

BEFORE THE
SURFACE TRANSPORTATION BOARD

ENTERED
Office of Proceedings
August 16, 2024
Part of
Public Record

STB Ex Parte No. 775

GROWTH IN THE FREIGHT RAIL INDUSTRY

**WRITTEN TESTIMONY OF
THE FERTILIZER INSTITUTE**

Presented by Ryan Bowley, Vice President, Government Affairs

Pursuant to the Surface Transportation Board (“STB” or “Board”) notice served on July 15, 2024, The Fertilizer Institute (“TFI”) hereby submits this written testimony on “Growth in the Freight Rail Industry.” TFI appreciates the opportunity to engage with the Board on this important issue.

Statement of Interest

TFI represents companies that are engaged in all aspects of the fertilizer supply chain in the United States. Half of all food grown around the world is made possible through the use of fertilizer, hence its importance to farmers and food production.

The U.S. fertilizer industry generates more than \$130 billion in economic benefit each year and supports approximately 487,000 American jobs.

Nearly 44 percent of all fertilizers produced globally, or more than 200 million tons of material, are exported annually. Moving this material from production facilities to farms requires virtually every mode of transportation and a carefully orchestrated system of logistics to serve farmers on a just-in-time basis. Over 50 percent of all fertilizer moves by rail year-round throughout the United States.

The Board’s Attention on Rail Industry Growth is Timely

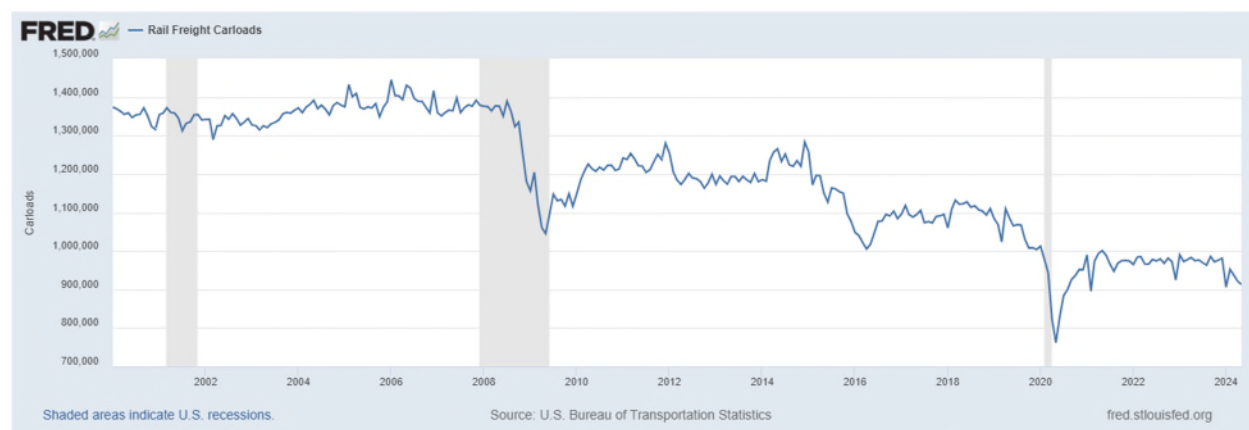
This hearing comes at an important time for the nation’s six Class I railroads. They form a critical part of the nation’s transportation infrastructure, with nearly 100,000 miles of track, tens of thousands of employees, and thousands of locomotives connecting ports, factories, terminals, and communities. With freight moving into, out of, and across this country ever increasing, the pain of highway congestion a constant, and a growing focus on “greener” goods movement, the rail industry should be growing its share of freight moved, providing customers with efficient and cost-effective service while securing strong returns for carriers’ shareholders.

Instead, the Board is holding this hearing out of concern over the future prospects for the industry, spurred on by the reality that not only have carloads dropped substantially from their highs in 2008, but also that even after a recovery post-pandemic, the industry’s volumes have plateaued.

As a major source of rail traffic, the fertilizer industry is acutely focused on the future capability of the rail industry, especially Class I carriers, to play an important role in the supply chain that moves fertilizers from production facility to farm field. TFI members also recognize the necessary role that the national rail network and rail carriers play in delivering agricultural products from the farm to market, whether here in the United States or to export countries across the globe. TFI members value strong operational partnerships with the Class I railroads.

