

TESTIMONY OF ELIZABETH HANFORD DOLE
SECRETARY OF TRANSPORTATION
BEFORE THE SUBCOMMITTEE ON COMMERCE, TRANSPORTATION, AND TOURISM,
HOUSE COMMITTEE ON ENERGY AND COMMERCE,
CONCERNING SALE OF CONRAIL
APRIL 18, 1985

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I APPRECIATE HAVING THE OPPORTUNITY TO APPEAR BEFORE THE COMMITTEE TO DISCUSS THE PLAN I HAVE SUBMITTED TO CONGRESS FOR TRANSFERRING CONRAIL TO THE PRIVATE SECTOR AFTER ALMOST A DECADE OF FEDERAL STEWARDSHIP. IN REACHING MY DECISION, I HAVE KEPT IN MIND THE SACRIFICES AND SECURITY OF CONRAIL'S EMPLOYEES, THE NEEDS OF ITS SHIPPERS AND THE INTEREST OF ITS MAJORITY STOCKHOLDER: THE AMERICAN TAXPAYER. WE HAVE LABORED LONG AND HARD TO REACH A RECOMMENDATION THAT WILL BEST SERVE NOT ONLY THE REGION, BUT THE NATION. I WILL ALSO ADDRESS RANKING MEMBER BROYHILL'S BILL, H.R. 1449, TO ACCOMPLISH THE TRANSFER PLAN.

I AM PARTICULARLY PLEASED THAT THE SUBCOMMITTEE WAS ABLE TO FINALLY SCHEDULE THIS HEARING. AS YOU KNOW, I HAVE BEEN ANXIOUS TO APPEAR BEFORE YOU, AND I WAS DISAPPOINTED WHEN IT WAS FIRST SCHEDULED FOR THE SAME TIME AND DAY AS HAD BEEN PREVIOUSLY ANNOUNCED BY THE SENATE COMMERCE COMMITTEE. MY DISAPPOINTMENT WAS COMPOUNDED AFTER MY STAFF REACHED TENTATIVE AGREEMENT WITH YOUR STAFF ON A HEARING DATE IN LATE MARCH, ONLY TO LEARN A FEW DAYS LATER THAT THE SUBJECT HAD BEEN CHANGED FROM CONRAIL TO AMTRAK. THUS, THE CHANCE TO APPEAR BEFORE YOU TODAY IS A MOST WELCOME ONE.

WE HAVE WEIGHED ALL FEASIBLE OPTIONS FOR CONRAIL'S FUTURE, INCLUDING THE OPTION OF NOT SELLING IT. WE RELIED ON THE

PROFESSIONAL ADVICE OF OUR INVESTMENT BANKER, GOLDMAN, SACHS AND COMPANY. WE CONSULTED WITH THE CONGRESSIONAL LEADERSHIP AND MANY MEMBERS OF CONGRESS, AND FEDERAL AGENCIES WITH EXPERTISE IN RELEVANT AREAS. WE TALKED WITH STATE AND LOCAL OFFICIALS FROM THE REGION, EMPLOYEE REPRESENTATIVES, SHIPPERS, CONRAIL MANAGEMENT, CONRAIL BOARD MEMBERS, AND OTHER INTERESTED PARTIES. FINALLY, AND MOST SIGNIFICANTLY, WE HAVE HONORED ALL THE DIRECTIVES OF THE STATUTE THAT GOVERNS THE SALE PROCESS, THE NORTHEAST RAIL SERVICE ACT OF 1981.

AS ADDRESSED IN NERSA, THIS PROCESS WILL ASSURE THE RETURN OF CONRAIL TO THE PRIVATE SECTOR AS A STRONG, VIABLE RAILROAD. GIVEN THAT CONRAIL IS PROFITABLE, THE STATUTE REQUIRES A SALE OF CONRAIL AS AN ENTITY THROUGH SALE OF ITS COMMON STOCK AND FURTHER REQUIRES US TO SUBMIT A SALE PLAN THAT --

- ENSURES CONTINUED RAIL SERVICE;
- PROMOTES COMPETITIVE BIDDING FOR CONRAIL'S STOCK; AND
- MAXIMIZES THE RETURN TO THE TAXPAYER FOR THE INVESTMENT THAT HAS BEEN MADE TO PRESERVE CONRAIL.

