's economic well-being, are becoming increasingly vital to the nation as a result of more imports, traffic on the highways, truck driver shortages, fuel price increases and the need for environmental solutions. My company, CONSOL Energy Inc., demands that freight rail companies expand capacity to serve us safely, reliably and for the long-term. In other words, what my company needs – what the nation needs – is exactly the opposite of what these hedge fund investors are demanding of railroads.

Very simply, railroads must be permitted to continue making critical infrastructure investments, which lead to improvements in operational and financial performance, while strengthening the U.S. economy. Most importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security.

Certain event-driven hedge funds want the money that would otherwise go into the railroads to go into massive share repurchases that would yield a short-term "pop" in the stock price. That's good for these hedge funds, but not good for my business or the economy.

By destabilizing the railroads through costly and disruptive proxy contests and by influencing strategic planning and capital investment without regard for long-term consequences, these hedge funds threaten far more than the railroads themselves. This is worrisome to me, and also should be to you.

The United States will struggle if it fails to meet its growing transportation needs, and railroads are a critical part of the solution. We simply cannot rely on long and costly highway fixes.

So I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy, as well as their long-term shareholders.

Thank you for your consideration of this important matter.

Sincerely,

Peter B. Lilly

PBL:jg

MAR 03 '08 10:58AM CONSOL OPER ADMIN P.3/3

Robert J. Buckler
President and Chief Operating Officer
Detroit Edison

2000 2nd Ave., Detroit, MI 48226-1279
Tel: 313.235 8774

DTE Energy

February 29, 2008

Facsimile Transmission – Two Pages

Honorable James Oberstar
Chairman, Committee on Transportation and Infrastructure
U.S. House of Representatives
2365 Rayburn House Office Building
Washington, DC 20515-2308

Honorable John Mica
Ranking Member, Committee on Transportation and Infrastructure
U.S. House of Representatives
2313 Rayburn House Office Building
Washington, DC 20515

Honorable Corrine Brown
Chairwoman, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives
2336 Rayburn House Office Building
Washington, DC 20515

Honorable Bill Shuster
Ranking Member, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee Transportation and Infrastructure
U.S. House of Representatives
204 Cannon House Office Building
Washington, DC 20515

Dear Committee on Transportation and Infrastructure Members:

I am writing you as President and Chief Operating Officer of The Detroit Edison Company, a subsidiary of DTE Energy which is the leading energy and energy technology provider in the State of Michigan. The Detroit Edison Company is one of the nation's largest electric utilities, supplying energy to 2.1 million customers in Southeastern Michigan. Since the majority of this energy is generated with coal, I am asking for your attention to an issue that could have major consequences with respect to the efficient transportation of coal, as well as that of thousands of other products produced in this country.

As a long-time customer of the freight rail industry – and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials – I urge you to carefully consider the very important negative implications of any proposal, including those put forth by certain hedge funds, to limit or freeze U.S. railroad investment in America's rail infrastructure.

U.S. railroads, which have always been critical to this country's economic well-being, are becoming increasingly vital to the nation for a variety of reasons including the level of imports, growing highway traffic coupled with truck driver shortages, fuel price increases and the need for environmental solutions. Rather than limit or freeze rail infrastructure investment, The Detroit Edison Company feels strongly that U.S. railroads should be expanding their capacity in order to serve us safely, reliably and for the long-term.

This nation has a growing need for efficient transportation and the U.S. railroads are critical to meeting this need. Long and costly highway transportation fixes alone are inadequate and cannot be relied on.

I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy by not allowing any impediment to their continued investment in critical railroad infrastructure.

Thank you for your consideration of this important matter.

Sincerely,

RR

RECEIVED
MAR 10 2008

March 3, 2008

The Honorable James Oberstar
Chairman, Committee on Transportation
And Infrastructure
U.S. House of Representatives
2365 Rayburn House Office Building
Washington, DC 20515-2308
FAX 202-225-0699

Subject: March 5 hearing "Investment in the Rail Industry"

Dear Chairman Oberstar:

My name is Curt Warfel and I am the Manager, Logistics and Distribution for Eka Chemicals, Inc., a subsidiary of Akzo Nobel. I am writing to bring your attention to an issue that could have major consequences on the movement of our chemical products, as well as the thousands of other products produced in the U.S. or around the world that rely on an efficient and economical rail transportation system here in the U.S.

