

TO THE SURFACE TRANSPORTATION BOARD
COMMENTS OF
NORTH DAKOTA GRAIN DEALERS ASSOCIATION
EX PARTE 665 -- RAIL TRANSPORTATION OF GRAIN

In response to STB announcement dated October 11, 2006
Comment deadline October 30, 2006

The North Dakota Grain Dealers Association (NDGDA) commends the Surface Transportation Board for looking into this matter, related to the Government Accountability Office's report titled "Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed", GAO-07-94.

Identity

NDGDA is a 95-year-old nonpolitical voluntary membership trade association representing the interests of the 400+ country grain elevators in North Dakota. Approximately 90 percent of those grain elevators are NDGDA members and the governing Board consists of managers of 10 companies operating 24 of those elevators. Approximately 85% of North Dakota grain elevators are located on a rail line. Many of the others truck at least a portion of their grain volume to elevators on rail.

Hearing topics interwoven

In its October 11 announcement the Board said this hearing would serve as a forum for parties to provide views about the GAO's observations and also about grain transportation markets in general. Railroad competition, capacity, rates and service are interwoven factors and outcomes in transportation markets. Lack of effective competition and limitations on capacity allow railroads to raise rates beyond what could be done in a truly competitive environment with adequate capacity. Service can also suffer when railroads need not aggressively pursue the business. Both the lack of effective competition and capacity limitations are affecting grain transportation in North Dakota and around the nation. These comments will focus much on the service aspect in this region's transportation market.

Scattered Captive Shippers Vulnerable

Shippers of agricultural products are tied to the land, widely dispersed in what urbanites might consider to be remote areas. These shippers are not clustered in metropolitan or heavily industrialized areas that typically have greater rail-to-rail competition. Less competition gives railroads greater pricing freedom on agricultural products. That is confirmed by GAO findings that economic areas in North Dakota and Montana were among those experiencing the greatest increase in traffic traveling at greater than 300 percent R/VC (Revenue to Variable Cost Ratio). (Page 33 of GAO-07-94) In contrast, north of the border in Canada the Canadian Transportation Agency enforces a Railway Revenue Cap on certain grain movements.

GAO reports the number of captive shippers has declined, while the severity of their captivity has increased. This is a situation ripe for abuse. At the same time the number of rail carriers has declined dramatically, giving those that remain increasing economic power over shippers, industries, and geographic regions. Since 1995 we have seen the Burlington Northern merge with the Santa Fe, the Union Pacific merge with the Southern Pacific, and Conrail being divided up between Norfolk Southern and CSX. The Canadian Pacific, Canadian National and Kansas City Southern are also Class I carriers, but much smaller than the big four of UP, BNSF, CSX and NS. BNSF is dominant west of the Mississippi River north of the nation's midsection. This includes North Dakota. This domination, also known as lack of effective competition, has set the stage for a restructuring of the grain marketing system at the local level to conform to the BNSF's wishes. This is also the case with the UP and CP. We can't comment on eastern carriers.

The railroad wants larger and larger trains from fewer and fewer locations. Farmers and the grain industry have been forced to respond by spending millions of dollars on new facilities. Had there been effective competition this might not have happened to the extent it has. Even the large train shippers have service disruptions. Service for smaller shipment sizes, whether for large or small shippers, has become less of a priority for railroads operating in this state.

Car Supply, Distribution and Control

Railroad management of its car supply is also one-sided. The last couple years are good examples. In 2005 the railcar market was tight and railroads reaped substantial premiums over the tariff rate in their car auction programs. (It should be noted that some of the windfall went to resellers of freight instead of to the railroad.) In early 2006 shippers tried to get ahead of the

curve by purchasing summer and fall freight early, some at substantial premiums. The BNSF decided to hold a mega auction in late June and early July for the remainder of 2006 certificate of transportation freight. Shippers paid premiums. Then as the year went on and harvest prospects weren't what they had been a year prior, and there were no hurricanes to disrupt service, car values declined. Many of the shippers who had paid premiums now had to dump their freight on the secondary market at discounts. This illustrates the transfer of risk that has been made from railroad to shipper, in both tight and soft markets. The lack of effective competition permits more of this. In a competitive market, service providers would have to be more considerate of their customers or risk losing business. When your customer is captive, your service is essential, and your capacity is constrained, there is ample opportunity to take advantage.