IN HONORING THESE CRITERIA, I AM RECOMMENDING A SALE PLAN THAT ENSURES LONG-TERM RAIL SERVICE TO THE REGION, TRUE EMPLOYMENT STABILITY FOR CONRAIL'S WORK FORCE, AND A VERY HIGH LEVEL OF CONFIDENCE THAT CONRAIL WILL NEVER AGAIN BECOME A WARD OF THE FEDERAL GOVERNMENT. WE CAN NOW GIVE CONRAIL THE OPPORTUNITY TO PROSPER AS A TRULY PRIVATE-SECTOR BUSINESS AND AS A KEY PART OF A STRONGER COMPANY.

LET ME BRIEFLY DESCRIBE WHY I AM RECOMMENDING NORFOLK SOUTHERN AS THE PURCHASER. CONRAIL MUST BE ABLE TO PROVIDE FIRST CLASS SERVICE OVER THE LONG TERM WITHOUT REGARD TO NATIONAL OR REGIONAL ECONOMIC CYCLES. ACCORDINGLY, WE ANALYZED WHICH PURCHASE OFFER WOULD PLACE THE RAILROAD IN THE STRONGEST CONDITION AFTER THE SALE. AMONG OTHER THINGS, WE ANALYZED THE FINANCIAL STRENGTH OF THE BIDDERS AND FINANCIAL PROJECTIONS FOR THE COMBINED ENTITY. NORFOLK SOUTHERN'S PROPOSAL IS TO PAY A MINIMUM OF \$1.2 BILLION IN CASH ENTIRELY OUT OF ITS OWN POCKET, A COMMITMENT NOT FOUND IN ANY OTHER PROPOSAL.

THE LONG-TERM STRENGTH OF THE COMPANY IS ESSENTIAL TO ITS SHIPPERS, THE COMMUNITIES IT SERVES, THE PEOPLE IT EMPLOYS AND THE TAXPAYERS WHO MUST NEVER AGAIN BE ASKED TO BAIL IT OUT. ANY MEASURE THAT WOULD WEAKEN CONRAIL FINANCIALLY THREATENS EACH OF THEM. THE SALE TO THE NORFOLK SOUTHERN WOULD LEAVE CONRAIL IN THE BEST POSSIBLE CONDITION.

IN ADDITION, WE WEIGHED EACH OFFER IN TERMS OF PROTECTING SERVICE TO SHIPPERS AND COMMUNITIES THROUGHOUT THE NORTHEAST. WE LOOKED AT REDUCTIONS OR ENHANCEMENTS OF SERVICE THAT MIGHT RESULT, INCLUDING EXISTING SERVICE COMMITMENTS BY CONRAIL. CONGRESS IS AWARE THAT THE JUSTICE DEPARTMENT ALSO CONDUCTED AN INDEPENDENT, EXTENSIVE ANALYSIS OF THE IMPACT ON COMPETITION OF THE PROPOSED SALE TO NORFOLK SOUTHERN, AND IT SET OUT A SERIES OF CONDITIONS TO MAINTAIN COMPETITION THAT MUST BE MET BEFORE A SALE CAN BE CLOSED.

UNDER THESE CONDITIONS, THE PURCHASE OF CONRAIL BY NORFOLK SOUTHERN WILL ENHANCE COMPETITION IN TWO IMPORTANT WAYS:

- o THE NORFOLK SOUTHERN HAS PLEDGED TO REOPEN MANY GATEWAYS AND REINSTITUTE JOINT ROUTES THAT ARE PRESENTLY UNAVAILABLE AS A RESULT OF CONRAIL'S ACTIONS; AND

- o THE DIVESTITURES, OPENING OF GATEWAYS AND GRANTING OF TRACKAGE RIGHTS NECESSARY TO SATISFY THE JUSTICE DEPARTMENT'S REQUIREMENTS WILL STRENGTHEN THE COMPETITIVE POSITION OF SMALLER RAILROADS IN THE REGIONS SERVED BY CONRAIL.

