SHIPPING REGULATORY REFORM ACT OF 1976

HEARING

BEFORE THE

SUBCOMMITTEE ON MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE
UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

S. 3180

TO ASSURE ADEQUATE, MODERN, AND EFFICIENT TRANSPORTATION BY WATER BETWEEN THE NONCONTIGUOUS STATES, TERRITORIES, AND POSSESSIONS OF THE UNITED STATES AND THE UNITED STATES MAINLAND, AND FOR OTHER PURPOSES

S. 3260

TO AMEND THE INTERCOASTAL SHIPPING ACT, 1933, BY REVISING ITS SUSPENSION PROVISIONS AND BY AUTHORIZING PERIODIC PROMULGATION OF RATE OF RETURN GUIDELINES

S. 3261

TO AMEND THE INTERCOASTAL SHIPPING ACT, 1933, FOR THE PURPOSE OF ASSURING ADEQUATE, MODERN, AND EFFICIENT TRANSPORTATION BY WATER BETWEEN THE NONCONTIGUOUS STATES, TERRITORIES, AND POSSESSIONS OF THE UNITED STATES, AND THE UNITED STATES MAINLAND

JUNE 8, 1976

Serial No. 94–100

Printed for the use of the Committee on Commerce

U.S. GOVERNMENT PRINTING OFFICE
78-725 WASHINGTON : 1976

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SHIPPING REGULATORY REFORM ACT OF 1976

TUESDAY, JUNE 8, 1976

U. S. SENATE,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON MERCHANT MARINE,
Washington, D.C.

The subcommittee met at 10 a.m. in room 5110, Dirksen Senate Office Building, Hon. Daniel K. Inouye presiding.

OPENING STATEMENT BY SENATOR INOUYE

Senator INOUYE. This morning the Merchant Marine Subcommittee opens hearings on three bills, S. 3180, S. 3260, and S. 3261.

These measures were introduced by the subcommittee chairman, Senator Long, earlier this year. They amend the Intercoastal Shipping Act, 1933, which provides the statutory basis for economic regulation of common carriers by water in our domestic offshore commerce.

The three bills have the same stated objective. That is, to assure adequate, modern, and efficient transportation by water between the noncontiguous States, territories, and possessions of the United States and the mainland.

In introducing these bills, Senator Long said that he is not wedded to any one of them and hoped that by introducing the measures, a full discussion of the subject would ensue.

That is precisely the purpose of this hearing.

Coming from a noncontiguous State, I have a great interest in this subject, but I have reached no conclusions regarding any of these bills.

Over 95 percent of Hawaii's imports and exports are dependent on ocean shipping. No other State depends so completely on one mode of transportation. The economic and physical well-being of Hawaii clearly requires adequate, modern, and efficient transportation. I want to see that the people of Hawaii benefit from such efficient and up-to-date facilities.

Today we will receive testimony from the Chairman of the Federal Maritime Commission (FMC), the president of Matson Navigation Co., a major ocean carrier in our domestic offshore trades, and representatives from the National Industrial Traffic League.

The subcommittee also invited officials of the Department of Transportation (DOT) to testify. I understand that we will receive a written statement from them.

Staff members assigned to this hearing: Richard Daschbach and David Clanton.

We will also receive comments on the subject from the Governor of Hawaii who could not be here today. I believe a representative from his office is here and I welcome him.

Any other persons who wish to submit statements to the subcommittee on these bills are requested to do so as soon as possible.

[The bills and agency comments follow:]

94TH CONGRESS
2D SESSION

S. 3180

IN THE SENATE OF THE UNITED STATES

MARCH 18, 1976

Mr. LONG introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To assure adequate, modern, and efficient transportation by water between the noncontiguous States, territories, and possessions of the United States and the United States mainland, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Intercoastal Shipping Improvement Act of 1976".

SEC. 2. (a) The Intercoastal Shipping Act, 1933 is amended by striking out "Federal Maritime Board" and "board" at each place where such terms are used and inserting in lieu thereof "Commission".

(b) The first section of the Intercoastal Shipping Act, 1933 (46 U.S.C. 843) is amended (1) by inserting "(2)" immediately before "The term"; (2) by striking out "by way of the Panama Canal"; (3) by inserting before paragraph (2) thereof as so designated the following new paragraph:

"(1) The term 'Commission' means the Federal Maritime Commission.";

and (4) by adding at the end thereof the following new paragraph:

"(3) The term 'State of the United States' includes any trust territory, Commonwealth, territory, or possession of the United States.".

SEC. 3. Section 3 of the Intercoastal Shipping Act, 1933 (46 U.S.C. 845) is amended (1) by inserting "(a)" immediately before the first sentence thereof, (2) by inserting "(b)" immediately before the first sentence of the second paragraph thereof; and (3) by adding at the end of such section as so designated the following new subsection:

"(c) Within 12 months after the date of enactment of this subsection, the Commission shall, in order to assure adequate, modern, and efficient transportation by water between the noncontiguous States of the United States and the 48 contiguous States of the United States, develop and promulgate (and thereafter revise and main-

tain) criteria, standards, and procedures, in accordance with this subsection, for determining what constitutes adequate revenue levels for a common carrier by water in intercoastal commerce. Such criteria, standards, and procedures shall be developed after notice and an opportunity for a hearing.

Adequate revenue levels are levels which are likely to be sufficient to cover total operating expenses, including depreciation and obsolescence, plus a fair, reasonable, and economic profit or return (or both) on capital employed by a common carrier by water in intercoastal commerce. In developing such criteria and standards, the Commission shall consider, as determinative factors—

"(A) the cost of replacing vessels and related equipment used in such commerce, including equipment used in stevedoring and terminal operations related thereto;

"(B) the degree of risk associated with the investment of such capital;

"(C) the prevailing cost of money in capital markets;

"(D) the public-interest need to assure that service continues to be provided on certain unprofitable segments or components of transportation by water in intercoastal commerce; and

"(E) other appropriate factors.

The Commission shall make an adequate and continuing effort, to the extent of available resources, to assist common carriers by water in intercoastal commerce (i) to apply such criteria, standards, and procedures to determine adequate revenue levels for themselves, and (ii) to attain such revenue levels.".

SEC. 4. Section 3(b) of the Intercoastal Shipping Act, 1933 (46 U.S.C. 845(b)), as amended by this Act, is further amended (1) by striking out "Pending such hearing and the decision thereon the Commission," and inserting in lieu thereof "(1) Except as provided in paragraph (2) of this subsection, the Commission, pending a hearing under subsection (a) and the decision thereon, and"; and (2) by adding at the end thereof the following new paragraph:

"(2) After the date of promulgation of criteria, standards, and procedures under subsection (c), the Commission may not, pending a hearing under subsection (a) and the decision thereon, suspend the operation of a schedule filed, under subsection (a), by a common carrier by water in intercoastal commerce, if such schedule seeks an increase in rates and other charges solely for the purpose of increasing the gross annual revenues of such carrier to adequate revenue levels, as determined thereunder. If a schedule is not suspended pending a hear-

ing under subsection (a) and the decision thereon, the Commission shall require the carrier involved to keep an account of all amounts received because of such increase from the effective date thereof. If the Commission finds, after a proceeding thereon, that such increase is unjustified, in whole or in part, it may order the carrier involved to refund to the person on whose behalf the amounts were paid that portion of the increased rate, fare, or charge found to be not justified, plus interest at a rate which is equal to the average yield (on the date such schedule is filed) of marketable securities of the United States which have a duration of 90 days.".

94TH CONGRESS
2D SESSION

S. 3260

IN THE SENATE OF THE UNITED STATES

APRIL 6, 1976

Mr. LONG introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To amend the Intercoastal Shipping Act, 1933, by revising its suspension provisions and by authorizing periodic promulgation of rate of return guidelines.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 3 of the Intercoastal Shipping Act, 1933 (46 U.S.C. 845), is amended by inserting at the end thereof the following: "*Provided, however,* That commencing in calendar year 1976 and with a frequency of not more often than once each twelve months a carrier may file a general increase in rates without suspension of that portion of such changed rates bringing about an increase of 7 per centum or less in its gross annual revenues. If at the conclusion of any proceeding

the Commission finds that such portion of the changed rates is unjustified in whole or in part, it may order the carrier or carriers concerned to make appropriate refunds, with interest, to the persons entitled. For purposes of this section a general increase in rates is defined as a change in rates that in the aggregate brings about an increase of 3 per centum or more in a carrier's gross revenue or in 50 per centum or more of its tariff items per trade for the twelve-month period ending not more than sixty days prior to the date of filing.".

SEC. 2. Section 3 of the Intercoastal Shipping Act, 1933 (46 U.S.C. 845), is amended by adding at the end thereof the following new paragraph:

"As a means of assisting in insuring that the noncontiguous States, territories, and possessions of the United States will have adequate, modern, and efficient ocean transportation service to and from the United States mainland, the Commission shall, within six months after enactment of this provision and from time to time thereafter as substantial change in circumstances may make appropriate, promulgate numerical guidelines as to common carrier rate of return on rate base and common equity which the Commission deems to be prima facie reasonable: *Provided*, That in its determination of such guidelines the Commission shall include therein as determinative factors—

"(A) the cost of replacing vessels and related

equipment including that associated with stevedoring and terminal operations;

"(B) the prevailing cost of capital;

"(C) the degree of risk associated with the investment of such capital;

"(D) the need of the public interest for the continued provisions by carriers of certain unprofitable segments or elements of service; and

"(E) other appropriate factors.".

94TH CONGRESS
2D SESSION

S. 3261

IN THE SENATE OF THE UNITED STATES

APRIL 6, 1976

Mr. LONG introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To amend the Intercoastal Shipping Act, 1933, for the purpose of assuring adequate, modern, and efficient transportation by water between the noncontinguous States, territories, and possessions of the United States, and the United States mainland.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 3 of the Intercoastal Shipping Act, 1933 (46 U.S.C. 845), is amended by adding at the end thereof the following new paragraph:

"The Commission shall within twelve months after enactment of this provision, and from time to time thereafter as substantial change in circumstances may make appropri-

ate, develop, and promulgate a reasonable prima facie rate of return for common carriers by water operating self-propelled vessels, with development of the initial rate of return to be preceded by notice and an opportunity for a hearing: *Provided*, That such rates of return shall include as determinative factors—

"(A) the cost of replacing vessels and related equipment including that associated with stevedoring and terminal operations;

"(B) the degree of risk associated with the investment of capital;

"(C) the prevailing cost of money in capital markets;

"(D) the need in the public interest for the continued provision by carriers of certain unprofitable segments or elements of service; and

(E) other appropriate factors.".

SEC. 2. Section 3 of the Intercoastal Shipping Act, 1933 (46 U.S.C. 845), is amended by inserting at the end of the second sentence of the second paragraph the following: "*Provided, however*, That when a carrier files a change in rates and charges there shall be no suspension of the effective date of that portion of such changed rates and charges which will provide the carrier with an opportunity to realize during the succeeding twelve months an increase in

gross revenues not exceeding that sufficient to raise the carrier's rate of return to the prima facie rate of return, which until its initial development and promulgation, shall be for this purpose 10.59 percent on rate base. Nothing in this paragraph shall be construed as establishing a presumption that any increase in gross revenues in excess of such amounts is unlawful or should be suspended. If at the conclusion of any proceeding the Commission finds that the portion of the changed rates and charges hereby made exempt from suspension is unjustified in whole or in part, it may order the carriers or carriers concerned to make appropriate refunds to the persons entitled to the excess charges collected during the four-month period of exemption from suspension, plus interest at a rate which is equal, on the date the changed rates or charges are filed, to the average yield of marketable securities of the United States having a duration of ninety days.".

OFFICE OF THE SECRETARY OF TRANSPORTATION,
Washington, D.C., July 19, 1976.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: This is in response to your requests for the views of the Department of Transportation on three similar bills.

(1) S. 3180. To assure adequate, modern, and efficient transportation by water between the noncontiguous States, territories, and possessions of the United States and the United States mainland, and for other purposes.

(2) S. 3260. To amend the Intercoastal Shipping Act, 1933, by revising its suspension provisions and by authorizing periodic promulgation of rate of return guidelines.

(3) S. 3261. To amend the Intercoastal Shipping Act, 1933, for the purpose of assuring adequate, modern and efficient transportation by water between the noncontiguous States, territories, and possessions of the United States, and the United States mainland.

There are two major provisions in each of these bills that would be applicable to common carriers in our domestic offshore trade—one dealing with promulgating a reasonable rate of return, and the other removing rate suspension powers. A different approach is used in each bill, but the end results would be similar.

Under S. 3180, the Federal Maritime Commission (Commission) would develop and promulgate criteria, standards, and procedures for determining what constitutes adequate revenue levels for a common carrier in domestic offshore commerce within 12 months after enactment. Under S. 3260, the Commission would promulgate numerical guidelines as to common carrier rate of return on rate base and common equity which it deems to be prima facie reasonable within six months after enactment.

Under S. 3261, the Commission would develop and promulgate a reasonable prima facie rate of return for common carriers by water, operating self-propelled vessels within 12 months after enactment. Also, this bill sets an initial rate of return of 10.59% on rate base to be in effect until the Commission promulgates the reasonable prima facie rate of return. Each of the three bills provides that the Commission may revise this rate of return if substantial changes in circumstances occur. In each of the bills the Commission would use the same determinative factors for setting rates of return; these would be:

(*a*) The cost of replacing vessels and related equipment including that associated with stevedoring and terminal operations;

(*b*) The degree of risk associated with the investment of capital;

(*c*) The prevailing cost of money in capital markets (the prevailing cost of capital in S. 3260);

(*d*) The need in the public interest for the continued provision by carriers of certain unprofitable segments or elements of service; and

(*e*) Other appropriate factors.

The Commission now has the authority under the Intercoastal Shipping Act to suspend rates, fares, charges, classifications, etc., for a period of no longer than four months beyond the time intended to go into effect. Each of these bills would remove that suspension power subject to slightly different conditions. Under S. 3180, the Commission could not suspend a rate after it promulgated the criteria standards if the rate increase was soley for the purpose of increasing gross annual revenues of the carrier to the adequate revenue levels determined by the Commission. Also, if the increased rate were found to be unjustified, after a hearing, the carrier would be required to refund that portion found unjustified, plus interest. Under S. 3260, the carrier may file a general rate increase not more than once a year without suspension of that portion that would bring about a 7% increase or less in the carrier's gross annual revenues. This bill also has a refund provision if a changed rate is found unjustified in whole or in part. Under S. 3261, there would be no suspension when the rate increase will provide the carrier with an opportunity to realize during the succeeding 12 months an increase in gross revenue not exceeding that sufficient to raise the rate of return to the prima facie rate of return, which initially would be 10.59 percent. A refund provision is also in this bill.

The Department believes that none of the bills, as written, are acceptable as noted in the following comments.

The Department agrees that the suspension powers of the FMC should be reduced, and believes such a change would be in keeping with the Administration's economic regulatory reform policy. However, we are concerned that the suggested methods of reducing suspension powers in the three bills will not work. It is difficult to see just how the commission would determine what effect a rate increase will have upon the carrier's total revenues for the upcoming year. At best, this might only be determined in a fairly extensive hearing, and to have this type of lenghthy hearing to avoid a suspension would seem to defeat the purpose of the no-suspension provision. A far better approach would be to set a percentage zone, in which carriers would raise or lower their rates if they were within a certain percentage of prior rates. This would be a very simple fact to determine. We further believe that the shipper would be adequately protected with a no-suspend zone since there would still be an opportunity for a hearing and a refund if the Commission found all or part of a rate increase unjustified. The loss of revenue represented by a four-month suspension of the effective date of an increase in rates can be very critical to a domestic ocean carrier today in light of the high costs of building, operating and maintaining vessels and shoreside facilities.

Finally, the Department objects to guidelines for determining rates of return which use replacement cost and which provide for cross-subsidy of some traffic by other traffic. The Department is fundamentally opposed to cross-subsidy as

being an unsound and unfair practice. As noted in the Department's "Statement of National Transportation Policy" (Sept. 17, 1975) if there are truly certain unprofitable segments or elements of service which merit being continued to carry out the public interest, then they should be specifically considered by the Congress and the President and subsidized directly. In addition, none of the revenue level determinations by the various transportation regulatory agencies use replacement cost. While DOT has urged that the issue of whether or not to use preplacement cost as the more appropriate cost base be seriously investigated in the case of railroads, we have not yet reached the point where we are ready to recommend that replacement cost be used. We agree that in determining whether revenue levels are adequate the Commission should consider the costs of capital and risk. We further believe that specific rates of return should not be established by statute but rather should be established by the competitive marketplace.

The Office of Management and Budget has advised that, from the standpoint of the Administration's program, there is no objection to the submission of this report for the consideration of the Congress.

Sincerely,

DONALD T. BLISS,
Acting General Counsel.

Senator INOUYE. Our first witness this morning will be Chairman Karl E. Bakke of the FMC.

Welcome, sir.

Mr. BAKKE. Thank you, Mr. Chairman.

STATEMENT OF HON. KARL E. BAKKE, CHAIRMAN, FEDERAL MARITIME COMMISSION; ACCOMPANIED BY DONALD BRUNNER, MANAGING DIRECTOR; AND RICHARD HULL, GENERAL COUNSEL

Mr. BAKKE. Before commencing with my statement, Mr. Chairman, I would like to introduce my colleagues from the Commission: Mr. Donald Brunner, Managing Director, and Mr. Richard Hull General Counsel.

