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# FAILING RAILROADS

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## HEARINGS

BEFORE THE

### COMMITTEE ON COMMERCE

### UNITED STATES SENATE

NINETY-FIRST CONGRESS

SECOND SESSION

ON

### S. 4011, S. 4014, and S. 4016

TO PROVIDE FOR LOAN GUARANTEES TO ASSIST RAILROADS IN ACQUIRING, CONSTRUCTING, OR MAINTAINING FACILITIES OR EQUIPMENT

#### PART 3

NOVEMBER 23, AND 24, 1970

Serial No. 91-90

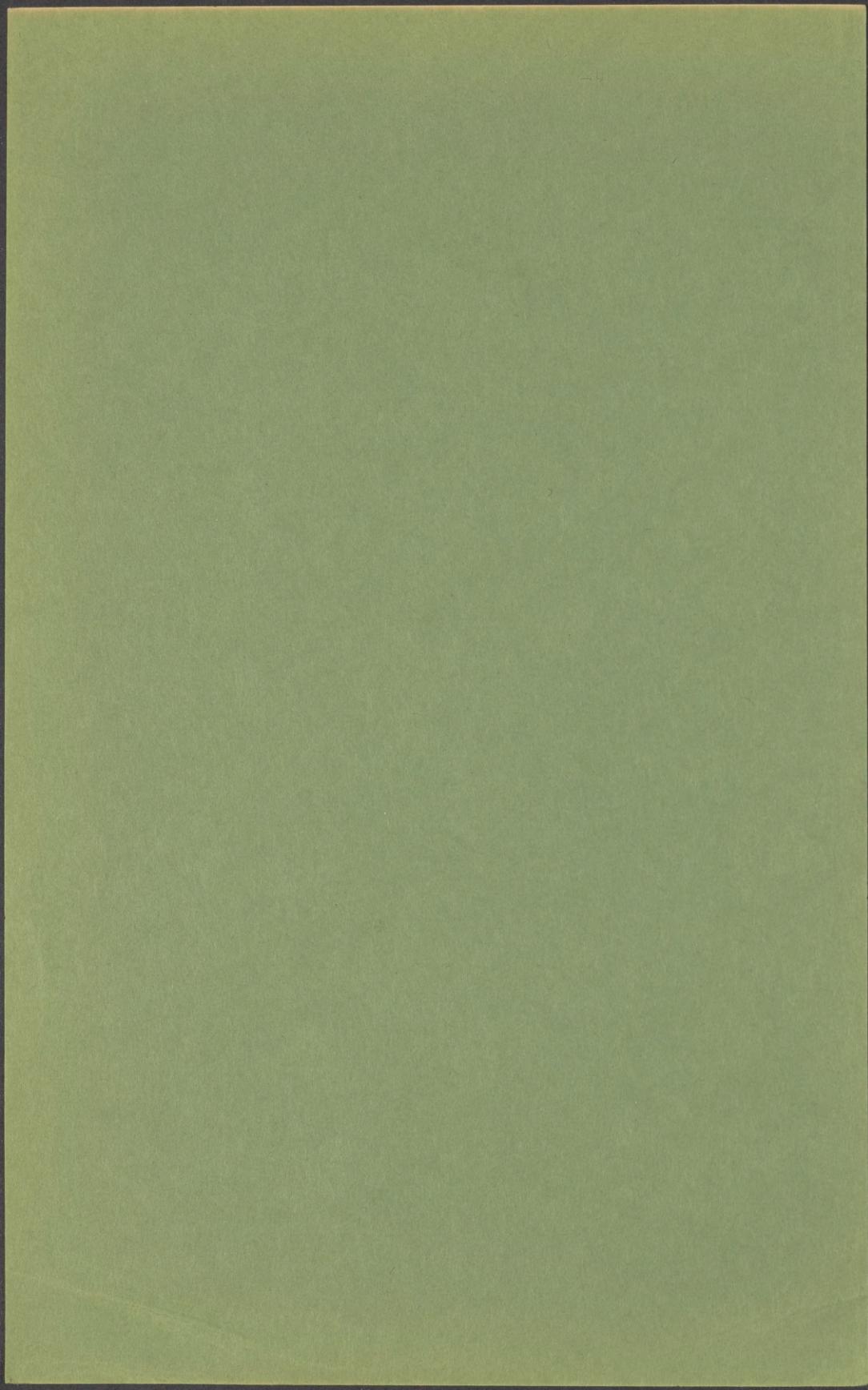
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# FAILING RAILROADS

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U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1971

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## FAILING RAILROADS

MONDAY, NOVEMBER 23, 1970

U.S. SENATE,  
COMMITTEE ON COMMERCE,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10:15 a.m. in room 5110, New Senate Office Building, Senator Vance Hartke presiding. Present: Senators Hartke, Cotton, Prouty, Pearson, and Baker.

### OPENING STATEMENT BY SENATOR HARTKE

Senator HARTKE. Good morning, gentlemen.

Although I expect that your presence this morning here means bad news, I am interested to learn what we can about what has happened to the Penn Central in the past few months. Good information and facts have been in rather short supply since this matter began.

The administration could not tell us much when it rushed up here with a very broad measure. It would have made \$75 million in guarantees available without much restriction, without limitation, without any understanding whatsoever of the potential clients or people who would qualify for such a loan.

Although this bill was entitled "The Emergency Transportation Assistance Act," I think a better title would have been "Bank Bail-out Bill."

Despite Secretary Volpe's assurance that our choice was between the administration's bill or nationalization, and that immediate action was urgent, the Penn Central is still running. We have had some time to study the situation. Things are not as they were represented to be.

It was not enough for the old Penn Central management to run a railroad, to get into real estate developments, golf clubs, beauty parlors, amusement parks, pipelines, and even the air carrier business.

They said the new nonrailroad acquisitions provided the money to keep the railroads running. But the pipeline sprung leaks; the real estate development company has run out of money; and the airplane venture has resulted in violations of Federal law, the second highest penalty in CAB history and millions of dollars down the drain.

The Interstate Commerce Commission has been working for 4 months to try to figure out what happened. Last Thursday, the Commission sent up a letter to the chairman of this committee showing that the subsidiaries had not brought in cash to keep the rail-

Staff members assigned to these hearings: A. Daniel O'Neal and John Cary.

road running. Instead, the railroad, short of cash for years, continually growing shorter, depleted its cash by \$153 million in order to diversify. If you add up the interest costs, the total is \$209 million. \$209 million in cash spent to get into the nonrailroad business.

In my opinion, if that money had been kept in the railroad, the Penn Central would not be in the condition it is today. It was the railroad that provided the cash for the subsidiaries, not the other way around.

I personally, and I do not believe anyone that I know of in the Senate, wants the Penn Central to stop operating. But we don't want to bailout just anyone out of this mess.

I expect that the public will in turn demand that the railroad keep its service going. So we have an obligation to be cautious in committing taxpayers' money to a private corporation. Our only justification for doing so is to preserve an essential public service.

It is for this reason that I am hopeful we can have some information today which will not alone be of help to us in making our future decisions, but also to clarify what are obviously either some misrepresentation or some misinterpretation of facts.

Mr. WIRTZ?

**STATEMENT OF WILLARD WIRTZ, ACCOMPANIED BY GEORGE P. BAKER, RICHARD C. BOND, JERVIS LANGDON, JR., TRUSTEES; WILLIAM H. MOORE, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF THE RAILROAD; JOHN GUEST, FINANCIAL CONSULTANT AND GENERAL PARTNER IN KUHN, LOEB & CO., S. H. HELLENBRAND, VICE PRESIDENT-REAL ESTATE AND TAXES AND PRESIDENT, THE PENNSYLVANIA CO.; ROBERT BLANCHETTE, COUNSEL FOR THE TRUSTEES**

Mr. WIRTZ. Thank you, Mr. Chairman.

May I first introduce the witnesses here today.

There are eight of us at the table, the four trustees: at my left, Mr. Bond, at my right, Mr. Langdon and Mr. Baker.

In addition, Mr. Moore, the president and chief executive officer of the railroad, and at the far end of the table, Mr. John Guest, partner in Kuhn, Loeb & Co. Two places to my left, Mr. Hellenbrand, who is the vice president of the railroad in charge of real estate and taxes and is also president of the Pennsylvania Co. At the far end of the table, Mr. Robert Blanchette, counsel for the trustees.

I think there is probably no need in introducing the trustees individually in terms of this background. Let me simply say that at least the other three come here with a very considerable background and familiarity with the field of finance and particularly with the field of the railroads.

I should also refer to the fact that the most important person in this picture as far as the trustees are concerned, is, of course, Judge Fullam of the U.S. District Court for the Eastern District of Pennsylvania.

We are trustees responsible in our stewardship to the court, and he shares fully the view that we should present here the complete information about this matter.

With respect to our plan of presentation, Mr. Chairman, members of the committee, with your leave we would file for the record the very long statement which we have here, which has gone into considerable detail.

Senator HARTKE. The entire statement will appear in the record and you may highlight such provisions as you wish.

Mr. WIRTZ. I will do that and in the questioning we will turn to the various trustees if the questions that are raised fall into their area of competence and familiarity.

Mr. Chairman and members of the committee, we have taken the risk of oversimplification which is involved in presenting this matter in its general terms. It is an involved situation and we feel we can best serve your interests by summarizing as you have suggested.

We will do three things. First, summarize the situation at Penn Central, then indicate those measures of self-help which appear to be indicated, and finally, suggest certain elements of additional assistance, which we feel are imperative to revitalize the railroad.

There are three points of terminology I should clear up very briefly and at the outset.

The first involves the phrase Penn Central. There is attached to the statement attachment No. 1 a chart, which shows this complicated Penn Central structure in its broadest outlines. The one corporation which is in reorganization, and of which we are trustees of the debtor estate is the Penn Central Transportation Co.

Very quickly, there is above in corporate hierarchy, the Penn Central Transportation Co., the holding company, the Penn Central Co. We have no control over its affairs, it has as a practical matter, none over ours.

There are technical points of importance, but we are talking about Penn Central Co. The Penn Central Transportation Co. has one very important subsidiary, along with a number of others, important in the sense that it presents problems of the kind to which you referred in your opening statement.

It is the Pennsylvania Co. that holds in one way or another, most of those nonrailroad assets to which you referred. We hold, the Transportation Co. holds 100 percent of the common stock of the Pennsylvania Co. There is preferred stock which is publicly held.

Technically, Pennsylvania Co. is a separate corporation, but we do not say that to in any way suggest any lack of or limitation on responsibility as far as we are concerned there.

So it is just roughly the holding company, Penn Central Co. here, the Penn Central Transportation Co. which is referred to in this testimony as PCTC, which is the corporation in reorganization. It is the old Pennsylvania Co. and New York Central brought together. It is the corporation which is in bankruptcy and then below that the Pennsylvania Co.

Now, the second point of terminology which ought to be cleared up is that there are two sets of figures which run all of the way through this testimony. We have got to use both of those figures.

We have on the one hand the profit and loss figures which show where we would stand today if we were not in reorganization. So that would assume we are paying all of our taxes, we are paying our debt, and so on. Those profit and loss figures, which are in some places referred to here as accrued figures, give you a picture of where this corporation would be today if it were not in bankruptcy and reorganization.

The other set of figures has to do with our cash flow situation. Now our cash flow is affected by the fact that a number of these payments are being deferred now, because we are in reorganization.

In immediate terms, of course, it is the cash flow figure which is of particular importance to us; that is the figure that determines whether we are going to stay alive or not. But, there are those two sets of figures.

Then the third point which should be cleared up in connection with the figures and which is dealt with carefully as we go along, involves the fact that there is presently pending a wage increase recommendation. An emergency board held hearings, issued a report, and that board has recommended wage increases for 1970 retroactive to the first of the year. Some of them wage increases for 1971 and for 1972. And we have tried to indicate the extent to which those recommendations are or are not included.

So there are those three points of clarification as far as terminology is concerned.

Now we will go over the whole picture, but make clear at the outset, Mr. Chairman and members of the committee, the key elements in our approach to this situation and the first to which you referred is the Penn Central, is obviously in grave difficulty.

The two sets of figures which suggest that are these: We will run out of cash as nearly as we can determine the facts, we will run out of cash or come down just about to the zero basis at the end of the first quarter of 1971. The other figure which suggests the degree of the difficulty in which we find ourselves is that our losses, figured on an accrued basis, which means if we were paying all of our taxes, debt, and the wage increases, our losses in this year, 1970, would come to over \$300 million.

Those are historic figures. We would have been here earlier if we would have been in a position to say exactly what these figures are with our full confidence. We are here now because it is our judgment those are the fair reflections.

The second key factor in this situation is in our judgment there are very real prospects for improving this situation.

If I started with a dichotomy to which you refer, between good news and bad news, we couldn't avoid your classification and yet we think it is good news that we know what the truth is.

I guess it would be a mistake to say the truth will make us free here. It will make us pretty expensive.

But, on the other hand, we do have facts and they are facts which lead us to no sense of hopelessness at all. We see the figures we have just given you in this perspective. Our operation, the one about which we are talking here, is so vast, that if we could improve the relationship between what comes in and what goes out by 12 to 15 percent, then we would meet at least our imperative needs. That is our goal.

The third point is this: We cannot at this point make official representations that the Penn Central can be restored to profitable operation. But, it is our considered judgment that there is a reasonable prospect of achieving this goal from within 3 to 5 years.

Now, this will depend entirely on the arrangements of interim financing, in the amount, in our present judgment, of about \$175 to \$250 million in the next 4 months, working out the arrangements for that for this year in the first 4 months, and possibly that much more over the following 24 months.

And we say, as you suggested, as has been said here before, it is our reluctant conclusion that the alternative to that is some sort of nationalization of the railroad. But we reject that as a counsel of completely needless despair.

We proceed finally on the basis that there is going to be a Penn Central railroad, because it is essential to the national economy. It is better this be a private rather than a public enterprise, and the prospect of a successful free enterprise reorganization of Penn Central is worth pursuing.

Now, into the present situation. First, in terms of cash flow we have today cash of about \$30 million. That is about the same picture that we found when we came to this trusteeship.

In other words, the cash flow situation has fluctuated, as it does quite markedly, but stayed about the same.

It has to be pointed out that the only reason we have been able to maintain that position is because of the deferments of a number of obligations under reorganization. In local taxes alone, those are \$35 million in the last half of 1970. And that bothers us.

Next, we can say to you with relative confidence, we can maintain a cash balance through the remainder of 1970. Now we have made projections for 1971 and those indicate that under present circumstances, meaning the deferments of the taxes and of the interest payments, and at present wage levels, we would carry our cash balance, our cash balance would carry us through the first quarter. It would come at the end of the quarter just to a very close balance point. It will carry us through the first quarter.

As nearly as we can figure, the picture for the rest of that year, if we got through the first quarter on that basis, present wages, no taxes, no interest payments, if we got through the first quarter, our cash picture would improve gradually during the year and at the end of the year would be at about \$100 million. That is December 31, 1971.

Now that cash projection does not include anything for the presently recommended wage increases. Those obviously got to be recognized in anything that is said about them without regard to the question of where they eventually come out.

I simply say to you that the effect of paying the wage increases recommended by the emergency board would be to add about \$182 million to our costs, to our cash outgo in 1971, because the retroactivity for 1970 would also be paid in 1971 and would result in a cash shortage at the end of 1971 of about \$100 million.

Now, I have already indicated that as big as those figures are, and we haven't got the slightest intent of trying to minimize them in any respect, they do have to be put into perspective of the size of the operations which are involved. That of cash flow.

Now, with respect to assets and liabilities, we are trying very hard to make a completely realistic evaluation of the assets of the debtor's estate. That is difficult for reasons we will come to, that evaluation is not yet complete, to make reliable statements regarding it in over-all terms.

But, we want to be clear, specific, and frank with respect to the point to which you referred. Both assets and the liabilities do go into other than railroad operations. And we have very substantial nonrailroad assets. Most of them held through the Pennsylvania Co. as a subsidiary. Those include the Buckeye Pipeline interests, the Great Southwest Corp., Arvida Co., several New York City hotels, 24 percent interest in Madison Square Garden.

Those holdings, although it is impossible to give you at this moment a precise figure with respect to their valuation, would have total values of several hundred million dollars, if they were unencumbered.

The rest of the story is they are all very heavily encumbered in one way or another. For example, a good deal of that interest comes to us through the Pennsylvania Co., of which we own 100 percent of the common stock and the whole 100 percent of the common stock has been pledged as collateral to the banks to secure loans to Penn Central. A good deal of that money came to the transportation company.

So I can simply say to you at this point that there is a very large gross value there. It is going to take quite a lot of time, probably some litigation, to determine what the net value is and how much of it is usable.

We will come back to this at a later point in the testimony.

The third point, financially, has to do with the profit and loss situation. As I have indicated already, the figuring for this year, the first three-quarters already in, indicates a loss to Penn Central Transportation Co. for the year 1970 of about \$300 million. As close as we come to that is \$300.9 million.

That is on a basis which would assume the payment of debt and taxes and of the recommended wage increase.

Now, you have referred, Mr. Chairman, in your opening statement, to the various possible reasons for coming to a situation of this kind. It is, of course, true that the public explanations of that have ranged all the way from particularized indictments of the management of Penn Central Transportation Co. to discussions at the other extreme that this is a uneconomic industry and that Penn Central is too big to be managed.

Our conclusion would be that the truth borrows from each of those various explanations, except for the one, we don't find anything in this situation which suggests that it cannot be effectively managed. We think that it can.

Now, further, with respect to an explanation of the reasons for being in this situation, we suggest that one way of analyzing that is to compare the picture as we have it now for the first 9 months of 1971, with the picture for 1969 to see how we are going in various connections.

I would point out that the loss reported to the Interstate Commerce Commission for 1969 was \$83 million and that the loss that I have indicated to you for this year is about \$300 million, which

would indicate on the face of it a situation tobogganing and out of control.

That comparison is not a reliable comparison. The figures for 1969, in the 1969 report, without suggesting that they departed from general accounting practice, obviously reflected a corporate policy at that time of putting the best conceivable face on the facts, even to the point where the facts became very dubious allies of the truth. But recognizing that difficulty you can still find a good deal about this situation by comparing the picture for these last 2 years.

It is very briefly this. Our operating revenues for the first 9 months of 1970 are up about \$55 million. But the rest of the story is that most of that comes from freight rate increases, the volume of our freight business is down and the short of it is that Penn Central has been losing railroad business to the competition.

The other side of it is that operating expenses have gone up ominously, about \$147 million for the first 9 months and the biggest factors there have been increased costs of materials, services, supplies, and labor.

There is another item that bothers us considerably, the cost of freight loss and damage claims and costs resulting from vandalism show a disturbing increase.

The interest obligations have increased about \$16 million, although that is dubiously included in this comparison.

Our financial income from our subsidiaries, which means dividends and tax allocation payments, has dropped sharply, over \$50 million.

Now, there are special factors in the Penn Central situation. One of them is that that merger was never completed, and another of them involves the diversification story, to which you have already referred. Neither of those should be minimized. But the rest of it is a classical story of lost business and higher costs resulting in losses.

As far as the future goes, there will be another loss situation in 1971. The closest our figures can come to indicating that shows a loss—this is on the accrued basis—in 1971 of \$118 million. We have rounded out at \$200 million as our best indication of what the loss picture will be in 1971.

We have also tried to project beyond 1971. That is very hard, to go beyond to next year. I can say this, there is no reasonable prospect of Penn Central Transportation Co. showing a profit in 1972 or probably in 1973.

There is a reasonably foreseeable set of circumstances, general economic circumstances, industry circumstances, Penn Central changes in practices of one kind or another, which would result in a profit in 1974 or 1975. But I should add that another equally likely set of prospects indicates that that could be postponed beyond that period.

All I can say, really, is the basis on which we are proceeding now and that is on the basis of a considered conclusion that it is a reasonable working assumption that Penn Central Transportation Co. can be made a profitable enterprise within 3 to 5 years.

We cannot make that representation. We can say to you that we are proceeding on a course of action for the next three years which will test fully this prospect of ultimate viability.

Now, turning to the operating side of the picture, and first to the self-help measures by Penn Central. Faced with a situation of the

kind to which we have referred, there are two questions which have to be discussed. The first is: Can railroad operating revenues be significantly increased? The second is; can railroad expenditures be drastically reduced? And the answer to both of these questions is yes. But the rest of the answer is that in the figures that we have given you in these projections, we have gone as far as we think we can responsibly go with respect to those two matters.

With respect to the increasing of railroad operating revenues, the projections which we have given you incorporate an increase of \$309 million in freight revenues, \$150 million of that is projected as an anticipated increase in business and the rest to a freight rate increase. So on that side we cannot honestly say to you that we think we can do better than what these projections show, although that is quite an improvement.

On the second question, drastic reduction of railroad revenues, we have carried those expenditure figures as far as we think they can be carried and we have gone pretty far on it.

Let me point out a striking evidence of this, in connection with transportation expense, which is our large item. We have projected that figure for 1971 at a slightly lower level of expense than in 1970, despite recommended wage increases and substantial increases in traffic.

As far as maintenance of way is concerned, we ought to have a substantial increase, but the 1971 projections anticipate the same level of maintenance work as in 1970. There has got to be repair and upgrading of over 20,000 cars for 1971. We figure that is an increase of \$67 million.

We have put that on as practical a basis as we can and we think the information we have given you suggests as drastic a reduction as possible as far as expenses are concerned. We have estimated capital expenditures for 1971 at \$74,600,000. That seems a minimum program if we are to restore this property to a basis on which it will be giving effective service.

As far as the equipment program, equipment capital program, the figure of \$198 million represents again the minimum that we think will meet the needs which we now face, which our suppliers face, and which the whole industry faces as it depends on Penn Central.

Let me point out in connection with this that part of our present problem is a consequence of the practices of the last 5 years. During that time the number of freight cars comparing present Penn Central with former Pennsylvania and New York Central, the number of freight cars has dropped 35,000 which is a figure of vital significance and of impact, almost 20 percent. That is why Penn Central was not giving the service that would have permitted it to continue on a viable basis, and which it has got to be.

There is another factor of tremendous importance as far as this operational situation is concerned. The easy popular assumption is that because Penn Central serves an area which includes all of or most of the major producing areas consumer areas in the country, all of these big cities, it ought to be a very easy thing to make money on this kind of operation.

As a matter of fact, it is the nature of the service, of the territory we serve, of the demands we have to meet, which to a considerable

extent gives us our most serious problem. Of course it gives us also our largest opportunities. But what most people don't realize is the significance of the fact that Penn Central Railroad is one huge terminal operation; such a high part of our business has to do with either the taking on of freight, making up the trains, or the distribution of the freight. Where other roads have very long hauls, we spend a large part of our time on operations which present much more serious operational difficulties.

The so-called unit train, turnaround service with loop tracks, is the kind of thing of which we have some, but most of our service does not permit that kind of thing. Most of our service involves situations in which these trains have to be made up of individual cars that have been brought together at a series of concentration points by innumerable yard crews, each operating with heavy power over miles of slow-speed industrial track, located in high cost, heavily taxed urban areas, sometimes in the city streets themselves, with high exposure to vandalism and loss and damage to freight itself.

Let me make it perfectly clear that we are not pleading impossibility or insuperable difficulties at all. We are pointing out why it is hard to run an operation of this kind on the basis which will make it a profitable business.

It is almost a retail type of business compared with what is in the other circumstances as a wholesale kind of business. Just two or three specific illustrations of that, because it is so important.

Take the Southern Railway. We are about twice the size of the Southern Railway. We have five times as many yard crews. There is another illustration of the same kind, where on Penn Central there are twice as many yard crews as road crews, on Southern there are more road crews than there are yard crews.

This problem of operating in the terminal situation is exceedingly difficult. Our yard transportation on freight is more than 15 percent of the freight revenue dollar, while on railroads generally it is less than 10 percent. So we face the problems which are inherent in a terminal railroad situation of this kind.

But, again, I come back to the point, particularly under new management, we view this as presenting a very real problem, but very warmly as presenting a very real prospect for improvement and we are out to change that picture.

There are some specifics about that. One factor which has affected this situation very greatly is the shortage of freight cars. Our program for 1971, as I have indicated already, includes provision for 7,492 new cars at a cost of \$137 million. That is in addition to the repair program which has been mentioned already.

Just as a reflection of what this means to us, where we have got an unserviceable freight car ratio today of about 9 percent, with this program and with the new management we project that as coming down to 4 percent by the end of 1971, in just 1 year.

We recognize as a second point that we have had just a generally poor service record in the past, as far as this railroad is concerned. I can only say to you that in the 2½ to 3 months with new management on this job, we are receiving the clearest sharpest indications of shipper reaction to the fact that they are now getting at Penn Central the kind of service which has been promised them for a very long time. It is first-class service.

There is another point, as far as the low equipment utilization factor is concerned, that can be improved very greatly through adherence to better operating practices, to the scheduling of empties as well as loads and terminal procedures which are modern instead of traditional.

This rolling reject problem has been a very serious and common problem at Penn Central. We have faced the expense of moving the reject cars from one loading point to another. That is a waste.

There has been the cross-hauling of empties which has to stop and is being stopped. The cars are being distributed now or will be on a system rather than a regional or local basis.

There are real opportunities to get ahead. Another of them has to do with the plant rationalization of the whole property. Involved here is the abandonment of about 3,800 miles of line and the elimination of maintenance costs of \$17 million and another nonrecurring saving of about \$50 million—we will come back to the abandonment point, Mr. Chairman. We do not have in mind any slashing kind of abandonment program. We are going to work that out carefully with a balancing of all the interests that are involved, and there are still prospective savings here, one-shot savings of about \$50 million, and then what is in effect a recurring maintenance saving of about \$17 million.

We can say how important Mr. Moore being the chief executive officer of this railroad is and what it is going to mean to us as a company and to this industry. It is already showing up in what is only briefly discussed here.

Returning to the financial aspects of the problem, those things which we recognize we have to do and which we recognize we can do, there are two areas which you have already referred to, Mr. Chairman, in your opening statement, and one of these areas involves the possibility of our selling certain corporate assets, especially the non-railroad properties. The other involves the possibility of private borrowing.

On the sale of corporate assets, I simply say to you in the most significant meaningful sense possible if we could, we would put up a "for sale" sign over every single nonrailroad property which we have, and I mean that in the fullest implications of the statement.

As far as we are concerned, as brought out in your opening statement, that diversification policy which was in effect at Penn Central Transportation Co., was at least on hindsight a serious mistake. Now, it may have postponed the showdown at Penn Central. These statements that the railroad was milked to support real estate, other operations, and the suggestions that a great deal more money went downhill or downstream than upstream are subject to one very important qualification as far as the cash situation is concerned and that is that on the basis of those operations there was a substantial amount of money borrowed and used for the railroad purpose itself. And that factor ought to be taken into account in making an analysis of that situation. But that is only by way of explanation, because on net we don't think there is any question but that that diversification policy worked very badly.

Under different economic conditions, it might have worked out better. As things turned out, though, what it too often meant was the

unavailability of cash to support the railroad and, furthermore, opportunities for bookkeeping and reporting practices which had the effect, regardless of what their intent may have been, they had the effect of postponing the day of reckoning at Penn Central which would have been less bleak if it had dawned earlier.

Under present circumstances, in any event, Penn Central Transportation Co. should be taken out, as far as making it an effective railroad operation is concerned, of every single business not significantly connected with running the railroad, except in a very few cases, where there are clear cash earnings advantages.

We are taking that course to the maximum extent consistent with the legal constraints involved. We have active explorations under way of the opportunities for sale of most of the nonrailroad properties. It would be plainly improvident to liquidate those on a fire sale basis, if taking some additional time would permit more advantageous terms.

The other thing that has to be pointed out is that being in reorganization, the legitimate claims of various interested parties on those profits, by mortgage, pledge, or otherwise, have to be taken into account and we are, we are not falling back because of that consideration.

I just say to you in general, Mr. Chairman and members of the committee, the trustees are proceeding on a policy of maximum practical and by that I mean maximum possible liquidation of nonrailroad assets.

With respect to the private borrowing the trustees are pursuing every possibility of private financing. An investment banking firm, Kuhn, Loeb & Co., has been retained by the trustees to assist in this effort. Mr. Guest is here with us today. We worked out one major financing arrangement which has not formally been announced yet, but it involves the financing of some 145 locomotives with General Motors Corp. That is to be on an equipment-lease basis.

We are also actively undertaking negotiations with respect to factoring our accounts receivable. There is a potential asset there of still undetermined precise amount. I should say to you in all candor that the factoring of accounts receivable in this industry presents some real difficulties of one kind or another. Nevertheless, we are pursuing it quite aggressively. We have also made extensive efforts to determine the feasibility of the issuance of trustee certificates. These have included discussions in depth with banking and industrial and investor groups and the Federal Reserve Board.

I say to you, frankly, the results of those efforts are that the trustees are flatly and directly advised that trustee certificates are not under present circumstances, cannot and will not be sold. I have no documents to go further into that. We will be glad to develop it. I would like to add to the record, if I may, at this time, Mr. Chairman, perhaps as an attachment B, an exchange of letters of November 20 between Mr. Langdon and David B. Eastburn, president of the Federal Reserve Bank of Philadelphia.

We have been pursuing very actively the possibility of financing under section 13 of the Federal Reserve Act. We have as of November 20 been advised—I will read it in its complete form in which it appears in the letter. This is from Mr. Eastburn. It is a memorandum

from the Federal Reserve Bank of Philadelphia, the Federal Reserve Bank of New York, the last paragraph :

At this time, based on the information available to us, it is our view that it would not be appropriate for the Federal Reserve Bank of Philadelphia, or the Federal Reserve Bank of New York, to extend credit to the Penn-Central Transportation Company under Section 13, paragraph 3 of the Federal Reserve Act.

Which is an appropriate, complete way of saying we are not credit worthy.

Senator HARTKE. This denial will be put into the record without objection.

Mr. WIRTZ. Now, we come to the point you referred to in the beginning, the point of Federal assistance. We would wish we could come here and tell you after 3 or 4 months that on the basis of what we see of this situation, we can make it whole, by our own efforts. We can't do that. We can say and do say to this committee that our considered judgment is that there is reasonable prospect that the Penn Central can be restored to effectiveness as a railroad and made viable again as a corporation through a combination of efforts and measures consistent with the ideas and the ideals of free enterprise.

I have already suggested at the outset that the closest we can come at this point to indicating the final assistance which will be involved, either from the private sources which we have still to explore or from outside financing, is probably best estimated for 1971 in the range of \$175 to \$250 million, with a large part of that, substantial part, coming at the beginning of the year with a prospect of a similar amount over the next two years combined, over 1972 and 1973.

It is quite obvious, we think, that there is going to have to be some form of joint private-public financing, which will have to be worked out to this end. Just in the interest of clearing the air, Mr. Chairman, and members of the committee, let me say this. What I have just said and what we are about to say will inevitably be shortened to the report of the Penn Central trustees coming here today asking for millions of dollars of money, and that is right, but what is not right and the danger we have to clear up here is the context in which that statement might appear. That would be a context of reference to a huge corporation, with all that that is mentioned, mishandling its own affairs, diverting energies and vitality away from the railroad, borrowing heavily beyond its means, wherever it could find lenders, on whatever terms, and coming now to the Government with a request that its creditors and its stockholders and it itself be bailed out. It is only to the last point that we speak in this particular connection.

We are charged as trustees of the debtor's estate, the railroad, with responsibility for exploring fully everything that happened at Penn Central and with dealing fairly with all of the private and the public interests that are involved. But in coming here to this committee and talking particularly about the matter of financing, we specifically reject any element of the idea of raising funds to pay creditors or to increase the stockholder's equity.

We point out in this connection one thing that is frequently overlooked. A good many of our creditors, particularly those in the secured position of one kind or another, would probably much prefer we go ahead and move toward liquidation of this asset or toward its

nationalization. It is probably true that a proposal to extend and expand the deficit financing arrangements we are talking about increase in some respects the risks of some of the creditors who are involved. I use that simply to underline the fact that when we are talking about the deficit financing, we are not talking about those interests.

When we come here suggesting a reliance on public credit, we are recommending, and I would rather use your language in the opening statement than ours here, we are recommending only what makes sense as far as providing a public service is concerned. And that has to do solely with the revitalization of the Penn Central as a key and effective unit in the railroad industry. And with nothing else. We mean this. There are a number of other things which under more relaxed circumstances we ought to point out that are important here, a good deal more than just the financing on a short-term basis of one railroad.

We know the problems of the industry are much broader than that, and there are points to which we would like to refer in passing. The trustees are familiar with the whole Astro report. We endorsed all of the provisions of that report, with its provision for creative Federal involvement. There is another very important matter of rationalizing our labor policy and now a particular opportunity to do that. That emergency board No. 178 has recommended some changes in working rules, new procedures for collective bargaining, which would go a long way toward putting not only Penn Central, but the industry on a sounder basis. There are also matters concerning the regulatory patterns which have to be met—this is page 26, now—in that connection, we are preparing special presentation of all of those regulatory strictures which affect our vision adversely and unwisely in our judgment. We are going to make that presentation to the ICC as soon as we can. That will include proposals for the emergency abandonment program. Present circumstances dictate certain procedures, approaches, which we think will help that a good deal.

It is at this point I want to say again, Mr. Chairman, that we appreciate the sensitivity of the abandonment point. We would expect to proceed with respect to any abandonment on the basis which would permit either abandonment that should be directed or the reference to regional authorities which would be created, with reference to regional authorities, and the possibility of a contract for continuation of lines for which an abandonment would otherwise be directed.

All of those things are important, but we come back to the necessity of the financing arrangements which are involved. We need a program in our judgment which will meet the situation of a railroad like Penn Central, which is operating under section 77 of the Bankruptcy Act, which is confronted with imminent cessation of railroad services. We suggest four ground rules in connection with any kind of discussion of that financing arrangement. One is that the funds be used solely for railroad purposes and not for any other. Second, that it not be enough that those funds be used to preserve a present situation, there has, obviously, got to be an improvement in the service situation as far as the railroads are concerned. Third, there not be

one single cent or dollar of public funds until there has been a complete exhaustion of whatever private remedies there are by way of sale of assets or by way of private borrowing and we proceed on the basis that that is an appropriate condition of whatever approach we might take here.

And then the fourth suggestion is, it be recognized that this ought to be done on an interim basis. We have said we think it will take about 3 years to prove this matter out one way or the other. So, there ought to be a provision that that can be done, subject to review, redirection, within that period of time.

Now, there are a variety of Federal programs that could be suggested. We simply call attention to the three possibilities. This committee has before it already in various forms proposals for the guarantee by the Federal Government of private borrowing by the railroads. We support that legislation strongly. We would feel it is appropriate here only on the basis of those four ground rules to which I referred before, and I repeat specifically the one, the fact it should not redound to the benefit of a railroad unless it has exhausted thoroughly the private remedies.

There is, second, the possibility that if the loan guarantee program failed to prove adequate, the situation here is sufficiently important to warrant consideration of a short-term service contract arrangement between the United States and Penn Central's trustees to preserve essential rail operations. And again, there should be provisions for standards of service; there should be provisions that no part of the moneys which were transferred on that basis would redound to anything except the advantage of a better railroad operation. And then third, we suggest that, without going into detail, the possibilities of working out an alternative financing procedure which would leave for subsequent determination the question of whether the original funding which would be required is to be repaid or whether it is to be treated as a payment for services rendered.

Mr. Chairman and members of the committee, you have been indulgent. This statement has been necessarily long. The situation it covers is serious. The reason for going into it in some detail here is our complete conviction that if the Penn Central situation can be generally understood, whatever doubts there may have been about it in the past can be replaced by an attitude of caution, but constructive confidence in the future.

We have suggested the combination of self-help and broader cooperation and assistance which we think will work. Most of what we talked about is self-help, but we have made it clear we are presently dependent, to get back on our feet, on government cooperation and assistance.

If, 5 years from now, the Penn Central is viable, credit will have to be divided among these major influences. One, vital government help at a crucial time, which is right now; and second, a hard hitting, aggressive, imaginative, resourceful management, able to surmount the difficulties of high-cost terminal operation, with new and different methods, pricing concepts, and in other ways. Third, a labor force that identifies its self-interests with the interest of the railroad and is willing to accept changes in outdated rules and working conditions. Fourth, a steadily growing economy with inflationary

influences at a minimum. Finally, a more enlightened government approach to rail transportation, including a willingness to treat it in the same manner as competing methods and to lift the more onerous regulatory restrictions.

Finally, Mr. Chairman and members of the committee, is that the Penn Central's public services are vital and can't be dispensed with. The choice is between relying on a combination of these forces, or turning the railroad over to the Government. And we opt for private enterprise reorganization.

Thank you.

Senator HARTKE. Thank you, Mr. Wirtz.

Do any of the other gentlemen at the table care to make a statement?

Mr. WIRTZ. I thought at this point we would move to whatever things are particularly on your minds.

Senator HARTKE. Thank you, Mr. Wirtz, for coming in with a rather thorough and informative report.

As I take it, the amount of cash that you have indicated you would need through the next 3-year period would be in the neighborhood of \$425 million. Is that right, approximately? \$350 to \$425 million?

Mr. WIRTZ. Any figure in that range. I don't have any—we don't have any difficulty accepting that figure, Senator. It is just this, for us to come up with a precise figure is to seem to kid ourselves about how precise you can be on projections. So, we have taken the range, rather than the precise approach, but your figures are surely in the area we are talking about.

Senator HARTKE. As you have indicated in your statement, you feel there is a possibility—not even suggested a probability, but a possibility—of saving the Penn Central operation as I understand it. Is that right?

Mr. WIRTZ. Again, my answer would be yes, with this refinement. We know it is going to continue to operate; it has got to. I interpret your question as being saving it in terms of a private enterprise forum and the answer is yes.

Senator HARTKE. Do you view this problem as one which is common to the railroad industry, or do you feel it is just one which is specially applicable to Penn Central?

Mr. WIRTZ. We feel it involves factors which are common to the industry. That is problems have been brought more sharply to bear on the facts. Penn Central's situation, partly by its own fault. But my answer to your question would be that we count the most serious factors in this situation as including those which are common to the industry.

Senator HARTKE. Just to make sure that some of these points are nailed down, that as I understand what you have said today. You have said, in effect, that to the best of your judgment, the railroad will stop operating some time before the end of the first quarter of next year—even if all of the breaks go your way, your fare rates are increased, your wages are not increased—nonetheless, some time you are not going to have enough cash in the bank at the end of the first quarter of next year, around March 31, to continue to operate.

Mr. WIRTZ. It goes a little further than that. Our present figures show a cash balance as of March 31 of less than \$1 million compared

with a daily inflow-outgo of about \$10 million. The closest we can come on a projection basis is we just get down to absolute zero by March 31.

Now if in the meantime there is a retroactive wage increase to be paid, we will have gone, the situation will have gone past control.

Senator HARTKE. If the retroactive wage increase is required to be paid, you would cease to have sufficient cash on hand to pay the operating expenses and pay the wages by at least March 31, 1971.

Mr. WIRTZ. That is correct. And that answer would be by a margin of \$30 or \$40 million.

Senator HARTKE. You would be short \$30 to \$40 million?

Mr. WIRTZ. That is correct.

Senator HARTKE. How much sooner would it be short—is it possible you would be forced to curtail operations before that?

Mr. WIRTZ. Last winter was a terrible winter as far as Penn Central was concerned. If there should be a recurrence of that, we would be quite close to the line all of the way through February and March. So there are conceivable factors which would carry us, even without the retroactive wage increase, which would carry us below the line in February or March.

Senator HARTKE. In substance you are saying that there is no way you can cut operating expenses or increase your available cash, other than what you have detailed today.

Is that correct?

Mr. WIRTZ. That is my judgment. I would invite Mr. Langdon's comments on it, that is particularly his area.

Mr. LANGDON. Mr. Chairman, there is one further factor we have to take into account in Penn Central's situation. Ordinarily when you get into a cash bind on a railroad, there is some flexibility in being able to defer the payment of bills for materials and supplies and sometimes even services. But in the case of Penn Central, it is not possible. As a matter of fact, we are having almost to pay ahead of time the bills for diesel oil and also power and some of the vital supplies that are necessary in the operation of the railroad.

So we have absolutely no flexibility in connection with the procurement of the supplies that are vital to the operation of the railroad.

Senator HARTKE. Let me ask you, is this true too, just to make sure we understand each other. As far as trustee certificates are concerned, you have anticipated you would need an amount in the neighborhood of between \$175 and \$200 million. Is that correct?

Mr. WIRTZ. Yes, sir.

Senator HARTKE. And there is no place in which you have been able to find anyone who is willing to buy trustee certificates, even though they would have a preferred status in relation to other creditors of the railroad?

Mr. WIRTZ. Again my general answer is a flat affirmative. Mr. Baker has been working particularly in this area and I think you might well want his supplementary comments on that.

Mr. BAKER. The answer to that, Senator, is there has been no place we could find that we could sell these. We have with us John Guest, our financial advisor, from Kuhn, Loeb, and he might expand on that.

Senator HARTKE. All right. We will come back to that in a minute.

I just want to make sure we have these basic situations pinned down.

Mr. BAKER. I would just say that that is where we would like to get money rather than any other way, if we could do it.

Senator HARTKE. I want to come back to the steps you have taken in a moment. I prefer to delay that for the moment. In other words, what you are saying in substance here is the only way that this railroad can continue to operate is for a loan to be granted from the Federal Government or for the Federal Government to take over the operating of the railroad itself.

Is that true?

Mr. WIRTZ. Yes, I would say that, because of the risk of being misunderstood with any other answer. I would add only this, Mr. Chairman: I think the way you put it is exactly right, but I think we would want to include the possibility that there would be developments which would permit a very quick return of any of that financing, if we should be able to arrange either financing or sale of assets. But I answer your question without qualification.

Mr. BAKER. May I comment on that?

I just might call attention to Mr. Wirtz's earlier statements, and that is a direct loan is one way, a guarantee of loans is another, and a third suggestion at the end of the statement has to do with a service contract.

Senator HARTKE. All right. And this is also true, is it not, that you make no predictions whatsoever that if there is a direct loan or a guaranteed loan, that the Penn Central can be made profitable enough that it would be able to repay that loan and the possibility of default is a real one which should be recognized at this time?

Mr. WIRTZ. We do predict there will be a position of repayment. We say that we cannot assure that at this point.

Senator HARTKE. Mr. Langdon?

Mr. LANGDON. Sir, I would only add that we do need at least 3 to 5 years.

Senator HARTKE. 3 to 5 years.

Mr. LANGDON. Yes. I say five. But we said three to five in the statement.

Senator HARTKE. Is that conditioned on the continued recession that we have in the economy today? If that continues, let us say, for another year?

Mr. LANGDON. I think that even in the continuance of a recession, sir, that the opportunities for Penn Central to regain traffic are still present, because we have lost a lot of traffic, not because of the economy, although we have lost it for that reason too, but we have lost traffic also because we haven't been getting our share. We have lost it to competitors.

I anticipate that under the service that Mr. Moore is providing, we are going to get that back. In fact we have already started. So to a certain extent I think Penn Central might run counter to the economic trend, even though it is on the downside.

Senator HARTKE. Let me ask you this: What if it worsens, which I anticipate? I just think this economy is going to go straight down the ladder. I don't think there is any question about it, unless they change it very quickly. What if that happens?

Let me say my predictions have been a lot better than the economists of the administration.

Mr. LANGDON. I appreciate that, sir. This would have a very serious effect on us of course. I do say that even despite that that the opportunities for Penn Central to improve its relative position in the transportation market, even though it is a receding market, are such as to offset in part at least the full effect of a declining economy.

Senator HARTKE. I do want to make this one point clear: What, in your judgment, is the possibility that any type of loan, direct or guaranteed, would ultimately come into default, at which point the Federal Government would have to assume that full loan?

Mr. WIRTZ. We have leaned way over backwards to be careful on that. I say to you completely, candidly, and frankly, that the kind of financing we are talking about here seems to me a substantially safe proposition as far as the Government is concerned. It would be a first claim on all of the assets of the corporation, coming ahead of everything else. I think that is a true statement. I think there would have to be exceptions for equipment. But I think, Mr. Chairman, that the prospect of repayment of that loan, or the loans which would be guaranteed by the Government is quite, quite good.

You will simply respect our not wanting to say to you that we know it can be paid back. But we say to you in complete candor that everything we see about it makes that a good risk.

Senator HARTKE. Now in regard to the conditions which you indicated before, you indicated first there would be an attempt to secure cash by other means, by sales of assets, increasing revenue, cutting costs. Also you indicated that as far as the funds were concerned—you correct me if I am wrong—that the utilization of any funds and cash obtained as a direct loan or as a result of a guaranteed loan would be held in reserve until you had totally exhausted all other cash on hand and available cash through these other sources.

Is that correct?

Mr. WIRTZ. I think that is correct, yes.

Senator HARTKE. You think it is correct?

Mr. WIRTZ. The only point I have in mind is the timing point. We face, for example, if the wage thing comes to a head very quickly, as it might, there would be a question of how to move just as a matter of timing on that. If I can change your statement—I don't need to change your statement.

I will answer your question yes with the explanation that we might possibly need the financing before there had been an opportunity to exhaust those private remedies.

Senator HARTKE. What I am getting at, would it be possible to provide for some type of court control, escrow agreement, in any loan or guaranteed loan, which would mean the cash would be available but only available in the event and after all other cash had been exhausted?

Mr. WIRTZ. My answer would be yes, but I would like Mr. Baker to answer that.

Mr. BAKER. Oh, yes.

Mr. WIRTZ. Our answer is yes.

Senator HARTKE. The mere fact that you have the cash reserve in the event it is needed does provide for additional operation and

provide for alleviation of some of the conditions under which you are presently forced to operate.

Is that true?

Mr. WIRTZ. That is correct.

Senator HARTKE. Isn't that what you said, Mr. Langdon, in regard to your so-called cash on the barrelhead type operation which you are operating now?

Mr. LANGDON. Yes. Well, of course the level we are operating at now gives you heart failure, frankly. And we would like to keep a balance, if we can, of a minimum of \$20 million. This is a tremendous operation and \$20 million really seems a lot of money, but in the light of the overall operation, it is really kind of a minimum.

When we first came there, it was said you had to have a balance of \$30 million. But we have got that down now to \$20 million. And as I say, this is a kind of balance which really is a minimum for a big operation like this, because it fluctuates from day to day almost \$10 to \$15 million as the payrolls are paid and then the tax payments of course aren't paid any more, but there are big commitments during the course of a month that will affect the up and down of the cash flow to the point where we ought really to try to keep a minimum of \$20 million.

Senator HARTKE. What is the present rate of payment on your accounts payable? What date, how long? How long do you hold them?

Mr. LANGDON. Mr. Moore has got the statement right in front of him. Do you mind if he answers?

Senator HARTKE. Fine.

Mr. MOORE. Well—

Senator HARTKE. It is good to hear from you finally, Mr. Moore.

Mr. MOORE. I am delighted to be here. I don't have the exact statement that you asked for. I did want to point out, just to give you some idea as to the magnitude of the Penn Central, what our average daily cash flow is for a typical month. Our payroll is \$2.7 million per day. Our debt service, that is on the equipment debts we are now paying, is \$0.5 million.

Senator HARTKE. Wait a minute. What is that for now?

Mr. MOORE. That is equipment trusts on locomotives and rolling equipment, boxcars, gondolas, and hoppers that is being paid now.

Senator HARTKE. That has not been under order of suspension?

Mr. MOORE. No.

Senator HARTKE. Why not?

Mr. MOORE. It was approved by the court to continue those payments because if we did not do so, we would not have the equipment.

Senator HARTKE. You mean the equipment would be sequestered in case you did not pay it, is that true?

Mr. MOORE. That is right.

Senator HARTKE. Is that a binding contract or is it possible the court could order you to continue to operate and still maintain the equipment?

Mr. LANGDON. That point, I think, sir, has been litigated and found in favor of the creditors. In other words, there have been instances where equipment has actually been retaken by the loaner of the money.

Senator HARTKE. Mr. Blanchette, you agree with that?

Mr. BLANCHETTE. That is by statute, Senator.

Senator HARTKE. What statute?

Mr. BLANCHETTE. Section 77 of the Bankruptcy Act specifically provides that if there is a default in payment on any obligation secured by equipment, that the creditor has a right to come in and foreclose and repossess the equipment.

Senator HARTKE. Even after the reorganization is filed?

Mr. BLANCHETTE. Yes, sir. The court has no power to alienate or suspend that right of repossession by statute.

Senator HARTKE. I would like to have you, not now, but I would like you to leave with the committee any brief or any information you have on that.

Mr. BLANCHETTE. Yes, sir.

Senator HARTKE. Senator Cotton?

Senator COTTON. I simply wanted to ask one quick question on this matter of the repossession of equipment. I would like to have this question answered because I want to be sure I understood the situation. Title does not pass on such equipment to the railroad does it?

Mr. LANGDON. A lot of the equipment has been furnished by lease, sir. A great deal of it. Of course, in that instance, the title has not passed.

Senator COTTON. The reason it can be immediately repossessed and becomes a primary obligation is that in many cases other people own it and the railroad is simply paying rent or leasing it?

Mr. LANGDON. That is right, sir.

Senator COTTON. Thank you.

Senator HARTKE. That is how much a day?

Mr. MOORE. A half million dollars.

Senator HARTKE. It seems peculiar to me we are paying that and not paying the property taxes here.

Mr. MOORE. Yes, sir, that is a half million dollars a day.

Senator HARTKE. A half million dollars a day. In other words, the general public can wait; you can go without schools, but you can't do without payment to these other people.

Mr. MOORE. Of course, we can't do without equipment either, Senator. If we didn't have it, the loss would be even greater.

Senator HARTKE. I understand that. Maybe we need to amend the Bankruptcy Act. I mean, I just think it is a question of which you put first. After all, you, if you can suspend payment of property taxes, which are the basis for keeping most local services going in most communities and if everyone else did that, you wouldn't have schools or police departments or fire departments operating. I don't know whether it is more important to have fire departments, police departments, and schools, or to have—who is this loan to; what equipment company?

Mr. MOORE. There are various equipment companies involved.

Senator HARTKE. But they are held by banks, are they not?

Mr. MOORE. No, not necessarily. Some are just leasing companies.

Senator HARTKE. To keep the leasing companies going, how is that?

Mr. MOORE. Insurance companies and individuals.

Senator HARTKE. I want to say at this time I just have one more line of questions here and then I will be glad to yield for a moment.

On accounts receivable, have you been able to come up with any type of realistic understanding of really what is owed to you? In other words, my understanding is that your accounts receivable ledger was in pretty bad shape when you took over. Isn't that true? Isn't that generally true?

Mr. LANGDON. The problem was, sir, the principal problem was in the time interval, between the rendering of the bill and the actual, the performance of the transportation service and the collection of money. That has been a period of 17 days, which is about twice as long as in the case of most railroads. In the last couple of months, we have made some progress in this respect. The billing procedures on the Penn Central are susceptible of improvements and particularly we are anxious to reduce this lag in the receipt of money. It is roughly \$6 million a day and every day that we can speed up is \$6 million roughly.

Senator HARTKE. How much have you been able to improve that time lag as far as collection? I am not talking about billing now, I'm talking about collection.

Mr. LANGDON. I think it has come down about 3 days. In other words, I think it has come down from 17 to 14 days.

Senator HARTKE. That is on billing?

Mr. LANGDON. No, that is on the collection.

Senator HARTKE. All right. I have more questions, but I will be glad to yield to Senator Cotton and the rest of the Senators at this time.

Do you have any other questions, Senator Cotton, that you want to go into now? I have taken quite a bit of time.

Senator COTTON. No, I defer to my colleagues here who are on the subcommittee.

Senator HARTKE. Senator Prouty?

Senator PROUTY. Mr. Chairman, first I have a brief statement that I would like to have appear in the record.

(The statement follows:)

STATEMENT OF HON. WINSTON PROUTY, U.S. SENATOR FROM NEW HAMPSHIRE

Mr. Chairman, I have a brief statement I would like to make with respect to my position on this matter. Because of the geographic location of Vermont and other New England states it is unthinkable that we should permit the service presently rendered by Penn Central to cease for whatever reason.

I am as concerned as anyone about the alleged past misdeeds of the old Penn Central management, but I believe that for present purposes those misdeeds, even if proven, are irrelevant. The fact is that Penn Central is now under new management so to speak and the question is one of preservation of vital railroad services.

Mr. Chairman, I am totally committed to finding a solution which will permit Penn Central to keep operating. I realize that this is a complex problem having both short term and long term implications. For the short term a bandage is obviously needed to keep the patient from bleeding to death. For the long term we must grapple with the more difficult problems of the railroad industry as a whole and of that segment which serves New England and the Atlantic Coast states in particular. For example, we shall have to face up to the fact that providing freight services in those areas is more expensive than elsewhere in the country. This may necessitate some resort to use of public funds to underwrite the providing of such services at charges that industries located in this part of the country can afford to pay. It will clearly require a rethinking of the regulatory approach to the problems of railroads operating in my section of

the country. These are the sort of problems I would hope that we will come to grips within the 92nd Congress.

In the meantime, as I have indicated, we must keep the Penn Central railroad viable if we are to achieve the long-term solutions. This I believe should be done in a manner which is least costly to the taxpayers of the country as a whole and so as to place maximum responsibility for operating decisions up to the management of the railroad itself.

I can find no reason for concern that funds provided in the form of direct loans or loan guarantees will be misspent. The operations of the railroad are under the supervision of four well-qualified trustees and the Federal District Court for the eastern district of Pennsylvania.

It is my hope that as a result of these hearings we will proceed expeditiously to consider and report favorably a bill which will make available to the Penn Central and other railroads in a similar position the funds necessary to continue operations. This will afford us an opportunity to consider solutions to the long-range problems without the pressure of an immediate crisis.

Senator PROUTY. Mr. Wirtz, what effect has been given in forecasting sufficient cash to continue operating through the end of the first quarter of 1971, to weather conditions during that period? Reference was made to the severity of the weather last year. Have you assumed an average winter?

Mr. WIRTZ. My understanding is we have assumed an average winter, rather than last year.

Senator PROUTY. How did you arrive at that average?

Mr. WIRTZ. On the basis of experience over the previous several years.

Senator PROUTY. What does the \$350 million deferred payments to which you refer consist of?

Mr. WIRTZ. I will give you a schedule on that. It is, in exact figures, \$351 million. First there are three post-bankruptcy items. One is our taxes, principally real estate, which have been deferred. That is \$36.5 million.

Next, a large item, principle and interest on debt, post-bankruptcy, came due following bankruptcy, that is \$160 million. Of that \$160 million, \$130 million is principle, and \$30 million is interest.

There is, then, an item for lease line rentals of \$8.7 million. Those are all post-bankruptcy items. There are, then three prebankruptcy items, obligations for materials and services in the amount of \$107.9 million. There was a loss and damage item of \$21 million and there was revenue due other carriers of \$16.9 million.

So, in rough terms, about half of that is prebankruptcy, half is post-bankruptcy, and it includes those specific items.

Senator PROUTY. Have you made any efforts to negotiate with States and localities for abatement of property taxes?

Mr. WIRTZ. No negotiations yet. There has been an application to the court on that. There has been an action by the court, and in the court's action there was provision that we could pay our taxes with respect to any taxing district in which Penn Central's property, the tax on that property accounted for more than 15 percent. So, that anticipates some discussions with those tax districts. They have not yet taken place.

Senator PROUTY. Have you made any projections of the savings which would result to Penn Central if S. 2289, providing for non-discriminatory taxation of railroad properties, which passed the Senate some months ago and is now pending in the House, were enacted into law?

Mr. WIRTZ. We have made studies. Mr. Hellenbrand would be in a position to speak to that.

Mr. HELLENBRAND. The best estimate that has been made up to now is an indication of some \$69 million in reduction for the industry. The actual application within the Penn Central itself has been a very difficult one. And it has been a changing picture. But our people are busy trying to assemble this right now.

Mr. WIRTZ. We would be glad to supply a statement on that, Senator Prouty.

Senator PROUTY. I think that would be helpful.

You refer to the fact that your projections take into account the National Rail Passenger Service Act becoming operative on May 1, 1971. Would you explain how it has been taken into account and how doing so affects your projections?

Mr. WIRTZ. The reason for a fairly cautious statement there is when we are talking about cash flow, it is difficult to identify the effect of entering into the Railway Passenger Service Act, because of the provisions for payments in cash or kind, advance service contracts and so forth.

I believe I can suggest the figure which will give you the answer, which will supply at least a general answer to your question. That, the enactment of that legislation will have a favorable effect, as far as we are concerned, taken along with the commutation arrangements which are being made in New York and other parts of the passenger service, of \$28.3 million; and our projections for 1971 involve an item of \$28.3 million. I should add that doesn't happen until May 1, the Railway Passenger Act. That would annualize out at \$40 million.

Senator PROUTY. What is the import of your statement that Penn Central will run out of cash during the first quarter of 1971? Will it have to stop operating if it runs out of cash to pay its employees?

Mr. WIRTZ. Your question is what is the basis for it, or whether we will stop?

Senator PROUTY. Will Penn Central have to stop operating if it runs out of cash?

Mr. WIRTZ. It is entirely conceivable that we will reach a point where we won't have money to pay the bills. We have had to start making plans for what we would do if we actually came to a shutdown situation. It would take emergency measures to prevent vandalism, that kind of thing.

So, in answer to your question, I would say that prospect is real. I think we would, as realists, recognize the prospect or possibility, if we came right up to that point, there might be pressures at work which would avoid that result. The answer to your question is, we are doing our thinking in terms of the prospect and possibility that we will just have to stop.

Senator PROUTY. Has any thought been given if such a situation develops to the feasibility of attempting to continue by some means mainline service to preserve a rail link to New England?

Mr. MOORE. Would you repeat the question?

Senator PROUTY. Has any thought been given to the feasibility of attempting to continue mainline service by some means to preserve a rail link to New England?

Mr. MOORE. We haven't given consideration to that, but I don't see how it would be feasible to operate the Penn Central Railroad simply by endeavoring to maintain certain segments of it.

Senator PROUTY. Well, it certainly is a connecting link, for shipments which originate in other parts of the Nation—

Mr. MOORE. That is true, sir. But, of course, we have several other links that are probably equally as important. I just don't see how we could possibly designate one link as being one we would open to the detriment of others.

Senator PROUTY. No thought has been given to that, then?

Mr. MOORE. No, sir.

Senator PROUTY. Now, I would like to—

Mr. WIRTZ. Mr. Baker has a comment on that, too, Senator Prouty.

Mr. BAKER. Another way of saying that, I think, is, we would consider keeping service to New England exactly certainly as important as keeping it to everywhere else.

Senator PROUTY. I would hope so.

Now, I would like to refer to attachment B. Would you please explain what accounts for the difference between the \$188.2 million projected loss for 1971 shown in column 1, and the \$47.5 million loss shown in column 2? Is the entire difference accounted for by the effect of the Presidential emergency board wage recommendation?

Mr. WIRTZ. Yes, sir.

Senator PROUTY. Would it be fair to state that the bulk of the moneys for which you are seeking a Federal guarantee are required to permit Penn Central to comply with the wage increase recommendation of the board?

Mr. WIRTZ. No, I don't think it would, Senator. The coincidence in timing contributes to that impression. I think we would feel quite strongly that the several factors which are entitled to equal consideration would include these, if I may, the wage increase to be sure, and the taxes. Some of the previous questions suggest our nonpayment of local taxes bothers us as much as any single factor in the picture. It does get in the way of education and we have to attach equal priority to that. But you also realize these projections include very substantial amounts for equipment, capital equipment, road, and service, and the only reason for singling out the wage element in our projections here is that it is one that we cannot yet predict in any way. But my answer to your question would be, we attach equal significance to the necessity of meeting all our operational expenses, including wages, and along with them the tax matter.

We feel a strong obligation, too, as far as other creditor situations are concerned. But we give prominence in our thinking and priority to those three, operational expenses, the wages, and the local taxes.

Senator PROUTY. If Congress should fail to provide some form of loan guarantee, I would gather that under no circumstances would it be possible for you to even consider following the recommendations of the emergency board with respect to wages?

Mr. WIRTZ. We have stated publicly so far that we are not in a position to pay those wages.

Mr. BOND. We just don't have the money.

Senator PROUTY. I don't know how serious this suggestion has been, but someone mentioned the fact to me a while back that it had oc-

curred to some, that money connected with the railroad retirement fund might be made available on some basis to Penn Central and perhaps other railroads faced with equally serious cash problems. Has any consideration been given to that suggestion?

Mr. WIRTZ. Those suggestions, which I think were made before this committee, I am not sure, have come to our attention. It would require legislation. If there is that prospect, it would be a matter of very real interest to us. I don't know that that presents any basically different consideration from the broader consideration of the use of Federal credit.

Senator PROUTY. I have some other questions, Mr. Chairman, but I will defer.

Senator HARTKE. Senator Baker?

Senator BAKER. Thank you, Mr. Chairman.

Thank you, Senator Prouty for giving me this opportunity at this time.

May I say first that Senator Pearson of Kansas asked me to express his regret that he had to leave this committee to attend the Transportation Subcommittee of the Appropriations Committee markup which he thought important enough to interest you gentlemen at this time.

Having some remnant of the lawyer instinct left in me after these years of service in the Senate, let me ask what sort of trustee certificates you offered for sale or discussed at the time you were trying to make a sale of these certificates?

Mr. BAKER. There was a petition by the previous management before we came in as trustees to the court to allow the sale of some 50 million of trustee certificates, which would simply have been promissory notes, as it were, by the trustees, with first lien on the property.

The hearing as to the allowability of selling those certificates was held up because the information had been found at that time by the court and subsequently by us that no underwriters would be willing to underwrite such certificates and then sell them, and no investment firms would be willing to act as agents in selling them, because they felt they simply would not be taken up. And that for any future financing, this was a bad thing to have happen.

Senator BAKER. I don't mean to belabor the issue, but I want to fully understand the import of what you are saying. A trustee certificate usually offers a first and prior lien on all of the assets of the debtor's estate, exclusive of cost of administration.

According to the balance sheet I see here, you have some \$4.6 billion in assets. So in effect you are saying that you couldn't sell \$50 million worth of trustee certificates, secured by \$4.6 billion in collateral.

Mr. BOND. The answer is yes.

Mr. BAKER. We can't but this is involved with the fact of the encumbrances on them.

One, the exact value of those assets, and, two, our ability to reach them.

Now most, a large number of those assets, so-called, are in the Pennsylvania Co., through our 100 percent stock ownership of it. Mr. Bond has been spending particular time on the problems of the Pennsylvania Co., and perhaps he could comment on why those aren't

available. The people to whom you would sell trustee certificates know that these are encumbered.

Senator BAKER. Do I understand then that the \$4.6 billion on your schedule C listed as assets are listed as the combined and consolidated assets of the several companies, but are not assets available for the debtor operation?

Mr. BAKER. A lot of them are not.

Senator BAKER. Do you have a schedule that shows the total assets that would be available to pledge as collateral for trustee certificates?

Mr. WIRTZ. We are under obligation, Senator, to prepare and present such a schedule to the court at the earliest possible time and we are presently engaged in the preparation of that schedule.

Senator BAKER. This is perhaps an unfair question, but can you give any sort of estimate of what percentage of the \$4.6 billion in assets would be available to secure trustee certificates?

Mr. WIRTZ. If you mean free of litigation, the answer is almost zero.

Senator BAKER. I don't mean free of litigation. I mean what is available in the usual or ordinary way as pledge for security for trustee certificates, which would be a first and prior claim against that asset, superior to everything except the cost of administration.

Mr. WIRTZ. I understand the question and so far we have been unable to identify any significant amount in that situation.

Senator BAKER. Is it unfair to say, and if it is, say so, that the reason you cannot reach a substantial number of the assets you show on schedule C is because of the interrelationship of the several companies to Penn Central railroad?

Mr. BAKER. I think Mr. Blanchette can comment on that.

Mr. BLANCHETTE. Senator, the point is that assets shown on the balance sheet on the asset side of the Transportation Co. reflect the assets only of the Transportation Co., and not of other subsidiaries. The question really is not whether or not trustee certificates could prime other liens, prebankruptcy on those assets, because it is my opinion they could.

You could come ahead of a prior mortgage and take a first lien. The question with regard to the private financing of trustee certificates is less one of getting a first lien, but one of the first lien only obtaining in the event of default. The creditor does not have—he has the ultimate assurance that if he waits long enough and the railroad liquidates and it is in default, he will come in first, or at least ahead of prebankruptcy mortgage creditors as to those assets. But the question is whether or not—

Senator BAKER. Can't the trustee certificates be arranged under appropriate orders of the court so the repayment of principal and interest is out of net operating revenues and prior to preexisting loan obligations?

Mr. BLANCHETTE. Yes, if you had net railway operating revenues, you wouldn't have the credit point that has been referred to before. You have to have enough to repay the loan, then the lien comes in only in the event of default.

So it is not particularly comfortable to know that if the credit risk fails, that after the delay and after foreclosure proceedings, that ultimately you will be able to go ahead of these other liens. You can ultimately, but you don't have a current prospect of payment.

There is another factor in addition, Senator, that a considerable portion of the transportation lines of the Penn Central Transportation Co. are not owned in any way by Penn Central Transportation but are held by some 37 leased lines.

Mr. BAKER. I was sort of amazed, when I got into this that the answer to your question is yes, but I think perhaps Mr. Guest, who is a pro in this area of selling stock certificates might comment as to why to him it seems to be yes.

Senator BAKER. Before you do, let me make sure you understand what troubles me, so we will have a full direct communication; and are not dealing with collateral implications.

First of all, addressing your point, it would seem to me, and I won't argue this further, that the fact that whether a first lien on foreclosure is given voluntarily or given by statute is totally unimportant, unless there is default.

So it seems to me that a contract obligation would be in precisely the same shape as one created by statute and given voluntarily with the approval of the court. The only question that concerns me at this point, and the reason for this line of questioning is this: What is the rationale and the reason for reorganization of this type? It is to preserve the asset until it can be determined that it can be operated successfully or it must be liquidated in deference to the rights of the creditors, employees and the public interest. That is the point I start from.

It seems to me that if you cannot sell trustee certificates, and you cannot pledge the assets of the debtor corporation, there is then a grave doubt that it is desirable to operate it in its present corporate form, excluding for the moment the consideration of public policy.

Extending that one step further, what happens if you do operate and you are not successful? Who is injured? Excluding once again the public interest, the person injured is the holder of the preferred lien, because you are consuming his assets with the cost of administration.

So that finally gets me to the place of finding out why you cannot isolate assets that can be sold to preserve the assets of the corporation, if you pledge some substantial part of this \$4.6 billion, and then to inquire who you have tried to sell them to.

Mr. GUEST. Sir, I am somewhat new in this picture, having only been retained within the last few weeks, so any questions you may have I may have to plead ignorance to. I intend to get fully familiar with the situation of course.

I have a statement which I would be happy to submit with regard to this whole question of financing. However, in answer to your question, the people that would buy trustee certificates are very largely fiduciaries, such as banks, who are not investing their own, but are investing the money of the other people and they need assurance of repayment, so as to be able to turn over their deposits and assets and make other loans to other people.

Senator BAKER. Isn't it so that ordinarily trustee certificates are considered the most secure of all debt obligations in the eyes of the investing public?

Mr. GUEST. Yes, sir.

Senator BAKER. All right. Go ahead, sir.

Mr. GUEST. In this case, however, where there is great uncertainty as to whether the provision of \$50 million or even more in trustee certificates, if they could be obtained, would in fact staunch this hemorrhage of cash which has been projected by Mr. Wirtz, I don't believe these people would say they should take that risk with their depositors' funds when the only way of recovering is to go to a lawsuit and say I come first for whatever comes out of the bankruptcy.

Senator BAKER. May I interrupt once more?

Isn't it so that in the ordinary course of events, the preferred creditor opposes the issuance of trustee certificates and the common stockholder is in favor of the issuance of the trustee certificates, because their interests are different?

Mr. WIRTZ. That is right.

Mr. GUEST. I would agree with that.

Mr. BOND. Senator, one of the things that happened in the New Haven situation, the trustee certificates did default, and I think this has hurt the salability of them.

Senator BAKER. How would you propose the Federal Government guarantee a loan? Would it be through the issuance of trustee certificates or would it be a note, a debenture or what, or is that question a little premature?

Mr. WIRTZ. We have been thinking in terms principally in this area, Senator, of the typical trustee certificate.

Senator BAKER. So the Federal Government would stand in the stead of the fiduciary or commercial banking institution that might be expected to buy the certificate.

Mr. WIRTZ. That is right.

Senator BAKER. And the Government would have a first lien, superior to all except the cost of administration?

Mr. WIRTZ. That is correct. And we would also welcome the additional provision that would require the exhaustion of these other possibilities to which you refer and requirements of immediate repayment if any of those alternatives could be developed.

Senator BAKER. If it could be included in the order of operation.

Mr. WIRTZ. That is right. As a condition.

I might say we have played with these same concerns to which you referred. I don't believe it is a dangerous oversimplification to say if we could get that cash flow situation turned around, then we think these forces to which you refer would become operative. As long as we are in a position where our prospects of not being able to meet wage payrolls, as they come due, we can understand a situation in which someone is hesitant to rely on these longer range possibilities.

We think give a correction of that cash flow situation these other more normal financing forces ought to come into operation.

Senator BAKER. I think what you are saying in effect is that the private lenders in the country would probably be willing to advance funds if they had a prior lien provided you had a plus operating record?

Mr. WIRTZ. Yes.

Senator BAKER. Cash flow record.

But they probably will not if they have to depend on the unencumbered assets of the corporation.

Mr. WIRTZ. That is correct.

Senator BAKER. Now let me ask the armageddon question, which I don't mean to imply any attitude on my part, but to keep things in perspective.

If it is impossible to sell trustee certificates, if you do in fact have a negative cash flow in the first quarter of 1971, and if there is not a Federal guarantee or some variation thereof, and then it becomes your obligation as trustees, your obligation to the court, to recommend whether or not you are dissipating the estate, or whether or not you should continue operating. Would you please tell me in that event what would likely occur to the Penn Central Railroad? Would it continue to operate, would it be sold, or what would happen?

Mr. WIRTZ. I can answer only in terms of the most likely of several futures, and I would have to answer that I would expect to see some form of this alternative of nationalization at that point.

The prospect of liquidation and termination of the operation doesn't seem to me real. You will know that we have been thinking in terms of whether this is too big an operation, whether it should be split up in one way or another. I think I speak for all of us in saying although we have taken account of those factors, it seems to us the essentiality of this particular operation in substantially its present form, and I am talking only about the railroad, is such that if we can't make a go on this basis, the prospect is somebody else's doing it.

Senator BAKER. Do you exclude the possibility that another private commercial operation would emerge from Penn Central?

Mr. WIRTZ. I do not exclude that possibility.

Senator BAKER. But I gather you don't think it is very likely.

Mr. WIRTZ. That is correct.

Senator BAKER. May I ask you a question about the accounts receivable?

Once again with what vestige of lawyer remains in me I have some recollection that the Interstate Commerce Act prohibits the extension of credit beyond a certain length of time. I am told by the staff that that is not quite so, that under the Federal regulations there is a 48-hour rule.

Mr. LANGDON. The 48-hour rule is in effect. I think that has recently been extended a few hours. But the freight charges are supposed to be paid and collected within a statutory period of, it used to be 48 hours, I think it is a little longer now.

Senator BAKER. Did I understand you to say the average for Penn Central is 17 days?

Mr. LANGDON. For the actual collection of the money, yes.

Senator BAKER. Isn't that what the Federal regulations apply to, the collection of money?

Mr. LANGDON. Yes, but this is complicated by the fact that the billing on our part is not as prompt as it should be.

Senator BAKER. I see. I am not trying to, as the saying goes, pin you to the wall on this, because things at best must have been hectic, but do you have any estimate of how much time elapses on the average between billing and collection, which is the interval to which the Federal regulation applies, as I understand it?

Mr. LANGDON. 7 or 8 days I think is the period there. It is too long. And it has got to be shortened.

Senator BAKER. Thank you, Mr. Chairman.

Senator HARTKE. Thank you, Senator Baker.

I think you pursued a line of questioning which I think is basic and I compliment you for it, because I don't think there is any question but what this is still an unresolved question.

You have never really gone forward to the marketplace with these certificates to see whether or not you will get turned down?

Mr. WIRTZ. That is right.

Senator HARTKE. Has the court indicated you should or should not?

Any advice on that?

Mr. BAKER. As far as the court is concerned, I would rather have Mr. Blanchette comment on that. But I think as to the reasons why we thought it unwise, I would like to hear from Mr. Guest.

Mr. GUEST. Well, gentlemen, in my belief there were two ways in which—

Senator HARTKE. Let's first put your beliefs down in point of time. I had a Mr. O'Herron here and I am not so sure in his beliefs my beliefs believe in him.

At what point in time did you enter the picture?

Mr. BAKER. We just asked Mr. Guest to come with us. Prior to that—

Senator HARTKE. When did he come into the picture?

Mr. BAKER. October 22. Prior to that time, for about 6 weeks, we had as our financial advisor Mr. Robert Fuller, and part of his assignment was to pick for us a financial advisor on a full time basis. He was just a part time advisor to us. So we did have his advice during that period as well as Mr. O'Herron's.

Senator HARTKE. Fine.

Mr. BAKER. Mr. O'Herron is leaving us, as I think you know.

Mr. GUEST. With regard to the sale of the trustee certificates, there are two basic ways in which this might be done. One is by public offer of sale on a competitive basis under certain terms. This is most unusual for trustee certificates.

More normal practice, when the priority of his claim is well known to all concerned, is by private sale and I believe that was the case in the New Haven.

So therefore, all of the efforts which have been made by the company officials and Mr. Fuller, and in the last 2 or 3 weeks I have helped him too, have been in relation to private sale of trustee certificates, if approved by the court, to institutions that might be interested in buying them.

There have been—would you like me to give you the full story of this now?

Senator HARTKE. Yes, I think that would be fine.

Let's try to nail down something here first.

Do you have an evaluation of the assets of the holding company, the total assets which are available under any circumstances, encumbered, unencumbered, or otherwise?

Mr. WIRTZ. Do you mean Penn Central?

Senator HARTKE. That is right.

I want to know how much in assets are available outside of the railroad itself, unencumbered or encumbered, the total evaluation.

Do you have an estimate of that at all?

Mr. WIRTZ. We have the annual reports, Mr. Chairman, and we simply cannot, as trustees, confirm the reporting that appears in those places. So I have got to answer you that as of right now, our evaluation of those assets and liabilities, our inventorying of them on both sides is not complete.

Senator HARTKE. You certainly ought to be able to give us the total amount of the encumbrances.

Mr. WIRTZ. We are pretty close to that, I think.

Mr. BAKER. You are speaking now of the holding company?

Mr. WIRTZ. Excuse me, Mr. Baker?

Mr. BAKER. I wanted to make sure whether we are talking about the holding company or the Transportation Co.

[Discussion off the record.]

Senator HARTKE. Outside of the actual Transportation Co. there are certain assets which are available and which have been repeatedly referred to in these hearings and previous hearings, which if they were unencumbered, could provide security or sale or ultimately for some type of alleviation of the present financial circumstances.

My understanding is that you are not able to give a firm evaluation as to these assets at this time and are, therefore, relying upon the annual statement until such time as you can either correct it or otherwise revise it.

What I am asking you is what is the total amount of the encumbrances on those assets without regard to their value?

Mr. WIRTZ. That we can supply. I don't think we have it immediately at hand. But there is no question about that.

We can also give you, Mr. Chairman, a list of the assets. It is only the valuation part that is a problem.

Senator HARTKE. I would like to have the list.

Do you have the total amount of those encumbrances, approximately, now?

Mr. BLANCHETTE. They would be on the liabilities of the Pennsylvania Co.

Mr. HELLENBRAND. And that is \$163 million.

Mr. WIRTZ. I have been advised the total liabilities of the Pennsylvania Co. are \$163 million.

Senator HARTKE. That is the total encumbrances—

Mr. BLANCHETTE. No. It is the total—

Senator HARTKE. Do you understand what I am asking?

Mr. BLANCHETTE. Yes, sir.

You have to realize the Pennsylvania Co., in turn has subsidiaries which, in turn, have encumbrances.

Now, the top encumbrances, or the top indebtedness of the Pennsylvania Co., is the figure which Mr. Hellenbrand just described, of \$163 million. We can now furnish you, however, and I think it is only fair, not only that top encumbrance, but the encumbrances on the assets of the subsidiary corporations, and we will get that schedule for you.

Senator HARTKE. You cannot give me the total of those encumbrances now?

Mr. BLANCHETTE. Not corporation by corporation.

Senator HARTKE. Can't you give me corporation by corporation and then the totals?

In other words, I want to find out how much you owe.

Everyone comes in here and says this property is not available, these assets are not available, because they are so tremendously encumbered. I heard Madison Square Garden advertised on the radio today, they were bragging about the place, since we can go there and see Sonja Henie and all of the other people. Twenty-four percent is owned by this corporation.

What I want to find out is what is the encumbrance.

Mr. WIRTZ. Mr. Chairman, we do not know. We will supply that figure.

But let me point out that any caution we exhibit here is for the very reasons you referred to earlier.

(The following information was subsequently received for the record:)

PENN CENTRAL TRANSPORTATION CO. AND PRINCIPAL SUBSIDIARIES LONG-TERM DEBT AT SEPT. 30, 1970

(In millions of dollars)

	Bank loans (part secured)	Mortgage bonds and notes	Collateral trust bonds and notes	Railroad equipment obligations	Real estate and other secured loans	Various unsecured notes	Miscellaneous obligations	Total long-term debt
Penn Central Transportation Co.....	431	637	51	519		49	64	1,751
Pennsylvania Co.....	1	50	67	2				118
Ann Arbor RR. Co.....		2			15			9
Arvida Corp.....		42						57
Buckeye Pipe Line Co.....		49					13	62
Chicago River & Indiana RR.....		14						14
Detroit, Toledo & Ironton RR. Co.....		7		17				24
Great Southwest Corp.....	84				85			187
Manor Real Estate Co.....	22					4		27
New York Central Transport Co.....								17
Pittsburgh & Lake Erie RR. Co.....				33				33
Railroad Equipment Leasing Cos.....				55				55
Leased railroads.....		360	2					362
Subtotal.....	538	1,166	120	626	100	53	113	2,716
Less eliminations of intercompany holdings.....		15				49		64
Total.....	538	1,151	120	626	100	4	113	2,652

NOTES

1. Great Southwest Corp. balances as of Nov. 30, 1970, but do not reflect liquidation of debt in connection with sale of property to Cerro Corp.

2. The above-stated liabilities do not reflect certain further encumbrances or restrictions arising indirectly through pledge of assets, negative pledge covenants and other contract requirements for asset maintenance, ratio tests, etc.

3. Current liabilities, including short-term loans and notes payable, incurred in the ordinary course of business, are not included in the above schedule of long-term obligations.

4. Does not include long-term lease obligations for railroad equipment and rental obligations for miscellaneous properties.

5. Miscellaneous obligations include \$60,000,000 of commercial paper that matured unpaid and is in default.

Mr. WIRTZ. On your question of what the total encumbrances are, we can give it to you down the line, on the Transportation Co., the Pennsylvania Co.—

Senator HARTKE. Would you prefer to wait until 2 o'clock to do that?

Mr. WIRTZ. We will give you the best we can at 2 o'clock.

Mr. BAKER. Could I make a sort of clarifying remark here?

There are three levels of encumbrances. Take Great Southwest, they have their own encumbrances. Then there are encumbrances on Pennsylvania Co. On top of all this, all of the stock that the Transportation Co. holds in the Pennsylvania Co., is pledged against a \$300 million loan that was used by our company.

Senator HARTKE. I understand what you are saying.

But the answer you gave to Senator Baker's statement was the fact that in spite of everything else, the reason these trustee certificates could not be sold was not alone the prospects of repayment out of the operating expenses, but due to the fact that there was this heavy encumbrance on the other assets of the corporation.

Mr. BAKER. This would be a reason, one of the reasons for the difficulty in selling the certificates.

Senator HARTKE. I am just trying to find out that amount, the total dollar amount of the encumbrances which we have been talking about here. And we will come to your statement, Mr. Guest, this afternoon, so you don't have to worry. You have time to rest for a moment. But you cannot give that to us now, right?

Mr. WIRTZ. We would prefer to give it to you at 2 o'clock and will.

Senator HARTKE. All right. We will defer that then.

When we had these hearings last time, I have to admit that this Senator was skeptical of these projections. In view of the fact we were warned at that time, first we were warned in June that if we didn't do something in June, they would collapse by July 1. Then we had hearings subsequently when your financial expert, Mr. O'Heron—

Mr. WIRTZ. He is the financial vice president, yes.

Senator HARTKE. He was in front of us and he gave us definitive statements that they would run out of cash the last week in September or the 1st of October. That you would go into a negative cash position.

Now you gentlemen were here at that time.

Mr. WIRTZ. No.

Senator HARTKE. Can you clarify for me what occurred between that time and now as to why the Penn Central didn't collapse?

Mr. WIRTZ. Yes, sir.

That testimony came shortly after we had been appointed trustees and it seemed to us sufficiently a matter of concern that we went out of our way to make clear to this committee that any testimony at that time did not represent the views of the trustees.

We were given the same information you were. We discounted the information because we felt the basis for those cash flow projections at that point was inadequate. We did not come here, even though we were advised that we were going to run out of money within 30 days. And we were advised that it would happen then in November. And still we did not come here for the same reason.

We have since that time, put these cash flow figures to the most searching cross examination and investigation possible and this is the first time we have felt in a position to give you reliable information.

The short answer to your question is, the early information was wrong.

Senator HARTKE. All right.

Mr. Wirtz, you know I value your honesty and integrity very highly. I would like to ask you for the record at this time, is there any statement which is being given today, or any testimony which is being given today, which is under the same type of apprehension or restriction or qualification in regard to the projections you have given us based upon information which has been handed to you other than that which you have specifically spelled out, or is materially unavailable, or is estimates?

Mr. WIRTZ. No, sir.

When it comes to cash flow, that is right.

The reason for this difficulty about 10 minutes ago on valuation of the assets is in this same area. And you will understand and respect our reluctance to tell you firmly what those figures are.

But otherwise, no, Mr. Chairman.

Senator HARTKE. I understand.

As long as we have those qualifications in front of us, so we know we are operating on the basis of information which is subject to change, and is being given to us on the basis or prior reports and prior accounting, that is perfectly all right.

A thought occurs to me, and I want to mull this over myself over lunch. In regard to the questions of the leased equipment, in the event the Congress should decide on nationalization of the railroads, under such circumstances, the leased equipment would immediately be acquired in that nationalization process?

Since that is true, any payment that they would ultimately receive, either by virtue of continuation of that lease or appropriation by the Government, would necessarily be deferred.

If that can be done under the doctrine of eminent domain, and nationalization, then it seems to me that that same authority would exist to postpone the payment of these leased payments at this time, which in and of itself would amount to approximately, if your statement is correct, of a half million dollars a day, of an additional cash flow on an annual basis of \$175 million for next year, which is about the amount that you have asked for.

I know this presents certain constitutional questions, but let me just continue a moment.

I think also that the reality of the situation is that in the event that the lessors did decide to repossess, that all they would do is they would have repossessed equipment which they could not use.

I am not unaware of the fact that you are also continuing arrangements whereby you are presently attempting to replace some equipment under similar arrangements. Of course, if that possibility developed into reality, you might have greater difficulty in acquiring new equipment. But, we are not dealing with an ordinary situation.

I leave that with you and we will recess until 1 o'clock.

Mr. LANGDON. Before you recess, sir, may I ask you to take into account during lunch, the fact that the most serious single operating

problem on the Penn Central is lack of equipment. And if there is anything done to question the integrity of the arrangements that have been made with regard to our present equipment, it will be absolutely impossible to make any arrangements as in contemplation for new equipment in 1971, and upon that new equipment depends, more than any one single factor, the revenue that we hope to live on or at least get by with in the years to come.

If equipment obligations become subject to question, then the Penn Central will be absolutely—and other railroads, too—absolutely unable to move forward with the acquiring of new equipment and upon the acquisition of that new equipment depends our future more than any one single operating factor.

Senator HARTKE. Yes.

Mr. Langdon, let me point out to you a factor which I would like you to think about over the lunch hour, and that is the fact that the proposals being submitted here today deal specifically with the Penn Central. One of my first questions to Mr. Wirtz was whether these things were peculiar to Penn Central or whether they were also industrywide?

If one of the suggestions be pursued, that is of an equipment pool, then the possibility exists that without providing for any type of guaranteed loan, without any direct loan, and without nationalization, the Government could move into the equipment pool field and maybe assume the obligations of these payments, and thereby continue to operate a railroad on an entirely different basis.

I am not suggesting that that is going to be followed, but that certainly is an avenue which I have not heard discussed.

Thank you.

We will recess until 2 o'clock.

(Whereupon, at 12:10 p.m., the committee was in recess, to resume at 2 p.m.)

#### AFTERNOON SESSION

Senator HARTKE. Good afternoon, gentlemen.

Can we return, Mr. Wirtz, now to where we left off and see if we can come up with the amount of encumbrances that are on the non-operating part of the railroad?

If you want to give it in any other way—what I am trying to find out is just what assets are really available and how much they are encumbered and what the potential is.

Mr. WIRTZ. Yes, sir. I hope the subject isn't so serious, Mr. Chairman, that I will abuse it by giving you my answer in terms of a story that is a part of the Midwestern folklore that you and I know.

You asked me for some information and I couldn't help thinking of the story of the traveling salesman in the Midwest who asked the waitress for two softboiled eggs and a kind word for breakfast. She brought him the softboiled eggs, as I am about to bring you this information. He asked for the kind words and it was "Don't eat the eggs." [Laughter.]

My point is this: You asked for the encumbrances first on the various assets and I can give them to you in this rough form. Perhaps this suggests that because these have been put together very quickly that we check them and correct the record if they are wrong. But this is the range.

If we were to look at Penn Central Transportation Co. itself, the encumbrances, liabilities, are in round figures \$3 billion. Now, that isn't the question you asked, because you asked about particularly the nonrailroad properties. We approach the answer to that by looking at three other units. Pennsylvania Co. is the big part of the answer to that, because most of those nonrailroad assets are held by that company.

The figure, combining the current liabilities and the long-term liabilities there is \$166 million for Pennsylvania Co. itself, but that is only part of the picture because your interest is really in the subsidiary corporations below that. So I think that the closest answer to the question you asked, which is Pennsylvania Co., plus all of those subsidiaries below Pennsylvania Co., including Arvida, Great Southwest, and so forth, is in round figures \$750 million in liabilities, divided between short-term and long-term. I can give you that by the various individual corporations.

Now, that's 750 then for Pennsylvania Co. and its subsidiaries, there are two sets of nonrailroad assets that don't come into Pennsylvania Co., but come directly to Penn Central Transportation Co. One of those is Madison Square Garden. The total liabilities with Madison Square Garden Corp. are \$105 million. We have a 24 percent interest in that. And therefore you have to discount that to about \$26 million and then we also have a subsidiary corporation, Manor Real Estate Corp., in which we have a good deal of industrial property along the lines. This is arguably—and also a number of coal properties—this is arguably nonrailroad, although it comes much closer to the railroad. The figure there is \$52 million in liabilities.

So, to recapitulate, as far as Pennsylvania Co. and its subsidiaries, \$750 million, and these other two, the Madison Square Garden interests and the Manor Real Estate interest, adding in round figures another \$75 million of liabilities.

Now that egg is good. Those are solid figures. You are right, it is possible for us to tell you what those liabilities are. But when you get to the other side of the picture it is very difficult to give you that with reliability. But I will describe the assets which are set off against these, and give you therefore a picture of the assets in Pennsylvania Co.

Pennsylvania Co.'s holdings are almost entirely securities of one kind or another. And they include these: in Arvida Corp. a 50 percent interest; in Buckeye Pipeline roughly a 100 percent stock interest; part of the Madison Square Garden interest is there, 10 percent of the 24. There is the Norfolk & Western interests and then there are a number of miscellaneous railroad properties. Then another large one is Great Southwest Corp. Then there is a group of leased line obligations or stock. Then there are notes from the Transportation Co.—the Transportation Co. is here, the Pennsylvania Co. here. I am talking about the Pennsylvania Co. But they hold our notes for a total of \$60 million, \$49 million of it unsecured, \$11 million secured.

