

UNITED STATES OF AMERICA
SURFACE TRANSPORTATION BOARD

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PUBLIC HEARING

REVIEW OF THE SURFACE
TRANSPORTATION BOARD'S GENERAL
PURPOSE COSTING SYSTEM

STB Ex Parte No. 431 (Sub-No. 3)

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Thursday,
April 30, 2009

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Surface Transportation Board
Suite 120
395 E Street, S.W.
Washington, D.C.

9:00 a.m.

BEFORE:

FRANCIS P. MULVEY	Acting-Chairman
CHARLES NOTTINGHAM	Vice Chairman

ALSO PRESENT:

PANEL I: SHIPPER INTERESTS

STEVE SHARP, Arkansas Electric
Cooperative Corporation

TOM O'CONNOR, Interested Associations

JOHN J. LeSEUR, Coal Shippers

GERALD W. FAUTH, III, Wheat and Barley
Commissions

PANEL II: FREIGHT RAILROADS

EDWARD R. HAMBERGER, Association of
American Railroads

RICHARD E. WEICHER, BNSF Railway
Company

LOUISE A. RINN, Union Pacific Railroad
Company

PANEL III: OTHER INTERESTED PERSONS

C. GREGORY BRESKIN

ROBERT H. LEILICH

GEORGE AVERY GRIMES
SANDRA J. DEARDEN, Highroad Consulting,
Ltd.

C O N T E N T S

Opening remarks	
Acting-Chairman Mulvey.4
Vice Chairman Nottingham.	11

PANEL I: SHIPPER INTERESTS

Presentation by Steve Sharp	16
Presentation by Tom O'Connor.	24
Presentation by Gerald W. Fauth, III.	36
Presentation by John H. LeSeur.	44
Question and Answer Period.	48

PANEL II: FREIGHT RAILROADS

Presentation by Edward R. Hamberger116
Presentation by Richard E. Weicher.121
Presentation by Louise A. Rinn.135
Question and Answer Period.140

PANEL III: OTHER INTERESTED PERSONS

Presentation by C. Gregory Breskin.193
Presentation by Robert H. Leilich198
Presentation by George Grimes208
Presentation by Sandra Dearden.213
Question and Answer Period.221

Closing remarks

Acting-Chairman Mulvey.245
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1 P-R-O-C-E-E-D-I-N-G-S

2 9:00 a.m.

3 ACTING-CHAIRMAN MULVEY: Thank you
4 all for coming today. Good morning and
5 welcome to our hearing on a review of the
6 Surface Transportation Board's General Purpose
7 Costing System.

8 The purpose of this hearing is to
9 examine issues related to the Board's Uniform
10 Railroad Costing System commonly known as
11 URCS.

12 This hearing is the first step in
13 what will be a continuing dialogue on this
14 issue. And as a reminder, we will keep the
15 docket open until June 1st, 2009, to receive
16 comments in response to this hearing.

17 The Board uses URCS to determine a
18 rail carrier's variable costs in a variety of
19 our regulatory proceedings.

20 URCS determines for each Class I
21 railroad, the portion of each category of
22 expenses shown in the carrier's Annual Report

1 to the Board, STB Form R-1, that represents
2 its system-average variable cost for that cost
3 category for that year.

4 More specifically, URCS consists
5 of a series of computer programs and manual
6 procedures organized into three phases.

7 Phase I compiles the raw data
8 provided by the URCS carriers, by the Class I
9 carriers, and then uses statistical estimation
10 procedures to determine the portion of
11 specific expense account groupings that vary
12 with changes in the volume of activity.

13 In Phase II, these cost/volume
14 relationships are then used to develop the
15 variable unit costs that allow costing of
16 specific rail movements.

17 And finally in Phase III, these
18 variable unit costs are applied to determine
19 costs of specific movements via an interactive
20 computer program that permits the user to
21 enter operating characteristic data for the
22 specific movements under consideration.

1 URCS was initially adopted in 1989
2 by our predecessor agency, the Interstate
3 Commerce Commission, as the general purpose
4 costing system for the agency. The Railroad
5 Accounting Principles Board Final Report of
6 September 1987, on which the ICC relied, calls
7 for a periodic review of URCS.

8 Now, the Board completed its first
9 review of URCS in 1997, at which time the
10 system was modified to: (1) alter the
11 procedures used to determine the variable
12 costs associated with rail movements of
13 intermodal traffic; (2) revise the train
14 switching conversion factor used in the
15 costing procedures and; (3) discontinue the
16 collection of cost data on switching and
17 terminal companies and (4) revise the
18 procedure for determining the variable cost of
19 using privately-owned railcars.

20 I note that during that review,
21 the Board was unable to take a broader effort
22 to revise and update URCS regression equations

1 due to "a lack of resources."

2 This means that the regression
3 analyses, which establish the variability
4 factors, have not been updated since 1987,
5 more than two decades ago.

6 In addition to the regression
7 analyses, it might be that the engineering
8 relationships on which URCS relies are also in
9 need of significant revision. Most of these
10 special engineering and time and motion
11 studies, that are the foundation for the
12 constant factors in URCS, were undertaken or
13 presented to the ICC in various proceedings
14 from the 1930s to the 1960s.

15 Given the enormous increase in
16 rail UNIT train traffic as well as the
17 rationalization and enhanced productivity of
18 railroad operations over the past 30 years
19 since the Staggers Act, it might well be that
20 these engineering relationships need updating.

21 Finally, URCS relies on a variety
22 of computer programs, some of which are now

1 obsolete. At present, URCS uses Fortran, C++,
2 VBNET and VB6, but all of our current
3 programming is done in Visual Basic Access,
4 VBA.

5 If we determine that recoding the
6 URCS Phase II WorkTables is necessary to
7 transition URCS to current program standards,
8 we might need to reverse engineer the legacy
9 program code.

10 In short, it's time for a new,
11 more comprehensive review of URCS to determine
12 whether and to what extent modifications are
13 needed to account for changes in railroad
14 operations, as well as recent changes in Board
15 procedures.

16 I am committed to continuing the
17 review and refinement of our costing system
18 through periodic analyses such as the effort
19 we begin today, which will include public
20 participation.

21 I have long indicated my personal
22 interest in revising and updating URCS. The

1 purpose of this hearing is to determine
2 whether and in what ways revisions to URCS
3 would benefit the public.

4 We're hoping that the key
5 stakeholders before us today can help us
6 define the scope of the potential reform of
7 our general purpose costing system.

8 We know that we cannot demand
9 perfection. Rather, we will look at whether
10 proposed changes would improve current
11 procedures, and whether such changes can be
12 implemented at a reasonable cost and without
13 undue burden on our railroad and rail shipping
14 industries, the public, and this agency.

15 Our ultimate goal, however, is to
16 ensure that the Board has a costing tool that
17 is as accurate as possible to enable the Board
18 to more effectively carry out its statutory
19 duties fairly and expeditiously.

20 Before I turn to Vice Chairman
21 Nottingham for his opening remarks, I want to
22 mention a few procedural notes regarding the

1 testimony itself.

2 As usual, we will hear from all
3 the speakers on a panel prior to any questions
4 from the Board members. Speakers, please note
5 the timing lights that are in front of me on
6 the dais. You will see a yellow light when
7 you have one minute remaining, and a red light
8 when your time has expired. So, please do
9 your best to keep within the time that you
10 have been allotted.

11 I assure you that we have read all
12 of your statements and comments and, please,
13 there is no need for you to read the
14 statements in their entirety here.

15 After hearing from the entire
16 panel, we will rotate with questions from the
17 Board members until we have exhausted all of
18 the questions or exhausted the panelists.

19 Additionally, just to remind
20 everybody, please turn off your cell phones.
21 And with that, now I would like to turn to
22 Vice Chairman Nottingham for his opening

1 remarks.

2 VICE CHAIRMAN NOTTINGHAM: Thank
3 you, Acting-Chairman Mulvey.

4 If I could start with just a quick
5 two points of personal privilege, one is to -
6 I'm pretty sure this is our first official
7 formal hearing with you at the helm.

8 And I wanted just to say something
9 I've said in other forums, which is I wish you
10 all the best in every success in your tenure
11 as acting-chairman, and congratulations to
12 you.

13 I also wanted to note we don't do
14 this very often, but it is a first for us in
15 recent times, we have a recently-departed
16 commissioner in our midst. Commissioner Doug
17 Buttrey, welcome back. I believe it's the
18 first time you've been back in the building
19 since your departure.

20 I won't use the "R" word, because
21 you didn't R. You departed gracefully, and we
22 look forward to following your career as it

1 develops further and keeping in touch.
2 Welcome back, and it's a pleasure to see you
3 back in this room even if it's at a little bit
4 more of a distance than we're accustomed to up
5 here.

6 Turning to the riveting subject of
7 the day, I know that there's no place you'd
8 rather be and no topic you'd rather be talking
9 about on the last day of April than the STB's
10 Uniform Rail Costing System.

11 We really held this hearing to
12 really find out who our diehard stakeholders
13 are, who are our most hard-core observers, and
14 now we know. So, we're taking lists and, you
15 know, if you're here today on a nice spring
16 morning to talk about this topic, we know you
17 are a true follower of the STB. So,
18 congratulations, but it is a serious topic.

19 I want to welcome everyone to this
20 hearing. Of course our topic today is the
21 Board's Uniform Rail Costing System adopted in
22 1989 to be our general purpose costing model.

1 URCS as it's affectionately known,
2 is an important tool for us. We use URCS
3 whenever we need to estimate the variable cost
4 of rail transportation. It, therefore, plays
5 a prominent role in rate cases and a number of
6 other agency proceedings.

7 The issue today is how best to
8 review and improve URCS. We are always
9 interested in finding ways to improve our
10 regulatory processes whether it's our
11 simplified guidelines for small rail disputes,
12 our calculation of the railroad industry cost
13 of capital or improvements to URCS.

14 Our staff has been conducting a
15 review of URCS to find ways to improve the
16 model, and we have an ongoing rulemaking that
17 seeks to improve the way URCS costs movements
18 of hazardous materials.

19 I fully support efforts to improve
20 the existing model where it makes sense to do
21 so, but we need to tread cautiously in
22 exploring a broader overhaul of URCS.

1 URCS itself took years to create
2 and replaced a costing model that the ICC had
3 used for over 50 years, and history
4 illustrates that even simple changes to URCS
5 will be complicated.

6 Just a few years after it created
7 URCS, the ICC undertook what it thought would
8 be a regular review of this costing model.
9 The resulting review took seven years to
10 complete.

11 I believe the process needs to be
12 managed carefully so that we not embark on an
13 open-ended journey without some clear
14 destination, timeline and project budget in
15 mind. Otherwise, we risk repeating the
16 mistakes of our predecessor and having a
17 second lengthy review that may provide some
18 benefits and improvements to URCS, but will
19 certainly impose a heavy burden on the Board,
20 the railroad industry, railroad customers and
21 the general public.

22 I have reviewed the comments from

1 all participants today and thank everyone in
2 advance for their constructive suggestions on
3 how to improve URCS. And I will certainly
4 keep an open mind on all of this and look
5 forward to hearing the testimony of those
6 parties that choose to attend our hearing
7 today.

8 And I also want to thank the STB
9 staff for their diligent efforts in preparing
10 for this hearing.

11 Thank you, Acting-Chairman.

12 ACTING-CHAIRMAN MULVEY: Thank you.
13 I agree that we want to do what is reasonable,
14 and we want to do what is going to have a
15 positive benefit-cost ratio.

16 But to paraphrase somebody else
17 here in Washington, if it was easy, it's easy
18 to do things that are easy, but sometimes we
19 need to do things that are hard because they
20 need to be done.

21 Let me now call up the first panel
22 representing shipper interests. This is Steve

1 Sharp for the Arkansas Electric Cooperative
2 Corporation; Mr. Tom O'Connor for the
3 Interested Associations, a group of
4 associations; Mr. John LeSeur for the Coal
5 Shippers and Mr. Gerald Fauth for the Wheat
6 and Barley Commission.

7 Mr. LeSeur is an added panelist
8 listed on a revised speakers list, and that's
9 available outside the hearing room as you
10 enter.

11 Thank you.

12 We can begin with Mr. Sharp.

13 MR. SHARP: Good morning, Chairman
14 Mulvey, Vice Chairman Nottingham, STB Board
15 and former Chairman Buttrey. I'm glad to see
16 you all and appreciate the opportunity to
17 speak to you this morning.

18 AECC has appeared before the Board
19 several times. I'll just make a quick recap.
20 We are a membership-based generation and
21 transmission cooperative that provides
22 wholesale electric power to electric

1 cooperatives in the State of Arkansas.

2 Those cooperatives, in turn,
3 provide electric power to their members
4 numbering about 490,000 there in the State of
5 Arkansas.

6 We hold substantial ownership
7 interest in three major coal-fired powerplants
8 in Arkansas that normally burn a total of over
9 400 - I mean, excuse me, 14 million tons of
10 PRB coal annually.

11 As described in our written
12 submission, we are interested in URCS because
13 of the way variable costs calculated by URCS
14 may determine the outcome of a future rail
15 rate case.

16 Two of our three coal plants are
17 captive to only one railroad. The possibility
18 of bringing a rate case to ensure the
19 reasonableness of rates there is an important
20 option for us.

21 Back when rate cases allowed so-
22 called movement-specific adjustments, we

1 didn't have quite so much reason to be
2 concerned about URCS. We knew it was out
3 there and were vaguely interested in it, but
4 I really felt like if we did have a rate case
5 at some point, that the outcome probably would
6 not be determined by URCS calculations.

7 When the Board ruled out those
8 adjustments, we knew, in a general way, that
9 URCS was becoming more important to us.

10 However, the thing that really
11 brought URCS' issues more to our attention was
12 the Board's decision in the Kansas City Power
13 and Light, Montrose case.

14 One of our powerplants, the
15 Independence powerplant, is situated very
16 similarly to the Montrose plant in that it
17 served at destination by the Missouri & North
18 Arkansas Railroad and receives PRB coal from
19 Union Pacific through Kansas City.

20 When we looked at the Montrose
21 case, we were struck by two things. First,
22 the parties stipulated that the 180 percent

1 revenue-to-variable-cost ratio would determine
2 the rate. So, the outcome of the case rested
3 on URCS rather than on the standalone cost
4 issues.

5 Second, the numbers that came out
6 of the unadjusted URCS appeared to be quite a
7 bit higher than we expected, and perhaps than
8 you would expect if you took results from
9 older rate cases that permitted the movement-
10 specific adjustments and escalated them to
11 reflect price inflation.

12 Some of those details regarding
13 this are contained in our filing in Ex Parte
14 681, you know, which we didn't repeat as
15 instructed by the Board. But basically, we
16 found that the use of unadjusted URCS, we
17 believe, leads to an artificial rate premium
18 of about \$4.50 per ton.

19 If you just use that estimate for
20 our two captive plants in which we have an
21 interest, that translates to about \$36 million
22 per year in rail rates that rest entirely on

1 the p or it could rest entirely on the
2 inaccuracy of the URCS cost.

3 Further time and investigation is
4 going to be required to dissect and remedy the
5 specific sources of the cost-over statement
6 that appears to result from the use of
7 unadjusted URCS for PRB coal traffic.

8 In the comparatively short time
9 available for parties to prepare written
10 comments in this proceeding, we did not go
11 very far into the nitty-gritty details and
12 specific problems and their solutions.

13 The effects of the short time
14 frame were compounded by the scarcity of
15 available documentation of the URCS regression
16 models. We looked for documentation on the
17 Board's website and several other sources, all
18 without success.

19 We also submitted an inquiry to
20 the e-mail address specified by the Board for
21 URCS questions, but so far have not yet
22 received a response.

1 If we're going to fix what's in
2 the black box, we need to be able to crack it
3 open. Transparency is very helpful. And for
4 these black box-type programs, you literally
5 have none.

6 Even without getting into the
7 details, we think the big picture view
8 provides plenty of important information
9 regarding the types of URCS improvements that
10 are now needed.

11 At the time URCS was developed, it
12 was probably reasonable to view costs in terms
13 of system averages, and deviations from system
14 averages p and the deviations from system
15 averages associated specific types of traffic
16 such as intermodal and unit-trains.

17 However, since the 1980s there's
18 been so much technological innovation and
19 volume growth in different traffic segments,
20 that the whole URCS framework needs to be
21 revisited.

22 Intermodal has undergone explosive

1 growth and relies heavily on specialized
2 equipment, facilities and operating practices
3 to produce a premium product with unique cost
4 and service attributes.

5 Likewise, unit-train movements,
6 particularly those involving PRB coal, have
7 evolved to a point of heavy-haul productivity
8 that is generally not achieved by other types
9 of traffic.

10 This environment is difficult to
11 make sense out of system-average costs without
12 accounting carefully for the mix of different
13 traffic types that are moving.

14 As a starting point, AECC suggests
15 revisiting the URCS regressions and attempting
16 to introduce new model specifications that
17 permit the direct estimation of variable costs
18 for different traffic types.

19 And parallel with this type of
20 effort, the Board should revisit the unit-
21 train adjustments currently used in URCS with
22 the idea of adding categories to reflect

1 different types of multiple car and unit-train
2 movements.

3 Hopefully, at some point p excuse
4 me p URCS can stop charging AECC and other
5 shippers for car costs when we already bear
6 all the costs of owning and maintaining the
7 fleet of cars used to move our traffic.

8 Just making a quick calculation on
9 the back of an envelope, PRB coal alone
10 accounts for somewhere around 25 percent of
11 all U.S. revenue ton miles in rail traffic.

12 As happened most recently in the
13 OD&E Muskogee case, it seems likely that URCS
14 is going to determine the outcome of many rate
15 cases involving PRB movements along high-
16 density trunk lines. And from what we can
17 see, the impacts of URCS' costing inaccuracies
18 in individual cases, can be quite large.

19 Under these circumstances, it is
20 reasonable for the Board to put significant
21 effort into making sure URCS is valid and
22 accurate.

1 I appreciate this opportunity to
2 participate in the Board's review of URCS'
3 issues, and look forward to answering any
4 questions you may have.

5 ACTING-CHAIRMAN MULVEY: Thank you,
6 Steve.

7 Mr. O'Connor.

8 MR. O'CONNOR: Thank you. Good to
9 be here, Chairman Mulvey, Vice Chairman
10 Nottingham, and let's see if we can put some
11 slides up there. You have copies of the
12 slides before you on the panel there.

13 I'm here presenting testimony this
14 morning that's sponsored by the Edison
15 Electric Institute, National Grain and Feed
16 Association, National Industrial
17 Transportation League and the American
18 Chemistry Council.

19 And we'll be focusing on two
20 things, all of which is based on the testimony
21 that's already been provided to you, the
22 guiding principles that we would suggest for

1 your consideration in any review of URCS that
2 you might undertake, and we'll talk about some
3 of our key findings.

4 Let's go to the guiding principles
5 first. URCS and its predecessor, Rail Form A,
6 have a long history. We'll talk a little bit
7 more about that on the timeline on the next
8 slide, and we would offer these three
9 principles:

10 Because URCS is a highly-technical
11 matter, a revision of URCS will require
12 significant resources to be expended by the
13 Board.

14 If the Board decides to initiate a
15 revision of URCS, it must commit to a review
16 and possible revision of all aspects of URCS.
17 A piecemeal or a partial revision would not be
18 appropriate.

19 And the third guideline is if the
20 Board decides to initiate a revision of URCS,
21 that effort must be transparent and the Board
22 or its contractor must make its data, analyses

1 and work papers available to the public.

2 And of course that can greatly
3 increase the power of your analysis. The
4 alternative, of course, would have the various
5 bodies basically duplicating that analysis.

6 Let's look at the timeline, and
7 you might hear a little bit more about some of
8 these events today. This rail costing
9 timeline, a certain chunk of which traces
10 fairly accurately my own career, goes back all
11 the way to 1907, Rail Form A came onto the
12 scene in 1939, the statistical studies in Rail
13 Form A source back to 1972, the new IC system
14 of accounts in 1978, and that begins the
15 movement towards URCS which is continuing up
16 to and including this proceeding today.

17 The three phases of URCS we have
18 presented on this slide, this kind of shows
19 you the reason why we're urging that if you
20 look at pieces of it, you really have to look
21 at all of it.

22 URCS Phase I is where the

1 regression analyses and estimates of cost
2 variability are produced, and they have an
3 affect that permeates the rest of URCS in
4 several different ways which we won't get into
5 in detail today. But once the regression
6 analyses are determined, to a large extent the
7 result of URCS Phase III has been determined.

8 So, the whole thing has to be
9 viewed as an integrated process. And if you
10 revise it, it needs to be reviewed in that
11 regard.

12 The URCS issue as identified by
13 the STB, we've covered all of these issues in
14 my testimony. And I won't repeat that
15 testimony here today, but we'll talk about one
16 or two of those issues.

17 The next slide is p here's the
18 issues. And the next slide we are calling
19 attention to some of the 1960 source documents
20 that are now in URCS, and this is a point on
21 which there's broad agreement. I mean
22 everybody recognizes this.

1 The statement STMT 763 which you
2 see there on the source column and it appears
3 seven times, that happens to be the manual
4 version of Rail Form A, is what that document
5 is.

6 And if you would like to see an
7 actual copy of that, I happen to have one in
8 my archives. I think that was one of the few
9 remaining copies.

10 That was what was done and how
11 Rail Form A was handled before it was
12 computerized, which occurred in the mid to
13 late '70s here at the then ICC.

14 And you can also see on that
15 chart, that there are seven references to
16 another source document that happens to deal
17 with TOFC/COFC which goes back to 1969.

18 So, there are --- this is what
19 you'd call a target-rich environment in terms
20 of is there anything to review.

21 Some of the areas affected on the
22 next slide by the Rail Form A costing factors

1 and studies, the efficiency adjustments
2 associated with unit-train, and we heard a
3 little bit about that from Steve Sharp and his
4 remarks, that goes back to Ex Parte 270, Sub-
5 4, which dates back to 1974, those same
6 factors are still being used today.

7 They were applied broadly in Rail
8 Form A, they were moved over into URCS, and
9 are still being used today.

10 Historical studies such as equated
11 switch factors and at the next level down in
12 that analysis, we find that there are certain
13 types of switches there that are allotted
14 portions of the minutes that are recorded, and
15 the actual switch type has pretty much
16 disappeared.

17 I'm talking about intra-terminal
18 switches and inter-terminal switches, very
19 short distance moves, where you would make the
20 entire move as a switch move. It may have
21 been part of the railroad practice then, but
22 it's pretty well disappeared now.

1 I&I train switch frequency non-
2 intermodal, is still going back to the Rail
3 Form A study. That's one every 200 miles.

4 Now, here is -- these are examples
5 where you could easily take a piecemeal
6 approach, but we'd recommend against that.

7 There will be some things where
8 you could get broad agreement, and fairly
9 easily get broad agreement, that some of these
10 factors need to be updated, but we have to
11 bear in mind p let me just go back to the
12 structure of URCS.

13 We have to bear in mind that at
14 the I&I switch level, you're down at URCS
15 Phase III, whereas much of the result that
16 you're dealing with in URCS Phase III, has
17 been determined in URCS Phase I, the
18 regression analysis.

19 Parenthetically, at that time I
20 participated in that regression analysis as
21 part of the team for the AAR. I don't recall,
22 however, whether I kept any work papers.

1 Let's take a look at Factor Number
2 12, moving back through the course of the
3 presentation. You asked for comments on
4 whether the Rail Cost Adjustment Factor would
5 be a suitable means of updating URCS' costs,
6 and it p the data that we're looking at
7 suggests that it would be a logical candidate.

8 The Rail Cost Adjustment Factor is
9 frequently used in negotiations and other
10 rate-related matters. The Rail Cost
11 Adjustment Factor is based on data assembled
12 by the AAR largely collected from the
13 railroads.

14 And of course as you're well
15 aware, it's reviewed and adjusted as
16 appropriate by the STB on a quarterly basis.
17 So, it gets a lot of attention and has slowly
18 changed in some respects over the years.

19 Now, if you look at the blue line,
20 the blue line is the Rail Cost Adjustment
21 Factor unadjusted for productivity. Of course
22 in 1989, RCAF-A, the Rail Cost Adjustment

1 Factor adjusted for productivity, was adopted,
2 and that was with the active participation of
3 the railroads and shippers and the advice of
4 the Rail Accounting Principles Board.

5 At that time, I served briefly as
6 a consultant to the Rail Accounting Principles
7 Board.

8 And what I see there on initial
9 inspection, looks like a long-term declining
10 cost curve.

11 Now, that certainly isn't
12 conclusive analysis to be sure, but it does
13 suggest the potential for revisions to
14 variability estimates because we're looking at
15 a 20-year pattern there of data that has been
16 reviewed thoroughly.

17 On the next slide, we're
18 considering your Item 13, the statistical
19 relationships used in URCS.

20 We think this is the single most
21 powerful issue that's identified by the STB,
22 and it could generate a significant change in

1 the estimation of railroad costs.

2 Parenthetically, when we consider
3 the role of URCS Phase I, if I can move back
4 to that slide, in URCS Phase I we not only are
5 determining variability, we're determining
6 cause and effect. We're determining what are
7 those dollars associated with? Are they
8 associated with gross ton miles, car miles?
9 What is the service unit they're associated
10 with?

11 The service unit that they were
12 associated with also moves over into URCS
13 Phase II, and the several successive stages of
14 URCS Phase II tend to be informed by the
15 relationships that were developed in Phase I.

16 So by the time you get to Phase
17 III, you have made knowingly or unknowingly,
18 lots of decisions that are going to determine
19 your Phase III outcome.

20 So again, it's an integrated
21 process. You have to look at the whole
22 picture. That's our advice.

1 And in -- let me move ahead to the
2 slide we were on. In RCAF-A, again we have a
3 20-year declining cost pattern, appears to be
4 a declining cost pattern, and it suggests the
5 potential for revisions to the variability
6 estimates.

7 Any revision of URCS especially in
8 this area, must be transparent. And we just
9 heard one of the reasons why.

10 The Board or any contractor
11 employed by the Board, really has to be
12 effective, make its data, analyses and work
13 papers available to the public. And that will
14 help you do your job as well.

15 So, let me conclude with the
16 guiding principles that shaped this testimony,
17 and I have adopted these guiding principles.
18 These principles came from the four trade
19 associations that sponsored the testimony, and
20 I adopted them in my testimony that has been
21 provided to you.

22 And just to reiterate, because

1 URCS is a highly-technical matter, a revision
2 of URCS will require significant resources to
3 be expended by the Board. If the Board
4 decides to initiate a revision of URCS, it
5 must commit to a review and possible revision
6 of all aspects of URCS. A piecemeal, a
7 partial revision would not be appropriate.

8 If the Board decides to initiate a
9 revision of URCS, then it must be transparent
10 for the reasons we've discussed. The Board or
11 its contractor must make its data, analyses
12 and work papers available to the public for
13 comment.

14 And that concludes my prepared
15 remarks today. And I appreciate, again, the
16 opportunity to be here.

17 Thank you.

18 ACTING-CHAIRMAN MULVEY: I want to
19 turn now to Mr. Fauth. You're the third
20 speaker on the list. Sorry, John, but I have
21 an order of speakers here.

22 MR. LeSEUR: I know.

1 MR. FAUTH: Hello. All right.

2 Thank you, Chairman Mulvey and Vice-Chairman
3 Nottingham, for holding this hearing and
4 allowing me time to speak.

5 I'm here on behalf of the various
6 wheat and barley commissions. I'm joined here
7 also today by Terry Whiteside who represents
8 those commissions in Montana, Colorado, Idaho,
9 South Dakota, Nebraska, Oklahoma, Texas and
10 Washington.

11 One cannot dispute that URCS needs
12 to be looked at again. It's been really 25
13 years since it was all developed, and the
14 industry has changed. It's consolidated, it's
15 become more efficient, and those changes could
16 be reflected in URCS.

17 The DOT says that URCS needs to be
18 reformulated. And it also says that the issue
19 here is the accurate measurement of those URCS
20 costs. And I agree that the issue should be
21 the accurate measurement of cost, but I don't
22 necessarily agree that URCS needs to be

1 completely reformulated to achieve that end.

2 There are many things you could
3 do, you the Board could do, without changing
4 URCS at all to improve its accuracy.

5 One of the things I think Chairman
6 Mulvey was quoted as saying, that fixing URCS
7 is no small undertaking, and I think we all
8 agree with that, but I think fixing URCS
9 depends on a great deal of how the fixing is
10 done and who is doing the fixing.

11 In that regard, I have suggested
12 that if you do move forward and get Federal
13 funding to help you with this process, that
14 you create an independent panel of experts to
15 take charge of this issue.

16 I have in my statement, and I
17 won't read it all here today, but I've
18 suggested some improvements that you could do
19 without changing URCS that would greatly
20 improve its accuracy.

21 Number one, allow additional
22 adjustments. The only adjustments that are

1 allowed right now are the 270 adjustments, the
2 make-whole adjustments which increase the
3 cost, and we're allowed to adjust the circuitry
4 factor to one when using actual miles, but the
5 Board's URCS Phase III program is much more
6 flexible. It's the Board's rules that only
7 allows to make those adjustments.

8 The URCS Phase III costing program
9 has like 45 different parameters that we could
10 adjust to make URCS more accurate.

11 For example, using actual switch
12 engine minute costs instead of the URCS
13 adjusted switch engine minute costs, or using
14 actual train characteristics instead of the
15 URCS average train characteristics.

16 And these -- The word "movement-
17 specific adjustments" kind of became a dirty
18 word, I think, in some of these coal cases
19 where they used very technical adjustments to
20 develop maintenance costs and other things.

21 URCS was designed, the Phase III
22 program, to allow the user to make

1 adjustments. It's you, the Board, that
2 doesn't allow us to make adjustments.

3 The second point I've pointed out
4 is the inclusion of nonrecurring special
5 charges of URCS. By including those charges,
6 it can greatly inflate the URCS unit cost.
7 And the Board's policy, I believe, is that
8 those special charges should be excluded, but
9 it's very difficult to know what a special
10 charge is.

11 There's nowhere in the Annual
12 Report that says this is a nonrecurring
13 special charge. That's very difficult for the
14 Board's staff and even somebody who looks at
15 annual reports like me, to figure out which is
16 a nonrecurring special charge and which is
17 excluded, but it can add hundreds of millions
18 of dollars to the cost and to the results.

19 My third suggestion is to improve
20 the make-whole adjustments. The make-whole
21 adjustments have a lot to do with not URCS,
22 but the waybill sample. The make-whole

1 adjustments are primarily based on the waybill
2 sample, and there's a lot of things in the
3 waybill sample that need to be audited and
4 corrected and adjusted that could improve the
5 make-whole adjustments.

6 For example, there are over 3,000
7 records in the waybill sample that have no
8 costs at all. So when you're making whole the
9 total cost, those zero cost records
10 essentially get allocated to somebody else
11 because they're not allocated to those
12 movements. And a lot of these are Canadian
13 shipments and other traffic.

14 There's also a problem in the
15 waybill sample with so-called re-bill
16 shipments. For example, wheat moving east
17 going through Chicago will show up sometimes
18 as a movement to Chicago, although it might be
19 destined to New York.

20 So, it essentially shows up as two
21 records in the waybill sample, Montana to
22 Chicago, Chicago to New York and essentially

1 gets two terminals added because you cost it
2 as an origin and a destination, and an origin
3 and a destination again.

4 So, there's some improvements in
5 handling the waybill sample that would improve
6 URCS and make it more accurate.

7 Another suggestion I've had is
8 segregating fuel costs and improving the Phase
9 III costing program to show a fuel cost line
10 item and also input for -- an input for the
11 fuel surcharges.

12 As you know, fuel surcharges have
13 become an increasing amount over the years and
14 there's nowhere in the URCS printout that
15 you'll see what the railroad's fuel cost is.
16 It's included in gross ton mile cost,
17 locomotive unit mile cost and switch engine
18 minute cost.

19 And if you segregated that and had
20 a line item for fuel, it would allow shippers
21 the ability to evaluate the fuel surcharges
22 and the railroads, more accurately. And it's

1 not a big deal to do, I wouldn't think, to
2 reprogram that.

3 My fourth p fifth suggestion is
4 there's some minor adjustments in the URCS
5 Phase III program that you could make. One
6 thing that some of the members of the wheat
7 and barley commissions have had problems with
8 is when you use actual miles and you're
9 costing a multiple-car movement, the URCS
10 Phase III program automatically adds a
11 circuitry factor.

12 For example, in the case of
13 Burlington Northern covered hoppers, it adds
14 a circuitry factor of 12.6 percent to the
15 actual miles. So, it automatically inflates
16 the cost and assumes that circuitry is added.

17 The circuitry factor -- when URCS
18 was designed, it was designed based on short-
19 line miles which were published miles. And
20 then when you use short-line miles, the
21 circuitry factor would be used. But most
22 people have access to actual miles, and the

1 added circuitry factor adds to that.

2 So, there's some minor adjustments
3 in the URCS Phase III program itself that you
4 could do to make things more accurate.

5 I have other comments on the
6 Board's process, but one other point I wanted
7 to point to is without the flexibility of
8 making adjustments, it really can distort the
9 picture of some movements.

10 And we have a specific example in
11 my testimony where the railroad has switched
12 from 52 cars to 48-car tariffs, and because
13 there's a default value in URCS which assumes
14 that anything under 50 cars is multiple-car
15 and anything over is a unit-train, and by
16 doing so by making that switch, the cost
17 should not be so different when you're just
18 moving four less cars.

19 In fact, the railroads aren't
20 moving four less cars, they just changed the
21 tariff to say four less cars. But when you
22 cost 48 versus 52, it takes the revenue-to-

1 cost ratio from, effectively, 268 down to 158.

2 So, this effectively deregulates
3 the traffic because you're taking that traffic
4 below the jurisdictional threshold.

5 So, it's because the rigidity of
6 your policies that won't allow us to adjust
7 for the actual train characteristics. And the
8 railroads are taking advantage of that and
9 effectively it takes that ratio down over a
10 hundred percent. And I have a graph in my
11 testimony.

12 Anyway, those are my only comments
13 and I'd be glad to answer any questions that
14 you have.

15 ACTING-CHAIRMAN MULVEY: Thank you
16 very much, Mr. Fauth.

17 Mr. LeSeur.

18 MR. LeSEUR: Chairman Mulvey, Vice
19 Chairman Nottingham, I am John LeSeur. I'm
20 appearing here today on behalf of the Western
21 Coal Traffic League, the National Rural
22 Electric Cooperative Association, the American

1 Public Power Association and Seminole Electric
2 Cooperative. I'll refer to these shippers,
3 these organizations, as the coal shippers.

4 Coal shippers have submitted a
5 written statement for the record. This
6 morning we want to highlight three points that
7 were made in that statement.

8 First, coal shippers believe that
9 a comprehensive review of URCS is premature at
10 this time. Any such review will be very
11 expensive for shippers, railroads and the
12 Board.

13 Chairman Mulvey has estimated the
14 Board's cost alone will be in the three to \$4
15 million range.

16 At a minimum, coal shippers urge
17 the Board to defer a comprehensive review of
18 URCS at least until such time as Congress has
19 decided whether it will fund the Board's
20 efforts.

21 Coal shippers further urge the
22 Board to consider deferring asking Congress

1 for URCS funding until the Board has had the
2 opportunity to see whether the new maximum
3 rate standards the Board has adopted for
4 application in small, medium and large rate
5 cases are being used. And if they are being
6 used, whether they're working as the Board
7 intended.

8 The Board's URCS review appears to
9 be motivated in large measure by the increased
10 role URCS plays under the new maximum rate
11 standards.

12 Coal shippers suggest the
13 resources of all involved, the shippers, the
14 railroads and the Board, could be better
15 served by first waiting to see whether these
16 new standards are working before focusing so
17 much time and effort on a costly review and
18 fine tuning of one component part in these
19 standards.

20 Second, the Board has asked the
21 parties to comment on how URCS can be
22 improved. Coal shippers are not in a position

1 at this time, to meaningfully respond to the
2 Board's inquiry.

3 To properly answer this question,
4 coal shippers need to undertake a substantial,
5 costly and time-consuming effort to review the
6 current URCS model, to obtain relevant data
7 that might be used to test the model
8 procedures and factors, analyze that data, and
9 then if coal shippers determine that better
10 procedures or factors could be developed, to
11 develop these factors or procedures and
12 present the results to the Board.

13 Third, if the Board does decide to
14 go forward now with a review of URCS, coal
15 shippers request the Board adopt some
16 principles to guide its review, including the
17 following: the Board will undertake a
18 comprehensive review of URCS, not a parse and
19 piecemeal review of isolated portions of URCS.

20 The Board will create a level
21 playing field by giving shippers access to all
22 relevant rail carrier data and specialist

1 studies. If the Board's goal is to make more
2 accurate cost determinations, the Board will
3 reconsider its decision to eliminate movement
4 or route-specific cost adjustments in coal
5 rate cases.

6 And finally, the Board will
7 measure its regulatory costing standards and
8 procedures against the costing standards and
9 procedures actually utilized by major rail
10 carriers today.

11 Coal shippers appreciate the
12 opportunity to present their views this
13 morning.

14 Thank you.

15 ACTING-CHAIRMAN MULVEY: Thank you
16 very much, John.

17 I want to start out with having a
18 few questions. Then I'll turn it over to Mr.
19 Nottingham, Vice Chairman Nottingham, and we
20 will go back and forth until we have exhausted
21 our questions.

22 Mr. Sharp, you mentioned about

1 sending us an e-mail about this hearing on
2 URCS over the last several weeks, but we have
3 no record of having received an e-mail from
4 you.

5 You know you can always call our
6 Office of Public Assistance and Government
7 Affairs and Compliance at 245-0245, and they
8 can answer any inquiries that you or the
9 public has. They have been very, very
10 responsive.

11 And so if you have an issue on
12 this, please contact us and we will be
13 responsive. I promise you that.

14 Starting out again with you, Mr.
15 Sharp, in your testimony you indicated that a
16 revision of URCS would likely benefit coal
17 shippers. And many of the changes that you
18 would make in URCS to reflect modern
19 railroading, would probably have the result of
20 benefitting the coal shippers in terms of
21 their variable costs.

22 Would you say that's an accurate

1 assessment of your testimony?

2 MR. SHARP: Yes. We believe that
3 just as far as the URCS analysis, in other
4 words the numbers, the costing numbers you
5 would get out of URCS, we believe if URCS is
6 revised, that they would be lower.

7 ACTING-CHAIRMAN MULVEY: To what
8 extent would that simply result in overall
9 railroad costs being shifted from coal
10 shippers to other shippers, or do you think
11 that the total variable costs that need to be
12 allocated would also come down, or would it be
13 largely a shifting of the costs between
14 groups, or would there be some reduction in
15 overall costs that need to be allocated to
16 shippers?

17 And that's for you or anybody else
18 who wants to answer that question.

19 MR. SHARP: Well, I'll start out.
20 Others may want to jump in on that, but I mean
21 it's really sort of outside the scope of what
22 we were looking at.

1 I mean we're, you know,
2 specifically looking at URCS and what we think
3 would need to be changed in URCS to make it
4 more accurate, more accurately reflect the
5 costs that the railroads actually have.

6 And then when you start looking
7 at, you know, what's the p if that does lower
8 the calculated cost of shipping these unit
9 coal trains that represent a lot of the
10 tonnage, you start looking at what's the
11 effect on the cost structure of the entire
12 rail industry and where do the costs go.

13 So, that would be something to yet
14 be determined by the Board perhaps in other
15 proceedings.

16 But as far as just looking at
17 results that have come out of URCS now that
18 we're seeing some of these rail rate cases
19 depending on URCS for their outcome rather
20 than standalone rail costs or some other type
21 of calculation, we're becoming more sensitive
22 to some of the inaccuracies. And can see from

1 what, you know, from the Board's notice, that
2 there are some things here that could be fixed
3 to make it more accurate.

4 ACTING-CHAIRMAN MULVEY: Anyone
5 else want to touch that?

6 Tom?

7 MR. O'CONNOR: Thank you, Chairman
8 Mulvey.

9 We touched on the reallocation of
10 costs that might flow from a lower cost from
11 coal. So, there's several subjunctives there.

12 We haven't done the studies to
13 indicate whether a revision would result in
14 lower costs for any particular commodity. But
15 let's take that p let's take your question as
16 a hypothetical and move to the issue of make-
17 whole, which is really what you were
18 discussing what happens to the costs if the
19 coal costs go down, do other costs go up.

20 Now, the time-honored or at least
21 traditional means of dealing with that
22 situation has been the make-whole factor. And

1 the make-whole factor comes about out of a
2 general rate increase period.

3 Now, I'm going to go back in my
4 career to when I was AVP of economics for the
5 Association of American Railroads, and I
6 happened to have that position when we were in
7 a general rate increase period. And then when
8 we deregulated, then moved into the current
9 period, and here is the rationale as I
10 understand it for the make-whole.

11 The make-whole was developed so
12 that when you applied the cost reductions that
13 flow out of Ex Parte 270, Sub 4, which came
14 about in 1974, and it engended significant
15 cost reductions for unit-trains, for example,
16 the question before the rail industry was we
17 still experienced those costs and we are going
18 into a general rate increase with a cost
19 justification for it.

20 And it would frequently be the
21 case that we'd have a general rate increase
22 every four or five months because costs were

1 going up. That prompted the next general rate
2 increase.

3 So, the mechanical problem was if
4 we're applying Ex Parte 270, Sub 4, we still
5 spent that money. How do we get that back
6 into the process? That resulted in the make-
7 whole factor.

8 And the make-whole factor is
9 basically p let me hazard -- let me take an
10 additional step and let me say an arbitrary
11 allocation or reallocation of those cost
12 savings to other movements.

13 So, that's the genesis of the
14 make-whole factor that still persists to this
15 day when we are no longer in a general rate
16 increase situation, but that's where it comes
17 about.

18 This would be one of the things
19 that if you were to do a comprehensive review
20 of URCS, you could consider the following
21 question: How, for example, does the cost
22 increase for a single-carload non-coal shipper

1 when we calculate the unit-train cost
2 reductions for the coal shipper, how do the p
3 how do the costs somehow shift from the powder
4 river basin to Houston, Texas from a unit-
5 train to a disconnected, unrelated, single-
6 carload shipment in Houston, Texas? That
7 would be a good question to ask.

8 But what we are p what we are
9 doing now is we're bound by tradition. And in
10 the current systems, make-whole is something
11 that we deal with. But I'd be hard pressed to
12 come up with a solid economic rationale for
13 it, but there it is.

14 Again, this is the reason for a
15 comprehensive review.

16 ACTING-CHAIRMAN MULVEY: Well, I
17 was going to get to that. There's three
18 possibilities.

19 There is an incremental, a
20 piecemeal approach to finding the things that
21 are most egregious about URCS, the studies
22 that are most needed and most out of date at

1 least reflective of modern railroading; two,
2 there's going back and doing everything in
3 URCS, redoing URCS and having a new URCS with
4 everything looked at and everything changed
5 that needs to be changed; and then finally,
6 there's a possibility of scrapping URCS
7 entirely and come up with some other sort of
8 costing formula.

9 Does anybody want to chime in on
10 the feasibility of the p especially the last
11 of those three?

12 MR. O'CONNOR: I'll take that.

13 I have some experience with
14 creating a cost system from a blank piece of
15 paper. I have looked at that situation in
16 Canada, and I have looked at that situation
17 for one of the major railroads when I was with
18 Conrail.

19 And, in fact, we created a
20 management-based costing system and it was
21 definitely not a trivial exercise, I can
22 guarantee you that, but it tended to follow

1 the structure that we sketched on that one
2 slide where you begin with regression
3 analysis, and then you begin with various
4 other types of analysis, and you're doing your
5 best to determine what caused this cost to be
6 incurred.

7 And some of them I think are going
8 to be fairly straightforward. We know that
9 that crew was on that train, we know that that
10 fuel was burnt, you know. We might even know
11 it was burnt on that train.

12 So, you're going to get some costs
13 that are going to be directly assignable,
14 you'll get other costs that are going to be
15 reasonably well-behaved. And if your records
16 are good, you're going to get decent
17 regression results out of it, but it's
18 entirely possible that most of your costs are
19 going to be in the next category. They don't
20 have produced good regression results, so now
21 you're into empirical analysis. This is
22 really where you need to have a transparent

1 process.

