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National Grain and Feed Association



October 12, 2005

To Whom It May Concern:

Enclosed please find the testimony I intend to submit to the Surface Transportation Board at their public hearing on Wednesday, October 19, 2005.

Please let me know if you have any questions.

Sincerely,

Kendell Keith
President, National Grain and Feed Association

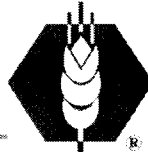
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National Grain and Feed Association

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Ex Parte No. 658

Statement of the

National Grain and Feed Association

Before the

Surface Transportation Board

October 19, 2005



Chairman Nober, Vice Chairman Buttrey and Commissioner Mulvey. I am pleased to present the views of the National Grain and Feed Association on this 25th anniversary of the Staggers Rail Act.

The NGFA is comprised of 900 companies in the U.S., Canada and Mexico involved in all aspects of grain merchandising, processing, storage, transportation, feed manufacturing, integrated livestock operations and exporting. We have as part of our membership country elevators, as well as the largest firms in the industry, most with access to only a single rail carrier at each of their rail-served facilities.

Following the passage of Staggers, which did much to deregulate rail rates and service, there has been rapid consolidation in the rail industry. That consolidation should come as no surprise as we have seen many other industries, such as airlines and telecommunications, where deregulation contributed to the same trend of consolidation. However, there have been noticeable differences in market and business outcomes in rail transportation as compared with those other consolidating industries. Unlike other deregulated industries, where consolidation was accompanied by new entrants offering competitive rates and service, railroad consolidation led to a sharp reduction in competitive routes and options for shippers of bulk commodities without any new intramodal competition, except for certain coal movements. These differences raise further long term concerns about the direction of rail service and its ability to contribute to needed freight capacity expansion for all shippers in the U.S. at reasonable rate and service levels.

We acknowledge at the outset that the Staggers Act has contributed many positive outcomes. The railroads have become more profitable. Railroads need to earn revenue to continue to provide service and expand operations where the market has needs. The flexibility brought about by Staggers and later refined in the Interstate Commerce Commission Termination Act, coupled with major improvements in efficiency, has provided the railroads with the opportunity to compete for freight business with other rail carriers and other modes that was not possible prior to Staggers. It also gave the railroads the market power to more uniquely define the direction of their business and the types of markets they want to serve. This has had both positive and negative impacts for our industry.

To delve into more specifics, we would like to observe some trends over the past 25 years and discuss how such trends have impacted the grain, feed and processing industries.

1. Rail Service Capacity. In 1980, the railroads carried 50% of the commercial grain movements in the U.S. Today, that number is closer to 35% or less. Rural branch lines have been abandoned; our industry built larger facilities for shipping with more rapid handling capacity, leading to unit train and shuttle loading operations. While the railroads have, on net, gotten more efficient at moving grain volumes between points, the rationalization of their infrastructure has led to losses in grain volume to other modes, primarily truck. There is concern in our industry whether this trend in rail volume losses will continue, and how agricultural shippers will effectively compete with other industries for available rail service. Market factors contributing to this trend in rail service are:

- Railroads are more dependent than ever on rail customers to supply car equipment. While private car ownership in our industry was not uncommon in the 1970s, today private cars dominate the grain hopper fleet, representing nearly 65% of the total supply. One hundred percent of all tank cars carrying vegetable oil, corn syrup, ethanol, and other liquid products of agriculture are privately owned. While the rail customers that own or lease private cars enjoy benefits at times, they also face a risk penalty formerly borne by the railroads. In soft markets, it is often the shipper's cars that are parked first. Compensation for private cars paid by the carrier becomes invisible or is substantially below the ownership or lease value, particularly as carriers become more selective about the traffic

they are willing to handle. Thus, the shipper that owns rail cars can confront considerably more ownership risk and uncertainty on car utilization than the carrier does. As private car ownership increases, shippers face larger uncompensated expenditures to meet new rail industry requirements, the costs of which previously were sustained to a greater extent by the railroad industry when it owned most of the cars. Some railroads now are pressuring shippers to construct new track to accommodate private cars, relieving the railroads of track investments that would have been required of them had they remained as the primary supplier of freight cars.

