S. HRG. 107–1057

RAIL FREIGHT TRANSPORTATION IN NORTH DAKOTA

FIELD HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

MARCH 27, 2002

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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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RAIL FREIGHT TRANSPORTATION IN NORTH DAKOTA

WEDNESDAY, MARCH 27, 2002

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Bismarck, ND.

The Committee met, pursuant to notice, at 1:30 p.m., at the Brynhild Haugland Room, North Dakota State Capitol, Hon. Byron L. Dorgan, presiding.

OPENING STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. We'll begin the hearing today. My name is Byron Dorgan and I'm Chairman of the Subcommittee of the Senate Commerce Committee that deals with consumer affairs and related issues and we are having a hearing today on the impact inverse rail rates are having on the State of North Dakota. I'm joined by Emmett O'Keefe who works with me on the Commerce Committee and two staffers, Debbie Hersman here on behalf of the Majority staff and Mary Phillips on the Minority.

The transcript of this hearing will be made available, of course, to the Full Commerce Committee and the Senate and I intend also to make the transcript available to the Surface Transportation Board.

I'll be making a couple of brief comments as we begin and then we have six witnesses. We will ask that the witnesses condense their comments, their testimony to 5 minutes each and we'll give you a signal at the end of 4 minutes. We won't be so rigid that if you go over a bit, there's no trap door through which you will fall, but we would like you to stay, if you can, close to 5 minutes; and following that I will ask a series of questions and then we may have some time at the end for others. If they wish to make comments, we will recognize them to do so.

I would make a couple of comments about railroads. First of all, we have a representative of Burlington Northern Santa Fe, Steve Bobb, we have a representative of Upper Great Plains Transportation Institute, Gene Griffin, and they will talk about the railroad company itself, about transportation in a more general way.

It is not a secret that I am one of those in the Senate that has cosponsored legislation called the Rail Shipper Protection Act because I believe that our rail system is broken. Deregulation, in my judgment, has led to a rail system dominated by what I believe are regional and actually larger monopolies today. We have gone from 42 to I believe only a few companies with very, precious little competition. A consolidation does not happen in a vacuum, it was accommodated by the U.S. Congress with specific legislation and then by the Surface Transportation Board and the ICC before it, which has been relatively unagressive in dealing with that concentration. The pro-competitive intent of the law, in my judgment, has not been realized by the consumers in this country.

Now, in 1999 the GAO documented in a study that I was a part of how it is nearly impossible for a shipper to get rate relief under these circumstances. The GAO found out that it takes up to 500 days to decide a rate case, can cost hundreds of thousands of dollars, and can take anywhere from 2 to 16 years to actually get a result in a rate case. So effectively, you have a circumstance where we don't have the capability under the law and under the circumstances that exist with the STB of having complaints on rail rates and other issues adjudicated in a circumstance that would be good for consumers.

Part of the hearing today is a result of a request by shippers in North Dakota who have reacted to another initiative by the Burlington Northern Railroad dealing with inverse rate structure. The inverse rate pricing, which was announced some while ago in North Dakota, it is alleged and will be alleged in testimony today is causing great problems in our State for country elevators, small towns and for shippers, and we want to explore what these rates are and what is the justification for the rates and what remedy might exist for shippers.

This chart shows some of the rail prices to the Pacific Northwest reported in North Dakota. These are wheat rates, 80 cents from Breckenridge, 80 cents from Alton, $1.18 from Minot, $1.08 from Gladstone. Now, these are shipments to the West Coast and one would probably question why would you pay more to ship a shorter distance. We know that that kind of system has existed in previous circumstances. I've been in hearings where they've talked about corn being shipped from Iowa to the West Coast being charged a lower rate than corn from North Dakota to the West Coast. So this inverse rate pricing or set of inverse rates is counterintuitive to someone who thinks that the rates ought to relate to distance travelled but we will hear a lot about that today.

The question I want to ask is, Is this divergence in rates fair? If one alleges it is fair, the question is, fair to whom? What will be the impact on elevators that are not able to offer the better rate if farmers are forced to bypass the better elevators for only a handful of designated elevators. Even if we make the assumption for BN to drag grain westward, is there an equal opportunity for all those elevators to offer the same rate? If not, what will happen to the elevators that are left out, especially when many have already spent millions of dollars to upgrade their facilities to the benefit of the railroad? Are all of the costs safe and efficiency passed on to the producers? What will the impact be on local, State, and Federal highway systems as thousands of trucks travel on our already overloaded road system because of displacement? These and other issues are things that we'll discuss.

I mentioned that I have worked with a bipartisan Rail Shipper Protection Act and it is a more comprehensive piece of legislation that would try to make life more fair for captive shippers. The legislation that we are trying to deal with is legislation that would address a range of issues, not just this pricing issue, but that legislation has not yet moved in the Congress and is, of course, somewhat controversial. Today we will address the narrower issue and I assume some will address, in their comments, the broader issues of rail competition.

With that, let us begin. And I would like to also introduce Commissioner Reinbold, Commissioner Wefald, who are in the audience, and Commissioner Johnson. Thank you for being here.

Why don't we begin and ask Mr. Steve Bobb from Burlington Northern to proceed.

Mr. Bobb, thank you for joining us and we will include your entire statement as a part of the record. I have read your statement and you may summarize.

Mr. Bobb.

STATEMENT OF STEVAN B. BOBB, GROUP VICE PRESIDENT FOR AGRICULTURAL PRODUCTS, THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

Mr. STEVAN BOBB. Thank you. Good afternoon. Senator Dorgan, my company appreciates the opportunity to appear today and represent our views.

My name is Steve Bobb and I'm Group Vice President of Agricultural Products for——

Senator DORGAN. Excuse me, do we know what that sound is?

Mr. STEVAN BOBB [continuing]. Burlington Northern Santa Fe—I have no idea what it is—Railway Company. I do want to make a few comments to summarize my testimony.

Senator DORGAN. We need to give you a better start than this, Mr. Bobb. Why don't we switch the microphone and see if we can avoid that sound.

Mr. STEVAN BOBB. I do want to make a few opening remarks and summarize my written testimony which covers these issues in great detail.

My written testimony touches on the efforts we've made this past decade to increase both the quality of service and the range of service products that we offer all of our customers as well as the role of capital investment in maintaining our infrastructure.

I do want to refer to a hearing held here in North Dakota in December 1997, in which service issues as well as rates were greatly discussed, and we believe these service issues that were raised at that hearing have been addressed. They were not addressed easily. Beginning in 1995 and through the end of 2001, our company spent nearly $12.5 billion, that would be $5.7 million per day, on infrastructure and that infrastructure is now, we believe, providing our constituents in North Dakota with the best service they have experienced.

I do want to describe how our pricing initiatives and discounts that we have made that have been the subject of some controversy in the last several months have been introduced to make North Dakota farmers competitive in export markets. We think we have responded to markets by providing farmers with rate efficiency discounts and essentially given wheat producers the same products that are available to corn and soybean producers in other geographic territories.

I also want to touch on the issue of rate levels. You mentioned a GAO study that touched on rates and our revenue per ton-mile has declined 32 percent, adjusted for inflation, in the agricultural commodities area between 1994 and the first quarter of 2001. That has occurred due to competition with other railroads and other modes, and we believe we have passed these efficiencies on to the customers in the form of lower rates.

I have some charts in my testimony that actually compare wheat transportation rates both westbound to export markets and eastbound to Minneapolis on 52-car shipments from a period of 1981 through calendar year 2001 and there are periods in which the rates go up and the rates go down, but essentially our producers are experiencing the same rate per bushel in both of those markets as they did in 1991. For example, to the Pacific Northwest. Burlington Northern Santa Fe has literally taken over a dollar per bushel of inflated transportation costs out of the market.

I do want to touch on the shuttle network which we believe represents the success, not only of infrastructure which means something to our customers of BN Santa Fe, but also of success in taking a new approach to how we operate that infrastructure. The growth over the last 5 years of the shuttle network reflects the benefits our customers are reaping. Grain cars in shuttle service make almost three times as many trips per month as cars in the rest of the grain fleet.

Three points I do want to make about our shuttle service. First, we still continue to offer single-car, 26-car, and 52-car service—it is not a one-size-fits-all program. We have merely broadened. Second, shuttles are not a large customer game; over 60 percent of our shuttle facilities are owned by local cooperatives and independent grain companies. And third, farmers are delivering grain to the shuttle networks because they make more money by doing so. The shuttle network shares characteristics of our other high efficiency and high service network, which is coal and intermodal and the results of transportation in those speak for themselves.

I want to talk about differential or market-based pricing and because that does lead to different rates for movements of different commodities or movements between areas of the country, and it specifically is not distance- or cost-based, it is based upon the competitive factors at both origin and destination. We seek to maximize the amount of product moving over our entire network. We are part of the supply chain that brings grain to markets and we respond to the market demands. Our so-called inverse rate structure helps supplement and does not displace the export markets traditional origination territory.

In summary, from a policy prospective, BN Santa Fe continues to urge the need for flexibility and market innovation in rail transportation. We believe that is essential not only for our company, but certainly for our customers to remain competitive in their marketplaces.

[The prepared statement of Mr. Stevan Bobb follows:]

PREPARED STATEMENT OF STEVAN B. BOBB, GROUP VICE PRESIDENT, AGRICULTURAL PRODUCTS, THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

My name is Stevan B. Bobb. I am Group Vice President, Agricultural Products for The Burlington Northern and Santa Fe Railway Company ("BNSF"), 2650 Lou Menk Drive, Fort Worth, Texas. I began my career in the railroad industry in 1987 with Burlington Northern and have held various positions in information systems, business analysis, and planning and yield management. In 1992, I moved to the marketing area in our company. I was appointed to my current position of Group Vice President, Agricultural Products in June 1999. I am responsible for the marketing of rail services on our system for whole grains agricultural, products, and fertilizer.

In response to the request from this Committee, I am appearing and offering this testimony for the purpose of providing information about BNSF, the role of our railroad in the movement of agricultural commodities, and the products and services we offer our customers. My testimony describes the efforts we have made over the past decade to increase the both the quality of service and the range of service products we offer our customers, as well as the role of capital investment in maintaining the infrastructure which is critical to providing that service.

I will also specifically describe our shuttle network and the efficiencies it provides our customers, as well as address aspects of our current pricing initiatives. Like other trends in the rail transportation of agricultural products over the last twenty years, the shuttle network and concept is another essential step to greater efficiency for all of us in this supply chain. Similarly, I will describe how the pricing initiatives and discounts we have made that have been the subject of concern in the last six months have been introduced to make North Dakota farmers more competitive in those markets. BNSF has responded to the market by providing rate and efficiency discounts and offering wheat customers and producers the same economic options for lower cost transportation that have been available to corn and soybean shippers, and other users of rail transportation. Thus, from a public policy standpoint, I will urge you to recognize the need for flexibility and market innovation in rail transportation, not increased or stifling regulation, to keep us a vibrant part of the agricultural supply chain in domestic and world markets. I believe this is essential for BNSF to be able to keep making the investments in rail infrastructure necessary to allow us to provide the service North Dakota needs.

AGRICULTURAL COMMODITIES AND PRODUCTS ARE A CRITICAL PART OF OUR BUSINESS

The transportation of agricultural commodities and products represented approximately 17 percent of BNSF's 2001 total freight revenues. Our business unit handles wheat, corn, sugar, high fructose corn syrup, soybeans, oil seeds and meals, feeds, barley, oats and rye, flour and mill products, milo, oils, specialty grains, malt, ethanol and fertilizer. The BNSF network is strategically located to serve the grain-producing regions of the Midwest and the Great Plains. In addition to serving most grain-producing areas, BNSF Railway serves most major domestic terminals, storage, feeding and food-processing locations. BNSF also has access to major export markets in the Pacific Northwest, the western Great Lakes, Texas Gulf and Mexico. We have historically played a key role in moving North Dakota's production to markets in the rest of the country and for export through the PNW ports.

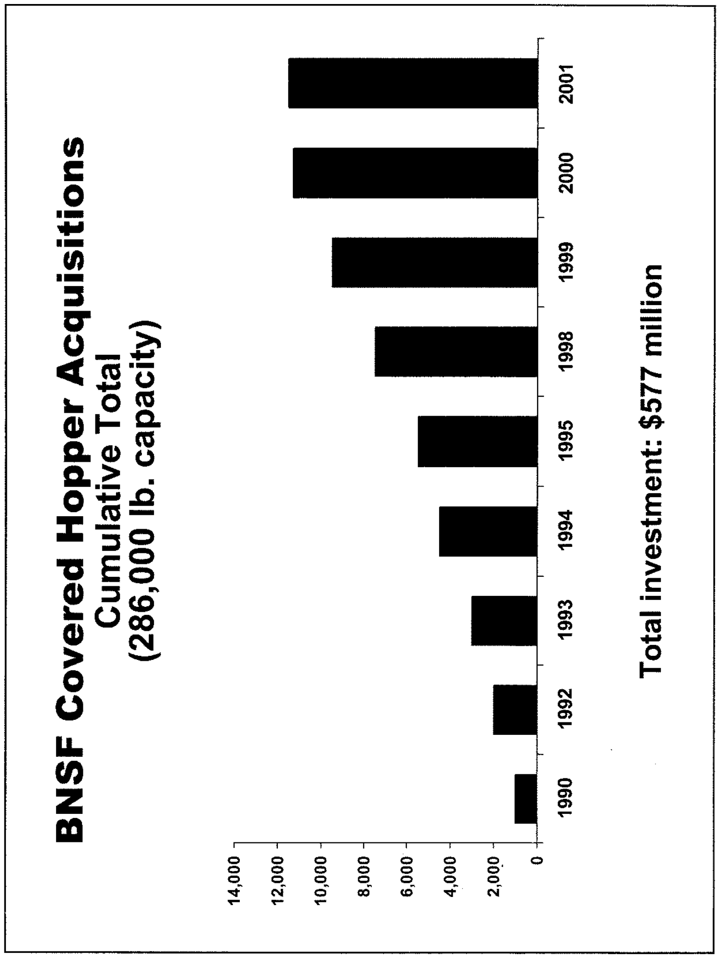
Our railroad and our agricultural customers are a part of both a North American and a worldwide market. Our revenues from movements of agricultural products were approximately 5 percent lower in 2001 than 2000 primarily due to weaker corn export shipments to the Pacific Northwest and Mexico, and decreased shipments of Gulf and Pacific Northwest wheat, both caused by worldwide crop competition. We also saw decreased shipments of sweeteners due to an oversupply of sugar and supplier price competition in the corn syrup market, which resulted in less rail traffic of those commodities. We continually look for ways to promote the movement of agricultural commodities to and from the territories we serve, as I will discuss below.

BNSF HAS CONTINUED TO INVEST IN OUR RAILROAD AND STRIVES TO IMPROVE OUR SERVICE AND EFFICIENCY

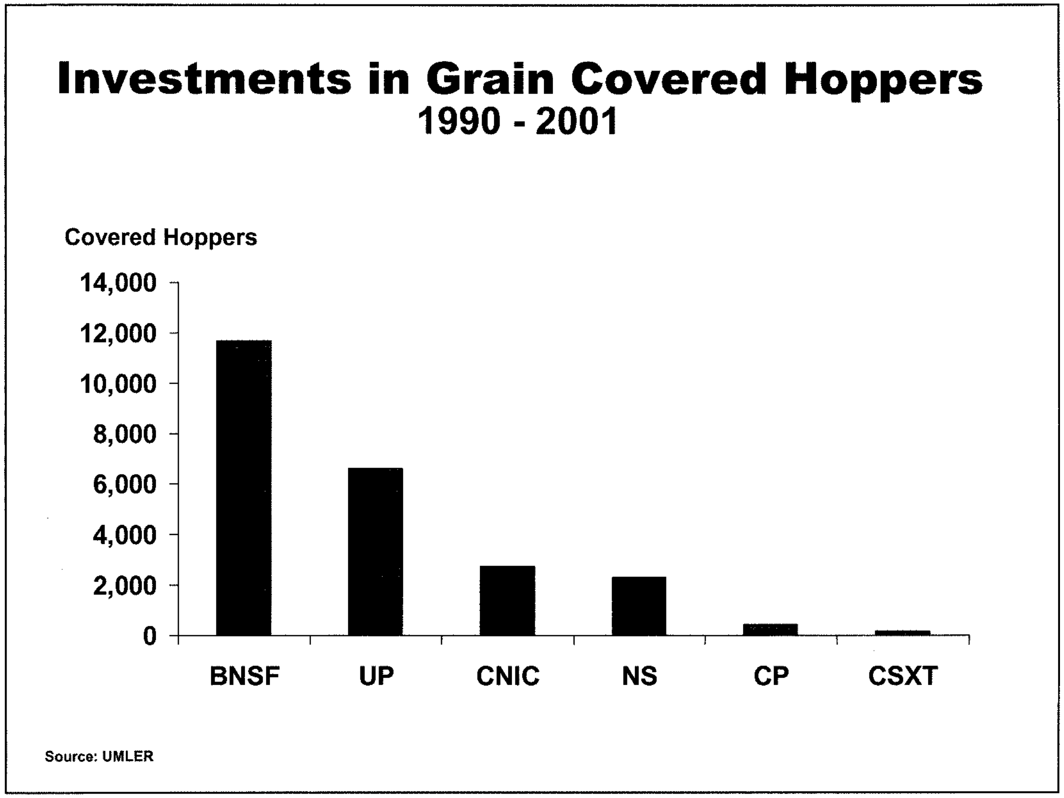
The key to our ability to provide our customers with the service they demand is our rail infrastructure, including equipment, track and associated structures. The BNSF merger in 1995 led to a huge capital investment program on our property. By the end of 2001, BNSF had spent about $5.7 million per day, or $12.5 billion, to improve our infrastructure—rails, ties, ballast, bridges, tunnels and yards; to expand our network by reopening the Stampede Pass route in Washington, by rebuilding Argentine yard in Kansas City, boosting intermodal lift capacity at hubs in Los

Angeles, San Bernardino, and by building a new Stockton, California, hub, not to mention adding 500 miles of double and triple track; and acquiring some 1,700 locomotives and thousands of freight cars.

We have a fleet of almost 29,000 grain covered hopper cars, which we either acquired ourselves, by purchase or lease from car leasing companies, or lease from shippers. Over the last four years, BNSF added 5,500 heavy axle, high cubic capacity covered hopper cars. The amount of our acquisitions of covered hoppers over the last decade are shown in the chart below.



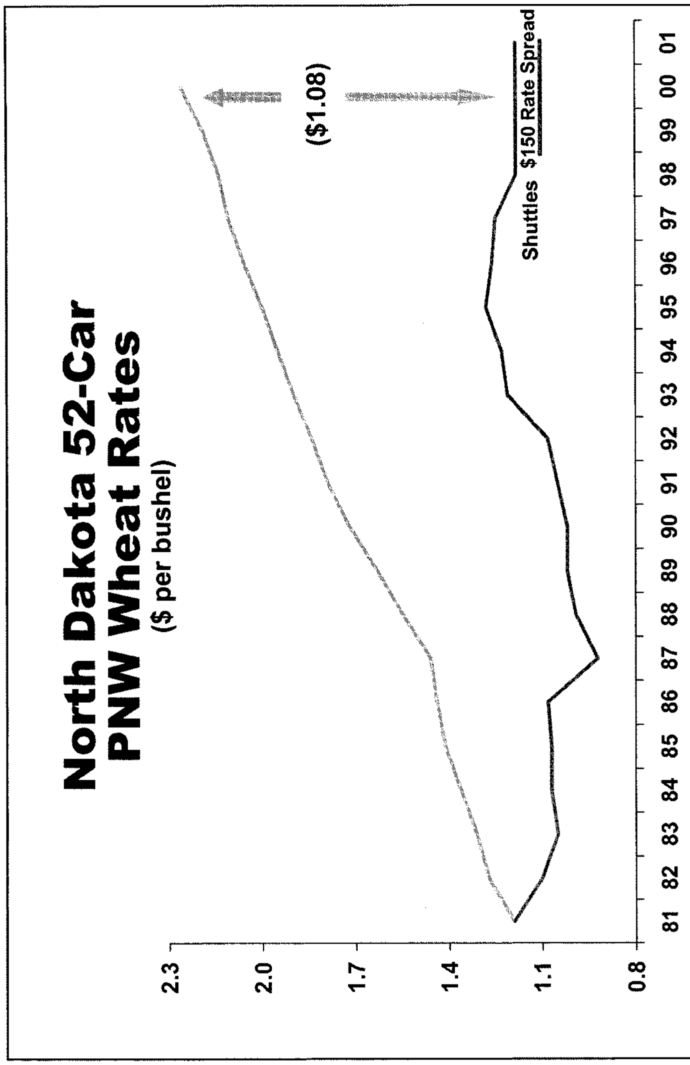
During the decade, BNSF's investment in equipment for transporting whole grains and some processed commodities has been greater than any other rail carrier.


Investments in Grain Covered Hoppers
1990 - 2001
Covered Hoppers
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
BNSF
UP
CNIC
NS
CP
CSXT
Source: UMLER

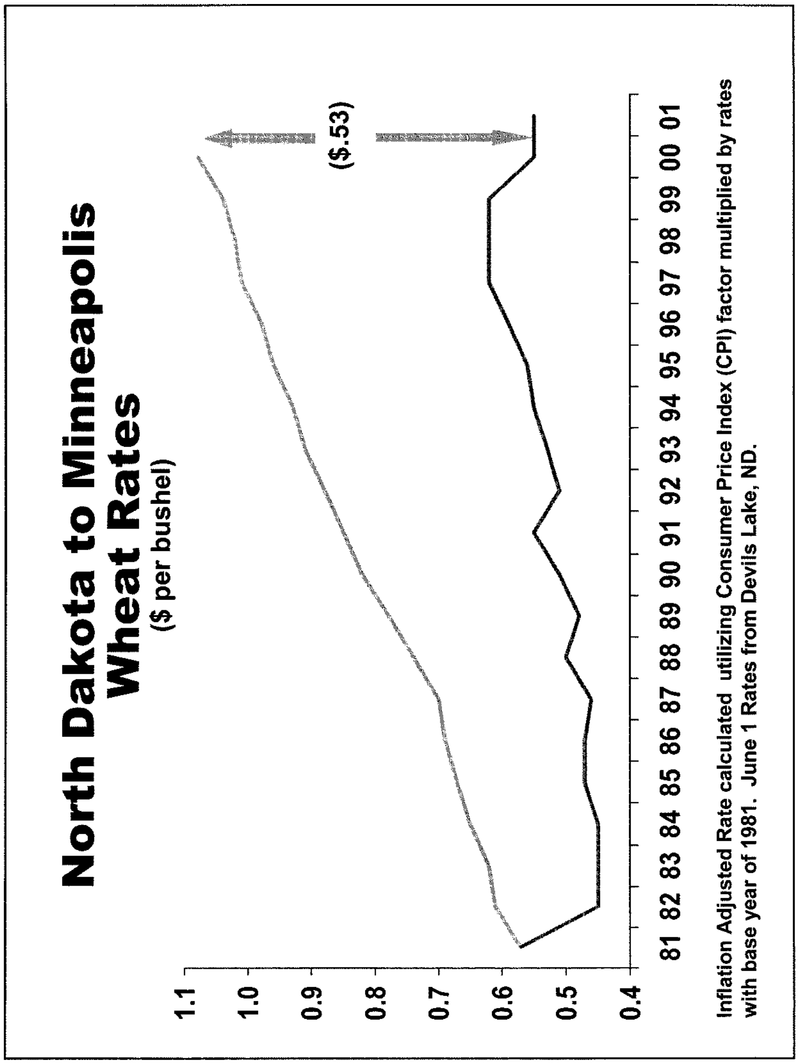
The point of this capital investment program is that we had to spend that money in order to provide better service levels to meet our customers' expectations and to support growth, which is part of the vision of our Company.

At the same time we have been making these investments, our transportation rates have been declining, and these declining rail shipping rates are benefiting both our shippers and consumers. A study released last December by the Surface Transportation Board ("Rail Rates Continue Multi-Year Decline") found that the ultimate beneficiaries of increases in rail productivity—and decreases in rail prices—have been consumers. A key finding of the study was that rail rates have fallen 45.3%, adjusted for inflation, since 1984. According to the STB, shippers would have paid an additional $31.7 billion for rail service in 1999 if revenue per ton-mile had remained equal to the 1984 level. Another key finding was that ". . . all types of rail customers, and not just those with competitive transportation alternatives, have received some portions of the rate reductions."

This industry study reflects what has happened at BNSF as well. Numerous examples confirm this decline. Two that stand out pertain to coal and agricultural commodities, on which I focus. BNSF's agricultural commodities average revenue per ton-mile declined by 32%, adjusted for inflation, from 1994 through the first quarter of 2001 due to competition with both other railroads and other modes. Further, we have passed these efficiency gains through to customers in the form of lower rates in order to grow our business. The charts below compare our rates on transporting wheat to the PNW and to Minneapolis over time and the level rates would be at had we simply passed on inflation.



Inflation Adjusted Rate calculated utilizing Consumer Price Index (CPI) factor multiplied by rates with base year of 1981. June 1 Rates from Devils Lake, ND.



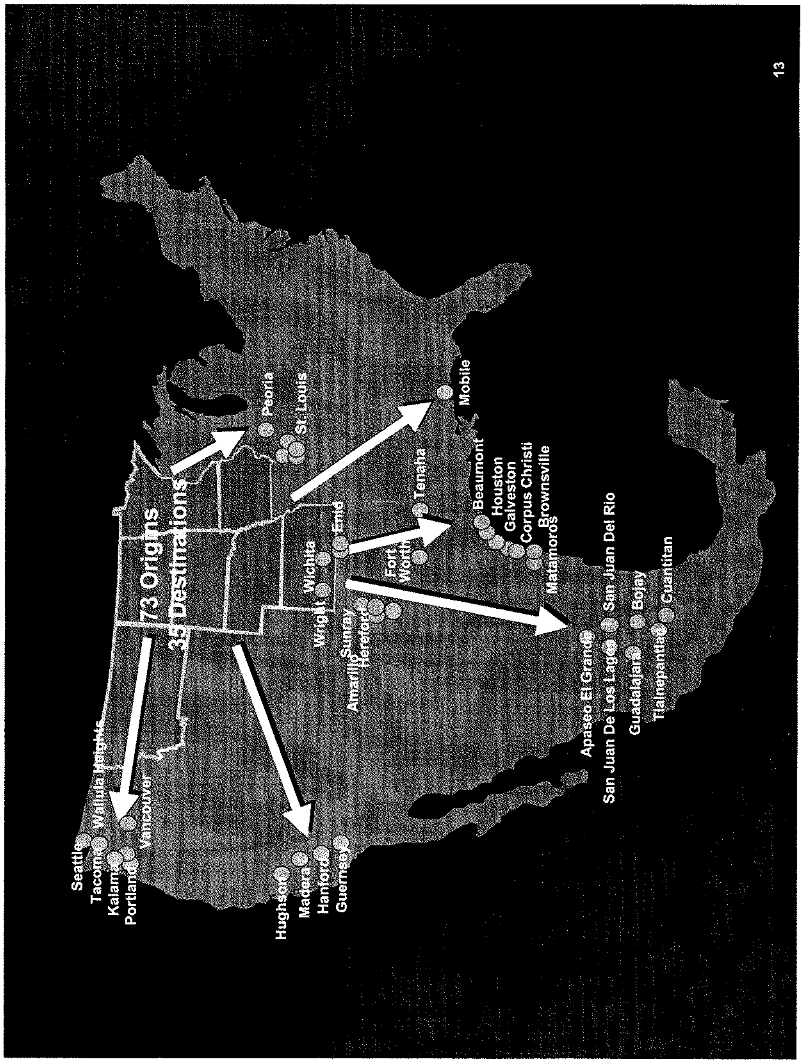
Inflation Adjusted Rate calculated utilizing Consumer Price Index (CPI) factor multiplied by rates with base year of 1981. June 1 Rates from Devils Lake, ND.

These charts reflect the same service product over the entire time period for a 52-car shipment. In each case, there has been a substantial reduction in the real cost of our services. The rates today to the PNW would be over a dollar a bushel higher, and 53 cents a bushel higher to Minneapolis, if those rates had simply reflected inflation. Additional savings have also been introduced into the market place in the form of new products, such as shuttle service, which as shown, above brings another $150 a car reduction to the customer.

At the same time that the economic benefits of shipping on our network have improved, our service performance has improved as well. In the first quarter of this year, BNSF provided our agricultural customers with 95% on time performance for unit trains compared with 80% in 1997, and 86% in 2001. BNSF is continually sharpening its customer focus, including development of a number of e-business initiatives to make BNSF easier to do business with. We receive ongoing feedback from our customers regarding our service and that feedback during the last two years reflects both a substantial improvement as well as a positive comparison to our competition.

Infrastructure investment in the grain network has been accompanied by operational changes that have improved the efficiency and reliability of those networks. That translates into more reliable service, with fewer assets, for our grain customers. Even with these improvements, however, we understand that BNSF service is not as good as it needs to be across all commodities and across our entire network. But, it is getting better, year after year. The biggest key to further service improvements is continuously making the capital investments to increase the capacity of our network.

Because of our continuing investment in infrastructure, we have continued to improve our ability to meet customer expectations. In addition to infrastructure investment, we have also introduced new products that provide new service levels, transportation economics and capacity. Our shuttle train network, which is outlined on the map below, is a key new service offering the agricultural sector.


73 Origins
35 Destinations
Seattle
Tacoma
Kalama
Portland
Vancouver
Wallula Heights
Hughson
Madera
Hanford
Guernsey
Wright
Wichita
Enid
Sunray
Amarillo
Hereford
Fort Worth
Tenaha
Peoria
St. Louis
Mobile
Beaumont
Houston
Galveston
Corpus Christi
Brownsville
Matamoros
Apaseo El Grande
San Juan De Los Lagos
Guadalajara
Tlalnepantla
San Juan Del Rio
Bojay
Cuantitan
13

The latest addition to our network of shuttle-loading facilities is under construction now at Ritzville, Washington. Shuttles improve utilization and velocity of grain-car assets. The shuttle network also improves utilization of locomotives and crews. Our customers gain the service benefit of using a solid train where they are not dependent on the actions of other shippers. In the case of Ritzville, we expect to grow our participation in the PNW white wheat market by being able to compete more vigorously with barges. Shuttles have also helped BNSF grow its domestic business. For example, our shuttle network has enabled us to move feedstock grain from the upper Midwest to California and to Mexico, both markets we were unable to penetrate previously.

How one views shuttles depends a lot on what one has invested in their use. Elevator operators who have not invested in shuttle-loading facilities say they do not think shuttles are a very good idea. Their claim is that the market does not want shuttle trains. If that were the case, one could ask why then have we seen substantial customer investment in BNSF's shuttle network as well as other railroad's own versions of a shuttle program. In terms of the users of shuttles, most North Dakota shuttle loading facilities are owned by producers through local or regional co-ops, not by big grain companies. In fact, approximately 60 percent of shuttle facilities are owned by independents or local cooperatives.

The shuttle network represents the success not only of infrastructure investment by both BNSF and its customers, but also the success of taking a new approach to how we operate the infrastructure. The growth over the last five years in the shuttle network reflects the benefits our customers are reaping from this more efficient way to move grain. Grain cars in shuttle service make almost three times as many trips per month on average as the rest of the grain-car fleet, delivering the value of asset velocity and a new level of service to rail customers as well as railroads.

The grain shuttle network—the part of the grain network that works best, in terms of on-time performance and reliability—shares the characteristics of other relatively high efficiency parts of our system, such as coal and intermodal networks. Two of these characteristics are solid trains moving within a defined set of origins and destinations and well-defined service standards.

The intermodal and grain networks certainly did not start out as rationalized networks with high service standards. There were several hundred piggyback ramps, as we used to call them, handling anywhere from hundreds of units a day to just a few units a week. There were many more grain elevators years ago, many of them small ones loading only a few cars at a time.

