415 Second St. NE, Suite 300
Washington, D.C. 20002
202-547-7800

Idaho Grain Producers Association
821 West State Street
Boise, ID
208-345-0706

Testimony of Wayne Hurst
Past President of the Idaho Grain Producers Association and
Member of National Association of Wheat Growers Budget Committee
before
the House Committee on Transportation and Infrastructure
at a Hearing to Review Rail Competition and Service
Sept. 25, 2007

Mr. Chairman and Members of this Committee, my name is Wayne Hurst. I am a wheat, sugar beet, potato, feed barley, alfalfa, silage corn and dry edible bean producer from Burley, Idaho, and a past president of the Idaho Grain Producers Association (IGPA) and a member of the National Association of Wheat Growers' Budget Committee.

I am honored and pleased to be here today on behalf of the Alliance for Rail Competition (ARC) and the agricultural community. The members of the Alliance for Rail Competition include utility, chemical, manufacturing and agricultural companies and agricultural organizations. Producers of commodities as wide ranging as soybeans, dry beans, lentils, rice, barley, peas and sugar beets all have expressed concerns similar to those I will share with you today. Together, these organizations represent growers of farm products in more than 30 states.

Wheat growers know that an effective railroad system is necessary for the success of the wheat industry. However, they continue to face many problems with rail rates and service. Over time, rail customers in the United States have grown more captive. As captivity levels have risen, a larger and larger share of the cost of transportation has been shifted to rail customers and state and local governments. Helping our members find solutions to rail freight problems remains a top priority for both IGPA and NAWG, leading to our alliances with ARC and many other commodity coalitions and to our support of H.R. 2125, which would provide a number of remedies to rail shippers.

Effects of Growing Rail Captivity

Since the passage of the Staggers Rail Act of 1980, the degree of captivity in many wheat growing regions has increased dramatically, and America's farmers continue to experience both unreliable service and higher freight rates. We have had continuing rail equipment shortages since the railroads started aggressively consolidating and merging in the early 1990s. Producers

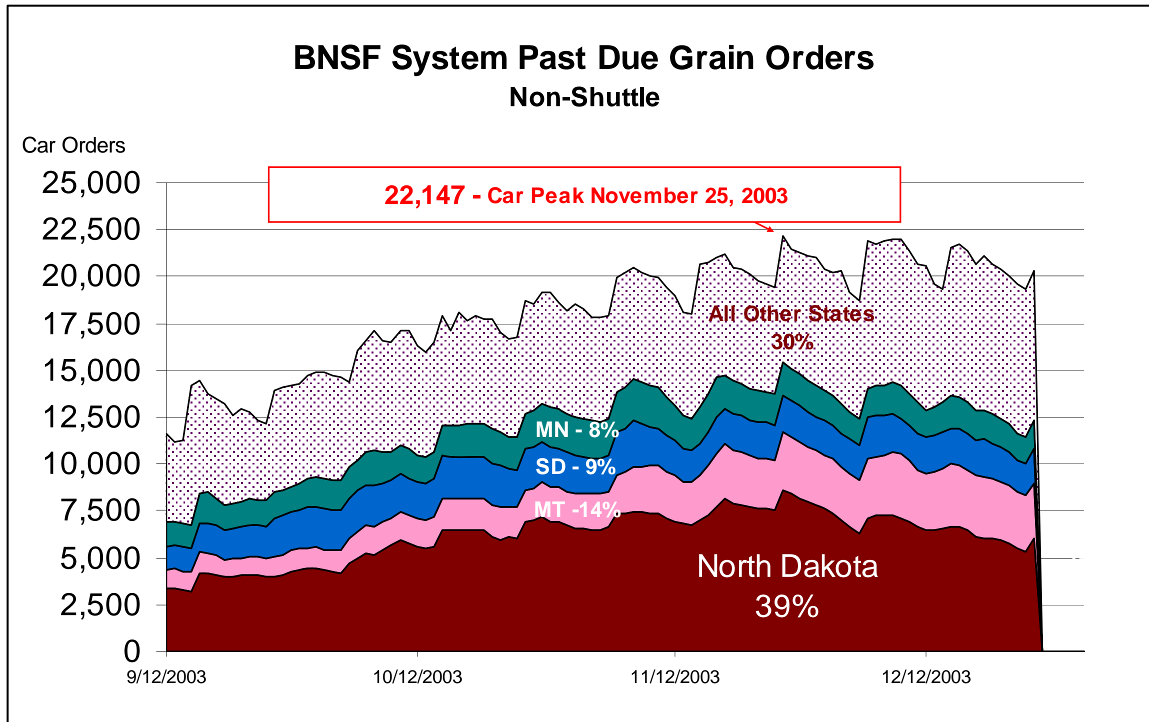
know that increasing the breadth of crop production on farms can lead to greater efficiency and higher income but, rather than a focus on diversity, railroad companies view efficiency as hauling larger and larger movements of a single grade crop from a single origin to a single destination. Rail investment in grain movement has been shifted to the grain merchandiser and farm producer while the service level for less-than-trainload movements continues to deteriorate. We see value-added agriculture having to invest in rail rolling stock to ensure adequate equipment supply, yet when railroad service levels do not meet railroad-supplied schedules, agriculture is frequently called upon to even further increase investment in railroad rolling stock.

Twenty years ago, there were multiple transcontinental railroads servicing agricultural regions. Today, however, whole states, whole regions and now whole industries have become completely captive to single railroads as a result of many railroad mergers. In the wheat industry alone there are substantial pockets of captivity in Texas, Oklahoma, Arizona, Colorado, Kansas, Nebraska, Wyoming, Idaho, South Dakota, Minnesota, North Dakota, Oregon, Washington and Montana. Because of these pockets of captivity, the cost of transporting grain can represent as much as 1/3 (or higher) of the overall price a producer receives for his or her grain. This cost comes directly from a producer's bottom line. It is important to keep in mind that producers, unlike other businesses, cannot pass their costs on; as price takers and not price makers, producers bear all transportation costs both to and from the farm and from the elevator to the processor or export terminal.

