



**Written Statement of
Cal Dooley
President and CEO
American Chemistry Council**

**Representing
The American Chemistry Council**

**Before the
United States Senate
Committee on Commerce, Science, and
Transportation**

**Regarding a Hearing on
“Freight Rail Service: Improving the Performance of
America’s Rail System”**

September 10, 2014

My name is Cal Dooley. I am the President and CEO of the American Chemistry Council (ACC), the national trade association representing chemical manufacturers in the United States. I am testifying today on behalf of our member companies and the nearly 800,000 men and women who make up America's business of chemistry. I am very pleased to be here to discuss steps needed to promote and improve the performance of America's freight rail system.

First, I would like to thank Chairman Rockefeller and Ranking Member Thune for their leadership on this very important issue and for introducing the "Surface Transportation Board Reauthorization Act of 2014." The legislation addresses numerous long-standing issues that have prevented the Surface Transportation Board (STB) from serving as an effective venue to resolve disputes between rail service providers and shippers.

To be clear, this legislation does not seek to reregulate America's freight rail system. In fact, it would make freight rail service more competitive, which is in the interest of large shippers, such as the chemical industry, and our economy as a whole.

The chemical industry is the second largest customer of the U.S. freight rail system. Thanks to the shale gas revolution our industry is projected to grow significantly in the coming years, with \$125 billion in new factories, expansions, and restarts already announced, meaning that our reliance on the rail system will only increase in the future.

Chemistry creates the building blocks for countless consumer goods, industrial processes and specialty materials that must be transported across the country and ultimately around the world. Efficient rail service; rational shipping rates; and when necessary, a timely, effective, and equitable way to resolve disputes between freight rail companies and shippers are critical to our success. However, a review of the facts suggests that many shippers currently are not benefitting from any of the three.

A recent survey of ACC members found that rail issues factor heavily into domestic investment decisions. In fact, more than a quarter of ACC members report that rail transportation issues have hindered domestic investments.

Publicly available data from the railroad industry shows that rail rates have increased more than 93 percent between 2002 and 2012, about three times the rate of inflation. ACC recently commissioned a study (summary attached) to explore the full economic impact of these increases. The study found that in 2011, 57 percent of all rail rates exceeded 180 percent of the revenue-to-variable cost ratio (RVC) – an important measure because any rate greater than 180 percent RVC could be subject to STB review for potentially being unreasonably high. In fact, a quarter of rail rates exceeded 300 percent RVC.

This means that many commodity shippers pay a very high premium to transport their products – premiums that totaled over \$16 billion in 2011. For perspective, a quick Google search will inform you that \$16 billion can pay House and Senate salaries for 172 years or cover almost 100 percent of NASA's annual budget. In more relevant terms, ACC's economists project that a \$16 billion chemical industry investment could support 54,000 direct and indirect jobs.

This issue deserves Congressional attention. Significant resources are being diverted from research and development, operations, investment, expansion, and hiring to pay extremely high rail shipping rates. Congress created the STB to help ensure that railroad companies reap

adequate returns but also to promote effective competition in the form of fair and reasonable and accessible and efficient service. Unfortunately, the Board has been unable to meet its mission. The bill introduced by Senators Rockefeller and Thune will help change that.

The Staggers Rail Act of 1980, which deregulated the freight rail industry, has been successful in many ways, but the freight rail service landscape has changed dramatically since its passage. Consolidation has reduced the number of Class I, railroads from 26 in 1980 to only seven today, with four essentially operating like regional duopolies that control 90 percent of the market. Today, more than three-quarters of U.S. rail stations are served by only one rail company, leaving customers captive to a single freight rail provider with no alternative if service or rates are unsatisfactory.

