

ASSOCIATION
OF AMERICAN
RAILROADS

John T. Gray
Senior Vice President - Policy & Economics

September 5, 2012

The Honorable Cynthia T. Brown
Chief, Section of Administration
Office of Proceedings
Surface Transportation Board
395 E Street, SW.
Washington, DC 20423-0001

Dear Ms. Brown:

This submission is the AAR forecast of the fourth quarter 2012 All-Inclusive Index and Rail Cost Adjustment Factor, filed in Ex Parte No. 290 (Sub-No. 5) (2012-4) *Quarterly Rail Cost Adjustment Factor*. The versions of RCAF-related indices covered in this filing are: the All-Inclusive Index (initiated in the second quarter of 1985), the Unadjusted RCAF (produced since October 1982), the Adjusted RCAF (first published in the second quarter of 1989), and the RCAF-5 (created by the STB in its Ex Parte No. 290 (Sub-No. 7) decision served October 3, 1996). The table below summarizes the fourth quarter 2012 results on the fourth quarter 2007 base, and shows the percentage changes from the previous quarter.

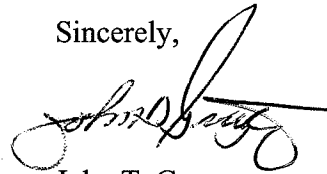
| | <u>2012Q3</u> | <u>2012Q4</u> | <u>% Change</u> |
|--------------------------------|---------------|---------------|-----------------|
| All-Inclusive Index | 117.7 | 121.6 | 3.3 |
| Preliminary RCAF | 1.177 | 1.216 | 3.3 |
| Forecast Error Adjustment | -0.006 | -0.007 | |
| RCAF (Unadjusted) | 1.171 | 1.209 | 3.2 |
| Productivity Adjustment Factor | 2.2815 | 2.2861 | |
| RCAF (Adjusted) | 0.513 | 0.529 | 3.1 |
| PAF-5 | 2.4146 | 2.4231 | |
| RCAF-5 | 0.485 | 0.499 | 2.9 |

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September 5, 2012

In its October 3, 1996 decision in Ex Parte No. 290 (Sub-No. 7), *Productivity Adjustment - Implementation*, the STB noted its intent to publish, in addition to the RCAF (Unadjusted) and RCAF (Adjusted), an RCAF-5 (i.e., a calculation of the productivity adjusted RCAF values as if the agency had always used a 5-year rolling average to calculate the productivity adjustment). In response to a request by STB staff, the AAR is including a calculation of the RCAF-5 in its quarterly RCAF filing. The AAR and its members, however, do not believe the publication of a third RCAF index is required or permitted by the applicable statute (49 U.S.C. § 10708) and do not endorse its publication.

We have notified Paul Aguiar, in the STB office handling this proceeding, of our plan to e-file the submission and hand-deliver workpapers. A copy of the quarterly non-proprietary workpapers underlying this submission will be hand-delivered and filed herewith, in accordance with the ICC's order in Ex Parte No. 290 (Sub-No. 2), *Railroad Cost Recovery Procedures*, served February 8, 1990. A second copy of the workpapers has been delivered to the STB office handling this proceeding. All workpapers are available for STB inspection. Questions should be directed to me or Clyde Crimmel (202 639-2309) of this office.

Sincerely,

A handwritten signature in black ink, appearing to read "John T. Gray", with a large, stylized flourish extending from the end of the signature.

John T. Gray

Attachments

**Fourth Quarter 2012
All-Inclusive Index**

Ex Parte No. 290 (Sub-No. 5) (2012-4)

**Quarterly Rail Cost Adjustment Factor
Surface Transportation Board**

**Policy and Economics Department
Association of American Railroads**

September 5, 2012

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Introduction

On January 2, 1985, the Interstate Commerce Commission (ICC) [now the Surface Transportation Board (STB)] adopted the All-Inclusive Index of Railroad Costs as the basis for the Rail Cost Adjustment Factor (RCAF). The quarterly projection of railroad costs, as documented herein, employ the All-Inclusive Index as required by the regulations. Also presented in this submission is the RCAF, both Adjusted and Unadjusted, as required by the ICC in its decision in Ex Parte No. 290 (Sub-No. 4), *Rail Cost Recovery Procedures - Productivity Adjustment*, served March 24, 1989. In addition, the AAR has included (but does not endorse) the RCAF-5, which was instituted by an STB decision served October 3, 1996 in Ex Parte No. 290 (Sub-No. 7), *Productivity Adjustment - Implementation*. This quarter's projection of railroad costs is for the fourth quarter 2012.

Each year's fourth quarter calculation utilizes new weights, which can be found on page 2. New annual report and wage statistics data are also utilized to rebenchmark labor (see Appendix A).

During April, one railroad revised Materials & Supplies pricing data used for both the 2012Q1 and 2012Q2 RCAF. Both revisions caused the Materials & Supplies Index to be 0.1 index points lower. Current calculations include both revisions. As always, fourth quarter RCAF calculations use data for the second quarter to calculate the forecast error adjustment. As noted in the Board's decision served June 20, 2012, the AAR will use the corrected Q2 Materials & Supplies Index (274.0) as the "actual" in the forecast error calculation, and the original as-filed number (274.1) as the "forecast".

Index Weights

In the Ex Parte No. 290 (Sub-No. 2) final rules, issued in April 1981, the Interstate Commerce Commission mandated that the weights of each major cost component be updated annually. These "external" weights are calculated using data from Schedules 410 and 210 of the R-1 annual report filed with the Surface Transportation Board by the Class I railroads. The weights are typically updated with the fourth quarter projection.