- Highway construction has provided government subsidization toward fewer major shipping points for grain. Railroad shuttle trains where dedicated engines and cars move grain from point to point have proven the most cost-efficient means for railroads in moving grain, as car cycle times can be reduced dramatically. While railroads have been able to price such services at rates that are more attractive than other types of service, the U.S. highway system, funded largely through federal support, and local state and county roads have made it possible for grain to be transported via truck over longer distances to feed shuttle loading facilities. As such, government expenditures have caused some of the trends in grain industry consolidation. It has created, perhaps temporarily, better rates for some elevators and, at least for the farmers nearby to those elevators, more attractive grain pricing. But what are the long-term consequences to the marketing infrastructure? Also, is this trend pushing more grain into simply be-

ing trucked to local market, such as ethanol production facilities? In some cases, the answer is definitely yes.

- Mergers have reduced shipper and receiver access to some markets. While rail mergers in the past could have been a positive for access to more customers for shippers or access to more sellers for buyers, in general the mergers did not accomplish this. Rather, as mergers occurred, the resulting larger carrier tended to reduce economic access to connecting carriers and at times restricted access (through the use of differential pricing to discourage certain movements) in its own network, effectively telling rail-dependent customers where they could and could not market grain and grain products. While this action by carriers may have had a relatively minor impact on total rail capacity, it did restrict the ability of some rail customers' businesses to compete and grow, and reduced overall agricultural marketplace competition. Railroad pricing policies thus have in many cases dictated "winners" and "losers" within the agricultural community.

2. Rail Rates. Up until the late 1990s, real (adjusted for inflation) rail rates were on a long-term decline as measured on a ton-mile basis. Some of this was due to greater efficiency; some due to excess capacity in the industry; but also contributing to such "declining" rates were the investments by rail customers in rail cars (as noted above) and the shipper and receiver investment in building highly efficient handling facilities, that are the predicate for grain shuttle trains. Today, rail rates are generally increasing -- very rapidly in some markets. Since the late 1990s, we have seen rail capacity shortages that have tended to be both more acute and more prolonged. With the additional problems of

low water on the river system, inhibiting barge traffic at times, and Hurricane Katrina disrupting both barge and rail movements, this fall's grain harvest may prove the most logistically challenging in the history of the Staggers Rail Act. Markets that are desperate for grain have required the payment of rail car premiums as high as \$2,000 or more, the equivalent of about 50 cents per bushel of corn (about one-third of the total value of the corn to the farmer).

There are growing signs of great concern to the agricultural community that changes brought about by the Staggers Act may bode far better for railroads than agricultural shippers. The fastest growing segment of rail traffic is intermodal, and it receives by far the best rail service. Train speeds for intermodal traffic exceed train speeds on other types of railroad traffic by as much as 50%, and by very nearly that much even for grain shuttle trains. Agricultural shippers continue to face difficulty in obtaining consistent or predictable rail service, almost as if railroads, having transferred the burden of car ownership costs to tank car and covered hopper car customers, can afford to make shipper car assets less productive through poor service in order to favor service provided in intermodal equipment. We face the anomalous situation where those rail shippers who pay more for rail service receive inferior service. Moreover, having lived with differential pricing for 25 years, during which agricultural products normally provided higher margins to railroads than intermodal traffic, yet provided an opportunity for railroads to attract increased volumes of intermodal traffic, agricultural shippers now face the further anomaly of being told that the influx of intermodal traffic makes many agricultural movements dispensable to the railroads, who openly "demarket" them either through frankly stated

disinterest or through prices designed to deter rail use. Some segments of the grain industry face a somewhat different demarketing problem which they see as the use of railroad grain car supply restrictions to prefer larger grain originating points even while rates are held out to service the smaller points.

Hopefully, this logistical crunch will be solved as quickly as possible, but it certainly confirms that the U.S., and agriculture in particular, has a freight capacity challenge in the years ahead. Railroads need to make infrastructure investments; they need to buy engines and cars; and they need to hire people that can provide rail service. The inland waterway navigation system needs more modern locks and dams and improved maintenance to maximize its flexibility to carry the volume of freight demanded by the market. We need to develop other transportation options, or we risk losing some of our potential for economic growth.