NORFOLK SOUTHERN HAS REACHED AGREEMENTS IN PRINCIPLE WITH GUILFORD TRANSPORTATION INDUSTRIES AND THE PITTSBURGH & LAKE ERIE RAILROAD ON DIVESTITURES TO THEM. NORFOLK SOUTHERN WOULD SELL, LEASE, OR PROVIDE TRACKAGE RIGHTS OVER SOME 1700 MILES OF THE COMBINED NORFOLK SOUTHERN-CONRAIL SYSTEM, OF WHICH 507 MILES WILL BE FROM CONRAIL. GUILFORD WILL PURCHASE AN INTERCONNECTED SYSTEM OF LINES LINKING ITS EXISTING RAILROAD AT BUFFALO WITH, AMONG OTHER POINTS, CLEVELAND, TOLEDO, FORT WAYNE, CHICAGO, AND EAST ST. LOUIS. THE P&LE WILL ACQUIRE LINES CONNECTING ITS OPERATIONS IN THE PITTSBURGH AREA WITH CLEVELAND, CANTON, AND TOLEDO AND, VIA THE GUILFORD PROPERTIES, TO GATEWAYS SERVED BY THAT SYSTEM. THE DEPARTMENT OF JUSTICE IS NOW REVIEWING THESE PROPOSED ARRANGEMENTS TO BE SURE THAT THEY PERMANENTLY RESOLVE THE COMPETITIVE ISSUES IT PREVIOUSLY IDENTIFIED.

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SOME HAVE QUESTIONED WHETHER GUILFORD AND P&LE WILL PROVIDE EFFECTIVE COMPETITION IN THE MARKETS WHERE THE DEPARTMENT OF JUSTICE IDENTIFIED COMPETITIVE ISSUES THAT MUST BE ADDRESSED. OF COURSE, THE JUSTICE DEPARTMENT HAS RESERVED JURISDICTION IN ORDER TO MAKE JUST THAT DETERMINATION. IN CONSIDERING THAT ISSUE YOURSELVES, ^{I would ask members to} REMEMBER THAT CSX IS ALSO IN VIRTUALLY ALL OF THE AFFECTED MARKETS PROVIDING VERY STRONG AND EFFECTIVE COMPETITION. I WOULD LIKE TO OFFER SOME THOUGHTS, HOWEVER, ABOUT THE ADVANTAGES OF THE PROPOSED DIVESTITURES.

THE DIVESTITURES TO GUILFORD ARE THE PRIMARY SOLUTION OFFERED TO THE ISSUES RAISED BY THE JUSTICE DEPARTMENT. FIRST, THE LINES THAT WOULD GO TO GUILFORD ARE GOOD LINES. THE LINE FROM BUFFALO TO CLEVELAND, THE ANCHOR OF THE GUILFORD SYSTEM, IS A 60 MILE PER HOUR, SIGNALLED LINE. FROM CRESTLINE JUNCTION OUT TO CHICAGO, THE LINE IS A 79 MILE PER HOUR LINE THAT AMTRAK USES. THE LINE TO ST. LOUIS IS A GOOD LINE WITH HEAVY-DUTY, TRUNK LINE RAIL THAT WILL NEED SOME CONVENTIONAL TIE AND SURFACING WORK, BUT THE LINES ARE UNIFORMLY CAPABLE OF OPERATION AT SPEEDS NECESSARY FOR COMPETITIVE FREIGHT OPERATIONS.

SECOND, THESE LINES, ALONG WITH THOSE DIVESTED TO THE P&LE, WILL INTERCONNECT WITH SINGLE^{LE}-LINE SERVICE ALL OF THE POINTS THAT MUST HAVE A NEW COMPETITOR IN THE MARKET.

THIRD, GUILFORD WILL RECEIVE AS MUCH COMPETITIVE ACCESS IN TERMS OF RECIPROCAL SHIPPING AS THE CARRIER IT REPLACES IN EACH MARKET.

FOURTH, GUILFORD WILL HAVE ACCESS TO MORE THAN HALF THE FREIGHT TRAFFIC IN THE COUNTRY THAT MOVES ~~EAST~~ FROM EAST TO WEST. IN ADDITION TO THE TRAFFIC ON ITS SYSTEM TODAY THAT IS NOW SEND UP INTO CANADA AT BUFFALO OR THROUGH VERMONT, GUILFORD WILL HAVE ACCESS TO THE TRAFFIC IN THE TWELVE NEW MARKETS IT ENTERS, THE TRAFFIC ALONG THE LINES CONNECTING THOSE MARKETS, AND THE TRAFFIC IT CAN RECEIVE AT INTERCONNECTIONS IN CHICAGO AND ST. LOUIS FROM THE BURLINGTON NORTHERN, THE CHICAGO & NORTHWESTERN, THE UNION PACIFIC SYSTEM, THE SOUTHERN PACIFIC, THE SANTA FE, THE KATY, THE ICG, THE MILWAUKEE, AND THE SOO.

