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SURFACE TRANSPORTATION BOARD

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RAIL TRANSPORTATION OF GRAIN

PUBLIC HEARING

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The hearing was convened in the Mercury Building, 1925 K Street, NW, Washington, DC at 10:00 AM, Charles Nottingham, Chair, presiding.

PRESENT

CHARLES NOTTINGHAM	Chairman
FRANCIS MULVEY	Vice Chairman
W. DOUGLAS BUTTREY	Commissioner

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10:01 a.m.

CHAIRMAN NOTTINGHAM: On the record. Good morning. I'd like to extend a warm, welcome to all of our visitors today and a special welcome to those of you who traveled from out of town to be here. Today's Surface Transportation Board Hearing will focus on issues related to the transportation of grain by rail.

As many of you know, this is my first hearing as Chairman of the Surface Transportation Board and I would like to thank all of the staff here at the STB who helped plan and prepare for this hearing which as many of you know was originally announced by my fellow Commissioners back in July of this year before I became a member. I'm glad to follow through on that announcement by holding this hearing today.

On the macro, big picture level, the United States has much to be proud of when it comes to both agricultural and freight railroad productivity. Our U.S. farmers are the most productive in the world and produce a wide variety of crops at very competitive prices while meeting or exceeding strict safety and nutritional requirements. U.S. consumers have more affordable and available food choices than ever and spend a much smaller percentage of income on food as compared with other developed nations.

Similarly, the U.S. freight and railroad industry manages the most productive and profitable freight rail network in the world. No other nation moves the volumes of freight by rail that we do. While we should be proud of our agricultural and transportation successes, we will hear today that many farmers feel economically threatened by our freight rail system and by what farmers see as a rail market that offers too few choices and too high costs, both direct rate costs as well as the indirect costs of doing business with the railroad. While I understand that tension between farmers and railroads is not a new phenomenon, I'm hopeful that through improved communication, information sharing, customer service, infrastructure investment and if necessary, new public policy, some of this tension can be reduced.

It is in our national interest to promote a healthy and strong agriculture sector as well as a healthy and strong freight railroad industry. I'm hopeful that today's hearing will shed light on both of these goals while demonstrating to us that agricultural and freight railroad interests do not necessarily need to be in conflict.

In my first few months at the board, I've much about the issues we'll be discussing today. In October, I personally visited grain producers in Montana and I'm glad to see some of those folks here today. Welcome. I was concerned to hear reports from them that they believe they are shouldering more transportation costs today

than in past years. I have heard concerns from grain producers about high rates, lack of car availability, the shifting of costs such as car ownership from railroads to farmers and inadequate service.

So that there can be a real dialogue on this issues, I am glad to see U.S. and Canadian railroads appearing here today. I look forward to hearing about the interplay of the Canadian and U.S. wheat markets and what impact that may have on grain transportation in the United States. I'm also glad to see on our docket today fellow government agencies directly involved in these issues. I believe the backbone of the U.S. economy is our highly efficient agricultural system and I look forward to hearing today from the Department of Agriculture to learn its perspective on how rail transportation of grain affects that system.

As the notice for this hearing indicated, one issue we would like to explore is the Government Accountability Office's (GAO) October 6, 2006 Report in which it observed while most freight rates have declined since 1985, grain rates have diverged from the industry trends. According to the GAO Report, the amount of grain traffic with comparatively high mark-ups over variable costs increased notably between 1985 and 2004. I am pleased that GAO is here today so that we can further explore those observations.

The agricultural sector is highly dependent upon

freight rail and I want to make sure that nothing under the STB's purview impedes agricultural either in domestic or international markets. I also want to encourage shippers and carriers to work together to make transportation of grain efficient, productive and profitable. This informational hearing is a good opportunity for me and my fellow Commissioners to learn about this important sector of our economy. Indeed I believe informational hearings are useful tools to stay abreast of issues important to the industry and to discern what role, if any, the Board should play in addressing the issues.

Now before we begin, let me just take a few minutes to review a few procedural points about today's hearing. We will hear from panels with breaks as appropriate. We will hear from all the speakers on each panel. Speakers, you will see a green light when you have one minute remaining in your allotted time and a red light when your time has expired.

After hearing from the entire panel, we will rotate with questions at five minutes per Board member until we've exhausted the questions. I ask all witnesses to please summary their written statements in the interest of time. I think I can speak for everyone and say that we have all read each of your full statements and you should not feel obligated to use every second of the time allotted. Additionally, the official record of this hearing will remain open until

January 12, 2007 to allow supplemental information to be provided to the Board.

Consistent with what I understand to be Board practice, we will allow all the witnesses on each panel to make full presentations before the members ask any questions. So with that, I certainly look forward to a very interesting day of testimony. I know I have a lot of questions and I'm sure that my fellow Commissioners do as well and with that I will recognize Vice Chairman Mulvey for any opening statement that he may have.

VICE CHAIRMAN MULVEY: Thank you, Chip. I'd just want to join Chip in welcoming all of you here today. This is a very, very important topic. The economic health of our nation's farm sector is critical to the overall well-being of the nation's economy.

The Board has undertaken in the last few months a number of initiatives which we hope will make the Board's processes and procedures more available or more open to more shippers and will help in the long term resolve some of the issues that we're going to hear about today. So with that, I'm looking forward to hearing these testimonies and I'll turn it over to Mr. Buttrey.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey.

COMMISSIONER BUTTREY: Good morning,

everyone. I'm very much looking forward to this hearing today on the important topic of rail transportation of grain. As some of you may know, I grew up on a farm. That may explain why I have a soft place in my heart for farmers and I'm not the only one. Outside the Beltway anyhow, there are a lot of people in this country who seem to have a soft spot in their heart for farmers.

I saw an article in the local Washington newspaper not long ago trying to make the point that farmers on average get more benefits from the Government than the typical citizen does. But in my mind, this makes some sense. It would be hard to find a riskier business than farming or one more essential to the well-being of this country and all of its citizens. We may not think about farmers very much because so few of us, probably none of us, have ever gone hungry. If we had, that might be different.

When I was preparing to come to the Board a couple of years ago, I started looking at issues relating to grain transportation in some depth. I talked to farmers, people who run elevators, grain traders, railroads, folks on the Hill and so on. During my tenure here, I have been out to Montana and Nebraska twice and to North Dakota once. I've met face-to-face with grain farmers in their offices and in their fields and you find the pictures on the Board's website to prove it. I've stood next to grain piles as big as condominium complexes outside

in the elements and I have seen the looks of desperation on the faces of growers who wonder if this year's crop will be their last.

After studying the matter for some time, I have concluded that the grain market for whatever reason seems to be standing on its head. In just about every other business endeavor I can think of, the accumulating costs of getting the product to the end consumer is paid by the end consumer.

In the grain business, that's not true. In the grain business, the cost of transportation is paid up front, in advance by the farmer. It is typically taken out of the proceeds from the sale of his grain at the elevator before he is paid. This is a serious concern for me because these farmers are struggling to make it. This added cost can make the difference between success and failure for them and it is a cost they do not, they do not, and cannot control.

We all know that in today's world grain competes in a global marketplace. To be competitive our domestic grain industry, including the transportation component, must be as efficient as possible. Great strides have been made in recent years to improve the efficiency and cost effectiveness of the rail transportation of grain. Today more unit trains and large capacity, high speed loading facilities have reduced costs and improved equipment utilization, but not every farmer has access to these innovations or the ability to participate and

share in these efficiencies and cost savings, at least, not now.

It would be great if every grain farmer in American could have ready access to a brand new, 110-car shuttle loading facility today. That would level the playing field in terms of service and cost of transportation. But we're not at that point yet.

So the question is how best to manage the inequities flowing from this lack of balance during the transition. Today it seems to me that the smaller operators are being penalized through no fault of their own. They have just as much right to receive service and pricing that suits their needs in the marketplace as corporate behemoths do and the last time I looked the common carrier obligation is still a part of the statute.

The challenge for the industry and for the Board is to work through what that means in today's situation. There needs to be a way to include the smaller operators in the benefits of efficiencies while the entire supply grain chain is being reinvented. Perhaps through creation of new cooperative arrangements or state sponsored consortia, the industry can take a larger view when looking at issues of pricing, car supply, siting of new facilities, etc. I hope to hear some fresh ideas and innovative suggestions on this subject from the witnesses who will appear before us today.

I'm also interested to hear from today's witnesses

about the impact the Canadian system might have on the U.S. grain business. We all know that Canada has a different regulatory system than we do. North of the border, the Canadian Wheat Board controls prices, marketing and car supply for most of the Canadian grown wheat, durum and barley and there are government regulated, yearly revenue caps in place for rail transportation. I hope to hear from the witnesses today whether they believe that U.S. producers are disadvantaged by the existence of the Canadian cartel-style regulation.

I've heard it said that one definition of insanity is continuing to do the same thing over and over expecting different results. In my view, that's not a bad description of some of the dialogue I have heard in the past about problems relating to the rail transportation of grain. Grain industry reps and railroads seem to talk past each other, ships passing in the night as it were.

It's time for this to change. I would dearly love to hear some fresh innovative ideas about how to solve the problems that have plagued this industry for many, many years. Don't forget, problems with grain transportation were the main reason the old ICC was created in the first place back in 1887.

I know that there are some really bright people, talented people, out there in this audience today and in this industry. At the risk of sounding like Don Quixote, I would hope that some

witness today would have the courage to proffer some new ideas and suggest some possible solutions, not just keep recycling the same old thread bare rhetoric.

It does sound like an impossible dream. But if this hearing today can be a starting point for a fresh new dialogue relating to the rail transportation of grain, then we will have accomplished something important. So I challenge every witness today. Please, please tell us something we haven't heard. Thank you very much.

CHAIRMAN NOTTINGHAM: Thank you, Commissioner Buttrey and Commissioner Mulvey. We are very honored today to have as our first witness on our first panel the Honorable Bruce I. Knight, the Undersecretary for Marketing and Regulatory Programs at the U.S. Department of Agriculture.

Bruce Knight, Undersecretary Knight, was confirmed by the Senate in early August, a development that I can relate to. I think we were in the same herd to use an agricultural term that cleared the Senate that day. Mr. Knight provides leadership and oversight for the Animal and Plant Health Inspection Service, the Agricultural Marketing Service and the Grain Inspector Packers and Stockyards Administration. These agencies protect animals and plants and promote fair and open and orderly markets for U.S. agricultural products. Safeguarding America's flocks, fields and forests from pests

and diseases is worth billions of dollars in losses avoided by American farmers and ranchers. Standardization grading and marketing efforts along with efficient transportation increase the efficiency of agriculture and provide better quality products to consumers at reasonable cost.

A third generation rancher and farmer and life-long conservationist, Mr. Knight grew up on a small farm near the Gann Valley, South Dakota where he owns a diversified grain and cattle operation using no till and rest to rotation grazing systems. His ranching background gave him the opportunity to practice stewardship and husbandry and provided firsthand knowledge of the interdependence of animal, plant and human health.

To sum it up, he know what he talks about and has walked the walk. We're honored in my home state of Virginia that Mr. Knight and his family have chosen to make Virginia their home while he serves the Federal Government. With that, Secretary Knight, the floor is yours.

SECRETARY KNIGHT: Thank you, Mr. Chairman, for the kind introduction. I often joke that I don't think anybody other than my mother wants to hear the entire thing, but, Mr. Chairman, members of the Board, I'm honored to sit before you today and present the views and the interests of the United States Department

of Agriculture regarding the issues related to rail transportation of grain. I believe the Board is providing a valuable service to the public by initiating this proceeding and I'm pleased to present USDA's interest for the Board as well as for other parties to consider.

On October 6, 2006, the United States Government Accountability Office released a report that include observations on rates, competition and capacity issues in the U.S. rail freight industry. GAO found that most rail rates have declined since 1985 but that grain rates diverged from trends in other industries. In addition, GAO reported the amount of grain traffic with comparatively high mark-ups over variable costs increased notably in the period 1985 to 2004.

An affordable and reliable transportation network as you all know is necessary to maintain the strength and competitiveness of American agriculture in rural communities. Rail service is a particularly important part of that network for the U.S. agriculture and is virtually the only cost effective bulk shipping mode available in many rural areas. Several states including Arizona, Kansas, Montana, North Dakota, Ohio, Oklahoma, Texas and Utah rely heavily on rail service for the transportation of grains. More than 50 percent of corn, wheat and soy beans produced in these states are in turn moved by rail.

The Staggers Act significantly reduced regulation in all phases of railroad operations. Among other reforms, the Staggers

Act encouraged greater reliance on competition to set rates, engage railroads increased freedom to price their services according to market conditions. Thus, railroads are now in a position to recover a greater proportion of their costs from rates charged to shippers with a greater dependency on rail transportation. At the same time, the Staggers Act gave the Interstate Commerce Commission and later the Board the authority to establish a rate appeals process so that shippers could obtain relief from unreasonably high rail rates.

Shipper benefits from railroad deregulation included preservation of railroad service, rate savings and in many cases, improved service. Short-line railroads have been able to operate now profitably on many rail lines that were not viable for the major railroads.

Benefits, however, as noted by GAO have not been distributed uniformly across or within commodities or communities. The distribution of benefits has tended to favor producers in regions with higher levels of intermodal competition. GAO noted that rates have not declined uniformly and that rates for some commodities are significantly higher than rates for others. Despite the overall success of the Staggers Act, many agricultural shippers continue to express concern about decreased rail-to-rail competition, increased rail rates, poor rail service, rail capacity constraints and the fair allocation of rail

capacity.

One of the key assumptions underlying the deregulation of the rail industry was that there would be sufficient competition. Thus, the authors of the Staggers Act and the Interstate Commerce Commission Termination Act included the preservation of effective competition as one of the rail transportation policy goals of the United States Government. Not only does effective competition promote reasonable rates and minimize the need for regulatory control, it also encourages efficient management of the railroads.

Agricultural producers of grain and oil seed crops have limited ability to influence the price they receive for their products and therefore are unable to pass increases in costs forward to buyers of their products. Instead these individual agricultural producers tend to absorb any cost increases because of their lack of market power. Consequently, increases in transportation cost typically result in decreased producer incomes and in turn, increased USGA outlays. Higher transportation costs also hinder the competitive position of U.S. agricultural products in a highly competitive export market.

GAO's analysis states that although many rates have decreases, rates have not declined uniformly and that rates for some commodities are significantly higher than for others. In fact, since 2003, rail rates for grain shippers have increased much more rapidly

than rail rates for other products. The average freight per carload per major grains has increased 27 percent since 2003 while the average freight revenue for all commodities including grain increased only one percent since 2003. Rates on corn, sorghum, soybeans and wheat have gone up 25, 23, 39 and 25 percent respectively since 2003. Grain shippers are shouldering greater responsibility for car supply and other functions railroads formerly provided.

Railroad consolidation has resulted in railroads having the ability to dictate the terms of service which may at times be at conflict with the present and future needs of some agricultural markets. Class one railroads for example encourage unit train movements of grain even though expanding specialty markets will require specialized handling in much smaller quantities.

Due to the less than robust rail-to-rail competition, the quality of service provided by class one railroads has been a concern for some agricultural shippers. Captive shippers, even though paying the highest rail rates, often claim to experience poor services because class one railroads may choose to first serve those shippers having competitive options.

Rail capacity for agriculture products has been tight during the last three years for a number of reasons, those reasons being both agricultural and non-agricultural. Non-agricultural factors

include general economic expansion, increased international trade, increased demand for coal due to the high natural gas prices, high fuel prices forcing truck traffic to railroads and new hours of service trucking regulations that increase rail intermodal demand. Agricultural factors include strong grain export demand, high prices for agricultural crops and back-to-back record or near record grain harvests.

USGA believes that all agricultural shippers, even the smallest, should have reasonable access to rail capacity. Agricultural shippers have often complained to USGA regarding grain car allocations that seemingly favor shuttle shippers. The lack of adequate rail service to smaller grain shippers could reduce competition among grain shippers as well as placing heavily costs and burdens on railroad systems. The common carrier obligation remains and should continue to be enforced.

The U.S. wheat industry has long complained that the special government enforced privileges afforded the Canadian Wheat Board including significant transportation subsidies have provided Western wheat and barley competitive advantages in both export markets and the Canadian domestic market. The CWB has operated in tandem with major Canadian railroads, the CN and the CP, to the benefit of Canadian grain exports.

For over 100 years, Canada has subsidized rail rates for agricultural products moving to export in certain domestic positions. For many years, the subsidies took the form of fixed cap on rail rates which were much below market rates and direct subsidies to the railroads. About a decade ago as a result of the Uruguay Ground Agreement on Agriculture, Canada removed the cap, raised rail rates considerably and compensated grain producers with offsetting direct payments. But Canada continues to subsidize rail rates through a cap on revenue from shipping grain. In addition, the CWB's grain exports have benefitted from preferential access to subsidize rail transportation.

The United States Government as well as private industry has pursued various actions to address the subsidies and other trading distorting practices associated with the CWB and the grain transportation system. These trade actions have been complicated by the lack of transparency surrounding both CWB activities and the extensive government regulation of the Canadian rail system. The United States pursued a WTO challenge against the CWB and certain aspects of the Canadian treatment of imported grain including the revenue cap for grain shipments.

The U.S. wheat industry brought a counter-veiling and anti-dumping case against the Canadian Wheat Board and other wheat subsidies including the rail revenue cap and the provision of

government-owned rail cars. Both actions only met limited success but made clear the distortive nature of the Western Canadian grain marketing and transportation system. The United States continues to pursue meaningful disciplines for state-trading enterprises within our WTO negotiations and objectives.

USDA, the Surface Transportation Board and all the interested and effected parties should continue to work together to ensure that rail transportation is an affordable and reliable option for the nation's grain shippers. USDA believes that healthy competition is essential for encouraging railroads to improve customer service, for preserving the economic vitality of the railroad industry and for protecting shippers from the abuse of a overhead marketing power and unfair rail rates. Finally, any system used to determining and reporting rail shipping charges should be fair, transparent and easily accessible to the public.

Mr. Chairman, Members of the Board, I thank you for the opportunity to present these comments and stand willing and ready to answer any questions you may have.

CHAIRMAN NOTTINGHAM: Thank you, Secretary Knight. I'll start off with a couple questions if I could. You mentioned in your testimony the importance of specialty markets and the emergency of specialty markets in the agricultural sector as a

growing area. It raises a concern I heard loud and clear in my travels to Montana in some of my meeting with agricultural interests that the move by the railroads towards large shuttle trains and certainly one can recognize some of the efficiencies and some of the reasons that move is taking place may actually, I'd love to hear your thoughts and experience on this and what you've heard, what I hear is that farmers in many cases are actually making their crop selection decisions based on the move toward large shuttle trains in that they are abandoning certain specialty crops in favor of crops that have larger volume yields and that play or are more compatible I guess with the large shuttle trains. It just obviously raises some concerns to me as to who is setting agricultural policy and I would hope it's you and farmers. But I would like to hear your thoughts on that.

SECRETARY KNIGHT: From my own farming experience, I might be able to provide some illumination to what is at best the result of the market forces. Certainly, unit train movements provide incredible efficiency and do in turn put a higher prices on the grain prices that a producer receives in that immediate area and I had a load out facility come into the community fairly recently and that made a tremendous difference. Then for those places and those locations that are not as close to a unit train load-out facility, that has tended to have them start to focus on alternative markets which may be these

specialty markets.

One of the intriguing things that we're started to see and is very difficult to track is how much for export and domestic purposes some of the container movements can now pick up the needs for some of these specialty markets. It's important to note that while the topic of the hearing today is largely on grain transportation the importance of some of these specialty market movements goes beyond just grains that we normally think of soybeans and corn, but can spread throughout the larger movement of agricultural products into some of these specialty markets.

CHAIRMAN NOTTINGHAM: Thank you. You travel a lot. You're in touch daily with farmers and where does this rate kind of on a scale? Is this something you hear about almost in every conversation as far as the concerns of farmers? Is this a peripheral issue you hear about occasionally? Give me a sense that you're living it every day.

SECRETARY KNIGHT: Every farmer, you make your living based off the price you receive for your crops and your ability to market those crops and we're all quite cognizant that our local prices are based off of the basis, the transportation differential between where your farm is located and Chicago or in my case, it may be export markets in Portland and so as that basis widens and narrows based off

the transportation costs, you are acutely aware of the impact of transportation on the bottom line.

CHAIRMAN NOTTINGHAM: Thanks. You spoke about the Canadian system and some of the efforts our government has had and the international trade world has undertaken to try to address the Canadian system of what seems to be pretty glaring subsidies and some market interference. Are we making progress there? We have no better, in most respects, friend and ally than Canada, of course, but to see a system that seems to be having a direct negative impact on so many U.S. farmers and not a level playing field, what's going on in that front?

It is very important to note that when it comes to agricultural products, Canada is one of our most important customers and we're certainly in an ever-increasing North American market of all forms of agricultural products moving north and south from the U.S. into Canada, Canada into the U.S., movements going north and south on both the east and west coasts and in the Great Plains. So with that noted, there is certainly a great deal of need, however, to through our international trade negotiations to address concerns with single desk trading enterprises such as what you see with the Canadian Wheat Board and the potential for distortion of the marketplace and the distortion of trade objectives.

CHAIRMAN NOTTINGHAM: Thank you. You know many economists will say or would say that prices send important signals into the market and that certain products are not yielding the prices that make it worthwhile to stay in that business, that perhaps folks if you look at it from a pretty cold statistical economic perspective should just move out of that business or those businesses and go into areas where the prices are better and let others in the world who maybe have some advantages produce those products. You take that sort of sterile view just for discussion purposes and then counterpose it with just the national importance of having a diversified productive agricultural sector, where does that leave us? Are there areas of crop development that you think our country can afford to just relinquish or see fade away?

SECRETARY KNIGHT: One of the real challenges for an agricultural producer when one's given that hard economic argument of follow the market signals is that, and I know many more active producers than I follow me on these panels, but it's important to keep in mind that throughout our lives as farmers we have 40 or 50 opportunities to get it right. You only raise one crop a year in each growing season. So through your entire life as a producer, you only get 40 chances, maybe 50 chances if you're lucky to really get it right and that means that the economic -- there's a disconnect between one's

ability to plant a particular crop at one given time of the year to respond to the marketplace direction and have that click and hit in the correct manner each time. So that's one of the reasons why you have the intervention in the marketplace. That's why you have the protections afforded by the STB, the protection afforded by USDA, to ensure that we have open transparent markets, that you have the right sideboards for these markets to clear and for these markets to work correctly.

CHAIRMAN NOTTINGHAM: Thank you, Secretary Knight. I'll yield now to Vice Chairman Mulvey.

VICE CHAIRMAN MULVEY: Thank you. I'll be the cold-hearted economist up here in the group. As Commissioner Buttrey noted, this issue has been around for a long time. He mentioned it was the reason for the ICC Act of 1887. In fact, before the ICC Act were the Granger laws pushed by the Society of the Grange back in 1870s which were the forerunners of the ICC Act. So this has with us for a long time.

SECRETARY KNIGHT: Yes, it has.

VICE CHAIRMAN MULVEY: And the issues are very similar to what they were then. One of the things that's happening today though which is somewhat unique in the last few decades is that there's a tremendous capacity constraint in the railroad industry. There's just not a lot of capacity there. Even though some of

the routes, which are relied upon for grain movements, have some capacity, it's a network system and there are really capacity shortages in the system.

There are some proposals to find ways to get the public involved in trying to help alleviate the rail capacity shortage including legislation proposed by Senator Lott and others to allow for a 25 percent investment tax credit for the railroads. These investment tax credits could be used to expand rail capacity and take some of those pressures off the railroad's need to raise prices especially on captive shippers. Has the Department taken a position on that bill?

SECRETARY KNIGHT: To the best of my knowledge, sir, the Department has not taken a position on that bill. But I will check on that and respond for the record.

VICE CHAIRMAN MULVEY: The AAR also noted in its written testimony, which you may not have seen, that over the last couple of decades the percent of the market share of railroad movements of grain has declined fairly precipitously. Back in 1980 about half of all grain movements moved by rail. Today it's about a third, or in 2004 it was about a third.

The railroads are concerned that if they make investments in cars and other infrastructure that they'll be left holding the bag as when the environment changes again, the farmer shift back

to trucks and more and more traffic movies by truck. The truck market share during that period of time gained at the expense of rail and barge. How do you get the railroads to make that kind of investment when indeed the farmers could be fickle and move the traffic back onto the highways?

SECRETARY KNIGHT: One of the things that I think we need to keep in perspective is the energy efficiency of rail movements and given where we are now with fuel prices and a great deal of speculation that we've reached a new plateau, if you will, on fuel prices, you probably have a very competitive client in the future for rail movement. You also notice the shift in rail movements increasingly to dedicated shuttle trains that are moving vast amounts of grain from grain production areas to livestock concentration areas that are vitally important and provide much of that long-term certainty for the grain trade as well as for the railroads. The uncertainty then lies with the opportunities for export markets in international trade and that's what provides for some of that variability and I think the long-term opportunity there then lies with meaningful reforms and opening of markets overseas that will provide us with that reliability that I think both the farmers, the shippers and the railroads are all seeking.

VICE CHAIRMAN MULVEY: This issue with

exports has both transportation and trade components, but do you see it more as a trade problem and as an ability to negotiate with Canada to get them to begin to reduce their subsidies or is it more of a transportation problem that's increasing our farmers' costs relative to the Canadians and where is the balance there or is it 50/50 or what?

SECRETARY KNIGHT: I'm not sure I can quite speculate on that chicken and egg scenario. What is readily apparent is that this is one that we need to pursue on a dual track for resolution on both sides of the issue.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey.

COMMISSIONER BUTTREY: Secretary, you mention in your testimony that the USDA has been involved either primarily or secondarily in the negotiations at the WTO about the Canadian situation and I would certainly echo what the Chairman said about our Canadian friends being among our greatest and most reliable allies but that's in another venue and the agricultural situation is in a different venue. So we'll speak freely about the agricultural and the trade issues I hope.

Do you get the impression that our trade negotiators -- and I don't want you to give any inside information or anything

necessary that you would anyway, but do you get the impression that our trade negotiator has sort of given up on the idea of trying to do anything about the Canadian Grain Board and other issues like that or do you think -- do you see anything in the pipeline that would indicate that that issue is going to continue to have some legs?

SECRETARY KNIGHT: All indications are that there continues to be a desire on the single desk scenarios like the Canadian Wheat Board to get those resolved.

COMMISSIONER BUTTREY: There has been a lot of attention given recently to this idea of specialty markets and specialty grains and also a lot of attention given to the interest in creating capacity in the current system without having to invest huge, huge amounts in capital although the railroads continue to do that in large amounts which will be good for everybody. Is the USDA doing anything to encourage this idea of using backhaul containers to take grain to the Pacific Northwest export markets?

SECRETARY KNIGHT: We were talking about that in the preparation of this. There are some intriguing opportunities out there for the containers as backhauls. One of the interesting things you may have noticed in the press articles recently where it is actually opening up for some of the smaller mills in some of our export markets for them to engage more directly with producers. That also gives them

the opportunity then to start specking for specific qualities in that grain, protein quality, milling quality, feed qualities, that they're seeking and desiring and that's a very intriguing concept and one that if there is any assistance that USDA can provide to the Board, we stand willing to do that as far as giving you the ability to look at what are the movements of those markets that we can pull from our data and our efforts.

COMMISSIONER BUTTREY: Thank you very much.

CHAIRMAN NOTTINGHAM: I have no further questions for this witness. Commissioner Mulvey.