The 2011 (current) and 2010 (previous) weights are shown below. The 2010 weights were used for the fourth quarter of 2011 through the third quarter of 2012. Beginning with the fourth quarter of 2012, 2011 weights are used. In 2011, expenses increased for every category with the exception of interest expenses. However, fuel expenses increased by the highest percentage and amount, caused by a huge increase in fuel costs and a much smaller increase in traffic. Not surprisingly, Fuel's weight increased from 18.0 percent to 22.5 percent. This is the second-highest weight ever for Fuel. The only other category to have its weight increase was Materials & Supplies, which increased 0.1 percentage points. Labor's weight decreased from 33.3 to 31.3 percent, despite an 8 percent increase in expenses. Weights for the remaining categories decreased by 0.4 to 1.2 percentage points.

| RCAF Weights | | |
|----------------------|------------------|-----------------|
| | Previous 2010 | Current 2011 |
| Labor | 33.3 % | 31.3 % |
| Fuel | 18.0 | 22.5 |
| Materials & Supplies | 5.0 | 5.1 |
| Equipment Rents | 6.2 | 5.6 |
| Depreciation | 12.8 | 11.6 |
| Interest | 2.9 | 2.5 |
| Other | 21.8 | 21.4 |

Reweighting of the index is accomplished by calculating both the current quarter (normally the fourth) and prior (normally the third) quarter indexes with the new weights. The relative change between the two quarters is then multiplied times the prior quarter (usually the third) *linked* index. Use of this method ensures that the weight change, by itself, does not cause a change in the level of the All-Inclusive Index.

Internal weights in the labor and equipment rents components are updated at the same time as the external weights. When these weights are changed, they are also linked using the procedure described above in order to eliminate the effect of the change in weighting.

All-Inclusive Index Fourth Quarter 2012

The components and values of the current and previous All-Inclusive Indexes are shown below. Details of the construction of each component of the index are contained in the Appendices.

| | 2011 Weights | Forecast | | Percent Change |
|------------------------|-----------------|--------------------|--------------------|-------------------|
| | | Previous 2012Q3 | Current 2012Q4 | |
| 1. Labor | 31.3% | 391.4 | 390.5 | -0.2 % |
| 2. Fuel | 22.5% | 353.4 | 403.3 | 14.1 |
| 3. M&S | 5.1% | 274.8 | 266.1 | -3.2 |
| 4. Equipment Rents | 5.6% | 205.8 | 205.7 | 0.0 |
| 5. Depreciation | 11.6% | 211.7 | 213.2 | 0.7 |
| 6. Interest | 2.5% | 90.6 | 92.9 | 2.5 |
| 7. Other | 21.4% | 221.6 | 218.0 | -1.6 |
| 8. Weighted Average | | | | |
| a. 1980 = 100 | | 301.8 | 311.8 | |
| b. 1980 = 100 (linked) | | 289.4 | 299.0 ¹ | |
| c. 4Q07 = 100 | | 117.7 | 121.6 ² | 3.3 |

Note: The 301.8 weighted average for 2012Q3 is recalculated with 2011 weights to eliminate any changes in the fourth quarter index that would be caused by changing weights. The Q3 weighted average with 2010 weights is 298.5.

¹ To calculate the 1980 = 100 Linked Index:

$$\begin{aligned} \text{Index}_{80} &= (\text{Current Index} / \text{Previous Index}) * \text{the Previous Quarter Linked Index} \\ &= (311.8 / 301.8) \times 289.4 \\ &= 299.0 \end{aligned}$$

² To calculate the 4Q07 = 100 index:

$$\begin{aligned} \text{Index}_{4Q07} &= (\text{Current Linked Index} / 4Q07 Linking Factor) * 100 \\ &= 299.0 \text{ divided by } 245.9 \text{ times } 100 \\ &= 121.6 \end{aligned}$$

Indexes based on other periods:

- 4Q02 based index = 299.0 / 192.1 x 100 = 155.6
- 4Q97 based index = 299.0 / 173.2 x 100 = 172.6
- 4Q92 based index = 299.0 / 156.9 x 100 = 190.6
- 4Q87 based index = 299.0 / 132.2 x 100 = 226.2

Forecast vs. Actual All-Inclusive Index Second Quarter 2012

Because of data availability, the forecast error adjustment has a two-quarter lag from each filing. As shown below, the second quarter actual index of 120.0 is 0.7 index points below the forecast value of 120.7. Therefore, the forecast error adjustment for fourth quarter 2012 is -0.7 index points.

| | 2010 Weights | Second Quarter 2012 | | Amt Difference |
|---------------------------------|-----------------|---------------------|--------------------|-------------------|
| | | Forecast | Actual | |
| 1. Labor | 33.3% | 385.8 | 385.8 | |
| 2. Fuel | 18.0% | 409.4 | 403.2 | |
| 3. M&S | 5.0% | 274.1 | 274.0 ¹ | |
| 4. Equipment Rents ² | 6.2% | 204.8 | 204.3 | |
| 5. Depreciation | 12.8% | 211.4 | 211.4 | |
| 6. Interest | 2.9% | 90.6 | 90.6 | |
| 7. Other | 21.8% | 218.8 | 218.9 | |
| 8. Weighted Average | | | | |
| a. 1980 = 100 | | 306.0 | 304.8 | |
| b. 1980 = 100 (linked) | | 296.7 | 295.2 ³ | |
| c. 4Q07 = 100 ⁴ | | 120.7 | 120.0 | -0.7 |

