

ASSOCIATION
OF AMERICAN
RAILROADS

Craig F. Rocky
Vice President - Policy & Economics

June 5, 2007

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
395 E Street, SW.
Washington, DC 20423-0001

Dear Mr. Williams:

This submission is the AAR forecast of the third quarter 2007 All-Inclusive Index and Rail Cost Adjustment Factor, filed in Ex Parte No. 290 (Sub-No. 5) (2007-3) *Quarterly Rail 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 third quarter 2007 results on the fourth quarter 2002 base, and shows the percentage changes from the previous quarter.

	<u>2007Q2</u>	<u>2007Q3</u>	<u>% Change</u>
All-Inclusive Index	119.7	121.8	1.8
Preliminary RCAF	1.197	1.218	1.8
Forecast Error Adjustment	-0.050	-0.021	
RCAF (Unadjusted)	1.147	1.197	4.4
Productivity Adjustment Factor	2.1348	2.1438	
RCAF (Adjusted)	0.537	0.558	3.9
PAF-5	2.2456	2.2562	
RCAF-5	0.511	0.531	3.9

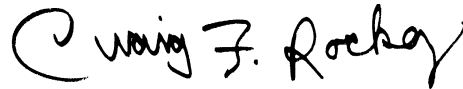
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June 5, 2007

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 Mac Frampton 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 initial "C".

Craig F. Rockey

Attachments

**Third Quarter 2007
All-Inclusive Index**

Ex Parte No. 290 (Sub-No. 5) (2007-3)

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

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

June 5, 2007

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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 third quarter 2007.

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 (2004) weights were used for the fourth quarter of 2005 through the third quarter of 2006. Beginning with the fourth quarter of 2006, the 2005 weights are used. As those familiar with the U.S. economy in 2005 would expect; Fuel, Materials & Supplies, and Interest all increased their weight – especially Fuel. Depreciation also increased in weight. Fuel's expense increase was larger than all others combined, and on a percentage increase basis, Fuel expense grew by nearly 43 percent. Labor, despite a 5.6 percent increase in the amount of expenses, decreased as a percentage of total expenses. The 2005 (current) and 2004 (previous) weights are shown below.

RCAF Weights		
	Previous 2004	Current 2005
Labor	36.0 %	35.3 %
Fuel	12.1	16.0
Materials & Supplies	4.4	4.6
Equipment Rents	8.9	8.2
Depreciation	10.6	11.1
Interest	3.0	3.1
Other	25.0	21.7

Reweightings 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 2007

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.

	2005 Weights	Forecast		Percent Change
		Previous 2007Q2	Current 2007Q3	
1. Labor	35.3%	298.2	298.5	0.1 %
2. Fuel	16.0%	235.9	253.9	7.6
3. M&S	4.6%	206.1	212.6	3.2
4. Equipment Rents	8.2%	190.2	192.5	1.2
5. Depreciation	11.1%	200.9	199.9	-0.5
6. Interest	3.1%	96.9	96.9	0.0
7. Other	21.7%	189.8	193.2	1.8
8. Weighted Average				
a. 1980 = 100		234.6	238.7	
b. 1980 = 100 (linked)		230.0	234.0 ¹	
c. 4Q02 = 100		119.7	121.8 ²	1.8

¹ To calculate the 1980 = 100 Linked Index:

$$\begin{aligned} \text{Index}_{80} &= (\text{Current Index} / \text{Previous Index}) * \text{the Previous Quarter Linked Index} \\ &= \quad 238.7 \quad \text{divided by} \quad 234.6 \quad \text{times} \quad 230.0 \\ &= \quad 234.0 \end{aligned}$$

² To calculate the 4Q02 = 100 index:

$$\begin{aligned} \text{Index}_{4Q02} &= (\text{Current Linked Index} / 4Q02 Linking Factor) * 100 \\ &= \quad 234.0 \quad \text{divided by} \quad 192.1 \quad \text{times} \quad 100 \\ &= \quad 121.8 \end{aligned}$$

$$4Q97 \text{ based index} = 135.1$$

$$4Q92 \text{ based index} = 149.1$$

$$4Q87 \text{ based index} = 177.0$$

Forecast vs. Actual All-Inclusive Index First Quarter 2007

As shown below, the first quarter actual index of 117.6 is 2.1 index points below the forecast value of 119.7. Therefore, the forecast error adjustment for third quarter 2007 is -2.1 index points.