Rail captivity has led to rail rates in the Northern Plains that have increased 40 percent faster than the Rail Cost Adjustment Factor including productivity unadjusted. Rail rates in Montana and North Dakota are between 250 and 450 percent of variable cost - far above the Surface Transportation Board's "threshold of unreasonableness," currently 180 percent. Though these are among the highest freight rates in the nation, agriculture rail rates in excess of 250 percent more than variable cost can be found in virtually all of the states that have captivity issues.

Service also continues to be a major issue in farm country. During the 2003 car shortage, data produced by Burlington Northern Santa Fe (BNSF) showed that the most captive areas on the system were singled out for the highest level of past due grain orders. Of the 22,147 cars that were past due, more than 70 percent of the past due orders were in the captive northern tier states of Montana, Minnesota, North Dakota and South Dakota, though this area of the country makes up less than 20 percent of that rail system.

In October, the Government Accountability Office issued a report, GAO 07-94, *Freight Railroads – Industry Health Has Improved, But Concerns About Competition and Capacity Ought to Be Addressed*, available in full at http://www.gao.gov/new.items/d0794.pdf, confirming what we in the captive shipper industry have been stating for years: those areas that are captive pay the highest freight rates yet receive some of the worst service.



<u>**Wheat Is On The Ground In The Grain States – and More Harvesting To Do**</u>

Dusty Tallman, chairman of NAWG's Domestic Policy and Infrastructure Committee, from Brandon, Colo., who was scheduled to testify at this hearing but was unable to be here after it was rescheduled, wanted me to talk about Colorado's transportation woes for this hearing. Following wheat harvest in July of this year, there were more than 10 million bushels of Colorado wheat stored on the ground primarily in areas where there was a lack of adequate rail service - captive branch line areas. Colorado did not experience a record crop - while the 2007 Colorado winter wheat crop was above average at 87.75 million bushels, it was well below the all-time record crop of 134.55 million bushels, produced in 1985, and the most recent high of 103.2 million bushels in 1999, and was smaller than wheat crops produced in 10 of the last 28 years. Yet millions of bushels sat on the ground because they were produced in areas served by single railroads with no rail-to-rail competition - areas we call captive.

Since 80 percent of Colorado's winter wheat moves by rail to export position in the Gulf of Mexico and the Pacific Northwest - too far to truck - the railroads know wheat on the ground will still be there when they get ready to move it. While U.S. wheat prices are at record highs, Colorado producers and elevator operators are being shut out of the market because they are located on captive rail lines. Compounding this problem is that the corn and millet harvests are just beginning and these commodities cannot be stored on the ground. The lack of rail cars creates an economic embargo on Colorado wheat producers, keeping them from fully participating in these record high prices. I am advised by Darrell Hanavan, executive director of Colorado Wheat Administrative Committee, that this has resulted in wider basis than normal and a loss of 25 to 50 cents per bushel to wheat producers. I am also hearing reports that

producers cannot deliver wheat to elevators because they are plugged, and these producers are contemplating storing their millet and corn crops on the ground because their farm storage is full - and there may not be any relief in sight until December or January.

I am also advised that, along with Colorado, there is wheat being stored on the ground in South Dakota, North Dakota, Montana, Idaho and Washington. In order to create wealth for farm producers, we need to ship what we produce. In Idaho, more than 50 percent of our wheat is shipped into export channels. The elevator I sell to has told me that delays in service have threatened their existence because railroad delays cause cash flow problems. This company is one of the more progressive merchandisers around but, at times they cannot sell and deliver the wheat they buy because the railroad doesn't provide cars as promised. This company is one of the pioneers in identity-preserved wheat marketing, which matches wheat varieties and characteristics to individual customer's specific needs. Shipments in smaller lots like identity-preserved wheat are not what the railroads demand in their business model, yet the identity-preserved business practice holds one of the future keys for American agriculture to maintain market position in the world.

When the railroad decided it didn't want to haul sugar beets about 10 years ago, it just quit hauling and now, with one exception, all beets in Idaho have been forced to truck. In the potato industry, we supplied potatoes to the JR Simplot plant in Heyburn, Idaho, for many years until the plant was shut down several years ago and moved to Canada, meaning the loss of hundreds of local jobs. Mr. Simplot told us the reason was high freight costs and, indeed, most of the shipment of frozen and fresh potatoes in my area today has been forced to trucks.

It is important to realize that rural communities need access to world markets to bring wealth back to our communities. Without reliable, equitable and efficient rail service, we cannot access and compete in that world market.

From Idaho, as the GAO report and our data show, we pay some of the highest freight rates because we are captive in our region to a single railroad. The actions of this single railroad have forced more and more farm product into trucks hauling further and further each year.

Grain Rail Rates

The GAO report I referenced earlier found that the entirety of the western United States is served by one or two railroads. Large areas shaded in black in Figure 12,[1] below, illustrate the portions of Oregon, Idaho, Montana North Dakota, South Dakota, Colorado, Texas, Oklahoma and Arkansas that are served by a single railroad.

---

[1] GAO Report 7-94 Freight Railroads, Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed, Page 26

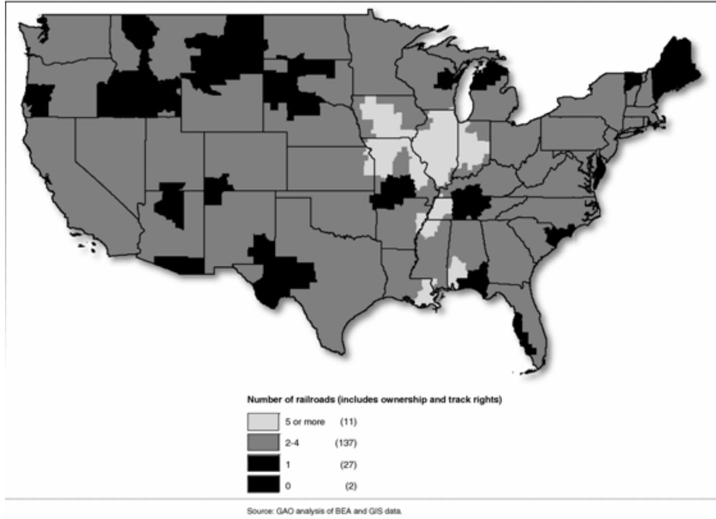


Figure 12: Number of Class I Railroads Serving Economic Areas, 2004

Additionally, the GAO showed that all industry tonnage originating with access to one Class I railroad mirrors the previous graph – Figure 13[2].

