



ASSOCIATION  
OF AMERICAN  
RAILROADS

**John T. Gray**  
Senior Vice President - Policy & Economics

June 7, 2012

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

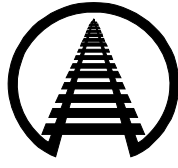
Dear Ms. Brown:

Attached are two revised pages to the AAR forecast of the third quarter 2012 All-Inclusive Index and Rail Cost Adjustment Factor, filed on June 5, 2012 with the Surface Transportation Board (STB) in ex Parte No. 290 (Sub-No. 5)(2012-3), Quarterly Rail Cost Adjustment Factor. The revision concerns only three of the percent change numbers on each page. The indices are not affected. If there are any questions, please contact me or Clyde Crimmel (202 639-2309).

Sincerely,

John T. Gray

Attachments



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Dear Ms. Brown:

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	<u>2012Q2</u>	<u>2012Q3</u>	<u>% Change</u>
All-Inclusive Index	120.7	117.7	-2.5 <i>r</i>
Preliminary RCAF	1.207	1.177	-2.5 <i>r</i>
Forecast Error Adjustment	-0.022	-0.006	
RCAF (Unadjusted)	1.185	1.171	-1.2 <i>r</i>
Productivity Adjustment Factor	2.2769	2.2815	
RCAF (Adjusted)	0.520	0.513	-1.3
PAF-5	2.4062	2.4146	
RCAF-5	0.492	0.485	-1.4

## Rail Cost Adjustment Factor

### Third Quarter 2012

### Revised June 7, 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 2012Q2	Current 2012Q3	Percent Change
All-Inclusive Index <sup>1</sup>	120.7	117.7	-2.5 <i>r</i>
Preliminary RCAF <sup>2</sup>	1.207	1.177	-2.5 <i>r</i>
Forecast Error Adjustment <sup>3</sup>	<u>-0.022</u>	<u>-0.006</u>	
RCAF (Unadjusted) <sup>4</sup>	1.185	1.171	-1.2 <i>r</i>
Productivity Adjustment Factor <sup>5</sup>	<u>2.2769</u>	<u>2.2815</u>	
RCAF (Adjusted) <sup>6</sup>	0.520	0.513	-1.3
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RCAF-5 <sup>8</sup>	0.492	0.485	-1.4

<sup>1</sup> See All-Inclusive Index on page 3.

<sup>2</sup> All-Inclusive Index divided by the All-Inclusive Index in the base period (100.0).

<sup>3</sup> 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.

<sup>4</sup> Preliminary RCAF plus the forecast error adjustment.

<sup>5</sup> See Productivity on page 5.

<sup>6</sup> RCAF (Unadjusted) divided by the Productivity Adjustment Factor (PAF).

<sup>7</sup> See Productivity on page 5.

<sup>8</sup> RCAF (Unadjusted) divided by the PAF-5.



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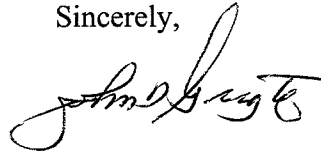
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	<u>2012Q2</u>	<u>2012Q3</u>	<u>% Change</u>
All-Inclusive Index	120.7	117.7	-2.4
Preliminary RCAF	1.207	1.177	-2.4
Forecast Error Adjustment	-0.022	-0.006	
RCAF (Unadjusted)	1.185	1.171	-1.1
Productivity Adjustment Factor	2.2769	2.2815	
RCAF (Adjusted)	0.520	0.513	-1.3
PAF-5	2.4062	2.4146	
RCAF-5	0.492	0.485	-1.4

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 cursive script, appearing to read "John T. Gray".

John T. Gray

Attachments

**Third Quarter 2012  
All-Inclusive Index**

**Ex Parte No. 290 (Sub-No. 5) (2012-3)**

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

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

**June 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 third quarter 2012.

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. In the case of the 2012Q1 index, the change does not affect the All-Inclusive Index or any versions of the RCAF. However, we used the corrected version of the Materials & Supplies Index (263.6) as the actual in this quarter's forecast error adjustment calculation, and the original as-filed Materials & Supplies Index (263.7) as the forecast.