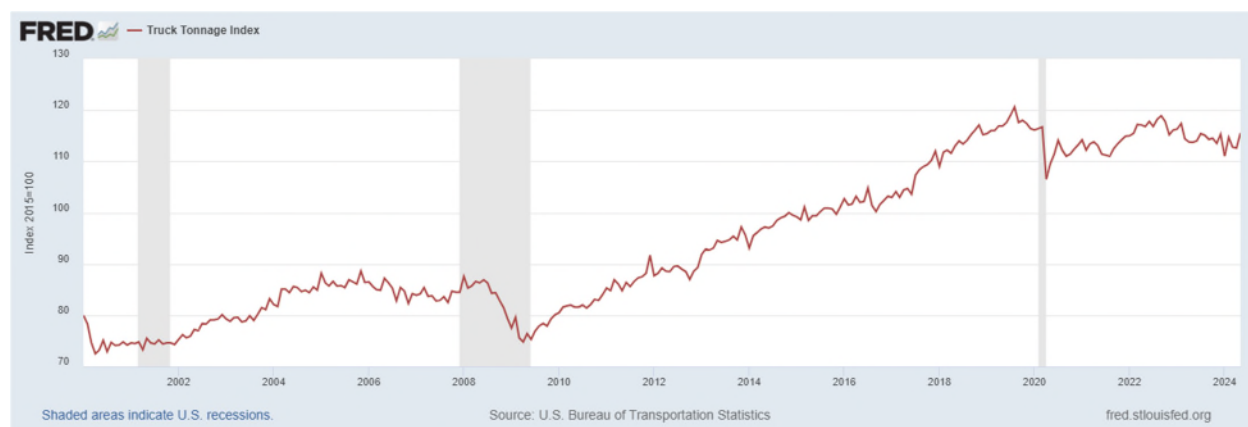
Therefore, it is with concern that the fertilizer industry looks at the rail carload trendline, especially in comparison with the truck tonnage data from the same time period. After recovering from the 2008 recession, the amount of freight moved by the trucking industry has largely and consistently grown. Looking deeper into data from the Department of Transportation, the number of motor carriers of property, trucks on the road, and truck drivers has grown significantly over the past five years.¹ In contrast, rail freight carloads have generally declined since 2008 and the rail industry has reduced service and staffing over this period. The rail industry is only now addressing the significant job cuts in critical roles made during the pandemic.

Fig. 1 – Rail Freight Carloads



¹ FMCSA, Analysis & Information Online, <https://ai.fmcsa.dot.gov/>. Federal Motor Carrier Safety Administration (FMCSA) data show that the number of active for-hire motor carriers with USDOT numbers registered as handling freight has increased by approximately 300,000 since December 2019. The drivers and vehicles these carriers use have also substantially increased during this period.

Fig. 2 – Truck Tonnage Index



Comparing employment statistics for the Class I railroads brings this to life. In 2006 at the height of the industry’s carload volume, Class I carriers employed over 167,500 employees who completed a total of 438.4 million service hours. In 2023, those numbers had dropped to fewer than 122,000 employees and below 300 million service hours. While some of this is attributable to improved technologies and the industry’s loss in traffic over this period, more likely this change is driven by the shift over this period by Class I rail carriers to so-called Precision-Scheduled-Railroading (“PSR”), which prioritizes cutting operational costs to the bare minimum required. There is no indication that the Class I railroads could handle volume levels similar to those they were transporting in 2006 given staff reductions.

The Experience of Fertilizer Companies as Rail Shippers

Fertilizers are bulk products that often must travel long distances from production facility or terminal to distribution point. As such, over sixty percent of fertilizers move at some point via rail in the United States, typically either in bulk hopper cars for solid fertilizers or in tank cars for liquid or compressed gas products.

Some background on the three major plant nutrients that make up most fertilizers is important to understand the criticality of rail to our industry. The raw materials for phosphate and potash fertilizers are mined, so they typically move in multi-car shipments from the mine to a processing plant and then to various distribution points. Nitrogen fertilizers are manufactured at sites around the country and move in bulk to distribution terminals in proximity to growing regions. Other secondary nutrients, micronutrients, and chemicals used in fertilizer manufacturing also move by rail. Importantly, the fertilizer industry is a global marketplace, meaning that many fertilizers are imported into the United States and fertilizer makers here are also exporting their products via rail to neighboring countries and to ports.

Given the bulk nature of fertilizer products, the often just-in-time needs of fertilizer customers, and because many fertilizers qualify as hazardous materials, rail is often the safest, and most efficient form of transportation for all but last-mile distribution of these products. The entire agricultural sector relies on consistent rail service as fertilizer must be pre-positioned ahead of busy

application seasons for food, feed, fiber, and fuel crops. Impacts to fertilizer transportation – either through elevated rates or reduced service – have knock on effects across the entire agricultural sector, impacting farmers large and small.