Forecast error **—————▶ -0.7 index points**

¹ During April 2012, one railroad revised data used for the 2012Q2 Materials & Supplies Index. Therefore, the forecast error calculation for 2012Q4, which is based on 2012Q2, uses the original number as "forecast" (274.1), and the corrected number as "actual" (274.0). See page 1 of this submission.

| | 2010 Weights | Second Quarter 2012 | |
|---------------------------|-----------------|---------------------|--------|
| | | Forecast | Actual |
| Car-Hire | 45.8% | 174.8 | 173.3 |
| Lease Rentals | 54.2% | 218.8 | 218.9 |
| Weighted Average | | 198.6 | 198.0 |
| Weighted Average (linked) | | 204.8 | 204.3 |

³ Linked actual index = (actual index / previous actual index) x previous linked actual index.

$$295.2 = 304.8 / 297.0 \times 287.6$$

⁴ The 4Q07 based indexes are 1980 based indexes divided by the 4Q07 linking factor (245.9/100). Other linking factors are: 4Q02 = 192.1; 4Q97 = 173.2; 4Q92 = 156.9; and 4Q87 = 132.2.

Productivity

On February 6, 2012, the Surface Transportation Board (STB) served a decision in Ex Parte 290 (Sub-No. 4) which added the year 2010 to the Productivity Adjustment Factor (PAF) and removed the year 2005. This creates a geometric average annual productivity change, for the five-year period 2006 through 2010, of 0.8 percent per year. The components of this average annual value are shown on the following table in ratio format – therefore, 1.008 is the same as an increase of 0.8 percent.

Productivity changes are calculated by multiplying each of the five productivity changes together and taking the result to the one-fifth power. The quarter productivity adjustment factors (PAF) are calculated by increasing the previous quarter's PAF by quarterly versions of the annual rate, which are the fourth root of the geometric average annual growth rate. The difference between the PAF and the PAF-5 is the timing of the five-year productivity trend.

| Comparison of Output, Input, & Productivity | | | |
|--|---------------------|--------------------|--|
| 2006 - 2010 | | | |
| Year | Output Index (1) | Input Index (2) | Productivity ¹ Changes (3) |
| 2006 | 1.018 | 1.024 | 0.994 |
| 2007 | 1.000 | 0.996 | 1.004 |
| 2008 | 0.990 | 0.970 | 1.021 |
| 2009 | 0.847 | 0.861 | 0.984 |
| 2010 | 1.109 | 1.070 | 1.036 |
| Average | | | 1.008 |
| Previous Average (2005-2009) | | | 1.014 |

¹ The values shown in Column 3 are based on full float calculations and may not exactly match numbers calculated using the rounded numbers displayed in Columns 1 and 2.

| Calculation of PAF and PAF-5 | | | |
|---|------|--------|--------|
| For 2006-2010, use fourth root of avg. productivity change = 1.0020 | | | |
| For 2005-2009, use fourth root of avg. productivity change = 1.0035 | | | |
| Quarter | Year | PAF | PAF-5 |
| Q1 | 2012 | 2.2724 | 2.3978 |
| Q2 | 2012 | 2.2769 | 2.4062 |
| Q3 | 2012 | 2.2815 | 2.4146 |
| Q4 | 2012 | 2.2861 | 2.4231 |
| Q1 | 2013 | 2.2907 | 2.4279 |

Rail Cost Adjustment Factor Fourth Quarter 2012

Four RCAF values are presented in this filing. Two are not modified for productivity (Preliminary RCAF and RCAF Unadjusted), and two incorporate a productivity calculation (RCAF Adjusted and RCAF-5). The All-Inclusive Index and all four RCAF values, plus the percent change for each, are shown below. Note that the All-Inclusive Index is on a 2007Q4=100 basis.

| | Previous 2012Q3 | Current 2012Q4 | Percent Change |
|---|--------------------|-------------------|-------------------|
| All-Inclusive Index ¹ | 117.7 | 121.6 | 3.3 |
| Preliminary RCAF ² | 1.177 | 1.216 | 3.3 |
| Forecast Error Adjustment ³ | <u>-0.006</u> | <u>-0.007</u> | |
| RCAF (Unadjusted) ⁴ | 1.171 | 1.209 | 3.2 |
| Productivity Adjustment Factor ⁵ | <u>2.2815</u> | <u>2.2861</u> | |
| RCAF (Adjusted) ⁶ | 0.513 | 0.529 | 3.1 |
| PAF-5 ⁷ | 2.4146 | 2.4231 | |
| RCAF-5 ⁸ | 0.485 | 0.499 | 2.9 |

¹ See All-Inclusive Index on page 3.

² All-Inclusive Index divided by the All-Inclusive Index in the base period (100.0).

³ The current figure is from Forecast vs. Actual All-Inclusive Index in this filing (page 4). The previous quarter figure is shown in a similar section of the previous quarter's filing.

⁴ Preliminary RCAF plus the forecast error adjustment.

⁵ See Productivity on page 5.

⁶ RCAF (Unadjusted) divided by the Productivity Adjustment Factor (PAF).

⁷ See Productivity on page 5.

⁸ RCAF (Unadjusted) divided by the PAF-5.

Appendixes

Labor

Fourth Quarter 2012

The fourth quarter 2012 Labor Index is forecast to decrease 0.2 percent from the previous quarter. The decrease was caused by rebenchmarking to 2011 wage statistics and annual report data plus lower employer contributions to employee 401(k) and stock plans.

