

(2)

STATEMENT OF CLAUDE S. BRINEGAR, SECRETARY OF TRANSPORTATION,
BEFORE THE SUBCOMMITTEE ON SURFACE TRANSPORTATION OF THE
SENATE COMMERCE COMMITTEE REGARDING THE NORTHEASTERN RAILROAD
PROBLEM, WEDNESDAY, MAY 30, 1973

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to appear before you today.

On March 26, in response to Senate Joint Resolution 59-2, the Department of Transportation submitted its report on the Northeastern Railroad problem. Since that time we have prepared one of three draft bills which are required to implement that report. Our first bill is the proposed Northeast Railroad Restructuring Act of 1973. We will submit to you very shortly the other two bills. The second one proposes major revisions in the system for the economic regulation of railroads throughout the Nation. The third bill proposes revisions of the procedure for the reorganization of railroads under Section 77 of the Bankruptcy Act.

It is well known that the Northeastern Railroad situation has been developing over a long period of time. We believe that the magnitude of the problem and the urgency for action are attributable in large part to the inability

of the railroads to make the necessary adjustments to changing economic conditions. In our implementing legislation we have endeavored to focus on the key elements of the problem and to include measures that will lead to a viable long-term solution.

I should like to stress one key point with respect to our bill that provides for the restructuring of the rail system in the Northeast. The bill does not set out in detail the specific actions that should be taken by various parties. What we have tried to do is to lay out a procedure for action, rather than a precise cookbook type formula. We are convinced that no one is capable of prescribing such cookbook details at this point. Many of the details cannot really be pinned down until the necessary early steps have been taken. Our recommendations are aimed at getting these early steps underway--and underway promptly enough to give the judges and the trustees sufficient confidence in the direction of progress so that they can postpone the threatened shutdown and liquidation.

Quite clearly, an essential objective is to find a solution that is within the broad framework of the private sector. However, let me stress that this does not mean a

hands-off attitude on the part of the Federal Government. What it means is that all affected parties--including the Federal Government--must work together to find the way out, with the abilities and resources of the private sector used to the maximum. We believe this approach properly protects the essential public interest, the private sector rail transportation system, and the Nation's taxpayers.

Before discussing the provisions of our proposed bill to restructure the Northeast Railroads, I think it would be appropriate to briefly review the major conclusions of our report on which it is based. Our key conclusions were as follows:

1. The Nation's private enterprise rail system, while suffering under many long-term burdens, is neither dead nor dying. Despite serious problems in the Northeast, many healthy rail companies are doing well and showing signs of further gains. For example, the president of the Southern Railway recently told his company's shareholders that capital expenditures in 1973 would approximate \$160 million--far higher than spent in any prior year. He was quoted as saying that the railroad has "more cash on our hands now than ever before in the company's history."

2. Rail nationalization is unnecessary and would solve little, except perhaps hide some of the short-term Northeast area problems under the bed of the Federal budget. Experiences elsewhere indicate that nationalization only means increasing subsidies and declining resource efficiency--something our Nation can ill afford. The largely state-owned rail systems of Japan, Britain, Germany, France, and Italy now report losses that in total exceed \$2 billion per year. Nor do we believe that partial or piecemeal nationalization, such as buying only the roadbeds of the bankrupt or ill carriers, is necessary or proper. It's awfully hard for the Federal government to become a "limited partner" in a private enterprise operation, for one thing almost inevitably leads to another. Likewise, such piecemeal nationalization would, in time, weaken--and perhaps destroy--the vigor of the private enterprise companies that would be forced to compete with such an operation.

3. Without question we face a short-term rail crisis in the Northeast. Six of the Class I rail carriers in this area are in bankruptcy, and the major one--the Penn Central--is on the verge of Court ordered liquidation in order to

prevent further erosion of the creditors' estates. If there were a complete and abrupt Penn Central shutdown, the Northeastern area would, in the short-term, feel the impact quite significantly. However, given the ability to make necessary adjustments to equipment and routes, other rail carriers and trucks would, in time, willingly step in and pick up most of the slack. The Penn Central Company, per se, is not essential, though much of the rail service provided over its mainline tracks is.