In the case of the 2012Q2 Index, the Materials & Supplies Index has been recalculated using the corrections for both quarters, and the resulting Materials & Supplies Index is 0.1 index points lower. This causes a recalculated Preliminary RCAF and RCAF-U to each be 0.1 index points lower, but has no impact on the RCAF-A or RCAF-5. In the 2012Q4 RCAF filing, which uses 2012Q2 for the forecast error calculation – we plan to use the corrected Materials & Supplies Index (274.0) as the actual, and the original as-filed number (274.1) as the forecast.

For the 2012Q3 Index, the Materials & Supplies Index has been calculated with the first and second quarter revisions – so the index matches the value it would be if the revised numbers were in the original submissions. For calculation of the 2012Q3 Index, the recalculated 2012Q2 All-Inclusive Index was used for calculation purposes, although the result is the same using either the original or recalculated All-Inclusive Index for 2012Q2.



## 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 2010 (current) and 2009 (previous) weights are shown below. The previous (2009) weights were used for the fourth quarter of 2010 through the third quarter of 2011. Beginning with the fourth quarter of 2011, the 2010 weights are used. The year 2010 was a recovery year from the reduced traffic levels of 2009, and operating expenses increased in every category. Fuel expenses increased by the highest percentage and amount, caused by increased traffic and higher fuel prices. Not surprisingly, Fuel's weight rebounded from 14.9 percent to 18.0 percent. This is the fourth highest weight ever for Fuel. The only other category to have its weight increase was Other, which had the second highest percentage increase in expenses. (Most of Other is purchased services, portions of general & administrative expenses, and property taxes.) Labor's weight decreased from 34.7 to 33.3 percent, despite increases in expenses. Weights for Depreciation and Equipment Rents decreased by 1.1 and 0.9 percentage points, respectively. Changes for the remaining categories were decreases of 0.1 percentage points.

RCAF Weights		
	Previous 2009	Current 2010
Labor	34.7 %	33.3 %
Fuel	14.9	18.0
Materials & Supplies	5.1	5.0
Equipment Rents	7.1	6.2
Depreciation	13.9	12.8
Interest	3.0	2.9
Other	21.3	21.8

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 Third 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.

	2010 Weights	Forecast		Percent Change
		Previous* 2012Q2	Current 2012Q3	
1. Labor	33.3%	385.8	391.4	1.5 %
2. Fuel	18.0%	409.4	353.4	-13.7
3. M&S	5.0%	274.0	274.8	0.3
4. Equipment Rents	6.2%	204.8	205.8	0.5
5. Depreciation	12.8%	211.4	211.7	0.1
6. Interest	2.9%	90.6	90.6	0.0
7. Other	21.8%	218.8	221.6	1.3
8. Weighted Average				
a. 1980 = 100		305.9	298.5	
b. 1980 = 100 (linked)		296.6	289.4 <sup>1</sup>	
c. 4Q07 = 100		120.6	117.7 <sup>2</sup>	-2.4

\* 2012Q2 has been recalculated on this page for the purpose of calculating 2012Q3 (although it makes no difference). See fourth paragraph on page 1. The original 4Q07=100 Index was 120.7.

---

<sup>1</sup> To calculate the 1980 = 100 Linked Index:

$$\begin{aligned} \text{Index}_{80} &= (\text{Current Index} / \text{Previous Index}) * \text{the Previous Quarter Linked Index} \\ &= (298.5 / 305.9) \times 296.6 \\ &= 289.4 \end{aligned}$$

<sup>2</sup> To calculate the 4Q07 = 100 index:

$$\begin{aligned} \text{Index}_{4Q07} &= (\text{Current Linked Index} / 4Q07 Linking Factor) * 100 \\ &= 289.4 \text{ divided by } 245.9 \text{ times } 100 \\ &= 117.7 \end{aligned}$$

Indexes based on other periods:

- 4Q02 based index = 289.4 / 192.1 x 100 = 150.7
- 4Q97 based index = 289.4 / 173.2 x 100 = 167.1
- 4Q92 based index = 289.4 / 156.9 x 100 = 184.4
- 4Q87 based index = 289.4 / 132.2 x 100 = 218.9

## Forecast vs. Actual All-Inclusive Index First Quarter 2012

Because of data availability, the forecast error adjustment has a two-quarter lag from each filing. As shown below, the first quarter actual index of 117.0 is 0.6 index points below the forecast value of 117.6. Therefore, the forecast error adjustment for third quarter 2012 is -0.6 index points.

