

ASSOCIATION
OF AMERICAN
RAILROADS

Craig F. Rocky
Vice President - Policy & Economics

December 6, 2004

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board, Room 711
1925 K Street, N.W.
Washington, DC 20423-0001

Dear Mr. Williams:

This submission is the AAR forecast of the first quarter 2005 All-Inclusive Index and Rail Cost Adjustment Factor, filed in Ex Parte No. 290 (Sub-No. 5) (2005-1), *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 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 first quarter 2005 results on the fourth quarter 2002 base, and shows the percentage changes from the previous quarter.

	<u>2004Q4</u>	<u>2005Q1</u>	<u>% Change</u>
All-Inclusive Index	107.5	109.7	2.0
Preliminary RCAF	1.075	1.097	2.0
Forecast Error Adjustment	0.022	0.010	
RCAF (Unadjusted)	1.097	1.107	0.9
Productivity Adjustment Factor	2.0163	2.0274	
RCAF (Adjusted)	0.544	0.546	0.4
PAF-5	2.1147	2.1263	
RCAF-5	0.519	0.521	0.4

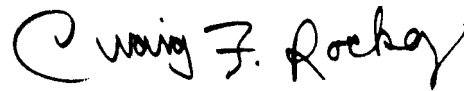
Page 2

December 6, 2004

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.

Two copies of the quarterly non-proprietary workpapers underlying this submission are 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 third copy of the working papers has been delivered to Jeff Warren in 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 that reads "Craig F. Rockey". The signature is written in a cursive style with a large, stylized initial "C".

Craig F. Rockey

Attachments

**First Quarter 2005
All-Inclusive Index**

Ex Parte No. 290 (Sub-No. 5) (2005-1)

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

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

December 6, 2004

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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, employs 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 first quarter of 2005.

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 previous (2002) weights were used for the fourth quarter of 2003 through the third quarter of 2004. Beginning with the fourth quarter of 2004, the 2003 weights are used. The biggest change in the weights was for Fuel, which increased by 1.6 percentage points, close to its weight based on 2001 data. The Other component increased again, this time by 0.7 percentage points. The remaining changes were decreases of less than one percentage point. The 2003 (current) and 2002 (previous) weights are shown below.

RCAF Weights		
	Previous 2002	Current 2003
Labor	38.0 %	37.5 %
Fuel	9.0	10.6
Materials & Supplies	4.6	4.4
Equipment Rents	10.3	9.4
Depreciation	10.9	10.7
Interest	3.7	3.2
Other	23.5	24.2

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 First Quarter 2005

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.

	2003 Weights	Forecast		Percent Change
		Previous 2004Q4	Current 2005Q1	
1. Labor	37.5%	286.8	290.3	1.2 %
2. Fuel	10.6%	148.3	171.5	15.6
3. M&S	4.4%	169.7	165.2	-2.7
4. Equipment Rents	9.4%	178.3	179.9	0.9
5. Depreciation	10.7%	162.4	161.3	-0.7
6. Interest	3.2%	90.2	90.2	0.0
7. Other	24.2%	173.3	176.3	1.7
8. Weighted Average				
a. 1980 = 100		209.7	214.0	
b. 1980 = 100 (linked)		206.5	210.7 ¹	
c. 4Q02 = 100		107.5	109.7 ²	2.0

¹ To calculate the 1980 = 100 Linked Index:

$$\text{Index}_{80} = (\text{Current Index} / \text{Previous Index}) * \text{the Previous Quarter Linked Index}$$

$$= 214.0 \text{ divided by } 209.7 \text{ times } 206.5$$

$$= 210.7$$

² To calculate the 4Q02 = 100 index:

$$\text{Index}_{4Q02} = (\text{Current Linked Index} / 4Q02 \text{ Linking Factor}) * 100$$

$$= 210.7 \text{ divided by } 192.1 \text{ times } 100$$

$$= 109.7$$

4Q97 based index = 121.7
 4Q92 based index = 134.3
 4Q87 based index = 159.4

Forecast vs. Actual All-Inclusive Index Third Quarter 2004

As shown below, the third quarter actual index of 106.5 is 1.0 index points above the forecast value of 105.5. Therefore, the forecast error adjustment for the first quarter 2005 is 1.0 index points.