The following two paragraphs are how the 2005 situation was described in an August 18 letter to BNSF President Matt Rose and Ag Products Vice President Kevin Kaufman, signed by the North Dakota Governor, Public Service Commission, Ag Commissioner, and eleven agricultural groups in this state:

"BNSF has almost completely shut down the ability to order grain railcars for the majority of shippers in our state. This has led to sharply higher costs to obtain what few railcars are available and is limiting North Dakota's ability to compete for market demand. You've cut the tariff lottery from 4860 cars in August 2004, to only 600 in August 2005, and none for September 2005. Where are the 11,000 cars that you moved from the Certificate of Transportation (COT) railcar ordering program to the tariff lottery in May 2004? Now, both COT and tariff ordering are shutdown for the busy harvest period. We call on you to immediately put adequate railcars back into nearby and future COT and tariff ordering programs and then commit sufficient locomotive, personnel and other resources to provide decent reliable service."

"Bidding for the few cars BNSF is making available for deferred positions has been frantic. On August 4 there were 858 bids for the 75 October single car COTs and 668 bids for 45 November singles. The

winning bids have required premiums of \$400 or more per car over the tariff rate. In nearby positions, some premiums hit the sky-high level of \$800 over tariff in the shipper-to-shipper secondary market! This is more than 25 percent over the normal tariff rate in many instances. This lowers the market return for North Dakota farmers and directly robs our state of revenue. Besides cost, the shutdown of car ordering programs threatens the competitive ability of North Dakota-grown products to meet domestic and international customer demand. In some cases, it may preclude shippers from participating in the market whatsoever. On the other hand, BNSF reaps more and more profit as its desperate shippers bid up and up to get railcars. This is not a market; it is a monopoly."

Unfortunately the last couple years aren't the only examples. In the fall of 2003 rail service deteriorated to the point where the North Dakota Governor and Public Service Commission Chairman twice led a delegation of North Dakotans to Washington, DC to meet with STB Chairman Nober and then with Nober and top BNSF officials, including its president and vice presidents for operations and agricultural products. During that winter of 2003-04 the BNSF ran up to eight weeks behind. Much of this was on freight that had been booked several months in advance, through programs the railroad said gave them advance notice of market demand and where their equipment would be needed. It had to pay late penalties on some of its certificate of transportation (COT) freight. But shippers want cars, not penalties; more explanation on that below. Following this disastrous winter, through a website announcement on February 25, 2004 BNSF told customers to order railcars early for the fall 2004 harvest. But only nine weeks later, in early May 2004, BNSF switched again, announcing a shift of a major portion of its fleet from the COT program that could be ordered early to its tariff lottery in which shippers put their names in the hat for cars in the following month. At the same time BNSF cut its COT late penalty in half while simultaneously doubling the penalty on shippers for canceling a tariff order. These are the kinds of things shippers put up with. Most shippers are scared to complain and/or think it won't do any good anyway.

Shippers want cars, not penalties. They have sales on and delivery commitments to make. They don't want to pay late delivery penalties to the grain buyer or have to buy out of

delivery contracts. This situation is similar to a businessman ordering a cab well in advance of the time needed to catch an airline flight. The cab is so late that the man misses his flight. He forfeits his airfare and misses the business deal he was to make at the other end. It is little consolation to him that the cabbie hands him \$20 late penalty.

The car auction programs of railroads have positives and negatives. One of the negatives is third parties, not actual railroads or shippers, capturing control of a significant portion of car supply. This happens through purchase or assignment. Then the shipper must go to these third parties for freight. This interrupts the direct link of price being a market signal to the railroad that more equipment is needed. In some instances those with control of freight are both a reseller of that freight and a competitor to those who purchasing the freight from them. This is a situation with its own anticompetitive implications.

