

ASSOCIATION
OF AMERICAN
RAILROADS

John T. Gray
Vice President - Policy & Economics

March 5, 2008

The Honorable Anne K. Quinlan
Acting Secretary
Surface Transportation Board
395 E Street, SW.
Washington, DC 20423-0001

Dear Ms. Quinlan:

This submission is the AAR forecast of the second quarter 2008 All-Inclusive Index and Rail Cost Adjustment Factor, filed in Ex Parte No. 290 (Sub-No. 5) (2008-2) *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 second quarter 2008 results on the fourth quarter 2007 base, and shows the percentage changes from the previous quarter.

| | <u>2008Q1</u> | <u>2008Q2</u> | <u>% Change</u> |
|--------------------------------|---------------|---------------|-----------------|
| All-Inclusive Index | 103.5 | 106.1 | 2.5 |
| Preliminary RCAF | 1.035 | 1.061 | 2.5 |
| Forecast Error Adjustment | 0.015 | 0.016 | |
| RCAF (Unadjusted) | 1.050 | 1.077 | 2.6 |
| Productivity Adjustment Factor | 2.1618 | 2.1655 | |
| RCAF (Adjusted) | 0.486 | 0.497 | 2.3 |
| PAF-5 | 2.2763 | 2.2859 | |
| RCAF-5 | 0.461 | 0.471 | 2.2 |

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March 5, 2008

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.

The STB's Productivity Adjustment Decision, served February 22, 2008, will not go into effect until March 17, 2008. Interested parties have until March 13 to comment, and the AAR has not yet received the data necessary to review the STB's calculation. Therefore, there is some uncertainty involving the productivity adjustment used to calculate the Productivity Adjustment Factor and the RCAF-Adjusted. (The PAF-5 and the RCAF-5 will not be affected by the new productivity adjustment until December's filing.) Since the decision says the "long-run measure of productivity is composed using a five-year moving geometric average", we have used the geometric average found on the first and fourth pages of the STB's decision – which is 0.7 percent per year. However, we recognize that there is a small chance that this number could change.

Two copies of the quarterly non-proprietary work papers 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 work papers are available for STB inspection. Questions should be directed to me or Clyde Crimmel (202 639-2309) of this office.

Sincerely,

A handwritten signature in black ink, appearing to read "John T. Gray", with a long horizontal flourish extending to the right.

John T. Gray

Attachments

**Second Quarter 2008
All-Inclusive Index**

Ex Parte No. 290 (Sub-No. 5) (2008-2)

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

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

March 5, 2008

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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 second quarter 2008.

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 |

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 Second Quarter 2008

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 2008Q1 | Current 2008Q2 | |
| 1. Labor | 34.5% | 312.8 | 313.6 | 0.3 % |
| 2. Fuel | 19.2% | 334.8 | 361.1 | 7.9 |
| 3. M&S | 5.0% | 218.5 | 225.1 | 3.0 |
| 4. Equipment Rents | 7.8% | 193.1 | 196.6 | 1.8 |
| 5. Depreciation | 10.6% | 200.1 | 196.9 | -1.6 |
| 6. Interest | 2.7% | 90.2 | 90.2 | 0.0 |
| 7. Other | 20.2% | 194.3 | 199.7 | 2.8 |
| 8. Weighted Average | | | | |
| a. 1980 = 100 | | 261.1 | 267.8 | |
| b. 1980 = 100 (linked) | | 254.4 | 260.9 ¹ | |
| c. 4Q07 = 100 | | 103.5 | 106.1 ² | 2.5 |

¹ To calculate the 1980 = 100 Linked Index:

$$\begin{aligned} \text{Index}_{80} &= (\text{Current Index} / \text{Previous Index}) * \text{the Previous Quarter Linked Index} \\ &= \quad 267.8 \quad \text{divided by} \quad 261.1 \quad \text{times} \quad 254.4 \\ &= \quad 260.9 \end{aligned}$$

² To calculate the 4Q07 = 100 index:

$$\begin{aligned} \text{Index}_{4Q07} &= (\text{Current Linked Index} / 4Q07 Linking Factor) * 100 \\ &= \quad 260.9 \quad \text{divided by} \quad 245.9 \quad \text{times} \quad 100 \\ &= \quad 106.1 \end{aligned}$$