ACC recently joined with 23 other groups representing a wide range of U.S. manufacturing, agricultural, and energy interests to express to the Committee our concern that the railroad industry is not providing the level of service we need at competitive rates. We outlined a series of reforms that will increase access to competitive freight rail service and modernize the STB to make it a more effective agency. The “Surface Transportation Board Reform Act of 2014” takes significant steps to address many of the issues that have plagued the freight rail system, including the following:

- **The STB’s rate review standards are complex, overly-burdensome, and prohibitively expensive for many shippers.** The barriers for bringing a case before the STB are so high that very few of our member companies can justify the time and expense. The Board estimates that a stand-alone cost challenge takes more than three and a half years and \$5 million to complete. ACC members have experienced cases that take even longer and cost much more to challenge. These costs and delays are simply prohibitive for many manufacturers, particularly small companies.

This legislation would make important changes to the organization that will facilitate communication between commissioners and more timely action.

- **Rate bundling by railroads is a deterrent to seeking relief from the STB.** Many times, railroads “bundle” a mix of rates into a single all-or-nothing contract proposal. Contract rates are typically lower than standard tariff rates, just like the actual price of a car is typically less than the sticker price. But only tariff rates can be challenged at the STB.

In order to challenge an unreasonable rate on one or more specific routes, a shipper has to accept much higher tariff rates on all routes covered by the contract. The premium for these tariff rates may exceed the amount the shipper would hope to recover if it wins the rate case. This bundling effectively deprives a shipper of its only recourse against unreasonable rates, and we believe it should be corrected by the STB, as it would be a violation of antitrust laws in other industries. This legislation calls for a review of the impact of rate bundling practices.

- **The STB’s stand-alone cost and revenue adequacy rules are outdated, impractical, and serve as obstacles to rational rate relief.**

The Staggers Rail Act imposed two rules that today require review and possible revision. First, the Act sought to ensure that railroads were revenue adequate, meaning that returns on investment were high enough to ensure the railroads remained solvent and profitable. Unlike the circumstances in 1980, the rail industry today is more than financially sound. The industry is setting records for operating ratios, operating income, and earnings per share. Railroad stocks have outpaced the broader market for years.

Despite their economic performance, two recent attempts by ACC members to challenge rates of the rail industry's longest-tenured revenue-adequate carrier were unsuccessful, even when rates exceeded 900 percent of the railroad's variable cost. This legislation provides guidance to the Board that progress is needed on revenue adequacy rule-makings.

Second, current STB rules require that in order to win a rate challenge, a shipper must prove that it could build and operate its own railroad from scratch for less than the railroad is charging. Not only is this rule irrational, it is extremely burdensome. To prove such a thing, a shipper must engage a virtual army of lawyers, economists, and consultants to create an entire railroad on paper.

This requirement has even been criticized by Professor Gerald Faulhaber, who originally defined the economic basis for stand-alone cost saying, "the economic models upon which the stand-alone cost test were developed bear no relation to the current freight industry," and the STB's use of stand-alone cost "has no economic validity." Even the current Chairman of the STB acknowledged in a recent decision that "we should never be satisfied with a process that is so expensive and time consuming for all parties."

This legislation will streamline rate case procedures and requires a report on rate methodology. Hopefully these steps will result in a more rational approach to justifying a rate case.

- **Competitive Switching is non-existent as an option for shippers.** Competitive Switching would allow rail shippers to gain access to another Class I railroad within a short distance of their facility if they are unsatisfied with their current carrier. It would also allow shippers to obtain competing quotes from carriers, rather than forcing them to use one railroad. The Staggers Rail Act envisioned competitive switching, but it has never been allowed at the STB because of a decision in the mid-1980's that effectively precludes its use by shippers. There is currently a case pending on this issue at the STB, but it has languished for more than four years.

We have long advocated for the STB to proceed with a rule-making to make competitive switching a more accessible solution for shippers. The legislation provides guidance to the STB from Congress that the Board should move forward with such a rule-making,

- **Current STB rules make arbitration an ineffective means to resolve disputes.** The STB's current cumbersome process does not create an incentive for parties to come to consensus and find solutions. To be more effective, the Board should move to a

binding final-offer arbitration system. Similar approaches are utilized by the Canadian rail system to resolve rate disputes, as well as by professional baseball to resolve salary issues.