The subcommittee this morning has before it three bills, proposals to revise the statutory provisions governing our domestic offshore trades.

While these bills differ somewhat in their approach and scope, each would have significant effect if enacted.

First, the Commission would be required periodically to promulgate "rate of return" or "adequate revenue level" guidelines for ocean common carriers operating in our domestic offshore trades; and second, a limitation would be placed on the Commission's suspension authority in connection with proposals by such carriers, for general rate increases.

These bills also would authorize the Commission, having found any given rate increase, after hearing, to be unjustified, to order refunds to overcharged shippers.

For the reasons summarized below, Mr. Chairman, although we fully understand and share the concerns of the sponsors that led to the introduction of these three bills, we are opposed to their enactment.

First I would like to talk about the rate of return guidelines. All three bills contemplate the issuance of rate of return guidelines for ocean cargo carriers in our domestic offshore trades. The Commission has no specific objection to the general guidelines, common to all three bills, for determining adequate levels. One of these, the use of replacement costs rather than acquisition costs in computing a carrier's rate bases, is being widely debated within the accounting community. Nevertheless, we agree that it should be taken into

account by the Commission, in one fashion or another, in determining the adequacy of revenue levels.

If the Commission were to be required to promulgate rate of return guidelines for carriers in the domestic offshore trades, we would feel constrained to do so on a carrier-by-carrier and a trade-by-trade basis, recognizing the vast differences in debt-equity ratios of these carriers, the difference in natural hazard risks between trade routes, and the unique circumstances of our island economies with their tremendous dependence on ocean commerce. Accordingly, in the event Congress sees fit to pass any one of the bills now pending, we would urge strongly that the Commission be allowed adequate time to make the initial rate of return determinations.

I would also like to comment briefly on the effect that the legislation would have upon the Commission's current suspension authority. All three bills would restrict the Commission's authority to suspend the effective date of a general rate increase under given circumstances.

Section 3 of the Intercoastal Shipping Act of 1933 now authorizes the Commission to suspend proposed rates for a period not to exceed 4 months if the Commission initiates a formal hearing concerning the lawfulness of such rates. While the current 4-month maximum suspension period is inadequate to give the Commission time to complete its proceedings and rule on the lawfulness of new rates, this is not a reason, in my view, to restrict the Commission's suspension authority. It would suggest, perhaps, the need for extending the suspension period.

The Commission recently has completed revision for final comment on the proposed rules in docket No. 67–57, to govern the submission of financial reports by ocean common carriers in the domestic offshore trades. The purpose of these new rules is to obtain a more accurate and detailed data base relating to assets, revenue, and expenses that are attributable to domestic offshore operations. With such detailed data, we hope to be in a position to reach an initial determination on whether a proposed general rate increase is just and reasonable within the 30-day notice period between filing and effectiveness of the rate increase, absent action by the Commission to suspend and to initiate a formal hearing. At the same time, the grounds for suspension, if necessary, also should become apparent within that period, and for this reason, we believe that our present judgmental authority with respect to suspension is desirable and necessary.

I can assure you that the Commission has no intention of exercising such authority capriciously or as a matter of course.

Mr. Chairman, I should now like to deal with the provisions of two of the bills before the subcommittee that would establish arbitrary formulas for prima facie reasonableness of proposed rate increases.

S. 3260 would permit a carrier to file a general rate increase every 12 months without suspension of that portion of such rates that would result in an increase of 7 percent or less in gross annual revenues. S. 3261 would provide that a rate of return of 10.59 percent on rate base would be prima facie reasonable, until a different rate of return were developed and promulgated by the Commission.

We are convinced that no formula could be applied uniformly to

all carriers to determine the justness and reasonableness of ocean freight rates, Each case must be considered in light of the carrier's particular circumstances at the time, coupled with factors present in a given trade route. We do not believe that any prima facie case of justness or reasonableness, or any corollary decision to suspend a rate or structure of rates, can be predicated on an arbitarary percentage of return. Therefore, we strongly oppose the provisions of S. 3260 and S. 3261 that would provide for such across-the-board numerical standards.

In addition, all three bills would authorize refund of overcharges to shippers, following final disapproval of rates by the Commission. While the standards for calculating the amount to be refunded are somewhat different in each of these bills, we believe neither provision is workable, in that they would fail to accomplish the desired goal—namely, to reimburse the ultimate consumer for incremental transportation charges assessed under a rate increase subsequently found to be unlawful. I think it safe to generalize that any rate increase is always passed on to the ultimate consumer. Accordingly, if a rate is disapproved eventually by the Commission, the refund process will always result in a windfall to the shipper, because it is virtually impossible to administer a refund system that would reimburse the ultimate consumer.

Finally, the Commission has serious reservations about the definition of the term "State of the United States" in S. 3180. Under this definition, any trust territory is to be included within the definition. This would appear to include United Nations trust territories administered by the United States, which currently are not subject to the provisions of the 1933 act. Foreign-flag common carriers providing service to and from such territories are regulated by the Commission as carriers engaged in the foreign commerce of the United States. If such foreign carriers were subjected to the more stringent requirements of the 1933 act, there could be international repercussions and interruptions of service in some trade routes.

In conclusion, Mr. Chairman, it is my opinion that enactment of any one of these three bills would be ill-advised.

With your concurrence, Mr. Chairman, we would like to submit a more detailed statement for the record,[1] which will elaborate on the points made in this summary.

Senator INOUYE. Without objection, so ordered.

Mr. BAKKE. Moreover, the Commission staff has done research concerning rates of return for particular carriers in the domestic offshore trades, most particularly the Hawaii and Puerto Rico trades, and has analyzed the applicability of various criteria to the realities of ocean commerce. Much of the information relied upon in making those analyses is of a business confidential nature, the public disclosure of which could give certain carriers an unfair competitive advantage over those carriers who submitted the data. I would be pleased, however, to have my staff work closely with the subcommittee staff, and make such information available to the subcommittee with appropriate safeguards to maintain its confidentiality.

The Office of Management and Budget has advised that time did not permit a thorough review of our testimony, and therefore the views I have expressed today do not necessarily reflect the position of the administration.

[1] See p. 22.

Thank you, Mr. Chairman. Now we will be glad to answer any questions you may have.

Senator INOUYE. Thank you very much, Mr. Chairman. How many carriers are currently operating in the domestic offshore trade?

Mr. BAKKE. May I consult with Mr. Brunner, our Managing Director?

Senator INOUYE. Certainly.

Mr. BRUNNER. Do you mean vessel operating carriers as distinguished from NVO's?

Senator INOUYE. Yes.

Mr. BRUNNER. Approximately 41.

Senator INOUYE. 41.

Mr. BRUNNER. Yes sir. This would include a number of tug and barge operators in the Alaska trade. In the Hawaiian trade, we have only one major carrier—Matson Navigation Co.; but there are a number of small tug and barge operators between the Pacific Northwest and the Alaska Panhandle.

Senator INOUYE. What sort of volume do they carry? Percentages.

Mr. BRUNNER. It is very difficult to ascertain, sir, because a number quote rates pursuant to the River's bill and are regulated by the Interstate Commerce Commission.

Senator INOUYE. I have just been notified that we have a vote on the Senate floor. We will have a short recess.

[Recess.]

Senator INOUYE. How many major carriers do you have currently operating in the domestic offshore trade?

I have been told it is about five or six; is that correct?

Mr. BRUNNER. Depending upon the definition of "major". In the Hawaiian trade, for example, the predominant carrier is Matson, and U.S. Lines is also active in that trade.

But U.S. Lines serves Hawaii as part of a longer voyage to the Far East. In Puerto Rico, we have the Puerto Rico Maritime Shipping Authority, which is the major carrier from Atlantic and Gulf ports to Puerto Rico; we have TMT, a tug and barge operator, but nonetheless a major carrier from Florida ports; Sea-Land from Pacific Coast ports to Puerto Rico and Seatrain-GITMO, which has one ship. I wouldn't consider Seatrain GITMO major, but it nonetheless does generate substantial amount of gross revenue in the course of a year. But five or six major self-propelled carriers is as good a figure as any, sir.

Senator INOUYE. Does that number, five or six major carriers, make determination of adequate revenue level on an individual carrier basis a difficult undertaking?

Mr. BAKKE. I think the undertaking, Mr. Chairman, may well be simplified considerably in the future, because we will have the reporting requirements of Docket 67–57, which should develop much more detailed information concerning the financial position and the revenues of carriers in the domestic offshore trades. With that fuller exposition on a regular basis, our staff should have a much more managable data base against which to measure proposed general rate increases on the part of those carriers.

And we also have under consideration a change in our rules with respect to the nature of supporting data and supporting justifications that will be required in connection with general rate increase filings.

With these two revised procedures, I believe the Commission should be in a position to make a fair judgment, within the 30-day notice period, that would continue under any of the proposed bills, whether the structure of the proposed rates is just and reasonable. This, of course, also spills over into the legislative proposals with respect to our suspension authority. Right now, within the 30-day notice period, if we make a judgment that the structure of a proposed rate increase is not just and reasonable under section 3 of the 1933 act, we can suspend all or part of the proposed increase even though there is a 4-month limitation on the duration of any such suspension. Under S. 3260 and S. 3261, however, the question of reasonableness would be disposed of by reference to an arbitrary percentage rate of return, whether or not the Commission would, under our present standards, conclude that the proposal was unjust and unreasonable. Whether the Commission retains its suspension authority or not, the fact remains that an initial determination could be made within the 30-day notice period that a proposed schedule of rates is not just and reasonable; yet we would have no recourse but to permit the rates to go into effect pending conclusion of our proceeding, looking ultimately to the justness and reasonableness of a proposal that we had already determined prima facie to be unreasonable and unjust.

I think the revised reporting and documentation procedures that we will be putting into effect should remedy a number of the criticisms of the time required for our determinations of lawfulness of proposed rates in the domestic offshore trades, and that the proposed "cures" could be worse in practice than the complaint sought to be remedied.

Senator INOUYE. Would you consider this new regulation an unreasonable imposition of regulatory burden on the carrier?

Mr. BAKKE. Our proposed regulation, Mr. Chairman?

Senator INOUYE. Yes.

Mr. BAKKE. No, I don't think so. I consider it part of the price of doing business in the domestic offshore trades. We have a statutory obligation under the 1933 act to take into account not only the revenue needs of the carriers in those trades, but also the public interest generally. As you are very much aware, Mr. Chairman, with island economies that are virtually totally dependent upon ocean trade for their existence and economic viability, the public interest can encompass considerations that are far more sensitive than those applicable in the case of the Continental United States, where there is the option of alternative sources of supply or substitution of products, and where the option of alternative methods of transportation exists. I believe the new reporting and documentation regulations will offer advantages, both to carriers serving the domestic offshore trades and to the economies that are served, by providing the Commission the opportunity to make more definitive and expeditious determinations of where the balance of the equities lies in terms of the public interest.

It is to the advantage of the carriers if we make an initial determination that the proposals are prima facie just and reasonable, and they can put those rates into effect forthwith. On the other hand, if a case is made that the proposal is prima facie unjust and unreasonable, with adequate suspension authority the Commission is in a position to protect our offshore economies by maintaining the status quo until such time as we have been able to develop a more considered judgment on the lawfulness of any such increase.

Senator INOUYE. How large is your Domestic Trades Division?

Mr. BAKKE. We have a domestic tariffs branch. It is difficult to answer, Mr. Chairman, because administrative matters and other staff functions within the purview of the Managing Director that spill over beyond the domestic tariffs staffs and, of course, there are legal considerations involved that require input from the Office of the General Counsel. So I don't know—I don't know that numbers of bodies are necessarily meaningful in this contest.

Senator INOUYE. I just want to know if you could have a better operation if you had more staff.

Mr. BAKKE. Absolutely. The Commission is, at the present, excessively overburdened with substantive activities, requiring some rather difficult decisions as to priorities. Certainly, there is no question that additional staff and appropriations would be most helpful, not only in this area, but in other areas of major concern to us.

Senator INOUYE. Does the Commission currently evaluate such factors as carriers' debt equity ratios, cost of embedded debt and other financial data in acting on rate filings?

Mr. BAKKE. Among other things, yes, sir.

Senator INOUYE. What do you see as the current purpose and effect of the 4-month suspension period?

Mr. BAKKE. The purpose, as I view it, is to give the Commission a device by which to defer the effective date of a proposed increase in rates that looks as though it might be excessive, pending its determination whether the public interest is served by the proposal. I don't know the history behind selection of a 4-month suspension period in our legislation. The ICC and CAB each has 7-month suspension authority. While I am not in a position to say whether 7 months is adequate or inadequate for their purposes, 4 months is certainly inadequate for the Commission's purposes, at least under present circumstances. The object really, is to provide some degree of protection to ultimate consumers in the offshore trades from increases in the price of goods that tend to follow on the heels of increases in the ocean cargo rates being charged in those trades.

The effect of suspension has been mixed. In some cases, it has provided the opportunity for the Commission to maintain the status quo, pending the submissions of further supportive information from the carrier, in order to make an assessment whether the proposal is on its face and reasonably just. In that sense, I believe it has served a very useful purpose, and its effects have been beneficial.

Basically, the problem is that, although the Commission may make an initial determination that a proposal is not just and not reasonable, beyond the existing 4-month period we lack the authority to freeze the acceptable rates until we render our final adjudication of the matter.

Senator INOUYE. Presumably all suspensions were fully justified at the time they were made, or at least had the appearance of being fully justified.

In how many instances were these suspended rates later found to be lawful?

Mr. BAKKE. I am not sure the premise upon which the question is based is accurate. On occasion we have had to ask carriers for supplemental information in order to be able to make a reasoned threshold determination. But since 1971, 32 proposals have been filed with

the Commission for general rate increases. Sixteen of those were from vessel operating ocean carriers; the other 16 were proposals by NVO's. Of the 16 general rate increase proposals by vessel operating ocean carriers, 5 were found to be lawful. The other 11 proceedings either were discontinued at the initiative of the carrier or were canceled because the applicants were marginal carriers that went out of business for other reasons. I don't know that you can draw any invidious conclusions from the fact that, in 11 of the 16 cases where a carrier was filing for a general rate increase, either they were absorbed by another carrier or went out of business during the pendency of the action. But, in answer to your question, the fact is that 5 of those 16 proceedings were pursued to conclusion, and the proposals in each of the 5 cases were found to have been reasonable.

Senator INOUYE. Does the escalation in capital requirements of ocean carriers give you any concern?

Mr. BAKKE. A great deal of concern, sir, because capital costs have to find their way, one way or another, into the rate base, and, once in the rate base they are reflected inexorably in the carrier's rate structure.

Senator INOUYE. Can loss of revenue resulting from suspension of rates be recovered by the carrier?

Mr. BAKKE. No, sir, they cannot; nor can consumers recover the higher prices they pay for products that reflect an incremental transportation cost later found to be unlawful.

Senator INOUYE. Do you think it is reasonable to prohibit the recovery of such lost revenues?

Mr. BAKKE. No; I believe that is just part of the price of doing business. Carriers, whether ocean carriers, air carriers, or inland carriers, historically have been in a position of having to justify their proposals for increased rates. The fact that there may be a hiatus before the rates or some of the rates are allowed to go into effect is part of the way the business operates.

Senator INOUYE. In listening to your testimony I note that although you oppose the enactment of all three measures, there are provisions in all three that you embrace. From that, could you come up with a composite of a bill that you could support?

Mr. BAKKE. Well Mr. Chairman, in essence, I am here in the position of being asked to comment on someone else's legislation. I would say that the concept of establishing a reasonable rate of return, or a fair and just return, to a carrier is entirely acceptable to us. And, as a matter of fact, I can see some advantages in approaching it that way. The problem we perceive, however, is related either to our current suspension authority or to the proposals to do away with all suspension authority in the domestic offshore trades. I think it will take some time to do a workmanlike job in assessing both the carriers' financial position and factors involved in the trade to come up with an initial reasonable rate of return standard. As a matter of fact, I am not certain that you can pick one figure out of the air. Perhaps it is more realistic to think in terms of a zone of reasonableness.

Nevertheless, I believe that, if the Congress in its wisdom asks us to undertake that task, we can do the job, assuming we receive at the same time adequate appropriations and staff authorization to handle the additional work that would be generated. I would also say that the Congress might wish to consider very carefully whether the process

of determination of reasonable rates of return may not require, at the very least, retention of our present suspension authority if the public interest is to be served as well as the interests of carriers.

Senator INOUYE. Have you any evidence that merchants increase their prices immediately upon filing of freight rate increases, notwithstanding the suspension?

Mr. BAKKE. Not the kind of evidence that would be admissible in a court of law, Mr. Chairman. But I have heard comments from a number of people in the Alaskan and Hawaiian communities that what may work out to a quarter of a cent increase in a can of peas, in terms of additional ocean carriage charges that must be borne, winds up as a 5 or 10 cent per can increase on the grocer's shelf. I think this is not an unrealistic example. And if a rate or schedule of rates were ultimately found to be unlawful, I suspect that merchants seldom would reduce their prices to reflect any incremental transportion overcharges in the landed price of this merchandise.

Senator INOUYE. Do you believe that the existence of the suspension power tends to discourage unreasonable rate increases?

