

Testimony of

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Railroad Antitrust Issues

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Chairman Kohl, Senator Hatch, and distinguished Members of the Committee, thank you for the opportunity to appear before you today to discuss the issue of rail transportation costs and the quality of service experienced by a captive customer. ATK (Alliant Techsystems, Inc.) is the captive customer at two of our locations: Radford Army Ammunition Plant in southwestern Virginia, and ATK Launch Systems in and around Promontory, Utah. I am Ken Vander Schaaf, the Director of Supply Chain Management at Radford Army Ammunition Plant. In my testimony today, I will address the captive customer issues at these two facilities. The first is the Army's Radford Army Ammunition Plant, which ATK operates under a GOCO (Government Owned Contractor Operated) arrangement with the U.S. Army. The second is the ATK Launch Systems facility in Promontory, Utah, a private facility that supplies large solid rocket boosters for the National Aeronautics and Space Administration's (NASA) Space Shuttle program, the Department of Defense's Minuteman and Trident strategic missile systems, and other large defense, commercial, and civil rocket programs.

Radford Army Ammunition Plant, Radford, Virginia
Alliant Techsystems, and its heritage companies, has continuously operated the Army's Radford Army Ammunition Plant under contract with the U.S. Army since the 1940s. The Radford facility is a large chemical plant, covering over 6,700-acres astride the New River in southwestern Virginia.

Radford is the nation's sole producer of single-base propellants for all military, law enforcement, and civilian ammunition. We annually produce 21 million pounds of nitrocellulose, eight and a half million pounds of propellant and four and a half million pounds of commercial powder. These products are used in the production of all small and medium caliber ammunition, tank ammunition, artillery and tactical rocket motors, explosives, and a variety of other ammunition products. Radford is the only domestic source of nitrocellulose, which is required in the production of all ammunition products, including those utilized by the military, law enforcement, and civilian sportsmen.

In order to support the production of propellants, significant quantities of chemicals must be safely transferred, stored, and processed while ensuring strict compliance with environmental standards. Since the plant was first opened by the Army during World War II, Radford has relied almost exclusively on rail shipment to receive needed chemicals. The Army and ATK have established and implemented procedures to ensure the safe receipt and handling of these chemicals from the railhead throughout the production cycle. Those deliveries are critical to the ability of the facility to supply the Army and other services with propellants to support operations and training, and for ATK to meet the

delivery requirements of its firm fixed price contracts with the Army in its role as the single manager for conventional ammunition.

Of increasing concern, and one that is directly addressed by this hearing on the pending legislation (S. 772), are rising transportation costs and the decreased quality of rail service experienced by ATK at Radford. Over the years, Alliant Techsystems has had a fairly constant relationship with our sole rail carrier, the Norfolk Southern Railroad. Historically the Radford Army Ammunition Plant was served by two railroads, the Virginian and Norfolk Western. As you know, the Virginian was acquired by the Norfolk Southern, and we are now a "captive customer," relying on a single rail provider for the receipt of large quantities of chemicals.

Rail Service at Radford: Over time, we frequently have experienced rail schedule slips due to weather, equipment breakdowns, and competing rail priorities. As a result, we plan around these potential schedule slips by building excess inventory into our business plans so that operations will continue uninterrupted, and so that we can meet the Department of Defense's expected delivery schedules. This practice is not atypical for many companies that rely on rail service for their inbound raw materials, but it adds cost and overhead to those operations.

However, given these service issues, we have looked for alternatives. ATK ships out finished propellants by tractor-trailer; for that reason, we have also considered inbound shipments of chemicals into the plant via highway as an option. Although via highway shipments occur occasionally when rail service is interrupted or delayed, there are a number of considerations that make this an undesirable option in regular practice. First, the plant lacks a facility for the regular receipt and transfer of large chemical shipments by tractor trailer. In order to pursue that option, the Army would have to fund and construct such a terminal. In addition, for every single rail car of ammonia, five tractor trailers are required to transport an equivalent amount of chemical. This translates to increases in loading and shipping time, increasing the possibility of accidents, potentially requiring additional hazardous materials facilities along highways and delivery routes, and incurring added environmental and safety concerns. In summary, for large chemical shipments to Radford, we prefer to rely primarily on rail shipment. For this reason, we strongly advocate measures to address our rail carrier's sometimes ambivalent attitude towards schedules, costs, and customer needs. For mostly environmental and safety reasons, we would strongly prefer that highway shipment remain an occasional exception to the rule, rather than become our primary means of transportation.

