BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE No. 772
OVERSIGHT HEARING PERTAINING TO UNION PACIFIC RAILROAD COMPANY'S EMBARGOES

TESTIMONY OF AMERICAN FUEL & PETROCHEMICAL MANUFACTURERS

I. Introduction

Chairman Oberman, Members Primus, Fuchs, Hedlund, and Schultz, thank you for providing this opportunity to testify before your Board today, and to weigh in on this important freight rail issue. My name is Rob Benedict, and I am the Vice President of Petrochemicals and Midstream at the American Fuel & Petrochemical Manufacturers (or AFPM). AFPM is the leading trade association representing the makers of the fuels that keep us moving, and the petrochemicals that are the essential building blocks for modern life. Refineries and petrochemical manufacturers across the country rely on a healthy rail network as a vital part of their supply chains. Annually in the United States, over 2 million carloads of our members' feedstocks and products, including crude oil, natural gas liquids, refined products, plastics and synthetic resins, are delivered by rail.

The Union Pacific Railroad ("UP") occupies an essential role in the movement of goods across the country. UP operates over 32,000 miles routes in 23 U.S. states west of Chicago and New Orleans.[1] It carries approximately 27% of freight served by rail and approximately 11% of all long-distance freight volume.[2] While AFPM member companies operate throughout the

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[1] https://www.up.com/aboutup/corporate_info/uprrover/index.htm
[2] This figure is derived from the Association of American Railroads (AAR) at *www.aar.org/facts-figures*.

country, we have a particularly large concentration along the rail lines that UP controls. This makes us acutely impacted by UP service issues, including their use of embargoes.

In today's testimony, I will highlight how UP's use of embargoes, or even threat of an embargo, negatively impacts U.S. refiners and petrochemical manufacturers. I will detail the "black box" AFPM members are forced to deal with, and the challenges AFPM members have had, when trying to understand UP's embargo determinations. Finally, I will provide some potential suggestions to resolve the issue.

Before I begin with the specifics of our testimony, I would also like to address a very real and important issue—the threat of retribution from railroads on their customers. With the publication of this meeting notice, AFPM strongly encouraged member companies to testify directly to you. While I am sure you appreciate an association's perspective on these important issues, hearing directly from freight rail shippers with specific examples can further aid you in your work. Unfortunately, many of our members are fearful of potential backlash should they testify. One AFPM member noted that they have been directed not to provide any service or embargo details publicly since such testimony could be linked back to their company leaving them vulnerable to retaliation or other subtler recourse from UP. Thus, in my testimony today on behalf of AFPM members I will be providing anonymized details to aid in your oversight.

II. The Use and Threat of Embargoes Negatively Impacts Refiners & Petrochemical Manufacturers

Embargoes are an important tool railroads use to control traffic movements and respond to adverse network conditions such as weather, or other issues, beyond a railroad's control. When a railroad declares an embargo, they are essentially alerting shippers that they will not be honoring their service contracts—whether ceasing to accept shipments of certain materials or rail cars or putting caps on the number and types of cars shippers may transport. Breaches of contract or of the common carrier obligation are serious and should only occur under extraordinary conditions.

The problem we're experiencing today is that UP is declaring a seemingly endless series of embargoes, and rarely for legitimate emergency scenarios. Recently, we have seen an abuse of this tool and a drastic increase in the use of embargoes related to general network congestion, which is not an exceptional circumstance and certainly not what embargoes were intended for. We have also seen the threat of embargo wielded by railroads to influence shipper behavior.

Since 2017, UP has increased embargoes by over 2,000%.[3] This is a staggering increase. With no regulations in place to govern embargoes, rail shippers have limited recourse to challenge an embargo. Much like we saw with the drastic increase of demurrage and accessorial fees over the past few years, railroads are again exploiting a gap in regulation for their gain. In the case of demurrage and accessorial fees, the Board ultimately had to step in and provide some guidance on the proper use of such fees. Similar intervention may be needed here to address the unchecked abuse of embargoes that railroads are imposing on rail shippers.