They also hold—this is the Pennsylvania Co.—a substantial block of Lehigh Railroad Co. bonds. They also have made advances, particularly to the American Contract Co., in the amount of \$20 million. And to the Philadelphia, Baltimore & Washington Railroad in the amount of \$33 million.

Now I want to just illustratively, so I won't be misunderstood, point out why it is so hard for us to place a valuation on these assets. Take for instance the last or next-to-last one, Pennsylvania Co. has made an advance to the American Contract Co. Another subsidiary of ours. That is for that executive jet airline. To place any particular value on that at this point would strain our credibility just completely out of joint.

Another of the assets, Lehigh Valley Railroad Co. bonds, well, Lehigh is in bankruptcy too. We can't give you that.

So all I can say to you, Mr. Chairman, is I have given you the liability side. When I come to the asset side I cannot give you a reliable figure on it and I do refer and with your understanding to one other thing: we are actively engaged in trying to get rid of or trying to sell a number of these properties. And to go into the detail there would be both inappropriate and—that is not the real point. It is that is hard to button up.

May I make one other point lest there be any misunderstanding? Of course our view on this makes clear it is the cash flow point, but we would like to come back, as a result of a very careful consideration of this, to your views this morning, your suggestion about working out some sort of arrangement, if once worked out, which means whatever credit is made available would result only in money going into some kind of registry or escrow, so it could not be taken out unless we satisfied the appropriate authorities that we had done everything within our legal power to get rid of the nonrailroad properties. We think that that is a very salutary suggestion and one which would meet our situation exactly.

Thank you.

Senator HARTKE. Now, Mr. Guest, let's come back to your statement. Do you want to do it all or summarize it? Your entire statement will appear, but you may proceed in any manner you care to.

Mr. GUEST. With your permission, Senator, I will summarize this document I have in front of me and I would like the committee to appreciate that some of the things I am saying are things I am not saying of my own knowledge, since I came in in October and certain things were done by the trustees or by the officers of the Transportation Co. Of course I have reviewed them with them. I have satisfied what I say has been done has been done. I have participated recently in a number of discussions.

Senator HARTKE. Yes.

Mr. GUEST. The areas covered by this statement of mine are the possible buyers of equipment trust certificates and there are seven groups of people who have been approached individually, not as groups. The first type are commercial banks and finance companies.

Now, the commercial banks already have very sizable loans to the railroad, as well as to the subsidiaries that Mr. Wirtz just spoke of. And in the case of a number of the leading commercial banks of this country they are subject to a proviso which prohibits them from making loans in excess of 10 percent of their legal capital and surplus.

I think I am correct on that, Mr. Wirtz.

Mr. WIRTZ. I am not sure of the percentage. It varies from State to State.

Mr. GUEST. Therefore, with all of the best will in the world, they would not be able to buy trustee certificates unless they got an opinion

from a lawyer saying they were exempt from the 10 percent limitation to a single borrower.

However, we have talked with other banks that do not have this hindrance, as well as certain banks that have not participated in any loans to the railroad to date. The attitude of all of the banks that I have spoken to, and some which the company officials and trustees have spoken to, is that until they can see a positive cash flow they are not prepared to commit funds on any basis of an unguaranteed nature.

Senator BAKER. Did I understand you to say equipment trust certificates or trustee certificates?

Mr. GUEST. I may have misspoken. I meant trustee certificates.

Senator BAKER. Did you say of an unsecured nature?

Mr. GUEST. Unguaranteed.

Now, the question of whether they might be secured or unsecured, they have indicated that that would not make any difference to them. This was the point we were discussing before lunch as to whether security makes much difference to a lender if he can't see how he is going to get repaid, if all he has to do is accept the security and then try to realize on it.

They have indicated they are aware of that problem, but until they see a positive cash flow they are not prepared to give any indication to the trustees that they would buy their certificates.

The second group in this category are finance companies.

I understand that officers of the transportation company have talked with one or more finance companies about pledging the railroad's receivables. This is something which I think is feasible, though it raises problems as to the mechanics, how much can be actually borrowed. And there again how can it ever be repaid if the company is running out of cash.

The third group is life insurance companies. They already hold a large number of bonds of the transportation company as well as equipment trust certificates which, as you know, are still being serviced. They have indicated that they are not interested in purchasing certificates, either secured or unsecured, until they see a rectification of the cash flow.

The third group are the pension funds in this country of which there are three categories, I would say. The first group are the State and municipal pension funds which are among the largest institutions in this country and we do business with them a great deal in selling high grade securities. We have contacted a number of the pension funds in the territory where the Penn Central operates. They have told us they act strictly as fiduciaries, they are governed by State laws and regulations as to what they can do and cannot do. In many cases they require what is known as a bond rating from an acceptable bond rating agency such as Moody's or Standard. And their hands are very largely tied. At the same time they did express interest in being helpful if they could, but nothing you could really hang your hat on, if I may use that expression.

Two other types of pension funds have also been contacted. A large number of pension funds are operated by banks in their trust departments which is a separate department from the commercial loan department. There we have had the same answer as we did from the

insurance companies, where is the cash flow. Until we see evidence of that, no interest.

The last, certain large companies operate their own pension funds, without the advice of a bank. They have been contacted and they indicated there was no point in talking to them at this time either.

Another group who has been contacted, and here I speak with some diffidence, because this involves the investment banking fraternity of Wall Street, before we came into the picture, officers of the railroad contacted I believe four leading banking firms, other than Kuhn, Loeb, of course, people who had done business handling railroad securities, and asked "Would you underwrite or act as placement agents for trustee certificates," and they all said "No." The reason being that they did not think they could be sold to their customers with any sense of responsibility at all on behalf of the part of the investment banking firm. Suppliers to the railroad.

I think Mr. Wirtz mentioned the arrangement with General Motors, which is pending. I believe or I have been told that discussions are proceeding with one or two other suppliers. The amount of credit that the suppliers would make available to a railroad as large as this is not very great, of course. I know this is being explored, however.

In connection with suppliers I might add leading companies who frequently act as intermediaries on behalf of some of the equipment manufacturers, two or three of them have been contacted and they indicated inability to be helpful.

Other railroads—in the General Motors transaction I understand there is an arrangement, I think five other railroads have agreed in case of some certain contingencies, they might take over the locomotives. This is a method of facilitating the financing. Apart from that I don't believe there are any indications of credit available from other railroads.

The last item is shippers. I believe the trustees have contacted one or two of the larger shippers on the Penn Central system to see if some form of credit could be obtained there and I think there are a number of difficult legal problems for the shippers, as well as the railroad. But the answer is the legal problems or not, they didn't indicate they could come up with any money.

I think I have covered the groups that have been contacted and the types.

The last thing I would like to say is that none of these observations would apply to a trustee certificate that was carrying a guarantee of the United States. I believe that they would be perfectly marketable. I think the amount of money that Mr. Wirtz spoke about in the area of \$175 million could certainly be raised with the bona fide of a Federal guarantee. I think the only thing that you would have to be careful on, the guaranteeing authority would have to make sure that the terms of the security and the terms of the guarantee were such that they would be attractive to the kind of investor who wants them.

For instance, a pension fund might want to have a long-term security as opposed to a short-term security. Details of that type would have to be carefully worked out before any guarantee program was enacted.

Senator HARTKE. What you are saying in substance is you have made a preliminary review of certain selected potential investors, but have you put together a proposal and attempted to market it on a competitive basis?

Mr. GUEST. No, sir.

Senator HARTKE. Is there any reason why you shouldn't do that?

Mr. Baker?

Mr. BAKER. Senator, I think, as I said earlier, there was taken to the court before we were appointed, a request for the right to issue \$50 million of trustee certificates and an application made to the Interstate Commerce Commission for approval thereof. Then the hearings were recessed. We were advised by our financial advisors that to go through with that and simply offer it and have no takers left you in worse shape than you were before.

I must say I don't know how we could be in worse shape, so—

Senator HARTKE. What worse shape can you be in? If you need money, you attempt to borrow and get turned down, so what difference does it make?

Mr. BAKER. Yes. I think we can go through this exercise perfectly well. I think every bit of information we have had is that with no positive cash flow, no one will take these up. But there is no reason why we shouldn't go through that process any more than that we should stop now in trying further on all of the various sources, as we certainly will. We were at first dependent on the financial officers of the company as we found the company for their advice. Then as I said we took on Mr. Robert Fuller, who is a very experienced man in this area as an outside advisor. Also in late August and early September two of the trustees, Mr. Langdon and Mr. Bond, both spent a lot of their own time feeling out the market for such securities and I think it might be helpful if perhaps we had Mr. Bond say a few words about how he approached that and what he found and Mr. Langdon also.

Mr. BOND. Well, I have very little to add, Senator. We did make these calls personally and in every case we were given a cold turn-down.

So our reaction is exactly as Mr. Guest has portrayed it. I see no reason why we can't pursue this other avenue, but to date everywhere we have gone, to the banks and insurance companies, either individually or collectively, the answer is the same, "Come back when your cash flow is positive and we will be glad to talk to you."

But we have had absolutely no support at all for the sale of them without a guarantee.

Senator HARTKE. Mr. Guest, let me ask you, do you agree that such a proposal should not be made? Should be made? What is your position on that?

Mr. GUEST. I would certainly agree with Dr. Baker that if it was decided by the trustees that it would be desirable, as evidence of good faith, to attempt to do this, I would fully concur with Dr. Baker's view.

However, I would not, I think, advise the trustees to expect any significant amount of bids on a realistic basis.

Senator HARTKE. What harm could it possibly do?

Mr. GUEST. I think as Dr. Baker said that it would hurt whatever credit is left, but there isn't much left, so I agree with you there is not a great deal of harm that would be done that way.

Senator HARTKE. Not a great deal.

Can you tell me any harm it would do?

Mr. GUEST. The only harm I can think of, sir, is the delay in getting the papers ready for such an offering.

Senator HARTKE. How long would that take?

Mr. GUEST. I would have to ask Mr. Blanchette what he thinks there.

Mr. BLANCHETTE. Depending on the details required by the Interstate Commerce Commission in a package where you know neither the borrower, nor the interest rate, nor the security, nor the other terms of the loan, because no one has already bid on it, I imagine a prospectus could be gotten up in fairly short order if one is required—

Senator HARTKE. What do you mean by short order?

Mr. BLANCHETTE. I hope my clients won't bind me to this, I would say within a month.

Senator HARTKE. Could it be done by the first of the year?

I understand that Congress is going to reconvene on the 18th or 19th of January. Could it be done and completed before the Congress reconvened?

Mr. BAKER. Yes.

Mr. WIRTZ. Sure the answer is yes, Mr. Chairman.

Mr. BAKER. Could I say this, it seems to me, personally, that nothing would be lost by this, we better go through the process. The people educated in this field don't give us the slightest hope, but it seems to me in the same category as I am going on and wanting to raise money anywhere we can, through any kind of sale, through any mechanism we can possibly think of. And our success in that, if we can be successful, reduces our need of government help, there is no question.

Senator HARTKE. If you put it out on competitive bidding though, that would not detract from it, would it?

Mr. BAKER. I don't think so.

Senator HARTKE. Would it, Mr. Guest?

Mr. GUEST. No, sir, it might improve chances, because there may be people that have not been contacted that might come out of the bushes.

Senator HARTKE. That is right.

Now you said you contacted the Pension funds. Did you pursue the idea suggested by Mr. Dennis of the Railroad Retirement Fund?

Mr. GUEST. I was aware of it, sir, but I have not made any contacts with the Railroad Retirement Fund, though I was aware of what Mr. Wirtz I think said this morning, that he knew about it, but it might require legislation.

Senator HARTKE. I understand. This is a government-controlled fund.

Mr. WIRTZ. Mr. Chairman, there will be further investigations along that line.

Senator HARTKE. All right.

The reason I asked these questions about the encumbrances and the assets and so forth, from what you have said here, and assuming

that any further pursuit of any other efforts to sell any trustee certificates failed, what you are really saying is that no one considers this an investment which is worth pursuing, isn't that correct?

Isn't that what you are saying, Mr. Guest?

Mr. GUEST. I think they regard this, for a fiduciary, an extremely risky investment to make at this time.

Senator HARTKE. Don't you believe also, when you come to the Government, you really come to the Government as a source of fund of last resort, isn't that true, Mr. Wirtz?

Mr. WIRTZ. Yes, that is right.

Senator HARTKE. In other words, every effort, every pursuit of every possible means, without utilizing government guarantees, government loans, or grants—

Mr. WIRTZ. Right.

Senator HARTKE. Should be pursued and should be demonstrated to its fullest extent before the Congress should act affirmatively. Isn't that true?

Mr. WIRTZ. Yes, I think you would read what all of us have said here properly, as indicating if there is any question about this, which question would be resolved only by actually undertaking this effort and in complete and total good faith, I think we should do it. I think that is the view of the trustees.

Senator HARTKE. Yes.

Mr. Guest, let me ask you, what you have said in substance is that there is no reasonable assurance that the Penn Central would be able to repay these loans? Isn't that true?

Mr. GUEST. I don't think I can say that yet, sir, because I have not yet been able to develop a feeling of what Mr. Moore can do for this railroad in turning it around.

Senator HARTKE. What I am saying is the judgment of the financial community that you have contacted so far is to that effect, is it not?

Mr. GUEST. Yes, it is not an entirely informed judgment, I think, because Mr. Moore has not yet had a chance to tell investing groups and the public as a whole as to what he is trying to do and how long he will need to do it. I think there is some positive elements here which can be developed. I don't think they can be developed in a short time though.

Senator HARTKE. Mr. Baker?

Mr. BAKER. I would agree, but it is that the investing community doesn't think we will be able to make this last long enough to even think about repaying them. But it isn't that we could last through this tough period ahead that we couldn't repay them. We believe we can. And I think there will be some credibility, we have some credibility in that regard. We think Mr. Moore is going to be able to turn this around if we can get the financing to get us over this period.

Senator HARTKE. Do you think the credibility of the corporation is better than it was last June?

I suppose the answer to that is self-serving, you would have to say yes.

Mr. BAKER. We sure do hope so.

Senator HARTKE. I suppose there is no asking witnesses that question. I will answer it for you. You see, the administration's bill—and

Secretary Volpe will be here tomorrow—requires that the general financial condition of the railroad would be such as to hold out a reasonable assurance of its ability to repay the loan within the time fixed therefore and afford reasonable protection to the United States.

Now I think that under this criterion, unless it be changed somewhat, that it would be impossible for Penn Central to even qualify for a loan under that type of legislation.

Mr. BAKER. This would depend somewhat on the period of repayment in the loan. If it is quite a long time, that is quite different from a short time.

Senator HARTKE. I plan to move to the subject of diversification, unless you have some questions, Senator Baker.

Mr. WIRTZ. Before we go on, Mr. Chairman, may I suggest there has been reference to Mr. Moore's feeling about what can be done with respect to the future, so at some point I think it would be helpful for the committee to have, as we have had, the benefit of that statement, if that fits in.

Senator HARTKE. Yes, certainly.

Let me say I hope you will continue as you have in the past, to keep us advised of the railroad's condition officially or unofficially.

Mr. WIRTZ. I mean it might be well to add to this record some comments of Mr. Moore.

Senator HARTKE. Yes.

Senator Baker?

Senator BAKER. Thank you, Mr. Chairman.

Do I understand that it is your collective view that an offering of trustee certificates, public offering, or a proposal to be submitted to the underwriters, or whatever, is sort of a vain gesture, that it won't accomplish much?

Mr. WIRTZ. Yes, sir.

Senator BAKER. And the only reason to do it if you do it is just to go the last mile to be sure you have done everything.

Mr. BOND. That is right.

Senator BAKER. Does anybody think you will get trustee certificates sold?

Mr. WIRTZ. I would like to say if we decide to make that effort, it will be made 100 percent. You say a vain hope. If I thought it were a totally vain hope, it would be almost to question the chairman's reaction on this. I would answer only qualifiedly, Senator Baker. I say if we decide to go ahead on the basis of this, we will really try.

Senator BAKER. I am sure you will. I don't mean to speak in derogation of your good faith. But isn't it fair to say no one really expects that you will be able to market these successfully?

Mr. WIRTZ. That is fair.

Senator BAKER. Here we are in a dilemma, and why are we in this? Isn't it fair to say three things are conspiring against the successful placement of trustee certificates? One, the amount of money required is very large. No. 2, there is at least the substantial prospect that if you wait long enough, the Federal Government will guarantee or bail it out. No. 3, everybody knows the national interest is so inextricably bound up with the operation of the railroad. Don't these things make it a real problem?

Mr. BOND. It makes it very difficult, yes.

Senator BAKER. Is there some flaw in that? If there is, I need to know now.

Mr. WIRTZ. I don't think there is, Mr. Baker. The only thing is, I am not sure the bigness is a barrier, if we didn't have the others. The great barrier is if we were just an ordinary business, we would stop and be sold.

Senator BAKER. The creditors of that business would probably shell out some more money just to protect their investment, wouldn't they?

Mr. BAKER. There comes a time when it is better to wash it out, sell the assets and be done, in an ordinary business. At that point, nobody puts anymore money in. That is the way they look at it unless they know who is going to continue and how. Then they get interested again.

Senator BAKER. But as long as there is a prospect, and I don't mean this to be critical, but as long as there is a prospect that the U.S. Government will guarantee trustee certificates, or loan money, or enter into an operations agency, or something else, isn't it virtually inconceivable that investors in substantial numbers, in substantial amounts, will come forward now and agree to put up this money?

Mr. BAKER. Extremely improbable.

Senator BAKER. For whatever it is worth, I think we are probably going to end up doing that. But what would happen—I will ask you this again—what would happen if the Congress didn't extend that guarantee of credit, in your judgment?

Mr. BAKER. I think we would just grind to a halt. We wouldn't have money to pay the payroll and it would be sort of like what happens in a strike, the railroad would have to stop operating and you would get all of the extreme pressures to continue operation brought on government to continue it somehow. We just wouldn't have—it would be like running out of money.

Senator BAKER. I can foresee the shutdown of operations and the trustees going to court and telling the court that they felt they could no longer operate the facilities and still conserve the assets.

Assume now that is done. What would happen next? Would somebody file a petition for voluntary bankruptcy, or what?

Mr. BLANCHETTE. No, sir, Of all of the bankruptcy laws, Senator, section 77 is the only one that does not provide for straight bankruptcy. There is no—the assumption is a continuation of operations, so there is no specific provision in the statute for shutting down. There is one instance, however, of the New York, Ontario, and Western, in which a Federal judge couldn't generate cash, so it just stopped, so the proceedings were dismissed, it was dismantled and the tracks ripped up and sold to abutting landowners, and so on.

Senator BAKER. There is no provision in that section of the statute or the corollary provisions of the act for disposition or for involuntary dissolution?

Mr. BLANCHETTE. No, sir, Unlike chapter 10.

Senator BAKER. Yes, or chapter 11.

Mr. BLANCHETTE. Yes.

Mr. BOND. I think the first thing we would have to do would be to meet the payroll.

Senator BAKER. Thank you, Mr. Chairman.

Senator HARTKE. I want to apologize for being engaged while you asked a question. What happened, did you say, in the case that nothing happened and March 31 came and you couldn't meet the bills? Couldn't you go into liquidation, into bankruptcy?

Mr. BAKER. We are sort of in bankruptcy now, except it is called something else.

Senator HARTKE. No, you are in reorganization now. The next step could be bankruptcy—and you correct me if I am wrong—and the next step under bankruptcy would be they would sell the assets. Not necessarily sell all of the tracks so that you could buy three spikes for yourself at wholesale rate and some of that driftwood that is called ties. What you would do, you go into bankruptcy; they could form new corporations that would buy parts of this thing; they could reorganize this even in a bankruptcy proceeding; isn't that true? Form new corporations and liquidate these assets? Isn't that true?

Mr. BLANCHETTE. I respectfully will say no, I don't believe it is, Senator.

Senator HARTKE. In bankruptcy?

Mr. BLANCHETTE. I was telling Senator Baker that unlike any other provision of the Bankruptcy Act, section 77 relates to railroads and has no provisions for liquidating or going to what is called bankruptcy. It was just never conceived a railroad would stop operating.

So, at a point, you would just stop and maybe dismiss the proceedings, allow the mortgage trustees to foreclose, dismantle the assets or dismember them in one way or another. Some corporation, I suppose, could be formed to bid.

Senator HARTKE. That is right. And they could bid in separately.

Mr. BLANCHETTE. Yes, but they would still—you still wouldn't be operating the railroad. The railroad would stop.

Senator HARTKE. You know, some people have suggested the only way out of this operation, basically anyway, is either nationalize or liquidate. Some people have advocated liquidation as the only way to straighten up this mess. After all, you didn't create it, but what I am saying to you is that maybe the only way to unravel this giant apparatus ultimately is to liquidate it.

Now, I don't think there is any question but what Southwest Corp. has some difficulties, but ultimately has some property that is worth something. Arvida is the same thing. Buckeye Pipeline is a going corporation, isn't that true?

Mr. WIRTZ. Yes, that is correct.

Senator HARTKE. All right. There is a lot of conversation in this country about the tremendous real estate holdings these corporations have as railroad properties which they will not piecemeal sell. I know of some which people will buy parts of them, but they won't buy them in total.

At the present time, you are negotiating—I think this is true—with the transit people with sale of right-of-way, unused right-of-way, in the eastern section of the United States, are you not? In the process of sale of right-of-way?

Mr. WIRTZ. Yes. There is no question about what you are suggesting, Senator, with respect to the nonrailroad properties in one way or another.

Senator HARTKE. Even in some of the railroad properties.

Mr. WIRTZ. I think there is more of a question there.

Senator HARTKE. There is quite a bit of real estate and right-of-way properties which are held which have tremendous investment potential in certain sections, especially if you consider the air rights, which have never been fully developed and explored. Isn't that true?

Mr. WIRTZ. Yes.

Senator HARTKE. The air rights, for example, are not carried on the books at hardly anything at the moment, yet you have, you see in the minds of the people, you have a gigantic corporation here. It has been estimated as much as \$7 billion, and as low as \$3 billion, I suppose, but \$4 to \$5 billion of assets, and somehow or another, a lot of people have a gnawing feeling in their minds, saying, look, why does Uncle Sam have to dip into the taxpayer's purse to bail out this tremendous operation when all around them they see this gigantic corporation owning property in almost every village and town throughout the country, a lot of which is still not presently being used for anything. Some of it has potential use for industrial purposes, and at the present time—I am not criticizing, I am just saying these facts remain, they are out in the wide open here. That is why I think it is very important that we have a complete revelation here. We must unravel this situation as to the final condition of these incumbrances, where they lie, how they ultimately exist, I don't think there is any question but what you could dispose of Southwest Corp. today and come up with quite a bit of cash.

Mr. WIRTZ. That is a serious question.

Mr. BOND. I think we should talk to that for a moment.

Senator HARTKE. All right. I understand that they have taken profits which ultimately are going to have to be written off. They have taken paper income which are now going to have to be written off as loss. Is that what you are going to tell me?

Mr. BOND. Our concern, when we get through, if we liquidate all of the assets, there would be practically nothing left. For example, the Great Southwest is a case in point.

Senator HARTKE. What value is it to you now?

Mr. BAKER. Nothing left for us at the moment.

Senator HARTKE. The primary purpose of these hearings, as far as I look at them—I am not talking about legalities; I am not talking about disabilities. I am talking about keeping a railroad going—we

are not primarily concerned with Great Southwest Corp. or Arvida or Buckeye Pipeline at this moment. Buckeye might be in a semi-public service capacity, but Southwest is certainly not a public service or interested operation. The railroad is.

When we had hearings in early May, I tried to get those people to talk about the railroad and railroad service. They wanted to talk about investment portfolio; they wanted to talk about investment risk; how they were ultimately getting money.

All I am saying now is there is a lot of talk, substantiated, unsubstantiated, that you have a gigantic corporation, tremendously wealthy in assets, which repeatedly have been said to be so heavily encumbered they cannot support any type of trustee certificates. I think it has to be very clear, as far as I am concerned at least, and I would think as far as the Senate and Congress is concerned and the people generally, that all of these issues have to be cleared up. And there may be merit in just passing legislation authorizing the revision of section 77 to the extent that it would provide for liquidation. Then certainly as far as these other people who are investing in this, they might have a lot of yelling and knashing of teeth, but when we are talking about a proposition in which this railroad alone anticipates it is going to need in the neighborhood of \$450 million to have a successful operation in 3 years, you know, I think that in view of all of the other demands on the Federal Treasury at the moment, that there is going to have to be an ironclad case made or I personally would not want to ask the Congress to go along with it.

Mr. BAKER. Can I try to answer that?

Whether we try to sell now every single piece of property that we can control that is not necessary to the running of the railroad, which we now want to do, or whether this be done under what you referred to as a normal bankruptcy, rather than a 77 one, the intent would be identical. We want to get rid of every single piece of valuable property for anything we can sell it for as long as it is not necessary to the operation of the railroad, which we feel is what we have been hired to do, to try to keep this railroad going.

So, that is our intent. We want to get rid of every last piece of property, no matter whether it is owned indirectly through the Pennsylvania Co. or whether we own it directly, that we can possibly do. That is our intent.

Senator BAKER. I am sure that is so. Let me ask this question? Are you encountering any resistance from the management of any of these subsidiary companies in this respect?

Mr. BOND. Well, first of all, Senator Baker, we have made some changes in the top management of the Pennsylvania Co. which we think will be helpful, and at the moment we are not encountering opposition. In fact, we are working very diligently right at this moment to attempt to make some of the sales of these assets.

Senator BAKER. Do you have the cooperation of the management of each of the subsidiaries?

Mr. BOND. We believe we do. Mr. Hellenbrand, here next to me, is the president of the Pennsylvania Co., and he can speak to this if he wants to, but it is my impression we are not having difficulties.

Senator BAKER. I fully understand in each case you are not necessarily the sole owner of the subsidiaries. In some cases, you are not the owner to the extent that by statute you would be entitled to authorize the dissolution and sale of the assets. But what I am reaching for is this: Are you receiving the cooperation of the management of the subsidiaries to the degree and to the extent that you can handle the assets and resources of these subsidiaries as if they were not subsidiaries but rather divisions?

Mr. BOND. I will ask Mr. Hellenbrand to answer that.

Mr. HELLENBRAND. To answer that question, I think we really have to separate the companies. I don't think we could appropriately take the position that we own 100 percent of the assets of a company when we only own 58 percent of the stock. Our obligations to the stockholders would be as fiduciaries, and I don't think under any concept of law we can represent ourselves as owners of 100 percent of the assets of the company if we only own 58 percent of the stock. So acting responsibly and responsively to the requirements of law, I don't think we have any feeling that anybody is being unresponsive or uncooperative. And certainly the Pennsylvania Co. and its board of directors is moving forward, I would say, aggressively and I hope imaginatively.

Senator BAKER. I hope you understand, and I am sure you do understand, why I put the question in that form. What I am trying to determine is whether or not, in spite of the degree and extent of the ownership of subsidiaries by the transportation company, you are able to deal with the assets of the subsidiaries for the maximum benefit of the transportation company. I would judge that your answer would be that you are not because in some cases you do not own 66 2/3 percent or whatever would be necessary unilaterally to authorize a dissolution. But that would not necessarily mean to me you are being antagonistic, because you have other equity interests to protect.

I am not trying to criticize; I am just trying to establish the relative availability of these resources for the operation and credit of the Transportation Co. So if I can rephrase it, I gather your answer is no, they are not being treated as if they were noncorporate divisions of the Transportation Co., but, yes, they are being as cooperative as you could expect under the circumstances, taking into account the antagonistic claims or positions of certain minority stock ownership.

Mr. HELLENBRAND. I would go a step further than that to indicate that each of these companies has its own debt and creditors and its

own liens and mortgages, and even if one were to think in terms of liquidation, and we have considered all of those alternatives, as you might imagine, it is the phasing out of trying to find the best opportunity to get the best result, taking into consideration every possibility.

Senator BAKER. Are you treating your equity ownership in the subsidiaries in a way that will do the most to alleviate your current difficulties in the Transportation Co.?

Mr. BOND. For the Transportation Co., yes.

Mr. WIRTZ. Categorically, yes, Mr. Baker. Where we are a part owner, we try to do the best for ourselves we possibly can. But where obviously a subsidiary company has its own board of directors, with some representatives of other interests, we expect them to look after those interests, too.

Senator BAKER. That is why I put the question the way I did.

Are you doing it to the maximum extent possible in the circumstances?

Mr. BOND. The answer to that is yes, sir.

Senator BAKER. Can you give me a second categorical answer that you are receiving maximum cooperation from the management of each of the subsidiaries under the circumstances?

Mr. HELLENBRAND. The answer is yes.

Mr. BOND. Yes, I also think in the suggestion made by the chairman that if the loan were made, one of the conditions might be if some of these assets were sold, that this would be deducted from the amount of the loan. This is this kind of thing that I think fits in with what you are suggesting.

Senator HARTKE. There is one other situation here that I pointed out before. If you try to market these certificates, of course, you have to have first approval of the judge, and then the Interstate Commerce Commission? In case you fail in either of those events, that in and of itself would be truth of the fact that no further action would be necessary.

Do you follow me?

Mr. BOND. Yes.

Senator HARTKE. Mr. Wirtz, what would be the situation today if the Penn Central had received a guaranteed loan before it went into reorganization?

Mr. WIRTZ. A guaranteed loan of how much?

Senator HARTKE. In other words, if we had passed this legislation when we were first asked to do so, wouldn't we have been in the same position we are now, except \$350 million shorter?

Mr. WIRTZ. Yes.

Senator HARTKE. I just thought that was a rather interesting point. In other words, if we had acted at the request of the administration last spring and granted the authority to proceed with the \$750 million, we would have been \$350 million short and you would still have been back here asking for more now?

Mr. WIRTZ. I am sure we all have certain very human traits—caution, timidity, respect, but that should not confuse the answer to your question. Speaking for myself and I think I am joined in by my colleagues, it would have been a great mistake to finance Penn Central Transportation Co. on the basis that was sought last summer. If it had happened, it would have only postponed the day of reckoning in our view; and we think we are coming in now on a quite totally different basis.

Senator HARTKE. As I understand you, according to your statement, you say diversification was a mistake. Are you trying to reverse that policy at the present time? You are interested in trying to sell off the assets as soon as you can of nonrailroad, nonoperating assets, and as far as you are concerned, any cash that is required from those sales will be used strictly, as far as you are concerned, in the operation of the railroad. Is that right?

Mr. WIRTZ. Yes. Just one little point in your last statement, that would be true only to the extent of our legal authority to do it. But with that qualification, yes, affirmative on your whole question.

Senator HARTKE. A good reason for that, the fact that witnesses from the old Penn Central management did tell us that the diversification produced income to keep the railroad running, that it covered railroad losses. They told us that the Pennsylvania Co. invested \$144 million of cash in the program, its realized returns were \$146 million between 1964 and 1969.

Last Thursday the Interstate Commerce Commission sent up a preliminary cash flow analysis of this diversification program. Without objection, I would like to enter into the record the letter from the ICC addressed to us which give this correction, that information concerning the diversification program.

This says: "A report indicates that the diversification cost the Penn Central \$153 million in cash."

In other words, \$153 million more went out of the railroad than came back in. It took the ICC about 5 months to figure this out. I think they should have figured it out before and I would hope they would take a look at some of the other railroads before we find ourselves faced with some of the same situation.

Anyway, it is clear now that the railroad furnished its cash for nonrailroad business, not the other way around as some people would have had us believe.

(The information referred to follows:)

INTERSTATE COMMERCE COMMISSION,  
OFFICE OF THE CHAIRMAN,  
Washington, D.C., November 18, 1970.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Surface Transportation,  
Senate Commerce Committee,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Members of our staff have recently completed a study of the flow of cash from the transportation companies to the nonrailroad com-

panies associated with the Penn Central Transportation Company. I have enclosed preliminary schedules which indicate that there was a net cash expenditure by the transportation companies of \$153 million for the period commencing January 1, 1963, and extending through June 30, 1970. This figure does not include some \$56 million computed to be the interest applicable to these funds.

The review was undertaken to determine the cash impact on the railroad companies included in the Penn Central group resulting from cash investments in unrelated activities. In this analysis the Pennsylvania Company was treated as a part of the transportation system. It had been a railroad related, wholly owned subsidiary of the former Pennsylvania Railroad Company prior to the merger, and its holdings have largely involved the ownership of rail property. Thus, references herein to "railroad" include the Pennsylvania Company as well as all railroad subsidiaries in the Penn Central group.

The scope of the review was limited to the period subsequent to January 1, 1963, and this was the beginning of the diversification program of the Pennsylvania and New York Central Railroads, although the merger of the two did not take place until February 1, 1968. References to cash investments made prior to that date include the two companies collectively. Before January 1, 1963, they had no substantial interest in nonrailroad holdings except for investments in land and hotels in New York City, owned by the New York Central, not considered relevant to our review. In determining the cash impact on the transportation group, all major transfers of assets, such as dividends, advances, and security purchases were considered.

The staff's analyses gave consideration to the following nonrailroad affiliates acquired since 1963:

1. *Buckeye Pipeline Company*—Acquired in 1963 by cash and stock exchange.
2. *Great Southwest Corporation*—Control acquired in 1965 through purchase of capital stock.
3. *Macco Realty Company*—Control acquired in 1965 by purchase of capital stock. Control was later vested in Macco Corporation which was merged into Great Southwest Corporation in February 1969.
4. *Arvida Corporation*—Control acquired in 1965 by purchase of capital stock.
5. *Strick Holding Company*—Control acquired in 1966 by purchase of capital stock—sold on December 31, 1968.
6. *Madison Square Garden Corporation*—Increased equity in 1968 and 1969 to approximately 25% through exchange of stock and additional purchase of stock.
7. *Executive Jet Aviation, Inc.*—Purchased 58% of capital stock during the period from 1964 through 1966, but stock was placed in a voting trust. Economic control retained through large advances of cash.

All except Strick Holding Company, which was originally a New York Central subsidiary, had been Pennsylvania Railroad affiliates prior to the Penn Central merger.

If we can be of further assistance, we are, of course, anxious to help.

Sincerely yours,

DALE W. HARDIN,  
Acting Chairman.

[Attachment 1]

*Summary of cash impact from diversification*

[In millions]

Cash expended by transportation group:	
Stock purchases.....	\$157
Dividends paid downstream.....	19
Loans and advances.....	33
<b>Total cash expended.....</b>	<b>209</b>
Cash received by transportation group:	
Dividends.....	41
Proceeds received from sale of assets.....	15
<b>Total cash received.....</b>	<b>56</b>
Net cash expenditures from the transportation group.....	153
Estimated interests costs.....	56
<b>Total cash expended from diversification.....</b>	<b>209</b>

[Attachment 2]

## ANALYSIS OF CASH IMPACT BY COMPANIES FROM DIVERSIFICATION

[In millions]

Companies	Cash from transportation group	Cash to transportation group	Net cash from transportation group
Buckeye.....	\$50	\$37	\$13
Arvida.....	22		22
Great Southwest.....	26	4	22
Macco.....	61		61
Madison Square Garden.....	5		5
Executive Jet.....	21		21
Strick.....	24	15	9
<b>Total.....</b>	<b>209</b>	<b>56</b>	<b>153</b>



1966	.....				5,425	2,987	8,422
1967	.....			344	2,441	6,440	9,225
1968	.....			3,458	2,390	.....	2,848
1969	.....			.....	2,324	.....	2,324
1970	.....			.....	2,000	.....	2,000
Total	.....			2,802	20,743	9,437	32,982
Total downstream cash	.....	49,869	22,047	26,014	61,351	4,802	21,088
Dividends:							
1963	.....	128	.....	.....	.....	.....	128
1964	.....	3,438	.....	.....	.....	.....	3,438
1965	.....	5,965	.....	.....	.....	.....	5,965
1966	.....	5,800	.....	.....	.....	.....	5,800
1967	.....	6,300	.....	210	.....	.....	6,510
1968	.....	6,300	.....	630	.....	.....	6,930
1969	.....	6,300	.....	3,416	.....	.....	9,716
1970	.....	3,100	.....	.....	.....	.....	3,100
Total	.....	37,331	.....	4,256	.....	.....	41,587
Sale of assets	.....	.....	.....	.....	.....	15,000	15,000
Total cash returned	.....	37,331	.....	4,256	.....	15,000	56,587
Cash from transportation group	.....	12,538	22,047	21,758	61,351	4,802	21,088
	.....	.....	.....	.....	.....	9,437	153,021

<sup>1</sup> Originally advanced as cash in 1967, 1968, and 1969. Converted to capital stock in December 1969.

<sup>2</sup> Dividend payments on Pennsylvania Co. preferred stock issued in connection with acquisition of Buckeye Pipeline Co.

<sup>3</sup> Advances made to predecessor company, Pennsylvania Terminal Real Estate Co.

[Attachment 4]

## COMPUTATION OF INTEREST COST RELATIVE TO MONEY BORROWED TO REPLACE MONEY EXPENDED IN CONNECTION WITH DIVERSIFICATION PROGRAM, JAN. 1, 1963, THROUGH JUNE 30, 1970

[In thousands]

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Year	Cash paid out	Cash received	Net cash outlay by year	Total cash outlay	Interest rate	Interest <sup>1</sup>
1963.....	\$28,169	\$129	\$28,040	\$28,040	4.52	\$634
1964.....	19,155	3,438	15,717	43,757	4.63	1,662
1965.....	74,884	5,965	68,919	112,676	4.67	3,653
1966.....	35,319	5,800	29,519	142,195	5.71	7,277
1967.....	21,490	6,510	14,980	157,175	6.25	9,355
1968.....	13,870	6,931	6,939	164,114	7.76	12,466
1969.....	13,088	<sup>2</sup> 24,716	(11,627)	152,487	8.66	13,709
1970 (6 months).....	3,632	3,100	532	153,019	10.00	7,638
Total.....	209,607	56,589	153,019	.....	.....	56,394

<sup>1</sup> Interest computed by average balance outstanding for year.<sup>2</sup> Includes \$15,000,000 received for sale of Strick Holding Co., 1968.*Penn Central Transportation Co., Equipment Financing—Interest Rates <sup>1</sup>*

	Percent
1960.....	5.22
1961.....	5.04
1962.....	4.91
1963.....	4.52
1964.....	4.63
1965.....	4.67
1966.....	5.71
1967.....	6.25
1968.....	7.76
1969.....	8.66
Last quarter of 1969.....	10.00

<sup>1</sup> Source of interest rates from sheet 1. The above effective interest rates were presented to the commission by Mr. Jervis Langdon on behalf of Penn Central Transportation Co., in his verified statement in support of freight rate increases in docket 267.

Senator HARTKE. I find it shocking that they decreased the car fleet by 20 percent, at the time when they needed more freight cars and more equipment to handle the traffic. This further indicates that their primary emphasis was not on the transportation business but on the nonrailroad business.

As I understand it, you intend to try to do everything you can to correct that situation within the limits of finances and legality?

Mr. WIRTZ. Yes, sir.

Senator HARTKE. I understand, Secretary Wirtz, that you have indicated that you do not want to be bound by the previous contracting statements as they were submitted at their face value and that includes some of the testimony given to us at the last hearing. Is that correct?

Mr. WIRTZ. There was with particular reference to the cash flow statement with respect to which that would be true as you put it. With respect to the general corporate accounting and reporting, we have tried to state very carefully that we feel that it did reflect a policy at that time of putting the best possible face on things, and the real question is—

Senator HARTKE. Dubious allies for the truth, is that what you say?

Mr. WIRTZ. That is correct. If you think of the truth, Mr. Chairman; I don't mean to be pious but if you think of it in terms of the technical accuracy of what is said, that is one thing. If you think of it in terms of what was reasonably conveyed, that is another. On the basis of the second, I think there is real question about the accuracy of the picture that was conveyed.

Senator HARTKE. I see no useful purpose in discussing the potentials of the Railroad Emergency Board decision or the potentiality of the strike at this time. They present problems we are all acquainted with.

Have you had any discussions with the Department of Transportation concerning the implementation of the Railroad Passenger Bill?

Mr. WIRTZ. Yes, sir.

Senator HARTKE. How are they proceeding?

Mr. WIRTZ. Both the railroad administration and the Department of Transportation—

Senator HARTKE. Senator Baker?

Senator BAKER. Let me ask one or two clarifying questions, just to make sure I have the picture fully in mind with respect to the corporate structure.

Is the Pennsylvania Co. a holding company as such?

Mr. WIRTZ. It is a holding company. Its assets, Senator, are just common stock of the Transportation Co., plus an interest in two—

Mr. BAKER. Excuse me. I hope that he is talking about the Pennsylvania Co., not the Penn Central?

Mr. WIRTZ. I beg your pardon.

Mr. BOND. It is a holding company. It holds things such as Great Southwest, Arvida.

Senator BAKER. Are these companies subsidiaries of the Pennsylvania Co.?

Mr. BOND. That is correct.

Senator BAKER. Are they subsidiaries, not only through stock ownership, but also for accounting purposes?

Mr. BOND. You better explain this.

Mr. HELLENBRAND. They are subsidiaries by reason of the stock ownership. For accounting purposes, their consolidated statements filed, if that is your question, a definition of a subsidiary has different connotations for different purposes. But the Pennsylvania Co. holds either stock investments or investments in bonds or advances, things of that kind. It does not operate a business other than the ownership of these securities.

Senator BAKER. Does the record show some place the extent of the ownership of the Pennsylvania Co. in the subsidiaries?

Mr. BOND. Yes, sir. You mean the percentage ownership.

Mr. HELLENBRAND. I will be glad to tell you.

Pennsylvania Co. owns 58 percent of the common stock of Arvida, some 90 percent of the common stock of Great Southwest Corp., 100 percent of the common stock of Buckeye, but there is some preferred outstanding.

I might just go back for a moment to point out that as Mr. Wirtz indicated earlier that the Transportation Co. owns 100 percent of the common stock of the Pennsylvania Co., but there is a reasonably substantial amount of preferred stock out held by the public of the Pennsylvania Co.

Senator BAKER. Do you have a majority of the board of directors in the case of each of the subsidiaries?

Mr. HELLENBRAND. No, we do not. It varies. We have referred here to only three subsidiaries, and there are a large number, and on some we do, some we do not. In neither Buckeye nor Arvida have we had a majority of the board of directors. And since the change in the management of the Pennsylvania Co., that matter will be under consideration by the Pennsylvania Co. board of directors.

Senator BAKER. Are all of the subsidiaries Delaware corporations, or New York or Pennsylvania corporations?

Mr. HELLENBRAND. Great Southwest is a Texas corporation. I think Buckeye and Arvida are Delaware corporations, but I am not sure.

Senator BAKER. Can you tell me offhand whether or not the State statutes in each case provide for a two-thirds stock ownership for dissolution?

Mr. HELLENBRAND. I just can't tell you offhand. Wherever you have dissolution, and we have considered this, you have the problem of having an undivided ownership in a piece of property, and there are other techniques which could be considered in solution of that problem, and I think are more susceptible to satisfactory solution than straight dissolution.

Then you get into the whole question of what you may lawfully do with the proceeds to which Mr. Wirtz averted a few months ago, which is a separate set of legal problems aside from what would happen in the straight sale of the securities.

Senator BAKER. I think that is all, Mr. Chairman.

Senator HARTKE. Any other statements from you gentlemen?

Mr. Moore, did you want to make a statement?

Mr. WIRTZ. We would be very grateful, Mr. Chairman.

Mr. MOORE. Senator Hartke, I have no prepared statement. I am sure you know I came to this property on September 1 as president and chief executive officer. And needless to say it has been a mammoth undertaking.

I spent the entire 2½ months on the property, out on the road, largely looking over the yards and terminals, the main tracks, meeting with the shippers in key locations along our railroad. I have been to at least 15 of those places.

In addition to that, in the evenings I have taken it on myself to have an employee meeting, having all of the employees get together and speaking to them, telling them the problems of the company and soliciting their efforts in getting the railroad back on the track.

I have talked to some 12,000 to 15,000 of our what you might say rank and file and supervisory employees. After I have addressed them, I am throwing the sessions open to questions and doing my best to answer any questions or take any recommendations that they might have as to what Penn Central needs to do. I am convinced that in the past 2½ months we have made tremendous improvements in the service on Penn Central. That is, the on-time performance of both our freight trains and our passenger trains.

The fact of the matter is this is pretty well recognized within the industry, among the shippers, and by the public. Frankly I haven't found any problems in the operation of Penn Central that I consider insurmountable. True, it is going to take money to do the things that we need to do. Right now we could spend in the neighborhood of \$20

to \$25 million on projects where we would get a 50 to 60 percent return on our money on an annual recurring basis. If we had the money to do it with.

We have too many facilities that are outdated, outmoded, hand-operated interlocking plants, numerous crossings that still have crossing watchmen, hundreds of things we can do to put the property on a better financial basis.

I could mention numerous other items that we have already done, but I see no need in burdening you with them.

I think the best indication that we have, the best yardstick, in the past few weeks we have been operating this railroad with some 20,000 to 30,000 less pieces of equipment than we did a year ago. By that I mean boxcars, gondolas, coal cars.

It is true our business is off, but still it is not off that much. That indicates to me and to others that we are doing a much better job in keeping the cars moving and getting them off our railroad and hopefully getting more business to move.

There has been a lot said about the vast number of employees on Penn Central. I would like to point out that in the last year that has been reduced by 5,630 people for a saving of around \$46 million. We still have more improvements that can be made in that area, and improvements that we intend to make.

If we can get the money that Mr. Wirtz has stated we need, I am confident that we can accomplish the successful reorganization of Penn Central within the 3 to 5-year goal that has been set.

In fact, I am more convinced of this now, much more, than I was when I joined Penn Central on September 1.

Senator HARTKE. Do the programs that you have instituted, Mr. Moore, constitute a significant change from the prior programs of the Penn Central operation or are you just doing it better than they did with the same program?

Mr. MOORE. No, we have made quite a number of changes in the operation of the trains and our organization setup. We don't have near the number of people particularly in the real top positions. Just a few months ago we had around 35 vice presidents, and executive vice presidents. We now have 11.

We have established a yard and terminal force, a man that is in charge of Penn Central's yards and terminals and he has under him a staff that is dedicated entirely to looking after the movements of cars through our yards and terminals. That has been one of Penn Central's main problems, delaying cars at their major terminals.

We are getting around a lot of that now by run-through trains. That is trains that are made up at one location, say, in New York City, and go all of the way to Detroit, with freight destined for those areas, and bypasses many of the major terminals. Those are just a few of the many things that we are doing to improve the operation.

Our locomotive fleet, which consists of over 4,000 locomotives, is not being kept up.

Senator HARTKE. Have you found them all?

Mr. MOORE. Yes, sir.

Senator HARTKE. You had some of them lost you know.

Mr. MOORE. I heard that. I think we have got a good hand on that, not only locomotives, but cars. Our bad order ratio, that is the number of locomotives that were out of service for repair, have been

running around 10 to 12 percent, which is far too high. It shouldn't be over 6 to 7 percent.

We have made great progress in reducing that. One of the first thing we had to do on the property, of all things, was to buy 50 caboose cars, we didn't have enough cabooses to put on the rear of the trains to operate the trains we needed to run. We were delaying anywhere from 10 to 15 trains a day, anywhere from 3 to 8 hours, for lack of a caboose, which was unbelievable.

Senator HARTKE. Any other statements, gentlemen?

Questions, Senator Baker?

Senator BAKER. No.

Senator HARTKE. On behalf of the committee, I want to thank you for your appearance and testimony today. I think you have given us honest, forthright evaluations and a very clear presentation. It appears the nation is faced with a rather serious problem and with the alternative of supplying either massive assistance to the Penn Central or watching this major railroad in our country come to a halt.

I want you to know that it seems to us that the transportation service which is provided by the Penn Central is a matter of broad national concern that does deeply affect the national interest. We do appreciate your candor and we ask that you continue to be frank with us, honest with us, and we will try to be as helpful as we can to make sure we meet all of the problems that do come forward.

I think one thing does emerge very clearly: The administration's original proposal was too broad. The purpose of continuing the essential rail service, which we all support, in my opinion can be achieved through a much more limited measure. I think only railroads which are already in reorganization—I am speaking personally, not on behalf of the committee now—which are unable to obtain private financing, and that includes the sale of trustee certificates, which are on the verge of closing down for lack of funds should receive Federal assistance. Assistance should be, as you have indicated, restricted to those operating expenses necessary to keep the trains moving. It should not be used to bail out investors or creditors. Finally, I think the Government is entitled to receive adequate security for the risk it undertakes. In line with that, I am going to ask the staff to see whether or not they can draft some preliminary legislation which includes some of these basic ideas so that the committee can consider that rather than the administration's bill which is the only legislation before the committee at the present time.

Thank you, gentlemen.

(The statements follow:)

STATEMENT OF GEORGE P. BAKER, RICHARD C. BOND, JERVIS LANGDON, JR., AND WILLARD WERTZ, AS TRUSTEES OF THE PROPERTY OF THE PENN CENTRAL TRANSPORTATION CO., DEBTOR

Mr. Chairman and Members of the Committee, we are grateful to the Committee for this opportunity to discuss the situation at Penn Central.

This picture is best presented in a manner which runs some risk of oversimplification. A summary description of the Penn Central family of companies, its operations and its corporate structure is included with this testimony as Attachment A. "Penn Central" is such a complex of interrelated separate corporations that any detailed description of it would invite confusion. Its activities, its assets and liabilities, are so extensive that detailing them in technically accurate accounting or corporate reporting terms would obscure more than illuminate.

What is said here is for purposes of identifying the central issues of national concern; it is not the kind of presentation upon which private investors or creditors would or could rely.

As Trustees appointed under Section 77 of the Bankruptcy Act, our stewardship is accountable to Judge Fullam in the United States District Court for the Eastern District of Pennsylvania. The views we express here are subject to that Court's ultimate determination with respect to all matters regarding the Debtor's estate. Judge Fullam concurs fully in the view, however, that all aspects of the reorganization should be presented here fully and openly. Penn Central is plainly a matter of broad national concern deeply affecting the public interest.

We will first summarize the situation at Penn Central, then indicate those measures of self-help which appear to be indicated, and finally suggest certain types of action beyond the control of management, the Trustees or the Court which will in our present judgment be necessary to revitalize the railroad.

It will be helpful to identify at the outset, however, the key elements in our general approach to this situation.

Penn Central is obviously in grave difficulty. The Penn Central Transportation Company (PCTC) will run out of cash—except as emergency action is taken—during the first quarter of 1971, even though most of its tax and debt payments are being deferred. Its losses this year, 1970, will be (on a fully accrued basis) over \$300 million.

There are at the same time very real prospects for improving this situation. Under new and vigorous management, freight business is already being brought back. The National Rail Passenger Service Act is about to become operative. Large as the corporate deficits and losses are, the size of the enterprise is such (gross revenues run about \$1.5 billion a year) that a ten to fifteen percent improvement in operating results will meet at least the imperative needs. This is our goal.

Although we cannot at this point make firm representations that the Penn Central can be restored to profitable operation, it is our considered judgment that there is a reasonable prospect of achieving this goal within from three to five years. But this will depend entirely on the raising of interim financing in the amount of \$175 million to \$250 million in the next four months, and possibly that much more over the next 36 months. The alternative is some form of "nationalization" of the railroad—which we reject as a counsel of needless despair.

We proceed on the basis that there is going to be a Penn Central railroad because it is absolutely essential to the national economy, that it is better that this be a private rather than a public enterprise, and that the prospect of a successful free enterprise reorganization of Penn Central is worth pursuing.

#### THE PRESENT SITUATION

The relevant financial data are those involving "cash flow," "assets and liabilities," and "profit and loss." The "cash flow" picture is the most critical in the short run. Simply stated, it portrays the receipt and disbursement of cash, and measures the ability of the operation to survive. The statement of "assets and liabilities" is important in determining what assets can be reduced to cash and what may be done with the proceeds under the law. The "profit and loss" statement reflects the viability of the operation in the long run, including the prospect of generating earnings and thereby attracting new money for growth.

##### (a) Cash Flow

The present (November 20, 1970) cash balance in PCTC is about \$30 million. This is about what it was as of June 21, 1970. This results only from the fact that a variety of otherwise obligatory payments have been suspended under the powers of the bankruptcy court. The obligations which would have been paid during the period since June 21, 1970 would have been in an amount of approximately \$350 million. In state and local taxes alone, we have had to defer payment of some \$35 million in the last half of 1970.

We believe we can maintain a minimum cash balance through the remainder of 1970.

Projections for 1971 indicate that under *present* circumstances (deferment of tax, debt and other payments by Court order; and present wage levels) a cash balance would be maintained into the first quarter of 1971. The most sharply honed projections presently available show that balance dropping vir-

tually to zero by March 31, 1971. If the railroad could survive the first quarter, the cash balance—still assuming present wage levels and deferment of debt, tax and other payments—would rise during the rest of 1971 and would be about \$100 million by December 31, 1971.

This 1971 projection assumes Interstate Commerce Commission (ICC) approval of the full 15% freight rate increase application, and takes into partial account the National Rail Passenger Service Act becoming operative as of May 1, 1971. The projection assumes limited but significant expenditures for equipment and roadbed improvements. It assumes a number of efficiency and economy measures.

This 1971 cash flow projection does not take account, however, of the prospect of wage increases. Presidential Emergency Board No. 178 has recently made recommendations for wage increases for 1970 (retroactive to January 1, 1970) and 1971 and 1972, for a number of rules changes, and for new railroad industry bargaining procedures. If these recommended wage increases are figured into the cash-flow projection, the result is a cash deficit at the time of payment of the retroactive increase which would be about \$47 million for union employees for 1970. There would be the effect, if both the 1970 and 1971 Emergency Board recommendations were accepted and were paid for in 1971, of a cash shortage for that year of approximately \$100 million. (See Attachment B).

In summary, so far as the cash-flow prospect is concerned: Even assuming the continued deferment of tax, debt and other obligations, the granting of freight rate increases, and the continuation of present wage levels—even on that spartan basis, there will be a near exhaustion of cash toward the end of the first quarter. On those same assumptions, but allowing for the wage increases recommended by the Emergency Board, it would be necessary to augment the sources of net cash by \$50 million in February 1971, and by an additional \$50 million during the rest of the year. Resumption of the payment of local taxes—which we consider an obligation of first priority, for it affects materially such functions as public education—would take another \$64 million annually.

These figures have to be put in the perspective of the vast scale of Penn Central's operations. There is no minimizing the magnitude of a prospective cash shortage of between a hundred and two hundred million dollars. But we are talking about a business in which the gross revenues are almost a billion and a half dollars a year. An improvement of between 12 and 15 percent in the receipts-disbursements relationship, by increasing revenues or by cutting expenditures or by both, would meet at least the immediate needs. This is still formidable. It is by no means beyond achievement.

#### (b) *Assets and Liabilities*

The Trustees are making a realistic evaluation of the assets of the Debtor's estate, as a key element in developing a plan or reorganization. This evaluation is not yet sufficiently complete to permit reliable statement regarding it.

One factor in this situation, however, is necessarily and appropriately noted further here. PCTC holds, to a considerable extent through its subsidiary Pennsylvania Company, very substantial "non-railroad" assets: 100 percent of the common stock of Buckeye Pipe Line Company; 90 percent of the voting stock of Great Southwest Corporation (which has large real estate and amusement park holdings); 58 percent of Arvida Corporation (real estate); 24 percent of Madison Square Garden; several New York City hotels. These holdings, if they were debt free, would have total values of hundreds of millions of dollars.

Most of these assets, however, are *heavily* encumbered. There are mortgages on a substantial part of the real estate. All of PCTC's common stock in the Pennsylvania Company is pledged to secure \$300 million borrowed by PCTC in 1969. There are other substantial creditor claims against these non-railroad properties. It is seriously questionable (i) whether these "non-railroad" holdings have a *net* value to PCTC; and (ii) how much bankruptcy litigation lies in the way of their being usable.

There will be further development later in this testimony of the Trustees' plans and present efforts to exhaust every possibility of using these non-railroad properties—responsibility and consistently with legal claims against them—to meet the railroad's needs. It is appropriate at this point simply to note the fact of these very large holdings, but also the seriously constraining fact of their substantial encumbrance.

*(c) Profit and Loss*

Present information (with the figures for the first three quarters already available) indicates that there will be a loss for 1970 of over \$300 million. This is on an "accrued" basis, which means that this is what the railroad would have lost if it had paid taxes, and debt service, and other claims; it also includes the wage increases recommended by the Presidential Emergency Board.

Public comment regarding the reasons for this loss situation has ranged from broad indictments of previous PCTC management policies to explanations that the whole railroad industry is on an unsound economic basis and that Penn Central itself is unmanageable. Our present conclusions are that the right answers come from recognition, in varying degrees, of elements of truth in virtually all of these factors—except that we find no basis for the idea that this situation cannot be handled effectively.

We have reviewed in detail in this connection the most recently assembled figures, which compare the profit and loss record for the first nine months of 1970 with the record for the comparable period in 1969. This comparison is included with this testimony as Attachment C. The PCTC loss for the year 1969 was reported to ICC as \$83 million. A comparison of this figure with the presently estimated loss of over \$300 million for 1970 appears to reflect a tobogganing situation, out of control. This comparison is misleading. Without questioning the consistency of the 1969 report with generally accepted accounting practices, it appears to have reflected a corporate policy at that time of putting the best conceivable face on the facts—to the point that these facts were dubious allies of the truth. The difference between the 1969 and 1970 situations is substantially less than what this comparison suggests.

Nevertheless, even with this discount factor recognized, the comparison between the first nine months in 1970 and the comparable period in 1969 is a basis for identifying the elements in a situation which has—up to the present—been deteriorating seriously. The principal elements include these:

Operating revenues are up somewhat (about \$55 million). But this is a consequence of freight rate increases. The volume of freight handled is down; and passenger and mail revenues are down in terms of both volume and revenues. Penn Central, in short, has been losing business.

Operating expenses have gone up ominously (about \$147 million). The biggest factors have been increased costs of materials, services, supplies, and labor.

Costs of freight loss and damage claims and costs resulting from vandalism show a disturbing increase.

Interest obligations have increased by about \$16 million. (Except for payment on equipment debt, these interest charges are currently being deferred.)

Financial income from PCTC subsidiaries (dividends and tax allocation payments) has dropped sharply (over \$50 million.)

This comparison is only suggestive of some of the elements in an obviously more involved situation. There are special factors in the Penn Central record, particularly the incomplete merger of two large organizations and an abortive effort to "diversify" assets, but this comes down most of all to the classical story of lost business and higher costs resulting in losses.

There will be a continuing loss situation in 1971. The amount of the loss will depend on a number of factors, including what increase is made in wages and what freight rate increases are allowed. A working assumption based on the Emergency Board wage increase recommendations and on the full 15% freight rate increase presently pending before the Interstate Commerce Commission produces a projected 1971 loss of approximately \$200 million. (This, again, is on an "accrued" basis.)

We have also made an effort at profit and loss projections beyond 1971. There are so many variables that specific prediction is impossible and would be unreliable. There is no reasonable prospect of PCTC showing a profit in 1972, or probably in 1973. A reasonably foreseeable combination of general economic conditions, industry circumstances, and changed PCTC operational and fiscal practices would result in a PCTC profit in 1974 or 1975. Other perhaps equally likely prospects would postpone this possibility.

The Trustees proceed at this point on the considered conclusion that present indications warrant the *working assumption* that PCTC can be made a profitable enterprise within from three to five years. The evidence does not warrant

representation to this effect. What it does warrant, in the Trustees' judgment, is the adoption of a course of action for the next three years which will test fully this prospect of ultimate viability.

SELF-HELP MEASURES BY PENN CENTRAL

(a) Operations

Penn Central, faced with a crash crisis of the magnitude just described, must answer at least two preliminary questions bearing on the immediate future:

Can railroad operating revenues be significantly increased?

Can railroad expenditures be drastically reduced?

On the first question, the 1971 cash projection already incorporates an increase of \$309 million in freight revenues. Of this, \$150 million is attributable to an anticipated increase in business, with the balance traceable to a further rate increase which hopefully will become effective during the year. While an even greater increase in revenues could occur in 1971, it would be unrealistic to count on it. Moreover, if the economy should slip, the revenue increase in the projection would be undermined and might even disappear, in which event Penn Central's cash deficit in 1971 would be still larger.

On the second question, there would appear to be no real prospect of 1971 expense levels lower than those set forth in the projection. The operating expense figures already reflect improvements, including personnel reductions, made and being made by Penn Central's new management. Striking evidence of this is found in transportation expenses which are projected for 1971 at a slightly lower level than in 1970 despite the recommended wage increases and substantial increases in traffic. For maintenance of way Penn Central should have a substantial increase in materials applied (rail, ties, and ballast), but the 1971 projection anticipates the same level of maintenance work as in 1970, with some increase in cost despite improved productivity. In maintenance of equipment a full program for the repair and upgrading of over 20,000 cars is planned for 1971 at an increase in expense of \$67 million. This increased car repair program had been too long postponed and is inescapable if Penn Central, chronically short of cars, is to carry the increased traffic and produce the additional revenue included in the projection.

Capital expenditures for 1971 likewise present no opportunity for curtailment. For road projects \$74,600,000, a minimum figure, has been earmarked, including:

Road capital:

work in progress.....	\$4, 400, 000
Safety.....	17, 800, 000
Industrial development.....	19, 200, 000
Economy—savings 75 percent and over.....	4, 300, 000
Economy—savings 50 percent—74 percent.....	7, 500, 000
Government directives.....	4, 100, 000
Other (yard improvements, and so forth).....	17, 300, 000
Total road capital.....	74, 600, 000

For equipment the program calls for a much larger involvement, as follows:

Equipment capital:

Locomotives:	
New Locomotives (231 units).....	\$50, 450, 000
Upgraded locomotives (38 units).....	3, 400, 000
Total locomotives.....	53, 850, 000
Freight car program (7,492 new units).....	137, 621, 000
Work equipment.....	6, 700, 000
Total equipment capital.....	198, 171, 000

Again it must be emphasized that the new equipment and maintenance programs included for 1971 are vital if the revenue projections are to be realized. Penn Central must make a start in acquiring an adequate car ownership. In

the last five years the combined ownership of the former Pennsylvania and the former New York Central has dropped by 35,000 cars, or almost 20%. This is one of the major reasons why Penn Central's service was unsatisfactory and why the railroad failed to keep pace with the growth of traffic in its territory.

Going beyond 1971 and considering the opportunities for increased revenues and reduced expenses in Penn Central's future generally, it is important to note the widespread impression that Penn Central ought to have earning power because it serves *all* of the important industrial centers throughout the eastern United States. But this very fact is responsible for some of the disabilities which contributed, at least in part, to Penn Central's downfall and contribute today to a high level of expenses.

Railroad transportation is at its best when it can be performed by the operation of so-called unit trains in turn-around service with loop tracks at each terminal where even the loading and unloading can be done while the train is in motion. In such an operation, equipment utilization is at its highest level and so is productivity, and no form of land transportation can even approach railroad efficiency under these or comparable conditions. Costs are low, service is tailor-made, and profitable rates are attractive to the shipper.

By sharp contrast, railroad transportation is at its poorest when trains have to be made up of individual cars that have been brought together at a series of concentration points by innumerable yard crews, each operating heavy power over miles of slow speed industrial track located in high cost and heavily taxed urban areas, sometimes in the city streets themselves, with high exposure to vandalism and loss and damage to the freight itself. The process of classifying individual carloads into trains for mainline movement is itself a relatively expensive and time-consuming operation. At destination points, in order to effect delivery the same tortuous and expensive terminal operation is repeated but in reverse. Equipment utilization is poor, service is generally erratic, productivity is low and costs are high. This retail type of business—where detailed pick up and delivery is effected by rail—is highly susceptible to the adverse impact of inflation. In fact, it is more susceptible to inflation than any other aspect of railroad service.

This latter point is of major significance to Penn Central for while there are many unit trains and long haul through services, a heavy proportion of its transportation work load represents railroad service "at its poorest". Penn Central, in a very real sense, is a giant terminal complex. As one indication of the character of its service demands, a comparison of yard crews on Southern Railway with those on Penn Central (which is only twice as large) is enlightening:

	Penn Central	Southern
Yard crews.....	2,636	511
Number of yard crew locations.....	381	77
Locations using 10 or more crews.....	79	15

Similarly, yard transportation expense (freight) on Penn Central is more than 15% of the freight revenue dollar while on railroads generally it is less than 10%. Stated differently, if Penn Central had the same proportion of its revenue dollar devoted to yard transportation service as other railroads, its expenses, for this reason alone, would be \$80 million less on an annual basis. Penn Central's ratio of yard switching tracks to main tracks (excluding branch lines) is almost three times higher than a similar ratio for the Baltimore and Ohio or Southern Pacific, for instance. On the Penn Central there are more than twice as many yard crews as road crews while on the Southern there are fewer yard crews than road crews.

The result is that Penn Central, as a mammoth terminal operator as well as road haul carrier, has many unfavorable transportation characteristics which are largely inherent, including short hauls, lower traffic density and freight revenue per mile of line than any other major eastern railroad, low train loading and equipment utilization, high man hours per million ton miles, high loss and damage expense.

Difficult as these operating conditions are, Penn Central's performance can be vastly improved. The opportunities for such improvement are certainly there.

Under the new management much is already under way, and more will come later.

1. One factor in Penn Central's low revenue level is directly attributable to shortage of freight cars. Penn Central's program for 1971 includes 7,492 new cars at a cost of \$137,621,400 in addition to the repair program already mentioned which will reduce the unserviceable ratio from more than 9% to less than 4%. This equipment schedule for 1971 is merely the start of what is expected to develop into a broad program of providing Penn Central with its fair share of an adequate national freight car fleet.

2. A second factor bearing on Penn Central's low revenue level is the generally poor service that has been provided since merger. In the last two months, however, service to shippers and receivers has improved markedly. There is much evidence that business, diverted to competitors in the past, is now returning to Penn Central as schedules are better maintained and car handling improved. If first-class service can be provided generally, and we are confident that it will be under the new management, opportunities for greater volume of freight traffic on Penn Central are clearly present. It should be emphasized, however, that our customers must have ready access to all of the freight cars they require not only to fill present needs, but to accommodate expanded production.

3. Penn Central's low equipment utilization can be improved through adherence to better operating practices, the scheduling of empties as well as loads, and terminal procedures which are modern instead of traditional. Cars must be better classified as to condition so that a customer requiring a grade A box car is not supplied with a box car good only for rough loading. Defective equipment known as "rolling rejects" have been common on the Penn Central, and the expense of moving such cars from one loading point to another is large and totally wasted. Moreover, the cross-hauling of empties must cease as more cars are distributed on a system, not regional or local, basis. Here, as in the case of more business on the railroad, the opportunities for an improved Penn Central performance are impressive. The new management is already on the move.

4. Another phase of the recovery process for Penn Central is what may be described as plant rationalization. Involved here is the abandonment of 3,818.8 miles of line with the elimination of maintenance cost of \$17 million. In addition, the non-recurring revenues would include:

	<i>Million</i>
Salvage.....	\$19. 9
Reusable material.....	20. 4
Real estate.....	10. 6
	<hr/>
Total.....	50. 9

The new management is moving ahead with the preparation of the necessary applications to the Interstate Commerce Commission, but under present procedures (which we hope can be changed) it will be many years before Penn Central will begin to have substantial savings from this source.

*(b) Financial*

Two sets of problems and possibilities face the Trustees, particularly in connection with meeting the immediately prospective need for additional funds. One involves the possibility of selling certain corporate assets, especially the "non-railroad" properties; the other the possibility of private borrowing.

1. *Sale of Corporate Assets*—The material facts have already been suggested: there are substantial corporate assets (particularly "non-railroad" holdings) which, if they could be liquidated, would provide sources of considerable funds; but there are critical, practical questions regarding such liquidation.

In a significant and meaningful sense, we would, if this were possible, simply put For Sale signs on the non-railroad properties held or controlled through subsidiaries by Penn Central. This would include the Pennsylvania Company itself, its three principal subsidiaries—Buckeye Pipe Line, Great Southwest Corporation, Arvida Corporation, the New York City hotels, and the 24% interest in Madison Square Garden Corporation.

The "diversification" policy which was in effect at PCTC was in our judgment, given the advantage of hindsight, a mistake. It conceivably postponed the showdown at Penn Central. The frequently repeated statements that "the railroad was milked to buy real estate" and that a great deal more money went "downstream" from the transportation company to these various subsidiaries than came back to it represent an incomplete judgment. It also has to be taken into account that these investments resulted in the borrowing of hundreds of millions of dollars for the use of the transportation company, with these real estate and other assets being used as collateral.

On net, however, the diversification policy worked badly. Some of the investments soured. Some, particularly in real estate development projects (especially Great Southwest Corporation), involved a need for additional cash just at a time—1969 and 1970—when credit opportunities tightened up severely. Under different general economic conditions, the policy might have worked. But as things turned out, the diversification policy often meant (i) the unavailability of cash to support the railroad operation, and (ii) opportunities for bookkeeping and reporting practices which had the effect—whatever their purpose—of postponing a day of reckoning at Penn Central which would have been less bleak if it had dawned earlier.

Under present circumstances, in any event, Penn Central Transportation Company should be taken out—so far as making it an effective railroad operation is concerned—of every business not significantly connected with running the railroad, except where there are clear cash earnings advantages. We are taking this course to the maximum extent consistent with the legal constraints involved.

As a matter of internal organization, the running of the railroad (including the financial aspects) has been separated out from relationships with most of the non-railroad subsidiaries.

Active exploration is under way, furthermore, of the opportunities for reasonable sale of most of the non-railroad holdings. It would plainly be imprudent to liquidate these properties on a fire-sale basis if taking some additional time would permit more advantageous terms. Being in bankruptcy reorganization, the legitimate claims of various interested parties on these properties—by mortgage, pledge, or otherwise—have to be taken into account. To fail to do so would be to invite protracted litigation. It is not being assumed that the encumbrances on these properties preclude their advantageous liquidation. It is simply being recognized that the Trustees must proceed here with due account to these *possibly* competing or conflicting interests.

In general, the Trustees are proceeding on a policy of maximum practicable—meaning, virtually, maximum possible—liquidation of "non-railroad" assets.

2. *Private borrowing.*—The Trustees are pursuing every possibility of private financing.

An investment banking firm, Kuhn Loeb & Co., has been retained by the Trustees to assist in this effort.

One major financing arrangement is being effectuated to cover the purchase of 145 locomotives from General Motors Corporation, for some \$33 million. This is on an equipment lease basis.

Negotiations are underway to factor the PCTC accounts receivable. There is at least the possibility of developing an emergency potential here, although the disadvantages and difficulties are considerable.

Extensive efforts have been made to determine the feasibility of the issuance of Trustees' Certificates. These efforts have included discussions in depth with various banking and industrial investor groups, and with Federal Reserve Board banks. The short of the results of these efforts is that the Trustees are flatly and directly advised that Trustees' Certificates will not, under present circumstances, be sold.

#### FEDERAL ASSISTANCE

We would wish greatly that it were possible to advise the Committee, the Court, and the public that there is reasonable prospect that Penn Central can by its own efforts alone recover its strength. It cannot.

We do, however, say to the Committee that in our considered judgment there is the reasonable prospect that the Penn Central can be restored to effectiveness

as a railroad and made viable again as a corporation through a combination of efforts and measures consistent with the ideas and ideals of free enterprise.

Present evidence indicates the need for from \$175 million to \$250 million of additional funds—available only for use in meeting PCTC operational needs (including labor costs), equipment and roadbed improvements, payment of local taxes—in 1971, a substantial part of this early in the year. The evidence further indicates, though less clearly, that approximately this much more will be needed over the two following years . . . meaning a total of another \$175 million to \$250 million in the two-year period, 1972 and 1973.

The likely, almost certain, prospect is that some form of joint private-public financing arrangement will have to be worked out if this need is to be met.

Mr. Chairman and members of the Committee: What we have just said, and what follows, will inevitably be shortened to the report that the Penn Central Trustees came here today asking for hundreds of millions of dollars of money. This is right.

But unless we can clear it up this will be put in a context we think is not right. That will be the context of reference to a huge corporation . . . mis-handling its own affairs . . . diverting its energies and vitality away from the railroad . . . borrowing heavily and beyond its means whenever it could find lenders and on whatever terms . . . *and coming now to the Government to raise money to bail out its creditors, its stockholders, and itself.*

We speak here to only the last part of this. We are charged as Trustees of the Debtor's estate with responsibility for exploring fully everything that happened at Penn Central and with dealing fairly with all private and public interests which are involved. But our discussion with the Committee, particularly as it involves any financing of Penn Central, specifically rejects any element of raising funds to pay creditors or to increase stockholders' equity. We point out that the expansion we propose in deficit financing, so that the viability of the enterprise can be tested, puts some of those other interests at increased risk. Many of the PCTC creditors would probably consider their interest enhanced by our proceeding toward (i) liquidation, or (ii) nationalization. When we propose additional deficit financing—relying on public credit—we are recommending what we think has to be done in order to provide a railroad service which a substantial part of the country depends on and the public interest demands.

This point is so important that we suggest several general principles which should control any joint public-private financing arrangement which may be considered.

The purpose of any Federal assistance program should be to improve America's rail network, rather than to maintain an unsatisfactory status quo. This will require concurrent programs designed: ultimately, to reform the national transportation system and re-establish the railroad industry generally on a healthy private enterprise basis: most immediately, to permit continuation of essential services which have a prospect of viability.

Penn Central's problems must be viewed first in national context.

While this railroad has many unique characteristics and problems, important causes of its illness are those which afflict the railroad industry generally. Some of these the industry may well have brought upon itself but others are due to Federal financing to the advantage of competing forms of transport and to an anachronistic regulatory pattern, which treats them as a monopoly they no longer are.

We are preparing a special presentation of all of those regulatory strictures which affect adversely and unwisely, in our judgment, the PCTC situation. We will make this presentation as soon as we can to the ICC, and will urge our critical financial condition as a reason for expedited processing.

This will include proposals for the emergency abandonment program which present circumstances dictate. Under stepped-up procedures, the Trustees could certify those lines of rail which fail to meet the avoidable costs incurred in their operation. The law should permit the review of these lines on a system approach rather than on a one-by-one basis, as in the past. If the cost findings are affirmed and the reviewing agency finds that continued operations on these lines are not necessary for the preservation of essential rail services, either abandonment should be directed or regional authorities should be created to

contract for the continuation of lines for which abandonment would otherwise be directed.

The recently published ASTRO Report outlines a broad corrective program of what it terms "creative Federal involvement" to redress the balance and put railroads on a sound footing within private enterprise. We endorse the proposals contained in the report.

There is the immediate necessity, and now the timely opportunity, to establish a more rational labor policy in the railroad industry. Presidential Emergency Board No. 178 has recommended significant changes in working rules and also a new collective bargaining procedure. The adoption of these rules changes and this procedure will improve greatly the prospects for a sound future in this industry.

Pending the close consideration which will have to be given to a general reform, the pressing needs of the immediate situation must be met.

A program is urgently required to meet the situation of a railroad, like Penn Central, which is operating under Section 77 of the Bankruptcy Act and which is confronted with imminent cessation of essential railroad services.

The program should be tailored to insure that new infusions of funds will be used, not solely to maintain, but basically to improve the standard of service rendered to the public.

It should also make clear that all internal sources of cash will be used for railroad purposes to the fullest extent consistent with the law. Diligent efforts must be made to exhaust all private sources of borrowing. Wherever practicable, unencumbered assets should be collateralized to secure such loans. This would include accounts receivable financing, and the assignment of future income from non-transportation properties.

Use of funds derived from this program should be restricted to meeting the deficiency by which internally generated cash fails to cover expenses for essential services including, without limitation; payroll; personal injury and freight loss and damage claims; state and local taxes which are not assessed in a discriminatory fashion; maintenance of way, structures and equipment; debt service (principal and interest) on freight equipment obligations; elimination and protection of hazardous grade crossings.

No payment should be permitted of unencumbered assets to satisfy pre-bankruptcy debt (except equipment obligations) or for dividends.

The interim program we contemplate would cover the next five years. However, at a much earlier point in time, the Trustees would undertake to formulate a plan of reorganization for the railroad and present it to the appropriate authorities. In the alternative, should they not consider reorganization feasible, they would similarly report their findings.

A variety of Federal programs must be considered.

*First.* Legislative proposals presently before the Committee provide for the guarantee by the Federal Government of private borrowing by railroads. We support such legislation, but feel at the same time that either in its terms or as part of the implementing procedures there should be a reflection of some of the general suggestions we have made here. It is important to determine in this same connection whether and to what extent the loan guarantee authority in Section 701 of the National Rail Passenger Service Act will be available to Penn Central to meet the problems facing it.

We propose consideration of the possibility that a loan guarantee program be linked, in the authorizing legislation itself, to the liquidation of the borrowing carrier's "non-railroad" assets to whatever extent might be called for.

*Second.* Should the loan guarantee program fail to prove adequate, the national impact of a liquidation of the nation's largest railroad would justify establishment of a short-term service contract arrangement between the United States and Penn Central's Trustees to preserve essential rail operations. Provision could be made for repayment, either in a plan of reorganization or currently from the sale of non-railroad assets, of portions of the contract payments deemed to have benefited private creditors. This would include, for example, payments on account of state and local taxes which remove tax liens or improvement programs which enhance the value of mortgaged properties.

*Third.* There is also the possibility of working out an alternative financing procedure which would leave for subsequent determination the question of

whether the original funding which would be required is (i) to be repaid by the carrier if its operations are profitable, or (ii) is to be treated as a payment for services rendered if, even with due diligence and the exhaustion of all private financing possibilities, there is a continuing operating deficit. Such an arrangement could properly include a specification of essential services.

This statement has necessarily been long. The situation it covers is obviously serious. The reason for going into it at such length is our conviction that if the Penn Central situation can be generally understood, whatever doubts there may be about the past can be replaced by an attitude of cautious but constructive confidence in the future.

We have suggested the combination of self-help and broader cooperation and assistance which we think will work. Most of what we have talked about is self-help. But we have made it clear that we are presently dependent, to get back on our feet, on government cooperation and assistance.

If, five years from now, the Penn Central is viable, credit will have to be divided among these major influences:

1. Vital government help at a crucial time, which is now.
2. A hard-hitting, aggressive management, able to surmount the difficulties of high-cost terminal operation either with new and different methods or imaginative pricing concepts or otherwise.
3. A labor force that identifies its self interest with the interests of the railroad and is willing to accept changes in out-dated rules and working conditions.
4. A steadily growing economy with inflationary influences at a minimum.
5. A more enlightened government approach to rail transportation including a willingness to treat it in the same manner as competing modes and to lift the more onerous regulatory restrictions.

Since Penn Central's public services are vital and cannot be dispensed with, the choice is between relying on a combination of these forces or turning the railroad over to the Government.

[Attachment A]

#### PENN CENTRAL TRANSPORTATION CO. OPERATIONS

Penn Central is the nation's largest transportation company, with some 20,000 miles of railroad lines spread over 16 states, the District of Columbia, and two provinces in Canada.

Its operating territory stretches from Chicago and St. Louis to Boston, New York City, Philadelphia, Baltimore and Washington. This territory contains half of the nation's population and 72 of the 195 metropolitan areas with populations in excess of 100,000. It also includes 55 percent of America's manufacturing plants and 60 percent of its manufacturing employees.

Penn Central itself provides employment for more than 90,000 persons; its annual payroll costs, including fringe benefits, exceed \$1 billion. Were Penn Central not in reorganization, it would be contributing more than \$85 million annually in state and local taxes.

Penn Central's private net investment in rail transportation properties is more than one-sixth of the total investment in the American rail industry. The railroad operates about 3,000 freight and passenger trains each day and moves about one million tons of freight and 300,000 passengers every 24 hours.

Specifically, there is hardly a major commodity produced or imported in this country which Penn Central does not handle at one time or another. Coal, metals, automobiles, foods, paper, grain, chemicals, construction materials and thousands of consumer products move on the Penn Central every day. The revenues from all freight revenues total nearly a billion and a half dollars each year. Additionally, Penn Central's TrailVan service handles hundreds of commodities in containers and highway trailers on flat cars in high-speed trains.

The importance of Penn Central to the United States is illustrated in many ways:

Penn Central interchanges with 164 railroads at 1,088 points;

Penn Central is the only railroad directly providing freight service to Manhattan.

Penn Central is the principal railroad serving the ports of New York, Albany, Boston and Philadelphia and a major railroad serving the ports of Baltimore and Norfolk.

Penn Central is the leading railroad for the movement of automobiles, chemicals, metals and manufactured consumer products and the second largest grain hauler among this nation's rails;

Ten of Penn Central's eleven leading shippers are among the top twenty percent on Fortune's list of the 500 largest industrial corporations;

Penn Central exclusively serves 34 U. S. Army installations, depots, arsenals and plants, 13 naval bases, stations and centers, 12 Air Force bases, and other defense facilities.

As a passenger carrier, Penn Central is the nation's second largest railroad—surpassed only by the Long Island Rail Road. Most of its passengers are commuters and more than 175,000 of them are served by the New York area trains. Additionally, Penn Central carries daily approximately 75,000 commuting passengers in the Philadelphia area, some 14,500 in Boston and nearly 1,000 between Baltimore and Washington, D. C. It is the only passenger railroad serving the densely populated Northeast Corridor. The Metroliner fleet has carried more than 1.7 million passengers and is currently averaging 3,450 passengers each day. Penn Central's conventional trains between New York and Washington carry a daily average of 13,675 passengers.

#### PENN CENTRAL CORPORATE STRUCTURE

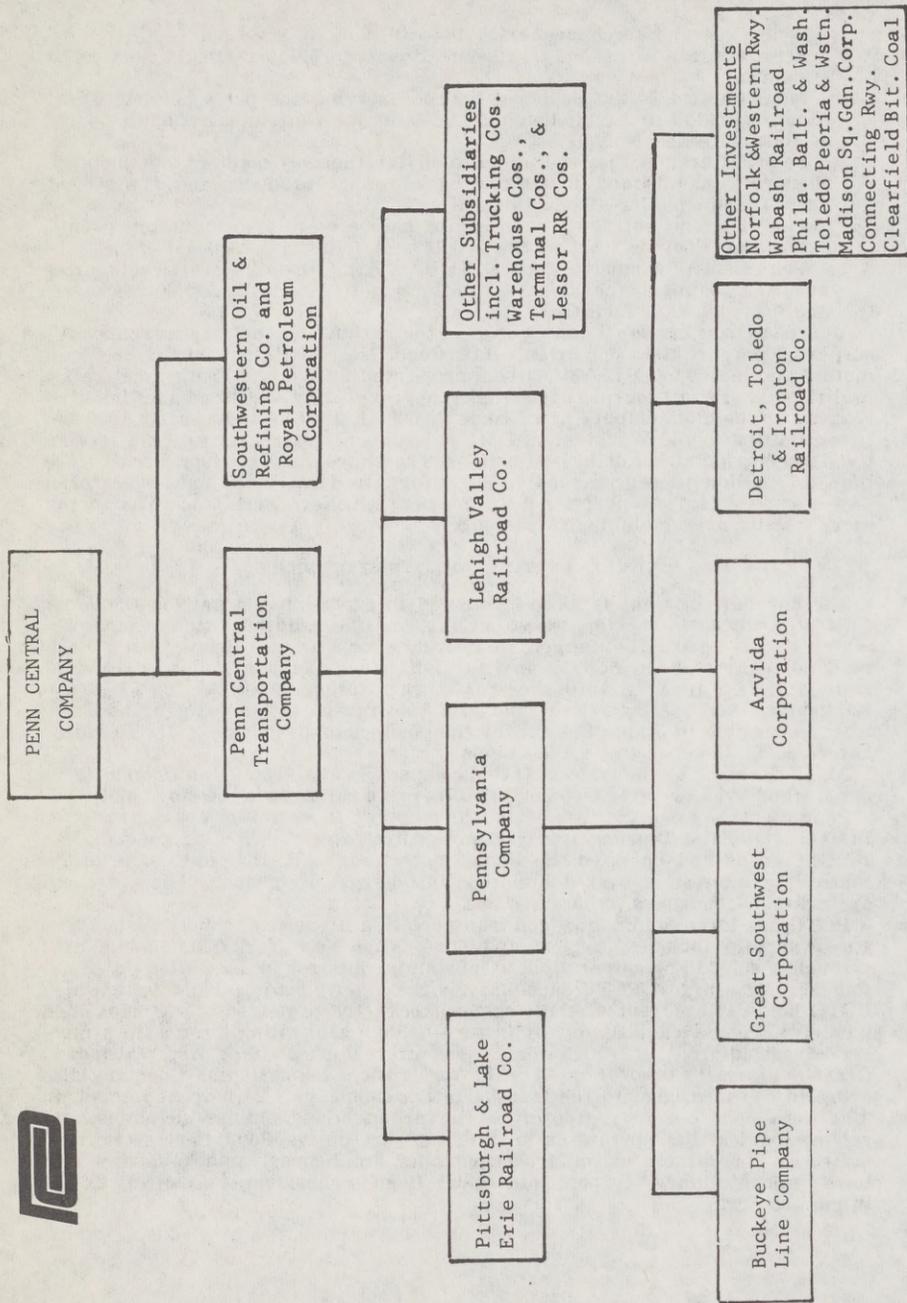
The key unit in what is loosely referred to as "Penn Central" is the *Penn Central Transportation Company* (PCTC, or "the transportation company") which resulted from the merger, in February 1968, of the Pennsylvania Railroad Company and the New York Central Railroad Company. This is the company which on June 21, 1970, filed for reorganization under Section 77 of the Bankruptcy Act. We hold the property of the transportation company as Trustees, responsible to Judge Fullam for the conduct of its business. Its Board of Directors no longer operates the Company.

All of the stock of the transportation company is owned by *Penn Central Company*, which was set up in October 1969. Its principal asset is the stock of PCTC.

Penn Central Company is not in bankruptcy; it exercises no control over PCTC, nor do the Trustees exercise any control over the holding company.

PCTC owns and operates the Penn Central railroad. In addition, it has a controlling interest in over a hundred subsidiary corporations. Some of these are railroad companies, others are not.

PCTC has large holdings in non-transportation properties, chiefly real estate. Its ownership includes, for example, five large New York City hotels and, through a subsidiary corporation, a substantial interest in *Executive Jet Aviation, Inc.* The largest PCTC subsidiary is the *Pennsylvania Company*, in which PCTC holds 100 percent of the common stock (the preferred stock being held publicly). Pennsylvania Company in turn holds a controlling interest in a number of subsidiaries, of which the largest are: *Buckeye Pipe Line Company*; *Great Southwest Corporation*; *Arvida Corporation*. Pennsylvania Company also owns, in conjunction with the transportation company, a 24 percent interest in *Madison Square Garden Corporation*. Its various other holdings include several rail companies that operate as an integral part of the Penn Central railroad network. The largest subsidiaries controlled by Pennsylvania Company also have "sub-subsidiary" corporations under them. Pennsylvania Company is not in bankruptcy.



## ATTACHMENT B

George P. Baker, Richard C. Bond, Jervis  
Langdon, Jr. and Willard Wirtz  
Trustees of the Property of  
PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR

SOURCE AND APPLICATION OF FUNDS

(In Accordance with Regulations of the Interstate Commerce Commission)

Dollars in Millions

SOURCE	1971		1970 Forecast
	Advance Fincl. Plan	Advance <u>1/</u> Fincl. Plan	
Net Ordinary Earnings(Loss)for Company	\$ (188.2)	\$ (47.5)	\$ (300.9)
Adjustments to Earnings:			
Depreciation	96.3	96.3	97.9
Deferral of Payments-Reorganization	174.9	174.9	87.5
Accounts Payable Increase	-	-	92.0
Accrual for Anticipated Wage Incr's.	-	-	46.5
Other Adjustments to Earnings	(8.9)	(8.9)	30.9
Total Adjustments	<u>262.3</u>	<u>262.3</u>	<u>354.8</u>
Net Cash Provided by Operations	<u>74.1</u>	<u>214.8</u>	<u>53.9</u>
Other Sources			
Proceeds from Sale of Property & Salvage	35.9	35.9	32.5
Gov't. Contribution N.E. Corridor	1.5	1.5	4.6
Passenger Service Subsidies	28.3	28.3	-
Other	-	-	(14.4)
Sub-Total	<u>65.7</u>	<u>65.7</u>	<u>22.7</u>
TOTAL SOURCE OTHER THAN FINANCING	<u>139.8</u>	<u>280.5</u>	<u>76.6</u>
<u>APPLICATION</u>			
Capital Program-Equipment	14.7	14.7	13.0
Capital Program-Road	74.6	74.6	68.0
Debt Retirement (1971-Equipment Only)	63.0	63.0	89.3
Debt Service-Commercial Paper	-	-	21.9
Merger Reserve	10.0	10.0	16.4
Retrospective Wage Payment for 1970	46.5	-	-
Passenger Service Expenses Net of Revenues	28.3	28.3	-
Other	-	-	25.2
TOTAL APPLICATION	<u>237.1</u>	<u>190.6</u>	<u>233.8</u>
NET INCR.(DECR.) IN CASH-OTHER THAN FIN.	<u>\$ (97.3)</u>	<u>\$ 89.9</u>	<u>\$ (157.2)</u>
CASH AT BEGINNING OF YEAR	\$ 20.5	\$ 20.5	\$ 58.0
FINANCING TO MAINTAIN CASH BALANCE	\$ 97.3	\$ -	\$ 119.7
CASH AT END OF YEAR	\$ 20.5	\$ 110.4	\$ 20.5

1/ These figures exclude any increase in current rate of pay and any retro-active adjustment for Labor agreements not settled as of this date.

