National Grain and Feed Association

1250 Eye St., N.W., Suite 1003, Washington, D.C. 20005-3922, Phone: (202) 289-0873, FAX: (202) 289-5388, Web Site: www.ngfa.org

TESTIMONY by

NATIONAL GRAIN AND FEED ASSOCIATION

Before the

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

May 1, 2008

Chairwoman Velazquez, Ranking Member Chabot, and members of the committee. I am Kendell W. Keith, president of the National Grain and Feed Association (NGFA). The NGFA has 900 member companies that operate approximately 6,000 plants and facilities that receive grain from farmers for storage, processing, shipping, and marketing throughout the year. The vast majority of our company members are small businesses and the majority of the customer base for our members are small business family farmers. This hearing is very timely, as freight capacity for hauling grain and other agricultural produce has become increasingly constrained in both the rail and other transport sectors.

Grain Marketing and Movement from Farm to the First Buyer

After grain is harvested, farmers may choose to deliver grain to a local livestock feeder, a commercial feed manufacturer, or grain processor; but most grain is delivered first to an elevator that can store the grain and later re-sell the grain to other processors, feeders or exporters. The value of the grain to the farmer is generally established by the grain elevator operator at the time the farmer delivers the grain, and transportation costs play a significant role in determining the price of grain at a given location. The elevator operator surveys alternative end-use markets for the grain, subtracts the cost of freight and an operating margin and the net value is what he bids for the farmers' grain delivered to the elevator. So, while the elevator that ships the grain pays the railroad directly for the cost of freight, in actuality, it is the farmer that ultimately makes the payment for the movement of the grain to a destination market.

Grain Movements from Elevators to End-Users

While farmers generally truck their grain to the first buyer, the grain elevator that stores and ships the grain may use one of three primary modes to reach end-use markets: barge (if the elevator is located on a navigable river system), rail or truck. Of all commercial movements of grain, approximately 1/3 is moved by rail, 1/5 is moved by barge and the remainder is trucked to destination.

Since most elevators are not located on a navigable river, the most typical transportation situation is for a grain elevator to have access to both rail and truck transportation. Generally, rail is used to reach more distant markets (300 miles or farther away) and trucks are often more economic for shorter-distance hauls.

While the elevator may have access to both rail and truck transportation, (with the exception of some terminal markets) it is rare that an elevator will be located at the juncture of two rail lines, a situation that would provide for direct rail-to-rail competition. Thus, for long-distance movements of grain, the elevator is generally dependent on a single railroad. And railroads are fundamentally different than truck and barge transportation. With trucks and barges, the rivers and highways are open to any carrier that wishes to operate; thus competition is readily available. In contrast, railroads own and maintain the rail bed and infrastructure, and generally do not permit other carriers to operate on the right-of-way. This fundamental difference with rail transportation can sometimes create situations where rail competition is restricted and cannot be relied upon to discipline marketplace behavior or pricing of freight service. This is the primary justification for maintaining the Surface Transportation Board and for regulating railroads differently than truck and barge.

Trends in Rail Transportation and Rail Access for U.S. Agriculture

While demand for grain transportation has a significant seasonal component, with the greatest demand typically coming during harvest, overall rail capacity in the U.S. was generally in surplus during most of the 1980s and early 1990s. Even so, the rail share of grain transportation declined sharply since the Staggers Rail Act was passed in 1980. In 1980, railroads carried 50% of the grain that was shipped from elevators. Today that share is about 33%.

But the days of surplus rail capacity are over. In the last 4 years, there are growing signs that the rail industry is nearing its capacity limits, at least in some shipping corridors. The biggest growth sector for the railroads and the factor that has contributed most to the tightening rail capacity has been intermodal freight, much of which is in the form of imports of manufactured goods from Pacific Rim countries.