	2005 Weights	First Quarter 2007		Amt Difference
		Forecast	Actual	
1. Labor	35.3%	297.4	297.4	
2. Fuel	16.0%	245.9	211.3	
3. M&S	4.6%	207.1	207.1	
4. Equipment Rents ¹	8.2%	188.2	189.0	
5. Depreciation	11.1%	191.6	194.8	
6. Interest	3.1%	96.9	96.9	
7. Other	21.7%	188.6	189.5	
8. Weighted Average				
a. 1980 = 100		234.5	229.6	
b. 1980 = 100 (linked)		229.9	226.0 ²	
c. 4Q02 = 100 ³		119.7	117.6	-2.1

Forecast error \longrightarrow **-2.1 index points**

1	2005 Weights	First Quarter 2007	
		Forecast	Actual
Car-Hire	49.2%	176.3	176.5
Lease Rentals	50.8%	188.6	189.5
Weighted Average		182.5	183.1
Weighted Average (linked)		188.2	189.0

² Linked actual index = (actual index / previous actual index) x previous linked actual index.

$$226.0 = 229.6 / 229.2 \times 225.6$$

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 31, 2007, the Surface Transportation Board (STB) served a decision in Ex Parte 290 (Sub-No. 4) which added the year 2005 to the Productivity Adjustment Factor (PAF) and deleted the year 2000. This creates an average annual productivity change for 2001 through 2005 of 1.7 percent – a 0.2 percentage point decrease from the 2000 through 2004 average of 1.9 percent. The components of this average annual value are shown on the following table in ratio format – therefore, 1.017 is the same as an increase of 1.7 percent. 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			
2001 - 2005			
Year	Output Index (1)	Input Index (2)	Productivity ¹ Changes (3)
2001	0.971	0.955	1.016
2002	1.012	1.006	1.006
2003	1.039	1.020	1.019
2004	1.033	1.057	0.977
2005	1.021	0.956	1.068
Average			1.017
Previous Average (2000-2004)			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 2001-2005, use fourth root of avg. productivity change = 1.0042			
For 2000-2004, use fourth root of avg. productivity change = 1.0047			
Quarter	Year	PAF	PAF-5
Q1	2007	2.1259	2.2351
Q2	2007	2.1348	2.2456
Q3	2007	2.1438	2.2562
Q4	2007	2.1528	2.2668
Q1	2008	2.1618	2.2763

2000-2004

2001-2005

Rail Cost Adjustment Factor Third Quarter 2007

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.

	Previous 2007Q2	Current 2007Q3	Percent Change
All-Inclusive Index ¹	119.7	121.8	1.8
Preliminary RCAF ²	1.197	1.218	1.8
Forecast Error Adjustment ³	<u>-0.050</u>	<u>-0.021</u>	
RCAF (Unadjusted) ⁴	1.147	1.197	4.4
Productivity Adjustment Factor ⁵	2.1348	2.1438	
RCAF (Adjusted) ⁶	0.537	0.558	3.9
PAF-5 ⁷	2.2456	2.2562	
RCAF-5 ⁸	0.511	0.531	3.9

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

Third Quarter 2007

The third quarter 2007 Labor Index increased 0.1 percent from the previous quarter. Increases in wages were offset by lower fringe benefit costs.