NOTE: The above figures, for 1971, do not include a \$183.5 million Capital Equipment Program that needs to be financed. The 1970 Forecast does not include Capital Equipment Financing of \$112.3, of which \$75.5 has been secured.

## ATTACHMENT C

George P. Baker, Richard C. Bond, Jarvis  
Langdon, Jr. and Willard Wirtz  
Trustees of the Property of  
**Penn Central Transportation Company, Debtor**

Sheet 1 of 2

GENERAL BALANCE SHEET

(In Accordance with Regulations of the Interstate Commerce Commission)

	September 30, 1970	December 31, 1969
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
701 Cash (in transit \$4,094,256; 1969-\$13,484,465)	\$ 43,839,700	\$ 61,117,923
702 Temporary cash investments	211,882	10,077,775
703 Special deposits	842,933	9,135,779
704 Loans and notes receivable	1,332,232	1,495,183
706 Net balance receivable from agents & conductors	101,800,369	92,258,004
707 Miscellaneous accounts receivable	79,510,703	58,854,455
708 Interest and dividends receivable	4,083,335	5,019,842
709 Accrued accounts receivable	175,716,827	135,553,420
710 Working fund advances	1,563,954	1,307,879
711 Prepayments	3,303,145	6,903,184
712 Material and supplies	85,998,488	89,669,579
713 Other current assets	8,292,411	6,421,902
Total Current Assets	<u>506,475,959</u>	<u>477,814,925</u>
<b>SPECIAL FUNDS</b>		
715 Sinking Funds	609	609
716 Capital and other reserve funds (excludes Company's issues \$4,293,320; 1969-\$5,422,071)	24,383,238	6,619,024
717 Insurance and other funds	11,992,641	13,083,267
Total Special Funds	<u>36,376,488</u>	<u>19,702,900</u>
<b>INVESTMENTS</b>		
721 Investments in affiliated companies		
Stock:		
Leased railroads	550,440,239	550,043,865
Other railroads	88,151,380	91,522,530
Pennsylvania Company	118,278,014	118,278,014
Other companies	29,880,129	31,546,379
Bonds, notes and advances:		
Leased railroads	119,665,028	186,020,502
Other railroads	117,516,030	102,354,231
Other companies	91,834,362	73,478,895
Total Investments in Affiliated Companies	<u>1,115,765,182</u>	<u>1,153,244,416</u>
722 Other investments		
Stock:		
Railroads	4,385,841	4,385,841
Madison Square Garden Corp.	11,499,995	11,499,995
Other companies	427,863	427,835
Bonds, notes and advances:		
Railroads	4,497,821	4,467,607
Other companies	3,035,725	2,497,218
Total Other Investments	<u>23,847,245</u>	<u>23,278,496</u>
723 Reserve for adjustment of investment in securities-Cr.	17,591,229	-
Total Investments	<u>1,122,021,198</u>	<u>1,176,522,912</u>
<b>PROPERTIES</b>		
731 Road and equipment property:		
Road	1,849,865,167	1,833,946,687
Equipment	1,692,621,696	1,725,339,946
Other property accounts	(12,066,402)	(14,173,342)
	<u>3,530,420,461</u>	<u>3,545,113,291</u>
732 Improvements on leased property:		
Road	265,622,336	263,695,436
Equipment	3,440,594	3,529,793
General expenditures	4,852,976	4,854,626
	<u>273,915,906</u>	<u>272,079,855</u>
Total Transportation Property	<u>3,804,336,367</u>	<u>3,817,193,146</u>
735 Accrued depreciation - Road and equipment	(884,196,277)	(875,534,971)
736 Amortization of defense projects - Road & equipment	(40,079,586)	(41,545,417)
Recorded depreciation and amortization	<u>(924,275,863)</u>	<u>(917,080,388)</u>
Total Transportation Property Less Recorded Depreciation and Amortization	<u>2,880,060,504</u>	<u>2,900,112,758</u>
737 Miscellaneous physical property	97,606,515	96,050,816
738 Accrued depreciation - Miscellaneous physical property	(42,912,281)	(41,223,764)
Miscellaneous physical property less recorded depreciation	<u>54,694,234</u>	<u>54,827,052</u>
Total Properties Less Recorded Depreciation and Amortization	<u>2,934,754,738</u>	<u>2,954,939,810</u>
<b>OTHER ASSETS AND DEFERRED CHARGES</b>		
741 Other assets	17,691,826	35,859,113
742 Unamortized discount on long-term debt	1,244,836	1,406,522
743 Other deferred charges	39,410,901	33,511,978
Total Other Assets and Deferred Charges	<u>58,347,563</u>	<u>70,777,613</u>
<b>TOTAL ASSETS</b>	<u>\$4,657,975,946</u>	<u>\$4,699,758,160</u>

George F. Baker, Richard C. Bond, Jarvis  
Langdon, Jr. and Willard Wirtz  
Trustees of the Property of

Sheet 2 of 2

**Penn Central Transportation Company, Debtor**

GENERAL BALANCE SHEET

(In Accordance with Regulations of the Interstate Commerce Commission)

	September 30, 1970	December 31, 1969
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<u>CURRENT LIABILITIES</u>		
751 Loans and notes payable	\$ 36,430,000	\$ 102,048,000
752 Traffic and car service balance - Cr.	11,093,093	3,378,136
753 Audited accounts and wages payable	162,457,183	43,317,081
754 Miscellaneous accounts payable	30,134,392	25,595,191
755 Interest matured unpaid	15,182,652	12,720,449
756 Dividends matured unpaid	312,904	10,805
757 Unmatured interest accrued	3,351,340	15,428,097
758 Unmatured dividends declared	119,366	162,917
759 Accrued accounts payable	286,686,512	230,499,421
760 Federal income taxes accrued	667,857	357,662
761 Other taxes accrued	57,918,705	39,784,234
763 Other current liabilities	44,676,641	10,153,259
Total Current Liabilities	<u>649,030,645</u>	<u>483,455,252</u>
<u>LONG-TERM DEBT DUE WITHIN ONE YEAR</u>		
764 Equipment obligations and other debt	<u>96,516,017</u>	<u>106,058,013</u>
<u>LONG-TERM DEBT DUE AFTER ONE YEAR</u>		
765 Funded debt unmatured	1,088,010,225	1,140,722,655
766 Equipment obligations	457,468,766	493,862,259
768 Debt in default	108,524,137	-
769 Amounts payable to affiliated companies	127,277,433	118,710,975
Total Long-Term Debt Due After One Year	<u>1,781,280,561</u>	<u>1,753,295,889</u>
<u>RESERVES</u>		
771 Pension and welfare reserves	6,195,272	6,646,084
772 Insurance reserves	5,169,239	5,489,319
774 Casualty and other reserves	147,177,734	161,028,212
Total Reserves	<u>158,542,245</u>	<u>173,163,615</u>
<u>OTHER LIABILITIES AND DEFERRED CREDITS</u>		
781 Interest in default	26,893,608	-
782 Other liabilities	27,509,287	28,797,678
783 Unamortized premium on long-term debt	72,116	75,911
784 Other deferred credits	57,361,601	61,399,187
785 Accrued depreciation - Leased property	168,291,695	167,343,379
Total Other Liabilities and Deferred Credits	<u>280,128,307</u>	<u>257,616,155</u>
<u>SHAREHOLDERS' EQUITY</u>		
791 Capital stock issued	<u>241,137,030</u>	<u>241,137,030</u>
<u>CAPITAL SURPLUS</u>		
794 Premiums and assessments on capital stock	87,610,462	87,610,462
795 Paid-in surplus	1,002,403,106	1,002,403,106
Total Capital Surplus	<u>1,090,013,568</u>	<u>1,090,013,568</u>
<u>RETAINED INCOME</u>		
797 Retained income - Appropriated	-	1,422,000
798 Retained income - Unappropriated	361,327,573	593,596,638
Total Retained Income	<u>361,327,573</u>	<u>595,018,638</u>
Total Shareholders' Equity	<u>1,692,478,171</u>	<u>1,926,169,236</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$4,657,975,946</u>	<u>\$4,699,758,160</u>

Dated:

Certified as correct:

C. S. Hill  
Controller

Notes:

- The above statement is presented in accordance with accounting regulations of the Interstate Commerce Commission and such regulations do not agree in certain respects with generally accepted accounting principles.
- The transportation company's results of operations are included without adjustment, except as described in note 3 below, which ultimately may result from the company's entry into reorganization under the Bankruptcy Act on June 21, 1970. These results include the period prior to the appointment of the Trustees in Reorganization and for this prior period do not constitute the report of the Trustees.

Debt in default classified in the balance sheet represents obligations not paid on their scheduled maturity dates. The payment of certain debt obligations has been deferred by court order. The reorganization proceedings have resulted in technical defaults on substantial additional portions of the transportation company's debt.

- Provision, in the estimated amount of \$17,591,229 is made for impairment in value of investments in Lehigh Valley Railroad, which entered reorganization July 24, 1970 under the Bankruptcy Act, and incidental holdings as to which realization has become doubtful since reorganization of the Penn Central Transportation Company.

George P. Baker, Richard C. Bond, Jarvis  
Lundgren, Jr. and Willard Wirtz  
Trustees of the Property of  
**Penn Central Transportation Company, Debtor**

INCOME STATEMENT

(In Accordance with Regulations of the Interstate Commerce Commission)

September		January 1 to September 30	
1970	1969	1970	1969
<b>RAILWAY OPERATING REVENUES</b>			
\$ 115,922,114	\$ 114,194,831	\$ 1,053,823,896	\$ 989,486,094
11,270,918	11,472,045	108,626,187	109,938,203
3,990,351	4,363,055	33,409,160	41,849,461
349,483	66,857	1,885,276	2,461,881
1,774,414	1,921,198	16,348,680	16,358,503
2,580,490	2,509,236	22,071,938	17,220,230
4,561,578	7,314,189	41,300,199	45,028,249
140,449,348	141,843,411	1,277,465,336	1,222,342,621
<b>RAILWAY OPERATING EXPENSES</b>			
17,941,129	13,596,665	164,851,598	137,084,547
24,559,362	21,969,492	242,760,645	203,855,062
1,793,894	2,000,769	17,119,742	17,980,990
71,615,810	65,562,381	665,377,830	588,807,728
828,573	895,358	8,310,875	8,866,785
8,498,213	8,419,059	80,192,250	74,953,787
125,236,961	112,443,724	1,178,612,940	1,031,548,839
15,212,387	29,399,687		
11,958,748	12,127,688	Net Revenue from Railway Operations	
19,002,322	12,832,019	Railway Tax Accruals	
418,444	280,659	Hire of equipment - Debit balance	
(16,167,127)	4,159,281	Joint facility rents - Debit balance	
		Net Railway Operating Income (Loss)	
		(166,548,922)	(32,367,429)
<b>OTHER INCOME</b>			
-	-	Revenue from miscellaneous operations	146,539
9,910	20,677	Income from lease of road and equipment	204,539
1,110,526	928,025	Miscellaneous rent income	8,598,346
1,494,753	1,761,810	Income from nonoperating property	15,595,752
6,084	-	Separately operated properties - Profit	3,687
446,907	14,173,220	Dividend income	53,477,774
399,033	483,771	Interest income	3,247,745
152,812	52,544	Income from sinking and other reserve funds	542,375
422	427	Release of premiums on funded debt	3,850
624,411	1,789,292	Miscellaneous income	7,390,961
4,242,858	19,209,766	Total Other Income	89,211,788
(11,924,269)	23,369,047	Total Income (Loss)	56,846,269
	975	<b>MISCELLANEOUS DEDUCTIONS FROM INCOME</b>	
-	3,980	Expenses of miscellaneous operations	29,333
45,922	28,965	Taxes on miscellaneous operating property	41,435
131,490	146,546	Miscellaneous rents	537,676
272,249	812,734	Miscellaneous tax accruals	1,184,208
117,371	68,993	Separately operated properties - Loss	2,697,064
25,354	92,101	Maintenance of investment organization	1,066,821
174,994	317,436	Income transferred to other companies	367,592
771,360	1,473,576	Miscellaneous income charges	18,952,705
(12,695,629)	21,895,471	Total Miscellaneous Deductions	24,847,494
		Income (Loss) Available for Fixed Charges	(123,977,107)
<b>FIXED CHARGES</b>			
2,959,303	2,284,641	Rent for leased roads & equipment	24,547,656
4,205,542	7,778,036	Interest on funded debt:	
4,321,400	-	Fixed interest not in default	52,056,400
351,921	1,101,271	Interest in default	25,815,499
26,803	25,120	Interest on unfunded debt	6,964,805
12,064,969	11,192,068	Amortization of discount on funded debt	331,598
(24,760,598)	10,703,403	Total Fixed Charges	109,713,958
-	(8,817,778)	ORDINARY INCOME (LOSS)	(233,691,065)
\$ (24,760,598)	\$ 1,885,625	Prior period items	-
		NET INCOME (LOSS)	\$ (233,691,065)
			\$ (49,032,314)

Dated:

Certified as correct:

C. S. Hill  
Controller

## Notes:

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- The transportation company's results of operations are included without adjustment, except as described in note 3 below, which ultimately may result from the company's entry into reorganization under the Bankruptcy Act on June 21, 1970. These results include the period prior to the appointment of the Trustees in Reorganization and for this prior period do not constitute the report of the Trustees.

Interest in default provided in the income statement represents interest on obligations not paid on their scheduled maturity dates. The payment of certain debt obligations has been deferred by court order. The reorganization proceedings have resulted in technical defaults on substantial additional portions of the transportation company's debt.

- Provision in the estimated amount of \$17,591,229 is made for impairment in value of investments in Lehigh Valley Railroad, which entered reorganization July 24, 1970 under the Bankruptcy Act, and incidental holdings as to which realization has become doubtful since reorganization of the Penn Central Transportation Company.

## FEDERAL RESERVE BANK OF PHILADELPHIA

PHILADELPHIA, PENNSYLVANIA 19101

OFFICE OF THE  
PRESIDENT

November 20, 1970

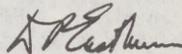
Mr. Jervis Langdon, Jr.  
Penn Central Transportation Company  
6 Penn Center Plaza, Room 1836  
Philadelphia, Pa. 19104

Dear Mr. Langdon:

In reply to your letter of November 20, 1970 requesting a statement with regard to the ability of the Federal Reserve Bank to extend credit to the Penn Central Transportation Company, I am enclosing a memorandum which states our position on the matter. This memorandum summarizes the results of extensive investigation on the part of the staffs of the Federal Reserve Banks of Philadelphia and New York. I concur in its conclusions.

I shall maintain a continuing interest in view of the concern of the Reserve Bank for the economy of the District, and the importance of continued operation of the Penn Central Transportation Company to the economy of the entire region which it serves.

Sincerely,

David P. Eastburn  
PresidentDPE/b  
Encl.

November 20, 1970

Subject: Federal Reserve Bank lending to the  
Trustees of the Penn Central Transportation Company

From: E. A. Aff, Vice President, Federal Reserve Bank of Philadelphia  
T. M. Timlen, Vice President, Federal Reserve Bank of New York

This has reference to Mr. Jarvis Langdon's letter of November 20, 1970 as to our conclusion on whether credit could be extended to the Trustees of the Penn Central Transportation Company by the Federal Reserve Bank of Philadelphia to enable the Company to continue its operations.

On August 25, 1970, Mr. Langdon and the other Trustees met with representatives of the Federal Reserve Banks of Philadelphia and New York for the purpose of discussing the status of the Penn Central Transportation Company and exploring possible approaches to its financial problems, including the extension of credit by the Reserve Banks. We agreed to study the situation and to analyze information provided by the Company. From time to time, subsequent to that meeting, we have discussed various aspects of the matter with Mr. Langdon and his associates.

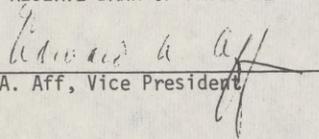
The only statutory authority under which we may consider the extension of credit in this situation is Section 13, Paragraph 3, of the Federal Reserve Act. Under that paragraph a Federal Reserve Bank, if authorized by the Board of Governors of the Federal Reserve System in unusual and exigent circumstances, may discount for individuals, partnerships, or corporations, notes eligible for discount for member banks when such notes are indorsed or otherwise secured to the satisfaction of the Federal Reserve Bank.

We have carefully analyzed the data submitted by Penn Central, together with other available information. We have studied the question of the possible amount of funds that would be needed to keep the railroad operating, its projected cash flow, collateral that might be available, the possible duration of the loan, and the probabilities of the ultimate repayment of a loan.

At this time, based on the information available to us, it is our view that it would not be appropriate for the Federal Reserve Bank of Philadelphia or the Federal Reserve Bank of New York to extend credit to the Penn Central Transportation Company under Section 13, Paragraph 3, of the Federal Reserve Act.

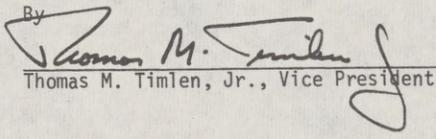
FEDERAL RESERVE BANK OF PHILADELPHIA

By


  
Edward A. Aff, Vice President

FEDERAL RESERVE BANK OF NEW YORK

By


  
Thomas M. Timlen, Jr., Vice President

STATEMENT OF JOHN S. GUEST, FINANCIAL CONSULTANT AND GENERAL PARTNER,  
 KUHN, LOEB AND CO.

My name is John S. Guest. I am a general partner of Kuhn, Loeb & Co., an investment banking firm with offices at 40 Wall Street, New York, New York.

Under arrangements made with the Penn Central Transportation Company Trustees and confirmed by order of Judge Fullam, my firm has served since October 22, 1970, as financial adviser to the Trustees. I am in charge of a task force in my firm which has the responsibility for this assignment. In this capacity, I work closely with Mr. Robert G. Fuller, who has served as financial adviser to the Trustees since September 21, 1970, and with the financial officers of the Company.

I have reviewed the extensive efforts taken by the Company to obtain financing in the private sources for operating funds, capital expenditures and equipment requirements. I have made independent inquiry of my own through direct discussions with senior officials of leading financial institutions. On this record and also on the basis of my own experience in financial matters, I have confirmed the conclusion which the Trustees have reported in their testimony today.

The principal sources of potential financing that have been explored are (1) commercial banks and finance companies, (2) insurance companies, (3) pension funds, (4) the broad category of investors served by investment bankers, (5) suppliers, (6) other railroads, (7) shippers. With one special exception related to the acquisition of equipment that I will discuss subsequently, all of these sources have indicated an unwillingness at this time to extend any credit, either directly or indirectly, to the Trustees of Penn Central. The grounds for this reluctance, as expressed by institutions which are existing creditors of the Company as well as by others who are not creditors, is a strong feeling that there must be some extensive evidence of a turnaround in the financial and operating results of the Company before any financial commitments can be made. Moreover, it does not appear that the Company has available any significant unpledged non-transportation assets such as real estate which would be acceptable collateral for further borrowing.

The following recites the position of each of these sources as expressed to the Company at this time:

*(1) Commercial Banks and Finance Companies*

Penn Central Transportation Company has relationships with approximately one hundred commercial banks in this country and Canada. The total indebtedness of the Company to these banks is in excess of \$600 million. Of this amount, payment of interest and principal has been suspended on over \$440 million of this indebtedness, and \$175 million represents equipment debt held by banks that is being serviced as provided by a court order issued August 19, 1970. In addition, commercial banks have loaned subsidiaries of the Company over \$150 million.

There has been constant contact between the Trustees and their staff with the commercial banking community. The principal banks with which the Company does business possess sufficient information to enable them to judge the risk factors that would be involved in the purchase of Trustees' Certificates.

There are a number of elements which make it extremely difficult for commercial banks to commit to acquire Trustees' Certificates. Twenty-five major banks in this country have already committed their maximum legal lending limit to the Company and its subsidiaries. Most of the other major banks where the Company has important relationships would have only a modest amount of funds available because of legal lending limit restrictions.

There are, of course, a few large banks that have played a minor role in financing the Company, but these banks have indicated to financial officers of the Company that, in view of the large amount of potential loan requirements from their present customers during the next few years, they would not be interested in acquiring Trustees' Certificates.

In general, commercial banks fully recognize that they have a major stake in assisting with the reorganization of the Company and desire to participate in a constructive way during the reorganization. However, the banks take the position that until such time as the Company can better demonstrate an ability to pay interest and amortize the principal on new loans, they are not prepared to commit additional funds.

It is customary for a borrower who has exhausted all possibilities of bank borrowing to turn to finance companies, and I understand that discussions have been commenced looking towards a loan secured by a pledge of the Company's receivables. Such an arrangement, if it could be consummated, would represent a one-shot palliative. At all events, this type of financing, even if it were feasible, would be of such limited amount that it could not support the cash needs of the railroad for very long.

#### (2) *Insurance Companies*

The Trustees' financing requirements for 1971 have been discussed at length with several large life insurance companies that hold some \$500 million of the Company's obligations on which, with the exception of equipment obligations, interest and principal are no longer being paid. These institutions also have a great stake in the viability of the Company, but they have indicated very definitely that they cannot consider advancing new funds to acquire Trustees' Certificates until such time as the Company demonstrates an ability to repay any new indebtedness.

#### (3) *Pension Funds*

Recently, my firm consulted several of the largest state and municipal pension funds to solicit their interest in acquiring Trustees' Certificates. While expressing deep concern regarding the plight of the railroad and in certain cases a positive desire to be helpful, they pointed out that their investment policies are closely governed by state law or regulations, which would likely inhibit their ability to purchase Company Trustees' Certificates. Most of such funds would also require a satisfactory rating from a bond rating agency, which would be difficult to obtain. Notwithstanding these uncertainties, every effort will be made to develop these sources.

Banks acting as trustees for large corporate pension funds have advised the Trustees' representatives that, pending evidence of a turnaround in the railroad's affairs, they are not in a position to buy Trustees' Certificates for these funds. Self-administered corporate pension funds, who were contacted directly, took a similar position.

The suggestion has been made that the Railroad Retirement Fund be authorized to make loans to railroads. I have been advised that adoption of such a suggestion would require new legislation. If that legislation were enacted, this could be an important source of new funds.

#### (4) *Investment Bankers*

In recent months presentations on the Trustees' behalf have been made to four other major investment banking concerns for the purpose of determining their interest in assisting in the sale of Trustees' Certificates and/or Trustees' equipment obligations, either as underwriters or as private placement agents. These firms responded that it would be impossible at this time to market, or place privately with their customers, Trustees' Certificates or any of the types of securities used to finance the acquisition of equipment, such as conditional sale agreements or equipment trust certificates.

From my experience as an investment banker, I concur in such opinions and say that they reflect real doubts as to the Trustees' ability to service new debt.

#### (5) *Suppliers*

Prior to June 21, 1970, the date of reorganization, the Company had placed with General Motors Corporation an order to build 145 locomotives. Although a tentative commitment for the financing for the acquisition of this equipment had been arranged prior to reorganization, the financing commitment was subsequently withdrawn. General Motors recognized that the Company desperately needed the locomotives and proceeded to build the locomotives with the order despite the lack of a financing commitment. During the past several months a number of alternatives have been thoroughly explored for financing these locomotives. In the next week or so, General Motors and the Trustees hope to announce that such financing has been completed. However, it is particularly important to note that if this financing is finalized, the institutions who commit the funds will be receiving an obligation of the Trustees affirmed by the court, but will be relying essentially on a General Motors guarantee as to payment of principal and interest.

Preliminary discussions have also been held with other Company suppliers along the lines of the transaction contemplated for financing of the G. M.

locomotives. However, until such time as the concept of the G. M. locomotive financing is delineated, it is premature to attempt to negotiate similar arrangements with other suppliers. Leasing companies, who frequently act as intermediaries in equipment financing, have expressed an inability to assist in any financing for the Trustees at this time.

*(6) Other Railroads*

Certain other railroads have tentatively agreed to participate in the G. M. locomotive financing previously mentioned, by means of a contingent purchase agreement. On the other hand, it has not proved possible to work out a financing arrangement whereby another railroad would buy equipment which in turn would be leased to the Trustees.

In view of the critical financial condition of the industry as a whole, it is not realistic to expect the Penn Central Transportation Company, which is the largest element in the industry, to obtain significant financial support from other railroads.

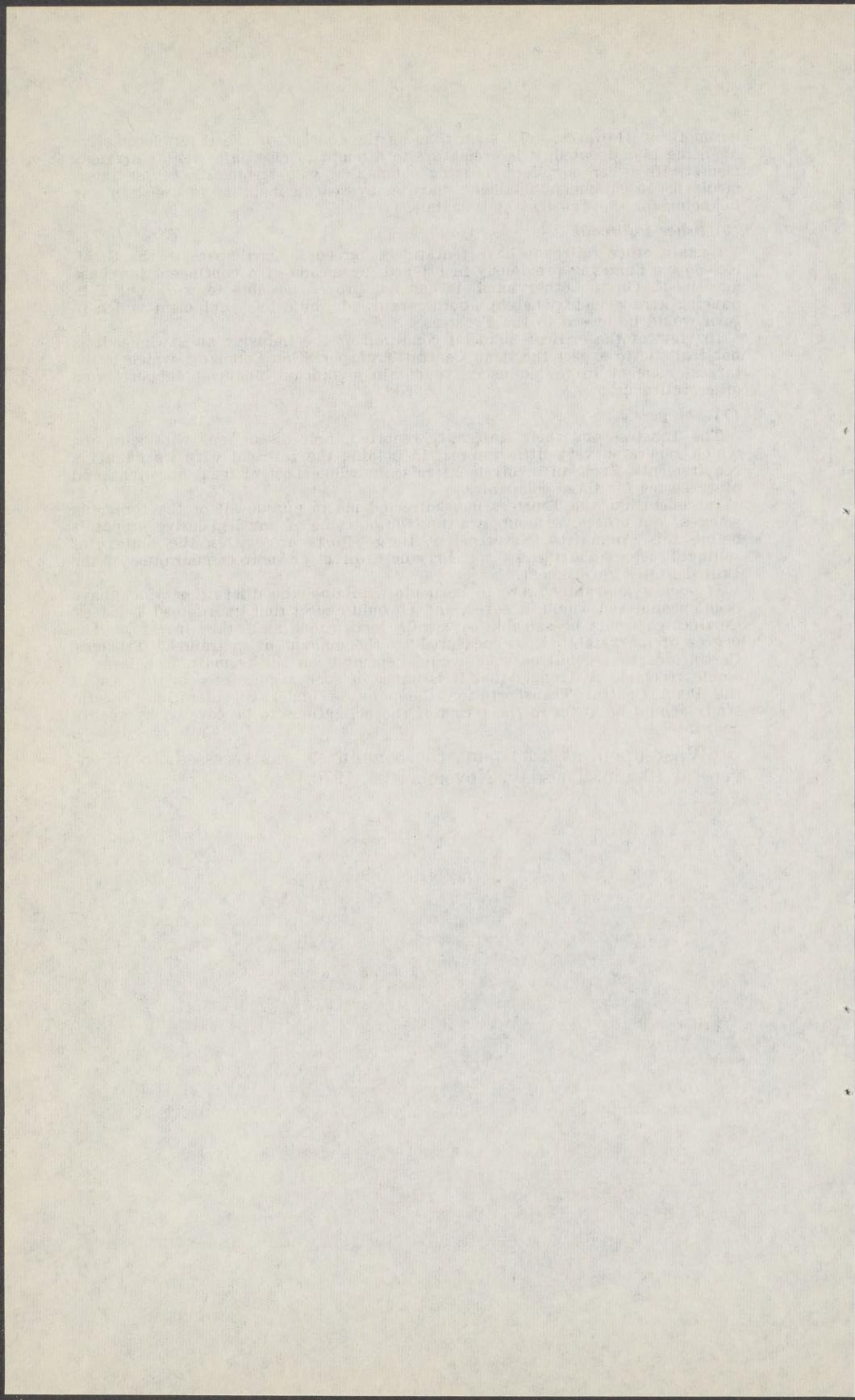
*(7) Shippers*

The Trustees and their staff have reported their discussions with shippers, which generated very little interest in helping the railroad with its financing requirements. Such an involvement raises a whole host of legal questions and other issues for these companies.

In conclusion, the Trustees have directed me to pursue all of the foregoing sources, and others, without awaiting the outcome of any legislative proposals before this Committee. Nevertheless, those efforts are within the context of selling Trustees' Certificates not carrying a direct or indirect guarantee of the United States government.

If such a guarantee were to be made available, the difficulties which have been encountered would be eased, and I would expect that guaranteed Trustees' Certificates would be saleable to certain institutions and other investors. The degree of marketability, as measured by the amount of guaranteed Trustees' Certificates that could be sold, would depend upon the terms of the issue. I would recommend strongly that if issuance of such a guarantee in the case of the Penn Central Transportation Company is under consideration, careful study should be given to the terms of the obligations to be covered by such a guarantee.

(Whereupon, at 3:30 p.m., the committee was recessed, to reconvene at 10 a.m. Tuesday, November 24, 1970.)



## FAILING RAILROADS

TUESDAY, NOVEMBER 24, 1970

U.S. SENATE,  
COMMITTEE ON COMMERCE,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10:12 a.m. in room 5110, New Senate Office Building, Hon. Vance Hartke presiding.

Present: Senators Hartke, Cotton, Pearson, and Baker.

Senator HARTKE. Good morning, gentlemen.

Yesterday the Penn Central trustees came in to report on the railroad's condition. They pointed out that the railroad is in grave difficulty; it faces continuing losses and continuing depletion of cash. They believe, however, that it is worth the effort to attempt to turn it around; they think they will know in 3 to 5 years whether or not the railroad can be made profitable.

In the meantime, they must obtain outside financing in order to meet their operating expenses. According to their testimony, \$175 to \$250 million are needed, in the next 4 months; \$350 to \$500 million over the next 3 years. According to the evidence given by the trustees, they cannot obtain this money by themselves; private sources will not lend it to them. They must rely on government assistance, directly or indirectly.

I do not believe we can permit the railroad service to be halted in the territory which is now served by the Penn Central. Cessation of service would endanger the health and welfare of the citizens of the region.

That is our legitimate goal—to preserve transportation service. We are not about to bail out banks and investors or protect the company's management. At the same time, we must be very cautious in our commitment of the taxpayers' funds to such a project.

Yesterday the trustees agreed with my suggestions that any Federal aid was properly limited to railroads already in reorganization, unable to obtain loans from private sources, and in danger of halting their operations for lack of cash. Further, that funds should be limited in their use to maintaining the railroad's operations and that the Government should receive security adequate to protect its interests.

We are interested today to learn your evaluation, from the Secretary of the Department of Transportation and the Department of the Treasury, of the situation now that the dust has settled somewhat and a few facts are beginning to appear. We are also interested to find out what you have learned since you were last up here and your recommendations.

Gentlemen, I would like to say, on the question of television, that I have talked to Senator Cotton, and he says he has objected to permitting television to appear here, and that the committee rule is that public hearings of the full committee or any subcommittee thereof shall be televised or broadcast only when authorized by the chairman and the ranking minority member of the full committee; and the ranking minority member, Senator Cotton of New Hampshire, has objected to television at these hearings; and therefore it is not permitted here.

Quite frankly, it does not make any difference to me whether they are or are not.

I do think, however, that the great importance of the Penn Central's function to the American public would indicate widespread interest. It would seem to me that it is in everyone's interest to have the general public well informed on this matter, and that television could make some contribution in that decision.

At any rate, this is an open hearing. We have no rules affecting the writing press. You can keep on writing. And certainly I intend to develop a full record so this committee will have sufficient information on which to base a judgment.

Senator COTTON. May I respond to that?

Senator HARTKE. Yes, sir.

Senator COTTON. Mr. Chairman, under the rules of the committee, in order to have hearings televised, approval must be given by both the chairman of the committee and the ranking minority member.

I have never objected in the past, although I am frank to say that I have never been very enthusiastic about televised congressional proceedings. I guess that we are all affected by the same bug—the minute we have proceedings televised, why, they cease to be a careful, dispassionate hearing and become a kind of a competition among members to be assured that they get their 5 cents' worth in so that their constituents will not think that they are silent and nonparticipants.

However, I have never objected before. In this particular case we are in a peculiar situation. We have an adjourned session of the Congress following a very hotly disputed and hard-fought political campaign.

If either the Senator from Indiana or the chairman of the committee had discussed this matter with me prior to the hearings, I might have been willing, on my part, to authorize television coverage. But frankly, I am concerned by the situation here presented. We are bringing a Cabinet officer up here who has taken an active part—as is natural—in the recent campaign.

The Senator from Indiana has been reelected, for which I give him my hearty and ungrudging congratulations.

Senator HARTKE. Thank you for that.

Senator COTTON. We should not be personal in this matter.

I think it is a dangerous time to put on a television show. And, while I am sure—knowing from my experiences how meek and mild the Senator from Indiana is—I am sure that we would have handled everything in a low key and very softly, I just did not think it was wise at this time to have televised proceedings.

I have been on this committee many years, and while I think the Senator from Indiana was not at that time in the Senate, the last time that we had real trouble in this committee was over the confirmation of Admiral Strauss when President Eisenhower named him to his Cabinet and he was rejected. We then had a very bitter time in this Commerce Committee, and it took us a number of years to overcome the ill feeling that was engendered.

Our committee has always enjoyed, with the exception of that period, an enviable reputation for dispassionate and careful weighing of problems before it with very little personal acrimony or partisanship.

I do not like the risk of marring our reputation in this respect by televised proceedings at this particular time. I have no apologies to make for my decision.

It might easily have been taken care of by the courtesy of a conference with the Senator from Indiana, because I am almost always able to come to a meeting of the minds with him whenever we sit down to attempt to do so. But I did object, and I still do object.

Senator HARTKE. I might say to my distinguished friend from New Hampshire that in the first place I was informed that the television had requested to be set up, and they told me this morning that you had objected.

The Committee tells me just now that they were merely notified, as is customary; no one asked them to come. I do not care if they come or not. That is their decision to make. As far as I am concerned, I did not know if they were going to be here yesterday; I found out today the objection was raised yesterday. I did not even know it was raised yesterday on that ground. So far as I am concerned, that does not represent any great problem. We are not interested.

I do think the public has a right to know, and I suppose television is entitled to their consideration. I frequently have found it very difficult to understand why television has to be excluded and other means of media can be included; but that is neither here nor there.

Senator COTTON. Do I understand the Senator to say he did not know yesterday there had been an objection?

Senator HARTKE. I knew there had been an objection, but I did not know anybody in television had even asked to appear. I do not know now; I do not know and I do not care.

Senator COTTON. The only reason I thought that it was well known, is that a member of the committee staff on the majority side came over and inquired yesterday as to whether I was going to make any explanation of the basis for my objection. I can assure you that if you had cared to discuss the matter, I would have been happy to discuss it.

This is not a matter of depriving the public of knowledge. I have heard that point raised for a long time. I think we carefully report what goes on during hearings before the committee.

Senator HARTKE. I might say to the distinguished Senator from New Hampshire that I have been here a little longer than he remembers. I was here and voted on the Strauss matter. I plan to be here quite a while.

Senator COTTON. You were much quieter then than you are now.

[Laughter.]

Senator HARTKE. That is what happens to you when you get old.

All right, Mr. Secretary, are you ready?

Can he go ahead with his statement to the committee?

Senator COTTON. Yes.

Senator HARTKE. Mr. Secretary, you can go ahead.

Senator COTTON. I would like to raise a point of personal privilege before he proceeds.

What did you say about being old?

Senator HARTKE. I find out that no one yet has been able to reverse that clock, and I find out each day I get older and each campaign I go through makes me less concerned about comments or inferences of any kind.

Senator COTTON. Then let me conclude this exchange on a good-natured note. During my last campaign I was accused of being too old.

Senator HARTKE. I did not do that, did I?

Senator COTTON. You did not?

Senator HARTKE. No.

Senator COTTON. Who around here is older than I?

Anyway, I simply responded by telling this story, about three old New Hampshire residents who were down in Florida sitting in the sunshine and discussing things together. They got on the rather morbid subject of where they would prefer to be buried after they passed on.

The first one said, "You know, I still believe in patriotism and I just was a great admirer of that great American patriot, Nathan Hale, who said those famous words, 'My sole regret is that I have but one life to give for my country.' I wish when I pass on that I could be buried somewhere near where his remains lie."

So the second one said, "I am a great admirer and I reverence and revere our late President John F. Kennedy. I wish I were eligible just to lie in Arlington Cemetery in sight of where he lies."

The third one made no comment, so they turned to him and said, "Where would you like to be buried?"

He said, "Well, I think I would like to lie next to Elizabeth Taylor."

They were somewhat surprised, and one of them said, "But she ain't dead."

He said, "And neither am I."

[Laughter.]

Now go ahead.

Senator HARTKE. All I can say is Senator Cotton displays his usual good humor, charm and wit, and we are glad we are on with him.

Mr. Secretary, you may proceed.

**STATEMENT OF HON. JOHN A. VOLPE, SECRETARY OF TRANSPORTATION, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY HON. JAMES M. BEGGS, UNDER SECRETARY; J. THOMAS TIDD, ESQ., DEPUTY GENERAL COUNSEL; AND CARL V. LYON, ACTING ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION**

Secretary VOLPE. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee: I appreciate this opportunity to appear before you again to discuss the financial prob-

lem confronting many of our Nation's railroads and the action necessary to deal effectively with that problem.

In testifying before the committee last June on S. 4011, the administration's bill to authorize Federal guarantees of loans to railroads, I recited some statistics reflecting the serious financial condition of the industry:

The margin of net operating income to gross had deteriorated to about half the 1966 level;

Net working capital had declined steadily from a 1963 level of \$828 million to a 1969 level of \$58.4 million and, I might add that by June 30, 1970, this figure had dropped to a deficit of \$321.8 million;

Cash flow from retained income and depreciation/retirement charges was providing for only about 60 percent of gross capital expenditures, the remainder coming from borrowing and drawing on working capital; and

Equipment obligations had increased from \$2.5 billion at the end of 1962 to \$4.2 billion at the end of 1968.

This was the situation as it appeared last June. Data available for the third quarter of 1970 show few signs of improvement. The net railway operating income for class I railroads in the eastern district was minus \$25.8 million, or a decrease of \$43 million over the same quarter of 1969. While the Eastern roads as a class are in the worst shape, six roads in the Western district experienced net railway operating income deficits in the third quarter. For the first 9 months of 1970, more than three-fourths of the class I railroads experienced either a deficit or lower net railway operating income compared with the same period in 1969. The rate increases recently approved by the ICC should lead to an improvement in 1971 but there will be some offset by factors such as the pending wage settlement.

Currently, there are four railroads in reorganization—the Penn Central, the Boston and Maine, the Central of New Jersey, and the Lehigh Valley. At least two of these are facing severe cash shortages as of the end of 1970. The Central Railroad of New Jersey and the Penn Central are approaching the point where they will not have sufficient cash to continue operating.

The cash balance of the Central of New Jersey as of December 31, 1970, is estimated to be \$566,000. On that same date, it must meet a payroll of \$925,000 and other operating costs totaling \$500,000; in other words, a cash deficit of almost \$1 million. For 1971, the trustees estimate a cash deficit of \$6 to \$7 million.

The cash balance of the Lehigh as of December 31, 1970, is estimated to be \$3.6 million. The forecast does not take into consideration the cost of a possible retroactive labor settlement or revenue losses due to the General Motors strike. Nor does it reflect obligations of \$6.9 million for such items as taxes, interline settlements, and per diem payments.

The Boston and Maine will not have as critical a cash shortage at the end of 1970 but it is also in need of working capital.

With respect to the Penn Central, you have already heard testimony from the trustees indicating the critical situation confronting them. Without taking into account substantial wage settlement costs, the company will be out of cash by March 31, 1971, and would face the prospect of closing down operations. The Penn Central operates

more than 20,000 route miles of track; serves 11 major metropolitan areas and eight major ports; employs 93,000 people; carries 12 percent of the Nation's rail freight traffic; and carries 66 million passengers a year. A failure to keep the Penn Central operating would have a devastating effect, not only on the 16-State Eastern region where it carries one-third of all rail traffic, but on the entire country.

The Penn Central, together with the other roads in reorganization, are not islands unto themselves. They are part of a national rail network. Given the importance of that network to our total transportation system and to the economic health of the country, we must start now to take the actions necessary to develop a sound and viable industry. To develop a strong railroad industry, we must develop strong railroads.

Both short-term and long-term measures are required. In the short term, there appears to be no substitute for Federal financial assistance. Without substantial infusions of cash, the roads now in reorganization face the possibility of liquidation. The measures that are possible and necessary in the long run will not meet bills coming due December 31, 1970.

In the case of the Penn Central, the trustees correctly stated the alternatives available in their testimony yesterday and, in essence, the choice is between having a public or privately-owned railroad. So long as there is a reasonable prospect of recreating a viable, privately-owned carrier through the process of reorganization—and I share the trustees' view that there is—we should make every effort to do so.

The bill proposed by the administration last summer, S. 4011, would have authorized the Secretary of Transportation to guarantee loans to rail carriers for the purpose of meeting their temporary and urgent financial requirements. The loans guaranteed could not have extended beyond 15 years from the date of issuance and the aggregate amount of loans guaranteed outstanding at any one time could not have exceeded \$750 million. The bill would have authorized guarantees for the next 5 years.

The purpose of the bill was not only to help railroads in reorganization to continue operating, but to keep railroads from going into reorganization in the first place. I know it was the feeling of many in the Congress that such an approach was too wide-ranging and might simply perpetuate poor management practices.

In light of those reservations and in light of the critical situation now confronting the roads in reorganization, the administration would support a narrower approach. Specifically, we would support a bill which reduced the aggregate guarantee authority to \$500 million; restricted guarantees to certificates issued by trustees of railroads in reorganization; and provided explicitly for priority of the guarantee over any other creditors of the railroad in the event of default. We believe that legislation of this nature would meet the most critical problem confronting us—keeping the railroads running—and provide the time necessary to develop and implement the long-run measures which are so essential.

I cannot overemphasize the need to deal with the more basic problems confronting the entire railroad industry. Short-run infusions of

cash are simply not the final answer. Without some fundamental corrections within the industry and in the Government's approach to the industry, a loan guarantee program may do no more than keep false hopes alive.

We must squarely face the long-standing problems affecting rail transportation and look for solutions in such areas as:

- Revising Federal and State regulatory policies;
- Removing discriminatory taxation and reviewing the tax laws for other inequities;
- Increasing the productivity of the industry through improved labor and management practices;
- Improving railroad operational efficiency with respect to such matters as utilization of freight cars, modernizing facilities, and improving track and roadway, and rationalizing the total railroad plant; and

Exploring other areas of railroad operations where new concepts or new technology might lead to greater efficiencies.

I realize that this committee fully shares this concern. Its concern is reflected in the major railroad legislation it has already favorably reported and steered through the Senate this session, including S. 2289 dealing with discriminatory taxation. I hope we can address these other problems in an equally constructive manner during the next Congress.

This concludes my prepared statement, Mr. Chairman. I shall be happy to answer any questions the committee may have.

Senator HARTKE. Thank you, Mr. Volpe.

Mr. Secretary, you and other members of your staff have testified at numerous hearings which I have chaired here several times in the past, and I suppose that it is not as important a matter, relatively speaking, at this time, as the financial plight of the railroads, but I do want to call something to your attention which I think is important as far as we are concerned in the committee, and especially for the staff itself, and that is that statements, according to committee rules and subcommittee rules, should be provided 72 hours before the hearing starts.

Do you have any idea how many times the Department of Transportation has complied with that request since you have been Secretary?

I will tell you. Not once, Mr. Secretary, since you took office.

Usually the staff has to make repeated calls down to your office to receive any information whatsoever.

Your statement was received last night at 8 p.m. Now I was still here at the office at 8 p.m., but I just want you to know that is when it was received.

I realize that maybe the hearings today were called on somewhat shorter notice than those in the past; letters went to you on November 16, 1970, asking you to testify.

But I would hope in the future that the Department would try to be more prompt. It frankly is very difficult for us to be ready for these hearings at times without the testimony being provided as requested.

I want you to know I have never said anything about this in the past to you, but it does seem it has reached the point where something

is going to have to be done about the failure to comply with committee rules.

Incidentally, this is the first time we have heard from you since your testimony upon the guarantee bill. We have had no requests, no indication that there is any urgent situation at this moment, nor requests for hearings or continuations of these policies.

In the Commerce hearings on S. 4011 on June 25, 1970, at page 48, the following discussion of the value of the Penn Central assets occurred in this exchange:

Senator HARTKE. Was this information submitted by the Penn Central? What is the source?

Mr. BEGGS. (answering for the Department of Transportation). This is public information, both information submitted to the ICC and financial information that was used for public statements of the corporation.

On page 133, Mr. Secretary, I said at that time, about railroads:

But if they divert that resource over to the purchase of other corporations? You don't know where it went; do you know?

Secretary VOLPE. No; except I do know in the case of the Penn Central, I can criticize many management decisions I suppose, but the one where they bought some properties that have given them some excellent dividends and kept the railroad going for a couple of years when it couldn't be kept going, these properties provided \$140 million worth of profits for it that were used to try to continue the railroad last year.

Now, if you recall, Mr. Bevan also told us in August that the subsidiaries brought in \$146 million to help keep the railroads going along with its losses. Now the Interstate Commerce Commission, however, has reported to us that there was \$153 million in cash—is what the corporation needed then and what it needs now—and instead of bringing it into the corporation, it went downstream, out from the corporation.

What I want to know is: Did you have other information other than that which Penn Central gave you at that time, upon which you relied? What was the source of your information at that time?

Secretary VOLPE. The source of my information, Mr. Chairman, was the management of the Penn Central Railroad at that time. They came before us, not once but two or three times. I sat in on at least two of the meetings; Mr. Beggs sat in at least three or four meetings in which they explained the total financial operations of the—if I can call it a "company," it is a series of companies, as I am sure you well know—and based on the information provided to us, which was the best that we could get at that time, based not just on one session but several sessions, it was indicated to us that the profits from the nonrailroad properties helped to keep the railroad loss to the point where it was. Without the profits from the non-railroad properties, the railroad loss would have been substantially in excess of what it was. Or, in other words, approximately \$140 to \$145 million.

Now it is true also that one could say that had those funds which were utilized to purchase other properties been retained in the railroad, conceivably that might have also brought some profits. But I cannot prove that at this time, and I do not know whether anybody can.

Senator HARTKE. Yesterday, from an excerpt from the hearing with the trustees, on page 17, Mr. Wirtz pointed out that the Penn Central corporate policy was, in his words:

To put the best conceivable face on the facts, even to the point where the facts became very dubious allies of the truth.

Then on page 179 of the transcript, and page 180, when he was talking about the corporate accounting practices and their reporting practices:

Mr. WIRTZ. If you think of the truth in terms of the technical accuracy of what is said, that is one thing. If you think of it in terms of what was reasonably conveyed, that is another. On the basis of the second, I think there is real question about the accuracy of the picture that was conveyed.

Now what is the source of your information today on the present condition of the railroad industry?

Secretary VOLPE. Of the railroad industry?

Senator HARTKE. Yes.

Secretary VOLPE. Well, our view of the railroad industry is even accelerated beyond the—

Senator HARTKE. I asked what is the source, not your view.

Secretary VOLPE. The source of the information? The information that we have comes from the railroad industry itself, the Interstate Commerce Commission—

Any other source?

Mr. BEGGS. We have had some studies.

Secretary VOLPE. We have had studies of our own based on figures that were submitted to us.

Senator HARTKE. You do have sources and means of evaluation of your own, independent of the industry and independent of the ICC?

Secretary VOLPE. We have evaluated the figures submitted to us; we do not have an independent body operating across the Nation which checks the books of all the railroads in the country, but we do know that the ICC does have a very strong arm for this type of work, and we have to take the word of the agency charged with this responsibility of watching the financial matters of the various railroads across the country.

Senator HARTKE. Is it fair to say, Mr. Volpe, in order to shorten this part of it, that you do not have any independent source in your own Department for information on the condition of the railroad industry other than the industry itself and the Interstate Commerce Commission?

Or do you have an independent source, other sources, inside the Department of Transportation? I am not talking about evaluation; I am talking about sources of information.

Mr. BEGGS. No.

Secretary VOLPE. I do not believe that we have any independent source of information. Naturally, our Federal railroad administrator tries to develop all the information he can. But basically it has to hinge on material he receives both from the Interstate Commerce Commission and the railroad industry itself.

Senator HARTKE. We only have an acting administrator; is that right?

Secretary VOLPE. That is correct.

Senator HARTKE. Does he have any source of information other than the Interstate Commerce Commission and the industry?

All I am saying is: Do you have any source of information?

Secretary VOLPE. No, we do not.

Senator HARTKE. Are you relying upon the industry and the ICC?

Secretary VOLPE. That is correct, sir.

Senator PEARSON. Mr. Chairman, it would be helpful to me to know what sort of information you are inquiring about. Financial information?

Senator HARTKE. Yes, I am talking about financial information, general operating information, other conditions. They testified here about the condition of the railroad industry generally; here is a long series of statements here; and I am just trying to find out what sources the information is based on.

You did not say very much, Mr. Secretary, about the condition of the Penn Central at present. How much money do you think they will need?

Secretary VOLPE. Let me preface my answer, if I may, Mr. Chairman, by indicating that last June you asked me about the finances and management of the Penn Central Railroad, and I indicated to you at that time that I was here neither to confirm nor deny any judgments, and that I was not here to defend the management of the Penn Central. We were here only to try to convince the Congress, which is going to have to make the final decision, that it would be desirable to have an insurance policy—stand-by authority vested in our Department which could be used if and when we believed it was essential to maintain public service and there was a reasonable chance of getting our money back.

So my answer is that insofar as sources of information and how we arrived at our judgments are concerned, those judgments can only be arrived at through the information we receive. We have to take it for granted that the people we are doing business with are honest people.

If we wanted to just take it for granted all the people we are doing business with are dishonest, then I suppose we would have to ask the Congress for a great many inspectors, like some of those the ICC has, to go out and check the books of railroads or other modes of transportation that we do business with.

Senator HARTKE. In other words, you took the information submitted to you by the Penn Central as to how much money they would need; is that right?

Secretary VOLPE. On the first occasions we took that information and indicated to you what we had received, but indicated also that we would under no circumstances grant a loan purely on the basis of the information we had at that time. We said that we only wanted the authority we requested as stand-by insurance in case they came along, proved their case, and we were completely satisfied about the needs, and that there was a good, reasonable chance that they would be able to repay the money.

Senator HARTKE. But your request for the legislation was based upon the information submitted to you by the Penn Central; is that correct?

Secretary VOLPE. That is correct. And also information submitted by the ICC.

Senator HARTKE. And it has turned out now that the Interstate Commerce Commission has demonstrated that that information was very faulty; and the fact of the matter is it was very bad information; is that not correct?

Secretary VOLPE. I cannot say it is correct.

Senator HARTKE. You do not say it is correct?

Secretary VOLPE. No.

Senator HARTKE. You disagree with the statement of the Interstate Commerce Commission about where the cash went and how much they needed; right?

Secretary VOLPE. I did not know that the ICC—Mr. Beggs is more familiar with that phase of it.

Mr. BEGGS. I think the two statements are consistent, Mr. Chairman.

Senator HARTKE. Let me ask you this: Do you disagree with Mr. Wirtz's testimony yesterday when he pointed out that:

The Penn Central corporate policy was to put the best possible face on the facts, even to the point where the facts became very dubious allies of the truth.

Mr. BEGGS. No, sir, I do not disagree.

Senator HARTKE. Do you disagree with his statement:

If you think of it in terms of what was reasonably conveyed, that is another. On the basis of the second, I think there is real question about the accuracy of the picture that was conveyed.

Mr. BEGGS. No, sir. But you have made two statements which, if I may, Mr. Chairman, I would like to try to clarify.

There was no question that the financial reports that were being made public by the Penn Central Holding Co. were, as Mr. Wirtz stated, "rather dubious allies of the truth." They were put in the best possible light, and they were published in such a way as to indicate that the railroad had a reasonable chance of recovering from current difficulties.

We understood that very clearly when we got into the situation, and that was the reason that the Secretary said that in his judgment it was going to take several years and quite a lot of money to bring this railroad around.

But the issue that you addressed yourself to then was whether the nonrailroad assets which they purchased were either a cash drain or a cash source; and I think both statements are true. The Penn Central Holding Co. advanced cash to acquire those assets, and then it received profits in return.

Now the question that has to be addressed here, I suppose, is whether it was prudent management to make that investment in the first place. And I have no particular brief on that at all.

Senator HARTKE. Yet you asked us to rely upon information which you yourself now say was a dubious ally of the truth?

Mr. BEGGS. I said we did not rely on the financial information that the Penn Central published in its financial reports.

Senator HARTKE. Why did you not tell us that last June?

Mr. BEGGS. I did say that we had had cash flow projections from the Penn Central direct, which we had looked into and studied ourselves.

Senator HARTKE. You knew, though, at that time that their published statements were not really conveying the right impression, and you left us with that information?

Mr. BEGGS. No, sir, I did not say that.

Senator HARTKE. Did you correct it here at all?

Mr. BEGGS. I believe we stated the facts for the record, yes, sir. We said that we had made an independent evaluation of the financial situation of the railroad.

Senator HARTKE. Let me ask you this: Do you think that the Penn Central can repay what it borrows?

Secretary VOLPE. Mr. Chairman, I have no crystal ball. The trustees have been on the job now for several months. Even they—and I have respect for all of them, they are very able men—have indicated to this committee that they cannot assure 100 percent that the Penn Central can be brought around and that they will be able to repay.

However, there is a reasonable chance that they can repay. And I personally feel that if they believe, after the examination of the records—they came to me within less than 30 days after they were appointed and indicated to me they could not and did not desire to make any commitment as to what the Penn Central might need because they were not satisfied with the records as they found them and wanted an opportunity to analyze them further.

Then they came back and said, having further analyzed them, having looked further at the total picture, that given the cash resources during the next 18 months to 2 years they believe are necessary to keep it going, they believe they can turn it around within 3 to 5 years.

Now I am not here to say that that is absolutely 100 percent accurate. It is as accurate as those four men—and I presume the judge to whom they report—believe the situation to be at this time.

Senator HARTKE. Well, what is the source of this information you have given us today, right now?

Secretary VOLPE. The information came from the trustees themselves in a visit I had with them, as well as from their testimony of yesterday.

Senator HARTKE. You have made no independent attempt to find any additional information?

Secretary VOLPE. I do not know of any way I can find out any additional information, Mr. Chairman.

Senator HARTKE. You have to rely solely upon the trustees?

Secretary VOLPE. Yes; these are public trustees.

Senator HARTKE. Senator Baker?

Senator BAKER. Is it the chairman's contention that the information supplied by the railroad in published form or to the Interstate Commerce Commission or to the Department of Transportation was inaccurate? Or that the conclusions and projections and speculations as to cash flow and other items was inaccurate?

Senator HARTKE. Basically what I am showing here is the fact that that is the sole source of information of the Department of Transportation, whether it is accurate or inaccurate, and that they have made no independent studies; they have made no attempt to find out information on their own; they have relied solely upon the

management of the old Penn Central and solely upon the trustees for this information.

So in other words, as far as we are concerned, any testimony they are giving here today is practically of no value whatsoever. They have all this information from other sources, and the Department of Transportation—which is charged with the responsibility of keeping the railroad system going—has utterly failed to do any part of any job whatsoever.

Senator BAKER. I am trying to find out what your question is.

Senator HARTKE. My question is to determine, and I am doing it very methodically and going through it step-by-step—I will tell you now if you want to know what I have concluded from my own observations: There is not one single bit of information of any help to us that has come from any study or testimony given by the Department of Transportation. They have been completely useless, and they have been of no help to us whatsoever in determining these hearings.

Senator PEARSON. That is your personal viewpoint?

Senator HARTKE. Yes, sir.

Senator BAKER. Mr. Chairman, really, regardless of your feeling about DOT and the quality of its presentation, I am still concerned about a point for the record; that is whether or not the information itself is inaccurate or whether the conclusions drawn from that information are inaccurate.

Let me state the reason why that concern is real in my judgment. As you know, Mr. Chairman, and certainly as these witnesses know, there is a reporting requirement by railroads to the Interstate Commerce Commission, a rather detailed and exacting set of requirements for the disclosure of raw data in the form prescribed by the Interstate Commerce Commission—not according to “generally accepted accounting practices,” as the saying goes, but, rather, according to the form prescribed by the Interstate Commerce Commission for reporting by railroads.

I have heard no challenge to the accuracy of that data. I have heard no challenge to the access of DOT to that data. I have heard repeated challenges to the accuracy of the inferences drawn and the speculations or projections made on the basis of that data.

The point I am trying to reach for the record is whether or not the chairman suggests that the data itself from Penn Central management or the trustees to the Interstate Commerce Commission was itself inaccurate.

If it was inaccurate, it is a violation of the penal code and I think we ought to know it.

Senator HARTKE. It is not a question of a violation of the penal code. I am talking about information submitted to us at that time.

Let me read to you, and you draw your own conclusions here.

This is an answer to a question directed to Secretary Volpe:

No; except I do know in the case of the Penn Central, I can criticize many management decisions I suppose, but the one where they bought some properties that have given them some excellent dividends and kept the railroad going for a couple of years when it couldn't be kept going, these properties provided \$140 million worth of profits for it that were used to try to continue the railroad last year.

That is from the hearings on page 133, beginning on line 20.

In the record at this time is a letter from the ICC, which I put in the record yesterday, dated November 18, and the letter is addressed to me. It was signed on behalf of the ICC by Dale W. Hardin, Acting Chairman:

Members of our staff have recently completed a study of the flow of cash from the transportation companies to the non-railroad companies associated with the Penn Central Transportation Company. I have enclosed preliminary schedules which indicate there was a net cash expenditure by the transportation companies of \$153 million for the period commencing January 1, 1963, and extending through June 30, 1970.

Senator BAKER. Was this a letter from you to the Commission?

Senator HARTKE. It is from the ICC. It was addressed to this subcommittee chairman.

Senator BAKER. Were copies given to the committee? I did not receive a copy. And speaking of advance copies, it would be helpful if the members of the committee had copies of correspondence as well.

Senator HARTKE. It is under date of November 18, and I certainly put it in the record yesterday while you were here.

Senator BAKER. Mr. Chairman, really I have no desire to belabor this issue, but is there a challenge—and I gathered from the burden of your questions that there is—to the accuracy of the information filed by Penn Central management or the Penn Central trustees with the Interstate Commerce Commission, on which the Secretary and his staff have testified that they base their judgments?

Senator HARTKE. I have asked a question here as to whether they agreed with Mr. Wirtz's statement, and they said, in the words of both Mr. Beggs and Mr. Wirtz, they both have used the statement that they were "dubious allies of the truth."

Mr. BEGGS. I said the published financial information in their public statements, not the ICC information.

Senator BAKER. The point of the matter is that what I am speaking of is not the published report of the Penn Central but specifically of the reporting requirements under the Interstate Commerce Commission Act to the ICC. Those are raw data. That is not the conclusion of the certified public accountant.

Senator HARTKE. Mr. Secretary, let me ask you: Do you believe that the information was accurate as given by the Penn Central management?

Secretary VOLPE. Prior to the reorganization, Mr. Chairman?

Senator HARTKE. Information they gave you upon which you came up and testified—was it accurate?

Secretary VOLPE. It was accurate as far as we could determine at that time, sir.

As a matter of fact, the sums of money now indicated by the Penn Central trustees pretty closely agrees with the information we gave you at that time.

Senator HARTKE. Did you know the financial condition of the Penn Central at that time?

Secretary VOLPE. We knew it to the very best of our ability. We worked very closely with the ICC at that time, just as we do now.

And if the questions whether management did the right thing in trying to diversify to reduce its losses, that is a question of judgment which I think none of us can make at this time. In hind-

sight, I suppose somebody might make a better judgment; but it is not one that I care to make.

Senator HARTKE. Did you feel that they had a good picture of the management? Did you have a good picture of the management at that time on what the financial condition was?

Secretary VOLPE. Yes, we did. And as a matter of fact, our request for this legislation, Mr. Chairman, as I will reemphasize, in no way committed us to make a loan to the Penn Central or any other railroad. That loan would be made only after this legislation received the approval of the Congress and only after we received complete information that we then would be in a position to check, doublecheck with the ICC, and make a full determination as to whether or not there was a reasonable chance that this money could be repaid; and only then, after we had satisfied ourselves that the management of the company was going to be such that there was a good chance that it would be managed well, would we have acceded to a request for financial aid.

And if you will recall, it was during the period we were investigating and looking at that whole picture that there was a change made in the management of the railroad, just a month-and-a-half or so before it went into reorganization.

Senator HARTKE. At the time that you were here testifying, did you have a complete picture of the cash flow?

You said you had the reports, which you said left an impression, or conveyed an impression which was not exactly correct.

Did you have the complete information as to the cash flow at that time?

Secretary VOLPE. We had a chart on cash flow, yes.

Senator HARTKE. What was the source of that chart?

Secretary VOLPE. The Penn Central.

Mr. BEGGS. Mr. Chairman, you asked us a question; I believe it was directed to me at that time.

Senator HARTKE. That is right.

Mr. BEGGS. And I said, "We do not have a complete picture of it;" that we did have, however, figures from the railroad which gave a rough outline of where they were headed, and that indicated that they were in a very serious cash flow position, and that it would probably worsen. And indeed it has.

Senator HARTKE. Do you have any more information now which you can give us at this time, from any source other than you had then? In other words, you are going to the trustees now, is that not correct? Is that your sole source of information?

Mr. BEGGS. We still, Mr. Chairman, have access to the information that Senator Baker referred to, in the ICC. That information is very detailed and of course, it is necessary to analyze what is there; but we still have access to that, and we still are using it in making our evaluations.

Senator HARTKE. I do not consider it very wise to rely solely upon information coming from the person who is asking for legislation upon which they expect to be the beneficiary, do you?

Mr. BEGGS. No, Mr. Chairman; except for the sworn information that they give both to the SEC and which the trustees are giving to the courts and to the ICC—unless, as the Secretary says, we employ a

number of examiners of our own and put them in the company—we have no other source of information.

And I might add here that there is no reason to believe, that I know of, that the information they have given us thus far is faulty—and this goes back to the original time of the reorganization, and even before. The information from the financial officers of the corporation before they went into the section 77 reorganization and afterwards has hung together.

Now, there has been additional information that has been developed since that time.

You referred to the published report. Their financial report for 1969, which came out in April of this year, reflected a profit in the total corporation of some 18 cents a share. And clearly, you know, that did not reflect the situation then; and as the situation developed we found that they were in increasingly serious financial difficulty. And as it went along, as I believe situations like this have evolved in many previous histories of bankruptcy, particularly those involving railroads, you find that they get into increasingly serious financial difficulties, and new financial facts come to life.

But the data that we were operating on in May and June, and the data we have operated on since, has in no way that we can find been fallacious.

Senator HARTKE. You are familiar with the hearings yesterday?

Mr. BEGGS. In outline. I did not sit through them, sir.

Senator HARTKE. Well, are you familiar with the fact that the trustees disassociated themselves from the statement of the chief financial officer?

Mr. BEGGS. I understand.

Senator HARTKE. You understand?

Mr. BEGGS. I understand that. I cannot speak for the trustees, Mr. Chairman, but I think that the projections—and I think that this is what we are talking about—the projections of the financial picture made by the financial officers of the company, dating back from the first time we got into this thing, have been very faulty. They have repeatedly reflected too optimistic a picture, and I think that I would disassociate myself from that if I were a trustee myself, because it has been proven by the history of the thing that their financial projections are not very good.

Now in this case, as I understand it from having talked to the trustees, they have made an independent assessment of the financial picture and have made their own projection of what is going to happen over the coming year, and have tried to peer out even further into the future, but this is difficult in this situation, and they find that it is more serious than the financial people in the corporation had reflected.

But their projections, I might add, Mr. Chairman, are based on the figures that the financial people gave them.

Senator HARTKE. You stated the trustees find it was more serious than the financial officers gave them?

Mr. BEGGS. I said that my judgment of the information that the financial people of Penn Central have given us since the beginning of the time we got into the Penn Central situation is that it has been too optimistic, and it has been a more serious situation each time.

Senator HARTKE. You consider the fact that the chief financial officer testified here that they would run out of cash by the first week of October, and they did not, as an optimistic statement?

Mr. BEGGS. No, that is not an optimistic statement.

Senator HARTKE. That is the statement from which the trustees disassociated themselves.

Mr. BEGGS. But I do think that the projections for their need for cash, the borrowings they were reflecting each time, have been short of what they were actually going to need.

Senator HARTKE. The projection for the need for cash there at that time was long. As far as they are concerned, they said they would run out of cash by the first week of October. Mr. O'Herron testified to that here, and that was the statement from which the trustees disassociated themselves.

They did not run out. Now they say they are going to run out on March 31.

Secretary VOLPE. There is a difference in the amount of money being expended by the present management as contrasted to the other management. The fact is that the trustees now do not have to pay many bills that the old management had to pay. So naturally there would be a difference between how much cash they need operating under reorganization and what they would have required operating under the management that existed before and without reorganization.

Senator HARTKE. That is immaterial, Mr. Secretary. This was in August after the reorganization and the appointment of the trustees.

I was talking about August when Mr. O'Herron was here under the reorganized management with the present trustees, and on which he said, "Let's go ahead."

Last June you said the Penn Central collapse was caused by the problems of merging the operations of two large railroads, failure of management properly to prepare for the merger, losses in passenger service, and the boxcar situation—pages 62 and 63 of the hearings.

Do you think that that evaluation is still correct?

Secretary VOLPE. I believe so.

Senator HARTKE. What do you mean by "the boxcar shortage"?

Secretary VOLPE. Not only the Penn Central Railroad but the entire industry has a problem with boxcars. Two bills already have been introduced in this area. We have been working on this problem for several months now and are evaluating two or three of the proposals that have already been made, as well as the overall situation, and we hope to submit some proposals that will deal effectively with the boxcar situation. All of us recognize there is a very serious shortage, which has made it impossible in some cases to ship potatoes from Maine; it has made it impossible to ship wheat from some of the Midwestern States when they want to ship it; and there are many problems associated with that.

Some of them can be corrected, I think, without a tremendous increase in the number of boxcars. There could be a better utilization, as I indicated in my statement, of the present boxcar fleet.

Senator HARTKE. But was the boxcar shortage something which was within the control of the management either before or after?

Secretary VOLPE. Mr. Beggs can comment on that.

Mr. BEGGS. Yes, sir. They had a very high ratio of what the railroad industry refers to as "bad order cars" in the shops. I think this amounted to 10,000 or 12,000 cars of their fleet. And at the same time they were running short on the railroad.

They also, I might add, had a shortage of power on the railroad, a shortage of locomotives. These two things combined to make service poor and resulted in a high per diem charge and borrowing of cars from the other roads.

In short, they were in a much worse condition than the industry as a whole.

Senator HARTKE. Do you agree with Mr. Saunders' statement that the railroad was in part unmanageable?

Mr. BEGGS. No, I do not think so. There are lots of billion-and-a-half dollar companies that are manageable.

Senator HARTKE. Do you think your summary of last June gave us correct information as to the proper perspective as to the role of management in regard to the activities and responsibility for the collapse of the Penn Central?

Secretary VOLPE. Do we believe that—

Senator HARTKE. That the role and responsibility of the management in regard to the collapse of the Penn Central—whether you gave us correct information in your summary of last summer, in June?

Secretary VOLPE. I do not believe that I tried to defend the management nor to condemn them. I only indicated that it was a case of judgment as to whether certain actions they had taken were wise ones or not.

Hindsight is a great deal better than foresight. I can only say, looking back upon this whole thing, that as a construction man, if I am doing one line of work in which I consistently lose money, I will decide I am going to get out of that line. If I lose constantly on hospital construction—and many contractors do—I decide I am not going to build them any more, and I try to diversify and get into some other line.

I think what happened here is perhaps because of their great anxiety to expand into other fields where at least it looked more profitable, or where there appeared to be avenues that would give them profits to offset losses they were sustaining, and because it was taking so long to get abandonments of railroad passenger services which were giving them the largest part of their loss, they decided that getting into some other fields and getting properties that would return a profit would help to subsidize, shall we say, the railroad operation itself.

Now whether or not in doing that they started to diminish the services on passenger trains, whether or not as a result of that activity they also did not maintain as well as they might have their service in the freight field is a question on which judgment can be passed. But the fact is that they did lose business and the fact is that by going into these other fields it is entirely possible they got their eye off the main ball, which is quite easy to do.

Senator HARTKE. I thought you said that they needed money to go ahead and correct the boxcar shortage, which was, you said, partially within their hands. Is that not right, Mr. Beggs? Why did they not use the money to clear up the boxcar difficulties and the difficulty they had in their shop orders there?

Mr. BEGGS. With the benefit of hindsight, they should have.

Senator HARTKE. I thought Secretary Volpe said they shouldn't have gone ahead and diversified.

Secretary VOLPE. I said in hindsight I do not think I would have diversified to the extent they did. I think they should have retained more of their money to improve upon their railroad service and thereby hopefully make a profit out of their railroad service rather than lose money as they were doing.

Senator HARTKE. I thought, Mr. Beggs, you said they were short of equipment; is that not true?

Mr. BEGGS. Yes, sir.

Senator HARTKE. While they needed to go ahead and do repairs, they took the cash and diversified. Now is that the kind of management you want to put your stamp of approval on?

Mr. BEGGS. No. We did not propose to, either, Mr. Chairman.

Senator HARTKE. You think that management was responsible then for the collapse of the Penn Central?

Mr. BEGGS. There were many causes of the collapse of the Penn Central, Mr. Chairman.

Management was one, and an important one. There were many others.

Senator HARTKE. Was management good or bad, Mr. Beggs, or Mr. Secretary?

Secretary VOLPE. Well, I have been a manager, Mr. Chairman. I have never been a railroad manager. I have been a manager in another line of work. If you look back on the total——

Senator HARTKE. A campaign manager, right?

Secretary VOLPE. Not very often. I have been a campaigner.

I would have to say that in the light of the facts that we know today, that the management of the railroad was a very significant factor in its collapse—along with the overall industry problems.

Senator HARTKE. Did you know that last May and June?

Secretary VOLPE. We felt that there needed to be a change in the management, and we did, shall I say, see a management change take place.

Senator HARTKE. Did you recommend a management change take place?

Secretary VOLPE. We were instrumental in the conversations that brought that about.

Senator HARTKE. You did suggest that they have a change of management?

Secretary VOLPE. I do not think I ought to go into, frankly, the kinds of discussions we had because of the market, the conditions and so forth prevailing at that time.

But I can broadly say that I believe as a result of our discussions with the management, we did not feel that the kind of progress to be made, that had to be made, could be made with the management then existing.

Senator HARTKE. So what we have here is a situation in which you made an independent evaluation, in which you recommended a management change, and the administration, in light of that, was still willing to use the Defense Production Act to provide money for a system in which you yourself and the administration had found the management defective; is that true?

Secretary VOLPE. We had made no guarantee of a loan to it. The Department of Transportation made no guarantee.

Senator HARTKE. It was ready to go.

Secretary VOLPE. The Department of Transportation was ready to look at an application for funds. An application for a loan under the terms of this legislation, if that legislation had passed.

Senator HARTKE. That was the Department of Defense—the Department of Transportation—as far as the Department was concerned it was practically sealed and ready to go?

Secretary VOLPE. As far as the Department of Defense is concerned?

Senator HARTKE. That's right, and the administration.

Secretary VOLPE. The Department of Defense was the agency responsible for that. It did not happen.

Senator HARTKE. No, it did not happen. Nor did we go ahead and approve the legislation.

Secretary VOLPE. No, you did not.

Senator HARTKE. Did you know about the problems of the Penn Central management in early spring?

Secretary VOLPE. We did not know all of the problems with management in the early spring, but we got to know more and more about them as we talked with them, starting in the early part of the year I think.

Senator HARTKE. Why didn't you advise the committee about the difficulties?

Secretary VOLPE. Because at the time, we had heard the cry wolf so often, that we were afraid that it was just another cry, and that has happened on many occasions. This time apparently it was the real cry.

And when we were sure of it, we did come up with the legislation.

Senator HARTKE. Well, that was after the information, after they had the abortive attempt to receive the loan from the Defense Department, isn't that true?

Secretary VOLPE. No, I met with the joint leadership of the Congress, on both sides of the aisle, in both the House and Senate, before the reorganization was filed.

Senator HARTKE. I am not talking about the reorganization. I am talking about the Defense Department's abortive efforts in regard to that loan.

Secretary VOLPE. I think it would be best for you to get that information from the Defense Department, Mr. Chairman.

Senator HARTKE. Well, I mean you said you were aware of it. All I am asking is, why didn't you tell the committee about it?

Secretary VOLPE. We told the—Senator Magnuson was present at the joint meeting of the Republican and Democratic leadership including Majority Leader Mansfield, and the Majority Leader on the House side, Carl Albert, and the ranking members and chairmen of the committees that were involved.

Senator HARTKE. When was that?

Secretary VOLPE. That was about, I would guess, sir, at least 3 weeks—3 to 4 weeks before the reorganization took place, before the Penn Central filed.

Senator HARTKE. That is not when you first knew of the problem?

Secretary VOLPE. It was not when I first knew of the problem. It was a time when I became convinced that unless something of this nature happened—and I reported this to the President of the United States—there was a genuine possibility of the bankruptcy of the Penn Central Railroad, and other railroads as well.

Senator HARTKE. After the trustees testified yesterday, I indicated that I was instructing the staff to draft a bill incorporating these ideas, in general, that is:

First, it would apply only to railroads already under reorganization under section 77 of the Bankruptcy Act. Second, to apply only to those railroads which had exhausted every avenue to obtain private financing, including attempts to sell trust certificates. Third, assistance available only to such railroads on the verge of closing down, that is, essential public services about to terminate, which are determined to be necessary and in the public interest. And Fourth, assistance should be applied only to those operating expenses necessary to keep the trains moving, not to be used to bail out investors and creditors. And, fifth, that the Government should obtain adequate security for the risk it undertakes.

That is quite different from the one you came up with last June, isn't it?

Secretary VOLPE. It imposes some additional restrictions or conditions on which loans will be made that I personally believe we certainly would have taken up ourselves. But I have absolutely no objection to their inclusion in the bill.

Senator HARTKE. Will the administration support such a bill?

Secretary VOLPE. I believe so.

Senator HARTKE. You don't know?

Secretary VOLPE. I think I can say yes. I believe the administration, yes, will support the bill.

Mr. BEGGS. Mr. Chairman, may I comment briefly on that? We have no objection to those conditions. They would be conditions, as the Secretary said, that he would impose himself. However, it's a little unwise in such a bill, not knowing the varying conditions in which railroads will enter reorganization, to put too many conditions into the bill.

But if it is your purpose to insure in the case of the Penn Central that this be done, then, as we said, we have no objection.

Senator HARTKE. But would you support such a bill? Would the administration support such a bill? I have found out in past experience, getting the Department of Transportation's approval is not necessarily the administration's approval.

Secretary VOLPE. In this situation, the answer is yes, Mr. Chairman.

Senator HARTKE. All right. How much of a loan guarantee provision would you approve?

Secretary VOLPE. We believe that if you restrict the bill to railroads that are already in reorganization, \$500 million would do the job.

That is our best estimate, based on what the trustees indicated here yesterday. They indicated they would, or might have a need for from \$350 million to I believe as much as \$500 million over the course of approximately the next 2 years.

I hope no other roads go into reorganization, but should that happen, it could be that the \$500 million figure might be on the low side.

Senator HARTKE. Would the administration approve of a loan guarantee provision specifically?

Secretary VOLPE. I don't—

Senator HARTKE. In other words, I am asking now—the others were the conditions upon which I said the loans would be granted—but what I am asking you now, so there is no mistake about it, that is, would the administration support a loan guarantee provision?

Secretary VOLPE. Yes, sir.

Senator HARTKE. Would you support a Federal loan program with the available funds being released only after these specified conditions had been met?

Secretary VOLPE. Yes, sir.

Senator HARTKE. And would you support—

Secretary VOLPE. Just so we are clear, would you repeat that last question?

Senator HARTKE. Would you support a Federal loan program with the available funds being released only after the specified conditions had been met?

Secretary VOLPE. If you leave the word guarantee out, Mr. Chairman, I cannot say that we could support the bill. What we have been talking about is a loan guarantee bill.

Senator HARTKE. Would you support—how do you feel about a direct monetary assistance, as I suggested yesterday, with the moneys being placed in an escrow account and releasable only after certain, specified conditions had been met? Are you familiar with what I am talking about?

Secretary VOLPE. Yes, sir, you mean having the Federal Government put funds in—

Senator HARTKE. That these funds would be put into a special escrow account, and only after certain conditions had been met could these moneys be touched.

Secretary VOLPE. Again, this gets back to the question of a difference between a loan guarantee and an actual loan by the Federal Government. I am not in a position to say that the administration would support a direct loan either with or without conditions.

Senator HARTKE. But you do not want to say they would not? You just say you do not know. I am just trying to get the record clear.

Secretary VOLPE. I do not believe they would support a direct loan provision.

Senator HARTKE. All right. Do you have any other suggestions on what should be done if a bill of that kind were to be drafted?

Secretary VOLPE. With a direct loan application?

Senator HARTKE. No, with this type of limited bill which I have been talking about at the present time.

Secretary VOLPE. No, I think that between the conditions that were in the bill originally, plus those that you suggested—if there are other avenues that the staff would like to discuss with us, we certainly would be very happy to meet with them.

Senator HARTKE. The trustees suggested yesterday an alternate financing proceeding which would leave for subsequent determination the question of whether the original funding source is to be repaid by the carrier if its operations are profitable, or second, is to be treated as a payment for services rendered if, even with due diligence and

th exhaustion of all private financing possibilities, there is a continuing operating deficit.

Then they say such an arrangement could properly include a specification of the essential services. What is your comment on that recommendation?

Secretary VOLPE. Mr. Chairman, I certainly concur with your statement at the beginning that one way or another we have to keep the railroad service running in those parts of the country where it is essential, as this system is in its basic components.

I would want to know a great deal more about the contents of a measure that would provide for, in essence, the forgiveness of the loan under certain conditions, before I could say that I would or would not favor it.

Senator HARTKE. In your statement today, you emphasize—and I quite agree with you—I am sure every member of the committee would agree—that short-run infusion of cash is not the final answer for the railroads. We have to seek long-run solutions to the problems of the rail industry.

It's been now 5 months since you testified on the Penn Central, and you recognize I am sure since that time that long-run solutions are needed, did you not?

Secretary VOLPE. Yes, we do.

Senator HARTKE. I have said for many more than 5 months that railroad problems are reaching serious proportions. We now have a letter directed to the committee from the Majority Leader, Senator Mansfield, in which he points out that action must be taken in this field too, and I think you recognized this for a long time.

Senator BAKER. May I ask about that letter, Mr. Chairman? The date, and whether the committee is furnished copies?

Senator HARTKE. It is addressed to Chairman Magnuson.

Senator BAKER. I understood you to say it was addressed to the committee.

Senator HARTKE. To the Commerce Committee. This letter is under date of November 19, and it also calls attention to the previous letter of the Interstate Commerce Commission, a letter to the committee.

Have you used this intervening time to prepare for a long-run program?

Secretary VOLPE. Mr. Chairman, we have been working along various avenues that we believe need to be followed if we are to make the railroad industry a viable and effective mode of transportation.

This year I think that the administration and the Congress have taken some steps which are going to be helpful to the industry. As you know, the railroad industry has just published the so-called Astro report. In our own shop over the last 8 or 10 months, as we watched the actions being taken by the Congress, we have tried to determine what additional steps ought to be taken in order to make the railroad industry a viable one. We are concerned because we have looked at the forecasts of the increases in transportation capacity that will be needed in this nation during the next 20 years.

I was amazed at the great share of various products that the railroad industry handles in this country. It is quite revealing to find that, for instance, 86 percent of the pulp and paper in this country is delivered by rail; 76 percent of the automobiles and automobile parts—this surprised me because ordinarily people think in terms of

automobiles being distributed on vans that carry six or nine cars, but there has been a tremendous increase in the transportation of automobiles by rail; 71 percent of household appliances; 74 percent of canned and frozen foods are transported by rail.

So as you look at these figures, you certainly have to say to yourself that something needs to be done to continue the railroad industry in this country on a viable basis.

Now the question is, do you approach this on a piecemeal basis? This year we have gone after several bills, one at a time, with regard to the rail industry. During the coming session of the Congress, we hope to either crystallize in one package a total program, or, not on a piecemeal basis, but perhaps in two or three different pieces of legislation, include all of the things that we believe are essential to keep this industry alive and viable.

It is not anything that can be done overnight. As a matter of fact, before he left, I had Reginald Whitman, our Federal railroad administrator, a man with a distinguished record, and general manager of a fine railroad, give me some of his thoughts with regard to what is needed.

I can assure you that our Department is continuing to work at this problem. There are all sorts of suggestions that have been made respecting the boxcar shortage. One, for instance, that we talked about earlier, involves the formation of a corporation that would lease boxcars to the railroads.

All I can say to you is, we are aware of these suggestions and we are working on them. And just as rapidly as we can come to grips with solutions that we believe are not just stopgap measures, we will propose them.

Senator HARTKE. Do you have any suggested legislation which you propose to send to the committee?

Secretary VOLPE. Not at this time, no, sir.

Senator HARTKE. Do we anticipate you may have?

Secretary VOLPE. Yes, I would certainly say that as early in the next session as humanly possible, we will have some legislation ready to submit.

Senator HARTKE. Is that in January?

Secretary VOLPE. I doubt it will be January, Mr. Chairman. It could be February or March, yes.

Senator HARTKE. January, February, or March?

Secretary VOLPE. February or March.

Senator HARTKE. February or March, we can expect something in February or March, is that right?

Secretary VOLPE. Yes, sir.

Senator HARTKE. I trust you are watching the other railroads themselves and watching the industry generally? Will you be able to give us any better information on these than on the Penn Central, or are you going to rely strictly on their information, rely on information from the railroads themselves, and their managers, as to what the condition of the railroad is? Or are you going to come up with something different?

Senator BAKER. Mr. Chairman, may I inquire, before the Secretary answers, whether the chairman is asking if the Secretary intends to commission independent audits of the several railroads of the country?

Senator HARTKE. I am trying to find out what the Department of Transportation is doing, if anything. That is simply it.

Secretary VOLPE. Mr. Chairman, I did not come down here 22 months ago for the purpose of flitting my time away. I have worked continuously not only on this problem but on all of the other problems of transportation in this Nation, and I believe with the help of a great many people, including the members of this committee, an extraordinary amount of legislation and good work has been done.

Now we haven't solved all the problems, and we are not going to solve them tomorrow, next month, or next year. But we are working at them, and we will continue to work, and we will come up with legislation, good legislation; and we are looking at the other railroads.

There is no way I can go into the operation of every railroad and try to examine their books to determine if they are giving us a true story. We can go to the ICC, which we do do. We know that the statements filed with the ICC are filed under risk of penalty, and, therefore, I believe we can depend upon them.

The fact that the industry-wide figures show a decline in the rate of return from a figure of 6 or 8 percent down to—now what—1.8 percent, is certainly evidence enough that unless something is done, you are not going to have an industry in this country.

And I have seen some of the railroads in other countries, and some people have said that they do a much better job than we do. The fact is that there is hardly a nation in the world that I have visited where the railroads aren't losing money, and the fact is that it behooves us, unless we want nationalization—and I for one certainly would prefer not to have nationalization—to do everything we can, consistent with what you and I would recognize to be our responsibilities, to be certain that this industry continues to move people and goods in the years ahead.

Senator HARTKE. Mr. Secretary, wasn't S. 4011 designed for the Penn Central situation basically? Basically?

Secretary VOLPE. No, I said at that time—

Senator HARTKE. Was it designed to help them?

Secretary VOLPE. It was designed so that if they came up with a proper application, and we were able to determine that it met all the criteria that was in the bill, as well as our own criteria, such a loan might be granted.

Senator HARTKE. Well, I just hope that your proposed legislation in the future has more thought and planning given to it than S. 4011, which I say was designed for the Penn Central to meet your criteria when the criteria in the bill itself would have prevented the Penn Central from even complying with it, and receiving any benefits from that bill.

Let's go over this department's record of 22 months and see—you say you spent 22 months here. Let's see exactly what the situation is.

You listed several subjects you thought should receive attention that deal with long established long-standing problems affecting the rail industry.

You referred to S. 2289, on page 6; hearings were held on June 30, 1969. The Department of Transportation had no letter or testimony for the subcommittee at that time. Do you know when the committee finally received the administration's views on this bill? I will tell

you, in case you don't know. On December 8, 1969, a month after the committee had reported the bill without hearing a word from the Department, and over 4 months after the hearings were completed.

I want to thank you for recognizing the fact that the committee did take some action.

You listed other specific areas in which the Department of Transportation feels an interest. I for one am not going to hold my breath waiting for you to send up your ideas.

When was it you first indicated that the Nixon administration would announce a national transportation policy? How long did you say it would be before that policy would be announced? Six months. How long has it been? Eighteen months. It's still not here.

What about the railroad safety legislation? I introduced a bill, S. 1933, in April 1969. Hearings were opened on this measure in May 1969. The administration was not ready with a proposal and asked for more time. In July 1969, another hearing was held. The administration still had no position.

Finally, on October 28, 1969, more than 5 months after we opened the hearings, 6 months after I introduced S. 1933, you appeared before the committee and testified on an administration proposal. All in all, we had 5 days of hearings, most of which went not alone in the morning but into the afternoon.

Incidentally, for the Senator from New Hampshire's information, I don't think the television was present.

After all was said and done, the subcommittee and the committee adopted some amendments which evolved from those hearings, and some of them which were proposed by the administration. But it was not the administration's bill that was passed, was it?

Secretary VOLPE. I don't think any bill passes the Congress—

Senator HARTKE. Was it the administration bill? It was the committee bill that passed. The one we introduced. Isn't that true?

Secretary VOLPE. By number, yes.

Senator HARTKE. Not alone by number, by substance.

Secretary VOLPE. By substance it was basically the administration bill, with some amendments.

Senator HARTKE. The administration bill when? You didn't have a bill. It was our bill that was adopted, with minor amendments.

Secretary VOLPE. Well—

Senator HARTKE. Let's look at the passenger service legislation. We have had hearings on no less than 10 railroad passenger bills. During 3 full days of hearings, we heard from numerous witnesses including representatives of the Department of Transportation.

Characteristically, the administration was not yet ready to provide the committee with its views. The subcommittee decided not to wait and recommended a proposal for consideration by the full committee.

A strange thing happened, Mr. Secretary. You began pleading with the committee not to take action until the Nixon administration could make up its mind. In a number of communications relayed through the ranking minority member of this committee, Senator Cotton, the Secretary—you, Mr. Secretary, asked for a few more days.

And on December 2, 1969, the Department said it would have ideas by January 1, 1970. The committee decided to wait until December 10. You said a proposal would be presented before the session began on January 13, 1970. Nothing happened. I wrote to you on February

10, 1970, saying the committee could not be expected to wait longer. On February 12, 1970, the chairman of the committee, Senator Magnuson, did the same thing. When no answer came, the committee decided to proceed without the Department's view.

Now we are not trying to take credit for all these things, but I want to point out that you came to the Hill personally, you visited with me and three other Senators, asking that we look more closely at the corporate approach.

