STB Chairman Martin J. Oberman
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Good afternoon. I'm delighted to be here and equally grateful for SEARS adding me to the agenda at a very late date.

But because of disturbing current trends facing the management of the four US Class Is, I thought it my responsibility to address this important gathering of rail stakeholders—and the public—about existing and potential threats to the soundness of our all-important national freight rail network.

As we all know, there's a proxy fight brewing for control of Norfolk Southern—and it does not bode well for the railroad industry, the U.S. economy, or the public. After weeks of news reports that Ancora Holdings, a Cleveland based hedge fund, was plotting to wrest control of Norfolk Southern's board, last week Ancora made their plans official and released a broadside attack on NS and its corporate philosophy of maintaining its workforce at resilient levels and investing for long term growth.

Ancora wants to oust CEO Alan Shaw for the sole purpose of reversing that corporate strategy.

This effort by a Wall Street firm—with short-term dollar signs in its eyes—to strip resources out of a railroad, of course, is not new.

Just last year, another hedge fund, Soroban, launched a successful effort to depose Union Pacific's CEO—not because he was adding resources—but because he wasn't cutting fast and deep enough.

Freight railroads are pillars of the nation's economy, moving 1.6 billion tons of freight annually, representing 40% of all long-distance freight movement. And important to the fight against climate change, as all of you well know, rail offers a significantly more fuel-efficient and lower carbon-emitting alternative to trucking.

In the past decade, activist investors—like Ancora and Soroban—began gaining influence, if not outright control, of some railroads. They recognized that the seven—now six—Class Is dominating the U.S. and Canada—are natural monopolies and are the only transportation option for a high percentage of their customers—and therefore held great potential for profit seeking.

Ignoring the essential role that railroads play in supporting the success of their customers, i.e., the manufacturers that drive our GDP, these investors succeeded in pressuring railroad management to exploit this monopoly power to achieve short-term profits. The strategy was, largely, to slash workforces, raise prices, and reduce output—i.e., service—which they did—thereby risking long-term viability in pursuit of massive stock buybacks and dividends.

This strategy not only affects the economic output of US industries which cannot thrive without robust rail service. It also undermines safety because rail workers are essential to safe rail operations—for themselves and for the communities through which railroads must travel, often transporting hazardous materials. Cutting the workers who perform inspections, repairs and otherwise are responsible to ensure safety, increases threats to the public as well as the workers themselves. And unsafe rail operations, of course, undermine rail service.

Because railroads are so essential to the public well-being; because they have benefited from massive governmental largess since their inception 200 years ago, and perhaps most importantly because they are monopolies—or at best, duopolies—for a major portion of their customers, the Congress long ago imbued railroads with a common carrier obligation.

To best comprehend the unique import and mandate of the common carrier obligation, a pronouncement from the US Supreme Court more than 125 years ago, bears repeating over and over again. Quote:

> ". . . railways are public corporations organized for public purposes, granted valuable franchises and privileges, . . . many of them are the donees of large tracts of public lands, and of gifts of money by municipal corporations . . ."
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> And this is key: ". . . they all primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders. The business which the railroads do is of a public nature, closely affecting almost all classes in the community—the farmer, the artisan, the manufacturer, and the trader."

[United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290, 332–33, 17 S. Ct. 540, 555–56, 41 L. Ed. 1007 (1897).]

In all the time since, and even with the passage of the Staggers Act, this wise and powerful admonition from the Supreme Court has never been repealed or weakened.

And I am going to repeat it over and over again until it seeps into the heads of every railroad shareholder—which includes Ancora and Soroban.

Indeed, just last week, no less a capitalist than Warren Buffet reminded his shareholders in his annual letter that "Rail is essential to America's economic future," and in his words, "[t]he words 'common carrier' define railroad responsibilities."

Unfortunately, ignoring their public duties, the largest railroads, beginning roughly around 2014 and persisting for years thereafter, lacerated their workforces by approximately 30%, or 45,000 persons. The euphemism they employed to label their actions was PSR.

Thus, it was no surprise that by early 2022, months after the economy started to rebound from the pandemic, the railroads were in, what one Wall Street analyst had astutely called, a "service crisis." After closely monitoring rail activity throughout 2021, and patiently listening to

the Class Is worthless claims that they had the situation under control, the STB had little choice but to act.

In April 2022, the Board intervened and instituted a two-day public hearing to address the causes of this crisis. At that hearing, the Board heard from numerous rail shippers who testified about missed shipments and delayed service that was costing them business. Several representatives of rail labor detailed the negative impact that the reduced workforce was having on rail operations and safety. We also commanded the appearance of senior executives from all the Class Is.