2 I would not speculate at this
3 particular point if you were to take that
4 course of action, exactly what the result
5 would be. But I can tell you that when I have
6 done that, I have come to something similar to
7 the regulatory costing system. Something
8 similar to it because you're describing the
9 same industry. And it's an industry replete
10 with joint and common costs which have to be
11 dealt with.

12 ACTING-CHAIRMAN MULVEY: Anybody
13 else want to try to address that question?

14 Mr. LeSeur, your group, you were
15 the only person not only in this group, but in
16 all the testimonies that were received, you
17 were the only ones to suggest that the Board
18 postpone or not move right now, suggesting
19 that we wait until we see what the experience
20 is with the simplified standards and the
21 streamlined guidelines for large rate cases.

22 Well, we are already getting

1 experience with that. We have already
2 adjudicated cases in both of those areas.
3 While they are at appeal, they are being done.

4 And it does seem that we are
5 getting that experience, and I'm not sure that
6 that's a particularly good reason for
7 postponing it further.

8 Finally, and secondly, Mr. Sharp
9 indicates, and I think most of the testimony
10 indicates, that coal shippers would very
11 likely be the ones who might benefit from
12 redoing URCS taking into account modern
13 railroading.

14 So given that, you feel
15 comfortable still saying that we should
16 postpone this?

17 MR. LeSEUR: I think if the Board
18 would stipulate that the variable costs for
19 coal movements would go down, we might have a
20 different position.

21 (Laughter.)

22 MR. LeSEUR: But we, the groups we

1 represent, we don't have access to any data to
2 say that that's going to be the case. I mean
3 this is a very complicated process.

4 Anybody who went through it the
5 first time around knows how complex and how
6 expert-driven this exercise is. And our
7 experts today can't, you know, say that costs
8 are going to go down or go up.

9 It would depend upon the types of
10 studies that you do, it would depend on how
11 extensive those studies are.

12 So, I think at this point, you
13 know, it's extremely difficult for anybody
14 sitting in our position to know what the
15 answers are going to be.

16 That's one of the reasons why you
17 undertake analysis, is to determine what the
18 answers are.

19 Insofar as your experience is
20 concerned, I think you've had one, in effect,
21 small rate case, you haven't had any medium-
22 sized cases, and you had a couple of large

1 cases and one standalone cost decision.

2 You have to understand from the
3 standpoint of the shipping community, you
4 know, one of the things that's very important
5 is just kind of know what the rules are and it
6 affects sometimes what the answer are going to
7 be.

8 And to the extent that you start
9 to go in and basically create a lot of
10 uncertainties to, you know, one huge
11 component, you're creating uncertainty within
12 the community.

13 And for our part, you know, coal
14 shippers and other shippers have been through
15 three or four, maybe five years, where the
16 standards were up in the air.

17 And when the standards are up in
18 the air, it's hard to know how to advise your
19 clients, clients don't know what to do, they
20 don't know what the answers are here.

21 And when you reopen URCS
22 particularly on some type of comprehensive

1 basis, you know, you're creating a lot of
2 upheaval and folks won't know what the answers
3 are again.

4 And our position basically is
5 we've been through a period of a lot of
6 upheaval, you have had a few cases, you
7 haven't had a lot of cases, take a look, see
8 where the answers are coming out, how things
9 are going, and at that point if you think URCS
10 is where you need to focus all your time and
11 attention insofar as the rate cases are
12 concerned, then go ahead and do it.

13 ACTING-CHAIRMAN MULVEY: I wouldn't
14 say we're focusing all of our time and
15 attention there, but it's certainly a major
16 concern.

17 And in your testimony, you do
18 admit that a revision of URCS is needed and
19 your question was more of a timing one. And
20 you also suggested that the Board secure
21 funding from the Congress before it went
22 forward.

1 And as I have said, we are trying
2 to get the Congress to pony up some of the
3 money to get this thing started. It will take
4 several years.

5 And so the sooner we get started
6 on this, I think the better off we're going to
7 be. If we wait several more years, it will be
8 a decade before this thing is put into place
9 assuming that it takes three or four years to
10 complete the analyses. And then of course it
11 will be challenged in the courts, as
12 everything else is.

13 And so by the time it finally goes
14 into place, it could be half a decade or more
15 from now.

16 MR. LeSEUR: I think in terms of
17 what we said in our comments, just for
18 clarification, we agree with the Board that
19 you want to develop accurate costs. I don't
20 think anybody disagrees with that principle.

21 I think that the only way you can
22 determine whether the current system is now

1 producing accurate results, is to go through
2 the exercise of collecting data, running all
3 the analyses. And you may find in the end
4 that the answers that are, you know, coming
5 out of URCS after you make all these changes,
6 aren't much different than what you have
7 today.

8 Our basic position is, you know,
9 we don't know the answers until you go through
10 the exercise.

11 ACTING-CHAIRMAN MULVEY: But
12 clearly we can't make the exercise to make
13 things more accurate dependant upon whether we
14 get an outcome that we like, but I think we
15 want to make it as accurate as we possibly
16 can.

17 And I think we've made other
18 changes in the Board. For example, it was at
19 the behest of the Western Coal Traffic League
20 that this Board undertook a review of how we
21 calculate the cost of capital, especially the
22 cost of equity capital.

1 And the coal shippers were very
2 active in putting resources forward and
3 helping the Board look at that and make the
4 changes. And we appreciated that. And we
5 have made changes.

6 Again, we think that our new cost
7 of capital estimate is a better measure and
8 it's a more accurate measure than the one that
9 we had before.

10 And I think this is part of a long
11 process that we are trying to get as accurate
12 measures as possible, cost of capital and
13 anything else this Board does.

14 Do you want to ask any questions,
15 Mr. Nottingham?

16 Thank you.

17 VICE CHAIRMAN NOTTINGHAM: Thanks,
18 Acting-Chair Mulvey. I'll be happy to ask a
19 couple questions. Thanks, panel. Welcome.

20 Mr. Sharp, thank you for jolting
21 me to attention. Nothing gets my attention
22 more than a public claim that the STB is not

1 being responsive to routine inquiries for
2 public information.

3 I think if I recall, you and I
4 have chatted about that personally before
5 where I reached out to you to express my
6 concerns and my interest in making sure you
7 had full access to the Board and I want to
8 reiterate that.

9 Could you just recount what you
10 have not b what you've asked for from the
11 Board that you've not received, when you asked
12 for it, and who exactly asked for it?

13 I didn't see it in your written
14 testimony. So, I just -

15 MR. SHARP: Right. I do not recall
16 the specific dates. We can provide that to
17 you.

18 But our consultant who was running
19 the analysis of URCS for us, Mike Nelson, is
20 the one that sent the e-mail to the e-mail
21 address that was suggested there, and didn't
22 get any response.

1 And part of the reason we didn't
2 contact you all by phone, there again, was
3 just the short lead time of the proceedings.
4 I mean we got to a point where the last few
5 days there, you know, we wouldn't have been
6 able to do anything with it.

7 But we will do that. We'll follow
8 up with a phone call.

9 VICE CHAIRMAN NOTTINGHAM: If you
10 could, please, get to us what you're looking
11 for, and also to help us address any potential
12 problems we may have internally getting back
13 to the public.

14 I've spent, and I know my
15 colleagues on the Board have too, we've made
16 exhaustive efforts to make sure that we are
17 more transparent, more accessible, using
18 websites, using the telephone.

19 Please, my direct dial, (202) 245-
20 0200. If there is ever p let me say this: If
21 there's ever a time when you are not getting
22 public information or responses to inquiries

1 of the Board, please call me.

2 MR. SHARP: Okay.

3 VICE CHAIRMAN NOTTINGHAM: The
4 most efficient way is probably to call the
5 number that first that the Acting-Chairman
6 gave you, the 245-0245 number, which is our
7 Office of Consumer Assistance.

8 But if you don't have p if you
9 have any trouble getting response there,
10 please call because we've p I've reached out
11 to you personally two years ago, going on
12 memory here, called you to say hey, I
13 understand you may have had a problem with
14 responsiveness or the type of response you've
15 received in the past, I want to correct that,
16 I want to make sure that never happens again.

17 And to hear -- and then, frankly,
18 a year or so later you went up to the House
19 Transportation Committee and publicly
20 recounted the same old episode from a previous
21 p under a previous Board where you were
22 concerned you didn't get the responses from

1 the Board.

2 I just p I worry that you have a
3 tendency to come into public forums and want
4 to lambast the Board's professionalism or
5 responsiveness. And maybe I'm a little
6 sensitive on this, but I'm starting to see a
7 pattern here. I mean let's just keep
8 communicating as best we can.

9 If you could, please give us who
10 asked for what, when, and then what you need,
11 and we'll make sure -- now, let me understand.
12 Was this in the context of a rate case that
13 you were not a party to?

14 Did you say this was the KCPL UP
15 case that you were kind of tracking for your
16 own p

17 MR. SHARP: We were just tracking
18 that. We're basically looking for information
19 on URCS. Like I said, this is not p and part
20 of the reason we didn't call the customer
21 service number is this p I mean it's a p this
22 is an URCS-specific kind of an issue.

1 I mean it's not, you know, it's
2 not the kind of thing where we've got a
3 problem with the railroads, we're going to
4 call the STB.

5 We were trying to get information
6 about URCS. And it says there, you know, if
7 you got a question, send this e-mail to this
8 address. And we did that.

9 VICE CHAIRMAN NOTTINGHAM: It says
10 where, what?

11 MR. SHARP: I'll get the specifics
12 to you.

13 VICE CHAIRMAN NOTTINGHAM: Okay.

14 MR. SHARP: I don't have that with
15 me at this time.

16 VICE CHAIRMAN NOTTINGHAM: But,
17 please, any -- no matter what the topic, if
18 it's an inquiry that depends on the STB to
19 provide you with something, please call the
20 number we've given you or call either one of
21 the Commissioners' offices.

22 MR. SHARP: Sure.

1 VICE CHAIRMAN NOTTINGHAM: I have
2 every confidence we'll get right back to you
3 assuming the information is not privileged.
4 And if it is, we'll explain why.

5 But now the case you p

6 MR. SHARP: Part of the problem was
7 just the time frame. Like I said, you know,
8 there was p by the time we got to this point
9 of starting to wrap things up, we realized we
10 didn't have that and -

11 VICE CHAIRMAN NOTTINGHAM: Was this
12 information important to you?

13 MR. SHARP: I think it would have
14 helped us preparing for this presentation.

15 VICE CHAIRMAN NOTTINGHAM: For
16 today's presentation?

17 MR. SHARP: For today's
18 presentation.

19 VICE CHAIRMAN NOTTINGHAM: But it
20 was important, but not important enough to
21 pick up the phone and call someone about it or
22 to follow up or p

1 MR. SHARP: Well, we just ran out
2 of time.

3 VICE CHAIRMAN NOTTINGHAM: I didn't
4 see it mentioned in your written testimony at
5 all and I just p now, the case you were
6 tracking that you mentioned, the KCPL UP case,
7 I can understand the point that when parties
8 mutually agree to resolve a case based on the
9 180 percent of revenue-to-variable-cost ratio,
10 that it could accentuate the reliance and
11 importance of URCS. That's a good point.

12 I will note that was a shipper
13 victory, if I recall. It also was a shipper
14 victory with substantially reduced timelines
15 and attorneys' and consultant fees.

16 And so, I hope you're not holding
17 that type of case up as a problem example as,
18 you know, if it is, I think we've come a long
19 way from when I came to the Board. We weren't
20 complaining about shipper victories in record
21 time at record-low expense.

22 But if you want to amplify what

1 your p do you have a problem with the fact
2 that those two parties and the shipper agreed
3 to address that case that way and that it
4 resulted in a shipper win?

5 MR. SHARP: No. And I'll expand on
6 that a little bit.

7 And like I said, we appreciate the
8 fact that these cases can be simplified and
9 can be dealt with in a short time frame.

10 But the point is prior to
11 movement-specific cost adjustments not being
12 used and prior to that type of result in a
13 rate case, we weren't all that concerned about
14 URCS because it wasn't likely going to be the
15 determining factor in a future rate case that
16 we might be in. So, I mean that's the point.

17 The point's not that we have any
18 problem with, you know, with the direction
19 things are going. But the direction things
20 are going puts more of the specifics of what
21 your rate is going to wind up being in the
22 hands of URCS, which is pretty much a black

1 box.

2 And that's where we say we were p
3 we're trying to understand as much as we can
4 about URCS.

5 And Tom O'Connor here talking
6 about his long history and involvement with
7 it, probably has a lot more insight to it than
8 myself and the consultant that we were using
9 who were p we were not involved in the
10 development of it and don't have some of the
11 source documents in our files. And just
12 reaching and not being able to find some of
13 those things on short notice, like I said,
14 that's really kind of the problem with that
15 that we were kind of pointing out.

16 We like the fact that the cases
17 can be done with a lot less time and a lot
18 less detail. And we like the concept that the
19 Board has put forth here that the Board feels
20 that URCS needs to be revised to reflect
21 current rail costs.

22 Like I said, there may be other

1 problems, as Chairman Mulvey has pointed out,
2 that that results in. But just in that narrow
3 context, we're glad the Board had this
4 proceeding and certainly don't have any
5 problem with the way that the rate cases in
6 general are going.

7 But it does wind up putting a lot
8 more emphasis, in our minds, on URCS.

9 VICE CHAIRMAN NOTTINGHAM: I
10 understand. Thank you.

11 Mr. LeSeur, I wasn't sure if you
12 were completely serious, but did I hear you
13 say that you'd be happy to move forward with
14 a comprehensive review and improvement of URCS
15 as long as we could stipulate that your
16 clients would benefit?

17 MR. LeSEUR: Well, that wasn't p

18 VICE CHAIRMAN NOTTINGHAM: Are you
19 seriously saying p I mean is that p

20 MR. LeSEUR: No, that was not --
21 that was a joke.

22 VICE CHAIRMAN NOTTINGHAM: Okay.

1 MR. LeSEUR: Everyone was p

2 VICE CHAIRMAN NOTTINGHAM: I have a
3 sense of humor too. I just want to make sure
4 I know to distinguish between what's p because
5 I mean we are p this is -- obviously, if we p
6 I mean who are we kidding?

7 If we take on a comprehensive
8 review of URCS, someone is going to possibly
9 be paying higher rates, someone at lower
10 rates. And if the going-in sort of assumption
11 is that if anybody ends up paying a higher
12 rate, then it's a flawed process no matter who
13 we get to bless it as being completely
14 objective procedurally and transparent, I
15 mean, you know, it makes it kind of hard to
16 get excited to launch off on that journey if
17 that's going to be the reward we get.

18 MR. LeSEUR: We haven't said
19 anything about what the outcome of the
20 proceedings p other folks have been saying
21 that the variable costs in coal will go down,
22 and that was p

1 VICE CHAIRMAN NOTTINGHAM: And I
2 don't know that for fact. That's p

3 MR. LeSEUR: Either do we.

4 VICE CHAIRMAN NOTTINGHAM: I think
5 that would be p

6 MR. LeSEUR: That's why I'm always
7 asking a question about that. So, that was
8 our, you know, our response to a question
9 which was, you know, why don't you want to go
10 forward if the variable costs on coal will go
11 down.

12 So, that was the repartee there.

13 VICE CHAIRMAN NOTTINGHAM: Thank
14 you.

15 Mr. O'Connor, are you familiar --
16 how familiar are you with the railroad
17 property investment piece of the puzzle, the
18 fixed costs versus variable costs, and the
19 fact that for many, many decades that there's
20 been kind of a rough compromise that that
21 should be apportioned 50 percent, 50 percent;
22 50 percent of a railroad's real property

1 should be attributed to fixed costs, 50
2 percent to variable?

3 That would seem to me, to have the
4 effect of keeping their costs from an URCS
5 vantage point, lower, but what's your sense of
6 the expert community's opinion on the accuracy
7 and sort of how that has stood the test of
8 time as far as that 50/50 split?

9 MR. O'CONNOR: Sure. The 50/50
10 split -- we've been talking to some extent
11 about things that were analyzed in the past.
12 And time has passed since that analysis. I'm
13 talking now about like the Rail Form A
14 regression analyses going back to 1978.

15 But even during that period, to
16 the best of my knowledge, there was no
17 regression analysis of the road property
18 investment. And that would be a good
19 candidate for running a regression analysis
20 and see what the data tells you.

21 The 50 percent, I really don't
22 know what is behind that, although I've been

1 familiar with it for decades. It was in place
2 when I first entered this profession.

3 And one of the first things that I
4 did when I was an economist at the ICC, was to
5 write a report on the cost evidence that was
6 brought to bear in various ICC decision-making
7 processes, and it kind of sprang from Ex Parte
8 270, Sub 4.

9 So, I came across the fact that we
10 had a 50 percent sort of assumed variability
11 there and it caught my attention, but I didn't
12 delve further into it then.

13 That would be a logical thing to
14 take a look at. I wouldn't presume that the
15 answer would be up or down, but that
16 particular piece of data should respond
17 reasonably well to a regression analysis.

18 MR. LeSEUR: Can I just add
19 something on that?

20 VICE CHAIRMAN NOTTINGHAM: Please.

21 MR. LeSEUR: The 50 percent that
22 you refer to was extensively reviewed during

1 the last URCS proceeding. I don't claim to be
2 an expert on this.

3 My understanding is that despite
4 all of the efforts from many p all sides
5 including the Board's contractor, no
6 regression that met the standards of, you
7 know, a proper regression could be met. And
8 so, therefore, it's a default, but it was
9 something that was extensively reviewed when
10 URCS was put together.

11 And the 50 percent based upon the
12 evidence of the record at that time, was
13 determined to be the proper standard.

14 So, but it was -- that was not
15 something that was just glossed over the last
16 time around, to my recollection.

17 VICE CHAIRMAN NOTTINGHAM: Mr.
18 O'Connor, it occurs to me you may be if not
19 singularly qualified, we probably have a few
20 others with us here, but you've worked on some
21 complex data research projects possibly in
22 even an oversight, managerial role, as well as

1 a technical role.

2 One of the challenges we have to
3 face looking at this from a project management
4 perspective is, and maybe I'm showing my old
5 highway project management background, but how
6 do we scope this out, put a budget and a
7 timeline together in a way that we can brief
8 Congress and the stakeholders and earn their
9 trust and respect that we have a plan that's
10 going to be on a fairly tight budget, it's not
11 open ended, and that when we go to Congress
12 for funding, we know what number we're asking
13 for and it's not going to be an annual
14 guesstimate as to with no end for ten years?

15 That could be very embarrassing to
16 the Board, it could be very much of a waste of
17 taxpayer dollars if we don't manage this p as
18 important as this topic is, it seems to me it
19 could be studied and analyzed until the cows
20 come home with unlimited expenditures before
21 everybody would agree that it's completely
22 spot on right.

1 And so, any advice on how we might
2 want to think about embarking on this in a way
3 that gets us to a sound, a well-managed
4 project?

5 MR. O'CONNOR: I can offer some
6 thoughts on that. And I, you know, indeed
7 when I was with Conrail, I took over. I took
8 over, and in fact practically doubled the size
9 of my staff, a project that had been underway
10 for several years.

11 It was an internal cost-finding
12 project, if you will, for internal management
13 purposes. It had nothing to do with the
14 regulatory arena, so you probably haven't
15 heard much about it.

16 And the way we tackled that was to
17 first make an analysis as to where we would
18 likely be able to be identifying major costs
19 in the first instance.

20 We'd look at the history, what are
21 the past efforts to resolve this problem?
22 Were they promising or were they a dead end?

1 I would not begin, for example,
2 with general overhead. I wouldn't begin
3 there.

4 I would begin with costs that your
5 heuristic analysis or your prior research
6 indicates should be directly assignable. And
7 then I would move to what are the results of
8 the regressions that have been run in the
9 past, what do our past efforts show in terms
10 of ρ excuse me ρ the responsiveness of major
11 blocks of expense?

12 Think of fuel, for example. Fuel
13 is a pretty decent and pretty well-behaved
14 cost category. And if we were in Canada, for
15 example, you would probably see a regression
16 from time to time proposed for fuel that would
17 have things like car mile, it would have gross
18 ton mile. So, we've got distance, we got
19 weight.

20 And you would probably find an
21 argument in that regression called gradient.
22 And gradient is a surrogate in the simplest

1 form for uphill/downhill.

2 Now, when I was going back to when
3 I was in grad school, I was a yard clerk on
4 the SOO line. And I got the concept of uphill
5 and downhill, because the trains on the SOO
6 line coming from Madison into Milwaukee, were
7 longer and heavier than the trains going from
8 Milwaukee to Madison, because that was uphill.

9 And so you -- there's a certain
10 common sense to this thing and -- but begin
11 with what you p begin with your experiences as
12 a highway project manager, that's an excellent
13 place to begin, and sort your problems out;
14 these should respond, these might respond,
15 these probably won't.

16 And you're talking to Congress,
17 let's start with the ones that should respond.
18 Let's do those first, especially if they're
19 big-dollar items, you know, especially if
20 you're getting a lot of complaint and debate
21 about it. I would begin there, but it's a
22 project management process.

1 And the key to project management
2 is communication. You communicate with your
3 audience, you let them know what you're doing,
4 you let them know what you're going to be
5 doing next, you listen to them, and you
6 reflect their views.

7 The project management approach is
8 a perfect approach for this.

9 ACTING-CHAIRMAN MULVEY: Chip, let
10 me follow up on that a little bit.

11 It's been suggested that p and I
12 think this gets to Chip's question about doing
13 this in a way that gives us a result that is
14 efficient, cost effective, et cetera. And it
15 does depend upon how you frame the question,
16 how you communicate the question, how you
17 communicate the project.

18 There have been several who have
19 suggested that the Board might put together a
20 panel of experts who would look at the issues
21 similar to what we put out in our request for
22 this hearing, the major issues that need to be

1 addressed, and to sit down and talk about what
2 will be the best way to approach them, and
3 then develop an RFP, Request for Proposal p
4 I've been in Washington, D.C. too long, but
5 put out a proposal that was well thought out
6 and was focused, et cetera.

7 It might be comprehensive, but
8 this panel of experts would be the ones who
9 would develop the proposal request. And that
10 could include, and it would definitely
11 include, of course, board members, board
12 staff.

13 Board staff are the ones who are
14 going to need to work with it. They also have
15 the expertise and the experience working with
16 URCS.

17 But then there's also the
18 possibility of including people from the
19 railroad industry, the shipper community, and
20 perhaps some academic experts and sort of
21 envision this as a sort of star panel.

22 We should be able to put something

1 out like that in several months. Would you
2 care to comment on the feasibility, doability
3 and desirability of that approach?

4 MR. O'CONNOR: Yes, I can comment
5 on that. And p now, I should be clear here.
6 We've now -- I'm speaking as Snavelly King at
7 the moment. Okay? Because I haven't
8 discussed issues like this with the clients in
9 response to the testimony that I put forward
10 today. Although, they may or may not agree
11 with my comments in the question and answer
12 period.

13 ACTING-CHAIRMAN MULVEY:
14 Understood.

15 MR. O'CONNOR: So, speaking from a
16 Snavelly King's perspective, I think that kind
17 of approach could be quite useful, and you
18 will know quickly whether it's going to be
19 useful or not.

20 Bear in mind again, now, this is
21 project management, this is communication.
22 And if that attempt turns out to be a blind

1 alley, to be unproductive, you'll probably
2 know fairly quickly.

3 And the Board staff would be an
4 excellent member of that. As you know, we've
5 had excellent interactions with the Board
6 staff. I think very highly of them.

7 You would need involvement from
8 the railroads. You would need involvement
9 from shippers. You would need involvement
10 from, I think, the academic community.

11 And just to put some size to that,
12 TRB would be a logical place, I think,
13 probably to look for that kind of involvement.

14 I would give them specific tasks.
15 I wouldn't give them a blank piece of paper
16 and hope for the best. I would give them a
17 specific task.

18 If your first thing is a project
19 plan, that's what I'd ask them to do. And if
20 your first thing is a timeline, that's what
21 I'd ask them to do.

22 And I would ask questions

1 initially that you are pretty confident about
2 the answer yourself. You thought you had a
3 pretty idea on the answer yourself. I would
4 not ask them for the meaning of life, which
5 could take them a bit.

6 And in that kind of an iterative
7 process, they can help move you forward and
8 you'll quickly see whether this is a
9 productive avenue of attack or it's something
10 else. In which case, you're going to of
11 course correct.

12 ACTING-CHAIRMAN MULVEY: Anybody
13 else want to address that?

14 Gerald?

15 MR. FAUTH: I've put that idea in
16 my statement.

17 ACTING-CHAIRMAN MULVEY: Yes.

18 MR. FAUTH: I think you saw that.
19 I think it would be a good idea, and I think
20 that's what they did with URCS. They had a
21 panel. My father was on that panel and helped
22 develop some URCS ideas. There's also been

1 other precedent for those.

2 I think the -- I was on the
3 Conrail Transaction Panel Council which came
4 out of the Conrail merger, and I felt that was
5 very effective working through with the
6 railroad's ideas and how to get through the
7 Conrail transaction. And I thought it was
8 effective council and helped work through some
9 of the difficulties with that transaction.

10 I think such a panel could be
11 effective with URCS, although I'd have the
12 fear of the railroads controlling it and there
13 would have to be an independent sort of
14 chairman of the panel.

15 Certainly you need the railroads
16 there. They're the major stakeholders, but -
17 and STB staff. And academic people on the
18 panel would be certainly a good idea.

19 ACTING-CHAIRMAN MULVEY: Well,
20 certainly it would have to be the case that
21 whoever chaired the panel and was directing
22 the panel would be somebody from either the

1 Board or an outside, unbiased academic. You
2 would not have either a shipper or the
3 railroad running it. And that, I believe, was
4 part of your suggestion.

5 And your suggestion was also
6 echoed in some of the other testimony, the
7 idea of having a bipartisan, an unbiased panel
8 help to formulate the Request For Proposal
9 that goes out to sort of speed things up, but
10 I think that's something that's very much
11 worth looking into.

12 One of the questions that comes
13 up, however, in all of this, and I address all
14 of you even when I think I know the answer,
15 but I want to hear it from the panelists, and
16 there's a problem of there's p this is a very,
17 very data-rich and data-intensive process and
18 there's real problems of confidentiality of
19 the data.

20 There is going to be a need to see
21 data from the railroads, their costing models,
22 et cetera, that are digging very much into the

1 railroad costs. And the railroads quite
2 rightfully want to make sure that proprietary
3 information is not leaked out.

4 How would you ensure the
5 confidentiality of the data in going about an
6 URCS revision?

7 MR. FAUTH: I'll just say that URCS
8 is based on all public data. So, I mean I
9 don't know what confidential data they would
10 have that you would really need.

11 I mean they might have other
12 regressions or other information as b
13 certainly they have fuel studies, that they do
14 their own that could be incorporated into
15 URCS, but I think basically you're using the
16 basic public R-1 data and transforming it into
17 URCS.

18 So, I don't know if there would be
19 big confidentiality problems, but we could
20 have the panel members sign agreements to
21 maintain the confidentiality.

22 ACTING-CHAIRMAN MULVEY:

1 Confidentiality pledges.

2 Tom?

3 MR. O'CONNOR: Yes, I have a
4 comment on that.

5 There would be a need for a very
6 stringent Confidentiality Agreement on this
7 and it's driven by the data.

8 Back when we were analyzing the
9 URCS regressions the first time through here
10 and certainly back with the Rail Form A
11 regressions, you had enough individual
12 operations, individual observations,
13 railroads, so that you could come up with a
14 statistically meaningful inference from that
15 population set.

16 We now are down to six, so we're
17 going to p the size of the universe drops from
18 roughly 40 members down to six or fewer.

19 Now, again we can learn from how
20 other people have handled this problem. And
21 the way that problem is handled in Canada, we
22 have two. And you've had two observations, CN

1 and CP for quite some time.

2 The unit of observation is the
3 operating division within each of those, not
4 mixing the two. It would be CN operating
5 divisions, and CP operating divisions.

6 Now, that takes you out of the
7 realm of publicly available data. That takes
8 you beneath the R-1.

9 And it would be very likely be the
10 case that with as few as six or seven
11 observations, you'd want to consider making
12 some sort of a data panel out of the data that
13 you had before you.

14 As soon as you leave the public
15 record, you need very, very strict
16 confidentiality agreements, but those kind of
17 agreements have been used quite successfully
18 in Canada.

19 The analyses I've just described
20 that were p we're going back 25 years with no
21 problems.

22 ACTING-CHAIRMAN MULVEY: Yes, that

1 was one of the thoughts I had with the problem
2 of only five or seven railroads. Depending
3 upon the data that are available, you would
4 have to break it down by regional or
5 divisional traffic, and that does get you into
6 data that are not in the public domain.

7 Other possibility, of course, is
8 to mix time series and cross-sectional data.
9 I'll talk about that a little bit later on.
10 There are problems with that. There are
11 issues with that statistically, but we don't
12 need to discuss that here.

13 Anybody else with that question?

14 John?

15 MR. LeSEUR: For shippers to
16 meaningfully participate in any review of
17 URCS, we need to have basically this access to
18 the same data that the Board and the railroads
19 have. Otherwise, you don't have a level
20 playing field.

21 And, you know, confidentiality
22 comes up all the time in proceedings before

1 the Board, it comes up in merger cases, it
2 comes up in rate cases, and the Board has an
3 established procedure to deal with it. They
4 have a Protective Order that's been developed
5 over the years.

6 And in the URCS proceeding, you
7 could, you know, use your Protective Order
8 procedure and material that's designated as
9 highly-confidential can only be seen by, you
10 know, outside counsel and consultants and
11 can't be disclosed to clients.

12 So, I think something along those
13 lines could be used. I think the important
14 thing at least from the shipper perspective,
15 would be that you actually p the shippers do
16 have access to all the data.

17 ACTING-CHAIRMAN MULVEY: We do want
18 the process to be transparent and I am
19 sensitive to the black box argument. And we
20 have in the audience today a couple of our
21 former consultants who did some work on
22 competition in capacity for us, Christensen

1 Associates. And they did a competition study
2 that was certainly excellent and that was
3 transparent.

4 They did lay out all the
5 econometric analysis, all their assumptions
6 and their results, which I think makes for
7 perhaps not the most exciting reading for the
8 non-economist, but certainly it's transparent
9 and you know what's done and you know where
10 you agree and where you might disagree with
11 the approach that was taken.

12 So, we will, I think, in doing any
13 of this, be as transparent as possible.

14 I'll turn it back over to Vice
15 Chairman Nottingham again.

16 VICE CHAIRMAN NOTTINGHAM: Thank
17 you.

18 Just perhaps for Mr. O'Connor
19 having worked with the ICC and having worked
20 at the technical level on these issues in the
21 past, you may, and I know others probably have
22 too, but maybe you'll address p this could be

1 just a hypothetical question, but I'll ask it
2 anyway: If the Board were to revisit or were
3 to be mandated to revisit on a fairly tight
4 timeline the issue of whether we should adopt
5 replacement cost accounting versus the
6 historic cost, and at the same time try to
7 embark on an ambitious schedule to rework and
8 update URCS, would you see any problems with
9 that, those two projects going on a parallel
10 track at the same time from either þ just from
11 any perspective?

12 MR. O'CONNOR: Sure. The
13 replacement cost versus historic cost, that
14 would be a good example of a debate that could
15 go on forever. So if you're looking for
16 something to do later, that would be a good
17 choice.

18 On that issue versus URCS, let's
19 come at it from a different perspective. URCS
20 affects all traffic, all shippers, and
21 actually goes beyond the regulatory arena
22 since the URCS þ you become the Esperanto, if

1 you will, for cost analysis even outside the
2 regulatory arena.

3 And as we've talked today, you've
4 indicated the project management approach to
5 URCS as to what do you do first. And we heard
6 from the panel the advisability of having an
7 overall plan, if you will, commitment as to
8 where you're going.

9 What you would not want to do is
10 start with a p this would be the worst
11 possible outcome, I think, this would be the
12 worst possible approach, would be to start
13 with a piecemeal approach that significantly
14 benefitted one party or the other. That would
15 be not good.

16 VICE CHAIRMAN NOTTINGHAM: I'm
17 sorry. Let me clarify to keep us on track.

18 MR. O'CONNOR: Go ahead.

19 VICE CHAIRMAN NOTTINGHAM: It's
20 hypothetical, but if we were to be, let's say,
21 directed on a tight timeline to conduct a
22 process to quickly adopt a replacement cost

1 accounting methodology, and at the same time
2 we were authorized to look at URCS, would you
3 have any concerns about the workload that
4 would present as well as just what the - how
5 that could impact some of the underlying
6 assumptions and data that would affect an URCS
7 project if we were directed, mandated in law
8 to do a quick adoption of replacement costs?

9 MR. O'CONNOR: I haven't considered
10 a mandated replacement b I've seen the
11 proposals that have been put forth from time
12 to time on replacement costs, and we've
13 considered it numerous times over the course
14 of my career.

15 It is b that particular issue is
16 you're not likely to get agreement, you're not
17 likely to get agreement on that.

18 So, if you were talking about a
19 tight timeline, just defining the issue as
20 replacement versus historical, it kind of
21 rules out a tight timeline. It's an
22 unreasonable request to ask for that to be

1 resolved in that tight timeline.

2 ACTING-CHAIRMAN MULVEY: The
3 replacement cost issue is one that has been
4 suggested that be included in the revision of
5 URCS by some of our subsequent testifiers
6 here. So, we'll address that at that time.

7 Steve, you also suggest that the
8 URCS should reflect input substitutability.
9 Do you want to elaborate on the steps required
10 to carry out that change to include input
11 substitutability?

12 I wasn't quite sure exactly what
13 you were talking about there. It's on Page 9
14 of your testimony. The Board should - let's
15 see.

16 Such refinement should include,
17 but not be limited to, specification changes
18 that intercept terms for the regressions,
19 reflect economies of density and input
20 substitutability.

21 MR. SHARP: Well, I think the
22 reference there is just to allow, basically,

1 to get us back to the point where you can
2 model movement-specific traffic rather than
3 just the system-average type thing.

4 I think it's basically just trying
5 to say there where you get down to the point
6 to where you can put different data in there
7 as opposed to the system-average.

8 ACTING-CHAIRMAN MULVEY: Well, one
9 of the things the Board was trying to do in
10 its streamlining processes, was to get rid of
11 the p all the adjustments to URCS that the
12 parties before us were coming, both the
13 shippers and the railroads, try to streamline
14 it.

15 And what I think what the
16 refinement of URCS would try to accomplish,
17 would be to go in and do that anyway, but then
18 fold those changes into the URCS processes.

19 Is that a fair characterization,
20 Tom or Steve or Jerry or John? Anybody want
21 to -

22 MR. O'CONNOR: I have no comment at

1 the moment.

2 MR. SHARP: I'll just very quickly.
3 That was part of our thinking on the process,
4 was rather than having to run URCS and make a
5 bunch of adjustments to it, is to have the p
6 change the model to where if you were talking
7 about coal traffic or if you're talking about
8 intermodal traffic, you know, you just p that
9 gets input from the beginning. And the
10 program takes care of that because it
11 recognizes the differences and handles those
12 rail costs differently.

13 ACTING-CHAIRMAN MULVEY: One would
14 presume that that kind of an approach would be
15 better than ad hoc adjustments.

16 So, Jerry, any comments on it?

17 MR. FAUTH: Well, I just would
18 comment I don't know if this is exactly what
19 he's talking about, but the URCS Phase III
20 program has places where you can change the
21 inputs like train weights.

22 The thru train weight may be like

1 5,000 average, system-average train weight.
2 But if you know you have a larger train size
3 average, then you could change that input.
4 And it's already flexible, it allows you to do
5 some of those changes. Car days is another
6 example.

7 So, I think it's flexible right
8 now that you could do that if the Board allows
9 you to do that.

10 ACTING-CHAIRMAN MULVEY: So, it's
11 increasing the p more or less increasing the
12 flexibility of URCS and coming up with new
13 parametric results.

14 MR. FAUTH: Possibly, but it's
15 already p it's already flexible and allows you
16 to do those things. It's the Board's policies
17 that don't allow you to do those things.

18 The Board's program, you can make
19 some adjustments. It has p allows the user to
20 change the system-average numbers to put
21 different inputs in.

22 ACTING-CHAIRMAN MULVEY: Chip, do

1 you have another question for the Board, for
2 the group?

3 VICE CHAIRMAN NOTTINGHAM: Thank
4 you. Just one last question.

5 It does occur to me that of course
6 we're talking here about the cost of doing
7 railroad business, the cost of each major
8 activity within the business of running a
9 freight and operating a freight railroad.

10 It occurs to me that there are
11 probably some people in this room and
12 elsewhere who actually keep maybe that
13 information and spend a lot of time making
14 sure it's as accurate as possible and that
15 would be freight railroads.

16 They have every incentive to keep
17 track of their costs and to know exactly what
18 each major activity costs.

19 Rather than hire squadrons of PhDs
20 and embark on a five or ten-year journey, what
21 about the idea of just figuring out some way
22 to protect the confidentiality and any kind of

1 business secrets involved, but to actually
2 look at the railroads who are the most
3 efficient freight railroads in the world
4 running the most efficient and productive
5 freight railroad system in the world and
6 actually say hey, let's have a panel sworn to
7 some kind of appropriate confidentiality, take
8 a look at the best practices out among the
9 industry and put together a hybrid approach
10 that wouldn't reveal any particular firm's
11 technique or approach, and just save a whole
12 lot of time and trouble.

13 Any reaction to that?

14 MR. LeSEUR: We put in our
15 comments, one of the things we think the Board
16 should look at if they are going to undertake
17 a comprehensive review of URCS, is to look at
18 what the railroads are actually doing. And I
19 think that should be one component part in
20 your analysis.

21 And then whether you want to rely
22 exclusively on that, over the years there's

1 been individual cases the railroads have said
2 that what they're doing internally is
3 different than what the Board is doing, has
4 different purposes.

5 I think that we would recommend
6 that you do take a look at that as you go
7 forward as part of your comprehensive review
8 of URCS for the very reasons you just
9 articulated.

10 MR. O'CONNOR: And I would return,
11 actually, to the guiding principles that I
12 opened and then closed the testimony with, and
13 I think it speaks to that issue.

14 A revision of URCS really is a
15 highly-technical matter, so it's going to
16 require significant resources.

17 So, asking the railroads what they
18 think about it as a means of not spending the
19 resources, I -

20 VICE CHAIRMAN NOTTINGHAM: If I
21 could, Mr. O'Connor, please, that's not what
22 I propose.

1 My thought is that each railroad
2 probably spends p has spent millions of
3 dollars and millions of internal hours
4 developing very sophisticated systems of
5 tracking costs.

6 And rather than ask the railroad
7 for their opinion or what they would like, you
8 know, looking at those systems, which probably
9 the cumulative time and money and effort spent
10 in developing each of those systems, would far
11 outstrip anything the Board could do in our
12 wildest dreams as far as, you know, in-depth
13 p right now my understanding is the railroads
14 basically have to keep two, you know, for lack
15 of a better phrase, two books.

16 They have their real books they
17 run their business on, and they have their
18 books they use to keep up with STB's URCS
19 process. And that's expensive and burdensome
20 unto itself, but that's just the way our
21 process, I guess, works.

22 But maybe it's naive, but would it

1 be possible just to have one set of books
2 where we're actually using something very
3 close to a hybrid blend of the best practices
4 in the railroad industry of all their
5 collective efforts over the years of updating
6 and adjusting their cost analyses?

7 MR. O'CONNOR: Well, it's a good
8 thought, but let me come back again to the
9 three principles. Let's go through all three
10 of them.

11 Highly technical, going to require
12 significant resources, you can't debate that.
13 I need to review all aspects of URCS, and the
14 third one is really important. If you're
15 going to embark on a revision of URCS, the
16 effort must be transparent. Must be
17 transparent.

18 Now, at any given railroad you may
19 in fact find more than one set of books. You
20 might find that you have a combination of
21 companies, each one of which up until some
22 given point in time had its set of books.

1 Matter of fact, that's very likely what you
2 will find.

3 So, there's going to be p when
4 you turn to the corporate books, if you will,
5 that will not completely eliminate the
6 processes that you're going to have to deal
7 with, but the need for being transparent, I
8 mean, is absolutely critical.

9 MR. FAUTH: Can I just add, vice
10 Chairman?

11 VICE CHAIRMAN NOTTINGHAM: Please.

12 MR. FAUTH: I think that's a good
13 idea. I think most of the railroads have
14 their own internal costing system, they don't
15 use URCS generally unless they p for internal
16 purposes, and I would think most of their
17 programs are probably p many are more
18 accurate.

19 Many studies I've seen, they use
20 more accurate fuel studies, crew studies and
21 switching studies that they don't rely on the
22 URCS outdated studies.

1 So, I think it would be a good
2 idea to take a look at some of their internal
3 studies that they have, and there might be a
4 more accurate way to look at them.

5 ACTING-CHAIRMAN MULVEY: And that
6 would certainly require protective orders and
7 confidentiality since this is internal p

8 MR. FAUTH: It would be
9 proprietary.

10 ACTING-CHAIRMAN MULVEY:
11 Proprietary railroad information, yes. All
12 right.

13 I have one last question for Mr.
14 O'Connor. You suggested there was an
15 important distinction between the RCAF-U and
16 the RCAF-A.

17 Could you tell us which one you
18 believe should be used in conjunction with the
19 revised URCS and why?

20 MR. O'CONNOR: Well, the - it's
21 kind of a classic question, isn't it? The p
22 both of these lines, the p you guys have got

1 it before you.

2 The blue line that's going up and
3 the red line that's sort of drifting downward,
4 one reflects productivity, and the other does
5 not reflect productivity.

6 Now, the question is who is
7 responsible for the productivity?

8 And clearly the railroad is
9 involved. These are railroad numbers we're
10 looking at here. But did the productivity --
11 was the productivity enabled by the, for
12 example, shippers represented by John LeSeur,
13 the coal shippers who ship massive amounts on
14 exactly the same pathway day after day, year
15 after year. You can be pretty efficient.

16 ACTING-CHAIRMAN MULVEY: And grain
17 shippers.

18 MR. O'CONNOR: Exactly.

19 ACTING-CHAIRMAN MULVEY: And grain
20 shippers with shuttle loading facilities
21 involved.

22 MR. O'CONNOR: Exactly. Exactly.

1 So, it will not be - probably if you would
2 adopt RCAF, probably neither one of those
3 lines viewed in isolation would get you an
4 answer that would be acceptable to both
5 parties, but some mix of the two, some
6 represent p some recognition of productivity.

7 Now, let's think about - let's go
8 back to the regressions again. The regression
9 is going to have the form $Y = A + b(x) + c(x)$
10 squared and so on. And the Y is the dollars,
11 and the X is some measure of production.

12 Now, if you were to rerun those
13 regressions with this time span in mind, I
14 would be utterly amazed if you did not see
15 some of that productivity evidencing itself.

16 ACTING-CHAIRMAN MULVEY: Thank you.
17 I want to thank all the panel members. It was
18 excellent testimony and this panel is
19 dismissed.

20 Okay. I want to keep going while
21 the Vice Chairman takes a break.

22 VICE CHAIRMAN NOTTINGHAM: Thank

1 you.

2 ACTING-CHAIRMAN MULVEY: Let me
3 call up our next panel. Representing the
4 freight railroads, Mr. Ed Hamberger, and for
5 the Association of American Railroad; and Mr.
6 Richard Weicher for the BNSF Railway Company;
7 and Ms. Louise Rinn representing the Union
8 Pacific.

9 Ms. Rinn is also an additional
10 panelist whose been added late to our revised
11 speaker list, so welcome aboard.

12 The Vice Chairman, I'm sure, will
13 be back in a second, Ed. I'm sure he wants to
14 hear all of your comments. So if we wait a
15 couple of seconds p

16 MR. HAMBERGER: As long as the
17 light's not on.

18 ACTING-CHAIRMAN MULVEY: What?

19 MR. HAMBERGER: Just as long as the
20 light's not on.

21 ACTING-CHAIRMAN MULVEY: The
22 light's not on. Well, doesn't count until the

1 light is on.

