

STATEMENT OF JOHN M. SULLIVAN
ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
OF THE
HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
JUNE 20, 1979

MR. SULLIVAN:

Thank you for inviting me here this morning to discuss DOT policies and the transportation of coal. This subcommittee has raised a wide range of issues related to railroad legislation and transportation policy generally. In my formal testimony I want to provide a framework for analyzing these issues. We have also prepared responses to your specific requests for information, and I will be glad to answer any questions you have on these or other subjects at the conclusion of my statement.

Recent events have underlined the fact that our country is facing a long-range energy crisis of serious proportions. Clearly, domestic sources of fuel must play an expanded role in meeting our energy requirements, and both the legislative and executive branches are committed to encouraging the use of coal. Railroads now move more coal than any other mode, and will continue to have cost and service advantages for carrying much of our coal traffic. Physically and financially sound railroads can help to keep coal an available and economical fuel and assure that our energy goals are met. Failing railroads with deteriorating roadbed and equipment cannot. Unless they are relieved of the burden of unnecessary

regulation--regulation that is sapping profits, diverting management attention, stifling innovation, and destroying the attractiveness of the industry to private investors--the railroads will not be able to play their crucial role in the transportation of coal.

Our deregulation proposal has been before the public for several months and we have had the opportunity to gather comments from coal producers and consumers. They are concerned with the quality of rail service they receive and the rates they pay for the service. In my testimony today I would like to discuss the changes in rail policy that we believe are necessary to permit the coal transportation system to function effectively. In particular I will deal with the aspects of the proposed deregulation bill relevant to these issues, including:

- rate provisions, especially rate protections for captive shippers;
- provisions governing rail abandonments, consolidation of facilities, and other restructuring actions; and
- car service requirements

To begin, we must recognize the special relationship between the railroads and those who mine and use coal. From the earliest days of railroading, the railroads and the coal industry have been interdependent. The railroads were once the major consumers of coal. Today our railroads no

longer use coal, but they still handle most of the coal produced in this country and coal is the railroads' major commodities. More than 20 percent of rail carloadings and 30 percent of the freight tonnage each year is coal. Historically, coal has particularly dominated traffic on many of the Eastern railroads, accounting for half or even more of the total tonnage carried and 30 to 40 percent of the revenues. Western coal production is projected to more than triple in the next decade, matching Appalachian coal production by 1990, and as these reserves are developed, coal is becoming an essential segment of the traffic on Western railroads as well.

Looked at from the perspective of shippers, railroads carry more than 60 percent by weight of the coal produced in the U.S. each year and an even larger share of the ton-miles, despite significant increases in the volume of coal shipped by truck and barge. As our energy demands grow and fuels become a more valuable resource, other modes such as slurry pipeline will become more attractive investments, but railroads still will represent a large share of the total coal-carrying capacity in the nation. Deteriorating roadbeds, recurring car shortages, and inadequate capital for improvements which railroads are now suffering will, if continued, have disastrous effects on those who mine and use coal, and on all of us who benefit from this abundant and economical energy source.

If railroads are to provide efficient transportation for coal, they must be able to adjust to the specific demands imposed by coal traffic. The nature of the product and the structure of the coal industry and its markets

create special requirements and special problems for the railroads. The heavy weight and high volume of coal shipments cause a great deal more wear on cars and track than shipments of most other commodities. This means considerable labor and funds must be devoted to maintaining track and equipment used in coal service. Maintenance is not the only increased expense. The rising demand for coal has necessitated construction of heavy-duty track to carry the coal traffic and purchase of new coal hopper cars and locomotives.

When petroleum prices went up in 1973 and 1974, demand for coal developed in areas where there previously had not been a market. This has affected both Western and Eastern railroads. For example, for many years Eastern Kentucky coal had moved primarily to the industrial centers in the Northeast and North Central states. The oil embargo made coal a more attractive alternative for utilities in the South Atlantic and Gulf states, in a different direction and on different rail lines out of the South Appalachian mines. Increased demand in the North Central region and the new markets in Texas and the Southwest also stimulated production in the Midwestern and Western coal fields. A rail system built to handle light density traffic from Wyoming east is now faced with heavy north-south volume. These sudden market shifts were not and could not have been anticipated by the railroads in their long-range planning, and they are placing an immediate and serious strain on the railroads' already tight capital and operating budgets.

