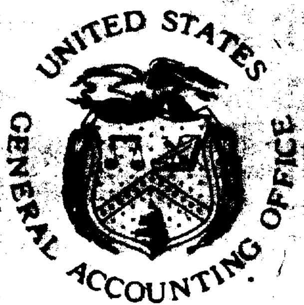
REPORT BY THE U.S.

General Accounting Office

Information On Regulatory Reform Under The Staggers Rail Act Of 1980

The Staggers Rail Act of 1980 continued reform measures aimed at reducing Federal regulatory control over the railroads and revitalizing the rail industry. According to the Association of American Railroads, the increased operational and ratemaking authority which the act gave the railroads helped to minimize the recession's impact on the industry. Selected shippers GAO surveyed indicated that they also benefited from certain of the act's provisions but were concerned with its implementation. This report presents information on these and other matters, such as railroad revenue adequacy and the Interstate Commerce Commission's handling of disputes between shippers and railroads.



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RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

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The Honorable Bob Packwood
Chairman, Committee on
Commerce, Science and
Transportation
United States Senate

The Honorable John D. Dingell
Chairman, Committee on Energy
and Commerce
House of Representatives

The Staggers Rail Act of 1980 reduced regulation of the railroad industry. Because of the act's importance, we developed information on selected aspects of its effects on shippers and railroads. This report discusses the Interstate Commerce Commission's revenue adequacy determinations as an indication of the railroads' financial condition, shippers' concerns about regulatory reform, and the Commission's actions to resolve shipper protests over railroad rate and service changes since the act.

As agreed with your offices, this report is being addressed to you for the committees' use in overseeing regulatory reform.

We are sending copies of the report to the Director, Office of Management and Budget; the Chairman, Interstate Commerce Commission; the Secretary of Transportation; the President, Association of American Railroads; and other interested parties.

J. Dexter Peach
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE CHAIRMEN OF THE HOUSE
COMMITTEE ON ENERGY AND COMMERCE
AND SENATE COMMITTEE ON COMMERCE,
SCIENCE AND TRANSPORTATION

INFORMATION ON
REGULATORY REFORM UNDER
THE STAGGERS RAIL ACT
OF 1980

D I G E S T

The Staggers Rail Act of 1980 reduced the Interstate Commerce Commission's (ICC's) regulation of the railroad industry. The act, along with earlier reform legislation, was intended to improve the railroad industry's poor financial condition by allowing railroads more freedom in establishing rates and providing services. In general, reform legislation limited ICC's authority to regulate maximum rates to situations where there is not sufficient market competition to maintain rates at reasonable levels.

ICC, however, still has regulatory responsibilities for balancing the needs of railroads and shippers which include establishing standards for evaluating the railroads' financial condition, using the standards to oversee the industry's performance, and resolving rate disputes among railroads and shippers.

Because reform legislation dramatically changed railroad industry regulation, GAO conducted this review to assist congressional committees in their oversight role by providing information on selected shippers and railroads since the enactment of the Staggers Rail Act. Because regulatory reform can affect individual shippers and railroads differently, the information GAO collected may not be representative of all railroads or all shippers.

RAILROAD FINANCIAL PERFORMANCE SINCE STAGGERS IS MIXED

In the first year after the Staggers Rail Act, railroad financial performance generally improved, while during the second year, performance generally declined. In its 1982 annual report, ICC stated that evaluating the act's effect on the railroads' financial performance will be difficult until the economy improves. (See pp. 5 and 6.)

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A spokesman for the Association of American Railroads stated that the flexibility provided by the act has already helped to minimize the effects of a weak economy. For example, the Staggers Rail Act allows a railroad to negotiate contract rates with individual shippers which differ from its published rates. The act also allows railroads to more easily change rates in order to cover costs for providing services. (See pp. 6 and 7.)

FEW RAILROADS EARN ADEQUATE REVENUE

In implementing its financial oversight responsibilities, ICC determined that 2 of the 37 largest railroads earned adequate revenue during 1981--revenue sufficient to support a railroad's continued financial needs. Such an ICC determination is important not only as an indicator of the railroad's financial health but also because it can affect a railroad's ability to increase rates. For example, a railroad not earning adequate revenue is allowed greater freedom in adding surcharges to certain of its rates. (See p. 7.)

After the Staggers Rail Act, ICC changed its criteria for evaluating revenue adequacy. Previously, it used several factors such as return on investment, financial ratios, and funds flow to make such evaluations. It now uses the return on investment criterion only. ICC's approach differs from the multicriteria approach used by investment analysts in evaluating the security of outside investments. ICC, however, stated that return on investment was a better indicator of the industry's long-term financial health, which ICC believes to be Congress' primary interest. (See p. 8.)

SELECTED SHIPPERS SEE CHANGE IN RATES AND SERVICE

GAO contacted 42 shippers that ICC determined possibly lacked competitive shipping alternatives for transporting some of their goods before the act was passed. These shippers do not represent a randomly selected sample of all shippers but rather those who potentially are more likely to be adversely affected if the act's safeguards are not enforced. (See pp. 11 to 13.)