2 BNSF always has very colorful
3 hand-out stuff.

4 MR. WEICHER: We look for a graph
5 or a map on something.

6 ACTING-CHAIRMAN MULVEY: What?

7 MR. WEICHER: We look for a graph
8 or a map just to break it up a little.

9 MR. HAMBERGER: They keep our paper
10 customers happy.

11 ACTING-CHAIRMAN MULVEY: A graphic
12 of URCS, I mean that would be p

13 (Whereupon, the foregoing
14 matter went off the record at 10:45 a.m. and
15 resumed at 10:46 a.m.)

16 ACTING-CHAIRMAN MULVEY: We want to
17 thank you all for your testimonies. We have
18 as the Vice Chairman has said and I have said,
19 we have read all the testimonies, so we would
20 appreciate it if you summarize your remarks.

21 And, Ed, we'll begin with you.
22 I'm sure Mr. Nottingham will be back very,

1 very shortly.

2 MR. HAMBERGER: Thank you, Mr.
3 Chairman, and I just echo Vice Chairman
4 Nottingham's opening comments. This is our
5 first opportunity to testify before you as the
6 Chairman, and congratulations on your
7 designation by the President as Chairman.

8 I want to thank the Board for the
9 opportunity to present the views of the AAR
10 this morning on the Board's proposal to
11 conduct a review of URCS, the Uniform Rail
12 Costing System.

13 Obviously, issues relating to the
14 accuracy of railroad costing systems for
15 regulatory purposes, are critical to our
16 industry. And a review of URCS must
17 undertaken deliberately and with a view to the
18 full range of impacts and consequences.

19 If the Board ultimately chooses to
20 go forward with such a review, we stand ready
21 to fully participate in that process.

22 With the limited time available to

1 prepare and address the questions raised by
2 the Board in your notice for the hearing and
3 in view of the magnitude and significance of
4 the issues involved, like some of your former
5 witnesses, we will, by necessity, present some
6 general views, observations and principles on
7 how the Board should proceed if indeed it
8 decides to do so.

9 Before we can consider specific
10 proposals for modifying URCS, we would require
11 additional time to assess the potential costs
12 and benefits of possible modifications.

13 As the previous witnesses, we have
14 principles. So, we will come forward with
15 five principles that should be the objective
16 of any Board review of URCS.

17 They are; number one, URCS should
18 reflect all costs associated with rail
19 transportation movements or categories of
20 movements, and these costs should be fully
21 allocated as precisely as possible to the
22 movements or to movement categories that give

1 rise to those costs.

2 The Board has inquired previously
3 about the full cost of transporting toxic
4 inhalation hazards in Ex Parte 681. This is
5 one of the more obvious areas where
6 substantial costs are not currently properly
7 identified and allocated.

8 Other possible areas for
9 investigation include the relationship between
10 costs borne by intermodal unit-train services
11 and also proper identification of switching
12 costs.

13 Two, URCS should reflect the full
14 variability of all costs. And to the fullest
15 extent possible, variability percentages
16 should be based upon current, actual data, not
17 default values.

18 Railroad operating conditions of
19 course have changed over time. And when URCS
20 was developed, the primary rail traffic was
21 carload merchandise moving small, average
22 carload sizes.

1 Loads are much heavier now and
2 tonnage density has doubled since 1980. This
3 means tracks and structures wear out more
4 quickly and it is, therefore, probable that a
5 higher percentage of infrastructure
6 replacement costs are variable with traffic
7 today.

8 Three, the structure of URCS
9 should be sufficiently flexible to ensure that
10 future changes in railroad operating
11 conditions can be readily accommodated.

12 For example, positive train
13 control has been mandated by Congress to be
14 implemented by 2015 on main lines carrying
15 TIHs or handling passenger trains.

16 Clearly, this will increase the
17 costs, however it cannot be predicted today
18 what impact PTC will have on longer-term
19 future costs for the carriers once it is
20 implemented.

21 Four, the capital portion of
22 variable costs should be based on replacement

1 cost methodology rather than a return on
2 investment calculated on depreciated value of
3 book assets.

4 As this Board and the Interstate
5 Commerce Commission before it have recognized,
6 replacement costs are the value in which a
7 carrier must earn an economic return if it is
8 to sustain its business.

9 And I was somewhat perplexed to
10 hear Mr. O'Connor earlier testify that he
11 thought that such p addressing this issue
12 would be, quote, unreasonable, when one of his
13 principles is that this approach must be
14 comprehensive.

15 To be comprehensive, I would
16 argue, means that you must take into account
17 replacement value, not book value.

18 Five, changes in the accounting
19 and the reporting processes that support any
20 revisions to URCS, should be effected in a
21 manner which minimizes administrative burdens
22 and systems adaptations.

1 To the extent possible, the Board
2 should attempt to use the current reporting
3 framework so it does not place an undue burden
4 on the carriers.

5 We recognize that as a decision to
6 proceed as you've discussed here this morning,
7 will result in a significant proceeding that
8 will be lengthy, extremely complex and quite
9 costly.

10 We look forward to further
11 participating in that proceeding should you
12 choose to move forward.

13 Thank you.

14 ACTING-CHAIRMAN MULVEY: Thank you.

15 Mr. Weicher.

16 MR. WEICHER: Good morning, Mr.
17 Chairman and Vice Chairman. Thank you for the
18 opportunity to appear. I am Rick Weicher from
19 BNSF Railway. I apologize for the hoarse
20 voice. It was a lot of airplanes and wind in
21 places.

22 We thank you for the opportunity

1 to appear. It's clear that this is to us, and
2 that we support the Board's direction. This
3 is an important issue to be looked at, we
4 believe it needs to be looked at, and we
5 believe it needs to be looked at thoroughly
6 and correctly.

7 It comes about because of the
8 statutory mandate that you use a URCS system
9 in calculating variable costs and you're using
10 them very extensively now in many regulatory
11 arenas more than ever.

12 Whether it's the simplified SAC
13 cases, the three benchmark standard or your
14 average total cost methodology in coal cases,
15 it's permeating everything.

16 That doesn't mean we agree that
17 this fixation on revenue variable cost for
18 rate making is the right policy, the right
19 direction, but that's not what this proceeding
20 is about. We fully recognize that.

21 If you're going to use RVCs,
22 you're going to use URCS, then we think they

1 should be as current and as accurate as they
2 can be.

3 And as I'll go through, and others
4 have, we're dealing with an outdated,
5 antiquated system that we don't think
6 necessarily reflects today's railroad
7 realities either.

8 As other witnesses have gone
9 through, some of these studies go back at
10 least 50 years.

11 I was practicing in the mid to
12 late '70s before the former Board with the
13 ICC, and was first working on Rail Form A and
14 then, people were saying gosh, some of the
15 stuff in this is 20 or 30 years old, and where
16 did this thing come from, and where did this
17 default come from, and you sort of roll along
18 with it.

19 That isn't to say that I'm
20 faulting the ICC or the STB for not doing more
21 to update it. It's a big effort. We know
22 that. But that still leaves us with the fact

1 that it is old and it involves assumptions
2 that are not where we are currently.

3 Your last review that began in
4 1990 p I say "your" generically. This
5 agency's last review started out as with noble
6 intentions and great goals, and others have
7 taken you through the timeline.

8 It started out to look at three or
9 four specific issues, it was going to take
10 just a couple of years. And within six months
11 it was extended to three years, adding some
12 issues, dropping some other issues.

13 By '93, we just went back through
14 this and went, well look what happened last
15 time.

16 Well, some more issues were added,
17 some more were dropped, no real decisions were
18 made, and it boiled down at that stage, boiled
19 down eight or nine years later to do some
20 refinements and some tweaks.

21 Because of the lack of resources,
22 it didn't approach the major issues, the

1 things like variability, the datedness of the
2 study, because that all takes time and money.

3 Having said that, we think it's
4 time to do it recognizing that you do need to
5 spend some time on process and what the
6 process is going to be.

7 As you've correctly noted this
8 morning, a little time at the beginning to
9 figure out the right approach and the right
10 way to do this, could yield real dividends in
11 having it done right on a more cost-effective
12 basis.

13 I think we do not think it is a
14 good idea to do a piecemeal tinker. We may
15 not like it the way it is, but we're not sure
16 that you should just start poking at the thing
17 if you're not going to really take a real look
18 at it, because then we'll get into more
19 aberrations, more side games.

20 At the end of the day, all the
21 costs we report and we spend, our costs,
22 certainly we are very interested in how these

1 are portrayed and what that means to the
2 regulatory thresholds, but we have a slightly
3 different interest than some of the shipper
4 groups that appear before you.

5 And in their own interest, it's
6 very easy to say, well, this costs p doesn't
7 go on coal, it goes over there, it goes on
8 grain, it goes on intermodal, it goes on p
9 they can each say that. Well, we have them
10 all.

11 So at the end of the day, the
12 accuracy particularly as your methodologies
13 are bringing in the relationships between
14 movements, this is very important that it be
15 done right. And that mitigates, from our
16 standpoint, against doing piecemeal things.

17 As we say in one of these slides,
18 I don't know if these are three points, five
19 points, whatever, but as you're doing that,
20 recognize with this proceeding today you need
21 to establish some priorities, establish
22 realistic schedules, perhaps consider some

1 kind of phased approach or a concurred
2 approach looking at some of the bigger issues
3 on a longer-term basis while you look at some
4 of the p and there are no simple issues here,
5 I guess, but some of the smaller modifications
6 in a similar vein.

7 We do think that you should elicit
8 as you're doing, and should continue to do,
9 and I'm sure will, comments from the parties
10 and the public on that process. Maybe there's
11 a role in the legal sense, for an ANPR on
12 process and what you're going to do. Those
13 things can move quickly, they don't have to
14 move slowly.

15 And if you believe or come to the
16 belief that you need to use consultants or do
17 RFPs and so forth, as you indicated you would,
18 we think it's appropriate that comments be
19 solicited, that that process be open. What
20 are you going to ask the consultant to do,
21 what is their work task going to be?

22 And if they're going to be given

1 guidelines on what to do, we'd like input on
2 those guidelines.

3 Turning to the next one, these are
4 some of the highlight issues. You've got your
5 list of issues in the order. They're all
6 important. Some of them are easier, some of
7 them are harder to deal with.

8 But certainly, we have to deal
9 with the issue that many of the factors and
10 allocations, whether to develop unit costs or
11 the regressions that say what are fixed and
12 variable, are from very outdated studies and
13 there's no question that things have changed.

14 Certainly of interest to us and
15 our customers, the focus on allocation of cost
16 between single-car, multi-car and unit-train
17 shipments is an important issue. We recognize
18 that. It's important to us. It's important
19 to our customers.

20 I'm sure we would not necessarily
21 agree with some of the shipper groups on which
22 way the thing should go, but we probably agree

1 whatever it is, it can't be really, really
2 right. That doesn't seem possible with the
3 changes in technology.

4 This next slide, and as you
5 indicated, we thought to throw in a slide or
6 two because p but this is not an URCS slide.
7 This is just sort of a trend slide.

8 If you look in the growth in unit-
9 trains on our railroad in the grain product
10 segment, you see we, as everyone knows, we
11 handle a lot of unit-trains and still a
12 substantial number of single-car trains.

13 If you tried to extend this line
14 backwards, and we took a quick looking for
15 that and I'm not sure we can do it, but if you
16 go back to the early `80s, we didn't have
17 anything like the shuttle system, the multi-
18 car system or multi-car offerings that we have
19 today with the different rate structures, with
20 the different layout of our unit.

21 That means that the historic
22 premises that are baked into URCS should be

1 updated in this area as well.

2 Similarly, basic operations have
3 changed because of the nature of our firm,
4 where we have had shifts in larger trains,
5 heavier loads, increased densities. Many of
6 these things, and we know this is a
7 fundamental issue and the commentators this
8 morning said this will need to be addressed,
9 what's fixed and what's variable.

10 We know that's a core issue.
11 Whether it's the 50/50 for road property,
12 what's done for maintenance and so forth,
13 those things need to be looked at.

14 And to my knowledge as a
15 practitioner in this area, I'm not a cost
16 consultant, but I p to my understanding, that
17 stuff hasn't been updated in decades.

18 And we don't think it can possibly
19 reflect the current what we live in, in terms
20 of the money we put into the railroad on an
21 ongoing basis and our ability to vary that
22 investment or vary that expense level just as

1 we're facing in the current unusual climate.

2 The next slide is another one of
3 these things that just shows, gosh, the world
4 has changed. This is sort of a comparison.
5 The colors try to show incremental changes in
6 density and so forth, but all our lines are
7 not the same.

8 And since the time of
9 approximately our merger, we've had
10 substantial changes in the way this physical
11 plant is utilized to provide efficient network
12 service across our system.

13 It is not clear to us that these
14 fundamental changes in density could possibly
15 p it does not appear to us that it's likely
16 that they are properly reflected in the kind
17 of regressions and in the kind of assumptions
18 that are made today by URCS and it may be
19 appropriate to separate cost categories into
20 different variabilities or categories.

21 This hasn't been studied in ages
22 between the different p the cuts that are done

1 today in the system.

2 The next one, obviously intermodal
3 is very important to us. We're not suggesting
4 intermodal is regulated or should be
5 regulated, but intermodal traffic is part of
6 our big cost base and it's permeating into SAC
7 cases, it's permeating into revenue adequacy,
8 it's permeating - it's so a big part of our
9 firm. Whether the buckets are right between
10 our big groups is something certainly worth
11 examining. It affects such things like the
12 RSAM.

13 We have an intermodal terminal
14 system today and costs there that are far
15 different than they were.

16 A couple on the next slide that
17 were not necessarily on your list. They may
18 be smaller items, but they can be important in
19 a given situation the way third party payments
20 are categorized today.

21 Whether it's between railroads,
22 major railroads, short times or typical switch

1 payments, these things, these third party
2 costs, it's not clear that they are reflected
3 in any current basis.

4 The next one, normalization
5 incurment costs, if you look at p may I
6 proceed for a moment or two?

7 ACTING-CHAIRMAN MULVEY: Continue,
8 yes.

9 MR. WEICHER: Okay. The time
10 periods, what you consider for normalization,
11 the five years on some things, those should be
12 looked at. They should be looked at in a
13 statistical way. What's the right way to do
14 these things? For some areas of expense,
15 should they be shorter?

16 And we also agree that replacement
17 costs should be reflected in p rather than
18 book value, in the return on investment
19 component of URCS. That is important p an
20 important piece of this.

21 No one size necessarily fits all
22 for all the existing categories or what's in

1 there today, but it needs a fresh look at how
2 these are approached.

3 If you look at the last graph,
4 you've probably seen this in another context,
5 we're very capital intensive. Which means the
6 capital portion, and I'm just talking here of
7 the variable costs that are in there, it is
8 not trivial, it is important, and those are
9 the dollars we have to spend on an ongoing
10 basis to provide the equipment, to provide the
11 assets, to provide the service to our
12 customers.

13 Finally, we certainly intend to
14 participate actively in whatever proceeding
15 you have here both in terms of the process, we
16 know railroad data will be called upon, there
17 are a lot of issues on how that's done, so
18 it's done properly, but we think it's
19 important and we want to help support an
20 effort for more accurate costs.

21 Thank you, sir.

22 ACTING-CHAIRMAN MULVEY: Thank you.

1 Ms. Rinn.

2 MS. RINN: Good morning, Chairman
3 Mulvey and Vice Chairman Nottingham. I
4 appreciate the opportunity to appear before
5 you and have an opportunity for Union Pacific
6 to be heard in this important matter.

7 There are three basic points I
8 want to cover in my prepared comments; the
9 fact that UP endorses the review of URCS; the
10 fact that your resources are not unlimited
11 and, therefore, it is important to focus on
12 meaningful opportunities for improving URCS;
13 and, finally, to command to your attention
14 just some, not certainly all, of the items
15 that we think would deserve your attention in
16 this effort.

17 UP endorses a review of URCS. I
18 won't go into detail of repeating what many
19 other witnesses have pointed out, which is
20 that URCS is more than 20 years old and much
21 of that data is already p was old at that
22 point in time.

1 And I'm going to say as a
2 statement of fact, not a criticism, that when
3 URCS was adopted, the plan, the expectation
4 was that on a regular basis it would be
5 reviewed to see whether it was still doing a
6 good job, whether it was still reflecting
7 current railroad operations.

8 Unfortunately, that did not happen
9 because the ICC, the Board, then felt it did
10 not have the resources to do it. And I think
11 that as a result, opportunities were lost.
12 That's just a statement of fact.

13 But now the fact is we are more
14 than 20 years later and railroad operations
15 have changed profoundly, and there is a need
16 to take a look at many of the underlying
17 relationships.

18 That said, you don't have an
19 unlimited resource in terms of time or money.
20 One lesson I have always kept from my freshman
21 year in college in studying economics, is that
22 economics, as my professor was explaining, is

1 the study of how to allocate finite resources
2 among infinite demands.

3 And certainly the railroads
4 understand increasing in ever-changing demands
5 and only having limited resources. That is
6 the situation the Board, the railroads, the
7 shippers and any other interested parties are
8 going to face here.

9 In the time we've had available,
10 we have not been able to do an exhaustive
11 study to say here are the things that we think
12 definitely need to be focused on.

13 But what I would suggest as one
14 possible way of helping to focus and shape the
15 study is if we can by an analytical analysis
16 say there are certain, either, minor cost
17 categories or major cost categories where the
18 current regressions still seem to do a
19 reasonably good job, that might be something
20 that could be determined early so efforts
21 could then focus on the areas where it seems
22 that there is a greater discrepancy between

1 what URCS currently does versus what might be
2 a better, more appropriate fit.

3 The other thing I would urge is
4 that there should be attention paid to
5 improving p URCS was an improvement over Rail
6 Form A in terms of accessibility and
7 usability. There are still some rooms for
8 improvement there. And I think that based on
9 the comments from the shipper panel, and I
10 certainly know from railroad panelists,
11 opportunities to do improvements like that
12 should not be overlooked.

13 It may not be the top of the item
14 list, but we ought to be looking for are there
15 ways of improving the usability of URCS.

16 Finally, as I said, you have 13
17 different topics. It would be hard to argue
18 with any of those categories.

19 At the risk of making it sound
20 like I only want things that are going to help
21 my railroad or the railroads generally, I'm
22 going to have two things I'm going to point

1 out that certainly deserve attention, but I'm
2 not saying they're the only ones.

3 One is road investment
4 variability. It has no data. It has no
5 science behind it. And yet, what we spend in
6 our capital budget every year to maintain our
7 road bed is one-and-a-half billion dollars as
8 a run rate.

9 We spend another several hundred
10 million dollars a year adding signals and
11 track capacity. That tells you that that
12 really is tied to output and ought to be
13 considered variable, but we're stuck with a 50
14 percent variability based on an educated guess
15 from the 1930s.

16 Clearly, that's an area that
17 warrants attention. I don't have a solution
18 to it, but I think that there are avenues that
19 the board has to explore.

20 Another one that actually will cut
21 both p could cut both ways, is I think that
22 currently there are certain movements that are

1 being over costed on car for private shipments
2 or in private cars, and there are other
3 movements that are being under costed as a
4 system-average, and that that is an area that
5 needs attention.

6 Thank you.

7 ACTING-CHAIRMAN MULVEY: Were you
8 finished?

9 MS. RINN: Yes, I was.

10 ACTING-CHAIRMAN MULVEY: Okay.

11 Well, thank you very much. Thank you to all
12 of our panelists. It was very, very
13 interesting.

14 I'm glad you mentioned the need
15 for science. I mean I think for many years
16 now we've gotten away from reliance on science
17 and on facts, and I think it's important to
18 bring science back to our analysis. And
19 sometimes it takes resources.

20 And I don't think we can make the
21 argument that the resources just aren't there,
22 there's too much at stake.

1 I've been here now for about five
2 years and I've seen these rate cases and how
3 much monies are involved. Hundreds of
4 millions of dollars over the life of a
5 contract, for example, can be involved in a
6 particular rate case. Which means that
7 ultimately billions of dollars can be involved
8 across the system almost on an annual basis.

9 To say that spending \$3 million or
10 \$4 million over three or four years is a lot
11 of money to get this right, I think that does
12 not do justice to the importance of the issue.

13 And in fact, virtually everybody
14 who has come today has said that URCS has got
15 problems, it needs to be adjusted, and only
16 one person suggested that we might want to
17 delay acting on it.

18 But I do think it's already been
19 20, 30, 40 years since some of these things
20 have been revisited and more, and so I think
21 the time to act is upon us.

22 You mentioned about the need to

1 focus on scope. I think that's a very
2 important point that several of you have made
3 and that we need to nail down exactly what we
4 need to do.

5 Now, I do believe that focus is
6 going to have to be comprehensive, but
7 nonetheless we need to be specific as to what
8 we expect, regardless of whoever we give to
9 from the outside on direction as to what we
10 need to do.

11 It has been suggested that one way
12 of getting better information and perhaps even
13 a way of expediting some of these analyses, is
14 to go to the freight railroads to work with
15 them on their internal cost data, internal
16 models, et cetera, to help that as an input to
17 getting a better handle on these costs.

18 Would you care to comment on the
19 willingness of the individual railroads to
20 share their cost data and their cost models
21 with the Board and whoever the Board contracts
22 with?

1 MR. WEICHER: I'll be happy to
2 comment.

3 We don't like the idea. I don't
4 think it's a good idea. It has legal issues
5 and business issues.

6 First of all, what we do
7 internally in different context at different
8 times, you can imagine at different times in
9 the economy, how you think of costs and what
10 you should go after for business advice is
11 quite different than the regulatory function
12 set up by URCS.

13 Secondly, we consider it
14 proprietary from the standpoint of our
15 competitors. How they think of what we think
16 of our costs for business purposes is not the
17 same.

18 Now, our basic accounting data,
19 what we're spending on lines, maintenance of
20 way that fits in the regulatory cost system,
21 some of that can be proprietary and
22 confidential, but we think that is something

1 that has to be looked at in the URCS system.

2 But how you go about taking the
3 major railroads' internal cost systems, I
4 can't sit in a room and go through what
5 they're using for these plans, I don't think.

6 I'm very uncomfortable with some
7 consultants doing it or it being, you know,
8 debated in the public arena. So, frankly, no,
9 I don't think that's an approach that should
10 be pursued.

11 MS. RINN: I'm in agreement with
12 Mr. Weicher. The reality is that as much as
13 I trust and regard Burlington Northern Santa
14 Fe, I would be very, very concerned about
15 being in a situation where our internal
16 costing information is out there for them to
17 see. And I cannot believe that they'd be any
18 happier about Union Pacific personnel having
19 to do it.

20 And yet, you need to have
21 knowledgeable railroad personnel involved in
22 these efforts, and those tend to be the ones

1 who are likely to be involved with both
2 regulatory and/or internal costing efforts.

3 I also question, quite frankly,
4 how valuable or relevant it would be. I do
5 not question how much. Some of our customers
6 or their lawyers and consultants would like to
7 see it, because we see this as a repeated
8 effort in discovery.

9 I cannot think of one proceeding
10 recently over the last several years where I
11 haven't had a request in discovery for our
12 internal costing system, and we've never
13 turned it over.

14 Internal costing systems are
15 obviously data intensive, but they also
16 reflect key commercial strategy. And I think
17 I can cite an example from far enough in
18 history that I'm not revealing anything out of
19 scope.

20 Back in the `80s when we were
21 working for transitioning from a four and
22 five-man crew to a two-man crew, UP adopted an

1 approach where we basically negotiated with
2 our labor unions to pay them to have a Reserve
3 Board.

4 And we treated that as a fixed
5 cost and we said okay, here's what our true
6 variable cost is on adding a train and take
7 people off the Reserve Board.

8 That was a very successful
9 commercial strategy for us in terms of
10 increasing our market share on key parts of
11 business, including the powder river basin.

12 Well, that's now history because
13 we're down to two-man crews, but internal
14 costing systems reflect key commercial
15 strategies. And, therefore, they cannot be
16 safely p I don't care what the confidentiality
17 requirements are, we share an environment
18 where it is exposed to your competitors and to
19 your customers.

20 But we are prepared p clearly
21 we've got a lot of public data that is out
22 there, and there is certainly operational data

1 that could be used to help update some of the
2 relationships in terms of switching and
3 whatever, that definitely the railroads are
4 going to have to look at what we can come up
5 with and help on updating those relationships.

6 And we would be willing to
7 cooperate with that with appropriate
8 confidentiality protection.

9 ACTING-CHAIRMAN MULVEY: Now, I'm
10 not sure to what extent it's the strategic
11 costs that are at issue here or it's the
12 operating costs which go into the URCS
13 calculations which are at issue.

14 But it did strike me that at least
15 some of the internal railroad cost data, if
16 it's not strategic cost data, are more of the
17 accounting and operating cost data, I think,
18 what is being talked about primarily, although
19 I'll have to talk more to the staff on that.

20 But you would feel comfortable
21 with a Protective Order, that would certainly
22 be required here so that even that accounting,

1 internal accounting data or operating data
2 would also be kept confidential.

3 MR. WEICHER: We believe that the
4 Board has sufficient confidentiality
5 protections and the right kind of thing you
6 set up, as you've done in other individual
7 proceedings, to protect the raw data that is
8 also sensitive.

9 What I don't think we want to have
10 this turn into, we have enough litigation,
11 we're not p this process of developing URCS
12 shouldn't necessarily turn into a fishing
13 expedition to be able to go through our raw
14 data and try and figure, oh, this might be fun
15 to go after, that might be fun to go after.

16 We think that would not be a
17 proper purpose of this URCS rulemaking or
18 wherever it goes.

19 But that data, the basic data of
20 what we spend, where we spend it, the
21 accounting data, the physical parameters, we
22 believe that that is something that needs to

1 be looked at for URCS. We accept that, we
2 understand that, we believe that's correct.

3 And that can be protected through
4 the proper form of confidentiality similar to
5 what you've done in other context usage
6 commitments that if you're going to retain a
7 consultant or, you know, things are going to
8 be looked at by people including at the STB
9 and so forth, it should be segregated and
10 Chinese walled, as it were, from the use for
11 that purpose and not be a repository for p I
12 hate to use that legal term p fishing
13 expeditions to go like whoa, what could be
14 found.

15 But, yes, at that level.

16 ACTING-CHAIRMAN MULVEY: Let me ask
17 you a broader question for a moment here.

18 What is the downside of
19 maintaining the status quo, of not doing
20 anything right now and just letting URCS
21 continue to use URCS as it's currently
22 formulated?

1 Is there a downside to that for
2 the regulatory process and the railroads and
3 shippers in the longer term?

4 Ed?

5 MR. HAMBERGER: Well, I've got to
6 say that we do not have a consensus at the AR
7 that endorses the testimony you heard from Mr.
8 Weicher and Ms. Rinn.

9 In fact, I believe one of the
10 railroads, Norfolk Southern, has filed a
11 written statement that believes that it is
12 premature for the Board to determine whether
13 or not the existing model should be replaced.

14 So, their view is that any
15 improvement in inaccuracy that is likely to
16 result, should be compared to the likely cost
17 of developing and implementing such
18 modifications.

19 So, I guess at least from one of
20 our members, the view is that your question
21 needs to be analyzed a little bit further
22 before, you know, we can come to an answer.

1 MS. RINN: I think that there are
2 real costs, but we may not be p well, we
3 cannot quantify them until we've done an
4 analysis and determined to what extent URCS is
5 not doing an accurate job of doing it.

6 My view is the successful outcome
7 of a review of URCS will reasonably measure
8 the total variable cost of the individual rail
9 carriers, and do a better job of allocating
10 those costs among types of activities and
11 types of traffic.

12 To the extent URCS currently
13 doesn't because of problems or limitations
14 with the equation forms, with the fact that
15 it's relying on older data, the fact that it
16 regresses a significant percentage, but not by
17 any means all of our costs, means that you
18 probably are misstating the costs for certain
19 types of traffic.

20 My assumption is that the end
21 result would be there would be some movements
22 that would find that they're having higher

1 costs. There are going to be other movements
2 that are going to find that there are lower
3 costs.

4 Unlike Lake Woebegone where all
5 the children are above average, it seems to me
6 that every time I encounter a customer in a
7 regulatory proceeding, they're convinced that
8 they're the ones who are below average and
9 URCS isn't accurately costing it that way.

10 I believe that to the extent we
11 are not correctly capturing all the costs and
12 allocating those costs, it means that we are
13 making business decisions and decisions where
14 we try to comply with the Board's regulations
15 and the expectations.

16 But if the regulatory costing
17 system is at odds with, it does not reflect
18 our current operating patterns, that basically
19 puts us into an untenable position that we may
20 be making rational business decisions that are
21 at odds with an obsolete regulatory costing
22 system.

1 And I'm fully prepared to accept
2 that if the URCS review is done properly, some
3 movements will have higher regulatory costs,
4 some will have lower regulatory costs, but I'd
5 like to have more accurate regulatory costs.

6 ACTING-CHAIRMAN MULVEY: What
7 you're saying, though, that even though you're
8 making rational business decisions, there may
9 be irrational rates in the sense that they're
10 reflecting regulatory costs as opposed to
11 economic costs.

12 Is that a fair assessment?

13 MR. WEICHER: And if we're going to
14 be pressured p if we're going to be pressured
15 in the regulatory arena to make economic
16 decisions, then the regulatory policy should
17 be based as much as they can on current
18 economic conditions we're facing.

19 ACTING-CHAIRMAN MULVEY: And sound
20 relationships, not ones that are dozens of
21 years old.

22 So, Ed, you want to weigh in on

1 that or are you p okay.

2 Chip?

3 VICE CHAIRMAN NOTTINGHAM: Thank

4 you. Thank you, panel. Welcome.

5 Ms. Rinn, you brought up the issue

6 I touched on earlier with the first panel on

7 road property investment variability. I think

8 it sounds like an important piece of this

9 puzzle.

10 For many, many decades as you

11 know, and as you mentioned, the Board has

12 without -- to my understanding without much

13 underlying data or research, has used a 50

14 percent attribution to fixed costs, 50 percent

15 to variable costs.

16 My understanding is, and we'll see

17 maybe the next panel can further educate me on

18 this, that it's pretty hard to find any other

19 business out there that owns a lot of real

20 property that actually assigns a 50 percent

21 fixed cost accounting concept to that

22 property. It's typically anywhere from 70 to

1 90 percent.

2 What could that do, for example?

3 Obviously, if in fact that 50/50 split is
4 outdated, as I believe your testimony
5 indicated it may well be, presumably then when
6 we go to look at our statutory threshold for
7 jurisdiction to the STB, for example, whether
8 or not a rate is at the 180 percent of
9 revenues compared with variable costs, but
10 your variable costs are being suppressed
11 because you can't get credit for all the real
12 property you have, your road bed, et cetera,
13 if we were to change that and go with what I
14 believe is what the consensus that we hear
15 from the economics community, is it fair to
16 say that one outcome could well be far fewer
17 shippers being able to be eligible for relief,
18 rate relief, before the STB?

19 MS. RINN: That answer is going to
20 vary from railroad to railroad. I believe
21 that actually we have a large percentage of
22 taking our PRB customers nigh at random, are

1 not capable or eligible to bring a rate
2 complaint right now because; one, many of them
3 are competitive. They're served by two
4 railroads at the origin, and they're served by
5 two railroads at the destination. Therefore,
6 there is effective competition and they can't
7 bring it.

8 Other customers that we have are
9 already below 180 percent on a revenue-to-
10 variable-cost ratio basis.

11 Thirdly, all other things being
12 equal, if you change nothing else in URCS and
13 the variability on the roadway investment was
14 increased above 50 percent and no other
15 changes happened, obviously our URCS variable
16 costs would change.

17 How that would affect different
18 customers is going to be hard to say, but
19 nobody is suggesting that that would be the
20 one thing that you would look at. There would
21 be other things that would be going on.

22 It could be that with intermodal

1 costs it's generally conceived, considered
2 that intermodal is under costed. So, if costs
3 are shifted to intermodal, that means that
4 they may be shifted away from other types of
5 traffic.

6 So bottom line, you cannot
7 quantify it. And one of the things I learned
8 the last time when we worked on doing the
9 review of URCS, is that you may have a concept
10 about how something is going to turn out, but
11 it turned me into an empiricist.

12 Until you actually do the analysis
13 with real data, you have to be careful about
14 reaching premature conclusions.

15 You certainly use your judgment
16 and experience to form the questions to be
17 asked and how to go about answering those
18 questions, but don't assume that you know the
19 answer ahead of time.

20 MR. WEICHER: May I?

21 VICE CHAIRMAN NOTTINGHAM: Please.

22 MR. WEICHER: May I comment on that

1 one?

2 I don't want to confuse myself or
3 go too far into the weeds because I know there
4 are experts far more in this, but there's so
5 many things going on here in the question you
6 raised you properly, and road property isn't
7 necessarily real property in all context.
8 There's more to it than that.

9 There are issues here that need to
10 be addressed in the replacement cost or the
11 current cost that are different or perhaps
12 easier to address than in the revenue adequacy
13 replacement cost proceeding you elected not to
14 proceed with. There were things there going
15 on about what's used and useful and what's the
16 real property.

17 But when we're talking about the
18 variable side of it, we have such a long
19 history of what's happened here. As Rail Form
20 A converted to URCS, the industry went from
21 what used to be called betterment accounting
22 where it expensed all kinds of things, some of

1 which are now capitalized. You've got
2 depreciation in there.

3 I don't know where the dust
4 settles. And I defer to an economist on
5 ultimately the right way to come out with it,
6 but we have sort of a Band-Aid on a cast
7 through things that should probably be
8 updated.

9 It is true that I think we believe
10 that ultimately there's a higher degree of
11 variability than the old studies would suggest
12 for elements not of real property, but of
13 things that are categorized as capital and
14 depreciated. And those things haven't been
15 looked at in a long time.

16 VICE CHAIRMAN NOTTINGHAM: Mr.
17 Weicher, obviously one of the more important
18 statutory provisions that we are mindful of
19 constantly here at the Board, is that 180
20 percent revenue-to-variable-cost threshold set
21 in statute by Congress.

22 I've never been able to get a full

1 understanding in the legislative history as
2 to what research and detailed kind of data
3 underlay that assumption, but presumably it
4 was a product of legislative compromise.

5 And it was the best minds at the
6 time, and the right positions in Congress felt
7 that was a solid number to assure railroads a
8 reasonable return. And at the same time,
9 assure that shippers would have reasonable
10 access to rate relief.

11 I'm assuming, though, that that
12 number had to have had some basis in URCS or
13 the understanding of the cost of railroad b
14 business cost of running a railroad at that
15 time.

16 If we were to completely redo
17 URCS, should we, you know, first if you could
18 speak to that assumption whether I'm even
19 remotely, possibly on the right track, but if
20 b and, Mr. Hamberger, I'll ask you to weigh in
21 on this too because you have extensive
22 experience working with the legislative branch

1 in having worked up there as counsel to the
2 Transportation Committee in the past and in
3 your current job.

4 How do we p if we were to just
5 announce tomorrow that we have miraculously
6 reworked p or let's say it's five years from
7 now p URCS and we have a new and improved
8 URCS, we've changed 20 or 30 components, and
9 all of a sudden one way or the other either of
10 a huge increase in numbers in percentage of
11 shippers now have access to the Board's rate
12 relief process or a big decrease were to
13 happen, how do we work that with the Congress?

14 Does it really undercut that 180
15 percent threshold they put in the statute
16 based on data at that time?

17 MR. WEICHER: I'd be happy to
18 comment on that. And some of these will be
19 more personal views from the legal standpoint,
20 from a regulatory standpoint from where this
21 comes from, but I've heard the stories over
22 the year of 180 came from.

1 And I don't know the ultimate
2 answer except I'm told they looked at a bunch
3 of stuff and somebody picked a number. A
4 number that they thought would keep the
5 industry from going bankrupt or permit it to
6 have some flex.

7 What averages, what gizmos, what
8 aggregations they were looking at are not
9 clear to me.

10 Having said that, you do have a
11 statutory framework here and the direction to
12 have this regulatory costing system. And I'll
13 make, if I could, a hypothetical distinction
14 because I don't want to use commodities and
15 then that suggests there's p that quickly goes
16 into the political pressure side of it.

17 But your directed p your
18 predecessor agencies were directed to have a
19 variable cost system and a numerical
20 threshold.

21 That's the law. Congress has to
22 change that if they do. I do think if you

1 went to a completely sort of like the
2 Chairman's initial question, I believe it was,
3 of do you go piecemeal, do you go completely
4 p if you came up with a completely different
5 thing, and there are other things people
6 suggested including in the recent studies that
7 Christensen did and others, you know, as
8 opposed to what was variable costs, then I do
9 think you either have to do some massive
10 adjustment or p or maybe you can't do that
11 without Congress telling you you're not going
12 to measure variable costs, you're going to
13 move, you know, measure revenues per ticket
14 and ton somethings. That doesn't mean that
15 might not be a better way, but that might go
16 too far.

17 Now, having said that, let's say
18 over the last 25 years in measuring variable
19 costs derived from the basic accounting data
20 of a railroad, it turned out that when you
21 were looking at the costs ascribed to
22 multiple-car widgets moving as opposed to

1 multiple-car chunks of concrete as compared to
2 something in a completely different vehicle,
3 gosh, these allocations are wrong. They don't
4 make any sense.

5 I don't think you're freezing in
6 time who's over 180 and 180 under today, and
7 that you therefore have to correct and say,
8 anybody who's under this old system p- no. If
9 the system is wrong, and you fix it, and you
10 reallocate it, then you try to stay true to
11 the intent of the statute. And maybe you do
12 some correction factors, and I think some of
13 that was done when the accounting systems
14 changed, but that would be the right thing to
15 be doing.

16 If they're in the wrong buckets
17 and there's still fundamentally variable
18 costs, you stay with the theory of the system
19 and that changes that some are under 180 and
20 some are under p over 180, which is probably
21 inevitable if you do anything to it, but
22 that's the proper function of keeping a

1 current variable cost system.

2 Go too far and reinvent the wheel,
3 then you got, I think, legislative issues.

4 VICE CHAIRMAN NOTTINGHAM: Mr.
5 Hamberger, do you have any thoughts for p

6 MR. HAMBERGER: I was going to
7 defer to the expert, Louann, first, if she had
8 anything she wanted to add.

9 MS. RINN: I have nothing I want to
10 add.

11 MR. HAMBERGER: Damn.

12 (Laughter.)

13 VICE CHAIRMAN NOTTINGHAM: Let me
14 expand on that for you, Mr. Hamberger. Work
15 with me on my hypothetical.

16 Let's assume p

17 MR. HAMBERGER: Can we write that
18 down as "Darn," please? Thank you.

19 VICE CHAIRMAN NOTTINGHAM: Let's
20 just assume, hypothetically, that a
21 comprehensive review of URCS is undertaken and
22 it does significantly change one of the

1 fundamental underlying assumptions beneath
2 that 180 percent threshold and significantly
3 alters the population for the percentages of
4 shippers who have -- either up or down, we
5 don't know which, that have access to the
6 Board, to our rate relief process.

7 How as an expert communicator with
8 the Congress, would we be wise to think about
9 building in a window of time for that new
10 process to actually kick in, give the Congress
11 some kind of notice that, gee, you might want
12 to, you know, just look at this, you know,
13 don't be surprised when, you know, we're going
14 to hit the switch on January 1 of next year,
15 or do we just p should we just activate it and
16 then let the chips fall where they will?

17 Part of this is p it's a two-step
18 partnership, almost, with the Congress. They
19 set up a very important test based on, in some
20 part, on our longstanding costing data. And
21 we can change that data, but someone is going
22 to have to explain to the Congress what that

1 might do and what they might want to consider.

2 Any thoughts on that?

3 MR. HAMBERGER: Well, I don't want
4 to presume to tell you how to deal with your
5 authorizing committees, but it does strike me
6 that Rick has it pretty well right.

7 And in fact, I was just thinking
8 how eloquent the Chairman was after we
9 testified and you said, Mr. Chairman, that
10 there's so much at stake here. There's so
11 much at risk here we've got to get it right.

12 And it's not a matter of
13 resources. We have to just look at it, make
14 the proper allocation, make the proper
15 allotment. And I would argue along those same
16 lines to take a look at replacement costs
17 because that is an issue that also has to be
18 taken a look at, and that there is nothing
19 magic about what percentage of shipments are
20 above or below 180.

21 The question is what do the
22 economics lead to? And that's p so, do you

1 want that to be as transparent and factual and
2 scientific as possible?

3 And then that's where, you know,
4 obviously --- Mr. O'Connor was speaking
5 earlier quite eloquently also, about project
6 management. That's not my field, but I think
7 he had an excellent point that communications
8 is key to any successful project management
9 and I would think that, you know, Congress
10 would be one of those constituencies that
11 you'd want to communicate with.

12 But to me, it is a matter of ρ and
13 Louann said it, you know, you don't know what
14 the bottom line is going to be. Some will
15 change variable costs for different kinds of
16 shipments.

17 ACTING-CHAIRMAN MULVEY: If indeed
18 you change the variability calculation, the
19 presumption would be that a larger proportion
20 of costs would be variable and would be in the
21 denominator in the RVC equation.

22 If you included ρ if you switched

1 to replacement cost instead of book cost, that
2 would also inflate the variable cost component
3 of the RVC equation.

4 MR. WEICHER: Well, it wouldn't
5 inflate it. It would b

6 MR. HAMBERGER: Actually, you
7 didn't give it the proper b

8 ACTING CHAIRMAN MULVEY: I'm sorry.

9 MR. HAMBERGER: Yes.

10 ACTING CHAIRMAN MULVEY: But the
11 point of the matter is it would have an affect
12 of likely meaning that less traffic would be
13 eligible to come to the Board under the 180
14 R/VC Rule.

15 Would you accept that that would
16 be the likely outcome?

17 And I think what the Vice Chairman
18 is saying is should that therefore engender
19 that the Congress take a look at whether or
20 not that is a proper threshold?

21 I mean the Christensen study that
22 was done for us last year suggested that the

1 180 R/VC ratio is not very predictive of
2 captivity.

3 So, would you want to comment on
4 that?

5 MR. HAMBERGER: Well, it p I'm
6 turning into an empiricist here with Louann.
7 I'm not going to project what it might mean in
8 any particular case.

9 But if one is going to go take a
10 look at whether or not 180 RVC needs to be
11 changed, one could argue that RVC itself, you
12 know, may or may not be the right, no matter
13 what the percentage is, RVC may or may not be
14 the right measurement.

15 And so to me, we're talking about
16 a whole, much broader discussion at that point
17 of what the entire regulatory regime should
18 look like.

19 I think what we're talking about
20 here is operating within the context of what
21 we have, how do we make it better and how do
22 we make it more economically sound?

1 And so, I don't think at this
2 point it warrants going back and trying to
3 determine whether or not RVC is the right
4 approach or whether or not 180 is the right
5 number, rather get into the projects of taking
6 a look at if you decide to go forward on URCS.
7 And also, of course, replacement costs.

8 VICE CHAIRMAN NOTTINGHAM: I guess
9 just getting back to the line of questioning,
10 the reason I just bring this up is not to get
11 too hypothetical, I just - I worry that folks
12 who probably aren't here in the room with us
13 today, but who care to some degree about the
14 STB and these related issues, most of them, I
15 hazard a guess, would believe that updating
16 and reviewing URCS is nothing but a good
17 government, kind of housekeeping accounting
18 update that doesn't really impact Congress
19 that much. It's sort of our job just making
20 sure our data is kind of up to date.

21 When we have an opportunity, when
22 the opportunity arises to actually explain,

1 well, it's very likely that whatever comes out
2 of this process is going to dramatically
3 impact one way or the other, we don't know,
4 some key underlying assumptions, I mean that
5 message needs to go forth, so I wanted to use
6 this hearing, frankly.

7 Thank you for p

8 MR. HAMBERGER: Well, if it p

9 VICE CHAIRMAN NOTTINGHAM: --

10 playing the foil, but I wanted to be able to
11 get the message out. Because I think right
12 now it's just being looked at, oh, the Board
13 has this obscure housekeeping, good government
14 thing they want to do. That's great. Fine.
15 Not enough people in the right places.

16 People outside of this audience
17 are actually realizing where this is likely to
18 go, up or down.

19 MR. HAMBERGER: I guess just
20 coursing through my thought here is an analogy
21 in another hearing that I appeared at speaking
22 of arcane issues before the Board, was whether

1 or not we should go from DCF or to CAPM.