VICE CHAIRMAN MULVEY: I wanted to ask you about the ethanol market. We're talking about the need for competition between the railroads and to make sure that the capacity is there to handle all of our farm shipment needs. But the farming community right now is very dynamic and there's a lot of movement towards shifting corn from export markets to moving more towards ethanol plants which may be closer to the points of origin and that would have a tremendous impact on the railroads. In fact, others are talking about the DDGs and the fact that the DDGs might cause a shift of cattle production north from Texas into the Plain States and again changing the demand for rail and truck transportation. Is the Department of Agriculture looking at these issues and trying to make

some sense as to what the possibilities might be and what that would mean for investment in our rail infrastructure?

SECRETARY KNIGHT: We will be looking at those issues, looking at capacity issues surrounding tanker cars for tanker car movement of the ethanol that's produced in those plants, what may be the impact of some of the locations. I know the location of the ethanol production and what that means for the movements of the stilled or dried grain or if that causes the livestock production to shift.

One of the important things to keep in mind is that ethanol does not consume, when you produce ethanol, all of the feed value of the grain. You've borrowed a small portion of the starch if you will and so there's a tremendous product with a great deal of feed value that then needs to move into a market export or a domestic.

I'm also aware of many concepts of actually moving grain to some of the grain deficit areas, California, the Pacific Northwest, move that as whole grain, produce the ethanol there and then in turn move those distillers' dried grains into the marketplace. You're seeing that occurring now in the Texas High Plains to a certain degree near the existing cattle feeding scenarios.

The marketplace is working these systems out very rapidly and we will take our role at USDA very seriously in monitoring

those changes, making sure that those are transparent and something that all of us can look at and see what are the appropriate sideboards that should be operating there.

VICE CHAIRMAN MULVEY: The marketplace relies very much on information. However and absent information, the marketplace can give you strange results. One of the things we learned yesterday at our Grain Council meeting is that ethanol plants are being constructed and being built and no one is asking the question as to how the ethanol is going to move once the plant is built. They think they can just call up and say "Send us a hundred or two hundred or three hundred ethanol tank cars". But, there aren't any ethanol tank cars available and it could be 2009 before they're delivered. These plants will be coming online in six months. Does your department have any responsibility or any authority to work with the ethanol producers in terms of making sure that what they're planning can be carried forth and making sure that the railroads have the tank cars available for them when they're ready to begin production or is that a DOE issue mostly?

SECRETARY KNIGHT: I would have to look at what authorities we might have in and respond to the record for you. I do know transportation -- In the location of an ethanol plant, there are a handful of key considerations that investors, folks putting together the

plant, always look at. It's availability of water. It's availability of the fuel source, quite often natural gas. And every bit as equal to that is the availability of transportation and that's access to rail or access to barge to be able to move that in and product out as well as the grain in. But I'll look at what our authorities are and report back in the record on that.

VICE CHAIRMAN MULVEY: Thank you.

SECRETARY KNIGHT: Thank you.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey. Thank you, Secretary Knight. That concludes our questions. Thank you so much for joining us and please remember that the record will remain open until January 12th. So feel free to supplement if needed.

SECRETARY KNIGHT: Thank you very much.

CHAIRMAN NOTTINGHAM: Okay. We'll now call up our second panel. I believe you know who you are, if you could come forward and we will move on with the next stage of testimony.

(Second panel comes forward.)

CHAIRMAN NOTTINGHAM: Okay. We may just jump around a little bit in this panel and let the technology folks have a chance to get the presentation together. Mr. Whiteside, would

you be willing to kick off this panel for us?

MR. WHITESIDE: Sure.

CHAIRMAN NOTTINGHAM: Thank you and welcome by the way. You may have come the farthest to be with us today and so we appreciate that.

MR. WHITESIDE: Probably Mr. Hayes has come a little bit further because he's from Idaho, but I appreciate it very much. Chairman Nottingham, Vice Chairman Mulvey, Commissioner Buttrey, I appreciate the opportunity to be here. My name is Terry Whiteside for the record.

We come here. I really want to thank the Board for holding this hearing. I think it's one of the most important hearings from our perspective out in the hinderlands. It comes after visits by Commissioner Buttrey several times and long helicopter rides and those sort of things. Mr. Chairman, you came out and visited Montana. By the way, just for the record, neither one of you got to fish. We understand that and we'll have to do something about that next time. And Vice Chairman Mulvey, you've had council from Congressman Oberstar for many years about the passions in this industry.

I came here today and I want to talk a little bit about some of the issues that are here. I appreciate keeping the record open. We are conducting as I talked about in my testimony some studies that

will not be done probably until mid December. So January will be fine for us and we also will probably have some comments back to the record after some of your questions.

A vast majority of the Wheat and Barley Commission producers are captive to single rail carrier for a significant portion of their freight systems. You're going to hear from several of the national groups today, National Barley and National Wheat, U.S. Bean and the Alliance for Rail Competition, that talk about it from the grower perspective. The uniqueness of the wheat and barley in transportation, it's kind of amazing because the uniqueness is embodied in the fact that although the wheat and barley growers bear the freight costs, they're not the payers. And unlike every other industry as one of the commissioners talked about, the farm producers are unable to pass on their rail costs to anyone else. This makes them unique in the marketplace.

For example, one of the things that we see going on is situations where the railroad is dictating to us the rail system, what it's going to look like. They have a branch line for example somewhere and they decide that they don't want freight traffic on that anymore. So they actually incentify (sic) a shipper not to ship on that line but to ship from a main line point and they do that by providing incentives.

Now as Chairman Nottingham and I talked about, if that was a commercial decision in the marketplace and they decided not to ship from there, that's not that big a deal but the bearer of the freight is not the payer of the freight. So those kind of decisions do have an impact on the farm producer without them having anything to do about it and yet the way the regulations are set up for abandonments, suddenly there's no shipments on that line, come along and say "Well, that's the justification for not shipping there anymore." Those are issues that start to dictate both the quality of the service and the price of the service.

One of the things that we talk about if this Board were to ask in this hearing room the railroads who their grain customers are, quite often the grain customers will be for them the elevators or the grain merchandisers. Why is that? It's because those are the ones that physically pay the freight bills.

Now the grain producer and the elevator and the merchandisers have a very close and very good relationship in the marketplace. The grain merchandisers are the ones that make the investment. They're the ones that invest heavily in their facilities. They respond to the grain markets that are created for them and provide the window for the grain producer. But the reality is that the farm producers is still the one in the main bears the cost.

The Wheat and Barley Commissions face a combined effect of increasing rail monopoly, market power, ineffective rail regulation and little or not ability to invoke things like antitrust laws. Grains is grown in areas where the distance to elevations are far and getting further away in many cases. The markets are distant and the transportation options are few and getting fewer.

One of the things that I heard Secretary Knight talk about is this idea that we might be able to take a look at containers problem, Montana for example. The Burlington Northern has done away with intermodal facilities all over the state. Now our closest intermodal facilities are Spokane or Minnesota. We can't have it both ways. The situation is getting to the point where railroad is dictating to the plant and also taking away the facilities that create options for us.

We talk about that the STB has not provided remedies nor sought to protect competitive balances between the rail customers and the railroads. I believe that this Board has not provided the remedies necessary to correct competitive imbalances, before the ICC and in fact, the ICC before them was instrumental in creating a lot of the problems that we have out on the west. They eliminated massive amounts of competitive rail.

Was that in the national interest? There are efficiencies that come with that, but the protections that needed to come

once the monopolies were created haven't been there and haven't been readily accessible by us. We believe that the railroads believe they have the right to set price in the marketplace. They call that interestingly enough market price setting and you'll hear that. But the reality, what it is, is the railroads simply take the differences in the prices in the market and allow some for elevation and the rest they take. What that does is take away the ability of the farm producer to get some of that price differential or the price increases in the market.

One farmer told me one day, he said, "You know I can come up with an efficiency on my farm that I can work very hard at and we can get it down and the railroad can take it away with a price increase just like that and I have no alternative." The areas that are captive and pay the highest freight rates coincidently receive some of the most erratic service.

I talk about in my testimony a little bit, I've gone through a number of the rate comparisons and we've talked about revenue to variable costs. One of the things we'll hear the railroads say sometimes is that the revenue per ton-mile is falling and it's fallen since 2000. Heavenly day, it's fallen since 1980. If you go back, it's fallen since 1933. Revenue per ton-mile falls when you go further and you increase the size of the container that you're hauling. That doesn't make a lot of sense to me to compare revenue per ton-mile.

So I talk a little bit about the concentration in the industry. Everything that we see when we do the analysis in Montana is mirrored by throughout the Northern Plains. If we look all the way into Texas, all the way into Oklahoma and Colorado, everything we see mirrors the GAO Report. The increases that have come in grain, I know that Kendell Keith is going to talk a little bit about the amount of increases you've seen in grain pricing on the railroads versus other commodities.

The fact is the railroads may come in and talk about decreases in rail rates nationally and then they may compare that, sometimes what I've seen them do is compare that to cost inputs, that the cost inputs have gone up more than rail rates. But cost inputs might be ten percent of the total cost. Rail rates run 30 to 50 percent in some place in the Great Northern Plains. So I think it's important that we keep in perspective.

We can find rates as high as 500 percent of variable. Now I don't know what's too high. That's your call, but I think 300, 400, 500 percent gets out of range. There are areas of captivity. That's what this GAO report says. There are areas of captivity spread from Texas up to the Great Plains. People are losing markets completely. National Barley will talk a little bit about that. We have to recognize those captivity levels are there and they are real.

Forced sourcing is probably one of our major concerns, simply that the railroads can dictate which markets we can go to and can keep us out of markets we want to go to. Diversity, Vice Chairman Mulvey talked a little bit about diversity. Diversity in the marketplace creates price, creates opportunity if we have that ability to be diverse. But we have poll scorers that tell us and they talked with Chairman Nottingham when he was out in Montana about the fact that they cannot access the market by rail and the reason is because they ship in smaller quantities and you'll find the bean people ship in smaller quantities. The barley people ship in smaller quantities. Those people are having trouble with access in the market and keeping their own markets. The forced sourcing, barley has completely lost some of their markets and I know they're going to talk a little bit about that.

Rail shippers, merchandisers and elevators, they're not here in large numbers. It isn't because you called a quick hearing. It's because they fear retaliation. I talk to them. I know. They're not allowed to come by their corporate boards.

Grain producers have a legitimate beef. The No. 1 priority, the rate mechanisms close the door that we have here at the STB. We just finished the Small Rate Case. I hope you'll look at those rules. I think they have to revised. I think they have to have access. But the reality is that farm producers today have small areas

of captivity and have little or no way of solving the problem.

I know I have a couple more things I want to talk about, but I think I want to leave that there. I think the key here is to recognize you've looked, Chairman Nottingham and Commissioner Buttrey, into their eyes. You've been in those meetings. These people are sophisticated people, but they're hurting. They're hurting because they have no access to solve any of the problems they have and they are in areas of the country in Nebraska and Oklahoma and Kansas and Texas and Montana and North Dakota and South Dakota and Idaho that are suffering because they are in the pockets of very, very high levels of freight rates and consequently the service level, it's interesting. If you're paying those high freight rates, they should be getting the best service in the whole world. Yet we hear from the railroads when they're talking about infrastructure development that unless you can be more profitable in the future, we're not going to continue to invest in these areas. We're going to invest in other areas in infrastructure. So it's very important that this infrastructure bill when we start to look at it covers and is good for all of America. I thank you.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Whiteside. We'll move next to Kendell Keith. Will you be taking the lead for your team?

MR. KEITH: Yes, Mr. Chairman. Dan Mack

unfortunately could not be here today. I am Kendell Keith. I'm with the National Grain and Feed Association. With me today is to my left, Andy Goldstein, our Transportation Counsel. We do appreciate the opportunity to participate in this proceeding.

Rail market share as was noted earlier has declined in the last 25 years. We think it's also very important to understand that the remaining rail/AG markets tend to be for long haul movements in the range of 500 to 1500 miles and have few competitive alternatives. So it's very important for agriculture to have predicted and affordable rail service.

The strained rail capacity that's affecting all industries has really surfaced in the last three years. So I want to focus in the next four slides on three year trends and rates and service comparing the first half data of 2003 with first half of 2006. This first chart shows the three year growth in total rail units shipped, cars and boxes in the case of intermodal. Looking at the first bar on the left, there was a 13 percent growth in total rail units across all industries shipped on class one carriers, but the growth rates that you see were very uneven across carriers from 25 percent on the BNSF to three percent on the CSX.

The second chart tracks the three year growth in strictly agricultural rail cars shipped. As the left-hand bar indicates,

total AG shipped growth was robust at 15 percent. But again that growth was highly variable as you compare the other bars reflecting growth on individual carriers.

This next chart compares three year growth rate in physical units handled across major classes of traffic. Starting on the left, all rail units were up 13 percent as I noted before. AG shipments were up 15 percent. Coal is up 11 percent. And intermodal is up a whopping 19 percent in three years.

While volumes have grown at varied rates among different rail customers, this fourth chart compares the change in revenue per unit for the same major classes of traffic. Over the three years, the lefthand bar reflects total rail revenues are up 23 percent per unit. AG revenue per unit is up by 32 percent, one of the highest of the classes. Coal is up 26 percent and intermodal up 27 percent. Thus, intermodal is both the fastest sector, but among the lowest in unit revenue growth in the last three years.

There are differences in the U.S. and the Canadian regulatory systems that may affect rates and service. In Canada, carriers are subject to an overall revenue cap. In some classes of service, they make tempered rate adjustments. The Canadian also permits the use of baseball style arbitration on rates and mandatory switching within 30 miles of the terminal which may affect

competition.

This next table compares the change in annual average revenue per unit over a five year time horizon from 2000 to 2005 for the largest class one carriers. It compares agricultural car load revenue on the left with coal in the middle and intermodal to the far right.

For the U.S. based Western carriers shown at the top, the BNSF and the UP, AG revenue growth has tended to be relatively high compared to other classes of business. The Eastern based carriers, NS and CSX in the middle, AG tended to be towards the mid range of increases for all classes of traffic. Among the lowest increases for AG moves were the Canadian National and the CP, although the Canadian National negative or actual decline across that period in revenue per car may have been affected by line acquisitions that shortened the average haul length.

Here are the most recent trends in revenue per unit. We've compared here the first nine months of 2006 to the first nine months of 2005 to see if trends are staying consistent. Annual rates of change in that period are shown for AG movements in the lefthand column and for all traffic on the right. For AG movements, the highest rates of increase were for the Union Pacific at nearly 17 percent and the NS at 15 percent and the Canadian National at 12 percent. For the

BNSF and the CP AG unit revenues were below that for all traffic. To me, this suggests that all rail movements are experiencing some healthy increases and in some cases, AG unit revenue is outpacing revenues from other sectors.

There's another way to look at rail rates and rail revenues and that is through Weigh Bill Sample Data. Our outside cost consultant, Gerald Fauth and Counsel, have examined the 2005 Confidential Weigh Bill file that was released by the Board for purpose of this proceeding. It should be noted that the Weigh Bill data made available to us may not be congruous with that used by GAO because GAO had access to this unmasked data while ours was masked.

Because we did not have Weigh Bill data for the same period as GAO we can do no more today than to suggest that the 2005 Weigh Bill data supports GAO's conclusions that grain rates continue to demonstrate a high incidence of revenue to variable cost ratios over 180 percent. This chart includes results for the entire whole grain and oil seed sector. It shows that the percentage of traffic moving at over 300 percent of variable cost is at 7.6 percent and that traffic that is moving at rates between 180 and 300 percent of variable costs represents 35.5 percent of the total grain and oil seed traffic. The remainder is operating at below 180 percent of variable cost. Overall, U.S. grain movements average 165 percent of variable cost.

And this next chart looks at process products, roughly the same type of data. Of total grain mill products, 6.8 percent are moving at levels above 300 percent of variable cost and that group of rates averaged 370 percent of variable costs, a fairly healthy number. Another 24 percent of grain mill products are moving at rates between 180 and 300 percent of variable cost. Bottom line is this traffic of processed commodities is averaging 140 percent of variable cost. If you compare that just briefly to some other sectors of processed products, soy bean oil is moving at an average of 142 percent of variable cost. Ethanol is up at 157. Those compare to the 165 for grain.

Because our industry is faced with some demarketing efforts by railroads and because there sometimes appears to be a battle for capacity between agriculture and intermodal traffic, we thought it was appropriate to make some comparisons between AG traffic and intermodal traffic. This chart shows 2005 characteristics of intermodal traffic in farm products. Because of the volume of intermodal data in the Weigh Bill file, we selected just California originations for the comparison. As you can see, the Weigh Bill data strongly suggests that a greater percentage of grain traffic is in the high yield per unit category that is moving at more than 180 percent of variable cost than intermodal traffic and it doesn't matter whether you compare that on the

basis of tonnage or revenue. The conclusions are the same.

Common carrier obligation of railroads requires them to provide reasonable service on reasonable requests. There are distinct differences in the types of service received on the railroads. One measure of service is train speed. This table compares train speeds and the average rail revenues for two class one carriers, the UP in the West and the NS in the East.

If you looked at other carriers, the data would look fairly similar. It's typical among class one carriers for both grain and coal trains to move substantially slower than intermodal. While we recognize that railroads have to provide time and service to intermodal traffic to build that part of their business, it does raise some critical questions regarding congestion, rail performance and common carrier obligations.

Rail increases for intermodal business in the last several years have not kept pace with rate increases for agricultural shipments in other sectors. Yet intermodal business has had the fastest growth in physical units handled.

Question: is the intermodal traffic contributing to the congestion that causes service declines in other sectors? If intermodal is a primary cause for capacity constraints, is intermodal contributing a fair share to the revenues to allow carriers to expand

capacity? What are the carrier's obligations to balance the business drive for profits with traditional obligations to provide reasonable service across all customer segments?

The GAO study acknowledged that rail rates were not fully reflective of the full cost of transportation. To achieve greater efficiencies, both carriers and their customers have had to make sizable investments. One of the major cost shifts that has occurred since 1980 has been the uptrend in requiring private cars for rail service. Private car ownership today dominates the rail car fleets. Private car ownership was considerably less in 1980.

Based on AAR data, 65 percent of the covered hopper cars in the fleet are owned by private entities. Ninety-nine percent plus of the tank cars that are used for agricultural products are owned by private companies. Lease costs are currently about $500 to $800 per car. So those costs can add another ten to twenty percent to the overall cost of freight.

Other costs for shippers and receivers is infrastructure investment costs. As railroad reduce prices for high volumes, many AG facilities have had to invest multi-million dollar amounts to be able to meet the rapid loading and unloading requirements. It should also be recognized that the railroads have also participated in some of this industrial development and in the purchase

of additional engine capacity and car capacity. Infrastructure costs are a fairly significant portion of the overall cost of transportation to rail customers, but I do not believe that was quantified in the GAO report.

Finally, railroads have increasingly moved toward component pricing systems for what are generally referred to as accessorial charges. Such charges include assessments for one shipper's refusal to issue bills of lading electronically or for correction of clerical errors, charges for paper invoices, charges for paper loss and damage claims, charges for private storage. The list goes on and on. While some of these items are clearly cost based for which assessments are reasonable, others are a nuisance frankly, contributing to railroad billing inefficiencies and they create unnecessary costs for processing by customers. Requirements that shippers issue bills of lading and do so electronically, for example, and error free are particularly vexing since the Carmack Amendment requires railroads to issue receipts and bills of lading.

Our conclusions today, we commend the STB for conducting this hearing. Moving forward, there are some things the STB could do as a regulator that would be helpful. First, the railroads are beginning to invest in infrastructure and locomotives, but it's difficult to obtain information on net new investment that is consistent across the carriers. We face a critical time in the rail-served industry

in the next five years to determine if the minimally-regulated rail industry can expand capacity adequately for the marketplace. The STB could provide a much needed public service by monitoring the nature and extent of net new infrastructure investment by rail carriers and reporting that data to the public and to Congress.

Secondly, the STB has made an important step in the revival of ex-Party 646 regarding small rate cases. And because of tight rail capacity, rail carriers have more pricing power today that has led to revenue growth. That's a positive for investment capacity, but this pricing power can be abused in this kind of a business environment. It's important therefore that the STB in timely fashion provide shippers of small volumes reasonable access to rate relief. Lowering the bar to make rate dispute resolution more accessible will provide more market discipline in our view point.

Third and finally, we would recommend that the STB do everything feasible to expedite unreasonable practice complaints brought before the Board. Unnecessary delays are discouraging rail customers from bringing legitimate issues before the STB which also impedes private negotiation of disputes. We urge the STB to seek the proper balance in applying its regulatory authority and to make decisions as timely as possible in order to support the private market efforts to resolve business issues.

Mr. Chairman, that concludes my testimony. I look forward to questions.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Keith. We'll now to turn to Mr. Evan Hayes from the National Barley Growers Association. Mr. Hayes, welcome to you.

MR. HAYES: Thank you very much. My name is Evan Hayes. I am the President of the National Barley Growers Association representing literally thousands of barley producers across the United States and also have an interesting relationship with the users of barley, primarily with our malters. I would like to first of all give you a little Barley Education 101 class just to give you an idea of what we're talking about.

I have here a little statistic that I think you will find --

COMMISSIONER BUTTREY: I can assure you that this group knows a little bit about what barley is used for.

(Laugher.)

MR. HAYES: I'm certain of that.

COMMISSIONER BUTTREY: So you can skip over that part.

MR. HAYES: Okay. If Chairman Knight was here, I always have fun with him or Secretary Knight. I always have fun with him and I remind him that corn may feed the world, but barley

makes the world happy. I have a statistic here that I think you'll find interesting. This is the economic impacts of U.S. barley, malting, brewing and feed industries in the United States. This business is a $181.4 billion business. Billion. I thought you would enjoy that statement.

Now to give you a little knowledge as far as barley is concerned, there are basically three categories of barley that we raise in the United States. There is feed barley which has already been referred to which is used primarily for the U.S. supply of livestock. There is malting barley which by far is the largest proportion of barley produced in the United States and of course, that is used for the manufacture of spirits. And we have a new barley called food barley. A year ago, FDA came out with a notification, a health notification, as far as barley is concerned that we have some health benefits equal to those of oats. So there are three categories of barley.

Now I'd like to start off by telling you a sad story and this is a very sad story. In the last 20 years from 1987 until today, my industry has lost 70 percent of our production in the United States, 70 percent. The U.S. National Agricultural Statistics Service says the `06 crop is the lowest since barley planted acreage estimates began in 1926.

Now, gentlemen, I know this is not your problem. However, one of the reasons for this loss in production is your problem

and it deals with transportation. Of course, there are multiple problems associated with the loss of production, but transportation is the big one.

Let me give you an example. For as many years as I can remember and I need to tell you that I farm at 6,000 feet. I'm an in-the-seat tractor farmer. I'm not a pick-up farmer. So I understand what farmers are going through. But anyway, we in the barley industry had a great, what we call, milk-shed industry market in California. We've shipped between 60 and 70 million bushels of barley into this milk shed industry in California.

We did. Along comes the mergers. In the mid to late 1990s, along came corn shuttles. Now I don't have a fight with corn. We'll compete with corn in the marketplace. Where my criticism comes is that this corn is being shipped into the milk-shed industry that we used to have according to the California Corn Foundation at 120 to 145 percent of variable while our barley that was being shipped in to California is now being shipped out of our two major barley producers to two of our major barley producing states. North Dakota and Montana have between 250 and 450 percent of variable.

What we have in that situation is we have an industry, a transportation industry, that dictated the marketplace for our

commodity. We no longer ship hardly any barley into the milk-shed industry. We ship 200,000 bushel a month into this industry where we used to ship 70 million. So this is the first example where a transportation issue is decimating our industry.

I have a graph here and I will enter it into the testimony later on, but I want to show it to you and I'm apologizing because it's small because I just thought of this last night. But if you look at this top graph right here, this is the history of barley. It's interesting. 1986 here, we had 12 million acres of barley. Now I understand this first drop down to eight million. I understand that. That was a government program called CRP, the Conservation Reserve Program. Barley is usually raised on marginal lands. And example, my farm at 6,000 feet, I can't raise anything else. But anyway when CRP came in we saw a significant decline in barley production. But then it leveled out because that ended the sign-ups. But we have continued to fall from eight million acres down to roughly four million acres, a little under four million acres to today.

The second story that I'd like to tell you, we think the United States produces the best malting barley in the world. We're proud of our quality. We think that we are able to serve the brewing industry very well. In the west, we specifically produce a malting barley that is not able to be raised in the east as well. It's a two-row

malting barley and that's sort of two rows of kernels on the head. The other kind is six-row that has six around the head. Okay. This is a traditional western two-row malting barley.

Now as these corn shuttles started rowing into California and we lost that business, we said, "Okay. We will ship our two-row malting barley to the processors in the midwest as a back-haul. In my other life, I used to run trucks and I always wanted to run these trucks loaded both ways as much as I possibly could. It only made sense and as we address this situation with our carrier, they said that it does not work well with their shuttle policy or their strategy. So they basically refused to haul our malting barley to the midwest as a back-haul.

So this ends up causing us a problem and the last year, western two-row malting barley lost between 20 and 30 percent of our contracted acres. Now where did this production go because obviously the world or the United States, that's where we're talking today, wants to have the spirits. Where did this come from? This came from our friends in the north because they were able to ship this barley. They can raise two-row malting barley also. They were able to ship this barley to replace the market that we as U.S. producers should have had, could have had, if we could only have gotten it to them.

On the world side, Secretary Knight talked about treaties, trade treaties. WTO stands out in all the minds, the bilateral, the multilateral treaties and I say this. I say the United States Government is wasting their time working on international trade if we the producers of American cannot get our product from our farm to the export origins economically and competitive with the world situation. Wasting our time.

Now I am not here bashing railroads because I want you to know that railroads are extremely important to my business. If I could not deliver my malting barley which I'm under contract to Idaho Falls, Idaho to have it put on a rail either on the form of barley or as a form of barley malt, I would be out of business. The difference in my area last year between malting barley contracts and feed barley contracts, $6.75 a hundred weight for malting barley, $3.50 for feed barley per hundred weight.

Now I'm out of business if I cannot ship my malt and you have to take into consideration those who are receiving my barley. In Idaho, across the barley industry, our contracts read that we are paid a storage fee by those that we contract to. I found it very interesting that one of our major brewers last year had storage capabilities available in the east but were paying farm storage in the west and could not get that grain from the west to the east into their own storage. It

cost them literally millions of dollars.

Now in conclusion, I'd like to leave with one thought. I'm not bashing the railroads. The railroads are as important to us as are our tractors. However, railroads are a little different than tractors. We have a choice. We can purchase red, green, yellow or whatever in the tractors. Yes. Most of our production areas are captive to one railroad that has the power to dictate our markets through rates and services without an empire. Folks, you're the empire. We're appealing to you to work through this situation. Thank you very much.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Hayes. We'll next turn to Mr. Steve Brown of the U.S. Dry Bean Council. Welcome Mr. Brown.

MR. BROWN: Thank you. Good morning. My name is Steve Brown and I'm from Holyoke, Colorado which is a small town of approximately 2,000 people. I'm the General Manager of Jack's Bean Company LLC which is a hybrid cooperative from growers from Colorado and Nebraska. Our growers produce specialty crops and we're similar to what some of the testimony earlier was in that a lot of our crops are sold identity preserved or in lots which leads to small quantity shipments, single cars at a time.

We sell the light red kidney beans, pinto beans,

yellow popcorn and black beans and these are processed and marketed and shipped both domestically and internationally. I'm proud to serve as the President of the Colorado Dry Bean Administrative Committee which is a state checkoff representing dry bean growers in the State of Colorado representing both growers and dealers.