Mr. BAKKE. Well Mr. Chairman, that is a value judgement that I don't believe I am sufficiently informed to make after having been at the Commission for only 6 months. But I would suspect that the answer to the question is not because a carrier recognizes that, so long as it can weather the status quo for 4 months it is home free. As a matter of fact, we have general rate increase cases that go back several years, for one reason or another, and the rates obviously have gone into effect long ago.

Additional rate increases derived from subsequent rate filings also have gone into effect. So I doubt that our present suspension authority is much of a deterent.

Senator INOUYE. Do you believe that the shift from labor to capital intensity in the ocean transportation industry merits or demands a shift in economic regulations?

Mr. BAKKE. Mr. Chairman, I think it will require a shift, not only in the economic regulations but perhaps even in terms of national policy with respect to our domestic offshore trades. I am very much concerned by the exponential rate at which capital costs are escalating in the shipping business.

As I indicated earlier, in one fashion or another those costs will have to be reflected in the rate base, which inevitably will cause an upward push on ocean cargo rates.

On the other hand, I recognize the right of ocean carriers, under our free enterprise economic system, to a fair return on their capital, and the stockholders of those companies are entitled to a fair return on their investment. In terms of the domestic offshore trades, I think there are unique problems that surround those island economies—and I include Alaska because it might just as well be an island with the expanse of Canada that separates it from the Continental United States. The island economies are totally at the mercy of ocean carriers, domestic or foreign. In my view, there will have to be some kind of balance, not only in terms of regulation but in terms of national policy, to come up with some mechanism through which the legitimate interests of both the carrier and the ultimate consumer can be accommodated.

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Senator INOUYE. For some time these operators have seen an increase in capital requirements, and you can also count on increased labor costs.

At the same time, there is a requirement on the part of the carrier to generate sufficient profit to continue in their venture, with regulations tending to reduce this possibility of profits, history has shown that our sea lanes have become less and less American.

You have indicated that the problems presented of island economies is a unique one. Do you have any other solution for it?

We provide unique assistance to those in foreign trade. Should we give any unique assistance to those in the domestic trade?

Mr. BAKKE. I think the two problems are somewhat different. In the foreign trades, I believe the subsidies, direct or indirect, are addressed to the fact that, historically manning costs have been considerably greater for vessels using American crews than for foreign vessels using foreign crews. In addition, plus the fact the cost of construction of vessels for the ocean trades historically has been considerably lower abroad than it has been here. On the other hand, the economic problem involved in vessel traffic between the U.S. mainland and our domestic offshore trades is restricted to U.S. carriers, so competitive conditions on those trade routes varies directly, as a corollary of inflation and escalation of costs generally within the U.S. economy. For this reason, I believe that, in the domestic offshore trades, we should consider an approach that might encompass some kind of Federal subsidy, direct or indirect, taking into account the unique problems with which our island economies are faced and their total dependence upon the carriers that are dedicated to serving those trades. But this is really a matter of national economic policy that needs serious study by people better qualified than I am to figure out the options and priorities.

Senator INOUYE. I hope you will give this matter the highest priority and report back to the subcommittee at your earliest opportunity with some recommendation.

Mr. BAKKE. I will.

Senator INOUYE. Thank you very much, Mr. Chairman, for your assistance this morning.

Mr. BAKKE. Thank you, Mr. Chairman.

[The following information was subsequently received for the record:]

SUPPLEMENTAL STATEMENT OF KARL E. BAKKE, CHAIRMAN, FEDERAL MARITIME COMMISSION

The following supplemental statement is submitted in conjunction with the Commission's testimony of June 8, 1976, and the Subcommittee's consideration of S. 3180, S. 3260, and S. 3261, three bills that would revise the statutory provisions governing the Commission's regulation of the United States domestic offshore trades by amending the Intercoastal Shipping Act of 1933.

While these bills differ somewhat in their approach and scope, each would have significant effect on the regulatory responsibilities of the Commission if enacted.

First, the Commission would be required periodically to promulgate "rate of return" or "adequate revenue level" guidelines for ocean common carriers operating in our domestic offshore trades.

Second, a limitation would be placed on the Commission's suspension authority in connection with proposals by such carriers for general rate increases.

Third, these bills would authorize the Commission, having found any given rate increase, after hearing, to be unjustified, to order refunds to overcharged shippers.

Although we fully understand and share the concerns that gave rise to the proposed legislation, we are opposed to enactment of any of these three bills for the reasons I shall summarize below.

Before relating the Commission objections to these legislative proposals, it first may be useful to provide some background on the trades between the U.S. mainland and the so-called noncontiguous, or domestic offshore, areas. These areas are: (1) Alaska, (2) Hawaii, (3) Puerto Rico, (4) U.S. Virgin Islands, (5) Guam, (6) American Samoa, (7) Wake Island, (8) Midway Island, and (9) U.S. territories and possessions of the Pacific.

Under the 1933 Act, the Commission is authorized to regulate the rates assessed by oceangoing common carriers between these areas and the continental United States to insure that such rates are "just and reasonable". Two *caveats* must be borne in mind, however. The vast preponderance of cargo moving to and from Alaska is carried pursuant to rates filed with, and regulated by, the Interstate Commerce Commission pursuant to Public Law No. 87–595. Moreover, service in four of the domestic offshore trades (Alaska, Guam, Hawaii and Puerto Rico), is restricted by U.S. Cabotage laws to American flag carriage.

The predominant carrier in the Hawaiian trade is Matson Navigation Company, which carries approximately 90 to 95 percent of the traffic. In the Puerto Rican trade, the predominant carrier to and from Atlantic/Gulf ports is the Puerto Rico Maritime Shipping Authority (PRMSA), an agency of the Commonwealth of Puerto Rico. There is, however, a very strong competing tug and barge operation between Jacksonville/Miami and Puerto Rico. In addition, Seatrain Lines, Inc., offers service between the Atlantic Coast ports and Puerto Rico, as does Sea-Land Service, Inc., to and from the Pacific Coast.

Matson and U.S. Lines, Inc., serve the trade between Guam and the United States. American Samona is served by two American flag carriers (PFEL and Farrell) and two foreign flag carriers (Pacific Island Transport and Polynesian Line).

The Virgin Islands trade is served primarily via transshipment through Puerto Rico. The major carrier providing the portion of service between Puerto Rico and the Virgin Islands is Inter-Island Intermodal Lines. Before abandonment approximately three years ago, there had also been direct service from U.S. Atlantic ports to and from the Virgin Islands.

Of the carriers so far mentioned, Sea-Land, Inc., is a wholly-owned subsidiary of R. J. Reynolds Industries, Inc. Matson Navigation Company is a wholly-owned subsidiary of Alexander & Baldwin, Inc. As previously mentioned, PRMSA is an agency of the Puerto Rican Government, established pursuant to a Commonwealth Statute approved June 10, 1974. U.S. Lines is wholly-owned by Walter Kidd Co. These companies, with the exception of PRMSA, are involved, *inter alia*, in land holdings in Hawaii, tobacco industries, food industries and numerous other non-transportation activities.

In addition to the foregoing described major vessel operating common carrier services, numerous nonvessel operating common carriers (NVO's) serve the regulated domestic offshore trades. These are generally freight forwarders and consolidators that neither own nor operate vessels, but that publish tariffs and hold themselves out to provide common carrier services to the public. They usually provide services for small-lot shipments, utilizing the underlying vessel services of the major vessel operating common carriers. Also, many domestic offshore trades are served by tug and barge operators.

The Federal Maritime Commission is well aware of the need to insure adequate, safe, dependable and efficient transportation in the domestic offshore trades, in view of unique environmental circumstances and the dependency of these island economies on maritime transportation. There simply is no alternative form of transportation for the vast preponderance of our domestic offshore commerce, since air transportation is not economically viable for most shipments moving in these trades.

With this broad general background, I now shall address myself to the provisions of these proposed bills.

RATE OF RETURN GUIDELINES

All three bills would require the Commission to promulgate rate of return guidelines for common carriers in the intercoastal commerce. Following promulgation, such standards would be employed by the Commission in determining the lawfulness of a given carrier's filed rate increases.

S. 3180 would require the Commission to promulgate guidelines for determining "adequate revenue levels" designed "to cover total operating expenses, including depreciation and obsolescence, plus a fair, reasonable, and economic profit (or both) on capital employed" by common carriers.

S. 3260 would require the Commission to "promulgate numerical guidelines as to common carrier rate of return on rate base and common equity."

S. 3261 would require the Commission to "develop, and promulgate a reasonable prima facie rate of return for common carriers by water operating self-propelled vessels."

The Commission has no objection in general to promulgating and administering rate of return guidelines, so long as we are given sufficient discretion to deal individually with carriers on particular trade routes. It is essential that the Commission be afforded the discretion to evaluate each carrier and its trade to determine a fair return for that carrier. I am well aware of the fact that the Interstate Commerce Commission and the Civil Aeronautics Board have promulgated profit guidelines applicable to all carriers within given classes of carriers operating within certain geographical areas of the United States. Thus, the Interstate Commerce Commission establishes a standard applicable to Class I motor carriers. However, there may be as many as 400 such carriers in that class. This is not the case with the Federal Maritime Commission.

The noncontiguous trades of the United States do not comprise a single, distinct category, either geographically or in terms of carrier size or operating characteristics. Rather, each trade is substantially different from the others because of various economic, geographical, financial, and operating conditions. These distinctions require individual inquiry and analysis concerning each separate trade.

Moreover, a proper rate for one carrier might be totally inappropriate for another carrier in the same trade, if the carriers have differing degrees of financial leverage. Not only do differing leverage and costs of embedded debt make direct comparison between carriers impossible, but also, because of the different types of operations and relative risk of the individual trades, issuance of anything other than separate rate of return guidelines for each carrier in our domestic offshore trades would seem to be impossible.

For example, carriers in the Alaska trade are subject to greater natural hazard risk than carriers in other trades. Some of them are able to operate only during about six months of a year, and in most cases have a low capital investment. Accordingly, earnings of these carriers may well produce a high rate of return on investment, but not always a reasonable profit when viewed in context of conditions in the trade.

A basic objection to the rate of return guidelines proposed in S. 3260 is that the "rate of return on rate base and common equity" test would be imposed as the exclusive method of determining the fair rate on investment to which the carrier is entitled. Secondarily, we are uncertain as to what this particular standard is intended to represent, inasmuch as our economists inform us that rate of return on rate base and rate of return on common equity, technically are two different factors ascertained by using two distinct arithmetic methods. Since the language seems to have no precise meaning in its present form, for the purposes of this discussion we interpret it to mean rate of return on rate base.

The rate base is a figure representing the money invested in the property and equipment utilized in providing service. Thus, the Commission determines the amount of investment in ships, terminals, lands, and other facilities and property at the time they were first devoted to the trade plus the amount prudently invested in improvements, all of which are depreciated to the period for which rates are being tested. These factors are included in the determination of the rate base for a carrier. When the rate base has been established, the Commission then determines the financial makeup of that rate base, that is, how much is debt capital and how much is equity capital. This is known as the debt/equity ratio. In determining the rate of return on the rate base, the carriers are entitled to sufficient revenue, not only to meet operating expenses, but also to meet capital costs including service on the debt and dividends. The equity owners' return should be sufficient to insure confidence in the financial integrity of the carriers, so as to maintain the carriers' credit and their ability to attract capital in the future.[1]

The Commission has traditionally considered "rate of return on rate base" as the appropriate standard for measuring that fair return to which carriers are entitled. However, we do recognize that there are other standards equally as

[1] See *Atlantic & Gulf-Puerto Rico General Increase in Rates and Charges*, 7 F.M.C. 37 (1962).

valid under appropriate circumstances. For example, the Interstate Commerce Commission commonly applies the operating-ratio standard. Operating-ratio is simply the relationship of total expenses to gross revenues. Thus, if a carrier generates $1 million in revenue and incurs expenses of $930,000 in providing the service, it would have an operating ratio of 93 percent. Or stated another way, it would have a profit margin of seven percent. This operating ratio test generally is appropriate where gross revenues are many times greater than the rate base. In addition, I am informed that, in a case presently in litigation before our Commission, a carrier that is substantially, if not totally, debt financed, is advocating a "fixed charges coverage ratio" test for determining the reasonableness of its profit. This is an entirely new concept to the Commission, and since it is a standard which will be decided ultimately by the Commission, I am not at liberty to comment further on it in this context. I mention it, however, merely to point out that there are a number of methods to determine a fair return, and that "rate of return on rate base" is but one of the methods and may not be appropriate in all circumstances.

I now shall focus upon the specific "determinative factors" which all three bills would require the Commission to consider.

The first of these factors is the cost of replacing vessels and related equipment, including that associated with stevedoring and terminal operations. The use of replacement costs as opposed to acquisition costs—the basis presently utilized by the Commission—is a subject widely debated by the accounting community. I agree, however, that replacement costs must be taken into account by the Commission in one fashion or another in determining the adequacy of revenue levels. I am well aware of the fact that one carrier operating in one of our noncontiguous trades has contracted for a new containership which will cost approximately $60 million. That same carrier had purchased two similar ships five years ago for approximately $20 million per ship. Replacing the fleet which services our noncontiguous trades is a matter of great concern, not only to the Commission but also to the trades which that fleet serves. In the past, carriers could obtain relatively efficient vessels through various government programs, whereby excessive tonnage in the reserve fleet could be purchased at a reasonable price and the ships converted to containerships. Thus, carriers were able to provide our noncontiguous trades efficient service with relatively small capital investments. That day has passed. As I indicated previously, in determining the return on capital, one of the criteria is that the return be sufficient to enable the company to continue to attract capital. I submit that the replacement costs of vessels and related equipment should be considered within that context.

The second determinative factor is the cost of capital. The Commission has no objection to considering this factor, since traditionally it has been a factor in determining rate of return. Thus, the rate of return must be sufficient to service outstanding debt capital and to meet the requirements of obtaining new equity capital.

The third factor is the degree of risk associated with such capital. Again, we have no objection to this factor, since traditionally risk has likewise been considered in determining the rate of return. I should note, however, that this is a sophisticated economic undertaking, and it is, at times, extremely difficult to quantify "degree of risk" into a firm percentage figure.

The fourth factor to be considered is the public interest need for continued provision by carriers of certain unprofitable segments or elements of service. While I am not quite certain as to the intentions of the drafters of this legislation, I presume this reference is to lower rates on backhaul movements, promotional rates, and maintenance of rate parity to out-ports.

I have no objection to this standard when considering the reasonableness of individual rates, or in analyzing the overall rate scheme of a carrier, such as whether the revenue from an individual rate or rates for a segment of the service makes an appropriate contribution to total expenses. However, it seems it is an inappropriate factor to consider in the context of this legislation, which attempts to establish guidelines for the entire service—not just segments of the service.

At the present time, the rate of return guidelines contemplated by these bills can, in my opinion, be applied only to a relatively few carriers serving the United States noncontiguous trades,[2] and I believe it would be a disservice to the public,

[2] Two major carriers in the domestic offshore trades are Matson (Hawaii) and PRMSA (Puerto Rico). Any rate of return guidelines developed for the government-owned PRMSA would be just as unsuitable for the smaller, privately-owned carriers in the Puerto Rican trade as they would be for the conglomerate-held Matson in the Hawaiian trade. The result might very well be that a standard would have to be developed for each carrier each time a rate increase is filed, which, in effect, is what the Commission does under present law.

as well as to most carriers, to impose this standard by statute to the exclusion of other recognized standards, as well as new standards which may be developed in the future. Moreover, should the Congress require the Commission, through passage of this legislation, to promulgate rate of return guidelines, we strongly urge that we be provided adequate time to develop such rate of return standards.

For example, as presently constituted, S. 3260 would require the Commission to publish rate of return guidelines for carriers in our domestic offshore commerce within a six-month period, which I emphasize in the context of our plea for adequate time to develop rate of return standards. It is the best estimate of our professionals at the Commission that the task of initially computing a rate of return guideline for a particular carrier may take as long as one year, per carrier. We therefore have no doubt that even the one year target date of S. 3180 and S. 3261 is a totally unrealistic period to complete the required rulemaking proceeding. Obviously, if any one of the bills passes in its present form, an intolerable situation would be created from administrative and legal standpoints. Moreover, we certainly would need additional personnel in order to expedite the calculation process—probably one professional economist and one professional financial analyst for each of the trades in our domestic offshore commerce.

SUSPENSION AUTHORITY

All three bills would limit the circumstances under which the Commission could suspend carriers' general rate increase filings.

S. 3180 provides that, following promulgation of rate of return guidelines by the Commission, no filed schedule of increased rates and charges could be suspended by the Commission if the increases were "solely for the purpose of increasing the gross annual revenues of such carrier to adequate revenue levels."

S. 3260 would permit a carrier to file "a general increase in rates without suspension of that portion of such changed rates bringing about an increase of 7 per centum or less in its gross annual revenues."

Under S. 3261, there would be no suspension of that portion of the filed rate increases which would permit the carrier to realize, during the succeeding twelve months, an increase in gross revenues not exceeding the rate of return which the Commission would have determined to be prima facie reasonable. Until such time as that prima facie rate of return were promulgated by the Commission, an arbitrary standard of 10.59 percent return on rate base would be recognized as a reasonable prima facie rate of return.