Rebenchmarking and Reweighting: Rebenchmarking, as well as updating the internal weights (i.e., the proportion of labor costs represented by wages and supplements, respectively), is reflected each year in the fourth quarter filing. The Labor rate is basically a group of benchmarks from annual data that are updated each quarter using additional information such as labor agreements, payroll tax rates, health & welfare rates, and other data. By rebenchmarking to newer annual data, the number of quarterly updates from the benchmark year to the current quarter becomes fewer – increasing the probability that the updated values match reality. Therefore, the impact of rebenchmarking is captured in the Labor Index, and by itself can cause a change in the index.

The new benchmark year is 2011, and it replaces data for 2010. The 2011 data underlying the fourth quarter rebenchmarking are obtained from a summary of the railroads' 112-Class Wage Statistics and a summary of the railroads' Annual Report Form R-1 submitted to the Surface Transportation Board. Railroad revisions through August 29 are included in the benchmark data.

The source for the wage and supplements internal weights, like the external weights, is also the Annual Report Form R-1 Summary. Unlike rebenchmarking, reweighting by itself is prevented from causing a change in the index. A linking process, where the previous quarter unlinked index is recalculated using the new weights, eliminates changes that would be caused solely by changing weights.

Wage Rate Index

The Wage Rate Index portion of the Labor Index increased 0.1 percent from the previous quarter. Although the net impact of rebenchmarking was a decrease of almost 0.1 percent, the addition of numerous independent labor agreements completely offset the small decline, and resulted in a small increase in the Wage Rate Index.

New Labor Agreements: Over 15 new independent labor agreements were added to the index. All featured lump sums and retroactive wage increases that caused back pay. Many of the new agreements affected less than 50 employees, meaning their impact on the Index was not as significant as the national agreements.

Wage Increases: There are no wage increases scheduled for the fourth quarter. However, the addition of over 15 new independent labor agreements, which featured retroactive wage increases and lump sum payments, caused small increases from the rebenchmarking version of the Index.

Lump Sums: The fourth quarter lump sum rate is unchanged from the previous quarter. Rebenchmarking caused a slight decrease to this rate, but lump sums from numerous new independent agreements increased the rate back to its original third quarter level.

Labor

Fourth Quarter 2012

Back Pay: Rebenchmarking caused the back pay rate to decrease by 5.4 cents, while the new labor agreements added 2.2 cents. The net result was a decrease of 3.2 cents or 2.9 percent.

Other: In wages, "Other" contains the amortization of incentive compensation payments that a large railroad makes each year to its dispatchers, yardmasters, and engineers. Rebenchmarking caused a decrease of 0.7 cents in the rate.

Supplements Index

The Supplements Index decreased 0.7 percent. Rebenchmarking caused 0.1 percentage points of the decrease. Most of the remaining portion of the decrease was related to lower employer contributions to 401(k) accounts and employee stock plans.

Health & Welfare: Almost all of the 1.4 percent decrease in the Health & Welfare rate was caused by rebenchmarking. A very small amount of the decrease was caused by new labor agreements that contained higher employee health & welfare cost sharing.

Railroad Retirement: Rebenchmarking caused almost all of the 1.6 percent increase in the Railroad Retirement & Medicare rate. A very small portion of the increase was caused by slightly higher taxable earnings for the fourth quarter.

Unemployment Insurance: The Unemployment Insurance rate decreased \$0.003 because of rebenchmarking.

Other: The "Other" category is a reflection of all other fringe benefits, and currently contain known employer contributions to employee 401(k) accounts and employer contributions to employee stock plans that are recorded as fringe benefits. Much of this quarter's decrease was caused by a return to normal contributions, as the prior quarter includes an annual bonus match of 401(k) contributions, and an annual perfect attendance stock award.

Labor Index Calculation

As shown in Table A-1 on the next page, the 0.1 percent increase in the Wage Rate Index and the 0.7 percent decrease in the Supplements Index combined to cause a 0.2 percent decrease in the Labor Index. The linked fourth quarter 2012 index of 390.5 is determined by multiplying the third quarter linked index of 391.4 times the change between the fourth quarter labor index (415.0) and the original third quarter labor index recalculated (416.0) using the original third quarter Wage Rate and Supplements indexes weighted with the new 2011 weights. This method eliminates changes caused by the new weights, but captures changes caused by rebenchmarking. Therefore, the purpose of the center "Updated to Reflect..." column in table A-1 is only to enable the reader to discern the impact of rebenchmarking.

Labor
Fourth Quarter 2012
Table A-1 Labor Index

| | 2012Q3 | | 2012Q4 | |
|---|-------------------------------------|---|-----------------------|---------------------------------|
| | Used in Previous Index Filing | Updated to Reflect 2011 Actual Data | Based on 2011 Data | Pct Chg From Prev. Filing |
| <u>Base Wage</u> – Straight Time & Pay For Time Not Worked | \$37.082 | \$37.141 | \$37.167 | 0.2% |
| Adjustments: | | | | |
| Lump Sum | 0.446 | 0.424 | 0.446 | 0.0% |
| Back Pay | 1.092 | 1.038 | 1.060 | -2.9% |
| Other | 0.128 | 0.121 | 0.121 | -5.5% |
| Total Wages | 38.748 | \$38.724 | 38.794 | 0.1% |
| Health & Welfare Benefits | 7.985 | 7.873 | 7.871 | -1.4% |
| RR Retirement & Medicare | 7.588 | 7.704 | 7.709 | 1.6% |
| Unemployment Insurance | 0.434 | 0.431 | 0.431 | -0.7% |
| Other | 0.219 | 0.209 | 0.107 | -51.1% |
| Total Supplements | \$16.226 | \$16.217 | \$16.118 | -0.7% |
| Total Labor (a check sum only) | \$54.974 | \$54.941 | \$54.912 | |
| Wage Index¹ | 331.6 | 331.4 | 332.0 | 0.1% |
| Supplements Index² | 599.6 | 599.3 | 595.6 | -0.7% |
| Total labor Index, 2010 Weights ³ | 412.5 | | | |
| Total labor Index, 2011 Weights ⁴ | 416.0 | 415.8 | 415.0 | |
| Labor Index (linked)⁵ | 391.4 | | 390.5 | -0.2% |