I'm also honored to serve as the Vice President of the United States Dry Bean Council which represents growers, dealers and end-users with production from 17 states. It is in that capacity which I'm speaking today. The U.S. Dry Bean Council is an avid member of the Alliance for Rail Competition due to the critical need for competitive rates, minimum levels of service with adequate equipment and siting from our railroads.

The railroads have had many mergers which has eliminated competition and created monopolies. We do not have a choice of railroads when shipping our product as there is only one railroad to choose for many. This is the same for many of our customers who receive the product in railroad cars. This lack of choice from the resulting monopolies affects freight costs, lack of equipment and siting and no minimum consistent dependable service.

The railroad's historical actions are consistent with monopolies that they are today. An example is how the railroad leases and sells the land granted to them when the railroads were originally

built for the public benefit. We have no control on lease rates for the railroad where our grain elevators and buildings were built. Years ago, there was no choice if you wanted to have railroad access but to build grain elevators and buildings upon the railroad land.

Later we were subject to arbitrary increases in the lease rates for the land and cancellation at any time. In my case, the railroad land was transferred to a real estate company that was a wholly-owned subsidiary of the railroad. The new wholly-owned subsidiary of the railroad company decided to sell the land at extremely high prices with no negotiation or third party review of the price arbitrarily established by this new company. You were forced to purchase the land or move your grain elevator or allow it to be sold to someone else. We made the choice to pay the railroad price as it was the best choice in a very bad situation. I think this could be called extortion by the railroad.

The railroad has closed and removed sitings without regard to the financial hardship that it causes on shippers and receivers previously served. Public access to other sitings is getting too distant for many. The railroad service schedule is consistently changed without notice. In our case, we see service three times per week, Monday, Wednesday and Friday, except when there's a full train load coming through. Single cars are not a priority and we only ship single

cars. Sometimes there's not enough time for a single car to be spotted or picked up due to the lack of crew time or equipment time. Sometimes there's not enough business, so we don't see any trains. Sometimes it's a week except when the union class one railroad employees and the non-union short line don't work together for the benefit of the American farmer.

There seems to be so many exceptions, but's and maybe's we can't count on service until it happens. This builds upon itself. As the less dependable our service is the more business we lose. The business does not wait for another day. It eventually goes away for good.

I have a customer in Miami, Florida which I visited last week and he says that if he gives me an order to ship a carload of beans today and he gives it to a competitor in Canada today, we both get the order at the same time, most of the time the railcar from Canada will be beat delivery to Miami, Florida by as much as a week. I'm closer and much of the transportation is on U.S. railroads, but he's able to get quicker delivery from Canada.

The biggest fear that I have is that many of my customers are on the coastal areas of the United States and so if we're not able to ship our product from the hinderlands my biggest fear is that Canada is Canada today and will probably be imports by ship

tomorrow and we see a tremendous amount of competition from places like China and I see the day coming to where we're going to have more and more competition. It's easier and cheaper to bring into the coast rather than to ship it from Colorado and Nebraska.

Today we continue to see arbitrary freight rate increases with no other choices other than shipping by railroad. Most of our shipments are by railroad because of the energy and in the case of the Miami, Florida, I think it's about $3.60 to ship by rail to Miami and it's about $7 per hundred weight to ship by truck. We do ship by truck but only when we don't have rail service. It's a tremendous cost burden.

We are captive and that is coupled with deteriorating service and the lack of equipment and inconsistent service. There are times that our service is s delayed for many days because the railroad discontinues train service due to other work that's called more pressing work demands. The American farmer, small businesses, in rural small towns need competitive rates, access to equipment and sitings with consistent, minimum service. We need to be able to tell our customers a schedule. We need to be able to tell them when they order something that we can count on so many days approximately of delivery.

Today we don't have that. You are the regulatory

agency that we in American agriculture must rely on. The public has a right to this and it's absolutely necessary for us to compete in the United States of America and the world markets that we compete with every day.

I wish to thank you for holding this hearing and giving me the opportunity to participate and voice our concerns on the issues of agricultural transportation. As a business in a vital agricultural industry on behalf of small town America, thank you.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Brown. Next we'll hear from Mr. Dale Schuler from the National Association of Wheat Growers. Mr. Schuler, good to see you again. I've had the privilege of spending some time with you both here in Washington and back in Montana. Good to see you. Welcome.

MR. SCHULER: Thank you, Mr. Chairman and members of this Board. My name is Dale Schuler. I'm a wheat farmer from Carter, Montana and I am currently serving as President of the National Association of Wheat Growers. I would like to thank you, Mr. Chairman, for your recent trip to Montana, taking time to visit not only with me personally but also with other members and wheat producers and also I would like to thank Commissioner Buttrey when he was serving as chairman for coming out to Montana to visit with our producers.

I'm pleased to be here today to discuss freight rail issues that are of great importance to the members of the National Association of Wheat Growers, our state affiliate organizations and the thousand of members that these organizations represent. Wheat growers face many problems with rail rates and also with service and helping our members find solutions to these problems remains one of our top priorities. Rail concerns are not entirely unique to wheat growers as you've already heard. We have joined other captive shippers to help find solutions on these issues as a member of the Alliance for Rail Competition.

The wheat industry believes that a viable railroad industry is necessary and critical for our continued success. But since the passage of the Staggers Railroad Act in 1980, the degree of captivity in many areas, in wheat regions and industry regions, has increased dramatically. Wheat growers have experienced declining local service, higher rates and are forced to pay directly an increasing share of the transportation costs. Twenty years ago, there were multiple transcontinental railroads serving many regions of the country but now because of the dramatically rapid expansion of consolidations and mergers, we are increasingly served by only one single railroad in many of our areas.

In the wheat industry alone, there are substantial

pockets of captivity in 17 states. Arizona, Colorado, Oregon, Washington, Idaho, Montana, North Dakota, South Dakota, Minnesota, Nebraska, Kansas, Oklahoma, Texas, Maryland, Virginia and North Carolina all are experiencing captivity which makes up a majority of the wheat growing land in this country. The cost of transporting wheat at times has represented as much as one-third of the overall price a producer receives for his grain.

As you have heard, farmers unlike other businesses are price takers. We are not price makers. We do not set the price for our grain an because of this, we cannot pass our cost onto the market or onto consumers. We must absorb all of these costs. Farmers directly bear the cost of transporting our grain. These expenses come directly from our bottom line.

In my home state of Montana and North Dakota, rail rates are between 250 and 400 percent of variable cost. This is far above the Surface Transportation Board's threshold of rate reasonableness which as you know is currently 180 percent. Though these are among the highest freight rates in the nation, grain rail rates in excess of 250 percent more than variable costs can be found virtually in all of the states that have captivity issues.

Differential pricing theory which this Board has subscribed to for many years is based upon the concept that when a rail

market has excess capacity or nonrevenue adequacy, railroad companies should be allowed to make up these lost revenues in other areas that lack competition. In today's market where the nation is faced with increasing demands on rail capacity and railroads that are making record profits, differential pricing policy has moved from a revenue practice to a potential abuse of market power where revenue levels are based upon a degree of captivity of rail shippers. We are very concerned that record profits are coming at the expense of those captive shippers that are paying in rates that are between the 250 and 400 percent to variable cost.

The GAO Report noted that of the large wheat producing areas in Arizona, Arkansas, Idaho, Missouri, Montana, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Texas and Virginia only a single railroad is serving the crop growing areas. Many of these same areas show more than 75 percent of the industry tonnage originating on a single railroad and when you overlay the GAO Report study on these areas with a single railroad serving the crop producers, 50 percent of the tonnage is moving at rates in excess of 180 percent of variable cost.

We have a rail industry that is increasingly sees their preferred business model as moving larger and larger movements of single grade crop from a single origin to a single destination.

Increasingly, we also see the direct cost of transportation shifted to the grain producer through greater trucking costs to a larger single origin facility. And what I'm talking about there is the railroad has experienced greater efficiency and they have passed on some of that cost in lower freight rates to our producers. But because of this move to these large shuttle facilities, our producers are having to invest in their own equipment, larger trucks, transporting their grain further distances and paying directly for that additional transportation cost that is not reflected in some of the reported lower transportation costs by the railroads.

Captive shippers primarily at non-shuttle facilities continue to suffer car and service disruptions and in some areas are experiencing delays of three to four weeks after the promised delivery dates. The high rates and service problems I have just described continue to especially frustrate our producers in my region especially when we just look across the border to see an effective Canadian system that has offered freight rates on wheat westbound right across the border that have been 25 to 30 percent lower than the freight rates that we pay on our grain moving westbound.

We grow some of the highest quality wheat in the world, but yet we are being rendered or put at a competitive disadvantage in both domestic and foreign markets because of these

shipping issues. When the Staggers Railroad Act and the ICC Termination Act promoted reliance on competition to protect shippers from unreasonable rates and unreasonable rate practices, captive shippers in my area or many areas in the country have yet to see the benefit of this.

This Board has been given the authority to resolve disputes between captive shippers and railroads and has previously established rate relief processes. These processes themselves are expensive. These processes are complex and continue to be out of reach of many of the grain shippers both large and small. We believe that this Board could be taking more steps to enhance competition in the rail industry and agree with the GAO Report that said "An assessment of competitive markets should be conducted to provide more information about the extent of captivity."

I would like to close by saying that we firmly believe that the railroad industry can survive and prosper in a competitive market. We know from history that competition breeds innovation and efficiency. We believe at this time it is time for the public policy in this area to be reexamined. Thank you for allowing me to provide these comments and look forward to answering any questions that you may have.

CHAIRMAN NOTTINGHAM: Thank you, Mr.

Schuler and fellow panelists, and commend all of you for staying on schedule and getting through some important and detailed material. We'll turn to questions now and I'd like to ask. There was some mention earlier in the panel of concern about retaliation, that this Board might have had more witnesses, more testimony, more information presented, but for concerns that the railroad industry would somehow reach out and retaliate in some ways.

Let me just say this. First, I would like each panelists to have the opportunity to expand on that if you are comfortable doing so. If you're not now, please know that I expect to hear about anything that would amount to that either in a confidential manner or otherwise, anything that gets in the way of the work of this Board in conducting our lawfully chartered work. I have heard those concerns and take them extremely seriously, however, have not been able to see any specific evidence of that to know how real or how deep it is. But let me give folks a chance to expand on that topic if you so choose.

MR. WHITESIDE: Mr. Chairman, I will respond confidentially to you on that.

CHAIRMAN NOTTINGHAM: Okay. Thank you. Would any other witness like to speak to that now or you can each reserve the option.

MR. KEITH: I hear from it time to time from our members.

CHAIRMAN NOTTINGHAM: You hear?

MR. KEITH: Yes.

CHAIRMAN NOTTINGHAM: That retaliation does happen.

MR. KEITH: That they're not all that willing to come forward because there are issues, business relationship issues, yes, and the potential for retribution. It perceived by the rail customer community, at least a portion of it.

MR. HAYES: If I can -- I think something that should be considered especially true in the barley industry is a good number of our markets, the barley is a raw product that goes into that market or in their product and they make their money from the product, the sale of the product. I think some of this potential retaliation that you hear about is a concern of these industries that they will not be able to move cash cow, that they will not be able to move their product and so consequently they are quiet about the raw material sourcing transportation.

CHAIRMAN NOTTINGHAM: Thank you. There was some discussion, Mr. Keith, I think you emphasized this in your remarks, about the railroads conducting demarketing efforts in the AG

sector. Could you expand on that? Is there actively a move away from -- In your view and your members' views, are the railroads less interested today in serving agriculture and grain? Or when you used the phrase "demarketing" I want to make sure I fully understand that.

MR. KEITH: There are markets today that would grow if you could get rail service or a commitment of rail service that are not growing because of that. Some of the railroads are sizing their systems, their volumes, and they're telling some of the customers that you're only going to get two trains a month and that's all we can get based on our system. For example, there are situations where plants that are grain elevators would like to put an ethanol facility beside it that have been unable to get an agreement with the carrier to handle the volume. Those are just examples.

CHAIRMAN NOTTINGHAM: I guess I'll throw this open to any of the witnesses and Mr. Hayes, would you like to expand on that point?

MR. HAYES: If I could I would like to. In my written testimony, I commented to this point and I was at this meeting. We had a large international brewer that we courted very highly to bring into Idaho. They have constructed a malting plant in Idaho which is a significant input or a significant advantage to Idaho producers and as I was sitting in the Governor of the State of Idaho's

office with these folks, I heard the manager of this new facility, he's a vice president of the company, say this. He said, "If I would have known what I know now about transportation in Idaho, we would have never located in Idaho."

Now this plant, yes, through captivity, but this plant came in designed to increase. It's an eight million bushel malt plant right now with the capabilities of expanding to 16 million. The chances of that happening are almost slim to none because of the relationship they have with the carrier to move malt from their malt house to the brewer in Mexico City. In fact, I was just with this vice president and he told me that they are running so close on their malt deliveries that they're afraid they're going to have to close the brewery in Mexico because they cannot get enough two-row Idaho malt into that brewery. Now that's a crisis. This is the largest importer of beer in the United States.

MR. WHITESIDE: I'll expand on that a little bit. When we sized that fleet, we went to the railroad in question and dealt with them on four separate occasions to give us the transit times and then we sized the fleet 15 percent bigger than what their worst projected times were and to date I don't think they've met it within 50 percent. So therein lies one of their biggest problems of trying to get consistent delivery and now their fleet size is not big enough for that

plant. And these are major multimillion dollar investments.

CHAIRMAN NOTTINGHAM: Vice Chairman Mulvey, do you have any questions?

VICE CHAIRMAN MULVEY: Yes, I do. Thank you. Mr. Keith, in your testimony you mentioned that the railroads now require shippers to issue bills of lading even though the Carmack Amendment requires railroads to issue them. Do you have any specific examples of that that you could supply the Board where the railroads are not fulfilling their obligations under the Carmack Amendment?

MR. KEITH: I'm going to let our counsel respond.

VICE CHAIRMAN MULVEY: Yes.

MR. GOLDSTEIN: We would be happy to provide to the Board tariff requirements of the railroads calling upon shippers to furnish bills of lading and containing penalties if they make an error when they do so. I can't give you the tariff citations at the moment.

VICE CHAIRMAN MULVEY: With the greater alliance on shuttle trains, it means that grain has to move longer distance on state and local highways and it's my understanding that it's putting a tremendous burden on state and local roads. I understand some states have almost given up on maintaining their local farm to market road networks because of the impacts of all the heavy trucks

using those roads. This suggests to me that the states would have some interest in trying to make sure that these farmers continue to be serviced by rail and that the railroads continue to serve these smaller elevators so that less of this heavy traffic is moving on state and local roads. Are any of you aware of state and local programs that are designed to help the farmers to continue to keep the smaller elevators in operation and continue rail service to them?

MR. KEITH: I believe there are some out there, but I'm not aware of specifics.

MR. SCHULER: I believe in the State of Montana the Department of Transportation is trying to work on comprehensive transportation regulations and proposals, but we have been addressing the rail transportation rate issue in Montana since, I think, 1980 in a case that was called Macarty Farms v. BN which you are all aware of I'm sure. But because of these consolidations and mergers and movement to these larger shuttle facilities, it has created quite a burden on our local roads which our state and county cannot afford to maintain at this point. So that is a great concern for us.

MR. HAYES: If I could point out because I did come from the trucking industry, there are also so many variables from state to state as far as trucking regulations are concerned. Dale is my neighbor in another state. In his state, he can run 129,000 on

highways. In my state, I can run 105,000 on my highways. Now these highways are all built of the same standard, either the WASTO or ASHTO specifications. But due to a freeze placed on interstate highways back in the early `80s that froze the interstates at 80,000 pounds and then the Simms Amendment allowed states to grandfather in, we have a hodgepodge of different weights. So this puts those states that have less hauling capabilities at a disadvantage to those states that have higher weights.

I just got through doing some analysis on my own farm for my 2005 haul and you'll find it interesting to know not counting the truck, not counting the driver, the registration and the license and the tires and etc., only diesel fuel it cost me nine cents a bushel to haul my barley to my market for fuel only and I'm extremely efficient. I'm very light on my light weight and I have California doubles and I can gross 92,000. So I'm very efficient, but the fuel costs alone were an incredible problem for us. So this is an issue for us and I'm glad you brought it up, Vice Chairman. Thank you.

VICE CHAIRMAN MULVEY: Terry.

MR. WHITESIDE: We have a whole series of states that are starting to become rather proactive in this process. The State of Washington has purchased grain lines. The State of Washington for example has purchased car fleets because some of the areas they need

cars. We have states in the Great Plains that have purchased access lines to competitive rail to start to see if they can solve some of their own even into another state by the way which is interesting.

In Montana for example, they developed a Rail Service Competition Council. One of the things that that Competition Council which is out of the governor's office, one of the things that the council is starting to look at is do we need to identify and develop the core system below which we will not allow the system to go. In other words, the public costs outweighs the cost of keeping the rail lines. That's of necessity anymore.

But the far more intriguing question is as we've abandoned, as the rail systems have abandoned, they've really shifted from the private to the public and the farm sector and the farm producers while the facilities have grown more efficient and gosh knows we need railroads, we need a efficient ones, but they've grown more efficient at the rail level. But what's happened is the farm -- What Dale was talking about, the truck process to those elevators sometimes we're seeing weights of three, four, five, six hours to unload. So the efficiencies have just been shoved away from the farm producer and they're having to pick up all the inefficiency. So this is of true concern now at the state levels and you're seeing a whole series of states starting to engage in starting to address their problems and

their concerns that are coming out of that and it goes to what you're saying about state relationships.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey.

COMMISSIONER BUTTREY: Thank you. In looking at these issues, it's very easy to see how the discussion can turn to kind of an academic level if you will. But if your grain farm is in Big Sandy, Montana it's not academic. It's emotional. Mr Hayes, you said that if you don't grow barley, you don't grow anything.

MR. HAYES: That's correct.

COMMISSIONER BUTTREY: I mean I think that's what I heard you say.

MR. HAYES: That is correct. There is wheat grown, but remember that we have -- we feel very fortunate to have 100 days between snow and snow because of our elevation and you know, we're in Idaho. So we don't have rotation crops. People ask me what my rotation crop is and I say barley. They say what's your major crop. I say barley. That's what I raise.

COMMISSIONER BUTTREY: So you get one crop.

MR. HAYES: Oh, absolutely. We're tickled to death to get one.

COMMISSIONER BUTTREY: Right. Now that crop does not require you to leave the land fallow a year before you grow it again.

MR. HAYES: No.

COMMISSIONER BUTTREY: You can actually grow it every season on that land.

MR. HAYES: I do.

COMMISSIONER BUTTREY: Yes.

MR. WHITESIDE: At 6,000 feet, you get six feet of snow every winter. So he gets plenty of moisture.

COMMISSIONER BUTTREY: He's thankful for the moisture I'm sure.

MR. HAYES: And the cold weather, of course, is a factor there too because of the cleansing power of freezing.

COMMISSIONER BUTTREY: Right. Sometimes in these academic discussions, Mr. Schuler, people say those farmers in Montana, they can store their entire harvest on the farm and then they hedge. They can use that to hedge their pricing strategy, etc., against what the market is and this year is sort of an unusual year in many ways. We probably should have had this hearing last year maybe. I don't know. But this year is somewhat of an unusual year, sort of an anomaly if you will in the market and the pricing and everything.

Of course, the pricing is controlled by a global pricing system over which the farmer has no control. But the argument sometimes is made that really the argument that they are really being hurt by the basis system and so forth. They really are able to take advantage of these price fluctuations in the market because they can store their harvest on the farm. But if you talk to producers, they say that there's a fallacy in that approach.

I really would like to get on the record if we could and I think this is probably the best time as any, probably the best time to get on the record, the sort of way that works in the global marketplace if you will and all know that farmer pays the transportation costs. But there are other parts of that system, if you will, global pricing and global marketing system that operates against the producer as well. If we get a little information on the record, a little more than what we have right now, either right now or later on, that would be helpful to us. And anybody in the whole panel can comment on that. I just picked Mr. Schuler out because I know where he is.

MR. SCHULER: I can certainly comment on part of that. To begin with as farms have continued to expand primarily to take advantage of economies of scale because the margins are getting slimmer and slimmer in our industry, we no longer have or many farms no longer have the capacity to store all of their grain on farm after

harvest. So we rely on the commercial grain facilities and also the railroads to be able to handle much of our grain even at harvest time and then with grain that is stored much of the overseas demand comes through some of the early winter or early fall and winter months. So we see an improvement in the price typically in November to March time periods. So are required in order to take advantage of some of these higher prices that we seen in that time frame to deliver within that the restrictions of that time.

Also in storing grain, there's additional cost involved in that just to maintain the quality. There's cost involved but also because of opportunity, the cost of that money, many of producers have to borrow their operating capital. So because of cash flow requirements, they're forced to market their grain to address those cash flow situations.

COMMISSIONER BUTTREY: Anyone else want to speak to that?

MR. HAYES: Mr. Buttrey, if I could please and I'm sorry if I'm monopolizing the time. A few years ago, I served as President of Idaho Grain Producers Association. It was the political arm of the grain producers in Idaho and I met with a group of Japanese marketing folks in Lewiston, Idaho at our port facility and they presented to me a nicely wrapped box and in the box was a variation of

sticks, rocks, dead birds and animal feces that came from ground piled grain. This group of marketers told me that Japanese custom was to return these commodities back to the point of origin.

Now I tell you this story because this is a horror story to me. I don't have grain in these piles because I'm a barley producer and I farm 100 miles away from my home. In my hometown, due to the amount of wheat that is produced there, they ground-pile wheat, milling quality wheat. These ground piles are two to three city blocks long. They are 40 yards wide and they're probably 50 feet high, millions of bushels of wheat.

Now they are moving those as fast they can get them moved with the rail facilities available. Today, they is still in my hometown one of those huge piles left. I don't know how much wheat is in it, but this is milling quality wheat. This is what you eat on your table every day. Now we don't like to publicize that, but the reason for this is we can't move it.

This as you mentioned is such a crazy market right now. These growers would like to get this wheat shipped and money in their pocket. They don't raise that stuff to see it sitting on a pile. They raise it to put money in their pocketbook and because of the fact they cannot move those piles, it's costing them tremendous amounts of money. Can they store all of this on the farm? Goodness sakes, no.

Too big of an expense when you look at the margins that they have there.

MR. WHITESIDE: One quick point. I think what you'll find too if you look at the facilities and the marketplace, there is more capability of storing in the Northern Plains. But the further south you go what you'll find is that there is not as much on-farm storage. So like in Kansas, for example, there is very little on-farm storage compared to the Northern Plains. So that hedging, you can't do that as much down there. You can do that on the pricing as you're contracting in but the reality is for holding and hedging on the farm. It's not as prevalent as you go south.

MR. KEITH: We have several of our members on the next panel that have particular expertise in this kind of a market analysis and I would encourage you, Commissioner Buttrey, to inquire of them what's driving the market.

COMMISSIONER BUTTREY: We'll do that.

MR. KEITH: That carries in the market because that's really what's telling the farmer or the elevator do we want your grain today or do we want to store it for the future.

MR. BROWN: In the case of dry beans, Mexico is a large customer for us and under our present NAFTA agreements we have windows where we're allowed to ship and one of our largest

shipping windows, its harvest is generally in September and that shipping window ends September 30th. So if we don't get the cars and get the transportation to make it across the border by September 30th, that market is effectively closed until the next shipping period.

CHAIRMAN NOTTINGHAM: I have a question for Mr. Hayes. You talked about, I believe, a 70 percent decline in U.S. barley production.

MR. HAYES: That's correct.

CHAIRMAN NOTTINGHAM: What's causing that? I've not noticed a real wide drop in consumption. Maybe that's -- Who's producing it and why aren't we?

MR. HAYES: Okay. There are multiple factors of course that has caused the decline in barley production, as I pointed out, one of them being transportation. We have lost that dairyship (phonetic) market that I referred to on the west coast. Another thing that's causing this depletion in barley acres is the fact that beer market is flat. As they looked at the statistics, the wine and spirits are on the increase. Now beer is starting to rise and as beer increases, obviously you cannot make beer without barley, good beer. I have to throw that in.

But the reality of it is we as farmers have to look at where we can make the most money. Our largest barley producing

state is North Dakota or was North Dakota and they have had tremendous decreases. I have a graph here just for fun if you'd like to see what's happened to North Dakota. The North Dakota production has gone from basically two hundred million bushel down to about forty million bushel in those twenty years. Now the reason for this is they can make more money raising something else.

Now if their freight rates for barley are so high and corn has a lower freight rate, this is going to effect that farm bottom line and once more, wherever they can make the money, this is where they're going to go. This is Economics 101. It's what keeps us in business. That's as honest as I can be with you.

CHAIRMAN NOTTINGHAM: Thank you. Vice Chairman Mulvey, do you have any additional questions?

VICE CHAIRMAN MULVEY: Yes. Mr. Hayes, you mentioned in your testimony that you tried to get the railroads to move as a back-haul some of your barley to the East and they refused to do so. Did you file a complaint with the Board about that or did you contact our Office of Compliance and Enforcement on an informal basis to see if they could give you some assistance in negotiating with the railroads?

MR. HAYES: Okay. Remember that I market my grain to a merchandiser or to someone that I contracted with. These

folks are the ones who tried to negotiate these back-hauls and it's basically out of my hand as either a national president or as an Idaho Barley Commissioners because we're not in the retail sales business. True we grow it, but as an individual farmer, I sell to an Anheuser Busch, to a Grupo Modelo, to a Great Western Malting, whoever it may be and from there on it's in their hands.

VICE CHAIRMAN MULVEY: Because we have available these people who do work with the railroads and do try and negotiate when these things arise. Very often we hear complaints, but they're not formally brought to our attention. So we can't use our good offices to see if we can help you devise a resolution. Often we are successful working with the railroads.

MR. HAYES: And we appreciate that. We appreciate it very much. Thank you.

VICE CHAIRMAN MULVEY: Mr. Brown, you mention in your comments loss of sidings and I was wondering if you had any details about how many of your members have lost sidings and whether there were any new sidings built and were your members expected to contribute to the cost of those?

MR. BROWN: I'll introduce testimony later on that.

VICE CHAIRMAN MULVEY: Okay. Mr. Keith, you talked about the lower rates for intermodal traffic compared to

grain movements, etc. It's my understanding, and see if you understand it also, that part of the reason for the lower rates for the intermodal traffic is a lot of the intermodal movements are moving under long term contracts and that the railroads have not been able to re-negotiate those contracts. As they come due, they are re-negotiating those contracts and those rates are going up because as we all know a lot of the increase in capacity constraint has been due to the tremendous growth in intermodal traffic. Therefore is that something that's going away over time as these long term contracts for intermodal come due and the railroads re-negotiate those contracts and begin raising those rates. In other words, are we looking at something which is a temporal phenomenon rather than a systemic one?

MR. KEITH: I'm not really aware of that. I'm certainly aware of the long term coal contracts and we've seen some carriers that have re-negotiated those in recent years and really jumped rates which is an adjustment in the marketplace. We understand that and they've been artificially low.

But if what you say is true, then that's somewhat encouraging. I mean we see -- We're greatly bothered by the fact that revenue per unit is growing in other sectors where the growth in the business is not and we know that the major problem we face today with rail is capacity and we would like to think that all classes of traffic are

contributing a fair share of revenue to capacity growth. So maybe the next panel, some of our members, could better answer that than me.

VICE CHAIRMAN MULVEY: I think that's all I have.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey.

COMMISSIONER BUTTREY: That's all I have.