BNSF has promoted the redesign and rationalization of both those networks to take out the complexity inherent in trying to provide consistent, high-quality service to hundreds of locations. The process of rationalization is continuous, and it has not been done without some friction with rail shippers, elected officials and other interested parties. However, the service and efficiency benefits of rationalized, focused networks are apparent for all to see.

While the grain shuttle network provides both our customers and BNSF with the benefits of a rationalized network, BNSF continues to offer single-car, 26-car and 52-car service. The service characteristics of our grain shuttle network are very different than the service characteristics needed by many of our small shippers. While there is much rhetoric about the negative impacts of shuttles on small shippers there are no facts supporting allegations that shuttles negatively impact small shippers. The rate differential between a single-car or a 26-car shipper and a shuttle shipper is no greater than that between those smaller shipment sizes and a 52-car shipment in 1995.

DEMAND OR MARKET BASED PRICING MAKES SENSE ECONOMICALLY AND BENEFITS SHIPPERS

Most of the efficiencies we have achieved have been passed through to shippers in the form of lower prices, as STB studies have confirmed, due to competition and our need to increase volumes. Fortunately, because railroad expenses were reduced even more deeply than rates, railroads managed to keep some of the difference, which allowed the industry to gradually shore-up its finances.

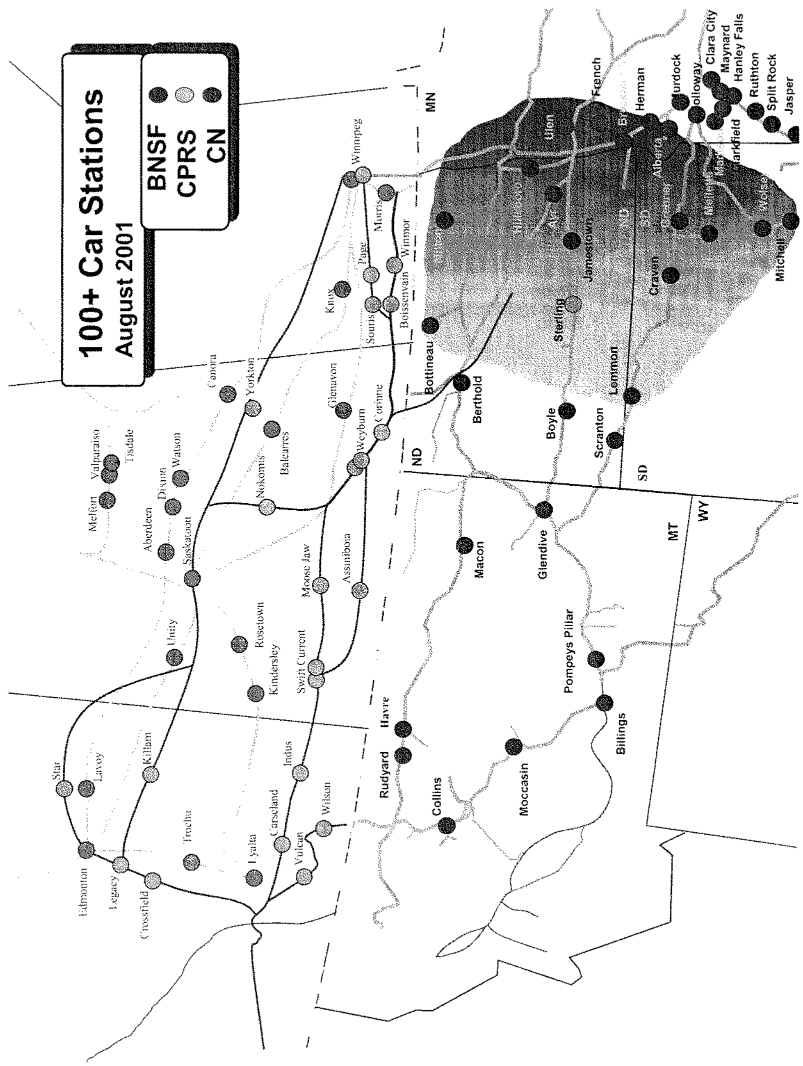
We do this through "differential pricing," which is the way virtually all industries set prices. Differential pricing, also known as demand base pricing, is the pricing of goods and services to yield various contributions to fixed costs based on the willingness and ability of various market sections to make those contributions. Costs, competitive factors, and the purchaser's demand elasticity all get factored into the price equation. Some rail customers have argued to change this approach to pricing, but the changes they suggest would severely and immediately constrain our ability to make capital investments. Railroads should not be denied the same pricing mechanism as other service companies.

Demand based pricing leads to different rates for movements of different commodities, for movements between different areas of the country, and on grain commodities moving to different markets. We are part of the supply chain that brings grain to markets, and we respond to that demand, as does the rest of the supply chain. What we do as a rail transportation provider is look at the difference between value of the grain at the origin and value of the grain at destination, and try to determine the level of charges for transportation with margin for the elevators to operate and make money. The fact is that winter wheat off the Texas Gulf at the destination has a lower value than hard Spring wheat off the Pacific Northwest. One can look at the value of grain at those two port destinations, and it is clear Spring wheat has a higher value. Therefore, it can stand a higher transportation cost and still move in the marketplace.

It is in our interest to move grain, not to charge rates so high that the grain cannot move. Hard Spring wheat is more valuable on a per bushel basis than winter wheat. If you look at the disappearance from the origin, there is grain disappearing from the State of North Dakota that BNSF does not handle—it goes into processors, it goes on the Canadian Pacific Railroad and it goes by truck. There are alternative markets for that grain to move to than the ones BNSF serves. If our rate does not provide a higher delivered value for the customer, the customer ships to alternative markets. We also have to compete with other sources of that grain, *i.e.,* in the case of Spring wheat out of North Dakota, we are competing with Canadian product delivered on the West Coast.

CURRENT DIFFERENTIAL PRICING FOR WEST-BOUND EXPORT WHEAT

The term that has lately also been used to describe an instance or application of market based pricing is so called "inverse pricing." I will describe how this applies in connection with our much talked about west-bound export wheat program. I believe the marketplace requires differentiated rail service. High volume rapid unload elevators at the Texas Gulf or Pacific Northwest (PNW) export terminals demand efficient high capacity train movements. Domestic flour mills and terminal markets like Duluth and Minneapolis do not yet efficiently or physically handle the larger shuttle trains. Thus, 110-car shuttle stations do not have shuttle rates to the domestic market segments which is by far the largest demand sector for eastern North Dakota wheat (see affected area shaded on the map of 100 car stations in the region below). Single, 26- and 52-car shippers must meet this demand.


100+ Car Stations
August 2001
BNSF
CPRS
CN
Winnipeg
Morris
Winmor
Page
Knox
Souris
Boissevain
Canora
Yorkton
Glenavon
Corinne
Weyburn
Balcarres
Nokomis
Valparaiso
Tisdale
Melfort
Dixon
Watson
Aberdeen
Saskatoon
Moose Jaw
Assiniboia
Unity
Rosetown
Kindersley
Swift Current
Star
Lavoy
Killam
Indus
Trochu
Carseland
Wilson
Edmonton
Legacy
Crossfield
Lyalta
Vulcan
MN
ND
SD
MT
WY
Ulen
French
Herman
Murdock
Holloway
Clara City
Maynard
Hanley Falls
Ruthton
Split Rock
Jasper
Alberta
Craven
Jamestown
Sterling
Bottineau
Berthold
Lemmon
Boyle
Scranton
Mitchell
Macon
Glendive
Pompeys Pillar
Billings
Havre
Rudyard
Collins
Moccasin

BNSF rates enable shuttle shippers to serve some select markets where shuttle efficiencies can be captured. These various alternative rate structures, like our recent PNW initiative, blend into and become a positive market factors facilitating shipments when market supply and demand for particular movements dictate. The program at issue provides just such a structure. It helps supplement, not displace, the major traditional supply sources for the PNW. It is available to take excess grain during periods of supply push (harvest) markets when traditional terminal and mill markets are full. This program will help relieve congestion and add capacity. It continues to increase our capability to compete with trucks, and it has not diminished the value or role of our single, 26- and 52-car stations.

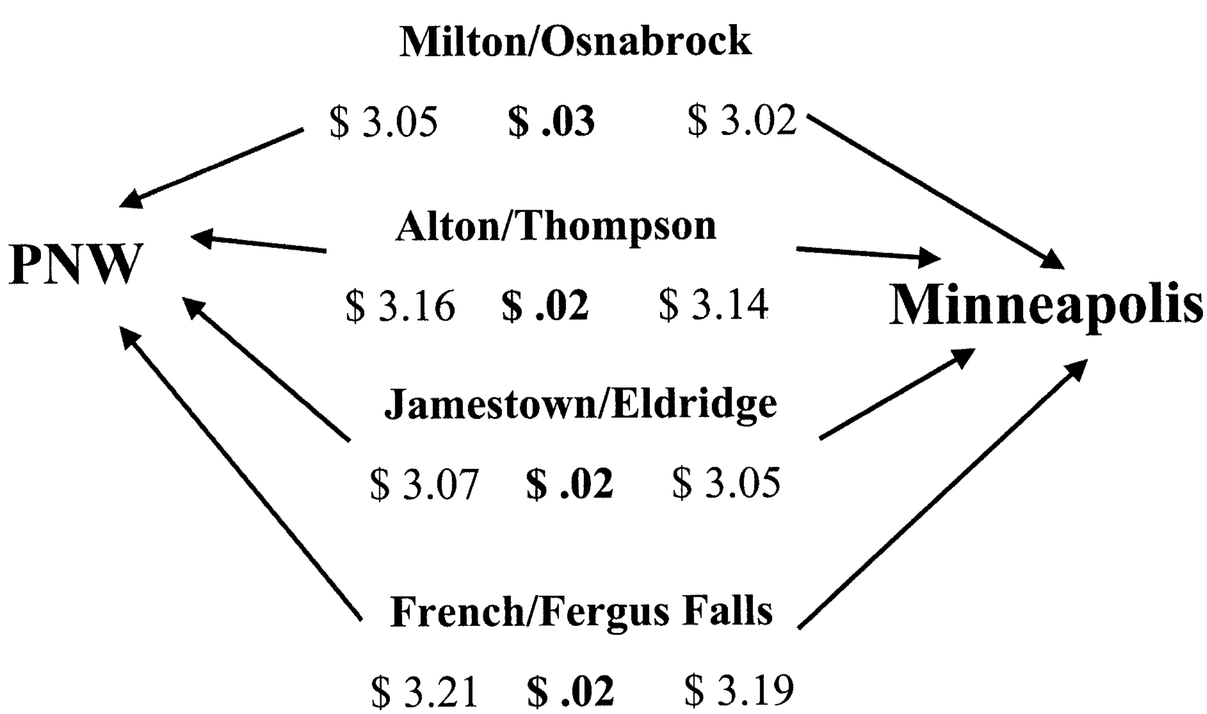
Our efforts in this initiative are driven by several factors. Montana's spring wheat crop is the lowest in 11 years at 65 million bushels, while spring wheat export demand from the PNW will approach 140 million bushels this year. This difference will have to be augmented from other regions. In fact, PNW export companies have indicated that the main problem that they have this year is finding enough wheat to offer to compete with Canada and Australia into the Asian market. I understand we are currently in a demand-rationing mode, which is not healthy for the producer in the long term. Lost markets are difficult if not impossible to recover. Avoiding loss of market share to international competitors is good for Montana and North Dakota producers alike.

Table 1

	FOB Origin (Flat Price)		
Origin	52's Basis MPLS	110's Basis PNW	Difference
Jamestown, ND		$ 3.07	
Eldridge, ND	$ 3.05		
Difference			$ .02
French, MN		**$ 3.21**	
Fergus Falls, MN	**$ 3.19**		
Difference			**$ .02**
Milton, ND		$ 3.05	
Osnabrock, ND	$ 3.02		
Difference			$ .03
Alton, ND		**3.16**	
Thompson, ND	**$ 3.14**		
Difference			**$ .02**

This initiative has also not had an adverse impact on country elevators. First, it is imperative to recognize that there is a distinction between a rate change as an absolute and the impact to the FOB value of grain at each grain facility. If a rate change is made that does not significantly change the FOB value between two elevators, there is no relative harm to the origin (single, 26 or 52-car) shipper. Our recent PNW spread initiative accomplished exactly that. While rates to the PNW have changed from North Dakota, the relative value of the grain between shippers of different unit sizes is at parity. Note the value of wheat between the 52-car market to the east and the PNW 110-car shuttle market for origins such as Eldridge and Jamestown. A market snapshot on Friday July 26, 2001, shows the FOB value quoted from both markets is only 2 cents per bushel difference.

PNW / Mpls FOB Spread



From an overall perspective, grain buying is globally competitive. For our farmers to participate in this market, pricing has to be linked to product quality and demand. Shuttles provide farmers with transportation efficiencies for those markets; it does not obviate the use of single car, 26 and 52-car rates.

We have also prepared a comparison of grain prices at comparable origins, for like quality, for shuttles to the PNW under our program compared with 52-car rates to the Minneapolis market (See Table 1 & Chart 1). We are told by grain companies that have bought new crop grain since our PNW program was established that the wheat was priced based on Minneapolis values and market terms. Merchandisers have included terms in their purchases which will allow them to shift or redirect the actual execution to the PNW in shuttles, if that is the best market when actual shipment takes place. These purchases are clearly not market distortive.

I believe that both for BNSF as a railroad and the consumers of our services, the development of regional elevators capable of loading large trains and our use of shuttle trains are motivated by the basic drive for efficiency as we all compete in world markets. Farmers are voting with their feet, or where they send the trucks with their grain, to obtain the benefit of these efficiencies by having their grain trucked to those regional elevators where they can obtain the best prices. Low density branch lines are costly to maintain, and are maintained with private dollars, at the same time public policy has been designed to improve the mobility of rural America by providing better roads so farmers can get their product to market. We and the elevator operators have developed a more efficient way to load, handle and transport grain using shuttle trains, and are investing in those elevators and rail assets on appropriate lines to be able to provide that service with an infrastructure that will last a long time. We will continue to serve our other elevator customers, but the most efficient will receive greater benefits, as is true across all rail systems

A RAILROAD MUST HAVE THE FLEXIBILITY TO ADAPT TO THE MARKETPLACE

In the over twenty years since the passage of the Staggers Rail Act, which gave railroads more flexibility to meet market conditions, we have seen a number of positive trends in the rail transportation of agricultural products. In the late 1980s, we introduced the COTS program, which offers locked-in rates, guaranteed service, and guaranteed car supply as benefits to our customers. In the 1990s, we saw more standardization of equipment; and we increased introduction of high-capacity cars, with 286,000 lb. gross weight capacity, which are consistent, allow ease of loading, and are solely dedicated to grain customers. The shuttle network and concept is another essential step to greater efficiency for all of us in this supply chain. BNSF has responded to the market by providing North Dakota producers rate and efficiency discounts and offering wheat customers and producers the same economic options for lower cost transportation that have been available to corn and soybean shippers, and other users of rail transportation.

From a public policy standpoint, I urge you to recognize the need for flexibility and market innovation in rail transportation, not increased or stifling regulation, so we are treated on a basis consistent with what happens in other industries and can remain a vibrant part of the agricultural supply chain in domestic and world markets. This is essential for BNSF to be able to keep making the investments in rail infrastructure necessary to allow us to provide the service North Dakota needs.

Senator DORGAN. Mr. Bobb, could you add to that testimony just another piece telling me the decisionmaking process by which you developed an inverse rate pricing schedule?

Mr. STEVAN BOBB. Yes, I can. There are several components to the inverse pricing that is approximately demonstrated by that board.

The first decision criterion was, we were approached by our export customers on the Pacific Northwest. Montana is a traditional source of much of the wheat that is exported out of the Pacific Northwest and those exporters, subsequent to the poor crop results last year, were concerned with their ability to continue selling grain to their customers. And so they came to us and asked if there was something we could do to make more grain available to the Pacific Northwest, and essentially that was—the first criterion was to make more grain available, not to displace the existing grain that moved into that destination market.

The second criterion, by way of decision, was to make sure that we did not distort the marketplace and we had two concerns there: The first was that too much grain would move from the Pacific Northwest and drive down rates that our producers received in that marketplace, or that we would inappropriately distort original values of grain; and so we designed a rate structure that essentially pivots off the domestic market.

While your chart there demonstrates an approximation of the transportation rate components, it does not have the other three pieces of math that are required for the entire equation. The second piece of math is the difference in the value of wheat in the Pacific Northwest and the domestic milling markets. Essentially our rate structure allows the exporter to compete more vigorously against a domestic market. The areas east of Sterling typically ship domestic only, and so what this does is it provides producers in that territory with a higher grain price when the Pacific Northwest wants the grain, because the Northwest has to bid up essentially to get the grain.

The third component of the math that none of us really sees is the individual elevator's choices in terms of their bid structure and how much money they want to make in handling the grain, make less pulling the grain further away. And the fourth component is the issue of which particular customers that may have elevator infrastructure in North Dakota have made the export sales in detail of grain. So all four of those are moving parts that we gave consideration to.

Senator DORGAN. Thank you very much.

Steve Strege of North Dakota Grain Growers Association.

STATEMENT OF STEVEN D. STREGE, ALLIANCE TO KEEP RURAL AMERICA ON TRACK; EXECUTIVE VICE PRESIDENT, NORTH DAKOTA GRAIN DEALERS ASSOCIATION

Mr. STREGE. Thank you, Senator. For the record, I'm the Executive Vice President of the North Dakota Grain Dealers Association and I'm also here on behalf of the Alliance To Keep Rural America On Track, which is a new organization that was formed last November by a number of major farm organizations and commodity promotion groups in the State who are concerned about the activities of the Burlington Northern Santa Fe.

Our primary focus at today's hearing is inverse rates, which is the unusual concept that grain elevators and farmers who ship grain a shorter distance should pay more than those who ship a longer distance. Inverse rates distort historic markets and traditional grain flows. BN claims no market distortion, but it's hard for us to believe that reversing the normal mileage-based rates to create a disadvantage for western shippers for westbound movements doesn't distort markets. We also have evidence from individual grain elevator operators who are in the areas where they are affected by the inverse rates having seen the spreads between themselves and the shuttle owners who have received the inverse rate widen substantially.

We are told that the BNSF needs more wheat for the Pacific Northwest market. However, there were 79 million bushels of spring wheat stored in Montana on the 1st of December and millions more bushels are in western North Dakota. Those would have been available to that market.

We believe that there's a different motive in mind also at BNSF on inverse rates, and that is artificially promoting the building of shuttle train loading facilities in other parts of the State and in western Minnesota——

Senator DORGAN. Steve, can you speak up just a bit?

Mr. STREGE [continuing]. With the eventual goal of closing other grain elevators in those areas. And if the railroad can give a special rate to a few selected shuttle loaders in eastern North Dakota and western Minnesota and prioritize that service, that takes volume away from the other elevators, jeopardizing their very future. Then when that volume goes down, the railroad will say it can no longer operate the branch line and it will be abandoned, and some may exist as receiving stations for shuttle loaders. Meanwhile, the grain in western North Dakota is held hostage to a much higher rate.

So there are two components that come off of the inverse rate plan, both the east to west discrimination as well as the discrimination between shuttle loaders in other parts of the State and other elevators. We think this is irresponsible for BN to be doing this to its present customers. We have a lot of 26- and 27-car and 52- and 54-car loaders in the State. In fact, of the 230 some North Dakota grain elevators served by BNSF and its short line affiliate, the Red River Valley and Western Railroad, about 60 load 52- and 54-car trains and another 50 load 26- and 27-car trains. Only nine load shuttle trains. Although the details are kept secret, it is commonly understood in the grain trade that only three of these nine have the special inverse rate. So what we have is the BNSF caters to a couple percent of its grain elevators, to the disadvantage of all others.

Our domestic milling market is primarily for 26 cars or less. The statement that the BN will maintain single, 26- and 52-car rates, they probably will, but if their practices push all the grain in the direction of the 110-car shuttle loaders, then these other elevators are not going to be able to exist on the dribblings. The rates may be there, but there will be no grain.

The BN also claims great efficiency for its shuttle trains and says that other trains cycle much more slowly from origin to destination and back again. That may be true, but who's controlling it? It is the railroad, and when the railroad lets the unit trains and other smaller shipments sit loaded for days and weeks at the elevator, or in rail yards, while pushing the shuttle trains on through, then the shuttle time differences are grossly exaggerated. It's all controlled by the railroad.

We believe that the BNSF could cooperate with its present elevator system, and gain shuttle train efficiencies, by allowing co-loading of shuttle trains. This means allowing two or more elevators to contribute loaded cars to that long train. Four of the five railroads operating in North Dakota do co-loading. Only BNSF does not. The Canadian Pacific and its two short line affiliates work with its customers and do co-loading. The BNSF has allowed the Red River Valley and Western short line to co-load for about the past 3 years, but that ends on June 30 by order of BNSF. We're told there is co-loading of BNSF equipment on the Dakota, Minnesota and Eastern and also on the CN-IC, that, too, may be expiring.

A month ago today we had the Interim Ag Committee hearing here in Bismarck at the North Dakota Legislative Committee and we were talking about much the same things as we did today. And for the record I'm attaching the minutes of that meeting, my testimony, and also attaching an article from our association magazine in March about that. My friend here, Jim Bobb, Grain Division Manager, Southwest Grain, was at the hearing and his remarks about wheat shuttle trains and BN shifting the PNW market to eastern shuttle loaders who would otherwise not have sufficient volume, confirm what I had previously said about the unspoken BNSF motive behind inverse rates.

Not only is BNSF distorting markets here at home, it is also jeopardizing our markets overseas. North Dakota Wheat Commission Administrator Neal Fisher stated at that Ag Committee hearing the Commission's concern that there be no quality disruptions. Asian buyers are accustomed to certain milling characteristics in wheat from the usual sources of supply in western North Dakota and Montana.

Another discriminatory car supply program being developed by BNSF is called "Scoots." These are smaller trains but they will be available to only 110-car shuttle loaders. This kind of discrimination should be flat out illegal.

Market forces are not at work in creating the inverse rates or the BNSF push for shuttle trains. It is well known in the grain trade that BNSF provides facility building incentive to some and not others. These are artificial incentives, money taken from high rates charged to its present customers.

Well, what should we do about it? You, Senator Dorgan, have been engaged in these issues for a number of years and for that we thank you. Senator Conrad and Representative Pomeroy have expressed their strong support for our efforts. We've had the support of our Governor, PSC, ag commissioner, tax commissioner and many State legislators. Unfortunately, BNSF's response so far has been to simply tell us we are against change.

You have introduced the Railroad Competition Act of 2001. It provides some needed changes like elimination of the revenue adequacy test and putting into law the elimination of product and geographic competition in the market dominance test. Shippers desperately need an inexpensive and quick way to resolve disputes with railroads. The size of the railroads and their ample number of attorneys tilts the table in their favor. Somehow the interest of shippers and shipper groups must be strengthened in dealing with railroads.

Perhaps there needs to be some restrictions on contracting for rail grain movements, or at least greater public disclosure of the provisions. I watched the process over the last 20 years move from no contracting to contracting with disclosure to contracting with hardly any disclosure, and now what little disclosure there is comes after the movement is completed. There is discussion going on about open access from some railroads on to other railroads, that might be a viable option. There is discussion here in North Dakota about filing a formal rate complaint. Maybe we have to require disclosure of these subsidies or rebates that are going into certain facilities.

The railroads were instrumental in settling the prairies and they were compensated for it with generous land grants. Now we see the process unraveling in the other direction as railroads promote what I call economic undevelopment by withdrawing services from many customers. Where effective competition exists, then competition should govern. But where competition does not hold railroads in check in their dealings with captive shippers, additional government oversight and relief must be provided.

Thank you, Senator Dorgan.

[The prepared statement of Mr. Strege follows:]

PREPARED STATEMENT OF STEVEN D. STREGE, ALLIANCE TO KEEP RURAL AMERICA ON TRACK; EXECUTIVE VICE PRESIDENT, NORTH DAKOTA GRAIN DEALERS ASSOCIATION

Thank you Senator Dorgan, Chairman Hollings and the entire Senate Commerce Committee for holding this hearing on issues so critical to not only this state, but also the region and nation as well.

My name is Steve Strege. I am the Executive Vice President of the North Dakota Grain Dealers Association, a 91-year-old voluntary membership trade association in which approximately 90% of our state's grain elevators hold membership. I've been with the Association since 1976 and have watched railroad matters with keen interest for more than 25 years. The Alliance To Keep Rural America On Track is a much newer organization. It was formed in November 2001. It includes every major farm organization and commodity promotion group in this state, as well as other ag-related organizations, and some groups from other states. A membership list is attached to this testimony. Members of the Alliance recognize the adverse long-term consequences of what the Burlington Northern Santa Fe Railway is doing at the present time in this state and region. The Alliance was formed to alert the public to these dangers, to make a broader appeal to the railroad to change its ways for the betterment of its customers, and to bring local, state and federal elected officials such as yourself into this situation. If prodding the BNSF to change its ways does not work, this group will be forced to consider other measures such as federal legislation or a formal complaint to the Surface Transportation Board, or the courts.

INVERSE RATES

Our primary focus today is on inverse rates, the unusual concept that grain elevators and farmers who ship their grain a shorter distance should pay more than those who ship a longer distance. Inverse rates distort markets and traditional grain flows, period. They cannot be explained away by calling them "differential pricing." The BNSF claims no market distortion. It is hard for us to believe that reversing the normal mileage-based rates, to create a disadvantage for western shippers for westbound movements, doesn't distort markets. It is also hard to believe that changing the cross-country freight differentials between two elevators from five cents per bushel to around 30 cents per bushel over a distance of 40 miles (Edgeley, ND-Jamestown, ND), or from 15 cents to around 35 cents across a distance of 20 miles (Portland, ND-Alton, ND), doesn't distort markets. Adversely affected elevators managers can tell you it definitely does.

The BNSF says these inverse rates from eastern locations are necessary to supply needs of the PNW export market. That is simply not true. According to the Montana Grain Growers Association, quoting the Montana Ag Statistics Service, there were 79 million bushels of spring wheat in Montana on December 1, 2001. Millions more bushels are in western North Dakota. But yet these areas are the very ones disadvantaged by BNSF's inverse rate scheme. If the Pacific Northwest market actually needed more bushels, then let it bid up the price to get them. This BNSF manipulation of rail rates has a price-depressing effect for farmers and elevators normally serving that market.

We believe there is a more sinister motive at BNSF for its inverse rates. That is to artificially promote the building of shuttle train loading facilities in other parts of this state and western Minnesota, with the eventual goal of closing other grain elevators in those areas and abandoning branch lines and short lines. The process goes as follows: Give a super special rate to a selected few shuttle train loaders in eastern North Dakota and western Minnesota, and prioritize their service. This takes grain volume away from existing elevators, jeopardizing their very future. Then when the volume from those elevators goes down, the railroad will say it can no longer operate the branch line, and so it will be abandoned. Some elevators will close, some others may exist as receiving stations for the shuttle train loader. The end result is less competition out in the country for the farmers' grain, longer hauls for everybody, a huge impact on roads and the taxpayers who fund them, and further deterioration in rural communities. Meanwhile the grain in western North Dakota is held hostage to much higher rates.

DISHARMONY WITH CUSTOMERS AND MARKETS

BNSF is being irresponsible to its present customers. BN encouraged investments in unit train facilities of 26/27 or 52/54-car capacity. The larger ones were the cream of the crop. Now they are second-class citizens because BNSF wants to emphasize shuttles. We are not against shuttles, or reasonable and consistent rate spreads between shipment sizes. What we oppose is the artificial manipulation of incentives and rates to benefit a very few at the expense of the very many.

In round numbers, of the 230-some North Dakota grain elevators served by BNSF and its shortline affiliate the Red River Valley and Western Railroad, about 60 load 52/54-car trains and another 50 load 26/27-car trains. Only nine load shuttle trains. Although the details are kept secret, it is commonly understood in the grain trade that only three of the nine have the special inverse shuttle rate. The BNSF caters to a couple percent of its grain elevator customers, to the disadvantage of all others.

Our domestic milling market is primarily for 26-car trains or less. It is not for the shuttle trains BNSF is pushing. BNSF has said that it will always have single, 26-car and 52-car rates for niche markets. (Niche markets don't take 52-car trains.) But if BNSF continues to push grain to shuttle train loaders through its discriminatory rates and service priorities, these other elevators can't exist on the dribblings.

There is sometimes a misconception that the struggle in our state over inverse rates and shuttle train loading is between modern shuttle loading facilities and small dilapidated elevators that have had their day and are no longer useful. This is not true. Many of the grain elevators being jeopardized by BNSF's new schemes are huge modern facilities that have kept themselves up to date for not only their own efficiency, but also for the railroad's. Millions of farmer dollar investments in their local cooperatives will be lost if these are put out of business.

EFFICIENCIES

BNSF claims great efficiency for its shuttle trains, and says other trains cycle much more slowly from origin to destination and back again. Well, whose fault is that? It is the railroad's! When the railroad lets unit trains and other smaller shipments sit loaded for days or weeks at the elevator or in rail yards, while pushing shuttle trains on through, the cycle time differences are grossly exaggerated. It is nearly all under railroad control. In fact, according to the BNSF's Fleet Performance Report, available on its website, the loader and unloader actually have control of a railcar about two days each, while the railroad has it the other 22 days of, for instance, a 26 day cycle time.

DELAYS AND DEMURRAGE

Another aspect of efficiency is demurrage, a charge to shippers for delaying railroad equipment. We agree with the railroads that there have to be limits on how long a shipper or receiver can hold a railcar. But there should also be responsibility on the railroad to pull the cars in a timely manner once they are released. Elevator managers and employees are all-too-familiar with loading cars on weekends or holidays, sometimes in terrible weather conditions, only to see the loaded cars or train sit for five or seven or 10 days before being pulled away. The BNSF might say these trains or cars are waiting for "matches" of other trains or cars to go off to destination. If more effort was made, and more sophisticated computer technology and management time was applied to this situation, we believe it could be improved significantly. And, if shippers must pay penalties to the railroad for delay, then the opposite should be true also.

CO-LOADING

The BNSF could cooperate with its present elevator system and gain shuttle train efficiencies by allowing co-loading of shuttle trains. This means allowing two or more elevators to contribute loaded cars to that long train. Four of the five railroads operating in North Dakota do co-loading. Only BNSF does not. The Canadian Pacific and its two short line affiliates work with their customers in co-loading. The BNSF has allowed the Red River Valley and Western short line affiliate to co-load for about the past three years. But that ends on June 30, by order of BNSF. We're told there is co-loading of BNSF equipment on the Dakota, Minnesota and Eastern, and the CN-IC. That too may be expiring.

RATES AND PROFITS

Our Association and Alliance favor lower rates. But we think they should be spread around so that everyone can benefit. The BNSF's current plan for elevator industry concentration will result in relatively few farmers, who are close to those remaining facilities, maybe getting a better deal for a short time. Others from farther out will burn up any advantage in trucking costs, time and road maintenance. Then when the other elevator competition is eliminated, the BNSF will have no reason to give preferential rates to anyone. Less competition among buyers will mean less incentive for them to pass on any savings. Farmers and rural America lose out, while BNSF pads its already hefty profit margins on our grain.

Those profit margins are substantial. The revenue to variable cost ratios on many North Dakota grain rail movements are far in excess of the 160% standard of adequate profitability. This is confirmed by the inverse rate scheme. If BNSF can afford to haul farther for less money, then its higher rates for the shorter distance shipping are even more out of line.

INTERIM AG COMMITTEE

One month ago today the Interim Ag Committee of the North Dakota Legislature held a hearing on rail rates and service, much as we are doing today. For the record, I am attaching the minutes of that meeting to my testimony, and also attaching an article from our Association's March Grainmen's Mirror magazine about the hearing. Southwest Grain Cooperative Grain Division Manager Jim Bobb's comments at that hearing about there being few markets for wheat shuttle trains and that the BNSF is shifting the PNW market to eastern shuttle loaders who would otherwise not have sufficient volume, confirm what I said previously about the unspoken BNSF motives with the inverse rates.

An exchange between Senator Bill Bowman and Steve Bobb of BNSF at that hearing confirms that the railroad will charge whatever the market will bear when it has the opportunity.

