

ASSOCIATION
OF AMERICAN
RAILROADS

Craig F. Rocky
Vice President - Policy & Economics

September 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 fourth quarter 2007 All-Inclusive Index and Rail Cost Adjustment Factor, filed in Ex Parte No. 290 (Sub-No. 5) (2007-4) *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 fourth quarter 2007 results on the fourth quarter 2002 base, and shows the percentage changes from the previous quarter.

| | <u>2007Q3</u> | <u>2007Q4</u> | <u>% Change</u> |
|--------------------------------|---------------|---------------|-----------------|
| All-Inclusive Index | 121.8 | 125.8 | 3.3 |
| Preliminary RCAF | 1.218 | 1.258 | 3.3 |
| Forecast Error Adjustment | -0.021 | 0.022 | |
| RCAF (Unadjusted) | 1.197 | 1.280 | 6.9 |
| Productivity Adjustment Factor | 2.1438 | 2.1528 | |
| RCAF (Adjusted) | 0.558 | 0.595 | 6.6 |
| PAF-5 | 2.2562 | 2.2668 | |
| RCAF-5 | 0.531 | 0.565 | 6.4 |

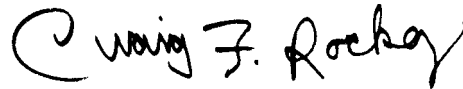
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September 5, 2007

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

**Fourth Quarter 2007
All-Inclusive Index**

Ex Parte No. 290 (Sub-No. 5) (2007-4)

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

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

September 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 fourth 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 2006 (current) and 2005 (previous) weights are shown below. The previous (2005) weights were used for the fourth quarter of 2006 through the third quarter of 2007. Beginning with the fourth quarter of 2007, the 2006 weights are used. As those familiar with the U.S. economy in 2006 would expect; Fuel and Materials & Supplies increased their weight – especially Fuel. Labor, despite a 5.4 percent increase in the amount of labor expenses, decreased as a percentage of total expenses because of double-digit increases in Fuel and Materials & Supplies expenses. The biggest weight changes were Fuel's increase of 3.2 percentage points, and Other's decrease of 1.5 percentage points. Absolute changes for all of the remaining categories were by less than one percentage point.

| RCAF Weights | | |
|----------------------|------------------|-----------------|
| | Previous 2005 | Current 2006 |
| Labor | 35.3 % | 34.5 % |
| Fuel | 16.0 | 19.2 |
| Materials & Supplies | 4.6 | 5.0 |
| Equipment Rents | 8.2 | 7.8 |
| Depreciation | 11.1 | 10.6 |
| Interest | 3.1 | 2.7 |
| Other | 21.7 | 20.2 |

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 Fourth 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.

| | 2006 Weights | Forecast | | Percent Change |
|------------------------|-----------------|--------------------|--------------------|-------------------|
| | | Previous 2007Q3 | Current 2007Q4 | |
| 1. Labor | 34.5% | 298.5 | 307.9 | 3.1 % |
| 2. Fuel | 19.2% | 253.9 | 276.4 | 8.9 |
| 3. M&S | 5.0% | 212.6 | 218.4 | 2.7 |
| 4. Equipment Rents | 7.8% | 192.5 | 192.9 | 0.2 |
| 5. Depreciation | 10.6% | 199.9 | 200.2 | 0.2 |
| 6. Interest | 2.7% | 96.9 | 90.2 | -6.9 |
| 7. Other | 20.2% | 193.2 | 194.1 | 0.5 |
| 8. Weighted Average | | | | |
| a. 1980 = 100 | | 240.2 | 248.1 | |
| b. 1980 = 100 (linked) | | 234.0 | 241.7 ¹ | |
| c. 4Q02 = 100 | | 121.8 | 125.8 ² | 3.3 |

Note: The 240.2 weighted average for 2007Q3 is recalculated with 2006 weights to eliminate any changes in the fourth quarter index that would be caused by changing weights. The original figure with 2005 weights is 238.7.