Indexes based on other periods:

- 4Q02 based index = 260.9 / 192.1 x 100 = 135.8
- 4Q97 based index = 260.9 / 173.2 x 100 = 150.6
- 4Q92 based index = 260.9 / 156.9 x 100 = 166.3
- 4Q87 based index = 260.9 / 132.2 x 100 = 197.4

Forecast vs. Actual All-Inclusive Index Fourth Quarter 2007

Because of data availability, the forecast error adjustment has a two-quarter lag from each filing. As shown below, the fourth quarter actual index of 99.9 is 1.6 index points above the forecast value of 98.3. Therefore, the forecast error adjustment for second quarter 2008 is 1.6 index points.

| | 2006 Weights | Fourth Quarter 2007 | | Amt Difference |
|---------------------------------|-----------------|---------------------|--------------------|-------------------|
| | | Forecast | Actual | |
| 1. Labor | 34.5% | 307.9 | 307.9 | |
| 2. Fuel | 19.2% | 276.4 | 298.5 | |
| 3. M&S | 5.0% | 218.4 | 218.4 | |
| 4. Equipment Rents ¹ | 7.8% | 192.9 | 192.9 | |
| 5. Depreciation | 10.6% | 200.2 | 197.0 | |
| 6. Interest | 2.7% | 90.2 | 90.2 | |
| 7. Other | 20.2% | 194.1 | 193.7 | |
| 8. Weighted Average | | | | |
| a. 1980 = 100 | | 248.1 | 251.9 | |
| b. 1980 = 100 (linked) | | 241.7 | 245.6 ² | |
| c. 4Q07 = 100 ³ | | 98.3 | 99.9 | 1.6 |

Forecast error \longrightarrow **1.6 index points**

| | 2006 Weights | Fourth Quarter 2007 | |
|---------------------------|-----------------|---------------------|--------|
| | | Forecast | Actual |
| Car-Hire | 46.3% | 179.7 | 179.6 |
| Lease Rentals | 53.7% | 194.1 | 193.7 |
| Weighted Average | | 187.4 | 187.2 |
| Weighted Average (linked) | | 192.9 | 192.9 |

² Linked actual index = (actual index / previous actual index) x previous linked actual index.
 $245.6 = 251.9 / 243.8 \times 237.7$

Note: The standard linking procedure has been used to eliminate any changes to indexes that would be caused by updating weights. The Q3 unlinked weighted averages for the All-Inclusive Indexes (forecast and actual) and for Equipment Rents (forecast and actual) were recalculated using the new (2006) weights.

³ The 4Q07 based indexes are 1980 based indexes divided by the 4Q07 linking factor (245.9/100). Other linking factors are: 4Q02 = 192.1; 4Q97 = 173.2; 4Q92 = 156.9; and 4Q87 = 132.2.

Productivity

On February 22, 2008, the Surface Transportation Board (STB) served a decision in Ex Parte 290 (Sub No. 4) which added the year 2006 to the Productivity Adjustment Factor (PAF) and deleted the year 2001. This creates a geometric average annual productivity change for 2002 through 2006 of 0.7 percent – a 1.0 percentage point decrease from the 2001 through 2005 average of 1.7 percent. The components of this average annual value are shown on the following table in ratio format – therefore, 1.007 is the same as an increase of 0.7 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 | | | |
|--|---------------------|--------------------|---|
| 2002 - 2006 | | | |
| Year | Output Index (1) | Input Index (2) | Productivity ¹ Changes (3) |
| 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 |
| 2006 | 0.994 | 1.024 | 0.971 |
| Average | | | 1.007 |
| Previous Average (2001-2005) | | | 1.017 |

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 2002-2006, use fourth root of avg. productivity change = 1.0017 | | | |
| For 2001-2005, use fourth root of avg. productivity change = 1.0042 | | | |
| Quarter | Year | PAF | PAF-5 |
| Q1 | 2008 | 2.1618 | 2.2763 |
| Q2 | 2008 | 2.1655 | 2.2859 |
| Q3 | 2008 | 2.1692 | 2.2955 |
| Q4 | 2008 | 2.1729 | 2.3051 |
| Q1 | 2009 | 2.1766 | 2.3090 |