	2010 Weights	First Quarter 2012		Amt Difference
		Forecast	Actual	
1. Labor	33.3%	379.4	379.4	
2. Fuel	18.0%	387.7	375.7	
3. M&S	5.0%	263.7	263.6 <sup>1</sup>	
4. Equipment Rents <sup>2</sup>	6.2%	203.4	205.3	
5. Depreciation	12.8%	208.7	210.3	
6. Interest	2.9%	90.6	90.6	
7. Other	21.8%	215.6	218.3	
8. Weighted Average				
a. 1980 = 100		298.3	297.0	
b. 1980 = 100 (linked)		289.2	287.6 <sup>3</sup>	
c. 4Q07 = 100 <sup>4</sup>		117.6	117.0	-0.6

**Forecast error**       $\longrightarrow$  **-0.6 index points**

<sup>1</sup> During April 2012, one railroad revised data used for the 2012Q1 Materials & Supplies Index. While the change had no impact on the All-Inclusive index or any versions of the RCAF, it caused the Materials & Supplies Index to be 0.1 index points lower. Therefore, the forecast error calculation for 2012Q3, which is based on 2012Q1, uses the original number as "forecast" (263.7), and the corrected number as "actual" (263.6).

	2010 Weights	First Quarter 2012	
		Forecast	Actual
Car-Hire	45.8%	175.5	176.2
Lease Rentals	54.2%	215.6	218.3
Weighted Average		197.2	199.0
Weighted Average (linked)		203.4	205.3

<sup>3</sup> Linked actual index = (actual index / previous actual index) x previous linked actual index.  
 $287.6 = 297.0 / 294.6 \times 285.3$

<sup>4</sup> 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.

<b>Comparison of Output, Input, &amp; Productivity</b>			
<b>2006 - 2010</b>			
Year	Output Index (1)	Input Index (2)	Productivity <sup>1</sup> 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
<b>Average</b>			<b>1.008</b>
Previous Average (2005-2009)			1.014

<sup>1</sup> 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

2005-2009

2006-2010

## Rail Cost Adjustment Factor Third 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 2012Q2	Current 2012Q3	Percent Change
All-Inclusive Index <sup>1</sup>	120.7	117.7	-2.4
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<sup>1</sup> See All-Inclusive Index on page 3.

<sup>2</sup> All-Inclusive Index divided by the All-Inclusive Index in the base period (100.0).

<sup>3</sup> 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.

<sup>4</sup> Preliminary RCAF plus the forecast error adjustment.

<sup>5</sup> See Productivity on page 5.

<sup>6</sup> RCAF (Unadjusted) divided by the Productivity Adjustment Factor (PAF).

<sup>7</sup> See Productivity on page 5.

<sup>8</sup> RCAF (Unadjusted) divided by the PAF-5.

# Appendixes

## Labor

### Third Quarter 2012

The third quarter 2012 Labor Index is forecast to rise 1.5 percent from the previous quarter. Much of the increase was the net result of general wage increases offset by lower health & welfare costs.

**New National Agreement:** The new national labor agreement for the Brotherhood of Maintenance of Way Employees Division-International Brotherhood of Teamsters (BMWED) has been added to the index. Like most of the other labor agreements, this contract has a lump sum payment and retroactive wage increases. The retroactive wage increases were 2 percent effective July 1, 2010, and 2.5 percent effective July 1, 2011. These increases caused back pay to be necessary, which (following standard procedure) will be amortized over four quarters.

