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**BEFORE THE
SURFACE TRANSPORTATION BOARD**

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RAIL TRANSPORTATION OF GRAIN

**VERIFIED STATEMENT OF JUDY HARROWER
OF CANADIAN PACIFIC RAILWAY COMPANY**

My name is Judy Harrower. I am Vice President, Marketing and Sales - Bulk, for Canadian Pacific Railway Company ("CPR"). My business address is 401 9th Avenue, S.W., Calgary, Alberta T2P 4Z4 Canada. In my current position, I have overall responsibility for managing CPR's marketing and sales efforts in connection with grain, fertilizer, coal, sulphur and other bulk commodities. Prior to assuming that position, I held a variety of positions in marketing, operations and customer service with CPR. I have been employed continuously by CPR since 1986, except for a period during 1995 when I worked in the Marketing Department at the Southern Pacific Railroad Company.

The purpose of this Verified Statement is to respond to the Board's request for views and information regarding certain issues related to the rail transportation of grain. Part I of my testimony addresses the report recently issued by the General Accounting Office ("GAO") in which GAO concluded that, while most rail rates declined between 1985 and 2004, rates for grain traffic appear to have increased during that period. As my testimony demonstrates, the trend in rail rates for grain traffic suggested by GAO does not comport with recent market conditions. In Part II, I describe various changes that have occurred over the past decade in grain production and shipment patterns in the territory served by CPR's U.S. lines. As Part II shows,

CPR responded to the sharp increase in demand for transportation of corn and soybeans from North Dakota origins to Pacific Northwest ports by developing improved interline rail services for such shipments. CPR made (and is continuing to make) substantial investments in infrastructure and equipment to enable it to meet the changing needs of our U.S. grain customers. Part III of my testimony responds to the Board's request for information regarding differences in regulations applicable to the Canadian and United States wheat markets.

I. THE GAO REPORT

On October 6, 2006, the GAO issued a report titled "*Freight Railroads: Industry Health Has Improved, But Concerns About Competition and Capacity Should Be Addressed*" ("GAO Report"). In the Report, GAO found that "[b]etween 1985 and 2000, rail rates generally declined, but then increased slightly from 2001 through 2004." GAO Report at 3. However, GAO observed that "rates have not declined uniformly, and some commodities are paying significantly higher rates than others." *Id.* at 9. In particular, GAO estimated that rail rates for grain increased by 9 percent during the study period. *Id.* at 9. More generally, GAO found that while "the extent of captivity [among rail shippers] appears to be dropping . . . the percentage of industry traffic traveling at rates substantially over the statutory threshold for rate relief has increased." GAO Report at 3. According to GAO, "[t]hese findings may reflect reasonable economic practices by the railroads in an environment of excess demand, or they may indicate a possible abuse of market power." *Id.* at 3.

In its response to the GAO Report, the Board correctly observed that the 9 percent increase in grain rates suggested by GAO is a nominal increase that does not take account of inflation. GAO Report, App. III at 79-80. The Report itself shows that, while rail rates for grain may not have fallen as much as those for certain other commodities studied by GAO, changes in grain rates lagged inflation (as measured by the GDP Price Index) throughout the 1985-2004

study period. See GAO Report at 14, Figure 4. Moreover, as GAO acknowledged, railroad revenue data are not always captured accurately and consistently in the STB Carload Waybill Sample. GAO Report at 65. In particular, the Waybill Sample may not fully account for rebates and other end-of-year adjustments provided for under rail transportation contracts. Such adjustments, which can significantly reduce the effective rates paid by shippers for rail service, are common in connection with U.S. grain shipments. The majority of the U.S. grain traffic handled by CPR in 2005 was subject to some form of efficiency incentive that reduced the customer's effective rate below the base tariff rate. To the extent that such reductions are not fully captured in the data upon which GAO relied, even the nominal increase in grain rates posited by GAO would be overstated. In any event, GAO's current observations regarding the trend in rail rates for grain shipments appear to be inconsistent with the conclusions reached by GAO in several previous studies.¹