2 And I, you know, at that point, I
3 believe the Board decided we don't know where
4 that's going to take us, but we've taken a
5 look at what is the proper and appropriate way
6 to measure the cost of capital, what is done
7 in other agencies, what's done on Wall Street,
8 how should this be done, it needs to be
9 updated and, you know, could have gone either
10 way.

11 Still don't know what it, you
12 know, the long-term impact of that will be,
13 but you went forward and implemented what you
14 thought to be the right decision without
15 saying, well, how's this going to impact one
16 side or the other and, you know, should we do
17 it because it might have an adverse impact on
18 the number of cases at 180.

19 I mean you just did what you
20 thought needed to be done. And so, I would
21 argue similarly in these areas that that would
22 be an appropriate way to go.

1 VICE CHAIRMAN NOTTINGHAM: Thank
2 you.

3 Mr. Weicher, getting back to the
4 topic of who has the best, most accurate, most
5 comprehensive data on the costs of being in
6 the railroad business and operating a freight
7 railroad, would you agree that today probably
8 the Class I, the current Class I railroads in
9 U.S. and Canada have the best data and
10 information on the costs of operating a
11 railroad?

12 MR. WEICHER: Yes, and the basic
13 data is our data of the cost and the
14 operations expenses.

15 VICE CHAIRMAN NOTTINGHAM: I'm
16 very, believe me, very protective of
17 proprietary information, business secrets.

18 At the same time, the Board has --
19 - one of our most sweeping authorities is to
20 look into the business operations of the
21 railroad and have access to data that we need
22 to get our job done.

1 We try extremely diligently to do
2 so without allowing any collusion or any other
3 improper commingling of information or sharing
4 of information among parties that shouldn't
5 have it.

6 But it does seem to me if we have
7 general agreement that the Class I railroads
8 are in possession of the most comprehensive
9 and most accurate data on the costs of
10 railroading in the U.S., and we're about to
11 embark on a multi-year, multi-million dollar
12 taxpayer-funded journey to try to figure out
13 whether we can come up with something parallel
14 to that, almost as thoughtful as that,
15 wouldn't it be helpful to the Board to figure
16 out a way to both protect everyone's
17 proprietary interest, never share with one
18 railroad another railroad's cost accounting
19 system, but actually say, you know, a group of
20 distinguished, respected people have walled
21 themselves them off, looked at the seven Class
22 I's and said we're not going to say anything

1 about any of them, but on average amongst the
2 seven, this is what the average numbers look
3 like and then -- address those thoughts if you
4 could.

5 MR. WEICHER: Certainly. I think
6 there's a distinction here between the data
7 and the expenses and what we spend where. In
8 the dialogue we had early on about p I heard
9 the term "costing methodologies" or
10 "strategies" and so forth.

11 There's a p we recognize, and this
12 is what the R-1 reflects and what URCS and,
13 before, Rail Form A drive off of, what do we
14 spend on the track, on the equipment, on all
15 the p on the crews and all p this is real
16 information and clearly a Uniform Rail Costing
17 System has to be derived from that
18 information.

19 The place that has come up in
20 litigation and similar to the comment Louann
21 made that goes into a different area, is when
22 you start talking about systems or

1 methodologies or basically strategies, you can
2 have in a given commercial environment such as
3 the present downturn, you might think of
4 what's a p what you'll take on the next car
5 traffic or how you approach your business
6 model in different commodities, in different
7 markets, in the short-term, in the medium-
8 term, quite differently than you would think
9 of a 25-year coal move or somebody locating a
10 new plant. There p and there's a lot of
11 commercial elements that go into that.

12 Those are not data. That is
13 proprietary business systems, thoughts. They
14 can change from time, they can change by
15 commodity, by business condition.

16 We don't think that should be a
17 model or a source for how a regulatory costing
18 system should be developed.

19 The regulatory costing system we
20 have here which it's time to update, is
21 supposed, I thought, I think, to think of what
22 are you going to do on a consistent,

1 regulatory basis as a regulatory system as
2 fixed, as variable, at unit cost for
3 locomotives, for fuel.

4 Therefore, you are entitled and
5 should have access to p it's still
6 confidential, you know. What do we spend on
7 this piece of railroad? If you get that, you
8 know, last year maybe somebody really clever
9 could figure out what it's run rate over time
10 is going to be, but that data belongs in this
11 process.

12 How we think of our business
13 climate today, last year, next year for
14 commodity X versus commodity Y, we
15 respectfully think it should not be part of
16 this process, if that's a distinction that
17 makes sense.

18 ACTING-CHAIRMAN MULVEY: I think
19 that's a good distinction. And I think that
20 Ms. Rinn's example before of the p of going
21 from the five-man crew to the two-person
22 crews, that there were going to be cost

1 impacts, and those cost impacts were
2 proprietary because that was a strategic
3 decision, was a good one.

4 Some of the strategic decisions
5 are really more revenue and demand-based than
6 they are particularly cost-based.

7 I think we are talking about costs
8 that are operating costs and that are, while
9 they're confidential, are necessarily the
10 things that are going to be necessary for the
11 Board to know about if it's going to develop
12 an URCS system that more accurately reflects
13 what the true cost of railroading is today.

14 Do you have any more questions on
15 this?

16 VICE CHAIRMAN NOTTINGHAM: Just one
17 last question. Thank you, Acting-Chairman
18 Mulvey.

19 Maybe each of you can take a shot
20 at this if you care to. If you care not to,
21 that's fine too.

22 If we were to decide to approach

1 this project by first putting out notice and
2 comment p or advance notice and comment to get
3 more comment, we p several of the witnesses,
4 and I believe you did, Mr. Hamberger, talked
5 about kind of limited time. I think we
6 announced this hearing just a couple weeks
7 ago. It's a pretty sweeping topic and
8 arguably the stakeholders wouldn't have had
9 enormous cause to anticipate a hearing.

10 It's not like when we had a
11 hearing on the common carrier obligation. It
12 probably doesn't take most of the people in
13 this room a few months to gather their
14 thoughts on the common carrier obligation.
15 That's an issue that's been around for, you
16 know, but, you know, this is something that
17 the Board hasn't looked at in years.

18 Anyway, so we hatched this hearing
19 on you pretty quickly. People said there
20 hasn't been enough time for all the
21 information to come forward for this hearing.

22 I note that a couple of the bigger

1 consulting firms that most of the large
2 stakeholders here rely on who I'm told are
3 arguably the most expert on URCS, aren't
4 witnesses today for whatever reason. Maybe
5 they needed more time.

6 But do an advance notice of
7 proposed rulemaking or some other type of
8 notice and comment to get more thoughts about
9 how we would proceed with this massive
10 project.

11 And then I wanted to get your
12 thoughts and reaction to this approach: We
13 retain a highly-qualified firm through a
14 competitive procurement process to actually
15 scope the project, to set up this is what p
16 introduced all the stakeholders, kind of take
17 an approach similar to what the Christensen
18 group did on their study last year, and come
19 back to us in a reasonable period of time with
20 here is our proposed plan, here are the big
21 items that need to be addressed, here is a
22 structure and a process and, by the way, here

1 is a budget and a timeline.

2 And then we put that out for bid
3 probably with the understanding that the first
4 firm wouldn't be eligible to be the lead
5 bidder on that on the bigger job.

6 Does that p then we can go to
7 Congress with actually a real budget, a real
8 timeline, show them a real thoughtful project
9 scope, and don't have to go back to them year
10 after year saying, gee, that four million we
11 guesstimated back in 2009, that was a
12 guesstimate and it's now nine.

13 Because that just gives me bad
14 flashbacks to highway projects that were
15 really important, the people were so anxious
16 start, and they never wanted to go communicate
17 with anybody what the actual cost was going to
18 be.

19 And reputations and entire
20 agencies' reputations can get impugned that
21 way, and I just don't want to see us fall into
22 that trap.

1 But any reaction to the type of
2 approach I just described?

3 MR. HAMBERGER: I notice, Rick, you
4 did mention ANPRM and you approach it like --
5 again like Tom.

6 It's nothing that we had actually
7 talked about as an industry, but that
8 certainly sounds like a logical p one logical
9 way to go.

10 Doesn't necessarily, you know,
11 have to be the only way. But, you know,
12 getting p scoping the approach obviously makes
13 some sense.

14 MR. WEICHER: I agree. I think the
15 p as we had suggested, I think there is a role
16 in here for an ANPR. And in the type of
17 sequence you suggested, I do think it's
18 important that the -- and I'm not saying the
19 Board would do this, but it not sort of
20 abnegate its core responsibility to set the
21 policy directions of this thing through a
22 consultant.

1 And having said that, they can
2 serve you up something and perhaps that
3 becomes a subject of an ANPR for the work plan
4 or something on that order.

5 The process you have in place now,
6 you p we're glad to get an opportunity for
7 some additional written comments after this
8 hearing, because we have not p and I'm not
9 sure we will in that time period, be able to
10 deeply address the 13 issues or p 12 or 13
11 issues, but they can be commented on, perhaps
12 some element of prioritization.

13 Some of them are different kinds
14 of things. Some of them like the RCAF thing
15 are things, well, what do you do with this and
16 that?

17 They're not the same as URCS.
18 Some like variability and multiple and single
19 all go to the core of URCS.

20 But, yes, I think if you go
21 through that, there is a role there p we
22 probably support somebody, I think it was Mr.

1 Convey, the panel type -- or your suggestion
2 of some kind of panel. That's - perhaps that
3 fits in the middle there someplace.

4 I do think it's important that
5 something of this magnitude not sort of
6 totally be booked out, so to speak.

7 Clearly, you will need that
8 resource to get down the path, but a blend of
9 comment and input on how they do that, I
10 think, is important to us as well.

11 MR. HAMBERGER: Why don't I take it
12 as an assignment that we'll go back and see if
13 in the next 30 days we can come to some
14 recommendation on process.

15 I don't know that we will, but
16 we'll p

17 VICE CHAIRMAN NOTTINGHAM: I would
18 appreciate that. I'm just one Board member,
19 but I just, you know, and I think if you put
20 yourselves in our shoes if your credibility
21 and reputations were on the line to properly
22 estimate the timeline and a budget for a

1 project of this magnitude and say your job was
2 on the line or your performance rating was on
3 the line, would you just kind of want to wing
4 a number and start and hope that it all works
5 out, or would you want to scope out the
6 complex project and actually have a budget and
7 a timeline?

8 That's kind of where I'm getting
9 at before you embark. But if you can think of
10 it from that perspective, is there anything
11 you'd like to contribute?

12 MS. RINN: I think what you're
13 talking about absolutely makes sense to me.
14 We try to take the same approach every time we
15 get involved in major litigation.

16 Obviously, it's complex, you don't
17 control all the variables, but you make
18 reasonable determinations about the types of
19 activities, the order in which they're going
20 to take and how you're going to source it.

21 And then you manage through that
22 plan and sometimes you do better, and

1 sometimes you don't do as well.

2 But the one thing I found is that
3 by having a plan, you end up getting more done
4 with less money than if you don't have a plan.

5 And that ultimately while you are
6 clearly a government agency and due process
7 means that all of the stakeholders have to
8 have an opportunity to have their views heard
9 and have access to what you're doing, at the
10 end of the day there's a project management
11 principle that has to be done. Which means it
12 comes down to a smaller group that's basically
13 focused on what's the work to be done, what's
14 the order in which to do it, and when do we
15 get the appropriate input from appropriate
16 parties.

17 And only with that can you come up
18 with a realistic schedule and budget.

19 ACTING-CHAIRMAN MULVEY: You always
20 need to start someplace. And we're in the
21 process right now of the STB being re-
22 authorized and being revised actually since

1 the first time it was created.

2 And that if we are going to forge
3 ahead with this, having within the budget some
4 monies, which based upon the best guesses,
5 best estimates, which all estimate always are,
6 of what it's going to cost and how long it's
7 going to take, I do know that agencies all the
8 time come up with a "needs forecast" for doing
9 things that they have been charged with.

10 Which may not bear much in the way or reality
11 or how much analysis behind them, but that's
12 what they think they're going to need.

13 And so they ask for that, and they
14 ask for that in the appropriations and in the
15 authorization.

16 So, I do think that we do need to
17 get going pretty quickly on this. I do think
18 that there can be revisions as time goes on.
19 And as we see what the needs are, we can re-
20 contract, re-forecast, either reduce or
21 increase our request as it warranted.

22 I did have one question though.

1 We'll see in the testimony that the railroads
2 do not use a uniform system of accounts in
3 their own accounting systems, but they have
4 their own systems and they translate those
5 data into the uniform system. And this
6 translation is said to lead to shortcomings in
7 the accounting data upon which URCS is based.

8 How do the railroads carry out the
9 development of the uniform system of accounts
10 data that is used in URCS? And if this
11 translation is indeed taking place, what steps
12 can be taken to improve that accounting data
13 being used in URCS?

14 MR. WEICHER: I'm not sure I'm
15 sophisticated enough as an accountant to
16 respond to that. I know that we have so many
17 accounting requirements. I mean our 10-K, our
18 R-1, these are all prepared under a variety of
19 prescribed rules.

20 I don't go beyond that I can't
21 really address how we get from one to the
22 other, except we are so regulated, so careful

1 of that, that I have to believe we do our very
2 best to follow all procedures in accordance
3 with generally accepted accounting principles.

4 MS. RINN: I likewise have to make
5 a disclaimer. I liked economics, but I quit
6 accounting after one semester.

7 But my understanding is we do use
8 the uniform system of accounts for the
9 accounting for the railroad which of course
10 now is the bulk of Union Pacific Corporation.

11 So, the financial data gets there.
12 Now, obviously there's a lot of stuff behind
13 that in terms of cost setters and cost codes
14 on how you get it into the USOA.

15 But when you're talking about the
16 R-1 which goes beyond the Uniform System of
17 Accounts, there may be a greater array of
18 interpretation of it depending on how a
19 particular railroad has its data systems set
20 up to record certain types of operational
21 data, for lack of a better term, that
22 different railroads are making different

1 assumptions on how to take their business data
2 and get it into the form that's required in
3 the R-1.

4 And so, I certainly think that
5 you're going to see that there's probably a
6 range of solutions there. I'm not sure to
7 what extent that there's really a range in the
8 accounting data, because your Uniform System
9 of Accounts tries to follow GAAP. Our other
10 reporting has to follow GAAP, but I may be p
11 I may be missing some things where there are
12 discrepancies or adjustments that have to be
13 made other than railroad versus non-railroad.

14 ACTING-CHAIRMAN MULVEY: Maybe
15 there's a need for more consistency that the
16 railroads are doing it very, very similar to
17 each other rather than major differences
18 between the railroads.

19 MR. WEICHER: Mr. Chairman, I have
20 been advised that it's conceivable depending
21 on how far you go with this, you may need to
22 look at the Uniform System of Accounts, you

1 may need to think about whether things fit the
2 same categories.

3 Beyond that, I don't understand p
4 I know there are these processes to go back
5 and forth p

6 ACTING-CHAIRMAN MULVEY: Okay.

7 MR. WEICHER: -- but it may be a
8 broader inquiry, not that we're looking for
9 ways to make this more complicated.

10 ACTING-CHAIRMAN MULVEY: No,
11 neither am I. That's all I have.

12 Well, this panel, again, thank you
13 very much, as always. Mr. Hamberger, Mr.
14 Weicher and Ms. Rinn, thank you very, very
15 much.

16 I want to call up our last panel.
17 This is our third and final panel today
18 classified as other interested parties. Mr.
19 Gregory Breskin and Mr. Robert Leilich, Mr.
20 George Grimes are representing themselves as
21 experts in these matters. And then Ms. Sandra
22 Dearden of Highroad Consulting, Limited.

1 So, welcome, panelists. I assume
2 the Vice Chairman is on his way back, but I
3 want to thank you all for coming. Nice to see
4 you again, Mr. Breskin.

5 I guess you can begin making your
6 presentation. We'll have you summarize your
7 presentations, and then we'll go to questions.

8 Mr. Breskin.

9 MR. BRESKIN: Thank you, Mr.
10 Chairman. Mr. Vice Chairman, when he gets
11 back.

12 My first interest p and I'm here
13 strictly on my own. I'm not representing any
14 group shippers or railroads.

15 My interest in URCS started with
16 my doctoral dissertation in 1983. At that
17 time, I happened to be working for the costing
18 section of the Sante Fe Railway. And my
19 dissertation, among other things, showed me
20 that rail costs are decidedly nonlinear in
21 nature.

22 And then I got to working heavily

1 with some Rail Form A numbers and some URCS
2 numbers, and looking into the history of Rail
3 Form A and URCS going back. And basically,
4 the technology of the variability in Rail Form
5 A and then in URCS, goes back to 1939 and
6 really hasn't changed that much since.

7 And I'd like to speak to the two
8 primary areas. One is non-linearity of rail
9 costs. And my own research, some of it
10 published, some not, some forthcoming, shows
11 that rail costs appear to be very nonlinear,
12 whereas the URCS variability estimates are
13 linear. So, I would suggest that nonlinear
14 models be used.

15 My personal preference is the
16 Translog Functional Form that allows you to
17 use multiple causal factors as opposed to one
18 measure of output, one measure of size. And
19 then it allows you to estimate very easily,
20 partial elasticities.

21 And elasticity on the cost meaning
22 tends to be the ratio of average cost to

1 variable cost p or, excuse me, average cost to
2 marginal cost.

3 And you can develop, as I have
4 done in a couple of articles which were
5 attached to my submission, from that you can
6 develop marginal cost estimates as well as
7 average cost estimates.

8 As far as I'm aware in the
9 literature, there is no specific definition as
10 to whether variable costs in the rail costing
11 framework is speaking to marginal or average
12 variable costs. Both of them are variable,
13 but it p there is nothing that I have been
14 able to find in the literature that says
15 specifically one way or the other which it's
16 supposed to be.

17 Now, from economics, we know that
18 optimal markup pricing, Ramsey pricing and so
19 forth all run off of marginal costs. And my
20 personal belief is that marginal cost is what
21 is meant by the use of the term "variable
22 cost" in rail costing.

1 So, I would strongly suggest that
2 we look at the idea of multiple causal factors
3 including size measures, as well as operating
4 or intermediate operating measures such as
5 gross ton miles, car miles, train miles and so
6 forth that have been used in some of my
7 research, because I believe those better
8 reflect what's actually going on when you
9 actually move a train and develop an estimate
10 of the actual movement of the train to the
11 cost, as well as including the total level of
12 activity on the railroad system. And costs
13 will vary depending on total activity on the
14 railroad system.

15 So, I would say first we need to
16 define, or someone in the industry, the Board
17 and so forth, needs to define are we looking
18 at marginal costs or are we looking at
19 variable costs. And from that point, I
20 believe marginal cost is probably the best.

21 Secondly, I think we need to
22 strongly consider non-linearities in costs.

1 This can be done using pulled data systems of
2 the railroads.

3 When you go back to the 1939 data,
4 we didn't have computers to do regression
5 analysis. Now, we have computers. We can
6 create panel data sets of both time series and
7 cross-sectional data that can be regressed
8 very quickly using even some very complicated
9 regression methodology.

10 So, I would suggest that those are
11 possibilities for us.

12 And then the last thing I would
13 suggest along with that, is that we use
14 definitely multi-variable regression models
15 where we apply multiple measures of railroad
16 activity, as well as including multiple
17 measures of size or capital stock.

18 And I think that that would give a
19 much better estimate of what's really going on
20 in the railroad, and we can develop marginal
21 costs which then apply to the regulatory
22 oversight.

1 And I have provided several
2 articles along with my submission that I think
3 cover in much more detail, how this might be
4 done.

5 And with that, I will leave it
6 there.

7 ACTING-CHAIRMAN MULVEY: Thank you.

8 Mr. Leilich.

9 MR. LEILICH: Thank you, Mr.
10 Chairman and Vice Chairman.

11 I'd like to summarize or my
12 interest in this proceeding is based on the
13 fact that at one time I was the project
14 manager and lead consultant on the development
15 of the Uniform Rail Costing System.

16 The original intent of my Peat
17 Marwick Mitchell & Company staff, was to fix
18 the known defects in the Rail Form A costing
19 methodology.

20 The ICC, however, wanted to
21 develop a new statistical approach to rail
22 costing that more accurately reflected real

1 costs and the long-term variability of those
2 costs.

3 The study team included some of
4 the best statistical experts in the nation.
5 As part of the study, the ICC also wanted a
6 new regulatory chart of accounts which better
7 reflected generally accounting p accepted
8 accounting principles.

9 The study team from former p from
10 the former Haskins & Sells, had the
11 responsibility of developing the new USOA to
12 be used as inputs into the new URCS
13 methodology.

14 Reviewing of the history of the
15 two teams, there was tension between the PMM,
16 my team, Haskins & Sells and the ICC on both
17 the development of the new form, R01USOA, and
18 the costing methodology and myself p in
19 itself.

20 In my opinion, too many of the
21 original proposed accounting definitions did
22 not have the functionality that best reflected

1 the many activities performed by railroads.

2 This tension ultimately led to the
3 restoration of much, but not all, of the
4 function definitions contained in the old
5 USOA. Differing viewpoints among the two
6 study teams and the ICC were never fully
7 resolved.

8 The biggest flaws in URCS, I think
9 lie in three areas; the USOA itself, the
10 problems with statistical analysis, and even
11 the reported operating statistics.

12 The USOA was never fully supported
13 in the proposed -- the present USOA was never
14 fully supported by the former Cost Analysis
15 Organization formed by the AAR.

16 The ICC did not accept the advice
17 and recommendations of the CAO, being wary of
18 being accused of being in the hands of the
19 railroad. Or as one ICC manager noted,
20 letting the fox design the security system for
21 the henhouse. While this is certainly a
22 legitimate concern, I think it missed out on

1 the value that the CAO could have contributed.

2 It was my feeling at that time,
3 that more public involvement of the railroads,
4 the ICC or the CAO and the shippers and other
5 interested parties, could have contributed to
6 developing a better, more accepted
7 evolutionary approach to railroad costing than
8 developing a totally new approach that few
9 really liked or understand.

10 The old adage if it ain't broke,
11 don't fix it, applies. A tune-up might have
12 worked better.

13 I think breaking out the
14 categories of labor materials, purchase
15 service, et cetera, was a good idea for a
16 number of reasons. Beyond this, only a few
17 other accounts needed changes, and a couple of
18 new accounts were also warranted.

19 To this day, no U.S. Class I
20 railroad uses Form R-1, USOA accounting for
21 its own use, internal use.

22 In many p in all cases, the

1 numbers are translated by the railroads as
2 best they can. In some ways, it's likely that
3 some of the conversions are analogous to
4 pounding a square peg in a round hole.

5 On the statistical analysis side,
6 the second fundamental flaw is the use of
7 statistical analyses to determine the
8 variability of costs and production factors
9 related to those costs.

10 When the concept was first
11 proposed to me in about 1976, it seemed like
12 a very good idea. Then, there were about 55
13 to 58 Class I railroads, the diversity of
14 which theoretically formed a good basis for
15 analyzing variability and causal relationships
16 between costs and transportation production
17 units.

18 No one anticipated that the
19 industry would shrink to the number -- the
20 small number of railroads that exist today.

21 Not surprisingly, one of the first
22 things the study team found were high levels

1 of statistical auto correlation. For example,
2 there was a high correlation between fuel
3 consumption and train crew wages.

4 Intuitively, this does not make
5 sense. It does make sense to relate fuel
6 consumption to one or more gross ton miles,
7 freight car miles, locomotive unit miles, et
8 cetera.

9 Here, however, there is yet
10 another statistical problem in determining
11 which factors are most directly related to
12 fuel consumption, because there are also very
13 good statistical relationships or auto
14 correlation between each of these same three
15 production units.

16 Some statisticians might say that
17 if they all work, then any one of them is good
18 enough. However, this may not work for all
19 kinds of railroad operations.

20 An example here is that GTMs are
21 much more related to fuel consumption on heavy
22 coal trains, whereas for short, fast,

1 intermodal trains, car miles and locomotive
2 unit miles are more prominent.

3 It was a frustrating experience to
4 try to make these statistical relationships
5 work across a broad spectrum of railroad
6 operations with a high degree of statistical
7 confidence.

8 Marginal improvements in accuracy
9 were burdened with complexity. The inaccuracy
10 and details of operating statistics simply did
11 not justify pursuing better statistical
12 relationships.

13 So, if you get a correlation of 80
14 percent, it means that 20 percent of the cost
15 relationships cannot be explained.

16 Then, there were many statistical
17 costs that could not be nailed down, because
18 they're heavily influenced by management
19 decision. Track maintenance is one example,
20 and equipment is another, and I won't go into
21 these details.

22 URCS and its predecessor has been

1 readily criticized by many people such as the
2 person on my left, and Rhodes and Westbrook in
3 1986, and many others, so it is pointless to
4 rehash which has been so eloquently stated,
5 or, for that matter, for me to add anything
6 new.

7 For all the time, money and effort
8 that went into developing URCS, I'm of the
9 opinion that it does not produce results that
10 are significantly more accurate or reliable
11 than the old Rail Form A.

12 The fact that many costs in URCS
13 are still based on the old RFA allocation
14 procedures, including translating some Form R-
15 1 USOA accounts back to the old USOA format,
16 strongly suggests that URCS has not achieved
17 its goals.

18 On the operating statistics side,
19 they're not as accurate as might be desired.
20 Though they are probably much, much better
21 than they have been in the past, problems
22 remain.

1 There is no audit or
2 reconciliation of operating statistics. There
3 are gray areas between switching and running.
4 Work train statistics are likely under
5 reported. Problems in generating operating
6 statistics are particularly evident in the
7 intermodal area.

8 Is an empty container on a flat
9 car considered a load or empty? Is that
10 influenced by whether the rail was getting
11 paid to move it?

12 What about a loaded and empty
13 container on the same car? Is a group of
14 articulated cars considered one or more cars?
15 I don't think this has been resolved. A
16 fundamental reassessment of rail costing
17 procedures is needed.

18 Well, I, like most people in the p
19 who do costing, use an engineered approach to
20 cost. Most avoidable costs can be quickly and
21 fairly and accurately determined. Given a
22 good description of the operation and a

1 profile of the route, simulation models can be
2 used.

3 While I do support the merits of
4 discontinuing the use of single-point
5 variabilities, URCS' more sophisticated
6 statistical approach still does not consider
7 that costs by category may have different
8 degrees of variability, or that changes in
9 variability may not be linear with changes in
10 volume, as Greg pointed out.

11 In short, I believe that a more
12 down-to-earth, practical oriented approach to
13 railroad costing is desirable.

14 ACTING-CHAIRMAN MULVEY: Another
15 minute.

16 MR. LEILICH: It should be easily
17 modified as specific circumstances might
18 warrant.

19 I am confident that if
20 knowledgeable costing people from the
21 industry, shippers, the STB were to work
22 together in a public forum, then a more

1 flexible, more workable costing methodology
2 more easily understood could be developed.

3 If nothing else, I base my
4 proposal on my many years of rail costing and
5 successfully negotiating many contracts or
6 resolving disputes. I will not cover the
7 response to my specific issues, because I
8 think they're well documented.

9 ACTING-CHAIRMAN MULVEY: Thank you.

10 Mr. Grimes.

11 MR. GRIMES: Thank you. It's a
12 privilege to be here. The subject I'm going
13 to talk about is capital inputs with respect
14 to URCS.

15 As a young railroad engineer, I
16 was often perplexed by the way we segregated
17 our costs into capital on one hand, and then
18 to expense on the other. We had a budget for
19 one, and we had another budget for the other,
20 yet they were really for the same kind of
21 activities.

22 These two accounting systems led

1 to some interesting conversations. For
2 example, I once had a roadmaster call me when
3 I was director of engineering, and ask for a
4 carload of ballast.

5 I told him that we were already
6 over our budget and couldn't afford a carload
7 of ballast, but then I asked him to go back
8 and check to see if he needed three. Because
9 if he needed three carloads of ballast, we
10 could afford that. Because three carloads of
11 ballast met the unit of property, it made it
12 capital, and we had room in our capital
13 budget.

14 He went back and checked, and
15 called and said he needed three carloads of
16 ballast.

17 The point of this story is that
18 from a strictly engineering standpoint, a tie
19 is a tie, ballast is ballast, rail is rail.
20 We all need it to run the railroad. We don't
21 really care which budget it comes out of.

22 As it turns out, economists think

1 a lot like engineers. Costs are costs whether
2 capital or expense.

3 Over the years, I began to wonder
4 whether these distinctions and the way we
5 segregated costs and capital and expense for
6 accounting purposes, might have some bearing
7 on the way we thought about variable costs and
8 the way we thought about prices. Was
9 something missing in our economic cost
10 equation?

11 These questions led me to
12 eventually engage in a series of studies that
13 combined economic and financial concepts of
14 cost. What I found was that capital and
15 expense both represent costs that could be
16 considered as either variable or fixed from an
17 economic viewpoint, and should be considered
18 in the economic equation.

19 Curiously, this relationship had
20 not previously been defined. There were hints
21 from Kahn, and Friedman, and Wilson, but
22 nothing specific.

1 The research I conducted also
2 examined the possibility that railroad capital
3 inputs represent an incremental cost for
4 traffic that was inadequately addressed in
5 regulatory estimates of variable cost.

6 Using data from 1988 to 2002, I
7 found that in aggregate for Class I railroads,
8 infrastructure capital spending was largely
9 variable with and caused by output as measured
10 by gross ton miles on a year-to-year basis.

11 I recently updated my original
12 analysis using data through 2007, to check my
13 initial studies. And found that in aggregate,
14 infrastructure capital spending had a
15 variability or elasticity of over 100 percent
16 with respect to output.

17 I also found that in aggregate,
18 net road assets had an elasticity very close
19 to that estimated for ongoing capital
20 spending.

21 URCS appears to be deficient in at
22 least a couple of ways. First, it uses

1 depreciation instead of ongoing capital
2 spending as an economic cost. Depreciation is
3 not an economic cost, capital spending is. It
4 represents money going out of the company.

5 Ongoing capital spending is almost
6 twice depreciation expense, so this is not a
7 minor error.

8 Second, URCS uses default
9 variability estimates that go back to 1939, a
10 50 percent for infrastructure capital inputs,
11 instead of the far higher estimates that I
12 found based on more recent data. Again, this
13 looks to be a significant error.

14 Should the Board consider
15 modifying URCS, it should consider using
16 ongoing capital spending instead of
17 depreciation as an economic cost, and revise
18 the elasticity estimates for capital inputs
19 whether for actual capital spending or return
20 on infrastructure investment.

21 In summary, railroads are
22 immensely capital intensive, and it's

1 particularly important to get this part of the
2 regulatory variable cost equation correct.

3 Thank you.

4 ACTING-CHAIRMAN MULVEY: Thank you,
5 Mr. Grimes.

6 Ms. Dearden.

7 MS. DEARDEN: Good afternoon,
8 Chairman Mulvey and Vice Chairman Nottingham,
9 and thank you for conducting this hearing.

10 Knowing that railroad marketing
11 people do not use URCS for decision making,
12 when I started my firm in 1996, I conceived
13 and directed development of the rail costing
14 model, INSIGHT: Rail Edition. And to my
15 knowledge, it is the only rail costing model
16 in the industry that is not based on URCS, and
17 it is the only cost model that includes costs
18 for Canadian railroads.

19 Instead, the U.S. railroad costs
20 are based on the railroad's financial data
21 filed in the annual R-1 Reports. And Canadian
22 railroad costs are based on data reported in

1 the stats in Canada Rail p Rail Canada Report.

2 We first started questioning the
3 accuracy of URCS in 2000, when a client
4 requested parallel costing. They wanted URCS
5 cost and INSIGHT cost. And at that time, URCS
6 cost for the steady lanes, were generally
7 about 40 percent higher than the cost
8 calculated by our model.

9 In 2006, again a client requested
10 URCS cost and INSIGHT cost. And for a
11 specific problem lane, it was a high-volume
12 lane, URCS costs were more than double the
13 cost calculated by our model.

14 Now, I don't suggest that our
15 model is perfect. However, we've done
16 numerous projects for two Class I railroads
17 and I've had an opportunity to compare the
18 cost calculated by our model against those
19 calculated by their internal management cost
20 system, and the difference in calculations
21 were less than \$5 a car. So, we think it's a
22 pretty good model.

1 Someone help me out here. Okay.

2 Thank you.

3 Railroad productivity has
4 increased significantly since 1980. Rail
5 employee productivity is up 428 percent,
6 locomotive productivity has increased 124
7 percent, productivity per mile of track is up
8 225 percent, fuel efficiency has increased 85
9 percent, and overall railroad productivity has
10 increased 163 percent.

11 The next slide illustrates the
12 improvement in railroad productivity since the
13 Staggers Rail Act was enacted.

14 Some of the Board's questions and
15 issues that were presented in the decision to
16 conduct the hearing are pretty
17 straightforward, so I'll just limit my
18 comments to a few key issues.

19 When URCS was developed in the
20 '80s, the objective was to develop a model
21 that calculated system average costs. One of
22 the questions was whether we should improve

1 the efficiency associated with the multi-car
2 and unit-train shipments.

3 Unit-trains are typically designed
4 to address specific service and supply chain
5 requirements of the shippers and their
6 customers. So, the shipment characteristics
7 with unit-trains can vary significantly.

8 Some of them include shipment
9 size, age and horsepower of locomotives, use
10 or non-use of run thru or distributive power,
11 deadheading of crews or locomotives when
12 trains are interchanged, and return of
13 empties.

14 Empties, for example, can be
15 returned in a manifest train service with
16 existing capacity or sometimes the railroads
17 dedicate engines and crews to return the
18 empties as a unit. So, the cost varies
19 significantly.

20 Because of the variations, I
21 submit that the railroads would be
22 significantly challenged when trying to

1 develop system-average costs per unit-train
2 operations.

3 It's possible that maybe what we
4 should look at instead is breaking it down by
5 commodity type. In other words, grain trains
6 may have different characteristics than coal
7 trains.

8 Also, it's been our experience
9 that cost models in general, understate the
10 actual savings in switching cost for multiple-
11 car and unit-train shipments.

12 For example, we recently performed
13 cost studies for moves of 75-car unit-trains
14 compared to single-car shipments. Switching
15 costs for the unit-trains were only 25 percent
16 lower than for single cars. Yet, we know from
17 experience, that the switching costs should be
18 much lower.

19 The question is the same as
20 presented in Ex Parte 681. Is the purpose of
21 URCS to calculate system-average cost or is it
22 the Board's objective to develop a revised

1 system that allows inputs as shipment-specific
2 information?

3 If the system is to be adaptable,
4 then guidelines need to be clearly defined.

5 Questions, Issues 2 and 13
6 regarding the historical studies and
7 statistical relationships, these comprise the
8 basic infrastructure of URCS. Switching
9 studies and other historical studies should be
10 updated so that costs reflect contemporary
11 equipment and operating practices.

12 One example of the need to review
13 statistical relationships are locomotive fuel
14 costs are allocated on a gross ton mile and
15 locomotive unit mile basis.

16 Is the current split still valid?

17 Other allocations should be
18 examined as well.

19 Also, the accuracy of reporting by
20 the railroad should be confirmed as some of
21 their data reported in the R-1 Reports appear
22 to be suspect.

1 For example, we noted that costs
2 for one p reported by one railroad for fuel,
3 switching fuel, was exactly the same percent
4 compared to total fuel for the last six years.

5 The system to cost intermodal
6 shipments is dated and should be revised to
7 reflect contemporary operating practices, and
8 I go into one more detail in my testimony that
9 I filed.

10 But we noted in 1997, that the
11 Board acted on the AAR's recommendation to
12 change the inter-train/intra-train standard
13 for intermodal shipments from 200 miles to
14 4,163 miles. Quite a difference. So, hold
15 that thought and we'll go to the next slide.

16 The current I&I standard for non-
17 intermodal shipments is still 200 miles.

18 Railroads have blocking and car
19 movement histories that can be used for new
20 studies. Since the railroads have the data,
21 most likely this factor could also be carrier
22 specific.

1 To my knowledge, there has not
2 been a test developed to test the validity of
3 the URCS model. Going forward, it is
4 important for URCS to reflect current
5 equipment, operations and cost. The Board
6 should determine the most cost-efficient
7 method to confirm the accuracy of the model in
8 the future, either perform scheduled updates
9 of the model as directed by the ICC when it
10 was released, or develop an analytical process
11 and schedule to test the validity of the
12 model.

13 In summary, we believe the URCS
14 model should be updated. If the Board decides
15 to update URCS, they should confirm if URCS is
16 to report system-average costs or if the
17 revised model will be adaptable to shipment-
18 specific information.

19 Historical studies and statistical
20 relationships make up the infrastructure of
21 URCS, and they should be reviewed and updated
22 to reflect current equipment and operating

1 practices.

2 The method to cost intermodal
3 shipments is dated and should be revised. And
4 the I&I standard for intermodal and non-
5 intermodal should be reviewed and updated, and
6 the Board should decide if the I&I mileages
7 should be carrier specific.

8 Finally, going forward we need to
9 develop the best system to maintain the
10 accuracy of the URCS model.

11 Thank you.

12 ACTING-CHAIRMAN MULVEY: Thank you.

13 Chip, do you want to go first on
14 this?

15 VICE CHAIRMAN NOTTINGHAM: Thank
16 you. I just was going to ask a housekeeping
17 question partly because although, Ms. Dearden,
18 you're a very familiar face here, I haven't
19 had the privilege of hearing the other
20 witnesses testify.

21 Are you each here, to clarify, on
22 your own dime, so to speak, or is anybody

1 compensating you to be here today? I'll just
2 ask each of the, just for the record, each of
3 the witnesses.

4 MR. LEILICH: My wife has given me
5 a budget to come here.

6 MR. GRIMES: I'm here on my own
7 time and my own p at my own expense. And I'm
8 also staying with a family member to be able
9 to reduce that expense.

10 MR. BRESKIN: I have to admit that
11 my university said that they would cover the
12 cost of my trip here. Other than that, I'm on
13 my own.

14 ACTING-CHAIRMAN MULVEY: That's
15 common procedure. If you're testifying before
16 the Congress or before an agency, the
17 university usually will pay for those
18 expenses, but you're not representing anybody
19 who's a party to this.

20 MS. DEARDEN: I did not ask my
21 clients to pay for this, because I'm just
22 passionate about this particular subject.

1 That's why I'm here.

2 VICE CHAIRMAN NOTTINGHAM: Thank
3 you. There's not necessarily a right or wrong
4 answer. I just, for the record, it's helpful
5 to know. Thank you.

6 I really don't -- this has been
7 very informative. I've looked through both
8 the testimony and some of the attachments that
9 some of you had submitted. And I will defer
10 to you to take the lead, Dr. Mulvey, with this
11 panel, doctor to doctors, and I'll just enjoy
12 listening and learning.

13 Thanks.

14 ACTING-CHAIRMAN MULVEY: Thank you,
15 Chip.

16 One of the issues that has come up
17 is that in doing statistical studies going
18 forward now with only having seven North
19 American railroads, five domestic ones, Class
20 I's anyway, is that the universe has gotten
21 too small for p unless we find some way of
22 disaggregating it.

1 We heard earlier about up in
2 Canada they use divisions of the two
3 railroads.

4 Mr. Breskin, you talked about
5 mixing time series and cross-sectional data
6 and doing that to up the number of
7 observations.

8 Can that be done? I mean you'd
9 have to do a Chow test, I would think, to show
10 that the groups belong to the same universe,
11 correct?

12 MR. BRESKIN: There are a number of
13 tests that you can do. In the process, you
14 will want to use some dummy variables to
15 indicate shifts from railroad to railroad.
16 Which also can be brought into the costing
17 methodology in that the underlying technology
18 is probably the same, or we can expect that
19 the basic technology would be the same
20 railroad to railroad, but there probably are
21 shifts in individual expense categories that
22 will differentiate one railroad to the other,

1 and you can take that into consideration.

2 Yes, trial test is one of the
3 possibilities.

4 ACTING-CHAIRMAN MULVEY: Would you
5 also accept that using divisions as opposed to
6 different years would also be an approach that
7 might take care of some of the problems of
8 using the multiple years where you might have,
9 autocorrelation and other difficulties showing
10 up, relating to the independence of the
11 observations?

12 MR. BRESKIN: A lot of my research
13 I have not found too much problem with auto
14 correlation. There is a little bit, but it's
15 not unworkable.

16 The use of the dummy variables,
17 the shift parameters seems to take away a lot
18 of that auto correlation that occurs.

19 One of the problems of using
20 divisions, and this comes back to the fact
21 that if we go back to 1931, there were a lot
22 more Class I railroads. So, you could use a

1 cross-sectional dataset and you still had some
2 limits.

3 Now, when we're down to seven
4 railroads, most of my recent research I go
5 back to 1984, and have a separate dummy for
6 each railroad. When mergers take place, it
7 becomes a new railroad and the previous two
8 would cease to exist. They'd go to a zero in
9 the dummy variable. And I find that that has
10 worked relatively well.

11 As well as the use, as I mentioned
12 earlier, I've been using five measures of
13 intermediate operating; gross ton miles, car
14 miles, train miles, locomotive horsepower
15 miles and switching hours, and along with a
16 couple of capital measures and a couple price
17 indices.

18 And I found that that extensive
19 dataset still gives me something in the
20 neighborhood of 250 degrees of freedom to work
21 with which is p it seems to be sufficient for
22 statistical inferences.

1 ACTING-CHAIRMAN MULVEY: Right.

2 Anybody else want to comment on
3 that?

4 Dr. Grimes, you mentioned that in
5 your analysis of the autocorrelation between
6 fuel consumption and wages, is that also p is
7 that related to the fact that wages are
8 mileage-based in this industry as opposed to
9 being hourly-based?

10 MR. GRIMES: Forgive me. I don't
11 think I submitted a p

12 MR. LEILICH: That was mine.

13 ACTING-CHAIRMAN MULVEY: I'm sorry.
14 That was you. I'm sorry. All right.

15 MR. LEILICH: We simply made the
16 observation that it existed, and it is
17 certainly true that locomotive wages are based
18 on train miles, but there are also variables.

19 You can have a one unit-train, a
20 train with one locomotive unit or ten
21 locomotive units, and the pay difference is
22 not all that great between the number of units

1 versus the number of miles that the crews run,
2 but I'm sure there's a huge difference in fuel
3 consumption between a train of one unit and a
4 train of ten units.

5 But when you get all through and
6 you take all the numbers at the end of the
7 year, run them through their regressions, that
8 is masked in the relationship between ρ that
9 we found, between fuel consumption and crew
10 wages, was just as good as gross ton miles,
11 car miles and locomotive unit miles.

12 So, I'll let the expert here
13 discuss how to resolve it, but that's what we
14 observe by PhDs from one end of the country to
15 the other who are really good at what they're
16 doing.

17 I'm an engineer, practical nuts
18 and bolts guy, not a statistician. So, I just
19 had to sit back and revel at what these guys
20 were arguing about and try to understand it.

21 MR. BRESKIN: From what I've found,
22 and I kind of go on the assumption that the

1 railroads are using the appropriate amount of
2 horsepower for how fast they want to run the
3 train and the trailing weight. And I find
4 that for as you change horsepower miles
5 relative to trailing weight, you'll tend to
6 get a faster train the same way as if you want
7 to drive a car faster, you tend to use more
8 horsepower.

9 And the combination of having four
10 or five independent variables, allows them to
11 work interactively so that you can have gross
12 ton miles. And gross ton miles in an
13 articulated piggyback train, is going to be
14 significantly different.

15 One gross ton mile isn't the same
16 as a gross ton mile in a coal train, and
17 you're going to use different amount of
18 locomotive horsepower to pull those, and part
19 of that's dependant on the speed.

20 But my assumption is that the
21 railroads are trying to balance the number -
22 the amount of horsepower in general over their

1 whole system with the amount of trailing
2 weight as well as the speed that they want
3 that train to run.

4 So, I'll leave it at that.

5 ACTING-CHAIRMAN MULVEY: Mr.
6 Grimes, care to chime in on this?

7 MR. GRIMES: Well, you know, I
8 would say that that's basically true. Having
9 been in the railroad business, is that
10 generally speaking the faster you want it to
11 run, the more power you want to put on it, but
12 you're limited to a certain degree by
13 obviously the characteristics of the road, if
14 that's what the major question was.