Coal has never been a high revenue commodity on a per ton basis, particularly for Eastern carriers. Coal-carrying railroads instead rely on high volumes to generate necessary profits. But the capital and maintenance costs of lines and equipment to accommodate the new traffic, coupled with increases

in the costs of labor in many cases have left coal revenues completely inadequate. Although the Interstate Commerce Commission (ICC) has recognized this revenue need in granting a series of recent coal rate increases, railroads and shippers have suffered from the lag in regulatory action.

By tying the railroads together in my discussions, I do not mean to obscure the great difference between individual companies, beginning with the critical variable of territory. Different railroads face different physical and economic environments, which greatly influence their cost and revenue prospects. In the East and West, most of the coal mines are located in mountainous regions while in the Midwest the coal beds are in relatively flat terrain.

To carry coal out of the winding valleys of the Appalachians, the railroads have had to build long, often circuitous spur lines. Routes from there north to Ohio and the Great Lakes are relatively level and direct, but hauling coal to the new markets in the South and East requires backtracking, adding locomotives and moving over the mountains, considerably increasing the cost of providing the service.

The cost structure of the Eastern coal-carrying railroads also reflects a second characteristic of Appalachian mining, and that is the large number of small mines. In the Appalachian region as a whole there are more than five thousand individual coal mines producing an average of 75,000 tons a year. Thirty percent of these produce less than 10,000 tons, and some as little as 1,000 tons each year. At 100 tons per hopper car, these

smallest mines fill less than one car a month. The Powder River Basin of northeastern Wyoming, one of the country's newest and richest coal supply regions, presents a sharp contrast. Total coal production there in 1977 was provided by ten mines averaging five million tons each, with several contributing almost twenty million tons. Future mines are likely to be at the high end of that range. Most Powder River coal fills large volume long-term contracts between utilities and mines and much of it moves by unit train, often in shipper-owned cars.

In the East, the small mines and the railroads have attempted to achieve the cost efficiencies of high volume shipments by gathering coal from several mines at a single rail loading facility. We are now studying the potential for additional consolidation of coal at centralized truck-to-rail transfer stations, with particular attention to the needs of small mines in the Appalachians. Devoting locomotives and labor to picking up, switching and delivering single rail carloads of coal to satisfy spot requests has never been an efficient allocation of our transportation resources, especially at times when the nation's demand for coal is highest and the railroads are called upon to move the largest possible volume of coal. A recent survey by the Department of Energy indicates that approximately 60 percent of the small mines in Eastern Kentucky now ship all of their coal all the way to its destination by truck. Many of the larger mines have also shifted to truck for its flexibility, particularly for short distance hauls. The increase in the number of surface mines, with their constantly shifting mining faces, reduces the possibility of convenient mine-mouth railheads and also encourages some form of at least short-haul motor carriage.

The availability of competition on highways, waterways, and other railroads differs among regions, depending on historical and geographic factors as well as on the volume of traffic and its ultimate destination. In the Midwest, river and lake barges provide a low-cost alternative to rail. Slurry pipelines have been proposed to serve large parts of the Western producing region, and the railroads see pipelines as a powerful competitive threat in the future. Probably the most intense competition in the coal market today is between the various sources of supply. Different carriers serve different coal-producing regions and as demand for coal grows each region's carriers as well as producers are trying vigorously to increase the market share for their coal. The railroads cannot affect the basic costs of mining coal, the content of the coal on their lines, or its distance from the market so their only leverage is in the rates and service they offer.

I think it is clear that in meeting coal transportation demand, the railroads face a very complicated set of problems. The combination of high operating costs, heavy capital requirements to adjust to market shifts, and low rates is reflected in the problems experienced by coal shippers. As coal consumption increased during the last five years, the supply of coal cars frequently was inadequate to carry the volumes of coal produced. Track was wearing very rapidly and we had derailments and slow orders on some coal lines. In the last year, the increase in coal consumption has slackened somewhat and the railroads have been able to supply almost all of the service requested, but we should not take this as a sign that the problems are over. The railroads cannot contend much longer with the uncertainty in revenues

and in demand; coal producers and coal consumers themselves need greater certainty in the long-term availability of rail service.

We believe the only reasonable solution is deregulation of the railroad industry. The rate and service freedoms provided by the proposed deregulation bill will allow railroads and shippers to make the adjustments that can halt the dangerous decline of the railroads and permit efficient and economical service. In the time remaining, I would like to discuss the opportunities that will exist under our proposal and the ways that our bill will address the major concerns that have been raised.