GUILFORD HAS ALSO DEMONSTRATED THAT IT IS ABLY MANAGED. IN EIGHTEEN MONTHS, WITHOUT ANY FEDERAL ASSISTANCE OR SPECIAL LEGISLATION, GUILFORD TOOK THREE RAILROADS, TWO OF WHICH WERE IN BANKRUPTCY, AND BUILT A PROFITABLE SYSTEM. ~~THEY HAVE MADE THE~~ KIND OF TURNAROUND ~~CONRAIL HAS~~, BUT WITHOUT FEDERAL AID.

Guilford's management has accomplished for which Conrail's management is so justifiably proud

THE DIVESTITURES TO THE P&LE WILL STEM A GROWING COMPETITIVE PROBLEM. THE PITTSBURGH & LAKE ERIE IS NOW SURROUNDED BY CONRAIL AND DOES NOT HAVE A GOOD CHANCE FOR LONG-TERM SURVIVAL BECAUSE IT HAS FRIENDLY CONNECTIONS THYAT WOULD ENABLE IT TO REACH THE ULTIMATE DESTINATIONS FOR ITS SHIPPERS' GOODS. THE DIVESTITURES BREAK P&LE OUT OF ITS ISOLATION, GIVING IT ACCESS TO TOLEDO, CLEVELAND, AND STEUBENVILLE, AND IMPROVED ACCESS TO CANTON AND MASSILON, SO IT CAN SURVIVE IN THE LONG RUN. AMONG OTHER THINGS, P&LE'S SURVIVAL SUSTAINS 1,100 JOBS AND RAIL COMPETITION IN A LARGE AREA. THESE DIVESTITURES PROVIDE A RARE OPPORTUNITY THAT SHOULD NOT BE LOST TO RESHAPE THE RAILROAD SYSTEM FOR THE BETTER

IN THE NORTHEAST AND MIDWEST. IN COMBINATION WITH THE EXISTING GUILFORD AND P&LE PROPERTIES, THESE LINES HAVE ENORMOUS POTENTIAL, AND EFFECTIVELY PRODUCE A MIRROR IMAGE OF WHAT WAS ONCE THE NICKLE PLATE RAILROAD. THE NICKLE PLATE REACHED EASTERN MARKETS OVER FRIENDLY CONNECTIONS WITH A SET OF RAILROADS WHOSE ROUTES ARE NOW DUPLICATED BY GUILFORD IN THE EAST. THESE SAME LINES IN CONJUNCTION WITH EASTERN CONNECTIONS AT BUFFALO PRODUCED \$9 BILLION REVENUE TON MILES IN 1964, THE YEAR THEY WERE ACQUIRED BY NORFOLK AND WESTERN. AT TODAY'S RATES, THAT LEVEL OF ACTIVITY, MUCH OF WHICH CONTINUES TO BE AVAILABLE, WOULD HAVE PRODUCED \$360 MILLION IN REVENUES.

Mr. Chairman, *for Conrail*
I ^{have} CHOSEN THE OPTION ^{for Conrail} THAT, CONSISTENT WITH THE SERVICE-ORIENTED CRITERIA I MENTIONED A MOMENT AGO, OFFERED ^S THE MAXIMUM RETURN TO THE UNITED STATES, ^{TREASURY} IT WOULD DO NO GOOD, OF COURSE, TO RUN UP THE PRICE, ONLY TO LOSE IMPORTANT SERVICE OR RISK RE-INHERITING THE RAILROAD AT SOME FUTURE DATE. NEVERTHELESS, WE HAVE A CLEAR STATUTORY MANDATE UNDER THE NERSA TO MAXIMIZE THE RETURN TO THE TAXPAYERS, AND I BELIEVE WE HAVE DONE SO. THE NORFOLK SOUTHERN CORPORATION WILL PAY US A MINIMUM OF \$1.2 BILLION IN CASH AT CLOSING. THE ACTUAL DOLLAR AMOUNT WILL PROBABLY BE HIGHER, SINCE THE FINAL PURCHASE PRICE IS KEYED TO THE AMOUNT OF CASH CONRAIL HAS ON THE DAY OF CLOSING. NORFOLK SOUTHERN WILL ALSO SURRENDER CONRAIL'S ACCUMULATED TAX BENEFITS -- \$1.8 BILLION IN NET OPERATING LOSSES AND \$306 MILLION IN INVESTMENT TAX CREDITS.