CHAIRMAN NOTTINGHAM: I just have one last question for really anyone on the panel to respond or all of you if so choose. Certainly we've heard much today and I've in the past concerns about both actual rates as we recognize what rates are and then also additional costs for transportation, costs of car ownership, different costs that in some ways seem to have been shifted from the railroads to the farmers over the years.

Sometimes we also hear though in that same vein that there have been new bonuses or incentive payments that railroads are now offering that go to some shippers or some producers. Are any of your members experiencing any of the plus side I guess of that equation, any type of incentive payment for volume or bonus payment and if you could make sure when you do your submissions for the record we would appreciate if that is happening that we see the whole picture. Would anyone like to respond to that?

MR. SCHULER: In Montana especially in other regions in the nation, we're seeing the railroads as we've mentioned work towards these larger shuttle loading facilities and they are passing on to these grain companies some incentives to help them pay for these facilities.

Along with that though, a lot of that transportation cost has been shifted over to our producers because of the largest, greater distances that we have to ship the grain to that facility. But because of some of these incentives that they're offering to the shuttle loading facilities, I think that we may see an increased number of those to fill in some of these holes and I think some of these rail companies are encouraging that and they're working with some of the grain companies to fill in holes that we're having to ship grain out of to these other facilities.

So those payments do help fund the construction of new facilities and if that trend continues, that may decrease some of that cost to our producers. So we do encourage that practice by the railroads to offer those incentives because hopefully some of that does get passed onto our producers.

MR. WHITESIDE: I guess I'll echo that. I think that one of the things that we have recognize too is that this is never done in a vacuum. We sit down and we work with the railroads. One

of the things that the railroad that serves Montana has done I think in the positive is that they've sat down and said to us maybe we can't put shuttles everywhere and we've shown them places where maybe they have to keep 52s because we have a stratification of grain and we also have grain fairly far apart. So what I'm saying is this is not always done in vacuum.

But I think the thing that we need to recognize too is that not all of the reduction in rates is being transferred back to the farm producer. We're seeing in large cases where their costs are actually going up and that will be part of the studies that we complete over the next couple of months to try to show you a little bit about it. We'll try to quantify exactly how much that is over the last ten and twenty years.

But I think coming up in the next panel, Terry Voss can talk a lot about it. I admire these guys for coming because I think it's important. They can talk a little bit about some of those transfers of costs and helping in the facility building that's going on.

CHAIRMAN NOTTINGHAM: Thank you.

MR. GOLDSTEIN: Mr. Chairman, just let me comment if I can that where there are incentives provided for the construction of some of these facilities they generally are tied to shipping requirements as well. It's not simply a question of constructing the facility but the incentive is there based upon the usage

of the railroad when the facility is constructed which is understandable. But just so you don't have the impression that it's more or less of a gift, it's not.

And secondly, the grain facility is basically a private facility unlike, let's say, intermodal facilities where the railroad very often bears the entire cost of that facility. The grain facility, contributions by the railroad are not to my knowledge ever for anything approaching the entire cost.

CHAIRMAN NOTTINGHAM: Thank you. Would anyone else like to address that question?

MR. WHITESIDE: I think Kevin Kaufman is coming up and he can answer some of those kind of questions too.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey, Vice Chairman Mulvey, any other questions?

COMMISSIONER BUTTREY: No, thank you.

CHAIRMAN NOTTINGHAM: Thank you. We'll dismiss this panel. Thank you again. The record will remain open until January 12th. We will now rearrange the schedule slightly just to accommodate the Government Accountability office and invite Ms. JayEtta Z. Hecker, the Director of Physical Infrastructures. She was to be our next witness and we will take though before she begins a ten minute break and reconvene promptly at 12:26 p.m. Thank you. Off

the record.

(Whereupon, at 12:17 p.m., the above-entitled matter recessed and reconvened at 12:28 p.m.)

CHAIRMAN NOTTINGHAM: On the record. If folks could please take their seats and we'll resume the hearing. Our next panel consists of the Government Accountability Office and we are very pleased Ms. JayEtta Z. Hecker, the Director of Physical Infrastructure Issues. Ms. Hecker, I hope you know I've been an avid consumer of your work for many years as a state official and as a federal official over the U.S. Department of Transportation Headquarters and it has been useful and we appreciate the time your team has spent working with our agency on your recent report and your past reports and we look forward to hearing more about that today and having a few questions. Thanks so much for being with you. Please proceed.

DIRECTOR HECKER: Thank you very much, Mr. Chairman. I want to start at the outset what an honor it is really to be here. I've actually worked with each of you or seen you in other settings and it's a great honor to be here to represent the fine work that I think our team has done and to contribute to this important debate. I have a brief slide outline. It's not really new. I'll try to go through it briefly because it really just highlights specific excerpts from the report

and I suspect you have some familiarity with it, but I'll try to briefly highlight some of the key things.

As you know, this was a request by several senators including Chairman Lott and a bipartisan request from some Senate Commerce Committee staff. Slide two basically outlines the objectives that they posed to us looking at changes in the industry in the entire period since enactment of the Staggers Act, looking at both rates, competition and captivity. The second objective was to look at what actions the STB itself has taken to address captivity and competition issues including what kind of alternatives have been considered and then thirdly to look at freight demand projections for the medium to long term, the capacity of the railroads to meet that need and what kind of public role might be appropriate.

I think you'll agree that this was an enormously complex and difficult task. I think if you're aware of our work in the past we have jobs just on aspects of one of these questions and the challenge to try to do the entire breadth of issues in one report really affected the scope and depth and rigor that we felt we could apply to what clearly are enormously important issues.

But on slide three, I'll quickly review the methodology. We followed our prior work in terms of using the Weigh Bill sample and building on an index that we had created for

standardizing the look at rates across the difference commodities and regions and went back and did that from an `85 to 2004 period. Then, of course, we talked with all the effected parties, all the class ones, many of the class two and three, all the key associations and many state governments as well as academics.

Then in that third questions, of course, we reviewed an enormous range of projections that had been done, talked to railroads about freight demand, looked at the published studies and, in fact, one of the more interesting things we did was convene an expert panel, the composition of that is outlined in the attachment to the report, because there were such despaired views on a lot of these and we knew that there wasn't a simple answer in the data that we'll just get in there and we'll sort this out and everyone will find that there's a factual answer to this. We knew that there were very different views and so we used an expert panel working with the Transportation Research Board to try to try to get a broad cross section of views.

Now one of the important things that I should mention about the methodology and we're often very careful to note some of the limitations in the methodology is that given the range of the issues that we were looking at we excluded any attempt to look at service. I have to tell you that came up quite a bit. We heard an awful lot about it. We know it's inextricably related to issues of

meeting the needs of shippers. We know it's an issue that you've looked at. So while we set it aside, we heard a lot about it and we believe solutions really perhaps need to be closely intertwined within an issue that we structurally kind of put outside the scope of the rigorous analysis in our work.

Now I have just two slides on the issue of the basic changes since Staggers and the first one is simply a railroad tax adjusted rate of return from 1980 to 2004 and as you see while there was lots of volatility with different recessions even after Staggers that as the industry has adjusted really since the end of the early `90s recession there has really been pretty general stability, some modest decline in tax return on investment by -- this is just the class ones. But as you know, there are a number of other measures that unequivocally show that we've achieved many of the objectives of Staggers of getting an industry from the edge of disappearing certainly from bankruptcy to an industry that really has emerged into a far healthier industry, taken a lot of actions that the new freedoms of Staggers allowed, right sizing, work force adjustments, innovation and new technology.

Now this slide six actually basically looks at some of the key changes also that while some revenues of increased costs have shifted and charges are not accurately tracked, this is basically an

overview chart and I'll start going into more detail on what some of the effects on rates have been. But as you've heard from the prior panel and as you well know that a limitation of just looking at rates is that some of those rates have -- costs have shifted, and some of the reporting of revenues is not really complete or consistent.

Then turning to slide five, this is really the broadest overview of the our completing the analysis of what's happened to rates since `85 and basically there was that solid line, I'm on slide five. It's not there. There it is. The solid line is basically the overall decline in industry rates. It's in nominal terms but because we did it as an index, it was a consistent back-skit of goods so that it has some inherent integrity just by itself. But, of course, what we did is add the GDP deflater on the top basically comparing what happened to actual rates which have gone down is that the GDP deflater during that same period was going up pretty rapidly. So if you just wanted to try to deflate which isn't a perfect process of applying that deflater you have even a more significant decline in real terms in rates.

Now I go to slide seven which breaks this out by different commodities and it begins to outline that most commodities actually did decline, but actual nominal rates for grain have increased over that 20 year period. In real terms again, that would be somewhat less, but it still stood apart from really all of the other commodities.

The next chart begins to try to probe into the issue of what's happened to competition and captivity. This is a very simple chart. Of course, everyone knows that we have increased concentration in the industry. This is the market share of the four largest, well above an amount of historic concern to the Justice Department, but I think none of us believe that an aggregate national market is really a useful one and therefore a lot of our work tried to break this down into more relevant markets either by commodity or by route.

Now, of course, the next slide is why competition is so important and I suspect none of you have to be told that. You know that competition has enormous benefits. But I think this is a wonderful chart that is basically a market where there was a single railroad in the early period and you see the rates. Everything is masked to not have this reveal proprietary data, but you have relatively stable rates at a certain amount. Then the dotted line is a new competitor. A new railroad enters that market, not surprisingly at a rate well below the going rate. It takes a while probably because of the expiration of contracts for the incumbent to lower their rates, again not surprisingly according to theory, below the rate of the new entrant and, in fact, stayed below the rate of the new entrant for the entire period, but just below. This clearly shows that competition when it's real and as you

know this study is about whether there is signaling or two is not a hugely competitive market, but this is a sign that competition was working, competition brought the rate and is enormously important in this sector.

Now slide ten is basically an acknowledgment that while we tried to identify what's happened to captivity we say at the outset, and I'm sure you all struggle with this all the time, it's very difficult to unequivocally identify the numbers or the geography of the placement of captive shippers and all of the measures really can have errors, both type one, type two, it can go in either direction. So we start with a caution about some of the limits of aggregate data particularly at the level we were able to complete given the scope of this work.

One of the things we did was look at BEA economic areas and looked at the state of competition, the presence of one railroad, two railroads, the change-over time of the presence of competition. Again, that's a very imperfect indicator. We talk in the report how it could overstate or understate, but it was an effort to try to get into some of the geography. And then another major factor we used was of course revenue to variable cost and as the chart shows, we know very well that it is itself a very imperfect indicator, that in fact as year two shows if costs go down and they're all passed onto a shipper,

the ratio just because of the algebra could actually increase and there's nothing nefarious, nothing that itself is a sign of anti-competitive behavior or abuse of a market position. So inherently we would never say that everyone over 180 is a captive shipper or that that's necessarily a pure observation about captivity.

Slide 11 we start to summarize the results of our analysis looking at all the measures we could pull together and basically we had a couple of interesting observations going in to two different ways. In one sense, we had several indicators that appear that the extent of captivity using imperfect measures actually appears to be dropping and I'll go into some of the examples of that. However, at the same time, we observed that the percentage of traffic traveling at rates substantially above the threshold for rate relief and we used a 300 R/VC ratio has actually increased, has doubled over the period.

Now the next few slides, I'll show you some of the data that we used to come to those observations. Slide 12 is basically the traffic or tonnage and revenue from traffic traveling at rates equal or greater than 180 and you see both of those lines are going down at a faster rate in the early period after Staggers Act but continued to go down if you regress those lines in the last decade.

Now the next slide is the one using the BEA analysis and this is a map. The BEA areas are the colored in and then we

overlaid the maps of states because geography is a way a lot of people look at things, not BEA areas. But basically, this shows that the tonnage with access to more than class one railroad actually increased. Now what the map shows is the percentage change of tonnage with access to one class one railroad in the last ten years. So the two lightest ones, the white and the light beige, have decreases in captivity and the dark gray and the black and increases in captivity, increases in BEA areas that have either a zero to 25 percent increase in tonnage traveling with one class one or the darkest areas in parts of Montana, South Dakota, West Texas, Tennessee have increases in the access to one railroad over 25 percent in the period.

Now slide 14 is basically the amount of traffic traveling at rates over 300 percent. That's the ratio I mentioned before. I think it's interesting that that drop that actually occurred after 2002 and we as you probably know are now working on the 2005 data to extend this analysis, so we'll be doing some additional analysis to see what happened there, but basically the amount of traffic traveling at rates over 300 really has steadily increased with this slight turnaround in the last few periods.

Slide 15 is basically the same data but it's on a different kind of scale and it shows the actual tonnage. You can see the first graph is the `85 period. The second is 2004. So you see the

amount, the bottom, is 60 percent of the traffic in `85 which was traveling at less than 180 and the amount traveling at less than 180 went up to 69. The 180, the 300 is the next point on the graph that went from 36 and that declined to 25 but the percentage traveling over 300 went from four percent to six percent over that 20 year period.

Again, we took the traffic traveling over 300 on slide 16 and mapped that into the BEA areas and again you can see very specific pockets where you have the greatest ratios of R/VC and the captivity.

Slide 17 is basically honing in on the two routes with the highest R/VC ratios of all of the routes because we also did this not by region but by routes and these two routes are Minot to Portland and Billings to Portland and for both of those you see after `98 very, very significant increases in the R/VC ratio and while there may be lots of explanations and we know the imperfections of the measure, looking at this specific data it was more rate driven than cost driven. So we believe there could be lots of factors that might explain not all of which would suggest the potential of a exercise of market power, but in fact, where they're rate driven and it's not passed through to the shipper, there's some real indication that this merits further review.

Chart 18 is another one that tries to map class one access or access to only class one and traffic over 180. Again, the dark

areas are the percent of tonnage over 180 which again is in those pockets where there is the access to only one railroad.

Slide 19 moves us to question two which was basically what actions the STB has taken and what alternative approaches there are. We start by noting the very broad authority in our view that you have as a board to both monitor the industry and inquire into and report on industry practices and we juxtaposed this with the more adjudicatory role which is more prominent.

(Bell sounds.) That's me. I will wrap up.

CHAIRMAN NOTTINGHAM: You can proceed.

DIRECTOR HECKER: Okay. The authority to us is an important one that we think is something that we then build our recommendation on. The Board in fact of course has taken many actions both with the simplified guidelines and has taken some action to review access and competition, but in fact, we conclude that there's really been little effective relief for shippers who are captive and that's the whole balancing of stackers. Let competition work where it can work, but the whole mission in many way of the Board or the ICC initially was where captivity, where competition, doesn't exist, where there's market dominance, where there's market power, work to either try to promote competition or provide relief and in fact, I think neither of those remedies have really effectively been instituted in the course of

the past 20 years.

Slide 20 is part of our conclusion in this area that in our view an assessment of competitive markets would potentially identify the basis for further action by the Board. The second is that improvements in the rate relief process where you can't promote competition and prevent the need for relief, you still need to try to get this relief process working and we know you're working on that issue and then, of course, the balancing. We recognize that continuing balance is always an issue. But because of the lack of real access, we wonder whether there isn't need for balance in a little bit more on the other side but not forgetting the fact that we need a viable performing revenue adequate rail industry.

That brings me to the third issue about future demand capacity and the Federal response. We all know that there are forecasts for significant freight rail growth. The capacity of the railroads to really meet that demand is somewhat uncertain. Rail capacity investments can produce not only private benefits which ought to be sufficient to motivate private investments, but they produce public benefits and in fact, already there have been public sector investments in freight railroads. Across the country, we identified over 30 states that had already published some freight rail plans and many have been taking some action.

Now our conclusions in this area built on the fact that the DOT as you well know has been moving aggressively in trying to develop a national freight policy, our concern is that the status quo is not a neutral freight policy. We don't have a freight policy in effect right now. We have very mode biased investments. We have a stovepipe structure of a national transportation policy. It's not promoting balanced decision making by states in infrastructure. It actually disadvantages railroads with the de facto subsidy that's given to trucking by their costs not being covered and all the risks of their capital infrastructure borne by the public sector. So we don't have a mode neutral national freight policy and that disadvantages rail and in fact, as the CBO Report and others have said before we ought to consider a new national subsidy to promote rail investment, we ought to remove the distorting effects by existing subsidies. So we're basically calling for a much more mode neutral approach where Federal programs treat freight modes more equitably and to come up with an approach that would focus any kind of public support whether it be Federal or state on public benefits.

The conclusions on 23 then, clearly the Staggers Act has achieved many of the benefits and objectives set out by the Act and in fact, we conclude that widespread changes to the relationship between railroads and customers is really not needed. But we are

however concerned that pockets of potential captivity appear to remain and relief is not available to many of the shippers in this area and we think there's an open question whether these rates reflect reasonable pricing practices or might reflect an abuse of market power.

We do however recognize that our analysis was limited both by the time, the scope, the data that we used, the proxy measures that we used, but we think it was a sufficient first step to put us in a position to call on the Board to use your broad statutory authority to inquire into and report on rail industry practices and mostly observe whether there are ways to promote competition and enhance the performance of the whole sector and, in fact, prevent the need for relief after the fact.

The recommendations as you know, we call for the STB to undertake a rigorous analysis of the state of competition. We also have a smaller recommendation about methods of data collection and trying to get more uniformity, consistency and accuracy in railroad reporting of revenues. And then finally we call on DOT as it moves toward developing a national freight policy to pay attention to creating a level playing field for all modes and to develop mechanisms to assess and maximize public benefits and I guess I wonder just kind of adding on here with the opportunity to be before you whether there's actually a connection with the central role of the Board in looking at the

performance of the industry being concerned about the revenue adequacy of the industry that this Board might not have some role to contribute to the Department's view and recognizing the important role that freight rail can play and provide your expertise on what this national freight policy ought to look like that doesn't continue to disadvantage the freight rail sector and what kind of appropriate public response makes sense.

That concludes the summary of the remarks and I'm very honored to take any questions if I can try to clarify what we've done or what our conclusions are.

CHAIRMAN NOTTINGHAM: Thank you, Ms. Hecker, for your detailed presentation. Just a couple of questions. You did reference early in your remarks the expert panel that you relied upon and that certainly seems to be a useful way to tackle a broad and challenging subject such as this. Did you face any problems or challenges in getting objective views from the panel? I mean clearly I'm looking and saw a lot of familiar names, very respected, familiar names in most cases, typically may even draw salaries from entities or institutions or companies or associations that have various perspectives on these issues and we struggle with that too frankly because when we go out and look for employees, our agencies have somewhere in the area of 40 percent of our current staff are retirement eligible and as we

look forward at succession planning and figure out where we're going to find good people, certainly some of the good people come from the field where they work as customers of or on the part of railroads trying to make sure we get good people are objective. Was the panel useful to you and did you feel that you got an objective snapshot of what's going on?

DIRECTOR HECKER: In true, I would say yes, it was useful. We have done a number of panels where we were a little bit more successful in identifying more areas of consensus. If you've ever worked with the TRB to help pull one of these informal panels together they are very clear to say you don't push the panel to consensus. They have their own methodology for getting consensus. So in that sense, there was a real mix of view.

We tried to design it so that it wasn't just shippers versus railroad, but more people with a more analytical view of different ways of looking analytically at the industry and then we had a period of presentation by shippers represented by the NT League and they brought in some shippers and a period of presentation represented by AAR and they brought in some railroad representatives. So we tried to not have it be just this is what the railroads think, this is what the shippers think, but at the end of the day, I would say it was corroborative with the broader range of analysis that we did and the

other research and studies that we used. So it was certainly useful but not dispositive as lawyers would say.

CHAIRMAN NOTTINGHAM: Okay. You mentioned in one of your recommendations that the STB should collect more data from industry and more data generally. Any specific examples that come to your mind of types of data we should be gathering?

DIRECTOR HECKER: One of our observations was the -- I think it's called the "miscellaneous category" that fuel is under and when we tried to examine -- And it's been rapidly growing. It's not a huge part of rates but it's rapidly growing and what we found, I think as you found when you did your fuel hearing, that railroads were reporting very inconsistently. So it's a very unreliable indicator and we thought that that was one area that really lent itself to some guidance to get more consistent reporting so that particularly if you have a factor that's increasing rapidly, you don't have to discount it and say some report one way. Some report another. So we can't really figure out what it might mean. But we can speak with you further in detail. I think there's a little bit more in the report on the specific areas where we thought some kind of consistency and guidance would improve the reliability of the data.

CHAIRMAN NOTTINGHAM: Thank you. I think we'll take you up on that because that's something we're very interested in. I'd love to get your thoughts on -- I think you touched on this, but we're very focused right now as an agency on some of the rulemaking proceedings before us as you might imagine, one of which we just concluded this past Monday in the area of trying to lower costs of bringing large rate case disputes to us, shortening the time frame that those cases should take or require to be seen through and address by our agency. And our sites now are very much focused on small rate case guidelines. We have active rulemaking underway. Do you think our attention is in the right place there, not to say that's exclusively what we're focused on? But clearly by focusing on that, we do believe that an excellent way to make sure that any market problems, rate problems, etc., any abusive market power, that specific cases can come to us with specific facts would be in a case and to make sure that our procedures for handling those cases are what they should be. I just would like to get your reaction to that.

DIRECTOR HECKER: We're very clear that we think it's excellent that the Board is moving forward looking at trying to both make large cases and more simplified cases functionally accessible and useful. However our analysis led us to say that there ought to be more emphasis than we've really seen with the prevention

of the potential abuse to try to get in there and see if there are some appropriate opportunities, whereby facilitating or promoting competition we basically prevent the problem and folks don't have to then come in through the relief process.

So I think it was a question of balance that we agreed that this focus on the relief process was good, but some attention to this other area was important and in comments, you talked about the shortage of resources and we know you're a very small organization and both in briefing the Congressional requesters and in talking with your staff and in writing the report, we agreed that if resources is the problem that really prevents that kind of analysis then you ought to go to the Congress and identify what kind of resources would be required because in our view, it's really our reading of one of the core responsibilities of the Board.

CHAIRMAN NOTTINGHAM: Thank you. Vice Chairman Mulvey, questions?

VICE CHAIRMAN MULVEY: Yes. Hello, JayEtta.

DIRECTOR HECKER: Hello.

VICE CHAIRMAN MULVEY: JayEtta is the reason I'm here actually. It was JayEtta who brought me back to

Washington, D.C. and brought me back to work for the Federal Government. So we've spent a quite a few of years working together at GAO. While I thought the report published was very good and very, very helpful, there was one thing that did stand out to me and sort of bothered me and I want you to address it if you can and that is the use of the BEA areas and the observations that gave you evidence that the degree of captivity in the country was lessening because it strikes everybody that you can't lessen captivity unless more shippers are getting more service from more railroads and clearly over the time period in which you're doing your analysis there wasn't any increase in the number of railroads serving shippers who were captive so captivity in that sense couldn't go down. It seems to me what you have is that the areas that have service by more than one railroad are growing more than those that are served by only a single railroad and so the importance of captivity would be going down but captivity itself is not going down. Can you comment on that?

DIRECTOR HECKER: As I even took time to summarize today, there are significant limitations with using the BEA data. We were aware of that and even weighed whether we should even present it and in the report we say there are at least three factors that it could understate captivity and I think we itemized too where it could overstate captivity. So it's rough and it's very illustrative but it

was some of the best geographic data that we thought we could try to use. So we are by no means coming up with strict conclusions.

Now the other piece of data, of course, is the amount of traffic traveling over 180 is steadily going down. Now we take that as a perfect measure either. So that's why we only say that it appears that it is the amount of captivity that may be decreasing. I don't think we have a definitive observation and it's in fact part of the reason why we hope that the Board would really look more in depth with your ability to subpoena and to cross examine that you can get the data. You have access to the data and the parties that we obviously don't have.

VICE CHAIRMAN MULVEY: One of the things you suggest that the STB do this study, but as you point out, we really don't have the resources and getting more money from the Congress these days is not the easiest thing to do. But in the SAFETEA legislation, there was an allocation of $1.8 million for a TRB, study , to do that kind of an analysis of the railroad industry, its future, the role of regulation in the 21st century and the like. We could help TRB to get the data it might need to the extent it would need data to do that kind of analysis. Wouldn't TRB be a better place to do it than have the STB staff of self-analyze itself? You know what they say about lawyers and doctors who have themselves for clients or patients.

DIRECTOR HECKER: There could be merit to that. I think some of the most thoughtful and probing work on national freight policy has already been done by two different TRB special studies. They are very far reaching. They are very thoughtful. So they clearly have the expertise to pull together very insightful folks and really grappled with really pretty difficult questions. I guess we weren't ready to give up on the fact that we thought that this was the central authority of the Board and that the responsibility in this balancing really included to assure and oversee and promote competition, not just be there after the fact for folks who as you may be suggesting are increasingly captive. So it was really an area that we thought was so important that we weren't so quick to say we heard about this other study. Maybe the TRB should do it.

VICE CHAIRMAN MULVEY: On the nominal versus real rates, would it fair to say that the data show that grain rates actually fell less than other rates but they still fell in real terms over the period you're looking at?

DIRECTOR HECKER: Yes.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey.

COMMISSIONER BUTTREY: Thank you. Ms.

Hecker, thank you again for coming today and sharing your thoughts and views with us again. I'm amused from time to time about this discussion about competition and what that means in terms of the way railroads operate and the way regulation is structured and the way the Congress has structured the Staggers Act. When you talk about increasing competition, what exactly do you have in mind or have you gotten that far along?

DIRECTOR HECKER: I think we have some specific ideas. It's interesting because I've been analyzing the implementation of the deregulatory policies for 25 years.

COMMISSIONER BUTTREY: Me too.

DIRECTOR HECKER: I was actually in the Carter White House when all of these bills passed and there with the debate. So I've had the privilege of doing a lot of work tracking airline deregulation, telecom deregulation, as well as this recent study and I think the reality is that it was a profoundly sound national policy to promote competition where it could work and we've seen the benefits in all these of those sectors in terms of investment and innovation and cost reductions and efficiencies, with pain to some, but definitely with national and net social welfare benefits.

On the other hand in all of those areas, there are remnant areas of captivity where competition was not a natural result of

letting markets be markets and I think in each of those legislative scenarios strategies were laid out to have some monitoring of the state of competition and affirmative action to facilitate and promote competition. I think in airlines there were issues about gate access that were very important and perseverance in the late `90s actually when most of the new entrants just kept going out of business. It was that perseverance of being able to get in that really sustained and we have a very different industry now.

Telecom I have some ongoing work that I'll talk about in about a month that about remnant market power and what the appropriate regulatory response is. But in the rail area, I think there are policies that are not without costs but the areas of reciprocal switching, of access, the four areas where we drew the maps to try to make it clearer what these policies were, we know these have been the subject of decisions in the past but we understand the Board has the authority if not perhaps the responsibility to review decisions where there are material changes and circumstances or fact that might justify looking at some of these decisions that may be able to promote competition, facilitate the performance of the market really to the betterment and the performance of the industry. I mean monopoly is not good for an industry.

COMMISSIONER BUTTREY: Wouldn't you agree

that there are some considerable differences between the airline industry and the railroad industry? For instance, in the airline industry, the airline do not own the airways.

DIRECTOR HECKER: Absolutely.

COMMISSIONER BUTTREY: People basically -- The American people own the airways and those airlines use the airways at the will of the Federal Government if you will and it seems to me that when you start talking about competition in the railroad industry, what people seem to be thinking is when you really boil everything down to the lowest common denominator is that the thought is that service would be better and prices would be better if there were two railroads competing on every single rail line of the country and I have asked over and over again for somebody to convince me how a shared monopoly works better than a plain monopoly and I have yet to have anybody explain to me how that would happen, how that would work and not the least of which it's legally impossible to do that, but that seems to be what people have in mind when they talk about competitive access and that logic totally escapes me how a shared monopoly would work better than just what we have right now. If you assume that that's the case, shouldn't we be focusing on pricing rather than the competition or the idea of competitive access?