Rail Cost Adjustment Factor Second Quarter 2008

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

| | Previous 2008Q1 | Current 2008Q2 | Percent Change |
|---|--------------------|-------------------|-------------------|
| All-Inclusive Index ¹ | 103.5 | 106.1 | 2.5 |
| Preliminary RCAF ² | 1.035 | 1.061 | 2.5 |
| Forecast Error Adjustment ³ | <u>0.015</u> | <u>0.016</u> | |
| RCAF (Unadjusted) ⁴ | 1.050 | 1.077 | 2.6 |
| Productivity Adjustment Factor ⁵ | 2.1618 | 2.1655 | |
| RCAF (Adjusted) ⁶ | 0.486 | 0.497 | 2.3 |
| PAF-5 ⁷ | 2.2763 | 2.2859 | |
| RCAF-5 ⁸ | 0.461 | 0.471 | 2.2 |

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

Second Quarter 2008

The second quarter 2008 Labor Index is forecast to increase 0.3 percent. The main contributors to the increase were an employee stock plan and the startup of one railroad's performance bonus.

Wage Index

The Wage Index portion of the Labor Index increased 0.1 percent from the previous quarter. One railroad's new performance bonus program with a major union accounted for much of the slight increase.

Wage Increases: There were no national or independent agreement wage increases scheduled for the second quarter. One new independent agreement for GTW's TCU-Carmen [see Appendix H for a list of railroad and union abbreviations], which featured three retroactive general wage increases plus a bonus, was the only change in regular wages.

Lump Sums: The lump sum rate increased by 2.3 cents mostly because of an independent agreement for one railroad that includes a new performance bonus for a major union. The latest CSX agreement with the BLET begins a performance bonus program payable in 2008 for performance in 2007. Some of the increase caused by the new CSX performance bonus was offset by the complete amortization and removal of last year's NS Thoroughbred Bonus for BLET and ATDA employees. Although a Thoroughbred Bonus was also paid (and added to the rate) in 2008, the amount was not as high as it was for the previous year. Two other smaller lump sums related to CN railroads were completely amortized and removed from the lump sum rate, while a small amount was added for the new CN GTW agreement with the TCU-Carmen.

Back Pay: The back pay rate decreased slightly, although some small amounts (such as back pay relating to the new GTW TCU-Carmen agreement) were added, because of the complete amortization and removal of amounts related to six CN-railroad agreements from one year ago.

Other: Other wages contains the amortization of profit sharing payments that the BNSF Railway makes each year to its dispatchers, yardmasters, and engineers. The current rate is unchanged.

Supplements Index

The Supplements Index is forecast to increase 0.6 percent from the first quarter filing. Almost all of the change was caused by one railroad's employee stock plan.

Health & Welfare: Although employee contributions involving two independent contracts increased, the impact of the change (611 employees affected) was not large enough to change the Health & Welfare hourly rate.

Labor

Second Quarter 2008

Railroad Retirement: The Railroad Retirement rate had a very slight increase because of the slight increase in 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 increase of 6.8 cents was caused mostly by an annual employer contribution by one railroad to an employee stock ownership plan.

Labor Index Calculation

As shown in Table A-1 on the next page, the 0.1 percent increase in the Wage Index and the 0.6 percent increase in the Supplements Index combined to cause a 0.3 percent increase in the Labor Index. The linked second quarter 2008 index is 313.6.