¹ To calculate the 1980 = 100 Linked Index:

$$\begin{aligned} \text{Index}_{80} &= (\text{Current Index} / \text{Previous Index}) * \text{the Previous Quarter Linked Index} \\ &= \quad 248.1 \quad \text{divided by} \quad 240.2 \quad \text{times} \quad 234.0 \\ &= \quad 241.7 \end{aligned}$$

² To calculate the 4Q02 = 100 index:

$$\begin{aligned} \text{Index}_{4Q02} &= (\text{Current Linked Index} / 4Q02 Linking Factor) * 100 \\ &= \quad 241.7 \quad \text{divided by} \quad 192.1 \quad \text{times} \quad 100 \\ &= \quad 125.8 \end{aligned}$$

$$4Q97 \text{ based index} = 139.5$$

$$4Q92 \text{ based index} = 154.0$$

$$4Q87 \text{ based index} = 182.8$$

Forecast vs. Actual All-Inclusive Index Second Quarter 2007

As shown below, the second quarter actual index of 121.9 is 2.2 index points above the forecast value of 119.7. Therefore, the forecast error adjustment for fourth quarter 2007 is 2.2 index points.

| | 2005 Weights | Second Quarter 2007 | | Amt Difference |
|---------------------------------|-----------------|---------------------|--------------------|-------------------|
| | | Forecast | Actual | |
| 1. Labor | 35.3% | 298.2 | 298.2 | |
| 2. Fuel | 16.0% | 235.9 | 257.0 | |
| 3. M&S | 4.6% | 206.1 | 206.1 | |
| 4. Equipment Rents ¹ | 8.2% | 190.2 | 191.4 | |
| 5. Depreciation | 11.1% | 200.9 | 195.9 | |
| 6. Interest | 3.1% | 96.9 | 96.9 | |
| 7. Other | 21.7% | 189.8 | 191.4 | |
| 8. Weighted Average | | | | |
| a. 1980 = 100 | | 234.6 | 237.8 | |
| b. 1980 = 100 (linked) | | 230.0 | 234.1 ² | |
| c. 4Q02 = 100 ³ | | 119.7 | 121.9 | 2.2 |

Forecast error \longrightarrow **2.2 index points**

| 1 | 2005 Weights | Second Quarter 2007 | |
|---------------------------|-----------------|---------------------|--------|
| | | Forecast | Actual |
| Car-Hire | 49.2% | 178.9 | 179.3 |
| Lease Rentals | 50.8% | 189.8 | 191.4 |
| Weighted Average | | 184.4 | 185.4 |
| Weighted Average (linked) | | 190.2 | 191.4 |

² Linked actual index = (actual index / previous actual index) x previous linked actual index.
 $234.1 = 237.8 / 229.6 \times 226.0$

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 |

Rail Cost Adjustment Factor

Fourth 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 2007Q3 | Current 2007Q4 | Percent Change |
|---|--------------------|-------------------|-------------------|
| All-Inclusive Index ¹ | 121.8 | 125.8 | 3.3 |
| Preliminary RCAF ² | 1.218 | 1.258 | 3.3 |
| Forecast Error Adjustment ³ | <u>-0.021</u> | <u>0.022</u> | |
| RCAF (Unadjusted) ⁴ | 1.197 | 1.280 | 6.9 |
| Productivity Adjustment Factor ⁵ | 2.1438 | 2.1528 | |
| RCAF (Adjusted) ⁶ | 0.558 | 0.595 | 6.6 |
| PAF-5 ⁷ | 2.2562 | 2.2668 | |
| RCAF-5 ⁸ | 0.531 | 0.565 | 6.4 |

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

Fourth Quarter 2007

The fourth quarter 2007 Labor Index is forecast to increase 3.1 percent. Seven new national agreements had significant impact on the Labor Index. In addition, the Labor Rate was rebenchmarked to new wage statistics and annual report data.

Rebenchmarking: Rebenchmarking, as well as updating the internal weights (i.e., the proportion of labor costs represented by wages and supplements, respectively), is reflected each year in the fourth quarter filing. The 2006 data underlying the fourth quarter rebenchmarking are obtained from the railroads' 112-Class Wage Statistics and the railroads' R-1 Annual Reports (including railroad revisions through July 3) to the Surface Transportation Board. The source for the wage and supplements internal weights, like the external weights, is the R-1 Annual Report Summary.