Physical Access to Rail Service. Rail service to the agricultural sector has been trending toward longer and longer train sizes. A “unit train” is a single train of cars with an identical commodity, loaded at a single origin point and generally unloaded at a single destination. The railroads have been encouraging the grain elevator industry and grain users, such as processors, to build the handling infrastructure to be able to ship longer trains. Longer trains from a single location are more efficient for railroads, so there is generally a price advantage for such freight. And since farmers ultimately pay for the freight, there is a passback of freight savings to the producer in the form of higher local cash prices. At the same time, the increasing concentration of grain handling at fewer loading points means that there may be fewer rail loaders for farmers to deliver to, causing the average farm-to-market distance to be longer. So, the efficiency gains of rail carriers moving larger trains has the effect of putting added traffic on highways and local road systems. The added cost of highway repairs, of course, is borne by the taxpayer.

Economic Access to Rail Freight. With the tightening rail capacity, not unexpectedly, railroads have been increasing freight rates. Shown in the table below is a comparison of the percentage change in revenue per unit for the last 3 years, comparing agriculture to other categories of freight. For the U.S.-based carriers (Norfolk Southern and CSX in the Eastern U.S.; and Union Pacific and Burlington Northern Santa Fe in the Western U.S.), agricultural revenue per car is up between 27 and 52% (simple average of 43% across all carriers). And in most cases, the percentage change in freight charges are higher for agricultural shippers than for all railcars. (The BNSF is the one exception to this pricing pattern.)

Does this indicate that agricultural shippers are being treated unfairly, or that railroads have more pricing power with agricultural shippers? Not necessarily. As the percentage of total rail movements in the intermodal sector grows, the average revenue increase per unit across the entire railroad tends to be dampened because the revenue per unit for intermodal is typically lower than for other types of shipments. (It should be noted that in the case of intermodal shipments, a single intermodal car may carry between 2 and 4 units.) While one cannot conclude with certainty that agricultural shippers are incurring generally higher rate increases from rail carriers compared with other rail customers, it is a situation that should be monitored over a period of years to see if current trends continue.

3-year Change in Rail Revenue per Unit

(1st QTR 2005 to 1st QTR 2008)

U.S. Railroads	Agriculture	Coal	Intermodal	Total
Norfolk Southern	49%	40%	17%	30%
CSX	45%	48%	10%	38%
Union Pacific	52%	27%	24%	33%
BNSF*	27%	29%	34%	32%

*BNSF data compare 1st Qtr 2005 to 4th Qtr 2007, because 1st Qtr 2008 BNSF data was not available at the time of this writing.

If a rail freight rate is excessive, are there solutions available? Generally, challenging rail rates before the Surface Transportation Board is a very costly exercise. The STB attempted to make rate challenges for smaller rate cases easier and less costly when it issued its decision on “Ex Parte 646” in September 2007. There are three cases now pending under those revised guidelines before the STB that should be completed in July of this year. Those cases may help determine how practical these new STB rate case rules are for rail customers. Regardless of the outcome of those particular cases, NGFA estimates that challenging rates on agricultural shipments will still cost about $250,000 per case, and the STB has placed a cap of $1 million on maximum rate relief that can be obtained under the so-called “3-Benchmark” simplified standard. In our comments to the STB in this rulemaking, as well as subsequently, the NGFA has told the agency that this cap is much too low and effectively will put many potential rate cases out of reach economically. (Note that this STB ruling is now being challenged by the Association of American Railroads and several Class I railroads in the DC Circuit Court of Appeals.)

Even if the rules can be changed to give greater access to rate relief for small shipments, we do not believe that rail rate challenges before the STB would ever become a popular course of action for rail customers, because litigation with a carrier that they are so dependent upon risks souring a business relationship that may be critical to business survival. But we do think it’s important to have access to reasonable litigated solutions so that rail carriers are encouraged to negotiate rate resolution with customers. To promote business-to-business negotiation, the STB needs to make the rules as practical as possible. Lowering the bar to rate challenges is important to a healthy business environment for rail transportation.

