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Given at a Surface Transportation and Merchant Marine Hearing:
Railroad Shipper Issues and S. 919, the Railroad Competition Act of 2003
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The Testimony of
Mr. Charles E. Platz
President, Basell North America Inc.

Madam Chair and Members of the Subcommittee, thank you for the opportunity to testify today on this important subject. My name is Charles E. Platz. I am President of Basell North America Inc., which is headquartered in Elkton, Maryland. Basell has manufacturing facilities in Texas, Louisiana and Tennessee, and markets products manufactured at a plant in Linden, New Jersey. We produce raw material plastic resin that our customers use in a variety of applications such as automobile components, textiles, packaging, medical products and numerous household goods. I appear today in support of S. 919, the Railroad Competition Act of 2003, as Co-Chair of Consumers United for Rail Equity and on behalf of the American Chemistry Council and my own company.

Madam Chair, I approach this issue from the perspective of an executive responsible for successfully running a U.S.-based manufacturing business in an extremely competitive global market. I am very concerned not only that our company succeeds in this dynamic global economy, but also that important American manufacturing jobs remain in this country. If Congress does not take action enabling the market to fix this problem now, American jobs will be lost and taxpayers will be forced to pay the bill later.

CAPTIVE RAIL CUSTOMERS

Madam Chair, I want to make two initial points about captive rail customers. First, as businesses dependent on the railroad industry, we are vitally interested in the financial health of America's railroads. We simply cannot operate successfully in this country without a financially viable railroad industry and a secure railroad infrastructure. Indeed, I believe that the ability of American manufacturers and producers to compete in today's global market is highly dependent on the rail freight industry. Today, unfortunately, the rail freight industry impedes -- rather than enables -- our global competitiveness.

Second, the captive rail customers that are petitioning Congress for action are not a "fringe group" -- as some of our opponents would like you to think. Our coalition includes 14 major trade organizations representing the agriculture, pulp and paper, fertilizer, chemical and plastics industries and electric utilities that use coal. We are the largest commodity customers of the freight railroads, spending more than \$18 billion a year on rail service, which represents about two thirds of U.S. rail shipments. Remarkably, our coalition represents more than half -- approximately 55% -- of the railroads' total annual revenue.

A very large number of American families depend on wages from our industries, which provide more than 2.4 million direct jobs. Commonly accepted economic multipliers put the indirect job impact at five times that number, or 12 million jobs. Our industries provide significant contributions to this country's balance of trade and the GDP. But in the current highly competitive global business environment, captive rail customers are under increasing pressure in our own businesses. Today, American manufacturers and producers find it more and more difficult to remain competitive against manufacturers and producers outside the United States. In fact, the business of chemistry, of which I am a part, suffered its first trade deficit in history last year.

BASELL NORTH AMERICA INC.

Our rail transportation costs are a major factor in our ability to be competitive at home and abroad and in retaining and growing our employment base. For example, in Basell's North American operations, rail transportation is our second highest cost -- trailing only feedstock -- and we overwhelmingly depend on rail shipping. One hundred percent of our finished product is loaded into rail hopper cars. To meet the needs of our customers, the vast majority of whom demand delivery by railcar, we have invested in a fleet of approximately 4,000 hopper cars with a replacement value exceeding \$260 million; our railcars are not supplied by the railroads. The operation of the fleet is strictly at Basell's expense. This investment coupled with the demands of our customers ties us, as it does many other industries among our coalition, firmly to rail transportation.

At many of our facilities we are served by a single railroad for the movement of our product to our customers. Rail customers with facilities served by only one rail carrier are known as "captive rail customers." Let me explain what captivity has meant to Basell. Although Basell is not captive at its facility in Lake Charles, Louisiana, one of the railroads at that location does have a monopoly on rail service at Basell's Bayport, Texas facility. That railroad used its market dominance at Bayport to obtain leverage over our Lake Charles traffic.

Within a short distance of our Bayport plant, a second major railroad intersects the line of the carrier that holds us captive. At this intersection point, our hopper cars could be moved to the second railroad where competition could be utilized for the remainder of the movement, thus spurring the rail carriers to provide better, more efficient service and more cost-effective transportation to our customers. Unfortunately, under current law, as interpreted by the Surface Transportation Board in 1996, our carrier is under no obligation to provide a rate for moving our cars to the second, competing carrier. This "bottleneck," where one railroad controls portions of a route, allows a single rail carrier to dictate the terms of the entire movement of our hopper cars from origin to destination, even over that portion of a movement where rail competition physically exists. When the bottleneck carrier can serve the customer from origin to destination, that carrier has every incentive to block access to the competitive alternative and to retain the traffic itself for the entire movement.

