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RAILROAD TRANSPORTATION POLICY ACT OF 1979

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HEARINGS

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BEFORE THE

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SUBCOMMITTEE ON SURFACE TRANSPORTATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION

UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

S. 1946

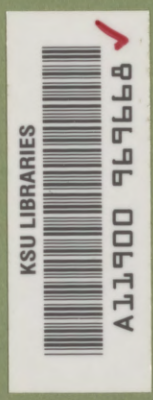
TO REFORM THE ECONOMIC REGULATION OF RAILROADS,
AND FOR OTHER PURPOSES

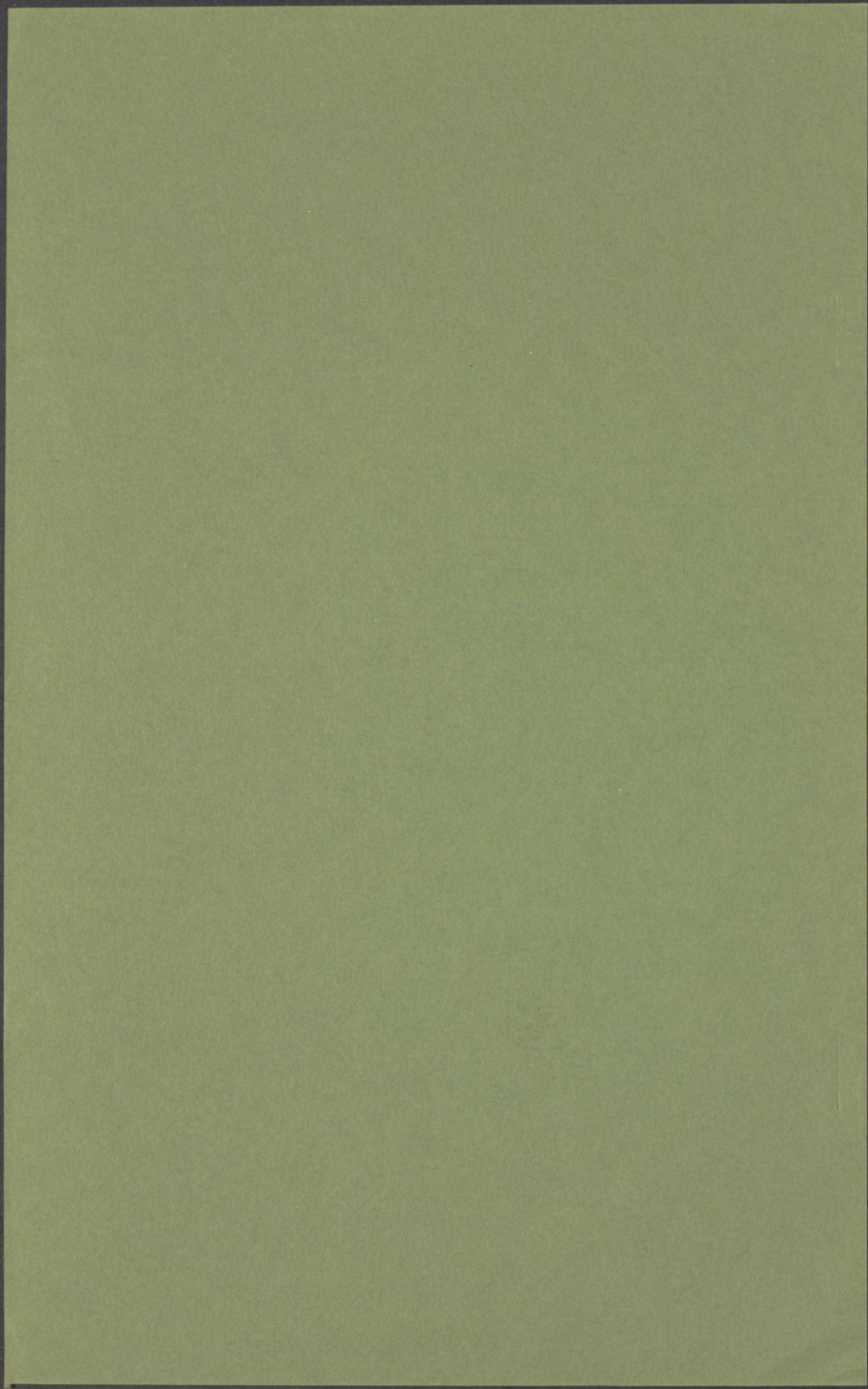
FEBRUARY 18 AND 22, 1980

PART 2

Serial No. 96-76

Printed for the use of the
Committee on Commerce, Science, and Transportation





RAILROAD TRANSPORTATION POLICY ACT OF 1979

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BEFORE THE
SUBCOMMITTEE ON SURFACE TRANSPORTATION
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RAILROAD TRANSPORTATION POLICY ACT OF 1979

Coal Transportation Amendment

MONDAY, FEBRUARY 18, 1980

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Baton Rouge, La.

The subcommittee met at 9:10 a.m. in the Mineral Board auditorium, Natural Resources Building, 625 North Fourth Street, Baton Rouge, La., Hon. Russell Long (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR LONG

Senator LONG. This hearing will come to order. I would like to welcome everyone here to this hearing by the Subcommittee on Surface Transportation on an amendment I have proposed to S. 1946, the Railroad Transportation Policy Act of 1979.

Early in 1979, the subcommittee had a series of hearings in Washington, and 3 days of hearings in Nevada, Nebraska, and South Dakota on the Department of Transportation's proposal to deregulate the rail industry. As it turned out, the only ones who supported the administration's deregulation proposal were the people who wrote it. There was almost unanimous agreement from the witnesses appearing before the committee that some reform of the current rail regulatory structure was needed. The committee, therefore, drafted and reported out S. 1946 as an alternative to the deregulation plan offered by the Department of Transportation.

Now, most people seem to agree that the bill as reported is a substantial improvement over the administration's proposal.

Generally, the objective of this bill is to relax some Federal regulation of the freight railroad industry by giving railroads more flexibility to set rates while seeking to insure protection for shippers and receivers who are captive to the rail industry.

In my opinion the bill accomplishes the first goal of increased rate flexibility, but if falls short of providing adequate protection to captive shippers from railroad abusive pricing at "what the traffic will bear." While this pricing characteristic plagues all commodities for which railroads are the only transportation alternative available, I am particularly concerned with the recent trend in coal rates.

Coal is the fuel that we are going to have to depend on to meet our national needs for electricity in the coming decades. Coal is

today in large measure a regional fuel, both produced and consumed principally within the same areas. Between now and 1985, however, the goals of the President's National Energy Plan require a reduction in our dependency on foreign oil through increased reliance on our abundant coal reserves.

In fulfilling its role during this transition, the Nation's transportation system will be called upon to move not only greatly increased quantities of coal, but also to move coal over greater distances and between mines and powerplants or industrial sites which may not currently be receiving coal shipments. Large investments will be needed both to add to our existing transport capacity and to replace and maintain the very large complete system already in place.

The deep concern I have is the risk that is faced by the coal industry, the public utilities, and every electrical consumer in this Nation that the railroads will achieve these financial needs by disproportionately increasing the rates for coal shipments, because rail represents the only feasible and practical alternative for moving coal in many parts of the Nation.

Utilities here in Louisiana and across the Nation are now carefully comparing costs of coal conversion with the costs of continued reliance on oil and natural gas. It is clear that escalating rail rates for moving domestic coal is threatening to eliminate any economic benefits to the use of coal as an alternative fuel to imported oil.

Part of the problem is apparently that the Interstate Commerce Commission's exercise of its current regulatory authority has not controlled the apparent desire of the railroad industry to exploit its monopoly over coal transportation. If there is no competition to replace Government regulation of rates in a captive market, or if the ICC fails to act to restrain exorbitant rate increases, the railroads will be free to charge whatever the market will bear, even if the resulting rates are highly inflationary and represent an unjustifiable and disproportionate contribution to a railroad's revenue needs.

My amendment is intended to insure that there be demonstrated justification of rate increases on coal and other captive commodities. Over a long period of time, some commodities have borne a greater share of the railroads costs than other commodities. While this may be necessary to some extent, no commodity should be forced to bear an unfair share of the burden. Once the railroads costs are recovered by a particular movement, any additional amount sought by the carriers should be fully justified. That is the intent of the amendment I propose, to let the railroads recover costs, but above that level, to put the burden of proof on the carriers to demonstrate that the rate should be higher.

The amendment I have proposed would require the Commission to develop standards which will be used to determine the specific revenue-to-variable cost levels at which the burden of proof as to the reasonableness of a proposed rate would shift to the carriers. Congress will then hold hearings to consider further action. If no congressional action is taken, then the Commission's standards become effective. In setting the level or point at which this shift of burden takes place, a number of factors will be considered. Among them are the following: Is there some traffic not paying its way?

What efforts are being made to correct such a situation? How much traffic is contributing only marginally? What are the carrier's revenue needs? What is the mix of traffic? What is the impact of various levels on the Nation's energy goals? These questions or factors will provide the basis for an appropriate balance between the railroads need for increased revenues and assurance that no unfair contribution to that need comes from a particular movement or commodity.

Now, I would like to call the first witness, Mr. Louis S. Quinn, secretary of the Louisiana Public Service Commission.

Mr. Quinn, we are very happy to have you here today.

STATEMENT OF LOUIS S. QUINN, SECRETARY, LOUISIANA PUBLIC SERVICE COMMISSION

Mr. QUINN. Thank you, Senator Long. First of all, we want to thank you for holding this hearing in Louisiana, which affords all of us an opportunity to express our views, particularly the representatives of both the railroads and the utilities, and the Louisiana Public Service Commission, which regulates both common carriers and utilities in this State.

I am Louis Quinn, secretary of the commission, and in case you don't recognize it in my statement, we have taken a position that you may not understand up in Washington, called the "straddle the fence approach" here, since we do regulate both the railroads and the public utilities.

Seriously, at the outset we are, of course, aware that both the utilities and the common carriers must charge just and reasonable rates if we are going to maintain a healthy economy, and if we are going to win the struggle against inflation and make this Nation strong internationally. Nevertheless, in some instances concession have to be made in the area of maximized profits.

To explain a little bit more fully, it is only a few years ago that Louisiana utility consumers were enjoying the generation of electricity and energy costs of about 20 cents per million Btu. Nowadays I guess if you look at the current market, you start off at \$3 and up per million Btu when you are attempting to replace fuels. That is what we are doing. Louisiana, having had all of this abundance of natural gas and oil, has geared all of its electricity generation for the use of these fuels. Now, because of the dwindling supply on the international market, and the fact that Congress has mandated a change, we are now having to substitute a different type of fuel. When we used oil and gas, the costs were relatively insignificant as a total item of cost in the generation of a unit of electricity. When you convert, the only meaningful conversion now is to coal, since nuclear has become somewhat costly and the safety aspects of it don't render it a desirable alternative at this stage, the transportation costs, the rail cost of bringing the coal from the coal fields to Louisiana becomes most significant. For that reason, I think that what we are looking at is to provide a reasonable accommodation where rail transportation can recover its costs, but at the same time not have these costs present an undue burden on the utility consumers in this State, who already have experienced in some instances up to a 1,200-percent inflation increase over the past 6 or 7 years.

This places Louisiana in a rather unique position. We become doubly captive. First, we are captive to the type of fuel we have to convert to, and second, we are captive to the type of transportation. What we have to look at overall is how can we best achieve our national goal, which is energy independence.

Now if the total cost of converting to other fuel, including the transportation costs, exceeds what you could substitute on an international market, you may find in some instances that utilities, in an effort to keep the costs down to their consumers, and also to be able to provide their stockholders with reasonable returns, will opt for fuel on a foreign market. What we would then be doing would be substituting, if we go to the foreign market, and do not attempt to maximize the use of our fuels that we have abundantly. As to coal, if the rails don't have some restraint on unwarranted increases, you would place them in the same position as you have the OPEC nations now. On the other hand, if we go to foreign fuel, foreign coal, then we are substituting the foreign nations who might control the coal supplies, we are just substituting the nations that have coal for those who have oil.

So I think it is a good step to at least look at the possibility of minimizing these increases. The Public Service Commission, on behalf of one utility, has already interceded in ICC proceedings in an effort to attempt to show that transportation costs must be stabilized or at least they have to be closely scrutinized, because the people in this State are already overburdened with monthly fuel adjustment costs. And if, because of inflation, if there is not some curb on transportation cost to provide coal down here, you would have the utility consumer in this State burdened again with the monthly cost of fuel, because the fuel costs would flow directly through and the transportation cost of coal would consist of the total cost of the fuel to generate electricity.

Thank you, Senator.

Senator LONG. Mr. Quinn, your commission, on the State level, regulates both the railroads and the electric utilities, so you understand what the problem is. Both of them are entitled to make a fair return on investment. But if the railroads are going to charge us an outrageous price or exorbitant price to move the coal, then the utility company, who is entitled to make a fair return, must pass that cost on to the consumers, and then the consumer has to bear a big increase if that railroad freight rate is not reasonable. Isn't that about the size of it?

Mr. QUINN. That is the size of it, that is the point we are trying to make. Some restraint must be made to minimize this impact that would occur monthly or on periodic occasions to the utility consumer. It is the same thing now if the OPEC nations met tomorrow and decided they wanted to double the price of the world oil market from whatever it is, \$28 to \$56, and we don't have enough supply, what happens is in order to generate electricity you just have to flow that increase directly through to the utility consumer.

What we are looking at is energy independence, and certainly we don't want anything to happen in this country that will cause the electric utilities to opt for some other type of fuel from a foreign

source, where we then would become the captive of the governments of those nations as we are now captive to the OPEC nations.

Senator LONG. Now it was once my privilege to take a course in the economics of transportation, and with regard to the rail industry, the best I could make of it was the whole science of railroad pricing was based on discrimination, basically. Repeatedly you find the industry charging a cheap rate one place, where they don't make much of anything, or nothing at all, even lose money, to keep somebody else from getting the business. Then they try to make it back by charging a very high price somewhere else.

What I am suggesting here doesn't prevent them from doing some of that, it just puts a limit on how much they can do and puts them at the burden of justifying the extent to which they raise these prices over what they are charging for other commodities with regard to what they are shipping down here. That is not limited to coal. Do you approve of that principle, to put some limit on what they can do in this respect?

Mr. QUINN. I certainly do. Of course, we are captive down here, because most of the coal comes from Wyoming. I read not long ago that the Burlington Northern is the railroad that has most of the shipments. It has kind of thrown its economic future into the transportation of coal. In other words, that is where it is going. And I don't think that they ought to take advantage of the fact that Louisiana has no other source of transportation basically to get the coal here and we can't argue with the fact that they have to justify or recover their costs. But they ought not to be able to take advantage and maximize profits where you have no alternative source or competition in the transportation field. That is the way it is with us down here.

[The statement follows:]

STATEMENT OF LOUIS S. QUINN, SECRETARY, LOUISIANA PUBLIC SERVICE
COMMISSION

Thank you, Senator Long, for holding this hearing in Louisiana permitting me and other interested parties the opportunity to express our views on proposed changes in the regulation of railroads which could impact vitally Louisiana utilities and industries, and, more particularly, the customers of utilities who have experienced already an abnormal financial pinch because of the changing worldwide energy situation.

I am Louis Quinn, secretary of the Louisiana Public Service Commission, which regulates the rates and services of utility and common carriers in this State.

At the outset, let me say that no one is more acutely aware than I of the necessity for maintaining just and reasonable rates for utilities and common carriers in this time of rampant inflation and dwindling and costly fuel. The health of these industries is vital if this country is to prevail in its struggle against worldwide inflation and is to retain a viable and growing economy second to no other nation.

Nevertheless, our national interests sometimes dictate that concessions be made, particularly in the area of maximized profits, if we are to achieve a long range goal, in this instance, energy independence, or prevent the possibility of an undue hardship on the citizens of a particular area of our country.

By way of explanation, all of us here know that Louisiana, for years, has been blessed with readily available, inexpensive fuel, at least until recently. Because of the abundance, efficiency, and economy of these fuels, our utility industry built its generation on the use of natural gas and oil where transportation costs were an insignificant part of the total cost of producing a unit of electricity. That would still be the case if these fuels would continue to be available for the future. However, congressional mandate and a worldwide shortage of oil have required our utilities to convert their generation to a fuel where transportation costs become a most significant element in total production costs. To compound the problem, Louisiana becomes a double captive—first, to the type of fuel—coal, if we exclude nuclear, which

economics and safety considerations seem to dictate; and, secondly, rail transportation, since this is virtually the only way domestic coal can reach this state.

I believe this places Louisiana in a unique situation. Utility consumers here in the past few years have experienced fuel cost increases far in excess of the average rate of inflation; for some utilities, as much as 1200 percent. Much of this is the result of the dominance by foreign producers in the world oil market. With a conversion to coal, and almost total reliance on railroads for transportation, rail rate increases could have an effect on utility fuel costs similar to that of the decisions of the OPEC nations in pricing oil unless regulation or a national energy policy dictates otherwise. This latter point—a national energy policy—can hardly be overemphasized.

Our national goal is to achieve energy independence. Coal, our most abundant fuel, must play a significant role if we are to meet this objective. Transportation of coal is almost without competition since the railroads dominate the market today. Certainly, it would be destructive to our objective of energy independence if rail pricing caused the utilities and industries in those states where water transportation is available to exercise an option and purchase less expensive imported coal from Africa, South America, or some other foreign source. Some utilities, we are told, presently import foreign coal. If price differentials become significant, more utilities will resort to imported coal, thereby again subjecting our energy capabilities to the whim of foreign governments.

The Louisiana Public Service Commission consistently has rendered decisions designed to maintain the lowest electricity costs in keeping with a sound program to assure adequate energy supplies for the future. It also has intervened in ICC proceedings on behalf of an electric utility in a dispute over coal freight rates because of a direct impact on the monthly fuel adjustment.

Senator Long's amendment to the rail deregulation bill would appear to be compatible with the regulatory principles applied by the P.S.C., which are adequate profits to the utility or carrier, while at the same time, providing some protection to the inflation-weary utility customer.

Senator LONG. Thank you very much, Mr. Quinn.

Next I will call Mr. Richard Bertrand of Lafayette, La., representing the Louisiana Association of Railroads.

Would you introduce the gentlemen who are accompanying you, Mr. Bertrand?

STATEMENT OF RICHARD BERTRAND, REPRESENTING THE LOUISIANA ASSOCIATION OF RAILROADS; ACCOMPANIED BY M. F. McCLAIN, SENIOR VICE PRESIDENT—MARKETING AND TRAFFIC, KANSAS CITY SOUTHERN RAILWAY CO.; AND FRITZ DOWLING, GENERAL MANAGER—MARKETING RESEARCH, MISSOURI PACIFIC RAILROAD CO.

Mr. BERTRAND. All right, sir.

Mr. DOWLING. Fritz Dowling, with the Missouri Pacific Railroad.

Mr. McCLAIN. Mike McClain with Kansas City Southern Railway Co.

Senator LONG. Mr. Bertrand, I am glad to have you here. You were a class or two ahead of me at Louisiana State. I welcome you back as an old friend. We don't agree on some items about this bill, but I don't think that ought to diminish the high regard I have had for you, and I hope you have had for me through the years.

May I point out to you, Mr. Bertrand, I recall one time when I first started practicing law, that one of my friends from college was outraged at me because I filed a lawsuit he was defending against and he didn't think much of my lawsuit. I said "Did you have that client before I filed the lawsuit?" He said "no." So I said, "What are you complaining about? Now you have a client you didn't have before."

Mr. BERTRAND. that's right, Senator, we went to the same law school, but I think we both took a graduate course besides that, and our teacher was Uncle Earl.

Senator, I might also point out that the railroads in Louisiana employ 10,000 people and their families that are dependent on the railroads. What we are saying in a nutshell, I think, is that we have no criticism of your desire to help the consumers. We have no criticism of that. Our only criticism is who are you going to pinch. Now if you take, for example, and say well, we have got to help the consumers, so we are going to have to pinch everybody a little bit, cut earnings down to 7 percent, if you tell the coal mines you are not going to make more than 7 percent on your money because we have to help the consumers, if you tell the barge lines, who are not regulated and who are hauling half of the coal—they actually haul half of the coal in this country and they are not regulated. You would have to tell them a little something too about cutting it down. And of course the truckers. And maybe the utilities would have to say we won't make quite as much. Let everybody contribute and when you do that, I think you would be lifting us up a little bit, and then I think we could help the consumers and I think you have a wonderful thought, but I just disagree with who you are pinching.

Senator LONG. Mr. Bertrand, it doesn't take much of an investment, in relative terms of what it takes to operate a railroad, it doesn't take much investment for somebody to buy some barges and operate on the Mississippi River, or wherever you have water navigation. You can have the coal going between two water points, and it might help to solve this problem if we could find some way to make those rails available for anybody to rent himself a locomotive, rent some cars and haul that freight up and down on a competitive basis. But they can't do that on the railroads, can they? We have had talk about moving in that direction, but I can't recall anybody ever got anywhere with it, can you?

Mr. BERTRAND. No.

Senator LONG. You say that the railroads are not regulated monopolies, but the railroads should be far more efficient, several times as efficient as a truck in hauling coal on a highway. In moving coal from Montana and Wyoming, or any of those points between here and there, as a practical matter aren't those people limited to railroads in that area? As far as that is concerned, aren't they in a monopolistic position there?

Mr. BERTRAND. Well, in certain respects. Certainly we are not a monopoly as is a utility, because they are in absolute control of their area, their territory; nobody else is in there. We might have barge lines in some of our territory, we do have trucks in most all of our territories. The railroads might be a monopoly, but they are not near the monopoly that the utilities are.

Senator LONG. Well, even the electric utility people don't have to use the electricity, they can still use a candle or coal oil lamp. It is impractical to haul that coal in trucks on the highway, because you tear up the highways. You are not here to advocate hauling coal on trucks on the highways, are you?

Mr. BERTRAND. No.

Senator LONG. You know it is a lousy idea, and so does everyone else. It won't work, it will tear up the highways, it is just not practical.

Mr. BERTRAND. That's right, but it is done to a certain extent.

Senator LONG. Let me just make it clear that I want the railroads to make a profit. I want your people to make a fair profit. And I don't think we have any need to argue about what you should have in the rate base and what you should not have. But basically my position is that we want you to make a good profit hauling coal, and we want you to haul a lot of it, we want you to have a lot more traffic than you have now. We just don't want this to go back to the so-called golden days of railroad, when we had old Commodore Vanderbilt getting together with Judge Gould and between the two of them they were dreaming up things and the public was paying through the nose. Those golden days of railroad, when the public took a beating, we don't want to bring back. We want you to make a fair profit. But we are concerned that in doing this, the consumer be protected and particularly the consumer of electric power.

Now you have been in the State legislature, Mr. Bertrand, you are aware that we have a consumer to protect. Frankly, if you were still in the legislature, I think you might be looking at it somewhat the way I am looking at it right now.

I want to ask you one more thing. You indicated that the railroads in the State are attempting to raise the rates on their low rated traffic. Can you tell me what you have done in this regard?

Mr. McCLAIN. Insofar as our individual railroad, Mr. Long, over the last I would say 10 years we have taken a look at a lot of commodities that are low rated, enumerated in the statement, and our railroad, for example, 10 to 12 percent of our total revenue is attributed to intrastate traffic within the State of Louisiana, and about 5 to 6 percent of it is intrastate Texas. And we have taken a look at specific movements that move within those States, and reviewed the costs, and in many cases we have sat down with the shippers involved—we have done that in 95 percent of the cases—and we have negotiated increased rates. We have gone to the State commissions and we have been given permission to adjust those rates.

In some cases we weren't able to negotiate a solution. But in addition to that, we have taken specific looks at the interstate traffic, sat down with the customers, negotiated increases, gone to the ICC or whatever, and filed for increases and we have been pretty successful.

I think that effort, more than any other effort, has been due to, if you will, the resurgence of the Kansas City Southern as a fairly healthy railroad.

We have still got a long ways to go, and we are still reviewing those commodities as each day passes.

Senator LONG. Do you believe that you are getting the productivity that the customer is entitled to expect on plant and labor in your system?

Mr. McCLAIN. I think we have done a lot more than we are being given credit for. You look at the decline in railroad employment over the last 10 to 15 years, and you look at the number of ton

miles that the railroads are experiencing over the last 15 years, and I think a comparison of those numbers alone gives you some indication of the kind of improvement in productivity that we recognized and realized.

But we have still got a long ways to go. I think that that is a key ingredient into the future success of the railroads, and we either do it or we won't survive.

Senator LONG. My impression is that your railroad management has got to the point to where they are afraid to even talk back to labor. I am for organized labor, I think they have done a great job for their workers, they have done a good job in your industry, and they are loyal to the union for a good reason, the union has gotten good benefits for them. But when you sit down to negotiate with labor, you ought to be pushing to get the best deal you can get from them.

How far does the average train crew move on those trains in a day?

Mr. McCLAIN. One of these what trains?

Senator LONG. An average train crew.

Mr. McCLAIN. An average train? In a 24-hour period, you ought to move an average freight train anywhere from, depending on the terrain, what have you, you ought to move a freight train 500 miles in a 24-hour day.

Senator LONG. You see, your answer to me just indicates what part of the problem is. You people are even afraid to discuss it. How far does that train go before you take off one crew and put another crew on it?

Mr. McCLAIN. Give or take a few miles, about 100 miles.

Senator LONG. About 100 miles. What is the average speed that train is moving?

Mr. McCLAIN. Somewhere between 15 and 20 miles an hour. It will vary with the railroad. If you are going over mountains, for example, in rugged terrain—

Senator LONG. In this part of the country, how many mountains do you have to go over?

Mr. McCLAIN. Well, I wouldn't call them mountains, but we go over four hills between here and Kansas City.

Senator LONG. Hills. My impression is that you are still going by an old 100-mile rule that had to do with the day when you had a fireman on that locomotive, he would shovel coal into the engine, in fact, prior to that time he would throw cordwood into the locomotive, or the boiler, and so when that train had moved about 100 miles, that fireman had thrown about as much coal or wood into the boilers as one man could do, he had moved that train about as far as one fellow could move it. At that point you would take the crew off and put another crew on.

Isn't that where the 100-mile rule got started?

Mr. McCLAIN. Yes, sir.

Senator LONG. Nowadays you have a diesel locomotive, you don't need the engineer, and you still have a four-man crew there. I think at one time it was five, and you got it down to four. But any time a railroad is in real trouble, and labor wants to help save it, they tend to agree that they can operate those trains with three men. And I would think if that were this railroad, and they were

trying to make a profit out of it, they would move that train more than 100 miles before they changed the crew.

Have you people tried to persuade those fellows to ease up on those rules?

Mr. McCLAIN. Constantly.

Senator LONG. Well, I think that is one of the things that ought to be done.

Mr. McCLAIN. I do too, sir.

Senator LONG. You should lean on labor and say "Hey, fellows, you know the public has a right, if we are going to fight inflation, we have to start getting productivity around here," and I don't think you ought to have to hire more people in order to move more cargo. It seems to me you ought to be able to negotiate with labor and they ought to be willing to cooperate. If they want to fight inflation like I do, and like you do, they ought to be willing to give us more productivity than they are giving us now.

Mr. McCLAIN. I agree 100 percent.

Senator LONG. I sort of gained the impression that you were afraid to mention the subject. Frankly, I have to run for office, and I know you people have to negotiate with labor, and it can be tough. But it seems to me you ought to be willing to face some of these things, because the public is entitled to better productivity than they are getting in your industry.

Mr. McCLAIN. I agree, sir.

Mr. DOWLING. I can make a statement here: If you want to sponsor that bill, we will be glad to support it. On productivity, as far as 100 miles, boiler capacity is something that determined how far they could go. But I think even despite the handicaps that we have from labor and other regulations and so forth, that the railroad industry—I know the Missouri Pacific has specifically increased our productivity substantially in the last 10 or 15 years. And we are going to continue to do that. I think a prime example of real productivity is the coordination and cooperation between the railroads and the coal shippers in moving unit trains. It is only by the cooperation that we have in moving the unit trains, in which we are providing a premium service to the coal shippers, that we can get the price down to the level it is. Because if we had to move it in regular train service, where they change engines and cabooses and have many delays enroute, then the price of the coal would be much higher than it is, than the utilities are paying now.

We feel that the utilities are receiving premium train service at a bargain price, and it is achieved by our cooperation with them to create greater productivity.

Senator LONG. Let me ask you one other question.

I think we can all agree that this movement of coal that we are all anticipating, as well as that which you have now, is a volume operation where you don't just load a single car, you have a train load of cars and you ship a lot of cars at one time. And being a volume trade, where you have a constant heavy volume, doesn't that indicate it is a much lower unit rate per ton?

Mr. DOWLING. It is much lower, yes.

Senator LONG. The point is that the points you make here, yes, this is lower than other commodities. But the fact is that it is a volume movement and that indicates that it should be lower.

Mr. DOWLING. Right.

Senator LONG. Well, thank you very much, gentlemen, I appreciate your statement.

[The statement follows:]

STATEMENT OF RICHARD J. BERTRAND, REPRESENTING CERTAIN RAILROADS SERVING LOUISIANA

Mr. Chairman, I appreciate this opportunity to present to you the views of certain railroads¹ serving Louisiana on the issues raised by your proposed amendment to section 104 of S. 1946.

The committee report on S. 1946 states that the purpose of the bill is to revitalize the railroad industry by providing substantial regulatory reform. The railroads are convinced that the proposed amendment will severely undermine the purpose of the bill. The proposed amendment is not a step in the direction of regulatory reform and it could, in fact, preclude the revitalization of the railroad industry.

In enacting the Railroad Revitalization and Regulatory Reform Act of 1976 the Congress directed the Secretary of Transportation to undertake a study of the capital needs of the rail system and to report his findings to the Congress. That report was submitted to the Congress in October, 1978. The essence of the Secretary's findings was that, in the period 1976-1985, the railroad industry (*excluding* Conrail) faced a capital shortfall of \$13-16 billion. The urgency of meeting the capital need was clear:

"The timing of the need is such that even if actions are taken immediately to improve railroad earnings and correct underlying problems, further deterioration in facilities and services is likely to occur."²

The Secretary's report confirmed what was all too apparent—despite the hopes of the 1976 Act, the railroad industry remained in perilous financial condition. In 1977, its rate of return on investment was below 1 percent. It stayed below 1 percent in 1978. In not one year since 1955 have the railroads earned a rate of return equal to the cost of their debt capital. The rate of return for the industry as a whole has not exceeded 3 percent since 1966. Even the relatively more profitable southern and western district railroads earned returns of only 4.12 percent and 3.61 percent, respectively, in 1978. This performance is to be viewed in the light of a determination by the Interstate Commerce Commission that the railroads are entitled to a maximum return of 11 percent on investment.

If one compares the return on equity in the railroad industry—the return on the stockholders' interest—the picture is just as bleak. The railroads are traditionally last or next to last among the 73 industrial groups ranked annually by Citibank. In 1978, the railroads earned a 1.3 percent return on equity. By way of comparison, the top industrial group earned 24.7 percent, the trucking industry earned 18.4 percent, and public utilities earned 12.1 percent.³

There have been numerous studies to determine how much the railroad industry must invest to maintain an adequate plant and service. Each of these has concluded that something on the order of \$5 billion per year is required. Over the last five years the amount actually invested has averaged about \$2.3 billion—less than one-half the amount required. Clearly, the capital necessary to the revitalization of the railroad industry cannot be attracted by the industry in the absence of very substantial increases in earnings and, hence, revenues. While requirements for new investment can be attributed in some part to all commodities, much of it must be attributable directly to coal traffic. The Department of Transportation has estimated that between 1977 and 1985 the railroads would have to invest \$9-12 billion to meet their coal transport requirements.⁴

Given the indisputable needs of the railroad industry, the Committee has sought to provide in S. 1946 the ratemaking flexibility necessary to achieve significant increases in revenues. The Committee has also recognized, through other provisions in S. 1946, that achieving adequate earnings in the railroad industry requires more than an increase in revenues—it also requires a decrease in costs. For that reason, the bill would expedite abandonments of uneconomic lines, encourage restructuring, and reduce regulatory interference in railroad operations. But the ratemaking provisions are the heart of the bill because cost reductions alone cannot provide the

¹ Illinois Central Gulf; Kansas City Southern; Louisville and Nashville; Missouri Pacific, Southern Railway; Southern Pacific.

² "A Prospectus for Change in the Freight Railroad Industry" at 4.

³ Citibank monthly economic letter, April 1979.

⁴ "Transporting the Nation's Coal—A Preliminary Assessment" at II-19.

necessary increase in earnings. To provide the necessary ratemaking flexibility, a three-pronged approach was adopted:

(1) No regulation of the maximum reasonableness of rates that are below the average level necessary to yield an overall adequate rate of return. (Section 102)

(2) No regulation of the maximum reasonableness of rate increases that are at or below the rate of rail inflation. (Section 102)

(3) No suspension or investigation of rate increases that do not exceed the inflation rate plus 4 percent, but the maximum reasonableness of such increases is to be determined by the Interstate Commerce Commission upon complaint with the burden of proof on the complainant. (Section 104)

As we will show, the effect of the proposed amendment to section 104 is to negate the only provision in S. 1946 that is specifically directed to achieving increased revenues essential to the achievement of economic viability.

The proposed amendment would apply to all commodities, but its avowed purpose is to hold down coal rates. It would do this by requiring the Interstate Commerce Commission to establish a threshold at which the burden of proof as to the reasonableness of any rate increase within the 4 percent zone established by section 104 would be shifted back to the railroads (to reach most coal rates this would have to be well below 180 percent of variable cost). The 4 percent zone created by section 104 reflects a legislative presumption that the railroads need to increase their revenues. If the Congress acknowledges that the railroads do indeed need increased revenues, it could adopt the amendment proposed only on the assumption that sufficient increases in revenue could be realized from rate increases on traffic moving at rates below the threshold to be prescribed. It is clear beyond any doubt that the contrary is true—sufficient increases in revenue can *only* come from the traffic moving at rates above that threshold. That is not to say that some of the rates on low-rated traffic cannot be increased—the railroads are already attempting to do just that. Nor is it to say that rate decreases will not in some instances attract more traffic to the railroads and improve revenues—the railroads are also attempting to do that. But, in the final analysis, the largest contribution to the revenue needs of the railroads must be sought from the higher rated traffic.

The Association of American Railroads analyzed the data in the 1975 one percent waybill sample to determine the distribution of traffic by revenue-to-variable cost ratios. As recognized in section 102 of S. 1946, the average revenue-to-variable cost ratio the railroads would have to earn from all traffic to realize an adequate return on investment is about 150 percent. The waybill analysis indicates that at least half of all railroad revenues come from traffic moving at rates below the 150 level. This is traffic which faces competition from other modes of transportation or from other commodities. The prospects of increasing the rates on that traffic by the amounts necessary to achieve adequate revenue levels are remote because, before such rate levels could be reached, the traffic would likely be diverted to other modes of transportation or would simply cease to move. Here in Louisiana, for example, the railroads would have to attempt to obtain the necessary revenue by drastically increasing the rates on low-rated commodities such as iron ore, construction aggregate, industrial sand, limestone, salt, bricks, cement, paper, fats and oil, sugar, molasses, bagasse, wood chips, and pulpwood.

We come back to the point, then—if the Committee agrees that the railroads need increased revenue, it has to recognize that most of the increase must come from traffic now moving at rates above 150 percent of variable cost. In many cases, that means bulk commodities such as coal and grain (although, as we will show, a great deal of coal moves at very low rates) as well as manufactured commodities such as steel and automobiles. This brings us to the arguments being made against the level of coal rates—the arguments that underpin the proposed amendment to section 104. First, the electric utility companies argue that they are willing to pay a fair share but that coal is bearing a disproportionate share of the burden. The other argument is that coal rates ought to be held down in order to hold down the electricity rates paid by the homeowner.

The following table, drawn from data compiled by the Bureau of Labor Statistics, shows the average rates charged for the movement of six bulk commodities and the average rate charged by the railroads for all traffic.

DATA COMPILED BY THE BUREAU OF LABOR STATISTICS

Commodity	Revenue per ton-mile (cents)	Percentage of average revenue per ton-mile
Bituminous coal	1.88	57
Grain	2.76	83
Gravel, sand	2.85	86
Iron ore	3.08	93
Crude petroleum	2.76	83
Pulp	2.76	83
Total traffic	3.32	100

It will be noted that, on a national average, coal revenues per ton mile are the lowest in the group and 43 percent below the average revenue per ton mile from all traffic.

Obviously, the average revenue from coal movements is not too high relative to other traffic. The question is are the western coal rates recently instituted for unit train movements too high relative to other traffic? In a recent case⁵ the Interstate Commerce Commission found that the rate being disputed was "approximately" 150 percent of variable cost—just at the average the railroads would have to charge all traffic. In none of the western coal cases has the rate prescribed exceeded 170 percent of variable cost. The lowest ratio bandied about by anyone to describe high-rated traffic is usually 180 percent of variable cost.

Are coal rates too high relative to the price of coal? Between 1973 and 1978, the minehead price of coal increased by 163 percent, far in excess of the rate of inflation. In the same period, the average rail rate for coal increased only 75 percent—roughly in line with inflation. In 1976, the cost of moving coal by rail constituted 39 percent of the delivered price of the coal. By 1978, the rail cost as a share of delivered price had declined to 25 percent.

Is the delivered price of coal too high relative to the price of oil and gas? The cost of coal to the electric utility industry increased from 41.4 cents per million BTU's (¢/MBTU) in 1973 to 111.6¢/MBTU in 1978, an increase of 170 percent. During that same period, the utilities' cost of oil went from 75.9¢/MBTU to 215.5¢/MBTU, an increase of 184 percent. The utilities' cost of gas went from 34.1¢/MBTU to 143.8¢/MBTU, an increase of 322 percent—almost double the increase in the price of coal.

While the price of the fuels lying virtually in the back yards of the southern and southwestern utilities has doubled and tripled between 1973 and 1978 and the price of coal has increased more than one and one-half times, the utilities' hue and cry has been directed at the railroads' rates for hauling coal some 1500 miles overland. Should anyone be surprised that it costs a lot of money to haul a bulk commodity that distance? If they were hauling sand and gravel that distance, would they be surprised that the cost of the transportation far exceeded the value of the commodity?

The principal issue before the Committee is the creation of an economically viable railroad system, not the level of electric utility rates. We fully appreciate the fact that a public utility has to recover its costs, including the cost of fuel, from its customers—because we do too. Since 1973, our fuel costs have increased almost 600 percent. They have more than *doubled* in the last 12 months! And we all know the end is not in sight. Unlike the utilities, the railroads are not regulated monopolies—they are only regulated. We are not protected from competition nor assured of a fair return on investment. In making such a comparison, we are not suggesting that electricity rates should be reduced at the expense of a fair return to those who provide capital to utility companies. But by the same token, given the fact that the return on equity in public utilities was 9 times that in the railroad industry in 1978, we are at a loss to understand why the railroad industry—and ultimately its shareholders—should be the instrument for holding down the increases in those rates. Those increases are attributable for the most part to increases in the price of fuel or, in the cost of transporting it. Most certainly they are not attributable to any excess profits being earned in the railroad business.

To summarize, the railroads need substantial increases in revenues and those increases must come in large part from the traffic that is relatively the most dependent upon rail. Given the rates on other commodities, coal rates are not too

⁵ *Incentive Rates on Coal—Axial, Co. to Coletto Creek, TX*, decided January 15, 1980.

high and coal shippers are not bearing a heavier burden than other shippers with a relatively high dependence on rail. Finally, if the objective were to hold down the rates on electricity, it would be grossly inequitable to pursue that objective at the expense of the railroads—the group least able to bear that burden.

Senator LONG. I am very pleased to learn that the Governor of Louisiana is here. Is Governor Edwards here? Governor, we would be very happy to have you testify on this subject and have your thoughts on the subject.

STATEMENT OF HON. EDWIN EDWARDS, GOVERNOR OF THE STATE OF LOUISIANA

Governor EDWARDS. Thank you, Mr. Chairman. I had to observe that in my observation it seems to me the only time trains go as slow as 15 miles an hour is at railroad crossings.

I want to compliment you for your attention again to the interests of Louisiana, and for calling to the attention of the Nation the aspects of this bill which I think have far-reaching adverse possibilities on the total economy.

Let me first say that I agree with my good friend Richard Bertrand that none of us wishes to punish the railroads, put them out of business. We think they are a very important part of America's economy. They employ over 10,000 people in Louisiana, I don't know how many nationally. But certainly we would be ill-advised not to make it as lucrative as possible for them to operate, consistent with good public policy.

But I think this is something deeper. This is mardi gras time, it might be a good time to unmask this bill. It is nothing more or less than another effort to punish the gas and oil producing areas that have been regulated for 40 years now, and which regulation has brought us to the unfortunate energy crisis we now have in this country.

If, as has been suggested, the railroads are in trouble, and need additional revenue, and that is probably correct, then let us let all Americans bear that burden, rather than just a few of us who have been penalized for 25 to 40 years by unfair Government policies as our gas and oil left our grounds and flowed to other parts of the country.

I would support, for instance, a measure which would add 10 cents a 1,000 cubic feet to natural gas leaving Louisiana, and give that to the railroads and subsidize their freight problems. Let those that are enjoying regulated low natural gas and regulated oil produced in Texas and Oklahoma and Louisiana bear some of the burden, not the people of this State, who are forced, because of bad Government policies, to now generate electricity by coal.

One of the few wise decisions made by the Federal Government since 1973 in energy matters has been to double the use of coal. But simultaneously with that announcement of that principle, the Congress began to heap on regulations and rules and ideas and restrictions which virtually made it impossible to mine coal, transport coal, to use coal, or to experiment with it.

The Governor of Ohio told me about 6 months ago that people in Ohio are sitting on unmeasured tons of coal, which is very badly needed in their industries and their generating plants. They cannot use it because Federal regulations in Washington say to the people of Ohio, who want to use the coal, that they may not use it,

because it may contain too high a percentage of sulfur or other impurities.

What we are looking at here is a reverse situation of the discrimination that we have suffered for 25 to 40 years, since the 1953 *Phillips* case, when the Supreme Court wrongly decided that the Federal Power Commission should regulate natural gas crossing State lines at the wellhead. We believe that the situation we now find ourselves in was brought upon us, requiring us now to burn coal when we are sitting on huge reserves of natural gas and oil.

I think, Senator, that the thing to do, if these people in Washington who support this bill without your amendment, are honest and sincere in their efforts, then we would be perfectly willing to support a measure which would remove all regulation from all energy, oil and gas, and then I assure you we would not have any concerns about how much the freight is for freighting coal, because we wouldn't have to buy their coal. They wouldn't be able to get our natural gas and oil. And we would all be a lot happier. They would use the coal, they wouldn't have to pay the freight charges, or if they want to increase the charges, it is all right with us, we would use our oil and gas and we would be very pleased.

But if we are to be the subject of regulation as our natural resources move north and east, so that we cannot command the kind of competitive prices that the world is commanding for these items, then certainly we are entitled to some protection nationally on the freight that we have to pay for transporting this coal which we are now required by the Government to use in order to generate electricity.

I would close by suggesting that it seems to me that from Wyoming to Louisiana, it is all downhill, and it ought to be pretty easy to transport the coal, at some fair regulated price in the interest of consumers here, our national energy policy, with some fairhanded application for everyone, not just to benefit a mass of people in the North and the East and the West at the expense of those of us in the South, who find ourselves in this unfortunate position, not of our own making, against our wishes, against our advice, but brought upon us by people who fail to stop and understand the wisdom that we have advocated for 10 to 15 years.

Senator LONG. Governor, thank you for a very fine statement. I think what you are saying reflects the position of the rank and file of people, the ordinary man on the street, to the extent that he understands the problem.

May I say that it is interesting to note that most, if not all, of the railroads that haul a lot of coal are the healthier railroads, they are in good financial shape. They are not the ones who are crying about not making money. It is the ones that are not fortunate enough to have much coal to haul that are in financial trouble. Coal is making all those who haul a lot of it very healthy railroads financially, and we are not complaining about that. We just don't want to have to pay an unreasonable price for it.

I appreciate the statement you have made, Governor. You have added a great deal of perspective to this hearing.

Governor EDWARDS. Thank you, Senator. I appreciate your efforts on behalf of the people of Louisiana and this Nation in

offering this amendment. I certainly hope it is passed by the Congress.

And in closing I want to again compliment you on your effective representation as our senior Senator. I am sure the next 6 years will see you occupying the same position.

Senator LONG. I hope you are right, Governor. Thank you.

Now let's hear from a panel, Mr. William McCollam, Jr., president of Edison Electric Institute, Mr. F. E. Autrey, president of Middle South Utilities in New Orleans, representing Middle South Utilities, Inc., Louisiana Power & Light Co., and New Orleans Public Service, Inc.

This group should limit their statements to 5 minutes each.

STATEMENTS OF WILLIAM McCOLLAM, JR., PRESIDENT, EDISON ELECTRIC INSTITUTE; F. E. AUTREY, PRESIDENT, MIDDLE SOUTH UTILITIES, INC., REPRESENTING MIDDLE SOUTH UTILITIES INC.; LOUISIANA POWER & LIGHT CO. INC., NEW ORLEANS PUBLIC SERVICE, INC., AND SYSTEM FUELS, INC., ACCOMPANIED BY JOHN L. PRENDERGAST, PRESIDENT, SYSTEM FUELS, INC.; ANDREW MOORE, VICE PRESIDENT, CENTRAL LOUISIANA ELECTRIC CO.; GEORGE KETTERER, MANAGER—FUELS TRANSPORTATION, GULF STATES UTILITIES; AND JOHN TURK, VICE PRESIDENT-SUPERINTENDENT, POWER PRODUCTION, SOUTHWESTERN ELECTRIC POWER CO.

Mr. McCOLLAM. Thank you Senator. I will lead off.

Let me first express the appreciation of the entire industry for the efforts that you, Senator Long, have already made to protect captive shippers and consumers from the potential excesses of complete railroad deregulation. These hearings and those you have had in Washington before, together with your proposed amendment, represent, in our judgment, a positive effort to remedy a serious flaw in S. 1946, the Railroad Transportation Policy Act of 1979, that flaw being the failure of the bill to provide for any reasonable limitations upon rates for captive coal traffic.

I have a more complete statement, which we have introduced into the record, which I will summarize in the interest of time, as you have requested.

The Railroad Transportation Policy Act is of vital concern to our industry, because the electric utilities are the largest coal users in the United States. In a great many cases the only method of transporting coal from a contracted source of supply to a generating facility in needed volume is by a single rail route. In those cases the utility is truly a captive shipper, since no viable alternative method of shipment exists.

We don't reject the concept that captive utility coal shipments may have to make an equitable contribution to the subsidy which some railroads may need. But we also strongly believe that the computation of this subsidy must have some reasonable cost basis, and must include some reasonable method of determining upper limits of those costs.

I would like to reiterate what some of the previous witnesses from our industry have indicated in their testimony before this subcommittee, and that is that we are here representing an industry gravely concerned that our ratepayers are being forced into a

position by this bill, unamended, to pay costs that should be borne by others.

In that connection, I would like to cite the potential costs of deregulation to our ratepayers in this country. They are literally staggering. This is particularly true in Louisiana, where coal must move, as has been indicated, over very long distances, and where the transportation costs, therefore, vastly exceed in many cases the cost of the fuel itself.

Under the terms of S. 1946, the authorized increases in all rail coal rates which are not justified by specific increases in costs would total \$10.5 billion per year at the end of 20 years according to our economic consultants, and according to testimony that our witnesses have previously introduced into the record in these hearings.

Throughout the last year our industry has been actively involved in the legislative debate on railroad deregulation which has been going on over the past year. We certainly want to continue to work with your subcommittee, Mr. Chairman, to fashion a bill that benefits consumers, shippers, and the railroads. We think it can be done, and in summary, we would like to state that your amendment is a very positive constructive step in that direction.

Unless you would like to ask questions as we go along—perhaps it might be better to have the entire panel and then respond to your questions—I would like to introduce Mr. F. E. Autrey, the president of Middle South Utilities, who will testify on the Middle South situation.

[The statement follows:]

STATEMENT OF WILLIAM MCCOLLAM, JR., PRESIDENT, EDISON ELECTRIC INSTITUTE

Mr. Chairman and Members of the Subcommittee: I am William McCollam, Jr., President of the Edison Electric Institute. The Edison Electric Institute is the national association of investor-owned utility companies. Member companies of the Institute provide 77 percent of all electric power purchased in the United States. I very much appreciate the opportunity to appear before the Subcommittee on Surface Transportation and to introduce representatives of Louisiana investor-owned utilities.

Let me first express the appreciation of the entire industry for the efforts that you, Senator Long, have already made to protect captive shippers and consumers from the potential excesses of complete railroad deregulation. From the first time that Ellis Cox, Executive Vice President of the Potomac Electric Power Company, testified before this Subcommittee in May of last year, it was clear that you had a firm grasp of the captive shipper's predicament and the potentially devastating effects which skyrocketing transportation rates could have on all consumers of electricity. These hearings and your proposed amendment represent a positive effort to remedy a serious flaw in S. 1946, the Railroad Transportation Policy Act of 1979. That flaw is the failure of the bill to provide for any reasonable limitations upon rates for captive coal traffic. We commend you, Senator Long, for recognizing that this is a clear issue for protection of consumers from monopoly power.

The Railroad Transportation Policy Act is of vital concern to our industry. Electric utilities are the largest coal users in the United States. In a great many cases, the only method of transporting coal from a contracted source of supply to a generating facility in needed volume is by a single rail route. In these cases, the utility is truly a "captive shipper" since no viable alternate method of shipment exists. Our great fear is that in these monopoly situations, railroads will raise their coal rates to unconscionable levels and will seek to make their coal shipments unreasonably subsidize other commodities. This is particularly disturbing in light of the announced national energy policy of increased use of coal to reduce consumption of imported oil. At a time when transportation costs are already increasing by leaps and bounds, complete deregulation could not only inhibit coal utilization to a considerable degree but also increase electric rates unreasonably. Moreover, we are convinced that unlimited subsidization of the railroads by electric utilities and their

customers does not represent the long-term solution to the problem of revitalizing our nation's rail system.

We do not reject the concept that captive utility coal shipments may have to make an equitable contribution to the subsidy which some railroads may need, even if operated at maximum efficiency. We certainly want a healthy railroad industry since we depend on the continued existence of the railroad to secure our plant fuel. We believe that a great many of the provisions of S. 1946 will result in healthier railroads. But while we understand that some commodities may, of necessity, be required to subsidize the movements of other commodities, we also strongly believe that the computation of this subsidy must have some reasonable cost basis and must include some reasonable method of determining upper limits.

In all of our previous testimony on this subject, we have stated our belief that in order to justify a subsidy paid by our consumers, railroads should show that they are not earning the overall fair rate of return permitted by the Commission and to show also that the railroad is doing its best to eliminate noncompensatory traffic and otherwise trying to achieve revenue adequacy. We continue to believe that this is a sound principle for establishing upper limits on rates for captive traffic that will be fair to the railroads without penalizing the consumers of electricity—consumers who are already being buffeted by forces, such as OPEC, which are beyond their control.

For as Senator Long pointed out in his speech of December 17, disproportionately high-rate increases will fall on "hundreds of public utilities and rural electric co-operatives, on thousands of industrial consumers, and on virtually every consumer of electricity in the country." In that regard, I would like to reiterate what Ellis Cox said in an earlier exchange with Congressman James Florio, Chairman of the counterpart House Subcommittee: "We are here representing an industry gravely concerned that our ratepayers are being forced into a position by this bill to pay costs that should be borne by others. Neither our company or any of our companies benefit on the bottom line from anything I have said this morning. Our ratepayers are the ones who benefit, not our companies."

The potential costs of deregulation to our ratepayers are staggering. Already utilities consume some 470 million tons of coal—71 percent of all domestically produced coal—and we look forward to consuming over 897 million tons by 1988. Fifty percent of this coal moves by rail today and more will have to do so as utilities are required to convert to coal. Already the costs of transportation nationwide amount to over half the delivered price of coal, and those costs are rising. In Louisiana, where coal must move long distances, the transportation costs vastly exceed the cost of fuel. In some cases, such as the well-publicized San Antonio and Houston cases, and even closer to home for AP&L and SWEPCO, new charges for transportation, even under existing law, are exorbitant. Under the terms of S. 1946, the authorized *increases* in all rail-coal rates which are not justified by increases in costs would total \$10.5 billion per year at the end of 20 years, according to our economic consultants. Obviously, this is a problem by no means small in scope.

Throughout the last year, the Edison Electric Institute and its member companies have been actively involved in the legislative debate on railroad deregulation. We have consistently tried to develop sound, constructive proposals that would allow railroads to receive a fair rate of return without burdensome regulations and without allowing for excessive prices charged to victims of monopoly power. I want to express my very deep appreciation not only to the Chairman of this Subcommittee and his colleagues but also to the members of the Committee staff who have been most courteous, open and patient with all of our suggestions. We want to continue to work with this Subcommittee to fashion a bill that benefits shippers, consumers and railroads. We believe that these hearings go a long way towards achieving that goal and that the proposals set forth by Senator Long are constructive ones which substantially improve the bill. The Edison Electric Institute looks forward to continued work with the Subcommittee and staff.

Thank you.

Mr. AUTREY. Mr. Chairman, I am Gene Autrey, president of Middle South Utilities, Inc., and I am here today speaking on behalf of Louisiana Power & Light Co., New Orleans Public Service Inc. and the other Middle South operating companies.

We appreciate the opportunity to express our concern over the adverse effects of the passage of S. 1946, because of the effect it would have on the consumers of Louisiana unless an amendment, such as you have proposed, is incorporated into the legislation.

We have filed our formal remarks with the committee and my brief remarks will be directed to that situation we in Louisiana find ourselves in today.

As you know, Senator, we have been working with you and your staff since this legislation was first introduced, to try to assure that Louisiana's electric consumers will be protected from excessive rail rates on the shipment of coal into Louisiana.

Thanks to your efforts, this legislation has been held up in order to consider and incorporate into the bill the protection that your proposed amendment aims to afford captive shippers.

Now due to the national energy policy, we in Louisiana will no longer be allowed to use our indigenous fuel, just as the Governor talked about, natural gas, to generate electricity after 1990. This means that future additional electric generating plants, in order to serve expanding loads, must be either coal or nuclear.

Now we will have to replace much of our existing oil- and gas-fired units with new coal and nuclear capacity. Middle South is committed to meeting the energy needs of the Middle South area through the construction of those needed coal and nuclear facilities.

Within the past few weeks Louisiana Power & Light Co. has announced its intention to exercise its option on the Wilton Plantation, 3 miles south of the Sunshine Bridge as a site for two future coal units. Additional future coal units are also being planned for Louisiana.

Now we estimate that the plants at the Wilton site will require shipment of up to 5 million tons of low-sulfur western coal per year. Within the next 10 years the Middle South system will be one of the larger shippers of coal in the United States.

Our experience to date with the railroads has been most frustrating. We have seen rates quoted in 1972 of \$5.96 per ton increase to \$16.45 per ton, far outstripping inflation effects in the same time frame. The \$16.45 rate is with us providing the coal cars. Although Middle South endorses the concept of replacing regulation with competition, this can not be done where competition does not exist, that is, with a captive shipper. When two-thirds of the cost of coal delivered to Louisiana is transportation costs, and one-third of the cost of electricity from a coal plant is attributable to the transportation cost of the coal, we have got to be concerned over a proposal that would give the railroads a blank check in regard to coal transportation rates.

For that reason we heartily endorse the concept of your amendment, since it attempts to place reasonable limitations upon the otherwise open-ended provisions of S. 1946.

Thank you.

Senator LONG. Thank you very much.

[The statement follows:]

JOINT STATEMENT OF F. E. AUTREY, PRESIDENT, MIDDLE SOUTH UTILITIES, INC.
AND JOHN L. PRENDERGAST, PRESIDENT, SYSTEM FUELS, INC.

Mr. Chairman and members of the committee, we are, respectively, F. E. Autrey, President of Middle South Utilities, Inc., P.O. Box 61005, New Orleans, Louisiana 70161 and John L. Prendergast, President of System Fuels, Inc., P.O. Box 61532, New Orleans, Louisiana 70161. We appreciate very much the opportunity to appear before the Committee today on behalf of the Middle South Utilities System and, needless to say, will be pleased to answer any questions that the Committee may have. Coal freight rates are of vital and increasing concern to the System and its

electric ratepayers and we are hopeful that our recent experiences in this, for us, new area will be of assistance to the Committee.

The Middle South Utilities System is an integrated electric generating system operated on a pool basis providing electric service to about 1.5 million customers in a 92,000 square mile area in the States of Arkansas, Louisiana, Mississippi and Missouri. The system embraces five subsidiary operating companies, the stock of which is owned by Middle South Utilities, Inc., an investor-owned public utility holding company. The operating companies are Arkansas Missouri Power Company (ARKMO), Arkansas Power & Light Company (AP&L), Louisiana Power & Light Company (LP&L), Mississippi Power & Light Company (MP&L) and New Orleans Public Service Inc. (NOPSI).

System Fuels, Inc. (SFI) is in turn a jointly-owned, nonprofit subsidiary of the System's operating companies acting in essence as the centralized fuel procurement agency for the System. Of particular relevance to the subject of this hearing, SFI has been charged with responsibility for negotiating coal contracts and, if possible, rail rates, acquiring the needed rail equipment and general supervision of rail transportation.

Because of the previous abundance of natural gas, none of the Middle South operating companies have used coal for the generation of electricity. Within the last decade, however, because of natural gas shortages, the Middle South operating companies were compelled to undertake costly conversion from gas to oil. This stopgap expedient, however, became suddenly and drastically uneconomic with the dramatic upsurge in the price of oil beginning with the OPEC embargo of 1973-1974. Even before that embargo, Middle South saw the necessity for increased and eventually primary reliance on alternate fuel sources such as nuclear and coal for its generation, and began planning with the result that the System presently has one nuclear unit in commercial operation, another expected to be commercial in a matter of weeks with three others in various stages of completion. In addition, four new coal units are under construction, the first of which is the White Bluff Electric Station of AP&L located at Redfield, Arkansas and which will be commercially operational within the next few months. The regular movement of coal in volume in unit train service for inventory buildup began on December 14, 1979 under a Burlington Northern-Missouri Pacific tariff which will be further discussed later. In order to keep up with increasing demand and to maximize efficiency, the System projects construction of five or six additional coal-fired generating units similar to these at White Bluff by its various operating companies before the end of this decade.

Included among the projected construction is at least one two-unit station of 750 megawatts each by LP&L near Union, LA. Purchase of the site for this station has just been announced. It is probable that late in the decade or in the early 1990's another similar pair of units will be built by the Middle South Utilities System in Louisiana. Each of the System's stations will require about 5 million tons of coal annually or a total movement of at least 20 million tons when all projected construction has been completed. With a movement of 20 million tons of coal annually, Middle South will be one of the larger coal shippers in the nation. The advantages to the railroads of an assured volume of traffic of this magnitude on a long-term basis must be readily apparent.

The construction of a new electric generating station is both costly and time consuming. Lead time is now approaching eight years for a new coal fired plant. Siting and permitting restraints require selection of an assured supply of coal under long-term contract before these processes can begin. Certain environmental restraints actually severely limit the range of selection of coal that can be used at a given site. To illustrate, AP&L has a contract on a minimum of 100 million tons at a rate of 5 million tons a year to fuel the White Bluff plant. That plant was specifically designed to burn coal of the characteristics of that under contract after, of course, a thorough study of the economics of both alternative sources of supply and transportation.

It is interesting to note the turnabout in the attitude of the railroads once the coal supply contract has been executed. The Burlington Northern and Missouri Pacific, which are the only carrier serving the Wyoming mine and the White Bluff station respectively, were actively soliciting our business before we signed the contract. In late 1972 they quoted us a rate in shipper cars of \$5.96 per ton and followed this up with a draft tariff in mid-1973 reflecting a rate of \$6.71 per ton.

Five years of frustrating negotiations, during which time, of course, the rate kept escalating, did not produce one penny of reduction in the BN-MOP rate quotations. The present rate under which the White Bluff coal is not moving is \$16.47 per ton, again with the requirement that we provide the cars, which is a staggering 276

percent of the rate first quoted little more than seven years ago. Furthermore, the railroads have just filed seeking an additional four percent increase in this rate.

AP&L and SFI elected to litigate the White Bluff rate before the ICC. Based upon costs that we believe to be exaggerated, the Administrative Law Judge who heard the case recommended a reduction of 51 cents per ton. The Commission, however, coming up with just about the same costs as had the Judge, arbitrarily added seven percent on the theory that captive coal should subsidize other railroad traffic at least to this extent.

We are fearful that our disappointing experience with the White Bluff rate is suggestive of what we may expect when we undertake to move coal to other new Middle South coal-fired stations including that of LP&L. Furthermore, we may not even have an opportunity to litigate those rates. The present Commission with some new appointees apparently dedicated to deregulation, has recently refused to even take jurisdiction over similar new unit train rates for coal under long-term contracts moving to Georgia Power, Central Illinois Light Company and Central Power & Light at Corpus Christi, Texas. This action has been taken on the theory that there is no railroad market dominance over clearly captive coal traffic because at some point in the past the shipper could have bought its coal some place else.

Middle South heartily endorses the language in the Committee's report accompanying S. 1946 admonishing the Commission to protect captive shippers, notably coal shippers, against being required to excessively cross-subsidize other traffic. This, of course, is what we feel has already happened through the so-called "seven percent solution" to AP&L, San Antonio and SWEPCO. We see no signs, however, that the Committee's views have been heeded by the Commission which, of course, under present law is required by the 4-R Act to balance the needs of the carriers, shippers and the public. Under these circumstances, it seems apparent that further legislation is required in order to make "crystal clear", to use the words of the Committee's report, to the Commission the legislative intent.

S. 1946 is, of course, intended to provide even greater pricing flexibility within certain parameters to the railroads and thus to correspondingly further reduce the powers of the Commission. Middle South endorses the concept of replacing regulation with competition where competition in fact exists. But utility coal shippers cannot look to competition to restrain the railroads from assessing exorbitant rates on their coal traffic.

Most coal mines and generating stations are landlocked and, indeed, usually served but by one railroad. The truck transportation of large volumes of coal over long distances would be physically, economically and environmentally impossible. Coal shippers, unlike large industrial concerns, have no "trade offs" to improve their bargaining powers with the railroads. In this respect they are distinguishable from, let us say, a large steel company which may, indeed, have a captive movement of inbound iron ore but has substantial bargaining "clout" because of transportation alternatives on outbound steel.

S. 1946 imposes no limits upon those railroads that elect to improve overall revenues through the simple mechanism of raising rates on captive coal. Moreover, it would permit rate increases of 12 percent every five years above those justified by inflated railroad operating costs whether or not the involved railroad is actually earning inadequate revenues. In this regard we might point out that the carriers serving Louisiana are not generally considered to be "problem" railroads. The Missouri Pacific, for example, has probably the highest earnings in the industry. The Southern Railway has once again just reported record earnings and increased its dividends. The Southern Pacific system has long been recognized as a sound and prosperous carrier.

We do not deplore the fact that the Louisiana carriers are generally among the more prosperous in the nation. We fully recognize that the preservation of a sound and viable rail industry is in the best interest of the nation. By the same token, however, there are other national policies of at least equal concern such as attempting to hold the line on inflation and promoting increased consumption of domestic coal in lieu of imported oil.

The proposed amendment fairly undertakes to keep these matters of public concern in proper balance. The amendment recognizes that freight rates on coal are passed on directly to the public in their electric bills. In focusing upon noncompensatory and marginally priced railroad traffic, the amendment also encourages the railroads to explore other "self help" avenues of improved revenues rather than simply resorting to the ready expedient of increasing coal rates.

To summarize, Middle South endorses S. 1946 so long as it is appropriately amended, as proposed, to at least provide an opportunity to resist the imposition of rates beyond any reasonable justification. The amendment goes far in this direction by placing some limitations upon the otherwise open-ended provisions of S. 1946. It

might possibly be "fine-tuned" even more, consistent with the objectives stated by the Chairman in announcing the amendment, by providing for power in the Commission to suspend or investigate rates in excess of the ratio called for by the amendment even where they result from the four percent authorized increases. Consideration might also be given to authorizing the Commission to develop different ratios for different commodities. The latter suggestion would perhaps avoid imposing upon coal, in possible frustration of national energy goals, an average ratio that might very well be appropriate for other commodities less affected by the public interest.

We commend these suggestions to the Chairman and the Committee for consideration. Moreover, and most significantly, Middle South on behalf of both itself and its customers wishes to go on record as expressing its deep appreciation to the Chairman for his strong stand on captive coal traffic. We don't see that any fair-minded person even including the railroads can reasonably object to an amendment that affords to all interested parties an equal opportunity to present their views.

Mr. McCOLLAM. I will next call on Mr. Andrew Moore, vice president of Central Louisiana Electric Co.

Mr. MOORE. Senator, Central Louisiana Electric Co. CLECO, is an electric gas and water utility operating in 31 of Louisiana's 64 parishes, and we serve an area that has about 800,000 population. It is on behalf of these electric customers that I make this statement today.

CLECO has under construction its first coal-fired electric generating facility, Rodemacher Power Station, which is estimated to cost \$248 million and scheduled to begin operation in early 1982. It will require 1.75 million tons of coal annually. On January 29, 1974, CLECO contracted with Kerr-McGee Coal Corp. for coal from their Jacobs Junction, Wyo., mine when projected rail rates were substantially lower than these now quoted CLECO. The mine at Jacobs Junction, Wyo. is located on the Burlington Northern railroad. The Rodemacher Power Station at Boyce, La. is served only by the Missouri Pacific Railroad Co. CLECO was left, therefore, with no alternative other than to undertake to negotiate a reasonable unit train coal rate with those two carriers. These negotiations have been ongoing for some years, but with no satisfactory resolution from our standpoint. CLECO employed a transportation economist to develop the specific railroad costs of service for the described movement over the designated 1,657-mile route of movement. After a meeting with Burlington Northern and Missouri Pacific representatives in mid-October 1979, CLECO wrote to the railroads offering to resolve our differences upon the basis of a rate that would permit the carriers to recover their full costs of service plus a generous return. To date we have had no response from the railroads to this proposal.

We believe this is because there is not effective competition for our coal transportation to serve as a restraining influence upon railroad pricing policies.

For this reason, CLECO heartily endorses the objectives of the amendment to S. 1946, The Railroad Transportation Policy Act of 1979, proposed by you, Senator Long. We suggest, however, that consideration might be given to empowering or even requiring the ICC to suspend and/or investigate rates which exceed this threshold trigger point.

Thank you, Senator.

Senator LONG. Thank you very much.

[The statement follows:]

STATEMENT OF ANDREW M. MOORE, VICE PRESIDENT, CENTRAL LOUISIANA
ELECTRIC Co., Inc.

Mr. Chairman and members of the committee, my name is Andrew M. Moore and I am Vice President of Central Louisiana Electric Company, Inc. (CLECO). My address is P.O. Box 111, Alexandria, Louisiana 71301. CLECO, which has its principal office in Pineville, Louisiana, is an electric, gas and water utility operating in 31 of Louisiana's 64 parishes with an estimated service area population of over 800,000 people. It is on behalf of our electric customers that this statement is presented.

Let me preface my remarks by expressing our appreciation to the Chairman both for the opportunity to appear here today and, even more particularly, for the Chairman's manifest concern for the protection of captive coal shippers against potentially abusive monopoly rates for the transportation of coal by rail. CLECO heartily endorses the objectives of the amendment to S. 1946, The Railroad Transportation Policy Act of 1979, proposed by the Chairman.

Until recent years CLECO, not unlike other Louisiana utilities, could rely upon a plentiful supply of low-cost natural gas as fuel for the generation of electrical energy. This situation has, of course, now changed very drastically. Consistent with the goals of the national energy policy, which includes increasing reliance upon domestic coal reserves as a source of energy, CLECO now has under construction its first coal-fired electric generating facility. Unit No. 2 of the Rodemacher Power Station located near Boyce, Louisiana, estimated to cost \$248,000,000 is scheduled to begin commercial operations in early 1982. The build-up of the coal inventory for this unit must begin in 1981. When fully operational Rodemacher Unit No. 2 will require approximately 1.75 million tons of coal annually.

Obviously no utility can prudently undertake construction of a coal-fired generating unit without an assured long-term coal supply. Indeed, because of variations in the type of coal available within the United States, notably in terms of BTU rating and sulphur content, it is necessary to design coal-fired units for particular coal of given specifications. That has been done in the case of Rodemacher Unit No. 2. The needed coal supply for this unit has been assured under a long-term contract with Kerr-McGee Coal Corporation and will be supplied from that company's mine at Jacobs Junction, Wyoming.

I should emphasize the fact that CLECO entered into this coal supply contract only after careful consideration of the economics of alternative sources of supply including transportation. The Committee should also be aware that when CLECO entered into this contract with Kerr-McGee on January 29, 1974 projected rail rates were substantially lower than those that are now quoted to CLECO. It should also be emphasized that the rail rate is not the total cost of rail transportation since the railroads require that CLECO provide the coal cars. CLECO has projected the acquisition of sufficient cars plus spares to make up four unit trains. This is the minimum number of trains adequate to move our required tonnage for Rodemacher Unit No. 2. The present estimated cost of the cars for these four trains is \$25,000,000.

Unfortunately, there is no effective competition for our coal transportation to serve as a restraining influence upon railroad pricing policies. The mine at Jacobs Junction, Wyoming is located on the Burlington Northern railroad. The Rodemacher Power Station at Boyce, Louisiana is served only by the Missouri Pacific Railroad Company. CLECO was left, therefore, with no alternative other than to undertake to negotiate a reasonable unit train coal rate with those two carriers. These negotiations have been ongoing for some years but with no satisfactory resolution from our standpoint. We have no choice but to attribute this lack of success to the fact that a captive shipper has little actual bargaining power.

To demonstrate the depth of our efforts to negotiate a rate that would be fair to both BN-MOP and CLECO, we employed a transportation economist to develop the specific railroad costs of service for the described movement over the designated 1,657 mile route of movement. After a meeting with BN-MOP representatives in mid-October 1979, CLECO wrote to the railroads offering to resolve our differences upon the basis of a rate that would permit the carriers to recover their full costs of service plus a generous return. To date we have had no response from BN-MOP to this proposal.

Turning now with particularity to S. 1946 and the proposed amendment to that bill, CLECO supports the bill provided it is appropriately amended as proposed to protect captive coal shippers like CLECO against potential and, I think reasonably foreseeable, railroad monopoly pricing abuses. Such protection is absolutely essential because, as I earlier indicated, the absence of effective transportation competition precludes reliance upon the marketplace to provide pricing restraints.

Let me hasten to point out in all candor that CLECO's interest in the proposed legislation is not grounded upon a belief that the railroads have been the victims of

over-regulation. The 4-R Act of 1976 gave the railroads a substantial measure of pricing flexibility on competitive traffic. Rather, in recent years they have elected to focus upon captive coal traffic to improve their revenues. Moreover, we find under the existing pattern of regulation a significant disparity in the fortunes of individual railroads all under the same regulatory scheme.

Some railroads are, indeed, in a deficit posture. Others, however, like the Missouri Pacific which serves our Rodemacher Power Station and which has earned an average of 16 percent on stockholders' equity during the preceding three years, cannot fairly be characterized as "problem railroads." These variations in railroad earnings suggest to us that there is an untapped potential for improving railroad earnings through better service and more realistic cost-oriented pricing.

Notwithstanding, CLECO perceives a need for new legislation if only to remind the Interstate Commerce Commission to await the will of Congress before changing the existing law. In recent months we have noted some ominous actions by the ICC which are tantamount to de facto deregulation. Thus, the Commission has flouted its own rules regarding market dominance promulgated pursuant to the 4-R Act to disclaim maximum rate jurisdiction even where a utility has performed entered into a long-term coal supply contract to fuel a new coal-fired unit. We would urge this Committee to direct the ICC to enforce the present law and regulations until the Congress has acted.

In the latter regard I have read the Committee report accompanying S. 1946 and note with approval in the discussion of maximum rate regulation the admonition to the Commission to protect captive shippers, notably coal shippers, against excessive cross-subsidization of other railroad traffic in the guise of improving railroad revenues. This balancing of carrier and shipper interests is called for by the 4-R Act and should be preserved. The present ICC, however, seems to view it to be its sole responsibility to improve railroad earnings irrespective of the relative prosperity of the carriers involved and without regard to the interests of utility coal shippers and their electric ratepayers or the national energy policy.

S. 1946 without the proposed amendment in our view fails unfortunately to implement the admonition in the accompanying report to which I have just referred. Without some statutory restraints upon railroad pricing policies respecting captive traffic, recent experience demonstrates rail coal rates can well be made the panacea for improved railroad earnings. With the tempting target of captive coal traffic there would be no incentive upon a railroad to explore other avenues of revenue adequacy. Moreover, S. 1946 permits the same automatic non-cost related escalation to a rich as to a poor railroad.

As I stated earlier, CLECO wholeheartedly endorses the stated objectives of the proposed amendment in the remarks of the Chairman as reported in the Congressional Record of December 17, 1979. Consistent with these objectives we would suggest two substantive changes in the amendment, specifically authorization to the ICC, should it see fit in the contemplated rulemaking proceeding, to provide for different measures of presumptive unreasonableness at which time burden of justification would shift to the carrier for different commodities or types of service. Second, we suggest that consideration be given to empowering the ICC to suspend and/or investigate rates which exceed this threshold "trigger point."

In CLECO's judgment the proposed amendment provides a fair and proper balance between the national energy policy and the preservation of a viable rail transportation system under private ownership. This balance would not be altered by incorporation of the suggestions that I have made. In either event the railroads would be assured of a fair opportunity to justify any rate proposal. Captive coal shippers no less than the railroads would be guaranteed nothing more than a forum in which to present their views. We can perceive of no provision that is more fair to all concerned.

Mr. McCOLLAM. Mr. Chairman, next we will call on Mr. George Ketterer, manager-fuels transportation for Gulf States Utilities, which serves a major part of Louisiana.

Mr. KETTERER. Good morning, Senator.

My name is George Ketterer and I am director of fuel transportation for Gulf States Utilities Co., which is headquartered in Beaumont, Tex. GSU is engaged primarily in providing electricity to 477,000 customers in a 28,000-square-mile area of southeast Texas and south Louisiana. More than half of our customers are in Louisiana.

As a utility company required and committed to serve the public interest by keeping electric rates as low as possible, we strongly support your proposed amendment to the railroad deregulation bill.

As you know, electric utilities are turning to domestic coal as one way to reduce the Nation's reliance on foreign oil. GSU has contracted for a large amount of coal to be used in our new generating units near Lake Charles, La., beginning in the fall of 1981.

Our agreement with the Kerr-McGee Coal Co. provides us with 2.5 million tons of low sulfur western coal annually for 20 years. We hope to have 4 million tons a year under contract by 1985.

Obviously, this coal isn't coming from Louisiana. Its source is the Powder River Basin in Wyoming, and the only practical way to get it from there to Lake Charles is by rail.

This, of course, puts our company, like many other utilities, in a very vulnerable position. We must have the fuel to generate the electricity for the homeowners, the small businessmen and the large industries we serve.

That means we are a captive shipper with no transportation alternative but the railroads. A National Coal Association study shows 85 percent of the coal now being shipped by rail could not, as either a practical or economical matter, be transported any other way.

Utilities will use 71 percent of the coal produced this year, and by 1983 the figure should be closer to 74 percent. That will make utilities and their customers even more vulnerable.

Our customers are already angry and confused about fuel costs, and I cannot help but wonder what might happen when they discover the cost of transporting coal can easily be twice the cost of the coal itself.

Between 1969 and 1978, coal traffic rates increased 128 percent compared with a 113 percent increase for all rail traffic. In the last couple of years, additional substantial increases in coal rail rates have attracted wide publicity. In July of 1974, as GSU prepared for its first coal unit, we obtained a rail rate of \$8.94 per ton for our shipments from Wyoming to Lake Charles. Today's comparable rate would be about \$21 per ton—a 235 percent increase.

We support adequate and equitable rail rates that contribute to the financial well-being of the railroads, but we do not believe captive shippers should be charged unreasonably high rates to offset losses in other areas. Therefore, we welcome Senator Long's proposed amendment requiring the railroads to furnish the burden of proof when establishing the reasonableness of rates that exceed the prescribed level.

One of the most telling commentaries on the rail cost issue is the fact that foreign coal is now economically competitive with domestic coal. Although soaring rail transportation cost have caused a steady increase in coal imports, we do not—for obvious reasons—want to become too dependent on foreign coal.

Gulf States Utilities is obligated to provide our customers with the most affordable electric power possible. Only through proposals such as yours, Senator Long can we hope to fulfill that obligation.

Mr. McCOLLAM. Finally, Mr. Chairman, I would like to call on Mr. John Turk, vice president-superintendent, power production, for Southwestern Electric Power Co. in Shreveport.

Mr. TURK. Thank you, sir.

Mr. Chairman, members of the committee, I am John Turk, vice president and superintendent of power of Southwestern Electric Power Co. I wish to thank the committee for affording me this opportunity to testify on the Railroad Transportation Policy Act.

My dealings with the railroads over the past 8 years have convinced me that the railroads require continued regulation at least insofar as the transportation of coal in unit trains is concerned.

As superintendent of power for Southwestern Electric Power Co., I have been directly responsible for insuring a reliable supply of coal at the lowest possible price so that our coal-fired electric generating plants can operate at optimum levels. Providing coal for fuel to be used by Southwestern Electric Power Co. is a sizable undertaking. SWEPCO, whose principal offices are in Shreveport, La., serves a population of approximately 820,000 with customers totaling approximately 326,000 in 170 communities located in a 25,000-square-mile service area in northwest Louisiana, northeast Texas, and western Arkansas.

Southwestern Electric Power Co. has in operation two coal-fired generating units rated at 528 MW each, one of these units is located at Flint Creek, Ark., and the other at Cason, Tex. SWEPCO has two additional 528 MW coal-fired generating units under construction at the Cason, Tex., site. One of these units will be placed in operation in March of this year, and the other will be operational in March of 1982.

The coal for the two operating units and the two units under construction comes from the Belle Ayr and Eagle Butte Mines located near Gillette, Wyo., and owned by the AMAX Coal Co. Transportation of coal to the generating units is by the Burlington Northern, Inc., the Kansas City Southern Railway Co., and the Louisiana and Arkansas Railway Co. The coal movement to the generating plants is handled by unit trains which handle coal exclusively. At the present time, ten 110-car unit trains are transporting the coal to the two operating plants and the unit scheduled for operation early this year, and in 1982 another four 110-car unit trains will be placed into operation to transport coal to the fourth generating unit which will then be in operation. Southwestern Electric Power Co. furnishes the railroad cars for this movement and has constructed and operates its own railroad car repair and maintenance facility which is located in Alliance, Nebr.

SWEPCO is now a captive shipper in the movement of Wyoming coal to its powerplants. Burlington Northern, Inc. is the only railway servicing the AMAX mines in Wyoming. BN has clear market dominance in this area. The railroads have clearly abused this dominant position by renigging on their prior contractual commitments to SWEPCO. This contract was a vital factor in SWEPCO's decision to commit to its present 25-year coal contract with the AMAX Coal Co. for Wyoming coal, to spend several million dollars on the railroad repair and maintenance facility at Alliance, Nebr., and to commit itself to place into operation four 528 MW generating units to burn this coal.

Wyoming coal was not the only fuel source examined by SWEPCO prior to entering its long-term contract with AMAX. SWEPCO in the early 1970's was seriously considering coal from

New Mexico and negotiating with the Santa Fe Railroad for transportation of that coal. Negotiation with the BN, KCS, and L & A, commenced in 1972 and in April of 1972, the railroads submitted SWEPCO a price and an escalation formula for transporting the coal to each of two powerplant locations. This proposal was accepted by SWEPCO in April of 1972 and resulted in a contract entered into effective September 20, 1974, at rates which were quoted in 1972.

Once SWEPCO accepted the proposal from the railroads, and then signed its 25-year contract with the AMAX Coal Co., it was clearly committed to coal movement from Wyoming and was a captive shipper of the railroads. Since 1974, the railroads have indeed attempted to press their advantageous position to the full. SWEPCO is presently fighting to uphold its 1974 contract in the U.S. Court of Appeals for the District of Columbia Circuit, and in the U.S. Court of Appeals for the Fifth Circuit.

The D.C. circuit case involves the activities of the railroads in attempting to charge higher than contract rates for freight movement to Flint Creek the generating plant located in northwest Arkansas. The railroads, prior to the time of scheduled initial shipments to the Flint Creek powerplant, contacted SWEPCO in an attempt to get an agreement by SWEPCO to allow the railroads to publish a higher rate than called for in the contract. The railroads offered to let SWEPCO skip several escalation periods called for in the contract until the differential in the rate between the higher rate and the contract rate was recouped, and offered to let SWEPCO recoup an additional \$100,000, and offered to let SWEPCO have a reduced fare of \$1 per ton on coal hauled to Flint Creek in railroad-owned cars, for the purpose of reducing the time necessary to achieve the recoupment of the differential.

The railroads made this offer to SWEPCO involving a higher rate than allowed by the contract in order to eliminate potential problems in relation to other rate negotiations in progress and to eliminate a potential problem of being in violation of the fourth section of the Interstate Commerce Act. SWEPCO refused this offer and requested the railroads to apply for a fourth section exception and publish a tariff with the contract rate. The railroads did apply for a fourth section exception at the rate in accordance with the contract and it was granted by the Interstate Commerce Commission—still the railroads would not publish the tariff in accordance with the contract. SWEPCO refused the offer of the railroads and authorized shipments to the Flint Creek plant located in northwestern Arkansas at an intermediate point of delivery to the Welsh plant at Cason, Tex., at the same rate as the Welsh powerplant, but under protest. SWEPCO moved for suspension and investigation of that rate before the Interstate Commerce Commission which, in its opinion, deplored the tactics of the railroads in disregarding their contract as "bait and switch tactics," and found the rate published by the railroads to be unreasonable, but allowed higher rates than that called for by the contract. SWEPCO appealed this decision and this litigation is presently on appeal in the D.C. circuit.

In July of last year, the railroads published a tariff some 30 percent higher than that agreed for in the contract of 1974 for

movement of coal to the Welsh plant at Cason, Tex. SWEPCO successfully obtained an injunction in the U.S. District Court for the Eastern District of Texas preventing the railroads from putting the excessive tariff into effect. The railroads have appealed the grant of this preliminary injunction and the case is now pending in the U.S. Court of Appeals for the Fifth Circuit.

The railroads have demonstrated a flagrant disregard for their prior contractual commitments which caused SWEPCO to enter a long-term contract for coal from Wyoming and to spend considerable sums of money on a car maintenance facility in Nebraska and coal generating plants in Texas and Arkansas. SWEPCO is clearly a captive shipper of Burlington Northern, Inc., the only rail line serving the AMAX mines in Wyoming, passing the car repair facility at Alliance, Nebr., and serving the generating plants. The railroads, in situations such as this where the utilities are captive shippers, exercise such absolute power over the shippers, that regulations of the rates for these shipments are essential to prevent abuse.

It is our belief that your proposed amendment to section 104 could protect us against unjust rail transportation rates. It is also our feeling that the Interstate Commerce Commission should specifically state to the Congress for its approval how the Commission would calculate the variable cost, and if this calculation is done in a manner resulting in approval by the Congress, then the ratio of revenue-to-variable cost should not exceed 150 percent. It is also our feeling that once the method of calculation of variable cost and ratio of revenue-to-variable cost have been set the Commission should not increase the rail rate for transportation of coal by increasing the cost by an arbitrary percentage such as the 7-percent additive which has recently been used by the Commission.

In addition to my testimony today, I am submitting a more lengthy written statement of the reasons why we feel regulation of the carriers is needed to prevent abuses of the captive coal shippers.

[The statement follows:]

STATEMENT OF JOHN W. TURK, JR., VICE PRESIDENT AND SUPERINTENDENT OF POWER, SOUTHWESTERN ELECTRIC POWER CO.

My name is John W. Turk, Jr., and I am Vice President and Superintendent of Power of Southwestern Electric Power Company, whose principal offices are in Shreveport, Louisiana, at 428 Travis Street.

Southwestern Electric Power Company serves a population of approximately 820,000 with customers totaling approximately 326,000 in 170 communities located in a 25,000 square mile service area in northwest Louisiana, northeast Texas, and western Arkansas.

Southwestern Electric Power Company has in operation two coal-fired generating units rated at 528 MW each, and has two additional 528 MW coal-fired generating units under construction. One of these which is under construction will be placed into operation in March of this year, and the other will be placed into operation in March of 1982.

The coal for the two operating units and the two units under construction is from the Belle Ayr and Eagle Butte Mines of AMAX Coal Company located in Gillette, Wyoming. Transportation of coal to the generating units is by the Burlington Northern, Inc., and the Kansas City Southern Railway Company, and Louisiana and Arkansas Railway Company. At the present time, ten 110-car unit trains are transporting the coal, and in 1982 another four 110-car unit trains will be placed into operation to transport the coal to the fourth generating unit. Southwestern Electric Power Company furnishes the railroad cars and has constructed and operates a

railroad car repair facility located at Alliance, Nebraska, for the purpose of maintaining these railroad cars.

Negotiations with the railroads mentioned above commenced in 1972 after negotiations had been underway for some time with the Santa Fe Railroad for transportation of coal which would have been mined in New Mexico. A comparison of the cost of coal, transportation rates, quality of coal and reserves led us to reach an agreement with Burlington Northern, Inc. and Kansas City Southern Railway Company which resulted in a contract for transportation of coal and led us to make an agreement with AMAX Coal Co. This contract with the railroads was signed by all parties effective September 20, 1974. Events since that time have led us to requests for suspension and investigation before the Interstate Commerce Commission and to litigation in the United States District Court for the Eastern District of Texas, the United States Court of Appeals for the Fifth Circuit, and the United States Court of Appeals for the District of Columbia Circuit in an attempt to see that the railroads abide by the contract which they entered regarding freight rates for the transportation of coal in unit trains to our Flint Creek generating plant located near Siloam Springs, Arkansas, and to our Welsh generating plant located near Cason, Texas.

The manner in which the railroads have dealt with Southwestern Electric Power Company (SWEPCO) regarding these freight rates, and the eventual breach by the railroads of their contract with SWEPCO clearly demonstrate the need for continued regulation of the railroads, especially in the area of the transportation of coal in unit trains. It is our belief that Senator Long's proposed amendment to Section 104 could protect us against unjust rail transportation rates. It is also our feeling that the Interstate Commerce Commission should specifically state to the Congress for its approval how the Commission would calculate the variable cost, and if this calculation is done in a manner resulting in approval by the Congress, then the ratio of revenue-to-variable cost should not exceed 150 percent. It is also our feeling that once the method of calculation of variable cost and ratio of revenue-to-variable cost have been set the Commission should not increase the rail rate for transportation of coal by increasing the cost by an arbitrary percentage such as the 7 percent additive which has recently been used by the Commission.

A history of the manner in which SWEPCO became a captive shipper of the railroads and the actions of the railroads leading to the eventual attempted breaches of their contract dramatically illustrate the need for continued regulation.

I. SWEPCO'S DECISION TO USE COAL AS A FUEL

Southwestern Electric Power Company had historically used natural gas as a primary boiler fuel up through the early 1970's. We did learn, however, in late 1968 that an impending gas shortage was a reality. We were warned of this by a longtime supplier who declined to make a proposal to us for supplying gas to our Wilkes Unit 3 which was then commencing construction and was scheduled to be placed in operation in early 1972. The Wilkes Unit 3 is a 350 MW gas-fired unit located between Jefferson and Avinger, Texas. Although we were able to obtain gas for this unit, we quickly determined that another fuel would need to be found for a proposed unit to begin operation in 1977, rated at 530 megawatts, to be located near Cason, Texas. This Power Plant was later designated as Welsh Power Plant. It was decided that coal was the correct fuel. Subsequently, plans for a similar 530 megawatt coal-fired unit, located at Flint Creek in northwest Arkansas, were drawn up. This latter plant has been in operation since April, 1978. Two other units at Welsh of equal capacity are planned for operation in 1980 and 1982.

Between April, 1971 and June, 1972, we negotiated with various coal suppliers with reserves in New Mexico concerning a long-term supply contract for the Welsh operation. There suppliers were Pittsburgh and Midway Coal Co. and Arch Mineral Company. Negotiations were also underway during this period with the Santa Fe Railway concerning transportation of the coal. In the early spring of 1972, we were approached by AMAX Coal Company which indicated it would like to talk to us about supplying our coal. Negotiations were commenced with AMAX, and at the same time negotiations commenced with Burlington Northern and the Kansas City Southern Railway for transportation of the coal from AMAX's mine located near Gillette, Wyoming, to our Welsh Plant and to the proposed Flint Creek Plant.

It became apparent that the Amax Coal Company and the Burlington Northern and the Kansas City Southern railroads has several advantages over coal from the southwest. AMAX's reserves were completely adequate for four 530 megawatt units (three at Welsh and one at Flint Creek), quality was uniform, sulphur content was low. Also the coal for both plants would be delivered by the same carriers over a common route as far as Flint Creek. The crucial factor now became the delivered cost which involved both the price of the coal and the railroad rate.

II. RATE NEGOTIATIONS AND AGREEMENT WITH BN AND KCS

On April 20, 1973, the Burlington Northern and Kansas City Southern Railways read me a telegram which they had sent quoting a price for shipment of coal to each of the two power plants. On April 22, I received the telegram. The price of the freight to our Welsh Plant located in northeast Texas was to be \$6.12 per ton shipped in our cars and the rate to the Flint Creek Plant located in Northwest Arkansas was to be \$4.62 per ton shipped in our cars. The railroads also quoted prices for shipment in their cars. These rates were to be subject to annual escalation.

With this information, we evaluated the cost of coal from New Mexico with that from AMAX's Belle Ayr mine. Although the freight charges from Wyoming were greater, the cost of the coal at the mine in Wyoming was less than at the mine in New Mexico. This resulted in a delivered cost of coal at Welsh from New Mexico of 50.7 cents per million BTU's, compared with a delivered cost from Wyoming at 48.0 cents per million BTU's (both in shipper-supplied cars). Because of the advantages of coal from the Belle Ayr mine, we elected to sign a 25 year contract with AMAX for a total of 175 million tons of coal. We immediately informed the railroads of this decision, and on May 30, 1972, I received a letter from a representative of the railroads indicating his pleasure at the news. The originally proposed \$4.62 Flint Creek rate was by agreement reduced to \$4.57 in our cars.

The rate and type of service which we were to receive from the railroads was a key factor in our decision to utilize Wyoming Coal. Our initial decision to purchase coal from AMAX based on our understanding of what this rail rate would be was only the beginning of many months of negotiations with the Burlington Northern and Kansas City Southern concerning the specific operations and tariff conditions for the coal transportation.

After the decision to purchase Wyoming coal in May of 1972, we immediately asked the BN and the KCS railroads to enter into discussions to finalize the working of a Letter of Understanding. The basic rate level had been agreed to. A number of meetings were held. The original draft of the Letter of Understanding had contained an escalator clause to compensate the carriers for changes in the cost of transporting SWEPCO's coal. The original offer contained an adjustment which would measure and compensate for increases in productivity. On May 6, 1974, I received a letter from the Burlington Northern requesting that this productivity adjustment be deleted from the escalator clause. The BN claimed that because of changes in the carriers mix, inclusion of a productivity adjustment in this clause before actual operations began would constantly erode the carrier's profit margin, and make it impossible for them to meet SWEPCO's future coal transportation requirements. Since the Letter of Understanding had not yet been finalized and because I felt that there might be some merit to this request, I agreed to this deletion.

III. ADDITIONAL NEGOTIATIONS CONCERNING CAR MAINTENANCE

On July 25, 1974, we received a letter from the Burlington Northern concerning maintenance procedures for coal cars. The Burlington Northern was suggesting that they set up a centralized maintenance facility designed to handle an entire unit train at one time. In other words, the unit train would be brought into the facility, each car would be checked and repaired as needed, and the train would leave as a unit in good shape. Burlington Northern asked if we were interested. I responded favorably to the plan. Later, Burlington Northern informed us that they had given up the idea of constructing a centralized coal car maintenance facility and they suggested we look for other means of maintenance for our cars. We had previously told them we planned to furnish our cars, a decision made so that we might have better control over the cars transporting our coal. We felt this provided us with added assurance of reliability. The Burlington Northern appeared to be pleased with this arrangement. One must realize that the price of cars had increased from about \$20,000 per car at the time we accepted their rate offer to approximately \$30,000 per car by the time our initial cars were received.

Because the Burlington Northern was not going to provide a centralized maintenance facility, we discussed maintenance with several railroad car repair shops and ultimately decided to construct our own maintenance facility at Alliance, Nebraska. This was done with the cooperation of the Burlington Northern, which located the land. In our final agreement with the carriers, it was stipulated that the necessary cars plus a 10 percent spare car float would be provided by SWEPCO. The regular, preventative maintenance provided at the Alliance facility and use of the spare car float results in almost continuous unit train service with a minimum of down time for unexpected repairs.

IV. COURSE OF NEGOTIATIONS OF LETTER OF UNDERSTANDING

It took approximately two years from the time SWEPCO made its initial decision to purchase Wyoming coal until the final Letter of Understanding, on which the tariff charges were based, was signed effective September 20, 1974. The negotiations with the railroads were lengthy and businesslike. We agreed, I believe, to a significant concession to the carriers in the form of deletion of the productivity adjustment. Tariff charges under the escalation clause had risen sharply during the negotiations, and we felt that these increases would provide the railroads with highly profitable revenue levels. From that time until January, 1978, the carriers have never indicated that they were dissatisfied with the base rates or that the rates were non-compensatory.

