Concerns Regarding Freight Rail Transportation and Regulation

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Staggers Act Benefitted All Parties

- Average real rail rates decreased 43.2% between 1985 and 2004.
- Grain handling efficiencies increased with unit trains.
- Railroad-Shipper contracts were allowed.
- Railroads were allowed to innovate.
- Railroad productivity increased.
- Railroad profits increased.

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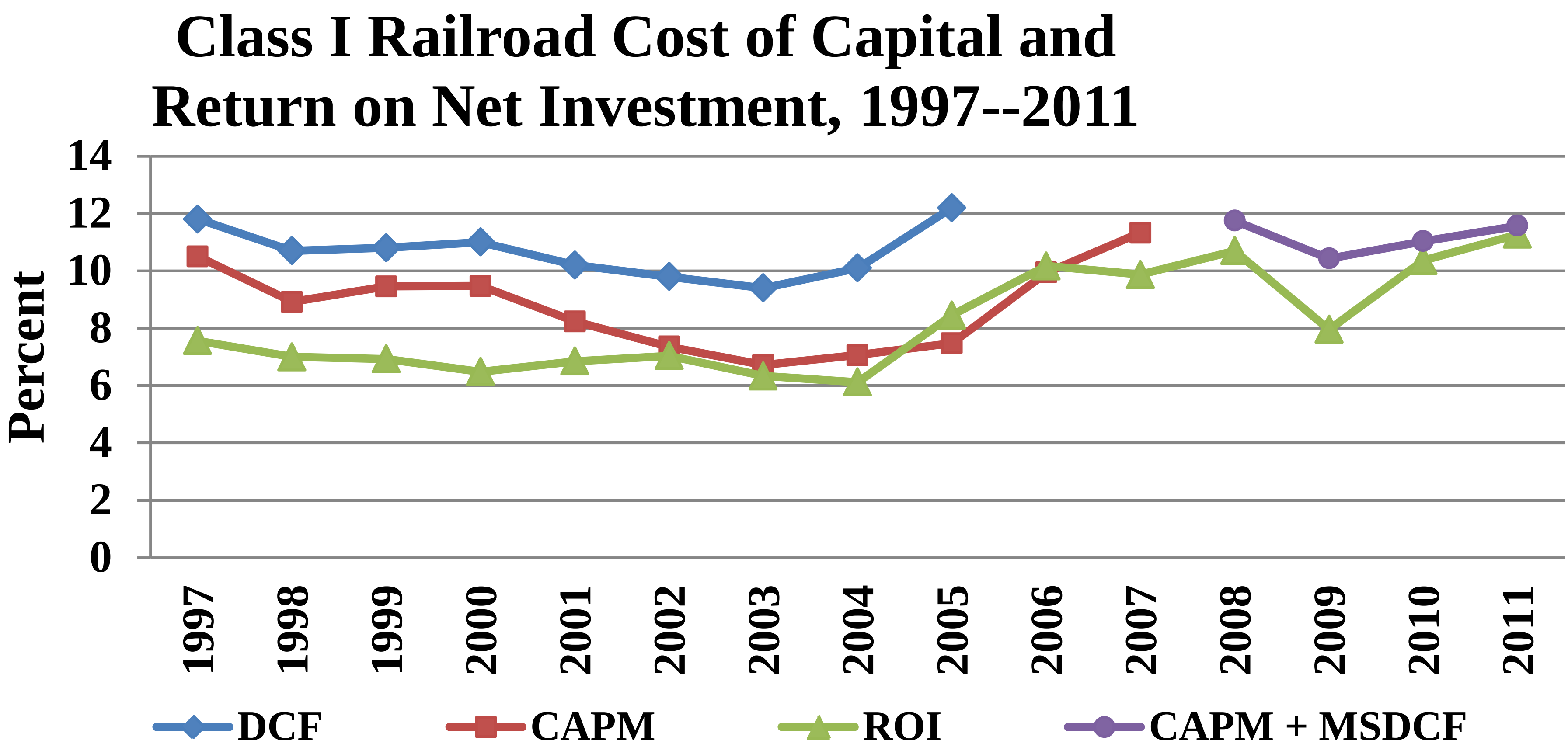
Railroad Industry is Now Close to Revenue Adequacy



Sources: AAR, Railroad Facts; Surface Transportation Board

Increased Rail Concentration

- Competition helps to maintain affordable transportation options and constrain the market power of individual railroads.
- The rapid consolidation of railroads has resulted in a decrease in the unrestricted interchange of traffic, routing choices, and the level of competition among railroads.

