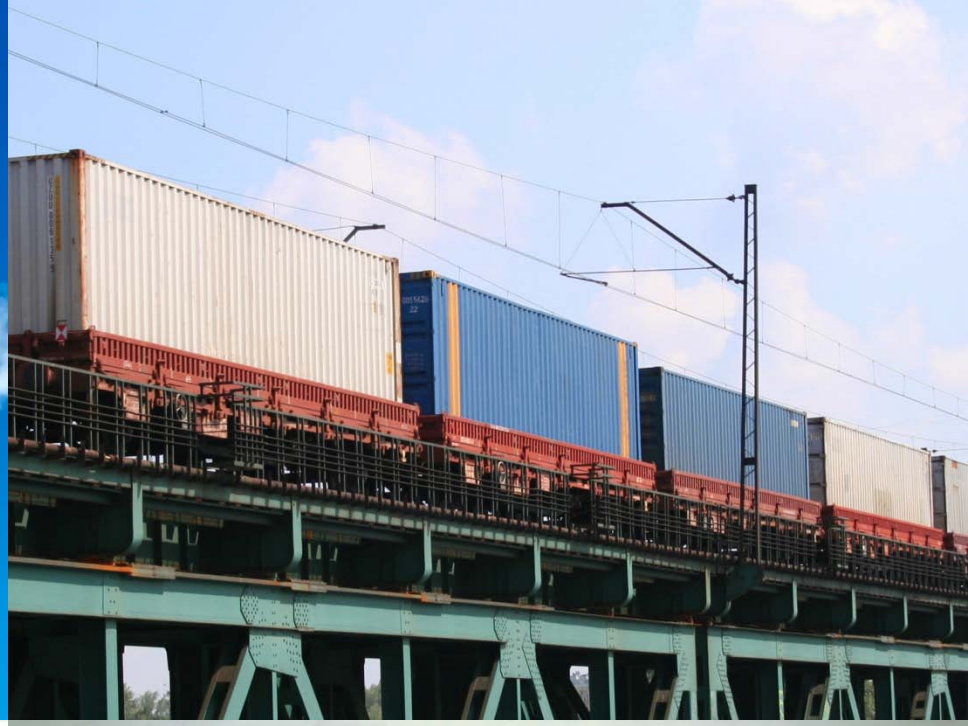


# Transportation Review – NSF/TRB Hearing - March 14, 2014

Whiteside & Associates/Alliance for Rail Competition – Billings, Montana

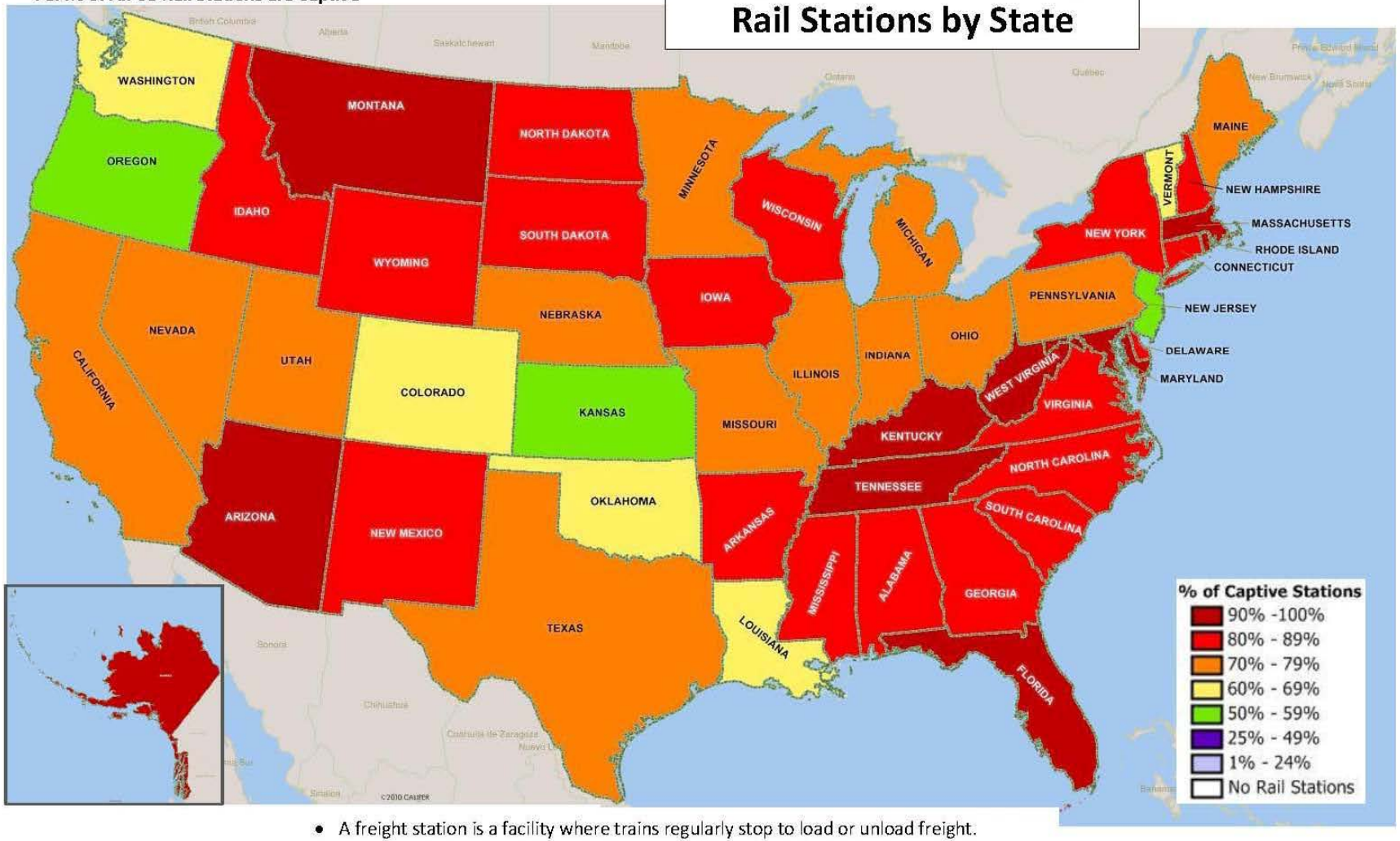
# History – Staggers Rail Act - 1980

- Two Mandates from Staggers Rail Act of 1980
  1. Don't bring Congress any more RR bankruptcies
  2. Develop protections for the captive shippers

- ICC and now the STB viewed these Mandates as <u>competing</u> mandates <u>not complementary</u> mandates – work on Railroad financials first and later address captive shipper issues