I WOULD LIKE, MR. CHAIRMAN, TO ADDRESS THE FALLACIOUS CONTENTION THAT THE PRICE WE WOULD RECEIVE FROM NORFOLK SOUTHERN IS

INADEQUATE BECAUSE NORFOLK SOUTHERN WILL REALIZE SOME SORT OF TAX WINDFALL FROM THE TRANSACTION. THE SALE WE HAVE NEGOTIATED DOES NOT PROVIDE NORFOLK SOUTHERN WITH SPECIAL TAX TREATMENT. THE SALE IS INTENTIONALLY STRUCTURED AROUND NORMAL TAX TREATMENT. WE CONSULTED EXTENSIVELY WITH THE DEPARTMENT OF TREASURY WHILE NEGOTIATING THE TAX-RELATED ELEMENTS OF THE MEMORANDUM OF INTENT, AND TREASURY CONCURRED IN OUR RESOLUTION OF SUCH ISSUES.

THE SOLE EXCEPTION TO NORMAL TAX CONSEQUENCES IS THAT NORFOLK SOUTHERN WOULD SURRENDER CONRAIL'S NET OPERATING LOSSES AND INVESTMENT TAX CREDITS. THAT EXCEPTION, OF COURSE, OPERATES ENTIRELY IN THE GOVERNMENT'S FAVOR.

IF THE GOVERNMENT CANCELLED THE SALE AND KEPT CONRAIL, CONRAIL WOULD BE ABLE TO USE ALL OF ITS TAX BENEFITS, INCLUDING THE NET OPERATING LOSSES AND INVESTMENT TAX CREDITS, TO SHELTER ITS INCOME. THUS, THE TAX CONSEQUENCES OF KEEPING CONRAIL APPEAR WORSE THAN THE TAX CONSEQUENCES OF SELLING IT. IF CONRAIL WERE SOLD THROUGH A PUBLIC OFFERING, THE SAME TAX ISSUES WOULD NEED TO BE ADDRESSED.

THE ALTERNATIVE TO OUR APPROACH WOULD BE TO DEPRIVE CONRAIL, IN ONE WAY OR ANOTHER, OF NORMAL TAX TREATMENT AVAILABLE TO ALL OF ITS RAIL AND NON-RAIL COMPETITORS. THAT WOULD BE BOTH UNWISE AND UNFAIR. IT WOULD PLACE CONRAIL AT A SIGNIFICANT COMPETITIVE DISADVANTAGE, WEAKENING ITS CHANCES FOR LONG-TERM SURVIVAL. SHIPPERS WOULD ALSO INEVITABLY FACE HIGHER COSTS.

WE MIGHT HAVE RECEIVED A HIGHER CASH PRICE FOR OUR CONRAIL STOCK IF WE HAD BEEN WILLING TO FOREGO THE PROTECTIVE COVENANTS -- CONTROLLING STOCKHOLDERS ARE NOT GENERALLY ACCUSTOMED TO THE SORTS OF RESTRICTIONS WE HAVE NEGOTIATED WITH NORFOLK SOUTHERN--BUT I BELIEVE THEY ARE ESSENTIAL TO THE PUBLIC INTEREST. THE COVENANTS WILL PRESERVE QUALITY SERVICE, PROTECT CONRAIL'S SHIPPERS, AND ENSURE CONTINUED FINANCIAL STRENGTH. THE COVENANTS REQUIRE NORFOLK SOUTHERN TO OPERATE CONRAIL AS A SYSTEM MUCH AS IT IS TODAY.

NORFOLK SOUTHERN HAS AGREED TO INVEST HUNDREDS OF MILLIONS ANNUALLY IN CONRAIL'S PHYSICAL PLANT AND TO REFRAIN FROM DEFERRING MAINTENANCE AS MEASURED BY NORFOLK SOUTHERN'S OWN STANDARDS, WHICH ARE THE HIGHEST IN THE INDUSTRY. THE COVENANTS REQUIRE CONRAIL TO REFRAIN FROM PAYING DIVIDENDS ON THE COMMON STOCK UNLESS \$500 MILLION IN CASH WOULD REMAIN AFTERWARD. CONRAIL'S EXPEDITED ABANDONMENT AUTHORITY WILL BE RELINQUISHED, AND ANY LINES THAT ARE TO BE ABANDONED AFTER INTERSTATE COMMERCE COMMISSION PROCEEDINGS WILL BE OFFERED TO SHIPPERS OR SHORT LINE RAILROADS AT 75 PERCENT OF NET LIQUIDATION VALUE. ALL OF CONRAIL'S CURRENT MINORITY BUSINESS ENTERPRISE AND EQUAL EMPLOYMENT OPPORTUNITY PLANS WILL BE CONTINUED. CONRAIL WILL MAINTAIN ITS HEADQUARTERS IN PHILADELPHIA AND WILL CONTINUE TO OPERATE THE ALTOONA SHOPS. ALL OF THESE COVENANTS WILL ~~LAST~~ ^{remain in force} FOR FIVE YEARS AND ARE ENFORCEABLE BY FEDERAL COURT INJUNCTION.