The increased use of embargoes by UP has adversely impacted AFPM members, our customers, and the supply chains we support. Embargoes amount to lapses in rail service and, as we've discussed repeatedly over the past several months, disruptions in service impact the ability of refiners and petrochemical manufacturers to maintain current high production and utilization rates. Embargos restrict our ability to move certain materials in and out of our facilities, which can eventually overwhelm on-site storage capacity, leading to bottlenecks and even forced production cuts.

UP's specific embargoes have forced inefficiencies in our operations and cost our members significantly. UP is using embargos to "reduce elevated inventory" in certain corridors as they work to correct service issues which they claim are caused by too much inventory on the network. Often these reductions are requested with little regard to customers, operational abilities, or storage capacity.

For example, multiple AFPM members noted that UP will issue embargoes that reduce car allocations by over half their shipping needs. In many of these instances members are

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[3] *See* Docket EP 772 https://dcms-external.s3.amazonaws.com/DCMS_External_PROD/1669134260584/51506.pdf

required to store the embargoed cars on-site. At refineries and manufacturing facilities, storage is limited, and many members have been faced with reduced allocations that result in a scenario where the number of cars needed to store exceeds storage capacity. For many sites, there simply isn't a bunch of extra space to store dozens of rail cars that UP refuses to move. Some AFPM members have even gone as far as to build Storage-in-Transit ("SIT") yards on their facilities to hedge against such upsets. This is incredibly costly and impossible in many instances given the constrained footprint of individual facilities.

Even when our members are not the ones experiencing direct embargoes, they still are impacted by embargoes aimed at their suppliers and customers elsewhere in the supply chain. If a railroad refuses to transport a certain product from one of our customers and this customer doesn't have sufficient storage space on site to allow them to continue producing as usual, that's when bottlenecks occur, production gets throttled, and congestion compounds up and down the supply chain.

UP's current allocation process—which is essentially when UP caps service or rail car movements for certain shippers—has imposed significant costs on our members. One facility that was under threat of an embargo was asked to allocate by cutting their outbound shipments nearly in half. In this case the AFPM member company had negotiated contract pricing with UP that included different rebate tiers based on shipment counts. By limiting this shipper, UP is forcing them to incur two additional costs, first, in the form of lost revenue from not being to ship product, and second, by losing a potential rebate due to not meeting contract obligations. In another instance, one AFPM member noted that during the November embargo, a facility narrowly avoided a shutdown by using alternative routes and more costly modes of transit, but these alternatives came with an added cost of over $100,000 accrued in just a few weeks.

The embargo of empty rail cars is also a major issue for AFPM members and one that has not been explained by UP despite multiple requests. One member noted that UP embargoed empty cars leaving two of their destinations, but only embargoed one of the origin locations on a specific route. The embargoing of the empty cars resulted in the terminals restricting the in-bound loads to match the outbound empty cars. The very issue UP wishes to resolve with the embargo is only worsened, as now the loaded cars slow down and overpopulate the UP yards. Despite member requests for explanation of this process, AFPM members have yet to receive a rationale for this practice.

Businesses cannot operate successfully under threat of embargo every few weeks. UP's embargoes have become far too frequent and are often open-ended. Railroads will not give shippers any indication of status of embargoes and UP has openly admitted to rail shippers that it doesn't know what will happen after an embargo ends if things don't improve. In the refining and petrochemical industries, business plans are made, and products are sold months in advance of actual shipments. The fact that UP can demand a reduction of our shipments in just 5-7 days has the potential to disrupt commercial contracts made 90-120 days prior and, even more, disrupt critical segments of the U.S. and global economies by destabilizing inventory positions at various points in the supply chain.[4]

