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TRANSCRIPT OF REMARKS DELIVERED BY
SECRETARY OF TRANSPORTATION ELIZABETH HANFORD DOLE
TO THE COALITION OF AMERICANS FOR PRIVATIZATION
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WASHINGTON, D.C.

I am delighted to welcome members of the Coalition of Americans for Privatization to the White House. We are delighted to have you with us this morning. We appreciate your support of the first effort at privatization -- the first major effort -- which is, of course, the sale of Conrail -- returning Conrail to the private sector. This is the flagship, this is the beginning of what we hope will be many initiatives in the area of privatization in 1986 and the years beyond. And we appreciate very much your being here and your support. Many of you, of course, I've talked with for the months and months that we have been involved in the sale of Conrail, the negotiations with buyers and all the rest. And we've had an opportunity to visit along the way. And, again, I appreciate your attention and your thoughts as we have discussed this over the many months.

Now, there's another aspect in looking at the broad picture here that I think is very important, and that is, of course, the deficit reduction potential of this particular sale because here you have on the day of closing $1.2 billion cash-on-the-barrel-head that goes to the Treasury, which is the equivalent of almost 10 percent of what Gramm-Rudman would require for fiscal year 1986.

Now, I would like to discuss with you for a little while about the sale process and the reasons for the selection of Norfolk Southern and some of the questions that have come up over the time that this has been under discussion. I believe at this point there have been literally 15 hearings where the sale of Conrail has been addressed in the House and the Senate. Of course, it is crucial now that we be sure that all relevant points are before the Senate because there will be a vote at 1:00 p.m., as you know. This is the cloture vote on the motion to proceed. So the time is now to make certain that questions are answered and the Senate is ready. And, of course, there will be procedural votes to follow and we'll have discussions on the merits in great detail.

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Now, NRSA, the Northeast Rail Service Act of 1981, directed the Secretary of Transportation to develop a plan to return Conrail to the private sector. When I became Secretary in February of 1983, Goldman Sachs had already been retained as the investment advisor and I asked Goldman at that point to go out and aggressively market this railroad. That was done over a two-time period -- the spring of 1983 and again in the fall of 1983. They visited with the Federal Railroad Administrator, 110 corporations both rail and non-rail, and aggressively marketed this railroad. That spawned 15 bids for Conrail, which I was delighted to see. When we started out I really didn't know what would happen. I didn't know how many bids we would have. We ended up with 15. And then the process began of narrowing them down with six and then with ultimately the three finalists. And at each stage there were extensive consultations.

When we got to the stage of three -- the negotiations with each of the three finalists -- we negotiated very hard to get the price up 20 percent, which we achieved, and also to build in very tough covenants that protect the financial strength of this railroad -- because the number one criterion for the sale of Conrail is financial strength. We want to make certain that this railroad never again comes back to the federal trough. This is it. So we need financial strength to make certain that it is a strong, viable system on down the road as far as the eye can see. That's the number one criteria.

The second is to preserve the shipping patterns and then, in light of those who's criteria is being fulfilled, to maximize the return to the taxpayers who have invested billions of dollars in this railroad.

But the first criterion is not how much money you get. The first criterion is the strength of the railroad. Based on that, we did get the price up, also an agreement to excess cash at the day of closing and these tough covenants which indeed are consideration to the government. I could have gotten more money for it if we had not required the covenants. For example, that $500 million must be in the till. If you're going to issue dividends, $500 million must be in the till after you issue those dividends. No more than 40 percent of your net earnings can go to dividends. Millions of dollars every year must go into capital. No differred maintenance. No preferred stock because we don't want that deadload on the company. And a number of other things that are built into this contract which -- for a five-year period Norfolk Southern has agreed to -- insure in this transition period the strength of the railroad.

Obviously, when I got to that point I knew that Norfolk Southern was definitely going to be one of the finalists, I wanted to look at the anti-trust aspects of this in terms of whether there are some points where there might be competitive issues that have to be resolved. This particular stock sale again was exempt under NRSA, the Northeast Rail Service Act. It was exempt from Interstate Commerce Commission (ICC) review. I did not have to send this to the Justice Department, but I chose to do so because I wanted to get everything out there, I wanted to make absolutely certain that if I chose the Norfolk Southern there would not be anti-competitive problems. Justice took five months, very independent review, they looked at it thoroughly, there was never a discussion of the merits --not one word on the merits with the Justice Department and the Transportation Department and arms length all the way -- and ultimately they said, yes, there are some points where there will be an anti-competitive impact. They can be cured by this plan and this plan will have to be carried out, a plan of divestitures, trackage rights, switching agreements, things of that sort.