About half the shippers GAO contacted were generally dissatisfied with ICC's implementation of the act, citing such concerns as a

lack of protection for shippers without access to more than one railroad and reduced competition among the railroads. However, shippers having access to two or more railroads were more satisfied with the act's implementation than those having access to one.

Half the shippers surveyed indicated that rail service (such as timely delivery of goods) had improved, although few attributed it to the Staggers Rail Act. Many believed the service improvements were the result of other economic factors, such as the depressed economy, which allegedly caused railroads to improve service as a result of reduced traffic. Additionally, half the shippers stated that they benefited from the act's contract provisions. One noted that it had contracted to move 98 percent of its coal at rates 20 percent below the railroad's published rate.

About 68 percent of the shippers responding noted primarily moderate rate increases which many believed to be a result of the Staggers Rail Act. But about 24 percent reported rate decreases since the act. The remaining shippers noted little change in rates. Bureau of Labor Statistics data indicate that rates have been increasing less rapidly after the act's passage than before.

ICC INVESTIGATES AND SUSPENDS FEWER RATES PROTESTED BY SHIPPERS

Shippers who believe that a proposed railroad rate change is unreasonable can protest the change with ICC. On the basis of information contained in the protest, ICC can deny the protest, investigate the rate to determine its reasonableness, or suspend the effective date of the proposed rate change and investigate the proposal.

The number of shipper protests has decreased by about two-thirds since the act's passage. Some shippers and shipper associations believe that the decline does not necessarily imply satisfaction with regulatory reform. (See p. 14.)

During the 2 years before the act's passage, ICC investigated about 20 percent of the shipper protests against proposed railroad rate and service changes, while for the 2 years after the act's passage, ICC investigated about 11 percent. ICC suspension of effective dates for proposed railroad actions protested by

shippers also decreased from 8 percent to almost zero over the same 4-year period.

Obtaining a suspension or investigation is more difficult because of (1) legislative changes to the suspension criteria and (2) ICC decisions affecting its jurisdiction over protests, as shown below:

--The Staggers Rail Act reduced the grounds for obtaining a suspension and decreased the time a shipper has to protest a rate increase from 30 to 20 days. (See p. 15.)

--ICC revised criteria for determining whether or not a protested rate falls within its regulatory authority. Its authority is dependent upon a determination that the railroad offering the protested rate is market dominant--the railroad has no effective competition. After the Staggers Rail Act, ICC changed its market-dominance criteria and required a shipper to provide more justification to support the existence of market dominance. ICC now considers not only competition from all transportation modes but also competition resulting from the availability of substitute products or the same product from other places. (See p. 15.)

Although the market-dominance criteria change made it more difficult to obtain an investigation or suspension, ICC's Suspension Board Chairman believes that it did not have as significant an impact on investigation and suspension rates as the above legislative changes did. In December 1982, the United States Court of Appeals Fifth Circuit ruled that portions of ICC's revised market-dominance criteria were invalid and remanded them to ICC for revision. However, because the entire circuit granted a rehearing, the remand order has been stayed.

SHIPPERS' CONCERNS ABOUT THE FUTURE

Several large shippers associations also are concerned about ICC's deregulatory actions. Major concerns center on a perceived lack of protection for shippers having few transportation alternatives and the possible reduction of competition by railroads. (See p. 16.)

Shipper associations have indicated that the real impact of the Staggers Rail Act will be masked until the economy improves. They

believe that railroads are currently forced to compete in a depressed economy for limited shipper business.

CONGRESSIONAL ACTION

The Staggers Rail Act authorized ICC to intervene in market-dominance situations in order to assure reasonable rates. The Congress is considering legislation which would provide ICC with additional guidance for implementing its responsibilities in this area. The proposed legislation would expand the circumstances under which ICC could regulate rate reasonableness by modifying ICC's current criteria for determining market dominance. Additionally, the legislation would require ICC to change its current revenue-adequacy standard. (See pp. 8 and 16.)

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ABBREVIATIONS

BLS	Bureau of Labor Statistics
GAO	General Accounting Office
ICC	Interstate Commerce Commission
4R Act	Railroad Revitalization and Regulatory Reform Act

CHAPTER 1

INTRODUCTION

The Staggers Rail Act of 1980 (Public Law 96-448) reduced the Interstate Commerce Commission's (ICC's) regulation of the railroad industry. It, along with earlier reform legislation, was intended to revitalize the industry by allowing railroads greater freedom in establishing rates and providing service. Although Federal regulation was reduced, ICC still has a significant role in balancing the needs of railroads and shippers. ICC's responsibilities include (1) approving railroad mergers and abandonments of rail lines, (2) establishing standards for evaluating the financial condition of railroads, (3) performing evaluations of railroads' financial condition, and (4) resolving rate and service disputes among railroads and shippers. In addition, ICC interprets legislation and is looked to by the Congress to oversee the impact of the act on both railroads and shippers.

THE RAILROAD INDUSTRY

The United States has nearly 500 railroads which are principal carriers for many bulk materials, such as coal and agricultural products. Rail is an energy-efficient mode of bulk transportation over land and is able to provide services to many shippers at far lower costs than other modes.