DIRECTOR HECKER: Some would call --

COMMISSIONER BUTTREY: Okay. It seems to me, and I'd like your views on this, that the effort should be placed on pricing and not on competitive access because that's what you're really talking about when you're talking about competition. You're talking about other railroads running on the private proprietary lines of another railroad and the world as I see it and I may not see the world clearly, sometimes my glasses are dirty or whatever or my vision is not as clear and I can't see around corners as well some people do, I don't see that happening. I don't see that happening in the real world. So shouldn't we change our focus from the idea of competitive access or forced competitive access or taking something that belongs to someone else away from them and giving it to someone else because they think they'd be a better steward of that resource and starting talking about pricing policy and how you figure out some way to get at the pricing side, the price side, of transportation at those levels?

DIRECTOR HECKER: It's such an important topic and it isn't appropriate to try to have a long discussion here. Those are very, very important issues. I would say I think it's both and I think that's what our recommendation was to really reexamine the state of

competition in this industry, these pockets of apparent captivity and whether there are some measures including those well within the authority of this Board where it's not a shared monopoly. It's new entry. It's real competition by just changing some of the access rules and if they represent a taking or a reduction of rights where decisions and investments were made, maybe that's an area where there's some public compensation if there are enough public benefits to providing a more competitive environment.

You hear from the prior panel that we have whole sectors that are really struggling and when you look to the future, we don't have the capacity to handle it. We need to be functioning much more efficiently and I think in monopoly situations you have the least amount of innovation, you have the least amount of efficiency, you have the least amount of service and if there are some markets where on the margin some actions might be able to facilitate new entry, facilitate competitive conditions, then that would make sense.

We're very clear we don't believe every market in this country can support two railroads. So this isn't a universal issue and that's why your other notion of focusing on pricing and focusing on meaningful availability of relief is absolutely important as well. So I basically agree that pricing is important, but I believe that this isn't an unimportant area to really open up and reexamine.

COMMISSIONER BUTTREY: Thank you.

CHAIRMAN NOTTINGHAM: Ms. Hecker, your report did a nice job of encapsulating the post-Staggers history a little bit and kind of was reminding me how we've come in many respects and I know the last year or so upon the 25th anniversary of the Staggers Act there was a lot of discussion and some time for reflection. Do you think based on your work and your experience that it's time now to revisit from a policy perspective the Staggers balance that was struck? Is there enough changed circumstances now that didn't exist when the Staggers Act was developed where the driving reality was railroads are going bankrupt and our country being threatened with the possibility of perhaps waking up one day and not having any more railroads functioning? Is there enough change where it's sort of, to use a card-playing metaphor, shuffle up and redeal and what should we be recommending to Congress in that regard?

DIRECTOR HECKER: We were very clear that we didn't call for a reexamination of the Staggers Act. I think what we said is that so much has worked quite well and the emergence of a relatively healthy and in many areas innovating rail sector is very, very important and has been important to the economic growth and logistics efficiently in this country.

On the other hand, I guess I would just go back to the

simple point about the balance that we just wonder whether there wasn't an appropriate opportunity to reexamine the balance issue. I personally have a view and I think it's in the report because I'm not supposed to have personal views, but I think the issue of revenue adequacy and how revenue adequacy is defined and what role it plays in the regulatory process looking forward a decade or more is an emerging issue of some significance. We do have a small footnote. We didn't make a big think of it that there are those who say that the best next step is for you all to find different jobs, that basically the full deregulation of the sector is to close down the STB, to have the industry completely subject to antitrust laws and whatever very limited remnant function might be required to, I guess, put that in DOT if those aren't the same folks who are calling for the elimination of DOT.

But we're aware that there are those who think that is actually a useful deregulatory step and still advocating that we've come far enough. We basically said enough is working well. Don't change the whole thing. Don't re-regulate and don't throw the baby out with the bath water. Let's look at the balance of implementation and the balance of focus by the Board.

CHAIRMAN NOTTINGHAM: Vice Chairman Mulvey, any additional questions?

VICE CHAIRMAN MULVEY: Yes. You

mentioned about the revenue adequacy of the railroads and of course that balances their revenues with their cost of capital and whether or not they earn enough and the Board actually is taking a look at how we go about calculating whether the railroads are revenue adequate through this discounted cash flow approach to measuring revenue adequacy. But some of us suggested that there are other techniques that Wall Street uses like Cap-M for example which might give you a different estimate as to the cost of capital for the railroads and I'm told that the Federal Reserve has moved over the years from a discounted cash flow formula to a Cap-M approach. Are you familiar with the way the Fed goes about measuring the cost of capital for its member banks at all?

DIRECTOR HECKER: No, and my suggestion was that I think there are just some important issues to look at as you've said that there is the ongoing debate about the best measurements and if asked, we will play a role in that and if not, then you will proceed as the Board deems appropriate.

VICE CHAIRMAN MULVEY: Commissioner Buttrey talked about the importance of competition and clearly it is an important component of transportation and getting good service and good rates. But the railroad industry is fairly unique in the way it's structured as he points out as, along with pipelines, the infrastructure is

owned by the carrier.

The railroads have said that legislation that calls for open access or reciprocal switching basically constitutes re-regulation. Would you agree with that that it would be re-regulation as you understand regulation?

DIRECTOR HECKER: No, I don't. I think re-regulation is -- We actually were recently asked whether the airlines should be re-regulated with all of their financial problems and pension problems. Wouldn't we, the nation, be better off if we just re-regulate it and so we examined that issue and the return of rigorous price and entry regulation that government bureaucrats know where trains ought to go and what they ought to charge and what packages or innovations they ought to make. That's what re-regulation is and promoting competition, enhancing competition, assuring competition, I think is a pro competition posture that's an appropriate one by the Government measured to be sure but I don't believe -- Carefully devised actions to facilitate and promote competition are the exact opposite of re-regulation.

VICE CHAIRMAN MULVEY: I agree. Thank you.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey, any questions?

COMMISSIONER BUTTREY: That's it.

CHAIRMAN NOTTINGHAM: Thank you. That concludes our questions, Ms. Hecker.

DIRECTOR HECKER: Thank you.

CHAIRMAN NOTTINGHAM: Thanks so much for being with us and we look forward to working with you and your staff.

DIRECTOR HECKER: As well. Thank you.

CHAIRMAN NOTTINGHAM: We will now take a break for some lunch of about 45 minutes to allow people time to get in and out of the building if they need to. So we will resume at 2:05 p.m.

(Whereupon, at 1:19 p.m., the above-entitled matter recessed to reconvene at 2:07 p.m. the same day.)

A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

2:07 p.m.

CHAIRMAN NOTTINGHAM: On the record. Good afternoon. We're going to proceed with the hearing and with our next panel. We're delighted to have this panel with us and we thank them for participating today. Our first witness we'll hear from is from the Alliance for Rail Competition, Mr. Michael W. Snovitch. Mr. Snovitch.

MR. SNOVITCH: Thank you. Good afternoon. I thank you for the opportunity to testify before the Board this morning. As you said, my name is Mike Snovitch. I'm the new Executive Director of the Alliance for Rail Competition, sometimes referred to as ARC. Though I'm new to this position, I'm very familiar with ICC and STB regulation. I was Manager of fossil fuel supply for PP&L for 17 years. I was intimately involved in rail coal rate litigation and served for about five years on ARC's executive committee.

ARC's membership include many shippers of grain and agricultural commodities. Some of them are here today in their own right and they gave testimony this morning. The Board is hearing in detail about the various problems grain shippers face. I want to discuss three main areas the Board has fallen short of meeting the

legitimate needs of grain shippers which are captive and I want to stress this word "captive."

Put bluntly, the STB hasn't done anything to aid captive shippers such as grain shippers other than provide a forum for discussion of shippers' problems. The proof will be in the pudding if anything of substance comes out of these hearings to help the grain people.

Let's first talk about rates. One of the duties Congress assigned to STB is to ensure that railroad on captive traffic, again I'm always stressing this "captive," which includes the captive grain traffic are reasonable, one of the main areas on the Board. Also ARC recognizes that Congress also called on this agency to promote railroad financial health. That's what causes this whole thing back long time ago to get the railroads back on good financial footing.

These goals always have to be somewhat in conflict. One person is asking for more money. The other person is asking for lower rates. The problem for grain shippers is that for 26 years such conflicts have always been resolved in railroad's favor other than the infamous McCarthy forums which we discussed earlier today.

Consider these points of what has occurred over the past years. The ICC started considering alternatives to SAC in 1986. No alternative was developed until 1996 after Congress mandated

action. However, this is telling, no grain shippers used the three benchmark test the Board announced in 1996. Finally, in 2006, the Board proposed to abandon the three benchmark test in favor of a version of SAC that offers less hope than the three benchmark approach.

In addition, as far as SAC is concerned, the Segment Cross Subsidy Test recently decided to be used in SAC guarantees that grain shippers will have no chance of relief. It should come as no surprise that grain shippers to the Board as indifferent to railroad gouging on grain rates. The action of the ICC and the Board make it hard to reach any other conclusions.

Now the railroads are certain to argue that they need high rates and they don't abuse their market dominance or monopoly status. In fact, the comments in the Board's Small Rates case proceeding seemed designed to make things even worse for non-coal shippers. Ultimately, the real test is whether any grain shipper have an effective recourse to STB rail rate regulation. For 26 years as I said, the answer has been no.

Let's talk about rail service. Being gouged is bad enough when rail service is good, but when service is bad, the system is broken. We've heard a lot about testimony this morning about people

not being able to depend on the railroad, it takes longer to move from an area in the United States than it is from an area in Canada. This common carrier obligation is mainly given lip service today. When there is no effective regulation of rail rates or charges, the railroads have a free hand to make good service either unavailable at any price or so costly that commodities such as grain and regions such as the upper Midwest which the people described in detail this morning are stuck with second class service. If shippers want more than a number of railcars the railroads provide, the shippers are forced to acquire the cars for the railroads as we discussed this morning. If the shippers want empty cars dropped off and loaded cars picked up when needed, they are forced to pay extra and to top it off, if shippers complain to the STB, there's a possibility of railroad retaliation.

ARC understands the Board should not micro-manage rail service. They shouldn't be in that business. As with rate issues, grain shippers are not calling for regulatory procedures under which shippers always get the relief they request. However, the Board offers no effective recourse. As a result, grain shippers expect rail service through a main port. The Board needs to act as a fair umpire when rail service issues arise.

Let's talk about what's happened with competition. ARC is not alone I believe in that shippers with competitive

alternatives are less likely to pay excessive rail rates and experience poor service. We talked about Economics 101 and the nation's experience with trucking deregulation support this view. However, the Board in this past has sheltered railroads from competition in numerous ways, bottleneck, etc. Its rare attempts to encourage competition among railroads have been ineffective.

The GAO as discussed this morning has suggested that the Board investigate shipper captivity and railroad competition issues. The GAO also points to actions the Board could take that would enhance competition among railroads as he mentioned, terminal, trackage rights and reciprocal switching. The Board should also end paper barriers.

In conclusion, the relationship between railroads and captive shippers has for far long been too one-sided and the railroads' financial strength has improved and believe it or not, this has not made the situation better but has made it worse. The Board must address this imbalance by learning more about grain shipper issues and by revising our banding policies adopted years ago that no longer make sense. Grain shippers need a change to challenge high rail rates using a reasonable, understandable, not very costly approach, a chance to challenge poor rail service and therefore a real chance to reduce railroads' monopoly power. Thank you and I'll answer questions.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Snovitch. Now next we'll hear from Mr. Terry J. Voss representing Ag Processing Inc. Mr. Voss, the floor is yours.

MR. VOSS: Thank you, Chairman Nottingham, Vice Chairman Mulvey, Commissioner Buttrey. I appreciate the opportunity to appear here today before you on this very important issue. As you said, my name is Terry Voss and I'm Senior Vice President for Transportation for Ag Processing located in Omaha. We're a cooperative owned by 211 local grain elevators and cooperatives. We are also owned by six regional cooperatives. We have 14 processing facilities and about 40 grain elevators and our membership has hundreds of grain elevators that they operate.

We filed a written statement earlier in this proceeding and I'm just going to highlight a few parts of that. I want to talk about the GAO study a bit if I could. If anything the GAO statements about increases in the grain transportation costs I feel are understated. For example, GAO can only measure the rates that are really used by the shipper.

Rates quoted from carriers that are too high to move any freight are not able to be used because they're not in the Weigh Bill Study. They don't show any of the GAO data and the rate increase. The Weigh Bill samples alone only include the shipments that are

moving, not those under the rate that has been increased to that level. They are excluded from that study.

The total cost of transportation as we heard earlier today, there's infrastructure costs which include track, high speed load-out systems, scales, onsite grading capability, storage space, etc. to comply with all the railroads rules. It is not altogether clear, however, or if GAO includes a premium paid for freight equipment in the various car audition markets. GAO does not include the cost for the shipper furnishing private cars. We heard discussions about that. The railroads however do furnish all the cars for the shuttle trains as far as I know.

In the grain products area, shippers furnish 100 percent of the tank cars for ethanol and vegetable oil movements, a large percentage of the covered hopper cars used in the grain products industry furnished by the shippers. One hundred percent of the DDGs for distillers dried grains are furnished by the shippers. The GAO does not take into account the reduction shippers have taken in the compensation level on the mileage allowance payments for furnishing the private cars.

Yesterday in the National Grain Car Council meeting, we heard the leasing companies and car builders talk about rates exceeding $800 per car per month for new equipment. This is

double what it was a few years ago and the compensation level that the railroads pay the shippers has not increased at all with the exception of one carrier. We have huge investments in rail cars and again the rates that we've looked at or talked about freight rates do not include the total transportation costs.

I read a portion of the AAR filing last night. It stated a USDA study showing that seed, fertilizer, farm machinery, labor and fuel have increased from 36 to 153 percent over the 1995 to 2005 period. These inputs as high as this percentage seems is a small percentage when it comes to a per bushel basis on the price of corn. Anhydrous ammonia has gone from $600 last year down to $350 or $400 this year. That would equate probably on 100 pounds of nitrogen per acre to four cents or three cents a bushel and that's the total cost. That's not the increase. So I think those numbers are a little highly inflated or they're not maybe the reality that we'd like them to be.

AAR states that their grain rates have only increased 12 percent on a mile ton basis. Freight charges as a percent of the bushel however are greater in transportation there and input costs. AAR also neglected to add in their statement that the fuel surcharge is 20 percent. That's added on top of the 12 percent increase. They neglected to add that into their statement.

Farmer producer and the processor in the grain elevator have a substantial investment at risk. This risk should be rewarded by the marketplace. Instead we see railroads telling us we cannot sell into certain markets. We must ship to carrier selected markets which can reduce the rewards that we would get from our own investment or risk.

Carriers have stated that railroads have decreased rates in the early years after Staggers. They should have. We sat here in this exact same hearing room during the Mergers studies and carrier after carrier sat up here or came up here and said they were going to be efficiencies. We're going to have new efficiencies gained. We're going to have new markets that are going to be available. Rates will be reduced and service will improve.

Rates did reduce for a while and so did service. Rates are now vastly escalating and service is not keeping pace with it. We have seen rates in the past couple of years increase from two percent to 300 percent. It is very difficult to sell a customer product for a forward period when we don't know what the freight rate is. These types of increases are having a huge impact on our export business of the Pacific Northwest for soybean meal.

We can hedge our grain and grain products, ethanol, soybean oil, corn, beans, whatever it may be. We cannot hedge our

grain transportation rates. We cannot help protect our owners or producers on their freight costs.

I want to emphasize that our company supported every railroad merger that was here. We were not anti-merger. This company that I work for and the membership that owns us we are not for regulation. We are for a deregulated rail industry, but we're in favor of a balance of equity and equality in a system that rewards those whose high rates are paying for the future infrastructure expansion.

Commissioner Buttrey asked us what recommendations we would like to see. Please give us an effective relief mechanism where when we feel a rate is too high we can come to this Board inexpensively or realistically priced and get a quick turn around and a decision. Thank you and I'll try to answer questions for you.

CHAIRMAN NOTTINGHAM: Thank you. Next we'll hear from Mr. Darrell R. Wallace of Bunge North America. Mr. Wallace.

MR. WALLACE: Thank you very much and thank you to the Board for holding this hearing and for allowing us the opportunity to participate. My name is Darrell Wallace and I'm Vice President of Transportation for Bunge North America. I've served in that position for the last eight years. Prior to employment with Bunge,

I've been employed by several other AG firms and have over 35 years of total transportation experience in dealing with railroads, including four years I spent as the Lead Transportation Officer for a large Canadian grain cooperative.

I am a member of the National Grain and Feed Rail Shipper/Rail Receiver Committee. I'm President of North America Freight Car Association which represents the interests of car builders, car owners, car lessors and car lessees of over 500,000 railcars. I'm also currently serving as Vice Chairman of STB's National Grain Car Council. Today I'm here representing Bunge and all of my comments will be on behalf of Bunge and no other organization.

Bunge North America is the operating arm of Bunge Limited. Bunge Limited is a global AG business company employing 22,000 people in over 32 countries. In North America, we operate 125 facilities including dry corn mills, soybean and cannola crushing facilities, eatable oil refineries and bulk grain handling facilities. In my position, I am responsible for all rail and truck transportation issues in North America.

Today this proceeding is not an inquiry into the pros and cons of rail regulation, but we feel it's important that we go on the record to say that Bunge is not a proponent of re-regulation. We believe the marketplace is better served when it's operated in a

deregulated environment and deregulation we believe has been mostly positive for railroads and shippers alike.

We support a healthy and prosperous railroad industry. Healthy railroads are vital to the economy of the U.S. and AG shippers depend heavily on railroads to move their product. We do, however, feel that there is a great need to balance the goals of the railroad industry and the needs of shippers today for dependable transportation at reasonable rates. One of the reasons we wanted to participate in this hearing is because of our concerns that steep increases in rail rates to the AG sector will both weaken the U.S. farm economy and the ability of the U.S. to compete effectively as it should in world markets. We believe that continued increases of AG rates will result in a reduction of the U.S. farm sector's participation in those world markets.

The Board's notice asked several questions and what we will try to do this morning is attempt to address some of those questions. First of all, we agree with the GAO study that grain rates have risen sharply and to prove that point we did an analysis of some randomly selected, origin destination pairs.

During the period from January 1, 2001 through September 30, 2006, within the U.S. our rates on soybeans increased 27 percent to 120 percent. Soybean meal rates increased 16 percent to 46

percent. Vegetable oil rates increased 13 percent to 80 percent. Within Canada, our cannola meal shipments increased 12 to 15 percent and veg oil four to 16 percent.

Now what you need to understand about those increases as large as they are they do not include any fuel surcharges. So you need to tack on three to 20.4 percent additional increase for fuel and the only reason that three percent is in there is because the carrier that has the three percent took a 16.4 percent increase in their base rate to compensation for fuel and then lowered their fuel surcharge. So we're talking rates that have increased very dramatically.

What we'll try to do is give you the four reasons we feel that grain rates have risen so dramatically. The first one is railroad capacity constraints. The second is poor quality of service. The third is a phase-out of rail contracts. And the fourth is private car usage.

Speaking about railroad constraints, we all know we're operating in a market today that is overly constrained. There is no doubt that in tight capacity the market allows for extraction of premiums which is what is happening today. The same when there is an excess of capacity, rates will come down.

Today we've seen an environment or we're in an environment that is unlike any we've ever known. The railroads have

more business than they can handle and they're taking advantage of that to increase their rates as they should. They are using though their inability to raise rates to take or get rid of some business that they believe is unwanted on their lines even if it's profitable.

Poor quality of rail service is another issue. The capacity problems we believe are complicated by the poor and inconsistent service that a lot of grain shippers receive. While rates have increase sharply in the past few years, service has not increased and is in fact declined. I'll give you a good example. Within the last month, we've had a hundred car unit train sit 18 days after it was loaded and released waiting on power to move that train. Had that power been put on the train that had to have been moved, we would have a lot more cars to load, we would have been able to move a lot more product with fewer cars and hopefully unplug the system which brings me to the next point which is the shipper's use of private cars.

We use a lot of private cars in the grain industry. When we has less than stellar service from the railroads, we size our fleets because of that performance. That means, poor service means we size our fleets at a higher level. Those additional cars are a detriment to the system and they place additional constraints on the carriers and add to the capacity problems. Consistent service will improve the velocity of the equipment and the long-term effect will be

it will alleviate some of the capacity issues we have today.

The next issue is the phase-out of contracts. We've seen a definite move from the carriers to move out of contracts and into public tariffs. We've lost over 75 percent of the contracts we had just a couple years ago and the reason is very simple. When you have a contract, the rates are generally locked up for the term of the contract and the carriers can't adjust those rates. When you move rates to a tariff, you can adjust rates on 20 days notice.

To give you an example of how this is happening, we had a carrier notify us the other day they were going to take a $200 increase on September 1. By September 10, they notified us they were going to adjust the rates another $200 by October 1. So within a matter of 30 days, we took two major increases on one set of rates.

The grain trade fixes their trades a lot of times a year in advance. When we have frequent increases like that, it adds a great deal of risk to the marketplace and that's risk that the grain companies and the farmers have to absorb.

Private car usage. Since the 1980s, the railroads have encouraged shippers to provide their own equipment. There's only two real major carriers that have been adding to their fleets and they've spent millions of dollars adding to their fleets and we commend them for that. Most of the AG railroads have not spent money on their

fleets.

Today in the AG industry, shippers provide 100 percent of their tank cars and probably over 50 percent of the hoppers. Owning and leasing cars kind of locks you into railroad service. When you're running some fleets as large as what some of us run, you're going to take those rate increases no matter what because you have to utilize your asset. You can't park 9,000 cars. You have to keep them moving. So you're somewhat locked into it irregardless of the rate increases that come about.

The other issue that Terry mentioned is that shippers have not been fully compensated for their cars. The law is very specific that shippers are supposed to be compensating for the use of private equipment. We've seen the spreads now. We've seen mileage go down. We've seen mileage go away and we have carriers today that publish only a rate that applies in private cars. While the rates on private cars have doubled and tripled, we have not seen the same thing happen with the spread we're getting paid. So that's an additional cost that the GAO study did not take into consideration.

When we looked at the Canadian rates, even though I spent some time in Canada, I've been gone from there for about nine years. So I don't really feel qualified to address the issue about the wheat rates and I think the trade associations have already outlined the

differences between the U.S. and Canada. The only observation I guess we would make is that the rate cap on the outside seems to have had an effect of not allowing Canadian rates to increase at quite the same pace that U.S. rates have increased.

I do appreciate you for allowing us the time to participate today. We would encourage this Board to help us find a balanced approach and help us balance the rail needs for infrastructure changes while providing shippers with a reliable and consistent service at reasonable rate levels. We would also ask this Board to help make sure that if the AG sector is going to pay higher rates on its movements, that somehow we can make sure that that money is directed toward infrastructure changes that will be of benefit to the AG sector and AG shippers. Thank you very much.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Wallace. Next we'll hear from Randal I. Linville representing the Scoular Company. Mr. Linville, welcome.

MR. LINVILLE: Thank you, Mr. Chairman. I will stick to my script that I submitted just briefly in the beginning and then just make some comments that highlight in the interest of time and will be happy to respond to questions. First of all so that you know the context for my remarks, and I'm representing the Scouler Company here, Scouler is a privately-owned company that will celebrate its 115th

anniversary next year.

Historically, our company has engaged in rather traditional grain elevator business, storing grain in the heartland for redistribution by truck and rail throughout the year. In the last 20 years, however, we have transformed our business to become supply chain managers for a wide variety of agricultural products including grain. In the last year alone, our freight bills paid the U.S. rail carriers a total of more than $200 million and we marketed more than 700 million bushels of grain.

There is no industry more central to Scouler's operation than bulk commodity transportation in the USA. We use truck, barge, container and vessel freight routinely, though rail is clearly the centerpiece of our transportation strategy and although we are moving many different products, my comments today will focus on our core and largest business which is grain marketing.

I think if I have one message that I would like to leave the Board with it is all the things we do today I believe and in the future should encourage infrastructure investment. As I consider the highlights of my remarks and other filings that I read in preparation for my comments, I really want to kind of group them into two ways.

As I look at the trailing indicators, you were given an enormous amount of data to look at. A lot of that was new and very

interesting to me and I'll just offer you my comments as a businessman. I'm not a transportation specialist but I am a businessman that needs to use these tools. First off, the context for the comments are that I think we're experiencing broad growth in demand in transport across the economy. It's not unique to agricultural and as was pointed out, we share the transport network with other parts of the economy and we certainly in agriculture want to make sure that we get to use our portion of the infrastructure and all the modes of transport that we deal in is absolutely a case that broad increases in demand has led to increases in rates in all modes, trucking sectors that we deal in, barge sectors that we deal in. Certainly the rail sectors have been amplified in this meeting.

And these will be maybe in no particular order. Another thing as I studied the rail rate data that you were given in terms of the trailing indicator, it seems like from my perspective as a businessman that kind of the elephant in the room that is not getting discussed is the density or the volume or the volatility of these different regions of the country that we're talking about. All of you know how big our country and the AG is largely the heartland, the corn belt or a lot of these comments have been focused in the Great Plains and I know as a company that operates businesses in all of those states that density of production, volatility of production and business volume

drives a lot of my decisions and my investment as a shipper and receiver of product.

I think the best way to maybe give you a parallel on that would be land prices are completely different in those regions of the country, some as low as $1,000 an acre, some more than $4,000 an acre and I would submit that density of production and volatility of production is a big driver of capital and the way that I look business. Capital flows to this demand. In some of these regions that we're talking about, certainly we aren't shipping much wheat out of Texas. The wheat yields have not increased over time.

We are shipping a lot of corn into Texas to meet dense demand in cattle feeding in West Texas. The industry has adapted to those needs and transport structures have evolved to those needs. The same thing has occurred in Idaho. We aren't shipping much wheat or was earlier noted barley out of Idaho, but the dairy industry has moved to Idaho. Our firm just constructed a facility in the heart of Idaho to bring in distillers' grains and big trains. So the market is shifting and adapting and participants, firms and railways, both are meeting the changing needs of the market.

And lastly, I would say that it is apparent to me that infrastructure is absolutely at capacity. Seasonal periods, fall and winter, we go over capacity and that creates all kinds of havoc across

all modes. So again, I would encourage investment in infrastructure.

In terms of leading indicators, most of the data I say was pretty void of anything looking into the future that we can use as guidelines and I would say that the trends that have gotten us here and the business growth in the economy look like those are going to be continuing into the future. So I don't think the future will get easier. In fact, it may get more difficult.

The AG market is expanding as we now have energy to serve in addition to feed, food and fiber. Many opportunities for firms in the agricultural market.

I see capital investment flowing to biotechnology for grains. I expect big benefits into the future and increased yields in corn and soybeans that will largely go to corn belt producing areas. I think that will serve to even accentuate these differences in density into the future. It took us forty years to double the yield of corn. We'll probably double it again with information I get from firms like Monsanto and DuPont in 20 to 25 years. That will double the density of production, volume of production, out of the corn belt and make these disparities even greater.

When I look at our operations, corn belt, plains, what I'm looking for is business and it's been raised that some of these plains areas it's competition, it's rates, it's access. To me, it's business. If we

had more business there, I would invest in more assets to ship and receive grain into those operations.

So if I would leave the Board with a recommendation, it's what can we get to do more business in some of these plains states and I would offer that some of the technology companies are investing in drought resistant varieties of corn and I know farmers farm the land. They don't farm to be barley or wheat growers. They can raise whatever is beneficial. Perhaps that is a win-win for people into the future. And again, I would close by saying I would recommend that we do anything that we can to encourage infrastructure investment. Thank you.