Increased Rail Concentration (cont'd)

- The U.S. is served by only 7 Class I railroads.
- Almost 75% of agricultural areas lost rail competition from 1992 to 2007.
- The areas in which only a single Class 1 railroad transported grain and oilseeds increased from 10% to 15%.
- The revenue-to-variable-cost ratio increased in 83% of these areas.

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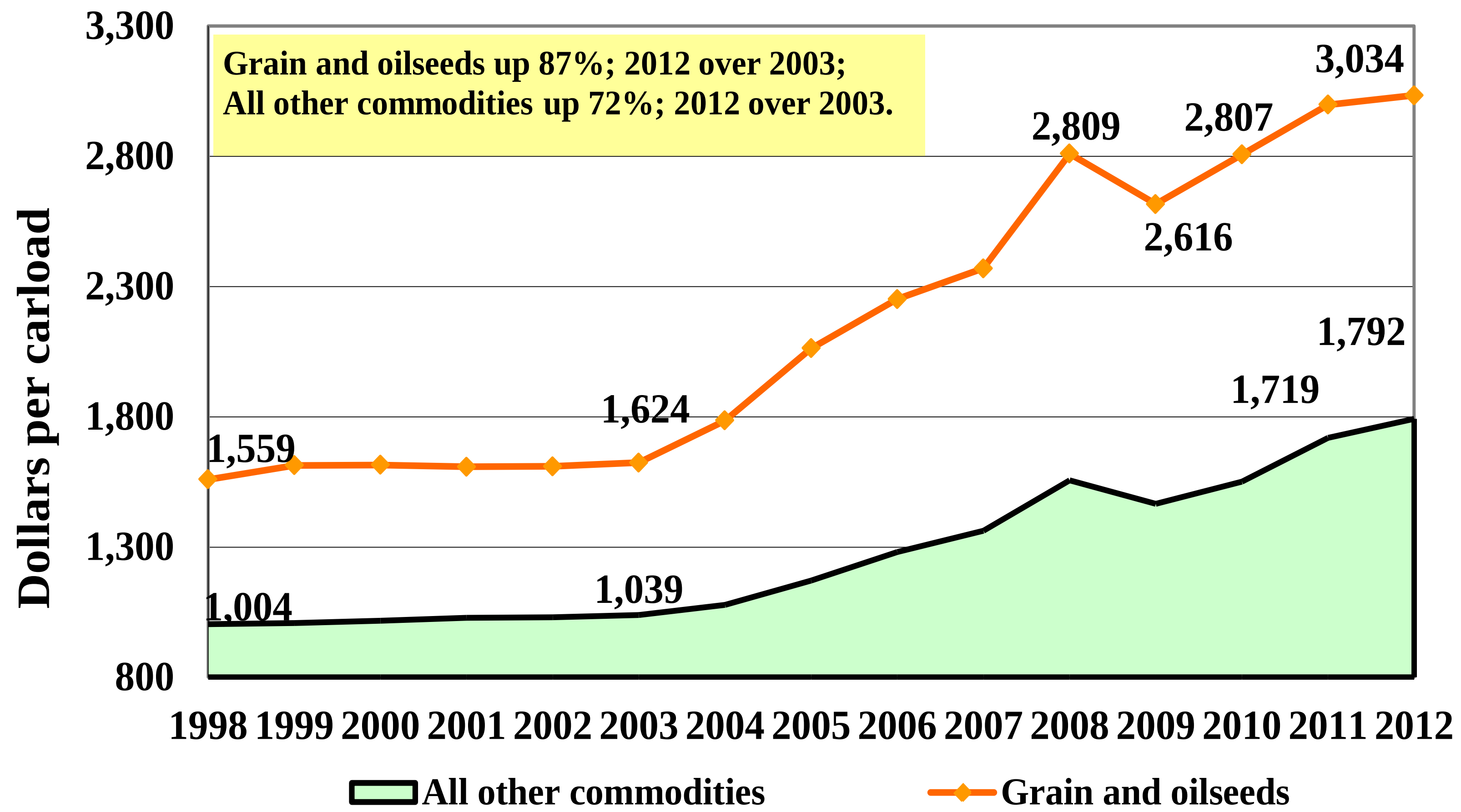
Rapidly Increasing Rail Rates