Pending Rail Legislation

H.R.2116 would amend the Internal Revenue Code to allow tax credits for 25% of the cost of new qualified freight rail infrastructure property. While railroads already are re-investing some of their increasing profits into expanded infrastructure, we think that legislation like this bill could encourage higher levels and more rapid investment to take place. NGFA intends to support this legislation with some minor changes to be recommended to ensure that the tax credits are available to rail customers that also invest in rail infrastructure that can help reduce congestion on railroads and contribute to overall rail capacity.

H.R.1650 would remove the railroads’ antitrust exemption and give the STB six months to review proceedings to bring the railroads into compliance with antitrust laws. The bill would further give the U.S. Attorney General, state attorneys general and private persons the ability to file suit in federal district court to challenge railroad actions on antitrust grounds. While NGFA is attracted to the fundamental logic of this bill, i.e. that railroads should be required to “play by the same rules” as all other businesses, we are not certain of the practical value of the bill. How much would market discipline be affected by the passage and implementation of such bill?

There may be other forms of rail regulatory reform that could also be helpful. For example, we would like to see the “national rail transportation policy” amended to direct the STB to strike a more reasonable balance between protecting rail revenue for carriers and protecting the business needs of rail customers. Current policy is more heavily skewed to the former. We think that legislation might also be considered to modify railroad “revenue adequacy” provisions to more realistically reflect the cost of capital. (Note that the STB recently took action on this matter and adopted a standard that is an improvement. However, now the agency appears to be in the process of reconsidering that decision.) NGFA would also be supportive of a change in the statute to address unnecessary delays in issuing decisions. (A recent decision by the STB required five years from the date of original complaint until a decision was issued. It does appear that in some recent proceedings, the STB is making an effort to expedite the process somewhat, but extended litigation in proceedings is very discouraging to rail customers that otherwise might make use of the protections intended to be afforded them under the law.)   Lastly, if the STB fails to ultimately adopt workable rules for challenging small rate cases, we believe that Congress should pass legislation directing the STB with great specificity as to what such rules should be. We don’t think that practical rules for challenging rates will promote litigation; we think such rules will promote healthy business relations between carriers and their customers.

Thank you for the opportunity to testify and I look forward to responding to any questions you may have.

Kendell W. Keith

Education/Employment History

- Native of Oklahoma
- Ph.D. Agricultural Economics, Okla State University, 1978
- 1978-1980, policy economist with National Cotton Council of America
- 1980-1986, policy economist with National Grain and Feed Association, specializing in trade policy, transportation policy, farm policy
- 1987-Current, president of National Grain and Feed Association, representing 900 member companies in the grain, feed and processing industries. Responsible for overall direction of Association activities.

HOUSE COMMITTEE ON SMALL BUSINESS
Witness Disclosure Statement
Required by House Rule XI, Clause 2(g)

Your Name:		
1. Are you testifying on behalf of a Federal, State, or Local Government entity?	**YES**	**NO** X
2. Are you testifying on behalf of an entity other than a Government entity?	**YES** X	**NO**
3. Other than yourself, please list what entity or entities you are representing: 900 Companies/6,000 locations shipping/receiving grain		
4. Please list any offices or elected positions held or briefly describe your representational capacity with the entities disclosed in question 3. N/A		
(For those testifying on behalf of a Government entity, ignore these questions below) **5. a) Please list any Federal grants or contracts (including subgrants or subcontracts), including the amount and source (agency) which you have received and/or been approved for since October 1, 2006:** none **b) If you are testifying on behalf of a non-governmental entity, please list any federal grants or contracts (including subgrants or subcontracts) and the amount and source (agency) received by the entities listed under question 3 since October 1, 2006, which exceeded 10% of the entities' revenues in the year received:** none		
6. If you are testifying on behalf of a non-governmental entity, does it have a parent organization or an affiliate who you specifically do not represent? If so, list below:	**YES**	**NO** X

Signature: Kendell Keith **Date:** 4/25/08