National Association of Wheat Growers
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Testimony of David Cleavinger
President
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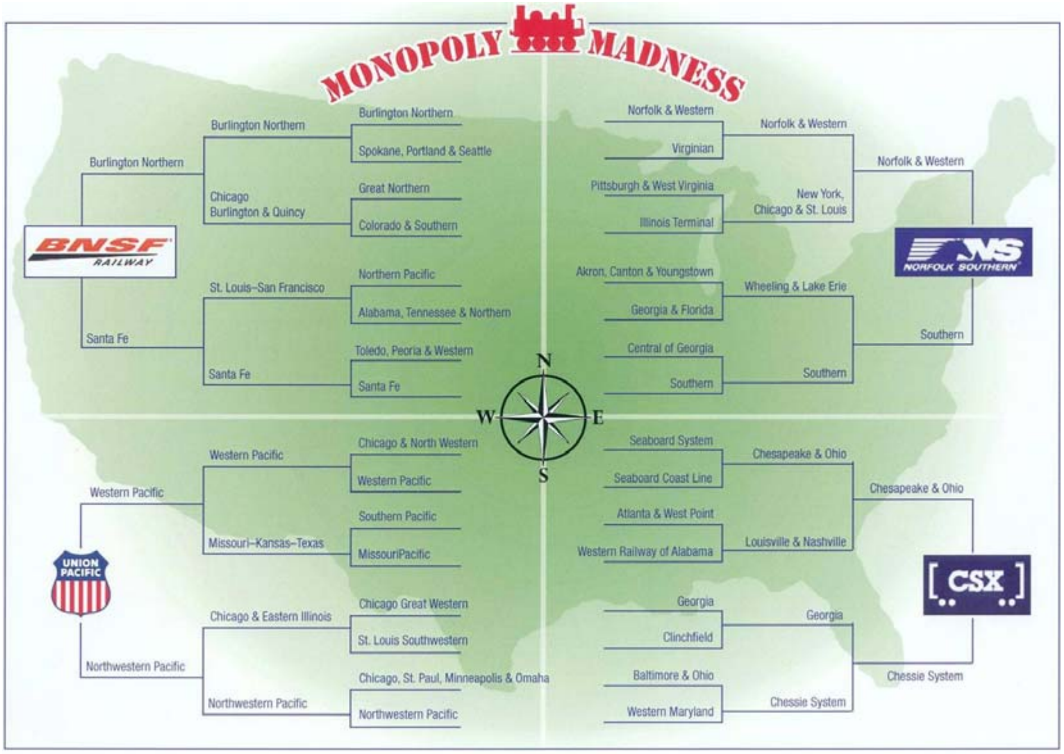
Before the House Committee on Small Business
Hearing to review rail competition and service
May, 1 2008

Madam Chairman and members of the Committee, my name is David Cleavinger. I am a wheat grower from Wildorado, Texas, and I currently serve as president of the National Association of Wheat Growers (NAWG). I am very pleased to be here today to discuss an issue of great importance to the wheat growers that I represent.

Wheat growers know that an effective railroad system is necessary for the success of the wheat industry. And while growers are committed to seeing an effective transportation system at work, over time, agriculture producers in the United States continue to suffer problems with rates and service. Helping our members find solutions to rail freight problems remains one of NAWG's top priorities.

There has been a lot of rhetoric in the past decade about the global economy, but wheat producers have been selling their product into a predominantly world market for over sixty years. Wheat is not typically used locally, therefore it endures long-distance transportation. By and large, wheat country is centered away from our waterways and ocean ports, leaving us primarily dependent on railroads to move our product to export facilities. Many times and in many locations, an ever-consolidating rail system has taken advantage of our dependence and lack of transportation options.

In 1980, we had over 40 Class I railroads serving this nation. In the convention of March madness, here is a graphic depiction of the massive concentration that has occurred over the last 25 years which left us with the final four!