First, in the area of ratemaking, we are proposing to eliminate maximum rate regulation after a five-year transition period. During this period, there will be a seven percent "zone of reasonableness," on top of inflation, within which carriers will be able to raise their rates as long as they are not discriminatory. For rates above this zone, the ICC will retain its authority to reduce a protested rate if a shipper can prove, drawing on the facts of its own situation, that it has no effective transportation alternative, and if the railroad cannot prove that its rate is reasonable.

During the transition period, the Department will be required to conduct two studies to determine how well competition is protecting shippers, and to recommend legislative changes if either study finds that ending maximum rate regulation would place an unfair burden on certain shippers

We are also proposing important procedural changes in the regulatory system. Under our bill, the ICC no longer will be able to suspend rates or initiate

investigations on its own. Shippers or others who actually are affected by the rail rate at issue will be able to bring cases before the ICC, and the ICC will be required to make a decision within four months. The ICC will be empowered to award damages and legal fees and costs to the complainant, so a railroad will have little incentive to abuse this no-suspend feature.

The bill also will specifically permit the types of rate and service changes Congress intended to encourage in the Railroad Revitalization and Regulatory Reform Act or 4R Act of 1976. One of the most important will be the use of contract rates. Shippers will be able to negotiate with the railroads all aspects of transportation service, including guaranteed rates, number of cars, and shipping dates, over any desired length of time. The ICC will have no jurisdiction over the agreement. Once the parties enter a contract, the railroad will be legally bound to provide service at the agreed volume, frequency, rate, or other measure specified. No railroad or rail shipper today is covered by this kind of enforceable long-term transportation contract. The assurance of shipments and therefore the reduction in the risk of investing in the traffic should make contract arrangements attractive to both the carriers and shippers.

The bill also permits peak or seasonal rates so shippers can be encouraged to time their shipments according to the importance of the traffic. While the present system extends uniform service and rates and uniform rate increases to the majority of shippers, regardless of their particular needs, our bill will allow railroads to tailor rate and service combinations to suit individual shippers.

We realize that some firms now dependent on rail, including many coal mine operators and utility companies, are concerned that rail rates will be increased prohibitively and that they will be left with no reasonable transportation choice. We believe that coal shippers as well as the rest of the shipping community must pay the full costs of receiving rail service. This is essential if the railroads are to survive. But we also know that the railroads cannot afford to lose their coal traffic. Faced with tight competition in the national coal market, they have a powerful incentive to negotiate with coal shippers for the fairest and most efficient rates. The railroads will not price their good customers out of business; to do so would be to price themselves out of business. On the other hand, they cannot continue to receive non-compensatory rates on such an important part of their traffic. If we preserve our present regulatory system, we will not only fail to meet our national energy goals, but we will find ourselves supporting a bankrupt rail system at the taxpayers' expense, or losing vital rail services.

Some additional rail lines may be abandoned under the proposed abandonment procedures, where traffic is light, and this prospect is very disturbing to the shippers and communities on light density lines. However, states, localities, or shippers along a line will have the option of subsidizing operations or purchasing a line proposed for abandonment. Railroads will be required to continue service if the subsidy covers the costs of the operations, as determined by an arbitration panel at the ICC.

Concerns have also been raised about the elimination of the ICC's authority to order a railroad to provide a given type and number of cars to a particular shipper at a particular time. These car service orders have been one of the ICC's least effective regulatory tools. The real problem is the efficient use of each railroad's equipment. The proposed bill provides railroads with the maximum flexibility to establish the services they offer and to control the way they use their resources to meet market demand. The railroads must be able to earn the capital to purchase necessary equipment. A second necessity is the balancing of peaks and troughs in demand for rail service. This smoothing can be accomplished partly through the expanded use of contracts and seasonal and peak rates. Subject to the common carrier obligation, each railroad must be able to control its own fleet. In the long run, this is the only way to improve car service and car utilization while keeping rail services adequately priced. We believe our bill will improve equipment availability by permitting railroads to earn a reasonable profit marketing service designed to suit shippers' needs.

You have requested a review of Department positions in key rulemaking and generic proceedings to implement the 4R Act, as well as a description of the financing mechanisms authorized in Title V of the same legislation. I do not want to take up more of your time by reporting on each of these in detail, but I have submitted the DOT statements and a report we have prepared on the implementation and efficacy of changes in the 4R Act, and I am prepared to discuss these and other matters.

Finally, as you consider the proposed deregulation proposal, I ask you to consider the legislation in light of the transportation system we have and the transportation system we will be left with if present trends continue unaltered. We believe that deregulation is a necessary first step to achieving a solution that not only will permit the survival of railroads, but will provide the country with the coal it will need to meet our energy demands.

Thank you for your time. I will be happy to address any questions you have.