Source: Association of American Railroads, Freight Commodity Statistics

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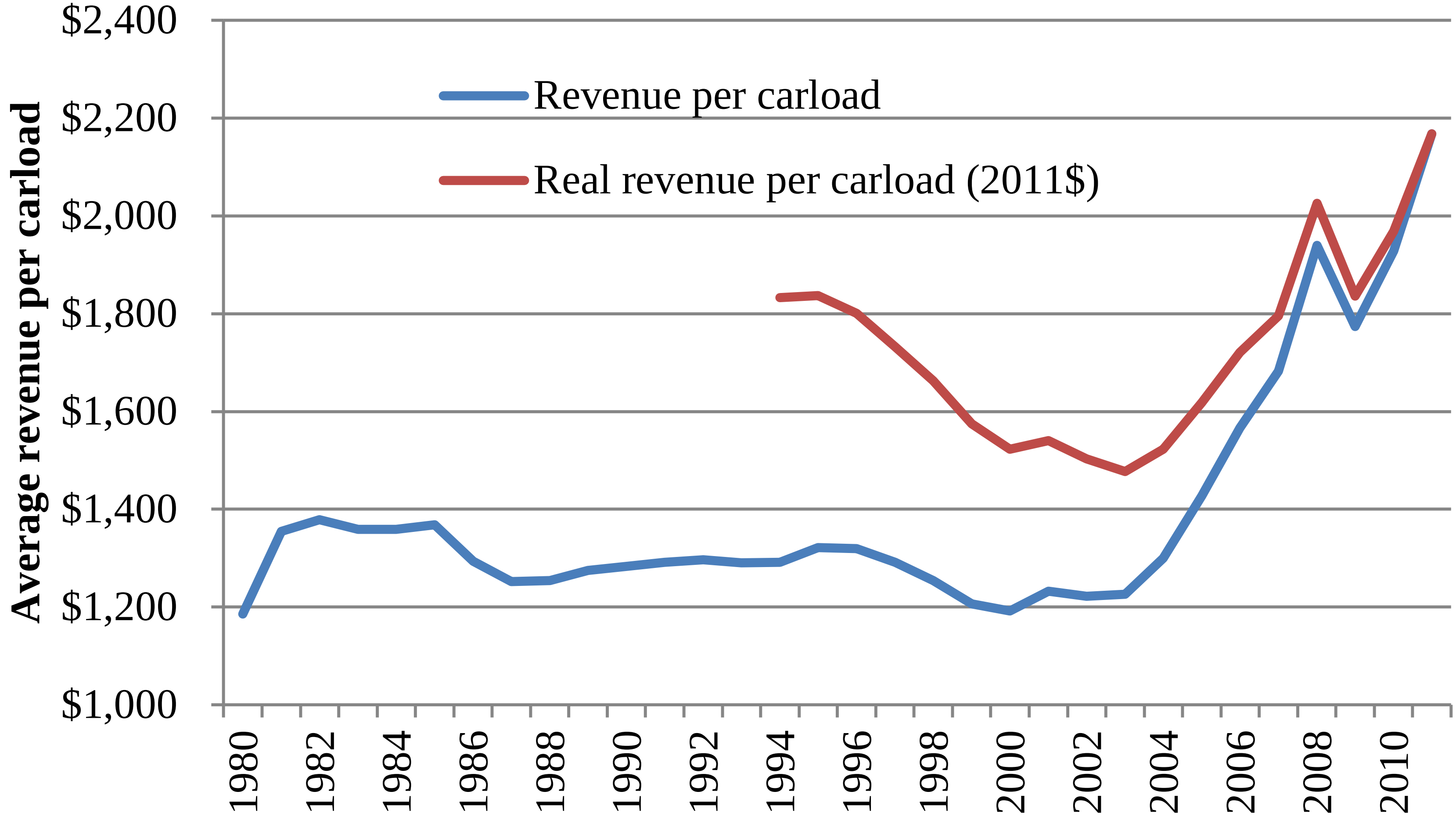
Real Rail Rates Increased 46.8%