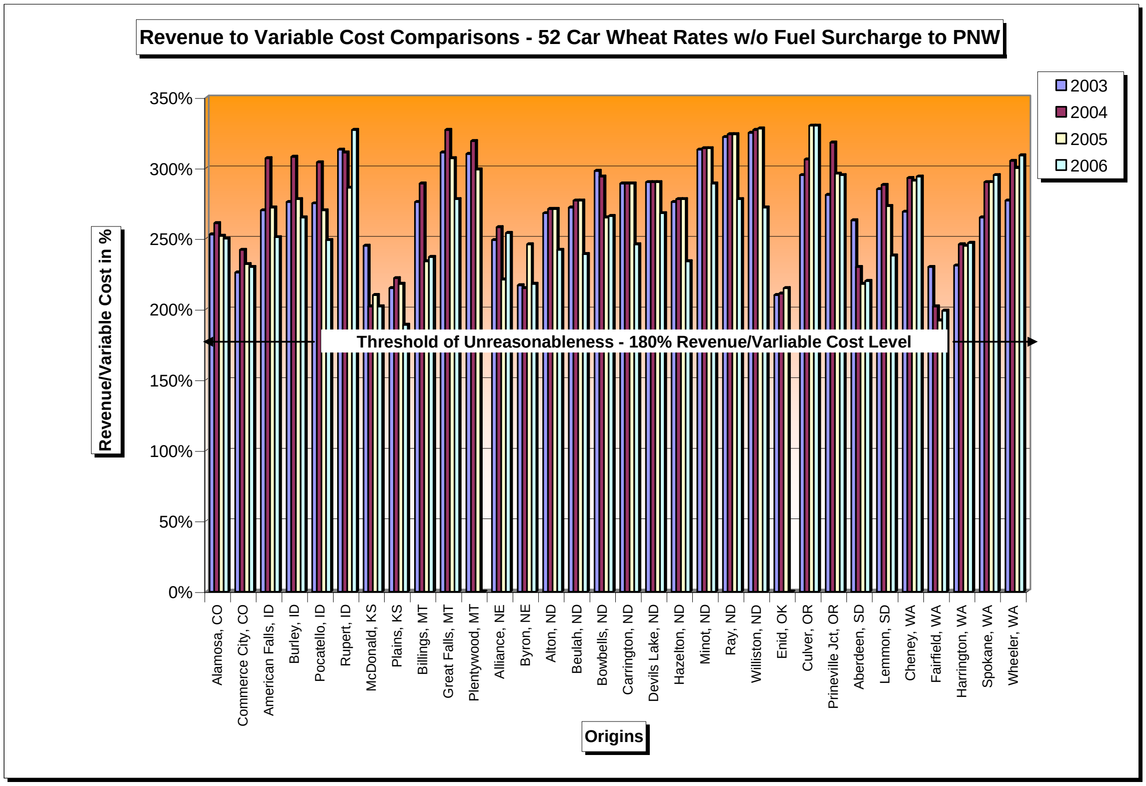
It's the opposite of competition. In 1980 there were over 40 railroads. Today there are just four major railroads that have divided the country into their own regional monopolies. Congress needs to stop the Monopoly Madness by reforming the Surface Transportation Board. Because when railroads compete, consumers win.

[NOTE: Monopoly Madness chart is for illustration purposes only and is merely representative of the mergers and acquisitions that have occurred in the railroad industry.]

Today, four major Class I railroads serve the United States controlling over 94 percent of the ton-miles, with two of these, the Union Pacific and the BNSF Railway, serving our primary wheat production west of the Mississippi River. While short line railroads may fill gaps in some areas they are tied to their Class I's under what are known as "paper barriers," which restrict their ability to act independently. Thus there are regions with little or no rail competition whatsoever. Where monopolies rule, our wheat growers believe effective oversight of rates and service is needed.

<u>Rates and service issues</u>

As the Government Accountability Office found in a study completed in 2006, rates in captive areas are well above the threshold of reasonableness established under the law and utilized by the Surface Transportation Board (STB). (For explanation of what Rail costing is and how it is interpreted, please see the "Rail Cost Primer" attached at the end of my testimony.) Full operating costs to most railroads are about 130-140 percent of variable costs. Rates in excess 180 percent are considered above the threshold of unreasonableness by the STB and are therefore challengeable. In some captive wheat growing areas the rates can run as high as 300 to 400 percent or more of variable cost.