	2002 Weights	Third Quarter 2004		Amt Difference
		Forecast	Actual	
1. Labor	38.0%	281.9	281.9	
2. Fuel	9.0%	137.7	144.7	
3. M&S	4.6%	160.3	160.3	
4. Equipment Rents ¹	10.3%	177.0	177.2	
5. Depreciation	10.9%	159.6	160.3	
6. Interest	3.7%	98.0	98.0	
7. Other	23.5%	171.4	171.1	
8. Weighted Average				
a. 1980 = 100		206.4	207.1	
b. 1980 = 100 (linked)		202.6	204.5 ²	
c. 4Q02 = 100 ³		105.5	106.5	1.0

Forecast error \longrightarrow **1.0 index points**

¹	2002 Weights	Third Quarter 2004	
		Forecast	Actual
Car-Hire	50.6%	171.7	171.8
Lease Rentals	49.4%	171.4	171.1
Weighted Average		171.6	171.5
Weighted Average (linked)		177.0	177.2

² Linked actual index = (actual index / previous actual index) x previous linked actual index.
 $204.5 = 207.1 / 203.9 \times 201.3$

³ The 4Q02 based indexes are 1980 based indexes divided by the 4Q02 linking factor (192.1/100).
 4Q97 based indexes are the 1980 based indexes divided by the 4Q97 linking factor (173.2/100).
 4Q92 based indexes are the 1980 based indexes divided by the 4Q92 linking factor (156.9/100).

Productivity

On January 12, 2004, the Surface Transportation Board (STB) served a decision in Ex Parte 290 (Sub-No. 4) which added the year 2002 to the Productivity Adjustment Factor (PAF) and deleted the year 1997. This creates an average annual productivity for 1998 through 2002 of 2.2 percent – an increase from the 1997 through 2001 average of 1.9 percent. The components of this average annual value are shown on the following table. Productivity changes are calculated by dividing the output index by the input index. The average annual rate is calculated by multiplying each of the five productivity changes together and taking the result to the one fifth power. The quarterly 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 average annual growth rate. The difference between the PAF and the PAF-5 is the timing of the 5-year productivity trend.

Comparison of Output, Input, & Productivity			
1998 - 2002			
Year	Output Index (1)	Input Index (2)	Productivity ¹ Changes (3)
1998	1.006	1.018	0.988
1999	1.032	1.008	1.024
2000	1.029	0.953	1.079
2001	0.971	0.955	1.016
2002	1.012	1.006	1.006
Average			1.022
Previous Average (1997-2001)			1.019

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 1998-2002 use fourth root of avg. productivity change			1.0055
For 1997-2001 use fourth root of previous avg. change			1.0047
Quarter	Year	PAF	PAF-5
Q1	2004	1.9834	2.0852
Q2	2004	1.9943	2.0950
Q3	2004	2.0053	2.1048
Q4	2004	2.0163	2.1147
Q1	2005	2.0274	2.1263

Rail Cost Adjustment Factor

First Quarter 2005

Four RCAF values are presented in this filing. Two of the indexes, the All-Inclusive Index and the Unadjusted RCAF, are not modified for productivity, while the Adjusted RCAF and the RCAF-5 incorporate a productivity calculation. The All-Inclusive Index and all four RCAF values, plus the percent change for each, are shown below.

	Previous 2004Q4	Current 2005Q1	Percent Change
All-Inclusive Index ¹	107.5	109.7	2.0
Preliminary RCAF ²	1.075	1.097	2.0
Forecast Error Adjustment ³	<u>0.022</u>	<u>0.010</u>	
RCAF (Unadjusted) ⁴	1.097	1.107	0.9
Productivity Adjustment Factor ⁵	2.0163	2.0274	
RCAF (Adjusted) ⁶	0.544	0.546	0.4
PAF-5 ⁷	2.1147	2.1263	
RCAF-5 ⁸	0.519	0.521	0.4

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

First Quarter 2005

The first quarter 2005 Labor Index is forecast to increase 1.2 percent, caused mostly by wage increases and higher health & welfare costs. Table A-1 on page four of this appendix lists the hourly rates for wages and supplements used to calculate the Labor Index. Appendix H lists the abbreviations for railroads and unions used here.