Every stakeholder, including most importantly the rail executives themselves—told the Board that the cause of the service meltdown was the simple fact that the Class Is lacked sufficient workers to move the trains needed to service their customers. The problem was mostly a lack of engineers and conductors. But carmen, mechanics, and electricians—the folks who keep the trains in shape to actually move freight and move it safely—had also been cut, slowing down rail operations. Shippers also reported difficulties at the white-collar level, with inabilities to reach salespeople and customer representatives.

Of course, the rail executives were slow to acknowledge the obvious—that the shortages were the inexorable consequence of their own choices to eliminate tens of thousands of rail workers in recent years.

Not ever having run a railroad—or having been a manager of any large business myself—I have thought long and hard about how the industry could ever have allowed itself to achieve such a dismal failure of its own business operations. No person who knows anything about running a railroad—and these executives do **know** how to run a railroad—could have failed to foresee that eventually the firing of 45,000 workers would catch up to them.

The explanation of course is that pressure from short term investors focused only on the operating ratio—or as my friend Tony Hatch likes to call it—the cult of the OR. Somehow, Wall Street has decided that the only important measure of success in the rail world is to have an OR at 60 or below. When the analysts can report progress towards that goal, rail stock prices have soared. These low ORs—which could only be achieved rapidly—as the activists demanded—by cutting payroll—have meant lots of free cash which the Class Is have not been shy about paying out in stock buybacks, dividends, and in BNSF's case, returns to its owner. The total in the last decade or so is over $250,000,000,000—money which was not invested in retaining workers or building new infrastructure to increase a railroad's reach and serve more customers.

It is no mystery that this service crisis depressed the nation's industrial output. It also was a contributor to port congestion, causing shortages of consumer goods and increased prices.

As a result of the eye-opening revelations at the hearing, the Board promptly ordered the four US Class Is—the railroads with the most significant service failures—to file with the Board service recovery plans with intermediate goals over the following six and 12 months for their service improvements. The Board also mandated regular reporting of the railroads' efforts to

rebuild their workforces to achieve those service goals. This included reports of hiring, training, washouts, and furloughs.

After that April 2022 hearing, some progress has been made generally throughout the industry. Up until recently, hiring and training had been reinstituted at higher levels which resulted in a slow beginning of service improvement.

But one standout failure of progress was at UP. During 2022, UP—alone among the railroads—was subject to two emergency service orders—the first issued by the STB in over 10 years. UP also instituted a massive upsurge of 1,100 embargoes annually—labelling them congestion embargoes—a legal animal which in my opinion, does not exist, except possibly when the congestion is entirely the fault of the rail customer.

In December 2022, the STB held an additional public hearing to investigate these embargoes. At the hearing, UP conceded that its colossal use of "congestion embargoes" was largely caused by crew shortages resulting from the fact that in previous years, UP had cut its overall work force by over 25%. At that hearing, when he was pressed on whether UP would commit itself to maintaining the resources to start providing adequate rail service, UP's Lance Fritz told the STB: "We learned our lesson once; we don't have to learn it again." And shortly thereafter, he was shown the door—replaced by a management strategy which we now know has profoundly rejected and <u>unlearned</u> the lessons of too much cutting.

By contrast, in recent years, other Class Is had appeared to learn the error of their ways and brought in new management committed to reversing these myopic and short-term strategies.

Some say it has been the Board's actions which have had a positive effect. But whatever the reason, Boards of Directors in the past two years have supported CEOs at Canadian National, CSX, CPKC, and very importantly, Norfolk Southern, to make a new and different commitment. Recognizing their public obligations, they have instituted long-term strategies to reinvest capital and, most importantly through the ups and downs of economic cycles, to hire and retain workers to provide consistent and reliable service.

This should be an important message to Wall Street investors because this strategy has every likelihood of producing more sustainable and long-term gains for shareholders as compared to the short-term thinking which dominated the advent of the PSR craze.

The problem with activist investors bowing down to the cult of the OR is that they are impatient and want immediate returns. Their approach to lowering OR as fast as possible can only be accomplished by drastically cutting payroll and other resources in the short term.

It does not take a degree in higher mathematics to understand that there is another way to lower the OR than by reducing the numerator, i.e., which includes the amount spent on payroll.

The OR will also go down if you increase the denominator—that is by having enough resources to attract new business to the railroad, increase the volume—the number of loads—and

thereby increase total revenue. That is the vision being employed up to now by this new group of CEOs—particularly those at CSX, CN and yes, Norfolk Southern.

Thus far, those CEOs and their Boards have resisted pressure from activist investors to eviscerate workforces and cut spending on expansion capital. They understand that planning and spending for the long run—while taking time—will ultimately benefit shareholders more than short-term cost cutting, which is detrimental to the long-term vitality of the railroads and undermines efforts to improve safety. And of course, a long-term, future-focused strategy is essential if the railroads are to support the nation's economy and the public interest.