In fact, such a bill developed on a bipartisan basis. I told you I was not wedded to any special proposition, and if the only thing that could be worked out was a corporate approach, I would be willing to do that. I wanted to save the passenger service business. I wasn't interested in credit or anything.

Why is it that your Department never seems to be able to furnish anything on time? You can't even get your statements up here on time. Isn't it true that almost every piece of legislation which has been in this body so far has been initiated by the Committee?

The only thing that you initiated in the Department of Transportation has been the loan guarantee legislation on which you testified, on S. 4011, and this legislation would have perpetuated in office a management responsible for the railroad's own predicament, and was not even considered by the Senate until after the Penn Central entered bankruptcy, and would not even have applied to it?

It would have bailed out the bankers to whom the railroad was in hock. A bill definitely contrary to the public interest, and apparently there was so little attention given to the responsibility of this as a department head, I wonder how you expect us to really believe that you are going to come up next March with a comprehensive program.

I am waiting. I hope you do. And when you do, I assure you, you will receive every consideration promptly, with or without television present.

The record seems to indicate that, as far as I at least am concerned, there is very little for us to expect in firm positions of trying to solve some of these crushing problems that Senator Mansfield has now asked us to cooperate with him on and to try to do something about.

Take S. 4011. This practically would have been a raid on the public treasury. What do you think the situation would have been if we had passed S. 4011 at the time the Penn Central was still out of reorganization? We would have had \$350 million given to that organization, at least according to the information at that time. You can probably say that you wouldn't have given it to them. I will give you the benefit of the doubt.

But if they had gotten it, we would have been in the same situation as today but with the Government and taxpayers out \$350 million. And the trustees said yesterday, the Government would have had to put up the \$350 million, plus \$175 to \$250 million that they are asking for in the next 4 months to keep the railroad running.

I want to read from Mr. Wirtz' statement in regard to that, on page 166 of the hearings yesterday:

Speaking for myself and I think I am joined in by my colleagues, it would have been a great mistake to finance Penn Central Transportation Company on the basis that was sought last summer. If it had happened, it would have only postponed the day of reckoning in our view . . .

The trustees said \$350 to \$500 million will be needed in reorganization. To that, if you added \$350 million, you would have given them, at that time, a total of \$700 million into one corporation alone.

There is reason for us to be concerned and upset. Do you still think the Congress should enact 4011?

You said so last June. Why not now?

Secretary VOLPE. Mr. Chairman, let me just say that as far as I am concerned, S. 4011, as I quoted from my testimony, was standby legislation. It was not authority to loan a dime to anybody. The fact is that had the Congress given me that legislation, we might not have loaned the Penn Central a dime.

There was no guarantee in that bill that I would loan anybody anything.

Senator HARTKE. Why did you stampede—attempt to stampede us at that time if it was standby? Why the need to have an urgent meeting? You said at that time it was urgent that it be passed for standby legislation.

Secretary VOLPE. Because I believe it would have been easier—I think the record shows that after a railroad has gone into reorganization, there have been as many as 21 years pass before it got back on its feet.

I believe it is much easier to get a railroad out of trouble and get it back on its feet without going into reorganization, and that is why I believed firmly at that time, with proper safeguards, which we certainly would have taken before we granted anybody a dime, that it would possibly, and I felt quite hopeful, prevent it from going into reorganization.

Senator HARTKE. But the point still remains you came here and asked us to urgently pass this legislation which at that time said it was necessary for the Penn Central. You stated you thought the management was bad. There is every indication that there had been substantial changes in the management since reorganization, and if we can take the board of trustees—and I do not vouch for them, all I am telling you is they have indicated they have made substantial changes in procedure by which they are saying they are trying to get the railroad turned around.

Isn't a reorganization basically to clear up some of these difficulties? As far as a lot of people are concerned, it is probably the best thing that happened to the railroad.

Secretary VOLPE. The fact is there were substantial changes made before the reorganization.

Senator HARTKE. In management and procedures?

Secretary VOLPE. Yes, change in the presidency, as a matter of fact.

Senator HARTKE. What did he do?

Secretary VOLPE. He was only in the office a month and a half before it was plunged into reorganization. I don't know that he had time to do much.

Senator HARTKE. He got himself a nice retirement benefit, didn't he? How much?

Secretary VOLPE. All I am saying—

Senator HARTKE. Didn't he get a nice retirement benefit?

Secretary VOLPE. I believe he did.

Senator HARTKE. How much?

Secretary VOLPE. I believe it was \$12,000 a year.

Senator HARTKE. Why?

Secretary VOLPE. I am not a part of that management. I am not defending it. I don't know why you want to know from me why the Penn Central gave him that kind of money. I didn't have anything to do with it.

Senator HARTKE. The Judge cut it down to that amount, didn't he?

Secretary VOLPE. I believe so.

Senator HARTKE. That's why it is that low?

I think the most charitable thing we can say about the administration is that you panicked last spring.

Senator BAKER. Mr. Chairman—

Senator HARTKE. Just a minute. Then I will let you say anything you want to say.

Senator BAKER. I intend to.

Senator HARTKE. You panicked and came here with information which I do not think intentionally misled us, I just don't believe you knew. And for that I think you can change in the future. I would hope you would.

And all I can assure you is that I am going to go ahead that extra mile with you, but you are going to have to take one or two steps with us. It won't be me walking by myself, from here on in. And I sat with you in good faith and worked out some of these things, so that you could go ahead and get what the administration wanted with the help of the Treasury. I think from here on in, the Department of Transportation ought to attend to its knitting, the transportation bills.

Now, Senator Pearson or Senator Baker, any questions?

Senator BAKER. I would like to ask one question and then I will defer to Senator Pearson. Would you advise me whether or not, Mr. Chairman, was there any opposition to the bill by the chairman at that time?

Senator HARTKE. To the bill—there certainly was. Or else it would have been passed. I will say this to you, that at one time I think I stood almost alone in opposition to that bill.

Senator BAKER. In committee? I have no recollection of any such statement in committee. I do recall Congressman Patman indicating considerable opposition, but I don't recall the chairman doing so.

Senator HARTKE. I suggest you read the record.

Senator PEARSON. Mr. Secretary, it might be a digression, but I want to talk about the bill that is here before us today.

We are entering a vast new field, extending beyond the Penn Central because, without being an alarmist, one cannot really look at the aviation industry today, the air carriers, without similar concern. The chairman of this committee, Senator Magnuson, has called for some hearings after the first of the year to look into whatever we have the right to look into with regard to the regulated air carriers, and railroads other than the Penn Central are likewise in considerable trouble.

Then you can go beyond that and recall Lockheed, for instance, which is in serious trouble today.

So we are moving into a field, it seems to me, of government guarantee of loans of regulated and nonregulated industry, which is going to be called upon or triggered only in those occasions where the private companies are in very, very serious condition.

I am wondering whether or not there has been with the administration consideration of some type of government program that might extend beyond transportation into other fields?

Has there been any such consideration at the policy level?

Secretary VOLPE. May I suggest, Senator, first of all, that the subject of the airlines which you spoke of is one that has not escaped our attention? We have already met with the presidents of the major airlines, and the financial vice presidents of the airlines.

We are aware of many of their problems. It is true also that there are those who feel that the kind of bill we are considering here today should be broadened to include all transportation, rather than just railroads.

However, I sense myself the mood of the Congress, that they wish to take care of an immediate situation, at least I hope that is the feeling, with regard to railroads which are already in reorganization, and any effort to expand that at this time probably would not be successful.

At the policy level, we have discussed, without coming to any conclusions at this time, whether or not an old RFC type of operation would be in the public interest.

Senator PEARSON. Let me interrupt to say that my question doesn't imply that a big general overall piece of legislation might be the best mechanism. It might be best to meet each problem with a specific kind of a solution so far as legislation is concerned.

Secretary VOLPE. But we have given consideration to the question you raised, Senator.

Senator PEARSON. Now a comment in the questioning and in the exchange with the chairman, there was reference made that it is your business to keep the railroads running. I don't understand that. Is it the duty of the Department of Transportation to keep the railroads running? What jurisdiction do you have now in relation to management, in relation to finance, in relation to organization?

Secretary VOLPE. Well, I probably would have to quote from the statute itself. But let me just give you one area, for instance, in which the Congress and our Department worked together and passed a bill that I think gives you some indication of how much jurisdiction we had, and that is the field of rail safety.

Our jurisdiction over safety as far as railroad operations were concerned amounted to about 5 percent.

Senator PEARSON. You have no jurisdiction over rates?

Secretary VOLPE. No jurisdiction over rates whatsoever. Ninety-five percent of the safety area was not under our jurisdiction at all.

It is our job I think from a policy viewpoint to try to forecast what is apt to happen in both the railroad industry and other modes of transportation, and to be prepared to submit legislation, if that becomes necessary, in those cases where we believe that the public interest requires it.

There is a very fine line here as to where private industry should be told, look, manage your house and do the job and carry out your responsibilities, and where we say, you are going to carry out your business thus and so, regulated in such a way that it is not able to carry on its responsibilities and stay in business and make a profit, which is the only way they can stay in business.

But basically when you come right down to it, we don't have an awful lot of clout, if you want to use that word, insofar as being able to tell a railroad to do or not to do something.

Senator PEARSON. Well, do you foresee legislation such as we are discussing today being applicable only after a regulated carrier has gone into reorganization?

Secretary VOLPE. My personal preference would have been to pass legislation that would have authorized loans with all the restrictions which have been talked about here today to both carriers in reorganization as well as those who we might prevent from going into reorganization.

But that is a judgment the Congress will have to make. And we will abide by the decision.

Senator PEARSON. Well, if the conditions of the loan guarantee might be, first, that the carrier cannot obtain financing from conventional sources, and two, the probability that they will have to discontinue operation without the financing, and three, the reasonable profitability of a return to profitable operations, this seems to me to be determinable after you go into reorganization. But I don't know what jurisdiction or what power you now have to make judgments on those conditions.

I am not criticizing you. I am talking about the jurisdiction of your Department, which I see as a very limited one.

Secretary VOLPE. If we get right down to the basic essentials, we don't have any jurisdiction. The only thing we can do is this: when an organization which is as vital to the economy of the country as this one was, indicates to us what their position is, we can examine the facts and have them examined by the organization that regulates the railroad—the ICC—and come in with suggestions for legislation that might help to cure the problem.

But as far as actual authority under the law is concerned, we have none.

Senator PEARSON. So under the proposed legislation—I guess we have got a bill floating around here, about to be introduced—

Senator HARTKE. Are you referring to S. 4011?

Senator PEARSON. No, I am referring to some memorandum that says we have a draft of the bill the staff is working on. Is that true, Mr. Chairman?

Senator HARTKE. Yes, that is right. I just wanted to make sure which one we are talking about.

Senator PEARSON. Well, there are three bills I think which have been introduced. S. 4011, 4014, and 4016. The only point I am trying to develop, and I will try to move on more quickly—is that there ought to be some conditions upon guaranteeing a loan to a carrier corporation whether or not it is in reorganization. And those conditions deal with very technical matters as to management, as to finance, as to operations.

Is there a possibility that this carrier can be profitable? Is there a possibility that if we don't make this loan they are going to shut down operations? Is there a condition that they can't get financing any other place?

These are technical sorts of things, and I am concerned that the limited jurisdiction that the Department of Transportation now has

will prevent them from making the judgments on these conditions that I think are necessary.

It may be that we will do it the same way that we do it in other places. They have to come in with an application, and they have to bring the information to fulfill these requirements.

I think that is all I have, Mr. Chairman.

Senator HARTKE. Senator Baker?

Senator BAKER. Mr. Chairman, it is 5 after twelve. I think I will reserve my questions until another time.

Senator HARTKE. Well, are you going to take a long time with the Secretary? I mean, otherwise we will come back this afternoon.

Senator BAKER. No. There is no need to bring him back, Mr. Chairman. I think that a rather searching inquiry by the chairman and questions by Senator Pearson have pretty well covered the subject. I have no questions at this time.

Senator HARTKE. Just for the record, do you still endorse S. 4011?

Secretary VOLPE. Yes, I would endorse 4011 with certain amendments that hindsight and a little additional experience would indicate would be desirable.

Senator HARTKE. What amendments?

Secretary VOLPE. Primarily, amendments concerning the conditions under which the loan would be granted. They were spelled out to some degree, but I think perhaps they could be spelled out more specifically than they were in the bill.

Senator HARTKE. I hesitate to ask, but could you supply those in writing to us within a reasonable time?

Secretary VOLPE. We would be happy to, sir, Mr. Chairman.

Senator PEARSON. May I say one other thing, Mr. Chairman?

The Secretary doesn't need anybody to make a defense for him. And I just happen to have been here, as the chairman was—the chairman has been here more years than I have—at the time of the reorganization and creation of the Department of Transportation. It's a new department. And the chairman saw fit to read into the record a long recital of failures to comply within a given time period.

And I think the Department has been negligent—no, not negligent, but very tardy in some instances of coming up with things. But I am not going to read into the record, or gather it up and put it into the record, the troubles that a very fine Secretary of Transportation, Secretary Boyd, had in meeting the statutory deadlines. They were all late.

It was a new department. They were consolidating many agencies and putting it together. This is a new administration. The Secretary doesn't govern all by himself, as everyone knows, and as the chairman knows. He has to go to the White House and the Office of Management and Budget. There have been long delays there.

I happen to know that to be a fact. So I just don't want to have the Secretary leave here this morning without one person indicating that while I do think there have been some delays, and the ranking minority member has complained about it a number of times, you have great difficulties.

I am very proud of the job you are doing, and grateful for your diligence and dedication, Mr. Secretary.

(Information with respect to the legislative requests initiated or substantially revised by Secretary Volpe since taking office and supplied pursuant to a request by Senator Pearson, follows:)

THE SECRETARY OF TRANSPORTATION,  
Washington, D.C., January 18, 1971.

Hon. JAMES B. PEARSON,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR PEARSON: Pursuant to your request, I am forwarding a partial list of the legislation submitted to the Congress since I took office as Secretary of Transportation. The list contains only those bills which were originated or substantially revised during my tenure. Numerous other pieces of legislation submitted to the 90th Congress by the previous Administration were also reviewed by me and, where concurred in, resubmitted in substantially the same form to the 91st Congress. I have not listed these items.

If I can supply any further information in this regard, please do not hesitate to call upon me.

Sincerely,

JOHN A. VOLPE,

Enclosure.

Subject or short title of bill	Number	Public Law
1. Airport and Airway Development Act of 1970	S. 2437; H.R. 12374	91-258
2. Urban Mass Transportation Assistance Act of 1970	S. 2821; H.R. 13463	91-453
3. Federal Railroad Safety Act of 1970	S. 3061; H.R. 14419	91-458
4. Federal-Aid Highway Act of 1970, including the following related bills	S. 4055	91-605
Highway beautification authorizations	} S. 2399	
Highway safety apportionment formula		
Highway trust fund extension		
Providing for bridge owner progress payments		S. 3107; H.R. 15752
5. Emergency Transportation Assistance Act of 1970	S. 4011; H.R. 18125	(1)
6. Federal Boat Safety Act of 1970	S. 3199; H.R. 15041	
7. Ports and Waterways Safety Act of 1970	S. 3918; H.R. 17830	
8. Improving vessel documentation procedures	S. 4422; H.R. 19381	
9. Legislation implementing the load lines convention	S. 3839; H.R. 17011	
10. Omnibus amendments to improve Coast Guard operations	S. 3081; H.R. 13816	91-278
11. Amendments to improve Coast Guard Reserve promotion system	S. 3080; H.R. 13716	91-402
12. Interest forgiveness, St. Lawrence Seaway Development Corporation	H.R. 19387 <sup>2</sup>	91-469
13. Air traffic controller benefits	S. 4478; H.R. 19415	
14. Providing guards aboard aircraft	S. 4383; H.R. 19225	
15. Extending the war risk insurance program	S. 3764; H.R. 17133	91-399
16. Extending the high-speed ground transportation program	S. 3730; H.R. 17538	91-444
17. Amendments to improve Administration of Gas Pipeline Safety Act	S. 3763; H.R. 17335	
18. Codification of title 49, United States Code	H.R. 14028	
19. National traffic and motor vehicle safety authorizations	S. 1996; H.R. 10105	91-265
20. Coast Guard authorizations, fiscal year 1971	S. 3473; H.R. 15694	91-261
21. National Capital Transportation Act of 1969, authorization	S. 2185; H.R. 11193	91-143
22. Amendments to 1970 Military Construction Authorization Act re international air show.	S. 3588; H.R. 17604	91-511

<sup>1</sup> A more limited proposal was enacted as Public Law 91-663.

<sup>2</sup> Incorporated by the Senate in an amendment to H.R. 15424.

Secretary VOLPE. Thank you very much, Senator Pearson.

Senator HARTKE. Thank you, Mr. Secretary.

Mr. Volcker is here, and I am prepared to go a little longer. I do not think his statement will take us past 12:30.

Senator PEARSON. Okay, I will stay.

Senator HARTKE. Mr. Volcker, may we have your statement.

Mr. VOLCKER. Thank you, Mr. Chairman.

#### STATEMENT OF HON. PAUL A. VOLCKER, UNDER SECRETARY FOR MONETARY AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. VOLCKER. I am pleased to have this opportunity to appear before the Committee on Commerce to discuss the important matter of possible financial assistance to the Penn Central Railroad. This com-

mittee has already heard detailed testimony from the trustees of the railroad as to its needs and prospects, as well as a statement on the general state of the Nation's railroads from Secretary Volpe. I cannot claim special expertise in either area.

Instead, I wish to confine my remarks to certain more general considerations bearing upon the question of providing funds to the Penn Central in present circumstances.

Certain important facts of the situation are not in dispute. The Penn Central Railroad has now been in reorganization for some 5 months. Under the terms of that reorganization, the cash drain on the railroad has been substantially lessened by the granting of relief by the court from payments on outstanding debt and payments on taxes. Despite this relief, however, the operations of the railroad may fail to generate sufficient cash to meet operating expenses over the coming period. You have heard the trustees project a large cash deficit in 1971, and perhaps beyond.

No doubt there is a considerable element of uncertainty as to the outlook for the railroad's receipts and expenditures in the quarters ahead. Nevertheless, it seems evident that a potential lender has substantial cause for doubting whether funds to repay additional indebtedness will be generated from cash flow in the near future, and that it will take a considerable time and effort to bring about a lasting improvement in the railroad's finances.

Financial assistance from private financial institutions must also be considered in the context of the fact that the railroad is presently in default on a large volume of bank loans and bonds. A substantial number of major banks in the country has been involved to some extent in the bank debt incurred by the Penn Central Transportation Co., and large additional amounts are outstanding to subsidiaries.

While a part of this debt is secured, the value of the security for even this portion of the debt is not easily determinable at the present time.

In circumstances of this kind, I believe there is no basis for assuming a willingness of private lenders to advance funds to the Penn Central Railroad for operating needs in the form of unguaranteed trustee certificates. This conclusion is supported by comments of members of the financial community closely familiar with the Penn Central situation. Consequently, I am convinced that relief from the pressing cash problem of the railroad cannot reasonably be anticipated from sale of trustee certificates of the railroad at the present time, or in the near future, without an adequate government guarantee.

Senator BAKER. May I interrupt? You mentioned unsecured trustee certificates. Do you have the same opinion as to secured trustee certificates?

Mr. VOLCKER. The security question in this railroad gets very complex. I think in general terms the comment would still have to apply. I am no expert in just what assets this railroad has, but I believe in present circumstances the lender would be interested in whether he saw the potential cash flow that could permit the repayment of the certificates without forcing the railroad into liquidation, which could take time and leave substantial doubts over when his advance of money might be repaid.

I think cash flow is the basic question here, although certainly an exhaustive search of what security might be available would be desirable.

As you know, intensive consideration was given last June to alternative means of providing funds to the railroad. On the basis of that review, and the subsequent amendment of section 301 of the Defense Production Act of 1950, to provide that no loan guarantee might be provided under the terms of that act in excess of \$20 million without the approval of the Congress, I know of no way under existing law that the administration can act effectively.

Thus, we are faced with a need for new legislation if financing capability is to be provided. As you know, this committee has considered S. 4011, a bill to authorize the Secretary of Transportation to guarantee loans to rail carriers, to assist them in the performance of transportation services necessary to the maintenance of a national transportation system.

I understand that a more limited concept, confining the guarantee to trustee certificates of railroads in reorganization and providing explicitly for the priority of the guarantee over any other creditors is now under consideration.

Since Penn Central is in reorganization, a bill incorporating such amendments could serve to meet the immediate problem.

One point that should be kept in mind, however, is that to encourage institutions to advance the necessary funds, the guarantee provided in such legislation should be unambiguous, cover the full risk, and provide means of promptly discharging the Government's obligations should recourse to the guarantee become necessary. The language of the original bill provided, I believe, the degree of assurance that is necessary, in those particular respects.

It is understandable that private investors should be unwilling to risk further funds in an organization with the financial difficulties of the Penn Central Railroad. However, the Government must take into account the broader interests of the transportation system and the economy as a whole. In providing a guarantee, it is right and proper that the Government be concerned with the prospect that the railroad will be able to repay advances over a period. There should be financial planning sufficient to indicate the means by which a railroad—and, in this case, Penn Central—would be expected to work its way into the black over a reasonable period of time. But the risks cannot be properly appraised, and the decision made, without the Government also weighing in the balance, the consequences of failing to maintain a critically important segment of our transportation network.

I would therefore support legislation providing the necessary authority to the Secretary of Transportation to guarantee trustee certificates so that he may have this tool available for use in the kind of potential railroad emergency that is now facing us with respect to the Penn Central situation.

I believe this tool should and would be used with discretion, taking into full account other possible sources of funds as they become available.

Thank you, Mr. Chairman.

Senator HARTKE. Mr. Volcker, does the Treasury endorse S. 4011 as it is written?

Mr. VOLCKER. We supported that legislation when it was introduced last summer, Mr. Chairman. I think a case can be made that the flexibility to provide this kind of guarantee to a railroad in reorganization, or, in certain circumstances before reorganization, might be desirable.

I think that is a decision Congress would want to look at.

Senator HARTKE. In other words, you endorse it as it was written, the Treasury endorses it as it was written?

Mr. VOLCKER. We did last summer.

Senator HARTKE. I know you did last summer. I am trying to find out do you endorse the legislation right now?

If you don't know, just say so.

Mr. VOLCKER. I think, so far as our department is concerned, that that legislation would represent a satisfactory way of delegating to the Secretary of Transportation the powers to deal with this kind of situation.

Senator HARTKE. You do endorse it then? Is that what I understand you to say?

Mr. VOLCKER. I would I think support that legislation without saying that it could not well be amended in some respects.

Senator HARTKE. How else can I ask you?

Mr. VOLCKER. I don't know how else to answer you, sir. I would support that legislation if Congress wished to pass it.

Senator HARTKE. Let me be specific. Does Treasury support it as it was written?

Mr. VOLCKER. The Treasury did support it as it was written. As I sat here now and as I have listened to all the conversation and testimony that has been going on since that time, I would probably rewrite some of the provisions, if I had my way, of that particular piece of legislation. But if the Congress chooses not to rewrite any of the provisions, I think it is still legislation we would not object to.

Senator HARTKE. Would you submit for the record the recommendations as to how you would rewrite that? They are not in your statement.

Mr. VOLCKER. I would be glad to.

(The following information was subsequently received for the record:)

THE UNDER SECRETARY OF THE TREASURY,  
FOR MONETARY AFFAIRS,  
Washington, D.C., December 1, 1970.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Surface Transportation, Senate Committee on  
Commerce, Room 5202, New Senate Office Building, Washington, D.C.

DEAR SENATOR HARTKE: I appreciated the opportunity to testify before your Subcommittee on the complex and difficult financial problems of the Penn Central Transportation Company.

You asked if the Treasury Department still supports S. 4011, "A bill to authorize the Secretary of Transportation to guarantee loans to rail carriers to assist them in the performance of transportation services necessary to the maintenance of a national transportation system." I indicated my belief there could be circumstances under which it might be desirable to avoid throwing a railroad into bankruptcy before providing financial assistance. S. 4011 would provide such capability. At the same time, amendments could well be appropriate.

I had no specific amendatory language in mind, but, in the light of the Subcommittee's discussions with Secretary Volpe and the trustees of the Penn Central Transportation Company, it seems to me reasonable and desirable for

the Congress to provide some additional guidance with respect to the conditions under which assistance would be forthcoming, if it were possible to do so without establishing a set of requirements so rigid that the Secretary of Transportation would be unable to deal effectively with a variety of situations.

S. 4011, Sec. 4(a) (2) specified that a guarantee would not be extended unless financing were not otherwise available on reasonable terms and conditions. Apart from this condition, it seems to me that the bill might be somewhat more specific in its requirements to assure that the financing was required to support essential transportation operations and that maximum effort had been made to mobilize any other resources of the railroad for that purpose. S. 4011 also would have required a reasonable prospect of repayment. The discussion this past summer looking toward a possible V-loan prior to the Penn Central bankruptcy would have conformed to these standards.

In this connection, however, I would like to take the opportunity to assure that the Record does not lend itself to any misunderstanding. As I testified, the loan guarantee arrangements then under consideration did not contemplate that bank lenders would be repaid from the proposed V-loan. But, should it have been decided to provide such assistance, it appeared neither possible nor desirable to arrange that payment of all creditor claims be postponed.

As a practical matter, if assistance is to be provided *before* reorganization, I am doubtful that it would be wise or feasible to insist, as a matter of law, that in every instance the Government assume a prior claim over all existing creditors or that all existing creditors receive no payment. Such rigid requirements would, in specific instances, make impracticable any effort to avoid reorganization and thus could negate the intention.

In the case of Penn Central last summer, for instance, there was no difficulty in ascertaining who the bank lenders were. A "standstill" agreement could be negotiated for those lenders, providing that the loans would remain outstanding. However, similar agreements would not have been practical in the time available for suppliers, for numerous and scattered bondholders, or for a substantial volume of outstanding short-term commercial paper of the Transportation Company. Given the representations of the management as to the urgency of the financial need, it would not have been possible to contact all of the holders of this paper, nor would all of them have been willing to cooperate. Moreover, one consideration at the time was the desirability of minimizing the uncertainties and repercussions for financial markets generally and for other railroads that could flow from failure to honor certain kinds of claims, including commercial paper. Consequently, if the V-loan had been consummated, it would have been possible to meet claims of some creditors on schedule, avoiding—as would have been the intention—throwing the Transportation Company into bankruptcy, even though bank creditors would have been asked to agree to "stand still" and would have been unable to liquidate their loans until the financial performance of the railroad substantially improved.

In my judgment, if the Congress is unwilling to grant to the Executive Branch the range of discretion implied by the provisions of S. 4011, it has no choice but to enact more restricted legislation such as that which you outlined during the Hearings. We would, as I indicated, support the latter narrower approach to assure the maintenance of essential transportation services.

Sincerely yours,

PAUL A. VOLCKER.

Senator HARTKE. Let me say in fairness to Secretary Volpe that your prepared statement arrived even later than his. In fact, we didn't see it until—if we had started the hearing on time, we wouldn't have seen it at all before the hearing began.

I do think that as far as Treasury is concerned, you have been quite deeply involved in this whole situation the beginning, isn't that true?

Mr. VOLCKER. In some aspects of it, yes, sir.

Senator HARTKE. I don't want at this moment to involve ourselves in all those details. It does seem clear to me that either the administration deliberately misled us, or else unintentionally misled us, when they tried to first lend this money under the Defense Production Act, under rather questionable circumstances, and then pro-

ceeded to try to stampede and rush us into legislation under the cloak of what appears to be erroneous information.

May I ask you, do you believe now that the administration would have gone ahead and granted the loan guarantee last spring under the Defense Production Act?

Mr. VOLCKER. It certainly should not have granted that loan without some assurance that it was going to have adequate resources to back up that temporary loan with further support and without some confidence that the longer range problems of the railroad could be dealt with effectively to the extent that they are influenced by government actions and to the extent they are influenced by the Transportation Company's own actions.

I have less confidence in those latter provisos now than I would have had last summer.

Senator HARTKE. Well, yesterday the trustees testified here that in their opinion, if the original request hadn't been granted, the Government today would have been in the same position as it is now, except they would have been out an additional \$350 million. Who would have benefitted from that action last summer?

Mr. VOLCKER. I think this involves a question of whether this railroad could have been brought into renewed health and profitability more easily in reorganization or out of reorganization. I am not an expert in reorganizing railroads, to say the least, or in railroads, whether or not they are reorganized.

I know there was some feeling last summer, which I have no independent way of verifying, that it would be desirable, as Secretary Volpe suggested this morning, in some circumstances certainly to reform an organization outside of reorganization, rather than in reorganization.

Senator HARTKE. If that had been granted last summer, though, the people who would have benefitted would have been the creditors and bankers, not the general public.

Mr. VOLCKER. The only criteria is whether the general public would have benefitted. There was nothing in the arrangements we were talking about last summer that would have permitted any banks to remove any money that they had committed to the railroad for loans.

Senator HARTKE. Nothing that would have kept them from?

Mr. VOLCKER. Yes. I would not have supported any loan agreements that did not require the banks to maintain their moneys in the company.

Senator HARTKE. I don't think it gave you authority to act on that.

Mr. VOLCKER. No, the act itself did not.

Senator HARTKE. In other words, you were approving legislation in which you said you would not have approved a loan but it had no provision for you to pass on this judgment?

Well, let that go.

Let me ask you why was it the administration, the Treasury, was willing to support \$750 million loan guarantee program which, at least in my opinion, would have principally benefitted the bankers and creditors, but was reluctant to go along with a \$300 million guarantee program to save the rail passenger service?

Mr. VOLCKER. I am not familiar with the legislation on the mail passenger service, Mr. Chairman.

Senator HARTKE. You weren't there?

Mr. VOLCKER. This has not come to my attention particularly at the Treasury Department. That doesn't mean the Treasury didn't express an opinion. I say I personally am not familiar with the legislative history on this.

Senator HARTKE. How long have you been in that position?

Mr. VOLCKER. Roughly 2 years.

Senator HARTKE. And you are Under Secretary of the Treasury for Monetary Affairs on Rail Assistance?

Mr. VOLCKER. That is not part of my title, Mr. Chairman—railroad assistance.

Senator HARTKE. I hope you will tell your information people down there that you are not the Under Secretary of the Treasury for Monetary Affairs on Railroad Assistance.

Mr. VOLCKER. The statement is on railroad assistance. I think that is the notion meant to be conveyed there, Mr. Chairman.

Senator HARTKE. Who would have made this decision down there, other than you? Wouldn't it come to your attention?

Mr. VOLCKER. There are two Under Secretaries of the Treasury Department. I just do not recall that particular matter coming to my attention. Perhaps I did approve it. If I did, I don't recall it at the moment.

Senator HARTKE. It could be the fact that there is an awful close relationship between the Treasury and the bankers that give this apparent contradiction in approaches to this matter.

Mr. VOLCKER. I don't think so, Mr. Chairman. As I suggested, I saw nothing in the loan arrangements, to the degree negotiations had proceeded, that would have permitted the banks to be repaid out of the money the Government would have guaranteed, and that was a condition which the Treasury in particular was insistent upon in negotiating that arrangement.

Senator HARTKE. S. 4011 is a bank bailout bill.

Mr. VOLCKER. S. 4011 gave the Secretary of Transportation authority to negotiate a loan. It didn't tell them what the terms of the loan were. This is one of the terms that I am sure the Secretary of Transportation would have prudently insisted upon.

Senator HARTKE. After the trustees testified yesterday, Mr. Volcker, I proposed and asked the staff to draft a bill incorporating the ideas of a proposal—

First, it would apply only to railroads already under reorganization under section 77 of the Bankruptcy Act; second, to apply only to those railroads which had exhausted every means to obtain private financing, including attempts to sell trust certificates; third, assistance would be available only to such railroads on the verge of closing down, that is, essential public services about to terminate, which it is determined are necessary and in the public interest; and fourth, assistance should be applied only to those operating expenses necessary to keep the trains moving and not to be used to bail out investors and creditors; and fifth, that the Government should obtain adequate security for the risks it undertakes.

That of course is a substantially different bill than S. 4011, is it not?

Mr. VOLCKER. It is a more limited bill, particularly in being available only in situations where the railroad is in reorganization.

Senator HARTKE. Will the Treasury Department support such a bill?

Mr. VOLCKER. Yes, sir.

Senator HARTKE. What kind of assistance would the Treasury Department support? Would they support a loan guarantee provision?

Mr. VOLCKER. Yes, sir.

Senator HARTKE. For how much?

Mr. VOLCKER. \$500 million figure—I think we would support that if that is what you are suggesting.

Senator HARTKE. \$500 million for the Penn Central alone, you know.

Mr. VOLCKER. I would hope not. I understand there are some projections that might bring it up to that magnitude, and we would have to be prepared.

Senator HARTKE. The trustees told us yesterday that they are going to need that much.

Mr. VOLCKER. They might need that much.

Senator HARTKE. Pardon?

Mr. VOLCKER. They might need that much.

Senator HARTKE. Well, it won't be much less.

Mr. VOLCKER. I think an assessment would have to be made about the Penn Central Railroad as to whether there are reasonable prospects for this becoming a viable operating institution over a period of time.

Senator VOLKE. Who should make that assessment?

Mr. VOLCKER. The man guaranteeing the loan.

Senator HARTKE. The Department of Transportation?

Mr. VOLCKER. Yes, sir.

Senator HARTKE. I think so too. I think they ought to do some studying on their own. That is what I have been saying all morning.

Would the Treasury support a loan program with available funds being released only after specified conditions had been met?

Mr. VOLCKER. I am not sure I fully understand the implications of that question.

Senator HARTKE. The difference is between the loan guarantee and a Federal direct loan—you understand the difference?

Mr. VOLCKER. If that is the difference you are getting to, we would support the guarantee, and not the direct loan.

Senator HARTKE. Would you support a direct monetary assistance with moneys being placed in an escrow account and releasable only after certain specified conditions had been met?

Mr. VOLCKER. This is what I am not sure I completely understand. This would be in the form of a direct loan?

Senator HARTKE. This could be several other ways. Some were suggested yesterday by the trustees. Service contracts and other methods—pooling of cars—a lot of different approaches.

Mr. VOLCKER. Without further understanding and ability to see what the details of these other proposals were, I would not support them. I am not saying that one cannot devise another reasonable method of assistance for this railroad.

Senator HARTKE. Do you have any other ideas of anything we should give consideration to incorporating in such a bill?

Mr. VOLCKER. I am inclined to think the most straightforward direct way that help could be extended at this time is through a kind of guarantee. If the railroad is not going to be a self-supporting proposition over a period of time, then I think—if it is going to be kept alive—you have to look for entirely different methods of assistance that would contemplate a continuing subsidy of some form. That is another question.

Senator HARTKE. What are you going to do if you make a study of this matter and come up with a conclusion that, at least in the foreseeable future, that the Penn Central will not ever be able to repay a loan and default is ultimately probably going to be the end result. And so with the end result being default, the effect of a direct grant and a guaranteed loan with default is the same. Right?

Mr. VOLCKER. Depending upon the degree of certainty with which one arrives at that conclusion. I would begin looking for other solutions.

Senator HARTKE. What are you going to do, just terminate the service? Is that your recommendation?

Mr. VOLCKER. That is certainly not my recommendation.

Senator HARTKE. What alternative do you see?

Mr. VOLCKER. I think at that point the Government and the Congress would need to make some judgement about just what elements in this service are essential to the national interest, whether any elements can be made self-supporting. If not, some method would need to be devised, if they determine that this is essential to the national interest, of keeping those portions operating. But I would not think a loan guarantee program is a desirable approach under those particular conditions.

Senator HARTKE. But any such approach would ultimately involve the Treasury of the United States, would it not? If you are going to keep the service going?

Mr. VOLCKER. If we assumed that the problems can't be dealt with through rate or other changes.

Senator HARTKE. If you assume the problems cannot be dealt with, ultimately, even under a loan guarantee program, right?

Mr. VOLCKER. If you assume essential services that you want to keep operating cannot be kept operating by means other than some kind of a subsidy, that will involve some kind of a subsidy, which in turn, involves the Treasury of the United States.

Senator HARTKE. The Treasury would have to provide the funds, isn't that correct?

Mr. VOLCKER. Yes, sir.

Senator HARTKE. And let me ask you, under such circumstances, of course, the immediate prospects would involve the fact that you would have to make a determination as to how it is going to be done, right?

Mr. VOLCKER. We would have no power to do it now. The Congress would have to make a determination.

Senator HARTKE. What I am coming to—has there been one single discussion with the Department of Transportation of how much money is going to be involved, where are you going to get the money,

whether or not the Treasury would agree to it, have they talked to you about this at all to your knowledge since last summer?

Mr. VOLCKER. In terms—

Senator HARTKE. Specifically, what is going to happen?

Mr. VOLCKER. My understanding is that the judgment of the Department of Transportation is that we are not in the sorry pass that this discussion suggests, and that they do not look toward solutions that would involve continuing subsidies.

Senator HARTKE. But did you tell them that you feel a \$500 million limit is the limit on a loan guarantee program?

Mr. VOLCKER. On this particular form of a loan guarantee program, to a railroad simply in reorganization, I have not discussed that question specifically.

Senator HARTKE. I am talking about under any circumstances.

Mr. VOLCKER. Well, the early bill provided \$750 million.

Senator HARTKE. You are still standing by the original proposal of \$750 million, but \$500 million if they are in reorganization?

Mr. VOLCKER. I would think one would need less capability under the revised proposal than under the original.

Senator HARTKE. Thank you, Mr. Volcker.

These hearings will be in recess.

(Whereupon, at 12:32 p.m., the committee recessed, subject to the call of the Chair.)

## ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

FREIGHT FORWARDERS INSTITUTE,  
Washington, D.C., December 14, 1970.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Surface Transportation,  
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN HARTKE: It is my understanding that what might have been the world's greatest transportation company will run out of money early in January.

May I say, respectfully, that this should not come to pass. It is not in the interest of this nation. Congress should act so as, where needed, to revivify and perpetuate our railroad system—and unless all else fails—to accomplish this under private, not public, direction—with free enterprise management and free enterprise labor.

The freight forwarder industry has been severely damaged by disruption in the railroad industry. It can be destroyed by the dissolution of the railroad industry or any of its major component parts.

The Freight Forwarders Industry is unique in the federally-regulated transportation complex in that it specializes in moving small shipments in volume lots, affording individual pick-up on one end and individual delivery on the other. Thus, this industry is closely intertwined with thousands of small business concerns, manufacturers and merchandizers.

A healthy Freight Forwarder Industry that provides good service at reasonable rates is vital to the maintenance of competitive standing between small businesses, which necessarily require the transportation of small shipments, and the giant corporations engaged in similar manufacturing and merchandizing activities.

The giant corporations can—and do—ship by full truckloads, utilizing the services of I.C.C.-regulated common and contract motor carriers, non-regulated shipper associations and even their privately-owned fleets of trucks. These trailer-loads can be moved over the highway or via rail-piggyback. The giant corporations can also meet transportation requirements through carload rail service. And, finally, they can—and do—utilize freight forwarders, express and motor carriers for that part of their transportation that, because of practical and economic considerations, falls into the category of small shipments.

Less-carload and less-trailerload freight quite often stands out as being the most prone to damage, loss, theft, bad service, selectivity and high rates. Why? Because, to move these shipments in boxcars and trailer-container piggyback requires literally hundreds of pickups, handlings for assembly, and ultimate deliveries. And this is specifically the field of transportation in which freight forwarders have been traditionally engaged.

Freight forwarders rely heavily on regulated motor common carriers and railroads in providing the transportation services required by law and good business practice. The forwarders, as regulated carriers, have long been aggrieved by legislative and regulatory restraints that effectively cripple their potential for serving the small shipment market. For example, terminal area zones hark back to pre-war days in their boundary definitions though the forwarder must operate to serve all the tremendous population and business growth around the core city hubs that has occurred in the last 30 years. Forwarders are denied privileges of other regulated carriers to own and operate equipment in competitive geographical areas. They are prohibited from making divisional arrangements and utilizing other economy-producing operational plans with the railroads. These and other matters affecting freight forwarders are presently being examined by the Congress, the I.C.C. and other arms of the government.

It is the forwarders' purpose herein to join with the railroads in seeking the means to improve railroad service. Great expenditures and efforts have been made by, with and through the government to advance progress in motorized, air and water carriage and we have to applaud all constructive advances to meet vital transport needs.

The forwarder is the vital link between the business community and the railroads in the movement of small shipments to or from anybody to anyplace. Without the forwarder, we would anticipate an evaporation of rail transport for small shipments. And without healthy railroads, the forwarder will be sorely strained to remain viable.

We, therefore, urge the Congress to move forward in this area where so much distress is already evident, to strengthen free enterprise along these steel life-lines and to guarantee the availability of all transport resources that will be required in the future.

Regardless of the causes, the railroad industry finds itself up tight in many areas, involving many thousands of gainfully employed workers and widely dispersed investors. Congress should treat the patient while he still lives. As for expressed fears of a raid on the federal treasury, Congress has the responsibility to put in the safeguards.

Finally, the forwarder industry is perplexed by the apparent unwillingness of Congress to give the railroads the leeway to innovate and experiment in their dealings with the other regulated common carriers. Pending legislation (H.R. 10293; S. 3808) offers a good corrective beginning.

Testifying before the House Subcommittee on Transportation and the Aeronautics, the spokesman for Western Railroad Traffic Association and the Traffic Executive Association—Eastern Railroads stated in supporting H.R. 10293:

“. . . The most important reason is, that it will permit railroads to coordinate their services with the services of their most important allies in the common-carrier field, the freight forwarders. This, in our view, ought to help the railroads maintain a share of the important market which is more and more being closed to them—the less-than-carload and small-shipment market. Of course, we would expect this new and improved alliance to result in increased traffic and earnings; otherwise, the railroads would simply refuse to publish anything. They would be under no compulsion to do so.

“Another reason why we think this represents sound and constructive legislation is that it will afford a legal basis upon which railroads may establish working rules and arrangements, and publish charges and rates specifically designed to accommodate the traffic of freight forwarders and other common carriers. When it moves on the railroad, freight forwarder traffic, like other common carrier traffic, has inherent characteristics which distinguish it from the traffic of shippers. These characteristics result, in large part, from the fact that the forwarder is a common carrier. He has solicited the freight (sic) and has a continuing responsibility to his shippers, each of whom holds a freight forwarder bill of lading evidencing complete responsibility for the safe and prompt transportation of the freight from the shipper's door to the consignee's platform. It is the forwarder who must deal with those myriad shippers—must publish and defend rates for their miscellaneous traffic, must trace their shipments, investigate and pay their claims, and must collect the freight charges applicable to their small lots of freight.

“When freight forwarder traffic is tendered to railroads it is processed traffic. It has been through the common-carrier mill. It is traffic which, because they have largely been forced out of the less-than-carload-lots field by a squeeze between costs and competition, the railroads would not otherwise handle or would handle at marginal or unprofitable charges. And in order to generate, process, and turn over this traffic to the railroads the forwarders must maintain, at their own expense, extensive freight station facilities manned by personnel sufficient in number and know-how to effectuate coordination between highway and rail service as to vast quantities of freight in predominantly small lots.

“. . . it is certainly a fact that the railroads' share of the transportation market has been shrinking alarmingly for the past several decades. The trend will not be arrested or reversed by adherence to old laws, old practices, or old fetishes about how the freight forwarders ought to be treated by the railroads.

“. . . We do not support this legislation as a gesture of philanthropy. We support H.R. 10293 out of self-interest. We expect it to provide a means that will contribute in some measure, large or small, toward our retaining a fair share of the market which has been shifting to our competitors. We realize, of

course, that the test which Congress must apply in evaluating the legislation is whether it promotes the public interest. We are convinced that it does. There are serious problems in the field of public transportation, and none more serious than in the areas of the small shipments. If this bill holds out any hope of alleviating that problem—and we strongly believe that it does—then it seems to us that Congress could hardly afford the risk of not enacting it into law, very promptly.”

The forwarders believe that prompt federal action to restimulate faltering railroads will be greatly in the interest of the forwarder industry and certainly in the public interest as well.

Respectfully yours,

CHARLES D. ROCHE,  
*Executive Vice President.*

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STATEMENT OF JAMES H. J. TATE, MAYOR OF PHILADELPHIA

My name is James H. J. Tate. I am Mayor of the City of Philadelphia, and President of United States Conference of Mayors.

The five-county metropolitan area of which Philadelphia is the hub has a population of almost four million persons and a daily working force of well over one million.

With the ever increasing attention being focused on development of an expanding network of public highways, newer and better automobiles, larger and faster trucks, more sophisticated air transport for passengers, there is a tendency in the public mind to forget the extremely important although less glamorous public service provided by the railroad industry. Also there is a tendency to forget or not to realize that railroads are inherently the lowest cost producer of transportation service.

In Philadelphia the Penn Central Transportation Company was the backbone of a vast transportation system responsible for the movement of both passengers and freight. Penn Central daily carries nearly 80,000 commuters in this five-county metropolitan area. 20,000 intercity passengers ride to, or through Penn Central's passenger stations in the Philadelphia area each day. On a typical day 1300 carloads of freight are moved into or out of Philadelphia by Penn Central plus thousands more moving through the area. Of this freight traffic some is destined to or from ocean-going freighters, which are responsible for the significance of the port of the City of Philadelphia. Others are moving to or from more than 6,700 of our local industries of all sizes.

What is equally important to the volume of the Penn Central activity is the fact that like most railroads it provides freight and commuter service at bargain basement prices, but unfortunately has not kept pace with the continually rising cost spiral. Factually, the 80,000 commuters who travel on Penn Central's rails pay substantially less than those who travel into and out of the City by highway and even less per mile than those who utilize buses and other urban mass transit facilities. This commuter service actually costs less to produce than equivalent bus service—and is certainly less damaging to our environment—and for this reason the City is currently devoting public funds to the support of metropolitan rail commuter service. Rising costs have not permitted any substantial needed capital investment in equipment, shops or stations—thus giving a poor reputation for operation efficiency.

It is ironic that millions of dollars of public funds have been poured into the expansion of the highway system and into the development of air transport facilities but that relatively little federal funding has been devoted to the maintenance and improvement of the heavily used railroad system. This means that the railroads have been compelled to draw on their ever diminishing resources in order to compete with the highly subsidized and less efficient services of their competitors.

The thought of the collapse and eventual abandonment of Penn Central services is devastating to anyone responsible for, or interested in, the well-being of the City of Philadelphia and its metropolitan area. The impact, of course, would not be confined to the passengers no longer able to commute or to the particular shippers or freight patrons of the railroad. The burden experienced by these persons and firms would necessarily be passed on to, and would be felt by, the public generally. Virtually every business enterprise in the City depends directly or indirectly upon materials, parts or supplies that move by Penn Central and virtually every business in the City has employees who travel to and from work by Penn Central.

In recent years the federal government has begun to realize the importance of the federal support of the railroads. E.g., a program is being finalized which would involve acquisition of more than 100 new commuter cars locally to replace the badly outmoded fleet presently available, consisting of cars many of which are more than 50 years old. State funds, likewise, have recently been made available in increasing amounts to the railroads to help maintain and improve railroad commuter service in this metropolitan area. It would be ironic if the program for which these local public funds were provided, totaling \$40 million during the past decade, were allowed by Congress to die as a result of the collapse of the remainder of Penn Central's operations.

Apart from the services which it provides to the public generally the well-being of the carrier affects the City in other ways. For example, several thousand residents of Philadelphia are employed by Penn Central, and the demise of the carrier would have a serious effect on this segment of our population. In addition, the nation has recently selected Philadelphia as the site for the 1976 bicentennial. Penn Central is indispensable to the success of this project. If Penn Central service is allowed to collapse there is little hope that the bicentennial can succeed.

For many years we have expected the railroads to provide an important public service and have taken it for granted. At the same time, by demanding that the fares and rates charged by the railroads be held at a low level, and by pouring millions of dollars in competing transportation facilities, we have deprived the railroad of the very sources of funds which are indispensable to their continued operation. Federal policy to date has not only prevented the railroads from earning sufficient revenues to maintain their operations but has in effect destroyed the ability of the railroads to raise needed funds by borrowing and other conventional means.

It is not merely the management of Penn Central that faces these problems. Both railroad lines connecting New York City with Philadelphia are in bankruptcy and practically out of cash, notwithstanding local aid to both and the density of industry in the heavily populated area served.

These railroad lines are a priceless asset to our metropolitan area, far more useful and efficient than super highways in moving the peak rush of urban traffic. It would cost billions to replace the 141 miles of Penn Central lines in our metropolitan area with highways of much less peak hour capacity. These railroad lines operate electrically on atomic and hydro power as well as fossil fuel, helping greatly to mitigate our air pollution problem which is quite serious.

Last Spring our voters elected to loan additional millions of dollars to help our Port Corporation develop our public port facilities to further international trade and maintain employment and earning power in our City and its environs. This investment depends upon maintenance of railroad service for its integrity. Foreign coal and ore shipments must have rail service.

The nation must also maintain its posture for national defense. There can be no substitute for an adequate defense. When manpower and material are rationed, the ability of four men to move a 10,000 ton train with only a dollar's worth of fuel per mile is necessary for survival. It would take 200 men driving heavy trucks burning ten times as much fuel to do the same job. We must not be caught short.

May I now thank the sub-committee for their time and interest in hearing our problem. I am sure it is in the national interest to solve it and I am confident you will do so. Thank you.

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#### STATEMENT OF NILS A. LENNARTSON, PRESIDENT, RAILWAY PROGRESS INSTITUTE

Mr. Chairman and Members of the Committee, earlier this year the Railway Progress Institute, national trade association of the railroad supply and equipment industries, was afforded the opportunity by the Committee to express its support for enactment by Congress of Senate Bill 4011, to guarantee loans to railroads to a maximum of \$750 million.

More recently—on Nov. 24, 1970, to be exact—Secretary of Transportation John A. Volpe stated at a public hearing held by the Committee that the Administration now would support a narrower approach in light of the critical situation presently confronting railroads in reorganization. Specifically, Secretary Volpe said he would go along with an approach advanced by Chairman Vance Hartke, D-Ind., which would reduce the aggregate guarantee authority to \$500 million.

This approach also would restrict guarantees to certificates issued by trustees of railroads in reorganization and would provide explicitly for priority of such guarantees over any other creditors of the railroad in the event of default.

As stated by both Senator Hartke and Secretary Volpe, this approach would be pointed at meeting the most critical problem confronting us—keeping troubled railroads running—and provide the time needed to develop and implement long-run measures which are so essential to the railroad industry.

The Railway Progress Institute also would support legislation along those lines. But we want to state our belief that such short-run aid to ailing railroads, beneficial as it would be, must be considered as merely a part of overall aid that must be provided for the railroad industry in general.

Immediate aid, in the form of loan guarantees, must be extended to such railroads as the Penn Central, which has a cash balance capable of lasting only a short time, and to other railroads in reorganization.

But the crying overall need of the railroad industry extends far beyond this. America's Sound Transportation Review Organization (ASTRO), after an intensive study, prescribed an expenditure of \$36 billion on capital improvements for railroads in general between now and 1980. Only through such a refurbishing program—geared to acquiring new locomotives, freight cars, improved rights-of-way and other measures—can the railroads be revitalized to play their necessary part in moving America's goods in the future.

Jervis Langdon, former President of the Rock Island Railroad and now a trustee for the Penn Central, testified before you that the most serious single problem effecting the Penn Central, in particular, is lack of equipment. The future of successful operation depends upon acquisition of equipment more than on any other single factor, said Mr. Langdon.

There is but one way for the Penn Central and other railroads in a similar position to get this needed equipment and that is through being able to borrow money. If the railroad can not borrow money on its own from private sources, then government guarantees of loans—extended to railroads in reorganization—must be provided. RPI heartily endorses any such proposal introduced and advanced by the Congress.

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INTERSTATE COMMERCE COMMISSION,  
Washington, D.C., November 23, 1970.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN MAGNUSON: This is in response to your letter of November 17, 1970, advising us that hearings have been scheduled for November 23 and 24, 1970, on the financial condition of the Penn Central Transportation Company and requesting in advance of the hearings an expression of the views of the Interstate Commerce Commission on rail loan guarantee legislation which would provide assistance only to railroads in reorganization under Chapter 77 of the Bankruptcy Act.

You will recall that the Senate Subcommittee on Surface Transportation held hearings beginning June 23, 1970, immediately following the filing of the petition for reorganization of the railroad before the United States District Court for the Eastern District of Pennsylvania. Although that hearing had been called for other purposes, the inquiry soon turned to the financial condition of the Penn Central Transportation Company, the circumstances leading to the bankruptcy of that carrier and the desirability for enacting rail loan guarantee legislation. The several witnesses who appeared on behalf of the Interstate Commerce Commission responded that the agency wholeheartedly supported the re-enactment of legislation similar to that which had been approved as Part V of the Interstate Commerce Act in the Transportation Act of 1958.

Our endorsement of such legislative proposal was based on our concern for the deteriorating economic situation affecting a number of the Nation's largest railroads. We noted that several railroads had sustained net operating losses in the year 1969 and that the liquidity of most had been impaired to the point that their continued operations were precarious. For these reasons we expressed the belief that appropriate legislative authority should be provided and the necessary administrative machinery should be maintained so that the railroads would have means available to them quickly to secure financial assistance.

In the meantime, we regret to say, the financial plight of the railroads of this Nation has worsened, and the need for providing quick and temporary financial

assistance has increased. We, therefore, favor the enactment of legislation providing for rail loan guarantees such as would be provided by H.R. 18125, which, as modified, we endorse, and S. 4011, S. 4014 and S. 4016, which are substantially similar in their purposes.

Your letter suggests that there may be sentiment for limiting the beneficiaries of a loan guarantee program to railroads in reorganization under Chapter 77 of the Bankruptcy Act. The need of such carriers for the infusion of funds may be even more pressing than that experienced by other railroads. Indeed, we painfully are aware that the Central Railroad of New Jersey, in reorganization before the United States District Court for the District of New Jersey, is experiencing such devastating drains upon its resources that a cessation of operations about the first of next year is a distinct possibility. Similarly, we know that the cash flow projections for the Penn Central Transportation Company make it certain that this carrier, too, will need additional funds if it is to continue operations. We cannot say with any certainty whether either of these bankrupt carriers would find a market for trustee certificates in the absence of Government guarantees; however, we feel confident that absent such Government guarantees the trustee certificates could probably only be marketed, if at all, at such exorbitant interest rates and other conditions as to be unacceptable to any of the parties involved. An application by the Penn Central Transportation Company for authorization to market up to \$50,000,000 of trustee certificates has not been perfected and continues pending before the Commission, presumably because the trustees have been unable to find potential purchasers at terms that could be approved by the Commission under the provisions of section 20a of the Interstate Commerce Act.

The Commission is also concerned, however, over the plight of certain railroads which while avoiding bankruptcy are nonetheless in a difficult cash position and may therefore delay necessary maintenance and acquisition of equipment that may adversely affect their ability to render safe and adequate service to the public. They, too, may find they cannot obtain acceptable or approvable loans without Government guarantees. However, we feel the railroads themselves or the AAR will be in the best position to testify on this question.

The financial assistance that the rail loan guarantee legislation would provide under Chapter 77 of the Bankruptcy Act in our judgment must be recognized as being only a temporary palliative. It must not be treated as a cure for the basic economic ills that have troubled these railroads and brought them to bankruptcy. Only to the extent that the reorganization courts, the trustees and the creditors of the financially distraught railroads realize that prompt and drastic actions must be taken to restore the viability of essential railroad operations does the temporary infusion of financial aid make any sense at all, whether it be only for railroads which are already in bankruptcy, or for other roads as well. In short, the former ways of doing business should not be perpetuated at the expense of the American taxpayers, but their assistance may be called for to assure continued operations of essential services that, absent such aid, would need to be curtailed or discontinued altogether.

We appreciate the opportunity afforded us to comment on the proposed rail loan guarantee legislation and should be pleased to respond further if you think it would be helpful.

Sincerely yours,

GEORGE M. STAFFORD,  
*Chairman.*

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INTERSTATE COMMERCE COMMISSION,  
*Washington, D.C., July 8, 1970.*

Hon. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: The enclosed forecast statement of the Penn Central Transportation Company for the month of July is submitted in response to your request of June 29, 1970. This statement supplements information submitted to you on June 30, 1970.

If we can be of further assistance in this matter, please advise.

Sincerely yours,

GEORGE M. STAFFORD, *Chairman.*

PENN CENTRAL TRANSPORTATION CO., CASH FORECAST, JULY

(In millions of dollars)

	7/1	7/2	7/3	7/6	7/7	7/8	7/9	7/10	7/13	7/14	7/15	7/16	7/17	7/20	7/21	7/22	7/23	7/24	7/27	7/28	7/29	7/30	7/31	Month
<b>Receipts:</b>																								
Revenue collected by Penn Central.....	6.0	6.0	6.5	7.0	4.0	5.0	7.0	7.0	7.5	5.0	6.0	6.5	7.0	7.5	4.5	7.0	6.0	7.0	7.0	4.0	6.0	5.0	7.0	141.5
Revenue from other railroads.....	.5	.3	.3	.2	.1	.1	.1	.2	.1	1.5	.5	.3	1.8	.2	.3	.7	1.0	3.0	4.0	4.0	2.0	1.0	2.0	24.1
Government collections.....	.1	.2	.2	1.2				1.1	1.0					.2	1.1	1.1			.1	1.2	.2			5.9
Salvage.....	.2	.2	.1	.1	.1	.2	.1	.1	.2	2.1	.2	.3	.2	.4	.5	.3	.3	.1	.1	.3	.2	.3	.1	1.2
Miscellaneous I. & C.....	.3	.2	.1	.1	.2	.2	.1	.3	.3	.2	.2	.5	.2	.7	.4	.1	.2	.4	.6	.2	.3	.1	.2	4.4
Rents.....	.1	.2	.1	.1	.2	.2	.1	.3	.3	.2	.2	.5	.2	.7	.4	.1	.2	.4	.6	.2	.3	.1	.2	4.7
Proceeds—sale of property.....	.1	.2	.1	.1	.2	.2	.1	.1	.1	.2	.2	.1	.1	.2	.2	.2	.2	.2	.2	.1	.1	.1	.1	1.0
<b>Total receipts.....</b>	<b>7.2</b>	<b>6.7</b>	<b>7.2</b>	<b>7.7</b>	<b>5.4</b>	<b>5.8</b>	<b>7.4</b>	<b>7.6</b>	<b>8.2</b>	<b>7.9</b>	<b>6.8</b>	<b>7.6</b>	<b>9.5</b>	<b>8.2</b>	<b>6.4</b>	<b>8.6</b>	<b>7.5</b>	<b>10.8</b>	<b>11.8</b>	<b>9.8</b>	<b>8.8</b>	<b>6.6</b>	<b>9.3</b>	<b>182.8</b>
<b>Disbursements:</b>																								
Revenue due other railroads.....	.3	.2	.2	3.5	.3	.5	.3	.3	1.0	1.5	.3	1.1	.3	1.1	.3	1.0	6.8	6.4	5.7	4.0	3.2	2.7	1.2	35.2
A/P vouchers.....	.2	1	1	.2	.2	.5	.5	1.0	.5	.2	.2	.2	.2	.5	.2	2.0	1.5	1.8	5.0	1.5	1.0	1.6	1.5	24.5
Material vouchers.....	.2	1	1	.2	.2	.5	.5	1.0	.5	.2	.2	.2	.2	.5	.2	2.0	1.5	1.8	5.0	1.5	1.0	1.6	1.5	42.8
Payroll taxes.....	3.6	1.2	8.5		8.5	3.8	8.8	.2	2.5	3.4	1.1			6.2	8.7		3.4	8.0		2.8		3.4	1.2	60.4
Payroll.....	3.6	8.3								2.0														27.1
Equipment debt obligation.....	3.8				.1			.8					.1						.4	.5				5.6
Equipment debt—Interest.....	3.8																							8.3
Leased line rents.....	.6																							1.4
Miscellaneous.....	.3		.1	.2	.2	.1	.2	.5	.1	.2	.2	.2	.6	.3	.3	.3	.3	.6	.6	.3	.2	.2	.6	6.6
<b>Total disbursements.....</b>	<b>8.8</b>	<b>3.9</b>	<b>9.9</b>	<b>3.9</b>	<b>9.2</b>	<b>.9</b>	<b>4.8</b>	<b>10.4</b>	<b>2.6</b>	<b>4.0</b>	<b>4.1</b>	<b>5.8</b>	<b>3.0</b>	<b>9.0</b>	<b>10.5</b>	<b>4.3</b>	<b>13.0</b>	<b>17.2</b>	<b>12.8</b>	<b>9.6</b>	<b>5.9</b>	<b>8.9</b>	<b>21.3</b>	<b>183.8</b>
<b>Net change.....</b>	<b>(1.6)</b>	<b>2.8</b>	<b>(2.7)</b>	<b>3.8</b>	<b>(3.8)</b>	<b>4.9</b>	<b>2.6</b>	<b>(2.8)</b>	<b>5.6</b>	<b>3.9</b>	<b>2.7</b>	<b>1.8</b>	<b>6.5</b>	<b>(.8)</b>	<b>(4.1)</b>	<b>4.3</b>	<b>(5.5)</b>	<b>(6.4)</b>	<b>(1.0)</b>	<b>2</b>	<b>2.9</b>	<b>(2.3)</b>	<b>(12.0)</b>	<b>(1.0)</b>
Beginning cash.....	38.0	36.4	39.2	36.5	41.4	44.0	41.2	46.8	50.7	53.4	55.2	61.7	60.9	56.8	61.1	55.6	49.2	48.2	48.2	48.2	48.4	51.3	49.0	38.0
Ending cash.....	36.4	39.2	36.5	41.4	44.0	41.2	46.8	50.7	53.4	55.2	61.7	60.9	56.8	61.1	55.6	49.2	48.2	48.2	48.2	48.4	51.3	49.0	37.0	37.0

INTERSTATE COMMERCE COMMISSION,  
Washington, D.C., July 16, 1970.

HON. VANCE HARTKE,  
Chairman, Subcommittee on Surface Transportation,  
Senate Commerce Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This is in reply to your request for various information to be supplied for the record of hearings before your Subcommittee, June 23, 1970. In some cases, our estimate of the time required to supply the data was too optimistic, but I am pleased to report that we now expect to be able to submit everything that is available from our files within the next week.

A status report of the data follows:

(1) Ownership of Penn Central—requested by letter to President Gorman, and will be submitted as soon as answer is received.

(2) List of railroads which may be asking for loan assistance if legislation enacted, with the relevant financial condition of these railroads—to be supplied shortly.

(3) Forecast of financial condition of railroads to be obtained from railroads, with estimate of time to obtain—tentative date for submission is August 14, 1970.

(4) Evaluate list of railroads which operated at a deficit in 1969—to be supplied shortly.

(5) Advise Committee of Penn Central bankruptcy proceeding—attached is material received to date from the clerk of the United States District Court for the Eastern District of Pennsylvania. In addition, all material received in the future will be sent to the Committee, attention A. Daniel O'Neal, Staff Counsel.

As indicated previously, the hearing for appointment of trustees was scheduled July 15, 1970. It has been postponed to July 22, 1970, but when the appointment is made, the nominees will file petitions with the Commission for ratification of the appointment. As soon as the Commission acts on the matter, copies of the order will be supplied to the Committee.

(6) Attached are copies of all orders dealing with transactions approved under section 5 which were steps taken by the debtor since the merger of the Pennsylvania Railroad Company and the New York Central Railroad Co. to simplify the corporate structure.

The first four orders deal with transactions by which a number of subsidiaries of Penn Central were merged into another subsidiary, the Pennel Company. The names of the carriers which were merged into Pennel follow, in order, with the finance docket number listed after each for the purpose of identification:

- Elmira & Williamsport Railroad Co., F.D. 25405.
- Battle Creek & Sturgis Railway Co., F.D. 25472.
- Lansing Transit Railway Co., F.D. 25487.
- Lansing Manufacturers Railroad, F.D. 25488.
- Detroit, Toledo & Milwaukee Railroad Co., F.D. 25489.
- Zanesville Terminal Railroad Co., F.D. 25761.
- Rosslyn Connecting Railroad Co., F.D. 25762.

The next three orders may be summarized as follows: Lease by the debtor of the properties of the New York Connecting Rail Road Co., Finance Docket No. 25811; merger into the debtor of the properties of the Cherry Tree & Dixonville Railroad Co., Finance Docket No. 26042; and merger into the debtor of the properties of the Lake Erie & Pittsburgh Railway Co., Finance Docket No. 26048.

One similar type corporate simplification case is pending in Finance Docket No. 26226, proposing the merger into the debtor of the properties of the South Manchester Railroad Company. The procedural requirements in this proceeding became complete just about the time the debtor filed its petition for reorganization under section 77 of the Bankruptcy Act. It is our plan, once the trustees for the debtor have qualified, to inquire of their counsel whether the trustees propose to proceed with the transaction and, if so, whether they will obtain whatever court order might be necessary to prosecute the application.

In addition to the foregoing data for the record, other information is now being prepared for the Committee to set forth those items of investigation that will be given priority in accordance with the Committee's desire. Included among these items are:

- (1) Analysis of transactions between the Pennsylvania Transportation Company and all of its affiliates, including any transactions with the Penn

Central Comapny (parent corporation). This examination will include all transactions back to the initial date of merger for the purpose of disclosing whether any railroad assets were diverted to noncarrier activities.

(2) The examination will determine the outstanding obligations of the Penn Central Transportation Company as of June 21, 1970, and the securities that were pledged to cover such obligations.

(3) The source and applications of funds subsequent to merger.

As the Committee was advised, an interim report will be submitted covering these matters at the earliest possible date, which will likely be two to three months from now.

I regret the length of time necessary to compile the data requested, but I wish to assure you that we are making every effort to gather, it is as expeditiously as possible.

Sincerely yours,

GEORGE M. STAFFORD,  
*Chairman.*

INTERSTATE COMMERCE COMMISSION,  
*Washington, D.C., July 23, 1970.*

HON. VANCE HARTKE,

*Chairman, Subcommittee on Surface Transportation, Senate Commerce Committee, U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: This has reference to the hearings before your Subcommittee on June 23, 1970, and will provide data for the record of the hearings, as requested, not included in my previous letter of July 16, 1970.

Preliminary to discussing the data requested, however, I should like to submit for the record the attached chart entitled "Capital Expenditures for Additions and Betterments, Cash Flow and Working Capital," in lieu of a chart of the same name attached to the statement of Commissioner Laurence K. Walrath. As you will recall, this chart, along with others, was a copy of a large one used by Commissioner Walrath as a visual aid in his presentation to you. Since the hearings, we discovered that this particular chart did not show the correct amount of expenditures in early years, but more importantly, did not accurately reflect the dramatic change in the comparison in amounts of expenditures and working capital in recent years. We regret any inconvenience that may have been caused by our understatement.

To supplement my letter of July 16, 1970, and in the same order listed there, the following information was requested for the record:

(1) Ownership of Penn Central—As you know, a list of stockholders registered on the books of Penn Central Company was requested, and attached is the reply and list provided to Vice Chairman Hardin by Paul A. Gorman, Chairman of the Board, on July 13, 1970.

We recognize that the list is less than satisfactory, and are in process of determining whether the Company has any additional information concerning the ownership of its stock. Once all the information that is obtainable from Company records has been reviewed, we propose to correspond directly with brokerage houses and others in order to obtain the actual owners of the stock. However, this is no simple undertaking and will require considerable time. Furthermore, if each of the brokerage houses or banks that hold stock for others should not be cooperative, it is possible that their records might have to be subpoenaed in order to obtain the information. At the present time we cannot estimate how long it is going to take to finish the task but it will be carried out with dispatch, and we will keep you advised as to progress.

(2) List of railroads which may be asking for loan assistance if legislation enacted, with the relevant financial conditions of these railroads. We have no way of determining which railroads would seek loan assistance if legislation should be enacted. Conceivably all of those railroads which operated at a deficit in 1969 might make a request. It is entirely possible, however, that other railroads which are still operating at a profit might seek such assistance as well.

(3) Forecast of financial condition of railroads to be obtained from railroads, with estimate of time to obtain. As previously advised, this information should be available for submission on August 14, 1970, as it has been requested by certified mail from each Class I railroad.

(4) Evaluate list of railroads which operated at a deficit in 1939. Attached are pertinent financial statistics and a financial evaluation of railroads which operated at a deficit in 1969.

(5) Keep Committee advised of Penn Central bankruptcy proceeding, etc. All orders of the Court entered prior to my letter of July 16, 1970, were supplied with it, and you are being furnished with them as we receive them. As you know, the trustees were named yesterday, and we will be acting on the matter shortly (press release attached). You will be advised further on this matter.

(6) List of steps taken by Penn Central since merger to simplify corporate structure as required by Commission. Supplied with my letter of July 16, 1970.

Any information that is yet to be supplied to you will be furnished as specified above, and we intend to submit it as promptly as circumstances permit.

Sincerely yours,

GEORGE M. STAFFORD,  
Chairman.

PENN CENTRAL,  
Philadelphia, Pa., July 13, 1970.

Mr. DALE W. HARDIN,  
Acting Chairman,  
Interstate Commerce Commission,  
Washington, D.C.

DEAR MR. HARDIN: There is attached a list of those stockholders registered on the books of this Company as of June 15, 1970, who own at least one per cent of the outstanding common stock.

Cede & Co. is a clearing house for the Brokers and this stock is owned by various Brokerage firms. C. A. England & Co., Carson & Co., Kane & Co., Leroy & Co. and Trude & Co. are nominees of the banks listed beside their names. The two Swiss accounts, we understand, also are held for many individuals.

We have no way of knowing who the beneficial owners of the stock are in any of the above.

The stock standing in the name of David C. Bevan, Edward A. Kaier & John J. Maher, Trs. of Penn Central Transportation Company—Thrift Plan, is stock held for employes of the Penn Central Transportation Company and other affiliates.

Sincerely,

PAUL A. GORMAN,  
Chairman of the Board.

STOCKHOLDERS REGISTERED ON THE BOOKS OF THE COMPANY AS OF JUNE 15, 1970, OWNING AT LEAST 1 PERCENT OF THE OUTSTANDING STOCK OF THE COMPANY

Name	Business address	Number of shares
(1) David C. Bevan, Ed. A. Kaier & John J. Maher, trustees of Penn Central Transportation Co. thrift plan.	In care of Treasurer, 6 Penn Center Plaza, Phila., Pa.	249,157
(2) C. A. England & Co.	In care of Chemical Corn Exchange Bank, Post Office Box 1368, Church St. Station, New York, N.Y.	550,412
(3) Carson & Co.	In care of Morgan Guaranty Trust Company of New York, Post Office Box 1426, Church St. Station, New York, N.Y.	345,177
(4) Cede & Co.	Box 20, Bowling Green Station, New York, N.Y.	2,101,771
(5) Credit Suisse	59 Wall St., New York, N.Y.	761,373
(6) Societe de Banque Suisse	15 Nassau St., New York, N.Y.	312,401
(7) Kane & Co.	In care of the Chase Manhattan Bank, Post Office Box 1508, Church St. Station, New York, N.Y.	366,841
(8) Leroy & Co.	In care of National Newark & Essex Bank, Post Office Box 569, Newark, N.J.	395,352
(9) Merrill Lynch, Pierce, Fenner & Smith, Inc.	70 Pine St., New York, N.Y.	430,311
(10) Richard Joyce Smith trustee of the property of the New York, New Haven & Hartford Railroad Co.	54 Meadow St., New Haven, Conn.	956,576
(11) Trude & Co.	In care of Continental Illinois National Bank & Trust Company of Chicago, Chicago Lock Box H, Chicago, Ill.	288,385

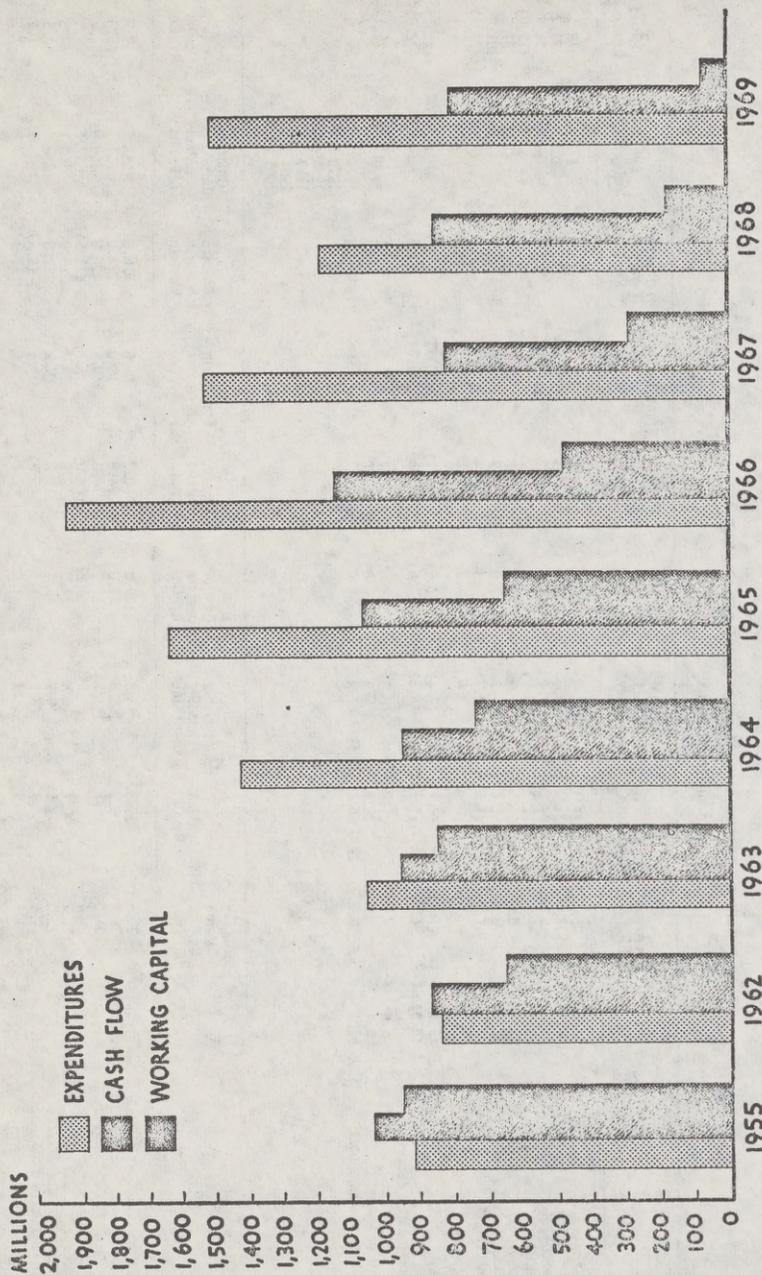
PERTINENT FINANCIAL STATISTICS AS OF DEC. 31, 1969  
 [In millions of dollars]

	Reading Co.	Ann Arbor RR. Co.	Boston & Maine Corp.	Central RR. Co. of New Jersey	Central Vermont Railway Inc.	Chicago & Eastern Illinois	Grand Trunk Western RR. Co.	Illinois Terminal RR. Co.	Lehigh Valley RR.	Long Island RR. Co.
Total assets	351.6	25.4	224.1	131.8	24.8	76.0	137.5	25.5	173.8	146.1
Long-term debt	107.1	13.0	81.7	69.7	47.2	15.1	232.9	11.6	88.6	79.2
Shareholders' equity (deficit)	194.4	9.6	99.2	7.2	(26.2)	51.2	(147.5)	7.9	67.7	13.7
Net working capital (deficit)	(3.4)	6	(12.3)	(5.2)	2.2	(3.1)	(2.9)	(3.1)	8	(19.0)
Total operating revenues	108.2	9.5	69.5	52.3	8.8	37.6	75.5	10.4	48.8	(87.9)
Total operating expenses	92.5	8.8	58.6	45.7	7.0	31.7	67.6	8.3	41.0	101.9
Income available for fixed charges (deficit)	2.6	(.8)	(1.9)	(4.7)	1.8	4.4	(17.8)	2.1	(2.4)	(24.1)
Fixed charges	3.9	.6	3.7	5.0	.7	1.5	2.7	.6	2.8	.1
Net income (deficit)	(3.4)	(1.4)	(6.1)	(9.4)	(.6)	(5.7)	(20.5)	(.4)	(7.5)	(24.2)
1969	(3.8)	(.5)	(3.7)	(8.0)	(1.6)	(1.8)	(11.3)	(1.4)	(6.0)	(12.6)
1968	5.0	(.8)	(1.8)	(6.9)	(.4)	(3.7)	18.9	.1	(5.1)	(20.1)
Funds generated—Net income plus depreciation (deficit)	6.4	1995 5.2	1970 65.2	1987 42.9	0	2054 1.7	0	1987 7.4	1974 9.2	1979 5.7
Long-term debt due within one year	5.0						0		1979 3.6	1984 4.8
Large bond maturities—Date and amount	1995 59.1						0		1989 2.0	1994 1.9
									2003 27.5	

	Maine Central RR. Co.	Monongahela Ry. Co.	Pennsylvania Reading Ry. Co.	Seashore Line	Central of Georgia Ry. Co.	Chicago, Rock Island and Pacific	Fort Worth & Denver Ry. Co.	Chicago & North Western	Chicago, Milwaukee, St. Paul & Pacific	Western Pacific RR. Co.
Total assets	70.5	25.3	15.6	148.6	129.0	480.2	64.6	820.6	688.2	19.2
Long-term debt	28.4	15.2	148.6	(141.9)	43.0	194.8	16.0	278.0	267.1	66.3
Shareholders' equity (deficit)	34.9	10.1	(.7)	(3.5)	86.0	270.3	40.7	478.9	359.9	132.7
Net working capital (deficit)	4	8	3.4	(3.5)	(6.2)	(2.0)	(.7)	(11.5)	2.1	(3.1)
Total operating revenues	25.2	6.1	8.7	64.9	64.9	250.6	17.8	283.9	269.1	67.8
Total operating expenses	22.1	3.9	9.2	21.2	46.4	211.2	15.2	231.9	230.6	62.5
Income available for fixed charges (deficit)	2.5	2.2	(.5)	(3.6)	3.6	(6.2)	.6	(9.9)	1.7	1.7
Fixed charges	1.4	1.9	.7	(3.6)	1.4	3.1	.6	(9.9)	7.8	2.7
Net income (deficit)	(1.4)	(.7)	(.2)	(.7)	2.2	(9.8)	(.4)	(11.6)	(11.6)	(.9)
1969	(.3)	(.5)	(.4)	(4.1)	2.2	(4.8)	(1.4)	(.1)	2.7	3.5
1968	.1	(.9)	(4.6)	(4.1)	2.5	4.8	.5	2.7	14.1	4.6
Funds generated—Net income plus depreciation (deficit)	1.0	0	3	0	3.0	4.8	.4	15.2	19.4	1981 16.2
Long-term debt due within 1 year	1978 13.0				1995 10.2	1980 32.7	1982 10.8	1976 15.2	1984 67.7	1981 4.6
Large bond maturities—Date and amount	1980 2.1				2020 11.9	1983 14.8	1988 6.2	1985 13.3	2019 23.2	1984 11.2
	2008 2.8					1995 50.3		1989 46.6		

INTERSTATE COMMERCE COMMISSION  
**CAPITAL EXPENDITURES FOR ADDITIONS AND BETTERMENTS,  
 CASH FLOW AND WORKING CAP.**



## INTERSTATE COMMERCE COMMISSION

(For Release July 23, 1970)

## COMMISSION PREPARED TO ACT QUICKLY ON PENN CENTRAL TRUSTEE APPOINTMENTS

Chairman George M. Stafford of the Interstate Commerce Commission announced today that the Commission was prepared to act quickly on applications for ratification of the four trustees of the Penn Central Transportation Company who were appointed yesterday by Judge P. Fullam in Philadelphia.

The Chairman stated that the Commission has yet been asked to pass upon the appointments. He noted that the Commission's regulations require that the trustees file petitions for ratification which must contain full statements of their own and their families' financial interests, and any business relationships they may have with the Penn Central or its affiliates.

The trustees appointed today by Judge Fullam are W. Willard Wirtz, former Secretary of Labor; George P. Baker, former Dean of the Harvard Graduate School of Business Administration; Jervis Langdon, Jr., Chief Executive Officer of the Rock Island Railroad and Richard C. Bond, Chairman of Wanamakers, a Philadelphia based department store.

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JULY 30, 1970.

HON. GEORGE M. STAFFORD  
*Chairman, Interstate Commerce Commission,  
 Washington, D.C.*

DEAR CHAIRMAN STAFFORD: You will recall that at the ICC oversight hearing on June 23, 1970, I raised the question about whether the ICC auditors were receiving cooperation of the Penn Central and its accountant with respect to your agency's inquiry into the financial condition of that Company. It was stated that the Penn Central was cooperating but that the accounting firm of Peat, Marwick, Mitchell & Company had refused to provide the ICC auditors with access to its working papers.

In view of recent information which has come to my attention, I would like to know whether access to the above noted working papers has yet been permitted. If not, please advise me as to what course of action the Commission has taken or plans to take.

Sincerely yours,

VANCE HARTKE,  
*Chairman, Surface Transportation Subcommittee.*

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INTERSTATE COMMERCE COMMISSION,  
 Washington, D.C., August 4, 1970.

HON. VANCE HARTKE,  
*Chairman, Surface Transportation Subcommittee, Committee on Commerce,  
 U.S. Senate, Washington, D.C.*

DEAR CHAIRMAN HARTKE: This responds to your letter of July 30, 1970, in regard to our access to the working papers of Peat, Marwick, Mitchell & Co., the accounting firm which certified the financial statements of Penn Central.

Our legal staff has been considering appropriate courses of action. In view of the appointment of trustees we have decided to seek access to such records through them. We are now in process of so doing. If these efforts fail, all available legal means to make the papers available to us for inspection will be explored.

We will keep you informed of our progress in this matter.

Sincerely yours,

GEORGE M. STAFFORD  
*Chairman.*

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AUGUST 17, 1970.

HON. GEORGE M. STAFFORD,  
*Chairman, Interstate Commerce Commission,  
 Washington, D.C.*

DEAR MR. CHAIRMAN: This is with reference to this Committee's review of Railroad Loan Guarantee legislation and specifically the Penn Central situa-

tion. In your letter dated August 3, 1970, you provided me with certain information about the cash flow condition of the Penn Central Railroad. Since the Penn Central is of course the major concern with respect to the pending legislation it is vital that this Committee have a clear picture of precisely how much money, if any, the Penn Central will need to keep operating through the end of this year and into the next session of Congress.

As you probably know, the chief financial officer of the Penn Central, Mr. Jonathan O'Herron, testified before this Committee on August 7 that in his view the railroad would be in a cash deficit position by the end of September 1970. This Committee will need in the very near future your Agency's evaluation of the cash flow situation for Penn Central. In addition to the projections, themselves, the Committee should have available to it the back-up materials utilized by the Penn Central and/or the Interstate Commerce Commission in reaching their conclusions.

Sincerely yours,

VANCE HARTKE,  
*Chairman, Surface Transportation Subcommittee.*

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INTERSTATE COMMERCE COMMISSION,  
*Washington, D.C., August 21, 1970.*

HON. VANCE HARTKE,  
*Chairman, Surface Transportation Subcommittee,  
Committee on Commerce, U.S. Senate, Washington, D.C.*

DEAR CHAIRMAN HARTKE: This has further reference to your letter of July 30, 1970, and my response of August 4, 1970, in regard to our access to the working papers of Peat, Marwick, Mitchell & Co., public accountants for the Penn Central.

The working papers have been made available to us and our staff is now in process of reviewing them.

Sincerely yours,

GEORGE M. STAFFORD,  
*Chairman.*

AUGUST 26, 1970.

HON. VANCE HARTKE,  
*Chairman, Subcommittee on Surface Transportation, Senate Commerce Committee, U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: This is in response to your letter of August 17, 1970, requesting the Commission's evaluation of the cash flow projections of the Penn Central Transportation Company submitted to your Committee by Mr. Jonathan O'Herron on August 7, 1970. You further requested the underlying work papers of the Penn Central Transportation Company in preparation of its cash flow projections and the analyses of these projections made by our staff.

I am sure you can appreciate the problems encountered in reviewing these projections and the difficulties in transmitting the voluminous work papers involved in these analyses. I would suggest that, instead of our reproducing the work papers, a member of your staff accompany Mr. John Grady, Chief of our Field Services, Bureau of Accounts, to the offices of the Penn Central Transportation Company to make a personal on-the-spot inspection and to review the company's projections and our staff's analyses.

Your representative can call Mr. Grady to arrange this inspection at a time that is convenient to your committee. If we can be of further assistance in this matter, please advise.

Sincerely yours,

GEORGE M. STAFFORD,  
*Chairman.*

MEMORANDUM

SEPTEMBER 3, 1970.

To: The Honorable VANCE HARTKE, *Chairman, Subcommittee on Surface Transportation, U.S. Senate Committee on Commerce, Washington, D.C.*

From: STUART T. SAUNDERS, *40 West Ardmore Avenue, Ardmore, Pa.*

During my testimony before your Committee on Wednesday, July 22, 1970, you and Senator Baker requested that I supply additional information for the record.

On pages 309 and 310 of this hearing, Senator Baker asked if I could tell him how many employees on Penn Central have vested pension rights. The answer is that approximately 65,000 Penn Central employees have more than ten years' service and thereby have vested pension rights.

On page 332 of this hearing, you asked if I could tell you who were the "limited number of individuals" to whom substantial portions of Great Southwest real estate sales were made in 1968 and 1969. Some of the major sales, such as Six Flags Over Georgia, Six Flags Over Texas and the Bryant Ranch property were made to Property Research Corporation, which is a broker for various investment syndicates. In addition, important individual sales were made to the following: Lonnie M. Dunn, James R. Knapp, Frank DeMarco, Herbert Kalmbach, Roy Dorami, Robert Morrison, Sherwood C. Chillingsworth, Eric Weissmann, Daniel H. Wolff, Virginia R. Ortleib, Abe Reider, Stephen Chambers, Myles P. Shanahan, William Connell, Daniel E. Lyons, Stephen E. O'Neil, Peter C. R. Huang, Andrew W. Hughes, Edward F. Paquette, George T. Scharffenberger and Ernest Wolff.

I do not know any of these purchasers and I have no further information concerning them.

If you desire additional information about them, I suggest that you get in touch with Mr. Robert T. Gowen, Secretary-General Counsel, Great Southwest Corporation, 881 Dover Drive, New Park Beach, California 92663.

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INTERSTATE COMMERCE COMMISSION,  
Washington, D.C., September 8, 1970.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR CHAIRMAN MAGNUSON: This is to supplement my letter of July 30, 1970, in respect to the cash flow of the Penn Central Transportation Company.

The Company's forecast of cash receipts and disbursements for July through December 1970, enclosed with my prior letter, has proved to be inaccurate. For example, cash of \$16.3 million was predicted as of the end of August whereas actual cash as of August 31 was \$37.0 million.

Revised cash forecasts for September and for the last two quarters in 1970 have been prepared by the Company and are enclosed. As seen, \$31 million in cash is now expected to be on hand as of the end of the year. This amount is predicated first on the payment in December 1970 of \$54 million of retroactive wage settlements and, secondly, on the receipt during the last quarter of 1970 of \$50 million from the sale of Trustee's Certificates. The retroactive wage settlement will be due and payable in December only if union agreements are signed by October 31, 1970. If they are not signed by that date payment will be deferred until 1971. There is also the possibility that in lieu of a lump sum payment the unions will agree to payment in installments over the term of the contract.

In respect to the issue and sale of Trustee Certificates, the application for such issue filed with this Commission on July 13, 1970 has not been completed, i.e., the buyer has not been named and terms of the sale have not been supplied.

I call your attention to the fact that the Company's cash forecast for the last two quarters of 1970 do not anticipate payment of state and local property taxes during those quarters. In this connection the Trustees have filed a petition with the Federal Court to permit deferment of payment of about \$45 million of such taxes that have become due since June 21 or will become due before December 31, 1970. The Court will hear the matter on September 17, 1970.

Sincerely yours,

GEORGE M. STAFFORD,  
Chairman.