New Labor Contracts

New National Agreements: Six major railroad unions signed new national agreements on July 1, including the Brotherhood of Locomotive Engineers and Trainmen (BLET), the Brotherhood of Maintenance of Way Employees Division (BMWED), the Brotherhood of Railroad Signalmen (BRS), the International Brotherhood of Boilermakers (IBBM), the National Conference of Firemen and Oilers (NCFO), and the Sheet Metal Workers' International Association (SMW). These agreements were not included in the third quarter Rail Cost Adjustment Factor, since it was filed on June 5 before the new contracts were finalized. A seventh national agreement was signed on September 1, affecting American Train Dispatcher Association (ATDA) employees for four Class I railroads. Highlights typical of the new agreements are as follows:

- Cost of Living Allowances (COLA) eliminated, and COLAs on and after July 1, 2005 recovered from any retroactive wage increase payments.
- Retroactive general wage increase of 2.5 percent effective July 1, 2005
- Retroactive general wage increase of 3.0 percent effective July 1, 2006
- General wage increase of 3.0 percent effective July 1, 2007 [This is considered retroactive in the RCAF since it is being added beginning Q4.]
- General wage increase of 4.0 percent effective July 1, 2008 [Added to RCAF at that time]
- General wage increase of 4.5 percent effective July 1, 2009 [Added to RCAF at that time]
- Employee Health & Welfare Cost Sharing monthly rate of \$166.25 effective January 1, 2007
- Future adjustments to the Cost Sharing rate in 2008, 2009, and 2010, all on January 1

The BRS and BMWED had some slight differences caused by unique items (differing COLAs and/or method of employee cost sharing) in their previous agreements. The retroactive wage increases will cause back pay amounts for all seven unions that, following the standard procedure, will be amortized over four quarters. COLA payments already made, and the new 2007 employee Health & Welfare cost sharing rate (less the payments already made), serve as credit against gross retroactive pay.

Labor

Fourth Quarter 2007

New Independent Agreements: New independent agreements were also added to the index in the fourth quarter for the BNSF BLET and SOO BLET. The BNSF BLET participates in the national agreement with some small changes, and has been benchmarked in the RCAF as "independent". Four new agreements were also added for CN-owned railroads. Because all of the Class I railroad dispatchers (in 2006) had independent agreements or are non-union, they have been benchmarked in the RCAF as independent. The new national ATDA contract has been applied to each participating railroad as an "independent" agreement. Two Class I railroads participate fully in the new agreement, one participates fully except for some differences in wages, and one participates for Health & Welfare only. [For a list of common railroad and union abbreviations, see Appendix H.]

Wage Index

The Wage Index portion of the Labor Index increased 4.3 percent from the previous quarter. The increase was caused by a combination of rebenchmarking and new labor agreements, including wage increases and large back pay amounts. Highlights for the seven new national agreements are listed on the previous page.

Lump Sums: The lump sum rate decreased slightly, despite the addition of amounts related to three new agreements for CN-owned railroads, because of rebenchmarking.

Back Pay: The back pay rate jumped by over 43 cents because of the new agreements that featured retroactive general wage increases. The new national agreements had retroactive general wage increases for 2005 and 2006. In addition, the RCAF owes back pay for an additional quarter since the new contracts were not added to the Index until the fourth quarter. The July 2007 general wage increases are, in effect, retroactive.

Other: Other wages contains the amortization of profit sharing payments that the BNSF Railway makes each year to its dispatchers, yardmasters, and engineers. The fourth quarter rate is slightly lower because of rebenchmarking to newer (2006) wage statistics.

Supplements Index

The Supplements Index is forecast to increase 1.5 percent from the third quarter filing. Rebenchmarking and higher taxable wages caused the increase.

Health & Welfare: The Health & Welfare hourly rate had a small increase that was the net result of an increase caused by rebenchmarking offset by a decrease caused by higher employee Health & Welfare cost sharing amounts in new labor agreements.

Labor

Fourth Quarter 2007

Railroad Retirement: The Railroad Retirement rate had a two percent increase caused almost entirely by higher taxable 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 1.9 cents was caused by lower employer contributions – a previous quarter employer contribution by one railroad to an employee stock ownership plan for one union is not part of the current quarter total.