Since the April 2022 hearing, the railroads have hired and trained approximately 9,000 workers. While that still leaves the railroads with 14,000 fewer workers than pre-pandemic, even this limited increase has resulted in improved rail service. Moreover, the economy is expected to grow in the coming months and years. If the railroads are to meet their obligation to serve this expected growth, they must continue their expansion of both railroad workforces and infrastructure. Norfolk Southern has promised to do this and has already begun to deliver.

Any campaign, proxy or otherwise, that threatens to undo recent efforts to rebuild the railroad resilience and move toward significant long-term growth would be a major setback. It would undercut safety and be the opposite of good business, the opposite of fulfilling the common carrier obligation, and the opposite of meeting the Congressional commandment to serve the public. Regardless of what happens with Norfolk Southern's governance, it is crucial that management take seriously their duties to customers and the public.

To envision the consequences to NS if Ancora's efforts result in a course reversal, we need only look at what has happened at UP since just last August when its new CEO arrived with Soroban's short term, OR lowering mandate.

In contrast to other Class Is, UP has embarked on a furlough odyssey. From the time Jim Vena arrived in August 2023, through January 2024, as shown in UP's reports to the STB, UP has reduced its operating personnel by 771—this, after cutting 25% of its workforce in previous years. Every other US Class I has increased employment during the same period.

At UP's 4th quarter earnings call, Mr. Vena promised growth, but at the same time promised to continue to reduce headcount throughout 2024 as he has done continuously since he arrived. Indeed, just last week, UP announced additional furloughs. And the railroads' year end filings show that UP is the only Class I which ended 2023 with hundreds of fewer workers than it had a year earlier. All of the others, including Norfolk Southern, the only railroad which reported zero furloughs, ended the year with a larger workforce.

Just today, the STB received a letter the FRA has sent to UP raising the specter of a threat to safety resulting from UP's eliminating hundreds of maintenance of equipment employees.

Equally important, UP, unlike the others, is also cutting its capital spending, just when it's most needed for growth. UP's 2023 financial statements show that at the end of last year

when it furloughed hundreds of maintenance of way workers, it also cut $100 million out of its 2023 capital budget.

Thus, at the end of 2023, UP had $100 million in deferred capital maintenance, the effects of which may not be seen tomorrow, but which will eventually haunt the railroad, as we have seen in the past.

UP also promises to continue on this path in 2024. Rather than make up for the $100 million cut in 2023, UP has actually reduced its 2024 capital budget by $300 million, planning to spend only $3.4 billion as compared to its 2023 capital budget of $3.7 billion. By contrast, BNSF's capital budget for 2024 is $3.9 billion. And BNSF has already spent hundreds of millions more on projects like double tracking its Southern Transcon and building a massive new intermodal facility at Barstow.

I must add, however, that BNSF only recently has decided to hop on the furlough bandwagon again—announcing hundreds of new furloughs just last week, with more to come. This is, indeed, unfortunate. How does BNSF's return to furloughing square with its exciting new partnership with J.B. Hunt to move millions of truckloads to rail by delivering 95% on time performance?

And does UP really expect us to believe that it is committed to growth when it is cutting personnel and capital—the very resources which are essential to that growth.

There's a saying of something about a turnip truck in here.

While UP's course since the advent of the Soroban era is instructive about what happens to a railroad whose strategy is set by an activist investor rather than by a Board and CEO committed to the best interest of the railroad, we can get a further taste of what can be expected to happen at NS if Ancora takes over by looking at how NS has already responded to Ancora's planned proxy fight thus far. Under obvious pressure from Ancora's threats, NS recently announced buy outs for 7% of its management and staff—in direct contrast to its previous strategy of holding on to workers. And while management doesn't drive trains, it is essential to a well-functioning railroad that serves its present and potential customers.

And in the all-important area of future growth for railroads by landing the burgeoning increase in intermodal traffic, one of Ancora's strongest criticisms is that NS has too much intermodal traffic compared to merchandise traffic. Ancora's complaint is that intermodal is not as profitable. Apparently, Ancora, inexperienced in railroading as it is, is unaware that roughly half of all rail traffic in the US is intermodal and that intermodal is where future volume growth is. Coal is not coming back.

So what has happened at NS since those threats were levied? NS, which has been a standout in growing its intermodal base, has only recently announced that it is terminating some of its lower density intermodal lanes, regardless of whether there might be growth potential for the future.