- We as captive shippers are here to express that "later" has arrived and NOW is the time to address captive shipper issues

Total Stations = 28,823
Total Captive Stations = 22,604
**78.4% of All US Rail Stations are Captive**

# Competition at U.S. Freight Rail Stations by State




- A freight station is a facility where trains regularly stop to load or unload freight.
- Freight stations are captive when they have access to only one Class I railroad.

Escalation Consultants, Inc.

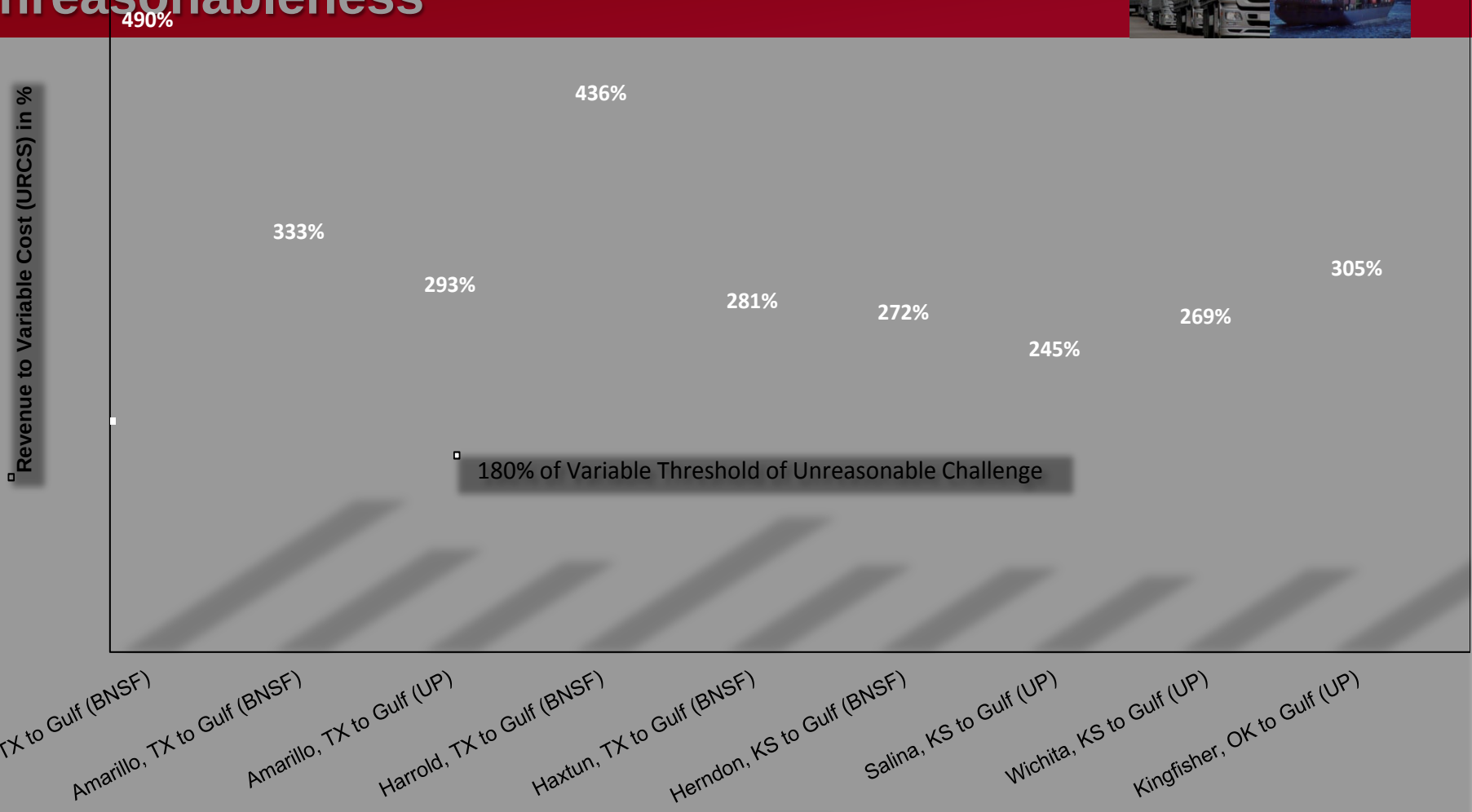
# What Does Rail Captive Mean?