The overall impression left by the GAO Report – i.e., that rail rates for grain are rising to a greater degree than rates for other commodities – is not consistent with current market reality. Over the past two years, the tariff rates for most CPR U.S. wheat shipments have declined. For example, both the single-car and multiple-car tariff rates for wheat from Minot, ND (located near the western end of CPR's U.S. grain network) to Minneapolis (a "hub" location from which grain moves to Midwestern and Eastern end users or to the Gulf of Mexico for export) have fallen by 18 percent. CPR's Minot-Minneapolis wheat rates are lower today than they were in 2000. CPR's tariff rates for wheat shipments from other key origins such as Enderlin and Devils Lake, ND to destinations such as Minneapolis, the Great Lakes ports and the Pacific Northwest

¹ See, e.g., *Railroad Regulation: Changes in Freight Railroad Rates From 1997 Through 2000*, (GAO, June 7, 2002); *Railroad Regulation: Current Issues Associated with the Rate Relief Process*, (GAO, April 29, 1999).

have likewise declined over the past several years. CPR's U.S. tariff rates for eastbound shipments of corn and soybeans have remained relatively flat during this time. Recent increases in CPR's tariff rates on westbound corn and soybean shipments are attributable to the dramatic growth in demand for transportation of those commodities to Pacific Northwest ports, and to investments in capacity expansion projects (described in Part II below) that were required to meet that demand. Furthermore, discounts from single-car tariff rates have increased over the past several years, as more U.S. grain shippers have taken advantage of incentives offered by CPR on its shuttle train services.

Overall, the revenues earned by CPR for grain shipments in 2005 averaged approximately \$.0289 CDN (or \$.0238 US, based upon the average 2005 exchange rate) per revenue ton mile. In other words, CPR transported a ton of grain for the typical customer for about 2 ½ cents per loaded mile. (This includes the cost of the return movement of the empty rail car.) By comparison, the estimated cost to transport grain by truck from farm to local elevator is 10-12 cents per ton mile, and the typical cost of grain elevation and handling at a local elevator is approximately \$4.00 per ton. The cost of line haul rail transportation is clearly not excessive when considered in the context of other costs farmers incur in producing their crops.

Moreover, data compiled by the U.S. Department of Agriculture ("USDA") indicate that the prices paid by U.S. farmers for other production inputs have increased substantially. USDA reports that, between 1992 and 2005, the cost of seed increased by 68%, the cost of fertilizer rose by 62%, and farm machinery costs rose 71%. During the same period, farm wages increased by 65% and the cost of fuel increased by 224%.² As these data show, increases in other agricultural

² See *2006 Agricultural Statistics*, USDA, National Agricultural Statistics Service
<www.nass.usda.gov/Publications/Ag_Statistics/index.asp>

production costs have far outstripped any increase in the cost of rail transportation over the past decade.

CPR's U.S. grain rates are constrained by a variety of competitive forces. All grain shipments begin in a truck, and many farmers have a choice regarding the elevator to which they deliver their grain. BNSF operates rail lines that parallel most of CPR's network serving the grain-producing areas of North Dakota and Minnesota. According to the North Dakota Public Service Commission, the typical truck movement from farm to elevator in that state is 10-20 miles.³ Approximately 2/3 of all North Dakota grain elevators served by CPR are located 20 miles or less from a BNSF-served elevator. The availability of competing rail service from nearby BNSF-served elevators must be considered by CPR in establishing its grain transportation rates. Rail rates on grain shipments to the Gulf of Mexico are influenced by the availability of barge transportation from the Twin Cities. Rates on shipments from origins in eastern North Dakota and Minnesota to Great Lakes terminals are constrained by truck competition as well. Moreover, grain originating on CPR's lines must compete in end markets with grain originating in neighboring states (such as Montana), Canada and abroad. While the Board has chosen not to consider "product" and "geographic" competition in deciding rail rate cases (in order to reduce the time and cost of such proceedings), such competition is a significant factor in the real world grain transportation marketplace.