### Wage Rate Index

The Wage Rate Index portion of the Labor Index increased 3.9 percent from the previous quarter. Most labor agreements had wage increases scheduled for July 1, and back pay for the new BMWED contract was added.

**Wage Increases:** The UTU and UTU-Yardmaster national labor agreements have a 3 percent general wage increase effective July 1, while the other national union contracts (including the new BMWED agreement) have a 4.3 percent wage increase. [See Appendix H for a list of railroad and union abbreviations.] Independent wage increases were typically national-like or cost of living adjustment increases of 12 cents, although one agreement has a 2 percent general wage increase.

**Lump Sums:** The third quarter lump sum rate increased 3.2 cents (or \$0.032). The increase was caused by the addition of bonus payments from the new national labor agreements for the BLET and BMWED. The BLET amount was "diluted" by independent agreements that do not participate in the wage portion of the national agreement. Two small lump sum amounts for one year ago were completely amortized and removed from the index.

**Back Pay:** Four back pay amounts were added (and one was completely amortized and removed) to the third quarter rate, netting to an increase of 38.5 cents. The largest amount was related to the new national BMWED labor agreement. Two other amounts were related to independent agreement, including one with a large railroad and one of its largest unions. Some back pay was also owed to the machinists participating in the national IAM labor agreement, since their employee health & welfare cost sharing contribution was lowered retroactively effective January 1. As always, index procedure dictates that back pay amounts are amortized over 4 quarters instead of applied entirely in one quarter.

**Other:** In wages, "Other" contains the amortization of incentive compensation payments that a large railroad makes each year to its dispatchers, yardmasters, and engineers. The payment made in early 2011 is now completely amortized, and has been replaced with the payment made in early 2012. The 2012 payment was lower than the previous year, causing the decrease in the rate.

## Labor

### Third Quarter 2012

#### Supplements Index

The Supplements Index decreased 1.6 percent. Major factors for the change were lower health & welfare costs and higher Railroad Retirement costs caused by higher taxable earnings.

**Health & Welfare:** Normally, new health & welfare premiums become effective on January 1. Because of labor agreement negotiations, the premiums in effect for 2011 continued into the first and second quarters. New health & welfare premiums are now available, and they are *retroactive to* January 1 (with one exception). The new premiums are generally lower (see pages 4 and 6 of this Appendix), and railroads will be able to take a credit for overpayment earlier in the year (see page 5 of this Appendix). Keeping aligned with index procedure for back pay and lump sums, the credit for overpayment in health & welfare costs will be spread over four quarters instead of taken all in one quarter. The credit causes a decrease of about 21 cents per hour. Employee cost sharing, which was lowered to \$198 per month effective July 1, is a small offset to the lower premiums and overpayment credit. The net result of lower premiums, an overpayment credit, and lower employee cost sharing contributions is a decrease in the hourly rate for health & welfare of nearly 57 cents per hour.

**Railroad Retirement:** The Railroad Retirement & Medicare rate increased 3.1 percent because of higher taxable earnings.

**Unemployment Insurance:** The Unemployment Insurance rate increased \$0.001 because of higher taxable earnings.

**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 increase was caused by 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 3.9 percent increase in the Wage Index and the 1.6 percent decrease in the Supplements Index had a combined effect of a 1.5 percent increase in the Labor Index. The linked third quarter 2012 index is 391.4.