- Today – large portions of the county are captive to a single railroad
- Which leads to:
  - Entire states
  - Entire regions
  - Entire industries or commodities

<u>ARE ECONOMICALLY CAPTIVE TO A SINGLE RAILROAD</u>

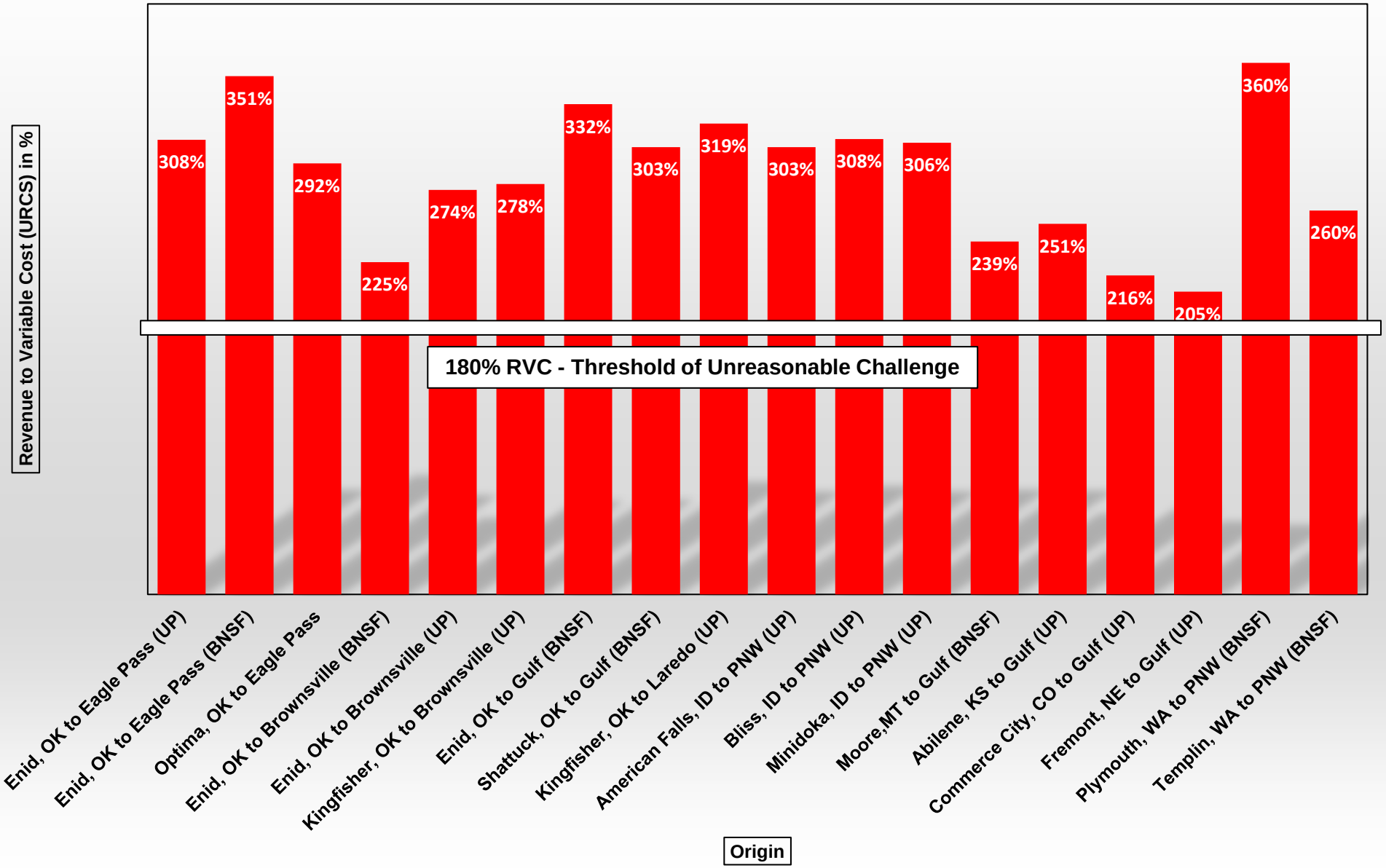
# Revenue to Variable Cost - Rail Wheat Shipments to Gulf BNSF and UP - March 2014