Not only is BNSF distorting markets here at home, it is also jeopardizing our hard-won markets overseas. North Dakota Wheat Commission Administrator Neal Fisher stated at that Ag Committee hearing the Commission's concern that there be no quality disruptions. Asian buyers are accustomed to certain milling characteristics in wheat from usual sources of supply in western North Dakota and Montana. This is not to say that our eastern wheat is inferior. It is just different, because it is raised under different climate conditions. But buyers notice these things.

SCOOTS

Another discriminatory car supply program being developed by BNSF is called Scoots. They've been called the domestic equivalent of the 110-car shuttle train program. BNSF first indicated these would be 58-car trains. But they are available to only 110-car shuttle loaders. This is a new and higher level of discrimination and manipulation.

Several of us in this room challenged BNSF on this, questioning why 52 and 54-car loaders who could accommodate 58 cars would not be eligible. The latest from BNSF is that Scoots will be in the 65-68-car range, but still available to only 110-car shuttle loaders. This is like requiring a person to drive an 18-wheeler to get a week's worth of groceries. This kind of discrimination should be flat-out illegal.

MARKET FORCES CIRCUMVENTED

Market forces are not at work in creating the inverse rates or the BNSF push for shuttle trains. It is well known in the grain trade that BNSF provides facility-building incentive to some but not others. At the Ag Committee hearing, Mr. Steve Bobb denied putting any upfront capital into new shuttle loading facilities. But that doesn't address the upfront commitments to provide rebates later. BNSF says it is not driving these changes. But that is contradicted by an article from the July 3, 1999 Hillsboro (ND) Banner in regard to the planned construction of the Alton Grain Terminal near Hillsboro, ND, quoting one of the directors of the Halstad, MN elevator, a significant owner in the facility:

In fact, Lovas said, it was the railroad that was pushing the project. "The railroad is driving this. Without their incentives," he continued, "this would not have happened. They're giving us a hell of a deal." BN-Santa Fe has assured board members that it will "protect" the rates it will give the terminal for a 75-mile stretch of track.

I would also like to submit for the record a copy of the article from the February 3 *Bismarck Tribune*, titled "Alliance claims railroad out to bust rural ND". The article states that Steve Bobb said BNSF has provided incentives to build all ND shuttle loading facilities. I don't know if that is true in every case, but it surely tells the direction BNSF is headed and willing to push for. This is the same article in which Steve Bobb said the elevator in Edgeley is a "victim of its own poor planning" for upgrading to 52/54-car loading a few years ago on the RRVW in order to feed the BNSF more traffic. It could have upgraded on a Canadian Pacific short line.

THE FEAR FACTOR

As the railroad has become bigger, more dominant, and more demanding, shippers and receivers become less willing to speak out in public forums like this one about their problems with railroads. Some will say privately that they disagree with the railroad's direction and the investment requirements. But for fear of reprisals or being left out of the next deal to come along, they decline to speak in public. Maybe some of that silence is breaking. Perhaps the formation and growth of our Alliance To Keep Rural America On Track has given more people a flag to rally around and encouragement to speak out. But many shippers remain apprehensive.

WHAT IS TO BE DONE

You, Senator Dorgan, have been engaged on these issues for a number of years and for that we thank you. You have been in contact with the BNSF on these current problems and arranged for this hearing to shed more light on the topic, provide additional encouragement to BNSF to mend its ways, and establish a record of abuse to document the need for change in regulatory oversight, should the railroad continue to think about only itself. Senator Conrad and Representative Pomeroy have expressed their strong support for our efforts. Governor Hoeven has met with BNSF officials and is forming a coalition of regional Governors to address these issues. Our PSC, Ag Commissioner, Tax Commissioner, and many state legislators are involved.

Unfortunately, the BNSF's response so far has been to tell us we are simply against change.

You have introduced the Railroad Competition Act of 2001. It provides some needed changes like elimination of the phony revenue adequacy test, and putting into law the elimination of product and geographic competition in the market dominance test. Shippers desperately need an inexpensive and quick way to resolve disputes with railroads. The size of the railroads and their ample number of attorneys tilts the table in their favor. Somehow the interests of shippers and shipper groups must be strengthened when dealing with railroads.

Perhaps there needs to be some restrictions on contracting for rail grain movements, or at least greater public disclosure of the provisions. I've watched the process move from no contracting to contracting with disclosure of terms. Then we went to contracting with hardly any disclosure. Now, what little disclosure there is can come after the movement is completed.

The railroads were instrumental in settling the prairies, and they were compensated for that with generous land grants. Now we see the process unraveling in the other direction as railroads promote what can be called economic UNdevelopment by withdrawing services from many customers. Where effective competition exists then competition can govern. But where competition does not hold railroads in check in their dealings with captive shippers, additional government oversight and relief must be provided.

ALLIANCE TO KEEP RURAL AMERICA ON TRACK MEMBERS 3-25-02

North Dakota Grain Dealers Association
North Dakota Farm Bureau
North Dakota Farmers Union
North Dakota Wheat Commission
North Dakota Barley Council
North Dakota Grain Growers Association
North Dakota Corn Growers Association
North Dakota Soybean Growers Association
Farm Credit Services of North Dakota
North Dakota Professional Insurance Agents

North Dakota Association of Telephone Cooperatives
Oliver-Mercer Electric Cooperative, Inc., Hazen, ND
Dakota Central Telecommunications, Carrington, ND
North Central Bean Dealers Association
North Dakota Association of Rural Electric Cooperatives
Mayco Export, Minneapolis, MN
Nebraska Agri-Business Association
Colorado Grain and Feed Association
North Dakota Mill

NORTH DAKOTA LEGISLATIVE COUNCIL, MINUTES OF THE AGRICULTURE COMMITTEE

WEDNESDAY, FEBRUARY 27, 2002, ROUGHRIDER ROOM, STATE CAPITOL, BISMARCK, NORTH DAKOTA

Senator Terry M. Wanzek, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Terry M. Wanzek, Bill Bowman, Duane Mutch, Ronald Nichols, Harvey Tallackson; Representatives James Boehm, Michael Brandenburg, Thomas T. Brusegaard, April Fairfield, Rod Froelich, C. B. Haas, Phillip Mueller, Jon O. Nelson, Dennis J. Renner, Arlo E. Schmidt, Ray Wikenheiser

Members absent: Representatives Joyce Kingsbury, Edward H. Lloyd, Eugene Nicholas, Earl Rennerfeldt

Others present: See Appendix A

It was moved by Senator Bowman, seconded by Representative Nelson, and carried on a voice vote that page 1 of the December 14, 2001, minutes of the Agriculture Committee be amended to provide that 17 percent of all gasoline used in this state contains ethanol and that Minnesota gets back about $10 for every dollar it invests in the ethanol industry.

It was moved by Senator Bowman, seconded by Representative Nelson, and carried on a voice vote that the amended minutes of the previous meeting be approved.

Chairman Wanzek recognized Mr. Stevan Bobb, Group Vice President, Agricultural Products Marketing, Burlington Northern Santa Fe (BNSF), who presented testimony regarding rail transportation of agricultural products. Mr. S. Bobb distributed a document entitled Enabling the Future Through Change. A copy of the document is on file in the Legislative Council office.

Mr. S. Bobb said from the BNSF perspective, the issues being addressed by the committee represent additional steps in a continuing process of change. He said elevators, producers, and multinational corporations had originally opposed many of the initiatives introduced by BNSF over the last 20 years. However, he said, as the individual initiatives played out over time, they proved themselves to add value to the marketplace.

Mr. S. Bobb said the rail industry was deregulated in 1980. He said railroads had been regulated much like utilities are today. He said railroads are not guaranteed a return on invested capital. He said railroads like BNSF make their decisions based on profit motives. He said they have stockholders who expect them to continue in that vein.

Mr. S. Bobb said in the early 1980s, Burlington Northern did a study regarding how it was running its grain business. He said there was serious consideration given to exiting the grain business. He said Burlington Northern was not making money on huge portions of its grain business. He said Burlington Northern decided to make some fundamental changes by moving from long-term contracts to a public transparent pricing environment. He said Burlington Northern stopped using a mileage-based-cost-plus approach for transportation rates and implemented a market-based approach. He said that caused some consternation, especially among the large multinational corporations that had been the beneficial holders of those contract rates.

Mr. S. Bobb said a farmer's cooperative that ships a single car or a shuttle train pays the same transportation rate from point A to point B as does Cargill. He said large shippers are not given favorable positions. He said BNSF gives rate differentials as a function of the efficiency of the product that a shipper elects to ship. He said BNSF does offer different rates for different efficiency programs. He said a single-car shipment is more expensive than a 26-car shipment, which in turn is more expensive than a 52-car shipment. He said a 52-car shipment is likewise more expensive than a shuttle train of 110 cars.

Mr. S. Bobb said in the late 1980s the certificate of transportation program was put in place. He said the program was controversial when introduced. He said the grain industry had sued the railroad over the introduction of the program. He said the railroad wanted to have the marketplace allocate capacity. He said the program provided customers with an opportunity to lock in rates. He said customers can still choose to lock in a rate with a certificate of transportation. He said it provides guaranteed service and a guaranteed car supply. He said despite having sued the company in the late 1980s over the program, most grain companies today view the program as being very beneficial. He said there would probably be a suit if BNSF stopped offering certificates of transportation.

Mr. S. Bobb said other changes were introduced in the 1990s. He said BNSF standardized unit train sizes and started investing in high-capacity cars. He said high-capacity cars allow for the handling of 10 percent more product per car. He said BNSF customers have benefited from having standard size cars. He said the cars are of higher quality and handle more product.

Mr. S. Bobb said during the last decade BNSF invested $600 million in equipment. He said that does not include the $70 million that BNSF spent to maintain its fleet of covered grain hoppers.

Mr. S. Bobb said BNSF believes its customers want BNSF to distinguish itself from its competition. He said the customers do receive benefits from the actions BNSF takes. In the last 10 years, he said, BNSF has made a substantial capital investment in the grain industry. He said no other railroad in the last 10 years has matched the BNSF investment in covered grain hoppers. He said BNSF is very focused on getting a return on its investment. He said BNSF's primary competition in North Dakota is the Canadian Pacific Railroad. He said investment in the Canadian Pacific Railroad is made by the Canadian government.

Mr. S. Bobb said BNSF has downsized its grain fleet since 1988. In 1988, he said, Burlington Northern had 35,000 cars in its grain fleet. He said the current grain fleet is approximately 29,000 cars. He said while taking cars out of the fleet, BNSF has actually increased its carrying capacity. He said the new cars carry 10 percent more product. He said BNSF has broadened its product offering from having only single-car, 26-car, and 52-car opportunities to also offering shuttle train capacity. He said this has created efficiencies in the network. He said in the fall of 2001 approximately 5,500 of BNSF's 29,000 cars were in shuttle service. He said those 5,500 cars were generating nearly 40 percent of BNSF's carrying capacity. He said the cars are high-capacity hoppers and they turn an average of three times a month as opposed to 1.4 times a month for a traditional grain fleet. He said the difference is not in transit time. He said the difference is in the end points. He said the difference comes from the amount of time it takes for customers to load and unload and in the amount of time it takes the railroad to put trains together. He said the other reason there is a faster turnaround is that shuttle trains are 110 cars long. He said for every such train moving throughout the network, more grain is being delivered.

Mr. S. Bobb said overall system performance has improved dramatically. He said the major reason is the company's willingness to invest capital in its operations. He said BNSF spent $11 billion in capital investment over the last six years.

Mr. S. Bobb said there is a disconnect between what their customers say about service and what the recent customer satisfaction survey has concluded.

Mr. S. Bobb said over time BNSF service to the grain shipper has improved, especially with respect to providing capacity to the marketplace. He said when grain is to be moved, that puts a demand on hopper cars. He said it would be impossible for BNSF to buy and maintain a fleet large enough to ensure that everyone who wants access to a grain hopper can have one during harvest. He said by making the investments in capacity and service improvement, BNSF has been able to dramatically shorten the number of days late. He said BNSF has also managed to narrow the gap between its guaranteed products and its tariff products. He said the nature of those two products will never be the same. He said a customer who chooses to buy a guaranteed product is going to get guaranteed service. He said a customer who chooses to buy a tariff product is going to get capacity available service.

Mr. S. Bobb said the shuttle program is a set of symmetrical commitments between BNSF and its shuttle customers. He said BNSF dedicates power, a covered hopper fleet, turn times that provide efficiency payments, and trip incentives to customers who take risks and put on forward freight. He said shuttle customers commit to having an appropriately efficient facility. Instead of having to break up trains, he said, BNSF can drive in with empty trains and drive out with loaded trains. He said shuttle customers commit to loading and unloading the trains within 15 hours at both the origin and destination. He said shuttle customers also commit to providing BNSF with logistical information. He said before BNSF spots a loaded or an empty shuttle train, the owner of the certificate of transportation has indicated where the empties will go next. He said this customer commitment to providing logistical information gives BNSF savings in the form of equipment costs and operating costs because shuttle trains use locomotives optimally. He said 110 cars, each loaded with about 110 tons of product, use about three locomotives over most of the BNSF network. He said shorter trains result in wasted horsepower. From a service perspective, he said, shuttle service has fewer moving parts. He said it is an intact train from origin to destination. He said there is not as much variability or risk of failure. Under the current shuttle network, he said, there are 73 origins and approximately 35 destinations across North America. He said those include destinations in Mexico and both origins and destinations on other railroads—both short line and Class I railroads. He said the BNSF shuttle network is not an BNSF-only product.

With 26- or 52-car service, Mr. S. Bobb said, BNSF has to wait until it gets a bill of lading from the customer indicating where those cars are going. He said the grain desk in Fort Worth, Texas, has to piece together the puzzle. He said BNSF does not run 26- or 52-car trains on rail lines because the economics are not there to do that. He said BNSF instead matches four 26-car trains or two 52-car trains or some other combination thereof. He said the time it takes to do that can average four to four and one-half days. He said shuttle trains get much better cycle time because they are not waiting to be matched up.

Mr. S. Bobb said BNSF had only one nonterminal elevator capable of handling shuttle trains in 1996—South Sioux City. He said in the early 1990s Burlington Northern tried coloading comprehensively across the network. He said under the program, Burlington Northern gave its customers incentives for providing information about coloading in advance. Upon evaluating the program, he said, it was found that customers did not see any service improvement, there was no enhancement of capacity for the network, there was no decrease in cycle time, there were no cost-savings, and there was a loss of market share to the Union Pacific because Union Pacific outperformed Burlington Northern. He said BNSF determined the coloading program was not something that ought to be continued and in its place developed the shuttle program.

Mr. S. Bobb said the Canadian rail network has undergone an even more dramatic change than the American rail network. During the last five years, he said, the Canadians have gone from a wooden car-single crib environment to a steel and concrete 112-car environment. He said the Canadians load a 112-car train more quickly than Americans load 110-car trains. He said the Canadians can load a car in 12 minutes. He said the grain is cleaned, graded, and ready to go before it hits the car.

Mr. S. Bobb said BNSF has had a shuttle product since 1996. He said BNSF still provides single-car service, 26-car service, and 52-car service because the marketplace demands differentiated service. He said one size does not and will not fit all. In 2001, he said, well over 40 percent of BNSF shipments were below 52 cars in size. He said about five shuttle facilities in North Dakota are presently owned by local cooperatives. He said that is the dominant type of shuttle facility ownership. He said two are owned by regional cooperatives, two are owned by multinationals, and one is a privately owned facility. He said over 20 of the 73 shuttle facilities across the BNSF network are owned by local cooperatives and 20 are owned by regional cooperatives.

Mr. S. Bobb said there are a lot of macroeconomic forces affecting rural America. He said those forces have been playing out for decades. He said BNSF is not driving the change in rural America. He said small elevators have a role and they will continue to have a role. He said there are markets that are not going to ship shuttle train quantities. He said examples are barley, canola, certain varieties of milling wheat, and identity-preserved grains. He said the single-car and 26-car trains provide transportation for these products. He said the 26-car rate is higher than the shuttle rate. He said one would presume that the niche markets provide higher value as well.

Mr. S. Bobb said the shuttle network will take trucks off the highway by reducing long-haul trucking on both outbound grains and inbound fertilizer. He said the highways are competition for BNSF. If it is cheaper to gather grain by truck than by rail, he said, the grain will be gathered by truck. He said that is what is happening on many branch lines. He said if highway economics are the better option, branch lines will disappear.

Mr. S. Bobb said BNSF is not a regulated utility that is guaranteed a return on invested capital. He said BNSF is not earning its cost of capital. He said BNSF can earn its cost of capital by one of three ways. He said BNSF can increase and has increased the volume of product it transports. He said BNSF takes and has taken tremendous cost out of the network. He said the shuttle train program is one such way BNSF has managed to take cost out of the network. He said the third way BNSF can earn its cost of capital is by increasing prices. He said the grain transportation business is tariff-based and the transportation rates therefore move with the market.

Mr. S. Bobb said BNSF has not done a good job of increasing grain transportation rates. He said the North Dakota car rates going to the Pacific Northwest have stayed about the same as they were in 1981. He said if BNSF were a utility or a good cost-plus pricer, it would have passed on the incurred costs of inflation and the rates would be $1.08 per bushel higher. He said if BNSF tries to raise its rates above that which the market will support, the grain will be trucked rather than shipped by rail. He said if BNSF rates are too high, the grain does not move into the destination markets. He said BNSF has managed to raise rates a bit on grain going west but not on grain moving east to the Minneapolis domestic market. Mr. S. Bobb said there are four parts to the economics of a shuttle train. He said the rate spread between a 52-car wheat train and a shuttle train is $100 to $150 per car. He said in the world of grain, that is a narrow rate spread. He said in some corn markets the rate spread approaches $600 per car. He said the rate spread will probably widen in the future. He said the present rate spread is too narrow to reflect current economic benefits. He said the elevator at the point of origin has the opportunity to earn $100 a car for loading the train in 15 hours or less. He said the elevator gains or loses that loading incentive on every train. He said the destination has an opportunity to earn $100 per car for unloading the train within 15 hours. He said they can also lose it by doing what many of the exporters do with the 26- and 52-car trains, i.e., mix and match them on the way.

Mr. S. Bobb said BNSF offers an additional incentive of $100 per car to customers who take a risk position and commit to running a train 24 consecutive times. He said that way BNSF does not have to take cars in and out of storage. He said BNSF has locomotives and crews available and it knows how long a commitment it has.

Mr. S. Bobb said the data does not support claims of a negative impact on small shippers. He said in 1995 the rate spread for the Pacific Northwest between a single-car and a 26-car train was about $300 per car. He said the rate spread between a 26- and 52-car train was about $300 per car. He said the current rate spread between a 52-car train and a shuttle train is about $50 to $100 per car. He said in 2000 the rate spread between a shuttle train and a single-car shipper was less than the rate spread between the 52-car train and the single-car shipper. He said while claims of impact on single-car shippers amount to interesting rhetoric, the claims are not supported by the facts.

Mr. S. Bobb said inverse pricing is another term for differential pricing. He said this is practiced in every business. He said when the rail industry was deregulated in 1980, it was coded in law as a way of allowing the rail industry to go from bankruptcy to potentially earning a return on invested capital. He said differential pricing is a way of doing business.

Mr. S. Bobb said in 1995 Burlington Northern had the opportunity to capture additional foreign business. He said there are two ways that southeast Asian customers can get corn from the United States. He said they can get it by transport down the river system to the Gulf or by rail to the Pacific Northwest. He said there were changes in ocean freight and barge freight. He said when barge rates went up, Burlington Northern raised its rail rates. He said when barge rates went down, Burlington Northern lowered its rail rates. He said in 1995 barge rates were up, ocean freight differentials moved, and Burlington Northern had an opportunity to take corn transport away from the barge system. To do that, he said, Burlington Northern had to price the corn off the river lower than the corn for the West. He said this is a great example of inverse pricing. He said some thought that Burlington Northern should have lowered all its rates. He said had Burlington Northern lowered all its rates and not engaged in differential pricing, it would have cost Burlington Northern more money than it would have made pursuing the additional traffic.

Mr. S. Bobb said differential pricing involves pricing to the market at every origin and capturing all the business one can. He said different customers pay different prices. In the 1995 scenario, he said, Burlington Northern realized a net benefit of $32 million by getting the additional corn. He said had Burlington Northern lowered all its rates to capture the corn market, it would have cost the company $42 million.

Mr. S. Bobb said the genesis of the westbound contract wheat program was that Montana had a bad crop and the Pacific Northwest export customers were indicating in early 2001 they were worried that they would not be able to source enough grain to backfill their wheat export plans. He said they were also worried that their customers would go to Canada. He said BNSF put in place rates that allowed the Pacific Northwest exporters to reach farther east than they traditionally would have to obtain the product. He said those rates were put in place in March 2001. He said BNSF does not believe that the rates have distorted the market.

Mr. S. Bobb said people said that BNSF flooded the Pacific Northwest with wheat, that the low-quality wheat was going to damage the Pacific Northwest's reputation, and that the low-quality wheat was going to distort the Asian markets. He said this issue is bigger than transportation. He said this is all about alternative markets. He said the domestic market, signified by Minneapolis, and the export market, signified by the Pacific Northwest, tend to move together. He said there is a market price relationship between those two market destinations and it has to do with the differing demands at those two destinations.

Mr. S. Bobb said during 2001 wheat prices in the Pacific Northwest were generally substantially higher than they were in 2000. He said the statistics do not bear out the charge that the Pacific Northwest was flooded with wheat that drove the prices down. He said the claim that there was lower quality wheat going to the Pacific Northwest is facetious as well. He said an exporter would not buy lower quality wheat and risk its customer relationships. He said wheat from western Minnesota and eastern North Dakota has been going to the Pacific Northwest for decades. He said the only difference is who is handling the wheat. He said if a Pacific Northwest exporter cannot go out and get an occasional bit of grain when needed, the exporter would risk losing customers because the customers could not be supplied with wheat.

Mr. S. Bobb said if a Pacific Northwest exporter wants to get grain away from the domestic market, the exporter would have to bid up the price to make it happen. He said bidding up results in more money going into the farmer's pocket. He said even at the closest spread point, Southwest Grain Cooperative has a three-cent advantage over everybody to its east. He said people need to look at more than just transportation rates. He said the grain industry is not that simple.

Mr. S. Bobb said about 4 percent of the wheat shipped out of North Dakota during 2001 moved under differential rates. He said 16 percent moved in shuttles. He said North Dakota's shipments are predominantly to the eastern mills, the western mills, Duluth-Superior, the Pacific Northwest, and Gulf-St. Louis. He said the Pacific Northwest and the Gulf-St. Louis are really the only shuttle destinations. He said even in those wheat shuttle destinations, the predominant shipments of choice are 26- and 52-car trains because that is what the market wants.

Mr. S. Bobb said BNSF has provided rate and efficiency discounts and multiple trip incentives. He said North Dakota shippers are given the same transportation options as are other shippers in North America. He said the shuttle network will continue to expand. He said there are probably about 30 origin and destination projects in the hopper. He said they should end up with approximately 200 origin and destination points on either BNSF or other rail lines.

Mr. S. Bobb said specialty crops and genetically modified organisms will result in more single-car shipments. He said BNSF will continue to offer single-car service to support that segment of the market. However, he said, single-car rates cannot be the same as the shuttle rates because the economics to support that are not available.

Mr. S. Bobb said until there are genetically modified crops with traits that create consumer-perceived value, it is unlikely the consumer will pay more for those crops. To date, he said, most genetic modification has resulted in value for the producer—disease resistance, insect resistance, and herbicide tolerance—through lower production costs. He said when the next wave of genetic modification hits and consumer-perceived value is added, then the consumer will pay more and that higher payment will address the enhanced segregation and transportation costs necessary to move the product. He said government intervention is always a risk. He said capital flight is a risk. He said Wall Street does not get excited when a company spends lots of money on investment and does not get an appropriate return on its invested capital. He said BNSF will be doing whatever it can to increase its return on invested capital.

Mr. S. Bobb said the macroeconomic forces in rural America have been coming for decades and they are going to play themselves out. He said rail service in North Dakota is better than it was 20, 10, and 5 years ago. He said customers can get access to guaranteed service and to guaranteed railcar supplies. He said rates have not gone up. He said BNSF has absorbed a lot of inflationary costs. He said both railroads are getting market share back from trucks. He said the facts are evidenced by statistics from the Upper Great Plains Transportation Institute.

Mr. S. Bobb said the biggest risk is not going for change. He said capital invested 20 years ago or 10 years ago might not be the right capital investment today. He said producers have trucks today. He said they have the ability and the opportunity to bypass the elevator network and go directly to market or to processors themselves. He said while change is uncomfortable, it is necessary for the future.

In response to a question from Senator Nichols, Mr. S. Bobb said the way the rate structure is designed, the Pacific Northwest has to bid up the price of grain slightly over the Minneapolis market. He said the Pacific Northwest's ability to bid up much higher is a function of the world market because of Canadian Wheat Board exports.

In response to a question from Representative Brandenburg, Mr. S. Bobb said BNSF spent a fair amount of time looking at the Edgeley situation in terms of the origin free on board value. He said Edgeley still has a better free on board value going east than Jamestown has going west. He said Edgeley also has elevator facilities on the Canadian Pacific and the area farmers therefore have an option to ship that way as well. He said BNSF has looked at its rates very carefully and it does not believe that its rates have had an impact on the Edgeley facility.

In response to a question from Representative Fairfield, Mr. S. Bobb said BNSF experiences a fair amount of competition across its network. With the trucks on the highway, he said, BNSF has had a lot of competition and has had to respond. He said the rate structure is designed to make wheat available to the Pacific Northwest. He said if a rate is already moving grain to the Pacific Northwest, a company would have no reason to lower the rate. He said the goal is to have a rate structure that puts more wheat into the Pacific Northwest, not a rate structure that degrades BNSF revenue.

In response to a question from Senator Krauter, Mr. S. Bobb said the bushel decrease mathematics is fairly close. He said the exporters did not use the differential rate as much as BNSF had expected them to use it. He said with respect to the three-cent differential rate, one must take into account not only the transportation rate, but also the destination market that French, Minnesota, has in Minneapolis. He said French, Minnesota, gets a net-back by selling to the Minneapolis market and that amount needs to be factored into an equation as well. He said one needs to know how much a Pacific Northwest exporter has to pay in order to pull the grain away from the domestic market.

Mr. S. Bobb said BNSF has very close working relationships with the grain exporters but those relationships do not impact the price of grain. In general, he said, freight is paid by the origin shipper. He said the choices of where to buy the grain and how to transport the grain are generally made by the destination. He said the majority of BNSF's revenue comes from the shipper, not from the receiver.

In response to a question from Representative Mueller, Mr. S. Bobb said BNSF's experience with coloading is that it does not increase capacity or create operational savings or improve service. He said economic and operational experience has caused BNSF to determine that coloading is not a comprehensive answer for the network. He said the reason that BNSF would not want to coload at certain select points along its railroad is that it would have an economic impact on those people who have made an investment in BNSF efficiency. He said BNSF has broadened its product line and given customers more options from which to choose. He said those people who have invested in the shuttle template have in effect earned a lower rate that is based on shared economics.

In response to a question from Representative Mueller, Mr. S. Bobb said there are some branch lines and single-car service issues that are the root cause of many of the comments on the Public Service Commission's customer satisfaction survey. He said other issues within the survey reflect philosophical differences regarding the shuttle program and demurrage.

Mr. S. Bobb said beginning in early 1996 and extending through early 1998, BNSF had a team that worked on designing the shuttle train program. He said the team was composed of people from various disciplines within BNSF and customers. He said people from elevators were on the design team.

Mr. S. Bobb said the issue is about economics. He said BNSF does have tremendous pressure from its investors. He said there are also customer pressures that are imbedded in the decisions that BNSF makes. He said the programs that BNSF puts in place are at the request of customers to meet the customers' opportunities. He said there are always a few people that believe something BNSF did was to their detriment. He said for each person who did not like the decision, there are probably 8 to 10 people who profited from the decision. He said shuttle trains drive up the origin value of grain.

Chairman Wanzek recognized Mr. Bob Stevens, Regional Manager, Southwest Grain Cooperative, Gladstone, who presented testimony regarding grain transportation rates. Mr. Stevens said Southwest Grain Cooperative has a shuttle loading facility between Gladstone and Taylor. He said Southwest Grain Cooperative is also in the process of building another shuttle facility in Lemmon, South Dakota. He said Southwest Grain Cooperative is a cooperative representing about 5,000 people. He said it has facilities in 12 communities.

Mr. Stevens said BNSF has transferred southwest North Dakota spring wheat markets that had been developed over the past 20 years to producers in the eastern Dakotas and western Minnesota by using inverted rate systems. He said BNSF has displaced millions of bushels of spring wheat raised in the western Dakotas. He said even though inverted rates have been in effect since last spring, the effects were not felt until after the 2001 harvest. He said the facility at Boyle is losing about a shuttle train a month to the eastern markets. He said the eastern grain does not have the same milling characteristics as western North Dakota grain. He said Asian markets will be lost to Canadian producers if those types of milling characteristics continue to move to the Asian markets.

Chairman Wanzek recognized Mr. Jim Bobb, Grain Division Manager, Southwest Grain Cooperative, who presented testimony regarding grain transportation rates. Mr. J. Bobb said the shuttle concept with respect to spring wheat is something about which people can get very excited. He said the problem arises when facilities are being built and there is the realization that there are not enough markets. He said the Pacific Northwest is the only real market right now. He said when you start looking at the facilities in the Red River Valley, you have to ask where they are going to ship the grain. He said there is no competition and the grain is held hostage unless the producer decides to move the grain first east and then west. He said the volume at Southwest Grain Cooperative is down about 20 percent at the current rate. He said Southwest Grain Cooperative will be down about 3.5 million to 5 million bushels of spring wheat this year. He said BNSF has not lost that volume. He said a lot of that volume is being loaded east at a lower rate. He said Southwest Grain Cooperative has invested about $6 million in the facility to be able to load shuttles. He said a long-term inverse rate will place Southwest Grain Cooperative in jeopardy.

Mr. J. Bobb said he does not understand why he needs to pay $120,000 more for a wheat train that has the same specifications for loading and unloading into the same marketplace as another product train. He said the Pacific Northwest market is 25 cents lower than it was a year ago. From the middle of November 2001, he said, the Pacific Northwest has lost value against last year. He said the export market is sluggish this year. Chairman Wanzek recognized Mr. Craig Fisher, farmer-trucker, Richardton, who presented testimony regarding grain transportation rates. Mr. Fisher said he normally hauls all his grain to the southwest corner of the state. He said this year he is hauling 70,000 to 80,000 bushels to Jamestown. He said his credibility with the local elevator will be hurt this year when he goes to buy fertilizer.

In response to a question from Senator Wanzek, Mr. Fisher said the net price per bushel difference that exists when he trucks his grain to Jamestown is 33 cents when contracted. He said that amount gives him a dollar a mile to drive.

In response to a question from Senator Krauter, Mr. Fisher said the road from Bismarck east is terrible. He said the truckers are the ones who are breaking up the roads. He said the truckers are using fuel and wearing out tires. He said he should not have to haul his grain east.

Chairman Wanzek recognized Mr. Vernon Mayer, farmer, Regent, who presented testimony regarding grain shipment rates. He said the majority of his wheat goes to the Southwest Grain Cooperative. He said Mr. S. Bobb presented a lot of overwhelming data regarding the economics of running a railroad. He said the average cost for BNSF to haul freight in the United States last year was approximately $18 a ton per thousand miles. He said BNSF's break-even costs are $15 to $16 per ton per thousand miles. He said that netted BNSF approximately $750 million in profit. He said to haul his wheat from Gladstone to the Pacific Northwest, it costs $26 per ton per thousand miles. He said that is $8 per ton more per thousand miles than the average of everything else that BNSF hauls in the country. He said if BNSF would just haul his wheat the average it costs to haul all other products in this country, the Southwest Grain Cooperative could pay 33 cents per bushel more for his wheat. He said there is a feeling of frustration out there, especially in the southwestern part of North Dakota. He said they feel they are being economically discriminated against by the railroads.