Railroads are classified in three categories: Class I railroads earn $50 million or more annually, Class II railroads earn between $10 and $50 million, and Class III railroads earn less than $10 million. According to the Association of American Railroads, in 1981 the Nation's 38 Class I railroads (excluding Amtrak) accounted for about 98 percent of railroad traffic, employed about 90 percent of the rail worker force, and had freight-operating revenues of nearly $29 billion. Major railroads (all Class I and 4 Class II railroads) moved 21.6 million carloads of goods. Coal was the largest single commodity moved by rail, comprising about 27 percent of all carloads. Other commodities with more than 1 million carloads included grain, chemicals, and metallic ores.

REGULATORY CHANGE IN THE RAILROAD INDUSTRY

In the early 1900's, ICC's responsibilities were largely geared toward guarding against monopolistic abuses by railroad carriers. As such, it had considerable authority to regulate rates, prohibit discrimination against shippers, and require adequate service to shippers. After 1929, the railroad's share of intercity freight traffic dropped from 75 percent to 36 percent as shipments were being diverted to truck and barge service. By the early 1970's, Penn Central, the Nation's largest railroad, and several other smaller railroads went bankrupt. In an effort to reduce the rail industry's general financial problems, the Congress passed the Railroad Revitalization and Regulatory Reform Act (4R Act) in 1976. One of the act's intentions was to restore the

industry's financial stability. The 4R Act limited ICC's maximum rate regulatory authority to situations where effective competition to assure reasonable rates and service did not exist.

In October 1980, the Congress passed further regulatory reform legislation--the Staggers Rail Act. One of the principal goals of the act was to continue improving the industry's financial condition while balancing the needs of railroads, shippers, and the public. The legislation refined certain concepts of the 4R Act and generally expanded rate and service freedoms for the industry. The act:

--Continued to limit ICC's rate jurisdiction to circumstances in which a railroad is market dominant--meaning that a railroad has sufficient market power to exercise monopoly pricing because of a lack of effective competition. While not changing the 4R Act's definition of market dominance, the act added that a railroad cannot be market dominant unless revenues generated by its rates exceed certain revenue-to-variable cost ratios. These ratios, known as jurisdictional thresholds, are comprised of the revenue generated by movement of goods compared to the railroad's variable cost of providing the service. The established ratios start at 160 percent on October 1, 1980, and rise in 5-percent annual increments until October 1, 1984, at which time the cost recovery percentage becomes applicable, subject to a floor of 170 percent and a ceiling of 180 percent.

--Gave ICC greater discretion in exempting specific commodities from any regulation. For example, ICC no longer regulates rates charged for railroad-owned truck trailers shipped on rail flatcar or for most agricultural commodities.

--With certain restrictions, permitted railroads to add a surcharge to certain of their published rates if the revenue from the rate does not exceed 110 percent of the variable costs to provide the service.

--Authorized railroads to contract with individual shippers for rate and service agreements that differ from published rates, and can vary on a shipper-by-shipper basis.

Railroad rates can be challenged when a shipper or another railroad submits a protest or complaint to ICC. In general, protests are filed to stop a proposed railroad rate or service change from being implemented. A complaint can be filed against an existing rate. In resolving rate disputes, ICC can (1) investigate a proposed rate in order to obtain additional information on its reasonableness, (2) suspend the effective date of a proposed rate change on the basis of ICC's analysis and investigate the rate, or (3) declare an existing rate unreasonable after having determined that the railroad offering the challenged rate is market dominant. If ICC declares a rate to be unreasonable, it may establish a reasonable rate. ICC can also deny a protest without an investigation.

OBJECTIVES, SCOPE, AND METHODOLOGY

Because regulatory reform dramatically changed the railroad industry's regulation, we performed this review to develop information on what has happened to railroads and selected shippers since the Staggers Rail Act's enactment in order to assist congressional committees in their oversight role. Our work concentrated more heavily on the act's impact on shippers because of the (1) limited available data on how the act has affected them and (2) railroads' general satisfaction with the act's increased rate and service flexibility.

The railroads and shippers contacted were not selected on the basis of a scientific random sample, so their views are not necessarily representative of the industry or all other shippers. Additionally, the Staggers Rail Act is relatively new and was implemented during a recession. As a result, the legislation's impact is difficult to evaluate at this time.

In examining the railroads' experiences since the act's passage, we obtained overall industry views through literature reviews and discussions with officials of the Association of American Railroads, American Short Line Railroad Association, and five railroads selected judgmentally--Illinois Central Gulf; Atcheson, Topeka, and Santa Fe Railway Company; Chicago and North Western Transportation Company; Southern; and CSX Corporation. Because of the act's emphasis on rehabilitating the industry, our examination concentrated on ICC's and financial analysts' views of rail performance before and after the act. In doing so, we identified which railroads ICC classified as earning adequate revenue and the basis for these determinations. To obtain financial analysts' perspectives, we spoke with officials from the investment firms of Standard and Poor's and Moody's and also obtained railroad bond ratings from Standard and Poor's as an indication of the industry's financial health.