Tentative New National Agreements: Tentative new national agreements have been reached with 7 of the 13 major railroad unions, including the American Train Dispatchers Association, the Brotherhood of Locomotive Engineers and Trainmen, the Brotherhood of Maintenance of Way Employees Division, the Brotherhood of Railroad Signalmen, the International Brotherhood of Boilermakers, the National Conference of Firemen and Oilers, and the Sheet Metal Workers' International Association. Because the results of the ratification votes will likely not be known until late June (and the third quarter Rail Cost Adjustment Factor is filed on June 5), these new agreements have *not* been incorporated into the Labor Index. If any of these agreements are ratified, they will be included in the fourth quarter Labor Index, with back pay calculations added at that time to include the impact for the third quarter.

Wage Index

The Wage Index portion of the Labor Index increased 0.5 percent from the previous quarter. Most national-agreement unions received a 10-cent increase in their cost-of-living allowances. Some of the independent agreements (mostly CN) had 3 percent general wage increases. [Appendix H contains common railroad and union abbreviations.]

Wage Increases from National Agreements: Based on the 2000-round national agreements, all of the national unions will receive a 10-cent increase in their cost-of-living allowance (COLA) on July 1 except the BRS and BMWE. The BRS does not have provisions for COLAs in its current agreement, and the BMWE will receive a five-cent cost-of-living wage adjustment. CSX BLET employees ratified a new independent agreement in April, and will not receive the 10-cent COLA. In addition to its July 1 COLA increase, the IBBM December 2004 National Implementation Agreement has a 34-cent increase effective June 1. The 34 cents has been added to the index effective July 1, and back pay has been added for the month of June.

Wage Increases from Independent Agreements: Ten-cent COLAs were added for all of the Soo Line unions, except their BMWE received 5 cents. CN railroads (B&LE, CC&P, DMIR, DWP, GTW, IC, SSAM, WC) have a mixture of no increases, 10-cent COLAs and 3 percent general wage increases. The BNSF BLET, CSX UTU-Yardmasters, UP dispatchers, and 3 railroads' ATDA dispatchers have all been benchmarked in this index as independent agreements – and they all have had 10-cent COLAs added effective July 1. The new CSX BLET independent agreement has been added to the index, and it includes a 3 percent general wage increase retroactive to January 1.

Labor

Third Quarter 2007

Lump Sums: The lump sum rate increased by 4.2 cents. One large amount was added for the signing bonus associated with the new CSX independent agreement with the BLET. Two smaller amounts were completely amortized and removed from the rate.

Back Pay: The back pay rate decreased by 1.1 cents because of the complete amortization and removal of a large back pay amount related to the SOO BLET. Two amounts were added that helped reduce the amount of the decrease. One month of back pay related to Section 5 of the national IBBM agreement was added. The other amount involved two quarters of back pay relating to the new CSX BLET agreement and its retroactive January 1 wage increase.

Other: Other wages contains the amortization of profit sharing payments that the BNSF Railway makes each year to its dispatchers, yardmasters, and engineers. A new (and higher) amortization is for a total of profit sharing payments made in early 2007 for performance in 2006. The previous year's amount has been fully amortized and removed from the rate.

Supplements Index

The Supplements Index is forecast to decrease 0.5 percent from the second quarter filing. Decreases in costs for health & welfare, and employer contributions to 401(k) accounts, caused the decrease.

Health & Welfare: The Health & Welfare hourly rate decreased 3.5 cents because of new employee health & welfare cost sharing rates effective July 1.

Railroad Retirement: The Railroad Retirement rate had a slight increase because of the increase in wages.

Unemployment Insurance: The Unemployment Insurance rate was unchanged for the quarter.

Other: The "Other" category is a reflection of all other fringe benefits, and currently contains employer contributions to employee 401(k) accounts, plus employer contributions to employee stock plans that are recorded as fringe benefits. The decrease of 4.5 cents was caused by lower employer contributions – a previous quarter employer contribution by one railroad to an employee stock ownership plan for one large union is not part of the current quarter total.