THERE WERE OTHER APPROACHES SUGGESTED FOR CONRAIL'S FUTURE. I WOULD LIKE TO SPEAK FOR A MOMENT ABOUT RECOMMENDATIONS THAT THE

SALE BE DELAYED IN THE HOPE THAT WE MIGHT GET A SOMEWHAT HIGHER PURCHASE PRICE. BY CONRAIL'S OWN PROJECTIONS, THIS YEAR WILL BE THE BEST OF ITS NEXT FIVE YEARS. IN MY OPINION, AND THAT OF OUR INVESTMENT ADVISER AS WELL, A "BETTER" OPPORTUNITY WILL NOT ARRIVE.

NERSA DIRECTED, IN 1981, THAT THE SECRETARY OF TRANSPORTATION RETAIN ^{an} THE INVESTMENT ADVISOR AND DEVELOP A PLAN TO RETURN CONRAIL TO THE PRIVATE SECTOR. WE SOLICITED OFFERS IN GOOD FAITH, AND WERE REWARDED BY A WIDE RANGE OF CREDIBLE OFFERS BY SERIOUS BIDDERS. THE BIDDERS BELIEVED WE INTENDED TO SELL A RAILROAD. CONRAIL'S CONTRACT EMPLOYEES HAVE ALSO TREATED THE SALE PROCESS SERIOUSLY, DEALING CONSTRUCTIVELY WITH EACH OFFER PRESENTED AND MAKING THEIR OWN OFFER AS WELL. SINCE THE PASSAGE OF NERSA IN 1981, CONRAIL HAS BECOME PROFITABLE AT NO SMALL COST IN TIME AND EFFORT. STATE AND LOCAL TRANSIT AGENCIES TOOK OVER COMMUTER RAIL OPERATIONS UNDER NERSA'S DIRECTIVE, CONRAIL'S EMPLOYEES MADE SIGNIFICANT WAGE CONCESSIONS, AND THE STATES IN THE REGION HAVE SACRIFICED TAX REVENUES FROM CONRAIL TOTALING MORE THAN \$25 MILLION ANNUALLY. NOW THAT CONRAIL IS A PROFITABLE RAILROAD, IT SHOULD NO LONGER BE PERMITTED TO COMPETE WITH OTHER CARRIERS IN THE PRIVATE SECTOR WHILE CONTINUING TO BE A WARD OF THE GOVERNMENT ENJOYING SPECIAL BENEFITS.

A PUBLIC OFFERING OF CONRAIL STOCK ALSO HAS BEEN SUGGESTED. AT MY REQUEST, GOLDMAN SACHS CONSIDERED A PUBLIC OFFERING EARLY IN OUR DELIBERATIONS. GOLDMAN SACHS ADVISED ME THAT THERE WERE PRACTICAL DIFFICULTIES AND SUBSTANTIAL RISKS. THUS, I USED THE COMPETITIVE

BID APPROACH, AND I CONDUCTED EXTENSIVE NEGOTIATIONS SIMULTANEOUSLY WITH SIX BIDDERS AND THEN THREE FINALISTS.

IN JANUARY, SOME MEMBERS OF CONRAIL MANAGEMENT SUBMITTED AN OFFER BASED ON A PUBLIC OFFERING. AGAIN, I ASKED GOLDMAN SACHS TO REVIEW IT. MEASURED AGAINST THE CRITERIA I HAD ESTABLISHED, GOLDMAN SACHS ADVISED ME THAT CONRAIL MANAGEMENT'S PROPOSAL IS LESS ADVANTAGEOUS THAN THE NORFOLK SOUTHERN BID IN A NUMBER OF RESPECTS.

FIRST, THE MANAGEMENT PLAN ^{would take} ~~TAKES~~ A MINIMUM OF \$300 MILLION IN CASH OUT OF THE COMPANY, REGARDLESS OF ITS CASH POSITION.