The resulting rates as agreed upon in the Letter of Understanding are the rates that were necessary for us to enter into the long-term coal supply commitment with AMAX Coal Company. These are rates which enabled us to make large capital commitments for the generating units and coal cars for the unit trains. The investment cost as of December 31, 1979, for Welsh Unit 1 was \$129.5 million, and for Flint Creek was \$147.8 million, and it is anticipated that the investment cost of Welsh Unit 2 will be \$132.9 million and for Welsh Unit 3 \$158.0 million. These costs do not include the costs of 1694 high-side gondola cars for all four units and the cost of the car maintenance facility—approximately \$71 million. It was a rate which was the highest we would have agreed to; in fact, we did negotiate a 5¢ per ton decrease in the rate to Flint Creek in our cars (from \$4.62 to \$4.57 per ton).

V. LETTER OF UNDERSTANDING

The Letter of Understanding was received from the Burlington Northern and Kansas City Southern Railroads in September of 1974, and was acknowledged and accepted by our company on September 20 of 1974, with the attached Tariff and escalation clause. The Tariff indicated a rate in our cars to the Welsh Plant in Northeast Texas of \$6.12 per ton and \$4.57 to Flint Creek. The Letter of Understanding is attached to this statement as Exhibit — (JWT-1).

This Letter of Understanding and Tariff covers the shipment of coal for twenty-five years for each of the three units at Welsh Plant and the single unit at the Flint Creek Plant. The rates, terms, and conditions stated in the Tariff are not subject to modification or adjustment, except as provided in Appendix "B" or by mutual agreement. Appendix "B" is the escalation agreement.¹

VI. FIRST ATTEMPT BY RAILROADS TO DEVIATE FROM THE LETTER OF UNDERSTANDING

In the fall of 1976, shortly before shipments to Welsh Power Plant were to commence, the Burlington Northern representatives met with me and said that to publish the freight rate to Welsh which would be in effect at that time in accordance with our Letter of understanding would work a hardship on them because of pending litigation in the San Antonio matter.² The rate for coal shipment to the Welsh Plant in our cars in accordance with our Letter of Understanding would have been \$9.85 per ton at that time. The Burlington Northern suggested that we increase this rate to something over \$10.00 per ton and to pass by the next escalation periods without applying escalation until we had recovered the differential between what it would have cost us under the terms of the Letter of Understanding and under their proposed trade-off. We had a meeting on this is the KCS offices in Kansas City, Missouri, so that I would be sure I understood what they were talking about. We told the Burlington Northern that we could not accept their proposal, that we had a Letter of Understanding, and that we wanted them to live up to the terms of this Letter of Understanding. They expressed disappointment but did publish the Welsh rate under the terms of the Letter of Understanding. The Welsh rate became effective on November 8, 1976, in Burlington Northern Freight Tariff 260, I.C.C. No. 419.

The escalation clause had resulted in a price increase for transportation of the coal of over 80 percent in only four years. On July 1, 1978, the tariff to Welsh was increased without any objection from us under the terms of the Letter of Understanding. At this time the Welsh rate has escalated to \$11.35 per ton.

¹ The attachments referred to in this statement have been retained in the committee files.

² Apparently a reference to Docket No. 36180, *City of San Antonio v. Burlington Northern Inc.*, et al.

VII. SECOND ATTEMPT BY RAILROADS TO DEVIATE FROM THE LETTER OF UNDERSTANDING

Under the Letter of Understanding at the time the move was scheduled to begin to Flint Creek (November 1, 1977), the rate was \$8.06 per ton. This would have reflected \$4.57 rate originally agreed to in 1974 escalated in accordance with the Letter of Understanding.

We asked the railroads to proceed with the preparation of the tariff for Flint Creek. Because there was a shorter haul over the same route to another plant at Amsterdam, Missouri, than to Flint Creek, and because the rate to Amsterdam, Missouri, was higher than that which would be in effect at Flint Creek if published in accordance with our Letter of Understanding, the railroads indicated that this might cause problems in relation to other rates and they would be in violation of the Fourth Section of the Interstate Commerce Act if "Fourth Section Relief" was not obtained. Therefore, they asked me to increase the rate to Flint Creek to \$8.56 per ton and again to pass by the escalation periods until we had recovered the differential in the rate of \$8.56 per ton to \$8.06 per ton. I again told them that we could not agree to such a solution. In the back of my mind these "trade-offs" were somewhat like playing games, I didn't think they were ethical.

VIII. ATTEMPT TO SOLVE "FOURTH SECTION" PROBLEM

In an effort to solve this "Fourth Section" problem, I told the railroads that I would like for all of the coal shipments to our plants to be folded into one tariff, and this would include Welsh Units 2 and 3. This would have been in accordance with our Letter of Understanding. This would result in a Tariff with considerably more tonnage than that to Amsterdam, Missouri. Additionally, the proposed tariff contained a "Disability Rule," a form of force majeure clause. I agreed that the "Disability Rule" could include a thirty day period of disability before we would invoke the provision. I did not believe that any other Tariff contained this provision. I felt that this would help to make it different from the Amsterdam tariff and would probably allow "Fourth Section Relief." Thus, at the conclusion of a meeting on October 28, 1977, in the offices of the KCS, I believed that all outstanding issues were resolved.

IX. RAILROADS' PROPOSAL TO SOLVE "FOURTH SECTION PROBLEM"

On November 8, 1977, an officer of the Burlington Northern visited with me in Shreveport. The officer indicated that the Burlington Northern would not publish this rate of \$8.06 per ton to Flint Creek because of their litigation not only with San Antonio but with Houston and possibly with Middle South Utilities. He again asked me to agree to the publication of the Tariff at \$8.56 per ton. He also said the escalation would not be exercised until we had recovered all of the money differential between the \$8.56 per ton and the \$8.06 per ton rates, plus \$100,000 by passing through future escalation periods without an increase in rate until the recoveries were achieved.

The officer then said that he wasn't making a threat, but if I did not give him an affirmative answer he would claim gross inequities in the escalation clause, and would raise the rates to both Welsh and Flint Creek Plants. I immediately told him I would fight him on every piece of ground I could find.

Shortly after the officer left he called me from the airport and said he had remembered that we had ordered an extra 180 thousand tons of coal in 1978 for Welsh Plant and an extra 180 thousand tons of coal in 1978 for Flint Creek to be delivered in railroad-owned cars. He said that if we published the \$8.56 per ton figure he would drop \$1.00 per ton off the carrier-owned car rates to Welsh and Flint Creek for these shipments and would hold the escalation at Flint Creek until we had recovered all our differential in money and the \$100,000. This \$1.00 per ton drop would result in \$1.00 less than would have been provided under the terms of our Letter of Understanding. At no time did the officer indicate that he was dissatisfied with the base rate in the tariff; he simply did not want anyone to know what SWEPCO was paying for its transportation services. Later, I received a letter from the officer dated November 11, 1977, which set out the trade-off. However, in this letter there was no mention of the \$100,000 increment.

After several prior attempts, I contacted the officer on November 15, 1977, and told him that we would not agree to this arrangement.

I received a letter dated November 14, 1977, from the officer in which he indicated that it was irresponsible for me to allow the I.C.C. to rule on the request for Fourth Section relief rather than resolve the matter by negotiation. However, the officer did agree to file the tariff to Flint Creek at \$8.06 per ton and to ask for Fourth Section relief.

Some time later, the Burlington Northern submitted Fourth Section Application No. 43468, with a copy of the proposed tariff at the \$.06 level. However, I was very disturbed by the BN request. On its face, the Burlington Northern petition appeared to be a request for relief; but the petition itself in my judgment discouraged the granting of relief and tried to come to the conclusion that the law did not allow Fourth Section relief, and if relief was not granted, the carrier would have to raise the rate to Flint Creek. At this point, SWEPCO submitted a statement in support of the request for Fourth Section relief.

On December 22, 1977, the I.C.C. issued Fourth Section Order 20538 which provided this relief. I felt that this would end the matter and that the Tariff would be published. But when we pressed the Burlington Northern for publication of the Flint Creek Tariff, they told us they were not going to publish it.

X. MEETING WITH RAILROADS IN AN ATTEMPT TO GET CONTRACT RATE PUBLISHED

On January 12, 1978, I met with senior officials of the BN and KCS concerning the Flint Creek freight rate. It was a lengthy meeting, during which I reviewed the nearly six years of history of the negotiations and discussions between SWEPCO and the carriers concerning coal to our Welsh and Flint Creek plants. I concluded by asking the Burlington Northern to accept their corporate responsibility and publish the agreed upon tariff.

BN officials responded that the escalation clause with regards to the productivity index had to be changed because it would not have reflected the productivity index of the unit coal train shipments as it was formulated. I told him we had no argument over that; that this change was made before the Letter of Understanding was finalized, and that we had agreed to it.

BN officials than said that they had originally planned to build a railroad car repair shop, but later they determined that the cost would be excessive and they decided it was not to their advantage to build a shop. I told him that we had no quarrel over this, that this was a management decision within their company, and that after we learned of it, we took action to build a shop in order to provide reliability for our cars and to make this Agreement between our companies work to the advantage of both of us.

BN officials then said that they felt the escalation clause as it now was would protect the rate from escalation, but after our Tariff and Letter of Understanding was executed, they had determined that their base rates were too low and that they must be increased. This was the *first* time that anyone from the Burlington Northern had indicated to us that our Welsh and Flint Creek base rates were too low. At all other times the carrier had proposed a "trade-off" in rates. I asked the BN to tell me specifically what they planned to do about the Flint Creek tariff so that I could determine what my own actions were to be.

The BN asked me to give serious thought to a proposal under which over a period of time our base rates to Welsh Plant and Flint Creek could be increased. They specifically told me that they were losing money on the freight traffic to Welsh Point and that the rates were non-compensatory.

I did not believe this statement to be correct. These rates were the result of long, hard bargaining. They were based on figures which the carriers themselves supplied. They were finalized upon in the Letter of Understanding after we made significant concessions to the carriers.

The BN then indicated that the communications between the two companies had not been good enough, that perhaps they should have come to us about these rates earlier, but he felt our answer would be in the negative. I told the BN that our operating communications are good and that their officials had been to see me in 1976 about this rate to Welsh Plant and had proposed the "trade-off." I told him that I turned it down but not because of the San Antonio litigation. I told him we had never become involved in this litigation because we had an Agreement with the railroads and we expect it to be followed.

I finally asked the BN again to tell me what the Burlington Northern was going to do about the Flint Creek tariff.

The BN said that they were not going to publish a Tariff. They said that we could take deliveries to Flint Creek as an intermediate point at the same rate as deliveries to Welsh Plant, that is, \$10.65 per ton at that time. I agreed with them that this was possible but not acceptable. They said that if we did go to the I.C.C., the Burlington Northern would propose a rate to Flint Creek that would be above \$10.65 per ton. They again requested that we reconsider and agree to some type of proposal for increasing our base rate over a period of years.

I told the carriers that I would tell them in approximately two weeks what we plan to do.

They indicated they could not do anything about the Welsh tariff at this time because Kansas City Southern refused to agree to any changes proposed by Burlington Northern. I told the BN that the Kansas City Southern had told me that they were not agreeing to the Burlington Northern proposal because they believe they ought to do what they said they were going to do. That is all that I wanted from the Burlington Northern.

I next called the BN and told them that we would agree only to the provisions in the Letter of Understanding. The BN refused to establish the agreed rate at Flint Creek. Indeed, they had aggravated the matter by applying on July 1 the same escalation on the rate to Flint Creek as applied to the rate at Welsh. Shipments were commenced to Flint Creek in February, 1978, as an intermediate point of delivery to the Welsh Plant and at the same rate per ton (\$11.35 per ton). This rate was paid under protest by SWEPCO and a complaint was filed with the I.C.C.

In its decision served May 25, 1979, the I.C.C. ruled that the \$11.35 rate to Flint Creek was not reasonable, but permitted the railroads to publish a rate not exceeding a maximum reasonable rate for the future of \$10.24 per ton, far above the agreed-upon level of \$8.67, as escalated pursuant to the Letter of Understanding.

XI. EFFORTS BY RAILROADS TO INCREASE THE WELSH RATE

Pursuant to the Letter of Understanding, the railroads published the agreed-upon tariff for the transportation of coal effective November 8, 1976, in Burlington Northern Freight Tariff 260, I.C.C. No. 419 (subsequently renumbered I.C.C. BN 4175).

Pursuant to the agreed-upon escalation formula, the railroads increased the rate on July 1, 1977 to \$10.65; on July 1, 1978 to \$11.35; and on July 1, 1979 to \$12.12 per ton—all in accordance with the Letter of Understanding.

Pursuant to the "gross inequities" clause contained in the Letter of Understanding, during mid-1979, the railroads and SWEPCO began negotiations seeking to adjust the tariff called for by the rate schedule contained in the Letter of Understanding. SWEPCO began negotiations seeking to adjust the tariff called for by the rate schedule contained in the Letter of Understanding. SWEPCO, pursuant to the "gross inequities" clause indicated that it would accept an increase in the tariff of \$1.39 per ton above the \$12.12 rate called for by the rate agreement. Thus, SWEPCO offered to accept the rate of \$13.51, effective July 1, 1979. However, the carriers flatly rejected SWEPCO's offer of \$13.51 made during negotiations under the gross inequities clause.

At this point, the carriers published the tariff which proposed to increase the rate to \$15.86, an increase of over 30 percent above the agreed-upon level of \$12.12, and \$2.35 per ton above the level SWEPCO had indicated it would accept under the gross inequities clause. based on SWEPCO's anticipated 1979 tonnage, this \$2.35 breach would cost SWEPCO an additional \$4.4 million per year.

The United States District Court for the Eastern District of Texas enjoined the railroads from putting into effect the \$15.86 per ton rate to Welsh which was in violation of the contract previously entered by the railroads. The railroads have appealed the grant of this preliminary injunction to the United States Court of Appeals for the Fifth Circuit where such case is presently pending as Civil Action No. 79-3049.

XII. CONCLUSION

Southwestern Electric Power Company strongly urges this Committee to continue the regulation of the railroads at least insofar as the movement of coal by unit trains is concerned. The history of SWEPCO's dealings with the railroads related above is one involving what the I.C.C. itself has termed as "bait and switch tactics." The railroads have negotiated a contractual Letter of Understanding regarding freight rates with SWEPCO and SWEPCO has entered a long-term contract for coal from Wyoming, and spent considerable sums of money on a car maintenance facility in Nebraska and coal generating plants in Texas and Arkansas. SWEPCO is clearly a captive shipper of Burlington Northern Inc., the only rail line serving the AMAX mines in Wyoming.

At the time SWEPCO negotiated its contract with Burlington Northern Inc., Kansas City Southern Railway Company, and Louisiana and Arkansas Railway Company, SWEPCO could have contracted with the Santa Fe railroad to haul coal from New Mexico. The BN, KCS, and L&A have breached their contracts with SWEPCO after SWEPCO had relied to its detriment on the representations made by the railroads in that contract.

Senator LONG. Thank you very much. Let me direct this question to Mr. McCollam, and you might want to ask somebody else to comment.

First let me say, Mr. McCollam, from my point of view you are a local boy who made good, you are a Louisiana citizen, and for a while you managed New Orleans Public Service in New Orleans, did you not? You were president of that company for a while?

Mr. McCOLLAM. That is correct, Mr. Chairman.

Senator LONG. Since that time you have been selected to be president of Edison Electric Institute. So, in effect you are here speaking for the entire investor-owned electric utility industry of America, are you not?

Mr. McCOLLAM. That is correct, Mr. Chairman.

Senator LONG. Tell us about this \$10 billion of unjustified freight rates. As I understand it, speaking for the investor-owned utilities, you would be the first to say that the railroads are entitled to have whatever they can justify. You just complain on behalf of the consumers of America about having to pay something that cannot be justified.

Could you give us some idea of what that means just to an average family? You have had experience in running an investor-owned company in New Orleans. What does that mean for an average family, this \$10 billion you mentioned?

Mr. McCOLLAM. Mr. Chairman, I don't have specific figures that would translate that into national averages. Perhaps the most meaningful way to respond to that question would be to ask the utilities here in Louisiana to indicate the manner in which these costs would be borne by their customers. Transportation costs are such a large component of fuel costs when you are dealing with coal. I believe Mr. Autrey indicated that in the Middle South system about two-thirds of those costs are transportation costs, so they are going to have a very severe impact on the consumers if we have these unconscionable increases in costs.

I would like to ask Mr. Autrey first, for the Middle South system, to respond, and perhaps then he might want to call on Mr. Prendergast, who is the president of Middle South's fuel subsidiary, to give some indication of the order of magnitude of those costs as they affect the consumers in Louisiana.

Senator LONG. I would like to get an idea, just for an average family, about what that is likely to mean. That is, the difference between what you think would be a fair rate, one that is justified, that you wouldn't complain about paying—after all, you know what a fair return is. You are entitled to make a fair return and so are they.

Would you give us some idea about what you think the difference would be?

Mr. AUTREY. Senator, you have heard from me. I would suggest the president of System Fuels, Mr. John Prendergast, be given the opportunity to give you that figure.

John.

Mr. PRENDERGAST. Senator, I have not reduced the number to a cost per customer per month in that fashion.

Senator LONG. It seems to me we ought to get it down to what it costs the average homeowner.

Mr. McCOLLAM. Senator, let me say if we are not able to respond specifically to your question in exactly the way you would like, it would be a simple matter for us to make those computations and to provide that information for introduction into the record. To whatever extent we can't respond specifically this morning, we will furnish that information for the record.

Senator LONG. I think that is what the average man wants to know, what does it mean to him.

Mr. PRENDERGAST. Senator, half of the cost of the power that comes on the busbar is fuel. One-half of the cost as it comes out of the powerplant is fuel. On our system you are looking at two-thirds of that fuel cost being for transportation. So you are looking at two-thirds of a half, if you will, is represented in transportation.

Senator LONG. That means about 40 percent of the cost is going to be transportation?

Mr. PRENDERGAST. Yes, sir. That is after it goes through the powerplant.

Senator, there were some comments made about a disparity between the numbers you hear from us and the numbers you heard earlier from the railroad witnesses. We are looking at a 175-percent increase in about a 7-year period in our rates. One of the gentlemen was experiencing in excess of 200. I suggest this divergence between the high rates you have been hearing from us and some of the earlier numbers you heard in the same time frame from the railroad is we are not comparing apples with apples. I think the rail rates that were being used were probably single-car rates, when coal was moving in that fashion. And now you see unit train rates, where the capital investment is being made by the utility companies. So we are not comparing the same animal, that is what we are talking about.

There was some lament about the low rates of return of the railroads. I would suggest that you examine not the railroad industry as one big entity, which it is not, it is a group of separate companies, with vastly differing levels of profitability. I think that you will find that particularly the railroads that are coming in and serving some of the plants in Louisiana, the Missouri Pacific in particular, is one, if not the most profitable railroad in America today.

We talk about these low rates of return. I think some of the things that contribute to this calculation have to be brought out. I am not an accountant, I am an engineer. But as I understand it, the railroads engage in a practice called betterment accounting which brings down to operating cost numbers that would be spread out in any other type of corporate situation over a longer time frame. It tends to inflate the present operating costs.

I suggest that also that these low rates of return are a result of some badly inflated rate bases. I would reference a case in which the Chicago and Northwestern a few years past sold the railroad operations, the transportation operations to the employees. Before the Securities and Exchange Commission would allow that transaction to take place, if my memory serves me correctly, some \$400 million was dewatered from the rate base as representing things that were no longer used or useful in rendering service.

You made a very good point earlier when you raised the question about the productivity and the incentive to improve productivity. I suggest that as long as you have the utilities sitting with the apple in their mouth, that you are not going to have any real incentive for meaningful improvements in some of these working rules. The question comes about noncompensatory traffic. You asked a question there, what was being done to take that situation in hand. We appeared about a year ago before the Interstate Commerce Commission, before an administrative law judge there, and in the discovery process we asked the Burlington Northern specifically for what studies they had made of the cost of rendering service on some of these commodities. We got the astounding answer, (a) They did not have any, and (b) if they had any, they would be badly out of date. And the last answer was that they didn't see where these answers were relevant to the situation. In other words, we were being asked to subsidize somebody else's movement and they couldn't see where it was relevant that we find out who was being subsidized and to what extent.

Mr. McCOLLAM. Senator Long, that hasn't been specifically responsive to your question, but I think Mr. Prendergast's testimony gives you some idea of the extreme problems we have had in dealing with the railroads on these matters.

I believe some of the other gentlemen have some figures that will be more responsive to your question.

Mr. AUTREY. Senator, we estimate it takes 5 million tons of coal a year to run two coal-fired units. We are going to have in Louisiana on the Middle South system about four coal units by 1985. So we are talking about 20 million tons a year, and you are talking about \$400 million transportation cost to move coal for those units into Louisiana in the late 1980's. If you take the rail rates with a captive shipper, you are talking about \$40 million to the consumers of Louisiana.

Senator LONG. \$40 million a year?

Mr. AUTREY. \$40 million a year. And that is today's rates. It has escalated of course even more so.

Mr. McCOLLAM. I believe Mr. Moore of CLECO has some figures for their system.

Mr. MOORE. All I know, Senator, is the difference between what our economist says is a fair return plus a generous profit and what the railroad wants to charge us is \$3.5 million a year for a small system like ours.

Mr. McCOLLAM. Mr. Turk from Southwestern Electric Power has some figures.

Mr. TURK. Mr. Chairman, we have had the Welsh unit 1 in service since 1977. The contract rate is \$12.12 per ton. That is the rate in effect because of the injunction handed down by the court. This unit uses 1,750,000 tons per year. At \$12.12 per ton, that is \$63,630,000. The railroads filed a tariff for \$15.86 per ton. This calculation is for three units. That rate would be \$83,265,000 a year, or, after all three units are in operation in 1982, based on the present \$12.12 contract cost and the \$15.86 the railroads filed for, it is a differential of approximately \$20 million per year.

Mr. McCOLLAM. Senator Long, we will make some further computations that are more specifically responsive to your question as

to the effect of these additional costs that would be imposed on the utilities by unreasonably high rates, how they would translate into specific costs for typical residential consumers. We will furnish that information for the record.

Senator LONG. Fine. Let me congratulate you, Mr. McCollam, and each one of you, for coming here and speaking up for the consumer, who happens to be your customer in this case. I think you have made a very good case.

I first became aware of this when some of you, speaking for this same industry, expressed alarm about this matter before the committee up in Washington. And it caused me to feel we should not let this matter go unchallenged.

One other thing that doesn't meet the eye is when we let all of the railroads, anybody that thinks he is not a healthy railroad, he will get healthy with all of the increases and by the time they get through, the next time they have a negotiation with labor, they will come in and demand two-thirds of that be passed on to them in a wage increase and we are back in trouble again, then, they are not making enough profit, so we have to raise it again.

So at some point somebody has to speak up for the consumer.

I am very happy that your industry has indicated a responsibility to look after your customers and have raised this issue and have been willing to testify to it. Thank you very much for appearing here today.

Mr. McCOLLAM. Thank you, Mr. Chairman, for affording us this opportunity.

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

MIDDLE SOUTH UTILITIES, INC.,
New Orleans, La., February 25, 1980.

Hon. RUSSELL B. LONG,
Russell Office Building,
Washington, D.C.

DEAR SENATOR LONG: At the Senate Transportation Subcommittee hearing on February 18, 1980 in Baton Rouge, you inquired what the economic impact would be on an individual electric customer if rail coal rates are set at levels above and beyond what is necessary for railroads to fully recover their cost of providing service and earn a reasonable return on investment (fully allocated costs).

I am sure you realize that the impact will vary from area to area of the country depending on many factors. To respond to your request, however, we have selected as an example a typical coal movement to a Louisiana utility. As you suggested, we have presented the results in 1985 dollars, the time frame in which substantial volumes of coal will be moving into the central-southwest, including Louisiana. The analysis utilizes data from an Arkansas Power and Light coal movement from Wyoming to Arkansas. As you know, this movement is typical of the long rail hauls that will be necessary to supply coal to Louisiana. The rates for this haul are currently under litigation.

In this case, expert cost witnesses have identified "differential pricing" or charges above fully allocated costs on the order of \$4.25/ton. Escalating that to 1985 dollars under the four percent plus inflation provisions of S. 1946 results in a 1985 rate that is \$7.70/ton above fully allocated costs. Based on 8500 BTU/lb coal of the type found in Wyoming, this represents an additional cost of 4.5 mills per KWH for each KWH generated by a new coal fired power plant. The projected 1985 average annual usage for a Louisiana resident on Louisiana Power and Light's system is 16,160 KWH. Thus, the effect on this quantity of electric service, of a 4.5 mills per KWH increase due solely to excessive coal haul rates, would be \$73/year or approximately seven percent of the total electric bill in 1985. The impact on the larger amounts of electricity used by commercial and industrial customers would, of course, be much greater and would be reflected in the cost of all goods and services purchased by Louisiana consumers.

The Railroad Industry argues that it is not unreasonable to impose on America's electric customers the burden of subsidizing the revitalization of the railroads, since when reduced to a cost per customer basis the cost is relatively small and not an unreasonable contribution in order to have a healthy railroad system. I believe this is a highly self-serving argument and one which flies in the face of our national commitment to increase the use of coal, for the following reasons:

1. The Railroad Industry is not the only group that uses the same argument in seeking to utilize a piece of the "pie" (the pie being the difference in the cost of coal and fuel oil for power generation) for their own self interests.

Coal producing states use it. Montana has advanced it in support of a 30 percent severance tax on coal.

Labor can use it. (Witness the black lung tax on strip-mined coal.)

Intervening states use it to support excessive ad valorem taxes on unit trains operating through such states.

The Federal Government has used it in the "orphan mine" tax and recently suggested a general tax on *all* coal to rebuild the highway system in those eastern states where truck hauling is prevalent.

Enough "small" slices and there is no "pie" left.

In light of our national commitment to increase coal use, I question the wisdom of continually imposing on coal, and ultimately America's electric customers, the burden of subsidizing other programs.

2. It overlooks the fact that many railroads including the Missouri-Pacific and the Burlington Northern are already "healthy." The Mo-Pac has one of the better (if not the best) returns on equity in the whole industry and the Burlington grows healthier by the ton.

3. It levels on the long haul captive users of coal rail transportation the major burden of giving relief (whether needed or not) to the railroads.

4. The "small" contribution will be extracted from some of the poorest people in the entire USA and, for the most part, those who have already borne the brunt of misguided Federal controls.

Let me take this opportunity to once again express the appreciation of the entire electric utility industry for your efforts to protect captive shippers and consumers from the potential excesses of complete railroad deregulation. Your amendment represents a positive effort to remedy a number of serious flaws in S. 1946 and does not deny the railroads anything. It merely directs that the ICC set some standard of reasonableness beyond which the railroads would have to assume the burden of proving that the tariffs they seek to impose on captive shippers are necessary and justifiable.

Again, we thank you, Senator, for this opportunity to be heard on this very important issue to our electric consumers.

Very truly yours,

F. E. AUTREY.

Senator LONG. Next we will hear from a panel speaking for the Louisiana Electric Cooperatives, and this panel will include Ms. Alice Howard, director of public affairs for Cajun Electric Power Cooperative, Mr. U. J. Gajan, general manager, SLEMCO, and Mr. Mark Bonner, Association of Louisiana Electric Cooperatives here in Baton Rouge.

STATEMENTS OF MARK BONNER, ASSOCIATION OF LOUISIANA ELECTRIC COOPERATIVES; U. J. GAJAN, GENERAL MANAGER, SLEMCO; ALICE HOWARD, DIRECTOR OF PUBLIC AFFAIRS; AND JAMES SMITH, MANAGER, CAJUN ELECTRIC POWER CO-OPERATIVE

Mr. BONNER. Senator, I am happy to report that Jim Smith, manager of Cajun, is with us. So if you have any specific questions, I am sure he can help.

I am Mark H. Bonner, Jr., executive vice president and general manager of the Association of Louisiana Electric Cooperatives, Inc., comprised of 13 consumer-owned distribution co-ops and Cajun Electric Power Cooperatives, Inc., our generating and wholesale supply organization, all of which are well-represented here today.

We deeply appreciate your hearings here in Baton Rouge, which are most timely. Cajun Electric will test fire Louisiana's first coal-fueled generating unit within a few days, located just 25 miles from here. Our sad experiences and story of woe, which include a 101-percent increase in delivered coal cost since contracts were initiated in 1976, are indicative of the impossible situation facing our State, its utilities and consumers under current national energy policy and S. 1946, as proposed without your amendment, Senator.

While I am speaking for the Rural Electrics specifically, we are also deeply concerned about Louisiana's future and that of other States and regions forced by Federal policy to substitute abundant local natural gas with coal. We are particularly concerned about the absence of reasonable regulations governing coal production, profits, priority scheduling, and the obviously excessive and inequitable rail and barge transportation costs to captive shippers, while our natural gas is going north and east under careful and rigid Federal regulations governing all these factors, plus the ultimate cost to consumers. Contrarily, as things now stand, our Louisiana utilities and their consumers must pay whatever their captors demand.

I'm somewhat ahead of the background story of why your amendment is so urgently needed to help correct present ruinous situations facing Louisiana utilities in general and our co-ops, serving low-density rural areas, in particular.

In our case, and this is largely true of the private companies, all costs of service must be passed on to our consumer-owners. We have over 245,000 metered connections serving about 1 million people, and I emphasize people. Eighty-five percent are farm-residential. Many are low-income, minimum consumers who could not have service but for the co-op principle.

Our co-ops own and maintain about one-half of the total miles of powerlines in Louisiana. They perform an essential service for decent living and progress with about 5 percent of the total revenue from power sales in this State, a rather awesome responsibility.

We are proud to note that our co-ops lead the Nation with total rural area coverage to all who need and want electricity.

I mention all this to emphasize that while we are the first to have to bite the bullet, our electric co-ops and their consumer-owners are probably the least able to support our captive situation.

In the early 1960's, our projections showed we needed to generate at least part of our wholesale power for many reasons. We launched Cajun Electric to pursue that goal. Cajun finally went on line in 1972 with two 115-MW gas units supplying around 30 percent of our total wholesale requirements at that time, purchasing the balance from the private companies.

Now comes the sad Louisiana story:

Using 22-cent per mfc gas, Cajun Electric generated power for 5.04 mills per kWh in 1973, blending it with the 70 percent purchased at a fraction over 6½ mills per kWh from the private utilities. The total wholesale cost to our co-ops averaged 6.616 mills per kWh, among the lowest in the Nation.

Alas, due to Federal policies and regulations, in 1979 the delivered cost to our cooperatives averaged 22 mills, an increase of over

350 percent, which our consumers must absorb in the form of fuel cost adjustments on monthly power bills. Most private utility consumers are in a similar sad boat. Today, all Louisiana consumers are faced with among the very highest electric rates in the Nation.

Mere pessimism? Consider these facts: In 1980, when our coal-fired units go on line, the projected wholesale cost is 30 mills per kWh. By 1985, it is expected to hit 40 mills, or 4 cents per kWh, compared to a bit over one-half cent in 1973. I have heard talk of as high as 6 cents; maybe 8 cents. It is not unusual to hear this in discussing the problem with other utilities.

Where it will stop nobody knows, unless something is done about coal transportation cost.

We stress that quoted costs quoted here today are based upon presently known circumstances. Unless your amendment, Senator Long, is approved by the Congress to control the obvious railroad gravy train philosophy toward captive utilities forced to use coal by the Federal Government, S. 1946 will result in unbearable rates to all Louisiana consumers. Barge lines also deserve congressional attention.

In fact, I just talked to Jim Smith about this, and we have had more problems with them in a lot of ways than we have with the railroads.

How did we and the private utilities get into such an untenable situation?

The initial so-called "energy crisis" struck in 1973. We were notified by the private companies in 1974 that they could no longer supply us with wholesale power beyond 1980. They thought they could supply us to at least 1990 at one time, but we had about a million people to come into this State in the last 10 years, so things have changed radically.

Meanwhile, the Federal Power Commission curtailed usage of natural gas to fuel Louisiana utility and industry boilers, giving priority to home and building heating usage in the North and East, in many instances cheaper than we could purchase it here in Louisiana. Both we and the companies had to supplement cheap gas with expensive fuel oil. While talking to Cajun Manager Jim Smith in 1973, Senator, he recalled that we were able to purchase fuel oil at around \$4 a barrel. In December Cajun paid as high as \$32 for this barrel of oil to supplement the limited gas they now have to fuel gas-fired boilers in Cajun No. 1.

COAL—ALTERNATIVE TO BLACKOUTS

Due to Federal decrees, our only alternative to blackouts in rural Louisiana was to build our own generation plants. Our directors accepted the challenge, obtaining REA approval for a \$640 million loan at open market interest to construct two coal-fired units to go on line in 1980. A third unit will go on line in 1982, with investments for the three units totaling \$1.1 billion.

That is a heavy burden for our rural people to have to bear while sitting on top of huge, untapped natural gas deposits.

Federal regulations gave us no choice but to use low sulphur Western coal. Nuclear would have taken too long, even if approved. As a pre-loan condition, we had to tie down rail transportation and coal contracts. And the railroad—I should say Burlington North-

ern—gave us no choice but to purchase and maintain our own railcars.

In 1976, the initial rail contract was an estimated \$7 per ton with expectations to escalate to \$9 by 1980. It is presently \$12.54, or an increase of 44.4 percent before a pound has been burned. Recently the railroad wanted \$13.50 per ton, exclusive of car maintenance. We haven't settled that yet.

Our initial 20-year contract with Shell Oil in 1976 was \$5 per ton at mine mouth. Immediately, the State of Montana tacked on a 30-percent severance tax. Then the Crow Indians objected, resulting in the Secretary of the Interior abrogating the contract for all practical purposes.

So we had to go to Kerr-McGee Coal Corp., and you might say almost beg them to help us—and I notice that Jim Randolph, the president of Kerr-McGee, is present. Under these circumstances which placed us in a bad bargaining position, I think they went out of their way to try to help us at \$7 per ton. This has escalated to \$10.82 as of December 1979. Delivered cost to New Roads, La., will average \$33.20 in 1980 under transportation rates over which we have no control.

By 1985, under present contract conditions and known escalatory factors, Cajun Electric will pay \$11.68 per ton at mine mouth. Projected delivered cost will be \$52.59, or an increase of over 36 percent, of which 54 percent is for rail transport from Wyoming to St. Louis, Mo., and 24 percent by barge to New Roads, La. It will cost another \$2 per ton to maintain our 848 railcars that we had to buy.

I had the opportunity to go up to Kerr-McGee's plant at Gillette, and climb up on the top of the coal elevator. I watched cars go through that elevator, Senator. They hardly slowed down. They were automatically filled up without stopping. And as Governor Edwards, or somebody, said "It is all down hill" to St. Louis. So we are not talking about the same thing in transporting coal as in shipping soap or hazardous waste, sidetracking it all over the country, necessitating having to subsidize that sort of thing with higher rates. It is a fast and efficient operation that they have.

How can our Louisiana citizens afford electricity for body comfort, productivity, and progress? That's the unanswered question. Many are already experiencing serious difficulty in paying their monthly utility bills.

So here we sit today, captives of money-hungry States, the railroads, and barge lines, all with unbridled freedom to exploit and take advantage of our dependence upon unregulated coal, while our Cajun Electric's coal-fired units sit squarely on top of the Nation's largest untapped natural gas strata.

If you have been reading the papers lately, some of the new gas wells are so strong that they have been blowing derricks and pipes up out of the ground lately.

Cajun Manager James R. Smith estimates that for every dollar per ton increase in freight (at today's rates) the cost to our Louisiana consumers will be \$6 million. He reported that over 60 percent of the total cost of plant, including operations, administration, depreciation, interest, and so forth will be for delivered coal. As noted, we will have \$1.1 billion invested in coal-fired plants by

1982. By 1985, Cajun Electric will spend 8 times more for fuel than it has in plant investment, and 10 times as much over the next 10 years.

Over the 30-year normal life of the three units using Western coal, our rural consumers will pay over \$43 billion for fuel at present 12-percent annual escalations. This means simply that the railroad and barge lines will harvest 77 percent of delivered coal costs, or around \$33 billion from rural Louisiana alone.

I noticed that one of the utility people here talked in terms of rail transportation averaging 54 percent of the delivered coal cost. If they can get that, it will amaze me.

Meanwhile, our natural gas will be going North and East under most rigid Federal regulation of production, profits, transportation, and ultimate cost to consumers. Justice, where art thou?

Justice can and should begin with congressional approval of your practical amendment to S. 1946, Senator.

Then it is hoped Congress will focus attention upon coal production, transportation, profits, and so on, as it is presently doing with the so-called windfall profits tax, and has done for years in the case of natural gas and oil production and transportation with regulatory legislation.

I want to emphasize, that like you and the Governor and everybody else appearing here have emphasized, I think, we would all be better off if we had never gotten into this energy regulatory field—especially oil and gas production. But we have to face up to it.

The nebulous revenue versus variable costs approach in S. 1946 gives the railroads a blank check to excessively profit from the energy crisis threatening our Nation's future, especially our irreplaceable private enterprise system. Coal transport should, and must, be regulated along with other captive traffic, if reasonableness and justice is to prevail.

Senator, something is obviously wrong when we have offers of coal shipments from South Africa and Australia to Baton Rouge, La., cheaper than we can obtain Western U.S. coal. Wake up, America. For the sake of our freedom and even the railroads', we better wake up, or we will all be running to OPEC.

As matters now stand, rates are not based upon competitive free enterprise principles. We are captives, pure and simple. Utilities forced by Federal mandate to use coal should not be placed in the position of having to subsidize other railroad operations or shippers, as we will obviously do under S. 1946 without your amendment, Senator.

Mr. Chairman, in view of some of our past difficulties, you may be a little surprised that we wholeheartedly agree with the testimony of the private power companies, especially the statements of Mr. F. E. Autrey, president, Middle South Utilities, Inc., and John L. Prendergast, president, System Fuel, Inc., and my friend Mr. Moore from CLECO and the others up here, before your subcommittee.

We of the electric cooperatives are already biting the bullet that all of the utilities in Louisiana and other gas-producing States must face. They have our full sympathy.

Our nonsalaried, consumer-elected directors are conservative community leaders, a lot of them are sitting back here now, farm-

ers, bankers, businessmen, teachers, and so forth. All are consumers who pay electric bills just like their neighbors they represent. They believe in reasonable profits and would not deny such to anyone, including the coal companies, barge lines, and railroads. They do not believe simple justice should permit anyone to exploit our inability to use our Louisiana natural gas or to unduly profit from our national energy crisis affecting all citizens of this great Nation.

Senator Long, our Louisiana consumers are terribly disturbed, and rightfully so. They need your help and understanding.

Senator, I personally, and for all of the electric co-ops, want to express appreciation for this opportunity to be heard and especially for your many years of leadership and assistance to the Rural Electric Cooperatives in pursuit of their ideal: Rural service at the lowest possible cost to all who need and want electricity.

Thank you.

Senator LONG. Thank you, Mr. Bonner.

Mr. BONNER. If you have any specific questions, Mr. Smith I am sure will help me answer them.

Senator LONG. Let me ask you this: Cajun is one witness here that moves coal by a joint rail-water rate, or rail-water traffic at least. I want to ask you is Cajun's situation any different with respect to the need for maximum rate regulation on the rail portion of this haul than the other utilities?

Mr. SMITH. I would say no, Senator, because we have approximately 1,200 miles to haul by rail. That is out of a total cost of \$30 to \$32 per ton, rail is \$12.54 out of that. Plus the barge transportation is again about—the total transportation is about two-thirds of our total delivered cost of coal.

Mr. BONNER. You mean both?

Mr. SMITH. Yes, barge and rail.

Senator LONG. What percentage of that cost is rail?

Mr. SMITH. I believe \$12.54 out of about \$32. That would be about 40 percent. We have got the maintenance of the railroad cars, too, which we estimate at \$2. So that makes it 14-something out of 32.

Senator LONG. What is the total freight cost of getting a ton of coal to you at Cajun?

Mr. SMITH. \$14.54, plus about \$21.34, rail and barge.

Senator LONG. So the cost of transportation is about two-thirds of the cost to you also.

Mr. SMITH. Yes, sir, that is correct.

Mr. BONNER. I calculated it out here from the figures that we finally got. The total transportation cost, plus the \$2 maintenance on the railroad cars will average about 77 percent of the total delivered cost by 1985.

Mr. SMITH. Yes. The current rail cost represents 43.8 percent of the total delivered cost of coal.

Senator LONG. Is it possible to enter into short-term supply contracts to take advantage of changing circumstances?

Mr. SMITH. We are tied down on long-term coal contracts. We are also tied with a 20-year barge contract. Burlington Northern is the only railroad that we can use.

Senator LONG. In bringing the coal over to the river point, am I correct in assuming that Burlington Northern can pretty well write their own ticket?

Mr. SMITH. Absolutely.

Senator LONG. You are required by law to use the coal and that railroad. And that is a healthy railroad, by the way. That railroad is in a position to pretty well write their own ticket on what you have to pay to get that coal to the barge.

Mr. SMITH. That is correct.

Mr. BONNER. As I just pointed out, recently they came down and demanded another increase, without any justification at all that we could see. They even so much as sort of, on the side, admitted they didn't have any justification for it.

Mr. SMITH. They brought down their cost figures and said here is the backup for our proposed \$13 per ton. So at the end of the meeting, their representative says "Well, I think this \$13 is a little high; we can reduce it," which they did, to \$12.54.

Senator LONG. Thank you very much.

Mr. BONNER. Senator, we have testimony here from your old friend, Mr. Gajan.

Senator LONG. Do you have a statement, Mr. Gajan?

Mr. GAJAN. Yes, Senator. I too want to express my appreciation for your giving us the opportunity to support the amendment that you are promoting. We thank you very much.

I am U. J. Gajan. For more than 40 years, until I retired just a few days ago, I was general manager and chief executive officer of the Nation's leading electric cooperative, the nearly 60,000-member Southwest Louisiana Electric Membership Corporation, known as SLEMCO.

I am here today to tell you that the electric consumers in Louisiana and all across the Nation are unhappy. They are angered by soaring electric bills. They can find no logic in some of the things that contribute to those high bills.

Mr. Bonner pointed out we have a big delegation from the various co-ops throughout Louisiana, the directors and managers, because they are taking the heat from their consumer members on high bill complaints.

SLEMCO serves 5,000 square miles of south Louisiana that is rich in oil and gas reserves. Wells that are pumping oil and gas get their power from our SLEMCO lines.

It is unreasonable that we in Louisiana must use coal from Wyoming to generate our electricity because we are forced to send our oil and gas to heat homes and run factories in the Northeastern States.

Washington has regulated, without justification, the oil and gas industry. Washington did not maintain any controls on outrageous coal shipping charges. We need all the help and support we can get from elected officials and policymakers to hold down coal transportation charges.

Because of this millions of electric customers will experience extreme hardship in paying high electric bills. They feel betrayed, and why not?

Years ago oil and gas were plentiful and electricity was cheap. A push was made to get people to build all-electric homes. The all-

electric home idea was promoted by all utilities in good faith. The people who built all-electric homes did so in good faith, too. And they did it to save money. Transportation of fuel to generate that electricity was not a significant cost factor then. Today it is.

Now, these all-electric customers are locked into electricity. And as the cost of transporting coal goes unchecked, these same people are locked into higher and higher bills.

I urge you to keep the best interest of these people in mind. These are good American citizens, who trusted Government.

At SLEMCO, our primary concern is to supply a continuous supply of electricity to our customers at the lowest possible cost. We have a secondary responsibility, and that is to make every effort to keep transportation costs within reasonable bounds.

I think it is worth repeating, Senator, Mark Bonner said it, but I think perhaps the best way to illustrate the impact that coal transportation costs have on Louisiana electric customers is this: If the cost of transporting a ton of coal goes up \$1, electric bills in our State go up \$6 million a year.

SLEMCO is a big cooperative, five or six times as large as most of the cooperatives in our State. We have nine customers for every mile of line in or system. Many co-ops in our State have only four or five customers per mile.

At SLEMCO we know the pinch of high coal shipping charges. In 1973 our fuel costs ran about 7 mills per kWh. This year the price is already more than four times that amount, it's 30 mills.

Keep in mind that no matter how bad high rail shipping charges are on SLEMCO's customers, the effects will be a whole lot worse on the smaller co-ops. And there are thousands of families depending on those small cooperatives for electric lights and electric heat.

Mr. Chairman, I am not an expert qualified to determine when railroad shipping charges rise so high that they begin to gouge the public. But I can see the adverse effect shipping charges will have on SLEMCO customers.

I would urge your committee to accept this amendment and to determine at what point a lid should be put on railroad shipping charges.

Again, Senator, thank you for letting us be with you today.

Mr. BONNER. Senator, since Ms. Howard will not present her formal testimony, I ask that it be placed in the record.

Ms. HOWARD. I did want to, since you used so many analogies, I did want to tell you in our opinion the Louisiana consumers are in the posture of having a gun being held on them, the finger is on the trigger and the safety catch is off. If this amendment is not accepted, the trigger is going to go off.

Senator LONG. Ms. Howard, we thank you. We will print your entire statement in the record.

[The statement follows:]

STATEMENT OF ALICE HOWARD, DIRECTOR OF PUBLIC AFFAIRS, CAJUN ELECTRIC
POWER COOPERATIVE

Mr. Chairman and Gentlemen of the Subcommittee Hearings: I am Alice Howard, Director of Public Affairs, CEPCO in New Roads, Louisiana, wholesale power supplier for the thirteen consumer-owned Electric Cooperatives in Louisiana. I want to commend Senator Russell Long and the other members of the Senate Commerce Committee for holding these hearings in Baton Rouge to allow Louisiana consumers,

particularly those from the rural areas, to have a direct input in the decision-making process on legislation which will directly affect their utility bills.

Cajun Electric is the generation and transmission cooperative supplying power to the rural electric cooperatives serving in 54 of the 64 parishes of Louisiana. As you are aware, Cajun Electric and the distribution cooperatives are private, nonprofit utility systems, owned and controlled by the people we serve.

Cajun's first generating plant has two 115 megawatt gas/oil fired turbine generating units. For reasons mentioned by ALEC's Mark Bonner, not long after completion of Big Cajun No. 1 in 1972, plans were begun for Big Cajun No. 2 utilizing coal because of Federal Power Commission rulings prohibiting usage of gas in new plants. Low-sulphur Western coal was selected to meet the sulphur emission and other standards required by federal mandates. The first 540 megawatt unit will be test-fired within a few days, with the second 540 MW unit schedules to go on the line in October, 1980. Construction has begun on a third unit of 540 MW to be completed in 1983.

Long-term coal supply, rail and barge contracts for Units No. 1 and No. 2 have been executed; however, Cajun is exploring all avenues and sources to supply fuel for Unit No. 3. There are presently over 500,000 tons of coal at the plant site and it is estimated that four million tons per year will be necessary to provide fuel for Units No. 1 and No. 2. When the third unit is completed, over seven million tons of coal per year will be purchased.

As you are aware, plants must be designed, boilers selected and type of fuel determined many years prior to completion of a plant. Cajun entered into barge and coal contracts in good faith and for all practical purposes is locked into low-sulphur Western coal. Although, we now find we could today purchase coal in South Africa and Australia delivered to Baton Rouge cheaper than Western Coal, primarily because of high rail costs.

What does this mean in terms of dollars to our consumers and what has been the escalation on the various components that comprise the price of a ton of coal since the original decision to use this type of coal was made. I ask you to keep in mind that Cajun has yet to burn the first ton of coal, or generate the first kilowatt of electricity using Western coal.

The escalation on the base price of the various components of a ton of coal have been:

Period	Coal	Rail freight	Rail cars	Total rail	Barge	Other	Total
June 1976.....	\$5.00	\$7.00			\$3.39		\$15.00
June 1979.....	10.33	10.53			5.98		26.84
December 1979.....	10.82	11.91			6.84		29.57
January 1980.....	10.82	12.54	\$2.00	\$14.54	6.84	\$1.00	33.20

These figures depict a 100 percent increase in the cost of coal and transportation (excluding the cost of rail cars) between June, 1976 and January, 1980. The January rate for the base price of coal and barge costs will not be available until February 15, 1980. Cajun, as other coal purchasers are doing, has been forced to purchase 848 rail cars and this figure is included in the January cost computation. At current prices, rail costs represent 43.8 percent of the total delivered cost of coal.

If you do not use our base cost figures, but use figures from the cheapest available coal source and project those figures for five years, (with a 12 percent escalation per year on the total price of delivered coal, but different percentages for the various components), by 1985 our computations show that the basic cost of delivered coal, broken down into the various components, will be: cost of coal—22 percent, barge and other costs—24 percent, while rail costs will have escalated to 54 percent of the delivered cost of a ton of coal.

Clearly if we do not have recourse to some mechanism whereby we are guaranteed a forum to challenge what we consider arbitrary and capricious rail rate increases, the opportunity exists for the railroads to continue to increase rail rates without regard to the undue burden this places on consumers. Indeed, S. 1946 provides for non-cost increases of 12 percent every five years, regardless of how profitable the rate.

What are we trying to achieve by appearing before this committee? The question that we must grapple with is the "gray area," of ratio of revenue versus variable costs and at what threshold it can be determined that increases in rail rates require scrutiny and special justification by the carrier. At what point do electric utilities utilizing coal have a valid basis for going in and arguing against an increase in

freight rates. S. 1946, without the proposed amendment, is open-ended in this regard. The bottom 150 percent jurisdictional threshold of revenue versus variable costs is not that important in this instance, except as a base for determining the appropriate threshold ratio. Again, it is the "gray area" and the higher threshold where the burden of proof shifts that need to be examined. Upon reaching this threshold (to be determined after the hearings set forth in this amendment), the burden of proof would shift to the railroads.

An important issue is by what method, and using what system, is this threshold to be determined. In the case of Cajun, using different *generally accepted* methods, we come up with various, widely disparate figures in determining the percentage of ratio of revenue versus variable cost. If you use, however, the so-called Iowa formula (the ICC method without cost of capital) with the variable cost of coal transportation per ton said to be \$6.72, the percentage is 186.6 percent.

In reviewing these methods of computation and looking at the various differences, the difficulty and enormity of your task is clear. It must be stressed that even though we do utilize barge transportation for a portion of the way, we are no less captive to rail shipment because there is only one rail route to move the coal over 1130 miles to the St. Louis barge terminal.

In summary, we are urging you to pass this amendment to S-1946, the Railroad Transportation Policy Act of 1979, allowing ICC hearings to be held to determine at what level a shift of the burden should be set, taking into consideration the national energy goals, the present and future burden being placed on all consumers of electricity directly attributable to transportation costs of fuel, a look at railroad management practices that include traditions perpetuated over many years regarding crewing levels, labor agreements, operating practices and the cross-subsidization of marginal traffic by profitable coal movements on individual carriers. It is obvious that S-1946, unless modified by Senator Long's amendment, permits and encourages excessive rail rates and the inequitable subsidization of general commodity shipments by captive coal shippers, such as Cajun Electric.

Certainly, we are all in agreement that a viable, financially sound rail system is a necessity; however, making certain that escalating transportation costs of fuel do not increase the cost on our consumers' utility bills to the point that they can no longer afford to pay for this basic necessity, is also of paramount importance. We feel sure that after hearings a "zone of reasonableness" can be determined that will benefit the railroads, the electric utilities and the American consumers.

Senator LONG. Mr. Gajan, I recall attending some of your meetings in Lafayette, where you had demonstrations of what the all-electric home was like, what a nice thing it was, how comfortable, how convenient and how people could afford it. Then to see the costs go up like this on the heating and air-conditioning is tragic.

Mr. GAJAN. It is tragic, Senator.

Mr. BONNER. Senator, so many of our cooperatives particularly those across northern Louisiana, serve very, very low density areas. As I have pointed out in other hearings, you might say well, why couldn't the private companies take on this responsibility? Well, I know if I were sitting here as chairman of the Board of Gulf States or Southwestern, or whatever, or L.P. & L., I wouldn't want most of them as a free gift.

The only way rural people will continue to get service is through the cooperative principle. Unfortunately they are in a tough position. The very people that are the least able to afford it are going to be the first to really be hit by all this. So we are in a real bad situation until things begin to level out.

Senator LONG. Thank you very much.

The next witness we will call is Mr. James Randolph, president, Kerr-McGee Coal Corp.

STATEMENT OF JAMES G. RANDOLPH, PRESIDENT, KERR-McGEE COAL CORP.

Mr. RANDOLPH. I am very pleased to be here today, Mr. Chairman, because unfortunately coal companies sell coal based upon

the delivered price of coal. So whatever happens to rail rates or State severance taxes vitally affects our ability to sell our coal and of course affects our own fortunes.

Kerr-McGee Coal Corp. is a producer of Western coal and a significant supplier to utilities that serve Louisiana. In 1976, Kerr-McGee signed a contract to supply 15 million tons for Cajun Electric Power Cooperative over a 5-year period. Earlier in 1973, Kerr-McGee entered into 20-year contracts to supply 1.7 million tons per year for Central Louisiana Electric Co., 2.5 million tons per year for Gulf States Utilities, and 5 million tons per year for Arkansas Power & Light Co., a subsidiary of Middle South Utilities. In addition, we supply coal to other utilities in Texas and Oklahoma. All of these contracts commit the parties to delivery schedules, prices, and other conditions of sale for the contract period. These agreements govern the sale of about 100 million tons of coal to generate electricity within the State of Louisiana.

The coal must be moved 1,500 to 1,600 miles from the mines in Wyoming to the electric generating plants. We are totally dependent on the railroad system to move this coal to the plants, or, in one case, to a barge terminal on the Mississippi River. A dependable and efficient railroad system, charging reasonable rates, is indispensable to deliver this coal for use as a source of electric energy.

Thus, I welcome this opportunity to present my company's views on proposals to change national railroad transportation policy and certain related aspects of rail carrier regulation addressed in S. 1946, especially in relationship to the proposed amendment to the bill furnished in the notice of this hearing. In my testimony today, Mr. Chairman, I will focus on five very important issues with respect to coal transportation and the potential implications of proposed changes in railroad transportation policy affecting railroad ratemaking regulation:

Coal shippers are faced with substantial railroad market dominance with respect to transportation required for moving coal from mines to user destinations.

Because rail market dominance is prevalent with respect to coal transportation, coal shippers must be given adequate protection from becoming subjected to unreasonable railroad transportation rates.

The jurisdiction and regulatory powers of the ICC with respect to the maximum reasonableness of railroad transportation rates should be clearly defined so that captive shippers who have no practical transportation alternative are protected.

Explicit authorization should be furnished in law to allow contracts between rail carriers and shippers without violating common carrier obligations as an essentially nonregulated transaction between private parties who can agree on terms and conditions governing transportation rates, services, equipment utilization, and other factors, over extended periods. This offers a clear method of reducing railroad ratemaking regulation.

The use of threshold ratios of revenue-to-variable cost, expressed as percentages, to determine points at which ICC jurisdiction and regulatory powers over maximum reasonableness of railroad transportation rates commence represents a sound approach toward re-

ducing unnecessary railroad ratemaking regulations if, at the same time, similar thresholds are established where the burden of proof regarding maximum reasonableness of railroad transportation rates shifts from affected shippers to proponent carriers.

At the national scale, approximately 65 percent of all domestic coal produced is transported by railroads to user destinations. Coal is the leading commodity shipped by railroad, accounting for 28 percent of total freight tonnage and 20 percent of all railroad carloadings. About 50 percent of the coal shipped by railroad nationally is moved by efficient unit trains dedicated to such movements. All of Kerr-McGee's Western coal moved from Wyoming to Louisiana, Oklahoma, and Texas is transported by such unit trains. Averaging in 1978 in our case 11.8 miles per hour. That is now up to around 13 miles per hour on the long trips in Texas, and the short trip to St. Louis in the last few days we are up to almost 20 miles an hour, which is reaching the rates achieved back in the 19th century.

It is well documented that coal shippers are faced with substantial railroad market dominance with respect to transportation required for moving coal from mines to user destinations. Studies conducted by the National Coal Association show that more than 490 million tons of coal per year are being transported by the Nation's railroads. Further, these studies indicate that approximately 85 percent of coal tonnage shipped via rail carriers has no practical transportation alternative. In other words, approximately 417 million tons of coal, or 55 percent of the 756 million tons produced in the United States during 1979, had to rely on railroad transportation to reach electric utilities and industrial users. Reliance on railroad transportation for coal shipments is expected to continue as evidenced by an NCA estimate of more than one-half billion tons of coal to be moved by Nation's railroads in 1980, of which approximately 427 million tons are expected to have no practical transportation alternative.

With respect to Western coal, the NCA studies show that more than 95 percent of the coal produced in the Western States is captive to railroad transportation due to limited availability of waterways and the impracticality of highway transportation for long-haul movement of coal. The lack of surface transportation competition underscores the importance of providing adequate regulatory protection with respect to the maximum reasonableness of railroad transportation rates for coal traffic originated across the Nation.

This lack of surface transportation competition is in sharp contrast with the competitive nature of coal marketing. It is not unusual to have 20 to 30 coal producers competing for the same long-term coal supply agreement. A typical long-term coal supply contract between coal producers and customers may be negotiated as much as 6 to 8 years ahead of coal deliveries in order to assure compatibility between design of coal-fired boilers and the physical properties of the coal that will be burned.

Accordingly, capital investments in plants and equipment needed to extract coal on the part of coal producers and to burn the coal on the part of the coal users, as well as management programs associated with both coal mining and user plant operations, become

key factors leading toward decisions regarding selection of coal for particular end uses. When long-term coal supply agreements are entered into, therefore, coal origins, supply rates, and user destinations are firmly established and are governed by the availability of adequate coal supplies having acceptable heat value, sulphur content, and other physical characteristics which differ from place to place according to the geology of certain geographic areas. Thus, the transportation requirements become well defined; and dependable transportation services and reasonable rates for such coal traffic from year to year are crucial concerns.

Although electric utilities and coal producers enter into such long-term agreements for coal supplies, similar balanced agreements have not been established between the coal shippers and the rail carriers. Instead of a long-term definitive legal agreement, coal shippers have only been able to achieve the degree of certainty associated with a "letter of understanding." These letters of understanding from the railroads are usually obtained during the time the coal user is negotiating with a coal supplier. They contain stated quantities of shipments and schedules for these shipments; however, only the estimated cost of railroad service, subject to annual escalation, is typically specified in such letters of agreement. The official tariffs are not published by the railroads until just prior to the first shipments, years after the coal supply agreement is reached and investment made. The tariffs established frequently exceed the initial or estimated tariff, adjusted for escalation, contained in earlier letters of understanding with the railroad. Therefore, we believe long-term contracts between rail carriers and coal shippers with escalation provisions will remove some of the uncertainty and establish a more durable relationship.

To illustrate this problem, during the last 5 to 7 years, railroad rate increases for unit train coal movements have been significantly greater than the general rate of inflation. We have seen railroad freight rates from the Powder River Basin of Wyoming increase from a range of 4 to 5 mills per ton-mile to as high as 15 to 16 mills per ton-mile. Rates for our contracts mentioned earlier are still at the 11 to 12 mills per ton-mile. However, recent ICC actions, such as the January 15, 1980, ruling on coal movement from Axial, Colo., to Coletto Creek, Tex., sustain rates at the 13 to 14 mills per ton-mile level. Such rate increases are a significant contributor to concern on the part of coal users and producers alike because of their impact on the delivered price of coal. Surely, the citizens of Louisiana would be required to pay much more for their electricity if railroad transportation rates for moving coal 1,500 miles to 1,600 miles are raised significantly.

Aside from contracting, and in view of the captive status of coal shippers, a measure of regulation over maximum rate reasonableness is required. We were pleased to see the proposed amendment to S. 1946, which was presented in the January 21, 1980, notice of this hearing, because we believe that it is necessary to assure sufficient ratemaking protection to captive shippers under the bill. We favor the amendment in that it will provide an additional threshold whereby the burden of proof with regard to reasonableness of a rate would shift to proponent rail carriers rather than to affected shippers. We do, however, respectfully recommend that

the proposed amendment be revised so that this additional burden of proof threshold shall be issued by the Interstate Commerce Commission concurrently with the issuance of the maximum reasonableness threshold now established in the bill and not later than 120 days following enactment of the bill.

A burden of proof threshold should be considered as a parallel requirement with a maximum reasonableness threshold. Both threshold percentages should be defined at the same time in order to avoid the likelihood of encountering unwarranted efforts to raise railroad transportation rates in the interim between times for promulgating each threshold. My suggestion is simply that a slight revision is desirable in order to gain the full value of the proposed amendment upon enactment of the bill rather than delay the important contribution that the amendment would make to the overall soundness of the ratemaking concept embodied in S. 1946.

It is clear that a reliable rail system is a necessity if we are to secure greater use of coal in order to lower our dependence on costly imported oil. We believe that coal shipments should bear their just share of costs for railroads, but coal shipments should not be used to subsidize the movement of other commodities, less efficient types of commodity movements, or railroads not moving coal.

Mr. Chairman, this concludes my remarks. I will be pleased to answer any of your questions.

Senator LONG. Thank you very much, Mr. Randolph. In order that we can expedite the hearing, I am going to ask that you answer these questions I have prepared in writing and hopefully you can get that to us before the day is out.

Mr. RANDOLPH. All right, sir.

Senator LONG. Thank you very much.

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

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question. The railroad testimony received this morning suggests that coal rates are not too high relative to the price of coal. Mr. Bertrand compared the cost of moving coal in 1967 to the cost in 1978—which illustrates a decline in the percentage the cost of moving the coal has on the delivered price of coal (from 39 percent to 25 percent).

How would you respond to this suggestion that it is more the cost of coal, and not the rate for moving the coal, which has resulted in the large increases in the delivered price of coal (and hence, the cost to consumers).

Answer. This question cannot be effectively answered by using aggregate national averages. Coal produced in the east is transported relatively short distances, whereas coal produced in the west is transported vast distances. We do not believe that comparing ratios of coal prices to transportation costs is instructive unless coal prices are adjusted to reflect the impact on prices of state and federal taxes placed on coal during the past few years. For example, a reclamation fee, black lung tax and increased royalties have been imposed by the federal government. Likewise, certain states have imposed additional production and severance taxes, for example, Wyoming's total tax is about 16.5 percent now and Montana's tax amounts to 30 percent. In addition, federal laws governing reclamation, mine safety and health, and other environmental practices have directly increased costs of production.

These cost increases are generally passed on to the coal buyer under terms of most long-term coal agreements.

Based on data compiled by the NCA, the contract price index increased from a base of 100 in 1974 to 177 by the end of 1978, primarily due to these exogenous factors.

On the other hand, the index for spot prices increased from 100 to only 112, manifesting the plight of the entire coal industry. Coal producers have not been able to pass on the increased production costs or higher taxes for spot sales and new

contracts. This fact explains why so many producers who generally supply the spot market have terminated their operations. Overall, the composite coal price index for 1978 (latest data available to us) stands at 146.1). The overall railroad price index for coal movement for the same period (1974-1978) is 147.4, but we are not aware of new federal or state taxes or requirements imposed on the railroads similar to those imposed on the coal industry.

Notwithstanding these aggregate numbers, we believe that a more differentiated regional market evaluation must be employed to determine the behavior of coal transportation costs under captive shipper conditions. We believe the testimony provided by specific utilities at the February 18, 1980 hearing bear witness to the real problem, which should not be blurred or masked by aggregate averages.

Question. Your only suggested revision is to require the burden of proof threshold to be determined at the same time as the Section 102 threshold.

Might there not be advantage to determining the Section 102 ratio first: And the burden of proof threshold shortly thereafter—for example thirty or sixty days later?

Answer. If the time between the effective date of the burden of proof threshold were extended beyond the effective date of the Section 102 threshold, the possibility exists that some railroads might be tempted to adjust their rates to such an extent that the effectiveness of the burden of proof threshold would become academic. With this possibility in mind, we believe that the public's interest would best be served by establishing the two thresholds concurrently.

Question. On Page two of your testimony, you make several references to the fact that coal shippers are faced with substantive railroad market dominance. How would you respond to the ICC's recent decision in the Coletto Creek case where they referred to the jurisdiction on a finding that there was not market dominance even though the utility was served by only one railroad?

Answer. We believe that the Interstate Commerce Commission has seriously erred in this decision on Coletto Creek and has ignored the major economic ramifications on the coal producer, and the utility and its customers who will pay for the decision or would have paid if the utility had selected any of the impractical alternatives cited by the ICC to support their decision. Once a utility selects a coal supplier and designs the boiler around the peculiar characteristics of a particular coal, any other choice of coal involves costly tradeoffs which will increase costs of producing electricity. Likewise, the coal producer develops his mine, purchases equipment, and hires people to supply the coal. Disruption, delays, or premature terminations of a contract involves significant costs. I suppose a utility could abandon a contract, park its railcars, and purchase an alternate coal, and accept the consequent sub-optimum performance of its plant, but I do not think many public utility commissions or electrical customers would be happy paying the consequent costs of such irrational judgments.

We believe the Coletto Creek situation is a classic example of market dominance.

Question. You mention that coal supply contracts are negotiated six to eight years prior to coal delivery while rail tariffs are not filed until shortly prior to the movement.

I assume there is no way to avoid this situation, that it is essential to enter supply contract with this kind of timing?

Answer. To obtain peak performance of an electrical generating plant, the plant must be designed around the characteristics of a particular coal, e.g., heat content, ash fusion temperature, chemical composition of ash, sulfur content, moisture, etc. If the utility wishes to have greater flexibility on selecting coals for its fuel, they must accept lowered efficiency and performance (higher costs to generate electricity) if the boiler is designed for a wider range of fuels. For this reason, most utilities recently have sought a long-term supply of coal to fuel the plant for most of the plant's expected life. In addition, some lending institutions and public utility commissions have required the utility to secure a coal supply before approvals for the plant are granted.

These factors determine when utilities generally seek and obtain coal supply agreements.

With the enactment of Section 106 of S. 1946, the carrier would be able to enter into a transportation contract at the same time the coal supply agreement is obtained.

Question. You state that the Cajun contract is for five years, while earlier contracts with other utilities are for twenty years.

Does this represent unusual circumstances or is there a trend toward shorter contract terms?

Answer. The Cajun contract represents an unusual situation. Originally, Cajun entered into a longer term coal supply agreement with Shell to purchase coal to be mined from a mine located within the Crow Indian Territory in Montana. These

plans were set aside by over-riding federal consideration, consequently, Cajun sought an alternative source of coal during the period required for Shell to develop a mine in coal reserves located elsewhere.

Generally speaking, however, some utilities are tending to seek shorter term contracts whenever there are several sources of coal which have characteristics compatible with their boiler design.

Senator LONG. Next we will have a panel consisting of Mr. Walter Morgan, manager of transportation policy, Union Carbide Corp., Mr. Grant Arnold, general traffic manager, Ethyl Corp., and Mr. Donald Watson, Manager, Traffic, Allied Chemical Corp.

STATEMENTS OF WALTER MORGAN, MANAGER, TRANSPORTATION POLICY, UNION CARBIDE CORP.; GRANT ARNOLD, GENERAL TRAFFIC MANAGER, ETHYL CORP.; AND DONALD WATSON, MANAGER, TRAFFIC, ALLIED CHEMICAL CORP., ACCOMPANIED BY JOHN CAMP, COUNSEL

Mr. CAMP. Mr. Chairman, I am John Camp. We are delighted to have this opportunity to be with you today. We have three major employers, chemical manufacturers in Louisiana, Mr. Walter Morgan of Union Carbide, Mr. Grant Arnold of Ethyl Corp., and Mr. Watson of Allied Chemical.

Mr. Morgan will make the principal statement and supplemental comments will be made by the other two gentlemen.

Mr. MORGAN. My name is Walter E. Morgan and I am manager of transportation policy for Union Carbide Corp. My office is located in New York City, N.Y. Union Carbide Corp. welcomes this opportunity to present its position on the amendment proposed by Senator Long to S. 1946, the Railroad Transportation Policy Act of 1979.

An efficient, sound, and healthy railroad system is vital to a strong national economy. Certainly, a healthy railroad system is essential to Union Carbide Corp. We support a reduction in the economic regulation of railroads whenever and wherever such reduction will foster a more efficient and competitive transportation system. However, wherever competitive market forces do not exist, some provisions are needed to create a substitute for such market forces to assure that the railroads do not take advantage of a monopoly position.

Although Union Carbide does make use of all modes of freight transportation—railroads, pipelines, water, motor carrier and air—a significant portion, about 60 percent, of our total railroad volume is to some extent captive to the railroad industry. Since the railroads transport almost half of Union Carbide's domestic tonnage either into or out of plants and warehouses, continuance of some measure of economic regulation is necessary to offset the absence of economically viable alternatives.

Union Carbide's plant at Taft, La., provides both an excellent example of our use of all transportation modes and, at the same time, a classic illustration of captive transportation. The Taft plant is a petrochemical complex which receives raw materials and feedstocks by water, pipeline, rail, and truck. These raw materials and feedstocks are converted into a wide variety of chemicals which are shipped by railroad, water, and truck to all 50 States and to all corners of the world. In 1979, the railroads moved almost 600 million pounds of product from the plant and received \$6.8 million

in freight revenue. When our current expansion at Taft is completed in 1983, total annual volume will exceed 1,200 million pounds and railroad revenues will approximate \$18 million. Since the railroads do not normally supply tank cars or hopper cars for chemicals, most of this railroad tonnage moves in tank cars or hopper cars owned or leased by Union Carbide. Our investment in tank cars, hopper cars, cleaning facilities, and loading and terminal facilities effectively prevents us from diverting our tonnage from rail to truck or water in the short term. Other factors also come into play. The economics of long haul transportation mitigate against sizable diversions from rail to truck. Volume requirements and lengthy transit time involved in use of inland waterways negate the value of this mode as an effective alternative for railroad movements.

The Taft plant is served by the Missouri Pacific Railroad. Our experiences with the Missouri Pacific have been good and our working relationships are excellent. Service has generally been satisfactory. We would not expect a railroad of this caliber to act in an arbitrary and capricious manner. We believe, however, that it is not good business practice to rely solely on the good faith of either party to business transactions and that some form of legal protection is necessary.

Our Taft facility is a massive complex of 2,000 acres between Taft and Hahnville in St. Charles Parish on the west bank of the Mississippi up river from New Orleans. We are now in the process of doubling its capacity. Over 1,300 employees of Union Carbide are engaged at that plant in receiving, producing, storing, and shipping basic industrial chemicals. Obviously, Union Carbide's investment in plant and people is too great to permit us to simply pick up and move away if the Missouri Pacific some day decided to test the limits of its economic strength. Even if we could do so, the likelihood is that we would find ourselves in the same situation at a new location on some other railroad line.

With full cognizance of our captive traffic position, Union Carbide continues to support regulatory reform of the railroads, particularly greater freedom in pricing, which we regard as necessary to improve their financial condition. In our opinion, S. 1946 does draw a careful balance between the revenue needs of the railroads and our need for regulatory protection for our captive traffic situations. Union Carbide believes that passage of S. 1946 is necessary to assure a healthy railroad system which will provide the service that we need now and in the future.

We have reviewed the amendment that you have introduced and are aware of the concerns that prompted this amendment. Union Carbide, along with other Louisiana chemical companies, represents more than half of the industrial electrical power purchased in the State. We are also aware that the transportation costs of coal make up a significant portion of the total delivered cost of coal. However, we believe that special treatment for coal or any other commodity or commodity groups merely places a greater burden on the chemical industry which already pays freight rates in excess of 180 to 200 percent of variable costs. Cross-subsidization from the chemical industry of coal rates and ultimately power costs

will create artificial distortions that serve no real purpose other than shifting burdens rather than sharing them.

We would endorse the amendment introduced in the Congressional Record of December 17, 1979, provided it is made clear that:

First, the standards and shift in point of burden of proof will apply to all commodities across the board. The amendment and legislative history should be explicit that the Commission will not establish separate standards or shifts in the burden of proof for coal or any other commodities.

Second, the amendment will not apply to nor affect the provisions in section 10701(g)(3) which prevents the Commission from investigating or suspending a rate increase not exceeding zone of 4 percent per year or 12 percent in 5 years established in the bill.

Third, the function of the amendment is to address rate increases which yield variable cost ratios which, because they exceed a certain level, result in the shifting of burden of proof on the rate increases to the carriers. The shifting of the burden of proof, however, does not establish any legal presumption that a rate above the level is unreasonable. If and when challenged by a shipper to justify a rate increase above a given level, the carriers will be required to provide justification. The amendment should not be viewed as a presumptive cap.

Fourth, congressional review, if required, should be limited solely to the standards employed by the Commission in determining the ratio and not to the ratio itself.

Before concluding, we would like to say that many of us who are interested in enactment of S. 1946 have worked diligently to resolve some of the questions raised by the amendment. We believe that progress is being made toward some compromise. With the committee's encouragement, we think these efforts should move forward more quickly.

Thank you for this opportunity. I would be pleased to answer any questions.

Senator LONG. Thank you, Mr. Morgan. I am going to call a 5-minute recess at this point.

[Short recess.]

Senator LONG. All right, let's get back to business now. Next let's hear from Mr. Arnold.

Mr. ARNOLD. Senator Long, my name is Grant Arnold, general traffic manager, Ethyl Corp., of Baton Rouge, La. I appreciate this opportunity of appearing in support of S. 1946, and the so-called Long amendment, and urge their approval.

In order to conserve time, I respectfully request my statement be inserted in the record of this hearing.

Senator LONG. Yes, that will be done.

Mr. ARNOLD. The main points of the statement can be summarized as follows:

Ethyl's contributions to the economic welfare of Louisiana approximate \$221 million annually.

We are dependent upon rail service for 90 percent of the traffic in and out of our Baton Rouge plant. This amounted to 8,460 carloads in 1979. We are substantial users of energy and therefore coal rates are of importance to us.

This interest is what prompted our active support of S. 1946 and the amendment to section 104(5)(A).

The main thrust of S. 1946 is to inject competition as a greater factor in our rail regulatory system in lieu of governmental regulations. We are in favor of this concept. We feel it would be a mistake for Congress to provide special treatment for any one class of traffic or any one industry. All traffic should be subject to the same rules in order that all traffic fairly share in supporting our vital rail system. The current wide spread in the level of rates requires this, so all segments of our economy, particularly here in Louisiana, can prosper:

Speaking of the spread in rates, the statement being submitted includes some of our rates on chemicals to and from Louisiana. I believe this shows why all rates should be subject to the same treatment.

Thank you for the opportunity of submitting these remarks.
[The statement follows:]

STATEMENT OF GRANT ARNOLD, GENERAL TRAFFIC MANAGER, ETHYL CORP.

My name is Grant Arnold, General Traffic Manager, Ethyl Corporation, 451 Florida, Baton Rouge, Louisiana.

I appear in support of the principles and goals of S. 1946, and the so-called "Long Amendment" to Section 104(5)(A), and urge their approval. However, I do have some reservations regarding the Amendment to Section 104(5)(A).

Ethyl's principal manufacturing plant, research and development center, and central offices are located here in Baton Rouge. These facilities pay about 222 million dollars annually into the economy of the area. Total employment in these facilities is about 3,100 people with an annual payroll of 86 million dollars. Purchases of goods and services in the Baton Rouge area total 132 million dollars. This total of 218 million dollars is pumped directly into the economy of the State of Louisiana. In addition to the above, the plant pays about 4 million dollars annually to the state and city-parish in property and sales and use taxes. So, we have total area expenditures of some 222 million dollars.

APPROXIMATE BATON ROUGE AREA ANNUAL EXPENDITURES

	Number of employees	Dollars in millions
Employment.....	3,100	86.0
Purchases Louisiana		132.0
Total goods and services.....		218.0
Sales and use taxes and property taxes		3.6
Total expenditures		221.6

During 1979 this operation, after all transportation options were considered, generated 8,460 carload shipments. This rail traffic constituted 93 percent of the total traffic. Most of this traffic is considered "high rated traffic". Ethyl Corporation is concerned in the regulatory process governing rates on these products as well as other rates. We are a substantial user of energy, so coal rates are not being overlooked. One other factor is that our products are intermediates used for the manufacture of finished products. These Louisiana produced intermediates are distributed throughout this country. To the extent lower rates are mandated for such a large block of traffic, such as coal, rates on Louisiana chemicals will be required to pay a disproportionate share of maintaining the rail system.

The Baton Rouge facility is just one of many throughout this country. Overall, 80 percent of our traffic moves via rail. In some locations this dependency is upon just one railroad. Our investment in rail equipment, historical locations, and old systems designed for rail transportation are not the sole reasons for our great reliance upon rail transportation. In some cases long volume hauls are the results of natural resources being available in only one area; other times, rail transportation is safer;

while at other times, rail transportation is the only practical means of conveyance. Thus, we have a vital interest in a financially sound, progressive, and dependable rail system to service our transportation needs. It is this interest that prompted Ethyl Corporation to vigorously support the needed improvements in the regulatory process governing railroads embodied in S. 1946.

The proposed Amendment to Section 104 directs increased attention to the high rates of captive shipper issue. This attention is needed as a large number of shippers, such as ourselves, fall in that category. There is no merit, however, for giving special treatment to any commodity, group of commodities, or any one industry. One of the main features of S. 1946 is to permit "competition" becoming a more dominant factor in our regulatory system in lieu of governmental regulations. It would be contradictory to this principle if Congress were to establish special treatment for certain commodities or industries. All traffic should be subject to the same rules and be required to fairly support our essential rail system.

The general thrust of S. 1946 is to give railroads greater freedom in establishing rates; but, as the level of rates goes upward, these rates become subject to greater scrutiny by the Interstate Commerce Commission as to their reasonableness. After a certain level is reached, the railroads must shoulder the burden of justifying the reasonableness of the rates, if reviewed by the Interstate Commerce Commission. The ICC would set the point where the burden would shift to the railroads. Uniform treatment of all traffic is superior to Congress arbitrarily establishing special treatment for certain commodities if Louisiana chemical shippers are to be competitive.

There has been considerable publicity on the level of coal rates. Reference has been made to a \$30.00 N.T. coal rate from Wyoming to Louisiana. As information, our rail rate on Motor Fuel Antiknock Compound from Baton Rouge to Wyoming is \$116.00 N.T. and \$102.00 N.T. to Colorado. These rates produce carload charges of \$6,680.00 and \$6,630.00. The solvent rates from Baton Rouge, LA to Oregon is \$64.60 N.T. and \$59.80 to California. The chemical rate from Arkansas to Baton Rouge, LA is \$16.00 N.T. Again, any hold down on rates on any commodity can further compound the problem of Louisiana chemical shippers.

My reservations on the proposed Amendment are:

1. Requiring Congressional Review of any standard the ICC develops regarding shifting the burden of proof to the railroads when rates go above a certain level, and

2. Possibly exempting rates on any commodity from the regulations.

My reasons for these concerns are:

1. The ICC has the expertise to appropriately carry out any mandate from Congress. Congressional review could delay implementation of badly needed reform. Moreover, Congress would unnecessarily be adding to their already heavy work schedule of vital subjects.

2. All traffic should be required to proportionately support our rail system. Free or reduced rides for any commodity or industry only means charging more on other freight.

Other provisions of S. 1946 adequately provide for negotiating, and contracting for reasonable rates to cover any set of circumstances, without further Congressional action.

Senator LONG. Thank you, sir. Mr. Watson?

Mr. WATSON. Senator Long, my name is Donald E. Watson. I am manager-traffic for the chemicals company, Allied Chemical Corp., Morristown, N.J.

As Mr. Arnold did, I am going to just read excerpts from my full statement, which has been submitted for the record.

Allied Chemical is a diversified manufacturing corporation engaged in the production and manufacture and marketing of chemicals, energy, fibers, plastics, and industrial products.

The corporation operates more than 100 plants and mines in the United States, 10 of which are located here in Louisiana. The Louisiana locations employ approximately 1,300 people, with a 1978 payroll in excess of \$36 million. We produce a wide variety of chemicals, plastics, fibers, as well as oil and gas.

Allied is heavily dependent on rail transportation in Louisiana and on a national basis. Annual rail freight expenditures are in excess of \$100 million. It is significant to note that a substantial

portion of these payments cover so-called captive freight, that is, movements for which there are no economical or practical alternatives to rail transportation.

This is further substantiated and underlined by the fact that Allied owns or leases 6,400 rail cars. Allied feels very strongly that no single commodity or group of commodities should receive favorable treatment at the expense of other commodities. To do so would place a ceiling for rates on one commodity, merely shifts the rail revenue needs unfairly and without justification to all other commodities.

To expand slightly on the captive traffic issue, I would like to point out a great deal of Allied's traffic from the Louisiana plants falls in this category. While we do use water transportation and motor carriers, our investment in railroad equipment, rail shipping, and receiving facilities, the nature of our products, the distance and diversity of our markets, all combine to give us no practical alternative to rail service.

Our high density polyethylene plant in Baton Rouge is a classic example. Approximately 92 percent of the finished product moves to market by rail, in Allied-owned covered hopper cars. There is no question but what the chemical industry in Louisiana is in large measure as captive as any other to rail service.

In summary, S. 1946 seems to provide a reasonable balance between the railroads needs for adding pricing freedom, and protection, on the other hand, for captive shippers. The Long amendment, applied to all commodities, would enhance the captive shippers opportunity to seek reasonable rates, with little impact on the pricing freedom proposed for the railroads.

Thank you for this opportunity to present our views.

Senator LONG. Thank you very much.

[The statement follows:]

STATEMENT OF DONALD E. WATSON, MANAGER-TRAFFIC, ALLIED CHEMICAL CORP.

Mr. Chairman and Members of the Committee: My name is Donald E. Watson. I am Manager-Traffic for the Chemicals Company, Allied Chemical Corporation, Morristown, New Jersey. Allied Chemical is a diversified manufacturing corporation engaged in the production and marketing of chemicals, energy, fibers, plastics and industrial products. The Corporation operates more than 100 plants and mines in the United States; ten (10) of which are located here in Louisiana. These locations in Louisiana employ approximately 1300 people with a 1978 payroll in excess of \$36 million. We produce a wide variety of chemicals, plastics, fertilizers, as well as oil and gas. Allied is heavily dependent on rail transportation, in Louisiana and on a national basis. Annual rail freight expenditures are in excess of \$100 million. It is significant to note that a substantial portion of these payments cover "captive" freight—that is movements for which there is no economical or practical alternative to rail transportation. This is further substantiated by the fact that we own or lease 6400 rail cars.

Due to the size of our stake in rail transportation, Allied is dependent on effective, economically healthy railroad industry, just as the railroads are dependent on the continued business and confidence of Allied Chemical and other substantial users of rail freight service.

Allied Chemical supports reduced Government intervention and control of the nation's rail industry. Whenever railroads face effective competition, ICC authority should be replaced by free market forces. However, where railroads do not face effective competition and shippers are captive to rail service, the substance of ICC control should be retained, namely the control over maximum rate levels and the provision for common carrier service including adequate supplies of general purpose rail cars. Allied Chemical feels that Senate Bill 1946, as it was reported by the Senate Commerce Committee, fulfills these requirements. However, we would also endorse Senator Long's Amendment, provided it applied to all commodities.

We feel strongly that no single commodity or groups of commodities should receive favorable treatment at the expense of all other commodities. To do so, to place a ceiling for rates on one commodity, merely shifts the rail revenue needs unfairly and without justification to all other commodities.

To expand somewhat on the "captive" traffic issue, I'd like to point out that a great deal of Allied's traffic from our Louisiana plants is definitely captive. While we do use water transportation, and motor carriage, our investment in railroad equipment, rail shipping and receiving facilities, the nature of our products, the distance and diversity of our markets—all combine to give us no practical alternative to rail service. Our High Density Polyethylene plant in Baton Rouge is a classic example. Approximately 92 percent of the finished product moves to market by rail, in Allied owned covered hopper cars. There is no question but that the Chemical Industry in Louisiana is in large measure as captive as any other to rail service.

In summary, S. 1946 seems to provide a reasonable balance between the railroads' need for added pricing freedom, and protection, on the other hand, for captive shippers. The Long Amendment, applied to all commodities, would enhance the captive shippers' opportunity to seek reasonable rates, with little impact on the pricing freedom proposed for the railroads.

Thank you for this opportunity to present our views.

Senator LONG. I just want to make one or two statements. Mr. Moore of CLECO in his testimony suggests authorization of different treatment for different commodities under the proposed amendment. Do I take it that you prefer uniform treatment?

Mr. ARNOLD. Yes, sir. Senator Long, as you know, the plastic industry is a very vital industry here in the State of Louisiana. The present rates on plastic materials by rail within the southwest at 700 miles, the ratio of revenue to variable costs at 700 miles is 2.80. At 1,100 miles it is 2.57. At 1,500 miles, it is 2.46. I submit any cap, free ride, reduced ride for any block of traffic such as coal that constitutes 28 to 30 percent, would not enable us to get these levels back to a normal basis or fair basis and it is subjecting us to an unfair burden of maintaining the vital rail service.

Senator LONG. I take it that your view would be when this increases your costs, you, too, are going to have to pass it on to the public in the price of the products, even though that might not be as readily apparent in your case as it is when an electric generating plant has to pass it on to its customers?

Mr. ARNOLD. It is not quite as apparent, but indirectly that is true.

In view of your discussion about productivity and rail service, unit train rates, as was explained to you, contemplate unit trains moving from the mine straight through, whereas we are dependent upon the common carrier obligations to move our freight. Our service in the year 1979 slipped an additional 10 percentage points, so that our actual rail service was 24 percent above what we think it should be and the railroad accepted normal standard service.

What I am saying is that our single cars are not enjoying that expedited service. It costs us about a quarter of a million dollars in additional cars, because of the deficiency in rail service.

You commented about rail service. From here to Houston we have a sizable move, as you know it is about 300 miles. Would it surprise you to know in 1979 the most frequent or the average transit time was in the neighborhood of 6 to 7 days. We finally got it down to 4 days in the last month or so. We hope it can be maintained. But again we don't get the attention or the service that many of these unit trains do, and it is extremely costly and it is all passed along to the ultimate consumer.

Senator LONG. It was my privilege the other day to go through one of many such plants, this happened to be the Western Electric plant at Shreveport, La., and I couldn't help but notice that that company, being a part of the American Telephone & Telegraph, was managing to provide a better service, year by year, at a price that certainly when you adjust for inflation, in terms of constant dollars, it is going steadily down, the amount the public pays for service. And to a very considerable degree, your capital intensive companies that you are representing here are doing much the same. The service, what you are doing once you take that feed stock, big capital investment; it is being done at a cheaper price. In other words, your part of the job is being done at a lower unit cost, even though you are paying higher wages even beyond inflation in many cases to do it.

I think that you people have a right to come in here and ask that the other guys do the same thing, that you not be constantly plagued with high costs, inefficiency, low productivity, when the answer to inflation is to increase productivity, give the public more for its money wherever you can by better mechanization, better production methods, finding ways to give the public the benefit of improved methods and improved machinery and improved techniques, and to do it without trying to encourage workers to feel that they're going to get by without doing a good day's work for a good day's pay.

I don't think we are going to get down to the point where machines can do it all, do you?

Mr. MORGAN. No, sir, I do not. We are delighted to have you have such a good grasp of the economy and we are privileged and honored to have such excellent leadership.

Senator LONG. Thank you.

Next we have Mr. Donald G. Griffin, vice president, distribution and transportation, PPG Industries, Inc.

Mr. CAMP. Senator, if I may say so, I am also attorney for PPG. Mr. Griffin wants to direct his remarks to one particular area, so we won't have duplication with the other chemicals.

Senator LONG. Fine.

STATEMENT OF DONALD G. GRIFFIN, VICE PRESIDENT, DISTRIBUTION AND TRANSPORTATION, PPG INDUSTRIES, INC.; ACCOMPANIED BY JOHN CAMP, COUNSEL

Mr. GRIFFIN. Thank you, Senator. I appreciate the opportunity to comment upon this important issue with the rest of the witnesses.

I also appreciate the opportunity to revisit Baton Rouge. I used to own a home and some property on the old Hammond highway, and after the hearing is over, I hope to go out and see if it has been paved over.

Senator LONG. That is out in my direction. I moved from downtown out to the edge of the city limits out there. Welcome to the club. I am pleased to have you out there. I hope your facilities are more adequate than mine.

Mr. GRIFFIN. I hope you hung on longer than I did.

I will briefly excerpt one or two statements from my prepared remarks, and then proceed to more remarks about the issues Mr.

Camp mentioned about a major facility being considered for Louisiana to produce synthetic fuels from coal.

First, as stated in my statement, PPG Industries operates its largest plant at Lake Charles. This plant consumes energy equivalent to a 450-megawatt station. Like the Louisiana utilities, we generate most of this power ourselves, but the rest we purchase from the Louisiana utilities.

Like the Louisiana utilities, we are most critically concerned about the Fuel Use Act which mandates that we get off natural gas and get on to coal or other fuels by the end of this decade.

In addition, we want to reiterate that this plant ships 10,000 cars a year of chemicals and has for a number of years, to other States in the Union. We are also paying high rail rates in excess of 180 percent variable. So it is difficult for us to conceive of a facility that is more dependent on rail transportation both for its inbound raw materials and outbound finished products.

Of course that brings us now to the key issue of what we are going to be doing by the end of this decade.

Like the rest of the chemical industry, the chemical industry in Louisiana uses almost 30 percent the electricity generated in this State, and if you add on the aluminum industry, it will push it up to 35 percent. So the Fuel Use Act is of major concern to us. Whether this electricity is generated by ourselves or purchased, we are very concerned about this act.

In facing up to the realities, we expect we are going to have to turn in a significant degree to synthetic fuels and feedstocks made from coal. These will require very large investments of capital. We expect that huge quantities of coal will have to be transported long distances into this State from other parts of the Nation.

As our chairman has previously advised you, there is a consortium of six companies jointly considering the construction of major facility in Louisiana to produce medium Btu gas from coal, or lignite or petroleum coke, perhaps. This consortium consists of ARCO, Bechtel, Inc., Cities Service Co., Conoco Coal Development Co., United Gas Pipeline Co., and PPG Industries. Current estimates indicate that this plant can cost upwards of \$1 billion, and will require over 5 years to design and construct.

The initial unit will produce 125 billion Btu's of energy per day, and there will be a second unit that will follow right behind that.

The entire output of this plant is going to be consumed in Louisiana, a good part of it in the Lake Charles area.

I think the next point is very important. This project should materially stretch Louisiana's petroleum and gas supplies; and very significantly it is going to serve to protect the existing plant investments and jobs already in Louisiana now.

It is estimated that the first unit of this facility is going to use about 3 to 4 million tons of coal a year, brought from other parts of the Nation. And if only half of this coal moves by rail, it is going to take about 18,000 rail car shipments a year that are going to roll into this State from somewhere else on the first unit, and 36,000 cars a year after the second one.

It is my understanding that another facility of similar magnitude is being considered by two other companies but I don't have the details on those.

PPG and other members of the chemical industry with plants in Louisiana are very critically concerned with the cost of transporting coal from across the country. We do not lose sight of the fact that coal must pay its fair share of the cost inherent in a sound reliable rail system necessary to assure the movements. As has been stated before, chemicals already bear an impressive burden of these costs, and we believe if coal doesn't pay its fair share, we, the chemical industry, might wind up paying even more.

This is of particular significance to chemical companies with plants in Louisiana, who, as a general statement, deliver large volumes to distant markets competing against other chemical plants.

Before I conclude on this, I would like to state that PPG and other members of this consortium want to express our deep appreciation to you, Senator Long, in your capacity as chairman of the Senate Finance Committee, for including in the Senate version of the windfall profits bill various tax credits applicable to this proposed gasification plant in Louisiana. Other factors being favorable, these tax credits will make the difference in making this project possible at this time. Otherwise, it might take some years before it finally becomes economically feasible. We regret and are concerned that the House bill did not contain similar provisions. We are pleased that in conference you have obtained agreement from the House Members on several parts of these tax credits. We appreciate that you are making every effort to persuade the House Members to accept the rest of the tax credit provisions which are critical to this project.

In summarizing all my remarks, what we would like to say is S. 1946 is a good bill, that treats the carriers' need for revenue, provides appropriate price flexibility for the carriers, and addresses shipper captivity.

We are especially pleased with the contract provisions which will provide us and the railroads with the mutual protection we need for our major relationships over the coming years, whether we are talking about the special facility or our own plant. We expect the railroads to make a profit, we expect to pay our fair share at least and we support differential pricing up to a point.

That brings us to the Long amendment, with its concern for all high-rated captive shippers. In four short words—we support this amendment.

Senator LONG. Thank you.

Mr. GRIFFIN. I would like to say another thing. We especially appreciate your remarks on the need to get the railroads' productivity up.

Our final comment is we urge you to maintain the balance among all commodities and treat them all alike in your legislation, and allow the marketplace, not any fixing otherwise, to create the differential pricing which will eventually merge. We appreciate the opportunity to appear and will be glad to answer any questions that may come up.

Senator LONG. Thank you very much, Mr. Griffin. I do want to discuss one matter with you that is not the subject of the hearings today. You said if you were able to build this gasification plant, that it will help to make Louisiana energy sufficient for a long

time to come and stretch our gas supplies here, which we are required to share with the rest of the Nation, it will make it last a great deal longer.

Mr. GRIFFIN. Yes, sir.

Senator LONG. Now what would you use that gas for if you were able to build the gasification plant? You would be making coal into gas?

Mr. GRIFFIN. Yes, sir, we bring coal in and then convert it into—actually carbon monoxide. And that in turn will both feed our chemical processes as well as fuel our energy needs.

Senator LONG. Will that be used primarily for industrial use, or will it be used for household use?

Mr. GRIFFIN. Industrial. The intent is for this to be used largely by the consortium that is putting it together. That is the initial intent in our case.

Senator LONG. Then if you are able to do that, that would take the pressure off of the consumers to share the gas, the natural gas that could be produced, so the consumers, householders, could use the cheaper natural gas and the industry would use the gas which you say will be really carbon monoxide made from coal that you have imported into the State and also some that would be made here?

Mr. GRIFFIN. That is correct. Actually the gas is only half as strong as the gas we burn in our homes, so it could not really well be used by consumers. But it relieves the consumer, gets us off the 1,000-Btu gas and leaves it for them.

