

**Statement of David McGregor, Senior Vice President
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Oversight of the Surface Transportation Board

**United States Senate
Subcommittee on Transportation and Merchant Marine
Safety, Security & Infrastructure
October 23, 2007**

Good morning, Mr. Chairman, Ranking Member Smith, and Members of the Subcommittee. My name is David McGregor, and I am senior vice president for North American logistics for BASF Corporation, headquartered in Florham Park, NJ. At BASF, I have responsibility for all modes of transportation, all warehousing, and all distribution activities. I am pleased to be here today on behalf of BASF to assist the subcommittee with its oversight of the Surface Transportation Board (STB).

In the opinion of BASF, this hearing is well timed, with the STB presently in need of legislative reform. Under the current statutory scheme and with the regulatory mechanisms now in place, captive commercial rail shippers, like BASF, are placed at an extreme disadvantage, without the means for effective relief from unreliable service at unreasonable rates imposed by the railroads. I respectfully urge this subcommittee to look carefully at the practices of the STB, as they relate to the commercial rail industry. My testimony here today will describe the following:

- BASF's status as a "captive" commercial rail shipper.
- How prior STB decisions have promoted a failed status quo.
- The unfairness in current pricing.
- Why the STB underestimates the importance of rail to rail competition.
- The STB should be promoting free and open markets.
- BASF's support for S. 953, a means for reforming and improving present STB practices and procedures.

I trust that the views of BASF will not be shared by all those who are appearing with me as witnesses, including the STB and the railroads. We have some serious disagreements on how and even whether STB reform is necessary. But, as we have worked collegially in the past with the railroads on matters such safe handling, rail car design, and satellite tracking technology, I remain hopeful that we can reach some common ground on STB reform.

BASF: The Chemical Company

As one of the largest chemical companies in North America, BASF is a responsible producer of materials for a variety of industries. With over 16,000 employees and nearly 50 U.S. production sites, we provide catalysts to vehicle manufacturers, ensuring trucks, buses, and automobiles run as clean as possible. We maximize home energy efficiency with formaldehyde-free insulating products, and our dispersions serve as the frame for water-based paint and coating products. In short, BASF has become *The Chemical Company*. With the highest emphasis on safety, we ship 40,000 rail cars a year to move our products to market, with an annual cost exceeding \$125 million.

Monopolies Do Exist: Captive Rail in America

For most Americans, the term “monopoly” refers to the board game that uses locations like “Boardwalk,” “Park Place,” and in keeping with the theme of this hearing, “Reading Railroad.” But it will interest this subcommittee to learn that monopoly is actually a very real thing for commercial rail shippers in this country. Instead of “Boardwalk,” “Park Place,” and the other popular squares on the game board, we invite the subcommittee’s attention to towns like Washington, NJ, Freeport, TX, and Spartanburg, SC, homes to BASF manufacturing sites, where one railroad – and only one railroad – goes in and out of the facilities. These facilities and many others like them across America are commonly referred to as “captive” rail sites, and they are routinely subject to abuses by the railroads.

In a very recent example of abusive railroad rate practices, consider the “take-it or leave-it” offer detailed below (Table 1). These are actual per-car rate offers, involving traffic where BASF is captive to only one railroad monopoly, including commodities in some instances, which are prohibited from moving by truck as a matter of policy. You can see that on this small sample alone, BASF will be subject to rate increases totaling \$7.9 million, and exceeding 100% on average.