Because TFI members produce and distribute rail-centric commodities, the association has been actively engaged before the Board on a multitude of Class I service quality, rate reasonableness, and competition-enhancing policies over the years. As noted by TFI in comments to the Board in its Ex Parte No. 770 proceeding on “Urgent Issues in Freight Rail Service,” actions by Class I carriers, including “implementation of precision scheduled railroading...eliminating too much rail carrier personnel, idling of locomotives, and closures of service yards” represent root causes for recent and especially severe service quality reductions.

Class I railroads enjoy substantial power to dictate rail pricing and service. Motor carriers are often ineffective competitors to rail carriers on long-haul routes for bulk commodities. In addition, many shipper facilities are served by only one rail carrier.

Fertilizer and other rail-centric shippers have been saddled with substantial rate increases, especially for traffic moving to or from a facility that is not served by multiple Class I railroads. As noted in an analysis of fifteen years of data, “in 2019, half of all railroad revenue was generated from non-competitive rates [(i.e., $R/VC \geq 180\%$)], up from 27% in 2004,” and “revenue from non-competitive rates increased 230%, while revenue from competitive rates increased only 24%.”²

Declining customer service and increasing rates are typically not a combination that leads to the retention of existing customers and attraction of new business. Not only does it drive shippers to seek out other modes, when possible, but it also brings greater uncertainty to freight movements that must occur on rail. “How much more will this shipment cost me to move?” and “Will this shipment arrive within the window the railroad estimated?” are questions that fertilizer shippers have asked themselves more and more over the past several years. Unfortunately, the answers are all too often “A lot more,” “No, it will be late,” and “The railroad doesn’t guarantee service.”

All of this leaves many rail customers wondering if Class I railroads have largely thrown in the towel on customer-focused efforts to retain and build business, either from traditional rail commodities or by attracting more sources of freight. The industry could be acting to make rail a more competitive mode of transportation or at the very least focusing on prioritizing customer success like countless other modern industries. However, Class I rail carriers seem intent on increasingly squeezing revenue out of customers with rail-centric commodities such as coal, agricultural products, fertilizers, and other chemicals. As noted by industry observers, if these actions continue without a change, “the [Class I] railroads would become more like utilities,”³ shrinking their networks and service offerings only to serve traffic over which they have effective monopoly power. In contrast, a focus on growth would reduce reliance on captive traffic for revenue, improve service offerings for all traffic, and generate safety and environmental benefits, all of which benefit the American economy and public.

² Escalation Consultants (prepared for the Rail Consumer Coalition), “Economic Analysis: Consolidation and Increasing Freight Rail Rates,” June 2021, <https://www.freightrailreform.com/wp-content/uploads/2021/07/Economic-Analysis-Consolidation-and-Increasing-Freight-Rail-Rates.pdf>.

³ Matthew Schabas and Adriane Bailey, “The Path to Long-Term Shareholder Value for Rail is Growth,” April 2024, <https://www.oliverwyman.com/our-expertise/insights/2024/apr/shareholder-value-rail-growth.html>.

Congress Provided the Board with a Mandate to Protect Shippers & Enable Growth

In enacting the Staggers Act in 1980, and subsequent legislation, Congress provided what is now the Board with a path and a responsibility for ensuring that our Class I railroad network does not become a mirror image of an electric utility system serving only a small number of essentially captive customers. It revised the Interstate Commerce Act to provide railroads with greater freedom and incentive to compete for traffic and grow their business, while ensuring that rail customers would continue to have important rate and service protections where competition is ineffective.

Under 49 U.S.C. 10101, the rail transportation policy of the United States includes:

- Allowing, “to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail”;
- Promoting an “efficient rail transportation system by allowing rail carriers to earn adequate revenues”;
- Ensuring “the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes...”; and
- Prohibiting “predatory pricing and practices, [and avoiding] undue concentrations of market power...”

In addition to establishing a policy that promotes growth through competition, Congress has provided railroads with the flexibility to enter contracts to provide rail service and generally removed these contracts and service under them from economic regulation, which allows carriers to compete for traffic without being limited by direct rate or service oversight. Congress has also removed from rate regulation traffic over which railroads face effective intermodal competition, regardless of whether railroads handle this traffic under contract. This not only allows railroads to compete more effectively for this traffic, but also allows railroads to grow revenues from this traffic without any regulatory limit, an important incentive for railroads to grow.