Source: Association of American Railroads, *Railroad Facts*

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But Adjusted Rail Costs Rose 28.6%

Annual rail cost adjustment factor
(Adjusted for productivity)
(4Q 2002 = 100 for unadjusted RCAF)

Year	RCAF (adjusted)
2003	0.517
2004	0.528
2005	0.558
2006	0.571
2007	0.565
2008	0.659
2009	0.554
2010	0.614
2011	0.665

Source: Association of American Railroads, *Railroad Cost Indexes*

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Rapidly Increasing Rail Rates (cont'd)

- In order for railroads to recover high fixed costs, shippers without competitive options pay a higher share of these fixed costs.
- In an era of record rail profitability, why should captive shippers be charged rates substantially higher than costs?
- It is neither appropriate nor the law that captive shippers should face unlimited differential pricing.
- As rail revenues become persistently adequate, high rates paid by captive shippers should be reviewed and lowered if deemed unreasonable.

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Rail Rate Appeals Procedures

- Agricultural shippers believe STB rail rate appeals procedures are too lengthy and expensive, preventing effective access to relief.
- The SAC procedure is too complex and costly for agricultural shippers (McCarty farms case).
- Simplified SAC has not been used by agricultural shippers.

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3-Benchmark Rail Rate Appeals

- Cost ranges from $250,000 to $500,000.
- Award limitation of $4 million over 5 years.
- Chemical companies have used successfully.
- No agricultural shipper has used.
- Allows rail company to raise rates across the board.
- Because of high costs and low expectations of meaningful results, agricultural producers have not used any of the STB's rail rate appeals procedures (since McCarty Farms).

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Possible Role for Rate Arbitration

- Rail rate arbitration could reduce the costs of appealing high rail rates.
- Montana Grain Growers Association, Montana Farm Bureau Federation, and BNSF Railway Company (BNSF) have developed rail rate mediation/arbitration procedures that can be accessed by producers.
- So far, no other major railroad has agreed to rail rate arbitration.

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Need for Competitive Switching

Agricultural shippers believe:

- Greater rail concentration, railroad antitrust exemptions, and record rail profits have increased the need for rail-to-rail competition.
- Rail-to-rail competition should not be further sacrificed to ensure railroad profitability.
- Increased rail-to-rail competition is a means to preserve the benefits of railroad economic deregulation.