## Rates to Gulf on Wheat (BNSF and UP) Are Well-above the Threshold of Unreasonableness

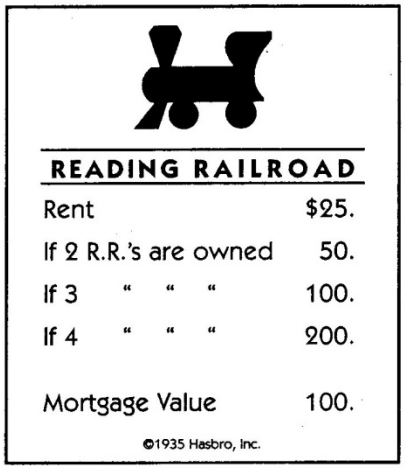


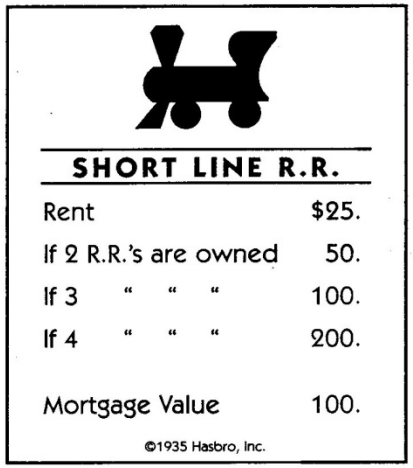

Whiteside & Associates
Billings, MT March 2014, email: twhitesd@wtp.net

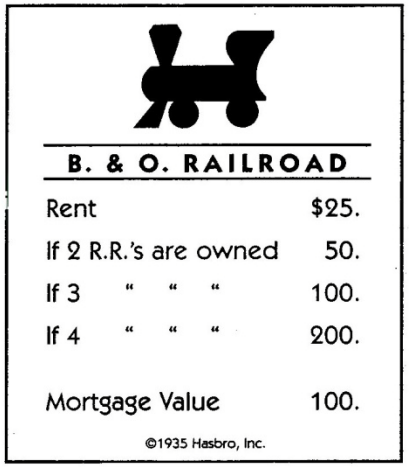
# Revenue to Variable Cost - Rail Wheat Shipments
# BNSF and UP to Mexico Crossovers, Gulf and PNW - January 2014

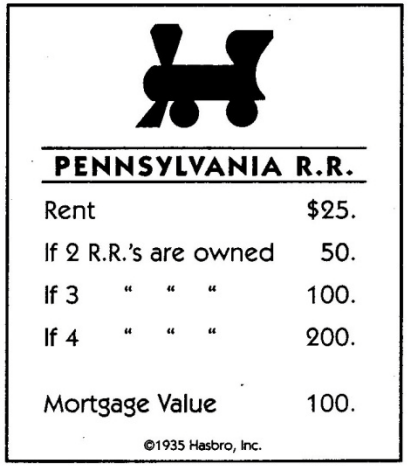


# Did HASBRO, in 1935, Get It Right About Railroads?




They said, "if you **own** all four of the railroads….you are allowed to charge

8 times the rates

that you can charge if you only own one railroad"!

# The Union Pacific 'Opoly' Game Is On The Shelves!!!!


- The UP became the UP of today by buying the Southern Pacific, the KATY, the Missouri Pacific, The Denver & Rio Grande, the Chicago Northwestern, and the Western Pacific…..
- On the Denver & Rio Grande card it states: <u>Rent = 4 times the amount show on the dice, 10 times amount shown on the dice if both "Western Pacific" and "Denver & Rio Grande" are owned!!!!!!!!</u> (see lower right hand corner)

If the UP gets it, why not everyone?

# The Big Four Control Over 95% of all Ton-Miles Hauled

BNSF


NS


UP


CSX

# What Have You Heard?

- **Rail rates have decreased**
  1. For many – this appears to be true up to 2008 but no longer factual
  2. For Captive shippers – not true – especially since 2008
- **Service Levels have increased**
  1. After the last of the mergers (BNSF, UPSP, Conrail breakup) there were service issues
  2. ★ The late summer/fall and winter of 2013-2014 – has proven to be one of the worst rail service meltdowns in modern history – affecting all classes of traffic but especially the northern plains movements