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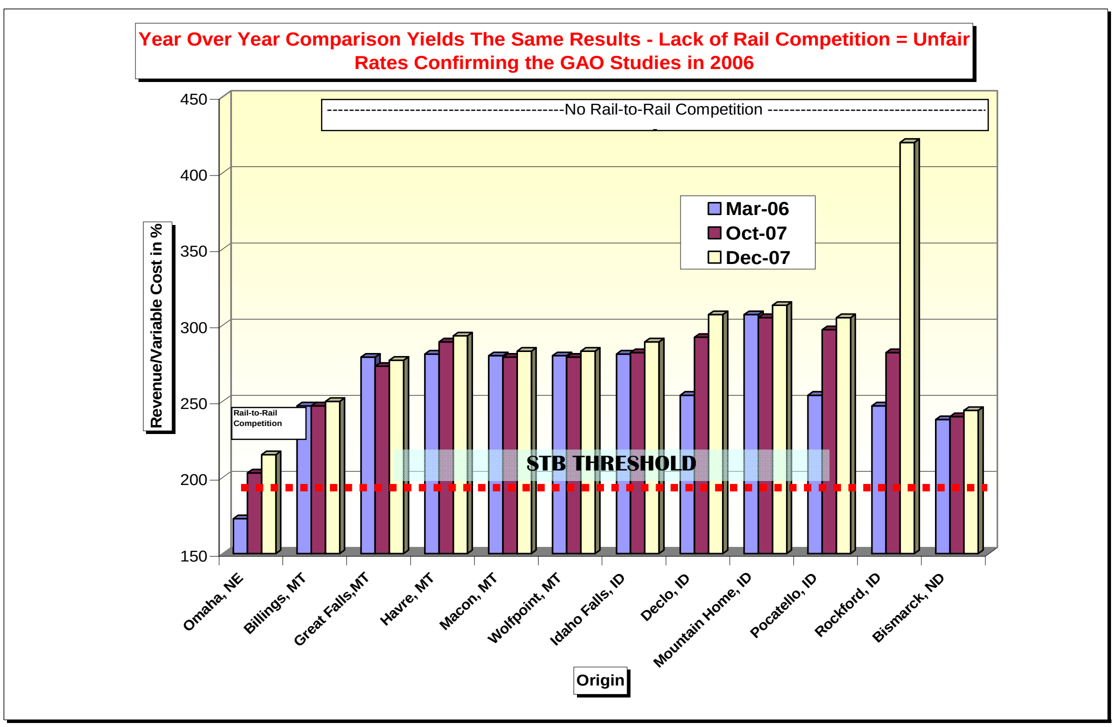