Labor Second Quarter 2008

Table A-1 Labor Index

| | 2008Q1 | 2008Q2 | Change | |
|---|-----------------|-----------------|---------|---------|
| | | | Percent | Amount |
| <u>Base Wage</u> – Straight Time & Pay For Time Not Worked | \$31.072 | \$31.078 | 0.0% | \$0.006 |
| Adjustments: | | | | |
| Lump Sum | 0.136 | 0.159 | 16.9% | 0.023 |
| Back Pay | 0.650 | 0.641 | -1.4% | -0.009 |
| Other | 0.170 | 0.170 | 0.0% | 0.000 |
| Total Wages | <u>32.028</u> | <u>32.048</u> | 0.1% | 0.020 |
| Health & Welfare Benefits | 5.506 | 5.506 | 0.0% | 0.000 |
| RR Retirement & Medicare | 6.530 | 6.533 | 0.0% | 0.003 |
| Unemployment Insurance | 0.195 | 0.195 | 0.0% | 0.000 |
| Other | 0.080 | 0.148 | 85.0% | 0.068 |
| Total Supplements | <u>\$12.311</u> | <u>\$12.382</u> | 0.6% | 0.071 |
| Total Labor | \$44.339 | \$44.430 | | |
| Wage Index¹ | 274.1 | 274.3 | 0.1% | |
| Supplements Index² | 455.0 | 457.6 | 0.6% | |
| Total labor Index, 2006 Weights ³ | 324.6 | 325.4 | | |
| Labor Index (linked)⁴ | 312.8 | 313.6 | 0.3% | |

¹ 1980 wage rate \$11.685
² 1980 supplements rate \$2.706
³ 2006 weights: wages, supplements 72.1% 27.9%
⁴ 2008Q2 linked Index = 2008Q1 linked x (2008Q2 / 2008Q1)
= 312.8 x 325.4 / 324.6

Fuel

Second Quarter 2008

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 through most of 2007, retreated in January 2008, and are now trending upward again. The average daily posted price for West Texas Intermediate crude oil averaged \$89.45 per barrel in January while declining, and for February will average over \$91 while increasing. Current events for February such as a Texas refinery explosion, tensions with Venezuela, and a falling dollar have contributed to higher prices. By early March, oil prices were over \$100, and the falling dollar was getting much of the blame. Typically during this time of the year, the Organization for Petroleum Exporting Countries (OPEC) cuts production to compensate for a seasonal decrease in demand for oil products. As of early March, OPEC appeared to be rethinking the production cut because of concern that high oil prices could push the U.S. into a recession – which would decrease the demand for oil.

Heating oil** followed a pattern similar to crude oil. The monthly average New York Harbor spot price trended upward for most of the year, but declined in December and January. Weekly prices show increases for the last half of February.

Locomotive diesel fuel prices followed a trend similar to crude and heating oil, as prices ascended to a record high in November, and retreated in December and January 2008. (Although the average price declined in December and January, those two months are still the second and third highest averages ever.)

The railroads believe that April (second quarter) locomotive diesel fuel prices will be 7.9 percent higher than the January (first quarter) forecast, but 12.4 percent higher than first quarter price actually experienced. This difference was caused by a first quarter forecast, probably influenced by the record November prices, that was higher than the actual average price experienced for January.

| | |
|---------------------------------------|-------|
| Forecast Fuel Index | 361.1 |
| Change from previous quarter forecast | 7.9% |
| Change from previous quarter actual | 12.4% |

* 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

Second Quarter 2008

The Materials & Supplies Index index increased three percent from the previous quarter level. Higher prices for ballast and metal products (such as rail and wheel sets) were the main contributors to the increase.

2008Q2 Materials & Supplies Index = 225.1

2008Q1 Materials & Supplies Index = 218.5

| | |
|------------|------------------|
| Difference | 6.6 basis points |
| | or |
| | 3.0 % |