Under section 3 of the 1933 Intercoastal Shipping Act, the Commission is now authorized, but not required, to suspend any proposed increase or decrease in rates, for a period not to exceed four months, whenever it orders an investigation and hearing into the reasonableness of any such rate changes. This authority is intended principally to provide a degree of protection to the interests of shippers, similar to the seven-month suspension authority of the ICC under the Interstate Commerce Act.

As far as I am concerned, suspension should not, and will not, be imposed routinely by the Commission merely as a means of providing shippers with additional notice periods, or consumers with a grace period. Revenue lost by the carrier during a suspension period can never be recouped. Therefore, it has been the practice of the Commission to suspend only when there is serious question regarding the justification for a proposed rate increase. This practice will be continued.

Recent experience of the Commission with respect to suspension of general rate increase filings seems to demonstrate that the Commission has not abused this authority, but has, in fact, used it sparingly and only in situations of critical importance. For the period from 1971 to the present time, the Commission has considered 62 general revenue increase filings involing 31 major vessel operating carriers in the domestic offshore trades.[3] After careful staff evaluation, 48 of these situations were referred to the Commission. Of these, only 20 resulted in general rate suspensions. In addition, five general rate investigation proceedings involving three major vessel operating carriers were instituted during this time without suspension.

I would be first to concede that if the four-month-maximum suspension period were solely intended to give the Commission adequate time to complete its proceedings and rule on the lawfulness of new rates, the allocated period is unresponsive to reality. In practice, most Commission proceedings now may take

[3] During this period, there were in excess of 400 other general rate increases filed by numerous smaller carriers and NVO's in the domestic trades, which were determined not to require any formal consideration by the Commission itself.

considerably longer, so that the suspension period does not cover the entire period of Commission investigation. But this, it seems to us, is insufficient cause to restrict the Commission's suspension authority.

In the near future the Commission expects to publish new rules to govern the submission of financial reports by common carriers in the domestic offshore trades. The purpose of these new rules is to obtain more accurate and detailed data relating to assets, revenue, and expenses that are attributable to domestic offshore operations. With such detailed data submissions required of carriers to justify rate increases, we are hopeful that the Commission will be in a position to determine more promptly the just and reasonable nature of a carrier's filings. With extensive supportive information provided upon filing, it is most unlikely that the Commission would fail to reach an initial determination on whether the filing appears to be just and reasonable within the minimum thirty-day period between filing and effectiveness of the rate increases. Should the Commission be required to promulgate rate of return guidelines for carriers as well, filings submitted thereunder could be incorporated easily into this first level of analysis. At the same time, the need for suspension, or, if you will, the likelihood of eventual disapproval, would be apparent more readily prior to the commencement of any hearing on filed rates. For this reason, the suspension authority could become a more effective regulatory tool than is now the case. With most of the information needed for final decision-making available before hearing, proceedings undoubtedly could be concluded with more thoroughness and speed.

I would also point out that the Commission, through an internal committee, has been revising its Rules of Practice and Procedure to eliminate any unduly technical or unnecessary procedural delays in completing its formal proceedings. This also raises the Commission's expectations that the time involved in the conduct of our general rate increase proceedings will be reduced.

For these reasons, we believe that our statutory suspension authority should at least remain as it. While a carrier has a legitimate expectation of a fair return on investment, the consumer has an equally legitimate right to expect that the element of cost attributable to transportation that is reflected in the price he pays will not be excessive. And while most merchants pass through to customers any transportation cost increases, I would venture to say that seldom are decreases in those costs passed through, whether or not the rate may be determined unjust or unlawful.

AUTOMATIC ESCALATION OF RATES WITHOUT SUSPENSION

As indicated above, two of the bills, S. 3260 and S. 3261, would provide for across-the-board rate increase formulas without threat of suspension. S. 3180 has no similar numerical standard provision, and therefore provides more flexibility than S. 3260 and S. 3261. Under S. 3180, the Commission would in effect set the "automatic escalator" standard, through promulgation of rate of return guidelines. As previously stated, S. 3260 would permit a carrier to file a general rate increase every twelve months without suspension of that portion of such rates that would result in an increase of seven percent or less in gross annual revenues. S. 3261 would provide that a rate of return of 10.59 percent on rate base would be the prima facie reasonable rate, until a different rate were developed and promulgated by the Commission.

There are a number of serious defects in these escalator provisions. For example, there is no apparent rationale for selection of an arbitrary numerical "trigger point" of seven percent, as found in S. 3260, or 10.59 percent,[4] as found in S. 3261, nor is there any definitive indication how the base for calculating the seven percent figure in S. 3260 is to be derived.

Moreover, the underlying reason for any proposed automatic numerical rate increase appreas to be that costs, and therefore rates, will continue to spiral upward, and that a reduction in, or elimination of, litigation costs will help hold down general increases. While enactment of S. 3260 (and S. 3261 until tne Commission promulgated a standard other than a 10.59 percent return on rate base) might have this limited effect—in the event that proposed general rate increases are not otherwise placed under investigation—a possible and predictable consequence of this legislation would be that general rate increases would be effected each year by each carrier. Thus, under S. 3260, in a relatively short span of five years every carrier could implement a compounded increase of forty percent in its schedule of rates, without concern about suspension at any point along the way.

[4] This percentage figure was found just and reasonable in *Pacific Coast/Hawaii and Atlantic-Gulf/Hawaii General Increases in Rates; Hawaii/Crockett and Hawaii/Galveston Bulk Sugar Rates; Hawaiian Rate—Ten Percent Increase.* 7 F.M.C. 260 (1962).

Also, under S. 3260 the automatic escalator would permit a carrier with an already high rate of return to collect revenues to which it may not be entitled, simply by keeping the overall increased rates at or below seven percent of gross revenues. Since there would be no suspension, this practice might be encouraged, with the result being a marked rate increase in the number of Commission proceedings, after the fact, to being rate levels back into line. While the Commission could ultimately find that the increase was not "just and reasonable", the carrier would have been collecting the higher rates in the meantime, and the clutter of resulting reparation proceedings could create an administrative mightmare.

While S. 3260 focuses on a carrier's "gross annual revenue" for suspension purposes, an increase of seven percent in revenue might also result in a radical increase or decrease in the rate of return on rate base, if the company had significantly reduced or enlarged its rate base during that period.

In this connection, a "general increase in rates," for the purposes of S. 3260, is defined as any change in rates which brings about, in the aggregate, an increase of about three percent or more in a carrier's gross revenue for the 12-month period ending not more than 60 days prior to the date of filing, or three percent or more in 50 percent or more of the tariff items in the trade.

The definition of a "general increase in rates" contained in S. 3260, which is not specifically addressed in S. 3180 or S. 3261, is basically the same as a definition now contained in the Commission's regulations (46 C.F.R. 512.3(d)(1)). That definition identifies rate changes filed with the Commission that are significant enough to require the filing therewith of certain financial and operating data to justify the reasonableness of the changes. We believe that this definition is an adequate description of "significant rate increases" for purposes of the Commission's threshold data submission requirements, but do not believe that it is an adequate working definition for purposes of waiving the suspension authority.

For example, although the general rate increase that would be permitted without suspension under S. 3260 is that increase, or portion thereof, which brings about an increase of seven percent or less in gross annual revenues of a carrier, a particular general increase in *rates* may not result in a seven percent increase in *gross revenues* for the future, depending on the future volume mix of cargo carried. Thus, under the proposed statutory definition, in order to reach a judgment whether these combinations of factors would amount to an increase in the carrier's gross revenues of seven percent or less, the Commission would have to project estimated volume of cargo to be transported in the future, in light of the filed rate increase.

Another difficulty could arise if more than 50 percent of the rates on tariff items were increased by an amount sufficient to increase gross revenues by more than seven percent, but proposed individual rate increases varied in amount, for example, some less than seven percent, some substantially more than seven percent. Since such commodities would have moved—and may move in the future—in different volumes, it would be extremely difficult for the Commission to determine which portion of which rate increase brought or would bring about, an increase in gross revenues of less than seven percent, and which brought, or might bring about, an increase in gross revenues of greater than seven percent.

In addition, even if a general rate increase should be filed by a carrier, which clearly could not be suspended because the general revenue increase resulting therefrom is less than seven percent, individual shipper and specific commodity rate problems still could arise. One particular shipper might protest, on valid grounds, that the rate increase on his particular commodity was unreasonable, hence unlawful. There well might be valid legal and economic grounds for the Commission to agree, and, under present authority, to suspend that particular commodity rate increase for the period permitted by law. There have been instances in the past where particular commodity shippers have raised such valid grounds for protest and requests for suspension of their particular commodity rates. Yet under S. 3260, the Commission would appear to be foreclosed from suspension of any individual commodity rate changes involved in a general rate increase, no matter how valid the reasons for suspension might be. This same problem would also be true under the arbitrary 10.59 percent return on rate base of S. 3261.

To summarize, we are convinced that no formula could be applied uniformly to all carriers to determine the justness and reasonableness of ocean freight rates. Each case must be considered in light of the carrier's particular conditions at the time, and the factors present in a given trade route. We do not believe that any

prima facie case of justness and reasonableness, or any corollary decision to suspend a rate or structure of rates, can be predicated on an arbitrary percentage of return. Therefore, we strongly oppose the provisions of S. 3260 and S. 3261 that would provide for any across-the-board numerical standards.

As previously stated, S. 3180 would require the Commission to set the standard for lawful rate increases without suspension, through promulgation of "adequate revenue level" guidelines. Were we to have the option to set and administer these standards for individual trade routes on a carrier-by-carrier basis as discussed above, we would offer no strenuous objection to this indirect form of limitation on our suspension authority.

REPARATIONS TO SHIPPERS FOR UNLAWFUL RATE INCREASES

I now shall refer briefly to the provisions of the three subject bills that authorize the refund of overcharges to shippers, following final disapproval of rates by the Commission. While two different standards for calculating the amount to be refunded are offered in these bills, we believe both provisions are unworkable, in that they would fail to accomplish the desired goal—namely, to reimburse the ultimate consumer for any charges assessed under a rate subsequently found to be unlawful.

S. 3180 and S. 3261 provide for the refund of overcharges to "the person on whose behalf the amounts were paid" (S. 3180) or "persons entitled" (S. 3261), plus interest at a rate which is equal to the average yield, on the date the increase is filed, of marketable securities of the United States having a duration of 90 days. S. 3180 further charges the Commission with the responsibility of requiring the carrier involved to keep an account of all amounts received as a result of any general rate increase pending final resolution of its lawfulness.

S. 3260 leaves more discretion in the Commission, providing that it may order any carrier to make appropriate "refunds, with interest, to the persons entitled."

We recognize the apparent equity in the concept that, where a nonsuspended rate increase has later been found unjustified and unlawful by the Commission, the excess monies should not be retained by the carrier. However, there would be many legal and practical difficulties in accomplishing such refunds under the proposed bills.

Of primary importance would be the threshold matter of determining the identity of the shippers entitled to such refunds. Normally, the seller or exporter has paid the increased rate to the carrier and has passed on this increased rate—if not a greater amount—to the purchasing consignee, who has further passed on this increase to the ultimate consumer. Any subsequent refund of the unlawful rate increase to the shipper who paid the freight, either the export seller or consignee purchaser, would be a windfall profit to him at that time, since he has already recouped from the consumer the increased freight rate he paid previously. It is highly unlikely that the refunded freight money would be passed on thereafter to consumers, who have had that increase in the commodities purchased during the time it was being charged.

Historically, protestants in the major general rate cases conducted by the Commission and its predecessor, the Federal Maritime Board, have been the state or territorial governments of the domestic offshore areas, arguing principally that increased rates would result in an adverse inflationary impact on the offshore economies. Later windfall profits returned to shippers or consignees would not resolve this critical problem.

There are also significant practical and administrative problems which would make carriers' refunds of unlawfully collected rate increases extremely difficult. During the time it would take the Commission to conduct and complete any general rate increase case, there would be literally thousands of individual shipments and shippers, involving hundreds of different commodities, with varying rate increases collected. The administrative and accounting burdens inherent in maintaining adequate records and calculating the specific refunds which might be due each individual shipper or consignee would be monumental.

In addition, during the period of time involved in conducting general rate investigation cases, the parties would have no way of knowing whether the increased rates collected ultimately would be found lawful or unlawful. The carrier well might continue to use these collections as its day-to-day working capital, and might not, after final decision, actually have sufficient available liquid assets to make the refunds, without creating critical corporate financial problems.

BROAD APPLICATIONS TO ALL CARRIERS

A. Non-Vessel Operating Common Carriers.

The bills are also very broad in terms of their coverage of "carriers". In the United States noncontiguous trades, there are basically two separate classes of carriers.

The first group includes those that operate their own vessels and directly provide the total common carrier services—these are known as vessel operating common carriers.

The second group includes the NVO's, that neither own nor operate vessels. They publish tariffs and hold themselves out to the public to provide common carrier services. Basically, they are consolidators that take numerous small-lot shipments, consolidate them into one container, and tender the container to the vessel operator for the ocean voyage. They accept delivery from the ocean carrier, de-consolidate the trailer, and tender delivery of the cargo to the consignee. NVO's exist because vessel operators in our noncontiguous trades generally publish, container-load Freight-All-Kinds (FAK) rates which are lower, on a per unit basis than individual less-than-container-load commodity rates. Thus, an NVO's margin of profit is the difference between his expenses of consolidation/de-consolidation and the ocean carriers' FAK rate, and the revenue which the NVO generates from small-lot shipments.

The NVO need not have any investment whatsoever. It could lease warehouse space to provide consolidation/de-consolidation services, and the containers it utilizes are those of the ocean carrier.

I do not believe that it should be the purpose of this legislation to cover NVO's. Thus, if any of these bills is passed in any form, it should be more precisely defined to be limited solely to vessel operating common carriers.

B. Non-self Propelled Carriers.

Also, the noncontiguous states of Alaska and Hawaii, as well as the Commonwealth of Puerto Rico and the United States Virgin Islands, have been, or are presently being, served by tug and barge services. In many instances, tug services are pursuant to short-term contracts. Indeed, in some instances the barges are chartered. Thus, there would be relatively little capital investment in this type of venture. Tug and barge operators can be similar to NVO's in their company's capital structure.

Actually the bills contemplate a carrier that has substantial investment in assets, either through debt or equity capital, through which it provides common carrier services. While many tug and barge operators in the above-mentioned trades have such an investment, some do not, and the bills may provide unworkable standards for that segment of the industry which provides tug and barge common carrier services in the United States noncontiguous trades.

C. S. 3261 Limitations

It should be noted that unlike S. 3180 and S. 3260, which are silent on the subject, S. 3261 limits its provisions regarding the development of standardized rate of return guidelines to "common carriers by water operating self-propelled vessels". This language would appear to exclude tug and barge services and NVO's and yet no further mention or exclusion of either form of service is to be found in other sections of the bill. The intended scope of the bill is in need of further clarification.

EXPANDING COVERAGE OF INTERCOASTAL ACT TO "ANY TRUST TERRITORY"

Finally, the Commission has serious reservations about the definition of the term "State of the United States" in S. 3180. Under this definition, "any trust territory" is included. This would appear to include United Nations trust territories administered by the United States, which currently are not subject to the provisions of the 1933 Act. Foreign flag common carriers providing service to and from such territories are regulated by the Commission as carriers engaged in the foreign commerce of the United States. If such foreign carriers were subjected to the more stringent requirements of the 1933 Act, there could be some international repercussions and interruptions of service in some trade routes.

CONCLUSION

In conclusion, for the reasons hereinabove stated, it is the opinion of the Federal Maritime Commission that enactment of any one of these three bills would be

ill-advised. While we do not oppose the concept of rate of return guidelines, we do not believe these legislative proposals provide the best mechanism for their development and application. Moreover, we strongly oppose any statutory limitation of our suspension authority and any provision requiring the Commission to monitor the distribution of refunds to overcharged shippers.

As mentioned in my testimony, the Commission staff has done considerable research concerning rates of return for particular carriers in the domestic offshore trades, most particularly those of Hawaii and Puerto Rico, and has analyzed the applicability of various criteria to the realities of ocean commerce. I have not included these data and analyses for two reasons: *First*, most of it is highly technical and very detailed: and *Second*, coming from individual carrier business records, much of the information relied upon in making our analysis is of a business confidential nature. I reiterate my offer, however, to have my staff work closely with the Subcommittee with appropriate safeguards for maintaining the confidentiality of these records.

I appreciate the opportunity to submit this supplemental statement in connection with the pending legislation.

Senator INOUYE. Our next witness is the president of Matson Navigation Co., Mr. Robert J. Pfeiffer.

Good morning, Mr. Pfeiffer. It is always good to see you, sir.

STATEMENT OF ROBERT J. PFEIFFER, PRESIDENT, MATSON NAVIGATION CO., SAN FRANCISCO, CALIF.; ACCOMPANIED BY JOHN R. KUYKENDALL, VICE PRESIDENT, WASHINGTON, D.C.

Mr. PFEIFFER. Mr. Chairman, I have with me Mr. John R. Kuykendall, vice president of the Matson Navigation Co., in charge of our Washington office.

Senator INOUYE. Welcome.

Mr. PFEIFFER. Mr. Chairman, I appreciate this opportunity to give testimony and discuss the proposed amendment of the Intercoastal Shipping Act, 1933. With your permission, I propose to read at this time a condensed version of my complete statement, which I would like included in its entirety in the hearing record.