¹ 1980 wage rate \$11.685

² 1980 supplements rate \$2.706

³ 2010 weights: wages, supplements 69.8% 30.2%

⁴ 2011 weights: wages, supplements 68.5% 31.5%

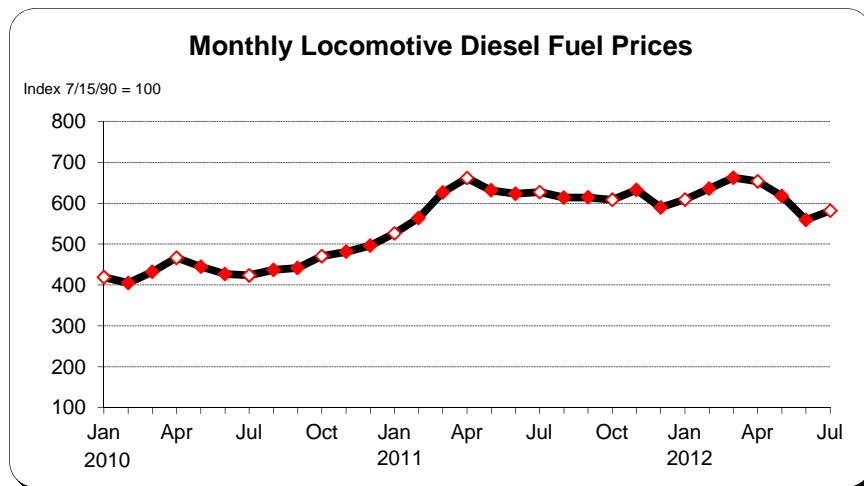
⁵ 2012Q4 linked Index = 2012Q3_{linked} X (2012Q4_{WT2011} / 2012Q3_{WT2011})
 = 391.4 x 415.0 / 416.0

Fuel Fourth Quarter 2012

The forecast for fuel is based on: (1) a survey of railroad fuel purchasing officers concerning current price and volume levels, (2) expectations of railroad purchasing officers based on their own forecast models and discussions with their major suppliers, and (3) a consensus of petroleum industry experts and general business publications. Fuel purchases are assumed to remain in inventory for 30 days before the fuel is consumed (and therefore expensed). Therefore, prices paid in the first month of each quarter are for fuel expensed in the second (or middle) month of the quarter, and the middle month is used to represent each quarter.

The nation's fuel prices have been increasing over the last two months. In the west, a California refinery fire has led to higher prices. In the east, Hurricane Isaac and resulting power outages along the Gulf Coast has disrupted fuel supplies, putting upward pressure on crude* and refined oil prices. While the latest average prices for locomotive diesel fuel are available only through July, the Energy Information Administration (EIA) has weekly data through August for related fuel types. EIA data show increasing futures prices for heating oil.** In addition, on-highway diesel fuel prices are also increasing.

The average price paid for locomotive diesel fuel increased in July after 3 months of falling prices. Railroads believe the locomotive diesel fuel price for October 2012 (Q4) will be 14.1 percent higher than the third quarter forecast (represented by July 2012), and 12.3 percent higher than the average price actually paid for July – meaning October's average price will be very close to the average for April.



| | |
|---------------------------------------|-------|
| Forecast Fuel Index (1980 = 100) | 403.3 |
| Change from previous quarter forecast | 14.1% |
| Change from previous quarter actual | 12.3% |

* Diesel fuel used by locomotives is made from refined crude oil, and therefore usually has some price correlation.

** Heating oil and locomotive diesel fuel are part of a group of closely related products, commonly labeled as distillates, that differ mostly by their sulfur content. Because of these similarities, these fuels are produced together and have similar pricing trends.

Materials & Supplies

Fourth Quarter 2012

The fourth quarter 2012 Materials & Supplies Index decreased 3.2 percent from the previous quarter. The change was caused mostly by decreases in prices in Metal Products. Rail, wheel sets, and ties plates are some of the more significant items in the Metal Products category.

2012Q4 Materials & Supplies Index = 266.1

2012Q3 Materials & Supplies Index = 274.8

Difference -8.7 basis points
or
-3.2 %

Equipment Rents Fourth Quarter 2012

The Equipment Rents Index consists of two components – car hire and lease rentals. The methodology used to create these two components and the final Equipment Rents Index are explained below.

Car Hire

The car hire component is indexed using data from the Car Hire Accounting Rate Master (CHARM) file. Car hire rates for the forecast quarter are estimated based on data for active freight cars using the most recent month available. For the first quarter, December 1 of the previous year is used. For the second, third and fourth quarters; March 1, June 1, and September 1 are used, respectively. Using data retrieved from the latest CHARM file, an average rate per car is developed. Next, those average rates are grouped into car type categories to create an overall summary of car hire rates. The summary rates are then compared from quarter to quarter to determine the Car Hire Index.