Equipment Rents Second Quarter 2008

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

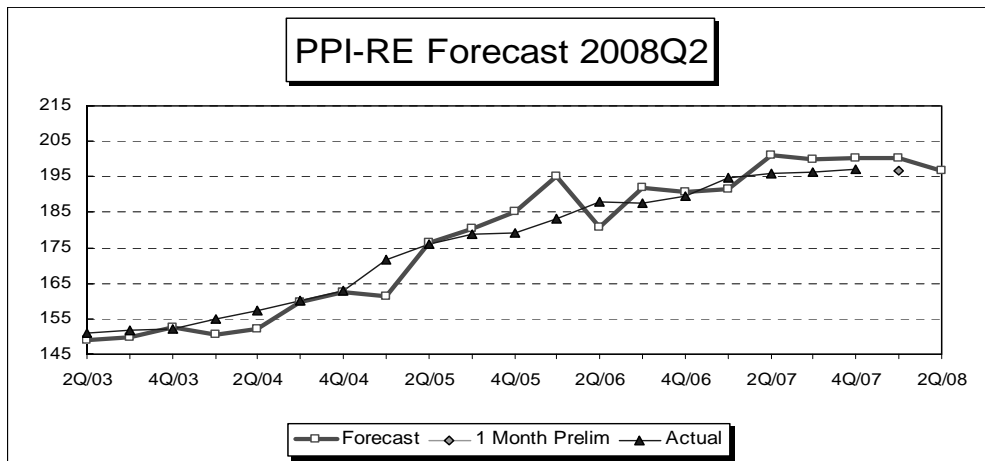
The table below lists the components of the Equipment Rents index, including weights. The Car Hire portion of the Index increased 0.6 percent, mostly because of rate increases for privately-owned cars (especially tank cars). A 2.8 percent increase for the PPI-LF (See Appendix G) used as a proxy for Lease Rentals, combined with the increase for Car Hire, caused the Equipment Rent Index to increase 1.8 percent.

| | 2006 | 2008Q1 | 2008Q2 | Percent |
|---------------------------|--------|--------|--------|---------|
| | Weight | | | Change |
| Car Hire | 46.3% | 179.9 | 181.0 | 0.6 % |
| Lease Rentals | 53.7% | 194.3 | 199.7 | 2.8 |
| Weighted Average | | 187.6 | 191.0 | 1.8 |
| Weighted Average (Linked) | | 193.1 | 196.6 | 1.8 |

Depreciation Second Quarter 2008

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

| | |
|--|-------|
| Forecast of Depreciation Index (1982=100) | 178.0 |
| Forecast of Depreciation Index (1980=100) | 196.9 |
| Change from previous quarter forecast | -1.6% |
| Change from actual first month of previous quarter | 0.2% |
| Change from same quarter of prior year (actual) | 0.5% |



Depreciation Second Quarter 2008

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

Recommended model: Box-Jenkins
Forecast Model for PPIRE
ARIMA(1,1,0)*(1,0,0)

| Term | Coefficient | Std. Error | t-Statistic | Significance |
|-------------|--------------------|-------------------|--------------------|---------------------|
| a[1] | 0.2539 | 0.1169 | 2.1724 | 0.9667 |
| A[12] | 0.2883 | 0.1212 | 2.3790 | 0.9799 |

Within-Sample Statistics

| | |
|----------------------|------------------------------|
| Sample size 72 | Number of parameters 2 |
| Mean 154.2 | Standard deviation 16.5 |
| R-square 0.9944 | Adjusted R-square 0.9943 |
| Durbin-Watson 2.085 | Ljung-Box(18)=22.35 P=0.7831 |
| Forecast error 1.242 | BIC 1.3 |
| MAPE 0.004773 | RMSE 1.225 |
| MAD 0.7493 | |

Actual Values for the Most Recent 6 Periods:

| Date | Actual |
|-------------|---------------|
| 2007-08 | 177.400 |
| 2007-09 | 177.900 |
| 2007-10 | 178.300 |
| 2007-11 | 178.200 |
| 2007-12 | 177.800 |
| 2008-01 | 177.700 |

Forecasted Values

| Date | 2.5 Lower | Forecast | 97.5 Upper |
|----------------|------------------|-----------------|-------------------|
| 2008-02 | 175.659 | 178.077 | 180.495 |
| 2008-03 | 174.315 | 178.192 | 182.070 |
| 2008-04 | 172.618 | 177.637 | 182.657 |
| 2008-05 | 172.072 | 178.039 | 184.006 |
| 2008-06 | 171.480 | 178.269 | 185.058 |
| QTR AVG | 172.057 | 177.982 | 183.907 |