Senator INOUYE. Without objection, it will be so ordered.

Mr. PFEIFFER. You are well familiar with the economic regulation by the FMC of the rates, charges, and conditions of carriage, assessed or applied, by carriers providing service in the domestic offshore trades. This regulation has been authorized by Congress in part in the 1933 Shipping Act and in part in the Shipping Act of 1916.

The revisions in the 1933 Shipping Act proposed at this time are in accordance with the President's order in his 1976 state of the Union message for a critical review of all Federal regulatory activities to eliminate regulations which are obsolete and inefficient in today's economic environment.

They are proposed because capital requirements and operating costs in the domestic offshore trades have increased so dramatically in recent years that it has become difficult to raise the capital required for fleet improvements and for continued operations in a regulated, capital-intensive, and low-profit environment.

As a result of these inflationary pressures, two major operators of self-propelled vessels have discontinued operations between the U.S. Pacific coast and the Territory of Guam, and one such operator between the U.S. Pacific coast and Hawaii.

Senator INOUYE. May I interrupt at this point?

Can you tell us who these operators are?

Mr. PFEIFFER. Yes, sir. The two that discontinued?

Senator INOUYE. Yes.

Mr. PFEIFFER. The two that discontinued in the Guam trade are Seatrain Lines, California, and Pacific Far East Lines, Inc. The one that discontinued in the Hawaii trade was Seatrain Lines, California.

Senator INOUYE. I just wanted that for the record, sir.

Please proceed.

Mr. PFEIFFER. In the U.S. Atlantic-Puerto Rico trade, the three major carriers sold their operating asset to an entity of the Commonwealth of Puerto Rico, the Puerto Rico Maritime Shipping Authority.

Would you like me to identify those?

Senator INOUYE. Yes, sir.

Mr. PFEIFFER. Seatrain Lines, Inc., Sea-Land Services, Inc., and TTT.

We now have Government ownership of a shipping service in the domestic offshore trades.

For many years it was not necessary for carriers in the domestic or foreign trades to construct new vessels because of the availability of surplus World War II vessels at attractive prices for conversion to specialized carriers and for fleet replacement purposes. Because of this inventory to draw on, no new vessels were constructed by Matson during the period 1946 to 1970.

Because in 1970 no suitable surplus conventional vessels were available, Matson took delivery of two new container vessels at a capitalized construction cost of $21,000,000 each. In 1973 Matson took delivery, under long-term charter arrangements, of two trailer vessels with a total capitalizable construction cost of approximately $30,600,000 for each vessel. We now have contracted for the construction of one new container vessel of the same design as those delivered in 1970, but at a contract cost of not less than $56,920,000.

In the past 3 years, vessel construction costs have increased dramatically, and shoreside equipment costs have gone up 50 to 75 percent. Fuel oil costs four times more than it did 3 years ago. Maritime labor costs have doubled in the last 5 years. Longshore costs have escalated at an annual rate of 10 percent.

Senator INOUYE. May I interrupt at this point, Mr. Pfeiffer?

This $56,920,000, that is the floor, isn't it?

Mr. PFEIFFER. That is what, sir?

Senator INOUYE. The floor price.

Mr. PEIFFER. No, sir, that cost represents the base or floor price plus assumed escalation in labor and material.

Senator INOUYE. You have escalator clauses?

Mr. PFEIFFER. Yes, sir. The contract with the shipyard does provide for escalation which may bring the ultimate price to an amount in excess of the $56,920,000.

Senator INOUYE. So it is almost three times the cost of the 1970 vessel?

Mr. PFEIFFER. That is correct. Yes, sir.

Senator INOUYE. Please proceed, sir.

Mr. PFEIFFER. If privately owned carriers are to continue to operate in the domestic offshore trades without Federal operating or construction differential subsidies, the investment climate must be improved, and the risk and uncertainty of the return to be realized on the new investments must be reduced.

New capital investment contributes substantially to a reduction in operating costs, or at the least reduces the rate at which such costs increase, and contributes to improvement in service to our customers. Matson's newer vessels provide day-of-the-week service and eliminate uncertainty as to the total transit time for goods shipped to Honolulu. Regular weekly service eliminates the need for prolonged warehousing, the costs of which would be borne by consumers.

Also, the recent institution of direct calls at Hilo, Hawaii by Matson's high-speed and efficient trailer vessels, the SS *Lurline* and SS *Matsonia*, reduces the transit time for goods moving from the mainland suppliers to their customers on the island of Hawaii.

Currently, the act does not place any statutory obligation on FMC to insure that the regulated party earns a fair and reasonable rate of return. This is not to say that FMC as currently constituted has no concern with this matter, but only that it has no statutory obligation in that regard. Under present law, investors have no rate of return guidelines issued by the FMC upon which they can base their expectations for a reasonable return on their investment.

Each of the three bills under consideration by the committee includes a provision for the development and promulgation by FMC of rates of return on rate base—that is, the relationship of net income, after State and Federal income tax, to the sum of the depreciated value of the carrier's assets and working capital.

Senator INOUYE. If I may interrupt, sir, I will have to rush off for a vote on the Senate floor. We will have a short recess.

[Recess.]

Senator INOUYE. Please, proceed, sir.

Mr. PFEIFFER. Matson supports the proposal that prima facie rates of return be promulgated after notice and opportunity for hearing, since it is our belief that such rates of return would serve as useful guidelines (1) for the benefit and encouragement of investors, (2) for use in exercising the suspension power, and (3) for use in expediting the conclusion of general rate increase proceedings.

That such promulgation would be helpful as an encouragement to investors can be attested by my personal experience. Only after an effort spanning the last 18 months did I receive approval from Matson's Board of Directors to enter into a contract with Bath Iron Works Corp. for the construction of the new containership previously referred to in my testimony.

As a result of the periodic and continuing effort to convince Matson's board to make this additional capital investment, I am completely conversant with the understandable reluctance to invest such substantial amounts of capital in the environment of uncertainty that now prevails, and will prevail in the foreseeable future, in the Pacific Coast-Hawaii trade.

Given the history of rates of return in that trade—an average of 5.604 percent per annum for the period 1947–74—the people of Hawaii are indeed fortunate that someone, and in particular a corporate citizen of Hawaii, has been willing to invest in Hawaii's lifeline with the U.S. mainland. Virtually risk-proof U.S. Treasury bonds offer a more satisfactory rate of return.

It must be understood that prima facie rates of return that are established as a result of this legislation do not provide any guarantee that the carrier will earn such a return from its operations. It still will

be faced with the same operating risks that always have been inherent in the shipping industry.

Further, the FMC still suspend the effective date if it does not agree with the carrier's projection of operating revenues, expenses, and rate base, and with the carrier's claim that its latest general increase filing will generate a rate of return that does not exceed the promulgated prima facie rate of return.

In addition to the requirement that the Federal Maritime Commission establish prima facie reasonable rates of return, each of the three bills pending before the committee proposes a revision of the suspension power of the Commission, but only to the extent of exempting a certain level of general rate increases from such suspension. All other changes in rates or charges, as well as changes in regulations, practices, or conditions of carriage, would remain subject to possible suspension.

A loss of revenue to the regulated carrier caused by the suspension of a general increase in rates is of particular significance in today's economic environment because of the unprecedented amount of capital currently required for the replacement of vessels and related equipment. The act currently provides the regulatory agency with unlimited power to impose a suspension.

It is a deterrent to an investor to have the effective date of a general rate increase suspended even before the increase is found to be unlawful. The practice of penalizing a carrier before it is found guilty no longer is consistent with economic reality.

Revision of the suspension power will not adversely affect the ratepayers in the Hawaii trade. The ratepayers already receive the benefit of a considerable delay in the passthrough to them of increased operating costs or other factors necessitating a general increase in rates. This delay is caused by the time required for the preparation of financial data and the issuance of corrective tariffs, which concurrently must be filed with the FMC, and by the regulatory notice period. If a suspension by the FMC also is involved, the timelag amounts to about 225 days for Matson Navigation Co., during which period Matson absorbs the cost increases and faces the prospect of an inadequate rate of return.

In addition to the timelag of the carrier, national retail organizations could absorb an increase in freight rates until it can be combined with other increases for passthrough. Our regulated customers—freight forwarders, NVOCC's, and used household goods carriers—ordinarily cannot pass the increase on to their customers until at least 30 days after it becomes effective in Matson's tariff.

Also, the 30- to 60-day inventories of nonperishable goods that generally are maintained in Hawaii permit the business establishments to defer a passthrough of an increase in freight rates until the inventories received at rates in effect prior to the latest tariff increase are sold.

Because of the foregoing reasons, the revision of the Commission's suspension power with respect to general tariff increases should not work to the disadvantage of Matson's customers in the Hawaii and Guam services.

In summary, we respectfully recommend to the committee that it favorably report that language appearing in section 1 of S. 3261 or

section 2 of S. 3260 in addition to that appearing in section 2 of S. 3261.

Senator INOUYE. Thank you very much, Mr. Pfeiffer.

How significant is the effect on your financial status, of this 4-month rate suspension?

Mr. PFEIFFER. It is most significant, sir. We do have an FMC docket pending now, 75–57, and the suspension period of that entails a cost absorption by Matson of $1,750,000. In addition, we have had an increase in the last 35 days of the price of our fuel oil, amounting to $1.4 million per annum. We haven't even begun to calculate what effect that will have on our financial results.

Senator INOUYE. Would you furnish the committee with specific dollar amounts since 1947?

Mr. PFEIFFER. Yes, sir, we would be happy to.

[The following information was subsequently received for the record:]

Since 1947 the suspension power has been exercised by FMC on six occasions. The cumulative effect of these actions has been to deprive Matson, in 1975 dollars, of $3,924,000 in additional operating revenues. $1,750,000 of this represents the suspension penalty imposed by FMC commencing on December 8, 1975.

Senator INOUYE. Do you have any ballpark figure at this time?

Mr. PFEIFFER. No, sir, I don't.

Senator INOUYE. In your judgment, where is the bottleneck at FMC which causes delays in reaching a final decision on rate proceedings?

Mr. PFEIFFER. I am not an expert on the FMC organization. I would assume, from my exposure to the Commission, that they are overwhelmed with many dockets of this nature and the horrendous amount of detail that goes into a proceeding.

Senator INOUYE. Do you have any recommendations to speed up this process? Other than, say, increasing personnel?

Mr. PFEIFFER. I think, Mr. Chairman, that if there were no suspension period, the Commission could attack its workload without being under the pressure they are. They still would have the filing period, which by law is 30 days, but in actuality in our case is 45 days, to take a rough cut at our filings to make sure that we weren't being unfair in our requests, but then they wouldn't be under the gun to do something in the 4-month period which they can't do anyway.

Senator INOUYE. I am going to ask you the same question I asked Mr. Bakke. Do you have any evidence that merchants increase their prices immediately upon filing of rate increases notwithstanding the suspension of those rates?

Mr. PFEIFFER. We have reason to believe that it may be the case. I could not specifically categorize it as evidence, Mr. Chairman. We do know that only about 13 percent of the westbound customers would be affected immediately when increased rates become effective, with or without suspension, with these customers, shipping privately owned vehicles, chilled perishable goods, animals, and other goods that do not move into inventory.

People with extensive inventories in Hawaii are not in the position of having to respond as quickly because they do consume their inventories first, but to answer you specifically and directly, we have no evidence or firsthand knowledge to present that that is the case.

Senator INOUYE. I am not certain whether statistics have been gathered but could you tell us approximately what percentage of the total cost to the consumer represents freight rates?

Mr. PFEIFFER. That involves a rather detailed answer. We have that information. I can't give it to you here and now but we can provide that answer to the subcommittee on a range of commodities.

[The following information was subsequently received for the record:]

Although such freight charges obviously contribute to the current level of retail prices the percentage attributable to such charges is much less than commonly believed. This is illustrated in the attached table.

MATSON NAVIGATION CO., RELATIONSHIP OF FREIGHT CHARGES TO RETAIL PRICES FOR SELECTED COMMODITIES

Commodity	Unit	Retail price [1]	Freight charges [2]	Freight charges as percent of retail price
Tomato soup	10¾ oz can	$0.26	$0.0176	6.7
Rice	25-lb bag	5.38	.4630	8.6
Spam	12 oz	1.15	.0160	1.4
Tomatoes (fresh)	Pound	.49	.0420	8.5
Frozen fryers	do	.55	.0390	7.1
Tide detergent	84 oz	1.95	.1360	7.0
Lilly Lawn fertlizer	20 lb	5.99	.4200	7.0
General Electric 18-cu. ft. refrigeration/freezer	Each	498.00	40.68	8.2
General Electric dryer	do	230.00	17.38	7.6
Zenith 23-in color TV	do	699.00	10.05	1.4
⅜ D.F. plywood 1,000 sq. ft.	1,000 sq. ft.	566.00	21.95	3.9
1976 Vega	Each	4,244.00	261.32	6.2
Simple average of above		6,252.77	352.5136	5.6

[1] Retail prices were obtained from—
(a) Advertisements appearing in the Honolulu Advertiser or Honolulu Star Bulletin, between June 3 and 7, 1976.
(b) "Matson—Still Good Bargain": An article published in the spring, 1976 issue of Ampersand.
[2] See Matson Navigation Co. Tariff Nos. 14–E and 30.

Senator INOUYE. I would appreciate that for the record, because we oftentimes hear of the cost of goods being high because of high freight rates. I am just wondering what the freight rate would be on a $200 suit.

Mr. PFEIFFER. It would be minimal. I gave a speech recently and we said that if the cost of moving gasoline to Hawaii went up 10 percent, the cost to the consumer at the pump for that item would be one-quarter of a cent per gallon.

Senator INOUYE. Thank you very much, sir. Have you any evidence that merchants increase prices in spite of the fact that they may be holding this 30- to 60-day inventory of goods in warehouses?

Mr. PFEIFFER. I have no evidence based on personal knowledge of that, sir.

Senator INOUYE. Do you believe that the shift from labor to capital intensity in the industry merits or demands a shift in economic regulation?

Mr. PFEIFFER. Yes, sir.

Senator INOUYE. You don't believe that FMC is facing up to the reality?

Mr. PFEIFFER. I am biased in that, Mr. Chairman, but I don't believe they are.

Senator INOUYE. Do you believe that the existence of the suspension power tends to discourage unreasonable rate increases?

Mr. PFEIFFER. I am not sure if I heard that phrase correctly, Mr. Chairman.

Senator INOUYE. Do you believe that the existence of the suspension power tends to discourage unreasonable rate increases?

Mr. PFEIFFER. No, sir, I do not; its existence neither encourages nor discourages such increases. Filing for a freight rate increase entails an onerous workload, it's time-consuming, it's a costly measure. We have also competitive restraints. We also have our credibility to protect at FMC and with the community in Hawaii. I can point to Matson's track record. We have been in Hawaii 94 years. We went 10 years without an increase. In 1971 when we knew we could no longer forestall it, we felt justified going in for a 50-percent increase. We went instead for 12½ percent so that we wouldn't impact too hard upon the community.

We followed that 2 years later with a 12½ percent, although it was far from that adequate. We do have a feeling of social responsibility to the community in Hawaii and later to the community in Guam. I am confident that no well-run steamship company would be encouraged to file more freight rate increases in greater regularity or greater amounts if the suspension period were not there.

Senator INOUYE. Then you would say the suspension would bring about rate stabilization?

Mr. PFEIFFER. Yes, sir.

Senator INOUYE. To what extent are your rates based on capital costs?

Mr. PFEIFFER. It is an important factor. It changes with the times and depends on your other costs. You have high operating costs, both on the ship and shore side. In the old days, the capital costs for our fleet were minimal. Now they are approaching a period where the pendulum is swinging in that direction. Here again we are in the middle of a docket today in Washington that the FMC and—I can provide the committee, not here, but later today with a precise figure if they like. I can't give it here today because we are testifying there, sir.

Senator INOUYE. We would like to know what proportion this capital costs makes up of the total figure.

Mr. PFEIFFER. Yes, sir. Thank you.

Senator INOUYE. And if you could also provide us with proportional changes in the past 5, 10, and 15 years.

Mr. PFEIFFER. Yes. sir.

[The following information was subsequently received for the record:]

Approximately 20 percent of the revenue earned by Matson in the Hawaii freight service in year 1975 was required to recover capital costs. This percentage figure will increase when Matson's new 071–J containership enters service in 1978, with, however, a corresponding decrease in operating expenses due to the withdrawal of four fully depreciated vessels from service.

HAWAII SERVICE, 1975

[In thousands of dollars]

	Current fleet		Current fleet plus new 071–J less 4 old vsls	
	Amount	Percent	Amount	Percent
Operating expenses (direct cargo handling, vessel voyage expense, general and administrative expense, repair and maintenance expense)	$105,711	80	$99,078	75
Ownership costs (depreciation, amortization, property taxes, etc.) [1]	19,646	20	29,014	25
Pretax net income [2]	6,835		4,100	
Total	132,192		132,192	

[1] These are costs associated with the ownership of assets, as compared with the costs that are incurred because of the operation of assets. The ownership costs, which would be incurred even though no operations occurred, are depreciation, amortization, property insurance, interest expense, property taxes and long-term lease expense of vessels and terminal facilities.

[2] The other element of capital costs is the charge to the ratepayer for a return on Matson's investment in the Hawaii trade. Specifically, this would be the pretax income which provides the company with the funds necessary to pay a return on net worth.