Under a binding final-offer approach, the shipper and the railroad each present a final proposal for the rate in dispute. At the end of the process, the arbitrator must choose one of these proposals, giving each side the incentive to converge towards a fair and practical solution. This straightforward reform would help level the playing field, swiftly and fairly resolve rate disputes, and lower administrative costs for shippers and railroads.

The legislation acknowledges the problems with the current arbitration program, requires the STB to develop new arbitration procedures, and raises the cap on damages to a more reasonable level.

A healthy, efficient, and affordable freight rail system is essential to the success of the chemical industry, many other manufacturers, and the U.S. economy overall. We firmly believe that greater competition and a more equitable approach to resolving rates are not mutually exclusive with a thriving, profitable freight rail system. It is true that there are other modes of transport, but that does not preclude the freight rail system from operating in a competitive and efficient manner.

Every policy reform we support is consistent with the policy goals set forth by the Staggers Rail Act. Unfortunately, the freight rail industry routinely opposes any reforms that would allow for more competition between railroads, including any operational changes that would give customers increased access. They have even opposed rules that would make the trucking industry more competitive.

We greatly appreciate the leadership this committee has shown on this important issue. We look forward to working with you to advance the “Surface Transportation Board Reform Act of 2014,” and we remain committed to cooperating with the Committee and our transportation partners to foster a strong freight rail system that serves both railroads and shippers well.

SUMMARY OF FREIGHT RAIL STUDY

Analysis of the Premium Railroads Charge Shippers

March 2014

Introduction

U.S. producers depend on rail service to ship their products to their customers. Over the past decade, railroads consolidated and government rules protected railroads from competition, causing freight rail rates to skyrocket more than 76 percent – nearly three times the rate of inflation and three times as much as truck rates have increased. While a strong rail industry is vital to the U.S. economy, excessive rates can be a burden on U.S. manufacturing and provide a competitive advantage to foreign producers. To better understand these impacts, Escalation Consultants quantified the premiums railroads charge U.S. manufacturers in a report entitled, *Analysis of Freight Rail Rates for U.S. Shippers*.

Methodology

For this study, Escalation Consultants examined Class I railroad rate data from the Surface Transportation Board's (STB) Public Use Waybill sample for all major commodity groups shipped by rail. Data was analyzed for 2011, the most recent year available from STB, and for 2005. Escalation Consultants calculated the railroad's revenue-to-variable-cost ratio (RVC) for each shipment that originated or terminated in the U.S. RVC is an important indicator for freight rail rates because a rate greater than 180% RVC is subject to potential STB review for being unreasonably high.

For each group of related commodities, Escalation Consultants calculated the average rate for shipments below 180% RVC (those assumed to be competitive) and the average rate for shipments above 180% RVC (those potentially non-competitive and subject to STB jurisdiction). The difference between these average rates is presented as the shipper's rate 'premium.' Escalation Consultants further broke down the potentially non-competitive rates by RVC ranges (180-240%, 240-300%, and above 300%) to show the impact of the highest rates on the total premium. Data are reported for all commodities combined, as well as for major commodity groups and individual products within each group.

Summary of Findings

These key findings are based on the Public Use Waybill sample provided by the railroads to the STB:

- In 2011, more than half (57%) of all rail rates exceeded the 180% RVC.

- The average rate for carloads above 180% RVC was \$1,335 higher than the average rate for carloads below 180% RVC, meaning that shippers paid a 53% premium for these shipments.
- As a result, the total premium paid by commodity shippers in 2011 exceeded \$16 billion.
- The commodity groups with the largest total rate premiums were coal (\$5.2 billion), chemicals and plastics (\$4.5 billion), and transportation equipment (\$1.2 billion).
- Many rates were far above the STB's jurisdictional threshold of 180% RVC; for example, nearly one quarter (23%) of rates exceeded 300% RVC, or three times the railroad's variable cost.
- From 2005 to 2011, the total premium paid by commodity shippers increased 90% while the carload volume declined by 1.1%.

