Good morning. I am appearing today on behalf of the American Chemistry Council because this proceeding is tremendously important to the chemical industry. Much of the chemical traffic that is transported in this country moves by rail and is captive to a single rail carrier at either the origin, destination, or both. Furthermore, three decades of consolidation in the rail industry has produced rail duopolies in the eastern and western portions of the country, and extended the distance over which many chemical production facilities are captive to a single railroad. As a result of this increased captivity, the rail industry has been able to impose substantial rate increases over very short periods of time. These rate increases reduce the ability of U.S. chemical producers to increase economic output and create new jobs. The NITL competitive switching proposal has the potential to restore some of the rail competition that has been lost through past mergers. This, in turn, would establish a fair and reasonable balance between the often conflicting goals of the Staggers Act to promote railroad revenue adequacy and effective competition.

Since the Conrail acquisition, which was the last major merger that completed the current eastern and western duopolies, rail rates have increased at an unprecedented pace.

For example, over the past decade, rail rates on a per car basis have increased 2.8 times faster than truck rates and inflation, which strongly suggests that railroads are exercising significant new-found leverage over captive shippers.
A recent study commissioned by ACC, which was included in ACC’s opening comments, estimated that the chemical industry paid $3.9 billion in freight charges above the 180% R/VC jurisdictional threshold in 2010.

Recently, ACC released an updated version of that study based upon 2011 rates, showing that this premium had increased to $4.5 billion. The jurisdictional threshold is a significant benchmark against which the study shows how much and how fast rates have increased in the years following the Conrail merger.

In just 5 years between 2005 and 2010, the chemical industry premium above 180% increased from $2.2 billion to $3.9 billion, which is a 78% leap.

If you benchmark it against the $4.5 billion premium in the updated 2011 figures, that increase jumps to 105% over just 6 years. The analysis also shows that more than one-third of chemical shipments have rates above 300% RVC. The high fraction of rates above 300% RVC confirms that trends identified by GAO and Christiansen Associates have continued, and likely become more pronounced, at least for the chemical shipments.

This increase cannot be explained by higher demand for rail transportation because overall carload volume in 2011 was virtually unchanged from 2005, while the overall rate premium across all traffic was up by 90%.
Comparisons to Canada illustrate the consequences of reduced rail competition for the competitiveness of U.S. chemical producers. Canada has long had inter-switching, which is a far more liberal form of competitive switching than NITL has proposed.

The same study commissioned by ACC compared 2010 rail rates to U.S. destinations from U.S. origins against Canadian origins. That study found that 40% of Canadian origin chemical traffic had R/VC ratios below 180%, whereas only 23% of U.S. origin chemical traffic was below 180%.

The competition that inter-switching creates at Canadian origins clearly gives Canadian chemical production an advantage over U.S. locations. Competitive switching would do much to level the playing field for domestic producers.

Restoring competitive balance to the rail industry would reduce the rate premium paid by chemical shippers, which would allow the U.S. chemical industry to increase economic output and create new jobs.

The NITL proposal would reverse some of the anti-competitive effects from 30 years of rail consolidation by breaking some of the bottlenecks that have grown increasingly longer with each merger. As a general rule, ICCTA permits the origin carrier its long haul. That long-haul, however, has increased in length for most shippers after so many years of end-to-end mergers. As a result, facilities where the origin carrier’s long haul may have been over a relatively short distance now find themselves captive to an origin carrier’s long haul that extends for several hundred miles or even the entire route to destination. This extended long-haul created by mergers precludes a shipper from using competitors that may be available for a majority of the distance.

The following example illustrates how rail mergers have reduced competition and how the NITL proposal promises to restore at least some of what has been lost. Competitive switching is a statutory exception to the long-haul rule that has the potential to restore some of this lost competition.

In this proceeding, the rail industry has described the NITL proposal as a “wealth transfer” motivated entirely by a desire for rate reductions. There can be no denying that rapidly rising
rail rates are an important factor. But the attainment of reasonable rate levels typically is a central objective of competition and, to the extent the rail industry has been exercising undue market power to charge excessive rates, competitive switching has the potential to introduce competition to keep that market power in check. In other words, what the rail industry calls a “wealth transfer” is really just competition at work.

Furthermore, ACC’s support for competitive switching is driven by more than just rates. Providing access to nearby rail alternatives promotes use of the most efficient carriers and routes for each movement, and it permits manufacturers to design more flexible supply chains. These are options that often are foreclosed today by monopoly origin carriers seeking to preserve their long haul. In contrast, if the incumbent carrier’s route is more efficient, based on both price and service, a shipper will continue to use it even after the implementation of competitive switching.

Competitive switching also is not the death knell for differential pricing. NITL’s analysis has demonstrated that the universe of traffic that is potentially eligible for competitive switching is limited and the revenue effects upon the rail industry will be moderate. Furthermore, today’s rail industry does not need to engage in differential pricing to the same magnitude as in the past. The industry is more than financially sound; it is thriving by setting records for operating ratios, operating income, and earnings per share, and railroad stock prices have outpaced the broader market for several years. Much of the money from current levels of differential pricing is being returned to shareholders through higher dividends and stock buy-backs. Ironically, this is a “wealth transfer” from captive shippers to the railroads that is facilitated by a lack of competition.

Competitive switching is not a panacea for every captive shipper or every captive movement, but it would be a substantial improvement over the status quo. ACC members harbor substantial concerns that, even with competitive switching, railroads will not compete. The Board’s public hearing in Ex Parte 705 revealed broad shipper support for policies to promote greater rail-to-rail competition. However, a number of shipper representatives expressed deep concern, based upon direct experience, that just two railroads will not compete in today’s highly-concentrated rail industry. But the Board need not choose to focus upon one fix to the exclusion of another; it can and should do both. Furthermore, the Board needs to be cognizant that two railroads will not always compete, and be prepared to address those situations through other regulatory remedies, even when competitive switching otherwise might be available. Specifically, the Board should clarify that the availability of competitive switching does not necessarily preclude a shipper from seeking rate relief under the statute.

In conclusion, ACC strongly supports competitive switching and urges the Board to proceed promptly to a notice of proposed rulemaking based upon NITL’s proposal. More than three years after launching EP 705 to explore policies to facilitate more rail competition, Board action is long overdue. The League filed its petition for rulemaking over 2½ years ago. In the meantime, the Board has requested and received extensive empirical analyses on the likely effects of that proposal. In response, the rail industry has mustered every conceivable legal, economic, and operational objection, but those have been rebutted by the numerous shipper and government participants in this proceeding. No further purpose would be served by requiring additional steps before offering specific rules for public comment other than to further delay this very important proceeding for the shipping community.