Several weeks ago, Ancora wrote me a letter. The essence of their message was that they had taken a $1 billion dollar stake in NS in order for it – quote - "to become a safer railroad." Really? What hedge fund raises $1 billion to promote safety anywhere? The measure of Ancora's disingenuous pitch to improve safety is that its slide deck completely omits reference to FRA data which shows that, in the last year, NS has been an industry leader in reducing mainline rail accidents and derailments. And NS is the only Class I railroad which has joined the Department of Transportation Confidential Close Call Reporting System, a major advance in instituting a safe culture in any workplace.

Ancora has nothing to say about what it could do better.

I think we can assume that if Ancora succeeds in its bid to control NS, its next move will be to put the Brooklyn Bridge on the market.

Let's be real. Looking at Ancora's slide deck issued last week in which they're required to be a little more candid when soliciting other shareholders, Ancora principally and repeatedly focuses on a rapid lowering of the OR to drive cash payouts and raise its stock price, harshly criticizing present NS management for not making a lower OR the objective.

We now know that this is wrong headed thinking. Making OR the corporate objective is what led to elimination of thousands of workers which caused the service crisis.

Joe Hinrichs emphasized this morning that using OR as an operating objective by itself will ultimately lead to bad results. And another CEO has put it so well: "the operating ratio has always been an outcome of running the railway the right way." You "don't cut your way to success." That same CEO pointed out to his investors: "I'm not enamored with having the lowest operating ratio. I'm enamored with earnings growth." In other words, managing a railroad for growth will achieve more sustainable profitability.

In fact, the rapid reduction in OR championed by Ancora can only be accomplished by new major reductions in the workforce. Indeed, Ancora rejects NS' new long-term growth strategy and is particularly harsh on NS' focus on all important intermodal traffic. Clearly, their plan is to install a CEO ordered to reverse Norfolk Southern's recently instituted corporate strategy to maintain a resilient workforce and to invest more in infrastructure to grow the railroad's capacity long term.

The implications of significant cost-cutting at one railroad are ominous for the US economy. The fall out could extend to the entire freight rail system. Railroads crisscross North America in an intertwined network; freight is often handed from one railroad to another before reaching its destination. When one railroad has a service meltdown, it has a ripple effect across all other railroads. Such a debacle occurred in 2017 when CSX went on a cost-cutting rampage—a shock to the system from which it took years to recover.

Already, industrial customers of Norfolk Southern and shortline railroads that feed into Norfolk Southern have raised serious concerns that significant cost-cutting would undo the progress of the last two years.

And of significance, two rail unions whose members' quality of life has improved under current NS management and whose personal safety is at stake have announced their strong opposition to Ancora's proposed management strategy which relies on the cult of the OR.

Contrary to Ancora's sales pitch, a reversion to cutting workforces by major railroads would actually impede efforts to improve service and to improve safety standards to minimize the chances of another disaster like last year's East Palestine, Ohio derailment. These very concerns about what could happen to Norfolk Southern were raised recently by FRA administrator Amit Bose.

Of equal if not greater concern to the health of the entire freight rail industry is that a successful takeover by any investors overly focused on cost cutting will have the other railroad CEOs looking over their shoulders, deterring them from pursuing long-term strategies, and harming the U.S. economy.

At least for the last three years since I've been chairman, the STB has engaged in a long, continuous and continuing struggle to counteract the effects of this Wall Street pressure.

It's a never-ending tension. Wall Street will always be there—which is fine, it's part of our capitalist structure. But the activist investors, such as the ones that have surfaced now at Norfolk Southern, have a very short-term goal and it's not constructive.

Indeed, if Ancora is successful, we will have a national rail network, in which half of it—UP and NS—will be run by CEOs answering to short term, cash maximizing, shareholders to the detriment of the long-term investors—and most dangerously to the detriment of rail customers and rail workers —and ultimately the US economy and every member of the public.

Under those circumstances, I do not expect the STB will sit by and watch and wait while another service crisis unfolds as we confronted in 2022.

On the contrary, if service suffers, ultimately the STB would be called in—and may have little alternative but to institute more accountability hearings and more regulatory intervention to protect the public, an outcome which neither railroad investors nor the STB would relish.

To be clear, the STB has tools available to incentivize better service. We are already considering a rule to make reciprocal switching a practical tool to provide relief to shippers experiencing subpar service. And the Board has also stated it is interested in considering additional ways to grant sole-served shippers competitive access to a second railroad. In my view, for example, it may well be time for the STB to re-examine the restrictions contained in the decades old bottleneck rule.

To be clear: Railroads are a regulated monopoly. They have a common carrier obligation to the public interest and to the nation's economy. Unlike other businesses, railroad management and owners are not just free to manipulate the business by draining the company's resources for short-term gain.

Those of us in the rail community—and every U.S. citizen—need to stay tuned. To be continued.

Thank you.