II. CPR'S RESPONSE TO CHANGES IN NORTH DAKOTA GRAIN PRODUCTION AND TRANSPORTATION REQUIREMENTS

Grain production patterns in the territory served by CPR's North Dakota lines have experienced significant change over the past decade. Since 1996, wheat plantings in the state

³ See Ex Parte No. 646, *Simplified Standards for Rail Rate Cases*, Comments of North Dakota Public Service Commission, et al., filed October 24, 2006 at 4.

have declined by 31%, from 12.7 million acres to 8.8 million acres, and barley plantings have declined by 58%, from 2.6 million acres to 1.1 million acres. During the same period, corn plantings grew by 133%, from 750,000 acres to 1.8 million acres, and soybean plantings increased by 347%, from 850,000 acres to 3.8 million acres.

This dramatic increase in corn and soybean production is attributable to several factors. Changes in U.S. agricultural regulations have afforded farmers greater economic freedom to plant crops in response to market conditions. Improvements in agricultural technology and climate changes resulting in generally warmer and wetter weather have made North Dakota more conducive to corn and soybean production. Strong Asian demand for U.S. corn and soybeans and the growth in biofuel production have also created incentives for farmers to produce those commodities. *The growth in the export market triggered a corresponding increase in demand for rail transportation of grain from North Dakota origins to Pacific Northwest ports.* During the last six years alone, shipments of grain from North Dakota farms to the Pacific Northwest have nearly tripled, from 41 million bushels in 1999 to 122 million bushels in 2005.

CPR responded to this shift in production – and, in particular, to the sharp increase in demand for transportation of corn and soybeans to Pacific Northwest ports – by developing improved interline rail services (in conjunction with UP) for North Dakota grain shipments to the Pacific Northwest. Export grain traffic moves from CPR-served elevators to the US–Canada border at Portal, ND, then via CPR’s Canadian lines to Kingsgate, BC/Eastport, ID, where it is interchanged with UP for delivery to Pacific Northwest grain terminals. Previously, most CPR grain traffic destined to the Pacific Northwest was interchanged with BNSF at Minot, ND.

To support this routing option, CPR has invested approximately \$40 million over the past two years in its line between Dunmore, Alberta and Kingsgate. CPR also expanded its yard and

track facilities at Portal and Kingsgate, increasing capacity at those border gateways by 30% and 50%, respectively. CPR purchased locomotives to support additional shuttle train services between North Dakota and the Pacific Northwest. CPR has also invested heavily to assist its shortline connections serving North Dakota (the Dakota, Missouri Valley & Western Railroad and Northern Plains Railroad, Inc.) in upgrading their grain gathering lines, and to help CPR-served elevators increase their capacity to take advantage of CPR's more efficient trainload service offerings.

The results of these initiatives have been impressive. CPR's grain traffic from North Dakota origins to the Pacific Northwest has increased from 23.1 million bushels in 2002 (at the inception of the new CPR-UP service offering) to 51.6 million bushels in 2005. During the same period, overall exports of North Dakota grain via the Pacific Northwest grew from 75.5 million bushels to more than 122 million bushels. As these figures demonstrate, the improved interline routing option introduced by CPR and UP in 2002-2003 has been very well received in the marketplace, and has helped North Dakota farmers to expand substantially their participation in export grain markets. Viewed in the context of that growth, the substantial investments that CPR has made (and is continuing to make) to expand its capacity to handle North Dakota grain and the recent upward adjustment in CPR's tariff rates for westbound corn and soybean shipments both represent appropriate market-based responses to the changing transportation requirements of North Dakota agricultural shippers.

III. CANADIAN REGULATION OF WHEAT PRODUCTION AND TRANSPORTATION

The Board has asked parties to address "the interplay between the American and Canadian wheat markets, how the Canadian regulatory system differs from the American system, and what impact those differences might have on grain production in the United States."

Decision served October 11, 2006 at 2. These issues have been debated frequently before the U.S. International Trade Commission ("USITC"), the World Trade Organization ("WTO") and other bodies charged with jurisdiction over trade matters. For example, in April 2004, a WTO panel dismissed claims by the United States that the single-desk marketing system employed by the Canadian Wheat Board violated GATT Article XVII. In June 2005, a panel convened pursuant to NAFTA held that tariffs imposed by the United States in 2003 on Canadian wheat and durum entering the United States were not justified. The United States repealed those tariffs in February 2006. Thus, the differences between U.S. and Canadian grain regulations and their potential effects on U.S. wheat producers are essentially "trade" rather than "transportation" issues.

