STATEMENT OF
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I appreciate the opportunity to present the position of the Department of Transportation on issues affecting America's coal industry, particularly as they relate to railroads and railroad regulation.

The Department believes that our transportation policies and our energy and economic policies are and must continue to be consistent--that a healthy, smoothly functioning transportation sector is vital to healthy and successful energy and industrial sectors, and on the other hand, that healthy energy and industrial sectors are vital for our carriers to continue to survive and provide effective service.

We are monitoring the experiences of carriers and shippers as regulatory reforms in the transportation sector are being implemented, with particular attention to bulk commodities, including coal. The principal purpose of the Staggers Act was to reduce or eliminate the burdens on commerce imposed by regulation and to permit competitive forces to work wherever possible for the benefit of railroads and shippers. Combined with the subsequent actions by the ICC to implement the legislation, the Staggers Act has allowed railroads to respond to shippers' needs and market conditions by adjusting rates and tailoring services to attract and retain traffic. Shippers' transportation options have increased, and many railroads have reduced rates or offered new types of service to meet competition, balance traffic flows, and hold or boost market share.

Railroads have been particularly active in negotiating rate and service contracts which were explicitly authorized by the Staggers Act, and these contract arrangements benefit both railroads and shippers. In September 1982, fewer than 2,000 contracts had been filed with the ICC; now, one year later, there are over 10,000 contracts on file. Contract terms include volume incentives, guaranteed car supply or other special services, covering one shipment or periods as long as 20 years or more.

In those commodity areas already exempt from regulation, the railroads have moved aggressively to build traffic. Railroads' piggyback business, the major service exempted since the Staggers Act was passed, has grown to record levels. Despite a reduction in overall rail traffic between 1981 and 1982, piggyback carloadings rose significantly.

In most markets, railroads have had to increase their rates to reflect increases in the prices they pay for fuel, materials, and labor. Rail carriers have also found it necessary to raise rates to obtain the funds required to modernize or upgrade their facilities and equipment. In the years since the Staggers Act was passed, rail tariff rates for unit train coal movements in the West have gone up more quickly than in the East and more quickly than rail rates in general. However, these figures do not cover rates established as part of long-term contracts negotiated between shippers and railroads, which often incorporate rate reductions. Our most recent statistics indicate that in 1981 coal rates nationwide averaged only 2.5 cents per ton-mile hauled--the lowest for any major commodity group. Western rates per ton-mile were even lower.

One of the Staggers Act changes with the most major impact on the industry and its shippers is the expansion of the ICC's power to exempt railroad traffic from regulation. The Commission can now approve an exemption if it determines that regulation is not necessary to carry out rail transportation policy and either the service is of limited scope or continued regulation is not needed to protect shippers from the abuse of market power. Effective September 12, 1983, the Commission exempted export coal moved by rail to U.S. ports.

DOT supports the exemption of export coal, and filed extensive comments with the ICC in the proceeding. We believe that there is ample competition in the export market. One of the most important forces in constraining rail rates for export coal is the power of the other parties in the export coal process. Our research indicates that the concentration of export coal traffic among relatively few railroads is effectively countered by the concentration of export coal business in the hands of a small group of exporters or "transshippers." These large firms generally own mines or contract with mines on more than one railroad and therefore control the volume of coal available for any railroad to carry to export. The exporting firms in some cases are also major shippers of coal to domestic customers, which gives them additional bargaining power with a railroad.

The Chessie System (part of CSX) and the Norfolk and Western (part of Norfolk Southern)--two major railroads carrying export coal from the Appalachians--reported that in 1981, when participation in the export coal market was more fragmented than it is today, the eight largest exporters accounted for two thirds of the coal exports shipped via the Chessie System and over 80 percent of the coal exports shipped via the Norfolk and Western. The volume of traffic they represent gives these exporters the considerable leverage in negotiating rates with the railroads. Failure of any railroad to deal constructively with any of the larger exporters could mean a significant diversion of traffic and loss of revenues, which would be particularly serious for these railroads, which have high fixed costs for rail lines and other facilities devoted almost exclusively to export coal movements.

The coal-exporting railroads have invested billions of dollars in tracks, bridges, tunnels, yards, and pier facilities as well as rolling stock, in order to get coal from the mines into the holds of ships, and all of these investments result in high fixed costs for the railroads.

Sound business principles dictate that a railroad price its transportation services to maximize the payback on those investments. A railroad would only hurt itself by raising rates indiscriminately, in the face of competition from other railroads and the producers they serve, as well as intense competition for U.S. coal from overseas suppliers. Such a strategy would reduce the volume of export coal shipped by the railroad and its ability to cover fixed costs.

Based on these factors, the Department of Transportation believes that there is sufficient competition in the export coal market that ICC regulation is not required to protect shippers and that the exemption of this traffic from regulation is entirely consistent with the national transportation policy. These are the statutory criteria that the ICC must apply in determining whether to exempt a particular portion of railroad traffic from regulation. The Department of Justice, representing the United States, has also determined that the ICC fulfilled its statutory obligations in granting the exemption and, therefore, has joined with the ICC in supporting the legality of the exemption in litigation before the U.S. Court of Appeals for the D.C. Circuit.

Experience during the past two years supports the position that competition can be relied upon to restrain rates on export coal movements. Several railroads have recently offered attractive contract terms or reductions in tariff rates for export coal, in response to market circumstances and shippers' needs. In addition, railroads have not taken any of the rate increases above inflation which the Staggers Act would have allowed on this traffic, nor did they apply the two most recent ICC approved inflation-based increases to export coal traffic.

For domestic coal, the ICC has proposed new guidelines to use in regulating rates for traffic over which a railroad has market dominance. These guidelines are based on the principle that no shipper should pay more than stand-alone costs, a proposition on which the ICC has found considerable agreement among the parties participating in this proceeding. We generally support the ICC's proposal, with several specific qualifications. I will summarize our position for you.

The Department concurs with the ICC and all other parties that a railroad should not set rates such that coal shippers have to make up for revenue shortfalls the railroad suffers as a result of other rates that do not contribute to going concern value or otherwise do not generate the maximum net revenues for the railroad. The Department also agrees that a coal shipper should not be required to cross-subsidize other shippers, by paying for facilities and operations that are not necessary for the railroad to serve that shipper.

We wish to see the Commission establish a single, clear definition of stand-alone costs, focusing on those items necessary for a railroad to offer the service in question. Estimates of stand-alone costs must cover the full annualized costs of equipment and facilities, as well as operations and management and other overhead that would be incurred to provide the service. We support the ICC's recommendation that stand-alone rates be phased in gradually, but we believe that the allowable 15 percent per year increases should not be cumulated when a railroad does not take the full increase in a particular year. For railroads that achieve revenue adequacy, however, we see no reason why earning more than the minimum revenues considered necessary by the ICC should be grounds for requiring a railroad to reduce its existing rates.

I believe that, with the modifications the Department has proposed, the ICC's regulation of domestic coal rates will be responsive to the needs of the affected parties and the requirements of the Staggers Act.