

BEFORE THE
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OVERSIGHT HEARING ON DEMURRAGE AND ACCESSORIAL CHARGES

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Statement of Jeanne Sebring, International Paper's strategic consulting resource and the company's former Director of Logistics, North America

Chairman Begeman, Vice Chairman Fuchs and Commissioner Oberman:

Thank you for the opportunity to testify and for holding this hearing on such an important issue that is significantly impacting rail shippers today.

Company Overview

International Paper (IP) is proud to transform renewable resources into recyclable products that people depend on every day. We are a leading global producer of renewable fiber-based packaging, pulp and paper products with manufacturing operations in North America, Latin America, Europe, North Africa, India and Russia. We are headquartered in Memphis, TN, and employ more than 52,000 colleagues around the world. In the U.S., we employ 33,000 team members at our 26 manufacturing mills, nearly 200 converting plants, our network of 16 recycling facilities and several corporate locations. Exports are a big part of our business: In 2018 IP exported nearly 28% of what we manufactured in the U.S. These exports supported approximately 9,000 IP U.S.-based jobs and thousands of small and medium-sized suppliers.

We proudly serve more than 25,000 customers in 150 countries by doing the right things, in the right ways, for the right reasons, all of the time. In fact, more than 90% of all U.S. goods are shipped in a corrugated package. We produce several product lines: 1) corrugated packaging that protects and promotes goods and enables world-wide commerce 2) pulp for diapers, tissue and other personal hygiene products that promote health and wellness and 3) papers that facilitate education and communication. As a supplier to all segments, our products are fundamental to the American economy. Reliable rail service is not only critical to our success, but to the success of the American economy.

Transportation Footprint:

International Paper is a leader in the movement of freight domestically and from U.S. ports. We are the second largest U.S. ocean exporter by volume, shipping 300,000 Twenty-foot Equivalent Units per year. In the trucking space, we ship more than 1.5 million outbound truckloads

annually. We also maintain 15 million square feet of warehouse space and a related distribution network.

For the purpose of this hearing, however, it's most relevant that International Paper is the largest box car customer of the U.S. railroads, shipping more than 135,000 carloads annually. International Paper is served by every Class I railroad and many short lines, so when we say we are committed to working with them, we are serious about this partnership.

At International Paper's 26 U.S. manufacturing mills, we rely heavily on rail for inbound raw materials such as chips, recovered fiber and chemicals, and for outbound production that ships predominantly in box cars. More than 50 percent of our mill's outbound tonnage is shipped by rail. IP is a highly integrated business, meaning that a high percentage of mill production ships to the company's many hundred converting and distribution facilities, in addition to traditional external customers. This increases our exposure to rail service failures because we often experience the repercussions on both sides.

We rely on the railroads as a strategic supply chain partner to safely and reliably move our products to customers, which supports our domestic and global competitiveness. We believe that a vibrant freight railroad network which supports a robust U.S. manufacturing industry is a critical tool for economic growth. Unfortunately, over the past two years, many of our partners at the railroads have begun a journey toward Precision Scheduled Railroading (PSR) that is undermining these longstanding partnerships. International Paper has had to contend with reduced service and unmet railroad commitments, increased rates and a dramatic growth in demurrage and accessorial fees that feel increasingly unavoidable the way they are constructed.

International Paper believes that since the recent advent of PSR and its focus on operating ratio, the rail carriers have used demurrage and accessorial charging as a revenue opportunity. This is the impetus for our testimony today.

It's not surprising that rising demurrage and accessorial charges generally occur at or later in the implementation of PSR. Carriers will tell you that these charges are not only compensatory, but that it incentivizes good shipper behavior for promptly turning cars at the dock. However, it fails to recognize the operational realities contributed by carriers, and now, the near-unavoidability of penalties under the new demurrage and accessorial provisions. For example:

- Reduced switch frequency has often led to last mile service issues.
- Fewer and longer trains have created higher stakes when failures occur, leading to more bunching and more volatile end-to-end transit times.
- Changes to local serving yards also have heightened risks for service failure.

As a result, since the adoption of PSR, IP has seen paid demurrage more than double to over \$7 million dollars when comparing the most recent quarter (Q1 2019) to pre-PSR first quarter 2017. By paid demurrage, I refer to real costs paid by IP after any validation or dispute process has

taken place. During 2018, we successfully disputed over \$2 million in fees by allocating two people nearly full time to focus on demurrage tracking for just two of our facilities. Not an easy task given the difficulty of uncovering all of the required data.

To illustrate how carrier changes to demurrage and accessorial charges have unfairly impacted shippers, I would like to walk you through a few key examples. Given my time allotment for testimony, I won't be able to reflect on the new or increasing fees nor the more austere manner in which they are applied. However, I want to be clear that we are very concerned by the direction of accessorial and demurrage charges and its heavy burden on costs, labor and administrative overhead. Please be reminded these burdens come on top of operational volatility and rising carload rates.

Example 1:

First, I'll speak to our experience with CSX, given IP's footprint with them and the head start they had in PSR over the more recent implementations by Norfolk Southern (NS), Union Pacific (UP) and Kansas City Southern (KCS). CSX notified shippers of the tariff changes toward the end of 2017 that new rates/rules would take effect 1/1/2018, failing to recognize that their operational changes and service delivery were important components to a customer's ability to turn equipment and thus avoid supplemental charging.