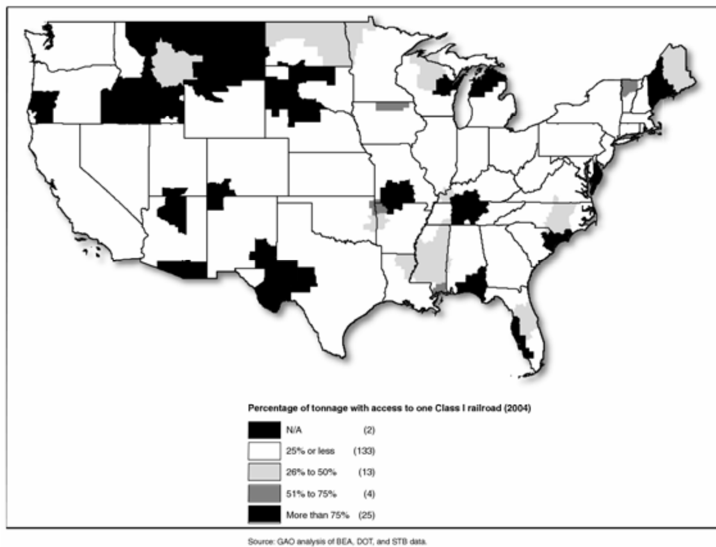


Figure 13: Percentage of All Industry Tonnage Originating in Economic with Access to One Class I Railroad, 2004

The GAO pulls these observations together with Figure 18, which shows changes in tonnage traveling at rates over 300 percent R/VC from 1985 to 2004[3].

[2] Ibid, Page 27

[3] Ibid, Page 34

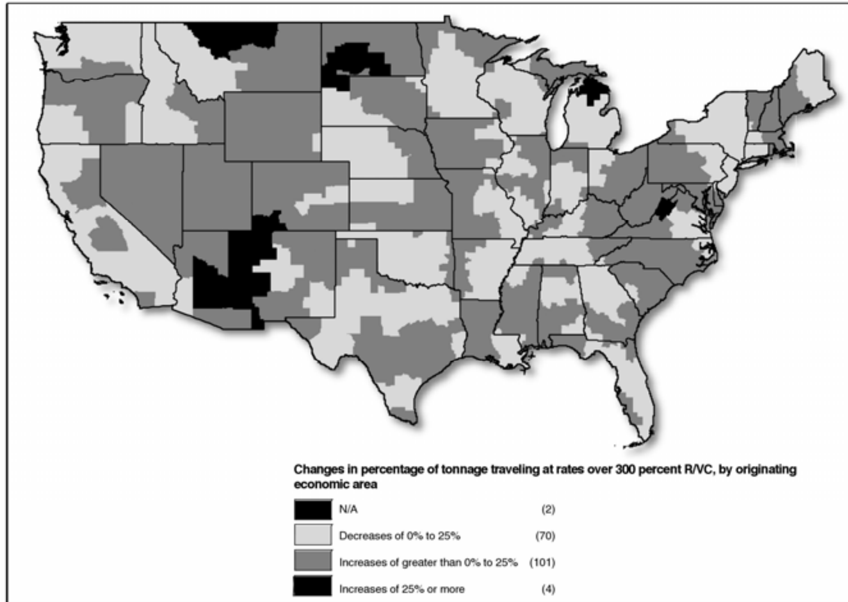


Figure 18: Changes in Percentage of Tonnage Traveling at Rates over 300 Percent R/VC, by Originating Economic Area, 1985 through 2004

Source: GAO analysis of BEA, DOT, and STB data.

Page 35 of the GAO report confirms what wheat and barley producers experience everyday.