15 I would point out that any
16 particular factor that you want to study has
17 many, many, many factors in the real world
18 that might affect it. So, if you're running
19 a p and I'm more of an engineer than an
20 econometrician, so forgive me here.

21 But the questions is, is how many
22 variables do we want to throw into this

1 equation?

2 ACTING-CHAIRMAN MULVEY: Well, the
3 economist's argument would be all those that
4 are significant and all those that are for
5 explanatory power without, again, getting into
6 autocorrelation or multiple ρ at any rate,
7 both Greg and Sandra, both of your models,
8 from what I can see, represent a real
9 departure from URCS.

10 I mean basically your models could
11 actually be used to replace URCS and take an
12 entirely different approach.

13 Would you see that as being
14 something that could be done at somewhat less
15 cost?

16 There's been talk about today
17 about how expensive it might be to redo URCS
18 and to redo all the engineering analyses and
19 the econometrics, et cetera.

20 But with your approach adopting a
21 translog cost function, or your approach with
22 your model, would that be a substitute for

1 URCS or would it be in conjunction with
2 redoing URCS?

3 MS. DEARDEN: I think it has
4 potential. I think if that was going to be
5 posed, I would like to reconfirm because our
6 model has been in place since 1997. I'd like
7 to reconfirm all the components in there and
8 make sure it's accurate because, like I said,
9 I don't suggest that it's perfect.

10 But it is based on the railroad's
11 own data, it also seems to match the costs
12 calculated by their management cost system, so
13 I think it has potential.

14 ACTING-CHAIRMAN MULVEY: Are your
15 calculations linear or nonlinear?

16 I mean do you wind up with the
17 elasticities that vary with output or is it
18 linear?

19 MS. DEARDEN: It's probably linear.

20 ACTING-CHAIRMAN MULVEY: Probably
21 linear?

22 MS. DEARDEN: Yes.

1 ACTING-CHAIRMAN MULVEY: Greg,
2 yours is nonlinear?

3 MR. BRESKIN: Mine is definitely
4 nonlinear. And I have a couple of p one
5 primary that I use a single equation, the
6 translog equation, that ends up with about 150
7 variables, including quite a few dummy
8 variables, but about 55 are actual causal
9 variables.

10 Does it give costs? I think it
11 gives reasonable costs. And if I could do it
12 by myself, it can't be terribly cost
13 ineffective.

14 Would it be a replacement? I
15 don't know.

16 I've also suggested at one point
17 in a published article, that you simply take
18 the current breakdowns of expense categories
19 in URCS and then use something like the
20 translog framework to estimate elasticities,
21 or really partial elasticities, that will give
22 you characteristics of those expense

1 categories, individual expense categories
2 relative to variation in train type. So, you
3 can look at actual trains and define the
4 characteristics of the train, and then take
5 that to costs.

6 A single equation is obviously
7 more cost effective. Does it necessarily give
8 a better or worse estimate? I'm not sure that
9 any of us know in reality exactly what the
10 costs are. So, I guess my feeling would be it
11 doesn't give any worse estimate.

12 Whether it's better or not, not
13 knowing what the true costs are and how I can
14 measure them, I can't really say that it gives
15 a better estimate. But I'm pretty convinced
16 that the multivariate, non-linear will give
17 you a better cost estimate than the one or two
18 variable linear model would give you.

19 ACTING-CHAIRMAN MULVEY: That would
20 be the general assumption, I would think.

21 Mr. Leilich, you suggest that the
22 Uniform System Of Accounts is flawed.

1 Do you have any specific changes
2 you would like to see made in the USOA?

3 MR. LEILICH: I'm not prepared to
4 comment on that this time. I think some of my
5 comments if the old notes still exist and they
6 haven't turned brittle and faded away,
7 document some of my feelings on that. And a
8 lot of the changes that I wanted to see made,
9 were made. Not all of them.

10 I think we should not lose sight
11 of the fact that costing is an art as much as
12 a science, and it will always be that no
13 matter what kind of methodology you develop.

14 So, I think the idea of a
15 transparent methodology -- and I agree with
16 the railroad's sensitivity to their own
17 internal methodology and their - particularly
18 the numbers they put into them.

19 But you've got a lot of talent
20 there in the railroad industry. And if you
21 were to get them together with a clean sheet
22 of paper, what they know in their heads, I

1 believe, can come together and develop a
2 methodology.

3 None of you have probably ever
4 seen the old Rail Form A book which was about
5 this wide and about this high that had page
6 after page of numbers flow here, flow there.

7 Well, at one time I was one of the
8 50 experts that really understood Rail Form A.
9 I also understood why -- there probably
10 weren't p probably 49 of those were liars,
11 because it was so difficult. But
12 nevertheless, there was a good flow and a good
13 methodology.

14 And today I think with the
15 knowledge that we have and the data that we
16 have, we can simplify that and still come up
17 with a much better system.

18 This doesn't mean we don't need
19 the help of the academic experts. I think we
20 still need that in the variability issue, but
21 there's a logic - lot of logic to costing.

22 And my experience has been that

1 from an engineered cost basis, I can build up
2 avoidable costs that probably represent at
3 least 50 percent or more of variable costs
4 without argument.

5 Who's going to argue over crew
6 wages for a train going so much distance or
7 the train performance calculators that do an
8 excellent job of calculating fuel consumption,
9 and the equipment, we know the cost of the
10 equipment that's assigned. So when you get
11 that far, there's no argument.

12 When you start getting into
13 arguments is, well, what portion of track
14 maintenance should be assigned and other costs
15 that are variable, but indirect, such as train
16 dispatching. Well, then you could go to your
17 statistical relationships and start adding
18 those on.

19 And so with at least half the
20 variable costs being avoidable and basically
21 non-arguable except maybe the cost of fuel or
22 the - my TPC model is different than his TPC

1 model, you get very, very close. And I've had
2 p worked really well with the railroads and
3 the shippers in reaching agreements on those.

4 And so you narrow down the area
5 where you disagree, and then by relying on
6 more sophisticated methodologies to distribute
7 those costs that are joint and common that we
8 talked about here today, I think on a p
9 costing would be much simpler, much easily
10 understood, and where people will argue on
11 differences is relatively small.

12 And you can take both sides of the
13 equation. Well, how far apart are they? 10,
14 15 or 20 percent? Focus on that and then
15 you've got a decision.

16 I have never ever had to come
17 before the ICC or the Surface Transportation
18 Board to successfully conclude a rate
19 negotiation. So, I've always been very
20 confident and comfortable with the way I and
21 my former firm worked with both railroads and
22 clients to do costing.

1 And if you can actually develop
2 that kind of methodology, there might be a lot
3 of unemployed people at the STB because
4 nobody's coming here to argue rates.

5 That's a joke.

6 ACTING-CHAIRMAN MULVEY: Arguments
7 keep us employed.

8 You mentioned some costs,
9 avoidable costs, common costs, joint costs.
10 It's quite interesting that an awful lot of
11 cost analysis in economics derived out of a
12 need to understand railroad costs.

13 As I was talking to Mr. Ripley
14 when we developed his formula together p
15 that's an inside joke.

16 But this idea of how much costs
17 are variable and how much costs are fixed is
18 one that has gone on in railroading for a
19 long, long time.

20 Mr. Grimes, you mentioned that --
21 the fact that we understate the variability of
22 road investment cost. You said that it's 88

1 percent and, not using that but using the 50
2 percent factor instead constrains railroad
3 prices and, therefore, railroad capital
4 investment, but isn't it true that railroads
5 have been able to attract capital even with
6 the charge of 50 percent variable instead of
7 a more, in your view, a more accurate 88
8 percent variable?

9 The railroads still seem to have
10 had access to capital markets, so are they
11 really capital constrained by having this
12 restriction?

13 MR. GRIMES: I'm not going to - I
14 don't think I can comment on their ability to
15 attract capital. They certainly have been
16 spending it.

17 But I would like to say that, you
18 know, if you look at the period from 1988
19 through the late '90s, they were building, but
20 their free cash flow was falling.

21 Net income was rising, the free
22 cash flow was falling to the point where it

1 got negative.

2 Now, as your free cash flow is
3 falling, you are essentially destroying your
4 business. They finally turn that around and
5 free cash flow started rising again.

6 But I think that if you want to
7 promote investment in this industry, you know,
8 you've got to have a rising p you've got to
9 have a rising free cash flow to support that
10 investment.

11 That's a policy question and I'm
12 going to back off from answering it.

13 ACTING-CHAIRMAN MULVEY: Okay.

14 MR. GRIMES: I would like to
15 respond to one thing that we talked about
16 earlier, and that's the issue of marginal
17 versus average variable costs.

18 When I'm looking - when I p if
19 I've been managing a railroad, and I have
20 recently, I've got to be looking at my long
21 run or my average run costs.

22 I've often had marketing people

1 come to me and say, you know, my marginal
2 costs are so much lower, why can't I reduce
3 the rate to get more volume?

4 And I say because we've got to
5 manage this business in the medium run, and a
6 lot of the assets are long lived.

7 So, looking at it on just a
8 marginal or strictly near-term incremental
9 basis, creates distortions when you're talking
10 about contracts that may go out for years or
11 investments that may go out for years.

12 So, I would - let me - I'm just
13 chiming in on this argument. I think the
14 average variability was a wise decision by the
15 ICC in its formation of URCS and Rail Form A
16 originally.

17 ACTING-CHAIRMAN MULVEY: Well, the
18 sole idea of variable cost and marginal cost
19 is it doesn't distinguish between the long run
20 and the short run.

21 I mean we haven't really talked
22 about what length of time we're talking about

1 here. And in fact in railroading, the
2 marginal costs we're talking about are long-
3 run marginal costs, not short-run marginal
4 costs, and that's a big distinction.

5 And, Ms. Dearden, you suggested
6 that your models gave results that the
7 railroads' costs were substantially less than
8 predicted by URCS, whereas some of the
9 criticisms that were heard of URCS at least
10 from the variable cost side, is that variable
11 costs are understated by the way they're
12 calculated.

13 Can you reconcile those two
14 observations from -- to you and Mr. Grimes?

15 MS. DEARDEN: Well, first of all, I
16 think what will happen is if we do an update
17 of URCS, there is -- some of the costs in some
18 areas will actually increase p

19 ACTING-CHAIRMAN MULVEY: Okay.

20 MS. DEARDEN: -- and some will go
21 down. But overall, I think overall the costs
22 overall will go down.

1 We did find in one study that we
2 did for one client, there were a couple lanes
3 where actually URCS costs were lower than the
4 costs calculated by our model. So, it's not
5 across the board.

6 ACTING-CHAIRMAN MULVEY: Mr.
7 Grimes, you get a jab in.

8 You said that if we change URCS
9 costs, it would probably go down, but that
10 would assume that we continue to use book
11 value for capital, correct?

12 MS. DEARDEN: Yes.

13 ACTING-CHAIRMAN MULVEY: If we
14 switched over to replacement capital cost,
15 then that would certainly not be the case,
16 right?

17 MS. DEARDEN: Right.

18 ACTING-CHAIRMAN MULVEY: Okay.

19 MS. DEARDEN: I think the goal
20 should be p it shouldn't be a shipper versus
21 railroad issue. It should not be what's in it
22 for me from any one standpoint. I believe it

1 should be p we should develop a system that
2 more accurately reflects what the real costs
3 are.

4 ACTING-CHAIRMAN MULVEY: That's all
5 the questions that I have for this panel.

6 Chip, do you have any others?

7 VICE CHAIRMAN NOTTINGHAM: No.

8 ACTING-CHAIRMAN MULVEY: Thank you
9 very, very much. We appreciate everybody here
10 coming today. I want to thank you all for
11 your testimonies.

12 As I said before, the record on
13 this will be open until the 1st of June,
14 anybody else who wants to comment, and thank
15 you all very much for coming today.

16 (Whereupon, this public hearing
17 for the U.S. Surface Transportation Board was
18 concluded at 12:48 p.m.)

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A				
AAR 30:21 31:12	148:1,21 154:21	1:21 3:2,22 4:3	234:3	39:1,2,20,21 40:1
116:9 200:15	158:21 163:19	11:3,11 15:11,12	ad 103:15	40:5 42:4 43:2,8
AAR's 219:11	164:13 171:17	24:5 35:18 44:15	adage 201:10	48:4 73:11 102:11
aberrations 125:19	175:18 189:3,7,12	48:15 50:7 52:4	adaptable 218:3	103:5,15 104:19
ability 41:21	189:17 190:3,6,9	55:16 58:12 62:13	220:17	191:12
130:21 240:14	191:8 199:7,8,21	64:11 68:5 85:9	adaptations 120:22	administrative
able 21:2 67:6	201:20 208:22	87:13 89:12,17	add 39:17 79:18	120:21
74:12 82:18 86:22	210:6	90:19 92:22 94:22	110:9 165:8,10	admit 62:18 222:10
137:10 148:13	accounts 23:10	96:17 101:2 102:8	205:5	adopt 47:15 98:4
155:17 159:22	26:14 189:2,9	103:13 104:10,22	added 16:7 41:1	99:22 113:2
172:10 184:9	190:8,17 191:9,22	111:5,10 112:16	42:16 43:1 114:10	adopted 6:1 12:21
195:14 222:8	199:6 201:17,18	112:19 113:16	124:16	32:1 34:17,20
240:5	205:15 234:22	114:2,18,21 115:6	adding 22:22	46:3 136:3 145:22
abnegate 183:20	accuracy 37:4,20	115:11,16 121:14	124:11 139:10	adopting 231:20
aboard 114:11	78:6 116:14	133:7 134:22	146:6 237:17	adoption 100:8
absolutely 110:8	126:12 204:8	140:7,10 147:9	addition 7:6	advance 15:2 180:2
186:13	214:3 218:19	149:16 153:6,19	additional 37:21	181:6
academic 86:20	220:7 221:10	168:17 178:18	54:10 114:9	advantage 44:8
88:10 90:17 91:1	accurate 9:17	179:17 187:19	117:11 184:7	adverse 173:17
236:19	23:22 36:19,21	191:14 192:6,10	Additionally 10:19	advice 32:3 33:22
accentuate 72:10	38:10 41:6 43:4	198:7 207:14	address 20:20	82:1 143:10
accept 149:1 153:1	48:2 49:22 51:4	208:9 213:4	58:13 66:21 67:11	200:16
169:15 200:16	52:3 63:19 64:1	221:12 222:14	70:8 73:3 89:13	advisability 99:6
225:5	64:13,15 65:8,11	223:14 225:4	91:13 97:22 101:6	advise 61:18
acceptable 113:4	105:14 110:18,20	227:1,13 230:5	117:1 158:12	advised 191:20
accepted 190:3	111:4 123:1	231:2 232:14,20	176:3 184:10	AECC 16:18 22:14
199:7 201:6	134:20 151:5	233:1 234:19	189:21 216:4	23:4
access 8:3 42:22	153:5 174:4 175:9	239:6 241:13	addressed 86:1	Affairs 49:7
47:21 60:1 66:7	205:10,19 232:8	242:17 243:19	130:8 158:10	affect 27:3 100:6
95:17 96:16	240:7	244:6,13,18 245:4	181:21 211:4	156:17 169:11
160:10 161:11	accurately 26:10	245:8	addressing 120:11	230:18
166:5 174:21	41:22 51:4 152:9	action 58:4	adds 42:10,13 43:1	affectionately 13:1
178:5 187:9	179:12 198:22	activate 166:15	adequacy 132:7	afford 209:6,10
240:10	206:21 245:2	active 32:2 65:2	158:12	afternoon 213:7
accessibility 138:6	accused 200:18	actively 134:14	adjudicated 59:2	age 216:9
accessible 67:17	accustomed 12:4	activities 151:10	adjust 38:3,10 44:6	agencies 162:18
accommodated	achieve 37:1	186:19 200:1	adjusted 31:15	173:7 182:20
119:11	achieved 22:8	208:21	32:1 38:13 40:4	188:7
accomplish 102:16	205:16	activity 5:12 105:8	141:15	agency 6:2,4 9:14
account 5:11 8:13	act 7:19 141:21	105:18 196:12,13	adjusting 109:6	13:6 187:6 222:16
59:12 120:16	215:13	197:16	adjustment 31:4,8	agency's 124:5
accountant 189:15	acted 219:11	actual 28:7 29:15	31:11,20,22	ages 131:21
accounting 6:5	acting 141:17	38:4,11,14 42:8	163:10	aggregate 211:7,13
22:12 32:4,6 98:5	169:8,10	42:15,22 44:7	adjustments 17:22	211:17
100:1 120:18	Acting-Chair	118:16 182:17	18:8 19:10 22:21	aggregations 162:8
143:18 147:17,22	65:18	196:10 212:19	29:1 37:22,22	ago 7:5 68:11 180:7
	acting-chairman	217:10 233:8	38:1,2,7,17,19	agree 15:13 36:20

36:22 37:8 63:18 72:8 81:21 87:10 97:10 122:16 128:21,22 133:16 174:7 183:14 235:15	alternative 26:4 alters 166:3 amazed 113:14 ambitious 98:7 AMERICA 1:1 American 2:12 24:17 44:22 53:5 114:5 223:19 amount 41:13 229:1,17,22 230:1 amounts 112:13 amplify 72:22 analogous 202:3 analogy 172:20 analyses 7:3,7 8:18 25:22 27:1,6 34:12 35:11 63:10 64:3 78:14 94:19 109:6 142:13 202:7 231:18 analysis 26:3,5 29:12 30:18,20 32:12 50:3 57:3,4 57:21 60:17 66:19 78:12,17,19 79:17 82:17 83:5 97:5 99:1 106:20 137:15 140:18 151:4 157:12 188:11 197:5 200:10,14 202:5 211:12 227:5 239:11 analytical 137:15 220:10 analyze 47:8 analyzed 78:11 81:19 150:21 analyzing 93:8 202:15 and/or 145:2 announce 161:5 announced 180:6 annual 4:22 39:11 39:15 81:13 141:8 213:21 annually 17:10	ANPR 127:11 183:16 184:3 ANPRM 183:4 answer 3:8,13,19 44:13 47:3 49:8 50:18 61:6 79:15 87:11 89:2,3 91:14 113:4 150:22 155:19 157:19 162:2 223:4 answering 24:3 157:17 241:12 answers 60:15,18 61:20 62:2,8 64:4 64:9 anticipate 180:9 anticipated 202:18 antiquated 123:5 anxious 182:15 anybody 50:17 56:9 58:12 60:4 60:13 63:20 76:11 89:12 95:13 102:20 164:8 182:17 221:22 222:18 227:2 245:14 anyway 44:12 98:2 102:17 180:18 223:20 apart 238:13 apologize 121:19 appeal 59:3 appear 121:18 122:1 126:4 131:15 135:4 194:11 218:21 appeared 16:18 19:6 172:21 appearing 44:20 appears 20:6 28:2 34:3 46:8 211:21 application 46:4 applied 5:18 29:7 53:12 applies 201:11	apply 197:15,21 applying 54:4 apportioned 77:21 appreciate 16:16 24:1 35:15 48:11 73:7 115:20 135:4 185:18 245:9 appreciated 65:4 approach 30:6 55:20 85:7,8 86:2 87:3,17 97:11 99:4,12,13 103:14 106:9,11 120:13 124:22 125:9 127:1,2 144:9 146:1 171:4 177:5 179:22 181:12,17 183:2,4,12 186:14 198:21 201:7,8 206:19 207:6,12 225:6 231:12,20 231:21 approached 134:2 appropriate 25:18 31:16 35:7 106:7 127:18 131:19 138:2 147:7 173:5 173:22 187:15,15 229:1 appropriations 188:14 approximately 131:9 April 1:10 12:9 AR 150:6 arbitrary 54:10 arcane 172:22 archives 28:8 area 34:8 130:1,15 139:16 140:4 176:21 206:7 238:4 areas 28:21 59:2 118:5,8 133:14 137:21 173:21 194:8 200:9 206:3 243:18	arena 82:14 98:21 99:2 144:8 153:15 arenas 122:11 arguably 180:8 181:3 argue 120:16 138:17 167:15 170:11 173:21 237:5 238:10 239:4 arguing 228:20 argument 83:21 96:19 140:21 231:3 237:4,11 242:13 arguments 237:13 239:6 arises 171:22 Arkansas 2:4 16:1 17:1,5,8 18:18 array 190:17 art 235:11 article 233:17 articles 195:4 198:2 articulated 107:9 206:14 229:13 artificial 19:17 ascribed 163:21 asked 31:3 46:20 66:10,11,12 69:10 157:17 209:7 asking 45:22 77:7 81:12 107:17 aspects 25:16 35:6 109:13 assembled 31:11 assess 117:11 assessment 50:1 153:12 assets 120:3 134:11 211:18 242:6 assignable 57:13 83:6 assigned 237:10,14 assignment 185:12 assigns 154:20
--	--	---	--	--

Assistance 49:6 68:7	attribution 154:14	67:12 71:2 78:14	95:17 101:22	belongs 178:10
associated 6:12 21:15 29:2 33:7,8 33:9,12 117:18 216:1	audience 85:3 96:20 172:16	84:2 93:8,10	102:4 108:14	benchmark 122:13
Associates 97:1	audit 206:1	94:20 97:14 102:1	146:1 152:18	beneath 94:8 166:1
Association 2:12 24:16 44:22 45:1 53:5 114:5	audited 40:3	109:8 113:8	177:1 187:12	benefit 9:3 49:16 59:11 75:16
associations 2:5 16:3,4 34:19	authorities 174:19	114:13 115:22	194:3 230:8	benefits 14:18 117:12
assume 157:18 165:16,20 193:1 244:10	authorization 188:15	123:9 124:13	231:10 237:20	benefitted 99:14
assumed 79:10	authorized 100:2 187:22	129:16 140:18	basin 55:4 146:11	benefitting 49:20
assumes 42:16 43:13	authorizing 167:5	145:20 171:2,9	basis 31:16 62:1	benefit-cost 15:15
assuming 63:9 71:3 160:11	auto 203:1,13 225:13,18	174:3 181:19	125:12 127:3	best 10:9 11:10 13:7 57:5 69:8 78:16 86:2 88:16 106:8 109:3 160:5 174:4,9 188:4,5 190:2 196:20 199:4,22 202:2 221:9
assumption 76:10 151:20 160:3,18 228:22 229:20 234:20	autocorrelation 225:9 227:5 231:6	182:9,11 185:12	130:21 133:3	better 46:14 47:9 63:6 65:7 103:15 108:15 138:2 142:12,17 151:9 163:15 170:21 186:22 190:21 196:7 197:19 199:6 201:6,12 204:11 205:20 234:8,12,15,17 236:17
assumptions 97:5 100:6 124:1 131:17 166:1 172:4 191:1	automatically 42:10,15	192:4 193:2,11	134:10 136:4	betterment 158:21
assure 10:11 160:7 160:9	available 16:9 20:9 20:15 26:1 34:13 35:12 94:7 95:3 116:22 137:9	194:3,5 197:3	141:8 156:10	beyond 98:21 189:20 190:16 192:3 201:16
attached 195:5	avenue 89:9	205:15 209:7,14	160:12 178:1	bid 182:2
attachments 223:8	avenues 139:18	212:9 225:20,21	202:14 211:10	bidder 182:5
attack 89:9	average 38:15 104:1,3 118:21 122:14 152:5,8 176:1,2 194:22 195:1,7,11 215:21 241:17,21 242:14	226:5 228:19	218:15 237:1 242:9	big 21:7 42:1 92:19 123:21 132:6,8,10 161:12 181:20 243:4
attempt 87:22 121:2	averages 21:13,14 21:15 162:7	241:12	242:9	bigger 127:2 180:22 182:5
attempting 22:15	AVERY 2:21	background 81:5	bear 23:5 30:11,13 79:6 87:20 188:10	biggest 200:8
attend 15:6	avoidable 206:20 237:2,20 239:9	backwards 129:14	bearing 210:6	big-dollar 84:19
attention 18:11 27:19 31:17 62:11 62:15 65:21,21 79:11 135:13,15 138:4 139:1,17 140:5	AVP 53:4	bad 182:13	becoming 18:9 51:21	billion 139:7
attorneys 72:15	aware 31:15 195:8	baked 129:22	bed 139:7 155:12	billions 141:7
attract 240:5,15	awful 239:10	balance 229:21	began 124:3 210:3	bipartisan 91:7
attributed 78:1	a.m 1:16 4:2 115:14,15	ballast 209:4,7,9,11 209:16,19,19	beginning 103:9 125:8	bit 12:3 19:7 25:6
attributes 22:4	<hr/> B <hr/>	Band-Aid 159:6	belie 139:7 155:12	
	back 11:17,18 12:2 12:3 17:21 23:9 26:10,13 28:17 29:4,5 30:2,11 31:2 33:3 48:20 53:3 54:5 56:2	bankrupt 162:5	belief 127:16 195:20	
		barley 2:8 16:6 36:6 42:7	believe 11:17 14:11 19:17 39:7 45:8 50:2,5 91:3 111:18 122:4,5 127:15 142:5 144:17 148:3,22 149:2 150:9 152:10 155:4,14 155:20 159:9 163:2 171:15 173:3 174:16 180:4 190:1 196:7 196:20 207:11 220:13 236:1 244:22	
		base 132:6 208:3	behest 64:19	
		based 24:20 31:11 40:1 42:18 72:8 80:11 92:8 118:16 119:22 138:8 139:14 153:17 161:16 166:19 188:4 189:7 198:12 205:13 212:12 213:16,20 213:22 227:17 232:10	believes 150:11	
		basic 8:3 64:8 92:16 130:2 135:7 143:18 148:19 163:19 174:12 218:8 224:19	belong 224:10	

26:7 29:3 73:6	166:6 169:13	briefly 32:5	242:5	64:22 65:7,12
85:10 89:5 95:9	172:12,22 173:3	bring 140:18 156:1	Buttrey 11:17	119:21 134:5,6
150:21 225:14	174:18 175:15	156:7 171:10	16:15	139:6 159:13
black 21:2,4 73:22	179:11 180:17	bringing 17:18	b(x) 113:9	173:6 197:17
96:19	183:19 185:18	126:13		208:13,17 209:12
blank 56:14 88:15	196:16 212:14	brittle 235:6	C	209:12 210:2,5,14
blend 109:3 185:8	219:11 220:5,14	broad 27:21 30:8,9	C 2:19 3:1,15 8:1	211:2,8,14,19
bless 76:13	221:6 238:18	204:5	calculate 55:1	212:1,3,5,10,16
blind 87:22	244:5 245:17	broader 6:21 13:22	64:21 217:21	212:18,19,22
blocking 219:18	Board's 1:6 4:6,9	149:17 170:16	calculated 17:13	226:16 240:3,5,10
blocks 83:11	12:21 18:12 20:17	192:8	51:8 120:2 214:8	240:11,15 244:11
blue 31:19,20 112:2	24:2 38:5,6 39:7	broadly 29:7	214:13,18,19	244:14
BNSF 2:13 114:6	39:14 43:6 45:14	broke 201:10	215:21 232:12	capitalized 159:1
115:2 121:19	45:19 46:8 47:2	brought 18:11 79:6	243:12 244:4	CAPM 173:1
board 1:2,13 4:17	48:1 52:1 69:4	154:5 224:16	calculating 122:9	captive 17:17 19:20
5:1 6:5,8,21 8:14	80:5 104:16,18	buckets 132:9	237:8	captivity 170:2
9:16,17 10:4,17	116:10 122:2	164:16	calculation 13:12	capturing 152:11
14:19 16:14,18	152:14 161:11	budget 14:14 81:6	23:8 51:21 168:18	car 23:1,5 33:8
18:7 19:15 20:20	215:14 217:22	81:10 139:6 182:1	calculations 18:6	83:17 104:5
22:20 23:20 25:13	bodies 26:5	182:7 185:22	147:13 214:20	129:18 140:1
25:14,20,21 32:4	boiled 124:18,18	186:6 187:18	232:15	177:4 196:5 203:7
32:7 34:10,11	bolts 228:18	188:3 208:18,19	calculators 237:7	204:1 206:9,13
35:3,3,8,10 37:3	book 120:3,17	209:6,13,21 222:5	call 15:21 28:19	214:21 217:11
39:1 45:12,17,22	133:18 169:1	build 237:1	49:5 67:8 68:1,4	219:18 226:13
46:1,3,6,14,20	236:4 244:10	building 11:18	68:10 69:20 70:4	228:11 229:7
47:12,13,15,17,20	booked 185:6	166:9 240:19	70:19,20 71:21	care 87:2 103:10
48:2,6 51:14	books 108:15,16,18	bulk 190:10	114:3 192:16	142:18 146:16
58:17 59:17 62:20	109:1,19,22 110:4	bunch 103:5 162:2	209:2	171:13 179:20,20
63:18 64:18,20	borne 118:10	burden 9:13 14:19	called 17:22 68:12	209:21 225:7
65:3,13 66:7,11	bottom 157:6	121:3	83:21 134:16	230:6
67:15 68:1,21	168:14	burdened 204:9	158:21 209:15	career 11:22 26:10
69:1 72:19 74:19	bound 55:9	burdens 120:21	calling 27:18	53:4 100:14
74:19 75:3 81:16	box 21:2 74:1 96:19	burdensome	calls 6:6	careful 157:13
85:19 86:11,11,13	box-type 21:4	108:19	Canada 56:16	189:22
88:3,5 91:1 95:18	branch 160:22	Burlington 42:13	83:14 93:21 94:18	carefully 14:12
96:1,2 98:2	break 95:4 113:21	144:13	174:9 214:1,1	22:12
101:14 102:9	115:8	burn 17:8	224:2	carload 55:6
104:8 105:1	breakdowns	burnt 57:10,11	Canadian 40:12	118:21,22 209:4,6
106:15 107:3	233:18	business 105:7,8	213:18,21	carloads 209:9,10
108:11 116:8,19	breaking 201:13	106:1 108:17	candidate 31:7	209:15
117:2,7,16 118:2	217:4	120:8 143:5,10,16	78:19	carrier 47:22 120:7
120:4 121:1	Breskin 2:19 3:15	146:11 152:13,20	CAO 200:17 201:1	180:11,14 219:21
123:12 136:9	192:19 193:4,8,9	153:8 154:19	201:4	221:7
137:6 139:19	222:10 224:4,12	160:14 174:6,17	capable 156:1	carriers 5:8,9
142:21,21 146:3,7	225:12 228:21	174:20 177:5,13	capacity 96:22	48:10 119:19
148:4 150:12	233:3	177:15 178:12	139:11 216:16	121:4 151:9
154:11 159:19	brief 81:7	191:1 230:9 241:4	capital 13:13 64:21	carrier's 4:18,22

carry 9:18 101:10 189:8	certain 26:9 29:12 84:9 137:16	185:17 191:19 193:2,10,10	charges 39:5,5,8 charging 23:4	clear 14:13 87:5 122:1 131:13
carrying 119:14	139:22 151:18	198:10,10 213:8,8	CHARLES 1:22	133:2 162:9
cars 23:7 43:12,14 43:18,20,21 140:2	190:20 230:12	221:15 223:2	chart 28:15 199:6	clearly 64:12 112:8 119:16 139:16
206:14,14 217:16	certainly 14:19	245:7	chatted 66:4	146:20 176:16
case 17:15,18 18:4	15:3 32:11 62:15	Chairman's 163:2	check 209:8 211:12	185:7 187:6 218:4
18:13,21 19:2	75:4 90:15,18,20	challenged 63:11	checked 209:14	clerk 84:3
23:13 42:12 53:21	92:13 93:10 97:2	216:22	Chemistry 24:18	clever 178:8
60:2,21 69:12,15	97:8 111:6 125:22	challenges 81:2	Chicago 40:17,18	client 214:3,9 244:2
71:5 72:5,6,8,17	128:8,14 132:10	change 32:22	40:22,22	clients 61:19,19
73:3,13,15 89:10	134:13 135:14	101:10 103:6,20	children 152:5	75:16 87:8 96:11
90:20 94:10 141:6	137:3 138:10	104:3,20 155:13	chime 56:9 230:6	222:21 238:22
170:8 244:15	139:1 146:22	156:12,16 162:22	chiming 242:13	climate 131:1
cases 13:5 17:21	147:21 157:15	165:22 166:21	Chinese 149:10	178:13
19:9 23:15,18	176:5 183:8 191:4	168:15,18 177:14	Chip 85:9 104:22	close 109:3 211:18
38:18 46:5 48:5	200:21 227:17	177:14 219:12	154:2 221:13	238:1
51:18 58:21 59:2	240:15 244:15	229:4 244:8	223:15 245:6	closed 107:12
60:22 61:1 62:6,7	cetera 85:14 86:6	changed 31:18	chips 166:16	Closing 3:21
62:11 73:8 74:16	91:22 142:16	36:14 43:20 51:3	Chip's 85:12	CN 93:22 94:4
75:5 96:1,2 107:1	155:12 201:15	56:4,5 118:19	choice 98:17	coal 2:6 16:4 17:10
122:13,14 132:7	203:8 231:19	128:13 130:3	choose 15:6 121:12	17:16 18:18 20:7
141:2 173:18	chain 216:4	131:4 136:15	chooses 116:19	22:6 23:9 38:18
201:22	chaired 90:21	161:8 164:14	Chow 224:9	44:21 45:3,4,8,16
cash 240:20,22	chairman 1:22 3:3	170:11 194:6	Christensen 96:22	45:21 46:12,22
241:2,5,9	9:20 10:22 11:2	changes 5:12 8:13	163:7 169:21	47:4,9,14 48:4,11
cast 159:6	16:13,14,15 24:9	8:14 9:10,11 14:4	181:17	49:16,20 50:9
categories 22:22	24:9 36:2 37:5	36:15 49:17 64:5	chunk 26:9	51:9 52:11,19
117:19,22 131:19	44:18,19 45:13	64:18 65:4,5	chunks 164:1	55:2 59:10,19
131:20 133:22	48:19 52:7 65:17	101:17 102:18	circuitry 38:3 42:11	61:13 64:19 65:1
137:17,17 138:18	67:9 68:3 70:9,13	104:5 119:10	42:14,16,17,21	76:21 77:10 103:7
192:2 201:14	70:16 71:1,11,15	120:18 129:3	43:1	112:13 122:14
224:21 233:18	71:19 72:3 75:1,9	131:5,10,14	circumstances	126:7 177:9
234:1,1	75:18,22 76:2	156:15 164:19	23:19 207:17	203:22 217:6
categorized 132:20	77:1,4,13 79:20	201:17 207:8,9	cite 145:17	229:16
159:13	80:17 90:14 97:15	235:1,8	City 18:12,19	coal-fired 17:7
category 4:21 5:3	97:16 99:16,19	changing 37:3,19	claim 65:22 80:1	code 8:9
57:19 83:14 207:7	105:3 107:20	characteristic 5:21	clarification 63:18	codes 190:13
caught 79:11	110:10,11 113:21	characteristics	clarify 99:17	colleagues 67:15
causal 194:17	113:22 114:12	38:14,15 44:7	221:21	collected 31:12
196:2 202:15	115:18 116:3,3,6	216:6 217:6	Class 4:20 5:8	collecting 64:2
233:8	116:7 121:17,17	230:13 233:22	174:8,8 175:7,21	collection 6:16
cause 33:6 180:9	135:2,3 154:3	234:4	201:19 202:13	collective 109:5
caused 57:5 211:9	157:21 159:16	characterization	211:7 214:16	college 136:21
cautiously 13:21	165:4,13,19 167:8	102:19	223:19 225:22	collusion 175:2
cease 226:8	167:9 169:8,10,17	charge 37:15 39:10	classic 111:21	Colorado 36:8
cell 10:20	171:8 172:9 174:1	39:13,16 240:6	classified 192:18	colorful 115:2
	174:15 179:16	charged 188:9	clean 235:21	

colors 131:5	103:16 106:15	community 61:3,12	comprehensive	204:7
column 28:2	114:14 116:4	86:19 88:10	8:11 45:9,17	confident 89:1
combination	127:9,18 135:8	155:15	47:18 54:19 55:15	207:19 238:20
109:20 229:9	138:9 184:7	community's 78:6	61:22 75:14 76:7	confidential 92:9
combined 210:13	215:18 235:5	companies 6:17	86:7 106:17 107:7	143:22 148:2
come 50:12 51:17	Commerce 6:3	109:21	120:14,15 142:6	178:6 179:9
55:12 56:7 58:6	120:5	company 2:14,15	165:21 174:5	confidentiality
69:3 72:18 81:20	commercial 145:16	114:6 198:17	175:8	91:18 92:5,19,21
93:13 98:19 109:8	146:9,14 177:2,11	212:4	comprise 218:7	93:1,6 94:16
117:14 123:16,17	commingling 175:3	comparatively 20:8	compromise 77:20	95:21 105:22
127:15 141:14	Commission 6:3	compare 214:17	160:4	106:7 111:7
147:4 150:22	16:6 120:5	compared 150:16	computer 5:5,20	146:16 147:8
159:5 169:13	commissioner	155:9 164:1	7:22	148:4 149:4
175:13 176:19	11:16,16	217:14 219:4	computerized	confirm 220:7,15
180:21 181:18	Commissioners	comparison 131:4	28:12	confirmed 218:20
185:13 187:17	70:21	compensating	computers 197:4,5	confuse 158:2
188:8 222:5	commissions 2:8	222:1	conceivable 191:20	congratulations
223:16 236:1,16	36:6,8 42:7	competition 96:22	conceived 157:1	11:11 12:18 116:6
238:16 242:1	commit 25:15 35:5	97:1 156:6	213:12	Congress 45:18,22
comes 53:1 54:16	commitment 99:7	competitive 156:3	concept 74:18 84:4	62:21 63:2 81:8
91:12 95:22 96:1	commitments	181:14	154:21 157:9	81:11 84:16
96:2 122:7 161:21	149:6	competitors 143:15	202:10	119:13 159:21
172:1 187:12	committed 8:16	146:18	concepts 210:13	160:6 161:13
209:21 225:20	Committee 68:19	compiles 5:7	concern 62:16	162:21 163:11
comfortable 59:15	161:2	complaining 72:20	200:22	166:8,10,18,22
147:20 238:20	committees 167:5	complaint 84:20	concerned 18:2	168:9 169:19
coming 4:4 62:8	commodities	156:2	60:20 62:12 68:22	171:18 182:7
64:4 84:6 102:12	162:14 177:6	complete 14:10	73:13 144:14	222:16
104:12 193:3	commodity 52:14	63:10	concerns 66:6	conjunction 111:18
239:4 245:10,15	177:15 178:14,14	completed 6:8	100:3	232:1
command 135:13	217:5	completely 37:1	conclude 34:15	Conrail 56:18 82:7
comment 35:13	common 58:10	75:12 76:13 81:21	238:18	90:3,4,7
46:21 87:2,4 93:4	84:10 180:11,14	110:5 160:16	concluded 245:18	consensus 150:6
102:22 103:18	222:15 238:7	163:1,3,4 164:2	concludes 35:14	155:14
142:18 143:2	239:9	complex 60:5 80:21	conclusions 157:14	consequences
157:22 161:18	commonly 4:10	121:8 186:6,16	conclusive 32:12	116:18
170:3 176:20	communicate 85:2	complexity 204:9	concrete 164:1	consider 33:2
180:2,2,3 181:8	85:16,17 168:11	Compliance 49:7	concurred 127:1	45:22 54:20 94:11
185:9 227:2 235:4	182:16	complicated 14:5	condition 177:15	117:9 126:22
240:14 245:14	communicating	60:3 192:9 197:8	conditions 118:18	133:10 143:13
commentators	69:8	comply 152:14	119:11 153:18	167:1 196:22
130:7	communication	component 46:18	conduct 99:21	207:6 212:14,15
commented 184:11	85:2 87:21	61:11 106:19	116:11 215:16	consideration 5:22
comments 4:16	communications	133:19 169:2	conducted 211:1	25:1 225:1
10:12 14:22 20:10	168:7	components 161:8	conducting 13:14	considered 100:9
31:3 43:5 44:12	communicator	232:7	213:9	100:13 139:13
63:17 87:11	166:7	compounded 20:14	confidence 71:2	157:1 206:9,14

210:16,17 considering 32:18 consistency 191:15 consistent 177:22 consists 5:4 consolidated 36:14 constant 7:12 constantly 159:19 constituencies 168:10 constrained 240:11 constrains 240:2 constructive 15:2 consultant 32:6 66:18 72:15 74:8 127:20 130:16 149:7 183:22 198:14 consultants 96:10 96:21 127:16 144:7 145:6 consulting 2:22 181:1 192:22 Consumer 68:7 consumption 203:3 203:6,12,21 227:6 228:3,9 237:8 contact 49:12 67:2 contained 19:13 200:4 container 206:8,13 contemporary 218:10 219:7 context 69:12 75:3 134:4 143:7 149:5 158:7 170:20 continue 127:8 133:7 149:21 244:10 continuing 4:13 8:16 26:15 contract 141:5 188:20 contractor 25:22 34:10 35:11 80:5 contracts 142:21 208:5 242:10	contribute 186:11 contributed 201:1 201:5 control 119:13 186:17 controlling 90:12 conversations 209:1 conversion 6:14 conversions 202:3 converted 158:20 Convey 185:1 convinced 152:7 234:15 cooperate 147:7 cooperative 2:4 16:1,21 44:22 45:2 cooperatives 17:1,2 copies 24:11 28:9 copy 28:7 core 130:10 183:20 184:19 corporate 110:4 Corporation 2:4 16:2 190:10 correct 68:15 89:11 149:2 164:7 213:2 224:11 244:11 corrected 40:4 correction 164:12 correctly 122:6 125:7 152:11 correlation 203:1,2 203:14 204:13 225:14,18 cost 5:2,2 6:16,18 9:12 13:3,12 19:3 20:2 22:3 27:1 31:4,8,10,20,22 32:10 34:3,4 36:21 38:3 39:6 39:18 40:9,9 41:1 41:9,15,16,17,18 42:16 43:16,22 44:1 45:14 48:2,4 51:8,11 52:10	53:12,15,18 54:11 54:21 55:1 56:14 57:5 61:1 64:21 64:22 65:6,12 73:11 79:5 83:14 85:14 98:5,6,13 98:13 99:1,22 101:3 105:6,7 109:6 118:3 120:1 122:14,17 128:15 130:15 131:19 132:6 137:16,17 142:15,20,20 143:20 144:3 146:5,6 147:15,16 147:17 150:16 151:8 154:21 158:10,11,13 160:13,14 162:19 165:1 169:1,1,2 173:6 174:13 175:18 178:2,22 179:1,13 182:17 188:6 190:13,13 194:21,22 195:1,1 195:2,6,7,20,22 196:11,20 200:14 204:14 206:20 210:9,14 211:3,5 212:2,3,17 213:2 213:17 214:5,5,6 214:7,10,10,13,18 214:19 216:18 217:9,10,13,21 219:5 220:5 221:2 222:12 231:15,21 232:12 233:12 234:7,17 237:1,9 237:21 239:11,22 242:18,18 243:10 244:14 costed 140:1,3 157:2 costing 1:6 4:7,10 5:15 6:4,15 8:17 9:7,16 12:10,21 12:22 14:2,8	23:17 26:8 28:22 38:8 41:9 42:9 48:7,8 50:4 56:8 56:20 58:7 91:21 110:14 116:12,14 144:16 145:2,12 145:14 146:14 152:9,16,21 162:12 166:20 176:9,16 177:17 177:19 193:17 195:10,22 198:15 198:18,22 199:18 201:7 206:16,19 207:13,20 208:1,4 213:13,15 214:4 224:16 235:11 236:21 238:9,22 costly 46:17 47:5 121:9 costs 4:18 5:15,18 5:19 6:12 13:17 17:13 21:12 22:11 22:17 23:5,6 31:5 33:1 36:20 38:12 38:13,20 40:8 41:8 49:21 50:9 50:11,13,15 51:5 51:12,20 52:10,14 52:18,19,19 53:17 53:22 55:3 57:12 57:14,18 58:10 59:18 60:7 63:19 74:21 76:21 77:10 77:18,18 78:1,4 82:18 83:4 92:1 100:8,12 103:12 105:17,18 108:5 117:11,18,20 118:1,6,10,12,14 119:6,17,19,22 120:6 122:9 125:21,21 126:6 128:10 132:14 133:2,5,17 134:7 134:20 142:17 143:9,16 147:11	147:12 151:2,10 151:17,18 152:1,3 152:11,12 153:3,4 153:5,10,11 154:14,15 155:9 155:10 156:16 157:1,2 163:8,12 163:19,21 164:18 167:16 168:15,20 171:7 174:5,10 175:9 179:7,8 193:20 194:9,11 195:10,12,19 196:12,18,19,22 197:21 199:1,2 202:8,9,16 204:17 205:12 206:20 207:7 208:17 210:1,1,5,7,15 213:17,19,22 214:12 215:21 217:1,15,17 218:10,14 219:1 220:16 232:11 233:10,11 234:5 234:10,13 237:2,3 237:14,20 238:7 239:8,9,9,9,12,16 239:17 241:17,21 242:2 243:2,3,4,7 243:11,17,21 244:3,4,9 245:2 cost-based 179:6 cost-effective 125:11 cost-efficient 220:6 cost-finding 82:11 cost-over 20:5 cost/volume 5:13 council 24:18 90:3 90:8 counsel 96:10 161:1 count 114:22 country 228:14 couple 60:22 65:19 96:20 114:15
---	--	--	--	--

