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BEFORE THE

COMMITTEE ON ENERGY AND COMMERCE

SUBCOMMITTEE ON TRANSPORTATION, TOURISM, AND HAZARDOUS MATERIALS

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Mr. Chairman. The transportation industry is an industry of special interests, and much of our legislative debate reflects that fact. The different modes jockey for a greater share of an essentially stable pie; labor and management fight to apportion the share each mode is able to acquire.

You and I have a special role in that process -- protecting the one interest that isn't represented by any of the local lobbyists. That's the public interest. And that's what makes talking about short line railroads both a challenging and a rewarding experience.

WHY SHORT LINE RAILROADS CAN OPERATE SUCCESSFULLY WHERE THEIR LARGER COMPETITORS HAVE FAILED

With the possible exception of the Staggers Rail Act, there is no transportation development in this decade that has brought more benefit to shippers and consumers than the movement toward short line and regional railroads.

We've learned in the 1980's that short line and regional railroads can profitably operate trackage that is not self-sustaining under the very different economics of a Class I carrier -- trackage that would literally have been abandoned and torn from the ground a decade ago. Two factors make that possible:

1. <u>Short line railroads have more flexible cost structures than their larger competitors</u>.

One need not have a doctorate in transportation economics to recognize that the economics of a major trunk line and the economics of a light density agricultural branch line are not the same. A marginal branch line simply cannot operate under the same cost structure as a heavy density main line if rates on the line are going to be competitive and the line is to remain in business.

Unfortunately, it is very difficult (if not impossible, as a practical matter) for a Class I railroad to establish varying cost structures within the confines of a single system. Labor, and to a lesser degree management, have never been comfortable with agreements that permit employees to work on adjacent parts of a single system under differing wages, work rules, and conditions. Nor do the major carriers have significant latitude to vary the nature of the capital investments used on different portions of their systems. Fortunately, the smaller independent railroad does not suffer these diseconomies of scale.

a. Fixed Costs:

The short line railroad can maintain a less costly equipment inventory, with power and rolling stock adapted to its own determinationof shippers' needs. Its lighter traffic density allows it to maintain its roadbeds to different standards than a heavy density system, and to better control its infrastructure costs.

b. Variable Cost:

Far more important is the fact that short line railroads -- whether union or non-union -- are generally free of the rigid craft lines and anachronistic work rules that typify major carrier labor management agreements. That enables the short line carrier to use the talents of a single employee on multiple tasks, rather than having to employ several individuals on a full-time basis when their services are needed only a portion of the time. This is not a wage issue -- the great majority of regional railroads are unionized carriers, and even non-union short lines pay approximately 85 percent of national scale, with bonus provisions that can take the employee's earnings higher when volume is good. It is a size of force issue, and short lines are better able to match the size of their work force with the actual needs of the shipping volume they service.

It is important to recognize, however, that these cost advantages are not the only factor underlying the short lines' ability to compete.

2. <u>Short line railroads can compete on pricing and service in areas where a Class I railroad can rarely be equally effective</u>.

The attention and resources of the major carriers inevitably focus on the things they do best, their areas of greatest profitability. Generally, they are the heavy density long haul operations. But light density lines live or die on their ability to serve the particular needs of a limited number of small shippers. The short line railroad's management philosophy is geared to that service, and short lines have proven their ability to compete with service in areas where large carriers find it difficult to do so. For example, a major carrier, concerned with equipment utilization over a ten or twenty thousand mile system, must mesh pickups and deliveries on light density lines with the need to ensure effective equipment utilization over the breadth of its system. In contrast, a small feeder railroad can use less costly equipment to shuttle traffic back and forth on a schedule that better fits the needs of local shippers.

The same point applies to nonservice marketing activities. The capacity of a small, locally-owned railroad to micromarket along light density lines on a car-by-car, shipper-by-shipper basis is unsurpassed. That is even more true when local shippers own all or part of the line, and have a direct financial stake in broadening its traffic base.

There are tangible examples of these factors at work throughout the United States. In fact, there has literally been an explosion in the number of small independent carriers created in this decade, and it is difficult to overstate the impact they have had in the preservation of America's rural rail infrastructure.