SECOND, THE MANAGEMENT PLAN ^{would} ~~FORCES~~ THE COMPANY TO ISSUE \$600 MILLION IN PREFERRED STOCK. IN FACT, THIS WOULD BE THE LARGEST PREFERRED STOCK ISSUE IN AMERICAN HISTORY. IN CONTRAST, NORFOLK SOUTHERN'S PROPOSAL DOES NOT INVOLVE ANY PREFERRED STOCK.

THIRD, THE MANAGEMENT PLAN ^{would} ~~CLEARLY VIOLATES~~ THE DIVIDEND COVENANT THAT NORFOLK SOUTHERN HAS ACCEPTED. BASED UPON CONRAIL MANAGEMENT'S OWN PROJECTIONS FOR THE 1985-88 PERIOD, THE DIVIDEND COVENANT WOULD ALLOW A TOTAL OF ONLY \$60 MILLION IN DIVIDENDS ON COMMON STOCK. THE MANAGEMENT PLAN REQUIRES COMBINED COMMON AND PREFERRED DIVIDENDS OF \$126 MILLION PER YEAR AND, ACCORDING TO GOLDMAN SACHS, IT WOULD REQUIRE INCREASED BORROWING BY CONRAIL OVER THE NEXT FOUR YEARS OF \$422 MILLION. THE RECENT U.S. RAILWAY ASSOCIATION STAFF STUDY, BASED ON SLIGHTLY DIFFERENT ASSUMPTIONS,

LEADS TO THE CONCLUSION THAT CONRAIL WOULD NEED TO BORROW AT LEAST \$260 MILLION OVER THAT PERIOD TO MEET ITS DIVIDEND OBLIGATIONS.

FOURTH, THERE IS NO INDICATION OF A FIRM COMMITMENT BY MORGAN STANLEY & CO. OR ANYONE ELSE TO UNDERWRITE THE MANAGEMENT PLAN. I HAVE ONLY BEEN GIVEN ESTIMATES, OPINIONS, AND PREDICTIONS. IF THE MARKET IS UNABLE TO ABSORB \$500 MILLION IN COMMON STOCK AND \$600 MILLION IN PREFERRED STOCK IN ONE OFFERING, THEN EITHER THE GOVERNMENT OR CONRAIL WILL ABSORB THE SHORTFALL.

FIFTH, DESPITE OPTIMISTIC ESTIMATES MADE BY SOME THAT WE CAN GET MUCH MORE FOR CONRAIL THROUGH A PUBLIC OFFERING, THE MANAGEMENT PLAN ONLY PROPOSES TO RAISE \$1.1 BILLION AT BEST. AGAIN, THE BALANCE IS TO BE PAID OUT OF CONRAIL'S CASH RESERVES.

IN CONSIDERING THE MARKET VALUE OF CONRAIL STOCK, WE MUST REMEMBER THAT CONRAIL HAS A SHORT HISTORY OF PROFITABILITY. ALTHOUGH CONRAIL REPORTED ABOUT \$500 MILLION IN EARNINGS LAST YEAR, MUCH OF THAT AMOUNT IS ATTRIBUTABLE TO SPECIAL CONTRIBUTIONS OR BENEFITS CONFERRED BY THE FEDERAL GOVERNMENT, CONRAIL'S EMPLOYEES, OR THE STATES DURING THE TIME CONRAIL HAS BEEN FEDERALLY OWNED. CONRAIL WOULD NOT EARN NEARLY AS MUCH IN PRIVATE HANDS, BECAUSE NONE OF THOSE CONTRIBUTIONS OR BENEFITS WILL BE AVAILABLE. CONRAIL PAYS NO STATE TAXES. THE STATES THEREFORE ARE MAKING, IN EFFECT, A \$25-26 MILLION ANNUAL CONTRIBUTION TO CONRAIL'S PROFITS. CONRAIL PAYS NO LABOR PROTECTION. THE UNITED STATES GOVERNMENT MAKES THAT CONTRIBUTION TO CONRAIL PROFITS, RANGING FROM \$125 MILLION TO \$23 MILLION OVER THE LAST THREE YEARS. UNTIL LAST FEBRUARY, CONRAIL

PAID ITS WORKERS BETWEEN \$120 AND \$130 MILLION LESS THAN THEY WOULD EARN IF CONRAIL HAD BEEN AT NATIONAL SCALE; AND THOSE SAVINGS HAVE GONE RIGHT INTO THE COMPANY'S PROFITS. CONRAIL HAS BEEN PAYING NO FEDERAL TAXES, AND THAT SAVING GOES TOWARD PROFITS, TOO. CLEARLY, CONRAIL WILL BE FAR LESS PROFITABLE IN PRIVATE HANDS THAN MIGHT APPEAR AT FIRST GLANCE.