As a long-time customer of the rail freight industry and, in advance of your committee's March 5 hearing on Investment in the Rail Industry, I would urge you and your fellow committee members to carefully consider the negative implications of a demand by certain hedge funds that U.S. railroads limit or freeze their investment in our nation's rail infrastructure. These activist hedge funds have, in the past year or so, become substantial shareholders in rail companies such as CSX and, in my opinion, are pushing them to make ill-advised changes.

As you are aware, railroads have always held a position of critical importance with regard to the countries economic well being and are becoming even more important to the movement of the nation's commerce as fuel costs continue to escalate and highways become more congested. My company, Eka Chemicals, requires that freight rail companies continue to expand capacity to serve us in a safe and reliable manner for the long term. What my company needs, in fact what our nation and economy need, is exactly the opposite of what these hedge fund investors are demanding of the railroads.

Our railroads must be permitted to continue making critical infrastructure investments which lead to operational and financial improvements. More importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security, a major concern for those of us in the chemical industry.

Yet, despite the continuing need for investment in railroad infrastructure, certain hedge funds desire that railroads curtail their capital investments in order to permit share repurchases which, while good for the hedge funds, will do nothing for our business or the economy. Additionally, by forcing certain railroads to focus on costly and disruptive proxy contests and by attempting to influence strategic planning and capital investment without regard for long term consequences, these hedge funds threaten far more than the individual railroads themselves.

Chairman Oberstar, perhaps no one in Washington is more aware of the infrastructure needs facing this country today than you. Railroads are a key piece of the puzzle in maintaining the safe and efficient flow of commerce within the U.S. I appeal to you and Congress for your support in enabling the freight rail companies to operate in the best interests of their customers and America's economy as well as the long term interest of their shareholders.

Thank you for your consideration of this very important issue.

Sincerely,

Curt H. Warfel
Manager, Logistics and Distribution
Eka Chemicals, Inc.
1775 West Oak Commons Court
Marietta, GA 30062-2254
Ph. 770-321-5913
FAX 770-321-5809
E-mail curt.warfel@eka.com

RR

GROWMARK

P.O. BOX 2500 • BLOOMINGTON, IL 61702-2500 • (309) 557-6000 • http://www.growmark.com

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MAR 1 0 2008

March 3, 2008

The Honorable James Oberstar
U. S. House of Representatives
2365 Rayburn Office Building
Washington, DC 20515-2308

RE: Investment in the Rail Industry

Dear Congressman Oberstar;

GROWMARK, Inc. is a regional agricultural supply and grain marketing cooperative operating from Colorado to the East Coast. Our corporate office is located at 1701 Towanda Avenue in Bloomington, Illinois.

The GROWMARK System of FS cooperatives supply their farmer owners with agrichemicals, petroleum, seed, and farm equipment. On behalf of GROWMARK, the FS member cooperatives, and their farmer owners, we offer these comments concerning "Investment in the Rail Industry" which is scheduled to be discussed before the Subcommittee on Railroads, Pipelines and Hazardous Materials.

Railroads have played a vital role in American agriculture, not only in shipping products to market, but also receiving inputs for farming operations. Without a strong transportation system, US agriculture would not be the leader in feeding the world that we have become. Therefore, it is extremely important that the transportation infrastructure be maintained in order to keep our agriculture economy strong.

We believe stockholders of the rail companies should receive a reasonable rate of return on their investment, just as in any business venture. However, when a class of shareholders take advantage of their ownership in a railroad with the sole intent to remove capital, it jeopardizes the economic viability of the business. When that business is a critical infrastructure such as railroads, the nation's economy and our national security are at risk. Reinvestment by railroads in critical infrastructure is vital to our economy and national security, and we urge you to ensure adequate reinvestment remains a priority for our critical transportation systems.