CHAIRMAN NOTTINGHAM: Thank you to all panel. I'll start with a couple of questions if I could. Mr. Linville, let me start with you. Your business, I want to make sure I understand, you don't actually have acreage under planning and your business isn't producing crops so to speak. You're more in the marketing.

MR. LINVILLE: Yes, we're in the shipping, receiving. We buy, sell, import, export merchandise. We have a North American network, 15 offices and 30 some facilities around North America. We have international reach and about 20 percent of our business is international.

CHAIRMAN NOTTINGHAM: How does your

business impacted with the fluctuation of transportation costs in the grain industry for example? Do you feel that at all or is that strictly someone else's more direct problem?

MR. LINVILLE: No, absolutely. It's obviously dynamic as you've heard from the different speakers today. But to me, the real essence is as long as our firm is lined up to the ever-changing market, the shifts I alluded in where the dairy cow is going to be, where the flour mill is going to be, where the international is going to be, and as long as we're aligned with that and then our business partners in the rail industry or the steamship industry are also after than same market, we make it through the evolutions, the dynamic phases with less friction than we might otherwise.

When we get out of step with the market it becomes more difficult. I've owned operations in markets that have been in decline that had no future, no opportunity for growth business, and that's a difficult place to be.

CHAIRMAN NOTTINGHAM: I wonder if I understood your statement earlier about business and is your point that if the Great Plains states, states like the Dakotas, Montana, if they were just more productive in what they were producing, they would see more investment and they wouldn't have some of the problems we've heard about today. I don't want to put words in your mouth, but that's what I

thought I heard you say.

MR. LINVILLE: Absolutely. Business volume attracts capital investment. It's more freight for any type of transport carrier, any mode of transportation. It's more for me to handle as a shipper or a receiver and to make these kind of capital investments it requires business volume. I think the other thing I would add is the change is quite significant to me over time. Wheat and barley yields have stayed relatively flat for a couple of decades and at the same time, we're getting great increases in yields in these other crops and that's influencing flows of capital from firms like mine and then my demand for transportation.

CHAIRMAN NOTTINGHAM: Mr. Voss, and I think, Mr. Wallace, both of you I think I heard you reference that railroads occasionally, maybe more than occasionally, dissuade you from entering certain markets, if I heard correctly, and actually turn away customers or stop serving customers. Could each of you expand on that.

MR. WALLACE: Yes, we've had instances where the prices that the railroad have given us to move freight have actually taken out of markets that we had or they've restricted markets to keep us out -- No, I shouldn't say to keep us out, but what they have done is kept out of those markets. We have one or two plants that we're

probably going to close down because it's cost ineffective to ship product to those markets. We've had other instances where we've facilities where we can't buy beans by rail anymore because the railroad has decided that they don't want to haul the beans in the facility. So they price those rates at such a level that there's no way we can afford to pay that.

CHAIRMAN NOTTINGHAM: And if I heard Mr. Voss correctly, we may not always be aware of those quoted prices because they don't actually make it into weigh bills.

MR. WALLACE: That's correct. If you don't pay freight on them, then they wouldn't show up in the weigh bill study.

MR. VOSS: Taking over what Darrell said to your question, we've had it happen where we've for maybe two or three years enjoyed a market, hypothetically Texas cattle market for example, and we ship into there out of certain origins and the buyers start to rely on us and count on us for good quality corn. The following year those freight rates may go up $200 or $300 per car and we'll talk to the carrier about that and they'll say we want the corn out of this particular origin area this year to west and not south and we're going to take this south stuff out of a different area.

CHAIRMAN NOTTINGHAM: Vice Chairman Mulvey.

VICE CHAIRMAN MULVEY: Yes. Mr. Snovitch, I guess also Mr. Voss and Mr. Wallace, in response to your comments that grain shippers have no effective remedies either under the SAC or the simplified SAC, I would just like to reassure you that the Board members are aware of your concerns and the three of us and the Board staff have been working on ways to improve our processes and as I'm sure you've noticed, we've put out new rules or proposed rules on these matters. I don't want to discuss them at this juncture, but these are aimed at making our processes less expensive and more expeditious and fair to all the parties involved. But I'm sure you all understand that part of the complexity of what we do and why it is so expensive is because we've been told by the courts that the SAC process is something that is accepted and that the courts have approved. To move away from that and into one that which gives us more leeway and which is maybe less expensive might be struck down the courts as being arbitrary. Can anyone comment on that? Someone mentioned McCarthy Farms earlier and that's where the court direction comes from.

MR. SNOVITCH: I understand, and we appreciate you trying to simplify the process. But I've been involved in SAC cases and one of the problems with SAC cases as far as coal rates and I've been involved in it, there were rules that were set up in the past and

when you do the SAC analysis and submit it all of a sudden the rules that were used in the past were arbitrarily changed like diversion of traffic. In the past, you weren't require, you were allowed to divert traffic to these higher density to your hypothetical railroad. Now it is no longer allowed unless it is on that railroad presently. That is a serious departure from what it was in the past.

But we've put these SAC cases together and for somebody such as small grain shipper or something it's not practical. We're talking we used to spend $2 to $3 million at PP&L to file a rate case such as that and that is not practical from the norm grain shipper to be able to do that. I recognize the courts may strike some of this down, but I think the STB has to take a look at what can be done.

Off the top of my head, I would think something like a revenue variable above a certain level you automatically are able to file a case and you drop below. If it's not the 180, it's something else, but something much more simplified, not so complex and detailed. When you get into the SAC cases today, you fight on whether they're revenue-adequate and all those assumptions that go into that. Then you fight over the assumptions as far as revenue variable. Are they 180 or not? Then you fight on the assumptions that go into the SAC. And all this is costly and time-consuming and takes too much time and too much effort.

VICE CHAIRMAN MULVEY: And that's one of the things we're trying to address with the simplified SAC case proposal and the small rate case guidelines. I think it's an ongoing process. These were sets of changes that we put out, but after we see how those work, we may find that we can do more. But it is going to take time. We're all committed to try to make our processes more accessible to more shippers.

MR. SNOVITCH: We appreciate it. It would save everyone a lot of time in addition to your staff in reviewing these rate cases.

VICE CHAIRMAN MULVEY: Mr. Voss and Mr. Wallace, you mentioned that the railroads don't want to carry certain traffic that's profitable traffic. That almost seems irrational. Is it because that even though that it's profitable the opportunity cost is too high for them? They could take that equipment and use it elsewhere and make even more money and that's why they're turning away traffic that is still profitable?

MR. WALLACE: A lot of it I would say is in our own equipment. It's not even the carrier equipment, but we're seeing instances where --

VICE CHAIRMAN MULVEY: Or the capacity of the line then could be better used?

MR. WALLACE: It could be the capacity of the line because we're seeing instances where we want to load a train and the carrier says don't load it because I'm not going to move it because you already have too much traffic on the railroad now. So it's a limiting factor. It's preventing us from being able to produce as much as we want to produce or sell as much as we want to produce.
But it generally would be more in our courts. In the east, we operate mostly with private cars compared with the west where it's generally system cars.

VICE CHAIRMAN MULVEY: But the railroad's rationale for that is they're just trying to ration the capacity that they have until they can expand that capacity or are the railroads trying to constrain capacity so that they can get the rates as high as they can and maximize their return on investment?

MR. WALLACE: I'm not sure I can address that one very good, but you know I would say that whenever they try to ration the capacity for an individual shipper the worry is that your competition is not getting that same rationing the capacity and I think that's one of the greatest fears that if they come to you and it's an example of your running ten trains and they say you can't run another train because you have too much, we don't know that our competition isn't running 20 trains and if he's running 20 trains then he's evidently

got a competitive advantage over us. So again, it gets back to the level playing field.

VICE CHAIRMAN MULVEY: But what would the railroad's rationale be to give one shipper a competitive advantage over another? We're going to let ABC company have 20 trains but we're going to restrict XYZ company to 10 trains. They would have a rationale for doing that, wouldn't they? It wouldn't just be arbitrary and capricious.

MR. WALLACE: I'm not sure. I mean --

MR. VOSS: Do you think it could be in a quarter that they want to operate in?

MR. WALLACE: Yes. It could be like he said in a line they want to operate in. It could be because the other company is much bigger and does much more business with them. It could be because it's moved into an area that they're trying to grow so they can strengthen their position in that market and it could be because they just don't want to haul that other shipper's traffic right then. Maybe that shipper took some freight away from them before, so they don't want to haul as much in the future.

VICE CHAIRMAN MULVEY: Would that be in the form of retaliation say for previous behavior perhaps?

MR. WALLACE: It could be.

VICE CHAIRMAN MULVEY: Thank you.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey.

COMMISSIONER BUTTREY: Thank you, Mr. Chairman. I sort of feel constrained here myself to correct the record a little bit here. There was a statement earlier about the fact that the railroads always win and we don't have many grain rate cases to look at but we have quite a few coal rate cases to look at and since you're with PP&L, you know about coal rate cases.

By my count and I think I'm correct on this, the railroads have won either exactly half or almost half, maybe by missing it by one of all of the coal rate cases that have been tried at the Board, and as I recall I think I'm correct in saying that the court has upheld the Board in every one of those cases. I don't think we've ever lost a coal rate case in court. So somebody can correct me on that if they have better memory or better records than I do, but I just want to correct the record on that.

The other comment I'd like to make and I'd like to get the panel's response to this is that I keep hearing that we have 507 railroads operating in the United States of America. We have about 500 short line railroads and seven class one railroads. I keep asking the question how much unused capacity is there in the system when

you take the short line railroads into account and I can't get an answer from anybody. All of a sudden the short line railroads are just dumbstruck when I ask that question.

Nobody seems to know that answer to that, but I suspect, I just have this feeling, that there's this huge amount of unused capacity out there in the system, in the short line system, that's not being utilized. I know Montana has short line railroads and they could probably use that capacity somewhere out there if the arrangements could be worked out.

It seems to me that it's in everyone's best interest, I mean everybody's best interest, to figure out a way to do that and why it hasn't been done before now, I don't know. But if I was taking this much heat, I think I would try to figure it out. Does anybody have any response to that observation? I'm just making an observation here. I'm not stating necessarily facts. I'm just making an observation.

MR. SNOVITCH: Some of the unused capacity of the short lines have not been able to be used because of the paper barriers. They have agreements with the class one railroads and the class one railroads are not allowing to interchange with the other class one railroads. Basically, there's a paper barrier. There's not a physical barrier there and I think opening up those paper barriers would do a lot to use additional capacity on the short lines.

CHAIRMAN NOTTINGHAM: Anyone else?

MR. LINVILLE: I would offer that the access capacity that's out there is in areas in my viewpoint that was built for markets of the past and not of markets of today or the future. For example, with growth in international coming in from Los Angeles to Chicago, a big containment movements and in AG products to some degree going back, we need more capacity there. That's what the market is demanding and there's no short line capacity that can fill that void. So it has to be capacity for markets that are vitally growing and markets of our future.

CHAIRMAN NOTTINGHAM: Anyone else?

MR. WALLACE: A comment I might make is that many years in the past the railroads were in a mode of kind of retreating. They were getting rid of branch lines. They were getting rid of tracks. They were getting rid of yard operations, getting rid of people, trying to cut back because they couldn't fill the capacity that they had. So they were getting rid of that capacity to become more profitable.

When Staggers came around, they started finding ways to be more profitable, operating more efficiently, trying to get some of those gains and we're in a situation now where the situation has reversed and we've all this freight out there that has to be moved

but the capacity has been taken away and we have to rebuild that infrastructure and rebuild that capacity.

And there may be a lot of capacity on these short lines. I'm not that familiar with them. But on the main, the class one carriers, there's probably some capacity there but it's minimal and the only way our companies can grow is to increase the amount of business that we're doing with the railroads. So we want them to add capacity. We want them to be able to make money with their rates and add to that capacity because if we can't grow our business, then we're all going to be in jeopardy.

MR. VOSS: I think it would be interesting to learn how much capacity growth we would have if we got two or three more mile per hour on the trains. If you get a ten percent, I think the railroads according to AAR reports are 21, 22, 23 miles an hour, somewhere in there, depending on commodity and if you could get a ten percent increase a mile an hour, what would that do to capacity?

COMMISSIONER BUTTREY: That's it.

CHAIRMAN NOTTINGHAM: If I could ask. There was some reference in at least one of the statements here about the concept of reciprocal switching or open access. Would any of the panelists like to speak to whether you believe that would result in more investment and attract more capital into rail transportation for both

maintenance and improvements and possibly new entrants or less or not have any impact?

MR. VOSS: I think the perception is any time you can build a facility that's served by more than one carrier you'll have a warmed feeling that you might be a little more competitive. I said this is a perception. I'm not sure. I know that our company that the last two or three facilities we've built there's more than one carrier.

MR. WALLACE: It's difficult to find places today where you can actually have access to more than one carrier and when you do, you don't always have full agreement from the carriers to allow everybody to have access to those facilities. So I think Terry is right. It is desirable to have access to more than one carrier but it's not always feasible.

CHAIRMAN NOTTINGHAM: Some of the shippers and folks we hear from who are concerned about railroad rates and services are pretty good, pretty successful, at their lines of business, make good money and more power to them, but I sometimes ask why don't more people go into railroad business? Why you guys, Bunge's pretty big. You guys work with some big firms out there, not to pick on Bunge, but I mean why don't more people pursue the business and go into it and create some more competition for us?

MR. SNOVITCH: Let me respond from my former

life as a utility executive. We've actually looked into building railroads and things like that. It's not your line of business. You have to take resources or energy from your core business and start to worry about the railroad business and that takes considerable effort. So it's basically a high hurdle to get over before you decide to get into the railroad business and it's even not practical for utilities and we owned over 1,000 cars, but we didn't want to get into building tracks or owning power and things like that.

MR. VOSS: I think if you look a good example might be if you look at the DM&E expansion in the Potter River Basin, my numbers are going to be wrong, but they're adding what? A couple hundred miles of track or 150 miles of track. They've been working on that process five, six, seven years and it's been blessed by the Board here. But they're tied up. I think they have one court case left yet. But the price of entry, you know, if you have to wait six or seven years to get that in, the costs has probably doubled in that time frame and I would hate to figure out or try to estimate what it would cost to build 10 or 15 or 20 miles of track even by the time you had to acquire the property and everything else.

MR. LINVILLE: I would add that I think the unifier that all of us has is that we have to access capital from the global capital market and railways are a huge amount of investment. The

profits that you get, do you have to reinvest those just to upkeep? What amount can you reinvest to add and still conform to the expectations of the global capital market and it's a tough business. I think that's why a lot of us haven't considered it.

CHAIRMAN NOTTINGHAM: Vice Chairman Mulvey.

VICE CHAIRMAN MULVEY: I know a lot of people are crazy as and getting into the airline business. I'm not sure we're so crazy to start building new railroads, but obviously acquiring a railroad, a shipper acquiring a railroad, would be something that you thought might happen. For example, we had a case not so long ago where a very, very large company was considering bringing a rate case, a small rate case, and the company's revenues are ten times greater than the railroad industry's revenues but I don't think even they considered buying the railroad to solve their problem.

I had a question about this a very volatile industry, Doug mentioned before about maybe we should have had this hearing a year ago or two years ago. Two years ago things were much worst in terms of railroad performance and delays and is it my understanding that today even for grain movements that things are pretty good that rates are down, that a lot of cars are available, and fact you can get cars at below tariff right now because there's an excess supplies of cars right

now?

MR. VOSS: If you said rates are down, that's incorrect.

VICE CHAIRMAN MULVEY: Not rates are down but you can get cars for October, November, December, etc.

MR. VOSS: I think the car supply has freed up. I think Burlington-Northern Santa Fe said yesterday that for the first time in John Davis's history he can remember in 30 years in the business they've had surplus cars for October and November. Cars are available.

VICE CHAIRMAN MULVEY: And when you have surplus cars, what happens to the rates?

MR. VOSS: I have seen no change. I have seen no decrease in them. Maybe I missed one, but I've seen no decrease in them.

MR. LINVILLE: But what I would offer is an active secondary market for freight. So when cars pile up, they trade at discounts. I'll give you an example.

A year ago, post Katrina, to place a hopper car, the secondary market was paying thousands of dollars. Today you can buy cards in the secondary market for less than zero, a couple hundred dollars. Somebody would pay you to take them. So the secondary

market does serve as a mechanism to price those supply demand shifts.

VICE CHAIRMAN MULVEY: That's what I was pointing to. In secondary market you can get cars below tariff, well below tariff right now.

Getting back to something you said earlier, Terry, that you can't hedge transportation. But to some extent you can hedge some transportation by buying in the secondary market though.

MR. VOSS: Just because you buy -- If I want to buy a train from Randy for March, there's no freight rate guarantee with it. I get the guarantee I'm going to have the cars, but there's no guarantee of the freight rate. My hedge for the wheels are there by buying the train from Randy or vice versa. But I have no idea what the freight rate will be for March. We know what we have the corn or beans or soybean meal or whatever product is hedged on the board of trade at. But we don't know what the freight rate is going to be.

MR. LINVILLE: And over time the offerings vary. I mean sometimes railways will offer, I can't remember the terminology, locked cots or something which is rate fixed. Not all carriers offer those, but we've seen innovations like that.

VICE CHAIRMAN MULVEY: But some do offer locked cots, right?

MR. LINVILLE: In some years. I don't know

presently.

MR. WALLACE: I don't think they're currently.

MR. VOSS: I could be wrong. Carriers could answer that. I don't think there's any that I'm aware of.

VICE CHAIRMAN MULVEY: Okay. Thank you.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey. Thank you. We appreciate your time today and we will now release this panel and move onto our next panel which will be a one person panel. If I can invite Mr. Gordon P. MacDougal forward representing the United Transportation Union General Committee of Adjustment. Welcome, Mr. MacDougal. We're delighted you are here and look forward to your testimony. Please proceed.

MR. MacDOUGAL: Thank you. I'm here representing John D. Fitzgerald who represents UTU in Great Falls, the UTU people employed at Great Falls. That's his General Committee of Adjustment. And we have a very limited statement here. It deals with the computation of the freight rate index. I've been waiting to present this for years. Various UTU people have. This is the first hearing where people have gone in to the freight rate index and labor has not liked that index. They prefer the BLS index, Bureau of Labor Statistics, which is the index you use in figuring out the classification of railroads every year. But we have this basically ten mile index

which has been used by the ICC, the STB and now the GAO.

The basis for the study as they say is the rates have declined since Staggers. Of course, they don't start from Staggers. They start from 1985. They eliminate that first five years and you can play with these figures in many ways. The actual fact is and I think most American people will believe freight rates have gone up in the last 30 years. The ICC said no, it's declined 45 percent since 1980 and the GAO says it's declined 20 percent.

Well, they haven't declined at all. They've gone up. They've gone up for grain. They've gone up for the general rate level and there's not much more to add to it. We were not part of the GAO process. We were not invited to their meetings where they discussed with the railroads and with the shippers how to index these things. We were not invited to it.

They know, GAO knows, that Labor has not been happy with the old ton mile index. They like the BLS and the BLS isn't in favor in other parts of the economy and they issue reports all the time. That's what we have to say here. We're glad you invited us. I do want to comment you for having the distribution of the papers in advance of today's hearing. We used to always have that until about four or five years ago, the staff would not distribute the presentations prior to the hearing. So you would know what we're saying, but I

wouldn't know what the next person to me was and it's helpful. This time you've done that. You've made it open. That's very much a plus sign and we thank you for that.

Another thing I want to point out Mr. Buttrey told me something new. I would like to say that the last time the ICC investigated the general grain rate structure, it's been printed, it's at 345 ICC. It was a 3,000 page volume, Volume 345. It's in three parts and there's a big discussion on the grain rates. There's a whole section on grain rates, the whole U.S. grain rate structure. It was finally finalized in 1979 and of course, it's basically obsolete because the 4R Act has intervened and so has the Staggers Act, but you want to get the background to it. I commend you for that case. In fact, I notice there is one person, one lawyer here, not me, but one lawyer in the audience whose name is shown who participated in that case back in the mid 1970s.

That's all that I have to say. One last thing, on the deflater thing raised by Member Mulvey, I think if you're going to have the deflater used location adjustment, there's a big difference in the various agricultural commodities in their pricing and I would not use an average deflater like you do generally. Do it by the product. Because I remember when we did this, you too did this with the Chicago Board of Trade about 12 years ago. We found big difference in the price

increases and decreases among commodities particularly agriculture commodities and I would commend you to look at that if you make any deflater adjustments.

But anyway we think you should use the BLS freight price index as you do for other things in your industry. Use it also for your own rate adjustments. Thank you.

CHAIRMAN NOTTINGHAM: Thank you, Mr. MacDougal. I have no questions for Mr. MacDougal. But Commissioner Buttrey?

COMMISSIONER BUTTREY: I have no questions.

CHAIRMAN NOTTINGHAM: Vice Chairman Mulvey.

VICE CHAIRMAN MULVEY: I just wanted to comment on you pointing out that deregulation did begin in 1996 with the RRRR Act and I think Staggers is very, very important, but I think you're absolutely correct that deregulation really began with the RRRR Act rather than in 1980 with the Staggers Act and that's an interesting and a valid observation.

MR. MacDOUGAL: Can I make one comment on that? I think there's a lot of public relations for saying this is Staggers Act because Staggers was considered a labor-oriented Congressman

and Labor had not supported the deregulation of 1976 and so forth, not really supported it. The problem of the RRRR Act was that the railroads were not coming in and using contract rates in `76 and there's a good reason I suspect because there were very serious anti-trust problems in the shipping industry on it and Commissioner Darius Dacus (phonetic) went out to Arizona and chided every one of the practitioners why aren't you using these contract rates and the answer was we'll do it. The ICC, we'll let you follow those things. The railroads didn't do it until they got legislation and the legislation came in 1980 and that was a major thing, contract rates. I don't want to say that's not part of deregulation. It is.

VICE CHAIRMAN MULVEY: It is, yes.

MR. MacDOUGAL: But basically everything was in place in the RRRR Act.

VICE CHAIRMAN MULVEY: But it's an interesting point. The Staggers, the two big things out of Staggers were contract rates and easing up the ability to abandon unprofitable branch lines. You had some of that.

MR. MacDOUGAL: No, the abandonment standard were the same. In the RRRR Act and Staggers Act, the abandonment standards are the same, public convenience and necessity. Procedurally, there were changes made in abandonments and they had

various things. But the substantive standards of the abandonments did not change or haven't changed today.

VICE CHAIRMAN MULVEY: But interestingly, the contract rates are something of today, may be going away, but the railroads are still deregulated. Thank you.

CHAIRMAN NOTTINGHAM: Thank you, Mr. MacDougal. We'll now move to our final panel and invite the representatives of the four railroads who have asked to speak today to come forward. Give them a couple minutes to get settled.

Welcome. We'll start with Mr. Kevin Kaufman representing the Burlington-Northern Santa Fe Railroad and the floor is yours, Mr. Kaufman.

MR. KAUFMAN: Thanks. We're loading up the presentation. Just give me minute.

CHAIRMAN NOTTINGHAM: Okay.

MR. KAUFMAN: But thank you very much, Chairman Nottingham and Vice Chairman Mulvey and Commissioner Buttrey. We really appreciate the opportunity to be here. My name is Kevin Kaufman. I'm Group Vice President for Agricultural Products for the Burlington-Northern Santa Fe Railroad and I'm trying to do more one thing at once here.

I've been a member of the railroad or joined the

railroad about two and a half years ago. I used to be a Senior Vice President for Louis Dreyfus Corporation, so for 25 years, I was a shipper in a large multi-national AG business corporation. I'm also formerly a charter member of the Rail/Shipper Transportation Advisory Council for which I sat on for six years and that was a great experience. So I have more experience as a shipper than as a railroader.

I want to start by saying that AG is an extremely important part of BNSF and we've always been a railroad that has focused very much on agriculture. We have grown significantly in agriculture and we will continue to grow significantly in agriculture. We would never consider demarketing it and we expect agriculture to continue to grow and we're going to be there.

Unfortunately, we serve most of the western grain areas and so it seems that sometimes no good deed goes unpunished and we get accused of everything short of starting the Iraq War. But of course, the truth is a little bit stranger than fiction and we think we have a pretty good record and we'd like to share that with you at this time.

You know the Staggers Act changed everything and the railroads became more efficient and suddenly they were able to follow market signals and appropriately size their capacity to the market. The fact is that Staggers is working and the GAO has said so

in their report. The most important thing that's happened is the railroads have regained their financial health and they now have capital with which they can now invest.

You know as all of us know, capital is linked and correlated strongly to returns and so it's not surprise that the railroad investment is closely tied to the returns it receives from its business. And so it's not a big surprise that last year we managed to get to a 10.1 percent return on investment which for the railroad is fantastic. For the rest of the world in the equity business, it's not very great. But for us, it was great and so we see record investment last year of $2.6 billion.

So what's happened with that? You see the result that we've invested in brand new grain-covered hopper cars, in fact, over 18,000 of them and more particularly since the year 2002 we've invested in a tremendous amount of cars. In addition, we've invested in locomotives. While that's a total locomotive increase of fleet for the railroad, AG itself, the locomotive fleet in the last couple years has increased over 30 percent. So again if you look at what happens with a very key investment for AG which is cars, it's directly correlated to the returns that we're getting.

So what happens? In addition to making significant investments in cars and locomotives, the railroad has focused very hard

on how do we become more efficient and more effective and those are operational design changes in order to make the railroad more efficient. So as Terry Voss talked about, you want to look at the impact of velocity in miles per day and the impact it has on what we can offer to our shippers, it looks like this.

Back in 2000, we had a lot more railcars than we have today, but today with fewer railroad cars we have a huge amount of additional capacity. So the result of that capacity has been that we have been able to carry the additional growth in especially the corn and bean markets that we've seen in the last three years and our growth reflects those increases in productivity on the farm.

One of the ways we've done that is by introducing, and this has gone on for some years but it's accelerated in the last five, is a shuttle train. Now why is a shuttle train such an important instrument? It's simply because it's a very effective way to move bulk products. Here we have an example of where a shuttle train, those cars will get almost three trips a month. It averages about 32 trips a year. So here we have cars that are turning three times faster than a non shuttle car.

What does that offer to the agricultural marketplace? An extraordinarily huge amount of additional capacity and I would submit to this panel that if we had not done that, we would no way have

been able to move the amount of agricultural products that the market has demanded.

Now many of those criticized us and said perhaps then that we're doing it at the expense of the non shuttle shippers or the small shippers. The reality is again truth is better than fiction because while approximately 30 percent or 12,000 of our cars are dedicated to the shuttle business which is carrying 60 percent of our car loads fully, 60 percent of our cars are only carrying 30 percent of cars or 18,000 and you can see that we've significantly grown our non shuttle capacity as well.

In fact, what's more interesting today is the way we break out these 18,000 cars is we actually have guaranteed segments of those cars for certain small shippers. For instance, eatable beans and peas and lentils, they have 3,000 cars a month set aside specifically for those kinds of processing businesses. So how many of those cars have they been using? About 2,000 cars a month and so we've been sitting with excess capacity.

In addition for small shippers who might not want to use our cot program or our other programs, we've set aside 2,000 cars of tariff orders a month. How many of those have been booked for the month of November? Almost zero. How many of those were booked for the month of October? About 100. So we are in a position today

where because of the velocity increases and because of the investments we've made, we actually today have more capacity for the non shuttle shipper because these numbers when we talk about the numbers of breakout of these cars and the improvements in velocity and service, it's all about the non shuttle shippers because the shuttle shippers, those trains are turning. By definition, they're never theoretically late.