While providing railroads with more flexibility to compete, Congress has also maintained several important regulatory protections for shippers. For example, it has preserved the common carrier obligation (“CCO”), which requires railroads to provide service upon reasonable request. (49 U.S.C. 11101). It also has maintained rate regulation for traffic for which railroads do not compete, requiring reasonable rates for this traffic. (49 U.S.C. 10701). And it requires carriers’ rules and practices to be reasonable. (49 U.S.C. 10702) These requirements compose a statutory bedrock of rail policy that provides shippers with protection from unreasonable rates and unreasonable service challenges and unreasonable carrier rules.

The rail industry has changed a great deal in the decades since the enactment of Staggers, making the guiding principles under Staggers even more relevant today. At the time Staggers was enacted, the rail industry was facing significant economic challenges that posed a dire threat to the rail network. To secure the financial health of the rail industry, Staggers and the Railroad Revitalization and Regulatory Reform Act of 1978 emphasized the importance of promoting railroad revenue adequacy. Today, due to policies promoting revenue adequacy, Class I railroads have largely met

the Board's revenue adequacy threshold consistently for many years. And despite the industry's sclerotic approach to customer engagement and growing traffic, the returns generated by many Class I carriers have continued to grow well beyond the revenue adequacy threshold. It is now time for the Board to rebalance the role of revenue adequacy in relation to other Staggers objectives.

Revenue adequacy does not accurately reflect traffic growth and, thus, should not be the primary measure that the Board or the Class I railroads and their investors consider as an appropriate indicator of the industry's direction. Similarly, while operating ratio may provide an illustration into a railroads financial approach, it should not be the sole or even primary datapoint for assessing the industry or an individual railroad. None of these measures provide a holistic window into a company's approach to growth. The Board must consider other factors to determine whether the rail industry is thriving or stagnating.

A growing company or industry is not one that maximizes financial returns by collecting more and more revenue out of the same focused group of customers. A growth-focused company or industry is one that offers current and potential customers competitive service and rates and that defines success by more than just an operating ratio or some other measure reported to shareholders. It defines success by how it enables its customers to grow, providing value, adding market share, and building returns for shareholders through growth.

Even looking at operating ratio as a measure, not all improvements in operating ratio result from pro-growth or pro-service posturing. Operating ratio improvements arising from productivity measures that allow a rail carrier to do more with less can reflect a pro-growth or pro-service stance. But when those improvements arise by doing the same (or less) with less, they suggest that the rail industry is focused on maximizing revenues from core, rail-centric customers, not growth or improving service.

In fact, improvements in operating ratios over the past decade do not reflect any attempt by the industry to grow or improve service. The industry has broadly adopted "precision scheduled railroad" operating models that focus on reducing operating costs. They have also implemented ever leaner staff in key areas such as operations and maintenance and reduced locomotive and other key assets. At the same time, the Class I rail carriers have been moving less and less traffic while increasing profitability. Even as carriers have added back some staff following the major post-pandemic supply chain snarls, shippers have seen continued reductions in customer-facing marketing and sales staff. This has strained the ability of even the most well-intentioned to provide appropriate customer service, pricing decisions, and more. The Board has rightly spoken up about the impact of railroad cost cutting measures on customers, and TFI sees the majority of these activities resulting in a reduced customer experience.

A customer-and growth-focused Class I carrier community is one that provides reliable and prompt service to core customers with rates that are not only reasonable but competitive. It is also one that can achieve lower operating ratios through higher revenues from a broader base of business. Hearings like this, increased oversight, and proceedings focused on unreasonable pricing and unreasonable service conditions have an impact.

TFI appreciates the enhanced attention of the Board to shippers' concerns regarding Class I railroad practices in recent years. Actions in these areas have been within the scope of the Board's mandate

from Congress and aligned with the policy goals of supporting reasonable service and rates. Some may use these proceedings to argue that the key to unlocking Class I railroad growth is to relax the Board's oversight. However, the experience of shippers – especially those who would like to shift more of their freight to rail – makes clear that the opposite is true.

For instance, during the Spring of 2022, Union Pacific ("UP") directed fertilizer customers to reduce their shipments on the eve of the Spring application season. UP's communication to customers referred to impacted shippers as "offenders" even though the directed reduction was driven by service failures on UP's network. While TFI acknowledges the struggles faced by UP's network at the time and that the railroad needed to take steps to reestablish fluidity on its network, service reductions and embargos are not a reasonable approach to operating a business. TFI appreciates the engagement of the Board on this matter, for holding a December 2022 hearing with stakeholders, and for issuing a set of findings on April 16, 2024.