We examined shippers' experiences with the act by obtaining overall shipper views through a literature review and contacts with shipper associations. The associations contacted included: The Fertilizer Institute, National Council of Farmers' Cooperatives, National Coal Association, Edison Electric Institute, and National Industrial Transportation League. We obtained additional information through a telephone survey of 42 shippers which ICC determined likely to be in a market-dominant situation (not having access to effective competition for certain commodity movements.) Our purpose was to obtain information on shipper rates and services before and after the act, and their views of the legislation's benefits and drawbacks. The shippers we contacted do not represent a randomly selected sample of all shippers. Rather, they are shippers more likely to be detrimentally affected by the act because sufficient competition to maintain rates at reasonable levels may not exist.

We selected the shippers included in our survey from ICC's records of protests filed during the 2 years before the act. We initially identified 58 individual shippers for which ICC's

records indicated a likelihood of market dominance. However, 16 shippers were not included in the survey for such reasons as our later finding that market dominance was not an issue or the shipper did not desire to participate. Of the 42 shippers contacted, 18 were electric utilities and 24 shipped commodities such as grain, coal, electrical equipment, chemicals, fertilizers, scrap metal, and steel products.

We also examined how the act has affected ICC's resolution of rate and service disputes between shippers and railroads (railroad line abandonments are not included in rate and service disputes). To do so, we reviewed ICC files on protests filed by shippers during the 2-year period before and the 2-year period after the act. We reviewed the (1) number of protests, (2) types of protests filed, and (3) protest resolutions.

Except as noted below, we conducted this review in accordance with generally accepted government audit standards. We did not obtain comments from ICC's commissioners because the report is primarily informational and contains no conclusions or recommendations. However, to assure the technical accuracy of the information presented, high level ICC officials who manage the implementation of the Staggers Rail Act reviewed the draft. They stated that the draft was technically accurate and their oral comments were incorporated into the final report.

CHAPTER 2

RAILROAD PERFORMANCE SINCE THE STAGGERS RAIL ACT

One of the Staggers Rail Act's intentions was to assist in rehabilitating the railroad industry. Although Class I railroad financial performance has fluctuated during the 2 years since the act's passage, the Association of American Railroads believes that increased rate and service flexibility granted by the act has enabled railroads to better endure a recessionary period.

The Staggers Rail Act continued to require that ICC oversee the industry's financial condition through evaluating the adequacy of railroads' revenues. ICC is responsible for developing criteria for determining revenue adequacy. In addition to being a gauge of the industry's financial health, these determinations are important because railroads that do not earn adequate revenue are allowed to increase rates more than railroads which do. After the act's passage, ICC changed its criteria for evaluating revenue adequacy. The first use of the new criteria reduced the number of revenue adequate railroads from 13 to 3 and subsequently to 2. The Congress is considering legislation that would require ICC to adopt revenue adequacy criteria more similar to criteria that investment analysts use for evaluating the industry's financial health.

STAGGERS ACT BELIEVED TO HAVE HELPED INDUSTRY BETTER WITHSTAND RECESSION

Railroads' financial condition during the first year after the Staggers Rail Act was passed generally improved, continuing a trend of the previous year. However, their condition generally declined during the second year. Railroad officials attribute some of the decline to the recession but believe that regulatory reform has helped the industry weather the recession by providing more freedom to change rates and services. In its 1982 annual report, ICC stated that it will be difficult to evaluate the act's effect on the railroad's financial performance until the economy improves.

The following chart, which is based on data from the Association of American Railroads, illustrates some of the performance fluctuations for Class I railroads before and after the act (these figures are based on betterment accounting practices--see discussion on p. 9).

Year	Operating revenue	Rate of return on net investment[a]	Rate of return on share-holders equity	Revenue ton miles[b]	Net working capital	Retained funds
	(billions)	(percent)		----------(millions)----------		
1979	$25	2.87	5.27	913,669	$ 555.0	$1,390.6
1980	28	4.13	6.00	918,621	897.4	1,839.3
1981	31	3.98	10.54	910,169	1,691.6	3,168.7
1982[c]	28	2.19	5.60	800,000	1,391.7	(d)

[a]Reflects inclusion of deferred taxes.
[b]A ton mile is the number of tons carried times the distance transported.
[c]1982 figures are preliminary.
[d]Not available.

Representatives from the Association of American Railroads and Federal Railroad Administration have indicated that the reduction in regulatory control has provided substantial freedom for railroads to meet changing times and market conditions and to be competitive with other carrier modes. For example, the Staggers Rail Act authorized individual contracts between rail carriers and shippers, a practice which was not previously allowed. This provides railroads with the flexibility to negotiate price and service agreements that differ from their published rates and can vary on a shipper by shipper basis. A representative from the Illinois Central Gulf Railroad stated that the flexibility provided by this provision allowed the railroad to obtain traffic that normally had been shipped by barge. Other provisions of the act which have increased a carrier's service and pricing flexibility include:

--Surcharges on certain joint rates (a single published rate to transport goods over two or more railroad lines)--the Staggers Rail Act, under certain circumstances, allows a railroad to add a surcharge to its joint rate without the concurrence of ICC or other railroads involved in the joint rate. The surcharge can increase revenue up to 10 percent above the variable costs to provide that service. This provision allows railroads to more easily adjust revenues from joint rates in order to cover their costs.

--Joint rate cancellations--the Staggers Rail Act allows a railroad participating in a joint rate to cancel that rate without the concurrence of the other railroad involved in the rate if the rate does not provide a specified level of revenue to the railroad cancelling the joint rate. It, therefore, eases a railroad's ability to terminate participation in a joint rate agreement which is not to its advantage.