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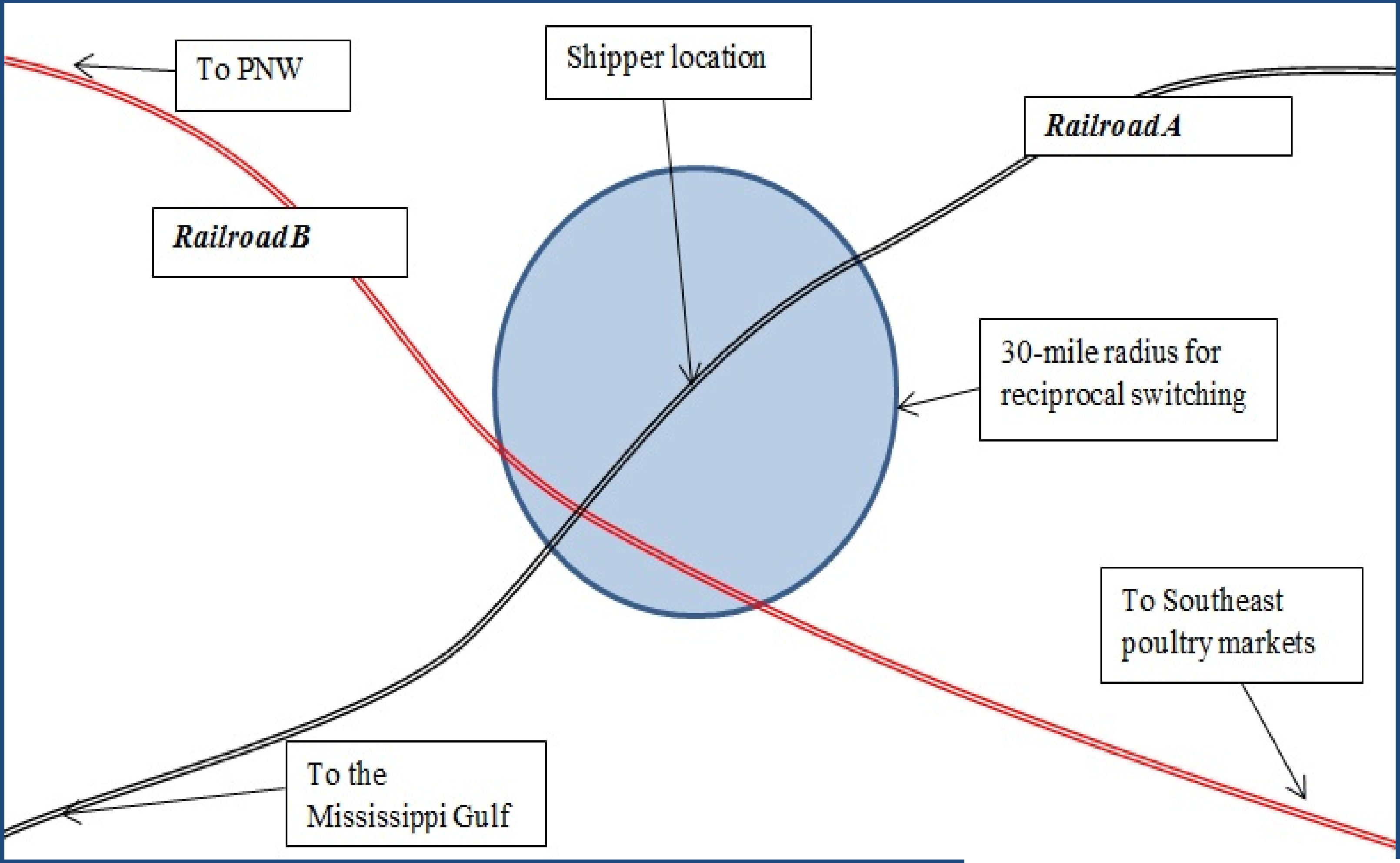
Competitive Switching



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NIT League Proposal

- Shipper served by only 1 major railroad.
- Movements have a R/VC ratio exceeding 240.
- Shipper shows that there is or can be a working interchange between the 2 major railroads.
- Competitive switching would not be imposed if either rail carrier shows it is not feasible, is unsafe, or unduly hampers operations.

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Effects of NITL Proposal

- USDA and DOT estimate of impacted carloads ranged from 1 to 6%.
- The most likely impact of competitive switching is a 1% reduction in grain revenues and a 6.4% reduction in railroad grain net income assuming duopoly competition, 30 mile threshold distance, and 240 R/VC.

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Factors Limiting Effects of Proposal

- Short line railroads are exempt from the NITL proposal, but their movements are often recorded as Class I railroad movements.
- Contract movements are about 24% of agricultural traffic.
- Lower rates from competitive switching would increase traffic.
- Not all eligible shippers will use competitive switching.

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Conclusions

- Rapidly increasing rates above costs should be reviewed for reasonableness.
- STB's current rate appeals procedures do not work for agricultural shippers.
- The new era of rail profitability may require some rebalancing within the priorities of Staggers, such as fairness to shippers.
- Within the construct of the Staggers Act, alternative mechanisms, such as competitive switching, need to be explored to infuse a slightly greater degree of rail-to-rail competition.

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