Interest Second Quarter 2008

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 |

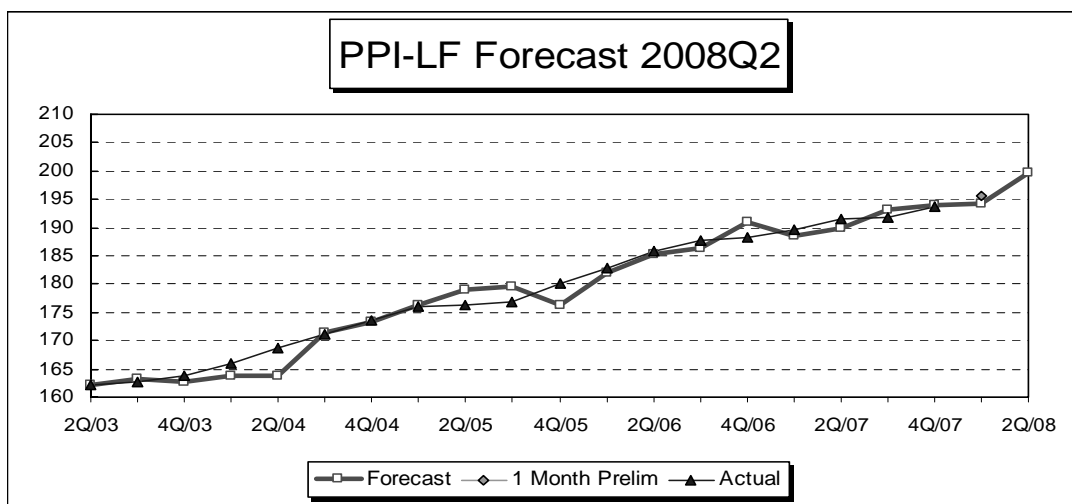
| | | |
|---------------|-----------------------|-------------|
| 2006 | Interest Rate | 7.08% |
| 1980 | Interest Rate | 7.85% |
| 2008Q2 | Interest Index | 90.2 |
| 2008Q1 | Interest Index | 90.2 |
| | Percent Change | 0.0% |

Other Expenses Second Quarter 2008

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 where the most recent month increased at a double-digit annual rate.

| | |
|--|-------|
| Forecast of Other Expense Index (1982=100) | 178.1 |
| Forecast of Other Expense Index (1980=100) | 199.7 |
| Change from previous quarter forecast | 2.8% |
| Change from actual first month of previous quarter | 2.0% |
| Change from same quarter of prior year (actual) | 4.3% |



Other Expenses Second Quarter 2008

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

Recommended model: Box-Jenkins
Forecast Model for PPILF
ARIMA(1,1,0)*(2,0,0)

| Term | Coefficient | Std. Error | t-Statistic | Significance |
|-------|-------------|------------|-------------|--------------|
| a[1] | 0.5274 | 0.1014 | 5.2003 | 1.0000 |
| A[12] | 0.1570 | 0.0942 | 1.6661 | 0.8997 <- |
| A[24] | 0.7498 | 0.0948 | 7.9094 | 1.0000 |

Within-Sample Statistics

| | |
|-----------------------|------------------------------|
| Sample size 72 | Number of parameters 3 |
| Mean 156.2 | Standard deviation 10.6 |
| R-square 0.9987 | Adjusted R-square 0.9986 |
| Durbin-Watson 1.991 | Ljung-Box(18)=19.83 P=0.6577 |
| Forecast error 0.3912 | BIC 0.4187 |
| MAPE 0.00186 | RMSE 0.383 |
| MAD 0.2969 | |

Actual Values for the Most Recent 6 Periods:

| Date | Actual |
|---------|---------|
| 2007-08 | 171.100 |
| 2007-09 | 171.200 |
| 2007-10 | 172.000 |
| 2007-11 | 173.100 |
| 2007-12 | 173.200 |
| 2008-01 | 174.600 |

Forecasted Values

| Date | 2.5 Lower | Forecast | 97.5 Upper |
|----------------|----------------|----------------|----------------|
| 2008-02 | 174.671 | 175.427 | 176.183 |
| 2008-03 | 174.748 | 176.128 | 177.508 |
| 2008-04 | 175.145 | 177.086 | 179.027 |
| 2008-05 | 175.961 | 178.399 | 180.837 |
| 2008-06 | 175.868 | 178.749 | 181.629 |
| QTR AVG | 175.658 | 178.078 | 180.498 |

Railroad and Union Abbreviations

Second Quarter 2008

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) |