RAIL CUSTOMER LETTER TO CONGRESS

July 10, 2014

The Honorable Harry Reid
Majority Leader
United States Senate
Washington, DC 20510

The Honorable Mitch McConnell
Minority Leader
United States Senate
Washington, DC 20510

Dear Majority Leader Reid and Minority Leader McConnell:

In April, a broad coalition of railroad customers representing a range of U.S. manufacturing, agricultural, and energy industries wrote to your office to highlight the need for rail policy modernization. Today, we write to you in support of the attached specific reforms that would increase competition among railroad companies and make the Surface Transportation Board (STB) a more effective and efficient regulatory body.

The lack of competition for rail services has become a critical problem for American industry, as more than three-quarters of U.S. rail stations are now served by just one major rail company. This consolidation has given the remaining railroads unprecedented market power, and has denied many rail-dependent companies the benefits of cost-effective and reliable rail transportation service. Unreasonable rate increases, service breakdowns, and diminishing competition, all act as headwinds on the many industries that require rail to do business in the United States.

In the past, the rail industry has inaccurately portrayed efforts to reform rail policy as “reregulation.” This coalition does not support a return to the 1970’s when all freight rates were automatically subject to strict government scrutiny. Because the nation’s freight rail network is vital to the strength of the economy, this coalition supports policies to create a more competitive and market-based system, while ensuring the STB has procedures to settle disputes efficiently.

There is no question that the United States needs a strong rail network to compete globally. Railroads are a remarkably efficient means for transporting bulk commodities over long distances. According to the Association of American Railroads (AAR), rail companies can now move one ton of freight 476 miles on one gallon of diesel fuel. Surprisingly, these increases in productivity have coincided with sharp increases in rail rates and declining service performance.

Several factors have contributed to the increasing imbalance in railroad market power, most importantly the dramatic consolidation of the nation’s freight rail network since Congress passed

the Staggers Rail Act of 1980. There were 26 Class I rail companies in 1980; now, four corporations control more than 90 percent of the market. Staggers helped the industry regain profitability, but unchecked consolidation has led to dramatic increases in rates. In fact,

according to AAR data, rates spiked 94.8 percent from 2002 to 2012, which outpaces increases in inflation and truck rates by about a factor of three. Furthermore, the STB held an emergency hearing and intervention this spring to address systemic rail service problems, while rates increases continue.

The STB process for rate cases can and should be improved by Congress. Although railroad rates may be challenged for being “unreasonably high”, shippers large and small who desire to bring a rate case face tremendous economic barriers. A major case at the STB is extremely complex, involves a multimillion dollar investment in lawyers and consultants, and takes several years to obtain a decision. During the rate case, shippers are forced to pay extremely high tariff rates in the hopes of recouping those costs at the end of the case if they are successful. Many shippers cannot afford to challenge a rate at the STB under current procedures, and for those that can afford it, the economics of filing a complaint are dubious.

Simply put, the current policies do not achieve the goals that Congress established in 1980, including promoting effective competition between rail companies, maintaining reasonable rates where there is an absence of effective competition, and providing expeditious resolution of all proceedings. In our view, it is the responsibility of Congress to ensure that the STB is perceived as an effective and viable intermediary between railroads and their customers who currently have no truly competitive option to ship.

We hope you will take a look at the attached document where we have outlined specific policy proposals that would help to modernize the U.S. rail policy framework. We look forward to working with Congress and the rail industry to ensure the nation’s freight rail works-- both for rail companies and the large and small American businesses that rely on them.

Sincerely,

Agricultural Retailers Association

Alliance for Rail Competition

American Architectural Manufacturers Association

American Chemistry Council

American Forest & Paper Association

American Public Power Association

Chlorine Institute

Consumers United for Rail Equity (CURE)

Edison Electric Institute

The Fertilizer Institute

Growth Energy

Institute of Scrap Recycling Industries, Inc.