Senator LONG. So by taking industrial producers off of oil, and off of natural gas, and putting them on a carbon monoxide that is made out of coal, you make your supply of energy go a lot further down here. Is that right?

Mr. GRIFFIN. That is absolutely correct.

Senator LONG. Any you maintain the jobs and permit the workers working in this area to stay here, rather than having to shut the plants down and migrate away.

Mr. GRIFFIN. That's right. This just stretches it.

Senator LONG. Let me ask you further about that. How many construction jobs would be involved in that operation?

Mr. GRIFFIN. I really don't have that information. We are talking about 4 years to actually be under construction, from ground-breaking to operation, about 4-plus years.

Mr. CAMP. I can give you that. It is an average of 800.

Mr. GRIFFIN. It is an average of 800 construction workers.

Senator LONG. An average of 800 construction workers over a 4- to 5-year period.

Then do I understand that there is another consortium that is looking at the same type of thing, that might locate here in Louisiana?

Mr. GRIFFIN. That's correct.

Senator LONG. That would be an average, if you add that, of about 1,600 jobs, good high-paying construction jobs while the plants are being built. Then after that you would have the feed-stock available for all of these industries down here, is that correct?

Mr. GRIFFIN. That's correct. I might add one thing, that is not well-known. It is very natural, from chemical processes with which I won't belabor this group, to make methanol. We hear a lot about ethenol in gasahol. But methanol is even better. So this plant will probably make a gasoline supplement called methanol. That would be a natural spinoff.

Senator LONG. That could supplement, just like the alcohol is used to make gasohol, that could supplement what you put in the gas tank to make it go further and stretch our supply?

Mr. GRIFFIN. Yes, this will make gasohol, too, and probably better.

Senator LONG. Now the question is asked whether this should rate a priority over just an ordinary tax cut for corporations and for individuals. Do I take it to be your view that if you are going to give a tax cut as part of a bill that has something to do with energy, it is better to give it in such a fashion that it rewards people to help solve the energy crisis, rather than giving it across the board whether it helps the energy crisis or not?

Mr. GRIFFIN. Absolutely. This is a synthetic fuels program. That is what they are talking about, getting a synthetic fuels program underway, and this is it, to make new energy sources. The so-called windfall tax credits should be applied to new sources and this is one.

Senator LONG. To what extent do you think the provision we have in conference between the Senate and the House now would assure that this would be done? In other words, it would increase the probability this could happen, and to what extent do you think it might get it speeded up?

Mr. GRIFFIN. It is hard for me to say. I can say categorically I think that the provisions that were in the Senate version, as contrasted with the lack of provisions in the House version, will definitely speed it up.

In other words, this thing might eventually get built 5 years later anyway, but I will hazard a guess it could be a 5-year differential, and I am winging it on that, in comparing the two bills.

Senator LONG. Isn't this true, that if we were further ahead than we are now with converting coal to gas, so that the gas could be used in industrial plants, as you are talking about here, and if we were further ahead in the coal conversion, so you could take coal and manufacture alcohol and use that in the gasoline tank to run a automobile, if we just were farther on down the road with that, we wouldn't have any energy shortage in America, we wouldn't have to rely on Iran or Saudi Arabia to provide us with oil? And those people wouldn't have the leverage they have on us now with regard to the 50 hostages over there.

Mr. GRIFFIN. That is right. We are very, very late, as a nation, and we must start finding more ways to get new sources of energy. This is just one of them.

Senator LONG. You are familiar with this fact, that even in terms of fossil fuels alone, there is no shortage of energy in the United States, but all we have is a shortage of the plants and equipment and the delivery system to take the energy, mine it, convert it into a useable form, and put it at the burner point, where the consumer can get the benefit of it?

Mr. GRIFFIN. That is a good statement. We have plenty of coal.

Senator LONG. We have enough coal to last for hundreds of years, don't we?

Mr. GRIFFIN. That's right, we have plenty of coal, but this is one way to get it into a form that we recognize we can use.

Senator LONG. We also have the shale in Colorado, we have enough of that to last for hundreds of years?

Mr. GRIFFIN. Right. But shale is not as close technically as this is. That is the important difference.

Senator LONG. You can talk about making products out of shale, but you can get more for your money by using coal to do that right now and we have the coal?

Mr. GRIFFIN. That is the way we are figuring it. We are figuring it every way, but that is the way we have it figured for now.

Senator LONG. Right. Thank you very much, sir, I appreciate your statement here today.

Mr. CAMP. Mr. Chairman, one thing you mentioned that might be worth repeating is that this kind of facility is to be financed by the industries themselves as opposed to the go-go's, where tax funds are used for Government-subsidized facilities or Government controlled facilities, where they are built under Government loans or whatever.

[The statement follows:]

STATEMENT OF DONALD G. GRIFFIN, VICE PRESIDENT, DISTRIBUTION AND TRANSPORTATION, PPG INDUSTRIES, INC.

PPG Industries operates a 450 megawatt equivalent chemical plant at Lake Charles, LA. It ships over 10,000 cars of chemical each year, most to distant markets in the U.S., at rail rates exceeding 180 percent revenue to variable cost. PPG faces the prospect of converting its energy sources in the 1980's. The Fuel Use Act mandates a shift from natural gas to coal. PPG intimately shares the electric utilities' concerns for receiving coal from distant U.S. points by reliable, economical transportation.

A consortium of six companies (Airco, Inc.; Bechtel, Inc.; Cities Service Company; Conoco Coal Development Company; United Gas Pipeline Company; and PPG Industries) is jointly considering a synthetic fuels-feedstock facility in Louisiana to produce 250 billion BTU's per day from 6-8 million tons per year of coal shipped into the state from distant U.S. points. Perhaps 36,000 rail car shipments per year would be required beginning in 1986-1987.

PPG Industries is critically concerned with a reliable, sound rail system, funded by all users on a fair and equal basis. Within fair and even-handed legislation, PPG will at least pay its fair share of rail costs for inbound raw materials and outbound finished products. PPG supports S-1946. PPG strongly supports the Long amendment in its concern for the high rated captive shipper. PPG abhors any and all attempts to differentiate by statute one commodity versus another.

PPG Industries wishes to enter certain remarks in support of subject amendment (Sec. 104 (5) (A)) to the "Railroad Transportation Policy Act of 1979" (S-1946).

PPG Industries is a major manufacturer of industrial chemicals, flat glass, coatings and resins, and fiber glass. Its 1979 sales were \$3.1 billion—over 80 percent in the U.S. In 1979, PPG used U.S. railroads to receive 1.9 million tons of raw materials and to ship 2.4 million tons of finished products from its 43 U.S. plants. This generated \$83 million of rail freight. Approximately 90 percent of this moved in bulk tank cars and covered hopper cars. There is little likelihood that much of this could move via another mode in the foreseeable future. PPG owns or leases over 3,200 rail cars—with a replacement value of over \$160 million. We are heavily committed to and highly dependent on rail transportation.

At Lake Charles, LA, PPG operates a chemical plant with an aggregate investment exceeding \$500 million. This facility ships 2.5 million tons per year, 30 percent of this by rail. This plant employs over 2,000 people. The Lake Charles plant is energy intensive. It purchases and produces energy for its own consumption equivalent to a 450 megawatt power station. We are presently in the process of expanding

the Lake Charles plant with expenditures approximating \$100 million per year, resulting in an annual construction payroll over \$15 million and 1,000 persons.

Rail transportation.—The Lake Charles plant ships more than 10,000 loaded rail cars of finished products each year, moving at rail rates with an average ratio of revenue to variable cost *exceeding 180 percent*. PPG now faces the need to convert this plant's energy sources in the 1980's. By the end of this decade, we expect the majority fuel to be coal, moving from other sources in the U.S., much of it by rail. It is difficult for us to conceive of a major facility more dependent on reliable, economical rail transportation—for moving raw materials and energy in and finished products out. It is wedded (captive) to rail transportation, and proposes to be even more so.

PPG has a critical interest in a viable national rail system. We fully recognize the rails' need for additional revenues to bring them to financial viability. On the other hand, we firmly believe and can further substantiate that our high rated traffic already is carrying its financial share, and then some—with the prospect of more as we convert to coal. Nonetheless, PPG expects that it must do its part to supply some additional revenues to the rails. PPG fully expects *all* users of rail transportation to do their fair share in meeting the rails' financial needs.

S. 1946.—PPG Industries finds this to be a generally well-crafted bill that seems to balance the various needs of the rail carriers and the shippers/receivers. *Sec. 102*—we accept the principle that all rates below the base threshold should be free from ICC intercession on the basis of reasonableness. We think this threshold should be set at a level which will give the rails financial returns between those of utilities and other industries. Our studies show these to be as follows for the past five years:

	Return on capital (percent)	Return on equity (percent)
All industry	11	15
Utilities:		
Electric and telephone	7	12
Natural gas	8	16
Railroads	5	9

Sec. 104—we accept the principle that rates above the base threshold should have some but diminishing freedom. This section is well crafted. We see no reason to change the rate flexibility zone free from suspension or investigation, up to 12 percent over 5 years, plus inflation as defined in *Sec. 103*. It follows that as rates go progressively higher, to and beyond a higher threshold or "trigger point" these rates must become subject to increasing scrutiny and impedance. To this end, we strongly endorse Senator Long's amendment which will shift the burden of proof to the railroads as they increase rates beyond the trigger point. *Sec. 106, Contracts*—this section provides an excellent step forward. It makes a meaningful contribution toward mitigating our concerns that new, heavy investments (i.e., conversion to coal) might be subject to unreasonable escalation, after the investment is made. *Critique of S. 1946*—we feel that the tendencies in S. 1946 markup to make special provisions for some commodities are unjustified. We feel that our products are as essential as any in the U.S. economy and its well being. We feel most strongly that the marketplace, not bureaucratic fixing, is the way for commodities to find their comparative evaluation in the economy. To that end, we abhor any attempt by legislative or administrative processes to fix one product vis-a-vis another in the U.S. economy. These remarks would also apply to any amendments that might attempt such fixing.

Senator Long's proposed amendment.—We applaud this amendment—which directs the ICC to set a trigger point beyond which the burden of proof shifts to the proponent carrier. We fully expect that this trigger point will be a single ratio applying equally to the movement of any commodity that reaches this level. We easily understand and fully expect that different types of service (unit train versus single cars) will yield different costs and, therefore, different rates—but all at a single given *ratio*. We utterly fail to comprehend why different commodities deserve different ratios. It is our expectation that the ICC in rulemaking must arrive at a single ratio for all commodities to define the trigger point. It is our hope that it will not exceed 180 percent. We are confident in the ICC processes which will set the trigger point, as directed by the Long amendment. We do not particularly see any need for further Congressional review.

Louisiana synthetic fuels-feedstocks from coal.—We would like to make special reference to Louisiana chemical industries' prospective dependence on coal delivered by rail from other points in the U.S. in the 1980's. PPG's 450 megawatt equivalent plant, along with other chemical and aluminum plants in Louisiana, are major users of electrical energy. Whether our electricity is generated by ourselves or purchased from Louisiana utilities, we are critically affected and keenly sensitive to our economic prospects under the Fuel Use Act which mandates a shift from natural gas to coal during this decade. We expect that we must turn in a significant degree to synthetic fuels and feedstocks made from coal. These synthetic fuels will require very large investments of capital. Huge quantities of coal will have to be transported long distances into the state from other parts of the nation.

As PPG's Chairman L. S. Williams has previously advised you, a consortium of six companies is jointly considering the construction of a major facility in Louisiana to produce medium BTU gas from coal, lignite, or petroleum coke. This consortium consists of Airco, Inc., Bechtel, Inc., Cities Service Company, Conoco Coal Development Company, United Gas Pipeline Company, and PPG Industries. Current estimates indicate that this plant could cost upwards of \$1 billion and require over five years to design and construct. The initial unit would be designed to produce 125 billion BTU's per day of fuel and/or feedstocks. A second unit following would double this. The entire output of the plant would be consumed in Louisiana with the largest share being used in Lake Charles. This project should materially stretch Louisiana's petroleum and gas supplies. Significantly, it will serve to protect existing plant investments and jobs in Louisiana. It is estimated that the first unit of the facility would use 3-4 million tons per year of coal. If only half of this coal moves by rail, 18,000 rail car shipments will move into Louisiana each year for the first unit, and 36,000 shipments annually for both units. It is our understanding that another plant of equal magnitude is being considered for construction in Louisiana by two other companies; however, I do not have the details on their proposed facility.

PPG and other members of the chemical industry with plants in Louisiana are, therefore, critically concerned, as are the Louisiana utilities, with the cost of transporting coal from across the country into Louisiana. However, we must not lose sight of the fact that coal must pay its fair share of the costs inherent in a sound, reliable rail system necessary to assure this movement. Chemicals already bear an impressive burden of these costs. We believe that if coal does not pay its fair share, we the chemical industry will end up paying an even larger share. This is of particular significance to chemical companies with plants in Louisiana. For the most part, our plants must deliver to distant markets, with laid-down costs competing head-to-head with chemical plants nearer these markets. Rail transportation is a major mode for reaching these markets, and its costs are a key factor in the competitive pricing of our products.

Before concluding, PPG and the other members of our consortium would like to express our deepest appreciation to you Senator Long in your capacity as Chairman of the Senate Finance Committee for including in the Senate version of the Windfall Profits Bill various tax credits applicable to this proposed gasification plant in Louisiana. Other factors being favorable, these tax credits will make the difference in making this project possible at this time. Otherwise, it might take some years before it finally becomes economically feasible. We regret and are concerned that the House bill did not contain similar provisions. We are pleased that in conference you have obtained agreement from the House members on several parts of these tax credits. We appreciate that you are making every effort to persuade the House members to accept the rest of the tax credit provisions which are critical to this project.

Summary recap.—S. 1946 is a good bill that treats the carriers' need for revenue, provides appropriate price flexibility for the carriers, and addresses shipper captivity. The proposed Long amendment effectively addresses concerns of the high rated captive shipper. We support it. We especially urge that you maintain the balance among all commodities and treat all alike in your legislation—allowing the marketplace to create the differential pricing which will enviably emerge.

PPG Industries appreciates the opportunity to comment on this important legislation.

Senator LONG. Thank you. Now let's hear from Mr. Joseph Cleary, director—corporate utilities, Airco, Inc.

**STATEMENT OF JOSEPH CLEARY, DIRECTOR—CORPORATE
UTILITIES, AIRCO, INC.**

Mr. CLEARY. Thank you very much, Senator. I am the director of corporate utilities for Airco, which is a multidivision company, with eight operating divisions. It is one of the Nation's largest consumers of electrical energy, most of which is generated by coal. We have about 30 power-intensive plants scattered throughout the United States. One of them is in Louisiana, another one we are going to break ground for in just a few weeks up in Madison Parish, for a \$150 million plant, which is the largest single investment our company has ever made.

Senator LONG. I hope I can be there when you break ground on that; I am hoping to be there.

Mr. CLEARY. For about 20 of those 30 plants, electric power is about 70 percent of the manufacturing costs. So we are very sensitive about anything that tilts electric power rates, especially if it is not truly cost based.

While Airco very strongly endorses deregulation of competitive businesses, we have very serious reservations about deregulating rail coal freight rates or any other captive market for that matter, absent the constraints such as you have contained in your proposed amendment.

We think that deregulating coal freight rates could seriously set back some of the key goals in our national energy policy. You addressed that on December 17, and I think your concerns are very well placed. After all, the keystone of our national policy is the conversion of coal into gas and liquids, what the previous witness talked about, which my company is involved in that same project.

Another keystone is the policy of getting utilities to switch from oil and gas to coal. Even without switches, coal now accounts for over 40 percent of the electricity generated in this country. The freight rates already are a very large component of coal costs. Even under regulation some of the recent increases in freight rates have been alarming. Coal certainly is a captive market, there is not much question about that, and what goes on in trucking and barging doesn't seem to have much effect on the setting of coal freight rates.

Our company believes the prices of any utility should be based on the cost of service, whatever that turns out to be, otherwise you get economic dislocations and the entire economy, we think, suffers. Consumers wind up paying for everything anyway, they might as well pay the right price.

Airco strongly suggests that it is painfully obvious that unrestricted coal freight rates will cause coal prices to just take off. And that is a situation in which again we do share your concerns, that that situation is just going to do violence to some of the major goals of our national energy policy that are directed to lessening our dependence on foreign oil.

We are happy to support your amendment. Thank you.

[The statement follows:]

STATEMENT OF JOSEPH M. CLEARY, DIRECTOR OF CORPORATE UTILITIES, AIRCO INC.

Airco is a multi-division company with eight operating divisions. It is one of the nation's largest consumers of electrical energy, most of which is generated by coal.

While our company strongly endorses deregulation of competitive businesses, we have serious reservations about deregulating rail coal freight rates. In fact, absent a constraint such as contained in Senator Long's proposed amendment, we believe deregulating coal freight rates could seriously set back some key goals of our national energy policy.

A keystone of our national energy policy is the conversion of coal into gases and liquids. Another keystone of that policy is the goal of electric utilities switching from oil and natural gas to coal at existing generating stations in order to reduce oil imports and to conserve natural gas. Even without such switching, coal presently fuels over 40 percent of U.S. electricity production.

Coal freight charges already are a large component of utility coal cost. And, even under regulation, recent increases to coal freight rates have been alarming.

For the most part, coal is a captive market for the railroads. Competition from trucking and barging is not now a major factor in setting coal freight rates. Once deregulated, the sky will be the limit on coal freight rates, at least for several years.

Airco suggests in the strongest possible terms that it is painfully obvious that unrestricted coal freight rates will cause coal prices to skyrocket, a situation that will surely make coal less attractive as an energy option, and which just as surely will do violence to major goals of our national energy policy that are directed to lessening our dependence on foreign oil.

Senator LONG. Thank you very much, Mr. Cleary, I appreciate your presence here today. That concludes this morning's hearing. We will have a further hearing on this amendment in Washington, D.C.

Let me thank all of the witnesses who have made themselves available and suggest that for those who can, that they follow this hearing as we conduct further hearings in Washington.

Thank you very much.

[Whereupon, at 12:25 p.m. the hearing was adjourned.]

RAILROAD TRANSPORTATION POLICY ACT OF 1979

Coal Transportation Amendment

FRIDAY, FEBRUARY 22, 1980

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, D.C.

The subcommittee met at 9 a.m., in room 235, Russell Senate Office Building, Hon. Russell B. Long (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR LONG

Senator LONG. This hearing will come to order.

This is the second day of hearings on the amendment that I have proposed to S. 1946, the Railroad Transportation Policy Act of 1979. We are here today because, in my opinion and the opinion of the shipper who is captive to the rail industry, the current regulatory policy being pursued by the Interstate Commerce Commission, and the provisions of S. 1946, do not now and will not—if S. 1946 is enacted as reported—provide adequate protection from the railroads' desire to extract exorbitant rate increases in noncompetitive markets.

I have particular concern for the recent trend in coal rates. The fact that escalating rail rates for coal has a chilling effect on the conversion to coal-fired utilities is unquestionable. The national transportation policy, or the current regulatory scheme, should not be inconsistent with the attainment of national energy goals. We all agree that the Nation needs a strong, viable railroad system, and it's clear that if this goal is to be achieved, financially strong carriers are essential.

The question I am seeking to address in my amendment is not whether coal or any other captive commodity or shipment should be required to make a reasonable and fair contribution to the financial needs of the rail industry. The question is whether contributions should be without limit, without justification, or without a demonstrated effort by the railroads to lessen the burden on captive shippers by maximizing the revenues obtained from the captive traffic.

The amendment I have proposed requires the Interstate Commerce Commission to develop standards which will be used to determine a specific revenue to variable cost level, at which the burden of proof as to reasonableness of the proposed rate would

shift to the carriers. It was my intent that the level established would raise a rebuttable presumption that the rate proposed above that level would be unreasonable.

It had been suggested that this amendment will present an additional obstacle to the railroads' ability to obtain profitability by increasing regulatory restraints. I believe that everyone here would support the idea of less regulation in competitive markets.

However, to prevent economic abuses from monopoly pricing, Federal regulation is appropriate and necessary in the absence of effective competition. In a monopoly market, once a railroad is recovering its full costs and a reasonable return, any additional amount sought by the carrier should be fully justified. This is the intent of the amendment I propose. Let the railroads recover costs, but, above that level, put the burden of proof on the carriers to demonstrate that the rates should be higher.

Now, I have a statement here from Mr. Bentsen, Senator from Texas. I think I will read it into the record since it is only a two-page statement.

STATEMENT OF HON. LLOYD BENTSEN, U.S. SENATOR FROM TEXAS

Mr. Chairman, I will begin by saying I appreciate your efforts on behalf of utilities to maximize coal usage to the consumers they serve. I want to reiterate my support for measures such as your amendment, the railroad legislation, which would protect consumers by guarding against unjustified increases in coal shipping costs.

Last July I chaired hearings of the Joint Economic Committee to consider the impact of coal shipping rate increases. We found that unfair coal shipping increases would impose an outrageous burden on hard-pressed consumers. We found that because of skyrocketing coal shipping rates, some utilities found it more advantageous to bring coal into the United States from Poland and South Africa, than to ship it by rail from Colorado and Wyoming.

We found that at a time of dangerous dependence on foreign energy sources, at a time when the policy of the United States is to encourage coal conversion, that high coal transportation costs stand as a roadblock in the path of both fairness and the national interest. We found that those who did what was good for the United States were punished, not rewarded; that policies that are good for the United States are discouraged, rather than encouraged.

In short, Mr. Chairman, we found that many consumers have been faced with increases that violate principles of basic fairness, national policy, and common sense. Take the case of San Antonio, a city that began in 1977 to generate electricity by burning coal. This step was taken with the national interest at heart, with the consumers' interest in mind. But it didn't work out that way.

Three years ago the ICC established a coal shipping rate of \$10.93 per ton for San Antonio. Today it is \$19.25 per ton, an increase of 75 percent over 3 years, an increase averaging 25 percent a year.

San Antonio is a captive shipper. There is no rail competition to provide an alternative, to allow our free market system to operate as it should. There is nowhere else to go. Consumers in San Antonio face increase after increase, far above what they expected when they converted to coal, far above what they should be paying. I believe that this situation is unfair and unnecessary and that Congress must take steps to protect captive shippers and to ensure that they are treated fairly.

I believe that the analysis mandated by the Long amendment is long overdue. It would require the ICC to develop standards which will be used to determine the specific revenue-to-variable-cost level at which the burden of proof as to the reasonableness of proposed rate increases would shift to the carriers. It would ensure that competitive traffic would pay its fair share before additional costs are placed on the captive consumer. It would ensure that our national energy needs are fully considered in setting coal shipping rates, and that we stop pursuing policies that fly in the face of our national energy needs. It will provide that railroads must demonstrate revenue needs and that they can only meet those needs by imposing additional costs on captive shippers, before they raise rates beyond a reasonable level.

Mr. Chairman, I have spoken out on this problem many times in recent years. I would refer you to the record of our Joint Economic Committee hearings, because I think the record demonstrates the need for action to protect the captive consumer. You can count on my support.

Senator LONG. We held hearings in Louisiana a few days ago and everyone that wanted to testify was invited to so testify.

We had representatives from the top down of the investor-owned electric utilities. The president of the Edison Institute testified on behalf of the entire industry. And as a regulated utility themselves, they said they want the railroads to make a fair return on their investment, but that they do not want the railroads to rip off the public or to require them to rip off their customers.

That was the unanimous view of all those representing the electric cooperatives providing service to farmers and others. And also, it was that type of thing that was the unanimous view of all of those who represent industry.

We want the railroads to make a fair return. But in the areas where they have a complete monopoly, we don't want them to rip off the public.

Now the Governor of Louisiana testified that as far as Louisiana is concerned, we would be happy to have no regulation at all, provided you apply that to oil and gas while you apply that to coal.

We'd be happy to keep our oil and gas at home, use it down there and not use any coal. And we'd be a lot better off if you did.

But we are regulated every step of the way. We're regulated on what we can charge, we're regulated on what we can charge for transportation of other production.

And for the life of us, we can't understand why we should be regulated strictly every step of the way and be required not to use, forbidden to use our own sources of energy which are superior to coal, and then be charged ripoff prices which cannot be justified for coal shipped to our area.

So I would say here that we really want to have the ICC fix some level at which these increases are presumed to be unfair, and above that point, let the railroad bear the burden of proving that these additional charges are fair with regard to their captive customers.

Now I will limit each witness to a 10-minute presentation in chief, and then we will have some interrogation. And I hope that the other Senators will join before the day is out because, if not, I will be required to call a recess at about 10:15 today because of the meeting of the conference on the energy tax bill, of which I'm chairman.

First, let's hear from Mr. William Johnston, Assistant Secretary for Policy and International Affairs of the Department of Transportation.

STATEMENT OF WILLIAM B. JOHNSTON, ASSISTANT SECRETARY OF TRANSPORTATION FOR POLICY AND INTERNATIONAL AFFAIRS OF THE DEPARTMENT OF TRANSPORTATION; ACCOMPANIED BY ROBERT STEARNS, DIRECTOR, OFFICE OF ECONOMICS AND OPERATIONS POLICY, FEDERAL RAILROAD ADMINISTRATION; AND EDWARD B. HYMSON, SENIOR ECONOMIST, OFFICE OF TRANSPORTATION REGULATION

Mr. JOHNSTON. Good morning, Mr. Chairman, I appreciate the opportunity to be here today to discuss railroad regulatory policy as it applies to ratemaking and specifically to comment on your proposed amendment to S. 1926.

Your actions in this area will have important implications for our long-term inflation prospects, the energy situation and the health of our rail industry.

With me this morning are Bob Stearns, the Director of the Office of Economics and Operations Policy in the Federal Railroad Administration, and Ed Hymson, senior economist from the Office of Transportation Regulation Policy on my staff.

As you all know, the maintenance of an adequate railroad transportation system is essential to this country's continued move toward a rational energy policy which would free us from dependence on foreign energy sources.

The railroads serve this goal in two ways—they provide transportation that is three to four times more energy efficient than the trucks against which they compete, and they are a major method of bringing coal to the utilities that produce electricity for American households and industry.

Unless the rail system is built up to the levels needed for reliable heavy-duty hauling, and then maintained in good repair, we will all pay more, not only for our energy but also for other consumer goods.

The railroads are a critical link in the President's plan to convert utilities to coal use nationally, and they must be financially self-sufficient to carry out their responsibility.

At present, the industry does not earn enough revenue even to maintain the system. Last year, the railroads in the aggregate earned only a 2.5 percent rate of return on investment and the inroads in bankruptcy or generally regarded as "marginal" outnumbered those earning an adequate rate of return.

This 2.5 percent rate of return can be compared with the average for all manufacturing industries of 10.6 percent and the average for electric and gas utilities, which in 1978 was more than 11 percent.

Senator LONG. Let me just stop you there for 1 minute.

Have you done a thorough study of those rate bases to see to what extent they could justify those rate bases?

Mr. JOHNSTON. The rail rate bases or the utility rate bases?

Senator LONG. I mean the rail rate bases. You haven't done that, have you? You have not.

Mr. JOHNSTON. I would concede—

Senator LONG. You have no responsibility in that connection. What responsibility does the Department of Transportation have to have with regard to the overall rate bases?

Mr. JOHNSTON. In a direct rate-base sense, we have none.

Senator LONG. Have you made any study of it?

Mr. JOHNSTON. We have.

Senator LONG. Where is your study?

Mr. HYMSON. Mr. Chairman, the Department of Transportation submitted testimony in Ex Parte 271 before the ICC. The purpose of that proceeding was to examine, among other things, the railroad rate base. In that proceeding, the Commission concluded the rate base for railroads was in general not overstated.

Senator LONG. You don't think it's overstated?

Mr. HYMSON. The Interstate Commerce Commission concluded it is not. I personally concur with their conclusion.

Senator LONG. Well, in Chicago & Northwestern, they sold their railroad to the workers and the court ordered them to squeeze \$400 million out of that rate base before they got into it.

Are you aware of that?

Mr. HYMSON. The Chicago, Illinois & Western was losing money and was sold off to a group of investors, who continued to operate it as a railroad.

The alternative, had the trends continued, would have been for the railroad to go into receivership.

Senator LONG. Let me ask you this. Before the Securities and Exchange Commission will allow the transaction to take place—that is for the workers to buy that railroad. Some \$400 million was dewatered from the rate base as representing things that were no longer used or useful in rendering service.

Mr. HYMSON. Mr. Chairman, I presume that you're talking about the spinoff of that railroad from the holding company to the current owners of it.

During that time, there was a substantial write-down for tax purposes that could be referred to as a dewatering. If you examined the earnings of that railroad during the preceding years, you will find that they were losing money and the only way that they could get anything out of their assets was to write them off.

However, to argue that they are not used and useful runs in the face of the ICC, which has not permitted many of the abandonments that they have asked for and certainly has made it clear, at least in the past, that they could not abandon major lines as opposed to branch lines.

Apparently, the shippers think those investments are still used and useful.

Senator LONG. Well, I think it's very clear, you come in here saying that you think that those rate bases are not—that they are not padded and they're not overrated. But these people had 100 years' experience in figuring out how to build up those rate bases and how to put them in for the highest price they can justify by any standard.

They have had a lot more experience and a lot more expertise than the people on the other side.

I'm not saying that you don't have some crusading public service commissions around this country because you do. But you also have some that are not all that diligent.

And to say that the public service utilities—the public service commission has squeezed out all the situations that has a potential

of stating those bases above the actual fact, to me, I just don't buy it.

And furthermore, I just don't believe that you will find people who are not committed to either side, don't work for one side and don't work for the other, who have some idea of this subject matter that would agree with you in that matter.

Just talk to people. And I have all my life, people that know something about that subject.

And one reason I thought about this 2.5 business is I always felt that was a value unsaturated.

Mr. HYMSON. Senator, that number includes the written down value—

Senator LONG. Why shouldn't they write a bunch of junk down? Why should they charge the public for a bunch of stuff that's not worth what they've got there?

Mr. HYMSON. I agree, they should and did. The ICC sets rates on the basis of the written-down value, not the old value to which you referred.

Similarly, if the railroad has gone through receivership, the written-down value is the value the ICC uses in ratemaking, not the value prior to bankruptcy or prior to other write-downs that occurred.

Senator LONG. Well, let's just face this fact. It might not tell you anything. It tells me something. It isn't just an impartial source.

The ICC and you people are supposed to be the ones that are supposed to be protecting the public against ripoff from the rail industry.

You come in here and you're the only people they can find in America to uphold their case. Private industry won't defend them. Regulated public utilities won't defend them.

The people shipping—the people who make laws—make those products won't defend them. They all said that I'm right about this.

And here they are complaining about being regulated by the ICC with regard to their captive business when the ICC and you, who are supposed to be regulating them, watching them, are the only people who will stand up and defend them.

And I must say, I don't see how you can very well be complaining about rate regulation on your captive business when the people who would regulate you are the only people in America who would defend what you're doing.

Go ahead.

Mr. JOHNSTON. Mr. Chairman, regardless of the rate base, I think the committee itself has concluded that overall, railroad revenues are inadequate. Whether the level should be compared to higher rate bases is part of the issue.

The administration and the Congress have been working on reform of railroad regulation for many years. In this process, we have both been giving attention to the need for sufficient rate protection for shippers.

At the same time, we must not lose sight of the legitimate revenue needs of the rail industry. Shippers of all commodities in all parts of the country are suffering the consequences of the railroads' long-term decline in financial health.

The purpose of the regulatory reform effort is to get away from unnecessary regulation, to eliminate extra layers of authority, and return decisions as much as possible to the private marketplace.

Any legislation should not prevent the railroads from adjusting rates and service to the demands of their shippers.

Railroads require flexibility in pricing, as do all competitive firms.

The Department of Transportation continues to believe that it's inappropriate to use revenue to cost ratios as a final test of the reasonableness of rates. Such ratios can be used to provide threshold tests of whether rates are compensatory. Beyond that they are but one of a number of measures of the level a particular rate should be.

To put the Department's position in perspective, I want to discuss briefly some of the economics of railroad ratemaking and railroad coal rates in particular. No matter how rates are set, they must, in the aggregate, cover all of a railroad's costs including a fair rate of return. If railroads do not earn enough to maintain their operations, either service will deteriorate and ultimately cease, or the Government will be asked to make up the deficit through subsidies.

Such subsidies represent a cost to society just as much as higher rates. In fact, administering a Government subsidy program is almost certain to be less efficient and more costly than permitting the railroads to earn the necessary revenue directly from the shippers using rail service.

A number of rate structures have been suggested to produce an adequate overall level of revenues for the railroads. The Department of Transportation supports a system of railroad ratemaking sensitive to the needs and demands of the variety of shippers, which we term "limited demand-responsive pricing." That is the pricing framework we see in the rest of the economy, and the framework that permits the fullest and most efficient use of the rail system.

Under this ratemaking framework, rates on all traffic should cover at least variable or incremental cost. Beyond that, rates should be set so as to recover as much fixed or nontraceable costs as market conditions permit, up to limits which are determined by the ICC to be reasonable on a case-by-case basis and in light of overall carrier revenue needs.

Because of differing competitive conditions, some traffic is able to cover more of those costs than other traffic. Generally, shippers for whom alternative transportation or markets are easily available will not pay a large share of nontraceable costs, and the rest must be recovered from the remaining traffic.

Setting all rates equal to fully allocated cost has often been suggested as an alternative to demand-responsive pricing. In this ratemaking system, each shipper pays the variable cost of service plus a pro rata share of the remaining costs.

Senator LONG. I've read your statement. To have more time for questions and answers, I'd like to put the entire statement in the record.

Senator LONG. Is the Burlington a profitable railroad?

Mr. JOHNSTON. It is—we would consider it a marginally profitable railroad.

Senator LONG. It's my understanding Burlington is a profitable railroad. They're going to get lots more coal business. We all agree they're going to haul that at a profit.

Mind you, under energy policy, we are required to buy that coal. We don't have any choice. We're required to buy that by law. We are willing to pay. You're going to make a nice profit, a good profit, on every ton of coal they load. That's the problem. They've got all the records. They've got the rules.

How about Missouri-Pacific; is that a profitable railroad?

Mr. JOHNSTON. Yes.

Senator LONG. Very profitable, they tell me. Now, here we are required to buy this coal. They have got the books. They have got all the expertise. They've got the rate experts. They have been using that and justifying their rates since time immemorial.

Now here we are having to buy this stuff that we've never bought before, and they're just ripping us off until nobody will have any money, while we are trying to find a way to pay for all of this.

So the burden of proof is on us, who have very little knowledge about all their operation. We have very little knowledge of their operation. Now, why should not at some point they have to bear the burden of proof, rather than us?

Mr. JOHNSTON. In many cases they do have to bear the burden of proof. In investigation situations, when the ICC decides to investigate a rate, the carrier bears the burden.

In S. 1946, that will continue in the area above the "no challenge zone" that the committee recommended.

Senator LONG. Well, now, take this situation. Once we agree that they are making a good profit on that coal, why shouldn't they have to bear the burden of proof that we ought to pay still more?

Mr. JOHNSTON. Our recommendation is that the ICC should determine on a case-by-case basis what the level of reasonableness is. In a situation in which the new rate is investigated by the ICC, the carrier does bear that burden of proof.

Senator LONG. It seems to me that once they are making what we think is a very good return on that movement, that they carry the burden, full burden of proof. Now, the railroads have made record earnings in 1979. Now we're talking about giving them more flexibility to make still more money, and we are having people in our part of the country who understand something about rate-making, who are screaming to high heaven on the way they're being ripped off.

Now, take somebody who is in the electric utility industry. Do you think those people are against private enterprise?

Mr. JOHNSTON. Certainly not.

Senator LONG. Do you think those people are in favor of unnecessary regulation?

Mr. JOHNSTON. I would hope not.

Senator LONG. So by the time they come in here—mind you, those are the kind of people who wouldn't come in to testify against the railroads' position. Usually you take them to be sort of

part of the brotherhood and help defend people who have a parallel situation, if that situation can be justified.

How would you explain the fact that the electric utility industry, represented by the Edison Institute and from there right on down to the lowest one in the whole group, coming in here and saying: Look, this isn't right. It's not fair to the consumer.

Mind you, they have a right to pass it on. They can put that right on the consumer. They have that right under law. But they would be the first to say it's not fair to the consumer. Now how can you—do you think they're prejudiced? Do you think that they would be unfair to their fellow regulated industry?

Mr. JOHNSTON. I don't think they would be unfair to their fellow regulated industry. But I think from our perspective, the long-term health of the industry is consistent with the utilities' needs. If we have an unhealthy railroad system, if we have a system that's bankrupt—for example, in the Rock Island case, where there is a coal utility on one of the lines proposed to be abandoned—worse problems can be created by loss of service than by some marginal increase just to keep the railroads—

Senator LONG. Let's just take the second point. Take the point you're getting to now. The Rock Island is in bankruptcy. You and I both are trying to do something about the Rock Island.

Missouri Pacific, serving the same area that I happen to represent, they're one of our most profitable railroads. They're doing great. Now, can you explain to me, how are you going to help the Rock Island by letting the Missouri Pacific rip us off more than they're doing already?

Mr. HYMSON. Senator Long, one of the reasons Missouri Pacific is doing well is that not too long ago they went through bankruptcy and reorganized on an income basis. As a result, the rate base was reduced substantially—

Senator LONG. Well, that's just what I was talking about. Now you're agreeing with me. The cause of this problem is the rate base.

Mr. HYMSON. And the ICC regulates on the lower rate base, not the higher rate base.

Senator LONG. Do you approve of that?

Mr. HYMSON. Of course I do, and that's what they're doing.

Senator LONG. Fine. Now, if you put that in the same type of procedure, you wouldn't have all this complaining of the lowering on that rate base you're talking about.

But let's agree some of them are losing money. All right. Rock Island is losing money and Rock Island is in bankruptcy. How are you going to help Rock Island, if you're letting Missouri Pacific make more profit than the law would allow?

Mr. HYMSON. We are not, according to the ICC, letting Missouri Pacific make more than the law does allow.

Senator LONG. Well, you're in here advocating deregulation of the Missouri Pacific, aren't you?

Mr. HYMSON. No; we're advocating rates be set at a level that allows an adequate return for those carriers who can earn that return. We would certainly hope that the ICC does not grant rates any higher than necessary. But for those many carriers, such as the Burlington Northern, who are not anywhere close to that ade-

quate rate of return, the alternative seems to be to create another Rock Island-like situation or let them earn enough money so they can attract the capital they need to make investments.

I think in practice the ICC does take into account the differing conditions of the various railroads and tries to govern the reasonableness of its decisions with some consideration to whether or not the overall revenues of each carrier are adequate. So that there would be a different situation on the MoPac as opposed to the Rock Island.

Senator LONG. All we're talking about here is the extent to which the railroads should be permitted to rip off their captive customers. In this case the consuming public of electric power is interested as far as coal for the generating plants, because the people they are really ripping off are the people who are using the electric power.

We're just here to put a limit on the extent to which they can rip those people off or the extent to which they can go out and haul something else at a loss and heap that up on the people who use electric power.

And the point of view of the consumer is shared completely by other industries that are captive customers. They say, well, we think that's fair and we think you ought to give us the same considerations. I don't see why not, because in the last analysis, when they have to pay too much, they've got to pass it on to the consumer in the price of the product.

Those people are all competing for the business, aren't they?

Mr. JOHNSTON. Certainly.

Senator LONG. Let me ask you this. Are not most of the railroads who haul a lot of coal doing very well? You know, you're talking about the sick railroads and those who are not sick. Is it not true that those railroads who haul a lot of coal are generally speaking in very good shape?

Mr. JOHNSTON. I think the answer is some are and some aren't. In the East, I think some of the major coal-hauling railroads are not doing as well. In the West, some are and some are not as strong.

Senator LONG. Now, would you give us a list, provide for the record for us, just an analysis? You can just put in one group the railroads that you don't think are doing well, even though they haul a great deal of coal, and indicate how much coal they're hauling; and then those that you think are doing very well and how much coal they are hauling.

Mr. JOHNSTON. Yes.

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

COAL TRAFFIC AND FINANCIAL HEALTH OF CLASS I RAILROADS

Railroad	Revenue adequate as determined by ICC ¹	Carloads of coal ² originated 1979	Carloads of coal originated as percent of total carloads originated 1979
Clinchfield.....	Yes.....	82,340	71.3
Bessemer & Lake Erie.....	Yes.....	68,710	23.6

COAL TRAFFIC AND FINANCIAL HEALTH OF CLASS I RAILROADS—Continued

Railroad	Revenue adequate as determined by ICC ¹	Carloads of coal ² originated 1979	Carloads of coal originated as percent of total carloads originated 1979
St. Louis Southwestern.....	Yes.....	1	0
Norfolk & Western.....	Yes.....	835,261	56.4
Southern.....	Yes.....	345,975	20.0
Union Pacific.....	Yes.....	177,487	16.5
Elgin, Joliet & Eastern.....	Yes.....	158	.1
Missouri Pacific.....	Yes.....	183,676	16.4
Western Maryland.....	Yes.....	78,520	58.1
Denver & Rio Grande Western.....	Yes.....	164,240	65.1
Soo Line.....	Yes.....	4,710	2.7
Chesapeake & Ohio.....	Yes.....	626,214	60.0
Pittsburgh & Lake Erie.....	Yes.....	16,213	12.4
St. Louis-San Francisco.....	No.....	40,487	10.6
Louisville & Nashville.....	No.....	686,500	49.7
Seaboard Coast Line.....	No.....	27,700	1.6
Colorado & Southern.....	No.....	20	0
Baltimore & Ohio.....	No.....	274,275	32.5
Kansas City Southern.....	No.....	5,607	2.9
Fort Worth & Denver.....	No.....	(³)	(³)
Atchinson, Topeka & Santa Fe.....	No.....	62,045	5.7
Western Pacific.....	No.....	8	0
Southern Pacific.....	No.....	51	0
Burlington Northern.....	No.....	830,223	36.3
Detroit, Toledo & Ironton.....	No.....	76	.1
Florida East Coast.....	No.....	0	0
Chicago & Northwestern.....	No.....	29,507	4.0
Illinois Central Gulf.....	No.....	192,683	20.4
Duluth Missabe & Iron Range.....	No.....	2,592	.4
Missouri-Kansas-Texas.....	No.....	11,393	12.0
Boston & Maine.....	No.....	0	0
Grand Trunk Western.....	No.....	273	.1
Chicago, Milwaukee, St. Paul & Pacific.....	No.....	57,118	11.9
Delaware & Hudson.....	No.....	272	.6
Chicago, Rock Island & Pacific.....	No.....	8,662	2.6
Conrail.....	No.....	462,655	17.6

¹ Taken from the Interstate Commerce Department's Ex Parte No. 353, "Adequacy of Railroad Revenue (1978 Determination)," served January 31, 1980. The ICC evaluated each railroad on the basis of whether it was able to engage in a healthy level of capital spending, as indicated by its operating ratio, fixed-charge coverage, earnings and rates of return, dividend payout, capital outlays, general sources and uses of funds, capital structure, and bond rating, using figures reported by the railroads, through March 31, 1978. The ICC considered that a railroad had adequate revenues if it had a rate of return on net investment higher than 5 percent for the years 1975 through 1977, as well as satisfactory financial ratios for the same period in comparison to the healthiest carriers. The ICC determined that the Bessemer & Lake Erie also had adequate revenues although it reported a rate of return of only 4 percent because the other financial indicators suggested that it could continue to sustain a health capital investment level.

² The tonnage of coal carried and the revenues earned on coal by each carrier in 1979 have not yet been reported. In 1978, the number of carloads of coal originated as a percentage of total carloads originated corresponded closely to the percentage of total revenues that were attributable to coal.

³ Reported as part of Colorado & Southern.

Senator LONG. Now let me ask you, how will the railroad industry be harmed by an amendment that would preclude a railroad from obtaining any greater rate increase than it can justify?

Mr. JOHNSTON. I don't think the railroad industry would be harmed by precluding of any greater rate than it could justify. I think that's current law.

Senator LONG. So all we're talking about here by my amendment is just at some point—in this case, the point determined by the ICC—the burden would be on the railroad to justify a further rate increase on these commodities on this captive business. How would the railroad be injured by that?

Mr. JOHNSTON. A substantial fraction of the bottom line of the railroad comes from the high-rated traffic. More than coal, it comes from things like automobiles and chemicals. If that traffic were subject to a presumptive cap as you suggested, it could substantially decrease railroad revenues, further exacerbating their problems in terms of overall support of their systems.

Senator LONG. Now, if that's the case, why can't they prove—why can't they carry that burden of proof of proving they're entitled to a higher rate? Why not? The burden of proof has got to be on somebody. Ordinarily it's got to be on somebody.

Mr. JOHNSTON. That's true. It's on the rail carriers when they're proposing new rates. For example, under the committee bill, when railroads are proposing new rates that the ICC investigates, the burden is on the carrier, and we would agree that's where it should be.

Senator LONG. All right. Now, when our people find a rate that they think is too high and it's beyond the point—let's say we have the ICC—this bill fits a level which we thought—I think we started out about 170 percent of variable costs, something around in that area.

Now, when the ICC fixes a level that it thinks would make a good return for that movement, why should not the railroad have to bear the burden of proving that it's entitled to more than that?

Mr. JOHNSTON. Well, they would have to bear the burden of proof of asking for more than that in a circumstance in which the ICC has already fixed a rate which they consider to be reasonable. The burden would be on the complainant to argue that that rate determined by the ICC was not in fact reasonable. And they would in that case have to bear the burden, and we would argue that that's the proper allocation of the burden in that circumstance.

Senator LONG. Why shouldn't the burden be reversed once you get above that point?

Mr. JOHNSTON. We would continue to rely on the ICC to make the judgments as to reasonableness, using such factors as overall carrier revenue needs and the other factors that they consider. When those determinations are made, we believe that the burden should rest on the complainant rather than on the carrier.

Otherwise you would create a situation in which any shipper could object to any rate and would then force the carrier to bear the burden of proof of rates that the ICC had already determined to be reasonable.

Mr. HYMSON. However, Senator Long, under current law, the ICC already requires the railroads to bear the burden of proof that a rate is not above a reasonable level. For example, in the Kuhn, Montana, to Minnesota case, the ICC set a rate and said that they would only allow an increase above that level if the railroads produced evidence showing that they were already using aggressive and innovative marketing techniques and pricing policies on their other traffic, and that their traffic mix did not allow any other alternative but to raise that rate. This was a burden that the railroads did not meet in that case adequately to justify a higher rate.

So even under current law, the burden is already on the railroad to make a showing if they want to get above a certain threshold rate level, a fairly low threshold.

Senator LONG. It sounds to me like you're agreeing with me, you think I'm right about it. In other words, when you say, all right, now, why shouldn't we say, as I suggested in this amendment, that when you propose to increase rates in the captive market above what we believe to be a reasonable return, that that shouldn't be fully justified by the carrier that will receive the benefit from the increase?

Mr. HYMSON. Current law already requires that. Why do we need another law to add an additional constraint on the ability of the ICC to make judgments based on all considerations of record? We don't believe that you do.

Senator LONG. Well, the ICC failed to take jurisdiction over the case because they said they could not find that the railroad had market dominance, even though the utility was being served by only one railroad.

Mr. HYMSON. The case to which you're referring is the *Coletto Creek* case. In that particular case, the railroad presented evidence that there was no market dominance. In legal proceedings, the Commission is required to review the evidence of record, and the shipper did not put evidence in the record to refute that of the railroads. With evidence put in by the railroad and no evidence put in going the other way by the shipper or evidence submitted that was, considered totally inadequate by the ICC, the Commission was required to rule that there was no market dominance, as a matter of law.

Had the shipper troubled to say that there was market dominance, I suspect the outcome would have been different.

Senator LONG. Now, you see, in that case the railroad had the books of the railroad available. They have the information available to them, what they were doing and a good deal about their competition. And the person receiving it, the shipper or the receiver of the goods did not have it.

In that particular case, was there water transportation available, was barge transportation available between those two points?

Mr. HYMSON. I believe, in that particular case the issue of alternative transportation by water wasn't raised directly, but I believe in the testimony of the protesting utility they claimed they could buy coal from another source for a dollar a ton cheaper. That does tend to make it easy for a judicial body to make a finding that there is no market dominance. The decision is not a matter of discretion once a record comes in that way.

Senator LONG. You didn't bother to mention that the cheaper source was South African coal?

Mr. HYMSON. The Commission made clear that there was no market dominance. The decision was not based on the South African coal. They decided the South African coal issue was not relevant to the situation presented here in their decision at page 9. So, South African coal was not the basis of their decision.

Senator LONG. The utility in that case, I am told, was locked into a long-term contract with the coal supplier. Was that correct?

Mr. HYMSON. The railroads asserted that that was an assignable contract, the utility could get out of it. The assertion was based on evidence provided by the utility under disclosure. The utility neither denied that nor presented any evidence at all to refute the statement of the railroads. The record showed evidence that the utility could easily get out of that contract without high cost.

Again, had the utility troubled to provide evidence showing they could not get out of it, the Commission would then have been able to rule that the market dominance existed.

Mr. JOHNSTON. I might also point out, Mr. Chairman, that the committee's bill eliminates the market dominance test so that this issue would not arise again in the future under the committee's bill, as reported.

Senator LONG. Well, thank you very much, gentlemen. I appreciate your testimony.

[The statement follows:]

STATEMENT OF WILLIAM B. JOHNSTON, ASSISTANT SECRETARY OF TRANSPORTATION
FOR POLICY AND INTERNATIONAL AFFAIRS, DEPARTMENT OF TRANSPORTATION

Mr. Chairman and Members of the Committee, I appreciate the opportunity to be here today to discuss railroad regulatory policy as it applies to ratemaking. Your actions in this area will have important implications for our long-term inflation prospects, the energy situation and the health of our rail industry. You have specifically asked us to comment on the long amendment.

The maintenance of an adequate railroad transportation system is essential to this country's continued move toward a rational energy policy which would free us from dependence on foreign energy sources. The railroads serve this goal in two ways—they provide transportation that is three to four times more energy efficient than the trucks against which they compete, and they are a major method of bringing coal to the utilities that produce electricity for American households and industry. Unless the rail system is built up to the levels needed for reliable heavy-duty hauling, and then maintained in good repair, we will all pay more, not only for our energy but also for other consumer goods. The railroads are a critical link in the President's plan to convert utilities to coal use nationally, and they must be financially self-sufficient to carry out their responsibility.

At present, the industry does not earn enough revenue even to maintain the system. Last year the railroads in the aggregate earned only a 2.5 percent rate of return on investment and the roads in bankruptcy or generally regarded as "marginal" outnumbered those earning an adequate rate of return. This 2.5 percent rate of return can be compared with the average for all manufacturing industries of 10.6 percent and the average for electric and gas utilities, which in 1978 was more than 11 percent.

The Administration and Congress have been working on reform of railroad regulation for many years. In this process, we have both been giving attention to the need for sufficient rate protection for shippers. At the same time, we must not lose sight of the legitimate revenue needs of the rail industry. Shippers of all commodities in all parts of the country are suffering the consequences of the railroads' long term decline in financial health. The purpose of the regulatory reform effort is to get away from unnecessary regulation, to eliminate extra layers of authority, and return decisions as much as possible to the private marketplace.

Any legislation should not prevent the railroads from adjusting rates and service to the demands of their shippers. Railroads require flexibility in pricing, as do all competitive firms. The Department of Transportation continues to believe that it is inappropriate to use revenue-to-cost ratios as a final test of the reasonableness of rail rates. Such ratios can be used to provide threshold tests of whether rates are compensatory. Beyond that they are but one of a number of measures of the level a particular rate should be.

To put the Department's position in perspective, I want to discuss briefly some of the economics of railroad ratemaking and railroad coal rates in particular. No matter how rates are set, they must, in the aggregate, cover all of a railroad's costs including a fair rate of return. If railroads do not earn enough to maintain their operations, either service will deteriorate and ultimately cease, or the government will be asked to make up the deficit through subsidies. Such subsidies represent a cost to society just as much as higher rates. In fact, administering a government

subsidy program is almost certain to be less efficient and more costly than permitting the railroads to earn the necessary revenue directly from the shippers using rail service. The ratemaking framework which the Congress establishes, therefore, will determine not only whether the railroads can earn enough to survive as private sector entities, but also whether shippers will be able to obtain reliable, efficient rail transportation service.

A number of rate structures have been suggested to produce an adequate overall level of revenues for the railroads. The Department of Transportation supports a system of railroad ratemaking sensitive to the needs and demands of the variety of shippers, which we term "limited demand-responsive pricing." That is the pricing framework we see in the rest of the economy, and the framework that permits the fullest and most efficient use of the rail system.

Under this ratemaking framework, rates on all traffic should cover at least variable or incremental cost. Beyond that rates should be set so as to recover as much fixed or nontraceable costs as market conditions permit, up to limits which are determined by the ICC to be reasonable on a case-by-case basis and in light of overall carrier revenue needs. Because of differing competitive conditions, some traffic is able to cover more of those costs than other traffic. Generally, shippers for whom alternative transportation or markets are easily available will not pay a large share of non-traceable costs, and the rest must be recovered from the remaining traffic.

Setting all rates equal to fully allocated cost has often been suggested as an alternative to demand-responsive pricing. In this ratemaking system, each shipper pays the variable cost of service plus a *pro rata* share of the remaining costs. In theory, such a rate structure assures that all costs are covered. But it also causes many shippers operating in a highly competitive transportation market to divert their traffic to other modes because each shipper must either make the same contribution to nontraceable cost per unit of service as every other or not ship by rail. The overhead costs of the rail system do not decline significantly when traffic is diverted. As a result, this diversion raises the cost of providing service to the remaining shippers. The evidence suggests that many shippers who have access to alternative transportation services, if asked to pay rates based on fully allocated cost, will stop shipping by rail. Commodities such as sand, aggregate, manufactured products, wood chips and pulp, some grain products and lumber will, we believe, be diverted to other models of transportation or cease to move altogether. We would see more traffic on our already strained highways and waterways, with a consequent increase in capital and maintenance costs for those systems and a loss in the contribution of such traffic to covering overall railroad costs. Fuel consumption would be likely to rise as well as rail rates on remaining rail traffic.

To illustrate this point, let us assume that a railroad ships only two commodities, for example, grain and coal. Let us assume that the variable cost of shipping the two commodities is \$100 for each. These two commodities must also cover all of the railroad's overhead, which, let us assume, totals \$100. Overall, then, the railroad must have \$300 of income to sustain itself. Ideally, both coal and grain would pay \$150 for rail service. Let us assume, however, that, because of competitive circumstances, grain will shift to a truck-barge route if its rate goes above \$140. If this happened, coal would have to be charged \$200 to sustain the railroad, since it would have to bear the overhead costs not borne by grain. To prevent this from happening, it is necessary for railroad to price grain at \$140 and coal at \$160.

In this case, which is reflected in the real world every day in hundreds of rail pricing situations, the railroad has more revenue, and both shippers have lower rates than would prevail if a fully allocated cost system were used. Everyone benefits because demand-responsive pricing results in a more intensive and efficient use of the rail system.

The Interstate Commerce Commission has permitted demand-responsive pricing to a limited extent. The Department of Transportation and many shippers have also recognized that such a ratemaking standard is necessary and to some extent desirable.

In a time in which we are pursuing a national policy of converting to coal, the limits to be imposed on demand-responsive rail pricing, particularly for coal, are critically important. While coal rates are not at the high end of the spectrum in terms of rate-to-variable cost ratios, the ICC has recently approved a number of coal rates that are somewhat above the fully allocated cost level, on the principle we have just reviewed that not all rates can be set at fully allocated costs if the railroads are to be efficiently used and adequately compensated. The Commission has said that, on average, all commodity movements should yield approximately 150 percent of variable costs to cover fully allocated costs, including a reasonable return

on investment. In recent decisions, the Commission has followed a general policy of limiting coal rates to 7 percent above the fully allocated cost level.

As the attached table shows, several coal rates the ICC has recently approved show rate-to-variable cost ratios that are generally close to 150 percent. (These ratios incorporate adjustments to system-average costs to reflect actual movement costs.) We do not think the rates shown are exorbitant. I should note that DOT has never urged the Interstate Commerce Commission to set high rates on coal movements. Instead, we have urged the Commission in coal rate investigations to consider the particular circumstances in each case and to balance the railroad's need to cover costs against both the shipper's interests and the general competitive conditions faced by shippers and railroads.

ICC COAL RATE DECISIONS

	Decision date	Rate per ton	Ratio of rate to ICC estimate of variable cost at revenue need level in percent
Incentive rate on coal:			
Cordero, Wyo., to Smithers Lake, Tex. (Houston Power & Light)	Nov. 28, 1977	\$15.60	146
Hayden, Colo., to Kings Mill, Tex. (Celanese)	Nov. 7, 1978	10.56	151
Annual volume rates on coal: Wyoming to Flint Creek, Ark. (SWEPCO)	May 21, 1979	10.24	142
City of San Antonio, Tex., v. Burlington Northern, Inc., et al ("San Antonio III")	June 1, 1979	17.23	141
United train rates on Coal—Burlington Northern, Inc.:			
To Council Bluffs	July 13, 1979	7.25	139
To Sergeant Bluffs	do	8.32	
Bituminous Coal, Hiawatha, Utah, to Moapa, Nev.	July 31, 1979	7.91	130
Incentive Rates on Coal: Axial, Colo., to Coletto Creek, Tex. (Central Power & Light)	Jan. 15, 1980	20.85	140

The proposed Long amendment has been decried as setting a "presumptive cap" on maximum rates for coal. However, as written, it would also apply to all other commodities. Such an amendment would concern us for several reasons, most importantly because it would interfere with the modest amount of rate freedom allowed by S. 1946.

We are also concerned that a "presumptive cap" on rates would discourage shippers and carriers from entering into contracts, as S. 1946 is intended to permit. Contracts offer a real opportunity to make railroad service as reliable and responsible as is required by the utilities and other shippers who depend on railroad shipments. A cap could also exacerbate the joint rate issue. If a joint rate on a through route is at or above the presumptive cap it might prove difficult to obtain a rate increase—even if one of the carriers is failing to cover its variable costs.

Most fundamentally, the proposed "cap" would ultimately harm our ability to meet our energy needs because it would lead to deteriorating rail service. Efficient and reliable rail service is essential to carrying coal from mine to utility, where it can benefit the consumer. The health of the railroads is inextricably linked to our ability to utilize coal to meet our domestic energy needs. Although the railroads should not be allowed to charge unreasonably high prices for coal transport, we do not believe the Long amendment provides an appropriate solution to the problem.

In summary, the Department of Transportation opposes any further amendments to S. 1946 that narrow the range of pricing options and prevent rates that suit the transportation market, thus reducing efficient use of the rail system and impairing a carrier's ability to provide service. Specifically, for the reasons cited above, the Department opposes the Long amendment.

This completes my testimony. I would be pleased to respond to your questions.

Senator LONG. Next we will hear from Mr. Jerry Pfeffer, Acting Assistant Administrator of the Office of Utility Systems, Economic Regulatory Administration, Washington, D.C., accompanied by Mr. Robert M. Hallman, deputy counsel for programs, Department of Energy, Washington, D.C.

Mr. Pfeffer, you are the assistant administrator now, Mr. Pfeffer?

Mr. PFEFFER. Yes, sir.

STATEMENT OF JERRY L. PFEFFER, ASSISTANT ADMINISTRATOR FOR THE OFFICE OF UTILITY SYSTEMS, ECONOMIC REGULATORY ADMINISTRATION, DEPARTMENT OF ENERGY, ACCOMPANIED BY ROBERT M. HALLMAN, DEPUTY COUNSEL FOR PROGRAMS; AND A. GREY STAPLES, DIRECTOR, DIVISION OF REGULATORY INTERVENTION, OFFICE OF UTILITY SYSTEMS

Mr. PFEFFER. Good morning, Mr. Chairman. I appreciate the opportunity of being here today to discuss the implications of railroad regulatory policy on national energy goals. Specifically, you have asked the Department of Energy to present its views on the proposed Long amendments to S. 1946. With me this morning are Mr. Robert Hallman, deputy general counsel, Department of Energy, and Mr. A. Grey Staples, who is director of the Department's regulatory intervention program, which participates, before various regulatory bodies including the Interstate Commerce Commission on railroad rate matters.

As you are well aware, Mr. Chairman, over the past few years, the Department of Energy has been an active participant in various ICC railroad ratemaking proceedings, which have had very important implications on the delivered price of coal to the utility and industrial users. The DOE involvement in these proceedings has dealt with two basic issues: the level of rates, which are mandated, we believe, have been excessive; and the process by which these rates have been determined.

DOE participation has required an intensive examination of the impact of rail tariffs on achieving our fundamental energy policy objectives and reducing the nation's reliance on scarce fuels, and, most importantly, that which pertains to this proceeding, the promoting of greater coal utilization.

There is a growing concern in the Congress, State and local governments, and those sectors of the economy that are required to convert to coal that evolving railroad ratemaking policies for coal will frustrate the achievement of these national policymaking objectives.

There should be no question, Mr. Chairman, on one basic issue: the Department of Energy administration, electric utilities, and, I believe, all responsible parties to this discussion recognize a need for a viable and financially sound rail transportation network. We are not debating railroad revenue requirements. In those cases where coal must be moved long distances from mine mouth to point of use, the most economical mode of transportation is most frequently by rail.

In addition, for many electric utilities, rail is the only viable mode of coal transportation. A financially strong, efficient, and well-maintained rail system is an essential element of a national energy policy which seeks to promote greater coal utilization. Indeed, without a viable rail network, there is no future for coal in this country. The Department is aware of the current deficiencies and the state of disrepair of many of our important rail lines which must be both rehabilitated and maintained to achieve our energy and transportation objectives.

We are also aware of the strong sentiment in Congress that the Federal Treasury should not be the primary source of funds necessary to return the Nation's railroads to a state of financial self-sufficiency. Moreover, where competition does exist, the free markets, rather than Federal regulation, should set the appropriate price for rail service.

The efforts of the Congress, and particularly this committee, to simplify Federal regulation of the Nation's railroads in a manner that tries to balance energy and transportation objectives are consistent with the administration's goal of reducing regulatory burdens, not just in the rail area, but in fact in all sectors of the economy.

Our fundamental energy reality, Mr. Chairman, is that today we are dependent on foreign oil to meet almost half of our daily oil needs. My testimony addresses several dimensions of this dependence. I don't believe there is any need to remind this committee of our primary energy objective of shifting off of imported oil and gas and moving on as quickly as possible to coal and other domestic fuels. The Power Plant and Industrial Fuel Use Act and the other congressional enactments over the last several years have given the Department of Energy a mandate to promote the shift to coal.

Mr. Chairman, we are quite aware that utilities in your State and other States are less than enthusiastic about the notion of investing millions of dollars in converting existing plants or, in fact, replacing those plants that cannot convert and go to coal. Utility management and State regulatory agencies which are attempting to assure a reliable degree of electric service at reasonable rates, while at the same time meeting their obligations to both ratepayers and shareholders, are reluctant to encourage major capital investments necessary to convert to coal, when they perceive railroad rates to be regulated in a manner which results in a systematic transfer of the economic savings they are promised, as a result of coal conversion, to the railroads instead of their ratepayers.

Indeed, without a regulatory system that is responsive to both transportation and energy needs in a balanced way, many believe the price of OPEC oil will become, in fact, the only real limit to the rate of escalation on rail coal rates. The administration, as you are aware, will soon be sending to the Congress legislative proposals which are designed to address some of the continuing regulatory and financial impediments to conversion to coal by utilities. These measures—and I frankly believe any measures—we propose on coal conversion will not be effective unless we eliminate the unconstrained increases in rates which implicitly accept world oil prices as an upper bound on the delivered cost of coal.

The recent increases in rail coal rates in cases, such as those we cited in San Antonio and others, have created a concern that the delivered price of coal is discouraging the expanded use of domestic coal and voluntary conversion of oil and gas units. With uncertainty about future levels of rail prices, utilities and industrial users are simply not going to make those investments which we believe are necessary now to take advantage of the differential between oil and coal prices. As a result, some utilities and industries are deferring construction of new coal-fired facilities; others are investigat-

ing—and as we pointed out, some are already exploiting foreign sources of coal supply. This is indeed ironic at a time when we have a hundred million tons of excess coal production capacity in this country and tens of thousands of coal miners out of work in the Midwest.

In response to those utilities which may have access to a foreign supply of coal, the ICC has determined a recent case that you just cited that the availability of foreign coal was a sufficient basis to find a lack of market dominance by the railroads.

Senator LONG. If I might interrupt you there, it seems to me you are putting your finger on the key point here: that if we want to have an effective energy policy, in my part of the country we are being required to ship our gas out of Louisiana, out of Texas, and deliver that—mind you, we are delivering it to the pipelines for a far lower price per Btu than we are paying for coal. We are being required to ship our gas at regulated prices for much less than the overall market prices to customers elsewhere, and then we are being required to buy this coal.

Now, we're willing to go along with that buying this coal, and we're willing to pay what seems to be the fair price of coal. But when the railroads rip us off as captive customers and then they proceed to charge us twice as much for the transportation as for the coal so that it's cheaper to buy coal from South Africa or Poland or somewhere and ship it across the ocean than it is to buy it here in this country, they are succeeding at that point in defeating the energy program by ripping off the customers who have to use electricity made from the coal.

That may not concern the Department of Transportation, but I applaud the Department of Energy that you fought to have the right to come down and explain your position. That defeats your energy program, because, obviously, our people are going to do everything they can to slow down that movement from gas over to coal, if we're being ripped off in what we have to pay for transportation of the coal.

Unless this administration and the Congress are willing to help solve the problem, we will keep having to find ways to drag our feet on converting the coal.

Mr. PFEFFER. In view of the importance of coal to our national economy, our national energy goals, and the rather significant effect of rail rates on the delivered price of coal, the Department of Energy is advocating that a rational, equitable, and most importantly, a predictable relationship be established between the cost of transporting coal and the rates for such movements. Because of the substantial impact of coal rates on the national coal conversion program, we have consistently emphasized the need for balance between transportation goals and energy goals.

To this end, our advocacy in the ICC and in these proceedings has specifically focused on three basic issues: (1) that all railroad rates, including the rates for coal, should at least cover the incremental costs of the specific movements; (2) wherever possible, the revenue needs of the entire railroad should be determined in a responsible way and respective contributions to be made by each commodity should be decided simultaneously in accordance with the determined revenue need of the system. To determine the fully

allocated cost of each movement, we believe that costs should be allocated to that commodity in direct proportion to its incremental cost.

Finally, we believe that a commodity should bear a higher net proportion of its share of its fixed cost, only—and I repeat only—if other commodities are at least bearing rates equal to their respective incremental costs and are otherwise generating maximum contribution to revenue.

We do not disagree, in fact, we fully accept the notion that in certain cases coal has to bear a share of these costs. What we are concerned with is the process by which that level of determination is made and the degree to which assurance is provided that other commodities are making their maximum level of contribution to the sustenance of the revenue requirements of the Nation's rail system.

We are aware that regulatory tools and accounting information which may be needed to implement these principles is not immediately available. In fact, in our work with the Department of Transportation we fully support their efforts to achieve more sophisticated and more detailed accounting systems.

It is well recognized within the regulatory community that some of the current ICC cost accounting mechanisms require improvements in order to provide a basis for determining the appropriate contribution that each commodity should make in the overall rail system.

We believe recent ICC decisions have had the effect of increasing rather than decreasing the uncertainty in coal rate patterns. We believe some of these decisions are supported in the degree that they indicate railroads should seek to provide supporting cost data and demonstrate that other commodities cannot further contribute to system revenue needs. Nevertheless, it has been our position that in some cases the Commission has approved increases in coal rates without the documentation that the Commission itself has suggested would be appropriate to be the basis for making that determination.

Railroads maintain that revenues from commodities such as coal must bear a larger share of overall revenue responsibility if they are to maintain financial viability, since competition may limit the contribution from other commodities. We accept that proposition, but DOE believes that without an accurate assessment of the contribution to that revenue requirement of all other commodities and the assessment for the opportunities available to the railroads to reduce or eliminate unnecessary costs, it is more difficult to make the kind of rational determination of adequate contribution or appropriate contribution that should be made by each commodity and certainly by coal.

We believe that any legislation which requires a reasonable assessment by the Interstate Commerce Commission of those commodities currently being carried at noncompensatory rates or those commodities which are being transported at artificially low rates would help to rationalize railroad ratemaking, and indeed, would be in the interests of the railroads themselves.

Such a mechanism could provide a rate structure which would not only enhance viability in a financial sense of the Nation's

railroads, but would also minimize the destructive impact of rate decisions on the achievement of our national energy goals.

We believe this noncompensatory traffic should be specifically identified and measures should be taken to eliminate such traffic, reducing and perhaps eliminating what we believe to be a significant source and a cause of the railroad revenue inadequacy.

Such legislation should also seek to maximize revenues from all traffic.

Mr. Chairman, we support and will cooperate with all reasonable efforts to improve our railroad and transportation regulatory processes and procedures, which at the same time achieve both national energy and transportation goals. A reasonable balance can and, indeed, must be struck between the contribution that coal can be expected to make to the financial stability of our Nation's railroads and national efforts to expand coal utilization and reduce our dependence on imported petroleum.

We will continue to work with the Department of Transportation, to participate with and suggest to the ICC specific initiatives which will provide a basis for more rational and effective regulatory procedures, and to intervene in those proceedings to seek appropriate consideration of energy policy objectives.

I very much appreciate the opportunity of appearing here today, and would be pleased to respond to any questions.

Senator LONG. Let me ask you specifically: Do you support the amendment that I am proposing?

Mr. PFEFFER. Mr. Chairman, as you are probably aware, the administration has designated the Department of Transportation to represent it on matters relating to this bill, so I will not take the position here on behalf of the Department on the amendment *per se*. I have only tried to deal with the concerns we have and the ones we have expressed in the area of rail ratemaking.

But I will defer to the Department of Transportation on the matter of administration position.

Senator LONG. Well, I take it—down—the people at the budget, they decide which view is supposed to be the view of the administration; is that what it amounts to?

Mr. PFEFFER. I will leave that to your imagination, Mr. Chairman.

Senator LONG. Does the DOE see this as a Western coal problem or nationwide problem—

Mr. PFEFFER. Mr. Chairman, the problem is nationwide but is perceived as a major problem in the West because of the much higher percentage of rail costs as related to the cost of coal. The problem, however, will be a problem nationwide, particularly where utilities such as those in your State and others in the northeast which have never burned coal before are suddenly confronted with a need to provide reliable and adequate rail service but at predictable costs.

We are not going to get utilities in the northeast or the gulf coast to convert unless they are sure of some predictability in the price they will pay for delivered cost of coal, and, consequently, would be assured that the savings we are promising them, the savings which are, in fact, the basis for the conversion, will in fact accrue to the utility ratepayer, not to the railroad.

Senator LONG. Does DOE see this conflict between the financial help of the railroads and the need to convert coal as a long-term or short-term problem?

Mr. PFEFFER. It certainly is going to be a long-term problem, Mr. Chairman. We have a long-term and continuing need for a rail network.

The short-term issue, however, is most critical. Unless we can overcome the near-term barriers and overcome the reluctance of utility management to make the investments to coal, we simply may not have the coal option to deal with in 10 or 20 years from now. We are losing coal capacity. We have unemployment in the coal industry and we are frankly running out of time in terms of reducing our dependence on imported oil.

Senator LONG. Have you seen an increase in resistance to conversion by executives because of the rail rate problem?

Mr. PFEFFER. No question, we've seen this resistance, Mr. Chairman. We've seen instances involving utilities. We've seen instances involving industrial manufacturers along the gulf coast who by and large are unwilling to make the upfront capital investment, when the payback or the stream of benefits which we have promised continues to be eroded.

Senator LONG. I want to thank you for your testimony here today.

Mr. PFEFFER. Mr. Chairman, we appreciate the opportunity.

[The statement follows:]

STATEMENT OF JERRY L. PFEFFER, ASSISTANT ADMINISTRATOR, ECONOMIC
REGULATORY ADMINISTRATION, DEPARTMENT OF ENERGY

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to be here today to discuss the implications of railroads regulatory policy for national energy goals. Specifically, you have requested the Department of Energy's (DOE) views on the proposed Long Amendment to S. 1946.

Over the past two years, the Department has been an active participant in various ICC rail ratemaking proceedings which have had important implications for the delivered price of coal to utility and industrial users. DOE participation has required an intensive DOE examination of the impact of rail tariffs on achieving our fundamental energy policy objective of reducing this nation's reliance on scarce fuels and promoting greater coal utilization. As this Committee is aware, there is a growing concern in Congress, state and local governments and among those sectors of the economy required to convert to coal that evolving rail ratemaking policies for coal may frustrate the achievement of this national energy policy objective.

DOE recognizes the need for a viable and financially sound rail transportation network. In those cases where coal must be moved long distances from mine mouth to point of use, the most economic mode of transportation is by rail. In addition, for many electric utilities rail is the only available mode of coal transportation.

A financially strong, efficient and well-maintained rail system is an essential element of a national energy policy which seeks to promote greater coal utilization.

The Department is aware of the current deficiencies and the state of disrepair of many important rail lines which must be rehabilitated and maintained to achieve both energy and transportation policy objectives. The Department is also aware of the strong sentiments in Congress that the Federal treasury should not be the primary source of funds necessary to return this nation's rail transportation system to a state of financial self-sufficiency. Moreover, where competition exists, the free market, rather than federal regulation, should set the appropriate price for rail service. The efforts of the Congress and particularly this Committee to simplify Federal regulation of the nation's railroads are consistent with this Administration's goal of reducing regulatory burdens in all sectors of the economy.

The fundamental energy reality this nation confronts today is that we are dependent on oil imports to meet almost half of our daily oil needs. Further, a substantial foreign portion of our crude oil supply is derived from one of the most unstable and politically volatile regions of the world.

This dependence on foreign oil imports also imposes a heavy burden on our economy. In 1971, we paid \$4 billion to foreign oil producers. In 1980, our oil import bill could exceed \$70 billion; and in just ten years, at our present rate of use, our dollar outflow for imported energy could increase fifteen-fold. This dollar drain has increased the pressures on domestic inflation, contributed substantially to our trade deficit and adversely affected our employment situation. Viewed from the perspective of both national economic and defense considerations, the importance of reducing oil imports cannot be over-emphasized.

The Powerplant and Industrial Fuel Use Act of 1978 (FUA) mandates an expanded use of coal and other alternate fuels as part of a national program to reduce oil imports, assure a reliable supply of energy at a reasonable cost, and allocate scarce oil and gas supplies to high priority uses. FUA restricts the construction of new powerplants and major fuel burning installations (MFBIs) which lack the capability of utilizing coal or other alternate fuels. FUA also grants to the DOE the authority to issue orders which prohibit the use of oil and natural gas in those existing facilities and MFBIs which have the capability to use coal as a primary energy source. DOE has already issued under FUA approximately 20 prohibition orders and anticipates issuance of 40 additional orders during 1980.

The electric utility industry, which now consumes about 3 million barrels per day of oil and natural gas equivalent, is the logical target for an accelerated national effort of reducing our dependence on imported fuel. No other sector of the economy can achieve as great a near-term savings of oil and gas, particularly through greater use of domestic coal resources. As a consequence, the DOE has encouraged the accelerated replacement by utilities of existing oil and gas burning facilities not otherwise subject to DOE's mandatory conversion authority.

However, decisions by electric utilities to convert generating units to coal either voluntarily or pursuant to provisions of FUA are largely dependent upon the perceived likelihood of actually obtaining the potential operating cost savings (i.e., economic rent) derived from the price differential between the operation of gas and oil fired versus coal fired units.

Utility management and state regulatory agencies attempting to assure reliable electric service at reasonable rates while meeting their obligations to ratepayers and shareholders are reluctant to incur the major capital investments necessary to convert to coal when railroad rates are regulated in a manner which result in a systematic transfer of the economic savings to the nation's railroads instead of the electricity consumer. Indeed, without a regulatory system responsible to energy policy goals, at least in part, the price of OPEC oil could become the only limit to coal rate increases.

The Administration will soon send to Congress legislative proposals designed to address some of the regulatory and financial impediments to accelerated coal use by utilities. These measures, as well, will not be effective if utilities perceive that the economic benefits of coal conversion will be eliminated by unconstrained increases in rates which are unrelated to associated costs.

Recent increases in rail coal rates such as those at issue in the well-known *San Antonio* case have created concern that the delivered price of coal will discourage an expanded use of domestic coal and the voluntary conversion of existing gas and oil units to coal. Transportation costs constitute a significant percentage of the delivered price of Western coal.

With uncertainty about the future level of rail cost rates, utilities and industrial concerns which are inclined to convert to coal anticipate that escalating coal rates will eliminate any economic advantage gained by the voluntary conversion. As a result, some utilities and industries are deferring construction of new coal-fired facilities; others are investigating foreign supply sources for coal. In response to those utilities which may have access to a foreign supply of coal, the ICC has determined in a recent case that the mere availability of foreign coal was a sufficient basis to find a lack of market dominance by the railroad. Absent market dominance, the ICC had no jurisdiction to determine a maximum reasonable rate and therefore dismissed the utility complaint, thereby leaving the utility unprotected from the monopoly power of the railroad.

In view of the importance of coal to our national energy goals and the significance of rail rates to the delivered price of coal, the Department of Energy, in contrast, has advocated that a rational, equitable and predictable relationship must be established between the cost of transporting coal and the rates established for such movements.

Because of the substantial economic impacts of coal rates on the national coal conversion program, DOE has consistently emphasized the need to balance national transportation goals and national energy goals in setting rail rates. To this end, DOE specifically has advocated the following principles:

1. All railroad rates, including rates for coal, should at least cover the incremental costs of the specific movement.

2. Where possible the revenue needs of the entire railroad should be determined and the respective contribution to be made by each commodity should be decided simultaneously in accordance with the determined revenue need of the entire railroad system. To determine the fully allocated cost of each movement, fixed costs should be allocated to that commodity in direct proportion to its incremental cost.

3. A commodity should bear a higher than proportionate share of fixed costs only if all other commodities are at least bearing rates equal to their respective incremental costs and otherwise are generating maximum possible revenues.

DOE is aware that the regulatory tools and accounting information necessary to implement railroad ratemaking in accordance with these principles may not be immediately available. It is well recognized within the regulatory community that current ICC cost accounting mechanisms require reform in order to provide a basis for determining the appropriate contribution that each movement should make to overall rail system revenue needs.

DOE believes that recent ICC decisions may have the effect of increasing uncertainty in coal rates. ICC decisions have indicated that railroads seeking coal rate increases must submit certain cost data and demonstrate that other commodities cannot further contribute to system revenue needs. Nevertheless, DOE believes that in some cases the Commission approved increases in coal rates without adequate documentation.

Railroads maintain that revenues from commodities such as coal must bear a larger share of overall revenue responsibility if they are to maintain financial viability since competition may limit the contribution from other commodities. DOE believes, however, that without an accurate assessment of the contribution to revenue need that could be made by other commodities and an assessment of the opportunities available to the railroads to reduce or eliminate unnecessary costs, it is more difficult to make a rational determination of the appropriate contribution that must be made by each commodity and coal in particular.

DOE believes that legislation that requires an assessment by the Interstate Commerce Commission of those commodities currently carried by the railroads at non-compensatory rates and those commodities which are being transported at artificially low rates, would help to rationalize railroad ratemaking. Such a mechanism could produce a rate structure which not only will enhance the financial viability of the nation's railroads but also will minimize the disruptive impact of rate decisions on the achievement of national energy goals. Non-compensatory traffic should be specifically identified and measures should be taken to eliminate such traffic, thereby reducing and perhaps eliminating that traffic which DOE believes may constitute a significant cause of railroad revenue inadequacy. Such legislation should seek to maximize revenues from all traffic.

Mr. Chairman, DOE will support and cooperate with all reasonable efforts to achieve our national energy and transportation policies. A reasonable balance must be struck between the contribution that coal can be expected to make to the financial stability of our nation's railroads and national efforts to expand coal utilization and reduce our dependence on imported petroleum. Consequently, DOE will continue to work with the Department of Transportation (DOT), to recommend to the ICC specific initiatives which will provide the basis for a more rational and effective regulatory process, and to intervene in ICC proceedings to seek appropriate consideration of energy policy objectives in the rail ratemaking process. We appreciate the opportunity of presenting our views in this important matter and would be pleased to answer any questions.

Senator LONG. Now, I had scheduled these hearings and planned them—but no other Senator showed up to conduct them throughout the day, and give every witness an opportunity to be heard.

I will try to do that, if I have to do it all by myself. But at this moment I am due to be over on the House side as the chairman of the conference on the energy windfall profits tax bill. What I wish to do is to recess over there in 45 minutes. And by then one of the members will be gone.

I'm going to recess this meeting until 10 minutes of 11. And at that time, I will call this meeting back to order.

[Recess.]

Senator EXON [presiding]. Ladies and gentlemen, we are going to reconvene the hearing at the request of the chairman, who will be back in about 40, 45 minutes.

To move things along, the chairman has asked me to proceed with the testimony from Mr. Gaskins, Chairman of the Interstate Commerce Commission.

Mr. Gaskins, if you will take the witness stand now, and then, as Chairman Long has requested, if possible, you remain here so that he might throw some questions to you when he returns to the Chair.

Mr. GASKINS. Be glad to.

Senator EXON. So at this time, thank you for coming. Mr. Gaskins, it seems like we are on opposite sides of the microphone almost every other day during these difficult times. We are reviewing a very important matter this morning, and so I would invite you to proceed at this time.

STATEMENT OF HON. DARIUS GASKINS, CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Mr. GASKINS. Thank you, Mr. Chairman. Thank you for the opportunity to be here today to present the views of the Interstate Commerce Commission on Senator Long's proposed amendment to S. 1946, the Railroad Transportation Policy Act of 1979. As you know, we testified last fall in support of many of the provisions of this bill.

We are sensitive to the problems confronted by coal users in recent years, and of the increasing need to utilize coal to help solve the Nation's energy problems. Nonetheless, we do not believe that this amendment is necessary to find solutions to these problems. In general, we believe that the provisions of S. 1946 as reported by the committee, are sufficient to deal with the problem, specifically those provisions dealing with maximum rates and with contract rates.

Under the amendment, the Commission would be required to establish standards and determine after hearing a second revenue-to-variable-cost ratio which would constitute a point at which the burden of proof as to reasonableness shifts to the carrier, notwithstanding the provisions of sections 10707(c) (1) and (2) and 11701. The introductory remarks to the amendment indicate that this ratio is not intended simply as a procedural threshold, but would in effect be a "presumptive cap of maximum rate reasonableness."

Our concern over this amendment relates to both its policy and technical aspects. The first problem is that it is unclear what the amendment would accomplish. The presumptive cap language of the introductory remarks is not reflected in the language itself, which merely shifts the burden of proof at a certain point. If the intention of the drafters is to create a real cap on rates, this language would not accomplish it. If, on the other hand, the intention is merely to shift the burden of proof, the amendment is simply unnecessary. Under current practice, the burden of proof is already on the railroad in nearly all cases involving the movement of coal, including such cases as *San Antonio*, *SWEPCO*, *Iowa Power*, and *Central Power & Light*.

Second, while the stated justification for this proposal lies in the area of coal and perhaps other energy-related commodities, it applies in terms to all commodities except recyclables, which are treated elsewhere in this bill. While an argument can of course be made that a lid on rates should be imposed to achieve certain energy goals, that rationale would not apply on all commodities. Therefore, if the presumptive cap—meaning maximum rate level—concept were retained, we believe it should be specifically pinpointed to particular commodities where the problem outlined in the introductory remarks is believed to exist.

Third, the amendment would appear to work at cross-purposes with the bill as a whole, which is to encourage cost-based rate-making as far as possible. The ratio to be arrived at under the amendment must take into account several criteria, some of which do not relate to costs. If this figure were a genuine cap on rates, which, we reiterate, it does not appear to be, this would result in an unjustified holding down of rates on some of the commodities, particularly those relating to energy. This could prevent the railroads from meeting their systemwide revenue needs which ultimately will deprive coal shippers of the rail system which they need most. As we have seen most recently with the Milwaukee and the Rock Island, rail bankruptcies cause immense economic disruptions and threaten the lifelines of our electric utilities.

Fourth, the criteria to be weighed in reaching the revenue-to-variable-cost ratio of the amendment appear to be weighed downward so that there would be little or no spread between this ratio and the ratio to be reached under section 102 of S. 1946. The consequences of this could be unfavorable, no matter whether the ratio of the amendment is a procedural threshold or whether it is a genuine lid on rates. If the former, then there appears to be little or no need to establish a second ratio. If the latter, the result could be a general holddown of rates that would prevent the railroads from achieving adequate revenue levels. While rates on all commodities could be set at the average system cost level, the fact is that numerous rates must be below that level or the traffic will not move by rail at all. Without this competitively sensitive traffic which makes only a partial contribution to overhead costs, average costs would rise and rail carriers would be forced to raise their rates for the remaining shippers on the system.

In addition, the factors which the Commission would have to consider in reaching the presumptive cap ratio, proposed sections 104(b) (1)–(5), would be extremely difficult to assess.

As mentioned earlier, we believe the contract rate provisions of the bill hold out the most promise for coal shippers. Electric utilities planning new generating units have available to them numerous competitive alternatives—coal mines located in every section of the country served by numerous railroads, barge lines, lake carriers and even trucks. Before deciding on an appropriate site for the plant and the best source of coal, that utility can ensure that its fuel source is competitively priced by entering into a long-term contract with both the coal operator and the railroad. S. 1946 eliminates any question as to the enforceability of these contracts, thereby allowing the electric utility as well as other shippers to

protect themselves from price gouging by railroads and coal mine operators.

In recent weeks, the Commission has taken several important steps with respect to coal shippers and contract rates. First, the Commission has decided that it wishes to reconsider its decisions in the *SWEPO* and *Iowa Power & Light* cases in order to give proper consideration to alleged contractual arrangements which may exist in those cases between the rail carriers and the electric utility. Previously, the Commission had refused to consider those allegations.

Second, the Commission has voted to give effect to three rate contracts involving the Burlington Northern, Detroit Edison, Minnesota Power & Light, and Cleveland Steel Co. In these situations, Burlington Northern had filed rates in excess of those to which it had previously agreed. The Commission had voted to prescribe the contract rate.

Finally, the Commission announced yesterday further clarifications in its contract rate policy. In effect, the Commission will enforce the rate specified in the contract, except where to do so will result in a rate which reduces the going concern value of the railroad.

In those rare situations, the Commission hopes that it will not be in the public interest to require adhering to the contract rate. Additional rulemakings will be coming over the next several weeks, implementing fundamental policy changes regarding our treatment of contract rail rates.

In summary, we believe that S. 1946, along with the Commission's own ratemaking procedures, constitutes a sufficient guarantee against excessive railroad rates and that the amendment before you today is not necessary to achieve that end.

This concludes my testimony. I'd be glad to try to answer any questions.

Senator EXON. Mr. Gaskins, as I indicated earlier, the chairman will be returning early and has some specific questions that he would like to have you expand on.

I would just like to say that once again, we are confronted on this subcommittee and the Commerce Committee itself with trying to insure fairness in this whole matter.

I understand that the utilities have a legitimate concern. As one member, I speak for the committee and the subcommittee also in that the railroads are in a very difficult position.

Of course, what we're wrestling with here is the continued problem of ever-increasing costs to people, wherever they are and what they are doing with regard to the ever-increasing costs of energy.

Now I would just like to say, as I understand the President's proposal in this matter, is that we have a substantial amount of coal in the United States of America and if, hopefully, we could convert to coal, we are going to cut down what most of us consider one of the No. 1 problems with the economy of the United States of America and the free world, and that is the dependence on foreign imports of oil.

Now what we are facing, of course, as you understand full well—I just want to put this in once again for the record—is the fact that it would appear that as we attempt to convert to coal, which is a

resource that we have in abundance in the continental United States, we are seeing the costs of coal going up, in some cases, as fast, and in some cases, faster, even, than the increase of the cost of imported petroleum.

Now in your statement, with that background, and that's what we're really wrestling with, trying to get to the heart of the problem—now I would say that I am somewhat sympathetic to at least the position being advanced by the chairman of the committee, and especially those States that have excessive coal reserves in those States because, as you know, I was one of those who obtained some benefit or some break for the grain shippers with regard to rates.

So I am struggling to be consistent with what I think is the overall fair and right policy.

So the questions we are asking you, basically, in an effort to go to the heart of the problem, how we're going to resolve this, I would point out that while it has been generally considered that the total deregulation of the airline industry has been a good thing, I am, nevertheless, receiving some very pointed signals from many, many different places today that, while the rates originally for rail transportation went down, they are now accelerating upward at a very, very rapid rate.

In fact, I have received word that Hawaii is receiving a great deal of difficulty today with the increased costs of the rail transportation, particularly the people who go to that island paradise, or semi-island paradise, for rest and relaxation.

In your statement, Mr. Gaskins, you argue that the factors which the Commission must consider must involve more than cost base ratemaking.

You seem to imply that the consideration of such other factors would result in a holddown of certain rates, and ultimately, a detrimental effect on the industry's overall picture.

Is it not true that the Commission must also consider adequate revenue levels for the industry pursuant to the amendment?

Furthermore, is it not true that the amendment encourages the consideration of cost base ratemaking by insuring that no one movement is oversubsidizing another?

Mr. GASKINS. My comment on the net tendency of the amendment to move in the direction of a holddown is my reading of the thrust of the totality of the amendment.

It's true that there are elements in the amendment which would require us to continue to consider revenue needs of railroads. But also, my reading is that there are factors in there that would lead the Commission to maintain additional pressure on holddowns.

Senator EXON. Mr. Gaskins, just to follow up on that, you state that the intent of the amendment is to shift the burden of proof to the carriers. It is unnecessary because the burden is on the rail carriers in coal cases, in any event.

Would you please explain this comment? Is the burden of proof in the coal cases different from that in cases involving the movement of other commodities?

Mr. GASKINS. In any case in which the Commission chooses to investigate a rate, the burden is on the carrier, the railroads.

And in almost every coal case of any significance in the last 5 years, the Commission has chosen to investigate that rate.

In that situation, the burden is on the carrier. We have lots of other rates that go into effect without investigation. The Commission may choose not to investigate because there was no complaint, no outcry on the part of the shippers.

We may, in some instances, not choose to investigate because the shipment is de minimis. But there are lots of rates which we do not investigate. In the case of coal rates, I think it's fair to say we investigate all significant coal rate increases. And in those proceedings, the burden is on the carrier.

Senator EXON. Mr. Gaskins, do you have concern about this matter that we have gone into, to some extent in this committee in previous testimony, about the fact that if we don't watch very closely, the rate of increase or the total cost of hauling coal, we are going to encourage the shipment of coal from abroad into the United States of America, which, in essence, gets us back to the same problem that we have today with the reliance on imports of petroleum. Are you—

Mr. GASKINS. We are concerned about that. But I would like to suggest that there is a fundamental difference. Our energy policy, as I understand it, is to reduce imports of highly priced and vulnerable petroleum from abroad.

We do not have as part of our energy policy the policy of discouraging imports of energy.

For example, recently we signed agreements with Mexico to import natural gas. We are happy to buy the oil and natural gas, particularly natural gas from Canada.

And importing coal does not necessarily create a vulnerability or the possibility of a worldwide cartel that we see with the case of oil.

So I think that those are different considerations.

Certainly, the Commission is concerned that we make full use of our ample coal resources. I'm not trying to imply we do not. But I do think that we have to have a fundamentally different attitude toward the imports of energy sources, depending on the nature of the threat they represent to our economy.

It's just simply—there's a real big difference between allowing Polish coal to be hauled back in a tanker which is running empty because it hauled fertilizer to Poland in the first place, and depending on oil from the unstable Middle East. That is a different situation.

Senator EXON. You have stated that the amendment does not work well procedurally with the rest of S. 1946. Please explain in detail your objections in this regard.

Assuming favorable consideration of such an amendment is in the overall form, what specific changes would you propose which would better indicate the amendment with the maximum rate provisions of S. 1946?

Specifically, is your testimony—you indicate that your concern that the rate you established under the amendment would not interface appropriately with the threshold under S. 1946.

What would be your reaction if the ration under the amendment were to be applied only outside of the inflationary cost zone and the 4 percent zone, as has been suggested by others?

Mr. GASKINS. I would say that that's an improvement over the amendment as written.

I would still be somewhat concerned in a parochial way with additional burdens that the amendment would require on us in our ratemaking procedures. But I think that that would be an improvement. That which you suggest would be an improvement over the amendment as written.

I'm concerned that to implement this amendment would require us to gather information which is currently not readily available and would create substantial administrative problems for the Commission.

And I'm very sensitive to the fact that over the last 5 years or so, 10 years, the Commission has been criticized a great deal for its regulatory lag and for being relatively slow to handle some of these proceedings.

So I'm always alert to that kind of a situation—a situation that will require administrative delay due to the requirement for us to get additional information.

Senator EXON. Mr. Gaskins, you certainly aren't trying to interfere with the rights of the Members of Congress to criticize the bureaucracy, are you?

Mr. GASKINS. Certainly not. I'm just suggesting that there's a trade-off there between making our procedures even more air-tight.

Senator EXON. You are aware that in the amendment, the Commission is directed to consider railroad not compensatory in marginally priced traffic.

Do you believe railroad pricing policy in this regard has had a significant impact upon the railroad earnings?

Is there any evidence of the magnitude of railroad are compensatory traffic?

Mr. GASKINS. Unfortunately, the evidence is relatively sketchy. We have in our recent proceedings tried to deal with adequate revenue levels, Ex Parte Nos. 353 and 363. We made an attempt to come to grips with those issues.

But I must admit that we certainly didn't do a definitive job. And we have exhorted the railroads to take actions to stop carrying noncompensatory traffic, either through surcharges or other arrangements. But we do not at this instance have a very good handle on the level of that noncompensatory traffic or know what the effect would be if the railroads tried to raise those rates to compensatory level.

The unknown, of course, is what will happen to the traffic. I presume that a good deal of it will leave the railroads and go to other modes. But I honestly don't know the facts in that situation.