Labor Index Calculation

As shown in Table A-1 on the next page, the 4.3 percent increase in the Wage Index and the 1.5 percent increase in the Supplements Index combined to cause a 3.1 percent increase in the Labor Index. The linked fourth quarter 2007 index of 307.9 is determined by multiplying the third quarter linked index of 298.5 times the change between the fourth quarter labor index (319.5) and a third quarter labor index (309.7) recalculated using the original third quarter wages and supplements indexes weighted with the new 2006 weights. This method eliminates changes caused by the new weights, but captures changes caused by rebenchmarking. The purpose of the center "Updated to Reflect..." column in table A-1 is only to enable the reader to discern the impact of rebenchmarking.

Labor
Fourth Quarter 2007
Table A-1 Labor Index

| | 2007Q3 | | 2007Q4 | |
|---|-------------------------------------|---|-----------------------|---------------------------------|
| | Used in Previous Index Filing | Updated to Reflect 2006 Actual Data | Based on 2006 Data | Pct Chg From Prev. Filing |
| <u>Base Wage</u> – Straight Time & Pay For Time Not Worked | \$29.781 | \$30.091 | \$30.642 | 2.9% |
| Adjustments: | | | | |
| Lump Sum | 0.138 | 0.135 | 0.136 | -1.4% |
| Back Pay | 0.013 | 0.013 | 0.448 | 3346.2% |
| Other | 0.176 | 0.171 | 0.171 | -2.8% |
| Total Wages | \$30.108 | \$30.410 | 31.397 | 4.3% |
| Health & Welfare Benefits | 5.515 | 5.719 | 5.584 | 1.3% |
| RR Retirement & Medicare | 6.235 | 6.236 | 6.362 | 2.0% |
| Unemployment Insurance | 0.186 | 0.186 | 0.186 | 0.0% |
| Other | 0.085 | 0.083 | 0.066 | -22.4% |
| Total Supplements | \$12.021 | \$12.224 | \$12.198 | 1.5% |
| Total Labor | \$42.129 | \$42.634 | \$43.595 | |
| Wage Index¹ | 257.7 | 260.2 | 268.7 | 4.3% |
| Supplements Index² | 444.2 | 451.7 | 450.8 | 1.5% |
| Total labor Index, 2005 Weights ³ | 309.2 | | | |
| Total labor Index, 2006 Weights ⁴ | 309.7 | 313.6 | 319.5 | |
| Labor Index (linked)⁵ | 298.5 | | 307.9 | 3.1% |

¹ 1980 wage rate \$11.685

² 1980 supplements rate \$2.706

³ 2005 weights: wages, supplements 72.4% 27.6%

⁴ 2006 weights: wages, supplements 72.1% 27.9%

⁵ 2007Q4 linked Index = 2007Q3_{linked} x (2007Q4_{WT2006} / 2007Q3_{WT2006})
 = 298.5 x 319.5 / 309.7

Fuel

Fourth 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 trended upward from January through July, but fell during the first half of August. Prices have begun rising again, and reached \$75 per barrel by September 4. Hurricanes have been a continuing concern.

The July 2007 average price for locomotive diesel fuel is the third highest price ever recorded. After the first month of the year, locomotive diesel fuel prices increased for six consecutive months, resulting in a July average that is 31 percent higher than January's.

Heating oil** followed a similar pattern, with NYMEX prices trending upward from January through July, but decreasing in August. On the supply side, distillate stocks are at the middle of their average range, but oil days of supply are lower than last year.

The railroads believe that October (fourth quarter) locomotive diesel fuel prices will be 8.9 percent higher than the July (third quarter) forecast, but just 0.1 percent above the third quarter price actually experienced. This difference was caused by a third quarter forecast that was too low.

| | |
|---------------------------------------|-------|
| Forecast Fuel Index | 276.4 |
| Change from previous quarter forecast | 8.9% |
| Change from previous quarter actual | 0.1% |

* 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

Fourth Quarter 2007

The Materials & Supplies Index increased 2.7 percent from the third quarter level. Ballast prices were a major contributor to the increase. Wheel sets and creosote also experienced price increases that had significant impacts on the Index.