Now, since that time, they once again looked at the plan and how it's being fulfilled and they've required some alterations to it. They took another several months to look very hard at that. They used the toughest standard that's ever been used in a rail merger -- tougher than down at the ICC, where the Justice Department often intervenes and doesn't prevail. This time they had the final say. So Justice was very tough on this -- very tough nosed about this. And they have signed off on this merger.

What they're doing at this point is a mechanical review to be sure, for example, that the tracks are where they say they are. They're literally dotting the "I"s and crossing the "T"s at this stage of things.

But Doug Ginsburg's testimony is the key, where he said in no way should the Senate wait for this mechanical exercise. Justice has signed off. Not only have they said that there are no anti-competitive points, but it is pro-competitive.

Let me talk for a minute about just exactly why I chose the Norfolk Southern once I had the report back from the Justice Department.

First of all, Conrail's picture looking out to the future: marginal profitability; marginal profitability into the 1990's. They have a very short profitability history now. And two of those years of profitability would not have shown profit had they not had special advantages. They pay no state taxes. They still don't in the 15 states through which Conrail runs. They pay no state taxes, they have labor protection paid by the government -- we paid a sizeable $125 million one year. They've asked for $23 million for this past year. They had wage concessions until very recently. So with these special benefits, Conrail is now profitable, but our figures show marginal profitability. Some say that in another recession, Conrail would not be able to stand -- the Northeast would not be able to support three systems and Conrail would be the one to go down.

This is their tonnage picture. Declining tonnage for 20 years at 3.6 percent a year. Last year, in the first 11 months, it was 5.2 percent. There's no projection at all that this is going to turn around. So when you see this kind of declining tonnage you know that what they're doing is shrinking their way to prosperity. And you can only do that for so long. Last year's figures show that they actually liquidated property, $77 million worth. They laid off 2400 employees, well, it was 3200 for the two-year

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period. And they project 5400 over the next five years. They have posted another hundred lines for abandonment for the ICC.

Look at their cash flow last year. It's very interesting. Negative cash flow -- negative -- for 11 months -- $14.5 million negative. Then, in the month of December, suddenly, positive cash flow. Low and behold, $78 million of positive cash flow in the month of December, which is usually the weakest month for Conrail. That's 60 times the normal monthly variance. So I suggest to you that either December bills were not paid or inventory was not purchased -- something happened there. And we've not been told. We've not been given anything behind those numbers to explain that. But that's what is happening. They are shrinking their way to prosperity. The Morgan Stanley deal, because it has to provide dividends attractive enough to attract investors, would continue this process of shrinking in order to pay off those dividends. They would take $270 million out of the company to pay the government with the potential of taking out as much as $375 million. If any player in the 42 investors with 10 percent backs out, there's no commitment to going forward with the deal. And we are to sign with each of those people individually -- each of those investors.

Now, that's on the one hand -- a shrinking picture. On the other hand, you have the Norfolk Southern. And this is why I chose Norfolk Southern, a company with the highest operating maintenance standards in the business. Excellent management. This company has a commitment to running a railroad, not to flipping stock. The Morgan Stanley deal even requires rescinding the 50-year old statute against insider information because they want to be able to sell the stock in six months. Here with Norfolk Southern you have a commitment to running a railroad. They're going to diversify the traffic. Conrail carries very recession-sensitive traffic. Conrail is subject to truck diversion with its short hauls. Conrail doesn't have any coal reserves to speak of. The Norfolk Southern is going to bring $180 million of additional volume onto the lines every year, diversify the traffic, fold Conrail into its family, so that you'll have synergies -- they'll be able to borrow at a lower rate -- things of that sort. Much strength pumped into Conrail because of the financial strength of this excellent company as opposed over here to a shrinking way to prosperity which ultimately has to impact on the employees and on the lines because that syndrome starts and the first thing you know you're downgrading lines, you're abandoning lines, you're laying off employees and the senior vice president of Conrail has said to the press that they're going to cut it back to a core system of 8-or 9,000 miles. Now that means cutting a third of Conrail from where it is today.

