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Secretary of Transportation Claude S. Brinegar today recommended to Congress the establishment in the Northeast of a streamlined rail system to supplant that now operated by six bankrupt companies.

The plan submitted by the Secretary recommended that one or more new "for-profit" corporations be established to provide continuity of needed rail service in the Northeast. These systems could be operated by one or more new companies or by existing non-bankrupt railroads.

The preliminary report responds to Congress' request of February 9 for a plan to preserve essential rail transportation services in the Northeastern United States where six railroad companies are in reorganization, some of which may soon be in liquidation if some action is not taken.

The bankrupt companies are the Penn Central, Erie Lackawanna, Boston & Maine, Central of New Jersey, Lehigh Valley and the Reading.

In presenting the report to Congress, Secretary Brinegar recommended against the alternatives of nationalization or massive Federal assistance and stated, "Quite clearly there is a healthy rail system trying to crawl out of the Northeastern wreck. All of us working together can help it escape."

The report says: 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 have made it abundantly clear that nationalization only

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means increasing subsidies and declining resource efficiency--something our Nation can ill afford. Nor do we believe that partial or piecemeal nationalization, such as buying only the roadbeds of the bankrupt or ill carriers, is proper. It's awfully hard for the Federal Government to become a "limited partner" in a private enterprise operation. Likewise, such piecemeal nationalization would weaken--and perhaps destroy--the vigor of the private enterprise companies that would be forced to compete with this Federally-backed operation.

There is, the report states, adequate present and future freight business in the Northeast to profitably support one or more new rail carriers to be formed from the assets of the six bankrupts. As an alternative, the Department suggested that, subject to further analysis of competitive balances, the systems might all become part of on-going rail companies.

The Department's plan calls for Secretary of Transportation to designate a "Core Rail Service" for the Northeast based on the concept of long-term economic efficiency in the use of transportation resources.

Under the plan, the Department would request legislation to authorize a new, for-profit corporation. The incorporators would be appointed by the President.

The corporation would design one or more rail systems in the Northeast based on the "Core Rail Systems" designated by the Secretary, and then, would proceed to design in specific details one or more rail system in the Northeast based on the Secretary's Core selections. In designing the system the Board would apply two criteria: economic viability of each element of the system (or systems), and preservation of rail service competition in high density markets.

Following the Secretary's approval, the corporation would acquire from the bankrupts, through negotiations, the facilities and equipment needed to operate the new system or systems. In return, the bankrupts would receive the stock in the new corporation.

"Because the 'going-concern' value of the Core assets will exceed their uncertain value under protracted, piece-meal liquidation," the report states, "we believe that the trustees should find it in their best interests to work out equitable agreements with the Board within the specific time limits."

The Department recommends services of the bankrupts not included in the corporation's final proposal could be terminated within a specified time and the rights-of-way abandoned without Interstate Commerce Commission's approval.

The actions of the Board of Incorporators and the approval of those actions by the Secretary would not be reviewable in any court, the Department recommends.

The stock of the new corporation would be placed in escrow until it could be allocated equitably to the estates of the bankrupt railroads, the report recommends.

Startup financing for the new operating entities, the Department believes, can be obtained in the private capital market, precluding the need for Federal financial assistance. But, the Department does recommend a period of special tax allowances and short-term suspensions of certain ICC regulations. Such action, the report states, "would help generate extra cash and would provide an incentive for immediate efficiency."

The six bankrupt railroads in 1971 employed 116,000 persons. The report points out that because the new system or systems will be substantially smaller in track mileage and somewhat smaller in traffic than the total of the six bankrupts, it will require fewer employees. To lessen the impact of this problem the report calls for the development of plans concerning adequate job protection or compensation for the affected employees.

The report addresses the national railroad industry as well as the problems of bankrupt Northeast carriers. It recommends modernization of the regulatory process, and states the intention of the Department to submit legislative proposals toward that end.