Over much of the life of the Staggers Act, average agricultural rail rates have not posed much of a problem, although if the rail capacity constraints are not addressed, average rates could prove to be an overwhelming problem, to the point of restricting commerce. However, the differential pricing authority that Staggers provided to carriers has proven to be a chronic and daunting challenge for many captive shippers, including those in agriculture. The STB, and the ICC before it, have not provided an avenue for rate relief for any but the largest point-to-point moves, none of which apply to agricultural commodities. Congress clearly intended for the railroads to price their services in response to market conditions, except where they are "market dominant," in which case their rates are to

be subject to regulation if above 180 % of variable cost. Differential pricing has been viewed as the appropriate way for the railroads to set their rates. Just as clearly, however, Congress intended for limits to apply to such pricing in captive situations, and that there be a process established that allows reasonable, practical, and economical access to rate relief in those situations. Differential pricing, adopted at a time when railroads had surplus capacity, was asserted by the ICC to produce benefits even for those shippers paying higher rates by allowing railroads to attract more elastic traffic that, if priced above direct cost, would yield a contribution to railroad overhead and thereby retard upward pressure on the pricing of captive rail traffic. For those captive shippers now learning that differential pricing and other factors are attracting and retaining for the railroads large new volumes of traffic that formerly moved by truck, leaving less capacity for the captive bulk shipper, differential pricing is not fulfilling its promise and actually is adversely affecting these shippers.

The STB should accomplish its rate responsibilities in as transparent a manner as possible, both to permit the rail customer to readily evaluate individual situations to determine the likelihood of obtaining relief, and for the carrier to accurately determine the risk of loss before the regulatory body, should pricing freedoms not be reasonably applied in captive market circumstances. If there is legitimate risk and/or cost for both parties----the cost and effort for the shipper bringing a case, and the potential for the carrier to actually lose a case----there will be some degree of market discipline, even in the absence of true or traditional market competition.

3. Customers' and Carriers' Business Relationship. While there have always been some elements of cooperation and conflict in the business relationship between carriers and

shippers, it seems that in the last 10 years conflict has grown in significance. We of course hear complaints from our members that use rail when service is unreliable or extremely costly. But we also hear many objections that seem to be less about economic issues and more about perceptions that railroads are in a position to dictate not just rates and services but also many other terms of the business relationship with their customers--to the customers' detriment. Some examples of this include:

- Grain processors have been required to purchase tank cars to get rail service for corn syrup or soy oil shipments. Then when railroad service deteriorates, those same shippers have been required to purchase or lease additional cars to make up for the poor performance, just to keep their plants operating and avoiding shutdowns. Then when car cycle improve the cars become in "surplus" capacity, and the railroad assesses "storage charges" for the cars.
- The credit terms of railroads are the tightest of all suppliers to our industry and they are not reciprocal. Typically a railroad will bill for a shipment once it is loaded. Payment must be received within 15 days of the date of the billing, or it is subject to penalties and interest. Shipping companies thus have to audit the bill for accuracy, because of frequent errors, and make payment in two weeks. Discovery of any billing mistakes after payment generally means the shipper will wait substantially longer than 15 additional days to obtain a refund from the carrier, to which no penalties or interest apply.
- One carrier instituted a \$50 charge for any challenge to a demurrage bill, if that challenge is not issued electronically. Shippers do not consider it equitable for

penalties to be assessed for correcting the railroad's mistakes. In a similar vein, some railroads impose penalties if shippers fail to issue freight billing electronically, as when faxes are utilized. Shippers generally strive to cooperate with railroads in modernizing ministerial documentation, but those unilateral penalties go too far. It is the carrier, not the shipper, required by law to issue a bill of lading, and the common carrier power of the tariff should not be utilized unilaterally to transfer that obligation to rail customers. If railroads believe that electronic data interchange is of mutual benefit to carriers and shippers, they can provide economic inducements, in the form of modest allowances, to those shippers who utilize a preferred methodology. Shippers have had to hire additional clerical staff to meet carrier electronic billing provisions. If carriers cannot recognize that these steps should be mutually beneficial to them and their customers, the carriers should not be permitted to impose these requirements unilaterally.

- Rail fuel surcharges have come to be a particular sore spot for some shippers as surcharges have risen to the 15% to 20% range with the jump in fuel and crude oil prices. NGFA and other shipper organizations have done considerable analysis that is publicly available that would indicate that some carriers' average surcharge assessed to customers to which the full surcharge is applied exceeds not just the increase in fuel costs, but actually exceeds the total cost of fuel for the average shipment. Carriers' ability to assess exorbitant fuel surcharges is some indication of a lack of effective competition among carriers and other modes, at least in the near term. Such actions by carriers also re-enforce the appearance that carriers do hold the ability to invoke one-sided rules in the business relationship with their

customers. (It should be noted that the Class I carriers have widely divergent policies for fuel surcharges. The BNSF Railway recently announced it would shift to a mileage-based surcharge more directly related to fuel costs, that it believes will be more equitable among shippers. Also, the Canadian National has announced two reductions in its fuel surcharge assessment since April 2005. These carriers are to be commended for making initial attempts to address customers' expressions of concern.)