So, on the one hand you've got the strength. On the other hand, you have this situation of shrinkage. And I think that says a great deal of it right there.

Let me just talk for a moment about how this pro-competitive aspect works because you're going to have with the merger of the Norfolk Southern and Conrail, you're going to have a north-south single haul line, which will

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mean that goods can be sent up from the south without interchanging out here at the Potomac yards, which can often be a day or two. They'll go straight up north, single line, single haul, and you have of course lower rates and faster delivery of goods because you don't have this time spent out here in changing railroads. From east to west, because of the divestitures that will be required and the trackage rights that will be given under the plan, you're going to strengthen two regional railroads. This is very good transportation policy because you're going to strengthen the Pittsburgh & Lake Erie (P&LE) and the Guilford Systems, and you're going to have for the first time in two decades since the merger of the New York Central and the Pennsylvania Railroads, an east-west line that competes. You'll have two now running from New England all the way out to Chicago and St. Louis. First time in two decades. Now, for western shippers, obviously that's very good. And I'm not sure why we have not articulated that as well as we should in terms of how this impacts on shippers out west. Many, many, many shippers see the positive aspects of this. I think that there are some out in the midwest who still need to understand the impact of this -- that there are going to be two lines competing, long hauls, single hauls, that means lower rates; it means faster delivery of goods. There will also be three cities -- that's Toledo, Cleveland and Ft. Wayne -- where there will be an additional railroad that they don't have now, another railroad competing. So that's good. You're going to have trackage rights, switching agreements that are lower in certain cities -- not lower just for one railroad, but for all the railroads that use those cities, like Indianapolis. So there are a number of pro-competitive aspects to this. Strengthening the regional railroads, long hauls, lower switching rights, things of that sort. So you not only cured any competitive problems with a very tough nosed Justice review, but you also have a pro-competitive picture at this point.

Is it good for employees? You bet it is. Let me tell you about that. And I think that once we get a strong vote out of the Senate this is going to be the time that labor will sit down and negotiate a deal with the Norfolk Southern. The reason by the way: the United Transportation Union's (UTU) Fred Hardin has worked with us and we've discussed this all along the way. That's the biggest union among the rail unions and the Railway Labor Executives' Association (RLEA). Now, what is the impact for labor? Well, you started out on the railroad with 87,000 jobs back in 1976. Today, there are 38,000 jobs. Now, put the impact of this merger in that framework. It's 1200 jobs net. A net of 1200 jobs will be impacted by attrition. Norfolk Southern has said by attrition. What this means is that ultimately in case there is a person who loses a job somewhere, rather than by attrition, six-years full salary will be paid to anyone who loses the job who's actually laid off. But they plan to do it by attrition. There's another 1,000 jobs that will be impacted very positively because if Conrail stands alone, if this merger doesn't go through, 1000 people in Pittsburgh are going to lose their jobs. The P&LE has been starved out by Conrail. That's Conrail's philosophy -- to starve out the competition, to shut down the gateways, cut them off from the good markets and the long hauls -- and that's what they've done with the P&LE, and those jobs will be lost. It will not make it if it doesn't get the opportunity to go all the way to Ft.

Wayne, to reach markets, other steel markets of its clients. It has the opportunity through this merger to really move out with the windows of opportunity. And the Guilford, of course, with the long haul lines all the way from New England to Ft. Wayne and to Chicago. So, you have a situation that has a very, very important impact on the employees. And I can't imagine anything as important to employees as a strong, healthy, viable railroad system where there's not going to be downgrading, where there's not going to be abandonment of lines and people laid off because you have to shrink your way. They're going to be expanding. They're going to be healthy.