THE 1980's HAVE BEEN AN ERA OF
DRAMATIC GROWTH FOR SHORT LINE RAILROADS

To put the 1980's in perspective, recognize that of the small carriers now operating, 15 began operations in the 1950's. Thirteen more were organized during the 1960's, and -- in the aftermath of the Milwaukee, Penn Central and Rock Island bankruptcies -- 44 commenced service in the 1970's.

In the first 7 years of the 1980's, 157 independent carriers have begun operation, bringing the current total nationwide to approximately 395. These numbers obviously reflect a more active effort by major carriers to rationalize their systems by shedding lines that have suffered from demographic and economic shifts. But they also demonstrate increased success in maintaining service over lines which 10 years ago would have been abandoned, pulled from the ground and sold for salvage. Even more encouraging is the fact that more than 80 percent of the lines established in this decade are operating successfully as 1987 draws to a close -- a success rate that exceeds the average for startup businesses, and a rate truly remarkable when one considers that the lines being transferred are invariably the lowest density, most poorly maintained, and least successful lines in the Class I railroad system. It is no coincidence that as the number of successful short line transfers has increased year to year in this decade, abandonment petitions have fallen dramatically -- from 4800 miles a year in the late 1970's to approximately 1900 miles in 1986.

TWO FEDERAL POLICY INITIATIVES -- ONE LEGISLATIVE, ONE ADMINISTRATIVE -- LIE AT THE HEART OF THE SUCCESS EXPERIENCES BY SHORT LINE RAILROADS IN THIS DECADE

The proliferation of independent railroads over the past 7 years was not a coincidence either. It was driven by two policy changes at the federal level which significantly enhanced the economics of short line operations. These policies lie at the heart of the short line railroad success story.

First, of course, was the adoption of the Staggers Rail Act of 1980. The Staggers Act gave short lines the ability to enter enforceable shipping contracts. That enabled short line entrepreneurs to lock in their traffic base with a high degree of certainty -- an essential element in dealing with financial institutions to arrange acquisition and rehabilitation financing. The Staggers Act also freed the short lines from the threat of the automatic rate protest -- a process common in the pre-Staggers era, and one which small carriers are least able to afford. Most important, however, the Staggers Act gave the short line operator the pricing and marketing flexibility necessary to compete with his real competitor -- the deregulated short haul trucker.

Equal in significance to Staggers was the policy position on labor protection announced by the Interstate Commerce Commission in the Gulf and Mississippi decision. In that case, the Commission made it clear that major carrier labor protection would not be automatically imposed in line transfers to newly formed, independent carriers. That was a victory for jobs, a victory for service, and frankly, a victory for common sense.

The imposition of mandatory labor protection materially alters the economics of light density lines. It adds to the purchase cost without producing any countervailing revenue -- increasing the need to borrow, weakening the carrier's cash flow, and by injecting both cost and uncertainty into the transaction, diminishing its appeal to potential purchasers. The more marginal the line, the greater the impact of these negatives.

Unfortunately, that impact does not end with the transfer of title to a light density line. Labor protection reduces the cash or borrowing capacity available to the new carrier for track rehabilitation, and burdens the already marginal short line with a cost of operation its trucking competitors do not have to bear. In Gulf and Mississippi, the cost of imposing Class I labor protection was estimated to range up to $67 million -- two to three times the actual purchase price of the line. By the time that case came before the Commission, it had become abundantly clear that mandatory labor protection was a major obstacle to preservation of jobs and service on light density lines. And it was that recognition which prompted the Commission to take the position it did. As the Commission itself wrote in its decision on Ex Parte No. 392:

> "It is our established policy that the imposition of labor protective conditions on acquisitions and operations under 10901 could seriously jeopardize the economics of continued rail operations and result in the abandonment of the property with the attendant loss of both service and jobs on the line."

The Gulf and Mississippi decision spurred short line development -- and preserved service on scores of rural branch lines -- because for the first time, it made preservation and sale of light density lines more attractive to the major carriers than the traditional remedy, abandonment.

For decades, carriers have preferred abandonment because, given the labor protection mandate attached to branch line transfers, abandonment was a far less costly option. If it sold the line, the carrier had to pay protection obligations for the entire work force. But if it abandoned the same line, those obligations could easily be avoided. The formula for avoidance was a simple one.