Thank you for considering our comments.

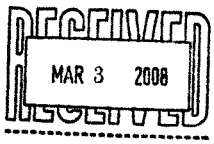
Sincerely,

GROWMARK, Inc.

Dan Vest, Manager
Government Relations

FEB.-28' 08(THU) 12:25 INTER CHEM TEL:9184921719 P. 001

RR



Inter-Chem
INTERNATIONAL CHEMICAL COMPANY
Southbridge Office Park
1897 East 71st Street
Tulsa, OK 74136-3984
Telephone (918) 495-7711
Fax (918) 492-1719
E-mail ic@icjusa.com

BRAD A. THOMAS
PRESIDENT

February 28, 2008

Facsimile Transmission - Two Pages

Honorable James Oberstar
Chairman, Committee on Transportation and Infrastructure
U.S. House of Representatives
2365 Rayburn House Office Building
Washington, DC 20515-2308

Honorable John Mica
Ranking Member, Committee on Transportation and Infrastructure
U.S. House of Representatives
2313 Rayburn House Office Building
Washington, DC 20515

Honorable Corrine Brown
Chairwoman, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives
2336 Rayburn House Office Building
Washington, DC 20515
Honorable Bill Shuster

Ranking Member, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee Transportation and Infrastructure
U.S. House of Representatives
204 Cannon House Office Building
Washington, DC 20515

Dear Committee on Transportation and Infrastructure Members:
I represent 165 U.S. employees of International Chemical Company and its subsidiaries in asking for your attention to an issue that could have major consequences on the efficient movement of our fertilizer, packaging, and steel products, as well as thousands of other products produced in this country and elsewhere.
As a long-time customer of the freight rail industry - and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials - I would urge you to carefully consider the very important negative implications of a demand by certain hedge funds that U.S. railroads limit or freeze their investment in America's rail infrastructure.
These activist hedge funds - some of them foreign owned and operated - have recently become substantial shareholders of rail companies like CSX and are pushing them for ill-advised changes.
As you know, railroads, which have always been critical to the country's economic well-being, are becoming increasingly vital to the nation as a result of more imports, traffic on the highways, truck

driver shortages, fuel price increases and the need for environmental solutions. My company, COMPANY, demands that freight rail companies expand capacity to serve us safely, reliably and for the long-term. In other words, what my company needs - what the nation needs - is exactly the opposite of what these hedge fund investors are demanding of railroads. Very simply, railroads must be permitted to continue making critical infrastructure investments, which lead to improvements in operational and financial performance, while strengthening the U.S. economy. Most importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security. Certain event-driven hedge funds want the money that would otherwise go into the railroads to go into massive share repurchases that would yield a short-term "pop" in the stock price. That's good for these hedge funds, but not good for my business or the economy.
By destabilizing the railroads through costly and disruptive proxy contests and by influencing strategic planning and capital investment without regard for long-term consequences, these hedge funds threaten far more than the railroads themselves. This is worrisome to me, and also should be to you. The United States will struggle if it fails to meet its growing transportation needs, and railroads are a critical part of the solution. We simply cannot rely on long and costly highway fixes. So I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy, as well as their long-term shareholders.

Thank you for your consideration of this important matter.

Best Regards,

Brad A. Thomas
President
International Chemical Company
Tulsa, Oklahoma

Paul H. Vining
Chief Executive Officer

304.380.0255 T
304.380.0384 F

MAGNUM COAL
Magnum Coal Company
500 Lee Street, East
Suite 900
Charleston, WV 25301

February 21, 2008

Facsimile Transmission – Two Pages

Honorable James Oberstar
Chairman, Committee on Transportation and Infrastructure
U.S. House of Representatives
2365 Rayburn House Office Building
Washington, DC 20515-2308

Honorable John Mica
Ranking Member, Committee on Transportation and Infrastructure
U.S. House of Representatives
2313 Rayburn House Office Building
Washington, DC 20515

Honorable Corrine Brown
Chairwoman, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives
2336 Rayburn House Office Building
Washington, DC 20515

Honorable Bill Shuster
Ranking Member, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee Transportation and Infrastructure
U.S. House of Representatives
204 Cannon House Office Building
Washington, DC 20515

Dear Committee on Transportation and Infrastructure Members:

I represent 1,750 U.S. employees of Magnum Coal Company in asking for your attention to an issue that could have major consequences on the efficient movement of coal, as well as thousands of other products produced in this country and elsewhere.