In Basell's case, over time the incumbent carrier to which we are captive has charged us such an excessive rate on our movements from the Bayport plant that it has jeopardized the continued successful operation of that plant in a highly competitive plastics industry. When this occurred, we considered all of our options. One option might have been to file a rate complaint at the Surface Transportation Board, but rate cases are not a viable option for the chemical industry. The chairman of the STB has testified that rate cases are costly and long. We applaud him for recognizing this situation and speaking about it publicly. The STB has begun a process to review and revise the procedures for small rate cases and for seeking to bring about needed change. The recent provision on small rate cases that was included in the STB Reauthorization legislation reported from the Committee on July 17th is a step in the right direction. Captive rail customers note, however, that this is the second time since 1995 that Congress has directed the STB to correct this problem. Nevertheless, prospective effective alterations that may or may not occur can't change the fact that today, just as when our situation in Bayport became critical, the only available remedy for achieving access to competition is pursuit of a build-out.

Basell and three other shippers have joined with another railroad to create competition in Bayport, of which you are very familiar, Madam Chair. We have formed San Jacinto Rail Limited, an \$80 million investment to provide competitively priced rail-service options. This is not an investment that is being made because we have more traffic than one railroad can handle. Rather, we're building this redundant rail line simply to gain access to the existing competing railroad. Frankly, Madam Chair, I would much rather that Basell direct its efforts and resources toward developing new technology or upgrading our plant assets so that we could further improve our competitiveness and that of our customers. Unfortunately, the captive rates and poor service we endure at our Bayport plant threaten its very existence -- and the jobs it provides -- and breaking that captivity became paramount.

I believe, Madam Chair, if a normal commercial relationship existed between the railroads and their captive rail customers, we would have been able to negotiate a mutually acceptable transportation agreement. In doing so, we would have avoided both disrupting the community and the unnecessary capital investment. And our current carrier may very well have retained our business. Unfortunately, current federal policy that grants virtually absolute power to the railroads over their captive customers removes major incentives for the railroads to achieve mutually beneficial commercial relationships with their captive customers.

In 1980, when Congress voted to partially deregulate the railroad industry by enacting the Staggers Rail Act, Congress believed partial deregulation was the needed cure -- and that economic regulation had outlived its usefulness; that railroads faced tough competition from trucks, barges, and pipelines, and that there were still a sufficient number of carriers to provide significant rail-to-rail competition. While the law did not deregulate the industry completely, Staggers freed the railroads from many regulatory burdens and allowed the rationalization of rail systems. In 1980, there were more than 40 major rail carriers. Today, however, just five major railroads handle 90% of the nation's rail traffic. The damage to competition, to market-driven efficiencies, and to the quality and reliability of railroad freight services from consolidation has been enormous.

WHY WE BELIEVE CONGRESS MUST ACT

The power that the highly concentrated rail industry now wields in the United States can be the dominant factor in a company's investment decision. In the Chair's state, for example, Toyota only decided to invest \$800 million in a new truck assembly plant in San Antonio after the creation of rail competition at the new plant. Toyota, a Basell customer, requires that at least two competing railroad companies have access to its manufacturing sites, which allows the company to keep its shipping costs down. We understand, by the way, that the incumbent rail carrier has, reluctantly, agreed to allow Toyota access to a second, competing railroad. It's unfortunate that the same two railroads have not come to a similar agreement in response to

the San Jacinto Rail Limited project in Bayport, Texas.

Madam Chair, these transportation issues present serious problems for American businesses. The continued competitiveness of America's manufacturing and producer industries demands that changes be made. That's why I am deeply involved and committed to these issues. When I first became involved, it was out of great concern for the welfare of my company. However, as I learned more about these important issues, it became clear to me that much more is at stake – that these issues are critically important not only to our business but also, and more importantly, to the greater American economy and the jobs it provides.

Over the course of the past year I have led a group of senior executives of U.S. manufacturing and production companies with facilities served by only one railroad carrier. Our group met with and pursued a dialogue with the CEO's of the major U.S. railroads that serve captive customers. The dialogue has centered on two critical issues: (1) The financial health and viability of the railroads, including needed infrastructure improvements, and (2) The absence of a satisfactory, balanced commercial relationship between the captive rail customers and their rail freight carriers. These conversations began after John Snow, then Chair of the CSX Corporation, and I testified before the Senate Surface Transportation and Merchant Marine Subcommittee on the captive rail customer issue in July of 2002. Following our testimony, Senator John Breaux of Louisiana, then Chair of the Subcommittee, asked both Mr. Snow and me to enter into a dialogue on this issue and to involve other shipper and railroad CEOs in that dialogue. After the President nominated Mr. Snow to serve as Secretary of the Treasury, the dialogue continued with Matt Rose, the CEO of the Burlington Northern and Santa Fe Railway and current Chair of the Association of American Railroads, taking over Mr. Snow's role in the dialogue. During this effort, we assembled representatives of many of the captive shippers and the railroads for one joint meeting. Since that group meeting, the dialogue has continued through a number of one-on-one meetings, telephone calls and correspondence. While engaged in the dialogue with the CEO's and senior management of the railroads, representatives of rail freight customers examined their position and the need for a change in the status quo. With renewed focus, rail freight customers began coalescing around a few key principles aimed at enhancing competition and represented in the provisions of S. 919. That support has continually grown throughout the year, and, as I mentioned before, S. 919 now enjoys the support of 14 trade associations representing 2.4 million American jobs and more than half of the railroads' total annual revenue.