Wage Index

The Wage Index is forecast to increase 1.8 percent. Significant factors in the increase include a new national agreement, a non-union wage increase, cost-of-living allowance increases for three national unions, and independent rate increases.

New National Contract: A new national agreement (effective November 5, 2004) with the International Brotherhood of Electrical Workers (IBEW) was added to the first quarter index. The agreement, which contains retroactive wage increases and employee health & welfare cost sharing, affects a group of railroads that includes 5 Class I railroads. Highlights of the new contract are listed below.

COLA: 27 cents of the cost-of-living allowance (COLA) is rolled into basic rates of pay effective October 1, 2001. COLAs terminate effective June 30, 2002. COLAs received after June 30, 2002 will be offset against retroactive wage payments. COLAs could resume beginning July 2005.

Wage Increases: Four retro-active wage increases: 2.5 percent effective June 30, 2002; 3.5 percent July 1, 2002; 3.0 percent effective July 1, 2003; and 3.25 percent on July 1, 2004.

Employee Cost Sharing: IBEW employees will participate in health & welfare cost sharing by making a pre-tax contribution toward health & welfare premiums. Effective July 1, 2001, 2002, and 2003, the monthly per employee health & welfare contribution will be \$33.39, \$81.18, and \$91.38, respectively. Effective July 1, 2004, the cost sharing rate changes to \$100 per month per employee. Retroactive employee health & welfare cost sharing will be offset against retroactive wage payments.

National Increases: In addition to the IBEW wage increases, three other sets of increases were also applied to the first quarter 2005 index. As done in previous years, non-union employees were given a wage increase similar to that of largest union. The 3 percent non-union wage increase matches the increase received by the UTU and UTU-Yardmasters on December 1. The first quarter index is also now receiving the full impact of the UTU and UTU-Yardmaster increase – it had only a one third impact for the fourth quarter 2004. Some unions are still receiving cost-of-living allowances from 1996 agreements. The IAM, NCFO, and SMW received 12 cent COLA increases.

Labor

First Quarter 2005

Independent Increases: For the first quarter of 2005, the Norfolk Southern Brotherhood of Locomotive Engineers received a 4 percent general wage increase. Many Soo Line unions are still receiving COLAs, and had the 12 cent COLA increase added. Three Soo Line unions (UTU, TCU, BRC) signed new agreements that included retroactive wage increases and health & welfare cost sharing. The non-union wage increase of 3 percent was also assigned to UP and IC's dispatchers, plus various employee groups from CN's Wisconsin Central, the Chicago, Central & Pacific, the Duluth, Winnipeg & Pacific, and the Sault Saint Marie Bridge Company.

Lump Sums: Most of the \$0.018 increase in the lump sum rate was caused by a signing bonus that was part of the new agreement between BNSF and its dispatchers. In addition, the new SOO agreement with the UTU had a Longevity Bonus.

Back Pay: The increase in the back pay rate was caused by back pay amounts that resulted from the new national agreement with the IBEW plus Soo Line's new agreements with the UTU, TCU, and TCU-Carmen. Some small amounts were generated by the new BNSF dispatchers agreement and two independent agreements that match the national IBEW cost sharing.

Other: This component contains the amortization of a profit sharing payment that the BNSF made to its dispatchers, yardmasters, and the former ATSF portion of its locomotive engineers. This component was unchanged from the prior quarter.

Supplements Index

The Supplements Index is forecast to increase 0.4 percent from the fourth quarter filing. Most of this increase was the net result of higher health & welfare costs offset by lower rates for all other fringe benefits.

Health & Welfare: The Health & Welfare hourly rate increased by a modest 2.3 percent from the fourth quarter level. The new 2005 monthly premiums (see pages 5 and 6 of this appendix) did not rise as much as they have in recent years, especially Group Health & Life. In addition, the new national IBEW agreement, and some new independent contracts, included employee health & welfare cost sharing that reduced some employer costs.

Railroad Retirement: The Railroad Retirement and Medicare hourly rate decreased despite a higher wage rate because of the lower Tier II tax rate for 2005.