## Labor Third Quarter 2012

**Table A-1 Labor Index**

	2012Q2	2012Q3	Change	
			Percent	Amount
<u>Base Wage</u> – Straight Time & Pay For Time Not Worked	\$35.956	\$37.082	3.1%	\$1.126
Adjustments:				
Lump Sum	0.414	0.446	7.7%	0.032
Back Pay	0.707	1.092	54.5%	0.385
Other	0.195	0.128	-34.4%	-0.067
<b>Total Wages</b>	<u>37.272</u>	<u>38.748</u>	4.0%	1.476
Health & Welfare Benefits	8.554	7.985	-6.7%	-0.569
RR Retirement & Medicare	7.363	7.588	3.1%	0.225
Unemployment Insurance	0.433	0.434	0.2%	0.001
Other	0.133	0.219	64.7%	0.086
<b>Total Supplements</b>	<u>\$16.483</u>	<u>\$16.226</u>	-1.6%	-0.257
Total Labor	\$53.755	\$54.974		
<b>Wage Index<sup>1</sup></b>	319.0	331.6	3.9%	
<b>Supplements Index<sup>2</sup></b>	609.1	599.6	-1.6%	
Total labor Index, 2010 Weights <sup>3</sup>	406.6	412.5		
<b>Labor Index (linked)<sup>4</sup></b>	<b>385.8</b>	<b>391.4</b>	1.5%	

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<sup>1</sup> 1980 wage rate \$11.685

<sup>2</sup> 1980 supplements rate \$2.706

<sup>3</sup> 2010 weights: wages, supplements 69.8% 30.2%

<sup>4</sup> 2012Q3 linked Index = 2012Q2 linked x (2012Q3 / 2012Q2)  
 = 385.8 x 412.5 / 406.6

**Labor**  
**Third Quarter 2012**  
**Supplement Comparisons**

**Health and Welfare Rates** (retroactive to January 1 unless noted otherwise)

Plan	Railroad Contribution Per Employee Per Month			Change	
	2010	2011	2012	'10-'11	'11-'12
Group Health & Life	\$1,305.91	\$1,401.06	\$1,349.77	7.3%	-3.7%
Early Retirement Major Medical	155.96	164.41	154.49	5.4%	-6.0%
Group Dental	57.29	59.47	55.90	3.8%	-6.0%
Group Vision	10.41	10.46	10.71	0.5%	2.4%
Supplemental Sickness					
Maintenance of Way	24.90	36.52	36.52	46.7%	0.0%
Shop Crafts	25.71	48.28	48.28	87.8%	0.0%
Signalmen	8.65	25.62	25.62	196.2%	0.0%
Yardmasters (eff 5/1/12)	32.16	33.48	34.95	4.1%	4.4%

Note: Supplemental Sickness for MOW, shop crafts, and signalmen, did not change for 2012.

**Labor**  
**Third Quarter 2012**

**NATIONAL RAILWAY LABOR CONFERENCE**  
**EMPLOYEE BENEFITS DEPARTMENT**

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April 13, 2012

**CONTINUED PARTICIPATION IN**  
**THE RAILROAD EMPLOYEES NATIONAL HEALTH AND WELFARE PLAN ("NH&W")**  
**NATIONAL RAILWAY CARRIERS and UNITED TRANSPORTATION UNION**  
**HEALTH & WELFARE PLAN ("NRC/UTU")**  
**EFFECTIVE JANUARY 1, 2012**

**CIRCULAR NO. 504-41-50**  
**CIRCULAR NO. 843-1-20**

**TO: MEMBER ROADS AND OTHER PARTICIPATING RAILROADS**

Our Circulars in these series provide information about the continuation of the Plans named above and the applicable Payment Rates. You'll recall that by multi-numbered Circulars 504-41-49 etc, dated November 30, 2011, we advised that the 2011 Payment Rates would continue into 2012 until such time as appropriate rates could be developed. New rates for 2012 have now been set, which are retroactively effective January 1, 2012. Note that for the NH&W and NRC/UTU Plans, the 2012 Payment Rates are lower than the 2011 Payment Rates, therefore, **you will be able to take a credit equal to the amount that you will have overpaid based on these new rates.**

**Labor**  
**Third Quarter 2012**

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May 7, 2012

Mr. Clyde Crimmel  
Director Statistical Information  
Policy & Communications Department  
AAR-5th Floor  
50 F Street N.W.  
Washington, D.C. 20009

Dear Mr. Crimmel:

The revised employer Payment Rates which are effective January 1, 2012 (unless otherwise noted) are as follows:

Aetna - Supplemental Sickness Plans		
ShopCrafts	(no change)	\$ 48.28
Signalmen	(no change)	\$ 25.62
Maintenance of Way	(no change)	\$ 36.52
Trustmark - Supplemental Sickness Plans		
Yardmasters	(eff 5/1/12)	\$ 34.95
Railroad Employees National Health & Welfare Plan & National Railway Carriers/United Transportation Union H&W Plan		
Non-Hospital Road		\$1,349.77
Railroad Employees National Early Retirement		
Major Medical Benefit Plan		
Non-Hospital Road		\$ 154.49
Aetna - National Dental Plan		\$ 55.90
VSP - National Vision Plan		\$ 10.71

If you have any questions or need clarification, please contact me.