Louisiana Chemical Association

Manufacture Alabama

National Association of Chemical Distributors

National Rural Electric Cooperative Association

Plastic Pipe and Fittings Association

Portland Cement Association

PVC Pipe Association

Resilient Floor Covering Institute

SPI: The Plastics Industry Trade Association

Steel Manufacturers Association

The National Industrial Transportation League

The Vinyl Institute

Enclosure

cc:

The Honorable John Boehner

The Honorable Nancy Pelosi

The Honorable John Rockefeller, IV

The Honorable John Thune

The Honorable Richard Blumenthal

The Honorable Roy Blunt

The Honorable William Shuster

The Honorable Nick Rahall, II

The Honorable Jeff Denham

The Honorable Corrine Brown

RAIL POLICY PROPOSALS

ENHANCE EFFICIENCY OF STB OPERATIONS

- Allow direct communication between STB Commissioners: Government “sunshine laws” prohibit a quorum of the STB (currently, any two members) from discussing pending matters with each other, forcing members to work via staffs. Congress should address this problem by expanding the STB to five Commissioners or by providing a limited exception that allows appropriate discussions of pending issues by STB members.
- Study STB staffing and resource requirements: Congress should initiate a study to determine whether the STB has adequate resources to fulfill its statutory mission.
- Eliminate railroad revenue adequacy determinations: As demonstrated by the industry’s high levels of capital investment and shareholder returns, the STB’s annual “revenue adequacy” calculations for Class I carriers are no longer necessary and may inappropriately shield railroads’ pricing power from STB scrutiny. Congress should eliminate this outdated requirement.
- Publicly report the status of STB proceedings: Rail stakeholders would benefit from regular reports from the STB detailing the status of pending rate cases, rulemakings, and complaints. Reports should include key STB actions and expected timelines for final resolution.

REFORM STB RATE CHALLENGE PROCEDURES

- Review the STB’s rate-reasonableness standards: Congress should direct the STB to review its three types of rate-reasonableness reviews. Significant concerns involve not only the cost and length of STB reviews, but also the fundamental principles on which each standard is based. Reformed standards should recognize that the Staggers Rail Act’s goal of restoring financial stability to the U.S. rail system has been achieved.
- Provide arbitration as an alternative means to resolve rail rate challenges: The STB’s rate review procedures are costly for railroads and shippers and, therefore, are rarely used. Binding arbitration, which has been used successfully under Canadian law, could provide a quicker and less expensive approach to resolve rail rate disputes.
- Prohibit “bundling” of contract rates that can prevent rate challenges: In some instances, a railroad will “bundle” rates in a single contract proposal for a group of origin-destination pairs and refuse to quote tariff rates for individual movements. This all-or-nothing approach
- effectively forces a shipper to agree to the complete package of contract rates and deprives them of the ability to challenge specific rates that it believes are unreasonable. The STB must be empowered to address this problem and fulfill its mandate to resolve rate disputes.

- Review STB commodity exemptions: Since passage of the Staggers Rail Act, numerous categories of rail traffic have been exempted from STB oversight. The rail industry and the state of rail competition have changed significantly since many of these exemptions were granted. Congress should direct the STB to conduct a comprehensive review of existing commodity exemptions and remove any exemptions that are no longer appropriate.

REMOVE BARRIERS TO FREIGHT RAIL COMPETITION

- Provide competitive switching to shippers: Competitive switching agreements facilitate the efficient movement of traffic between carriers and are critical to a competitive rail system. Consistent with existing authority under the Staggers Rail Act, the STB should be directed to provide competitive switching service to shippers, without requiring evidence of anti-competitive conduct by a rail carrier from which access is sought. The availability of switching should not preempt STB authority to review rates.
- Allow shippers to obtain service between interchange points on a rail carrier's system: Current STB policies and precedents effectively block many shippers served by a single Class I railroad from obtaining competitive service. In order to provide effective competition among rail carriers, a Class I rail carrier should be required to quote a rate and provide service between points on that carrier's system where traffic originates, terminates, or may be reasonably interchanged.