The major carrier would simply stop investing in the line in question, allowing the quality of service to deteriorate. As service deteriorated, traffic volumes fell, and carriers could lay off the employees -- with no protection -- under the decline in business clauses common to industry labor agreements. When only a handful of employees remained, the carrier would formally abandon the line. The few remaining employees did receive protection payments, but they were few indeed. Furloughed employees received no benefits, and both jobs and service on the line were lost permanently. Ironically, one thing labor protection did not do effectively was protect labor.

This was a cycle of deterioration that occurred in rural areas across the United States throughout the 1960's and 1970's. By reversing that cycle, the Gulf and Mississippi decision did far more than create incentives for short line development. It preserved service on countless agricultural branch lines, along with the jobs required to provide that service. It is no accident that in the years since Gulf and Mississippi, approximately 80 new short lines have been created -- and abandonment filings have declined by nearly two-thirds.

THE TRANSFER OF LIGHT DENSITY LINES TO SHORT LINE AND REGIONAL RAILROADS PROMOTES THE PUBLIC INTEREST

The movement toward creation of independent railroads is the closest thing to a "win-win" proposition for shippers, employees and carriers that one is likely to find in the transportation environment.

- Short lines benefit shippers and communities by preserving service on light density lines that would otherwise be targets for abandonment. By preserving transportation alternatives, they directly benefit consumers.

- Short lines benefit the major carriers by allowing the Class I's to shed their least profitable lines without losing the traffic that originates on those former branch lines. Unlike an abandonment (or continued operation by a large carrier which cannot competitively price its services), conversion of a branch line to an independent feeder railroad does not surrender the traffic to trucks, but allows the major carrier to continue to carry at least a portion of the movements it formerly served.

- Employees gain in two respects. The very concept of the spinoff railroad emphasizes job preservation, rather than elimination of jobs in return for protection payments to a few of the former employees. Moreover, by converting branch and secondary lines into feeder networks that can price their services on a more realistic basis, these line divestiture programs enable the Class I's to retain (and in some cases actually increase) the volume originating on these lines, rather than surrendering it to trucks. Retaining that volume betters job opportunities on the major carriers at the same time it preserves jobs on the former branch lines.

- Safety and efficiency benefit because the new owners make investments in these lines that the Class I's were rarely willing to make. Be it as rudimentary as tie work or as complex as a rail replacement program, the investments made by short line entrepreneurs are often the first meaningful investments made in these lines for years, if not decades. Invariably, these lines are better maintained in the hands of their new owners than they were as unwanted appendages to a large Class I system.

It is simply better to place these lines in the hands of men and women who want to run them than to leave them owned by carriers with no interest in their future. While there are no absolutes in this world, and individual projects will always have to be judged on a case-by-case basis, independent ownership is generally preferable to its two principal alternatives -- abandonment, or continued ownership by a larger railroad with very different priorities.

IT IS IN THE PUBLIC INTEREST TO PURSUE LEGISLATIVE AND ADMINISTRATIVE POLICIES WHICH PRESERVE RAIL SERVICE BY FOSTERING THE ECONOMIC FEASIBILITY OF SHORT LINE AND REGIONAL RAILROADS

The future of short line and regional railroads is largely dependent on our common willingness to continue support for the policies that have permitted their success over the past half decade. We need to face the reality that most of the light density lines now being studied for abandonment will ultimately be abandoned if they cannot be cost effectively operated in the hands of independent owner-operators. It is in the public interest to promote policies which do not constrain the economic feasibility of independent carriers because it is in the public interest to preserve rail service wherever it is economically feasible to do so. If we are to achieve these objectives, there are several important issues that must be addressed in the years ahead:

1. It is essential to recognize the importance of Staggers Act rate making flexibility in the successful operation of a short line railroad. Protection of the Staggers reforms is an essential element in any effective rail service preservation policy.

2. It is essential to preserve the labor protection guidelines established by the ICC in the Gulf and Mississippi Case. Those guidelines provide a powerful incentive for carriers to preserve and transfer rather than simply abandon light density lines. Reversing that incentive is not in the public interest. Legislation which would limit the ICC's discretion, and impose protection on all line transfers, amounts to a direct trade-off between protection for a few people today, and continuation of service and jobs for many in the future. That is not a sound trade-off.