Rail Pricing at Radford: While suffering from decreased quality of service by our rail carrier, Norfolk Southern, price increases at rates substantially higher than inflation have also given our Radford facility cause for concern. Over the last three years, rail tariffs have changed and commodities have shifted within the railroad's groups, resulting in multiple, new pricing rules, each within a consistent pattern of increased costs to the customer - and leaving the customer with no means of seeking redress. For example, prior to three years ago, although pricing generally increased on an annual basis, mostly consistent with inflationary patterns, we viewed those price increases as both realistic and relatively justified. However, in May 2006, Cherokee Nitrogen, ATK's supplier for ammonia, advised us that they had just been notified by Norfolk Southern that their "zero mileage rates" had been cancelled. Effective June 1, 2006, Cherokee, which simply passes on the rail increases, was forced to raise its freight rate for shipments to our Radford facility from 39-dollars per ton to 65-dollars per ton for all future shipments of ammonia. Our first notification of this 69 percent rate increase came within 30 days of its effective date. This massive price increase demonstrates the ability of the railroad to levy price increases with little if any notice, and virtually no time for an effective rebuttal or discussion by a captive shipper (in this case, Cherokee Nitrogen), or captive customer (ATK).

We understand that Norfolk Southern's rationale for rate increases relies in part on the liability risks associated with transport of toxic inhalants. In 2006, ATK was advised that those liability risks would continue to drive rail rates upward by seven to ten percent annually. While we began to adjust our planning accordingly, that rate increase estimate has proven to be significantly understated. On December 15, 2006, Norfolk Southern Railroad increased rates by 15 percent. On June 6, 2007, new rates added another 15 percent. In the last 15 months, rates have increased by over 330 percent from 39-dollars per ton (May 2006), to 132-dollars per ton (July 2007). Although we understand liability exposure, we believe that an accounting audit would demonstrate that these rate increases are excessive in comparison to actual liability-related costs.

Significant fuel surcharges have also added to the cost of shipments, far out of line with any associated increases in the cost of fuel. Whenever the cost of oil increases, our rail carrier has unilaterally added a "fuel surcharge" to the cost of shipments. Norfolk Southern has then almost always then adjusted its tariff rates to incorporate the new fuel

surcharges. This compounding of fuel surcharges far exceeds actual increases in fuel costs. Our experience is that railroads modify the tariff rates to incorporate the higher rates such that there is never a corresponding drop in cost of freight when the price of oil decreases.

To summarize ATK's situation at our Radford facility, we believe that Norfolk Southern Railroad is deliberately trying to "price itself out" of the business of shipping chemicals at all, the end result of which will be the shifting of those hazardous materials from the railroad to the highways. Our company has several concerns with this forced path. In ATK's experience, railroad has several inherent safety advantages over trucks: railcars are constructed of stronger materials than are tanker trucks; rail traffic is more segregated from other means of transportation, whereas trucks travel on the same roads and thoroughfares with civilians; and, the number of railcars required to transport the same quantity of material as a tractor trailer differs by as much as a factor of five.

Expanding on this last point, in our experience, there are significant advantages to the shipper and to the receiver when shipping with larger railcars. Each time a shipment is loaded or unloaded, the people involved are potentially exposed during the sampling process and connecting of transfer hoses. As the number of individual shipments increases - as it would if we were to ship via truck rather than rail - then the exposure time of our workers increases as well. While the chemical industry has a very good safety record in handling chemicals properly, each unnecessary transfer increases the opportunity for an incident, or an accident. For these reasons, it is the practice of our Radford facility to minimize the use of tractor trailers and truck shipments for chemicals. We use highway shipping only emergency situations, for the protection of our workers and facility, as well as the communities surrounding our facilities and through which our purchases and products travel. However, we are concerned that we may be soon forced to reconsider this practice by the policies and practices of our captive rail carrier.

