



ASSOCIATION OF
AMERICAN RAILROADS

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Dr. William Brennan
Office of Economics
Surface Transportation Board
395 E Street, SW
Washington, DC 20423

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Dear Dr. Brennan,

On September 5, 2019, the Association of American Railroads (AAR) filed with the Surface Transportation Board (STB) the Rail Cost Adjustment Factor (RCAF) for the fourth quarter, 2019. In that filing, the Materials and Supplies Index (M&S), a component of the quarterly RCAF, increased 18.2%. At the time of that filing AAR could not provide as complete an explanation of the circumstances surrounding that increase as the situation might warrant or the STB might desire. Since then, we have obtained further detail on the issue, have been able to further substantiate the transactions which drove the increase and have also been able to determine that the written procedures provided by AAR to the railroads for selection of appropriate supplier prices for the index were followed by the railroads in question.

The magnitude of the M&S increase was driven by significant cost increases for track ballast, a major component of the index, for two eastern railroads, Norfolk Southern (NS) and CSX.

To report quarterly supplier prices of materials, railroads fill out a document called the P Form which identifies the specific materials and supplies they must document. There are specific written instructions from AAR that they must use to fill out the form including identification of appropriate suppliers and the prices charged by those suppliers.

To select a supplier price to report on this form, the instructions state that the railroad should "determine the major supplier of each major item specification for that quarter."; The major supplier whose prices are to be reported is defined as "... the supplier from whom the largest total dollar amount of the major item specification was invoiced". After determining the major supplier, the railroad should select the invoice from that supplier that represents "...the largest dollar amount". In short, the railroad should choose the single largest invoice from the largest supplier.

Regarding ballast, supplier prices may vary each quarter depending on the quarry from which the ballast was obtained, the physical specifications of the material purchased, the transportation costs to move the ballast to the point of distribution and the season in which the acquisitions occur. Certain circumstances, such as weather emergencies, quarry production constraints, seasonal requirements or transportation cost differentials sometimes require that the railroad purchase ballast from a more expensive quarry or a quarry with which they do not have an ongoing contract. In the current

instance, several of these factors were in play as is explained by the carrier explanations included below. Names of specific suppliers or their locations have been edited from the explanations to maintain confidentiality.

NS:

“The reported unit price is based on the unit price associated with the highest total value invoice processed per period. Accordingly, the reported price is correct.”

“As for the reason for the price fluctuation. We deliver the ballast by rail as a company move from the pick-up location to the job sites. We calculate our internal delivered cost to the job site to determine the optimal quarry to purchase from. The price per ton for quarries in the south is less than from quarries in the North. Taking the cost of the rail move into account, we choose to purchase from the more expensive quarries for many of the Northern regions. In the summer (warm) months, our construction gangs are heavily working in the North. Therefore, for this period the largest ballast invoice that was paid was from the most expensive quarry.”

CSX:

“The price includes production of the product at (the Supplier’s) quarry and the cost to get it to (the CSX distribution) yard.”

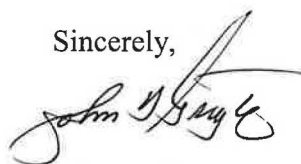
“CSX purchases ballast from over 70 different (Supplier) locations. The low-end prices are the quarries where we have contracted pricing and from where we normally pull almost all volume. In this instance, the higher-end prices are for locations where there are no natural, local quarries available so the material is brought in and stockpiled for local use and for emergencies when they arise in the area.”

In both cases, the carriers involved have provided to AAR, documentation which indicates that they followed the appropriate procedure in selection of the invoices from which the supplier prices were extracted. Clearly, the convergence of these two sets of events in a single quarter represents an anomaly but one which was properly reported by the railroads in question. Additionally, both events report normal operating costs which must be recovered by the carrier, even though one was routine while the second was much less common.

Based on the AAR’s written instructions and the supporting documentation supplied by the carriers, it appears that both railroads have followed the required process to select the single largest invoice from the major supplier.

I hope that this helps clarify this unusual situation. If you have additional questions on this matter, please do not hesitate to contact either myself at (202) 639-2319 or Tiffany Placker at (202) 639-2381.

Sincerely,



John T. Gray