As a long-time customer of the freight rail industry – and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials – I would urge you to carefully consider the very important negative

implications of a demand by certain hedge funds that U.S. railroads limit or freeze their investment in America's rail infrastructure.

These activist hedge funds – some of them foreign owned and operated – have recently become substantial shareholders of rail companies like CSX and are pushing them for ill-advised changes.

As you know, railroads, which have always been critical to the country's economic well-being, are becoming increasingly vital to the nation as a result of more imports, traffic on the highways, truck driver shortages, fuel price increases and the need for environmental solutions. My company, Magnum Coal, demands that freight rail companies expand capacity to serve us safely, reliably and for the long-term. In other words, what my company needs – what the nation needs – is exactly the opposite of what these hedge fund investors are demanding of railroads.

Very simply, railroads must be permitted to continue making critical infrastructure investments, which lead to improvements in operational and financial performance, while strengthening the U.S. economy. Most importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security.

Certain event-driven hedge funds want the money that would otherwise go into the railroads to go into massive share repurchases that would yield a short-term "pop" in the stock price. That's good for these hedge funds, but not good for my business or the economy.

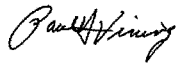
By destabilizing the railroads through costly and disruptive proxy contests and by influencing strategic planning and capital investment without regard for long-term consequences, these hedge funds threaten far more than the railroads themselves. This is worrisome to me, and also should be to you.

The United States will struggle if it fails to meet its growing transportation needs, and railroads are a critical part of the solution. We simply cannot rely on long and costly highway fixes.

So I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy, as well as their long-term shareholders.

Thank you for your consideration of this important matter.

Best Regards,



Paul H. Vining

8813 Highway 41 South
Riverview, Florida 33569

Phone. 813-672-7100
Fax: 813-671-6146
rich.krakowski@mosaicco.com

February 25, 2008

Honorable James Oberstar
Chairman, Committee on Transportation and Infrastructure
U.S. House of Representatives
2365 Rayburn House Office Building
Washington, DC 20515-2308

Dear Congressman Oberstar:

I represent approximately 4,057 U.S. Employees of Mosaic in asking for your attention to an issue that could have major consequences on the efficient movement of fertilizer products, as well as thousands of other products produced in this country and elsewhere.

As a long-time customer of the freight rail industry – and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials – I would urge you to carefully consider the very important negative implications of a demand by certain hedge funds that U.S. railroads limit or freeze their investment in America's Rail infrastructure.

These activist hedge funds – some of them foreign owned and operated – have recently become substantial shareholders of rail companies like CSX and are pushing them for ill-advised changes.

As you know, railroads, which have always been critical to the country's economic well-being, are becoming increasingly vital to the nation as a result of more imports, traffic on the highways, truck driver shortages, fuel price increases and the need for environmental solutions. My company, Mosaic, demands that freight rail companies expand capacity to serve us safely, reliably and for the long-term. In other words, what my company needs – what the nation needs – is exactly the opposite of what these hedge fund investors are demanding of railroads.

Very simply, railroads must be permitted to continue making critical infrastructure investments, which lead to improvements in operational and financial performance, while strengthening the U.S. economy. Most importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security.

Certain event-driven hedge funds want the money that would otherwise go into the railroads to go into massive share repurchases that would yield a short-term "pop" in the stock price. That's good for these hedge funds, but not good for my business or the economy.