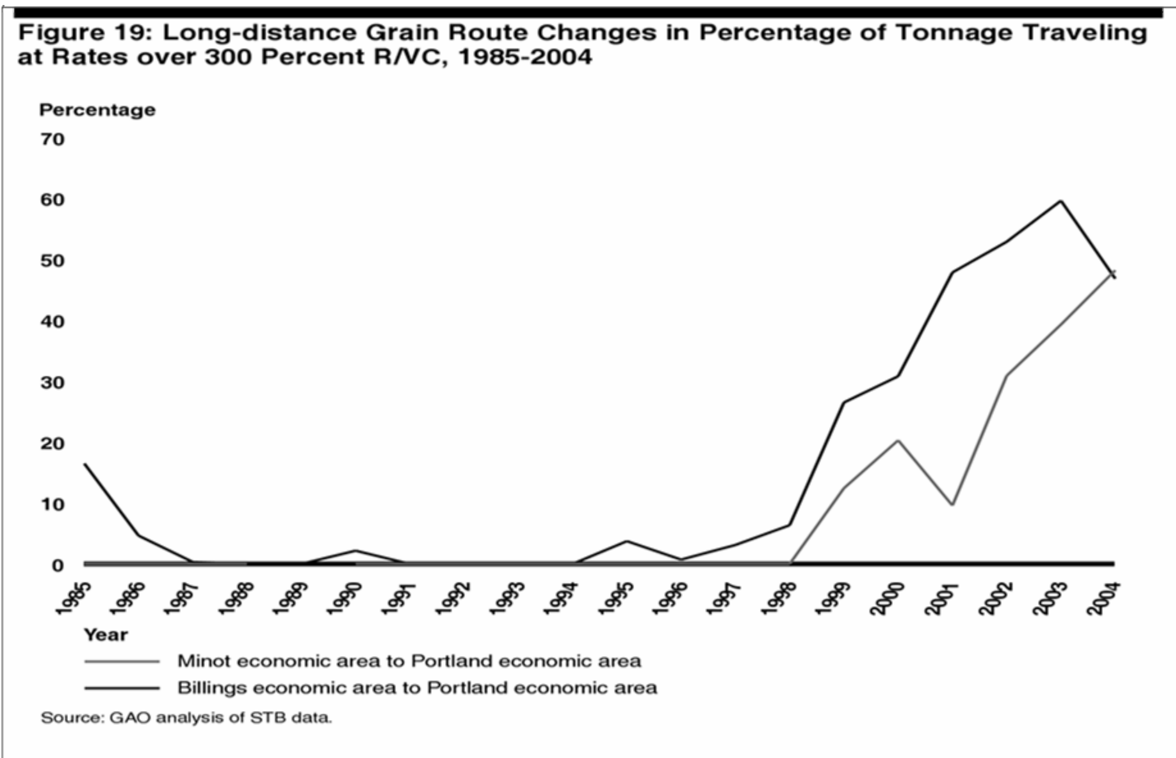


Figure 19: Long-distance Grain Route Changes in Percentage of Tonnage Traveling at Rates over 300 Percent R/VC, 1985-2004

Source: GAO analysis of STB data.

Finally, the GAO report correctly establishes the link between single railroad access and elevated percentage of tonnage above the threshold for rate relief.

