# Jim Young Testimony

## Ex Parte No. 705
## Competition in the Railroad Industry

Good afternoon Chairman Elliott, Vice-Chairman Begeman, and Commissioner Mulvey.  I appreciate the opportunity to testify today.

Lance Fritz, our Executive Vice President of Operations, was going to appear with me today.  But given the severe flooding we are dealing with, I felt it was better for him to remain in Omaha and manage the railroad.

Mr. Fritz was going to discuss the significant operational issues that would arise from the new access remedies, and, their disruptive impact on decades of investment and hard work to improve safety, service, and productivity.

I would appreciate if the Board would allow us to submit a written copy of the testimony that he would have given for the record.

My testimony focuses on two closely related issues, competition and investment.

Union Pacific invests so that we can compete effectively for our customers' business. But to continue to invest, we must also deliver competitive financial returns to our investors.

Shippers proposing new access remedies say they are trying to increase competition. But railroads are already subject to intense competition. Each year, we lose and must replace over 10% of our business. We continually struggle with other railroads, trucks, and water carriers to win and retain business.

Sometimes competition is easy to see because one carrier takes traffic directly from another. For example, just a few days ago KCS and UP won a significant coal movement from BNSF. Our reply filing gave other recent examples of traffic switching between carriers.

Other competitive actions are just as important. We compete by increasing the value we offer customers through high-quality, reliable service, and innovative products.

To give just one example, we have been working with H.J. Heinz Company to redesign its supply chain, using refrigerated rail cars to shift traffic from truck to rail. We helped Heinz become more cost-effective, competitive, and environmentally friendly by reducing its fuel use, $CO_2$ emissions, and costs. And, this year Heinz won the Frozen Food Industry's sustainable supply chain award.

Successes like this show why you cannot measure competition by looking only at rates or rate computations. You also have to look at the value we provide. Similarly, you cannot just look at whether traffic shifts between carriers. If our service creates enough value for our customers, they keep their business with us, give us more business, and are willing to pay for the value we provide.

Competition is what drives us to invest. It's why we poured $30 billion of capital into our network from 1999 through 2010. It's why we plan to spend $3.3 billion this year, $1.9 to replace and renew existing assets, and over a billion for new growth capacity. This is the highest capital spent in the history of our company.

Competition is why we have committed to investing 17 to 18% of revenue annually over the next several years – assuming the regulatory environment will allow us the opportunity to earn adequate financial returns.

In short, competition is why we devote so much of our creativity, energy, and resources to improving service and expanding our network. As our earnings have grown, so have our investments. We can't afford to ignore our customers. And our customers – at least most of them – recognize our efforts. Our customer satisfaction scores have been marching upward. In the first quarter of 2011, we earned a record score of 91. The picture of complacent monopolists that some parties paint does not fit with our approach to service, investment and growth!

Proponents of new access remedies are not seeking more competition, they want policies that will shift revenue from railroads to shippers. These policies will also have the unintended consequence of increasing our operating costs, eliminating efficiencies, and consuming network capacity.

The predictable decline in railroad earnings means that these policies would have a serious negative impact on our investment plans.  Capital spending would decrease immediately just as our nation is looking to railroads to provide more transportation capacity.  This would reverse the progress we've made during the last 30 years.

This is financial reality.  If regulation prevents us from generating competitive returns on the replacement value of our capital investments, our shareholders will not allow us to continue investing at the levels we have planned.  They will require that we return more cash to them directly, rather than investing to support future growth.

Several parties in this proceeding say that stock buybacks and dividend payments are evidence that we are already earning more than we can profitably invest.  They argue that we can easily spare this supposedly excess revenue without cutting back on capital expenditures.  This simply is not true.

Stock buybacks and dividend payments are not evidence of excess profit or a lack of investment opportunities.  Every company must balance between providing investors with immediate returns in the form of stock buybacks and dividend payments, and investing capital for long-term value appreciation.

We cannot ignore shareholder demands that we allocate some of our cash to stock repurchases and dividends.

- Every one of the publicly-traded, non-rail companies that filed comments in this proceeding and that has more than $10 billion in revenue, bought stock back ***and*** paid dividends during the last three years.

- During that same time frame, almost two-thirds of the S&P 500 companies repurchased shares, and nearly three-quarters paid dividends to their shareholders.

These are mainstream practices for delivering financial returns to shareholders, not a sign of excessive profits, as some commenters claim. We must compete for capital with other companies that provide the same type of returns to their investors.

[Slide comparing pie charts]

Indeed, as you can see on this slide, comparing how cash spent on shareholders and capital investment has been allocated by Union Pacific and all S&P 500 companies:

Union Pacific allocates a higher proportion to capital spending than to dividends and stock buybacks combined; and

In 2009, while we continued to invest significantly in capital expenditures, we had no share repurchases at all, while the S&P 500 companies allocated 19% to share repurchases.

It is critically important for the Board to recognize that using regulation to force down railroad revenue and earnings will increase, not decrease, shareholder demands that we return cash to them instead of investing it.

Our investors have questioned our need to re-invest 17 to 18% of revenue on an on-going basis. In their experience, this is a significant amount of money for a company to invest. But recently, they have been encouraged by our progress in growing financial returns.

They are willing to stick with us so long as they see the opportunity for more attractive return. They expect our capital spending to pay off through a higher stock price, stronger dividends, and share repurchases, to increase the value of their investment. We are just beginning to meet those expectations.

But, if regulation reduces Union Pacific's prospects for revenue growth, our investors will insist that we provide returns through higher dividend payments and more share repurchases now, rather than investing in growing the business. Our capital expenditures will decrease.

As I said, this is financial reality. Earlier this month, I met with shareholders and prospective investors at a major equity conference. Our shareholders are very aware of this proceeding and its implications.

They have a fiduciary responsibility to the pension funds, endowments, trust funds and individual mutual fund investors who entrust money to them, and they compete with other investment managers. If Union Pacific cannot provide competitive returns, many of our current investors will redirect their investment to companies that are not forced by regulation to reduce revenue.

The investors who replace them and those who remain will not be satisfied with lower returns. They will press Union Pacific's managers to reduce the investment base and cut costs by taking drastic action such as slashing capital expenditures, selling assets and cutting jobs.

We all know the significant challenge our country faces to fund the high replacement cost of transportation infrastructure. If our economy is to succeed and thrive in the global market place, shippers will need the rail network to carry more of the nation's freight. The Board should be considering how it can encourage more private investment in railroads, not policies that will reduce such investment.

That concludes my testimony.  I will be pleased to answer any questions you may have.