--Notice period for rate changes--before the enactment of the Staggers Rail Act, railroads were generally required to give 30 days notice before raising or lowering their published rates. The act reduces the required notice period for lowering rates to 10 days and notification time for raising rates to 20 days. This allows a railroad to more quickly adjust rates in response to changes in the market environment.

Rail officials believe that freedoms, such as those discussed above, have minimized the effects of a depressed economy. In November 1982, for example, an official from the Association of American Railroads stated that deregulation had helped the industry avoid an inundation of railroad bankruptcies despite the severity of the recession. Additionally, a Federal Railroad Administration official stated that in contrast to its poor performance in previous recessionary periods, the railroad industry today was healthy, as evidenced by an increase in market share, retained earnings, and cash flow, all in the face of recession. He attributed the industry's improved performance during an economic recession to, among other things, a change in management philosophy and the move toward deregulation.

ICC CLASSIFIES FEW RAILROADS AS EARNING ADEQUATE REVENUE

ICC is responsible for determining which of the Class I railroads earn adequate revenue. In addition to being a gauge of industry performance, these determinations are important because they can affect a railroad's ability to raise rates without regulatory interference. Since the act's passage, ICC changed the criteria it used for evaluating revenue adequacy. As a result, the 13 railroads previously determined as being revenue adequate were reduced to 3, on the basis of 1979 financial data. Under ICC's most recent evaluation, using 1981 data, 2 of the 37 railroads evaluated earned adequate revenue. Unlike ICC's approach, financial analysts use several factors for evaluating a railroad's financial health. From the analysts' perspective, the industry is in a considerably better position than would be indicated using ICC's method of determining revenue adequacy. (See p. 9.)

Legislative requirements for revenue-adequacy determinations

The Staggers Rail Act continues previous requirements that ICC establish criteria to determine if railroads' revenues are adequate. The Interstate Commerce Act provides general guidance, stating that revenues should be sufficient to:

"(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) **attract and retain capital in amounts adequate to provide a sound transportation system in the United States.**"

The concept of revenue adequacy is important throughout the Staggers Rail Act. One of the act's principal policies is promoting safe and efficient rail transportation by allowing rail carriers to earn adequate revenues. Furthermore, the act states that ICC is supposed to consider this policy in determining whether a rate established by a railroad is reasonable. The act also requires revenue-adequacy consideration in several other more specific areas. For example, railroads not earning adequate revenue have greater freedom in adding surcharges to joint rates. (See p. 6.) Additionally, certain rate increases allowed under the act will not be available to railroads earning adequate revenue after October 1984.

ICC changes criteria for determining revenue adequacy

Prior to the Staggers Rail Act, ICC used a number of financial indicators such as the rate of return on investment, financial ratios, and funds flow to evaluate revenue adequacy. It now uses a single financial indicator--return on investment. The single criterion approach differs from how financial analysts that we spoke with examine railroads' financial positions.

In changing from a multi-criteria to a single-criterion approach, ICC, in a 1981 decision, stated that the financial ratios previously used to determine revenue adequacy could be misleading. It indicated that the earlier ratios, excluding return on investment, were not appropriate indicators of the long-term viability of railroads, which it believed to be the Congress' primary concern.

Financial analysts that we spoke with use a multi-criteria approach to evaluate a company's financial position. For example, Standard and Poor's, a major investment firm, uses cash flow, long-term debt-to-capital ratios, and pretax interest coverage, among other things in examining a corporation's financial health. It makes evaluations of the company's future credit strength (ability to pay debts) on the basis of current conditions and an assessment of the long-term outlook in which it considers management's financial projections. Another investment firm, Moody's, also uses several similar criteria in evaluating a corporation's financial position.

In April 1983, two bills were introduced in the Congress that would provide ICC with additional guidance for determining railroads' revenue adequacy. House bill 2584 and Senate bill 1082 would, among other things, both require ICC to use several financial performance indicators to evaluate revenue adequacy.

Other actions affecting revenue-adequacy determinations

ICC also took other actions affecting revenue-adequacy evaluations, including: (1) changing its method of computing the cost of capital which is used to evaluate the adequacy of return on investment and (2) requiring railroads to change past accounting practices.

--Before the Staggers Rail Act's passage, one factor ICC used to compute the cost of capital was the cost of embedded debt (basically the historical cost of borrowing). It now uses the current cost of debt. This change resulted in raising the 1979 cost of capital from 11 percent to 11.7 percent. In explaining the change, ICC stated that the embedded debt would understate capital costs in periods of high inflation and might overstate the cost when inflation decreases.

--ICC took steps to improve the accuracy of return on investment calculations by requiring that railroads use depreciation accounting principles as opposed to betterment accounting principles. Betterment accounting principles, which have been used only by the railroad industry, do not systematically depreciate an asset's value over its useful life. In a report entitled "Accounting Changes Needed in the Railroad Industry" (AFMD-81-26, Feb. 4, 1981), we indicated that such accounting practices could considerably understate income. As a result, return on investment would also be understated. ICC's actions in this area should make return on investment calculations more meaningful and easier to compare with other industries.