Table 1									
Origin		Destination		Old Rate	New Rate	Dollar Change	Percent change	Annual Loads	Total Additional Cost
GEISMAR	LA	WASHINGTON	NJ	\$6,836	\$18,106	\$11,270	165%	355	\$4,000,850
GEISMAR	LA	WHITESTONE	SC	\$5,849	\$11,441	\$5,592	96%	322	\$1,800,624
PLAQUEMINE	LA	WHITESTONE	SC	\$6,622	\$10,274	\$3,652	55%	137	\$500,324
GEISMAR	LA	WYANDOTTE	MI	\$3,240	\$7,695	\$4,455	138%	93	\$414,315
PLAQUEMINE	LA	WASHINGTON	NJ	\$5,404	\$12,177	\$6,773	125%	124	\$839,852
BAYPORT	TX	WHITESTONE	SC	\$8,631	\$12,118	\$3,487	40%	108	\$376,596
								1139	\$7,932,561

BASF has concluded that for the time being, filing an STB rate case, with historic average cost and duration of \$3 million and 3 years, is not a worthwhile effort. The current process simply does not provide the shipping community with a meaningful remedy or relief. The STB’s most recent decision on September 7, 2007, which favored the railroad over Basin Electric Corp., despite a 100% rate increase, certainly offers little hope.¹ The STB is now considering a railroad’s latest request to dismiss DuPont’s recent filing, arguing that “rate cases involving hazardous materials should not be determined under a methodology that is less rigorous than a stand-alone cost analysis.”² Only time will tell if the STB will accept this argument, allowing the railroad to change the rules in the middle of the game. Given these actions and decisions, we are left with the

¹ Western Fuels Association, Inc.; and Basin Electric Power Cooperative v. BNSF Railway Company, STB NOR42088 0 (STB served Sep. 7, 2007).

² DuPont, E.I DuPont De Nemours and Company v. CSX Transportation, Inc., STB NOR 42100 (STB filed Aug. 31, 2007).

unfortunate opinion that in today's regulatory environment, a rate case filing with the STB offers no value to the shipping community.

Recent STB Decisions Promote Failed Status Quo

Historic and noteworthy STB missteps, which precede the current chairmanship, include acceptance of inappropriate mergers and the ongoing failed rate dispute process. The former includes the UP/SP merger and the NS/CSX split up of Conrail, which many characterize as near disasters in both operational and financial terms. The Government Accountability Office (GAO) characterizes the current failed rate dispute process as inaccessible to shippers and rarely used.³

While I must commend the current chairman for his noteworthy efforts to quickly enact improvements in a difficult and complex environment, the questionable quality of even the most recent decisions and actions, offer evidence recognizable to even the layman, that today's STB requires reform. Ten months after the GAO recommended that the STB perform a study of the competitive environment of freight railroads for example, the STB reluctantly accepted. The STB's passive attitude in both establishing the study and subsequently permitting another full year to pass before requiring its results in late 2008, fall well short of the sense of urgency demonstrated by the GAO.

Next, consider the STB's January 2007 ruling on unfair railroad fuel surcharges practices amounting to a \$6.4 billion overcharge to their customers.⁴ Despite the fact that Congress explicitly states, "it is the policy of the United States Government to encourage honest and efficient management of railroads,"⁵ the STB took no action on this fuel scheme for a full three years after the railroads initiated it. The STB then dedicated considerable time and effort debating its jurisdiction to even consider the issue. This predisposition toward inaction and great care repeatedly exercised to avoid perception of exceeding procedural jurisdiction, lends itself to the consistent benefit of the railroads and to the consistent detriment of shippers.

Once the STB conceded that its office, not another, was the appropriate body to review this railroad matter, only disappointment followed in the form of an ineffective decision, with astonishing failings highlighted by the following:

- a. The STB recommended, but failed to mandate, the use of a consistent fuel index across railroads. In the words of dissenting STB Vice Chairman Buttrey, "the use of a single well recognized index would make fuel surcharges more transparent to the shipping community, the public, and the STB, and to impose reporting requirements without mandating a specific index seriously undercuts the effectiveness of that reporting."⁶

³ GAO, Freight Railroads: Industry Health Has Improved, but Concerns about Competition and Capacity Should Be Addressed, GAO-07-94 (October 2006).

⁴ Rail Fuel Surcharges, STB Ex. Parte No. 661 (STB served Jan. 26, 2007).

⁵ 49 U.S.C. 10101.