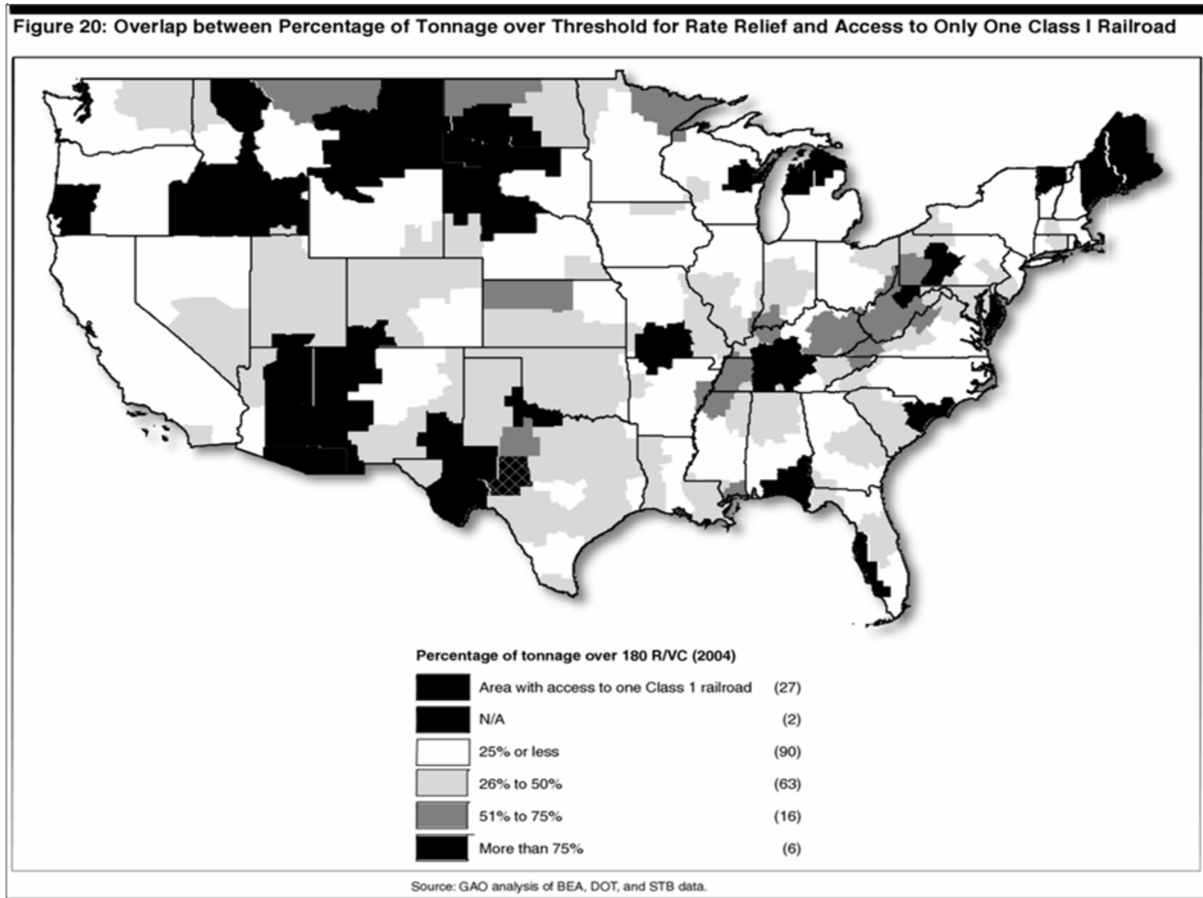


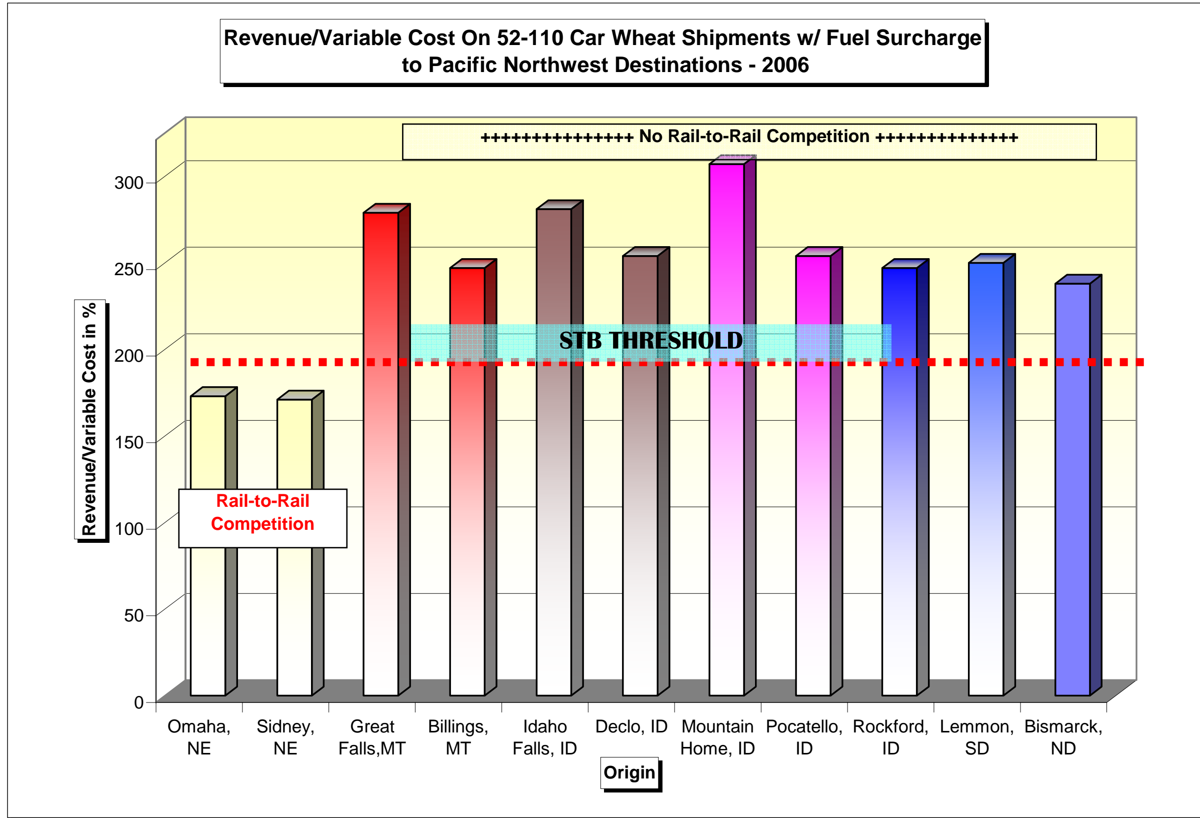
Figure 20: Overlap between Percentage of Tonnage over Threshold for Rate Relief and Access to Only One Class I Railroad

Our consultant's[4] research of R/VC levels on grain from the western growing areas confirm what the GAO found. (Please see the *2006 Montana Rail Grain Transportation Survey and Report,* prepared for the Montana Rail Service Competition Council and *A Joint Survey and Analysis* by the Montana Department of Transportation and Whiteside & Associates, at: **http://rscc.mt.gov/docs/Rail_Grain_Transp_Survey_2006_Final_05_22_07.pdf**)

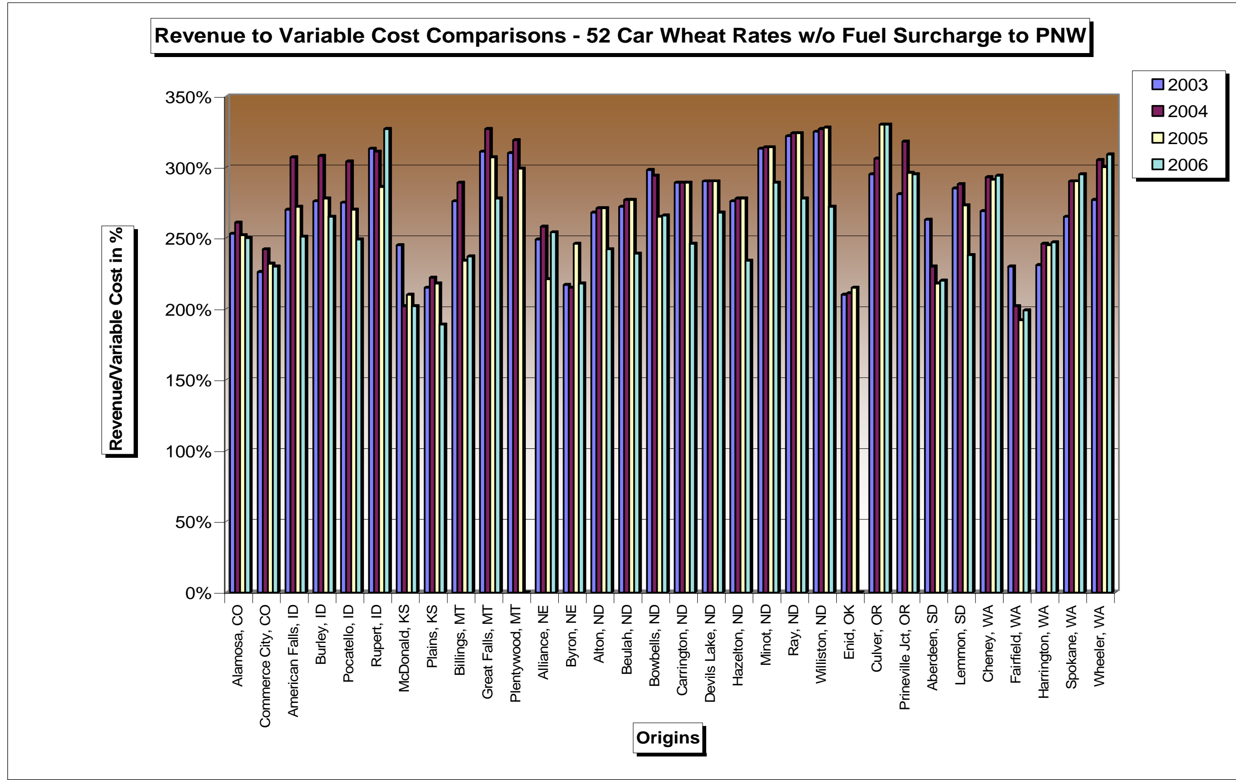
In examining the R/VC levels on rates to common destinations of the Pacific Northwest, we find large areas moving at rates considerably above the threshold. The chart below shows that areas where little or no rail-to-rail competition exists are exposed to much higher R/VC, in line with the GAO study. This graph shows points in Montana, Idaho, South Dakota and North Dakota that experience R/VC levels upwards to 300 percent. This analysis can be done for points in all parts of the grain growing areas of the country.