     P.S. – it is not due to the weather

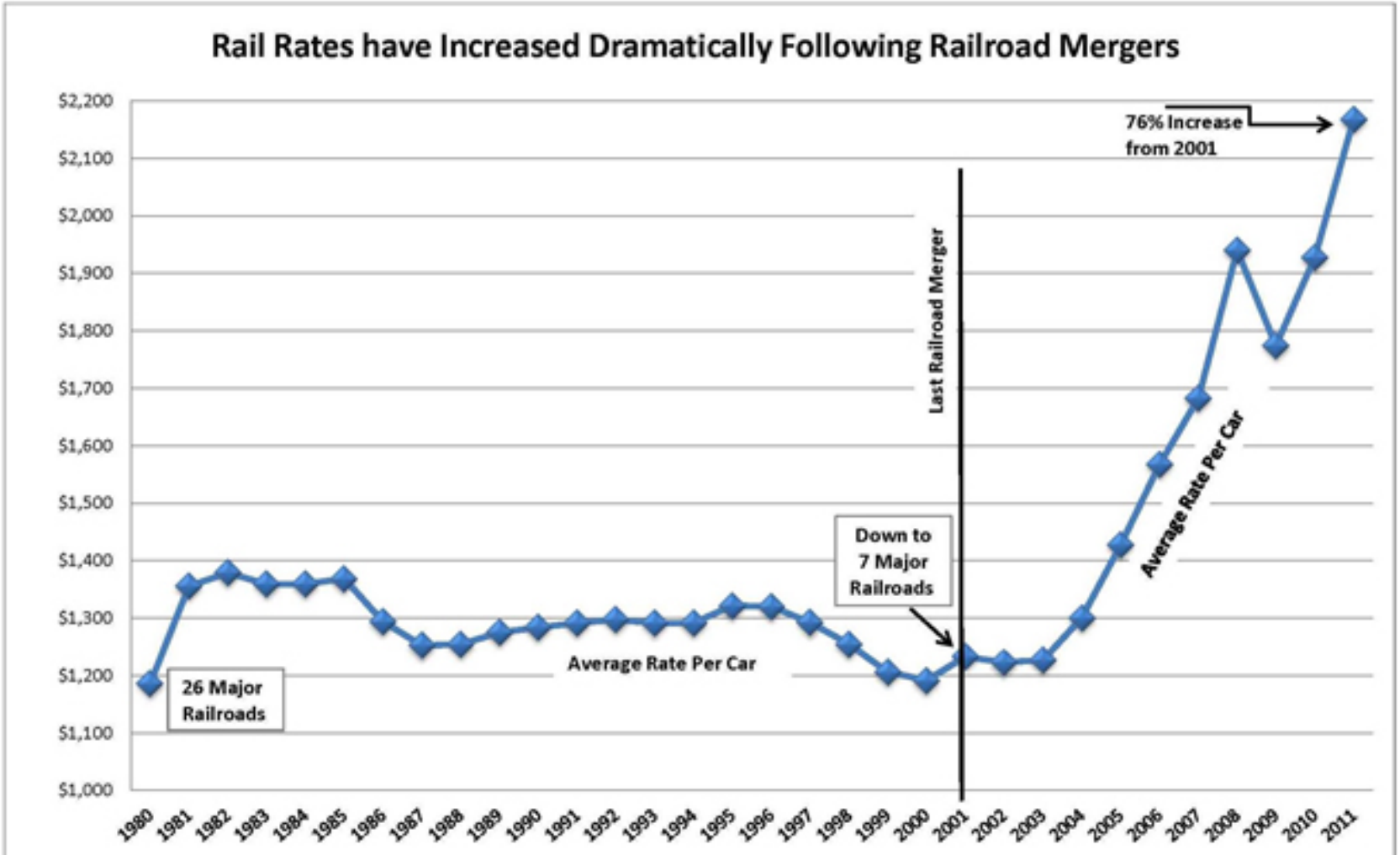
★ Be mindful – that those that are captive – such as grain movements – the rail has no urgency to move plugged elevators – it will still be there in summer

*STB is now have weekly calls with BNSF to provide the Board members current status of the problems and railroad proposed solutions – so far service has gotten NO better, expect no improvement for several years!*

# Rates: Have Far Outstripped Inflation Since 2005

- As ACC stated earlier - from 2005 to 2011, the total premium paid by commodity shippers increased 90% while the carload volumes declined by 1.1%
- Rail rates since 2005 have far outstripped CPI and truck rate levels
- For the first time in history, the railroads have been able to turn in record profits in the face of carload volume declines
- Why? Due their absolute market dominance in the market place - something they didn't have until after the last of the major railroad mergers

# The HOCKEY STICK – published by the American Chemistry Council
# Tie Together the Concentration of the Railroad by Mergers and Rise of Average Rate/Car




The number of large railroads in the US have reduced from 26 in 1980 to only 7 by 2001. The lack of rail competition resulting from rail mergers has caused the cost of shipping by rail to increase substantially since 2001 .

Source: AAR "Railroad Facts" * Rates are based on average revenue per car unadjusted for inflation (nominal dollars).

# Agricultural Rail Rate and Service Trends

- Developing Trends
  - Increased short lining & continuing abandonments
  - Transportation cost shifting from Railroads to Farm producer and from Railroads to State and local governments
  - Decreasing intermodal loading and unloading facilities
  - Decreasing number of grain elevators and marketing outlets for agricultural crops
- Prairie Grain Elevator System Continues to Consolidate – from less-than-shuttle to shuttle loaders – RR's are in large part forcing the change – but increases rail rate spreads between less-than-shuttle and shuttle loaders and outright forcing smaller elevators to single car rates and service – (e.g. 48 - Car Marriage Rule in Montana)
- Vast areas of the Plains States have lost competitive rail service in ICC/STB approved mergers over the last thirty years

# Montana Grain Transportation Survey – 12 Findings

1. Grain is being hauled further and further over the state and county highway systems.
2. The majority of farm producers have experienced increasing hauling distances over the past 10 and 20 years.
3. Those farm producers experiencing increased haulage are hauling over 3 times as far as those farm producers who have not experienced any increased hauling distances.
4. The non-wheat crops are experiencing significantly greater hauling distances that wheat crops further burdening alternative and rotational crop practices.
5. Some counties show average hauling distances upwards of 80+ miles.