In response to a question from Representative Nelson, Mr. J. Bobb said the freight spread between a shuttle rate and a 52-car rate will vary depending on the barge rate through St. Louis. He said destination markets are very small for spring wheat right now. He said the Pacific Northwest is the primary market. He said he does not understand why all the new facilities are being built if there is no market. He said he is not saying there will not eventually be a market. He said right now they do not have any destination markets that can accommodate a shuttle. He said shuttle service to the Pacific Northwest has been profitable for the Southwest Grain Cooperative. He said the cooperative has loaded 33 shuttle trains since 1999. He said between the 2001 harvest and January 2002, the Southwest Grain Cooperative did not ship any grain to the Pacific Northwest. He said at that time the best market involved smaller trains going to Minneapolis. He said there are economic risks with shuttle trains. He said in order to get the incentives, everything has to click and that does not always happen.

In response to a question from Senator Wanzek, Mr. J. Bobb said it took everyone awhile to figure out why grain was moving the way it was. He said right now there is an unfair shifting of customers. He said everything west of the Southwest Grain Cooperative is a mileage rate and everything east is an inverse rate.

In response to a question from Senator Bowman, Mr. J. Bobb said BNSF holds a farmer's grain hostage until it is ready to ship it. He said BNSF will eventually ship everyone's grain.

In response to a question from Representative Fairfield, Mr. J. Bobb said the Southwest Grain Cooperative was built at Boyle because the two branch lines south had been abandoned, as had one branch line north. He said in 1999 the Southwest Grain Cooperative completed an addition to the facility which expanded it to two million bushels. He said the cooperative also completed an addition to its track to allow loading of the 110-car shuttle trains. He said the cooperative was told that inbound shuttle trains carrying fertilizer would become a reality and the cooperative therefore has a fertilizer plant. He said he has unloaded one such fertilizer train.

In response to a question from Representative Schmidt, Mr. J. Bobb said the elevator consolidation in southwestern North Dakota happened in the late 1980s. He said the Southwest Grain Cooperative also owns eight elevator facilities in the country.

Chairman Wanzek said a representative from the North Dakota Farm Bureau was not able to be present today. However, he said, he was given written testimony compiled by Mr. Eric Aasmundstad, President, North Dakota Farm Bureau. A copy of the testimony is attached as Appendix B.

Chairman Wanzek recognized Mr. Ron Raushenburger, Governor's office, who presented testimony on behalf of Governor Hoeven. He said Governor Hoeven has asked the Governors of neighboring states to join him in working toward a solution for the unfair grain prices. He said BNSF is using its power to offer discounted inverse rates. He said Governor Hoeven is asking BNSF to evaluate its rates and commit to making them equitable. He said BNSF practices are having impacts on the state's roads and the state's smaller elevators.

Chairman Wanzek recognized Mr. Tony Clark, Public Service Commissioner, who presented testimony regarding the role of the Public Service Commission in regulating railroads. A copy of his testimony is attached as Appendix C. Commissioner Clark said BNSF views North Dakota as being resistant to change. He said the problem is that North Dakota has a monopolistic imposition of will upon captive producers and elevators. He said North Dakota is against creating unfair and irrational advantages for a small number of shippers.

Representative Brandenburg said he wonders why there is a $1.08 rate in western North Dakota and lower rates farther east. He said it appears that the western part of the state has no competition; whereas, there is competition in the eastern part of the state and in western Minnesota.

In response to a question from Representative Mueller, Commissioner Clark said a rate complaint case would have to be taken before the Surface Transportation Board in Washington, DC. Until a few years ago, he said, going before the board was not a realistic option. He said in order to prevail in such a case, one had to prove the rates are unreasonable and the railroad was market dominant. Before the recent rules, he said, the railroads were able to stymie anyone who brought a rate complaint case. He said a rate complaint case brought in Montana was bottled up by the railroads for 17 years, just on the issue of whether the railroad was market dominant. He said they never were able to get to the issue of whether the rates were above what a competitive market would allow. He said in western North Dakota the railroad is clearly market dominant. He said the standard rule of thumb is a 180 percent ratio of revenue to variable cost. He said the Public Service Commission has looked at some shipments and determined that the ratios were in the 200 to 300 percent range.

In response to a question from Senator Wanzek, Commissioner Clark said federal preemption applies to the rail industry. On the federal level, he said, we have seen what has happened to other network providers, such as the telephone industry and the electric industry. He said the competitive changes have not happened in the rail industry and would require federal intervention.

In response to a question from Senator Krauter, Commissioner Clark said the Public Service Commission has intervened in cases before the Surface Transportation Board. He said new rules issued by the board are much more favorable to states like North Dakota and get beyond the initial determination regarding market dominance and move to the issue of the rates themselves. However, he said, the rules are now bottled up in litigation because the railroads apparently challenged the rules. He said during the last legislative session the Public Service Commission asked for an appropriation of $100,000 so it could begin to explore whether filing a rate case was the appropriate thing to do. He said the commission still believes it would be appropriate to pursue such research. However, he said, the commission also understands it will take a lot more money than $100,000 to prevail in a rate complaint case. He said because the new rules are being litigated by the railroads, the new rules are not in effect.

In response to a question from Senator Wanzek, Commissioner Clark said the Public Service Commission would be the entity to pursue a rate complaint case against BNSF.

In response to a question from Representative Schmidt, Commissioner Clark said before implementation of the Staggers Act in 1980, there were difficulties in the rail industry. He said there were a lot of bankruptcies. He said the rail industry was a very insolvent industry. He said the Act gave the railroads more ratemaking freedom and allowed them to streamline their abandonment procedures. He said it may be time to review the provisions of the Act and determine if changes are merited.

In response to a question from Senator Wanzek, Commissioner Clark said the Public Service Commission has the authority to initiate a rail case but without dollars to appropriately staff the effort, it would not be effective. He said rail rate cases are highly specialized. He said there is not the time to get involved in such an effort, given the number of staff employed by the commission and the statutory duties of the commission. He said a rail rate case would require specialized attorneys and specialized expert witnesses. He said such individuals can charge a premium for their services. He said the type of information that would have to be used in litigation would be above that which the commission is able to provide.

Chairman Wanzek recognized Agriculture Commissioner Roger Johnson who presented testimony regarding grain transportation rates. Commissioner Johnson said participants at the national meeting of agriculture commissioners passed a resolution urging all railroads to charge reasonable rates, offer fair and consistent rate spreads and service to all shippers, and treat all shippers equitably. He said the resolution also urged all railroads to offer coloading of trains and to implement reasonable loading policies that hold both shippers and railroads responsible for moving equipment promptly. He said the agriculture commissioners believe the federal government should increase its oversight over railroad issues, including issues pertaining to rates and services in areas where competition is not present. He said this is an issue that is beyond North Dakota. He said some of the states give their agriculture commissioners regulatory authority in this area. He said North Dakota does not do so.

In response to a question from Representative Froelich, Ms. Marcy Dickerson, State Supervisor of Assessments, Tax Department, said only the real property of railroads is subject to taxation in this state. Ms. Dickerson said the personal property of railroads used to be taxed too but the Railroad Revitalization and Regulatory Reform Act precluded discrimination in the way states tax railroads. She said because North Dakota does not tax the personal property of other businesses, it cannot impose a tax on the personal property of railroads.

In response to a question from Representative Froelich, Ms. Dickerson said to determine the taxation of a railroad's real property, the state begins by valuing the entire railroad. She said this is done via the cost, income, and stock and debt approaches to value. She said this is the method used by most states and it is known as unit valuation. She said a portion of that unit value is then allocated or apportioned to North Dakota. She said allocation factors include gross earnings, revenue traffic units, and car and locomotive mileage. She said the North Dakota figure is then taken and divided by the system figure to arrive at a percentage. She said the percentage of the unit value is then allocated to this state. She said the next step is to assign a value per mile of track to each rail line. She said all the value has to be allocated according to miles of track without regard to other factors. She said to arrive at the mile of track value, the Tax Commissioner asks the railroads for statistics on their income and their various activities on their miles of track. She said this enables the Tax Commissioner to determine which are the most valuable lines of track, as opposed to those that are less valuable. She said the Tax Commissioner calculates the relative value of each track. She said the railroads provide the Tax Commissioner with the number of miles in each taxing district.

In response to a question from Representative Brusegaard, Ms. Dickerson said when a railroad spur becomes nonoperating or abandoned, it becomes subject to local assessment. She said at that point it is not subject to the system assessment.

In response to a question from Representative Brandenburg, Ms. Dickerson said the Tax Commissioner does not collect property taxes. She said that is done at the local level.

Representative Brandenburg said elevators pay property taxes, fuel taxes, and other taxes that go to support local communities. He said when the local elevators close, somebody has to make up that shortfall in the local revenue stream.

Chairman Wanzek recognized Mr. Steven D. Strege, Executive Vice President, North Dakota Grain Dealers Association, who presented testimony regarding grain transportation rates. Mr. Strege said the issue of grain shipment rail rates is attracting national attention. He said the association has been accused of being adverse to change. He said in fact the association has a record of opposing changes that are detrimental to North Dakota. He said the inverse rates are in effect secret contract rates that will not be disclosed by BNSF. He said the shuttle packages are sold as 6, 12, or 24 packs. He said it is a large shipper's game. He said there is a discount for the 24 pack of $100 a car. He said the inverse rates go only to large shippers. He said it is not an even playing field. He said recently it became known that 52-car loaders east of Bismarck could also participate in the inverse rate. He said they get less of a rate break and it is only a temporary rate lasting through the end of March 2002. He said this move widens the discriminatory pricing in effect between the 26- and 52-car loads. He said instead of bringing rate levels down across the board, this brings a different fracture level to the program.

Mr. Strege said the shuttle program is claimed to be very efficient. However, he said, shuttle trains are given priority while other trains are left to sit for 7 to 12 days. He said the trains are loaded and ready to go but they are not picked up. He said the inefficiencies in the smaller shipments are created by the railroads. He said if BNSF would put as much effort into coordinating these smaller trains as they do into advancing the shuttle train concept, the efficiencies could be enjoyed by all.

Mr. Strege said BNSF says it had tried coloading and it did not work. He said that was tried in Union Pacific territory. He said all railroads in North Dakota, except BNSF, provide for the coloading of trains. He said BNSF has allowed its Red River Valley and Western Shortline to coload until June 30, 2002. He said the question to be asked is if the other railroads can make coloading work, why cannot BNSF. He said BNSF has made a decision not to coload and to instead push the single-loading shuttle station concept and to let other customers find their own way or simply go out of business.

Mr. Strege said in the eastern part of the state and particularly in the northern part of the state, the shuttle concept amounts to an elevator and branch line abandonment plan. He said if certain elevators are given a preferential rate and if those elevators have a circle of dominance that can extend out for 50 to 60 miles, the reality is that other elevators will close. He said that gives farmers in the area less marketing opportunities and it creates difficulties for rural communities.

Mr. Strege said there will probably always be single-, 26-, and 52-car rates on the books. However, he said, if the volume is pushed into the shuttle facilities, the smaller facilities will not be able to continue to exist. He said the scoots program is another indication that the 52-car loads are destined to be loaded only by the shuttle loaders.

Mr. Strege said Mr. S. Bobb stated that BNSF is not driving the change but rather the market is driving the change. He said the North Dakota Grain Dealers Association is not against efficiency and lower rates. He said the association would simply like to see those lower rates and efficiencies made available to everyone in North Dakota.

Mr. Strege said the eastern part of the state and the western part of the state should not get into a war. He said neither should shippers of different sizes get into a war. He said the common goal is lower rates for everyone. He said the Agriculture Committee could work with the National Conference of State Legislatures to bring attention to this matter. He said the committee could support remedial federal legislation, press BNSF for coloading on its lines, and investigate what it would take to file a rate complaint case. He said those efforts will put pressure on BNSF to be friendlier to all shippers.

In response to a question from Representative Brandenburg, Mr. Strege said a shuttle loading facility needs to have track on each side that can accommodate 110 cars, plus the necessary number of locomotives. He said that is two and one-half miles of track. He said, in the alternative, a facility could have circle tracks. He said the track needs to be able to accommodate 286,000-pound gross weight cars. He said the gross weight on hopper cars used to be 263,000 pounds. He said in the last 10 years, the hopper cars have increased to 286,000 pounds gross weight. He said one of the disadvantages of the increase was that it did create a problem for short line tracks that were not heavy enough to accommodate the heavier cars.

In response to a question from Senator Wanzek, Mr. Strege said there are nine elevators that are shuttle capable. He said some load 110-car trains but not within the 15 hours or they load for shipment to destinations that are not subject to the preferred rates. He said some elevators believe if they do not participate in the shuttle program, another elevator down the road will get the incentives from the railroad. He said it is not accurate to say the railroads are not pushing the shuttle facilities. He said the railroads could do more to work for the current system by encouraging coloading and by matching the 52- and 54-car trains.

In response to a question from Senator Bowman, Mr. Strege said the committee needs to determine whether this discussion is just about the efficiency of railroad transportation or whether it is about the efficiency of the entire food chain, from the elevator to the end consumer. He said the domestic milling market requires mainly 26-car trains or less. He said that market does not take 110-car trains. He said the railroad is creating a system that does not fit the domestic market. He said 52-car trains were serving the export market adequately and people had to spend money on the other end to gear up for 110-car trains. He said because there is the 15-hour unloading requirement, the exporters sometimes have to keep crews on even when they would otherwise not do so, simply so the exporters can be ready for the train and get it unloaded in the time required. He said the exporters also experience logistical problems, especially when they have other trains onsite.

Chairman Wanzek recognized Mr. Neal Fisher, Administrator, North Dakota Wheat Commission, who presented testimony regarding grain shipment rates. Mr. Fisher said most of the shuttle movement is much more applicable or adaptable to commodities other than spring wheat. He said the quality traits in the spring wheat markets do vary. He said there are different milling and baking attributes and performance within the spring wheat production regions. He said Asian customers have certain preferences. He said the commission is concerned about quality disruptions in key markets and the allocation of resources that might in the future dictate where wheat can be produced.

In response to a question from Representative Brusegaard, Mr. Fisher said the rates that do not make sense on a ton-mile basis are what is generating the concern about fairness. If the opportunity exists to lower rates in an area that requires longer shipping to the end market, he said, there must be enough margin to work with and still make a profit.

Chairman Wanzek recognized Mr. Keith Brandt, Manager, Farmers Elevator, Enderlin, who presented testimony regarding grain shipping rates. Mr. Brandt said BNSF seems to be ignoring branch lines that serve entities that have been BNSF customers for many years. He said more grain is being trucked on highways. He said North Dakota will probably lose $27 million in federal highway funds. He said the committee needs to determine who is going to bear the brunt of that. He said because BNSF has done a good job of reducing expenses, it should have the ability to reduce rates.

Chairman Wanzek recognized Mr. Todd Vogel, Manager, Marion Elevator, and a director of the North Dakota Grain Dealers Association, who presented testimony regarding grain shipping rates. Mr. Vogel said in the 1980s the railroad went to the 26-unit cars. He said the elevator incurred the cost and made the required change. He said in 1987 Red River Valley and Western Shortline took over the track from Burlington Northern but Burlington Northern still had a lot of control over the short line. He said in the early 1990s the certificate of transportation program came into existence. He said the North Dakota Grain Dealers Association opposed introduction of the program. He said the association thought it was not a decision that would help North Dakota. He said what Mr. S. Bobb did not explain was that under the certificate of transportation program, BNSF auctions off cars. He said in the auction process, the Marion Elevator had to pay the original $2,000 per car tariff rate and then had to go out and buy cars for $300 to $400 over that rate to get the cars to Marion. He said, as a result, the Marion Elevator started using trucks to move grain. He said in the past seven years there has been flooding in the Marion area. He said track in the area was under water. He said the railroad indicated that because the elevator did not ship cars in the past 5 to 10 years, the railroad would not fix the tracks in the area. He said the railroad blames the elevator for not shipping cars when the reality is that the railroads made it too expensive for the Marion Elevator to ship the cars. He said in 2001 the area tracks became abandoned. He said railcars will never be seen in Marion. He said the farmers in the area are shipping their grain by truck and that has a negative impact on roads. He said farmers are working land that was once owned by the railroads and the railroads therefore have a responsibility to service all the communities in North Dakota, and not to just pull out and say it is the community's fault or the elevator's fault that rail service is not provided or that cars are not loaded to make the rail service work. He said the circumstances are something over which the local residents have no control.

Chairman Wanzek recognized Mr. Dana Brandenburg, who presented testimony regarding his experience with BNSF. Mr. Brandenburg said all he heard today is how the railroad has used people, lied to people, and cheated people. He said in 1997 he had a business that involved picking up railroad ties from BNSF and reselling them to farmers and other entities. He said he had submitted a proposal to the railroad to develop a chipping facility in Mandan so he could chip the scrap ties, take the chips to the Heskett Plant, mix them with coal, and make electricity. He said he was told by the road masters that he would get the contract. He said BNSF had in fact given the contract to another entity. He said there should be an investigation into what BNSF did to him.

Chairman Wanzek recognized Professor Dwight Bauman, Pittsburgh, Pennsylvania, who presented testimony. Professor Bauman said his grandfather was involved in setting up the State Mill and Elevator and the State Bank. He said his grandfather was concerned that people in Minneapolis were trying to run North Dakota. He said that is happening now. He said farm people are driven by yearly cycles and city people are driven by economic cycles. He said in 1970 he convinced Carnegie Mellon University to buy a bankrupt taxi company to study the regulatory process. He said those who do not learn from history live to repeat it. He said the railroad is the model of the reregulation process. He said computer models have determined that 52 cars work and 51 cars do not work. He said the airlines had the same problem. He said the regulatory process does not fit a nice model. He said Oregon and Washington formed a process to take over branch line railroads and run them. He said the main lines are selling to Amtrak and someone should find out how much they will charge to use the track. He said farmers could then ship their own grain. He said the State Mill and Elevator Act included this possibility.

In response to a question from Representative Froelich, Mr. S. Bobb said in 2000, $390,731,000 of revenue was generated by BNSF in North Dakota. He said total taxes paid in North Dakota by BNSF was $7,246,602.

In response to a question from Senator Bowman, Mr. S. Bobb said BNSF sets transportation rates by capturing as much grain as it can at the various origins and by capturing as many destination opportunities as it can. He said in some origins, BNSF can set the rates higher and in some origins, it has to set the rates lower. He said the rate levels set by BNSF are a function of what the markets will bear. He said the question is how else would others suggest that BNSF set the rates. He said looking only at BNSF transportation rate impacts will give an incomplete equation. He said the elevation margins also need to be reviewed as well as export sales. He said during January, February, and March 2002, the wheat export market has gotten a lot softer and there is really only one entity that has exports. He said the question is from whom is that entity choosing to buy wheat and is that decision driving some of the other behaviors. He said is Jamestown simply needing to fulfill a commitment they made to supply bushels and are they therefore bidding flat to negative margins to avoid some sort of penalty. He said there is grain being trucked from the Dickinson area east and then moved west. He said BNSF will do the mathematics. He said if there are enough bushels moving, BNSF will have to do something to offset that. He said it would be a bad business decision for wheat to go from the Dickinson area east by truck to get on a lower rate moving west.

Mr. S. Bobb said BNSF has to make certain that this is a rate issue rather than a customer choosing to manage its elevator margins in this way. He said Minnesota producers have eastern domestic markets to which they are choosing to ship. He said producer marketing is driven by price expectations, tax purposes, and storage situations rather than by shipping rates.

In response to a question from Representative Fairfield, Mr. S. Bobb said testimony was offered about the trucking of grain from Dickinson to Jamestown. He said if people are trucking their grain instead of paying a premium for guaranteed cars, that shows there is competition. He said none of today's presenters has refuted the economic arguments he has made. He said there are opinions about future impacts and philosophical differences about what is right and wrong but no one has disagreed with BNSF's economic explanations. He said a question that needs to be asked is how many John Deere dealerships and Chevrolet dealerships have recently opened in rural North Dakota. He said those macroeconomic forces have nothing to do with BNSF but they are taking place.

Senator Bowman said the problem is that there is no profit left to the farmers. He said the farmers have been squeezed by everyone.

Mr. S. Bobb said farms are getting larger and the fact is that fewer farmers are therefore buying tractors. He said that is why there are fewer dealerships. He said farm income is derived from crop production and crop prices are very low. He said the railroads have not been able to get rail rate increases in part due to the fact that the destination market cannot pay more and still be competitive.

In response to a question from Representative Fairfield, Mr. S. Bobb said BNSF is charting its way through the macroeconomic forces. He said there is a perception that BNSF is causing consolidation in rural America. He said the reality is that BNSF is responding to the changes that are causing consolidation.

In response to a question from Representative Fairfield, Mr. S. Bobb said reprisals and punitive actions would not be acceptable in BNSF's corporate culture. He said if someone has a difference of opinion with what BNSF is doing, that person should express his or her opinion. He said some people have assumed that if the rates are lowered in western North Dakota, the rates will have to be raised in eastern North Dakota. He said the marketplace does not work like that. He said rates are set where the market allows them to be set. He said rates are not set as a result of reprisals.

In response to a question from Representative Renner, Mr. S. Bobb said BNSF is not a cost plus pricer. He said the rate per thousand miles is going to vary across commodity markets and across geographic origins as a function of each commodity's competitive environment. He said he does not know how BNSF agricultural rates compare to BNSF coal rates. He said BNSF agricultural business is 90 percent tariff-based. He said the agricultural rates are published on the web; whereas, coal rates are highly contractual.

In response to a question from Representative Brandenburg, Mr. S. Bobb said BNSF's shuttle program is both international and domestic. He said the largest growth in the shuttle program has been in Mexico and in domestic destinations. He said the scoots program was designed to fit the unique needs of some processors. He said the scoots program has been run primarily out of shuttle locations because they are capable of handling 58-car trains without any additional capital investment. He said because the nature of the domestic marketplace requires BNSF to partner with eastern railroads in offering the scoots program, it has taken a long time to achieve the appropriate design parameters for the program. He said the program started out at 58 cars and it is now at about 65 to 68 cars because that is what the eastern railroads want to run. He said the scoots program is in the developmental stages. He said today there are no wheat scoots running out of North Dakota. He said it looks like the scoots program's loading origination will not be confined only to shuttle elevators but it will be confined to the 286 network.

In response to a question from Representative Mueller, Mr. S. Bobb said he has been responsible for BNSF's agricultural products area for only four years so he does not know who said what to whom or who implied what prior to that time. He said he does not believe anyone could say that the 26-car or the 52-car arrangement is the only way to go. He said over 50 percent of the grain that left North Dakota in 2001 was shipped in 26-car shipments or less. He said in 1980 unit trains were introduced. He said in some markets, a shuttle is the best shipping method. He said shuttle economics is the way to get North Dakota grain to Mexico. He said the same is probably true of the Pacific Northwest. He said those customers who invested in 52-car facilities made that investment because it had an inherent set of capacity-creating and efficiency-creating service opportunities. He said the investment gave them a rate structure different from the single- and 26-car shippers. He said BNSF does not believe it would be fair to allow 26-car shippers to coload on the 52-car rate. He said given the investment made by facilities that have gone to 110-car facilities, it would not be fair to allow the same 110-car rate for 52- or 26-car shippers. He said not too many years ago no one would have been able to predict the kind of locomotive traction and horsepower characteristics in the marketplace today. He said a big new locomotive weighs 435,000 pounds and will literally squash a non-286 line when it rolls onto it. He said BNSF's coal fleet involves 315,000-pound cars. He said the coal trains are 117 to 135 cars. He said coal moves over a very dense network called the central corridor. He said there is less coal moving through North Dakota because the siting infrastructure is not in place to handle the trains. He said the grain network is never going to have the same density. He said if BNSF goes to a 315,000-pound railcar, six inches will be added to every railcar. He said that means that a train hauling grain in 315,000-pound cars with a locomotive consist would be longer than the typical siting infrastructure. He said BNSF therefore chooses to maintain a 286,000-pound grain car.

In response to a question from Senator Wanzek, Mr. S. Bobb said if one local elevator is already a 110-car facility and a second local elevator made the commitment to upgrade to a 110-car facility, BNSF would not discriminate against the second facility. He said both facilities would be offered the same rate. He said a single area might not, however, be able to support both shuttle facilities.

No further business appearing, Chairman Wanzek adjourned the meeting at 3:45 p.m.

[From ND Grain Dealers Association *Grainmen's Mirror* magazine, March 2002]

LEGISLATIVE COMMITTEE HEARS FROM STEVE BOBB

Tensions were high as the North Dakota Interim Legislative Agriculture Committee met on February 27 at the State Capitol in Bismarck. Sole item on the agenda was the committee's study into railroad rates and practices. Leadoff witness was BNSF Ag Products Vice President Steve Bobb. His presentation promoted shuttle trains and attempted to show there were no adverse effects from BNSF's inverse rates on wheat to the West Coast.

A very revealing point of the hearing came when Richardton area farmer Craig Fisher told of how those inverse rates caused him to truck his wheat 170 miles east to Jamestown for loading on a shuttle train to go back west past his normal delivery point of the Southwest Grain Terminal near Gladstone. Fisher said he didn't want to do that, what with time and wear and tear on his equipment involved, and bypassing his local business, but it gave him the best price on his wheat. Steve Bobb said he would have to look into the matter because he didn't want to be hauling wheat for less from Jamestown than he could haul those same bushels from Gladstone.

Committee member Senator Bill Bowman of Bowman, ND has been an outspoken critic of the inverse rate, which means farmers and elevators in his west end of the state pay more to ship grain to the West Coast than is charged for grain from eastern North Dakota and western Minnesota. He says this has robbed western North Dakota farmers of markets they have developed and traditionally served, and has had a significant depressing effect on wheat prices.

Southwest Grain Cooperative Grain Merchandiser Jim Bobb, a cousin of Steve Bobb, confirmed the market distortion by saying his cooperative's grain volume is down 20% from a similar period a year ago, which he blames on the inverse rate.

Senator Bowman questioned Steve Bobb pointedly about rate-setting by railroads. Bobb said they had to meet the competition. Well, asked Bowman, what about where there is no competition, like western North Dakota. Bobb basically admitted they charge what the traffic will bear.

Steve Bobb had actually set the stage for a high tension hearing when, in his opening remarks, he said North Dakota is simply against change. He said North Dakotans opposed unit train rates 20 years ago, the COT program, and now shuttle trains. Public Service Commissioner Tony Clark rebutted the accusations by stating that a definite pattern was showing, but that it wasn't of resistance to change; instead it is a monopolistic railroad trying to impose its programs on captive producers and elevators.

Grain Dealers Executive Vice President Steve Strege pointed out that on a Fargo area radio talk show the previous Friday, Mr. Bobb had singled out the ND Grain Dealers as opposing change, opposing any innovative concept the railroad had come up with. Strege thanked Mr. Bobb for the recognition of the key role the Grain Dealers Association had played in resisting changes like wholesale abandonment of branchlines and the car auction program that pits one shipper against another while the railroad controls the car supply faucet. He said the BN had more money and more lawyers to outlast the grain industry, including the National Grain and Feed Association and some large grain companies in the COT case, and that after seven years the grain industry just quit.

At one point during the hearing, Bobb said "macroeconomic forces" were driving the conversion to shuttle trains. He denied BNSF had anything to do with it, or that it was putting in any "upfront capital". Committee members seemed unconvinced. Representative April Fairfield of Jamestown asked Bobb if he was "a pawn or a predator" within the "macroeconomic forces." Strege read to the committee from a July 1999 North Dakota newspaper report in which an official with a company building a shuttle facility had stated: "The railroad is driving this. Without their incentives this would not have happened. They're giving us a hell of a deal."

Steve Bobb said that BN had decided back in the 1980's to get away from secret contracts and go to transparent rate-making. His intentions were questioned later in the hearing when someone asked why these inverse rates are in secret contract.

Steve Bobb might have been surprised at the level of discontent these rates have generated. Upper management, half the Board, and a number of other patrons from Southwest Grain were at the hearing. Grain Dealers was there in force with five people. The Governor's office, Public Service Commission, Ag Commissioner, Wheat

Commission and others testified in opposition to what BNSF is doing. Public Service Commissioner Tony Clark's testimony is printed elsewhere in this issue.

Southwest Grain Cooperative General Manager Bob Stevens, with a shuttle facility near Gladstone, ND and another going up at Lemmon, SD, said the railroad is transferring markets developed by western North Dakota and Montana, to the east. He said there is a difference in the quality and milling characteristics of the production from these areas and that (by trying to fill markets with something different) we risk losing market share to Canada.

Jim Bobb said the shuttle train concept for spring wheat is a little baby. He warned easterners that there are few destination markets that take shuttle trains of spring wheat. He said the BNSF has used the PNW market to keep the eastern shuttle loaders going, robbing western shippers of their usual markets. If people are building shuttle facilities for spring wheat, they better take a look at destination markets, he said, there are no mill markets in the U.S. that take shuttle trains. He also said that competing non-shuttle elevators in the east are vulnerable to this use of the shuttle concept.

Jim Bobb also brought up the significant but unexplained difference in rates between different crops. Why, he asked, does it cost him $120,000 more to ship a wheat train west than it would for corn or barley. He said the wheat rates are high enough to allow for the inverse rates.

From Governor Hoeven's office, Policy Advisor Ron Rauschenberger said Hoeven has been in contact with other Governors around the region and that a joint letter of concern to the BNSF is being circulated for signatures.

Ag Commissioner Roger Johnson stated that the National Association of State Departments of Agriculture had addressed rail issues at its meeting the previous weekend and had adopted a resolution calling for equitable treatment of all shippers.

Wheat Commission Administrator Neal Fisher reported some Asian market complaints about the milling characteristics of wheat they have been receiving off the PNW Coast. It is not yet confirmed, but Fisher thinks this could be related to eastern North Dakota and western Minnesota wheat moving into those markets, instead of the traditional supply from western North Dakota and Montana. Fisher emphasized that he wasn't saying the eastern wheat was of lower quality, but it is a *different* quality, and mills differently because of the differences in climates under which the two are raised.

Steve Bobb claimed that the PNW wanted more wheat than was available in Montana or western North Dakota, and so he had to put in lower rates from the east in order to fill the demand. He did not mention the Montana Ag Statistics report showing 79 million bushels of spring wheat stored in Montana in December 2001, or the millions of bushels stored in western North Dakota. State Senator Ron Nichols of Palermo asked if PNW buyers wouldn't have had to bid up to get more grain had the inverse rates not been put in. Bobb said the business would have gone to Canada.

State Representative Mike Brandenburg of Edgeley said he is concerned about BN's new tactics wiping out elevators, jobs and the tax base. He cited a widening spread in the rate between his local elevator, of which he is a director, and a shuttle loader 40 miles away. Bobb said the FOB values are the same and so there had been no impact. Brandenburg cited volume figures that showed otherwise. His elevator invested heavily in its station on the Red River Valley and Western Railroad, that feeds the BNSF. Edgeley could have made these improvements at one of two stations they have on the Dakota, Missouri Valley & Western. Now, said Brandenburg, the BNSF takes grain away from them with discriminatory rates. (Steve Bobb had said in a recent newspaper article that Edgeley was a victim of its own poor planning.)

State Senate Minority Leader Aaron Krauter of Regent accused BNSF of taking over the marketing process and being the exporter and the handler. Bobb said the majority of their revenue comes from the shipper and it is not BNSF's place to get in between the shipper and the exporter.

At one point during the meeting, Steve Bobb said, "We have not been very good at raising rates." This probably didn't score many points with Committee members. Bobb said they had cut costs. This prompted Grain Dealers Association President Keith Brandt to ask why all rates hadn't been going down. Brandt also made reference to the many times Steve Bobb talks about taking care of Wall Street and stockholders. Brandt quoted the new CEO of Ford Motor Co as saying a company should take care of its customers first and then the stock will take care of itself. Grain Dealers Director Todd Vogel said his elevator at Marion had spent money to upgrade for unit loading on BNSF, later becoming an RRVW line, but then couldn't remain competitive with high priced COTs. Lack of volume and serious roadbed problems have since led to the line being abandoned.