Few carriers are determined to be revenue adequate

Under its old criteria, ICC classified 13 of the Class I railroads as earning adequate revenue on the basis of their performance during 1975 through 1977. Under ICC's first evaluation using its new criterion, three railroads were determined to have earned adequate revenue during 1979.[1] Currently, two railroads are revenue adequate on the basis of 1981 data. ICC believes that a small number is consistent with overall congressional findings of insufficient industry earnings. From financial analysts' perspective, however, the railroad industry is relatively healthy.

Very few of the railroads came close to meeting ICC's 16.5-percent return on investment criterion used in the 1981 determination of revenue adequacy. Return on investment for the 35 railroads classified as being revenue inadequate ranged from zero percent to 11.8 percent and averaged 4.8 percent. Return on investment for the two revenue-adequate railroads was 18.1 percent and 21.9 percent.

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[1] ICC did not make individual revenue-adequacy determinations using 1978 data.

ICC believes that the small number of revenue-adequate carriers is consistent with what the Congress anticipated. In 1981, ICC stated that

> "Section 2(6) and 2(7) of the Rail Act explicitly found that the railroad industry's earnings are insufficient to generate funds for necessary capital improvements and that by 1985 there will be a capital shortfall within the industry of between $16 billion and $20 billion. These findings make clear that Congress did not anticipate that a large number of carriers would be found to have adequate revenues."

However, financial analysts at Standard and Poor's and Moody's disagree with the implication that the industry is not financially healthy. Both firms' analysts stated that the industry was in relatively good financial condition. Standard and Poor's, for example, classifies company bonds as being either speculative or of investment-grade quality. Bonds rated as investment grade are found likely to provide timely payment of debt while there is a greater possibility of default for speculative bonds. Of the 22 railroad bonds Standard and Poor's rated under this system, 18 were classified as investment-grade bonds. Two of the remaining four that were classified as being speculative just missed receiving an investment-grade rating.

CHAPTER 3

SELECTED SHIPPERS' ATTITUDES TOWARD DEREGULATION

Given the relatively short time since the Staggers Rail Act's passage and the accompanying recession, predicting the long-term effect of reform legislation on rail service and rates is difficult. However, despite general concern about the act's implementation, about half of the 42 shippers we contacted believed that service has improved and that they have benefited from the act's contract provisions. Additionally, rates in general have been increasing less rapidly since the act's passage. Questions remain as to whether these changes are due to the Staggers Rail Act or other factors.

Although the number of shipper protests against railroad rate and service changes have decreased by about two-thirds since the act was passed, shippers have had more difficulty in getting ICC to investigate their protests. Additionally, ICC has suspended the effective date of fewer proposed railroad actions protested by shippers. These difficulties are due, in part, to changes in ICC's criteria for taking such actions. Shippers are also concerned that act's implementation will ultimately cause decreased rail competition and will allow railroads to charge unfair rates.

MANY SHIPPERS SURVEYED EXPERIENCE BENEFITS SINCE STAGGERS RAIL ACT, BUT FEW ARE ATTRIBUTED TO THE ACT

In order to obtain information on shippers' experiences with the act, we surveyed 42 shippers which ICC had found likely to be in a market-dominant situation before the Staggers Rail Act--shippers which lacked effective competitive alternatives for certain movements of their goods. We found that (1) about half of the shippers were, overall, dissatisfied with the act, citing such concerns as a lack of protection for captive shippers and decreases in rail competition, (2) shippers having access to two or more railroads were generally more satisfied with the act's implementation than those having access to one, (3) half of the shippers reported service improvements but most attributed them to factors other than the Staggers Act, (4) half the shippers said that they had benefited from the act's contract provisions, and (5) about two-thirds of the shippers believed that rates increased since the act.

The shippers we contacted do not represent a randomly selected sample of all shippers but rather those who might be more likely to be adversely affected if the act's safeguards were not enforced. Our survey included 18 electric utilities and 24 general commodity shippers who submitted protests during the 2 years prior to the Staggers Act and were found likely to be in a market dominant situation for certain goods movements. (See p. 3 for additional information on survey selection.)

Rail competition provides greater shipper satisfaction

Shippers having access to competition from two or more railroads were generally more satisfied than those which had access to one. Only 1 utility had access to a competitive railroad, while 13, or about half, of the general commodity shippers did. Significantly, none of the utilities expressed satisfaction with the act's implementation, while 42 percent of the general commodity shippers did.

About half of the shippers surveyed expressed at least a moderate degree of dissatisfaction with ICC's overall implementation of the act, about 24 percent were satisfied and the remainder were neither satisfied or dissatisfied and/or uncertain. Areas of dissatisfaction included changes in criteria for determining market dominance and railroad revenue adequacy, which shippers believe benefited railroads, and the ease by which railroads can cancel joint rates.

Many shippers observe service improvements

About half the shippers responding believed that service has improved since the Staggers Act was passed. One, for example, stated that the shipment time had decreased and that reliability of train service had improved. While noting service improvements, only six, or about 29 percent, attributed such improvements to the act. Most did not attribute service improvements to the Staggers Rail Act but rather to factors such as the recession, which reduced traffic and led to improved service, and to competition that existed before the act. About 37 percent of the shippers responding noted little change in service since the Staggers Rail Act, and the remainder believed service to have deteriorated.