IT IS OBVIOUS THAT THE COMBINATION OF CONRAIL AND NORFOLK SOUTHERN IS STRONGER THAN CONRAIL STANDING ALONE. CONRAIL ALONE CANNOT SHOULDER A MAJOR ACQUISITION DEBT OR THE LARGE DIVIDEND PAYOUTS PROPOSED FOR PREFERRED AND COMMON STOCKS.

THIS WAS DRIVEN HOME DRAMATICALLY BY USRA'S REPORT ENTITLED OUTLOOK FOR CONRAIL DATED APRIL 1, 1985. IF YOU CAREFULLY EXAMINE THE CHART ON PAGE 43 OF THE REPORT, YOU WILL SEE THAT CONRAIL IS PROJECTED TO HAVE A TOTAL NET CASH FLOW FROM 1986 THROUGH 1988 OF ONLY \$118 MILLION, OR ABOUT \$40 MILLION PER YEAR. TO PUT THAT IN PERSPECTIVE, THE CONRAIL MANAGEMENT PLAN REQUIRES THE COMPANY TO PAY \$126 MILLION IN DIVIDENDS EVERY YEAR -- A BURDEN THAT WOULD EXCEED THREE TIMES CONRAIL'S AVERAGE ANNUAL NET CASH FLOW DURING THOSE YEARS. MOREOVER, \$100 MILLION OF THAT \$118 MILLION COMES FROM THE SALE OF CONRAIL PROPERTY AND THE REST COMES FROM INTEREST ON CONRAIL'S CASH.

WHAT THE REPORT TELLS US IS THAT, WHILE CONRAIL CAN STAND ALONE IN THE SHORT RUN, IT CAN STAND ALONE ONLY marginally WITH LITTLE OR NO NET CASH FLOW, AND ONLY SO LONG AS IT DOES NOT HAVE TO PAY DIVIDENDS. THAT IS PRECISELY THE CONCERN THAT LED ME TO THE SALE

TO NORFOLK SOUTHERN AS THE BEST WAY TO PRESERVE CONRAIL'S EMPLOYMENT AND SERVICE IN THE LONG RUN. AS STANLEY CRANE TESTIFIED BEFORE THE SENATE APPROPRIATIONS COMMITTEE, CONRAIL LOST MONEY IN JANUARY AND MADE ONLY \$10 MILLION IN FEBRUARY, FAR BELOW ITS BUDGETED REVENUES. WHILE CONRAIL'S ECONOMIC PERFORMANCE HAS IMPROVED SUBSTANTIALLY IN RECENT YEARS, IT IS STILL A FRAGILE COMPANY.

I HAVE MADE WHAT I TRULY BELIEVE IS THE BEST RECOMMENDATION FOR A STRONG CONRAIL IN THE FUTURE. CONGRESS NOW HAS THE IMPORTANT ROLE TO PLAY. THE CONGRESS MUST WEIGH THE RECOMMENDED OFFER AND MAKE THE ULTIMATE JUDGMENT AS TO WHETHER IT SHOULD BE ACCEPTED. I HAVE TRANSMITTED A LEGISLATIVE PROPOSAL TO THE HOUSE AND THE SENATE THAT WOULD MAKE THE TECHNICAL CHANGES NEEDED TO CONCLUDE THE SALE. H. R. 1449 WILL AUTHORIZE AND DIRECT THE SALE, REQUIRE THAT CONRAIL BE TREATED LIKE ANY OTHER PRIVATE-SECTOR RAILROAD AND ASSURE THAT THE GOVERNMENT'S INVESTMENT AND ROLE IN CONRAIL WILL BE TERMINATED.

IN CONCLUSION, I URGE YOU TO ACT SWIFTLY TO EVALUATE THE PLAN AND TO REPORT THE LEGISLATION NEEDED TO CONSUMMATE A SALE. I HAVE MADE THE UTMOST EFFORT TO FIND THE BEST POSSIBLE BUYER FOR THIS RAILROAD. IF WE UNDULY HESITATE, THIS HISTORIC OPPORTUNITY MAY BE LOST.

MR. CHAIRMAN, THIS COMPLETES MY PREPARED STATEMENT. I WOULD BE PLEASED TO RESPOND TO QUESTIONS YOU MIGHT HAVE.