Senator INOUYE. What long-term effects do you foresee as a result of the elimination of the current suspension power?

Mr. PFEIFFER. The long-term effect, sir, would be our ability, management's ability to encourage investors to commit the large sums required for new ships and new shoreside operating improvements. We, frankly, should have ordered this ship 2 or 3 years ago. It would have cost less. Our savings to the ratepayers would have been more dramatic and would have been put into effect sooner. I would say that the more ready availability of capital for such investments would insure lower ultimate costs to the ratepayers.

We have only talked about ships, but the shoreside costs, the cost of shoreside equipment is ever mounting. We must do something to lower those high costs. We are no longer talking about a rope sling and a two wheel hand-truck in this business. We are talking about $2 million Gantry cranes and $250,000 straddle carriers.

Right now we are looking at an overall improvement in our terminal facilities that would require a total expenditure of something like $35 million. Again, the rate payer would benefit by the ultimate reduction in costs, or at least the delay of further increases.

Senator INOUYE. Do you favor the extension of direct Federal subsidies to carriers in the domestic trades?

Mr. PFEIFFER. No, sir, I don't. One, I don't think that's the answer in the domestic trades; the private enterprise system is far superior for the rate payers in the Hawaii and Guam trades. I think the oversight of the manager in which a steamship company is managed by the Federal Government would be costly and I think it would be cheaper to the taxpayers of the country to permit the carriers in domestic offshore trades to earn a fair rate of return rather than be subsidized.

Senator INOUYE. What remedy do you believe should be available for refunding overcharges to shippers?

Mr. PFEIFFER. If I understand correctly, there is such a procedure provided by ICC regulations and I think it would be quite easy if the shippers were adequately informed of this possibility, for them to save their shipping documents, and submit copies of them at the proper time with a claim for overcharges, plus interest for the refund period.

Senator INOUYE. We have a few questions that we would like to submit to you for your study and response. Mr. Pfeiffer, Mr. Kuykendall, I thank you very much.

Mr. PFEIFFER. Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF ROBERT J. PFEIFFER, PRESIDENT, MATSON NAVIGATION CO.

Mr. Chairman, I appreciate this opportunity to give testimony and discuss the proposed amendment of the Intercoastal Shipping Act, 1933 (Act), through revision of the Act's suspension provisions and by authorizing the promulgation of rate of return guidelines by the Federal Maritime Commission (FMC).

Initially, the 1933 Act applied only to those carriers operating via the Panama Canal between U.S. Pacific Coast ports and U.S. Atlantic/Gulf ports. In 1938, however, the Act's application was expanded to include the domestic offshore trades, that is those carriers, including Matson, transporting cargo between U.S. Mainland ports and ports in Alaska, Guam, Hawaii, Puerto Rico and the Virgin Islands. Since 1940 the Act has applied only to carriers serving any of these domestic offshore communities.

Economic regulation by FMC of the rates, charges and conditions of carriage assessed or applied by carriers providing service in such trades has been authorized by the Congress, in part in the Act, and in part in the Shipping Act, 1916.

The substance of such regulation is summarized below:

a. Rates and regulations and practices relating thereto shall be just and reasonable.

b. Rate schedules or tariffs must be filed with FMC in a form prescribed by FMC and remain open to public inspection.

c. Any change in rates and related regulations or conditions of carriage must be filed not later than 30 days prior to the effective date of the change, unless FMC grants special permission for filing within a shorter preiod of time.

d. Either upon its own initiative, or upon complaint, or upon a protest from any party of interest, FMC is authorized to enter into a hearing concerning the lawfulness of such changes; and, further, is authorized to suspend the operation of such change for a period of time not exceeding four months beyond the date when it otherwise would have gone into effect.

e. Common carriers are prohibited from:

Paying or allowing a deferred rebate to any shipper.

Using a vessel or vessels either alone or in agreement with other carriers for the purpose of excluding, preventing or reducing competition by driving another carrier out of a trade.

Refusing service to any shipper in retaliation for the filing of a complaint by such shipper or such shipper's use of another carrier's service.

Entering into any unfair or unjustly discriminatory arrangement with any shipper based on the volume of freight offered.

Giving any undue or unreasonable preference or advantqge to any particular person, locality or description of traffic.

Allowing any person to obtain transportation at less than the lawful rates in effect by any means.

Although differing in detail, all three bills under consideration by the Committee today—S. 380, S. 3260 and S. 3261—only undertake to revise the suspension power described in paragraph d. above; all other existing regulatory requirements would remain unchanged.

Why such revision or modification now?

In his 1976 State of the Union message the President indicated that he has ordered "a critical review of all Federal regulatory activities to eliminate regulations which are obsolete and inefficient in today's economic environment . . . to make government more responsible to current economic and social realities."

The Act was enacted in an economic, political and social environment much different from that prevailing some forty-three years later . . . for example, prior to 1938 domestic offshore carriers had only to file their maximum rates rather than the rates actually charged, creating a potential for undue preference and unjust discrimination among shippers, localities or class of traffic and, therefore, a need for regulation. The economic power of the maritime and longshore unions was yet to evolve, and capital requirements for vessel construction and for acquisition of terminal and stevedoring for vessel construction and for acquisition

of terminal and stevedoring equipment were far more modest than currently is the case.

Recent increases in capital requirements and in operating costs have been dramatic.

Rather than invest the capital required for fleet improvement and continue operations in a regulated, escalating cost and low profit environment, two major operators of self-propelled vessels have discontinued operations between the U.S. Pacific Coast and the Territory of Guam, and one such operator between Hawaii and the U.S. Pacific Coast. In the case of the U.S. Atlantic-Puerto Rico trade, the three major carriers have sold their operating assets to an entity of the Commonwealth of Puerto Rico—the Puerto Rico Maritime Shipping Authority. We now, therefore, have government ownership of a shipping service in the domestic offshore trades.

Due to the availability of surplus World War II vessels at attractive prices for conversion to specialized container vessels and for fleet replacement purposes, it was not necessary for many years for carriers to construct new vessels. For example, no new cargo vessels were constructed by Matson during the period 1946–1970.

In 1957 Matson's U.S. Pacific Coast/Hawaii fleet consisted of 15 vessels, all acquired as surplus units from the federal government at a total price—in 1975 dollars—of approximately $40,200,000. During the period 1957–1970, however, Matson invested a total of $39,500,000 in the conversion of such vessel to specialized container vessels, as well as $46,100,000 for related shoreside equipment required for such specialized operations. This infusion of private risk capital brought the innovative concept of containerized shipping to the Pacific Basin, the economics of which made it possible for Matson to forego any general increase in its freight rates for a ten-year period from 1961 to 1971.

Finally no suitable surplus conventional vessels were available for conversion, and in 1970 Matson took delivery of two new container vessels at a capitalized construction cost of $21,100,000 each; in 1973 Matson took delivery, under lease arrangements, of two trailer vessels with a total capitalizable construction cost of approximately $30,600,000 for each vessel. Matson now has reluctantly contracted for construction of one new container vessel of the same design as those delivered in 1970 but at a contract cost of not less than $57,920,000, as compared with the 1970 capitalized construction cost of $21,100,000.

In the past three years, shoreside equipment costs have gone up 50 to 75 percent and fuel oil costs have quadrupled. Maritime labor costs have doubled in the past five years.

If we are to continue to have privately owned carriers operate in some of the domestic offshore trades without federal operating or construction differential subsidies, the investment climate must be improved by diminishing the risk of and uncertainty over the return to be realized from the investment in modern, more efficient replacement vessels and related shoreside equipment.

Elements of risk and uncertainty—now heightened by the unprecedented escalation in operating costs and investment capital required—include, for example, the following in the U.S. Pacific Coast-Hawaii trade:

1. *Free entry-exit to and from the trade.*—Any U.S.-flag carrier (provided that it does not receive federal operating-differential subsidy for operations in foreign commerce) may enter or withdraw from the Hawaii trade without benefit of prior permission or certification. U.S.-flag carriers operating vessels built with federal construction-differential subsidy on mixed domestic-foreign voyages may and do participate and compete with Matson in that trade. Because there are at present no certification requirements, such competing carriers may at their election serve only those ports in the trade, or provide those specific services, that are most profitable.

2. *Price competition.*—There is no collective rate making in the trade.

3. *Sizing fleet to demand for service.*—Prior to containerization Matson operated "standard" vessels in the sense that they were those vessel types generally operated by U.S.-flag carriers as well as by many foreign-flag operators. Consequently, if a new competitor entered the Hawaii trade, Matson could react to a reduction in its share of the total cargo volume by chartering out or selling one or more of these "standard" fleet units, for which there was a ready market. Today, however, we have specialized vessels tailored to the requirements of the Hawaii trade and having a capacity for as many as 1,153 24-ft. containers. There is no ready market for these specialized vessels, and they obviously cannot be cut down in size as a response to the reduced demand brought about by the entry of new competitors into the trade.

4. *Regulatory lag.*—Concurrent with filing a general increase in rates, common carriers such as Matson are required by FMC to file detailed financial data supportive of the increase for evaluation by certain of FMC's staff. The preparation of revised tariffs and such supportive data is the first step in what can constitute substantial "regulatory lag" as outlined below:

a. Elapsed time required for preparation of tariff revisions and supportive financial data—60 days.

b. Elapsed time between date of filing tariff revisions and supportive financial data and scheduled effective date of the increase—45 days.

c. Suspension period—120 days.

d. Total elapsed time before an increase becomes effective—225 days

5. *Minority role in labor-management collective bargaining.*—Matson negotiates with the U.S. West Coast maritime and longshore unions as a minority member of the Pacific Maritime Association (PMA). The balance of the Association's membership consists of stevedores and carriers engaged in the foreign commerce including U.S.-flag carriers, some with and some without construction and/or operating-differential subsidy.

Those members engaged in the foreign commerce can pass through any increase in longshore labor costs by filing tariff increases on 30 days' notice without fear of the effective date being suspended while those U.S.-flag carriers receiving operating-differential subsidy pass through the majority of any increase in offshore union wages and benefits to the taxpayer and the balance by tariff increases not subject to suspension.

6. *Labor-management disputes.*—Since 1946 Hawaii has suffered, as a result of such disputes, a total of 35 separate interruptions in ocean transportation service with the aggregate length of such interruptions totaling almost 4 calendar years. An offshore maritime strike on the Pacific Coast has a more immediate impact on Matson's Hawaii service than it does on the vessel operations of the other members of PMA who are engaged in the foreign commerce. For example, if a strike had commenced on April 1, all of Matson's vessels in that service with one exception would have been strike-bound at Pacific Coast ports by April 9. On the other hand, all of those vessels operated by other U.S.-flag carrier members of PMA would not be strikebound until May 21—51 days after the strike commenced.

All vessels would become strikebound as they arrived inbound at a U.S. Pacific Coast port; the difference in time before Matson's vessels and other U.S.-flag vessels would become idled at such ports is due to the greater distances traveled by those other carriers in the foreign commerce. For example, one such carrier operating vessels between the Far East and California would require 45 days to complete a round trip voyage between those two areas. Some Matson vessels, however, can complete a voyage to and from California and Hawaii in as few as 10 days. As a consequence, those Matson vessels that have commenced a voyage before the strike begins will be strikebound upon their return to a Pacific Coast port in a relatively short time; those union personnel manning Matson vessels are "on the beach" without income at a much earlier time than those union members serving on other PMA U.S.-flag vessels.

7. *Delay in rendering of decisions by FMC.*—The regulatory agency as well as the shipping public and the carriers have an interest in expeditious determinations; prolonged proceedings are expensive and time-consuming, and the carriers' lending institutions view pending general rate increase hearings and investigations with apprehension.

To summarize at this point, it becomes clear that new technology in shipping—without which freight rates would be astronomically high—when combined with the effects of inflation and the other factors described above makes it timely that the Congress undertake to update certain aspects of the manner in which the domestic offshore carriers are regulated, by wherever possible reducing risk and uncertainty for those providing the investment capital necessary for the further modernization of the offshore interstate transportation system.

Each of the three bills under consideration by the Committee makes some provision for the development and promulgation by FMC of rates or return on rate base, i.e., the relationship of net income, after State and Federal income tax, to the sum of the depreciated value of the carrier's assets and working capital.

The Act presently does not place any statutory obligation on FMC to ensure that the regulated party earns a fair and reasonable rate of return; this is not to say that FMC as currently constituted has no concern with this matter, but only that they or successor Commissions have no statutory obligation in that regard. Under present law investors have no FMC rate of return guidelines or

determinations reflecting current economic conditions upon which they can base their expectations as to return on their capital.

Matson supports the proposal that prima facie rates of return be promulgated after notice and opportunity for hearing, since it is our belief that such rates of return would serve as useful guidelines (1) for the benefit and encouragement of investors, (2) for possible use in exercising the suspension power, and (3) for use during general rate increase proceedings in expediting conclusion of the same.

That such promulgation would be helpful as an encouragement to investors, by giving them an indication of the rate of return that would be lawfully permitted, can be attested by my personal experience. After an effort spanning the last 18 months I recently did receive approval from Matson's Board of Directors to enter into a construction contract with Bath Iron Works Corporation for the construction of the new containership previously referred to in my testimony. As a result of the periodic and continuing effort to convince Matson's Board to make this additional capital investment, I am completely and currently conversant with the understandable reluctance to invest such substantial amounts of capital in the environment of uncertainty that now prevails and will prevail in the foreseeable future in the Pacific Coast-Hawaii trade. Given the history of rates of return in that trade the people of Hawaii are indeed, fortunate that someone, and in particular a corporate citizen of Hawaii, has been willing to invest in Hawaii's life-line with the U.S. Mainland. As the following table demonstrates, Matson's experienced rate of return on rate base has clearly been unsatisfactory with the exception of the six-year period from 1962 to 1968 which were the initial years of containerization with rapid though short-lived improvement in productivity. Virtually riskproof U.S. Treasury Bonds offer a more satisfactory rate of return.

RATES OF RETURN, PACIFIC COAST-HAWAII TRADE

Period	Matson's average rate of return on rate base [1]	Average yields of long-term Treasury bonds [2]
1947–56	1.287	2.598
1957–61	2.998	3.780
1962–68	14.273	4.439
1969–74	4.855	7.393
1947–74	5.604	4.047

[1] Roseman's Schedule 1: FMC Docket No. 75–57.
[2] Treasury Bulletin, U.S. Treasury Department, Office of the Secretary.

With the exception of ship channel improvement at ocean ports, the citizens of the State of Hawaii do not receive any direct federal financial assistance for their interstate ocean transportation system, unlike many of the contiguous mainland, States which derive economic benefits from federal assistance for construction, improvement and maintenance of inland waterway systems or construction of highway systems for movement of their interstate commerce. Hawaii depends on continued capital investment by common carriers serving the state, a dependence that has been well served by the development of the container shipping system and, until the recent inflation, rate stability.

It is in the public interest that private enterprisers be encouraged to invest in modern and more efficient vessels and related equipment, not only for the contribution that such investment makes towards reducing costs, or at least slowing the rate at which costs increase, but also towards improving service that is, thereby, made possible. For example, Matson's two Enterprise class container vessels make it possible to provide day of week vessel departures from the west coast which, by reducing uncertainty as to the total transit time for goods coming from the mainland, permit some reduction in inventories at Honolulu and thus the cost of doing business. The same result is realized by having day of the week vessel

arrivals at Honolulu, with goods arriving in sufficient time for week-end shopping by consumers but not too far in advance of the week-end to require prolonged warehousing as inventory, the costs of which would of course be borne by consumers. Another example is the recent institution of direct calls at Hilo, Hawaii, by Matson's high speed and efficient trailer vessels, the SS *Lurline* and SS *Matsonia*. These direct calls reduce the transit time for goods moving from the Mainland suppliers to heir customers in Hawaii.

The Civil Aeronautics Board has, through rule-making procedures, developed and promulgated fair and reasonable rates of return on investment which are used not only for the purpose of establishing the lawfulness of a general rate increase but also as a benchmark for application of the Board's suspension power (see CAB Docket 21866-8: April 9, 1971). It is our belief, therefore, that FMC should have an equal capacity, pursuant to its own rule-making procedures, for development and promulgation of the proposed rate of return guidelines.

In respect to such guidelines, of the three bills pending before the Committee, Matson would recommend that the Committee favorably report that language appearing in Section 1 of S. 3261 or Section 2 of S. 3260.

In our opinion it is preferable for all parties that promulgated rates of return be prima facie rather than be considered as standard rates, and desirable that the statute specify that at least the initial rate of return be developed through the hearing process.

Because of the prevailing economic differences among the various domestic offshore trades, it would be appropriate and desirable that initial rates of return be developed and promulgated for each trade. In those instances where general rate increases are filed subsequent to such promulgation, the prima facie rate of return would be subject to potential disprovement during any ensuing hearing by either the carrier who may wish to argue for a higher rate of return or by protestant intervenors who may argue for a lower rate of return.

The prima facie approach thus does provide an opportunity for the parties to the proceeding to convince FMC that the rate should be changed. Since the major parties of interest would participate in the development of the initial promulgated rate of return, however, such opportunity probably would be exercised only when there has been a substantial change in circumstances without any subsequent change in the previously promulgated rate of return. Any changed rate of return included as part of FMC's ultimate finding as to the lawfulness of a general rate increase would then become the prevailing prima facie rate of return for that carrier and for the trade if the carrier is the dominant carrier in the trade.