By destabilizing the railroads through costly and disruptive proxy contests and by influencing strategic planning and capital investment without regard for long-term consequences, these hedge funds threaten far more than the railroads themselves. This is worrisome to me, and also should be to you.

The United States will struggle if it fails to meet its growing transportation needs, and railroads are a critical part of the solution. We simply cannot rely on long and costly highway fixes.

So I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy, as well as their long-term shareholders.

Thank you for your consideration of this important matter.

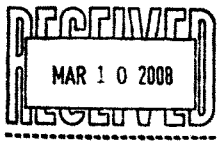
Best Regards,

Richard Krakowski
Vice President-Supply Chain
Mosaic

Cc: Honorable Corrine Brown
Honorable John Mica
Honorable Bill Shuster

MAR. 4. 2008 11:47AM NO. 0277 P. 1

RR



Patriot Coal Corporation
12312 Olive Boulevard
St. Louis, Missouri 63141
314.275.3600
www.patriotcoal.com

March 4, 2008

Facsimile Transmission – Two Pages

Honorable James Oberstar
Chairman, Committee on Transportation and Infrastructure
U.S. House of Representatives
2365 Rayburn House Office Building
Washington, DC 20515-2308

Honorable John Mica
Ranking Member, Committee on Transportation and Infrastructure
U.S. House of Representatives
2313 Rayburn House Office Building
Washington, DC 20515

Honorable Corrine Brown
Chairwoman, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives
2336 Rayburn House Office Building
Washington, DC 20515

Honorable Bill Shuster
Ranking Member, Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee Transportation and Infrastructure
U.S. House of Representatives
204 Cannon House Office Building
Washington, DC 20515

Dear Committee on Transportation and Infrastructure Members:

I represent 2,400 U.S. employees of Patriot Coal Corporation in asking for your attention to an issue that could have major consequences on the efficient movement of coal, as well as thousands of other products produced in this country and elsewhere.

As a long-time customer of the freight rail industry – and in advance of the March 5 hearing on "Investment in the Rail Industry" before the Subcommittee on Railroads, Pipelines and Hazardous Materials – I would urge you to carefully consider the very important negative implications of a demand by certain hedge funds that U.S. railroads limit or freeze their investment in America's rail infrastructure.

These activist hedge funds – some of them foreign owned and operated – have recently become substantial shareholders of rail companies like CSX and are pushing them for ill-advised changes.

As you know, railroads, which have always been critical to the country's economic well-being, are becoming increasingly vital to the nation as a result of more imports, traffic on the highways, truck driver shortages, fuel price increases and the need for environmental solutions. My company, Patriot Coal Corporation, demands that freight rail companies expand capacity to serve us safely, reliably and for the long-term. In other words, what my company needs – what the nation needs – is exactly the opposite of what these hedge fund investors are demanding of railroads.

Very simply, railroads must be permitted to continue making critical infrastructure investments, which lead to improvements in operational and financial performance, while strengthening the U.S. economy. Most importantly, the investment decisions that railroads make are integral to their ongoing efforts to improve safety and security.

Certain event-driven hedge funds want the money that would otherwise go into the railroads to go into massive share repurchases that would yield a short-term "pop" in the stock price. That's good for these hedge funds, but not good for my business or the economy.

By destabilizing the railroads through costly and disruptive proxy contests and by influencing strategic planning and capital investment without regard for long-term consequences, these hedge funds threaten far more than the railroads themselves. This is worrisome to me, and also should be to you.

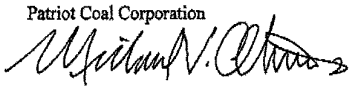
The United States will struggle if it fails to meet its growing transportation needs, and railroads are a critical part of the solution. We simply cannot rely on long and costly highway fixes.

So I appeal to Congress for your support in enabling the freight rail companies to operate in the best interest of their customers and America's economy, as well as their long-term shareholders.

Thank you for your consideration of this important matter.

Best Regards,

Patriot Coal Corporation



Michael V. Altrudo
Senior Vice President
Chief Marketing Officer

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