Senator EXON. You state in your testimony that, in general, utilities do have adequate alternatives and thus, that they are not captive to certain excessive rail pricing.

What do you consider to be such reasonable and viable alternatives?

Mr. GASKINS. I want to be careful here. I'm not talking about a utility that already has an existing plant, a boiler or an existing investment. But a utility that contemplates the building of a new plant will typically have access to several railroads who have the ability to draw coal from several different coal sources.

In addition, those railroads that lie near the Mississippi River, for example, may very well have access to barge lines, which can provide part of their transportation.

And the nature of the competition that exists is the kind of competition that you can take advantage of if you attempt to write long-term contracts.

I'm talking about writing long-term contracts before you buy your boiler, before you commit to your coal source.

I'm talking about having the railroads and the barge lines, as the case may be, compete with each other to provide transportation at the lowest cost.

And if you do write such a contract, and if the Commission and the courts act to enforce that contract, I think that you basically will have in that situation ample competition in many instances.

I don't want to misstate the situation. There are still utilities that have really only one railroad that can service them and there are no alternative transportation modes.

But I think if the utilities look hard at the long-term contracting possibilities, that they may perceive that a competitive situation is better than it is—better than they conceive it to be under the present situation.

Senator EXON. Mr. Gaskins, in your testimony you state the amendment is not necessary, as written; particularly, the contract rate provisions are adequate to protect the sole users and respond to our energy problem.

Would you please explain how contract rates would protect coal users from excessively high rates? Furthermore, to what extent can contract rates respond to the problem of cross-subsidization in rate-making, a reality which the amendment also is intended to alter and which the amendment attempts to address?

Mr. GASKINS. I will give you a very clear example of this. The reason I mention it is not necessary is not because everybody is going to go along with the contract tomorrow; it's because we have other procedures under our ratemaking methods to protect utilities.

But in terms of the contract situation, I mention in my testimony two cases involving Minnesota Power & Light and Detroit Edison. In those particular instances, the Commission decided a reasonable rate was not the rate proposed by the railroad in a particular proceeding but was, rather, a rate they agreed to in a contractual arrangement. And that particular rate corresponds to fully allocated costs, given our best estimate of fully allocated costs at this time.

So, there is a situation where the Commission decided, based on the existence of the contract, that a reasonable rate has no add-ons for revenue adequacy because it was a rate agreed to by the railroads and by the utility at a prior time.

So, I presume the railroad made that deal at that time because they were competing with some alternative source of coal for the business and because of the competition at the time of the signing of the contract the utility was able to get a rate which did not in fact have an add-on to revenue adequacy.

Senator EXON. That's all the questions I have in this particular regard. But before you are excused, I would like to explore just for

a moment another matter regarding grain that I did not have an opportunity to take up with you when we were discussing Rock Island and grain movement the other day.

It has come to my attention, and I was wondering if the Commission knows anything about this, that since the grain embargo and since corn and wheat, particularly, prices are down, interestingly enough—or maybe not interestingly enough—there seems to be more cars available for movement of grain than there was before the embargo was announced.

This is somewhat puzzling to me, and I was wondering if you as Chairman of the Commission have heard about this phenomenon and if you might be able to give me your reasons for saying if you believe that to be the case.

Mr. GASKINS. Our evidence is that the car shortage has grown smaller. And, in fact, in some instances, there may actually be a surplus of cars. We are not sure exactly of the causes. But one fundamental fact is that a lot of people who were planning to ship grain to the Gulf for transshipment to the Soviet Union have decided that they are not going to need cars for that purpose, and cars that are not going to be then involved in a movement of grain for export to the Soviet Union are available for other movements of grain.

In addition, I think there is some uncertainty in the Midwest as to where the grain is ultimately going to go. As you know, the Government has agreed to hold the price up, to some extent, through a program. And there is some uncertainty as to whether that grain will move and when it will move and in which direction it will move.

I think you have a situation where you can explain the increase in the availability of the cars merely by the fact that we are having a little less pressure on the cars at this time.

Senator EXON. Mr. Gaskins, if you could remain for a few moments, the chairman will be back, and he has asked for the opportunity to ask you some more questions in his forum. Could you please remain?

Mr. GASKINS. I would be glad to.

[The statement follows:]

STATEMENT OF DARIUS W. GASKINS, JR., CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Mr. Chairman, Members of the Committee, thank you for the opportunity to be here today to present the views of the Interstate Commerce Commission on Senator Long's proposed amendment to S. 1946, the "Railroad Transportation Policy Act of 1979". As you know, we testified last fall in support of many of the provisions of this bill.

Senator Long's amendment, according to the Congressional Record, would require the Commission to establish standards for determining a revenue to variable cost ratio that would be a "presumptive cap" on maximum rate reasonableness. The apparent purpose of the amendment, again from the Congressional Record, is to provide an additional measure of protection for those coal shippers who are captive. However, the actual language of the amendment is not limited to coal.

We are sensitive to the problems confronted by coal users in recent years, and of the increasing need to utilize coal to help solve the Nation's energy problems. Nonetheless, we do not believe that this amendment is necessary to find solutions to these problems. In general, we believe that the provisions of S. 1946 as reported out by the Committee are sufficient to deal with the problem, specifically those provisions dealing with maximum rates and with contract rates.

Moreover, the amendment does not mesh well with the existing provisions of the bill in a procedural sense, and would be difficult to implement. This is important, we believe, since there is clearly a need to simplify regulatory procedures and expedite decisionmaking.

As presently drafted S. 1946 creates the opportunity for carriers to set their rates at a level, expressed as a revenue-to-variable cost ratio, which, on average, would permit the achievement of adequate rate levels (section 102). Added to this are cost increase adjustments (section 103) and limited rate flexibility (section 104). Rates set under these sections are protected from Commission intervention, except that in regard to rates set under section 104, we would have to entertain a complaint filed by a shipper. But rates set above this threshold level would be subject to protest and possible suspension or investigation. Protested coal rates are already subjected to intense scrutiny by the Commission to insure that they do not exceed our maximum rate standards.

Under the amendment, the Commission would be required to establish standards and determine after hearing a second revenue-to-variable-cost ratio which would constitute a point at which the burden of proof as to reasonableness shifts to the carrier, notwithstanding the provisions of sections 10707(c) (1) and (2) and 11701. The introductory remarks to the amendment indicate that this ratio is not intended simply as a procedural threshold, but would in effect be a "presumptive cap of maximum rate reasonableness".

Our concern over this amendment relates to both its policy and technical aspects. The first problem is that it is unclear what the amendment would accomplish. The "presumptive cap" language of the introductory remarks is not reflected in the language itself, which merely shifts the burden of proof at a certain point. If the intention of the drafters is to create a real cap on rates, this language would not accomplish it. If on the other hand the intention is merely to shift the burden of proof, the amendment is simply unnecessary. Under current practice the burden of proof is already on the railroad in nearly all cases involving the movement of coal, including such cases as *San Antonio*, *SWEPSCO*, *Iowa Power*, and *Central Power & Light*.

Second, while the stated justification for this proposal lies in the area of coal (and perhaps other energy-related commodities), it applies in terms to all commodities except recyclables, which are treated elsewhere in the bill. While an argument can of course be made that a lid on rates should be imposed to achieve certain energy goals, that rationale would not apply on all commodities. Therefore, if the "presumptive cap"—meaning maximum rate level—concept were retained, we believe it should be specifically pinpointed to particular commodities where the problem outlined in the introductory remarks is believed to exist.

Third, the amendment would appear to work at cross-purposes with the bill as a whole, which is to encourage cost-based ratemaking as far as possible. The ratio to be arrived at under the amendment must take into account several criteria, some of which do not relate to costs. If this figure were a genuine cap on rates—which, we reiterate, it does not appear to be—this could result in an unjustified holding down of rates on some of the commodities—particularly those relating to energy. This could prevent the railroads from meeting their systemwide revenue needs which ultimately will deprive coal shippers of the dependable and expanded rail system which they need most. As we have seen most recently with the Milwaukee and the Rock Island, rail bankruptcies cause immense economic disruptions and threaten the lifelines of our electric utilities.

Fourth, the criteria to be weighed in reaching the revenue-to-variable-cost ratio of the amendment, although not entirely clear, appear to be weighted downward so that there would be little or no "spread" between this ratio and the ratio to be reached under section 102 of S. 1946. The consequences of this could be unfavorable, no matter whether the ratio of the amendment is a procedural threshold or whether it is a genuine lid on rates. If the former, then there appears to be little or no need to establish a second ratio. If the latter, the result could be a general hold down of rates that would prevent the railroads from achieving adequate revenue levels. While rates on all commodities could be set at the average system cost level, the fact is that numerous rates must be below that level or the traffic will not move by rail at all. Without this competitively sensitive traffic which makes only a partial contribution to overhead costs, average costs would rise and rail carriers would be forced to raise their rates for the remaining shippers on the system.

In addition, the factors which the Commission would have to consider in reaching the "presumptive cap" ratio (proposed sections 104(b)(B)(1)-(5)) would be extremely difficult to assess. The first of these—the ratios of section 102 plus "the demonstration of an appropriate differential between that ratio" and the "presumptive cap"—is so unspecific that our judgment on the matter would have to be wholly subjective

as to what "appropriate" means. The remaining factors would present tremendous—and we believe unjustified—data-collection problems. For the most part the railroads themselves would have to supply this information, and most of it is information which they do not ordinarily maintain. While we think that information on some of these matters ought to be at their disposal more readily than it now is (e.g., the amount of traffic which contributes only marginally to fixed costs), the fact remains that significant burdens on resources would be involved in developing such data. We do not believe that the amendment is sufficiently beneficial in other respects to justify such an effort.

As mentioned earlier, we believe the contract rate provisions of the bill hold out the most promise for coal shippers. Electric utilities planning new generating units have available to them numerous competitive alternatives—coal mines located in every section of the country served by numerous railroads, barge lines, lake carriers and even trucks. Before deciding on an appropriate site for the plant and the best source of coal, that utility can ensure that its fuel source is competitively priced by entering into a long-term contract with both the coal operator and the railroad. S. 1946 eliminates any question as to the enforceability of these contracts, thereby allowing the electric utility as well as other shippers to protect themselves from price gouging by railroads and coal mine operators.

In summary, we believe that S. 1946, along with the Commission's own rate-making procedures, constitutes a sufficient guarantee against excessive railroad rates and that the amendment before you today is not necessary to achieve that end.¹

This concludes my prepared testimony. I would be glad to try to answer any questions you may have.

Senator EXON. At this time I will call Mr. William Dempsey—the chairman has requested that Chairman Dempsey be held, and being a junior member of the committee, I go along with the chairman's request. Therefore, we will call at this time Mr. Thomas Boggs.

Mr. Dempsey, I am sorry. We were misinformed.

STATEMENT OF THOMAS H. BOGGS, JR., COUNSEL FOR THE COMMITTEE OF RAILROAD SHIPPERS; ACCOMPANIED BY JOHN CAMP, COUNSEL; JOHN LIND, DIRECTOR, CORPORATE PHYSICAL DISTRIBUTION, CORNING GLASSWORKS; J. ROBERT HOON, GENERAL MANAGER, TRANSPORTATION, ALUMINUM COMPANY OF AMERICA

Senator EXON. Mr. Boggs, and gentlemen, we welcome you.

We appreciate very much your coming to testify. You can proceed at this time.

Mr. BOGGS. Thank you, Mr. Exon. We are appearing this morning on behalf of the Committee of Railroad Shippers, on S. 1946. Accompanying me today are Mr. John Lind of Corning Glassworks, and Mr. J. Robert Hoon of Alcoa, and my cocounsel, John Camp.

Just to repeat, Mr. Chairman, CORS supports enactment of S. 1946. We believe the bill draws a careful balance between revenue needs of the railroads and the shippers' needs for regulatory protection.

We have carefully reviewed the amendments Senator Long introduced, in the Congressional Record on December 17. We basically support the amendment, provided, however, that certain questions raised by the amendment are resolved. This can be accomplished either by revising the text of the amendment or through the development of appropriate legislative history.

¹ Commissioner Alexis was absent and did not participate.

First and most importantly, it must be made clear that the amendment applies to all commodities and that a single trigger ratio is to be established by the Commission which will apply to all. We read section (a) of the amendment in the Senator's remarks in Monday's hearings in Baton Rouge in this manner. However, we are concerned that the introductory statement in the Congressional Record, which addressed utility coal rates, could be misinterpreted as suggesting separate treatment of this one commodity, and urge that this point be cleared up.

In evaluating our position, it is important for the Senate committee to focus on the fact that one-fourth of the Nation's coal is consumed by nonutility industrial users, including steel, aluminum, chemical industries, and other members of CORS. We estimate the steel industry, for example, used nearly 6 million tons of coal in 1978. This is approximately 30 percent more coal than even the largest utility used in that year. Nonutility industrial use of coal is certain to increase substantially in the coming years. But notwithstanding our direct interest in coal rates, CORS believes that all commodity rates, and not just coal rates, merit the protections afforded by the amendment.

Let me explain why CORS takes this view. One primary purpose of S. 1946 is to improve railroad revenues so that all shippers can get better service. This is a long-term objective, and it can be achieved only if nearly all commodities bear their fair share of the rate increases that are allowed under the rate flexibility provisions of S. 1946.

If any commodity is exempt from these increases or given greater protection from them than is extended to other commodities, these others necessarily must pay the cost of such protection. These include chemicals, steel, aluminum, automobile parts, pulp and paper products, and other commodities, which, as the Senate report on S. 1946 states, are heavily dependent on rail transportation.

In this connection, I draw your attention to the chart appended to my testimony, in which the average revenue-to-variable-cost ratios of selected commodities are compared with those of various coal movements. These figures are taken from testimony submitted to the Commission this month in support of the most recent application of the rail industry for a general rate increase. What they show is that if the proposed general rate increases goes into effect, of the 24 commodities reported on this chart only 3 will have lower revenue-to-variable-cost average ratios than coal in intradistrict movements and only 2 interdistrict commodity average ratios will be lower than coal. In other words, nearly all the commodities listed will be transported in at least some cases at rates that are higher than average coal rates.

Another significant statistic revealed by this chart is that of these 24 commodities, 15 of them currently experience in at least 1 rail district an average revenue-to-variable-cost ratio that substantially exceeds 180 percent. These statistics are confirmed by the experience of the members of CORS.

Alcoa, for example, moves aluminum ingot an average of 1,200 miles—nearly twice the national average shipment distance—from its smelting facilities in the State of Washington to fabricating plants in the Midwest and East. In 1977 Alcoa's west-east interdis-

strict traffic moved at a revenue-to-variable-cost ratio of 214.1 percent. If the general rate increase now under study is approved, this ratio will rise to 220.1 percent. Similarly, soda ash for Corning Glass has recently moved at a ratio of 257 percent; glassware shipped from the manufacturing plants has reached that level as well.

While these figures are averages, their comparison, I believe, makes our point: Rate increases for all commodities, including coal, should be covered by the amendment. For these reasons, we urge that it be made clear that the amendment requires the Commission to establish a single trigger point that applies equally to all commodities.

The second point that we think should be clarified is that the amendment as drafted does not impinge on the "no suspend, no investigate" zone in section 104 of the bill. As we read the amendment, it does not affect a rate increase within that zone. However, as the testimony presented on behalf of the Louisiana railroads last Monday indicates, the rail industry may be interpreting that provision in a manner more detrimental to their interests than it actually is.

This point can be cleared up by a statement in the legislative history that the amendment is intended to have no effect on proposed section 10707(g)(3) of the bill.

Third, we agree that it is appropriate to require a carrier proposing a rate increase that raises the rate above a given level to justify the rate increase. We read Senator Long's amendment as doing just that. It directs the Commission to establish "a point at which the burden of proof with regard to reasonableness shall be upon the proponent carrier."

This means that, for rate increases above a certain point, the railroads will have the burden of coming forward with the evidence to justify the rate increase. This is quite different from placing a "presumptive cap" on rates at any given point. A presumptive cap would assign the railroads not only the burden of coming forward with evidence to justify the increase, but also the burden of overcoming the statutory implication that the level of proof needed is higher than that now required by the Act. Adoption of the former approach is preferable and should be made clear.

Further, we suggest the addition of two factors to the considerations set forth in paragraph (b) of the proposed amendment: First, that the rate evaluation employ a standard of honest, efficient, and economic railroad management in order to place emphasis on greater productivity by the carriers; and second, that the adequacy of revenues derived from traffic moving or expected to move at rates below the proposed level be taken into account. We think these to be relevant factors for the Commission to consider in establishing the trigger point.

Finally, we agree that the ratio established by the Commission should not be subject to congressional review. Because the Commission is receiving congressional guidance on the matter of standards in section (b) of the amendment, we see no need to provide for subsequent congressional review of the Commission's action.

Before closing, I want to make one final point. In the past several weeks many of us who favor enactment of the bill have

worked together and with the committee staff to resolve the differences over the proposed amendment that might cause the defeat of this important legislation. A number of variations of the amendment have been discussed, and we want to advise the committee that the following changes in the amendment would be acceptable to CORS:

(A) Shortening the period for the Commission to establish the trigger point;

(B) Permitting Commission investigation of proposed rates which are within the no-suspend zone, but above the trigger-point level;

(C) Slightly expanding the zone in section 104 of the bill to 5 percent per annum, with a maximum of 16 percent over any 5-year period;

(D) Maintaining the amendment's allocation of burden of proof on the proponent carrier in complaint proceedings on rate increases above the trigger point;

(E) Refining the language of the standards to be used by the Commission in establishing the trigger point to broaden the energy criterion in subsection (b)(5) to include maximum utilization of energy resources.

Thank you for the opportunity to testify. My colleagues and I would be pleased to answer any questions the subcommittee may have.

Senator EXON. Thank you, Mr. Boggs.

In the summary portion of your testimony, it appears that the group of shippers that you represent support S. 1946 and the amendments that have been proposed by Senator Long.

How would you respond to the thought that coal shippers have no tradeoffs to improve their bargaining power, some like large industrial concerns, and are therefore distinguishable from a company which may have the captive movement inbound of raw materials or transportation alternatives on the outbound of finished products?

Mr. BOGGS. Mr. Hoon will answer that.

Mr. HOON. I don't think I agree with your basic premise on that that utilities would be somewhat different than the manufacturers concerned such as the one I now represent.

Senator EXON. You don't believe that the premise and thrust of the question has merit? Is that what you're saying?

Mr. HOON. No. I'm saying that the industrial concern need not necessarily have the alternatives which you suggest might be available to it or nonavailable to it.

Senator EXON. Let me follow up on that, and I would ask either of you to respond.

Some have suggested that because of certain transportation characteristics—for example, the efficient unit train movements that we're familiar with, particularly in the grain field—it might not achieve the purpose of the amendment in proposing this amendment at one level if it is established for all commodities.

How would you respond to that type of a scenario?

Mr. HOON. I think if it's established for all commodities, I think you could all share equally on it—equally in that, independent of the amendment.

Senator EXON. Mr. Boggs?

Mr. BOGGS. Senator Exon, I should point out, the trigger point would be based on average variable costs which are revenue factors. So if there is a cost savings accomplished by unit trains, that is factored into the average railroad cost formulated, so any differences in cost—if you have heavier track, certain types of movements of chemical products, steel products—that is factored in. So you have a factor which really takes into account the various cost savings which are accomplished by the methodology used in the shipments.

Senator EXON. It seems you gentlemen support the factors that have to be considered in establishing a trigger, then. Is that a fair assumption?

Mr. HOON. Correct.

Mr. BOGGS. Yes.

Senator EXON. Arguments lodged against this set of factors point out that the revenue needs of the rail industry would not be considered adequately.

Furthermore, opponents state that the considerations are impractical and unworkable.

What are your reactions to these arguments?

Mr. LIND. Senator, I don't believe they are impractical. I think that there should be a level on all commodities, and I think that we have addressed that in the legislation.

Senator EXON. Mr. Boggs, you state, the amendments should not apply in the 4 percent zones to shipments, or to improvements to carriers, calling for a clearer expression of this intent.

Should it not be the intent of this amendment to deal with the rates which are excessive, whether they are in the 4 percent zone or not?

Mr. BOGGS. Senator Exon, I think the main thrust of the bill is to provide rate flexibility to the railroads in an attempt to help them raise overall revenues. I think you have to maintain that integrity.

I think this amendment should maintain this integrity, and that's our position. I do think what we are stating that perhaps in the zone itself you could have Commission investigation, but you would not have a shift of the burden of proof on the proponent carrier.

Senator EXON. Mr. Boggs, thank you very much. I have no further questions at this time. We appreciate very much your testimony.

As far as I know, the chairman has no questions of you, but if you will remain around he may have.

[The statement follows:]

STATEMENT OF THOMAS H. BOGGS, JR., COUNSEL FOR THE COMMITTEE OF RAILROAD SHIPPERS

Mr. Chairman and Members of the Subcommittee, the Committee of Railroad Shippers (CORS) appreciates the opportunity to address the amendment that you have proposed to S. 1946, the "Railroad Transportation Policy Act of 1979." Accompanying me today are John W. Lind of Corning Glass Works, J. Robert Hoon of the Aluminum Company of America, and our co-counsel, John Camp.

CORS supports enactment of S. 1946 as it was reported in November by the Commerce Committee. We believe the bill draws a careful balance between the revenue needs of the railroads and shippers' needs for regulatory protection, particularly where the traffic is captive to a single carrier. We think it desirable that this legislation be passed, for it will help the railroads to meet their revenue needs

and thereby help assure our members and other shippers of satisfactory rail service in the future.

We have carefully reviewed the amendment that Senator Long introduced in the Congressional Record on December 17. We appreciate the concerns that gave rise to it and we basically support the amendment, provided, however, that certain questions raised by the amendment are resolved. This can be accomplished either by revising the text of the amendment or through the development of an appropriate legislative history.

First and most importantly, it must be made clear that the amendment applies to all commodities and that a single trigger ratio is to be established by the Commission which will apply to all. We read section (a) of the amendment and your remarks, Mr. Chairman, at Monday's hearing in Baton Rouge in this way. However, we are concerned that the introductory statement in the Congressional Record which addressed utility coal rates could be misinterpreted as suggesting separate treatment of this one commodity and urge that this point be cleared up.

In evaluating our position, it is important for the Senate Committee to focus on the fact that one-fourth of the nation's coal is consumed by non-utility industrial users, including the steel, aluminum, chemical and other members of CORS. We estimate that the steel industry, for example, used nearly 66 million tons of coal nationwide in 1978. This is approximately 30 percent more coal than even the largest single utility used in that year.¹ This substantial non-utility industrial use of coal is certain to increase in the coming years in view of the provisions of the Fuel Use Act. But notwithstanding our direct interest in coal rates, CORS believes strongly that all commodity rates, and not just coal rates, merit the protections afforded by the amendment.

Let me explain why CORS takes this view. One primary purpose of S. 1946 is to improve railroad revenues so that all shippers can get better service. This is a long-term objective, and it can be achieved only if nearly all commodities bear their fair share of the rate increases that are allowed under the rate flexibility provisions of S. 1946. If any commodity is exempt from these increases or given greater protection from them than is extended to other commodities, these others necessarily must pay the cost of such protection. These include chemicals, steel, aluminum, automobile parts, pulp and paper products, and other commodities, which, as the Senate Report on S. 1946 states, are heavily dependent on rail transportation.

In this connection, I draw your attention to the chart appended to my testimony, in which the average revenue-to-variable-cost ratios of selected commodities are compared with those of various coal movements. These figures, I might add, are taken from testimony submitted to the Commission this month in support of the most recent application of the rail industry for a 4 percent general rate increase. What they show is that if the proposed general rate increase goes into effect, of the 24 commodities reported on this chart only 3 will have lower revenue-to-variable-cost average ratios than coal in intradistrict movements and only 2 interdistrict commodity average ratios will be lower than coal. In other words, nearly all the commodities listed will be transported in at least some cases at rates that are higher than average coal rates.

Another significant statistic revealed by this chart is that of these 24 commodities, 15 of them currently experience in at least one rail district an average revenue-to-variable-cost ratio that substantially exceeds 180 percent. These statistics are confirmed by the experience of the members of CORS. Alcoa, for example, moves aluminum ingot an average of 1,200 miles—nearly twice the National average shipment distance—from its smelting facilities in the state of Washington to fabricating plants in the midwest and east. In 1977 Alcoa's west-east interdistrict traffic moved at a revenue-to-variable-cost ratio of 214.1 percent. If the general rate increase now under study is approved, this ratio will rise to 220.1 percent. Similarly, soda ash for Corning Glass has recently moved at a ratio of 257 percent; glassware shipped from the manufacturing plants has reached that level as well.

While these figures are averages, their comparison, I believe, makes our point—rate increases for all commodities, including coal, should be covered by the amendment. For these reasons, we urge that it be made clear that the amendment requires the Commission to establish a single trigger point that applies equally to all commodities.

The second point that we think should be clarified is that the amendment as drafted does not impinge on the "no-suspend, no-investigate" zone in section 104 of the bill. As we read the amendment, it does not affect a rate increase within that zone. However, as the testimony presented on behalf of the Louisiana railroads last

¹Department of Energy, Energy Data Report—"Bituminous and Subbituminous Coal and Lignite Distribution" (Catalog No. DOE/E1A0125/4Q78).

Monday indicates, the rail industry may be interpreting that provision in a manner more detrimental to their interests than it actually is.² This point can be cleared up by a statement in the legislative history that the amendment is intended to have no effect on proposed section 10707(g)(3) [see p. 50, lines 14-22 of S. 1946] which bars the Commission from suspending or investigating rate increases which exceed inflation costs by less than 4 percent per year and less than 12 percent over any five-year period.

Third, we agree that it is appropriate to require a carrier proposing a rate increase that raises the rate above a given level to justify the rate increase. We read Senator Long's amendment as doing just that. It directs the Commission to establish "a point at which the burden of proof with regard to reasonableness shall be upon the proponent carrier. . . ." This means that, for rate increases above a certain point, the railroads will have the burden of coming forward with the evidence to justify the rate increase. This is quite different from placing a "presumptive cap" on rates at any given point. A "presumptive cap" would assign the railroads not only the burden of coming forward with evidence to justify the increase, but also the burden of overcoming the statutory implication that the level of proof needed is higher than that now required by the Act. Adoption of the former approach is preferable and should be made clear.³

Further, we suggest the addition of two factors to the considerations set forth in paragraph (b) of the proposed amendment. First, that the rate evaluation employ a standard of honest, efficient and economical railroad; management in order to place emphasis on greater productivity by the carriers; and second, that the adequacy of revenues derived from traffic moving or expected to move at rates below the proposed level be taken into account. We think these to be relevant factors for the Commission to consider in establishing the trigger point.

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Before closing, I want to make one final point. In the past several weeks many of us who favor enactment of the bill have worked together and with the Committee staff to resolve the differences over the proposed amendment that might cause the defeat of this important legislation. A number of variations of the amendment have been discussed, and we want to advise the Committee that the following changes in the amendment would be acceptable to CORS:

- (a) Shortening the period for the Commission to establish the "trigger point";
- (b) Permitting Commission investigation of proposed rates which are within the "no-suspend" zone but above the "trigger point" level;
- (c) Slightly expanding the zone in section 104 of the bill to 5 percent per annum, with a maximum of 16 percent over any five-year period;
- (d) Maintaining the amendment's allocation of burden of proof on the proponent carrier in complaint proceedings on rate increases above the "trigger point";
- (e) Refining the language of the standards to be used by the Commission in establishing the "trigger point" to broaden the energy criterion in subsection (b)(5) to include maximum utilization of energy resources.

Thank you for the opportunity to testify. My colleagues and I would be pleased to answer any questions the Subcommittee may have.

Attachment.

²Statement of Richard J. Bertrand, Before the Surface Transportation subcommittee, February 5, 1980. At page 4, the testimony stated:

The proposed amendment would * * * hold down coal rates * * * by requiring the Interstate Commerce Commission to establish a threshold at which the burden of proof as to the reasonableness of any rate increase *within the 4 percent zone* established by section 104 would be shifted back to the railroads. (Emphasis added)

³A further reason for avoiding a statutory provision expressed in terms of a "presumptive cap" on rates can be found in the Commission's experience with the presumptions promulgated in connection with the market dominance provision of the 4R Act. The Commission initially proposed four "rebuttable presumptions" of market dominance [41 F.R. 44183 (October 7, 1976)]; these presumptions were challenged in *Atchison, Topeka & Santa Fe v. ICC*, 580 F. 2d 623 (D.C. Cir. 1978), as lacking a rational basis in fact. The reviewing court upheld three of the four presumptions; however, last month the Commission proposed abandoning two of the three remaining presumptions. 45 F.R. 3353 (January 17, 1980). The surviving presumption has been the target of much criticism, as has the underlying criterion of market dominance as a threshold test for ICC rate review jurisdiction. By contrast, the Commission has successfully administered both statutory and regulatory burdens of proof for many years. *CF.* 49 U.S.C. § 10707; *Louisville & N.R. Co. v. United States*, 238 U.S. 1 (1915); *Darling & Co. v. Alton & S.R.R.*, 299 I.C.C. 393 (1956).

COMPARISON OF REVENUE TO VARIABLE COST RATIO AVERAGES ¹

[Based on proposed, present, and base year rates]

Commodity	Proposed average R/VC		Average		
	Intradistrict	Interdistrict	Present lowest	Present highest	Base year 1977
Bituminous coal	106	118	76	166	111
Cotton	105	132	72	454	131
Soybeans	129	117	95	155	110
Iron ore	105	120	17	167	111
Industrial sand	130	130	99	192	124
Potash fertilizer	147	144	22	179	140
Fresh meat	170	164	60	242	157
Corn mill. production	154	157	62	212	149
Pulpwood logs	89	89	70	173	87
Lumber	138	123	82	157	120
Wood particle-board	159	156	70	411	150
Newsprint paper	167	184	36	235	183
Corrugator pulp	146	136	73	166	130
Industrial inorganic chemical	202	168	97	229	165
Agriculture chemicals	160	159	69	176	156
Rubber	174	150	82	240	153
Salt	116	125	26	243	117
Liquified gases	159	153	96	206	147
Manufactured iron/steel	166	151	81	238	152
Prim. Aluminum products	188	182	111	220	178
Heavy machinery	193	180	75	287	188
Motor passenger cars	154	172	92	281	166
Motor vehicle parts	165	163	107	383	159
Soda ash	182	169	116	273	165
Total carload traffic	128	137	102	161	133

¹ Expressed as a percentage.

Source: Attachment MLH-5, Verified Statement No. 5, M. L. Hall; before the Interstate Commerce Commission "In Support of Petition of United States Railroads for Authority to Increase Freight Rates and Charges Nationwide—1980" (February 1980).

Senator EXON. Again, at the request of the Chairman, I am going to go out of order on the list of witnesses, and at this time I would like to call Mr. Edmund Frost, vice president and general counsel for the Chemical Manufacturers Association for his testimony on this.

Mr. Frost, we welcome you this morning. I understand you are accompanied by Mr. Midkiff of Tennessee Eastman. Is that correct?

Mr. FROST. Yes, sir. That's correct.

STATEMENT OF EDMUND B. FROST, VICE PRESIDENT AND GENERAL COUNSEL, CHEMICAL MANUFACTURERS ASSOCIATION, INC.; ACCOMPANIED BY DOUG MIDKIFF, EASTMAN CHEMICAL DIVISION, EASTMAN KODAK CO., KINGSPORT, TENN.

Senator EXON. Would you proceed, Mr. Frost.

Mr. FROST. Yes, sir. I'd be glad to.

The Chemical Manufacturers Association appreciates the opportunity to address the amendment you propose to S. 1946—that Senator Long has proposed to S. 1946.

With me today is Doug Midkiff. He's the manager of rates for the Eastman Chemical Division of Eastman Kodak Co. in Kingsport, Tenn., and he is the chairman of the rail task group of the CMA Distribution Committee.

Chemical Manufacturers Association is a nonprofit trade association with 192 U.S. company members, representing more than 90 percent of the production capacity of basic industrial chemicals within this country. Total shipments of chemicals and allied products were valued at \$148 billion in 1979. These shipments comprised 9.5 percent of the total manufacturers' shipments of both durable and non-durable goods. Exports totaled \$17.3 billion, representing 11.7 percent of the chemical industry's sales. Those exports totaled 9.5 percent of U.S. total exports.

CMA commends Chairman Howard W. Cannon, Subcommittee Chairman Russell B. Long and the staff of the Senate Committee on Commerce, Science, and Transportation on its diligence in preparing S. 1946 and the Long amendment. CMA has already testified on S. 1946. Our remarks today will briefly address the Long amendment. The amendment is responsive to the needs of carriers, the users of rail transportation, and the public, and reflect a rational balance in meeting the interests of each of these groups.

A strong, efficient, and safe rail system is essential for the economic prosperity of this Nation. S. 1946 and the Long amendment will foster such a healthy system without unduly burdening captive shippers.

And now I'd like to go to briefly address some of the specifics.

The development of a triggerpoint level by the Interstate Commerce Commission under the Long amendment should not be subject, in our view, to congressional review. The Interstate Commerce Commission has the expertise to develop such a triggerpoint, expressed in terms of a revenue-to-variable-cost ratio, beyond which the burden of proof lies with the carrier. Congressional review of the Interstate Commerce Commission's findings would not, therefore, be necessary and could result in a delay in reaching a final determination of that threshold level. We would anticipate that the Interstate Commerce Commission could establish this triggerpoint level within 1 year.

In making its determination of this level, the Interstate Commerce Commission should take into full consideration the amount of traffic which does not contribute or contributes marginally at best to the fixed costs incurred in moving that traffic. To insure a viable railroad system, all traffic should be carried at rates which will yield adequate revenues for the railroads.

In endorsing the Long amendment, our interpretation is that it makes the standards it sets forth applicable to all commodities. It would not be proper to establish different criteria for different commodities.

The Interstate Commerce Commission has, since its inception, approved individual rate increases reflecting differential pricing. We will not here address the inequities or benefits resulting from this pricing mechanism, but wish to express our view that Congress should not add any statutory preferences to a century-old pricing structure by artificially capping prices for one commodity as opposed to another.

As proposed in the Long amendment, all captive shippers should receive the same statutory and regulatory protection from monopoly prices. And the chemical industry is clearly "captive" to rail transportation. The nature of chemical products, the distance and

diversity of chemical markets, and most importantly the substantial capital investments in rail equipment, tank cars, and shipping and receiving facilities often serve to make modes of transportation other than rail service unfeasible as economic and practical alternatives. The rail system itself usually does not offer the protection of competition with regard to pricing of individual movements.

In conclusion, Senator Exon and members of the committee, we once again commend your efforts in this complex and difficult area. We believe the committee has taken a constructive step toward the efficient, economical, and responsive railroad system this Nation needs. We thank you for hearing our views on the amendment introduced by Senator Long. We will be pleased to respond now or later to your questions.

Senator Exon. Thank you, Mr. Frost. I'm not singling you out, and it doesn't offend me at all, but all of the witnesses here this morning have mispronounced my name. My name is Exon, which was at one time a very respectable name.

It is distinct and different from that other well-advertised name.

As a man with the name of Exon, which is an old respectable name, I always distinguish between myself and the others that I refer to as the "doublecross boys."

The name is Exon.

Mr. Frost, it has been stated that the amendment might encourage a holddown on the coal rate because of the mandated consideration of energy policy resulting in rates on other commodities being allowed to increase to cover the revenue needs.

What is your reaction to this argument, as I assume your commodity is one of those others that I referred to as part of the question?

Mr. FROST. We are quite concerned that any other major commodity groups could benefit from an artificial holddown.

My clients already are paying substantially high rates, and I think on the average quite a lot higher than the coal shippers.

And the chemical industry is willing to do its fair share to contribute additional revenue to assist the railroads in their financial needs. But we are quite concerned that we not be required to contribute an unfair or disproportionate share.

Mr. MIDKIFF. Senator Exon, I think we could add to that point. A shipment of chemicals, excluding fertilizer, paid \$1.5 billion in railroad freight charges in 1978.

And this represents 6.5 percent of the total railroad revenues, and accounted for 12.5 percent of the total profits.

And so as you see by this disproportionate contribution for railroad profits, chemical commodities already are there in high railroad rates, and chemical shippers are captive shippers very often.

Senator Exon. Gentlemen, some argue that the amendment, at least as drafted, does not technically mesh well with S.1946, which I believe you gentlemen support.

How would either of you respond to this criticism, and do you think it is justified?

Mr. FROST. There has been some discussion of fine-tuning, and I think in any difficult and complex area such as this fine-tuning may be appropriate.

We have participated and would be willing to continue to participate in that process.

Basically, we think that it will mesh, and we think that it is going down the right track.

Senator EXON. Since the Long amendment will only require the railroad to carry the burden of proof, it will not hold down justifiable rates—at least that is the assumption. Do you agree with this assumption?

Mr. FROST. Yes, sir, indeed.

Senator EXON. I have one last question, and then I will turn the chair back to the Chairman.

Mr. Frost, you mentioned that the revenue needs of the railroad industry are appropriate for consideration under the Long amendment. However, it is argued that such needs are given less weight when considered with the other factors such as energy policy.

What is your reaction to this argument, and indeed, if your associate Mr. Midkiff, wishes to comment on this, it would be most welcome.

Mr. FROST. Let me take a quick shot, and then let Mr. Midkiff comment.

The Long amendment is part of the whole legislative package developed in S.1946, and I believe the package as a whole does fairly consider the railroads' needs, and that the Long amendment is a reflection to provide protection of captive shippers where that is truly needed.

Mr. MIDKIFF. I would agree to that. I would say further that the S. 1946 plus the Long amendment represents what we consider to be a very logical, balanced approach to the problem of railroad revenue, and that implementation or adoption of S. 1946 and the Long amendment will allow the railroads to determine or to develop adequate revenue.

There's no question but that we support the idea that this bill and the Long amendment will allow adequate revenue without resort to any preferential treatment of any particular commodity.

Senator EXON. Those are all the questions I have. I will recognize Senator Long in 1 moment to resume chairmanship of the meeting again.

Is there any other statement that you have, Mr. Midkiff, that you would like to make, in general, on the subject?

Mr. MIDKIFF. I would like to restate the fact that we appreciate the effort of this committee and of the staff and the diligence and the expertise that they have shown in developing the ability to put out a well balanced bill that addresses the needs of the railroads and the shippers.

Particularly, we appreciate the Long amendment in that regard. We think that this is a necessary addition to S. 1946. Thank you very much.

Senator EXON. Thank you very much. There may be a question by the chairman, if you would wait. Mr. Chairman, I'm going to turn it back over to you. I don't know whether there are any captive shippers represented here this morning or not. But there are certainly some captive witnesses, and I have held them.

Mr. Gaskins, chairman of the Interstate Commerce Commission, has testified, but I told him that you likely would ask some ques-

tions, and likewise we passed over the testimony of Mr. Dempsey until you returned.

Senator LONG [presiding]. I don't think I care to question him. I'd rather read Mr. Gaskins' testimony before I interrogate him.

As I said before, I had to be at a conference between the Senate and the House. I want to thank Senator Exon for filling in the gap while I was necessarily absent here. I suggest we call Mr. William Dempsey next. I think he did a great job presiding.

Why don't you go ahead and preside?

Senator EXON. Mr. Dempsey, I apologize. We wish to recognize you at this time.

Would you be good enough to introduce those gentlemen with you this morning?

STATEMENT OF WILLIAM H. DEMPSEY, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS; ACCOMPANIED BY RICHARD E. BRIGGS, EXECUTIVE VICE PRESIDENT; AND J. THOMAS TIDD, GENERAL SOLICITOR

Mr. DEMPSEY. Yes; to my left is Mr. Richard E. Briggs, who is executive vice president of the Association of Railroads, and to my right is Mr. J. Thomas Tidd, our general solicitor.

I usually begin my testimony by saying it's a pleasure to be here. I think that's an overstatement.

I'll protect myself with good morning.

Senator LONG. Mr. Dempsey, if you weren't here, I'd say you'd be in bad shape with the people who pay your salary.

Mr. DEMPSEY. That's even more encouraging.

Let me begin by saying something that I'm sure will not come as a surprise to the committee. And that is that the railroad industry strongly opposes the proposed amendment, and indeed, so strongly that if it is annexed to S. 1946 we will then strongly oppose the bill.

I'd be glad to go into detail later, but I say that basically because of two reasons. We had hoped for some rather major regulatory reform in this session of Congress, and that is not to be had by S. 1946. To us it is a modest bill. We concluded early on that we should not let the best be the enemy of the good.

We should be satisfied with a bill that most shippers could support and we could support, so we do support S. 1946, but without any notable enthusiasm.

Senator LONG. I hope you understand that this isn't the only bill we can amend. On occasion we try to do something about the crying need of serving the public interest. I even put things on revenue bills to resolve issues. I think we ought to address ourselves to the issue.

I'm very much aware that you're interested in that very essential service. It's essential to the whole country. And you've got some very good people in your industry. I'm not saying that they're all going to rate it A-plus, but you've got some very fine, dedicated Americans in your industry and in the management.

We are interested in your needs and really, we don't want anything to hurt the rail industry. We just want to see you do a good job, and we want to do a good job.

And I hope that you and those in your industry can stand a little constructive criticism.

I get it in my line of business whether I want it or not, so I might as well adjust to it. That's part of being in the public life. You've got to take with the sweetness some criticism and try to adjust yourself to the views of others.

Those who sponsored this amendment, those who support me—we just want to make it a good deal for all concerned.

Mr. DEMPSEY. I understand, Mr. Chairman. You have been very open with us in the past. Let me get directly to what seems to me to be the factual questions, then I can talk about the particulars of the amendment later.

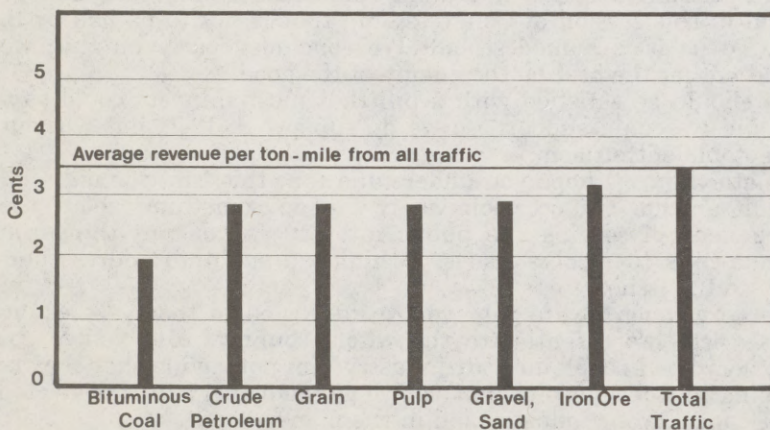
The genesis of all this, obviously, is a concern about coal transportation rates. I've looked with care at all of the documents submitted to the committee up to today and I think that they are most notable for the absence of any analysis of the coal rate structure, or for that matter, any other part of the rail transportation rate structure in the United States. Such an analysis is set forth in our statement and I invite your attention to it.

In the time available, I will just be able to touch upon some items. We begin with the basic question: What has happened to coal transportation rates? Are they exorbitant or are they not? Is there a need for some kind of additional regulation here or not?

First, it is to be noted that coal represents 30 percent of our traffic and contributes less than 15 percent of our revenues. That indicates, right off the bat, that coal rates are not high in relation to other rates.

Senator LONG. Isn't that kind of irrelevant, Mr. Dempsey? If you are able to have a coal contract where you just roll those cars up in the loading facilities—the thing rolls up. It just automatically fills up a coal car. Just load them out on a volume basis—isn't that kind of irrelevant to what you're talking about?

REVENUE COMPARISONS



Mr. DEMPSEY. Yes; you carried me to the next step, Mr. Chairman, and quite properly so. You will see from this chart that per

ton mile the rates on coal are only about 57 percent of the average rates on all commodities.

Revenue per ton mile, coal brings in slightly under 2 cents per ton mile. All other traffic about $3\frac{1}{2}$ cents per ton mile. Grain, pulp, gravel, sand, iron ore—all return significantly more revenue than coal.

Now then, the question the chairman raised is: Yes, but what about the lower costs on coal movements, at least some coal movements, as contrasted with the higher costs on some other types of movements.

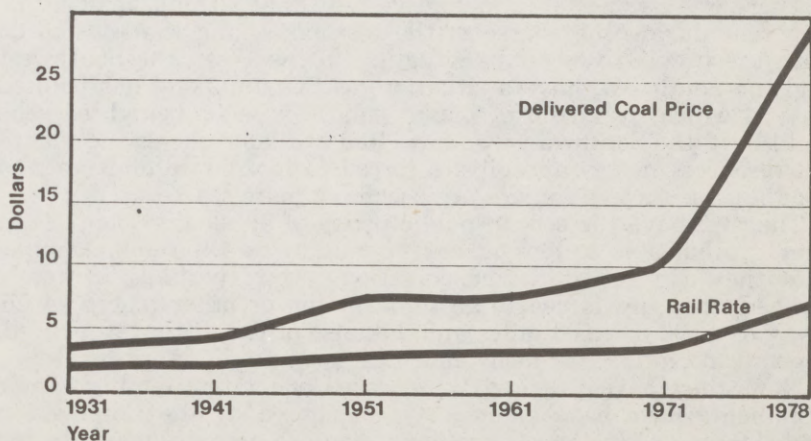
There I would refer you to the detail that I am grateful has just been presented by Mr. Boggs, dealing with revenue cost relationships. It demonstrates that, among all the commodities the railroads carry, coal ranks relatively low. That data is also presented by way of the Western coal cases in DOT's statement, as an appendix, and there you will see that in not a single one of these Western coal cases is there a ratio of rate to variable costs in excess of 151 percent. And we need to make 165 percent, by our calculations, and 150 percent by the Commission's, in order to make a reasonable rate of return.

These ratios are not high in relation to what we have to get, or in relationship to what we charge our other customers. Well, then, what is the source of the problem?

I suggest that it is twofold. In the first place, there is quite proper concern on the part of this committee, the utilities, as major consumers of coal, and everyone else, with the skyrocketing costs of energy—not just oil and gas, but also coal—and that, of course, is in the aftermath of the shocking action by OPEC beginning in 1973 with respect to oil prices.

But if the suggestion is that the principal reason for the increase in the price of coal laid down at the utility is rail rates, then I suggest to you that there is nothing to that case.

COAL PRICES vs RAIL RATES

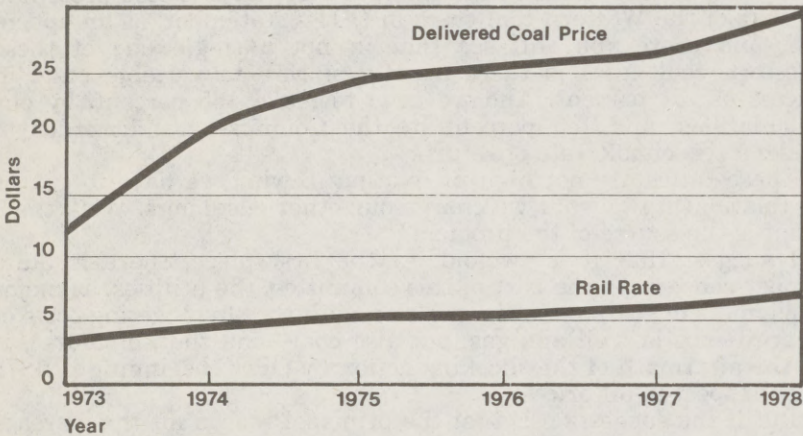


The next chart shows you what has happened from 1931 through 1978, with coal prices at the mine mouth in contrast with rail rates.

Coal prices at the mine mouth are in green, and you can see the sharp upward escalation. Rail rates are in red, and as you can see, they have made a much more modest contribution to the increase in the delivered price of coal at the utility than have coal prices at the mine mouth.

Now let us look at the more recent period, since 1973 when OPEC took charge of this whole situation.

COAL PRICES vs RAIL RATES



Between 1973 and 1978, we see an increase in coal prices of 163 percent but only a 75-percent increase in rail coal rates—or less than half as much.

There is a second factor operative here that I think has become apparent during the course of the testimony, and that has to do with the peculiarities of the situation in the West, the Southwest and the South. We have a situation, as Senator Long has pointed out, in which by virtue of public policy—wise or benighted—the utilities in the Southwest who have had available cheap and plentiful resources in gas and oil are forced to look more and more to coal because those resources are becoming more scarce.

Then we have the second public policy of air quality control. So they are not able to look at coal as nearby as Ohio, for example, that they can get at a transportation cost of perhaps \$8 a ton. Instead, they are forced to go to Wyoming or other places as far away as 1,500 or 1,600 miles and, because of the distance involved, the transportation cost looms much larger.

Now, they have litigated those cases one after another. Their arguments have been extensively considered by the Commission and the courts, and they have lost. They are now, I suggest, trying to recapture their position. But the fact of the matter is that the

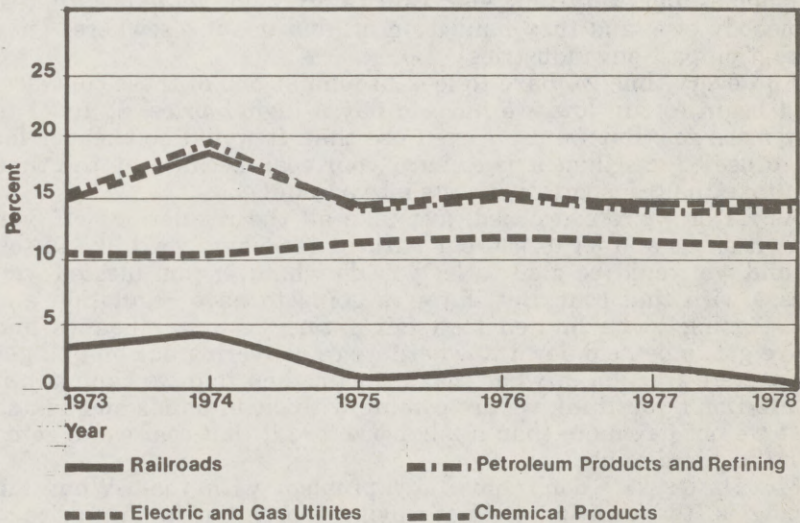
rates on coal in the West are low. They range about 1 cent per ton mile.

That's to be contrasted with about 1.96 cents per ton mile for coal nationally. The problem, of course, is that if you have to carry coal for 1,500 miles, when you get to the end, no matter how long the per-unit rate is, the total cost balloons. And that's the whole problem, I think, in a nutshell. So hamburger may be relatively cheap but, if you have to buy 20 pounds of it instead of 2 pounds, you've run up a pretty big bill.

So nationally the portion of the delivered cost of coal is only 25 percent, and that's gone down from 29 percent 10 years ago. In the West, of course, in this new situation, it's a lot higher than that because the price of western coal is lower than eastern coal and it has to be hauled much further. I think that's the root of the problem.

But what I want to suggest is that it is inappropriate to look to the railroad industry—if it were appropriate to look to any private parties—in order to promote national energy policy. I think the utilities' are entitled to a fair rate of return, as are the coal companies and everybody else. But if it were appropriate to look to private parties, I suggest it would not be appropriate to look at the rail industry.

RETURNS ON EQUITY



This chart compares the rates of return on equity are for the rail industry with those of the electric utility, chemical and petroleum industries. Senator, if you would like to double the railroads' rates of return, it wouldn't really matter because they wouldn't come close to the rates of return of utilities or petroleum products, or for some of our other customers who benefit by this amendment, such as chemical products which are way up there around 15 percent.

Senator, that concludes the summary of my statement which has been submitted for inclusion in the record.

Senator EXON. Thank you very much.

Senator Long?

Senator LONG. Let me assure you, I'm going to take your statement home, read it very carefully, Mr. Dempsey. It's a good statement. It deserves thorough consideration at the committee by me and everybody else. And I urge all Senators to give it their full attention.

I want to congratulate you on your summary statement here. It's been a long time since I've heard a better argument made for such a weak case.

Mr. DEMPSEY. I take compliments when I can get them.

Senator LONG. Like me, you need all the help you can get. I don't begrudge you for a moment.

Now, I am sure you understand what some of our situation is. Take Louisiana and Texas, for example. I personally am signed up to a gas contract. We're selling natural gas for 50 cents a thousand, and a lot of it. And we put that in a pipeline, ship it out, and we move that so cheaply that the railroads can't compete with it. The cost of moving that energy by pipeline is cheaper than moving it by ship.

And we are selling a lot of oil for \$6, about \$6.60, something like that, and we would just love to keep all that stuff down there in Louisiana and use that to provide jobs and opportunities and heat our homes and everything else. But we are made to deliver that to somebody else, and they haul it on off and use it elsewhere. They take it on past our industries.

And every time we have to look around at one of these contracts that begin to run low, we have to pay a higher price, \$3 to \$4 to buy more gas. But we can't even use that. It would be cheaper for us to use \$3 gas than it is to burn your coal, because by the time you take the transportation costs into account.

As far as we're concerned, just take all the regulations off, you take it off us and let us sell our natural gas where we'd like to sell it, and we would be glad to let you do whatever you blessed well please with that coal. But if you're going to have regulation and we're going to be limited to a fair return on our pipelines and we've got to be held down to where we're delivering our oil and gas for a mere fraction of what that's worth, then told we can't use it at all. Don't you think we are coming with clean hands and asking that we not pay more than a fair price for all that coal we're going to be required to use?

Mr. DEMPSEY. I don't have any problem with that. What I'm saying is, the utilities are not paying more than a fair price. I would accept your proposed amendment at such point as we got the same rate of return as the utilities do.

Senator LONG. Well, that gets us into all kinds of arguments. But it's good. Some of your people are doing pretty good.

Mr. DEMPSEY. Not as well as any utility in the long range. You take San Antonio, with a rate of return at the rate of 13 percent, Houston 14 percent. There's no railroad that's close to that, not close.

Senator LONG. Well, we get involved also in things, and I'm not here to argue about—I don't feel like quarreling with your railroad about the rate base and all that. By the time we get this fight over with, we'll all be friends all over again. So there's no point in bruising people's dignity one way or another by arguing about all of this.

But basically, we feel that at some point the presumption ought to be in favor of the consumer, and from that point forward you ought to carry the burden of justifying a higher rate. I don't understand what's wrong with that.

Mr. DEMPSEY. I don't disagree with that, Senator. I really don't. I don't have a board policy on that particular issue. But the fact of the matter is if a public utility is not making a reasonable rate of return, it really doesn't have much of a burden in order to get an increase. When a railroad is operating at a low rate of return, it can only think that things ought to be more relaxed then, too.

But beyond that, a point that another witness made is that the Commission is imposing a shifting in the burden of proof now. I don't want to defend the Commission, because I think that they shift the burden too early with their 7 percent solution. I don't think we're going to be able to live with that.

But the fact of the matter is that right now their rule is that on any particular coal movement we can make fully allocated costs, including a profit plus 7 percent, and then the burden shifts. What I object to is the form in which the proposed amendment shifts that burden.

Senator LONG. Well, now, if the Interstate Commerce Commission would do their job the way that you would think they ought to do their job with regard to coal deliveries to captive customers, is there anything in this bill that would hurt your industry?

Mr. DEMPSEY. Yes. I'll answer that in two stages. In the first place, I think that you're being too restrictive now on coal rates. When you consider that—

Senator LONG. Hold on just a minute. I'm just saying, if they would do the job the way that you think it ought to be done, is there anything in this bill that would hurt your industry—in my amendment that hurts your industry?

Mr. DEMPSEY. Yes, I think so. Unfortunately, you weren't here to listen to Chairman Gaskins. But you'll have an opportunity to read his testimony. What he said was that, all things considered, this amendment would require them—or at least suggest to them very strongly—that they should exert a further downward pressure on coal rates, no matter where they are at the present time. That's the way the Commission reads this amendment, a further downward pressure.

Well, so far as I'm concerned, they're not up where they ought to be now. But even if they were, they would be further down.

Senator LONG. What you are saying here is that they would do their job the way they think they ought to do their job—now, I would hardly think that you would so construe it. I know if it becomes law and you come before that Commission, you're going to be saying that it's too low already, it ought to be higher. And I'm just saying, if they do their job the way you think they ought to do

their job, is there anything in this bill that would injure your industry?

Mr. DEMPSEY. I think so.

Senator LONG. Only one thing: You just might not get away with charging the public a great deal too much.

Mr. DEMPSEY. I don't think so. We have been trying, as you know, Mr. Chairman, to suggest something to you that would be a reasonable compromise. But as some of the shippers have said to me from time to time, the amendment really doesn't do anything. And my response to that is, if it doesn't do anything, why do all these others so badly want it.

So I just kind of assume that it does something. And my assumption is, as Chairman Gaskins says, that it might put a lid, as you describe it, a presumptive lid on at least coal rates and I guess on all other rates that are covered by the amendment. I think that would be very damaging.

Let me say one other thing. It even rolls back the advance that was made in the Quad R Act on suspensions. If you remember, we lost hundreds of millions of dollars over the years in suspension cases over this inequity. The rate was suspended, and when the railroads won, we never got that money back.

On the other hand, if we lose the shippers always get a refund. Well, the Congress and your committee recognized that was an inequity and so it put a heavy burden on the shipper in the Quad R Act to get a suspension.

This amendment even wipes that out. It puts the burden of proof on us in a suspension case. We just stand to lose again hundreds of millions of dollars.

Senator LONG. Mr. Dempsey, it's all right with me—in fact, I'm going to pay my share to bring back the golden days of railroads, the golden days of railroads. But I don't want to bring back the kind of thing that brought up all these great fortunes back in the days where these fellows acquired reputations for being robber barons. We're willing to pay a fair price, and that's all we're getting, by the way, being regulated on things that we think ought to be sold on a competitive basis.

But to say to us that our consumers are going to have to carry the burden of proof, when you people have all the records and have all the information—all we're asking you for is that above some point set by the ICC, you have to carry the burden of justifying a higher rate. It seems to us eminently fair.

Now, please understand, I want your people to make money. I want you to make a good profit. And I can't for the life of me believe that you would find the Edison Institute in here pleading for the investor-owned public utilities supporting this amendment if they didn't think that this is fair, this is reasonable, and this is what ought to be done on a fair basis. Because as a practical matter, as someone told me from your industry, a real topnotch executive in the railroad industry—you admire him, so do I; I'm not going to quote him today. But when I mentioned the utilities being in favor of this, he said—what he said, at least the meaning was, that you were making a fair return.

He said, they've got to be in favor of us making a fair return. And he's right, because as a practical matter, if you fellows fall out

and if it's not on a good basis, why, you're just inviting the other guy to come in and testify against you when it's your turn to ask for an increase.

But I would submit that the American business community, they are certainly very much alert and aware of railroad problems, and when the other regulated industries come in and they say they think this is right and it's fair, it seems to me when this industry has to plead its case alone because it can't find other regulated industries to support your case or the other competitive industries, then I would submit that you ought to take another look at your whole cause. Because all we want is what's fair, and I think that's all we're asking.

Mr. DEMPSEY. Sir, I say in the first place, we'd settle for a copper era instead of gold right now.

Senator LONG. What is copper selling at at this point?

Mr. DEMPSEY. It's an unusual situation when we have shippers supporting our cause. Now, we do have, I think, more enlightenment among the shipping community, and that's essentially because part of the industry, our industry, is falling to pieces in front of their eyes. So they know something has to be done.

And I think by and large the shipping community has been very constructive in its approach to S. 1946. I hope we have been, too. I think the committee came out with a bill that was supported pretty broadly. In this particular instance with respect to these coal transportation costs—incidentally, I read the statement of the president of the Edison Electric Institute, and I found very little in terms of principle that I could disagree with in that statement.

What I understood him to be saying was that he acknowledged that coal as well as other commodities that were heavily dependent upon rail might very well have to carry more of the costs of the plant than the average shipper, but that the question was how much more.

Then one has to look at the overall needs of the carriers, they have to look at the capital investment. They have to see, as you pointed out, whether the railroads are maximizing their profit on other commodities they're carrying.

I think the Commission said the same thing. We all agree with that. I appreciate the problem of the utilities in your part of the country. When you look at the total delivered cost of coal, you say, oh my goodness, this is just awful, can't we do something about that.

They've got to go to their public utility commissions and show that they've done everything possible to keep these escalating costs down. Otherwise, they might not get the cost passed through.

I think they are doing their job in a responsible way. I'm just saying, it's up to the committee and the Congress to look at these coal rates on the data that's in this record before you and see whether they can really be considered to be unreasonably high. And I suggest to you that when you compare them with all the other rates of all other commodities, that they cannot be. Otherwise, we would be making a much greater rate of return than we are.

Senator LONG. Well, you ought to be doing all in your power. I made a speech a while back talking about the fact that the indus-

try is not getting the most efficient use out of manpower. My labor friends complained I sounded like I was criticizing labor.

I think we have the right to point the finger at everybody when we think we have a right to expect better. I would think there's a lot of room for increasing productivity in your industry. We ought to get the benefit of it and the consumer ought to have the benefit of it.

But I also think that the idea of really going all the way in making a huge profit on these captive customers, captive shippers, is something that the public doesn't approve of. And I think we ought to try to see that that doesn't happen.

I don't think you disagree with the principle. I just think you don't agree with me that this is the best way to do it. Because I don't believe you disagree with the principle.

Mr. DEMPSEY. I don't, Senator. You are right. I might say, in defense of my colleagues in the coal industry, the decline in productivity in the coal industry has a lot to do with the escalating costs of coal prices. That decline is due largely, I would suppose, to governmental policies of one sort or another.

I'm not saying they're unwise, but they do diminish productivity.

Senator LONG. Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman. I have no questions at this time, although I share a lot of the sentiments that you have been expressing here.

Senator LONG. Thank you very much, Mr. Dempsey. I would recommend your statement be read by all members.

Mr. DEMPSEY. I would like to insert in the record the statement of O. W. Cobb, vice president—pricing, Burlington Northern, Inc.

Senator LONG. Without objection it will be done.

[The statements follow:]

STATEMENT OF WILLIAM H. DEMPSEY, PRESIDENT OF THE ASSOCIATION OF
AMERICAN RAILROADS

Mr. Chairman, I appreciate this opportunity to present to you the views of the Association of American Railroads on the proposed amendment to section 104 of S. 1946 which was set forth in the Committee's release of January 21, 1980.

The amendment would seriously weaken, if not destroy, one of the principal ratemaking provisions of S. 1946. But it threatens to do much more than that. It is the hope of the amendment's most vigorous proponents that it can become a tool for holding down coal rates—and that result can only occur at the expense of the railroads, other rail shippers, or both. Therefore, to deal adequately with the proposed amendment in this hearing, it is necessary to deal with the coal rate issue.

THE PREMISES OF S. 1946

Before discussing the amendment and its premises I would like to review some of the premises of S. 1946 as reported out of the Committee.¹ In discussing the need for the legislation, the Committee stated:

"Unfortunately, at a time when the need for increased transport capacity is developing at a rapid pace, the railroads are the weakest sector in our transportation system, and the ability of the railroad industry to meet its future responsibilities to society is considered by many to be in doubt."²

"Basically, the railroads cannot function without constant large infusions of capital. The ability to get capital depends on profitability."³

Profitability depends, of course, on more than increased revenues—it also hinges on decreased costs. In S. 1946, the Committee has addressed both elements of the problem. The cost issue is dealt with in provisions such as those encouraging the

¹ S. Report No. 96-470, dated December 7, 1979

² At page 1.

³ At pages 2 and 3.

abandonment of uneconomic plant and the restructuring of the system into more efficient units, as well as those designed to improve the railroads' ability to compete and thereby lower unit costs. But the heart of the bill lies in its ratemaking provisions—sections 102, 103 and 104—which are designed to provide the revenues necessary to profitability. The Committee and its staff labored long and hard to develop in S. 1946 a bill that recognized the legitimate interests of all concerned without compromising the objective of creating a healthy railroad industry. The Committee has assessed that effort in its report:

"The goal is to allow for the restoration of the rail industry to vigorous and profitable growth. The Committee believes this goal need not be achieved to the detriment of rail labor, shippers, intermodal competitive relationships which foster healthy competition, or any other interest group. The rail industry may be allowed more latitude in ratemaking, operations, mergers, and abandonments. The only significant question is what is the proper mix of regulation and latitude in the marketplace necessary to maximize rail efficiency and service.

"The Committee believes that the bill as reported achieves that proper mix without causing disruptions⁴ and inequities."

The ratemaking concept which emerges from sections 102, 103 and 104 is simple, straightforward and, on balance, a step in the right direction. While the railroads would have preferred considerably more latitude in the ratemaking sections, we understand the Committee's concern with minimizing the resulting effects on other interests. We believe, however, that the Committee has gone as far as it should go in that respect. And we would hope the Committee would agree that any further dilution of those sections as proposed by the amendment to section 104 would thwart the objective of the bill.

In brief, sections 102, 103 and 104 create the following regime:

Section 102.—No regulation of the maximum reasonableness of rates that are below the average ratio of revenue-to-variable cost the industry would have to realize from all traffic in order to earn an adequate return on capital. For the most part, traffic in this area (all of that below a revenue-to-variable cost ratio of approximately 150 percent) is competitive and the rates charged are as high as market conditions permit.

Section 103.—No regulation of the maximum reasonableness of rate increases that do not exceed the increase in an index of rail costs. This is intended to permit the adjustment of rates to keep pace with inflation and to assure that the existing revenue to cost relationships are not eroded.

Section 104.—The Commission may not suspend or investigate, under section 10707 of title 49, U.S. Code, a rate increase that does not exceed the inflation factor plus 4 percent (12 percent in any 5-year period). Such increases, however, remain subject to review by the Commission on complaints filed under section 11701 of title 49.

A complaint alleging the unreasonableness of a rate increase can be filed under either section 10707 or section 11701 of title 49. In accordance with the general rule, a party bringing a complaint under section 11701 has the burden of proof. Section 10707 provides an exception to the general rule by placing the burden of proof as to the lawfulness of a changed rate on the carrier rather than on the complainant. By making section 10707 inapplicable to rate increases that do not exceed the inflation rate plus 4 percent and requiring complaints to be brought under section 11701, section 104 requires the shipper to carry the burden of proof as to the unlawfulness of an increase within the 4 percent zone.

Section 104 was developed as a compromise to an approach being urged by the Administration in S. 796. The Administration had proposed—as a means of helping the railroads meet their revenue needs—that a zone of inflation plus 7 percent be created in which the reasonableness of rate increases would be entirely free of challenge. The Senate bill reduced the zone from 7 percent to 4 percent, limited the number of times the zone could be used in any five year period, and retained the right of a shipper to challenge the increase but only in a proceeding in which it has the burden of proof.

Thus, in adopting section 104, the Committee was recognizing the railroads' needs for increased revenues by requiring the shipper to show in any particular case that an increase within the 4 percent zone was unreasonable, the revenue need notwithstanding. For rate increases in excess of 4 percent, the Committee left the law unchanged—the increase can be suspended and investigated under section 10707 and, in that event, the carrier has the burden of proof.

To summarize, the ratemaking regime as proposed to be altered by S. 1946 would be as follows:

⁴ Report at 6.

- (1) Rate increases below (about) 150 percent of variable cost—no regulation as to maximum reasonableness.
- (2) Rate increases within the rail inflation index—no regulation as to maximum reasonableness.
- (3) Rate increases within the 4 percent zone above inflation—no suspension or investigation under section 10707 but reasonableness can be adjudicated under section 11701 with the burden of proof on the complainant.
- (4) Rate increases in excess of the 4 percent zone—no change in the law. Suspension and investigation is available under section 10707 and the burden of proof is on the carrier.

THE AMENDMENT AND ITS PREMISES

The amendment proposed by Senator Long would require the following:

(1) The establishment by the Commission of standards and a revenue-to-variable cost ratio that would constitute a threshold at which the burden of proof as to the reasonableness of increases within the 4 percent zone would be upon the carrier in a proceeding under section 11701 rather than upon the shipper (complainant).

(2) An opportunity for review by the Congress to determine whether the standards (and presumably the ratio) should be adopted. They would become effective in the absence of action by the Congress.

This is the clear effect of the amendment. In some other respects its effects are not so clear. For example, the amendment embraces not just the rate increases within the 4 percent zone but also "other rate increases which exceed those authorized under paragraph (1) of this subsection [i.e., those within the 4 percent zone], or new rates which exceed the adjusted base rates . . ." This language would appear to shift the burden of proof in complaints under section 11701 for all rate increases, not just those within the 4 percent zone where suspension and investigation is not available under section 10707. That would constitute a substantial and wholly unwarranted change in existing law and would be strongly opposed by the railroads.

There is also in the amendment a reference to section 10707(c)(1) and (2), which section provides standards for suspension and places on the complainant the burden of proof as to whether those standards have been met. The language suggests that the burden of proof as to whether the standards for suspension have been met is also being shifted to the carrier. This change would repeal one of the basic reforms in the 4-R Act of 1976. Such a change is wholly unwarranted and strongly opposed by the railroads.

We will first discuss the principal and clearest issue raised by the amendment—the effective repeal of section 104 for rate increases in excess of some revenue-to-variable cost ratio to be established by the Commission. In making section 104 inapplicable to the most profitable traffic handled by the railroads, the amendment necessarily proceeds from the premise that, although the railroads may need increased revenues, that need does not necessarily have to be met at the expense of the more highly rated traffic. I believe we can show the Committee that that premise is ill-founded.

The amendment does not, in terms, address coal rates. Nonetheless, one can only conclude from Senator Long's remarks introducing the amendment that providing a device for holding down coal rates is its principal purpose. Putting the amendment in that context raises other issues which we shall address such as: Are coal rates in fact too high—either in absolute terms or relative to rates on other commodities? Should the railroads continue to be used by the Federal Government as instruments for pursuing non-transportation objectives—indeed, can they afford to be so used? If conversion to coal needs to be encouraged, or if utility rates need to be held down, should not all elements in the profit chain from the mining of coal to the sale of electricity be scrutinized?

CAN RAIL REVENUES BE INCREASED SIGNIFICANTLY WITHOUT A GREATER CONTRIBUTION FROM ALL TRAFFIC?

In 1978, on freight revenues of \$203 billion, the railroad industry had a net railway operating income of \$443 million and a rate of return of net investment of 1.62 percent. The Interstate Commerce Commission has recently found that the railroad industry is entitled to a maximum rate of return on investment of 11 percent. To have earned 11 percent on net investment in 1978, the industry would have needed almost a 7-fold increase in net operating income—about \$3 billion. Even if that figure were trimmed to take into account factors such as excess plant in the east and midwest it is apparent that the railroads need a very large increase in net income to even approach a rate of return of 11 percent.

It is reasonable to suppose that some increase in revenue can be obtained from low-rated traffic, or that some increase in net income can be achieved by eliminat-

ing uneconomic traffic. It is not reasonable, however, to suppose that very large increases in revenues and net income are available through those means. Low-rated traffic is, by definition, subject to the strongest competitive forces—competition from other modes of transportation, other products, or other markets are operating to hold down the rates on that traffic. The inability over time to increase rates on low-rated traffic strongly suggests that market conditions are such that significant rate increases would simply drive the traffic off the railroads—at the expense of the higher rated traffic which is benefitting from whatever contribution to overhead the lower rated traffic is now making.⁵

Yet the shippers of high-rated commodities who support the Long amendment argue, first, that they are already paying enough, and, second, that other traffic can pay more. This becomes a bit of a shell game in which increases in rail revenues is the pea that is always found to be under some other pod. To understand this, it is necessary to understand that for each commodity there is a wide range of rail rates and the traffic moves over a wide spectrum of revenue-to-variable cost ratios. The spectrum is wide because competition varies greatly between different markets for the same commodity. Thus, the typical chemical company will be moving some of its products in competitive markets at low rates while moving other products at higher rates in less competitive markets.

The effect of the Long amendment would be to restrict the applicability of section 104 to a rather thin "slice" of traffic which would also be, in the case of many commodities, a zone of considerable competition. The previously cited Kearney report contained a distribution of commodities by revenue to variable cost ratios based on the 1977 waybill sample.⁶ The following table was prepared from the data in that report. It shows the wide distribution of rates by revenue-to-variable cost ratios on three commodity groups. The distributions shown are typical of those occurring in other groups of traffic having some more highly rated components.

[In percent]

	Below 150	150-160	160-170	170-180	Above 180
Wheat	42	5	4	4	35
Inorganic chemicals	39	7	13	2	39
Motor vehicle parts	41	7	8	6	38

The first point to be drawn from these data is that, although in each example there are high-rated components of traffic, a substantial portion of the total traffic in each also moves at rates below the 150 level. The portion below 150 is obviously moving in very competitive markets and is not susceptible to large rate increases.

The second point to be made is the thinness of the band of traffic between 150 and 180. Of the wheat moving above 150, only 13 percent is below 180; 35 percent is above that level. Of the chemicals moving above 150, only 22 percent is below 180; 39 percent is above. Of the motor vehicle parts moving above 150, only 21 percent is below 180; 38 is above.

So we come back to the shell game. The 39 percent of chemical traffic below 150 cannot be raised much or we lose it. There is only a small proportion of traffic between 150 and 180 to which a 4 percent increase could be applied. For the 39 percent above 180 the proposed amendment shifts to the railroad industry the burden of proving it needs the 4 percent revenue need increase which the Committee, in approving section 104, has already concluded it needs. And it is the hope of some advocates of the amendment to restrict the applicability of section 104 to a ratio below the 180 level—the utilities would argue for a level of 160!

Thus, the Congress would find that the railroads need more revenue and then direct them to extract it from a small and reasonably competitive share of the total traffic. In the example cited, the applicability of the section would be effectively limited to that traffic yielding as little as 13 percent and no more than 22 percent of the total rail revenues yielded by the commodities listed. To create a 4 percent "revenue need" zone applicable to such a small traffic base would be little more

⁵ By stressing the difficulties in obtaining substantial increases in revenue from low-rated traffic, it should not be inferred that the rates on the balance of the traffic are not subject to competitive forces and could be summarily raised but for the regulatory hand of the Commission. A. T. Kearney Associates completed for the Commission last year an in-depth study of competition in rail transport markets, which concluded that 85-95 percent of rail traffic was subject to some degree of competition.

⁶ At Exhibit V-6.

than a gesture. It could not be represented as a serious effort to cope with the problem of inadequate revenue.

One final point before turning to the coal issue. There is always in the shipper's argument the suggestion (if not assertion) that it is somehow unfair to increase the higher rates because they are already "subsidizing" the other traffic. In the case of the utilities, they argue that coal in general is subsidizing other commodities. The short answer to the subsidy argument is that differential pricing of railroad services benefits the rail dependent shipper and the more dependent he is the greater the benefit. Because this fact is frequently misunderstood or misrepresented, there is attached as an addendum to this statement a brief analysis of the concept of differential pricing.

ARE THE UTILITIES ENTITLED TO SPECIAL CONSIDERATION IN THE SHIPMENT OF COAL?

The general level of coal rates.—The utilities assert that coal rates are too high and that recent increases are unwarranted. There are several ways to look at coal rates. The following table compares the average rate on bituminous coal (including lignite) with the average rate on all other commodities for the period 1960–1977:⁷

Year	Bituminous coal and lignite	All commodities ¹	Percent column 1 is of column 2
1960.....	340	773	44.0
1961.....	340	781	43.5
1962.....	332	789	42.1
1963.....	321	780	41.2
1964.....	311	771	40.3
1965.....	313	786	39.8
1966.....	301	794	37.9
1967.....	300	812	36.9
1968.....	301	855	35.2
1969.....	311	878	35.4
1970.....	342	920	37.2
1971.....	370	1,053	35.1
1972.....	367	1,077	34.1
1973.....	378	1,113	34.0
1974.....	471	1,271	37.1
1975.....	525	1,390	37.8
1976.....	582	1,539	37.8
1977.....	648	1,702	38.1

¹ Cents per ton except bituminous coal and lignite.

The first point to note is that in the entire period the average coal rate was never as much as 50 percent of the average rate per ton for all commodities. Since the surge in oil prices beginning with the OPEC boycott in 1973, coal rates have increased 4 percent relative to the average rate for all commodities—and 3 percent of that increase occurred in 1974. Between 1974 and 1977, the increase was only 1 percent. But even with the increase since 1973, the average coal rate in 1977 was only 38 percent of the average rate for all commodities. This data would indicate rather clearly that, on the average, coal rates are not too high and they certainly have not increased drastically relative to other traffic.

Have coal rates increased rapidly relative to the price of coal? Stated another way, can the increase in the delivered price of coal be attributed primarily to increased transportation costs? The following table compares the average minehead prices of coal with the average railroad coal rates for the period 1931–78:⁸

⁷ Source: I.C.C. Freight Commodity Statistics.

⁸ Source: Department of Energy.

COMPARISON OF COAL RATES, 1931-78

Year	Mine price	Rail rate	Total	Percent of destination value	
				Coal	Rail rate
1931.....	\$1.54	\$2.22	\$3.76	41.0	59
1941.....	2.19	2.22	4.41	49.7	50.3
1951.....	4.92	3.16	8.08	60.9	39.1
1961.....	4.58	3.40	7.98	57.4	42.6
1971.....	7.07	3.70	10.77	65.6	34.4
1972.....	7.66	3.67	11.33	67.6	32.4
1973.....	8.53	3.78	12.31	69.3	30.7
1974.....	15.75	4.71	20.46	77	23
1975.....	19.23	5.25	24.48	78.6	21.4
1976.....	19.43	5.86	25.29	76.8	23.2
1977.....	20.50	6.48	26.98	76	24
1978.....	22.40	7.32	29.72	75.4	24.6

This is a very enlightening table:

Between 1931 and 1941, coal rates increased 42 percent. Rail rates did not increase one penny.

Between 1941 and 1951, coal rates increased 125 percent. The rail rate increased 42 percent.

Between 1951 and 1961, the coal rate decreased by 7 percent. The rail rate increased 8 percent.

Between 1961 and 1971, the coal rate increased 54 percent. The rail rate increased 9 percent.

Between 1971 and 1978, the coal rate increased 217 percent. The rail rate increased 98 percent.

Over the entire period, the rail share of destination value (delivered price) decreased from 59 percent to 24 percent. Since the OPEC embargo in 1973 the rail share has decreased 6 percent—although rising slightly in the last 3 years.

How, on this record, can coal rates be condemned? In the period following World War II, the coal market suffered greatly from oil and gas competition. It is quite apparent that coal rates bore the brunt of that competitive battle. During that same period—thanks in large measure to depressed rail rates such as those for coal—the railroads developed an acute case of financial malnutrition that sent much of the physical plant into disrepair and many of the firms into bankruptcy.

Now, the railroads are being called upon to invest billions of dollars in new plant and equipment—at greatly inflated replacement costs—to meet the surge in demand for coal. When they attempt to obtain rates that would justify that investment and keep them in business they are met by a chorus of outrage from the utility companies. These are companies who for years have enjoyed cheap oil, cheap gas, cheap coal, cheap rail transportation, and a healthy profit. There is no more cheap oil, cheap gas, or cheap coal—and only by continuing to drive railroads into bankruptcy can there any longer be cheap rail transportation. Coal has to pay its share—and as we shall see, its share is and has been a very substantial one indeed.

Coal relative to other commodities.—Coal is, admittedly, a major source of rail revenues. A fact not stressed by the utility interests, however, is the dominance of coal as a user—and thus the principal beneficiary—of the rail system. The table which follows shows the tonnage and revenues for bituminous coal as a percent of all rail traffic for the period 1967-1977.^a

[In percent]

Year	Tons	Revenue
1967.....	26.78	11.91
1968.....	25.98	10.98
1969.....	25.56	10.84
1970.....	26.87	12
1971.....	25.53	10.76

^a Source: ICC, Freight Commodity Statistics.

Year	Tons	Revenue
1972.....	25.64	10.48
1973.....	24.3	9.83
1974.....	25.34	11.17
1975.....	29.04	13.4
1976.....	28.85	13.28
1977.....	29.63	13.83

While accounting for 25-30 percent of rail tonnage, coal has been providing only 10-14 percent of the revenues. On the surface, this does not suggest that coal is paying more than its fair share. When coal is examined in more detail relative to other rail traffic, it is hard to find any support for the proposition that coal rates are too high, or that coal is bearing a disproportionate share of the load.

There are 35 basic groups of commodities. The following table ranks the top twelve commodities by tonnage and shows the revenue contributed by each:¹⁰

Commodity	Percent of		Rank ¹
	Total tons	Total revenue	
Coal.....	29.7	13.9	10
Nonmetallic minerals.....	10.0	3.5	12
Farm products.....	8.7	7.7	9
Chemicals and allied products.....	7.5	11.4	3
Food and kindred products.....	7.1	10.5	4
Lumber and wood products.....	7.1	7.3	7
Metallic ores.....	6.0	2.3	11
Stone, clay, and glass products.....	4.3	4.2	8
Primary metal products.....	4.0	4.9	5
Petroleum and coal products.....	3.3	3.6	6
Pulp, paper, and allied products.....	3.2	6.2	2
Transportation equipment.....	2.4	10.3	1
Subtotal.....	93.3	85.8	
All others.....	6.7	14.2	
Total.....	100.0	100.0	

¹ In revenue per ton.

These twelve commodity groups produce 93 percent of total tonnage and 86 percent of total revenue. Coal is the dominant commodity—accounting for almost 30 percent of all tonnage. But if we look at its contribution in terms of revenues relative to tonnage it ranks number 10. Farm products, for example, provide only 29 percent of the tonnage provided by coal but the revenue contribution is 55 percent that of coal's. At the other end of the scale, transportation equipment provides only 8 percent of the tonnage provided by coal but the revenue contribution is 74 percent that of coal's. The three highest contributors in terms of revenue relative to tonnage provide twice as much revenue as coal at only half the coal's tonnage.

Tonnage, of course, is only one measure of use of the rail system. Carloads is another measure of use that does not penalize the bulk commodities which are more "heavy loading" than most processed commodities—although the heavily loaded car requires more power, heavier rail, and takes a heavier toll on the roadbed. The following table provides a ranking of the same twelve commodities by carloadings:¹¹

Commodity	Percent of—		Rank ¹
	Total carloads	Total revenues	
Coal.....	18.5	13.9	10
Nonmetallic minerals.....	6.0	3.5	11
Farm products.....	5.5	7.7	3
Chemicals and allied products.....	7.5	11.4	1

¹⁰ Source: ICC, Freight Commodity Statistics, 1977.

¹¹ Source: ICC, Freight Commodity Statistics, 1977.

Commodity	Percent of—		Rank ¹
	Total carloads	Total revenues	
Food and kindred products.....	9.4	10.5	5
Lumber and wood products.....	8.0	7.3	9
Metallic ores.....	4.2	2.3	12
Stone, clay, and glass products.....	4.4	4.2	7
Primary metal products.....	3.8	4.9	4
Petroleum and coal products.....	3.5	3.6	6
Pulp, paper, and allied products.....	6.8	6.3	8
Transportation equipment.....	7.2	10.3	2
Subtotal.....	84.8	88.0	
All others.....	15.2	12.0	
Total.....	100.0	100.0	

¹ In revenue per ton.

In terms of revenues relative to carloads, coal still comes in number 10. By comparison, farm products again are shown to yield 55 percent as much revenue as coal utilizing only 29 percent as many carloads. The three highest contributors in terms of revenues relative to carloads yield more than twice as much revenue as coal while utilizing only 9 percent more carloads.

A third way to measure system use is by ton-miles—the distance a ton of traffic is moved. Does coal fare better on this basis? The following table compares the revenue per ton-mile for six bulk commodities with the average revenue per ton-mile for all commodities:¹²

Commodity	Revenue per ton-mile in cents	Percentage of average revenue per ton-mile
Bituminous coal.....	1.96	57
Crude petroleum.....	2.87	83
Grain.....	2.87	83
Pulp.....	2.87	83
Gravel, sand.....	2.96	86
Iron ore.....	3.20	93
Total traffic.....	3.46	100

It is to be noted that none of these bulk commodities yield as much as the average from all traffic but coal is far and away the lowest of the lot. Among this group of bulks, the revenue per ton-mile from coal is only about two-thirds the yield realized from grain, crude petroleum or pulp, and only some 60 percent of the yield from iron ore.

The "high" western coal rates which we will discuss in a moment are clearly the product of the distance travelled, not the ton-mile rate charged. Most of those are around one cent per ton-mile—well below the national average for coal of 1.96 cents. It is inevitable that when coal is moved some 1,500 miles—even at a low ton-mile rate—the transportation charge will become a significant part of the total cost of the coal.

To sum up, based on any measure of system use, the average revenue from coal movements does not appear to be too high relative to other commodities. If anything, it is too low. So what is the fuss from the utilities all about? Let us look at the recent western coal rate cases.

THE WESTERN COAL RATES

In the Western states there has been a tremendous expansion in coal production and consumption in the period since oil and natural gas prices began to soar and supply, especially of the latter, became uncertain for utility use. For the Western railroads this surge in coal traffic has posed great problems. On the one hand, it has meant new and large investment requirements—for new lines, for upgraded track and roadbed, and for locomotives and other rolling stock. On the other hand, the carriers of the region—in common with the railroads generally—continue to realize

¹² Based on the 1977 Waybill Sample with rates updated through 1979.

an exceptionally low rate of return. In the 12 months ended last September 30 the rate of return on average net investment for the Western roads was on 2.8 percent, far below the rate of return of the electric utilities, the coal producers, and American industry generally.

Despite the immense problems with which they have had to contend the Western railroads have responded effectively to the coal challenge. In 1973 they originated 61 million tons of bituminous coal but by 1978 they originated almost 122 million tons of coal—up 200 percent. Longer hauls were involved, with the result that from certain western origins coal ton-miles increased even more, up by 211 percent as of 1977. Quite literally it has been the response of the railroads which has made it possible for the country to substitute increasing amounts of coal for imported oil and for scarce domestic oil and natural gas, thereby improving our energy posture. Making this feasible has been the railroads' inauguration of efficient unit train operations for carrying the coal—often well over a thousand miles—from the mines to the users. And in doing so the Western railroads are charging rates for their large-volume movements that average out to just about a penny a ton-mile—a level far below the average freight rate for rail service. Depending on the distance of the movement and the energy content of the coal per pound, the railroads in the West deliver coal for a mill or less per thousand Btu's.

We think the unit train rates for coal transportation in the West are clearly reasonable, but this is not just the opinion of the railroads. The new unit train rates posted by the railroads in the West in the last four years (since the 4-R Act took effect) have been exhaustively reviewed by the ICC in extensive adversary proceedings. In these proceedings literally thousands of pages of testimony have been filed—by the railroads and by the utilities and their teams of experts. Hearings have been held in a number of the cases and every key issue—costs, operations, investment plans, etc.—have been fully exposed to scrutiny. The Commission and its staff specialists have reviewed the submissions with meticulous care and arrived at their own independent evaluations. With but rare exception the carrier rates have been found reasonable by the Commission and, where challenged on appeal, by reviewing courts as well.

In evaluating our unit train rate proposals the Commission has given close attention to a number of key factors. First, it has taken into account the specific variable cost of the individual movement. This has called for a detailed, almost microscopic investigation of each expense element as it relates to the unit train service at issue—the operating cycle, crew time, fuel expense, and the costs of maintaining the roadbed and the relevant rolling stock for unit train movements. These variable costs clearly should be paid by the users.

Second, in almost every situation involving a new unit train operation the carriers involved have had to make substantial new investment. For the unit train service between Axial, Colorado and Corpus Christi (Coletto Creek), as an example, the railroads plan to spend almost \$55 million for new locomotives and major roadbed improvements of a type required to handle the 11,000 gross ton trains that will be operated along the 1,400 mile route. These identifiable investment costs properly are the responsibility of those who use the service which gives rise to them.

Third, if railroads are to function as private enterprises and to serve all their customers—be they shippers of coal, or grain, or chemicals, or forest products, or whatever—their substantial fixed (non-variable) overhead costs must also be apportioned among those who use and benefit from the services they provide.

Fourth, fidelity to the goals of the 4-R Act (and of S. 1946) requires that the railroads be allowed to seek where possible a level of rate revenue adequate to the realization of a fair return on their investment in line with the current cost of capital. Given the anemic rate of return now being realized by the railroads it is reasonable to establish rates that offer some promise of bringing existing earnings up to a more desirable level.

In reviewing proposed Western unit train coal rates in recent proceedings the Commission has taken each of the four above factors carefully into account. It has, first of all, independently determined the variable costs involved. Second, it has scrutinized the new carrier investment that is required, for locomotives, other rolling stock, and for plant. Third, it has computed fully allocated costs, thus taking into account all of the actual costs incurred by a railroad in conducting its business and allocating them among the shippers. Finally, it has made allowance for a profit—calculated in such a way as to yield a modest 10.6 percent return. This rate of return, I should emphasize, is too low, in our view, since the current cost of capital is now well over 11 percent (with a new railroad debt issue marketed this month at an effective interest rate of over 12 percent).

This process has not yielded all the railroads have sought. But it is a fair process, and one in which both the railroads and the utilities have been fully heard. By no

measure do the resulting rates suggest that coal is being overcharged or in any way subsidizing other traffic.

THE ENERGY CONVERSION ARGUMENT

It has been fashionable for almost 100 years to confer economic favors upon various groups or regions in this country by holding down railroad rates. The sorry state of the railroad industry is due in no small part to these and similar Federal policies. Granting that the conversion to coal as a fuel for generating electricity should be encouraged, it does not necessarily follow that the consumers of electricity should not pay for the full cost of conversion. But even if one concludes that they should not, several more steps must be taken in the reasoning process before reaching the conclusion that rail coal rates should be held down.

First, who are the consumers of electricity who would be the beneficiaries of such a policy? Nationwide, some 60 percent of electricity sales are to commercial and industrial users who are writing off much of the cost as a tax deductible expense of doing business. In Texas and Louisiana 66 percent of the electricity is consumed by commercial and industrial users.

Second, how expensive is coal relative to other fuels? The cost of coal to the electric utility industry increased from 41.4 cents per million BTU's (¢/MBTU) in 1973 to 111.6¢/MBTU in 1978, an increase of 170 percent. During that same period, the utilities' cost of oil went from 75.9¢/MBTU to 215.5¢/MBTU, an increase of 184 percent. The utilities' cost of gas went from 34.1¢/MBTU to 143.8¢/MBTU, an increase of 322 percent—almost double the increase in the price of coal. With decontrol of oil and gas prices, the rates to consumers are likely to decrease as a result of conversion to coal rather than increase.

Third, what are the effects of coal rate increases on the electricity consumer? In four of the recent western coal rate cases, the amount in dispute amounted to less than 1 percent of the average monthly residential charge (about 25 cents per month). An analysis using national data would show that a 10 percent increase in coal rates would increase the consumer price of electricity less than 1 percent—also about 25¢ per month. How much more per month are those customers paying in heating oil for their homes or in gasoline for their cars? If the concern is the cost of energy to the consumer, the rail rates on coal are the least of his worries. And what about the railroads as consumers of energy? The railroads' fuel costs have increased 600 percent since 1973 and more than doubled in the last twelve months. We have no one to pass those costs on to other than our customers.

Fourth, we are bombarded by advertisements from the energy industry to the effect that "profits" is not a dirty word but, rather the driving force to greater investment. Again, I would note that the railroad industry is in complete accord with the belief that adequate profits are essential to obtain the investment capital necessary to replace, modernize, and improve the productivity of plant. That is the message we have been trying to leave with the Congress for years. It gained some acknowledgement in the 4-R Act of 1976 and was being reinforced in section 104. Frankly, we do not understand why healthy profits are essential to investment in energy production but not in energy transportation.

Fifth, if coal conversion is to be subsidized by someone other than the Federal Government, why should it be the railroads and their shareholders? Why not the coal producers and their shareholders, or the utilities and their shareholders? We think all shareholders are entitled to a fair return on their capital, but if capital is going to be squeezed the utility shareholder is a much more deserving target than the rail shareholder. For decades, the latter's equity has been the victim of Federal regulatory and investment policies. In this regard, it is instructive to compare some of the returns to shareholders' equity in recent years as compiled by Citibank:

Year	Railroads	Electric and gas utilities	Petroleum products and refining	Chemical products
1973.....	3.5	10.8	15.6	15.0
1974.....	4.3	10.4	19.9	19.0
1975.....	.8	11.6	14.1	14.6
1976.....	1.8	11.8	15.1	15.7
1977.....	1.9	11.7	14.2	14.5
1978.....	1.3	11.3	14.3	15.0

Of the 70-odd industrial groups reported by Citibank, the railroads had the lowest or next to the lowest returns in each of the years shown.

Among those you will hear from today are the electric utilities and the chemical companies. As the Citibank data indicates, investors in electric and gas utilities and chemical product earned, respectively 11.3 and 15.0 percent return on equity in 1978. The railroads earned 1.3 percent. All of these figures are of course averages. Some railroads earn more than 1.3 percent on equity—that's just what they average. By the same token, some chemical product companies and some utilities earn returns well in excess of 15 percent and 11.3 percent—that's just what their industries average. And we do not begrudge the energy companies their average of 14-15 percent return on equity—we would settle for the 11 percent earned by the electric utilities.

The most telling point in this table is the consistency of the data. The utilities earn a rather steady 11-plus percent. Chemicals and petroleum are consistently 14-15 percent or better. The past year was a relatively good one for the railroads and I would expect to see improvement over 1978 in the Citibank report for 1979. But the railroad industry needs more than an occasional, relatively good year—it needs to develop a consistently good earnings record.

And this leads us back to the point of S. 1946 and the proposed amendment to section 104. It is the railroads who are facing a large capital shortfall, not the utilities, not the chemical companies, not the refineries and, indeed, not any of the rail shippers who are now urging the proposed amendment upon this Committee. All traffic must contribute more to meeting the railroads' capital needs—and coal must bear its full share. The utilities, who are the strongest advocates of the amendment, have been provided regulatory and judicial forums in which to contest the reasonableness of coal rates and unhappy with the results, have sought the congressional forum. We do not believe it is sound public policy to try such technically complex matters as coal rate cases in the Congress. But that is the effect of the proposed amendment. The utilities are asking the Congress to find that—although the railroads need for greater revenue is demonstrable—a presumption should be created that above a modest level that revenue need can and should be satisfied without imposing an increase on coal rates. This is urged as necessary to the achievement of our national energy goals. That argument simply does not withstand critical scrutiny.