## PENN CENTRAL TRANSPORTATION CO., CASH FLOW 1970, BY QUARTERS

[In millions of dollars]

	Actual		Forecast		
	1st	2d	3d	4th	Year
<b>RECEIPTS</b>					
Revenue collected by Penn Central.....	406	447	442	487	1,812
Collections from other railroads.....	77	79	78	81	315
Government collections.....	19	17	16	17	69
Salvage.....	7	4	4	6	21
Miscellaneous accounts receivable.....	16	17	14	16	63
Rents.....	17	17	14	17	65
Pennsylvania Co. and dividends.....	6	6	-----	-----	12
Other dividends and interest.....	5	5	3	2	15
Proceeds—sale of property.....	6	4	1	9	20
Financing:					
Commercial paper.....	16	-----	-----	50	66
By subsidiaries.....	43	61	-----	-----	104
Bank loans (to refund Commodity—paper).....	9	87	-----	-----	96
Special items:					
Tax allocation agreement.....	-----	-----	-----	5	5
N.E. corridor contract.....	-----	-----	5	-----	5
SEPTA.....	-----	-----	4	-----	4
Miscellaneous (net).....	-----	-----	1	-----	1
Total receipts.....	627	774	582	690	2,673
Disbursements.....	676	746	601	677	2,700
Net charge.....	(49)	82	(19)	13	(27)
Beginning cash.....	58	9	37	18	58
Ending cash.....	9	37	18	31	31
<b>DISBURSEMENTS</b>					
Revenue due other railroads.....	76	54	75	72	277
Mileage and per diem.....	35	32	32	32	131
Claims to other railroads.....	6	5	7	8	26
Car repairs.....	3	3	2	3	11
Other accounts payable (other I. & C.).....	10	13	12	10	45
Utilities, services, etc. (A/P).....	101	95	93	103	392
Fuel oil, materials and supplies.....	49	51	35	44	179
Loss and damage claims.....	12	12	9	11	44
Taxes—R. E. franchise, excise (Miscellaneous vouchers).....	19	21	-----	-----	40
Paychecks.....	17	10	12	12	51
Withholding taxes—FIT.....	163	173	172	184	692
Railroad retirements—employer (estimate).....	37	38	38	41	154
Unemployment insurance.....	34	38	37	40	149
Employee savings bonds.....	4	5	5	5	19
Debt service—principal:					
Equipment obligation.....	1	1	1	1	4
Commercial paper.....	22	16	19	12	69
PCC and STL bonds.....	9	108	-----	-----	117
Other.....	-----	-----	-----	-----	18
Debt service—interest:					
Equipment obligation.....	3	1	-----	-----	4
Bonded debt.....	11	6	11	6	34
Commercial paper.....	10	12	-----	-----	22
Miscellaneous obligation.....	6	1	-----	-----	7
Advances to subsidiaries—net.....	7	6	-----	-----	13
Equipment leases.....	(4)	16	2	-----	14
Leased line payments.....	15	10	16	14	55
Injuries to persons.....	5	3	5	7	20
Freight and passenger agents checks.....	7	8	4	5	24
Employees travel and business expenses.....	8	8	7	7	30
Special items:					
Southern divisions case.....	3	3	3	3	12
Fidelity Bank—Mortgage trustee.....	6	-----	-----	-----	6
Retroactive wage settlements.....	-----	11	-----	54	11
Vouchers canceled (utilities, material, etc.).....	-----	-----	-----	-----	54
Miscellaneous—net.....	1	(36)	-----	-----	(36)
Total.....	676	746	601	677	2,700

[In millions of dollars]

	1	2	3	4	8	9	10	11	14	15	16	17	18	21	22	23	24	25	28	29	30	Total
September 1970	5.8	6.7	6.5	6.6	7.5	6.7	6.5	6.6	7.5	6.5	7.8	7.7	7.5	7.6	7.3	9.0	8.7	8.6	7.1	6.5	7.9	152.2
Revenue collection by Penn- Central	3.0	2.3	1.0	.3	7.8	.8	.6	.5	1.1	2.0	.7	.2	.2	.8	.7	.7	.8	4.3	2.5	2.3	5.9	31.6
Revenue from other railroads	1.2			.1	1.2			1.2					.3	.1	1.2	.2		.1	.2	1.2	.2	8.9
Government collections			.3				.3		.1													1.9
Salvage																						1.9
Miscellaneous I. and C.	.2	.3	.2	.3	.3	.3	.1	.2	.3	.1	.3	.2	.2	.2	.4	.3	.3	.3	.2	.2	.2	5.0
Rents				.1	.2	.2	.3	.2	.1		.2	.2	.2	.3	.3	.2	.2	.2	.2	.2	.2	4.0
Proceeds, sale of property																						
Other dividends and interest																						
Special items:																						.3
Tax allocation																						
Northeast corridor																						
SEPTA																						5.4
Total receipts	10.4	9.6	8.0	7.7	10.1	8.0	7.8	7.7	9.2	9.8	9.2	8.7	8.5	9.0	10.0	10.4	10.1	13.6	10.4	10.4	19.8	208.4

[In millions of dollars]

	1	2	3	4	8	9	10	11	14	15	16	17	18	21	22	23	24	25	28	29	30	Total	
September 1970.....	1.0	.4	1.0	.3	.1	.1	.5		.1	.5		2.0	2.0	1.0	4.0	4.0	4.0	4.0	3.5	3.0	2.0	2.5	28.0
Disbursements:																							
Revenue due other railroads..																							
Mileage and per diem.....	.1	.5	.2	.5	.1	.1	.5		.1	1.2	2.0	2.0	2.0	.7	.4	.2	1.2	1.0	1.5	.5	.5	11.0	
Claims.....																							2.5
Car repairs.....																							1.1
Other I. and C.....	.2		.3	.1	.2	.2	.3		.2	.3	.1	.1	.2	.3	.2	.2	.2	.5	.5	.5	.5	3.5	
Vouchers:																							
A/P.....	1.2	1.1	1.2	1.3	1.2	1.1	1.2	1.3	1.2	1.2	1.6	1.6	1.7	1.6	1.6	1.6	1.6	6.2	1.6	1.6	1.6	5.3	38.0
Material.....	.6	.6	.6	.7	.6	.6	.6	.7	.6	.6	.8	.9	1.1	.9	1.0	.9	1.0	1.1	1.0	1.0	1.0	1.0	16.9
Loss and damage.....																							3.0
Miscellaneous.....	1			.2	.1					3.0					1								4.0
Paychecks.....	8.4		3.3	8.3	2.7		3.2	1.0		7.8		3.2	7.7	2.9			3.3	1.2			8.0		61.0
Withholding taxes.....													7.0										13.0
Railroad retirement.....																							11.0
Unemployment insurance.....																							12.0
Employee savings bonds.....																							
Equipment debt service:																							
Principal:																							.4
C.S.A.....	3.5				.7					2.0													7.6
Equipment trust.....	1.0				.4					1.0	.2												1.2
Interest.....										.9													2.8
Advances.....					.1					.8		.5						.2	.8				2.5
Equipment leases.....																							3.6
Leased line rentals.....																							
Injuries to persons.....																							
Freight agents checks.....																							
Employees tr. exp.....	.2	.2	.3	.3	.3	.3	.2	.3	.3	.2	.2	.3	.3	.1	.3	.2	.3	.3	.3	.3	.2	.2	5.3
Retroactive wage settlements.....																							
Miscellaneous—net.....				.2									.2										1.0
Total disbursements.....	16.4	2.8	12.9	11.9	5.1	2.4	6.2	5.2	2.2	32.3	4.5	8.9	20.9	4.6	10.7	6.9	12.0	14.6	9.3	14.0	16.7	220.4	
Net change.....	-6.0	6.8	-4.9	-4.2	5.0	5.6	1.6	2.5	7.0	-22.4	4.7	-2	-12.4	4.4	-7	3.5	-1.9	-1.0	1.1	-3.6	3.1	-12.0	
Beginning cash.....	35.0	23.0	35.8	30.9	26.7	31.7	37.3	38.9	41.4	48.4	26.0	30.7	30.5	18.1	22.5	21.8	25.3	23.4	22.4	23.5	19.9	35.0	
Ending cash.....	29.0	35.8	30.9	26.7	31.7	37.3	38.9	41.4	48.4	26.0	30.7	30.5	18.1	22.5	21.8	25.3	23.4	22.4	23.5	19.9	23.0	23.0	

INTERSTATE COMMERCE COMMISSION,  
Washington, D.C., October 9, 1970.

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,*  
*U.S. Senate, Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: This is in further response to your request to be kept informed in respect to the cash flow of the Penn Central Transportation Company.

The Company's cash-flow forecasts remain the same as they were when I wrote you on this subject last month, and its actual cash flow is running close to the amounts previously predicted. Cash as of the close of business September 30, the end of the third quarter, was \$7 million more than the \$18 million forecasted.

You will recall that the positive cash flow of \$13 million forecasted by the Company for the fourth quarter is predicated on (1) the sale of \$50 million of trustees' certificates, (2) payment of \$54 million in retroactive wage settlements, and (3) deferment of payment of about \$45 million in state and local property taxes. William H. Moore, the Penn Central's new president, was quoted in the press as saying, "I don't think there's any question but that the trustees will be successful in selling their certificates before the year end." Contrary to this statement, indications from some of the larger banks are that they already have loans to Penn Central up to the limit allowed under State and Federal banking laws, and that in view of its negative cash flow the banks are not interested, in additional loans to Penn Central without a Government guaranty.

The retroactive wage settlement will be confirmed when union agreements are signed this month. The Court has deferred its decision probably until February 1971, on the payment of property taxes.

Other elements that can affect cash flow are the rate increases requested by the Eastern roads, including Penn Central, on which hearings are currently being held, and the strike at General Motors.

We have recently requested further information from the Penn Central management in respect to the serious cash flow situation. I will advise further when a reply is received and evaluated.

Sincerely yours,

GEORGE M. STAFFORD,  
*Chairman.*

INTERSTATE COMMERCE COMMISSION,  
Washington, D.C., October 16, 1970.

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,*  
*U.S. Senate, Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: It has come to my attention, through discussions between members of the staff of the Interstate Commerce Commission and that of the Senate Commerce Committee, that you anticipate a preliminary report from the Commission on the progress of the staff's investigation into the bankruptcy of the Penn Central Transportation Company.

As you know, the investigation has been both intensive and far reaching, with a number of different facets of the railroad's operations and the affairs of its affiliates being examined. The investigation is continuing, and no one phase has as yet been completed. Our examination has uncovered many problem areas, not anticipated at the outset, which are extremely complex and will require additional investigation.

We have learned a number of things in the course of our investigation which can almost certainly be said to have contributed to the collapse of the railroad. It must be conceded, however, that many of the facts which have been gathered have simply confirmed what was already suspected from the carrier's performance since the date of the merger of the Pennsylvania and the New York Central. For example, there are indications that the failure of the merged railroads, and their respective operating executives, properly to mesh gears and to operate as a truly single rail system contributed to numerous service problems which, in turn, led to increased costs.

We are also uncovering the ownership of the shares of the railroad's parent holding company. While this aspect of the investigation also remains incomplete, it now appears, as expected, that a very large proportion of the shares,

and probably a majority, are held in "street names" and are voted for undisclosed nominees. We are in the process of identifying the beneficial owners of such stock.

The staff has devoted many hours of its time to the investigation of the financial transactions of the railroad and of its various affiliates and of transactions by the railroad's officers in its own stock and in that of its actual or potential affiliates. The information which is coming to light here—and I should stress once again that the investigation remains incomplete—indicates that there may have been very substantial dealings by individual officers in these shares, and that such dealings may have worked to the ultimate disadvantage of the railroad.

Under these circumstances, we do not deem it proper to spread upon the public record the partial information which we have obtained. In doing so, we would, in effect, be accusing a number of individuals who would be unable to respond to the charges implicit in the results of our still incomplete investigation. In addition, such an early release of the facts which we have assembled thus far might well impair our staff's ability to complete the investigation satisfactorily. It has been determined, therefore, that this material should only be disclosed in a Commission hearing or, if appropriate, referred to the Department of Justice for possible criminal prosecution. Only in this way would the persons involved have the opportunity to be represented and have available to them such protections as our legal system provides.

If I can be of further assistance to you in this matter, please call upon me. We will, of course, continue to keep you informed. Also, as you are aware, the documentary material obtained in the course of this investigation is being made available to your staff upon their request.

Sincerely yours,

GEORGE M. STAFFORD,  
*Chairman.*

cc: Hon. Harley O. Staggers.  
Hon. Wright Patman.

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INTERSTATE COMMERCE COMMISSION,  
*Washington, D.C., November 2, 1970.*

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: The major assignment of the large force of our auditors working on the Penn Central situation is directed to investigating the financial transactions which occurred prior to the June 21, 1970, petition for reorganization.

In addition you have asked for any information we may obtain relative to the Penn Central's cash flow subsequent to the petition for reorganization.

In response to this request we have been forwarding to you compilations of the cash flow information which the Company sends to the Commission.

The Company has submitted a new cash flow forecast for October through December 1970, copy enclosed, which is considerably different from the forecasts discussed in my prior letters. Also enclosed is a statement prepared by our accountants which compares the new cash forecast with the last one furnished by the Company. The "difference" column highlights the significant changes.

As we have previously emphasized, truly accurate estimates of the cash flow of the Penn Central (in reorganization) from the mid part of the year to the end of the year would be almost impossible to forecast. There are just too many "if" factors.

Their people—operating, engineering, financial, accounting, etc., must all contribute the best judgment their respective units can give regarding the ever changing picture of day-to-day and week-to-week operations. Then from these submissions monthly estimates are made. As each month passes, actual figures take the place of the estimated figures. The actual figures can be expected to be, and generally are, considerably different from the estimates.

Each month our Accounting Bureau finds some of both estimated and forecast items which it questions, and our field men are instructed to obtain full details of these items. A number of adjustments have followed.

An example of this is that in their previous forecast the Company showed expected revenues of \$9 million from the sale of property and that item was

deleted from their latest forecast. Additionally, their previous forecast showed expected expenditures of \$3 million under "miscellaneous-net" whereas in the latest forecast that item was increased to \$10 million. An adjustment of these two items to conform to the previous forecast would result in a revised forecast of \$36.5 million cash balance at the end of the fourth quarter instead of \$20.5 million as shown. Our staff sought an explanation of these two items in a letter dated October 27, 1970, and by telephone on October 30. The reply was that the sale of property which was expected to produce \$9 million was a carry-over from the days before the reorganization, and that since there has now developed a question as to whether such property could be disposed of and the proceeds used by the trustees, that item was dropped in their latest forecast.

In this connection, recent newspaper articles and a statement by Penn Central officials confirmed that New York State had agreed to pay Penn Central \$7.2 million in cash to buy the commuter line within that State, and that New York and Connecticut between them will purchase 97 commuter cars for a total of about \$3.9 million from Penn Central. Further, the State of Connecticut has entered into an agreement to lease its part of the line for sixty years at about \$1 million per year. The Commission cannot, at this moment, determine what effect, if any, these transactions will have upon the cash flow for the current quarter. Information is that the \$7.2 million may not be received by the Company until after the first of January. However, they are making an effort to try to obtain those funds within this quarter.

The explanation as to the difference of \$7 million in disbursements under "miscellaneous" was that heretofore the renovation and construction of cars in the Altoona shops were financed by outside sources. Since that financing has now dried up, they are required to pay for the work as it is performed.

Also there are other—very major—"if" factors which vitally affect the ultimate cash flow figure.

In my letter of October 9, 1970, I pointed out that a positive cash flow figure of \$13 million for the fourth quarter was predicated upon (1) the sale of \$50 million of trustees' certificates, (2) payment of \$54 million in retroactive wage settlements, and (3) deferment of payment of about \$45 million in state and local property taxes.

It now seems apparent that the Company will not be able to sell the \$50 million of trustee certificates without a government guaranty, so this amount is no longer included among Receipts. And since management now feels that a wage settlement will not be reached and the payments made before the end of the year, most of the retroactive wage payment has been omitted from Disbursements.

As to item (3), the hoped for deferment of about \$45 million in state and local taxes, the trustees are now only assured of indefinite deferment of approximately \$34.6 million. They will very probably have to pay out at least a large part and maybe all of the balance before the end of the year. The enclosed forecasts were made up and submitted prior to Judge Fullam's decision of October 26, 1970, on this matter, and thus no state and local tax payments (which could be up to \$10 million) are shown as disbursements in the enclosed fourth quarter forecast.

Now, two more—very major—"if" factors are included.

The fourth quarter Receipts in the enclosed cash flow forecast are predicated (1) on the hope that in the currently pending general rate increase case (15 percent is sought by the Eastern roads) they will get a 7 percent freight rate increase, effective on November 18, 1970, and (2) on a settlement of the General Motors strike by October 31, 1970. Management explains that because of the time lag between billing and the collection of receivables, the strike will cost the Company only \$3 million in October but about \$8 million in November. The hoped for settlement of the General Motors strike by October 31 did not materialize.

In this report we have tried to give you a little more of a review and summary of the Company's latest cash flow forecast, and of factors which vitally affect their estimates. We hope our comments and observations will be helpful to your Committee.

Sincerely yours,

GEORGE M. STAFFORD,  
*Chairman*

## PENN CENTRAL TRANSPORTATION CO., CASH FORECAST, 1970

[In millions of dollars]

	Actual		Preliminary, September	Forecast			2d half year
	July	August		October	November	December	
<b>Receipts:</b>							
Revenues collected by Penn Central.....	152.6	141.2	148.9	152.0	146.2	159.0	899.9
Collections from other railroads.....	10.9	32.5	20.1	22.4	24.1	24.0	134.0
Government collections.....	6.4	3.7	6.9	5.5	6.8	5.5	34.8
Salvage.....	1.7	1.8	.8	2.5	2.3	2.0	11.1
Miscellaneous accounts receivable.....	5.2	3.3	5.0	4.0	5.5	5.5	28.5
Rents.....	4.7	3.9	4.2	4.0	5.0	4.0	25.8
Dividends and interest.....	1.8	.5	.2	1.2	.1	.2	4.0
Proceeds—sale of property.....	.6				.1		.7
Advances (to) subcontractors.....	(1.4)						(1.4)
Financing: trustee certificates.....			3.4			5.4	5.4
Tax allocation.....				1.2			4.6
North East corridor.....		3.5					3.5
SEPTA.....							
<b>Total receipts.....</b>	<b>182.5</b>	<b>190.4</b>	<b>189.5</b>	<b>192.8</b>	<b>190.1</b>	<b>205.6</b>	<b>1,150.9</b>
<b>Disbursements:</b>							
Revenue due other railroads.....	24.0	28.4	22.8	26.8	20.0	22.0	144.0
Mileage and per diem.....	9.0	10.8	12.9	12.0	9.0	10.5	64.2
Claims to other railroads.....	2.1	1.2	2.6	2.5	2.5	2.5	13.4
Car repairs.....		1.2	1.7	1.1	1.1	1.1	6.2

Other accounts payable.....	3.0	3.9	4.2	4.0	3.0	3.5	21.6
Utilities, services, etc. (A/P).....	27.4	25.7	29.8	32.0	35.9	30.0	180.8
Fuel oil, material and supplies.....	8.2	10.8	14.9	15.4	13.5	15.0	87.8
Loss and damage claims.....			3	1.0	1.5	2.0	4.8
O.C. claims, private mileage, etc.....	1.6	3.6	6.1	4.0	3.7	4.2	23.2
Paychecks.....	98.1	51.3	60.1	62.0	51.0	58.3	340.8
Withholding taxes—F.I.T.....	13.7	11.3	12.4	11.0	12.0	11.0	71.4
Railroad retirement—employer (ES).....	13.7	11.7	12.0	15.0	12.3	11.8	76.5
Unemployment insurance.....		4.6		4.5	4.5		9.1
Employees savings bonds.....	4	4	4	4	4	4	2.4
Debt service—principal: Equipment obligations.....	3.8	5.8	8.7	4.1	4.2	4.0	30.9
Debt service—interest: Equipment obligations.....	1.6	6.3	2.8	2.6	1.0	2.4	16.7
Equipment leases.....	10.2	3.7	2.8	6.4	4.2	5.0	32.3
Leased-line rentals.....	2.3	1.4					3.7
Injuries to persons.....	2.1	1.4	1.2	1.5	1.5	1.5	7.0
Freight and passenger agents checks.....	2.1	2.6	1.7	2.0	2.0	2.5	12.0
Employees travel and business expenses.....	1.2	1.0	1.0	.9	.9	2.9	5.9
Retroactive wage settlements.....						5.5	5.5
Miscellaneous (net).....	(1.0)	4.2	2.9	2.4	5.7	1.9	16.1
Total, disbursements.....	182.5	190.8	201.5	207.1	189.9	196.0	1,167.8
Net change.....		(.4)	(12.0)	(14.3)	2	9.6	(16.9)
Beginning cash.....	37.4	37.4	37.0	25.0	10.7	10.9	37.4
Ending cash.....	37.4	37.0	25.0	10.7	10.9	20.5	20.5

## PENN CENTRAL TRANSPORTATION CO., CASH FLOW, 4TH QUARTER, 1970

[In millions of dollars]

	Revised forecast	Previous forecast	Difference
<b>RECEIPTS</b>			
Revenues collected by Penn Central	457	487	30
Collections from other railroads	71	81	10
Government collections	17	17	
Salvage	7	6	(1)
Miscellaneous accounts receivable	15	16	1
Rents	13	17	4
Dividends and interest	2	2	
Proceeds—sale of property	0	9	9
Advances (to) subsidiary companies	0	0	0
Financing: Trustee certificates	0	50	50
Tax allocation	5	5	
Northeast corridor	1	0	(1)
SEPTA	0	0	
<b>Total receipts</b>	<b>588</b>	<b>690</b>	<b>102</b>
<b>DISBURSEMENTS</b>			
Revenue due other railroads	69	72	3
Mileage and per diem	32	32	
Claims to other railroads	8	8	
Car repairs	3	3	
Other accounts payable	10	10	
Utilities, services, etc. (A/P)	98	103	5
Fuel oil, material and supplies	44	44	
Loss and damage claims	4	11	7
O.C. claims, private mileage, etc.	12	12	
Paychecks	171	184	13
Withholding taxes—F.I.T.	34	41	7
Railroad retirement—Employer (ES)	39	40	1
Unemployment insurance	5	5	
Employee savings bonds	1	1	
Debt service—principal: Equipment obligations	12	12	
Debt service—interest: Equipment obligations	6	6	
Equipment leases	15	14	(1)
Leased line rentals	0	7	7
Injuries to persons	5	5	
Freight and passenger agents checks	7	7	
Employees travel and business expenses	3	3	
Retroactive wage settlements	5	54	49
Miscellaneous—net	10	3	(7)
<b>Total disbursements</b>	<b>593</b>	<b>677</b>	<b>84</b>
Net change	(5)	13	18
Beginning cash	25	18	(7)
Ending cash	20	31	11

CHAIRMAN OF THE BOARD OF GOVERNORS,  
FEDERAL RESERVE SYSTEM,  
Washington, D.C., November 24, 1970.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In accordance with my letter of November 20, 1970, I submit herewith the views of the Board of Governors with respect to possible Government assistance to the Penn Central Transportation Company.

The Board believes that the economic consequences of a complete shutdown of Penn Central Railroad should be a matter of serious concern to the U.S. Government. The economic impact of such a shutdown is difficult to estimate in absolute terms. However, in view of the importance of Penn Central in the transporting of basic raw materials, heavy semi-finished and finished products, and consumer durables, it is evident that a shutdown would have a prompt adverse effect on production and employment in the area served by the railroad. The impact on employment would be magnified in metropolitan areas because of the importance of Penn Central in providing short-haul commuter services. Finally a continued shutdown would affect other areas in a relatively short time because of the dependence of other railroads on Penn Central tracks and facilities.

Such a shutdown would be a particularly serious threat to the production of electric power. Penn Central transportation of coal seems vital to public utilities,

especially in the heavily populated Eastern metropolitan corridor. Given the already existing shortage of fossil fuels, it does not appear feasible to substitute either adequate alternative means of transportation or other types of fuel if coal shipments by rail were suspended. Resulting power shortages would probably impinge first on industrial users, with further adverse effects on production and employment.

You state that your Committee is particularly interested in the possibility that the Federal Reserve might make, or arrange for, a loan to Penn Central under the provisions of existing law. The only provision of existing law under which the Federal Reserve Banks might possibly make a loan to Penn Central is paragraph 3 of section 13 of the Federal Reserve Act (12 USC Sec. 343). This paragraph empowers the Board of Governors, in "unusual and exigent circumstances" and by an affirmative vote of at least five members of the Board, to authorize the Federal Reserve Banks to make certain types of direct loans to individuals, partnerships or corporations.

The purpose of this provision of law, which was enacted in 1932, was to permit Federal Reserve Banks to lend to individuals, partnerships, or corporations that were creditworthy but that were unable to secure adequate credit accommodations because of unfavorable conditions within the financial system. All of the loans under this provision were made between 1932 and 1936, totaling 123 in number and about \$1.5 million in amount.

Paragraph 3 of section 13 of the Federal Reserve Act provides that paper discounted by Federal Reserve Banks under that paragraph must be of the "kinds and maturities made eligible for discount for members banks under other provisions of this Act." This language means, among other things, that the paper may not have a maturity of more than 90 days at the time of discount. The paragraph further provides that the paper shall be "indorsed or otherwise secured to the satisfaction of the Federal Reserve Bank," which the Board of Governors has construed to mean that a Federal Reserve Bank should ascertain to its satisfaction that the indorsement or the security offered is adequate to protect the Federal Reserve Bank against loss.

In the light of these restrictions in the law and the background as to the intent of the law, and based on careful study of available information pertaining to the current financial condition, needs and prospects of the Penn Central, the Board has concluded that it would not be appropriate to invoke paragraph 3, section 13 of the Federal Reserve Act to authorize a Federal Reserve Bank to extend credit to Penn Central Transportation Company.

With respect to other ways in which Federal assistance might be provided, the Board supports the objectives of S. 4011, especially in its focus on protecting the national interest. The Board believes that Federal financial assistance should never be provided to bail out poor management or to protect the interests of creditors or shareholders. However, in the Penn Central case the Board believes that the national interest is paramount. Further, it appears to us that the authority granted to the Secretary of Transportation by Sec. 4(a) of S. 4011 is sufficient to insure that proceeds of guaranteed loans would be used only for current operating expenses, and not to bail out earlier creditors or shareholders.

The Board also supports the approach of S. 4011 in relying upon Federal guarantees of private loans rather than outright advances of public funds. Besides its obvious budget savings, this approach would have the advantage of assuring that experienced private lending officers will administer the loans, under Federal supervision.

While S. 4011 would provide Federal financial assistance for troubled rail carriers, the economic vicissitudes that we have witnessed also warrant attention to a broader precautionary measure. The Board believes that the Government should give consideration to the feasibility of establishing a standby authority to provide emergency financial assistance to any type of company when such assistance appears to be the only practical way to prevent the cessation of activities which are essential in the national interest or to forestall a failure which could precipitate a national financial crisis.

This assistance could take the form of Government guarantees of private loans, but direction of the program might be delegated to an Emergency Loan Board composed of top officials of key agencies and departments that deal with overall economic and financial matters, namely, the Secretary of the Treasury, the Secretary of Commerce, and the Chairman of the Federal Reserve Board.

This board would be authorized to call on any department or agency for advice, but would itself make all loan decisions. A small staff would be required, allocated as needed from the staff of one of the departments represented on the board, and the operation of the program could probably be best lodged in the Treasury Department. This arrangement seems to us an appropriate mechanism for administering a program focused on the national interest. It seems likely that very few loans would be eligible for guarantee under such a program. Under these circumstances, the Congress could, and should, be informed of each loan while the loan was still under consideration.

Sincerely yours,

ARTHUR F. BURNS.

THE SECRETARY OF TRANSPORTATION,  
Washington, D.C., December 3, 1970.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: At the hearings held by your Committee on November 24, 1970, on railroad loan guarantee legislation, Senator Hartke asked that we submit to the Committee the amendments the Department would like to make to S. 4011. Please find enclosed our proposed changes to that bill.

You will note that the enclosure not only incorporates changes suggested in our prepared testimony, but also a number of suggestions made by Senator Hartke and the trustees of the Penn Central. The revision reduces to \$500 million the aggregate guarantee authority, allows only rail carriers in reorganization to participate in the loan guarantee program, makes explicit the priority to be given Government guarantees in the event of default, and specifies certain conditions and assurances which were left to administrative discretion in S. 4011.

Before the Secretary of Transportation could guarantee any loan under the revised bill, he would be required to find that the loan is necessary to the continued performance of rail transportation services by the carrier; the carrier is otherwise unable to obtain private financing on reasonable terms; the general operating condition of the carrier holds out a reasonable assurance of its ability to emerge from reorganization as a viable, privately-owned carrier; and the probable value of the assets of the carrier in the event of liquidation would provide reasonable protection to the United States. Also as a condition to a guarantee under the bill, the Secretary would be required to obtain assurances from the rail carrier that the proceeds of the loan would be used solely for rail transportation services; other revenues of the rail carrier would be used, to the fullest extent possible, for rail transportation services; and the assets of the rail carrier would not be used to satisfy debts (other than equipment obligations created prior to the carrier's entrance into reorganization).

The bill does not contain an absolute bar to a carrier's use of revenues for purposes other than the provision of necessary rail transportation services. We believe some flexibility must be provided in the bill to permit a carrier to carry out necessary functions with respect to non-railroad assets. In some cases, it might be in the best interests of the Government and the railroad for the carrier to retain and operate certain non-railroad functions.

The bill also omits reference to the proposal discussed during the hearings respecting the establishment of an escrow account for the financial aid provided a carrier in reorganization. This is one of several conditions to making a guarantee that it might be wise for the Secretary to adopt from time to time. However, instead of requiring its application by statute in each instance, we believe it would be preferable if the Secretary could require it, in his discretion, under the provision of the revised bill authorizing him to prescribe "such other terms and conditions as he deems appropriate."

For the same reason, we have avoided the inclusion of a flat requirement that, as a condition to a guarantee, the rail carriers dispose of non-railroad assets. Instead, the revised bill directs the Secretary in each case to consider the feasibility of requiring the rail carrier to dispose of such assets.

Sincerely,

JOHN A. VOLPE.

*Sec. 2*

On line 7, page 1, add the words "in reorganization" following the word "carriers".

On line 8, page 1, strike the words "temporary and".

On line 9, page 1, strike the words "might seriously" and insert the word "would".

*Sec. 3*

Add the following paragraph as a new "paragraph 3" as follows:

"(3) the term 'in reorganization' means in reorganization under section 77 of the Bankruptcy Act (11 U.S.C. 205)."

*Sec. 4*

Amend section 4(a), lines 12 through 25, page 2, to read as follows:

"Sec. 4. (a) (1) To carry out the purpose of this Act, the Secretary is authorized to guarantee, in whole or in part, payment of principal and interest on loans made to rail carriers in reorganization. Before making a guarantee under this section, the Secretary must find, in writing that—

"(A) the loan is necessary to the continued performance of rail transportation services by the rail carrier;

"(B) the rail carrier is otherwise unable to obtain the loan on reasonable terms and conditions from private lending sources;

"(C) the general operating condition of the rail carrier holds out a reasonable assurance of its ability to emerge from reorganization as a viable, privately-owned rail carrier;

"(D) the probable value of the assets of the rail carrier in the event of liquidation provides reasonable protection to the United States.

"The Secretary's findings shall not be reviewable in any court.

"(2) As a condition to a guarantee, the Secretary shall obtain satisfactory assurances from the rail carrier that—

"(A) the proceeds of the loan will be used for rail transportation services;

"(B) other revenues of the rail carrier will be used, to the fullest extent possible, for transportation services;

"(C) the assets of the rail carrier will not be used to satisfy debts (other than equipment obligations) created prior to the rail carrier's entrance into reorganization.

"The Secretary shall prescribe such other terms and conditions as he deems appropriate. In each case, the Secretary shall consider the feasibility of requiring the rail carrier to dispose of non-railroad assets as a condition to a guarantee."

On line 1, page 3, insert "(3)" immediately preceding the letter "A".

On lines 6 and 7, page 3, strike the words "including all extensions and renewals thereof," and strike the word "fifteen" and insert the word "five" in lieu thereof.

On lines 8 and 9, page 3, strike the words "may prescribe such other terms and conditions as he deems appropriate, and".

On line 14, page 3, strike the figure "\$750,000,000" and insert the word "\$500,000,000."

Add a new subsection (c) to Section 4 to read as follows:

"(c) For any claim of the United States against a rail carrier in reorganization arising by virtue of a default of a loan guaranteed pursuant to this Act, the United States shall have a first lien on the property of the rail carrier which shall be given priority over all other obligations of the rail carrier."

*Sec. 5*

On line 16, page 3, strike the word "stock" and insert the words "on stock" immediately following the word "dividend".

*Sec. 6*

Strike Section 6 and renumber Sections 7 through 12, accordingly.

THE SECRETARY OF TRANSPORTATION,  
Washington, D.C., December 15, 1970.

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,*  
*U.S. Senate,*  
*Washington, D.C.*

DEAR WARREN: I have received a copy of your Committee's Print, dated December 11, 1970, of legislation which would authorize the Interstate Commerce Commission to provide up to \$100 million in emergency financial assistance to the railroads through the making of either direct loans or guarantees of privately arranged loans. Since we understand you plan to consider this legislation later this week, the staff of the Committee requested our comments on it.

First let me say that I am extremely pleased that the Committee has taken affirmative action on this very critical matter. While as I indicated in my testimony on S. 4011, I believe this problem is larger than the specific aspects addressed in the Committee Print, the legislation now before your Committee will cover the immediate problems in this area and in my view constitutes a very constructive step. As your Committee is aware, the most immediate problem and one of considerable magnitude concerns the Penn Central Railroad. We have already furnished to the Committee staff a summary paper, indicating the highly essential nature of the Penn Central's operations, both in the territory served by it and other parts of our nation's economy. The bill before your Committee will permit address of this critical problem immediately upon enactment.

Turning to the particulars of the bill itself, I believe that the use of loan guarantees rather than direct loans only is the best approach. This approach has the principal advantage of keeping the private financial community more actively involved in private carrier investment than would be the case with direct loans. It, of course, has the added benefit of less near-term budgetary impact.

Another feature of this bill which differs from our original proposal is vesting the administration of this program in the Interstate Commerce Commission rather than the Department of Transportation. While I recognize that the Commission is capable of carrying out this assignment, I feel it would be more appropriate to designate this Department rather than the ICC as the administering agency. There are several reasons which might be mentioned for this view. First, provision of assistance to railroads in financial difficulty is not, strictly speaking, a regulatory function as that term is generally used. While it is true that the Commission administered the loan guarantee program from 1958 to 1962 under Part V of the Interstate Commerce Act, it has been pointed out that the administration of this program by the Commission raised a possible conflict between the Commission's usual regulatory responsibilities over the railroads and its responsibilities to insure the ability of the railroads to repay the loans guaranteed. Moreover, because the administration of this program will require close coordination with other departments in the Executive Branch, in particular the Department of the Treasury, it seems more appropriate that this function be lodged in the Executive Branch and in this Department. In this connection I would point out that practically all other programs involving grants, loans, or guarantees of loans for transportation purposes are presently vested either in this Department or in some other agency of the Executive Branch.

As to the question of the Department's securing adequate information from railroads who might be beneficiaries of this legislation, it is my feeling that this authority could be given to the Department in this legislation. This could take the form of requiring an applicant to provide the Department with all necessary information before making a decision to guarantee a loan. Aside from these major points there are a few other technical matters with regard to this legislation which we will be happy to work with you and your staff on as the Committee considers this bill.

Again, let me say that I feel the Committee is taking a very forward step in considering this matter and, with the two points made above, I most strongly support this bill. I am hopeful that the Congress can complete action on this in the very near future in view of the critical situation we are facing. My staff and I will be happy to work with you and the other members of the Committee

in any way that we can be of assistance in securing prompt enactment of this legislation.

Sincerely,

JOHN VOLPE.

PENN CENTRAL CO.,  
Philadelphia, Pa., December 22, 1970.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR SENATOR MAGNUSON: This refers to your letter of December 11 which I received December 19.

As you know, during the past several months my associates and I have furnished considerable information to various interested parties in Washington concerned with Penn Central problems.<sup>1</sup>

I realize there are a few items we agreed to furnish which have not been completed because of the complexity of gathering together the information. As I recall, I indicated to Senator Hartke we were working night and day on the immediate problems caused by the Reorganization and that some of the work in connection with gathering historic data would have to be delayed.

As I have resigned from the Penn Central effective December 31, my associates will do everything possible to accelerate getting to you and your staff the balance of the information requested.

Very respectfully,

JONATHAN O'HERRON.

LABRUM AND DOAK LAW OFFICES,  
Philadelphia, Pa., January 4, 1971.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR SENATOR MAGNUSON: Thank you for your letter of December 11, 1970, to Mr. David C. Bevan. As you may know, I am counsel for Mr. Bevan.

I assume the additional information you are referring to is in relation to the question asked by Senator Hartke on page 451 part 1 of the hearing record, dealing with the role played by European money and Swiss banks in the whole Penn Central operation. Since Mr. Bevan is no longer with the Penn Central, this information is a little difficult for us to obtain. However, we will make additional efforts and try to have it for you in the relatively near future. I am sure this information can also be obtained by your Committee directly from the Trustees or the current officers of the Penn Central.

Thank you again for your reminder.

Very truly yours,

EDWARD C. GERMAN.

TREASURY DEPARTMENT,  
Washington, D.C., January 8, 1971.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: For the Secretary, I am replying further to your letter of December 22, 1970, asking the views of the Treasury on a proposal by Mr. C. L. Dennis, President of the Brotherhood of Railroad and Airline Clerks, that the Railroad Retirement trust funds be used as a source of loans to railroads which need outside financing in order to remain in operation.<sup>2</sup>

Loans from the Railroad Retirement Accounts to railroads would be treated as outlays in the budget, just as loans from the general fund are treated as outlays. If these outlays were subject to the same budgetary control in the Executive Branch and the same appropriation control in the Congress as loans from the general fund, then it would appear that nothing would be gained by designating the Accounts as their source.

<sup>1</sup> See dialog on p. 339 of part 1.

<sup>2</sup> See p. 525, part 2 of these hearings.

It appears likely, however, that the proposal was made on the theory that budgetary and appropriation control could be avoided if the source of the loans was the Accounts. While the Congress could by appropriate legislation provide for such a result, it would in our judgment be highly undesirable to do so. The appropriation process requires the Administration and the Congress to face up to the hard choices that must be made among the many pressing needs for funds. If funds for one particular purpose bypass that process, the range of choices remaining has been undesirably limited. And the use of trust-fund money to finance one particular program makes it difficult to resist pressures to finance other, perhaps equally pressing, programs by similar means, which would, of course, further limit the desirable freedom to review all programs in making choices for the use of limited outlays.

In view of the foregoing, the Treasury would be opposed to the use of the Railroad Retirement Accounts as a source of loans to railroads.

Sincerely yours,

JOHN K. CARLOCK.

In the court of common pleas of Franklin County, Ohio

August 13, 1969.

JOHN H. KUNKEL, JR., 137 MILL STREET, GAHANNA, OHIO, PLAINTIFF,

v.

EXECUTIVE JET AVIATION, INC., 100 WEST 10TH STREET, WILMINGTON, DEL., PENN-CENTRAL CO., 6 PENN CENTRAL PLAZA, PHILADELPHIA, PA., AMERICAN CONTRACT CO., 400 PENNSYLVANIA BUILDING, WILMINGTON, DEL., GLORE FORGAN, WM. R. STAATS, INC., 45 WALL STREET, NEW YORK, N.Y., O. F. LASSITER, 2900 EAST MOUND STREET, COLUMBUS OHIO, CHARLES J. HODGE, 26 BARBERRY LANE, SHORT HILLS, N.J., AND DAVID C. BEVAN, IDLEWILD ROAD, GLADWYNNE, PA., DEFENDANTS

PETITION

*First cause of action*

1. Since on or about July, 1966 plaintiff has been, and still is, the owner and holder of 4,400 shares of the issued stock of defendant EJA, Inc. and became the owner of record of these shares of stock on or about July 1966 and brings this action in behalf of himself and all other stockholders of EJA, Inc. similarly situated, and in behalf of EJA, Inc. itself.

2. At all times hereafter mentioned defendant EJA, Inc. was, and now is a corporation duly organized and existing under and by virtue of the laws of the State of Delaware, and is duly licensed and qualified as a foreign corporation to do business in the State of Ohio, having at the time of the commencement of this action, its principal place of business and executive office at Port Columbus, City of Columbus, County of Franklin, State of Ohio; at all times herein mentioned EJA, Inc. was engaged in the business of an air taxi service throughout the United States. The Penn-Central Railroad is a corporation organized and existing under the laws of the State of Pennsylvania, is a common carrier by railroad engaged in interstate commerce and doing business in the State of Ohio within the territorial jurisdiction of the Court. The American Contract Company is a corporation organized and existing under the laws of the State of Delaware and is a whollyowned subsidiary of the Penn-Central Railroad.

3. Defendant O. F. Lassiter is a resident of the City of Columbus, County of Franklin, State of Ohio and Chairman of the Board, President and Chief Executive officer of EJA, Inc. Charles J. Hodge is a resident of the State of New Jersey and a former member of the Board of Directors of EJA, Inc. David C. Bevan is a resident of Pennsylvania and Chairman of the Financial Committee of the Directors of Penn-Central Railroad.

4. The capital stock of defendant EJA, Inc. consists of two classes, Class A—Voting and Class B—Non-Voting. The voting power of the corporation is controlled by the two major holders of the Class A Voting stock, O. F. Lassiter with 224,900 shares and the American Contract Company of 400 Pennsylvania

Building, Wilmington, Delaware with 659,405 shares. The Class B—Non-Voting is owned by:

J. Russell Forgan Sr., 68,946  
45 Wall Street  
New York, N.Y.

5. O. F. Lassiter who is the President and Chairman of the Board of defendant EJA, Inc., as set forth above by virtue of his acceptance of these offices was and is in a fiduciary capacity toward EJA, Inc. and its stockholders, an owes to them the duty of faithfully, loyally, diligently, prudently, honestly, and carefully conducting the business of EJA, Inc. and conserving its assets, and as such fiduciary was and is bound to act toward and deal with and in behalf of EJA, Inc. with the utmost fidelity, loyalty, care and good faith. Charles J. Hodge was a member of the Board of Directors of EJA, Inc. and was in a fiduciary capacity toward EJA, Inc. and its stockholders. David C. Bevan is an officer of Penn-Central and Chairman of the Finance Committee.

6. Continuously up to the filing of this action defendant Penn-Central Railroad, dominated and controlled the election of the Board of Directors and the American Contract Company, Glore Forgan, Wm. R. Staats, Inc., Charles J. Hodge and David C. Bevan. Disregarding the corporate well being of EJA, Inc. and the rights of the minority shareholders the defendants entered into an illegal conspiracy to enable the Penn-Central Railroad to dominate the world air transportation market.

7. In furtherance of the conspiracy the Penn-Central Railroad, through David C. Bevan agreed to supply all necessary capital for expansion and operations through the American Contract Company, Glore Forgan, Wm. R. Staats, Inc., and various other financially controlled corporations to enable the attainment of their illegal objective while hiding the true entity guiding and shaping the corporate policies. This plan of action and the various corporate intrigues has been partially documented in hearings before the Civil Aeronautics Board and because of the illegal acts, EJA, Inc. has had to pay great and unwarranted expenses; has lost the opportunity to acquire a supplemental airline; has had to and will have to defend itself before the Civil Aeronautics Board and is in great jeopardy of losing its right to maintain air-taxi service to its customers because of the flagrant disregard of the Board's jurisdiction.

8. Acting with the concurrence of his co-conspirators and without taking into consideration the goals or necessities of EJA, Inc. and its minority stockholders, O. F. Lassiter operated the company with reckless abandon to accomplish this illegal objective. He directed EJA, Inc. on a course of action designed to gain control of and acquire foreign air carriers with funds supplied through various means of financial subterfuge by the Penn-Central Railroad and Glore Forgan, Wm. R. Staats, Inc. in violation of the rules and regulations of the Civil Aeronautics Board and the laws of the United States. In furtherance of these objectives O. F. Lassiter and Charles Hodge made frequent trips to Europe staying in plush resorts and entertaining lavishly at the expense of EJA, Inc. As a result of these posh junkets an agreement was executed on or about February 11, 1968 by and between O. F. Lassiter representing EJA, Inc., Carl A. Hirschman and Slick Boodlin whereby EJA would operate TRANSAVIA, a Dutch charter company, Hispanair, a paper airline owned by Antonio Van de Walle of Barcelona, Spain, Sudwestflug, a German charter airline and Jet Aviation of Switzerland. These airlines would all be operated in Switzerland under EJA by an executive committee composed of Maj. Gen. Perry M. Hoisington (USAF ret.), Carl A. Hirschman and Slick Goodlin. EJA was to supply all working capital and jet aircraft and to purchase 90% of the Transavia stock for \$800,000.00, \$400,000.00 cash and the balance within 24 months or EJA stock. This agreement was consummated without the approval or concurrence of the Board of Directors, the management, or the shareholders of EJA except the co-conspirators named herein. Financial reports later obtained by the treasurer of EJA showed a loss of approximately \$72,000.00 for Transavia in the first 3 months of 1968 and accumulated losses of nearly \$500,000.00 as of May 31, 1968. To finance this and other similar conspiratorial transactions the Penn-Central Railroad caused \$500,000.00 to be made available to EJA, to be placed in the bank of America and had one Fidel Gotz loan EJA \$650,000.00 for which Mr. Gotz received interest and a warrant for 40,000 shares of EJA. Mr. Gotz is a German textile magnate and the controlling stockholder in Sudwestflug, a German supplemental carrier.

9. Subsequent to the agreement of February 1968 EJA leased a Boeing 707 to Transavia and is presently owed in excess of \$1,000,000.00 by Transavia for

the use of this airplane and attempts to collect this bill or to have the airplane returned to EJA have not been successful.

10. During the month of February 1968 the co-conspirators embarked upon a plan whereby EJA would control and operate International Air Bahamas and absorb all losses therefrom while the conspirators would personally benefit from a wholesale tour agency known as Holiday International Tours which had been hired as general sales agent for International Air Bahamas. Holiday International Tours was financed and controlled by an investment company call Penphil which had a list of stockholders including O. F. Lassiter, Charles J. Hodge, and David C. Bevan, in fact half of Penphil's shareholders are either present or retired employees of the Penn-Central Railroad or Glore Forgan, Wm. R. Staats, Inc. The conspirators charged EJA, Inc. with large sums of money for plush and elaborate entertainment expenses and ballyhoo far beyond any reasonable corporate expenditures for promotional purposes. International Air Bahamas is presently indebted to EJA, Inc. in excess of \$1,500,000.00 in back lease payments, maintenance costs and air crews for a Boeing 707 furnished by EJA, Inc. and every attempt by the former treasurer of EJA Inc. to this account was hampered and stopped by O. F. Lassiter for reasons unknown. This indebtedness grows monthly while EJA, Inc. goes further in debt to Penn-Central Railroad to finance this operation.

11. These transactions and acquisitions were part of the overall master plan to control the world air transport business disregarding the rights of all EJA shareholders by deliberately involving EJA, Inc. in financial manipulations far beyond its ability to handle and by deliberately spending corporate funds when there wasn't any reasonable probability of a return. The operating losses is in excess of \$9,500,000.00 and the outstanding indebtedness to the Penn-Central Railroad is in excess of \$19,500,000.00. Totally disregarding the financial condition of EJA, Inc., O. F. Lassiter has maintained a completely irresponsible attitude towards corporate expenditures, authorizing and demanding, over the objections of the financial officers of the company, projects which were and are useless and without merit such as the conversion of N366EJ, a Lear Jet, which has been modified into a one of a kind aircraft, spending in excess of \$300,000.00 on this modification and the aircraft has not flown any revenue producing miles for the corporation since January 1968.

12. Plaintiff the former treasurer and the senior vice-president in charge of financial matters brought these facts and other documented facts involving gross mismanagement and expenditures before the Board of Directors in New York City on January 31, 1969 and plaintiff was forced to submit his resignation as Senior Vice-President of EJA and there has not been any corporate action to correct these wrongdoings.

13. Plaintiff alleges and believes that the wrongful acts set forth herein were concealed by the defendants to the detriment of the shareholders in order that the defendant Penn-Central Railroad could grow quickly in the aviation field and become as dominant therein as they are in other fields of transportation; that the financial agreements between Penn-Central Railroad, American Contract Company, and EJA, Inc. are unconscionable and were not entered into in good faith but for the purposes of siphoning the assets and funds of EJA, Inc., and depriving it of the reasonable prospect of making profits while suppressing the true financial conditions of the company by failing to cause the filing of an audited tax return for 1968.

14. By reason of said facts the financial indebtedness of EJA, Inc. to the Penn-Central Railroad, American Contract Company and any other entity used by the Penn-Central Railroad to funnel money into EJA, Inc. should be cancelled and rescinded and the defendants should be required to account for any profits made by them directly or indirectly as a result of their actions and to account to EJA, Inc. for all damages done to it.

#### *Second cause of action*

15. For his second cause of action plaintiff incorporates all previous paragraphs as fully as if they were re-written herein.

16. Plaintiff further says that O. F. Lassiter with the knowledge and concurrence of David C. Bevan and Charles J. Hodge used and expended corporate funds to obtain a lease on a New York apartment and used corporate men and material spending in excess of \$3,000.00 to remodel the apartment. O. F. Lassiter also caused to be paid to Miss V. Austins \$2,850.00 with corporate funds for her furniture and personal belongings, then leased the apartment in the name of O. F. Lassiter personally and have charged EJA a rate of \$50.00 per day per man for various questionable corporate guests staying there ostensibly for corporate purposes.

17. Further O. F. Lassiter with the knowledge, aid, and concurrence of David C. Bevan and Charles J. Hodge has completely dominated and controlled all corporate policies and has caused illegal expenditures of corporate funds for personal obligations and has grossly mismanaged corporate funds causing many expenditures to be made over the objection of the former treasurer and other corporate officers that were improper and were for the sole purpose of personal gratification and entertainment or escape from a personal dilemma.

18. Further plaintiff says that because the corporation is being operated without any regards to proper corporate management as a one man operation and for personal aggrandizement, the employee morale is so negative that there has been an employee turnover in excess of 150% since the beginning of operation in February 1965.

19. Further plaintiff says that O. F. Lassiter with his co-conspirators caused the Board of Directors to declare illegal stock dividends to himself and to Glore Forgan, Wm. R. Staats, Inc.

20. Plaintiff has no adequate remedy at law.

Wherefore, Plaintiff prays that judgment be duly entered herein that:

1. Cancels all indebtedness between EJA, Inc. and the Penn-Central Railroad or its subdivisions or affiliates that exists because of the conspiracy entered into by the defendants.

2. The defendants and each of them, other than EJA, Inc., accounts for their acts as directors, officers, and fiduciaries of defendant EJA, Inc., and as conspirators in respect of and participants in the above-described acts and conduct, that they be directed to pay over to EJA, Inc. any and all money, assets, facilities, and property of defendant EJA, Inc. which were wrongfully, unlawfully, negligently, and fraudulently wasted, misapplied, diverted, siphoned, misappropriated, and lost and that they be directed to pay over to EJA, Inc. any and all sums of money and any and all assets, facilities, and properties thus accounted for;

3. Plaintiff have such other and further relief as may be just and proper, with costs and disbursements of this action, including the fair and reasonable allowance for counsel fees, accountant fees, and other lawful expenses in connection with the prosecution of this action.

ROBERT L. VAN HEYDE,  
JOHN J. WOLERY,  
*Attorneys for Plaintiff, 895 South High Street, Columbus, Ohio.*  
By ROBERT L. VAN HEYDE.

#### AFFIDAVIT

*State of Ohio*

*County of Franklin, ss:*

John Kunkel, being first duly sworn, says he is the Plaintiff in the foregoing Petition and that the facts stated and allegations contained therein are true as he verily believes.

JOHN H. KUNKEL, Jr.

SWORN to before me and subscribed in my presence this \_\_\_\_\_ day of August, 1969.

ROBERT L. VANHEYDE,  
*Notary Public.*

The following tables, provided by the Penn Central, show the sales of property and securities between Penn Central and subsidiary companies for the period January 1, 1965, through December 31, 1969.

PENN CENTRAL INTERCOMPANY TRANSFER OF ASSETS—INTERCOMPANY SALES OF PROPERTY BETWEEN PCT CO. AND/OR COMPANIES OWNED OR AFFILIATED WITH PCT CO.,  
FOR THE PERIOD JAN. 1, 1965, TO DEC. 31, 1969

LAND AND IMPROVEMENTS

By—	To—	Description of property	Use of property	Date of sale	Original purchase date	Original cost recorded	Depreciation recorded	Depreciated L.V.	Sales price	Profit or (loss)
Manor RR. Co.	Pennsylvania RR. Co.	Industrial land and buildings (0.531 acres).	Construction of dormitory facilities.	Aug. 30, 1965	1957	\$2,551,803	\$85,349	\$186,454	\$94,946	(\$91,508)
Do.	Philadelphia, Baltimore & Washington RR.	0.2592 acres of industrial land.	Industry track	Mar. 23, 1966	Dec. 22, 1961	55,197		5,197	5,191	(6)
Do.	do.	6.8549 acres of industrial right-of-way.	do.	Feb. 16, 1966	May 11, 1964	1,144,842		134,842	134,006	(836)
Do.	do.	0.1636 acres of industrial right-of-way.	do.	Feb. 11, 1966	Jan. 30, 1963	22,669		2,669	2,652	(17)
Do.	Little Miami RR.	7.039 acres of industrial land.	Site for diesel fuel storage tanks.	Mar. 4, 1966	Jan. 29, 1953	110,606		10,606	11,894	1,288
Do.	Cleveland & Pittsburgh RR. Co.	0.3210 acres of land.	Industry track	July 13, 1966		11,187		1,187	1,185	(2)
Do.	United New Jersey RR. & Canal Co.	1 acre right-of-way land.	Industry track	Aug. 11, 1966		127,913		17,913	17,469	(444)
Do.	Cleveland & Pittsburgh RR. Co.	2.455 acres of land.	Yard track	Oct. 20, 1966		99,165		9,165	9,196	31
United New Jersey RR. & Canal Co.	West Jersey & Seashore RR. Co.	1.209 acres of industrial land.	Railroad facilities	Jan. 5, 1967	Nov. 16, 1830	11,138				
					Dec. 31, 1859	11,520				
					Mar. 21, 1902	44,148				
					Dec. 21, 1889	550				
					July 1, 1949	11,880				
					June 23, 1966	44,095				
		Total land				113,331				
		Improvements				457,594				
		Total				660,925		60,925	97,148	36,223

West Jersey & Seashore R.R. Co.	United New Jersey RR. & Canal Co.	Industrial land	Railroad Facilities	Jan. 9, 1967	May 8, 1901	778,388	78,388	78,388
Manor R. E. Co.	Philadelphia, Baltimore & Washington RR. Co.	0.445 acres of industrial land.	do.	Feb. 23, 1957	Dec. 26, 1961	88,277	8,277	8,277
Do.	Cleveland & Pittsburgh RR. Co.	12.367 acres of industrial land.	Additional yard facilities.	Mar. 7, 1967	1960	366,955	36,955	39,111
Do.	do.	1.4817 acres of industrial land.	Railroad facilities.	Mar. 28, 1967	1961	233,714	23,714	23,714
Do.	Philadelphia, Baltimore & Washington RR. Co.	0.1856 acres of industrial land.	do.	do.	1961	44,251	4,251	4,251
Manor R. E. Co., trustee P.B. & W. RR. Co.	do.	0.08 acres of industrial land.	Widen railroad right-of-way.	Apr. 24, 1967		1	1	1
Monongahela Ry. Co.	Waynesburg & Southern RR. Co.	0.424 acres of industrial land.	Construction of railroad.	Jun. 8, 1967	1948	100,194	10,194	9,145 (1,049)
Pennsylvania Improvement Corp.	Philadelphia, Baltimore & Washington RR. Co.	3,214 acres of industrial land.	Railroad facilities.	Aug. 7, 1967	1956	233,659	23,659	23,659
Waynesburg & Washington RR. Co.	Waynesburg Southern RR. Co.	0.30 acre land for station facilities.	Construction of railroad.	Mar. 6, 1968	1884	301	301	301
Philadelphia, Baltimore & Washington RR. Co.	Penn Central Transportation Co.	0.049 acre of industrial land.	Complete sale of other Penn Central property to University of Pennsylvania.	Apr. 30, 1968	1864	560	560	3,675 3,115
Manor R. E. Co.	Pittsburgh, Youngstown & Ashtabula Ry. Co.	7,5039 acres of industrial land.	Construction of yard	June 10, 1968	1956-57	90,846	90,846	90,433 (413)
Monongahela Ry. Co.	Waynesburg Southern RR. Co.	7 miles of industrial land.	Construction of railroad.	Aug. 13, 1968		189,269	189,269	189,269
Penndel Co.	Cambria Land Co.	10,324 acres of industrial land.	Industrial development coal lease.	Dec. 5, 1968	Oct. 21, 1952	None		1,000 1,000
New York Central Development Corp.	Cleveland, Cincinnati, Chicago, & St. Louis RR. Co.	15.63 acres of industrial land.	Railroad facilities.	Apr. 8, 1968		28,964	28,964	28,964
Manor R. E. Co.	Cleveland & Pittsburgh RR. Co.	0.43 acre of industrial land.	Spur track	Mar. 29, 1968	1956	1,940	1,940	702 (1,238)
Michigan Central RR. Co.	Ann Arbor Railroad Co.	78,564 acres of land	Railroad facilities.	Dec. 30, 1969	1972			
		Land.				11,312		
		Improvements.				104,496		
		Total.				115,808	115,808	99,898 (15,819)

## EQUIPMENT

Units	Description	Sold by—	Sold to—	Use	Date of sale	Date original purchase	Original cost	Depreciation recorded	Depreciated L.V.	Sale price	Profit or (loss)
1	D. E. Loco ARS 16	PRR	A. & B. B.	Transportation service	November 1967	April 1951	\$143,900	\$129,919	\$13,982	\$15,000	\$1,018
3	Caboose	NYC	IURY	Rehabilitated for transportation service	February 1965	1946	1,251	594	657	1,050	393
1	Locomotive	PRR	IURY	Spare parts	January 1967	July 1948	102,139	75,154	26,985	5,000	(21,985)
2	Caboose	NYC	IURY	Rehabilitated for transportation service	January 1969	1944	3,486	1,103	2,383	1,200	(1,183)
6	do	NYC	IURY	do	March 1969	Various	14,314	14,314	0	3,600	3,600
1	Locomotives	NYC	C.R. & I.	Transportation service	January 1965	January 1950	597,908	283,692	314,216	314,216	0
1	do	NYC	C.R. & I.	do	June 1965	October 1950	77,761	39,143	38,143	38,143	0
3	Freight covered hoppers	NYC	P. & E.	do	January 1968	1946	56,254	37,430	18,824	18,824	0
2	Work equipment	IHB	NYC	M. of W. maintenance	August 1966	March 1947	29,966	20,375	9,591	9,591	0
2	Miscellaneous equipment	PC	Excellent truck lease	Lease to PCT Co.	December 1968	Various	7,848,758	5,428,694	2,420,064	2,420,064	0
6	Auto	C.R. & I.	do	Lease to C.R. & I.	July 1968	do	69,456	48,982	20,474	20,474	0
2	do	P. & E.	do	Lease to P. & E.	November 1968	do	92,561	43,788	48,773	48,773	0

Note: Transactions involving Despatch Shops, Inc., and Owners Equipment Construction, the company's freight car building units, have been omitted. These are nonprofit operations for which the lease or finance costs to the transportation companies are based on the car building units' actual cost.

## PENN CENTRAL SYSTEM

## INTERCOMPANY SALES OF PROPERTIES FOR THE PERIOD JAN. 1, 1965 TO DEC. 31, 1969

By	To	Date	Description	Book value	Sales price	Profit or (loss)
Indiana Harbor Belt RR. Co.	New York Central	1966	7 train control and speed recorders	\$45,483	\$4,000	(\$41,483)
Do.	do	1966	2 burro cranes	29,966	9,591	(20,375)
Chicago River & Indiana RR. Co.	do	1967	Diesel refueler	15,290	12,092	(3,198)
Do.	do	1967	Ramp	6,820	1,000	(5,820)
Do.	Excess Truck Lsr. Co.	1968	16 units of automotive equipment	69,456	20,470	(48,986)
Do.	Indiana Harbor Belt RR.	1969	1 used diesel locomotive	62,226	6,000	(56,226)
Do.	Penn Central Transportation Co.	1969	Ramp	5,698	3,681	(2,017)
Do.	do	1969	Radio equipment	34,244	34,244	0
Merchants Despatch Transportation Co.	New York Central	1966	Containers and icing platform	683,320	532,023	(51,297)

New York Central Transport Co.	1965	Tractors	575	0	(575)
Do	1966	do	540	0	(540)
Do	1966	Tractors and related equipment	10,340	13,023	2,683
Detroit, Toledo & Ironton RR. Co.	1967	Land at Toledo, Lima and Ironton	301,302	237,236	63,066
Do	1965	Caboose and transmission racks	2,080	1,358	622
Do	1965	Transmission racks	2,890	3,830	3,830
Do	1965	do	6,720	3,850	3,850
ETI Enterprises	1965	Land, Michigan	31,505	1,299	1,299
Do	1966	do	27,655	68	27,587
Do	1967	do	2,314	2,382	668
Do	1969	do	47,165	65,282	18,117
Manistique & Lake Superior RR.	1969	Diesel locomotive and caboose	25,134	22,500	(2,634)
Ann Arbor RR. Co.	1968	Caboose	7,197	3,185	(4,012)
Do	1968	Land, 0.4 acre, Toledo	2,118	800	(1,318)
Do	1969	Caboose, locomotives, and engine racks	12,440	12,440	0
Do	1969	File cabinets and trailers	5,000	16,559	11,559
Do	1969	Tru Train trailers	9,614	11,156	1,542
Excelsior Truck Leasing Co., Inc.	1969	do	46,506	65,478	18,972
Do	1969	Power units	300,045	600	200
Do	1969	Trailers	340,960	40,915	299,045
Do	1969	do	62,129	69,212	7,083
Do	1968	Trailers, power unit, and adding machine	1,182	3,276	1,882
Do	1968	Power units and trailers	87,704	31,287	56,417
Do	1968	Car and truck	2,320	2,320	0
Do	1968	Truck	29	146	117
Do	1968	Tru Train trailers	4,610	5,970	1,360
Do	1965	Auto and trailers	16,346	16,281	65
Do	1965	Tractors and trailers	42,565	42,762	197
Do	1965	Trailers	200	200	0
Do	1966	do	1,180	1,248	68
Do	1966	do	3,028	3,028	0
Do	1967	do	150	150	0
Do	1967	Tractor	50	30	20
Do	1967	Tractor	1,669	1,781	112
Do	1968	Trailers	76	76	0
Do	1968	Track wrench	7,707	7,705	2
Do	1969	Office trailer and adding machine	4,227	4,227	0
Do	1969	Tractors	12,959	12,369	610
Do	1965	Power equipment	3,600	3,600	0
Do	1966	do	100,604	100,604	0
Do	1967	Rolling stock and garage equipment	6,395	6,395	0
Do	1968	Leasehold improvements	0	6,871	6,871
Do	1965	Rolling equipment	0	4,929	4,929
Do	1966	do	0	2,320	2,320
Do	1968	do	0	7,210	7,210
Do	1968	Forklift	7,324	6,773	(551)
Do	1966	do	6,773	0	(6,773)
Do	1969	Tractor	1,336	1,236	100
Do	1969	Tractor	1,336	1,236	100

## PENN CENTRAL TRANSPORTATION CO—INTERCOMPANY SALES OF INVESTMENT SECURITIES

Sales and date	Description (including reason)	Number of shares or par value	Book value	Sale price	Profit or loss
By Penn Central Transportation Co to Asso. of the Jersey Co : Aug 26, 1965	United New Jersey RR & Canal Co, capital stock (from Pennsylvania RR supplemental pension)	305 shares.	\$63,135.00	\$63,135.00	
By Penn Central Transportation Co to Beech Creek RR : Sept 30, 1965	Beech Creek RR 1st mortgage 4-percent bonds (to trustee for cancellation against reimbursement from funds on deposit A/C proceeds sale of property)	\$3,000.	3,000.00	3,000.00	
Oct. 31, 1965	do.	\$4,000	4,000.00	4,000.00	
Mar 31, 1966	do.	\$9,000	9,000.00	9,000.00	
Mar 31, 1967	do.	\$2,000	2,000.00	2,000.00	
May 31, 1967	do.	\$250,000.	250,000.00	250,000.00	
Apr 30, 1969	do.	\$1,000.	1,000.00	1,000.00	
By Penn Central Transportation Co. to Cambria Land Co.: 1968.	General Motors Acceptance Corp. note due June 18, 1968.	\$25,000	24,820.83	24,820.83	
By Penn Central Transportation Co. to Cleveland, Cincinnati, Chicago & St. Louis Ry. Co.:					
May 31, 1965	Cleveland, Cincinnati, Chicago & St. Louis 1st Collateral Trust St. Louis division 4 percent bonds due Nov. 1, 1970 (to trustee for cancellation reimbursement from funds on deposit A/C sale of released property).	\$125,000.	121,470.21	125,156.25	\$3,686.04
Sept. 30, 1965	do.	6,000	5,830.57	5,520.00	(310.57)
Oct. 31, 1965	do.	8,000	7,763.90	7,360.00	(403.90)
Nov. 31, 1965	do.	133,000	129,040.25	133,166.25	4,126.00
Jan. 31, 1966	do.	4,000	3,879.64	3,680.00	(199.64)
Feb. 28, 1966	do.	146,000	141,593.89	134,320.00	(7,273.89)
Mar. 31, 1966	do.	27,000	26,185.27	24,840.00	(1,345.27)
Apr. 30, 1966	do.	180,000	174,411.67	176,568.75	2,157.08
June 30, 1966	do.	\$24,000	23,254.89	24,000.00	745.11
Nov. 30, 1966	do.	\$137,000.	132,609.70	137,171.25	4,561.55
Jan. 31, 1967	do.	\$51,000.	49,362.22	51,000.00	1,637.78
Feb. 28, 1967	do.	\$3,000.	2,901.17	3,000.00	98.83
Mar. 31, 1967	do.	\$17,000.	16,439.96	17,000.00	560.04
May 31, 1967	do.	\$48,000.	46,411.04	48,051.25	1,640.21
Nov. 30, 1967	do.	\$134,000.	129,564.14	134,167.50	4,603.36
Dec. 31, 1967	do.	\$12,000.	11,602.76	12,000.00	397.29
Feb. 28, 1968	do.	\$55,000.	53,179.31	55,000.00	1,820.64
May 31, 1968	do.	\$136,000.	131,497.94	136,000.00	4,502.06
Dec. 31, 1968	do.	\$143,000.	138,266.22	143,178.75	4,912.53
May 31, 1968	do.	\$93,000.	89,921.38	93,000.00	3,078.62
By Penn Central Transportation Co. to Cleveland & Pittsburgh RR:					
July 31, 1965	Cleveland & Pittsburgh G. & R. 3 percent registered mortgage bonds serial "C", due Oct. 1, 1974 (for retirement through sinking fund).	\$227,000.	227,000.00	227,000.00	

July 31, 1966	do	\$227,000	227,000.00	227,000.00
Aug 31, 1967	do	\$235,000	235,000.00	235,000.00
Aug 31, 1968	do	\$255,000	255,000.00	255,000.00
Aug 31, 1969	do	\$258,000	258,000.00	258,000.00
By Penn Central Transportation Co. to connecting railway:				
June 20, 1966	Little Miami RR Co. common stock (contract advance to connecting railway for purchase of stock).	71,000 shares	6,174,586.00	6,174,586.00
July 15, 1966	do	5,130 shares	446,135.58	446,135.58
June 20, 1966	Little Miami RR Co. refunding stock special Gtd. betterment (contract advance to connecting railway for purchase of stock).	121,400 shares	6,070,000.00	6,070,000.00
Do	do			
Do	Pittsburgh, Youngstown & Ashtabula Railway Co. common stock (contract advance to connecting railway for purchase of stock).	126,687 shares	6,239,487.91	6,239,487.91
Do	do	20,997 shares	2,099,700.00	2,099,700.00
Do	Pittsburgh, Youngstown & Ashtabula Railway Co. preferred stock (contract advance to connecting railway for purchase of stock).	60,134 shares	7,830,168.41	7,830,168.41
July 5, 1966	do			
January 31, 1965	Connecting railway 1st mortgage 3 $\frac{1}{2}$ % percent bonds serial "A," due March 1, 1976 (sinking fund).	7,826 shares	1,019,039.11	1,019,039.11
January 31, 1966	do	\$275,000	250,120.00	250,120.00
January 31, 1967	do	\$288,000	250,002.17	250,002.17
April 30, 1967	do	\$277,000	227,785.33	227,785.33
November 30, 1967	do	\$10,000	7,980.00	7,980.00
January 31, 1968	do	\$16,000	13,625.00	13,625.00
January 31, 1968	do	\$290,000	250,550.00	250,550.00
January 31, 1969	do	\$285,000	249,950.00	249,950.00
By Penn Central Transportation Co. to New York & Long Branch:				
March 31, 1965	New York & Long Branch Construction mortgage serial "B," 4 percent bonds (temporary) due September 1, 1981 (sinking fund).	\$15,000	15,000.00	15,000.00
March 31, 1966	do	\$15,000	15,000.00	15,000.00
March 31, 1967	do	\$15,000	15,000.00	15,000.00
March 31, 1968	do	\$15,000	15,000.00	15,000.00
March 31, 1969	do	\$15,000	15,000.00	15,000.00
By Penn Central Transportation Co. to Pennsylvania Co.:				
October 31, 1967	Pennsylvania Co. 5 $\frac{1}{4}$ collateral trust bonds due June 1, 1985.	\$912,000	877,352.50	877,352.50
October 31, 1968	do	\$6,000	5,040.00	5,040.00
July 2, 1969	Madison Square Garden Corp. common stock.	\$1,462,109 shares	16,197,243.50	16,197,243.50
do	Transport Pool Corp. & Strick Inc. warrants.	\$4,700,000	4,700,000.00	4,700,000.00
do	Strick Inc. subscription note dated December 31, 1968 due December 31, 1978.	\$6,776,000	6,776,000.00	6,776,000.00
Do	Transport Pool Corp. subordinate note due Dec. 31, 1978.	\$2,661,000	2,661,000.00	2,661,000.00
Do	Pennsylvania RR. General mortgage 4 $\frac{1}{4}$ percent registered bonds serial "A," Apr. 1, 1950, due Apr. 1, 1986.	\$4,666,000	4,666,000.00	4,666,000.00
Sept. 30, 1965	Arrvida Corp. Class "A" common stock	3,052,077 shares	18,312,462.00	18,312,462.00

Sales and date	Description (including reason)	Number of shares or par value	Book value	Sale price	Profit or loss
By Penn Central Transportation Co. to Pennsylvania, Ohio & Detroit RR. Oct. 31, 1965	Pennsylvania, Ohio & Detroit 1st and refunding mortgage 2½ percent serial "E" registered bonds due Oct. 1, 1975 (sinking fund).	\$7,000	\$6,930.70	\$7,070.00	\$139.30
Oct. 31, 1966	do.	\$7,000	6,930.70	7,061.25	130.55
Oct. 31, 1967	do.	\$7,000	6,930.70	7,052.50	121.80
Oct. 31, 1968	do.	\$7,000	6,930.70	7,043.75	113.05
Oct. 31, 1969	do.	\$7,000	6,930.70	7,035.00	104.30
By Penn Central Transportation Co. to Pennsylvania Tunnel & Terminal RR. Feb. 18, 1965	Pennsylvania Tunnel & Terminal RR. capital stock (for cancellation in exchange for cancellation by Penn Central Transportation Co. of an equal amount of face value of open Indebtness A/C 769 to Pennsylvania Tunnel & Terminal per authority of board of resolution Dec. 23, 1964).	50,000 shares	5,000,000.00	5,000,000.00	-----
By Penn Central Transportation Co. to Indianapolis Union Ry. Co. May 31, 1967	Indianapolis Union Ry. R. & I. mortgage 2½ percent serial "C" bonds.	\$19,000	19,000.00	19,000.00	-----
October 31, 1967	do.	\$75,000	75,000.00	75,000.00	-----
February 28, 1968	do.	\$105,000	105,000.00	105,000.00	-----
March 31, 1969	do.	\$200,000	200,000.00	200,000.00	-----
May 31, 1968	Commercial credit note	\$24,912.50	24,912.50	24,912.50	-----
May 6, 1968	General Motors Acceptance Corp. note due June 17, 1968.	\$99,300.00	99,300.00	99,300.00	-----
By Penn Central Transportation Co. to Lehigh Valley: February 26, 1968	U.S.A. Treasury bonds due June 15, 1967-1972, 2½ percent (investment transaction).	\$500	500.00	500.00	-----
May 31, 1968	U.S.A. Treasury bonds due Aug. 15, 1970 4 percent (investment transaction).	\$46,000	46,000.00	44,160.00	(1,840.00)
By Penn Central Transportation Co. to Manor Real Estate: Dec. 19, 1968	Pennsylvania Co. 5½ percent collateral trust bonds	\$2,221,244	2,221,244.00	2,221,244.00	-----
By Penn Central Transportation Co. to Monongahela Ry: May 6, 1968	(from Penn Central supplemental pension). Ford Motor Co. note due, July 10, 1968	\$25,000	24,734.81	24,734.81	-----
Do.	Ford Motor Co. note due, July 29, 1968	\$25,000	24,657.29	24,657.29	-----
Do.	Ford Motor Co. note due, July 1, 1968	\$25,000	24,766.67	24,766.67	-----
Do.	Ford Motor Co. note due, Dec. 2, 1968	\$100,000	96,572.92	96,572.92	-----
Do.	General Motors Acceptance Corp. note due July 16, 1968.	\$25,000	24,710.33	24,710.33	-----

By Penn Central Transportation Co. to New York & Harlem RR.:

Feb. 28, 1965	New York & Harlem RR. Co. 3½ percent gold mortgage bonds dated May 1, 1900, due May 1, 2000 (to reduce New York Central liability for amount due for land sold by turning over to Morgan Guaranty 3½ percent mortgage bonds).	\$13,000	12,073.28	12,073.28
Apr. 30, 1965	do	\$36,000		
Do	do	\$82,000		
May 31, 1965	New York & Harlem RR. Co. 3½ percent gold mortgage bonds dated May 1, 1900, due May 1, 2000 (sinking fund).	\$90,000	33,433.69	33,433.69
			76,154.52	76,154.52
			83,655.00	83,655.00
By Penn Central Transportation Co. to New York & Harlem RR.:				
May 31, 1965	New York & Harlem RR. Co. 3½ percent gold mortgage bonds dated May 1, 1900, due May 1, 2000 (to reduce New York Central liability for amount due for land sold by turning over to Morgan Guaranty 3½ percent mortgage bonds).	\$2,000	1,857.43	1,857.43
Nov. 30, 1965	New York & Harlem RR. Co. 3½ percent gold mortgage bonds dated May 1, 1900, due May 1, 2000 (sinking fund).	\$92,000	85,514.00	85,514.00
Do	New York & Harlem RR. Co. 3½ percent gold mortgage bonds dated May 1, 1900, due May 1, 2000 (to reduce New York Central liability for amount due for land sold by turning over to Morgan Guaranty 3½ percent mortgage bonds).	\$3,000	2,783.67	2,783.67
Jan. 31, 1966	do	\$23,000	21,319.09	21,319.09
Feb. 28, 1966	do	\$33,000	30,558.35	30,558.35
May 31, 1966	New York and Harlem RR. Co. 3½ percent gold mortgage bonds dated May 1, 1900, due May 1, 2000 (sinking fund).	\$94,000	87,420.00	87,420.00
May 31, 1966	New York & Harlem RR. Co. 3½ percent gold mortgage bonds dated May 1, 1900, due May 1, 2000 (to reduce New York Central liability for amount due for land sold by turning over to Morgan Guaranty 3½ percent mortgage bonds).	\$267,000	247,282.19	247,282.19
Oct. 31, 1966	do	\$287,000	267,884.57	267,884.57
Jan. 31, 1967	do	\$97,000	90,325.03	90,325.03
Feb. 28, 1967	do	\$37,000	34,502.50	34,502.50
Mar. 31, 1967	do	\$5,000	4,662.50	4,662.50
June 30, 1967	do	\$43,000	40,097.50	40,097.50
Sept. 30, 1967	do	\$15,000	13,987.50	13,987.50
Nov. 30, 1967	do	\$76,000	70,870.00	70,870.00
Mar. 31, 1968	do	\$12,000	11,190.00	11,190.00
Nov. 30, 1968	New York & Harlem RR. Co. 3½ percent gold mortgage bonds dated May 1, 1900, due May 1, 2000 (reduction of liabilities to New York & Harlem RR. A/C 769).	\$663,000	617,990.00	617,990.00

Sales and date	Description (including reason)	Number of shares or par value	Book value	Sale price	Profit or loss
By Penn Central Transportation Co. to Philadelphia, Baltimore & Washington:					
July 31, 1966	July 31, 1965 Penn Central Transportation Co. & St. Louis General Mortgage 3% percent serial "E", bonds (to Philadelphia, Baltimore, & Washington for sinking fund).	\$262,000	\$240,331.17	\$240,331.17	
Do	do	130,000	126,151.70	126,151.70	
July 31, 1967	do	133,000	113,692.50	113,692.50	
July 31, 1968	do	273,000	239,452.32	239,452.32	
July 31, 1969	do	289,000	240,667.50	240,667.50	
By Penn Central Transportation Co. to Pittsburg & Lake Erie:					
May 15, 1968	Comm. Credit Co. note due August 5, 1968.	\$25,000	24,328.12	24,328.12	
Do	Comm. Credit Co. note due December 2, 1968.	\$50,000	56,409.72	56,409.72	
Do	Ford Motor Co. note due, July 30, 1968.	\$200,000	487,683.25	487,683.25	
May 15, 1969	Ford Motor Co. note due, June 3, 1968.	\$200,000	199,366.67	199,366.67	
May 15, 1968	Ford Motor Co. note due, June 10, 1968.	\$25,000	24,560.76	24,560.76	
Do	do	\$25,000	24,312.50	24,312.50	
May 15, 1967	General Motors Acceptance Corp. note due December 2, 1968.	\$100,000	95,491.32	95,491.32	
By Penn Central Transportation Co. to United New Jersey RR. & Canal: June 16, 1966.	Philadelphia & Trenton RR. Co. common stock.	13 shares	2,496.00	2,496.00	
By Penn Central Transportation Co. to Washington Terminal Co.:					
November 30, 1966	Washington Terminal, 2% percent 1st mortgage bonds serial "A" due February 1, 1970 (sinking fund).	\$153,000	145,732.50	153,000.00	\$7,267.50
November 30, 1967	do	\$220,000	215,974.47	220,000.00	4,035.53
November 30, 1968	do	\$169,000	166,295.53	169,000.00	2,704.47
November 30, 1969	do	\$4,000	3,810.00	4,005.00	195.00
By Association of the Jersey Co. to Penn Central Transportation Co.: Apr. 15, 1970.	United New Jersey RR. & Canal Co. capital stock (dividend payments)	3,171 shares	581,086.90	581,086.90	
By Battle Creek & Sturgis Pennidel Co.: July 1, 1967.	U.S. Treasury bonds 4½ percent due Aug. 15, 1987-1992 (merged into Pennidel).	\$15,000	15,000.00	15,000.00	
By Cambria Land Co. to Manor Real Estate Co.: Sept. 1, 1969	U.S. Treasury bonds 2½ percent due June 15, 1967-1972 (merged into Manor Real Estate)	\$5,000	4,431.25	4,431.25	
Do	H.P. & H.A. callable note Dec. 6, 1965 due Jan. 1, 1971 (merged into Manor Real Estate).	\$3,416.25	3,416.25	3,416.25	
By Central Indiana Ry. to New York Central RR.: July 19, 1966.	General Electric Credit Corp. unsecured promissory note	\$50,000	48,648.78	48,648.78	
July 27, 1965	James Talcott Inc. unsecured promissory note	\$50,000	48,937.50	48,937.50	
By Cherry Tree & Dixonville RR. to Manor Real Estate: Apr. 5, 1966.	Commercial Credit Co. notes	\$15,000	14,817.19	14,817.19	



Sales and date	Description (including reason)	Number of shares or par value	Book value	Sale price	Profit or loss
By Clearfield Bituminous to Penn Central:					
Feb. 16, 1968	Ford Motor Credit Corp., note due June 30, 1968	\$500,000	\$487,682.29	\$487,682.29	
Do	Sears, Roebuck & Co., note due Apr. 1, 1968	\$100,000	99,375.00	99,375.00	
Mar. 7, 1968	New York & Harlem 3½ percent due May 1, 2000	\$12,000	11,190.00	11,190.00	
Mar. 8, 1968	New York Central collateral trust 6 percent due April 15, 1960 (sinking fund)	\$400,000	400,000.00	400,000.00	
May 24, 1968	New York & Harlem 3½ percent due May 1, 2000	\$663,000	617,990.00	617,990.00	
Feb. 27, 1969	New York Central collateral trust 6 percent due April 15, 1960 (sinking fund)	\$400,000	400,000.00	400,000.00	
Aug. 14, 1969	New York Central collateral trust 6 percent due April 1, 1980 (sinking fund)	\$422,000	395,787.50	395,787.50	
Feb. 26, 1970	New York Central collateral trust 6 percent due April 15, 1960 (sinking fund)	\$400,000	400,000.00	400,000.00	
Do	Mohawk & Malone 4 percent due Sept. 1, 1991	\$61,000	45,025.00	45,025.00	
Do	Big 4 percent due Nov. 1, 1990	\$21,000	18,345.38	18,345.38	
Mar. 3, 1970	Big 4 percent due June 1, 1993	\$39,000	29,656.38	29,656.38	
Sept. 30, 1966	New York & Harlem Co. 3½ percent gold mortgage bonds May 1, 1900 due May 1, 2000 (New York Central cash)	\$74,000	69,005.00	69,005.00	
Oct. 31, 1966	do	\$60,000	55,950.00	55,950.00	
By Cleveland Union Terminals to Penn Central Transportation Co.:					
Jan. 10, 1967	General Electric Credit Corp. note due Feb. 28, 1967	\$350,000	347,201.21	347,201.21	
Apr. 21, 1967	General Electric Credit Corp. note due May 3, 1967	\$50,000	49,912.50	49,912.50	
Do	General Electric Credit Corp. note due May 10, 1967	\$50,000	49,561.46	49,561.46	
Do	Ford Motor Co. note due June 9, 1967	\$50,000	49,643.71	49,643.71	
Do	Ford Motor Co. note due June 15, 1967	\$100,000	99,217.01	99,217.01	
Do	Ford Motor Co. note due Aug. 2, 1967	\$50,000	49,302.60	49,302.60	
By Connecting Ry. Co. to Penn Central Transportation Co.:	Zanesville Terminal RR. Co. stock (sold prior to merger of Zanesville into Pennidel)	1,500 shares	91,523.52	91,523.52	
By Mahoning Coal RR. to New York Central:	General Electric Credit 4½ percent note due Oct. 1, 1965	\$1,000,000	985,125.00	985,125.00	
May 28, 1965	General Motors Acceptance Corporation 4 percent note due July 1, 1965	600,000	597,662.50	597,662.40	
Do	do				
By Mahoning Coal RR. to Penn Central Transportation Co.:	U.S. of A. 4½ percent Treasury bonds due Feb. 15, 1974	50,000	50,000.00	44,656.25	(\$5,343.75)
Apr. 14, 1970	do	\$27,000	27,000.00	23,835.94	(3,164.06)
June 9, 1970	do				
By Manor Real Estate to Pennsylvania Co.:	Pennsylvania Co. 5½ percent collateral trust (connection with purchase of Wabash stock)	\$2,221,244	2,221,244.00	2,221,244.00	
Dec. 30, 1968	do				

By Manor Real estate to Pennsylvania RR.:				
Mar. 31, 1965.....	Pennsylvania RR. 3-1/2 percent bonds due May 1, 1985.....	\$1,515,000.00	1,515,000.00	
Dec. 15, 1965.....	Sheriff Land Co. note 6 percent due Oct. 25, 1968.....	35,000.02	35,000.02	
Do.....	Samuel Sudler & David Steiner note 6 percent due Oct. 28, 1969.....	32,916.88	32,916.88	
Aug. 15, 1966.....	U.S. Treasury note due 1970.....	396,750.00	396,750.00	
Aug. 16, 1966.....	Heching Enterprises Promissory note 6 percent due Oct. 1, 1980.....	216,890.96	216,890.96	
Do.....	National Ref. Term. note 5 percent due Mar. 1, 1979.....	183,455.75	183,455.75	
May 18, 1967.....	M. H. McCloskey note.....	3,098,262.30	3,098,262.30	
By United New Jersey RR. & Canal Co. to Association of the Philadelphia & Trenton RR. Co. stock (investment bought for Association of New Jersey RR. Apr. 15, 1970, and put on United New Jersey RR. & Canal Co. in error):		41,860.00	41,860.00	
By Wabash RR. Co. to Pennsylvania Co.: June 30, 1965.....	Detroit, Toledo & Ironton RR. Co. capital stock.....	4,782,209.50	10,425,670.00	5,643,460.50
By Western Allegheny RR. to Manor Real Estate: Aug. 1, 1969.....	Manor Real Estate Co.—mortgage Pittsburgh property (merged into Manor Real Estate).....	393,750.00	393,750.00	
By Michigan Central RR. to Penn Central Transport Co.: June 17, 1969.....	Battle Creek & Sturgis RR. Co. capital stock (sold prior to merger of these companies into Pennel).....	\$1.00	\$1.00	
July 21, 1969.....	Detroit, Toledo & Milwaukee RR. Co. capital stock (same as above).....	1.00	1.00	
Do.....	Lansing Manufacturing Co. capital stock (same as above).....	50,000.00	48,000.00	(2,000.00)
Do.....	Lansing Transit RR. Co. capital stock (same as above).....	1,000.00	1,000.00	
By New England Car Co. to Providence Produce Warehouse Co.: Mar. 31, 1970.....	New York, New Haven & Hartford RR. Co. 1st mortgage 4 percent bonds due July 1, 2007, (company dissolved—securities transferred to Providence Produce Wholesalers and recorded at \$2,662.50).....	10,698.90		
PCT Co. stock.....		3.00	3.00	
By Penn Central Holding to Penn Central Transportation Co.: Apr. 10, 1969.....	Ford Motor Co. note due June 3, 1968.....	199,175.00	199,175.00	
By Peoria & Eastern to Penn Central Transportation Co.: May 17, 1968.....	Rosslyn Connecting RR Co. stock (sold prior to merger Rosslyn connecting into Pennel Co.).....	1.00	100,000.00	99,999.00
By Philadelphia, Baltimore & Washington Penn Central Transportation Co.: June 17, 1969.....	Rosslyn Connecting RR Co. stock—subscription (Cancellation of subscription).....	201.25	201.25	
Dec. 31, 1965.....	for release of Penn Central Transportation Co. & St. Louis obligations to purchase Union Depot stock).....	162,701.25	162,701.25	
By Philadelphia, Baltimore & Washington to Union Depot Co.: Dec. 31, 1965.....	Tenneco Corp. 5-1/2 percent debentures (merged into Pennel Co.).....	76,005.00	76,005.00	
By Rosslyn Connecting RR to Pennel Co.: Dec. 1, 1969.....	Strick common stock.....	4,666,667.00	4,666,667.00	
By Strick Holding Co. to Penn Central Transportation Co.: Dec. 31, 1968.....				