So what's happened since 2005? We've had a huge increase in the amount of capacity that we've been able to carry. Now when you look at 100,000 cars what that means is when we started out a few years ago, we were shipping about 90,000 units in our AG business and so 100,000 cars. That's a huge increase in capacity for the agricultural shipper.

Now at the same time and this is the rest of the story which is about velocity as well, our services improved dramatically and what's remarkable is how little has been talked about this is that if you ask our shippers this year whether there have been any service problems in macro because there's always somebody that might be disappointed in micro case, our service has increased dramatically. In fact, today there are less than 1,000 orders that are late and those orders that are late are less than six days late. So if anybody wants to order a car from us today, they'll get it immediately and we'd be happy to invite them to do so.

Now when we look at cost, we like to look at the investment we made in railcars and we like to think about what changes in those cost. Since 1980, those costs have increased 79 percent. In nominal terms, our rates have increased 15 percent. Now I know we've taken issue when we compare this with other farm input costs and I understand that transportation is a greater percentage of some of those other costs, but still it's illustrative that when you compare what transportation costs have done compared to other costs, it's still we consider transportation to be a real bargain.

Now when you look at it in real terms, I'm sorry, but our rates are pretty much unchanged from the time of 1981 in real terms and now we sometimes talk about RCF (phonetic). If you look at RCF, the problem is it doesn't necessarily assume that any productivity gains will be shared. We of course would not be incented to invest if we didn't share in some of the productivity gains.

So inflation has far exceeded what our rates have done. In fact, if you look at one particular market which is wheat, rates have declined and in fact, rates have declined across the board whether they be shuttles and shuttles are a function of productivities passing on, but also single car rates have changed too as some market rates have been changed. And further when we look at how our rates compare to other places, if you look at like markets versus like markets,

in other words, export markets to export markets, you'll see that the northern part of our country despite the fact that it would be indicated that they are "single-served" that the rates are not significantly or materially different than any other part of the country.

So the problem is we spend a lot of time talking about old news and old news, there's been significant changes since 2004. Our service has improved significantly. Rates in the case of wheat have come down and we would like to talk about the fact that our service this year has been excellent. I think if you ask people to talk about it sincerely they would have to say that the service has been excellent and in fact, we have had members of these same groups who are actually interested in submitting testimony to you in written form to talk about the fact that they are actually quite satisfied with our service and not necessarily in agreement with some of the testimony that has been submitted.

The other issue that Terry brought up which I appreciate him doing so is that we work very closely and we want to thank Commissioner Buttrey for this because over a year ago he encouraged us to go out into the country and work with the producers and in fact, in the State of Montana, it's another good news story. They're actually encouraging us to find ways to build additional shuttle facilities so that there can be an improved gathering network in the

State of Montana and we are doing that. In fact, one facility will be announced within the next month and we're working on two others. So we very much appreciate the ability to work with the state producer groups to work on these things.

The other thing we wanted to mention in our testimony and perhaps the Canadian railroads will talk about this a little bit more is that the Canadian system and the U.S. system is totally different. So when we cherry-pick pieces of it, we really are not doing ourselves a very good favor of being thorough in our analysis. So what we did was we commissioned a study in order to look at just the fact of which producers are better off, the U.S. or the Canadian producers. And it's very, very clear that in the last few years the Canadian producers are far worse off and in fact they're declining compared to their U.S. counterparts.

There's no question the Canadian rates are no longer cheaper than U.S. rates. In fact, at the 1,000 mile level, Canadian rates are the same as U.S. rates. This is again old news.

So if we kind of get to the go forward, we think we've been extremely reasonable, proactive and we've seen the results of what happens when we get reasonable returns. It motivates investment that increases capacity, that increases service to our customers and it certainly adds value to them. We think we've been reasonable and

responsible and we're excited about the future of agriculture because we think it's even going to be better.

So if we look instead of looking to the past, we look to the future, we like to think we know we're going to continue to invest in agriculture. We like agriculture and we anticipate big growth in agriculture whether it be ethanol or the other products and we're prepared for that growth and we are committed for service and capacity to further improve. But from the standpoint of these rate issues, we as we testified in our filing on the small rate case, we are completely supportive in the STB's look to try and make their judicial review process more accessible for small shippers. We are frankly tired of the rate debate because what it does is it takes away from our ability to work with our shippers, to talk about how can we improve service, how can we benefit their business, how can we improve their businesses. The whole rate debate tends to take away the positive look-forward attitude that we would like to have in the future.

So we applaud the Board's efforts in these areas. We encourage you to look at these things and we'll be supportive of those actions. We thank you very much for your attention and allowing us to testify at this hearing. Thank you very much.

CHAIRMAN NOTTINGHAM: Thank you, Mr. Kaufman. Next we'll hear from Jean-Jacques Ruest and Wayne

Atamanchuk from the Canadian National Railway Company.

Welcome.

MR. RUEST: Thank you, Mr. Chairman and the Board members. My name is Jean-Jacques Ruest. I'm the Senior Vice President of Marketing at CN and I've been involved in the grain industry only since last May. With me today is Wayne Atamanchuk. Wayne is our Assistant Vice President of Bulk Marketing at CN and Wayne has been involved the bulk industry for quite a few years.

I will not repeat what the Board read in our written filing, but I would rather concentrate on some of the points the Board was especially interested in namely the interplay between the American and Canadian wheat market and how the regulatory system differs from both countries since CN is in a rather unique position of doing business rather extensively in both countries.

The Canadian grain market and the Canadian grain transportation market differs very significantly from the United States. First, the grain market and the land transportation supply train market is dominated in Canada by the export grain. More than half the volume is export grain and definitely a lot of the attention goes to the export market in terms of all the stakeholders.

Second, the Canadian Wheat Board which is a single desk marketing monopoly that controls all wheat and barley exports

outside the country. They have the only export program. Also the Canadian Wheat Board is also including the nomination of land logistics transportation, therefore they're very involved. The logistics transportation on land is done for the export market.

Having said that, the Federal Government is reviewing whether or not what will be the role of the Canadian Wheat Board as a single desk mandate for grain and we'll see in the next year whether that changed or not, but that might be evolving.

A third major difference is the Federal and the Provencal Government have collectively invested and own 16,000 hopper cars for their grain export trade and these hopper cars are older and smaller in general than the comparable hopper cars in the United States.

There is another major difference between the U.S. and the Canadian systems when it comes to transport wherein the U.S. you have a much younger fleet and bigger fleet and it's all private. However, here again as a fleet is getting older and the government is looking at reinvestment time, it's not obvious that neither the Provencal or Federal Government will invest in the fleet and that model will probably change and evolve over time.

Fourthly both CN and CP as both Canadian regulated railroads are subject to a complex revenue system called the Revenue

Rate Cap and the revenue cap only applies on export grain which as I said earlier is a major part of the business on the grain side. Export grain moving to the Canadian port, whether a western port or and east. That is to say that the pricing that we can charge for a customer is regulated to the extent that the overall revenue that you would collect over a crop year from August to August is capped by a formula of tonnage and mileage. The more tonnage we move and the more mileage we move, eventually you generate your cap and at the end of the year you file all your tonnage and mileage and you file all your revenue and it is a cap system that puts a cap on how much you can collect from the marketplace.

Finally, since CN/U.S. grain business is mostly comprised of corn and soybean and since the Canadian grain business that we move is mostly comprised of wheat and cannola, there is minimum interplay between the two countries as far as the wheat market goes because of the location of our U.S. rail line which is mostly in the Midwest and the natural divide of the crop being grown around our line which is mostly corn, soybean and very little wheat, the interplay at least at the CN level is quite limited.

However putting all this aside, the bottom line is CN is focused on efficiencies in both countries and that's when you're working in a very regulated environment or a not so regulated

environment. This crop season we have moved about 20 percent carloads of grain and grain product in the July to September period with our U.S. network and we project a double-digit carload growth for the same period of October to December period depending on the crop price for those export market.

At CN, we have a transportation model on the view that the overall supply chain is what matters the most. Therefore, what's happening and how we connect with the country elevator, with the rail ourselves, with the export port elevator, not just the rail portion and today we've had a lot of discussion of the rail portion, but the supply chain capacity and pricing is really a combination of all these elements, not just the rail.

We need to be an efficient, seamless, interconnecting supply chain. To view regardless of the regulatory environment, we may need the maximum efficiency that comes as a result of a balanced network, seamless interface with a port elevator, seven days of operation of the elevator in the country, seven days of operation of the railroad to the port and seven days of operation at the port by the port terminal operator, very high payload railcars, high efficiency unit train or high efficiency merchandise train which would have blocks of grain on them like we do for half the business that we do on the grain side and to the extent possible, to smooth out the seasonal peak of the crop.

The crop grows once a year, but it's consumed over a period of time and I think barley, an example that was made, those products obviously truly have limited seasonality compared to the effort to bring that product to market. That creates the best cost and price value proposition, looking at the capacity in total for the whole network including the non rail part and that creates also carrying capacity.

You talked about innovation this morning. I wanted to just make one small point. The hearing today, we talked about the specialty crop market which typically it works in smaller volume to a carload type and at CN, we're experimenting to promoting a specialty crop export by loading part of the containers that are coming back at us from Asia and going back into Asia and use some of that to move specialty crop. This month we're opening a container plant facility loading in Edmonton, Alberta which is the middle of a nice growing area to move specialty crop back to Asia and it is one form of capacity which truly utilizes all these containers coming in and a lot of them going back empty and using capacity of the rail line and the corridor and there surely is a way to use more of that for products including specialty products.

On that note, if you have questions for CN we would be glad to answer those.

CHAIRMAN NOTTINGHAM: Thank you very

much, Mr. Ruest. Next we will hear from Judy Harrower representing the Canadian Pacific Railway Company. Welcome.

MS. HARROWER: Thank you. I'm just going to get our slides. Chairman Nottingham, Vice Chairman Mulvey, Commissioner Buttrey, my name is Judy Harrower and I am Vice President of Marketing and Sales for Bulk at Canadian Pacific Railway Company and thank you very much for giving us the opportunity to appear today in front of you.

Now in my written statement is in response to the issues raised in the Board's orders scheduled for this hearing, but during my testimony today, I will focus on three principal points. First, I will speak to GAO's conclusion that rail rates for grain are rising to a greater degree than rates for other commodities and talk about how that is not consistent with our current market reality. Second, I will explain how CPR rates for U.S. grain traffic are constrained by a variety of factors. We face direct rail competition with Burlington Northern through our U.S. grain service territory and barge and truck competition to certain end markets and we need to keep CPR served producers competitive in national and grain world markets. Third, I will describe how CPR has responded to the changing needs of North Dakota grain shippers by investing heavily to develop improved rail services for shipments of grain from North Dakota to the Pacific

Northwest.

So first the GAO report and I know we've heard a lot about this this morning, so I'll be brief. The GAO report found that rail rates for grain increased by nine percent from 1985 to 2004 while rates for most other commodities were declining. The Board, of course, has correctly observed that the increase suggested by GAO and it was confirmed this morning was a nominal increase that takes into account no inflation.

I've shown the same slide. In fact, it was also shown this morning through the GAO presentation which is a copy of Figure 4. It clearly shows that the grain rates which are the blue rates lagged inflation significantly which is the dotted yellow line at the top.

The second key point I'd like to make is that GAO's findings certainly do not reflect our current market conditions. As my written statement shows, most CPR rates for wheat have been declining and are lower today than they actually were in 2000. Our rates for eastbound corn and soybeans have actually remained relatively flat and in fact the only category of our U.S. grain business that has seen increases over the last few years is westbound corn and soybeans. As I will discuss a little bit later, these rates increases are a natural market-based phenomena to soaring demand for transportation of corn and soybeans to Pacific Northwest export terminals and of the

substantial investments in capacity expansion projects that we've made in order to meet that demand.

Overall, the revenue earned by the Canadian Pacific Railway on all grain shipments in 2005, this is all grain shipments, is approximately 2.4 U.S. cents per ton mile. If you think about it, we move a ton of grain for the typical customer for about 2.5 cents a mile. By comparison, USDA has estimated that it costs the typical farmer in CPR service territory approximately 10 to 12 cents per ton mile to transport grain by truck from farm to local elevator and about $4 per ton for elevation and handling at the local elevator. Our rates for line haul transportation we think compare favorably to these other logistics costs.

Furthermore, even if the nine percent increase in rail rates claimed by GAO were accurate, that increase as we've seen earlier today a couple of times as well, would pale in comparison to the increases in other farm production inputs during the same period. This slide shows that according to the USDA between 1992 and 2005 the cost of seed increased by 68 percent, fertilizer by 62 percent, farm machinery costs by 71 percent. During the same period, farm wages increased by 65 percent and the cost of fuel increased by 124 percent. So as this slide shows increases in other agricultural production costs while they may not be of the same total cost have far outstripped any

claimed increase in the cost of moving rail transportation which is depicted on the far righthand side of the slide.

Moving onto my second point that CPR's U.S. grain rates are constrained by a variety of competitive factors. First and foremost, all grain shipments do begin in a truck. This slide depicts our grain gathering network and as you can see BNFS lines which are in green parallel almost all of our network.

The testimony filed last week by a number of North Dakota grain interests in Ex Parte No. 646 says that "the typical truck movement from farm to elevator in North Dakota is approximately 10 to 20 miles." Two-thirds of all of the U.S. grain elevators that we serve are located 20 miles or less from a BNFS served elevator. So our rates are clearly influenced by the availability of competing rail service from BNFS served elevators.

As I discussed in my written statements, rates on grain shipments to the Gulf of Mexico are also influenced by the availability of barge transportation from the Twin Cities and rail rates from eastern North Dakota and Minnesota to the Great Lakes' terminals are constrained by truck competition as well.

Lastly, grain originating on CPR's lines must compete in end markets with grain originating in other states, in Canada and aboard. We cannot price in a manner that would eliminate

our grain shippers from those markets because we would lose the business and as I will show you in a few moments we've grown the business substantially which is an incredibly important piece of the business for us. So product and geographic competition are very important factors in the real world grain transportation marketplace.

Moving onto the third point, our response to changes in North Dakota grain production and transportation demand. As my written testimony explains, grain production in the territories served by CPR has undergone significant changes. As this slide shows, since 1996 wheat and barley production in North Dakota have declined sharply.

During the same period, corn plantings grew by 133 percent and soybean plantings by 347 percent. One of the key drivers in this shift has been growing demand for U.S. corn and soybeans in Asian end markets. This phenomena triggered a dramatic increase in demand for rail transportation of grain especially corn and soybeans from North Dakota origins to Pacific Northwest ports.

CPR responded to that demand by developing an improved interline rail service to the Pacific Northwest in conjunction with the Union Pacific. This interline route which is depicted on this next slide shows how export grain traffic moves from CPR elevators in

the U.S. to the Canadian border point at Portal, North Dakota then via our Canadian line to Kingsgate, B.C. where we interchange it with the Union Pacific for delivery to Pacific Northwest grain terminals. To support this routing option, we made a number of substantial investments in infrastructure and equipment. We invested approximately $40 million in our line between Dunmore, Alberta and Kingsgate and you can see Dunmore on the line. It's tough to see, but it's under the middle yellow arrow just above Coutts. We also expanded our yard and track facilities at the Portal and Kingsgate border crossings to increase their daily capacity. We acquired a number of locomotives to support shuttle train services with dedicated power between North Dakota and the Pacific Northwest and we have partnered with our short line connections, the Dakota, Missouri Valley and Western Railroad the Northern Plains railroad to help them upgrade their grain gathering lines. And finally, we've assisted a number of the elevators we serve in increasing their capacity so that they can take advantage of the more efficient train load rates and services.

The results of these initiatives have been impressive. The next slide depicts the growth in both the overall exports from North Dakota to the Pacific Northwest and the increase in the volume of North Dakota grain moved by CPR to the Pacific Northwest since

2002. The blue bars show that the overall movements from North Dakota to the Pacific Northwest increased from 75.5 million bushels to more than 122 million bushels over the past four years. As the red bars show, CPR's grain traffic from North Dakota origins to the Pacific Northwest have grown from 23.1 million bushels in 2002 to 51.6 million bushels in 2005 and indeed as the narrow lines on the slide show CPR's grain traffic to the Pacific Northwest has grown at twice the overall rate of growth in all shipments from North Dakota indicating to us that shippers have responded favorably to our improved and more efficient service offering.

As I mentioned earlier, CPR's westbound rates for corn and soybeans have increased during this period, but those rate increases are an example of exactly how the market should work. An increase in demand for corn and soybeans created an opportunity for North Dakota farmers to participate in a growing export market. This in turn triggered an upsurge in demand for rail service from North Dakota to Pacific Northwest export terminals.

We responded to that demand by developing improved interline service in conjunction with the Union Pacific and by investing in additional infrastructure and locomotives to serve this traffic. We adjusted our rates to justify those investments and to reflect the strength of demand for our rail services. As this slide

shows, CPR's rates have not hampered North Dakota's participation in the growing export market. Rather we believe it's been a win-win for all stakeholders. Thank you very much.

CHAIRMAN NOTTINGHAM: Thank you, Ms. Harrower. Our final witness today will be Mr. Douglas Martin from the Union Pacific Railroad Company. Welcome Mr. Martin.

MR. MARTIN: Good afternoon. My name is Doug Martin and I'm Senior Business Director of Wheat and Flour for Union Pacific. I appreciate the opportunity to address you today concerning the issue of grain transportation and rates provided by Union Pacific to our grain customers.

As a preface to my remarks, I'd like to emphasize that UP views agricultural products as an important part of our overall business mix as well. We take our responsibility as a part of the overall grain supply chain seriously, weighing the decisions that we make each day as to the impact they will have on our customers, our employees and our shareholders. I filed an extensive statement discussing UP's grain business and I'm not going to try and go over the whole statement here. I'll just focus on two points today, competition and pricing.

Railroads in general, Union Pacific, in particular operate in a highly competitive marketplace for grain. One cannot

look at competition simply by looking at rail options. As Judy mentioned, all grain transportation starts in a truck at the farm and competition for it all starts there. In that truck, the grain can go from the farm to an elevator served by UP or an elevator served by one of my rail competitors at a location nearby or even fairly far away. It can also remain on the truck and go to a barge terminal or even direct to grain processor like a flour mill, ethanol plant, crushing plant, feed lot.

UP competes against other railroads and other modes by inducing the farmer to deliver grain to an elevator we serve. We do this by offering rates to those elevators that enable the grain merchant there to offer as good or better price to the farmer than other competitive options.

One of the mechanisms we utilize to do this is through shuttle trains. Shuttles enable us to move more grain more efficiently at the lowest possible cost. If we fail to offer rates that are market competitive the farm truck will simply pass the elevators we serve and seek the best price in the market less the cost of delivery.

Just because a single rail carrier serves a particular elevator does not mean there is no competition for the grain. In fact, elevators served by just one railroad have always been common. Single carrier access is not the issue that some might have you believe. It is simply not possible for UP to systematically charge higher rates at

locations where we are the only serving railroad. If we attempted this, grain from the farm as previously stated will flow pass elevators we serve to an elevator served by a competing rail carrier, another transportation mode or a truck direct to an enduser. Differentially higher rates for these shippers is a self-defeating strategy for us.

Competition hasn't lessened. It's really stronger than ever. It certainly is more competitive today than the pre Staggers era of rigid regulatory restrictions and collective rate making through railroad rate cartels. Mergers have given grain processors, grain producers and users more rail options, increasing access to more markets for grain producers and more production sources for endusers.

The GAO report indicates that rail prices for grain have increased by nine percent in the period of 1985 to 2004. First, this increase is actually a decrease in real dollars. As was mentioned before, GAO didn't take the increases in the general price index into account. Grain rates at the end of 2005 averaged 48 percent lower in real dollars than in 1981. At Union Pacific, we certainly haven't taken price increases even recently that get us back to 1981 levels in real dollars.

Secondly, recent rail grain price increases do not imply a lessening of competition. In competitive market, prices go up when demand increases relative to supply. This is true in grain

markets as well as transportation markets. If ethanol driven corn demand continues to increase and production fails to keep up for some reason with that demand, corn prices will rise. Our markets have to go up if we are to keep up with recent and future traffic growth.

Gone are the days when we had ongoing excess capacity and it made sense to set relatively low rates to use as much of that capacity was we could. Today traffic has to pay for the capacity it consumes, both new and existing traffic. The cost to add capacity in line, terminal, locomotive equipment and labor to handle increasing volumes when capacity is constrained is higher than was the cost of filling the unused capacity we used to have.

Just to keep up, existing infrastructure must be replaced at today's prices. New capacity must be added to handle growth. However, no competent management is going to invest in any venture if the returns available are below the cost of capital. The only way to attract investment necessary is for the returns to be there. If not, investment in the rail industry will inevitably decline and as infrastructure wears out, service will decline and capacity will shrink.

We have managed to maintain the capacity in our grain network over the past 20 years, but it is only in the last few years that we at UP have been investing and increasing that capacity based on the prospect of increased grain and grain products volume and rates that

will provide an adequate return on our investment.

Thanks for your attention and I guess as the last speaker on the last panel of the day, I'll turn it back over to you guys for questions.

CHAIRMAN NOTTINGHAM: Thank you. Thanks to the whole panel. Boy, I'm sort of reminded of the great Dickens piece of work, *A Tale of Two Cities*. We heard two very different depictions of what's going on out in the world between this panel and the other panels. It's interesting but somewhat frustrating as well because we're here to try to get to the bottom of what's happening and, Mr. Kaufman, if I could ask. In your opinion, you've working sort of both sides of the street so to speak on this issue as you said and what would it take to bring a little more peace and harmony out there in your customer base and your customers' customers? If you cut price rates in half, do you think that would end the need for hearings like this in the future or just hypothetically, what can we do? What can be done?

MR. KAUFMAN: I think there's no question that there's been a lack of communication in the past. I mean we have not been very good at communicating down. I think in fact Mr. Whiteside mentioned this. I mean the people who pay are afraid by the large elevators and the companies and historically I think the railroads

haven't engaged very well with producers who ultimately it is a pass-through and they end up paying for it. So part of the thing and I was a little bit sorry that we didn't hear a little bit more positive comments about the results of the reach-out that we've made to our producer groups, but it's certainly communication.

But the other thing is a lot of the gas would be let out of the balloon if the producers really felt like they had access to a judicial review process that worked. Like I said at the end of my comments, I would be thrilled to not have to spend a lot of time arguing about whether our rates are too high or not because it's an inherent conflict of interest. I mean they would prefer, our shippers would like rates to be zero. We'd like them to be infinity. Also there's an inherent conflict of interest right there and we would rather like to spend most of our time talking about how we can add value and service and that kind of thing.

Now there's no question there's a correlation between rates and investment and so there has to be an investable level. Otherwise, the result would be you don't have enough justification for more capital investment. And that's what I tried to show. We've invested a lot of money in AG and our service has improved dramatically. We've added a lot of value.

CHAIRMAN NOTTINGHAM: I'm very interested

to hear of your support for simplifying and lowering barriers and making it earlier to pursue claims for rate disputes. That's something we've obviously very focused on here. I would be curious to your colleagues on the panel to share that. Should we be expecting lots of litigation from you guys when we announce whatever we announce or are you here today to make some news and say no, never?

PARTICIPANT: Never say never.

MR. RUEST: I think in the end each issue needs to be resolved. Each issue if it festers too long, it becomes bigger than what it is. So whatever it's those processes or other processes there has to be a way to come conclusion and then move on. And sometimes the issues in the end are not that big and become big just to become big because they've festered for too long and that's kind of the experience that we have is being able to close issues and move on. Then you can move a whole lot more grain that way.

CHAIRMAN NOTTINGHAM: Anyone else like to take a stab at that one?

MS. HARROWER: I would agree that timeliness is key in terms of diffusing issues that come about. In terms of how the whole process unfolds, I think it will be interesting to see how that happens. But I think timeliness is going to be a key factor in terms of going forward on the specific approach you're trying to take and as well

as solution comes about. It has to be a timely solution for the shippers and for the railways.

CHAIRMAN NOTTINGHAM: Vice Chairman Mulvey.

VICE CHAIRMAN MULVEY: As long as we're referencing 19th century authors, I'll recall Mark Twain with his lies, clamn lies, and statistics. You obviously came up with observations using the same data very different fromGAO's. Obviously you don't agree with GAO's conclusion that grain rates have gone up more than other commodities. But could you reconcile what GAO did with your own findings and why or where do you think GAO went wrong in its findings to the extent GAO was saying that grain rates have gone up disproportionately and unfairly?

MR. KAUFMAN: I think, Vice Chairman, one of the problems with the study is it uses old data and there's been a lot of changes since 2004. I think we submitted some corrections to the record on some of the issues. It's a big study. They're very smart people, but it's a very complicated industry. So I don't think any of us expect them to perfectly understand the business and especially it's not just about the railroad industry. It's about the peculiarities of the grain industry.

We all know that the grain industry as a whole is a

very complex and difficult business and nobody in my mind has ever been able to write a tome of any kind that really adequately described the way the grain business and that's why it makes it particularly difficult for the railroads to engage on the grain side because it is so dynamic and ever changing and it is so market-volatile that it's a constantly changing picture and it's just a credit to our industry that we've been able to get it mostly pretty good. But at the same time, there's no question that there's haves and there's have nots and that's part of the market process and that's also an issue of time.

VICE CHAIRMAN MULVEY: You mentioned about improvements in service. You showed us metrics that you pointed out in your presentation. But to some extent those improvement are coming at the cost of changing who you're serving. In other words, you're getting better speeds by not serving the small, single car shippers or not serving the smaller elevators. If you're focusing just on the shuttle trains and the unit trains it's easier to get better results overall on average they are better results, but if you average zero and infinity, it's still infinity.

MR. KAUFMAN: I really appreciate that question because again here we have, let's just say for illustrative purposes, 30,000 cars and we have 12,000 in shuttle service and 18,000 in non shuttle service. So it would be incredibly wrong for us to sit there and

say we have 18,000 cars in assets. We're just let them kind of float around and do a cruddy job of providing any return for the railroad.

So the fact of the matter is we've actually significantly changed the way we handle that business. For instance, I can give you specific illustration of that it wasn't so long ago that we got less than one turn per month out of these cars, in fact, to be precise 0.89 turns. Today we're almost up to 1.2. Now that doesn't sound like much on the decimal basis but with 18,000 cars, it's a lot of additional capacity and it's one of the reasons why there is excess capacity today.

So the railroad has actually changed the way we handle those cars. We put them in merchandise network access in a similar way that CN handles them and we've gotten much bigger velocity than just setting the agricultural cars aside waiting to match them up to move them as a whole agricultural train. So the answer to your question is we are working even harder in improving the service on that and we're proud of that.

VICE CHAIRMAN MULVEY: The shippers said before that despite the fact that excess capacity is developing in the grain car market grain fleet, they're not seeing reduced rates. Is that accurate?

MR. KAUFMAN: Here's the deal of course. In

reality when we spent a lot of money on cars and they sit around, our costs actually go up. Right? Okay. So there's a tremendous burden for us to right size the fleet every time and the problem with the grain business of course is the farmer wants to sell here. Oh, this year he's not going to sell here. He's going to sell there and right sizing is very difficult. So again, volatility demands a different sort of compensation. So the reality is our costs actually go up.