SUMMARY

If section 104 is to be effective in generating the additional revenues needed to support the capital investment requirements of the railroad industry, it must be applicable to all traffic. The proposed amendment is an attempt to have the Congress once again put shipper concerns ahead of rail needs. Section 104 does not give ratemaking freedom to the railroads, even for the modest increases which fall within the ambit of that section. All such increases remain subject to Commission review. It means only that the Congress has found a revenue need to exist within the 4 percent limit unless a shipper shows that, in a particular case, the increase is unreasonable. That is but a modest step toward the solution of the railroad industry's most pervasive and persistent problem.

[ADDENDUM]

THE PRACTICE OF DIFFERENTIAL PRICING

The railroads engage in differential pricing. The practice is otherwise labeled "value of service" pricing. The latter term is frequently used pejoratively to suggest that such traffic is being "gouged." In the transport markets of today it is more correct to say that traffic is charged at rates permitted by competition and that results in differential pricing.

There are three basic arguments for the use of differential pricing:

- (1) It is a common business practice;
- (2) It is economically desirable because it maximizes the use of rail assets; and
- (3) It holds down the rates that would otherwise have to be charged the more rail dependent traffic.

Whenever a firm varies its markup of the cost of a good or service it is engaging in differential pricing. Luxury cars usually have a higher markup than economy cars. The price differential between first class and coach airline tickets usually exceeds the differential in the cost of providing the service. Television advertising rates are higher at 8:00 p.m. than at 8:00 a.m. In each of these instances price is related to value, not just to cost.

If, as the opponents of differential pricing seem to be urging, the railroad industry were to engage in average pricing—using the same markup above costs for all traffic—the immediate consequence would not be more equity among rail shippers. It would be a reduction in the number of rail shippers. Much of the traffic that

moves by rail also moves by other modes. Many of the bulk commodities moving by rail are in direct competition with water carriers and the rates reflect that competition. The majority of all manufactured goods move by truck and virtually every manufactured good moving by rail is susceptible to diversion to truck. If the pricing of such traffic did not reflect the reality of competition it would cease to move by rail and the rates on high-rated traffic would have to be increased to compensate for its loss. This can be demonstrated by some simple examples:

If a railroad could engage in average pricing, its rate structure would look like this:

	Commodity			Total
	A	B	C	
Rail rate.....	\$1.60	\$1.60	\$1.60	\$4.80
Less: variable (direct) cost.....	(1.00)	(1.00)	(1.00)	(3.00)
Contribution.....	.60	.60	.60	1.80
Less: fixed (overhead) cost.....				(.80)
Income.....				1.00

But if the shipper of commodity A could move his traffic by truck at \$1.40 and the railroad refused to cut its price, the structure would look like this:

	Commodity		Total
	B	C	
Rail rate.....	\$1.60	\$1.60	\$3.20
Less: variable (direct) cost.....	(1.00)	(1.00)	(1.00)
Contribution.....	.60	.60	1.20
Less: fixed (overhead) cost.....			.80
Income.....			.40

The loss of commodity A would reduce the railroads' income from \$1 to \$.40. If the shippers of commodities B and C were totally dependent on rail, and market or product competition did not restrict the rail rate, the railroad could recoup the loss of revenue from commodity A only by restructuring its prices as follows:

	Commodity		Total
	B	C	
Rail rate.....	\$1.90	\$1.90	\$3.80
Less: variable (direct) cost.....	(1.00)	(1.00)	(2.00)
Contribution.....	.90	.90	.90
Less: fixed (overhead) cost.....			(.80)
Income.....			1.00

Thus, the consequence of commodity A's diversion to truck is a \$.30 increase in the rates for B and C.

Because commodity A is not rail dependent, it is apparent that any rate in excess of the variable cost of \$1.00 that would induce commodity A to move by rail benefits commodities B and C. Thus:

	Commodity			Total
	A	B	C	
Rail rate.....	\$1.20	\$1.80	\$1.80	\$4.80
Less: variable (direct) cost.....	(1.00)	(1.00)	(1.00)	(3.00)
Contribution.....	.20	.80	.80	1.80
Less: fixed (overhead) cost.....				.80
Income.....				1.00

In the above example, although commodity A moves at a rate \$.40 below the rates charged B and C, B and C are better off with A's \$.20 contribution than without it—\$.10 each to be exact. Our economy at large is also better off because excess rail capacity is being used to move a good that would otherwise move by truck at a rate greater than \$1.20 and with a waste of resources.

As the above examples show, high-rated traffic does not subsidize low-rated traffic. Is there any reason to believe that, the theoretical examples notwithstanding, the more rail dependent shippers are still paying more than their "fair share?" A shipper who is entirely dependent on rail transportation can argue that his rate is unreasonable in only three circumstances. The first would be upon a showing that an increase in rates on competitive traffic would not cause diversion and thus increase that traffic's contribution to fixed costs—and that with such an increase in contribution the carrier would earn an overall adequate rate of return. The second would be upon a showing that the carrier is earning an excessive rate of return on its investment, in which case the excess profit should be eliminated by reducing the rate charged the rail dependent shipper. The third would be upon a showing that the railroad was mismanaging its assets and thereby incurring unnecessary costs which it should not be entitled to recoup from the rail dependent shipper.

Addressing these items in reverse order, there is no allegation of which I am aware of any significant mismanagement of rail assets. Moreover, as long as virtually every railroad management decision is either regulated directly or directly influenced by regulation, responsibility for any inefficiencies that may exist in the system should not be placed on the shoulders of rail management. If management is to be held responsible, it must first be given authority commensurate with that responsibility.

The second circumstance can be dismissed with the observation that any talk of excessive rates of return for the railroad industry is, at the very least, premature.

The first circumstance—unreasonably low rates on competitive traffic—involves issues of judgment in the marketing of rail services. One thing is certain, until a railroad reaches the point of excessive earnings, it has a compelling profit motive to maximize its revenue from each movement so there is a strong presumption that it is attempting to do so. In any event, unless it could be shown that competitive rail services were so grossly underpriced that, but for that underpricing, a railroad would be earning an adequate rate of return, the rail dependent shippers' rates cannot be shown to be too high. They cannot be shown to be too high because unless competitive rates could be raised to a level that generated excess profits, there would be no reason to lower the rail dependent rates. So far as I am aware no one has even alleged an underpricing shortfall of that magnitude and there is certainly no evidence to support such an allegation.

STATEMENT OF O. W. COBB, VICE PRESIDENT—PRICING, BURLINGTON NORTHERN, INC.

My name is O. W. Cobb. I am Vice President-Pricing, Burlington Northern Inc., St. Paul, Minnesota. My duties presently involve the pricing and market development activities on coal and taconite. Prior to appointment to my present position January 1, 1980, I was the Chief Pricing Officer on general commodities for Burlington Northern.

This statement is submitted on behalf of Burlington Northern Inc. in opposition to Section 104 of S. 1946, which is an amendment to shift to the carrier the burden of proof for the justification of maximum rate levels which are as yet unspecified. Such "benchmarks" have in the past become standards, and we have no reason to believe this amendment, if adopted, will not do so. Those in support of the amendment do not address themselves to the procedural change but support the amendment in order to hold down rates on coal or other commodities or to provide a "Cap". Therefore, this statement addresses the problem as a maximum rate level or "Cap".

In 1979, Burlington Northern originated 70.6 million tons of coal in the states of Wyoming and Montana, virtually all of which moved in unit train type operations to destinations or transload facilities located east of the Rocky Mountains and on and west of the Great Lakes and Mississippi River. To reach this high level of transportation capacity my company has done a prodigious job of converting a light density granger rail system to a modern heavy duty coal system. It now handles tremendous tonnages over the longest routes of their kind in the world. This it has done at a great financial risk in a regulated economic environment in an unparalleled effort to respond to the national energy crisis.

For over two years, Burlington Northern because of burgeoning inflation has been forced to revise its rates to achieve a revenue position that will allow us to continue to handle western coal in large volumes. We must also establish a financial base which will allow the acquisition of necessary capital from internal or external sources, enabling us to increase our investment in track structures, power, and cars so that we may handle future increases in the volume of coal. It is this rate increase activity which has created concern on the part of the members of this committee and other members of Congress, as well as certain utilities who have resisted these efforts.

It is imperative that we increase and maintain our coal rates at a level that will permit us to provide adequate and satisfactory service and make the concomitant capital investments necessary to insure service is maintained to meet the demands of coal traffic that moves and will move by rail from the Powder River Basin.

Within ten years, coal has achieved a position of dominance in Burlington Northern's traffic mix, as is revealed by the following table:

BN REVENUE TON-MILES AND FREIGHT REVENUES—1978

	Revenue ton- miles in thousands	Percent of total	Revenue	Percent of total	Mills per ton- mile
IA. Agricultural exempt commodities:					
Grain	10,758,937	9.96	\$259,907,472	13.28	24.2
Apples and potatoes	497,550	.46	14,673,939	.75	29.5
Total—IA	11,256,487	10.42	274,581,411	14.03	24.4
IB. Products of agriculture other than exempt—IB	5,409,699	5	125,264,540	6.40	23.2
II. Products of mines:					
Coal	48,421,039	44.78	463,641,877	23.69	9.6
Other than coal	7,661,992	7.09	134,734,086	6.88	17.6
Total—II	56,083,031	51.87	598,375,963	30.57	10.7
III. Products of forests	15,068,805	13.94	338,617,297	17.30	22.5
IV. Miscellaneous	20,297,626	18.77	620,352,395	31.70	30.6

Statistical data is not available for the year 1979 in a manner that will permit the same display. However, coal is the most rapidly growing commodity in Burlington Northern's traffic mix. Significantly, while coal creates about 45 percent of Burlington Northern's revenue/ton miles, it contributes only about 24 percent of BN's revenue. This is the greatest disparity between ton/miles of work performed on Burlington Northern as related to its share of gross freight revenue in the four major commodity groupings, and is the only group in which revenues is not a higher percent of BN's total revenue than the revenue/ton miles is of total BN revenue/ton miles. In other words (as shown by the mills per ton mile column), coal produces less than a penny for a ton moved one mile (9.6 mills per ton mile), while every other category produces nearly twice as much or more—17.6 mills per ton/mile on non-coal Mine Products, and nearly 1.7 cents and 2.3 cents per ton/mile for other categories. There are no rates being proposed by Burlington Northern on coal either presently or in the past—that will approach the mills per ton/mile produced by all other categories of traffic.

This demonstrates shippers and receivers of coal on BN obtain overall, ton/miles of service at a substantially lower charge than shippers and receivers of other commodities. As an example, grain produces some 13 percent of BN's revenues, while requiring only about 10 percent of the revenue ton/mills (or work) produced by Burlington Northern's rail system. Any contention that coal is subsidizing other

commodities simply does not comport with the facts. In fact, the ICC's recent report in the L&N coal Case 362 ICC 370 at Page 428 shows that coal is now only contributing the average of BN's revenue/cost requirements. Since that average is substandard, coal as well as other traffic must have increased revenue responsibility.

Burlington Northern does not serve the western "sunbelt" territory. The growth of industry and population in BN territory has been substantially less in the last 20 to 30 years than has been true in sunbelt territory. The opportunities for us to obtain revenues to defray the costs of operating a rail system are essentially limited to coal, and other product of mines, agricultural commodities and forest products. There is no economic regulation of the movement of agricultural commodities by highway or water. Forest products are produced in abundance in the Pacific Northwest and must meet competition of other forest products and substitute building materials in the populace centers located 2,000 miles or more from the points of production.

Coal has become, in a very short time, the number one commodity being transported on Burlington Northern. The initial movements of coal began as an effort to utilize unused rail capacity in moving western coal in competition with nuclear, oil, and eastern coal to the lake states of Illinois and Minnesota. With the advent of OPEC; the various environmental standards making western low sulfur coal more desirable than the environmentally less attractive high sulfur, eastern coal and oil; and the concern about nuclear safety, resulted in an overwhelming demand for Powder River Basin low sulfur coal in a period of less than ten years. This coal can be mined at less cost than most other coal because of the thick seams and less overburden.

The massive increased coal tonnage requires us to invest \$2.2 billion in new capacity—including new fixed plant and in rolling stock. We are making these investments at a time of skyrocketing increases in costs. Past and proposed future investment have been made in spite of 16.8 percent and 30 percent severance and ad valorem taxes imposed in the states of Wyoming and Montana, and a 35 cent/ton reclamation tax and other costs associated with returning the surface of mined areas into an environmentally acceptable condition.

The change in emission standards for utilities has created a rather bizarre condition requiring utility plants under construction after September 18, 1978, to install fuel gas desulphurization systems regardless of the sulphur content of the coal. This will result in the scrubbing of Powder River Basin coal which, before scrubbing, will generate less sulphur dioxide than some coal located in the Midwest and in the East after these latter coals have been scrubbed. Scrubbing can add 30 to 40 percent to the capital and operating cost of a plant. Therefore, an advantage of western Powder River Basin coal will be lessened by the standards presently in force. Although these hazards add to the other, more familiar risks facing an enterprise, the BN is and wants to continue to make investments to make us better able to move huge volumes of Powder River Basin coal. As stated, an improvement in revenues is a necessary step to permit this to be done.

Coal is now the overwhelmingly dominant commodity on the Burlington Northern. It will continue to grow, although the present demand is softening. Whether we survive in the private sector or become a part of the public supported sector will depend on how well our rates produce revenues sufficient to cover all costs including capital costs for handling coal. Powder River Basin coal will produce over 90 percent of our coal revenues. Pricing flexibility on coal is, therefore, essential, particularly in the present inflationary trend, to insure financial viability and meet coal transportation needs.

Ironically, it is Burlington Northern, not most mining interests and most utilities, which has no alternative of consequence to Powder River Basin coal to supply us with coal revenues. Present Powder River Basin production is largely controlled by coal companies having ownership in most of the major coal fields in the United States, or the petroleum companies who have interests in Powder River Basin coal and in many cases, other major coal producing points in the United States. The utilities have alternatives, as they have made abundantly clear to us from time to time in our negotiation of freight rates. From public data we have developed the competitive coal analysis as shown on Table 1 attached. With minor exceptions, Powder River Basin coal can be transported to destinations shown at a laid-down cost per million BTU that is lower than competitive western coal and the overall average of costs of all fuels in the destination states. Where the Powder River Basin coal is more expensive, as shown by the Table, the movement from Powder River Basin is being made because of low sulfur content of the Powder River Basin coal, vis-a-vis alternatives, or other causes which permits product differentiation in favor of Powder River Basin coal, regardless of the slight unfavorable delivered cost

differential. Tables 2 and 3 lend perspective to the costs borne by utilities using Powder River Basin coal compared to utilities in general.

There is now a "Cap" on Powder River Basin coal. The maximum that can be obtained from Powder River Basin coal is the cost of an acceptable substitute. There are acceptable energy substitutes for Powder River Basin coal. Powder River Basin coal will be competitive only so long as the price is competitive in the marketplace.

Nothing in S. 1946 or the 4-R Act proposes complete economic freedom for the railroads to "Act at will". In BN's coal case, we have been determined to be "market dominant." The power to prevent any abuse, therefore, will remain with the ICC on complaint of any party in interest. S. 1946 does not propose unbridled rate freedom. It is clear S. 1946 proposes at most that the ICC grip of strangulation be loosened to permit greater opportunity for the marketplace to set rates. The ICC relinquishes little of its authority and Congress loses none.

Inherent in the provisions of Section 104 is a concern that coal will subsidize other traffic. As shown in the Table on pages 2 and 3 herein coal traffic pays the lowest price per ton mile of any principal commodity group on the BN. It would take an 80 percent plus increase in coal rates to achieve a ton mile cost equal to the next lowest priced commodity group—Products of Mines, other than coal. This showing, alone will not support the conclusion that other commodities subsidize coal; it supports the conclusion that coal is transported at very low rates compared to other commodity groups. This can be justified only because it is transported in a relatively efficient manner, moves in great volume and the marketplace, more than public policy, requires low transportation charges. We know the present rate structure on Powder River Basin coal is too low to support the capital we have invested and will have to invest in the future. Rates prescribed by the ICC at present do not reflect future investment requirements. Overall, earnings on the BN rail system clearly are too low by any standard. We have made major efforts to increase revenue contribution from traffic other than coal for over 10 years. Yet, oddly enough, none of that work has generated anything like the publicity produced by coal rate changes.

BN's unfavorable revenue and financial position is supported by the findings of the ICC in Ex Parte 353, a proceeding mandated by the Congress in the "4-R Act" of 1976. In its decision of December 6, 1979, 363 ICC, 301-303, the ICC made these comments:

"Conclusion.—BN demonstrates weakness in its operating ratio, its rates of return, and its liquidity ratios (throw-off to debt and fixed charge coverage). With its low rates of return, BN appears to be able to maintain only a marginally satisfactory financial condition, even with a below average capital spending program. Judging strictly from this historical record, a conclusion of revenue inadequacy is warranted at the present time."

Attached as Table IV is the complete findings as to the BN in this proceeding.

Indeed, BN's return on net investment was 1.98 percent compared to the top 8 railroads selected by the ICC who's composite return was 6.66 percent and for all Class I Railroads of 1.83 percent. BN's rate of return on railroad investment is woefully inadequate. In 1979 our rate of return was 3.8 percent, the highest rate of return we have had since our merger in 1970. However, if we are to be a financially viable railroad, we must do better. In the decision issued January 31, 1980, in Ex Parte 353, "Adequacy of Railroad Revenue" 362 ICC 205, the ICC stated, "... an adequate revenue level for the national composite is one that provides a return on net investment of between 7 and 10.6 percent." Railroad returns are far below those of the electric utilities. Burlington Northern's return on equity as of September, 1979, was only 7.4 percent which was increased to 8.7 percent as of December 31, 1979. The January 2, 1980, 100-utility survey by Salomon Brothers shows an average of 11.8 percent return on equity. The Western Railroads' average was 6.42 percent.

In light of the low rates on coal and an inadequate rate of return, why should the BN be opposed to a "Cap" on rates, which "Cap" is not intended to thwart the objective of Congress that the railroads be given an opportunity to improve their financial position by greater rate freedom. While there is a fundamental inconsistency between more freedom and the imposition of a "Cap" where there is no "Cap" today, the wording of Section 104 is almost exactly the same as has appeared in position papers and ICC decisions that support the view there is presently "Cross subsidization" and rates should be based on costs so that such subsidy is eliminated and a better utilization of assets will occur. From this springs the cosmetic, appealing conclusion that the nation's transportation bill will be reduced and the railroads financial health will be improved—terribly appealing and terribly wrong.

Coal rates are very low and BN's rates could probably be increased to a greater degree than the marketplace will allow by a reasonable revenue-cost standard established by the ICC as directed by the provisions of Section 104 of the bill. The

theory of Section 104 will force all freight rates into a narrow band, however. A cost oriented "Cap" on rail rates will require that the primary source for revenues, to replace the last revenues from the movements on which the rates exceed the "Cap", will be transferred to those commodities moving at rates substantially less than the "Cap". While regulatory policy has done a great deal to thwart an adequate revenue base for the railroads, the reason coal moves in volume on the BN at rates which produce revenues about 40 percent of the revenues on grain is because the grain market and transportation competitive environment in which grain moves is very different than that in which coal exists. The demand on the rail transportation system is different because we have to serve the special requirements of each industry. A transportation system such as railroads does not directly participate in the purchase and sale of any commodity. We serve to bridge the gap between the point of production or location and the point of consumption or use. We are a derived demand industry. For the cost plus theory propounded by Section 104 to work, we have to be able to exercise some significant control in the purchase and sale of commodities that require a transportation service to fulfill the contract of sale. Obviously, we have no such control.

We must also be able to control the transportation market. Seldom do we have any significant control. Highways, waterways, and pipelines have made railroads "one of the crowd" offering a transportation service. We can't cover revenue losses a "Cap" will produce on grain, for example, by increases in rates on low valued short haul commodities. Short hauls are characteristic of those commodities on the lower end of the rate scale. They will divert to alternate transportation service or cease to move. They do not now move in volume sufficient to replace any significant reduction in revenue on a primary commodity such as grain.

A railroad is a relatively high fixed cost industry. The goal of its managers must be to obtain, over time, enough revenue to cover the direct cost of operation and an aggregate contribution over the direct costs to cover the fixed costs, including capital costs. The greater the contribution the greater the financial health or strength of the railroad. It does not matter, from the standpoint of fixed cost coverage whether the contribution is made by a few commodities or a few movements or by a great number of commodities moving in great volume. However, the level of the rate must be higher if there are few commodities moving infrequently than if there is a large volume of traffic. The rate times the volume produces the revenue as long as this is the source of our income. The degree to which the internally generated revenues cover all costs determines the accessibility of the railroad to external capital, debt or equity. The railroads, including BN, are having great difficulty competing for external capital at present. Further limitations on railroad earning power could be disastrous.

When there are market constraints, and there are, and when there are transportation competitive constraints, and there are, an arbitrary "band" of rates imposed by a regulatory "Cap" creates an economic equivalent of Russian Roulette. If the "Band" happens to be adequate so there is a best fit between the arbitrary rate zone on the one hand and the combination of the competitive forces in the commodity market and the transportation market on the other hand, the railroads will be able to survive. For reasons I have stated, railroads do not have control of the commodity markets or the transportation market. A cost oriented "Cap" will worsen or destroy, not improve, the railroads opportunity to survive in the private sector.

As long as a commodity, industry or firm pays a rate that covers its direct costs and makes some contribution to the railroads fixed costs, it is not subsidized. The best way to cover all costs is to price the service for each commodity so as to produce the greatest gross revenue over direct costs. This is differential pricing. Section 104 threatens the efficient use of this complex but economically sound pricing theory in the railroad industry. It is because railroads have a high proportion of costs that do not vary directly with changes in the volume of traffic that value of service pricing maximizes contribution to fixed costs. It is our belief the financial well-being of the railroad industry will be improved by a reduction in the regulatory interference with the economic laws governing the carriers and its customers in the market, not an increase in such interference. The history of the industry bears out the adverse effects of excessive and continued regulation.

It is recognized the railroads rate of return is inadequate. If improvement in the rate of return continues to be thwarted or for whatever reason is not improved, there will be a point reached that continued capital investments will not be possible; maintenance will become inadequate; service will be reduced or eliminated; every attempt will be made to convert assets to cash or more productive assets. This is not a rhetorical exercise. It is the recent history of the Milwaukee and the Rock Island.

TABLE I.—COMPARISON OF DELIVERED COAL COSTS FOR REPRESENTATIVE POWERPLANTS RECEIVING POWDER RIVER BASIN COAL VERSUS OTHER PLANTS USING ALTERNATIVE COALS (1978)

State and utility	Plant	Origin of coal	Average sulphur (per-cent)	Percent for million btu's			
				Plant average	Whole State		Low-sulphur average
					Overall average		
Colorado:							
Public Service Co. of Colorado	Comanche	Powder River Basin	0.35	0.07 }	.66	.64	
Colorado Springs Department of Public Utilities	Drake	Colorado	.51	.99 }			
Illinois:							
Commonwealth Edison	Waukegan	Powder River Basin	.53	1.25 }	1.25	1.58	
Illinois Power	Wood River	Colorado	.62	1.63 }			
Indiana:							
Commonwealth Edison	State Line	Powder River Basin	.39	1.36 }	1.11	1.51	
Northern Indiana Power Service	Mitchell	Wyoming, Colorado, Illinois	.87	1.57 }			
Iowa:							
Iowa Power & Light	Council Bluffs	Powder River Basin	.39	.62 }	1.18	1.14	
Iowa Public Service	Neal #3	Wyoming	.77	.97 }			
Kansas:							
Kansas Power & Light	Jeffrey	Powder River Basin	.36	.72 }	.90	.77	
Kansas Power & Light	Lawrence	Wyoming	.56	1.33 }			
Michigan:							
Detroit Edison	St. Clair	Powder River Basin	.70	1.04 }	1.29	1.48	
Do.	Monroe	West Virginia, Ohio	2.56	1.19 }			
Minnesota:							
MSP	Sherburne	Powder River Basin	.77	.69 }	.81	.70	
Rochester Public Utility	Silver Lake	Illinois, Oklahoma	2.06	1.46 }			
Nebraska:							
Nebraska Public Power Systems	Gentleman	Powder River Basin	.38	.65 }	1.11	1	
Do.	Sheldon	Wyoming, Oklahoma, Utah	.61	1.41 }			
Texas:							
Swepeco	Welsh	Powder River Basin	.36	.96 }	1.69	1.17	
Texas Power & Light	Monticello	Texas	.60	1.54 }			
Wisconsin:							
Wisconsin Power & Light	Columbia	Powder River Basin	.54	.88 }	1.14	.88	
Do.	Edgewater	Illinois	2.27	1.25 }			
Wyoming:							
Black Hills Power & Light	Osage	Powder River Basin	.43	.40 }	.38	.33	
Pacific Power & Light	Jim Bridger	Wyoming	.54	1.35 }			

¹ Average coal cost is very low due to heavy reliance on local coal at mine-mouth plants.

Source: "Cost and Quality of Fuels for Electric Utility Plants—1978." Department of Energy, October 1979.

TABLE II.—Delivered coal costs for selected utilities located near eastern coal reserves (1978)

State and Utility:	Average price ¹
Pennsylvania:	
Pennsylvania Electric	1.20
Pennsylvania Power & Light	1.19
West Virginia:	
Appalachian Power	1.31
Monongahela Power	1.15
Kentucky:	
Tennessee Valley Authority	1.01
Louisville Gas & Electric	1.16
Kentucky Utilities	1.26
Virginia: Appalachian Power	1.47

Ohio:	
Ohio Electric Co.....	1.65
Ohio Edison.....	1.14
Cleveland Electric Illum.....	1.30
Dayton Power & Light.....	1.29
North Carolina: Duke Power.....	1.43
Georgia: Georgia Power.....	1.25
South Carolina: South Carolina Electric & Gas.....	1.33
Alabama: Alabama Power.....	1.35
Tennessee: Tennessee Valley Authority.....	1.20
Florida:	
Tampa Electric.....	1.44
Gulf Power.....	1.38
Florida Power Corp.....	1.73

¹ Per million Btu.

Source: "Cost and Quality of Fuels for Electric Utility Plants—1978," DOE, October 1979.

TABLE III.—DELIVERED FUEL COSTS FOR SELECTED UTILITIES USING NONCOAL FUELS (1978)

State and utility	Fuel type	Percent of total	Average price ¹
Connecticut: Connecticut Light & Power	Oil	100	2.14
Maine: Boston Edison	Oil	100	2.05
New Jersey: Jersey Central Power & Light.....	Oil	100	2.35
New York:			
Consolidated Edison	Oil	99	2.18
Long Island Lighting.....	Oil	100	1.87
District of Columbia: Potomac Electric Power	Oil	100	2.35
Maryland: Baltimore Gas & Electric.....	Oil	88	2.12
Virginia: Virginia Electric & Power	Oil	85	2.02
Florida: Florida Power & Light.....	Oil	72	2.04
Louisiana: Central Louisiana Electric.....	Gas.....	99	1.95
Texas:			
Central Power & Light.....	Gas.....	89	2.10
Dallas Power & Light.....	Gas.....	99	1.87
West Texas Utilities.....	Gas.....	99	1.54

¹ Dollars per million Btu.

Source: "Cost and Quality of Fuels for Electric Utility Plants—1978," DOE, October 1979.

[Table IV—Pages 301-303 363 I.C.C. decided Dec. 6, 1979]

5. BURLINGTON NORTHERN INC. (BN)

Contentions.—In its verified statement, BN emphasizes the importance of an adequate return on invested equity capital to support needed capital spending.

Earnings and capital outlays.—BN's revenue in relation to its investment is about the same as for the top eight roads, but its expenses are much higher in relation to revenue.

	Percent		
	Burlington Northern	Eight roads	All class I
Operating ratio.....	0.95	0.86	0.93
Gross revenue as a percent of net investment.....	58.0	58.9	69.5

As would be expected, this unfavorable operating ratio translates into relatively low rates of return.

	Percent		
	Burlington Northern	Eight roads	All class I
Return on net investment (traditional)	1.72	6.66	1.83
Return on net investment (tax adjusted)	1.98	6.72	1.74
Return on total capitalization	4.70	9.31	4.74
Return on equity	3.88	10.82	2.77

In fact, BN states that most of its earnings come from nonrailroad lines of business, such as land and natural resources, and that its railroad line of business actually lost \$10.7 million in 1977.

From reported data it appears that BN has not been making capital outlays at a very substantial level. Over the last 3 years its annual purchase of new property has averaged about \$159.7 million or only about 6.3 percent of its net investment in road and equipment. This level of investment is low in comparison to the average for the top eight roads of 7.7 percent. However, in its verified statement, BN states that:

During the five year period, 1978-1982, a projected \$2.0 to \$2.1 billion will be devoted to capital expenditures. Of this, up to \$1.0 billion will be related to currently anticipated coal traffic volume increases. Additionally, approximately \$2.2 billion of maintenance-of-way and structures operating expenses will be incurred during the same period.

Thus, BN has entered a period of large capital outlays. Much of this spending is intended to increase the carrier's capacity to handle bulk movements of grain and coal.

Funds flow and financial condition.—During the 3-year period of 1975-77, BN's working capital sources averaged almost \$444 million, of which about 32 percent came from operations. Its working capital increased about \$3.2 million during this period.

Other pertinent ratios are listed in the table below.

	Burlington Northern	Eight roads	All class I	Burlington Northern 3- year change
Current ratio	1.20	1.29	1.09	(¹)
Throw-off to debt ratio	2.14	3.94	1.82	-0.12
Capital structure ratio	.35	.37	.46	-.04
Fixed and contingent charge coverage	2.16	4.64	4.04	+0.07
Dividend payout ratio	.54	.52	.41	+1

¹ No change.

BN has a bond rating of A, which may reflect in large part its earnings from nonrail operations. In its transactions with affiliates over the past 3 years, it experienced cash inflows of \$194 million and cash outflows of \$192 million.

At its recent capital spending level, BN has maintained a current ratio and a capital structure comparable to the top eight roads. Its throw-off to debt ratio and its fixed charge covered, however, have been only marginally satisfactory.

Conclusion.—BN demonstrates weakness in its operating ratio, its rates of return, and its liquidity ratios (throw-off to debt and fixed charge coverage). With its low rates of return, BN appears to be able to maintain only a marginally satisfactory financial condition, even with a below average capital spending program. Judging strictly from this historical record, a conclusion of revenue inadequacy is warranted at the present time.

However, it is appropriate to note that BN's areas of weakness all are influenced by its high reported expense level. This in turn, reflects the impact of a recently accelerated track replacement program under a betterment accounting system. BN's reported track structure maintenance-of-way expenses climbed from \$54 million in 1971 to \$163 million in 1977. Had track replacement been recorded as capital investment rather than current expense, BN's reported expense level for the 1975-77 period would have been lower and somewhat less weakness would have been demonstrated by its financial indicators.

Even if the effect of betterment accounting could be discounted, it is not clear that BN's historical ratios would place it in the adequate category. However, the prospect of substantial future revenue gains from coal traffic cannot be overlooked.

With these taken into account, it is likely that future assessments of BN's revenue adequacy will be more favorable.

Senator LONG. Now let's here from Mr. Ellis Cox, executive vice president of Potomac Electric Power Co. on behalf of the Edison Electric Institute, Washington, D.C.

STATEMENTS OF ELLIS T. COX, EXECUTIVE VICE PRESIDENT, POTOMAC ELECTRIC POWER CO. ON BEHALF OF THE EDISON ELECTRIC INSTITUTE; ROBERT LUNDGREN, EXECUTIVE VICE PRESIDENT, DETROIT EDISON CO., ACCOMPANIED BY LEONARD TROSTEN

Mr. Cox. It's nice to be here, Mr. Chairman. I certainly appreciate the invitation to appear before you on behalf of the investor-owned electric utilities and, in fact, on behalf of consumers of electric energy.

Let me introduce Bob Lundgren, who is executive vice president of Detroit Edison Co., and Leonard Trosten, who is with the firm of LeBoeuf, Lamb, Leiby & MacRae.

In all previous testimony before this committee on May 23 and November 9 of 1979 concerning S. 796 and S. 1946, we stated that the primary concern of the electric utility industry is that railroads not be permitted to exercise their monopoly power over captive utility coal shipments to raise rates to unreasonable levels, thereby sharply driving up the rates consumers of electricity must pay. At the same time, our industry is vitally interested in a healthy railroad system. We are dependent on railroads.

Senator LONG. And let me say to you, Mr. Cox, I agree with that 100 percent.

Mr. Cox. Without railroads, my company would not be able to supply electricity to the Nation's capital.

Our primary concerns remain the same. In our previous testimony we also articulated the basic electric utility position concerning what should form the core of rail regulatory reform legislation. I will briefly recapitulate our prior testimony as follows.

One, there must be continuing rate regulation for captive utility coal shipments.

Two, a reasonably threshold must be established to define the ICC's jurisdiction over rates.

Three, basic rail rates should be cost based.

Four, rate escalation should reflect only increases in the railroad's costs.

Five, rail rates should enable a carrier to recover all of its costs of a movement as well as a reasonable return on its investment allocated to the movement.

Six, captive shipments, including electric utility coal shipments, must make an equitable contribution to any such subsidy.

Seven, in order to justify the subsidy, a railroad should be prepared to demonstrate to the ICC its overall need for the revenue, that all traffic is bearing at least its variable costs and that the railroad is doing its best to maximize the contribution of competitive traffic to the railroad's revenue need.

Eight, there needs to be a continuing limitation on the maximum rates which a rail carrier is allowed to impose on captive coal movements.

Our November 9 testimony described the serious deficiencies which we perceive in S. 1946. I wish to take this opportunity to express the sincere appreciation of our industry for the work you have done to improve S. 1946 and thus to help protect captive utility coal shippers and consumers from the potential excesses of railroad market power.

I agree with you, Senator, in the statements you made on the floor on December 17, 1979, the text of which is included in my written testimony.

Our industry fully supports the intent of your amendment to S. 1946, but we believe there are several respects in which the amendment might be clarified or modified. I will address this matter in the context of the questions Senator Long asked in his letter to me of February 15, 1980, inviting my testimony today.

You asked whether the amendment "strikes a proper balance between the need to insure a healthy rail transportation system and the implementation of national energy goals."

We agree that the amendment achieves this balance in the sense that it provides a sensible mechanism for establishing the point at which the burden of proof is on a railroad to justify charging a rate which is in excess of its variable and fixed costs plus a reasonable return on its investment allocated to the movement. We believe this concept is a rational approach to a difficult problem. We further believe that the amendment lists appropriate factors for the ICC to consider in establishing standards and that these factors appropriately recognize the need to give due weight to sometimes conflicting policy objectives.

You also asked me to explore the efficacy of the maximum rate provisions of S. 1946 and the relationship of these to the amendment you have proposed.

As I stated on November 9, our fundamental objections to S. 1946 include the fact (a) that it permits the railroads to impose exorbitant and unreasonable rate increases upon captive coal traffic, which are not based on the railroads' costs or a showing of revenue need, through the use of "free zones" provided in the bill and (b) that it fails to specify standards for determining maximum rates for captive coal traffic.

Although your amendment definitely helps to resolve these problems, I believe that some modifications should be made to fulfill the objectives of the amendment—assurance of a healthy railroad system consistent with protection of consumers of electricity.

Let's take a look at revenue level standards. We are concerned that if S. 1946 were enacted with your amendment, the ICC might consider that it has no authority to establish more than one revenue-to-variable-cost ratio or other test as the standard for a presumptively maximum reasonable rate level. Should the ICC reach such a conclusion, the effect could be harmful to both railroads and shippers.

For example, if the ratio were established which was appropriate for volume coal movements, this might be too low relative to other commodities or movements which do not share the same transportation characteristics. This would be adverse to the interests of both railroads and shippers.

If, on the other hand, the Commission established a single ratio at a rather high level appropriate for some movements or commodities other than volume coal movements, this would not afford the protection for captive utility coal shipments that you clearly envision. Worse yet, coal rates might tend to rise to the level of the single ratio, even though rates at such a level might be clearly unreasonable in relation to a railroad's cost of service and its revenue requirements.

We are deeply concerned with both these possibilities. Hence, we recommend that the Commission be authorized, but not required, to establish more than one ratio for determining a presumptively maximum reasonable rate.

In this connection, we believe it would be useful to clarify the amendment's language to reflect what we understand to be your intent that if a new or increased rate reflects a ratio so established by the ICC, it will be presumed to exceed a maximum reasonable level. A railroad could, of course, rebut this presumption.

Notwithstanding your amendment, S. 1946 could be read to preclude the ICC from suspending and investigating rates that exceed the standards set by the Commission if such rates fall within either the zone of rate freedom for inflation-related costs provided in section 103 or the zone of rate flexibility above inflation-related cost increases provided in section 104.

The decision whether to suspend and investigate should remain with the Commission, but we see no justification for eliminating the ICC's authority to consider in a suspension and investigation proceeding either initial rates or any increase in rates—that is, to the extent of the increase, the ratio of which exceeds the standards set by the Commission under your amendment.

To relegate shippers to filing a complaint in such a situation could mean a shipper would have no real chance to recapture excessive rates while the shipper is in the process of proving his case. Moreover, even if recapture were permitted by the ICC there is no assurance that the same consumers who bore the burden of the excessive charges would ever be made whole.

In summary, our position can be simply stated. We oppose S. 1946 without your amendment, primarily because it leaves open the door to the same type of railroad exploitation of captive coal traffic that we are now experiencing.

We again express our sincere appreciation to you for your efforts to protect the interest of consumers of electricity.

Resolution of the concerns expressed in my testimony today would require what we believe to be minor technical changes in the Long amendment and be entirely consistent with your objectives as set out in your Senate floor statement.

Further, the amendment preserves a forum in which all parties have an opportunity to be heard if rail rates appear to be reflective of monopoly abuse. We urge serious consideration of the minor technical changes expressed in my testimony today.

Senator LONG. Thank you very much for your statement, Mr. Cox.

We started out with a bill that was supposed to be a railroad deregulation bill. And by the time we conducted the hearing, the

only person who was for the bill the way it was written was the man who wrote the bill.

Mr. Dempsey came here for the American Association of Railroads. They thought the bill was good in some respects. The railroad thought that they ought to have a better deal than that.

But the great concern that was expressed was mainly with these captive customer situations. People said, hold on just a minute. Do you realize what you're doing here?

You're just letting the public in for all sorts of exploitation, and that wouldn't be the first time it's happened.

That's why you have the regulation now.

And so we have had to modify the bill and take care of those kinds of complaints and try to protect against those types of things because of concerns expressed.

Now from people in your industry, and I have to go no further than the area that I represent, they're in there complaining bitterly that they will be taken to the cleaners and that means that customers are going to have to pay a lot more than they ought to have to pay.

And I must say that I just think that what you have testified here and what your witness testified, and I don't think it could be successfully refuted.

It seems to me that you are coming here speaking for a regulated industry and speaking for the consumer. And you wouldn't be doing that if it wasn't that you have honest concern that without this amendment or something very similar to it, that the consumer will be victimized, and in some respects, he will blame you when it's not your fault when you did the best you could to try to see that he was treated fairly.

Mr. Cox. That's exactly correct. And Senator, I think it bears repeating, and I think I have mentioned this before, that our companies do not profit, nor are we hurt. That is, on our bottom line in terms of income to our investors by these matters.

It is our ratepayers who are put upon.

And we feel that we are here in their interest.

Senator LONG. Mr. Riegle?

Senator RIEGLE. Thank you, Mr. Chairman. I have to open up a session today at noon, so I must leave very shortly.

I wanted to just welcome Mr. Lundgren here today from Detroit Edison. I assume that he may be making a statement. If not, I have a series of five questions that I would like to have him respond to for the record that relate to the problem as we are experiencing it in Michigan.

You will recall, Mr. Chairman, previously in hearings we got into the case of Burlington Northern, which is in this situation with Detroit Edison, where we locked into long-term contracts to bring coal across country and into Michigan for use by Detroit Edison, and experienced a 41-percent rate increase in February 1979, which is just raising havoc with our customers and the ratepayers of Michigan.

And so I am a supporter of your amendment. I think it is necessary, and whether it stays exactly in that form or whether at some point along the way it gets altered somewhat is an open question, I suppose.

But I feel very strongly that we need some help in this area. So I would appreciate it, Mr. Lundgren, if you would respond to these questions for the record. Do you have a statement that you intend to make today?

Mr. LUNDGREN. Well, my statement here, really, we are the prime example of being a captive shipper or receiver.

As we testified to before, we entered into a top contract with a coal company and actually signed the contract in the offices of Burlington Northern, where they gave us certain assurances as to what the escalations were due to be and various things that they were going to do, which they didn't do.

As soon as we were locked in, we built a facility. We bought boats, we bought cars, and various things like that.

As soon as we were locked in, then the Burlington & Northern proceeded to advance against us, and that's really my reason for being here, because there isn't anything that we can do unless we have protection from the Interstate Commerce Commission or someone.

I would like to bring out for both Senator Riegle and Chairman Long that we learned something very good from the testimony today from the Chairman of the Interstate Commerce Commission, Mr. Gaskins, who said that they were going to take into consideration the fact that we had agreed upon escalation in our contract with the Burlington & Northern.

Now this is a new venture for the Interstate Commerce Commission. There are some other cases during the course. But as I understood what he had to say today, that they are going to have the Burlington & Northern go through with their agreement, which is very great news for us.

I have—I guess I won't go through all of the particulars here of how captive we are.

Senator RIEGLE. May I just say that I think it's important that you put that entire statement and the case facts here in the record because you are exhibit A to exactly the kind of problem we are trying to solve here. And in the same sense, I want to make sure that I get from you for the record responses to these five questions which will also lay out this difficulty in perhaps a slightly different way.

So without objection, Mr. Chairman, I would like to ask that those things be a part of the record.

Senator LONG. By all means.

Is there something else that you wish to put in the record?

Mr. Cox. I think we have agreed.

Senator LONG. Thank you very much.

Mr. LUNDGREN. May I add one thing here?

In our statement, we show or we indicate that the rich railroads are the ones that are going to be benefiting the most by unit legislation.

I don't know how much it's going to help the poor railroads because the rich railroads all carry a lot of coal. And I do have some exhibits here to show—let's see what we said in the statement here. That three-fourths of all coal revenues are generated by the country's 10 strongest railroads. And the weaker railroads like the Milwaukee & Rock Island, Conrail would benefit very little

from the ability to increase coal subsidy payments because coal is less than 10 percent of their revenues.

On the other hand, the relatively prosperous railroads that carry most of the Nation's coal earn 30 percent of their revenues from the traffic and they will have the ability to increase their rates and become even more prosperous.

I do have some tabulations here which might refute a little what Mr. Dempsey has to say, which I will leave with you, sir.

Senator LONG. Thank you very much, gentlemen.

Mr. Cox. Thank you, Senator.

Senator LONG. Mr. Lundgren, you have a statement there that shows a comparison of 1978 for run of the ICC's 10 highest investments.

That will be part of the record that you offer, I take it.

Is that right?

This chart that you have as exhibits returns to railroads, that's part of the statement that you have submitted to the railroads.

I will ask that it be printed in full, together with the exhibits that you attach to the statement.

[The statements follow:]

STATEMENT OF ELLIS T. COX, EXECUTIVE VICE PRESIDENT, POTOMAC ELECTRIC POWER CO.

I am Ellis T. Cox, Executive Vice President of Potomac Electric Power Company. I am appearing on behalf of the investor-owned electric utilities which comprise the Edison Electric Institute and provide 77 percent of all electric power purchased in the United States.

In our previous testimony before this committee on May 23 and November 9, 1979, concerning S. 796 and S. 1946, we stated that the primary concern of the electric utility industry is that railroads not be permitted to exercise their monopoly power over captive utility coal shipments to raise rates to unreasonable levels, thereby sharply driving up the rates consumers of electricity must pay. At the same time, our industry is vitally interested in a healthy railroad system.

Our primary concerns remain the same. In our previous testimony we also articulated the basic electric utility position concerning what should form the core of rail regulatory reform legislation. I will briefly recapitulate our prior testimony as follows:

There must be continuing rate regulation for captive utility coal shipments. A reasonable threshold must be established to define the ICC's jurisdiction over rates.

Basic rail rates should be cost based.

Rate escalation should reflect only increases in the railroads' costs.

Rail rates should enable a carrier to recover all of its costs of a movement as well as a reasonable return on its investment allocated to the movement.

Certain rail carriers may need a subsidy to enable them to achieve a reasonable return on their investment. Captive shipments, including electric utility coal shipments, must make an *equitable* contribution to any such subsidy.

In order to justify the subsidy, a railroad should be prepared to demonstrate to the ICC its overall need for the revenue, that all traffic is bearing at least its variable costs and that the railroad is doing its best to maximize the contribution of competitive traffic to the railroad's revenue need.

There needs to be a continuing limitation on the maximum rates which a rail carrier is allowed to impose on captive coal movements.

Our November 9 testimony described the serious deficiencies which we perceive in S. 1946. I wish to take this opportunity to express the sincere appreciation of our industry for the work Senator Long has done to improve S. 1946 and thus to help protect captive utility coal shippers and consumers from the potential excesses of railroad market power. As Senator Long stated so well in his December 17, 1979 statement on the floor of the Senate when offering his proposed amendment to S. 1946:

"Large investments will be needed both to add to our existing transport capacity and to replace and maintain the very large complex system already in place. The

capability of both the public and private sectors to finance the needed investments in infrastructure and equipment will be sharply challenged.

"There is no doubt that coal will properly be called on to provide a healthy share of the revenues which are needed to accomplish these goals. The question is whether that share should be virtually without limit. The question is whether the rails should be permitted to ignore the highly inflationary impact which disproportionately high transportation charges on coal will have on hundreds of public utilities and rural electric co-operatives, on thousands of industrial consumers, and on virtually every consumer of electricity in the country. My position is that the de facto railroad monopoly on coal transportation must not be allowed to weight the balance disproportionately in favor of exorbitant charges on this one vital commodity."

Our industry fully supports the intent of Senator Long's amendment to S. 1946 but we believe there are certain respects in which the amendment might be clarified or modified. I will address this matter in the context of the questions Senator Long asked in his letter to me of February 15, 1980 inviting my testimony today.

Senator Long asked whether the amendment "strikes a proper balance between the need to ensure a healthy rail transportation system and the implementation of national energy goals." We agree that the amendment achieves this balance in the sense that it establishes a sensible mechanism for establishing the point at which the burden of proof is on a railroad to justify charging a rate which is in excess of its variable and fixed costs plus a reasonable return on its investment allocated to the movement. We believe this concept is a rational approach to a difficult problem. We further believe that the amendment lists appropriate factors for the ICC to consider in establishing standards under Senator Long's amendment and that these factors appropriately recognize the need to give due weight to sometimes conflicting policy objectives.

Senator Long also asked me "to explore the efficacy of the maximum rate provisions of S. 1946 and the relationship of these to the amendment I have proposed." As I stated on November 9, our fundamental objections to S. 1946 include the fact (a) that it permits the railroads to impose exorbitant and unreasonable rate increases upon captive coal traffic, which are not based on the railroads' costs or a showing of revenue need, through use of the "free zones" provided in the bill and (b) that it fails to specify standards for determining maximum rates for captive coal traffic. Although Senator Long's amendment definitely helps to resolve these problems, I believe that some modifications should be made to fulfill the objectives of the amendment—assurance of a healthy railroad system consistent with protection of consumers of electricity.

REVENUE LEVEL STANDARDS

We are concerned that if S. 1946 were enacted with Senator Long's amendment, the ICC would consider that it has no authority to establish more than one revenue-to-variable cost ratio (or other test) as the standard for a presumptively maximum reasonable rate level. Should the ICC reach such a conclusion, the effect could be harmful to both railroads and shippers. For example, if the ratio were established which was appropriate for volume coal movements, this might be too low relative to other commodities or movements which do not share the same transportation characteristics. This would be adverse to the interests of both railroads and shippers. If, on the other hand, the Commission established a single ratio at a rather high level appropriate for some movements or commodities other than volume coal movements, this would not afford the protection for captive utility coal shipments that Senator Long clearly envisions. Worse yet, coal rates might tend to rise to the level of the single ratio even though rates at such a level might be clearly unreasonable in relation to a railroad's cost of service and its revenue requirements and thus make it more difficult to achieve the national objective of increasing the use of coal.

We are deeply concerned with both these possibilities. Hence, we recommend that the Commission be authorized, but not required, to establish more than one ratio for determining a presumptively maximum reasonable rate. In this connection, we believe it would be useful to clarify the amendment's language to reflect what we understand to be Senator Long's intent that if a new or increased rate reflects a ratio so established by the ICC, it will be presumed to exceed a maximum reasonable level. A railroad could, of course, rebut this presumption.

SUSPENSION AND INVESTIGATION OF RATES

Notwithstanding Senator Long's amendment, S. 1946 could be read to preclude the ICC from suspending and investigating rates that exceed the standards set by the Commission if such rates fall within either the zone of rate freedom for

inflation-related costs provided in section 103 or the zone of rate flexibility above inflation-related cost increases provided in section 104. The Decision whether to suspend and investigate should remain with the Commission, but we see no justification for eliminating the ICC's authority to consider in a suspension and investigation proceeding either initial rates or any increase in rates (i.e., to the extent of the increase) the ratio of which exceeds the standards set by the Commission under Senator Long's amendment. To relegate shippers to filing a complaint in such a situation could mean a shipper would have no real chance to recapture excessive rates while the shipper is in the process of proving his case. Moreover, even if recapture were permitted by the ICC there is no assurance that the same consumers who bore the burden of the excessive charges would ever be made whole.

In summary, our position can be simply stated. We oppose S. 1946 without the Long amendment, primarily because it leaves open the door to the same type of railroad exploitation of captive coal traffic that we are now experiencing.

We again express our sincere appreciation to Senator Long for his efforts to protect the interest of consumers of electricity.

Resolution of the concerns expressed in my testimony today would require what we believe to be minor technical changes in the Long amendment and be entirely consistent with Senator Long's objectives as set out in his Senate floor statement. Further, the amendment preserves a forum in which all parties have an opportunity to be heard if rail rates appear to be reflective of monopoly abuse. We urge serious consideration of the minor technical changes expressed in my testimony today.

STATEMENT OF ROBERT W. LUNDGREN, EXECUTIVE VICE PRESIDENT FOR
ADMINISTRATION, THE DETROIT EDISON CO.

My name is Robert Lundgren. I am Executive Vice President—Administration of the Detroit Edison Company. Detroit Edison provides electric power to a 7600 square mile urban and rural service area in Southeastern Michigan. The area comprises about 13 percent of the State's total land area, but accounts for over one half of Michigan's population, electricity consumption and industrial capacity.

Detroit Edison burns mostly coal. Approximately 85 percent of the kilowatthours generated comes from this source. Historically, Edison's major coal supply has come from the Eastern Appalachian region of the country—primarily high-sulfur coal from Ohio, West Virginia, and the surrounding area.

In 1972, however, as a result of changing environmental concerns, Detroit Edison, on its own initiative, made a series of innovative decisions. Instead of relying exclusively on Eastern coal, a new source of environmentally acceptable Western coal was developed. A contract for 200 million tons of low-sulfur coal over a 26 year period was negotiated with the Decker Coal Company in Montana to supply Edison's St. Clair, Michigan Power Plant and the adjacent Belle River Power Plant, still under construction.

As I previously testified before this Subcommittee on November 9th, transportation arrangements were made with the Burlington-Northern Railroad. The Burlington-Northern gave us a lot of encouragement to begin using Western coal. They quoted a rate which they have subsequently characterized as a "missionary" rate.

On the basis of these representations, we not only signed the 26 year contract with the Decker Coal Company, we also purchased our own railroad cars; we invested in two lake vessels which cost \$100 million; we invested \$326 million in the aforementioned power plants; and we built a transshipment facility in Superior, Wisconsin for approximately \$43 million. If we are called upon to return to Eastern coal, it would now cost us approximately \$1 billion to accomplish that conversion.

Because the Burlington-Northern provides the only feasible transportation between the Decker Mine and our transshipment facility at Superior, Wisconsin, we are a prototypical example of a captive coal shipper. Once the Burlington-Northern had established its monopoly power over us, it was able to begin its game of "bait and switch". Our escalation between 1972 and 1978 amounted to 69 percent. Last year, the Railroad attempted to exact an additional increase of 41 percent which the ICC has recently determined to be "excessive and unreasonable".

Although we are currently unaware of what the final outcome of our ICC case will be, we anticipate that the prescribed rates will reflect the 7 percent solution established by the ICC in the *San Antonio* case. That means that if the ICC continues its policy and establishes 10.6 percent as an adequate rate of return for the Burlington-Northern and then applies the 7 percent solution, the Burlington-Northern's rate of return on our traffic would amount to approximately 14 percent.

If coal is to be used to overcome the failure of other movements to pay their fair share, the railroads ought to be required to prove they need a subsidy and that the

particular subsidy demanded from us is fair. I, therefore, support an amendment which would limit this so-called "zone-of-freedom", so that the railroads must justify increases within, as well as beyond, the 4 percent zone-of-freedom, whenever the increased rate rises above an upper threshold to be set by the Interstate Commerce Commission, after hearings.

S. 1946, as now constituted, without the amendment I support, authorizes the railroads to exploit captive traffic as much as they believe is needed to bring their earnings to optimum levels. Their prime target is plainly going to be captive coal, which they are carrying in increasing volumes as a result of a deliberate national policy. The railroads demand this "rate freedom" because they claim they will not otherwise survive. But, the simple truth is that the railroads who will benefit most from such flexibility are those who need it least.

Coal is carried by the rich, not the poor railroads. Three-fourths of all coal revenues are generated by the country's ten strongest railroads. Sick railroads like Milwaukee, Rock Island, and ConRail would benefit very little from the ability to increase coal subsidy payments because coal is less than 10 percent of their revenues. On the other hand, the relatively prosperous railroads that carry most of our nation's coal earn 30 percent of their revenues from that traffic. They will be able to use their ability to increase rates to become even more prosperous.

To the extent that the drafters of S. 1946 may have been persuaded to provide a "zone-of-freedom", in the belief that they would thereby be helping needy railroads otherwise in/or facing bankruptcy, they were deceived. If this bill passes in its present form, they will instead have provided the rich, or soon-to-be rich, coal-carrying railroads like the Burlington-Northern with the ability to exploit helpless rate payers.

The Burlington-Northern's common stock price doubled over the last year, on record-shattering earnings computed under betterment accounting, which charged off the whole cost of largely rebuilding its western road bed against current earnings. Even under this income-shrinking accounting, it reported earnings providing a 7.4 percent return on equity in the year ending September 20, 1979. Burlington-Northern went on, in fourth quarter 1979, to record its highest earnings ever—two and a half times its 4th quarter 1978 earnings.

I support limitations upon the "zone-of-freedom" to protect Detroit Edison and other captive electric utilities from endless rate increases by the prosperous railroads, who carry the preponderance of this country's rail coal traffic. I thank you for your attention and for this opportunity to present my company's views.

Attachment.

COMPARISON OF 1978 COAL REVENUES OF THE ICC'S 10 "HIGHEST-INVESTMENT GRADE RAILROADS"
(MOODY'S RATING=AAA OR AA) TO TOTAL U.S. COAL REVENUES FOR 1978

Railroad	Coal revenue	Percent return on equity ¹
Chesapeake & Ohio ²	\$501,450,127	15.1
Burlington & Northern.....	463,867,172	7.4
Norfolk & Western.....	349,356,263	19.2
Seaboard Coast Line ²	278,457,356	9.4
Union Pacific.....	167,745,042	10.2
Southern Railway.....	155,524,907	13.8
Denver & Rio Grande Western.....	65,679,794	12.5
Missouri Pacific.....	65,035,106	14.6
Atchison, Topeka & Santa Fe.....	50,717,653	8.3
Southern Pacific.....	14,933,770	5.0
10 "Highest grade".....	2,111,767,190	10.6
Total U.S. railroads.....	2,813,428,000	5.4
Percent of 10 of total coal revenues.....		75.06

¹ For year ending Sept. 30, 1979, as shown by AAR's witness Levine in Ex Parte 375.

² Including all system lines.

COMPARISON OF 5 TOP COAL-CARRYING RAILROADS¹ AND 5 SICK RAILROADS' TOTAL COAL
REVENUES TO TOTAL REVENUE

	Coal revenues	Total revenues	Percent coal of total
5 top coal-carriers:			
Burlington Northern ²	\$651,080,274	\$2,422,471,509	26.88
Norfolk & Western	349,356,263	985,055,116	35.47
Chesapeake & Ohio	276,335,958	655,370,919	42.16
Louisville & Nashville	225,313,667	818,151,699	27.54
Baltimore & Ohio	202,277,062	830,705,023	24.35
Total 5 coal-carriers	1,704,363,224	5,711,754,266	29.84
5 sick railroads:			
Chicago, Milwaukee, St. Paul & Pacific	34,054,774	421,149,827	8.0
Chicago North Western	44,215,046	584,101,505	7.57
Chicago Rock Island & Pacific	15,036,620	381,844,989	3.94
Consolidated Rail Corporation	324,896,694	2,826,374,970	11.50
Illinois Central Gulf	69,877,741	707,763,824	9.87
Total 5 sick lines	488,080,875	4,921,235,115	9.92

¹ All 5 are among the 10 "highest-grade railroads" or within one of the Railroad systems on that list. These top 5 accounted for 57 percent of all rail coal revenues in 1978.

² 1979 data is used. All other data is for 1978.

Senator LONG. Now we will hear from a panel of Mr. Richard E. Miller, executive vice president, AMAX Coal Co.; Mr. Craig McNeese, vice president of public affairs, Houston Lighting & Power Co., accompanied by Mr. Leroy Peabody and Mr. William Slover.

STATEMENTS OF RICHARD E. MILLER, EXECUTIVE VICE PRESIDENT, AMAX COAL CO., AND CRAIG McNEESE, VICE PRESIDENT OF PUBLIC AFFAIRS, HOUSTON LIGHTING & POWER CO.; ACCOMPANIED BY LEROY E. PEABODY, PRESIDENT, L. E. PEABODY & ASSOCIATES; AND WILLIAM SLOVER, COUNSEL

Senator LONG. We are pleased to have you, gentlemen.

Mr. MILLER. Thank you. My name is Dick Miller. I am executive vice president of AMAX Coal Co. AMAX, as you know, is the third largest producer in the United States. We produced 34½ million tons in 1979, and the bulk of that production, which is about 30 million tons, moved by rail.

I am appearing today on behalf of the National Coal Association. And in the interest of time, my oral statement, which is supplementary to the written testimony, will be very brief. I would like to address three points.

First of all, the National Coal Association supports the amendment that would add a level of revenue to variable cost which would shift the burden of proof regarding maximum reasonableness of a railroad rate from the affected shipper to the performer railway.

NCAA also recommends the timing for issuance of the burden of proof test be made simultaneous with the establishment of the maximum reasonableness jurisdictional threshold, which is now set forth in the bill. We feel that this combination of threshold and test values is considered to be necessary in order to furnish protection for captive shippers against potentially excessive railroad rates

that might be encountered because the shipper has no practical alternative to railroad transportation.

Further, the National Coal Association strongly supports the directive of the amendment that the Interstate Commerce Commission, in applying standards for establishing the burden of proof tests, must consider the inflationary impact at various levels of revenue to variable cost, particularly as such impacts relate to national energy goals, taking into account the railroad's role as a primary source of energy transportation and the need for a sound railroad system.

Next, the National Coal Association considers the authorization and encouragement of contract between rail carriers and shippers with respect to railroad transportation rates, service requirements, equipment utilization, and so forth, over extended periods, represent an important element of new approaches to railroad rate-making. This should help to assure adequate service commensurate with reasonable rates and should assist in reducing regulation in the railroad industry.

NCA perceives contracting between railroad carriers and shippers to be both a critical concept for acquiring dependable transportation service and a benefit to railroad carriers.

We see these benefits, that they would lessen the likelihood of losing valuable coal traffic to alternative transportation after investments have been made, also to acquire added revenues that are attributable to a higher value connected with commitments for transportation service and rates over extended periods.

A third point, Mr. Chairman—it was not my intent this morning to get into that certain kind of a contest with Mr. Dempsey regarding whose rates have gone up the most, but I think that I must address his testimony a little bit. First of all, I would like to commend him because it is the first study I have seen in a long time—or have ever seen—where they went back to 1931 for comparison purposes.

There is no question that the cost for producing coal has risen dramatically in recent years, and this has forced the f.o.b. mine prices to much higher levels. The two primary factors causing these increases in costs are: excessive Government regulations; and general inflation in costs of materials and supplies for both the construction and operation of mines.

But the profitability of producing coal has not increased. And let me give you an example, taken from my testimony before the task force on inflation in the House Budget Committee in June of last year.

In 1970, the average f.o.b. mine price of coal from AMAX Illinois-based mines—and that's the only area that we operated in in 1970—was \$4.40 per ton. By 1978, the f.o.b. mine price had increased to \$18.38. These are averages of the midwestern mines. During this 8-year period when our mine price increased over 400 percent, our net profit on a ton of coal from those mines increased 3 cents per ton. In real terms, this represents a substantial decrease in profitability, particularly when viewed against the substantial investment which is now required to build a coal mine.

In 1970, we could build mines in the Illinois basin for \$12 to \$15 per annual ton of production capacity. That is a 2 million-ton coal

mine would cost \$25 to \$30 million. Today a similar mine costs between \$90 and \$110 million, or \$45 to \$55 per annual ton of capacity.

I just wanted to insert that into the record so that we are all aware of where we are coming from.

That concludes my oral testimony.

Senator LONG. You did not include labor as one of the principal items of the increasing costs of coal. Would you give us your estimate of the extent to which labor has increased?

Mr. MILLER. I included that in general areas of inflation. There is no question that labor rates have gone up and productivity has gone down. Much of the reduction in productivity has been a result of various regulations that have been passed and promulgated on the coal industry.

Senator LONG. Thank you very much.

[The statement follows:]

STATEMENT OF RICHARD E. MILLER, EXECUTIVE VICE PRESIDENT, AMAX COAL CO.
ON BEHALF OF THE NATIONAL COAL ASSOCIATION

Mr. Chairman and Members of the Committee, my name is Richard E. Miller. I am Executive Vice President of AMAX Coal Company, a division of AMAX, Inc. AMAX Coal is the third largest producer of coal in the United States. We operate mines in the Illinois Basin and in the Powder River Basin of Wyoming.

I am here to present views of the National Coal Association on your proposed amendment to ratemaking regulation provisions of S. 1946. As indicated in the testimony on S. 1946, which I presented on November 9, 1979 on behalf of NCA, the coal industry has great interest in this important legislation. We continue to favor passage of legislation that would eliminate unnecessary railroad regulation, help improve the health of the railroad industry, and upgrade railroad transportation service and performance, while assuring protection against unreasonably high railroad transportation rates that might be encountered by captive shippers who have no practical alternative transportation available. We support the proposed amendment under consideration today.

IMPORTANCE OF TRANSPORTATION POLICIES TO COAL

A dependable and efficient railroad system, charging reasonable rates, is indispensable. At the national scale, approximately 65 percent of all coal produced in the U.S. is transported by railroads. Coal is the leading commodity shipped by railroad, accounting for about 30 percent of total freight tonnage and 20 percent of all railroad carloadings. About 50 percent of the coal shipped by railroad nationally is moved by unit trains dedicated to such movements.

Coal shippers are subject to railroad market dominance

It is well documented that coal shippers are faced with substantial railroad market dominance with respect to moving coal from mines to user destinations. Studies conducted by the National Coal Association show that approximately 85 percent of coal tonnage shipped via railroad carriers has no practical transportation alternative. This heavy reliance on railroad transportation for coal shipments is expected to continue. The lack of surface transportation competition underscores the importance of providing adequate regulatory protection with respect to the maximum reasonableness of railroad transportation rates for coal.

Coal producers and prospective coal users often must negotiate long-term coal supply contracts as much as six to eight years ahead of coal deliveries in order to assure compatibility between design of coal-fired boilers and the physical properties of the coal that will be burned. When long-term coal supply agreements are entered into, coal origins, supply rates, and user destinations are firmly established. User facilities are limited in terms of acceptable heat value, sulphur content, and other physical characteristics of coal which differ widely from place-to-place. These conditions thus limit transportation alternatives for coal users. Dependability of essential transportation services and reasonableness of the rates are crucial concerns.

Railroad transportation rates have been rising rapidly from 1974 to 1978. Bureau of Labor Statistics data indicate that the Producer Price Index rose about 32 percent and the Gross National Product Deflator grew about 31 percent, whereas the Rail-

road Index for all traffic increased about 43 percent and for coal traffic about 48 percent during this period. Thus, railroad rates have been increasing appreciably faster than overall economic indicators and railroad rates for moving coal have been growing at a somewhat higher rate than for other commodities.

Railroad rates for transporting coal, moreover, have shown especially serious growth trends in 1979. For instance, ICC-supported rate increases in 1979 for coal traffic originated on the Louisville and Nashville Railroad resulted in an increase of 40 percentage points (up to 169 percent) in the ratio of revenue-to-variable cost attributed to such traffic. In 1979, the ICC also upheld several coal tariffs for western coal that generate ratios of revenue-to-variable cost in a range of 170 percent to more than 200 percent for movements using efficient unit coal trains—often with shipper-owned railcars and maintenance of such railcars provided by the coal shipper's facilities.

With these recent events in mind, coal producers and users are seeking assurance that coal to be moved by railroads in the 1980's is not called upon to contribute more than an equitable amount required to cover costs of providing transportation service plus reasonable return on investment.

Contracts for coal transportation should be encouraged

Mr. Chairman, reliable and responsive railroad transportation, at reasonable rates, is important to the goal of greater use of domestic coal to supply the Nation's energy needs. Therefore, the coal industry urges that initiatives now being taken to reshape railroad ratemaking regulation, ostensibly in the interest of assuring a dependable and viable private enterprise system of railroads, include protection of captive shippers. We also believe legislation should stimulate contracting between rail carriers and shippers.

As indicated earlier, long-term (15 to 30 years) coal supply contracts between coal producers and users are regularly negotiated in good faith in order to commit parties to coal supply schedules, prices, and other conditions. However, coal shippers have not been able to secure long-term agreements with railroad carriers.

Therefore, to reduce the potential need for regulatory intervention in railroad ratemaking processes involving coal transportation, we support establishment and enforcement of contracts between railroad carriers and shippers. We think it is proper for a railroad and its customers to be able to enter into long-term agreements relative to the transportation of goods so long as both parties are obligated to perform under those agreements.

Under present arrangements, tariffs finally established frequently exceed the initial or estimated tariff, adjusted for escalation, contained in letters of understanding. Long-term contracts between shippers and carriers should remove some of the uncertainty.

Coal prices are becoming relatively stable but inadequate Federal transportation policies could affect this stability

During the past decade, the coal industry has gone from a situation of virtually no regulations on production to massive control of health, safety, and environmental conditions. Despite the huge burden of these constraints, the costs imposed by these regulations are becoming more clearly defined and are being internalized and reflected in the price of coal.

With the future price of competing fuels expected to increase rapidly, coal should be able to look forward to a period of relatively stable and predictable prices of coal at the mine. But the stability of the delivered price of coal is being reduced by existing and proposed transportation policies.

IMPROVEMENTS ARE DESIRABLE WITH REGARD TO RATEMAKING REGULATION,
ESPECIALLY IN THE AREA OF MAXIMUM REASONABLENESS

Mr. Chairman, the thrust of your amendment goes directly to the need for improvements in railroad ratemaking regulation under S. 1946, especially in the area of maximum reasonableness. This is particularly important to the coal industry inasmuch as coal is the leading commodity carried by the railroads in terms of its share of total railroad tonnage and carloadings originated by Class I railroads. It is also significant that coal traffic is not spread evenly across the railroad industry. In fact, six railroad systems (Norfolk and Western, Chessie, Burlington Northern, Family Lines, Southern Railway, and Conrail) account for about 80 percent of originated tonnage and carloadings of coal.

Ratemaking regulation should be sensitive to achieving cost reductions and realizing adequate revenues

The coal industry supports many of the provisions of S. 1946 as reported by the Senate Committee on Commerce, Science, and Transportation. Certainly cost reduc-

tions possible through improvements contemplated in railroad mergers and transactions involving abandonment of unprofitable lines are highly desirable. The bill's provisions with respect to establishing deadlines for certain critical regulatory proceedings are also beneficial. My earlier remarks address another desirable provision in the bill that would enable contracts between railroad carriers and shippers.

Likewise, it is understandable that railroad rates, which would generate revenues not adequate to fully cover the cost of transportation service plus a reasonable return on investment in transportation facilities, should be eliminated from consideration in ratemaking proceedings. However, these provisions do not constitute a total system of regulatory protection for captive shippers against the bargaining power held by railroads.

ICC has sustained large railroad rate increases for coal movement and has reduced its vigilance in market dominant situations

Coal producer and user concerns have grown in recent months because the ICC has sustained high coal rates established by railroads—including rates on coal traffic which generate revenue-to-variable cost ratios of 170 percent to more than 200 percent. In addition, very recent ICC actions have suggested a tendency to abrogate responsibility to protect captive shippers in cases of rail market dominance. For instance, decisions on the movement of coal from Axial, Colorado to Coletto Creek, Texas reached by the ICC on January 15, 1980 are a good example. Among their unusual features are the ICC's conclusions that rail market dominance did not exist because the utility had the option of securing coal from South Africa or Australia, and that the utility's more than \$15 million investment in rail equipment also did not establish that it was rail market dominant.

Developments such as these contribute to the concern about the future impact on coal rates of proposals to reduce regulation of railroads. We favor the reduction of unnecessary regulations, but we have yet to see an acceptable substitute for regulatory protection for captive shippers.

S. 1946 requires amendment in order to furnish essential regulatory protection against unreasonable railroad transportation rates

Aside from contracting, in view of the captive status of coals shippers, better regulation is required over maximum reasonableness of railroad rates than is now offered in S. 1946 as reported. Mr. Chairman, we were pleased to see the proposed amendment to S. 1946, which you are considering, because we believe that it is a necessary step towards assuring sufficient ratemaking protection to captive shippers under the bill. NCA favors the proposed amendment in that it will help provide an additional test whereby the burden of proof with regard to reasonableness of a rate would shift to proponent rail carriers instead of affected shippers at an appropriate revenue-to-variable cost threshold level. We do, however, recommend that the proposed amendment be revised so that this additional burden of proof threshold must be issued by the Interstate Commerce Commission simultaneously with the issuance of the revenue-to-variable cost threshold level now established in the bill to determine ICC jurisdiction over maximum reasonableness of rates.

The burden-of-proof test should be considered as a parallel requirement with a maximum reasonableness threshold. Both should be established at the same time in order to avoid the likelihood of encountering unwarranted efforts to raise railroad transportation rates in the interim between the times that each of the thresholds in promulgated.

Further, NCA strongly supports the directive of the amendment that the Interstate Commerce Commission, in applying standards for establishing the burden-of-proof test, must consider the inflationary impact of various levels of revenue-to-variable cost, particularly as such impact relates to national energy goals taking into account the railroad's role as a primary source of energy transportation and the need for a sound railroad transportation system.

Mr. Chairman, the coal industry appreciates the opportunity to testify on your proposed amendment to S. 1946. I will be glad to respond to any questions at this time.

Senator LONG. I take it you have another statement to make; don't you?

Mr. McNEESE. Yes, sir, I have one to make, Senator.

I am Craig McNeese, vice president of Houston Lighting & Power Co., which serves Houston and the surrounding area, which includes about one-quarter of the population of Texas. I appear today on behalf of Western Coal Traffic League, of which my company is

a member. The league is a voluntary association of major rail shippers of coal mined west of the Mississippi River. It was founded in 1976 to deal with issues related to coal transportation, and its members ship some 25 million tons of coal per year in unit train service.

On my far left is Mr. William L. Slover, counsel for the league; and next to me is Mr. Leroy Peabody, economic consultant for the league. Mr. Peabody earlier submitted a written statement, which we ask be made a part of the hearing record.

Mr. Chairman, we are deeply appreciative of the concern you have demonstrated for the plight of captive coal shippers. As you know, a great majority of coal transported by rail is consumed by utilities such as my own company and the cost of that transportation is ultimately paid by our customers. Thus, the issues you address in these hearings in a very direct way affect the pocket-books of virtually every electric consumer throughout the nation.

In your statement on December 17, 1979, announcing that you intend to offer an amendment to S. 1946, you expressed the concern that the present provisions of the bill are not sufficient to protect captive rail traffic from the imposition of unreasonably high rates. We think that this concern is well-founded and for this reason the coal league is opposed to the enactment of S. 1946 as reported by the Commerce Committee.

In its present form, the provisions of S. 1946 which deal with rate regulation are limited, in essence, to jurisdictional matters, determining when the commission shall have the authority to examine the reasonableness of rates and, on the other hand, when it shall not. The bill does not address the standards to be applied by the commission in those instances where its rate review jurisdiction is exercised. We believe that experience to date with the Commission's implementation of the 4R Act in the area of maximum rate regulation demonstrates a need for a provision such as the amendment which you, Mr. Chairman, have proposed, to afford some guidance in this area.

It has been suggested by a railroad representative before this subcommittee that coal traffic does not even pay its fair share towards the railroads' revenues and that there is little basis for the widespread concern that coal traffic will be forced to pay unjustly high rates under the terms of S. 1946.

Mr. Peabody has explained in his statement why these suggestions are incorrect and the facts used to support them are misleading. I commend his expert analysis to the subcommittee.

If there is any doubt, however, as to the extremely high levels of rates which the railroads have been demanding for coal traffic, it should be dispelled by the large and growing numbers of coal rate litigations before the ICC in the last several years. Where there is smoke, there is fire, and I can assure the subcommittee, based solely on the experiences of my own company and the other members of the coal league that there is, in fact, a raging fire in the form of exorbitant rate demands for the rail transportation of coal and, in particular, coals from the huge new coal fields of the West.

The Interstate Commerce Commission has been approving in many of these rate litigations rates which we believe are unjustifiably high, primarily on the basis of the railroads' needs for im-

proved revenues. In doing so, the Commission has focused almost exclusively upon rates of return on net investment which, due to several factors peculiar to the railroad industry, cannot be relied upon as an accurate measure of the adequacy of carriers' revenues.

This and other problems with the Commission's ratemaking activities in the coal rate area are discussed in a report of the Subcommittee on Oversight and Investigation of the House Committee on Interstate and Foreign Commerce, released earlier this week, which we would commend to the subcommittee as a comprehensive and incisive analysis of the problems which exist in this area under the present law.

Recently, the Commission has ruled in its first comprehensive determination as to what level of return is required to permit the railroads to achieve revenue adequacy as defined in the 4R Act that returns on net investment of 7 to 10.6 percent are sufficient. This judgment, made in a comprehensive proceeding known as "Ex Parte No. 3563, Adequacy of Railroad Revenue—(1978) Determination," was arrived at considering a variety of important tools of financial analysis, including the cost of capital, funds flow analysis, and financial ratios such as fixed charge coverage ratios.

In its evaluation of the revenues of 36 individual class I railroads based on data for 1977, the Commission found that 13 of the 36 roads had adequate revenues to fulfill the goals described in the 4R Act. More recent data, such as that described by Mr. Peabody in his statement, indicate that today the number of rail firms which have achieved revenue adequacy is higher. It is of particular interest that the railroads with high percentages of coal traffic in their overall traffic mix are, in general, among the most profitable lines.

We do not suggest that there are not problem railroads. However, we do contest the image which the railroad industry conjures up before Congress that the entire industry is on its last legs. When the administration's bill, S. 796, was unveiled a year ago, it was described by some proponents as the railroad industry's last chance to achieve financial stability. Yet, without any change in the law, a significant number of railroads have announced record earnings.

We do not oppose the enactment of legislation to aid those members of the rail industry which truly need it. We believe, however, that whatever law is enacted should be designed to alleviate the problems of the financially troubled roads and not to afford an unintended and unnecessary windfall to carriers which are already enjoying adequate profits.

Most important, we believe that any legislation must protect coal shippers, the most numerous and most vulnerable of all captive shippers, from being forced to pay the full tab for whatever improvements to rail revenues are to be achieved.

Coal traffic should unquestionably pay rates which cover the full costs to the railroads of hauling the traffic and afford a reasonable return on the investment involved in providing the services which are entailed. It should not, however, nor should any other segment of captive traffic, be forced to pay unlimited premiums over and above such rate levels in order to make up for other traffic which the railroads claim cannot pay adequate rates.

If, as the railroads contend, it is necessary for coal traffic in some instances to pay rates higher than full costs and a reasonable return on involved investment, then the railroads should be required to demonstrate some concrete justification for imposing any such premiums. This, as we understand it, is the thrust of your amendment, Mr. Chairman. It would require the Commission to establish a level, expressed as a ratio of revenues to variable costs, which would constitute a presumptive cap on rates. Where a rate is challenged which exceeds the presumptive cap, the proponent carrier would be required to establish its reasonableness.

The coal league heartily endorses this concept. We are concerned, however, over some of the wording of the amendment as proposed in the Congressional Record of December 17, 1979.

The amendment appears to contemplate the establishment by the Commission of one ratio of revenue to variable cost which would serve as the presumptive cap for all rates on all commodities. The transportation characteristics of the myriad commodities moving by rail vary tremendously and, historically, the rate levels for different commodities, when expressed as a ratio of revenue to variable cost, have also varied over a broad range.

As a result, what might be an appropriate level for the presumptive cap on one major commodity group may well be inappropriate for another. For this reason, the Coal League would urge that the amendment permit the Commission, where appropriate, to establish separate presumptive cap levels for separate major commodity groups. This would not operate to the detriment of any type of commodity, but rather would merely permit recognition of the inherent and established differences between commodities where such recognition is shown to be appropriate.

Another major area which we think should be clarified in the amendment is the manner in which it would operate in conjunction with section 104 of S. 1946, the rate flexibility zone. Where a rate exceeds the presumptive cap level established under the amendment, it should be clear that it is subject to suspension and investigation regardless of the 4 percent rate flexibility zone.

In closing, Mr. Chairman, as major consumers of coal and rail transportation services for coal, we are heartened at the concern and interest being focused in these hearings upon the need to amend S. 1946 in order to afford adequate protection to captive coal shippers and ultimately the Nation's electricity consumers against exorbitant rail freight rates. We have recommended specific language to the subcommittee's staff to implement the specific points of clarification which we believe are essential in order for the proposed amendment to achieve this goal.

My associates and I would be pleased to respond to any questions concerning this statement or Mr. Peabody's statement, which was submitted in advance for your consideration.

Senator LONG. Thank you very much. Now do you have another statement that you want to present here?

Mr. McNEESE. This concludes our presentation.

Senator LONG. I will ask to print Mr. Peabody's discussion in the record.

I want to ask Mr. Peabody, just with regard to his background, it looks to me that just from reading over your study, Mr. Peabody,

you spent most of your lifetime since you graduated from college studying these rail rates that contribute, and so forth, to the coal industry.

Mr. PEABODY. Yes, sir. It goes back to my initial employment as a fuel economist in the Bureau of Coal Economics with the National Coal Association.

Senator LONG. When was that?

Mr. PEABODY. That was in 1950.

Senator LONG. That's about 30 years ago. So I take it that—incidentally, that's about 2 years after I came to the U.S. Senate. I've been around here for a while now.

But you have been studying this subject right about as long as I've been in the U.S. Senate. As I take it, off and on, you've been studying this thing, this type of thing ever since that time?

Mr. PEABODY. Yes, sir, very heavily involved both on behalf of shippers as well as the railroads.

Senator LONG. Have you been retained by the railroads on occasion to do some work for them?

Mr. PEABODY. Yes, sir. Some years ago, I participated on behalf of the railroads in establishing the then Cohasset rate from Montana on behalf of Minnesota Power & Light and Burlington Northern.

Senator LONG. So that at least is one point that railroads thought highly enough of your credentials to employ you to represent them, didn't they?

Mr. PEABODY. Yes, sir, and they still do.

Senator LONG. Well, good, I hope you don't lose any prospective business in the future because you came up here and gave us your opinions about this matter because I'm sort of like you, Mr. Peabody, having done business with the railroads on occasion, I hope by the time we get through this issue, we can all be friends again.

We all need one another to do business together.

But I think you've got a good statement here and I think it deserves careful analysis by those of us who serve on the committee.

Thank you very much, gentlemen, for your presentation.

[The statement follows:]

STATEMENT OF LEROY E. PEABODY, JR., ON BEHALF OF THE WESTERN COAL
TRAFFIC LEAGUE

Mr. Chairman and Members of the Subcommittee, my name is Leroy E. Peabody, Jr. I am President of L. E. Peabody & Associates, Inc., economic consultants. I appreciate the opportunity to appear before you to address the issues concerning the proposed amendment to Section 104 of S. 1946. I appear on behalf of the Western Coal Traffic League ("the Coal League"), a group of shippers and receivers of western coal. Members of the Coal League have no viable short-run alternative to the production of electric energy from sources which require a long-haul rail movement. Over the past five years, the railroads have used the captive nature of western coal traffic to accelerate rate levels and extract excessive profits.

As an economic consultant to the Coal League over the past four years, I have observed closely the evolving rail rate structure for the volume movement of western coal. I have appeared on behalf of Coal League members and other major shippers of western coal in negotiation and/or litigation concerning reasonable rail rate levels for this energy source.

I have been asked by the Coal League to present data relative to the proposed amendment to Section 104 of S. 1946 and the possible impact of other provisions of S. 1946 on coal. I will address these issues under the following topics: Railroad

Earnings; Railroads' Return from Western Coal Rates; Coal Rate Levels; Impact of Rail Rates on Delivered Price of Coal; and Proposed Standard.

RAILROAD EARNINGS

The railroad industry, through the Association of American Railroads (AAR), has presented a dismal picture of the financial condition of the nation's railroads. Reference is made to the less than one percent return on net investment in 1978 and the meager increase to less than 3 percent in 1979. Reference is also made to the claimed dismal return on equity in the railroad industry, i.e., the return on the stockholders' equity.

Before proceeding with my analysis of the financial condition of the nation's major coal-hauling railroads and particularly those in the west, I believe it appropriate to comment on the railroad industry's position concerning all railroads. There are problem railroads and these problems must be analyzed and resolved. But we should not make changes in the regulatory process for the entire industry based on the influence of a few (albeit major) railroads. The Commission recognized this in its recent decision in Ex Parte No. 353, *Adequacy of Railroad Revenue (1978 Determination)* served January 31, 1980:

"Revenue adequacy figures for the national composite are useful or convenient for certain purposes. The health of the Nation's railroads is frequently discussed in terms of total industry data. Many of the statistics provided on the present record are of this nature. Proceedings in which nationwide relief is sought, such as general rate increase proceedings, also rely heavily on national data.

"Nonetheless, total industry results may obscure significant differences among regions and individual carriers." (Emphasis added) (362 I.C.C. 198, 247).

There are 37 Class I line-haul railroads in the United States. There are at least 3 major systems beset with financial and other problems. The Conrail story is well known. Two other Western carriers, the Milwaukee and the Rock Island, are in bankruptcy. The balance of the industry, however, is enjoying relative prosperity. In the tabulation below, I have shown the return on net investment for the three major regions and for the United States total, excluding the three railroads identified above.

TABLE 1.—RETURN ON NET INVESTMENT FOR THE 12 MONTHS ENDING SEPT. 30, 1979

Geographical area	Net investment (millions)	Net railway operating income (millions)	Rate of return in percent
1. East ¹	\$5,449	\$361	6.6
2. South	6,088	348	5.7
3. West ²	14,369	756	5.3
4. United States	25,906	1,465	5.7

¹ Excludes Conrail.

² Excludes Milwaukee & Rock Island.

Source: Association of American Railroads, "Property Investment and Condensed Income Account, Class I Railroads in the United States, Calendar Year Ended December 31, 1978," and Interstate Commerce Commission, "Class I Line-Haul Railroads Selected Earnings Data", year ending Sept. 30, 1979.

The above rates of return do not present the poverty picture portrayed by the railroad industry. The results for the Western District include the Chicago & North Western which had a deficit of some \$23 million for the 12 months ending September 30, 1979. If this carrier is not denied access to the major source of western coal in the Powder River Basin, I believe that there will be a dramatic turnaround in the financial picture for this carrier.

The above results must be viewed in light of the Commission's decision in Ex Parte No. 353. Although it is frequently represented by the railroads that the Commission has determined that the railroads are entitled to 10.6 percent return on investment, this decision clearly shows that the Commission considered both the cost-of-capital and the return generated by funds flow. In reference to this subject, the Commission stated:

"The maximum level of revenue adequacy is shown by a rate of return on net investment equal to the cost of capital—10.6 percent at the present time. The minimum level of revenue adequacy depends on the ability to raise needed capital, as shown by financial ratios and funds flows." (362 I.C.C. 198, 204)

The Commission concluded:

"Upon examination of the results of our funds flow computations, we conclude that, for the national composite, a return on net investment of 7 percent would provide a sufficient flow of funds for the needed level of capital spending." (362 I.C.C. 198, 204)

I will now proceed with my examination of the financial condition of the nation's coal-hauling railroads.

Coal-hauling railroads

My analysis of the financial condition of the coal-hauling railroads is based on three major factors, the proportion of coal tons carried to total tons carried, the aggregate volume of tons carried, and the aggregate revenue from coal traffic. The rates of return are based on the financial results for the 12 months ending September 30, 1979, the latest available to me.

East.—Major eastern coal-hauling railroads based on the proportion of coal to total traffic (tons carried) are shown below. I have also shown the total volume as measured by aggregate tons and aggregate revenues. Finally, I have shown the rate of return on net investment.

TABLE 2.—COAL HAULING RAILROADS, EASTERN DISTRICT

Railroad	Percent coal tons carried ¹	Tons in millions		Revenue in millions		Rate of return ²
		Amount ²	Rank	Amount ²	Rank	
1. N. & W.	55	60.2	2	\$4,37.6	2	9.33
2. Chessie ⁴	50	81.6	1	444.6	1	5.08
3. E.J. & E.	39	7.6	5	23.3	5	19.22
4. B. & L.E.	35	8.4	4	45.0	4	12.82
5. P. & L.E.	34	6.2	6	13.4	6	6.27
6. Total 5 carriers						7.39

¹ Coal tons carried divided by total tons carried.

² Most carrier reports were available for the first three quarters of 1979. For those carriers filing annual reports the annual figure is adjusted to three quarters for comparability.

³ Net railway operating income divided by net investment in transportation property as of the end of the year, including an allowance for working capital.

⁴ Includes B. & O., C. & O., and Western Maryland.

The above 5 carriers accounted for 98 percent of the tons carried in the Eastern District (Eastern District excluding Conrail). The weighted average return on investment is 7.39 percent. The major carrier in terms of the proportion of coal tonnage to total tonnage, the N&W, earned a return on investment of 9.33 percent. Other rates of return ranged from 5.08 to 19.22 percent. Financial results for these carriers handling the coal traffic in the east do not demonstrate that coal rate levels are depressed or that the Eastern coal roads are in dire financial circumstances.

South.—Railroads in the South consist of 4 basic systems, the Family Lines which include the Seaboard Coast Line, the Clinchfield, and the Louisville & Nashville; the Southern Railway System; the Illinois Central Gulf Railroad; and the Florida East Coast. Tons of coal carried by the combined Family Lines amounted to 29 percent of total tons carried. The Family Lines carried 69.1 million tons for the first three quarters of 1979 (includes duplication of tonnage interchanged between Family Lines) and ranked No. 1 in terms of aggregate coal tons carried and coal revenues in the South. The rate of return on net investment for the 12 months ending September 30, 1979 was 6.45 percent.

Southern Railway System carriers ranked No. 2 in the proportion of coal to total tons carried, 27 percent. It also ranked No. 2 in terms of aggregate coal tons carried and coal revenue.

Its rate of return for the 12 months ending September 30, 1979, was 9.22 percent. These two carriers accounted for approximately 87 percent of the coal tonnage handled for the first 9 months of 1979. The Illinois Central Gulf handled the balance of the coal tonnage and showed a deficit net railway operating income for the 12 months ending September 30, 1979.

West.—The top 5 coal-hauling railroads in the West are shown in Table 3 below.

TABLE 3.—COAL HAULING RAILROADS, WESTERN DISTRICT

Railroad	Percent coal tons carried ¹	Tons in millions		Revenue in millions		Rate of return ³ in percent
		Amount ²	Rank	Amount ²	Rank	
1. D. & R.G.W.	56	14.3	4	\$67.9	5	9
2. B.N. family lines ⁴	44	76.7	1	708.6	1	3.46
3. U.P.	23	17.2	3	129.8	2	7.69
4. K.C.S.	21	5.2	9	16.3	10	6.39
5. Mopac.....	20	19.8	2	102.8	3	8.4
6. Total, 5 carriers.....						6.16

¹ Coal tons carried divided by total tons carried.

² Most carrier reports were available for the first three quarters of 1979. For those carriers filing annual reports the annual figure is adjusted to three quarters for comparability.

³ Net railway operating income divided by net investment in transportation property as of the end of the year, including an allowance for working capital.

⁴ Includes B.N., Colorado & Southern, and Fort Worth & Denver.

The five major western coal-hauling railroads accounted for approximately 76 percent of the coal tons carried and 84 percent of Western District carriers' coal revenue during the first 9 months of 1979. The most important carriers measured by the percent of coal to total traffic also were the most important carriers in terms of aggregate coal volume and coal revenue with the exception of the KCS. The weighted average rate of return on net investment was 6.16 percent.

Earnings of these major coal-hauling railroads must also be viewed in light of the Commission's Ex Parte No. 353 decision served January 31, 1980. In Appendix G to that decision, revenue adequacy for individual carriers was discussed. The Commission's conclusions concerning revenue adequacy for the coal-hauling railroads are summarized in Attachment No. 1.

Of the 18 Class I coal-hauling railroads in the three territories (East, South, and West), the Commission concluded that 11 carriers had revenue adequacy based on "underlying data . . . of evidence submitted by the railroads for the years 1975 through 1977." (362 I.C.C. 198, 294) Subsequent to 1977 and based on 1979 data included in the above discussion, the rate of return on net investment has increased. Thus, more current earnings may well place additional carriers in the adequate revenue level. Moreover, the Commission recognized the unusual position of the Burlington Northern, Inc. (BN). The Commission's conclusion refers to the BN's low rates of return and states that "the prospect of substantial future revenue gains from coal traffic cannot be overlooked." (362 I.C.C. 198, 303) In my opinion, BN Family Lines, from the standpoint of earnings from coal traffic, must be viewed as one entity as coal originating in the Powder River Basin of Montana and Wyoming is routed via BN, C&S, and FWD to southwestern destinations.

Return on equity

The railroad industry has also compared the return on equity for the railroad industry with other industrial groups. Reference is made to a 1978 return on equity of 1.3 percent. Again, this is an industry average which reflects the few problem carriers discussed above. In a recent Reply Statement in Ex Parte No. 374, *Increased Freight Rates and Charges, Western Railroads-2 Percent*, BN's Witness G. W. Brown shows the rate of return on stockholders' equity for Western District carriers. Table 4 below shows this rate of return for the major coal-hauling railroads of the west as identified above.

Table 4.—Rate of return on equity for the major coal-hauling railroads of the West

	Rate of Return ¹
D.&R.G.W.	12.47
BN family lines:	
B.N.	7.41
C.&S.	24.53
F.W.D.	30.50
U.P.	10.19
K.C.S.	11.53
Mopac	14.56

¹ On stockholders' equity in percent.

The above return reflects the stockholders' book value. The market value is substantially less and the rate of return would be correspondingly much higher.

This is in contrast to the electric utility industry where the book value is much closer to the market value as shown by Verified Statement No. 12 introduced by G. W. Brown in Ex Parte No. 374.

Alternatives to rate of return

The rate of return on the net investment in transportation property is but one of the measures considered by the Commission in Ex Parte 353. In the conclusions on the composite adequate revenue levels, the Commission stated:

"Having analyzed the designated elements of revenue adequacy, we are prepared to state a composite adequate revenue level in numerical terms.

"The first of the designated elements is a rate of return on net investment equal to the cost of capital. On the present record, we have found this return to be 10.6 percent.

"Financial ratios indicative of a sound financial condition comprise the second element. The record shows that carriers with a bond rating of A or better have an average rate of return on net investment of 5.51 percent. The 'top eight' carriers in our individual analyses have an average tax-adjusted return on net investment of 6.72 percent. The return on total capitalization necessary to maintain a fixed charge coverage of 3.5 with investment equal to 10 percent of net investment a year would grow from 7.42 percent to 8.18 percent over a 5-year period. We believe that this would be equivalent to a return on net investment of no more than 7 percent.

"We have also concluded that at the 10-percent investment level, a return on net investment of 7 percent a year would provide a sufficient flow of funds both to make new investment profitable and to provide required equity capital from retained earnings." (362 I.C.C. 198, 245)

On the following page the Commission concluded that:

"On the present record, we conclude that both requirements [needed capital and sound financial ratios] would be satisfied at the national composite level by a return on net investment of 7 percent."

The Commission also noted the betterment accounting used by the railroad industry. On commenting on this subject in dealing with the BN's revenue adequacy, the Commission stated:

"However, it is appropriate to note that BN's areas of weakness all are influenced by its high reported expense level. This in turn, reflects the impact of a recently accelerated track replacement program under a betterment accounting system. BN's reported track structure maintenance-of-way expenses climbed from \$54 million in 1971 to \$163 million in 1977. Had track replacement been recorded as capital investment rather than current expense, BN's reported expense level for the 1975-77 period would have been lower and somewhat less weakness would have been demonstrated by its financial indicators." (362 I.C.C. 198, 303)

Coal's contribution to the financial prosperity of the western carriers is substantial. This subject is discussed in the following section.