Since beginning the dialogue with rail executives at Senator Breaux's request, I have engaged in many discussions and meetings about this issue. I am now convinced that the freight railroads will not budge from the status quo in which they have complete market dominance over their captive customers. The Staggers Act, the ICC Termination Act of 1995 and agency interpretation of those acts provided the market dominance railroads hold over their captive customers. While today's railroad CEO's may believe, or may be advised, that their fiduciary duties and corporate governance obligations require them to defend the status quo, that belief is misguided since it focuses only on the very short term. Indeed, I do not accept the status quo as a reasonable business model designed to propel the rail service business into the future. To the contrary, the current model will inevitably lead railroads to their financial brink, costing not only railroad shareholders, but also taxpayers and rail-dependent American enterprise.

A FLAWED RAILROAD BUSINESS MODEL

Madam Chair, based on my experience, I believe the major railroads in the nation are pursuing a flawed business model. Even the railroads agree that the gap between their annual income needs and their annual income is expanding, not shrinking. This is despite the fact that they have been allowed to consolidate to achieve cost synergies. These synergies should have allowed them to operate more efficiently and in a fashion that permits them to recover their cost of capital. They've also had the opportunity to transfer less profitable track to short line railroads and they have been able to increase the burden on captive rail customers. The result is simply that those customers with no alternative pay the most.

Pursuing a strategy of continually loading more costs on captive rail customers does not appear to be a business model that will result in healthy American railroads in the long run. Captive rail customers will try to escape and the universe of captive rail customers is likely to be reduced over time. Some captive customers will construct rail line "build-outs" as we are. Some captive customers will shift their manufacturing activities to facilities that have transportation competition. Some captives will shift their manufacturing to foreign countries, exporting American jobs overseas. Some companies might be forced to close a U.S. plant or to forego an expansion without even having an offshore alternative. Under this business model, the industry will be required to load up even more costs on the remaining captives, thus accelerating the cycle.

Let me be very clear: none of us seeks a return to the "bad old days" of the 1970's when several of the major railroads were in bankruptcy and the industry lacked the capital necessary to maintain their systems. Unfortunately, after more than two decades since passage of the Staggers Act, the industry apparently continues to fall short of the revenue needed to provide a first class rail system for the nation. As described above, today's rail executives will defend the status quo at all costs, and thus no solution to this problem

can be negotiated among the relevant business interests. Unfortunately, captive rail customers likewise cannot expect regulatory relief from the Surface Transportation Board.

While the STB has made several positive changes to its operating procedures since the arrival of Chairman Roger Nober, not everything at the railroad regulatory agency is up for review. In an interview published in the newsletter "Rail Business," Chairman Nober, in response to a question about the reform sought by the captive rail customer coalition, stated, and I quote, "They have a lot of legitimate issues that they are raising. The core issues that they want to see done, though, are for the Congress." End of quote. Madam Chair, this is a clear and definitive statement that the changes we urge today cannot be pursued anywhere but in Congress.

S. 919 IS NOT RE-REGULATORY

Madam Chair, there must be a better way for the railroad industry to achieve long-term financial viability while providing efficient service at prices that will allow American business to compete successfully in the global market. The time has come to move toward a partnership between government, the railroad industry and their customers -- a partnership that will ensure a national rail system that can meet the demands of our nation's role in a global economy. We believe that balanced, fair legislation is needed to bring about a positive relationship between the railroads and the captive customers.

Madam Chair, the railroad industry argues that S.919 is "re-regulatory". Rail Industry documents cite two reasons. First, that S.919 allegedly caps rail rates. Second, that S.919 allegedly provides for "universal trackage rights", a concept under which any railroad could run over any other railroad's tracks. These allegations are simply not true.

S.919 does not cap rates. In fact, S.919 does not address the rate regulatory process at all. S.919 does not change the current rate standards of the Surface Transportation Board. S.919 does not force the railroads to provide rates to a "special group of customers" at "lower than market rates." S.919 does not reduce the minimum captive rail customers must prove they pay, which is 180% of the railroads' variable costs, in order to seek rate relief at the STB. Notably, rail freight customers enjoying competition pay on average only 106% of the railroads' variable costs, even though railroads state they must receive 150% of their variable costs in order to earn a sufficient return.