4. While the Northeast has lost some of its rail freight business in recent years, the overall freight total remains quite large. Certainly it is large enough to support operations of one or more new private sector rail systems that could be developed from the various systems owned by the six bankrupt carriers. To illustrate, the bankrupt railroads in the Northeast carry some 330 million tons of freight per year, roughly triple that handled by the Norfolk & Western. Further, the average length of haul in the Northeast differs little from that of such railroads as the Norfolk & Western and the Chessie System.

5. The streamlining process will lead to a reduction in rail employees and to some community and shipper problems.

We recognize that plans concerning adequate job protection or compensation to the affected employees will need to be developed. These plans will require consultations with management and employee representatives, as well as with the trustees and creditors of the bankrupt estates. Likewise, special studies will be needed to determine the extent of the problems of communities and shippers, and how best to handle this period of transition.

6. The emergence of a healthy, streamlined rail system as a new on-going company would significantly add to the value of the total estates of the six bankrupt carriers. This added value, plus the proceeds from prompt liquidation of the remaining pieces (including sales of assets to other railroads), should provide a sufficient total to permit the various claimants to work out equitable divisions of the values. Such incentives as special tax allowances and short-term suspensions of certain time consuming procedures should encourage the parties to resolve their differences in a reasonable time period.

7. Looking beyond the immediate problems of the Northeast, it is clear that significant changes are needed

in the regulatory framework if rail systems throughout the Nation are to avoid the problems of the Northeast and to become the really effective private sector competitors they are capable of being. The regulatory bill we will submit to you shortly will contain specific provisions to provide these needed regulatory changes.

Let me now turn to the details of our proposed Railroad Restructuring Act. The basic steps that we recommend are as follows:

First, the Secretary of Transportation would be directed to prepare within 90 days after the date of enactment of the bill a Core Rail Service report identifying geographic zones in the Northeast within and between which rail service shall be provided, and the minimum number of independent railroads that shall provide such service. The principal factors the Secretary would take into account in preparing the report are the amount of rail traffic that is presently generated within the zones, whether rail service is more economically efficient than available transportation alternatives, the need for achieving rail service that is economically self-sustaining, and the need to preserve rail service competition

in markets of heavy rail traffic. Provision is made for the input of views by all interested parties, including the Interstate Commerce Commission.

Second, it is necessary to establish a procedure to enable the bankrupt railroads of the Northeast to cut through the problems caused by current procedures applicable to the restructuring of bankrupt railroads and establish or reshape operating entities capable of providing, as a minimum, the designated Core Service. Accordingly, the bill would authorize the creation of a Northeast Railroad Corporation to serve as the vehicle for: (1) preparing a service plan which identifies the rail lines which the Corporation proposes to operate and the method of operation proposed for each service; (2) negotiating agreements with bankrupt and other railroads for the acquisition of rail assets needed to provide service; (3) issuing and allocating stock to those railroads based upon the consideration they provide under those agreements; (4) negotiating agreements with railroad employees to be hired by the Corporation; (5) negotiating debt financing for the Corporation to provide working capital and capital for modernization and improvement of the

Corporation's system; and (6) providing for the operation of rail service on its own, by contract, or by creating and transferring its assets to one or more additional operating corporations. Provision also is made for the negotiation of agreements by the bankrupt railroads and representatives of their employees who are not to be hired by the new Corporation providing for fair and equitable arrangements for these employees.

To provide for organizational expenses incurred in carrying out the above steps it is proposed that a total of \$40 million in Federal funds be appropriated.

The service plan devised by the Corporation and the agreements it negotiates would be subject to review by the Secretary on the basis of their consistency with the Core rail service report issued by the Secretary. Agreements the Corporation negotiates with bankrupt railroads would also be subject to review by the courts on the basis of whether the agreements are in the best interests of the debtor railroads' estates. As previously noted, we believe that the selected assets of the bankrupt railroads, as a going-concern value, will exceed their uncertain value under

protracted and piecemeal liquidation and, thus, that it will be in the best interests of the bankrupt railroads to work out equitable agreements with the Corporation.

