

NAWG Testimony, Dale Schuler, Grain Hearing 11-02
BEFORE the SURFACE TRANSPORTATION BOARD

Ex Parte No. 665

Rail Transportation of Grain

Written Testimony Submitted by
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National Association of Wheat Growers
on behalf of
National Association of Wheat Growers
California Association of Wheat Growers
Colorado Association of Wheat Growers
Idaho Grain Producers Association
Montana Grain Growers Association
Kansas Association of Wheat Growers
Nebraska Wheat Growers Association
South Dakota Wheat Incorporated
Texas Wheat Producers Association
Washington Association of Wheat Growers

October 30, 2006

In accordance with this Board's Oct. 11, 2006, announcement, Dale Schuler, on behalf of the members of the National Association of Wheat Growers and the previously listed organizations, submits these comments for a public hearing to be held on Nov. 2, 2006, before the Surface Transportation Board.

Wheat growers face many problems with rail rates and service, and helping our members find solutions to rail freight problems remains one of NAWG's top priorities. NAWG, as a member of the Alliance for Rail Competition, works with other captive shippers on a continuing basis to help resolve the needs of all shippers.

This Board has recently taken action on items that are very important to our members, including examining fuel surcharges and paper barriers, and your efforts on these issues are appreciated. Like this Board, the wheat industry believes that a viable railroad industry is necessary for its continued success. Since the passage of the Staggers Rail Act of 1980, however, the degree of captivity in many wheat regions and industry areas has increased dramatically. In addition to instances of both unreliable service and higher rates, we have had, more-or-less, continuing rail equipment shortages since the railroads started aggressively consolidating and merging in the early 1990s, especially during periods of peak demand.

Twenty years ago there were multiple transcontinental railroads servicing the farming regions of the country. Today, whole states, whole regions and now whole industries have become completely captive to single railroads as a result of many railroad mergers. In the wheat industry

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alone there are substantial pockets of captivity in Arizona, Colorado, Idaho, Kansas, Minnesota, Montana, Nebraska, North Carolina, North Dakota, Maryland, Oregon, Oklahoma, South Dakota, Texas, Virginia, Wyoming and Washington. These states make up the majority of the wheat producing land in this country.

Because of these pockets of captivity, the cost of transporting wheat can represent as much as 1/3 of the overall price a producer receives for his grain. These costs come directly from a producer's bottom line. Grain producers, unlike other businesses, cannot pass their costs on; as price takers and not price makers, producers bear all transportation costs both to and from the farm and from the elevator to the processor or export terminal.

Rail rates in Montana and North Dakota are between 250 to 450 or more percent of variable cost

- far above the Surface Transportation Board's "threshold of rate reasonableness," which is currently 180 percent. In fact, the recently released GAO report on this issue notes, "Four economic areas located in Montana, New Mexico, North Dakota and West Virginia have had the largest increase in traffic traveling at rates of over 300 percent R/VC, with an increase of more than 25 percent from 1985 through 2004."¹ Though these are among the highest freight rates in the nation, grain rail rates in excess of 250 percent more than variable cost can be found in virtually all of the states that have captivity issues. The GAO report mirrors these observations repeatedly and states "...some areas with access to one Class I railroad have higher percentages of traffic traveling at rates that exceed the statutory threshold for relief."² The report goes on to state, "This situation may reflect reasonable economic practices by the railroads in an environment of excess demand, or it may represent an abuse of market power."³

Differential pricing theory, which this Board has subscribed to for many years, is based upon the concept that when a rail market is characterized by excess capacity and non-revenue adequacy, the railroads should be allowed to make up revenues in areas that lack competition for those revenues that cannot be recovered in competitive areas. However, in today's market, where the nation is faced with inadequate rail capacity and railroads making record profits - nearing revenue adequacy, with one railroad achieving it - a differential pricing policy rapidly moves from a revenue practice to a potential abuse of market power where revenue levels are based upon the degree of captivity of rail shippers, as the GAO report identifies. This

Board should be concerned that record profits are coming at the expense of those areas of the country that are paying rates of 250 to 450 percent of variable costs, and that the differential pricing has clearly moved from a rate practice acceptable to the Board to a pricing mechanism that now is allowing for pricing abuse.