Very truly yours,



Susan E. Parks

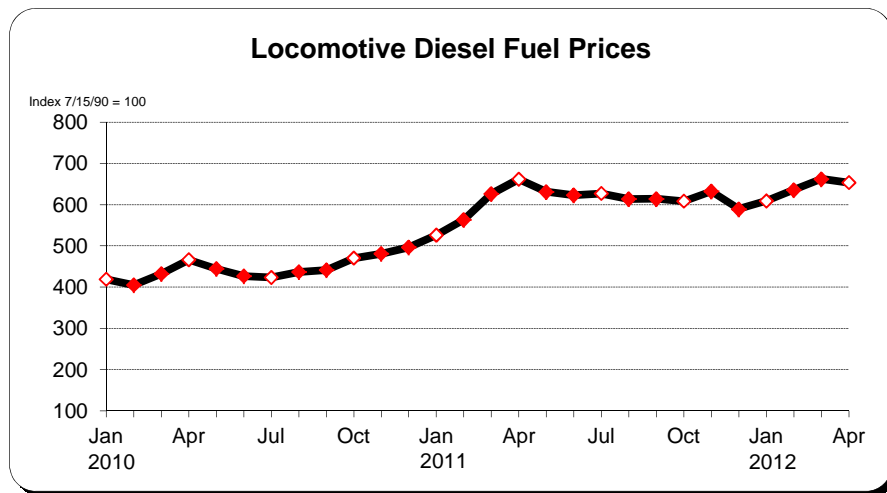
cc: Glen Williams

## Fuel Third 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.

Locomotive diesel fuel prices decreased in April, and are 1.2 percent lower than their price one year ago. While average prices for locomotive diesel fuel are not currently available after April, the Energy Information Administration (EIA) has weekly data in May for related fuel types. EIA data show declining futures prices for heating oil\* and crude oil.\*\* In addition, on-highway diesel fuel prices are decreasing.

Railroads believe locomotive diesel fuel prices for July 2012 (Q3) will be 13.7 percent lower than the second quarter forecast (represented by April 2012).



Forecast Fuel Index	353.4
Change from previous quarter forecast	-13.7%
Change from previous quarter actual	-12.4%

\* 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.

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

## Materials & Supplies Third Quarter 2012

The third quarter 2012 Materials & Supplies Index increased 0.3 percent from its revised second quarter value (see note below). The change was the net result of slightly higher prices for the Forest Products and Metal Products categories, offset by slightly lower prices for Miscellaneous Products.

2012Q3 Materials & Supplies Index =	274.8	
2012Q2 <u>Materials &amp; Supplies Index =</u>	<u>274.0</u>	revised from 274.1 (see note below)
Difference	0.8 basis points	
	or	
	0.3 %	

**Note:** During April, the AAR received corrections to the price for one item used for the 2012Q1 RCAF and another item used in the 2012Q2 RCAF. The first correction decreases the M&S Index by 0.1 index points, but does not affect the All-Inclusive Index. The second quarter correction, in combination with the recalculated Q1, also decreases the M&S Index by 0.1 index points compared to the filed version. This causes a recalculated Q2 All-Inclusive Index, and a recalculated RCAF-U, to decrease by 0.1 index points. Recalculated RCAF-A and RCAF-5 indices were not affected.

The AAR notified the Surface Transportation Board of the corrections. For the current 2012Q3 RCAF calculation, the M&S Index has been calculated as if the 2012Q1 and 2012Q3 indices used the corrected prices, as has the RCAF.