Prior to its becoming an operator of rail service, the affairs of the Corporation would be managed by a three-member Board of Incorporators appointed by the President with the advice and consent of the Senate. A 17-man Board of Advisors, made up of representatives of the various constituent groups, would provide policy guidance to the Board of Incorporators.

The bill would also establish a special procedure for the abandonment of rail service. First, it would permit bankrupt railroads to discontinue on 60 days' notice any service within a geographic zone for which rail service is not designated in the Secretary's Core rail service report. In most cases it would also permit bankrupt railroads which transfer assets to the Corporation to discontinue on similar notice any rail service not included in the service plan approved by the Secretary. During the first two years of providing service, the Corporation itself or any corporation it establishes to operate service would be permitted to

discontinue service on 60 days' notice following changed market or other conditions or a natural disaster if the Secretary finds that there is no reasonable prospect that the service can become self-sustaining with efficient and economical management. Track used for discontinued service would not be abandoned, however, until State and local governments, shippers, or other persons have been given an opportunity within 120 days after the cessation of services to purchase the track for railroad purposes or to contract for the continuation of service thereon on terms ensuring that no losses are incurred as a result of the continued provision of the service. State and local governments could also use the 120-day period to determine whether they should take action to acquire the rights-of-way for rapid transit, recreational, or other purposes in the event no offers are made to permit the continuation of rail service.

To encourage immediate efficiency and help generate extra cash during the critical early days, it is proposed that the new corporation or corporations be able to use the accumulated tax losses of the bankrupt railroads.

Third, it is necessary to establish procedures to ensure that the transition from today's over-built, financially troubled system to the streamlined system is reasonably smooth and that it treats investors, employees, competitors, and shippers as equitably as possible. This is obviously a complex task. Certainly our proposal, or for that matter, any other proposal, will not work without the cooperation of the various major interest groups. We envision the new corporation as the key vehicle and the Board of Incorporators, working with the Board of Advisors, as the catalyst to bring together these interest groups at the point where decisions can be made, negotiations conducted, and issues resolved in a timely manner.

A key immediate issue for the bankrupt carriers and their creditors is whether they should delay attempts to liquidate or continue to permit cash losses pending the takeover of rail service by the proposed new operating entity or entities. We believe that a realistic appraisal of the options will show that implementation of our plan will increase the present value of the bankrupt estates and that this will give these parties adequate reasons to delay requests

for immediate overall liquidation. (It should be recognized that some special short-term steps may be needed to provide Penn Central with adequate working capital to continue operations until the new entity or entities are ready to take over.)

Another key issue is the problem of financing start-up and consolidation costs and providing initial working capital for the entity or entities which will operate the restructured system. At this point we will simply note that our investigation convinced us that such financing can be obtained from the private capital market, provided the proper incentives exist.

Now I would like to turn to the other two bills we will submit to Congress shortly. As indicated in our report, it is clearly necessary to revise outmoded and overly restrictive regulatory procedures that are applicable to railroads. These out-of-date procedures must take much of the blame for the Northeastern mess. Our proposal to revise these regulatory procedures should help ensure the railroads in all sectors of the country, including the forthcoming streamlined system in the Northeast, avoid the experiences of the Northeast. Some of the proposals are the same or

similar to proposals the Administration submitted to the 92nd Congress. They include:

- A. Liberalizing abandonment procedures.
- B. Instituting greater flexibility in ratemaking and requiring all below-cost rates to be raised to the variable cost level.
- C. Eliminating the subsidization of government traffic at the expense of others.
- D. Modifying certain practices of the rate bureaus.
- E. Providing measures to facilitate rail merger decisions, the joint use of rail facilities, and intermodal ownership.
- F. Encouraging substitute transportation services to fill gaps created by liberalized rail abandonments.
- G. Eliminating discriminatory state and local taxation of rail assets.
- H. Eliminating delays in State approval of intrastate rates that coordinate with changes in interstate rates.

We will also propose a bill to amend Section 77 of the Bankruptcy Act to give courts adequate authority to act promptly and rationally to solve railroad bankruptcies.