S.919 does not shift any burden of proof in rate cases to the railroads; perhaps unique in American regulatory experience, all burdens of proof are on the rail customer. S.919 does not require the railroads to post tariffs or to obtain prior approval of the STB for any tariffs that they do post. Finally, S.919 does not even prescribe the rate that a railroad must quote across a bottleneck. Rather, S.919 simply requires the railroad to provide a rate across its bottleneck to the facilities of a competing railroad.

Nor does S. 919 provide for "universal trackage rights" under which one railroad may operate over the tracks of another on demand.

What S.919 does in the area of competition is over-rule three interpretations of the Staggers Rail Act by the Surface Transportation Board and its predecessor agency that we believe were not contemplated by Congress in 1980. S.919 over-rules the "bottleneck" decision of the STB in 1996 by requiring a railroad that has a customer captive behind a "bottleneck" to provide a rate across the bottleneck to the facilities of a competing carrier. It is important to recognize that the customer will remain captive for the bottleneck movement and that S.919 does not prescribe the rate to be charged. However, we believe strongly that a railroad should not have the right to make a customer captive artificially over that portion of a movement where a rail transportation alternative exists.

S.919 also overturns a 1986 interpretation of the "terminal access" provision of the Staggers Rail Act. "Terminal access" governs how railroads interact with each other at various rail terminals where they exchange railcars for the purpose of moving freight across the nation and how freight moves from the bottleneck carrier to the competing railroad in the San Jacinto and Toyota examples. Since the 1986 interpretation, no captive rail customer has won a "terminal access" case at the STB or its predecessor agency. Finally, S.919 provides a mechanism by which "paper barriers" can be removed by the STB. The Staggers Act of 1980 allowed the major railroads to "rationalize" their systems. One way they did this was to sell their less profitable track to short line railroads. However, through provisions in their sales or leases of this track, all of which provisions were approved by the STB or its predecessor, the railroad retained control of the traffic over the short line by requiring it to come back to the major railroad for long distance movement, even when the short line could deliver the freight to a second major railroad. Thus, these "paper barriers" have prevented captive customer access to rail competition. S.919 outlaws these provisions in the future and allows the STB to remove existing provisions that have been in place 10 years, after making certain findings. We believe S.919 will enable the national rail system to evolve toward a more competitive system that serves the needs of our nation in a competitive global market. The Ocean Shipping Reform Act of 1998 is an example of how market forces can restore balance to commercial relationships. That act opened the door for large and small ocean shippers and ocean transportation

intermediaries to put in place creative contracts that allow them to combine freight in multiple trade lanes and reduce shipping costs.

CONCLUSION

Madam Chair, we believe there is nothing in S.919 that is either re-regulatory or radical. Yes, if S.919 or its provisions were to be enacted, the railroads would have less opportunity to load up on at least some of their captive customers. There may be temporary difficulties as the railroads move to a new, modern business model. We understand the difficulties of the competitive environment. We operate in a competitive environment every day. However, we believe S.919 will force the railroad industry to move to more normal commercial relations and partnerships with their captive customers. We believe this will result in increased rail business as the competitiveness of their captive customers improves. This evolution is crucial to the health and viability of the railroad industry, to our nation and to our ability to compete in the global market place.

Madam Chair, I am not here today to ask Congress to resolve issues that can be resolved by captive rail customers and the railroads working together, and with the STB, to benefit their own industries. We are in fact doing that. But what I have learned over the past year in immersing myself in this issue is that there is a basic impediment to affecting any meaningful move in rail competition and it cannot be resolved without the intervention of Congress.

Finally, Madam Chair, captive rail customers are not the enemy of the railroads – we are their best customers. But, the fact is that the STB's interpretation of the Staggers Act has given railroads a monopolistic advantage over captive shippers, which provides a major, steady stream of revenue for the railroads. Furthermore, the rail CEO's view of their fiduciary responsibilities blinds them from considering any course of action other than to protect and exercise this monopoly advantage. Consequently, they will not give this advantage away through negotiations with their customers. If the railroads, our business and the economy are to prosper, our relationship must evolve from one of captivity with all of its negatives to one of partnerships where mutually beneficial transportation agreements can be developed. But, we cannot get to that point without your help. The railroads won't willingly change and the STB has declared this issue is for Congress. Thus, Congress must address this situation before the current system creates more serious problems that will be very difficult and costly to correct.

Thank you, Madam Chair, for this hearing, for your interest in this issue and for the opportunity to present our case to you and your colleagues.

508 Dirksen Senate Office Bldg | Washington, DC 20510-6125 | Tel: 202-224-5115
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