124:10 132:16 180:6,22 195:4 201:17 211:22 226:16,16 233:4 244:2 course 12:20 26:2,4 31:2,14,21 58:4 63:10 86:11 89:11 95:7 100:13 105:5 118:19 171:7 190:9 coursing 172:20 courts 63:11 cover 135:8 198:3 208:6 222:11 covered 27:13 42:13 cows 81:19 CP 94:1,5 crack 21:2 create 14:1 37:14 47:20 61:9 197:6 created 14:6 56:19 188:1 creates 242:9 creating 56:14 61:11 62:1 credibility 185:20 credit 155:11 crew 57:9 110:20 145:22,22 178:21 203:3 228:9 237:5 crews 146:13 176:15 178:22 216:11,17 228:1 critical 110:8 116:15 criticism 136:2 criticisms 243:9 criticized 205:1 cross-sectional 95:8 197:7 224:5 226:1 cumulative 108:9 Curiously 210:19 current 8:2,7 9:10 47:6 53:8 55:10	63:22 74:21 118:16 121:2 123:1 130:19 131:1 133:3 136:7 137:18 152:18 153:17 158:11 161:3 165:1 174:8 218:16 219:16 220:4,22 233:18 currently 22:21 118:6 124:2 138:1 139:22 149:21 151:12 curve 32:10 customer 69:20 152:6 customers 14:20 115:10 128:15,19 134:12 145:5 146:19 155:22 156:8,18 216:6 cut 139:20,21 cuts 131:22 c(x) 113:9 <hr/> D <hr/> dais 10:6 Dakota 36:9 Damn 165:11 Darn 165:18 data 5:7,21 6:16 25:22 31:6,11 32:15 34:12 35:11 47:6,8,22 60:1 64:2 78:20 79:16 80:21 91:19,21 92:5,8,9,16 93:7 94:7,12,12 95:3,6 95:8,18 96:16 100:6 102:6 118:16 134:16 135:21 139:4 142:15,20 143:18 145:15 146:21,22 147:15,16,17 148:1,1,7,14,19 148:19,21 151:15	154:13 157:13 160:2 161:16 163:19 166:20,21 171:20 174:5,9,13 174:13,21 175:9 176:6 177:12 178:10 189:5,7,10 189:12 190:11,19 190:21 191:1,8 197:1,3,6,7 211:6 211:12 212:12 213:20,22 218:21 219:20 224:5 232:11 236:15 dataset 226:1,19 data-intensive 91:17 data-rich 91:17 date 55:22 171:20 dated 219:6 221:3 datedness 125:1 dates 29:5 66:16 day 12:7,9 54:15 112:14,14 125:20 126:11 187:10 201:19 days 67:5 104:5 185:13 DCF 173:1 dead 82:22 deadheading 216:11 deal 28:16 37:9 42:1 55:11 96:3 110:6 128:7,8 167:4 dealing 30:16 52:21 123:4 dealt 58:11 73:9 Dearden 2:22 3:17 192:22 213:6,7 221:17 222:20 232:3,19,22 243:5 243:15,20 244:12 244:17,19 debate 84:20 98:14 109:12	debated 144:8 decade 63:8,14 decades 7:5 77:19 79:1 130:17 154:10 decent 57:16 83:13 decide 47:13 171:6 179:22 221:6 decided 45:19 173:3 decidedly 193:20 decides 25:14,20 35:4,8 117:8 220:14 decision 18:12 48:3 61:1 121:5 173:14 179:3 204:19 213:11 215:15 238:15 242:14 decisions 33:18 124:17 152:13,13 152:20 153:8,16 179:4 decision-making 79:6 declining 32:9 34:3 34:4 decrease 161:12 dedicate 216:17 deeply 184:10 default 43:13 80:8 118:17 123:17 212:8 defects 198:18 defer 45:17 159:4 165:7 223:9 deferring 45:22 deficient 211:21 define 9:6 196:16 196:17 234:3 defined 210:20 218:4 defining 100:19 definitely 56:21 86:10 137:12 147:3 197:14 233:3	definition 195:9 definitions 199:21 200:4 degree 159:10 171:13 204:6 230:12 degrees 207:8 226:20 delay 141:17 deliberately 116:17 delve 79:12 demand 9:8 demands 137:2,4 demand-based 179:5 denominator 168:21 densities 130:5 density 23:16 101:19 119:2 131:6,14 departed 11:21 departure 11:19 231:9 depend 60:9,10 85:15 dependant 64:13 229:19 depending 51:19 95:2 190:18 191:20 196:13 depends 37:9 70:18 depreciated 120:2 159:14 depreciation 159:2 212:1,2,6,17 deregulated 53:8 deregulates 44:2 derived 163:19 176:17 239:11 described 17:11 94:19 183:2 describing 58:8 description 206:22 deserve 135:15 139:1 design 200:20
---	--	---	--	---

designated 96:8	33:15 36:13 47:10	236:11	208:6	224:6 228:16
designation 116:7	53:11 96:4 118:20	difficulties 90:9	dissect 20:4	dollar 175:11
designed 38:21	177:18 208:2	225:9	dissertation 193:16	dollars 33:7 39:18
42:18,18 216:3	215:19 220:2	digging 91:22	193:19	81:17 108:3
desirability 87:3	239:14	diligent 15:9	distance 12:4 29:19	113:10 134:9
desirable 207:13	developing 108:4	diligently 175:1	83:18 237:6	139:7,10 141:4,7
desired 205:19	108:10 148:11	dime 221:22	distinction 111:15	domain 95:6
despite 80:3	150:17 199:11	direct 22:17 67:19	162:13 176:6	domestic 223:19
destination 14:14	201:6,8 205:8	directed 99:21	178:16,19 243:4	DOT 36:17
18:17 41:2,3	development 74:10	100:7 162:17,18	distinctions 210:4	double 214:12
156:5	189:9 198:14	213:13 220:9	distinguish 76:4	doubled 82:8 119:2
destined 40:19	199:17 213:13	directing 90:21	242:19	Doug 11:16
destroying 241:3	develops 12:1	direction 73:18,19	distinguished	downhill 84:5
detail 27:5 74:18	deviations 21:13,14	122:2,19 142:9	175:20	downside 149:18
135:18 198:3	dial 67:19	162:11	distort 43:8	150:1
219:8	dialogue 4:13	directions 183:21	distortions 242:9	downturn 177:3
detailed 160:2	176:8	directly 57:13 83:6	distribute 238:6	downward 112:3
details 19:12 20:11	diehard 12:12	203:11	distributive 216:10	down-to-earth
21:7 204:10,21	difference 214:20	director 209:3	diversity 202:13	207:12
determinations	219:14 227:21	dirty 38:17	dividends 125:10	dozens 153:20
48:2 186:18	228:2	disaggregating	division 94:3	Dr 223:10 227:4
determine 4:17	differences 103:11	223:22	divisional 95:5	dramatically 172:2
5:10,18 6:11 8:5	191:17 238:11	disagree 97:10	divisions 94:5,5	dreams 108:12
8:11 9:1 17:14	different 21:19	238:5	224:2 225:5,20	drifting 112:3
19:1 23:14 33:18	22:12,18 23:1	disagrees 63:20	doability 87:2	drive 176:13 229:7
47:9 57:5 60:17	27:4 38:9 43:17	disappeared 29:16	docket 4:15	driven 93:7
63:22 150:12	59:20 64:6 98:19	29:22	doctor 223:11	dropped 124:17
171:3 202:7 220:6	102:6 104:21	disclaimer 190:5	doctoral 193:16	dropping 124:12
determined 18:6	107:3,4 126:3	disclosed 96:11	doctors 223:11	drops 93:17
27:6,7 30:17	129:19,20 131:20	disconnected 55:5	document 28:4,16	due 7:1 187:6
51:14 80:13	131:22 132:15	discontinue 6:15	235:7	dummy 224:14
137:20 151:4	138:17 143:7,7,8	discontinuing	documentation	225:16 226:5,9
206:21	143:11 156:17	207:4	20:15,16	233:7
determines 4:20	158:11 163:4	discovery 145:8,11	documented 208:8	duplicating 26:5
determining 6:18	164:2 168:15	discrepancies	documents 27:19	dust 159:3
33:5,5,6 73:15	176:21 177:6,6	191:12	74:11	duties 9:19
203:10	184:13 190:22,22	discrepancy 137:22	doing 37:10 43:16	D.C 1:14 86:4
develop 5:14 38:20	207:7 217:6 225:6	228:13	55:9 56:2 57:4	
47:11 63:19 86:3	229:14,17 231:12	discussed 35:10	85:3,5,12 97:12	E
86:9 89:22 128:10	237:22	87:8 121:6	105:6 106:18	E 1:14 2:13 3:1,11
179:11 195:3,6	differentiate	discussing 52:18	107:2,3 123:20	earlier 120:10
196:9 197:20	224:22	discussion 170:16	126:16,19 127:8	154:6 168:5 224:1
198:21 215:20	differently 103:12	dismissed 113:19	136:5 144:7	226:12 241:16
217:1,22 220:10	177:8	dispatching 237:16	149:19 151:5,5	early 129:16
221:9 235:13	Differing 200:5	dispute 36:11	157:8 164:15	137:20 176:8
236:1 239:1 245:1	difficult 22:10 39:9	disputes 13:11	187:9 188:8	earn 81:8 120:7
developed 21:11	39:13 60:13		191:16 223:17	easier 128:6 158:12

easily 30:5,9 194:19 207:16 208:2 238:9	215:8 216:1 efficient 36:15 68:4 85:14 106:3,4 112:15 131:11	embarking 82:2 embarrassing 81:15 emphasis 75:8 empirical 57:21 empiricist 157:11 170:6	entirely 19:22 20:1 56:7 57:18 231:12 entirety 10:14 entitled 178:4 envelope 23:9 environment 22:10 28:19 146:17 177:2	et 85:14 86:6 91:22 142:16 155:12 201:15 203:7 231:19 evaluate 41:21 events 26:8 eventually 210:12 everybody 10:20 27:22 81:21 141:13 245:9 everyone's 175:16 ever-changing 137:4
echo 116:3 echoed 91:6 econometric 97:5 econometrician 230:20 econometrics 231:19 economic 55:12 120:7 153:11,15 153:18 210:9,13 210:17,18 212:2,3 212:17	effort 6:21 8:18 22:20 23:21 25:21 46:17 47:5 108:9 109:16 123:21 134:20 135:16 145:8 205:7 efforts 13:19 15:9 45:20 67:16 80:4 82:21 83:9 109:5 137:20 144:22 145:2	employed 34:11 239:7 employee 215:5 empties 216:13,14 216:18 empty 206:8,9,12 enable 9:17 enabled 112:11 enacted 215:13 encounter 152:6 ended 81:11 endorses 135:9,17 150:7	envision 86:21 episode 68:20 equal 156:12 equated 29:10 equation 151:14 168:21 169:3 210:10,18 213:2 231:1 233:5,6 234:6 238:13 equations 6:22 equipment 22:2 134:10 176:14 204:20 218:11 220:5,22 237:9,10	evidence 79:5 80:12 evidencing 113:15 evident 206:6 evolutionary 201:7 evolved 22:7 Ex 1:8 19:13 29:4 53:13 54:4 79:7 118:4 217:20 exactly 58:4 66:12 101:12 103:18 105:17 112:14,18 112:22,22 142:3 219:3 234:9
economically 170:22 economics 53:4 136:21,22 155:15 167:22 190:5 195:17 239:11 economies 101:19 economist 79:4 159:4 economists 209:22 economist's 231:3 economy 143:9 Ed 114:4,13 115:21 150:4 153:22 Edison 24:14 Edition 213:14 educate 154:17 educated 139:14 Edward 2:12 3:10 effect 33:6 51:11 60:20 78:4 effected 120:20 effective 34:12 85:14 90:5,8,11 156:6 234:7 effectively 9:18 44:1,2,9 effects 20:13 efficiency 29:1	either 70:20 77:3 90:22 91:2 98:10 123:7 137:16 161:9 163:9 166:4 173:9 188:20 210:16 220:8 elaborate 101:9 elasticities 194:20 232:17 233:20,21 elasticity 194:21 211:15,18 212:18 elected 158:13 electric 2:4 16:1,22 16:22 17:3 24:15 44:22 45:1 element 184:12 elements 159:12 177:11 elicit 127:7 eligible 155:17 156:1 169:13 182:4 eliminate 48:3 110:5 eloquent 167:8 eloquently 168:5 205:4 embark 14:12 98:7 105:20 109:15 175:11 186:9	ends 76:11 233:6 engage 210:12 engended 53:14 engender 169:18 engine 38:12,13 41:17 engineer 8:8 208:15 228:17 230:19 engineered 206:19 237:1 engineering 7:7,10 7:20 209:3,18 231:18 engineers 210:1 engines 216:17 enhanced 7:17 enjoy 223:11 enormous 7:15 180:9 ensure 9:16 17:18 92:4 119:9 enter 5:21 16:10 entered 79:2 entire 10:15 29:20 51:11 170:17 182:19	equity 64:22 error 212:7,13 escalated 19:10 especially 34:7 56:10 64:21 84:18 84:19 Esporanto 98:22 essentially 40:10 40:20,22 241:3 establish 7:3 126:21,21 established 96:3 estimate 13:3 19:19 65:7 185:22 188:5 194:19 196:9 197:19 233:20 234:8,11,15,17 estimated 45:13 211:19 estimates 27:1 32:14 34:6 188:5 194:12 195:6,7 211:5 212:9,11,18 estimation 5:9 22:17 33:1	Ex 1:8 19:13 29:4 53:13 54:4 79:7 118:4 217:20 exactly 58:4 66:12 101:12 103:18 105:17 112:14,18 112:22,22 142:3 219:3 234:9 examine 4:9 examined 211:2 218:18 examining 132:11 example 38:11 40:6 40:16 42:12 43:10 53:15 54:21 64:18 72:17 83:1,12,15 98:14 104:6 112:12 119:12 141:5 145:17 155:2,7 178:20 203:1,20 204:19 209:2 216:14 217:12 218:12 219:1 examples 30:4 excellent 84:12 88:4,5 97:2 113:18 168:7

237:8	58:19 59:1,5	112:20	158:3,4 163:16	210:13 213:20
excited 76:16	60:19 86:15	facing 131:1	165:2 191:21	find 12:12 13:15
exciting 97:7	157:16 160:22	153:18	195:8 212:11	29:12 64:3 74:12
excluded 39:8,17	204:3 217:8,17	fact 43:19 56:19	237:11 238:13	83:20 109:19,20
exclusively 106:22	236:22	73:1,8 74:16 77:2	fast 203:22 229:2	110:2 151:22
excuse 17:9 23:3	experienced 53:17	77:19 79:9 82:8	faster 229:6,7	152:2 154:18
83:10 195:1	experiences 84:11	109:19 110:1	230:10	195:14 223:21
exercise 56:21 60:6	expert 78:6 80:2	123:22 135:9,10	father 89:21	226:9 229:3 244:1
64:2,10,12	165:7 166:7 181:3	136:2,12,13	faulting 123:20	finding 13:9 55:20
exhausted 10:17,18	228:12	141:13 150:9	Fauth 2:8 3:6 16:5	findings 25:3
48:20	expertise 86:15	151:14,15 155:3	35:19 36:1 44:16	fine 46:18 172:14
exhaustive 67:16	experts 37:14 60:7	167:7 198:13	89:15,18 92:7	179:21
137:10	85:20 86:8,20	205:12 225:20	103:17 104:14	finished 140:8
exist 202:20 226:8	158:4 192:21	227:7 235:11	110:9,12 111:8	finite 137:1
235:5	199:4 236:8,19	239:21 243:1	Fe 144:14 193:18	firm 130:3 132:9
existed 227:16	expert-driven 60:6	factor 6:14 31:1,4,8	fear 90:12	181:13 182:4
existing 13:20	expired 10:8	31:11,21 32:1	feasibility 56:10	213:12 238:21
133:22 150:13	explain 71:4	38:4 42:11,14,17	87:2	firms 181:1
216:16	166:22 171:22	42:21 43:1 52:22	Federal 37:12	firm's 106:10
expand 73:5	explained 204:15	53:1 54:7,8,14	Feed 24:15	first 4:12 6:8 11:6
165:14	explaining 136:22	73:15 219:21	feel 59:14 147:20	11:14,18 15:21
expect 19:8 142:8	explanatory 231:5	230:16 240:2	feeling 201:2	18:21 25:5 45:8
224:18	explore 139:19	factors 7:4,12	234:10	46:15 60:5 68:5
expectation 136:3	exploring 13:22	28:22 29:6,11	feelings 235:7	79:2,3 82:17,19
expectations	explosive 21:22	30:10 47:8,10,11	feels 74:19	84:18 88:18,20
152:15	exposed 146:18	128:9 164:12	fees 72:15	93:9 99:5 116:5
expected 19:7	express 66:5	194:17 196:2	felt 18:4 90:4 136:9	123:13 143:6
expediting 142:13	extend 129:13	202:8 203:11	160:6	154:6 160:17
expedition 148:13	extended 124:11	230:17	fewer 93:18 155:16	165:7 180:1 182:3
expeditions 149:13	extensive 60:11	facts 140:17	field 47:21 95:20	188:1 193:12
expeditiously 9:19	160:21 226:18	factual 168:1	168:6	196:15 202:10,21
expended 25:12	extensively 79:22	faded 235:6	fifth 42:3	211:22 214:2
35:3	80:9 122:10	fair 102:19 153:12	figure 39:15 125:9	221:13 243:15
expenditures 81:20	extent 8:12 27:6	155:15	148:14 175:12,15	fishing 148:12
expense 5:11 72:21	50:8 61:8 78:10	fairly 9:19 26:10	178:9	149:12
83:11 130:22	118:15 121:1	30:8 57:8 81:10	figuring 105:21	fit 138:2 192:1
133:14 208:18	147:10 151:4,12	88:2 98:3 206:21	filed 150:10 213:21	fits 133:21 143:20
210:2,5,15 212:6	152:10 191:7	fall 166:16 182:21	219:9	185:3
222:7,9 224:21	extremely 60:13	falling 240:20,22	files 74:11	five 53:22 61:15
233:18,22 234:1	121:8 175:1	241:3	filing 19:13	95:2 105:20
expensed 158:22	e-mail 20:20 49:1,3	familiar 77:15,16	final 6:5 192:17	117:15 120:18
expenses 4:22	66:20,20 70:7	79:1 221:18	finally 5:17 7:21	126:18 133:11
174:14 176:7		family 222:8	48:6 56:5 59:8	141:1 161:6
222:18	F	far 20:11,21 50:3	63:13 134:13	223:19 226:12
expensive 45:11	face 81:3 137:8	51:16 78:8 108:10	135:13 138:16	229:10
108:19 231:17	221:18	108:12 132:14	221:8 241:4	five-man 145:22
experience 56:13	facilities 22:2	145:17 155:16	financial 190:11	178:21

fix 21:1 164:9 198:17 201:11	230:20	found 19:16 149:14 187:2 202:22	full 66:7 116:18 118:3,13 159:22	genesis 54:13
fixation 122:17	form 5:1 25:5	210:14 211:7,13	fullest 118:14	George 2:21 3:16
fixed 52:2 77:18 78:1 128:11 130:9	26:11,13 28:4,11	211:17 212:12	fully 13:19 116:21	192:20
146:4 154:14,21	28:22 29:8 30:3	225:13 226:18	117:20 122:20	Gerald 2:8 3:6 16:5
178:2 210:16	78:13 84:1 93:10	228:9,21	153:1 200:6,12,14	89:14
239:17	113:9 123:13	foundation 7:11	fun 148:14,15	getting 21:6 58:22
fixing 37:6,8,9,10	138:6 149:4	four 34:18 43:18,20	function 143:11	59:5 67:12,21
flashbacks 182:14	157:16 158:19	43:21 53:22 61:15	164:22 200:4	68:9 84:20 142:12
flat 206:8	176:13 191:2	63:9 119:21 124:9	231:21	142:17 171:9
flaw 202:6	194:1,3,4,16	141:10 145:21	Functional 194:16	174:3 183:12
flawed 76:12	198:18 199:17	182:10 229:9	functionality	186:8 187:3
234:22	201:20 205:11,14	fourth 42:3	199:22	206:10 231:5
flaws 200:8	236:4,8 242:15	fox 200:20	fund 45:19	237:12
fleet 23:7	formal 11:7	frame 20:14 71:7	fundamental 130:7	give 69:9 88:14,15
flex 162:6	format 205:15	73:9 85:15	131:14 166:1	88:16 117:22
flexibility 43:7	formation 242:15	framework 21:20	202:6 206:16	142:8 166:10
104:12	formed 200:15	121:3 162:11	fundamentally	169:7 197:18
flexible 38:6 104:4	202:14	195:11 233:20	164:17	233:10,21 234:7
104:7,15 119:9	former 16:15 96:21	FRANCIS 1:21	funding 37:13 46:1	234:11,16,18
208:1	117:4 123:12	frankly 68:17	62:21 81:12	given 7:15 59:14
flow 52:10 53:13	199:9,10 200:14	144:8 145:3 172:6	further 12:1 20:3	70:20 109:18,22
236:6,6,12 240:20	238:21	free 240:20,21	45:21 59:7 79:12	127:22 132:19
240:22 241:2,5,9	forms 151:14	241:2,5,9	121:10 150:21	177:2 206:21
focus 62:10 128:15	formula 56:8	freedom 226:20	154:17	222:4
135:11 137:14,21	239:14	freezing 164:5	future 17:14 73:15	gives 85:13 182:13
142:1,5 238:14	formulate 91:8	freight 2:10 3:9	119:10,19 220:8	226:19 233:11
focused 86:6	formulated 149:22	105:9,9,15 106:3		234:14
137:12 187:13	forth 48:20 74:19	106:5 114:4	G	giving 47:21
focusing 24:19	100:11 127:17	142:14 174:6	GAAP 191:9,10	gizmos 162:7
46:16 62:14	149:9 172:5	203:7	games 125:19	glad 16:15 44:13
foil 172:10	176:10 192:5	frequency 30:1	gather 180:13	75:3 140:14 184:6
fold 102:18	195:19 196:6,17	frequently 31:9	gee 166:11 182:10	glossed 80:15
folks 62:2 76:20	forthcoming	53:20	general 1:6 4:6 6:3	go 20:10 25:4 30:11
171:11	194:10	fresh 134:1	9:7 12:22 14:21	47:14 48:20 51:12
follow 56:22 67:7	Fortran 8:1	freshman 136:20	18:8 53:2,7,18,21	52:19,19 53:3
71:22 85:10 190:2	forum 207:22	Friedman 210:21	54:1,15 75:6 83:2	59:19 60:8,8 61:9
191:9,10	forums 11:9 69:3	front 10:5	117:6 175:7 217:9	62:12 64:1,9
follower 12:17	forward 11:22 15:5	frustrating 204:3	229:22 234:20	76:21 77:9,10
following 11:22	24:3 37:12 47:14	fuel 41:8,9,11,12,15	generally 22:8	81:11 98:15 99:18
47:17 54:20	62:22 65:2 75:13	41:20,21 57:10	110:15 138:21	102:17 107:6
forecast 188:8	77:10 87:9 89:7	83:12,12,16 92:13	157:1 190:3 199:7	109:9 113:7
foregoing 115:13	107:7 116:20	110:20 178:3	214:6 230:10	116:20 123:3,9
forever 98:15	117:14 121:10,12	203:2,5,12,21	generate 32:22	126:7 128:22
forge 188:2	171:6 173:13	215:8 218:13	generating 206:5	129:16 135:18
forgive 227:10	180:21 220:3	219:2,3,4 227:6	generation 16:20	142:14 143:10
	221:8 223:18	228:2,9 237:8,21	generically 124:4	144:2,4 147:12
				148:13,15,15

149:13 155:6,13 157:17 158:3 163:3,3,15 165:2 170:9 171:6 172:5 172:18 173:1,22 177:11 182:6,9,16 183:9 184:19,20 185:12 191:21 192:4 193:7 197:3 204:20 209:7 212:9 219:8,15 221:13 225:21 226:4,8 228:22 237:16 242:10,11 243:20,22 244:9 goal 9:15 48:1 244:19 goals 124:6 205:17 goes 26:10 28:17 29:4 63:13 91:9 98:21 126:7,7,8,8 148:18 162:15 176:21 188:18 190:16 194:5 going 15:14 20:4 21:1 23:14 30:2 33:18 40:17 53:3 53:17 54:1 55:17 56:2 57:7,12,13 57:14,16,19 60:2 60:8,15 61:6 62:9 63:6 68:11 70:3 73:14,19,20,21 75:6 76:8,17 78:14 81:10,13 84:2,7 85:4 86:14 87:18 89:10 91:20 92:5 93:17 94:20 98:9 99:8 106:16 107:15 109:11,15 110:3,6 112:2 113:9,20 122:21 122:22 124:9 125:6,17 127:12 127:20,21,22 136:1 137:8 138:20,22,22	142:6 147:4 149:6 149:7 152:1,2 153:13,14 155:19 156:18,21 157:10 158:5,14 162:5 163:11,12 165:6 166:13,21 168:14 170:7,9 171:2 172:2 173:4,15 175:22 177:22 178:10,20,22 179:10,11 182:17 186:19,20 188:2,6 188:7,12,17 191:5 194:3 196:8 197:19 208:12 212:4 220:3 221:8 221:16 223:17 229:13,17 232:4 237:5,6 240:13 241:12 going-in 76:10 good 4:4 16:13 24:8 55:7 57:16,20 59:6 72:11 78:18 89:19 90:18 98:14 98:16 99:15 109:7 110:12 111:1 121:16 125:14 135:2 136:6 137:19 143:4 171:16 172:13 178:19 179:3 201:15 202:12,14 203:13,17 206:22 213:7 214:22 228:10,15 236:12 236:12 gosh 123:14 131:3 164:3 gotten 140:16 223:20 government 49:6 171:17 172:13 187:6 gracefully 11:21 grad 84:3	gradient 83:21,22 grain 24:15 112:16 112:19 126:8 129:9 217:5 graph 44:10 115:4 115:7 134:3 graphic 115:11 gray 206:3 great 37:9 124:6 172:14 227:22 greater 137:22 190:17 greatly 26:2 37:19 39:6 Greg 207:10 231:7 233:1 Gregory 2:19 3:15 192:19 Grimes 2:21 3:16 192:20 208:10,11 213:5 222:6 227:4 227:10 230:6,7 239:20 240:13 241:14 243:14 244:7 gross 33:8 41:16 83:17 196:5 203:6 211:10 218:14 226:13 228:10 229:11,12,15,16 group 16:3 58:14 58:15 105:2 175:19 181:18 187:12 193:14 206:13 groupings 5:11 groups 50:14 59:22 126:4 128:21 132:10 224:10 growth 21:19 22:1 129:8 GTMs 203:20 guarantee 56:22 guess 108:21 127:5 139:14 150:19 171:8,15 172:19 193:5 234:10	guesses 188:4 guesstimate 81:14 182:12 guesstimated 182:11 guide 47:16 guideline 25:19 guidelines 13:11 58:21 128:1,2 218:4 guiding 24:22 25:4 34:16,17 107:11 guy 228:18 guys 111:22 228:19 <hr/> H <hr/> H 2:20 3:7,15 half 63:14 237:19 Hamberger 2:12 3:10 114:4,16,19 115:9 116:2 150:5 160:20 165:5,6,11 165:14,17 167:3 169:6,9 170:5 172:8,19 180:4 183:3 185:11 192:13 hand 208:17 handle 129:11 142:17 handled 28:11 93:20,21 handles 103:11 handling 41:5 119:15 hands 73:22 200:18 hand-out 115:3 happen 28:7 136:8 161:13 243:16 happened 23:12 53:6 124:14 156:15 158:19 193:17 happens 28:3,16 52:18 68:16 happier 144:18 happy 65:18 75:13	115:10 143:1 161:17 hard 15:19 55:11 61:18 76:15 138:17 154:18 156:18 harder 128:7 hard-core 12:13 Haskins 199:10,16 hatched 180:18 hate 149:12 hazard 54:9 171:15 hazardous 13:18 hazards 118:4 heads 235:22 hear 10:2 26:7 68:17 75:12 91:15 114:14 120:10 155:14 heard 29:2 34:9 82:15 99:5 135:6 150:7 161:21 176:8 187:8 224:1 243:9 hearing 1:4 4:5,8 4:12,16 9:1 10:15 11:7 12:11,20 15:5,6,10 16:9 36:3 49:1 85:22 117:2 172:6,21 180:6,9,11,18,21 184:8 213:9 215:16 221:19 245:16 heavier 84:7 119:1 130:5 heavily 22:1 193:22 204:18 heavy 14:19 203:21 heavy-haul 22:7 held 12:11 Hello 36:1 helm 11:7 help 9:5 34:14 37:13 67:11 89:7 91:8 134:19 138:20 142:16
---	---	---	---	---

147:1,5 215:1 236:19 helped 71:14 89:21 90:8 helpful 21:3 175:15 223:4 helping 65:3 137:14 henhouse 200:21 heuristic 83:5 hey 68:12 106:6 high 23:15 202:22 203:2 204:6 236:5 higher 19:7 76:9,11 119:5 151:22 153:3 159:10 212:11 214:7 highlight 45:6 128:4 highly 88:6 109:11 highly-confidential 96:9 highly-qualified 181:13 highly-technical 25:10 35:1 107:15 Highroad 2:22 192:22 highway 81:5 84:12 182:14 high-volume 214:11 hints 210:20 hire 105:19 historic 98:6,13 129:21 historical 29:10 100:20 218:6,9 220:19 histories 219:19 history 14:3 25:6 74:6 82:20 145:18 146:12 158:19 160:1 194:2 199:14 hit 166:14 hoarse 121:19	hoc 103:15 hold 17:6 219:14 holding 36:3 72:16 hole 202:4 home 81:20 hope 72:16 88:16 186:4 Hopefully 23:3 hoping 9:4 hoppers 42:13 horsepower 216:9 226:14 229:2,4,8 229:18,22 hourly-based 227:9 hours 108:3 226:15 House 68:18 housekeeping 171:17 172:13 221:16 Houston 55:4,6 how's 173:15 huge 61:10 161:10 228:2 humor 76:3 hundred 44:10 139:9 hundreds 39:17 141:3 hybrid 106:9 109:3 hypothetical 52:16 98:1 99:20 162:13 165:15 171:11 hypothetically 165:20 <hr/> I <hr/> IC 26:13 ICC 6:6 7:13 14:2 14:7 28:13 79:4,6 97:19 123:13,20 136:9 198:20 199:5,16 200:6,16 200:19 201:4 220:9 238:17 242:15 Idaho 36:8 idea 22:22 89:3,15	89:19 90:18 91:7 105:21 110:13 111:2 125:14 143:3,4 196:2 201:15 202:12 235:14 239:16 242:18 ideas 89:22 90:6 identification 118:11 identified 27:12 32:21 118:7 identifying 82:18 II 2:10 3:9 5:13 8:6 33:13,14 III 2:8,18 3:6,14 5:17 27:7 30:15 30:16 33:17,19 38:5,8,21 41:9 42:5,10 43:3 103:19 illustrates 14:4 215:11 imagine 143:8 immensely 212:22 impact 100:5 119:18 171:18 172:3 173:12,15 173:17 impacts 23:17 116:18 179:1,1 implemented 9:12 119:14,20 173:13 implementing 150:17 importance 72:11 141:12 important 13:2 17:19 18:9 21:8 61:4 71:12,20,20 81:18 96:13 109:14 111:15 122:3 126:14 128:6,17,18,18 132:3,18 133:19 133:20 134:8,19 135:6,11 140:17	142:2 154:8 159:17 166:19 182:15 183:18 185:4,10 213:1 220:4 impose 14:19 improper 175:3 improve 9:10 13:8 13:9,15,17,19 15:3 37:4,20 39:19 40:4 41:5 189:12 215:22 improved 46:22 161:7 improvement 75:14 138:5,8 150:15 215:12 improvements 13:13 14:18 21:9 37:18 41:4 138:11 204:8 improving 41:8 135:12 138:5,15 impugned 182:20 inaccuracies 23:17 51:22 inaccuracy 20:2 150:15 204:9 inadequately 211:4 incentive 105:16 include 8:19 86:10 86:11 101:10,16 118:9 216:8 included 41:16 101:4 168:22 199:3 includes 213:17 including 26:16 39:5 47:16 80:5 86:18 146:11 149:8 163:6 196:3 196:11 197:16 205:14 233:7 inclusion 39:4 income 240:21 incorporated 92:14 increase 7:15 26:3	38:2 53:2,7,18,21 54:2,16,22 119:16 161:10 188:21 243:18 increased 46:9 130:5 156:14 215:4,6,8,10 increasing 41:13 104:11,11 137:4 146:10 incremental 55:19 131:5 211:3 242:8 incurment 133:5 incurred 57:6 independence 18:15 225:10 independent 37:14 90:13 229:10 indicate 52:13 224:15 indicated 8:21 49:15 99:4 127:17 129:5 155:5 indicates 59:9,10 83:6 indices 226:17 indirect 237:15 individual 23:18 93:11,12 107:1 142:19 148:6 151:8 224:21 234:1 Industrial 24:16 industries 9:14 industry 13:12 14:20 36:14 51:12 53:16 58:9,9 86:19 106:9 109:4 116:16 158:20 162:5 183:7 196:16 202:19 207:21 213:16 227:8 235:20 241:7 ineffective 233:13 inevitable 164:21 inference 93:14
---	--	---	---	---

inferences 226:22	inspection 32:9	144:3,15 145:2,12	52:16 69:22 98:4	239:9
infinite 137:2	instance 82:19	145:14 146:13	98:18 100:15,19	joke 75:21 239:5,15
inflate 39:6 169:2,5	Institute 24:15	147:15 148:1	101:3 107:13	jolting 65:20
inflates 42:15	instructed 19:15	201:21 214:19	120:11 122:3	journey 14:13
inflation 19:11	integrated 27:9	235:17	128:9,17 130:7,10	76:16 105:20
influenced 204:18	33:20	internally 67:12	141:12 147:11,13	175:12
206:10	intend 134:13	107:2 143:7	154:5 167:17	judgment 157:15
information 21:8	intended 46:7	interpretation	180:15 236:20	jump 50:20
66:2 67:22 69:18	intensive 134:5	190:18	241:16 244:21	June 4:15 245:13
70:5 71:3,12 92:3	145:15 212:22	Interstate 6:2	issues 4:9 18:11	jurisdiction 155:7
92:12 105:13	intent 164:11	120:4	19:4 24:3 27:13	jurisdictional 44:4
111:11 142:12	198:16	inter-terminal	27:16,18 85:20,22	justice 141:12
144:16 174:10,17	intentions 124:6	29:18	87:8 95:11 97:20	justification 53:19
175:3,4 176:16,18	interactions 88:5	inter-train/intra-...	116:13 117:4	justify 204:11
180:21 218:2	interactive 5:19	219:12	124:9,12,12,16,22	
220:18	interactively	intra-terminal	127:2,4 128:4,5	K
informative 223:7	229:11	29:17	134:17 143:4,5	Kahn 210:21
informed 33:14	intercept 101:18	introduce 22:16	158:9 165:3	Kansas 18:12,19
infrastructure	interchanged	introduced 181:16	171:14 172:22	KCPL 69:14 72:6
119:5 211:8,14	216:12	Intuitively 203:4	184:10,11 208:7	keep 4:14 10:9 15:4
212:10,20 218:8	interest 8:22 17:7	investigation 20:3	215:15,18 218:5	69:7 99:17 105:12
220:20	19:21 66:6 126:3	118:9	223:16	105:16 108:14,18
inhalation 118:4	126:5 128:14	investment 77:17	item 32:18 41:10	113:20 115:9
initial 32:8 163:2	175:17 193:12,15	78:18 120:2	41:20 138:13	162:4 239:7
211:13	198:12	130:22 133:18	items 84:19 132:18	keeping 12:1 78:4
initially 6:1 89:1	interested 2:5,18	139:3 154:7	135:14 181:21	164:22
initiate 25:14,20	3:14 13:9 16:3	156:13 212:20	iterative 89:6	kept 30:22 136:20
35:4,8	17:12 18:3 125:22	239:22 240:4	I&I 30:1,14 219:16	148:2
innovation 21:18	137:7 192:18	241:7,10	221:4,6	key 9:4 25:3 85:1
input 41:10,10	201:5	investments 242:11	I's 175:22 223:20	145:16 146:10,14
101:8,10,19 103:9	interesting 140:13	involved 46:13		168:8 172:4
104:3 128:1	209:1 239:10	74:9 106:1 112:9	J	215:18
142:16 185:9	interests 2:2 3:4	112:21 117:4	J 2:6,22	kick 166:10
187:15	15:22	141:3,5,7 144:21	jab 244:7	kidding 76:6
inputs 103:21	intermediate 196:4	145:1 186:15	January 166:14	kind 26:18 38:17
104:21 199:12	226:13	involvement 74:6	Jerry 102:20	61:5 69:15,22
208:13 211:3	intermodal 6:13	88:7,8,9,13 201:3	103:16	70:2 74:14,15
212:10,18 218:1	21:16,22 30:2	involves 124:1	job 34:14 136:6	76:15 77:20 79:7
inquired 118:2	103:8 118:10	involving 22:6	137:19 151:5,9	87:16 88:13 89:6
inquiries 49:8 66:1	126:8 132:2,4,5	23:15	161:3 174:22	94:16 100:20
67:22	132:13 156:22	in-depth 108:12	182:5 186:1 237:8	103:14 105:22
inquiry 20:19 47:2	157:2,3 204:1	irrational 153:9	John 2:6 3:7 16:4	106:7 111:21
70:18 192:8	206:7 219:5,13,17	isolated 47:19	35:20 44:19 48:16	127:1 131:16,17
inside 239:15	221:2,4,5	isolation 113:3	95:14 102:20	148:5 160:2
insight 74:7 213:14	internal 82:11,12	issue 4:14 13:7	112:12	166:11 171:17,20
214:5,10	108:3 110:14,15	27:12 32:21 36:18	joined 36:6	180:5 181:16
insofar 60:19 62:11	111:2,7 142:15,15	36:20 37:15 49:11	joint 58:10 238:7	185:2 186:3,8

208:20 228:22 235:13 239:2 kinds 158:22 168:15 184:13 203:19 King 87:6 King's 87:16 knew 18:2,8 know 9:8 12:7,14 12:15,16 19:14 35:22 39:9 41:12 49:5 51:1,7 52:1 57:8,9,10,10 60:7 60:13,14 61:4,5 61:10,13,18,19,20 62:1,2 64:4,8,9 67:5,14 70:1,6 71:7 72:18 73:18 76:4,15 77:2,8,9 78:22 80:7 81:12 82:6 84:19 85:3,4 87:18 88:2,4 91:14 92:9,18 95:21 96:7,10 97:9,9,21 103:8 103:18 104:2 105:17 108:8,12 108:14 123:21 126:18 130:6,10 134:16 138:10 144:7 149:7 150:22 154:11 157:18 158:3 159:3 160:17 162:1 163:7,13 166:5,12,12,13 168:3,9,13,13 170:12 172:3 173:2,3,9,11,12 173:16 175:19 178:6,8 179:11 180:16,16 183:10 183:11 185:15,19 188:7 189:16 192:4 195:17 217:16 223:5 230:7 233:15	234:9 235:22 237:9 240:18 241:7 242:1 knowing 213:10 234:13 knowingly 33:17 knowledge 78:16 130:14 213:15 220:1 236:15 knowledgeable 144:21 207:20 known 4:10 13:1 198:18 knows 60:5 129:10 <hr/> L <hr/> labor 146:2 201:14 lack 7:1 108:14 124:21 190:21 Lake 152:4 lambast 69:4 lane 214:11,12 lanes 214:6 244:2 large 23:18 27:6 46:4,9 58:21 60:22 155:21 181:1 largely 31:12 50:13 211:8 larger 104:2 130:4 168:19 late 28:13 114:10 123:12 240:19 Laughter 59:21 165:12 launch 76:16 law 100:7 162:21 lawyers 145:6 lay 97:4 layout 129:20 lead 67:3 167:22 182:4 189:6 198:14 223:10 leads 19:17 League 24:17 44:21 64:19 leaked 92:3	learn 93:19 learned 157:7 learning 223:12 leave 94:14 198:5 230:4 leaves 123:22 led 200:2 208:22 210:11 left 205:2 legacy 8:8 legal 127:11 143:4 149:12 161:19 legislative 160:1,4 160:22 165:3 legitimate 200:22 Leilich 2:20 3:15 192:19 198:8,9 207:16 222:4 227:12,15 234:21 235:3 length 242:22 lengthy 14:17 121:8 LeSEUR 2:6 3:7 16:4,7 35:22 44:17,18,19 58:14 59:17,22 63:16 75:11,17,20 76:1 76:18 77:3,6 79:18,21 95:15 106:14 112:12 lesson 136:20 letting 149:20 200:20 let's 24:10 25:4 26:6 31:1 52:15 52:15 69:7 84:17 84:18 98:18 99:20 101:14 106:6 109:9 113:7,7 161:6 163:17 165:16,19 level 29:11 30:14 47:20 95:19 97:20 130:22 149:15 196:11 levels 202:22	liars 236:10 lie 200:9 life 89:4 141:4 light 10:6,7 18:13 115:1 lights 10:5 light's 114:17,20,22 liked 190:5 201:9 likewise 22:5 190:4 limit 215:17 limitations 151:13 limited 101:17 116:22 137:5 180:5 192:22 230:12 limits 226:2 line 31:19,20 41:9 41:20 42:19 84:4 84:6 112:2,3 129:13 157:6 168:14 171:9 185:21 186:2,3 linear 194:13 207:9 232:15,18,19,21 234:18 lines 23:16 96:13 111:22 113:3 119:14 131:6 143:19 167:16 list 16:8 35:20 114:11 128:5 132:17 138:14 listed 16:8 listen 85:5 listening 223:12 lists 12:14 literally 21:4 literature 195:9,14 litigation 148:10 176:20 186:15 little 12:3 25:6 26:7 29:3 69:5 73:6 85:10 95:9 115:8 125:8 150:21 225:14 live 130:19 lived 242:6	load 206:9 loaded 206:12 loading 112:20 loads 119:1 130:5 locating 177:9 locomotive 41:17 203:7 204:1 215:6 218:13,15 226:14 227:17,20,21 228:11 229:18 locomotives 178:3 216:9,11 logic 236:21,21 logical 31:7 79:13 88:12 183:8,8 long 8:21 25:6 65:10 72:18 74:6 75:15 86:4 114:16 114:19 158:18 159:15 188:6 239:19,19 241:20 242:6,19 243:2 longer 54:15 84:7 150:3 longer-term 119:18 127:3 longstanding 166:20 long-term 32:9 173:12 199:1 look 9:9 11:22 15:4 24:3 26:6,20,20 31:1,19 33:21 62:7 65:3 79:14 82:20 85:20 88:13 100:2 106:2,8,16 106:17 107:6 111:2,4 115:4,7 121:10 124:8,14 125:17 127:3 129:8 133:5 134:1 134:3 136:16 147:4 155:6 156:20 166:12 167:13,16,18 169:19 170:10,18 171:6 173:5
--	--	---	---	--