Unemployment Insurance: Railroad unemployment insurance rates are experienced-rated by employer and will range from 2.15 (0.65 plus a 1.5 percent surcharge) to 12 percent on monthly employee compensation up to \$1,150. The weighted-average 2005 unemployment insurance rate for the Class I railroads is 2.28 percent, which is lower than 2004's 2.88 percent.

Labor

First Quarter 2005

Unemployment Insurance (continued): Because the 2005 weighted average rate is lower than the 2004 version, the hourly rate for Unemployment Insurance declined. (The 2005 rate of 2.28 percent is based on the Class I railroads in 2003 that were used in the recent rebenchmarking. If two railroads recently purchased by Canadian National Railway are included in the 2004 Class I data used for rebenchmarking in the September 2005 filing, the unemployment insurance rate will become 2.29 percent.)

Other: The "Other" category, a reflection of employer 401(k) matching contributions for two railroads, decreased by 0.7 cents per hour.

Labor Index Calculation

As shown in table A-1 on the next page, the 1.8 percent increase in the Wage Index and the 0.4 percent increase in the Supplements Index had a combined effect of a 1.2 percent increase in the Labor Index. The linked first quarter 2005 index is 290.3.

Labor First Quarter 2005

Table A-1 Labor Index

	2004Q4	2005Q1	Change	
			Percent	Amount
<u>Base Wage</u> – Straight Time & Pay For Time Not Worked	\$28.801	\$29.231	1.5%	\$0.430
Adjustments:				
Lump Sum	0.221	0.239	8.1%	0.018
Back Pay	0.141	0.215	52.5%	0.074
Other	0.014	0.014	0.0%	0.000
Total Wages	<u>29.177</u>	<u>29.699</u>	1.8%	0.522
Health & Welfare Benefits	5.004	5.120	2.3%	0.116
RR Retirement & Medicare	6.151	6.129	-0.4%	-0.022
Unemployment Insurance	0.203	0.164	-19.2%	-0.039
Other	0.029	0.022	-24.1%	-0.007
Total Supplements	<u>\$11.387</u>	<u>\$11.435</u>	0.4%	0.048
Total Labor	\$40.564	\$41.134		
Wage Index¹	249.7	254.2	1.8%	
Supplements Index²	420.8	422.6	0.4%	
Total labor Index, 2003 Weights ³	299.8	303.5		
Labor Index (linked)⁴	286.8	290.3	1.2%	

¹ 1980 wage rate \$11.685
² 1980 supplements rate \$2.706
³ 2003 weights: wages, supplements 70.7% 29.3%
⁴ 2005Q1 linked Index = 2004Q4_{linked} x (2005Q1 / 2004Q4)
 = 286.8 x 303.5 / 299.8

Labor
First Quarter 2005

Supplement Comparisons

Health and Welfare Rates

Plan	Railroad Contribution Per Employee Per Month				
	2003	2004	2005	Change	
				'03-'04	'04-'05
Group Health & Life	\$875.93	\$935.45	\$948.19	6.8%	1.4%
Early Retirement Major Medical	65.73	70.93	90.57	7.9%	27.7%
Group Dental	52.20	52.20	47.20	0.0%	-9.6%
Group Vision	8.61	9.37	10.84	8.8%	15.7%
Supplemental Sickness					
Maintenance of Way	39.25	38.00	36.00	-3.2%	-5.3%
Shop Crafts	47.50	61.00	61.00	28.4%	0.0%
Signalmen	31.75	33.00	32.00	3.9%	-3.0%
Yardmasters	31.33	40.74	44.48	30.0%	9.2%

Railroad Retirement and Medicare

	Earnings Base			Employer Rate		
	2003	2004	2005	2003	2004	2005
Tier I	\$87,000	\$87,900	\$90,000	6.20%	6.20%	6.20%
Tier II	64,500	65,100	66,900	14.20%	13.10%	12.60%
Medicare	no limit	no limit	no limit	1.45%	1.45%	1.45%

Unemployment Insurance

Monthly Taxable Earnings Base			Weighted Avg. Class I Rate		
2003	2004	2005	2003	2004	2005
\$1,120	\$1,130	\$1,150	4.61%	2.88%	2.28%

Labor

First Quarter 2005

NATIONAL RAILWAY LABOR CONFERENCE EMPLOYEE BENEFITS DEPARTMENT

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November 23, 2004

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, 2005 are as follows:

UNUMProvident - Supplemental Sickness Plans	
ShopCrafts	\$ 61.00
Signalmen	\$ 32.00
Maintenance of Way	\$ 36.00
Trustmark - Supplemental Sickness Plans	
Yardmasters	\$ 44.48
Railroad Employees National Health & Welfare Plan & National Railway Carriers/United Transportation Union H&W Plan	
Non-Hospital Road	\$948.19
Railroad Employees National Early Retirement Major Medical Benefit Plan	
Non-Hospital Road	\$ 90.57
Aetna - National Dental Plan	\$ 47.20
VSP - National Vision Plan	\$ 10.84

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

Very truly yours,



Susan E. Parks

cc: Glen Williams

Fuel

First Quarter 2005

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 discussions with their major suppliers, and (3) a consensus of petroleum industry experts and general business publications.

In general, world crude oil* prices have been high because of strong demand and concern about supply. Prices exceeded \$55 per barrel in October, although they were below \$50 for most of November. The Energy Information Administration's *This Week in Petroleum* noted that it expects oil prices to average between \$45 and \$50 during the winter. In early December, crude oil prices fell below \$45 because of warmer than expected weather in the U.S., rising inventories, and the recovery of Gulf of Mexico area refiners from the damage done by Hurricane Ivan. These factors caused many speculators, who had expected oil prices to continue rising toward \$60, to sell oil futures contracts and oil company stocks, which helped drive down oil prices.

Railroad fuel prices have risen for ten of the last twelve months. The fourth quarter (October) average price for locomotive diesel fuel was 71 percent higher than the October 2003 level. The railroads believe that their first quarter 2005 (January) fuel prices will be 9.6 percent *below* the prices they paid in October, and 15.6 percent *higher* than the fourth quarter forecast. (As can be discerned by comparing those two percentages, the fourth quarter forecast was much lower than the average price the railroads eventually paid.)

Forecast fuel index	171.5
Change from previous quarter forecast	15.6%
Change from previous quarter actual	-9.6%

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

Materials & Supplies

First Quarter 2005

The Materials & Supplies Index decreased 2.7 percent from the fourth quarter of 2004 because of regional purchases of ballast. The carriers' average ballast prices reverted to prices similar to those of two quarters ago. Metal prices, which had been increasing significantly because of soaring scrap steel prices, increased by an average of only 0.5 percent.

2005Q1 Materials & Supplies Index = 165.2

2004Q4 Materials & Supplies Index = 169.7

Difference -4.5 basis points
or
-2.7 %

Equipment Rents First Quarter 2005

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 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 rental 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 Rent Index Calculation

The table below calculates the Equipment Rent Index, which increased 0.9 percent. The slight increase in the Car Hire portion of the Index was caused entirely by higher rates for privately-owned cars. The PPI-LF proxy for Lease Rentals, which caused most of increase in Equipment Rents, was influenced by relatively significant increases in every month of 2004.

	2003 Weight	2004Q4	2005Q1	Percent Change
Car Hire	50.1%	172.5	172.7	0.1 %
Lease Rentals	49.9%	173.3	176.3	1.7
Weighted Average		172.9	174.5	0.9
Weighted Average (Linked)		178.3	179.9	0.9

Depreciation

First Quarter 2005

The Producer Price Index for Railroad Equipment (PPI-RE) is used to index depreciation expense. The PPI-RE 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 monthly data 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 reflects monthly PPI-RE figures that are up 5.6 percent from January.

Forecasted depreciation index (1982=100)	145.8
Forecasted depreciation index (1980=100)	161.3
Change from previous quarter forecast	-0.7%
Change from actual first month of previous quarter	0.1%
Change from same quarter of prior year (actual)	4.2%

Depreciation First Quarter 2005

PPI RAIL EQUIPMENT

Forecast Model for PPIRE
ARIMA(1,1,0) with log transform

Term	Coefficient	Std. Error	t-Statistic	Significance
a[1]	0.3690	0.1080	3.4161	0.9989

Within-Sample Statistics

Sample size 72	Number of parameters 1
Mean 4.916	Standard deviation 0.02064
R-square 0.9709	Adjusted R-square 0.9709
Durbin-Watson 2.128	Ljung-Box(18)=17.41 P=0.5048
Forecast error 0.003521	BIC 0.4916
MAPE 0.002392	RMSE 0.4825
MAD 0.329	