Before deciding upon the proposals outlined above, we studied other approaches to solving the rail problem in the Northeast. The alternatives ranged from a hands-off approach to that of either partial or complete nationalization of the bankrupt railroads. Each was discarded because of serious drawbacks. In some cases, the alternatives simply were inadequate to the task in terms of time and substance. Others would have provided temporary relief, but failed to face up to the real problems and could have been grossly unfair to the Nation's taxpayers.

It is clear that to allow events to run their course under the current procedure prescribed by Section 77 of the Bankruptcy Act could well result in a major disruption of railroad operations, including those parts of the system which are essential to the economy of the region and the Nation.

Another alternative would be to strengthen the procedure under Section 77 of the Bankruptcy Act, vest

more powers in the reorganization courts, provide emergency Federal financial assistance to the trustees in bankruptcy, and look to an eventual solution through the enactment of broad regulatory reforms. A major difficulty with this approach is that it does not correct the multiplicity of services of the railroad system in the Northeast. While the approach might help delay the cessation of railroad operations, by continuing operations of the various bankrupt entities, it would also postpone finding a reasonable long-term solution to the problem.

Still another approach would be to provide for one of a number of schemes involving Federal acquisition or control. These include the establishment of a quasi-governmental corporation to operate the railroads; Federal acquisition of the rail rights-of-way; the assumption of direct control of the railroads for a limited period of time for the purpose of "reordering" operations; and outright Federal ownership and operation of the railroads. In varying degrees, all of these alternatives would impose upon the Nation's taxpayers the unfair financial burden of acquiring the necessary interests in the railroads and operating and maintaining

railroad services in the Northeast. Also, we doubt most seriously that Federal control would result in better management or lower costs than those which could be expected if the railroads were operated under private ownership unburdened by today's restraints.

Now I would like to turn to two other major bills currently before the Committee which deal with issues raised in our report.

S. 1031, the proposed Essential Rail Services Act, would have a government created corporation acquire the rail rights-of-way of bankrupt railroads in the Northeast and rehabilitate and maintain the roadbed through the use of Federal funds and user charges. Even though it provides for the DOT to designate an Interstate Rail System, it contemplates the preservation initially of nearly all of the existing track system as a burden to be assumed by the new corporation. Such an approach fails to allow for the changes that the economy of the region has undergone in the past few decades which have contributed so heavily to the downfall of the bankrupt railroads. Again, we believe

the system must be rationalized and restructured expeditiously. If this is done, we believe that private capital can supply the financing needed for the operation and improvement of a restructured system.

I would also like to discuss the bill proposed by the ICC. Let me say at the start that we welcome the ICC's suggestions and that we look upon them as partners in our efforts to solve this problem. I hope they likewise view us this way. We believe there is merit in many of the ICC proposals, especially those having to do with abandonments and the need to improve labor productivity.

On the other hand, the ICC Bill contains undesirable measures providing for Federal financial involvement. One calls for the leasing by the Government on a temporary basis of the lines of bankrupt railroads pending the restructuring of rail service of such railroads. We do not believe that this step is the proper way to address this problem. Also, once the leases are made, the incentive to restructure will diminish and there will be strong pressures to extend the leases on and on.

Another calls for a Federal assistance program for the improvement of rail plant. I have already expressed

our views in opposition to such a proposal which would tend to freeze the present system in place. We also oppose the proposal in the ICC Bill for Federal payments to states to help finance state programs to continue service on rail lines that otherwise would be abandoned. While we favor state programs of this nature--provided that they are financed at the state and local level on the basis of state and local decision-making--we believe that Federal financial involvement in such programs would only work to lock-in rail inefficiencies. Finally, we oppose the idea of a national public carrier waybill tax to finance the ICC's proposed restructuring in the Northeast. We believe the tax has serious inequities and, in any event, is unnecessary.

Now I would like to briefly comment on some of the criticisms that have been made about our proposal. Most of them can be broadly characterized by phrases that imply that we are "putting private profit ahead of public service," or that we haven't really "come to grips with the issue," or, more simply, as someone was quoted as saying, "no dough--no go."