Similarly, TFI thanks the Board for advancing much needed changes to its emergency service order process earlier this year. This streamlined process enables faster action by the Board as shippers experience service-related emergencies. Attention on issues such as this are incredibly important as Class I railroads continue to focus on maximizing their profits, achieving operating ratio goals, and implementing initiatives such as PSR that promise efficiency but have largely only resulted in negative outcomes for shippers.

One of the many major changes in the railroad industry that has occurred since passage of the Staggers Act is the shift towards private ownership of railcars. While over 70 percent of all railcars today are privately owned either by shippers directly or leased to shippers, 100 percent of rail tank cars are in private, non-railroad ownership. Railcars, no matter who owns them, represent a massive capital investment, and their efficient movement benefits shippers and railroads alike. However, as noted by TFI and other shippers before the Board, there is no Board policy focused on creating incentives for railroads to maximize the efficiency in which it uses and transports cargo on private railcars. Shipment delays, held cars, and other practices have resulted in shippers incurring substantial financial, operational, and customer-impacting costs, including lost production, manufacturing shutdowns, and the need to purchase additional cars. The lack of reciprocity in this area, combined with the Class I railroads' general disinterest in meeting the needs of customers is an area where further action by the Board is warranted and would have a positive impact on shippers.

As noted above, fertilizer companies and other rail shippers have experienced significant and consistent increases in rail rates. For instance, rates for carloads of anhydrous ammonia increased by 206 percent between 2005 and 2017. TFI and other shipper organizations have long noted the challenge shippers face from the Board's existing rate review procedures, and past Board members have made similar observations, including former Chairman Begeman noting in 2016 that the existing large rate case process is "too costly, too time consuming, and too unpredictable." From the perspective of shippers, the reasonableness of rates has a significant impact on their ability to grow and maintain rail traffic. For captive shippers the impact is even more acute.

TFI thanks the Board for actions such as Final Offer Rate Review and the Small Rate Case Arbitration Program to improve the rate review process. However, both are largely focused on

smaller rate cases and large rate review continues to be extremely burdensome and costly, effectively cutting off avenues for meaningful oversight of unreasonable rail rates.

The Board, however, should not continue to overlook the very tool that Congress provided to spur growth and service quality—reciprocal switching. Improving access to reciprocal switching merely to avoid poor service levels is not enough to promote growth and improved service. Instead, the Board must provide access to reciprocal switching where railroads lack effective competition, which the Board has refused to do even as railroads have produced record financial performance, while their traffic and service have declined.

Conclusion

Through attention to the issues outlined above and a focus on meeting the policy goals set out by Congress, the Board can take actions that will promote rail-industry growth. This is critical as the Class I carriers have continued to focus solely on growing revenue from a small set of rail-centric and largely captive shippers, allowing their service and traffic levels to falter. This is inconsistent with the goal of the Staggers Act to generate a rail system that meets the demands of interstate commerce and the national defense. See Staggers Act § 3.

Oversight activities such as this hearing, action on key rate and service reasonableness matters, and increased access to reciprocal switching to promote competition can drive carriers to rethink their approach and look to repositioning their businesses towards growth. Indeed, the Class I railroad business model of a concentrated set of customers continually paying more for lower quality service is very much the outlier across both business as a whole and within the freight transportation sector. In comparison to other modes, the industry does not appear to have much of a focus on competing for freight.

A contrasting example can be found within food distribution sector, which provides food and other items and services to restaurants. This industry recognizes that if the restaurants – from small businesses to global chains – they serve as customers are not growing, then the distributors are similarly not growing. As such, distributors have increasingly prioritized a focus on customer success and leveraged innovative thinking to help them meet multiple challenges from COVID-19 to the rise of farm-to-table eating. In many cases this has required distributors to make significant changes in how they do business, but by prioritizing customer success they are positioned to grow as their customers grow.

Another example is provided by truckload carrier JB Hunt in their most recent annual report:

*“We navigated through each quarter remaining committed to investing in our strategic company foundations of People, Technology and Capacity. These investments allow us to **deliver exceptional value for our customers and prepare us to grow with them over the years ahead**, working toward what makes us better*

over the long term.” – JB Hunt, Letter to Shareholders & Employees, 2023 Annual Report [emphasis added]

TFI thanks the Board for the opportunity to participate in this hearing, and we look forward to continued engagement with the Board on key issues for freight rail shippers.