You hear about tax benefits. Now let's talk about that a minute. On the revenues, tax revenues, I look at it this way. The deductions are the same. There are no special deals. No special deals at all. Tax laws apply just the same for both and there are no special considerations. It's just normal tax laws. It's just when are they going to use their deductions? Who uses them first? O.K., on the one hand you have a tax paying, healthy, viable company -- Norfolk Southern-Conrail. That company will be utilizing the tax incentives that the Congress provided for the reasons that the Congress provided. They will be investing, keeping the system strong, keeping it healthy by putting money into capital and all the rest, and by not deferring their maintenance. That's going to mean they may receive some tax advantages like the Investment Tax Credits (ITCs) and Net Operating Loss Carry Forwards (NOL's), that kind of deduction for depreciation, rather, and utilize them earlier than would the stand-alone Conrail or in a Morgan Stanley deal. So what's wrong with that? That's the purpose of the law. And, ultimately, let me tell you, for a little more in money I'll take the financial strength any day for nominal value. We are going to get with the Norfolk Southern not only $1.2 billion, we're going to get the surrender of $2.1 billion worth of value to the Treasury in investment tax credits and net operating losses that they will surrender. We're going to get extra cash. And we are going to get covenants that really tie them down and make them sacrifice in a way that does mean consideration to the government because it does mean that we're never going to get that railroad back. We'll never have to think about it in the future coming back to the federal trough. So we're going to get the fair market value. This is what the market place produced in a competitive bid process. That's the test of what a company is worth. It's what the market produces. I think that Mr. Robert Platt of Conrail and others, Berger of the U.S. Railway Association (USRA), have said that's the test. And it produced the $1.2 billion. But in trying to say, well, maybe there's going to be some revenue to impact here to mean that you lose something, well, O.K. For nominal value, like I say, I'll any day take the strength over some nominal value because that's what we are looking for overall is the strength of this railroad.

Why should the federal government be running a freight railroad, and especially a profitable freight railroad that's competing with other railroads with special benefits? We pay their labor protection. You know they don't pay state taxes and yet they're out there competing against other railroads. So I think certainly the time is now.

My bottom line is I was asked to do this. I didn't cook this up. The Congress said do it. The Secretary of Transportation was mandated to develop a plan to return Conrail to the private sector. I happen to think it's an excellent idea. The merits are absolutely with us. But my job is to determine what is in the public interest. That means employees, that means what is in the interest of the shippers, and that means what is in the interest of the taxpayers and their investment so that we don't get it back again. I don't think there's any confusion whatsoever about what's in the public interest. On the one hand, you have the shrinkage and you have the pulling back and cutting down and paring and talking about going to a system of 8- and 9,000 miles and liquidating property every year, laying off employees, projecting 4500 more, and you're talking about posting for abandonments, and on the other hand you have a company that just can't wait to put money into it, to put additional volume on its lines and diversify its traffic and turnaround all this decline that we have here.

Let me just read to you what Mr. Hays Watkins, the Chief Executive Officer of CSX wrote to me earlier on -- in fact, he wrote me three letters. And he said, "The largest eastern railroad, of course, is CSX." And he stated in his letter, "Rail traffic in the Conrail service area will not grow and is likely to continue its decline over any foreseeable period. The business cycle will produce a recession at some point and the market will only support two carriers. Because of Conrail's particular vulnerability to truck diversion, its lack of significant coal reserves and the lack of a strong parent, an independent Conrail will be the carrier to fail."

Now, Hays has a little different picture of things today because he is a prime mover in the Morgan Stanley deal. This is a Hertz -- Avis situation. They don't want to go from number one to number two. They don't want the competition. Well, that's what we want. We want competition.

And by the way, talk about a big system, there are now three railroads. In the west there are over 20,000 route miles and there is one in the east, and that's CSX. After this merger, there will be three in the west that are over 20,000 route miles and there will be two in the east. There will be CSX and there will be Norfolk Southern-Conrail. As you can see, there is going to be a better competitor for CSX in the east. So I think that we can talk about this issue of big railroads very effectively with just that one little example -- about how many you're going to have that are 20,000 route miles and over after this merger.

These are the points that I want to cover and I think that we do have to take a break for just a moment to let the press set up here, but again I come back to the flagship for privatization, which is crucial. We can sit around in the Councils for business and industry and government and talk privatization -- it sounds wonderful -- but this is the test, folks. This is it. Now, if we don't do it, stop talking about it. I mean, this is it. Now is the time to make it happen and to start the momentum for all these other initiatives.

I want to transfer National and Dulles Airports. I want to get this done so that I can go ahead and complete that on down the road. Maybe I can get this group to help me a little bit there, too.

But again, thank you so very much for being here and I can see the Press is coming in, so I'll give them a chance to set up and the President will join us in just a few minutes.

Thank you.

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