## PENN CENTRAL SYSTEM—INTERCOMPANY SALES OF INVESTMENT SECURITIES FOR THE PERIOD JAN. 1, 1965, TO DEC. 31, 1969

Sold by	Sold to	Date	Description	Book value	Sales price	Profit or (loss)
Pittsburgh & Lake Erie RR. Co.	Despatch Shops	Nov. 1, 1967	Equipment certificates	\$3,739,489	\$3,739,489	0
Do	do	Apr. 1, 1968	do	3,105,000	3,105,000	0
Do	do	Aug. 5, 1968	do	4,050,000	4,050,000	0
Do	Penn Central Transportation Co.	December 1968	Promissory notes	378,000	378,000	0
Do	do	January 1969	do	1,350,000	1,350,000	0
Do	do	February 1969	do	1,100,000	1,100,000	0
Do	do	March 1969	do	1,000,000	1,000,000	0
Do	do	April 1969	do	2,000,000	2,000,000	0
Do	do	May 1969	do	600,000	600,000	0
Do	do	June 1969	do	1,500,000	1,500,000	0
Do	do	July 1969	do	1,000,000	1,000,000	0
Do	do	August 1969	do	500,000	500,000	0
Do	do	September 1969	do	2,000,000	2,000,000	0
Do	do	October 1969	do	500,000	500,000	0
Do	do	do	do	100,000	100,000	0
Lake Erie & Eastern RR. Co.	P. & L.E. RR. Co.	Aug. 10, 1969	do	165,000	165,000	0
Montour RR. Co.	P. & L.E. RR. Co.	February 1965	C.C.C. & St. L. Ry. 4½ percent bonds	71,429	71,429	0
Merchants Despatch Transportation Co.	New York Central	Feb. 6, 1967	Wabash RR. preferred stock, 50,940 shares at 81.	1,919,980	4,115,100	\$2,195,120
Pennsylvania Co.	Supplemental pension					
Do	Buckeye Pipe Line Co.	March 1967	Wabash RR. preferred stock, 3,000 shares at 80.	113,073	240,000	126,927
Do	Provident & Loan Association	August 1967	Wabash RR. preferred stock, 7,000 shares at 79.	263,837	550,900	287,063
Do	Manor Real Estate Co.	December 1968	Wabash RR. preferred stock, 30,428 shares at 73.	1,146,862	2,221,244	1,074,382
Do	Penn Central Transportation Co.	October 1967	PRR "F" bonds due Jan. 1, 1985	430,000	430,000	0
Do	do	September 1968	do	500,000	500,000	0
Do	do	October 1969	do	498,000	498,000	0
Do	do	December 1965	PRR "H" bonds due Apr. 1, 1988	33,000,000	33,000,000	0
Do	do	July 12, 1966	do	7,000,000	7,000,000	0

## INTERSTATE COMMERCE COMMISSION

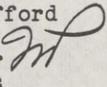
CONGLOMERATE MERGER  
STUDIES

- SPECIAL REVIEW OF RAILROAD CONGLOMERATES—Report from M. Paolo, Director, Bureau of Accounts, ICC, to Chairman Brown and Vice Chairman Stafford dated March 11, 1969.....
- CONGLOMERATE MERGER ACTIVITY—Memorandum from Bernard A. Gould, Director, Bureau of Enforcement, ICC, to Chairman Brown and Vice Chairman Stafford dated March 26, 1969.....
- CONGLOMERATE MERGER ACTIVITY OF CLASS I RAILROADS AND RELATED REGULATORY PROBLEMS—Report on Project #46 from Bureau of Economics, ICC, dated March 26, 1969.....
- CONGLOMERATE MERGERS—Memorandum from Robert W. Ginnane, General Counsel, Office of the General Counsel, ICC, to Chairman Brown dated March 28, 1969.....

INTERSTATE COMMERCE COMMISSION  
WASHINGTON, D. C. 20423

March 11, 1969

TO : Chairman Brown  
Vice Chairman Stafford

FROM : M. Paolo, Director   
Bureau of Accounts

SUBJECT: Special Review of Railroad Conglomerates

I. PURPOSE AND SCOPE

This report is the result of the Bureau of Accounts' special review of railroad holding company activity, consistent with the staff's previously expressed concern about the current trend toward regulated carriers' involvement in conglomerate formations. Our objective was to identify the real and potential effects, both beneficial and adverse, of such holding company activity on regulated carriers.

The audit program designed specially for this assignment enabled us to perform this review in a manner consistent with generally accepted auditing standards and within the framework of regulations of the Commission; however, because of staff and time limitations this examination did not include all the procedures usually employed in our regular examination of railroads' accounts and related records.

Conclusions of this report derive primarily from information obtained or extrapolated from intercompany transactions between the carrier and its associated and affiliated companies, including its respective holding company. Special effort was made to explore the significance of several areas of basic concern, such as:

- ... Whether irregular activities have been or could be effected through conglomerate transactions.
- ... Whether conglomerate activity does or could affect carrier ability to perform reasonable and adequate service.
- ... Whether carrier resources have been or could be transferred to noncarrier companies, either within or outside the conglomerate structure.

Thirteen railroad holding companies (identified in Attachment 1) are currently engaged in conglomerate corporate activity. The following were selected for current review on the basis that they would provide the most representative results:

Bangor Punta  
 Illinois Central Industries  
 Kansas City Southern Industries  
 Katy Industries  
 Northwest Industries

Our survey of Katy Industries, however, was curtailed upon indication of very limited diversified corporate activity since its formation.

As previously indicated, the scope limitations under which this examination was necessarily conducted precluded comprehensive or conclusive resolution of all issues and matters which exposed themselves to us. Accordingly, we are obliged to note that this report may be supplemented as a result of our continuing examination of certain areas which remain of concern to us. Moreover, we are contemplating extending our review of conglomerate activity to other transportation modes under our jurisdiction.

## II. CONCLUSIONS

The transfer of railroad ownership to holding companies formed to engage in diversified activities is relatively new, having principally occurred during the past few years. The practice has taken hold and from all indications will continue to pyramid as evidenced by the current plans of Penn Central, Southern Pacific, Union Pacific, and others.

The serious financial manipulations set forth in this memorandum, whereby assets and earnings of railroads are being dissipated to noncarrier companies in the group, are definite indications of what may be expected in the future--all of which are detrimental to the carriers and hence to the national transportation needs of the public and national defense.

We recognize there are many railroad officials who contend that corporate diversification is the answer to their financial problems. The results of the staff's audit, although limited, indicate that one of the shining examples of benefits of corporate conglomerate arrangements may be slightly overstated.

Bangor Punta group has often been cited by those in favor of railroad diversified holding companies as an example of the railroad receiving benefits from a holding company relationship. The claims were based on the premise that Bangor & Aroostook Railroad service is better because of the capital available for its activities from Bangor Punta, which would not ordinarily be available to the Railroad. This allegedly resulted in an overall improved financial condition of the Railroad.

Our review disclosed the contrary. The Railroad has been contributing funds to the holding company by payment of special

dividends; lending funds at rates below prevailing interest rates; helping to maintain Punta's cash working capital requirements; using Railroad's credit; and by borrowing funds at local banks to pass on to the holding company.

Regardless of all the glowing self-serving statements made in current merger proceedings, our belief is that when circumstances warrant, these managements will involve the railroads in similar transactions. For certainly, holding company managements, in addition to their own strong self-interests will owe their allegiance to the stockholders of the holding company and not to the railroad or any individual part of the conglomerate.

While the Commission's regulatory authority, as now embraced in the Act and related statutes, may not be broad enough to eliminate all possible abuses that may result in railroad conglomerate activities, we believe the Commission should immediately exercise all of its available power to stop abuses before the carriers' assets are dissipated.

III. RECOMMENDATIONS

1. Railway systems are made up of two or more carriers, some operating independently of each other. Therefore, it is strongly recommended that the Commission take another look at its position that in the acquisition of a railroad system a holding company is not construed to be a carrier under the terms of Section 5 of the Act.

If the Commission can legally decide that "systems" are not a single carrier, but two or more, we recommend that all such cases be reopened and the respective holding companies be declared "carriers" and made subject to Sections 20(1) through (10) and Section 20a(2) through (11). Under the provisions of the Act, the Commission's order could restrict the approval of the issuance of securities under Section 20(a) to only those relating to the acquisition of railroad assets or where railroad assets are to be used as collateral. We do not recommend that the Commission assume responsibility of passing on all security issues by holding companies.

If it is determined that carrier systems are legally construed to be one carrier under the provisions of Section 5 of the Act, then we recommend that the Commission strongly endorse H.R. 7373. This bill introduced by Representative Staggers is to amend Section 5(2) of the Act to provide that a person who is not a carrier may acquire control of a carrier only with the approval and authorization of the Interstate Commerce Commission. The enactment of this legislation would negate the question of whether a system is one or more carriers. In this event, we would recommend certain modifications of Staggers' bill to give the Commission

authority to place certain limitations so that we could limit this to corporations which are acquiring a carrier, size of carriers, etc.

2. If and when holding companies are found to be "carriers", we recommend that the Commission's order provide that all transactions between the railroad and other affiliated company members of the conglomerate must first be approved by the Commission as being in the public interest. This embraces, among other things, the payment of dividends, use of railroad tax losses in consolidated returns, and sales and exchanges of assets.

3. Require certification by independent accountants that certain schedules pertaining to the reporting of financial information and transactions with affiliated companies in the annual report of carriers are in accordance with rules and regulations of the Commission.

4. Immediately, as a stopgap in inspection authority by Commission auditors, we recommend that the Director of the Bureau of Accounts be granted authority for inspection of affiliated companies' records under provision of Section 20(5) of the Act, and that holding companies now subject to Section 20(1) and (2) also be made subject to Section 20(5) of the Act.

5. Design an annual report for holding companies which will enable surveillance of questionable practices and corrective action.

6. Revise carrier annual reports to provide reporting requirements for:

- a. Consolidated Federal income tax data, particularly the basis and extent of allocation between members of a group.

- b. Reconciliation schedule explaining differences between net income recorded in the books and in the Federal income tax return.
- c. Nature, extent and payments for management services provided by affiliates.
- d. Allocations of common costs between members of group.
- e. Details permitting evaluation of effectiveness and independence of pension fund managers.
- f. Detail information of exchange or transfer of assets between carrier and affiliates.
- g. Detail of leasing arrangements with affiliates.

7. Lastly, we recommend that staff be set up to review annual and quarterly reports of railroads and others involved in holding company relationships to see whether they continue to maintain plant and equipment, review transactions with affiliates, etc.

#### IV. SUMMARY OF QUESTIONABLE PRACTICES

The review of railroad holding companies disclosed a number of questionable practices including:

1. Intercompany dividends detrimental to financial welfare of railroad.
  - a. Railroad required to pay dividend of common stock of its subsidiary consisting primarily of real estate and marketable securities which had a book cost of \$20 million and an appraisal value of \$45 million.
  - b. Holding company liquidated loans to the extent of about \$900,000 by requiring railroad to declare special dividends.
  - c. Holding company lent cash to railroad to pay dividends to holding company.
  - d. Holding company exercises control over railroad dividends to maintain its (holding company) dividend policy.
2. Sales of carrier real estate (\$65 million in past nine years) for the purpose of generating cash and profits necessary to establish a holding company and maintenance of the holding company's dividend policy.
3. Intercompany sales and transfers of railroad assets without adequate compensation to railroad, such as sales of air rights, sales and transfers of real estate and transfers of marketable securities at less than their appraised or market value.
4. No reimbursements by the holding company or affiliates in consolidated tax returns for use of carrier tax benefits resulting from accelerated depreciation methods, investment tax credits and net operating losses. However, one carrier has been required to pay holding company about \$1.4 million for holding company loss contributions on a consolidated tax return, including a year in which no tax was actually paid.

5. Intercompany leasing arrangements whereby carrier is required to finance the property to be leased, pay rental charges in excess of authorized depreciation plus a profit and rental charges in advance. This results in a carrier paying considerably more than if the property were owned and yet the carrier enjoys none of the benefits available in a normal lease arrangement such as conservation of capital.

6. Advances were made by railroad to holding companies and affiliates at no interest cost or at rates below market.

7. Use of railroad's credit by holding company without adequate compensation.

8. Officers and administrative salaries and expenses applicable to the holding company have been included as a cost of railroad operations. Arbitrary management services have been billed by a holding company to its railroad subsidiary.

9. Insufficient details in carrier records to support intercompany transactions, such as leasing, management services and transfers of assets.

10. Access to records was limited - staff was unable to review noncarrier records.

11. Diversion of carrier resources without just compensation has an adverse impact on minority stockholders.

V. DETAILS OF QUESTIONABLE PRACTICES

The questionable practices developed as a result of our review, which are shown by company on Attachment 2, are described below.

1. Dividend practices

A. Transfer of railroad subsidiary to holding company as a dividend

A rather complicated plan was devised by Kansas City Southern Industries where the carrier's assets were diverted to the benefit of the holding company and non-carrier activities without reasonable compensation to the carrier. This was accomplished by means of a dividend paid to Industries in the form of capital stock of North Baton Rouge Development Company, a fully-owned subsidiary of the Louisiana & Arkansas Railroad Company, which is a wholly-owned subsidiary of the Kansas City Southern Railway. North Baton Rouge Development Company was a real estate company with assets that had an appraisal value considerably in excess of the cost recorded on its books. There were many transactions exchanging stock between the companies. The result of these transactions was that Industries took from the carrier net assets with a book cost of \$20,600,000 and with an appraisal value of \$45,400,000. Industries, therefore, took as dividends assets with an appraisal value of some \$25 million in excess of amounts recorded.

By this device a holding company can require the carrier to make all of its investments and when assets appreciate, the benefits are taken by the holding company.

Included in the above transaction, the carriers or their subsidiaries transferred to North Baton Rouge Development at

cost securities which had substantial market appreciation. To cite an example, Landa Motor Lines, which owned about 42,000 shares of Philadelphia and Reading Corporation preferred stock, which had a market value of \$3 million, transferred this ultimately in settlement of an indebtedness of about \$360,000. This was received by Industries when it received the stock of Baton Rouge as a dividend from Kansas City Southern Railway.

In addition, Kansas City Southern Railway transferred 50 shares of Railway Communications Company stock with an undetermined market value, but with a book value of \$12,500, for shares of North Baton Rouge Development Company which were subsequently passed up to the holding company as a dividend. Railway Communications Company stock, commonly controlled by Kansas City Southern and other companies, was a good income producing stock. It had paid about \$190,000 in dividends for the years 1964 through 1966, paying \$75,000 in 1965 and 1966. Industries was acquiring a stock that was paying an annual dividend equal to about six times the amount assigned to the dividend it received, which was stated at book cost of \$12,500.

Also involved in the transaction was Tolmak, Inc., a wholly-owned subsidiary of Louisiana & Arkansas Railway. It transferred its capital stock in exchange for the amount which North Baton Rouge Development Company owed to its parent, Louisiana & Arkansas. On the surface, there is no book gain or loss because of this transaction, however, the appraisal value of the assets transferred to Tolmak was about \$200,000 in excess of the cost of the assets. The effect of this transaction reduced the difference

between the book cost and market value of the assets ultimately transferred to Industries by \$800,000. If this transaction had not been consummated, Industries would have received an additional \$800,000 of assets in excess of cost.

At the present time, it seems that Tolmak is a current candidate for a transaction similar to North Baton Rouge, namely a transfer of its stock in the form of a dividend to the holding company.

Again, it can be seen that by using a dividend as a vehicle, assets which have a much higher market value can be distributed to the holding company without any compensation to the Railroad. On the surface, it appears that the carrier has paid a dividend in terms stated at book cost which really understates the true value of the dividend. This results in Railroad's resources being diverted to holding company purposes instead of being used in the development of its own transportation system.

B. Special dividends to pay holding company's loan

The Bangor Punta group formulated a plan in 1966 to liquidate loans from the Railroad of \$1,187,700 by requiring the carrier to pay special dividends. Dividends paid to Bangor Punta in 1966 and 1967 for this purpose aggregated \$886,680. Payment was made possible by requiring the Bangor Investment Company, a subsidiary of the Railroad, to pay a special dividend to the Railroad in 1967 of \$585,700, representing a note for amounts lent the holding company. Using dividends as a vehicle, most of the loans were liquidated on the books of the holding company (although minority stockholders of the Railroad did receive about

\$12,000 dividends). The Bangor group also planned to have the Railroad declare another special dividend in 1968 which would have eliminated all loans payable to the Railroad, but because of bond indenture restrictions concerning the level of retained income this special dividend could not be declared. Further, because of special dividends in 1966 and 1967 the usual dividend was not paid in 1968. Such dividend policies may contribute adversely to the carrier's borrowing capability.

The above demonstrates a holding company's ability of achieving its financial goals by controlling dividend policies and practices of a carrier. The holding company had obtained these loans from the carrier and by the creation of a special dividend in the years 1966 and 1967 it was able to reduce these loans without any cash requirements on its part. The holding company was also able to reduce its annual interest costs by \$56,000. The impact of the payment of these dividends on the carrier was to weaken its financial position.

This may have an impact on future dividends; for example, if the railroad is not profitable in the future no more dividends could be declared because of certain bondholders' restrictions. The minority stockholders may have received irreparable damage in spite of the special dividends they received because of the impact on future dividends.

C. Holding company lends subsidiary cash to pay itself a dividend

Illinois Central Industries. When Illinois Central Industries was formed as a holding company, an agreement was entered into between Illinois Central Railroad

and Industries requiring Industries to pass on all dividends received from the railroad to the stockholder of Industries on a dollar-for-dollar basis. Industries wanted to increase or maintain its retained income balances but was unable to accumulate any earnings from Illinois Central because of the dividend agreement. It then became necessary for Industries to obtain sufficient income to offset its expenses for the year. This apparently was accomplished in part by advancing \$600,000 to Chicago & Illinois Western Railroad Company, a wholly-owned subsidiary, to enable that company to pay an \$800,000 dividend to Industries in December of 1967. This transaction resulted in Industries depleting the Railroad's retained income, which was about \$803,000 prior to this dividend. The State of Illinois is currently investigating the transaction and may well require Industries to return the dividend due to the financial impact on the carrier.

The practice of advancing funds with which to pay dividends is reminiscent of the abuses uncovered by the Federal Trade Commission in its investigations of the public utility holding companies during the 1930's, although the public utility holding company used the appraisal method as a device to increase its plant accounts, which also increased its retained income and then required its subsidiaries to pay special dividends or increased dividends to the holding company. One of the problems encountered was that the subsidiary companies usually did not have sufficient funds to pay the dividend. The holding company was usually able to circumvent this problem by lending the companies money in the form of notes and then discounting the notes at some financial institution. This practice of

advancing funds to increase the earnings of the holding company is an artificial financial device and one which the Commission must cope with in order to prevent future similar transactions.

D. Control over dividend policies by holding company

The control over dividend practices of the carrier is the stated policy of Northwest Industries. It provides management with the directive to increase the dividends of any of its companies if such becomes necessary to maintain the policy.

The policy was initially established by the Railroad in 1964, about the same time it commenced converting excess real estate into cash. Subsequently Industries was formed and the Chicago & Northwestern Railway Company was used as a springboard to jump off into the conglomerate area. Without the sales of Railroad real estate, certainly the amount of dividends would be considerably less than Industries would be receiving from Railroad, possibly curtailing its capability to enter into other acquisitions.

2. Sales of carrier real estate

As previously commented in the dividend section of the report, Chicago and Northwestern Railway Company has a plan to dispose of all of its real estate holdings not currently used in carrier operations. This policy seems to be a short-term goal in which the Railroad will maintain, by sales of profitable real estate holdings, Northwest Industries earnings. Also, it will provide Industries with funds with which to make additional acquisitions.

The following statement is contained on page 15 of the Chicago and Northwestern Railway Company annual report to stockholders for the year 1967:

"Real estate sales by the railway totaled \$7,332,000 and resulted in a net gain of \$5,840,000 credited to income, of which \$3,331,000 is included in extraordinary items. During the last nine years real estate sales have totaled \$65,558,000. It is anticipated that 1968 sales will continue at the current level."

The effect of these transactions has not been fully developed during our review. However, a further investigation of this policy and its impact on the future financial status of the carrier will be made. One wonders whether these sales of assets would be made if the carrier were not a member of the holding company and were not attempting to maintain a high dividend policy.

Essentially, these sales and the passing of profits to Industries have an adverse financial impact on the carrier. The Railroad is losing these resources which should be used in furthering its transportation goals. Further, if after selling off these valuable assets the carrier was then divested from Industries, which could possibly be at some future date when the carrier contributes a smaller portion to Industries' overall income, these resources would not be available to develop its transportation system.

3. Intercompany sales and transfers of railroad assets

A. Sale of air rights

A questionable item which requires further investigation is the arrangement between Illinois Center Corporation, now a subsidiary of Illinois Central Industries,

and Illinois Central Railroad Company whereby Center acquired an option for \$300,000 to purchase certain air rights in downtown Chicago for about \$7.6 million.

At the time of the agreement, about 1965, Center was allegedly not controlled by Illinois Central Industries. However, during 1968 Industries obtained control of Center through Mid-American Improvement Corporation, a wholly-owned subsidiary of Industries formed expressly for this purpose.

There are negotiations in progress for the sale of these air rights to Standard Oil Company of Indiana for about \$12 million. By agreement with Industries, Railroad will only receive what it would have received if Center had exercised its option, about \$7.6 million. The balance of \$4.5 million would then be passed on to a noncarrier member of the group.

This transaction may either be the result of initial poor judgment by the Illinois Central Railroad's management in 1965 when they sold this option for the air rights, or it may be this is another corporate device used to divest the carrier of profitable assets without full compensation.

#### B. Intercompany transfers of assets

Transactions previously commented on in the dividend section of this report also involve the improper disposition of assets. The intercompany transfers were made at less than the fair market value of these assets which were later distributed to the holding company in the form of dividends. The transfer of North Baton Rouge Development Company in the form of a dividend to the holding company, Kansas City Southern Industries, illustrates two problems; (1) the transfer between companies of marketable securities

at their book cost rather than at their market value, and (2) the transfer of assets such as land and properties at their book cost rather than their appraisal value.

This in effect understates the contribution that the carrier makes to the holding company when these are labeled as dividends. Further, future profits can be manipulated within the group by merely transferring an asset with an appreciated market value to one company within the group at cost prior to selling it to outsiders. The profit potential then has been effectively transferred from the company which should have been entitled to such profit to some other member of the group.

There is certainly opportunity for managing current as well as future earnings between members of the group by such transfers and if the objective is to misstate earnings of the carrier, we have seen evidence that this can be accomplished.

#### 4. Consolidated Federal income taxes

Three of the holding companies examined indicated policies regarding allocation of consolidated tax liability among associated and affiliated companies which worked to the distinct disadvantage of the railroad carriers.

The Bangor Punta group has not paid any tax through September 30, 1967 (fiscal year). However, there will be a tax liability for the group for the year ending September 30, 1968. Substantial investment tax credits of \$1.5 million and tax operating losses of \$1.9 million (primarily because of using liberalized depreciation methods) have been contributed by Bangor & Aroostook Railroad Company and its subsidiaries. These operating

losses and investment tax credits have been used by the Bangor group without reimbursement to the carrier for its contribution.

Management of Bangor has not established guidelines as to whether it will reimburse the carrier for the carrier's contribution to the reduction of the overall group taxes, but we understand it is in the process of establishing a future policy for allocation of taxes between the various members of the group.

The policy of Chicago and Northwestern Railway is one where the railroad receives no compensation for its tax benefits used in the consolidated return. There is an intercompany agreement between the Railroad and Michigan Chemical Company that the minority interest portion of such tax loss contributed by the Railroad which results in a lower income tax to Michigan Chemical Company will be paid to the Railroad.

To summarize, Chicago and Northwest policy is not a two-way street--when the Railroad contributes losses to the companies within the group it receives nothing, but when it contributes losses to the benefit of outsiders, namely the minority stockholders of Michigan Chemical Company, the carrier receives payment for such benefits.

Aggravating the Chicago and Northwestern Railway inequity was the fact that the net losses after 1966 were increased for the benefit of other associated companies within its group. The carrier commenced using rapid depreciation in 1967. If the carrier were not a member of a holding company group, it would not use these additional tax depreciation charges until it was in a profitable

position. The primary reason for the use of accelerated depreciation was to offset the profit of the chemical companies in the group. No benefits were received by the Railroad for these tax contributions.

The use of rapid depreciation in filing Federal income tax returns and use of investment tax credits will certainly reduce future tax benefits that the carrier would have received if these were not used on a consolidated return, and may possibly result in higher future costs when the carrier becomes a profitable company.

A variation of this inequity was demonstrated by Illinois Central Industries in its dealings with Illinois Central Railroad. The holding company charges the carrier in excess of the consolidated Federal income tax liability. Illinois Central Industries thereby took into income from 1963 through September 30, 1968, about \$1.4 million more than its actual consolidated tax requirements. The payments were primarily made by Illinois Central Railroad. This was based on amounts which Railroad would have had to pay if filing a separate return. Further, in the year 1966 there was no tax paid by Illinois Central Industries, however, Illinois Central Railroad was required to pay about \$150,000 for Federal income taxes.

The staff has been concerned with these matters for some time and is currently working toward the development of appropriate rules or interpretations which would set forth proper accounting for Federal income taxes by a carrier participating with affiliated companies in a consolidated return. It appears timely here, however, to note the inequities stemming from (1) the uncompensated exhaustion

of a carrier's contingent assets (net operating loss deductions, aggravated, in at least one instance, by deliberately accelerated depreciation; unused investment tax credits, etc.) by its associated companies within a group, or (2) the arbitrary assessment on profitable carriers, of charges in lieu of income taxes when, in fact, a lesser consolidated tax is actually paid.

#### 5. Leasing activities

There were no substantial leasing problems encountered, except at the Kansas City Southern group.

Carland, Inc., was formed by Industries to lease equipment of all kinds to members of the group.

The leases provide for advance rentals which provided Carland with downpayments to purchase the equipment. The financing is guaranteed by the railroads. The rental charges include depreciation charges based on a shorter life than a normal service life, which results in the railroad paying higher amounts than if it owned the equipment. The rentals include an element of profit since the equipment is rented on a cost plus basis. The staff was unable to determine the reasonableness of the charges because of denial of access to their records. However, it is reasonable to assume that the charges to operations, because of these arrangements, will substantially exceed the costs if purchased by the carrier.

In addition to the above provisions, the leases may be cancelled at the end of the first term of the lease and the equipment, such as freight cards and work equipment, transferred to another affiliated company and then leased again to the carriers at their market value. This

provides further opportunity for profits which result in additional costs to the carrier because the carrier had already paid for the cost of the equipment under the original lease.

Bids were advertised for lease of equipment. Due to the numerous types and kinds of properties, such as small tools and minor equipment, it would be practically impossible to find prospective lessors adequately equipped to supply such items. This may have been the objective in this type of lease arrangement involving multiplicity of items.

It is hard to imagine what benefits, if any, accrue to the carrier in this leasing arrangement. The carrier's resources are being used to provide the downpayment, pay rentals in advance, and to guarantee the financing. We can only surmise that this results in the carrier paying considerably more than if the equipment were owned, thereby passing on profits to another member within the holding company. And, this results in higher costs to the public.

(Left blank intentionally)

6. Advances by railroad at no interest cost or at rates below market

The Bangor Punta group has had the benefit of Railroad's cash in meeting requirements of certain banks in maintaining minimum balances. Prior to the Railroad's joining the holding company group, the excess cash was invested in short-term investments, but since joining the group these investments have essentially all been sold. Bangor Punta and the Railroad have entered into an agreement whereby the Railroad will deposit funds in certain banks to meet the holding company cash commitments. The holding company has agreed to pay Railroad 3% per annum on amounts of banks balances required by the holding company which are in excess of the Railroad's normal balances.

The financial impact of the above arrangement is that the holding company, in effect, is borrowing money from the Railroad at 3% per annum which is substantially below today's prevailing interest rates. This is another instance where the holding company is operating the carrier for the benefit of the holding company, and certainly not in the interest of the carrier and the public.

Louisiana & Arkansas Railway, wholly-owned subsidiary of Kansas City Southern Railway, entered into an arrangement whereby it committed itself to advancements of \$6 million to North Baton Rouge Development Company and \$4 million to Landa Motor Lines, both wholly-owned subsidiaries of L & A. These commitments were primarily made so its subsidiaries would have a readily available source of funds in order to take advantage of opportunities in connection with further investments in securities and real estate. The funds were committed to the

companies at no interest cost. Now that North Baton Rouge Development Company has been transferred from Louisiana & Arkansas to Kansas City Southern Industries, this does not constitute a proper use of Railroad funds and is not in the financial interests of the carrier to be supplying funds to a non-carrier subsidiary of Industries at no interest cost.

A further inequity to the carrier is manifest in the transfer of the securities thus obtained to Industries at book cost without compensation for market appreciation being passed on to the carrier. This same procedure was followed with respect to preferred stock of the Philadelphia and Reading Corporation which was transferred by Landa Motor Lines, a certificated motor carrier, to Industries at book cost although the stock had considerable market appreciation.

The above transaction demonstrates the holding company's ability to use carrier funds to invest in nonrelated activities and upon market appreciation of the assets transfer these assets to the holding company at cost without any benefits of market appreciation passed on to the carrier.

Southern Enterprises, Inc., a wholly-owned subsidiary of Industries, has received advances of several millions of dollars from Louisiana & Arkansas at various interest rates which, at times, were considerably below prevailing interest rates.

#### 7. Use of carrier's credit

There were several other instances not previously mentioned elsewhere in this report, where the holding company is using the carrier's credit. For example, Louisiana & Arkansas' former subsidiary, North Baton Rouge Development Company (now a subsidiary of Kansas City Southern Industries)

is leasing equipment from Carland, also a subsidiary of Industries. Carland borrows 60% of purchase price, assigns the lease and rental payments as security for the loan, and Louisiana & Arkansas guarantees payment of such rental.

Carthage Cablevision, Inc., controlled by Kansas City Southern Industries, operates a TV station at Carthage, Missouri. The station was financed by Southern Development, a subsidiary of Industries, through a loan of \$360,000 obtained from a local bank. The bank agreed not to record the mortgage provided that Kansas City Southern Railroad Company would guarantee to repurchase this property if Southern were in default.

Bangor Punta operates a central cash control for all of its subsidiaries, except the Railroad. The subsidiaries deposit funds in local banks which are subsequently transferred to a central bank controlled by the holding company. Subsidiaries request funds for payments and transfers are made, directed by the holding company, to meet their needs.

The holding company frequently requires the railroad to advance funds when the cash requirements of the group are low.

The railroad may even be required to borrow money to meet these demands of Industries. For example, in 1968 two transactions occurred which involved short-term loans of from 30 to 45 days to the holding company from the railroad. The loans involved \$2,200,000, of which \$1,500,000 was borrowed from local banks. Although the railroads were adequately compensated for interest on these loans, the use of carrier's credit is wholly for the benefit of the holding company and may have a detrimental effect on the carrier's financial status.

8. Allocation of expenses

Officers' and administrative salaries and expenses

The staff encountered problems in the allocation of officers' and administrative salaries and expenses in all companies reviewed. There were generally no allocations of officers' salaries or any administrative costs to the holding company. These services were performed at no cost to the holding company.

Bangor Punta attempted to allocate certain costs for some officers' salaries and administrative costs which were billed by the Railroad.

Bangor Punta charged the Railroad \$588,000 for management, accounting and audit services, for the period from October 1, 1964, through September 1967. The annual charge for these services for the year 1967 was \$240,000. These payments for management services were stopped on September 3, 1967. The company has not been able to provide any of the details for the previous billings for management services or even the basis for discontinuing these charges.

The Railroad received its first bill of \$9,700 for audit fees from Peat, Marwick, Mitchell & Co., independent accountants for the Bangor group, directly for its accounting services for full year 1967. This may possibly indicate that the Railroad was paying excessive amounts of about \$230,000 a year to the Bangor group, unless we assume Bangor Punta is now providing these services at no cost to the carrier. Further investigation will be made of these transactions.

There certainly is great opportunity for the holding company to charge its subsidiaries for any type of management services based on any price it wishes. The above demonstrates

an arbitrary billing from the Bangor group to the carrier amounting to about \$240,000 a year for 1967, where there has been no support other than a statement for such expenses from the chief accounting officer of the carrier.

Illinois Central Industries was able to conduct its operations without the burden of paying any officers' salaries or any administrative salaries, rental charges for use of office facilities or without the payment for any legal staff or payment of any legal retainer fees, because they were all supplied free by the Illinois Central Railroad. This is a very convenient way to operate a holding company at the Railroad's expense. Officers of the Railroad have stated that as Industries grows and acquires new companies there will be separation between Industries and the Railroad, including separation of expenses among the group.

Because of the denial of access to the records of Kansas City Southern Industries the staff was not able to draw any conclusions on the propriety of allocations of these expenses. The records of the Railroad indicate no salaries had been allocated to Industries. This seems to be another case where the holding company was able to operate without any administrative costs, as all costs were assumed by the carrier.

Initially, Northwest Industries was reluctant to allow the staff to review the records of the holding company and we are unable to ascertain at this time to what degree Industries is using the talents and facilities of the carrier without compensation. However, on the transactions that were reviewed it appears that Railroad is being compensated for items, even such small items as the use of carrier's medical supplies for

physical examinations of chemical company employees and for the use of the Railroad's computer facilities and other facilities.

9. Adequacy of records detailing transactions between companies

In many instances there were insufficient documents in carrier records supporting intercompany transactions for such items as management services, leasing arrangements and the transfer of assets and securities. At the moment we have not taken steps to insist on compliance with General Instruction 1-3 of the Commission's prescribed uniform system of accounts which reads as follows:

"Each carrier shall keep its books of account, and all other books, records and memoranda which support the entries in such books of account so as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit ready identification, analysis, and verification of all facts relevant thereto."

In some instances staff auditors were granted access to holding company records to secure the necessary detail to support intercompany transaction. Nevertheless, our rules require that adequate data to support all entries be maintained by the carrier.

10. Access to records

The term "records" as used herein is not limited in a technical sense to the accounting records, but to all other records, such as corporate minutes, bylaws of the corporation, capital stock records, reports to or filings with Governmental agencies, correspondence files, contracts and other documents necessary to develop the history of the facts regarding any transaction entered into by the company or companies under review.

The primary problem encountered with access to records occurred at Kansas City Southern Industries. All holding company records were refused other than a copy of the annual report to the stockholders. The staff was denied access to such important records as consolidated Federal income tax data and the records supporting the cost of affiliated companies' properties leased to the carriers on a cost plus basis. Further, the staff was even denied access to the general ledger of a former wholly-owned subsidiary of the Louisiana & Arkansas Railway Company because the carrier had transferred the subsidiary through the medium of a dividend to the holding company. The company denied the staff access to that general ledger because it contained information after it became solely owned by the holding company.

Northwest Industries, Inc., initially denied the staff records for the holding company and its noncarrier affiliates but subsequently permitted the staff access to all of its records. This change in attitude occurred, incidentally, after petition by B. F. Goodrich to the Commission to block its acquisition by Northwest Industries.

The auditors' free access to records of carrier companies is well defined in the Interstate Commerce Act. In connection with authority to examine records of noncarrier affiliates, Section 20(5) states in part as follows:

"The Commission or any duly authorized special agent, accountant, or examiner thereof shall at all times have authority to inspect and copy any and all accounts, books, records, memoranda, correspondence, and other documents, of such carriers, lessors, and associations, and such accounts, books, records, memoranda, correspondence, and other documents, of any person controlling, controlled by, or under common control with any such carrier, as the Commission deems relevant to such person's relation to or transactions with such carrier."

This differs from the direct unqualified authority granted the staff in this section to examine carrier accounts and records. Without free access to records, the staff is limited in the scope of its examination and the verification of transactions, particularly between the various companies in the group.

Our auditors for the purpose of this exploratory examination were instructed not to insist on or demand holding company records. Although in most instances free access was granted to the staff's request for holding company corporate records, it does not necessarily follow that in the future such requests will be granted.

11. Impact on minority stockholders

There is an impact on minority stockholders when a carrier's resources are diverted without just compensation. Kansas City Southern Railroad Company minority stockholders own about 8% of its outstanding common stock. When the common stock of North Baton Rouge Development Company was passed along to Kansas City Southern Industries (which owned 92% of Railroad) the stockholders of the Railroad gave up assets worth about \$25 million of unrealized market appreciation.

Commencing in April 1967, Louisiana & Arkansas Railway Company accelerated its purchases of Kansas City Southern Railway Company common stock from the minority stockholders at a price twice as much as the price quoted for Kansas City Southern Industries. (This was based on the exchange rate of 2 shares of KCSI common stock for each share of KCSRy common stock.) It appears that this was being done while the officers and directors had knowledge that the North Baton Rouge stock would be issued to stockholders, but prior to their notification. These purchases also continued after the stock dividend

of North Baton Rouge, but Louisiana and Arkansas Railway Company paid only for the Kansas City Southern Railway stock and asked the stockholders to throw in the North Baton Rouge stock at no value as a package deal. This was done in most instances.

Further, the annual report to stockholders did not inform the minority stockholders as to the value of the North Baton Rouge Development Company stock. Computed on the basis of shareholders equity as of July 31, 1967, each share is valued at \$20.16 and by using the appraised or market value of the assets the value would be \$44.53 per share. On this basis, the minority stockholders are selling their stock to the railroad at what would appear to be far below its actual value, certainly considerably below the assigned value of \$100 a share, the basis used for intercompany transfers.

The 1967 annual reports to stockholders of the Kansas City Southern Industries and the Kansas City Southern Railway made on a consolidated basis December 31, 1967, give the impression that items such as the profit of \$1,435,000 realized from the sale of Ransburg Electro-Coating Corporation common stock is applicable to these companies. However, this stock was owned by North Baton Rouge Development Company; therefore, the profit realized on the sale of this stock was wholly applicable to the outstanding shares of North Baton Rouge.

In January 1969, the Louisiana and Arkansas Railway Company made a direct purchase from Kansas City Southern minority stockholders of North Baton Rouge Development Company common stock at \$10.75 per share. It has not been determined as to how that value was established.

In conclusion it appears, as the facts indicate, the officers and directors are taking advantage of the minority

stockholders through the purchase of their stock by the Louisiana and Arkansas Railway Company without fully informing them of the value of the North Baton Rouge Development Company as a separate entity.

12. Other questionable practices

A. Management diversification services

Bangor Punta group has entered into agreement with Katy group to provide advice on a program of business diversification. Bangor has obtained options to purchase \$2.4 million of shares of Katy's common stock which when issued will be equal to about 10% of outstanding common stock.

The above agreement may possibly indicate Katy management did not believe it had the expertise to undertake such a diversification program. One of the problems advocated by opponents of diversification programs by railroads was the concern that railroad management, although expert in the transportation industry, could encounter considerable difficulty in non-transportation activities resulting in serious financial problems for the group and with serious permanent, adverse financial effect on the railroad.

It is interesting to note that the Bangor group is not pleased with the recent acquisitions made by Katy over their objections and Bangor is now consideration severing any further relations with Katy because of these acquisitions and the adverse effect on the company.

B. Security transactions

Illinois Central Industries acquired about \$8 million of stock of Gulf, Mobile & Ohio Railroad during 1967. A large block of this stock was sold to the railroad in December 1967 for \$101.50 a share, whereas Industries purchased the

stock at prices varying from \$77.00 to \$101.50; the profit realized by Industries was not substantial, about \$35,000. This demonstrates a method by which a holding company can take advantage of any market appreciation in stock by merely transferring it to a subsidiary and recording the profits on its books.

No guidelines have been established by Industries for such transfers within the group. Whether Industries will pay Railroad any market appreciation on the stock of GM&O RR when reacquired is questionable.

## VI. POTENTIAL QUESTIONABLE PRACTICES

Although the review did not disclose these questionable practices, we would be remiss in this report of holding company practices if we did not include the following comments on opportunities for other abuses.

### 1. Deterioration of plant

One of the more significant areas requiring future attention is the preservation of the physical plant in consonance with the mandate of the national transportation policy. This is to say we must keep alert to see that adequate funds are reinvested in the transportation facility through current maintenance and capital expenditures.

Obviously, the prime consideration of any conglomerate is the whole and not any of its parts. What is good for the holding company could be very detrimental to the carrier. Funds will be invested where the return is greatest regardless of the impact on any component. There will be little incentive for management to invest in maintenance and capital expenditures to support a plant to provide quality service. There will be less incentive to invest in the necessary research and development.

### 2. Divestiture of railroad

A railroad's position in the conglomerate group becomes less important as the holding company grows financially. For example, Bangor Punta's annual report to stockholders for the year ended September 30, 1968 showed that the Railroad's contribution to revenues was 19 percent in 1964 and only 6 percent in 1968. In the same period, the contribution to consolidated profits declined from 22 percent

to 1 percent. In such situation, a holding company might be inclined to dispose of a railroad after having used it advantageously.

This situation would prevail where a holding company would dispose of a carrier after it had utilized all tax benefits, sold all valuable assets, and also under maintained the plant. In fact, a holding company might be forced to do this, as a result of stockholder demands, when a carrier shows operating losses for a few years.

### 3. Financing

Financing, including current debt, will probably be managed at the holding company level. This will tend to provide an opportunity to assign low-yield investments or high-debt cost to a regulated company.

Also, concern has been expressed by many financial experts about the high-debt cost being assumed by holding companies and their ability to pay these high fixed charges, particularly when dips and downward trends occur in our economy. For example, Goodrich, a reluctant takeover candidate by Northwest Industries, alleges that Northwest's outstanding debt structure, assuming all of its pending acquisitions are consummated, will be about \$1.7 billion; extensive capital programs would require even further debt costs. The annual interest fixed charges were estimated to be about \$50 million.

We are concerned with such acquisitions because in many instances equity stock acquired is exchanged for debt securities of the holding company. This can result in a holding company committing itself to future financial problems which in the final result may be detrimental to the carrier.

#### 4. Distortion of carrier income

It is possible to shift earnings through transfers of property. This may involve a transfer of property to a loss corporation by a related profitable entity, or, alternatively, the transfer of high-basis, low-value property to a profitable corporation prior to a realization of a loss. Also, carrier assets where a substantial unrealized appreciation has taken place could be transferred to another company prior to liquidation. Although it did not involve liquidation of a company, we have already observed one situation where stock of a railroad subsidiary was transferred to a holding company at book cost which was substantially less than current value.

Profits may be controlled by a holding company charging excessive interest to members of the consolidated group and by borrowings from financial institutions at lower rates than interest rates charged to subsidiaries.

#### 5. Commodities clause

Complicated corporate structures with many diversified activities could render ineffective the commodities clause, Section 1(8) of the Act, which prohibits transportation of certain articles in which carriers may have an interest, direct or indirect. Extensive diversification would certainly make it more difficult to enforce this section of the Act.

RAILROAD HOLDING COMPANIES - FEBRUARY 28, 1969  
STATUS UNDER I.C. ACT

Name	Sections of Act Subject to	Principal Rail Carrier Controlled
Allegheny Corporation	20(1) thru (10); 20a (2) thru (11)	Formerly controlled New York Central RR Co.
Atlantic Coast Line Company	20(1) thru (10); 20a (2) thru (11)	Seaboard Coast Line RR Co. <u>1/</u>
Bangor Punta	Application dismissed by Commission	Bangor & Aroostook RR Co.
Boston & Maine Industries, Inc.	Application dismissed by Commission	Boston & Maine RR Co.
Dereco, Inc.	20(1) thru (10); 20a (2) thru (11)	Erie-Lackawanna Ry Co. - D & H Ry Co.
Illinois Central Industries, Inc.	20(1) (2)	Illinois Central RR Co.
Kansas City Southern Industries, Inc.	Application dismissed by Commission	Kansas City Southern Ry Co. & Controlled Companies
Katy Industries, Inc.	Application dismissed by Commission	Missouri-Kansas-Texas RR Co. & Controlled Companies
Mississippi River Fuel Corp.	20(1) (2)	Missouri Pacific RR Co.
Northwest Industries, Inc.	20(1) (2)	Chicago & Northwestern Ry System
Pennsylvania Company	20(1) thru (10); 20a (2) thru (11)	Subsidiary of Penn Central Co.
SCL Industries, Inc.	Application dismissed by Commission	Seaboard Coast Line RR Co. <u>1/</u>
Mississippi Valley Corp. <u>2/</u>	20(1) (2)	Peoria & Pekin Union RR Co.
Newspaper articles indicate the following railroads are contemplating holding companies:		
Atchison Topeka & Santa Fe Ry Co. & affiliated cos. (Santa Fe Industries)		<u>1/</u> Status of Atlantic Coast Line Company at present is questionable. In merger of the Seaboard Air Line Ry and Atlantic Coast Line RR, Atlantic was held subject as a holding company. Subsequently, SCL Industries was formed and stock of Seaboard Coast Line RR Co. was exchanged for stock of SCL Industries.
Denver & Rio Grande Western RR Co. (Rio Grande Industries)		
Union Pacific RR Co. (Union Pacific Corp.)		
Penn Central Co.		
Southern Pacific		<u>2/</u> Mississippi Valley Corp. owned 100% by Illinois Central RR Co., indirectly controlled by Illinois Central Industries, Inc.

## BANGOR PUNTA CORPORATION

HISTORY

Incorporated on April 14, 1932, as Punta Alegre Sugar Corporation to acquire at public sale held April 18, 1932, all the property, assets and business of Punta Alegre Sugar Company in accordance with a plan of reorganization. Name changed to Bangor Punta Alegre Sugar Corporation on October 13, 1964, and to the present name on January 19, 1967.

Bangor Punta Overseas, S. A., incorporated in Switzerland, has been recently formed for the purpose of acquiring foreign companies.

For 1968, transportation service accounted for 6% of total revenues of the holding company's operating subsidiaries.

AFFILIATES - ACTIVITIES

Bangor Punta as of December 31, 1968, owned or controlled some 65 companies. The major affiliates of the holding company and their principal activities are as follows:

- Jensen Marine - Sporting goods
- The Luhrs Company - Sporting goods
- The O'Day Company - Sporting goods
- Seagoing Boats - Sporting goods
- Rent-A-Cruise of America - Sporting goods
- Starcraft - Sporting goods
- Duo Marine - Sporting goods
- Bale Pin Company - Sporting goods
- The Kenney Company - Sporting goods
- Smith & Wesson - Public security products
- Smith & Wesson Leather Co. - Public security products
- Smith & Wesson Pyrotechnics, Inc. - Public security products
- Dominator Company - Public security products
- General Ordnance Equipment Corporation - Public security products
- The Lake Erie Chemical Company - Public security products
- Stephenson Company - Public security products
- Waukesha Motor Company - Engines and power systems
- O & M Manufacturing Company - Engines and power systems

Waukesha Alaska, Inc. - Engines and power systems  
 Waukesha Motor Western Limited - Engines and power systems  
 Producers Cotton Oil Company - Agriculture  
 Crown Fabrics - Wearing apparel  
 Knitbrook Mills - Wearing apparel  
 Knitbrook of Allentown - Wearing apparel  
 Specialty Dyers - Wearing apparel  
 Laminac, Inc. - Wearing apparel  
 Melena - Wearing apparel  
 Bartlett-Snow - Process engineering  
 BSP Corporation - Process engineering  
 FECO - Process engineering  
 The Barker Manufacturing Company - Process engineering  
 Jetstream Systems Company - Process engineering  
 Fameco-Aire - Process Engineering  
 Bangor and Aroostook Railroad Company - Transportation  
 Metcalf & Eddy, Inc. - Professional services  
 Enesco, Inc. - Professional services  
 Bangor Punta Management Services Company - Professional services  
 \*Van Buren Bridge Co. - Transportation  
 \*Bangor Investment Co. - Real estate  
 Bangor Punta Operations, Inc. 1/

\* 100% owned by Bangor & Aroostook Railroad Co.

1/ Controls Bangor & Aroostook Railroad Co. 99%

### QUESTIONABLE PRACTICES

#### 1. Dividend practices

The following tabulation shows dividends declared and paid by the Bangor & Aroostook Railroad Co. for the ten year period 1957 - 1967:

<u>YEAR</u>	<u>NET INCOME</u>	<u>REGULAR DIVIDEND PER SHARE</u>	<u>TOTAL DIVIDEND</u>
1957	\$1,051,453	\$2.40	\$431,544
1958	1,431,684	2.20	395,582
1959	379,571	1.20	215,772
1960	823,495	.80	143,848
1961	464,092	.80	143,848
1962	562,992	.80	143,848
1963	745,157	.80	143,848
1964 *	1,171,893	.60	575,392 <u>1/</u>
1965	898,631	.80	143,848
1966	983,001	.80	593,373 <u>2/</u>
1967	883,762	.80	593,373 <u>3/</u>

- \* In October 1964 railroad was acquired by Bangor Punta
- 1/ Includes special dividend of \$2.60 (\$467,506) declared 10/13/64
  - 2/ Includes special dividend of \$2.50 (\$449,525) declared 7/15/66
  - 3/ Includes special dividend of \$2.50 (\$449,525) declared 1/27/67

The circumstances surrounding the special dividends for the years 1966 and 1967, based on documents copies from carrier files, are as follows:

Prior to October 1964, the Railroad was owned by the Bangor & Aroostook Corporation, which combined with Bangor Punta Operations, Inc. (Operations) in October 1964. Operations at this time assumed the Bangor & Aroostook Corporation's obligations including \$602,000 in 5% promissory notes due to the Railroad, and \$585,700 in 4 3/4% notes payable to the Bangor Investment Co., wholly-owned by the Railroad.

In July 1966, Operations formulated a policy whereby special dividends in addition to the regular dividend would be declared by the Railroad; as Operations owned 98.9% of the Railroad no cash would pass, except to minority stockholders, to reduce the amounts owed by Operations to the Railroad. It was decided in July 1966 the following special dividends would be paid for the years 1966, 1967, and 1968: \$2.50, \$2.50 and \$1.70.

The 1966 special dividend reduced Operations' \$602,000 debt to the Railroad by \$443,227, leaving a balance of \$158,773.

On January 27, 1967, Bangor Investment Co. declared a dividend to its parent Railroad of Operations' \$585,700 note. Simultaneously, Railroad declared a special dividend of

\$449,525, of which \$443,340 served to reduce Operations' direct and indirect debt to the Railroad to an amount of \$301,133, i.e., \$158,773 plus \$585,700 less \$443,340.

The planned 1968 special dividend was aborted because Railroad's earnings declined in the face of a poor potato crop. Through the 1966 and 1967 special dividends and poor earnings in 1968, retained income has been reduced to an amount below which dividends may be paid under restrictive provisions of the Railroad's mortgage.

The foregoing practices, which were planned to improve the holding company's own balance sheet, deprived the Railroad of approximately \$56,000 in interest payments for the year, transferred Railroad assets to the parent reducing its net worth and income.

Unless the Commission seeks the necessary powers to prevent such practices, management may very well strip the carrier of additional assets reducing it to a corporate shell and then dispose of it. In this connection, attention is directed to the last paragraph under "Acquisitions" on page 24 of the holding company's annual report to stockholders for the year ended September 30, 1968, quoted herein as follows:

"In accordance with our policy of continuously reviewing the return on investment which our operations produce, we determined that our Pacific Coast foundry operation was not meeting our corporate goals and it was disposed of during the year."

## 2. Sales and transfers of carrier's assets

Other than the disposal of temporary cash investments as discussed in paragraph 4, advances by carrier, no questionable practices were noted.

### 3. Consolidated Federal income taxes

No taxes have been paid by the consolidated group through 1966. A minor tax of \$57,191 was paid in 1967 as a result of recomputation of prior years' investment credits of various acquired companies. There will be a tax liability for the group for the tax year ending September 30, 1968.

Summarized below are the Railroad's substantial tax credits and operating losses which have been made available to the parent in filing a consolidated tax return.

Year Ended Sept. 30	Taxable Income		Railroad
	Railroad	Railroad & Subs.	Investment Tax Credit
1964 Forward			\$ 280,509
1965	\$ 457,806	\$ 818,160	532,562
1966	(597,017)	(139,173)	496,025
1967	(1,200,631)	(1,147,289)	4,369
1968	<u>(1,395,418)</u>	<u>(1,428,090)</u>	<u>253,322</u>
TOTAL	<u>(\$2,735,260)</u>	<u>(\$1,896,392)</u>	<u>\$1,566,787</u>

( ) Indicate loss

Railroad operating losses result largely from use of accelerated depreciation methods, a practice which it has followed consistently for many years.

Our auditor reports that the total investment tax credits earned by all companies in the group through September 30, 1967, totaled \$1,532,402, of which \$1,313,466 was contributed by the Railroad.

No guidelines have been established by management whereunder Railroad will be reimbursed for its contribution in lowering taxes for the group. Now that the group is in a taxable position, the investment tax credits contributed by Railroad assumes greater significance. The question remains, is their value lost to the Railroad for future use?

#### 4. Advances by carrier

During 1965, Railroad advanced Bangor Punta cash secured by \$2,200,000 promissory notes bearing the prevailing prime interest rates. \$1,700,000 was repaid prior to year end, and the remainder repaid in 1966. Similarly, subsequent advances (\$2,050,000 in 1966, \$800,000 in 1967, and \$2,200,000 in 1968) were made and repaid. However, with respect to the 1968 advances, the Railroad was required to borrow \$1,700,000 for which it received 1/8 of 1% interest over that paid to the lending institution.

Although interest earnings on these advances by the Railroad were in accordance with prevailing rates, it restricted the carrier from otherwise investing its excess cash more profitably. It also restricted the temporary investment of Railroad cash to the whim of the parent, including the ability of the parent to require Railroad to borrow money for the parent.

Except for minor items, temporary cash investments of the Railroad were disposed of after joining Bangor Punta. One investment carried at a cost of \$1,568,915, was disposed of during 1965 and 1966 at a profit to Railroad of \$137,099.

Bangor Investment Co., a 100% owned affiliate of Railroad, in 1965 had an investment of \$37,431 in International Telephone and Telegraph Common and preferred stock. During 1965 and 1966 the investment was disposed of for \$363,203. Investment Company's cash at December 31, 1967, was minimal.

There is substantial reason to believe the investments were disposed of to provide cash to be used by the parent as discussed in paragraph 5, Use of carrier's credit.

5. Use of carrier's credit

Bangor Punta operates a central cash control whereby all subsidiaries, except Railroad, deposit funds in local banks which are transferred to a central bank. Each subsidiary pays its bills from imprest funds ranging from \$5,000 to \$70,000 which is replenished as needed by Bangor.

Railroad is required to keep sufficient cash on deposit in the banks to allow Bangor Punta to borrow up to \$1,312,000 to supplement its working capital on short term notes. Railroad receives 3% per annum on cash deposits exceeding \$1,344,000; during 1968 Railroad received \$1,329.03 interest for deposits exceeding \$1,344,000. The foregoing practice was established on September 22, 1965, by Vice President John E. Hess of Bangor Punta through letter to the president of Railroad, a copy of which is in our files.

Under this procedure Railroad is discouraged or precluded from investing its cash, even on a temporary basis. Control of Railroad cash is in the hands of the parent, Bangor Punta to further its corporate needs.

6. Allocation of expenses

Generally, most of the services performed by general officers and staff of the railroad for the holding company are billed.

In October 1964, when Bangor Punta Operations took control of Railroad, monthly bills were rendered to the Railroad for so-called "Corporate Charges." The following tabulation shows amounts paid by the Railroad between October 1964 and September 1967:

<u>PERIOD</u>	<u>MONTHLY CHARGE</u>	<u>FISCAL YEAR TOTAL</u>
Oct. 1964 - Sept. 1965	\$13,000	\$156,000
Oct. 1965 - Sept. 1966	16,000	192,000
Oct. 1966 - Sept. 1967	20,000	<u>240,000</u>
	TOTAL	<u>\$588,000</u>

These charges were discontinued about the time Railroad net income started to decline.

No specific details were available to support the amounts assessed. Officials of both the Railroad and Bangor Punta Operations attributed the charges to general management services, including legal and professional audit services. The Chief Accounting Officer of Bangor Punta Operations told our auditor he had no knowledge of the basis for these amounts or why the billings were discontinued.

Railroad was billed \$9,714 by Peat, Marwick & Mitchell Company, independent public accountants, for audit services for fiscal year ending September 30, 1967; this contrasts with the \$240,000 in annual charges which the carrier was required to pay.

No legal services alleged to have been performed as part of this assessment were reported by the Railroad between 1964 and 1967 in its annual report to the Commission. Annual report Form A, Schedule 563, Payments for Services Rendered by Other Than Employees, requires disclosure of amounts paid for legal services in excess of \$30,000.

The only conclusion to be reached is the Railroad was overcharged by as much as \$588,000 over this period of time.

7. Adequacy of records for transactions between companies

As full access was given to the records, transactions between companies, carrier and noncarrier, were readily traced and facts obtained. However, as discussed above Railroad's records contained charges for such costs as management fees which were not sufficiently supported by appropriate documentation.

8. Other questionable practices

Agreement with Katy Industries

Bangor group on August 31, 1967, entered into agreement with Missouri-Kansas-Texas Railroad Co., whereby it will advise Katy Industries, Inc. on a program of business diversification. Katy will grant the Bangor group an option to purchase 10% of outstanding shares of Katy Industries.

Bangor group records indicate that Katy has acquired or is in process of acquiring companies which Bangor group does not recommend.

Through Board of Directors' action on October 1, 1968, the proper officers were directed to dispose of all or any part of the Corporation's interest in Katy Industries, Inc.

## ILLINOIS CENTRAL INDUSTRIES

HISTORY

Incorporated on August 31, 1962, as a holding company, for the purpose of acquiring the capital stock of Illinois Central Railroad Company and providing for expansion and diversification into non-transportation fields. At the present time, revenues for non-transportation business activities are relatively minor.

AFFILIATES - ACTIVITIES

Major affiliates of the holding company and their principal activities are as follows:

- Illinois Central Railroad Company - Transportation
- Illinois Center Corporation - Real estate
- Chicago and Illinois Western Railroad Company - Transportation
- Chandeysson Electric Company - Electrical equipment
- Waukesha Foundry Corporation, Inc. - Castings
- Abex Corporation - Machinery and equipment
- \* Mississippi Valley Corp. - Holding Co. - Transportation
- \* Blue Island Railroad Co. - Transportation
- \* Madison Coal Co. - Coal land - leasing
- \* Waterloo Railroad Co. - Transportation

\* Owned by Railroad

QUESTIONABLE PRACTICES1. Dividend practices

When Illinois Central Industries was formed as a holding company, an agreement was entered into between Illinois Central Railroad and Industries requiring Industries to pass on all dividends received from the railroad to the stockholder of Industries on a dollar-for-dollar basis. Industries wanted to increase or maintain its retained income balances but was unable to accumulate any earnings from Illinois Central because of the dividend agreement. It then became necessary for Industries to obtain sufficient income to offset its expenses for the year. This was

accomplished in part by advancing \$600,000 to Chicago & Illinois Western Railroad Company, a wholly-owned subsidiary, to enable that company to pay an \$800,000 dividend to Industries in December 1967. This transaction resulted in Industries depleting the Railroad's retained income, which was about \$803,000 prior to this dividend. The State of Illinois is currently investigating the transaction and may well require Industries to return the dividend due to the financial impact to the carrier.

It is not in the public interest for a carrier to pay out substantially all of its retained income in dividends, especially when such payments are made with borrowed funds. A sufficient portion of earnings should be retained to support the carrier's credit, provide for emergency needs, offset obsolescence and to provide necessary investments for additions and betterments of plant and equipment. Prior to acquisition of the carrier by Industries, an average balance of \$744,406 was maintained for these purposes in retained income.

The effect of this action is to provide Industries with additional income of \$800,000 for 1967 at the expense of the carrier by increased debt and depletion of required retained income.

2. Sale and transfer of carrier assets

Under current negotiations is a transaction involving the sale of air rights in Chicago owned by Railroad to Standard Oil Company of Indiana (Standard) for a total consideration of \$12,080,148 computed at \$89 times 135,732

square feet, of which only \$7,634,925 would be allowed to the carrier, the difference to be credited to Illinois Center Corporation (Center), a subsidiary of Industries.

The amount to be allocated to the Railroad is based on a purchase option for the air rights sold to Center for \$300,000 which entitled the latter company to make the purchase for \$56.25 a square foot or \$7,634,925. Ostensibly, Center was not affiliated with the carrier or any of the companies in the holding company group at the time the option was granted. Apparently, when it was discovered a far greater price for the air rights could be obtained by selling to Standard, the holding company proceeded to secure control of Center, and thus the option to the air rights, by purchasing 81 percent of that company's outstanding capital stock through a wholly-owned subsidiary (Mid-America Improvement Corporation) established on June 17, 1968, for that purpose.

The error in judgment initially exercised by the railroad in selling the option for purchase of air rights at a price substantially below what Standard is willing to pay seems incongruous for a company of this size and caliber of management. It is also noted that Center was primarily organized for the purpose of investing in real estate on January 4, 1961, only a short time prior to entering into negotiations with the railroad for the air rights. A special investigation will be instituted to determine whether an element of affiliation or control was in effect between Center and any companies in the holding company

group when the option agreement was entered into; in such circumstances, the carrier would be the victim of a device to expropriate \$4,445,225 of its assets.

### 3. Consolidated Federal income taxes

The following shows the amount of income tax credits paid between 1963 and September 1968 to Industries by Railroad. This is predicated on a consolidated income tax return being filed and tax assessed each company on the basis of separate return. Industries received a credit because of its losses included in the consolidated tax return.

	<u>Federal Income Taxes</u>
1963	\$ 155,400.00
1964	54,863.00
1965	302,776.00
1966	150,612.00
1967	416,901.00
1/1/68 - 9/30/68	319,207.00
TOTAL	<u>\$1,399,759.00</u>

In the year 1966 no tax was paid by Industries, however, Railroad was required to pay about \$150,000, an amount equal to what Railroad would have paid if filing a separate return.

The payments of \$1,399,759, most of which were made by Railroad, were accounted for as income of Industries.

### 4. Advances by carrier

Mid-American Improvement Corporation, which was the vehicle used by Industries in acquiring Illinois Center Corporation stock, was advanced funds by Industries which were in turn furnished by Railroad.

Industries acquired Chandeysson Electric Company in May 1965 for about \$4 million; the funds were supplied by Railroad

in the form of a demand note. Interest charged by Railroad to Industries was below prevailing interest rates. Interest charged Industries from 1963 to 1968 is as follows:

3/1/63 - 12/31/63	Cash advances	\$ 106,359.30	- None
1/1/64 - 12/31/64	Cash advances	100,000.00	- 3-1/4%
1/1/65 - 12/31/65	Demand note	4,000,000.00	- 3-1/4%
1/1/66 - 11/30/68	Cash advances	1,461,756.23	- 3-1/4%
		<u>\$5,668,115.53</u>	

As of 11/30/68, \$840,578.89 in cash advances remains outstanding.

#### 5. Allocation of expenses

Since the time of incorporation, August 31, 1962, to the present, the officers of the Railroad have served in a dual capacity providing management services to both the Railroad and Industries, all salaries and expenses, including legal costs and office rents, being charged to the Railroad.

The following is a quote from the December 1962 Prospectus of Illinois Central:

"All of the officers of Industries are presently serving without compensation and it is contemplated that they will continue to service without compensation until such time as Industries shall engage in some business or activity not presently conducted by the Railroad. At such time, the Board of Directors will determine the compensation to be paid to executive officers of Industries. Until such time, Industries does not contemplate employment of additional personnel. Directors and members of the Executive Committee of Industries are paid a fee of \$100 for each meeting attended."

#### 6. Adequacy of records for transactions between companies

Summaries and supporting detail for all transactions between affiliated companies were not readily available.

Such information maintained at one source would be very helpful in reviewing intercompany transactions.

7. Security transactions

Industries acquired about \$8 million worth of stock of Gulf, Mobile & Ohio Railroad during 1967. A large block of this stock was sold to Railroad on December 1967 for \$101.50 a share, whereas Industries purchased the stock at prices varying from \$77.00 to \$101.50. Although the profit realized by Industries was not substantial, about \$35,000, it does uncover a device for enabling the holding company to take advantage of any market appreciation in stock by merely transferring it to a subsidiary and recording the profits on its books.

No guidelines have been established by Industries for such transfers within a group and whether Industries will pay Railroad any market appreciation on the stock of GM & O when reacquired is questionable.

## KANSAS CITY SOUTHERN INDUSTRIES

HISTORY

Incorporated on January 29, 1962, as a holding company to acquire capital stock of Kansas City Southern Railway Company and to expand into noncarrier activities.

AFFILIATES - ACTIVITIES

Major affiliates of the holding company and their principal activities are as follows:

- American Coleman Company - Manufacture of machine and automobile parts
- Carland, Inc. - Equipment leasing
- Carthage Cablevision, Inc. - Television
- Grasis Fabricating Company - Manufacture of electrical equipment
- Horn Dean Limited - Insurance
- Kansas City Southern Railway Company - Transportation
- \* Kansas City Transport Company - Transportation
- \* Louisiana and Arkansas Railway Company - Transportation
- Mid-American Television Co. - Radio and Television
- Pabtex, Inc. - Construction
- Supervised Investors Services, Inc. - Investments
- Shreveport T.V., Inc. - Television
- Trans-Serve, Inc. - Real estate
- \* Louisiana, Arkansas & Texas Transportation Co. - Transportation
- \* Landa Motor Lines - Transportation
- \* Tolmak, Inc. - Finance - Real estate
- \* Kansas City Shreveport & Gulf Terminal Co. - Transportation
- \* Kansas & Missouri Ry. & Terminal Co. - Transportation
- \* Fort Smith & Van Buren Ry. Co. - Transportation
- Southern Development Co. - Real estate
- \* Joplin-Southern Corporation - Real estate
- \* Arkansas Western Ry. Co. - Transportation
- \* Owned by Railroad

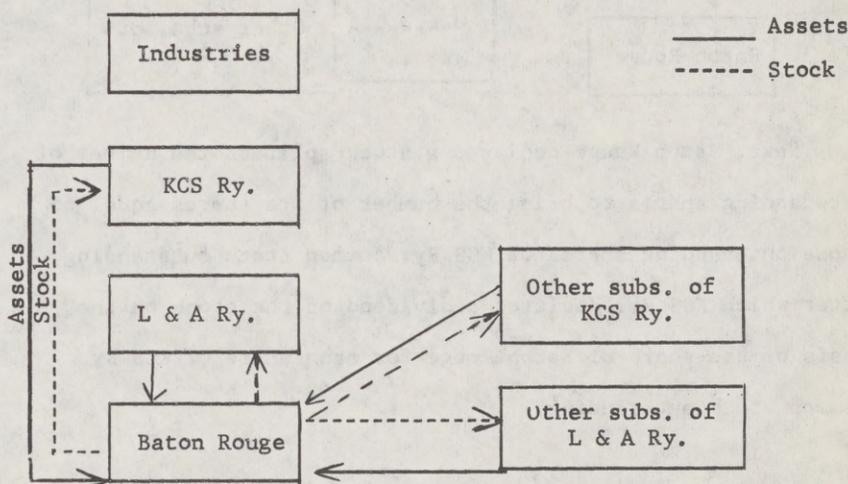
QUESTIONABLE PRACTICES1. Dividends and transfer of assets

The following transaction provides a good illustration of the method used by Kansas City Southern Industries, Inc.,

(Industries) to siphon off approximately \$45 million in railroad assets to Industries through so-called dividend payments.

The plan was decided upon in order to provide Industries with sufficient asset value to enable that company to obtain a \$15 million revolving loan. In order to accomplish this, Baton Rouge, a wholly-owned railroad subsidiary, arranged to issue a block of no par value common stock which was then exchanged for assets of Kansas City Southern Railway (KCS Ry.), the Louisiana & Arkansas Railway Co. (L & A Ry.) and their subsidiaries on the basis of 1 share for each \$100 of asset value at current market.

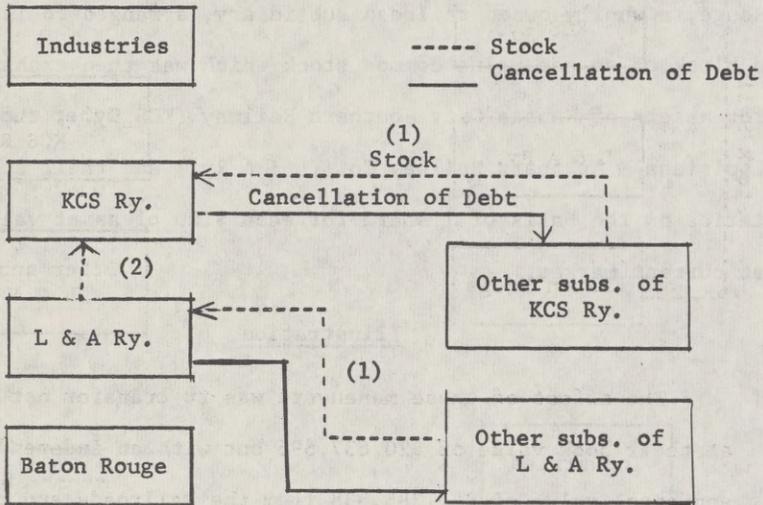
#### Illustration



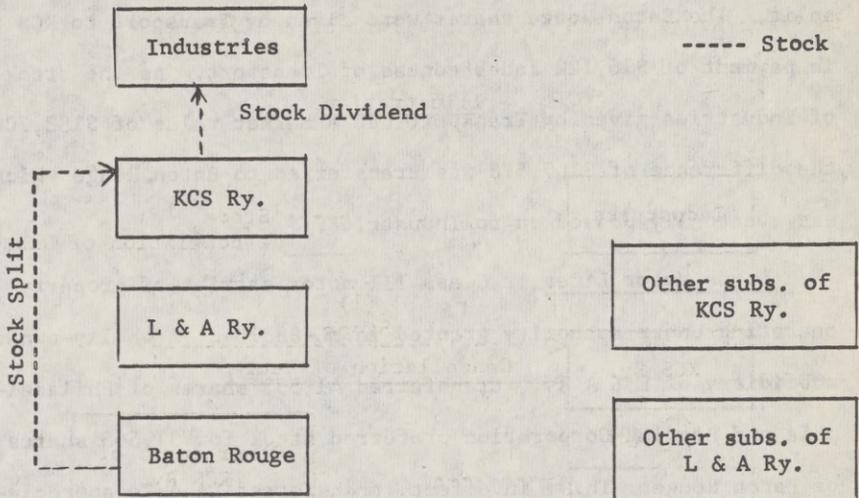
The subsidiary companies of KCS Ry. and the L & A Ry. in turn transferred the Baton Rouge stock received to their respective parent companies in exchange for cancellation of loans and advances payable to the parent companies, thus placing all of

the stock issued by Baton Rouge in the hands of KCS Ry. and L & A Ry. L & A Ry. then transferred all the stock they held in Baton Rouge to KCS Ry. in the form of a dividend.

Illustration



Next, Baton Rouge declared a stock split on the number of outstanding shares to bring the number of its shares equal to those outstanding shares of KCS Ry. common stock outstanding after which KCS Ry. declared a dividend of the stock on the basis of one share of Baton Rouge for each share of KCS Ry. common stock outstanding.

Illustration

The effect of these maneuvers was to transfer net assets at their book value of \$20,637,696 but with an independent appraisal value of \$45,385,338 from the Railroads and their affiliates to Industries, thus taking from the Railroads assets valued at \$45 million and depriving the Railroads of \$25 million in asset value, which amount would have been realized in the form of income to the railroads if these assets had been sold to others. Conversely, should the Railroad be required to replace these assets at some future date, they would have to do so at substantially higher costs.

Details of other affiliated companies involved in the above described transactions follow.

Kansas City Southern Transport Company (Transport), a wholly-owned subsidiary of KCS Ry., in May 1967 exchanged 4,400 shares of common stock of Industries for 1,837 shares of

Baton Rouge. This exchange was based on Baton Rouge shares having an assigned value of \$100.00 per share prior to the stock split. The Baton Rouge shares were given by Transport to KCS Ry. in payment of \$16,122 indebtedness of Transport. As the stock of Industries given by Transport had a market value of \$183,700, the difference of \$167,578 was transferred to Baton Rouge which was eventually passed on to Industries.

Landa Motor Lines, a Class III motor carrier of property operating under authority granted in MC-88370-C, a wholly-owned subsidiary of L & A Ry., transferred 41,533 shares of Philadelphia and Reading Corporation preferred stock for 31,565 shares of Baton Rouge. This, in effect, transferred Landa's appreciation in value of Philadelphia and Reading Corporation's stock in the amount of \$3,156,508 to Baton Rouge since it subsequently transferred the Baton Rouge stock to L & A Ry. in settlement of an indebtedness of \$360,683. Industries eventually received the benefit.

Tolmak, Inc., a wholly-owned subsidiary of L & A Ry., transferred 19,900 shares of its capital stock for \$1,238,169 of Baton Rouge indebtedness to the L & A Ry. Since Baton Rouge had transferred land and buildings along with the indebtedness on each, having a net book value of \$1,238,169, no book gain or loss was caused by this transaction. However, the land and buildings transferred to Tolmak, had an appraised value of \$2,052,826, which reduced the effect of the spin off of Baton Rouge by the difference between the net book cost and the appraised value. At the present time, Tolmak is in the same vulnerable position for spin off as was Baton Rouge.

L & A Ry. has 29,211 shares of Baton Rouge common stock which is recorded at \$1,634. This represents 29,059 shares recorded at no cost and 152 shares purchased for \$1,634. This stock likewise could be transferred to an affiliated company at a relatively small cost under the present accounting regulations, whereas the alleged value of the stock is \$2,905,900 (29,059 @ \$100.00 share).

KCS Ry. in May 1967, transferred 50 shares of Railway Communications Company (50% ownership) with a book value of \$12,500.00 to Baton Rouge for 10,500 shares of Baton Rouge. Communications was jointly controlled by KCS Ry. and two other unaffiliated stockholders. KCS Ry. received dividends from Communications in the amounts of \$40,000, \$75,000 and \$75,000 for the years 1964, 1965 and 1966, respectively. The result of this transaction was to deprive the railroad of approximately \$75,000 of income per year from the stock now held by the holding company.

## 2. Consolidated Federal income taxes

The examiners were verbally furnished by a company representative the names of the subsidiary companies of Industries which are reported on the holding company's consolidated tax return. Other than the above and the reports to stockholders, all corporate records were refused and any information not included in the above about this company was obtained from other sources. Industries files a consolidated tax return which includes all companies controlled 80% or more. Taxes are accrued by the regulated companies on an estimated

basis and no adjustments are made when the actual amounts are determined except when there is a change in the tax rate. Upon asking for the regulated companies' worksheets from which the tax returns are prepared, the examiner was given the monthly accrual sheets which in some instances could be tied in with the accruals on the books but it was impossible to see whether the taxes computed were on the same basis as the income tax return filed by Industries. Also, only figures in totals were given to support additions to or deductions from the income and expenses as reported to Internal Revenue Service.

### 3. Leasing problems

Carland, Inc., controlled by Industries group was formed to lease equipment of all kinds to the rail carriers in the group. Leases include railway cars, locomotives and spare parts, automobiles, trucks, hand tools, etc. Carland, Inc., requires initial rentals to be paid in advance, which provides the necessary capital for the down payment on the leased item. The lease is then assigned to a banking institution to which the rail carriers make the lease payments, including interest charges. To meet the requirements of the Clayton Act carriers did advertise for bids, and filed such bids with the Commission. Representative of such a filing is bid 68-22 (Commission Control Number). The items for which bids were asked consisted of 24 classes of rail rolling stock, 40 classes of maintenance of way equipment, 12 classes of automotive equipment, 4 classes of construction and paving equipment, 3 classes of water carrier equipment including tow boats and barges,

8 classes of data processing equipment, 5 classes of communications equipment, 3 classes of office equipment, and 25 classes of miscellaneous equipment.

Carland was the only bidder. However, due to the numerous types and kinds of property to be leased, it would be practically impossible to find prospective lessors adequately equipped to supply such items other than a company established for that special purpose.

Under these leases the carrier is charging operating expenses with the cost of these items, plus interest and Carland's profit thereon, over a five year period (in some instances eight or nine years).

As we were denied access to Carland's records and were not furnished detail supporting rental billings indicating costs of items being leased, at the moment we cannot state how the carriers are being hurt. Our auditors report there are some 400 such leases in effect.

#### 4. Advances by carrier

A long term agreement was entered into in 1965 between L & A Ry. and its wholly-owned subsidiaries. This agreement was made because of limited annual earnings by Baton Rouge and Landa Motor Lines and because it was highly desirable to management that they have available a continuing firm commitment from L & A Ry. These commitments for future advances, upon demand, were made so that they may have readily available a source of funds in order to take advantage of opportunities in connection with further investments in securities and real

estate. Such commitments were made for advancement within 10 years, from 1965 upon demand, of the sum of \$6,000,000 to Baton Rouge and \$4,000,000 to Landa.

In addition, Southern Enterprises, Inc., a wholly-owned subsidiary of Industries, has received advances of millions of dollars over the past five years from L & A Ry. The advances are made without interest charges.

The effect of these types of agreements is to give primary consideration to the investment needs of the holding company at the expense of the Railroad. Also, the Railroads are deprived of interest which would normally accrue on surplus funds invested elsewhere by the Railroad.

#### 5. Use of carrier's credit

Baton Rouge has made arrangements to lease equipment from Carland, Inc., who has arranged to borrow from Chemical Bank New York Trust Company approximately 60% of the amount of the purchase price by a promissory interest bearing note and to assign the lease and rentals payable to the Bank as security for the loan. Further, L & A Ry. gives the bank its unconditional and irrevocable guaranty of the payment of the lease rental.

Carthage Cablevision, Inc., controlled by Industries, operates a TV station at Carthage, Missouri. This station, including tower and coaxial cable, was financed by Southern Development Company (wholly-owned by Industries) through a 6% loan for \$360,000 obtained from the First National Bank of Joplin, who agreed not to record the mortgage upon this property provided the KCS Ry. guaranteed to repurchase this

property at the unpaid balance of the loan if Southern Development Company was in default. After construction of this station was completed, Southern Development transferred it to Carthage Cablevision, Inc., by accepting a mortgage on the property for the cost of construction with interest at 6% per annum on the unpaid balance, payable over a period ending in 1975.

These guarantees of loans were not reported by the regulated companies in their annual reports filed with the Commission, although such reporting is currently required.

The Railroad receives no compensation for assuming this liability which would not be the case if the guaranty were given to a non-affiliated company. Only the holding company benefits from this type of arrangement.

6. Allocation of expenses

In reviewing allocation of expenses, no definite conclusions could be reached because of limited access to records. However, in discussing officers' salaries with company representatives, it was understood by the examiner that no portion of their salaries are allocated to Industries or companies other than those regulated by the Commission.

7. Adequacy of records for transactions between companies

Records were not made available to ascertain whether sufficient support existed for intercompany transactions.

8. Access to records

All holding company corporate records were refused other than a copy of the annual report to stockholders. Access was granted only to the transportation companies and their

subsidiaries. Certain records pertinent to review of carrier accounts were also refused such as consolidated Federal income tax data, and cost of affiliated companies property leased on a cost plus basis to the carrier.

A striking example of access to the records problems was encountered by the staff in the review of North Baton Rouge Development Company (Baton Rouge), a subsidiary of the Louisiana & Arkansas Railway Co. (L & A Ry.) until July 31, 1967, after which date it became a subsidiary of the holding company. Since Baton Rouge's general ledge contained information posted after it became a subsidiary of the holding company, access to this record was denied.

The staff then resorted to obtaining information concerning Baton Rouge through transactions with the Railroad obtained from Railroad records. The staff was unable to verify entries recorded by Baton Rouge under these circumstances.

9. Adverse impact on minority stockholders

There is an adverse impact on the minority stockholders of KCS Ry. (minority stockholders own approximately 8% of KCS Ry.) when assets are transferred from KCS to Industries at prices substantially lower than market value as detailed in the Baton Rouge spin off.

## NORTHWEST INDUSTRIES

HISTORY

Incorporated on August 3, 1967, as a wholly-owned subsidiary of North Western Railway until April 4, 1968, when it became a holding company and parent of North Western Railway. The company was organized to provide expansion for subsidiaries into non-transportation fields. About 40.8% of revenues is derived from transportation service, 12.1% from chemical products, 24.4% from industrial products, and 22.7% from consumer products. The railroad received about \$6 million as dividends in 1967 from its chemical company affiliates.

AFFILIATES - ACTIVITIES

Major affiliates of the holding company and their principal activities are as follows:

- Chicago and Northwestern Railway Company - Transportation
- \*Velsicol Chemical Corporation - Chemical products
- \*Michigan Chemical Corporation - Chemical products
- Philadelphia and Reading Corporation - Holding company
- Acme Boat Company - Sporting goods
- Imperial Reading Corporation - Wearing apparel
- Lone Star Steel Company - Steel pipe
- Union Underwear Company - Wearing apparel
- Fruit of the Loom, Inc. - Wearing apparel
- Universal Manufacturing Corporation - Electro-magnetic equipment
- \*Minneapolis & St. Louis Land Co. - Finance - real estate
- \*Wisconsin Town Lot Co. - Real estate
- \*North Western Leasing Co. - Other

QUESTIONABLE PRACTICES1. Dividend practices

Northwest Industries became parent of the Railroad on April 4, 1968, and the history of dividend practices is very

\*Owned or controlled by Railroad

limited. The following quote is taken from Industries prospectus of November 8, 1968, as amended December 31, 1968, filed with the Securities and Exchange Commission for issuance of securities.

"Dividend Information

Industries has established a dividend policy for the payment of quarterly cash dividends on its Common Stock of \$1.00 per share, as well as dividends payable on its share of \$4.20 Cumulative Convertible Prior Preferred Stock, Series A 5% Convertible Preferred Stock and (if the Exchange Offer in consummated) Series B 6% Preferred Stock, in accordance with their respective terms. Industries' ability to carry out its dividend policy will be dependent upon dividends from its subsidiaries or other sources of funds, such as loans or advances, funds derived from future acquisitions, investments or other transactions of Industries, and cash from tax deferrals and tax savings as may be determined to be properly available to Industries. If adequate funds are not available from other sources, an increase in dividends from some or all of its subsidiaries will be necessary to permit Industries to carry out its dividend policy, since existing dividend rates on shares of stock of North Western Railway, Philadelphia Reading and (if the Exchange Offer is consummated) Milwaukee Road will not be a sufficient source of funds from which to pay the intended dividends on shares of stock of Industries. The payment of dividends will be dependent upon earnings, financial condition and other relevant factors affecting Industries' dividend policy and the dividend policy of its subsidiaries."

After Industries acquired Railroad, it received the 3rd and 4th quarter dividends on Railroad's common and preferred stock, which amounted to \$2 and \$2.50 per share, respectively.

While no increase was made in Railroad dividends in 1968, Industries apparently is following its declared dividend policies.

In turn, dividends of \$3.15 per share were declared on Industries \$4.20 Cumulative Convertible Prior Preferred Stock

in 1968. The Prior Preferred stock is the issue used by Industries to acquire Philadelphia and Reading Corp. common stock. Our auditor reports that the previous rate paid by Philadelphia Reading prior to acquisition by Industries was \$1.20 in 1966 and \$1.50 in 1967.

Prior to Industries acquiring the Chicago and North Western Railway Co., the Railroad dividends were as follows for the 10 year period ending December 31, 1968:

<u>Year</u>	<u>Common Stock Amount</u>	<u>Preferred Stock Series A 5%</u>
1959-1963	-0-	-0-
1964	-0-	\$5.00
1965	\$3.00	5.00
1966	4.00	5.00
1967	4.00	5.00
1968	4.00	5.00

Railroad in 1964 established a policy whereby all excess real estate was to be converted to cash. The resumption of dividend payments in 1964 is related to these real estate sales since prior to that time dividends were not paid. With this dividend policy established, Industries was formed and the railroad was used as a springboard to jump off into the conglomerate area.

## 2. Consolidated Federal income tax returns

### A. Chicago and Northwestern Railway

The policy of Chicago and Northwestern Railway is one where the railroad receives no compensation for its tax benefits used in the consolidated return. However, an inter-company agreement between the Railroad and Michigan Chemical Company indicates that such tax loss applicable to minority interests, contributed by the Railroad which results in a lower income tax to Michigan Chemical Company will be paid to the Railroad.

To summarize, Chicago and Northwest policy is not a two-way street--when the Railroad contributes losses to the companies within the group it receives nothing, but when it contributes losses to outsiders, namely the minority stockholders of Michigan Chemical Company, the minority stockholders are required to pay Railroad for such benefits.

Aggravating the Chicago and Northwestern Railway inequity was the increased net loss after 1966 for the benefit of other associated companies within its group. The carrier commenced using rapid depreciation in 1967. If the carrier were not a member of a group, it would not use these additional tax depreciation charges until it was in a profitable position. The primary reason for the use of the accelerated depreciation was to offset the profit of the chemical companies in the group. No benefits were received by the Railroad for these tax contributions.

The use of rapid depreciation in filing Federal income tax returns and use of investment tax credits will certainly reduce future tax benefits that the carrier would have received if these were not used on a consolidated return, and may possibly result in higher future costs when the carrier becomes a profitable company.

B. Northwest Industries, Inc.

Industries will be a party to a consolidated tax return for the first time in 1968. Since it will probably not be filed until September 15, 1969, its impact on the Railroad cannot be ascertained. However, we have learned that the Philadelphia Reading Corp. paid Industries some \$17 million, an amount equivalent to its Federal income tax liability had it

filed on an individual basis. Our auditor was advised this would result in income to Industries of between 12 and 13 million dollars. Industries' officials would not divulge any credit for loss carry-forwards which at December 31, 1967, was \$8,400,000.

Particularly pertinent to the investment tax credits, the preliminary prospectus filed with Securities and Exchange Commission concerning Industries' offer to acquire B. F. Goodrich Co., contains the following note to Industries' Consolidated Statement of Earnings:

"(4) Starting in 1968, the Federal Income tax provisions, both currently payable and deferred have been reduced by Investment Tax Credits to the extent of \$14,050,000 for the year ended December 31, 1968, which includes investment credit carry-forward of \$11,800,000, of which \$5,300,000 related to extraordinary items. There is available at December 31, 1968, for financial statement purposes \$5,100,000 of unused investment credit carry-forward. The unused investment credit expires as follows: \$2,000,000 in 1973 and \$3,100,000 in 1974."

It is evident that Industries will be taking advantage of Railroad's tax credits when it files its 1968 return.

### 3. Advances by carrier

Industries is not using Railroad's assets to derive benefits for which Railroad is not compensated. Instead, Industries is loaning the Railroad substantial sums of money at prime interest rates. The source of funds generated by Industries is the Philadelphia Reading group. Railroad records disclosed the following borrowings from Industries during 1968, which were used primarily to acquire 50% of Alton Southern, the Des Moines & Central Iowa Railroad and the Fort Dodge Railroad Co., as well as to make substantial improvements to plant.

<u>Month</u>	<u>Borrowed</u>	<u>Repaid</u>	<u>Month End Balance</u>
July	\$14,100,000	-	\$14,100,000
August	13,800,000	-	27,900,000
September	5,800,000	\$13,700,000	20,000,000
October	4,000,000	1,500,000	22,500,000
November	3,000,000	2,500,000	23,000,000
December	-	14,000,000 <sup>1/</sup>	9,000,000

Industries has notified Railroad of its intent to waive the 1969 dividend from Railroad which was declared in December 1968. This would amount to some \$9,000,000.

<sup>1/</sup> The December repayment of \$14,000,000 was made up of the following: Railroad cash of \$6,200,000, Velsicol dividend of \$6,800,000, and a Velsicol note of \$1,000,000.

## BUREAU OF ENFORCEMENT

March 26, 1969

MEMORANDUM TO CHAIRMAN BROWN AND  
VICE CHAIRMAN STAFFORD:

Subject: Conglomerate Merger Activity

The Bureau of Enforcement has undertaken consideration of the limitations, if any, on the Commission's rail enforcement powers against illegal acts, such as rebates, concessions, discriminations, Clayton Act violations, etc., which may be effected by one means or another through holding companies or non-railroad controlled affiliates. The conclusions reached are, with some exceptions, necessarily tentative since experience with the rail related conglomerate is limited. Test applications of enforcement principles were made upon speculative situations rather than upon facts underlying a specific existing situation. Bureau analysis has been limited to the principal areas discussed hereafter.