The availability of rail competition did not seem to affect shipper responses concerning service as much as it did their overall satisfaction with the act's implementation. About 60 percent of the utilities, which generally did not have access to two or more railroads, believed that service improved since the act was passed, while 43 percent of the general commodity shippers observed such improvements.

Shippers believe contracts to be beneficial

About half of the shippers, including some that generally lacked rail competition, reported to have benefited from the act's contract provisions. One shipper, for example, stated that it was able to negotiate a contract for 20 percent less than the general tariff rate, which permitted the sale of a product that would otherwise have been impossible. About two-thirds of the general commodity shippers said that they benefited from the contracts, while one-third of the utilities said that they did. One utility reported that 98 percent of its coal movements formerly moving under tariff rates had been converted to contract movements for 20 percent less.

Shippers see moderate rate increases

Twenty-eight shippers, or 68 percent of the 41 shippers that discussed rate changes, reported rate increases since the act's passage; only 21 percent of the increases were classified as great. About 30 percent of the utilities reporting rate increases categorized the increases as great as compared with 9 percent of the general commodity shippers. One utility, for example, stated that rates had risen 40 percent above the inflationary cost increases in the 2 years following the act's passage. Twenty of the 28 shippers reporting rate increases believed that the act had contributed to the increase.

Ten shippers (about 24 percent), including a utility, reported rate decreases since the act's passage. One, for example, reported a 30-percent decrease for short movements of a particular commodity shipment. This reduction was followed by similar reductions by other railroads. Three shippers noted little change in rates since the act's passage.

Bureau of Labor Statistics (BLS) data also indicates that overall rail rates have not dramatically increased. According to BLS, rates have increased less rapidly during the 2 years after the act than for the same period before the act.[1] During the 2 years after the act was passed, rates increased by 18 percent, which is less than half of the 38-percent increase before the act's passage. The extent to which the Staggers Rail Act influenced these changes as opposed to the depressed economy is not known.

None of the rates for the 11 major commodities which BLS categorizes increased more after than before the act was passed. Rates for coal and nonmetallic minerals increased the most during the 2 years after the act while rates for transportation equipment and farm products increased the least. The following chart shows how rates have changed on a commodity-by-commodity basis since 1980 when the legislation was enacted.

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[1]BLS samples rail rate information on a nationwide basis using a subsample of a 1-percent sample of all rail shipping bills. The data does not include rates negotiated by contract.

Commodity	Percentage increase Oct. 1978-Oct. 1980	Percentage increase Oct. 1980-Oct. 1982
Chemical	37	17
Clay, concrete and glass, or stone	41	19
Coal	37	22
Farm products	39	16
Food products	41	18
Metallic ores	41	20
Nonmetallic minerals	45	23
Primary metal products	35	17
Pulp and paper or allied products	40	17
Transportation equipment	31	13
Wood/lumber products	41	19

SHIPPERS HAVE FILED FEWER PROTESTS AGAINST PROPOSED RAILROAD RATE AND SERVICE CHANGES SINCE THE ACT'S PASSAGE

A shipper disagreeing with a proposed railroad rate or service change (e.g., rate increase or route cancellation) can challenge the change through a protest filed with ICC. Such a protest basically requests that ICC investigate and suspend the proposed rate or service until it determines whether or not the change is reasonable. The number of shipper protests filed with ICC during the 2 years before and after the act was passed has decreased from 324 to 119, or about two-thirds. Some shippers and shipper associations, however, believe that this decline does not necessarily represent satisfaction with regulatory reform. In addition to fewer protests filings, the reasons for shippers' protests has changed.

Some associations representing various types of shippers were cautious about interpreting the implications of the protest decrease. Some believed that the decrease may not signify less concern but rather their belief that protesting was useless because ICC would not rule in their favor. In our survey, eight shippers filing fewer protests after the act believed that submitting protests was pointless.

The composition of shipper-filed protests has also changed. Shipper concern shifted to areas in which the act granted railroads additional flexibility. For example, rate surcharges represented only 5 percent of the protests submitted before the act, but now they constitute 25 percent of the protests. Additionally, the proportion of joint rate or route cancellations increased from 4 percent to 14 percent since the act was passed. In these areas, the Staggers Rail Act gave railroads increased freedom to take action without ICC approval. (See p. 6.)

ICC INVESTIGATES AND SUSPENDS FEWER RAIL ACTIONS PROTESTED BY SHIPPERS

During the 2-year period before the Staggers Rail Act was passed, ICC investigated about 20 percent of the protests shippers filed, while for the same period after passage, it investigated 11 percent of the protests. The percentage of protested rate or service changes suspended by ICC also declined from 8 percent to almost zero. Legislative changes to the suspension criteria and subsequent ICC interpretations affecting its jurisdiction over rate protests have made it more difficult to obtain investigations and suspensions. The percentage of protested rail actions that ICC's commissioners ultimately determined as being unreasonable decreased from 7 percent before the act was passed to zero after its passage.