RAILROADS' RETURN FROM WESTERN COAL RATES

In a series of recent western coal decisions, the Commission has established the rail rate for transporting coal by increasing fully allocated costs calculated at the revenue need level by 7 percent. This results in a return higher than that found reasonable by the Commission's decision in Ex Parte No. 353 served January 31, 1980. The Commission referred to a maximum level equal to the cost of capital at 10.6 percent.¹ The minimum level based on funds flow and financial ratios was shown to be 7 percent. The Commission stated further that a return of 6.72 percent based on the stronger carriers "may be taken as one indication of the earnings level needed to maintain sound financial ratios." (362 I.C.C. 198, 204)

In addition, various sections of the proposed deregulation bill (S. 1946) would allow increases in rail rates which will further increase the rate of return on the railroads' net investment. The impact of the 7 percent additive and provisions of S. 1946 are discussed below.

7-percent additive

The methodology followed by the Commission in recent western coal cases has established rates based on fully allocated costs at the revenue need level plus a 7 percent additive. Rail Form A return was increased from the embedded debt level to the revenue need level based on the cost of capital found in Ex Parte 353. Variable

¹Subsequent findings in Ex Parte No. 363, *Adequacy of Railroad Revenues (1979 Determination)* served January 31, 1980, have revised the cost of capital to 13.5 percent on equity, 7.25 percent on debt and a composite of 11.0 percent.

expenses and return were further adjusted to include a pro rata share of constant expenses and return.

As total expenses have been met under the Commission's methodology, the 7 percent additive will accrue to the return component of the constructed rate. Further, as the procedures do not contemplate any further increase in the cost of debt capital, the increment from the 7 percent additive accrues directly to return on equity.

In order to more clearly explain the application of the 7 percent additive and other adjustments contemplated by S. 1946, Attachment Nos. 2 and 3 have been prepared. The purpose of Attachment No. 2 is to develop basic data from Rail Form A and to determine fully allocated costs at the revenue need level based on the Commission's procedures. Data from the Commission's territorial Rail Form A's for the calendar year 1975 were used in this analysis. While calendar year 1976 data were available, I am informed that the return portion of this publication may contain errors. Thus, I have used the 1975 data base.

The purpose of Attachment No. 3 is to show the impact of the 7 percent additive and certain provisions of S. 1946 on the return on the railroads' investment. Net investment in Line 1 is taken from Rail Form A for each territory as shown in Attachment No. 2. Total capital has been allocated between debt and equity based on the commission's findings in Ex Parte 353, i.e., 40 percent debt and 60 percent equity. The before-tax return at the revenue need level on Line 3 of Attachment No. 3 is based on the before-tax cost of capital of 17.2 percent as found by the Commission in Ex Parte 353.

Increased return from the 7 percent additive was determined by applying 7 percent to the fully allocated cost at the revenue need level as contemplated in the Commission's methodology. Resulting dollars are shown on Line 5 of Attachment No. 3. The amount of \$1.4 billion when added to the equity return contained in the fully allocated costs at the revenue need level results in the following before-tax return.

TABLE 5.—BEFORE-TAX RETURN

Capital component	Return in billions	Rate of return in percent
1. Debt	\$0.8	7
2. Equity	5.7	32.15
3. Composite	6.5	22.09

Source: Attachment No. 3, lines 6 and 7.

The impact of the 7 percent additive is to increase the before-tax rate of return on equity from 24.07 percent as determined in Ex Parte 353 to 32.15 percent. The composite before-tax rate of return is increased from 17.2 percent to 22.09 percent.

Following the Commission's procedures, the after-tax return is computed based on the statutory tax rate of 46 percent. Results are shown in Lines 8 and 9 of Attachment No. 3 and summarized below:

TABLE 6.—AFTER-TAX RETURN

Capital component	Return in billions	Rate of return in percent
1. Debt	\$0.8	7
2. Equity	3.1	17.36
3. Composite	3.9	13.22

The adjusted after-tax rate of return on equity of 17.36 percent may be compared with the after-tax rate of return on equity of 13 percent found by the Commission in Ex Parte 353. The composite after-tax rate of return for both debt and equity is 13.22 percent as compared to the rate of 10.6 percent found in Ex Parte 353.

The following section will deal with the impact of the proposed procedures under Section 104 of S. 1946.

S. 1946, section 104

Under Section 104 of S. 1946 the carriers would be permitted to increase the rate for transportation by 4 percent of the adjusted base rate each year. Total increases over a period of 5 years would not be allowed to exceed 12 percent of the adjusted base rate. The increased rate will result in increased return as the carriers' expenses are covered under the "rail cost adjustment increases" set forth in Section 103 of S. 1946.

Application of the 12 percent increase over and above cost increases would add an additional \$2.6 billion to the fully allocated revenue need level costs, L. 10 of Attachment No. 3. The before-tax return adjusted for this additive is shown in the summary below:

TABLE 7.—BEFORE-TAX RETURN

Capital component	Return in billions	Rate of return in percent ¹
1. Debt	\$0.8	7
2. Equity	8.3	² 46.98
3. Composite	9.1	30.99

¹ It should be noted that the rate of return is calculated on the 1975 net investment base (\$29.7 billion). Reference to "Yearbook of Railroad Facts" published by the Association of American Railroads, shows that the net investment in 1978 was \$29.2 billion. Investment for the Eastern District was lower while the Southern and Western Districts showed an increase in net investment. It should be further noted that in 1978 the net investment base was redefined in certain areas, e.g., computation of working capital.

² Assumes the debt rate of 7 percent is not increased. If the composite debt cost increases, the proportion of return applicable to equity would be reduced and consequently the rate of return on equity would be reduced.

Assuming the carriers applied the maximum increase permitted under Section 104 of S. 1946, the estimated before-tax rate of return on equity would rise to 46.98 percent (Table 7, Line 2, Col. (4)). The composite before-tax rate of return on net investment would rise to 30.99 percent. The after-tax return, assuming the statutory tax rate of 46 percent, is developed on Attachment No. 3, Lines 13 and 14. A recap is shown below:

TABLE 8.—AFTER-TAX RETURN

Capital component	Return in billions	Rate of return in percent ¹
1. Debt	\$0.8	7
2. Equity	4.5	² 25.37
3. Composite	5.3	18.02

¹ See footnote 1 to table 7.

² See footnote 2 to table 7.

As shown above, the rate of return on equity is almost double that considered by the Commission in Ex Parte 353 (25.37 percent vs. 13 percent). The composite rate of return would be 18.02 percent as compared to 10.6 percent in Ex Parte 353.

The impact of Section 103 of S. 1946, when compounded on Section 104, is discussed below.

S. 1946, section 103

Section 103 of S. 1946 permits the carriers to increase the base rate, the rate in effect on January 1, 1980, to cover increased costs "as often as practical, but in no event less often than quarterly. . . ." (Section 103, paragraph 3). The base rate in effect January 1, 1980 will be adjusted by application to the cost adjustment factor published by the Commission. The numerator of this ratio will be the latest published index of railroad costs. The denominator will be the same index for the fourth quarter of 1979. Under Section 103 of S. 1946 it is stated that the "index shall be compiled or verified by the Commission, with appropriate adjustments to reflect the quality and mix of material and labor." (Section 103, paragraph 3). No reference is made to capital costs and thus the return (profit) component of the rate, although excluded from the calculation of the index, will be subject to the same increase.

For purposes of measuring the potential increased return resulting from Section 103 of S. 1946, it is assumed that the inflation rate will be 8 percent per year for the next five years, a compounded increase of 46.9 percent. As the 46.9 percent increase is also applicable to the return component of the rate, it was applied to the adjusted before-tax return resulting from the permitted rate increases under Section 104—See Line 15 of Attachment No. 3. The resulting before-tax return and rates of return are shown below:

TABLE 9.—BEFORE-TAX RETURN

	Capital component	Return in billions	Rate of return ¹ in percent
1.	Debt	\$0.8	7
2.	Equity	12.6	² 71.20
3.	Composite	13.4	45.52

¹ See footnote 1 to table 7.

² See footnote 2 to table 7.

The after-tax return is shown below:

TABLE 10.—AFTER-TAX RETURN

	Capital component	Return in billions	Rate of return ¹ in percent
1.	Debt	\$0.8	7
2.	Equity	6.8	² 38.45
3.	Composite	7.6	25.87

¹ See footnote 1 to table 7.

² See footnote 2 to table 7.

Fully allocated costs at the revenue need level developed in Attachment No. 2 and used as a base to calculate return on investment did not consider return on fixed plant investment² included by the Commission in determining "strict" costs for western coal traffic. The following section deals with this subject.

Impact of S. 1946 on recently established coal rates

The "strict" costs referred to in the Staff Report³ have been employed by the Commission in recent western coal litigation. Using *Iowa*,⁴ for example, variable costs plus additives under the Commission's "strict" cost methodology were \$4.78 per ton (*Iowa*, Appendix C, L. 24(b)). The rate of \$7.25 per ton was determined by applying the 7 percent additive to the fully allocated costs at the revenue need level of \$6.78 per ton (*Iowa*, Appendix D, L. 25(b)). The ratio of the rate to variable costs is 1.52 ($\$7.25 \div \4.78). If the ratio were calculated on the basis of Section 102 of S. 1946, it would be much higher as the "strict" costs calculated by the Commission in *Iowa* include a return on an additional fixed plant investment at the revenue need level.

Obviously the fixed plant additive cannot be added to incremental investment as developed in Rail Form A for all commodities—it would result in more investment dollars than recorded by the railroad industry.⁵ Thus the return component of variable costs to be used in constructing the ratio of revenues to variable costs in

²The fixed plant investment includes return on the net investment in road property already included in Rail Form A. This issue has been discussed at length in a number of proceedings, but the Commission has continued to use this additive for coal traffic in calculating variable costs at the "strict" cost level.

³Report to the Senate Committee on Commerce, Science and Transportation on S. 1946, p. 19.

⁴Interstate Commerce Commission, I&S Docket No. 9199, *Unit Train Rates on Coal-Burlington Northern, Inc.* Includes No. 37021, *Annual Volume Rates on Coal-Rawhide Junction, WY, to Sergeant Bluff, Iowa*, No. 36944, *Iowa Power and Light Company v. Burlington Northern, Inc.*, and No. 37029, *Iowa Public Service Company v. Burlington Northern, Inc.*, and *Chicago and North Western Transportation Company*, decided July 13, 1979.

⁵This further demonstrates the Commission's double count of return on investment in road-way property in establishing recent western coal rates.

Section 102 of S. 1946 will include return on investment as calculated in Rail Form A but exclude return on fixed plant investment.

The ratio of the rate to variable cost in *Iowa* adjusted to exclude the fixed plant additive is shown below:

TABLE 11.—RATIO OF RATE TO VARIABLE COST ADJUSTED TO EXCLUDE RETURN ON FIXED PLANT INVESTMENT

Item	Source	Amount per ton
1. Rate per ton	<i>Iowa</i>	\$7.25
2. Variable costs plus additives	<i>Iowa</i> , app. C, L 24(b)	4.78
3. Fixed plant investment	<i>Iowa</i> , app. C, L 23	.75
4. Variable costs plus additives, excluding fixed plant investment	L2—L3	4.03
5. Ratio of rate to variable costs	L1 ÷ L4	1.80

The ratio of the rate of \$7.25 per ton to the variable costs, excluding the fixed plant additive, is 1.80. Thus, the carriers could set coal rates at levels higher than that for traffic generally and the ratio of revenues to variable costs (variable costs based on *Iowa* procedures) might not exceed the ratio developed under the procedures for Section 102 of S. 1946.

These procedures would also result in significantly higher rates or return on investment for coal traffic as demonstrated below:

TABLE 12.—RATE OF RETURN ON NET INVESTMENT FROM WESTERN COAL TRAFFIC BASED ON APPLICATION OF S. 1946, SECTION 102 PROCEDURES

(Dollars in thousands)

Item	Source	Capital structure		
		Debt	Equity	Total
1. Net investment	Attachment No. 3, L1	\$11,757,232	\$17,635,848	\$29,393,080
2. Variable costs	Attachment No. 2, L7			\$13,288,790
3. Ratio of revenue to variable costs for coal traffic	Above tabulation, L5			1.80
4. Revenue level-coal traffic ¹	L2 × L3			\$23,919,822
5. Revenue level-overall ²	Attachment No. 2, L17			\$20,362,546
6. Additional return	L4—L5 ³		\$3,557,276	3,557,276
7. Before-tax return included in L5	Attachment No. 3, L3	\$823,006	\$4,244,949	\$5,067,955
8. Before-tax return included in coal rates ..	L6 + L7	\$823,006	\$7,802,225	\$8,625,231
9. Before-tax rate of return	L8 ÷ L1	⁵ 7	⁵ 44.24	⁵ 29.34
10. After-tax return	L8 × .54 ⁴	\$823,006	\$4,213,202	\$5,036,208
11. After-tax rate of return	L10 ÷ L1	⁵ 7	⁵ 23.89	⁵ 17.13

¹ Fully allocated costs at revenue need level plus 7 percent additive.

² Fully allocated costs at revenue need level at before-tax rate of 17.2 percent.

³ Excess return would accrue to equity assuming no change in debt rate.

⁴ Debt costs are not affected by income taxes. Equity is adjusted for the statutory tax rate on 46 percent.

⁵ Percent.

Note.—Implicit in the above analysis is the Commission's overstatement of investment in fixed plant as used in determining "strict" costs. The return on the claimed fixed plant investment is included in the Commission's calculation of the rate and thus the additional return which would accrue to the carriers is properly calculated.

The above before-tax and after-tax rates of return are significantly higher than the rate of return developed under procedures for Section 102 of S. 1946. The additional additives from provisions of S. 1946 as shown on Attachment No. 3, Lines 10 through 19 would be compounded on the rates of return derived for coal traffic under the Commission's "strict" cost procedures followed in *Iowa*.

Western coal's contribution to the carriers' return and the overall earnings of the nation's major coal-hauling railroads are further supported by the analysis of coal rate levels which follows.

COAL RATE LEVELS

The railroad industry has historically referred to coal rates as "depressed." In recent general increased proceedings the railroad industry attempted to justify

higher increases on coal traffic by reference to the proportion of coal tons vis-a-vis proportion of coal revenues, i.e., the revenue per ton for coal is lower than that for other commodities. Similar comparisons have been based on ton-mile earnings. I would point out that gross revenues do not provide an appropriate measure of an individual commodity's contribution to rail earnings. Net revenues, after meeting operating expenses, provide the funds to meet return on equity and for capital improvements. Thus, the economies of handling coal traffic and the volume of traffic moved are important attributes to be considered. Before proceeding with these subjects, I will briefly touch on gross revenue comparisons.

Gross revenue comparisons

Ton-mile comparisons are not appropriate when comparing coal with all traffic. While the mileage factor adjusts for the variance in the length of haul, it does not recognize the heavier loading for coal traffic. Based on waybill statistics⁶ published by the U.S. Department of Transportation (DOT), the average loading for coal traffic, Standard Transportation Commodity Code (STCC) 11, was 86.9 tons per carload in 1978. This exceeded the average loading for all carload traffic of 62.8 tons by 38 percent.

In order to test the appropriate traffic unit for a comparison of earnings between coal, on the one hand, and all traffic, on the other hand, I applied unadjusted Western District territorial unit costs to the traffic characteristics for coal traffic in the United States.⁷ A summary of that analysis is shown in Table 13 below.

TABLE 13.—UNADJUSTED VARIABLE COSTS SEPARATED BETWEEN CAR AND TON FUNCTIONS

Function of	Variable costs per carload	Percent of total
1. Carload and car-mile	\$324.15	72
2. Ton and ton-mile	127.27	28
3. Total.....	451.42	100

As demonstrated above, the costs incurred by the railroads are primarily a function of the car (terminal) and the car-mile (line haul). Thus, revenue per car-mile which reflects both the average load and the length of haul is more appropriate to measure the earnings of coal traffic with other traffic. Revenue per car-mile based on 1978 waybill statistics is shown in Table 14 below.

TABLE 14.—REVENUE PER CAR-MILE

Item	Coal traffic STCC 11	All carload traffic	Percent coal of total (2) ÷ (3)
1. Coal	\$1.58	\$1.51	104

When the more appropriate traffic unit is used, it shows that revenue earnings from coal traffic exceed that for all traffic combined by 4 percent.

Economies of handling coal traffic

Coal generally moves evenly throughout the year, avoiding peaks and valleys which increase costs in terms of investment in both roadway and equipment. The volume of individual point-to-point movements is enormous and, in an industry characterized by substantial fixed plant, high density is important to the utilization of the facilities. This is particularly true in the west where almost all new coal traffic utilizes unit train service, i.e., trains of one commodity from one origin to one destination in a continuous cycle. This maximizes the utilization of both locomotives

⁶ U.S. Department of Transportation, Federal Railroad Administration, 1978 *Carload Waybill Statistics*, Statement TD-1, October 1979.

⁷ For purposes of this illustration, no operating adjustments were made to reflect the rail handling of coal traffic.

and cars. In a recent proceeding,⁸ a witness on behalf of the BN, a major western coal railroad, cited the surge in coal traffic handled by the BN. Unit train service increased 167 percent between 1973 and 1978, from 6 trains per day in 1973 to 16 trains per day in 1978. Density as measured by revenue ton-miles increased 309 percent from 12.9 billion revenue ton-miles in 1973 to 52.7 billion revenue ton-miles in 1978.

Unit train service with very minor exceptions eliminates terminal handlings between the origin and destination. Other operating characteristics of coal traffic are extremely favorable to the railroads, e.g., heavy loading per carload, relatively long hauls, minimum switching at origin and destination, and low loss and damage claims.

A further factor to be considered in the economies of the rail handling of coal is the fact that in many unit train operations the cars are furnished by the shipper. For some traffic the locomotives are also provided by the shipper. All members of the Coal League are providing or will provide shipper-furnished cars for their unit train service. Thus the railroad avoids capital and maintenance costs associated with the involved equipment. Capital risk is also avoided by the railroad.

It is evident from the above discussion that expenses incurred by the railroads for handling coal traffic are substantially lower than for traffic generally. This has been recognized by the Commission in numerous publications⁹ wherein adjustments made for the movement of coal reduce territorial or system average expenses substantially for application to coal traffic.

A further important consideration is the volume of traffic moved.

Impact of volume

While much emphasis is placed on the ratio of revenue to variable costs, aggregate dollars of contribution to meet the railroads' fixed costs and profits are determined by the volume of traffic handled multiplied by the contribution per unit of traffic. Movements with very high unit contribution (dollars and cents per ton) but which move in small volume, provide less contribution than traffic with a smaller unit contribution but higher volume. An illustration comparing coal traffic with metalworking machinery and equipment utilizing data published in the Commission's Contribution Study¹⁰ is shown below in Table 15.

TABLE 15.—IMPACT OF VOLUME ON AGGREGATE CONTRIBUTION

Item	Bituminous coal	Metalworking machinery and equipment
1. Ratio of revenue to variable costs.....	1.30	2.37
2. Contribution per ton	\$82	\$16.78
3. Tons (1-percent expanded)	301,533,300	132,700
4. Aggregate contribution to fixed cost and profits	\$246,948,000	\$2,227,000

Source: Interstate Commerce Commission, "Rail Revenue Contribution by Commodity and Territory for the Year 1972," Statement No. 153-72, April 1975.

Coal's ratio of revenues to variable costs is 1.30 and its contribution is \$0.82 per ton in comparison with Metalworking Machinery and Equipment's ratio of 2.37 and its contribution of \$16.78 per ton. However, coal's aggregate contribution to the railroads' fixed costs and profits is \$247 million, or over 100 times the contribution made by the low-volume commodity. The carriers must meet their fixed costs, interest on debt, and dividends from aggregate dollars, not from dollars per ton or from percentages and ratios. Thus, volume is a critical attribute to be considered in assessing the reasonableness of rates.

Another illustration of this point is shown by the ratio of rate to variable costs required to meet the carriers' fully allocated costs at the revenue need level. In Table 16 below, I have assumed the requirement of a rail line for two separate commodity movements, one a low-volume movement and the other a high-volume movement. It is also assumed that each commodity is the only traffic handled over

⁸ Interstate Commerce Commission, Docket No. 37135, *Increased Rates on Coal, BN, Montana to Superior, Wisconsin* and Docket No. 37135 (Sub-No. 1), *Increased Rates on Coal, BN, Montana to Cohasset, Minnesota*.

⁹ Interstate Commerce Commission, *Rail Revenue Contribution*, and Ex Parte No. 270 (Sub-No. 4), *Investigation of Railroad Freight Rate Structure—Coal*.

¹⁰ Interstate Commerce Commission, *Rail Revenue Contribution by Commodity and Territory for the Year 1972*, Statement No. 153-72, April, 1975.

the line and that this single commodity movement must meet the total cost of providing the service, including return on capital.

TABLE 16.—IMPACT OF VOLUME ON RATIO OF REVENUE TO VARIABLE COSTS REQUIRED TO RETURN FULL COSTS INCLUDING AN ADEQUATE RETURN ON THE INVESTMENT IN TRANSPORTATION PROPERTY

Item	Source	Low volume traffic	High volume traffic
1. Volume (tons)	Assumed	100,000	1,000,000
2. Average variable cost per ton	Assumed	\$1	\$1.00
3. Aggregate variable costs	(L1 × L2)	\$100,000	\$1,000,000
4. Constant costs unrelated to volume	Assumed	\$100,000	\$400,000
5. Constant costs per ton	(L4 ÷ L1)	\$1	\$4.00
6. Rate to meet full costs	(L2 + L5)	\$2	\$1.40
7. Ratio of rate to variable costs	(L6 ÷ L2)	2.00	1.40

The above illustration is not intended to show a relationship of a ratio of 2.00 for a low volume commodity vis-a-vis a ratio of 1.40 for a high volume commodity. Its sole purpose is to show that the aggregate contribution required to meet all costs may result in substantially different ratios. Thus, the simple use of a ratio is not appropriate for determining the value of a commodity to the railroads' earnings.

Another issue raised by the railroads is the impact of rail rates on the delivered price of coal. This is discussed below.

IMPACT OF RAIL RATES ON THE DELIVERED PRICE OF COAL

The Organization of Petroleum Exporting Countries (OPEC) oil embargo and the concomitant increase in oil and natural gas prices resulted in a substantial increase in the price of coal, f.o.b. mine between 1973 and 1974. This increase in coal prices, together with the nation's energy policy to rely more heavily on coal have had a significant upward impact on the electric utility industry's production costs. Subsequent to 1974, however, the purchase price of coal has not accelerated as rapidly, increasing 42 percent over the last five years. Coal prices f.o.b. mine are compared with rail rates over the 1974-78 period in Table 17 below:

TABLE 17.—COMPARISON OF TREND IN F.O.B. MINE PRICES WITH RAIL RATES, 1974-78

Year	Price per ton f.o.b. mine		Railroad freight charges	
	Per ton	Index 1974=100	Per ton	Index 1974=100
1974	\$15.75	100	\$4.71	100
1975	19.23	122	5.23	111
1976	19.43	123	5.86	124
1977	19.82	126	6.48	138
1978	^p 22.40	142	7.18	152

^p Preliminary.

Source: Department of Energy, "Energy Data Reports," Weekly Coal Report No. 81, Apr. 20, 1979.

As shown above, between 1974 and 1978, the f.o.b. mine price rose 42 percent while rail rates rose 52 percent. Thus, over this period of 5 years, there has been an increase in the rail rate component of the delivered price of coal.

Moreover, the substantial jump in coal prices between 1973 and 1974 did not affect a large portion of the rail coal originated in the west. Based on DOT's waybill statistics, 40.2 million tons were originated by rail in 1973. The figure rose to 47.8 million tons in 1974 and to 84 million tons in 1978. Thus, approximately one-half of the 1978 production came on line after the increase in coal prices which occurred because of the OPEC embargo between 1973 and 1974.

Further, data published by the Department of Energy for individual states show that the 1977 value f.o.b. mine was \$5.93 and \$8.21 per ton in the Powder River Basin states of Montana and Wyoming, respectively. My personal knowledge of rail rates for coal originating in the Powder River Basin would indicate that the rail rates in almost all cases constitute more than 50 percent of the delivered price.

Thus, further changes in rail rates will have a significant impact on the cost of Coal League members' sources of energy.

Having addressed the major issues raised by the railroad industry, I will now turn to the proposed standard (ratio) contemplated in the proposed amendment to Section 104 of S. 1946.

PROPOSED STANDARD

The proposed amendment to Section 104 of S. 1946 would impose a standard establishing a presumptive cap on rates and impose the burden of justifying higher rates on the railroads. This standard would be expressed as a ratio of revenues to variable costs.

Although not specifically addressed in the proposed amendment, I believe that the Commission will, to some extent, rely on historical data. Prior to 1962, the ratio of revenues to variable costs by major commodity groups was published annually by the Commission's Cost Section.¹¹ Ratios were also calculated for the major territorial movements. Subsequent to 1962, this document has been published periodically by the Commission. A separate contribution study was conducted by the Department of Transportation for the calendar year 1969.¹² The most recent Commission study covers the calendar year 1972.¹³ All traffic data are based on the DOT's waybill sample published annually. The traffic data from the waybill studies provide the minimal information required to apply territorial or individual carrier system average costs as calculated in Rail Form A. Attributes measured by the waybill sample include revenues and the count of carloads, tons, car-miles, and ton-miles. From this basic information, other attributes are calculations which include revenue, loading, and mileage (average haul) characteristics.

There is extreme variance in the ratios of revenues to variable costs as calculated in the contribution studies. Ratios ranging from lows of less than 1.0 (assumed noncompensatory traffic) to a high in excess of 5.0. In my opinion, this wide variance results from two major factors. First, the procedures used in determining the ratios do not reflect characteristics peculiar to individual commodities or to individual territorial movements.¹⁴

Based on my long experience in studying rail operations, I have found enormous variation in the handling characteristics of individual commodities. Even within a commodity group, there will be significant differences in handling characteristics. For example, the rail handling of unit train movements of coal is different than that for other coal movements. The ratios of revenues to variable costs for individual commodities are also affected by the segment of the traffic flow under consideration. For example, whole grains moving into milling or transit points generally have a much higher rate level than the outbound movement of products from the milling points. A separate ratio of revenues to variable costs is computed for each commodity movement.

A second major factor affecting the variance in the ratios of revenues to variable costs is the inexact procedures inherent in the costing methodology. The development of rail costs is an art, not an exact science. Present procedures do not accurately reflect the cost impact of seasonal movements, peak movements, and other characteristics which influence rail costs.

It is very possible that the wide range in the ratios of revenues to variable costs would be significantly narrowed if more detailed traffic and operating characteristics were available for all commodities in the various territories. For example, the Commission's Contribution Study shows a ratio of revenues to variable costs for a major commodity moving in the southeast to be substantially less than 1.0, i.e., noncompensatory. Based on detailed studies conducted with the railroads, which developed traffic and operating characteristics for this traffic flow, we found that revenue exceeded variable costs. Thus the failure to use rail handling characteristics peculiar to the specific commodity resulted in greater variance from the mean than actually existed. On the other hand, based on detailed studies of major grain flows, I have found that the use of system average costs overstate the ratio of revenue to variable costs.

If the Commission were to develop the ratio of revenues to variable costs for the presumptive cap called for in the proposed amendment based in part upon the historical ratios which I have described above, restricting it to the establishment of

¹¹ Interstate Commerce Commission, *Rail Revenue Contribution*, 1972

¹² Department of Transportation, Office of Policy Review, *An Estimation of the Distribution of the Rail Revenue Contribution by Commodity Groups and Type of Rail Car*, 1969.

¹³ A more recent study was developed for the Commission by A. T. Kearney, Inc., covering the waybill data for the calendar year 1977.

¹⁴ The more recent A. T. Kearney study makes additional adjustment based on data developed in Ex Parte No. 270, *Investigation of Railroad Freight Rate Structure*.

one ratio for application as a presumptive cap on all commodities would, in my opinion, fail to permit the Commission sufficient flexibility to recognize the nature of rail traffic flows and costing procedures. The determination of such a standard would be very complex and the Commission might find it appropriate to establish separate ratios for major individual commodities or groups of commodities.

EXCERPTS OF CONCLUSIONS FROM COMMISSION'S DECISION IN EX PARTE NO. 353,
APPENDIX G, REVENUE ANALYSES FOR INDIVIDUAL CARRIERS

EAST

N. & W.

The N&W has adequate revenue. Although it had a rather low capital spending level during the 3-year period, it is earning comparatively high rates of return and has a sound financial condition. On the basis of the present data, we see no reason to doubt its ability to make capital outlays at the level needed for good service.

B. & O.

The B&O does not have adequate revenue. While its recent capital spending level has been high, the carrier has been able to maintain only a marginally satisfactory financial condition, even with its very low dividend payout. We do not believe that B&O's present low rates of return provide the support needed for a continued strong capital investment program.

C. & O.

The revenue of the C&O is adequate. It has a relatively high capital spending level and is maintaining a sound financial condition. A mild depression in its rates of return appears to be due to temporary causes. We do note, however, that the C&O's future health will require a return to more peaceful labor conditions in the eastern coal industry.

WM

The revenue of the WM is adequate. Its returns on net investment are relatively good, and its financial condition is generally sound. While the carrier's recent investment level has been low, it appears to be sufficient for the carrier's existing configuration and position within the Chessie System.

E.J. & E.

The EJ&E has adequate revenue. With its comparatively high rates of return, it has been able to undertake an ambitious investment program while remaining in sound financial condition.

B. & L.E.

The revenue of the B&LE is adequate. With rates of return that are comparatively high for a railroad, it is able to carry on a very strong capital investment program while maintaining an exceptionally sound financial condition.

P. & L.E.

The revenue of the P&LE is adequate. Although its rates of return are somewhat low, the carrier's earnings are still sufficient to support a fairly high level of capital spending and to maintain a sound financial condition.

SOUTH

Clinchfield

The Clinchfield has adequate revenue. While its capital spending level was not high during the reported period, its operations are profitable and provide ample resources for capital investment.

L. & N.

The revenue of the L&N is inadequate. Although it is making substantial capital outlays, higher earnings appear needed to restore its financial ratios to more satisfactory levels.

SCL

SCL does not have adequate revenue. Its rates of return and capital outlays both have been relatively low. It appears to lack a sufficient flow of funds for a higher spending level.

SRS

The Southern is earning adequate revenue. With comparatively high rates of return and a substantial capital spending level, it is maintaining a healthy financial condition.

*WEST**D. & R. G.W.*

The Rio Grande has adequate revenue. While its rates of return are slightly below the top eight carrier averages, they are still high enough to make Rio Grande one of the top eight carriers. The level of capital spending was also somewhat below the top eight average, but Rio Grande indicates that it is now spending at higher levels. The carrier's financial condition is sound, and we believe that it reflects the ability to support a strong capital spending program.

BN

BN demonstrates weakness in its operating ratio, its rates of return, and its liquidity ratios (throw-off to debt and fixed charge coverage). With its low rates of return, BN appears to be able to maintain only a marginally satisfactory financial condition, even with a below average capital spending program. Judging strictly from this historical record, a conclusion of revenue inadequacy is warranted at the present time.

However, it is appropriate to note that BN's areas of weakness all are influenced by its high reported expense level. This in turn, reflects the impact of a recently accelerated track replacement program under a betterment accounting system. BN's reported track structure maintenance-of-way expenses climbed from \$54 million in 1971 to \$163 million in 1977. Had track replacement been recorded as capital investment rather than current expense, BN's reported expense level for the 1975-77 period would have been lower and somewhat less weakness would have been demonstrated by its financial indicators.

Even if the effect of betterment accounting could be discounted, it is not clear that BN's historical ratios would place it in the adequate category. However, the prospect of substantial future revenue gains from coal traffic cannot be overlooked. With these taken into account, it is likely that future assessments of BN's revenue adequacy will be more favorable.

C. & S.

The revenue of the C&S is inadequate. It has comparatively low rates of return and a somewhat low capital spending level. Its earnings do not appear to be providing sufficient internally generated capital or sufficient borrowing capacity to support a stronger capital spending program.

FWD

The revenue of the FWD is inadequate. Its rates of return and its investment level have been relatively low. Its flow of funds does not appear adequate to support a higher capital spending level on a continuing basis.

UP

The revenue of the UP is adequate. The carrier's comparatively high rates of return are allowing it to maintain a sound financial condition along with a substantial capital spending program. We do note, however, that care must be taken to avoid deterioration in UP's revenue levels, because of the need to control somewhat adverse trends in its working capital and capital structure, and also in view of its ambitious \$1.5 billion capital spending program for 1979-83.

KCS

The revenue of KCS and its controlled companies is inadequate. It exhibits low rates of return, a low capital spending level, marginal fixed charge coverage and a weak working capital position. A higher earnings level and more internally generated capital are needed in order to provide the proper support for capital investment.

MoPac

MoPac's revenue is adequate. With its comparatively high rates of return, it is making substantial capital outlays, and exhibiting a sufficient flow of funds to sustain this level of spending.

ATTACHMENT NO. 2.—RELATIONSHIP OF REVENUES BASED ON COSTS AT THE REVENUE NEED LEVEL TO VARIABLE COSTS UNDER RAIL FORM A, MAJOR TERRITORIES AND THE UNITED STATES, 1975
(Dollars in thousands)

Item	Source: rail form A computer locations	Region		Total United States
		Official	Western	
NET FREIGHT INVESTMENT				
1. Roadway	(1)	\$6,738,978	\$3,012,438	\$7,880,463
2. Equipment	(2)	\$3,313,092	\$2,466,058	\$5,982,056
3. Total	(11 + 12)	\$10,052,070	\$5,478,491	\$13,862,519
VARIABLE COSTS				
4. Operating expenses	(B2397)	\$4,370,891	\$1,920,287	\$5,774,385
5. Return-road	(B3095)	\$154,465	\$72,485	\$162,798
6. Return-equipment	(B3105)	\$215,351	\$187,420	\$430,708
7. Total	(14 + 15 + 16)	\$4,740,707	\$2,180,192	\$6,367,891
FULLY ALLOCATED COSTS				
8. Operating expenses	(B2364)	\$5,525,250	\$2,441,608	\$7,340,249
9. Return-road	(B3094)	\$303,254	\$144,597	\$323,099
10. Return-equipment	(16)	\$215,351	\$187,420	\$430,708
11. Total	(18 + 19 + 110)	\$6,043,855	\$2,773,625	\$8,094,056
EMBEDDED DEBT RATE				
12. Road (percent)	Form 2, 27, (A565)	4.5	4.8	4.1
13. Equipment (percent)	Form 2, 27, (A338)	6.5	7.6	7.2
FULLY ALLOCATED COSTS AT REVENUE NEED LEVEL				
14. Expenses	(18)	\$5,525,250	\$2,441,608	\$7,340,249
15. Return-road	(19 × 2)	\$1,159,037	\$518,091	\$1,355,400
16. Return-equipment	(110 × 2)	\$569,819	\$424,131	\$1,028,961
17. Total	(114 + 115 + 116)	\$7,254,106	\$3,383,830	\$9,724,610
				\$20,362,546

¹ Development of net freight investment follows:

[Dollars in thousands]

Item	Source: rail form A	Region		Total United States (6)
		Official	Southern Western	
ROAD				
1. Return on net investment-freight.....	Form 2,L46 col. (6) (82756)	\$303,254	\$144,597	\$323,099
2. Embedded debt rate.....	Form 2, 2 nd (A565)	.045	.048	.041
3. Net investment road.....	L1 - L2.....	\$6,738,978	\$3,012,438	\$7,880,463
				\$17,631,879
EQUIPMENT				
4. Cost of capital-freight.....	Form 2,L47 col. (6) (82759)	\$215,351	\$187,420	\$430,708
5. Embedded debt rate.....	Form 2, 2 nd (A338)	.065	.076	.072
6. Net investment equipment.....	L4 - L5.....	\$3,313,092	\$2,466,053	\$5,982,056
				\$11,761,201

² Ratios to develop return at revenue need level of 17.2 percent before taxes are:

Region	Embedded debt rate in percent		Ratio of 17.2 percent to embedded rate for:	
	Road	Equipment	Road	Equipment
Off.....	4.5	6.5	3.822	2.646
Sou.....	4.8	7.6	3.583	2.263
West.....	4.1	7.2	4.195	2.389

Senator LONG. Next we will hear a panel representing public utilities and rural electric cooperatives: Mr. C. Michael Loftus; Mr. Robert A. Hewlett, Mr. Dennis Wright.

STATEMENTS OF C. MICHAEL LOFTUS, COUNSEL, REPRESENTING THE CITY OF SAN ANTONIO, TEX., ON BEHALF OF THE AMERICAN PUBLIC POWER ASSOCIATION; ROBERT A. HEWLETT, MANAGER, LEGAL AND ADMINISTRATIVE SERVICES, ARIZONA ELECTRIC COOPERATIVE, INC., ON BEHALF OF THE NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION; AND R. DENNIS WRIGHT, REPRESENTING THE NEBRASKA PUBLIC POWER DISTRICT, COLUMBIA, NEBR.

Senator LONG. All right, gentlemen. We'll be very pleased to hear your statement.

Mr. HEWLETT. Mr. Chairman, my name is Robert A. Hewlett. I am manager of legal and administrative services for Arizona Electric Power Cooperative of Benson Arizona.

It is my pleasure to appear today before the subcommittee on behalf of the National Rural Electric Cooperative Association. The NRECA is a national service organization whose membership consists of approximately 1,000 separate rural electric cooperatives.

My basic qualification for appearing on behalf of the NRECA is the experiences of Arizona Electric in dealing with the coal and the railroads. Despite the fact that our coal transportation needs and requirements are essentially identical to those of most other major coal consumers in the West, we have the unfortunate distinction of paying the highest railroad prices in the West for unit train service.

By way of illustration, I presented a short table in my written testimony which illustrates those problems. For example, as of November 1979, AEPCO paid 20.4 mills per ton mile while the next highest rate is that of Houston, at 11.99 mills per ton mile.

AEPCO is paying nearly twice as much for unit train coal service as are other similarly situated Western coal users.

Our misfortunes at the hands of the ICC are, we believe, due in large part to the fact that our rate is established as so-called capital incentive rate under new provision added to the law by the 4R Act. Both S. 796 and S. 1946 wisely provides for the repeal of the capital incentive rate provision, which has been sorely abused by the carriers.

However, in its present form, S. 1946 would not permit the reopening of AEPCO's case. Senator Tower has proposed an amendment to S. 1946 which would afford such a reopening.

And we take this opportunity to urge the members of the subcommittee to support that amendment.

Even though AEPCO is subject to a capital incentive rate, the chairman's proposed amendment is of great importance to us, as it is to other members of NRECA and captive shippers in general.

S. 1946 and its predecessor, S. 796, are apparently prompted by the notion that America's privately owned railroads are on the brink of financial extinction. However, the railroads serving us, the Sante Fe and Southern Pacific, are prosperous concerns.

I have appended to my written testimony a copy of the analysis of these concerns which indicates that they are viable, healthy, and

able to raise capital and provide high quality transportation services.

In its present form, S. 1946 has not in any way targeted the increased rate freedoms which it offers so that the primary benefit accrues to the railroads which need it most.

As a result, the bill's new rate provisions would, to a large extent, simply enhance the earnings of already healthy lines at the expense of captive shippers.

Another major defect in S. 1946, as we see it, is that it fails to provide any standards which would limit the contribution that the railroads are permitted to extract from captive shippers on the basis of so-called differential prices.

Accordingly, we are most appreciative of the attention which the Chairman has focused on this problem and the efforts he has undertaken to formulate an amendment addressing the problem in a manner which will afford captive shippers some protection from exploitation while not unduly hampering the railroad's legitimate needs for rate flexibility.

At the same time, however, we believe the terms of the amendment should be modified in a number of respects. The length of time afforded in the proposed amendment for establishment by the Commission of presumptive cap is, in our opinion, too long.

We would recommend that the length of time permitted to the Commission be reduced from 1 year to 6 months.

Similarly, the period allowed for congressional review of the Commission's action might be reduced from 120 to 90 days.

The amendment should also be modified to provide that separate ratios or presumptive caps may be established by the ICC for separate commodities or categories of commodities.

Given the many commodities which move by rail and the tremendous variety in their transportation characteristics, we believe it may be impossible for the Commission to establish one ratio which could serve as an appropriate presumptive cap for all commodities.

We do not suggest that the Commission be required to establish separate caps for different commodities, but only that it be permitted to do so should it find it be appropriate.

Restricting the Commission to one ratio for all commodities may frustrate the amendment's purpose of affording meaningful protection for all captive shippers.

In its present form, the amendment is not clear as to the effect it would have upon a rate proposal which falls within the rate flexibility zone of section 104 of the bill.

We believe that any challenged rate which exceeds the presumptive cap of maximum reasonableness established under the amendment should be subject to suspension and investigation.

Mr. Chairman, I would like to reiterate that we are grateful for the concern which you have demonstrated for captive coal shippers and the true parties in interest, the Nation's electric ratepayers.

Until you announced your intention to introduce an amendment to establish a presumptive cap on coal rates, we feared that our comments and those of many other coal shippers or shipper groups about the deficiencies in S. 1946 affecting coal rates would go unheeded.

With the modifications which we have recommended, we believe the amendment you propose will offer sorely needed protection to captive shippers and hopefully bring some calm into the troubled coal rate area.

Senator LONG. Thank you very much.

[The statement follows:]

STATEMENT OF ROBERT A. HEWLETT ON BEHALF OF THE NATIONAL RURAL
ELECTRIC COOPERATIVE ASSOCIATION

My name is Robert A. Hewlett and my business address is P.O. Box 670, Benson, Arizona 85602. I am Manager of Legal and Administrative Services for Arizona Electric Power Cooperative, Inc. of Benson, Arizona. It is my pleasure to appear today before the Subcommittee on behalf of the National Rural Electric Cooperative Association (N.R.E.C.A.). The N.R.E.C.A. is a national service organization whose membership consists of approximately 1,000 separate rural electric cooperatives. These member systems supply electricity to over 25 million people in 46 states. N.R.E.C.A. maintains its headquarters in Washington, D.C. at 1800 Massachusetts Avenue, N.W.

Rural electric cooperatives are deeply concerned about the proposed changes in rail transportation regulation contained in S. 1946. Currently, the rural electrics generate about one-third of their own wholesale electricity requirements: 80 percent of this is derived from coal-fired capacity. Based on REA forecasts, we estimate that by the year 2000, rural electrics will be generating one-half of their own needs. Thus, in the years ahead coal, which already plays an important role, will become a critical factor in meeting the electrification needs of rural America.

THE ARIZONA ELECTRIC SITUATION

Let me begin by stating my own conviction that there are major problems with the way in which the Interstate Commerce Commission is administering the Interstate Commerce Commission Act in connection with railroad rates on bituminous coal. To all appearances, the situation is deteriorating rather than improving and for that reason, it is gratifying to see that the Subcommittee is making this thorough investigation into the problem.

My basic qualification for appearing on behalf of N.R.E.C.A. is my familiarity with the unsatisfactory and unhappy experiences of Arizona Electric Power Cooperative, Inc. (AEPPO) in dealing with the coal hauling railroads as part of our program to convert from oil and gas to bituminous coal. Despite the fact that our coal transportation needs and requirements are essentially identical to those of most other major coal consumers in the west, we have the unfortunate distinction of paying the highest railroad prices in the west for unit train service. I am sure that the Subcommittee is familiar with some of the more publicized coal rate controversies for movements such as the ones to Houston and San Antonio. Let me say that we would welcome coal transportation service at the prices that have caused such an uproar in these communities. By way of illustration, I have prepared a short table which illustrates how badly we have fared at the hands of the I.C.C. in comparison to others who contend with equal vigor that they too have been prejudiced by that agency's unreasoned approach to coal ratemaking.

Comparison of the level of AEPPO's rail rate to levels applying to other selected destinations

[Rate—November 1979]

Destination:	Mills per ton-mile ¹
Arizona Electric.....	20.40
San Antonio.....	11.58
Houston.....	11.99
Kansas City.....	11.65
Arkansas (White Bluff).....	11.88
Oklahoma (Oolagah).....	10.18

¹ Rail rates for moves of differing distances customarily are converted to mills earned by the railroads per ton-mile of transportation for purposes of comparability.

As this table shows, AEPPO is paying nearly twice as much for unit train coal service as are other similarly situated western coal users. To me this underscores

the fact that the actions of the I.C.C. not only discriminate unfairly against coal, but also discriminate amongst various consumers of coal transportation.

Our misfortunes at the hands of the I.C.C. are, we believe, due in large part to the fact that our rate was established as a so-called capital incentive rate under a new provision added to the law by the *4-R Act*. Were it not for the that fact, we could obtain a reduction in our rate as it clearly exceeds the maximum rates currently being prescribed by the I.C.C. pursuant to its seven percent solution. As a capital incentive rate, our rate is immune from I.C.C. action for 5 years.

Both S. 796 and S. 1946 wisely provide for the repeal of the capital incentive rate provision which has been sorely abused by the carriers. However, in its present form, S. 1946 would not permit a reopening of AEPCO's case or those of the other few coal shippers which have been burdened with capital incentive rates. Were it not for that fact, we could obtain a reduction in our rate as it clearly exceeds the maximum rates currently being prescribed by the I.C.C. pursuant to its seven percent solution. As a capital incentive rate, our rate is immune from I.C.C. action for five years. Senator Tower has proposed an amendment to S. 1946 which would afford such a reopening, and we take this opportunity to urge the members of the Subcommittee to support that amendment.

Even though AEPCO is subject to a capital incentive rate, the Chairman's proposed amendment is of great importance to it, as it is to the other members of N.R.E.C.A. and captive shippers in general. Before turning to the Chairman's proposed Amendment to S. 1946, however, I would like to offer some observations on S. 1946 itself and in particular what I conceive to be a widely held misimpression on the financial health of the nation's railroads.

RAILROADS AS FINANCIAL CHAMELEONS

S. 1946 and its predecessor S. 796 are apparently prompted by the notion that America's privately-owned railroads are on the brink of financial extinction. I am sure the Subcommittee is all too familiar with the railroad industry's oft-cited industry aggregate rate of return figures. These industry wide averages are deceiving, however, as a measure of the financial health of many individual railroads which are, in fact, prosperous concerns. The railroads serving our facility, Sante Fe and Southern Pacific, are good examples. I have appended to my testimony a copy of a recent analysis of these concerns which indicates that they are viable, healthy entities able to raise capital and provide high quality transportation services.

If many of the nation's railroads are, in fact, financially healthy concerns, rather than the orphans of American industry as some would seek to portray them, we are dealing with a situation very different from the one upon which S. 1946 proceeds. While it cannot be denied that the Milwaukee Road, the rock Island and others are very sick railroads, it is not at all apparent that the same is the case of most of the other major rail systems.

In its present form, S. 1946 does not in any way target the increased rate freedoms which it offers so that the primary benefit accrues to the railroads which need it most. As a result, the bill's new rate provisions would to a large extent simply enhance the earnings of already healthy lines at the expense of captive shippers. This is particularly true with respect to captive coal traffic as the coal-hauling roads are, for the most part, financially solid firms.

Another major defect in S. 1946, as we see it, is that it fails to provide any standards which would limit the contribution the railroads are permitted to extract from captive shippers on the basis of so-called differential pricing. In its comments on S. 1946 submitted to this Subcommittee in November of last year, NRECA urged that: "[a]n established ceiling should be set on the captive shipper (coal) contribution to the subsidization of more competitive commodities and routes if such a subsidy is required by the rail carrier. In our opinion, the consumers of rural electric systems . . . and electric consumers generally, should not be required to subsidize more competitive rail transportation routes and commodities without limit and without good faith efforts on the part of rail management to explore alternate avenues of improvement. Further, this subsidy charge should be borne equally by the consumers of all captive shippers not just electric consumers."

The proposed amendment

We believe that the amendment proposed by the Chairman is responsive to our major concerns with S. 1946. Indeed, we are most appreciative of the attention which the Chairman has focused on this problem of such importance to the nation's electric consumers and the efforts he has undertaken to formulate a provision addressing the problem in a manner which will afford captive shippers some protection from exploitation while not unduly hampering the railroads' legitimate needs

for rate flexibility. At the same time, however, we believe that the terms of the amendment should be modified in a number of respects.

The length of time afforded in the proposed amendment for the establishment by the Commission of the presumptive cap is in our opinion excessive. Although the issues to be considered by the Commission in the proceeding might be complex, a year is too long a time to operate under the terms of S. 1946 before bringing the presumptive cap into play. We would recommend that the length of time permitted to the Commission be reduced to six months. Similarly, the period allowed for Congressional review of the Commission's action might be reduced from 120 to 90 days.

The amendment should also be modified to provide that separate ratios or presumptive caps may be established by the I.C.C. for separate commodities or categories of commodities. Given the many commodities which move by rail and the tremendous variety in their transportation characteristics, we believe it may be impossible for the Commission to establish one ratio which could serve as an appropriate presumptive cap for all commodities. We do not suggest that the Commission be required to establish separate caps for different commodities, but only that it be permitted to do so should it find it be appropriate. Restricting the commission to one ratio for all commodities may frustrate the amendment's purpose of affording meaningful protection for all captive shippers.

In its present form, as printed in the Congressional Record of December 17, 1980, the amendment is not clear as to the effect it would have upon a rate proposal which falls within the rate flexibility zone of Section 104 of the bill. We believe that any challenged rate which exceeds the presumptive cap of maximum reasonableness established under the amendment should be subject to suspension and investigation notwithstanding the provisions of section 107-1(g)(3) which would be added by Section 104 of the bill.

Mr. Chairman, I would like to reiterate that we are grateful for the concern which you have demonstrated for captive coal shippers and the true parties in interest, the nation's electric ratepayers. Until you announced your intention to introduce an amendment to established a presumptive cap on coal rates, we feared that our comments and those of many other coal shippers or shipper groups about the deficiencies in S. 1946 affecting coal rates would go unheeded. With the modifications which we have recommended, we believe the amendment you propose will offer sorely needed protection to captive shippers and hopefully bring some calm into the troubled coal rate area.

[ATTACHMENT]

BEFORE THE INTERSTATE COMMERCE COMMISSION

Docket No. 37226

Incentive Rate on Coal Axial, Colo. to Coletto Creek, Tex.

Verified Statement of Myron J. Gordon on behalf of Central Power & Light

I. INTRODUCTION

The Railroad Revitalization and Regulatory Reform Act of 1976 (the 4-R Act) charged the Commission with the development and implementation of standards and procedures for the establishment of revenue levels that: (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 considered the criteria which should be taken into account in making determinations as to revenue adequacy in *Ex Parte No. 338, Standards For The Establishment Of Adequate Railroad Revenue Levels*. In its regulations promulgated at the conclusion of that proceeding, the Commission enumerated the relevant criteria as follows:

"STANDARDS

"(1) The revenue adequacy of the Nation's railroads on a composite level shall be judged in accordance with the criteria of section 15(a) (4) and upon consideration of all pertinent financial indicators, including a rate of return on net investment equal to the cost of capital, other financial ratios, and the flow of funds.

"(2) The revenue adequacy of an individual carrier shall be determined in accordance with the criteria of section 15(a)(4), upon consideration of all pertinent financial

indicators and other evidence as to ability to make needed investment. (Italics supplied.)

* * * * *

The above passages from the 4-R Act and from the regulations promulgated in Ex Parte No. 338 indicate quite clearly that the purpose to be served by revenue adequacy is investment in needed rail property, and that a number of indicators are to be employed in reaching a conclusion on revenue adequacy. Nonetheless, it seems that the Commission's decisions in recent coal cases affix upon the rate of return on book value as the sole measure of revenue adequacy and have arrived at rates substantially in excess of the full cost of carrying coal traffic.

The primary purpose of my statement is to examine the relevant financial indicators for the Southern Pacific, Sante Fe, and Rio Grande Corporations in order to establish the role that their revenue requirements should play in the coal rate case under consideration here.

Hence, the questions at issue are: Is a tariff in excess of cost needed to finance and motivate the investment required to carry the traffic? Would such a tariff stimulate additional investment by providing funds that would not otherwise be available to finance additional investment or by providing a profitability motive for additional investment?

A second purpose of my testimony is to establish what the cost of capital on investment in coal traffic is for the three corporations.

Section II of this statement presents the basis for my understanding that certain of the procedures employed by railroads in previous cases result in a tariff far in excess of cost for coal traffic. Sections III to VI deal with the availability of funds to finance investment for the three corporations. The two major sources of funds for a corporation are debt and equity—more precisely, the debt associated with a rise in the debt ratio, and the debt and equity associated with equity funds under a given ratio. Section III looks at the bond ratings of the three corporations in order to establish their ability to raise their debt ratios. Section IV investigates the same question through the underlying determinants of debt capacity—capital structure and interest coverage ratio. Section V investigates the debt capacity dynamics of these three corporations by comparing their rates of growth in net property, debt, and equity over the last five years.

On the assumption that the capital structures of these three corporations are fixed and that investment is tied to equity funds, Section VI examines whether retained earnings and the sale of stock place a constraint on the funds available for investment. Section VII considers whether a rate of return on coal traffic in excess of cost can be expected to motivate investment in rail property beyond the investment required to carry the traffic. Section VIII establishes the cost of capital for new investment in coal traffic, and an appendix describes my background and qualifications.

The conclusions from the analysis which follows are summarized below. A tariff equal to the full cost of carrying the coal traffic provides a return in excess of the cost of capital on the incremental investment, and it is quite adequate to insure that the investment required to carry the traffic will be carried out. A higher tariff is in no way required to finance additional investment, and it will in no way motivate such investment. It is also not required to finance—and will not motivate—other investment. Turning back to the passage from the 4-R Act quoted above, part (a) is concerned with the financing of investment. On that question, it is shown below that existing revenue levels for the three railroads under consideration provide a flow of net income plus depreciation adequate to support much higher levels of capital outlays, assure the repayment of much higher levels of debt, permit the raising of additional equity capital, and cover the effects of inflation.

My response to part (b) must be qualified, since it is beyond my competence to determine whether these three railroads are or are not at the present time satisfactory components of a sound transportation system in the United States. If these three railroads at present fill the above role in the United States transportation system, existing revenue levels are adequate to “insure retention and attraction of capital”—that is, to motivate the investment required to keep them in the present state. If further investment in rail property to carry coal traffic is required to realize this goal, existing revenue levels are adequate. If further investment in rail property to carry traffic other than coal is required, existing revenue levels may not be adequate to motivate the retention and attraction of capital needed for rail investment. However, higher revenue levels on coal traffic will not provide the motivation.

My testimony reaches these conclusions only for the three railroads under consideration. It is quite possible that higher revenue levels are required to finance and

motivate investment in rail property for other railroads, such as the Chicago North-western and the Milwaukee Road.

II. PROFITABILITY OF WESTERN COAL TRAFFIC

It is my understanding that the following practices have been employed in certain previous cases in arriving at a tariff for coal traffic. First, in arriving at the investment in the traffic, all investment that is required to carry the traffic is charged to the traffic. This is correct for rolling stock, if the rolling stock is employed exclusively in carrying the traffic. However, the same practice is followed for fixed investment attributed to the traffic. Insofar as this investment reduces the cost of carrying other traffic, the investment in coal traffic is thereby overstated.

Secondly, the Commission has been accepting in recent coal rate cases what is in effect a double counting of the investment which will be required to move new traffic. The amount of fixed plant which will be occasioned by a given movement has been measured through the averaging methodology in Rail Form A and through a direct methodology specific to the traffic, with the resultant figures being added together. I understand that this subject is to be addressed in some detail by the Central Power and Light Company's Witness Snively.

Given the investment assigned to coal traffic, the computed cost per ton of coal depends on the cost of capital used in the computation. The determination of the cost of capital for carrying coal in Section VIII below will establish that the cost rates customarily recommended by the railroads are excessive.

Finally, after the full cost of carrying coal is determined, by methods that include the practices cited above, the cost is raised by 7% to arrive at the tariff. Persuasive evidence of the inordinately high levels of the resultant tariffs is provided by the security markets and security analysts. Share prices for corporations that are closely identified with the western coal traffic, such as Rio Grande and Burlington Northern, have risen dramatically in the last year. Furthermore, security analysts continue to list such corporations as strong-buy recommendations.¹ Clearly, for this traffic to have such an impact on current and forecast profits, it must be believed that the traffic will be exceptionally profitable.

III. DEBT CAPACITY AND BOND RATINGS

An important source of funds for corporations is debt. A corporation with a level of debt below its debt capacity has no problem financing additional investment since the gap between its debt capacity and its debt level is a readily available source of funds. At the other extreme, a corporation with a debt capacity that has fallen below its debt level, typically due to adverse fortunes, finds it difficult to refinance outstanding debt as it falls due, and the corporation is unable to debt finance additional investment through the ordinary recourse to capital markets.

Between the above opposite situations there are corporations with debt level and debt capacity about equal. Such corporations are able to issue additional debt to finance investment only as their equity base is increased via retained earnings or the sale of stock. Hence, the ability of such corporations to finance investment depends on the size of their retained earnings and on their ability to issue stock.

The simplest measure of a corporation's ability to raise additional debt capital is the quality rating on its outstanding debt. A corporation with a rating of Baa on its outstanding debt would find it extremely difficult to go to the capital markets on a scale that would raise its debt ratio. A lower rating implies difficulty in refinancing existing debt through normal channels. On the other hand, ratings of A, Aa, and Aaa represent situations in which a corporation can increase its debt ratio—the higher the rating, the higher the possible increase.

According to "Moody's Transportation Manual, 1978," all of Southern Pacific's equipment trust certificates were rated Aa early in 1978. All of the corporation's outstanding bonds but one were rated A. The Baa rated bond had the lower rating only because it was not secured by a mortgage, and the low yield at which that bond is selling makes clear that the market looks on the bond as being comparable in quality to Southern Pacific's other bonds.

All but one of the Santa Fe equipment trust certificates has an Aaa rating early in 1978. The corporation's two outstanding bonds had an Aa and an A rating, respectively. The difference in their rating is due to the difference in their liens, a technicality of no real current significance, as will be explained shortly.

¹ For examples, see the April 25, 1979 report on Burlington Northern by Morgan Stanley; the March 28, 1979 report on Burlington Northern by Goldman Sachs; the July 20, 1979 report on Rio Grande by L. F. Rothschild, Unterberg, Towbin; and the reports on both corporations in the May 25, 1979 *Value Line Investment Survey*.

The Rio Grande equipment trust certificates all had an Aa rating early in 1978, and two of its outstanding bonds had an Aa rating. The third bond had an A rating, but it is a mark of the corporation's financial strength that an income bond, which is what this third bond is, should have such a high rating.

As stated above, the lower rated bonds for these corporations are so rated due to their restrictive features. These bonds could all be called and reissued without these restrictive features, and the newly issued bonds would carry higher ratings. These bonds are not called in order to keep the advantage of their low coupon interest rates.

It is clear from the above ratings that all three of the corporations face no problem whatsoever in financing the purchase of additional rolling stock by means of equipment trust certificates. The ability of these corporations, the Santa Fe and Rio Grande in particular, to finance the cost of fixed investments by means of additional debt are good to excellent. In this connection it should be added that changes in bond ratings lag behind in some measure the changes in a corporation's financial circumstances, and that all the above ratings were in effect during the early part of 1978. The major determinants of bond ratings are debt ratios and earnings before interest and taxes. The former have not changed materially over the past few years, while earnings have increased materially and are expected to increase even more dramatically in the future.

The obvious conclusion which follows from the above bond-rating data is that all three of the above corporations have excess-debt capacity, with Santa Fe and Rio Grande having substantial excess-debt capacity. Without doubt, Santa Fe and Rio Grande are able at present levels of profitability to raise their debt ratios substantially. The present relation between debt level and debt capacity allows them to finance a substantial increase in investment through this source.

IV. CAPITAL STRUCTURE AND INTEREST COVERAGE STATISTICS

As indicated above, the financial statistic of the Southern Pacific, Santa Fe, and Rio Grande corporations reveal an even stronger financial position than their bond ratings indicate.

Exhibit I presents the capital structures of the three corporations as of December 31, 1978, the date of their latest annual reports. Long-term debt, including the current position thereof, represents only 31.3 percent of the long-term capital of Southern Pacific. The corresponding statistics for the other corporations are 24.7 percent for the Santa Fe and 33.0 percent for the Rio Grande. Debt ratios are typically much higher in the electric power, telecommunication, airline, and other regulated industries. In the electric power industry debt ratios of about 45 percent excluding preferred stock are typical, and with preferred stock most electric power companies have debt ratios well above 50 percent. Many manufacturing companies would be delighted to have the debt ratios in Exhibit I.

A more important statistic than the debt ratio is a corporation's interest coverage rate (ICR), which is its earnings before interest on taxes divided by the interest on its long term debt. A railroad with a low debt ratio may still have no excess-debt capacity if its earnings leave it with an unsatisfactory ICR. Earnings and debt capacity are closely related through the ICR.

However, none of our three corporations have unsatisfactory interest coverage ratios. The Value Line Investment Survey (Edition 8, May 25, 1979) reported that their long-term interest coverage ratios, based on 1978 data, were:

Corporation:	ICR
Southern Pacific	2.9
Santa Fe	5.7
Rio Grande	6.1

All three corporations are forecast to have substantially higher earnings in 1979 than in 1978, and the five-year prospects for earnings growth are even more favorable. Hence, these statistics understate the coverage ratios enjoyed by the debt of these corporations.

Most electric power companies have coverage ratios below 3.0. Hence, the coverage ratios for Santa Fe and Rio Grande are exceptionally strong. The ICR for Southern Pacific may be considered marginally satisfactory, but this corporation's earnings are considered exceptionally stable, and Value Line rates the "Company's Financial Strength" as A+.

The above data on capital structure and interest coverage ratios reinforce the conclusion reached earlier on the existence of excess-debt capacity for these three corporations, i.e., all have excess-debt capacity, with Santa Fe and Rio Grande having substantial excess-debt capacity.

V. DYNAMIC PRESSURE ON DEBT CAPACITY

The data in the previous section described the financial position of each of the three corporations at just one point in time, and it may be misleading with regard to the dynamic circumstances of these corporations. Specifically, it is possible that over the past five years these corporations have been raising their debt ratios and reducing their coverage ratios. In that event, a rise in debt ratios to finance investment would soon have to end, and other sources of funds would have to be found. However, that is shown not to be true for any of the corporations in Exhibit 2, which presents the 1978/1973 ratio of net property, long-term debt, and stockholders equity.

For Southern Pacific over the five-year period net property rose by 14 percent, long-term debt rose by 46 percent, and stockholders equity rose by 13 percent. Debt rose at a materially higher rate than did equity, indicating a rise in the debt ratio. However, net property rose at the same rate as equity, indicating that the higher debt ratio was not used to finance investment in property. In fact, the rise in long-term debt was used to finance a rise in working capital, in particular cash and short-term marketable securities. Furthermore, analysis of the net property account revealed that rail property rose by less than 14 percent, while other property rose by a higher percentage.

The data for Santa Fe and Rio Grande in Exhibit 2 reveal that the percentage increase in long-term debt was smaller than the percentage increase in stockholder equity for both corporations. Clearly, the rate at which investment in property grew from 1973 to 1978 in relation to the rate at which stockholder equity grew was not absorbing the excess-debt capacity. Quite the contrary, excess-debt capacity grew over the five-year period.

None of the three corporations have issued stock over the past five years, and the increase in equity is due to retained earnings. It would seem that given the increased equity due to retained earnings for the Santa Fe and Rio Grande, these two corporations do not have investment opportunities, rail or other, to keep their debt ratios from falling. The conclusion follows that these corporations will have to diversify further into other nonrail activities in order to absorb all the funds generated by their rail and other existing operations.

VI. EQUITY FUNDS

We have seen that the capital markets stand ready to extend these three corporations credit to finance investment on a scale that would substantially increase their debt ratios. It is possible, however, that these corporations are unwilling to raise their debt ratios, perhaps because the troubled past history of many railroads has made their managements determined to maintain conservative capital structures. In that event, both investment and the rate of growth in net property for each corporation would be tied to the rate of growth in its shareholder equity. Other sources of funds, such as depreciation and deferred taxes, are assumed to be given.

There are two sources of equity funds—retained earnings and the sale of stock. If the latter source is ruled out as being impossible or unprofitable, investment is tied to retained earnings and to the additional debt that keeps the capital structure unchanged. These are the conditions—a fixed capital structure and no sale of stock—under which increased profitability is the condition for a corporation to obtain funds required to finance a higher rate of investment in rail property. Tariffs on coal traffic above cost and excess profitability would then result in additional rail investment, if such tariffs also motivated additional investment.

The motivation of rail investment is examined in the next section. First, let us consider whether the sale of stock must be ruled out as being impossible or unprofitable. The shares of all three corporations are selling at prices below their book values, and it is sometimes argued that a market-to-book ratio (MBR) below one rules out the sale of stock by a corporation. Clearly, it is possible for a corporation with a MBR below one to sell stock. During the last five years, large numbers of electric power companies have put out one or more issues of common stock with their stock selling below book at the time of issue. Furthermore, as demonstrated by the data in Exhibit 5 of my testimony in Ex Parte No. 363,² these issues were sold with very low flotation costs, and the available evidence indicates that market pressure on the sale of stock is on average negligible.

A MBR below one makes the sale of stock by an electric power company unprofitable, because these companies are subject to rate-base, rate-of-return regulation. A MBR below one means that the company is earning a rate of return on its existing common equity that is below the company's cost of capital. With rate-base, rate-of-

² These pages are attached as Exhibit III to this statement and incorporated herein.

return regulation the rate of return the company is earning on its existing common equity is the best estimate of what the company will earn on the funds raised from the sale of stock. The sale of stock is, therefore, unprofitable because the investors who buy the stock require and get a rate of return (the company's cost of capital) in excess of what the company is expected to earn on the money raised. The difference dilutes the equity of the existing shareholders, because the stock price is depressed by the issue. Electric power companies with MBR below one have, nonetheless, issued common stock in large numbers, because of their commitment to having the facilities required to meet the demand for service. They may also believe that the harm to shareholders is temporary, which will be true if the rates of return they earn rise above the cost of capital in the near future.

A MBR below one makes it unprofitable for an electric power company subject to rate-base, rate-of-return regulation to issue stock, but the same reasoning has no relevance for unregulated companies or for railroads, because the rate of return on the investment financed with the stock issue is not tied to the rate of return on the existing equity for such companies. A stock issue is profitable if the investment it will finance is expected to earn a rate of return in excess of the cost of capital. In that event, the stock issue will raise the price of the stock, which is all that concerns the stockholders.

If the MBR is below one at the time of the issue, the stock issue will reduce the book value of the stock. However, that is of absolutely no economic significance and it should be of no concern to anyone. If book value were of any intrinsic economic significance, shares such as IBM would not sell at prices far above book value.

The conclusion of this analysis is that a MBR below one is no barrier to the issue of stock by these three corporations, and this source of funds to finance investment is readily available to them.

VII. MOTIVATION OF INVESTMENT

Although some railroads may lack the ability to finance investments in railroad property that they believe to be attractive and profitable, it is absolutely clear that this is not the case for the Southern Pacific, Santa Fe, and Rio Grande corporations. Let us now consider whether exceptionally high tariffs and excess profitability on coal traffic are required to motivate investment that is desirable in the public interest. For this purpose rail investment may be classified as: (1) coal traffic investment; (2) other traffic investment; and (3) investment that serves both coal and other traffic.

With regard to coal traffic investment, the extraordinary rise in earnings during the last few years of corporations such as the Rio Grande and Burlington Northern, the forecasts of exceptional further growth in earnings over the next five years by Wall Street analysts, and the rise in the prices of their shares in the recent past are striking evidence that the tariffs currently being granted on the coal traffic provide rates of return far in excess of the cost of capital on the investment in this traffic. There is no doubt that these rates of profit are far in excess of the rate of profit required to motivate the investment in rolling stock and fixed property needed to carry the coal traffic. This is further demonstrated by the lack of any evidence that railroads are turning away from this traffic because of the tariffs currently being provided. On the contrary, there is considerable evidence that large corporations which are not well situated to participate in the coal traffic are scrambling to acquire smaller roads which would allow such participation.

Would tariffs that make the coal traffic excessively profitable motivate investment in facilities which in no way serves coal traffic? The answer is self-evident. If rail property in no way related to coal traffic does not offer a satisfactory rate of return, raising the rate of return on coal traffic would in no way create a motivation to invest in such property.

In the third case the investment required to handle coal traffic also serves to carry other traffic. Here, tariffs above cost and an excessively high rate of profit on coal traffic would motivate such investment under the following circumstances. Assume that an improvement in fixed property required to carry coal traffic will also carry other traffic, and assume that it will reduce the cost of carrying the other traffic or it will increase capacity beyond the level required to carry the coal. Then, the tariff for the coal traffic includes only an equitable share of the investment's cost, and if the tariff on the other traffic does not cover cost, the revenue in total on the investment will not provide a return equal to the cost of capital. In this situation, a rate of return on the coal traffic in excess of the cost of capital is required to make the investment pay and to motivate the investment. Cross subsidization is necessary.

However, it is my understanding that in arriving at a tariff for the coal traffic, the practice is not to include only an equitable portion of the long-run, incremental

cost of the facilities required to handle the traffic. The total cost of all investments required to carry the coal traffic, regardless of any contribution they make toward serving other traffic, is charged to the coal traffic in arriving at a tariff. Consequently, with cost determined in this way there is no need to set the tariff above cost in order to motivate investment in facilities that serve coal and noncoal traffic.

There are two other ways in which a tariff above cost on coal traffic could motivate investment or avoid disinvestment in facilities that serve other traffic, but neither of these ways seems applicable to the corporations under consideration. First, the overall profitability of the whole railroad may be inadequate to justify or even to cover the total out-of-pocket costs of continued operation. An excessive tariff on coal may then keep the road in operation and prevent the disinvestment in the facilities required to handle all traffic. Clearly, none of these three corporations in any way approaches that situation.

The other way in which a tariff above cost on coal traffic could motivate investment in other traffic is the tying of investment to the coal tariff. For instance, the coal tariff might be tied to certain investments that the railroad would not otherwise make by a direct order of the Commission. Alternatively, if the railroad were subject to rate-base, rate-of-return regulation, as the electric power companies are, all investments required to meet the demand for service would be made at the prevailing tariffs, even though some of these investments might be unprofitable at these tariffs. This would take place because it is known that some or all other tariffs (in this case the coal tariff) would be raised to provide a return equal to the cost of capital on the incremental investment on the other unprofitable traffic. Neither of these ways for motivating investment hold for the coal traffic under consideration.

The inescapable conclusion is that tariffs above cost and excessive rates of return on the coal traffic are not required to finance—and will not motivate—investment in rail property. The only consequences of such tariffs are the enrichment of stockholders and the provision of funds for further diversification into other types of business enterprise.

VIII. WEIGHTED-AVERAGE COST OF NEW CAPITAL

In arriving at a tariff for carrying coal a proper element of cost is the product of the incremental investment required to carry the coal and the weighted-average cost of capital for that investment. In his testimony in "Incentive Rate on Coal—Hayden, Colorado to Kings Mill Texas," ICC Docket No. 36936, September 8, 1978, John A. Darling made the statement (p. 5):

"Based on the verified statement prepared by Dr. J. Rhoads Foster and submitted herein, the after-tax cost of capital in 1978 for Rio Grande and Santa Fe is 12.5 percent. In order to be conservative, I have used after-tax costs of capital for Rio Grande of 11.6 percent and for Santa Fe of 11.0 percent."

However, Dr. Foster used different methods and, in fact, arrived at a number of different figures for the cost of capital. Furthermore, on page 90 he stated:

The current after-tax cost of total capital to be applied to the incremental investment required to move coal is 11.8 percent. The computation follows:

[In percent]

	Percent of total capital	Cost rate	Weighted component
Debt.....	40	8.5	3.40
Equity.....	60	14.0	8.40
Total.....	100		11.80

Regardless of how conservative the figures used by Mr. Darling are in relation to the various figures produced by Dr. Foster, they are still substantially in excess of the best possible estimate of the weighted-average cost of capital on new investment in coal traffic.

In *Ex Parte No. 363* (pp. 29-30)³ I have estimated the cost of capital on new investment for Southern Pacific as follows:

³ These pages are attached as Exhibit IV to this statement and incorporated herein.

Item	Weight	Cost rate	Weighted cost
Debt.....	0.422	0.095	0.0401
Deferred Taxes.....	.156	0	0
Common Equity.....	.422	.133	.0561
Total.....			.0962

This 9.62 percent figure for Southern Pacific is substantially below the 11.0 percent to 12.5 percent range of figures cited by Mr. Darling. To compare my 9.62 percent with Dr. Foster's 11.8 percent figure, we first must raise his figure to 12.05 percent to reflect current yields on long-term debt of about 9.5 percent. A small part of the difference between my 9.6 percent and Dr. Foster's 12.05 percent is due to the difference in our figures for the cost of equity capital, 13.3 percent versus 14.0 percent. Most of the difference between the 12.05 percent and 9.62 percent, however, is due to my inclusion of deferred taxes in the capital structure and to my use of a 50/50 debt-equity ratio instead of the corporation's actual capital structure.

The reasoning under which I included deferred taxes in the capital structure at a zero cost rate is contained in pages 22-24 of my testimony in *Ex Parte No. 363*.⁴ I understand that the Commission has adopted the same position in *Ex Parte No. 338*, a position that has been widely, if not universally, adopted by other regulatory commissions.

With regard to the debt-equity ratio, my testimony here and in *Ex Parte 363* establishes the conservative nature of Southern Pacific's capital structure and justifies the use of a higher debt ratio in arriving at the corporation's weighted-average cost of capital.

The above 9.62 percent cost of capital for Southern Pacific represents the corporation's overall cost of capital. It is generally accepted that the cost of capital for a specific investment or tariff should be the corporation's overall figure only if there is no reason to believe that the specific investment or class of traffic is no more or less risky than is the company as a whole. This assumption is clearly not warranted where the investment is in moving coal to electric power companies in unit trains. Coal for these movements is purchased under long-term contracts, the shippers involved are totally captive to their rail carriers and most of the shippers have made financial commitments to fleets of coal hopper cars. The volume of traffic is subject to very little year-to-year fluctuations. It is difficult to imagine a less risky investment and source of revenue. Consequently, the use of Southern Pacific's overall cost of capital for costing coal traffic biases the figure upward.

There is no reason to believe that the cost of capital for western coal traffic differs among the three railroads, and estimates of the after-tax and the pre-tax weighted-average cost of capital are presented below for this traffic.

Item	Weight	Cost rate	Weighted cost
Debt.....	0.45	0.095	0.0428
Deferred taxes.....	.15	0	0
Common equity.....	.40	.13	.052
After-tax WACC.....			.0948
Corporate income tax.....	.40	.11	.0444
Pre-tax WACC.....			.1392

By comparison with the cost-of-capital data for Southern Pacific, the change in weights (from .422 for both debt and equity to .45 for debt and .40 for equity) and the reduction in the cost of equity (from .133 to .130) represent a modest adjustment in those figures to recognize the lower risk of this coal traffic than the overall risk of Southern Pacific. The after-tax cost of capital that results is 9.48 percent.

In arriving at the pre-tax, weighted-average cost of capital, the federal income tax rate is assumed to be 46 percent, the rate used by the Commission, which results in a cost rate of 11.1 percent to cover the income taxes on the equity return. The end result is a pre-tax, weighted average cost of capital of 13.92 percent for western coal traffic, traffic such as that under consideration in this case.

⁴ These pages are attached as Exhibit V to this statement and incorporated herein.

**EXHIBIT I—CAPITAL STRUCTURES OF THE SOUTHERN PACIFIC, SANTA FE AND RIO GRAND
CORPORATIONS, AS OF DEC. 31, 1978**

[Dollars in millions]

Account	Southern Pacific		Santa Fe		Rio Grande	
	Amount	Percent	Amount	Percent	Amount	Percent
Debt ¹	\$1,155	31.3	\$761	24.7	\$136.6	33.0
Deferred taxes.....	562	15.3	434	14.0	41.2	10.0
Common equity ²	1,968	53.4	1,891	61.3	236.1	57.0
Total.....	3,685	100.0	3,086	100.0	413.9	100.0

¹ Includes long-term debt and current portion thereof, ordinary preferred, and capitalized value of leases.

² Includes common stock and convertible preferred stock.

**EXHIBIT II.—1978-73 RATIOS OF LONG-TERM DEBT, COMMON EQUITY, AND NET PROPERTY FOR
SOUTHERN PACIFIC, SANTA FE, AND RIO GRANDE CORPORATIONS**

[Dollars in millions]

Account	Amount 1978	Amount 1973	Ratio 1978-73
Southern Pacific:			
Net property.....	\$3,317	\$2,911	1.14
Long-term debt.....	1,155	789	1.46
Common equity.....	1,968	1,738	1.13
Santa Fe:			
Net property.....	2,703	2,036	1.33
Long-term debt.....	761	581	1.31
Common Equity.....	1,891	1,412	1.34
Rio Grande:			
Net property.....	389.9	314.1	1.23
Long-term debt.....	136.6	112.2	1.22
Common equity.....	236.1	181.2	1.30

EXHIBIT III.—PUBLIC OFFERINGS OF UTILITY SECURITIES (common stock)

(Not under rights—1977)

Date	Company	Number of shares offered	Amount (millions)	Competitive or negotiated	Price to public	Spread	Proceeds to company	Prior market ¹ price	Underwriting as a percent of price to public	Estimated expenses	Dilution ratio
Jan. 6	Madison Gas and Electric Co.	750,000	\$12,281	N	\$16.375	\$0.57	15,805	\$157½ (B) - 16½ (A)	3.48	\$80,000	1:5.1
Jan. 11	Middle South Utilities, Inc.	8,000,000	134.0	C	16.75	.444	16,306	16½	2.65	320,000	1:7.4
Jan. 12	Iowa Public Service Co.	1,000,000	21.5	C	21.50	.472	21,028	21¼	2.20	103,000	1:5.6
Jan. 19	Intermountain Gas Co.	250,000	4.188	N	16.75	.70	16,05	16¼ (B) - 16½ (A)	4.18	110,000	1:4.6
Jan. 19	Iowa Illinois Gas & Electric Co.	750,000	16.5	N	22.0	.64	21.36	22.0	2.91	100,000	1:9.7
Feb. 9	New York State Electric and Gas Corp.	1,200,000	35.4	N	29.50	.77	28.73	29¼	2.61	175,000	1:10.9
Feb. 16	Houston Industries, Inc.	2,000,000	68.0	N	34.00	.97	33.03	34	2.85	130,000	1:13.4
Feb. 17	General Telephone and Electronics Corp.	5,000,000	146.875	N	29.375	.94	28.435	29½	3.20	244,600	1:25.9
Feb. 17	South Carolina Electric and Gas Co.	2,200,000	41,250	N	18.75	.55	18.20	18½	2.93	100,000	1:8.1
Feb. 23	Northern Indiana Public Service Co.	2,000,000	37.0	N	18.50	.55	17.95	18½	2.97	140,000	1:12.1
March 8	Potomac Electric Power Co.	3,000,000	46.5	N	15.50	.44	15.06	15½	2.84	110,000	1:12.0
March 9	Kansas Gas and Electric Co.	1,400,000	30.1	N	21.50	.60	20.90	21½	2.79	78,000	1:4.8
March 15	Ohio Edison Co.	5,000,000	100.0	C	20.00	.517	19,483	19½	2.59	155,000	1:8.0
March 17	Central Maine Power Co.	1,600,000	25.6	N	16.00	.49	15.51	15½	3.06	136,000	1:5.3
March 21	Duke Power Co.	5,500,000	116.875	N	21.25	.56	20.69	21¼	2.64	150,000	1:10.8
March 22	Union Electric Co.	5,000,000	77.5	N	15.50	.50	15.00	15¼	3.23	75,000	1:8.2
March 23	Utah Power & Light Co.	1,100,000	45.375	C	41.25	.928	40,322	41¼	2.25	170,000	1:10.7
March 29	Pennsylvania Power & Light Co.	3,200,000	68.8	N	21.50	.55	20.95	21½	2.56	130,000	1:9.6
March 31	California-Pacific Utilities Co.	300,000	5.550	N	18.50	.71	17.79	18½	3.84	130,000	1:4.6
Apr. 5	Elizabethtown Water Co.	175,000	3.194	N	18.25	.72	17.53	17½ (B) - 18½ (A)	3.95	70,000	1:9.0
Apr. 5	Indiana Gas Co., Inc.	300,000	7.613	N	25.375	.73	24.645	25¼	2.88	93,000	1:6.2
Apr. 13	Portland General Electric Co.	3,000,000	60.750	N	20.25	.58	19.67	20½	2.86	90,000	1:6.4
Apr. 14	Consumers Water Co.	125,000	2.625	N	21.00	1.20	19.80	20½ (B) - 21½ (A)	5.71	90,000	1:5.3
May 3	Texas Utilities Co.	5,000,000	96.875	N	19.375	.56	18.815	19½	2.89	185,000	1:14.0
May 4	Boston Edison Co.	2,000,000	53.0	N	26.50	.72	25.78	26½	2.72	166,000	1:4.8
May 10	Pacific Power and Light Co.	2,500,000	55.938	C	22.375	.519	21.856	22½	2.32	105,000	1:12.8
May 10	St. Joseph Light and Power Co.	350,000	4.506	N	12.875	.50	12.375	12¾	3.88	68,000	1:5.2
May 11	The Toledo Edison Co.	2,000,000	51.5	N	25.75	.69	25.06	25½	2.68	110,000	1:5.8
May 17	Kansas City Power and Light Co.	1,100,000	33.137	N	30.125	.77	29.355	30	2.56	75,000	1:6.9
May 18	Consumers Power Co.	3,500,000	80.937	N	23.125	.69	22.435	23	2.98	175,000	1:9.9
May 18	Eastern Utilities Associates Co.	600,000	10.650	C	17.75	.411	17.339	17½	2.32	150,000	1:6.0

EXHIBIT III.—PUBLIC OFFERINGS OF UTILITY SECURITIES (common stock)—Continued

(Not under rights—1977)

Date	Company	Number of shares offered	Amount (millions)	Competitive or negotiated	Price to public	Spread	Proceeds to company	Prior market price	Underwriting as a percent of price to public	Estimated expenses	Dilution ratio
May 19	Commonwealth Edison Co.	6,000,000	177.750	N	29.625	.80	28.825	29½	2.70	305,000	1:10.5
May 24	The Cleveland Electric Illuminating Co.	2,400,000	79.5	N	33.125	.87	32.255	33½	2.63	160,000	1:7.9
May 24	Central Illinois Public Service Co.	1,750,000	26.250	N	15.00	.48	14.52	14½	3.20	175,000	1:10.0
June 2	Minnesota Power & Light	1,300,000	27.950	N	21.50	.60	20.90	21½	2.79	105,000	1:4.7
June 7	The Lincoln Telephone and Telegraph	350,000	10.5	N	30.0	1.20	28.80	29(B)-31(A)	4.00	110,000	1:4.2
June 8	Public Service of Indiana	1,700,000	49.087	N	28.875	.75	28.125	28½	2.60	120,000	1:13.4
June 14	Continental Telephone Corp.	2,000,000	34.250	N	17.125	.67	16.455	17	3.91	175,000	1:18.8
June 15	Central Illinois Light	1,000,000	18.750	N	18.750	.52	18.23	18½	2.77	96,000	1:8.9
June 16	Iowa Electric Light & Power	1,000,000	17.875	C	17.875	.404	17.471	17½	2.26	85,000	1:6.2
June 16	Northwestern Public Service	400,000	7.600	N	19.00	.54	18.46	18½(B)-19(A)	2.84	80,000	1:5.0
July 18	Baltimore Gas & Electric	1,500,000	42.000	N	28.00	.74	27.26	28	2.64	85,000	1:19.2
July 19	Peoples Gas	1,000,000	53.000	N	53.00	1.45	51.55	53	2.74	95,000	1:18.5
July 20	New England Electric System	1,250,000	30.781	C	24.625	.448	24.177	24½	1.82	160,000	1:15.5
Aug. 10	Public Service Co. of New Hampshire	1,200,000	25.800	N	21.50	.59	20.91	21½	2.74	105,000	1:6.0
Aug. 16	The Dayton Power & Light Co.	2,500,000	50.625	N	20.25	.59	19.66	20½	2.91	176,000	1:7.1
Aug. 17	Southwest Gas Corp.	750,000	8.531	N	11.375	.45	10.925	11½(B)-11½(A)	3.96	60,000	1:4.3
Aug. 18	Sierra Pacific Power	1,000,000	14.125	C	14.125	.344	13.781	13½	2.44	88,000	1:7.0
Sept. 8	Madison Gas & Electric	750,000	12.750	N	17.00	.55	16.45	16½(B)-17(A)	3.23	90,000	1:6.1
Sept. 12	Interstate Power	800,000	13.840	C	17.30	.395	16.905	17	2.28	86,300	1:8.2
Sept. 20	Bangor Hydro-Electric	250,000	3.937	N	15.75	.67	15.08	15½(B)-15½(A)	4.25	110,000	1:4.9
Sept. 20	Iowa Power and Light	850,000	22.567	C	26.55	.479	26.071	26½	1.80	50,000	1:13.8
Sept. 21	Rochester Gas & Electric	1,000,000	21.000	N	21.00	.61	20.39	20½	2.90	141,000	1:5.8
Sept. 28	Columbus and Southern Ohio Electric	2,000,000	55.000	N	27.50	.70	26.80	27½	2.55	100,000	1:7.0
Oct. 4	Hawaiian Electric	400,000	10.350	N	25.875	.73	25.145	25½	2.82	135,000	1:13.6
Oct. 5	Philadelphia Electric	4,000,000	80.500	N	20.125	.54	19.585	20	2.68	130,000	1:17.5
Oct. 18	San Diego Gas & Electric	3,000,000	46.650	N	15.55	.46	15.09	15½	2.96	165,000	1:6.5
Oct. 19	Savannah Electric & Power	600,000	7.050	N	11.75	.47	11.28	11½	4.00	120,000	1:3.9
Oct. 25	Cincinnati Gas & Electric	2,700,000	61.425	N	22.75	.71	22.04	22½	3.12	155,000	1:7.8
Nov. 1	The Detroit Edison	4,000,000	64.000	N	16.00	.52	15.48	16	3.25	270,000	1:13.6
Nov. 1	The Southern	11,000,000	188.100	C	17.10	.471	16.629	17½	2.75	321,000	1:11.3
Nov. 3	The Empire District Electric	560,000	8.750	N	15.625	.54	15.085	15½	3.46	98,000	1:4.9

EXHIBIT III.—PUBLIC OFFERINGS OF UTILITY SECURITIES (common stock)—Continued

(Not under rights—1977)

Date	Company	Number of shares offered	Amount (millions)	Competitive or negotiated	Price to public	Spread	Proceeds to company	Prior market ¹ price	Underwriting as a percent of price to public	Estimated expenses	Dilution ratio
Nov. 8	Northern Indiana Public Service	2,000,000	36,000	N	18.00	.54	17.46	17 $\frac{1}{2}$ %	3.00	95,000	1:13.1
Nov. 8	Public Service of New Mexico	1,400,000	29,050	N	20.75	.65	20.10	20 $\frac{1}{2}$ %	3.13	107,000	1:5.3
Nov. 9	American Telephone & Telegraph	12,000,000	718,500	N	59.875	1.65	58.225	59 $\frac{1}{2}$ %	2.76	484,000	1:52.1
Nov. 15	Arizona Public Service	4,000,000	82,500	N	20.625	.59	20.035	20 $\frac{1}{2}$ %	2.86	130,000	1:5.6
Nov. 17	Kansas Gas & Electric	1,200,000	25,350	N	21.125	.59	20.535	21	2.79	90,000	1:6.8
Nov. 21	Consumers Power	2,500,000	60,313	N	24.125	.72	23.405	24	2.98	165,000	1:15.6
Nov. 22	Delmarva Power & Light	2,000,000	28,000	N	14.00	.46	13.54	13 $\frac{1}{2}$ %	3.29	113,500	1:9.6
Nov. 22	Public Service of Colorado	2,000,000	36,250	N	18.125	.56	17.565	17 $\frac{1}{2}$ %	3.09	135,000	1:11.9
Nov. 29	Pacific Gas & Electric	7,500,000	177,187	N	23.625	.70	22.925	23 $\frac{1}{2}$ %	2.96	260,000	1:12.1
Dec. 1	The Kansas Power & Light	1,250,000	27,031	N	21.625	.72	20.905	21 $\frac{1}{2}$ %	3.33	105,000	1:6.1
Dec. 6	Puget Sound Power & Light	2,000,000	34,500	N	17.25	.52	16.73	17 $\frac{1}{2}$ %	3.01	100,000	1:7.0
Dec. 6	Ohio Edison	6,000,000	118,200	C	19.70	.479	19.221	19 $\frac{1}{2}$ %	2.43	185,000	1:7.5
Dec. 6	Southern Indiana Gas & Electric	750,000	14,719	N	19.625	.590	19.035	19 $\frac{1}{2}$ %	3.01	100,000	1:5.9
Dec. 7	Utah Power & Light	2,500,000	48,750	C	19.50	.468	19.032	19 $\frac{1}{2}$ %	2.40	100,000	1:10.4
Dec. 12	Virginia Electric & Power	5,000,000	72,750	N	14.55	.47	14.08	14 $\frac{1}{2}$ %	3.23	150,000	1:14.8
Dec. 13	Allegheny Power System, Inc.	3,500,000	70,000	C	20.00	.549	19.451	19 $\frac{1}{2}$ %	2.75	132,000	1:8.8
Dec. 13	Middlesex Water	65,000	1,393	N	21.50	.70	20.80	20 $\frac{1}{4}$ (B)—21 $\frac{1}{4}$ (A)	3.26	88,000	1:7.3

¹ Over the counter stocks show closing bid and asked prices.

[EXHIBIT IV]

C. Southern Pacific

For Southern Pacific the WACC on the basis of the existing capital structure is presented below:

Item	Weight	Cost rate	Weighted cost
Debt.....	0.299	0.0726	0.0217
Deferred taxes.....	.156	0	0
Common equity.....	.545	.1329	.0724
WACC.....			.0941

Southern Pacific's equipment trust certificates are all Aa rated, all but one of its bonds are A rated, and the company's interest coverage ratio is between three and four. In my judgment a somewhat higher debt ratio is justified by the corporation's current level and stability of earnings. There is no question that a rise in the corporation's return on common from the current six percent level above 10 percent would make possible a large increase in the debt ratio without jeopardizing the railroad's financial security. The WACC on the basis of a more reasonable capital structure is:

Item	Weight	Cost rate	Weighted cost
Existing debt.....	0.299	0.0726	0.0217
New debt.....	.123	.095	.0117
Deferred taxes.....	.156	0	0
Common equity.....	.422	.1329	.0561
WACC.....			.0895

For new investment projects the WACC based on a capital structure of .422 debt, .156 deferred taxes, and .422 common equity is 9.62 percent.

[EXHIBIT V]

ALLOWANCE FOR DEFERRED TAXES

Federal income tax law allows a company to charge for tax purposes depreciation in excess of the amount considered to be the correct depreciation charge. The law also allows corporations under certain circumstances to reduce the income tax paid in a year by some percentage of the cost of investment in plant facilities. Common practice in the annual reports of companies to their shareholders is to show as income tax expense the tax actually paid plus the additional tax that would be paid if these provisions of the tax law were not in force. The latter amount is shown separately, and the offsetting credit is to a liability account "Allowance for Deferred Taxes." The Deferred Income Tax Expense and the Allowance for Deferred Taxes have posed problems for regulatory practice.

One practice that has been adopted by regulatory agencies has been to "flow through" the reduction in taxes. That is the deferred tax expense is included in profits and therefore not allowed as an expense in calculating revenue requirements. This practice is the most beneficial to the consumers of a public utility since the tax reduction flows through to them in the form of a reduction in the rates they pay for service.

The other practice, which has become widely adopted in the electric power industry in order to help the companies solve their financing problems, is to allow the deferred income tax expense as an expense in calculating revenue requirements. Of course the companies are not allowed to earn a return on the allowance for deferred taxes. The theoretical rationale for this treatment of the allowance for deferred taxes which is called "normalization" of the tax reduction may be explained quite briefly. The deferred tax expense is recognized as an expense on the reasoning (considered questionable by many authorities on the subject) that the deferred portion of the tax expense will have to be paid some day. On that reasoning the allowance for deferred taxes is a liability to the Government. However, no interest is paid on this liability, and therefore it represents capital obtained at no cost.

Accordingly one of two practices may be followed and is followed by most regulatory agencies in the electric power and telephone industries. One practice is to compute the weighted average cost of capital for a company without including the allowance for deferred taxes but to then deduct the balance in the allowance account from the rate base. The other practice, which is more common, is to allow the weighted average cost of capital on the entire rate base, but the allowance for deferred taxes is included in the computation with a zero capital cost rate. This latter course of action will be followed in computing the weighted average cost of capital for the railroads in the next section.

Both of the above practices, it should be noted have the same net effect on the company and its customers. The Government or the consumers provide the company with the funds represented by the allowance for deferred taxes, and the company pays and earns a zero rate of return on these funds. The benefit to the company is the use of the funds to meet its investment requirements under very favorable terms—a zero interest rate and the payment of the principal at a very distant date in the future, and then only if the company remains profitable in the intervening years.

Senator LONG. Mr. Loftus.

Mr. LOFTUS. Senator Long, thank you. My name is Michael Loftus. I am a transportation attorney appearing here today on behalf of the City Public Service Board of San Antonio, Tex. Mayor Lila Cockrell of San Antonio has asked that I express her regrets to the subcommittee that she herself could not deliver the statement. On this occasion San Antonio is also serving as a representative of the American Public Power Association of which it is a member.

The City Public Service Board of San Antonio is a municipally owned electric utility serving the city of San Antonio and portions of several surrounding counties. In all its system services, some 300,000 homes and businesses. The American Public Power Association is a national service organization representing more than 1,400 local, publicly owned electric utilities throughout the Nation.