Rebates, Concessions and  
Economic Discriminations

The principal enforcement tool in the area of rail rebates, concessions and economic discriminations is the Elkins Act (49 U.S.C. 41 et seq.). The Bureau concludes that the advent of the "conglomerate" places no limitation upon the effective use of this act which makes it:

"\* \* \* unlawful for any person, persons, or corporation to offer, grant, or give, or to solicit, accept or receive any rebate, concession, or discrimination in respect to the

transportation of any property in interstate or foreign commerce by any common carrier ... whereby any such property shall by any device whatsoever be transported at a less rate than that named in the tariffs posted and filed by such carrier ... or whereby any other advantage is given or discrimination is practiced."  
(Underscoring supplied)

The report of the House Committee on Interstate and Foreign Commerce illustrates the intended scope of the Elkins Act prohibitions as follows:

"Your committee believes that the legislation proposed by the Elkins bill, together with the present interstate commerce law, covers about all the way that thought or language can devise or describe to prevent the granting of discriminations in favor of one shipper as against another, or the building up of one concern through the favoritism of railroad corporations."  
(Page 6, HR No. 3765, 57th Congress, 2d Session)

The Courts have given the Elkins Act a broad judicial construction. The most recent Supreme Court case under the Act is United States v. Jerry Braverman, 373 U.S. 405(1963). Braverman was traffic manager for a shipper and solicited rebates without the shipper's knowledge. Several brief quotations from that decision will illustrate the recognized breadth of the Act:

"It strikes at any and every kind of rebate, no matter by whom or to whom given."

"It was recognized that, in order to ensure carrier efficiency, rates must be maintained unimpaired and that the Elkins Act no more intended to allow third persons to tamper with the statutory scheme than it intended to allow carriers and shippers themselves to do so."  
(Underscoring supplied)

In Spencer Kellogg & Sons, Inc. v. United States, (CA 2) 20 F. 2d 459, cert. denied 275 U.S. 566, the Court considered a situation involving a grain elevator operator, neither shipper nor carrier, who rebated to a shipper in respect to interstate shipments and stated:

"The application of the statute (The Elkins Act) is not limited to shippers and carriers, but includes and punishes any person or corporation whose intended acts result in the transportation of property at less rates than those mentioned in the tariffs lawfully published and filed by common carriers.

Its broad and sweeping language is a clear expression of the intendment of Congress to make the purpose of the Act applicable to any person or corporation who might be in a position to commit an act which would accomplish the forbidden result, namely, transportation of property at less rates than those named in the tariffs published by the carriers. \*\*\*"

The case of United States v. Miller, 18 S. Supp 389 involved a shipper's bookkeeper who with various other persons unrelated to either the shipper or carrier, solicited and obtained rebates with respect to the transportation of the shipper's property but did not act in concert with the shipper. In holding Miller's activities to be in violation of the Elkins Act as an interference with the even flow of interstate commerce, the Court stated:

"An essence of the offense is interference, aside from the gain or loss occasioned thereby."

As a practical matter, most rebate or concession cases result from covert activity and require careful and painstaking investigation and analysis of the facts uncovered. Matters of this nature

come to the attention of the Commission by compliance survey, complaints of injured parties, competitors, labor unions or public spirited persons. The existence of the conglomerate is unlikely to make the already difficult tasks of investigation and legal analysis any more difficult nor is the conglomerate existence likely to limit the sources of discovery of such violations. As previously indicated, our conclusion is that the statutory basis for dealing with such violations is already on the books.

Commodities Clause

Section 1(8) of the Interstate Commerce Act (49 U.S.C. 1(8)) reflected the early policy of Congress that rail carriers should disassociate their primary business of furnishing transportation, from the production and sale of commodities (other than lumber and items for use in carrier operations). In short, Congress did not favor a dual position for a railroad, namely, common carrier and private shipper. It was felt that such dual position enhanced rate discriminations, unfair car distribution and the control of production through refusal to effect switch connections with competitive producers. This rationale would seem equally applicable in respect to the operation of conglomerate holding companies and the courts have indeed applied the Commodity Clause to the situation where the ownership of both railroad and producer was in a holding company. In United States v. Reading Co., 253 U.S. 26, the court held that the

Commodities Clause was violated when the officers and directors of a railroad and coal-mining company and holding company owning all the stocks of the other two companies were the same. Subsequently, in the Elgin and South Buffalo cases the Commodities Clause effectiveness was impaired. The Commission's 69th Annual Report (page 93) summarizes the situation as follows:

"United States v. South Buffalo R. Co.,  
333 U.S. 771.

The Supreme Court held in this case that the commodities clause of the Interstate Commerce Act, section 1(8), does not prevent the South Buffalo Railway Company, which is a wholly owned subsidiary of the Bethlehem Steel Corporation, a holding company, from transporting commodities of a producer, the Bethlehem Steel Corporation, which is a subsidiary of the same holding company, so long as the control of the South Buffalo is not so exercised as to make it the alter ego of the holding company.

The Court pointed out that following its 1936 decision in the case of United States v. Elgin, Joliet & Eastern R. Co., 298 U.S. 492, the holding company revised its intercorporate relationship to comply, as it was advised, with the conditions under which the Court had found the statute inapplicable to United States Steel. Bethlehem (the Court said) "unquestionably had power to favor its shipping subsidiary at the expense of its carrying subsidiary, or vice versa." The Court concluded under the facts of this case, that mere possession of power regardless of whether it is exercised or remains dormant, does not make out a violation of the statute. While stating that if the Elgin case were before it as a case of first impression, its doctrine might not now be approved by the Court, Mr. Justice Jackson writing for the majority pointed out that in the Commission's 50th annual report, it recommended to Congress, following the decision in the Elgin case, an amendment to the commodities clause, but that Congress took no action on such recommendation.

The opinion also refers to the fact that in S. 2009, which became the Transportation Act of 1940, Congress considered amending the commodities clause, but found that to do so would be "far too drastic." Under these circumstances the Court refused to disturb the Elgin decision.

The equitable consideration that if the Court refused to follow the Elgin precedent, a different and more drastic rule to Bethlehem would apply than applied to its competitor, United States Steel Corporation, was also relied upon. The Court said:

Congress, however, in making a rule for the future, can make one of impartial application to all like situations. Limitations that are traditional upon our powers do seem not to permit us to do so."

The fact that Congress failed to amend the Commodities Clause in the Transportation Act of 1940 after repeated urgings by the Commission may be construed as a change of policy upon the part of Congress and an acquiescence in the Elgin and South Buffalo decisions. Indeed, in 1939 a bill had been introduced in the Senate (S. 2009, 76th Cong. 1st Sess., March 30, 1939) which would have extended the commodity clause to cover carriers other than railroads, and subsidiaries, affiliates and controlling persons. The matter was dropped, the Committee, in reporting the bill said "The re-written commodities clause was considered far too drastic and the subcommittee early decided against any change therein."

It may be that with the current conglomerate boom the legislative and judicial atmosphere has changed. The Commission has alternative avenues open to it. If a substantial commodity clause

situation involving a conglomerate arises in the immediate future, despite the Elgin and South Buffalo cases, the Commission can risk a third strike by seeking an injunction in the new factual situation in what may be presently a more favorable Court atmosphere. Alternatively, the Commission could now recommend modification of the Commodities Clause to reach carriers other than railroads, and subsidiaries, affiliates and controlling persons. I favor the legislative approach in statutory language designed to overcome the decisions in the Elgin and South Buffalo cases. Indeed, the Court invited that approach and although Congress once rejected the Commission's urgings of change, there is presently proposed legislation involving akin matters which might serve as a springboard to effect the desired changes.

#### Clayton Act

Section 11 of the Clayton Act (15 U.S.C. 21) vests jurisdiction in the Commission to enforce compliance with sections 2 (price discrimination in the sale or purchase of goods), 3 (tying arrangements), 7 (lessening competition), 8 (interlocking directorates and officers), "where applicable to common carriers subject to the Interstate Commerce Act." The Section 7 and 8 obligations of the Commission are largely supervised under the authority of Section 5 of the Interstate Commerce Act pertaining to combinations and consolidations. Section 10 of the Clayton Act (15 U.S.C. 20) prohibits common carriers from any dealings in securities, supplies or other

articles of commerce to the extent of \$50,000 in any one year with another corporation, firm, etc., when there are common officers or directors, or if they have any substantial interest in such other corporation, firm, etc., unless such dealings or purchases are made under competitive bid.

The existing thrust of these Clayton Act provisions directed to the carrier's participation in the described prohibited activities would appear to be in no way altered or diminished by the existence of a conglomerate. However, from the point of view of investigation and analysis of fact, the complexity of the conglomerate would by its nature add to the complexity of enforcement. Unresolved questions arise under the competitive bidding provisions, Section 10, as to the applicability of that section to transactions between a carrier and a non-carrier which are under the control of a common parent and where there are no interlocking officers and directors between the carrier and non-carrier and no personal financial interest of officers or directors of the carrier in the non-carrier. (Cf. Commission Minute July 6, 1966 re "The Application of Section 10 of the Clayton Act to transactions between a carrier and another corporation, both of which are wholly or largely owned by the same parent or holding company (G.C. Memo No. 144-66))." Essentially, the Commission is but an advisory agency under Section 10. Its duty is to implement the statute by publishing bid regulations, require bid filings, and when its formal or informal investigations disclose

potential violations, to forward the information concerning violation to the Department of Justice as the action agency. Richard W. McLaren, current Assistant Attorney General, Anti-Trust Division, has indicated that he will give "high priority" to conglomerates and that it is his view that antitrust suits should be brought under the existing Clayton Anti-Trust Act before the Justice Department asks Congress for new legislation to deal with the conglomerate issue. (Cf. Wall Street Journal, 1/30/69).

It should be noted that in keeping with the problem considered in the above referenced Commission minute, representatives of the General Counsel's Office and Bureau of Enforcement have conferred with Anti-Trust Division officials concerning dealings between a carrier and non-carrier under a common parent. At this informal conference, a tentative position was taken that Commission staff would not opine upon such problems but would refer information concerning potential violations to the Justice Department as required by the statute.

No change is proposed concerning enforcement under the Clayton Act.

Section 660 Criminal Code

Passing mention should be made of Section 660 of the Criminal Code (18 U.S.C. 660) pertaining to embezzlement, theft, conversion, and misapplication of common carrier funds, securities, property or

assets by a president, director, officer or manager of a common carrier as well as a certain class of employee (restricted to the ticket taker level).

While the Commission does not directly administer this statute, information of such misuse of carrier funds or assets is transmitted to the Department of Justice for prosecution. For example, it was the Bureau's recommendations under this statutory provision that led to the trial and conviction of former officials of the Boston & Maine Railroad for conversion of carrier assets.

It is our view that the growth of the conglomerate will offer greater opportunities to convert carrier assets and some consideration should be given to strengthening this statute to embrace all classes of carrier employees rather than the specifically named officers and the limited description of a small class of carrier employees.

Section 20, I. C. Act

A note of warning should be sounded in regard to guarantees in violation of the letter or spirit of Section 20a(2) which requires Commission approval where the carrier assumes "any obligation or liability as guarantor ... in respect of the securities of any other person." In its interpretation of section 20a, the Commission has generally distinguished between a loan agreement and a credit agreement. The former is a security, the latter is not. (Cf. Capital

Transit Co. Securities, 40 M.C.C. 17(1944)); Transcontinental Bus System, Inc. Notes, 80 M.C.C. 54(1959)). To some degree this section of the Act is self enforcing in that most knowledgeable financial institutions would not rely upon a carrier guarantee not approved by the Commission since if such guarantee were discovered, it would be worthless. On the other hand, the financial position of a holding company could be enhanced by a credit agreement on the part of a carrier even though subsequent issues of notes might be disapproved by the Commission. Such credit agreements are not presently uncommon. To some extent the thrust of the guarantor provisions might also be avoided by carriers issuing excessive dividends to the stockholders including the holding company.

Sections 5, 12 and 20 I. C. Act

Section 5 provides the Commission's authority to approve mergers and consolidations. Sections 12 and 20 provide the Commission's authority to investigate and require reports from common carriers and to some extent from persons controlling carriers, controlled by carriers or under a common control with such carriers.

Obviously, the Commission has the power to condemn unlawful control situations and seek to have them severed by Court action (49 U.S.C. 20(9)). Thus, the problem that may exist in connection with preventing unlawful control is not so much an enforcement problem in terms of legal theory, but the "nitty gritty" problem

of accumulating evidence which of course concerns the Bureau of Accounts and the Bureau of Operations, the investigative arms of the Commission and the Commission's own willingness to institute formal investigation proceedings and to issue subpoenas to require the attendance and testimony of witnesses and the production of all books, papers, tariffs, agreements, and documents relating to any matter under investigation.

It should be emphasized that Section 20(5) grants the Commission power to inspect all carrier records, but then limits the Commission's power to inspect only those records of a party controlling a carrier, controlled by a carrier or under common control with a carrier, which are relevant to such person's relation to or transactions with such carrier. Section 12(1) twice limits the Commission's right to inspect non-common carrier records of person controlled by, controlling or under common control with a carrier to matters related to the management of the business of one or more such carriers. Since a cardinal rule of statutory construction is that a statute which is unambiguous on its face is not subject to construction, it is several times made clear that Congress, at the time of enactment of these provisions, did not intend the Commission's investigative rights in holding company files to reach the extent of a "hunting and fishing expedition" such as those refused by the Courts in applying subpoena and discovery procedures in early cases. The problem here then, is not one of construing an ambiguous statute, but of

practically effectuating the intent of an unambiguous statute which may be difficult of administration. In short, the Commission's investigatory powers should not be curtailed by officials of holding companies making the decision as to which of their records are relevant to the Commission's considerations, yet Congress has not authorized carte blanche entry to the records of a holding company which has not been held to be a carrier by the application of Section 5(3). Congress has, however, authorized the Commission to look at holding company records relevant to carrier operations. Ergo, the holding company cannot refuse records which the "Commission deems relevant" (49 U.S.C. 20(5)). Recent case law permits administrative agencies to make roving inquiries in private books and records to whatever extent seems necessary to make the power of investigation effective. In Oklahoma Press Pub. Co. v. Walling, 327 U.S. 186, 209, the Court laid down the broad standard that the requirement of particularity "comes down to specification of the documents to be produced adequate, but not excessive, for the purposes of the relevant inquiry. Necessarily, as had been said, this cannot be reduced to formula, for relevancy and adequacy or excess in breadth of the subpoena are matters variable in relation to the nature, purposes and scope of the inquiry." The same principle would apply to the Commission's visitorial power as to its subpoena power. Probably the leading case in this area is United States v. Morton Salt Co., 338 U.S. 632, involving an FTC requirement

of broad periodic reports by the company. The Court's language is particularly helpful:

"Even if one were to regard the request for information in this case as caused by nothing more than official curiosity, nevertheless law-enforcing agencies have a legitimate right to satisfy themselves that corporate behavior is consistent with the law and the public interest."

\* \* \*

Again:

"Of course a governmental investigation into corporate matters may be of such a sweeping nature and so unrelated to the matter properly under inquiry as to exceed the investigatory power. ... But it is sufficient if the inquiry is within the authority of the agency, the demand is not too indefinite and the information sought is reasonably relevant."

The breadth of an investigation is for the investigator to determine; the test of a subpoena or a search is relevance to the specific purpose of the investigation. In Detweiler Bros. v. Walling, 157 F. 2d 841, 843 (9th Cir. 1946), cert. den. 330 U.S. 819, the Court stated:

"The only limitation upon the scope of the Administrator's inquiry is that the records demanded be reasonably relevant to the matter in issue."

For those who wish a certain black and white, easy to read chart of relevancy, this is not the area of government enterprise in which to apply their talents.

It might be noted that in those cases where a holding company comes before the Commission in respect to mergers and consolidations,

and subjects itself to conditions imposed by the Commission, there should be no hesitancy in the public interest in finding that that holding company should be considered as a carrier and requiring that all its records without limitation be subject to Commission review on demand.

In view of the state of the law described above, it is concluded that the Commission has adequate statutory authority to perform its investigative obligations under existing legislation.

Possible untested approaches to conglomerate problems presently available to the Commission and the government under existing legislation

Undoubtedly, the Commission's views will be solicited in respect to presently proposed legislation pertaining to the relationship of the conglomerate to the railroads. Commission representatives may be queried as to what measures may presently be available to prevent a conglomerate holding company from misusing assets of the carrier.

Section 20(1) of the Interstate Commerce Act (49 U.S.C. 20(1)) authorizes the Commission to require special reports from carriers. Accordingly, the Commission could order all rail carriers to file special reports of contemplated transactions between the carrier and a conglomerate holding company or affiliate of said holding company thirty days in advance of the consummation of such transaction. Failure to file such reports could be punished pursuant to Section 20(7)(a) of the Act (49 U.S.C. 20(7)(a)) by imposition of a

forfeiture of \$500 per day of refusal, said forfeiture to be imposed upon the carrier and/or the person refusing the report. (For example - when New York Central and the C&O were contesting for control of the B&O and each were making direct or indirect purchases of B&O stock, the Commission required daily reports of all stock purchases).

If a reported transaction appears on its face to result in a misuse of carrier assets or likely misuse of carrier assets, the Commission could seek a preliminary injunction and ultimately a permanent injunction against the transaction pursuant to Section 20(9) of the Interstate Commerce Act (49 U.S.C. 20(9)) and the principles set forth in Section 660 of Title 18 of the Criminal Code providing criminal penalties for misuse of carrier assets. Section 20(9) of the Act provides authority for the Commission to request the Attorney General to seek "mandamus" (now, mandatory injunction Rule 81(b) FRCP) to compel compliance by a carrier with the provisions of the Interstate Commerce Act and "any Act supplementary thereto." Section 660 of the Criminal Code (formerly Section 9 of the Clayton Act) proscribes the misuse of carrier assets and has long been considered by the Commission as being supplementary to the Commerce Act and Elkins Act. (Cf. Commission's Annual Report 1915, pp. 26-27). The general rule that equity will not enjoin a crime would not be applicable in this situation since statutory authority for the injunction exists and where public rights are involved injunctions will issue notwithstanding that the acts

enjoined may also constitute crimes (CJS, Injunctions, Section 152).

Should reports of proposed carrier-conglomerate transactions raise some question as to their propriety rather than clearly point to illegality, the Commission could further investigate the proposed transaction pursuant to its authority under Section 12(1) "to inquire into and report on the management of the business of persons controlling, controlled by, or under a common control with, such carriers ... ." Subpoenas to produce witnesses and documents are available to the Commission under this Section 12(1). (Cf. Ellis v. I.C.C. (1914) 237 U.S. 434 Use of Sec. 12 to discover inter-corporate relationship of Armour Car Lines with Armour Packing Company). It is likely that under a good factual situation, the Courts would grant a preliminary injunction under 20(9) to stay any proposed transaction in aid of the Commission's jurisdiction to investigate "in order to perform the duties and carry out the objects for which it was created ... ." Congress has indicated in its declaration of transportation policy that one of the Commission's duties is to "foster sound economic conditions in transportation and among the several carriers." Further, the Commission must constantly keep itself informed of the financial condition of carriers so that it may be in a position to judge the honesty, economy and efficiency of carrier management as directed by section 15a(2) of the Act on those occasions when the carrier submits rate proposals to the Commission.

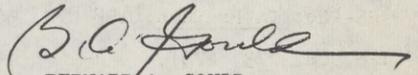
The whole thrust of the Interstate Commerce Act is to preserve the economic well being of the common carrier utility. The Act has oft-times been held to be remedial. Accordingly, when a specific interest and right has been conferred upon the United States by statute, remedies and procedures for enforcing such right and interest are not to be narrowly construed so as to prevent effectuation of the policy declared by Congress. (Cf. Wyandotte Transportation Co. v. U.S. (1967) 389 U.S. 191 (Rivers & Harbors Act of 1899); U.S. v. York (1968) 398 F. 2d 582 (Medicare)). Indeed, if no enforcement procedure had been provided, the Attorney General, by virtue of his office, could protect the United States in the usual way by bringing an action in an appropriate court. (Cf. U.S. v. York, 398 F. 2d 582(1968); U.S. v. American Bond & Mortgage Co., 31 F. 2d 448, affirmed 52 F. 2d 318, cert. denied 285 U.S. 538; Sanitary District of Chicago v. U.S., 266 U.S. 405, 425-426; In Re Debs, 158 U.S. 564; U.S. v. San Jacinto Tin Co., 125 U.S. 273, 279).

#### Summary

With the exception of possible strengthening of the commodities clause (49 U.S.C. 1(8)) and of the embezzlement provisions of the criminal code (18 U.S.C. 660)) and the necessity in all situations in which the Commission authorizes control of carriers

by holding companies to make clear in the order of approval the fact that all of the holding companies' records will thereafter be subject to inspection, the principal enforcement problem which we envision is in the complexity of the investigatory and prosecutorial burdens which come into existence because of the creation of complex corporate devices. Such complexity, as well as the sheer size of the resulting combinations, call for additional personnel for the enforcement staff sufficiently qualified to develop and to prosecute the extremely complicated situations which will arise. Such staff personnel are both difficult to locate and difficult to retain in the light of restrictions on compensation which are presently applicable.

The above should be considered in connection with my comments submitted contemporaneously on H.R. 7373 and H.R. 7374 which would require Commission approval for single-carrier control transactions.

  
BERNARD A. GOULD  
Director

REPORT ON PROJECT # 46

CONGLOMERATE MERGER ACTIVITY OF  
CLASS I RAILROADS AND RELATED REGULATORY PROBLEMS

BUREAU OF ECONOMICS  
INTERSTATE COMMERCE COMMISSION

March 1969

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## BUREAU OF ECONOMICS

March 26, 1969

CONGLOMERATE MERGERSI. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

A new generation of financial promoters have rediscovered the holding company. Near the turn of the century, J. P. Morgan and other investment bankers employed it very profitably in the construction of giant corporations within various industries. It also was the basic mechanism employed by Insull in building his grandiose public utility structure during the thirties. In its present reincarnation, the holding company is being used to assemble aggregations of enterprises across industry lines, i.e., corporations engaged in diverse kinds of business enterprise.

The holding company device has long been used to extend and/or restructure railroad systems. It is now being used to join railroads, financially, with other types of industries. This use intensifies the Commission's regulatory and enforcement problems. The present threat to the public interest is not the creation of railroad monopolies or restriction of intra-railroad competition, but the dilution of the interest of managements of the conglomerates in the provision of efficient transportation service and the potential dilution of the capital structure of the railroads. More specifically, the conglomerate holding company provides a convenient means for the transfer to other industries of assets

now devoted to transportation. The first step in such transfer could be neglect of reinvestment of revenue from railroad service in order to accumulate cash for the industrial expansion. This could lead eventually to the wholesale abandonment of run-down, virtually worthless railroad trackage and equipment, and the necessity for nationalization of the railroads. There are, of course, more optimistic possibilities. It can be argued, quite reasonably, that a broader involvement of the railroad industry with other industries could lead to a revitalization of the railroads. It may be that some railroads will be exploited and others revitalized.

Of more immediate concern to the Commission is the certainty that the inclusion of railroads in conglomerate holding companies seriously impairs the Commission's ability to obtain information or to take timely action required for effective regulation of railroad rates and services. The Commission also has responsibility for the capital structure of the total conglomerate since the existence of the conglomerate affects the Commission's control over a railroad subsidiary.

The holding company device greatly facilitates the formation of conglomerate aggregations of corporations. It provides easier access to capital with which to pursue diversification, a greater ability to issue securities and a better opportunity for manipulation of securities. Because of the current tax structure, diversification may be profitably accomplished through the issuance of debt, but the issuance of debt invites abuses of the principles of sound capitalization. Since a sick holding company can have

serious consequences for its subsidiaries, when these include regulated carriers, it is incumbent on this Commission, in the public interest, to determine what action it can and should take in furtherance of the national transportation policy.<sup>1</sup>

Both the railroad and motor carrier industries are in need of economic rationalization of plant. This may be, and is being, accomplished by merger of carriers within each of these modes, particularly railroads. Mergers result in certain disinvestments in excess plant, but these generally require substantial capital to accomplish. Thus useful disinvestment, the rationalization of the nation's rail plant, is more likely to take place as the result of a merger which is under the guidance and control of the Commission, and to which the Commission may attach conditions as needed to protect the public interest.

Other methods of disinvestment (including methods available through the holding company) with the exception of abandonment, generally are not subject to control by the Commission. One of the basic operating assumptions has been that the transportation plant was adequately protected by stockholder interest and indentures on bonds and debentures. With the elimination of public stockholders, such protection is likely to be less adequate. While the bond indenture usually provides some protection, it is generally de minimus. It is noted in this regard that after high special dividend payments in the preceding three years, Bangor and Aroostook,

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<sup>1</sup>No specific consideration has been given here to the adequacy of existing authority or need for legislation.

subsidiary of Bangor Punta, as of June 30, 1968, was not permitted to pay regular dividends because of certain First Mortgage Deeds and Promissory Loan Agreements.

In a sense the Commission must take the position of a minority stockholder for protection of the public interest. To these ends certain recommendations are made: The Commission should -

1. Extend fully the provisions of section 20, 20(a) and 20(b) to the one carrier holding company (possibly section 5), including disclosure of beneficial ownership. If counsel deems the act cannot presently be applied, legislation should be sought.
2. Require that intercompany transactions between the carrier and the parent company or any affiliated therewith should receive prior Commission approval.
3. Require proper allocation agreements, re joint expenses, tax credit benefits, etc., between the parent and its affiliates, including the carrier, to be submitted to the Commission to ascertain the equity of the agreement to the carrier.
4. Require affiliates of the parent, and the parent if a goods producing company, to submit periodic reports on traffic routing by affiliated carrier or carriers.

5. Require the parent company to submit lists of its directors, officers, and directors and officers of all affiliates showing for each director and officer all other corporate affiliations.
6. Develop and apply criteria on the level of dividend payments, loans, advances, and sales or transfers of assets from the transportation company to the parent holding company or to any company affiliated with either the transportation company or the holding company.

The sixth recommendation would go far in eliminating the attractiveness of affiliated companies as a device for transferring assets or income from the transport company. The need for its implementation is therefore stressed.

## II. INTRODUCTORY STATEMENT

### A. Purpose of the study.

The purpose of the present study is to present such readily available information as is likely to be useful to the Commission in dealing with regulatory problems which confront the Commission as the result of the involvement of a substantial and increasing number of railroads in so-called "conglomerate mergers."

B. Technical definition vs. common understanding of the term "conglomerate merger."

Strictly speaking, the term "merger" should be applied only to a consolidation of corporations in which one or more corporations are merged into a surviving corporation.<sup>2</sup> Three basic types of corporate mergers are generally recognized. These are (1) the horizontal merger which consolidates competitors serving a common market, (2) the vertical merger which joins a supplier and a customer, and (3) the conglomerate merger, which brings together corporations which are not directly competitive, i.e., they do not offer the same or similar products or services in the same market, nor have a supplier-customer relationship.

It has become a common practice, during the past few years, to apply the expression "conglomerate merger" to the establishment of any form of intercorporate relationship between or among corporations which do not produce or distribute similar products or services in substantially the same market.

C. Incentives for recent railroad involvement in conglomerate mergers.

One of the objectives which railroads seek by the establishment of conglomerate mergers is diversification of products, service or investment. Diversification is not new to the railroad industry which has a long history of exploitation of the mineral,

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<sup>2</sup>Where all of the previously existing corporations involved in a consolidation lose their identities, i.e., are absorbed by a new corporation organized for that purpose, the consolidation is properly called an "amalgamation."

oil, gas and timber resources of railroad-owned property. Railroads also have been active in the development of real estate along their routes. The primary difference between this type of railroad diversification and recent conglomerate activity is that the early development was generally rail-related, and frequently directed toward generation of on-line traffic. Furthermore, earlier non-transportation activities of railroads generally were carried out by an operating division or a subsidiary of the railroad. They represented a logical form of internal growth, i.e., they were developed by the railroad rather than acquired as going concerns by means of holding corporations created for that purpose.

Diversification as effected by means of conglomerate mergers enables the railroad to utilize its resources more profitably. Entry into more varied types of business activity may tend to smooth the cyclical fluctuations in railroad earnings which are greater than for most other industries. Broader participation in general economic activity may, in many instances, stabilize railroad earnings as well as provide the railroads a better chance to share in long-term national economic growth.

If diversification is a primary objective of the management of a particular railroad, the device of setting up a parent holding company for the purpose of acquiring going concerns through exchange of capital stock has some very real advantages. The risk and cost of failure are likely to be less in purchasing an established firm than in initiating a new business. A going concern's products usually have already gained public acceptance and an

established market. An established business may be expected to have a trained work force and may have, as well, competent middle and top management personnel. The development of a new company generally requires a larger investment in new machinery and facilities as well as a substantial cash fund to cover operating losses until revenue from sales are sufficient to cover expenses.

Once embarked upon a program of diversification by means of conglomerate mergers or similar devices, further diversification would continue more or less on its own initiative. As non-railroad subsidiaries are acquired they may tend to acquire subsidiaries of their own.

There is a rather common belief that railroads, by investing in non-transportation enterprises, are seeking a higher rate of return than is available on assets reinvested by railroads in their own companies. However, in most instances incremental investments in modernization of a railroad yields a substantially high rate of return. Unfortunately, a large proportion of rail assets represent sunk capital, i.e., capital that is more or less permanently committed to railroad purposes. Such assets can be converted to liquid assets available for non-railroad investment in most instances only by gradually being worn out in the production of transportation service. They are converted to cash as part of the revenue received for the service provided. This may be accomplished over a period of time by restricting maintenance or replacement in order to accumulate funds for unrestricted investment outside the railroad industry.

The establishment of intercorporate relationships with companies outside the industry is a much simpler matter for the railroad than is a merger with another railroad. Expensive and lengthy proceedings required to obtain Commission approval of an intramodal merger are avoided. Of course intermodal mergers or investments, except for pipelines and certain types of freight forwarders, are denied to railroads by statute or regulatory policy. Railroads having surplus capital may be, in some instances, virtually forced to look outside the transportation field for investment opportunities.

Federal tax credits generated by rail operations are a factor in some instances. Such credits may be consolidated in Federal tax returns as an offset against net income of jointly-held affiliates, subject to the 80 percent stock ownership rule.

#### D. Corporate structure and intercorporate relations.

In most instances, railroads that have become involved in the current "conglomerate" movement have found it advantageous to create a holding company to acquire, by exchange of stock, the stock of the railroad. Thus, the railroad becomes the first subsidiary of the parent holding company. The holding company then proceeds to exchange additional shares of its own stock for shares of non-railroad companies. This basic plan may be modified in various ways. For example, convertible debentures of the holding company may be offered to non-railroad companies in exchange for their stock. The use of debentures has an important tax advantage to the acquiring corporation because interest paid on the debentures

may be deducted as an expense in determining net taxable income. Debentures are also advantageous if they permit a tax-free reorganization, or are not taxable as capital gains until their redemption date. From here, the financial devices can become incredibly complicated, but this is beyond the necessary scope of the present study.

E. The conglomerate merger movement -- beginnings, rate of development and present status.

The conglomerate merger movement as distinguished from earlier intramodal merger movements began during the late 1950's or early 1960's. However, the rush by railroads to set up parent holding companies as a device for acquiring non-transportation subsidiaries has developed a strong momentum only within the past few years. During that period its development has proceeded at an increasing rate. Recently, in February 1969, both Union Pacific and Penn Central announced plans to create parent holding companies,<sup>3</sup> and the following class I line-haul railroads were, or were expected to become, involved in conglomerate mergers.

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<sup>3</sup>Union Pacific Corporation was organized in Utah on February 3, 1969 to become the parent of the Union Pacific Railroad. On February 17, 1969, the UP Corporation filed registration with the SEC covering \$75 million convertible debentures, 4.75s, due 1999, and 22,429,235 common shares to be offered in exchange for at least 90 percent of the outstanding preferred and 90 percent of the outstanding common stock of the UP Railroad. (Moody's Transportation News, Volume 40, page 1773, dated March 6, 1969.)

Table 1. Selected Class I Railroads: Total Assets as of year end 1967 and Effective Date of Holding Company Involvement

Railroad	Total assets (millions)	Effective date
Bangor & Aroostook	\$ 67.2	10/13/64
Boston and Maine	232.2	5/1/64
Illinois Central	833.5	8/31/62
Kansas City Southern	169.9	1/29/62
Missouri-Kansas-Texas	228.9	8/24/67
Chicago & North Western	672.8	8/3/67
Missouri Pacific	998.1	12/31/62
Seaboard Coast Line	1,211.3	1/21/69
Atchison, Topeka & Santa Fe	1,852.6	8/19/68
Penn Central	4,269.7	Pending
Southern Pacific	2,449.4	Pending
Union Pacific	2,054.2	2/17/69
Denver & Rio Grande Western	282.5	Pending
Total	\$15,322.2	
Total all class I railroads	\$32,308.7	

### III. NATURE AND SIGNIFICANCE OF CONGLOMERATE HOLDING COMPANIES FOR THE COMMISSION

#### A. Introduction.

The next two sections of this part discuss, first, the possible problem of railroad disinvestment<sup>4</sup> through the holding company and, second, the adequacy of present reporting requirements for both rail and motor carriers. In addition to these two, there

<sup>4</sup>Disinvestment may be defined briefly as withdrawal of capital from physical plant, e.g., by failure to use a part of revenues to replace worn out components; as opposed to dissipation which is the withdrawal of useful assets. Given the rates of growth of both public and private motor carriage it is unlikely that disinvestment would be a general problem in that field although occasional disinvestment may occur. The problem of railroad disinvestment is emphasized since undue depletion of rail assets could cause serious service problems.

are five other areas of major concern for the Commission in regulation of carriers under holding companies. Present concern is with the power of the conglomerate holding company for potential action, rather than what it is likely to do. The relevant questions appear to concern effects of the conglomerate holding company on:

1. the efficiency of transportation activities,
2. the Commission's ability to regulate rates and services,
3. inter- and intra-modal competition,
4. innovation by the transport company, the mode, or the industry, and
5. present modal segregations, e.g., between rail and motor carrier, and other forms of transport.

Disinvestment and reporting problems are involved in all of these areas of concern; except to the extent touched on in sections B and C. These questions cannot be answered on the basis of information available at this time. It is possible to speculate on the answers, but it is by no means certain that extensive research would presently yield more than tentative conclusions. Diversification may be the saving force for the railroads; that is no more than a possibility. However, the questions that present themselves in connection with diversification are too important for the industry and the total economy not to make every effort to find the answers.

Many railroads, as they are known today, are the result of consolidation of numerous small railroads. Some railroads have, through the years, merged many underlying corporations into the

parent structure. However, mergers were not always possible, and portions of the railway were made up by control and/or leasing of the smaller units.<sup>5</sup> As a result, many railroad systems still have corporate structures of such complexity as would tax the ingenuity of anyone attempting to allocate overhead items among the various affiliates and subsidiaries.<sup>6</sup>

The problem of allocations is more difficult when some of the affiliates or subsidiaries are non-carriers. In order to more fully demonstrate this complexity, corporate structure charts have been included in the Appendix for the following companies: (1) Bangor Punta Corporation, (2) Illinois Central Industries, Inc., (3) Kansas City Southern Industries, Inc., (4) Katy Industries, Inc., (5) Mississippi River Corporation, (6) Northwest Industries, Inc., and (7) Penn Central Company. These charts indicate the direct and indirect relationships between the parent company and its affiliates and subsidiaries. It is interesting to note that as of December 31, 1967 the Penn Central Company had more than 190 corporate affiliates.

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<sup>5</sup>Reasons for this are numerous. For example, the State of Texas required that railroads operating in Texas be incorporated in Texas. Other railroads, some of which were incorporated more than a century ago, obtained franchises which contained certain privileges which would be lost if the underlying company were merged into the parent railroad. By maintaining the underlying company the parent railroad might be able to limit liability for any mishaps that occurred on the property of the subsidiary company.

<sup>6</sup>By "corporate structure", as used in this particular paragraph, is meant the direct and indirect relationships between the parent company and its affiliates and subsidiaries.

B. Disinvestment in plant or dissipation of assets.

In July 1965 a carrier bought two industrial concerns for \$27 million and the credit of the purchased companies. Funds for the purchase were derived primarily from sales of carrier real estate. By the end of 1967 these companies had earned in excess of \$35 million dollars and paid nearly 50 percent of that in dividends to the carrier. These transactions appear to constitute disinvestment but certainly not dissipation. Dividends to date have been nearly 50 percent of amount invested -- a much higher return than from additional (incremental) investments in railroad plant. A clearer case of dissipation (in the sense of diminishing the assets of the railroad) could have been made had the available funds been paid out in dividends to stockholders of the railroad.

Railroads in their diversification activities have used, generally speaking, two approaches in acquiring and including non-carrier companies into their, the railroads', corporate structures, namely:

1. A non-carrier company is acquired by and becomes a subsidiary of a holding company, which company, in turn, is a subsidiary of the railroad. An example of this would be: Macco Realty Company, a non-carrier, is a wholly-owned subsidiary of the Pennsylvania Company. All common stock of the Pennsylvania Company, in turn, is owned by the Penn Central Company.<sup>7</sup>

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<sup>7</sup>On January 22, 1969, the Penn Central Company issued a press release which indicated that Penn Central was in the process of setting up a holding company on top of the railroad. The proposal will be submitted to the stockholders at their May 13, 1969 meeting.

2. A holding company is set up "on top" of the railroad. The capital stock of the railroad is exchanged for capital stock of the holding company. Thereby, the stockholders of the railroad become stockholders of the holding company and the railroad becomes a subsidiary of the holding company. An example of this would be: Northwest Industries, Inc., a holding company, owns in excess of 90 percent of the capital stock of Chicago and North Western Railway, as well as, in excess of 90 percent of the capital stock of Philadelphia & Reading Corporation, a non-carrier.

Holding companies are used to "own" the stock of individual corporate entities of controlled companies as distinguished from acquisitions which are merged into existing corporate structures. In the latter situation, the corporate structure of the merged company ceases to exist.

1. Motivation.

- (a) Rates of return.

Prudent management would dictate a limitation of investment activities to companies showing substantially greater rates of return than generated by the railroads themselves, to provide a greater return for the stockholders of the parent corporation. This would apply regardless of whether the parent in the organization is the railroad itself or a holding company which owns the capital stock of the railroad. In either case, it could cause disinvestment in railroad plant if the investment is financed by funds obtained from railroad operations.

It is generally conceded that there is substantial over capacity in rail plant in the United States. One fundamental objective of railroad mergers is to create the opportunity to reduce

the size of railroads rationally without materially reducing viable service in a particular area. Stated differently, a rail merger can provide the opportunity to shrink rail plant with a minimum of detrimental effect upon all parties concerned. However, the creation of this opportunity to disinvest via merger (or consolidation) is under the control and guidance of the Commission and its conditioning powers under section 5 of the act. Under these circumstances, a merger permits the internal rationalization of economic units in the railroad industry as well as some assurance that the public interest is being safeguarded.

On the other hand, there is a broader rationalization which relates the railroad industry to the economy as a whole. Other things being equal (e.g., equal risk, etc.) and under ideal conditions, the national economy, theoretically, is at maximum efficiency (creating maximum benefits to industry and to the consumer) when rates of return are equal for each industry and each company in the economy. Under such conditions, each firm and each industry would be using the exact proportion of national assets required to produce maximum consumer benefits. This condition of economic equilibrium, however, is never actually achieved because the national economy is constantly adjusting to change. Because such adjustments to change are delayed by contractual relationships and other resistance to change, as well as differences in risk, etc., rates of return tend to vary significantly as between industries and as between companies in the same industry. However, despite these obstacles capital has a tendency to flow out of low return

or overinvested industries into those yielding high returns (primarily as the result of under investment). The following table shows percent return on net worth for various types of enterprises as compared with that of class I railroads.

Percent Return on Net Worth, 1958-1967

Year	Class I Railroads	Other Transportation	Manufacturing	All Corporations
1958	3.5	7.2	9.8	9.0
1959	3.4	8.7	11.6	9.8
1960	2.6	5.8	10.6	9.1
1961	2.2	4.0	9.9	8.7
1962	3.3	7.3	10.9	9.0
1963	3.7	9.1	11.6	9.7
1964	3.9	15.8	12.6	10.3
1965	4.6	20.2	13.9	11.1
1966	5.1	19.7	14.0	11.4
1967	3.0	p 17.8	12.5	10.5

p - Preliminary.

Source: First National City Bank, New York.

Under these conditions, capital invested in railroads tends to flow to more remunerative industries.

To some extent, railroads and other utilities are regulated with a view to the achievement of goals other than economic efficiency, e.g., social objectives. This, together with the difficulty of liquidating "sunk" capital investments, has tended to retard the outflow of capital from railroads to industries having higher rates of return.

Despite regulation, however, the railroad industry has not been entirely insulated from the capital market. The Chicago

and North Western at the initiation of its diversification program was able to take \$30 million from the sale of real estate and from its cash drawer without Commission approval for investment in chemical subsidiaries. Such action produced returns far in excess of those that could be anticipated from investment of the same amount in its railroad plant. The returns from its chemical companies have been significant and may have, in fact, benefited its rail operations (by reason of strengthening C&NW's overall financial position). The obvious lesson to be learned, however, even if C&NW's management continues to be prudent, is that the rail enterprise must stand on its own feet if it is to continue to receive the capital input which may be necessary to provide an adequate and efficient service to the public. Under these circumstances, there would be no problem for the Commission in respect to disinvestment as long as the railroad continues to be a profitable concern earning an adequate rate of return.

Diversification will raise certain problems for management, for the Commission and for rail transportation users, however, should the railroad become unprofitable. For example, if rail management, or the holding company owning its stock, views the long-run prospect as a continuation of currently unprofitable operations, its management is likely to attempt to shift its capital funds to an increasing extent to non-transportation investments. Given alternative investment opportunities, if management arrives at the conclusion that there is no future in railroading, it may be expected to try to shift its investment to non-transportation activities. If such

judgment is premature, then the transportation system will suffer unnecessarily. If the management's judgment is correct, the rail system as it is known today would die a natural death unless government action were taken to restore and maintain the rail plant or to defer its demise.

Except for some differences in procedure the result would be much the same where the railroad itself seeks to transfer its capital to non-rail companies or where it accomplishes such transfer through the vehicle of a parent holding company. In either respect, the Commission's existing reporting requirements are inadequate to provide the information necessary to prevent such disinvestment of rail assets.

(b) Tax incentives.

Initially Federal tax laws assumed some importance because corporate securities may be exchanged under certain circumstances on a tax free basis. The price offered, in terms of a proposed securities issue of an acquiring company, must be above, and usually is substantially above, the market price of the securities to be acquired. The holders of the latter securities are thus provided with immediate non-taxable paper profits. In addition, if acquisitions are financed through the issuance of debentures, the resulting interest payments become tax deductible expenses to the holding company.

Many railroads also have substantial tax loss credits which can be carried forward as offsets against future earnings. These can be lost if the railroad fails to earn offsetting income

in future annual periods. These amounts are substantial and in some instances may offer a strong inducement to rail stockholders to approve conglomerate mergers, since railroad tax credits can be consolidated with the income of other affiliates.

There is also the possibility that diversification itself may create continuing tax benefits. A confidential staff study by the Federal Power Commission indicated that the diversified companies they studied paid about 32.5 percent on net income while non-diversified firms paid about 37.5 percent. The staff report cautioned that a definitive conclusion could not be reached because of data deficiencies.

While initial tax considerations are important to many railroads, they do not appear to be such an important factor for motor carriers or general industrial enterprises.

(c) The recent tendency to attribute growth of enterprises to diversification.

The recent surge in the acquisition of disparate companies began in the computer and electronic field -- the "glamour" stocks of the last few years. These companies, because of their actual and projected growth, captured the imagination of the investing public. As the leading conglomerates, such as Litton Industries, expanded into other fields, there may have been an undue tendency to attribute their remarkable rate of earnings growth to diversification. Growth prospects, whether in terms of earnings or equity capital, are attractive, and securities of such companies sell at high earnings multiples. This factor has made acquisitions

of conglomerates more attractive to stockholders of acquired firms. There is also a widely accepted belief that inclusion in a conglomerate has inherent synergistic benefits.

Under normal circumstances, the stock of a single product firm may sell at conservative multiples of 10 to 12 times earnings, which, incidentally, may be justified in part by lack of growth prospects. The stock of an aggressive holding company on the other hand may sell for 20 to 30 times earnings because its assets and absolute earnings appear to be continuously growing. Thus, stock market values of the holdings of subsidiaries may improve regardless of whether or not there is any concomitant improvement in economic value.

(d) Other factors -- motivations to acquire.

Some rail conglomerate holding companies may have been motivated by the desire to avoid the necessity for Interstate Commerce Commission approval of new security issues. This motive is indicated by the following paragraph from a Securities Exchange report on Katy Industries' application:

Katy has for some time been considering a program of diversification through the acquisition of non-railroad business. Since Katy's debt severely hampered its ability to finance acquisitions and since no equity securities of Katy could be used for acquisitions because of Interstate Commerce Commission limitations and not more than 20 percent of the total voting securities of a subsidiary could be so used because of Federal income tax provisions, it was concluded that the vehicle for conducting this program should be a new parent corporation which would own the stock of Katy and would not be burdened by the debt of Katy or Interstate Commerce Commission prohibitions.

In this situation Katy Industries became the equity owner in M-K-T railroad, a company whose equity value is somewhat in doubt because of its large debt. If the top officers of the railroad gain control of the holding company, they and the erst-while rail stockholders will have escaped the railroad debt as well as ICC restrictions on the issuance of securities used to acquire non-rail subsidiaries. Under these conditions, the officers' sense of identity of their own fortunes with those of the railroad becomes tenuous. Future demands for funds for diversification by the holding company may be such as to induce these officers to transfer rail funds needed for rejuvenation of rail service to investment in non-rail enterprises.

A further problem exists if Katy Industries' bonds or debentures are issued, and funds are needed to meet interest payments. Since normal income from all conglomerate sources may be insufficient to pay the bond interest, there may be every inducement to obtain the needed funds from the railroad with little regard for the railroad's needs for reinvestment. In this way, the holding company, Katy Industries, with which management now identifies itself, may survive and proceed to acquire non-rail enterprises.

## 2. Methods of financing.

### (a) Securities and financing.

Part of the problem in the area of securities and financing was touched on in the discussion of Katy Industries. Before considering other problem areas it must be emphasized

again that the parent holding company may provide various benefits for the carrier. In the case of Katy Industries, for example, it may be that it can provide needed capital on favorable terms when the railroad itself would be obliged to pay high rates for funds, or be barred from capital markets completely (e.g., Northwest Industries provided C&NW railroad with \$14 million at prime interest rates, i.e., lower rates than the railroad itself could have obtained). The holding company may, if it has the cash, advance investment and working capital to the carrier from its own funds.

An area of major concern is the present propensity of the conglomerate holding companies, industrial as well as railroad, to issue interest bearing debentures plus other securities to security holders of the company being acquired. One such proposal called for the issuance of debentures requiring interest payments of over \$50 million a year. This, with interest on the acquired companies own debt, would have matched the total income available for payment of the fixed charges of the proposed acquisitions. The inherent dangers are obvious. If the industrial concerns acquired by the holding company should experience financial difficulties, the railroad would be looked to as a possible source of debt-servicing funds.

There is generally in these transactions a heavy discount of prospects for future growth. The conglomerate holding company, in exchanging its debentures for stock of an industrial subsidiary being acquired, often finds it necessary to value the stock of the industrial company well above its market price. This impairs the

financial strength of the conglomerate and of its railroad subsidiary. Loans, advances or guarantees which may pose a similar threat to carrier assets and income and methods are considered in the next part.

Disinvestment may be achieved by many methods. In the case of a railroad company, which must maintain a large investment in fixed assets, two primary methods are available:

1. The undermaintenance of plant; and
2. The payment of excessive amounts for service charges, including management fees where there is a superimposed holding company.

Another method, where the possibility exists, is the sale of assets of a railroad subsidiary to the holding company at book value or at less than market value. Where tax credits due to rail losses exist, they may be partially denied to the railroad by virtue of adverse tax allocation agreements. For a limited time, a railroad could be operated at a loss (through excessive charges for maintenance, depreciation or service charges, etc.) in order to produce significant tax losses to offset the profitable returns from the non-transportation activities of the conglomerate enterprise. "Sunk" capital or initial investment in rail plant may be high enough to foreclose this approach. There is also a remote possibility that additional tax losses could be created by rail bankruptcy.

(b) Inter-company transactions.

A non-railroad holding company, which has been regarded by the Interstate Commerce Commission as not subject to its regulatory control, may have scant regard for the obligation of a railroad to provide adequate transportation service. The holding company, as the controlling stockholder of its subsidiary corporations, generally controls policies of the subsidiary. In an effort to serve the primary interests of its own stockholders, the holding company may set policy for the railroad subsidiary that is distinctly adverse to the interests of rail customers. Such a holding company may, for example, seek to have the railroad pursue a policy of liquidating its assets in order to transfer cash or other liquid holdings to the holding company on less than favorable terms to the railroad.

As indicated in the foregoing, the most likely avenue of programmed disinvestment would be through the undermaintenance of plant, excessive service charges, or the collateral payment of excessive dividends up to the maximum limit permitted by bond indentures.

The preceding analysis has been primarily concerned with rational and possibly prudent disinvestment in excess rail plant. The problem of dissipation is conceived to be the transfer of carrier assets to non-carrier activities in a manner causing inevitable deterioration of service and is discussed in Part V.

There are many methods which may be used in transferring assets or income from the carrier to the holding company. The

holding company can set up subsidiary companies to service the railroad (or perform the functions itself) at charges higher than those available in the market and above the cost of having the carrier perform the service function itself. Conceivably, a separate company could even be set up to perform rail maintenance work. Management services may also be rendered at excessive charges. Rail carrier property may be sold at less than fair market value, or the carrier may be directed to buy property of other affiliates at prices in excess of its reasonable market value.

C. Adequacy of present reporting requirements.

Present reporting requirements of the Commission may be able to provide adequate after-the-fact information, but they are totally inadequate for control purposes. If the Commission is to control carrier conglomerate investment activities, it must have knowledge of transactions which are contemplated rather than that of transactions consummated. Pre-knowledge of contemplated actions, similar in nature to that required in rail abandonment hearings, would be required if the Commission is to influence rail conglomerate activities.

Regardless of whether the holding company owns the railroad or vice-versa, the Commission will experience difficulties in administering the act because the data reported to the Commission does not provide sufficient detail. More information is required to determine the proper allocation of items between carrier and non-carrier operations. Examples of this include both the handling of overhead items and the treatment of tax savings resulting from

the application of tax loss carryovers. Similar difficulties will be experienced in such areas as cost of capital and rate of return. Numerous other items will also require allocation between rail and non-rail accounts.

Railroads, in their Form A annual reports to the Commission, are obliged to list the 30 largest stockholders of record.<sup>8</sup> With the advent of a rail holding company, only the holding company will show the extent of its holdings.<sup>9</sup> While it knows that the holding company controls the railroad, the Commission does not know, from its own records, who controls the holding company, unless the holding company is presently required to file a Form A report with the Commission.<sup>10</sup>

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<sup>8</sup>At the present time, many of the names shown on the list of 30 largest stockholders of record for each of the respective railroads are "street names." As such there is a veil between the identity of the beneficial stockholders of record. In the current Rock Island case, F.D. No. 22688, an attempt was made to pierce that veil as to the identity of certain stockholders of five railroads.

<sup>9</sup>This is illustrated by the following example. Schedule 108 of the Bangor and Aroostook 1967 Form A indicates that it is controlled by Bangor Punta Corporation, which in turn controls through another wholly-owned subsidiary, Bangor Punta Operations, Inc., 98.6 percent of the capital stock of the railroad. Schedule 109 shows that Bangor Punta Operations, Inc. is the largest BAA stockholder with 177,337 shares; the 30th largest BAA stockholder owns only two shares.

<sup>10</sup>Should the Commission require the holding companies to file reports with the Commission under section 20 of the act, presumably the Commission could and would also require the holding company to identify the 30 largest stockholders of record, and to identify, if it can, the beneficial owners of blocks of stock of the holding company.

The holding company, however, is now required to meet SEC requirements on "insider reporting." The SEC-required report shows for each officer and director of the holding company, and for anyone owning more than 10 percent of any class of capital stock of the holding company, the extent of his respective ownership of holding company capital stock.

Even where the top company is a railroad required to meet the Commission's reporting requirements under section 20 and security issuance requirements under section 20(a) of the act, the Commission has only a limited amount of information on the railroad's non-carrier activities. When the top company is the holding company, less information would be available to the Commission.

The problem areas mentioned thus far are for illustrative purposes only and should not imply that these are the sole problem areas. The following list cites 15 problem areas or questions. Even here the 15 items are not an exhaustive list of problems posed by conglomerates; the list could vary depending on corporate structure and financial activities.

1. Rate of return earned on non-carrier investments as compared to return on incremental investments in transportation services.
2. Analysis of methods used in allocating overhead items.
3. Analysis of transactions made between the parent company and its subsidiaries, and between the subsidiaries and the parent company which do not now require ICC approval.
4. Has the parent company assumed or guaranteed the long term debt of the subsidiary or has the subsidiary guaranteed any debt of the parent?

5. How is long term debt handled? Who makes the decision to borrow? Who borrows the money, the parent or the subsidiary?
6. How are tax loss carryovers handled? Does the transportation function get any benefits of the savings in taxes?
7. How are intercorporate transfers of real or personal property handled?
8. Precisely what services or functions do the holding company and the operating company render each other?
9. How is short term financing handled?
10. What are the franchise rights of the holding company and its scope of authorized operations?
11. To what extent, if any, have non-carrier investments of the holding company aided or hindered the operating company in its traffic solicitation?
12. What about the commodities clause of the act?
13. Has the acquisition of non-carrier companies by the parent affected the Moody's or Standard & Poor's ratings of outstanding or new securities of the operating company?
14. What is the capital structure of the various corporations involved?
15. What is the effect, if any, of interlocking directorates?

#### IV. MOTOR CARRIER DIVERSIFICATION

Two of the most significant and controversial motor transportation trends today are diversification by motor carriers or the purchase of trucking firms by enterprises outside the industry. Although both trends are recent phenomena, prevailing economic conditions indicate that they will continue at an accelerated rate in the future.

Diversification by the motor carriers, as in the case of railroads, can be attributed to many factors. Some of the more important include: (1) a desire to improve the carrier's competitive position; (2) the influx of second generation management; (3) an effort to lower the firm's financing costs; (4) stockholder pressure for growth and higher dividend; (5) to take advantage of a favorable tax position; (6) to gain greater financial resources; (7) to smooth out effects of the business cycle; (8) to obtain higher rates of return; (9) to create further expansion possibilities; (10) to broaden the base of earnings; (11) to attract managers better acquainted with modern management techniques; and (12) to improve earnings in order to reduce risks for bankers, financiers and shareholders.

For the most part, motor carrier diversification appears to have been directed principally to the entering of new markets which are basically transport oriented. These activities can range all the way from the manufacturing of heavy duty springs to the performing of non-scheduled air taxi service. The extent of diversification varies with the carrier. Since the motor carrier industry generally is in need of capital rather than a capital supplier, it would appear that most immediate non-transportation diversifications would tend to be in those areas where limited amounts of capital are necessary for purchase.

Some companies such as Consolidated Freightways, Inc. have been very aggressive in their transportation-oriented diversification programs. A few motor carriers, by diversifying into

such non-transportation activities as the production of furniture, beverages, door-operating devices, cleaning and laundry plants (and even a string of trade and technical schools) have taken on the characteristics of "conglomerates."<sup>11</sup> The real giants of the industry in this respect, however, are The Greyhound Corporation and to a lesser extent, Transcontinental Bus System, Inc., itself a subsidiary of the TCO Industries, Inc.

The Greyhound Corporation's national and international diversification program is so extensive and has been in such a constant state of change during the past few months that its present corporate structure is subject to change almost over night. An example is its recent offer to purchase the Armour Company. While the direction of the company's future is still open to speculation, its present activities have been primarily in such areas as food and financial services, computer and transportation equipment leasing, and airport services. Although bus operations still account for the bulk of the company's net operating income, company management and a cash-rich position make it likely that even more of the conglomerate company's funds will be allocated to activities other than intercity bus transportation.

Trucking diversifications are generally being financed with cash, stock, or a combination of both, with the transactions being directed by motor carrier holding companies. The vigorous

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<sup>11</sup>It should be noted that a motor carrier can inadvertently become a conglomerate merely by securing through normal motor carrier merger proceedings a non-transportation firm.

use of the holding company as the means by which trucking firms can diversify should be of major concern to the Commission. Not only are most of such holding companies now free of Commission jurisdiction, but very little actual data are available to the ICC concerning their activities or financial interrelationships.<sup>12</sup> Evidence of the difficulty of ascertaining financial relationships is illustrated in Table 2.

Although the use of the holding company as a tool for expansion is not a new concept, its use by the motor carrier industry has been increasing rapidly. This is indicated by the fact that more than two-thirds of the 42 trucking holding companies<sup>13</sup> reporting to the Commission have been established in the past five years.

Of all the contemporary industry changes, by far the greatest future concern to the Commission in terms of economic consequences is likely to be the trend toward the purchase of motor transport companies by conglomerate corporations (i.e., Novo Industrial Corporation, Alleghany Corp., etc.). Because of the fluidity of the present situation, it is extremely difficult to make a static appraisal of the present scope of this movement. However, a review of some of the more recent transactions (see Table 3) will shed some light on the magnitude of the trend.

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<sup>12</sup>Consolidated Freightways, Inc., for example, in its 1967 Annual Report to Stockholders reported consolidated operating revenues of \$311,872,000, or roughly \$113,593,000 greater than the operating revenues reported in the carrier's ICC Annual Report. In other words, over 36 percent of the carrier's total income now comes through non-reported activities.

<sup>13</sup>The listing of holding companies involved in affiliations with motor carriers is complete as of January 1, 1969.

Table 7. Net Operating Revenues Reported in the 1967 ICC Annual Reports by Motor Carrier Holding Companies

Name	Classification of Motor Carriers of Property Principal Type of Service Performed	Operating Revenue (Item 3000)	Income From Noncarrier Operations (Item 6100)	Interest Income (Item 6300)	Dividend Income (Item 6400)	Other Nonoperating Income (Item 6500)
1. Asbury System	Liquid Petroleum Products	\$ 964,366	\$ 106,271 <sup>1</sup>	\$ 3,400 <sup>a</sup>	\$ -	\$ -
2. City Bus Company	Bus Transportation	-	573,041 <sup>a</sup>	61,631 <sup>a</sup>	200,000 <sup>a</sup>	-
3. Ohio Rapid Transit, Inc.	Did not file in 1967	-	-	-	-	-
4. Service Tank Lines	Liquid Petroleum Products	341,603	90,331 <sup>b</sup>	-	1,882 <sup>a</sup>	-
5. U.S. Truck Lines, Inc. of Delaware	-----	1,746,354	-	124,478 <sup>a</sup>	905,000 <sup>a</sup>	405,657 <sup>c</sup>
6. The Conway Corporation	Consultant <sup>d</sup>	-	-	-	-	-
7. Garage Services, Inc.	----- <sup>e</sup>	-	-	-	-	-
8. Consolidated Freightways, Inc.	-----	-	-	659,620 <sup>a</sup>	3,500,000 <sup>a</sup>	8,505
9. The Pittston Company	-----	-	229,987,193 <sup>f</sup>	558,611 <sup>a</sup>	3,900,000 <sup>a</sup>	872,137
10. Harms Holding, Inc.	Did not file in 1967	-	-	-	-	-
11. Yale Express System, Inc.	-----	1,021,612	-	20,605 <sup>a</sup>	-	66,030
12. Transco, Inc.	Corporation owning securities of motor carriers	1,272,593	-	-	-	238,686 <sup>g</sup>
13. 2625 Territorial Road Company	-----	869,895	-	-	-	-
14. The Greyhound Corporation	-----	1,036,282	-	6,923,178 <sup>a</sup>	24,000,000 <sup>a</sup>	17,348
15. Buffalo Express, Inc.	-----	183,084	-	1,767,233 <sup>a</sup>	5,763,320 <sup>a</sup>	-
16. Hudson-Mahwah Realty Corporation	Bus Transportation	121,000	-	-	-	-
17. Hudson-Paramus Realty Corporation	-----	26,330	-	2,171 <sup>a</sup>	-	-
18. Hudson Transit Corporation	-----	572,362	-	-	-	-
19. Jupiter Transportation Company	-----	-	-	1,608 <sup>a</sup>	472,500 <sup>a</sup>	12,500
20. Orblank Securities	Bus Transportation	-	-	-	-	50,000 <sup>h</sup>
21. Short Line Terminal Agency, Inc.	Bus Transportation <sup>i</sup> and Real Estate	605,014	-	-	-	-
22. Fleet Management Company	-----	1,401,646	200,471 <sup>j</sup>	71,994 <sup>a</sup>	-	-
23. Harnac Insurance Agency, Inc.	Insurance and Truck Hauling	-	225,598 <sup>k</sup>	2,715 <sup>a</sup>	150,000 <sup>a</sup>	1,540
24. Harold Ralph Corporation	-----	-	-	-	15,475 <sup>a</sup>	-
25. Trailhold, Inc.	-----	-	-	-	-	-
26. Trailmar Corporation	----- <sup>l</sup>	383,750 <sup>l</sup>	-	-	-	-
27. Transport Services, Inc.	-----	400,424	-	-	-	-
28. Mel and Christie Peterson Foundation	-----	-	-	71,285 <sup>a</sup>	180,000 <sup>a</sup>	107,901 <sup>l</sup>
29. Weber Moving and Storage, Inc.	-----	44,237	-	1,788 <sup>a</sup>	3,109 <sup>a</sup>	-
30. A. F. A. Truck Leasing Corp.	Leasing and providing driver personnel for private carriage	-	1,358,121 <sup>m</sup>	-	-	4,350
31. Merchants Transfer and Storage Co.	-----	533,213	180,402 <sup>n</sup>	16,500 <sup>a</sup>	-	147,672 <sup>l</sup>
32. Midwest Terminals, Inc.	Year consummated 1968	-	-	84,537 <sup>a</sup>	2,479,601 <sup>a</sup>	-
33. National City Lines, Inc.	-----	-	55,652	-	1,613,400 <sup>a</sup>	-
34. Spector Industries, Inc.	-----	-	-	1,084 <sup>a</sup>	-	-
35. BHM Corporation	Year consummated 1968	-	-	-	-	-
36. The Capital Corporation	Year consummated 1968	-	-	-	-	-
37. The Colony Company	Year consummated 1968	-	-	-	-	-
38. International Utilities, Inc.	Year consummated 1968	-	-	-	-	-
39. Matlack Corporation	-----	-	-	543,850 <sup>a</sup>	117,000 <sup>a</sup>	-
40. Mohr Leasing Corporation	Year consummated 1968	-	-	25,589 <sup>a</sup>	-	-
41. Red Arrow Securities Corp.	Year consummated 1968	-	-	-	-	-
42. Transcontinental Bus System, Inc.	-----	17,553,714	22,250 <sup>o</sup>	13,188 <sup>a</sup>	6,147,417 <sup>a</sup>	214,205 <sup>l</sup>
					106,950 <sup>a</sup>	

<sup>a</sup> Motor carriers - affiliated carriers  
<sup>b</sup> Other than motor carrier

<sup>c</sup> Marine operations.

<sup>d</sup> See indication as to the source of income.

<sup>e</sup> Trucks and trailers leased to oil companies.

<sup>f</sup> Believed from filing motor carrier company consolidated financial statements.

<sup>g</sup> Garage services, Inc. did not have operations, income, operating expenses nor pay any salaries.

<sup>h</sup> Sale from bituminous coal, wholesale and retail fuel oil, retail stores, natural gas, and lumber, etc.

<sup>i</sup> Rent and Service income & sale of land.

<sup>j</sup> Payment of \$30,000 per year to Orblank Securities Corp. by Orange & Black Bus Lines, Inc. for advice, consultation, financing and other services.

<sup>k</sup> Short Line has ownership of the following companies: Hudson Transit Lines, Inc. (54.5%); Hudson Paramus Realty Corp. (50.0%); Hudson Mahwah Realty Corp. (50.0%); and Hudson Transit Corp. (50.0%)

<sup>l</sup> Income from Four Seasons Apartments.

<sup>m</sup> Commissions on sale of insurance.

<sup>n</sup> The Trailmar Corporation holds 100% ownership of the holding company -- Trailhold, Inc.

<sup>o</sup> Lease income on equipment.

<sup>p</sup> Nonoperating income from such sources as rental of buildings, ranch lease, gain on liquidation, insurance refund, oil royalty and misc.

<sup>q</sup> Truck, trailer and tractor leases and rentals.

<sup>r</sup> Income from rents, leased equipment & storage.

<sup>s</sup> Of the total figure shown for nonoperating income, \$147,517 was derived from a management fee.

<sup>t</sup> Rental of restaurant equipment.

<sup>u</sup> Nonoperating income included \$320.00 from vending machines, \$3,154 from snack bar income, \$139,542 earnings from wholly-owned subsidiaries and \$71,189 damages due from B. F. Goodrich.

Table 3: Recent Purchase of Regulated Motor Carriers by Non-Transportation Companies<sup>1</sup>

Purchasing Company	Principal Business Activity	Consolidated Income -1967- (Million)	Motor Carrier	Operating Revenue -1967- (Million)	Operations
1. Banner Industries, Inc. (Cleveland, Ohio)	Diversified Industrial Products Manufacturer	\$ 15.51	Commercial Motor Freight, Inc.	\$24.5	Ohio Indiana West Virginia Kentucky Pennsylvania
2. Myle Laboratories (El Segundo, Calif.)	Mfg. & distributes electronic components. They also handle data processing systems.	29.75	Redwing Carriers, Inc.	11.2	Southeast
3. Fuqua Industries (Atlanta, Georgia)	Diversified industrial and commercial enterprise -- includes radio & television broadcasting, photo processing and the manufacture of agricultural equipment, construction products, metal buildings and lawn mowers.	60.07	Interstate Motor Freight System	66.28	Midwestern extending to Denver and the East Coast
4. Woods Corporation (Oklahoma City, Okla.)	Manufacturing	38.00	Woods Industries, Inc. (Auto Carrier Division)	13.0	Oklahoma Iowa Missouri
5. U. S. Industries, Inc.	An international manufacturing and marketing organization	283.19	B & F Motor Express  C. I. Whitten Transfer Co. (Explosive hauler)	23.3 4.2	Routes from the East Coast to Wisconsin and Illinois. East Coast
6. Novo Industrial Corp. <sup>2</sup> (New York City)	A diversified manufacturing and service company.	48.41	Boss-Linco Lines, Inc. Hourly Messengers, Inc.	13.0 Not Known	Limited to the East Coast Philadelphia
7. Essex Wire Corporation	Manufacturer of products used in the production, transmission and control of electric current; and a manufacturer of plastics, aluminum extensions and gas controls.	356.29	Transport Motor Express, Inc.	20.0	Indiana Illinois Kentucky Ohio Pennsylvania West Virginia
8. National City Lines, Inc. <sup>3</sup>	A diversified transportation holding company	109.59	D. C. International, Inc. Time-Freight, Inc. Los Angeles-Seattle Motor Express Co. and subsidiary companies	57.0 55.0 23.3	Nationwide
9. Pepco, Inc. <sup>4</sup>	Diversified industrial conglomerate.	665.35	North American Van Lines, Inc.	68.0	Nationwide
10. Allegheny Corp.	A diversified investment firm		Jonas Motor Co., Inc.	42.8	Eastern Seaboard & West to St. Louis and South to Charlotte, N. C.
11. Kmac, Inc. <sup>5</sup>	A pean processor and equipment manufacturer	3.37	Red Ball Motor Freight, Inc.	42.4	Texas Oklahoma Arkansas Mississippi Alabama Missouri New Mexico Colorado Kansas Tennessee
12. Saturn Industries	Production of ordnance hardware and electronic sub-systems & manufacture of precision machine parts.	60.52	C&H Transport Company Bell Transportation Co.	22.7 2.0	Nationwide East of the Mississippi
13. Hill-Elliott, Inc.	Industrial corporation with interest in residential subdivisions and real estate.		Srickland Transportation Co., Inc.	28.1	East of the Mississippi

<sup>1</sup>Source: Review of Transport Topics.<sup>2</sup>Woody's Industrial Manual (New York), July 1968, and Woody's Transportation Manual (New York), September, 1968.<sup>3</sup>1967 Carriers Annual Report to the I.C.C.<sup>4</sup>Novo Industrial Corporation also controls other transportation firms such as Fleet Carrier Corporation (an interstate common carrier of n.w. trucks and buses moving from factory to dealer); Air Dispatch, Inc. (a domestic and international air freight forwarder) and two equipment leasing firms.<sup>5</sup>National City Lines, Inc. also controls local bus lines and an auto distribution carrier.<sup>6</sup>The Pepco family controls one of nation's larger truck tractors, trailers and car leasing companies, Lease Plan International, Inc. Lease Plan in turn owns National Trailer Convoy, Inc. (a common carrier of mobile homes); Beer Transport, Inc. (a contract carrier hauling for Heingold Breweries, Inc.); Relay Transport, Inc. (a contract carrier hauling group to points in New York and south to Virginia); Whitehouse Trucking, Inc. (a hauler of prefabricated buildings and truck bodies); and Flagstaff Trailer Sales, Inc. (which also has rights to haul prefabricated buildings).<sup>7</sup>Kmac, Inc. of San Antonio, Texas is a portfolio company of Texas Capital Corporation of Georgetown, Texas, a business investment firm.

The advantages of having large outside firms invest in an industry that is in need of capital (rather than a "capital supplier") are fairly evident. Not so evident, however, are the ulterior reasons behind the purchase by these outside firms. In spite of the newness of the trend and the lack of quantifiable data, some of the reasons for a non-transportation firm purchasing a truck firm appear to be: (1) the desire to purchase growth (i.e., the firm buys the cash flow and earnings of the carriers, which in turn can cause the market price of the acquiring firm's stock to rise); (2) the purchasing of ready made transportation facilities; (3) the hope for high return on a rather limited capital investment; and (4) the relatively small capital investment by existing management.<sup>14</sup>

The potential for tying the numerous transportation modes together into common ownership by the use of conglomerates has actually been available for a number of years. Only recently has interest been focused on such transactions.

The present concern of the industry appears to have been triggered by the Alleghany Corporation's attempted control of Jones Motor Company, Inc. and the Walter Kidde and Co. proposed merger with Pacific Intermountain Express. While Alleghany already

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<sup>14</sup>Additional reasons could include such things as: (1) the availability of a scientifically oriented staff (i.e., engineers and scientists available to design and develop tank trailers (the recent acquisition of Red Wing Carriers, Inc. by Wyle Laboratories is an excellent example of this); (2) the increased availability of capital with which to make greater investments in revenue producing property; (3) the building of borrowing power and the financial position of the firm; and (4) the ability to increase its market penetration.

had transport interests, Kidde's financial interest, until very recently, was outside the transportation field. Even though Kidde Company plans for a world-wide intermodal transportation system appear to have been at least temporarily thwarted by a number of problems (including a "technical impasse" with P.I.E.) the potential remains.

In view of the importance of these trends to the future of the motor transport industry, it seems imperative that they should be kept under continuing Commission surveillance, while a more in-depth report is undertaken. The study should focus on those specific areas which relate to the effects of such trends on (1) the profitability and earnings of motor carriers; (2) the effect of acquisitions on the companies involved and on their common and preferred stockholders; (3) the extent of possible service curtailments; (4) the general rate levels associated with particular motor carriers; (5) the affects on the total capitalization of conglomerate subsidiary firms; (6) the economic, social and service effects, should a non-transportation firm seek to divest itself of the motor carrier after management has determined that the future of the firm would be unprofitable; (7) the contribution which the conglomerate makes to the overall improvement of its subsidiary motor carrier; (8) the financial interrelationships; (9) interlocking directorships; (10) the potential development of motor or general transportation cartels; (11) the efficiencies generated; (12) the need for greater public disclosure of financial relationships, especially as they apply to holding companies; and (13) the

economic consequences of present trends, including the possible restriction of both inter- and intra-modal competition.

#### V. SECURITIES CONTROL

The securities control problems facing the Commission today are similar in many respects to problems which led to the enactment of present sections 5, 20, 20(a) and 20(b) of the act. The main economic problem at that time, when the present sections were drafted, was to assure Commission control over competitive changes in the railroad industry. Holding companies of today, however, are formed to acquire enterprises in other industries. This raises the question of whether a holding company having only one regulated carrier as a subsidiary is presently subject to the Commission's authority in the issuance of securities.

To date the Commission has declined to extend its section 20, 20(a) and 20(b) authority to conglomerate holding companies. It is strongly recommended that this position be reversed.<sup>15</sup> It is obvious that rail companies could become involved in a precarious financial condition as the result of unsound security issues by the conglomerate parent. If this should occur, the primary source of income or assets would appear to be the carrier component of the holding company. The potential risks to

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<sup>15</sup>Our recommendation is based in large part on such examples as (1) Katy Industries (created in part to evade Commission restrictions on M-K-T security issuance); and (2) Northwest Industries' proposed debenture offer for B. F. Goodrich.

the future of rail service seem great enough to warrant the extension of ICC control to the holding company.

Table 4 shows the capital structure of existing and proposed carrier-based conglomerates with a parent holding company. With the exception of Bangor Punta, the figures reflect basically the railroad capital structure and illustrate the instability that could result from the issuance of debt by some of the parent companies.

Passage of the Mills bill, introduced February 24, 1969, could substantially eliminate the debenture issue problem. The present draft bill would not, however, affect other security issues. Nor does it appear that the proposed bill would prevent issuance of conglomerate debt for general purposes not tied to specific acquisitions.

Commodities Clause. As the number of holding companies increase, the opportunities both for various forms of reciprocal trading and for subtle forms of preference or prejudice among shippers tend also to increase. Industrial traffic managers would naturally tend to route shipments over the lines of carrier members of the corporate family.<sup>16</sup>

The problem can be illustrated by a hypothetical example. Assume a railroad serves two or three meat packers each having several plants on the railroad. If the railroad and one of the

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<sup>16</sup>There is some indication that rerouting of traffic may already have occurred. In F.D. No. 24182, C&NW-Milwaukee merger, the question was raised as to Velsicol Chemical Co. traffic routing after its acquisition by C&NW. Since the question was in the form of "Would you be surprised if routing had changed?", it did not have probative value.

Table 4: Capital Structure

Holding Company	Debt	Equity	Percent Debt	Percent Equity
	<i>millions</i>			
IC Industries <u>b/ c/</u>	\$ 205.0	\$ 500.1	29.1	70.9
Bangor Punta Corp. <u>b/ d/</u>	67.8	47.1	59.0	41.0
Katy Industries <u>b/ c/</u>	111.3	11.0	91.0	9.0
KCS Industries <u>b/ c/</u>	117.1	132.4	46.9	53.1
Northwest Industries <u>b/ e/</u>	400.0	605.0	39.8	60.2
SCL Industries <u>c/ g/</u>	406.7	635.9	39.0	61.0
Mississippi River Corp. <u>a/ c/ i/</u>	38.8	96.8	28.6	71.4
"    "    " <u>b/ c/</u>	63.7	96.8	39.7	60.3
Santa Fe Industries <u>b/ c/</u>	306.3	1,379.6	18.2	81.8
Union Pacific System <u>b/ c/</u>	265.2	1,619.6	14.1	85.9
Southern Pacific System <u>b/ c/ h/</u>	804.8	1,457.6	35.6	64.4
Boston & Maine Industries <u>b/ c/</u>	78.1	232.2	25.2	74.8
Denver & Rio Grande Western <u>a/ c/ g/ h/</u>	85.4	282.5	23.2	76.8
Penn Central Company <u>a/ c/ f/ h/ i/</u>	1,311.6	2,090.8	38.5	61.5
"    "    " <u>b/ c/ f/ h/</u>	2,128.6	2,895.8	42.4	57.6
Pennsylvania Co. <u>a/ c/ i/</u>	66.5	399.4	14.3	85.7
"    " <u>b/ c/ i/</u>	377.9	481.9	44.0	56.0
Total	\$5,040.0	\$9,895.6	33.7	66.3

a/ Company only basisb/ Consolidated basisc/ As of Dec. 31, 1967d/ As of Sept. 30, 1967e/ As of June 30, 1968f/ Pro forma basisg/ Railroad only basish/ No superior holding company formed as yeti/ Excluded from totals

meat packers come under the common control of a single holding company, the opportunity to improve the competitive position of the owned meat packers for the ultimate benefit of the holding company is obvious. While it is true that the Commission's power to regulate service may have to be brought into play to maintain competitive conditions, the opportunities and incentive for the holding company to avoid that power appear substantial. The existence of interlocking directorates may tend to reinforce this potential.

#### VI. WHAT ACTION CAN AND SHOULD THE COMMISSION TAKE?

The foregoing discussion has generally covered the problems of disinvestment and dissipation of rail assets. It has pointed out five problem areas to which only speculative answers can presently be given. This last section examines the disinvestment problem further in terms of existing Commission authority and, whether the authority should be exercised.

##### A. Criteria for disinvestment: Long-run implications.

The fundamental problem in establishing a long-run policy to deter or control disinvestment in plant or dissipation of assets is the creation of measures by which to determine when disinvestment may be justified or when it turns into unjustified dissipation of assets. In essence, the Commission may have to substitute its judgment for that of existing management.

The methods by which disinvestment may be made have been discussed. Criteria, therefore, may have to be developed to determine which securities issues, financing or intercompany transactions

are reasonable and necessary to the operation of the carrier. It is clear that if effective control is to be exercised, such transactions must be subject to prior Commission review and approval. The Commission could thus be inserted into the management of the companies on an almost daily basis. Indeed, the Commission might necessarily have to review everything from carrier maintenance expenditures to dividend practices and might need the power to disapprove unjustified activities.

Control of maintenance expenditures could require that the railroad submit to the Commission its proposed capital and expense budgets for prior approval, to be sure that rail plant was not being downgraded to generate cash. The Commission would thus become, to some extent, the executive committee of every railroad. Such controls could move the railroads a giant step forward toward eventual nationalization.

Under present conditions, the Commission would not undertake such control measures, and the present recommendations for action do not contemplate that it will. The fact remains that the ICC must have information and statutory power available in advance of conglomerate transactions. Even latent power in itself could be a partial deterrent to irresponsible corporate action.

A prime example of the type of transaction which the Commission should review for possible impact on rail transportation is the attempt of Northwest Industries to acquire Goodrich. The following quote comes from the prospectus of Northwest Industries (Feb. 6, 1969):

Industries' ability to pay interest on the Debentures and to carry out its dividend policy will be dependent upon dividends from corporations controlled by it or other sources of funds, such as loans or advances, funds derived from future acquisitions, investments or other transactions of Industries, and cash from tax deferrals and tax savings as may be determined to be properly available to Industries. If adequate funds are not available from other sources, an increase in dividends from some or all of such corporations would be necessary to permit Industries to meet the interest requirements on the Debentures and to carry out its dividend policy since current dividend rates on shares of stock of its present subsidiaries ... directly held by it and ... on shares of B. F. Goodrich Stock, will not be a sufficient source of funds for this purpose. The payment of dividends will be dependent upon earnings, financial condition, covenants in debt instruments of corporations controlled by Industries ... and other relevant factors affecting Industries' dividend policy and the dividend policy of corporations controlled by it.  
(Emphasis supplied)

There appears to be certain evidence of managerial attitudes which could imperil the carrier's stability. Whether it will or not will not be known until some future date.

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Due to the pressure of time, these charts and tables were based on sources which were most readily available. In the past the sources used in the preparation of these charts have proven to be reliable. However, time did not permit the cross checking of the data from these sources against other sources, nor did it permit the resolution of some minor inconsistencies in the data.

A P P E N D I X

In reference to the charts pertaining to: (1) Illinois Central Industries, Inc., (2) Kansas City Southern Industries, Inc., (3) Katy Industries, Inc., (4) Mississippi River Corporation, and (5) Northwest Industries, Inc., the following symbols have been used:

Circles = Stockholders' Interests  
 Boxes with curved ends = Holding Companies  
 Boxes with squared ends = Transportation Companies  
 Boxes with pointed ends = Non-Transportation Companies

In reference to placement on the chart:

Shareholders' Interests are at top of chart  
 Holding Companies come next  
 Transportation Companies come next  
 Non-Transportation Companies come last

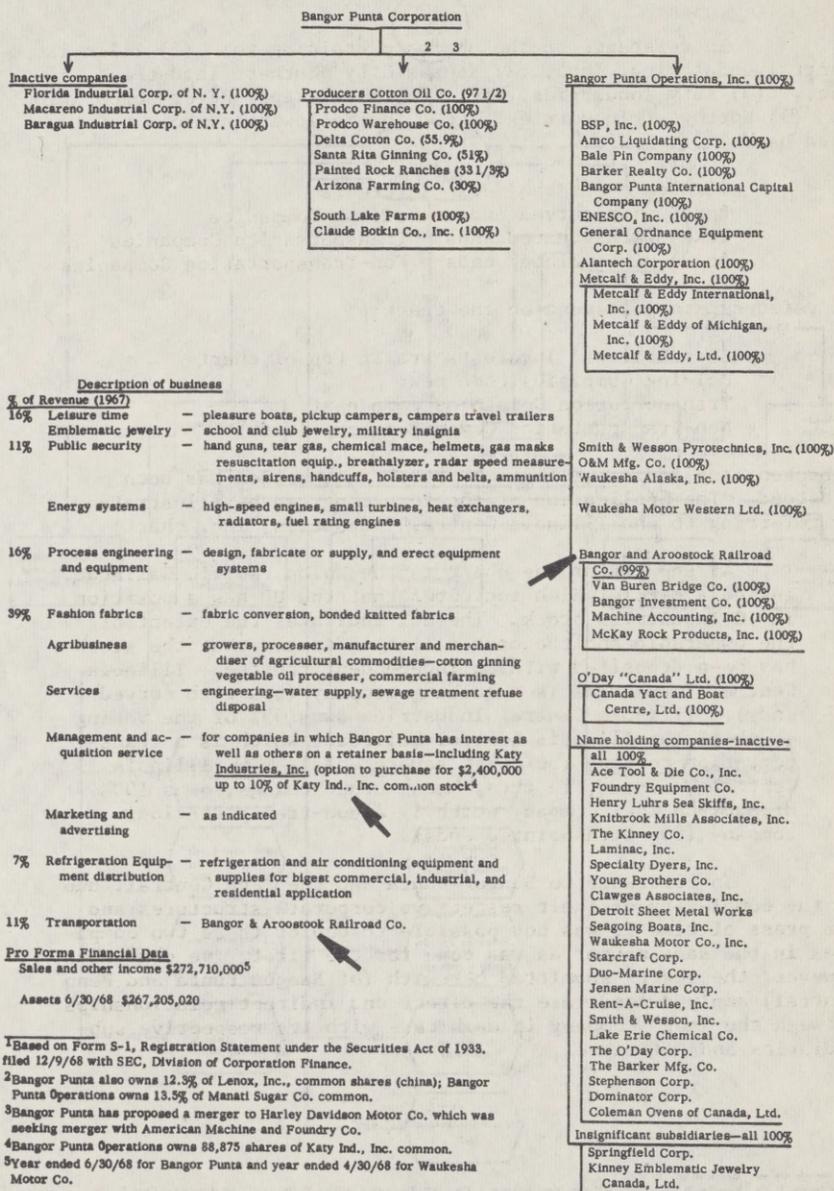
A broken line indicates that the stock in question has been trusteeed. The application of the foregoing can be illustrated by referring to the Illinois Central Industries, Inc. chart.

At the top of the chart is the Union Pacific Railroad, inside a circle which indicates that the UP has a position in IC Industries stock. The 24% indicates the extent of the ownership and the broken line indicates that the stock has been deposited with an independent trustee. Illinois Central Industries is a holding company (box with curved ends). Illinois Central Industries owns 93% of the voting stock of the Illinois Central Railroad, which is a transportation company (box with square ends). The Illinois Central Railroad, in turn, among other things, owns 100% of Madison Coal Company which is a non-transportation company (box with pointed ends).

In reference to Bangor Punta and the Penn Central, due to the complexity of their respective corporate structures and the press of time it was not possible to depict these two companies in the same manner as was done for the first five companies. However, the charts submitted herewith (of Bangor Punta and Penn Central) amply demonstrate the direct and indirect relationships between the "top" company in each case with its respective subsidiaries and affiliates.

BANGOR PUNTA CORPORATION<sup>1</sup>

(No stockholder known to own 10% or more of any class of voting securities)



<sup>1</sup>Based on Form 5-1, Registration Statement under the Securities Act of 1933, filed 12/9/68 with SEC, Division of Corporation Finance.

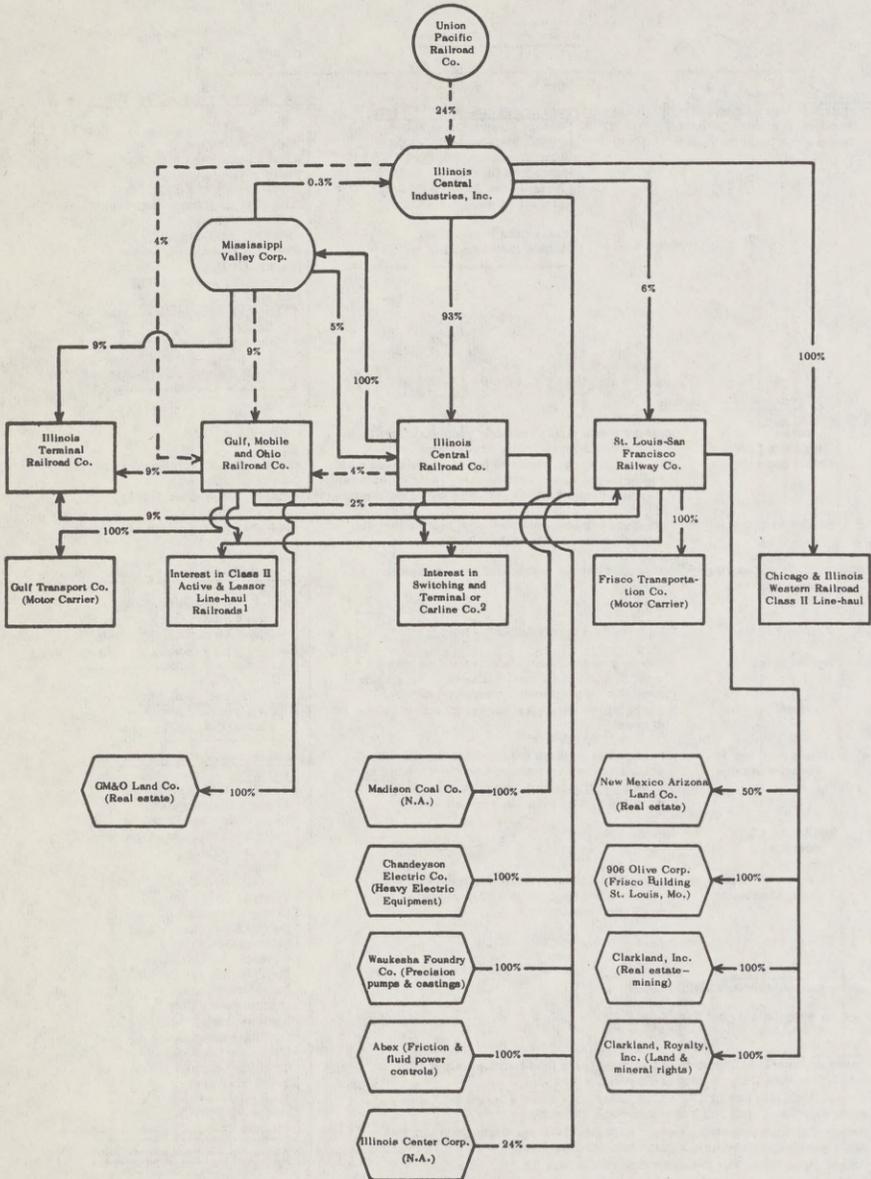
<sup>2</sup>Bangor Punta also owns 12.3% of Lenox, Inc., common shares (china); Bangor Punta Operations owns 13.5% of Manati Sugar Co. common.

<sup>3</sup>Bangor Punta has proposed a merger to Harley Davidson Motor Co. which was seeking merger with American Machine and Foundry Co.

<sup>4</sup>Bangor Punta Operations owns 88,875 shares of Katy Ind., Inc. common.

<sup>5</sup>Year ended 6/30/68 for Bangor Punta and year ended 4/30/68 for Waukesha Motor Co.

ILLINOIS CENTRAL INDUSTRIES, INC.



Note: - - - - - Indicates held in trust.