Actual Values for the Most Recent 6 Periods:

Date	Actual
2004-05	143.500
2004-06	143.700
2004-07	144.200
2004-08	145.400
2004-09	145.200
2004-10	145.600

Forecasted Values

Date	2.5 Lower	Forecast	97.5 Upper
2004-11	144.746	145.748	146.757
2004-12	144.107	145.803	147.518
2005-01	143.559	145.823	148.122
2005-02	143.089	145.830	148.623
2005-03	142.679	145.833	149.056
QTR AVG	143.109	145.829	148.600
2005-04	142.314	145.834	149.441
2005-05	141.983	145.834	149.790
2005-06	141.678	145.834	150.112

Interest First Quarter 2005

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.

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

2003	Interest Rate	7.08%
1980	Interest Rate	7.85%
2005Q1	Interest Index	90.2
2004Q4	Interest Index	90.2
	Percent Change	0.0%

Other Expenses

First Quarter 2005

The Producer Price Index for Industrial Commodities less Fuel 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 monthly data 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 reflects monthly PPI-LF figures that have jumped at an annual rate of 3.2 to 9.8 percent every month in 2004.

Forecasted Other Expense (1982=100)	157.3
Forecasted Other Expense (1980=100)	176.3
Change from previous quarter forecast	1.7%
Change from actual first month of previous quarter	1.8%
Change from same quarter of prior year (actual)	6.2%

Other Expenses First Quarter 2005

**PPI INDUSTRIAL COMMODITIES LESS FUEL
AND RELATED PRODUCTS AND POWER**

Forecast Model for PPILF
 Multiplicative Winters: Linear trend, Multiplicative seasonality
 Confidence limits proportional to indexes

Component	Smoothing Weight	Final Value
Level	0.90366	154.24
Trend	0.31392	0.76640
Seasonal	0.99865	

Seasonal Indexes

January - March	1.00030	1.00011	1.00001
April - June	0.99980	0.99973	0.99990
July - September	1.00010	0.99971	0.99932
October - December	1.00169	1.00012	0.99923

Within-Sample Statistics

Sample size 72	Number of parameters 3
Mean 143.7	Standard deviation 3.559
R-square 0.9934	Adjusted R-square 0.9932
Durbin-Watson 1.612	Ljung-Box(18)=21.1 P=0.7258
Forecast error 0.2935	BIC 0.3141
MAPE 0.001594	RMSE 0.2873
MAD 0.2299	

Actual Values for the Most Recent 6 Periods:

Date	Actual
2004-05	150.500
2004-06	150.900
2004-07	151.800
2004-08	152.700
2004-09	153.300
2004-10	154.500

Forecasted Values

Date	2.5 Lower	Forecast	97.5 Upper
2004-11	154.408	155.023	155.639
2004-12	154.697	155.652	156.607
2005-01	155.381	156.584	157.787
2005-02	155.914	157.322	158.729
2005-03	156.486	158.073	159.659
QTR AVG	155.927	157.326	158.725

Railroad and Union Abbreviations

First Quarter 2005

Railroads

ATSF	The Atchison, Topeka & Santa Fe Railway (Merged with Burlington Northern to form BNSF.)
BNSF	The Burlington Northern and Santa Fe Railway
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 (Most of CN's U.S. operations.)
CP	Canadian Pacific Railway (Also noted as CPR. Owns the U.S. Class I railroad Soo Line.)
CSX	CSX Transportation
DWP	Duluth, Winnipeg & Pacific 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 (Most of Canadian Pacific Railway's western U.S. operations.)
SSAM	Sault Saint Marie Bridge Company (Part of CN's Grand Trunk Corp.)
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
BLE	Brotherhood of Locomotive Engineers and Trainmen (a.k.a. BLET)
BMWE	Brotherhood of Maintenance of Way Employees
BRC	(see TCU-Carmen)
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
IBFO	International Brotherhood of Firemen and Oilers (predecessor to NCFO)
NCFO	National Conference of Firemen and Oilers (labeled in AAR data bases as IBFO)
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)