

Testimony of PBF Energy & PBF Logistics

before the

U.S. SURFACE TRANSPORTATION BOARD

395 E Street, S.W.
Washington, DC 20423-0001

300046

ENTERED
Office of Proceedings
November 26, 2019
Part of

"OVERSIGHT HEARING ON REVENUE ADEQUACY" Public Record
Docket No. EP 761
December 12, 2019

Written Submission of PBF Energy and PBF Logistics
Presented by Kent Avery, Vice-President

INTRODUCTION

Good morning, Chairman Begeman, Vice-chairman Fuchs and Member Oberman, and Surface Transportation Board staff. Thank you for providing this opportunity to testify before you today on Revenue Adequacy.

I am Kent Avery, the Vice-President responsible for managing rail activities for both PBF Energy and its master limited partnership, PBF Logistics. PBF Energy Inc. (NYSE: PBF) is one of the largest independent refiners in North America, operating oil refineries and related facilities in California, Delaware, Louisiana, New Jersey and Ohio through its subsidiaries. PBF Logistics LP (NYSE: PBFX) is a fee-based, growth-oriented master limited partnership formed by PBF Energy Inc. to own or lease, operate, develop and acquire crude oil and refined petroleum products terminals, pipelines, storage facilities and similar logistics assets.

During my 30-year career in the rail industry I have worked in every aspect of rail operations, including a Class 1 railroad, shortline railroads, and now with rail-served customers. Having experienced both sides of the rail industry, I bring a unique perspective to this topic and again, appreciate being able to testify.

I respectfully submit these comments to the Surface Transportation Board ("STB") on behalf of PBF Logistics. We sincerely appreciate STB's willingness to start a constructive dialogue on critical rail competition issues.

BACKGROUND

PBF's goal is to safely and reliably transport crude oil, intermediate feedstocks, and petroleum products and co-products on the combined fleet of 7,000 railcars we own and lease. Our fleet plays a critical role in operating our refineries and supplying our customers with the products that help provide American citizens with the highest standards of living and mobility in history.

PBF operates five refineries and two terminals that are rail-served. Of these seven operations, four or roughly 57% are captive to one serving rail carrier, which puts rail shipper's like PBF - the railroad's customer - in a difficult position. This is because railroads use their market power over captive shippers to secure favorable commercial contracts that are railroad-created and controlled, with minimal to zero flexibility in terms of the customer being able to negotiate fair and balanced terms.

PBF applauds the Rate Reform Task Force's recent report, which was developed by STB staff as a set of recommendations for Board members to consider. We look forward to continuing engagement on finding administrative, legislative, and procedural fixes to this power imbalance that will lead to rail transport markets that are more open and competitive, that move the industry away from practices of certain railroads that are perceived as being monopolistic.

REVENUE ADEQUACY

In the STB's Notice on Revenue Adequacy, The Board asked interested parties to provide input on the RRFT's recommendations regarding long-term revenue adequacy. The board specifically asked for participants to address the (i) Definition of long term revenue adequacy; (ii) Rate Increase constraint; (iii) Bottleneck Changes and; (iv) Simplified Stand Alone Cost.

I will defer to other shippers and the American Fuel & Petrochemical Manufacturer's ("AFPM") - PBF is a member of this association - written testimony to address specifics on testimony to address how to fairly measure Revenue Adequacy as well as their comments on the Simplified Stand-Alone Cost (Simplified-SAC). In regard to Rate Increase Constraints, PBF believes a rate increase constraint is only necessary in the event shippers remain captive to one serving railroad. However, if substantial changes are made to the Bottleneck provisions, PBF believes increased competition will negate the need to put rate increase constraints in place. Lastly PBF respectfully requests that The Board consider the U.S. Senate Commerce Committee's report The Current Financial State of the Class 1 Freight Rail Industry, which concluded the railroad industry to be revenue adequate and financially healthy. PBF is in general agreement with AFPM's position on the other topics currently before the Board.

¹ United States Senate Committee on Commerce, Science, and Transportation, Office of Oversight and Investigation Majority Staff. *The Current Financial State of the Class 1 Freight Rail Industry*. Accessed November 23, 2019. https://www.strtrade.com/media/publication/4036_2010-September-21-rail_report.pdf.

¹ *Id.* at 11, "While they tell Congress that they are still not producing sufficient revenue to address their longterm capital needs, a review of the railroads' financial filings and their statements to their investors suggests the opposite."

¹ Freight Rail Customer Alliance, "Competition at U.S. Freight Rail Stations by State." Accessed November 23, 2019. <https://railvoices.org/wp-content/uploads/2012/12/US-Map.pdf>.

BOTTLENECK CHANGES

PBF believes that fair, transparent, market-based competition, like we experience as suppliers in the refining sector, is the most impactful way to address an industry that has shifted from financially weak firms (Pre-1981 Staggers Act) to a set of local and regional monopolies or duopolies. Estimates show 80% of the shippers are now captive to one railroad. My testimony will focus on Bottleneck changes as PBF views correcting this imbalance as the most impactful way to address the lack of competition in the railroad industry.