Mr. Bobb told the Committee that BNSF was hauling 40% of its grain volume in the 5,500 cars dedicated to shuttle train service. The other 20,000 cars picked up the rest. Strege said that much of this efficiency difference is explained by the railroad's concentration on shuttle service, while leaving other trains and cars sit at the elevators or on sidings or in rail yards so that shuttle trains can be pushed on through. It is the railroad that controls the efficiency. He said if BNSF would spend as much time and effort on working with its current customers, for example co-loading of shuttle trains, as it does on pushing the shuttle concept into areas where it doesn't make sense, by manipulative rate schemes, the railroad could gain efficiencies and much of the current elevator system could be maintained to service farmers.

Bobb said they had tried an extensive program of co-loading in the mid 1990's, but lost market share to the Union Pacific. It was later pointed out that the closest Union Pacific tracks are some distance south of North Dakota and so the comparison is invalid. All other railroads in North Dakota, except BNSF, do co-loading.

The state's authority over railroads doing business in interstate commerce is limited. The Public Service Commission is the designated agency to represent the state in railroad matters such as at the federal Surface Transportation Board. That does not preclude other state officials such as the Governor or Ag Commissioner or Attorney General from becoming involved.

Public Service Commissioner Tony Clark stated in his testimony that in the 2001 legislative session a PSC request for $100,000 to look into bringing a rail rate complaint to the STB was turned down. The railroads had lobbied against it. Sentiment at the Interim Ag Committee seemed to be that the rejection of that funding had been a mistake, and that getting something going like that should be taken up again.

State Representative Rod Froelich of Selfridge asked a number of questions about the amount of property taxes BNSF pays in North Dakota. A representative of the Tax Department was called to the hearing to explain the formulas for assessment.

State Representative Phil Mueller of Wimbledon said the BNSF is certainly not talking fairness when it put programs in place that bypass its own 52-car loaders. He also brought up co-loading. Steve Bobb said he doesn't know what was said by whom about the duration of 52 car trains being "top dog".

Strege urged continued joint action with other states through Governors, Public Service or Utility Commissions, Ag Commissioners, and the Conference of State Legislatures. Support of federal legislation to provide more oversight on the railroads is likely necessary, and should be supported by state government and the Congressional delegation he said.

The Committee plans to meet again in April regarding the railroad issues. It is scheduled to meet again in March to take up one of its other studies, on genetically modified crops.

[From the *Bismarck Tribune*, February 3, 2002]

ALLIANCE CLAIMS RAILROAD OUT TO BUST RURAL N.D.

(By Lauren Donovan)

Farmers and the railroad are like a couple locked in a bad marriage.

They can't break up and they can't get along either.

The relationship never has been easy. But it has now reached the point where an agriculture coalition in North Dakota is spending big advertising bucks to tell the world how far things have deteriorated.

In thousands of dollars worth of newspaper and radio ads, the Alliance to Keep Rural America on Track claims Burlington Northern Santa Fe is behind a system of super shuttle elevators on its line, giving some of those shuttles better rates than others and ultimately driving smaller elevators right off the map.

Among casualties, the alliance says, will be more small towns, more jobs and more roads and highways beat up bald because they're used like branch lines to fewer elevators.

The alliance says BNSF looks, smells and acts like a monopoly and it can do whatever it wants because it doesn't have any significant competition here, pushing rail rates higher in North Dakota than any other state. They estimate the railroad's gross revenue in the state approaches $340 million.

The railroad answers that the alliance puts emotion ahead of fact.

BNSF says the 110-car super grain shuttles so disliked by the alliance accounted for 16 percent of its grain freight in North Dakota last year and have helped keep rates fairly steady over the last 20 years.

And besides, the market, not the railroad, will decide how many elevator shipping points are viable in the future, BNSF says.

As to charges of monopolistic behavior, the railroad says it isn't regulated like one and the presence of the Canadian Pacific railroad, plus any number of semi trucks in North Dakota, provide a competitive rate atmosphere. Rates are highest here because distance to the market is longest, it says.

BNSF owns or controls 70 percent of all the railroad track in North Dakota and correspondingly has a 70 percent share of all grain moved by rail, according to a study by the Upper Great Plains Transportation Institute at North Dakota State University.

The alliance has the attention of state officials.

An interim Agriculture Committee will investigate BNSF's rates, and railroad representatives were called into Gov. John Hoeven's office Thursday. At that meeting, BNSF agreed to open its books so a third-party analyst can look at the railroad's rates and its economic justification for other shipping practices in dispute.

The North Dakota alliance, arm-in-arm with a national Alliance for Rail Competition, is pushing federal legislation. The proposal, while still a long way from regulating the railroads like they were before the deregulation of the 1980s, would give shippers and producers better avenues for rate complaints and access to rate arbitration.

Jon Mielke, who oversees elevator issues for the state Public Service Commission, agrees with the alliance's position that the future looks very worrisome for many of the state's 420 elevators.

Farmers and elevators on one side and BNSF on the other were rubbing along in their usual fractious way until last summer.

Then, because BNSF wanted to pull grain from eastern North Dakota away from Minneapolis and into the Pacific Northwest markets, the railroad implemented a new inverse rate system that suppressed freight rates for only a few 110-car shuttle elevators east of Bismarck. The further east of the usual market dividing line at Bismarck, the lower the rate.

Mielke said BNSF should give all farmers an equal shot at lower rates.

Because the railroad not only gives better rates to shuttles and then picks and chooses among shuttle elevators which ones get favorable inverse rates, "It's thereby dictating who will live and who will die," Mielke said.

Terry Whiteside of Billings, Mont., heads up the National Alliance for Rail Competition.

He said BNSF's inverse rates in North Dakota were a tactical blunder that could cost the company in the ongoing battle.

"This is not a nice company. This is a war," Whiteside said.

To illustrate, he holds up Monopoly cards that let the players charge eight times the rate when they own all four railroads on the game board.

"The inverse rates were classic market abuse, creating winners and losers," Whiteside said.

Stevan Bobb, a Richardton native, is head of agricultural products for BNSF at Fort Worth, Texas.

He said the railroad had to pull more grain to export markets in the Pacific Northwest this summer, and if it hadn't, both the railroad and North Dakota grain producers would have left money on the table to be snatched up by the Canadian Wheat Board.

"Should we do what the alliance says and let the Canadian Wheat Board make the sale?" Bobb said. He said the inverse rate only pulled 4 percent more wheat onto shuttles.

Steve Strege, head of the North Dakota Grain Dealers Association, says it isn't that simple. He said rates were lowered to less than $1 per bushel at some shuttle elevators, primarily because of competition from Canadian Pacific. But out at Southwest Grain Cooperative, the shuttle elevator in Gladstone, the rate stayed at $1.08 because BNSF is the only game in town, he said.

Today, there are nine elevators that can load the super shuttle trains on BNSF's lines. Bobb said in every case, the railroad provided incentives to encourage the elevator boards and managers to build to that capacity.

Shuttles are the best rates around. They're lower than for unit trains of 52 or 26 cars, pushed by BNSF in the 1980s and 1990s, and far lower than single car shipments.

Strege said shuttles do, for now, offer farmers a better rate.

"But for who and for how long? Once they get rid of the other elevators, the rates will go back up and no one will get a break," Strege said.

As a case in point, he nods to the Edgeley elevator, which two years ago invested $1.5 million to ratchet up to 52-car capacity.

Then, when BNSF lowered the shuttle rates at Jamestown, 40 miles north on the main line, producers were attracted to a 30-cent rate spread. As a consequence, Edgeley saw about 1 million bushels that it normally handles go right up on the highway.

Bobb said Edgeley is victim of its own poor planning.

"If they went to a 52-car system in the last five years, they probably made a bad business decision," Bobb said. "They're welcome to build to shuttle size."

Same thing for elevators that invested in track and equipment to load 26-car unit trains.

"They face nothing (from the shuttles) that they haven't already faced from the 52-car guy. The small shipper, I don't get their story," Bobb said.

Bobb said BNSF invested heavily in the high cubic volume shuttle cars, adding 5,500 of them to its fleet of 29,000 cars to cut operational costs.

The shuttle trains—a mile long, pulled by three locomotives and as big as grain trains get—are a response to changes in the market place. They're most profitable on the long-haul runs to the Pacific Northwest export market. BNSF gives shippers incentives to load and unload them in 15 hours, so they can be quickly turned around used again.

"Where else in industry do you have 20 years before a change in technology comes along? Most of them (26- and 52-car unit facilities) were built in the 1980s," Bobb said.

With nine shuttle elevators already in operation and six in various stages of development in eastern North Dakota, it's clear that more and more grain and oil seed in North Dakota will move on shuttles and less and less on single and unit car trains.

It's also a tactic that could increasingly pull grain away from BNSF's competition in eastern North Dakota.

That part of the state has a high concentration of Canadian Pacific rail lines, which doesn't have any shuttle elevators, and semi-trucks can compete in a short-haul to the Minneapolis market.

The summer's experiment with inverse rates proved that BNSF can pull wheat from eastern North Dakota—traditionally bound to Minneapolis and out—into the Pacific Northwest export market.

Since that has been a western North Dakota wheat market until now, some say the availability of even more product will only further depress the price.

Bobb said BNSF did not crash the Pacific Northwest market with inverse rates this summer.

"A delivered market is a delivered market," he said.

Research by the Upper Great Plains Transportation Institute shows that the shuttle elevators—only 2 percent of all elevators in the state—can already handle one-third of all grain freight in the state and will have to, in order to show a profitable return.

That kind of concentration into so few locations has implications for roads, towns and elevators.

The institute estimates that another 100 elevators will close within the decade, meaning farmers will have to drive further to get to those that remain. The number of farmers who own semi-trucks increased 200 percent since 1995.

"We're fighting for more than a town here and there, an elevator here and there and a bunch of beat-up roads in between," Strege said.

Whiteside, the chairman of the national Alliance for Rail Competition, said there's talk in the industry that shuttle elevators and consequently BNSF are having difficulty filling the super grain trains. They're too big to provide the kind of product consistency and grading required by the end users, he said.

"The jury is still out on whether the shuttle train is going to work or not," Whiteside said.

Some also fear that the shuttles—huge trains hauling nearly a half million bushels at a crack—will limit economic development in small niche markets for identity preserved grain and specialty crops.

Ward Uggerud of Otter Tail Power helped organize the national Alliance for Rail Competition.

He's worried about the future of the 250 or so towns it serves that have fewer than 300 people in them.

Uggerud said in the drive to encourage shuttle trains that drive out small elevators, BNSF may be working adverse to its own best future interests in niche markets.

"I think they've lost a certain amount of business acumen," Uggerud said. "They've lost the wisdom that would have allowed them to be more profitable in some of these niche markets."

But Bobb says if the market demands small niche grain shipments, the shipper elevators will be there to respond.

He said there was a 2 to 5 percent increase in single car shipments in the 2001 crop year compared to the year before. However, those were confined to commodities like dry edible beans, because no one out there is willing to pay a premium for wheat.

He said BNSF does and will continue to service small elevators, but to expect them to get the same favorable rates as the super shuttles is out of line.

One thing BNSF doesn't dispute is that it has 1,000 less track miles in North Dakota than it did 20 years ago—more than Interstate 94, both directions.

It also doesn't deny that in some instances, it provides incentives for small elevators to use trucks instead of branch lines to move grain to the main line.

It will abandon another 4,000 miles of track through its entire system over the next four years.

Mielke said some of those miles will likely be in places like Zahl and Grenora where BNSF will be able to claim the line isn't being used because it's paying incentives for it not to be.

Bobb said cutting down track maintenance is one way BNSF takes costs out of the equation and keeps rates stable.

"We would raise rates if we could," Bobb said. "It's not like we're nice guys."

Whiteside said North Dakota and regional farmers and shippers who are locked inland are engaged in a critical struggle against BNSF's practices.

"It's a struggle we can't afford to lose," Whiteside said, "or we'll never be able to pull ourselves up by our bootstraps."

Senator DORGAN. Mr. Strege, thank you very much.

Next we'll hear from Jim Bobb, Grain Division Manager, Southwest Grain. And we have two Bobbs on the panel, can you describe the origin of the two Bobbs?

STATEMENT OF JIM BOBB, GRAIN DIVISION MANAGER, SOUTHWEST GRAIN

Mr. JIM BOBB. Yes. First of all, thank you, Senator Dorgan, I appreciate the opportunity to testify today. Steve and I are cousins and I don't know why we're not sitting next to each other, but then I notice their names are the same, so I thought, maybe you guys are related, too (Steve Bobb and Steve Strege). I have to apologize, I do have a handout, but I don't know where they're at and I can put it on PowerPoint, but I see you're direct in line with the screen so I don't know if that's viable.

Senator DORGAN. It's your choice. I'd be happy to move if that's easier for you, if that would allow the people in the galleries to see. I'll just move to this side of the table. Why don't you proceed.

Mr. JIM BOBB. I apologize for the delay. Are my 5 minutes up?

I'm going to begin and we can look at the handout as I go through it.

I'm Jim Bobb, Grain Division Manager for Southwest Grain, Regional Division of Cenex Harvest States. Our headquarters are northeast of Gladstone, North Dakota, about 80 miles straight west of Bismarck.

I provided a handout stating our concerns and reasons we feel we need your help. Why would I come here today when freight is not a cost for a company, but fully passed on to the producer? It's very simple. I would like to be the voice for those producers. I feel it's an appropriate time to testify before this Subcommittee asking for a simplified rate relief mechanism.

In southwest North Dakota, there's only one railroad and trucks are not a viable competitor with the volume of wheat that needs long haul transportation. Producers have been assessed high rates when compared to product competition and now this past year with the inverse rates, a compelling case can be made that at our shuttle location, the rate on wheat is 31 percent too high, or $.29 a bushel. In southwest North Dakota, the 2001 spring wheat production was 36 bushels an acre, 5 percent higher than the year before. With a reasonable rate structure, producers would have realized $10.47 an acre decrease in their transportation expense. A typical producer that raises 1,500 acres of wheat would have seen a $15,000 savings. Over his 30 years of farming this would be $450,000. This would increase land values. To give you an example of what the savings would have been to these producers, this past year we shipped 15 shuttles to the PNW from Boyle alone; that would have been a savings of $1.8 billion.

My presentation will also address Southwest Grain's decreased handle, financial impact, and it is a direct result of the BNSF-initiated inverse pricing structure.

This slide that's currently up is something we're having a hard time understanding when the corn/barley rate for a shuttle that operates under the exact same loading, unloading, and shipping conditions at Boyle is $1,101 more. So if you farmers could figure out some way to bring your grain in so that we could buy it as corn, we'd be doing all right. As you can see, that is a substantial savings.

Senator DORGAN. This is the West Coast?

Mr. JIM BOBB. That's just to the West Coast.

This slide, and I'm not going to go through this, but what we did is we took the revenue per ton per thousand miles at each of these locations along the interstate and showed what that revenue was in the blue graph. The yellow line is a revenue that BN received in the year 2001 on all commodities hauled at $18.05, and the red line is their operating expense. The space in between there would be $731 million they reported as their profits in 2001. As you can see, we feel, probably justifiably, that rates are quite above that out West.

This slide compares a flat price track value 14 protein spring wheat, delivered to the PNW, for the past 2 years. With increased procurement, from the inverse pricing scheme, comes a direct correlation to the lower prices.

This slide shows mileage and rates charged per bushel for wheat shuttle at various locations both to the PNW and Minneapolis, and there are farmers in this room that wouldn't mind if the BN could pull those cars to Minnesota and back if they just need mileage, you know. If that's all you're looking for, they can pull them cars around awhile after they're loaded.

The inverse pricing scheme has affected our operation as much or more than any elevator in North Dakota for a couple reasons. First, access to Interstate 94. Interstate 94 provides availability for back hauling of corn, feed stuffs, and fertilizer. Second, the quality and quantity of spring wheat grown in our immediate area.

I want to share with you these three areas that I believe have directly impacted Southwest Grain's bushel handled, rail cars loaded and spring wheat margins.

This next slide shows the seven counties within a 50 mile radius of our terminal. Production in 2000 and 2001, as I stated before, up 5 percent. If you look at those seven counties, according to the information that was given before here in North Dakota, 50 percent of North Dakota's production was within 50 miles of our elevator but where is this production going right now?

This next slide shows our handle since September through February, we're down 14 percent, about 800,000 bushels just at our own facility.

This next slide shows cars loaded in each of those months. This will be just wheat cars loaded out of Boyle, 2000 versus 2001, down 21 percent.

This next slide is what really hurts us, this represents our margin retention per bushel compared to the 6 months a year ago. Loss of margins is directly related to local procurement against the inverse rate.

As you have been able to see, business is not as usual. Relationships with our producers are stressed. If this trend continues our co-op is in jeopardy as bushels move east and margins are lost.

In conclusion, I would like to ask that the BN stop this destructive practice of using an inverse rate pricing scheme in North Dakota. Second, that we'd have an affordable, timely, and simplified rate relief process that all shippers of commodities, in captive markets, can access. In simple terms, a rate relief mechanism without long litigation.

On behalf of patrons and management of Southwest Grain, I would like to thank you personally, Senator Dorgan, and the rest of the Committee on Commerce, Science, and Transportation, for the opportunity to testify in your presence today.

Senator DORGAN. Mr. Bobb, thank you very much.

Next we will hear from Tony Clark from the Public Service Commission.

Tony.

STATEMENT OF TONY CLARK, PUBLIC SERVICE COMMISSIONER

Mr. CLARK. Thank you, Senator Dorgan, for having me here today on behalf of the Public Service Commission. As you mentioned earlier, I am in attendance with my fellow commissioners, Susan Wefald and Leo Reinbold.

The Public Service Commission is the State agency charged with both regulating grain elevators and representing the State's rail interests. Since this hearing involves transportation of grain out of North Dakota, I believe the Commission is especially well qualified to testify and on behalf of the Commission, I thank you for this opportunity.

Burlington Northern Santa Fe's inverse rates on wheat shipped from North Dakota to the Pacific Northwest make a great deal of sense from the railroad's perspective, they allow BNSF to maximize profits and shift part of its costs to the public sector. Now, if this were a competitive market, we likely wouldn't be here today. But in a noncompetitive market, this policy raises great concern, as these are essential services that are being provided to North Dakota farmers.

The BNSF has been able to carry out its plan because shippers in almost all of western North Dakota are captive to BNSF. If there was effective competition in the market, BNSF could not implement this particular rate structure. Because unlike so many other regions of the country, we simply have no other alternatives. BN is the only rail carrier west of the Missouri River in North Dakota, it's the dominant carrier throughout all of North Dakota. We do not have any direct access to water transportation, and trucks are just simply inadequate when it comes to moving bulk commodities in distance.

The extent of North Dakota's captivity is exemplified by the rates that we pay. North Dakota's rail rates are among the highest and most profitable anywhere. While the Staggers Rail Act sets 180 as a reasonable and profitable revenue-to-variable-cost ratio, many of North Dakota's rates generate ratios of 300 or more. If there was effective competition in the local transportation marketplace, the railroads would not be able to achieve the high ratios of this magnitude. We estimate that these excessively high rates cost North Dakota farmers and shippers between 50 and 100 million dollars each year.

BNSF's inverse rates were implemented about a year ago. At the present time, the 110-car shuttle train rate from southwestern North Dakota to the PNW is about 28 cents per bushel higher than the rate paid by shippers in eastern North Dakota, even though the shippers in western North Dakota are over 250 miles closer to the market.

These preferential rates are available only to a very small number of eastern shuttle train loaders. They put western North Dakota shuttle and non-shuttle shippers at a disadvantage relative to their eastern counterparts, but they have an even greater impact on non-shuttle loaders in eastern North Dakota.

Prior to the implementation of these inverse rates, eastern shuttle loaders had a 15 cent per bushel rate advantage over nearby 52-car loaders. The advantage increased to as much as 38 cents with the implementation of inverse rates.

Grain elevators cannot compete when they are faced with rate disadvantages of this magnitude. In the long run, we believe these unfair rate advantages will result in the closure of many grain elevators, a loss of local competition and farmers being forced to truck their grain to more distant markets. Farm operating costs will increase and branch lines will be abandoned. The railroad's costs will be shifted to public roadways and State taxpayers. These changes will be forced in ways that a competitive market would not allow.

Existing Federal law unfortunately leaves shippers with few workable solutions when they are faced with harmful railroad practices. Railroads are exempt from Federal antitrust laws and other forms of regulatory relief are costly, slow, and largely unworkable. The rail industry truly has done a masterful job of stacking the deck in its favor.

In closing, I would like to address the BNSF's assertion that North Dakota is simply being resistant to change and macroeconomic forces out there, because frankly, nothing could be farther from the truth.

The truth is, this is something that was said repetitively and this is the Commission standpoint, we are not against shuttles per se. What we are against is using market dominance to create unfair and irrational advantages for a small number of shippers. BNSF offered millions of dollars in incentives to select shippers to encourage them to build shuttle train facilities. Then the railroad implemented inverse rates, which doubled the size of the rate advantage that some of these shippers were initially given. It appears that the BNSF is attempting to forcibly restructure the State's grain industry rather than responding to its needs. That is what we are opposed to.

North Dakota needs transportation and its shippers have very few transportation options. This captivity makes us very dependent on the railroad. The company needs to be profitable, but we also need to be treated fairly here in North Dakota.

I thank you for this opportunity for the Commission to express its views. I would be happy to entertain any questions at this time.

[The prepared statement of Mr. Clark follows:]

PREPARED STATEMENT OF TONY CLARK, PUBLIC SERVICE COMMISSIONER

Good afternoon. My name is Tony Clark. I am a member of the North Dakota Public Service Commission. Also in attendance this afternoon are my fellow commissioners, Susan Wefald and Leo Reinbold.

The PSC is the state agency charged with both regulating grain elevators and representing the state's rail interests. Since this hearing involves the transportation of grain out of North Dakota, I believe that the Commission is especially well qualified to testify. On behalf of the Commission, thank you for the opportunity.

Burlington Northern Santa Fe's inverse rates on wheat shipped from North Dakota to the Pacific Northwest (PNW) make a great deal of sense from the railroad's perspective—they allow BNSF to maximize profits and shift its costs to the public sector. If this were a competitive market, we likely wouldn't be here today. But in a non-competitive market, this policy raises great concern, as these are essential services that are being provided.

The BNSF has been able to carry out its plan because shippers in almost all of western North Dakota are captive to BNSF. If there was effective competition in this market, BNSF could not implement this rate structure. Unlike so many other regions of the country, we simply have no alternatives. BNSF is the only rail carrier west of the Missouri River, and is the dominant carrier throughout all of North Dakota. We do not have any direct access to water transportation and trucks are inadequate when it comes to moving bulk commodities distances of 300 to 1000 miles.

The extent of North Dakota's captivity is exemplified by the rates that we pay. North Dakota's rail rates are among the highest and most profitable anywhere. While the Stagger's Rail Act sets 180 as a reasonable and profitable revenue-to-variable-cost ratio, many of North Dakota's rates generate ratios of 300 or more. If there was effective competition in the local transportation marketplace, the railroads would not be able to achieve ratios of this magnitude. We estimate that these excessively high rates cost North Dakota farmers and shippers between $50 and $100 million annually.

BNSF's inverse rates were implemented about a year ago. At the present time, the 110-car shuttle train rate from southwestern North Dakota to the PNW is about 28 cents per bushel higher than the rate paid by shippers in eastern North Dakota, even though the shippers in western North Dakota are over 250 miles closer to the market.

These preferential rates are available to only a very small number of eastern shuttle train loaders. They put western North Dakota shuttle and non-shuttle shippers at a disadvantage relative to their eastern counterparts, but they have an even greater impact on non-shuttle loaders in eastern North Dakota.

Prior to the implementation of these inverse rates, eastern shuttle loaders had a 15-cent per bushel rate advantage over nearby 52 car loaders. This advantage increased to as much as 38 cents with the implementation of inverse rates.

Grain elevators cannot compete when they are faced with rate disadvantages of this magnitude. In the long run, we believe these unfair rate advantages will result in the closure of many grain elevators, a loss of local competition and farmers being forced to truck their grain to more distant markets. Farm operating costs will increase and branch lines will be abandoned. The railroad's costs will be shifted to public roadways and state taxpayers. These changes will be forced in ways a competitive market would not allow.

Existing federal law leaves shippers with few workable solutions when they are faced with harmful railroad practices. Railroads are exempt from federal anti-trust laws and other forms of regulatory relief are costly, slow, and largely unworkable. The rail industry has done a masterful job of stacking the deck in its favor.

In closing, I would like to address the BNSF's assertion that North Dakota is simply being resistant to change and macroeconomic forces. Nothing could be further from the truth.

The truth is, as we have said repetitively, we are not against shuttles per se. We are against using market dominance to create unfair and irrational advantages for a small number of shippers. BNSF offered millions of dollars in incentives to select shippers to encourage them to build shuttle train facilities. Then the railroad implemented inverse rates, which doubled the size of the rate advantage that some of these shippers were initially given. It appears that BNSF is attempting to forcibly restructure the state's grain industry rather than responding to its needs. That is what we are opposed to.

North Dakota needs transportation and its shippers have very few transportation options. This captivity makes us very dependent on the railroad. The company needs to be profitable but we also need to be treated fairly.

Thank you for this opportunity for the Commission to express it views. I would be happy to respond to any questions that you may have.

Senator DORGAN. Mr. Clark, thank you very much.

Next, we'll hear from Craig Fisher who's a wheat farmer in western North Dakota.

Craig.

STATEMENT OF CRAIG FISHER, NORTH DAKOTA WHEAT FARMER

Mr. FISHER. My name is Craig Fisher. I'm a small grains farmer from Stark County in southwest North Dakota. Not only am I a small grains farmer, I am a small farmer—so I need to concentrate a little bit more heavily on the market.

This year one of the opportunities, if you would call it that, was the inverse freight rate from western to eastern North Dakota. I'm 20 miles from the Gladstone terminal (that is where my farm is). I had to make a choice to haul my grain to Jamestown which is 160 miles to the east. There was a 34 cent price difference on January 28 when I made the contract. It was a 50,000 bushel contract which gave me an income of about $17,000, based on 14 protein over my local elevator (which I would have much rather gone to). It takes 2 months to deliver instead of 2 weeks, but in this case the difference in the income is about $340 a load before expenses. That's on a 1,000 bushel load. Some of our trucks haul 1,200 bushels if you pull double trailers and some are going to haul 800 with single trailers, but for an estimate we're looking at 1,000 bushels a load. That gave me $2.12 a loaded mile or $1.06 a running mile. The expenses incurred by this are approximately $76.80 a load for fuel, a driver income allowance of 25 percent would be $85.00 a load. I put in a depreciation on the truck, which was quite liberal, of 10 cents a mile. The trucks are already depreciated considerably but I put it in there. This would have been about $32 a load. After fuel, oil, and tire wear and tear, I still realized a 14.1 cent per bushel advantage after all expenses.

The trucking that I plug into this scenario goes back to me, because I do 90 percent of my own driving or my family members do, but driver allowance was put in for math's sake as well. A few other things that we have to keep in mind is time lost. I should have been home working on machinery. I've got a lot of equipment that should be maintained that hasn't been yet, family time that I have lost, rest that I have lost, informational meetings that we need to go to in the winter to be more productive. We've missed out on a lot of those things in order to be trucking this grain.

We made the trade and we did realize somewhat of a profit although it's not really a—it's not a net profit and it's profit that we're basically recovering. We should have gotten the same price in Gladstone that we got in Jamestown and there would have been very little expense, we had to go and get that profit back minus your expense.

I've got in my testimony—I, in the past, have had no beef with the BNSF or with the eastern elevators. I think up until now they've been doing what's best for their companies. Changes need to be made however, and I hope we can work that out here.

Most of all, I think we need to keep in mind there's a lot of farmers in my area that don't have the options I have. I've got the trucks and the time where I can do this, but for every one of me, there's probably 30 or 40 farmers that don't have this option, and they're the ones that took that 30 cent beating—the entire beating, not just part of it. Now when you look at a 100,000 bushel grain contract at 34 cents, that's a considerable income loss. Also with the loss of our LDP's this year, our input costs being higher due to the fact that we had higher fuel costs, we had fertilizer prices that were considerably higher. On top of that, we've had inverse freight rates, it is putting these boys right up against the wall. There's going to be a lot of people who won't pay debt down this year. Along with our local co-ops losing money—there will be no dividends from them—there has also been a stress between your local elevators and your producers that are shipping east. There are big problems from this. I guess that's all I have to say right now.

Senator DORGAN. Before I call on Gene Griffin, I want to understand your story just for a moment.

You live 20 miles from the Gladstone facility?

Mr. FISHER. Right.

Senator DORGAN. But instead of taking your grain to the Gladstone facility and having it moved to the West Coast, you trucked it 160 miles east and got a pricing differential by—how many loads of grain did you truck?

Mr. FISHER. Fifty loads approximately.

Senator DORGAN. You made 50 trips, 160 miles east and then had it taken to the West Coast?

Mr. FISHER. Shipped right back through my yard. I've got land on both sides of the railroad and it's going right back. It is counterproductive for the grain industry as a whole. For me, I recovered some lost income, but it's almost embarrassing actually that that's what we had to do to recover some of our monies lost.

Senator DORGAN. All right. I'll come back to you, but I think I understand. You took 50 trips from Stark County to Stutsman

County and received a price advantage and then had the grain come back through your yard to the West Coast shipped at a lower rate?

Mr. FISHER. That's correct.

Senator DORGAN. Mr. Griffin, you're an expert in transportation; can you respond to that? I won't ask you to respond to that. Gene Griffin, of course, runs the Upper Great Plains Transportation Institute, and, Gene, why don't you proceed. I may ask you to respond after you're done; we'll see.

STATEMENT OF GENE GRIFFIN, DIRECTOR, UPPER GREAT PLAINS TRANSPORTATION INSTITUTE, NORTH DAKOTA STATE UNIVERSITY

Mr. GRIFFIN. Thank you, Senator. Good afternoon. For the record, my name is Gene Griffin, I'm the Director of the Upper Great Plains Transportation Institute.

I would like to preface my statement by pointing out that the United States production agriculture industry is critically dependent on an efficient and effective transportation and distribution logistical system. Recent research suggests that it is the distribution system which makes the U.S. grain producing industry competitive in the global economy. It is also important to recognize that some of those efficiencies must be passed on through the supply chain to have an impact on the delivered price of grain and processed commodities. Regardless of how exactly the distribution of efficiency gains eventually takes place, it should be emphasized that an efficient, reliable, and equitable transportation system is critical to the viability of agriculture in the United States, one of the major industrial sectors of the U.S. economy.

The 110-car shuttle train program introduces a new level of efficiency for the BNSF in transporting wheat to export and domestic markets. This is a trend that began over a hundred years ago and was introduced into North Dakota grain marketing around 1980. The traditional effects of increased concentration in the country elevator industry and increased truck traffic in select locations are predictable. Presumably, it has a positive impact on farm prices as well. The impacts of increased rail shipment size are not significantly different from the effects of other changes such as farm production technology, larger farm equipment, truck technology, and highway quality and capacity.

As in all change, there are winners and losers resulting from the transformation taking place in the rail grain system. It is intuitive how each will react to such changes. However, there are fundamental questions that need to be addressed. Does the State's grain producing sector need continued advances in the grain handling and transportation system to remain economically viable in a highly competitive global market system? Are cost efficiencies gained by railroads reflected, at least to some degree, in rail rates? What are the impacts on traffic patterns of both local and long haul trucking and what are the corresponding impacts on local, State, and Federal road and highway systems?

Although this is not a complete set of questions of all of the important issues, a final question is the method of implementation of these systems. Do they provide an equal opportunity for all shippers to compete for fewer viable number of country grain stations? This seems to be an issue with the implementation of the 110-car shuttle train program.