These bullet points raise a number of what we would consider to be unreasonable practices by the rail carriers. The STB needs to provide more effective relief for such practices than exists today. There needs to be a prompt way to address such concerns. Under today's STB operations, unreasonable practice cases take years to resolve, and very often the market needs an answer much more quickly, as a late answer is simply untimely and ineffective.

The business relations between railroads and their customers is not all about conflict. NGFA, the AAR and major carriers have made some progress in private dispute resolution. In 1997, several points of potential business conflict between rail carriers and agricultural shippers were jointly identified by railroads and shippers as arbitrable, and NGFA, the major carriers and AAR agreed to develop a private arbitration system to handle such disputes. Issues subject to this arbitration system include: 1) application of demurrage terms; 2) misrouting of rail cars; 3) disputes regarding bills of lading; 4) disputes on rail contracts; 5) disputes involving the mishandling of private cars; and 6) disputes involving the lease of property owned by a railroad or affiliate company (including real estate leases). This arbitration system has proven to reduce friction and litigation

between grain and grain product shippers and the carriers. While it does not address either rates or service, it has helped to dispense with some of the other issues.

NGFA is now engaged with the Union Pacific Railroad and the BNSF Railway in a collaborative effort to expedite the clearance of grain trains moving from the U.S. south to Mexico. This rapidly expanding market has been challenging to serve by rail because of the sometimes multi-day delays at the border. We are hopeful that we can get resolution of this problem in the next few months through our efforts in working with the Mexican government.

Looking Ahead

The Surface Transportation Board, as the Interstate Commerce Commission before it, is charged with interpreting the law and Congressional intent. While our industry has some differences with how both the ICC and the STB have interpreted the law, that interpretation has remained rather consistent since 1980, regulating the rail industry in a way that "...enables carriers to earn adequate revenues." No doubt the STB believes it has tried to strike a balance between the need for rail revenue adequacy and implementing reasonable shipper protections (as provided in other provisions of the ICC Termination Act), but from our perspective, the primary emphasis has been on protecting carriers' revenue streams.

The STB appears to have been very successful in doing its part to ensure the financial success of the Class I carriers. As those carriers are now very profitable, and nearing

revenue adequacy as judged by the STB, we submit that a shift in policy and legal interpretations needs to be seriously considered. Railroad performance suggests strongly that railroad assets are being concentrated increasingly on the movement of intermodal freight, coal, or other "hook and haul" traffic such as grain shuttle trains. These may well be the most profitable forms of rail carriage for the railroad industry to handle, but we must ask whether the growing dedication of rail assets to a limited number of rail services threatens to leave many rail customers, including agricultural shippers of tank cars, specialty covered hopper cars, or other non-shuttle movements, without a vision of continued affordable rail service. Although railroads like to view and compare their presumed prerogatives to those of totally unregulated industries, railroads are not like all other industries. Railroads have a protectable, government-issued common carrier franchise essentially immune from the operation of most of the nation's laws, including antitrust laws. Going forward, the Board or Congress will have to decide if the special privileges granted the railroad industry mean that railroads must temper their managerial discretion with considerations other than those aimed at maximizing rail profits at any cost.

To help assess how the rail industry is performing and how it is meeting or not meeting the needs of customers, present and potential, it is essential that the Board exercise its authority to require better and consistent railroad performance data. The importance of establishing rail performance metrics was recognized by the Board in the wake of service failures that followed the mergers of the 1990's. Those metrics are starting to erode. Railroads have changed how they report terminal dwell time, which may or may not be a wise decision, but is one that disrupts any continuity of data. On-time performance records are maintained by carriers, but not published along with other service metrics.

With advancing computer technology, data collection and publication is easier than ever for railroads. The Board should institute a proceeding to establish categories of data that carriers must compile and submit to the Board for public consideration.

One of the principal reasons that we think the NGFA system of rail arbitration has been successful is that both carrier and shipper perceive themselves to be at some risk. Once an arbitration proceeding on a dispute is initiated, both sides have strong incentives to cooperate in negotiating a mutually agreeable solution. Thus, simply having the arbitration system available provides a mechanism that assists in policing market behavior, even when only a very small fraction of total disputes are actually arbitrated. While government-based compulsory arbitration is not something we are prepared to endorse today, if the Congress or the STB could create a dispute resolution mechanism or environment similar to that within the NGFA system, we think the level of friction between carriers and shippers could be reduced considerably, with enhanced market performance.