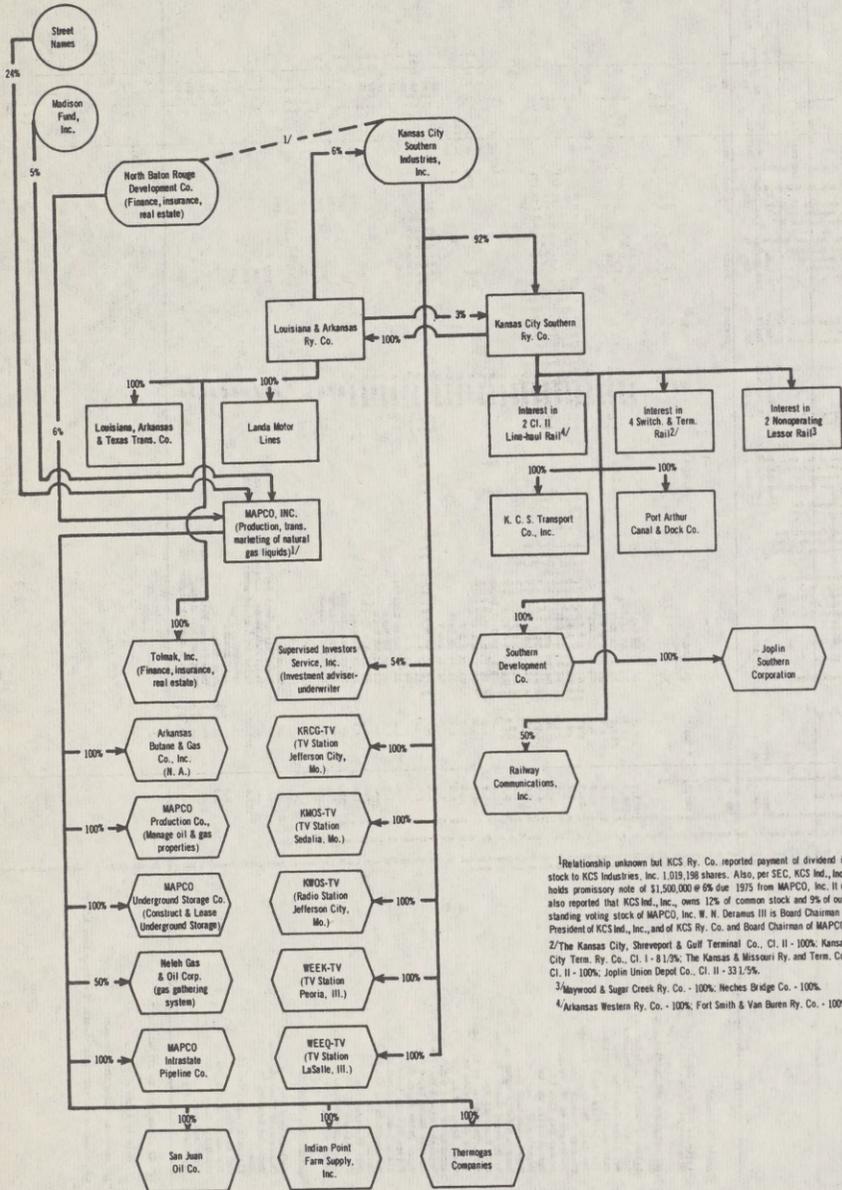
Illinois Central R. Co.: Waterloo R. Co.-100%; Jefferson Southwestern R. Co.-33%; Paducah & Illinois R. Co.-33%; Gulf Mobile and Ohio R. Co.; New Orleans Great Northern Ry. Co.-95%; Mississippi Export R. Co.-25%; St. Louis-San Francisco Ry. Co.: Quannah, Acme and Pacific Ry. Co.-100%; Alabama, Tennessee and Northern R. Co.-100%; Northeast Oklahoma R. Co.-100%; Illinois Central R. Co. also held following inactive railroads: Blue Island R. Co.-100%; Kensington and Eastern R. Co.-100%; and South Chicago R. Co.-100%.

<sup>1</sup>Illinois Central R. Co. (or Mississippi Valley Corp.)-No. 6; GM&O R. Co.-No. 3; St. Louis-San Francisco Ry. Co.-No. 7.

Bur. of Econ. 3/69



KANSAS CITY SOUTHERN INDUSTRIES, INC.



1 Relationship unknown but KCS Ry. Co. reported payment of dividend in stock to KCS Industries, Inc. 1,019,196 shares. Also, per SEC, KCS Ind., Inc., holds promissory note of \$1,500,000 @ 6% due 1975 from MAPCO, Inc. It is also reported that KCS Ind., Inc., owns 12% of common stock and 9% of outstanding voting stock of MAPCO, Inc. N. N. Deramus III is Board Chairman and President of KCS Ind., Inc., and of KCS Ry. Co. and Board Chairman of MAPCO.

2 The Kansas City, Shreveport & Gulf Terminal Co., Cl. II - 100%; Kansas City Term. Ry. Co., Cl. I - 81.2%; The Kansas & Missouri Ry. and Term. Co., Cl. II - 100%; Joplin Union Depot Co., Cl. II - 33.1-5%.

3 Maywood & Sugar Creek Ry. Co. - 100%; Heches Bridge Co. - 100%.

4 Arkansas Western Ry. Co. - 100%; Fort Smith & Van Buren Ry. Co. - 100%.

Kansas City Southern, Industries, Inc.

Interest in	Total assets (mil)	Gross revenues or sales (mil)	Business or product line	Acquisition date	Report filed with SEC	Interest of				
						KCS Industries Inc.	Kansas City Southern Ry. Co.	Louisiana and Arkansas Ry. Co.	Tulshac Inc.	Southern Devel. Co.
<b>Holding companies:</b>										
Kansas City Southern Industries, Inc. <sup>5/</sup>	295.3	85.3	Holding	Inc. 1/29/62	No				Prof.	5.7
<b>Transportation and related companies:</b>										
Louisiana & Arkansas Ry. Co.	100.0	27.8	C I LH Rail		Form A		100			
The Arkansas Western Ry. Co.	..	..	C II LH Rail		Form C		100			
The K.C. Shreveport and G.T. Co.	..	..	C II S & T		Form C		100			
E.C. Terminal Ry. Co.	43.5	--2/	C I S & T		Form A		8 1/3			
The Kan. & Mo. Ry. and Terminal Co.	1.5	..	C II S & T		Form C		100			
Fort Smith and Van Buren Ry. Co.	..	..	C II LH Rail		Form C		100			
Joplin Union Depot Co.	..	..	C II S & T		Form C		33 1/3			
Kansas City Southern Ry. Co. <sup>3/</sup>	169.9	44.3	C I LH Rail	Acq. 1962	Form A	91				
K.C.S. Transport Co., Inc.	..	..	Transportation of persons and property primarily intrastate				100		2.6	
Waywood and Sugar Creek Ry. Co.	..	..	Non operating				100			
Meches Bridge Co.	..	..	Non operating				100			
Burt Arthur Canal & Dock Co.	..	..	Deep water channels and turning basin				100			
Mid-America Pipeline Co. (MAMCO, Inc.) <sup>2/ 5/</sup>	132.6 111.4	47.1 13.6	Production, transportation and marketing of natural gas liquids		Form F					
Louisiana, Arkansas & Texas Trans. Co.	..	..	C II MCC		Form B					
Louisiana Water Lines	..	..	C II MCC		Form B					
<b>Non-carrier operating companies:</b>										
Arkansas Butane & Gas Co., Inc.	..	..		2/69	No					100
MAMCO Interstate Pipeline Co.	..	..			No					100
San Juan Oil Company	..	..			No					100
Indian Point Farm Supply, Inc.	..	..	Mfg. liquid plant foods	1/1/68	No					100
Southern Development Co.	..	..	Mfg. - also has investments		No		100			100
Joplin-Southern Corporation	..	..			No					
Railway Communications, Inc.	..	..	Manufacturing investment adviser and Underwriter		No	53.6	50			100
Supervised Investors Services, Inc.	..	..			No					
KMCO-TV (Jefferson City, Mo.)	..	..	Television station	1966	No	100				
KMS-TV (Sedalia, Mo.)	..	..	Television station	1966	No	100				
DSB (Jefferson City, Mo.)	..	..	Radio station	1966	No	100				
WEEB-TV (Peoria, Ill.)	..	..	Television station	1966	No	100				
WECQ-TV (Le Salle, Ill.)	..	..	Television station	1966	No	100				
Tulshac, Inc.	..	..	Finance, insurance		No					
Salak Gas & Oil Corp.	..	..	Gas gathering system	8/1/67	No			100		
MAMCO Production Co.	..	..	Manage oil & gas properties	1963	No					50
MAMCO Underground Storage Co.	..	..	Contracting & leasing underground storage	1963	No					
Flemco, Inc.	..	..	Manufacturing		No					100
Thermox Companies	..	..	Distributors and manufacturers of retail and wholesale		No			7 shares x book value \$3,000		100

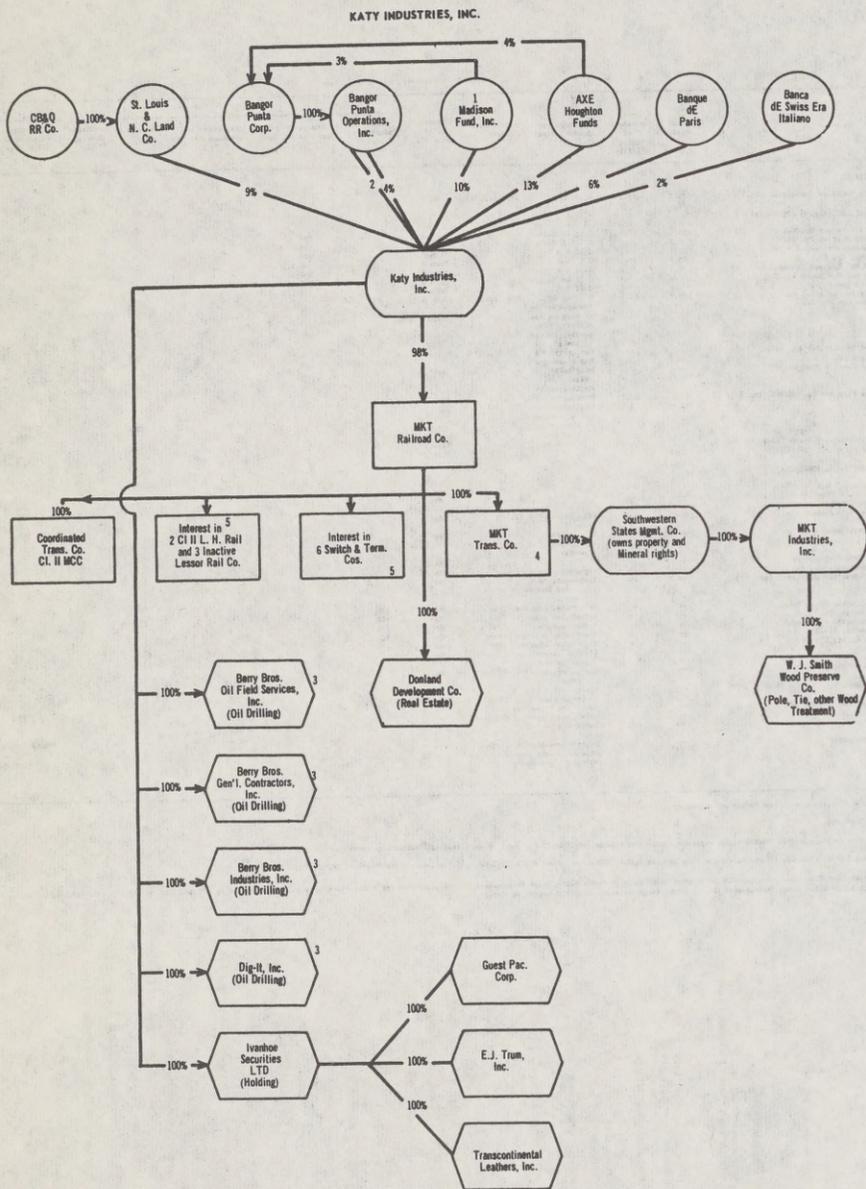
1/ All income and expenses absorbed by parent companies.

2/ Less than \$100,000

3/ Report to stockholders states "MAMCO files separate income tax returns for itself and each of more than 100 subsidiary companies".

5/ W.M. Bertram III is Chairman of the Board and President of E.C.S., Ind. Inc., and K.C.S. Ry. Co. and Chairman of the Board of MAMCO, Inc.

Note: It appears that KCS, Ind. Inc. has 6.3 percent of MAMCO through North Baton Rouge Development Co. of which KCS has 1,019,198 shares paid as dividend by KCS Ry. Co. on 7/31/67. No information could be found in North Baton Rouge Development Co. or other large holdings of MAMCO except as noted.



<sup>1</sup> Mr. Mentle, board chairman of Katy Industries, Inc., says primary job is running Madison Fund, Inc., headquartered in New York, a closed end investment company of which he is president. WSJ 12/20/68.  
<sup>2</sup> Option to purchase not exceeding 200,000 shares re contract to assist in diversification program.  
<sup>3</sup> Acquired for 165,000 shares (Moody's 11/12/68); approximate market value to 3.9 mil.  
<sup>4</sup> Although no report in ICC, stockholders report of MKT R. Co., 1967, states MKT Trans. Co. "operates the company's piggyback and affiliated truck services. It also leases tractor and trailer equipment used in piggyback service."  
<sup>5</sup> See attached table.

## Key Industries, Inc.

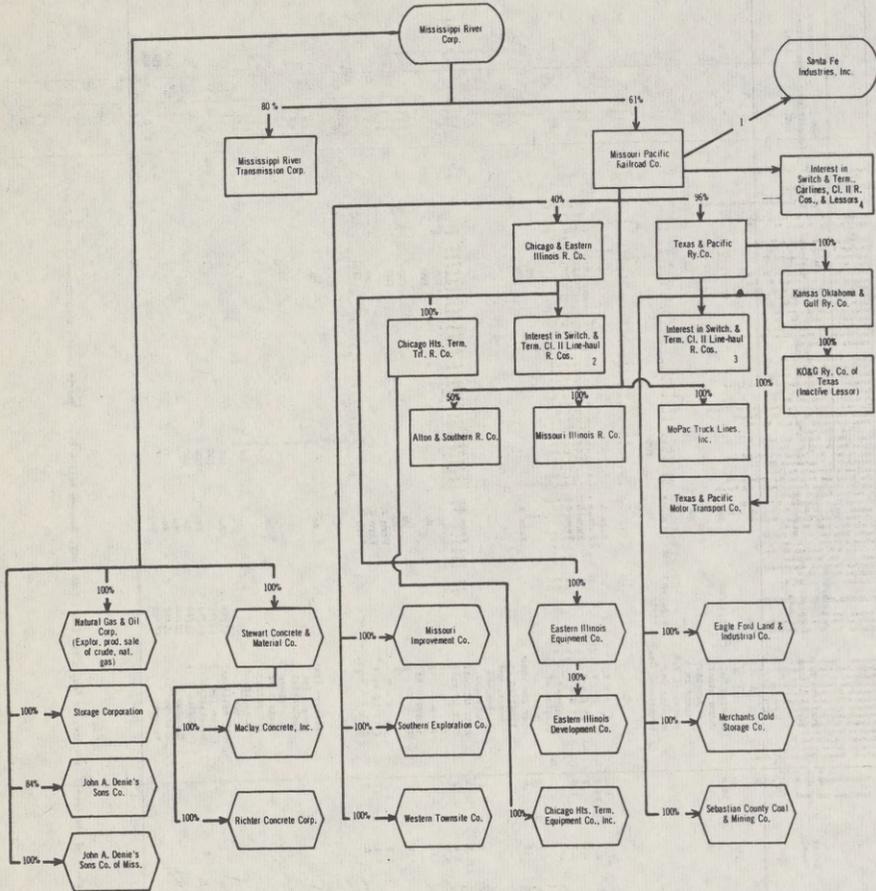
Interest in	Total assets (mil)	Gross revenue of sales (mil)	Business or product line	Acquisition or incorporation date 1/	Report filed with SEC	Interest of				
						Key Ind. Inc.	Southern States Management Co.	M-K-T Railroad Co.	N-K-T Trans. Co.	M-K-T Industries Inc.
<b>BOLIVIAN COMPANIES:</b>										
Key Industries, Inc. Southern States Management Company		56.8	Holding Co. Owns mineral & property rights in 4 C.R.M. Holding Co. Investment Co.	5/31/68	No	100				
M-K-T Industries, Inc. Ivembo Securities Ltd. 2/				8/26/67 10/68	No	100		100.00		
<b>TRANSPORTATION COMPANIES:</b>										
Kansas City Terminal Ry. Co.	45.5	1.6	C I S & T		Form A		8.33			
Terminal Mt. Arm. of St. Louis	78.	23.1	C II S & T		Form A		6.25			
Union Terminal Co. of Dallas	6.6	.2	C II S & T		Form A		15.50			
Union Terminal Ry. Co.	5.6	1.0	C II S & T		Form C		31.33			
M-K-T Transportation Co.	--	--	planning		Form C					
Cooperated Transportation Co.	.2	.4	M-K-T of Texas, in pickup and delivery		Form B		100			
M-K-T Railroad Co.	228.9	56.8	C II M Rail		Form A	97.74				
Bayou, Neuse and Englewood Railroad Co.	2.4	.3	(operating)		No		100			
Central Terminal Ry. Co.	3.2	1.3	(operating)		No		100			
The Wichita Falls and Northwestern Ry. Co.	1.4	1.4	(operating)		No		100			
Texas Central RR. Co.	1.2	1.2	C I S & T		Form A		100			
Port Terminal Railroad Ass'n. 3/	3.1	.1	C II M Rail		Form C		100			
Port Terminal Ry. Mount. & Mand. RR. Co.	5.1	.1	C II S & T		Form C		50			
Appita Water Report Co.	.8	.2			Form C		33.33			
<b>NON-SERVICES OPERATING COMPANIES:</b>										
Boisland Development Co.			Railroad real estate		No		100			
M.J. Smith Wood Preserving Co.			Industrial development		No				100	
Merry Brothers Oil Field Services, Inc.			Oil well (on the Mississippi)	11/68	No	100				100
Merry Brothers General Contractors, Inc.			Oil well (Louisiana)	11/68	No	100				100
Pig-it, Inc.			Oil well (Louisiana)	11/68	No	100				100
Quest Pac Corp.			Unknown	10/68	No					100
Tram-Commutational Leathers, Inc.			Unknown	10/68	No					100

1/ If subsequent to 1/1/60.

2/ Acquisition effects for \$13 million.

3/ Not a corporation. Owned and operated by members of the Assn.: Son Pac, No Pac, AT&amp;T, CHIP, F&amp;M, MKT, Houston Mail &amp; Term, Harris County Ship Channel, Nav. District.

MISSISSIPPI RIVER CORPORATION



1 MoPac R. Co. held \$29,644,000 in Alchison Topoka & Santa Fe R. Co. preferred stock (about 8%) as of 12/31/67. Prospectus of Santa Fe Industries, Inc., 6/7/68, offering exchange of Industries for Railroad securities states MoPac would promptly tender its holdings for Industries debentures.  
 2 Jefferson Southwestern R. Co.—33 1/3%; Term. R. Assn of St. Louis—6 1/4%; Chicago & W. Indiana R. Co.—20%; Belt Ry. of Chicago—8 1/2%; Ill. Term. R. Co.—9.1%.  
 3 Ft. Worth Belt Ry. Co.—40%; T. P.—Ill. P. Term. R. of New Orleans—50%; Texas & New Mexico Ry. Co.—100%; Abilene & Southern Ry. Co.—100%; Western Ry. Co.—100%; El Paso Union Pacifi. Depot Co.—16.2.3%; Great Southwest R. Inc.—45%; Union Term. Co. of Dallas—12.1.2%; Midland Valley R.—100%.  
 4 See attached sheet.

Mississippi River Corporation

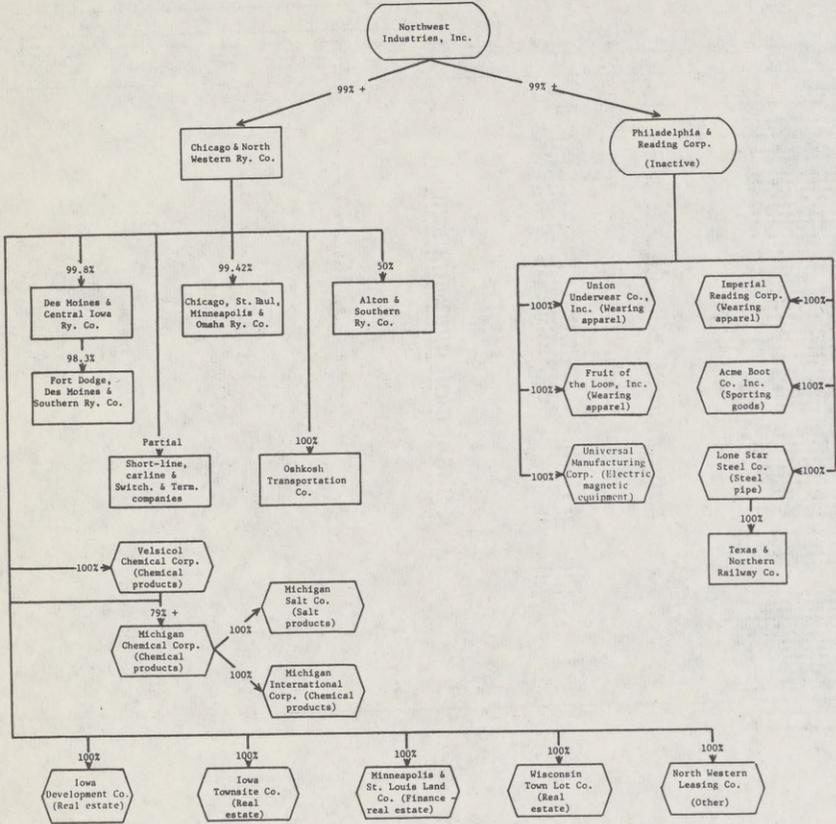
Interest in	Total assets or sales (\$mil)	Gross revenues or sales (\$mil)	Business or product line	Acquisition date if	Report filed with SEC	Interest of							
						Mississippi River Corporation	Missouri Pacific Railroad Company	Stewart Concrete & Material Company	The Texas and Pacific Ry. Co.	Eastern Ill. Equip. Co.	Chicago & Eastern Ill. RR. Co.	Ch. Mgrs. Trf. Co.	Kansas, Okla. & Gulf Ry. Co.
<b>Building companies:</b>													
Mississippi River Corporation	186.2	111.1	Holding		Form A								
<b>Transportation companies:</b>													
Mississippi River Transportation Corporation	53.3	73.1	Natural gas			80.5							
Missouri Pacific Railroad Company	988.1	338.3	C I RR Rail		Form A								
Amer. Railg. Transit Co.	72.0	12.1	Railg. car		Form B-1	60.7		71					
Atchafalaya Union Depot & RR. Co.	.2	--	C II S & T		Form C			15					
Chicago & Eastern Ill. RR.	122.8	42.0	C I RR Rail		Form C			39.9					
Dowdham, Kama, & Seasey Ry.	.8	.1	C II RR Rail	61	Form C			40					
Fort Worth Rail Ry. Co.	.8	.2	C II S & T		Form C			50					
Galv., New, & Henderson RR. Co.	5.1	--	C II RR Rail		Form A			40		60			
Houston Rail & Terminal Ry. Co.	32.2	--	C I S & T		Form C			50					
Jefferson Southwestern RR. Co.	44.7	--	C II RR Rail		Form A			33.3					
Lawrenceville Depot & RR. Co.	.2	--	C II S & T		Form C			20					
Memphis Union Station Co.	2.1	--	C II S & T		Form A			32.1			33.3		
Missouri-Illinois RR. Co.	46.2	4.3	C I RR Rail		Form C			20					
New York Truck Lines, Inc.	8.4	11.4	C I Motor Carrier		Form A			59.8					
New Orleans & Lower Coast RR. Co.	1.9	.6	C II RR Rail		Form A			100					
Packard Car Line Co.	--	--	Railg. car		Form C			100					
Public Union Depot & RR. Co.	.7	--	Line		Form B-1			6.3					
St. Joseph Rail Ry. Co.	.7	.1	C II S & T		Form C			75					
Southern Ill. & No. Bridge Co.	1.4	--	C I S & T	10/60	Form C			100					
Terminal RR. Association of St. Louis	18.1	22.8	C I S & T		Form C			40					
Texas and Pacific Ry. Co.	232.4	76.0	C I RR Rail		Form A			12.5					
Texas City Terminal Ry. Co.	5.8	.9	C II S & T		Form A			95.5					
T.I.C., Terminal Railroad of New Orleans	12.7	--	C I S & T		Form C			23.2					6.25
Union Terminal Ry. Co. (St. Joseph)	2.8	.6	C II S & T	10/60	Form C			50					
W.F. Stewart Pacific RR. Co.	--	--	Inactive		Form C			100					
A.L.I.M.F. Ry. Co.	1,922.9	662.5	C I RR Rail		Form A			100					
Transocean Marine Ry. Co.	20.8	6.6	C I RR Rail		Form C			100					
Ark. & Mem. Ry. Bridge & Terminal Co.	4.0	.8	C I RR Rail		Form C			100					
Brookville & Metromex RR. Co.	4.6	--	C I S & T		Form C			33.3					
Arkansas & Metromex RR. Co.	1.6	.4	C I S & T		Form C			50					
The Texas and Pacific RR. Transp. Co.	1.0	.1	C I RR Rail		Form C			100					
The Washford Marine, Mail, and Merch- western Railway Company	3.7	7.3	C I Motor Carrier		Form A			100					
Chicago Mts. Terminal Trf. RR. Co.	4	--	C II RR Rail		Form C			100					
Kemper, Okla. & Gulf Ry. Co. of Texas	18.3	2.5	C II S & T		Form C			100					
St. Paul Union Passenger Depot Co.	--	--	Inactive - lessee		Form C			100			100		
Great Southern RR. Inc.	1.8	.3	C II S & T		Form C			100					100
Union Terminal Co. of Dallas	36.3	8.8	C I S & T	3/66	Form A			14 2/3					
Alton & Southern Railway	29.8	--	C I S & T		Form C			45					
Chicago & V. Indiana RR. Co.	43.2	13.3	C I S & T		Form A			12 1/2					
Mtly Ry. Co. of Chicago	--	--	C I S & T		Form A			100					
Wichita Terminal Association	11.4	--	C I RR Rail		Form A			100					20
Wilson Valley RR.	23.8	9.5	C I RR Rail		Form A			100					8 1/2
Illinois Terminal RR. Co.	--	--	C I RR Rail		Form A			100					9.1
<b>Noncarrier operating companies:</b>													
Wesley Concrete, Inc.								100					
Elkhart Concrete Corporation								100					
Natural Gas and Oil Corporation			Exploration, prod. & sale of crude oil & natural gas			100							
Missouri Improvement Co.								100					
Eight Four Road & Industrial Co.								100					
Merchants Cold Storage Co.								100					
Sebastian County Coal and Stone Co.								100					
Eastern Illinois Equipment Co.								100					
Chicago Mts. Terminal Equip. Co., Inc.								100					
Stewart Concrete & Material Co.								100					
Southern Exploration Co.						100							
Western Traction Co.			Unknown			100							100
Storage Corporation						100							
John A. Justice Sons Co.						100							
John A. Justice Sons Co. of Miss.						86							
						100							

1/ Period Report 1/1/67 to 4/1/67.

2/ Less than \$100,000.

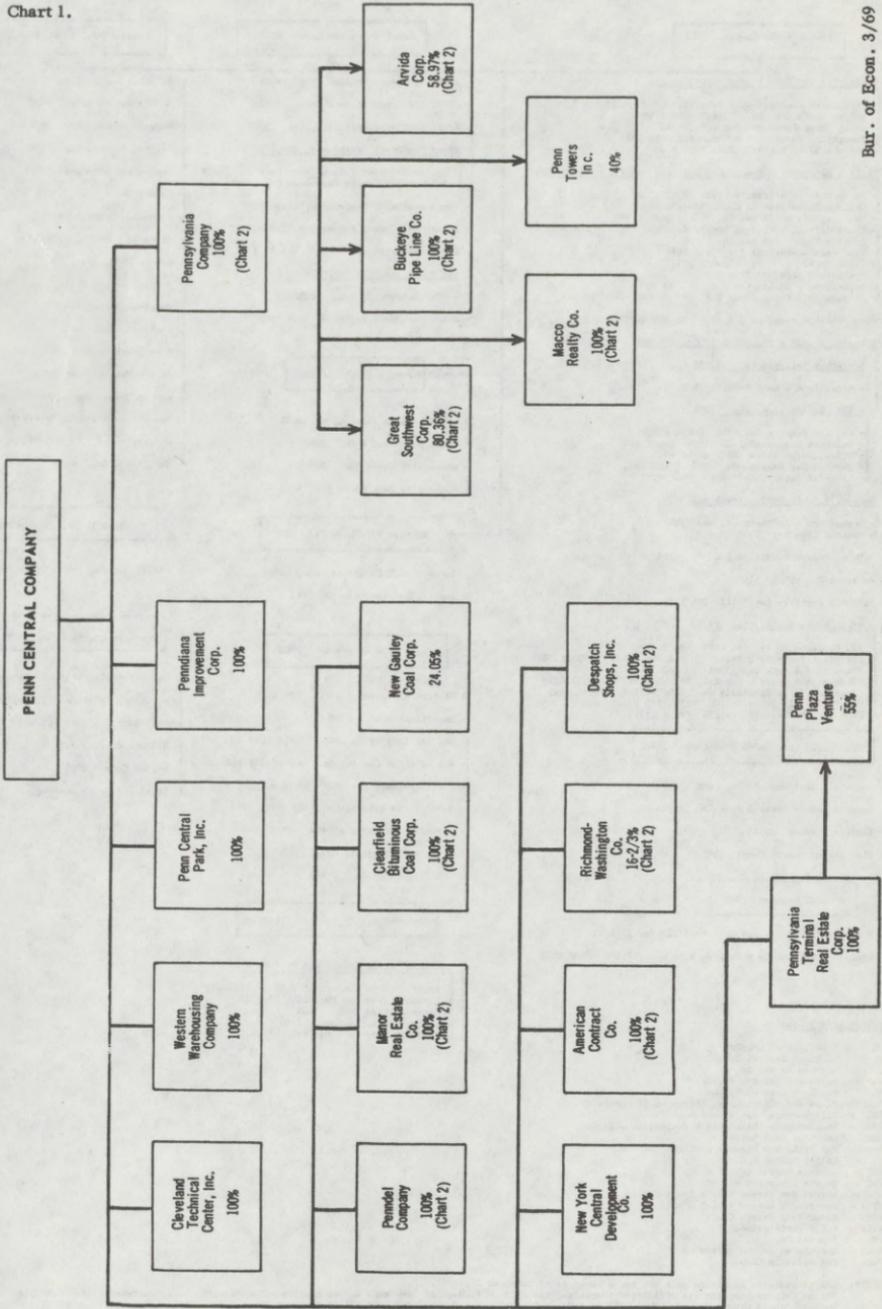
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NORTHWEST INDUSTRIES, INC.



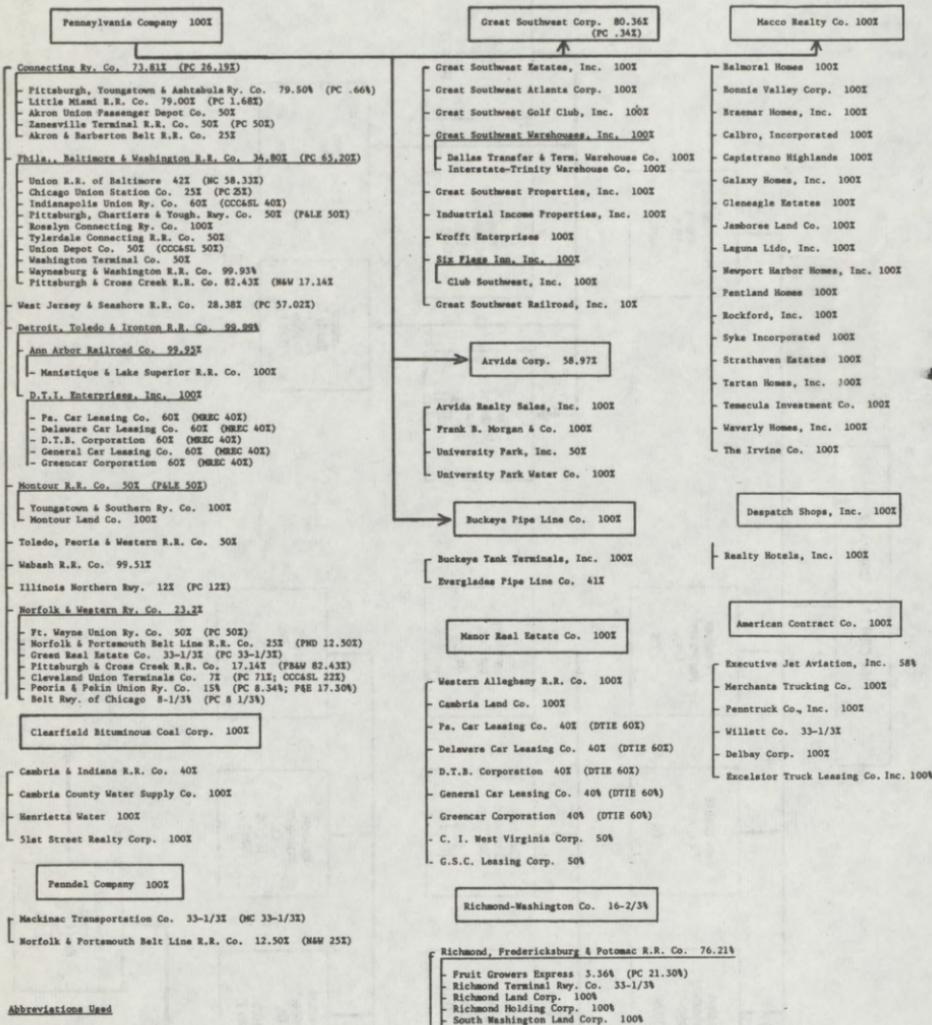
Bur. of Econ. 3/69

Chart 1.



Bur. of Econ. 3/69

Chart 2.



**Abbreviations Used**

- PC - Penn Central Company
- MC - Michigan Central R.R. Co.
- C Ry. - Connecting Ry. Co.
- MAW - Norfolk & Western Ry. Co.
- NC - Northern Central Ry. Co.
- CCCSL - Cleveland, Cincinnati, Chicago & St. Louis Ry. Co.
- PALE - Pittsburgh & Lake Erie R.R. Co.
- FBAM - Philadelphia, Baltimore & Washington R.R. Co.
- MCR - Mahoning Coal Railroad
- NI - New York, New Haven & Hartford R.R. Co.
- LV - Lehigh Valley R.R. Co.
- IEB - Indiana Harbor Belt R.R. Co.
- FAE - Peoria & Eastern Ry. Co.
- UNJHAC - United New Jersey R.R. & Canal Co.
- NY&B - New York & Harlem R.R. Co.
- MBEC - Manor Real Estate Co.
- DTIE - D.T.I. Enterprises, Inc.
- PWD - Pennadel Co.
- Ac/I - Associates of the Jersey Co.
- PCo - Pennsylvania Company

NOTES: Charts indicate situation on a pro forma basis as of December 31, 1967.  
 Strick Corporation, and its affiliated companies, was sold to Prudential Insurance Co. of America and Lehman Brothers, December 1968. (Moody's)  
 Madison Square Garden Corp. now owns 100I of Madison Square Garden Center, Inc. and 80I of Two Penn Plaza. (Moody's)

Chart 3.

**Penn Central Company**

**Class I Line-Haul Railroads**

- Lehigh Valley R.R. Co. 57,727
- Lehigh & Hudson River Ry. Co. 22,145 (PC 14,432)
- Bay Shore Connecting R.R. Co. 502
- Buffalo Creek R.R. Co. 502
- Trenton R.R. Co. 502
- Onasco River Ry. 502 (PC 502)
- Niagara Jct. Ry. Co. 252 (PC 502)
- Black Diamond Transport Co. 1002
- Abelan Corp. 1002
- Consolidated Real Estate Company 1002
- United Real Estate Company 1002
- Pennsylvania-Reading Seashore Lines 66,644
- Pittsburgh & Lake Erie R.R. Co. 81,045
- Monongahela Ry. Co. 33-1/2 (PC 13-1/2)
- Montour R.R. Co. 502 (PaCo 504)
- Youngstown & Southern Ry. Co. 1002
- Montour Land Co. 1002
- Pittsburgh, Chartiers & Trough. Ry. Co. 502 (PSAW 502)
- Mahoning State Line R.R. Co. 502 (PC 1,832)
- Lake Erie & Eastern R.R. Co. 502 (NCR 502)
- Illinois Terminal Railroad Co. 9,091

**Class II Line-Haul Railroads**

- Baltimore & Eastern R.R. Co. 1002
- Cherry Tree & Dinwiddie R.R. Co. 1002
- Central Indiana Ry. Co. 502 (CCCB&I 502)
- Lake Erie & Pittsburgh Ry. Co. 1002
- Monongahela Ry. Co. 33-1/2 (PaLE 33-1/2)
- New York & Long Branch R.R. Co. 502
- New York Connecting R.R. Co. 502 (NM 502) 1/
- Pennsylvania & Atlantic R.R. Co. 1002
- Lehigh & Hudson River Ry. Co. 14,432 (LV 22,145)
- Raritan River R.R. Co. 49,992
- Stearnsston R.R. Co. of Pa. 13,772
- Nicholas, Fayette & Greenbrier R.R. Co. 502

**Class I Motor Carriers**

- Pennsylvania Truck Lines, Inc. 1004
- New York Central Transport Co. 1007
- New York Central Transport Co., Inc. 1002

**Class I Switching & Terminal Companies**

- Belt Ry. Co. of Chicago 8-1/2 (MM 8-1/2)
- Chicago Union Station Co. 252 (PSAW 252)
- Cincinnati Union Terminal Co. 14-2/7 (CCCB&I 14-2/7)
- Indiana Harbor Belt R.R. Co. 711 (MC 502)
- Calumet Western Ry. Co. 502 (PC 252)
- Lakeshore Dock & Terminal Co. 502

**Class II Switching & Terminal Companies**

- Calumet Western Ry. Co. 252 (198 504)
- Dayton Union Ry. Co. 33-1/2 (CCCB&I 33-1/2)
- Fort Wayne Union Ry. Co. 504 (MM 504)
- Peoria & Pekin Union Ry. Co. 8,343 (PaE 17,301; MM 154)
- Toledo Terminal R.R. Co. 32,124 (MC 10,724)
- Wilkes-Barre Connecting R.R. Co. 502
- Onasco River Ry. 502 (LV 504)
- Boston Terminal Corp. 304 (MM 704) 1/
- Chicago River & Indiana R.R. Co. 1004
- Cleveland Union Terminals Co. 711 (CCCB&I 224; MC 711)
- Detroit Terminal R.R. Co. 252 (MC 252)
- Illinois Northern Railway 124 (PaCo 124)

**Non-Operating Railroads**

- Chicago, Galena & Saginaw Ry. 404 (MC 604)
- Detroit, Toledo & Milwaukee R.R. Co. 502 (MC 502)
- Hudson River Bridge at Albany 1002
- Lansing Manufacturers R.R. 502 (MC 502)
- Lansing Transit Railway 504 (MC 504)

**Other Transportation Subsidiaries**

- Canadian Pacific Car & Pass. Term. Co. Ltd. 502
- Merchants Despatch Transportation Corp. 1002

**Lessors**

- Cleveland & Pittsburgh R.R. Co. 80,192
- Connecting Ry. Co. 26,122 (PaCo 73,814)
- (See Pennsylvania Company, Chart 2, for subsidiaries)
- Delaware R.R. Co. 84,922
- Elmer & Williamsport R.R. Co. 87,572
- Erie & Pittsburgh R.R. Co. 87,262
- Northern Central Ry. Co. 80,122
- Shamokin Valley & Pottsville R.R. Co. 71,272 (PC 28,732)
- Union R.R. of Baltimore 28,232 (PSAW 422)
- Penna. Tunnel & Terminal R.R. Co. 1004
- Phila. & Trenton R.R. Co. 10,972 (ULR&AC 64,432)
- Phila., Balt. & Washington R.R. Co. 45,202 (PaCo 34,802)
- (See Pennsylvania Company, Chart 1, for subsidiaries)
- Pittsburgh, Fort Wayne & Chicago Ry. Co. 88,502
- Pittsburgh, Youngstown & Ashokola Ry. Co. 442 (C Ry. 79,202)
- Shamokin Valley & Pottsville R.R. Co. 28,732 (MC 71,272)
- United New Jersey R.R. & Canal Co. 52,634 (PaCo 1,494)
- Phila. & Trenton R.R. Co. 64,432 (PC 10,972)
- Associates of the Jersey Co. 1002
- West Jersey & Seashore R.R. Co. 37,022 (PaCo 28,282)
- Emmettsville Terminal R.R. Co. 30,002 (C Ry. 504)
- Battle Creek & Sturgis Ry. Co. 16,502 (MC 93,502)
- Beech Creek R.R. Co. 79,182 (PaE 1,832)
- Cleveland, Cin., Chicago & St. Louis Ry. Co. 99,474
- Central Indiana Ry. Co. 502 (PC 502)
- Cin. Union Term. Co. 14-2/7 (PC 14-2/7)
- Dayton Union Ry. Co. 33-1/2 (PC 33-1/2)
- Indianapolis Union Ry. Co. 502 (PSAW 602)
- Union Depot Co. 502 (PSAW 502)
- Cleveland Union Terminals Co. 222 (PC 711)
- Peoria & Eastern Railway Co. 50,12 (PC 29,012)
- Peoria & Pekin Union Ry. Co. 17,302 (PC 8,343; MM 152)
- Chicago & Harrisburg Coal Co. 1002
- Shenandoah Coal R.R. Co. 80,645
- Lake Erie & Eastern R.R. Co. 502 (PaLE 502)
- Mahoning & Shenango Valley Co. 1002
- Mahoning State Line R.R. Co. 2,832 (PaLE 92,902)
- Michigan Central R.R. 99,887
- Battle Creek & Sturgis Ry. Co. 83,502 (PC 16,502)
- Canada Southern Ry. Co. 29,442 (PC 15,072)
- Niagara River Bridge Co. 1002
- Detroit Terminal R.R. Co. 252 (PC 252)
- Indiana Harbor Belt R.R. Co. 711 (PC 211)
- Calumet Western Ry. Co. 502 (PC 252)
- Toronto, Hamilton & Buffalo Ry. Co. 21,814 (PC 37,164)
- Chicago, Galena & Saginaw Ry. Co. 404 (PC 604)
- Detroit, Toledo & Milw. R.R. Co. 504 (PC 504)
- Lansing Manufacturers R.R. 502 (PC 502)
- Lansing Transit Railway 502 (PC 502)
- Detroit Manufacturers' Railroad 81,472
- Detroit River Tunnel Co. 1002
- Joliet & Northern Indiana R.R. Co. 1002
- New York & Harlem R.R. Co. 24,432
- Beech Creek R.R. Co. 79,182 (PC 79,182)
- Peoria & Eastern Railway Co. 29,012 (CCCB&I 30,312)
- Peoria & Pekin Union Ry. Co. 17,302 (PC 8,343; MM 152)
- St. Lawrence & Adirondack Ry. Co. 1002

1/ It appears that this property was included in package deal between Trustees of New Haven and Penn Central Company. See Chart 2 for abbreviations.

Interest of Other Federal Agencies in Conglomerates

Congress and certain Federal agencies have had the issue of conglomerate merger activity under scrutiny for some time. In the House, Representative Celler, Chairman, House Judiciary Committee has previously held hearings on conglomerates and plans more. Chairman Mills of the House Ways and Means Committee has indicated that his committee also will investigate the tax treatment accorded stockholders in conglomerate merger transactions and related tender offers.

Representative Keith of the House Interstate and Foreign Commerce Committee has introduced H.R. Res. 315 which would direct various government regulatory agencies, including the ICC, to undertake a joint study of the effect of conglomerate activities on Federally-regulated industries. Representative Staggers has introduced H.R. 7373 and 7374 either of which would give the Commission power over conglomerate transactions.

Between 1950 and 1966, Justice and the Federal Trade Commission, primary enforcement agencies, challenged less than 2 percent of conglomerate mergers, and then only those involving product-extension or market-extension characteristics.<sup>1</sup> Justice has singled out conglomerate mergers involving potential entrants (i.e., competitors) into a relevant market and those which create a danger of reciprocal buying as having sufficiently identifiable

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<sup>1</sup>The March 1969 Federal suit against Ling-Temco-Vought by Justice represents the first instance wherein a "pure" conglomerate merger has been challenged by the Federal government.

anticompetitive consequences to be the subject of industry guidelines. The current Justice suit will test the effectiveness of existing antitrust law to restrict "pure" conglomerate expansions.

The F.T.C. is also the chief source of merger statistics, publishing annual data on the number, size and scope of corporate mergers. It is currently conducting an in-depth staff investigation of the conglomerate merger movement. It hopes to determine whether conglomerate mergers result in technical or business efficiencies, to measure the economic performance of conglomerates in the market place, and to evaluate their effect on market competition.

A current study by the Federal Communications Commission hopes to analyze the ownership of radio and TV stations by licensees with substantial non-broadcasting interests. Some of the specific issues involved in the F.C.C. study are: (a) conglomerate ownership of broadcasting stations and the public interest; (b) advertising reciprocity; (c) allocation of broadcast profits; and (d) technical innovation.

The Securities and Exchange Commission has formulated tentative guidelines for the disclosure of product-line information by conglomerate corporations of their major production activities which contribute over 10 percent of annual sales or profits. A revision of current S.E.C. registration Forms S-1, S-7, and 10, has been proposed. This revision would require multi-business companies to show the approximate amount of total sales and operating revenue produced by each of its 10 most important sales items and the

contribution to corporate net income attributable to each. Separate breakdowns would also be required for any item contributing more than 10 percent of total company sales, income or losses. The S.E.C. also requires the filing of disclosure information at the time conglomerate security issues are offered for public distribution.

A Federal Power Commission staff study on the effects of diversification by natural gas pipelines indicates both benefits and detriments to the regulated firms.

## OFFICE OF THE GENERAL COUNSEL

March 28, 1969

No. 52-69

MEMORANDUM TO CHAIRMAN BROWN:

Re: Conglomerate Mergers

This memorandum seeks to explore some of the legal problems posed by conglomerate mergers affecting railroads and other carriers regulated by the Interstate Commerce Commission and the Commission's power, under the laws administered by it, to deal with such problems.

At the outset it may be well to define what we mean by conglomerate mergers affecting railroads and other carriers subject to Commission jurisdiction. Historically and traditionally mergers or other business affiliations have been vertical or horizontal within a single industry. A vertical merger or affiliation is one that would bring within a single company or common control the supplies of raw materials, the processor or distributor, and a typical example that might be cited as Brown Shoe Company v. United States, 370 U.S. 294. An example of a vertical affiliation involving a carrier regulated by the Commission is provided by Consolidated Freightways, Inc., which controls, among other subsidiary companies, Freight Line Corporation, a manufacturer of heavy-duty trucks and tractors;

Transicold Corporation, a manufacturer of mechanical refrigeration equipment; Plasti-Glas, Inc., a manufacturer of glass, plastic products, and other materials; Transportation Equipment Rentals, Inc., a lessor of freight handling vehicles and equipment, and other companies the products of which could be used in the motor carrier operations of Consolidated Freightways.

A horizontal affiliation is one of enterprises engaged in substantially similar activities, and an example that might be offered is United States v. Philadelphia National Bank, 375 U.S. 321. In the transportation area, a typical example of a horizontal merger is provided by Penn Central, the lines of which represent the merger of literally hundreds of separate railroad companies. An affiliation of railroads is horizontal regardless of whether the lines parallel each other or are end to end.

Generally speaking the antitrust laws are directed at these forms of mergers or affiliations. The Sherman Act, 15 U.S.C. 1, prohibits illegal combinations in restraint of trade and the Clayton Act, 15 U.S.C. 18, prohibits acquisitions where in any line of commerce in any section of the country the effect of such acquisition may be substantially to lessen competition or to end to create a monopoly. Violations may occur whether the affiliations are vertical or horizontal.

Conglomerate mergers or affiliations differ in that they do not conform to the normal pattern of vertical or horizontal affiliations. A conglomerate merger is not one that involves different layers of production or marketing within a single industry or of different units at the same level within a single industry. In other words, conglomerate mergers or affiliations cross industry lines and involve units seemingly wholly unrelated in terms of their output. An example that immediately comes to mind is provided by the International Telephone and Telegraph Company, which, among other companies, now controls the Sheraton Hotels and the Avis Car Rental Company.

Conglomerate mergers are not necessarily new. They have existed even in the transportation area for any number of years. For example, the United Steel Corporation long has controlled the Bessemer & Lake Erie Railroad Company, the Elgin, Joliet & Eastern Railway Company and the Duluth, Messabe & Northern Railway Company.

What is new is the accelerated growth of conglomerate mergers and the increasing concern that the traditional restraints of the Sherman and Clayton Acts may be inadequate to arrest this trend. Certainly, to the best of our knowledge, there have been no successful suits against conglomerate mergers under the Sherman and Clayton Acts, although recently there have been reports that Assistant Attorney General McLaren in charge of the

Antitrust Division would be instituting actions to determine the reach of these laws.

The concern of the Interstate Commerce Commission, of course, is not primarily with the enforcement of the antitrust laws. Rather its principal concern must be that the Nation have an adequate transportation system, capable of meeting the needs of passengers and shippers at reasonable charges and rates. There presently is no reason to believe that conglomerate mergers affecting railroads and other carriers regulated by the Commission necessarily will impair their ability to perform their services. However, the potential exists that such transactions may have detrimental consequences. In the balance of this memorandum we shall address ourselves to the means presently available to the Commission to keep itself informed as to the well being of carriers involved in conglomerate mergers and to take what action may be required to assure the viability of such enterprises.

While much of the discussion in this memorandum pertains to the railroads, the problems posed by conglomerate mergers are not limited to railroads, and the statutory framework within which the Commission can act in dealing with such problems is substantially similar for the other modes of transportation regulated by the Commission. Possibly the attention currently is more directly focused upon the railroads since the railroads

have an overexpanded plant, are seeking to cut back their facilities and, hence, the industry is not one characterized by ease of entry, in the sense that an unsuccessful enterprise may be readily replaced by another.

There is nothing inherent in the conglomerate form of business organization that poses a threat to the financial vitality of a railroad in which it may be affiliated. Conversely, neither does the absence of an affiliation with a conglomerate assure the continued financial well being of a railroad. The problems which some observers now see for railroads and other transportation enterprises resulting from the accelerated trend toward affiliation with conglomerates may arise no matter whether the railroad is wholly independent or affiliated only with other railroads. The experience of the New Haven, an independent railroad, immediately comes to mind. Its recent history has been one of almost continuous financial difficulty, culminating in its receivership a few years ago and the very real threat of discontinued operations the beginning of this year. The Central of New Jersey is in receivership and able to operate only with very substantial financial assistance from the State of New Jersey. And, yet, the Central of New Jersey is controlled by the Reading, which in turn is controlled by the prosperous Chesapeake & Ohio-Baltimore & Ohio system. Similarly, some years ago speaking of the Alleghany Corporation, a holding

company of almost only railroads, the Commission in its report on C.&O. Ry. Co. Purchase, 261 I.C.C. 239, 255-256 (1945), stated:

We should not overlook the fact that Alleghany in the past has not always exercised its control of the railroads in its system in a manner consistent with the public interest. Alleghany, under prior management in times of great financial stress and for its own purposes caused or permitted carrier corporations which it controlled to pay dividends when they were not being earned, or to pay dividends when they were under a heavy burden of debt, when traffic was declining, and earnings were decreasing notwithstanding scrimping of maintenance. It entered into transactions whereby the burden of carrying properties and securities which had been purchased at prices found subsequently not to be justified was transferred to one of its carrier subsidiaries, which sold to the Chesapeake & Ohio securities at prices in excess of market quotation. At the times these things were done Alleghany and those who were then in control of the corporation were facing serious financial difficulties and were in need of financial assistance. \* \* \*

The manner of affiliation with a conglomerate may vary. The railroad itself may acquire control of disparate companies; it may establish a subsidiary company to be a holding company for its controlling interest in disparate enterprises or it may establish a new company that would control it as well as the companies engaged in other businesses. Of course, the conglomerate affiliation with the railroad may come about from an outside source, with or without the cooperation of the railroad, and here, too, the affiliation may take a variety of forms. The manner in

which the affiliation is effected may have very significant consequences.

Perhaps the leading Commission expression in point is in New York, N.H. & H. R. Co. Investigation, 220 I.C.C. 505, 615 (1937), in which the Commission summarized its authority, as follows:

\* \* \* Under section 20a of the Interstate Commerce Act, for example, we may deny an application of a carrier for authority to issue securities for acquiring property that is not to be used in the operation of its railroad or in the legitimate improvement, extension, or development of its railroad. Paragraph (12) of this section makes it unlawful for any officer or director of any carrier to participate in the making or paying of any dividend of any operating carrier from any funds properly included in capital account.

Under section 5(4) and (5) of the act, no railroad may lease or purchase any other railroad or any part thereof, or acquire control of another railroad by purchase of stock without prior authorization.

Notwithstanding the several amendments to the act, there is nothing in the law directly to prevent a railroad company from acquiring stock of other railroad companies where the amount of stock purchased is insufficient to give the acquiring company control, or from acquiring stock of companies not engaged in interstate commerce, or from acquiring property of any character so long as such acquisitions are made without the issue of securities or the assumption of obligation or liability in respect to the securities of some other person. The law as now in force does not prevent carriers from buying into many such undertakings as those reported above, nor is the law now adequate to protect the investor in railroad securities from results similar to those reported above.

Railroads also are required to keep their accounts in accordance with our regulations. Those regulations relate only to the accounting of carriers under our jurisdiction. They do not, and under the law cannot be made to, relate to the accounting of the many permissive outside companies. A railroad may form a "company" (such as a holding company), own, report, and account for its investment in such company, and through the company proceed to bankrupt the railroad. \* \* \*

In that proceeding the Commission expressed some concern that the railroads' investments in non-transportation enterprises may have jeopardized its ability to perform transportation services. The Commission reviewed that it had expressed ~~misgivings~~ about railroad investments in earlier reports including Denver & R. G. Investigation, 113 I.C.C. 75; St. Louis-S.F. Ry. and C., R.I. & P. Ry. Stock Acquisitions, 186 I.C.C. 137 and Propriety of Operating Practices--New York Warehousing, 198 I.C.C. 134; and, indeed, in New England Investigation, 27 I.C.C. 560, 616 (1913), the Commission had considered the promulgation of certain standards, quoted in its report, at 220 I.C.C. 612, as follows:

In conclusion this Commission desires to call attention to one lesson from this investigation of national application.

No student of the railroad problem can doubt that a most prolific source of financial disaster and complication to railroads in the past has been the desire and ability of railroad managers to engage in enterprises outside the legitimate operation of their railroads, especially by the acquisition

of other railroads and their securities. The evil which results, first, to the investing public, and finally, to the general public, can not be corrected after the transaction has taken place; it can be easily and effectively prohibited. In our opinion the following propositions lie at the foundation of all adequate regulation of interstate railroads:

1. Every interstate railroad should be prohibited from expending money or incurring liability or acquiring property not in the operation of its railroad or in the legitimate improvement, extension, or development of that railroad.
2. No interstate railroad should be permitted to lease or purchase any other railroad, nor to acquire the stocks or securities of any other railroad, nor to guarantee the same, directly or indirectly, without the approval of the federal government.
3. No stocks or bonds should be issued by an interstate railroad except for the purposes sanctioned in the two preceding paragraphs and none should be issued without the approval of the federal government.

The Commission concluded its New Haven report with the observation, at 220 I.C.C. 616:

If the law is to remain as it is at present, permitting common carriers to form holding companies and to function through subsidiary companies not subject to the act, then, to say the least, such companies and subsidiaries should be made subject to our jurisdiction and regulation as to accounting and the issuance of securities. As previously stated, the act, as amended in 1933, requires that our authorization be obtained before investments in other carriers by railroad which amount to control or power to exercise control are made. Acquisition of control by railroads of motor

carriers is restricted by the Motor Carrier Act, 1935. No restriction on investments other than in carriers is now imposed. The unfavorable financial effect of so-called outside investments, including those in other carriers not amounting to control, indicates a practical necessity of amending the law in this respect. On consideration of the amendments to the act since 1914, and in view of the fact that outside investments may, in specific instances, be found justified, we now are not prepared to renew our recommendation of the absolute prohibition of all such investments. The resources of a railroad ordinarily should be devoted to the proper development of its own transportation system. If they are to be invested in an outside activity it should be after a finding that such investment constitutes a proper use of railroad funds or credit, that the terms of the transaction are reasonable, and that the investment is in the public interest. The rule should apply equally to subsidiaries. Restrictions, to this end, should be imposed on the expenditure of money, incurring obligations or acquiring property by a carrier other than in the operation or legitimate improvement or development of its own railroad. Reserves and surplus funds awaiting use should, however, be available for the production of income. In order that this may not be impeded there should be exempted from such restrictions investments such as are permissible for savings banks and trustees.

More recently the Commission reviewed again its limited authority where a carrier subject to its jurisdiction sought to make investments in non-transportation enterprises. In Greyhound Corp., Stock, 90 M.C.C. 215 (1962), the Commission had before it a proposal by the carrier to issue stock to be exchanged for the stock of Boothe Leasing Corporation, a company engaged in the leasing of machinery and equipment to manufacturers and other parties. The Commission, at 90 M.C.C. 220, said:

Whether or not the value ascribed by Greyhound to the Boothe equity is accurate, and despite its contentions that the transaction represents a sound investment, the question remains as to the justification of the proposed transaction from the standpoint of the public interest. Section 20a(2) of the act provides that before a carrier can issue securities the proposal must be approved by the Commission based on a finding that such issue (a) is for a lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose. Section 214, applicable to the issuance of securities by motor carriers, incorporates certain provisions of section 20a, including paragraph (2).

The Commission reviewed some of its earlier decisions in which it had passed on proposed stock issuances for non-transportation purposes, including Columbia Terminals Co.--Notes, 40 M.C.C. 288; Consolidated Freightways, Inc., Stock, 282 I.C.C. 616; Central Greyhound Lines, Inc.--Stock, 36 M.C.C. 229; Rough--Control--Southern California Freight Lines, 80 M.C.C. 573 and Ryder System, Inc., Stock, 295 I.C.C. 626; and concluded at 90 M.C.C. 222-223, as follows:

As a general rule, it is clear that the issuance by a carrier of securities, or the use of the proceeds from such issuance, generally should be authorized only in those instances where it would be of benefit to or enhance its carrier transportation. In no event, should a carrier be authorized to issue securities or use the proceeds therefrom, or assume obligation or liability with respect to the securities of any other person, where it is not for some lawful object within its corporate powers, is not compatible with the public interest, and where it would impair, in any

respect, the carrier's ability, financially or otherwise, to perform its service to the public as a common carrier. A carrier's major endeavors should continue to be confined to matters related to transportation, and no authorization should be granted where the effect of the issuance of securities, or assumption of obligation or liability, would materially affect the promotion of such major activity. The issuance of securities, as proposed by Greyhound, for investment in noncarrier enterprises should be limited and should constitute a proper use of funds, and the investment should be consistent with the proper performance by the carrier of service to the public. In such instances we do not believe the public interest would be adversely affected. Judicious common carrier investment in stable noncarrier business enterprises, if limited, would contribute to the provisions of a soundly financed common carrier system and would not do violence to the principle that corporations endowed with a public interest should direct their primary activities to the public service nature of their operations.

The foregoing cases dealt with the Commission's powers when a railroad or other carrier subject to its jurisdiction invests in other enterprises. Ordinarily, however, the problems posed by conglomerate mergers arise more frequently in the context of an acquisition of two or more carriers. Commission authorization under section 5 of the Act is required

(1) for two or more carriers to consolidate or merge their properties or franchises, or any part thereof, into one corporation for the ownership management, and operation of the properties theretofore in separate ownership; or for any carrier, or two or more carriers jointly, to purchase, lease or contract to operate the properties,

or any part thereof, of another; or for any carrier, or two or more carriers jointly, to acquire control of another through ownership of its stock or otherwise; or for a person which is not a carrier to acquire control of two or more carriers through ownership of their stock or otherwise; or for a person which is not a carrier and which has control of one or more carriers to acquire control of another carrier through ownership of its stock or otherwise; \* \* \*

Whenever the Commission authorized a non-carrier to acquire two or more carriers, the Commission is empowered under Section 5(3) of the Act to designate the non-carrier as a carrier

subject to such of the following provisions as are applicable to any carrier involved in such acquisition of control: Section 20(1) to (10), inclusive, of this part, sections 204(a)(1) and (2) and 220 of Part II, and section 313 of part III, (which relate to reports, accounts, and so forth, of carriers), and section 20a(2) to (11), inclusive, of this part, and section 214 of part II, (which relate to issues of securities and assumptions of liability of carriers), \* \* \*.

When a holding company acquires control of a railroad with various subsidiary of affiliated corporations, a recurring question under Section 5(2) is whether there is involved an acquisition of control over two or more carriers, or merely a single carrier. In series of cases, the Commission has held that it lacks jurisdiction under Section 5(2) and (3) when a non-carrier acquires control of two or more carrier corporations comprising a "single established carrier system."

The "single established carrier system" concept had its genesis in Louisville & J. B. & R. Co. Merger, 295 I.C.C. 11 (1955), in which the entire Commission held, inter alia, that the acquisition of control of the New York Central system by Alleghany Corporation was not subject to Section 5(2). This holding rested on the conclusion that Central, despite its control of many subsidiary railroads, was "recognized as a single established system" and, therefore, Alleghany should be regarded as acquiring control of but a single carrier. The regulatory rationale for this conclusion was set forth persuasively, as follows (295 I.C.C., at 15-16):

\* \* \* When Alleghany, by stock ownership and by the favorable action of the stockholders, acquired control of Central, all the properties within the carrier's orbit were under long established single operating control. \* \* \*

The consolidation and integration of separate railroad properties, most of them having originated as small or short lines, has been largely responsible for the development of the present great network of rail transportation in this country. \* \* \*

One of the outstanding characteristics of this process of consolidation and integration has been the formation of so-called family lines or systems of railroads--that is, separate railroad properties functioning as unified systems under common control and management.

To give section 5 an interpretation which would require our approval each time stockholders decide to change directors of established system properties, or to elect new officers, and, consequently, to install new management would have a tendency to set in motion within the organizations, contending forces which might well impair or destroy the results of legitimate integration. \* \* \*

Nevertheless, the "single established carrier system" concept has been challenged. Indeed, in the Louisville & J. B. & R. Co. case itself, it was initially rejected by Division 4 in the following terms (290 I.C.C. 733-734):

The Central system includes many individual carriers which are controlled by Central through stock ownership or otherwise. We long have recognized under section 5, that railroad systems are comprised of 2 or more carriers, and that control of a single system may not lawfully be effectuated without our approval and authorization. That principal is considered basic, almost as a definition. So much so, that the question of acquisition of a carrier system has never been contested before the Commission, and as far as we know, there have been no court decisions touching on that issue. Nevertheless, because of the stress which Alleghany places on this point, some discussion thereof is necessary. [Footnote omitted.]

During and following the argument before the Commission on May 14, 1954, in docket No. 31535, counsel for Alleghany contended that the acquisition by Alleghany of stock of Central, and the election of directors of Central as proposed by Alleghany, would not result in the effectuation of control of 2 or more carriers in a common interest within the meaning of section 5(2) of the act. This, they premise on the theory that Central and its related carriers constitute a single carrier already in existence as a system, control of which Alleghany may lawfully acquire without our specific authorization

\* \* \*

\* \* \* As a consequence, a holding company and those in control thereof, admittedly acquired control of a carrier which controls subsidiary carriers. In our opinion, the Congress sought to prohibit that type of acquisition of control, unless approved and authorized by us upon consideration of an application, and upon our finding that the proposal would be consistent with the public interest.

Moreover, in the Breswick litigation that followed a three-judge court in the Southern District of New York twice rejected the concept that the Central system was but a single carrier for the purpose of Section 5(2). Thus, in Breswick & Co. v. United States, 134 F. Supp. 132, 144, the three-judge court stated that "We believe that where a non-carrier acquires control of the parent corporation of a railroad system it acquires control of the subsidiaries and consequently of 'two or more carriers' so as to require I.C.C. approval." In reversing on appeal in Alleghany Corp. v. Breswick & Co., 353 U.S. 151, 161, on other grounds, the Supreme Court stated that "We need not decide this question, however, and intimate no opinion on it, \* \*." Upon remand from the Supreme Court, the three-judge court reiterated its view. Breswick & Co. v. United States, 156 F. Supp. 227, 232.

Notwithstanding the reiterated view of the three-judge court in Breswick, I am of the opinion that the concept of a system as a single carrier for the purposes of Section 5, as articulated and applied to the facts by the Commission in the Louisville & J. B. & R. Co. case, is both persuasive and practical. That concept is that even though a rail system comprises several corporate entities it will be regarded as a single carrier if it is operated as an integrated system under common management. As thus defined, the concept was properly applied to find no jurisdiction under Section 5 when holding companies were created to assume control of such systems, in Kansas City Southern Industries, Inc.--Control--Kansas City

Southern Ry. Co., 317 I.C.C. 1 (1962), and in Katy Industries, Inc.--Control--MKT R. Co., 331 I.C.C. 405 (1967).

However, there are other cases which seem to go beyond the principle as stated and applied in Louisville & J. B. & R. Co., in that the factor of common control alone, without integrated operation, led to the conclusion that several carrier corporations under common ownership or control constituted a single established carrier system and therefore should be treated as a single carrier for the purpose of Section 5. Three recent cases will illustrate this apparent expansion of the Louisville & J. B. & R. principle.

In Docket No. MC-F-9256, Eugenia Properties, Inc.--Control--National Trailer Convoy, Inc., Pepsico, Inc., through a wholly owned subsidiary, acquired control of one motor common carrier and three motor contract carriers, by an exchange of stock with Lease Plan International which controlled them. Despite the fact that the individual operations of these four carriers were diverse and unrelated, the Commission, under the authority of Louisville & J. B. & R. Co. Merger, 295 I.C.C. 11, held that the common ownership by Lease Plan International rendered these carriers a "single-established carrier system" and that the transaction was therefore exempt from Section 5.

A far more important case from the point of view of potential jurisdiction over rail conglomerates is Finance Docket

No. 25283, SCL Industries--Control--Seaboard Coast Line Railroad Co. SCL was organized to acquire control of the railroad and to engage in non-carrier business. On October 9, 1968, the Commission, by Review Board No. 5, dismissed for lack of jurisdiction SCL Industries' application for authority to acquire control of Seaboard Coast Line R. Co. and its carrier subsidiaries on the ground that "the Seaboard Coast Line Railroad Company and carriers subsidiary to or affiliated with it comprise a single established carrier system." Seaboard Coast Line owns about 33 percent of the voting stock (admittedly control) of the Louisville & Nashville R. Co. The conclusion of Review Board No. 5 would appear to be inconsistent with the entire Commission's decision in the Seaboard Coast Line Merger case, 320 I.C.C. 122, where it took pains to demonstrate that the Seaboard Coast Line and the L.&N. in fact operated independently:

The fact is, however, that throughout the history of the relationship between these carriers the Louisville & Nashville has operated under separate management unhampered by any influence of Coast Line. . . . After the merger [of Atlantic Coast Line and Seaboard Air Line], the Louisville & Nashville will continue to be operated under independent management, separate and apart from the merged company. [320 I.C.C. at 188-89]

If the "system" concept of Louisville & J. B. & R. requires not only common control but also integrated operation of the railroads under common control, then it would seem that the

Commission could have asserted jurisdiction under Section 5(2) over the SCL Industries' acquisition, and could have determined under Section 5(3), as a matter of discretion, whether to subject SCL Industries to I.C.C. regulation as to reports, accounts, etc. and security issues.

Another example of the problem is the transaction in Finance Docket No. 24911, under which Texas Gas Transmission Company acquired control of American Commercial Lines. By virtue of that acquisition, Texas Gas controls the "largest inland barging complex in the country--over 8,000 miles of waterways", and at least two motor common carriers, one of which in 1967 grossed in excess of \$39 million and the other in excess of \$18 million. By order entered April 17, 1968, Division 3 dismissed, for want of jurisdiction, the Section 5(2) application filed by Texas Gas, for the reason that "the above-named carriers comprise a single-established common carrier system within the purview of Louisville & J. B & R. Co. Merger, 295 I.C.C. 11, and Woods Industry, Inc.--Control--United Transports, Inc., 85 M.C.C. 672." Here, too, it appears that the "system" concept was regarded as involving only common control--without integrated or unified operation. Later Texas Gas, through a subsidiary, sought to acquire an additional motor carrier application.

and joined in a Section 5(2) application. In approving the acquisition, the Commission, as a matter of discretion, determined not to assert jurisdiction as to reporting and securities over Texas Gas because most of its operations were subject to regulation by FPC and SEC. Terminal Transport Co., Inc.--Purchase (Portion)--Dixie Highway Express, 184 M.C.C. 797.

If the Commission desires to retain some limited jurisdiction over some rail conglomerates, it well may wish to limit the "system" concept of a single carrier to the rationale and facts of the Louisville & J. B. & R. case regarding New York Central. Admittedly, this would produce an uneven result in that under Section 5(2) and (3) the Commission would have a limited jurisdiction over some conglomerates and no such jurisdiction over others. However, this is inherent in the statute, for the Commission may make the designation under Section 5(3) only insofar as it exercises authority under Section 5(2). It should also be noted that even where the Commission asserts jurisdiction under section 5(2) over a holding company's acquisition of a rail "system", Section 5(3) leaves the Commission with discretion as to whether to subject the holding company to the requirements of Sections 20 and 20a.

In a recent proceeding before the Commission, Chicago & N.W. Ry. Co.--Merger, 333 I.C.C. 236 (1968), the Commission determined that Northwestern Industries, Inc., which previously had acquired control of the Chicago & Northwestern Railway Company, required Commission authorization under Section 5(2) of the Act to obtain control of a second carrier subject to Commission jurisdiction, the Chicago Great Western Railway Company. The Commission, however, at 333 I.C.C. 241, concluded that it would not subject Industries to the several requirements set forth in Section 5(3) of the Act except to the extent of obliging it to make such periodic and special reports as the Commission may from time to time call for pursuant to Sections 20(1) and (2) of the Act.

The Commission determined that Industries should not be made subject to the other requirements of Section 20a of the Act for two reasons. As recited by the Commission, at 333 I.C.C. 240-241, they were, as follows:

Inasmuch as most of Industries' income is derived from nontransportation activities and most of its business is unrelated to transportation, it is our view that Industries should not be subject to all of the cited provisions of the act. Another reasons for not subjecting Industries to complete regulation under the act is the fact that its transportation common carrier subsidiaries are themselves subject to regulation. Seaboard Air Line Co.--Merger--Atlantic Coast Line, 320 I.C.C. 122, 197; Missouri Pac. Co.--Control--Chicago and E. I. R. Co., 327 I.C.C. 279.

Preliminarily and reluctantly I am inclined to believe that the grounds relied upon by the Commission may have been legally insufficient.<sup>1/</sup>

The cited cases aid the Commission's rationale very little. In the first of these, the Seaboard case, you will recall, the Commission declined to designate Mercantile, a carrier under Section 5(3) of the Act and, hence, subject to the requirements of section 20a of the Act. The Commission in that report, at 320 I.C.C. 197, said:

Mercantile is an investment company engaged exclusively in the banking and trust business. Its direct interest in the merged company is merely incidental to its primary business of managing trusts and estates. In addition to its minor stockholdings in Seaboard and Coast Line, it holds securities of other railroads in various fiduciary capacities and in relatively small amounts.

The record in that proceeding established that, while Mercantile owned 55 percent of the stock of the Atlantic Coast Line Company, giving it control of the merged railroad, its interest in the Company was only 2.08 percent of the value of the assets in all the trusts and estates managed by Mercantile at the end of 1959. Moreover, in that case the Atlantic Coast Line Company, which had previously been made subject to provisions of the Act

<sup>1/</sup> The factual premises on which the Commission's determination as to Industries was made is similarly questionable. While it may be true that, on a constructive basis, Industries' transportation revenue for 1968 came to only 39 percent of its total revenues, its transportation assets were approximately 60 percent of its total assets.

with respect to reports, accounting, and securities of carriers, 300 I.C.C. 124, was continued as such.

In the second case, the C&EI case, Mississippi River Fuel Corporation was deemed to be an essential party to the acquisition, and its control under Section 5(2) of the Act was approved. The Commission, however, did not subject Mississippi Fuel to full regulation under Section 5(3) of the Act. Although the Commission acknowledged, at 327 I.C.C. 315, that Mississippi Fuel's interest in transportation subject to Commission regulation was substantial, the Commission said that there did not appear to be any practical purpose to be accomplished by subjecting it to accounting and stock-issuance regulation. The Commission noted that Mississippi Fuel's security issues were regulated by the Securities and Exchange Commission, and, in part, by the Federal Power Commission and added, at 327 I.C.C. 316, that "[s]ubjecting its securities issues to our regulation could disrupt the established pattern of such issues and lead to jurisdictional conflicts." The Commission continued, "In our opinion it is neither necessary nor advisable to subject it to regulation as a common carrier, particularly in view of the fact that its common carrier subsidiaries, for the regulation of which we are primarily responsible, will remain within our jurisdiction, whatever action we take in regard to Mississippi Fuel." In that proceeding the record

the record established that Mississippi Fuel's assets exceeded \$144 million and that it owned about six million shares of Missouri Pacific, purchased at a cost of more than \$27.3 million. Its total revenues came to \$86 million in 1961, but the report of the Commission fails to disclose what part of this, if any, represented dividends on its holdings of Missouri Pacific stock. 327 I.C.C. 314, 348. However, since most of the stockholdings by Mississippi Fuel were class A stock on which dividends are limited to \$5 per share in any calendar year, not more than about \$3 million of Mississippi Fuel's revenue could have been derived from this source.

The Commission might well have cited many other of its decisions, for substantially the same grounds have been relied upon by the Commission in declining to subject a non carrier acquiring control of two or more carriers to the requirements of Section 20a of the Act, but, in my judgment, the discussion in these, no more than that in the cited cases, lends support for the Commission's rationale. See, for example, Milwaukee Livestock Handling Co.--Control, 257 I.C.C. 796 (1944); Valdosta S. R.--Purchase, 282 I.C.C. 705 (1952); Missouri--K.T. R. Co.--Consolidation, 312 I.C.C. 13 (1960).

Section 5(3) of the Act was enacted in substantially its present form as part of the Emergency Railroad Transportation Act, 1933, 48 Stat. 217. Its enactment was the product of

recommendations made by the Commission, which in turn led to a comprehensive study by Dr. Walter M. W. Splawn for the House Committee on Interstate and Foreign Commerce.

In the Forty-Third Annual Report, 1929, the Commission invited the Congress' attention to the fact that, while the statute, as it then read, dealt with the unification of carriers by railroad, one with another, acquisition of control or mergers could be accomplished through holding companies and, inasmuch as holding companies were not carriers within the meaning of Section 5(2) of the Act, they were not subject to Commission regulation. The Commission noted the recent and rapid acquisitions of control by the Alleghany Corporation and the Pennroad Company and, at page 82, said:

Certainly if common control of two railroad companies by a single holding company is neither a consolidation under section 5 (6) of the interstate commerce act nor an acquisition of control under section 5 (2), as we found in that case, [Stock of Denver & Rio Grande Western R.R., 70 I.C.C. 102] the same conclusion may be reached as to common control brought about by utilizing a holding company in combination with powers of control possessed by certain individuals. Plainly, also, if this be the situation, the subjection of the unification of carriers by railroad to the orderly processes of a carefully planned scheme of public regulation, which section 5 was designed to accomplish, is very likely to be partially or even wholly defeated, subject to the possibility that the Clayton Antitrust Act may in some measure, after protracted litigation, enable control over the situation to be maintained.

Two years later in the Forty-Fifth Annual Report, 1931, the Commission noted that its expression of concern had led to a Congressional inquiry and the recommendation of Dr. Splawn that Section 5(2) of the Act be amended "so as to bring within the jurisdiction of the commission for approval or disapproval any acquisition of the control of a railroad which would result in bringing that road into affiliation with, in control of, or under the management of another railroad, whether the acquisition be by holding company or otherwise." The Commission, at page 85, expressed its "heartly agreement" with that recommendation and went on to say, "We are also of the opinion that if a holding company is allowed to control a carrier by rail through ownership of stock thereafter the accounts and capitalization of that holding company should be subject to regulation by the Commission. The present financial depression has brought into clear relief the evils involved in permitting stock equities in railroad companies to be made the basis for the issue by holding companies of unsupervised securities, including funded debt and preferred stock."

Dr. Splawn's study, House Report No. 2789, 71st Congress, Third Session, is a wealth of information about stock ownership in railroads. It is unnecessary at this time to summarize Dr. Splawn's findings or recommendations, except

to note, as it seems to be pertinent to our present inquiry, that much weight was attached to the testimony before the House Committee of Commissioner Joseph B. Eastman, who has reported to have testified, as follows:

The third point which I want to bring to your attention as possibly worthy of inquiry is this: The capitalization of holding companies is not subject to public regulations and hence may be inflated practically at will. The results may be to withdraw from the open market the securities of the railroad company which are regulated and substitute, so far as the investing public is concerned, wholly unregulated securities. It is often argued that since a railroad or a public utility is entitled to no more than a reasonably return upon the fair value of its property, it is of no public consequence whether the company which owns it, or the holding company which controls it, is overcapitalized. Now, it is my opinion--and this is an opinion which is based for what it is worth on 15 years' experience in public regulation as a member of either the Interstate Commerce Commission or a State commission--and I say, it is my opinion, based upon that experience, for whatever it is worth, that this argument is wholly unsound and fallacious. Overcapitalization always threatens and is often very harmful to the public interest. This is so for at least two reasons.

In the first place, an inflated capitalization in the long run means poor credit, unless earnings are excessive, and a railroad or public utility with poor credit can not long give good service. In the second place, when capitalization is inflated, every possible effort will be made to secure the excessive earnings which are necessary to support it, and in particular every resource will be employed to secure an excessive evaluation of the property, the underlying property of the public utility or railroad. I believe that if there

were no overcapitalized railroads and public utilities, the valuation problem would be much less serious than it is at the present time. Overcapitalization also invites attempts to drain off profits surreptitiously in various indirect ways, and if worst comes to worst it will lead to neglect of maintenance and depreciation. Now, it may be said that all those matters can be covered by regulation, and theoretically they can be; but it is my opinion that the fact of overcapitalization renders the task of regulation much more difficult than it would otherwise be. One of the reasons for inflation in capitalization of holding companies is the payment of excessive prices for the stocks which are purchased. In the absence of public regulation, experience has shown that such prices are very apt to be inflated. \* \* \* Along with overcapitalization goes an improper capital structure. A further reason for this method of financing by holding companies is that it makes it possible to control large properties by a relatively very small investment of capital.

Dr. Splawn's report led to the introduction of H. R. 9059, 72d Cong., 1st Sess., to implement the report's recommendations. Among its provisions was a discretionary grant of power to the Commission to designate a non-carrier acquiring control of two or more carriers, a carrier subject to Section 20a, substantially as is presently contained in Section 5(3) of the Act. The hearings on the measure evoked little discussion of that particular section, but, at page 60, Commissioner Eastman explained:

I question whether adequate occasion for such a method [acquisition of control of two or more railroads through the device of a single holding company] could be shown [to be consistent with the public interest] except in rare instances, but it is conceivable that this could be shown.

In such an event, the condition designated (C) ~~provides~~ that the holding company shall be subject to the supervision of the commission with respect to accounts and capitalization, just as if it were a carrier. This is necessary in the public interest, for in the event of combination through such a holding company, the latter becomes a medium for financing and administering the affairs of the controlled railroad companies, and supervision of its operation will be just as essential as supervision of the operations of the carriers.

That bill failed of enactment but in the following Congress its provisions were reintroduced as part of H. R. 5500 and S. 1580. Neither the Conference Report, H. Rep. No. 213, nor the earlier reports of the House, H. Rep. No. 193, or of the Senate, S. Rep. No. 87, shed much light on the present question. The House Report, pages 20-21, says, "This bill specifically treats a holding company which has been authorized to acquire a railroad as though it were a common carrier, in that, first it must obtain approval of the Commission to acquire control of two or more railroads; second, after obtaining such approval it must then, like the railroads, be subject to paragraph (1) to (10), inclusive, of Section 20 of the act (relating to reports, accounts, etc. of carriers) and to paragraphs (2) to (11), inclusive, of section 20a (relating to issues of securities and assumption of liabilities of carriers)." The Senate Report, page 9,

simply states "This paragraph supplements paragraph (4) by providing that if a single holding company is permitted by the Commission to acquire control of carriers as provided in paragraph (4), such holding company shall be subject to complete supervision by the Commission of its reports and accounts and the issuance of its securities."

The legislative history of Section 5(3) makes clear that the fact that the railroads are themselves subject to regulation affords no basis whatever for concluding that a non-carrier acquiring control of more of them should not be subjected to the requirements of Section 20a of the Act. Indeed, there would have been no occasion for the enactment of its provisions if that were the case, for the Commission had such regulatory jurisdiction over the railroads all along.

Neither does the legislative history of Section 5(3) support the conclusion that, if the acquiring company's income is derived principally from non-transportation activities, it should not be made subject to the requirements of Section 20a of the Act. The Commission's and Congress' concern at the time of the enactment of Section 5(3) of the Act was with the unification of control of railroads through the device of a non-carrier corporation and quite obviously it matters not whether such transaction is accomplished by a holding company deeply involved in transportation or only incidentally. More

specifically, Commissioner Eastman's fear of overcapitalization of the acquiring company and the possible drain of carrier resources resulting therefrom is no less real in the one instance than it is in the other.

Even in those situations where the Commission, because of the statutory limitations or the exercise of administrative discretion, is unable to treat with a company controlling a railroad or other carrier subject to its jurisdiction as if it were a carrier, the Commission, nevertheless, enjoys substantial power to inquire into affairs of the controlling company, as well as the carrier. Section 12(1) of the Act provides, in part:

(1) The Commission shall have authority, in order to perform the duties and carry out the objects for which it was created, to inquire into and report on the management of the business of all common carriers subject to the provisions of this part, and to inquire into and report on the management of the business of persons controlling, controlled by, or under a common control with, such carriers, to the extent that the business of such persons is related to the management of the business of one or more such carriers, and the Commission shall keep itself informed as to the manner and method in which the same are conducted.

\* \* \*

Similarly, the Commission is empowered by Section 20(5) "to inspect and copy any and all accounts, books, record, memoranda, correspondence, and other documents, of such [regulated] carriers, lessors, and associations, and such accounts, books, records,

memoranda, correspondence, and other documents, of any person controlling, controlled by, or under common control with any such carrier, as the Commission deems relevant to such person's relation to or transactions with such carrier."

The plain language of these provisions of the Act would appear to confer sweeping investigatory powers upon the Commission to inquire into the financial affairs of railroads and other carriers subject to Commission regulation and companies controlling them. Certainly, neither court cases nor Commission decisions suggest that the powers conferred by these two sections are not as broad as their literal provisions would indicate. Indeed, the leading case in point, Smith v. Interstate Commerce Commission, 245 U.S. 33 (1917), confirms that these sections quite properly may be given a broad reading. In that case the Commission sought to inquire of the Louisville & Nashville Railroad Company's President of expenditures made in political campaigns and public relations efforts in behalf of adjustments of the Railroad's rate structure. The Supreme Court, at 245 U.S. 42-43, said:

The Interstate Commerce Act confers upon the Commission powers of investigation in very broad language and this court has refused by construction to limit it so far as the business of the carriers is concerned and their relation to the public. And it would seem to be a necessary deduction from the cases that the investigating and supervising powers of the Commission extend to all of the activities

of carriers and to all sums expended by them which could affect in any way their benefit or burden as agents of the public. \* \* \*

The inquisitorial power conferred by these two sections may be the most effective tool available to the Commission in coping with the problems posed by conglomerate mergers. Public disclosures of transactions between carriers and the companies controlling them may be the most effective device for assuring that the company's controlling the carrier will not exercise such control in a way detrimental to the carrier's ability to render a transportation service.

Several other provisions of the Act may have relevancy. Section 1(8), the commodities clause, prohibits a railroad from transporting "any article or commodity, other than timber and the manufactured products thereof, manufactured, mined, or produced by it, or under its authority, or which it may own in whole or in part, or in which it may have any interest, direct or indirect, except such articles or commodities as may be necessary and intended for its use in the conduct of its business as a common carrier." The commodities clause however has been very well emasculated by the decisions of the Supreme Court in United States v. Elgin, J. & E. Ry., 298 U. S. 492 (1936) and United States v. South Buffalo R. Co., 333 U.S. 771 (1948). As the Commission said in Florida East Coast Ry. Co. Reorganization, 282 I.C.C. 81, 120-121 (1951):

A brief discussion of the commodities clause of the Interstate Commerce Act, by way of supplementation of our references thereto in the third supplemental report, is appropriate. In United States v. Elgin, J. & E. Ry. Co., 298 U.S. 492 (1936), a majority of the Supreme Court held that the commodities clause did not bar control of both a carrier and a shipper by the same interests even though it did bar control of a shipper by a carrier. Justice Stone wrote a dissenting opinion, concurred in by two other justices, in which he stated in part:

The active and continuous control over appellee's finances and expenditures is alone sufficient to create a continuing danger of neglect and abuse of appellee's carrier duties in favor of the dominating production and shipping interest, a temptation and an opportunity which it was the purpose of the commodities clause to forestall.

A similar situation arose in United States v. South Buffalo Ry. Co., 333 U.S. 771, in which the Court was asked to overrule its decision in the Elgin case, on the ground that the decision misconstrued the act, misunderstood its legislative history, and misapplied the Court's own prior decisions. On these matters the opinion of the majority stated: "It is enough to say that if the Elgin case were before us as a case of first impression, its doctrine might not now be approved. But we do not write on a clean slate. What the court has written before is but one of a series of events, which convinces us that its overruling or modification should be left to Congress." A dissenting opinion by Justice Rutledge, in which three other justices joined, argues that the doctrine of the Elgin case should then be overruled by the Court itself. Thus, while the doctrine of the Elgin case technically remains the law, its philosophy has been materially weakened by the South Buffalo case, not only by the dissenting opinion of the four justices but by the attitude of the majority in not supporting it except on the

ground of stare decises. And strength is thereby added to the force of our view in Chesapeake & O. Ry. Co. Construction, 261 I.C.C. 655 (1946), where, speaking with reference to the Elgin case decision, we said that "we have not been convinced that the interpretation by the Supreme Court, while undoubtedly binding upon us, truly represented the intent of Congress or reflected sound economic policy."

Section 10 of the Clayton Act, 15 U.S. 20, provides, in part, that:

No common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of commerce, or shall make or have any contracts for construction of maintenance of any kind, to the amount of more than \$50,000, in the aggregate, in any one year, with another corporation, firm, partnership, or association when the said common carrier shall have upon its board of directors or as its president, manager, or its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such other corporation, firm, partnership, or association, unless and except such purchases shall be made from, or such dealings shall be with, bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission.

As was discussed in considerable detail in General Counsel Memorandum No. 144-66, dated June 10, 1966, the obvious purpose of this provision of the Clayton Act to prohibit officers and directors of a carrier from organizing companies to siphon off earnings through unconscionable contracts has been obscured by two Supreme Court decisions. United States v. Boston & Maine Railroad, 380 U.S. 157 (1965) and Minneapolis & St. L. R.

Co. v. United States, 361 U.S. 173 (1959). These cases suggested that where a carrier and a non-carrier corporation or both wholly or largely owned by the same company and where the interlocking officers or directors have no personal financial interest in the transactions, there may be no violation of the Act in dealings between the carrier and non carrier. Whether there be interlocking officers and directors or not, there does not appear to be a violation of Section 10 of the Clayton Act where a holding company owns all or substantially all of a stock of a carrier and of a non carrier which sells supplies or leasing equipment to the carrier.

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