# Montana Grain Transportation Survey – 12 Findings (Cont.)

6. The vast majority of farm producers have the capabilities of storing most if not all of their grain production in Northern states – Southern states goes on the ground
7. *Even with the diversity of yields, most prairie farm producers experienced elevator pluggings multiple times during harvest – due to lack of rail cars (NOTE – Currently Northern Plains – continuing plugging for months)*
8. With the multiple elevator pluggings, most farm producers held onto to their crops and waited for the rail car shortages to abate rather than take their grain to more distant elevators – (NOTE can only do that so long)
9. *Farm producers generally thought delays and elevator pluggings were 'about average' and par for the course*
10. Farm producers are finding unloading delays at ever more distant elevators each year
11. *As the elevator system is being forced to larger, more rail efficient shuttles coupled with the loss of thousands of miles of rail branchlines in the state, the costs of transportation for gathering grain seem to be shifting from the railroads to the farm producers and to the State and local highway system*
12. The service levels do not seem to be improving with the transition to larger grain handling facilities

# Enhanced Competition – Where Rail-to-Rail Competition Doesn't Exist

- The concept of enhanced competitive access doesn't make rail competition happen
- Many shippers today are just too far away from another railroad – up to 500 miles in some cases
- Alliance for Rail Competition's focus has been on rate relief

# Class I RR's Believe They Have A Mandate To Set The Price Of Grain In the Marketplace AND THEY ARE

- In a Senate Commerce Committee hearing in April, 2002 a VP of Grain for a major Class I railroad in the West made the following statement,
- "What we do as a rail transportation provider is look at the difference between the value of the grain at the origin and value of the grain at the destination, and try and determine the level of charges for transportation with margin for the elevators to operate and make money."
- "The fact that winter wheat off Texas gulf at the destination has a lower value than hard Spring wheat off the PNW…it is clear Spring wheat has a higher value. <u>Therefore, it can stand a higher transportation cost and still move in the marketplace</u>."

- The TRB here needs to be mindful that the railroad here is making the price in the marketplace and the farm producers/coal producers/chemical producers/etc. are the ones paying for the transportation cost that is now dictated by his/her captivity not by market demands. Only a company with absolute power and little or no effective competition can price in this way.

# Rails Now Dictating To Captive Shippers - Winners and Losers – Which Markets, and Which Crops Can Be Marketed

- In Montana – 48 Car Marriage Rule – BNSF is trying to force less than shuttle elevators out of business by requiring them to arrange and 'marry' their shipments with one of their competitors
- In Montana – Central Montana RR developed an economic project of 1. a 110 Car Shuttle facility and later 2. a large fertilizer plant –BNSF told the owners of the to be built facility, it wouldn't reliably serve this plant if they located on the shortline CMR (300 feet from the BNSF junction) – but offered to finance the loop track of the plant 400 feet away on its own line – p.s. the facility was built on BNSF
- In North Dakota, James Valley Grain has filed suit against the BNSF because the railroad BNSF refuses to provide a rate for over 2 years for a new to-be built shuttle facility at Verona, ND, that James River wants to build on the Red River Valley railroad *(Note: Red River Valley already has 7 shuttle facilities on its line which connect with the BNSF)*

# Railroad's Argue Out of Both Sides of Their Mouth!

- Railroad's argue that government intervention is necessary to insure that they earn "adequate revenues"

- At the same time, railroad's argue that NO GOVERNMENT intervention is necessary to limit their monopoly power!