It is understood that any promulgated rate of return does not guarantee in any way that the carrier will earn such return from his operations; and, further, FMC may not agree with the carrier's projection of cargo volume, operating revenues, expenses and rate base, and thus with the carrier's claim that his latest general increase filing will generate a rate of return not exceeding the promulgated prima facie rate of return. I will address myself further at a later point in my testimony to this eventuality and the use by FMC of the prima facie rate of return in effect for each trade in conjunction with the suspension power.

Matson shares with FMC and others a concern for seeking ways to expedite the conclusion of proceedings before FMC in a manner that would be consistent with the requirements of due process. In FMC Docket No. 75-36—a rule-making proceeding undertaken for the purpose of amending FMC's rules of practice and procedure—Matson has submitted various suggestions as to ways and means of bringing about procedural expedition.

The availability of a promulgated prima facie rate of return and the factors, usually repetitive from proceeding to proceeding, upon which it is based will substantially assist in reducing the time and fees expended on testimony and cross-examination of expert rate of return witnesses.

As a common carrier by water in the domestic offshore trades, Matson became initially subject to the Act and its suspension provisions in 1938. Since World War II intervened, however, Matson and other domestic offshore carriers have been subject to complete economic regulation, including suspension, only since 1946-1947. For this reason the following history of the frequency with which the suspenslon power has been exercised in the Pacific Coast-Hawaii trade begins at that time:

Year	Docket No.	Percent of increase	Date filed	Suspended	Decision as to rate of return: Date	Percent	Not unlawful
1947	660	20.0	Feb. 1, 1947	No	Aug. 24, 1948	3.00	Yes.
1957	808	12.5	Dec. 1956	Partial	Dec. 9, 1957	6.70	Yes.
1959	869	12.5	Aug. 1959	No	June 28, 1962	8.32	Yes
1961	941	10.0	July 1961	No	June 28, 1962	10.59	Yes.
1961	960	7.6	Oct. 1961	Yes		(1)	
1971	71-18	12.5	Jan. 1971	Partial	Jan. 31, 1973	9.15	Yes.
1973	73-22	12.5	Feb. 15, 1973	No	(2)	(2)	(2)
1974	74-36	[2] 25.5	July 25, 1974	Partial	(4)	(4)	(4)
1975:							
Sub 1	73-22	5.0	Mar. 7, 1975	No	(2)	(2)	(2)
Sub 1	74-36	[3] 3.0	Mar. 7, 1975	Yes	(2)	(2)	(2)
1975	75-57	5.4	Oct. 16, 1975	Yes	(2)	(2)	(2)

[1] Increase canceled.
[2] Pending.
[3] Applies to automobiles only.
[4] Proceeding discontinued.

Summary

Complete suspension	3
Partial suspension	3
No suspension	5
Total	11

In all instances where a decision has been rendered, the projected rate of return on rate base was found to be "not unlawful," and as a consequence the effect of exercising the suspension power was to deprive the carrier of additional operating revenues to which it was entitled. Up to this time neither FMC nor its predecessor agencies have made a determination as to what constitutes a fair and reasonable and thus a lawful rate of return.

The loss of revenue to the regulated carrier, represented by a four-months' suspension of the effective date of a general increase in rates, is of more significance than heretofore because of the unprecedented amount of capital currently required for replacement of vessels and related equipment; the Act presently provides the regulator with unlimited power to impose the suspension penalty. It is a deterrent to the investor to have the effective date of general rate increases suspended even before the increase has been found to be unlawful; the practice of penalizing a carrier before he is found "guilty" is no longer consistent with economic reality.

Even without suspension, rate payers under current law have the benefit of considerable delay in the pass-through to them of increased operating costs or other factors necessitating a general increase in rates. Such delay is caused by the lead time required for preparation of supportive financial data and issuance of corrected tariffs, both of which in accordance with FMC regulations must be filed concurrently with FMC. Such delay normally amounts to about 105 days, during which period the carrier absorbs increases in costs and/or the effect of an inadequte rate of return.

Our belief is that to some extent the mere filing of a rate increase triggers a pass-through of the increase by many rate payers to the ultimate consumer—with the exercise or non-exercise of the suspension power having no effect on that event. Not knowing whether there will be suspension or not, many of our customers will anticipate that the increase will become effective as scheduled and thus proceed to pass through the increase perhaps along with other increases in their operating costs. If suspension is ordered, then such customers enjoy a windfall benefit.

National retail organizations, especially those which extend national or regional pricing of their products to the Hawaiian market, probably absorb the increase in freight rates until such time as they can combine it with other cost increases for pass-through. Our regulated customers—freight forwarders, NVOCC's and used household goods carriers—ordinarily cannot pass through the increase until at least 30 days after it becomes effective in Matson's tariff.

Given the 30 to 60 day inventories of non-perishable goods generally maintained in Hawaii, it is not necessary for the receiver to pass through the increase in freight rates until he has sold inventory received at rates in effect prior to the effective date of the increase. To do otherwise brings about an unjustified windfall benefit to the carrier's customer.

Each of the three bills pending before the Committee proposes a revision of the suspension only to the extent of exempting a certain level or portion of general rate increases from its application. All other changes in rates or charges as well as changes in regulations, practices or conditions of carriage would remain subject to possible suspension. We respectfully recommend to the Committee that it favorably report Section 2 of S. 3261.

Senator INOUYE. Our next witness is Mr. Stanton Sender, chairman of the Legislative Committee, National Industrial Traffic League.

Welcome, sir.

STATEMENT OF STANTON SENDER, CHAIRMAN, LEGISLATIVE COMMITTEE, NATIONAL INDUSTRIAL TRAFFIC LEAGUE, WASHINGTON, D.C.; ACCOMPANIED BY CURTIS R. MERRITT; AND ROBERT RICKER

Mr. SENDER. Thank you.

Mr. Chairman, my name is Stanton Sender. I am transportation counsel for Sears, Roebuck & Co. I am serving and completing my term as voluntary chairman of the National Industrial Traffic League's legislative committee.

I have served as chairman for the past 3 years.

Accompanying me today on my right is Mr. Curtis R. Merritt, Export Traffic Manager of ASARCO in New York City, who is voluntary chairman of the National Industrial Traffic League's Export-Import and Maritime Committee.

On my left, by Mr. Robert Ricker, manager of transportation, eastern region, Georgia Pacific Corporation, and a member representing the league's Intercoastal and Coastwise Transportation Committee.

Mr. Ricker is familiar with conditions in the U.S.—Puerto Rico trade, and Mr. Merritt is our league expert on maritime matters.

As you are aware, my company is a major shipper of consumer commodities to Hawaii. I would ask that my statement be incorporated in the record in full, so that I may summarize it.

Senator INOUYE. Without objection, so ordered.

Mr. SENDER. The league is appearing today in opposition to the three bills, but would support provisions to speedup Federal Maritime Commission regulatory proceedings.

I will skip a description of the league. I am sure the chairman is familiar with it. I presented testimony on behalf of the laegue in the last Congress on S. 3173, which you introduced, to amend section 6 of the Intercoastal Shipping Act so that Government and commercial shippers would be treated equally.

As you pointed out, that equal treatment would give both the Government and shippers the right to seek suspension under the Intercoastal Shipping Act.

We are very pleased that that has become law.

I will skip in the statement the description of bills. They have been described. The idea of the no-suspend zone is not an origianl concept.

The DOT has been trying to get no-suspend zones in various so-called regulatory reform bills, before this Congress and in particular, this committee.

They sought one in the rail bills. They are now seeking one in the motor-carrier and air bills. The no-suspend zones have varied. Some

have been up to 150 percent. Some go 7, 12, and 15, but this is a concept the Department of Transportation has been pressing. The shippers have opposed this concept.

And, the viewpoint of the shippers and the league is that competition where it is effective, can be a substitute and protecting the shipping public in place of regulation, but there must be effective competition. If not, the shipping public is not protected.

Now, during the hearings on the railroad regulatory reform bills, this concept of effective competition was put in the legislation.

I will come to that in a moment. But, during the hearings, the league presented the following testimony to this committee on a better way of going at it than doing away with the suspension provision by a no-suspension zone.

I would like to quote the league testimony on reducing timelag and speeding up regulatory proceedings. The league testimony before this committee was:

> The League also favors reducing timelag. The League believes that it is in the interest of the Nation and the general public to reduce regulatory timelag, such as the time between the increases in wages or other costs, and approval of increases in freight rates necessary to meet such cost increases, to the minimum consistent with the interests of consumers and the shipping public; provided there are necessary safeguards to assure adequate notice and justification of the proposed rates, timely receipt of the representations of shippers with respect to such rates, and prompt refunds in interim rate increases exceeding the maximum amounts found reasonable by the Commission in its final determination.
>
> The principle of reducing unnecessary regulatory delay applies as well to decreases as increases in rates, and in short, to all regulatory proceedings.

Further, the league testified:

> The league would favor the speeding up of regulatory proceedings through granting the Commission the power to define or limit by general rule, notwithstanding present administrative law requirements, expedited new procedures to handle its proceedings through advance evidentiary filings, guidelines for desired presentations, and the limitation of the right to apply for reconsideration, rehearing, or reargument, while preserving necessary safeguards. The ICC should be encouraged to experiment and innovate in handling its workload.

And this is the approach that this committee adopted with respect to railroads. You put in absolute time limits to make sure the ICC would get its workload out in time. And you took other measures which are in Public Law 94–210, recently sent out of this committee. With respect to adequate revenue levels, each of the bills contains that provision.

The league submits that these criteria, as the chairman testified to today, can now be considered by the FMC and the need for this provision is nonexistent.

We quote in our testimony from docket 6757, in which the FMC said it would consider handling of these cases. Docket 6557, I believe is so numbered because it began in 1967.

We do believe it's not necessary to put in legislative requirements to have the FMC consider these elements.

We have listened to your questions and the testimony concerning means to assist the carriers in the domestic offshore trade in maintaining competitive rate levels and the league has adopted the following policy as a means to that end:

> That the league support legislation that would allow new foreign-built ships or partially foreign-built ships to operate in domestic trades with United States crews under the U.S. flag, provided there is a concurrently and equalizing subsidy

to American shipyards to enable them to compete with foreign shipyards for the shipbuilding involved and further provided that a system of construction subsidies be provided for U.S.-built ships on which construction began after January 1, 1968, designed to protect their economic competitive position.

Finally, there is one point with respect to S. 3180 that no one has mentioned. The legislation would propose to strike out the words "by the way of the Panama Canal." It could be that this amendment is only to clarify the impact of previous amendments in 1938 and 1940.

If, however, the purpose is to shift jurisdiction from ICC to FMC, then the league would object to such a change without full justification being submitted for the need for such a change.

If this committee is considering the no-suspend provision as desirable, we would encourage as a minimum that this subcommittee, follow what was done in the rail bill by putting the market dominance test in. That is, where a carrier is found to have market dominance, it cannot utilize a no-suspend zone, and only where there is found by the Commission to be effective competition controlling the rates, could a carrier utilize a no-suspend zone.

As this committee report said on the rail bill, to achieve the dual goals of assisting the railroads and protecting the public interest, the new section 15 introduces an entirely new concept and that is that the Commission regulation of maximum rate levels will apply only when the railroad or railroads publishing the rate increase have market dominance over the service involved. Otherwise, in a truly competitive market then this committee allowed the railroads the benefit of a 7-percent up and down no-suspend zone for 2 years only. And that 2-year 7-percent zone is only where there is effective competition.

The league on behalf of shippers and receivers in the trade, subject to the Intercoastal Shipping Act urges that the provisions of these bills not be adopted but instead, consideration be given to measures to speed up the FMC regulatory proceedings.

We are not in favor of regulatory delay. This proceeding, as the Chairman of the FMC mentioned, has been going on for 2 years. It went from 1971 to 1973. That's a long time for a rate increase to be pending before a regulatory agency, so we do favor speeding up these proceedings.

Senator INOUYE. How would you suggest speeding up the proceedings?

Mr. SENDER. I think following the approach passed for the ICC and the recent railroad bills. This committee should set down guidelines in the statute for completion of the regulatory proceedings and it should give the Commission the power to adopt innovative measures under its statutes to handle these.

Senator INOUYE. As you know, in the domestic offshore trades, there are no rate bureaus nor limitations of entry.

Mr. SENDER. Well, sir, Matson attempted to attain approval for a conference under section 15, in the Hawaii trade.

A number of shippers opposed this, and it was dropped when Seatrain dropped out of the trade, but they attempted to.

With respect to restrictions on entry, there are the cabotage laws which restrict it to U.S.-flag carriers.

Senator INOUYE. But it's not like the limitations you find on other industries.

Mr. SENDER. That's correct. The railroad, the air carriers, and motor carriers have statutory restrictions on entry.

Senator INOUYE. Notwithstanding, you still oppose a no-suspend zone at the present levels.

Mr. SENDER. That's correct.

Senator INOUYE. Do you believe the revision of the suspension power will encourage carriers to file general rate increases?

Mr. SENDER. I am not certain I understand the question. Under these bills, interestingly, the definition of general increase would allow increases only on consumer commodities going to Hawaii from the west coast. Matson could file westbound only and not westbound and eastbound, because of the way general increase is defined, but I'm not sure I fully understand your question.

Senator INOUYE. Put another way, does the suspension authority today discourage the filing of general rate increases?

Mr. SENDER. I would assume that suspension provisions require a carrier to decide whether he has a prima facie case, that he can justify the increase he is seeking. Whether it be general or selective. But I'm not certain as to the answer.

Mr. MERRITT. I believe the carriers under the procedures adopted by the FMC now, must submit cost data when they do submit a general increase level. This cost data is helpful to the Commission in deciding the input ability of a general increase, but I don't believe the suspension power has an effect one way or the other.

I believe the carriers, when they need a general increase and their costs dictate it, will file for a general increase.

Senator INOUYE. Can you suggest any language to be applicable to the domestic offshore carriers similar to that found in the Railroad Revitalization Act which establishes the adequate revenue level?

Mr. SENDER. With respect to that provision, we did mention in the statement—I did not in my summary—the league members were split on that provision in the rail bill. Many league members felt it was not necessary to enact adequate revenue level language. Other shippers felt it would be good for Congress to set down some guidelines.

The important thing in the adequate revenue level language that was adopted by this committee is, it contains the key prerequisite reference to honest, economical and efficient management as well as consideration of other items, such as you have mentioned, Senator, replacement of capital and the risks involved.

The league was split on the rail bill. We don't feel such language is necessary. We have no objection to the rail language and I would assume if this committee wanted to adopt some adequate revenue level that would be a good guideline for language.

Senator INOUYE. Do you favor the carriers terminating on profitable segments or elements of service?

Mr. MERRITT. Senator, one of the bills carries such a provision and I am concerned that this provision in these bills would simply result in high freight rates going higher and low freight rates going lower, because there would be a statutory mandate to protect the lower freight rates.

Senator INOUYE. How should low-paying cargo be moved?

Mr. MERRITT. I believe low-paying cargo has to contribute a segment to its voyage, but generally, low-paying cargos have a sub-

stantial volume. And the carriers rely upon a high volume to make it worth their while to lift such low-paying cargos.

Senator INOUYE. I thank you for your assistance this morning.

[The statement follows:]

STATEMENT OF NATIONAL INDUSTRIAL TRAFFIC LEAGUE

The National Industrial Traffic League appears today in opposition to the no-suspend provisions of S. 3180, S. 3260 & S. 3261 but would support provisions to speed up regulatory proceedings.

The National Industrial Traffic League is a voluntary organization of shippers, shippers associations, boards of trade, chambers of commerce, and other entities concerned with traffic and transportation service for all carrier modes. Our primary concern is to provide for our members a sound, efficient, well-managed transportation system privately owned and operated. Members of the National Industrial Traffic League are located throughout the United States, consist of enterprises large, medium, and small, which use all modes of transportation by land, river, sea, and air. Carriers are ineligible for membership in the League and since the membership has such a broad base, the League is generally looked upon as representing the shippers' point of view.

For the more than sixty-five years of its existence The National Industrial Traffic League has been dedicated to the development and maintenance of sound conditions in transportation having in mind the needs of the nation, the carriers, and the shippers/receivers who are the consumers of transportation. The League has frequently presented its views to Congress on proposed transportation legislation.

The League submitted testimony during the last Congress before this Subcommittee in favor of S. 3173, introduced by Senator Inouye, to amend section 6 of the Intercoastal Shipping Act, 1933. The League agreed with Senator Inouye's statement introducing the bill on March 13, 1974, that:

"Repealing the applicability of section 6 would subject all government cargo rates in that trade to economic regulation. As a consequence the government shipper, as does now the commercial shipper, would have the right to file a formal protest with the Federal Maritime Commission as to any change in rates or attendant conditions filed by a carrier, requesting that the effective date of the matter be suspended and set down for hearing and investigation. In this way the Government, as does any shipper, would have full protection from any pricing action taken by the carrier that it may believe to be unreasonable, unduly preferential or unfair."