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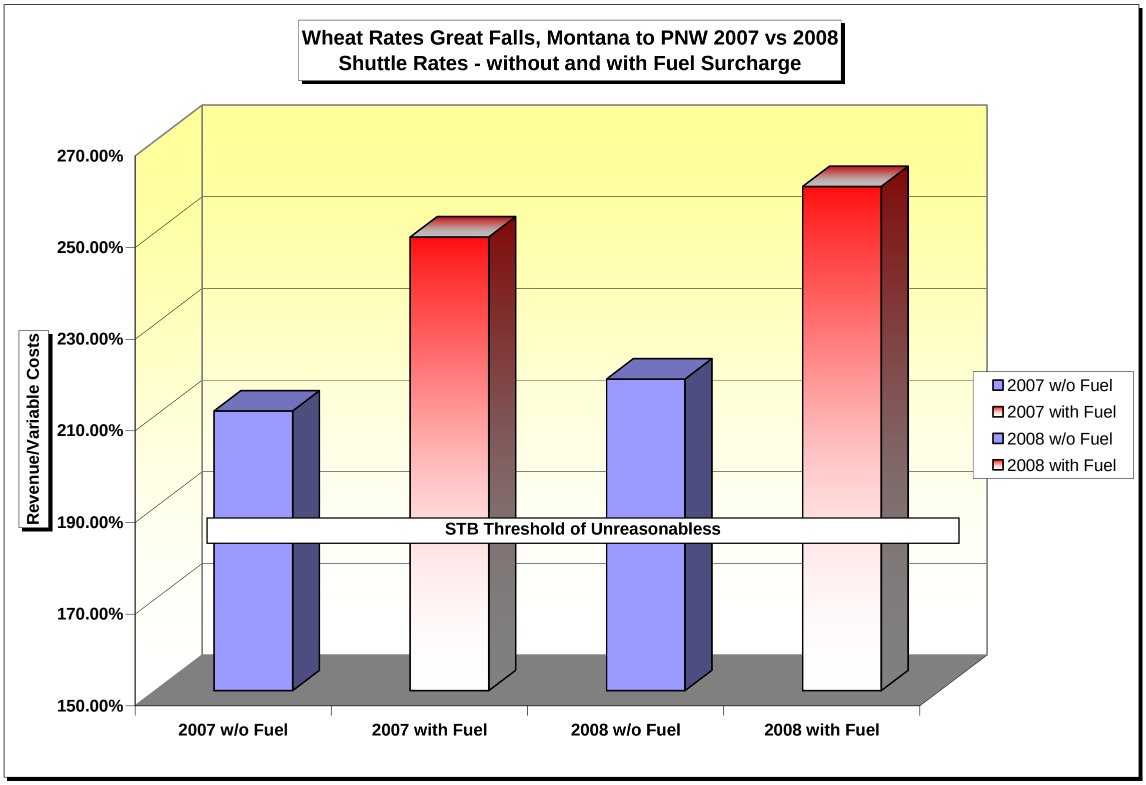

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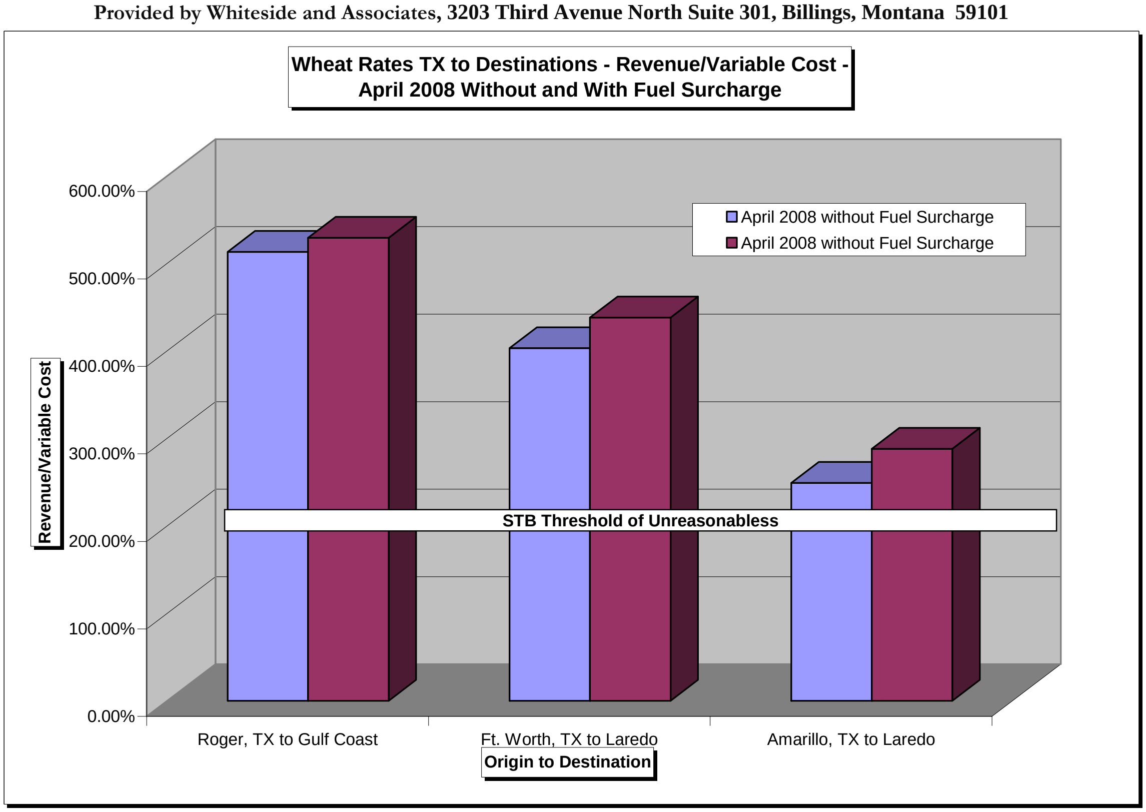