# U.S. Grain Shippers Are Paying a Big Price

Material prepared by
Jay Roman, Escalation
Consultants for ACC

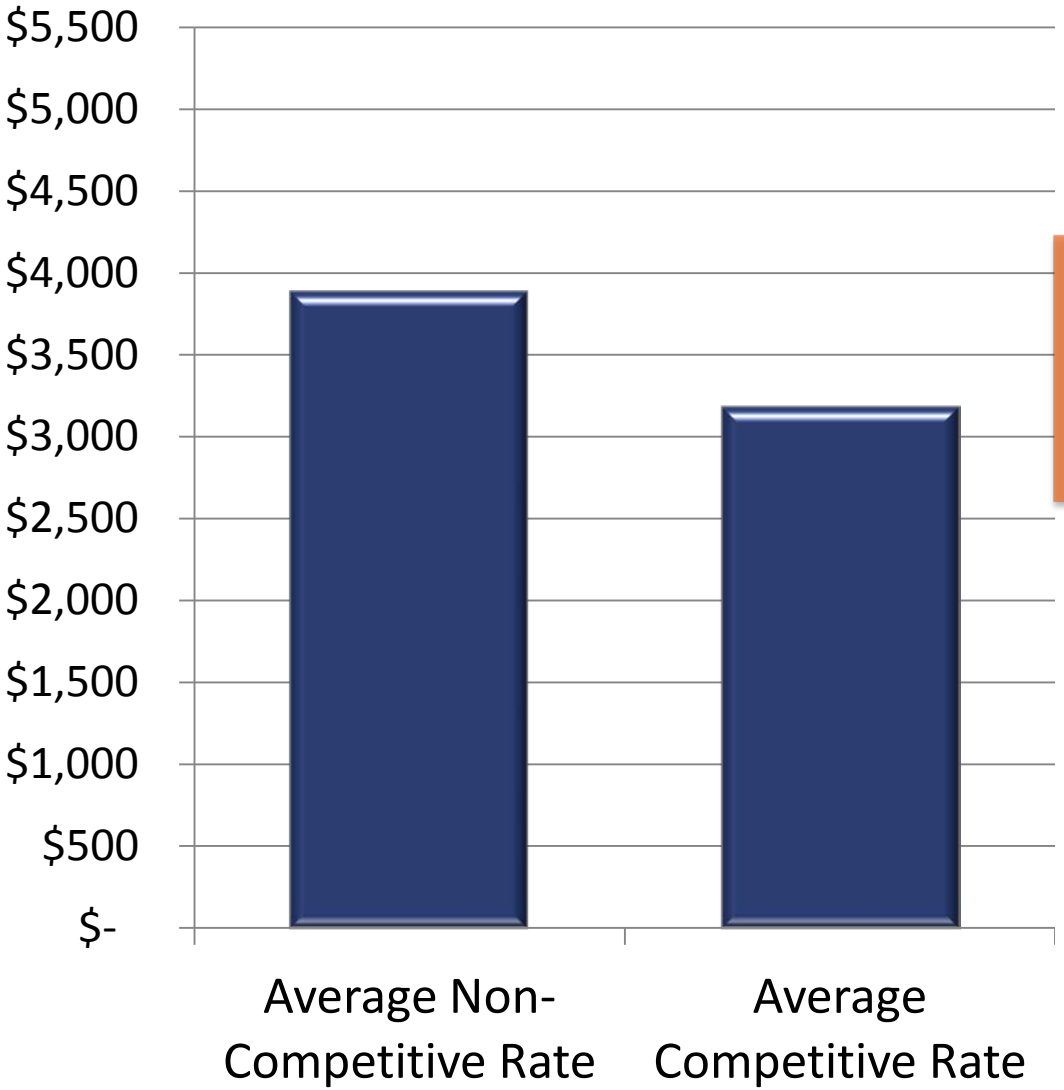
# Farm Products Premium by RVC Range

**The premium on farm products adds up to $559 million for 2011 alone**

| RVC Range | % Total Carloads | Premium for Rates above 180% RVC |
|---|---|---|
| 180-240 | 33% | $189 Million |
| 241-299 | 12% | $222 Million |
| >300 | 7% | $148 Million |
| Total | 52% | $559 Million |

Material prepared by Jay Roman, Escalation Consultants for ACC

# Rail Shipments of Farm Products



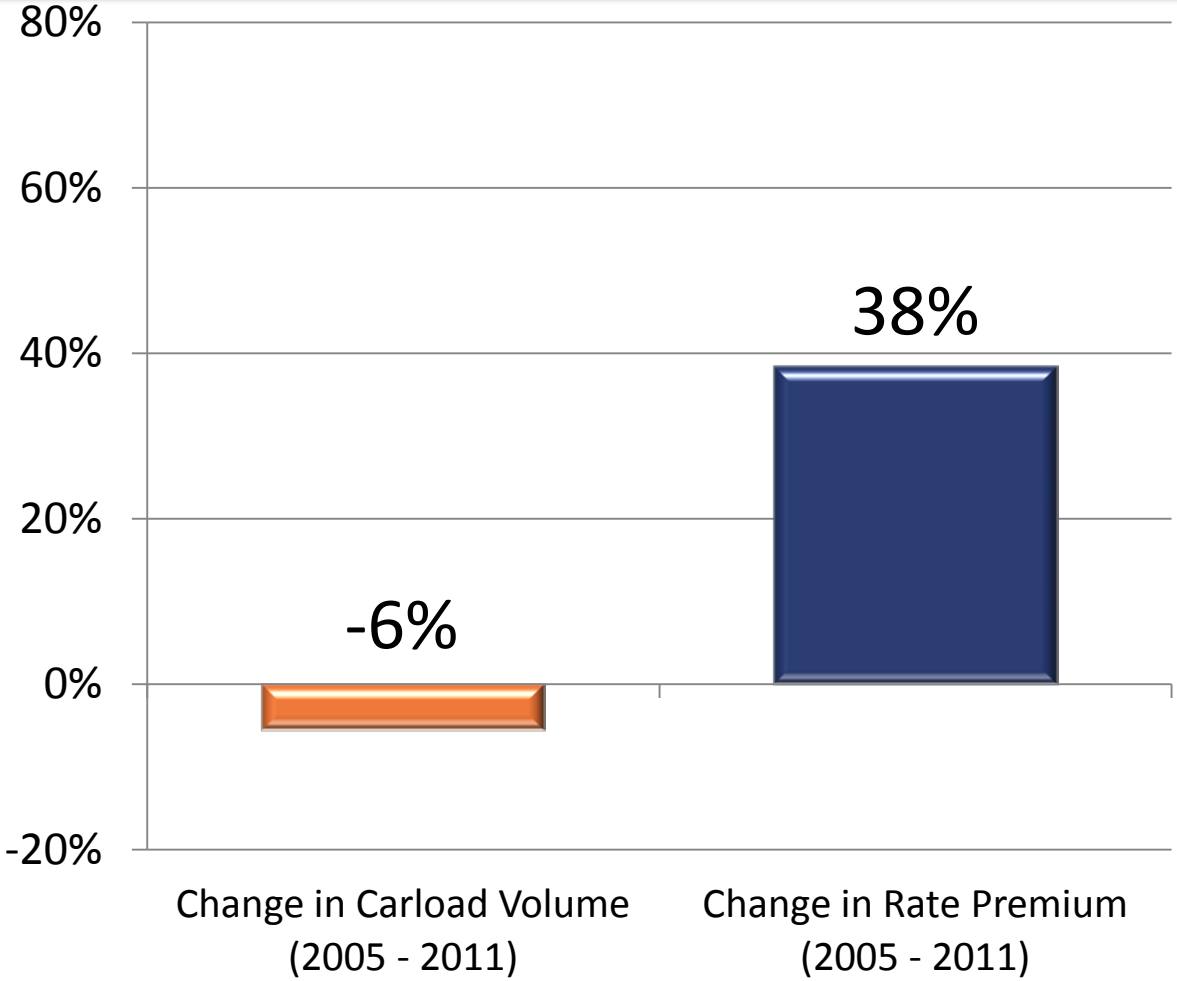

**$703 per car**

In effect, a 22% "tax"