Labor Index Calculation

As shown in Table A-1 on the next page, an increase of 0.5 percent in the Wage Index and a 0.5 percent decrease in the Supplements Index combine to cause the Labor Index to increase 0.1 percent. The linked third quarter 2007 index is 298.5.

Labor Third Quarter 2007

Table A-1 Labor Index

	2007Q2	2007Q3	Change	
			Percent	Amount
<u>Base Wage</u> – Straight Time & Pay For Time Not Worked	\$29.684	\$29.781	0.3%	\$0.097
Adjustments:				
Lump Sum	0.096	0.138	43.8%	0.042
Back Pay	0.024	0.013	-45.8%	-0.011
Other	0.161	0.176	9.3%	0.015
Total Wages	<u>29.965</u>	<u>30.108</u>	0.5%	0.143
Health & Welfare Benefits	5.550	5.515	-0.6%	-0.035
RR Retirement & Medicare	6.220	6.235	0.2%	0.015
Unemployment Insurance	0.186	0.186	0.0%	0.000
Other	0.130	0.085	-34.6%	-0.045
Total Supplements	<u>\$12.086</u>	<u>\$12.021</u>	-0.5%	-0.065
Total Labor	\$42.051	\$42.129		
Wage Index¹	256.4	257.7	0.5%	
Supplements Index²	446.6	444.2	-0.5%	
Total labor Index, 2005 Weights ³	308.9	309.2		
Labor Index (linked)⁴	298.2	298.5	0.1%	

¹ 1980 wage rate \$11.685
² 1980 supplements rate \$2.706
³ 2005 weights: wages, supplements 72.4% 27.6%
⁴ 2007Q3 linked Index = 2007Q2 linked x (2007Q3 / 2007Q2)
= 298.2 x 309.2 / 308.9

Fuel

Third Quarter 2007

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.

Crude oil* prices have risen since January, and traders may be concerned about recent events in Russia and Nigeria, but the overall trend in the last 10 weeks is somewhat flat. There are currently (June 4) some concerns about the Category 5 hurricane moving northwest in the Arabian Sea, possibly threatening the Persian Gulf and its oil resources.

After the first month of the year, locomotive diesel fuel prices increased for three consecutive months, resulting in an April average that is 22 percent higher than January's. Heating oil** followed a similar pattern, with New York Harbor spot prices rising from January's 152.76¢ to April's 186.36¢ – a 22 percent increase. Weekly spot prices for May appear to be slightly higher than April. However, demand for heating oil is taking its seasonal decline as the weather in New England becomes warmer, resulting in lower demand for distillates. On the supply side, distillate stocks are at the high-end of their average range.

The railroads believe that July (third quarter) locomotive diesel fuel prices will be 7.6 percent higher than the April (second quarter) forecast, but 1.2 percent *below* the second quarter price actually experienced. This anomaly was caused by a second quarter forecast that was too low, as forecast models were influenced by the low fuel prices that occurred in January and February.

Forecast Fuel Index	253.9
Change from previous quarter forecast	7.6%
Change from previous quarter actual	-1.2%

* Diesel fuel used by locomotives is made from refined crude oil, and therefore 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

Third Quarter 2007

The Materials & Supplies Index increased 3.2 percent from the second quarter level. Metal products such as rail and tie plates caused much of the increase. The increase in prices paid by railroads for metal products is not a surprise given the jumps in the Producer Price Indexes for Metals & Products and Iron & Steel. From January to April, those PPI indexes were up 5 and 11 percent, respectively.