Lease Rentals

The lease rentals portion of the Equipment Rents Index uses the Producer Price Index for Industrial Commodities less Fuel and Related Products and Power (PPI-LF). The Commission adopted this surrogate in its decision served March 13, 1987. The AAR uses six years of historical data to derive its forecast for the PPI-LF. The forecast is used not only for lease rentals, but also for the "Other" component of the All-Inclusive Index. Appendix G discusses the forecast in more detail.

Equipment Rents Index Calculation

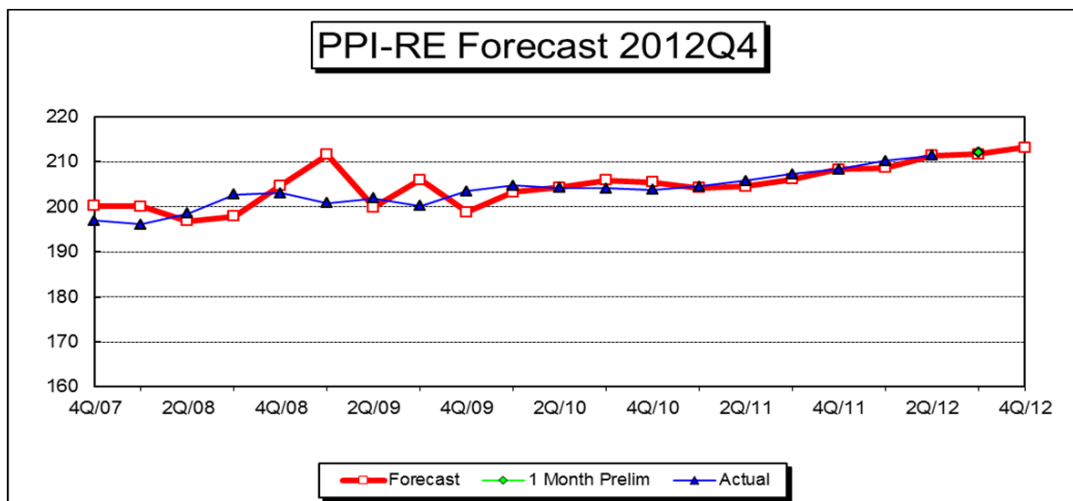
The table below calculates the Equipment Rent Index, and features new weights based on 2011. To eliminate any changes caused by the new weights, the third quarter weighted average (but not the linked value) has been recalculated using the new weights. The original third quarter weighted average using 2010 weights is 199.6. The fourth quarter Car Hire portion of the Index increased 2.1 percent because of higher rates for privately-owned cars (especially tank cars). A 1.6 percent decrease for the projected PPI-LF (See Appendix G) used as a proxy for Lease Rentals, combined with the 2.1 percent increase for Car Hire, caused the Equipment Rent Index to decrease by only 0.1 percentage points, or 0.049 percent.

| | 2011 Weight | 2012Q3 | 2012Q4 | Percent Change |
|---------------------------|----------------|--------|--------|-------------------|
| Car Hire | 48.6% | 173.6 | 177.3 | 2.1 % |
| Lease Rentals | 51.4% | 221.6 | 218.0 | -1.6 |
| Weighted Average | | 198.3 | 198.2 | -0.1 |
| Weighted Average (Linked) | | 205.8 | 205.7 | 0.0 |

Depreciation Fourth Quarter 2012

The Producer Price Index for Railroad Equipment (PPI-RE) is used to index depreciation expense. The PPI-RE is forecast using an ARIMA (Auto-Regressive Integrated Moving Average) process where a statistical package picks the model that best fits the historical data set (see next page), and that model is then used for the forecast. The historical data set contains 6 years of monthly data (a sample size of 72), where the most recent available data point is the first month of the quarter prior to the forecast quarter. For a first quarter forecast, the most recent month of data available would be for October of the prior year. For a second quarter forecast, January would normally be the most recent period available. April and July would be the most recent months available for third and fourth quarter forecasts, respectively. The output from the forecast model is shown on page 2 of this appendix on a 1982=100 basis. The figure forecast by the model reflects monthly PPI-RE figures that jumped in May, but have otherwise changed little over the last few months.

| | |
|--|-------|
| Forecast of Depreciation Index (1982=100) | 192.7 |
| Forecast of Depreciation Index (1980=100) | 213.2 |
| Change from previous quarter forecast | 0.7% |
| Change from actual first month of previous quarter | 0.5% |
| Change from same quarter of prior year (actual) | 2.3% |



Depreciation Fourth Quarter 2012

PPI RAILROAD EQUIPMENT

Recommended model: Exponential Smoothing
 Forecast Model for PPIRE
 Holt exponential smoothing: Linear trend, No seasonality

| Component | Smoothing Weight | Final Value |
|-----------|------------------|-------------|
| Level | 0.80753 | 191.66 |
| Trend | 0.01677 | 0.26489 |

Within-Sample Statistics

| | |
|-----------------------|------------------------------|
| Sample size 72 | Number of parameters 2 |
| Mean 182.1 | Standard deviation 5.393 |
| R-square 0.9664 | Adjusted R-square 0.9659 |
| Durbin-Watson 1.999 | Ljung-Box(18)=25.59 P=0.8904 |
| Forecast error 0.9961 | BIC 1.042 |
| MAPE 0.003715 | RMSE 0.9822 |
| MAD 0.6719 | |