MR. RUEST: If I may echo that point, when you're looking at investing in railcars, you're looking at the railcars for not over a trip or just over a year. So you're looking at a contribution for a car on the movement, the faster the cycle, the less money you need to make on that movement. But if in between movements, you get months of no movements, your costs go way up because really you should not be short-sited and think that when the car sits, it's free. Somebody has to be paying for that investment. Otherwise you won't invest again. So when you look at a business which is seasonal or two seasonal, you have the issue of who will take the risk of these idle days and in the end the user of the car movement and paying of idle days as well. So a model whereby you invest in extra crews, extra equipment, extra cars for a peak is not really financially sustainable because probably that peak is going to be very costly to either the investor who is making a mistake or the buyer is going to be paying dearly.

MR. MARTIN: And our problem also is that the seasonality is not even predictable anymore. It used to be that there were typically car shortages around harvest periods which logically occur about the same time every year. Anymore, there's enough vagaries in the marketplace based on export demand and a number of other factors that the timing of the peak demand periods has changed and changes from year to year.

MR. RUEST: We want that business, but the last car may not be possibly viable for the condition. It's also like when you look at an extra unit train that's offered you this week. When you look at a shuttle service or something that looks like a shuttle, you only run your shuttle service as conveyor belt. It's going to a port and there's no point putting more cars in the country to load to go to that port if that port is not unloading what it has. So you should run, at least in our minds, your conveyor belt based at the port to unload because the port could be the bottleneck and if the port is a little slow at unloading, then you have a lot more train to be given to you. If the port is unloading very fast then you can speed up the conveyor. But as soon as the conveyor slows down, it's not so much that this extra train offered to you are not profitable. It just has no point putting it in the conveyor because the stuff is not moving well at the port.

CHAIRMAN NOTTINGHAM: Commissioner

Buttrey.

COMMISSIONER BUTTREY: Thank you, Mr. Chairman. Mr. Kaufman, you mentioned about the fact and I know you might not be able to talk about this in public because maybe some of this is still being negotiated and I wouldn't want to ask about that, but you mentioned two other, I think, you said shuttle loading facilities in Montana. Is that in addition to Fort Benton or is that including Fort Benton?

MR. KAUFMAN: It's including Fort Benton.

COMMISSIONER BUTTREY: Including Fort Benton. So it's Fort Benton and one other one.

MR. KAUFMAN: Right. It's actually not in Fort Benton but it's on that line.

COMMISSIONER BUTTREY: Right. I forget the name of the town where it actually is but I call it Fort Benton because it's easy for me to remember. Will this addition of rail service, I know Fort Benton is not, but will this addition of another shuttle facility be on a rail line that's an already active rail line or will it require you to reactivate some line that hasn't been used in recent history?

MR. KAUFMAN: Actually it will be on a short line.

COMMISSIONER BUTTREY: It will be on a short

line. Okay. What percentage of the car loading that you have do you think is touched by a short line railroad?

MR. KAUFMAN: You know I don't have that statistic, but it's interesting though that our largest shuttle loader is on a short line. So I can't tell you precisely how many cars.

COMMISSIONER BUTTREY: Do you mean the largest in terms of loading facilities or track --

MR. KAUFMAN: Total cars.

COMMISSIONER BUTTREY: Or do you mean the one that produces the most volume?

MR. KAUFMAN: Exactly.

COMMISSIONER BUTTREY: The one that produces the most volume is on a short line.

MR. KAUFMAN: Right.

COMMISSIONER BUTTREY: And how many different short lines do you interchange with?

MR. KAUFMAN: Of course, I'm going to miss some and so somebody's going to be offended, but for instances, DM&E is one of the railroads that actually has the largest shuttle loader on it. RVW. There's the Yellowstone and Western Railroad and Montana. I mean we have a number of short line partners and we work with them because they have customers on there and if they have

the density of grain produced in that area then we work with them. We actually drive the shuttle on their line with our locomotives right to the origin. It gets loaded and it just pulls out.

COMMISSIONER BUTTREY: And I presume you're moving some coal on those lines as well or is it just almost exclusively grain?

MR. KAUFMAN: In this particular case in the grain business in our grain areas, it's -- Mostly the short lines I'm talking about are moving grain.

COMMISSIONER BUTTREY: The Canadian Grain Board is like a nonprofit corporation, quasi Government corporation. Is that basically a good description of it or do you have a better one?

MR. RUEST: You know I'm not too good in my understanding of what the board is. It's really run for the farmers and all the money one way or another after all the costs are deducted, it's going back to the farmers and in the price that they get for their product at the port.

COMMISSIONER BUTTREY: So if they miss it in terms of the margin on what they're paying and what they're actually collecting when they sell the grain and they're selling it on the global marketplace. So there's probably room there for some fairly large

fluctuations between what paid for the grain up front and what they sell it for. Since they're not allowed to make "a profit" that money goes back to the producers using some formula or something?

MS. HARROWER: It goes back into a fund.

MR. ATAMANCHUK: What they will typically do because of the vagaries of the market and it's tough to pay the price for the entire crop year is at the beginning of each crop year they will establish an initial price. So any farmer who's delivering wheat or barley to the Wheat Board and the price will vary by pools. Barley is different than wheat and then they sell through the year. And if they're selling for more than that or less than that and if they're paying additional costs for handling or that, they pool all those costs and at the end of the year, they'll make a final payment to the producer on the basis of their deliveries in the simplest fashion that I can explain.

MR. RUEST: The final payment is how this whole thing gets resolved.

COMMISSIONER BUTTREY: I'm sorry. What was that?

MR. RUEST: The final payment is how this whole thing gets --

MS. HARROWER: Gets resolved.

COMMISSIONER BUTTREY: Like a

clearinghouse.

MS. HARROWER: Yes.

COMMISSIONER BUTTREY: And they do that on an annual basis. So the whole system starts over again August of the next year.

MR. RUEST: Yes.

COMMISSIONER BUTTREY: Some people make a lot of this baseball arbitration issue that's been mentioned a couple of times today. Any time you discuss this issue, the baseball arbitration issue comes up. Am I correct in saying that the raw number of baseball arbitrations that are filed if you will, requests for arbitration are filed, is a public information kind of thing or is that publicly known or is that a secret between the railroad being filed against and the person filing the claim? My understanding is that to my surprise actually there are very few of these.

MS. HARROWER: That's correct.

MR. RUEST: I think the number may be public but each decision is confidential and the number of FOAs I would think is probably the public domain. But the conclusion of each FOA, the outcome, is confidential.

MS. HARROWER: That's correct.

COMMISSIONER BUTTREY: Is confidential. Is

the number that had been filed with any particular railroad confidential?

MS. HARROWER: No.

COMMISSIONER BUTTREY: That's public.

MS. HARROWER: Yes.

COMMISSIONER BUTTREY: Am I correct in assuming, in my assumption or my understanding, not assumption, understanding that there are very few of these and I'm talking about less than two dozen a year or less than a dozen a year or something like that or is that in the ball park?

MR. RUEST: It's very few.

COMMISSIONER BUTTREY: Is that in the ball park?

MR. RUEST: Yes. On that basis, it's very few.

COMMISSIONER BUTTREY: I'm sorry.

MR. RUEST: It's very few.

COMMISSIONER BUTTREY: Very few.

MR. RUEST: -- the whole size of the marketplace that's the whole number of contract negotiated all the time. It's used on a fairly limited basis.

COMMISSIONER BUTTREY: On the CP, do you have any idea how many cars, the total car loadings you have, what

percentage would be handled by in first instance a short line railroad?

MS. HARROWER: I was afraid you were going to ask me.

COMMISSIONER BUTTREY: You can answer for several short line railroads.

MS. HARROWER: Yes. In the U.S. portion, the U.S. part of our business we have two short lines.

COMMISSIONER BUTTREY: I'm talking about just U.S. now.

MS. HARROWER: Yes, just U.S. we work with Dakota Missouri, Valley Railway and the Northern Plains Railway. Those are the two major short lines that we work with. And if you look at the map, they -- Boy. Their total mileage as compared to our mileage is almost equal. They have a lot of grain originations very similar to what Kevin was talking to you on the Burlington Northern. They have a lot of large grain originations for us in the U.S. network as well.

If you look at our main line that runs up from Chicago up through Portal, I mean that is our main line and we don't have a lot of wheat. We do have some large shuttle loaders on that line but there are also shuttle loaders on the short lines, probably to an equal degree. I couldn't give you the breakdown of cars, I'm sorry, in

terms of how many originate on the short lines versus ours.

COMMISSIONER BUTTREY: Are Bisby and Bernard the only two places where you have co-located shuttle facilities? It looks like on the map those are the only two. Is that right or is it Oaks?

MS. HARROWER: Well, Oaks. What you see there is in fact Burlington Northern and ourselves both service Oaks.

COMMISSIONER BUTTREY: Serve the same facility, not two different facilities.

MS. HARROWER: No. I don't believe we serve the same facility. I believe we have separate facilities.

COMMISSIONER BUTTREY: Two different shuttle locations?

MS. HARROWER: Yes.

COMMISSIONER BUTTREY: Okay. Virtually co-located. The same for Bisby?

MS. HARROWER: That's correct. Bisby of course is on our short line. The dotted line that you see across the top, that's the Northern Plains Railroad. If you look at the red dotted line that goes across, that is the Northern Plains Railroad.

COMMISSIONER BUTTREY: Thank you.

CHAIRMAN NOTTINGHAM: We had some

testimony earlier today you, I'm sure, heard those of you were here, I think most of you were about basically stating that we would have more witnesses today, perhaps better information, more information. But for concerns amongst farmers and/or shippers about some type of retaliation, some type of negative action, that would take place emanating from railroads towards farmers and shippers. Can I get any insurances today that this does not happen? I've not seen any evidence, but what you would do in that case or I can't tell how serious we would take that, I think I can fairly speak for my colleagues, if we thought that it was actually a fact that we were not getting needed information because of such a situation. But I think since the issue was raised, in the spirit of fairness I ought to give you a chance to at least speak to it.

MR. KAUFMAN: Frankly, I'm offended. I mean we would be disciplined. I would lose my job. It's ridiculous. That's just not the way we do business. Look. We have disagreements with our customers because either we may have two different interests in a particular case, but we would never ever retaliate against anybody for coming before the Board. We're happy for people to come before the Board. I don't know what else to say.

VICE CHAIRMAN MULVEY: If I could interrupt for one second. What we often hear is it's not management policy and

it's not senior management policy. But what happens sometimes is somebody complains, a complaint comes in and they get angry at the person out in the field and then that person out in the field retaliates. He says I'll get even and that sort of thing happens and as you say they might lose their job. But apparently that's where the fear emanates from, not that it is company policy.

MR. KAUFMAN: Not only -- I mean we take very seriously the interaction that we have with any customers as I'm sure all of the railroads here do and it's perfectly possible that somebody locally -- a local operations person might deal offensively with a customer. If that happens though and I find out about it or we find out about it, we basically coach that individual about the proper way to treat a customer. So this is just something we don't tolerate.

MR. RUEST: I can assure that we, CN has not seen that. No, we do not promote or engage into any retaliation. We're in the service industry. We start with the customer. The transportation market right now is pretty good. It will always be good. We're also in a cyclic industry and we need our customers to grow, to pay for the investment that we're investing in right now at a record level and no industry can afford to turn off customers for the long run.

But from time to time, you do have disagreements and from time to time, the disagreements are difficult to reconcile and

people maybe have some sour feelings but retaliation no. Disagreement from time to time. Again we're business, private business. We both need to find a way to generate not a high profit but a sustainable profit and sometimes that's difficult to find a solution. No, retaliation. I hope that customers would feel more, those that feel more, would want to come forward more specifically. The confidential process that you offer or in the case like CN we created a service group for them to be able to bypass all these different steps and go directly to the service group like a service dealer when you buy a car. You go to somebody that just does that and use different avenues to get their voice heard and the issue resolved.

MS. HARROWER: Yes, from our perspective, we would be extremely disappointed if we thought that any of our customers were afraid to come forward and testify or speak in any way quite frankly in front of this type of a hearing.

We actively solicit feedback from our customers from our president and CEO all the way down quite frankly to customer service reps that are literally on the phone with customers every day. So we would be very disappointed if we heard that our customers were afraid of any type of retaliation. Just very surprised actually.

MR. RUEST: And they could use the Board's offer

of this morning to use your services to be the go-between if you wish to resolve and bring these issues to a head.

MR. MARTIN: Our policy at UP is really no different than any of my other counterparts. We take an occurrence like that very seriously. It's not in our long-term best interest to prevent any of our customers from dealing with you on any matters that they feel that they would need to. It's very simple.

CHAIRMAN NOTTINGHAM: Okay. We've heard a lot today and I hear lots in my travels and visits with shippers and farmers about the whole variety that they describe of transportation related costs that they feel have been shifted from the railroad onto their shoulders whether it be car ownership, the requirement or the need they feel to drive longer distances and wait some times in long lines for the large shuttle facilities. Help me understand. What's doing on out there and is this a situation of farmers and shippers somehow not knowing how to manage their risks and their exposure? Or is this an example of the railroads unfairly exercising market power? Help me understand what's going on and why we should be comfortable with it.

MR. KAUFMAN: Some of it's historical, isn't it?

MR. MARTIN: I've worked for Union Pacific or a predecessor company for over 30 years and I don't remember when we're ever owned tank cars as an example. It's a specialty piece of

equipment. There are contamination issues and things that we're frankly just not very well able to deal with. Some of the other specialty type hopper cars are similar in vein that it just doesn't make sense for us to invest in them. We couldn't get the kind of productivity in all likelihood that the customer direct could himself.

MR. KAUFMAN: If you think about, part of it is trying to align economic interests. If somebody is able to store their product on our tracks, there is certain consequences and there are certain benefits that accrue to somebody that gets free storage on the tracks. When you do that, that basically encourages one set of economic behavior that consequences somebody else and historically some of those things were allowed to happen.

I think the railroads in reacting to the capacity changes that have occurred have basically gone through their decks of businesses trying to figure out how to extract more capacity from the existing plant. So that may mean that whereas before they had access tracks and you could go ahead and store your product on the railroad, that no longer works anymore because we can't then move the overall volume of the railroad that the railroad needs. So we will go back and say we're not going to lease those tracks to you or we're going to raise the price of leasing the tracks because we can no longer afford it and in fact, we're subsidizing your business.

It's all about costs. If we owned a tank car, we would have to build the infrastructure to be able to clean the tank cars. I mean there's a lot to tank cars and we would have to pass those costs on. So when we talk about those things, it's just where do you want the cost to reside, in the rate. It's just part of the cost of overall transportation.

And in the case of DDGs for example that's a perfect example. Why don't we want DDGs to go into our railcar? Well, I can show you a picture of a railcar with a one foot by one foot torched cut out of it because they couldn't unload the car because the stuff stuck on the inside of the car. That's not really a real good utilization of our cars to cut holes in them.

So we say do you want to ship DDGs. You go ahead and use your own cars because then the incentive will be make a product that will flow through the cars instead of giving us the product in the car and forcing us to figure out how to unload it. So it's this kind of economic incentive in the exchange of the costs.

MR. RUEST: These are different products. In one case maybe the historical product was here's the price from moving the product from A to B in the railroad car, so transportation including the car itself. More and more today, we'll do the transportation where you provide the car and we'll have a lower rate and then the debate is about

whether the rate is acceptable between the fact that we now no longer provide the car and used to provide the car.

Another service is you load the car, but you actually park the car for three days. You don't want to ship it right away. That's called storage. Now storage on wheels, that's a service in itself. It's not a dumb thing of accessorial charges. It's a service in itself. You're now buying warehouse on wheels.

Or if you buy the warehouse on wheels inside your plant or night track then you're also using night track. So you go from historically selling transportation including the railroad car. Now it's the same transportation using somebody else's car. Then it's not transportation at all, but just temporary storage for three days in my car and on my track or just for two or three days in my car on your track. So these products you sell and they come at different price and as Kevin said in some cases, if the product is not generic or it's a tank car, then we can't easily move from one commodity to another or customer to another because it's too specialized and we can't really invest in that because we're not in the business of DDG. So we would just hook and haul.

MS. HARROWER: Our experience at this point on the U.S. side, we haven't felt quite the same impacts of ethanol and DDG yet. We will. So at this point the majority of the hopper cars

that we use in our grain business are still owned by the railway. We have not seen the impact of private cars from a hopper car perspective into our fleet. Tanks cars as you've heard from everybody, that's always been the case. Tanks cars have been owned by private industry and they continue to be. So that's no change.

MR. RUEST: The private car model in many cases, well you look in the plastic industry where they use the private car for two reasons to move the product and the car is very specialized but also they want to do some amount of storage on wheel and some industries, plastic is an industry to have this need, sometime to store the produce on wheels and that's where the product car model maybe works better than the railroad model.

CHAIRMAN NOTTINGHAM: Vice Chairman Mulvey.

VICE CHAIRMAN MULVEY: One last question. On this final arbitration issue in my conversations with people up in Canada as well as down here, I know that it's not the most popular procedure with the Canadian railroads, but the criticism that I hear are two, one that the people who do the arbitration are often unaware of the economics of the railroad industry and then two, there's no precedential value. So every arbitration is something of a crap shoot. But if you could design a final offer arbitration approach that addressed both of

those issues that the arbitrators were people with some expertise and you could develop some procedure of precedential value to the findings, so of there was consistency , do you think arbitration would be an acceptable way of resolving some of these issues or do you think there are still problems beyond those two complaints?

MR. RUEST: I will make my comments strictly to how it relates to Canadian environment which you have to take it as a whole, not just the FOA process. If you just take the FOA process in isolation, I think you need to put out the whole system including the element of how the Canadian regulation applies to transportation. But arbitration, the Canadian position on the FOA as pieces of the pie in Canada is there's nothing wrong with arbitration, nothing wrong with baseball arbitration.

We find first of all it leaves too much scar to go through this process and we find from a commercial basis it makes things difficult. Second, there's really no rule assigned to the arbitrator to what he will guide his decision and also some of the arbitrator may not have much skill in the transportation market. So you get into a whole education process through the arbitration process itself and in the end you cannot get a written decision whether you won or you lost. You're not too sure why you won or lost but you're not going to get a written decision. So we think there's a couple of maybe major flaws

that could be looked at and fixed to make the process more positive and maybe more business like.

MS. HARROWER: I would -- I really don't have anything to add to that. That's a good answer, J.J.

VICE CHAIRMAN MULVEY: Thank you. That's all I have.

CHAIRMAN NOTTINGHAM: Commissioner Buttrey.

COMMISSIONER BUTTREY: That's all I have.

CHAIRMAN NOTTINGHAM: I just have a couple of more questions. Thanks for your patience. It's often as I sit here and as we work here with the Board, it's often hard for us to discern when we hear about service problems or delays, things such as farmers having to wait five and six hours at a terminal for a shuttle train to be loaded and the attendant cost of that especially when it's during harvest season. Are instances like that in your experience more often the cause of the railroad or more often the cause of someone else? Obviously we can't hold you accountable for problems you don't cause, but it's not always easy for us as we sit here to know what's going on out there.

MR. KAUFMAN: The AG logistics supply chain is very complicated and during guts-slot harvest you're going to always

have truck lines in an elevator because nobody is going to make the investment in an infrastructure so big just to meet the needs for a week period. The other thing for instance if you take for example the market with Iraq, they announced 400,000 tons of business sold through Iraq last week. That's great news. The problem is Iraq buys FOV. Now what that means is that they control the ocean going vessels and so while they will buy in their commitment December, January and February, what happened last year is they bought the same thing and they delivered the vessels in April. So was there a truck line in January? Yes, there was. Was it because there was no railroad service? No, it was because the elevator was filled up. There was no place of the railcars to go because there was no business. There was no elevation capacity at B&W. So it's a very complicated thing.

Now I get the fact that the farmer is frustrated when he's sitting in his truck and he wants to shake his fist at somebody because he wants to turn around and get back to his harvester as quickly as possible. Today a harvesting machine basically harvests about 600 bushels about every 15 minutes. One of the reasons while these whole shuttle facilities network has changed so much is to be able to receive that volume as quickly as possible. But that doesn't necessarily mean in any specific point in time that the logistics will all match up.

But over time if those logistical changes hadn't been made, then you're right. He would have been sitting there for a whole lot longer and so an investment will keep reaching out to make the thing more and more efficient.

MR. ATAMANCHUK: I think just building on that particularly on an export movement whether it's in Canada or the U.S. a lot of times people look at the supply chain and think it ends at that grain terminal on the west coast or in the Gulf and it's a complete supply chain delivered to the end market and vessels can be an issue as Kevin indicated. If the vessel is late, if the terms of sale are very different and if a terminal becomes plugged, then as J.J. said the conveyor stops and you now no longer have the loads being unloaded which create the empties for the next train load. That's where delays can be caused because the person at the elevator is just looking at the rail service that's often attributed to the railway.

MS. HARROWER: Just to lay on a little bit more as Kevin said there is no way that you'd ever have anybody build enough storage at a rail loading site to store all of the grain that might come off a field in one week. However, I will say that what we are seeing as a change in the industry is the grain shipping companies are building more and more storage at rail head on the basis that they -- Getting back to the whole fact and Doug mentioned it and I mentioned it as

well, grain originates in a truck and the grain shipping companies are looking at it as a competitive way to attract that grain to their grain elevator if they have storage. So we're seeing actually more and more larger bins of storage built at the rail head for that very specific reason.

Obviously they can load a shuttle train more quickly and they can load more shuttle trains, but at the same time they're doing it for the purpose of attracting the grain from the farmer's field into their storage facility so that they have it on hand to sell. That is something new that we're seeing more so in the last 12 months than we've ever seen.

CHAIRMAN NOTTINGHAM: And I think that's consistent with what we've heard a little bit earlier today and recently in some different venues including the Grain Car Council yesterday that happened to be in the town meeting. On that, following that line of thought, are the railroads ready for what might be a different type of peak this year? There might not be a peak right now or in the fall. It could be a January peak that might be driven by tax planning reason, international trade reasons, the increased access to warehousing storage. But should we be holding our breath and not take a Christmas holiday this year because you guys aren't going to be able to deliver when the peak hits?

MS. HARROWER: As it pertains to grain, we are

seeing significant volume right now. So we are feeling a peak right now especially given the fact that I think there was a lot of feeling that with the drought conditions that were experienced in the Midwest that there would be a lot less crop, but in fact the quality is there and some of the crops that are there are resulting in a fairly dramatic demand.

Frankly if the peak -- If you were able to take the peak and spread it out a little bit, we would be quite happy with that and I think you've heard that consistently as well that if you had volumes continue to move into January and February that would be a good thing for us frankly. So we are in terms of car supply, locomotives, railway capacity, we're ready to continue to handle the volumes all the way through January and February.

MR. MARTIN: I think as a system from our perspective we're probably better positioned right now to do anything than we have been probably for the last 12 months or so, but you have to tell me how big the peak is to tell you whether you need to be here on Christmas to answer the phone because we're all guessing.

CHAIRMAN NOTTINGHAM: On the Canadian system, there was some reference to the cars being government owned and being generally older and smaller. Tell me about the condition of the track. Are you incentivized or disincentivized to making investments you would like to make when you're constrained on your

rate collections? I've heard reference in some briefings to some track not being able to handle the heaviest cars that are in use in some parts of the system in the western part of Canada. Is there any truth to that?

MR. RUEST: The only part of the revenue which is constrained in terms of a revenue cap is only the export grain business. All of the business that CN moves don't have the same models. So when you talk about main line track, there's a lot of different traffic that that paces the main line upkeep. So that's not an issue. It's only when you get to the branch lines who would only be having grain business, in some cases it's only a short line, then denser traffic on that short line or that branch line may be the cause where the tracks may not be as good as the 286 or it's not as good as the 286 today because maybe the short line has not enough capital to do that. When you talk about very long distance to get to a fuel elevator as you get to the north, the issue of density becomes the level of reinvestment. But on the main line, not an issue.

MR. ATAMANCHUK: A legacy of some of the regulation in the Canadian grain system in the past had been some light-loading grain branch lines. Over the last few years, most of those have been removed and as J.J. indicated, I don't think we have any grain branch line that would be less than 263,000 pounds loading. There could be opportunities to go to 286, but again it comes out to the

economics and that's as one of the speakers earlier said is simply it's a density issue. Is there enough traffic coming off that line?

CHAIRMAN NOTTINGHAM: On a different topic and I'm winding up, so bear with me. I want to sort of just hear a commitment to the common carrier obligation that we take so seriously here. We had testimony earlier today about markets being closed or shippers wanting to send product to the Gulf Coast for example and the railroad saying no that will cost you just hypothetically a gazillion dollars. We want you to send it to the west coast.

I just get concerned about who is calling the shots on AG policy and should it be the railroad? Should it be the farmer and the shipper? Help me sort of understand what's going on out there and why if you could.

MR. KAUFMAN: You know the issue you raise, it's a complicated issue. For instance sometimes what the shipper wants we can't provide. If he wants to move it to a certain place and it's not economic for us to move it or the return is so low that it's not investable, that's just a fact and so if we quote a rate than is economic for him to do the business that's just kind of an irreconcilable difference. I mean we're not in the business to subsidize their business and just because a shipper wants to go to a certain place doesn't mean that it's an economic supply chain.

In the grain business, the problem with the grain business is it's ever changing and so you hear certain anecdotes where somebody says the railroad wouldn't quote me a rate. Well, that's not true. I'll always quote them a rate, but it may not be the rate that they want but I'm sorry. I'm not in the business to subsidize their particular business and we all know that when somebody invests in plant equipment, when they invest, they're not given a lifetime guarantee that the particular location that they picked out for that particular asset is going to be a viable business for a million years in the future. So things change and we can't be expected to basically engage in uneconomic behavior in order to perpetuate somebody else's poor business decision.

MR. ATAMANCHUK: Just to add to Kevin's comments, I mean the CN system in the U.S. is relatively narrow in scope from the destination perspective going predominantly to the Gulf. We have actually worked with Kevin and his group for shippers in Iowa on our lines where his shuttle trains come into those origins and can go to the PNW or can go to the Texas markets and the California markets. We've actually worked in the last year or so to expand the market opportunities for shippers in Iowa on the CMIs.

MS. HARROWER: I think from our perspective you heard me talk about the growth that we've seen in our traffic to the

PNW and in particular with the Union Pacific. Like the CN, we actually don't serve a lot of destination markets either. We do serve some of the wheat milling markets in the Midwest, but a lot of the larger export markets we don't serve. So we rely on other carriers to work with us.

From a common carrier perspective, we would actively work with any other carrier to provide a rail service at a rate to the customer to get the product to destination, but again we're not for the most part a single rail carrier in the U.S. and so we're very reliant on a number of intricacies and logistics and I think Kevin has pointed those out very well in terms of the logistics of the overall business that come into play when you price.

MR. MARTIN: We take the common carrier obligation seriously but as Kevin mentioned if a customer wants to go to a market that it's uneconomic for us to get to, we'll quote them a rate but it may not be what they're looking for.

CHAIRMAN NOTTINGHAM: In your mind though would it be reasonable under the circumstances?

MR. MARTIN: In our minds it would reasonable, yes, relative to what the cost is for us to get it there.

MS. HARROWER: You have to take into consideration cycle times. You know if you have some very small

volume business and I think, Kevin, your explanation of the number of cars you have in place to move your shuttles versus your single car type business just demonstrates if you get a trip per month out of a car your cost is going to be substantially higher than it would be if you had three trips per month out of a car.

CHAIRMAN NOTTINGHAM: Any questions from colleagues?

VICE CHAIRMAN MULVEY: No.

CHAIRMAN NOTTINGHAM: Thank you. That concludes today's hearing. I do want to note that we will keep the record open as stated before until January 12, 2007. We thank all the witnesses for your time today and look forward to working with all of you to try to include the situations we've heard about today. Thanks. Off the record.

(Whereupon, at 4:31 p.m., the above-entitled matter was concluded.)