The report outlines nine areas of the economic regulatory system that it will propose to improve by legislation. They are:

- Liberalized rail abandonment procedures.
- Elimination of discount rates for governments.
- Restrict practices of rate bureaus.
- Simplification of mergers, joint use of common facilities and facilitation of intermodal ownership.
- Easier entry of motor and water carriers to continue abandoned rail services.
- Strengthen bankruptcy laws to enable courts to more rationally solve rail bankruptcies.
- Eliminate discriminatory taxation of rail assets.
- Eliminate delays in state approval of intrastate rates.

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REMARKS BY CLAUDE S. BRINEGAR, SECRETARY OF TRANSPORTATION,
TO MEMBERS OF CONGRESS CONCERNING THE TRANSMITTAL OF THE
DEPARTMENT OF TRANSPORTATION REPORT TO THE CONGRESS ON THE
NORTHEASTERN RAILROAD PROBLEM, IN RESPONSE TO SENATE JOINT
RESOLUTION 59-2, MARCH 26, 1973.

Forty-five days ago Congress directed me to submit a plan that would deal with the Northeast area rail problem. I have today filed this requested report, and I am pleased to have this chance to review some of the details with you personally.

But, first, a word of caution. Though we have worked hard at it, 45 days is a woefully brief time to deal thoroughly with problems that, in many ways, have been decades in the making. We have done our best to analyze the causes, to examine alternatives, and, finally to outline what appears to us to be a workable plan of action. Obviously, other plans are possible and, with further analysis, improvements to this plan might be found. However, we believe our recommendations are sound and that they are in the overall National interest. We urge you to give them close consideration.

Our eight key conclusions are these:

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. With prompt corrective action the overall system can be restored to its role as an efficient carrier of large quantities of freight, as well as providing rail systems for AMTRAK's passenger service.

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 have made it abundantly clear that nationalization only means increasing subsidies and declining resource efficiency--something our Nation can ill afford. Nationalization would only be one more one-way street to more and more Federal spending. 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 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 weaken--and perhaps destroy--the vigor of the private enterprise companies that would be forced to compete with this Federally-backed operation.

3. Without question we face a short-term rail crisis in the Northeast. Six of the 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. Correcting this short-term problem will require cooperative and public-spirited action by all parties involved--Congress, the Administration, regulators, labor, creditors, shippers, and the courts. We believe that the problem can--and indeed must--be solved within the broad framework of the private sector. We are recommending such a plan of action.

4. 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, per se, is not essential, though much of the rail service provided over its mainline tracks is.

5. 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 one or more new private sector rail systems that could be developed from the various systems owned by the six bankrupt carriers. It should also be possible, and it certainly is desirable, to continue rail competition in high-density markets. Our studies suggest that, if permitted to emerge unencumbered from the tangled web that now embraces the Northeast carriers, a new entity (or entities) would generate sufficient profits and be able to raise sufficient cash to finance operations and expansion. In a word, quite clearly there is a healthy rail system trying to crawl out of the Northeastern wreck. All of us working together can help it escape.

6. 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.

However, until we have a better understanding of the numbers involved and the extent of the dislocations, it is difficult to address these issues in specific terms. 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.

7. 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 ICC regulations should encourage the parties to resolve their differences in a reasonable time period. If the incentives to reach agreements are strong enough--and if the alternatives

are sufficiently unpalatable--reasonable men should reach reasonable agreements. We believe that our plan provides for those incentives--that it helps to create the machinery and oils the gears. With your help, the private sector can make the machinery move.

8. 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. Our report contains several specific recommendations for these needed regulatory changes.

Turning to the report itself, in the first part we outline in an historical and regulatory context, how the railroad industry problems have evolved. I won't go into the details now, but I encourage you to read this section when you have the time.

Let me now elaborate on our proposals to streamline rail service in the Northeast, and then describe briefly our proposals for regulatory revisions. We feel that it is essential that Congress deal with both a plan for the

bankrupt roads and for regulatory modernization as a package, so that the new operations can begin without unnecessary hindrances.

Following enabling legislation, the streamlining procedure would start promptly. Using freight and passenger traffic forecasts for each area in the Northeast, the Department of Transportation would select a Core Rail Service for the region. The service would be based on the concept of long-term economic efficiency in the use of transportation resources. During the 90 days following enactment of legislation, the Secretary would prepare a preliminary report identifying the Core Rail Service. Following a period of public comment, final selections, free from judicial review, would be made.