Legislative changes in protest suspension criteria

The Staggers Rail Act changed earlier suspension criteria and reduced the grounds for suspending a protested rate. In addition to changes in the suspension criteria, the legislation reduced the time a shipper has to prepare a protest against rate increases from 30 to 20 days. According to ICC's Chairman of the Suspension Board, these changes have made it very difficult to obtain a suspension and have also made it more difficult to obtain an investigation.

The Staggers Rail Act modified one of two earlier suspension criteria and added a third; these changes decreased the basis for obtaining a suspension. Previous legislative criteria generally permitted ICC to suspend a rate only if it was likely that the shipper would prove the rate to be unreasonable and that without a suspension, the rate would cause substantial injury. The Staggers Act revised the first part of the criteria by requiring ICC to determine that it is "substantially" likely that the rate will be found unreasonable. The legislation also added a third condition which requires ICC to determine if "peculiar" economic circumstances exist which would not allow the shipper to retroactively recover payments for that portion of rates found by ICC to be unreasonable.

Changes in ICC's jurisdiction over rate protests

Before ICC can determine that a protested rate is unreasonable, it must determine that the railroad has market dominance--that effective competition is unavailable. To prove market dominance, it must be shown that a railroad has sufficient market power to exercise monopoly pricing. The market-dominance concept was initiated in the 4R Act in order to limit ICC's rate-setting authority to areas where insufficient competition exists. After the Staggers Rail Act was passed, ICC revised its market-dominance criteria by increasing the amount of justification needed to prove market dominance. Since ICC considers market dominance in deciding whether or not to investigate and suspend a protest, obtaining

either of these actions is more difficult. However, the Chairman of ICC's Suspension Board stated that changes in market-dominance criteria did not have as significant an impact on investigation and suspension rates as did the previously discussed legislative changes.

In revising the market-dominance criteria, ICC basically went from three quantifiable factors to qualitative guidelines. In explaining the change, ICC stated that factors influencing the degree of competition are too numerous to be gauged by so few measures and that, in general, past determinations had placed too much emphasis on quantitative evidence which may not have adequately reflected the degree of competition. ICC's current guidelines for determining market dominance rely more heavily on qualitative measures. Additionally, the act now requires a shipper to show that rates have exceeded certain cost thresholds before ICC can even consider market dominance. (See p. 2.)

In its guidelines, ICC stated the importance of providing evidence related not only to direct forms of competition, such as other railroads or other modes of transportation, but also indirect competition. The guidelines state that competition resulting from the availability of substitute products (product competition) or the availability of the same product from other places (geographic competition) also provides competition.

The Western Coal Traffic League believed that ICC had overstepped its statutory authority in considering product and geographic competition as part of the market-dominant decision and challenged ICC's criteria in court. On December 8, 1982, the United States Court of Appeals, Fifth Circuit, ruled that ICC's definition of market dominance was invalid in this regard and remanded the guidelines back to ICC for revision. However, because the entire circuit granted a rehearing that remand order has been stayed.

In April 1983, House bill 2584 and Senate bill 1082 were introduced for congressional consideration. Both bills propose that ICC replace the current market-dominance guidelines with the criteria similar to that used earlier.

SHIPPERS CONCERNED ABOUT FUTURE

All of the shipper associations which we contacted were concerned about possible detrimental effects of the act that may appear once the economy improves. Their fears are based on the idea that the recession has forced railroads to actively compete for reduced amounts of rail traffic and has restricted the full use of actions allowed by the Staggers Rail Act.

The National Industrial Transportation League, a major shipper association, recently expressed concern over the future of competition. On February 25, 1983, it petitioned ICC to initiate rulemaking actions to prohibit anticompetitive cancellation of railroad routes and rates and to implement provisions of the

Staggers Rail Act intended to promote rail competition. The petition specifically noted actions taken by the Chessie System and Conrail which limited shippers' transportation alternatives through joint-rate and route cancellations. Concern over the possible reduction in competition through joint-rate cancellation is not limited to shippers. Railroads are also concerned because such actions can eliminate traffic that the affected railroad previously handled and the related revenue from that traffic. On July 7, 1983, ICC denied the petition for rulemaking.

In a related area, associations expressed concern over what they felt to be inadequate protection for those shippers with limited transportation alternatives (captive shippers). They were particularly concerned about ICC's inclusion of product and geographic competition in its definition of market dominance. In November 1981, testimony before the Subcommittee on Surface Transportation, Senate Committee on Commerce, Science and Transportation, the National Coal Association, which classifies 85 percent of the 500 million tons of coal shipped annually by rail as being captive to railroads, stated that the Congress should, among other things,

> "* * * set forth in the law certain definitive and measurable conditions which shall determine the existence of rail market dominance over specific traffic, and thereby permit a captive shipper to seek timely relief from the Commission when monopolistic abuses are encountered in regard to rail rates and service."

The association also emphasized the importance of promoting competition for coal shipments by facilitating the construction of coal slurry pipelines.

In examining concerns over the future of captive shippers, it is important to consider how many shippers are captive to the railroads. Although difficult to do, a 1979 study by Kearney Management Consultants estimated that about 10 to 15 percent of rail traffic was captive on the basis of short-term transportation alternatives. However, the study stated that this figure could increase by an additional 10 to 15 percent, depending on future rail competition and motor carrier competition.

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