Actual Values for the Most Recent 6 Periods:

| Date | Actual |
|---------|---------|
| 2012-02 | 190.100 |
| 2012-03 | 190.600 |
| 2012-04 | 190.400 |
| 2012-05 | 191.700 |
| 2012-06 | 191.100 |
| 2012-07 | 191.700 |

Forecasted Values

| Date | 2.5 Lower | Forecast | 97.5 Upper |
|----------------|----------------|----------------|----------------|
| 2012-08 | 189.882 | 191.925 | 193.968 |
| 2012-09 | 189.547 | 192.190 | 194.833 |
| 2012-10 | 189.324 | 192.455 | 195.586 |
| 2012-11 | 189.168 | 192.720 | 196.272 |
| 2012-12 | 189.057 | 192.985 | 196.913 |
| QTR AVG | 189.183 | 192.720 | 196.257 |

Interest Fourth Quarter 2012

The Interstate Commerce Commission, in its decision served February 28, 1989, revised the All-Inclusive Index methodology to include a specific interest component, which is to track changes in the average interest rate from year to year. The interest rate is essentially the embedded cost of debt, i.e., total interest expense divided by average total long term debt. The interest rate is calculated for the most recent year and used until the next year's figures are available. Typically in the fourth quarter filing, the interest rate is updated to the new level. The source for interest expense is Schedule 210, column b, from the R-1 annual report. The lines used from current R-1 annual reports are listed below. The source for average total debt is Schedule 200 from the R-1 annual report. The sums of data from columns b and c (ending and beginning balances) are combined and divided by 2 to compute an average balance. The line numbers are listed below. Beginning with fourth quarter 2012, the Interest Index is based on data for 2011.

The interest index is the latest year's interest rate divided by 7.85 percent, which was the interest rate in the 1980 base period.

Interest Expense (Schedule 210)

| | |
|------|-----------------------------------|
| Line | |
| 42 | Total Fixed Charges |
| 44 | Contingent Interest |
| less | |
| 22 | Release of Premium on Funded Debt |

Average Total Debt (Schedule 200)

| | |
|------|--|
| Line | |
| 30 | Current Loans and Notes Payable |
| 39 | Equipment Obligations and Other Long Term Debt Due Within One Year |
| 41 | Funded Debt Unmatured - Non-Current |
| 42 | Equipment Obligations - Non-Current |
| 43 | Capitalized Lease Obligations - Non-Current |
| 44 | Debt in Default - Non-Current |
| 45 | Accounts Payable: Affiliated Companies - Non-Current |
| 46 | Unamortized Debt Premium - Non-Current |

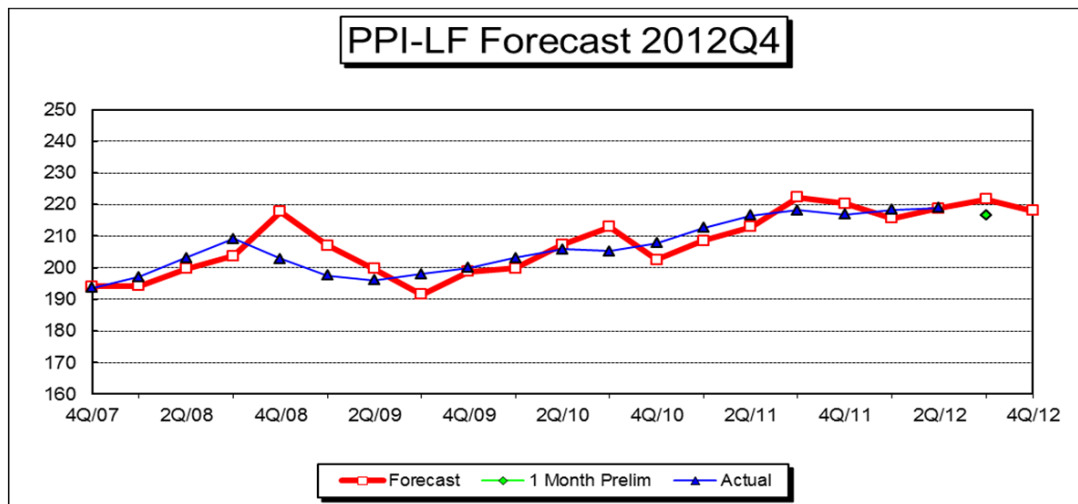
| | | |
|---------------|-----------------------|-------------|
| 2011 | Interest Rate | 7.29% |
| 1980 | Interest Rate | 7.85% |
| 2012Q4 | Interest Index | 92.9 |
| 2012Q3 | Interest Index | 90.6 |
| | Percent Change | 2.5% |

Other Expenses Fourth Quarter 2012

The Producer Price Index for Industrial Commodities less Fuels and Related Products and Power (PPI-LF) is used to index purchased services, casualties and insurance, loss and damage, taxes (other than income and payroll), general and administrative expenses, and lease rentals. These expenses, when grouped together, are usually called "Other" expenses.