San Antonio began burning coal to generate electricity in 1977. Its efforts to obtain reasonable freight rates for the rail transportation of roughly 3 million tons of coal which it must move each year from Wyoming to Texas have been the subject of three major rate decisions by the ICC within as many years. The net result thus far has been for it to see its freight rate climb from a rate of \$10.93 per ton, established a little over 3 years ago by the ICC, to \$19.25 today. This amounts to an increase of over 75 percent, or roughly 25 percent per year.

The major portion, however, is attributable to the ICC's changing concepts of the level of profits which railroads should be permitted to earn on captive coal traffic. At the time the Commission established the rate of \$10.93 per ton, for example, it explained in its decision that this rate level would afford the carriers a contribution to revenues of roughly \$6.4 million per year over the variable costs of service; 3 years later, the Commission determined that the carriers were entitled to earnings over variable costs of \$21 million per year.

The radical change in the ICC's perception of where the maximum reasonable rate level for this movement lies is attributable to the provision of the 4R Act requiring the Commission to establish standards and procedures for determining what earnings are necessary for rail carriers to achieve revenue adequacy and directing the Commission to assist the carriers in achieving such earnings level.

San Antonio believes that the Commission has far overstepped the bounds of what Congress intended in the 4R Act.

The Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce recently released a report concluding an extensive investigation which it conducted into the ICC's coal rate decisions during the period 1977-79, inclusive.

In its letter of transmission of the report to the full committee, Chairman Eckhardt stated:

We find the ICC has failed to fulfill its statutory obligation under the 4R Act to protect against railroad abuse of market power in noncompetitive markets.

We wholeheartedly agree. San Antonio and APPA believe that any rail deregulation legislation which may be enacted must not only preserve maximum rate regulation for captive shippers, but must do so in a fashion which establishes meaningful guidelines to assist the ICC in exercising such regulatory authority. We do not believe that S. 1946, as reported by the Senate Commerce Committee, accomplishes that goal. In fact, the rate regulation provisions of the bill and, in particular, section 104, providing for a 4-percent rate flexibility zone, would, in our opinion, exacerbate the situation with respect to coal rates.

In the case of the San Antonio rate, for example, a rate which stands for what the ICC has prescribed as the maximum reasonable rate level, section 104 would deprive the ICC of jurisdiction to suspend or investigate rate increases within the rate flexibility zone. This is especially unjust in light of the fact that under section 103 of the bill the railroads would be able to recoup any increases in their costs. Thus, increases within flexibility zone would be, by definition, for the sole purpose of increasing the profits earned on the movement.

More fundamentally, however, S. 1946, in its present form, fails to lend the ICC any guidance with respect to how to determine maximum reasonable rate levels. All of the rate provisions of the bill deal solely with the Commission's jurisdiction to review rates.

San Antonio and APPA applaud the initiative of you, Senator Long, to address the problems which exist with respect to present ICC ratemaking policies and the shortcomings of S. 1946 through the imposition of a presumptive cap on rates for captive traffic. The factors identified in subparagraph (B) of the amendment are clearly factors which should be fully considered by the Commission in permitting any rate to be established at a level in excess of the full costs of service and a reasonable return on capital investment related to the service afforded.

The establishment of a presumptive cap on rates is a reasonable and balanced method of seeking to insure that coal or other commodities will not be forced to pay whatever rate levels the carriers may demand due solely to their captive status. On the one hand, it permits the ICC flexibility to permit rates above the presumptive level of maximum rate reasonableness where adequate justification can be presented by the railroads, and on the other, it would afford captive shippers some assurance as to where the upper levels of rates will lie absent the demonstration of circumstances sufficient to overcome the presumption. The extent of the protection which is afforded by the amendment would, of course, depend upon the level

at which the presumptive cap is established and the manner in which the effect of the cap is interpreted. In this regard, we believe several changes are required in the language of the amendment in order that its intended purpose be fulfilled.

First, although the language of the statement appearing in the Congressional Record of December 17, 1979, announcing the amendment, appears to be clear in its explanation that what is intended is a "presumptive cap of maximum rate reasonableness," the language of the amendment itself does not clearly reflect this intent. To avoid any confusion, the language should be modified to provide that rates which exceed the cap are presumed to be above a maximum reasonable level, and the burden of proof shall be upon the proponent railroad to rebut this presumption.

We believe the distinction between a presumptive cap of maximum rate reasonableness and a point at which the burden of proof is imposed upon the railroad is a critical one. In this regard, Senator Long, we would point out in the recommendations with respect to rate regulation made in the Oversight Subcommittee report referred to earlier, it is suggested that—and I quote:

Any rate reviewed in an individual rate proceeding shall be deemed unreasonable if it exceeds the actual cost of service plus a fair and reasonable return on capital attributable to the haulage of the subject traffic in the designated market.

Second, the amendment should allow for the establishment of separate presumptive caps for separate commodities. As several other witnesses have mentioned, we feel that imposing one ratio or ratio of revenue for all commodities won't undo the limit the Commission in trying to satisfy the competitiveness.

Third, the amendment should be clearly worded to permit suspension and investigation of the rate proposals which fall within the rate flexibility zone if they exceed the level of a presumptive cap. Where rates are shown, upon protest, to exceed the relevant ratio established under the amendment, there is no logical basis for insulating the challenged rate from suspension for investigation. As always, the decision whether or not to suspend or investigate would lie with the Commission.

In summary, Mr. Chairman, we believe that the approach embodied in the proposed amendment holds great promise for achieving meaningful and much needed protection for captive shippers. We also believe, however, that before that promise can be fulfilled, changes of the nature we have described must be made in the specific language of the amendment.

[The statement follows:]

STATEMENT OF C. MICHAEL LOFTUS ON BEHALF OF CITY PUBLIC SERVICE BOARD OF SAN ANTONIO AND AMERICAN PUBLIC POWER ASSOCIATION

Mr. Chairman and Members of the Subcommittee, my name is Michael Loftus. I am a transportation attorney appearing on behalf of the City Public Service Board of San Antonio, Texas. Mayor Lila Cockrell of San Antonio has asked that I express her regrets to the Subcommittee that she herself could not deliver this statement. On this occasion, San Antonio is also serving as a representative of the American Public Power Association of which it is a member.

The City Public Service Board of San Antonio is a municipally-owned electric utility serving the City of San Antonio and portions of several surrounding counties. In all its system services some 300,000 homes and businesses.

The American Public Power Association is a national service organization representing more than 1,400 local, publicly-owned electric utilities in 48 states, Puerto Rico, the Virgin Islands, American Samoa and Guam.

THE COAL RATE PROBLEM: A CASE HISTORY

San Antonio began burning coal to generate electricity in 1977. Its efforts to obtain reasonable freight rates for the rail transportation of roughly 3 million tons of coal which it must move each year from Wyoming to Texas have been the subject of three major rate decisions by the I.C.C. within as many years. The net result thus far has been for it to see its freight rate climb from a rate of \$10.93 per ton, established a little over three years ago by the I.C.C., to \$19.25 today. This amounts to an increase of over 75 percent or roughly 25 percent per year! A portion of this tremendous increase is attributable to increases in the cost to the railroads involved of performing the required transportation services. The major portion, however, is attributable to the I.C.C.'s changing concepts of the level of profits which railroads should be permitted to earn on captive coal traffic. At the time the Commission established the rate of \$10.93 per ton, for example, it explained in its decision that this rate level would afford the carriers a contribution to revenues of roughly \$6.4 million per year over the variable costs of services. Three years later, the Commission determined that the carriers were entitled to earnings over variable costs of \$21 million per year. According to the Commission's formal decisions in the San Antonio case, the radical change in the I.C.C.'s perception of where the maximum reasonable rate level for this movement lies is attributable to the provisions of the 4-R Act requiring the Commission to establish standards and procedures for determining what earnings are necessary for rail carriers to achieve revenue adequacy and directing the Commission to assist the carriers in achieving such earning levels.

San Antonio believes that the Commission has far overstepped the bounds of what Congress intended in the 4-R Act in its own case and the flurry of other coal rate litigations which have occurred in the last several years. Rather than developing rational standards for determining how much revenue improvement the various coal hauling roads might need to reach overall adequate revenue levels and then translating these overall needs in some intelligible fashion into the profit levels which would be appropriate for a particular movement, the Commission has simply permitted rate increases on a grand scale on the basis that the carriers' overall earnings were not adequate. As a result, virtually all of the major coal rate cases decided by the I.C.C. in the last two years are under appeal in the federal courts.

The Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce recently released a report concluding an extensive investigation which it conducted into the I.C.C.'s coal rate decisions during the period 1977-79 inclusive. Committee Print 96-IFC "40 Railroad Coal Rates and Public Participation: Oversight of I.C.C. Decisionmaking," (February 1980). In his letter of transmittal of the report to the Chairman of the full committee, Chairman Eckhardt of the Subcommittee states:

"We find that the I.C.C. has failed to fulfill its statutory obligation under the 4-R Act to protect against railroad abuse of market power in noncompetitive markets."

Based upon its experience before the I.C.C., San Antonio and APPA wholeheartedly agree with this assessment of the agency's implementation of the ratemaking provisions of the 4-R Act in coal rate cases.

S. 1946

San Antonio and APPA believe that any rail deregulation legislation which may be enacted must not only preserve maximum rate regulation for captive shippers but must do so in a fashion which establishes meaningful guidelines to assist the I.C.C. in exercising such regulatory authority. We do not believe that S. 1946 as reported by the Senate Commerce Committee accomplishes that goal. In fact, the rate regulation provisions of the bill and in particular, Section 104 providing for a four percent rate flexibility zone, would exacerbate the situation with respect to coal rates.

In the case of the San Antonio rate, for example, a rate which stands at what the I.C.C. has prescribed as a maximum reasonable rate level for the movement, Section 104 would deprive the I.C.C. of jurisdiction to suspend or investigate rate increases within the rate flexibility zone. This is especially unjust in light of the fact that under Section 103 of the bill, the railroads would be able to recoup any increases in their costs. Thus, increases within the flexibility zone would be, by definition, for the sole purpose of increasing the profits earned on the movement. To be sure, Section 104 would afford shippers a complaint remedy but under that procedure, the shipper is required to pay the contested increase, no matter how patently unreasonable, throughout a lengthy proceeding. In addition, the burden of proof as to the reasonableness of a rate challenged by complaint falls upon the shipper.

More fundamentally, however, S. 1946 in its present form fails to lend the I.C.C. any guidance with respect to how to determine maximum reasonable rate levels. All

of the rate provisions of the bill deal solely with the Commission's jurisdiction to review rates.

THE PROPOSED AMENDMENT

San Antonio and APPA applaud the initiative of the Chairman to address the problems which exist with respect to present I.C.C. ratemaking policies and the shortcomings of S. 1946 through the imposition of a presumptive cap on rates for captive traffic. The factors identified in subparagraph (B) of the amendment are clearly factors which should be fully considered by the Commission in permitting any rate to be established at a level in excess of the full costs of service and a reasonable return on capital investment related to the service afforded. The establishment of a presumptive cap on rates is a reasonable and balanced method of seeking to insure that coal or other commodities will not be forced to pay whatever rate levels the carriers may demand due solely to their captive status. On the one hand, it permits the I.C.C. flexibility to permit rates above the presumptive level of maximum rate reasonableness where adequate justification can be presented by the railroads, and on the other, it would afford captive shippers some assurance as to where the upper level of rates will lie absent the demonstration of circumstances sufficient to overcome the presumption. The extent of the protection which is afforded by the amendment would, of course, depend upon the level at which the presumptive cap is established and the manner in which the effect of the cap is interpreted. In this regard, we believe several changes are required in the language of the amendment in order that its intended purpose be fulfilled.

PRESUMPTION CLARIFIED

First, although the language of the statement appearing in the Congressional Record of December 17, 1980 announcing the amendment appears to be clear in its explanation that what is intended is a "presumptive cap of maximum rate reasonableness," the language of the amendment itself does not clearly reflect this intent. To avoid any confusion, the language should be modified to provide that rates which exceed the cap are presumed to be above a maximum reasonable level, and the burden of proof shall be upon the proponent railroad to rebut this presumption.

We believe the distinction between a presumptive cap of maximum rate reasonableness and a point at which the burden of proof is imposed upon the railroad is a critical one. Establishing a presumption that rates are unreasonable above the ratio of revenue to variable costs to be established under the amendment would, in our judgment, insure that the presumptive level were not exceeded without substantial justification. Based upon the I.C.C.'s decisions in recent coal rate cases, in many of which—including the more recent San Antonio decisions—the burden of proof was on the railroads, we have serious doubts that a shifting of the burden of proof would lend the same assurance. We would note that in the recommendations with respect to rate regulation made in the Oversight Subcommittee's Report referred to earlier, it is suggested that:

"Any rate reviewed in an individual rate proceeding shall be deemed unreasonable if it exceeds the actual cost of service plus a fair and reasonable return on capital attributable to haulage of the subject traffic in a designated market." (at p. 8)

SEPARATE RATIOS FOR SEPARATE COMMODITIES

Second, the amendment should allow for the establishment of separate presumption caps for separate commodities. If one ratio of revenue to variable costs is established as the presumptive cap for all rates on commodities, the resulting level may be so high as to be of little practical benefit to particular commodities. In the case of coal, for example, the rates established by the I.C.C. of late pursuant to the "seven percent solution"—including the San Antonio rate—equated to roughly 155-165 percent of the variable costs of service. These are rates defined by the Commission as the maximum lawful levels for these coal movements and are heatedly contested as being unjustifiably high. Clearly, in order for the proposed amendment to afford protection for unit train coal shippers, the presumptive cap should be set below the level of these rates. Yet, if the same presumptive cap is to apply to beer traffic, for example, it might be too low, as such traffic does not possess many of the unique transportation characteristics of high volume unit train coal traffic which is almost certainly the most efficient and lucrative type of rail service yet devised.

Alternatively, if the single presumptive cap is set at a level appropriate to beer traffic, it may be of no benefit to coal traffic. Even worse, if a single ratio were established at a level which is high in relationship to the coal rates I have described, preposterous as it may sound, it might be argued by reference to that ratio that the coal rates were too low.

SUSPENSION AND INVESTIGATION

Third, the amendment should be clearly worded to permit suspension and investigation of rate proposals which fall within the rate flexibility zone if they exceed the level of the presumptive cap. Where rates are shown upon protest to exceed the relevant ratio established under the amendment, there is no logical basis for insulating the challenged rate from suspension and/or investigation. As always, the decision whether or not to suspend or investigate would lie with the Commission.

In summary, Mr. Chairman, we believe that the approach embodied in the proposed amendment holds great promise for achieving meaningful and much-needed protection for captive shippers. We also believe, however, that for that promise to be fulfilled, changes of the nature we have described must be made to the specific language of the amendment.

Senator LONG. Mr. Wright?

Mr. WRIGHT. We have introduced a written statement. I would like to have that introduced into the record, and at this time extemporaneously supplement that written testimony.

Mr. WRIGHT. Mr. Chairman, we represent Nebraska Public Power District. Nebraska Public Power District is a public corporation and a political subdivision of the State of Nebraska. As such, it elects its board of directors popularly. They act in lieu of a public service commission.

NPPD provides fully integrated electrical service to almost the entire State of Nebraska. It provides service in 245 municipalities and serves many, many individual customers at retail.

We think it is important that you and the committee understand circumstances that Nebraska Public Power District has undergone recently in connection with the obtaining of coal transportation.

Right now two power stations are very crucial to Nebraska Public Power District. One unit has already been constructed and went into commercial operation in 1979. There is also a second unit which we had hoped to have in commercial operation by 1986. Just recently and due to a lower projection in load growth, NPPD has decided to forgo the 1986 commercial operation date and set it back another year, one of the largest factors being the inability to obtain a transportation agreement for that unit.

With respect to the unit that's already been constructed, in 1972 Nebraska Public Power District had a choice. Prior to the time it committed its financial resources and prior to the time that plant was constructed, NPPD conducted simultaneous negotiations with coal suppliers and two western rail carriers.

After the transportation agreements were analyzed, it was decided that one particular carrier and one particular coal supplier, combined for the most economical delivered cost of fuel for the consumers of Nebraska. Almost simultaneously, Nebraska Public Power District entered into a coal supplier in Wyoming and a transportation contract with a western rail carrier.

Now everything was fine, Mr. Chairman, until coal was needed to fire that plant after it was constructed. The utility got 1 year's benefit under the written agreement with a railroad carrier before the carrier came back and requested a 31-percent rate increase. Negotiations ensued, and really as the public utility perceived it, the threat was, "If you don't negotiate with us, we'll go to the Interstate Commerce Commission. We don't have an agreement with you."

Mr. Chairman, we filed suit, and the U.S. district court in Nebraska entered an injunction prohibiting the carrier from going to

the Interstate Commerce Commission until a suit on the merits be had to determine whether there was, in fact, a contract, our position of course being that there was, and the railroad's position was that this written document really was never intended to do anything—that the carrier had the authority to change a rate when it desired.

That case will be tried shortly. I mention this, and I kind of digress from the point, but this is in response to the chairman of the ICC's testimony this morning.

I think the record will reflect that he alluded to certain protections that he perceives to be in the regulatory scheme today in connection with contract rates, changes in the ICC's policy with respect to contract rates, and with S. 1946's allusion to contract rates.

We would say in response that this is a placebo that has no real salutary effect so far as shippers are concerned. The Chairman mentioned that in the beginning a utility does have the ability to select different suppliers. That, of course, is correct until one thing happens.

Once the utility commits \$600 or \$700 million dollars to build a large plant, it is no longer able to go to supplier A or supplier B because the utility has a contract with one coal company. To breach the contract would cost hundreds and hundreds of millions of dollars, and no one would advocate that this should be a policy for the industry—to breach contracts.

Once the railroad has indicated in writing that it will serve the particular station and if the railroad is not required to live up to that agreement, the benefit of the competition that may have existed prior to the construction of the plant is merely an illusion. One has no ability to move that plant. They don't put them on wheels.

In NPPD's case, we had to construct some 19 miles of private spur track to connect with one railroad carrier. So as far as we're concerned, in that situation there is no other railroad in the entire world that can serve that plant.

Now going to the other point that the Chairman of the ICC made today, apparently there has been a revision in the Commission's policy wherein the ICC will now look to the agreements or contracts, as he described them. In our written statement, we urge that Congress through legislation provide firm guidelines to the Interstate Commerce Commission.

I think what has happened in terms of these contracts is a good point for an example. Last year at the time when other utilities were going to the Interstate Commerce Commission with written agreements or contracts, the Interstate Commerce Commission in the *Flint Creek* Case and one of the Iowa power cases said, "This is reprehensible conduct, 'Mr. Railroad Carrier.' You shouldn't have told somebody that you would do something and then back away from it." They characterize it as "bait and switch."

"But unfortunately, this is a matter for the courts, notwithstanding that there may have been an agreement. We can't do anything about it. It's beyond our jurisdiction." And those cases, as the record would show, resulted in rates in excess of what the railroad and the utility agreed to.

Now the point is, if the ICC in a written decision states that these contracts are not a matter for ICC review, can we rely on a statement today that they will be enforceable?

If policy can shift that soon, I submit that we need legislation that provides for that. Rate stability is important to the utility. Besides the rate itself, you have to be able to depend on and project what the coal transportation costs are going to be, and we submit that this will not happen until firm legislative guidelines are given to the Interstate Commerce Commission.

Second, on the same point, your amendment we applaud. We applaud the principle of it. We think that you have succinctly stated the issue in your address in December, but we would point out that the ICC at this very moment may be avoiding the practical effect or may be predicting the variable ratios that your legislation may require if it does become law.

Right now, in a proposed rulemaking decision, the Interstate Commerce Commission is deciding to do away with the heretofore criteria to determine market dominance. The proposed rulemaking indicates that in the ICC's best present judgment—and this is subject, of course, to hearings before the rules become effective—but right now, in their best judgment, the variable ratio—before the burden of proof would shift absolutely from a shipper to a carrier—is 180 percent. This is going on right now. We are concerned that if firm legislative guidelines are not set down in your amendment, that the intended benefit will not exist.

With respect to other sections of the amendment——

Senator LONG. If you will pardon my saying so, your time has expired. I would suggest that you put the rest of your statement in the record, and I will read it.

Thank you very much, gentlemen.

[The statement follows:]

STATEMENT OF R. DENNIS WRIGHT ON BEHALF OF NEBRASKA PUBLIC POWER DISTRICT

My name is R. Dennis Wright and I am an attorney representing Nebraska Public Power District (NPPD). I am a partner in the law firm of Hillix, Brewer, Hoffhaus & Whittaker, 2715 Commerce Tower, Kansas City, Missouri 64105. NPPD has authorized me to make this statement on its behalf. I am authorized to practice law before all courts in Missouri, both state and federal. I also am authorized to practice before the United States Court of Appeals for the Fifth Circuit, Sixth Circuit and Eight Circuit. In addition, I am licensed to practice before the Interstate Commerce Commission and have appeared before the Commission on rail transportation matters. I have also testified before a Senate Committee reviewing other proposed legislation to deregulate the railroads. NPPD has previously filed a statement concerning perceived shortcomings in S. 1946's attempt to provide regulatory protection for captive shippers.

NPPD is a public corporation and political subdivision of the State of Nebraska. Its management is vested in a board of directors consisting of eleven members who are popularly elected from districts comprising subdivisions of NPPD's chartered territory. These districts encompass 85 of Nebraska's 93 counties and portions of two other counties. NPPD operates an integrated electrical utility system, including facilities for generation, transmission and distribution of electric power and energy at wholesale.

NPPD presently serves approximately 105,000 customers at retail, including retail service in 245 municipalities and communities, and supplies at wholesale the total requirements of 78 municipalities, public power districts and cooperatives. In addition, NPPD provides at wholesale part of the requirements of the City of Lincoln, Nebraska, and also has interconnection agreements with 22 self-generating municipalities pursuant to which such municipalities may purchase part of their requirements from NPPD.

The purpose of this statement in this proceeding is to inform the Committee of NPPD's belief that Senator Long's proposed Amendment (the "Amendment"), while beneficial in its intended purpose, needs modification to implement that purpose.

THE AMENDMENT'S PURPOSE IS LAUDABLE

Senator Long's address of December 17, 1979 succinctly states the reason and the intended purpose for the Amendment:

Nevertheless, I believe that, without an Amendment, captive rail movement of coal under the provisions of S. 1946 would be detrimental to the interests of American customers who have already borne the burden of loss of low cost gas and conversion to high price oil.

I repeat, Mr. President, the issue is not whether coal transportation should be profitable. The issue is whether coal should subsidize the transportation of other commodities. The issue is whether this profit and subsidy should be completely without limits and at the sole discretion of the railroads.¹

NPPD concurs in this statement of the issue. As we have previously pointed out to the Committee, NPPD, like most utilities who depend upon western coal to fire their power plants, is, in many instances, a captive shipper to one railroad. Although NPPD is a very large shipper of coal, it has had to rely upon the courts in an attempt to require a railroad to comply with its written agreement to transport coal to one of NPPD's largest power plants near Wallace, Nebraska. NPPD has recently attempted to negotiate a transportation agreement for a new 600 megawatt station to be built near Comstock, Nebraska. To date, those negotiations have been futile. Unless competitive rail transportation is provided from the Powder River Basin coal fields in Wyoming, a captive shipper such as NPPD needs the protection of regulation to protect it from monopolistic rail pricing policies. Neither NPPD nor its customers can afford legislation which provides no protection to shippers in situations where the natural protection of competition totally fails to exist.

THE AMENDMENT SHOULD BE MODIFIED

While agreeing with the Amendment in principal and purpose, the language of the proposed Amendment does not appear to clearly act upon that purpose. Section 104 of S. 1946 proposes to add certain provisions to Section 10701 of the Interstate Commerce Act. The rate flexibility provisions of Subsection (g)(1) allow a railroad to increase its rates for captive shippers by an amount not exceeding 112 percent of the adjusted base rate during a prescribed four year period. Section 102 of S. 1946 contemplates requiring the Interstate Commerce Commission ("Commission") to determine and publish the average ratio of revenue to variable costs that rail carriers would be required to realize on its transportation services. The Amendment also proposes to require the Commission to determine another ratio of revenue to variable costs for establishing a ceiling for rates beyond which the burden of proof with regards to reasonableness would be placed upon the proponent carrier. NPPD believes that the language of the Amendment does not indicate in what respect the ratio of revenue to variable costs under the Amendment is any different from that to be established by the Commission under Section 102 of the proposed legislation.

Section (B) of the Amendment describes many factors which the Commission should take into account to establish standards; however, the amendment is ambiguous as to what the term "standards" refers to.

Because the Amendment was proposed to deal primarily with coal rates, we believe it is crucial the Amendment allow the Commission to establish different ceilings for different commodities. Coal should be treated differently from other commodities which may have rates justifiably based on very high variable cost ratios.

Assuming that the Amendment does require the Commission to determine a ratio of revenue to variable costs which is different than that proposed under Section 102 of S. 1946, the question still remains as to whether the 4 percent "free zone" may be applied in excess of the "Cap" rate determined by the Commission in accordance with the Amendment. We hope that the language of the Amendment will be clarified to provide that the use of the 4 percent increases cannot exceed the cap ratio determined by the Commission pursuant to the Amendment.

OTHER SUGGESTED AMENDMENTS

The Amendment does not allow the Commission to suspend a rate on the grounds that it is unreasonably high nor may the Commission begin an investigation author-

¹ Congressional Record, December 17, 1979 at S. 18775.

ized by Section 104 of S. 1946. Given the tremendous economic impact associated with an unreasonable increase in unit train tariff rates, NPPD urges that the Amendment include a provision requiring the Commission to suspend, upon protest, any rate which exceeds an overall maximum rate ceiling which would be determined by the Commission in an administrative proceeding. We believe that given the nature of captive shipper/market dominant carrier situations, it is unfair to allow a "no suspend" rule to be used as an economic hammer by railroads. In addition, requiring suspension should result in railroads using restraint in attempting to assess rates at unreasonable levels.

THE COMMISSION SHOULD BE GIVEN FIRM LEGISLATIVE GUIDELINES

The Commission has filed a notice of proposed rulemaking in connection with rail market dominance and related considerations.² Under present regulations, 49 CFR 1109.1(g), a rebuttable presumption that market dominance exists arises upon the establishment of one or more of the following:

1. That the proponent carrier controls at least 70 percent of the relevant market.
2. That the rate in issue is at least 160 percent of variable costs.
3. That shippers or consignees have made substantial investments in rail related equipment or facilities.

The Commission is proposing to change these "tests" to one where a complaining shipper has the burden of proof on both the issue of market dominance and the unreasonableness of the proposed rate, without the aid of presumptions, unless the rate in effect is more than 180 percent of variable cost. In connection with this figure, the Commission has stated in its notice of proposed rulemaking that:

"The upper level is taken at 180 percent of variable cost, is based on our experience to date, and represents our best judgment when our scrutiny should be intensified. It should be noted here that, while we must necessarily establish numerical standards, we are dealing in an area in which judgment must play a major role in which mathematical precision is not possible."³

NPPD fears that the Commission, if it adopts the 180 percent level in Ex Parte No. 320 (Sub-No. 1), will do no differently if the Amendment is enacted.⁴ Without clear legislative direction to the Commission that the Amendment is intended to put a ceiling on coal rates applicable to captive shippers, no real protection will be afforded to shippers such as NPPD.

CONCLUSION

NPPD fully supports a viable and flourishing rail transportation system. NPPD, however, does not support attempts to require coal shippers to subsidize other rail transportation rates. Such subsidization only encourages continued inefficient rail management practices and discourages utilization of coal to move our country away from dependence on other forms of energy. Rail carriers must find ways to become competitive in all transportation markets which they serve. Railroads will not be encouraged to do so if they believe they will obtain subsidies from their captive shippers.

We believe that the Amendment should firmly implement the Amendment's purpose to establish a "[v]ariable cost ratio that would be a presumptive cap of maximum rate reasonableness."⁵

On behalf of Nebraska Public Power District, I appreciate this opportunity to discuss this very important legislation.

Senator LONG. I'm going to call a 5-minute recess, and then we'll appear back here.

[Brief recess.]

Senator LONG. All right, let me call Mr. Carl Glaze, assistant attorney general of Texas.

Mr. Glaze?

²Ex Parte No. 320 (Sub-No. 1).

³45 Fed. Reg. No. 12 at 3353.

⁴While recognizing that S. 1946 may eliminate the concept of "market dominance," the proposed changes that the Commission is considering clearly indicate what the Commission believes to be a rate level which justifies shifting the burden of proof. NPPD anticipates filing a statement in Ex Parte 320 (Sub-No. 1) and hopefully the Commission will not adopt the percentages of variable cost which it is now considering.

⁵Senator Long's address, *Congressional Record*, December 17, 1979, at S 18775.

STATEMENT OF CARL GLAZE AND STUART FRYER, ASSISTANT ATTORNEYS GENERAL OF TEXAS, ON BEHALF OF MARK WHITE, ATTORNEY GENERAL OF TEXAS

Mr. FRYER. Thank you, Mr. Chairman. I am Stuart Fryer. I am speaking today. Mr. Glaze is with me, and we are assistant attorneys general of Texas. And we appreciate the opportunity to appear here on behalf of Mark White, the attorney general of Texas.

Today we will summarize the written comments previously submitted and make a few basic proposals regarding the pending legislation.

Senator LONG. The statement will be placed in the record.

Mr. FRYER. One proposal deals with the procedural issue regarding the triggering of the burden of proof. The other deals with the more fundamental issue of maximum reasonable rates.

Initially, we would like to make a few general observations regarding these issues:

The 4R Act constituted a turning point in ICC regulation of the railroad industry, a turn which we believe was in the right direction. However, problems have developed in the implementation of that statute. Rather than seeing a revitalization of the railroad industry by flexible, imaginative, and aggressive competition among railroads and other transport modes, we have seen an increasing dependence on captive traffic.

This dependence has been implemented and encouraged by the Commission's imposition of subsidy burdens on captive traffic—most notably, and painfully for Texas, on Western Coal.

Section 205 of the 4R Act directed the Commission to implement procedures designed to aid the railroads in attaining profitable operation.

For a wide variety of reasons, many railroads operate services at rates inadequate to sustain overall profitable operation.

Instead of undertaking to assist the railroads in improving their performance on those services, the Commission has decided to implement section 205 by requiring captive shippers to subsidize or underwrite those unprofitable services.

They have done this directly through the so-called 7 percent solution. They have also done it indirectly by the use of certain overly generous cost-finding methodologies and decisions.

The result has been grossly inequitable and has also removed any incentive for the railroads to remedy their fundamental weaknesses.

This approach is counterproductive.

The Congress, in its consideration of amendments to the Interstate Commerce Act, faces a twofold task: First, it must insure that captive shippers are not subjected to monopoly abuses. Second, it must provide the railroads with the ability to respond to the pressures and disciplines of competition where competition exists.

Our experience has shown that merely placing the burden of proof on the railroads is not sufficient to protect captive shippers. As we mentioned earlier, the Commission has interpreted the language of section 205 regarding adequate revenue levels as being an expression of congressional intent that the profitability of the rail

system should override that agency's fundamental duty to protect against the abuse of monopoly power and discrimination.

The Commission has taken seriously its perception of the intent of Congress and when the profitability criteria has conflicted with those fundamental duties, profitability has prevailed.

In the San Antonio coal rate case, for example, the Commission acknowledged that certain evidence should be submitted to justify the imposition of a substantial subsidy burden on the San Antonio ratepayers. Yet the Commission proceeded to assess a 7-percent subsidy additive despite the absence of that information.

Further, the method selected by the Commission for advancing the railroads' profitability not only conflicts with those fundamental duties but also, as stated above, is counterproductive.

Although the burden of proof is important, and with some change of heart on the part of the Commission would become even more so, more specific protection of captive shippers is necessary.

Specific language is needed to deal with the Commission's failure to prevent the railroads from abusing their position by sanctioning monopoly prices.

We have addressed this issue in the statutory language which appears in our written comments.

As a result of what we believe is the Commission's misinterpretation of the intent of Congress, it has sanctioned monopoly pricing by the railroads.

That the Commission has not always allowed as thorough an abuse of that monopoly position as the railroads sought to impose is no defense.

Unfortunately, it appears the Commission will continue these erroneous practices, unless the Congress specifically directs it to do otherwise.

We feel that the proposed amendment is not so strict or confining as to hamstring either the Commission or the railroads, but is a clear expression of the principle that the profitability of the railroads and the prevention of abuse of monopoly position are not mutually exclusive.

The Commission's utilization of captive traffic to finance the entire operation of the railroads must be stopped. Such an approach is not only unfair to captive shippers, but it is an affront to the clear goal of Congress to promote honest, economical, and efficient management of the Nation's rail system.

If the present scheme continues, the railroads will have no incentive to remedy new problems in the noncompensatory segments of their operations. So long as the railroad is allowed to rob Peter to pay Paul, it will have no incentive to improve the lot of Paul.

On the other hand, if the railroads are forced to operate all services in an efficient and economical manner, the present unfair system of cross subsidization will be unnecessary.

Back to the issue of burden of proof for a minute, we have also suggested that the Long amendment be revised to rely on rate standards to be incorporated in other sections of S. 1946, rather than on separately computed formulas. We feel this would remove one level of regulatory complexity and help avoid the regulatory gap between the free-rate zone provided by S. 1946 and the imposition of the burden of proof on the railroads.

Thank you. If you have any questions, we would be glad to answer them.

Senator LONG. Thank you very much for your statement. We will give it thorough consideration.

[The statement follows:]

STATEMENT OF MARK WHITE, ATTORNEY GENERAL, STATE OF TEXAS

As chief legal officer of the State of Texas, I appreciate this opportunity to present our office's views on the important issues raised by S. 1946 and specifically by the Long Amendment to that bill. I had the opportunity in connection with S. 796 to discuss with you some of the impacts which rail rates and especially western coal rates are having in Texas. Therefore, I will not dwell again on the details of those specific problems.

The American Railroad Industry has been in difficult financial circumstances. However, the financial condition of individual railroads varies greatly. Further, the western roads, generally, and especially those involved in western coal movements have shown strong financial performance in recent years. It has generally been conceded that one of the causes of the problems faced by the railroad industry has been excessively broad and rigid regulation the federal level. However, we must not lose sight of the fact that there are many other sources of those problems. They range from differing levels of subsidy to the various modes of freight transport from the several levels of government, to management inadequacies in the railroad industry itself, to changing conditions in the American economy as a whole. A regulatory bill cannot hope to deal with all of these problems. For example, we as a nation have held oil and, therefore, diesel fuel prices to artificially low levels for the past several years. One effect of that policy has been to make trucks, which are less fuel efficient, more competitive with trains than they otherwise would have been. This bill cannot overcome either that problem or many of the other problems.

Further, this bill cannot compel good management on the part of the railroads. In fact, this bill constitutes a recognition of the fact that the federal government cannot effectively manage the nation's railroads. The proper goal of this bill is to keep the federal government from being an obstacle to the railroad's attainment of profitability in a competitive environment. Some railroads, even with that obstacle removed, may be unable to accomplish profitable operation, and, in that event, the shareholders will be the losers. This reflects a market allocation of resources and constitutes a risk of doing business. This is not necessarily bad. However, to the extent that the currently existing federal regulatory scheme impairs the railroad's ability to attain and maintain profitable operation in a competitive environment this bill should be designed to alleviate that situation.

The foregoing leaves open the question of the proper role of government where effective competition does not exist. This office believes that federal regulation of interstate railroad's operations and rate structures is entirely appropriate in the absence of effective competition from other railroads or other modes of transport. This view is founded not only on considerations of equity but also upon a desire to avoid the economic distortions which result from monopoly pricing.

As this hearing deals only with the Long Amendment to Senate Bill 1946 we will focus our comments on that amendment and the issues which it raises. The fundamental issue raised by the Long Amendment is that of maximum permissible rates for rail transportation.

S. 1946 constitutes a fundamental procedural departure from the 4R Act in that it substitutes various cost based standards for the 4R Act's "market dominance" test. However, the thrust of the two approaches is similar, removal of Commission control from the railroad's rate decisions where and only where shipper's interests are adequately protected by market forces. Parenthetically, Texas welcomes the provisions of S. 1946 which explicitly authorize contract rates as a way of expanding the scope of substantive market control of rail rates.

The Long Amendment requires the Commission to define a revenue to variable cost ratio which will serve as a trigger for the imposition of the burden of proof as to the reasonableness of a proposed rate on the railroad making such proposal. In doing so it recognizes an extremely important principle. A railroad unquestionably should be required to justify rates in excess of the levels authorized by the other provisions of S. 1946. However, we would suggest one caveat concerning the use of cost based standards and one simplification of the Long Amendment.

Both the Long Amendment and Section 102 of S. 1946 rely on ratios of revenue to variable cost as triggers. The ratios in those two provisions are to be separately evaluated and established although they reflect similar considerations. Under the

Long Amendment if the expected revenue from a movement divided by the expected variable cost of that movement exceeds a ratio established by the Commission then the burden of proof as to the rate's reasonableness is imposed upon the railroad. The crucial point to be remembered in regard to this type of regulatory device is that no matter how carefully the Commission considers and formulates its triggering ratio there will be a substantial motivation for the railroad to state its costs in such a manner that the highest possible variable costs are reflected in movements whose rates are relatively high. In addition, the use of such a formula removes the incentive for the railroads to reduce their cost if the demand for a particular service is such as to enable them to increase rates with impunity, i.e. a market dominance situation. Thus, the use of such a formula imposes a heavy but necessary burden on the Commission to scrutinize with great care any cost assertions made by the railroads. Notwithstanding the weight of that burden, it is crucial that costs control rate making decisions where the pertinent issue is protection of consumers against abuse of monopoly power and that those costs carefully be examined to guard against overstatement and inflation through poor management therefore, it is not our position that the standards used in S. 1946 should not be cost based. Our intent is merely to point to a fundamental problem faced by all regulators who attempt to apply cost based standards.

This office suggests that the Long Amendment's use of a separate triggering ratio in regard to the imposition of the burden of proof on the railroads is an unnecessary complication in the regulatory scheme. We advocate that the burden of proof be placed on the railroads for any proposed new rate or rate increase which would exceed the levels specifically authorized under subsections (e), (f), or (g) of this Section. This would remove a burden from the Interstate Commerce Commission and would prevent a regulatory gap between the rate levels specifically authorized and the rate which would result under the contemplated revenue to variable cost ratio in a triggering of the burden of proof. It is not unreasonable to suggest that the railroads should bear that burden of proof for any rate which exceeds the levels specifically authorized by the statute. The vast majority of the evidence relevant to the reasonableness of that rate will be in the possession of the railroad proposing the rate and the benefit of the proposed rate will inure to that railroad. Thus the burden as to the reasonableness of such a rate should lie with the railroad in all cases rather than only in cases where the proposed rate exceeds some separately set ratio of revenue to variable cost.

Having suggested that the Long Amendment be revised to delete the separate triggering ratio it is necessary to examine another more fundamental issue. S. 1946, including the Long Amendment, is and should be designed to do two things. First, the railroads must be given an opportunity to succeed or fail in the competitive world of freight transportation unimpeded by nonessential regulation. Second, the Commission must preclude abuses by the railroads where sufficient competition does not exist to afford such protection. These comments will not deal in any detail with the first of those issues. The railroads are perfectly capable of explaining any difficulties which the proposed legislation may create in their efforts to adapt to competitive circumstances.

In any event, the Long Amendment is directed to the second issue. This office favors the Long Amendment as written and would support it even more strongly if revised as suggested above. However, it must be stated that neither S. 1946 generally nor the Long Amendment specifically will result in the provision of any significant protection to captive shippers.

In order to accomplish that the bill must address more than just the burden of proof. The Long Amendment would provide an appropriate medium for doing so. Stated generally, that additional issue is the definition of a maximum reasonable rate for rail freight movements. If shippers are to be adequately protected from abuses of monopoly power it is essential that Congress provide guidance, indeed, provide a clear mandate to the Commission in regard to the issue of maximum rates. Specifically, the issue which has plagued coal shippers has been the implementation by the Commission of rates which constitute and are intended to constitute subsidies to the railroads in regard to the shipment of other commodities. The Commission has held the rates set at subsidy levels are reasonable and are mandated by the so called revenue adequacy provision of the 4R Act, now Section 10704(a)(2). This should not be allowed. For the Commission to allow the railroads to set or to set (as it has done in several cases) rates which impose cost subsidy obligations on shippers who are captive to specific railroads is to allow the sort of abuses which the ICC was founded to prevent.

The 4R Act included some rather detailed provisions in regard to the definition of minimum reasonable rates. However, neither in the existing statutes nor in S. 1946 is there a definition of a maximum reasonable rate. The Commission in recent

years, especially in coal rate cases, has set captive shipper rates at levels which constitute subsidies to the railroads in regard to their operation of less profitable traffic. They have done this under the banner of Section 10704(a)(2).

The argument advanced in support of that procedure is that the railroads operate certain services at rates only marginally above variable cost. It is contended that the rates on these routes are held down by competition. It is further contended that as a result of these operations the overall revenue level of the railroad in question is inadequate. From this the railroads argue and the Commission concludes that the railroads should charge rates to their captive shippers above the level necessary to pay their costs and return a reasonable profit in order to secure rates which on the average yield adequate revenues.

That a regulatory body charged with responsibility of protecting against abuse of monopoly power would accept such an argument is remarkable. But the Interstate Commerce Commission has indeed accepted that argument. Thus, although the Long Amendment would be some improvement over the provisions of S. 1946 it does not go nearly far enough. In the absence of some clear directive to the Commission as to what Congress means when it says that a rate must be reasonable, the Commission will continue to permit the railroads to abuse their monopoly power. This will occur at the expense of people like the citizens of San Antonio whose electric utility rates will skyrocket unjustly and unnecessarily as a result of Commission and railroad action.

The argument advanced by the railroads in support of the imposition of subsidy burdens is specious. If a railroad is operating a particular service at an unprofitable rate the railroad should seriously attempt to find a way to make that operation profitable either by raising the rate, reducing costs, or improving service, or failing that, the railroad should cease that operation. A railroad may deem it appropriate to continue operating an unprofitable service in the short run because it believes that service will become profitable in the future. If that is the case the Commission should certainly allow it to do so. However, that is a business decision which entails both risk and cost. That risk and cost should properly fall on the shoulders of the railroad making the decision, not on the shoulders of shippers who are compelled by circumstance to rely upon that railroad for other services.

If, as a matter of national policy, it is determined that a particular railroad should continue to operate a service despite the fact that it cannot be made profitable then the nation as a whole should bear the cost of that policy decision and not some selected group of shippers.

Further, the action of the commission in allowing the railroads to make up for any revenue shortfall by reliance on captive traffic serves only to exacerbate the underlying problem by removing any incentive for those railroads to improve the financial performance of their other traffic. If a railroad knows that it need only to look to its captive shippers to make up any revenue shortfalls on unprofitable routes then it has no motivation to attempt to improve the financial performance of those unprofitable routes.

The railroads have also asserted that because those unprofitable routes pay some part of fixed cost (although not their fully allocable share) their operation actually benefits the captive shipper upon whom the subsidy burden is being imposed. This is said to be true because otherwise the captive shipper would have to pay all of the fixed cost. Again this argument is specious. It ignores a fundamental law of economics: all costs are variable in the long run. We do not know and the Commission certainly does not know what the total fixed costs of the railroads would be if they ceased operating services which could not, with efficient and imaginative management, be made profitable. The necessary adjustments would range from possible shortline operation on selected segments of track to reduction of the ranks of central office staff and executives. Clearly the fixed costs would not remain the same. Further, that argument would treat the railroads as if they were factories producing varying levels of homogeneous products. The existing plant and equipment of such a factory entail certain fixed costs. Those fixed costs will exist and will be prorated over whatever level of output is produced and sold. (It should be noted that the owner of such a factory can sell his plant and construct either a larger or smaller plant in the long run.) But a railroad is not such a factory. There are many different services produced by a railroad using many different facilities. Sometimes those facilities overlap in the production of various services and sometimes they do not. Thus, it is clear that the fixed costs of a railroad are not necessarily and, in fact, are not generally jointly incurred for the pro rata benefit of all traffic.

A well operated railroad does not require that a subsidy be imposed on its captive shippers. The reliance upon subsidies by the Commission creates a disincentive to "honest, economical, and efficient" operation of the railroads as mandated by Section 10704(a)(2) of the 4R Act and, further, is grossly inequitable. Thus, it is our

position that, although S. 1946 and the Long Amendment may be positive steps in regard to the resolution of some of the issues surrounding federal regulations of the railroads, they will be small steps unless a specific provision delineating maximum reasonable rates is included.

The following language is suggested as a substitute for the language contained in the Long Amendment. It reflects the change suggested above in regard to the use of the standards for rates set forth in other subsections of the section to be amended as triggers for the imposition for the burden of proof. It also includes specific language defining a maximum reasonable rate under this statute.

"The burden of proof as to the reasonableness of a proposed rate increase which exceeds or would exceed that authorized by paragraph (1) of this subsection or a proposed new rate which exceeds or would exceed that authorized by subsection (e) of this section shall be upon the proponent carrier. In that regard the proponent carrier shall prove not only its need for such rate increase or new rate, but also that such rate increase or new rate does not exceed the level necessary to pay the variable cost reasonably incurred or to be incurred by the proponent carrier in connection with the transportation or service to which such rate applies, the share of fixed cost reasonably incurred or to be incurred by the proponent carrier which is fairly allocable to such transportation or service, and a reasonable and economic profit or return on capital employed in the business of the proponent carrier, which level shall constitute the maximum reasonable rate on such transportation or service for purposes of this section."

Note that the word "reasonable" modifies both cost elements in the suggested definition of maximum reasonable rate. This was done to ensure that those costs are not inflated by either misallocation, overstatement, or inefficiency of operation. Such a standard is crucial to the effective implementation of cost based regulatory criteria. The burden imposed on the Commission by that standard is substantial but, nonetheless, crucial.

The following constitutes additional language which is offered as an amendment to Section 10704(a)(2). The purpose of the following is to incorporate in the revenue adequacy provision of the 4R Act a statement of policy in regard to the use of subsidy burdens in implementing the provisions of that paragraph.

"Provided, however, that the standards and procedures established by the Commission pursuant to this paragraph shall not include the utilization of subsidy burdens imposed upon some shippers as a means of securing overall revenue adequacy for such rail carriers." This office would like very much to see the railroads have the opportunity to make themselves prosperous and profitable and believes that they can do so even in the face of significant competition. We do not believe, however, that subsidies are necessary to the profitable operation of this nation's railroads as private businesses. If a particular railroad cannot operate in the long run without subsidization that fact reflects the judgment of the market-place which judgment should be respected. If a railroad is deemed to need subsidies in the short run to overcome financial difficulties and if such assistance is deemed to be in the national interest that subsidy should be paid from the national treasury not from the pockets of a certain class of shippers. The Commission should be removed from its position as an impediment to competent, profitable management of the railroads in a competitive environment. It should retain and fully implement its responsibility to protect against undue discrimination and against abuse of monopoly power.

In the past the Commission has been used and has acted as a vehicle to implement social policy unrelated to the basic responsibilities of and to the justifications for Commission authority over railroad activities. Neither the Commission nor the Congress should attempt to utilize the Commission's authority to accomplish social goals unrelated to the basic tasks of the Commission: prevention of discrimination and of abuse of monopoly power. In this regard we would direct your attention to Section 111 of S. 1946 which provides for special treatment of grain shipments in regard to the setting of demand sensitive rates. In the vast majority of cases the movement of grain by any railroad is done under competitive circumstances. Thus, the market should be allowed to determine when, how, and at what rate grain is shipped. If the railroads' ability to haul grain profitably is impaired they will press for further subsidies from captive shippers, which subsidies the Interstate Commerce Commission has shown a willingness to grant. Thus, to the extent subsidies are granted, the burden of that regulatory provision falls on other shippers such as San Antonio and its electric rate payers. Otherwise the burden falls on the railroads. In any event, such a provision perpetuates precisely the kind of regulatory distortions which S. 1946 is otherwise designed to alleviate.

A chart showing earnings in various U.S. industries appears in the February 18, 1980, issue of U.S. News and World Report. Three entries are of particular interest. Coal Mining showed \$29.1 million in the fourth quarter, 1979, earnings, down 46

percent from that quarter of 1978, with profits at 2.4 percent of sales. The Trucking Industry had fourth quarter earnings of \$23.2 million in 1979, down 42 percent from 1978. Trucking Industry profits were 2.3 percent of sales. The Railroad Industry's fourth quarter earnings of \$505.3 million were up 41.4 percent over 1978, with profits at 9 percent of earnings. Out of 29 listed industries the railroads were third in percentage improvement in earnings and sixth in profits as a percentage of sales. Our purpose is not to suggest that no problems exist in the Railroad Industry, but rather to suggest that that industry does indeed have strong potential to remain viable as a private, competitive enterprise. However, clear guidance from the Congress and diligent oversight by the Commission remains necessary to guard against discriminatory practices and abuses of monopoly power during that industry's resurgence.

In summary, the Attorney General of Texas supports S. 1946 as amended by the Long Amendment. We suggest that the Long Amendment be altered so as to delete the requirement that a separate revenue to variable cost ratio be established. Most importantly, however, the Attorney General of Texas would assert that in the absence of a specific provision defining and limiting the maximum reasonable rate which the Commission may approve, neither S. 1946 generally nor the Long Amendment specifically will serve to provide any significant protection against the abuse by the railroads of the monopoly power which they possess. We appreciate very much the opportunity to present our views on these critically important matters.

Senator LONG. Next, we will hear from Mr. Donald Boyes, president of the National Industrial Traffic League.

STATEMENT OF DONALD BOYES, PRESIDENT, NATIONAL INDUSTRIAL TRAFFIC LEAGUE; ACCOMPANIED BY JAMES E. BARTLEY, EXECUTIVE VICE PRESIDENT; JOHN K. MASER III, COUNSEL; AND STANTON P. SENDER, TREASURER

Mr. BOYES. Good morning, Senator Long. My name is Donald Boyes. I am president of the National Industrial Traffic League and am employed as director of transportation for Reynolds Metals Co. of Richmond, Va. Accompanying me this morning are Mr. Stanton P. Sender, treasurer of the league; Mr. James E. Bartley, executive vice president of the league; and Jack K. Maser III, of league counsel.

The league is the oldest and largest nationwide association of shippers and receivers. Its members directly or indirectly represent about 80 percent of the commercial traffic moving in our country.

The league appears before you today to offer its support of the objectives of your amendment to S. 1946, the Railroad Policy Act of 1979, as it appeared in the December 17, 1979, Congressional Record. That amendment applies to rate filings on all commodities which are both within and above the 4 percent no-suspend zone. It would require railroads to specifically justify rates over a particular revenue-to-variable-cost ratio to be developed within 1 year by an Interstate Commerce Commission formal proceeding. After completion of the ICC rulemaking, Congress would have 120 days to hold hearings and take action on the Commission's findings. If no action is taken, the ICC-recommended standards would become effective.

Specifically, the amendment provides that once a rate exceeds the ICC-determined ratio, the burden of proof for the reasonableness of the contested rate rests on the publishing carrier. This burden would remain on a carrier in complaint cases, despite other statutes which place it on the complaining shipper.

In addition, when contested rates are above the 4 percent no-suspend zone, the amendment makes the publishing carrier respon-

sible at the suspension stage to show the likelihood of prevailing on the merits for rates above the specified ratio.

The league is pleased by the amendment's recognition of its contention that a point exists beyond which the forces of effective competition are too weak to perform their function as the "natural" regulator. We are also pleased by the amendment's even-handed treatment of this problem by making its provision applicable to all commodities.

In previous appearances before this committee the league has offered a three-tier approach for insuring adequate shipper safeguards to prevent rail carriers from abusing their market power. This plan sets the first tier as the variable-cost of providing service. The second tier would be set by an ICC-determined revenue-to-variable cost ratio, based on the results of the most efficient rail carriers, which allows carriers to recoup their variable costs plus a fair return. This second tier would act as a threshold, and all rates below it would be free from Commission scrutiny.

The third tier would also be set by an ICC-determined revenue-to-variable-cost ratio, and would serve as the point beyond which a shipper would be presumed to need some type of protection against abuses of market power. Between the second and third tiers, the Commission would have discretionary authority, upon protest, to suspend and investigate rates. Above the third tier, the agency's discretionary authority would become mandatory upon protest.

Our three-tier proposal would provide carrier management with responsibility and freedom for ratemaking, but would recognize the shippers' need for maximum rate protection through the retention of the ICC's investigation and suspension powers. For your convenience, an illustration explaining this plan is attached as appendix A to my testimony.

Although the amendment does not go as far as the league advocates by retaining the ICC's power to suspend as well as to investigate, we commend its recognition of shippers' need for some sort of maximum rate protection and are willing to accept it as a necessary, workable compromise for early enactment of S. 1946.

The league has not had the opportunity to bring your amendment before its general membership. However, that proposal has been circulated among our affected committees—about 200 shippers. Their reaction was an overwhelming support for its incorporation into S. 1946.

The league strongly supports the amendment's provision for allowing an unlimited time for filing complaints against new rates or rate adjustments which exceed the maximum reasonableness ratio and for allowing it to supersede the 9-month limit imposed in section 116 of S. 1946.

The league believes that the unlimited time provision is a crucial protection for shippers who are trying to meet the constantly changing demands of the marketplace. We firmly believe that any attempt to impose a time limit on this amendment, such as was done in section 116, would render the proposed maximum rate protection meaningless.

With respect to standards for creating the ratio proposed in the amendment, the league has not yet formulated specific recommendations. However, we do ask consideration of another factor in

those deliberations—the standards contained in our proposed national transportation policy, a copy of which is attached as appendix B. We ask adoption of the standards contained in our proposed policy because they serve as an expression of congressional intent without changing the Interstate Commerce Act.

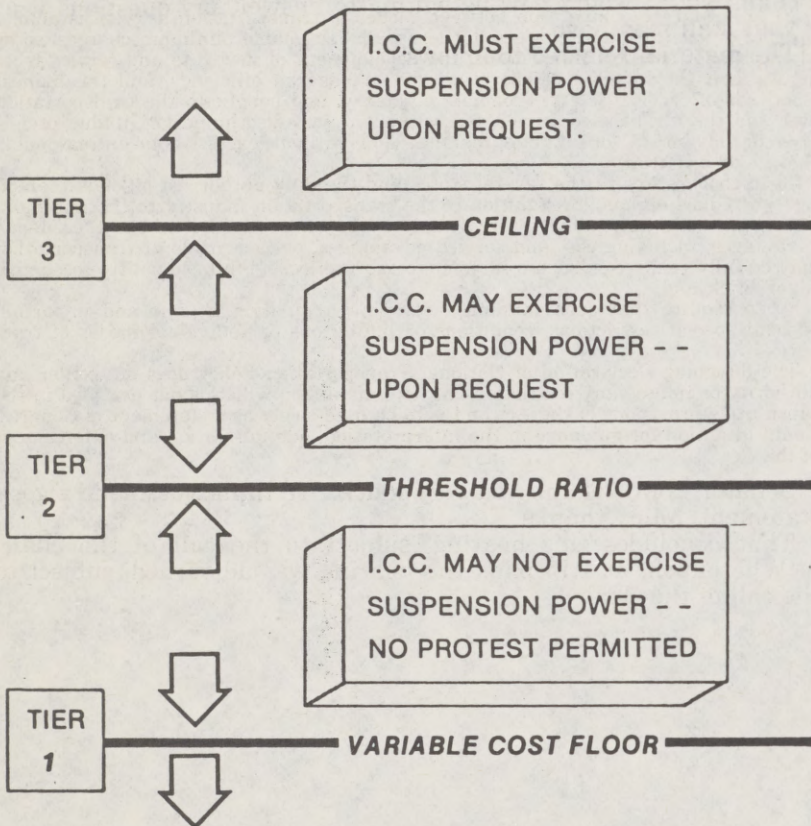
In conclusion, the league supports your amendment because, like the third tier of our proposed plan for maximum rate regulation, it simply opens the door for ICC action to safeguard the shippers' long-established rights to protection from the carriers' abuse of their market power. It does so not by imposing a mandatory cap on all rates, but by placing the burden of proof on the carriers who are the possessors of the cost information vital to the assessment and evaluation of the reasonableness of any rate proposal. Therefore, we urge early enactment of S. 1946 with Chairman Long's amendment as proposed in the December 17 issue of the Congressional Record.

Thank you. I would now be willing to answer any questions you or your staff may have.

[The material referred to follows:]

N.I.T.L.'S THREE TIER APPROACH

RATE MAKING FREEDOM



[APPENDIX B]

THE NATIONAL TRANSPORTATION POLICY OF THE NATIONAL INDUSTRIAL TRAFFIC LEAGUE

The League is of the opinion "that Congress should declare that the national transportation policy is to preserve and promote private ownership and operation of all forms of transportation; to preserve the inherent advantages of each; to promote, safe, economical and efficient service; to encourage competition and the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair competitive practices, all to the end of insuring the development and preservation of national transportation service adequate at all times to meet economically and efficiently the full needs of the commerce of the United States."

The following language was adopted by the League as a recommended preamble to the Interstate Commerce Act:

"It is hereby declared to be the national transportation policy of the Congress—

(1) to provide for and develop, under the free enterprise system of dynamic competition, a strong efficient and financial sound national transportation industry by water, highway, and rail, as well as other means, which will at all times remain fully adequate for national defense, the postal service, and commerce;

(2) to encourage competition between modes of transportation as well as among carriers of each mode at charges not less than reasonable minimum charges, so as to encourage technical innovations, the development of new rate and service techniques, and the increase of operating and managerial efficiency, and the highest standards of service, safety, economy, efficiency, and benefit to the transportation user and the ultimate consumer, but without unjust discrimination, undue preference or advantage, or undue prejudice, and without excessive or unreasonable charges on any traffic;

(3) to cooperate with the several states and the duly authorized officials thereof;

(4) to reduce economic regulation of the transportation industry to the minimum consistent with the public interest and to the end that the inherent economic advantages, including cost and service advantages, of each mode of transportation may be fully realized in such a manner so as to reflect its full competitive economic capabilities; and,

(5) to require that such minimum economic regulation be fair and impartial, without special restrictions, conditions or limitations on individual modes of transport.

The foregoing Declaration of National Transportation Policy does not confer any authority or impose any restriction on the Commission which is not provided in the substantive provisions of the Act and is to be used solely as a statement of Congressional intention for guidance in the interpretation, administration and enforcement of the Act."

Senator LONG. Thank you very much. We think you made a good statement. Many thanks.

That concludes this hearing, subject to the call of the chair.

[Whereupon, at 1:15 p.m., the hearing was adjourned, subject to the call of the Chair.]

The first of these is the fact that the journal is published quarterly. This is a significant feature, as it allows for a more frequent update of the information contained within. The second is the fact that the journal is published in a single volume. This is a significant feature, as it allows for a more comprehensive coverage of the subject matter. The third is the fact that the journal is published in a single issue. This is a significant feature, as it allows for a more focused and concise presentation of the material.

The fourth is the fact that the journal is published in a single language. This is a significant feature, as it allows for a more consistent and uniform presentation of the material. The fifth is the fact that the journal is published in a single format. This is a significant feature, as it allows for a more consistent and uniform presentation of the material. The sixth is the fact that the journal is published in a single location. This is a significant feature, as it allows for a more consistent and uniform presentation of the material.

The seventh is the fact that the journal is published in a single country. This is a significant feature, as it allows for a more consistent and uniform presentation of the material. The eighth is the fact that the journal is published in a single city. This is a significant feature, as it allows for a more consistent and uniform presentation of the material. The ninth is the fact that the journal is published in a single street. This is a significant feature, as it allows for a more consistent and uniform presentation of the material.

The tenth is the fact that the journal is published in a single house. This is a significant feature, as it allows for a more consistent and uniform presentation of the material. The eleventh is the fact that the journal is published in a single room. This is a significant feature, as it allows for a more consistent and uniform presentation of the material. The twelfth is the fact that the journal is published in a single chair. This is a significant feature, as it allows for a more consistent and uniform presentation of the material.

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF THE AMERICAN PAPER INSTITUTE, INC.

We appreciate the opportunity, pursuant to the invitation from the Committee of January 21, 1980, to present this further testimony, specifically directed to the subject of maximum railroad rate regulation and more precisely to the proposed amendment, Section 104(5)(A) offered by Senator Russell B. Long.

In full recognition of the importance of the legislation here involved, we have earlier presented testimony on June 20, 1979 [S. 796], October 15, 1979 [S. 796], November 13, 1979 [S. 1946].

Throughout all of the previous testimony we have emphasized the position of our industry that the ultimate objective is the end of federal regulation, whenever and wherever possible. Our testimony has strongly favored the thrust of deregulation embodied both in S. 796 and S. 1946. We strongly support reliance upon competitive forces in the market place and our only reservation applies where railroad monopoly power continues to exist.

While standing by our earlier testimony on the provisions of S. 796 and S. 1946, at this juncture we shall concentrate on the proposed Section 104(5)(A) and related considerations pertaining to maximum rate regulation. It is appropriate to note that in our testimony on S. 796 we supported the provision of Section 102(b) for termination of maximum rate regulation after five years. We had supported this provision toward deregulation on the presumption that the Congress would legislate any remedial action indicated necessary by studies to be undertaken by the U.S. Department of Transportation.

ESSENTIAL PROTECTION OF CAPTIVE SHIPPERS IN THE FACE OF RAILROAD MONOPOLY

In all our testimony we have emphasized the value of relying upon competitive forces operating in the market place. There is, of course, one area where this does not apply, i.e. where shippers are forced to rely on a railroad or railroads enjoying a monopoly position as to the movement of particular traffic. While we oppose federal regulation we reluctantly accept it only when particular circumstances require it—such as where competitive forces are not operating due to the existence and exercise of monopoly power. It is for this reason that electric, gas, telephone and other public utilities are regulated.

Pursuant to the Railroad Revitalization and Regulatory Reform Act (the 4R Act) the Interstate Commerce Commission has implemented the so-called "market dominance" protection for shippers. The Commission created rebuttable presumptions based on (1) market share enjoyed by the railroads; (2) investment in railroad equipment and facilities by the shippers and/or receiver; and (3) a revenue/variable cost ratio benchmark. We continue to feel that these tests are both viable and essential and we continue to support them. However, we note that S. 1946 takes a different approach and in essence uses a single benchmark, i.e. a revenue/cost ratio test. It is our understanding that the underlying rationale of the single revenue/cost ratio test is that application of the market dominance protective provisions was unduly complicated. While respectfully we do not agree with the latter, we much emphasize that our members face the unavoidable risk involved in a single test and deem it essential that such test be made as meaningful, realistic and workable as possible. We feel that Senator Long's proposed amendment in principle contributes significantly to that objective.

THE NEED TO STRENGTHEN THE SINGLE TEST APPROACH OF S. 1946

If the Congress is determined to pursue the single test approach, our industry stresses that every precaution must be taken to make that test as realistic and meaningful as possible. The new approach taken by S. 1946 is departure from the "market dominance" test, with total reliance upon a single test—use of the average

ratio of revenue to variable cost to be established by the Interstate Commerce Commission.

A basic significance of the S. 1946 approach is that where a particular railroad freight rate is found to produce a revenue-to-variable cost ratio that is equal to or less than the average ratio of revenue to variable cost established by the Commission shippers will have no standing to assail such rate as unreasonably high under the Interstate Commerce Act.

Based on our experience we cannot over-emphasize (1) the importance of accurate computation of variable costs of rail transportation and (2) the frequency of the situation where there are honest and fundamental differences between the carriers and the shippers as to what the actual variable costs are.

This can be illustrated by a hypothetical and practical example. With respect to the movement of a particular commodity shipped by our industry let us assume the rate was \$0.855 per hundredweight. Let us further assume that the railroads contend that the comparable variable costs were a \$1.00 per hundredweight resulting in an alleged ratio of rate to variable costs of 85.5 percent. During the interim period under Section 102 if the aim was to establish a ratio of rate to variable cost of 150 percent the rate would be increased from \$0.855 to \$1.50 per hundredweight, resulting in an increase of 75 percent in the rate.

Let us further assume that independent analysis on the part of our industry developed the fact that the variable costs per hundredweight were actually \$0.684 instead of \$1.00. Utilizing the latter figures the ratio is 125 percent and if it were desired to achieve a ratio of 150 percent the rate would be increased from \$0.855 to \$1.03 per hundredweight, or an increase of 20 percent. In other words, you will note the tremendous difference in terms of the percent increase in the rate depending upon the actuality of the variable costs involved.¹

This brings us to a most important point. Senator Long's proposed amendment Section 104(5)(A) specifically contemplates a rulemaking proceeding by the I.C.C. which in turn would enable shippers as well as carriers to provide input to the record upon which the Interstate Commerce Commission would reach its decision as to the point at which the burden of proof with regard to reasonableness shall be upon the proponent carrier.

While it may be contemplated to occur in Section 102 of S. 1946 the present tax does not specifically provide for a similar rulemaking proceeding by the Commission where in input would be received from shippers as well as carriers in developing the record upon which the Commission establishes the threshold for Commission jurisdiction based upon the average ratio of revenue-to-variable cost. (To be 150 percent for the first 120 days from date of enactment).

In order to strengthen the development of the threshold test for I.C.C. jurisdiction over maximum reasonable rates under S. 1946 our industry proposes the following language as an amendment to the present Section 102 of S. 1946:

Add to Section 102, sub-section (e)(2), inserting at line 18 after the word "States"

"The Commission shall expressly provide for the receipt of written representations from shippers and others concerned in developing the record to be utilized in determining such average ratio. Such determination shall be subject to judicial review."

Change Section 102 subsections (3) and (4) to read subsections (4) and (5) respectively. Insert new Subsection (3) to read as follows:

"(3) With respect to any railroad freight rate or charge which is challenged as in excess of a maximum reasonable level the Commission shall in its rules of practice provide for receipt of representations as to the applicable revenue-to-variable cost ratio, duly verified, from the shippers and carriers affected thereby. The Commission shall thereafter determine whether the applicable ratio is equal to or less than the ratio previously determined pursuant to this sub-section. The parties shall to the fullest extent possible present the applicable costs based upon the particular circumstances and conditions of transportation pertaining to the movement(s) of the commodity involved under the rate being challenged. The proponent railroad shall have the burden of proof as to the ratio applicable to the rate, commodity and movement involved."

¹The present uncertainties in railroad costing are exemplified by the fact that there is currently pending before the Commission Docket No. 37203, *Cost Center Accounting and Reporting System for Class I Railroads*, a basic purpose of which is to improve the accuracy of railroad cost accounting.

THE LONG AMENDMENT WILL SIGNIFICANTLY STRENGTHEN THE SINGLE COST TEST
TAKEN IN S. 1946 FOR THE PROTECTION OF CAPTIVE SHIPPERS

We have earlier reiterated our concern with the fact that S. 1946 as presently drafted terminates the market share and the investment in railroad facilities and equipment presumptions for the protection of captive shippers. A basic reason why our industry supports the Long Amendment is that it is a significant step toward further strengthening the much weaker single cost test presently contained in S. 1946.

Senator Long summarized the essence of his proposed amendment when he states in the Senate on December 17, 1979:

"The effect of this amendment will be to have the ICC, with final congressional review, establish standards for determining a revenue to variable cost ratio that would be a presumptive cap of maximum rate reasonableness. At this level of rate reasonableness the burden would shift to the railroads to prove in a proceeding at the ICC their need for further rate increases. If this burden of proof is met, the ICC could grant the increase. The entire process would continue to be subject to judicial review."

Senator Long's amendment and his commentary, above quoted, stress a crucial point—the placing of the burden of proof upon the railroads when the applicable revenue-to-variable cost ratio is exceeded. This is important protection to captive shippers and to a degree at least counterbalances the loss of the present protection under the market dominance provisions.

This naturally leads to an important and related point on the matter of burden of proof. Both under Section 102, in accordance with our suggested amending language, and under the Long amendment of Section 104, the burden of proof should be placed upon the railroads to demonstrate the actual revenue-to-variable costs involved. These costs pertain to the railroads' own operations. They are especially in a position to know the pertinent facts. They should have the burden of proving the revenue-to-variable cost ratios applicable to the railroad movements involved. It cannot be otherwise, particularly in the short frame because of the undeniable fact that great difficulties are encountered by shippers in endeavoring to obtain the essential information upon which to make the determinations as to costs. It is to be remembered that for the captive shippers this is a life and death matter and simple fairness and justice require the above conclusion.

Here we take note of another crucial point, over and above the necessity of accurate cost findings. Our industry is confident that the Congress does not contemplate other than efficient railroad operations. Accordingly, we ask this Committee and Congress to make clear beyond doubt that the railroad costs developed for the purpose of Section 102 and Section 104 of S. 1946 should be railroad costs based upon genuinely efficient railroad operations. To do otherwise would be unjust to the shipping public and at bottom an exercise in futility.

We note with approval and support the important language which appears at page 19 of Senate Report No. 96-470 on S. 1946 where the following appears:

"* * * In determining the ratio, the Commission has flexibility to utilize data of all carriers, that group of carriers selected for determining adequate revenue levels under section 10704(a)(2) of this title, or any other carrier group deemed appropriate for the purposes of this subsection * * *"

We would suggest changing the phrase "all carriers" to "all profitable carriers" in the second line of the above language. To us it is obvious that inclusion of Conrail and other bankrupt railroads in the cost computations of Section 102 and Section 104 would be directly contrary to the basic rationale of S. 1946, particularly the new elements of Railroad Transportation Policy contained in Section 2.

The importance of the use of efficient railroad operations in applying the railroad cost benchmarks can be readily illustrated. We are aware, of course, of three vital applications of the cost standards. First, no railroad should transport traffic at rates below going concern value, i.e., variable costs. Secondly, the threshold for I.C.C. jurisdiction on the issue of maximum reasonable rates is set by the average revenue-to-variable cost ratio provided for in Section 102. Thirdly, Senator Long's amendment will provide for the determination of the ratio of revenue-to-variable cost (expressed as a percentage) at which the burden of proof with regard to reasonableness shall be upon the proponent carrier.

All of us are aware that there are several railroads which have a notable reputation for efficiency and there are others where this cannot be said. The example of Conrail inevitably comes to mind. Without purporting to use the precise figures, a hypothetical example can be useful in making our point. For a period of 120 days after enactment, Section 102 contemplates the use of a ratio of revenue-to-variable cost of 150 percent. Under our hypothesis, an efficient railroad E in performing transportation of a commodity from Y to Z incurs a cost of \$1.00. For performance

of the same service on the same commodity from Y to Z, the cost incurred by Conrail could be \$1.25. The cost threshold based on the efficient railroad would be \$1.50 and this should be the cost threshold for Conrail, in this hypothetical example.

The protection contemplated in the 4R Act as to the cost floor pertaining to going concern value was specifically limited. It most certainly did not and should not contemplate the use of inefficient railroad operations as the basis for the cost ratios contemplated under Section 102 of S. 1946 and Section 104 as it would be amended under the proposal of Senator Long.

We commend the Committee for its efforts toward achieving ultimate deregulation of the industry. We share the concern of the Committee as to the necessity for recognizing the problems of captive shippers confronted with the threat of railroad monopoly where the protection of competition is lacking. The suggestions which we have offered reflect the desire of our industry to assist the Committee and the Congress in grappling with this problem of railroad monopoly.

The opportunity to supplement our earlier testimony on S. 796 and S. 1941 is very much appreciated.

STATEMENT OF B. F. BIAGGINI, CHAIRMAN AND CHIEF EXECUTIVE OFFICER,
SOUTHERN PACIFIC CO., AND SOUTHERN PACIFIC TRANSPORTATION CO.

Mr. Chairman and Members of the Subcommittee, my name is B. F. Biaggini, and I am Chairman and Chief Executive Officer of Southern Pacific Company and Southern Pacific Transportation Company. I appreciate this opportunity to express my views on S. 1946, the Railroad Transportation Policy Act of 1979, and also as a member of TRAIN to join the other railroad chief executives in supporting a compromise joint rate proposal.

I. COMMENTS ON S. 1946

Before discussing TRAIN's joint rate proposal, I would like to comment briefly on the provisions of S. 1946. This bill goes a long way to correct the number of the deficiencies in S. 796 which various members of Congress, shippers and railroads addressed before your Surface Transportation Subcommittee. We at Southern Pacific heartily support most of the provisions of S. 1946, and I wish to commend the members and staffs of this Committee and the Surface Transportation Subcommittee for your extended consideration of the problems of the railroad industry. This bill is of critical significance to the railroad industry, shippers, and the general public. If enacted, it would grant some regulatory reform and pricing freedom and thereby aid the railroads to compete more freely with other forms of transportation which have been significantly deregulated for years. Although this is not a complete deregulation bill, it is urgently needed because of the industry's inability to finance through earnings on the huge capital expenditures which are necessary if railroads are to remain viable. Mr. Chairman, the industry's return on investment last year was under 2 percent for the fourth consecutive year and Southern Pacific's railroads' average return on investment was only 3.21 percent for the last 10 years. It is absolutely essential that this bill, with some modifications that I will suggest, be adopted as quickly as possible.

Mr. William Dempsey, President of the Association of American Railroads has commented in detail on the bill, and we in TRAIN generally support his views.

The most significant provisions of the bill are those relating to rate flexibility. My own personal preference is to eliminate all regulation pricing. However, as a first step the rate flexibility provisions of the bill (Secs. 102-105) do provide essential rate freedom zones by granting the right to raise very low rates up to an average cost ratio and the right to increase rates by the amount of increases in the rail cost index. The additional right to raise rates by a limited amount in excess of inflation without investigation or suspension, but subject to shipper complaint that the rate exceeds maximum reasonableness, is at least a start in the direction of permitting the railroads an adequate level of earnings.

The ICC in Sec. 104 is directed to study and report on adequate revenue levels, but I suggest that DOT also be a participant in the study.

I agree with Mr. Dempsey that the limitations on general freight rate increases contained in Sec. 105, whereby the general increase as we know it today would be ended after six years, are too radical. Rather than end completely general rate increases after six years, I suggest that they be permitted pending completion within the six year period of a joint ICC-DOT study of the problems faced by the railroads in recovering inflationary cost increases.

I sincerely believe that much of the criticism of general rate increases is unjustified and too often is made by persons who are not familiar with the ratemaking

process. The last general increase case, Ex Parte 368, involved 325 individual rate judgments, and therefore was selective to the extent market data warranted. We believe future general rate increase proposals can be refined to reflect not only cost but also demand factors and this would remove the basis of much of the criticism which has been leveled at past general increases.

Without general rate increases, evidence regarding increased costs would have to be presented again and again for each region, carrier and commodity. Thousands of individual rate adjustments not only would create major problems for the railroads but shippers would have great difficulty in determining any particular rate. This explains why many shippers are not opposed to the general rate increase.

I am pleased that the bill grants the rights to railroads and shippers to enter into contract rates. However, I question the wisdom of permitting the ICC to limit a railroad's right to enter into future contracts based upon the ICC's study of car and locomotive supply. Contract activities of a railroad are and should be entirely separate from its common carrier obligations and services. As it stands, the bill would inhibit any substantial movement into contract rates by the railroads.

It is disappointing that the bill does not provide for exclusive Federal jurisdiction over the rates and services of railroads which are subject to the jurisdiction of the ICC. We have an excellent working example of such Federal preemption in the Airline Deregulation Act of 1978.

The present situation whereby the States have jurisdiction over intrastate rates and services permits local political considerations to prevail over the proven needs of the railroads for greater revenue, even after those needs have been ruled upon favorably by the ICC. After rate increases are obtained from the ICC, it is often many months before a particular increase can be obtained at the State level. Although not all States engage in this delaying tactic, some do and either deny such increases or even limit them by disallowing the increase in the event the railroad exercises its statutory right to appeal to the ICC. The bill as written would give the States the ability to thwart the intent of Congress as expressed in the legislation.

If Congress is hesitant about preempting State action with respect to railroads to the same extent as it has done for airlines, the very least that should be done is to write into the legislation a requirement that State action as to rates and services must be consistent with the standards established by S. 1946 and any Federal regulations implementing those standards.

II. TRAIN'S COMPROMISE JOINT RATE PROPOSAL

Mr. Chairman, as you recognized in your statement introducing S. 1946, the bill does not address the joint rate issue. The members of TRAIN believe this issue must be resolved. As a result of existing joint rate regulation, no railroad is free to adjust the price of its participation in joint movements. Rate increases and decreases which a railroad may feel are justified by its own market circumstances cannot be instituted unless it can secure concurrence of all parties participating in the rate. Carriers are even unable to raise rates which are below variable costs unless the other participants concur. This regulation has led to a rigid rate structure and there is now little opportunity for railroads to establish more innovative price and service structures which are appropriate for their individual markets.

We have formed TRAIN to actively promote the modification of these restrictions. As you know, Conrail favors their complete and immediate elimination. Conrail, however, has joined with the members of TRAIN in a compromise which we believe will significantly reduce the need for additional Government subsidies.

The Congressional Record of October 29, 1979 contains some staff joint rate suggestions. Although these are based upon the TRAIN proposal, there are significant differences between the staff's suggestions and TRAIN's. The details of both will be commented on specifically by the lawyers who will participate in a following panel, but I would like to point out what I believe to be the most significant difference. The staff's joint rate proposal would require a carrier proposing a surcharge to raise it far above the level necessary to cover its own revenue needs, as it would have to divide the surcharge with all connecting carriers. In my view, this would defeat the objective of the surcharge which is to take care of the revenue needs of the proponent carrier. The TRAIN proposal, which is attached to my statement as Exhibit A, requires that the surcharge be divided with the proponent railroad's intra-territorial connections on the basis of intra-territorial divisions.

As you are aware, modification of existing joint rate regulation is a controversial issue within the railroad industry. While the TRAIN compromise is opposed by some railroads, we believe that opposition is based upon a misunderstanding of its effects. Those who oppose the compromise proposal have expressed concern that permitting a railroad to impose a surcharge will deprive them of revenues. However, the opposing railroads are not likely to suffer any more than those of us who are

proposing the compromise. Our railroads also connect with Conrail and yet we feel that our proposal is the most equitable way to allow Conrail to help itself to achieve adequate revenues and become less dependent upon Government and the American taxpayers.

The joint rates issue is not a regional one. It is a nationwide problem although at the moment it arises in the context of Conrail's financial difficulties. The effect of the compromise proposal on shippers to and from the west is likely to be similar to the effect on shippers to and from the south. Yet, we in the west, and the Chessie, which is Conrail's most significant competitor in the east, believe that this compromise is in the railroads' interest and the Nation's interest.

Attachment.

[EXHIBIT A]

JOINT RATE COMPROMISE PROPOSED BY "TRAIN" MEMBER RAILROADS: CONRAIL, CHESIE, SANTE FE, SOUTHERN PACIFIC AND UNION PACIFIC

1. Notwithstanding any other provision of law, any carrier may publish and apply a surcharge in order to bring its earnings over any route to a level that will cover its variable costs of handling the given traffic moving over that route under any joint rate, without the concurrence of its connecting carriers. The surcharge must be applied in equal dollar amounts to all of that carrier's routes under the rate and to all of its competing single line routes. Such increases shall accrue solely to that carrier.

(a) Before increasing the rate, the carrier proposing the rate must give other carriers party to the rate 45 days notice. If a connecting carrier wishes to respond to a surcharge on the effective date of another carrier's surcharge, it may initiate its own surcharge no less than 25 days before that effective date. At this time only, a carrier responding to a surcharge which results in different charges applicable to different routes under the same joint rate, may make unequal surcharges applicable to its routes under the rate and any competing single line route in order to re-establish route parity.

(b) As proof of its costs, the proponent carrier may file a cost analysis developed in accordance with a cost accounting system accepted by the ICC.

(c) In an investigation, the proponent carrier shall bear the burden of showing that the surcharge is required to cover its variable costs. The Commission may suspend such a surcharge only to the extent that the amount of the surcharge exceeds a variable costs showing accepted by the Commission. Any such suspension must apply to the application of the surcharge via all routes. The Commission must complete its investigation of the matter within four months. If the investigation is not completed within that period, it shall be terminated and the surcharge shall become effective.

(d) The Commission may not investigate the lawfulness of the overall joint rate as a result of the application of a surcharge.

(e) Any further increases in the joint rate to which such a "variable cost" surcharge applies shall increase the surcharge in the same proportion as the proportion of the increase to the joint rate.

(f) A carrier may not adopt a surcharge unless, for one year prior to the surcharge, it has participated in all increases in rates of general applicability agreed to by all other parties to the rates in question.

2. A carrier may otherwise publish and apply to a joint rate (in the form of a surcharge) an increase or decrease not exceeding ten (10) percent annually of the joint rate, subject to the following conditions:

(a) The rate change must be applied in equal dollar amounts to all of the proponent carrier's routes under that rate. Rate decreases may and rate increases must also be applied in equal dollar amounts to all of its competing single line routes.

(b) A surcharge must be divided with the proponent carrier's intra-territorial connections on the basis of intra-territorial divisions. An intra-territorial connecting carrier may refuse to accept all or any portion of its division of the surcharge, in which case, the surcharge applied to that route will be applicable in the amount of the proponent carrier's division, plus any amount accepted by its intra-territorial connections. The proponent carrier may, within ten days of receiving notice of any such refusal, decrease its surcharge over any competing route or routes to re-establish route parity.

(c) Surcharges reflecting either an increase or decrease shall not be applicable to other carriers except as provided in paragraph (b).

(d) Connecting carriers shall be given 45 days notice of an above variable cost surcharge.

(e) If a connecting carrier wishes to respond to a surcharge on the effective date of another carrier's surcharge, it may initiate its own surcharge no less than 25 days before that effective date. At this time only, a carrier responding to a surcharge which results in different charges applicable to different routes under the same joint rate, may make unequal surcharges applicable to its routes under the rate and any competing single line routes in order to re-establish route parity.

(f) A carrier may not adopt a surcharge unless, for one year prior to the surcharge, it has participated in all increases in rates of general applicability agreed to by all other parties to the rates in question.

(g) Surcharges made applicable under this subsection shall not limit the increases permitting connecting carriers under Section 10701a(b). For purposes of maximum rate regulation under the Act, only the carrier proposing a surcharge and any carrier claiming a division of that surcharge pursuant to paragraph (b) shall be required to defend the surcharge, and the lawfulness of the surcharge shall be determined without regard to the amounts received and the services performed by other carriers other than carriers claiming a division of that surcharge pursuant to paragraph (b) party to the joint tariff to which the surcharge is applied. In any subsequent proceeding to investigate the lawfulness of the joint rate to which a surcharge applies, that surcharge shall not be taken into consideration unless the Commission determines that each carrier participating in the surcharge is earning adequate revenues as defined in 49 U.S.C. Sec. 10704(a)(2).

STATEMENT OF BENJAMIN BIAGGINI, CHAIRMAN, SOUTHERN PACIFIC TRANSPORTATION CO., ON BEHALF OF TRAIN (TRANSPORTATION BY RAIL FOR AGRICULTURAL AND INDUSTRIAL NEEDS)

Mr. Chairman, I appreciate the opportunity to testify today on behalf of TRAIN. So there won't be any confusion about the matter, I want to begin by making it clear that the members of TRAIN wholeheartedly support the position of the Association of American Railroads articulated by Mr. Dempsey. We believe in addition, however, that without reform of joint rate regulation, the program advocated by the AAR will not achieve its goals and the problems that plague the nation's railroads today will become increasingly aggravated.

The nation's railroad system is in dire condition today largely because the nation's railroads have been insulated from market forces by regulation. As a whole, they have been unable to adapt to the extraordinary changes which have occurred in our economy in the past 40 years.

This inability to adapt has acted like a straitjacket on the nation's railroad system. Some railroads, including the Southern Pacific have been fortunate enough to escape the most dire consequences of regulation. Circumstances have operated in our favor and enabled us to operate profitably within the confines of regulation. But the increasingly disastrous financial results of the industry as a whole makes it clear that the burden of regulation is too heavy for the industry to bear. If regulation is not radically changed in accordance with today's realities, I am convinced that we can expect the eventual nationalization of much of our national railroad system.

We can avoid this result by removing the Interstate Commerce Commission's regulation of most of the detailed day to day running the nation's railroads. Intensive regulation of railroad rates and services, which may once have been warranted by the railroads' dominance of the transportation market, can no longer be justified. As the most recent studies conducted on behalf of the Interstate Commerce Commission make clear, the railroads have effective control over less than 5 percent of their traffic. Thus, there is no rationale for Commission interference in the other 95 percent of our business. And far less regulation than now exists would adequately protect those shippers that might still be subject to potential market abuses by the railroads.

The heart of any program to restore the competitive vitality of the nation's railroads is pricing freedom; it will permit railroads to adjust to market realities. In this respect, S. 1946 would make some significant changes in the existing regulatory structure. The bill does not by any means deregulate the railroads; but it does put some limitations on the ability of the Commission to interfere with the pricing of railroad services.

Again, we concur with the comments made by Mr. Dempsey yesterday on behalf of the AAR. I must state emphatically, however, that because it does not address the significant restrictions on the ability of individual railroads to establish prices for the 70 percent of their services involving joint rates, we do *not* believe the program proposed in S. 1946 can alone possibly be successful.

As a result of existing joint rate regulation, no railroad is free to adjust the price of its participation in joint movements. Experimental rate increases and decreases which a railroad may feel are justified by its own market circumstances cannot be instituted unless it can secure concurrence of all parties participating in the rate. Revenues now cannot be changed for *one* carrier without proportional changes, whether needed or not, for *all* carriers party to the joint rate. Carriers are even unable to raise rates which are *below* variable costs unless the other participants concur. This regulation has led to a rigid rate structure and there is now little opportunity for railroads to establish more innovative price and service structures which are appropriate for their individual markets.

We have formed TRAIN to actively promote the modification of these restrictions. As you know, Conrail, along with the Administration, favors complete and immediate elimination of these restrictions. Conrail, however, has joined with the members of TRAIN and the Chicago and North Western—together we account for almost half the industry's revenues—in a compromise which we all believe will achieve many of the goals of the Administration proposal and significantly reduce the need for additional subsidies. It will also minimize the short-term dislocations that could have resulted from the Administration's original proposal.

With your permission I will submit this compromise for the record. In essence, it would permit any railroad to raise its portion of a joint rate to the variable cost level and, subject to whatever rules govern maximum rates and discrimination, to raise and lower its rates above the variable cost level within a zone without the concurrence of other carriers participating in the joint rate.¹ It contains provisions to prevent discrimination on routes and gateways and it is designed to eliminate the possibility of any monopolistic or anticompetitive practices.

As you are aware, modification of existing joint rate regulation is a controversial issue within the rail industry. At the present time, the compromise proposed by TRAIN and the C&NW is opposed by some carriers. We believe that opposition to our proposal is based upon a misapprehension of the effects resulting from its enactment. As the proposal becomes better understood, we believe that this opposition will lessen. Those currently opposing this compromise proposal apparently fear that the elimination of rigid joint rate regulation will deprive them of revenues. None of the railroads which oppose the compromise, however, are likely to suffer any more adverse consequences than those of us who are proposing this compromise.

This is not, as some railroads have implied, a regional issue. The divisions of the western railroads with the eastern carriers and the relative profitability of inter-regional movements between the west and east are very similar to those between the south and the east. The effect of this proposal on shippers to and from the west are likely to be similar to the effect on shippers to and from the south. Yet, we in the west, and the Chessie, which is Conrail's most significant competitor in the east, believe that this compromise is in our interest and in the nation's interest.

Nor is this an efficiency issue. Contrary to allegations that this proposal would discourage improvements in efficiency, we know of no credible economic theory which supports the proposition that depriving a railroad of revenues will make it more efficient. That did not happen in the northeast before Conrail and there is no reason to believe it will happen now. Without adequate revenues (or subsidy) and an ability to price services to efficiently serve markets, a carrier has *less* ability to effect efficiencies, not more. Moreover, the profitable railroads in TRAIN are not inefficient and we believe the compromises is in the best interests of our companies.

Our compromise joint rate reform proposal will not end the problems of the nation's railroads. But we are convinced that without significant reform similar to that set out in our proposal, the eventual nationalization of Conrail and the rest of the nation's railroads is inevitable.

Mr. Chairman, despite the controversy surrounding this issue, it is essential that this Committee directly address joint rates in S. 1946. We do not believe that positive steps proposed in that bill will be adequate without joint rate reform and I urge you to incorporate our compromise if S. 1946 is further considered by your committee.

We thank you and the other Members of the Committee and look forward to working with you and your staff to help assure early enactment of this badly needed legislation.

¹ The joint rate proposal contained in Senator Cannon's remarks accompany S. 1946 would require carriers to raise a joint rate far above the level necessary to cover its revenue needs. This approach is contrary to both the railroads' and shippers' interests.

STATEMENT OF LEE CISNEROS, DIRECTOR, CORPORATE PHYSICAL DISTRIBUTION,
FIRESTONE TIRE & RUBBER CO.

My name is Lee Cisneros and I am Director of Corporate Physical Distribution for the Firestone Tire & Rubber Company, which is located in Akron, OH. The Firestone Tire & Rubber Company is a substantial user of public transportation. Firestone's annual expenditure for transportation is in excess of \$125 million.

We have requirements for all modes of transportation including air freight, water, motor carrier, as well as substantial movements by rail.

More than 60 locations function as distribution centers in our distribution system and we have approximately 4,000 retail and dealer outlets.

Firestone has two of these facilities in Louisiana, located at Lake Charles and near Baton Rouge. The Lake Charles facility, established in 1943, currently employs 850 people and produces general purpose synthetic rubber and Duradene, an advanced type of synthetic rubber developed by Firestone. Annual shipments exceed 600 million pounds, of which 66 percent is shipped by rail.

In West Baton Rouge Parish the Firestone Plastics Company has recently begun production at its new polyvinyl chloride resin plant. Approximately 85 people are employed at the plant which will reach full production by the end of this year. The plant has an annual capacity of 250 million pounds. We estimate 80 percent will move by rail and have purchased 125 covered hopper cars at a cost exceeding \$4 million to transport plastic resin by rail.

Both facilities ship to customers throughout the United States and are highly dependent on rail service. As should be apparent Firestone as a major user of rail service is extremely interested in an economically viable national rail transportation system and is pleased to have the opportunity to express our views concerning S. 1946, the Railroad Transportation Policy Act of 1979 and more specifically to Senator Russell B. Long's proposed amendment.

Firestone generally supports S. 1946 as drafted and believes it provides railroads with the flexibility necessary to become economically self sufficient.

Firestone believes all commodities should bear their fair share of transportation charges and there should be a minimal amount of cross subsidization in which captive commodities bear excessively higher rail freight rates to subsidize relatively lower rates on other, generally more competitive commodities.

We also believe that certain classes or types of transportation rates should not be artificially depressed as a means to solve non-transportation economic or social problems.

Firestone is in general agreement with Senator Long's Amendment and would support Senate approval if it explicitly provides application to all commodities, with the Interstate Commerce Commission directed to establish a presumptive cap of maximum rate reasonableness that will apply to all commodities. The ICC should specifically be directed *not* to establish a separate cap or ratio for any single commodity except as provided in Sec. 113, Transportation of Recyclable Commodities.

As we understand it, a major factor in Senator Long's presenting the Amendment, is a concern to prevent a disproportionately high transportation charge on coal. We agree with Senator Long that a balance must be struck to insure coal traffic pays its fair share and thus contributes to the financial good health of the railroads, but not so high a share as to be ruinous to the users of coal and the ultimate consumer. This same criteria is important to all traffic, however, and for precisely the same reason, a balance should be struck for all commodities and not just for coal. An April 10, 1979 analysis by A. T. Kearney concerning Market Dominance and its relationship to other provisions of the 4-R Act presented at a recent Joint Economic Committee hearing, showed various commodity groups with a large percentage of their carload traffic in excess of 180 percent of variable cost. For example, plastics materials such as that produced at Firestone's new Baton Rouge plant shows 59.11 percent in excess of 180 percent.

Thus we believe there is a valid question concerning exactly what commodities are and are not bearing their fair share and there should be a thorough investigation of all commodities to resolve this.

In conclusion we believe both S. 1946 in general and Senator Long's amendment expanded along the lines of Firestone's recommendations presented here today would be in the best interests of the railroads, shippers and general public, and we would support and urge swift passage of this legislation.

STATEMENT OF BRUCE HAGEN, NORTH DAKOTA PUBLIC SERVICE COMMISSIONER

My name is Bruce Hagen. I am a member of the Public Service Commission of the State of North Dakota and have been for the past 19 years. One of my portfolios or responsibilities during that time has been in the area of both State and Federal regulation of common carriers. I am also testifying for 40,000 farmers represented by the State Wheat Commission.

In this connection, I have attempted as best I can to follow and understand proposed legislation with regard to railroads.

John Finsness, Attorney for the North Dakota Wheat Commission and the North Dakota Public Service Commission, is here with me today. He joins in this statement. Mr. Finsness is a recognized expert in transportation and freight rates, and he has been working in these areas for over 40 years. We will try to answer any questions you may have.

I wish to comment specifically concerning Senator Long's proposed amendment to Section 104 which appears to be an outgrowth or modification of the coal industry's attempt to achieve some measure of protection in the area of differential pricing by the railroads on traffic which is so clearly captive to them.

I wish to point out that we in the grain producing states are no strangers to differential pricing by the railroads and consider ourselves, particularly on the longer hauls, to be also captive. In this connection, railroad revenues intradistrict in the west exceed one half billion dollars per year on wheat alone.

The latest railroad cost information submitted early this month to the Interstate Commerce Commission to substantiate a new rate increase shows that with an "embedded interest for cost of capital" total rail intradistrict traffic produces for the present proforma year a revenue/variable cost ratio of 123.5. For bituminous coal the comparable ratio is 102.3; and, for wheat the comparable ratio is 171.0. For barley it is 204.2.

We know from our own studies that the weighted average ratio of revenue to variable cost from North Dakota on wheat is 2.13 and on barley 2.80. These are averages, of course, indicating higher ratios exist as well.

These North Dakota rates have been in almost constant litigation since 1970, with no disposition on the part of the Interstate Commerce Commission to declare them unreasonably high.