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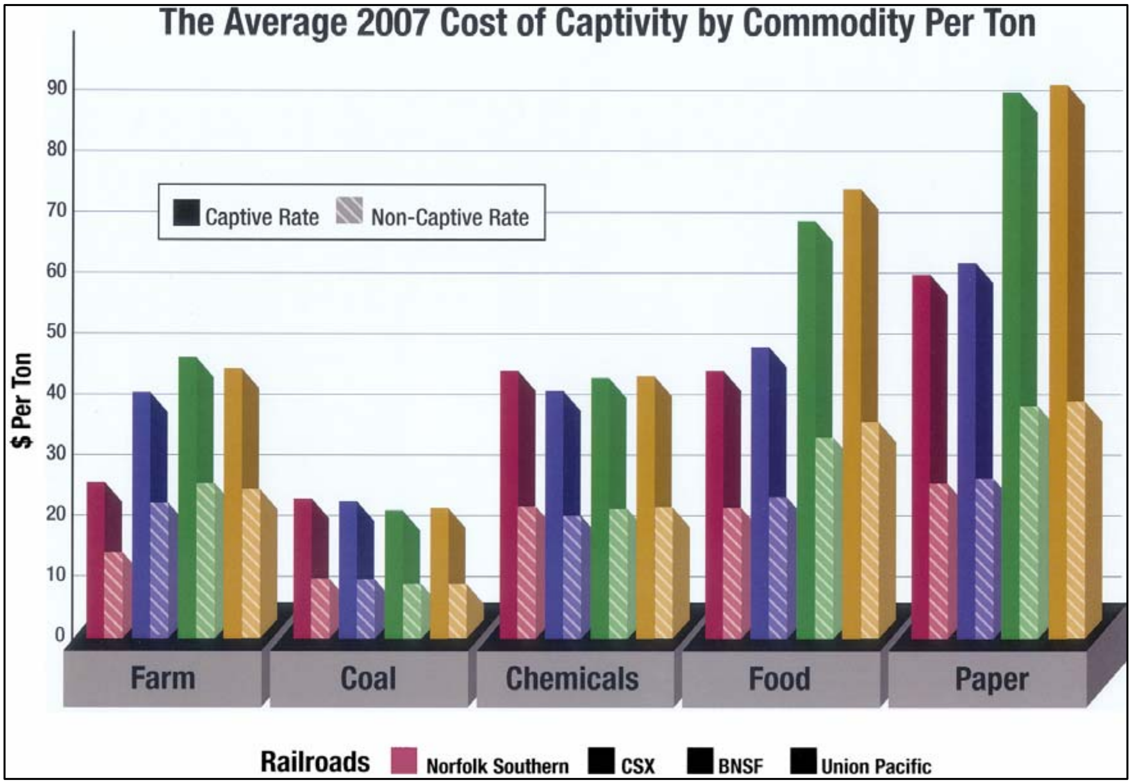
The areas of rail captivity that result in high freight rate levels include parts of Colorado, Idaho, Kansas, Minnesota, Montana, Nebraska, North Dakota, Oklahoma, Oregon, South Dakota, Texas and Washington.

Escalation Consultants, a Washington, D.C. based firm, recently completed studies of the cost of captivity by industry based upon 2007 figures. The chart below clearly shows that the cost of captivity is being borne by most customers.