III. Rationale Behind Embargoes is Unclear

It is AFPM members' experience with UP that allocations and embargo justifications are insufficient, with one member referring to UP's decision-making process to as a "black box." Notifications of embargos appear to be auto generated when certain allocation criteria are triggered. These notifications include a "justification" for the embargo, but that justification only highlights shipper-controlled issues such as number of private cars on the network, but neglect to consider railroad-controlled issues that impact congestion, such as missed switches and connections due to insufficient workforce or lack of locomotives power. This unduly puts the burden of proof on the shipper and withholds key factors that could impact congestion. Some members have attempted to reverse engineer the reasoning behind the embargoes to no avail.

In another instance when one member received the initial notice about a potential embargo of multiple lanes of their traffic, they viewed it as an opportunity to talk through the

[4] Such demands are a clear violation of 49 USC 11101 which states a rail carrier may not increase any common carrier rates or change any common carrier service terms unless 20 days have expired after written or electronic notice is provided to any person who, within the previous 12 months - (1) has requested such rates or terms under subsection (b); or (2) has made arrangements with the carrier for a shipment that would be subject to such increased rates or changed terms.

movements and provide feedback to UP. This member company established a team that researched what made up the current car count in each lane, as well as a list of what they believed to be false or inaccurate assumptions by UP. For example, the UP embargo appeared to be based on extremely aggressive and inaccurate assumptions about transit times. This company's request for clarifications was left unanswered, and embargoes followed.

In the event UP does respond to shipper requests for clarification, UP personnel in charge of response do not seem to fully understand exactly how their own company arrived at the decision to reduce service. One of our members was initially told to formally submit requests or questions to an embargo team but was later told that they needed to submit a "ticket" to Customer Service for evaluation. They are still awaiting an answer. Across the board, AFPM members are receiving no clear direction from UP on these issues, and this has created a lack of confidence in the system and the impression that customer service concerns are not taken seriously. Without clear rationale presented for UP's decisions to embargo and allocate service, AFPM members have no way to determine if a given embargo is justified.

IV. Potential Reasons for Increased Use of Embargoes

While we are glad to hear directly from UP at this hearing on why they believe there has been such a massive increase in congestion-related embargoes, we have our own theories. AFPM members' experience, thus far, has led us to the conclusion that UP's embargo decisions are directly related to their efforts to minimize their operating ratios and maximize investor profits. As the Board's own data shows, UP has increased its' use of embargoes by over 2,000% in the last five years. During this same time UP decreased its workforce by over 10,000 employees, a 23% reduction in force.[5] Simultaneously, UP also closed hump yards and storage facilities and mothballed locomotives. The result of these moves for UP has been a 2.7% reduction to an already record low operating ratio.[6] The increased use of embargoes also coincides with UP's release of the "Unified Plan 2020", that implements their version of Precision Scheduled Railroading ("PSR"). This is no coincidence, AFPM believes that the increased use of embargoes is self-inflicted and not related to traditional reasons for the use of embargoes. PSR

[5] *See* https://www.macrotrends.net/stocks/charts/UNP/union-pacific/number-of-employees
[6] Derived from UP's annual investor reports from 2017-2021.

and the related changes in operations surely are a contributing factor to the increased congestion and use of embargoes.

There is an additional and far simpler reason for UP’s 2000% increase in service embargoes, they’re doing it because they can. With no regulations or formal accountability in place on when an embargo is appropriate, or a formal position from the Board on how the common carrier obligation relates to the use of embargos, the UP has *carte blanche* to use embargoes.

Captive shippers face additional challenges around embargoes. Railroads know they hold all the cards in negotiations with captive shippers. Threats of embargo have been levied in negotiations with captive shippers to strengthen the railroads’ negotiating positions and maximize their profits on the backs of shippers who have no ability to shop for better service. An AFPM member with responsibility for rail operations expressed this sentiment and the frustration of many members when they said:

> *I struggle to find a law, regulation, or contract term that allows this sort of behavior. A railroad’s mismanagement of its’ own network is not a valid reason to deny a reasonable request for service from a paying customer.*

Without some guidance or guardrails on the use of embargoes AFPM fears this problem will only get worse. That means less service for shippers and higher supply chain costs for all American consumers to shoulder. That said, the Board can address this issue and larger issues to ensure that the railroads do not violate their common carrier obligations.