The GAO report's Figure 12, found on page 26, shows large areas of the wheat producing parts of Arizona, Arkansas, Idaho, Missouri, Montana, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Texas and Virginia that have only a single railroad serving crop growing

1 Government Accountability Office Report to Congressional Requesters, Freight Railroads, Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed, GA007-94, October 2006, page 32.

2 Ibid, page 9.

3 Ibid, page 9.

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areas. Many of these same areas show more than 75 percent of their industry tonnage originating on a single railroad. One of the most alarming figures in the GAO report is Figure 20, found on page 37, where the GAO overlays the areas with access to a single railroad and the percentage of tonnage moving at more than the threshold level of 180 percent of revenue to variable costs. Vast areas of the wheat producing states show more than 50 percent of their tonnage moving under rates in excess of 180 percent of revenue to variable cost - including Arizona, Arkansas, Montana, Idaho, Kansas, Minnesota, Nebraska, New Mexico, North Carolina, North Dakota, Oregon, Pennsylvania, South Dakota, Virginia and Wisconsin. Our research shows that if one looks at wheat shipments only, the percentage of wheat tonnage moving in excess of 180 percent of revenue to variable costs is even higher in all of these states and Colorado and Washington - virtually the entire wheat growing region of the United States.

Wheat producers know that increasing the diversity of crop production on farms can lead to greater efficiency and higher income, but the railroad industry does not have the same goal. The rail industry increasingly sees their preferred business model as moving larger and larger movements of a single grade crop from a single origin to a single destination with rail companies shifting the transportation cost to the grain merchandiser and producers while the service level for less-than-trainload movements continues to deteriorate. We see value-added agriculture having to invest in rail rolling stock to ensure adequate equipment supply, yet when railroad

service levels do not meet railroad-supplied schedules, agriculture is being called upon to continually increase investment in railroad rolling stock.

In addition, non-shuttle rail service in many areas has continued to deteriorate. Captive shippers continue to suffer car and service disruption. Our experience shows that those areas that are captive and paying the excessively high freight rates are also experiencing some of the worst service. Shippers that order rail cars well in advance are still experiencing delays of three to four weeks after promised delivery dates. This can and does cause major problems during and after harvest - all of which contributes to lower prices for wheat producers.

The high rates and poor service I have just described continue to be especially frustrating for producers in my region who need only look across the northern border to see a much more effective system. Canadian freight rates on wheat westbound - right across the border - are 25 percent lower than the rail rates we pay in Montana. We grow some of the highest quality wheat the in world, yet we are being rendered residual suppliers against our Canadian counterparts and find ourselves at a significant competitive disadvantage in both domestic and foreign markets because of these shipping issues.

While both the Staggers Rail Act and the ICC Termination Act promoted reliance on competition to protect shippers from unreasonable rates and unreasonable rate practices, captive shippers in many areas have yet to see this. And, while this Board has been given the authority to resolve disputes between captive shippers and railroads, and has previously established rate relief processes, those processes themselves are expensive and complex and continue to be out of reach for grain shippers large and small.

We are aware this Board has recently released new guidelines for small rate cases, and we appreciate these efforts. However, as we stated in the recently filed Opening Comments with

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ACC et al, Supplemental Opening Comments with National Grain Feed Dealers, et al and Supplemental Opening Comments with Wheat & Barley Commission in Ex Parte 661 Sub No. 1, the new guidelines as proposed do not appear to lead to the development of reasonable, simple or expedited rules. NAWG concurs with comments filed by the Alliance for Rail Competition and the Wheat and Barley Commissions in this proceeding. We are hopeful that this Board will seriously consider the comments made in the combined shipper filings and substantially modify

the proposed rules. Otherwise, wheat producers will continue to be denied effective, simplified and economical rate relief from this Board.

we believe that this Board could be taking more steps to enhance competition in the rail industry and agree with the GAO report that stated, "While STB continues to refine its practices, an assessment of competitive markets would provide further information about the extent of captivity among shippers and the merits of a range of proposed actions to enhance competitive options available to shippers. In addition changes to the rate relief process could provide greater protection from unreasonable rates."⁴

wheat growers believe that the railroad industry can survive and prosper in a competitive environment and, indeed, we know from history that competition breeds innovation and efficiency. However, in light of the horrific situation wheat growers are facing with major railroads unable to meet common carrier obligations, we believe it is time that public policy in this area be reexamined.

We look forward to working with this Board on these issues.

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⁴ Ibid, page 38.

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