The issue seems to be that this method of promoting the movement of 110-car system has not been widely available to all or even a majority of shippers. This would appear to conflict with basic human nature, although it may be warranted from a business prospective. Recent experimental economic research indicates that as human beings, we have an inherent bias toward fairness within groups. However, it should be noted that it would be unreasonable to expect that a large number of the existing country elevators would be able to participate in this program without an extensive amount of excess storage and throughout capacity being developed. Excess capacity that would be paid for, in the most part, by producers, especially if the facilities are dominated by farmer-owned cooperative facilities. It does seem that there might have been a mechanism to limit the development of such facilities consistent with the demand while still being seemingly fairer in the eyes of country grain elevator interests.

The inverse rate poses another whole issue and has been discussed widely already, so I think I will just say that inherently it seems, or intuitively it seems unfair to look at a rate system that is demonstrated on the chart.

However, it should be pointed out that it is not the first instance in which there has been inverse rates to the PNW. Railroads published inverse rates on wheat to the PNW from North Dakota in the 1960s and 1970s in an effort to promote wheat sales to the Pacific Rim countries off the PNW. This program, although successful, was eliminated and replaced with distance-based rates sometime in the 1980s, due in part to criticism from producers. I might add to extreme—everybody remembers Herman Schmitz from Williston, you know what I mean.

A major issue with such rates is if they displace wheat from more traditional market territory in western North Dakota, if it does, such rates may be in violation of regulations governing rail rates. Also, the question of its effect on farm prices is another issue, albeit a difficult one to answer.

Another question—which has already been addressed and will probably be addressed by others—is the impact of filling traditional markets with wheat of different characteristics from different producing areas of the region. The North Dakota Wheat Commission and other agriculture interests in this State, the Department of Agriculture and others, have spent a great deal of effort in developing a market for wheat with certain characteristics, and it would appear that there is certainly a question that that could damage that market development activity that's taken place over the last 30 and 40 years.

Finally, I'd like to focus—or briefly focus—on the rail-to-revenue cost ratios. We conducted two types of analysis at the Institute to make an assessment of the reasonableness of rail rates to North Dakota wheat shippers. One was an analysis of the waybill sample and the second was an analysis of specific BNSF stations. The 2000 waybill analysis of revenue-to-variable cost ratios and the analysis of current revenue-to-variable cost ratios for BNSF wheat movements to Portland and Minneapolis paint a similar picture. Both analyses suggest that North Dakota wheat shipments to Portland and Minneapolis are highly profitable for the BNSF. For all service levels in either analysis, the average revenue-to-variable cost ratio to either market is at or above 1.85. Moreover, for all service levels of 26 cars or more to either market, the average revenue variable-to-cost ratio exceeds 2.43. For all service levels of 52-cars or more to either market, the average revenue-to-variable cost ratios exceed 2.7. The trend obviously is, the larger the shipment size, the higher the revenue cost in relation to variable revenue cost ratios.

As was pointed out, although a revenue-to-variable cost ratio of 180 percent is often used as a baseline for comparison, rail rates above the 100 percent—180 percent of variable costs are not necessarily unreasonable. The 180 percent of variable cost figure comes from a congressional determination that rates exceeding this level can be examined for market dominance. That is, if rail rates exceeds 180 percent of variable costs, then the shipper can try to establish market dominance by examining the extent of intramodal and intermodal competition. If a rate above 180 percent is shown, and it is shown that intramodal and intermodal competition do not serve to effectively discipline rates, then market dominance is established. And subsequently, the Surface Transportation Board examines other measures in making an assessment of whether or not rates are reasonable.

In evaluating some of those measures, without getting into a lot of technical jargon, what we did find was the revenue shortfall allocation method of determining what their rates were, compared to North Dakota rates, would seem to put North Dakota in terms of a very unfavorable light in terms of the rates that—the net profitability that the Burlington Northern Santa Fe earns on those rates.

Also, we did look specifically at 84 stations in North Dakota and just found some averages, and we found that, for instance, into Portland that on the 110-car rate, the average revenue-to-variable cost ratio was 3.23 and ranged from 2.94 to 3.68. Further, looking at rates into Minneapolis we found that on the 52-car shipment the average revenue-to-variable cost ratio varied from 3.14 to 6.64, significant, a very high revenue-cost ratio.

I would conclude by—one more thing is we did look at the road impacts and we did not come up with what we thought were conclusive numbers. I think it's fair to say that there was probably not sufficient time to conduct an adequate analysis of the road impacts; thus the confidence in the analysis is not what we would want it to be if the time and resources were available to develop more accurate models. I think it is fair to say that road impacts on a statewide basis are indeterminate at that time. However, based on past experience we can say with confidence there will be some significant localized impacts on the road system and how those will be paid for is certainly a subjective question at this time.

I would like to close with the recent controversy surrounding the 110-car shuttle train program and inverse rates raises a larger question concerning the adequacy of rail regulation, and, additionally, how should railroads be regulated, if at all. There seems to be a popular perception among certain groups, such as the country grain marketing industry, that the Surface Transportation Board has been less than effective in interpreting and applying rail regulating laws. Further, there is a perception that the STB has a positive bias toward the rail industry. This leads to the question of why hasn't anyone used the simplified rate guidelines procedure to challenge the rate? In view of these perceptions, should current railroad regulation be changed in some way to strengthen the interests of the shipper? A more fundamental question arises regarding treating railroads like other industries. Should railroads be totally deregulated and subject to oversight by the Federal Trade Commission and Department of Justice, governed by antitrust law, and stripped of their antitrust immunity? Would shippers and railroads both be better off under such a scenario?

These are merely questions which raise issues of a subjective nature. Economics, political science and other disciplines can provide valuable insights into such questions, but the answers still remain largely subjective. Thus, it is highly appropriate that these issues be debated before and decided by the U.S. Congress.

Thank you.

[The prepared statement of Mr. Griffin follows:]

PREPARED STATEMENT OF GENE GRIFFIN, DIRECTOR, UPPER GREAT PLAINS TRANSPORTATION INSTITUTE, NORTH DAKOTA STATE UNIVERSITY

Good afternoon. For the record my name is Gene Griffin, Director of the Upper Great Plains Transportation Institute, North Dakota State University. A number of Institute Research Fellows were collectively responsible for developing the testimony forwarded to the Committee: Denver Tolliver, Senior Research Fellow; John Bitzan, Advanced Research Fellow; and Mark Berwick, Associate Research Fellow.

I would like to preface my statement by pointing out that the United States production agriculture industry is critically dependent on an efficient and effective transportation and distribution logistical system. Recent research suggests that it is the distribution system which makes the U.S. grain producing industry competitive in the global economy. It is also important to recognize that some of those efficiencies must be passed on through the supply chain to have an impact on the delivered price of grain and processed commodities. Regardless of exactly how the distribution of efficiency gains eventually takes place, it should be emphasized that an efficient, reliable, and equitable transportation system is critical to the viability of agriculture in the United States, one of the major industrial sectors of the U.S. economy.

There appears to be three fundamental issues that are causing a great deal of consternation among grain producers and shippers, as well as those public sector entities responsible for transportation. They are: (1) the 110 car shuttle train program being developed by the BNSF; (2) the manner in which this program is being implemented; and (3) the so-called inverse rate structure. There is a great deal of anecdotal evidence regarding all three of these issues as well as much second-hand information. There is little hard reliable data to evaluate these from a research perspective, thus my remarks will be largely conceptual in nature and somewhat speculative. However, I will present more conclusive findings on rail cost and rate relationships as well as an estimate of the road impacts that could result from the 110 car system. Finally, I will conclude with a general statement about my perceptions of the adequacy of the regulatory system as it applies to rail pricing and service.

110 CAR SHUTTLE TRAIN PROGRAM

The 110 car shuttle train program introduces a new level of efficiency for the BNSF in transporting wheat to export and domestic markets. This is a trend that began over a hundred years ago and was introduced into North Dakota grain marketing around 1980. The traditional effects of increased concentration in the country elevator industry and increased truck traffic into select locations is predictable. Presumably, it has a positive impact on farm prices as well. The impacts of increased rail shipment size are not significantly different from the effects of other changes such as in farm production technology, larger farm equipment, truck technology, and highway quality and capacity.

As in all change, there are winners and losers resulting from the transformation taking place in the rail grain system. It is intuitive how each will react to such changes. However, there are fundamental questions that need to be addressed. Does the states' grain producing sector need continued advances in the grain handling and transportation system to remain economically viable in a highly competitive global market system? Are cost efficiencies gained by railroads reflected, to some degree, in rail rates? What are the impacts on traffic patterns of both local and long haul trucking and what are the corresponding impacts on the local, state, and federal road and highway system? Although this is not a complete set of questions of all the important issues, a final question is the method of implementation of these systems. Do they provide an equal opportunity for all shippers to compete for fewer viable number of country grain stations. This seems to be an issue with the implementation of the 110 car shuttle train program.

IMPLEMENTATION OF THE 110 CAR SHUTTLE TRAIN PROGRAM

There is no documentable evidence or data available to address this issue because of the private and proprietary nature of contracts, thus it is speculative in nature. However, there are allegations that special contract rate agreements have been developed with certain shippers giving them an advantage over others in developing a 110 car facility. These contracts most likely take the form of rebates on shipments of grain conforming to certain loading, unloading, origin, and consignment size standards.

The issue seems to be that this method of promoting the movement of a 110 car system has not been widely available to all or even a majority of shippers. This would appear to conflict with basic human nature, although it may be warranted from a business perspective. Recent experimental economic research indicates that as human beings, we have an inherent bias towards fairness within groups.[1] However, it should be noted that it would be unreasonable to expect that a large number of the existing country elevators would be able to participate in this program without an extensive amount of excess storage and throughput capacity being developed. Excess capacity that would be paid for, in the most part, by producers, especially if the facilities are dominated by farmer-owned cooperative facilities. It does seem that there might have been a mechanism to limit the development of such facilities consistent with the demand, while still being seemingly fairer in the eyes of country grain elevator interests.

The most controversial of the three issues mentioned in the beginning of this statement appears to be the so-called inverse rate.

INVERSE RATE ON WHEAT TO THE PACIFIC NORTHWEST (PNW)

There is hearsay that BNSF has instituted contract rates for wheat originating at shuttle facilities to the Pacific Northwest market that are inversely proportional to distance. In other words, they charge a lower rate for a longer haul. Thus, rates to the PNW from western North Dakota are higher than similar rates from eastern North Dakota. Since these are contract rates they are proprietary in nature and are not published. However, if they do exist, it intuitively seems to be unfair. That does not mean there is not a sound business reason for the implementation.

It should be pointed out that this is not the first instance in which there has been inverse rates to the PNW. Railroads published inverse rates on wheat to the PNW from North Dakota in the 1960s and 1970s in an effort to promote wheat sales to the Pacific Rim countries off the PNW. This program, although successful, was eliminated and replaced with distance-based rates sometime in the 1980s, due in part to criticism from producers.

A major issue with such rates is if they displace wheat from more traditional market territory in western North Dakota? If it does, such rates may be in violation of regulations governing rail rates. Also, the question of its effect on farm prices is another issue, albeit, a difficult one to answer.

Another question is the impact on filling traditional markets with wheat of different characteristics from different producing areas of the region. The markets in Asia are extremely conscious of specific milling and baking characteristics and have come to depend on quality and end-use performance traits associated with the hard red spring wheats produced in the drier, less disease-prone areas of western North Dakota and eastern Montana. However, under the current inverse rate structure, spring wheats produced in the eastern part of the region are now more likely to

[1] Karl Sigmund, Ernst Fehr, and Martin Nowak, The Economics of Fair Play, *Scientific American*, January, 2002.

move to PNW terminals for eventual shipment to Asian destinations, rather than traditional domestic or gulf export positions.

These wheats, which under normal conditions are not tributary to PNW markets, are typically lower in protein content and often have lower gluten strength. Challenges in functionality and performance are also more likely to arise due to negative impacts resulting from disease pressures more often associated with eastern production areas.[2]

Increased incidence of processor concerns has been noted by US Wheat Associates personnel in regional offices in Asia and is thought to be related to the inverse rate structure. This could harm the overall market development efforts that have been so successful over the past four decades.

As stated earlier, much of what has been addressed is speculative and conceptual in nature. There are two issues that can be addressed in a more definitive and researchable manner, rail revenue/cost ratios and the impact on roads.

RAIL REVENUE/COST RATIOS

Two types of analysis were performed to make an assessment of the reasonableness of rail rates to North Dakota wheat shippers: (1) an analysis of BNSF revenue-to-variable cost ratios for wheat originating in North Dakota from the 2000 annual railroad waybill sample, and (2) an analysis of BNSF revenue-to-variable cost ratios for wheat originating in North Dakota and terminating in Minneapolis or Portland using the current rate structure and an operationally specific costing methodology.

The 2000 waybill analysis of revenue-to-variable cost ratios and the analysis of current revenue-to-variable cost ratios for BNSF wheat movements to Portland and Minneapolis paint a similar picture. Both analyses suggest that North Dakota wheat shipments to Portland and Minneapolis are highly profitable for the BNSF. For all service levels in either analysis, the average revenue-to-variable cost ratio to either market is at or above 1.85. Moreover, for all service levels of 26 cars or more to either market, the average revenue-to-variable cost ratios exceed 2.43. For all service levels of 52 cars or more to either market, the average revenue-to-variable cost ratios exceed 2.7.

While all of these revenue-to-variable cost ratios seem high, one must put them in the context of rate reasonableness guidelines to determine if they are unreasonably high. These guidelines provide insight into equity considerations and revenue adequacy considerations that should be taken into account when making an assessment of the magnitude of a particular rail rate.

Although a revenue-to-variable cost ratio of 180 percent is often used as a baseline for comparison, rail rates above the 180 percent of variable costs are not necessarily unreasonable. The 180 percent of variable cost figure comes from a Congressional determination that rates exceeding this level can be examined for market dominance. That is, if a rail rate exceeds 180 percent of variable costs, then the shipper can try to establish market dominance by examining the extent of intramodal and intermodal competition. If a rate above 180 percent is shown, and it is shown that intramodal and intermodal competition do not serve to effectively discipline rates, then market dominance is established. Subsequently, the Surface Transportation Board examines other measures in making an assessment of whether or not rates are reasonable.

In its simplified rail rate guidelines, the Surface Transportation Board uses three measures to establish the reasonableness of a rail rate. These measures consider the equity of similarly situated shippers, the revenue adequacy needs of the railroad, and the reasonableness of the carrier's revenue requirements borne by a shipper or group of shippers. The three measures include: the revenue shortfall allocation method (RSAM), the average revenue-to-variable cost percentage for all shipments with revenue-to-variable cost percentages above 180 ($RVC_{>180}$), and the average revenue-to-variable cost ratio on comparable shipments (RVC_{COMP}).

As recognized by the Surface Transportation Board, none of these measures can be used alone to make an assessment of whether a rate is reasonable, but in combination they provide a good baseline for examining the level of various rates. RSAM measures the uniform markup above variable cost that would be needed from every shipper of potentially captive traffic (traffic with revenue-to-variable cost ratios above 180 percent) in order for the carrier to recover all of its costs. The RSAM recognizes the need for differential pricing by the railroad, and the railroad's need for revenue adequacy.

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[2] Personal Communications, Neal Fisher, Administrator, North Dakota State Wheat Commission, Bismarck, ND, March 21, 2002.

$RVC_{>180}$ measures the average markup for all of the railroad's traffic that moves at rates exceeding variable costs by 180 percent or more. The idea behind the $RVC_{>180}$ measure is that a particular shipper should not be bearing an unreasonable share of the carrier's revenue requirements relative to other potentially captive traffic. Moreover, an interesting comparison between the $RVC_{>180}$ and the RSAM can be made. An $RVC_{>180}$ that exceeds the RSAM suggests that the railroad is meeting its revenue adequacy requirements. Such a finding may be further justification for a rate reduction.

RVC_{COMP} measures the average markup on traffic of similar commodities moving under similar transportation conditions. It is designed to serve as a comparison with traffic that has a similar elasticity of demand. The idea is that a shipper should not be penalized for being on a railroad that has higher revenue needs from its potentially captive traffic. Because of the short time frame for performing the analysis, revenue-to-variable cost ratios for comparable traffic were not developed.

STB estimates of the RSAM for BNSF indicate that it is below the average revenue-to-variable cost ratios for North Dakota wheat to many markets. Moreover, the number of revenue-to-variable cost ratios that exceed the RSAM increases when such an efficiency adjustment is made. Similarly, many North Dakota wheat shipments show revenue-to-variable cost ratios that exceed the average charged by BNSF to potentially captive shippers. Finally, a comparison between the RSAM and the average revenue-to-variable cost ratio charged to potentially captive shippers by the BNSF shows that in the most recent year, the average revenue-to-variable cost ratio charged to potentially captive shippers exceeds the RSAM with or without the efficiency adjustment. This suggests that BNSF is charging an average rate to its captive shippers that exceeds the average rate necessary for the railroad to cover all of its costs, including a return on investment. This would seem to indicate that the BNSF's rates to many North Dakota shippers may exceed reasonable limits.

While rates on the BNSF for North Dakota wheat shipments appear to be high relative to costs, it is important to note that the overall rate levels associated with larger shipment sizes are lower for North Dakota shippers. Thus, these larger service level options provide a benefit to North Dakota shippers.

The waybill analysis further provides a comprehensive picture of revenue-cost ratios for North Dakota shipments to major markets. This section focuses on current rates to Portland. It also includes an analysis of shuttle trains and 110-car co-loading service levels. Shipment costs are computed using the 2000 Uniform Railroad Costing System (URCS) and BNSF cost factors. Rates are derived from Item 43538 of the BNSF's current rate book, which is effective as of March 2, 2002. These rates are applicable to wheat movements in 286,000-pound rail cars, which appear to offer the greatest mainline efficiency and profit potential for the BNSF. The following service levels are analyzed for movements from North Dakota to Portland:

1. 1-car
2. 26-car
3. 52-car
4. 110-car multiple-origin (55 cars per station)
5. 110-car single-origin train

Only a few stations in North Dakota currently originate 110-car shipments. However, rates are analyzed for all stations in order to present a meaningful comparison of the relative efficiencies of BNSF service levels. Because few stations currently originate 110-car shipments, the summary statistics presented in Table 1 are not weighted by shipment volumes—i.e., they represent simple averages or means.

Table 1—Average Revenue-Cost Ratios for BNSF Wheat Shipments From North Dakota to Portland By Service Level

Service Level	Average Revenue Variable Cost Ratio	Minimum Revenue Variable Cost Ratio	Maximum Revenue Variable Cost Ratio	Standard Deviation of RVC Ratio
1-Car	1.85	1.72	2.11	0.09
26-Car	2.44	2.24	2.85	0.14
52-Car	2.71	2.49	3.09	0.15
55-Car	3.07	2.80	3.55	0.18
110-Car	3.11	2.83	3.54	0.18

The statistics shown in Table 1 reflect 84 individual stations. These stations are a subset of the 92 stations listed in the latest revision of Item 43538.

The revenue-cost ratios for wheat from selected origins to Minneapolis are shown in Table 2. Because of the shorter trip distances to Minneapolis, fewer adjustments are needed to URCS. Way and through train miles are based on BNSF division points. Intertrain and intratrain switches are assigned by URCS, using a 200-mile distance interval. The origin-destination and train size adjustments developed for 52-car movements to Portland are also implemented for 52-car shipments to Minneapolis. However, no adjustments are made for 26-car or single-car shipments. According to the waybill sample, over 50 percent of wheat shipments from North Dakota to Minnesota and Wisconsin are single-car shipments or multi-car blocks of less than 25 cars. Given this movement pattern, BNSF's system-average through train characteristics are probably reflective of the mix of car block sizes and commodities that move in eastbound trains.

Table 2—Average Revenue-Cost Ratios for BNSF Wheat Shipments From North Dakota to Minneapolis By Service Level

Service Level	Average Revenue Variable Cost Ratio	Minimum Revenue Variable Cost Ratio	Maximum Revenue Variable Cost Ratio	Standard Deviation of RVC Ratio
1-Car	2.26	1.81	3.30	0.25
26-Car	3.15	2.48	4.86	0.36
52-Car	4.04	3.14	6.64	0.50

An important economic question is: What are the relative efficiency gains of 110-car unit train movements to the Pacific Northwest? Appendix A presents detailed comparisons for 84 stations in North Dakota. One of these stations, Hillsboro, is used to illustrate the magnitude of the potential efficiency gains.

Hillsboro is located 40 miles south of Grand Forks and 1,553 miles from Portland. An existing shuttle-train facility is located in the vicinity of Hillsboro. In the BNSF tariff, single-car, 26-car, 52-car, and 110-car rates are published for Hillsboro. In addition, a 110-car co-loading rate is published for Hillsboro. Table 3 shows the estimated variable cost for shipping wheat from Hillsboro to Portland in 286,000-pound rail cars. The costing methods and data used in these calculations are documented in the appendix.

As Table 3 shows, the estimated variable cost for the 110-car single-origin shipment is 47 percent lower than the estimated variable cost of a single-car shipment from the same origin. Moreover, the estimated 110-car cost is 25 percent lower than the estimated variable cost of a 26-car shipment. Although an individual 52-car shipment is often referred to as a "unit train," it does not offer the same efficiencies as a 110-car train. Typically, a 52-car shipment must be matched with one of similar size or with several smaller multi-car blocks before a large grain train can be assembled. On average, the single origin 110-car shipment results in a 15 percent savings in comparison to the 52-car shipment.

Table 3—Illustration of the Relative Efficiencies of 110-Car Consignments

Service Level	Variable Cost Per Car
1-Car	$2,732
26-Car	1,974
52-Car	1,710
110-Car Two-Origin	1,498
110-Car Single-Origin	1,454

This comparison probably understates the efficiency gains from shuttle trains because there are certain operational and car utilization effects that cannot be captured with a costing formula. Nevertheless, the illustration suggests that 110-car trains offer the potential for large efficiency gains, greatly reducing the cost of long-distance movements to the Pacific Northwest.

ROAD IMPACTS

One reason the 110-car shuttle program and the so-called inverse rate structure mentioned previously are controversial is because of the potential road impacts resulting from each. The UGPTI examined case studies of Jamestown, Berthold, and Milton in order to make an assessment of some of the potential road impacts resulting from these programs.

The Jamestown case study showed an average incremental distance hauled as a result of the shuttle facility of 5.3 miles for every bushel. For Berthold, the extra distance from the shuttle program was estimated at 1.8 miles. For Milton, the extra distance from the shuttle program was estimated at 4.5 miles per bushel. It is important to note that these estimates are based on simulated case studies, and some movements may be much farther than the estimated incremental miles. Moreover, it is fair to say that there was not sufficient time to conduct an adequate analysis of the road impacts. A more detailed study is needed before definitive conclusions about highway impacts can be drawn.

In summary, producer marketing decisions are based on board prices, elevator and community loyalty, and other variables. Because of the rate incentives at only some elevator facilities, provided by the railroad, board prices may be higher resulting in longer truck movements. It is difficult to quantify the longer movements, and truck costs would be a determinant of those movements. There may be cases in the future where facilities are located where the highway infrastructure is not adequate to handle the truck traffic. In these specific cases, large infrastructure investments may need to be made.

ADEQUACY OF RAIL REGULATION

The recent controversy surrounding the 110-car shuttle train program and inverse rates raises a larger question concerning the adequacy of rail regulation and, additionally, how should railroads be regulated, if at all. There seems to be a popular perception among certain groups, such as the country grain marketing industry, that the Surface Transportation Board (STB) has been less than effective in interpreting and applying rail regulatory laws. Further, there is a perception that the STB has a positive bias towards the rail industry. This leads to the question of "Why hasn't anyone used the simplified rate guidelines procedure to challenge a rate?" In view of these perceptions, should current railroad regulation be changed in someway to strengthen the interests of the shipper? A more fundamental question arises regarding treating railroads like other industries. Should railroads be totally deregulated and subject to oversight by the Federal Trade Commission and the Department of Justice, governed by antitrust law, and stripped of their antitrust immunity? Would shippers and railroads both be better off under such a scenario?

These are merely questions which raise issues of a subjective nature. Economics, political science and other disciplines can provide valuable insights into such questions, but the answers still remain largely subjective. Thus, it is highly appropriate that these issues be debated before and decided by the United States Congress.

Senator DORGAN. Mr. Griffin, thank you very much.

Let me begin with Mr. Fisher's example and then I have a series of questions for most of the panelists.

Mr. Fisher, I was just doing a quick calculation, it appears to me that you drove your truck—18-wheel truck, is that correct—you drove your truck 16,000 miles on our roads in North Dakota to truck your grain 160 miles east so that it could be put on a railroad and then come back past your farm to go to the West Coast?

Mr. FISHER. Right.

Senator DORGAN. That sounds just preposterous to me.

You described to us the economic incentive for you to do that.

Mr. FISHER. Right.

Senator DORGAN. But it sounds just preposterous that that economic incentive should exist. What part of the economic incentive was represented by the inverse rates, inverse rail rates? You said that there was roughly a 40-cents-per-bushel advantage?

Mr. FISHER. Thirty-four cent.

Senator DORGAN. Thirty-four cent bushel advantage. I'm sorry. What part of the 34 cents was represented by the inverse rates?

Mr. FISHER. I'm not sure. I went and got my bid in Gladstone and I got my bid in Jamestown elevator and that's—that was the difference, the 34 cents. I'm not sure how much of it was actually freight, how much of it was—one elevator with a marketing advantage. Maybe they wanted to pull some better grain from the west. I've heard that argument; they wanted to pull a higher quality grain or higher proteins from the west. I don't know what all it was with freight or not but it was a 34 cents difference.

Senator DORGAN. This chart would show 17 cents difference with respect to the inverse rate structure so that's about 50 percent of the change in price but—go ahead.

Mr. FISHER. Right. And with the margins that I've seen, some of these elevators are working on—something's missing, there's something missing in this because we've got a very small margin and a very big difference in price there.

Senator DORGAN. Mr. Bobb, let me come to you. This is an interesting discussion because the incentives Mr. Fisher had as a farmer was to put his grain on a truck and haul it 16,000 miles so that it could be—put the grain on the truck, haul it 16,000 miles to be put on your railroad in order to come back through his farm later on and go to the West Coast. Why would that seem plausible to anyone and does it seem plausible to you to have that happen?

Mr. STEVAN BOBB. I think it—I have two reactions to it. The first is, I think it does underscore the trucking economics that are out in the marketplace. It is not the first time that we have experienced wheat trucking east out of western North Dakota. It has, I mean, there is a competitive factor that we have faced in the past and continue to face.

Senator DORGAN. Except that his was all free labor.

Mr. STEVAN BOBB. I understand.

Senator DORGAN. He did that on his own time, doesn't charge anything for labor, so that's not the competitive trucking, I believe. But I mean, how does it strike you that we've got a guy from Dickinson essentially having to drive to Jamestown to put it on your railroad to come back through Dickinson?

Mr. STEVAN BOBB. And I think the second reaction would be it is not a desired outcome to see wheat that we could allegedly handle for 1.08 westbound being handled for 91 cents westbound, that's not in our best interest either.

Senator DORGAN. So if Mr. Fisher's driving his truck 50 times between Dickinson and Jamestown is not a desired outcome, and at least half of the incentive for him to have done that was inverse rates?

Mr. STEVAN BOBB. Our perspective would be that the inverse rate structure that's suggested by your board there would not compensate him for doing that. I'm questioning as well where the other 17 cents came from.

Senator DORGAN. But 50 percent of it would come from inverse rates and I think in your testimony you were saying what we're trying to do is pull that grain from western North Dakota, right, rather pull the grain from eastern North Dakota to move it to the West Coast. In fact, you hauled grain from western North Dakota in order to haul it back to western North Dakota and through western North Dakota. My problem is, isn't that a Byzantine result? And if you agree that it's a Byzantine result, doesn't it suggest the inverse pricing here is a failure from the standpoint of the consumer?

Mr. STEVAN BOBB. I would characterize it as an unintended result, but I'm not sure I would characterize it as a failure of the rate structure. He has testified to 50,000 bushels having moved. Relative to the amount of grain that has moved out of North Dakota, it is a very small amount. And second, when we look at Gladstone's shipping experience, crop year to date this year versus last year, we actually see their shipments up nearly 6 percent. So our view of their shipments is dramatically different then what has been testified here. So I do not see it as a failure of the rate structure.

Senator DORGAN. Mr. Fisher, you're an unintended result.

I want to ask a question of Jim Bobb and also Steve Bobb; when the railroad imposed this pricing structure was there consultation with the shippers and if so, can we describe that consultation?

Mr. Bobb.

Mr. STEVAN BOBB. Our consultation would have been primarily with, in this instance, Cenex Harvest States and Inver Grove Heights.

Senator DORGAN. Mr. Bobb.

Mr. JIM BOBB. Last fall—especially when we start seeing bushels as Craig Fisher was talking about—who I expect, and myself, made calls to BNSF asking about five times comparable rate reduction of all bushels and we were flatly told no. We were never once given the opportunity.

Senator DORGAN. Tell me from the standpoint of the railroad company why you wouldn't answer the Southwest Grain's request?

Mr. STEVAN BOBB. Well, again, from a factual perspective we have not seen a reduction in their grain volumes, and so when we do the math, we did not and still do not see the negative impact. If you look at the elevators in western North Dakota, on a crop year basis, and that would be very consistent with how the grain industry looks at it, July of 2001 through February of 2002, Boyle's shipments are up nearly 6 percent; Dickinson, which is west of Boyle and a 52-car shipper, I believe their shipments are up nearly 18 percent; Beach up 42 percent; Scranton up 9 percent, they also are a shuttle shipper. So we do not see reduced shipments occurring in western North Dakota.

Senator DORGAN. So you're saying it's really not bad for them. I'm not sure you're saying it's good for them, you're not saying it's bad for them.

Mr. STEVAN BOBB. Correct.

Senator DORGAN. Mr. Bobb, he's saying that your numbers are wrong. Tell me about his math assessment of what's happening at Southwest Grain.

Mr. JIM BOBB. We're looking at two different timeframes and one of them is gut slot of harvest, July, August, September, as I stated before, production was up 5 percent out there. During the peak of harvest producers do not have time to run across the State. So I didn't bring those volumes along. We probably were compatible to the year before, or maybe up that 5 percent at harvest time. What's been a problem since the grain's been put in a bin when the producers have time to move that grain and look at other marketing positions. There's no doubt we haven't fudged them a bit.

So I think it's looking at different time periods. You could say both of us are trying to make a point. I know it's taking place since September, when we started a new fiscal year, so the ones we have here today, that's factual.

Senator DORGAN. And Steve Bobb, if Jim Bobb from Southwest Grain is correct with respect to the numbers in your fiscal year, would that give us evidence that the inverse rates are hurting companies like Southwest Grain?

Mr. STEVAN BOBB. Well, that's one of the—I mean, we are trying, based upon the testimony by Mr. Fisher earlier this month, that there was trucking occurring and he was making money by doing it, we've been trying to dig a lot deeper and make sure that there is not a lot of grain going east to go west because that would not be what we wanted to have happen. And there again, as we mentioned earlier, there are several moving parts to this rate structure. We're trying to understand, for instance, what the elevator in Jamestown may be doing with its bid structure that is impacting this rate structure in an unexpected way. Are they narrowing their margins so dramatically as to draw more grain than they normally would?

The other thing we're trying to peel out of this is if you look at the period really October, November, December, there was really one dominant exporter on the West Coast and it—how much of it was a fact that they had the export program on and had made the sales determined where the grain went, because they chose to run it through their affiliated elevators, I don't know.

Senator DORGAN. Mr. Strege, how many elevators in North Dakota are taking advantage of the inverse rate structure at this point?

Mr. STREGE. Right now as far as we know there are the three shuttle loaders that you have listed there, Alton, Jamestown, Sterling. Although I'm told Sterling doesn't get into it very much. Just about the 1st of February the BN did offer an inverse rate structure to 52-car loaders also, but it wasn't nearly as good a deal, I understand it did not include an origin efficiency payment and it expires, as far as I know, the end of this month. So it was put in just on a short-term basis. I think it was put in to quiet down the complaint from the 52-car loaders against the few selected 110-car loaders.

Senator DORGAN. Now, you represent the North Dakota Grain Dealers Association, can you tell me what kind of consultation existed with respect to inverse rates?