V. Potential Paths Forward

With no regulations governing the use of embargoes, AFPM strongly supports Board intervention. While this intervention could take several forms, AFPM recommends completing open regulatory dockets focused on improving rail competition. Specifically, AFPM urges the Board to complete regulatory action on reciprocal switching, as this will reintroduce competition into the current competition constrained rail market and push railroads to refocus on serving their customers' needs. AFPM also urges the Board to conduct a review of embargoes as part of a larger assessment of the railroads' common carrier obligation. Given that "reasonable service" is at the heart of determining whether common carrier obligations are being fulfilled, we believe this is a logical approach.

As defined in the *Staggers Act* the "common carrier obligation" requires that rail carriers serve the wider shipping public "on reasonable request." The recent use of embargoes interferes with the common carrier obligation and requires STB to establish reasonable guardrails relating to railroad-imposed embargoes to ensure that the railroads comply with their common carrier obligation. Failure to define how embargos relate to the common carrier obligation has contributed to insufficient rail service and exorbitant costs to get American products to market. Clearly defining this ambiguous principle has taken on greater importance as the railroad industry faces consolidation and has undertaken practices that reduce capacity on the rail network to maximize profits.

While some on this Board have indicated openness to reviewing and updating the common carrier obligation, and both the U.S. Senate and House of Representatives have recognized the need to address rail service deficiencies. In August of this year the *Freight Rail Shipping Fair Market Act* was introduced and included provisions to clarify the common carrier obligation. Specifically, the act proposed to require *"common carrier service terms to include service delivery standards for efficient, timely, and reliable rail service, and transportation and remedies for when the service delivery standards are not met."*[7] In September of this year, the Senate introduced a more targeted act solely focused on the common carrier obligation. As proposed in the *Reliable Rail Service Act*, the common carrier obligation would be updated to clarify, among other things, what is considered *"impacts of reductions or changes in the frequency of transportation or service."*[8]

Congress clearly sees a need to address this issue, but the Board does not need to wait for Congressional action to address the common carrier obligation. AFPM urges the Board to

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[7] *See* Freight Rail Shipping Fair Market Act Fact Sheet
[8] *See* Reliable Rail Service Act Fact Sheet

undertake a review of the common carrier obligation and provide needed clarity on what a "reasonable request for service" is, and what minimum standard of service a railroad must provide. This could include the appropriate use of embargoes, critical materials exempt from embargoes, as well as other common carrier issues. As previously stated, when it comes to embargoes, we are currently operating blindly with no guardrails around what a railroad can and can't do. AFPM favors regulation in this area over guidance because we need real accountability for rail service and a path to enforceable action.

I leave you with one final thought. On December 9th in a note to UP customers regarding the resolution of the recent labor disputes, UP's Executive Vice President of Marketing and Sales Kenny Rocker noted:

> *The president's action ended any uncertainty about the threat of a strike by rail union workers. If you stopped or slowed down shipping by rail because of that uncertainty, I encourage you to resume your shipments.*

And while a threat of a strike is behind us, the U.S. freight rail system can hardly be described as "certain" for shippers. To be clear, our members want to do just what Mr. Rocker is asking, which is resume all their UP shipments at normal, contracted levels of service, but that is impossible when we are faced with an endless wave of embargoes that run counter to agreed-upon contracts. Unfortunately, there seems to be no end in sight.

I would like to thank you for your time and attention to this issue and offer AFPM and our members as a resource to you as you pursue a remedy to the unchecked abuse of embargos.

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