2007Q3 Materials & Supplies Index = 212.6

2007Q2 Materials & Supplies Index = 206.1

Difference	6.5 basis points
	or
	3.2 %

Equipment Rents Third Quarter 2007

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 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 Rent Index Calculation

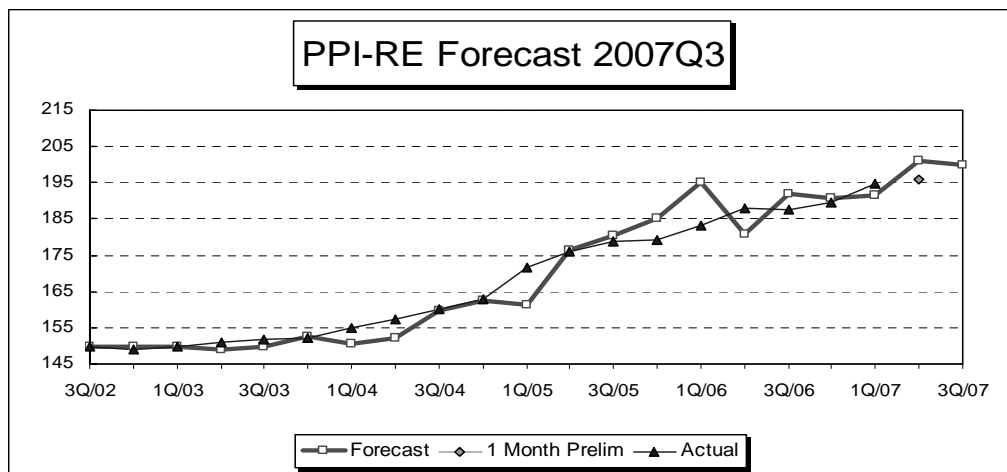
The Car Hire portion of the Index increased 0.5 percent because of higher rates for almost all categories, including railroad-owned cars and privately-owned tank cars. A 1.8 percent increase in the PPI-LF forecast (see Appendix G) used as a proxy for Lease Rentals, combined with the 0.5 percent increase in the Car Hire Index, caused the overall Equipment Rent Index to increase 1.2 percent.

	2005	2007Q2	2007Q3	Percent
	Weight			Change
Car Hire	49.2%	178.9	179.8	0.5 %
Lease Rentals	50.8%	189.8	193.2	1.8
Weighted Average		184.4	186.6	1.2
Weighted Average (Linked)		190.2	192.5	1.2

Depreciation Third Quarter 2007

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 have not been increasing as rapidly as they were 3 months ago.

Forecast of Depreciation Index (1982=100)	180.7
Forecast of Depreciation Index (1980=100)	199.9
Change from previous quarter forecast	-0.5%
Change from actual first month of previous quarter	1.9%
Change from same quarter of prior year (actual)	6.5%



Depreciation Third Quarter 2007

PPI INDUSTRIAL COMMODITIES LESS FUEL AND RELATED PRODUCTS AND POWER

Recommended model: Exponential Smoothing
 Forecast Model for PPIRE
 Holt exponential smoothing: Linear trend, No seasonality
 Confidence limits proportional to level

Component	Smoothing Weight	Final Value
Level	0.99994	177.30
Trend	0.07744	0.85169

Within-Sample Statistics

Sample size 72	Number of parameters 2
Mean 148.9	Standard deviation 15.04
R-square 0.9924	Adjusted R-square 0.9923
Durbin-Watson 1.838	Ljung-Box(18)=27.06 P=0.9221
Forecast error 1.319	BIC 1.38
MAPE 0.005154	RMSE 1.3
MAD 0.8071	

Actual Values for the Most Recent 6 Periods:

Date	Actual
2006-11	170.300
2006-12	172.700
2007-01	177.200
2007-02	175.100
2007-03	175.900
2007-04	177.300

Forecasted Values

Date	2.5 Lower	Forecast	97.5 Upper
2007-05	175.145	178.152	181.158
2007-06	174.583	179.003	183.423
2007-07	174.375	179.855	185.335
2007-08	174.341	180.707	187.073
2007-09	174.416	181.558	188.701
QTR AVG	174.377	180.707	187.036

Interest Third Quarter 2007

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 2006, the Interest Index is based on data for 2005.