Material prepared by Jay Roman, Escalation Consultants for ACC

# Change in Carloads and Premium for Farm Products (2005–2011)

**Railroad Pricing Power – Not Demand or Costs – Is Driving Rates Higher**




Material prepared by Jay Roman, Escalation Consultants for ACC

# Farm Products with Highest Total Premium (2011)

| Description | Carloads >180% RVC | Premium for Rates Above 180% RVC |
|---|---|---|
| Wheat (excluding buckwheat) | 67% | $245 Million |
| Corn (excluding popcorn) | 45% | $168 Million |
| Soybeans | 50% | $85 Million |
| Barley | 48% | $10 Million |
| Sorghum grains | 66% | $6 Million |

Material prepared by
Jay Roman, Escalation
Consultants for ACC

# FINAL OFFER ARBITRATION – HOLDS SOME NEW PROMISE FOR LEVELING THE PLAYING FIELD FOR CAPTIVE SHIPPERS

- Final Offer Arbitration utilized in all Canadian shipper/rail disputes - FOA requires each party to submit their final offer to the arbitrator who then must pick one of the offers as the settlement. There is no “splitting the baby”. This simple process forces each party to not give an unreasonable offer since it will not pass the “smell test” and will be quickly ruled out by the arbitrator. This results in the other party offer being used as settlement.
- Final offer arbitration has significant advantages to both parties. They are:
  - Reasonable costs since there is no long and drawn-out regulatory procedure such as developing a stand alone cost railroad
  - Easy to understand methodology
  - A quick decision
- Canada has used compulsory FOA in the resolution of rate and service disputes between railroad and rail customers since 1996. Levels the playing field

# WHAT IS THE CAPTIVE SHIPPER RAILROAD PROBLEM?

1. Combination of ineffective regulation and ineffective competition
2. Monopoly railroads control essential facilities of commerce
3. Railroad negotiating position is too often “Take it or leave it” or even “No, we won’t allow that”
4. STB regulation is too expensive, too slow and too rarely actually helps. Railroads are not penalized when they act unlawfully. At most, they are merely required to undo the damage they caused (e.g., refund excess rates after the rare successful shipper rate challenge)
5. Short lines are neutralized and antitrust laws are largely inapplicable due to erroneous assumption of effective regulation

# INEFFECTIVE REGULATION AND INEFFECTIVE COMPETITION MEAN THERE ARE NO REMEDIES FOR ABUSES

1. When regulation and competition are ineffective, railroads can and do abuse their market power with impunity
2. ***Abuses include excessive rates, which transfer to railroads many hundreds of millions of dollars that would otherwise be available for use by rail customers, including farmers***
3. Abuses also include excessive charges, the shifting of costs and burdens to shippers, and poor service
4. ***Railroads are also able to restructure markets to maximize their own efficiency and revenues, e.g., jeopardizing the survival of mid-size country grain elevators that shippers built at railroad request***
5. Railroads should not be able to dictate to buyers and sellers what sources and markets are and are not viable

# STB RATE REGULATION DOES NOT WORK FOR MOST SHIPPERS

1. The STB's main rate reasonableness standards, SAC and SSAC, are prohibitively expensive ($ millions) for almost all captive shippers

2. *The STB's only other standard, Three Benchmark, costs less ($ hundreds of thousands), but does not work for most shippers of agricultural commodities*

3. Three Benchmark is a comparable rates test that can be neutralized if a railroad simply charges the same rates to most comparable shippers

4. ***Three Benchmark led to rate relief in a case involving U.S. Magnesium Corp., but rates were unreasonable only <u>above 350% of variable cost</u>***

5. To its credit, STB recently initiated a proceeding to consider effectiveness of existing remedies for excessive rail rates on grain, and possible need for new approaches. ARC will participate in this proceeding.

# RAILROAD REVENUE NEEDS DON'T JUSTIFY MAINTAINING THE STATUS QUO

1. **Shipper interests, including ARC, want strong railroads capable of growing to meet growing demand**

2. *However, as ICC and STB have recognized, rail rates can be unreasonably high even if a railroad is far short of revenue adequacy. A railroad can single out certain commodities or shippers for too great a revenue contribution, and there must be a regulatory remedy if there's no competitive alternative*

3. No major railroad today is far short of revenue adequacy. Most are making more than needed to attract capital investment as Warren Buffett will attest to.

4. **It makes no sense for railroads today to have monopoly power in many markets, plus regulatory advantages based on different conditions 40 years ago, plus little or no competition from short lines, plus antitrust immunity.** No other mode of transportation enjoys these advantages, and no other industry of any kind is so insulated from marketplace and regulatory remedies.

# How to Fix This Mess?

1. A Legislative fix IS required to open up rail system to competitive forces and level playing field between shipper and rails, i. e. Fair arbitration, competitive access and/or competition
2. Regulatory agencies, must be mandated to protect shippers from monopolistic practices of U. S. railroads
3. And captive shipper alliances must be formed to educate the Federal governments