The enabling legislation would authorize the establishment of a new for-profit private corporation, whose Board of Incorporators, appointed by the President, would select assets from the bankrupt carriers needed to provide the Core Rail Service and such other services as they deemed desirable.

Bankrupt railroads would be permitted to terminate (but not abandon) rail service not included in the Core System within a specific time period and without ICC approval. The new corporation would also afford viable railroads, shippers, communities and others the opportunity to provide for the continuation of service not included in the Core by compensating either the bankrupt roads or the new corporation.

The corporation would then proceed to design in specific details one or more rail system in the Northeast based on the Secretary's Core selections. In designing the system the Board would apply two criteria: economic viability of each element of the system (or systems), and preservation of rail service competition in high density markets. After the Secretary approves the Board's proposals as to meeting overall criteria, the Board would acquire the facilities and equipment of the bankrupt roads through negotiation with the estates and others. We believe the value of the Core assets as a going-concern would exceed their uncertain value under protracted and piecemeal liquidation, and therefore the trustees should find it

in their best interests to work out equitable agreements with the Board in the specified time periods, and that the Courts would agree with the settlements. If the Board designates more than one new system, the Board would establish as many additional corporations as are required to run the systems. Alternatively--and subject to guidelines on competitive balance and negotiations with other carriers--the systems might all become part of on-going rail companies.

The stock of the new corporation or corporations would be placed in escrow until it could be allocated equitably and distributed to the bankrupt estates. Following this step the new corporation or corporations would hire managements, employees, raise capital, and take over the operations. At this point, track not included in any continuing rail system could be abandoned without ICC approval.

Without doubt the transition to a streamlined rail system in the Northeast will cause strains and dislocations to three major groups--the bankrupt carriers themselves,

their employees, and the affected shippers. In our plan we have outlined some of the ways to handle the problems that may arise. They include such possibilities as special tax treatment for settlements of claims of displaced employees, a carryover of the tax losses of Penn Central into the new corporation or corporations, and time for shippers to arrange for alternate service where previous rail service is no longer available. Additional plans to deal with problems caused by displaced labor and the problems of communities and shippers can best be developed following better understanding of the numbers involved and the extent of the dislocations.

While we think that this approach would lead to an eventual solution to the problem of the bankrupt roads in the Northeast, we must also address the regulatory problems which face all railroads. Our proposals for modernization of regulatory procedures should go far toward solving these problems.

I will list our regulatory proposals only briefly, as they are outlined in more detail in the report. We recommend:

- liberalized procedures for rail abandonment of uneconomic routes;
- procedures to make rate-making more flexible;
- the elimination of special rates for Federal, state and local governments;
- modifying the antitrust immunity of rail rate bureaus;
- providing new procedures to simplify mergers and encourage the acquisition and joint use of common facilities and to promote intermodal ownership;
- permitting liberalized entry of motor and water carriers to fill gaps created by rail abandonments;
- amending Section 77 of the Bankruptcy Act to give courts adequate authority to act promptly and rationally to solve the problems caused by railroad bankruptcies;

- eliminating discriminatory state and local taxation of rail assets; and
- eliminating delays in state approval of intrastate rates that coordinate with changes in interstate rates.

We will discuss our recommendations for regulatory revisions that affect other modes in another report.

In this briefing I hope that we have helped give a general idea of our plan for the bankrupt roads of the Northeast and for railroads as a whole. We have tried to deal with the broad procedures that are needed to get rail back on the right track. We are confident that, if agreement can be reached to put proposals such as these into effect promptly, we can promote the kind of change that President Nixon has pledged his Administration to achieve--change that works. And, I'd like to stress, change that strengthens our proven free-enterprise system.

Finally, I'd like to note that time is pressing us hard. The Penn Central reorganization court has set July 2, 1973, as the date to hear proposals either for a workable plan or the trustees' blueprint for piecemeal liquidation. If no plan is forthcoming, we see liquidation as the Court's only legal recourse. If, however, Congress acts expeditiously along the lines outlined in this report, and if various affected parties work together, we believe that the Court will have an alternative that is better for all concerned--and especially for the Nation.