ATK Launch Systems, Promontory, Utah

The Norfolk Southern Railroad is not the only railroad on which Alliant Techsystems is a captive customer. Our sister location in Promontory, Utah, is a captive customer of Union Pacific Railroad. As stated earlier, ATK's Promontory facility supplies the U.S. government the solid rocket boosters for the Space Shuttle program, the solid rocket motors for both the Trident and Minuteman strategic missile programs, plus multiple other rockets configurations. The rocket motors manufactured at Promontory are loaded by ATK onto railcars at our facility in Corinne, Utah. Union Pacific then transports those rail freights to locations as divergent as Titusville, Florida, Vandenberg Air Force Base, California, and Seattle, Washington; and, in the future, we will be shipping to Huntsville, Alabama. Because of the associated safety setbacks and the enormous size of the products, there is no other way to ship these products. Our Promontory facility is not only held captive by Union Pacific because of a lack of competition amongst railroad carriers, we are also captive because there is no other physical means of transport.

Like Norfolk Southern, Union Pacific has also demonstrated similar radical pricing trends, though our Utah carrier does not cite the risks of handling chemicals as justification for their rate increases. In 2002, ATK Promontory paid about 14,000-dollars per rail car to Union Pacific. In 2003, the rate increased by three and a half percent. In November 2005, the rate grew by another eight percent. On January 1, 2007, the rate increased by another 13 percent. In April 2007, the rate increased yet again to over 21,000-dollars per rail car, an increase of yet another 12 percent, and an increase of over 50 percent in five years.

Union Pacific cites two main reasons for these rate increases: a "special train" status, and increase in fuel costs. Union Pacific recently began charging us to provide "special train" service between the shipping point and the interchange to Kansas City Southern Railway at Kansas City. However, ATK never requested this service. Rather, it was initiated in 1994 by Union Pacific to facilitate the flow of traffic across their lines. "Special train" was Union Pacific's decision, not ATK's, yet they now expect us to pay for it. The explanation given for the rate increases in April was that the Surface Transportation Board mandated that all fuel surcharges be based on transportation mileage. This increase is now permanent regardless of any future changes in fuel costs, and is on top of previous fuel surcharges that were already in excess of the actual cost of fuel expended to facilitate shipment of goods. The reasons given for rate increases reflect either services never requested by our company, or fuel surcharges in excess of rises in actual fuel costs.

Similar to Radford's experiences, our Promontory facility also experiences a lack of reliability by their rail carrier. Union Pacific often misses promised pick up or delivery dates, and transit times are routinely longer than promised.

For this reason, extra time is built into schedules as a matter of regular practice at our Promontory facility in order to reduce customer complaints over late deliveries.

Unfortunately, because we are captive to only one rail carrier at each of our locations, we are forced to tolerate that carrier's performance, prices and attitude toward service. In addition to not having choice among rail carriers, we often do not have alternatives to rail in general. As stated earlier, a solid rocket booster shipping to Cape Canaveral in Florida is too massive to move on anything other than a railcar. The combined effect of uncertainty in rail service coupled with unreasonable price increases has proved to be a burden on our operations and our customers, and has added to ATK's cost of operation at Promontory. Those financial and schedule costs ultimately add cost and risk to our government customers at both NASA and the Department of Defense. The problem quite simply is that there is no other transportation service to use, and our observations of the feasibility of obtaining redress through the Surface Transportation Board leave us with few if any alternatives.

Conclusion

All of us at ATK are extremely proud of the role we play in support of our war fighting, homeland security, law enforcement, space exploration, and outdoor sportsmen customers. However, our ability to perform those missions safely and economically for our customers is negatively impacted by the quality of the service we receive, and extremely high rates demanded by monopoly rail carriers. We understand that ATK's experience at our facilities in Radford, Virginia, and in Promontory, Utah, is paralleled by the experiences of many others in the chemical industry, as well as those in the agriculture, energy, and national security industries. ATK's experience also calls into question that larger issues of increased costs born by NASA and the Department of Defense - and ultimately the U.S. taxpayer - as it annually transports by rail millions of tons of equipment, products, and supplies to and from depots, military bases, and ports.

Thank you again, Chairman Kohl and Senator Hatch, for your leadership on this issue, and for your Committee's continued interest in looking for ways to redress these important issues. We look forward to working with you in support of this legislation, and other possible legislation needed to solve the issues facing ATK and other companies held captive by the monopoly railroad companies. I would be pleased to respond to any questions you might have.