If attempts are successful now through aggressive "deregulation" or "re-regulation," or whatever it is called, by the Interstate Commerce Commission to parallel, perhaps, the Civil Aeronautics Board's deregulation, it simply means North Dakota Farmers who already pay excessive freight rates to move our grain to market by rail will be asked to carry more burden again, which should be paid by someone else.

We sympathize with the coal industry in its attempt to, as we conceive it, place some sort of a cap on differential pricing. In important aspects the coal industry has been more successful than grain in that the Commission has gone so far as to impose an interim standard for differential pricing of 7 percent above fully allocated costs (calculated at the revenue need level), I.C.C. Docket 37105. Why coal, and why not grain? Grain is energy too!

As far as I know such a standard has been imposed on no other commodity group, certainly not as to grain.

The amendment in our opinion is an improvement insofar as it requires that a ratio be developed which, when exceeded, will shift the burden of proof with regard to reasonableness upon the carriers. The fact that the burden shifts, however, does not impose a mandatory limit upon the Commission's power to allow differential pricing. In this connection we suggest some statutory ratio as the upper mandated limit for differential pricing. The apparent thinking of the Interstate Commerce Commission recently is that a ratio of 1.80 should trigger investigation—no discernible reason being advanced for this figure other than the obvious one that railroad revenue needs should be buttressed by differential pricing to this extent. At any rate the Commission is now suggesting that a ratio above 1.80 should establish a prima facie case that market dominance exists. This trigger point as well as the one suggested by Senator Long's amendment to shift the burden of proof are a long way from establishing a cap on differential pricing.

The Commission points out that the burden of proof in any proceeding is merely the burden of persuading the finder of fact that the interpretation of evidence urged is correct.

After all is said and done and in the context of this amendment and present or proposed rules of the Commission, the matter is left to the judgment of the Commission and not by fiat of Congress. The Commission itself is a highly volatile body molded by presidential appointment. This judgment of the Commission in the area

of differential pricing is constricted and constrained within the regulatory conflict of reasonable freight rates in the particular and adequate revenues generally.

Paragraph 5 of the Amendment admonishes the Commission to consider the inflationary impact of various ratios particularly as they relate to national energy goals which we take to be a veiled reference to coal. We have no quarrel with this but wish to point out that national energy goals will be related to imported oil for a long time to come and that exported grain now provides a very large chunk of foreign exchange which we must have to buy imported oil. Agricultural products now produce fully half of our foreign exchange.

If there is to be particular emphasis on the inflationary impact of various levels of revenue to variable costs insofar as they relate to national energy goals, we hope the Commission will be reminded that the implications of the enormous exports of grain and the consequent foreign exchange for the purchase of oil derived therefrom are also related in no small way to the national energy goals.

Last year agricultural exports were \$32 billion dollars. Grain amounted to \$12.6 billion dollars of the total exports.

Oil and natural gas imports are vital to our economy. So, too, are grain exports vital to our economy.

The proposed Amendment, in effect, protects energy, but no equity appears to be offered farmers who are again apparently expected to pick up the tab for someone else. The energy industry's squeal seems to have pointed out the need for some grease to silence the squeal. Our farmer's railroad grain freight rate squeal has been squeaking and squawking for a long time. Its noise is getting louder, but that noise apparently still is falling on deaf ears.

We are here in all sincerity hoping there are some hearing aids around so our grain farmers can be heard. Our grain is a form of energy, too!

Thank you.

STATEMENT OF WILLIAM W. LYONS, VICE PRESIDENT, NERCO, INC.

The following comments are submitted in behalf of NERCO, Inc., a wholly-owned subsidiary of Pacific Power & Light Company, headquartered in Portland, Oregon. NERCO is an energy firm with surface coal mining operations and development projects in Montana, Wyoming and Alabama.

NERCO supports the presumptive cap on coal rate increases proposed by Senator Long's amendment to S. 1946. Without a specific requirement tying coal rates to actual costs, railroads will unreasonably increase coal subsidies for unprofitable traffic. This policy has pushed up rates for electricity consumers and ratepayers, promoted inflation, and discouraged efforts to replace imported oil with domestic coal.

While we encourage the efforts of Edison Electric Institute, the rail industry and the Senate Commerce Committee staff to improve the Long amendment, the most important issue is the following: for ratemaking purposes, "captive coal hauls" must be treated separately from traffic which has transportation alternatives available.

BACKGROUND

The thrust of the Railroad Transportation Policy Act of 1979 (S. 1946), introduced by Senator Cannon October 29, 1979, is to remedy railroad financial problems through rate deregulation. Along with S. 796, introduced earlier by the Administration, S. 1946 is based on the premise that pricing freedom will provide railroads with sufficient financial incentives to make needed improvements.

NERCO concurs that railroads do need assistance in improving service, in simplifying the rate structure, and in being assured of an adequate return on investment. These are important objectives and vital to meeting the nation's energy objectives. However, it is essential that the needs of shippers be carefully weighed in developing solutions to the railroad's ills. This is particularly true in the case of "captive" shippers totally dependent upon rail transportation, such as Western utility coal.

S. 1946 states that its basic objective is "to provide protection for captive shippers where necessary in the public interest, and to provide pricing freedom for the railroads in the many areas where competition exists." While we endorse the intent of this legislation, we do not feel S. 1946 can achieve its objectives.

Similar Congressional intent has been expressed before. The Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act) was intended to:

1. Balance the needs of carriers, shippers, and the public;
2. Foster competition among all carriers by railroad and other modes of transportation, to promote more adequate and efficient transportation services, and to

increase the attractiveness of investing in railroads and rail-service-related enterprises;

3. Permit railroads greater freedom to raise or lower rates for rail services in competitive markets;

4. To promote the establishment of railroad rate structures which are more sensitive to changes in the level of seasonal, regional, and shipper demand;

5. Promote separate pricing of distinct rail and rail-related services;

Formulate standards and guidelines for determining adequate revenue levels of railroads; and

7. Modernize and clarify the functions of railroad rate bureaus.

In passing the 4-R Act, Congress tried to balance two import needs. Railroads were to be assured of adequate revenue levels provided they demonstrated honest, economical, and efficient management. At the same time, Congress sought to protect the captive shipper where such shippers are not protected by competition—that is, in monopoly markets.

However, the 4-R Act has not prevented railroads from exercising monopoly power over captive utility coal shipments.

Railroads have raised their rates to unreasonable levels, sharply driving up the rates paid by electricity consumers. Moreover, as pointed out in the ICC draft Environmental Impact Statement on "Ex Parte No. 347, Western Coal Investigation—Guidelines for Railroad Rate Structure," these rate practices are producing a chilling effect on coal conversion. In other words, oil imports increase as railroad rates increase.

The President and the Congress have concurred that coal is the best and most immediate solution to the nation's energy and economic problems. Abundant deposits of cheap, low-sulfur coal are found in many regions of the west. Southwestern and midwestern utilities were among the first major consumers of oil and gas to begin the long, expensive conversion from oil or gas to coal-burning facilities.

For many of these utilities, as well as for many proposed coal development projects in the west, a single railroad line provides the only means of moving the coal from where it is produced to its point of consumption. Consequently, the fulfillment of the national energy goals is heavily dependent on railroad movement of coal at a price which competes favorably with oil and gas. (Utilities are forced to make price conscious fuel choices, since public utility commissions closely scrutinize what is passed-through to consumers. Coal conversion, including air quality control equipment, cost billions of dollars, and is not eligible for inclusion in the rate base in many states.)

Unfortunately, the railroads have consistently exploited this situation and have sought to greatly increase profits from the massive new coal movements captive to their lines. Transportation generally costs between one-half and three-quarters of the delivered price of coal. The worst aspect of this situation is the railroads habit of increasing rates substantially after a prospective utility customer has committed to the long-term utilization of coal.

For example, Houston Lighting and Power Company charged that it had been quoted rail prices which were nearly doubled following its commitment to coal power. Subsequently, in a nearly identical situation in San Antonio, Texas, the approach of these same railroads was described as "bait and switch tactics" where the receiver "was persuaded to enter into particular long-term arrangements for the supply of coal as fuel based upon a perceived bargain with defendants. Once these commitments had effectively eliminated the railroads' competition, they engaged in various pricing maneuvers in an attempt to use their newly monopolistic position to enhance their revenues." (*San Antonio, Texas v. Burlington Northern Inc.*, Docket No. 36180, Decision Serviced October 25, 1979 (unprinted), p. 9)

Continued uncertainty about future coal rate levels will continue to deter investments in coal-fired facilities and jeopardize fulfillment of national energy goals.

The source of the problem is that ICC has not effectively provided "regulation in lieu of competition" where the railroads operate a monopoly. The railroads have been allowed to:

1. Justify rate increases on the basis of "revenue needs"; and

2. Single out coal traffic for a disproportionate share of railroad financing, thereby subsidizing less profitable traffic.

This contradicts not only national energy policy, but basic American beliefs about the value of competition and free enterprise.

The regulation of monopolies (or regulation in lieu of competition) is a familiar method of dealing equitably with such situations as "captive" coal and the railroads. It is ironic that electric utilities, themselves subject to such regulation under the Federal Power Commission, are victims of the railroad monopoly.

CONCLUSION

In suggesting changes for S. 1946, utilities have stated three main objectives for treatment of captive traffic:

- Development of a rate structure based on specific costs of service;
- No unreasonable subsidies for unprofitable traffic; and
- Ceilings on rate increases.

Deregulation is not appropriate when applied to these monopoly situations. Texas and Alabama or Oregon ratepayers should not be required to subsidize the nation's railroads. In the absence of feasible competition, the ICC must perform the role of regulator in lieu of competition. We contend that essential modifications to S. 1946 can be summed up in three main points:

1. Captive coal hauls must be treated separately from traffic which has transportation alternatives available;
2. Captive rates must be based on specific costs plus a percentage of costs as fair rate of return, figured on a case-by-case basis; and
3. ICC must require railroads to justify through use of uniform cost accounting procedures and enforce such procedures through regular audits. (In recent hearings the ICC, the rail industry has argued on the basis of additional revenue needs, but not been able to document specific costs.)

These changes would benefit the coal industry, utility ratepayers, and the nation as a whole. We would achieve:

- Utilization of domestic energy sources, and less dependence on imported oil;
- Reduced energy costs and inflation;
- Improved balance-of-payments with other nations; and
- Strengthened national security owing to reduced vulnerability to political/economic pressure from the Middle East.

S. 1946 in its existing form is a good start toward achieving these goals. It is the best version of rail reform legislation introduced so far, but it's not enough.

We must recognize that transportation, energy, and economic needs are interdependent. Adding provisions to S. 1946 which protect captive shippers through cost justified rates provides a balanced remedy to these urgent problems.

Attachments.

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, D.C., January 4, 1980.

Mr. W. W. LYONS,
Nerco, Inc., Portland, Ore.

DEAR MR. LYONS: Thank you for your mailgram dated December 12, 1979 supporting an amendment regarding rates on coal to the Railroad Transportation Policy Act of 1979, S. 1946.

The amendment you referred to is one which is presently being negotiated by the Edison Electric Institute, the rail industry, and Senate Commerce Committee staff. I certainly do appreciate your sharing your concerns on this matter and look forward to an amendment which all parties can live with. I agree that the points you raise in your mailgram justify the inclusion of such an amendment in S. 1946. Further, you should be advised that the full Senate will not pick up this bill until such a specific amendment has been worked out.

I want you to understand that I do appreciate and share your concern on this issue. It is my hope that the details of the amendment can be worked out as soon as possible. Once again, Mr. Lyons, thank you for bringing your views to my attention on this important issue.

Cordially,

BOB PACKWOOD.

[Mailgram]

NERCO, INC.
Portland, Ore., December 11, 1979.

Senator MARK O. HATFIELD,
U.S. Senate, Washington, D.C.:

The proposed Railroad Transportation Policy Act of 1979 (S. 1946) as reported by the Committee on Commerce, Science and Transportation will be considered on the Senate floor December 17. Nerco, Inc. is affected by this proposal because the coal we produce in Wyoming and Montana depends exclusively on rail transportation to utility consumers at a great distance from our mines, and, as you know, coal is key to national energy goals.

We agree that the railroads need the kind of assistance reflected in S. 1946. However, to be effective, rail legislation must include the following provisions:

1. Captive western coal must be treated separately from traffic which has other transportation alternatives available;

2. Captive rates must be based on specific costs plus a percentage of costs at a fair rate of return. These should be figured on a case-by-case basis; and

3. The I.C.C. must require railroads to justify rates through use of uniform cost accounting procedures. The I.C.C. must also enforce such procedures by conducting regular audits.

Electric Institute (EEI) has proposed an amendment to S. 1946 which reflects the intent of these objectives. The amendment reads: "That in the case of increases in railroad rates on shipment of coal above 150 percent of variable costs, railroads have the burden of proof to show they need said increase in terms of revenue."

We urge you to support this amendment which will benefit shippers, carriers, and consumers alike. While we endorse the intent of S. 1946, we believe its objectives will not be achieved without additional, specific provisions to prevent railroads from exercising monopoly power over captive shipments, especially western coal. If such provisions are not added to S. 1946, we believe the proposal should not be supported.

Sincerely,

W. W. LYONS.

STATEMENT OF ERNST A. UPMEYER III, VICE-PRESIDENT, ELECTRIC FUELS CORP.

Mr. Chairman and Members of the Subcommittee, my name is Ernst A. Upmeyer, III. I am Vice President of Electric Fuels Corporation ("EFC"), P.O. Box 15208, St. Petersburg, Florida. EFC, a Florida corporation, is a wholly-owned subsidiary of Florida Power Corporation ("Florida Power"), one of the largest electric utilities in the State of Florida. Florida Power provides electric service to nearly 670,000 customers in 375 cities, towns and rural communities. The territory served comprises approximately 20,600 square miles and has a population of 2.8 million in 32 of Florida's 67 counties. EFC was formed in 1976 for the purpose of obtaining and transporting the coal used by its parent to generate electricity.

I have been employed by EFC since 1976; from 1965 to 1976 I was employed by Florida Power. My experience with EFC has made me acutely aware of the critical need for additional legislative and regulatory protection for captive shippers of coal. EFC commends Chairman Long and the Subcommittee for their diligent efforts in addressing this serious rational problem. EFC supports the purpose of Senator Long's amendment which is to afford this additional necessary protection to coal shippers by establishing a maximum reasonable ratio of revenue to variable cost for this captive traffic. EFC supports the Long Amendment to S. 1946, a bill "to reform the economic regulation of railroads and for other purposes" insofar as it accomplishes that goal, and appreciates this opportunity to suggest to the Subcommittee several proposals for clarifying and strengthening the Amendment.

THERE IS A SERIOUS NEED FOR A CLEAR STANDARD OF MAXIMUM REASONABLENESS
TO PROTECT CAPTIVE SHIPPERS

EFC's experience over the last several years with shipping coal by rail points out the need for continued regulatory authority over rail rates in the absence of binding transportation agreements. Like many utilities in this country, Florida Power has been converting its generating facilities to coal-fired plants. During the 1960's and 1970's, Florida Power generated electricity using oil or natural gas for fuel. These energy sources were cheap and plentiful. As recently as 1973, Florida Power had an average fuel cost per million BTUs of only \$.54. By the following year, the fuel cost per million BTUs had nearly tripled to \$1.51. The fuel cost of the utility for 1975, computed on the same basis, rose to \$1.68.

Florida Power responded to these fuel cost increases by reconvertng two conventional generating units at Crystal River, Florida to the use of coal. The first of these coal conversions became functional in 1977 and contributed greatly to a \$.16 reduction in fuel cost per million BTUs over the previous year, the first significant fuel cost reduction since the oil crisis of 1974.

As part of the coal reconversion program, EFC was created to acquire and ship the large amounts of coal needed by Florida Power. EFC now supplies to its parent more than two million tons of coal annually, obtained under long-term contracts with mine operators in southern Illinois, Indiana and eastern Kentucky. EFC transports a substantial volume of this coal with the L&N/Seaboard Coast Line rail system. About 900,000 tons of coal from eastern Kentucky are transported annually over the road of the L&N and the Seaboard Coast Line ("SCL") in two 70-car unit trains utilizing cars owned by EFC. This traffic originates at Creech, Kentucky, a point on the L&N Line, and is purchased by EFC pursuant to a production contract

that runs until 1994. The unit train carrying EFC coal proceeds from Creech to Corbin, Kentucky; Knoxville, Tennessee; Etowah, Tennessee; and then to Atlanta, Georgia where the unit train transfers from the lines of the L&N to the lines of the SCL. From Atlanta the unit train continues to High Springs, Florida, and finally to Red Level Junction, Florida where the carrier's line terminates. The distance from Creech to Red Level Junction is 870.4 miles. At Red Level Junction the unit train switches from the main track of the carrier to a spur line constructed by Florida Power and proceeds another 8 miles to the Florida Power generating site at Crystal River.

The minimum weight for each trainload of coal is 6,500 tons and a round-trip requires about five and one-half days. On this basis, each train may make about sixty-six deliveries per year, for a total of about 900,000 tons annually for the two unit trains owned by EFC.

Florida Power has no choice but to increase its reliance on coal as a source of fuel. By 1984, Florida Power will be operating four coal-powered generating units at Crystal River that annually will consume about five million tons of coal, more than double the present amount.

EFC owns 160 modern hopper cars which are used in its two unit trains and has constructed coal handling terminal facilities. EFC recently has ordered another 80 cars for unit train operations; delivery of these new cars will be completed by early 1981. This represents a present investment of more than 15 million dollars in rail transportation facilities. If EFC continues to increase its utilization of coal as it currently plans, EFC will make an additional investment of \$79 million in necessary transportation equipment; some \$34 million of this will be spent on new rail equipment and terminal facilities.

There is currently no available alternative to rail movement as a means of transporting much of the coal needed by EFC. EFC, for example, is contractually obligated to purchase a minimum of 850,000 tons of coal annually from mines located at Creech, Kentucky. EFC entered this long term coal purchasing contract as part of its program to convert from scarce and expensive oil and gas to the more plentiful and less expensive coal. This particular coal is necessary for EFC's generating operations at Crystal River because of its low sulphur content needed to meet current EPA requirements. The only method of transporting this coal is by rail over the L&N and the SCL. EFC is truly a "captive" shipper of coal. This traffic is guaranteed business to the L&N for at least the next 14 years.

When EFC embarked upon its coal conversion program and entered into a long-term contract for low sulphur coal, it appeared that this action was sound from energy, economic, and environmental perspectives. EFC, however, was not able to anticipate the seemingly uncontrollable cost problems that would be caused by its necessary reliance on rail transportation. When EFC began transporting coal in April of 1978 the applicable unit train rate in effect was \$8.24 per ton for coal moving in shipper owned cars. On June 21, 1978, this rate was increased by 4 percent to \$8.57 pursuant to increases granted in Ex Parte 349. Barely half a year after EFC's first rail movement, in November of 1978, the rate was increased by an astounding 22 percent to \$10.46 pursuant to increases granted by the Interstate Commerce Commission in Docket No. 37063 et al., *Increased Rates on Coal, L&N Railroad*. This rate increase, initiated by the L&N, applied only to coal traffic. On December 15, 1978, EFC's rate was increased to \$11.04 pursuant to the 5.5 percent increase allowed on coal in Ex Parte 357. The rate currently paid by EFC is \$12.27 per ton; this rate includes additional increases allowed in Ex Parte 368, and fuel adjustment increases. The railroads currently are seeking an additional rate increase of at least 4 percent in Ex Parte 375. If this increase is granted, EFC's rate will be \$12.77 per ton. This represents a total increase of a staggering 55 percent on the EFC coal rate in less than two years.

When the L&N sought to increase its rates to EFC by 22 percent in Docket No. 37063, and by an additional 14 percent in Ex Parte 357, EFC portested those increases at the Commission. The results of that proceeding further emphasize the need for an upward cap on reasonableness for coal rates. The railroad sought to justify its increases largely on the basis of a general revenue need and attempted to avoid issues related to the cost of specific movements. The railroad relied heavily on the so-called "new rule of ratemaking" created by the 4R Act, which according to the railroads' view seems to mean that a rail carrier can continue to raise its rates as long as it can show that it "needs" the additional money as a general matter.

Although the Commission did rule that evidence related to the cost of specific movements was relevant, it nonetheless permitted the L&N to assess the full 22 percent increase against EFC, plus an additional 5.5 percent in Ex Parte 357. EFC was very disappointed with this outcome. EFC supplies its own cars for the traffic movements and the cost to the railroad of providing unit train service to EFC is

lower than for ordinary general cargo operations. EFC is currently contributing even more to the L&N's revenues than other shippers of coal—a fact which has been specifically recognized by the ICC (see, *Increased Coal Rates, L&N Railroad, October 31, 1978*, 362 ICC 369 at 467, served February 11, 1980)—and needs additional protection against future rate increases. Replacement of the vague and elastic provisions of the 4R Act with a definite level of maximum reasonableness as contemplated in S. 1946 would afford that additional protection.

When EFC began shipping over the lines of the L&N in early 1978, it presumed that \$8.24 per ton rate charged by the carrier was a fair and profitable one to the railroad. EFC, of course, recognized that its rail costs would increase in the future, but EFC believed that those increases would be directly related to the cost of the service provided and thus reasonable in amount, and would occur at well-spaced intervals. EFC did not anticipate six increases by L&N totaling 55 percent in less than two years. If EFC had foreseen even a part of the staggering increases in rail transportation costs which it has suffered in less than two years, EFC probably would not have decided to convert to Kentucky coal. Other utilities that have not yet committed themselves to rail transportation and become captive shippers like EFC will certainly weigh these problems in their future decisions.

Chairman Long noted in his remarks introducing his amendment that several utilities are purchasing foreign coal and shipping it to the United States because it is cheaper than buying U.S. coal and shipping on American railroads. Reliance on foreign coal is hardly a satisfactory solution to the problems created by reliance on foreign oil. Railroad pricing policy should not be allowed to drive domestic utilities to foreign sources of fuel. Clearly a balance must be struck between the railroads' revenue needs and the needs of coal shippers that will not prevent development of a responsible national energy policy.

THE LONG AMENDMENT WOULD FURTHER THE ESTABLISHMENT OF A REASONABLE AND PREDICTABLE CEILING FOR COAL RATES

The Long Amendment recognizes the need for a limit on the rates which can be charged to captive coal traffic. It attempts to strike a balance between this need and the railroads' need for revenue by providing for the establishment of a standard of maximum reasonableness for coal rates. EFC agrees that this balance must be reached. In order to adequately protect shippers and consumers of coal, and not merely give the railroads an additional zone of rate flexibility beyond that already provided in S. 1946, the proposal should be amended and clarified.

EFC supports the concept of establishing a presumptive maximum rate for coal traffic

The Long Amendment directs the Commission to establish after hearing a ratio of revenue to variable cost for coal rates. This ratio will serve as the presumptive maximum limit on reasonableness where the rates exceed those permitted under the provisions of proposed sections 10701(f) and 10701(g)(1). The ratio will apply where existing or new rates exceed the adjusted base rate, the level to which carriers would be free to increase rates without suspension or investigation. The Amendment thus recognizes that without statutory authority to the contrary, rates for captive commodities such as coal may increase more rapidly than other rates, a fact about which our experience has shown there can be little dispute. As envisioned by the Amendment, the Commission must establish a specific and rational figure limiting the amount of captive traffic rate increases that will be allowed.

EFC supports the concept of establishing this upward limit on coal rates. EFC believes that railroads should not be allowed to raise rates on coal beyond any direct relation to cost of service simply by alleging revenue need. The amount of increase must be limited; and the limit must be fair and determined on the record, giving due weight to the relevant considerations set forth in the Amendment. The standard must be clear to notify shippers of what they can expect their future rail transportation rates to be.

The establishment of such a standard will greatly improve the present situation. Coal rates now subsidize other rail traffic, but the amount of that subsidy varies widely and cannot be determined exactly by individual shippers. The Commission has granted increases of various ratios when the carriers merely allege revenue need, without clearly articulating any standard of reasonableness. Shippers consequently are unable either to protect their rights by intelligently challenging rates or to plan to meet future transportation costs. The lack of standards permits carriers to engage in "bait and switch" tactics of luring traffic with attractive rates and then seeking exorbitant increases once the shipper is locked into a specific rail service. This legislation should aid shippers in the exercise of their legal rights and permit them to predict what their future rail rates are likely to be.

The mechanics for implementing this standard of maximum reasonableness must be clarified

The proposed standard of maximum reasonableness embodied in the Long Amendment will function by shifting the burden of proof in rate proceedings. These provisions need clarification and revision. Under the present law, when a carrier initiates a new rate, the carrier bears the burden of proof as to the reasonableness of that rate. However, the Commission may suspend such a rate pending an investigation of its reasonableness only if the party complaining against the rate shows that the rate will cause substantial injury to the complainant and that the complainant is likely to succeed on the merits.

The Long Amendment provides that where the carrier institutes a rate which exceeds the ratio established by the Commission, the carrier will have the burden of proof on the issue of reasonableness without regard to the provisions of the Interstate Commerce Act which place that burden on the complainant with respect to suspension. In its present form, the Long Amendment does not make clear to what extent the burden of proof is shifted to the carrier. Arguably, the question of injury to a complainant is not directly related to the reasonableness of the rate. If a carrier seeks to impose a rate higher than the maximum reasonableness standard, the carrier should bear the burden of proof with respect to the entire amount of the rate increase, not just that portion which exceeds the standard of maximum reasonableness. The Amendment also should be clarified to provide that in such instances the complainant is not required to make a showing of injury. Specific language for these purposes should be added to the Amendment which sets out the carrier's burden.

These provisions when clearly stated in the Amendment would give procedural benefits to a shipper protesting a new coal rate. They are certainly the minimum called for by the legislation. Once the Commission has established a maximum reasonableness ratio for rates, the burden of proof must be on the carrier in all respects if it seeks to implement a rate above that level. As discussed below, this burden must be substantial.

The Long Amendment also appears to intend to shift the burden of proof in complaint proceedings. Under existing law, in proceedings challenging existing rates, the burden of proving the unreasonableness of the rates is on the complainant. The Long Amendment provides that when a rate exceeds the "cap" established by the Commission, the burden as to reasonableness will be on the carrier notwithstanding the provisions of this section 11701 of the Interstate Commerce Act. It should be noted, however, that section 11701 does not specifically refer to the burden of proof. To achieve its objective, the Amendment should be modified to state specifically that in such instances, the burden of proof will be on the carrier. Again, these procedural benefits are the minimum called for by the Amendment.

EFC further submits that this Amendment should place an extremely heavy burden of proof on a carrier which publishes rates higher than the maximum standard. The Amendment should be modified to provide that, with respect to any rate which exceeds the ICC-prescribed ratio, there shall be a presumption of unreasonableness. A presumption of unreasonableness, rather than merely a shift of the burden of proof is compatible with the stated purpose of the Amendment to provide a "presumptive cap" on coal rates.

In establishing the standard ratio, the Commission will consider issues relevant to the carriers' need for revenue. Thus, the legislation should provide that need is not an issue in a proceeding to justify such a specific rate. The carrier should be required to show some overriding factor not considered in promulgating the maximum ratio in order to justify an increase; carrier financial need is not such an issue. Further, the legislation should provide that in a proceeding where an issue is whether, in fact, a specific rate exceeds the maximum ratio, the burden of proof shall be on the carrier to establish that the ratio is within the prescribed limits.

The mechanics of this legislation also create a question as to the appropriate allocation of the burden of proof for proceedings involving rates which exceed those permitted by proposed section 10701(g), but are below the standard established by the Commission pursuant to the Long Amendment. Shippers should not be required to sustain any greater burden than is presently imposed. The Amendment should provide that, with respect to rates within this zone, the burden of proof is unchanged; in complaint proceedings the burden of establishing unreasonableness will be on the shipper, but when initiating new rates, the carrier must sustain its burden of establishing reasonableness. Further, the Amendment is not clear as to the allocation of the burden of proof in a proceeding if the presumptive maximum falls within the 4 percent zone authorized by section 104. This should also be clarified.

The scope of the amendment must be clarified

It should also be noted that while the stated intent of the Long Amendment is to provide relief from excessive coal rates, the text of the Amendment refers neither to coal nor to captive traffic. The Amendment should be revised to clarify its precise scope.

CONCLUSION

EFC strongly supports legislation establishing a maximum ceiling on coal rates and believes that the Long Amendment with the modifications discussed above would accomplish this purpose. EFC's experience with its own coal movements is a prime example of the bait and switch tactics which railroads may employ on captive coal traffic. It is essential to the shippers and consumers of coal, and to the national energy policy, that an appropriate legislative balance be struck between their needs and the railroads' revenue needs. EFC commends Chairman Long and the Subcommittee for their efforts in reaching this balance, and urges the Subcommittee to clarify this Amendment so that it will achieve that goal.

SLOVER & LOFTUS,

Washington, D.C., November 26, 1979.

Mrs. JANICE ROSENAK,
Senate Committee on Commerce,
Washington, D.C.

DEAR MRS. ROSENAK: As evidenced by its appearance before the Committee, the Western Coal Traffic League and its constituent members are vitally concerned over S. 1946 and specifically with Section 102—Maximum Rate Regulation.

Today there is more maximum, rail rate litigation before the I.C.C. and the federal courts than at any time in recent history and perhaps since the beginning of federal regulation. We did a quick survey of the pending court appeals which I attach and which shows the extent of the turmoil. We believe that it can be said fairly that the root cause of each of these vigorous litigations between coal receivers and railroads is the about-face of the I.C.C. first revealed in its *Smithers Lake* and *Cochise* decisions served in November, 1977. In these decisions, the Commission, for the first time in its history, sought to fashion railroad rates, in part at least, under rate base/rate-of-return methodology. What it viewed as its statutory mandate for its new approach, was Section 205 of the 4 R Act (Section 10704(a)(2) of Title 49, United States Code). While Western Coal believes it is clear that Section 205 never intended such an approach, there is no dispute that the I.C.C. is now taking this approach, justifying it by reference to Section 205, which brings us to our point.

Section 102 of S. 1946, whether innocently or intentionally, will have the effect of intensifying the present chaos in maximum rate regulation because it can be read as continuing and, indeed, mandating the utilization of rate base/rate of return methods in gauging railroad rates. Once we go down this road, the problems are enormous and we point to the firestorm of litigation engendered by the Commission's first tenuous steps under the 4 R Act.

Sections 102 and 103 of S. 1946 are appealing to the naive in their simplistic reliance upon routine concepts which unfortunately have no easy application to railroad pricing; namely, making rates which earn a "reasonable return" (Section 102(e)(2)). Being for a reasonable return is like being against sin and for motherhood, but how is it calculated for a specific rate on a specific rail movement? This is the Pandora's Box which S. 1946 will open or officially keep open. It is one thing to make rates for water or electricity which produce a "unreasonable return" on a well-defined, regulated, used, and useful investment base and something entirely different in the railroad industry. The apportionment of a return required by the railroad to increments of output (i.e. particular movements) which use only selected parts of an unregulated investment base raises extremely complex questions which S. 1946 overlooks.

As you know, Rail Form A is a tool for the ascertainment of costs and was never intended nor has it ever been relied upon extensively for the development and allocation of returns or profits. Indeed, its weaknesses in this area were underscored by Dr. Ford K. Edwards at the time he developed the formula in California where he noted as to the return feature:

"It would not be sensitive to variations in the road investment or variations in the traffic density between various portions of the system. To remove this objection, one would have to break down the valuation and the traffic statistics by divisions, by valuation districts, or even by sections of valuation districts."

Study of Rail Cost Finding For Rate Making Purposes, Case No. 4402, California Railroad Commission, Dr. Ford K. Edwards, December 1, 1938.

The road return element is in terms of dollars, the major element in the existing rate disputes before the Commission. *S. 1946* does nothing to clarify or resolve this situation. Western Coal urges that if we are to go to rate-of-return, that the Committee recognize the rate base problems in the rail industry, including the complexities in apportioning the "reasonable return" amongst dissimilar units of output which utilize only parts of the system investment. To accomplish this, and at the same time deal with the practical problems of regulating rates in the *interim*, Western Coal would urge the Committee to consider the following approach:

1. A moratorium on rate base/rate of return rate-making and a return to the traditional analysis focusing upon contribution over variable costs;

2. A study of the concept of using rate of return on used and useful investment for establishing railroad rates to be completed within a specified time period and, if the Commission's conclusion is that such rate-making methodology should be adopted, requiring the promulgation by the I.C.C. of rules and guidelines to implement such methodology within a further specified time frame.

We appreciate the opportunity to bring to the Committee Staff's attention our very real reservations on the maximum rate provisions and our reasons therefor.

Very truly yours,

WILLIAM L. SLOVER,
Attorney,
Western Coal Traffic League.

Enclosure.

PETITIONS FOR REVIEW FILED IN U.S. CIRCUIT COURTS FROM ICC COAL RATE DECISIONS

Southwestern Electric Power Company v. ICC and United States, No. 79-2701 (5th Cir., filed July 23, 1979).

Southwestern Electric Power Company v. ICC and United States, No. 79-2082 (5th Cir., filed May 3, 1979).

Burlington Northern, Inc. and Kansas City Southern Railway Company v. United States and I.C.C., No. 79-1547 (D.C. Cir., filed May 25, 1979).

Systems Fuels, Inc. and Arkansas Power & Light Co. v. United States and I.C.C., No. 79-2491 (5th Cir., filed June 22, 1979).

Nevada Power Company v. I.C.C. and United States, No. 79-7504 (9th Cir., filed October 1, 1979).

Utah Railway Company v. United States and I.C.C., No. 79-2059 (10th Cir., filed September 28, 1979).

Union Pacific Railway Company v. United States and I.C.C., No. 79-1840 (10th Cir., filed August 17, 1979).

San Antonio, Texas Acting By And Through Its City Public Service Board v. United States and I.C.C., No. 78-2051 (D.C. Cir., filed October 25, 1978).

Burlington Northern, Inc. v. United States and I.C.C., No. 78-2307 (D.C. Cir. filed November 24, 1978).

The State Of Texas v. United States and I.C.C., No. 78-2216 (D.C. Cir., filed November 24, 1978).

Burlington Northern, Inc. v. United States and I.C.C., No. 79-1712 (D.C. Cir., filed July 9, 1979).

Iowa Public Service Company v. United States and I.C.C., No. 79-1550 (8th Cir., filed July 13, 1979).

Burlington Northern, Inc. and Chicago and North Western, Transportation Company v. United States and I.C.C., No. 79-1747 (D.C. Cir., filed July 16, 1979).

Iowa Power and Light Company v. United States and I.C.C., No. 79-1534 (8th Cir., filed July 6, 1979).

Celanese Chemical Company, Inc. v. United States and I.C.C., No. 78-3849 (5th Cir., filed December 4, 1978).

Burlington Northern, Inc. v. United States and I.C.C., No. 79-2286 (D.C. Cir., filed October 26, 1979).

Burlington Northern, Inc. v. United States and I.C.C., No. 79-2295 (D.C. Cir., filed October 29, 1979).

Dayton Power and Light Company v. United States and I.C.C., No. 79-2088 (10th Cir., filed September 14, 1979).

Hazard Coal Operators Association v. United States and I.C.C., No. 79-2245 (D.C. Cir., filed October 18, 1979).

Electric Fuels Corporation v. United States and I.C.C., No. 79-2255 (D.C. Cir., filed October 19, 1979).

Tampa Electric Company v. United States and I.C.C., No. 79-2300 (D.C. Cir., filed October 29, 1979).

Alabama Power Company, et al. v. United States and I.C.C., No. 79-2090 (D.C. Cir., filed September 17, 1979).

Louisville and Nashville Railroad Company v. United States and I.C.C., No. 79-2002 (D.C. Cir., filed August 29, 1979).

The Commonwealth of Kentucky v. United States and I.C.C., No. 79-2172 (D.C. Cir., filed October 4, 1979).

Seaboard Coastline Railroad Company v. United States and I.C.C., No. 79-2001 (D.C. Cir., filed August 29, 1979).

COAL RATE CASES CURRENTLY PENDING BEFORE THE ICC

Docket No. 37135 F, Increased Rates On Coal, BN—Montana To Superior, Wisconsin.

Docket No. 37135 (Sub No. 1) F, Increased Rates On Coal, BN—Montana To Cohasset, Minnesota.

Docket No. 37135, Minnesota Power and Light Company v. Burlington Northern, Inc.

Docket No. 37162, The Cleveland Cliffs Iron Company v. Burlington Northern, Inc.

Docket No. 37169, Detroit Edison Company v. Burlington Northern, Inc.

Docket No. 37276, Coal, Wyoming To Redfield, Arkansas.

Docket No. 37266, Incentive Rate On Coal—Axial, Colorado To Coletto Creek, Texas.

EDISON ELECTRIC INSTITUTE,
Washington, D.C., December 6, 1979.

Subject: Railroad deregulation.

Chief Executive Officer.

Federal Affairs Contact.

Member Company.

On November 27, the Senate Committee on Commerce, Science and Transportation reported out S. 1946, the Railroad Transportation Policy Act of 1979. A copy of that bill, which was amended before being reported, was sent to you on November 9. The bill is not yet available, but will be sent to you shortly.

Attached is a one-page statement of EEI's position on S. 1946, along with suggested amendments, and an explanation of these amendments.

Absent inclusion of our amendment, EEI will oppose S. 1946. We again strongly urge you to contact your Senators and inform them that our amendment will be offered on the Senate floor and urge them to support our position.

Sincerely yours,

FREDERICK L. WEBBER,
Executive Vice President.

Attachments.

RAILROAD DEREGULATION BILL

1. EEI supports legislation with attached amendment. Without this amendment, EEI opposes the bill.

2. Amendment provides that in the case of increases in railroad rates on shipment of coal above 150 percent of variable costs, railroads have the burden of proof to show they need said increase in terms of revenue.

(a) This is not a cap—it is a shifting of the burden of proof.

(b) Electric utilities have the burden of proof to show the need for rate increases, why shouldn't the railroads?

3. Cost of bill w/o amendment to industry is \$10.5 billion annually at end of 20 years if maximum increases are realized.

4. Bill w/o amendment is against national policy and is not in the best interest of our country, since it is prejudicial against the use of coal, unreasonably increasing the cost thereof.

5. It is an indirect tax on coal to subsidize the railroads.

(a) Tax is regressive in nature, i.e., burden of this tax falls equally on the rich and the poor without concern about the ability to pay.

6. Our industry is willing to bear a reasonable subsidy, if necessary, as far as the railroads are concerned, but we must know what this subsidy is for future planning, which is a prerequisite to the good economic health and reliability of the industry, as well as the Nation.

ANALYSIS OF CHANGES PROPOSED BY THE EDISON ELECTRIC INSTITUTE IN S. 1946
AS ADOPTED BY THE COMMITTEE

The proposed changes in S. 1946 as adopted by the Committee¹ accomplish the following objectives.

1. REVISIONS TO SUBSECTIONS 10701(F) (1) AND (F) (4)

The revised bill requires rail carriers to certify the revenue-to-variable cost ratio for the movement which is yielded by the base rate as adjusted for inflation. If the new rate yields a higher revenue-to-variable cost ratio for the movement than the average ratio of revenue-to-variable cost established by the Commission, the new rate shall presumptively be deemed to exceed a reasonable maximum for the transportation. The rail carrier shall have the burden of demonstrating to the Commission that such rate is not unjust and unreasonable. It is expected that the Commission would require the carrier to show that:

(a) the carrier system as a whole is not earning its established fair rate of return on all its property used and useful in its rail transportation business;

(b) the carrier has exercised due diligence to eliminate its non-compensatory traffic and to maximize the contribution to fixed costs from its competitive traffic; and

(c) any subsidy implicit in the carrier's rates is equitably allocated among all shippers.

These showings could be made either in a general proceeding or in an individual investigation or complaint proceeding.

2. REVISIONS TO SUBSECTION 10701(G)

The revised bill provides that whenever a rail carrier increases its rates in excess of the inflated related adjustments authorized by subsection 10701(f), it must certify to the Commission the revenue-to-variable cost ratio yielded by the proposed new rate. If the new rate yields a revenue-to-variable cost ratio for the movement greater than the average ratio of revenue-to-variable cost established by the Commission, the new rate shall presumptively be deemed to exceed a reasonable maximum for the transportation. The rail carrier shall have the burden of demonstrating to the Commission that such rate is not unjust and unreasonable. It is expected that the Commission would require the carrier to make the same showings as described in item 1 above.

CHANGES PROPOSED BY THE EDISON ELECTRIC INSTITUTE IN S. 1946 AS ADOPTED BY
THE COMMITTEE

1. Modify section 10701(f)(1), as added by section 103 of S. 1946, to read as follows:

"(f)(1) A rail carrier providing transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title may increase any rate for such transportation so long as the new rate is equal to or less than the adjusted base rate for such transportation. *At the time it increases the rate, the rail carrier shall file a verified statement with the Commission declaring the revenue-to-variable cost ratio for the transportation which is yielded by the changed rate. If the new rate yields a revenue-to-variable cost ratio for the transportation of utility coal greater than the average ratio of revenue-to-variable cost established by the Commission pursuant to subsection (e) of this section, the new rate for utility coal shall presumptively be deemed to be unjust and unreasonable and the rail carrier shall have the burden of demonstrating to the Commission that such rate is not unjust and unreasonable.*

2. Modify section 10701(f)(4), as added by section 103 of S. 1946, to read as follows:

"(4) *If a new rate for utility coal authorized pursuant to this subsection yields a revenue-to-variable cost ratio for the transportation greater than the average ratio of revenue-to-variable cost established by the Commission pursuant to subsection (e) of this section, the new rate for utility coal shall presumptively be deemed to be unjust and unreasonable and the rail carrier shall have the burden of demonstrating to the Commission that such rate is not unjust and unreasonable. Notwithstanding any other provision of this subchapter, if the new rate for utility coal yields a revenue-to-variable cost ratio for the transportation equal to or less than the average ratio of revenue-to-variable cost established by the Commission pursuant to subsection (e) of this section, the Commission shall not have authority to find any such rate (for transportation authorized under this subsection) to be unjust or unreasonable on the basis that such rate exceeds a reasonable maximum for the service rendered or to*

¹ Existing portions of the bill to be deleted are bracketed; new material is underscored.

be rendered, nor may the Commission suspend or investigate such rate under section 10707 of this title."

3. Modify subsection 10701(g), as added by section 104 of S. 1946, to read as follows:

"(g)(1) Subject to the provisions of subsection (g)(3) of this section, during any calendar year a rail carrier providing transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title may increase the rate for such transportation by an amount not exceeding 4 percent of the adjusted base rate for such transportation as defined in subsection (f)(2) of this section: *Provided*: That in no event shall the total increase under this subsection during the period from January 1, 1980 to December 31, 1984, or during each consecutive period of 5 years thereafter, exceed an amount equal to 12 percent of the adjusted base rate for such transportation as defined in subsection (f)(2) of this section.

"(2) Any part of a rate increase authorized under paragraph (1) of the subsection which is not implemented in a calendar year may be implemented in the next succeeding calendar year: *Provided*, That in no event shall the total increase under this subsection in any calendar year exceed an amount equal to 8 percent of the adjusted base rate for such transportation as in subsection (f)(2) of this section.

"(3) At the time it increases a rate for transportation in accordance with this subsection (g) the rail carrier shall file a verified statement with the Commission declaring the revenue-to-variable cost ratio for the transportation which is yielded by the new rate. If the new rate for utility coal yields a revenue-to-variable-cost ratio for the transportation greater than the average ratio of revenue-to-variable cost established by the Commission pursuant to subsection (e) of this section, the new rate for utility coal shall presumptively be deemed to be unjust and unreasonable and the rail carrier shall have the burden of demonstrating to the Commission that such rate is not unjust and unreasonable. Notwithstanding the provisions of section 10707 of this title, if the new rate yields a revenue-to-variable cost ratio for the transportation equal to or less than the average ratio of revenue-to-variable cost established by the Commission pursuant to subsection (e) of this section, the Commission may not suspend any such rate increase authorized by this subsection pending final Commission action, nor may it begin an investigation proceeding under section 10707 of this title with regard to a rate increase authorized by this subsection: *Provided*, That an interested party may file a complaint under section 11701(b) of this title alleging that such increase violates the provisions of this subtitle.

"(4) Not later than 3 years after the effective date of this subsection, and at least every 3 years thereafter, the Commission shall submit to the Congress a report that analyzes the revenue needs of rail carriers and makes such recommendations for the modification of this subsection as the Commission determines may be necessary."

PUBLIC UTILITY COMMISSION OF OREGON,
Salem, Oreg., January 16, 1980.

Hon. BOB PACKWOOD,
U.S. Senator, Washington, D.C.

DEAR BOB: As you are well aware, a healthy railroad industry is of major importance to the Oregon forest products industry. Oregon rail shippers have been seriously disadvantaged in recent year by a series of general rate increases which have injured our competitive standing in national markets.

One major problem which places Oregon shippers at a disadvantage is the long-term railroad practice of differential pricing; that is, the overpricing of some commodities (those which are relatively more rail-dependent), so that other commodity movements can move at lower rates. This results in some shippers (including Oregon forest products shippers) subsidizing others.

Also, I am concerned that coal shipments are priced in such a way as to not subsidize the movement of other commodities. This can have a service impact on Oregon consumers in that a new coal fired generating plant will go into production this year at Boardman, Oregon.

We urge your support of the amendment to S. 1946, which we are submitting with this letter. This amendment and a cover letter (same as this letter without these first three paragraphs) are being sent to Senator Cannon, the ranking members of the House Committee on Interstate and Foreign Commerce, the ICC, and industry representatives.

There is a consensus that rail carrier legislation is necessary. Proposals vary from deregulation to a return to the pre-4R Act status quo. We feel that S. 1946 is the best proposal toward solving transportation problems today. However, S. 1946 falls short of a necessary solution.

We propose an amendment to S. 1946 which will add impetus, clarification and definition to the purpose and policy of the 4R Act. To summarize:

(1) The amendment clarifies responsibility for dealing with transportation problems among the Interstate Commerce Commission, the Department of Energy, and the railroad industry.

(2) The amendment removes legal barriers to realization of a healthy rail system by removing rail carriers' common carrier obligations to provide retail transportation services which do not contribute to the carriers' going concern value.

(3) The amendment seeks long-run cost efficient solutions so that the captive users of rail transportation do not, after subsidizing the retail services of rail transportation for so long, get priced out of the market. We specifically refer to the small and local industry users who depend on the long haul rail carrier services; they are the real captive shippers not appropriately represented in current legislative considerations.

We cannot support a large step towards deregulation. We strongly feel regulation is necessary to integrate a national energy policy with the National Transportation Policy to help in attaining national energy independence. Because transportation uses 53 percent of the petroleum consumed, the solutions to the problems must necessarily be based on integrated policies.

Concerns for the small rail-dependent industries, quite common in Oregon, are not evident in S. 1946. Concerns for a healthy railroad industry have been relatively static under the 4R Act implementation. The 4R Act mandates a cost accounting system. It is now time to use this mandated system in a manner that will not further injure the small shipper who requires wholesale transportation.

Noncompensatory traffic necessary in the public interest should be subsidized by only the concerned public interest.

Please support the proposed amendment. It makes no social, scientific or economic sense to have major national policies in conflict where such conflict can be easily avoided. Without these amendments, national energy policy and the National Transportation Policy will be at odds with each other.

Please realize, it took years to iron out the weaknesses of the Interstate Commerce Act and determine what it means. We ask that similar problems with the 4R Act be solved by inclusion in S. 1946 of the attached amendment.

Thank you for your consideration.

Respectfully submitted,

JOHN J. LOBDELL, *Commissioner.*

Enclosures.

PUBLIC UTILITY COMMISSIONER OF OREGON COMMENTS ON S. 1946 PROPOSED AMENDMENTS TO REPORT NO. 96-470, CALENDAR NO. 502

Replace in S. 1946 (p. 45, lines 12 and 13) amending Sec. 10101 of Title 49, United States Code—

"(11) Cooperation with other Federal agencies in executing national policies, particularly as they relate to the highest priorities of long-range achievement of the goals of conservation of non-renewable energy resources and reduction of atmospheric pollution."

Add to S. 1946, Title IV a new section heading commencing on page 92, line 15—

"DIRECTIVE TO COMMISSION

"Sec. 307 A new Chapter 116 entitled *Federal Interagency Relationships* of Title 49, United States Code, is added—

"Sec. 11601 Department of Energy Relationship.

"The Commission shall strongly weigh in its administrative processes net energy use and potential savings in all cases under its jurisdiction. Congress has delegated primary responsibility for energy expertise and conservation to the Department of Energy. The Commission shall recognize this department and administer transportation regulation within the scope of future energy needs and limitations. Annually, the Commission shall report the net annual energy savings as realized from all regulatory policy and rule changes relating to the transportation modes under Title 49, subtitle IV of the United States Code. The Department of Energy will give an opinion on each report and report major discrepancies therein to Congress. The report shall consider the productivity as measured by lading ton-mile output per BTU (British Thermal Unit) input.

Replace deleted part of Sec. 10701(b)(1), last two sentences, by—

"A rate that is below a level which contributes or would contribute to the going concern value of a carrier is unreasonable and places an undue burden on interstate commerce."

Add at the end of Sec. 10701(b)(2)(B)—

"The Commissioner will include in variable costs of service (for example on Branch lines) all normalized costs. If such costs cannot be borne by the distinct service for which the carrier holds itself out to provide, the Commission will specify the time beyond which the service will be subsidized or terminated, but such time is not to exceed one year. Normalized costs are costs necessary to maintain the service at a specific level of volume for an indefinite time period. No service shall be subsidized by profits from other services."

In S. 1946, page 57, line 17, (in Sec. 10701a(d)) add after "except," "that rates shall satisfy Sec. 10701(b)(2)(B) and except."

In S. 1946, page 81, line 3, add immediately after "carrier" the following " , including debt and equity capital with an allowance for income tax at the maximum effective tax rate as a function of equipment life."

Add to S. 1946, page 89, line 5, after the period (append to Sec. 10505(a))—"Pick up and deliver service solely contiguous to rail movement is for purposes of economic regulation exempt whenever two conditions exist:

(1) The rail carrier is providing only wholesale transportation, and;

(2) The consumption of the non-renewable energy resources used in the complete commodity movement and aggregate bidirectional movement of equipment is less than the non-rail alternative."

Add to Sec. 10728, Title 49, Subtitle IV of the United States Code, by changing "(b)" to "(c)" and adding:

"(b) Distinct services shall include but not be limited to the wholesale functions of rail transportation.

"(1) In the case of TOFC/COFC movements, the wholesale function of transportation is the movement of the trailer or container from the origin ramp facility over the railroad to the destination ramp facility. This function includes ramping or deramping but excludes pick up and delivery beyond the ramp facility. Rates shall be published exclusive of the container/trailer ownership costs. Shipper equipment will move at no ownership expense to the rail carrier for equipment use. Distinct services for which there shall be separate rates include but are not limited to:

"(A) Terminal handling including ramping or deramping.

"(B) Loss and damage protection by commodity.

"(C) The Carrier-owned freight car.

"(D) The Carrier-owned van or container.

"(E) Timely service guarantees.

"(F) Train service.

"(2) In the case of carload movements, the wholesale function of transportation is the movement of multiple car shipments from rail head gathering points over rail in solely through trains to distribution or manufacturing points. Distinct services for which there shall be separate rates include but not limited to:

"(A) Origin or destination switching by industry location.

"(B) Loss and damage protection by commodity.

"(C) Railroad-owned car equipment. The time portion of the rate shall include seasonal and peak demand variations. The shipper shall not pay for the time portions subsequent to the release of the car at destination. In the case of non-rail carrier equipment, the equipment will move at no expense to the rail carrier for the use of the equipment.

"(D) Timely service guarantees.

"(E) Train service—to add shipper incentives to optimize rail productivity and to isolate and orient the cause and effect relationships to variable costs—separately, for:

"(i) The loaded car movement.

"(ii) In the case of movements in railroad-owned cars, the prior empty movement."

Replace in S. 1946, p. 43, line 15, the "an" by the words "a negative."

PUBLIC UTILITY COMMISSIONER OF OREGON, COMMENTS ON S. 1946, A BILL PROPOSING THE "RAILROAD TRANSPORTATION POLICY ACT OF 1979" WITH PROPOSED AMENDMENTS

INTRODUCTION

Purpose

After an extensive review of the above bill, as amended December 7, 1979 (legislative day November 29), we feel this statement should be considered in the development of national policy and direction relating to railroad transportation.

The Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) initiated a positive legislative strategy of tremendous importance to the rail industry.

The key to successful implementation of this Act is based on a mandatory rail carrier cost accounting system. In rail ratemaking under rate regulation, it is extremely important to be able to determine whether or not a specific rate contributes to the going concern value of the carrier. The 4R Act's cost accounting requirements directly address this issue. This follows years of direct and indirect cross-subsidization sanctioned by both the regulators and regulated in ratemaking processes.

Congressional direction

To this date the Commission has not made a decision on Ex Parte 355, which centers on this issue. Rail carriers continue to be peak period carriers. Rail carriers continue to attempt to compete in the retail transportation market with motor carriers, where instead it is more the national interest for railroads to complement the highway distribution system as *wholesalers* of transportation (as defined in the attachment, page 4, lines 1 through 13 in the case of TOFC/COFC; and page 4, line 25 through page 5, line 5, in the case of carload traffic).

It is too soon to expect a rail cost accounting system to yield the type of logically-based management decisions found in the private, unregulated sector of our economy. Likewise, it is too soon to surrender the 4R Act impetus toward regulatory reform. It is the time to give direction to regulation. The Commission's responsibilities have been: (1) solely to the legislature, (2) almost totally independent of national policy other than in transportation, (3) subordinate to no other agency of government, and (4) restricted primarily to safety, rate, and compulsory service. Briefly, rail regulation has not been in harmony with democratic incentives or long-range social issues.

We feel it is time for a national change in attitude—one which will make rational use of both energy and transportation resources. No longer can transportation be so tied to immediate concerns as to ignore future economic realities and future requirements.

Three areas to be addressed

Statutory change in strategy is necessary in three areas—not just in matters of Commission jurisdiction. This statement addresses (1) national energy policy, (2) federal economic incentives, and (3) Title 49 mandates. We feel an integrated approach is required to prevent further erosion of transportation services required by those dependent on the wholesale functions of transportation.

NATIONAL ENERGY POLICY

Introduction

The best way to realize and stimulate energy conservation is to: (1) establish guidelines under which an unregulated system can choose alternatives sensitive to energy as well as economic issues (this not only includes the shipper groups, but the retail function of transportation—see amendments to S. 1946 (49 USC 10505(a) on page 3, lines 13 through 21); and (2) relieve the rail carrier of its common carrier duty where the rates for these services do not contribute to the rail carrier's going concern value (S. 1946 amendment to 49 USC 10701(b)(1) on page 2, lines 9 through 14).

Energy efficient mode

National energy policy must address transportation requirements. The Department of Energy, Energy Information Administration, reports show approximately one-third the national energy consumption is for transportation. Of this amount, only pipelines consume less fuel than rail carriers. This comparison includes the air, marine, and truck modes.

Testimony in the most recent case involving a general increase of railroad freight rates and charges, submitted by John E. Murray, Vice-President of the American Association of Railroads and head of the AAR's Energy Committee, states that trucks generate 287 ton-miles per million BTU while railroads generate 1,493 ton-miles per million BTU. This energy efficiency of over 520 percent should attract legislative attention. Stated differently, the total truck/rail ton-mile output could be increased over 25 percent with a 10 percent reduction in fuel used by truckers transferred to rail carriers (additional data used in the calculation comes from DOE/EIA-0173/3 Annual Report to Congress, 1978, Volume 3, page 322, Tables 20.1 and 20.2).

Need for wholesale transportation

We applaud the congressional recognition in the statement of National Transportation Policy of the unique role railroads play (49 USC 10101) by separating policy pertaining to the distinct wholesale and retail obligations of transportation as it relates to the various modes. We are very apprehensive, however, of the proposed removal of the rail mode from the regulatory obligation "... to recognize and preserve the inherent advantage of each mode of transportation." Energy efficiency is a primary advantage of the rail carrier. This regulatory obligation should transcend current National Transportation Policy. This obligation is included in the OPUC proposed amendment to S. 1946 (page 1, line 1, through page 2, line 8; and page 3, lines 18 through 21, and page 6, lines 4 through 6) which specifically incorporates the energy conservation issue as it relates to rail transportation.

Shipper incentives

Note that because of the significant fuel advantage of rail carriers, it is important to include shipper incentives to use primarily empty rail direction capacity in addition to nonpeak demand/seasonal incentives (OPUC amendment to S. 1946—Sec. 10728(b)(2)(E)(ii), page 6, lines 4 through 6). Rates specifically including half the prior and subsequent movement, as prescribed in Finance Docket 34013 Costs for Ratemaking, do not give any incentive toward fuel conservation. Loaded movements, where prior empty movements are minimized (in the long run through plant relocation, if necessary), save fuel. If the shippers are given the opportunity to know where rail fuel and other productive economies are realized, true fuel conservation will be realized.

Summary

Our proposed amendments do not totally deregulate motor carrier or rail carrier modes. Such a policy would encourage energy waste. This policy would orient the modes to serving the shippers in the way each mode does it best, emphasizing the inherent advantage of each.

FEDERAL ECONOMIC INCENTIVES

General issues

We do not address specific legislation here. We strongly suggest, however, that without specific tax legislation and changes in Congressional attitude toward public subsidy of selected modes, the ideals of any national policy are unattainable.

We have made our position known to the Federal Railroad Administration through submissions in Economic Docket 78-1 and to the Interstate Commerce Commission through submissions in Dockets Ex Parte 230(5), 270(9A, B, C), 355 and 363. Governmentally created disincentives to railroad investment have Congressional solutions independent of ICC regulation.

Mode bias subsidies

Rail carriers, unlike water and motor carriers, are solely responsible for maintaining their rights-of-way. User charges for competing modes have been so short of meeting public costs that rail carriers can no longer effectively compete in the retail market for transportation services and can barely compete for long-haul, time-sensitive commodity transportation due to lack of capital.

Tax disincentives

Taking the time value of money into consideration, current Federal tax laws favor investment in short-life equipment over long-life equipment. The OPUC statements in Ex Parte 353 and 355 showed that rail carriers must earn considerably more before taxes to realize the same after tax return on investment as motor carriers. This is because there is a maximum effective tax rate (on an ICC accounting basis) of 11 to 27 percent for motor carriers, versus 31 percent for rail carriers. This comes about through investment tax credits, and accelerated depreciation treatment and the fact that motor carrier trailers have 12-20 years life and motor carrier tractors have an 8 year life. The railroad freight train car, on the other hand, has a life of 30 years.

These tax incentives are so biased against investment in railroad equipment that is hard to conclude that promotion of intermodal competition is a Congressional policy.

Taxation parity is essential to enable the market to rely on competition. Cash flow adequate to meet stockholder requirements can be substantially influenced by a legislative removal of this disincentive.

Intent

We believe that S. 1946 only skirts issues critical to solving the problem of attaining adequate railroad revenues and the railroads' ability to perform their common carrier duties. The issues are so interrelated to energy conservation and federal incentives mentioned above, that we emphasize again here where regulation can help railroads help themselves.

The attached proposed amendment to S. 1946 is an effort to supplement and to clarify the 4R Act directives to the ICC. Specifically, the issues of cross-subsidization, resource productivity and the common carrier duty to serve are addressed.

Going concern value

ICC Finance Docket 34013 (average "variable cost" for ratemaking) should once and for all vanish from the regulatory decision-making process. Rates set on 34013 principles are contrary to rational decisions based on fuel economies. Additionally, these rates subsidize certain shippers resulting in the rail carrier's inability to serve necessary functions as the wholesaler of transportation.

"Variable cost" is a presumptive cost for a distinct service that is defined as an estimate of the minimum rate level that would contribute to the carrier going concern value—not as the carrier average or representative cost, but as a cost reflective of the input source and its productivity (refer to OPUC amendment page 2, line 15, through page 3, line 1). If railroads are to remain viable in the private sector, they must disinvest in that part of their plant which cannot yield a positive return on investment.

We would argue that rates which are below a level which contribute to the going concern value of the carrier should be unlawful (OPUC amendment page 2, lines 11-14). This effectively relieves the rail carrier of its common carrier obligation to provide noncompensatory service.

Retail carrier exemption

The OPUC amendment further exempts the retail carrier from economic regulation where (1) the rail carrier provides only the wholesale transportation, and where (2) energy conservation can be realized. (OPUC amendment page 3, lines 13 through 21.) This is intended to give the private and unregulated sector of our economy an incentive to attain national energy policy objectives. Regulation has failed to do this.

Transportation/not commodity regulation

The attached OPUC amendments to the Interstate Commerce Act intentionally do not center on specific commodities. At this time it is impossible to know what rates contribute to the going concern value of the rail carriers. Congress should not prejudice. Instead, the Commission should oversee a necessary rail carrier commodity analysis using a rational cost accounting system as mandated by the 4R Act. In this Age of Information, made possible through inexpensive telecommunications and microprocessing, the Commission can no longer make decisions on a macro basis when micro detail, so important in the decision processes of the unregular sectors of our economy, is available and yields decisively different results.

Congress should want to know where public subsidy is necessary. The rail carriers can no longer be "quasi-governmental" philanthropists at the expense of shippers dependent on rail services.

The OPUC amendment objective, in addition to energy conservation, is to orient regulation toward using the rail carrier as the primary carrier (not the peak demand carrier) where the rail carrier has the inherent advantage. This is done through distinct service pricing (OPUC amendment, pages 4, line 14 through page 6, line 6) and codification of the rail carrier common carrier obligation to provide wholesale transportation.

Freight train car supply and demand by location is a large part of supply and demand for transportation. By pricing by direction/car type (and not commodity differential pricing) rail car productivity can go up from its current level of approximately one load per car-month. In the long run, shippers will relocate to better utilize the transportation system and the rail carriers will be motivated to sell services that increase productivity. Indeed, railroad costing does not reflect the directional advantages the rail carriers have. (For example, Ex Parte 290 Schedule C filing requirements in rail carrier general increases require cost burden analyses insensitive to this carrier advantage.) Continuation of this policy assures us that rail carriers will remain as "peak-demand" carriers and will not regain any diverted traffic lost through poor legislated pricing.

Computer technology is sufficient today to allow rail carriers to implement good decision-making tools consistent with public convenience and necessity. The Commission is necessary to police such requirements. Rail carrier management, on the other hand, must be free to manage with other than pseudo-costs and must be free from its obligations to furnish non-compensatory transportation. In this way, the rail carriers can control their own destiny and remain in the private sector.

Conclusion

By relieving the rail carrier of its common carrier obligation to provide retail transportation in cases where rates do not contribute to the going-concern value of the carrier, and by defining wholesale transportation, emphasizing the rail carrier obligation as a common carrier to provide that transportation; the rail carriers will be better able to compete and fit into an integrated and healthy national transportation system.

The ICC should now center its concern on determining whether or not rates contribute to the going concern value of the carrier (eliminating rail carrier self-cannibalism) and cease the fixation on the 34013 tradition. This 34013 presumption is clearly contrary to the intent of the 4R Act and of any bill, such as S. 1946, enacted by Congress.

The regulatory change of emphasis, as forwarded above, will better meet the needs of the rail dependent shippers while addressing head-on the solutions to the rail carriers' financial plight.

SUMMARY

A National Transportation Policy which does not strategically integrate National Energy Policy and does not acknowledge the plight and inherent advantages of the rail carriers falls short of the goals implied in the Title 49 S. 1946 amendment. The attached OPUC amendment to S. 1946 established an integrated strategy.

CITY OF SAN ANTONIO,
San Antonio, Tex., January 26, 1980.

Hon. RUSSELL B. LONG,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR LONG: I have learned that you are sponsoring an amendment to the railroad deregulation legislation which would require that railroads prove the necessity of some rate increases. I am writing to applaud your efforts.

The City of San Antonio has been gravely affected by recent ICC rulings which have allowed our carrier to double the hauling rates for coal used in our two electric generating plants.

I have been attempting to call attention to this contradictory situation whereas one national policy encourages the switch from gas and oil to coal while at the same time another policy is forcing the costs of using coal up to where foreign coal becomes an economical alternative. I have testified before the President's Commission on Coal as well as the Joint Economic Committee.

It is gratifying to me to see that the situation is getting some attention now.

We are very supportive of your position and stand ready to assist you with any information you may need.

Sincerely,

LILA COCKRELL, Mayor.

OFFICE OF PEOPLE'S COUNSEL,
Baltimore, Md., January 30, 1980.

Senator RUSSELL B. LONG,
U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: You are precisely on target with your observation that, "without an amendment, captive rail movement of coal under provisions of S. 1946 would be detrimental to the interests of American customers . . ." (Congressional Record-Senate, December 17, 1979 at S18775).

The opportunity for the railroads to earn and sustain excess (monopoly) profits for at least twenty years in coal hauling markets clearly will obtain under deregulation. Since railroads are directed and managed by rational beings, they will take advantage of that opportunity, limited perhaps by their collective perception of a politically acceptable level of gouging.

Customers of electric power will literally pay the freight. This is so because of the utility pricing mechanisms for recovering their fuel costs: Fuel Adjustment Clauses.

Fuel clauses permit electric utilities to pass through to consumers on a virtually current (monthly) basis increases in the cost of fuel. As you noted, transportation costs are a substantial part of the cost of fuel and are discretely identified in FERC and state systems of utility accounting as such. Fuel costs represent about 40 percent of the electric industry's annual operating costs.

Given the wide differential between the cartel established world oil price and coal, the transportation cost can escalate to unconscionable levels. Retail consumers of electricity will immediately bear the burden of further subsidy of inefficient railroad markets.

Except for the railroad industry, regulation of utilities is aimed at cost of service where cost includes a return of and on equity capital. It is wholly appropriate, and indeed in the public interest, for railroads to earn a reasonable return on equity. It is wholly inappropriate however for a captive segment of the market to pay rail rates that provide excess profits on equity capital required to provide rail service to it. In short, there should be a nexus between rates and cost of service.

I previously noted a minimum period of twenty years of probable captive pricing bounded by OPEC prices. It is possible that domestic coal production, coal slurry pipelines (5 percent of that market by 1995), development of nonconventional gas supplies synthetic fuels, biomass, coal gasification, solar and other renewable resources will establish a backstop price against OPEC in that time period. Even if this optimistic appraisal is accurate, rail deregulation will permit the railroads for twenty years to effectively tax away the differential between coal and OPEC oil.

In behalf of my clients, residential consumers in Maryland, I applaud your efforts. If I may be of assistance please call upon me for additional written comments or for testimony before the Congress.

Fifty copies of this letter are enclosed for your use and inclusion in the record at your discretion.

Sincerely,

JOHN K. KEANE, Jr.,
People's Counsel,
State of Maryland.

THE FERTILIZER INSTITUTE,
Washington, D.C., February 21, 1980.

Hon. RUSSELL B. LONG,
Chairman, Subcommittee on Surface Transportation,
Washington, D.C.

DEAR SENATOR LONG: Recognizing that the Subcommittee has an extensive list of witnesses to appear before it at the hearings set for Friday, February 22, 1980, we desire to submit this letter as a part of the record and not appear personally.

Your amendment to Section 104 of S. 1946 is acceptable to the members of The Fertilizer Institute. While you will recall my testimony before your Subcommittee on November 9, 1979, that we believed a return on investment test was the preferred way to measure a rate, it is obvious that the Committee did not concur. In the instant situation (i.e., the amendments) we would be strongly in support if the Congress would have established, as a matter of statute, a ceiling when the burden of proof shifted to the carrier to establish a rate. In discussing this matter with the staff at an earlier date we had suggested that the burden would shift on a rate when it exceeded 160 percent of variable cost. We have a large volume of our member's traffic moving today with a rate level at 220 percent of variable cost!

Admittedly, this route would call for Congress—as a policy matter—to invade the so-called expertise with which the Commission is supposed to be equipped. Admittedly, it would deprive the Commission of some flexibility. With rail rates rising faster than the Consumer Price Index (e.g., 30 percent in 18 months) I would hope you can understand our concern at leaving the shipper at the discretionary mercy of the Commission.

We are reassured by both the review of Congress language as well as the seven guidelines established in your amendment. It is for this reason, therefore, that we support your amendment.

Respectfully submitted,

EDWIN M. WHEELER, *President.*

SHIPPERS NATIONAL FREIGHT CLAIM COUNCIL, INC.,
Huntington, N.Y., February 25, 1980.

Hon. HOWARD W. CANNON,
Russell Senate Office Building,
Washington, D.C.

DEAR CHAIRMAN CANNON: Our Council studied the markup version of S. 1946 and wishes to submit the following amendments for your Committee's consideration in its deliberations on railroad regulation reform.

RAILROAD TRANSPORTATION POLICY

SEC. 2. Section 10101 of Title 49, U.S.C., is amended—

"(b) In regulating transportation provided by rail carriers, the Commission shall consider the following as being in the public interest:

(3) avoidance of undue concentrations of market power on the part of rail carriers and the maintenance of regulatory protection for shippers and receivers against the abuse of market power, *particularly with respect to contract terms and conditions;*

* * * * *

(8) encouragement of the establishment and maintenance of reasonable rates, *charges and rules* for transportation without unreasonable discrimination or unfair or destructive competitive practices;

CONTRACT RATES

SEC. 106. Section 10701 of 49 U.S.C. is amended by adding a new section 10701a. *Authority for rail carriers to establish contract rates or service:*

"(a) One or more rail carriers may enter into contracts with one or more purchasers of rail services to provide specified services under specified rates and conditions. Such contracts may contain provisions on subjects including, but not limited to . . . [force majeure] . . ."

Add subparagraph (a)(1) as follows:

(1) *No contract may contain provisions which relieve any common carrier by railroad from the common law governing carrier liability from the provisions of Sections 10730 or 11707 of Title 49, U.S.C., or from I.C.C. regulations governing liability and claim rules and practices.*

RELEASE RATES

SEC. 112. Retain the Commission's jurisdiction over railroad released rates, and add to the proposed amendment of Section 10730 of Title 49, U.S.C.:

"(b) A rail carrier providing transportation or service subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title may, subject to the provisions and procedures set forth in this chapter and the general tariff requirements of section 10762 of this title, establish *lower* rates for the transportation of property under which the liability of the carrier for such property is limited to a value established by written declaration of the shipper, or by written agreement between the carrier and the shipper, *provided, however, that full value rates are continued in effect at the same basic rate level published on January 1, 1980.*"

EXEMPTION

SEC. 302.

"(b) No exemption order issued pursuant to this section shall operate to relieve any common carrier by railroad from the common carrier liability for claims imposed under section 11707 of this title, *or from the Commission's regulations governing liability and claim rules and practices.*"

JUSTIFICATION STATEMENT

Our justification for these requested amendments rests on conclusive evidence that peripheral areas of transportation, such as contract terms and accessorial services (as distinguished from rates and service) do not respond to increased competition.¹ Since these areas do not react favorably to the public when all regulations are removed, those controls designed to protect shippers against carriers' superior bargaining position must be retained.

Accordingly, the Council urges that this issue be addressed in the Railroad Transportation Policy statement to mandate the Commission's adherence to a Congression-

¹ See Appendix A.

al intent that its regulations over bill of lading contract terms, loss and damage, and overcharge claims be continued and expanded when deemed to be necessary.² To this end, the phrase "charges and rules" must be added to Section 10101(8), the Transportation Policy statement.

These public-interest measures must be retained whether the railroad serves a shipper as a common or contract carrier. The railroads originating fresh fruits and vegetables clearly demonstrated their preoccupation with their pecuniary gain at the expense of shipper protection against loss or damage in transit in their unilateral contracts of carriage imposed on shippers under the Commission's exemption in Ex Parte 346 (Sub-No. 1). (See details in Appendix A, p. 3.) The railroads must not be permitted the same freedom to severally limit their liability for loss or damage of general freight without review by the Commission.

The removal of the Commission's jurisdiction over released rates presumes that contract rates will be negotiated at arms length by parties having equal bargaining positions. The fresh fruit and vegetable experiment has demonstrated that this will not necessarily follow exemptions from regulation. The reason is that most shippers are served by only one railroad.

The energy crisis is having a substantial impact on the competitive balance between the trucking and railroad industries. As rail transportation becomes more of a dominant mode because of fuel costs and shortages, shippers will have less and less real choice between modes.

Rail contracts, therefore, will soon become unilateral agreements dictated to shippers on a "take-it-or-leave-it" basis, as they were handed to the produce industry last summer. (See testimony of Sunkist and Western Growers Association before the special joint hearing of the Economic Growth and Stabilization Subcommittee and the House Commerce Committee, September 27, 1979.)

Under existing regulations and statutes, carriers are held strictly accountable for losses occurring during their possession of the goods under the laws governing bailees-for-hire. This induces carrier claim prevention programs and encourages management's constant search for means of reducing avoidable losses. Permitting carriers to introduce exculpatory terms in contracts of carriage will reverse the trend of lower claim ratios and cause irreparable harm to shippers and consumers.

With respect to released rates, the bill would permit railroads to establish released rates without Commission approval. In connection with third provision the Committee has stated that: "full value rates will of course continue in effect for the use of those shippers and receivers which choose not to utilize released rates."³

The Committee obviously is referring to the common law requirement that a choice of rates be available to a shipper as a condition for limiting the liability of a common carrier.⁴ Limitations without such a choice are presently unlawful and void.⁵

While this may be the common law, carriers frequently publish rates and rules in violation of this fundamental principle either in contempt or in ignorance of the law. The Railroads' imposition of the \$100 deductible and exclusion of claims under \$100 on exempt fresh fruit and vegetable traffic is the most recent example of this violation. Certain motor carriers' imposition of a \$1.00 per lb. limitation of liability within the New York City Commercial Zone, is another, (See Appendix A, pp. 3 and 5.) The bus industry's imposition of a \$500 per shipment limit on liability for decades has just recently been unlawful.⁶ Airlines have attempted similar devices to evade

² See, for instance, *Ex Parte 263, Rules, Regulations and Practices of Regulated Carriers With Respect to the Processing of Loss and Damage Claims*, February 24, 1972, 340 I.C.C. 515; *Ex Parte 342, Procedures Governing the Processing, Investigations, and Disposition of Overcharge, Duplicate Payment, or Overcollection Claims*, 49 C.F.R. 1008; *Ex Parte 372, Notice to Shippers of Freight Refused or Unclaimed at Destination*, Federal Register, December 12, 1979, pp. 71, 849.

³ See Report No. 96-470, pp. 32-3.

⁴ *Adams Express Co. v. Croninger*, 226 U.S. 491 (1913); *Scott Truck Line, Inc. v. Chicago R. I. & P. R. Co.*, 312 F. Supp. 511 (N.D. Ill. 1970); *Emily Shops, Inc. v. Inter-State Truck Line, Inc.*, 139 N.Y.S. 2d 561, aff. 161 N.Y.S. 2d 46, cert. den. 355 U.S. 827 (1957); *W. R. Grace & Co. v. Railway Express Agency, Inc.*, 202 N.Y.S. 2d 281, cert. den. 364 U.S. 830 (1960).

⁵ See Section 7-309(2) of the Uniform Commercial Code: "(2) Damages may be limited by a provision that the carrier's liability shall not exceed a value stated in the document if the carrier's rates are dependent upon value and the consignor by the carrier's tariff is afforded an opportunity to declare a higher value or a value as lawfully provided in the tariff, or where no tariff is filed he is otherwise advised of such opportunity; but no such limitation is effective with respect to the carrier's liability for conversion to its own use."

⁶ *Prohibitions and Limitations on Shipment of Articles*, 355 I.C.C. 793(1977), affirmed *National Bus Traffic Assn., Inc. v. I.C.C.*, Docket 78-1163, U.S. Court of Appeals, District of Columbia, September 12, 1979.

liability, such as a rule stating: "Not responsible for damage or loss to shipment unless a value is declared."⁷

Without a specific statutory prohibition to serve as a constant reminder of the common law, these attempts to evade and reduce liability will persist. As a result, the shipping public, particularly the unsophisticated shippers and receivers that constitute the great majority of the shipping public, will continue to suffer losses incurred due to carrier negligence.

It may be observed that there are in existence today numerous rail and motor classifications which contain mandatory declarations of value without a choice of shipping at full value rate.⁸ These unusual limitations have been approved by the Commission after full hearings by the Classification Board and the Commission. The committee's approach would preclude a public forum on released rates and place shippers at the mercy of railroads, as has happened with the fresh fruit and vegetable exemption experiment.

Furthermore, Congress must mandate that rail carriers not be permitted to convert existing "full value" rates into released rates, and publish a *higher* level of rates at full value liability.

The *quid pro quo* for limiting a carrier's liability is a *reduction* in freight costs. This condition cannot be met by shifting the burden of assuming the risk of loss in transit to the shipper without considering the added cost of the shipper's insurance.

Under the existing classification system upon which all surface carrier rates are constructed, an increment has been included in the rate for loss of damage exposure. To remove carrier liability for those losses without reducing the rate by that amount would constitute an increase in rates.

Our suggested amendments would prohibit this result. The use of the term "basic rate level" in the suggested amendment of Section 112 would permit periodical, general or other increases in the full value rates prevailing today. New rates for limited value would have to be published at a lower level.

In conclusion, our Council shares the Committee's concern that: "greater use of the exemption power would not be at the expense of captive shippers who have no reasonable transportation alternatives." Report No. 96-470 on S. 1946, p. 43

The growing fuel crisis is accelerating a greater number of shippers into the "captive shipper" category by forcing greater use of rail transportation, the more energy-efficient surface mode vis-a-vis motor carriage.⁹ Contract terms and conditions are the aspects of transportation where most all shippers are "captive."

The Committee is urged to restore the balance so urgently needed by shippers in their future dealings with railroads under the provisions of this legislation. We respectfully request that this statement be included in the record of the hearings on S. 1946.

Very truly yours,

WILLIAM J. AUGELLO,
Executive Director/General Counsel.

[APPENDIX A]

Judicial Deregulation

In 1956, the federal courts overruled the I.C.C.'s interpretation that the freeing of agricultural commodities was a manufacturing process which destroyed the exempt status of such products when transported by truck in interstate commerce.¹ Thus,

⁷ *Fairchild Hiller Corp. v. Commuter Airlines, Inc.*, 321 N.Y. S. 2d 621 (Sup. Ct. Boone 1971). See also *Klicker v. Northwest Airlines, Inc.*, 563 F. 2d 1310 (9th Cir. 1977).

⁸ See Appendix B, reproduced from "Freight Claims In Plain English," SNFCC (1979).

⁹ See the following table:

ENERGY EFFICIENCIES OF ALTERNATIVE FREIGHT MODES—1970

Mode:	Btu's per ton- mile
Pipelines	420
Railroads	675
Waterways	750
Trucking	3,440
Air freight	37,500

Source: Selected "Transportation Topics," Energy Primer DOT, Technology Sharing Program 1970.

¹ *East Texas Motor Freight Lines, Inc. v. Frozen Food Express*, 351 U.S. 49 (1956); *East Texas Motor Freight Lines, Inc. v. Frozen Food Express*, 355 U.S. 6 (1957); *Home Transfer and Storage Co. v. I.C.C.*, 141 F. Supp. 599 (Wash., 1956) aff'd per curiam, 352 U.S. 884 (1956); *Frozen Food Express v. U.S.* 148 F. Supp. 399 (Tex., 1956) aff'd per curiam, 355 U.S. 6 (1957).

substantial volumes of frozen fruits and vegetables began to move exempt from the economic regulations of the I.C.C. (rates and entry).

Within two years, the shippers of these products became so disenchanted with exempt transportation that they pleaded to Congress for re-regulation. Congress responded by enacting the Transportation Act of 1958, P.L. 85-625, 72 Stat. 573. The turmoil and destructive practices that followed is well documented in the legislative history of that Act. See House Report 1922 on H.R. 12832, 85th Cong. 2d Session. The financial responsibility of the new carriers entering the field, and the resultant liability problems that resulted, were of concern to the shipping public at that time. Law an order were quickly restored by Congress by subjecting this traffic to the provisions of the I.C. Act, including the Carmack Amendment. 49 U.S.C. 11707 (formerly Section 20(11) of the I.C. Act)

LEGISLATIVE DEREGULATION

The first trail with legislative deregulation occurred on November 9, 1977, when the air cargo industry was freed from virtually all C.A.B. controls.²

Unfortunately, in addition to its much publicized intent to free the airlines from rate and entry controls, the statutory language finally adopted also freed the airlines from C.A.B. jurisdiction over "rules, regulations and practices" as well. This came as a surprise to the airline industry and the shipping public, both of which had just completed seven years of litigation before the C.A.B. which resulted in the Board's prescription of reasonable and lawful rules, regulations and practices concerning carrier liability and claims.³

The airlines' actions following this windfall legislation clearly reveal the natural tendency of common carriers to place their pecuniary gain above the public interest when free of regulatory restraints. In brief, airlines:

1. limited their liability below the level set by the C.A.B. as being the minimum reasonable and lawful level;
2. some lowered their liability *below* that which prevailed before the C.A.B. investigation was instituted;
3. restricted their liability against special or consequential damages, as formerly required by C.A.B.;
4. increased excess value charges substantially while lowering liability limits;
5. severely reduced and changed time limits for filing claims to as little as 15 days (via Federal Express), and suits.

Each of these had serious financial consequences on airfreight shippers, and were accompanied by substantial increases in rates and accessorial charges.

ADMINISTRATIVE DEREGULATION

Despite the adverse results air cargo deregulation had upon liability standards, the I.C.C., effective May 28, 1959, decided to grant a complete exemption for railroads transporting fresh fruits and vegetables.⁴

When freed from federal statutes and the Commission's liability regulations, the origin railroads apparently borrowed a leaf from the airlines' rule book, and similarly limited their liability in many respects, some more subtle than others. In sum, the new rail produce contracts contain clauses which:

1. Impose a \$100 deductible for all loss or damage claims;
2. Establish a minimum of \$100 below which no claims will be honored;
3. Reduce the time limit for filing claims from nine months to amounts ranging from as little as 30 days (via the Burlington Northern) to 120 days after delivery;
4. Reduce the time for filing suits to one year from declination of claim;
5. Change the common law concept of liability as a "virtual insured" to a standard which requires the claimant to prove that the sole cause of the loss or damage was the negligence of one of the connecting carriers (a virtually impossible burden of proof for one not present during the carriers' handling of the shipment);
6. Introduce a concept of "contributory negligence," which has been declared unlawful for interstate transportation by common carriers;⁵

² Air Transportation Regulatory Reform Act of 1977, P.L. 95-163, 91 Stat. 1278.

³ Docket 19923, Liability and Claim Rules and Practices Investigation, Order 77-3-61.

⁴ Ex Parte 346 (Sub-No. 1) Rail General Exemption Authority—Fresh Fruits and Vegetables, March 22, 1979 (not printed).

⁵ Atlantic Coast Line R. Co. v. Riverside Mills, 219 U.S. 186 (1910); American Hoist & Derrick v. Chicago M. St. P. & P., 414 F. 2d 68 (6th Cir. 1969); Klauber v. American Express Co., 21 Wis. 21; McCarthy, et al. v. Louisville & N. R. Co., 14 So. 370; Northwestern Marble & Tile Co. v. Williams, 151 N.W. 419 (Sup. Ct. Minn. 1915).

7. Disclaim liability for losses incurred as a result of the decline of the destination market for which the produce was scheduled to be delivered (Burlington Northern bill of lading, Section 1(b));

8. Eliminate the term "reasonable dispatch" from the contract of carriage;

9. Make the carriers liable only for "loss of or damage to commodities when caused solely by such carriers while in such carriers' possession, resulting from fire, train accident, failure of refrigeration equipment provided by carriers, or delay in transportation of Equipment in Excess of the carriers scheduled date of delivery for such transportation *plus 24 hours.*" (*emphasis added*)

10. Require, at least by one carrier, the claimant to prove the condition of the produce at the time the connecting carrier transferred the car to the delivering carrier. See L.I.R.R. Master Transportation Agreement, Paragraph 8A, which provides, "Receiver shall have the burden of proving delivery of commodities by LIRR in worse condition than when received by LIRR at time of interchange, and the amount of damages resulting therefrom."

A shipper of produce can find little comfort in the Commission's desire for increased competition when it has only one railroad serving its packing plant. These new produce contracts were not "negotiated"—they were presented to shippers on a "take-it-or-leave-it" basis.

Similarly, when the I.C.C. broadened the Commercial Zones of municipalities to as much as 20 miles from the corporate limits, certain motor carriers took advantage of this freedom to impose a \$1 per lb. limitation on their liability without offering a choice between full value or released rates.⁶

Some carriers have also displayed a great deal of ingenuity in camouflaging limitations of liability provisions. The Southern Pacific Railroad, for instance, provides in its new produce agreement:

"In the event that SPT quotes a released value rate Shipper may, at its option, provide SPT with a written declaration of the released value, lower than the actual value of the shipment. In this event the maximum amount recoverable in the event of loss, damage or delay to the commodities under Section 11A hereof shall not exceed the declared released value plus freight charges, if paid. When less than the entire shipment is lost, damaged, or delayed, such maximum recoverable amount shall be limited to a proportion of the declared released value equal to the ratio of the lost or damaged commodity to the entire shipment."

This rule has the same effect as the airlines' "average value" rule (Rule 32(A)(2)(c)(ii)), which limits recovery of a partial loss or damage to the *average* declared value per lb., rather than the full actual loss up to the value declared.⁷ In both instances, the claimant recovers much less than anticipated despite payment of excess value charges on the full amount declared.

A copy of the rule in which 25 airlines participate is annexed as Appendix C to illustrate the shipping public's dilemma in attempting to ship in an unregulated environment without a forum in which to have these unconscionable contract terms and conditions judged by unbiased federal agencies charged with protecting the public interest.

Once these contract terms are incorporated in the bill of lading, a claimant has no relief in the courts, except for these instances in which the contract may violate a common law rule such as the prohibition against contracting against one's negligence. *Klicker v. Northwest Airlines, Inc.*, 563 F. 2d 1310 (9th Cir. 1977).

Another "gimmick" employed by at least two airlines has been to change the overcharge claim time limit to nine months, the same time applicable to loss and damage claims. No amount of training and education will ever suffice to prevent claimants' missing short deadline for filing overcharge and duplicate payment claims against these two carriers when the limit for all other carriers is two years.

⁶ M.A.C. Tariff 500-D, Item 1455; Supplement 19 to M.A.C. Tariff 308-B, Items 1365A and 1390: "Note C: In the event of loss or damage to any shipment, carrier liability shall be limited to a maximum liability of \$1.00 per pound. Additional insurance or carrier liability must be arranged and negotiated by shipper prior to date of shipment."

⁷ For example, on February 7, 1979, a shipment of 24 cartons of drugs moved by air from St. Lorenzo, California to Dallas, Texas, valued at \$5,000. One case valued at \$1,566.72 was missing on delivery. In lieu of recovering the full value of the missing case, the claimant received a check in the amount of \$215.53. Under the provisions of the average value rule (unknown to the claimant), the average value of the shipment was \$19.01 per lb. (\$5,000 divided by 263 lbs.). The average weight of the shipment 11 lbs. (263 divided by 24 pieces). Therefore, the claimant received $\$19.01 \times 11$ lbs., plus \$6.42 for freight—a total of \$215.53. In addition to avoidance of liability for the major portion of the \$1,566 loss, the carrier also collected \$10.80 in excess value charges for protection of the full amount of declared value (\$5,000).

[APPENDIX B]

Appendix 39.—RELEASED RATE COMMODITY LIST [MOTOR CARRIER]

NMPC item no.	Commodity description	ICC released rate order no.	Optional	Mandatory
47500-10.....	Chinaware, earthenware, porcelain or stoneware, NOI.....	MC-1.....	X.....	
48390.....	Ore, NOI.....	MC-1.....		X
49825.....	Clothing, fur or fur lined used.....	MC-292.....		X
60000.....	Drugs, chemicals, medicines, toilet preparations and other items named in the NMFC making reference to item 60000 (See appendix A-1 for list of articles).	MC-342.....	X.....	
62650.....	Parts (electrical), semiconductors.....	MC-719.....		X
62820.....	Transmitters, radio or TV.....	MC-597.....		X
63025.....	Electrical semiconductors.....	MC-529.....		X
63473.....	Tubes, cathode ray.....	MC-594.....	X.....	
63476.....	Tubes (Electric), NOI.....	MC-594.....	X.....	
70080.....	Flatware, dresserware or hollow ware.....	MC-525.....		X
71000.....	Rugs, NOI.....	MC-1.....	X.....	
88070.....	Glass-ceramic ware.....	MC-545.....		X
88140.....	Glassware, NOI.....	MC-607.....		X
99400.....	Hides, pelts or skins, NOI, dry.....	MC-519.....		X
100240.....	Household goods and personal effects.....	MC-314.....		X
107830.....	Jewelry, costume or novelty.....	MC-455.....		X
110800.....	Leather scrap, NOI.....	MC-1.....		X
110820.....	Leatherboard, scrap.....	MC-1.....		X
111230.....	Lighters, cigar, cigarette, or pipe.....	MC-560.....	X.....	
120820-40.....	Engines, internal combustion, NOI.....	MC-296.....		X
136500.....	Metal, NOI or metal alloys, NOI.....	MC-459.....		X
144900.....	Oils, essential.....	MC-342.....		X
149420.....	Paintings or pictures.....	MC-1.....		X
155000.....	Personal effects.....	MC-618.....		X
161850.....	Printed matter with exchange value.....	MC-1.....		X
164900.....	Radioactive materials.....	MC-558.....		X
168960.....	Records, office, old.....	MC-294.....	X.....	
176450.....	Silk.....	MC-1.....	X.....	
196420.....	Watches or watch movements.....	MC-615.....		X

Note.—NOI:—More specifically described herein.

Source: (Reproduced from "Freight Claims in Plain English," published by SNFCC, 1979.

SALT INSTITUTE,
Alexandria, Va., March 7, 1980.

Hon. HOWARD W. CANNON,
Chairman, Senate Committee on Commerce, Science and Transportation,
Washington, D.C.

DEAR SENATOR CANNON: The Salt Institute wishes to submit written comments on the proposed "Railroad Transportation Policy Act of 1979", S. 1946. The Salt Institute is a nonprofit organization whose purpose is to encourage, foster and promote the use of salt. Its members account for approximately 95 percent of all salt production in the United States.

The salt industry ships the major portion of its production by rail. Because any Act of Congress affecting railroads will affect the salt industry, the Salt Institute's Transportation and Distribution Committee has carefully considered S. 1946, the report of your committee on the bill, and various positions taken by interested parties. Based upon this review, the Salt Institute wishes to endorse, with certain exceptions, the positions taken by the National Industrial Traffic League on S. 1946.

The Institute believes that the National Industrial Traffic League's position would best serve to promote the Railroad Transportation Policy set forth in section 2 of S. 1946, while at the same time protecting shippers from potential abuses of market power by the railroads. The Salt Institute offers the following comments on S. 1946 and the NIT League position:

1. The Salt Institute recommends that paragraph 10 of the proposed subsection (b) to section 10101 of Title 49, United States Code, set forth in section 2 of S. 1946, be

eliminated. The policy enunciated in paragraph 10 is already encompassed in paragraph 8 of subsection (b). Furthermore, the term "noncompensatory rates" in paragraph 10 is ambiguous and future attempts to interpret and apply the term in proceedings before the ICC and the courts can only result in increased bureaucratic and regulator involvement, to the detriment of rail carriers and shippers alike.

2. The Salt Institute recommends that Senator Long's amendment to S. 1946 of December 17, 1979, be adopted.

3. The Salt Institute, in support for the NIT League position on Section 107 of S. 1946, wishes to emphasize that it strongly supports the elimination of independently announced surcharges.

4. The Salt Institute supports the NIT League position on Section 108 of S. 1946 with one exception: the Institute believes the voting record at rate bureau meetings should not be made public. The bill as reported out of Committee is consistent with the Institute's position on voting records; however, the Institute recommends that the language at p. 60, lines 12-14, of the bill: "and made available to other federal agencies in connection with their statutory responsibilities over rate bureaus" be eliminated so as to conform with the NIT League position that only the ICC should have access to such rate bureau records.

5. The Salt Institute recommends the following additions to Section 114 of S. 1946:

(6) in subsection (d)(2), by striking "2d year" and inserting in lieu thereof "6th month".

(7) in subsection (d)(2), by striking the last sentence and inserting in lieu thereof: "A rate not incorporated in an individual tariff as required by the Commission is void, and furthermore, rail carriers and rail rate-making associations shall be prohibited from petitioning for any increase in rate or rates until any previous increases have been incorporated into the base tariff."

6. The Salt Institute is adamantly opposed to the addition of § 10732, "Car Utilization", to Title 49, United States Code, as set forth in Section 117 of S. 1946. This section creates too great an opportunity for preferential and discriminatory practices by rail carriers to the detriment of rail carriers' common carrier obligations. In addition the Institute fears that carrier elective premium service at premium rates would soon deteriorate to normal service at premium rates.

The Salt Institute would be pleased to amplify its positions in detail if you so desire.

Sincerely,

WILLIAM E. DICKINSON,
President.

PORT OF LAKE CHARLES,
Lake Charles, La., March 18, 1980

Hon. HOWARD W. CANNON,
U.S. Senate, Washington, D.C.

DEAR SENATOR CANNON: The Port of Lake Charles is concerned that S. 1946, Railroad Transportation Policy Act of 1979, does not contain specific provisions for the maintaining of Port Relationships which currently exist for rail rates.

These long-established bases for rail rates assure that all of the nations ports will be able to compete for cargoes which can be considered naturally tributary to that port.

We would respectfully request that wording similar to that found in Section (f)(3) and (4) of Public Law 94-210 (4-R Act) be included in S. 1946, which wording is quoted below:

Nothing in the amendments made by this section shall be construed: (3) to affect the existing law or the authority of the Commission with respect to rate relationships between ports; or (4) to affect the authority and responsibility of the Commission to guarantee the equalization of rates within the same port.

This provision is especially important to small and intermediate size ports.

Respectfully,

DOYLE G. OWENS,
Transportation Consultant
Beaumont, Tex.