---

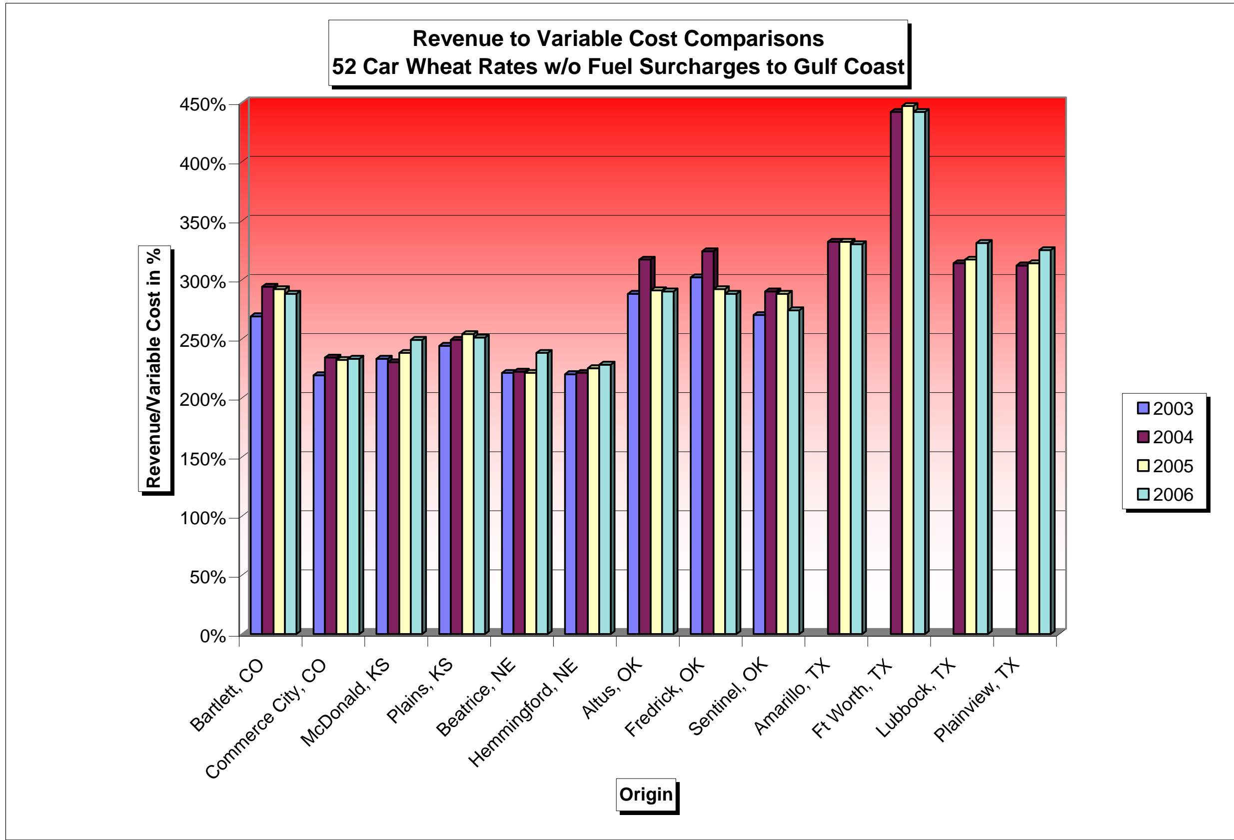
[4] Whiteside & Associates, Billings, Mont.



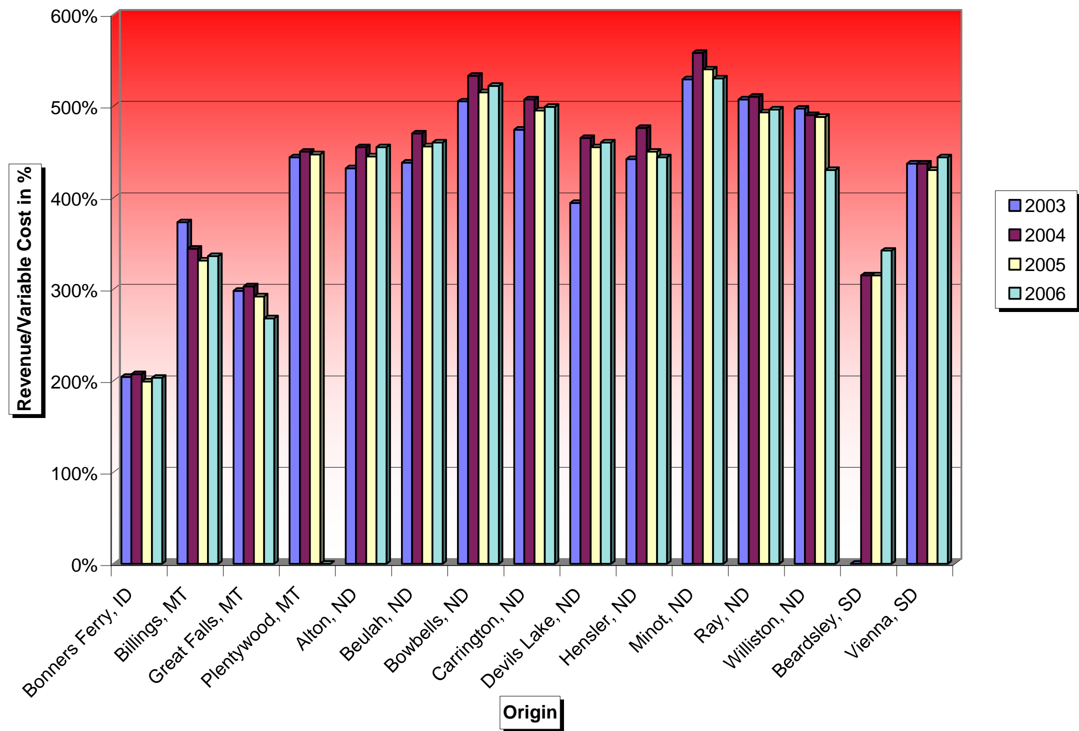
A historical look of the R/VC ratios for various markets further confirms the conclusion presented by the GAO. The chart below shows that, between 2003 and 2006, without fuel surcharges, R/VC ratios were well in excess of the threshold on movements from origins all over the Plains to the Pacific Northwest. If railroad-applied fuel surcharges were added to these states, the R/VC ratios would be even higher.