CPR has not been a party to those trade disputes, and takes no position on the merits of the claims raised by the participants in those proceedings. Nevertheless, for the Board's information, following is a brief description of three principle aspects of the Canadian system of regulating the production and sale of wheat that differ from practices applicable in the United States:

First, all sales of wheat, durum and barley produced in Western Canada are controlled by the Canadian Wheat Board ("CWB"). The CWB is a marketing organization that represents the interests of approximately 85,000 grain farmers in Western Canada. The CWB is responsible for average annual sales of 20 million tons of wheat, durum and barley with an approximate value of \$4-6 billion (CDN). The CWB does not have jurisdiction over grain grown in Eastern Canada, or grain and grain products other than wheat, durum and barley.

The CWB operates a "single-desk" marketing system for Western Canadian wheat, durum and barley exports. Farmers are compensated for their crops on the basis of "pooled"

pricing – i.e., each participating farmer receives the same price regardless of the time at which that farmer's grain was sold or the destination market to which it was shipped. By contrast, the price earned by each U.S. farmer can be affected by the timing and destination market for the sale of that farmer's crop.

Second, the rates charged by CPR and CN for certain grain shipments are subject to a "revenue cap" imposed by Canadian law. Specifically, most grain and grain products that (1) originate west of Thunder Bay, ONT and (2) move to Vancouver, Prince Rupert or Thunder Bay for export, or to a point east of Thunder Bay for export or domestic consumption, are subject to the revenue cap. The Canada Transportation Agency ("CTA") establishes separate revenue caps for CPR and CN annually, based upon a formula that takes into account, among other things, each carrier's volume and average length of haul on covered grain traffic, as well as increases in certain volume-related costs (as determined by the CTA). CPR and CN are permitted to set rates for individual grain shippers, origins and destinations in accordance with market demand, subject to the requirement that their overall revenues from grain movements to covered export points do not exceed their respective revenue cap for that year.⁴ Rail shipments of Canadian grain to the United States and Mexico are not subject to the revenue cap.

Third, and finally, the majority of the hopper car fleet used to provide rail service to Canadian grain shippers is owned by the Canadian Government. Those cars are made available to CPR and CN for use in handling Canadian export grain traffic, and their cost is taken into account by the CTA in establishing each carrier's annual revenue cap. In the past, the Canadian

⁴ If CPR's revenues on covered grain shipments exceed the cap established by the CTA, CPR must pay a penalty to the Grain Research Foundation.

Government also provided funding to support the maintenance of branch lines used to serve grain shippers.

IV. CONCLUSION

GAO'S finding that rail rates for grain are rising to a greater degree than rates for other commodities is not consistent with current market conditions. The tariff rates for most CPR U.S. wheat shipments have declined in recent years, while tariff rates for eastbound shipments of corn and soybeans have remained relatively flat. CPR has increased tariff rates on westbound corn and soybean shipments in response to the sharp growth in demand for transportation of those commodities to Pacific Northwest ports, and the need to make substantial investments in new capacity to meet that demand. The CPR-UP interline rail service for North Dakota grain shipments to the Pacific Northwest has helped North Dakota farmers to take advantage of opportunities presented by growing export grain markets.

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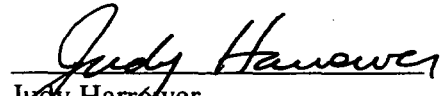
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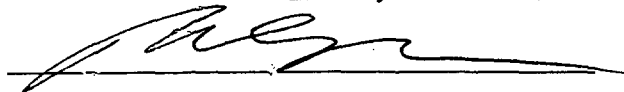
VERIFICATION OF JUDY HARROWER

I declare under the penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this testimony on behalf of Canadian Pacific Railway Company.

Executed on this 27th day of October, 2006.


Judy Harrower

Sworn before me this 27th day of October, 2006.



MARC SHANNON
Barrister & Solicitor
Notary Public
in and for the Province of Alberta