In fact, in January 2018, CSX also expanded their weekly car fulfillment window from 7 to 14 days to fill weekly orders, but shipper must pay \$300 per car for any cancellations or reductions after three days from the order date or if within seven days of the order week. A wider empty fulfillment window helps CSX make up for uneven supply, but has increased the potential for bunching empty cars into a facility, thus triggering penalties and further downstream impacts at our receiving facilities. No such consideration exists for the customer disruption that uneven supply could cause to our operations or lost business, except for the heavy and uncertain burden of dispute resolution specific to the carrier's billing.

At one of our mill complexes in the Southeast that is captive to CSX, changes in CSX's demurrage and accessorial charges have intersected with reduced service execution to cause increased costs.

At the complex we face the following challenges:

- Unreliable and inconsistent car supply – In the most recent 12 months, fewer than 43% of weekly car orders were filled to a target rate of 95% or better.
- Poor last-mile execution – Using ShipCSX, the mill will frequently order-in very specific cars to support planned production, but CSX brings the complex the wrong cars than what was specified.
- Bunching of railcars – Suppliers carrying products like chemicals will often originate our railcars on different days, but CSX brings them to the mill on the same day. Naturally, this reduces our ability to unload and turn the cars in the allowed free time.

- Volatility in transit times – CSX’s inconsistent performance reduces our planning and predictability, which is paramount at 24/7 manufacturing facilities, and impacts how and when we can turn cars when they do not arrive as expected.

As a result, this particular complex has seen its demurrage fees increase by 39 times since the advent of PSR, again using a quarter 1 comparison, from \$910 in Q1-2017 to \$9,600 in Q1-2018 and now \$376,000 in Q1-2019. Massive fees cannot simply be absorbed for an American manufacturing facility that is competing in the domestic and global markets. Of course, there is no reciprocity here. When carriers fail, and in many cases fail consistently, shippers do not have the same ability to charge their carriers for the operational harm that is done to their business. This equation fundamentally lacks reciprocity and commercial fairness.

Example 2:

I’ll share another mill example, also located in the Southeast, from January of this year and characterizes issues stemming from reduced cooperative equipment pooling by carriers at several of our competitively-served locations. Picture a large mill that runs well and controls its costs by operating as lean and efficiently as possible. Suddenly, they get a \$14,000 bill for an issue that, upon copious research, the mill discovers it had minimal control over. This is what occurred when NS delivered seven empty cars to an IP dual-served mill to fulfill a NS car order, and where we subsequently loaded-out the cars back to NS routes. It certainly appeared that we did all the right things, except that CSX billed the mill \$14,000 for adverse loading on these same cars. Upon investigation, it turns out that the UMLER (Universal Machine Language Equipment Register, a national registry for rail equipment) file showed CSX ownership but NS delivered the cars to the mill. Unfortunately once the bill is received, the burden falls on the shipper to make the case. These are very labor-intensive cases that require pulling and reviewing detailed communications, rail and IP move records, dates, circumstances and times, in order to dispute charges like these, which actually stem from issues between the two serving carriers.

Dedicating the man hours required to research and dispute demurrage and accessorial charges should not be overlooked. These scenarios require countless hours and extra overhead to drive resolution. In cases like demurrage, these can be very complicated issues possibly tied to upstream disruptions like service. The burden is on the shipper to verify and rectify billing issues that may arise from the carrier’s operations, process changes or sometimes simply imperfect data. While I am not suggesting that these invoices are released universally without due diligence, I am saying the customer bears the burden of disputing these bills even in the event the charges are dubious. The toll on our company’s productivity cannot be underestimated, especially now that these types of charges are rising, as this is time that could be better spent working with customers or driving other supply chain improvements.

Example 3:

One example that speaks to the unavoidability of accessorial charges in the new PSR operating model concerns NS at another one of our dual-served mills in the Southeast. Painfully, this is not an isolated issue and repeats itself here and at other locations.

Due to late fulfillment of NS empty box cars intended for use on NS routes, the mill often has to make other choices for that production. By the time NS empties do arrive, the mill is forced to make an expensive decision between two costly choices:

- Holding the equipment until the next scheduled run on NS routing, which would incur IP demurrage fees (at \$150/day, breakeven would be at 20 days per car), or
- Quickly redeploying the equipment on an adverse load, which would incur adverse loading charges for \$3,000 per car.

Over the month of February 2019, this mill adverse-loaded 10 late-supplied NS cars, for which NS billed us \$30,000. If NS had delivered the cars when ordered, we would not have been forced into choosing between penalties; the mill has very limited ability to hold production for late box supply. This underscores what we've seen at NS. Their rules and rates appear detached from their service performance, with limited recourse.

In addition to these examples, railroads continue to add new fees (such as the NS congestion fee) that are so new in application for us that we don't have evidence of the impact. But these fees appear to be highly subjective in nature and further escalate our concerns in terms of both the financial burden and the time and effort required to dispute the reasonableness of application. Carriers continue to create new fees as an avenue for revenue generation.

Conclusion:

The implementation of PSR across many of the Class I's has led to significant operational problems for U.S. manufacturers and exposure to unavoidable charges. Rail transportation is truly fundamental to the manufacturing economy in the United States, particularly the industrial segment. The movement to drive lower operating ratios and implementation of fees has become cumbersome and expensive for all manufacturers, which will continue to impact the broader economy unless addressed. We expect to pay for the value proposition for services we receive at a reasonable cost.

International Paper greatly appreciates the efforts of the Board in holding today's hearing on this critically important topic. We value our partnerships with the railroads and will continue to do our part to be a strategic customer. However, without continued Board oversight, these added fees will undoubtedly continue. I look forward to your questions.