Mr. STREGE. None at all. The BN did not talk to us about this. It was put into effect and I found out about it after the matter was decided on; and I don't know whether they were in affect or not but apparently they were coming along, and the railroad was quite surprised that the news had gotten out. That these few selected shuttle loaders that were to get that kind of relief.

Senator DORGAN. And what did you do when you learned of the inverse rates?

Mr. STREGE. Well, we discussed it at a board of directors' meeting early July and we decided we had to try to stop this, try to change their mind. I talked to Mr. Bobb at some point around that time, he also was at a Public Service Commission meeting, I think that was the 17th of July, and we visited with him about it.

At that time the first reaction of the BNSF was to deny that there was anything out there or to say that there were allegations or rumored rates, and now I think it's become more public that these things do actually exist.

Senator DORGAN. Mr. Griffin, let me ask about one of the graphs that was used by Mr. Bobb talking about wheat and corn rates because you had, in your testimony, talked about the issue of the rates being charged for wheat, you couched it—I used to teach economics in college briefly, so I was able to follow you and you couched it in very careful terms. But I think if I read between the lines, I think you were saying a pretty good case can be made for our paying a much higher rate than most and for wheat bearing a much bigger burden than most and that there's a basis for thinking that is unjustifiably—but maybe I'm putting words in your mouth.

Let me ask you to take a look at this chart that was passed out, it talks about the wheat rate versus corn/barley rate. Now, that goes a bit afield from the issue of the inverse rates, but I'm wondering because you testified in your written testimony substantially about rates generally with respect to wheat, can you tell me why this exists in your judgment, and is there justification for it with respect to wheat?

Mr. GRIFFIN. The reason it exists is because they're setting rates in response to market conditions and the competition, you know, in different markets, I think that there may not be total agreement on this, but I think North Dakota wheat is generally considered a residual market. In other words, we're sitting in a market where the grain generally speaking is going to be here for some time. There are reported instances which you may have observed where corn, for instance, would move from the Iowa, southern Minnesota producing region through North Dakota to the Pacific Northwest while corn from North Dakota was not moving. That's because that's subject to competition down the river, the Mississippi, and if that corn isn't moved at that time when the market is there, the Pacific Northwest, it's going to go to the Gulf, and then the railroads can come back to move North Dakota corn at a later date because it's not going to move to the river or PNW at that time without the available equipment.

So I think we're fairly captive in that context and wheat does pay a considerably higher rate, there is no appreciable difference in the cost of moving wheat versus corn with the same equipment at the same service level. And the reason would be that the market conditions permit them to charge a higher rate.

Senator DORGAN. But let me ask about those market conditions because it relates to inverse rates as well. Market conditions would suggest that there is a "market" when in fact the railroads, Mr. Bobb and those who run the Burlington Northern Railroad, simply, I assume, sit in an office somewhere and decide here are the rates we're going to charge. There's really no consultation as has been stated. There's an opportunity to do it because they don't have competition.

Mr. Bobb will say—and I'll give him a chance in a minute—he'll say, "Well, but the competition would be trucking." But the fact is, we're now down to very few railroads in our country and they set prices the way they want to set prices and set service patterns the way they want to set service patterns. So, in fact, you don't have normal market condition circumstances to try to keep a company somewhere within boundaries, do you? What would prevent Mr. Bobb from announcing tomorrow that they have increased their inverse rates, the differentials, by another 25 percent effective tomorrow morning? What would prevent that from happening?

Mr. GRIFFIN. Senator, I don't believe there's anything that prevents them from doing that other than certain market conditions, but certainly there's no competitive factor that would prevent them from doing that.

Senator DORGAN. Mr. Clark, what is the role of the Public Service Commission? I assume the floor Act and other Federal legislation prevents you from doing anything effectively with respect to these rates; is that correct?

Mr. CLARK. Right. On the Federal level, before the Staggers Act, Commission authority was always limited to intrastate shipments but since then even those things have been preempted by Federal law.

The Public Service Commission gets involved in a few different ways. One is, State law charges us with the responsibility of representing State interests before the courts, Surface Transportation Board, and Congress so we get involved in a few different ways. For example, there has been some exploration about whether the Commission should bring—in some form or another, explore the possibility of bringing a rate case before the Surface Transportation Board. There have been some recent hopeful changes in some of the STB rules that might make a case more viable now than it was prior to those changes and so we continue to explore that.

We get involved in other Surface Transportation Board proceedings. We're currently an intervenor in a proceeding that deals with rail arbitration and would like to see more workable rules for small shippers to kind of fast track some of this so they can get more redress in a timely way, because it's not effective right now.

Senator DORGAN. What is the official view within the Public Service Commission with respect to inverse rate?

Mr. CLARK. The official view, we're opposed to the current rate structure that they have, as my testimony indicated. We believe that they're having a number of harmful effects on North Dakota shippers and on the current transportation industry in North Dakota. So the current structure gives us great concern.

Senator DORGAN. And how have you communicated that to the Surface Transportation Board?

Mr. CLARK. That specific concern, frankly, hasn't come up in a STB proceeding—we've been working more with rail competition and things like that. But certainly if a proceeding came up, it would be something that we could include. Potentially these inverse rates, if a rate case does come up, the nature of them may make a rate case more—the opportunities more available for a successful rate case to be brought. And we'll continue to look at that, contingent of course on available funds for the Commission to do it.

Senator DORGAN. Under current Federal law is there anything that prevents a State commission such as the Public Service Commission from initiating a complaint with the Surface Transportation Board on behalf of, for example, grain elevators and farmers?

Mr. CLARK. I don't believe that there is and that's one of the reasons that the Commission has been—well, we asked for appropriation to do it last legislation session, we didn't get the appropriation to——

Senator DORGAN. What size appropriation did you ask for?

Mr. CLARK. It was $100,000 to begin a feasibility study for a rate case and we will again go back to the legislature and ask for that. I anticipate that we will be doing that again. So I don't know the exact mechanics of how it would work, whether it would be the Commission bringing it in on behalf of a class of shippers or if you go out and find kind of poster child for an elevator that's been harmed and then bring it for that specific elevator on their behalf, or if it's just a matter of gathering information so that that entity can bring forth a successful case on its own.

Senator DORGAN. I'm skipping around some, but I'll come back to you, Mr. Bobb.

But, Mr. Strege, what will be the consequences, in your judgment, to the array of grain elevators in North Dakota if nothing changes? The inverse rates exist, they will continue to exist, we will continue to move toward the larger shuttle trains; and tell me what you see as a future for the country grain elevator.

Mr. STREGE. I think it doesn't look too bright and for people in the western part of the State who built up these western markets and can't get access to them, it looks bad from that respect. In other parts of the State, where the shuttle loading facilities are going in and being given advantages over everybody else, eventually that is going to wear these other people down; and, I mean, you can't blame a farmer for hauling to an elevator where they can get a better price. But if he's bypassing the local elevator, in the end, he's doing a disservice to himself and to his community for a short run benefit; and I think Mr. Fisher's testimony over here is an example of that and he stated that. But in the short term the farmer wants to go to those places that offer the better price, that have the lower rate.

What we're in favor of is spreading those rate reductions around and if you look at those revenue of variable cost ratios that Gene Griffin just laid out in front of us, that's why they're quite eye-popping. You had mentioned or had talked about whether we had a market and that rates should be set in response to market conditions. A market assumes that there are a number of willing buyers and sellers. That's not what we have here. I'd like to make a reference to one of the items in Mr. Bobb's testimony here, and it's on page 10 and it says,

> "What we do as a rail transportation provider is look at the difference between value of the grain at the origin and value of the grain at the destination and try to determine the level of charges for transportation with margin for the elevators to operate on enough money."

I guess that could be interpreted as saying they're going to take as much out of the middle as they possibly can and leave just enough for the elevator to continue to exist; and that is simply what is monopolistic, being able to do that rather than pricing their services on what they cost. It's based on what they can extract from the origin and the destination.

And I think somebody touched on the market, what has happened to the grain market as a result of these inverse rates. If that PNW market needed more grain then let it bid up that way. We're not letting the market work if we put in a system like this, because it gives more reason for them to keep the price lower.

Senator DORGAN. Mr. Bobb, let me ask you a series of questions. You're Group Vice President for Agriculture Products; is that correct?

Mr. STEVAN BOBB. Yes.

Senator DORGAN. How long have you been with the company?

Mr. STEVAN BOBB. Fifteen years.

Senator DORGAN. This is not unfamiliar territory for you to go testify someplace and have to defend rates and so on. And yet you hear the testimony today of people who think that your company has imposed rates that are unfair.

First question I guess is, Mr. Strege and Mr. Bobb say that they effectively are customers of yours, I assume big customers in the aggregate, good customers, customers for many, many years, and yet when your company decided to create a new rate system, you didn't call them to talk to them about it or consult with them. Why would a company do that? Why would your company sit in a room and decide here are our new rates and we don't intend to talk to our customers about them?

Mr. STEVAN BOBB. Well, it has—I would say it goes to the definition of a customer. We spent a lot of time talking to the export customers for which our westbound programs are primarily designed; and, second, we spent a lot of time talking to the individuals that various grain companies have indicated they want us to talk to.

Our commercial relationship with Boyle is primarily—or Gladstone on that map—is primarily through Cenex Harvest States and Inver Grove Heights based upon Cenex States' direction. The Gladstone facility is essentially owned by Cenex Harvest States and they prefer us not to talk to their elevators independently. So that's their choice, it's their company. We have our interaction in a manner that they prefer.

Senator DORGAN. So who did you talk to at Harvest States?

Mr. STEVAN BOBB. We would have talked to their vice president of transportation as well as the individuals responsible for their various line facilities throughout the Upper Midwest.

Senator DORGAN. And when would you have done that?

Mr. STEVAN BOBB. In the first quarter and second quarter of last year.

Senator DORGAN. How did they react to this? They obviously didn't share it with Jim Bobb, but how did they react when you said we're going to create a new inverse pricing system?

Mr. STEVAN BOBB. I think in general they were concerned about the ability to get grain to the West Coast and they saw the value of it. It was testified here earlier about a 79 million bushel reserve in Montana, that sounds like a really big number, but when you put that in the context of historical stocks-to-use ratio in Montana, that would essentially draw Montana inventory to a level to which they've never been down and the current low flat rate price they've produced today, those stocks aren't going to magically come out. So we think that there was a supply problem.

And I think the second reaction is there were some individuals that had a philosophical disconnect. They said, "Well, rates should be distance-based," and there was some discussion with some individuals at Cenex Harvest States that, you know, that they had philosophical—they said, "Your rates should be distance-based as opposed to inversely rated distance."

Senator DORGAN. So let me understand, you talked to the Harvest States executives, perhaps in Minneapolis/St. Paul, they didn't want you to talk to the folks out here, and in any event they perhaps disagreed with you?

Mr. STEVAN BOBB. Some of them disagreed, some of them agreed. We also got concurrence from the other grain companies with which we have relations.

Senator DORGAN. Now, let me also ask the question about the market. Mr. Strege I think raised a point that I have questioned, if you have a market for grain and the West Coast is having trouble getting the grain it needs, letting the market system work would mean that you would bid a higher price for that grain to access that grain to the West Coast. If a railroad comes in and creates an inverse pricing, what you've done is you've been a conduit for an exporter to create circumstances to lower the price for the farmer, saying the grain is less valuable because we won't let the market system work for you. How would your company justify that?

Mr. STEVAN BOBB. Well, that would occur—you asked the question earlier what stops BN Santa Fe from lowering the inverse rate an additional 25 percent. What stops us is our own financial self interest, because essentially that rate would be unnecessary to get more grain tributary to the west.

In the terms of why not let the market work, in general, the West Coast market has an upside that is capped by what the Wheat Board delivers wheat for on the West Coast, and the exporters essentially didn't have a lot of head room in terms of ability to bid that grain up. The way this structure is designed, the intention is that wheat prices actually have to bid up somewhat relative to eastern North Dakota's traditional net packet they get from the actual market. So in that effect it actually facilitates the market by allowing more market negotiators to work on eastern North Dakota grain.

Senator DORGAN. Mr. Griffin, you're an economist, aren't you?

Mr. GRIFFIN. Should I admit to that? Yes.

Senator DORGAN. Did you understand that and agree with it? Again, having both studied and taught economics, it seems to me the logical answer is, if the West Coast is unable to access the grain it needs, the way you get access to that grain is to have the market system increase the value of that grain through market pricing and they will access as much grain as they need. The development of inverse rates short-circuits that. Would you agree with that?

Mr. GRIFFIN. I think——

Senator DORGAN. If you don't, I'll ask somebody else.

Mr. GRIFFIN. I think the answer is yes to both of you.

Senator DORGAN. No, you can't do that.

Mr. GRIFFIN. OK. But I think what Steve Bobb was saying was that the Canadians capped the price in the West Coast because of the similar wheats and we've got the Canadian Wheat Board which is a single seller, a monopoly seller basically.

Senator DORGAN. That's a different source of shame that we are burdened with, we have a monopoly that would be illegal in this country playing those kinds of games. But aside from that.

Mr. GRIFFIN. But if I may, I think it makes the point that if, in fact, those prices are capped on the Canadian Wheat Board, then lower rates in North Dakota overall should be very beneficial to North Dakota producers because the market out there is capped at a level.

Senator DORGAN. Let's explore this just a bit because this is central to the question to what Burlington Northern is doing. You're saying and Burlington Northern is saying the Canadian Wheat Board sets a top price for wheat on the West Coast; is that correct?

Mr. GRIFFIN. I think that's what he's suggesting.

Senator DORGAN. But you also said that. Do you disagree with what he said?

Mr. GRIFFIN. I tend to probably agree with that, but I'm not an expert. I'm no—off a limb here.

Senator DORGAN. It is fascinating that we start with an assumption that fundamentally illegal trade by the Canadian Wheat Board capping our price on the West Coast is the basis on which we should judge the behavior and actions of a railroad in the States, I guess I just don't accept that. But that's a fascinating premise from which to start.

Mr. Bobb, you said that because they're capped by the Wheat Board on the West Coast, you then can come in and draw grain from eastern North Dakota that wouldn't have otherwise gone to the West Coast by creating inverse rates; is that essentially correct? My feeling is that what you have done is interrupted the marketplace in a way that is detrimental to producers, and you're saying not, because the Canadians will injure those producers anyway. Is that a fair representation of what you said?

Mr. STEVAN BOBB. Yes. There's a value for wheat on the West Coast and if it's not the Canadians, it's the Australians or the Argentinians. There's a value at which our specialty exporters need to deliver wheat to the West Coast.

Senator DORGAN. How do you know that?

Mr. STEVAN BOBB. In conversation with them.

Senator DORGAN. All right. Let me ask a couple other questions. I'll come back to this. What consultation did you have with those elevators that benefited from your inverse rate schedules in North Dakota? There are several of them that benefited substantially, did you have consultation with them before you announced the rates or were they totally surprised, pleasantly surprised by what you did?

Mr. STEVAN BOBB. I would imagine that some of them were pleasantly surprised. To the extent that some of them are independent grain companies, like Alton for instance, we may have had a conversation with them directly. Jamestown is owned by another company, we would have had a conversation with their corporate headquarters, as we would with Gladstone and Sterling. So who we talk to is a function of who has financial ownership of those facilities.

Senator DORGAN. So, Mr. Bobb, what you're hearing is that your headquarters apparently had conversations with Burlington Northern, but didn't want you to know. The companies who benefit from the actions of the railroad apparently had consultations with the railroad. Tell me how you react to all of that.

Jim Bobb.

Mr. JIM BOBB. How do I?

Senator DORGAN. Yes.

Mr. JIM BOBB. Well, I knew it was going on and like I stated before, as of last fall, we could not access those rates by, it seems like, any means. It's a hard pill to swallow.

Senator DORGAN. And what happens to you? I mean, you come from a part of the country where I grew up, you invested a substantial amount of money, in fact, you did that, I believe, because of the way the railroad described its intent to serve our State, and the result is I got to work helping try to find some money for paving certain roads and doing various things, and we had trucks moving in and they move into one central location to a facility that was built, really, because of what the railroad was saying to you. And now we have a change in the approach by the railroad. What happens to you, I mean, will you tell us what has happened since the start of your fiscal year, what happens the rest of this year, do you think?

Mr. JIM BOBB. I don't know. We're so reliant—I mean, on my grain margins, I'm totally reliant on what the programs are. It's been obvious since last summer that they're not willing to look at some other rate structure across the State that would have been fair as we see it, or equitable. That's our differential, what we see as equitable, as agriculture elevators to our producers, and how the railroad sees it.

Senator DORGAN. Steve Bobb, you know that Jim is representing a number of country elevators here today, he's testifying on behalf of his elevator, but he and Steve Strege represent a good number of country elevators. Tell me why the Burlington Northern Railroad Company will not provide the Southwest Grain Cooperative the same rates that you're offering to eastern North Dakota for shipments west. Why will you not do that, he's requested that?

Mr. STEVAN BOBB. Well, we get a lot of requests for something that isn't always necessarily in our best financial interest. But again, the quandary here with Gladstone is the economic facts, as we have looked at them time and time again in talking to various participants in the marketplace, is that volumes of grain should not be able to flow east to places like Sterling or Jamestown to access the lower rates. That's not—the math doesn't add up.

Now, we are continuing to have conversations with Southwest Grain. As a matter of fact, I believe since the last set of conversations we had up here a month ago with the legislative testimony, we have had a couple more interactions where we're trying to better understand their grain handled in the months of September, October, November, December and really understand. If there's something going awry here, we need to fix it, but we're not going to fix it without facts.

Senator DORGAN. Have you ever heard of Craig Fisher before today?

Mr. STEVAN BOBB. Yes.

Senator DORGAN. Oh, really. How?

Mr. STEVAN BOBB. I grew up in Richardton, North Dakota.

Senator DORGAN. Oh, so you know Craig?

Mr. STEVAN BOBB. I don't know him very well personally, but I recognize the name.

Senator DORGAN. Well, there's a start. Let me ask, I assume that you didn't know that Craig Fisher drove 16,000 miles to Jamestown with his 50,000 bushels of wheat, did you?

Mr. STEVAN BOBB. The first I heard that was approximately one month ago and at that point in time he indicated he had handled between 60,000 and 70,000 bushels of grain to Jamestown and that begun our more extensive research in terms of what some of the unintended effects might be.

Senator DORGAN. And in that research in the past month what have you concluded, if anything?

Mr. STEVAN BOBB. Interestingly enough, to this point Jamestown has denied buying any grain from people in Stark County. This is an onion that needs to be peeled.

Senator DORGAN. I guess it's your position that you're not sure Craig Fisher ever drove to Jamestown, that's what you're suggesting; is that correct?

Mr. STEVAN BOBB. I'm sure he did.

Senator DORGAN. Well, you're saying that the folks in Jamestown are telling you that probably no one delivered grain over there from western North Dakota.

Mr. STEVAN BOBB. Senator, we're trying to decide if it was 50,000 bushels or 500,000 bushels and that's really what the economic question boils down to.

Senator DORGAN. Fifty-thousand bushels may not seem much to you, but it's a whole lot to Craig Fisher, it's a whole lot to people in my home county, and I bet 50,000 bushel is a pretty good chunk to Jim Bobb. So I'm trying to ask a question, I think the implication of your answer was that yes, you heard that a month ago, that story, but you're not sure it exists?

Mr. STEVAN BOBB. We're sure it exists for 50,000 bushels.

Senator DORGAN. I thought you just said the folks in Jamestown deny receiving it?

Mr. STEVAN BOBB. That's what I said but, see, we're trying to get a sense from Jamestown how much grain is trucking into Jamestown.

Senator DORGAN. But you don't deny that, you think there's some being trucked in?

Mr. STEVAN BOBB. Well, there's always been grains, that is a factor.

Senator DORGAN. Do you think more has been trucked east because of your inverse rates?

Mr. STEVAN BOBB. That's what we're trying to understand.

Senator DORGAN. If that's the case, then what will the company do about it?

Mr. STEVAN BOBB. We may need to adjust some spread relationships.

Senator DORGAN. Now, I asked you why you wouldn't adjust your rates so that the Southwest Grain company could receive the same rates and you said you talked about what is in your financial interest. When there's a tension between good public policy and the financial interest of your railroad, how is that tension resolved? It seems to me that in a railroad where you really don't have much competition, if any, you always resolve that in your favor; would that be correct?

Mr. STEVAN BOBB. That would not be correct.

Senator DORGAN. Could you tell me instances in which you resolved rates in favor of the consumer and against the interest of your company?

Mr. STEVAN BOBB. There are probably a number of occasions where we have not been as aggressive on rate increases as the market opportunities may have allowed because of our position. Because there is a natural tension in our company between all of our constituents, those constituents include not only our owners, which is where the financial rewards flow, but our employees, the communities we serve and our customers. So in my 4 years being responsible for our grain business I have not had an occasion, up until this exact case, where the issue has been this unclear in terms of the economics of the action. I can tell you in terms of making infrastructure investments where there were branch lines, we have upgraded branch lines where it was not in our financial best interest to spend money to continue.

Senator DORGAN. Mr. Strege, you heard my question. Do you see circumstances where the railroad essentially pulls a punch and says, "Well, let's do this in the interest of consumers, we're not so interested in our well being"?

Mr. STREGE. I guess I can't recall any of those things at this point. Mr. Bobb just mentioned that—the upgrading of some branch lines and that did happen. Twenty years ago when the BN was going to announce or announced a series of abandonment possibilities, probabilities, and the State sort of rose up in defiance and there were some branch lines fixed up. Many of those are still in existence, running maybe as a short line.

One of the questions that I wonder about is if somehow the BN can take care of the problem with Southwest Grain, is that where you stop? Or do we try to fix the inequities in other places and between other elevators not only in southwestern North Dakota but in other places?

Senator DORGAN. Well, my question wasn't designed simply to say, "Why don't you do something for Southwest Grain?" The reason I was asking the question is what about the fairness of rates for all country elevators in North Dakota?

Mr. STREGE. Senator, if I may, I've got the BN's latest annual report here for the year 2001 and I think part of the problem is where the focus is, at the company, and right inside the front cover the first thing we see is a focus on customers. There's also a focus on employees, owners, and communities. Then later on there's a tribute here to Rob Krebs who was stepping down as chairman—and I don't want this to sound like an attack on Mr. Krebs, because certainly it is not—but there are some quotes in here from people saying nice things about Mr. Krebs. There are four economic analysts, one locomotive engineer, one professor, one who was described as a journalist and rail industry observer, and absolutely no customers. And I think that says something about where the focus is at, it's on Wall Street, not Main Street, and we need to get it back on Main Street.

Senator DORGAN. I had intended to ask a question earlier, Mr. Bobb, you mentioned that the rail rates for grain and wheat especially have fallen, generally, your testimony describes those circumstances and timeframes, and I think you referenced a GAO study for that, did you not? An STB study and a GAO study. My understanding is, though, that the studies demonstrate that while you might be talking about trends nationally, that there are regional trends that are starkly different from that, is that not the case?

Mr. STEVAN BOBB. There may very well be, but my testimony specifically points out that rates for agricultural commodities for the BN Santa Fe, declined on a revenue per ton-mile basis; and it goes on to point out just the point that you make, that there are some areas where rates may not have gone down dramatically in nominal terms and I have examples there of 52-car shipments, they certainly haven't gone up, and when adjusting for inflation they are down dramatically.

So, you know, North Dakota is a great example of what ails the rail industry. We are unable to get rate increases because we compete against a public infrastructure, the highway and barge system, and in attempting to get rates up, I can personally tell you I've seen convoy lines of trucks form out of elevator facilities like Southwest Grain and we end up having to retract our attempt to raise rates. So there are parts of the rail network that rates are down dramatically, there are parts of the network that they are stable.

Senator DORGAN. But I think it is the case you charge what you can and for example, putting a carload of wheat on a track here in Bismarck, trucking it to Minneapolis which is just over 400 miles, close to 450, I guess, you charge more than twice as much then would be charged for the same carload of wheat from Minneapolis to Chicago. So we pay more than double the price because you can charge that price; is that not correct?

Mr. STEVAN BOBB. Well, that's an interesting example, the reality is that the rate between Minneapolis and Chicago is an additive rate. Not a lot of grain ships between Minneapolis and Chicago. The rate is structured to allow customers to deliver grain to Minneapolis or continue that shipment through to Chicago and it is designed that essentially once you have rail car originated and moving, it's just as efficient to keep it ongoing to Chicago as opposed to stopping short in Minneapolis, it does not move grain from Minneapolis to Chicago.

Senator DORGAN. How many carriers are you able to use between Minneapolis and Chicago?

Mr. STEVAN BOBB. Between Minneapolis and Chicago?

Senator DORGAN. Yes.

Mr. STEVAN BOBB. I would imagine there are three or four railroads that move through that corridor. Again, the question is, how much grain originates from Minneapolis and moves to Chicago.

Senator DORGAN. Right, but I'm talking about rates, not quantity, and how many railroads exist between that would carry grain from Bismarck or Jamestown to Minneapolis?

Mr. STEVAN BOBB. We would carry grain from Jamestown specifically. However, CP stations compete for Jamestown as well.

Senator DORGAN. Bismarck?

Mr. STEVAN BOBB. Yes.

Senator DORGAN. My point is, it's like pulling teeth here, my point is, you got one carrier to charge what they want, another route you got three carriers and there's price competition and voila, the prices decrease by more than half and I think it describes almost everything that's wrong with what's happening with the railroads today, in increasing concentration and higher prices.

Having said all that, let me do this, Mr. Bobb, you represent your company, you represent your company well. You've heard that the State regulatory body has no regulatory teeth, it's kind of a gummer body when it comes to railroads, but then that's the case—I don't mean that in terms of age—but that's the case with every State regulatory body because the Federal legislation has preempted them. But you heard testimony from the State regulatory body here that they think your rates are unfair and unwarranted. You hear from your customers that they are unfair. My own view is that these rates are not fair, should be changed and we need to find ways to force that change.

Now, I well recognize that we don't have the capability to do that unilaterally on our Committee, for example, and I'm going to re-authorize the Federal Trade Commission as Chairman of this Subcommittee at some point later this year and see if I can put a provision in that re-authorization to give the FDA a crack at your pricing. They don't now have the opportunity, but I want to give them that opportunity. We've got a fair number of lawyers at the FDC that I hope that we could turn loose on pricing by railroads. I'd like to see us pass a couple pieces of legislation that have been introduced about this pricing strategy, but I feel very strongly about this, and I hope that you will consider this and go back and do what you can about pricing.

I think your pricing choices have a profound impact on rural communities, on country elevators, and on family farmers, and just because you can impose these rates, does not mean you should. Just because you have the opportunity to do it, does not mean they're fair. And I think that when you take a look at this, I would not have had a problem if you say that you want to move grain to the West Coast and create incentives to do that, if you provide the same incentives to all of our State shippers. But you've not done that; you decided to pick and chose; and I think you create very serious problems with that.

I'll be happy to let you have the last word as we proceed in just a moment, but there are some others in the room, we only have about 10 minutes left, I promised that I'd have the room for 2 hours. There are some others in the room that may wish to make comments. And I would like to ask you to do so briefly and identify yourself and make comments if you would like to make comments.

STATEMENT OF ROGER JOHNSON, NORTH DAKOTA AGRICULTURE COMMISSIONER

Mr. JOHNSON. Senator Dorgan, thank you for holding this hearing. For the record, my name is Roger Johnson, I'm the Ag Commissioner.

I think the case has been clearly made that there aren't a whole lot of people who think what's happening here is the way it ought to be happening. A month ago all of the ag commissioners of NASDA, Nationally Association of State Departments of Agriculture, I brought to that meeting a resolution dealing with this issue and I would like to read just the policy recommendation part of that for you, it is three sentences in length.

> "NASDA urges all railroads to charge reasonable rates and consistent rates to all shippers and treat all shippers equitably. NASDA also encourages railroads to offer co-loading of trains and to have reasonable loading policies that hold both shippers and railroads promptly—NASDA believes the Congress and Federal Government should substantially increase oversight of railroads including rates and services where competition is not present."

And I think that is the heart of what this hearing is about through the testimony that's been given.

For the record, I would like it also known that there was some concern about, I mean, this is essentially saying it's time to re-regulate railroads where competition doesn't exist and there was some concern that this language may be too strong when it got to the floor, and all of the ag commissioners were there debating it. It was passed without a single dissenting vote, and the only debate was critical of me for not making it even stronger. And so, I mean, I think that speaks volumes about the feeling across this country in agriculture as to how they are being treated by railroads all across America.

If you have any questions, I'd be pleased to respond.

Senator DORGAN. We will be willing to take written testimony from anyone who wishes to submit any written testimony following this hearing, and that would be from anyone who feels any way on any side of this issue. We'll take one more piece of testimony, then we'll adjourn.

STATEMENT OF LARRY LEE, VICE CHAIRMAN, NORTH DAKOTA WHEAT COMMISSION

Mr. LEE. Senator Dorgan, on behalf of North Dakota's 20,000 wheat producers we thank you for holding these meetings, extremely important to us. I am Larry Lee, I'm a wheat producer from Bell, North Dakota, Vice Chairman of North Dakota Wheat Commission and chair the Transportation Portfolio. I'm going to make this as brief as possible.

First of all, I think one assumption comes out of here is that these rate structures are discriminatory. Discriminatory rates applied by BN have little to do with change, efficiency, or pro-market forces. BN tells the rest of the world to adapt, improve efficiency, but it appears that this efficiency is a cost that is borne by the rest of the farm-to-fork chain of supply. I think BNSF is behaving badly, it is a rail monopoly and maybe we are going to have to look at some type of regulation.

With that, any questions?

[The prepared statement of Mr. Lee follows:]

PREPARED STATEMENT OF LARRY LEE, VICE CHAIRMAN, NORTH DAKOTA WHEAT COMMISSION

Senator Dorgan, on behalf of the state's nearly 20,000 wheat producers, I thank you for holding this hearing to look into an issue that is extremely important to all of North Dakota.

I am Larry Lee, a wheat producer from Velva, N.D. I serve as vice-chairman of the North Dakota Wheat Commission and I'm one of two commissioners who carry the transportation portfolio for the Commission.

Before I get into specific implications of BNSF's inverse rate scheme, I think it's important to put this issue into context. No matter how many coats of whitewash Burlington Northern Santa Fe applies to its discriminatory rate structure, the situation producers are facing has little to do with "change," "efficiency," or the "forces of a free market," and more to do with BNSF flexing its market dominant muscle.

Approximately 70 percent of the grain sold in North Dakota each year moves to market by rail. Burlington Northern Santa Fe directly and indirectly (through its short line affiliate) controls about 75 percent of the so-called rail "service" in North Dakota.

We are captive shippers, and as such North Dakota and Montana farmers pay the highest per mile rail rates of farmers anywhere. The North Dakota Public Service Commission and Upper Great Plains Transportation Institute (at NDSU) estimate that the state's farmers pay $50 million to $100 million annually in excessive freight rates. In other words, farmers would net about $.17 to $.33 per bushel more from sales of wheat if rail rates were at a reasonable level, which is 180 percent of variable costs, according to the Surface Transportation Board.

High rail freight rates mean lower grain prices and lower farm income, so you'll seldom find the North Dakota Wheat Commission in opposition to the lowering of rail rates. However, rates need to be equitable. Rates should be lowered for all shippers and all farmers.

At a hearing held recently before North Dakota's legislative interim agriculture committee, BNSF executive Steve Bobb testified that BNSF put the inverse rate into place at the request of exporters in the Pacific Northwest to giive them access to more wheat from a larger draw area. This scheme is allowing BNSF, not the market, to dictate who and where the grain merchandisers will be.

BNSF's secretive, lower contract rate to a few shuttle loaders, and now perhaps a few unit train loaders, in eastern North Dakota and western Minnesota has distorted local producer prices and shifted typical wheat movement. Producers west of BNSF's "Great Divide" are being deprived of traditional and hard-earned sales to West Coast markets, with no reciprocal access to markets in the east. We are receiving lower prices for our wheat as a result.