174:20 176:2 191:22 196:2 217:4 234:3 240:18	78:5 152:2 153:4 217:16,18 242:2 244:3	198:14 200:19	163:14 169:21 170:7 172:4 173:19 189:17 224:8 231:10 232:16 236:18 242:21	72:4,6 140:14 141:22 154:11 226:11 227:4 239:8,20
looked 18:20 20:16 36:12 56:4,15,16 122:3,4,5 130:13 133:12,12 144:1 149:1,8 159:15 162:2 172:12 175:21 180:17 223:7	M	mandate 122:8 mandated 98:3 100:7,10 119:13	meaning 89:4 169:12 194:21 meaningful 93:14 135:12 meaningfully 47:1 95:16	merchandise 118:21 merger 90:4 96:1 131:9 mergers 226:6 merits 207:3 message 172:5,11 met 80:6,7 209:11
looking 31:6 32:14 50:22 51:2,6,10 51:16 67:10 69:18 81:3 91:11 98:15 108:8 112:10 127:2 129:14 138:14 162:8 163:21 192:8 194:2 196:17,18 241:18,20 242:7	Madison 84:6,8 magic 167:19 magnitude 117:3 185:5 186:1 main 119:14 maintain 92:21 139:6 221:9 maintaining 23:6 149:19	manifest 216:15 manner 120:21 manual 5:5 28:3 map 115:5,8 marginal 195:2,6 195:11,19,20 196:18,20 197:20 204:8 241:16 242:1,8,18 243:2 243:3,3	means 7:2 31:5 52:21 107:18 119:3 120:16 126:1 129:21 134:5 141:6 151:17,17 152:12 157:3 187:7,11 204:14 meant 195:21 measure 46:9 48:7 65:7,8 113:11 151:7 163:12,13 173:6 194:18,18 234:14	method 220:7 221:2 methodologies 126:12 176:9 177:1 238:6 methodology 100:1 120:1 122:14 197:9 198:19 199:13,18 208:1 224:17 235:13,15 235:17 236:2,13 239:2
looks 32:9 39:14 212:13	maintenance 38:20 130:12 143:19 204:19 237:14 major 17:7 48:9 56:17 62:15 82:18 83:10 85:22 90:16 105:7,18 124:22 132:22 137:17 144:3 186:15 191:17 230:14	market 146:10 marketing 213:10 241:22 markets 177:7 240:10 markup 195:18 Marwick 198:17 masked 228:8 massive 112:13 163:9 181:9 match 232:11 material 96:8 materials 13:18 201:14 matter 25:11 35:1 70:17 76:12 107:15 110:1 115:14 135:6 167:12 168:12 169:11 170:12 205:5 235:13	measured 211:9 measurement 36:19,21 170:14 measures 65:12 196:3,4 197:15,17 226:12,16 measuring 163:18 mechanical 54:3 medium 46:4 60:21 177:7 242:5 member 88:4 185:18 222:8 members 10:4,17 17:3 42:6 86:11 92:20 93:18 113:17 150:20 membership-bas... 16:20 memory 68:12 mention 9:22 183:4 mentioned 48:22	met 80:6,7 209:11 method 220:7 221:2 methodologies 126:12 176:9 177:1 238:6 methodology 100:1 120:1 122:14 197:9 198:19 199:13,18 208:1 224:17 235:13,15 235:17 236:2,13 239:2 mid 28:12 123:11 middle 185:3 midst 11:16 Mike 66:19 mile 41:16,17 83:17 83:18 215:7 218:14,15 229:15 229:16 mileages 221:6 mileage-based 227:8 miles 23:11 30:3 33:8,8 38:4 42:8 42:15,19,19,20,22 196:5,5,5 203:6,7 203:7 204:1,2 211:10 219:13,14 219:17 226:13,14 226:14,15 227:18 228:1,10,11,11 229:4,12,12 million 17:9 19:21 45:15 139:10
lose 235:10 lost 136:11 lot 31:17 39:21 40:2,12 51:9 61:9 62:1,5,7 74:7,17 74:17 75:7 84:20 105:13 106:12 121:20 129:11 134:17 141:10 146:21 154:19 177:10 190:12 210:1 225:12,17 225:21 235:8,19 236:21 239:2,10 242:6 lots 33:18 Louann 165:7 168:13 170:6 176:20 Louise 2:15 3:12 114:7 lower 50:6 51:7 52:10,14 76:9	make-whole 38:2 39:20,20,22 40:5 52:22 53:1,10,11 54:8,14 55:10 making 23:8,21 40:8 43:8,16 66:6 94:11 105:13 122:18 138:19 152:13,20 153:8 171:19 190:22 193:5 213:11 manage 81:17 186:21 242:5 managed 14:12 management 81:3 81:5 82:12 84:22 85:1,7 87:21 99:4 168:6,8 187:10 204:18 214:19 232:12 management-bas... 56:20 manager 84:12	markets 177:7 240:10 markup 195:18 Marwick 198:17 masked 228:8 massive 112:13 163:9 181:9 match 232:11 material 96:8 materials 13:18 201:14 matter 25:11 35:1 70:17 76:12 107:15 110:1 115:14 135:6 167:12 168:12 169:11 170:12 205:5 235:13 matters 31:10 192:21 maximum 46:2,10 mean 17:9 27:21 50:20 51:1 60:2 67:4 69:7,21 70:1 73:16 75:19 76:5 76:6,15 92:8,11 110:8 115:12 122:16 140:15	mentioned 48:22	

141:9,10 182:10 millions 39:17 108:2,3 141:4 Milwaukee 84:6,8 mind 14:15 15:4 30:11,13 87:20 113:13 mindful 159:18 minds 75:8 160:5 mine 227:12 233:3 minimizes 120:21 minimum 45:16 minor 42:4 43:2 137:16 212:7 minute 10:7 38:12 38:13 41:18 207:15 minutes 29:14 miraculously 161:5 missed 200:22 missing 191:11 210:9 Missouri 18:17 misstating 151:18 mistakes 14:16 Mitchell 198:17 mitigates 126:15 mix 22:12 95:8 113:5 mixing 94:4 224:5 model 12:22 13:16 13:20 14:2,8 22:16 47:6,7 102:2 103:6 150:13 177:6,17 213:14,15,17 214:8,13,15,18,22 215:20 220:3,7,9 220:12,14,17 221:10 231:22 232:6 234:18 237:22 238:1 244:4 models 20:16 91:21 142:16,20 194:14 197:14 207:1 217:9 231:7,10	243:6 modern 49:18 56:1 59:12 modifications 8:12 117:12 127:5 150:18 modified 6:10 207:17 modifying 117:10 212:15 moment 87:7 103:1 133:6 149:17 money 54:5 63:3 108:9 125:2 130:20 136:19 141:11 187:4 205:7 212:4 monies 141:3 188:4 Montana 36:8 40:21 months 53:22 87:1 124:10 180:13 Montrose 18:13,16 18:20 morning 4:4 12:16 16:13,17 24:14 45:6 48:13 116:10 121:6,16 125:8 130:8 135:2 motion 7:10 motivated 46:9 move 23:7 29:20,20 33:3 34:1 37:12 52:16 58:18 75:13 83:7 89:7 121:12 127:13,14 163:13 177:9 196:9 206:11 moved 29:8 53:8 movement 19:9 26:15 38:16 40:18 42:9 48:3 117:22 196:10 219:19 movements 5:16,19 5:22 6:12 13:17 22:5 23:2,15 40:12 43:9 54:12	59:19 117:19,20 117:22 126:14 139:22 140:3 151:21 152:1 153:3 movement-specific 17:22 73:11 102:2 moves 29:19 33:12 217:13 moving 22:13 31:2 40:16 43:18,20 118:21 163:22 multi 129:17 multiple 23:1 184:18 194:17 196:2 197:15,16 217:10 225:8 231:6 multiple-car 42:9 43:14 163:22 164:1 multivariate 234:16 multi-car 128:16 129:18 216:1 multi-million 175:11 multi-variable 197:14 multi-year 175:11 Mulvey 1:21 3:2,22 4:3 11:3 15:12 16:14 24:5,9 35:18 36:2 37:6 44:15,18 45:13 48:15 50:7 52:4,8 55:16 58:12 62:13 64:11 65:18 75:1 85:9 87:13 89:12 89:17 90:19 92:22 94:22 96:17 101:2 102:8 103:13 104:10,22 111:5 111:10 112:16,19 113:16 114:2,18 114:21 115:6,11 115:16 121:14	133:7 134:22 135:3 140:7,10 147:9 149:16 153:6,19 168:17 169:8,10 178:18 179:18 187:19 191:14 192:6,10 198:7 207:14 208:9 213:4,8 221:12 222:14 223:10,14 225:4 227:1,13 230:5 231:2 232:14,20 233:1 234:19 239:6 241:13 242:17 243:19 244:6,13,18 245:4 245:8 Muskogee 23:13 mutually 72:8 <hr/> N <hr/> N 3:1,1 nail 142:3 nailed 204:17 naive 108:22 narrow 75:2 238:4 nation 199:4 National 24:15,16 44:21 nature 130:3 193:21 near-term 242:8 Nebraska 36:9 necessarily 36:22 123:6 128:20 132:17 133:21 148:12 158:7 179:9 183:10 223:3 234:7 necessary 8:6 179:10 necessity 117:5 need 7:9,20 8:8 10:13 13:3,21 15:19,20 21:2 30:10 40:3 47:4	50:11,15 51:3 57:22 62:10 69:10 85:22 86:14 88:7 88:8,9 90:15 91:20 92:10 93:5 94:15 95:12,17 109:13 110:7 125:4 126:20 127:16 130:8,13 136:15 137:12 140:14 141:22 142:3,4,7,10 144:20 158:9 174:21 181:21 185:7 187:20 188:12,16 191:15 191:21 192:1 196:15,21 209:20 218:4,12 221:8 236:18,20 239:12 needed 8:13 21:10 55:22 62:18 173:20 181:5 201:17 206:17 209:8,9,15 needs 14:11 21:20 27:10 36:11,17,22 56:5 74:20 122:4 122:5 134:1 140:5 141:15 148:22 150:21 170:10 172:5 173:8 188:8 188:19 196:17 negative 241:1 negotiated 146:1 negotiating 208:5 negotiation 238:19 negotiations 31:9 neighborhood 226:20 neither 113:2 192:11 Nelson 66:19 net 211:18 240:21 network 131:11 never 68:16 145:12 159:22 175:17
--	--	---	---	--

182:16 200:6,12 200:13 238:16 nevertheless 236:12 new 8:10 22:16 26:13 40:19,22 46:2,10,16 56:3 65:6 104:12 161:7 166:9 177:10 198:21 199:6,11 199:12,17 201:8 201:18 205:6 219:19 226:7 nice 12:15 193:3 nigh 155:22 nine 124:19 182:12 nitty-gritty 20:11 noble 124:5 nobody's 239:4 non 30:1 219:16 221:4 nonlinear 193:20 194:11,13 232:15 233:2,4 nonrecurring 39:4 39:12,16 non-arguable 237:21 non-coal 54:22 non-economist 97:8 non-linear 234:16 non-linearities 196:22 non-linearity 194:8 non-railroad 191:13 non-use 216:10 Norfolk 150:10 normalization 133:4,10 normally 17:8 North 18:17 223:18 Northern 42:13 144:13 note 6:20 10:4 11:13 72:12	180:22 noted 125:7 200:19 219:1,10 notes 9:22 235:5 notice 52:1 74:13 117:2 166:11 180:1,2 181:6,8 183:3 Nottingham 1:22 3:3 9:21 10:22 11:2 16:14 24:10 36:3 44:19 48:19 48:19 65:15,17 67:9 68:3 70:9,13 70:16 71:1,11,15 71:19 72:3 75:9 75:18,22 76:2 77:1,4,13 79:20 80:17 97:15,16 99:16,19 105:3 107:20 110:11 113:22 115:22 135:3 154:3 157:21 159:16 165:4,13,19 171:8 172:9 174:1,15 179:16 185:17 213:8 221:15 223:2 245:7 Nottingham's 116:4 number 13:5 31:1 37:21 68:5,6 69:21 70:20 81:12 117:17 129:12 160:7,12 162:3,4 171:5 173:18 186:4 201:16 202:19,20 224:6 224:12 227:22 228:1 229:21 numbering 17:4 numbers 19:5 50:4 50:4 104:20 112:9 161:10 176:2 194:1,2 202:1 228:6 235:18	236:6 numerical 162:19 numerous 100:13 214:16 nuts 228:17 <hr/> O <hr/> O 3:1 objective 76:14 117:15 215:20 217:22 obligation 180:11 180:14 obscure 172:13 observation 94:2 227:16 observations 93:12 93:22 94:11 117:6 224:7 225:11 243:14 observe 228:14 observers 12:13 obsolete 8:1 152:21 obtain 47:6 obvious 118:5 obviously 76:5 116:13 132:2 145:15 155:3 156:15 159:17 168:4 183:12 186:16 190:12 230:13 234:6 occur 105:5 occurred 28:12 occurs 80:18 105:10 225:18 odds 152:17,21 OD&E 23:13 offer 25:8 82:5 offerings 129:18 Office 49:6 68:7 offices 70:21 official 11:6 oh 148:14 172:12 okay 68:2 70:13 75:22 87:7 113:20 133:9 140:10	146:5 154:1 192:6 215:1 241:13 243:19 244:18 Oklahoma 36:9 old 68:20 81:4 123:15 124:1 135:20,21 153:21 159:11 164:8 200:4 201:10 205:11,13,15 235:5 236:4 older 19:9 151:15 once 27:5 119:19 209:2 ones 58:17 59:11 84:17 86:8,13 139:2 144:22 152:8 153:20 223:19 one-and-a-half 139:7 ongoing 13:16 130:21 134:9 211:19 212:1,5,16 open 4:15 15:4 21:3 81:11 127:19 245:13 opened 107:12 opening 3:2 9:21 10:22 116:4 open-ended 14:13 operating 5:21 22:2 94:3,4,5 105:9 118:18 119:10 147:12,17 148:1 152:18 170:20 174:6,10 179:8 196:3,4 200:11 204:10 205:18 206:2,5 218:11 219:7 220:22 226:13 operation 206:22 operational 146:22 190:20 operations 7:18 8:14 93:12 130:2	136:7,14 174:14 174:20 203:19 204:6 217:2 220:5 opinion 78:6 108:7 199:20 205:9 opportunities 135:12 136:11 138:11 opportunity 16:16 24:1 35:16 46:2 48:12 116:5,9 121:18,22 135:4,5 171:21,22 184:6 187:8 214:17 opposed 102:7 153:10 163:8,22 194:17 225:5 227:8 optimal 195:18 option 17:20 order 35:21 96:4,7 128:5 147:21 184:4 186:19 187:14 orders 111:6 Organization 200:15 organizations 45:3 organized 5:6 oriented 207:12 origin 41:2,2 156:4 original 198:16 199:21 211:11 originally 242:16 ought 138:14 139:12 outcome 17:14 18:5 19:2 23:14 33:19 51:19 64:14 76:19 99:11 151:6 155:16 169:16 outdated 110:22 123:4 128:12 155:4 output 139:12 194:18 211:9,16 232:17
--	---	---	--	---

outside 16:9 50:21 91:1 96:10 99:1 142:9 172:16	223:11 245:5	59:6 61:22 126:12 179:6 206:6 213:1 235:17	159:20 161:15 166:2 204:14,14 211:15 212:10 214:7 215:5,7,8,9 215:10 217:15 219:3 237:3 238:14 240:1,2,6 240:8	PERSONS 2:18 3:14
outstrip 108:11	panelist 16:7 114:10	parties 15:6 18:22 20:9 46:21 72:7 73:2 102:12 113:5 127:9 137:7 175:4 187:16 192:18 201:5	215:10 217:15 219:3 237:3 238:14 240:1,2,6 240:8	perspective 81:4 87:16 96:14 98:11 98:19 186:10
overall 50:8,15 99:7 215:9 243:21 243:21,22	panelists 10:18 91:15 138:10 140:12 193:1	partly 221:17	percentage 119:5 151:16 155:21 161:10 167:19 170:13	Phase 5:7,13,17 8:6 26:22 27:7 30:15 30:16,17 33:3,4 33:13,14,15,16,19 38:5,8,21 41:8 42:5,10 43:3 103:19
overhaul 13:22	paper 56:15 88:15 115:9 235:22	partnership 166:18	percentages 118:15 166:3	phased 127:1
overhead 83:2	papers 26:1 30:22 34:13 35:12	parts 146:10	perfect 85:8 214:15 232:9	phases 5:6 26:17
overlooked 138:12	parallel 22:19 98:9 175:13 214:4	party 69:13 99:14 132:19 133:1 222:19	perfection 9:9	PhDs 105:19 228:14
oversight 80:22 197:22	parameters 38:9 148:21 225:17	passed 78:12	perform 220:8	phone 67:2,8 71:21
ownership 17:6	parametric 104:13	passenger 119:15	performance 186:2 237:7	phones 10:20
owning 23:6	paraphrase 15:16	passionate 222:22	performed 200:1 217:12	phrase 108:15
owns 154:19	Parenthetically 30:19 33:2	path 185:8	period 3:8,13,19 53:2,7,9 62:5 78:15 87:12 181:19 184:9 240:18	physical 131:10 148:21
O'Connor 2:5 3:6 16:2 24:7,8 52:7 56:12 74:5 77:15 78:9 80:18 82:5 87:4,15 93:3 97:18 98:12 99:18 100:9 102:22 107:10,21 109:7 111:14,20 112:18 112:22 120:10 168:4	parse 47:18	pathway 112:14	periodic 6:7 8:18	pick 71:21
	part 29:21 30:21 46:18 61:13 65:10 67:1 69:19 71:6 91:4 103:3 106:19 107:7 132:5,8 166:17,20 178:15 199:5 213:1 229:18	pattern 32:15 34:3 34:4 69:7	permeates 27:3	picked 162:3
	Parte 1:8 19:13 29:4 53:13 54:4 79:7 118:4 217:20	patterns 152:18	permeating 122:15 132:6,7,8	picture 21:7 33:22 43:9
	P	pay 146:2 222:17 222:21 227:21	permit 22:17 162:5	piece 56:14 77:17 79:16 88:15 133:20 154:8 178:7
	partial 25:17 35:7 194:20 233:21	paying 76:9,11	permits 5:20	piecemeal 25:17 30:5 35:6 47:19 55:20 99:13 125:14 126:16 163:3
	participants 15:1	payments 132:19 133:1	permitted 19:9	pieces 26:20
	participate 24:2 95:16 116:21 134:14	Peat 198:16	perplexed 120:9 208:16	piggyback 229:13
	participated 30:20	peg 202:4	persists 54:14	place 12:7 63:8,14 79:1 84:13 88:12 121:3 176:19 184:5 189:11 226:6 232:6
	participating 121:11	people 42:22 86:18 90:17 93:20 105:11 123:14 146:7 149:8 163:5 172:15,16 175:20 180:12,19 182:15 205:1 206:18 207:20 213:11 238:10 239:3 241:22	person 58:15 141:16 205:2	places 103:20 121:21 172:15
	participation 8:20 32:2	percent 18:22 23:10 42:14 44:10 72:9 77:21,21,22 78:2,21 79:10,21 80:11 139:14 154:14,14,20 155:1,8 156:9,14	personal 8:21 11:5 161:19 194:15 195:20	plan 81:9 88:19 99:7 136:3 181:20 184:3 186:22 187:3,4
	particular 52:14 58:3 79:16 100:15 106:10 141:6 170:8 190:19 222:22 230:16		personally 66:4 68:11	
	particularly 22:6		personnel 144:18 144:21	

plans 144:5	portion 4:21 5:10 119:21 134:6 237:13	18:14	26:18 215:15 217:20	private 140:1,2
plant 18:16 131:11 177:10	portions 29:14 47:19	practical 207:12 228:17	presenting 24:13	privately-owned 6:19
plants 17:16 19:20	portrayed 126:1	practically 82:8	President 116:7	privilege 11:5 208:12 221:19
playing 47:21 95:20 172:10	posed 232:5	practice 29:21	pressed 55:11	privileged 71:3
plays 13:4 46:10	position 46:22 53:6 59:20 60:14 62:4 64:8 152:19	practices 22:2 106:8 109:3 218:11 219:7 221:1	pressure 162:16	probable 119:4
please 10:4,8,12,20 49:12 67:10,19 68:1,10 69:9 70:17,19 79:20 107:21 110:11 157:21 165:18	positions 160:6	practicing 123:11	pressured 153:14 153:14	probably 18:5 21:12 49:19 68:4 74:7 80:19 82:14 83:15,20 84:15 88:1,13 97:21 105:11 108:2,8 110:17 113:1,2 128:22 134:4 151:18 159:7 164:20 171:12 174:7 180:12 182:3 184:22 191:5 196:20 205:20 224:18,20 232:19,20 236:3,9 236:10 237:2 244:9
pleasure 12:2	positive 15:15 119:12	practitioner 130:15	presume 79:14 103:14 167:4	problem 40:14 54:3 68:13 70:3 71:6 72:17 73:1 73:18 74:14 75:5 82:21 91:16 93:20 93:21 95:1 203:10 214:11 225:13
pledges 93:1	possession 175:8	PRB 17:10 18:18 20:7 22:6 23:9,15 155:22	presumption 168:19	problems 20:12 42:7 67:12 75:1 84:13 91:18 92:19 94:21 95:10 98:8 141:15 151:13 200:10 205:21 206:5 225:7,19
plenty 21:8	possibilities 55:18 197:11 225:3	precedent 90:1	pretty 11:6 29:15 29:22 73:22 83:13 83:13 89:1,3 112:15 154:18 167:6 180:7,19 188:17 214:22 215:16 234:15	procedural 9:22
PMM 199:15	possibility 17:17 56:6 86:18 95:7 211:2	precisely 117:21	previous 68:20,21 117:13 226:7	procedurally 76:14
point 18:5 22:7,14 23:3 27:20 39:3 43:6,7 58:3 60:12 62:9 67:4 71:8 72:7,11 73:10,16 78:5 102:1,5 109:22 135:22 138:22 142:2 168:7 169:11 170:16 171:2 173:2 196:19 209:17 230:15 233:16 240:22	possible 9:17 25:16 35:5 57:18 65:12 97:13 99:11,12 105:14 109:1 117:12,21 118:8 118:15 121:1 129:2 137:14 168:2 217:3	predecessor 6:2 14:16 25:5 162:18 204:22	previously 118:2 210:20	procedure 6:18 96:3,8 222:15
pointed 39:3 75:1 135:19 207:10	possibly 64:15 76:8 80:21 104:14 130:18 131:14 160:19	predicted 119:17 243:8	pricing 195:18,18	procedures 5:6,10 6:11,15 8:15 9:11 47:8,10,11 48:8,9 190:2 205:14 206:17
pointing 74:15	postpone 58:18 59:16	predictive 170:1	primarily 40:1 147:18	
pointless 205:3	postponing 59:7	preference 194:15	primary 118:20 194:8 233:5	
points 11:5 45:6 126:18,19 135:7	potential 9:6 32:13 34:5 67:11 117:11 232:4,13	premature 45:9 150:12 157:14	prices 210:8 240:3	
point's 73:17	potentially 64:15 76:8 80:21 104:14 130:18 131:14 160:19	premises 129:22	pricing 195:18,18	
poking 125:16	powder 55:3 146:11	premium 19:17 22:3	primarily 40:1 147:18	
policies 44:6 104:16	power 16:22 17:3 18:12 26:3 45:1 216:10 230:11 231:5	prepare 20:9 117:1	principle 63:20 187:11	
policy 39:7 122:18 153:16 183:21 241:11	powerful 32:21	prepared 35:14 135:8 146:20 153:1 189:18 235:3	principles 6:5 24:22 25:4,9 32:4 32:6 34:16,17,18 47:16 107:11 109:9 117:6,14,15 120:13 190:3 199:8	
political 162:16	powerplant 18:15	present 2:1 8:1 47:12 48:12 100:4 116:9 117:5 177:3 200:13	printout 41:14	
pony 63:2	powerplants 17:7	presentation 3:5,6 3:6,7,10,11,12,15 3:15,16,17 31:3 71:14,16,18 193:6	prior 10:3 73:10,12 83:5	
population 93:15 166:3		presentations 193:7	priorities 126:21	
		presented 7:13	prioritization 184:12	

proceed 117:7 121:6 133:6 158:14 181:9	112:4,5,7,10,11 113:6,15 215:3,5 215:6,7,9,12	159:12 209:11	pulled 197:1	188:22 217:19 221:17 230:14 241:11
proceeding 20:10 26:16 75:4 80:1 96:6 121:7,11 122:19 126:20 134:14 145:9 152:7 158:13 198:12	profession 79:2 professionalism 69:4	proportion 168:19 proposal 86:3,5,9 91:8 116:10 208:4	purpose 1:6 4:6,8 6:3 9:1,7 12:22 148:17 149:11 217:20	questioning 171:9 214:2
proceedings 4:19 7:13 13:6 51:15 67:3 76:20 95:22 148:7	professor 136:22 profile 207:1 profoundly 136:15 program 5:20 8:7,9 38:5,8,22 41:9 42:5,10 43:3 103:10,20 104:18	proposals 100:11 117:10	purposes 82:13 107:4 110:16 116:15 143:16 210:6	questions 10:3,16 10:18 20:21 24:4 44:13 48:18,21 65:14,19 88:22 91:12 117:1 157:16,18 179:14 193:7 210:11 215:14,22 218:5 230:21 245:5
process 14:11 27:9 33:21 37:13 43:6 54:6 58:1 60:3 65:11 76:12 84:22 89:7 91:17 96:18 99:22 103:3 108:19,21 116:21 125:5,6 127:10,12 127:19 134:15 148:11 150:2 161:12 166:6,10 172:2 178:11,16 181:14,22 184:5 185:14 187:6,21 220:10 224:13	programming 8:3 programs 5:5 7:22 21:4 110:17	propose 107:22 proposed 9:10 83:16 181:7,20 199:21 200:13 202:11	pursued 144:10 pursuing 204:11 put 23:20 24:10 63:8 74:19 80:10 81:6 85:19,21 86:5,22 87:9 88:11 89:15 100:11 102:6 104:20 106:9,14 130:20 161:15 182:2 185:19 230:11 235:18	quick 11:4 16:19 23:8 100:8 129:14
proceedings 4:19 7:13 13:6 51:15 67:3 76:20 95:22 148:7	project 14:14 81:3 81:5 82:4,9,12 84:12,22 85:1,7 85:17 87:21 88:18 99:4 100:7 168:5 168:8 170:7 180:1 181:10,15 182:8 186:1,6 187:10 198:13	proprietary 92:2 111:9,11 143:14 143:21 174:17 175:17 177:13 179:2	puts 73:20 152:19 putting 65:2 75:7 180:1	quickly 87:18 88:2 89:8 99:22 103:2 119:4 127:13 162:15 180:19 188:17 197:8 206:20
process 14:11 27:9 33:21 37:13 43:6 54:6 58:1 60:3 65:11 76:12 84:22 89:7 91:17 96:18 99:22 103:3 108:19,21 116:21 125:5,6 127:10,12 127:19 134:15 148:11 150:2 161:12 166:6,10 172:2 178:11,16 181:14,22 184:5 185:14 187:6,21 220:10 224:13	projects 80:21 98:9 171:5 182:14 214:16	protect 105:22 148:7 175:16	puzzle 77:17 154:9	quit 190:5
processes 13:10 79:7 102:10,18 110:6 120:19 192:4	prominent 13:5 204:2	protected 149:3 protection 147:8 protections 148:5 protective 96:4,7 111:6 147:21 174:16	P-R-O-C-E-E-D... 4:1	quite 18:1 19:6 23:18 87:17 92:1 94:1,17 101:12 121:8 143:11 145:3 168:5 177:8 219:14 233:7 239:10
processes 13:10 79:7 102:10,18 110:6 120:19 192:4	promise 49:13 promising 82:22 promote 241:7 prompted 54:1 proper 80:7,13 118:11 148:17 149:4 164:22 167:14,14 169:7 169:20 173:5	provided 5:8 24:21 34:21 198:1	p.m 245:18	quo 149:19
processes 13:10 79:7 102:10,18 110:6 120:19 192:4	promises 49:13 promising 82:22 promote 241:7 prompted 54:1 proper 80:7,13 118:11 148:17 149:4 164:22 167:14,14 169:7 169:20 173:5	provides 16:21 21:8	qualified 80:19	quote 120:12
processes 13:10 79:7 102:10,18 110:6 120:19 192:4	promote 241:7 prompted 54:1 proper 80:7,13 118:11 148:17 149:4 164:22 167:14,14 169:7 169:20 173:5	provisions 159:18 PTC 119:18	quantify 151:3 157:7	quoted 37:6
processes 13:10 79:7 102:10,18 110:6 120:19 192:4	properly 47:3 118:6 131:16 134:18 153:2 158:6 185:21	public 1:4 8:19 9:3 9:14 14:21 26:1 34:13 35:12 45:1 49:6,9 65:22 66:2 67:13,22 69:3 92:8,16 94:14 95:6 127:10 144:8 146:21 201:3 207:22 245:16	quarterly 31:16	Q
processes 13:10 79:7 102:10,18 110:6 120:19 192:4	property 77:17,22 78:17 130:11 154:7,20,22 155:12 158:6,7,16	provided 5:8 24:21 34:21 198:1	question 3:8,13,19 47:3 50:18 52:15 53:16 54:21 55:7 58:13 62:19 70:7 77:7,8 85:12,15 85:16 87:11 95:13 98:1 105:1,4 111:13,21 112:6 128:13 145:3,5 149:17 150:20 158:5 163:2 167:21 179:17	R
processes 13:10 79:7 102:10,18 110:6 120:19 192:4	properly 47:3 118:6 131:16 134:18 153:2 158:6 185:21	publicly 68:19 94:7 published 42:19 194:10 233:17	quarterly 31:16	R 2:12 3:10 11:20 11:21 205:14
processes 13:10 79:7 102:10,18 110:6 120:19 192:4	property 77:17,22 78:17 130:11 154:7,20,22 155:12 158:6,7,16	pull 229:18	quo 149:19	rail 4:18 5:16 6:12 7:16 9:13 12:10 12:21 13:4,11 17:14 19:22 23:11 25:5 26:8,11,12 28:4,11,22 29:7 30:2 31:4,8,10,20 31:22 32:4,6 47:22 48:9 51:12 51:18,20 53:16

74:21 78:13 93:10 103:12 116:11 117:18 118:20 123:13 138:5 151:8 158:19 176:13,16 193:20 194:1,2,4,8,11 195:10,22 198:15 198:18,21 205:11 206:10,16 208:4 209:19,19 213:13 213:14,15 214:1,1 215:4,13 236:4,8 242:15 railcars 6:19 railroad 2:15 4:10 4:21 6:4 7:18 8:13 9:13 13:12 14:20,20 17:17 18:18 29:21 33:1 43:11 50:9 77:16 86:19 91:3 92:1 105:7,9 106:5 108:1,6 109:4,18 111:11 112:8,9 114:5 116:14 118:18 119:10 123:6 129:9 130:20 134:16 136:7,14 138:10 138:21 144:21 147:15 155:20,20 160:13,14 163:20 174:6,7,11,21 175:18 178:7 190:9,19 191:13 196:12,14 197:15 197:20 200:19 201:7,20 203:19 204:5 207:13 208:15 209:20 211:2 213:10,19 213:22 215:3,9,12 218:20 219:2 224:15,15,20,20 224:22 226:6,7 230:9 235:20	239:12 240:2,3 241:19 244:21 railroading 49:19 56:1 59:13 175:10 179:13 239:18 243:1 railroads 2:10,12 3:9 31:13 32:3 41:22 43:19 44:8 45:11 46:14 51:5 53:5 56:17 70:3 88:8 90:12,15 91:21 92:1 93:13 95:2,18 102:13 105:15 106:2,3,18 107:1,17 108:13 110:13 114:4 132:21,22 137:3,6 138:21 142:14,19 144:3 147:3 150:2 150:10 156:4,5 160:7 174:8 175:7 189:1,8 190:22 191:16,18 193:14 197:2 200:1 201:3 202:1,13,20 211:7 212:21 213:18 214:16 216:16,21 219:18,20 223:19 224:3 225:22 226:4 229:1,21 238:2,21 240:4,9 243:7 railroad's 41:15 77:22 90:6 175:18 213:20 232:10 235:16 Railway 2:13 114:6 121:19 193:18 raised 117:1 158:6 Ramsey 195:18 ran 72:1 random 155:22 range 45:15 116:18 191:6,7 rate 13:5 17:15,18 17:21 18:4 19:2,9	19:17 23:14 46:3 46:4,10 48:5 51:18 53:2,7,18 53:21 54:1,15 58:21 60:21 62:11 69:12 73:13,15,21 75:5 76:12 96:2 122:18 129:19 139:8 141:2,6 155:8,18 156:1 160:10 161:11 166:6 178:9 231:6 238:18 242:3 rates 17:19 19:22 76:9,10 153:9 239:4 rate-related 31:10 rating 186:2 ratio 15:15 19:1 44:1,9 72:9 156:10 170:1 194:22 rational 152:20 153:8 rationale 53:9 55:12 rationalization 7:17 raw 5:7 148:7,13 RCAF 113:2 184:14 RCAF-A 31:22 34:2 111:16 RCAF-U 111:15 reached 66:5 68:10 reaching 74:12 157:14 238:3 reaction 106:13 181:12 183:1 read 10:11,13 37:17 115:19 readily 119:11 205:1 reading 97:7 ready 116:20 real 77:22 91:18 108:16 124:17	125:10,17 151:2 154:19 155:11 157:13 158:7,16 159:12 176:15 182:7,7,8 198:22 230:17 231:8 245:2 realistic 126:22 187:18 realities 123:7 reality 144:12 188:10 234:9 realized 71:9 realizing 172:17 reallocate 164:10 reallocation 52:9 54:11 really 12:11,12 18:4,10 26:20 34:11 36:12 43:8 50:21 52:17 57:22 74:14 78:21 92:10 107:14 109:14 125:17 129:1,1 139:12 161:14 171:18 178:8 179:5 182:15 189:21 191:7 194:6 197:19 201:9 208:20 209:21 223:6 228:15 233:21 234:14 236:8 238:2 240:11 242:21 realm 94:7 reason 18:1 26:19 55:14 59:6 67:1 69:20 171:10 181:4 reasonable 9:12 15:13 21:12 23:20 160:8,9 181:19 186:18 233:11 reasonableness 17:19 reasonably 57:15	79:17 137:19 151:7 reasons 34:9 35:10 60:16 107:8 201:16 reassessment 206:16 recall 30:21 66:3 66:15 72:13 recap 16:19 receive 4:15 received 20:22 49:3 58:16 66:11 68:15 receives 18:18 recently-departed 11:15 recoding 8:5 recognition 113:6 recognize 121:5 122:20 126:20 128:17 176:11 recognized 120:5 recognizes 27:22 103:11 recognizing 125:4 recollection 80:16 recommend 30:6 107:5 recommendation 185:14 219:11 recommendations 200:17 reconcile 243:13 reconciliation 206:2 reconfirm 232:5,7 reconsider 48:3 record 45:5 49:3 72:20 80:12 94:15 115:14 190:20 222:2 223:4 245:12 recorded 29:14 records 40:7,9,21 57:15 record-low 72:21 recount 66:9
---	--	--	---	--

recounted 68:20	regresses 151:16	203:13 204:4,12	169:1 171:7	resolve 72:8 82:21
red 10:7 112:3	regression 6:22 7:2	204:15 218:7,13	233:14 244:14	228:13
redo 160:16 231:17	7:6 20:15 27:1,5	220:20 237:17	replete 58:9	resolved 101:1
231:18	30:18,20 57:2,17	relative 229:5	report 4:22 6:5	200:7 206:15
redoing 56:3 59:12	57:20 78:14,17,19	234:2	39:12 79:5 125:21	resolving 208:6
232:2	79:17 80:6,7	relatively 226:10	214:1 220:16	resource 136:19
reduce 188:20	83:15,21 113:8	238:11	reported 200:11	185:8
222:9 242:2	197:4,9,14	released 220:10	206:5 213:22	resources 7:1 25:12
reduced 72:14	regressions 22:15	relevant 47:6,22	218:21 219:2	35:2 46:13 65:2
reduction 50:14	83:8 92:12 93:9	145:4	reporting 120:19	107:16,19 109:12
reductions 53:12	93:11 101:18	reliable 205:10	121:2 191:10	124:21 135:10
53:15 55:2	113:8,13 128:11	reliance 72:10	218:19	136:10 137:1,5
refer 45:2 79:22	131:17 137:18	140:16	reports 39:15	140:19,21 167:13
reference 101:22	228:7	relied 6:6	213:21 218:21	respect 81:9 208:13
references 28:15	regular 14:8 136:4	relief 155:17,18	repository 149:11	211:16
refinement 8:17	regulated 132:4,5	160:10 161:12	represent 51:9 60:1	respected 175:20
101:16 102:16	189:22	166:6	113:6 210:15	respectfully 178:15
refinements 124:20	regulations 152:14	relies 7:8,21 22:1	211:3 231:8 237:2	respects 31:18
reflect 19:11 22:22	regulatory 4:19	rely 106:21 110:21	represented 112:12	respond 47:1 79:16
49:18 51:4 74:20	13:10 48:7 58:7	181:2	representing 15:22	84:14,14,17
85:6 101:8,19	82:14 98:21 99:2	relying 151:15	114:3,7 192:20	189:16 241:15
112:5 117:18	116:15 122:10	238:5	193:13 222:18	response 4:16
118:13 130:19	126:2 143:11,20	remain 205:22	represents 5:1 36:7	20:22 66:22 68:9
145:16 146:14	145:2 150:2 152:7	remaining 10:7	212:4	68:14 77:8 87:9
152:17 196:8	152:16,21 153:3,4	28:9	reprogram 42:2	208:7
218:10 219:7	153:5,10,15,16	remarks 3:2,21	reputations 182:19	responses 67:22
220:4,22	161:20 162:12	9:21 11:1 29:4	182:20 185:21	68:22
reflected 36:16	170:17 177:17,19	35:15 115:20	request 47:15	responsibility
131:16 133:2,17	178:1,1 197:21	remedy 20:4	85:21 86:3,9 91:8	183:20 199:11
198:22 199:7,22	199:6 211:5 213:2	remind 10:19	100:22 145:11	responsible 112:7
reflecting 136:6	rehash 205:4	reminder 4:14	188:21	responsive 49:10
153:10	reinvent 165:2	remotely 160:19	requested 214:4,9	49:13 66:1
reflective 56:1	reiterate 34:22	reopen 61:21	require 25:11 35:2	responsiveness
reflects 112:4	66:8	repartee 77:12	107:16 109:11	68:14 69:5 83:10
123:6 176:12	relate 203:5	repeat 19:14 27:14	111:6 117:10	rest 19:22 20:1
179:12 245:2	related 4:9 171:14	repeated 145:7	required 20:4	27:3
reform 9:6	202:9 203:11,21	repeating 14:15	101:9 147:22	rested 19:2
reformulated	227:7	135:18	191:2	restoration 200:3
36:18 37:1	relating 116:13	replace 231:11	requirements	restriction 240:12
regard 27:11 37:11	225:10	replaced 14:2	146:17 189:17	result 20:6 27:7
144:13	relationship 118:9	150:13	216:5	30:15 49:19 50:8
regarding 9:22	210:19 228:8	replacement 98:5	rerun 113:12	52:13 58:4 73:12
19:12 21:9 218:6	relationships 5:14	98:13 99:22 100:8	research 80:21	85:13 121:7
regardless 142:8	7:8,20 32:19	100:10,12,20	83:5 154:13 160:2	136:11 150:16
regime 170:17	33:15 126:13	101:3 119:6,22	194:9 196:7 211:1	151:21
regional 95:4	136:17 147:2,5	120:6,17 133:16	225:12 226:4	resulted 54:6 73:4
regressed 197:7	153:20 202:15	158:10,13 167:16	Reserve 146:2,7	resulting 14:9

results 19:8 39:18 47:12 51:17 57:17 57:20 64:1 75:2 83:7 97:6 104:13 205:9 243:6	27:10 212:17 revised 16:8 50:6 74:20 111:19 114:10 187:22 217:22 219:6 220:17 221:3	172:11,15 173:14 187:21 223:3 227:1,14 244:16 244:17	routine 66:1 ROIUSOA 199:17 RSAM 132:12 Rule 169:14 ruled 18:7 rulemaking 13:16 148:17 181:7	saying 37:6 59:15 75:19 76:20 123:14 139:2 153:7 169:18 173:15 182:10 183:18
resumed 115:15 retain 149:6 181:13 return 107:10 120:1,7 133:18 160:8 212:19 216:12,17	revising 8:22 revision 7:9 25:11 25:15,16,17,20 34:7 35:1,4,5,7,9 49:16 52:13 62:18 92:6 101:4 107:14 109:15	rightfully 92:2 rigidness 44:5 Rinn 2:15 3:12 114:7,9 135:1,2 140:9 144:11 150:8 151:1 154:5 155:19 165:9 186:12 190:4 192:14	rules 38:6 61:5 100:21 189:19 run 83:8 103:4 108:17 139:8 178:9 195:19 209:20 216:10 228:1,7 229:2 230:3,11 241:21 241:21 242:5,19 242:20 243:3	says 36:17,18 39:12 70:6,9 195:14 scarcity 20:14 scene 26:12 schedule 98:7 187:18 220:11 scheduled 220:8 schedules 126:22 school 84:3 science 139:5 140:15,16,18 235:12
returned 216:15 reveal 106:10 revealing 145:18 revel 228:19 revenue 23:11 122:17 132:7 158:12 179:5	revisit 22:20 98:2,3 revisited 21:21 141:20 revisiting 22:15 reward 76:17 rework 98:7 reworked 161:6 re-bill 40:15 re-forecast 188:20	Rinn's 178:20 Ripley 239:13 rise 118:1 rising 240:21 241:5 241:8,9 risk 14:15 138:19 167:11 river 55:4 146:11 riveting 12:6 road 78:17 130:11 139:3,7 154:7 155:12 158:6 211:18 230:13 239:22	running 64:2 66:18 78:19 91:3 105:8 106:4 160:14 206:3 230:18 Rural 44:21 RVC 168:21 169:3 170:10,11,13 171:3 RVCs 122:21 R-1 5:1 92:16 94:8 176:12 189:18 190:16 191:3 201:20 213:21 218:21 R/VC 169:14 170:1	scientific 168:2 scope 9:6 50:21 81:6 142:1 145:19 181:15 182:9 186:5 scoping 183:12 scrapping 56:6 second 14:17 19:5 39:3 46:20 114:13 202:6 212:8 secondly 59:8 143:13 196:21 seconds 114:15 secrets 106:1 174:17
revenue-to 43:22 156:9 revenue-to-varia... 19:1 72:9 159:20 reverse 8:8 review 1:5 4:5 6:7 6:9,20 8:11,17 13:8,15 14:8,9,17 24:2 25:1,15 28:20 35:5 45:9 45:10,17 46:8,17 47:5,14,16,18,19 54:19 55:15 64:20 75:14 76:8 95:16 106:17 107:7 109:13 116:11,16 116:20 117:16 124:3,5 135:9,17 151:7 153:2 157:9 165:21 218:12	revisited 21:21 141:20 revisiting 22:15 reward 76:17 rework 98:7 reworked 161:6 re-bill 40:15 re-forecast 188:20 RFA 205:13 RFP 86:3 RFPs 127:17 Rhodes 205:2 Richard 2:13 3:11 114:6 Rick 121:18 167:6 183:3 rid 102:10 right 36:1 38:1 58:18 66:15 71:2 81:22 104:7 108:13 111:12 122:18,18 125:9,9 125:11 126:15 129:2 132:9 133:13 141:11 148:5 149:20 156:2 159:5 160:6 160:19 164:14 167:6,11 170:12 170:14 171:3,4	roadmaster 209:2 roadway 156:13 Robert 2:20 3:15 192:19 role 13:5 33:3 46:10 80:22 81:1 127:11 183:15 184:21 roll 123:17 room 12:3 16:9 105:11 144:4 171:12 180:13 209:12 rooms 138:7 rotate 10:16 rough 77:20 roughly 93:18 round 202:4 route 207:1 route-specific 48:4	S S 3:1 SAC 122:12 132:6 safely 146:16 sample 39:22 40:2 40:3,7,15,21 41:5 Sandra 2:22 3:17 192:21 231:7 Santa 144:13 Sante 193:18 save 106:11 savings 54:12 217:10 saw 89:18	secrets 106:1 174:17 section 193:18 secure 62:20 security 200:20 see 10:6 12:2 16:15 23:17 24:10 28:2 28:6,14 32:8 41:15 46:2,15 51:22 58:19 62:7 66:13 69:6 72:4 78:20 83:15 89:8 91:20 98:8 101:15 113:14 129:10 136:5 144:17 145:7,7 154:16