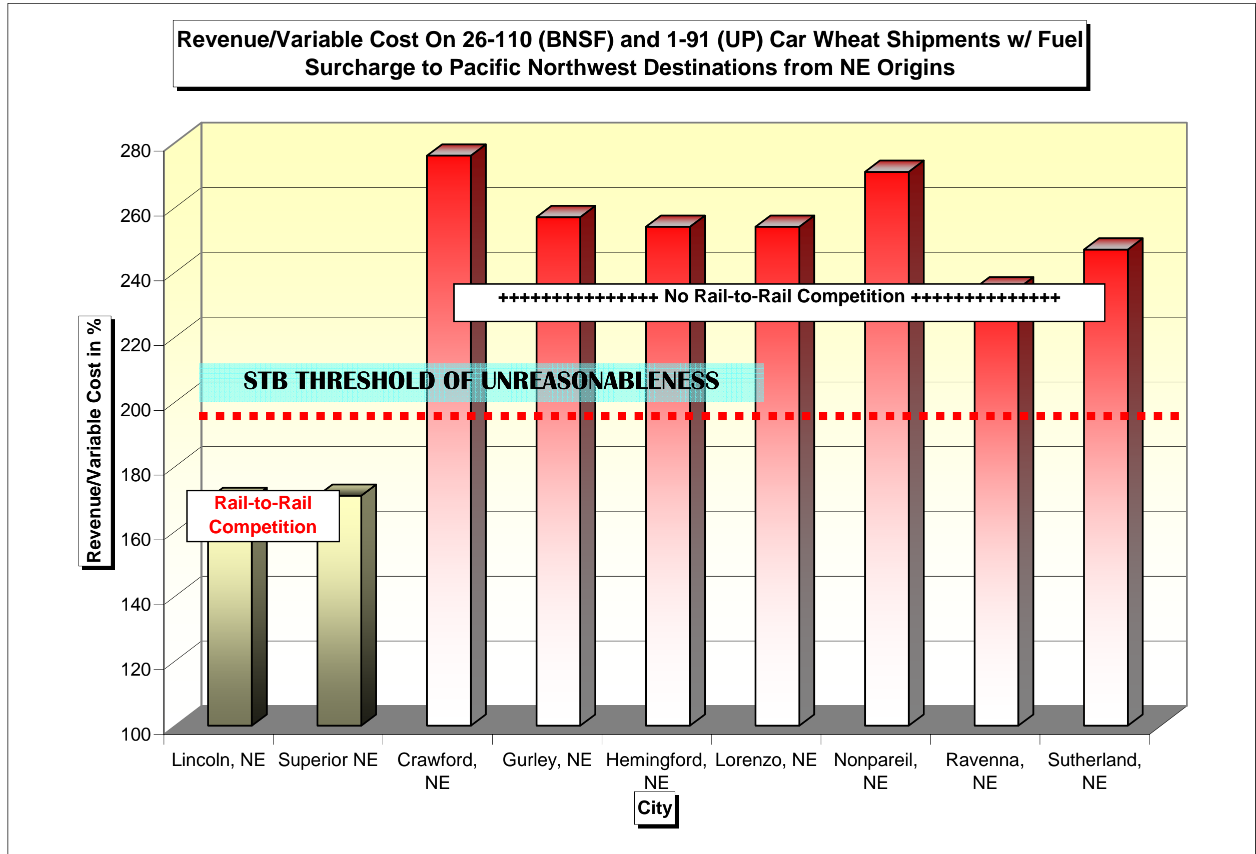
Examination of R/VCs from 2003-2006 into the Gulf Coast destinations from the states that market into these destinations finds a similar story. Origin states including Colorado, Kansas, Nebraska, Oklahoma and Texas routinely see wheat rates well above the threshold and some as twice as high as the threshold level.



The highest R/VC historical numbers can be found in the movements into the Twin Cities over the Northern Plains. The chart below illustrates where one can find rates as high as 500+ percent R/VC over the 2003-2006 period. In all of these examples, we did not select certain points but found that the analysis agreed with the GAO report that the trend is all over affected states. Here the affected states (which also have little or no rail-to-rail competition) are Idaho, Minnesota, Montana, North Dakota and South Dakota.



What is clear is that the areas of the country served by single and dual rail are experiencing increasing rate levels that are not found in areas that have some rail-to-rail competition.



Perhaps not noticed by the GAO, however, was the timing of the sharp increase in the percentage of tonnage traveling at rates over 300 percent of revenue to variable costs, which began rapidly increasing in 1997-1998 at the same time the Surface Transportation Board allowed the BNSF merger and the Union Pacific/Southern Pacific merger – mergers that eliminated the last vestiges of rail competition in the western U.S.

While one might debate the exact level of the R/VC costs with railroad experts, what is indisputable is the highest R/VC is found in the captive areas in Arizona, California, Colorado, Idaho, Kansas, Minnesota, North Dakota, Nebraska, South Dakota, Oklahoma, Oregon, Texas and Washington. We also know that the grain experience is mirrored in coal, silica, sand, plastics, chemicals and many other industries covering the width and breadth of this country.

I would echo what ARC wrote in comments in STB's Ex Parte 665, "At every turn, [grain producers] face Board-created barriers to reasonable rates, adequate service, and rail to rail competition that the STB shows little inclination to remedy. In these and other respects, the promise of the Staggers Rail Act is belied by the way its provisions have been interpreted by the ICC and STB, so as to insulate the railroad industry from effective regulatory oversight <u>and</u> from marketplace discipline."