⁶ Rail Fuel Surcharges, supra note 4.

- b. The STB failed to prescribe a consistent, best practice methodology, or peg/base level across carriers. This means one railroad can continue to charge fuel based on mileage, another on ton mileage, and another by railcar weight. Some may set the peg/base level at a WTI \$64 barrel level, others at WTI \$26, or any other unlimited combination of methodologies and peg/base levels. Beyond transparency concerns highlighted by Vice Chairman Buttrey, this great shortcoming clearly increases the administrative burden for shippers, and more importantly, increases the likelihood of continued carrier manipulation, such as the post-decision increase to base freight rates that several carriers applied on April 26 2007, offsetting the reduction in fuel surcharge revenues in full. While astonishing to many, this is not surprising under current STB oversight.
- c. The STB prescribed that a quarterly report must be provided from each class 1 carrier regarding total fuel expenditures and consumption, keeping the report narrow “to avoid the regulatory burden.”⁷ Such narrow reporting is nearly useless toward achieving the end of ensuring honest and efficient management of railroads, and without some broader level of reporting, it is impossible to determine if rail shippers continue to be exploited on an individual basis. Clearly, after exposing an exploitive practice, the regulatory burden should not be the height of concern.

These missteps and the ongoing rate case debacle are important to be sure. My greater concern however, falls to deficiencies in STB policy underpinnings that truly damage the intended balance between shippers and railroads.

Rail Pricing: Where is the Fairness? Where is the Relief?

The STB sanctions “differential pricing,” the industry preferred term which applies when a railroad charges a premium to customers that are captive to only one railroad monopoly, and have no other options. The STB says that this sanctioned pricing scheme is required for the financial well being of the industry. It argues that individual shippers must suffer against their marketplace competitors for the common good, in order to provide railroads adequate margin for their high levels of capital spending and maintenance.

Reason and cause aside, the STB has overlooked the fact that this concept applies arbitrary and disproportionate rate and service disadvantages to shippers on the strict basis of their geographical misfortune and nothing more. The *differential* penalty for a shipper that has access to only one railroad monopoly, compared to a neighboring shipper that has access to two railroads, will typically result in rail rates that are 50% higher. Further, this effect is wide spread and growing, where The World Bank’s Louis Thompson, sites an estimate 40% captivity rate in 1980, has grown to greater than 50% today,⁸ chiefly due to the STB’s lax historic merger oversight. The STB makes no apologies for this failing however, and in fact appears to accept the argument that rail to rail competition is not important.

⁷ Id..

⁸ The World Bank, Regulatory Developments in the U.S.: History and Philosophy, pg. 11 (March 2000).

The STB Underestimates the Importance of Rail to Rail Competition

When the STB advises that rail to rail competition may not matter if another mode is available, even at higher cost,⁹ it demonstrates a preference for textbook theory over real world practice. Rail to rail competition is first and foremost critical in those instances where there are physical and economic limitations to modal shifts, applicable to shippers across industry, including chemical, coal, agriculture goods, and more.

While shippers know that arguments about potential shipper leverage against railroads has been oversimplified, the STB seems to have accepted them at face value. For example, one railroad argues that large customers can use their traffic at dually served facilities to negotiate a better rate/service package on traffic at the captive monopoly served facilities.¹⁰ I believe that members of the STB accept this notion, because they have never sat across from a railroad that threatens 100% rate increases at captive facilities unless excessive rate increases are accepted at the dually served facilities, such as the example we detailed above in Table 1. In these instances, rail to rail competition is critical.

The Association of American Railroads (AAR) represents that rail to rail competition will develop if there is sufficient demand.¹¹ Shippers understand the fallacy of this idea, but are not confident that the STB embraces it. While there are rare exceptions, barriers to entry seldom permit new carrier competition, in that new railroads simply do not have access to the thousand of miles of land grants that were provided to the industry in it's infancy over 100 years ago.