Escalation Consultants, http://www.escalationconsultants.com/

While service in many areas seems to be getting better, there were pockets in 2007 that suffered from lack of adequate service. In the fall of 2007 for example, over 10 million bushels of grain had to be stored on the ground in Colorado because of the lack of rail service. Storing grain on the ground diminishes value and causes market delivery disruptions. Efforts by Colorado's Governor to provide emergency orders on trucking to facilitate movement from grain piles to railheads outside of Colorado proved to be only marginally successful.

Shifting costs

One of the more difficult problems for growers is that costs are shifting to them as railroads increase their efficiency. While fewer, larger grain elevators decrease railroad costs and speed movement of grain to our ports; farmers are required to truck their grain ever increasing distances to more distant and fewer elevators. While these shuttle facilities may offer higher prices (lower freight rates), there is an increased cost to the grain producer to relocate their grain to the shuttle. States are also seeing increases in maintenance costs in both primary and secondary highways due to the creation of the shuttle system. Grain producers are not opposed to increasing the efficiency of the grain handling system, but the costs are being borne by the farm producers and the grain industry.

Farmers are not in a position to pass their freight costs along to consumers. In fact, they pay freight on fertilizer and other supplies they purchase, and pay freight on the wheat they ship. Further complicating their position, these farmers are not the actual customers of the railroads that haul their grain. The grain companies, which buy the producers' wheat and other grains, order the freight from the railroad, and then pass the cost directly to the farmer. This is an important point, because most of the rights of rate and service appeal to the Surface Transportation Board are granted to the actual rail customer - the grain companies.

Working for a solution

NAWG and other agriculture industry leaders have requested oversight by the STB, as we believe it is within their charter to do so. Very little progress has been made. The STB's proposed new revisions to simplify guidelines are highly restrictive and would make regulatory relief to challenge unreasonable rates virtually non-existent for all but a few facilities shipping "miniscule" volumes of grain and grain products. But, again, these rules serve rail customers - the grain elevators -rather than my wheat producers. This situation has continued far too long. The STB recently, after listening to years of rail customers' grievances, finally changed its methodology for calculating the cost of capital to Capital Asset Pricing Methodology (CAPM) on the railroad. This could result in benefit to shippers as more railroads will be revenue adequate under the new standards. While these changes are significant, they still fall short of producing a pro-active STB that growers can rely on for relief from captive rates and service.

This frustration with the lack of regulatory oversight has led us to help develop and support legislation that would strengthen the rules of the game for growers. We believe parts of H.R. 2125, the "Railroad Competition and Service Improvement Act of 2007" introduced by Chairman Oberstar, would address some of our concerns regarding both rates and service. This bill would put us in a position to be treated as a customer should be treated. The basic thrust of HR 2125 (companion bill S953) is to restore the provisions and tenants of the Staggers Rail Act of 1980 which provides for fair treatment of captive shippers as the railroads were partially deregulated.

H.R. 2125 contains language addressing areas of inadequate competition, common carrier obligation, bottleneck, terminal access, paper barriers and developing a system of arbitration of rate and service issues, called final offer arbitration that mirrors a system that has and continues to work well in the resolution of rail/shipper disputes in Canada. These are complex subjects for complex problems, in a business where one size does not fit all.

We also support H.R. 1650 (companion bill S. 772), the "Railroad Antitrust Enforcement Act of 2007" introduced by Representative Tammy Baldwin, which would remove several antitrust exemptions for the railroads.

While we support these bills, we also know that these issues will take time to move through the congressional process. So, paying heed to the old axiom "if you are not at the table, then you are on the table", we have begun a process of problem-resolution with one of the four major Class I railroads. The National Corn Growers Association, the American Soybean Association, the National Association of Wheat Growers and other agriculture interests, along with representatives of BNSF Railway, have formed the Ag Rail Business Council. Our first meeting was in February, and I will say we were treated like customers, rather than as a third-party who happens to be picking up the bill for freight.