182:21 185:12	set 93:15 109:1,19	128:21 138:9	162:16 173:16	situated 18:15
188:19 189:1	109:22 143:12	244:20	202:5 205:18	situation 52:22
191:5 193:3 209:8	148:6 159:20	shippers 2:6 16:5	243:10	54:16 56:15,16
231:8,13 235:2,8	166:19 181:15	23:5 32:3 41:20	sides 80:4 238:12	132:19 137:6
seeing 51:18	183:20 190:19	45:2,3,4,8,11,16	sight 235:10	144:15
seeks 13:17	sets 197:6	45:21 46:12,13,22	sign 92:20	six 93:16,18 94:10
seen 96:9 100:10	setters 190:13	47:4,9,15,21	signals 139:10	124:10 219:4
110:19 134:4	settles 159:4	48:11 49:17,20	significance 117:3	size 82:8 88:11
141:2 236:4	seven 14:9 28:3,15	50:10,10,16 59:10	significant 7:9	93:17 104:2
segment 129:10	94:10 95:2 175:21	61:14,14 65:1	23:20 25:12 32:22	133:21 194:18
segments 21:19	176:2 223:18	88:9 95:15 96:15	35:2 53:14 107:16	196:3 197:17
segregated 41:19	226:3	98:20 102:13	109:12 121:7	216:9
149:9 208:16	shape 137:14	112:12,13,17,20	151:16 212:13	sized 60:22
210:5	shaped 34:16	137:7 150:3	231:4	sizes 118:22
segregating 41:8	share 142:20	155:17 160:9	significantly 99:13	sketched 57:1
Sells 199:10,16	146:10,17 175:17	161:11 166:4	165:22 166:2	slide 25:8 26:18
semester 190:6	sharing 175:3	193:14 201:4	205:10 215:4	27:17,18 28:22
Seminole 45:1	Sharp 2:4 3:5 16:1	207:21 216:5	216:7,19,22	32:17 33:4 34:2
send 70:7	16:12,13 29:3	238:3	229:14	57:2 129:4,5,6,7
sending 49:1	48:22 49:15 50:2	shipping 9:13 51:8	similar 58:6,8	131:2 132:16
sense 13:20 22:11	50:19 59:8 65:20	61:3	85:21 127:6 149:4	215:11 219:15
76:3 78:5 84:10	66:15 68:2 69:17	shoes 185:20	176:20 181:17	slides 24:11,12
127:11 153:9	70:11,14,22 71:6	short 8:10 20:8,13	191:16	126:17
164:4 178:17	71:13,17 72:1	29:19 42:18 67:3	similarly 18:16	slightly 126:2
183:13 186:13	73:5 101:21 103:2	73:9 74:13 132:22	130:2 173:21	slowly 31:17
203:5,5	sheet 235:21	203:22 207:11	simple 14:4 127:4	127:14
sensitive 51:21	shift 55:3 225:17	242:20	simpler 238:9	small 13:11 37:7
69:6 96:19 148:8	shifted 50:9 157:3	shortcomings	simplest 83:22	46:4 60:21 118:21
sensitivity 235:16	157:4	189:6	simplified 13:11	202:20 223:21
sent 66:20	shifting 50:13	shorter 133:15	58:20 73:8 122:12	238:11
separate 131:19	shifts 130:4 224:15	shortly 116:1	simplify 236:16	smaller 127:5
226:5	224:21	short-line 42:20	simply 50:8 204:10	132:18 187:12
September 6:6	ship 112:13	short-run 243:3	227:15 233:17	Snavelly 87:6,16
sequence 183:17	shipment 55:6	short-term 177:7	simulation 207:1	sole 242:18
series 5:5 95:8	216:6,8 220:17	shot 179:19	single 32:20 55:5	solicited 127:19
197:6 210:12	shipments 40:13,16	show 40:17 41:9	184:18 217:16	solid 55:12 160:7
224:5	128:17 140:1	83:9 131:5 182:8	233:5 234:6	solution 139:17
serious 12:18 75:12	167:19 168:16	224:9	single-car 128:16	solutions 20:12
seriously 75:19	216:2 217:11,14	showed 193:19	129:12 217:14	191:6
serve 184:2	219:6,13,17 221:3	showing 81:4 225:9	single-carload	somebody 15:16
served 18:17 32:5	shipment-specific	shown 4:22	54:22	39:14 40:10 90:22
46:15 156:3,4	218:1	shows 26:18 40:20	single-point 207:4	162:3 177:9 178:8
service 22:4 33:9	shipper 2:2 3:4	131:3 194:10	singularly 80:19	184:22
33:11 69:21	15:22 54:22 55:2	shrink 202:19	sir 134:21	someplace 185:3
131:12 134:11	72:12,13,20 73:2	shuttle 112:20	sit 86:1 144:4	187:20
201:15 216:4,15	73:4 86:19 91:2	129:17	228:19	somethings 163:14
services 118:10	96:14 126:3	side 125:19 158:18	sitting 60:14	somewhat 120:9

231:14	88:17 117:9 124:9	stage 124:18	statistical 5:9 26:12	stories 161:21
SOO 84:4,5	142:7 195:9	stages 33:13	32:18 133:13	story 209:17
soon 94:14	207:17 208:7	Staggers 7:19	198:21 199:4	straightforward
sooner 63:5	210:22 214:11	215:13	200:10 202:5,7	57:8 215:17
sophisticated 108:4	216:4 219:22	stake 140:22	203:1,10,13 204:4	strategic 147:10,16
189:15 207:5	220:18 221:7	167:10	204:6,11,16 207:6	179:2,4
238:6	235:1	stakeholders 9:5	218:7,13 220:19	strategies 146:15
sorry 35:20 99:17	specifically 5:4	12:12 81:8 90:16	223:17 226:22	176:10 177:1
169:8 227:13,14	51:2 195:15	180:8 181:2,16	237:17	strategy 145:16
sort 50:21 56:7	specification	187:7	statistically 93:14	146:9
76:10 78:7 79:10	101:17	stand 116:20	95:11	streamline 102:13
84:13 86:20,21	specifications	standalone 19:3	statistician 228:18	streamlined 58:21
90:13 91:9 94:12	22:16	51:20 61:1	statisticians 203:16	streamlining
112:3 123:17	specifics 70:11	standard 80:13	statistics 200:11	102:10
129:7 131:4 159:6	73:20	122:13 219:12,16	204:10 205:18	Street 1:14 173:7
163:1 171:19	specified 20:20	221:4	206:2,4,6	strict 94:15
183:19 185:5	spectrum 204:5	standards 8:7 46:3	stats 214:1	strictly 193:13
sound 82:3 138:19	speculate 58:2	46:11,16,19 48:7	status 149:19	209:18 242:8
153:19 170:22	speed 91:9 229:19	48:8 58:20 61:16	statute 159:21	strike 147:14 167:5
sounds 154:8 183:8	230:2	61:17 80:6	161:15 164:11	stringent 93:6
source 26:13 27:19	spend 105:13 125:5	standpoint 61:3	statutory 9:18	strongly 196:1,22
28:2,16 74:11	125:21 134:9	126:16 143:14	122:8 155:6	205:16
177:17 186:20	139:5,9 148:20,20	161:19,20 209:18	159:18 162:11	struck 18:21
sources 20:5,17	176:7,14 178:6	244:22	stay 164:10,18	structure 30:12
South 36:9	spending 107:18	star 86:21	staying 222:8	51:11 57:1 119:8
Southern 150:10	141:9 143:19	start 11:4 48:17	STB 1:8 5:1 12:17	181:22
so-called 40:15	211:8,14,20 212:2	50:19 51:6,10	15:8 16:14 27:13	structures 119:3
span 113:13	212:3,5,16,19	61:8 84:17 99:10	31:16 32:21 65:22	129:19
speak 16:17 36:4	240:16	99:12 125:16	70:4,18 90:17	stuck 139:13
160:18 185:6	spends 108:2	176:22 182:16	123:20 149:8	studied 81:19
194:7 221:22	spent 54:5 67:14	186:4 187:20	155:7,18 171:14	131:21
speaker 35:20	108:2,9	237:12,17	187:21 207:21	studies 7:11 26:12
114:11	split 78:8,10 155:3	started 63:3,5	239:3	29:1,10 48:1
speakers 10:3,4	218:16	124:5,8 193:15	STB's 12:9 108:18	52:12 55:21 60:10
16:8 35:21	sponsored 24:14	213:12 214:2	steady 214:6	60:11 92:13
speaking 87:6,15	34:19	241:5	step 4:12 54:10	110:19,20,20,21
168:4 172:21	spot 81:22	starting 22:14	steps 101:9 189:11	110:22 111:3
195:11 230:10	sprang 79:7	49:14 69:6 71:9	Steve 2:4 3:5 15:22	123:9 128:12
speaks 107:13	spring 12:15	State 17:1,4	24:6 29:3 101:7	159:11 163:6
special 7:10 39:4,8	squadrons 105:19	stated 205:4	102:20	210:12 211:13
39:9,13,16	square 202:4	statement 20:5	stipulate 59:18	217:13 218:6,9,9
specialist 47:22	squared 113:10	28:1 37:16 45:5,7	75:15	219:20 220:19
specialized 22:1	staff 13:14 15:9	89:16 136:2,12	stipulated 18:22	223:17
specific 5:11,16,19	39:14 82:9 86:12	150:11	STMT 28:1	study 30:3 97:1
5:22 19:10 20:5	86:13 88:3,6	statements 10:12	stock 197:17	125:2 137:1,11,15
20:12 21:15 38:17	90:17 147:19	10:14	stood 78:7	169:21 181:18
43:10 66:16 88:14	198:17	STATES 1:1	stop 23:4	199:3,5,9 200:6

202:22 230:16 244:1 studying 136:21 stuff 115:3 123:15 130:17 162:3 190:12 Sub 29:4 53:13 54:4 79:8 subject 12:6 184:3 208:12 222:22 subjunctives 52:11 submission 17:12 195:5 198:2 submit 216:21 submitted 20:19 45:4 223:9 227:11 subsequent 101:5 substantial 17:6 47:4 118:6 129:12 131:10 substantially 72:14 243:7 substitutability 101:8,11,20 substitute 231:22 Sub-No 1:8 success 11:10 20:18 successful 146:8 151:6 168:8 successfully 94:17 208:5 238:18 successive 33:13 sudden 161:9 sufficient 148:4 226:21 sufficiently 119:9 suggest 24:22 32:13 46:12 58:17 101:7 137:13 159:11 194:13 196:1 197:10,13 214:14 232:9 234:21 suggested 37:11,18 62:20 66:21 85:11 85:19 101:4 111:14 141:16	142:11 163:6 169:22 183:15,17 233:16 243:5 suggesting 58:18 132:3 156:19 suggestion 39:19 41:7 42:3 91:4,5 185:1 suggestions 15:2 suggests 22:14 31:7 34:4 162:15 205:16 suitable 31:5 Suite 1:13 summarize 115:20 193:6 198:11 summary 212:21 220:13 supply 216:4 support 13:19 120:19 122:2 134:19 184:22 207:3 241:9 supported 200:12 200:14 supposed 177:21 195:16 suppressed 155:10 surcharges 41:11 41:12,21 sure 11:6 23:21 32:12 59:5 66:6 67:16 68:16 69:11 70:22 75:11 76:3 78:9 92:2 98:12 101:12 105:14 114:12,13 115:22 125:15 127:9 128:20 129:15 147:10 171:20 184:9 189:14 191:6 228:2 232:8 234:8 Surface 1:2,5,13 4:6 238:17 245:17 surprised 166:13 surprisingly	202:21 surrogate 83:22 suspect 218:22 sustain 120:8 sweeping 174:19 180:7 switch 29:11,15,20 30:1,14 38:11,13 41:17 43:16 132:22 166:14 switched 43:11 168:22 244:14 switches 29:13,18 29:18 switching 6:14,16 110:21 118:11 147:2 206:3 217:10,14,17 218:8 219:3 226:15 sworn 106:6 system 1:6 4:7,10 6:4,10 8:17 9:7 12:10,21 21:13,13 21:14 26:13 56:14 56:20 58:7 63:22 106:5 110:14 116:12 122:8 123:5 129:17,18 131:12 132:1,14 141:8 143:20 144:1 145:12 152:17,22 162:12 162:19 164:8,9,18 165:1 175:19 176:17 177:18,19 178:1 179:12 189:2,5,9 190:8 190:16 191:8,22 196:12,14 198:15 200:20 214:20 215:21 218:1,3 219:5 221:9 230:1 232:12 234:22 236:17 245:1 systems 55:10 108:4,8,10 116:14	120:22 144:3 145:14 146:14 164:13 176:22 177:13 189:3,4 190:19 197:1 208:22 system-average 5:2 22:11 102:3,7 104:1,20 140:4 217:1,21 220:16 S.W 1:14 <hr/> T <hr/> T 3:1,1 tackled 82:16 take 6:21 30:5 31:1 37:15 52:15,15 54:9 56:12 58:3 62:7 63:3 76:7 79:14 89:5 106:7 107:6 111:2 120:16 124:9 125:17 136:16 146:6 167:16 169:19 170:9 173:4 177:4 179:19 180:12 181:16 185:11 186:14,20 188:7 191:1 223:10 225:1,7,17 226:6 228:6 231:11 233:17 234:4 238:12 taken 97:11 124:7 167:18 173:4 189:12 takes 43:22 44:9 63:9 94:6,7 103:10 113:21 125:2 140:19 talent 235:19 talk 12:16 25:2,6 27:15 86:1 95:9 147:19 208:13 231:16 talked 99:3 147:18	180:4 183:7 224:4 238:8 241:15 242:21 talking 12:8 29:17 74:5 78:10,13 84:16 100:18 101:13 103:6,7,19 105:6 134:6 158:17 170:15,19 176:22 179:7 186:13 190:15 239:13 242:9,22 243:2 target-rich 28:19 tariff 43:21 tariffs 43:12 task 88:17 127:21 tasks 88:14 taxpayer 81:17 taxpayer-funded 175:12 team 30:21 199:3,9 199:16 202:22 teams 199:15 200:6 technical 38:19 81:1 97:20 109:11 technique 106:11 technological 21:18 technology 129:3 194:4 224:17,19 telephone 67:18 tell 58:5 111:17 167:4 telling 163:11 tells 78:20 139:11 ten 81:14 227:20 228:4 tend 33:14 144:22 229:5,7 tended 56:22 tendency 69:3 tends 194:22 tension 199:15 200:2 tenure 11:10 ten-year 105:20 term 149:12 150:3
--	---	---	--	---

176:9 177:8	165:18 172:7	192:1 193:19	188:17 191:4	161:15 162:20
190:21 195:21	174:1 179:17	202:22	192:1 196:21	166:2 169:20
terminal 6:17	192:12,14 193:3,9	think 21:7 28:8	197:18 198:2	thresholds 126:2
132:13	198:7,9 208:9,11	32:20 37:5,7,8	200:8,22 201:13	throw 129:5 230:22
terminals 41:1	213:3,4,9 215:2	38:18 42:1 50:10	206:15 208:8	Thursday 1:10
terms 21:12 28:19	221:11,12,15	51:2 57:7 59:9,17	209:22 214:21	ticket 163:13
49:20 63:16 83:9	223:2,5,14 245:8	60:12,20 62:9	224:9 227:11	tie 209:18,19
101:18 130:19	245:10,14	63:6,16,20,21	232:3,4,13 233:10	tied 139:12
134:15 136:19	Thanks 65:17,19	64:14,17 65:6,10	234:20 235:4,10	tight 81:10 98:3
138:6 146:9 147:2	223:13	66:3 71:13 72:18	235:14 236:14,19	99:21 100:19,21
190:13	theoretically	77:4 82:2 83:12	238:8 240:14	101:1
terribly 233:12	202:14	85:12 87:16 88:6	241:6 242:13	TIHs 119:15
Terry 36:7	theory 164:18	88:10,12 89:18,19	243:16,21 244:19	time 6:9 7:10 8:10
test 47:7 78:7	they'd 144:17	89:19 90:2,10	thinking 103:3	10:8,9 11:18 20:3
166:19 220:2,2,11	226:8	91:10,14 92:15	167:7	20:8,13 21:11
224:9 225:2	thing 18:10 27:8	96:12,13 97:6,12	third 25:19 35:19	30:19 32:5 33:16
testified 167:9	42:6 63:3,8 70:2	99:11 101:21	39:19 47:13	36:4 45:10,18
testifiers 101:5	79:13 84:10 88:18	102:4,15 104:7	109:14 132:19	46:17 47:1 60:5
testify 116:5	88:20 96:14 102:3	106:15,19 107:5	133:1 192:17	62:10,14 63:13
120:10 221:20	123:16 125:16	107:13,18 110:12	Thirdly 156:11	67:3,21 70:15
testifying 222:15	128:22 138:3	110:13,16 111:1	thoroughly 32:16	71:7,8 72:2,21
testimonies 58:16	148:5 156:20	113:7 122:22	122:5	73:9 74:17 78:8
115:17,19 245:11	163:5 164:14	123:5 125:3,13,13	thought 14:7 86:5	78:12 80:12,16
testimony 10:1	172:14 183:21	127:7,18 130:18	89:2 90:7 108:1	83:16,16 93:9
15:5 24:13,20	184:14 187:2	134:18 135:15	109:8 120:11	94:1 95:8,22 98:6
27:14,15 34:16,19	197:12 241:15	136:10 137:11	129:5 162:4	98:10 100:1,11,12
34:20 43:11 44:11	things 15:18,19	138:8 139:18,21	172:20 173:14,20	101:6 105:13
49:15 50:1 59:9	18:21 24:20 30:7	140:15,17,20	177:21 210:7,8	106:12 108:9
62:17 66:14 72:4	37:2,5 38:20 40:2	141:11,18,20	219:15	109:22 113:13
87:9 91:6 101:14	43:4 52:2 54:18	142:1 143:4,9,15	thoughtful 175:14	116:22 117:11
107:12 113:18	55:20 61:4 62:8	143:15,22 144:5,9	182:8	118:19 124:15
150:7 155:4 189:1	64:13 71:9 73:19	145:9,16 147:17	thoughts 82:6 95:1	125:2,4,5,8 131:8
219:8 223:8	73:19 74:13 78:11	148:9,16 151:1	165:5 167:2 176:3	133:9 135:22
tests 224:13	79:3 83:17 91:9	154:7 159:9	177:13 180:14	136:19 137:9
Texas 36:9 55:4,6	102:9 104:16,17	162:22 163:9	181:8,12	141:21 152:6
thank 4:3 11:2 15:1	106:15 125:1	164:5,12 165:3	three 5:6 17:7,16	157:8,19 159:15
15:8,11,12 16:11	126:16 127:13	166:8 168:6,9	25:8 26:17 45:6	160:6,8,15 161:16
24:5,8 35:17 36:2	128:13 130:6,13	169:17 170:19	45:14 55:17 56:11	164:6 166:9
44:15 48:14,15	131:3 132:11	171:1 172:11	61:15 63:9 109:9	174:18 177:14,20
52:7 65:16,20	133:1,11,14	176:5 177:3,8,16	109:9 119:8	178:9 180:5,20
75:10 77:13 97:16	137:11 138:20,22	177:21,21 178:12	122:13 124:8,11	181:5,19 184:9
105:3 113:16,17	141:19 149:7	178:15,18,19	126:18 135:7	186:14 188:1,8,18
113:22 115:17	156:11,21 157:7	179:7 180:5	141:10 200:9	193:17 197:6
116:2,8 121:13,14	158:5,14,22 159:7	183:14,15,17	203:14 209:8,9,10	198:13 201:2
121:17,22 134:21	159:13,14 163:5	184:20,22 185:4	209:15	205:7 214:5 222:7
134:22 140:6,11	179:10 184:14,15	185:10,19 186:9	threshold 44:4	224:5 235:4 236:7
140:11 154:3,4	188:9 191:11	186:12 188:12,16	155:6 159:20	239:19 242:22

timeline 14:14 25:7 26:6,9 81:7 88:20 98:4 99:21 100:19 100:21 101:1 124:7 182:1,8 185:22 186:7	203:6 211:10 218:14 226:13 228:10 229:12,12 229:15,16	train 6:13 7:16 22:21 30:1 38:14 38:15 44:7 55:5 57:9,11 103:21,22 104:1,2 119:12 146:6 196:5,9,10 203:3 206:4 216:15 226:14 227:18,20 228:3,4 229:3,6,13,16 230:3 234:2,4 237:6,7,15	trap 182:22 TRB 88:12 tread 13:21 treated 146:4 trend 129:7 trial 225:2 tried 129:13 tries 191:9 trip 222:12 trivial 56:21 134:8 trouble 68:9 106:12 true 12:17 146:5 159:9 164:10 179:13 227:17 230:8 234:13 240:4 trunk 23:16 trust 81:9 144:13 try 58:13 98:6 102:13,16 131:5 148:14 152:14 164:10 175:1,12 186:14 204:4 228:20 trying 63:1 65:11 70:5 74:3 102:4,9 171:2 216:22 229:21 tune-up 201:11 tuning 46:18 turn 9:20 10:20,21 17:2 35:19 48:18 97:14 110:4 148:10,12 157:10 241:4 turned 145:13 157:11 163:20 235:6 turning 12:6 128:3 170:6 turns 87:22 209:22 tweaks 124:20 twice 212:6 two 7:5 11:5 17:16 18:21 19:20 24:19 27:16 40:20 41:1	56:1 68:11 73:2 93:22,22 94:4 98:9 108:14,15 113:5 118:13 129:6 133:6 138:22 156:3,5 194:7 199:15 200:5 208:22 214:16 224:2 226:7 234:17 243:13 two-man 145:22 146:13 two-person 178:21 two-step 166:17 type 22:19 29:15 51:20 61:22 68:14 72:17 73:12 102:3 181:7 183:1,16 185:1 217:5 234:2 types 21:9,15 22:8 22:13,18 23:1 29:13 57:4 60:9 151:10,11,19 157:4 186:18 190:20 typical 132:22 typically 154:22 216:3
timelines 72:14 times 11:15 16:19 28:3 100:13 132:22 143:8,8 time-consuming 47:5 time-honored 52:20 timing 10:5 62:19 tinker 125:14 today 4:4 8:19 9:5 12:15,20 13:7 15:1,7 26:8,16 27:5,15 29:6,9 35:15 36:7 37:17 44:20 48:10 60:7 64:7 87:10 96:20 99:3 119:7,17 126:20 129:19 131:18 132:1,14 132:20 134:1 141:14 164:6 171:13 174:7 178:13 179:13 181:4 192:17 202:20 222:1 231:16 236:14 238:8 245:10,15 today's 71:16,17 123:6 TOFC/COFC 28:17 told 162:2 181:2 209:5 Tom 2:5 3:6 16:2 52:6 74:5 93:2 102:20 183:5 tomorrow 161:5 ton 19:18 23:11 33:8 41:16 83:18 163:14 196:5	tonnage 51:10 119:2 tons 17:9 tool 9:16 13:2 top 138:13 topic 12:8,16,18,20 70:17 81:18 174:4 180:7 topics 138:17 total 17:8 40:9 50:11 122:14 151:8 196:11,13 219:4 totally 185:6 201:8 touch 12:1 52:5 touched 52:9 154:6 toxic 118:3 TPC 237:22,22 traces 26:9 track 98:10 99:17 105:17 139:11 160:19 176:14 204:19 215:7 237:13 tracking 69:15,17 72:6 108:5 tracks 119:3 trade 34:18 tradition 55:9 traditional 52:21 traffic 6:13 7:16 20:7 21:15,19 22:9,13,18 23:7 23:11 40:13 44:3 44:3,21 64:19 95:5 98:20 102:2 103:7,8 118:20 119:6 132:5 151:11,19 157:5 169:12 177:5 211:4 trailing 229:3,5 230:1	trains 51:9 84:5,7 119:15 129:9,12 130:4 203:22 204:1 216:12 217:5,7 234:3 transaction 90:3,7 90:9 transforming 92:16 transition 8:7 transitioning 145:21 translate 189:4 translated 202:1 translates 19:21 translating 205:14 translation 189:6 189:11 translog 194:16 231:21 233:6,20 transmission 16:21 Transparency 21:3 transparent 25:21 34:8 35:9 57:22 67:17 76:14 96:18 97:3,8,13 109:16 109:17 110:7 168:1 235:15 transportation 1:2 1:6,13 4:6 13:4 24:17 68:19 117:19 161:2 202:16 238:17 245:17 transporting 118:3	trouble 68:9 106:12 true 12:17 146:5 159:9 164:10 179:13 227:17 230:8 234:13 240:4 trunk 23:16 trust 81:9 144:13 try 58:13 98:6 102:13,16 131:5 148:14 152:14 164:10 175:1,12 186:14 204:4 228:20 trying 63:1 65:11 70:5 74:3 102:4,9 171:2 216:22 229:21 tune-up 201:11 tuning 46:18 turn 9:20 10:20,21 17:2 35:19 48:18 97:14 110:4 148:10,12 157:10 241:4 turned 145:13 157:11 163:20 235:6 turning 12:6 128:3 170:6 turns 87:22 209:22 tweaks 124:20 twice 212:6 two 7:5 11:5 17:16 18:21 19:20 24:19 27:16 40:20 41:1	two-man 145:22 146:13 two-person 178:21 two-step 166:17 type 22:19 29:15 51:20 61:22 68:14 72:17 73:12 102:3 181:7 183:1,16 185:1 217:5 234:2 types 21:9,15 22:8 22:13,18 23:1 29:13 57:4 60:9 151:10,11,19 157:4 186:18 190:20 typical 132:22 typically 154:22 216:3
U				
ultimate 9:15 162:1 ultimately 116:19 141:7 159:5,10 187:5 200:2 unable 6:21 unadjusted 19:6,16 20:7 31:21 unbiased 91:1,7 uncertainties 61:10 uncertainty 61:11 uncomfortable 144:6 undercut 161:14 undergone 21:22 underlay 160:3 underlying 100:5				

136:16 154:13 166:1 172:4 224:17 understand 53:10 61:2 68:13 69:11 72:7 74:3 75:10 137:4 149:2 192:3 201:9 228:20 239:12 understanding 80:3 108:13 130:16 154:12,16 160:1,13 182:3 190:7 understate 217:9 239:21 understated 243:11 understood 87:14 208:2 236:8,9 238:10 undertake 25:2 47:4,17 60:17 106:16 undertaken 7:12 116:17 165:21 undertaking 37:7 undertook 14:7 64:20 underway 82:9 undue 9:13 121:3 unemployed 239:3 Un fortunately 136:8 uniform 4:9 12:10 12:21 116:11 176:16 189:2,5,9 190:8,16 191:8,22 198:15 234:22 Union 2:15 18:19 114:7 135:5 144:18 190:10 unions 146:2 unique 22:3 unit 5:15,18 7:16 22:20 33:9,11 39:6 41:17 51:8 55:4 94:2 128:10	129:8,20 178:2 203:7 204:2 209:11 216:18 218:15 227:20 228:3,11 UNITED 1:1 units 202:17 203:15 227:21,22 228:4 unit-train 22:5 23:1 29:2 43:15 55:1 118:10 128:16 216:2 217:1,11 227:19 unit-trains 21:16 53:15 129:11 216:3,7 217:13,15 universe 93:17 223:20 224:10 university 222:11 222:17 unknowingly 33:17 unlimited 81:20 135:10 136:19 unproductive 88:1 unreasonable 100:22 120:12 unrelated 55:5 untenable 152:19 unusual 131:1 unworkable 225:15 update 6:22 98:8 123:21 147:1 171:18 177:20 220:15 243:16 updated 7:4 30:10 130:1,17 159:8 173:9 211:11 218:10 220:14,21 221:5 updates 220:8 updating 7:20 8:22 31:5 109:5 147:5 171:15 upheaval 62:2,6 uphill 84:4,8 uphill/downhill	84:1 URCS 4:11,17,20 5:4,8 6:1,7,9,22 7:8,12,21 8:1,6,7 8:11,22 9:2 13:1,2 13:8,13,15,17,22 14:1,4,7,18 15:3 17:12,13 18:2,6,9 18:11 19:3,6,16 20:2,7,15,21 21:9 21:11,20 22:15,21 23:4,13,17,21 24:2 25:1,5,10,11 25:15,16,20 26:15 26:17,22 27:3,7 27:12,20 29:8 30:12,14,16,17 31:5 32:19 33:3,4 33:12,14 34:7 35:1,2,4,6,9 36:11 36:16,17,19,22 37:4,6,8,19 38:5,8 38:10,12,15,21 39:5,6,21 41:6,14 42:4,9,17 43:3,13 45:9,18 46:1,8,10 46:21 47:6,14,18 47:19 49:2,16,18 50:3,5,5 51:2,3,17 51:19 54:20 55:21 56:3,3,3,6 59:12 61:21 62:9,18 64:5 66:19 69:19 70:6 72:11 73:14 73:22 74:4,20 75:8,14 76:8 78:4 80:1,10 86:16 89:20,22 90:11 92:6,7,15,17 93:9 95:17 96:6 98:8 98:18,19,22 99:5 100:2,6 101:5,8 102:11,16,18 103:4,19 104:12 106:17 107:8,14 108:18 109:13,15 110:15,22 111:19	115:12 116:11,16 117:10,16,17 118:13,19 119:8 120:20 122:8,22 129:6,22 131:18 133:19 135:9,12 135:17,20 136:3 138:1,5,15 141:14 143:12 144:1 147:12 148:11,17 149:1,20,21 151:4 151:7,12 152:9 153:2 156:12,15 157:9 158:20 160:12,17 161:7,8 165:21 171:6,16 176:12 179:12 181:3 184:17,19 189:7,10,13 193:15 194:1,3,5 194:12 199:12 200:8 204:22 205:8,12,16 207:5 208:14 211:21 212:8,15 213:11 213:16 214:3,4,5 214:10,12 215:19 217:21 218:8 220:3,4,13,15,15 220:21 221:10 231:9,11,17 232:1 232:2 233:19 242:15 243:8,9,17 244:3,8 URCS-specific 69:22 urge 45:16,21 138:3 urging 26:19 usability 138:7,15 usage 149:5 use 11:20 13:2 19:16,19 20:6 42:8,20 96:7 108:18 110:15,19 121:2 122:8,21,22 127:16 149:10,12	149:21 157:15 162:14 172:5 189:2 190:7 194:17 195:21 197:13 201:21,21 202:6 206:19 207:4 213:11 216:9 224:2,14 225:16,22 226:11 229:7,17 233:5,19 244:10 useful 87:17,19 158:15 user 5:20 38:22 104:19 uses 4:17 5:9 8:1 201:20 211:22 212:8 USOA 190:14 199:11 200:5,9,12 200:13 201:20 205:15,15 235:2 usual 10:2 usually 222:17 utilized 48:9 131:11 utterly 113:14 U.S 23:11 174:9 175:10 201:19 213:19 245:17
V				
			vaguely 18:3 valid 23:21 218:16 validity 220:2,11 valuable 145:4 value 43:13 120:2,6 120:17,17 133:18 201:1 244:11 values 118:17 vantage 78:5 variabilities 131:20 207:5 variability 7:3 27:2 32:14 33:5 34:5 79:10 118:14,15 125:1 139:4,14	

154:7 156:13	VBA 8:4	161:19 187:8	182:16 198:20	Weicher 2:13 3:11
159:11 168:18	VBNET 8:2	virtually 141:13	199:5 214:4 235:8	114:6 115:4,7
184:18 194:4,12	VB6 8:2	Visual 8:3	wants 50:18 114:13	121:15,16,18
199:1 202:8,15	vehicle 164:2	voice 121:20	245:14	133:9 143:1
207:8,9 211:15	vein 127:6	volume 5:12 21:19	warrant 207:18	144:12 148:3
212:9 236:20	version 28:4	207:10 242:3	warranted 188:21	150:8 153:13
239:21 242:14	versus 43:22 77:18		201:18	157:20,22 159:17
variable 4:18 5:2	98:5,13,18 100:20	W	warrants 139:17	161:17 169:4
5:15,18 6:11,18	138:1 178:14	W 2:8 3:6	171:2	174:3,12 176:5
13:3 17:13 22:17	191:13 228:1	wages 203:3 227:6	wary 200:17	183:14 189:14
49:21 50:11 59:18	241:17 244:20	227:7,17 228:10	Washington 1:14	191:19 192:7,14
76:21 77:10,18	vice 1:22 3:3 9:20	237:6	15:17 36:10 86:4	weigh 153:22
78:2 119:6,22	10:22 11:2 16:14	wait 58:19 63:7	wasn't 73:14 75:11	160:20
122:9,17 128:12	24:9 44:18 48:19	114:14	75:17 101:12	weight 83:19
130:9 134:7	65:17 67:9 68:3	waiting 46:15	waste 81:16	103:22 104:1
139:13 146:6	70:9,13,16 71:1	Wall 173:7	way 13:17 17:13	229:3,5 230:2
151:8 154:15	71:11,15,19 72:3	walled 149:10	18:8 26:11 63:21	weights 103:21
155:9,10 156:15	75:9,18,22 76:2	175:20	68:4 72:19 73:3	welcome 4:5 11:17
158:18 162:19	77:1,4,13 79:20	want 9:21 12:19	75:5 81:7 82:2,16	12:2,19 65:19
163:8,12,18	80:17 97:14,16	15:8,13,14 35:18	85:13 86:2 93:21	114:11 154:4
164:17 165:1	99:16,19 105:3	45:6 48:17 50:20	105:21 108:20	193:1
168:15,20 169:2	107:20 110:9,11	52:5 56:9 58:13	111:4 125:10,15	well-behaved 57:15
178:2 195:1,10,12	113:21,22 114:12	63:19 64:15 65:14	128:22 131:10	83:13
195:12,21 196:19	115:18 116:3	66:7 68:15,16	132:19 133:13,13	well-managed 82:3
210:7,16 211:5,9	121:17 135:3	69:3 72:22 76:3	137:14 142:11,13	went 60:4 62:21
213:2 226:9	154:3 157:21	77:9 82:2 89:13	143:20 152:9	68:18 115:14
234:18 237:3,15	159:16 165:4,13	91:15 92:2 94:11	159:5 161:9	124:13,14 158:20
237:20 239:17	165:19 169:17	96:17 99:9 101:9	163:15 172:3	163:1 173:13
240:6,8 241:17	171:8 172:9 174:1	102:20 106:21	173:5,10,22	205:8 209:14
242:18 243:10,10	174:15 179:16	113:17,20 115:16	175:16 181:22	weren't 72:19
variables 186:17	185:17 193:2,10	116:8 134:19	182:21 183:9,11	73:13 236:10
224:14 225:16	198:10 213:8	135:8 138:20	188:10 193:2	Westbrook 205:2
227:18 229:10	221:15 223:2	141:16 148:9	195:15 208:16	Western 44:20
230:22 233:7,8,9	245:7	153:22 158:2	210:4,7,8 223:21	64:19
variable-cost	Vice-Chairman	162:14 165:9	229:6 238:20	we'll 24:19 25:2,6
156:10	36:2	166:11 167:1,3	243:11	27:15 67:7 69:11
variation 234:2	victories 72:20	168:1,11 170:3	waybill 39:22 40:1	71:2,4 101:6
variations 216:20	victory 72:13,14	172:14 182:21	40:3,7,15,21 41:5	115:21 125:18
varies 216:18	view 21:7,12	186:3,5 192:16	ways 9:2 13:9,15	154:16 185:12,16
variety 4:18 7:21	116:17 117:3	193:3 221:13	27:4 138:15	189:1 193:6,7
189:18	150:14,20 151:6	224:14 227:2	139:21 192:9	219:15
various 7:13 26:4	240:7	229:2,6 230:2,10	202:2 211:22	we're 9:4 12:4,14
36:5 57:3 79:6	viewed 27:9 113:3	230:11,16,22	wear 119:3	21:1 26:19 31:6
vary 5:11 130:21	viewpoint 210:17	241:6 245:10	website 20:17	32:14,17 33:5,6
130:22 155:20	viewpoints 200:5	wanted 11:8,13	websites 67:18	38:3 51:1,18,21
196:13 216:7	views 48:12 85:6	43:6 165:8 172:5	weeds 158:3	54:4 55:9 62:14
232:17	116:9 117:6	172:10 181:11	weeks 49:2 180:6	63:6 69:18 70:3

74:3 75:3 81:12 93:16 94:20 105:6 109:2 112:9 123:4 125:15 131:1 132:3 134:5 139:13 143:19 146:13 148:11 153:13,14,18 158:17 166:13 170:15,19 175:10 175:22 184:6 187:20 192:8 226:3 242:22 243:2 we've 27:13 35:10 62:5 64:17 67:15 68:10 70:2,20 72:18 78:10 83:18 87:6 88:4 99:3 100:12 131:9 137:9 140:16 145:12 146:21 151:3 161:8 167:11 173:4 214:15 242:4 wheat 2:8 16:5 36:6 40:16 42:6 wheel 165:2 Whiteside 36:7 whoa 149:13 wholesale 16:22 wide 236:5 widgets 163:22 wife 222:4 wildest 108:12 willing 147:6 willingness 142:19 Wilson 210:21 win 73:4 wind 73:21 75:7 121:20 232:16 window 166:9 wing 186:3 wise 166:8 242:14 wish 11:9 witnesses 117:5,13 123:8 135:19	180:3 181:4 221:20 222:3 Woebegone 152:4 wonder 210:3 word 11:20 38:16 38:18 words 50:4 217:5 work 26:1 30:22 34:12 35:12 86:14 90:8 96:21 127:21 142:14 161:13 165:14 184:3 187:13 203:17,18 204:5 206:4 207:21 226:20 229:11 workable 208:1 worked 80:20 97:19,19 157:8 161:1 201:12 226:10 238:2,21 working 46:6,16 86:15 90:5 123:13 145:21 160:22 193:17,22 workload 100:3 works 108:21 186:4 WorkTables 8:6 world 106:3,5 131:3 230:17 worry 69:2 171:11 worse 234:8,11 worst 99:10,12 worth 91:11 132:10 wouldn't 42:1 62:13 67:5 79:14 83:2 88:15 106:10 169:4 175:15 180:8 182:4 wrap 71:9 write 79:5 165:17 written 17:11 20:9 45:5 66:13 72:4 150:11 184:7 wrong 164:3,9,16 223:3	<hr/> X <hr/> X 113:11 178:14 <hr/> Y <hr/> Y 113:9,10 178:14 yard 84:3 year 5:3 19:22 68:18 112:14,15 136:21 139:6,10 161:22 166:14 169:22 178:8,13 178:13 181:18 182:9,10 228:7 years 7:18 14:1,3,6 14:9 31:18 36:13 41:13 61:15 63:4 63:7,9 68:11 81:14 82:10 94:20 96:5 106:22 109:5 123:10,15 124:10 124:11,19 133:11 135:20 136:14 140:15 141:2,10 141:19 145:10 153:21 161:6 163:18 180:17 208:4 210:3 219:4 225:6,8 242:10,11 year-to-year 211:10 yellow 10:6 yield 125:10 York 40:19,22 young 208:15 <hr/> Z <hr/> zero 40:9 226:8 <hr/> P <hr/> p 20:1 21:14 23:3,4 27:17 30:11 31:6 42:3 51:7 52:15 54:9 55:2,8 56:10 66:10 67:20 68:8 68:10,21 69:2,16 69:19,21,21 71:5 71:8,22 72:5 73:1	74:2,9 75:17,19 75:19 76:1,4,5,5 76:20,22 77:2,5 80:4 81:17 83:10 83:10 84:11 85:11 86:3 87:5 91:16 92:12 93:17 94:20 96:15 97:22 98:10 98:22 99:10 100:10,15 102:11 103:5,8 104:11,15 104:19 108:2,13 110:3,15,17 111:7 111:21,22 113:6 114:15 115:12 120:11 124:4 126:6,8 127:4 129:6 130:16 131:15,22 133:5 133:17,19 135:21 138:5 139:21 146:16,20 148:11 149:11,12 151:2 153:14 154:1 160:13,20 161:4,6 161:7 162:15,17 163:4,10 164:8,20 165:5,16 166:15 166:17 167:22 168:12,22 169:5,7 170:5 171:19 172:7,8 176:8,11 176:15,15 177:4 177:10 178:5,20 180:2,3 181:15 182:6 183:8,12,15 184:6,8,10,21 185:16 189:20 191:10 192:3,5 193:12 195:1,13 199:7,9,18 201:22 206:18 214:1 219:2 222:7 223:21 226:21 227:6,11 228:8 230:19 231:6 233:4 236:10	238:2,8 239:14 241:8,18 243:18 244:20 245:1 <hr/> \$ <hr/> \$3 141:9 \$36 19:21 \$4 45:14 141:10 \$4.50 19:18 \$5 214:21 <hr/> 0 <hr/> 0200 67:20 <hr/> 1 <hr/> 1 6:10 166:14 205:15 1st 4:15 245:13 10 238:13 10-K 189:17 10:45 115:14 10:46 115:15 100 211:15 11 3:3 116 3:10 12 31:2 184:10 12.6 42:14 12:48 245:18 120 1:13 121 3:11 124 215:6 13 32:18 138:16 184:10,10 218:5 135 3:12 14 17:9 140 3:13 15 238:14 150 233:6 158 44:1 16 3:5 163 215:10 180 18:22 72:9 155:8 156:9 159:19 161:14,22 164:6,6,19,20 166:2 167:20 169:13 170:1,10 171:4 173:18
---	---	---	--	---

1907 26:11	225 215:8	50/50 78:8,9 130:11
193 3:15	24 3:6	155:3
1930s 7:14 139:15	245 3:22 67:19	52 43:12,22
1931 225:21	245-0245 49:7 68:6	55 202:12 233:8
1939 26:12 194:5	25 23:10 36:12	58 202:13
197:3 212:9	94:20 163:18	
1960 27:19	217:15	<hr/> 6 <hr/>
1960s 7:14	25-year 177:9	681 19:14 118:4
1969 28:17	250 226:20	217:20
1972 26:13	268 44:1	<hr/> 7 <hr/>
1974 29:5 53:14	270 29:4 38:1 53:13	70 154:22
1976 202:11	54:4 79:8	70s 28:13 123:12
1978 26:14 78:14	<hr/> 3 <hr/>	75-car 217:13
198 3:15	3 1:8 6:15	763 28:1
1980 119:2 215:4	3,000 40:6	<hr/> 8 <hr/>
1980s 21:17	30 1:10 7:18 123:15	80 204:13
1983 193:16	141:19 161:8	80s 129:16 145:20
1984 226:5	185:13	215:20
1986 205:3	36 3:6	85 215:8
1987 6:6 7:4	395 1:14	88 239:22 240:7
1988 211:6 240:18	<hr/> 4 <hr/>	<hr/> 9 <hr/>
1989 6:1 12:22	4 3:2 6:17 29:5	9 101:13
31:22	53:13 54:4 79:8	9:00 1:16 4:2
1990 124:4	4,163 219:14	90 155:1
1996 213:12	40 93:18 141:19	90s 240:19
1997 6:9 219:10	214:7	93 124:13
232:6	400 17:9	
<hr/> 2 <hr/>	428 215:5	
2 6:13 218:5	431 1:8	
20 123:15 135:20	44 3:7	
136:14 141:19	45 38:9	
161:8 204:14	48 3:8 43:22	
238:14	48-car 43:12	
20-year 32:15 34:3	49 236:10	
200 30:3 219:13,17	490,000 17:4	
2000 214:3	<hr/> 5 <hr/>	
2002 211:6	5,000 104:1	
2006 214:9	50 14:3 43:14 77:21	
2007 211:12	77:21,22 78:1,21	
2009 1:10 4:15	79:10,21 80:11	
182:11	123:10 139:13	
2015 119:14	154:13,14,20	
202 67:19	156:14 212:10	
208 3:16	236:8 237:3 240:1	
213 3:17	240:6	
221 3:19		