S. 3180 would amend the Intercoastal Shipping Act to remove the power of the Federal Maritime Commission upon protest of commercial—and U.S. Government interests as shippers—to suspend a rate of increase by a common carrier by water "if such schedule seeks an increase in rates and other charges solely for the purpose of increasing the gross annual revenues of such carrier to adequate revenue levels * * *". S. 3180 also contains provisions for the Federal Maritime Commission within 12 months to develop criteria, standards and procedures for the determination of adequate revenue levels; and provisions for keeping accounts and refunds in cases where schedules are not suspended.

S. 3180 would make a further change by striking out in the jurisdictional section of the Intercoastal Shipping Act the words: "by the way of the Panama Canal."

S. 3260 would amend the Intercoastal Shipping Act to provide for a 7% no-suspend zone for general rate increases (but not decreases) each twelve months, and would require the Commission to promulgate adequate revenue levels.

S. 3261 would amend the Intercoastal Shipping Act to provide a no-suspend zone for any rate increases which will raise a carrier's gross revenues in an amount sufficient to raise the carrier's rate of return to the prima facie rate of return, which is initially set at 10.59 percent on rate base. S. 3261 also contains provisions requiring the Commission to establish an adequate rate of return which will determine the limits of the no-suspend zone in place of the initial 10.59 percent on rate base.

The no-suspend zone concept has been proposed by the Department of Transportation in various bills submitted to Congress. Originally, the Department proposed a 150 percent zone up and down; later this was changed to 7 percent the first year; 12 percent the second year; and 15 percent the third year. The

Department of Transportation has also proposed similar zones in its air carrier and motor carrier regulatory reform proposals.

These no-suspend zones proposed by Department of Transportation are both up and down, and are accompanied by reforms to rate bureaus and entry (in the case of motor and air carriers) to substitute competition, where it is effective, as a protection to the shipping public, in place of regulation.

These three bills contain a one-way 7 percent up or to a rate of return ceiling increase only; and contain no provisions to insure that competition, where it is effective, is substituted as a protection for the shipping public, in the place of regulation.

During the hearings on railroad regulatory reform before the Senate Commerce Committee, the League opposed no-suspend zones proposed by Department of Transportation—noting that where there is effective competition, competition itself provides the ceiling or maximum for such rates.

The League favored instead reducing "time-lags"—speeding up regulatory proceedings and greater freedom for individual carrier management to experiment with innovative rate-making. The League testified:

"The League also favors reducing 'time-lag'. The League believes that it is in the interest of the nation and the general public to reduce regulatory time-lag, such as the time between the increases in wages or other costs, and approval of increases in freight rates necessary to meet such cost increases, to the minimum consistent with the interests of consumers and the shipping public; provided there are necessary safeguards to assure adequate notice and justification of the proposed rates, timely receipt of the representations of shippers with respect to such rates, and prompt refunds in interim rate increases exceeding the maximum amounts found reasonable by the Commission in its final determination. The principle of reducing unnecessary regulatory delay applies as well to decreases as increases in rates, and in short, to all regulatory proceedings.

"The League would favor the speeding up of regulatory proceedings through granting the Commission the power to define or limit by general rule, notwithstanding present administrative law requirements, expedited new procedures to handle its proceedings through advance evidentiary filings, guidelines for desired presentations, and the limitation of the right to apply for reconsideration, rehearing or reargument, while preserving necessary safeguards. The ICC should be encouraged to experiment and innovate in handling its workload."

Each of the bills today proposes to require the Federal Maritime Commission to determine adequate revenue levels for common carriers by water subject to the Intercoastal Shipping Act. The League submits these criteria can now be considered by the Federal Maritime Commission and need for this legislation is non existent. As an example in Federal Maritime Commission Docket 65–57, Page 37, paragraph 4 sets forth: "the basic theory of rate regulation is to set rates at a level, which, on the basis of estimated future revenues, will enable the carrier to recover its cost of operation plus a reasonable return on its investment. The reasonable return on investment, in turn envisages an amount sufficient to meet imbedded debt, recovery of depreciation of assets used up in the public service, and sufficient return on the equity investment in light of comparable risks so as to attract equity sufficient to the needs of the company and the expansion thereof as may be prudently required."

This legislation proposes adequate revenue levels be determined including the need of the public interest or the continued provisions by carriers of certain unprofitable segments or elements of service. This appears to be a method of insuring that low paying cargo is underwritten by high paying cargo in the voyage or in other words the high rates go higher and low rates go lower.

Therefore since the Federal Maritime Commission can already consider the elements of revenue levels as suggested here, there is no need for legislating such revenue level criteria.

As a means to assist the carriers to maintain competitive rate levels, the League adopted the following policy at its 1969 annual meeting:

"That the League support legislation that would allow new foreign built ships or partially foreign built ships to operate in domestic trades with United States crews under the U.S. Flag, provided there is a concurrently and equalizing subsidy to American shipyards to enable them to compete with foreign shipyards for the shipbuilding involved and further provided that a system of construction subsidies be provided for U.S. built ships on which construction began after January 1, 1968, designed to protect their economic competitive position."

Finally, with respect to the provisions in S. 3180 striking out "by the way of the Panama Canal", if this is only clarifying to reflect the 1938 Amendment to the Intercoastal Shipping Act, the League has no objection.

If, however, the purpose is to shift jurisdiction from I.C.C. to F.M.C., then the League would object to such a change without full justification being submitted for the need of such change.

The League opposes the no suspend zone provisions and the revenue level criteria provisions of these three bills. This Committee and the Congress rejected such unlimited no suspend zones in P.L. 94–210, the new rail legislation.

The Senate Commerce Committee Report on S. 2718 said as follows with respect to limiting a no-suspend zone and carrier pricing freedom by the market dominance concept:

"To achieve the dual goals of assisting the railroads and protecting the public interest, the new section 1(5) introduces an entirely new concept to determine when the railroads should have rate flexibility and when the public interest requires regulation.

"The major innovation of this section is that Commission regulation of maximum rate levels will apply only when the railroad or railroads publishing a rate increase set market dominance over the service involved. Otherwise, in truly competitive markets the railroads will have freedom, absent discrimination and prejudice, to raise prices as they choose in order to maximize revenues."

The legislation, in section 205, does contain a requirement that the I.C.C. within 24 months establish adequate revenue levels for rail carriers but includes the prerequisite for honest economical and efficient management, as provided for in the Interstate Commerce Act.

P.L. 94–210 incorporates a 7 percent up and down no-suspend zone for two only, *provided*, that the carrier is not found to have market dominance over the service to which such rate increase applies. Market dominance refers to an absence of effective competition from other carriers or modes of transportation, for the traffic or movement to which a rate applies.

The League on behalf of shippers and receivers in the trades subject to the Intercoastal Shipping Act urges that the provisions of these bills not be adopted but instead that consideration be given to measures to speed up regulatory proceedings.

Senator INOUYE. This hearing will stand in recess, subject to the call of the Chair.

Thank you very much.

[Whereupon, at 11:50 a.m., the hearing was adjourned, subject to the call of the Chair.]

[The following information was subsequently received for the record:]

STATEMENT OF SEA-LAND SERVICE, INC.

Sea-Land Service, Inc. is a common carrier by water operating extensively in the foreign and domestic trades of the United States. Since the late 1940's Sea-Land, and its predecessor companies, have served the U.S. West Coast/Puerto Rico trade, under the jurisdiction of the Federal Maritime Commission. It previously also operated in the U.S. East Coast/Puerto Rico trade and the U.S. Gulf Coast/Puerto Rico trade. However its earnings, and those of its competitors, in those trades were consistently unsatisfactory and substantial losses were incurred. In 1974 the Commonwealth of Puerto Rico instituted its own service in those trades, acquiring for that purpose the vessels of Sea-Land and the other carriers then operating.

Sea-Land's U.S. West Coast/Puerto Rico service is and has always been operated in conjunction with its Atlantic-Pacific domestic intercoastal service. The preponderance of traffic moving in the U.S. West Coast/Puerto Rico trade is eastbound, and this unbalanced situation has been alleviated by the carriage of traffic westbound from U.S. Atlantic to U.S. Pacific coast ports. Despite this, however, the service has always been at best a marginal one.

Sea-Land is the only carrier now operating in the U.S. West Coast/Puerto Rico trade, although several other carriers at various times since World War II have served this trade. Among those were American Hawaiian Steamship Company, Pope & Talbot Inc. and Isbrandtsen Steamship Company (as it was then named). However, all of these carriers have long since withdrawn from the trade.

Since 1969 Sea-Land has attempted at various times to increase its rates in the West Coast/Puerto Rico trade to compensate for increased operating costs. With one exception every proposed increase has been placed under suspension for the statutory four month period by the Federal Maritime Commission, pending hearing as to its lawfulness. This has led to costly and time consuming litigation. The four months' losses of revenue increases due to the suspensions and the tremendous amount of time, effort and expense involved in defending rate increases before the Commission have cost Sea-Land dearly and have contributed to its present unsatisfactory profit position in the trade.

Sea-Land strongly supports the stated objectives of S. 3180 and S. 3261, which are to assure adequate, modern and efficient transportation by water between the non-contiguous States, territories and possessions of the United States and the U.S. mainland. Of the three bills under consideration today, Sea-Land believes that S. 3261 will best accomplish the intended purposes. We, however, have a reservation in one area.

We do not think it is the intention of this bill or the other bills to require the carriers to maintain a system of accounts in order to be able to refund with interest to persons entitled to any charges found to be excessive those charges collected during the four month period of exemption from suspension. Rather we would expect the legislation or the legislative history to recognize what has been historical in transportation regulations that the only viable means of providing refunds is upon request, when the shipper or the party entitled to the refund documents a formal request with proof of overcharge. Any other system would become what our accounting department terms an "administrative nightmare".

Sea-Land is strongly in favor of the provisoin of S. 3261 requiring the Federal Maritime Commission to develop and promulgate a reasonable prima facie rate of return for common carriers by water operating self-propelled vessels, which rate of return shall include as determinative factors (A) the cost of replacing vessels and related equipment, including that associated with stevedoring and terminal operations; (B) the degree of risk associated with the investment of capital; (C) the prevailing cost of money in capital markets; (D) the need in the public interest for the continued provision by carriers of certain unprofitable segments or elements of service; and (E) other appropriate factors. We urge that the replacement costs of vessels and related equipment not only should be taken into account in promulgating a reasonable prima facie rate of return, but also should be reflected in the rate bases of the carriers. It is requested either that S. 3261 be amended so as to provide this or that the legislative history make it clear that this is the intention of the Congress.

For too long the Federal Maritime Commission, among other agencies, has refused to consider the foregoing factors in passing upon applications for rate increases. Particularly factors such as equipment replacement costs, risk and the prevailing cost of money have been ignored to the severe disadvantage of regulated carriers. In the business world all of these factors are taken into account, and we applaud the proposal that they be applied with respect to domestic offshore shipping.

We further support fully the provision of S. 3261 that will allow a carrier to increase its revenues sufficient to raise its rate of return up to 10.59 percent on rate base, pending the development and promulgation of a reasonable prima facie rate of return. We submit that under no proper standards can such rate of return be considered excessive. Rates of return on investment as high as this, and higher, have heretofore been approved by the Federal Maritime Commission. We have reference to *Pacific Coast/Hawaii and Atlantic-Gulf/Hawaii General Increases in Rates*, 7 F.M.C. 260, 292 (1962) and *Kimbrell-Lawrence Transportation, Inc., General Increases in Rates in Kodiak Island, Alaska Peninsula, and Aleutian Islands Area of Alaska*, 12 F.M.C. 15, 17 (1968). The allowance of rates of return up to 10.59 percent, pending the formulation of guidelines by the FMC, is a necessary incentive if existing carriers are to continue to invest their efforts and money in operating and developing the domestic offshore trades, and if additional services are to be encouraged for the future.

In summary, Sea-Land strongly supports S. 3261, with the stated reservation with respect to refunds. We believe that this legislation is long over-due, and that the future welfare of the domestic offshore services depends to a substantial degree upon its passage.

TRANSPORTATION ASSOCIATION OF AMERICA,
Washington, D.C., June 23, 1976

Hon. RUSSELL B. LONG,
Chairman, Senate Merchant Marine Subcommittee,
Washington, D.C.

DEAR CHAIRMAN LONG: Three bills now under consideration by your Subcommittee—S. 3180, S. 3260, and S. 3261—contain provisions that seek to assure that the Federal Maritime Commission gives proper recognition to the need for adequate revenue levels of common carriers by water operating between the United States mainland and noncontiguous states, territories, and possessions of the U.S. The Transportation Association of America favors such a Congressional directive to the FMC.

As you will recall, similar provisions were contained in Section 205 of P.L. 94-210, the Railroad Revitalization and Regulatory Reform Act of 1976. A copy of this Section is attached. Its language, with the exception of the last sentence is virtually identical to that proposed by TAA in its written statement to the Senate Commerce Committee of September 5, 1975 (see page 4). At that time, TAA requested that the proposed language on adequate carrier revenue levels also apply to domestic water carriers.

One of the major problems of regulated transport carriers of virtually all modes is the growing scarcity of capital funds—both internal and external. The causes are many, although an underlying one is inadequate carrier revenue levels—a condition brought about in large part by restrictive and time-consuming regulatory practices. Delays in adjusting revenue levels to help absorb rapidly rising labor, fuel, and equipment costs have proved to be particularly harmful to carriers during periods of steep inflation, such as experienced during the past several years. While transport regulatory agencies can't be expected to guarantee that carriers under their jurisdiction will maintain adequate revenue levels, they should be expected to seek this as an objective and recognize the need for such revenues if these carriers are expected to provide good service and be innovative.

If we want common carrier service to be efficient and progressive, it should be able to generate capital at levels that compare favorably with other types of business enterprises. This is the only way that common carriers can compete for private investment funds. The alternative is more and more U.S. financial assistance—which leads to greater control and, eventually, to Government take-over.

We request that this letter be made a part of the official record of hearings on these three bills.

Sincerely,

PAUL J. TIERNEY.

PUBLIC LAW 94-210, 94TH CONGRESS, S. 2718, FEBRUARY 5, 1976

An act to improve the quality of rail services in the United States through regulatory reform, coordination of rail services and facilities, and rehabilitation and improvement financing, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act, divided into titles and sections according to the following table of contents, may be cited as the "Railroad Revitalization and Regulatory Reform Act of 1976":

ADEQUATE REVENUE LEVELS

Sec. 205. Section 15a of the Interstate Commerce Act (49 U.S.C. 15a) is amended—

(1) by adding at the end of paragraph (2) and at the end of paragraph (3) the following new sentence: "This paragraph shall not apply to common carriers by railroad subject to this part." and

(2) by redesignating paragraph (4) as paragraph (6), and by inserting immediately after paragraph (3) the following new paragraph:

"(4) With respect to common carriers by railroad, the Commission shall, within 24 months after the date of enactment of this paragraph, after notice and an opportunity for a hearing, develop and promulgate (and thereafter revise and maintain) reasonable standards and procedures for the establishment of revenue levels

adequate under honest, economical, and efficient management to cover total operating expenses, including depreciation and obsolescence, plus a fair, reasonable, and economic profit or return (or both) on capital employed in the business. Such revenue levels should (a) provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure the repayment of a reasonable level of debt, permit the raising of needed equity capital, and cover the effects of inflation and (b) insure retention and attraction of capital in amounts adequate to provide a sound transportation system in the United States. The Commission shall make an adequate and continuing effort to assist such carriers in attaining such revenue levels. No rate of a common carrier by railroad shall be held up to a particular level to protect the traffic of any other carrier or mode of transportation, unless the Commission finds that such rate reduces or would reduce the going concern value of the carrier charging the rate.".

AMERICAN INSTITUTE OF MERCHANT SHIPPING,
Washington, D.C., June 25, 1976.

Hon. RUSSELL B. LONG,
Chairman, Subcommittee on Merchant Marine, Committee on Commerce,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Your Subcommittee recently held a hearing on legislation (S. 3180, S. 3260 and S. 3261) to assure that the carriers serving U.S. domestic offshore (non-contiguous) trades are regulated by the Federal Maritime Commission (FMC) in a flexible manner that avoids unfair suspension of rates designed to bring about a reasonable rate of return.

On behalf of those members of the American Institute of Merchant Shipping (AIMS) which serve these trades, we offer the following comments in support of the objectives of this legislation. (Since we understand that the Subcommittee has differently worded drafts under consideration, we have refrained from addressing ourselves to specific language at this time.)

1. AIMS believes that all vessel operating common carriers, whether self-propelled or not, should be covered by the legislation insofar as they operate in domestic trades subject to the FMC's economic regulation.

2. AIMS believes that FMC should be given the discretion to promulgate what is a reasonable rate of return on a carrier-by-carrier and trade-by-trade basis. The differences among these trades and the variety of carriers serving them require that a range of accounting standards be considered.

3. AIMS believes that an operator, offering honest, economical and efficient service, should not have to face suspension of a rate change which is within a "zone of reasonableness." Even a four-month suspension period, when combined with other delays associated with the rate regulatory process, could seriously impair a carrier's ability to generate capital needed for maintaining the high-quality service which American shippers deserve.

In summary, AIMS urges favorable consideration of this progressive legislation designed to give carriers in the domestic offshore trades more freedom to earn a profit commensurate with other industries. The objectives of the legislation are compatible with the economic regulation currently practiced in those trades.

We request that this letter be made a part of the official record of the Subcommittee's deliberations on S. 3180, S. 3260, and S. 3261.

Sincerely,

JAMES J. REYNOLDS, *President.*

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