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

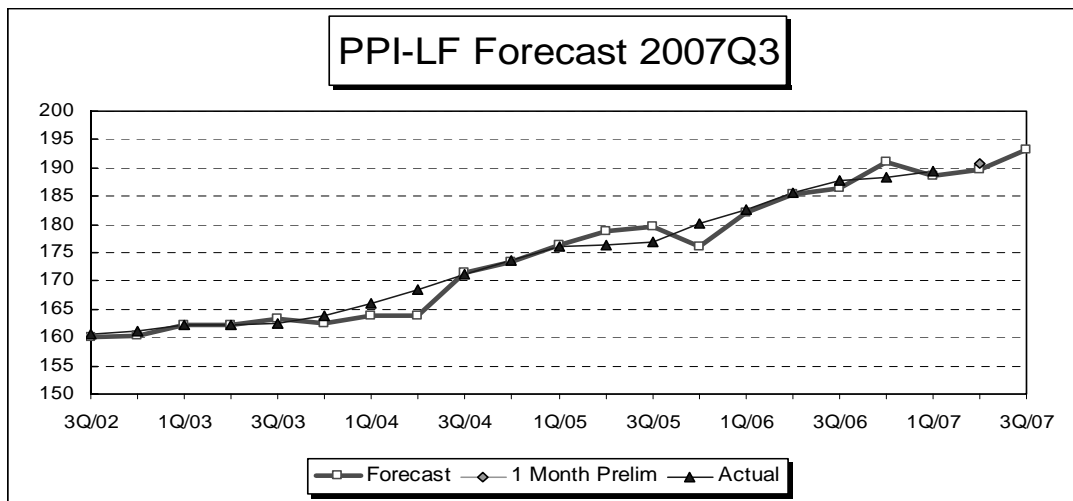
2005	Interest Rate	7.61%
1980	Interest Rate	7.85%
2007Q3	Interest Index	96.9
2007Q2	Interest Index	96.9
	Percent Change	0.0%

Other Expenses Third Quarter 2007

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 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 reflects monthly PPI-LF figures that increased at higher rates for the four most recent months.

Forecast of Other Expense Index (1982=100)	172.3
Forecast of Other Expense Index (1980=100)	193.2
Change from previous quarter forecast	1.8%
Change from actual first month of previous quarter	1.3%
Change from same quarter of prior year (actual)	2.9%



Other Expenses Third Quarter 2007

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

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

Component	Smoothing Weight	Final Value	Seasonal Indexes			
Level	0.93812	170.25	January - March	1.00016	0.99979	0.99971
Trend	0.34984	0.52337	April - June	0.99973	1.00014	0.99992
Seasonal	0.99967		July - September	1.00006	1.00000	0.99972
			October - December	1.00130	1.00031	0.99916

Within-Sample Statistics

Sample size 72	Number of parameters 3
Mean 152.6	Standard deviation 9.499
R-square 0.9982	Adjusted R-square 0.9981
Durbin-Watson 1.41	* Ljung-Box(18)=29.13 P=0.9532
Forecast error 0.4127	BIC 0.4416
MAPE 0.002091	RMSE 0.404
MAD 0.3207	

Actual Values for the Most Recent 6 Periods:

Date	Actual
2006-11	167.800
2006-12	167.900
2007-01	168.400
2007-02	169.000
2007-03	169.600
2007-04	170.200

Forecasted Values

Date	2.5 Lower	Forecast	97.5 Upper
2007-05	169.927	170.793	171.658
2007-06	169.883	171.279	172.676
2007-07	170.051	171.827	173.602
2007-08	170.253	172.339	174.425
2007-09	170.458	172.814	175.170
QTR AVG	170.254	172.327	174.399

Railroad and Union Abbreviations

Third Quarter 2007

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 Railway (Also noted as CPR. Owns the U.S. Class I railroad Soo Line.)
CSX	CSX Transportation
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.)
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 (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
BLET	Brotherhood of Locomotive Engineers and Trainmen Division 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)