For the 2012Q3 forecast error calculation, the as-filed 2012Q1 M&S Index is the forecast (263.7), and the corrected 2012Q1 M&S Index is the actual (263.6). For the 2012Q4 RCAF filing in September, the plan for the forecast error calculation is to use the 2012Q2 as-filed M&S Index (274.1) as the forecast, and the revised M&S Index (274.0) as the actual.

## Equipment Rents Third 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

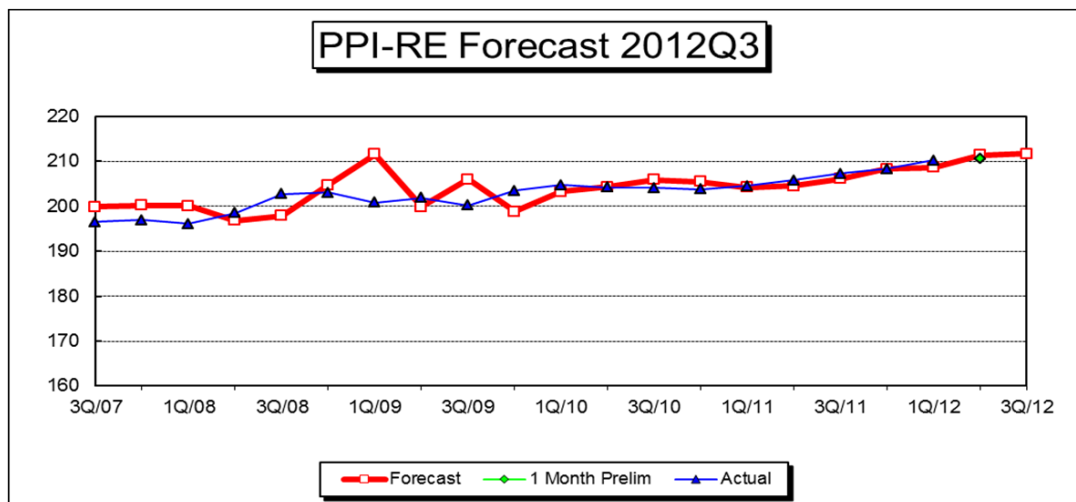
The table below calculates the Equipment Rent Index, which increased 0.5 percent. The third quarter Car Hire portion of the Index decreased 0.7 percent because of lower rates for railroad-owned cars. A 1.3 percent increase for the projected PPI-LF (See Appendix G) used as a proxy for Lease Rentals, combined with the 0.7 percent decrease for Car Hire, caused the Equipment Rent Index to increase 0.5 percent.

	2010			Percent
	Weight	2012Q2	2012Q3	Change
Car Hire	45.8%	174.8	173.6	-0.7 %
Lease Rentals	54.2%	218.8	221.6	1.3
Weighted Average		198.6	199.6	0.5
Weighted Average (Linked)		204.8	205.8	0.5

## Depreciation Third 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 have had changed very little in recent months.

Forecast of Depreciation Index (1982=100)	191.4
Forecast of Depreciation Index (1980=100)	211.7
Change from previous quarter forecast	0.1%
Change from actual first month of previous quarter	0.5%
Change from same quarter of prior year (actual)	2.1%





## Depreciation Third 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	0.81045	190.42
Trend	0.01645	0.25689

### Within-Sample Statistics

Sample size 72	Number of parameters 2
Mean 181.2	Standard deviation 5.489
R-square 0.9671	Adjusted R-square 0.9666
Durbin-Watson 2.017	Ljung-Box(18)=24.43 P=0.8587
Forecast error 1.003	BIC 1.049
MAPE 0.003736	RMSE 0.9885
MAD 0.6719	

### Actual Values for the Most Recent 6 Periods:

Date	Actual
2011-11	187.700
2011-12	189.900
2012-01	189.900
2012-02	190.200
2012-03	190.200
2012-04	190.400

### Forecasted Values

Date	2.5 Lower	Forecast	97.5 Upper
2012-05	188.621	190.677	192.733
2012-06	188.270	190.934	193.598
2012-07	188.034	191.191	194.347
2012-08	187.865	191.448	195.030
2012-09	187.742	191.704	195.667
<b>QTR AVG</b>	<b>187.880</b>	<b>191.448</b>	<b>195.015</b>

## Interest Third 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 2011, the Interest Index is based on data for 2010.