Like the PPI-RE, the PPI-LF is forecast using an ARIMA process on 6 years of monthly data (a sample size of 72) with the most recent available monthly data being the first month of the quarter prior to the forecast quarter. For a first quarter forecast, the most recent month of data available would be for October of the prior year. For a second quarter forecast, January would normally be the most recent month available. April and July would be the most recent months available for third and fourth quarter forecasts respectively. The output from the forecast model is shown on page 2 of this appendix for 1982=100. The figure forecast by the model for the third quarter reflects monthly PPI-LF figures that have decreased for 3 consecutive months. The decrease may have been amplified by a forecast for Q3 that was too high.

| | |
|--|-------|
| Forecast of Other Expense Index (1982=100) | 194.5 |
| Forecast of Other Expense Index (1980=100) | 218.0 |
| Change from previous quarter forecast | -1.6% |
| Change from actual first month of previous quarter | 0.6% |
| Change from same quarter of prior year (actual) | 0.5% |



Other Expenses Fourth Quarter 2012

PPI INDUSTRIAL COMMODITIES LESS FUELS AND RELATED PRODUCTS AND POWER

Recommended model: Exponential Smoothing
Forecast Model for PPILF
Holt exponential smoothing: Linear trend, No seasonality

| Component | Smoothing Weight | Final Value |
|-----------|------------------|-------------|
| Level | 1.00000 | 193.20 |
| Trend | 0.01719 | 0.31665 |

Within-Sample Statistics

| | |
|----------------------|---------------------------|
| Sample size 72 | Number of parameters 2 |
| Mean 181.3 | Standard deviation 8.992 |
| R-square 0.9854 | Adjusted R-square 0.9852 |
| Durbin-Watson 0.5165 | **Ljung-Box(18)=86.49 P=1 |
| Forecast error 1.095 | BIC 1.146 |
| MAPE 0.004286 | RMSE 1.08 |
| MAD 0.7835 | |

Actual Values for the Most Recent 6 Periods:

| Date | Actual |
|---------|---------|
| 2012-02 | 194.700 |
| 2012-03 | 195.700 |
| 2012-04 | 195.900 |
| 2012-05 | 195.600 |
| 2012-06 | 194.400 |
| 2012-07 | 193.200 |

Forecasted Values

| Date | 2.5 Lower | Forecast | 97.5 Upper |
|----------------|----------------|----------------|----------------|
| 2012-08 | 191.271 | 193.517 | 195.762 |
| 2012-09 | 190.630 | 193.833 | 197.037 |
| 2012-10 | 190.215 | 194.150 | 198.085 |
| 2012-11 | 189.917 | 194.467 | 199.016 |
| 2012-12 | 189.692 | 194.783 | 199.874 |
| QTR AVG | 189.941 | 194.467 | 198.992 |

Railroad and Union Abbreviations

Fourth Quarter 2012

Railroads

| | |
|------|--|
| BLE | Bessemer & Lake Erie Railroad (Part of CN's Grand Trunk Corp.) |
| BNSF | BNSF Railway Company |
| CC | Chicago, Central & Pacific (Part of CN's Grand Trunk Corp. Sometimes noted as CC&P.) |
| CN | Canadian National Railway (Commonly known as CN, owns Grand Trunk Corporation.) |
| CNGT | AAR's abbreviation for Grand Trunk Corporation (Almost all of CN's U.S. operations.) |
| CP | Canadian Pacific (Also noted as CPR. Owns the U.S. Class I railroad Soo Line.) |
| CSX | CSX Transportation |
| D&H | Delaware & Hudson (Canadian Pacific's U.S. operations, to be included beginning 2011Q4.) |
| DME | Dakota, Minnesota & Eastern (Canadian Pacific's U.S. operations, to be included beginning 2011Q4.) |
| DMIR | Duluth, Missabe & Iron Range Company (Part of CN's Grand Trunk Corp.) |
| DWP | Duluth, Winnipeg & Pacific Railway (Part of CN's Grand Trunk Corp.) |
| EJE | Elgin, Joliet & Eastern Railway (Part of CN's Grand Trunk Corp.) |
| GTW | Grand Trunk Western Railroad (Part of CN's Grand Trunk Corp.) |
| IC | Illinois Central Railroad (Part of CN's Grand Trunk Corp.) |
| KCS | Kansas City Southern Railway |
| NS | Norfolk Southern Combined Railroad Subsidiaries (a.k.a. Norfolk Southern Railway or NS Rail) |
| SOO | Soo Line Railroad (the largest of Canadian Pacific's U.S. operations.) |
| UP | Union Pacific Railroad |
| WC | Wisconsin Central and subsidiaries (Part of CN's Grand Trunk Corp.) |

Major Unions Involved with Railroads

| | |
|------------|---|
| ATDA | American Train Dispatchers Association |
| BLET | Brotherhood of Locomotive Engineers and Trainmen Div. of the International Brotherhood of Teamsters |
| BMWED | Brotherhood of Maintenance of Way Employees Division of the International Brotherhood of Teamsters |
| BRS | Brotherhood of Railroad Signalmen |
| IAM | International Association of Machinists and Aerospace Workers |
| IBBM | International Brotherhood of Boilermakers, Iron Ship Builders, Blacksmiths, Forgers & Helpers |
| IBEW | International Brotherhood of Electrical Workers |
| NCFO | National Conference of Firemen and Oilers |
| SMW | Sheet Metal Workers' International Association |
| TCU | Transportation Communication International Union |
| TCU-Carmen | Brotherhood of Railway Carmen Division of the Transportation Communications International Union |
| UTU | United Transportation Union |
| UTU-Yard | United Transportation Union Yardmaster Department (also noted as UTU-YMD) |

Predecessor Unions (Some AAR databases use these old abbreviations.)

| | |
|------|---|
| BLE | Brotherhood of Locomotive Engineers (predecessor to BLET) |
| BMWE | Brotherhood of Maintenance of Way Employees (predecessor to BMWED) |
| BRC | Brotherhood of Railway Carmen (predecessor to TCU-Carmen) |
| IBFO | International Brotherhood of Firemen and Oilers (predecessor to NCFO) |