The Transportation Cost Shift

The IGPA, NAWG , ARC and farm producers across the country recognize the need of railroads to make adequate return, but remain concerned that the Surface Transportation Board has not focused on the price being paid by producers and has not seen fit to provide reasonable remedies to guard against market abuse. The evidence presented by GAO studies in 2006, 2002 and 1999 all point to the same conclusion – that the STB is not adequately protecting large parts of the country from market abuse where no competition exists.

Railroads' claims to this Committee and to the Surface Transportation Board that their rates are falling neglect the fact that costs are being shifted to agricultural producers in captive areas. Transportation costs, therefore, for farm producers and state governments are actually rising.

One of the most comprehensive studies on the effects of this cost shifting was conducted by the Montana Department of Transportation and Whiteside & Associates in March 2006 (http://rscc.mt.gov/docs/Rail_Grain_Transp_Survey_2006_Final_05_22_07.pdf). The report came to eight conclusions:

1. Grain is being hauled farther and farther over the state and county highway systems.
2. The majority of farm producers have experienced increasing hauling distances over the past 10 to 20 years. More than 70 percent of Montana grain producers are hauling their products farther than they were 10 years ago, and 100 percent of those hauling farther than 10 years ago are also hauling farther than they were 20 years ago. This trend reflects the transition to a smaller number of elevators located in the state. Distances to local elevators continue to increase in all of the Plains states; data from all respondents shows an average one-way haul today of 37.19 miles compared to an average haul of 17.35 miles 10 years ago (an increase of 114 percent) and 9.69 miles 20 years ago (an increase of 285 percent).
3. Those farm producers experiencing increased haulage are hauling more than three times as far as those farm producers who have not experienced any increased hauling distances.
4. The non-wheat crops are experiencing significantly greater hauling distances even than wheat crops, further burdening alternative and rotational crop practices.
5. Some counties show average hauling distances upwards of 80 miles.
6. The 2006 harvest in Montana could be best described as a tale of two cities – with winter wheat showing average to above average yields and spring wheat, durum, barley, pulse, peas and lentils showing average to below average yields.
7. The vast majority of farm producers have the capability to store most, if not all, of their grain production.
8. Even with the diversity of yields, most Montana farm producers experienced elevator pluggings multiple times during harvest due to lack of rail cars.

This all adds up to an increase in the portion of transportation costs being borne by farm producers and the state as railroads continue their push to serve fewer and fewer facilities. As there are fewer, smaller elevators serving as the principal markets for rotational, pulse and non-wheat crops, farm producers have to pursue markets for their crops farther and farther away from their farms, meaning more and ever distant trucking.

Captive shippers also continue to suffer car and service disruption. Shippers that order rail cars well in advance are still experiencing delays after promised delivery dates. This can and does cause major problems during and after harvest and costs both the farm producer and elevators loss of income.

The high rates and lack of service continue to be especially frustrating for producers in our northern wheat growing states who need only look across the border to see a much more effective system. Canadian freight rates on wheat westbound - right across the border - are only 2/3 of the rail rates our growers pay in Montana. U.S. wheat growers produce some the highest quality wheat in world, yet are often rendered residual suppliers against their Canadian counterparts and find themselves at a significant competitive disadvantage in both domestic and foreign markets because of these shipping issues.

There is currently no effective regulatory body to address these frustrations and complaints. The Surface Transportation Board does not balance the needs of shippers and the railroads. In fact, we believe the STB has abandoned its lawfully designated role as a regulator of railroads.

<u>Fixing the Problem</u>

Railroad market power should not foreclose access to otherwise competitive grain elevators, ports, coal mines or chemical plants.

The railroads' common carrier obligation and historic concerns about discrimination are related issues that should be re-examined.

- ✓ Is it really the case that a railroad is free to decide which of two similarly-situated shippers succeeds and which one fails, so long as every mile of track over which they are served is not identical?
- ✓ Is it really in the public interest for railroads to force industry consolidation, notwithstanding the demise of smaller elevators, mines, power plants and factories nationwide, because unit train service is more efficient?
- ✓ Should inter-modal freight always displace bulk freight for an extra penny a ton in profit?

We have reports of railroads raising their rates just to drive off unwanted rail traffic, thereby abandoning common carriage. We also have reports of the railroads refusing to service locations that the railroads deem operationally unacceptable. The result appears to be that

railroad market power is being exerted to create haves and have-nots in the shipping community.

Conclusions

Agricultural growers together with the members of the Alliance for Rail Competition truly believe that a healthy and competitive railroad industry is essential for their continued viability. However, with poor service, a lack of available cars, increased rail rates and a regulatory agency that does not meet the needs of shippers, it is increasingly difficult for agricultural producers to remain competitive in a world marketplace.

We believe that the government needs to be the facilitator and the catalyst for increasing competition in this historically strong industry. We believe the railroad industry can survive and prosper in a competitive environment and, indeed, we know from history that competition breeds innovation and efficiency. In light of the horrific situation U.S. grain producers are facing with major railroads unable to meet common carrier obligations all over the nation, it is time that public policy in this area needs to be reexamined. The Alliance for Rail Competition and the agricultural community believe the STB and its predecessor, the ICC, have failed to protect the interests of the captive rail shippers as the Staggers Rail Act intended.

Wheat growers and other producers, along with members of ARC, believe that both railroads and shippers would be better off with more competition in the marketplace, and they support provisions in H.R. 2125, a bill that calls for increasing competition without increasing regulation. We fervently believe that final offer arbitration as outlined in H.R. 2125 will provide a host of benefits where competition cannot physically be created. Providing for "final offer" arbitration and the removal of "paper barriers" will restore balance to the commercial relationship between the railroads and their customers.

We in agriculture and the members in ARC believe this legislation will improve rail transportation by providing fairness and openness in the negotiations between railroads and their customers over rates and service. By simply requiring railroads to provide rates to their customers between any two points on their system, many additional rail customers will gain access to the benefits of rail transportation competition.