3. It is important to recognize reasonable distinctions between larger and smaller railroads in the formulation of federal rules and policies. Compliance costs inherent in federal regulations place a greater burden on light density carriers, which have a smaller traffic base over which to spread those costs. While the public interest generally requires that railroads, regardless of size, meet the same safety standards, there is a sound argument for limiting the recordkeeping and reporting requirements applicable to smaller carriers. Consistent with that premise, FRA has exempted the smallest short lines from certain paperwork requirements associated with the safety regulatory program. We will continue to seek such opportunities

in the future, and it will continue to be important for Congress and the administrative agencies to ease the compliance costs of new laws and regulations applicable to short line railroads whenever it is reasonable to do so from a public interest perspective.

4. On November 1, 1982, the FRA track standards were modified to permit continued operation on light density agricultural branch lines that would otherwise be unable to bear the expense of compliance with FRA standards. There are thousands of miles of deteriorated, light density rail lines serving elevators throughout the grain belt. For the shippers they serve, these are important connections. But their shipping volume is often too light to finance the type of maintenance needed to keep the track in conformance with FRA standards. To preserve service for shippers dependent on their marginally serviceable tracks, FRA established a special exemption to our standards when:

- there is no passenger traffic moving on the line, and

  - no traffic moves at speeds in excess of 10 miles per hour.

There are many short lines operating today in the Midwest solely because of this "excepted track" provision. Our experience over the past 5 years demonstrates that retention of the excepted track rule is in the public interest from both a safety and an economic perspective.

5. FELA is an extremely expensive compensation system that works to the mutual disadvantage of small carriers and their employees. While FELA applies to all railroads, its burden falls particularly hard on smaller carriers, again because they lack an extensive traffic base across which to spread these costs. The Congress and this Administration must move this issue up on our list of priorities, and consider options ranging from revising the system (shifting it from a fault based to a

no-fault system, thus protecting the worker while lightening the burden on the companies by reducing the middleman's share) to giving smaller carriers the ability to elect state workers compensation coverage.

6. In 1986, the ICC adopted a class exemption for line transfers to independent carriers. The exemption was an effort to promote short line organization by easing the compliance costs associated with regulatory review. It was based on two premises:

a. the recognition that divestitures to non-rail entities do not raise the antitrust issues that normally form the basis for ICC review, and

b. recognition that time is truly of the essence in the consummation of these transactions. The projects involved are by definition marginal, and the costs associated with a burdensome and lengthy review proceedings may in and of themselves be sufficient to threaten consummation of the transaction. Moreover, the ability to ensure a smooth and timely exchange of ownership is essential to maintaining continuity in marketing and service.

These factors are as valid today as they were when the Commission approved the class exemption, and we believe the case for continuing that exemption is compelling. We do not, however, believe that there is anything sacrosanct in the current 7 day period. Nor would we oppose, in principle, a process that involves some distinction between the review accorded true short line divestitures, and that accorded relatively larger transactions. If such distinctions were created, however, they should be premised on density, rather than the number of track or route miles involved. Density is the primary factor which determines the marginality of any railroad system, and the factors which prompted adoption of the exemption were keyed to easing the expense of regulatory compliance for the more marginal lines.

This should not be read as support for any specific proposal to extend or alter the current exemption procedure. We believe, as a matter of policy, that the review period should be kept as short as possible consistent with the Commission's oversight obligations, and the need to provide interested parties with a reasonable opportunity to file statements of support or opposition. We do not, however, believe it is unreasonable for the Commission to review its exemption procedures periodically to ensure that they remain consistent with this objective as the form and substance of these transactions evolve over time.

The key to providing adequate opportunity for public comment lies in the accessibility of information which would give interested parties a reasonable opportunity to evaluate the impact of the transaction on their interests. In this respect, requiring petitioning parties to file more detailed information in their initial petition may be as effective or more effective than an extension of the 7 day review period. FRA would not object to a reasonable expansion of the data that must now be disclosed in a verified Notice of Exemption, so long as the mandatory disclosure does not extend to proprietary information on financial structure or marketing proposals.

The evolution of the short line carrier as an effective alternative to light density line abandonments is one of the most positive developments of this decade. If we work together to preserve the policies which have made that evolution possible, we can achieve in the 1980's what seemed like an illusive goal just a decade ago -- an effective mechanism to stabilize and then reverse the 30-year deterioration of America's rural transportation network.