2007Q4 Materials & Supplies Index = 218.4

2007Q3 Materials & Supplies Index = 212.6

| | |
|------------|------------------|
| Difference | 5.8 basis points |
| | or |
| | 2.7 % |

Equipment Rents Fourth 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

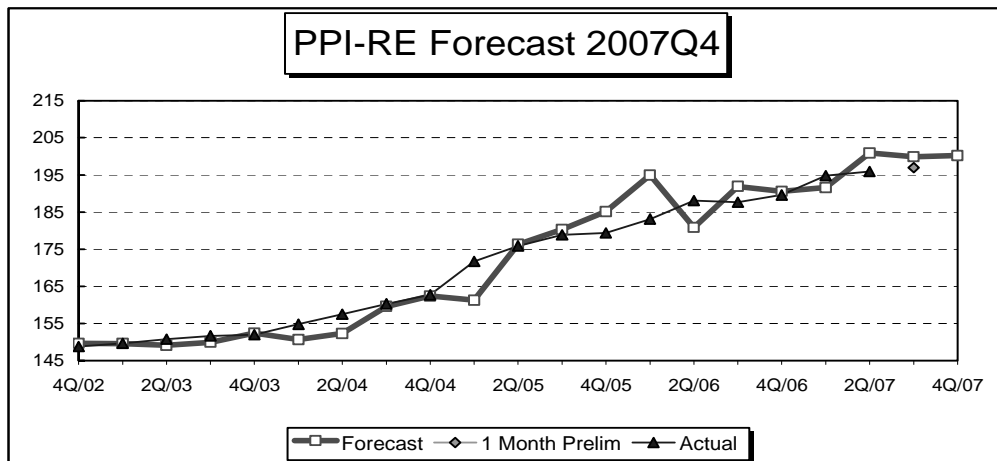
The table below calculates the Equipment Rent Index, and features new weights based on 2006. To eliminate any changes caused by the new weights, the third quarter weighted average (but not the linked value) has been recalculated using the new weights. The original third quarter weighted average using 2005 weights is 186.6. The Car Hire portion of the Index decreased slightly because of rate decreases for privately-owned tank cars. A 0.5 percent increase in the PPI-LF (See Appendix G) used as a proxy for Lease Rentals, combined with the decrease in the Car Hire Index, caused the overall Equipment Rent Index to rise just 0.2 percent.

| | 2006 Weight | 2007Q3 | 2007Q4 | Percent Change |
|---------------------------|----------------|--------|--------|-------------------|
| Car Hire | 46.3% | 179.8 | 179.7 | -0.1 % |
| Lease Rentals | 53.7% | 193.2 | 194.1 | 0.5 |
| Weighted Average | | 187.0 | 187.4 | 0.2 |
| Weighted Average (Linked) | | 192.5 | 192.9 | 0.2 |

Depreciation Fourth 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 in the previous year.

| | |
|--|-------|
| Forecast of Depreciation Index (1982=100) | 181.0 |
| Forecast of Depreciation Index (1980=100) | 200.2 |
| Change from previous quarter forecast | 0.2% |
| Change from actual first month of previous quarter | 1.6% |
| Change from same quarter of prior year (actual) | 5.6% |



Depreciation Fourth 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 | 0.99997 | 178.10 |
| Trend | 0.09913 | 0.72831 |

Within-Sample Statistics

| | |
|----------------------|--------------------------------|
| Sample size 72 | Number of parameters 2 |
| Mean 150.7 | Standard deviation 15.74 |
| R-square 0.9943 | Adjusted R-square 0.9942 |
| Durbin-Watson 1.726 | ** Ljung-Box(18)=38.79 P=0.997 |
| Forecast error 1.198 | BIC 1.253 |
| MAPE 0.004892 | RMSE 1.181 |
| MAD 0.7638 | |

Actual Values for the Most Recent 6 Periods:

| Date | Actual |
|---------|---------|
| 2007-02 | 175.600 |
| 2007-03 | 176.100 |
| 2007-04 | 177.300 |
| 2007-05 | 177.000 |
| 2007-06 | 176.900 |
| 2007-07 | 178.100 |

Forecasted Values

| Date | 2.5 Lower | Forecast | 97.5 Upper |
|----------------|----------------|----------------|----------------|
| 2007-08 | 176.039 | 178.828 | 181.617 |
| 2007-09 | 175.413 | 179.557 | 183.701 |
| 2007-10 | 175.130 | 180.285 | 185.439 |
| 2007-11 | 175.016 | 181.013 | 187.010 |
| 2007-12 | 175.007 | 181.742 | 188.476 |
| QTR AVG | 175.051 | 181.013 | 186.975 |

Interest Fourth 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 2007, the Interest Index is based on data for 2006.