In addition, BNSF's rate is distorting the source of hard red spring wheat being shipped to key customers in the Asian region. It is not that the spring wheat produced in eastern North Dakota and Minnesota is of lower quality; it is a different quality. Because of the varieties grown and for environmental reasons, a 14 protein spring wheat from the eastern growing region will typically be more mellow in its protein quality and gluten strength than a wheat with 14 percent protein content from the western region. Our customers don't like surprises and the North Dakota Wheat Commission has recently been catching some heat from customers in Japan and other important Asian markets.

At the request of U.S. Wheat Associates and the Wheat Commission, the North Dakota State University Cereal Science Department is currently testing samples obtained from customers in Asia to determine their varietal make-up. The number of samples is relatively small at this point, but varieties like Forge (SD), Russ and 2375 are showing up in greater numbers. These are weaker mixing, lower absorption varieties. Although they are also grown in western North Dakota as well these days, they are grown in larger percentages farther east.

Testing of cargo samples on export shipments is also revealing weaker dough mixing characteristics than would be traditionally found in wheat shipped from the PNW. The drop-off appears to have happened since mid-2001 to the present, which seems to coincide with BNSF's inverse rate. It is too soon to say for sure, but we speculate that the change in wheat origins might be playing a role in the concerns we are hearing from Asian customers.

A recent analysis of farm expenses and income showed that southwestern North Dakota is the best place—the most profitable place, if there is any—to grow wheat. This area has been favored by good weather and a relatively disease-free growing environment in recent years. These producers are sitting on some of the highest quality wheat stocks in the state. BNSF must not be allowed to dictate who can grow wheat and where they can grow it, but if the monopoly railroad is not stopped, the inverse rate structure has the potential to seriously damage the viability of wheat production in many sectors of the state due to its unfair and inequitable nature.

BNSF tells the rest of the world to "adapt" to improve efficiency. But it seems to me that we're improving BNSF's efficiency at a cost to other sectors in the farm-to-fork supply chain. I thought rail transportation was supposed to be a service industry. What happened to the concept of customer service?

BNSF is behaving badly. The rail monopoly's abuse of the freedoms it was given under deregulation make a sound argument for increased government oversight. Without the discipline of competition or effective regulations, North Dakota agriculture is at risk of being completely derailed. Senator Dorgan, we appreciate your attention and encourage you pursue solutions to the problem of excessive and inequitable rail rates.

Senator DORGAN. Mr. Lee, thank you very much.

I think because of the time we will have to ask for people to submit—you have submitted a statement, we will make that entire statement a part of the record. We will keep the record open for 2 weeks, if that is satisfactory, and if you submit testimony for the record within 2 weeks, it will be, by consent, made a part of the record of this hearing.

Mr. Bobb, thank you for coming on behalf of the railroad, in support, rather, of the railroad company, and explaining the policies.

I thank the rest of the witnesses for being here to describe your view of things and this, of course, is a discussion that will continue and go on for some while.

My hope is that in the final analysis we will have circumstances that exist that all of us would feel represent fair rail rates for our customers and North Dakota farmers, shippers, country elevators and others.

First of all, I would say this, we need a railroad in our State. If Burlington Northern woke up tomorrow and said, "By the way, we won't run any trains in North Dakota", we would be severely disadvantaged. So we need rail service in North Dakota. It must be good rail service, reliable rail service, affordable rail service with fair rates; and because we've had so much concentration in recent years and we have had prior to that substantial deregulation, it is perfectly reasonable for us to be talking about what kind of thoughtful regulation is necessary in this new era. That's a discussion for a later day and will provoke enormous—spark controversy in the full Congress. I'm convinced that, we've said it before and we'll say it again, it is time—high past time—for us to discuss all of these issues.

So we thank the witnesses for coming and this hearing is adjourned.

[Whereupon, at 3:30 p.m., the hearing was concluded.]

APPENDIX

BURLINGTON NORTHERN SANTA FE, APRIL 10, 2002

Senator BYRON DORGAN, *Chairman,*
Subcommittee on Consumer Affairs, Foreign Commerce and Tourism
Senate Committee on Commerce, Science and Transportation,
Washington, D.C. 20510

DEAR SENATOR DORGAN: Pursuant to your offer to accept submissions for the record following the March 27th Commerce Committee hearing in Bismarck, North Dakota, I am providing on behalf of Burlington Northern Santa Fe Railway the following information. The intent of this submission is to clarify several points made in the testimony of Southwest Grain, which we believe will provide for a more complete hearing record.

Thank you for this opportunity to submit this information.

Sincerely,

STEVE BOBB,
Group Vice President
Agricultural Products

RESPONSE TO SOUTHWEST GRAIN TESTIMONY BEFORE THE SENATE COMMERCE COMMITTEE HEARING ON RAIL TRANSPORTATION PRICING, MARCH 27, 2002

Response to page 3:

The flat price graph for delivered grain bid prices presented in SW Grain's testimony (page 3) is not the relevant measure of grain value year over year. Commercial grain transactions are conducted in a hedged environment, which is not reflected in SW Grain's graph. Instead, the graph (at right) more accurately reflects the Minneapolis basis (bid price) and PNW basis (bid price) year over year, which indicates that during the differential pricing program, delivery prices at major markets remained at a premium to year earlier levels. This is evidence that BNSF transportation pricing did not depress delivered grain bid prices. These bid prices determine FOB Boyle grain values.

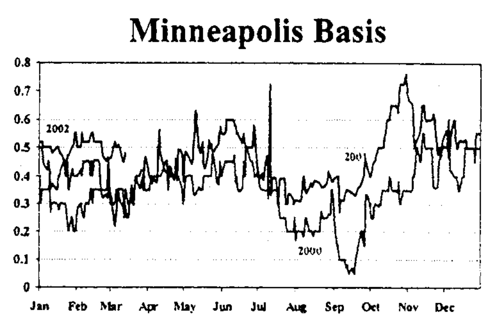

Chart 1

Response to page 7:

The wheat volumes reflected in the graph on page 7 do not appear to include harvest movement (Jul, Aug & Sept). When all volumes are included, the harvest movement for the Boyle, ND facility in 2002, under the present pricing program, is 149% of 2001's harvest movement.

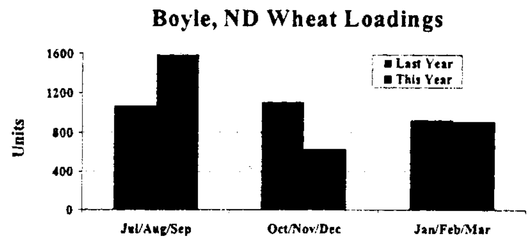

Chart 2

Response to page 8:

With the inclusion of harvest volume (Jul, Aug & Sept Shipments), while the differential pricing program was in place, Boyle's volume was not adversely affected. A comparison of year over year volume by major competing shippers in Southwest North Dakota, both shuttles and non-shuttles, show year over year growth occurred at ALL of the facilities in this region. Southwest North Dakota elevators benefited from greater production in the 2001-2002 wheat crop year. Increases in carload volumes from all of these stations indicate that significant volumes of grain did not leak away from Southwest Grain, as suggested.

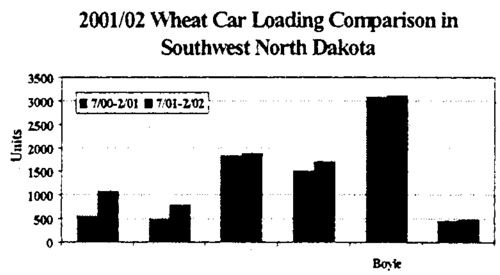

Chart 3

Response to page 10:

Lower wheat margins are likely due to increased competition from both shuttle and non-shuttle stations in southwest North Dakota as demonstrated in Chart 3 above. In fact, two nearby facilities shown in the chart achieved shuttle status in early 2001.

PREPARED STATEMENT OF LINDA J. MORGAN, CHAIRMAN, SURFACE TRANSPORTATION BOARD

My name is Linda J. Morgan, Chairman of the Surface Transportation Board (STB or the Board). I am testifying at the request of the Committee to discuss the Board's jurisdiction over railroad rates. I have appeared before this Committee many times over the past several years and have discussed at some length matters before the Board, including issues relating to railroad rates.

Rate Regulation in General. Although the Board is charged with regulating railroad rates and routings, see 49 U.S.C. 10701(d)(1), 10704(b), 10707(b), its responsibilities are limited by the statute. Historically, customers often directed railroad routings, railroads were generally required to charge the same rate regardless of the routings a particular shipment used, and the rate regulation of the Interstate Commerce Commission (ICC) was pervasive. Through the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act) and the Staggers Rail Act of 1980 (Staggers Act), however, Congress ended the requirement that railroads provide service and rates over all possible routes, and instead gave carriers the discretion to choose the routes over which they will provide service, intending to free them to maximize their use of efficient routes and to eliminate less efficient ones. The 4-R and Staggers Acts also gave railroads more pricing freedom and curtailed regulatory rate review. The current statute reflects this changed approach and provides for the review of complaints about unreasonably high rates under certain circumstances.[1] The current law also prohibits unreasonable discrimination (49 U.S.C. 10741), but the prohibition does not apply to the cancellation of joint rates, rail rates applicable to different routes, or different rates that result from different services.[2] Shippers have not made substantial use of the anti-discrimination provision in litigation before the Board.

Market Dominance. The Board may review a rail rate only where the railroad has market dominance (that is, where there is an absence of effective competition for the transportation to which the rate applies), 49 U.S.C. 10701(d)(1), 10707. There are two components to a market dominance inquiry. One is, in effect, a quantitative test. The statute establishes a conclusive presumption that a railroad does not have market dominance over transportation if the rate that it charges produces revenues below 180% of the "variable costs" of providing the service. 49 U.S.C. 10707(d)(1). This 180 revenue-to-variable cost (r/vc) percentage is thus the floor for regulatory scrutiny.

For situations in which the 180% threshold is met, the second component of a market dominance inquiry involves a qualitative analysis in which the STB must determine whether there are any feasible transportation alternatives that could be used for the traffic involved. 49 U.S.C. 10707(a). Currently, in its market dominance determination, the STB considers actual or potential direct competition, that is, competition either from other railroads (intramodal competition) or from other modes of transportation such as trucks, pipelines, or barges (intermodal competition) for the same traffic moving between the same points. For many years, the ICC (and later the Board) also considered two other types of indirect competitive alternatives: geographic competition (the ability to use other railroads or modes to ship from or to other locations) and product competition (the ability to use other railroads or modes to ship substitute products). The STB no longer considers these forms of indirect competition because it found that they are unduly complicated for the Board to assess, that they prolonged the handling by the Board of rail rate cases, and that they discouraged shippers from pursuing legitimate rate complaints.[3]

Large Rate Cases. In cases where market dominance has been found, the determination of what is a reasonable rate is not an easy task. It would seem that the relatively straightforward way to adjudicate reasonableness would be through reference to the cost of service. But the full costs of serving each individual shipper cannot be measured directly, due to the high degree of shared costs (e.g., overhead costs) and sunk costs (e.g., costs for tunnels, bridges, etc.) in the rail industry that cannot be attributed to individual traffic. Additionally, railroads are not able to price their services based on preset cost allocations because they serve a mix of captive and competitive traffic, and the competitive traffic would not pay a pro rata share of costs assigned by a formula if the resulting rate is any greater than the rate for using competitive transportation alternatives. Thus, a preset allocation formula would drive away those shippers with less costly competitive options, and the remaining captive shippers would then have to pay even higher cost-based rates once the departed shippers would no longer be contributing to shared costs.

Accordingly, to limit the rates on captive rail traffic to reasonable levels while affording railroads the opportunity to cover all of their costs and earn a reasonable

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[1] Complaining shippers bring cases under the procedures outlined below. Shippers are required to pay a filing fee (effective April 8, 2002, $61,400 for "large" rate cases and $6,000 for "small" cases), which has been a matter of concern to various parties. The Board (and the ICC before it), however, has been required for some time by statute to cover some of its expenses through filing fee assessments that reflect the costs to the Board of handling the various matters brought to it.

[2] The current law does provide a discrimination-type remedy for shippers of agricultural commodities by permitting them to protest an agricultural contract given to another shipper on one of two grounds: that the protesting shipper has been denied the same terms for contemporaneous movements of the same commodity provided under similar transportation conditions (in which case the protesting shipper will be entitled to receive matching terms), or that the contract with the other shipper constitutes a destructive competitive practice. See 49 U.S.C. 10709(g); 49 CFR 1313.

[3] *Market Dominance Determinations—Product and Geographic Competition*, STB Ex Parte No. 627 (STB served Dec. 21, 1998), pet. for reconsideration denied (STB served July 2, 1999), remanded, *Association of Am. Railroads* v. *STB*, 237 F.3d 676, 679 (D.C. Cir. 2001) ("AAR v. STB"), decision on remand, *Market Dominance Determinations—Product and Geographic Competition*, Ex Parte No. 627 (STB served Apr. 6, 2001) for judicial review pending sub nom. *Association of Am. Railroads* v. *STB*, No. 01-1213 (D.C. Cir. filed May 15, 2001).

profit, the STB uses demand-based differential pricing principles as contemplated by the statutory scheme. In other words, the statute anticipates that the railroads will apply differing markups (amounts by which rates exceed variable costs) based on the price sensitivity (degree of captivity) of the traffic. Shippers with more choices are offered lower markups in order to keep their traffic in the rail network and thus minimize the overall contributions to the railroads' shared costs needed from those shippers with few, if any, choices.

These pricing principles, which apply in many industries in addition to railroads, make determining the reasonableness of an individual rate a complex task. Neither attributable costs nor degree of captivity (demand elasticity)—the bases for demand-based pricing—can be measured directly. Therefore, to assess whether market dominant rates are reasonable, the Board uses a well-established concept known as "constrained market pricing" (CMP) whenever possible.[4] CMP principles recognize that, in order to earn adequate revenues, railroads need the flexibility to price their services differentially by charging higher mark-ups on captive traffic, but the CMP guidelines impose constraints on a railroad's ability to price differentially.

The most commonly used CMP constraint is the "stand-alone cost" (SAC) test. Under the SAC test, a railroad may not charge a shipper more than what a hypothetical new, optimally efficient carrier would need to charge the complaining shipper if such a carrier were to design, build and operate—with no legal or financial barriers to entry into or exit from the industry—a system to serve only that shipper and whatever group of traffic is selected by the complaining shipper to be included in the traffic base. The ultimate objective of SAC in particular, and CMP in general, is to eliminate cross-subsidies from one shipper to another and to have optimal efficiency reflected in the rate base used to evaluate the reasonableness of rates paid by captive shippers. Thus, the SAC test allows railroads to price differentially, but it limits rates through the hypothetical efficient new railroad model by assuring that a captive shipper not be required to unreasonably subsidize a carrier's competitive traffic by being forced to bear the costs of any facilities or services from which it derives no benefit.

The Board has used this test to resolve five rate complaints since the agency was established at the beginning of 1996 (cases brought by West Texas Utilities Company, Arizona Public Service Company, McCarty Farms, Inc., FMC Corporation, and Wisconsin Power and Light Company), and the test is being used to evaluate the reasonableness of rates in several ongoing cases. The Board has also established procedures for expediting these cases. While presenting a SAC case is not inexpensive, large rail shippers have used it to obtain substantial rate relief. One shipper, for example, was awarded over $10 million in reparations for past shipments, and obtained a rate prescription that lowered its rate for future shipments by 30%.[5] Another shipper was awarded over $20 million in reparations and obtained a 40% rate reduction.[6] The parties have reached voluntary settlements in various other large rate cases,[7] while the railroad has prevailed in some cases.[8]

Small Rate Case Simplified Guidelines. Although the CMP guidelines provide the most economically authoritative procedures for evaluating the reasonableness of rail rates, CMP can be impractical to use where the amount of money at issue is not great enough to justify the expense of such an evidentiary presentation. In the ICC Termination Act of 1995, Congress directed the Board to develop a simplified, alternative procedure to CMP. 49 U.S.C. 10704(d). Accordingly, in December 1996, the

[4] See *Coal Rate Guidelines, Nationwide*, 1 I.C.C.2d 520 (1985), aff'd sub nom. *Consolidated Rail Corp.* v. *United States*, 812 F.2d 1444 (3d Cir. 1987).

[5] *West Texas Util. Co.* v. *Burlington N. R.R.*, No. 41191 (STB served May 3, 1996), aff'd sub nom. *Burlington N.R.R.* v. *Surface Transp. Bd.*, 114 F.3d 206 (D.C. Cir. 1997); reparations calculated, No. 41191 (STB served Oct. 24, 1997).

[6] *Arizona Pub. Serv. Co. et al.* v. *Atchison, T.&S.F.R.R.*, No. 41185 (STB served July 29, 1997), modified (STB served Apr. 17, 1998). More recently, shippers obtained substantial rate relief in *FMC Wyoming Corp. and FMC Corp.* v. *Union Pacific Railroad Company*, STB Docket No. 42022 (STB served May 12, 2000) and *Wisconsin Power and Light Company* v. *Union Pacific Railroad Company*, STB Docket No. 42051 (STB served Sept. 13, 2001) (petitions for reconsideration pending).

[7] E.g., *Potomac Elec. Power Co.* v. *CSX Transp., Inc.*, STB Docket No. 41989 (STB served June 18, 1998); *Sierra Pac. Power Co.* v. *Union Pac. R.R.*, STB Docket No. 42012 (STB served July 15, 1998); *Pennsylvania Power & Light Co.* v. *Consolidated Rail Corp., et al.*, No. 41295 (STB served May 13, 1999); *PSI Energy, Inc.* v. *CSX Transp., Inc., et al.*, STB Docket No. 42034 (STB served May 13, 1999); *Northern Indiana Public Service Company* v. *Consolidated Rail Corporation*, STB Docket No. 42027 (STB served Nov. 28, 2001).

[8] E.g., *McCarty Farms, Inc.* v. *Burlington N., Inc.*, Nos. 37809 et al. (STB served Aug. 20, 1997), modified (STB served May 11, 1998), aff'd sub nom. *McCarty Farms, Inc.* v. *STB*, 158 F.3d 1294 (D.C. Cir. 1998); *Bituminous Coal—Hiawatha, UT to Moapa, NV*, 10 I.C.C.2d 259 (1994).

Board adopted simplified guidelines that employ three revenue-to-variable cost benchmarks as starting points for a case-by-case rate reasonableness analysis. Subsequently, the Board adopted procedures for expediting those cases. Although the evidence needed to use these benchmarks is available and inexpensive to obtain, no complaint cases have been filed by shippers seeking application of these guidelines, and the one case already pending to which these guidelines would have been applicable was settled by the parties. The customer community remains concerned that this process is still too burdensome.[9]

Summary. The statute that the Board administers assumes that the railroads will price differentially, that is, price depending on market sensitivity. At the same time, the law is intended to ensure that, while customers may pay different rates, no customer will pay a rate that includes an unreasonably high share of the railroad's overall costs.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. BYRON L. DORGAN TO LINDA J. MORGAN

Question 1. The March 27 hearing focused to a large extent on the inverse export wheat rates of BSNF; that is, rates to the west coast which are lower from certain points in eastern North Dakota or western Minnesota than from points in western North Dakota or Montana, even though the rail line that carries the cheaper eastern wheat passes through the communities, or over main lines just a short distance from the communities, where there is wheat that could have been shipped to the west coast but for the inverse rate structure.

Your testimony points out that "current law . . . prohibits unreasonable discrimination (49 U.S.C. 10741), but the prohibition does not apply to the cancellation of joint rates, rail rates applicable to different routes, or different rates that result from different services," and you observe: "Shippers have not made substantial use of the anti-discrimination prohibition in litigation before the Board."

A. Do you think that the anti-discrimination provision was or is available to wheat shippers who believe they were injured by the BNSF inverse rates in North Dakota?

B. Would the inapplicability of that remedy to "different routes" be likely to defeat a discrimination claim?

C. If you think the answer to the latter question is affirmative, then, where all of the rates and routes involved are under the control of the same carrier, would you see any substantial harm in changing section 10741 so that it would be inapplicable to different carriers, rather than different routes, bearing in mind that the defendant carrier could still defend by arguing that the rate disparity was due either to different services provided under the different rates, or for performing services that are not "like and contemporaneous" or applicable under "substantially similar circumstances"?

Answer. I am not in a position to attempt a definitive answer to the first two parts of your question, as it could prejudge an issue that could come before the Board in a formal proceeding. However, it is virtually certain that, if such a complaint were brought, the railroad would raise as a defense the argument that the anti-discrimination remedy is expressly precluded by the statute because the services at issue involve different routes. That, I suspect, is why a formal complaint has not been brought before the agency by North Dakota wheat shippers.

Changing the statute by repealing the categorical exclusion of a discrimination remedy for services over different routes, as you suggest in the third part of your question, would not completely foreclose a carrier from defending itself in a discrimination case: a carrier could still prevail by showing that the services or circumstances at issue are not similar, and thus that the different rate treatment is not unlawful. Whether or not such a statutory change would be harmful depends upon the interest that is being considered. The existing statutory scheme reflects a delicate balance of competing interests. Certain statutory changes could upset that balance, and could restrict the ability of rail carriers to respond to market forces. This, in the long run, might reduce the revenues flowing into the rail network to cover capital needs and have a negative effect on the service to be provided overall.

Question 2. Your testimony also reviews the methods available for challenging unreasonably high rail rates. You observe that there is a "simplified, alternative proce-

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[9] To address this continuing concern, the Board recently issued a decision seeking comment on the idea of legislation mandating the use of arbitration to resolve these small rate cases. *Arbitration—Various Matters Relating To Its Use As An Effective Means of Resolving Disputes That Are Subject To The Board's Jurisdiction*, Ex Parte No. 586 (STB served September 20, 2001).

dure" but that it has not been used and that rail customers remain concerned that even the simplified procedure is still too burdensome. You note that, to "address this continuing concern, the Board recently issued a decision seeking comments on the idea of legislation mandating the use of arbitration to resolve these small rate cases."

As you know, one of the criticisms leveled at the "simplified" procedure is that the three "benchmarks" it relies upon appear destined to produce a maximum reasonable rate well in excess of 200% of variable cost—some say in the vicinity of 240% of variable cost—while the stand-alone methodology, utilized in large volume cases, is capable of achieving a maximum rate as low as 180% of variable cost.

A. Do you agree that the simplified methodology is likely to result in a maximum rate that is higher than 200% of variable costs or, in general, higher than the lowest maximum reasonable rate obtainable under the stand-alone methodology? If so, why should one of the Board's recognized rate case methodologies be more likely to produce a higher maximum reasonable rate than the other methodology?

B. If an arbitration system either relies on or allows the use of existing maximum rate case methodologies, won't arbitration virtually compel shippers in cases suitable for arbitration to engage in the costly proofs required under the Board's litigation methodologies or run the risk of being overwhelmed by railroad arbitration presentations that rely on approved methodologies?

Answer. A. The simplified maximum rail rate procedure, like the stand-alone cost (SAC) methodology, was designed to give effect to all of the considerations that the statute directs the agency to consider in rail rate cases. As we do not have much experience in applying the simplified guidelines, I cannot project the range of results that the methodology would likely produce. But even if the simplified methodology did produce ratios above 180%, comparing a small rail rate case to a case involving high-density rail movements of a commodity such as coal does not seem to me to be a valid exercise. The stand-alone methodology is designed to determine the lowest cost at which a hypothetical, efficient railroad could provide the transportation service needed by the complaining shipper. High-density coal movements, which have been the subject of most of the SAC cases handled by the agency, tend to produce efficiencies of scale that in many cases would not likely be generated by the traffic associated with a small rate case. Thus, under the economic principles underlying the statute that the Board administers, it would not be surprising or inappropriate if the rates set in a coal case were lower than those that would be set if the SAC methodology were applied to the traffic involved in a small rate complaint.

B. Although we do not believe that the small rail rate case process need be particularly burdensome, it is true that an arbitration system based on SAC could involve elaborate presentations comparable to those currently made before the Board. With this concern in mind, if Congress decided to adopt an arbitration remedy, it could prescribe a standard other than those currently used by the Board. If it proceeds along those lines, however, whatever standard or approach is adopted should recognize that most railroad traffic is competitive, and that if rates on captive traffic are held down too far, carriers will not be able to meet their capital needs or make appropriate investments in their facilities.

Supplemental Testimony of North Dakota Grain Dealers Association and Alliance to Keep Rural America on Track

Assertions by BNSF Railway that it is trying to keep North Dakota farmers more competitive are directly contradicted by the extremely high revenue to variable cost ratios on wheat movements from this state documented in the testimony of the Upper Great Plains Transportation Institute. These ratios also undercut the relevancy of BNSF's claim that rail rates have declined. *Shippers* have provided investments to make themselves and the railroad more efficient. Railroads have trimmed their labor force, abandoned unprofitable track and spun off other pieces of track to short lines. This has further reduced their costs. When comparing *costs*, we learn that rates should have declined more, to below their current levels.

BNSF's claimed on-time performance percentages do not fit with customer reports. The measurement of what is "on-time" is not disclosed in the BNSF testimony. At times in the past it has been plus or minus one business day for some kinds of service, and more for other kinds of service. Accurate prenotification of car deliveries and timely pick-up of loads remain unpredictable.

Comments from Mr. Steve Bobb of BNSF that are now on the record document that BNSF consults with very few of its customers before making huge changes in rate structures that dramatically affect volume handled by many elevators on its system. This is manipulative and designed to favor a few at the expense of the many.

Some of the numbers BNSF uses are not representative of what is going on most of the time. Here is a description from an elevator manager regarding Table I on page 12 of Mr. Steve Bobb's testimony:

An example is given comparing 52 car shipments of wheat from Eldridge to Minneapolis and 110 car trains of wheat from Jamestown to the PNW. The comparison is how the two types of shipments would relate on a FOB basis. The example picked July 26, 2001 for comparison purposes.

Two things are very notable in this comparison. First, July 26, 2001 was definitely a date hand-picked in an attempt to show the least differential. The basis to Minneapolis and the PNW on this date were the narrowest they had been for some time. Both prior to that date and also after that date the basis was wider, favoring the PNW.

Second, these comparisons are using tariff rates and it is well known that Jamestown has an inverse rate for 110 car shuttles of wheat to the PNW. On July 26,using Jamestown's inverse rate, they would have a 13 cent advantage on a FOB basis instead of the 2 cents that is shown in Steve Bobb's testimony. This advantage of Jamestown over Eldridge was 19 cents on July 5 and quickly widened back to 19 cents by September 4 and 21 cents by October 1.

No allowance is factored in for the origin and destination efficiency payments that the BNSF offers for participation in their shuttle train programs. These payments can be as much as $300/car, another 8 cents per bushel. None of these car credits are available to less than shuttle train loading elevators.

Mr. Steve Bobb states that railroads must have flexibility to meet market conditions. This is code language for changing rates and service policies on very short notice for the railroad's benefit, with little concern for how it affects their shipping customer and the investments those customers have made on or adjacent to railroad property in order to give the railroad more business.

PREPARED STATEMENT OF NORTH DAKOTA FARM BUREAU

Thank you Senator Dorgan, Chairman Hollings and the entire Senate Commerce Committee for the opportunity to present our views on railroad shipping rates. North Dakota Farm Bureau is a member of the Alliance to Keep North Dakota on Track, and as such we are very disturbed and concerned about the pricing practices of the Burlington Northern-Santa Fe Railroad.

North Dakota farmers produce some of the best quality small grains and row crops in the nation. However, we do not receive premium prices for our products in part due to the tremendous costs we incur in shipping our goods to market. We are at a competitive disadvantage because of our distance from the markets. That is a fact of life that we must accept. We are also disadvantaged because there is no competition for delivery of our goods. We are a captive supplier, held hostage to the pricing policies and railcar distribution practices of railroad companies. It is those policies and practices that we cannot accept.

An inverse pricing structure that provides eastern North Dakota and western Minnesota elevators cheaper rail rates to the west coast markets than comparable elevators in western North Dakota is blatantly unfair. As we see it, there are two reasons for BNSF to employ this practice. First, there is competition for the business in those eastern locales. The western elevators have only one choice. The second reason, we believe, is that BNSF is positioning grain facilities that are most efficient for the railroad. By selectively choosing which elevators they want to survive and then providing incentives to those elevators and their customers, BNSF can dictate where commodities will be delivered.

Currently, some producers are benefiting from BNSF's practices. If you happen to be lucky and are located close to one of the "chosen" elevators, you will probably receive more for your product than farmers at more distant locations. Also, those distant farmers have the added expense of hauling their product to the elevator. As stated, there may be some price advantage to the producers right now. But what happens after local elevators close and your only option is to haul great distances to market your product? Incentives will no longer be needed to insure product delivery and shipping costs will rise. Nearby producers will no longer receive a premium, and the distant farmers will still have the hauling costs.

What impact will this scenario have on the North Dakota road infrastructure as more grain is hauled more miles on highways and secondary roads? They will require more maintenance and more tax dollars. At the Senate Budget Field Hearing conducted by Senator Conrad on February 20, 2002, there was talk of increased taxes being needed to offset fewer Federal highway funds. We can see this being compounded by the decisions of the railroad company. It won't be just the farmers that are negatively impacted. It will be every taxpayer in the state.

Public awareness of the inequities in freight rates and the detrimental effects they have on our economy is vital in getting changes made. We believe it is prudent that this committee contact other states regarding freight rates and incentive programs to find out what the situation is and what potential solutions there may be. We encourage you to continue researching this issue.

Thank you for your consideration of our concerns.

PREPARED STATEMENT OF JIM CHRISTIANSON, EXECUTIVE VICE PRESIDENT, MONTANA WHEAT AND BARLEY COMMITTEE

Senator Dorgan, the grain producers in Montana ask your indulgence to permit our intrusion into a hearing that we know was intended for the citizens of North Dakota. But, the rail transportation problems that North Dakota faces are identical to those confronted by your state's neighbors to the west, most certainly including Montana.

The United States railroad industry has become more and more concentrated throughout the last 20 years. Large areas of our states, and the United States as a whole, have industries that are captive to a single railroad. Industries such as grain, coal, chemicals, forest/paper products, and manufacturing, are suffering as they try to compete in a world market, but with a major component of their cost structure being dictated by the rail transportation industry.

States' economies are integrally tied to the need for competitive transportation service. In order for our industries to prosper, it is essential that efficient, capable and competitive rail transportation be available in order to move products to a position that will create wealth for all.

The Burlington Northern Santa-Fe (BNSF) has recently instituted inverse rate structures on wheat moving from western Minnesota and eastern North Dakota to the Pacific Northwest. The BNSF is charging higher rates for shorter distance transportation services to export destinations than longer distance services over the same routes. A point 1600 miles from Portland has the same freight rate as a point eight hundred miles from Portland. This practice provides preference to the eastern rail customers that have competition over those in the west who do not, destroying traditional marketing patterns. Inverse rate structures are glaring examples of how railroads are unfairly able to discriminate in their captive rail customers' areas.

Inverse rate structures and the injustice created through discriminative practices are grounded in the lack of competition within the U.S. railroad system. The effect of the inverse rate structures has been documented throughout western grain markets. Cash prices paid to farmers at those elevators impacted by inverse rates immediately dropped the moment inverse rates were announced. Our states cannot be put at a disadvantage due to transportation monopolies that contribute to making the United States a residual supplier of goods and services to the world.

After a multitude of rail mergers since 1980, today over 95 percent of the U.S. rail industry's gross ton miles are controlled and dominated by only four railroads. This nation's output industries have a growing concern about monopolistic railroad behavior in both pricing and service. They, and we, face deterioration in service performance, a decrease in rail transportation choices among major industries and inadequate regulatory protection from monopolistic behaviors. Value-added economic development efforts by State and local governments are virtually not possible with these railroad monopolies pricing inbound and outbound commodities.

All farmers, regardless of geographic location, need the U.S. rail industry to provide competitive rail service, and inverse freight rates are a symptom of the railroad industry's arrogance, not to mention a disservice to us all. If the rail industry is not capable of providing competitive transportation services at equitable rates, then, together, we must ask the Congress to intervene on our behalf.

Senator Dorgan, on behalf of Montana farmers, thank you for your proven concern and attention to this important issue.

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