Closing this topic, The World Bank clearly disagrees with the STB. The World Bank advises that "the concept of rail to rail competition being less important than intra-modal competition, becomes highly questionable in countries where the rail share is high."¹² This points becomes moot however, as the STB takes the position that extended application of free market competition among railroads would dry investment, an incorrect concept on many levels.

The STB Should be Promoting Free and Open Markets

The STB acts under the principle that if railroad monopolies were required to operate in free and open markets, they would suddenly begin pricing services at unsustainable levels, generating inadequate infrastructure capital. In reality however, we must presume that railroads, like any business would instead act responsibly and with self control, pricing services at reasonable and sustainable levels, posing little risk to investment capital supply.

Like railroads, the operations of chemical producers are highly capital intensive. In 2006, BASF's North American capital and maintenance spending totaled \$944 million. 2007

⁹ Testimony of W. Douglass Buttrey, Chairman, STB, Before the Senate Subcommittee on Surface Transportation and Merchant Marine, Hearing on Economics, Service and Capacity (June 21, 2006).

¹⁰ Testimony of Charles W. Moorman on Behalf of the Association of American Railroads, Before the House Transportation and Infrastructure Committee, Hearing on Rail Competition and Service (September 20, 2007).

¹¹ AAR, Overview of Railroad Regulation, (June 2007)

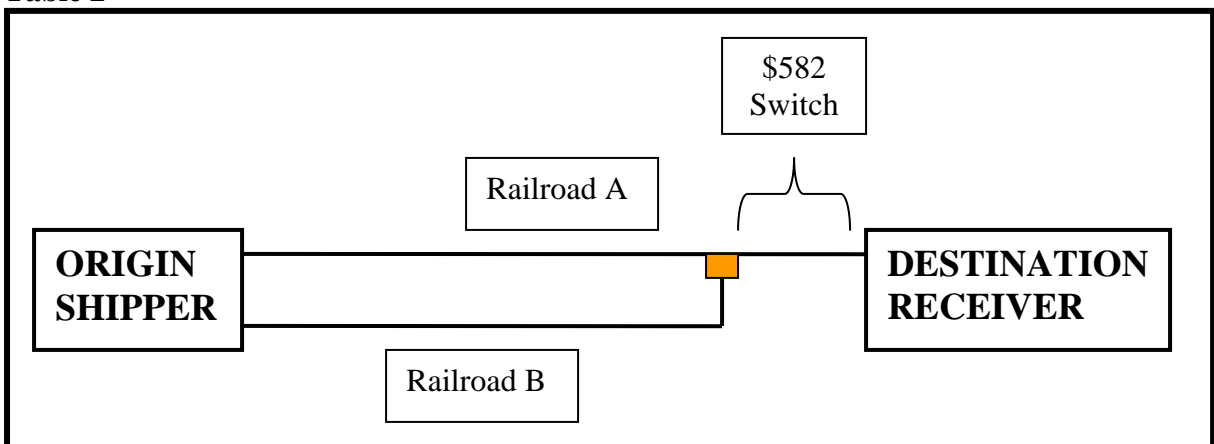
¹² The World Bank, Final AICCF: Directions of Railway Reform, Pg. 4 (September 2001).

spending is projected at \$1.1 billion. Industry wide, chemical producers spend \$23.5 billion annually on capital investment compared to railroad's \$8.4 billion. Further, chemical producers incur \$20.8 billion in Research and Development spending, compared to railroad's \$300 million.¹³ I ask this distinguished subcommittee, why do the railroads require regulatory subsidies in the form of monopoly permissive treatment, to fund similar capital spending levels that BASF and the chemical industry fund through the sale of its products, without capital flight, under free market conditions?

Competitive access already works in U.S. We invite the subcommittee to look at BASF's Geismar, LA facility, which ships nearly 10,000 rail car loads annually, and is served by the Canadian National (CN). In 1999, competitive access was granted to the Kansas City Southern (KCS). The CN and the KCS have shared in this business for years, with the CN providing KCS access to the business through a reasonable reciprocal switch charge, which the KCS pays for on a large volume of traffic. The CN accepts this compensation, and year after year moves the business with strong and sustainable service and no sign of capital erosion.