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 |

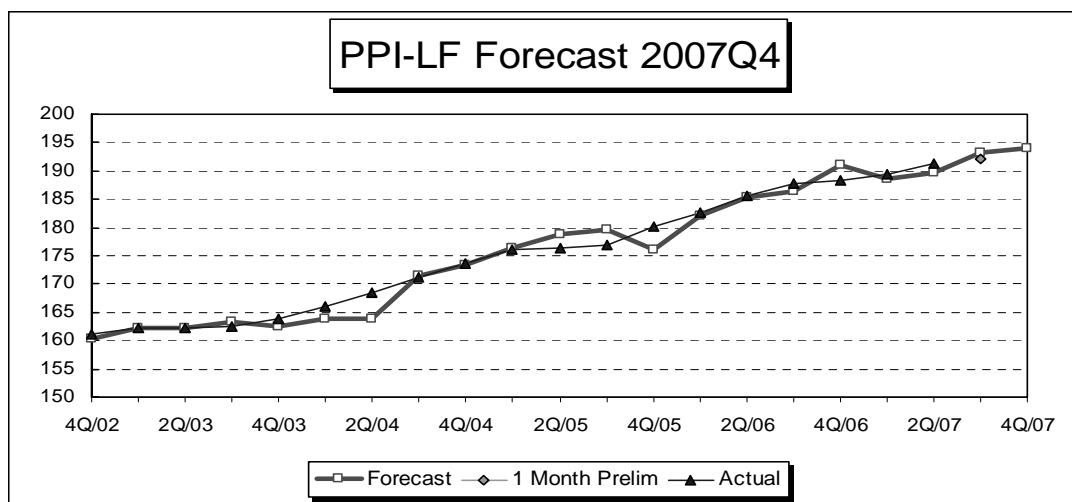
| | | |
|---------------|-----------------------|-------------|
| 2006 | Interest Rate | 7.08% |
| 1980 | Interest Rate | 7.85% |
| 2007Q4 | Interest Index | 90.2 |
| 2007Q3 | Interest Index | 96.9 |
| | Percent Change | -6.9% |

Other Expenses Fourth 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 lower rates in 2007 than 2006.

| | |
|--|-------|
| Forecast of Other Expense Index (1982=100) | 173.1 |
| Forecast of Other Expense Index (1980=100) | 194.1 |
| Change from previous quarter forecast | 0.5% |
| Change from actual first month of previous quarter | 1.0% |
| Change from same quarter of prior year (actual) | 3.1% |



Other Expenses Fourth 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 | 0.95283 | 171.42 | January - March | 1.00023 | 0.99987 | 0.99992 |
| Trend | 0.33037 | 0.42159 | April - June | 0.99981 | 0.99999 | 0.99984 |
| Seasonal | 0.99993 | | July - September | 0.99991 | 1.00007 | 0.99972 |
| | | | October - December | 1.00103 | 1.00024 | 0.99938 |

Within-Sample Statistics

| | |
|-----------------------|--------------------------------|
| Sample size 72 | Number of parameters 3 |
| Mean 153.7 | Standard deviation 9.975 |
| R-square 0.9983 | Adjusted R-square 0.9982 |
| Durbin-Watson 1.397 | * Ljung-Box(18)=37.24 P=0.9951 |
| Forecast error 0.4205 | BIC 0.45 |
| MAPE 0.002132 | RMSE 0.4117 |
| MAD 0.3285 | |

Actual Values for the Most Recent 6 Periods:

| Date | Actual |
|---------|---------|
| 2007-02 | 168.600 |
| 2007-03 | 169.400 |
| 2007-04 | 170.200 |
| 2007-05 | 170.700 |
| 2007-06 | 171.200 |
| 2007-07 | 171.400 |

Forecasted Values

| Date | 2.5 Lower | Forecast | 97.5 Upper |
|----------------|----------------|----------------|----------------|
| 2007-08 | 170.968 | 171.850 | 172.732 |
| 2007-09 | 170.786 | 172.209 | 173.633 |
| 2007-10 | 171.047 | 172.857 | 174.668 |
| 2007-11 | 171.014 | 173.143 | 175.271 |
| 2007-12 | 171.011 | 173.415 | 175.819 |
| QTR AVG | 171.024 | 173.138 | 175.253 |

Railroad and Union Abbreviations

Fourth 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) |