I suspect that this last phrase--"no dough, no go"--neatly gets to the heart of the objections. Since we haven't proposed that the Nation's taxpayers lay out a billion or so to bail out the Northeast, we are accused of callously adopting a "public be damned" attitude. I submit that our approach is the opposite of "public be damned."

To assume that the only way to solve the Northeast problem is to appropriate massive amounts of Federal money is, to me, to adopt a "taxpayer be damned" attitude. We think there's a better way--and that's to use the maximum capabilities of the private sector. While public service safeguards are required, and can be provided, we cannot escape the fact that the private sector is the Nation's prime mover. But, of course, it must be permitted to move.

Some of the controversy about our proposal may have arisen because of the difficulty of sorting out the key issues in the rail problem--the impact on labor, the impact on communities, the willingness of the financial community to finance future rail operations, and the extent of Federal financial involvement. We have tried to say that no one really knows enough at this time to lay out specific programs

or dollar commitments. We have approached these uncertainties by outlining a procedure (1) for developing the needed information, (2) for moving forward on the streamlining process, and (3) for providing adequate reasons for the judges and trustees to defer action on overall liquidation. We think that these are the urgent and proper first steps.

Perhaps I can illustrate the value and need for moving cautiously by briefly citing some data on the labor situation.

Employment of the six bankrupts totalled 116,000 at the end of 1971. By the end of 1972 it had dropped to 108,000--a 7% decline in one year. It seems reasonable to expect such attrition to continue, thus pointing to a total of about 95,000 by late 1974, the earliest date at which significant streamlining in the system seems likely. Since the streamlining procedure would require some time to complete, attrition should further reduce the total (perhaps by 5,000-10,000) during the transition period. In addition, about 15,000 of the work force now exceed age 60--the railroad unions' newly bargained optional normal retirement age. With adequate additional incentive, most of these 15,000 could be expected to accept early retirement. Another group of railroad

employees are those in their 20's, with less than three years of service. Based on cut-back experiences in other railroads it seems likely that this group (which may approximate 15,000) could be terminated and provided with reasonable severance pay. A further possibility to handle displaced labor is an agreement that other railroads will give them "first-offer" rights before new hiring. Also, of course, extra labor will be needed in the early years to handle the catch-up maintenance and capital programs.

As indicated previously, it's not possible to spell out the details of the labor issue--or all the solutions, for that matter--until the streamlining procedure is well along. However, the possibilities outlined above--attrition, retirements, separation of young, short-service employees, offset by the need for maintenance workers--could handle 40% or so of the current work force. Whether this is too few or too many no one can tell. But it does suggest that, with careful handling, the labor issue is manageable. Some moves and some re-training will be needed, but that's common experience in industries undergoing periods of transition.

In another area, several critics of our plan have stressed that we haven't really addressed the Northeast Corridor passenger service problem. Their presumption appears to be that the Incorporators, in designing the streamlined system, will exclude this passenger service corridor from the new system. Our answer is that such speculations are inappropriate until the Incorporators develop their preliminary service plan. Perhaps some later Federal actions will be needed, but at this point it is clearly premature to attempt to lay out any specifics.

Finally, I'd like to observe that much of the criticisms and suggestions about our proposal really turn on the larger issue of what is the proper Federal role in a situation such as we now face in the Northeast.

We interpret that role as requiring us to do all we can, as stated in the Declaration of Purpose of the 1966 Department of Transportation Act "to facilitate the development and improvement of coordinated transportation service, to be provided by private enterprise to the maximum extent feasible."

Our analyses indicate that (1) there are healthy private enterprise railroads that serve the Northeast and

nearby regions, (2) there are healthy private sector truck carriers that serve the Northeast and compete with the rail carriers, (3) there is adequate freight business in the Northeast to support one or more new healthy railroads, and (4) that private enterprise financial institutions are providing growth capital for healthy rail and truck carriers.

Clearly then, we conclude, it can likewise be done for the rail system in the Northeast--provided we somehow come up with the proper procedures and incentives. This is what our plan tries to do.

And now either I or my associates will do what we can to answer your questions or to amplify upon the points that I have covered.