Customer Relations and Requirements

A lack of effective competition allows railroads to take a one-sided approach to other requirements of customers. Shippers are penalized for not loading cars in the prescribed amount of time. Penalties accumulate by the day or by the hour. But if the railroad is late getting there or late pulling the load, the shipper is to grin and bear it. For shuttle trains the shipper gets his crew lined up to load on the basis of an ETA (estimated time of arrival) given by the railroad. When the train is late the crew waits and waits and waits. Their wages continue to accumulate. Sometimes they are sent home and told to come back six or eight or 12 hours later. There are instances where the train comes a full day later than the original ETA. After the train is loaded it sometimes sits for many hours and even days before being pulled to market. Turns out the shipper's rush was not necessary.

This also becomes a serious safety issue when tired crews who have been on the clock, then off, and then on again have to load quickly for the railroad's convenience. This is even worse here in the northern latitudes with few daylight hours in winter, and with the cold, ice, wind, snow, etc. But that is the railroad's way and so customers must dance to their tune.

Quality employees command reasonable working conditions. They are obligated to themselves and their families for a quality of life. When the railroads force erratic hours and dangerous conditions on their customers, those customers will loose to other employers one of the most valuable resources they have – their employees.

This is not to say that customer relations are always negative. It should be noted that progress was made with BNSF Railway on fuel surcharges. Thus far it is the only railroad to convert from a rate-based surcharge to one partially based on mileage. CP Rail has had one or two people stationed in this trade area for sometime and a couple years ago BNSF began and has since expanded its ombudsman position. These kinds of direct customer contacts are helpful.

Leases and Track Agreements

Shippers must deal with site lease and track agreement terms heavily tilted in the railroad's favor. The liability aspect is particularly troubling. If something bad happens, even if it is the railroad's fault, the lessee or track agreement signer will most likely be held liable. Insurance to cover the risks is very expensive, and in some cases cannot be obtained at all. When a bill was introduced into the North Dakota legislature in 2003 to force negligent parties to accept their liability, one major railroad told its lessees they might have to destroy their improvements and get off the railroad property. The legislation was severely diluted and even then the railroads still resisted. Lease rates and pricing on site sales are often way out of line when compared to the local market. The shipper is captive to paying what the railroad property management company requires.

There have been a couple positive breakthroughs on BNSF leases just recently, and within the past couple years Canadian Pacific responded to customer outcry by backing away from its plan to have shippers pay the cost of mainline switches to their facilities.

Railroads seek Tax Breaks but resist Oversight

S. 3742, The Railroad Investment Tax Credit Act, has been introduced in Congress. It gives railroads tax incentives to increase capacity. Increasing capacity is necessary, but whether taxpayers should help with that is questionable. For the most part, railroads have been announcing record earnings quarter after quarter and year after year. At a hearing of the Senate Surface Transportation Subcommittee this past June the Government Accountability Office expressed its concern that any new investment brought on by tax breaks not be investments that would have been made anyway.

Meanwhile the shipper-friendly S.919, The Railroad Competition Act of 2005, has also been introduced. Similar legislation has been introduced in previous Congresses. Its modest oversight reforms are intensely opposed by the railroad industry.

It is the position of the North Dakota Grain Dealers Association that if the railroads are to receive tax incentives they should also willingly agree to some strengthening of oversight and standards of service for customers, especially captive customers who have no alternative means of transportation.

STB Should be Pro-active

The Board should be aware of these matters and use its authority and influence to bring about decent service and a balancing of interests between railroads and their customers. The present situation in this industry in this region is out of balance. Shippers are often reluctant to complain, for fear of railroad retaliation. The function of STB to foster a financially healthy rail system in the United States has succeeded. An unplanned consequence of that is so few railroads with such great economic power over their customers. We will take the opportunity of this proceeding on Rail Transportation of Grain to urge the Board to shift its focus to another aspect of Rail Transportation Policy in Title 49, Part A, Chapter 101, Sec. 10101, that being “(12) to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination.”

We’re glad to see the STB take up these matters, after a long dry spell of attention to shipper concerns. It is unfortunate that the comment deadline in this proceeding was scheduled in the same month as that for Ex Parte 661 Railroad Fuel Surcharges and virtually on the heels of the October 24 comment deadline in Ex Parte 646 Standards for Rail Rate Cases. More time between these would have allowed participants to give the STB better information.

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