IMPACTS OF BEING A CAPTIVE SHIPPER

Today the Commissioners will hear from many economists and lawyers on the impact of being a captive shipper. Many of them likely have little day-to-day tactical knowledge of how this industry actually transacts business. My testimony combines a shipper's perspective and my personal experience of working in and around the rail industry for 30 years.

Within PBF's current system, four of our five refineries are located east of the Mississippi River. Of these, two are captive to one railroad--which happens to be the same provider in both instances. The railroad that serves our captive locations also serves two PBF refineries that are open to competition. Please note that there is no feasible way to build out of either of our captive refineries in order to create and promote competition.

The serving railroad at the two captive refineries has enormous leverage when negotiating rates or confidential contracts. Simply put, not only are they the only game in town for captive business, they can all but require the lion's share of traffic handled at PBF's non-captive refineries simply by adjusting rates upward at the captive facilities if PBF shifts volumes to the other carrier. In this way, a shipper like PBF can be harmed by awarding traffic at an open location to a competing carrier that does not have the captive volume leverage the serving carrier with captive locations maintains. In short, one captive terminal plus one captive terminal equals four terminals (two of which are nominally open to other carriers). The leverage at the captive locations makes the open location into a de-facto closed location, never to be open, as long as railroads are able to enforce the leverage they have from captive/closed locations. At PBF's four eastern refineries, the serving carrier of our captive locations handles roughly all traffic at our open locations, except for traffic that has a destination which is closed to them. This particular carrier handles roughly 80% of all of our rail traffic, which puts PBF in a very vulnerable place when negotiating a contract.

PBF proposes changing the landscape of shippers by allowing any captive industry within a 50-mile radius of a competing but non serving railroad, the ability to pay a standardized per mile fee, by commodity, by car to the serving railroad (haulage rights), to an interchanged point of a competing railroad. For instance, our refinery in Chalmette LA (captive) is within 10 miles of 6 competing railroads. The ability to open up other origins or destinations to a captive shipper should have a positive impact on railroad rates and

open up industries to become more efficient whether on the origin or destination side of the supply chain.

The difference in a freight rate structure and competitiveness between competitive versus captive locations is significant. PBF's observations on rates differentials of like commodities with like mileage tells us that refineries that have access to two or more railroads experience a 23% reduction in freight costs versus a refinery that is captive to one serving carrier, which is telling. For our part, PBF feels unable to access these lower rates, even at our open refineries, due to the offsetting increases we will end up paying at our captive locations.

I am certain the Railroads view Bottlenecking changes as the largest threat to their market dominance. I expect the railroads will take an extremely aggressive stance in this area by attempting to convince the Board bottlenecking changes will be an operational disaster to implement. Board members should keep in mind though, these railroads have successfully managed through multiple mergers, monthly service interruptions, PTC implementation, and significant commodity growth or decline in areas such as Crude by Rail, Ethanol, Sand, and Coal and so forth successfully. They certainly have the competency to manage an increase in interchange traffic, in the name of fair competition. The Board should not be fooled by any fear tactics regarding this topic.

If refineries like ours remain captive to one serving carrier, rate escalations need to be reviewed and addressed. The Board should refer to the recently stated record railroad earnings for 2019 YTD, in an environment where volumes are dropping at an alarming rate. How can there be no correlation between sinking car loads and profits one may ask? The answer is simple, the railroads Revenue per Unit (RPU) is going up faster and more aggressively than the volume is decreasing. For example I would ask the commissioners to refer to the NS's 3rd quarter earnings presentation where you will find the following statements: "year-over-year RPU growth for 11 consecutive quarters". You will also find 2 of their 3 business units, (i.e. Merchandise and Intermodal) showed 3Q record RPU Less Fuel. Even Coal which has experienced a precipitous drop of 15% shows an RPU Less Fuel of a 5% increase. PBF believes you should see a softening of freight rates when volume drops in an effort to attract more car loads in a competitive market such as air, marine or trucking. Simply put prices are not adjusting in response to market conditions as they would in an open and fair demand driven market. There is simply no real way to keep price escalations in check without making significant regulatory changes.

SUMMARY

PBF believes deregulation of the rail industry via the Staggers Act of 1981 was needed and has effectively achieved its legislative goal of making railroads financially healthy. Now it's time to bring balance back to the freight rail markets and enact sensible regulations to stop the monopolistic and duopolistic practices of this very profitable industry, which evolved through mergers of regional players into dominant super-regional carriers. Of all the recent NPRM's recently announced, changes to Bottlenecking will be the most impactful way to address the inherently anti-competitive characteristics of the rail industry, to reduce the need for many of the announced NPRM's, and to reduce the need for shippers to rely on rate cases to address fair and adequate rates. PBF is very encouraged by the Board's willingness to take the necessary steps to rebalance a playing field that is significantly slanted in favor of the railroads, who are definitely winning this game, as evidenced both by their earnings and by the disparities in rates between those routes with and those without market-based competition.