The agenda included discussion on railcar allocation, harvest congestion, differential pricing, revenue/variable cost ratios, and a discussion on what constitutes a "reasonable freight rate." Some of these topics will require considerable homework on our part, but we are determined to find solutions for our growers. This is a forum to educate the railroad about the needs of producers. It will also enhance our understanding of the rail freight business, with the ultimate goal of finding mutually beneficial solutions.

Conclusion

Madam Chairman and members of the committee, wheat industry leaders have been working on rail rate and service issues for thirty years. We believe the complexity of this issue has been a deterrent for many of the parties involved, including Congress. It would be easy to throw in the towel and say "we're tired", but we can't do that. Ample opportunities exist to increase service to American agriculture, such as new STB accountability, H.R.2125, S953, HR 1650 and S772, and coalitions like the Ag Rail Business Council.

We understand that new railroads are not going to be built, so competition in that sense is unrealistic. What we can accomplish is accountability on all sides, to find good service at reasonable rates.

Madam Chairman, thank you, again, for allowing me to be here today to share our views and provide education on this very important issue. I am ready to answer any questions that you and other committee Members may have.

Many of the specific rail issues are detailed in the October 2006 GAO report on rail competition and capacity. The internet link to this report is: http://www.gao.gov/new.items/d0794.pdf

RAIL COST PRIMER

Railroads rate levels can be evaluated based upon the comparison of the rate level compared to the variable cost associated with the movement. The revenue to variable cost analysis gives the reader a perspective on the relative profitability of the rail movement.

Generally all rail costs are measure in variable costs.

- 100 percent of variable costs - One hundred percent of variable cost is exactly what one would think it means – namely the variable cost associated with a particular movement. Cost that vary with output such as labor, fuel, wear and tear of equipment, etc. Generally, it does not make sense for any business to perform its service for less than the variable cost associated with the service.
- 140 to 150 percent of variable costs – this figure is generally accepted as the level at which the railroads cover all costs and make a decent return.
- 180 percent of variable costs – this is considered the threshold of unreasonableness by the Surface Transportation Board.
- In the various state rail cost analyses, one will find that the captive origins (lack of choice of rail carrier) will have the highest revenue to variable cost levels. In parts of many states where there is no rail competition, one can find rates that are 200-250 percent or event 350 to 400 percent of variable cost. These are extremely high rail rates and show the high degree of captivity of the local rail shippers.

The calculation of rail costs can be somewhat complicated. Whiteside & Associates, Billings, Montana utilizes a rail costing model developed in conjunction with FRN, Inc and the rail costing mirrors revenue to variable cost levels found at the STB.

David Cleavinger
President
National Association of Wheat Growers

David Cleavinger is a fifth-generation Texas farmer and rancher operating his 4,500-acre irrigated family farm and ranch in Wildorado, near Amarillo. His crop production has included wheat, corn, grain sorghum, seed milo, sorghum silage, cotton and sugar beets along with stocker cattle. In 1979, he earned a degree in agriculture business and economics from West Texas A&M University.

David began his leadership in agriculture with the Texas Agriculture Lifetime Leadership (TALL) program in 1992. This two-year program allowed him to study agriculture enterprises and local economies throughout Texas and provided the opportunity for travel to Mexico, Argentina, California and Washington, D.C. David also served as chairman of the Texas Rural Communities Board in Austin, which provides grants and loans to start up businesses in rural Texas.

David has been an advocate for agricultural policy at the state and federal level for more than 15 years. He served as chairman of the Texas Wheat Producers Board in 2000 and represented Texas on NAWG's Domestic Policy Committee during the negotiations of the 2002 Farm Bill. In 1996, he served on the U.S. Wheat Associates Board of Directors and traveled to Europe and the Middle East to promote U.S. wheat products to foreign buyers.

David and his wife, Jackie, attend Hillside Christian Church in Amarillo and have been married for 29 years. Jackie serves as business manager for Wildorado Independent School District, the board of which David has served on in the past. They have two children, Kent, who is in the family farming operation, and Kelly, a sales representative for Graham Data Supplies in Amarillo.