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 Obligatons - Non-Current
44	Debt in Default - Non-Current
45	Accounts Payable: Affiliated Companies - Non-Current
46	Unamortized Debt Premium - Non-Current

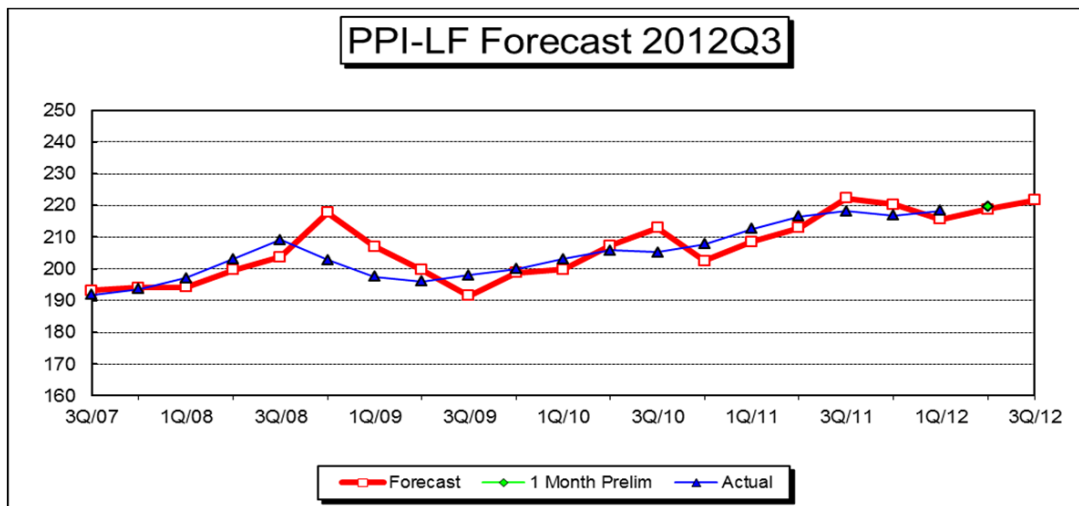
2010	Interest Rate	7.11%
1980	Interest Rate	7.85%
<b>2012Q3</b>	<b>Interest Index</b>	<b>90.6</b>
2012Q2	Interest Index	90.6
	Percent Change	0.0%

## Other Expenses Third 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 increased for 4 consecutive months.

Forecast of Other Expense Index (1982=100)	197.7
Forecast of Other Expense Index (1980=100)	221.6
Change from previous quarter forecast	1.3%
Change from actual first month of previous quarter	0.9%
Change from same quarter of prior year (actual)	1.6%



## Other Expenses Third 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	195.90
Trend	0.03165	0.43844

#### Within-Sample Statistics

Sample size 72	Number of parameters 2
Mean 180.2	Standard deviation 9.012
R-square 0.9863	Adjusted R-square 0.9861
Durbin-Watson 0.5414	**Ljung-Box(18)=100.3 P=1
Forecast error 1.062	BIC 1.111
MAPE 0.004019	RMSE 1.047
MAD 0.7312	

#### Actual Values for the Most Recent 6 Periods:

Date	Actual
2011-11	193.200
2011-12	192.700
2012-01	193.500
2012-02	194.800
2012-03	195.800
2012-04	195.900

#### Forecasted Values

Date	2.5 Lower	Forecast	97.5 Upper
2012-05	194.160	196.338	198.517
2012-06	193.647	196.777	199.906
2012-07	193.363	197.215	201.068
2012-08	193.194	197.654	202.114
2012-09	193.098	198.092	203.086
<b>QTR AVG</b>	<b>193.218</b>	<b>197.654</b>	<b>202.089</b>

## Railroad and Union Abbreviations

### Third 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)