A similar opportunity allowed us free market access to two competing railroads, where the origin of the movement in question is jointly accessible by railroad A and railroad B (Table 2), both having tracks into the site, but the destination is served by the tracks of only railroad A, while railroad B's tracks are located just a few miles away. For a reciprocal switch charge of \$582, paid by B to A however, railroad A will move railcars those remaining few miles for railroad B, allowing railroad B to effectively access the destination and compete for the business. In our example, railroad B under-bid railroad A's rate offer by 35%, willingly, and despite the additional reciprocal switch cost that railroad B incurred and railroad A did not. This demonstrates again, that the competitive access model does indeed work in the U.S. today, and that with the establishment of reasonable and sustainable interswitching rates, it can continue to work and even thrive.

Table 2



These examples highlight how competitive access works in the U.S. rail industry today, sustainably, and without capital flight. For more convincing evidence I ask this Subcommittee to examine the Canadian rail industry. Free market access is not only

¹³ Bureau of Economic Analysis (2005).

permitted but required under Canadian rail oversight, and Canadian railroads, similar in size and structure to their U.S. peers, not only succeed, but thrive under such constraints, running significantly more profitable operations, again, without , and have seen no such investment flight.

In summary, and to quote Dr. Curtis Grimm, former economist at the Interstate Commerce Commission's Office of Policy Analysis, what we saw from the Staggers Act of 1980, and in these examples is that "when faced with new competitive opportunities, railroads cut costs and increase productivity. If open market competition were permitted, the same will happen again."¹⁴ Corroborating Dr. Grimm's view, the variance in operating ratio across railroads, ranging from near 60% to near 80%, provides certain evidence that opportunity for productivity gains remain. History also tells us that railroad oversight has been and should continue to be dynamic.

A Solution Has Arrived: Support S. 953

The solution for many of the problems that I have described lies with S. 953, the Rail Competition and Service Improvement Act, a bill introduced by Senator Rockefeller, a member of this subcommittee. This bill has received bipartisan support and presently has 11 cosponsors. In addition, it enjoys private sector support from a cross-section of American industry that ships by rail, including chemistry, paper, glass, fertilizer, petroleum, electrical utilities, and the farming community. BASF hopes that today's oversight hearing will lead to the subcommittee's favorable consideration of S. 953.

In particular, S. 953, if enacted, will ensure customer access to rail competition, establish a workable rail rate challenge process, mandate a proactive Surface Transportation Board, and clarify railroad obligation to serve.

I'd like to finish with one important thought. While the Staggers Act of 1980 is used by many as a near synonym for rail deregulation, it was by no means the only legislation in this area. Rail regulatory policy in fact has been amended every 12 years on average since 1887 (see Appendix 1), where we are now into the 27th year of Staggers, with no updates to reflect the significant challenges the industry faces. I believe that the greatest mistake we can make now, in fact the only fatal mistake, is further inaction.

Conclusion

Thank you very much for the opportunity to present testimony and assist the members of this subcommittee in the panel's oversight of the STB. BASF looks forward to being an active partner with the subcommittee, the railroads, and the STB itself, as we seek to find common ground on the ways to improve service by the STB to commercial rail shippers. I would be pleased to answer any questions that subcommittee may have for me.

¹⁴ Testimony of Curtis M. Grimm Before the House Subcommittee on Railroads (March 2004).

Appendix 1

Railroad Regulatory History

Interstate Commerce Act of 1887

Elkins Act of 1903

Hepburn Act of 1906

Mann-Elkins Act of 1910

Transportation Act of 1920

Emergency Transportation Act of 1933

Transportation Act of 1940

Reed-Bulwinkle Act of 1948

Transportation Act of 1958

Railroad Revitalization and Regulatory Reform Act of 1976

Staggers Act of 1980